

## STAFF PAPER

September 2015

## IASB Meeting

|                    |  |                            |                  |
|--------------------|--|----------------------------|------------------|
| <b>Project</b>     | <b>Definition of a business research project</b> |                            |                  |
| <b>Paper topic</b> | <b>Project plan — Approach to the project</b>    |                            |                  |
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This paper has been prepared for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

**Introduction**

1. The PIR of IFRS 3 *Business Combination* concluded that the definition of a business is one of the top four concerns with IFRS 3. There is general agreement by the participants to the review that it is an issue that needs to be addressed.
2. In February 2015, the IASB discussed the issues arising from the PIR of IFRS 3 and decided that more work on the definition of a business would be justified. Therefore, the IASB added the topic to its research programme.
3. FASB has a project to improve the application of the definition of a business. The FASB project aims to cover most of the concerns that we heard through our PIR. A key objective of FASB proposals is to move practice under US GAAP to be more aligned with practice under IFRS.
4. FASB plans to publish an exposure draft in late Q3 or early Q4 2015.
5. At their joint meeting in September, IASB and FASB will discuss how they can work together on converged standards. Consequently, the definition of a business is one of the issues that will be discussed at that meeting.

## Objective

6. The objective of the discussion at this meeting is to agree the next steps for project on the definition of a business. We will not ask the IASB to make any technical decisions at this meeting.

## Structure of this paper

7. This paper includes the following sections:
  - a) FASB tentative decisions on how to clarify the definition of a business;
  - b) challenges that participants to the PIR of IFRS 3 have identified when determining whether an acquisition includes a business;
  - c) staff analysis;
  - d) recommendations and questions.

## FASB tentative decisions

8. FASB tentatively decided:
  - a) if substantially all the fair value of the gross assets acquired is concentrated in a single tangible or identifiable intangible asset (or group of similar tangible or identifiable intangible assets), the set of acquired assets is not a business. FASB directed the staff to develop indicators and examples to describe what constitutes similar assets;
  - b) to retain the concept of “capable of” in the definition of a business;
  - c) to revise the definition of outputs to focus on goods and services to customers;
  - d) not to explore changes to the concept of “market participant” in the definition of a business;
  - e) explore adding examples to help with the interpretation of what is considered a business.
9. In addition, FASB tentatively decided to include a framework to determine whether a set of acquired assets and activities includes a substantive process. In particular, FASB decided that when a set does not have outputs (for example, an early stage

company that has not generated revenues), in order to have a substantive process, the acquired set should include both of the following:

- a) an organised workforce that has the skills, knowledge, or experience necessary to complete one or more acquired processes that are critical to the ability to create outputs;
- b) rights or access to inputs that are being or could be developed into goods or services that can be provided to customers.

10. FASB decided that if a set has outputs (for example, there is a continuation of revenues before and after the transaction), having outputs is not determinative on its own and an entity should exclude customer contracts, customer lists, leases, or other similar arrangements from the determination of whether the set has a substantive process. When the set has outputs, either of the following would indicate that the set includes a substantive process:

- a) the set includes an organised workforce that has the skills, knowledge, or experience necessary to complete one or more acquired processes that are critical to the ability to create outputs;
- b) the acquired process (or group of acquired processes together) is unique, scarce, or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

### **Challenges identified during the PIR of IFRS 3**

11. The main challenges that participants to the PIR of IFRS 3 have identified when determining whether an acquisition includes a business are the following:

- a) the assessment of the relevance of processes acquired as part of the acquired set of assets and the significance of the processes missing from the set. This is particularly the case when only some of the processes are being acquired and it is necessary to determine whether the processes that are acquired (and those missing) are necessary to the production of outputs or are merely administrative processes
- b) the definition of a business is broad and IFRS 3 has little or no guidance on when an acquired set of assets is not a business.

- c) the wording ‘capable of being conducted as a business’ does not help in determining whether a transaction includes a business.
  - d) IFRS 3 is not clear on the definition of a business when the entity acquired does not generate revenues.
  - e) the term ‘market participant’ is not defined in IFRS 3. Some sets of assets may be considered as a business for a specific group of market participants if they could integrate the set of assets in their processes. However, the same set of assets may not be considered as a business from the perspective of other market participants. Further guidance on what constitutes a market participant would help in this determination.
  - f) IFRS 3 requires a fact-driven assessment that excludes the business rationale, the strategic considerations and the objectives of the acquirer.
12. Taking into consideration the challenges that arise from having to determine whether a transaction represents an acquisition of assets or a business combination, many participants to the PIR asked the IASB to reduce the accounting differences between business combinations and assets acquisitions. They think that a separate accounting treatment for business combinations and asset acquisitions is conceptually justified only with respect to whether or not goodwill is recognised.

### Staff analysis

13. We think that FASB tentative decisions respond to most of the challenges identified during the PIR of IFRS 3. In particular, we think that the guidance proposed by FASB on a substantive process (see paragraphs 9 and 10 of this paper) would help in the assessment of the relevance of processes acquired and when the entity acquired does not generate revenues. In other words, FASB proposals respond to the issues mentioned in paragraphs 11a) and d) of this paper.
14. We think that the FASB proposed clarification in paragraph 8a) of this paper (ie if substantially all the fair value of the gross assets acquired is concentrated in a single asset the set is not a business) could help in determining what set of assets is not a business (ie it responds to the issue mentioned in paragraph 11b) of this paper). We also think that the FASB tentative decisions to revise the definition of outputs (see

paragraph 8c) of this paper) and to explore adding examples to help with the interpretation of what is considered a business (see paragraph 8e) of this paper) could be helpful.

15. Consequently, we think that the IASB should consider whether it should propose changes that are the same as the FASB tentative decisions in paragraphs 8a), 8c), 8e), 9 and 10 of this paper. We propose bringing an analysis of those decisions to a future IASB meeting to enable the IASB to make a decision about proposing the same changes as proposed by FASB.
16. On the other hand, we note that FASB tentatively decided not to change/clarify the concepts of “capable of” and “market participants”. Many participants to the PIR of IFRS 3 asked the IASB to clarify or change these two concepts. Consequently, we think that the IASB should consider whether there are some additional amendments to propose or to discuss with FASB in response to those issues.
17. Paragraph 11(f) mentions a concern that IFRS 3 requires a fact-driven assessment that excludes the business rationale, the strategic considerations and the objectives of the acquirer. We think that the assessment of whether an acquisition includes a business should continue to be a fact-driven assessment. In our view, including the business rationale and the strategic considerations of the acquirer would increase the subjectivity of this assessment and thus the diversity in practice. Consequently, we think that the IASB should not consider this issue. We propose bringing an analysis of this matter to a future IASB meeting.
18. Regarding the request in paragraph 12 of this paper for the IASB to reduce the accounting differences between a business combination and an asset purchase, we think that the IASB could consider in a separate long-term research project whether and how these accounting differences could be reduced. Doing so could relieve some of the pressure on the definition of a business.
19. We think that a project to reduce those accounting differences would need to wait for progress on the IASB research project on income taxes, because one of the main accounting differences between a business combination and an asset acquisition is the accounting for temporary differences on initial recognition of an asset or liability. We also think that such a project could be informed by the outcome of the IASB’s project on goodwill, intangibles and impairment because the key difference between an asset

purchase and a business combination is the presence of goodwill in the latter and not the former.

## Staff recommendations

20. On the basis of the above analysis we recommend that we should bring an analysis to a future IASB meeting to enable the IASB to:

- a) consider whether it should propose changes to IFRS 3 that are the same as the FASB tentative decisions in paragraphs 8a), 8c), 8e), 9 and 10 of this paper; and
- b) consider whether it should change or clarify the concepts of “capable of” and “market participants”.

21. We think that these recommendations should lead directly to an Exposure Draft (rather than a Discussion Paper). We think that it is not necessary to publish a Discussion Paper because the aim of this project is not to develop new or substantially amended concepts, but to improve the drafting of the existing definition of a business and the related application guidance.

### Questions for the IASB members

1. Do you agree with the staff recommendation to consider proposing changes to IFRS 3 that are the same as the FASB’s tentative decisions summarised in paragraphs 8a), 8c), 8e), 9 and 10 of this paper? If you agree, the staff will bring analysis and proposals to a future meeting.
2. Do you agree with the staff recommendation to consider changing or clarifying the concepts of “capable of” and “market participants”? If you agree, the staff will bring analysis and proposals to a future meeting.
3. Do you agree with the staff recommendation to work towards an Exposure Draft, and not to start with a Discussion Paper?