Accounting Standards Advisory Forum

FASB Project on the Clarifying the Definition of a Business

ASAF agenda paper 5A

September 29, 2016

The views expressed in this presentation are those of the presenter. Official positions of the FASB are reached only after extensive due process and deliberations.

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Background Information

- The FASB added the project to the agenda for the following reasons:
  - Practice issues raised in the post-implementation review (PIR) of Statement 141(R), Business Combinations. The FASB also observed the definition was applied differently under IFRS.
  - Issues raised within the new revenue standard
    - The scope of the new revenue standard includes nonfinancial assets and transactions with noncustomers (Subtopic 610-20, Other Income– Gains and Losses from the Derecognition of Nonfinancial Assets). However, it excludes a business that is not an in-substance nonfinancial asset.
    - The standard supersedes the partial sales guidance in Subtopic 360-20, Sales of Real Estate, leaving no guidance on partial sales of real estate
- The project is being addressed in 3 phases:
  - Phase 1: Clarify the definition of a business (in the redeliberations phase)
  - Phase 2: Address the scope of asset derecognition guidance and accounting for partial sales (comment-period ended on August 5, 2016)
  - Phase 3: Address other asset versus business accounting differences (not yet started)

Major Changes to the Proposed Update

- Single or Similar Asset Threshold
  - 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
    - A single asset is generally an asset that would be considered a single asset in a business combination but could include tangible assets that are attached to and cannot be physically removed and used separately (e.g., land and buildings)
    - The comparison of the fair value is made between the single identifiable asset or group of similar assets compared to the gross assets acquired (including goodwill but excluding liabilities)
  - The Board did not provide guidance on what is considered similar but provided some guidelines for what *cannot* be considered similar:
    - Tangible and intangible assets
    - Different major classes of intangible assets
    - Financial and nonfinancial assets
    - Different major classes of financial assets
    - Different major classes of tangible nonfinancial assets

Major Changes in the Proposed Update

- At a minimum, to be a business, a set must include and input and a substantive process
  - The Board decided to remove the requirement that a market participant must be able to replace all the missing elements in order to be a business
    - The removal is intended to refocus the analysis of what is acquired
    - Takes pressure off of identifying the market participant
  - The Board also decided to provide a framework to assist in this determination
    - For **a set with no outputs** to be a business, (e.g., an early stage company that has not generated revenues) it needs <u>both</u> an input and an organized workforce that performs an acquired process (or group of processes) critical to the ability to develop or convert that acquired input into outputs
    - For **a set with outputs** to be a business, it needs <u>any</u> of the following:
      - An organized workforce that performs an acquired process (or group of processes) critical to the ability to create outputs
      - The acquired process cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs or it is considered unique or scarce
- Outputs should be defined similar to goods or services provided to customers (i.e., focus on revenue)

Proposed Update

- Comment period ended January 4, 2016
- 37 comment letters received

Stakeholders	# of Comment Letters
Accounting Firms	9
Industry Trade Groups	3
Professional Organizations	8
Preparers	17
Total	**37**

- Overall respondents expressed support for the objective of the proposed Update
- A majority of respondents requested further clarification on the threshold, contractual arrangements and simultaneous contracts.

Threshold

- Most respondents supported the threshold and agreed that the threshold should be applied to a single or group of similar assets.
- Stakeholders also commented that:
  - In some cases, the application of the threshold might lead to a conclusion that is inconsistent with the framework
  - The threshold could result in too many transactions being considered assets
- In redeliberations the Board will consider the following alternatives
  - Alternative A: Affirm that the threshold is a determinative factor
  - Alternative B: Make the threshold an indicator
  - Alternative C: Make the threshold a rebuttable presumption

Threshold: Single Asset

- Respondents noted that requiring entities to separately measure assets for the threshold test when not otherwise required to do so for financial reporting could create unnecessary complexity
- Others requested clarification on whether certain types of intangible and tangible assets should be combined for purpose of the threshold
- In redeliberations the Board will consider the following alternatives
  - Alternative A: Remove the exception for intangible and tangible assets that otherwise could be combined for financial reporting purposes.
  - Alternative B: Combine certain contracts with other assets

Threshold: Similar Assets

- Stakeholders suggested that the Board clarify its intent because diversity in practice may develop around what is considered similar. Suggestions included:
  - Indicating whether or not assets within the same class need to be further disaggregated into groups based on nature, risks, and characteristics
  - Indicating that the assets cannot have “significantly different risk characteristics” to be considered a similar
  - Reconsidering when different asset classes can be combined
- In redeliberations the Board will consider the following alternatives
  - Alternative A: Clarify that the nature, risks, and characteristics within the asset class need to be substantially the same.
  - Alternative B: Apply the threshold to assets within the same asset class. Alternative C: Apply the threshold to a single asset.

Contractual Arrangements

- The proposed Update indicates that an organized workforce that performs a process critical to the ability to create outputs is either:
  - Required (if outputs are not present)
  - One factor (if outputs are present) that indicates the set is a business
- It also states that an organized workforce could be outsourced through a contractual arrangement (for example, property management)
- Some respondents commented that
  - it is difficult to distinguish whether the organized workforce is an input or process and requested the Board provide further guidance.
  - there is diversity in how stakeholders evaluate acquired contracts under the current definition of a business. Some assess:
    - all acquired contracts as inputs
    - all acquired contracts as processes
    - facts and circumstances and make a determination

Contractual Arrangements

- In redeliberations the Board will consider the following alternatives
  - Alternative A: Contracts are inputs and do not provide a substantive process
  - Alternative B: Contracts cannot provide a substantive process when outputs are not present
  - Alternative C: Provide indicators of when a contract is akin to an organized workforce
  - Alternative D: Align with certain IASB Amendments

Simultaneous Contracts

- Several respondents requested clarification on whether or not contracts entered into with the seller at the same time of the sale transaction should be part of the acquired set

- In redeliberations the Board will consider the following alternatives
  - Alternative A: Evaluate whether a contract is part of the acquired set
  - Alternative B: Only in place contracts are included in the set.
  - Alternative C: All contracts should be considered a part of the set.
  - Alternative D: Amend Case F so that the contract was already in place.

Phase 2: Other Income- Gains and Losses from the Derecognition of Nonfinancial Assets

- Background
  - The guidance in Subtopic 610-20, was added to
    - address the absence of general accounting guidance on transfers of nonfinancial assets in nonrevenue transactions.
    - replace the real estate-specific guidance from Subtopic 360-20
  - A business is typically excluded from Subtopic 610-20 unless it is an in-substance nonfinancial asset, which was not defined in Updated 2014-09
  - The real estate guidance on partial sales was not replaced

- The objective of this phase is to accomplish the following:
  - Clarify the scope of Subtopic 610-20 on the derecognition of nonfinancial assets
  - Clarify the term “in-substance” nonfinancial asset
  - Replace the real estate guidance on partial sales that was eliminated when the new revenue standard was issued

Phase 2: Other Income- Gains and Losses from the Derecognition of Nonfinancial Assets

- The Board's decisions simplify GAAP by consistently accounting for assets and businesses as follows:
  - A retained interest in a partial sale is measured at fair value
  - A sale of a noncontrolling ownership interest in a subsidiary is recorded through equity
  - A transfer of a nonfinancial asset to an equity method investee (in a nonrevenue transaction) results in full gain or loss recognition
  - A contribution to a joint venture results in the investor recording its investment at fair value
- Exposure draft was issued June 6, 2016
- Comment letters were due August 5, 2016