# STAFF PAPER

14–15 May 2013

## IFRS Interpretations Committee Meeting

IFRS IC: July, Sep 2011

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| **Project** | **IFRS IC Work in progress** |
| Paper topic | IFRS 3—*Definition of a business*—Summary of outreach results and analysis |

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## Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') wants to contribute to the IASB's PIR of IFRS 3 *Business Combinations* (revised 2008) ('the PIR of IFRS 3') its experience on difficulties in distinguishing a business combination from an asset acquisition.

2. In order to do so, the Interpretations Committee asked the staff to continue their discussions with the staff of the US accounting standard-setter, the Financial Accounting Standards Board ('the FASB'), 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 of IFRS 3 (for further details on the background on the Interpretations Committee's direction see paragraphs 1–11 of Staff Paper 6).

## Purpose of the paper

3. The purpose of this paper is to:

   (a) give the Interpretations Committee an overview of the outreach activities that we have performed;

   (b) give a summary of the outreach responses that we received; and

(c) summarise the issues that we think could be further explored as a part of the PIR of IFRS 3.

## Structure of the paper

4. The paper will therefore:

   (a) explain the outreach activities that we have performed and reproduce the questions that we asked preparers and preparers groups in different industry sectors and seven large accounting and auditing firms ('the large firms');

   (b) summarise the responses that we have received from preparers and preparer groups in different industry sectors and the large firms;

   (c) summarise the conversation that we had with the staff of the FASB ('the FASB staff') and the FAF PIR team (that is, the team performing the post-implementation review of the Financial Accounting Foundation ('FAF'), the trustee organisation of the FASB) of FASB Statement No. 141R, *Business Combinations* ('FAS 141R');

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

   (e) ask questions of the Interpretations Committee.

## Outreach requests

5. We sent out requests for information to preparers of IFRS financial statements in the following industry sectors:

   (a) investment property;

   (b) extractive industries;

   (c) pharmaceutical;

   (d) banking;

   (e) shipping; and

(f) solar and wind farms.

6. We have sent 36 outreach requests to preparers and preparer industry groups, to which we received 28 responses.

7. 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.

8. Accordingly, we contacted seven large firms and received six responses.

9. The outreach requests that we have been sending by email are reproduced in Appendix A to this paper.

10. For further details on our approach to identify the stakeholders that we did outreach to and the questions we asked, see paragraphs 27–32 of Staff Paper 6.

## Outreach results

11. Overall, we noted from the outreach responses that discussions among preparers have resulted in generally (although not universally) agreed views about distinguishing between business combinations and asset acquisitions in the investment property, extractive industries and pharmaceutical sectors, although there is still diversity in practice both in general and in detail.

12. In contrast, in the banking, shipping and solar and wind farm sectors we have not identified anything like an industry-wide view from the outreach responses.

13. We understand that this difference results from the type of significant acquisitions that typically occur in these industry sectors and from the greater accounting consequences of the distinction between business combinations and asset acquisitions for the financial reporting of preparers in the investment property, extractive industries and pharmaceutical sectors.

14. This is further explained in the following paragraphs as part of the summary of the outreach responses that we have received.

15. Please note that the summary of the outreach results is solely based on the outreach responses. It does not analyse whether the views given or indicated in the outreach responses are appropriate judgements in applying IFRS 3 or draw conclusions about the appropriateness of the guidance in IFRS 3.

### *Investment property sector*

16. **General question:** *We are particularly interested in your experience of any difficulties in the identifying a business in an acquisition in the investment property sector. That is, what are the challenges you face when distinguishing between an asset purchase and a business acquisition in the investment property? What factors do you see as important when distinguishing a business combination from an asset purchase? Please give details.*

17. Acquisitions of investment property include, in many cases, the takeover of processes for rendering services such as cleaning, security and maintenance by the acquirer that are considered minor in comparison to the investment property, and that hold little interest for the acquirer. Typically, these processes did not affect the acquirer's decision to purchase the investment property. In many cases, the acquirer replaces the processes by integrating the acquired investment property into the processes that it has used so far to render these types of services.

18. Nevertheless, processes for rendering services such as cleaning, security and maintenance might be considered processes that meet the specifications in paragraph B7(b) of IFRS 3.

19. One of the main challenges that respondents in the investment property sector therefore face when distinguishing between an asset acquisition and a business acquisition in the investment property is the identification of processes that give rise to a business.

20. Because identifying a business on the basis of its definition in Appendix A of IFRS 3 and the related application in paragraphs B7–B12 of IFRS 3 requires a significant degree of judgement, different interpretations have developed in practice on what the characteristics of processes that give rise to a business are:

(a) **View 1:** some respondents think that any processes that, when applied to an input or inputs, create or have the ability to create outputs, give rise to a business.

(b) **View 2:** others instead would require more 'sophisticated' processes or processes that involve a degree of knowledge unique to the assets being acquired for a business.

21. Accordingly, proponents of View 2 base their judgement on this question on:

(a) the nature and extent of the services related to the property; and/or

(b) the nature and the size of the property; and/or

(c) the number and/or complexity of the properties acquired.

22. However, there appears to be no general agreement among the proponents of View 2 on the details of what specific criteria are relevant to distinguish an asset acquisition from a business combination. We could only identify some tendencies:

(a) Significant management processes or other processes that management views as being an integral part of the acquisition were generally considered as giving rise to a business. Examples of significant management processes that were given were marketing, tenancy management, financing, development operations and other functions that are typically undertaken by the parent company or external management companies.

(b) Accordingly, the acquisition of a large shopping centre was given as a typical example of a business combination in the investment property sector and the acquisition of investment property together with key management personnel was given as a strong indicator for the existence of a business.

(c) Other processes, such as cleaning, security and maintenance are generally not considered by proponents of View 2 to be significant processes that give rise to a business.

(d) Accordingly, the simple acquisition of only an office building and associated simple processes (for example processes for rendering cleaning, security and maintenance services) is given as a typical example of an asset acquisition by the proponents of View 2.

23. While View 2 is predominant in practice in Europe and Australia, View 1 is predominant in the applying the nearly identical guidance under US GAAP.

24. The discussion of which processes that the seller used in operating the business need to be included in the acquisition, and which processes might be missing for it still to be a business combination, is less relevant for the investment property sector for the following reasons:

(a) Proponents of View 2 typically consider processes that are unique or not easily replaceable to be ‘sophisticated’ processes that give rise to a business. Such processes, however, are likely to be included in the acquisition, that is, to be taken over by the acquirer from the seller. Consequently, the processes of the seller that are not included in the acquisitions are typically irrelevant for the identification of a business for proponents of View 2.

(b) Proponents of View 1 consider processes such as cleaning, security and maintenance to be processes that give rise to a business. At least some of these processes, however, are likely to be included in the acquisition and/or, if they are missing, they are easily replaceable. Consequently, the fact that these processes of the seller are not included in the acquisition does not affect the identification of a business either (see paragraph B8 of IFRS 3). Some also think that the acquisition of a rented office or apartment building without any such processes is a business combination because it does not require any processes to produce outputs.

25. While identification of processes that give rise to a business is the main challenge faced by respondents from the investment property sector when distinguishing between an asset acquisition and a business acquisition in an investment property, one respondent pointed to the definition of a business in Appendix A of IFRS 3.

The respondent thinks that clarity could be provided with regard to the term "capable of being conducted and managed". For the respondent, it is unclear to what extent this part of the definition distinguishes business combinations from asset acquisitions, because any asset is capable of being conducted and managed, either internally or externally, to provide a return directly to investors.

26. For the summary of the responses from preparers and preparer industry groups in the investment property sector to our **specific questions**, see paragraph B2 of this Staff Paper.

### *Extractive industries sector*

27. **General question:** *We are particularly interested in your experience of any difficulties in the identifying a business in an acquisition in the extractive industries. Specifically, what challenges do you face when distinguishing between an asset purchase and a business combination? What factors do you see as important when distinguishing a business combination from an asset purchase? Please provide details.*

28. Significant and common transactions in the extractive industries sector are acquisitions of inputs and processes from an upstream oil and gas or mining operation.

29. Taking into consideration the length, complexity and variety in detail of such operations, preparers in the extractive industries sector discuss the application of all three elements of a business (that is, inputs, processes and outputs) (see paragraph B7 of IFRS 3).

30. Most respondents from extractive industries, however, adopted an approach for distinguishing asset acquisitions from business combinations that is primarily based on the stage in its life cycle that the upstream oil and gas or mining operation is in at the time of the acquisition (**View 1**).

31. On the basis of this approach, acquisitions of upstream oil and gas or mining operations in the early stages of exploration and evaluation are usually considered to be asset acquisitions, whereas acquisitions of upstream oil and gas and mining

operations in the production phase are generally considered to be business combinations.

32. This approach is reflected in the following technical conclusions by proponents of View 1 in applying the definition of a business in Appendix A of IFRS 3 and the related application guidance in paragraphs B7-B12 of IFRS 3:

(a) Output that gives rise to a business is, for an oil and gas producing company or a mining company, the intended output. The intended output is determined on the basis of the business model of the acquirer. If the acquirer’s business model is to sell the ultimate commodity (for example oil and gas, copper, gold or iron), intended output is, for such an acquirer, only the commodity and not, for example, exploration data or the capital increase for the owner of the exploration property that results from the exploration data. The intended output of an oil- and gas-producing company or a mining company is therefore viewed by proponents of View 1 as being the ultimate commodity and exploration data is only the intended output, if the acquirer is only an exploration and evaluation company.

(b) For an acquired set of activities and assets to be a business, one of the acquired inputs has to be a proved and probable reserve. The proponents of this view argue that otherwise, the acquired set of activities and assets does not have the ability to create the output, that is, the ultimate commodity, when processes are applied to those inputs. There is a variation in this approach for the mining sector, in that one of the acquired inputs has to be either a proved and probable reserve or mineralised material (that is, measured and indicated, not merely inferred). To identify proved and probable reserves or mineralised materials, these respondents apply the definitions in:

(i) SEC Industry Guide 7 *Description of Property by Issuers Engaged or To Be Engaged in Significant Mining Operations* (SEC Industry Guide 7); and

(ii) SEC Regulation S-X, Rule 4-10 *Financial accounting and reporting for oil and gas producing activities pursuant to* *the Federal Securities Laws and the Energy Policy and Conservation Act of 1975* (SEC Rule 4-10).

33. Most respondents from the extractive industries sector (that is, producers of the ultimate commodity) apply **View 1** and rarely consider the acquisition of an upstream oil and gas or mining operation in the exploration or evaluation phase to be a business combination.

34. Some respondents however take a broader view (**View 2**) that is not based on the business model of the specific acquirer but considers all types of market participants. Consequently, they:

    (a) determine the output based on:

        (i) the stage in the life cycle that the upstream oil and gas or mining operation is in at the time of the acquisition. If the operation is in the production stage, the output would be the produced commodity. If the operation is, however, still in the exploration or evaluation stage, the output could be something such as dividends resulting from a sale of the exploration and evaluation property and the related data or capital gains from selling the shares in the exploration and evaluation (E&E) operation; or

        (ii) the type of the licence. If the upstream oil and gas or mining operation is working with an exploration-only licence, the output could be something such as dividends resulting from a sale of the exploration and evaluation property and the related data or capital gains from selling the shares in the exploration and evaluation (E&E) operation. If the upstream oil and gas or mining operation is instead working with an exploration and production licence the output could either be the ultimate commodity or something such as dividends resulting from a sale of the exploration and evaluation property and the related data or capital gains from selling the shares in the exploration and evaluation (E&E) operation.

    (b) do not interpret IFRS 3 as requiring a proved and probable reserve as one of the inputs for an upstream oil and gas or mining operation to be a business. The factors that would influence the classification by the proponents of this view are instead whether the acquired inputs and processes are capable, on a stand-alone basis or through integration with other inputs and processes, of generating an output that will provide a return.

35. The views presented above also affect the assessment of what types of processes give rise to a business:

(a) For proponents of **View 1**, only processes in the development, construction or production phase of an upstream oil and gas or mining operation can give rise to a business if the acquirer is an oil and gas producing company or a mining company. Only processes applied to the input (a probable and proved reserve) are able to create the intended output of such entities, that is, the ultimate commodity.

(b) For these respondents, processes associated with exploration and evaluation activities do not give rise to a business. Even if they were to acquire such exploration and exploration processes together with a probable and proved reserve, they would not classify the acquisition as a business combination, because they consider these exploration and evaluation processes to be insignificant compared to the probable and proved reserve. They therefore assume that they have bought, in substance, a proved and probable reserve and nothing else.

(c) Views vary more widely, however, among proponents of **View 1** on when an upstream oil and gas or mining operation in the development and construction phase turns from an asset or a group of assets into a business.

(d) For proponents of **View 2**, in contrast, processes such as permitting activities, exploration and drilling programmes, or performing pre-feasibility/feasibility studies, are also processes that may give rise to a business, if they generate an output that will provide a return, either on a stand-alone basis or through integration with other inputs and processes.

36. Accordingly, respondents in extractive industries considered the following factors as important when distinguishing a business combination from an asset acquisition:

    (a) whether the acquired property is substantially undeveloped or developed with significant production;

    (b) whether significant associated processes are included in the acquired operation, for example processing plants, pipeline infrastructure, compressor stations, etc;

    (c) whether significant exploration and evaluation costs have to be incurred after the acquisition to establish economic viability of the acquired property;

    (d) whether significant development costs have to be incurred to bring the property into a producing status (for example costs for drilling activities, costs for tying in production for transport, costs for constructing compressor stations and drilling facilities, etc); and

    (e) whether staff and equipment have been acquired.

37. On the basis of the approach of distinguishing asset acquisitions and business combinations according to the stage in the life cycle that an oil and gas or mining operation is in at the time of the acquisition, a challenge arises when multiple projects in different stages of development are acquired in one transaction and there is uncertainty over whether:

    (a) this transaction should be bifurcated into asset acquisitions and business combinations; or

    (b) this transaction should be classified according to the dominant part.

38. For the summary of the responses from preparers and preparer industry groups in the extractive industries sector to our **specific questions**, see paragraph B3 of this Staff Paper.

### *Pharmaceutical sector*

39. **General question:** *We are particularly interested in your experience of any difficulties encountered in identifying a business in an acquisition in the pharmaceutical sector, for example:*

    (a) *What challenges do you face when distinguishing between an asset purchase and a business combination? What factors do you see as important when distinguishing a business combination from an asset purchase? Please provide details.*

    (b) Transactions in the pharmaceutical sector that are significant and prevalent are acquisitions of research and development results that are carried forward so that ideally a drug can be sold at the end of the process.

    (c) Considering the length, complexity and variety in detail of the research and development process in the pharmaceutical sector, preparers in the pharmaceutical sector face similar challenges in distinguishing business combinations from asset acquisitions as do preparers in the extractive industries sector.

    *Inputs*

    (d) They apply similar approaches as preparers in the extractive industries sector to respond to those challenges, with one significant exception:

        (i) Most respondents from the extractive industries sector require that one of the acquired inputs has to be a proved and probable reserve. Otherwise, the acquisition of the upstream oil and gas or mining operation cannot be a business combination for an oil- and gas-producing company or a mining company, because without a proved and probable reserve the acquired set of activities and assets does not have the ability to create the intended output, that is, the ultimate commodity, when processes are applied to those inputs.

        (ii) Respondents from the pharmaceutical sector instead do not require that one specific input, for example an approved drug, is included in the acquired set of activities and assets for it to be a business combination. The acquisition of any results from the research and development process may qualify as an input that gives rise to a business combination. In spite of that, respondents from the pharmaceutical sector require that the acquired set of activities and assets is capable of creating the output. Consequently, large pharmaceutical companies only consider an acquired set of activities and assets to be a business if it includes the resources (inputs and processes) to carry the research and development process forward to the stage when the final drug can be sold.

(e) In addition, many inputs and processes that are used in research and development ('R&D') projects (for example lab equipment) and in producing drugs are more easily replaceable than inputs and processes used in an oil and gas or mining operation (for example a pipeline). The acquirer of an R&D project or of the production of a specific drug is quite often only interested in the rights to a drug or a product candidate, and to the related knowhow and the skills of some key staff. Other inputs and processes included in the acquisition do not influence the acquirer's decision to enter into the transactions. Very often the acquirer wants to replace these other inputs and processes by its own inputs and processes.

(f) Respondents from the pharmaceutical sector therefore highlight that one of the challenges that they face when distinguishing a business combination from an asset acquisition is to distinguish inputs and processes that give rise to a business from other inputs and processes.

(g) For example, respondents from the pharmaceutical sector tend to consider the acquisition of a production plant without a distribution network to be an asset acquisition, if operating the production plant does not require specific knowhow and the operators could be replaced easily. While the respondents from the pharmaceutical sector share this challenge with respondents from the investment property sector, the issue seems to be less prevalent for respondents from the extractive industries sector.

(h) Notwithstanding these differences, we understand that both approaches, that is, the approach applied by respondents from the pharmaceutical sector and the majority of respondents from extractive industries, have the same effect in practice on the classification of acquisitions of a set of activities and assets. Acquisitions of R&D projects and of upstream oil and gas and mining operations in the early stages of the projects tend to be asset acquisitions for oil- and gas-producing companies, mining companies and large pharmaceutical companies, whereas acquisitions close to the production phase are quite likely to be classified as business combinations. For further details on the approach applied by respondents from the pharmaceutical sector, see the following paragraphs:

### *Outputs*

(i) Respondents in the pharmaceutical sector (just like the majority of respondents from the extractive industries sector) determine the output of a pharmaceutical activity that gives rise to a business on the basis of the business model of the acquirer:

- (i) For a large pharmaceutical company, the output that gives rise to a business is an approved drug that can be sold. The results at various stages of the R&D process do not represent outputs that give rise to a business for such companies, because they do not generate economic benefits on their own.
- (ii) For a biotech company, whose business model is to develop compounds up to a certain level and sell them on to another party for final development, their output might instead be considered to be the results of the final phase in their development process and consequently give rise to a business.

*Processes*

(j) As explained in subparagraphs 39(d) and following of this Staff Paper, for an acquired set of activities and assets to be considered a business, large pharmaceutical companies require that:

(i) it includes all the inputs and processes that are crucial for value creation; and

(ii) these resources (inputs and processes that are crucial for value creation) are sufficient to carry the research and development process forward to the stage when the final drug can be sold.

(k) In order to implement that principle, respondents from the pharmaceutical sector apply the following approach:

(i) They first of all focus on the type of processes acquired. In the pharmaceutical sector, processes are typically acquired either with the process documentation or by taking over the workforce of the seller. Processes that are crucial for value creation are very often intrinsically linked with (parts of) the workforce. Consequently, respondents from the pharmaceutical sector consider that acquiring the workforce is a strong indicator for a business combination.

(ii) However, they do not require that, for a business combination, all processes that will be used to carry the R&D process forward to a stage when the final drug can be sold have to be acquired.

(iii) On the basis of paragraph B8 of IFRS 3, which states that 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, the respondents concluded that a degree of sophistication in the processes and the importance and materiality of the processes acquired is needed.

(iv) In other words, they tend to assume that the acquisition is a business combination even if the acquisition includes only very few processes next to the inputs, provided that:

- these processes are unique or rather specific output-relevant processes; and
- any missing processes can easily be replicated by most market participants.

(v) If, however, only very limited, unsophisticated and not output-critical processes are taken over, and the missing processes are complex, the respondents tend to assume that it is an asset acquisition.

(vi) An indicator used to determine whether processes are sophisticated and relevant in this sense is whether the processes are crucial for value creation or whether the process is one of the key value drivers.

(vii) For respondents from the pharmaceutical sector all crucial processes have to be included in the acquisition. Otherwise, it is not a business combination, even if a limited number of market participants have the specific knowhow to add such processes, because those processes are essential for combining a set of activities and assets into a business.

(viii) Consequently, an acquisition is quite likely to be considered an asset acquisition, and not a business combination, if the inputs and processes that are missing in an acquired set of activities and assets are:

- sophisticated;
- not readily available; and
- of such a nature that few market participants within the pharmaceutical industry could supply the missing processes.

(ix) Furthermore, if a large number of processes are acquired, respondents from the pharmaceutical sector usually assume that the transaction qualifies as a business combination, regardless of the degree of sophistication of the processes.

This is because the sheer quantity of the processes acquired makes it difficult to replace its setup.

*Variety of scenarios*

(l) Consequently, the assessment of whether the acquisition meets the definition of a business combination depends on what is considered to be the output that gives rise to a business (the ultimate product or results of Phases I–III—see subparagraph (n) for an explanation of the phases) and what inputs and processes are required to get to that output.

(m) The acquirer then has to assess whether the processes required to get to that output are:

(i) sophisticated;

(ii) readily available;

(iii) not in place with the acquired entity; and

(iv) of such a nature that few market participants within the pharmaceutical sector could supply the missing processes.

(n) This adds (as respondents from the pharmaceutical sector highlight) significant complexity to the decision on whether an acquisition meets the definition of a business combination, taking into consideration that the development of pharmaceutical products goes through distinct phases that require different skill sets such as:

(i) research;

(ii) pre-clinical development;

(iii) Phase I (20-80 patients or fewer with some oncology products);

(iv) Phase II (100-300 patients); or

(v) Phase III (1,000-3,000).

(o) Other relevant skills in later stages that may influence the distinction are:

(i) the ability to scale up manufacturing;

(ii) the ability to register the product and manage the process;

(iii) dealing with the requirements of national healthcare systems; and

(iv) manufacturing on a commercial scale.

(p) Further complexity is added to the decision if:

(i) as happens from time to time, the workforce is employed by subcontractors, even if it includes experts or specialists who cannot be easily replaced; or

(ii) the acquirer acquires a controlling interest in an entity but is only interested in one specific asset of the entity.

(q) *Paragraph B7(c) of IFRS 3 describes 'outputs' as the result of inputs and processes applied to those inputs that provide, or have the ability to provide, a return. When applying IFRS 3, what do you consider to be the output of pharmaceutical businesses:*

(i) *the ultimate output of the assets and processes such as the ultimate product, eg, the drug; or*

(ii) *some other type of output that is produced at various phases of the research and development process, eg intellectual property such as Phase II studies of compounds; or*

(iii) *either (a) or (b), depending on the phase of the research and development project? Why, or why not*?

(r) A explained above, respondents in the pharmaceutical sector determine the output of a pharmaceutical business on the basis of their business model:

(i) For a large pharmaceutical company the output is an approved drug that can be sold. The results at various stages of the R&D process do not represent outputs that give rise to a business for such companies, because they do not generate economic benefits on their own. The value of results at various stages of the R&D process is based on their contribution to the approval of a product that is capable of generating sales. Consequently, they consider such results to be an input into the intellectual property of the final product.

(ii) For a biotech company, whose business model is to develop compounds up to a certain level and sell them on to another party for final development, the results of the final phase in their development process might, however, be considered to be the output of this biotech company. Consequently, the output of a biotech company depends on its specific skill set. However, it has to be considered that the biotech company might be growing organically and thereby developing the processes, skill set and workforce that is able to create and sell the approved product. Such a development of an entity might change the relevant output.

(s) *Do pharmaceutical entities consider processes that are applied during research and development to be processes as specified in paragraph B7(b) of IFRS 3 that give rise to a business? Please explain.*

(t) As explained subparagraphs 39(j) and following of this Staff Paper, respondents from the pharmaceutical sector consider sophisticated and value crucial processes that are applied during the R&D phase to be processes that give rise to a business, because R&D is a critical part of the activities of a pharmaceutical company and is a prerequisite for being able to create a saleable product (output). For that reason, R&D processes are targeted towards a specific outcome for which customers exist and from whom revenues are generated.

(u) Furthermore, the maintenance and further development of such processes requires substantial knowhow and a skilled workforce. The service cannot be easily replaced by services acquired from a third party.

(v) For a large pharmaceutical company, however, the sellable drug/medicine is considered to be the relevant output that gives rise to a business and early-stage R&D processes are far removed from the eventual output, that is, the saleable product. Consequently, the acquisition of an early-stage development asset by such a pharmaceutical company may often not constitute a business on its own if the acquirer has to add the sophisticated (and lengthy) processes of subsequent R&D work, gaining of regulatory approval, manufacturing scale-up, etc.

(w) For a biotech company, on the other hand, such processes might be sufficient to give rise to a business, because the output that is produced during of the research and development phase is the relevant output for a biotech company as the acquirer.

(x) Consequently, processes that are applied during research and development are many times processes that give rise to a business if the acquirer is a biotech company whereas the same processes might not give rise to a business, if the acquirer is a large pharmaceutical company that sells medicine/drugs.

(y) *Generally speaking, a research and development process in the pharmaceutical industry starts with the identification of a candidate that is being researched and the proposal for its development, and then moves to the pre-clinical and clinical phases and production. In practice, are these phases relevant for distinguishing business combinations from asset acquisitions and, if relevant, at what stage in the research and development process do preparers generally start accounting for the acquisition of a set of inputs and processes as a business combination? What are the factors that influence that decision?*

(z) Taking the approach presented in the previous paragraphs, respondents from the pharmaceutical sector consider none of the phases to be relevant for distinguishing business combinations from asset acquisitions.

(aa) Each part or result from the R&D process is deemed to be a critical input in the value creation chain.

(bb) As long as a large pharmaceutical company does not merely license in or acquire the results of certain R&D processes, but also acquires key employees to advance the project to an approved drug that can be sold and also acquires, along with those employees, the processes leading to these results, they would usually consider the acquisition of R&D activities at any stage as the acquisition of a business.

(cc) However, for a company that has only one early-stage compound, and that does not have a history of being able to develop such activity, they would assume that this is not a business combination.

(dd) *Do you consider the acquisition of a promising scientist in a leased lab a business combination?*

(ee) Respondents from the pharmaceutical sector do not consider the acquisition of a promising scientist in a leased lab to be a business combination, as long as there is no specific compound (input) acquired that could be separated from the scientist.

(ff) The scientist would be considered to have specific process knowhow, for example on how to do research, but without an input, it cannot be turned into outputs.

(gg) They consider the contribution of a scientist to the development of an R&D asset as evidence of processes, but not as being input, because they can apply their knowhow to more than one project. In other words, the knowhow is not really consumed like an input, but represents the capability to run R&D projects.

(hh) The leased lab cannot be considered a sufficient input in this setup to qualify as a business because it can easily be replaced.

40. For the summary of the responses from preparers and preparer industry groups in the pharmaceutical sector to our **specific questions**, see paragraph B4 of this Staff Paper.

### *Banking sector*

41. **General question:** *We are particularly interested in your experience of any difficulties in the identifying a business in an acquisition in the financial sector. That is, what are the challenges you face when distinguishing between an asset purchase (and/or assuming liabilities) and a business combination? What factors*

*do you see as important when distinguishing a business combination from an asset purchase? Please give details.*

42. Projects in the banking sector usually do not run through as many different and prolonged stages as R&D projects or oil and gas or mining operations.

43. Typically, banks acquire groups of assets, for example a portfolio of loans/receivables or a deposit book. This acquisition might include associated processes that the seller used in managing the group of assets. Alternatively, the acquisition of the loan portfolio might not include any processes because processes related to credit granting and credit risk parameters might be provided by the acquirer (through existing processes) while credit application processing and collections (front office operations) will remain with the seller. Other acquisitions do not transfer the ownership of a portfolio of assets but instead confer the right to be a fund manager for specific funds.

44. Consequently, respondents from the banking sector do not face the same challenges when distinguishing between a business combination and an asset acquisition. We did not observe from the outreach responses that there is any debate over:

    (a) what output from an acquired set of activities and assets in the financial sector gives rise to a business combination and what output does not, that is, what is the relevant output of a bank; and

    (b) whether one specific input has to be included in the acquisition for it to be a business combination.

45. From outreach responses we noted that the main challenge that respondents from the banking sector face in practice when distinguishing between an asset acquisition and a business combination is also the identification of processes, as described in paragraph B7 of IFRS 3, that give rise to a business.

46. In this respect, the discussion for the banking sector seems to be more similar to the discussion in the investment property sector.

47. However, unlike in the investment property sector, all respondents from the banking sector think that only processes that meet specific criteria may give rise to

a business combination. Every respondent asks in one way or another whether a process is important for producing the output. However, the criteria used to determine whether a process is important for producing the output vary significantly and the criteria used reflect the specific experience and business background of each respondent.

48. For example, some respondents consider processes such as loan collection not to be processes that are used to create outputs, while others consider them to be an integral part of the ability to generate income from a loan.

49. Another respondent explains that the conclusion on whether a process such as loan collection gives rise to a business depends on the quality of the book being acquired:

(a) If the loan portfolio quality is poor, the collections process is likely to be significant and therefore to form part of the processes in terms of IFRS 3.

(b) If the loan portfolio quality is good, then the collections process is more likely to be an administration function rather than a substantive creator of outputs.

50. In addition to the specific issues addressed in our outreach request, respondents identified the following challenges when distinguishing between an asset acquisition and a business combination:

(a) The acquisition of a set of activities and assets, without the takeover of the staff that the seller employed to operate the business, is considered an asset acquisition. This view addresses situations of acquisitions in which the staff that the seller employed to operate the business are replaced by the acquirer’s own staff or by staff from an external third-party service provider. The identification of a business becomes more complicated, however, if the purchase agreement itself does not include the takeover of the workforce employees but the acquirer has extended employment offers to certain employees as allowed in the purchase agreement to facilitate the integration of loan assets.

(b) The acquired set of assets and activities consists in significant part of assets that the acquirer does not intend to use after the takeover (that is, they are redundant assets).

(c) The acquirer does not take over the existing portfolio of loans and receivables but only the right to the further growth of the portfolio (for example the seller has rights to the existing portfolio, while the acquirer has rights to the growth of the portfolio).

51. For the summary of the responses from preparers in the banking sector to our **specific questions**, see paragraph B5 of this Staff Paper.

### *Shipping sector*

52. **General question:** *We are particularly interested in your experience of any difficulties in identifying a business in an acquisition in the shipping industry. That is, what are the challenges you face when distinguishing between an asset purchase (and/or assuming liabilities) and a business combination? What factors do you see as important when distinguishing a business combination from an asset purchase? Please provide details.*

53. Significant acquisitions in the shipping sector are acquisitions of vessels and they might include the takeover of processes such as maintenance, charter and manning by the acquirer that are considered minor in comparison to the vessel and/or that are of no interest to the acquirer. These processes typically did not affect the acquirer's decision to purchase the vessel.

54. In other words, preparers in the shipping sector might face a similar challenge as preparers in the investment property sector.

55. Notwithstanding that, the preparers from the shipping sector did not think that they have so far experienced any challenges or borderline cases in the shipping sector.

56. Accordingly, one respondent highlights that it considers the current guidance for the identification of a business in IFRS 3 to be sufficient.

57. Some respondents explained that they did not face any challenges when distinguishing between asset acquisitions and business combinations, because it is business practice to acquire only the vessel; or, in other words, the target of the purchase would be the vessel without any of the processes and contracts necessary to create outputs.

58. For the summary of the responses from preparers and preparer industry groups in the shipping sector to our **specific questions**, see paragraph B6 of this Staff Paper.

### *Solar and wind farm sector*

59. **General question:** *We are particularly interested in your experience of any difficulties in identifying a business in an acquisition in the solar industry and/or the wind industry. That is, what are the challenges you face when distinguishing between an asset purchase (and/or assuming liabilities) and a business combination? What factors do you see as important when distinguishing a business combination from an asset purchase? Please give details.*

60. For the solar and wind farm sector we were not able to identify something like an industry view.

61. We think this results from two facts:

    (a) the diversity of acquirers. Among the acquirers of solar and wind farms are very different entities, for example institutional investors such as banks and insurance companies on the one hand and utility companies on the other hand.

    (b) The solar and wind farm sector is still not established but is evolving.

62. Consequently, we can only report indicative views and tendencies on the questions that we asked in our outreach activities.

63. However, some of the examples given from practice of where respondents faced challenges in distinguishing business combinations from asset acquisition indicate that preparers in this sector face similar challenges to preparers in other industry sectors.

64. For the summary of the responses from preparers and preparer industry groups in the solar and wind farm sector to our **specific questions**, see paragraph B7 of this Staff Paper.

### *Large firms*

65. **General question:** *We are interested in your experience about any difficulties in identifying a business in an acquisition across all of the industry sectors. That is, what challenges do preparers, auditors and advisors face when distinguishing between an asset purchase and a business combination? What factors do you observe as being considered important when distinguishing a business combination from an asset purchase?*

66. Our outreach to large firms confirmed the overall results from our outreach to preparers but highlighted some additional challenges.

67. For the large firms responding to the outreach, diversity in practice results from the following aspects of the definition of a business in Appendix A of IFRS 3 and the related application guidance in paragraphs B7-B12 of IFRS 3:

    (a) The guidance on processes in paragraph B7(b) of IFRS 3 is considered insufficient as to which processes give rise to a business and which do not. For example, do processes associated with operation and maintenance of an asset give rise to a business, or should preparers be looking only at higher-level processes such as strategic management, sales and marketing and contract negotiation?

    (b) Questions sometimes arise as to whether a specific acquired resource is a ‘process’, an ‘input’ or something else, especially when no employees are involved. For example, would an acquired property management contract or a wind farm operating licence be considered a process?

    (c) ‘Output’ is defined broadly. Specifically, output that gives rise to a business can consist of more than revenue or saleable products or services.

(d) Paragraph B8 of IFRS 3 makes clear that, to be a business, it is not necessary to 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 of continuing to produce outputs by integrating the business with their own inputs and processes. This can lead to questions about:

(i) How many inputs/processes can be 'missing' to conclude that an acquired set is yet still a business? The definition of a business is silent on whether at least one process must be acquired or whether it is possible to acquire no processes at all and yet still meet the definition of a business.

(ii) How to apply the guidance on integrating the acquired set with existing processes and inputs of the acquirer? For example, an existing industry operator—especially in an asset-based industry such as property or shipping—will almost be always be capable of using its own existing processes and inputs to the extent that they are not acquired in the transaction. This would be the case even for a bare asset purchase.

(e) Assessing whether an acquired set is capable of being conducted and managed as a business by a market participant might depend on the type of market participant (for example a financial buyer vs an existing industry participant).

(f) The definition is framed in terms of what is or could be a business, but it has little or no guidance on what is **not** a business.

(g) The guidance refers to various indicators, for example employees, liabilities, and the four factors in paragraphs B10(a)-(d) of IFRS 3 for qualifying integrated sets of activities and asset in the development stage, but it also explains that none is determinative in isolation. There is little guidance on relative weighting. Accordingly, some respondents look for 'rules of thumb' to assist in the assessment. For example, the transfer of employees is in practice very often considered to be a strong indicator for a business.

(h) The reference in paragraph B12 of IFRS 3 to goodwill. Goodwill is only determined once the acquirer has concluded that the acquired set is a business and in some cases arises in large part as a result of recognising deferred tax.

(i) The specific transactions given by the large firms and their related explanations show that:

  (i) The distinction between asset acquisitions and business combinations depends very much on the specific facts and circumstances of a transaction in practice. Even on the acquisition of the same type of operation, or the same type of main asset, the conclusion can differ for two transactions because of some additional or different facts and circumstances.

  (ii) Problems in distinguishing between asset acquisitions and business combinations might arise across industry sectors, depending on the specific fact pattern.

68. For the summary of the responses from the large firms to our **specific issues**, see paragraph B8–B16 of this Staff Paper.

## Discussion with the FAF PIR team and the FASB staff

### *FAF PIR team*

69. We contacted the FAF PIR team performing the post-implementation review process of FAS 141R (now Topic 805 *Business Combinations* in the *FASB Accounting Standards Codification*®) and shared with them the contents of this Staff Paper.

70. They have been reviewing the application of the definition of 'business' in paragraph A4 of FAS 141R (now paragraph 805-10-20 of Topic 805) and the related application guidance in paragraphs A4–A9 of FAS 141R (now paragraphs 805-10-55-4 – 55-9 of Topic 805). In conducting their review they have observed that the definition of business is considered to be very broad and preparers

therefore face difficulties in distinguishing business combinations from asset acquisitions.

71. The FAF PIR team is in the process of completing their report of their findings for review with the FAF President and CEO, the Oversight Committee Co-chairs and the FASB Chairman. Afterwards, they will provide a summary report on their PIR, available on the FAF's website, after approval by the FAF Trustees.

72. The FAF PIR approach keeps stakeholder input confidential rather than making it publicly available. Consequently the FAF PIR team will not be able to share with us full details of the stakeholder input they received, however, the FAF PIR team has offered to discuss our outreach results and their findings in greater detail after publishing their PIR report.

### *FASB staff*

73. We contacted the FASB staff to ask for their experience on the application of the definition of a 'business' in paragraph A4 of FAS 141R (now paragraph 805-10-20 of Topic 805) and the related application guidance in paragraphs A4–A9 of FAS 141R (now paragraphs 805-10-55-5 – 55-9 of Topic 805) and shared with them the contents of this Staff Paper.

74. The FASB staff explained that neither the FASB nor its Emerging Issues Task Force had received any formal requests for additional guidance to help practice in applying the definition of a business since issuing FAS 141R. Nor has the FASB received a significant number of requests for help in applying the guidance through its technical inquiry service. That said, the FASB staff is aware, based on anecdotal evidence provided by experienced practice fellows and informal discussions with FAF staff assigned to the PIR of FAS 141R (now Topic 805 *Business Combinations*), that significant judgements may sometimes be required to apply the definition of a business in practice. The upcoming post-implementation review findings may provide insights into the nature and frequency of those judgements.

75. However, they offered to continue the discussion when the findings from the post-implementation review process of FAS 141R (now Topic 805 *Business Combinations*) are available.

## Contribution to the post-implementation review of IFRS 3

### *Type of information to be contributed to the post-implementation review*

76. Considering that this is the first time that the Interpretations Committee is contributing experience based on outreach activities to a post-implementation review, we outlined in greater detail in Staff Paper 6 how the outreach results and the results from the discussion of the Interpretations Committee will be used by in the PIR of IFRS 3.

77. In summary, we think that these results:

(a) will help the IASB in its identification of issues for setting the scope for 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 (see paragraph 22 of Staff Paper 6); and

(b) could be used with the feedback received from the Request for Information (RFI) to gain an understanding of the challenges entities face in applying aspects of IFRS 3 (see paragraph 37 of Staff Paper 6).

78. Accordingly, we will merely 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, together with the list of issues that could be further explored as part of the PIR of IFRS 3 and amended in the light of the discussion of the Interpretations Committee, will be contributed to the post-implementation review.

### *Summary of experience*

79. From the outreach responses that we have received, we have noted divergent views and approaches on distinguishing business combinations from asset

acquisitions. There is diversity in views and approaches within and between industry sectors.

80. We think that these divergent views and approaches relate to some specific issues that are relevant to the identification of a business and these issues could be further explored as a part of the PIR of IFRS 3.

81. In addition, we have identified some issues:

(a) that are either not explicitly addressed in the definition of a business in Appendix A of IFRS 3 and the related application guidance in paragraphs B7─B12 of IFRS 3; or

(b) for which it is not apparent how the views and approaches of some of the respondents on these issues are reflected, or align with, this guidance in IFRS 3.

82. Please note that the following list of issues that could be further explored as a part of the PIR of IFRS 3 was solely derived from the outreach responses by applying the criteria given in the paragraphs 79-81 of this Staff Paper. The inclusion of an issue in the list does not imply any conclusion with respect to the guidance in IFRS 3, for example, that the guidance in IFRS 3 is unclear for these issues or that it needs to be amended.

83. The issues that we identified for possible further exploration by the PIR of IFRS 3 are:

*What types of processes give rise to a business?*

(a) Paragraph B7(b) of IFRS 3 describes processes as any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. There are however divergent views among respondents on whether:

(i) any type of such processes, for example processes such as security, cleaning or maintenance that are associated to an investment property, give rise to a business; or

(ii) only processes that meet specific criteria, for example processes that are significant or more 'sophisticated' such as strategic management processes associated with investment property, give rise to a business and what these criteria are.

(b) The views differ between respondents from the same industry sector and between respondents from different industry sectors.

(c) In particular, views differ on whether and when the acquisition of a single significant asset, for example an investment property or a vessel, with some simple processes associated with it, gives rise to a business combination.

*What inputs and processes need to be included in the acquired set of activities and assets to be a business?*

(d) From our outreach we noted many approaches for determining the vital inputs and processes of a business:

(i) What inputs and processes that the seller used in operating the business, or that a market participant needs to operate the business, have to be included in the acquired set of activities and asset, because otherwise it is not considered a business?

(ii) What inputs and processes that the seller used in operating the business, or that a market participant needs to operate the business, might be missing or excluded from the acquired set of activities and assets for it nevertheless to be considered a business?

(e) The issue is relevant if the acquirer does not take over all the staff and the equipment that the seller used in operating that business but includes and combines the acquired set of activities and assets into its own inputs and processes.

(f) Many respondents interpret paragraph B8 of IFRS 3 to mean that an acquired set of activities and assets need not include all inputs and processes necessary to create output. However, they presented many different approaches for distinguishing inputs and processes that are vital for a business from inputs and processes that might be missing from the acquired set of activities and assets that would nevertheless still be a business.

(g) The different approaches result in different conclusions, in particular on the following issues:

(i) whether missing inputs and processes must be easily replaceable for the acquired set of activities and assets still to be a business or whether inputs and processes might even be missing, if only a very few specialised competitors can replace missing inputs and processes; for example, only other pharmaceutical entities can develop a promising product candidate into a final drug?

(ii) whether all inputs and processes that meet certain criteria, for example, inputs and processes that are crucial for value creation and not easily replaceable, have to be included in the acquired set of activities and assets for it to be a business, or whether it is sufficient that at least one of these inputs and processes is included in the acquired set and the missing ones are replaced by the acquirer?

(iii) how the market participants that are capable of acquiring the business and continuing to produce outputs without some of the inputs and processes that the seller used in operating the business (see paragraph B8 of IFRS 3) are determined? What is the relevant peer group of market participants? Are only entities with the same or similar business model as the acquirer part of the peer group, or could entities with a different business model also be part of the peer group? For example, are oil- and gas-producing entities part of the peer group of an oil and gas exploration entity?

(h) The issue of what inputs and processes need to be included in the acquired set of activities and assets and what inputs and processes might be missing from it and it is nevertheless still considered a business is particularly relevant in an asset-based industry such investment property or shipping. This is because an entity operating in such a business will very often be capable of acquiring investment properties or vessels and continuing to produce outputs by integrating the investment properties and vessels with its own inputs and processes.

*How do you consider employees in the assessment of whether an acquired set constitutes a business?*

(i) Most respondents considered the takeover of employees from the seller a very important factor in identifying a business.

(j) Considering the importance of employees for a business, these respondents presented many different views about how to consider the workforce in the business evaluation, taking into consideration many possible scenarios. The different approaches result in different conclusions, in particular on the following issues:

(i) How to determine the employees of the seller that are relevant for a business, that is, the workforce that has to be included in an acquisition for it to be a business combination? This issue is relevant for the classification of an acquired set of activities and assets as either a business combination or an asset acquisition, if the acquirer does not take over all or specific parts of the workforce that the seller used in operating the business, but instead replaces it by its own workforce or outsources these activities to external third-party providers.

(ii) How to consider employees that have been working for the acquired set of activities and assets, but who have not been employed by the seller but by external third-party service providers, for example employees working on outsourced activities or leased labourers? The issue is whether they are considered in the same way as for any other employee in the assessment of whether an acquired set of activities and assets constitutes a business, or whether specific features have to be considered.

*How do you consider redundant assets, inputs and processes in the assessment of whether an acquired set constitutes a business?*

(k) On the one hand, several respondents consider redundant assets, inputs and processes (that is, assets, inputs and processes that are included in the acquired set of activities and assets but that the acquirer does not intend to use) to be irrelevant in the assessment of whether the acquired set constitutes a business. Instead, they focus on whether the parts of the acquired set of activities and assets that the acquirer is interested in constitute a business.

(l) On the other hand, paragraph B11 of IFRS 3 explains that in evaluating whether a particular set of activities and assets 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. Instead, the evaluation of whether the set 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.

(m) The question that therefore arises is whether and when redundant assets, inputs and processes give rise to a business if a market participant is capable of conducting and managing the integrated set as a business because of the redundant assets, inputs and processes?

(n) We think that the PIR of IFRS 3 could further explore the relevance of redundant assets, inputs and processes for the evaluation of whether an acquired set of activities and assets is a business and of the relevance of the guidance in paragraph B11 of IFRS 3 in this context.

*How do you consider inputs and processes that have been outsourced or that are rendered by external third-party providers in the assessment of whether an acquired set constitutes a business?*

(o) From outreach we noted the least diversity in approaches for identifying a business if:

  (i) the seller operated the business with own staff and equipment; and

(ii) the acquirer takes over all of the staff and the equipment from the seller.

(p) The more the activity was based, however, on inputs and processes that have been outsourced or that are rendered by external third-party providers on a contractual basis, the wider was the diversity in views among respondents in distinguishing between business combinations and asset acquisitions.

(q) One respondent extended the issue by raising the scenario in which the acquired set of activities and assets does not include the takeover of the contractual arrangements of the seller, but the acquirer immediately enters into new contractual arrangements with the external third-party providers of the seller.

(r) We think that the PIR of IFRS 3 could further explore the identification of a business for activities that are based for a more than insignificant part on inputs and processes that have been outsourced or that are rendered by external third-party service providers.

*What output gives rise to a business?*

(s) Paragraph B7(c) of IFRS 3 specifies output as 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. There are however divergent views among respondents on whether:

(i) any type of output that is created by a set of activities and assets gives rise to a business; or

(ii) only specific types of outputs are relevant for this classification, for example only the output intended by the acquirer gives rise to a business, or whether is it sufficient that other entities produce the same output as is produced by the acquired set of activities and assets.

For example, exploration and evaluation (E&E) data is not the intended output of an oil- and gas-producing company. However, exploration and evaluation companies produce and sell such data.

(t) In addition, there is diversity in views among some respondents who think that only a specific type of output is relevant for the identification of a business for which the relevant output of a business can change in the course of a project, that is, in the different stages or phases of an upstream oil and gas or mining operation or a pharmaceutical R&D project. For example, could the relevant output of an upstream oil and gas operation in the exploration and evaluation phase be E&E data, whereas it turns into oil and gas in the development and construction phase?

(u) The diversity in views affects in particular the classification as either a business combination or an asset acquisition of:

(i) an acquisition of an upstream oil and gas or mining operation in the exploration and evaluation phase by a large commodity producer; and

(ii) an acquisition of a biotech company by a large pharmaceutical company.

*When are processes applied to inputs capable of creating output?*

(v) Paragraph B7 of IFRS 3 explains that a business consists of inputs and processes applied to those inputs that have the ability to create outputs. There is however diversity in views among respondents on whether capability requires that:

(i) a project is technically feasible and economically viable or whether technical feasibility is sufficient; and

(ii) the production of the relevant output is (highly) probable or whether significant uncertainty about this is still acceptable. If oil and gas, for example, is considered to be the relevant output of an oil- and gas-producing company that gives rise to a business, is the acquisition of an upstream oil and gas project in the exploration and evaluation phase without a proved and probable reserve a business combination of the oil- and gas-producing company, even though the production of oil and gas is very uncertain before a reserve is probable and has been proven?

(w) This diversity in views affects in particular the accounting for the acquisition of an upstream oil and gas or mining operation in the early stages of exploration and evaluation.

*When does an integrated set of activities and assets in the development stage qualify as a business?*

(x) Paragraphs B9 and B10 of IFRS 3 give guidance for identifying businesses in the development stage of integrated sets of activities and assets. There are however divergent views among respondents on whether and when:

(i) the acquisition of an upstream oil or gas or mining operation in the exploration and evaluation phase or development and construction phase constitutes a business combination; and on whether and when

(ii) the acquisition of a pharmaceutical R&D project constitutes a business.

(y) We think that the PIR of IFRS 3 could further explore the identification of a business for such activities.

*How do you identify inputs, processes and outputs when they are closely interrelated?*

(z) Paragraph B7 of IFRS 3 specifies all three elements (that is, inputs, processes and outputs) of a business. Some respondents noted, however, difficulties in identifying these elements in some items.

(aa) They noted difficulties, for example, in classifying an acquired property management contract, or a wind farm operating licence, as being either an input or a process or both.

(bb) Furthermore, knowhow might be included in all three elements or only two of them or only one of them.

(cc) We think that the PIR of IFRS 3 could further explore whether additional guidance for identifying inputs, processes and outputs in specific items is needed.

*When does goodwill indicate that a particular set of activities and assets is a business?*

(dd) Paragraph B12 of IFRS 3 specifies that in the absence of evidence to the contrary, a particular set of activities and assets in which goodwill is present shall be presumed to be a business.

(ee) Some respondents noted however difficulties in applying this indicator because:

(i) the presumption seems to result in circular logic because goodwill is measured and recognised after concluding that the acquired set of activities and assets is a business and its acquisition is a business combination; and

(ii) goodwill recognised in a business combination may arise in large parts as a result of recognising deferred tax assets and liabilities.

(ff) We think that the PIR of IFRS 3 could further explore the difficulties in applying the presumption in paragraph B12 of IFRS 3.

## Questions for the IFRS Interpretations Committee

| Questions for the IFRS Interpretations Committee |
|---|
| 1. What comments do the Interpretations Committee members have on our outreach activities or the summary of the outreach responses or on our discussions with the FAF PIR team and the FASB staff?<br>2. What comments do the Interpretations Committee members have on the tentative summary of the issues that could be further explored as a part of the PIR of IFRS 3? |

## Appendix A—Outreach requests

A1. Appendix A reproduces the outreach requests submitted to:

(a) preparers and preparer industry groups in the investment property sector;

(b) preparers and preparer industry groups in the extractive industries sector;

(c) preparers and preparer industry groups in the pharmaceutical sector;

(d) preparers in the banking sector;

(e) preparers and preparer industry groups in the shipping sector;

(f) preparers and preparer industry groups in the solar and wind farm sector; and

(g) large firms.

### *Outreach to preparers and preparer industry groups in the investment property sector*

**General issue:**

Following a submission to the IFRS Interpretations Committee ('the Interpretations Committee'), the Interpretations Committee would like to know what practical difficulties preparers have encountered when applying the definition of a business in Appendix A of IFRS 3 *Business Combinations* (revised 2008) and the related application guidance in paragraphs B7–B12 of IFRS 3 (revised 2008). The Interpretations Committee is discussing whether the Standard is clear about the identification of a business in an acquisition and, if not, what clarifications are needed. The results of the Interpretations Committee's work on this topic will also feed into the IASB's post-implementation review of IFRS 3 (revised 2008).

**General question:**

We are particularly interested in your experience of any difficulties in identifying a business in an acquisition in the investment property sector. That is, what are the challenges you face when distinguishing between an asset purchase and a business acquisition in the investment property? What factors do you see as important when distinguishing a business combination from an asset purchase? Please give details.

**Specific issue:**

Initial outreach activities suggest that there are divergent views on whether the acquisition of a single investment property with relatively simple processes associated with it meets the definition of a business combination. More specifically, the question is whether the acquisition of a single investment property, with lease agreements with multiple tenants over varying periods and associated processes, such as cleaning and maintenance, and administrative services, such as rent collection, meets the definition of a business combination. The critical point in these discussions is not the acquisition of control over the assets and liabilities but whether these assets and liabilities are part of a business or not.

**Specific questions:**

What is your experience of this particular issue:

1. Do you classify such transactions as business combinations or merely as the acquisition of an asset or a group of assets, ie an investment property, and related contractual assets and liabilities, if any ('asset acquisitions')?
2. What criteria do you use to consistently distinguish business combinations from asset acquisitions?
3. Do you consider associated processes, such as cleaning and maintenance, and administrative services, such as rent collection, to be processes, as specified in paragraph B7 of IFRS 3 (revised 2008), that give rise to a business in distinguishing between business combinations and asset acquisitions? Why, or why not?
4. Does it have any impact on the classification of an acquisition of investment property either as a business combination or an asset acquisition, if the acquirer does not acquire the associated processes? For example, the acquirer does not adopt the staff that renders cleaning, maintenance and administrative services associated with the investment property and the equipment they use in rendering the services from the vendor. Instead, the acquirer uses staff and equipment, which it already had before the acquisition to render the services. Alternatively, it acquires these services from external third party service providers.
5. Does it make a difference to the classification if the acquisition of a single investment property, with multiple tenants and associated

processes, as described above, in place is, from a legal perspective, an asset deal or a share deal? Please explain.

### *Outreach to preparers and preparer industry groups in the extractive industries sector*

**General issue:**

Following a submission to the IFRS Interpretations Committee ('the Interpretations Committee'), the Interpretations Committee would like to know what practical difficulties preparers have encountered when applying the definition of a business in Appendix A of IFRS 3 *Business Combinations* (revised 2008) and the related application guidance in paragraphs B7-B12 of IFRS 3 (revised 2008). The Interpretations Committee is discussing whether the Standard is clear about the identification of a business in an acquisition and, if not, what clarifications are needed. The results of the Interpretations Committee's work on this topic will also feed into the IASB's post-implementation review of IFRS 3 (revised 2008).

**General question:**

We are particularly interested in your experience of any difficulties encountered in identifying a business in an acquisition in the extractive industries. Specifically, what challenges do you face when distinguishing between an asset purchase and a business combination? What factors do you see as important when distinguishing a business combination from an asset purchase? Please provide details.

**Specific issue and questions:**

Initial outreach activities suggest that difficulties arise on the following issues:

- Appendix A of IFRS 3 (revised 2008) defines a business as an integrated set of activities and assets that is 'capable' of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants. How is the notion of 'capable' being applied in practice? Consider, for example, a minerals or oil and gas project that has the infrastructure necessary to produce minerals or oil and gas. However, given the current market conditions, it is not economically viable to proceed with the project to develop the mine or field and produce the mineral or oil and gas. Given this should 'capable' be interpreted as meaning 'it is possible to conduct and manage the integrated set of activities and assets for the purpose of providing return' (ie the project is technically feasible) or as 'it is economically and commercially viable to conduct and manage the integrated set of activities and assets for the purpose of providing return' (ie the project is economically feasible)?

- Paragraph B7(c) describes 'outputs' as the result of inputs and processes applied to those inputs that provide or have the ability to provide a return. When applying IFRS 3 (revised 2008), what do you consider to be the output of an oil and gas operation or a mining operation:
  - (a) the ultimate output of the assets and processes such as the ultimate commodity, e.g., oil and gas, copper, gold, iron; or
  - (b) some other type of output that is produced at various stages of the lifecycle of an extractives project, eg exploration data; or
  - (c) either (a) or (b), depending on the project lifecycle?
- Generally speaking, the lifecycle of an oil and gas or mining operation starts with exploration and evaluation, then moves to development/construction and then to production. In practice, at what stage in the lifecycle do preparers generally start accounting for the acquisition of a set of inputs and processes as a business combination? What are the factors that influence that decision?

### *Outreach to preparers and preparer industry groups in the pharmaceutical sector*

**General issue:**

Following a submission to the IFRS Interpretations Committee ('the

Interpretations Committee'), the Interpretations Committee would like to know what practical difficulties preparers have encountered when applying the definition of a business in Appendix A of IFRS 3 *Business Combinations* (revised 2008) and the related application guidance in paragraphs B7–B12 of IFRS 3 (revised 2008). The Interpretations Committee is discussing whether the Standard is clear about the identification of a business in an acquisition and, if not, what clarifications are needed. The results of the Interpretations Committee's work on this topic will also feed into the IASB's post-implementation review of IFRS 3 (revised 2008).

**General question:**

We are particularly interested in your experience of any difficulties encountered in identifying a business in an acquisition in the pharmaceutical sector, for example:

1. What challenges do you face when distinguishing between an asset purchase and a business combination? What factors do you see as important when distinguishing a business combination from an asset purchase? Please provide details.
2. Paragraph B7(c) of IFRS 3 describes 'outputs' as the result of inputs and processes applied to those inputs that provide, or have the ability to provide, a return. When applying IFRS 3, what do you consider to be the output of pharmaceutical businesses:
    a. the ultimate output of the assets and processes such as the ultimate product, eg, the drug; or
    b. some other type of output that is produced at various phases of the research and development process, eg intellectual property such as Phase II studies of compounds; or
    c. either (a) or (b), depending on the phase of the research and development project? Why, or why not?
3. Do pharmaceutical entities consider processes that are applied during research and development to be processes as specified in paragraph B7(b) of IFRS 3 that give rise to a business? Please explain.
4. Generally speaking, a research and development process in the pharmaceutical industry starts with the identification of a candidate that is being researched and the proposal for its

development, and then moves to the pre-clinical and clinical phases and production. In practice, are these phases relevant for distinguishing business combinations from asset acquisitions and, if relevant, at what stage in the research and development process do preparers generally start accounting for the acquisition of a set of inputs and processes as a business combination? What are the factors that influence that decision?

5. Do you consider the acquisition of a promising scientist in a leased lab a business combination?

**Specific issue:**

Initial outreach activities suggest that difficulties may arise in classifying the acquisition of a licence for a product candidate from, for example, a bio-tech company that entitles the acquirer to the 'knowhow' associated with the product candidate. The licence agreement may define 'knowhow' as all biological materials and other tangible materials, inventions, practices, methods, protocols, formulas, knowledge, trade secrets, processes, procedures, specifications, assays, skills, experience, techniques, data and results of experimentation and testing, including pharmacological, toxicological, safety, stability and pre-clinical and clinical test data and analytical and quality control data, patentable or otherwise. More specifically, the question is whether, and if so, which components of knowhow give rise to a business combination.

**Specific questions:**

What is your experience of this particular issue:

1. Do you usually classify the acquisition of a licence for a product candidate with the associated knowhow as a business combination or as the acquisition of an asset or a group of assets ('asset acquisition')? Please explain.
2. What criteria do you use to consistently distinguish business combinations from asset acquisitions?
3. Do you consider knowhow to be an input, a process or an output as specified in paragraph B7 of IFRS 3 or does this classification depend on what is actually acquired as part of knowhow? Consequently, is knowhow either an input, a process or an output—or might knowhow include two or even all three of these elements? Why, or why not?
4. If the acquirer does not take over the employment of the staff that

was involved in the development of the product candidate so far and the equipment they use in rendering the services for the seller, but instead uses staff and equipment that it already had to further develop product candidates into a final product, does it have any impact on the classification of an acquisition of a licence for that product candidate and the associated knowhow as either a business combination or an asset acquisition? Alternatively, would acquiring these services from external third party service providers have an impact on the classification.

5. Does it make a difference to the classification if the acquisition of a licence for a product candidate and the associated knowhow is, from a legal perspective, an asset deal or a share deal? Please explain.

### *Outreach to preparers in the banking sector*

**General issue:**

Following a submission to the IFRS Interpretations Committee ('the Interpretations Committee'), the Interpretations Committee would like to know what practical difficulties preparers have encountered when applying the definition of a business in Appendix A of IFRS 3 *Business Combinations* (revised 2008) and the related application guidance in paragraphs B7–B12 of IFRS 3 (revised 2008). The Interpretations Committee is discussing whether the Standard is clear about the identification of a business in an acquisition and, if not, what clarifications are needed. The results of the Interpretations Committee's work on this topic will also feed into the IASB's post-implementation review of IFRS 3 (revised 2008).

**General question:**

We are particularly interested in your experience of any difficulties in identifying a business in an acquisition in the financial sector. That is, what are the challenges you face when distinguishing between an asset purchase (and/or assuming liabilities) and a business combination? What factors do you see as important when distinguishing a business combination from an asset purchase? Please give details.

**Specific issue:**

Initial outreach activities suggest that difficulties may arise in classifying the acquisition of a loan/receivable portfolio, a deposit book, or acquiring the rights to be a fund manager in the asset management sector. More specifically, the question is whether, and if so, which, processes associated with managing the loan/receivable portfolio, a deposit book, or the funds, the acquirer needs to acquire from the transferor so that the acquisition is classified as a business combination? The critical point in these discussions is not the acquisition of control over the assets and liabilities but whether these assets and liabilities are a business or not.

**Specific questions:**

What is your experience of this particular issue:

1. Do you classify the acquisition of a single or a small number of loan portfolio(s), deposit book(s) or the management of a fund usually as business combinations or merely the acquisition of a group of assets or management rights ('asset acquisitions')?
2. What criteria do you use to consistently distinguish business combinations from asset acquisitions?
3. Do you consider associated processes, such as loan collection, to be processes as specified in paragraph B7 of IFRS 3 (revised 2008), that give rise to a business in distinguishing between business combinations and asset acquisitions? Why, or why not?
4. Does it have any impact on the classification of the acquisition of a single or a small number of loan portfolio(s), deposit book(s), or the takeover of the funds management either as business combinations or asset acquisitions, if the acquirer does not acquire the associated processes? For example, the acquirer does not take over the employment of the staff that manages the loan portfolios, deposit books, or the funds so far and the equipment they use in rendering the services for the vendor. Instead, the acquirer uses staff and equipment that it already had before the acquisition to render the services. Alternatively, it acquires these services from external third party service providers. Also, does it make a difference whether the acquired loan portfolio(s) or deposit book(s) is/are acquired as 'closed portfolio(s)' that is/are run off or whether it is/they are intended to be used as 'open portfolio(s)' that

is/are intended to generate replacement business or growth?

5. Does it make a difference to the classification if the acquisition of a single or small number of loan/receivable portfolio(s), deposit book(s), or the funds management as described above is, from a legal perspective, an asset deal or a share deal? Please explain.

### *Outreach to preparers and preparer industry groups in the shipping sector*

**General issue:**

Following a submission to the IFRS Interpretations Committee ('the Interpretations Committee'), the Interpretations Committee would like to know what practical difficulties preparers have encountered when applying the definition of a business in Appendix A of IFRS 3 *Business Combinations* (revised 2008) and the related application guidance in paragraphs B7–B12 of IFRS 3 (revised 2008). The Interpretations Committee is discussing whether the Standard is clear about the identification of a business in an acquisition and, if not, what clarifications are needed. The results of the Interpretations Committee's work on this topic will also feed into the IASB's post-implementation review of IFRS 3 (revised 2008).

**General question:**

We are particularly interested in your experience of any difficulties in identifying a business in an acquisition in the shipping industry. That is, what are the challenges you face when distinguishing between an asset purchase (and/or assuming liabilities) and a business combination? What factors do you see as important when distinguishing a business combination from an asset purchase? Please give details.

**Specific issue:**

Initial outreach activities suggest that difficulties may arise in classifying the acquisition of a ship. More specifically, the question is whether, and if so, which, processes associated with managing the ship the acquirer needs to acquire from the seller so that the acquisition is classified as a business combination? The critical point in these discussions is not the acquisition of control over the assets and liabilities but whether these assets and liabilities are part of a business or not.

**Specific questions:**

What is your experience of this particular issue:

1. Do you classify the acquisition of a single ship, or a small number of ships, usually as business combinations or merely the acquisition of a group of assets or management rights ('asset acquisition')?
2. What criteria do you use to consistently distinguish business combinations from asset acquisitions?
3. Do you consider associated processes, such as maintenance, charter and manning, to be processes as specified in paragraph B7 of IFRS 3 (revised 2008), that give rise to a business in distinguishing between business combinations and asset acquisitions? Why, or why not?
4. Does it have any impact on the classification of an acquisition of a single ship, or a small number of ships, either as a business combination or an asset acquisition, if the acquirer does not acquire the associated processes? For example, the acquirer does not take over the employment of the crew and the staff that manages the ship(s) and the equipment they use in rendering the services for the seller. Instead, the buyer uses staff and equipment that it already had before the acquisition to manage the acquired ship(s). Alternatively, it acquires these services from external third party service providers.
5. Does it make a difference to the classification if the acquisition of a single ship, or a small group of ships, is, from a legal perspective, an asset deal or a share deal? Please explain.

## *Outreach to preparers and preparer industry groups in the solar and wind farm sector*

**General issue:**

Following a submission to the IFRS Interpretations Committee ('the Interpretations Committee'), the Interpretations Committee would like to know what practical difficulties preparers have encountered when applying the definition of a business in Appendix A of IFRS 3 *Business Combinations* (revised 2008) and the related application guidance in paragraphs B7–B12 of IFRS 3. The Interpretations Committee is discussing whether the Standard is clear about the identification of a business in an acquisition and, if not, what clarifications are needed. The results of the Interpretations Committee's work on this topic will also feed into the IASB's post-implementation review of IFRS 3.

**General question:**

We are particularly interested in your experience of any difficulties in identifying a business in an acquisition in the solar industry and/or the wind industry. That is, what are the challenges you face when distinguishing between an asset purchase (and/or assuming liabilities) and a business combination? What factors do you see as important when distinguishing a business combination from an asset purchase? Please give details.

**Specific issue:**

Initial outreach activities suggest that difficulties may arise in classifying the acquisition of a solar farm, a wind farm or a piece of such a farm (eg for regulatory reasons). More specifically, we would like to know whether, and if so, which, processes associated with managing the (piece of the) solar farm or the wind farm the acquirer needs to acquire from the seller so that the acquisition is classified as a business combination? The critical point in these discussions is not the acquisition of control over the assets and liabilities but whether these assets and liabilities are part of a business or not.

**Specific questions:**

What is your experience of this particular issue:

1. Do you usually classify the acquisition of a (piece of a) solar farm or a wind farm as a business combination or as merely the acquisition of a group of assets ('asset acquisition')?
2. What criteria do you use to consistently distinguish business combinations from asset acquisitions?
3. Do you consider associated processes, such as maintenance or feeding the power into the grid, to be processes as specified in paragraph B7 of IFRS 3 (revised 2008), that give rise to a business in distinguishing between business combinations and asset acquisitions? Why, or why not?

4. Does it have any impact on the classification of an acquisition of a (piece of a) solar farm or a wind farm, either as a business combination or an asset acquisition, if the acquirer does not acquire the associated processes? For example, the acquirer does not take over the employment of the staff that manages the (piece of the) solar farm or the wind farm and the equipment they use in rendering the services for the seller. Instead, the buyer uses staff and equipment that it already had before the acquisition to manage the acquired (piece of the) solar farm or wind farm. Alternatively, it acquires these services from external third party service providers.
5. Does it make a difference to the classification if the acquisition of a (piece of a) solar farm or a wind farm is, from a legal perspective, an asset deal or a share deal? Please explain.
6. At what stage of a project to construct a solar farm or a wind farm do you generally start accounting for the acquisition of a set of inputs and processes as a business combination? Is it acquiring the land or the land owners' permission to build the solar farm or the wind farm on its land, obtaining the official permit from the government to build the solar farm or the wind farm on the land, the installation of the solar panels or wind turbines, acquiring the licence to feed energy into the power grid, or any other stage in the construction project? What are the factors that influence the decision about when to start accounting for the acquisition as a business combination?

## *Outreach to large firms*

**General issue:**

Following a submission to the IFRS Interpretations Committee ('the Interpretations Committee'), the Interpretations Committee would like to know what practical difficulties you observed in relation to applying the definition of a business in Appendix A of IFRS 3 *Business Combinations* (revised 2008) and the related application guidance in paragraphs B7–B12 of IFRS 3 (revised 2008). The Interpretations Committee is discussing whether the Standard is clear about the identification of a business in an acquisition and, if not, what clarifications are needed. The results of the Interpretations Committee's work on this topic will feed into the IASB's post-implementation review of IFRS 3 (revised 2008).

**General question:**

We are interested in your experience about any difficulties in identifying a business in an acquisition across all of the industry sectors. That is, what challenges do preparers, auditors and advisors face when distinguishing between an asset purchase and a business combination? What factors do you observe as being considered important when distinguishing a business combination from an asset purchase? The critical point in these discussions is not the acquisition of control over the assets and liabilities but whether these assets and liabilities are a business or not.

**Specific issues:**

Our initial discussions suggest that difficulties in identifying a business particularly arise for the following transactions:

1. acquisition of a single investment property with relatively simple processes associated with it;
2. acquisition of a ship with associated processes;
3. acquisition of a wind farm, eg several wind turbines, related PPE and a licence to operate the wind farm;
4. acquisition of a solar farm, eg several solar modules, related PPE and the licence to operate the solar farm;
5. acquisition of an exploration interest in the oil and gas field or mining operation compared with the acquisition of an interest in the development phase or the production field oil and gas field/mine; and
6. acquisition of intellectual property and related processes in the pharmaceutical industry.

Whilst we have a good information basis about the acquisition of a single investment property with relatively simple processes associated with it, we would also appreciate it if you could give us details on transaction types 2–6.

## Appendix B—Outreach responses on specific questions

B1. Appendix B summarises the responses that we received on our specific questions from:

(a) preparers and preparer industry groups in the investment property sector;

(b) preparers and preparer industry groups in the extractive industries sector;

(c) preparers and preparer industry groups in the pharmaceutical sector;

(d) preparers in the banking sector;

(e) preparers and preparer industry groups in the shipping sector;

(f) preparers and preparer industry groups in the solar and wind farm sector; and

(g) large firms.

### *Summary of responses on our specific questions from preparers and preparer industry groups in the investment property sector*

B2. **Specific questions:** *What is your experience of this particular issue:*

*(a) Do you classify such transactions as business combinations or merely as the acquisition of an asset or a group of assets, ie, an investment property, and related contractual assets and liabilities, if any ('asset acquisitions')?*

(b) In practice, it is merely the application of View 1 or View 2 that determines the classification of the acquisition of a single investment property with relatively simple processes associated with it as a business combination or as the acquisition of an asset or a group of assets (see paragraph 20 of this Staff Paper for an explanation of these views).

(c) Proponents of View 1 mostly classify such transactions as business combinations. Only acquisitions of undeveloped land or investment property under development tend to be classified as asset acquisitions.

(d) Proponents of View 2 instead consider acquisitions of investment property without significant management processes to be acquisitions of assets.

(e) *What criteria do you use to consistently distinguish business combinations from asset acquisitions?*

(f) Proponents of View 1 see no need for criteria to classify the acquisition of a single investment property with relatively simple processes associated with it either as a business combination or as the acquisition of an asset or a group of assets as long as:

(i) the property is fully developed and operating; and

(ii) the use will continue.

This is because proponents of View 1 think that any processes that, when applied to an input or inputs, create or have the ability to create outputs, give rise to a business.

(g) Proponents of View 2 apply very different criteria or indicators to distinguish significant processes that give rise to a business from other processes:

(i) acquiring not only investment property but also key management personnel or property management that are important to the management of the investment property (for example marketing, development, financing, tenancy management etc.) indicates a business combination;

(ii) acquiring “unique knowledge” of managing the investment property indicates a business combination. For example, acquiring a large shopping centre with key management personnel includes obtaining knowledge about the area where the shopping centre is located, knowledge of the mix of retail outlets etc;

(iii) acquiring only the investment property and integrating it into its own pre-existing specific processes indicates the acquisition of an asset;

(iv) acquisitions of a significant number of investment properties indicate business combinations;

(v) acquisitions to enter a new market indicate a business combination, because such acquisitions usually go hand-in-hand with acquiring strategic management processes for the new market;

(vi) acquisitions that include other significant assets (other) than (those related to) the investment property indicate a business combination; and

(vii) acquisitions of complex groups of investment properties with several entities together with, perhaps, non-controlling interests and the processes to administer those entities, indicate business combinations.

*(h) Do you consider associated processes, such as cleaning and maintenance, and administrative services, such as rent collection, to be processes, as specified in paragraph B7 of IFRS 3 (revised 2008), that give rise to a business in distinguishing between business combinations and asset acquisitions? Why, or why not?*

(i) Proponents of View 1 generally consider processes associated with the investment property, such as cleaning, security and maintenance, to be processes that give rise to a business.

(j) For proponents of View 2, associated processes, such as cleaning, security and maintenance, are generally not significant or sophisticated enough to give rise to a business.

(k) Some proponents of View 2 think, however, that processes such as cleaning, security and maintenance give rise to a business if they result in lower costs.

(l) One respondent highlights that processes such as rent collection are often not considered to be processes that create ‘outputs’ and therefore do not give rise to a business.

*(m) Does it have any impact on the classification of an acquisition of investment property either as a business combination or an asset acquisition, if the acquirer does not acquire the associated processes? For example, the acquirer does not adopt the staff that renders*

*cleaning, maintenance and administrative services associated with the investment property and the equipment they use in rendering the services from the vendor. Instead, the acquirer uses staff and equipment, which it already had before the acquisition to render the services. Alternatively, it acquires these services from external third party service providers.*

(n) Taking into consideration paragraph B8 of IFRS 3, none of the respondents requires that the acquisition must include the takeover of all the processes that the seller used in operating the business.

(o) In particular, respondents do usually not require that the seller's processes for rendering cleaning, security and maintenance services must be included in the acquisition for it to be a business combination. This is mainly because:

(i) these processes can be easily replaced, either by the acquirer's own processes or by services rendered by third-party service providers; and

(ii) acquirers usually seek to integrate an acquired investment property into the processes that it already uses. Consequently, the takeover of the staff or contracts for cleaning, security and maintenance services is typically 'coincidental'.

(p) In very rare circumstances, however, the takeover of services such as cleaning, security and maintenance as part of the acquisition might, for proponents of View 2, be relevant for the classification of the transaction as a business combination or an asset acquisition. This might be the case if the processes involve a significant cost reduction.

(q) Apart from that there is huge diversity in views about which processes that the seller used in operating the business have to be included in the acquisition to classify it as a business combination:

(i) The majority of respondents require that (all) the processes that are an integral part of the acquisition for the acquirer (for example property management by key personnel) have to be included in the transactions for the acquisition to be a business combination. A strong indicator is whether the acquirer could continue the operation without the specific process of the seller. Others describe the processes that have to be included in the acquisition for the transaction to qualify as a business combination as 'sophisticated' or 'unique'.

(ii) Other respondents instead think the acquisition of one process that is used to create output is enough to make it a business combination, if the acquirer or other market participant can replace the missing processes, for example by their own processes or by third-party service providers.

(iii) Other respondents go even further and question whether a transaction has to include at least one process to qualify as a business combination. If the acquirer or market participants can easily replace the processes that the seller used in operating the business, they think that processes are not necessary for an acquisition to be a business combination.

(iv) There is debate on whether inputs always require processes to generate returns and whether processes are always required for a business. Some respondents give the example of the acquisition of a single investment property with a non-cancellable long-term lease and outsourced contracts. They argue that this set of inputs, consisting of the investment property and the contractual arrangements, is a business although it does not include a process. This set of inputs is capable of producing outputs (rental income) without any processes applied to the inputs.

(v) Some elaborate upon the argument and go even further. For them investment property is by definition capable of generating outputs (that is, rental income) whether or not any process is present.

*(r) Does it make a difference to the classification if the acquisition of a single investment property, with multiple tenants and associated processes, as described above, in place is, from a legal perspective, an asset deal or a share deal? Please explain.*

(s) It does not generally make a difference whether the purchase is an asset deal or a share deal. For some respondents, however, the fact that an investment property is acquired via a share deal may be an indicator of a business combination, because businesses are usually acquired by acquiring the shares in corporate entities. However, this in itself would not indicate a particular outcome.

### *Summary of responses on our specific questions from preparers and preparer industry groups in the extractive industries sector*

B3. **Specific questions:** *Initial outreach activities suggest that difficulties arise on the following issues:*

*(a) Appendix A of IFRS 3 (revised 2008) defines a business as an integrated set of activities and assets that is 'capable' of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants. How is the notion of 'capable' being applied in practice? Consider, for example, a minerals or oil and gas project that has the infrastructure necessary to produce minerals or oil and gas. However, given the current market conditions, it is not economically viable to proceed with the project to develop the mine or field and produce the mineral or oil and gas. Given this should 'capable' be interpreted as meaning 'it is possible to conduct and manage the integrated set of activities and assets for the purpose of providing return' (ie the project is technically feasible) or as 'it is economically and commercially viable to conduct and manage the integrated set of activities and assets for the purpose of providing return' (ie the project is economically feasible)?*

(b) All respondents pointed out that the distinction between technical and economic feasibility is not itself relevant for their decision-making. Instead, their answer to this question was derived from other criteria that they focus on in their decision-making process.

(c) For some of the respondents, the distinction between 'technically feasible' and 'economically feasible' is redundant when distinguishing between asset acquisitions and business combinations, because they would not have done the deal if they had not thought that the project was technically and economically feasible.

(d) If a project is not currently economically feasible, one respondent explains that it would only buy it if it expects the market to pick up in the medium term and the respondent would consider it as economically feasible.

(e) The majority of respondents, however, require a project to be economically feasible to be a business:

   (i) For some respondents this follows from the fact that they usually require the acquisition of proved and probable reserves for a business combination, and the assumption that there are proved and probable reserves implicitly requires economic feasibility. This is because SEC Rule 4-10 defines reserves as estimated remaining quantities of oil and gas and related substances anticipated to be *economically producible*, as of a given date, by application of development projects to known accumulations (see also paragraph 32(b)(ii) of this Staff Paper). In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and gas or related substances to market, and all permits and financing required to implement the project must have been obtained. Until exploration is complete and reserves are proved, they argue that one cannot say that the existing inputs and processes are truly capable of producing the economic benefit described in IFRS 3 (dividends, lower costs or other economic benefits).

   (ii) For another respondent, 'economic feasibility' follows from the assumption that only oil and gas and mining operations in the development/construction and production phase are businesses. To be in the development phase, however, a plan to produce outputs must have been finalised and approved by the Board of the acquiree, and development must have commenced or be pending. All this would not happen if the project were not to have been considered economically feasible.

(iii) For other respondents, economic feasibility follows from the assumption that a market participant must be capable of operating the acquired set of assets and activities as a business. Accordingly, if a project requires additional development costs to be incurred to bring the property/project into production, it is not yet a business.

(iv) Others think that this interpretation is consistent with the rationale of Topic 932 *Extractive Activities—Oil and Gas* in the *FASB Accounting Standards Codification*® (formerly SFAS 19) regarding the unit of account, which considers that there are future economic benefits only when proved reserves do exist. These respondents also believe that this interpretation is consistent with the judgement of being within or outside the scope of IFRS 6 *Exploration for and Evaluation of Mineral Resources*.

(v) For another respondent, technical feasibility is not required for a property to generate economic returns, because an owner can increase the value of a mineral or an oil and gas property by advancing the exploration and evaluation activities without technical feasibility. This increase in value can provide a return to owners in the form of capital gains from selling the shares or dividends.

(f) Only a minority of respondents focuses instead on technical feasibility. This focus leads them to the conclusion that acquisitions of upstream oil and gas or mining projects in the development or production phase are usually business combinations, whereas acquisitions of such projects in the exploration and evaluation phase are usually asset acquisitions.

*(g) Paragraph B7(c) describes 'outputs' as the result of inputs and processes applied to those inputs that provide or have the ability to*

*provide a return. When applying IFRS 3 (revised 2008), what do you consider to be the output of an oil and gas operation or a mining operation:*

(i) *the ultimate output of the assets and processes such as the ultimate commodity, eg, oil and gas, copper, gold, iron; or*

(ii) *some other type of output that is produced at various stages of the lifecycle of an extractives project, eg exploration data; or*

(iii) *either (a) or (b), depending of the project lifecycle?*

(h) As described in paragraph 32(a) of this Staff Paper, most respondents define output as the intended output and determine the output based on the business model of the entity acquiring the upstream oil and gas or mining operation:

(i) if an entity has a business model of acquiring and selling exploration data, this entity would consider exploration data to be the output; whereas

(ii) if it is the entity's business model to sell the ultimate commodity, for example oil and gas, copper, gold or iron, this entity would consider the ultimate commodity to be the output and would consider exploration data to be only an ancillary element.

(i) For proponents of this view, that fact that exploration data is important and valuable, even for an entity selling the ultimate commodity, is not relevant for the determination of the output of a business. They focus on the intended output and therefore on the business model of the acquiring entity, for the following reasons:

(i) exploration data or other forms of output are not the returns that an investor is looking for when it invests in a business that sells the ultimate commodity;

(ii) paragraph B7(b) of IFRS 3 focuses on the main element of the activity and not on ancillary activities;

(iii) only the ultimate commodity is capable of producing the economic benefit as described in IFRS 3 (dividends, lower costs or other economic benefits);

(iv) the actual beginning of planned principal activities and pursuing a plan to produce outputs are factors that have to be considered when assessing whether an integrated set of activities and assets in the development stage is a business; and

(v) exploration data is not an output but part of an exploration and evaluation asset.

(j) Some respondents, however, define output on the basis of the stage in the life cycle that an operation is in at the time of the acquisition:

(i) if the operation is in the production stage, the output would be the produced commodity; but

(ii) if the operation is in the exploration or development stage, the output could be something like exploration data, dividends or capital gains to shareholders, which would probably occur as a result of advancing the property through additional drilling, evaluation, development or construction work.

*(k) Generally speaking, the lifecycle of an oil and gas or mining operation starts with exploration and evaluation, then moves to development/ construction and then to production. In practice, at what stage in the lifecycle do preparers generally start accounting for the acquisition of a set of inputs and processes as a business combination? What are the factors that influence that decision?*

(l) As described in paragraphs 30 and following of this Staff Paper, respondents from extractive industries that are oil and gas producing companies or mining companies tend in general to consider the acquisition of producing upstream oil and gas or mining operations to be business combinations, while acquisitions of inputs and processes in the exploration or evaluation phase are in principle considered to be asset acquisitions. Only some of these respondents consider acquisitions of inputs and processes in the exploration or evaluation phase to be business combinations. They take that view on the basis of the stage of completion of the exploration and evaluation work or the type of the licence, that is, an exploration-only licence or an exploration and production licence.

(m) There are, however, several diverse views on upstream oil and gas and mining operations that are in the development or construction phase. While several respondents tend to consider acquisitions of such operations at the end of the development or construction phase to be business combinations, others consider upstream oil and gas and mining operations at the beginning of the development or construction phase to already be businesses. For some respondents from the mining sector, a mining operation typically turns from a simple asset or group of assets into a business just before the development and construction phase, when commercial recoverable reserves have been declared and a plan is being pursued to produce the intended output.

(n) The diversity in practice in classifying acquisitions of upstream oil and gas or mining operations in the development or construction phase as either asset acquisitions or business combinations results from divergent views on the following two issues:

(i) When is an acquired set of inputs and processes capable of creating the intended output?

- Some respondents think that processes for producing the intended output must be in place. Otherwise, the acquired set of inputs and processes is not capable of producing the ultimate commodity as the intended output. Consequently, these respondents require operational processes to be in place that produce the ultimate commodity for a business to exist: that is, processes for running the processing plants, running pipeline infrastructure, running compressor stations or relative access to markets to sell the output.

Accordingly, these respondents tend to consider only operations at the end of the development or construction phase to be businesses.

- Other respondents think that an acquired set of inputs and processes is already capable of creating the intended output when all inputs, processes and resources are in place. Consequently, an acquired set of inputs and processes is already a business when it can be developed into a producing upstream oil and gas or mining operation. Accordingly, these respondents tend to consider all upstream oil and gas and mining operations in the development phase to be businesses.

(ii) What inputs and processes must be included in the acquisition to classify it as a business and what processes might be missing for it nevertheless to be classified as a business?

- Taking into consideration paragraph B8 of IFRS 3, none of the respondents from the extractive industries sector requires that all the inputs and processes necessary for producing the ultimate commodity have to be included in the acquired set to classify it as a business.
- Furthermore, the majority of respondents require that one of the inputs of the acquired set is a proved and probable reserve for it to be a business.
- Apart from this there is a variety of views:
  (a) For some respondents, any and all types of processes in the development or production phase are sufficient to give rise to a business.
  (b) Another respondent requires that processes included in the acquisition must be significant compared to the oil and gas or mining property to give rise to a business.

(c) The majority of respondents however require that the acquired set of activities and assets in principle must include all inputs and processes necessary to be able to produce outputs when applying these processes to the input(s) acquired.

- All respondents agree however that inputs and processes necessary to be able to produce outputs might be missing in the acquired set of activities and assets, but the acquired set might still be considered a business, if the missing inputs and processes are considered minor because their absence does not significantly restrict the ability to create outputs and they can be easily replaced or replicated by the acquirer or other market participants. This would indicate that a market participant is capable of operating the acquired set to generate a return and may therefore be considered a business.
- For one respondent, even a process that is not minor might also be missing, if the process is available at a currently owned location and it could process the inputs from the acquired properties.
- One respondent notes that the uncertainty in assessing which processes have to be included in an acquired set of activities and assets, and which might be missing, for it still to be a business results from the fact that paragraph B11 of IFRS 3 is at odds with paragraph B8 of IFRS 3:

  (a) On the one hand, paragraph B8 of IFRS 3 explains that a business need not include all of the inputs and processes that the seller used in operating that business, if the market participants are capable of acquiring the business and continuing to produce outputs.

(b) On the other hand paragraph B11 of IFRS 3 states that it is not relevant, in evaluating whether a particular set is a business, whether a seller operated the set as a business.

The respondent questions how an acquired set can be a business, that is, how can it include the essential elements of inputs and processes, if the seller did not operate the set of activities and assets as a business.

(iii) As described in paragraphs 32(b) and following of this Staff Paper, divergent views exist on whether an unproved reserve can be an input in terms of paragraph B7(a) of IFRS 3 and thereby give rise to a business combination for an oil- and gas-producing company or a mining company:

- Some respondents deny that an unproved reserve could ever give rise to a business combination for an oil- and gas-producing company or a mining company, because there would be no ability for any process to be applied to a resource to provide an output. Even if there were a plant but no proved and probable reserve included in the acquisition, proponents of this view would conclude that the plant does not constitute a business, because there would be no input that could be processed through the plant in order to obtain outputs.
- Others respondents from the mining sector instead consider not only proved and probable reserves to be inputs that are required for a business, but also mineralised materials, that is, measured and indicated but not inferred.
- Finally, other respondents do not interpret IFRS 3 as requiring a proved and probable reserve as one of the inputs of an upstream oil and gas or mining operation in order to have a business. For the proponents of this view, the factors that would

influence the determination of a business are whether there are inputs and processes that currently exist in relation to the property that, on a stand-alone-basis or through integration with other inputs and processes, can generate an output that will provide a return. For proponents of this view a return in the form of exploration data, dividends or capital gains may occur as a result of advancing the property through additional drilling, evaluation, development and construction work.

### *Summary of responses on our specific questions from preparers and preparer industry groups in the pharmaceutical sector*

B4. **Specific questions:** *What is your experience of this particular issue:*

(a) *Do you usually classify the acquisition of a licence for a product candidate with the associated knowhow as a business combination or as the acquisition of an asset or a group of assets ('asset acquisition')? Please explain.*

(b) Respondents from the pharmaceutical sector treat such acquisitions as asset acquisitions, if only a licence for an unapproved product candidate is acquired.

(c) The unapproved product candidate is considered an input for future research processes. However, no processes resulting in an output have been acquired. This conclusion might change if the acquisition includes the takeover of a workforce.

(d) Even items such as “methods, protocols, formulas, knowledge, trade secrets”, that may be acquired with the licence, are not considered processes that give rise to a business. This is because there is no “integrated set of activities and assets” (see the definition of a business in Appendix A of IFRS 3) if no activities that use those processes are being acquired. Even if a pharmaceutical company would be able to integrate the project into its processes and create an output, these respondents do not consider it to be a business because no output-critical processes have been acquired.

*(e)* *What criteria do you use to consistently distinguish business combinations from asset acquisitions?*

(f) As outlined in paragraph 39(k)(i) of this Staff Paper, respondents from the pharmaceutical sector think that a key criterion for distinguishing business combinations from asset acquisitions is whether the acquirer takes over the workforce (for example R&D personnel) from the seller, because very often this evidences the acquisition of processes that give rise to a business.

(g) If no workforce is taken over but a set of assets is acquired, detailed documentation of the output processes is considered an indicator for a business combination.

(h) Another indicator is whether a company (either in a share deal or an asset deal) or a group of assets is acquired (see paragraph B4(q)-(s) of this Staff Paper).

*(i)* *Do you consider knowhow to be an input, a process or an output as specified in paragraph B7 of IFRS 3 or does this classification depend on what is actually acquired as part of knowhow? Consequently, is knowhow either an input, a process or an output—or might knowhow include two or even all three of these elements? Why, or why not?*

(j) Respondents explain that a substantial part of the knowhow is often with the workforce and is considered to be a process for the reasons given above. In addition, knowhow related to manufacturing processes is often well documented and exists independently of the specific workforce.

(k) However, if the knowhow can be separated from the employees, because it is, for example, embedded in a product technology, which can be licensed to a third party, this knowhow would be considered to be an output for the generation of licence fees.

(l) Similarly, if specific knowhow is embedded in an R&D project, it would be considered an input into further R&D activities or instead as an input into a final product.

*(m) If the acquirer does not take over the employment of the staff that was involved in the development of the product candidate so far and the equipment they use in rendering the services for the seller, but instead uses staff and equipment that it already had to further develop product candidates into a final product, does it have any impact on the classification of an acquisition of a licence for that product candidate and the associated knowhow as either a business combination or an asset acquisition? Alternatively, would acquiring these services from external third party service providers have an impact on the classification?*

(n) As explained in subparagraphs B4(b)-(l) of this Staff Paper, the acquisition of an unapproved product candidate without a workforce or formal documentation of all details of the processes in place, which is rarely the case in pharmaceuticals, would lead these respondents to consider the transaction an asset acquisition.

(o) Furthermore, they tend to conclude that if no processes are acquired, the acquisition does not constitute a business. Consequently, the question of whether the acquirer possesses the processes itself or could purchase them from a third party is irrelevant.

*(p) Does it make a difference to the classification if the acquisition of a licence for a product candidate and the associated knowhow is, from a legal perspective, an asset deal or a share deal? Please explain.*

(q) For the respondents from the pharmaceutical sector, it does in principle make no difference whether the acquisition of a product candidate and the associated knowhow is, from a legal perspective, an asset deal or a share deal.

(r) However, they acknowledge that there is often a presumption made that if shares in the entity are acquired, then a business is acquired. The basis of this presumption is that a corporation is usually set up to conduct a business and consists at least of processes and inputs.

(s) However, for tax reasons transactions are sometimes structured so that a single asset is put into a corporate shell, which might lead to the conclusion that it is an asset acquisition.

### *Summary of responses on our specific questions from preparers in the banking sector*

B5. **Specific questions:** *What is your experience of this particular issue:*

*(a) Do you classify the acquisition of a single or small number of loan portfolio(s), deposit book(s) or the management of a fund usually as business combinations or merely the acquisition of a group of assets or management rights ('asset acquisitions')?*

(b) For most respondents from the banking sector the distinction between asset acquisitions and business combinations depends in particular on:

(iv) whether the acquirer only acquired the loan portfolio(s), deposit book(s) and/or the right to manage a fund; or

(v) whether the acquisition also includes the employees, processing equipment and sales processes.

(c) The acquisition of a single loan portfolio, or a small number of loan portfolios, deposit book(s) or the management of a fund is mostly classified as an asset acquisition.

*(d) What criteria do you use to consistently distinguish business combinations from asset acquisitions?*

(e) Several respondents from the banking sector have developed their own company guidance that explains the application of paragraphs B7-B12 of IFRS 3 in further detail and gives examples in particular of inputs, processes and outputs that are typical in their businesses.

(f) Examples of inputs identified by these respondents are:

(i) deposits;

   (ii) mortgage loans;

   (iii) car loans;

   (iv) home equity lines of credit;

   (v) credit cards; and

   (vi) fund manager relationships.

(g) Examples of processes that may give rise to a business in the banking sector are:

   (i) strategic management processes, for example customer and vendor relationships, risk framework and policies;

   (ii) operational processes, for example transaction services and data mining applications; and

   (iii) resource management processes, for example tailored legacy systems and credit card security systems.

(h) Examples of output identified by respondents from the banking sector are:

   (i) increased return on equity;

   (ii) increased net interest margin;

   (iii) loan growth;

   (iv) deposit growth; and

   (v) improved efficiency ratios.

(i) For several respondents, a process is only a key distinguishing feature for separating asset acquisitions and business combinations if the process is 'instrumental' in achieving the purpose of the business. Whether and when a process is 'instrumental' is further explained in the following paragraphs.

(j) Accordingly one respondent explained that it would probably consider:

   (i) the acquisition of a closed (run-off) portfolio of loans or deposits (for example automobile loans):

      - **without** some of the key processes required for loan growth (such as dealer relationships, sales staff, etc) to be an asset acquisition, because the acquisition does not include the processes that are instrumental in producing sustainable economic returns.

- **along with** some of the key strategic management/operational processes (such as dealer relationships, customer statistics, sales staff etc) to be a business combination, because the acquisition includes processes that are instrumental in producing sustainable economic returns.

(ii) the acquisition of an open portfolio of loans or deposits (for example mortgages) (that is, one that is continuing to generate loans):

- **without** any key processes required to continue to originate loans (such as broker relationships, tailored legacy systems, etc) to be an asset acquisition, because the acquisition does not include processes that are instrumental in building loan growth and producing sustainable economic returns.
- **along with** some of the key strategic management/operational processes (such as broker relationships, tailored legacy systems, etc) to be a business combination, because the acquisition includes the processes that are instrumental in building loan growth and sustainable economic returns.

(iii) the acquisition of a credit card portfolio:

- **along with** some of the key strategic management personnel (such as executives and staff for marketing and risk management, etc) or operational processes (such as transaction services) and key relationships (affinity relationships with major universities, sports brands and professional bodies) to be a business combination, because the acquisition includes processes that are instrumental in building loan growth and producing sustainable economic returns.

- **without** any of the key processes required to continue to originate loans such as key strategic management (such as executives and staff for marketing and risk management, etc) or operational processes (such as transaction services) and key relationships (affinity relationships with major universities, sport brands and professional bodies) to be an asset acquisition, because the acquisition does not include the processes that are instrumental in building loan growth and sustainable returns.

(k) One respondent determines classification of an acquisition as an asset acquisition or a business combination on the basis of the scope of the pricing:

(i) when the scope of pricing excludes associated processes: asset acquisition;

(ii) when the scope of pricing includes associated processes: business combination.

(l) Very similarly, another respondent uses pricing to analyse whether goodwill is present in the acquired set of assets and activities. Consequently, it determines whether the sum of the bottom-up calculated fair value of tangible net assets (that is, loans, deposits) and intangible assets (that is, the value of existing customer relationships) that is acquired approximates to the purchase price.

*(m) Do you consider associated processes, such as loan collection, to be processes as specified in paragraph B7 of IFRS 3 (revised 2008), that give rise to a business in distinguishing between business combinations and asset acquisitions? Why, or why not?*

(n) Only one respondent considers loan collecting, in itself, to be a process that might give rise to a business, because the quality of a process such as loan collection drives the ability to turn an input, that is, the loan, into an output, that is, the receipt of interest and principal. The respondent therefore considered loan collection to be an integral part of the ability to generate income from a loan.

(o) For other respondents, servicing processes, including loan collection, are akin to back-office functions, such as accounting, billing, payroll and other administrative functions as explained in paragraph B7(b) of IFRS 3 and such processes are typically not processes used to create outputs, that is, processes that give rise to a business.

(p) Most of the respondents, however, consider whether a servicing process such as loan collection is significant in achieving the purpose of the business and whether it would therefore be a key distinguishing feature between asset acquisitions and business combinations.

(q) If, for example, the quality of a loan portfolio is poor, then the collections process is likely to be significant and would therefore form part of processes in terms of IFRS 3. If the loan portfolio quality is good, then the collections process is more likely to be an administration function rather than a substantive creator of outputs.

(r) However, none of the respondents considers a significant loan collection process to be a definitive criterion. Instead, they would only assess it in combination with other processes.

*(s) Does it have any impact on the classification of the acquisition of a single or a small number of loan portfolio(s), deposit book(s), or the takeover of the funds management either as business combinations or asset acquisitions, if the acquirer does not take over the employment of the staff that manages the loan portfolios, deposit books, of the funds so far and the equipment they use in rendering the services for the vendor. Instead, the acquirer uses staff and equipment that it already had before the acquisition to render the services. Alternatively, it acquires these services from external third party service providers. Also, does it make a difference whether the acquired loan portfolio(s) or deposit*

*book(s) is/are run off or whether it is/they are intended to be used as 'open portfolio(s)' that is/are intended to generate replacement business or growth?*

(t) Most of the respondents considered it an indicator of an asset acquisition if the acquirer does not take over the employment of the staff that have managed the loan portfolios or deposit books or the funds for the vendor. This is because relevant processes are often intrinsically linked with (parts of) the workforce. There were however divergent views on how strong this indicator is.

(u) Only a few respondents considered the takeover of staff as not relevant, on the basis of paragraph B8 of IFRS 3 because market participants are capable of acquiring the set of activities and assets and continuing to produce outputs.

(v) Again, most respondents agreed that an acquired set of activities and assets must have at least some inputs and processes of the type that they consider relevant in determining whether this set is a business.

(w) If the acquired set of activities and assets—including some relevant inputs and processes—is not itself sufficient to give rise to a business, these respondents consider whether the acquirer can (easily) replace the missing elements by:

   (i) incorporating the acquired inputs and processes into its own inputs and processes; or

   (ii) acquiring the missing services from external third-party providers (for example outsourcing); and

   this additional considerations might lead to the conclusion that it is a business.

(x) For some respondents such replacing considerations only apply to minor inputs and processes. All inputs and processes that are key to achieving the purpose of the operation, however, must be acquired.

(y) Responses were mixed on whether it makes a difference whether the acquired loan portfolio(s) or deposit book(s) is/are run off or whether it is/they are intended to be used as 'open portfolio(s)' that is/are intended to generate replacement business or growth:

(z) While some respondents thought that a closed portfolio of loans and deposits is more indicative of an asset acquisition, for example because an open portfolio is more indicative of a growth component and therefore of a business. Others did not have a specific view on this issue.

(aa) One respondent considered the distinction between open and closed portfolios as irrelevant because the difference between them is that:

   (i) the future economic benefit of a closed portfolio has limited time until exhaustion of the portfolio; while

   (ii) a future economic benefit of an open portfolio does not have a discernible expiry date.

(bb) If, however, the lack of a discernible expiry date is considered to indicate a business combination, the application of this approach would, for this respondent, lead to inappropriate results in the following example:

A debt collector purchases defaulted accounts from a bank. These would always be closed portfolios and would typically be considered to be asset acquisitions. However, if the debt collecting business itself is in turn being acquired by a bank it is likely to constitute a business, regardless of the fact that it mainly consists of closed loan portfolios.

*(cc) Does it make a difference to the classification if the acquisition of a single or small number of loan/receivable portfolio(s), deposit book(s), or the funds management as described above is, from a legal perspective, an asset deal or a share deal? Please explain.*

(dd) None of the respondents considered the structure of an acquisition that, from a legal perspective, is an asset deal or a share deal, to be relevant in itself for distinguishing asset acquisitions from business combinations.

(ee) The legal structure might however indicate the existence of other arrangements that might give rise to a business.

### *Summary of responses on our specific questions from preparers and preparer industry groups in the shipping sector*

B6. **Specific questions:** *What is your experience of this particular issue:*

*(a) Do you classify the acquisition of a single ship, or a small number of ships, usually as business combinations or merely the acquisition of a group of assets or management rights ('asset acquisition')?*

(b) Respondents classify such acquisitions mostly as asset acquisitions, not business combinations.

*(c) What criteria do you use to consistently distinguish business combinations from asset acquisitions?*

(d) Respondents use very different criteria to distinguish business combinations from asset acquisitions:

(i) One respondent thinks that acquiring the vessel without any operating processes is an asset acquisition. This is because for them acquiring any operating processes and liabilities with the vessel is the key factor in distinguishing business combinations from asset acquisitions.

(ii) For another respondent, processes do not give rise to a business, if they are insignificant compared to the vessel. Whether processes are insignificant compared to the vessel is assessed on the basis of how much they contribute to the total price of the vessel.

*(e) Do you consider associated processes, such as maintenance, charter and manning, to be processes as specified in paragraph B7 of IFRS 3 (revised 2008), that give rise to a business in distinguishing between business combinations and asset acquisitions? Why, or why not?*

(f) The respondent who thinks that only processes that are not insignificant give rise to a business, and who determines significance of processes on the basis of how much they contribute to the total price of the vessel, has not considered processes such as maintenance, charter and manning, to be processes that give rise to a business, because their share in the total price of the vessel was always insignificant.

(g) This respondent notes that the answer might be different if an entity buys an old ship with a short useful life, but the respondent does not have a track record of buying old vessels.

(h) In addition, the respondent pointed out that acquired charters are usually an insignificant part of the total price of the vessel, because for the time being it is almost impossible to get a time-charter for more than one year.

(i) Other respondents however would consider associated processes, such as maintenance, charter and manning when assessing whether they have acquired a business. However, that they have so far only acquired the vessel without any operating processes.

*(j) Does it have any impact on the classification of an acquisition of a single ship, or a small number of ships, either as a business combination or an asset acquisition, if the acquirer does not acquire the associated processes? For example, the acquirer does not take over the employment of the crew and the staff that manages the ship(s) and the equipment they use in rendering the services for the seller. Instead, the buyer uses staff and equipment that it already had before the acquisition to manage the acquired ship(s). Alternatively, it acquires these services from external third party service providers.*

(k) None of the respondents considered the acquisition of the ship without any processes to be in itself a business combination.

(l) They classify such acquisitions mostly as asset acquisitions.

*(m) Does it make a difference to the classification if the acquisition of a single ship, or a small group of ships, is, from a legal perspective, an asset deal or a share deal? Please explain.*

(n) Respondents think that in principle it does not matter whether the transaction is, from a legal perspective, an asset deal or a share deal.

However, they highlight that share deals usually involve business combinations. Consequently, they think that a share deal points to a business combination.

### *Summary of responses on our specific questions from preparers and preparer industry groups in the solar and wind farm sector*

B7. **Specific questions:** *What is your experience of this particular issue:*

(a) *Do you usually classify the acquisition of a (piece of a) solar farm or a wind farm as a business combination or as merely the acquisition of a group of assets ('asset acquisition')?*

(b) Respondents agree that the answer to this question depends on the specific fact pattern.

(c) However, the acquisition via a share deal of wind parks or solar farms at a stage where the construction of the wind turbines or solar panels is already completed and operation has already started is very often classified as a business combination, if the transaction includes the takeover of all service-level contracts with the acquiree.

(d) The takeover of all service-level contracts with the acquiree is considered important for the classification as either a business combination or an asset acquisition, because the entity owning the wind or solar farm does not in many cases employ any staff, and instead all business activities are supplied by service providers.

(e) These contractual arrangements document that processes are established and ensure that the acquiree has access to the necessary resources to operate the processes. Thus, the entity owning the solar or wind farm is normally an already self-sustaining business.

(f) Respondents gave the following fact patterns as examples in which they think it is more difficult to distinguish business combinations from asset acquisition:

(i) Only one wind turbine is acquired so that it is questionable whether there are sufficient inputs.

(ii) The solar or wind farm is still under construction as of the acquisition date so that processes required for operating the solar or wind farm are not part of the acquisition, but are instead established by the acquirer immediately after completion.

(iii) The different components of the solar or wind farm are acquired from different parties, that is, the land (or the right to use the land), the wind turbines or solar panels, and the processes are acquired from different sellers. In this case one respondent thinks that it might be questionable whether an integrated set of activities and assets is acquired, although all the inputs and processes that are needed for a business have been acquired.

(iv) Existing contractual arrangements for relevant processes to operate the solar or wind farm of the acquiree are terminated at closing of the acquisition and are substituted for by established contractual relationships or resources of the investor. This may raise the question of whether the acquisition lacks the key element 'processes'.

(g) Another respondent explains that the criterion that distinguishes asset acquisitions from business combinations is whether the acquired set of activities and assets is operating with an 'autopilot' mechanism or whether it requires significant management decisions on an ongoing basis, for example, to determine marketing or financing strategies or to develop operations. In the first case, the respondent considers the acquisition of a solar farm or a wind farm typically to be an asset acquisition. In the second case, the respondent considers the acquisition mostly to be a business combination, if the acquisition includes the inputs and processes for performing these management functions. Otherwise the respondent would usually consider it to be an asset acquisition.

*(h) What criteria do you use to consistently distinguish business combinations from asset acquisitions?*

(i) To ensure consistent distinction of business combinations from asset acquisitions, one respondent has the developed a three-step-approach:

(i) **Step 1**: identification of the elements of the acquiree that are subject to the acquisition, by distinguishing inputs, processes (including resources that are associated with these processes) and outputs and then assessing whether they form an integrated set. In order to qualify as an integrated set, the acquisition must comprise at least those processes that influence the nature, structure and/or level of the return for the acquirer (the key processes). Which processes are key processes to operate the wind farm or solar park depends on the specific facts and circumstances.

(ii) This approach leads the respondent to the conclusion that terminating the existing service-level agreements that supply the necessary resources to operate the wind farm or solar park immediately as of the acquisition date and replacing them with new service-level agreements with other third-party providers, or integrating them into the acquirer’s own existing processes, results in an asset acquisition.

(iii) If existing service-level agreements or resources can be easily replaced, while the underlying processes operated on the basis of these arrangements or resources continue almost unchanged, this may indicate for the respondent that processes are not key processes to the acquiree and thus the acquisition is not by itself a business combination.

(iv) **Step 2**: assessment whether the acquirer is exposed to a significant entrepreneurial involvement when operating key processes.

(v) The respondent distinguishes between acquirers that are in substance passive investors because they are not able to exercise a significant entrepreneurial activity and acquirers that have this ability because they are able to take strategic decisions that are associated with a significant risk from running the solar park or wind farm. While the respondent would consider the first case to be an asset acquisition, the latter case would be a business combination, because the acquiree would provide a return to meet the business definition.

(vi) **Step 3**: assessment of whether the acquiree in its current condition is capable of generating economic outputs. If the acquiree is in its current condition not capable of creating outputs because it is missing some elements (that is, parts of the inputs or processes), the respondent assesses whether a typical market participant is able to replicate or obtain such missing elements to make the acquiree capable of providing outputs.

*(j) Do you consider associated processes, such as maintenance or feeding the power into the grid, to be processes as specified in paragraph B7 of IFRS 3 (revised 2008), that give rise to a business in distinguishing between business combinations and asset acquisitions? Why, or why not?*

(k) On the basis that an acquired set of activities and assets must comprise at least key processes to qualify as a business, the respondent thinks that key processes have the ability to influence the nature, structure and/or level of return of the acquiree for the investor.

(l) Accordingly, basic activities, such as accounting, controlling, cash collection, security, routine servicing and maintenance, billing or payroll do not constitute key processes, although they may be necessary to operate the acquiree as an ongoing business.

(m) The respondent developed the following non-exhaustive list of (types of) processes associated with a wind a farm or a solar park that it regularly identified and thinks that most of these processes may qualify as key processes that might, depending on the specific fact pattern, give rise to a business:

(i) General monitoring of daily business:

- performance monitoring (that is, production and availability);

- technical and operational reviews (that is, clarifying whether technical updates need to be done, investigating why sites or turbines are not working);
- communicating with third-party providers;
- cash monitoring of the entity;
- responsibility for payment processes and authorisation of all relevant payments;
- negotiation of new service contracts;
- monitoring of health and safety issues; and
- perform management duties for a wind-power or solar entity according to local company law.

(ii) Technical management:

- responsibility for the whole wind or solar site including laying of cables in made ground, grid connection points, roads, etc;
- reviewing the work done by the turbine service provider and ensuring that all health and safety issues have been properly implemented; and
- building and keeping relationships with landowners, local residents etc.

(iii) Turbine servicing and maintenance:

- responsibility for the whole maintenance of the wind turbine including blades, setup, etc; and
- keeping each individual wind turbine running.

(iv) Commercial management:

- point of contact for grid operator for reconciling metered data as well as information for grid problems;
- receiving invoices for the daily business and forwarding them to the asset management team;

- invoicing monthly production figures to grid operator;
- keeping the accounts and preparing financial statements; and
- monthly, quarterly and/or annual reporting.

(n) Finally, the respondent highlights that the regulatory environment may significantly influence the assessment of whether some of the listed processes are key processes that give rise to a business.

(o) For example, in jurisdictions in which the sales market for solar and wind farms is highly regulated, that is, prices for and quantities of supplied power cannot be negotiated with grid operators, technical management activities as well as turbine servicing and maintenance processes may become more relevant in identifying key processes that give a rise to a business.

*(p) Does it have any impact on the classification of an acquisition of a (piece of a) solar farm or a wind farm, either as a business combination or an asset acquisition, if the acquirer does not acquire the associated processes? For example, the acquirer does not take over the employment of the staff that manages the (piece of the) solar farm or the wind farm and the equipment they use in rendering the services for the seller. Instead, the buyer uses staff and equipment that it already had before the acquisition to manage the acquired (piece of the) solar farm or wind farm. Alternatively, it acquires these services from external third party service providers.*

(q) For one respondent, a significant characteristic of an acquisition to qualify as a business combination is that the acquiree consists of inputs and processes that form an integrated set.

(r) Consequently, it thinks that it is in general irrelevant whether the transaction includes or excludes support processes. However, if no key process is acquired, the transaction will not result in a business combination.

(s) This distinction also decides the judgement required if employment of the staff is not taken over as part of the acquisition:

(i) If the acquirer does not take over employees necessary to operate key processes, that is, staff that have unique knowledge related to these activities, the acquiree would not be an integrated set. The more an employee of the acquiree is responsible for deciding on financial and operating policies as defined by IAS 27 *Consolidated and Separate Financial Statements*, the more would this employee be considered as being necessary to operate key processes.

(ii) Accordingly, it would not have an impact on the classification as a business if the acquirer does not take over employment contracts related to non-key processes. Whether such employees are replaced by employees of the acquirer or by staff of an external third-party service provider should not be decisive.

*(t) Does it make a difference to the classification if the acquisition of a (piece of a) solar farm or a wind farm is, from a legal perspective, an asset deal or a share deal? Please explain.*

(i) One respondent argues that the acquisition of a solar park or a wind farm may be structured in a variety of ways for legal, taxation or other (economic) reasons, which might include that the acquisition is structured as either a share deal or an asset deal.

(ii) The legal structure as either a share deal or an asset deal does not itself distinguish a business combination from an asset acquisition. The acquirer has always to assess the substance of the entire structure acquired.

(u) *At what stage of a project to construct a solar farm or a wind farm do you generally start accounting for the acquisition of a set of inputs and processes as a business combination? Is it acquiring the land or the land owners' permission to build the solar farm or the wind farm on its land, obtaining the official permit from the government to build the solar farm or the wind farm on the land, the installation of the solar* *panels or wind turbines, acquiring the licence to feed energy into the power grid, or any other stage in the construction project? What are the factors that influence the decision about when to start accounting for the acquisition as a business combination?*

(v) The term "capable" in the definition of a business in Appendix A of IFRS 3 and paragraph B8 of IFRS 3 indicates that the absence of outputs does not constrain an acquiree from qualifying as a business.

(w) One respondent thinks that it should therefore not be decisive at which stage of construction a solar park or wind farm is acquired as long as the seller has already established processes and associated resources necessary to operate the relevant key processes after completion of the solar farm or wind park.

(x) In such cases, the contribution of the acquirer for completing the ability of the acquiree to be capable of generating outputs is limited to necessary financial resources to fund outstanding construction activities.

### *Summary of responses on our specific questions from the large firms*

B8. **Specific issues:** *Our initial discussions suggest that difficulties in identifying a business particularly arise for the following transactions:*

*(a) acquisition of a single investment property with relatively simple processes associated with it;*

(b) The large firms responding to the outreach noted that the discussion on whether the acquisition of a single investment property with processes associated with it is not only held with respect to office buildings, but also with respect to other types of buildings such as shopping centres, hotels and schools.

(c) In addition, there is a discussion on whether the acquisition of investment property with relatively simple associated processes/ancillary processes gives rise to a business, which is not only related to the acquisition of a single investment property but also to the acquisition of a number of investment properties.

(d) Others discuss whether:

(i) the acquisition of a new type of investment property for the acquirer, for example an entity that holds only office buildings so far, acquires a shopping centre; or

(ii) the acquisition of investment property in a geographical region that is a new one for the acquirer, for example an entity that holds only office buildings in Europe so far, acquires some office buildings in North America

gives rise to a business combination. The argument for such acquisitions to be business combinations is that an acquirer who acquires a type of investment property that it did not have before or who acquires investment property in a geographical region that it has not been operating in previously, very often also takes over the strategic management processes from the seller, because it cannot incorporate the new type of investment property or the investment property in the new geographical region into its existing processes.

*(e) acquisition of a ship with associated processes;*

(f) Large firms responding to the outreach noted that the acquisition of ships or bare ships with no employees and subject to a bare-boat charter is usually considered an asset acquisition.

(g) Beyond that, some of them noted that the discussion on which processes give rise to a business not only arises within the context of investment property but also within the context of acquiring a ship.

(h) Some respondents would distinguish between processes for operation of the vessel and processes concerned with using the vessel in a shipping business.

(i) Other respondents would instead distinguish between asset acquisitions and business combinations by the nature of the ship acquired. They would consider a ferry specially designed for cross-Channel passenger transport and operation to be a business, provided that it would be acquired together with the licence to operate cross-Channel transport.

(j) In contrast, the acquisition of a container ship together with the crew to operate it would not be considered as a business combination when the acquirer is only adding another container ship to its fleet in order to meet an increase in demand or to replace an old ship.

(k) One firm noted that a cruise ship with staff and processes such as ticketing, catering, other guest services and associated assets such as docking rights becomes indistinguishable from a hotel, which is considered a business by many.

(l) Some large firms noted that IFRS 3 does not require all inputs and processes to be present, but merely that market participants are themselves able to supply or obtain them. If taken to extremes, it could be difficult to defeat the notion that a new cruise or container ship, bought from a shipyard, is a business because someone in the shipping industry should be able to use it to produce outputs.

*(m) acquisition of a wind farm, eg several wind turbines, related PPE and a licence to operate the wind farm;*

(n) There is uncertainty whether and when the acquisition of a wind farm is a business combination.

(o) This is relevant in practice because some entities in the renewable energy sector have developed a business strategy of constructing wind farms and obtaining the operating licence in order to sell the turnkey plants. Are their customers merely buying a group of assets or buying a business?

(p) Other transactions occur because of regulatory constraints, because in some jurisdictions there exist regulatory limits on the power that wind farms held by a single investor are allowed to have. Consequently, operators develop large wind farms in a specific location, that is, wind farms beyond the regulatory limit for a single investor, and then split the farm into parts that can be held by a single investor and sell them to competitors. In exchange, some competitors sell them parts of their own wind farms that they have developed elsewhere in excess of the regulatory limit.

(q) We understand from the outreach that the acquisition of an operating wind farm is usually accounted for as a business combination. Such transactions include the licence to operate the wind farm and the contracts to sell the energy.

(r) The situation is, however, less clear when a wind farm project under construction is sold.

(s) In addition, there is uncertainty over classifying the acquisition as an asset acquisition or a business combination, if non-utility companies buy into wind farms as an 'ethical' investment.

*(t) acquisition of a solar farm, eg several solar modules, related PPE and the licence to operate the solar farm;*

*(u)* Please refer to the explanations of the acquisition of a wind farm in subparagraphs B8(m)–(s) of this Staff Paper.

*(v) acquisition of an exploration interest in the oil and gas field or mining operation compared with the acquisition of an interest in the development phase or the production field oil and gas field/mine; and*

(w) The large firms confirm that preparers in extractive industries use an approach that is based on the stage in the life cycle of an oil and gas or mining operation (see paragraphs 30 and following of this Staff Paper). While acquisitions of upstream oil and gas or mining operations in the early stages of exploration and evaluation are usually considered to be asset acquisitions, acquisitions of upstream oil and gas and mining operations in the production phase are generally considered to be business combinations. Views vary more broadly, however, of when an upstream oil and gas or mining operation in the development and construction phase turns from an asset or a group of assets into a business.

(x) In this context one large firm noted that there is a discussion over whether a mine with trial production is still a group of assets or is already a business. Trial production refers to the time during which an entity may have revenue from saleable material during this phase.

(y) According to this large firm, some think that trial production shows that the mining operation is capable of producing the intended output, while others think the intended production level has to be achieved to turn a group of assets into a business or that the operating licence is required to be able to produce the intended output. In other words, a mine has to be in the condition necessary for it to be capable of operating in the manner intended by management for it to be a business and this still is not the case for a mine with trial production.

(z) The large firm explains that the issue is relevant because there may be a long commissioning period for a mine, sometimes over twelve months, during which production is gradually increased towards design capacity.

(aa) Like the preparers, some large firms focus on the oil and gas or mining property and not on the operation, because they consider such a property to be the relevant element of the acquisition.

(bb) Proved and probable reserves are thereby considered a strong indicator for a business, because a market participant would have, or could acquire, everything else it needs to start production of oil and gas or the ultimate commodity.

(cc) One large firm highlights that in many cases acquisitions do not involve the acquisition of employees, but only certain legal rights, for example exploration licences, information (data collected through drilling, seismic surveys, etc), and sometimes contracts, because exploration activities are often outsourced and acquisitions may involve the acquisition of outstanding contracts for these activities. In such cases, there is often discussion over whether the transaction is an asset acquisition or a business combination.

(dd) One large firm noted that challenges in identifying businesses in the extractive industries sector arise from influential local practice or guidance that was not necessarily intended for application when using IFRSs, such as the US SEC's Corp. Fin guidance (see also paragraph 32(b) of this Staff Paper).

(ee) Furthermore, some mines are not run on a stand-alone basis but are dependent on centralised management and corporate sale hubs that, if separated, would not be directly able to operate on a stand-alone basis.

(ff) One large firm considers the acquisition of a royalty interest in producing oil and gas operations not to be a business combination, because the acquirer does not participate in the operating decisions of the operation.

*(gg) acquisition of intellectual property and related processes in the pharmaceutical industry.*

(hh) In general, the intellectual property, for example a patent, is considered to be an input in terms of paragraph B7(a) of IFRS 3.

(ii) Consequently, distinguishing asset acquisitions from business combinations depends on the processes that can be identified on the acquisition of the intellectual property.

(jj) In practice, large firms see very different types of acquisitions. They range from the acquisition of a promising scientist in a leased lab to a lab with scientists who have produced sound results that have been kept confidential and who are exploring possible applications.

(kk) There are likely to be more processes included in the acquisition of a drug compound in the later stages of development than in earlier stages. Early-stage compounds based on intellectual property are often acquired or licensed between big pharmaceutical entities or from smaller biotechnology entities. Later-stage drug compounds are instead typically accompanied by blueprints, plans, protocols or employees, such as a team of scientists, researchers or a labour force that will further develop the intellectual property for approval by a regulatory body. The acquired group is more likely to be a business when the actual scientists are included, but it is less clear when only data related to the research has been acquired.

*B9. Other transactions for which large firms identified difficulties in identifying a business:*

### *Acquisition of fund manager*

B10. One respondent explains that the acquisition of a fund manager, whose only asset is a management contract with third parties to manage a fund, and the fund manager has its own employees, is usually considered to be a business combination.

B11. However, the respondent noted uncertainty in assessing whether this conclusion is still correct, if the fund manager has no employees and the activity had been outsourced to either the acquirer (bringing the entity in house) or another party?

### *Termination of contracts*

B12. One respondent noted difficulties in assessing the impact of the replacement of the contractual basis of an operation in the course of an acquisition.

B13. An entity might, for example, acquire a group of assets from another entity without the underlying contracts, for example employee contracts, customer contracts, etc. Instead, the acquiring entity will target a new customer base, hire employees, find new suppliers and enter into new contracts, while the seller retains the customer contracts and outsources their satisfaction. Sometimes, the seller might even outsource the completion of the retained contracts to the acquirer.

B14. Does such an acquisition still include the inputs and processes necessary for a business combination?

### *Early stage ventures*

B15. The seller has developed a promising business model and has just started implementing the business when the acquirer takes the project over. In other words, the acquisition includes only very limited early development stage inputs and processes and the acquisition price is in substance paid for the 'idea' and not inputs and processes that finally produce the output.

B16. The respondent noted significant uncertainty in applying paragraph B10 of IFRS 3 and in assessing when and whether such an acquisition might be a business combination. The question is whether such an acquisition includes sufficient inputs and processes to give rise to a business.