

STAFF PAPER

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IFRS Interpretations Committee Meeting

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Project	IFRS IC Work in progress		
Paper topic	IFRS 3— <i>Definition of a business</i> —Cover note		
CONTACT	Thomas Harzheim	tharzheim@ifrs.org	+44 (0)20 7246 0552

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. Accounting for business combinations as defined in IFRS 3 *Business Combinations* (revised 2008) differs from the accounting for the acquisition of an asset or a group of assets (ie ‘an asset acquisition’). This applies in particular to:
 - (a) the accounting for a **premium paid** in addition to the identifiable net assets, eg a premium paid for synergies. Such a premium is either recognised as a separate asset, ie goodwill, (business combination) or is allocated to the identifiable assets based on their relative fair values (asset acquisition);
 - (b) the accounting for **deferred taxes**. Deferred tax assets and deferred tax liabilities arising from the initial recognition of assets and liabilities, except for deferred tax liabilities arising from the initial recognition of goodwill, are either recognised on the acquisition date (business combination), or else not, because of the initial recognition exceptions in paragraphs 15 and 24 of IAS 12 (asset acquisition); and
 - (c) the accounting for **acquisition-related costs**. They are either capitalised (asset acquisition) or recognised as an expense with the exception of costs to issue debt or equity securities (business combination). Such costs are recognised as a reduction of the proceeds of the debt or equity securities issued.

2. Furthermore, IFRS 3 includes guidance that is specifically tailored to business combinations. Other IFRSs do not include an equivalent for asset acquisitions. This includes:
 - (a) the accounting for **contingent consideration**; and
 - (b) the **disclosure requirements** in paragraphs B64–B67 of IFRS 3.
3. Consequently, identifying a business and thereby distinguishing a business combination from an asset acquisition is in many cases of fundamental importance for the accounting for a transaction that involves the acquisition of more than one asset.
4. Because of the importance of distinguishing between a business combination and an asset acquisition, the IFRS Interpretations Committee (‘the Interpretations Committee’) received a request seeking clarification on whether an asset with relatively simple associated processes meets the definition of a business in accordance with IFRS 3.
5. More specifically, the question was whether the acquisition of a single investment property, with lease agreements with multiple tenants over varying periods and associated processes, such as cleaning, maintenance and administrative services such as rent collection, constitutes a business as defined in IFRS 3.
6. In analysing this issue, the staff did outreach to the International Forum of Accounting Standard Setters (‘the IFASS’), formerly known as National Standard-Setters (‘the NSS’), and discussed the issue with the staff of the US accounting standard-setter, the Financial Accounting Standards Board (‘the FASB’).
7. The Interpretations Committee observed, supported by the results from the outreach to IFASS, difficulty in determining whether the acquisition of a single investment property with relatively simple associated processes meets the definition of a business in Appendix A of IFRS 3, which has resulted in diversity in practice.

8. Furthermore, the Interpretations Committee observed that the difficulty in determining whether an acquisition meets the definition of a business in Appendix A of IFRS 3 is not limited to the acquisition of investment property.
9. It noted that this broader issue goes beyond the scope of the Interpretations Committee's activities and should be addressed by the IASB as part of its post-implementation review of IFRS 3.
10. However, the Interpretations Committee considered that it would be useful for the IASB's Post-Implementation Review ('the PIR') if the Interpretations Committee were to contribute to that review its own experience and the results from its discussions on this issue.
11. Consequently, the Interpretations Committee directed the staff to continue their discussions with the FASB staff and to continue their outreach to interested parties from other industry sectors with the aim of providing the IASB with relevant information for its PIR.

Purpose of the paper

12. This is the first time that the Interpretations Committee is contributing experience based on outreach activities to a post-implementation review. In this Staff Paper, we therefore want to outline first how the experience and the information contributed by the Interpretations Committee will be used in the Post-Implementation Review of IFRS 3 ('the PIR of IFRS 3').
13. In Staff Paper 6A we summarise:
 - (a) the outreach responses that we have received from preparers and preparer groups in different industry sectors and the large accounting and auditing firms ('the large firms');
 - (b) the conversations that we had with the FASB staff;
 - (c) the conversation that we had with the FAF PIR team (ie the team performing the PIR of the Financial Accounting Foundation ('FAF'), the trustee organisation of the FASB) of FASB Statement No. 141R, *Business Combinations*; and

- (d) on the basis of the outreach results, the issues that could be further explored as part of the PIR of IFRS 3.

How to contribute experience to the PIR of IFRS 3

14. The Interpretations Committee decided to contribute to the PIR of IFRS 3 its own experience and the results from its discussions on this issue. Consequently, it is relevant for the Interpretations Committee's contribution to consider how the PIR of IFRS 3 gathers and processes relevant information.
15. In the following paragraphs, we outline the two phases of the PIR process and explain, how the information from the work of the Interpretations Committee can be contributed to the PIR of IFRS 3.

The Post-Implementation Review process

16. As explained in paragraph 6.54 of the *Due Process Handbook*—February 2013 ('the *Due Process Handbook*'), each PIR has two phases:

Phase 1 Initial assessment and public consultation

17. The objective of this phase is the initial identification and assessment of matters to be examined, which are then subject of a public consultation by the IASB in the form of a Request for Information ('the RFI').
18. In order to establish an appropriate scope for the PIR, the IASB and the technical staff also consult the wider IFRS community to help the IASB to identify areas in which possible unexpected costs or implementation problems were encountered.
19. This initial review draws on the broad network of IFRS-related bodies and interested parties, such as the Interpretations Committee, the IASB's consultative groups, including the Advisory Council, security regulators, national accounting standard-setting bodies, regional bodies involved with accounting standard-setting, preparers, auditors and investors.

20. For the purpose of completing Phase 1 of the PIR of IFRS 8 *Operating Segments* (the PIR of IFRS 8), for example, the IASB consulted the Interpretations Committee in completing the schedule of issues for investigation during the PIR process (see Staff Paper 16 for the May 2012 Interpretations Committee meeting).
21. At the end of Phase 1, the IASB publishes a RFI, setting out the matters for which it is seeking feedback by means of a formal public consultation. In the RFI, the IASB explains why it is seeking feedback on the matters specified and includes any initial assessment by the IASB of the Standard or the major amendment of a Standard that is being reviewed.

Use of the Interpretations Committee's contribution in Phase 1

22. We think that the results from our outreach, together with the issues that we identified for further exploration by the PIR of IFRS 3 and the results from the Interpretations Committee's discussion, will help the IASB in its identification of issues for setting the scope of the PIR of IFRS 3 and providing an understanding of the nature of the issues that the PIR of IFRS 3 will focus on in its Phase 2.
23. We expect this contribution to supplement the consultations that the PIR team will undertake during Phase 1, similar to the consultation of the Interpretations Committee in May 2012 when the Interpretations Committee reviewed the draft schedule of issues identified for investigation during the PIR of IFRS 8 *Operating Segments*.
24. The contribution from the Interpretations Committee will therefore be helpful for the IASB, along with studies from other organisations, in:
 - (a) selecting the issues to follow up in the RFI; and
 - (b) designing the questions for inclusion in the RFI.
25. This contribution does not duplicate the work that the PIR will perform, because this contribution is based on correspondence and meetings with a limited number of stakeholders. The PIR of IFRS 3, on the other hand, will involve a broader, public consultation on a wider range of issues.

26. It would not compromise the PIR process being an entirely open one, because the public consultation by means of the RFI will permit everyone in the IFRS community to provide information for review before concluding on the PIR of IFRS 3.

Outreach performed

27. Accordingly, we performed outreach that we think was suitably designed to identify challenges in distinguishing business combinations from asset acquisitions and so help in identifying matters for which the IASB might be seeking feedback by means of the RFI.
28. We first of all identified industry sectors that we expected could contribute relevant experience on the basis of:
- (a) our experience;
 - (b) discussions that we had earlier with interested parties; and
 - (c) guidance/inputs from Interpretations Committee members.
29. In a second step we then identified the preparers and preparer industry groups in these industry sectors that our organisation has consulted before within the context of other projects.
30. In applying this approach, we sent out requests for information to preparers of IFRS financial statements in the following industry sectors:
- (a) investment property;
 - (b) extractive industries;
 - (c) pharmaceuticals;
 - (d) banking;
 - (e) shipping; and
 - (f) solar and wind farms.
31. In addition, we expected that the large firms could contribute relevant experience because of their broad experience on the application of the definition of a business

in Appendix A and the related application guidance in paragraphs B7–B12 of IFRS 3.

32. Accordingly, we contacted 36 preparer and preparer groups and seven large firms.

Phase 2 Consideration of evidence and presentation of findings

33. The purpose of this phase is that the IASB generates its findings and the next steps it plans to take, if any, as a result of this review.
34. The IASB does so by analysing the comments that it has received from the RFI along with evidence and information that it has obtained from any additional analysis, such as:
- (a) analyses of financial statements or other financial information;
 - (b) reviews of academic and other research related to the implementation of the Standard being reviewed; and
 - (c) surveys, interviews and other consultation with relevant parties.
35. When the IASB completes the PIR, the IASB could conclude that it should:
- (a) continue to monitor the implementation of the Standard or the major amendment to a Standard, if the results of the PIR are inconclusive;
 - (b) retain the Standard or the major amendment to the Standard as issued, if no significant problems are identified by the PIR; or
 - (c) revise the Standard or the major amendment to the Standard to remedy any problems identified by the PIR.
36. Depending on the nature of any findings, revisions could be made through the Annual Improvements process or as a narrow-scope amendment to a Standard. Identifying severe problems would indicate that the IASB should consider a proposal for a standards-level project to reassess specific guidance. This proposal process would include an assessment of the priority that should be ascribed to this topic compared with that of other topics to be considered by the IASB.

Use of the Interpretations Committee's contribution in Phase 2

37. We expect that the depth of information included in the Interpretations Committee's contribution to the PIR of IFRS 3 could be used with the feedback received from the RFI to gain an understanding of the challenges that entities face in applying aspects of IFRS 3.
38. However, we think that that the Interpretations Committee should not recommend any conclusions, findings or next steps that should result from the PIR of IFRS 3 because:
- (a) the PIR of IFRS 3 will gather information from a broader population of stakeholders; and
 - (b) this information will supplement the Interpretations Committee's contribution.

Type of information to be contributed to the PIR of IFRS 3

39. The purpose of these staff papers is therefore to summarise the outreach results and identify from these outreach results issues that could be further explored as a part of the PIR of IFRS 3. This summary of the outreach results and the list of issues that could be further explored as part of the PIR of IFRS 3, which will be amended in the light of the discussions of the Interpretations Committee, will be contributed to the post-implementation review.
40. For clarification purposes we want to note that the analysis presented as part of the summary of outreach responses dives much deeper into the issue than we would expect that a typical PIR would do. Accordingly, it might be that no document will be presented or published in the course of the PIR of IFRS 3 showing the same level of detail on the identification of a business issue. An analysis with the same level of detail might not be presented again before the IASB starts working on the next steps resulting from the PIR of IFRS 3.

Questions for the IFRS Interpretations Committee

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1. Do the Interpretations Committee members have any comments on how the experience and the information contributed by the Interpretations Committee will be used in the PIR of IFRS 3?
2. Does the Interpretations Committee agree with this contribution of experience and information to the PIR of IFRS 3?