

STAFF PAPER

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Project	Definition of a business
Paper topic	Comparison between FASB Amendments and IASB tentative decisions
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Purpose of the paper

1. In June 2017, the International Accounting Standards Board (Board) completed its discussions on the comments received on the Exposure Draft *Definition of a Business and Accounting for Previously Held Interests* (the IASB ED) (ED/2016/1). The IASB ED included proposals intended to clarify the definition of a business and the related application guidance.
2. The purpose of this paper is to obtain advice from ASAF members on the Board's tentative decisions made at its April and June 2017 meetings (Board's tentative decisions). We are specifically seeking ASAF members' view on the differences between the Board's tentative decisions and the Accounting Standards Update *Clarifying the Definition of a Business* (the FASB Amendments) issued by the FASB in January 2017. This is because many respondents to the IASB ED, including some ASAF members, encouraged the IASB and FASB to reach converged solutions on their respective amendments.
3. We will report feedback from the ASAF discussion to a future Board meeting.
4. This paper:
 - (a) compares the Board's tentative decisions with the FASB Amendments;

- (b) explains the main differences; and
 - (c) asks for ASAF members’ advice on the differences between the Board’s tentative decisions and the FASB Amendments.
5. Appendix A of this paper includes a table that shows a summary of all the Board’s tentative decisions against the FASB decisions.
 6. The IASB ED also included proposals on previously held interests in a joint operation. This paper does not discuss those proposals.

Comparison between FASB Amendments and Board’s tentative decisions

7. The following paragraphs of this paper set out the main differences between the Board’s tentative decisions and the FASB Amendments. We have only included the differences in the Application Guidance, because we want to focus the discussion with ASAF members on the authoritative part of the forthcoming amendments to IFRS 3 *Business Combinations*. Consequently, possible differences in the Basis for Conclusions and in the Illustrative Examples are not included in this paper. The main difference between the two sets of Illustrative Examples will probably be that the Illustrative Examples of the forthcoming amendments to IFRS 3 will include the example of acquisition of oil and gas operations proposed in the IASB ED. This example is not included in the FASB Amendments, because the FASB removed the oil and gas example proposed in its Exposure Draft. As suggested by some respondents to the IASB ED, in drafting the Illustrative Examples we will try to use the same wording as much as possible.

The screening test

Board’s proposal

8. The IASB ED includes a proposal to consider a set of activities and assets acquired not to be a business if the fair value of the gross assets acquired is concentrated in a single asset or group of similar assets. This proposal is often called a ‘screening test’.
9. The proposed screening test is determinative. This means that if an entity has performed the screening test and concluded that a concentration exists, the entity

should treat the transaction as an asset purchase. There is no further assessment that might change that conclusion. If no concentration exists, the entity then should assess whether it has acquired a substantive process.

10. The proposed screening test was mandatory. This means that an entity would always be required to assess whether a concentration of fair value exists (ie even when it is evident that the acquired set meets the definition of a business).

Feedback received

11. Many respondents to the IASB ED, including some ASAF members, observed that in some circumstances the proposed screening test may result in inappropriate conclusions. They were concerned that certain transactions that are currently (and appropriately) accounted for as business combinations would be classified as asset purchases because of the proposed screening test. They also observed that the screening test might lead to a conclusion that is inconsistent with what would be concluded by assessing whether an acquired process is substantive.

Board's tentative decision

12. In the light of the comments received, in its April 2017 meeting, the Board tentatively decided to:
 - (a) make the screening test optional on a transaction-by-transaction basis. Consequently, an entity could on a transaction-by-transaction basis elect to bypass the screening test and assess directly whether a substantive process has been acquired; and
 - (b) confirm that the screening test is determinative.
13. The Board decided to make the test optional to enable entities to assess on a transaction-by-transaction basis, whether a substantive process has been acquired if this assessment would be more efficient or result in a conclusion that better reflects the economics of a particular transaction. The Board acknowledged that the screening test might not reach the same outcome as the assessment of the guidance on substantive processes. It observed that there is the risk that using the screening test an entity will fail to reflect the 'core goodwill' acquired. But, if substantially all the fair value of the gross assets acquired (including core goodwill) is concentrated in a single

asset (or a group of similar assets), the fair value of the core goodwill cannot be a substantial part of the total fair value of the gross assets acquired. Thus, even if the entity acquired a business, not recognising the core goodwill seemed acceptable to the Board on materiality grounds.

14. During its redeliberations, the Board also considered: (i) making the screening test an indicator that the set is not a business and (ii) providing factors that would overcome the results of the screening test. The Board tentatively decided that those suggestions would be inconsistent with the intended purpose of the test, that is to reduce the cost and complexity of applying the guidance on the definition of a business in cases that are straightforward.
15. The screening test included in the FASB Amendments is mandatory and determinative. Consequently, the Board's tentative decision to make the screening test optional would create a difference between the future amendments to IFRS 3 and the FASB Amendments.

Definition of output

Board's proposal

16. In the ED, the Board proposed to narrow the definition of output in paragraph B7(c) of IFRS 3 as follows:

Output: 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~~ goods or services to customers, investment income (such as dividends or interest) or other revenues.

Feedback received

17. Some respondents to the IASB ED asked the Board to clarify the term “other revenues” as part of the definition of outputs. They noted that the term “other revenues” may create diversity in practice, because the term can be applied and interpreted in various ways.

18. Other respondents to the IASB ED suggested removing the term “to customers” from the definition of outputs to clarify that a set of assets acquired for the purpose of captive consumption may be a business (eg an entity acquires a supplier and subsequently consumes all the output from the supplier).

Board’s tentative decision

19. In the light of the comments received, in its June 2017 meeting, the Board tentatively decided to:

- (a) reaffirm the proposal to amend the definition of ‘output’ by removing the reference to the ability to reduce costs,
- (b) clarify that ‘other revenues’ means other income arising from contracts that are within the entity’s ordinary activities but are outside the scope of IFRS 15 *Revenue from Contracts with Customers*, and
- (c) clarify that if an acquired set of assets generated revenues before the acquisition, but is integrated by the acquirer and no longer generates revenues after the acquisition, that set of assets is regarded as creating outputs. This statement was in the Basis for Conclusions of the IASB ED, Respondents to the IASB ED generally supported this statement. The Board tentatively decided to move this statement into the Application Guidance of IFRS 3 because it is a requirement.

20. We think that the Board’s tentative decision in paragraph 19(c) above is not consistent with the FASB Amendments, because according to paragraph 805-10-55-5E of the FASB Amendment a set has outputs if there is a continuation of revenue before and after the transaction. This paragraph states that:

When the set has outputs (that is, there is a continuation of revenue before and after the transaction), the set ...

21. The FASB’s definition of output¹ does not explain the meaning of ‘other revenues’. However, we think that the Board’s tentative decision in paragraph 19(b) above (ie

¹ The definition of output included in the FASB Amendments is the following:

Output. The result of inputs and processes applied to those inputs that provide goods or services to customers, investment income (such as dividends or

the clarification that ‘other revenues’ means other income arising from contracts that are within the entity’s ordinary activities but are outside the scope of IFRS 15) is consistent with the FASB Amendments, because paragraph BC59 of the FASB Amendments states that:

BC59. The Board decided to narrow the definition of outputs by aligning it with the ability to generate goods or services provided to customers. That is consistent with how outputs are discussed in Topic 606, which describes goods or services that are an output of the entity’s ordinary activities. However, the Board noted that not all entities have revenues within the scope of Topic 606 and, therefore, decided to incorporate other types of revenues in the definition. For example, the Board decided to include the reference to investment income in the definition of outputs in the amendments in this Update to ensure that the purchase of an investment company can still qualify as a business combination.

Definition of a business and definition of output

Board’s proposal

22. In the ED, the Board did not propose any amendments to the current definition of a business in Appendix A of IFRS 3. The current definition is the following:

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.

~~interest), or other revenues 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.~~

Feedback received

23. Some respondents to the IASB ED suggested the Board should amend the definition of a business in Appendix A to IFRS 3 to make it consistent with the revised definition of output in paragraph B7(c) of the ED.

Board's tentative decision

24. In its June 2017 meeting, the Board tentatively decided to align the definition of a business in Appendix A of IFRS 3 with the revised definition of output in paragraph B7(c) of IFRS 3, because the Board agreed that the definition of a business might be perceived as inconsistent with the revised definition of output and thus cause confusion.
25. That tentative decision differs from the FASB Amendments, because the FASB did not change the definition of a business. However, the definition of a business in the FASB Amendments² includes an explicit reference to the guidance on the definition of a business, and that guidance includes the definition of outputs.

Guidance on acquired outsourcing agreements

Board's proposal

26. In the ED, the Board proposed to clarify that an acquired contract is not a substantive process. However, an acquired contract may give access to an organised workforce, for example a contract for outsourced property management or outsourced asset management. The Board proposed that an entity should assess whether an organised workforce accessed through such a contractual arrangement performs a substantive process that the entity controls, and thus has acquired (for example, considering the duration and the renewal terms of the contract). According to the IASB ED, an outsourced workforce may perform a substantive process even if the acquired set of assets has no output.

² The definition of a business included in the FASB Amendments is the following (emphasis added):

A business is 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. **To be considered a business, an integrated set must meet the requirements in paragraphs 805-10-55-4 through 55-6 and 805-10-55-8 through 55-9.**

Feedback received

27. Respondents to the IASB ED generally supported the proposal that an outsourced workforce may perform a substantive process even if the acquired set of assets has no output.

Board's tentative decision

28. In its June 2017 meeting, the Board tentatively decided to confirm the proposed guidance on acquired outsourcing agreements, including the proposal that an outsourced workforce may perform a substantive process even if the acquired set of assets has no output. The Board tentatively decided not to change this proposal, because respondents to the IASB ED generally supported this proposal.
29. This Board's tentative decision is not consistent with the FASB Amendments, because, in its redeliberations, the FASB decided that, when outputs are not present, the acquired set of assets would need to include an organised workforce that is made up of employees.

Goodwill

Board's proposal

30. The Board proposed to remove from paragraph B12 of IFRS 3 the presumption that the presence of goodwill indicates that the acquired set of activities and assets is a business. This is because the Board believes that an entity may be willing to pay an insignificant premium for an asset or an assembled group of assets in some cases. Consequently, in the ED the Board proposed to specify that the presence of an insignificant amount of goodwill does not mean that the acquired assets should automatically be considered a business.

Feedback received

31. Some respondents to the IASB ED observed that the presence of goodwill as a separate indicator may not be consistent with the new guidance on substantive process. They suggested various solutions, for example: clarify this potential inconsistency, delete the reference to the presence of goodwill as a separate indicator.

Board's tentative decision

32. In its June 2017 meeting, the Board tentatively decided:
- (a) to reaffirm the removal from paragraph B12 of IFRS 3 of the statement that a set of assets and activities in which goodwill is present is presumed to be a business; and
 - (b) not to include the statement, proposed in the ED, that the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive. This is because, in the light of the comments received, the Board believe that this additional indicator may create more confusion than benefits.
33. The latter tentative decision (paragraph 32(b) above) is not consistent with the FASB Amendments, because paragraph 805-10-55-9 of the FASB Amendments states that:
- ...When evaluating whether a set meets the criteria in paragraphs 805-10-55-5D through 55-5E, the presence of more than an insignificant amount of **goodwill** may be an indicator that the acquired process is substantive and, therefore, the **acquired set** is a business. However, a business need not have goodwill.
34. However, we think that this difference should not cause significant divergence in practice, because paragraph BC57 of the FASB Amendments states that:
- The Board did not intend for the consideration of goodwill to create an additional step in the analysis or result in more transactions having goodwill than have had goodwill in the past. The intent of paragraph 805-10-55-9 is only to provide another indicator to assist an entity in evaluating whether a substantive process is included in the set.

Difficulties in replacing an acquired workforce may indicate that the workforce performs a substantive process

Board's proposal

35. Paragraph B12A of the IASB ED states that a set that does not have outputs is a business only if:
- (a) it includes a workforce;
 - (b) the acquired workforce is able to perform an acquired substantive process;
and
 - (c) that acquired substantive process is critical to the ability to develop or convert another acquired input into outputs

Feedback received

36. A respondent to the IASB ED suggested replacing the tests described in paragraph 35(b) and (c) above, with the test of whether replacing the acquired workforce would cause significant cost, effort and delay in the production or the development of outputs.

Board's tentative decision

37. In the light of the comments received, in its June 2017 meeting, the Board tentatively decided to:
- (a) confirm the guidance proposed in the ED to assess whether a substantive process has been acquired, and
 - (b) specify in the guidance on substantive processes that difficulties in replacing an acquired workforce may indicate that the workforce performs a substantive process.
38. The clarification in the latter tentative decision (paragraph 37(b) above) is not included in the FASB Amendments.

Questions to ASAF members

Question 1

Do you have any advice regarding the differences between the Board's tentative decisions and the FASB Amendments, including any differences in practice that could emerge because of these differences?

Appendix A - Board’s tentative decisions against FASB decisions

A1. In the table below we provide a summary of all the Board’s tentative decisions against the FASB decisions in their respective projects on the definition of a business.

Summary of IASB tentative decisions	Summary of FASB decisions
Definition of output	
Amend the definition of ‘output’ by removing the reference to the ability to reduce costs.	Amend the definition of ‘output’ by removing the reference to the ability to reduce costs (see footnote 1 above).
Clarify that ‘other revenues’ means other income arising from contracts that are within the entity’s ordinary activities but are outside the scope of IFRS 15 <i>Revenue from Contracts with Customers</i> .	The FASB explained the meaning of ‘other revenues’ in the Basis for Conclusions (see paragraph 21 above)
Definition of a business	
Align the definition of a business in Appendix A of IFRS 3 with the revised definition of output in paragraph B7(c) of IFRS 3.	The FASB did not align the definition of a business with the definition of output. However, the definition of a business in the FASB Amendments includes an explicit reference to the guidance on the definition of a business.
Minimum requirements to be a business	
Clarify that to be considered a business an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together are required to contribute significantly to the ability to create outputs.	Clarify that to be considered a business an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together are required to contribute significantly to the ability to create outputs.
Remove the statement that a set of activities and assets is a business if market participants can replace the missing elements and continue to produce outputs	Remove the statement that a set of activities and assets is a business if market participants can replace the missing elements and continue to produce outputs.

Summary of IASB tentative decisions	Summary of FASB decisions
The screening test	
<p>An entity may on a transaction-by-transaction basis elect to apply the screening test to determine when a set would not be considered 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 the acquired set is not a business. Thus, the screening test is optional and determinative.</p> <p>If the fair value is not concentrated, further assessment is necessary to determine whether the set is a business.</p>	<p>An entity shall consider a set of activities and assets not to be 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. Thus, the screening test is mandatory and determinative.</p> <p>If the fair value is not concentrated, further assessment is necessary to determine whether the set is a business.</p>
<p>Specify that the gross assets considered in the screening test exclude: (i) goodwill resulting from the effects of deferred tax liabilities; and (ii) deferred tax assets.</p>	<p>Specify that the gross assets considered in the screening test exclude: (i) goodwill resulting from the effects of deferred tax liabilities; (ii) deferred tax assets; (iii) and cash and cash equivalents [The IASB has not discussed yet whether the cash acquired should be excluded from the gross assets acquired].</p>
<p>Clarify that, for the screening test, a tangible asset that is attached to and cannot be physically removed and used separately from other tangible assets (or a right-of-use asset, as described in IFRS 16 <i>Leases</i>), without incurring significant cost, significant diminution in utility, or fair value to either asset, shall be considered a single identifiable asset.</p>	<p>Clarify that, for the screening test, a tangible asset that is attached to and cannot be physically removed and used separately from other tangible assets (or intangible asset representing the right to use a tangible asset), without incurring significant cost, significant diminution in utility, or fair value to either asset, shall be considered a single identifiable asset.</p> <p>In-place lease intangibles and the related leased assets are considered a single asset [this is not a difference, because according to paragraph B42 of IFRS 3 an in-place lease and the related leased asset are a single asset].</p>

Summary of IASB tentative decisions	Summary of FASB decisions
<p>Clarify that the following would not be considered similar assets:</p> <ul style="list-style-type: none"> • A tangible asset and an intangible asset • Identifiable intangible assets in different intangible asset classes • A financial asset and a nonfinancial asset • Different classes of financial assets • Different classes of tangible assets • Identifiable assets within the same asset class that have significantly different risks. <p>Clarify that the new guidance on what assets may be considered a single asset or a group of similar assets is not intended to modify the existing guidance on similar assets in paragraph 36 of IAS 38 <i>Intangible Assets</i> and the term 'class' in IAS 16 <i>Property, Plant and Equipment</i>, IAS 38 and IFRS 7 <i>Financial Instruments: Disclosures</i>.</p>	<p>Clarify that the following would not be considered similar assets:</p> <ul style="list-style-type: none"> • A tangible asset and an intangible asset • Identifiable intangible assets in different major intangible asset classes • A financial asset and a nonfinancial asset • Different major classes of financial assets • Different major classes of tangible assets • Identifiable assets within the same major asset class that have significantly different risks. <p>[The FASB uses the term 'major classes', the IASB uses the term 'classes' because the term 'major classes' is not used in IFRS Standards.]</p>
Guidance on substantive processes	
<p>When a set does not have outputs, the set is a business only if it includes an organized workforce (made up of employees <u>or accessed through an outsourcing agreement</u>) that has the necessary skills, knowledge, or experience to perform an acquired process that when applied to another acquired input or inputs is critical to the ability to develop or convert that acquired input into output.</p> <p>When a set has outputs, the set is a business if any of the following are present:</p> <ul style="list-style-type: none"> • An organized workforce that has the necessary skills to perform an acquired process that when applied to an acquired input is critical to the ability to continue producing outputs. • An acquired process that is unique, scarce, or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs <p>Specify in the guidance on substantive processes that difficulties in replacing an acquired workforce may indicate that the workforce performs a substantive process.</p>	<p>When a set does not have outputs, the set is a business only if it includes an organized workforce (that is made up of employees <u>and is not accessed through an outsourcing agreement</u>) that has the necessary skills, knowledge, or experience to perform an acquired process that when applied to another acquired input or inputs is critical to the ability to develop or convert that acquired input into output.</p> <p>When a set has outputs, the set is a business if any of the following are present:</p> <ul style="list-style-type: none"> • An organized workforce that has the necessary skills to perform an acquired process that when applied to an acquired input is critical to the ability to continue producing outputs. • An acquired process that is unique, scarce, or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs

Summary of IASB tentative decisions	Summary of FASB decisions
Goodwill	
<p>Remove the existing statement that a set of assets and activities in which goodwill is present is presumed to be a business.</p> <p>Do not include the statement, proposed in the ED, that the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive.</p>	<p>Remove the existing statement that a set of assets and activities in which goodwill is present is presumed to be a business.</p> <p>Confirm the statement, proposed in the ED, that the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive.</p>
Transition	
<p>An entity would not be required to apply the proposed amendments to transactions that occur before the effective date of the amendments</p>	<p>An entity would not be required to apply the proposed amendments to transactions that occur before the effective date of the amendments</p>