FASB FINANCIAL ACCOUNTING STANDARDS BOARD

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Memo

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Project	**Clarifying the definition of a Business**
Project Stage	**Initial Deliberations**
Issue(s)	**Project Summary**

Purpose of This Memo

1. The purpose of this memo is to summarize the FASB's standard-setting project on clarifying the definition of a business for discussion at the September 23, 2015 joint Board meeting. This memos is organized as follows:
   (a) Background
   (b) Phase 1: Definition of a Business
   (c) Comparison with IFRS Practice
   (d) Next Steps.
2. Please note that references in brackets "[ ]" indicate references to converged IFRS standards.

Background

3. On May 29, 2013, the Board added a standard-setting project to clarify the definition of a business with the objective of addressing whether transactions should be accounted for as acquisitions (or disposals) of nonfinancial assets or businesses. When the project was added, the Board anticipated that the project also would include clarifying the guidance for partial sales or transfers of nonfinancial assets and the corresponding accounting for the retained interests in a nonfinancial asset or assets. The project was added for two primary reasons:

   (a) During the Post Implementation Review (PIR) of FASB Statement No. 141 (revised 2007), *Business Combinations*, the Board learned that many stakeholders thought the definition of a business is too broad, and, as a result, that too many acquisitions qualify as businesses. Furthermore, many stakeholders indicated that the definition was difficult and costly to apply in practice. In addition, the Board observed that although the definition is converged, it does not appear to be interpreted or applied consistently in practice between jurisdictions that apply GAAP and jurisdictions that apply IFRS. That is, stakeholders have said that in jurisdictions that apply IFRS, the definition of a business generally is not applied as broadly as it is in jurisdictions that apply GAAP.

   (b) In addition to concerns about the broad application of the definition of a business, the scope of Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (created as part of the amendments in FASB Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers [Topic 606]*), excludes a set of activities and assets that is a business unless that business is deemed to be an in substance nonfinancial asset. The derecognition of a business (other than a business that is an in substance nonfinancial asset) will continue to apply the guidance in Subtopic 810-10, Consolidation—Overall.

4. The scope of Subtopic 610-20 is particularly important to certain industries, such as the real estate industry. Until the amendments in Update 2014-09 are effective, the derecognition of real estate should be accounted for consistently, regardless of whether that real estate is an asset or a business. The amendments in Update 2014-09 remove the existing industry- or transaction-specific real estate guidance. Instead, an entity would derecognize real estate that is not a business (or that is a business, but is an in substance nonfinancial asset) in sales transactions with noncustomers in accordance with Subtopic 610-20 and apply the recognition and measurement

guidance in Topic 606. Sales of real estate that are not within the scope of Topic 606 or Subtopic 610-20 will apply the deconsolidation guidance in Subtopic 810-10.

5. At its meeting on October 8, 2014, the Board directed the staff to address this project in three phases.

   (a) Phase 1: Clarify the definition of a business.

   (b) Phase 2: Clarify the accounting for partial sales and retained interests for transactions in the scope of Subtopic 610-20 and clarify the reference to in substance nonfinancial assets in Subtopic 610-20.

   (c) Phase 3: Consider whether asset versus business accounting differences could be aligned. Phase 3 of this project has not yet commenced.

Phase 1: Definition of a Business

Background and Issues Considered

6. Currently, paragraphs 805-10-55-4 through 55-9 [IFRS 3, *Business Combinations*, paragraphs B5–B12] provide implementation guidance on how to evaluate whether an acquired set of activities and assets (collectively referred to as a "set") is a business. Under that implementation guidance, there are three elements of a business—inputs, processes, and outputs. While a set that is a business usually will have outputs, outputs are not required (for example, certain entities in the development stage). In addition, all of the inputs and processes that the seller uses in operating a set are not required if market participants are capable of acquiring the set and continuing to produce outputs, for example, by integrating the set with its own inputs and processes.

7. Topic 805, Business Combinations, [IFRS 3] does not specify the minimum inputs and processes required for a set to meet the definition of a business. That lack of clarity has led to broad interpretations in practice of what is a business. Some stakeholders have said that a set may qualify as a business even if no processes are included in the transaction when revenue-generating activities continue after an acquisition. Other stakeholders have said that the presence of any process can give rise to a business, regardless of significance when there is a continuation of revenue.

8. The definition of outputs in current GAAP refers to 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. Many transactions can provide a return in some form (for example, the acquisition of a new machine could be expected to lower costs). Thus, the definition of outputs can further contribute to broad interpretations of what meets the definition of a business.

9. The following examples illustrate interpretations that some stakeholders think are too broad under the current definition of a business:

   (a) Real estate industry–The acquisition of a single-family home with a one-year lease. Because the transaction includes inputs (the home), outputs that remain the same before and after the transaction (the lease payments), and the process of managing the lease that can be replaced by a market participant, some have concluded that this constitutes a business. Others have interpreted this fact pattern to be representative of a business because the in-place lease is a process, and, therefore, the entity acquired inputs and processes that produce outputs (which is evidenced by revenue stream before and after the transaction).

   (b) Real estate industry–The acquisition of a corporate headquarters in which a portion of the building will continue to be leased to others. The logic for this transaction being identified as a business is consistent with the discussion in subparagraph (a) above.

   (c) Pharmaceutical industry–The acquisition of a license to a product candidate may be deemed a business if the acquirer concludes that a market participant is capable of applying its own processes to continue development of the product candidate, or that some of the elements of the license (including the related know-how) are processes, and concludes that the license is capable of producing outputs.

Tentative Decisions Made to Date

10. The Board considered various alternatives to address the practice issues in the definition of a business. For example, the Board considered the guidance in Emerging Issues Task Force (EITF) Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," that requires that substantially all of the inputs and processes used by the seller should be included in the set or that the set needs to have outputs to be a business. The Board generally believes those requirements would make the definition too narrow. The Board noted that the basis for changing the definition of a business from the definition used

in Issue 98-3 to the definition in Statement 141(R) was that stakeholders said that too many transactions that represented businesses economically did not meet the EITF definition.

11. The Board also considered whether the evaluation of a transferred set should continue to be performed from the market participant perspective as stated in paragraph 805-10-55-8 [IFRS 3, paragraph B11]. Some stakeholders have indicated that the evaluation of a transaction from a market participant's perspective makes the application of the definition too broad or that it can be difficult to identify the appropriate market participant. However, the Board believes that this requirement instills discipline into the overall assessment and takes the buyer's and seller's intent of how the set was or will be used out of the analysis. Furthermore, retaining this requirement helps prevent similar transactions being accounted for differently depending on the buyer.

12. The Board ultimately decided on the following:

    (a) To clarify that to be considered a business, a set must include, at a minimum, an input and a substantive process that together contribute to the ability to create outputs.

    (b) To remove the requirement that a set is a business if market participants can replace the missing elements and continue to produce outputs.

    (c) To not consider the set a business if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets.

    (d) To narrow the definition of outputs so that the term is consistent with how outputs are described in Topic 606, Revenue from Contracts with Customers [IFRS 15, *Revenue from Contracts with Customers*].

13. Appendix A summarizes the potential amendments to the guidance based on the decisions above.

14. Some Board members, while supportive of the proposed decisions above, indicated that the issue of what is an asset versus what is a business should be addressed more directly by attempting to reduce or eliminate differences in the accounting arbitrage between assets and businesses. For example, in an acquisition the accounting for contingent consideration, in-process research and development, and transaction costs are different between assets and business. However, the Board ultimately decided to begin this project by clarifying the definition of a business to respond to stakeholder concerns on the definition of a business in a timely fashion. The Board was concerned that the alignment of the accounting for the acquisition and derecognition of assets and businesses would be a broader project that would take a significant amount of time to complete

because the outreach has been mixed on how those differences might be aligned. As such, the Board directed the staff to consider aligning certain differences in Phase 3 of this project.

Substantive Processes

15. The Board decided that to be considered a business, a transaction must include, at a minimum, an input and a substantive process in response to the practice issues of determining what processes are required to meet the definition of a business. The Board noted that the existence of a process (or processes) is what distinguishes a business from an asset because all asset acquisitions have inputs, and, therefore, providing additional guidance related to processes should help differentiate between assets and businesses. The input and substantive process together are only required to contribute to the ability to create outputs because not all of the inputs and processes needed to create outputs are required for the set to be a business.

16. The Board considered whether additional guidance was necessary to determine whether a transferred set includes a substantive process (that is, whether the clarification that a substantive process must be included in the set is sufficient or whether additional guidance that would describe a substantive process is needed). The Board noted that it would be difficult to specifically define a substantive process or determine what processes are substantive because that determination would vary significantly from industry to industry and from transaction to transaction. However, the Board concluded that additional guidance could provide a framework for an entity to make judgments about the existence of a substantive process and increase consistency in application of that guidance.

17. The framework developed by the Board includes two different sets of criteria to consider that depend on whether a set has outputs (that is, whether there is a continuation of revenues before and after the transaction). Because outputs are a key element of a business and paragraph 805-10-55-4 [IFRS 3, paragraph B7] notes that a business usually has outputs, the Board reasoned that when that key element is missing, the other elements should be more significant. As such, the Board developed more stringent criteria for what is required for a set to have a substantive process when outputs are not transferred as part of the set.

Transactions Involving Sets with No Outputs

18. The Board concluded that when a set does not have outputs, it must include an organized workforce that has the necessary skills, knowledge, or experience to perform a process (or group of processes) that, when applied to another acquired input or inputs, is critical to the ability to

develop or convert that acquired input or inputs into outputs. An entity should consider the following when evaluating whether the acquired workforce is performing a substantive process:

(a) A process (or group of processes) is not critical if, for example, it is considered ancillary or minor in the context of all the processes required to create outputs.

(b) Inputs that the organized workforce could develop (or is developing) or convert into outputs could include intellectual property that could be developed into a good or service, resources that could be developed to create outputs, or access to necessary materials or rights that enable the creation of future outputs.

19. The Board believes that an organized workforce that has the necessary skills, knowledge, or experience to perform processes that create outputs allows the set to actively perform the process. If there is no workforce to perform an acquired process, the set on its own likely would not be able to actively contribute to the creation of outputs because the acquirer would have to provide all the activities to perform the process. The Board also does not intend for the existence of *any* employee to indicate that a set without outputs is a business, but, instead, believes that the organized workforce should be able to perform a process (or group of processes) that is critical to the ability to develop the acquired inputs into outputs.

20. When a set does not have outputs, the framework also requires that the set have an input or inputs that the organized workforce could develop (or is developing) into future outputs. The Board noted that the existence of an organized workforce and any input is not sufficient and that the set should include the assets that are intended to eventually be developed into outputs. The Board noted that most entities in the development stage would meet this criterion because there is technology, intellectual property, or other assets that are being developed into a good or service. When a set is currently producing outputs, inputs that are being converted into outputs are already in the transferred set, and, therefore, the type of inputs to which the process is applied is not specifically considered when the set has outputs.

Transactions Involving Sets with Outputs

21. The Board concluded that the following criteria should be evaluated to determine whether a set with outputs includes a substantive process:

(a) An organized workforce that has the necessary skills, knowledge, or experience to perform a process (or group of processes) that when applied to an acquired input or inputs is critical to the ability to continue producing outputs. A process (or group of processes) is not critical if, for example, it is considered ancillary or minor in the context of all the processes required to continue producing outputs.

(b) The acquired process (or group of processes), when applied to an acquired input or inputs, contributes to the ability to continue producing outputs and cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

(c) The acquired process (or group of processes), when applied to an acquired input or inputs, contributes to the ability to continue producing outputs and is considered unique or scarce.

22. Because outputs are generated before and after the transaction, the Board concluded that it is more likely that both an input and a substantive process have been acquired when compared with a set having no outputs. Therefore, not all of the criteria are required. Instead, if any of the criteria are present, the Board believes that a substantive process would be present. Although the Board believes that an organized workforce is an indicator of a substantive process, the Board does not believe that an organized workforce is required when outputs are present. For example, an organized workforce might not be required if the set includes automated processes (for example, through acquired technology, infrastructure, or specialized equipment) or other significant processes that contribute to the ability to continue producing outputs.

23. To address situations in which a business is transferred without an organized workforce, the Board included the other criteria in paragraph 21(b and c above). Those criteria were included to help evaluate when a transferred process is substantive without the related workforce.

24. In addition, there is diversity in stakeholder views on whether leases, customer contracts, or other contractual revenue arrangements that result in the continuation of revenues are, in and of themselves, processes. Because contractual arrangements can vary significantly, rather than stating that such arrangements are not a process, the Board decided to specifically exclude those revenue arrangements from the analysis of whether a substantive process has been acquired. That is, the Board does not believe that a set should be a business just because there is a contract that provides a continuing revenue stream.

Market Participants Capable of Replacing Missing Elements

25. The Board decided that because the guidance that requires a business to have inputs and substantive processes would establish minimum requirements for a set to be a business (that is, at least an input and a substantive process would be included that together contribute to the ability to

create outputs), it diminishes the need for the analysis to focus on a market participant's ability to replace any missing elements and continue producing outputs. The Board believes that eliminating that requirement could reduce confusion on what elements need to be included in the set versus what a market participant could replace and helps focus the analysis on the substance of what was acquired rather than how a market participant could potentially use the set.

Single or Similar Assets Threshold

26. The definition of a business in Issue 98-3 allowed for a transferred set of activities to be an asset if all but a de minimis amount of the fair value was represented by a single asset. No such guidance was carried over into Statement 141(R). The Board is proposing a similar threshold as a practical screen to evaluate when a set is not a business. That is, when this threshold is met, the set would not be a business and an entity would not evaluate the rest of the implementation guidance to determine whether the set includes a substantive process.

27. In contrast to the de minimis threshold in Issue 98-3, the Board decided that this screen should be based on whether or not the fair value of a single identifiable asset or group of similar identifiable assets represents substantially all of the fair value of the gross assets acquired. The Board decided to use the term *substantially all* because it is more commonly used throughout GAAP (for example, substantially all is used in Topics 810, Consolidation, and 606), and stakeholders indicated that they would be comfortable in applying that concept.

28. An entity would compare the concentration of fair value in a single identifiable asset or group of similar identifiable assets with the gross assets acquired rather than with the total consideration paid or net assets. The Board reached this conclusion to avoid the existence of debt (for example, a building with a mortgage) or other liabilities skewing the analysis of whether the threshold has been met, which would have the potential of too many sets not meeting the definition of a business.

29. The Board also decided that the threshold could be met if the fair value is concentrated in a group of similar identifiable assets. That is, the application of the threshold in the amendments in the forthcoming proposed FASB Accounting Standards Update on clarifying the definition of a business would not be limited to a single asset like the threshold in Issue 98-3. If an entity acquires, for example, multiple versions of substantially the same asset type instead of precisely one asset, the Board does not believe that should disqualify the acquired items from being considered an asset. The Board believes that this could help alleviate pressure around what is a

single asset because some stakeholders may conclude that they would be required to separate what is typically a single unit of account into multiple units of account (for example, separating a customer list into 1,000 different assets because there are 1,000 different customers).

30. The use of a threshold should help alleviate some of the tension in practice around transactions that stakeholders have difficulties with. Some examples include the acquisition of a single-family home with a lease or the acquisition of certain drug candidates in the pharmaceutical industry when the fair value of the assets acquired in those transactions is concentrated in the real estate or the in-process research and development asset.

Definition of Outputs

31. Outputs currently are defined in Topic 805 [IFRS 3] 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. The Board noted that many asset acquisitions can provide a return in the form of lower costs or other economic benefits. For example, the purchase of new equipment for a manufacturing facility may increase efficiency and lower costs. The Board believes that the current definition of outputs does not appropriately distinguish between an asset and a business. Furthermore, the Board believes that if the definition of outputs is not narrowed, the effect of the other changes might be mitigated because a substantive process contributes to the creation of outputs.

32. The Board decided to narrow the definition of outputs by aligning it with the ability to generate goods or services provided to customers. This is consistent with how outputs are discussed in Topic 606 (IFRS 15), which describes goods or services that are an output of the entity's ordinary activities.

Comparison with IFRS Practice

33. The FASB staff understands the IASB received similar comments from stakeholders as part of its PIR of IFRS 3. While the issues identified in the PIR of IFRS 3 appear to be similar to the issues identified by stakeholders in the United States, the FASB staff's understanding is that generally the definition of a business is applied more broadly under GAAP (that is, more transactions are considered businesses in the United States) than under IFRS. For example:

(a) In the real estate industry, acquisitions of investment properties are typically businesses in the United States and assets in the jurisdictions that apply IFRS. The FASB staff understands that this difference is driven by the predominant practice in Europe and Australia to require a set to include a more "sophisticated" process or processes that involve a degree of knowledge unique to the assets being acquired for the set to be considered a business.[1] However, in the United States any process could give rise to a business and sometimes no processes are required at all.

(b) In jurisdictions that apply IFRS, large pharmaceutical companies require that the set includes all inputs and processes that are crucial for value creation and in which resources are sufficient to carry the research and development process forward to the stage when the final drug can be sold.[2] However, in the United States any process can give rise to a business that leads to more licensing transactions being considered a business if a process is acquired.

34. Because practice under IFRS tends to require more significant or sophisticated processes, the FASB staff thinks that the Board's decision to require both an input and a *substantive process* will more closely align practice under GAAP and IFRS. That is, transactions with minor processes may no longer be businesses under the proposed definition in the United States, which would be more in line with current practice under IFRS. Furthermore, the proposed single or similar asset threshold also would reduce the number of transactions with insignificant processes that are considered businesses under GAAP.

Next Steps

35. The Board instructed the FASB staff to draft guidance in a proposed FASB Accounting Standards Update for exposure. The comment period will be 60 days and the amendments would be effective for new transactions occurring after the effective date. The Board expects to issue the Exposure Draft in late Q3 or early Q4 of 2015. The Board expects to continue with Phase 2 of the

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[1] IFRS Interpretations Committee Meeting Staff Paper discussed at the May 2013 meeting (agenda reference 6A: IFRS 3—*Definition of a business*—Summary of outreach results and analysis), paragraphs 22-23.

[2] IFRS Interpretations Committee Meeting Staff Paper discussed at the May 2013 meeting (agenda reference 6A: IFRS 3—*Definition of a business*—Summary of outreach results and analysis), paragraph 39(j).

project, and the feedback received on the Exposure Draft may help the Board evaluate how to clarify the term *in substance nonfinancial asset* as used in Subtopic 610-20 in that phase.

Appendix A – Draft Amendments and Select Examples

A1. This appendix summarizes a draft of some of the potential amendments to the implementation guidance and select examples that may be included in Section 805-10-55, Business Combinations—Overall—Implementation Guidance and Illustrations. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Business Combinations—Overall

Implementation Guidance and Illustrations

> Implementation Guidance

> > Definition of a Business

805-10-55-4 A **business** consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. The three elements of a business are defined as follows:

a. Input. Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include long-lived assets (including **intangible assets** or rights to use long-lived assets), intellectual property, the ability to obtain access to necessary materials or rights, and employees.

b. Process. Any system, standard, protocol, convention, or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes, and resource management processes. These processes typically are documented, but an organized workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. Accounting, billing, payroll, and other administrative systems typically are not processes used to create outputs.

c. Output. The result of inputs and processes applied to those inputs that provide goods or services to customers, other revenues, or investment income, such as dividends or interest.~~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~~.

805-10-55-5 To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. ~~However, a~~A business need not include all of the inputs or processes that the seller used in operating that business~~ if **market participants** are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes~~. However, to be considered a business, the set must include, at a minimum, an input and a substantive process that together contribute to the ability to create outputs. Paragraphs 805-10-55-5A through 55-5D provide a framework to assist an entity in evaluating whether the set includes both an input and a substantive process.

805-10-55-5A When a set does not have outputs (for example, an early stage company that has not generated revenues), the set would have both an input and a substantive process that together contribute to the ability to create outputs if it includes an organized workforce that has the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that, when applied to another acquired input or inputs, is critical to the ability to develop or convert that acquired input or inputs into outputs. An entity should consider the following in evaluating whether the acquired workforce is performing a substantive process:

a. A process (or group of processes) is not critical if, for example, it is considered ancillary or minor in the context of all the processes required to create outputs.

b. Inputs that the organized workforce could develop (or is developing) or convert into outputs could include the following:

   1. Intellectual property that could be used to develop a good or service

   2. Resources that could be developed to create outputs

   3. Access to necessary materials or rights that enable the creation of future outputs.

   Examples could include technology, mineral interests, real estate, or in-process research and development.

805-10-55-5B When the set has outputs (that is, there is a continuation of revenue before and after the transaction), the set would have both an input and a substantive process that together contribute to the ability to create outputs when any of the following are present:

a. An organized workforce that has the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that when applied to an acquired input or inputs, is critical to the ability to continue producing outputs. A process (or group of processes) is not critical if, for example, it is considered ancillary or minor in the context of all of the processes required to continue producing outputs.

b. The acquired process (or group of processes), when applied to an acquired input or inputs, contributes to the ability to continue producing outputs and cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

c. The acquired process (or group of processes), when applied to an acquired input or inputs, contributes to the ability to continue producing outputs and is considered unique or scarce.

805-10-55-5C If a set has outputs, a continuation of revenues does not, on its own, indicate that both an input and a substantive process have been acquired. Accordingly, assumed contractual arrangements that provide for the continuation of revenues (for example, customer contracts, customer lists, and leases [when the set is the lessor]) should be excluded from the analysis in paragraph 805-10-55-5B of whether a process has been acquired.

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

805-10-55-6 The nature of the elements of a business varies by industry and by the structure of an entity's operations (activities), including the entity's stage of development. Established businesses often have many different types of inputs, processes, and outputs, whereas new businesses often have few inputs and processes and sometimes only a single output (product). Nearly all businesses also have liabilities, but a business need not have liabilities. In addition, some transferred sets of assets and activities that are not a business may have liabilities.

805-10-55-7 Paragraph superseded by Accounting Standards Update 2015-XX.~~An integrated set of activities and assets in the development stage might not have outputs. If not, the acquirer should consider other factors to determine whether the set is a business. Those factors include, but are not limited to, whether the set:~~

~~a. Has begun planned principal activities~~

~~b. Has employees, intellectual property, and other inputs and processes that could be applied to those inputs~~

~~c. Is pursuing a plan to produce outputs~~

~~d. Will be able to obtain access to customers that will purchase the outputs.~~

~~Not all of those factors need to be present for a particular integrated set of activities and assets in the development stage to qualify as a business.~~

805-10-55-8 Determining whether a particular set of assets and activities is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a **{add glossary link}**market participant**{add glossary link}**. Thus, in evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.

805-10-55-9 ~~In the absence of evidence to the contrary, a particular set of assets and activities in which **goodwill** is present shall be presumed to be~~ When evaluating whether an acquired workforce or process meets the criteria in paragraphs 805-10-55-5A through 55-5B, the presence of more than an insignificant amount of **goodwill** may be an indicator that the acquired process is substantive and is a business. However, a business need not have goodwill.

805-10-55-9A Notwithstanding the guidance in paragraphs 805-10-55-4 through 55-9, if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not considered a business.

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

805-10-55-9C For purposes of applying the guidance in paragraph 805-10-55-9A, the following should not be combined into a single asset or considered similar assets:

a. Tangible and intangible assets (for example, real estate and in-place lease intangibles)
b. Identifiable intangible assets in different major **intangible asset classes** (for example, customer-related intangibles, trademarks, and in-process research and development), except for groups of identifiable intangible assets that are recognized and measured as a single identifiable asset in accordance with this Topic (for example, complementary intangible assets that have similar useful lives as described in paragraphs 805-20-55-18 and 805-20-55-30)
c. Financial and nonfinancial assets
d. Different major classes of financial assets (for example, cash, accounts receivable, and marketable securities)
e. Different major classes of tangible nonfinancial assets (for example, inventory, manufacturing equipment, and automobiles) other than those that meet the criterion in paragraph 805-10-55-9B.

> Illustrations

> > Example 6: Illustrations of the Definition of a Business

805-10-55-51 The Examples in paragraphs 805-10-55-52 through 55-88 illustrate the guidance in paragraphs 805-10-55-4 through 55-9C on the definition of a business. In each of the Examples, the first step of the analysis is the evaluation of the threshold in paragraphs 805-10-55-9A through 55-9C. If substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not a business. If that threshold is not met, an entity would evaluate whether the set includes an input and a substantive process that together contribute to the ability to create outputs. Whether both an input and a substantive process are included in the set is evaluated using the guidance in paragraphs 805-10-55-5A through 55-5D.

> > > Case A: Acquisition of Single-Family Homes

805-10-55-52 ABC acquires, renovates, leases, sells, and manages single-family residential homes. ABC acquires a portfolio of 10 single-family homes that each have at-market in-place leases. The only elements included in the acquired set are the 10 single-family homes and the 10 in-place leases. Each single-family home includes the land, building, and property improvements. Each home has a different floor plan, square footage, lot, and interior design.

805-10-55-53 ABC first considers the guidance in paragraph 805-10-55-9A and analyzes whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. ABC must first determine whether each single-family home would be considered a single asset for purposes of this analysis. ABC concludes that the land, building, and property improvements can be considered a single asset in accordance with paragraph 805-10-55-9B. That is, the building and property improvements are attached to the land and cannot be removed without incurring significant cost. However, the in-place lease is an intangible asset and cannot be combined with the tangible real estate in accordance with paragraph 805-10-55-9C.

805-10-55-54 ABC then considers whether the 10 tangible assets (the combined land, building, and property improvements) are similar. Each home is different; however, the nature of the assets (all single-family homes) are similar. As such, ABC concludes that the group of 10 single-family homes is a group of similar assets.

805-10-55-55 Next, ABC compares the fair value of the group of similar tangible assets with the fair value of the total gross assets acquired (the combined tangible assets plus the 10 in-place lease assets) and concludes that substantially all of the fair value of the gross assets acquired is concentrated in the group of similar tangible assets. That is, the in-place leases in this Example do not have significant fair value. As such, the set is not a business.

> > > Case B: Acquisition of a Drug Candidate

805-10-55-56 Pharma Co. purchases from Biotech a legal entity that contains the rights to a Phase 3 compound being developed to treat diabetes (the in-process research and development project). Included in the in-process research and development project is the historical know-how, formula protocols, designs, and procedures expected to be needed to complete the related phase of testing. The legal entity also holds an at-market clinical research organization contract and an at-market clinical manufacturing organization contract. The clinical research organization contract provides services in which the vendor performs certain research and development activities that are part of the current phase of the research and development activities required by the U.S. Food and Drug Administration. The clinical manufacturing organization contract provides access to some of the necessary materials to perform those activities. No employees, other assets, or other activities are transferred.

805-10-55-57 Pharma Co. first considers the guidance in paragraph 805-10-55-9A and analyzes whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. Pharma Co. concludes that the in-process research and development project is an identifiable intangible asset that would be accounted for as a single asset in a business combination. Pharma Co. also concludes that there is no fair value associated with the clinical research organization contract and the clinical manufacturing organization contract. Therefore, all of the consideration in the transaction would be allocated to the in-process research and development project. As such, Big Pharma concludes that substantially all of the fair value of the gross assets acquired is concentrated in the single in-process research and development asset and the set is not a business.

> > > Case E: Acquisition of Biotech

805-10-55-67 Pharma Co. buys all of the outstanding shares of Target Biotech. Target Biotech's operations include research and development activities on several preclinical compounds that it is developing (in-process research and development projects). The set includes the scientists that have the necessary skills, knowledge, or experience to perform research and development activities. In addition, Target Biotech has long-lived tangible assets such as a corporate headquarters, a research lab, and testing equipment. Target Biotech does not yet have a marketable product and, therefore, has not generated revenues.

805-10-55-68 Pharma Co. first considers the guidance in paragraph 805-10-55-9A and analyzes whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. The identifiable assets in the set include multiple in-process research and development projects and tangible assets (the corporate headquarters, the research lab, and the lab equipment). In addition, Pharma Co. concludes that there is fair value associated with the acquired workforce. Pharma Co. also concludes that substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset or group of similar identifiable assets. Furthermore, because of the significant amount of fair value associated with both the tangible assets and the acquired workforce, Pharma Co. does not assess whether the in-process research and development projects are similar (because even if those projects were similar, the threshold would not be met).

805-10-55-69 Because the set does not have outputs, Pharma Co. evaluates the criteria in paragraph 805-10-55-5A to determine whether the set has both an input and a substantive process. Big Pharma concludes that the criteria in paragraph 805-10-55-5A are met because the scientists make up an organized workforce that has the necessary skills, knowledge, or experience to perform processes that, when applied to the in-process research and development inputs, is critical to the ability to develop those inputs into a good that can be provided to a customer. The presence of a more than insignificant amount of goodwill is another indicator that the workforce is performing a critical process. Thus, the set includes both inputs and substantive processes and is a business.

> > > Case H: Acquisition of Corporate Office Building

805-10-55-76 REIT purchases all of the outstanding shares of Building Co. from Seller. Building Co. holds a multitenant corporate office park with six 10-story office buildings leased to maximum occupancy. Seller manages its properties centrally and manages the operations of Building Co. with its own employees.

805-10-55-77 As part of the transaction, REIT acquires the land, buildings, and in-place leases and assumes vendor contracts for outsourced cleaning and security. Seller's employees that perform leasing (sales, underwriting, and so forth), tenant management, financing, and other strategic management processes are not included in the set. REIT plans to replace the property management and employees with its own internal resources.

805-10-55-78 REIT first considers the guidance in paragraph 805-10-55-9A and analyzes whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. Although the leases are at market value, REIT concludes that the fair value of the in-place leases are significant and that the fair value of the gross assets acquired is not concentrated in either the leases or the tangible assets.

805-10-55-79 The set has continuing revenues through the in-place leases and, therefore, has outputs. As such, REIT must consider the criteria in paragraph 805-10-55-5B to determine whether the set includes both an input and a substantive process that together contribute to the ability to create outputs.

805-10-55-80 REIT concludes that the criterion in paragraph 805-10-55-5B(a) is not met because the processes performed through the cleaning and security contracts (the only process acquired) would be considered ancillary or minor in the context of all the processes required to create outputs in the real estate industry. That is, while those outsourcing agreements may be considered to provide an organized workforce that performs cleaning and security processes when applied to the building, the processes performed by the cleaning and security personnel would not be considered critical in the context of all the processes required to create outputs.

805-10-55-81 REIT also concludes that the criterion in paragraph 805-10-55-5B(b) is not met because the cleaning and security processes could be easily replaced with little cost, effort, or delay in the ability to continue producing outputs. While the cleaning and security processes need to be completed to continue the operation of the buildings, these contracts can be replaced quickly with little effect on the ability to continue producing outputs.

805-10-55-82 REIT concludes that the criterion in paragraph 805-10-55-5B(c) is not met because the cleaning and security contracts are not considered unique or scarce. That is, these types of arrangements are readily accessible in the marketplace.

805-10-55-83 Because none of the criteria were met, REIT concludes that the set does not include both an input and substantive processes that together contribute to the ability to create outputs and therefore is not considered a business.

> > > Case I: Acquisition of Corporate Office Building

805-10-55-84 Assume the same facts as in Case H except that the set includes the employees responsible for leasing, tenant management, and managing and supervising all operational processes, such as the cleaning and security vendors.

805-10-55-85 REIT evaluates the criteria in paragraph 805-10-55-5B and concludes that the criterion in paragraph 805-10-55-5B(a) is met because the set includes an organized workforce that performs processes critical to the ability to continue producing outputs when applied to the acquired inputs in the set, such as the land, building, and in-place leases (that is, REIT concludes that the leasing, tenant management, and supervision of the operational processes are critical to the creation of outputs). Because only one criterion in paragraph 805-10-55-5B needs to be met, the set includes both an input and substantive processes that together contribute to the ability to create outputs and is considered a business.