IFRS® Foundation

Definition of a business and reacquired rights in IFRS 3 *Business Combinations*

Agenda Paper 2

Section 19 *Business Combinations and Goodwill*

SME Implementation Group meeting

January 2022

Disclaimer

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Project	**Second Comprehensive Review of the *IFRS for SMEs*® Standard**	
Paper topic	Definition of a business and reacquired rights in IFRS 3	
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Purpose of the meeting

Purpose	To seek SMEIG members’ views on whether Section 19 needs: • to introduce a rebuttable presumption for the assessment of a business (Q1 as set out in slide 14 of this paper). • to provide additional guidance on reacquired rights as set out in paragraphs B36 and B53 of IFRS 3 (Q2 as set out in slide 18 of this paper).

Structure

- Background (Towards an Exposure Draft—IFRS 3)
- Rebuttable presumption for the assessment of a business
- Guidance on reacquired rights

Background (Towards an Exposure Draft—IFRS 3)

IASB’s tentative decisions

Towards an Exposure Draft—IFRS 3

Background

The IASB met on 14 December 2021:

- to consider all forms of feedback on the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard*, published in January 2020, and the recommendations of the SMEIG on the alignment of Section 19 of the *IFRS for SMEs* Standard with IFRS 3, including the 2018 definition of a business.
- to decide whether and how to propose amendments to the *IFRS for SMEs* Standard to align with parts of IFRS 3, including the 2018 definition of a business.

Agenda Paper 30A of the December 2021 IASB meeting can be accessed here.

IASB's tentative decisions

- The IASB tentatively decided to propose amendments to Section 19 of the *IFRS for SMEs* Standard.
- The IASB's tentative decisions can be found here.

Rebuttable presumption for the assessment of a business

Possible simplification

Align with the definition of a business, issued in October 2018

The proposed amendments

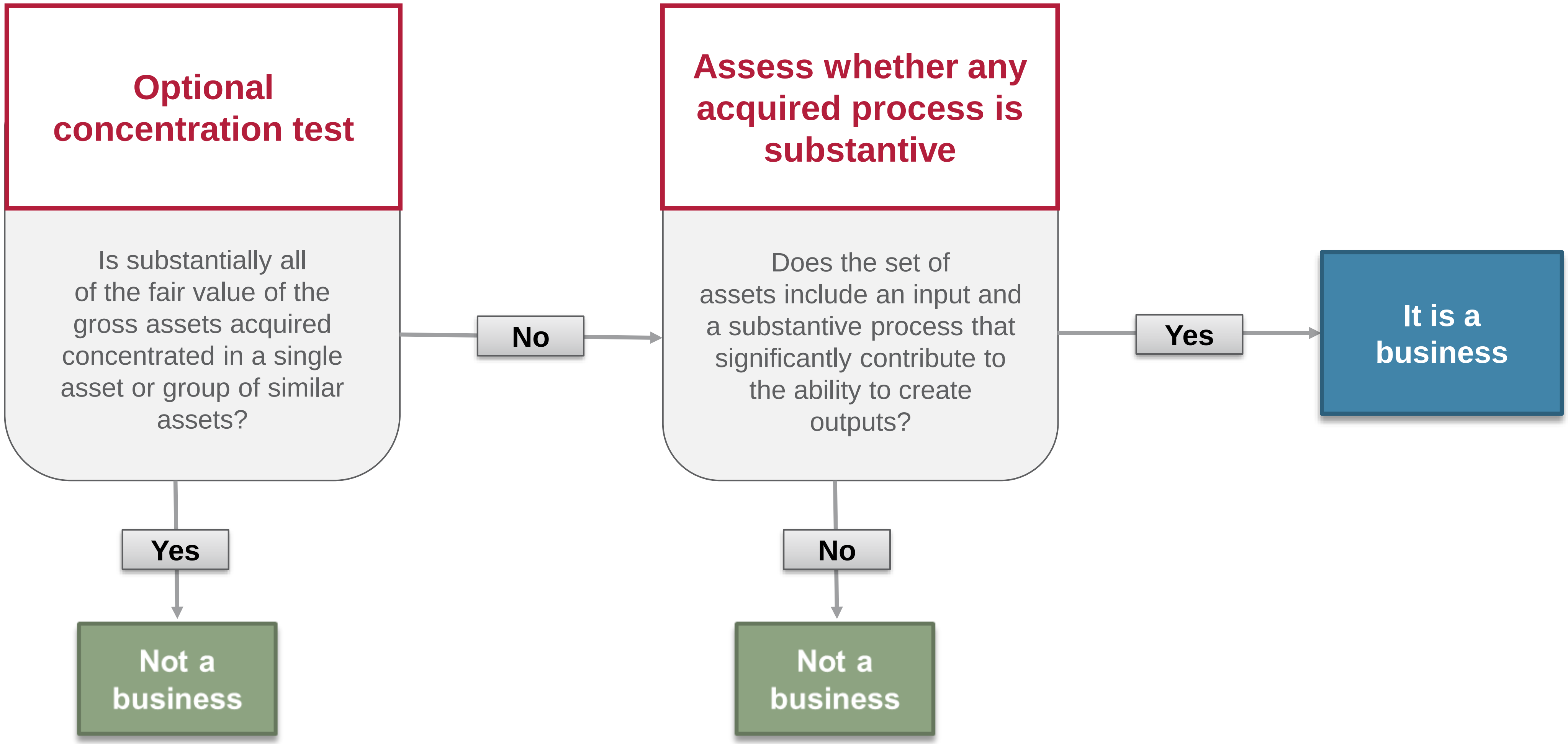
The IASB has tentatively decided to propose aligning the definition of a business in the *IFRS for SMEs* Standard with the amended definition of a business, issued in October 2018, by reproducing, in a new appendix to Section 19, application guidance that includes:

- the optional concentration test set out in paragraphs B7A–B7B of IFRS 3;
- **a decision tree to assess whether an acquired process is substantive; and**
- the application guidance for the assessment set out in paragraphs B8–B12D of IFRS 3, alongside some illustrative examples.

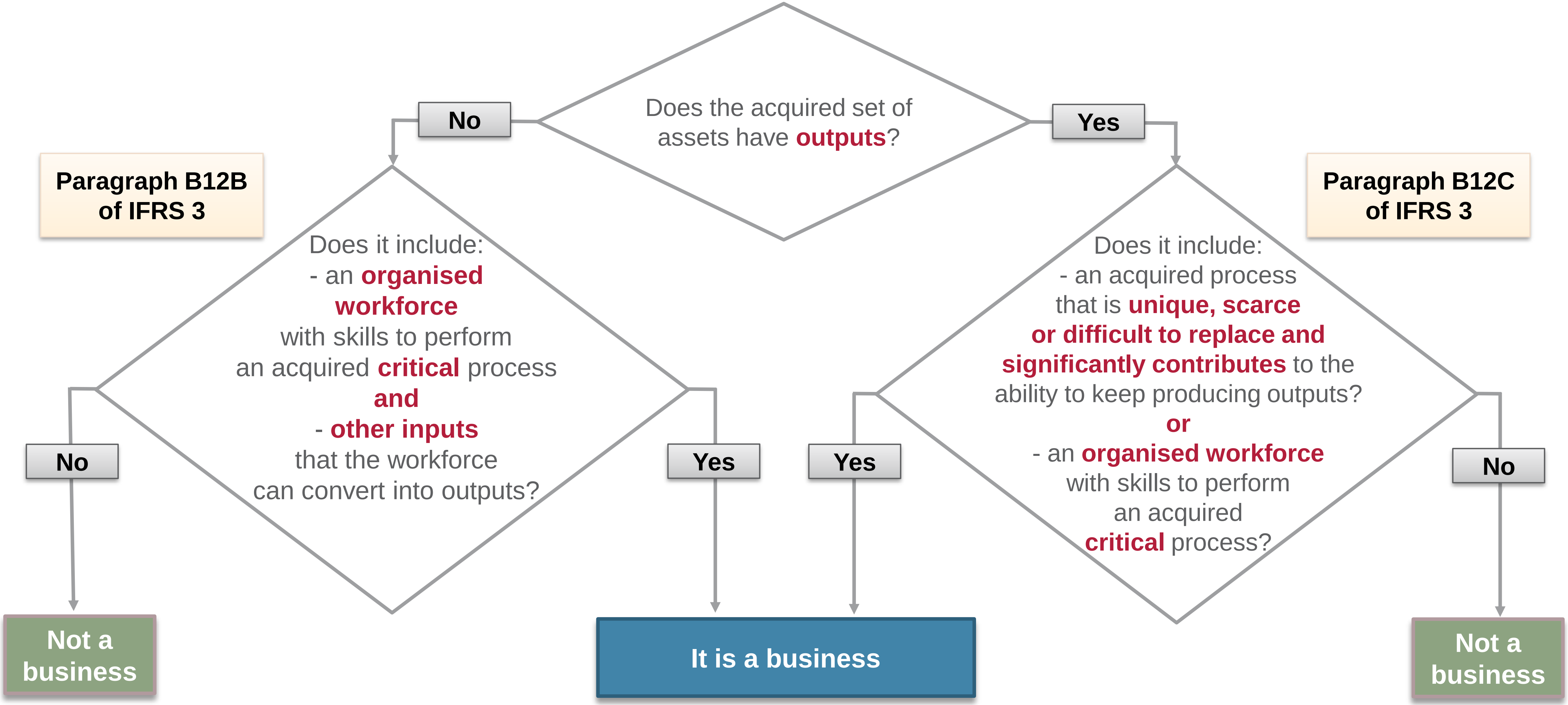
Diagrams

See slides 9 and 10 for the decision tree.

Definition of a Business



Assessing whether an acquired process is substantive



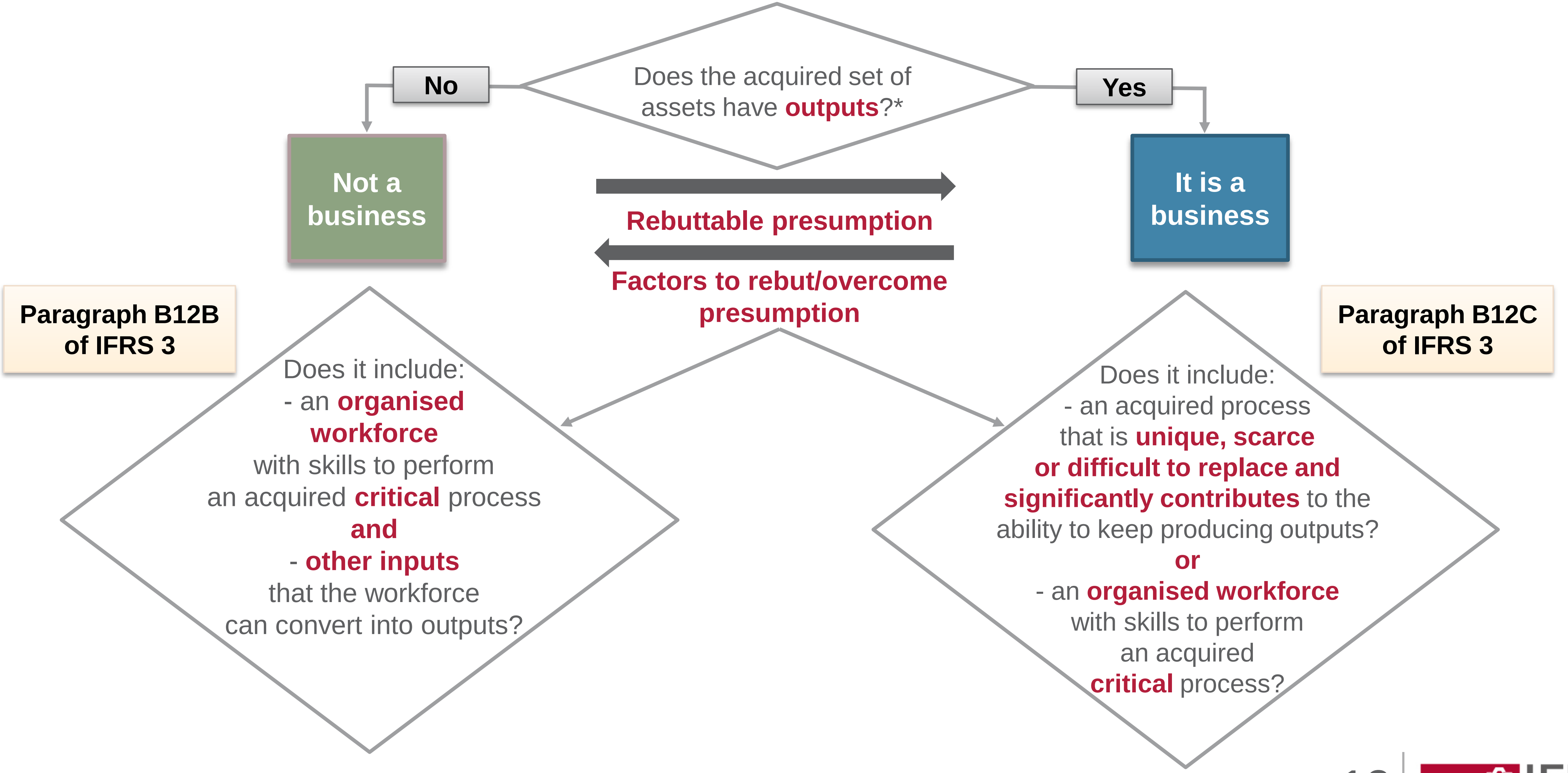
Rebuttable presumption for the assessment of a business

Possible simplification

One IASB member suggested introducing a rebuttable presumption for the assessment of a business—so that if an acquired set of activities and assets has outputs, there is a rebuttable presumption to qualify as a business at the acquisition date. This presumption can be rebutted using the factors set out in paragraphs B12B and B12C of IFRS 3.

Diagram	See slide 12 for the decision tree '<u>revised</u>'.

Rebuttable presumption for the assessment of a business—decision tree ‘revised’



* For the avoidance of doubt, as set out in slides 8 and 9, the concentration test **remains** an option before being into this step.

Staff's preliminary views on introducing a rebuttable presumption

Pros

- If the optional concentration test is not met, it is simpler to operate and less costly than applying the detailed assessment required by paragraphs B8–B12D of IFRS 3.
- It might be easier for SMEs to make judgement.

Cons

- Economics of an acquisition transaction
  - In some cases, if the set of activities and assets **has outputs** (**ie real estate**), applying the rebuttable presumption would, in effect, force SMEs to apply **business combination accounting**—which might not be the case (see Illustrative Examples, Examples A scenario 2 of IFRS 3).
  - In other cases, if the set of activities and assets **does not have outputs** (**ie an early-stage entity**)*, applying the rebuttable presumption would, in effect, force SMEs to apply **asset acquisition accounting**—which might not be the case (see Illustrative Examples, Example C of IFRS 3).
- It could be perceived as contradicting the focus-angle on the 'minimum requirements to be a business' as set out in paragraph BC21F of the Basis for Conclusions on IFRS 3**.
- It might lead to an inappropriate goodwill recognition outcome, leading to structuring opportunities.

* Paragraphs BC17–BC18 of the Basis for Conclusions on IFRS 3 explain that the IASB continue to **exclude** a presumption that an integrated set of activities and assets in the development stage that has not commenced planned principal operations cannot be a business.

** "The existence of a process (or processes) is what **distinguishes** a business from a set of activities and assets that is not a business…".

Question for SMEIG members

Q1 What are the views of SMEIG members on recommending to the IASB the introduction **a rebuttable presumption** (**as possible simplification**) for the assessment of a business, as set out in slides 11–12?

Guidance on reacquired rights

Paragraphs B36 and B53 of IFRS 3

Additional guidance on reacquired rights

Request for Information

As set out in paragraph B63 of the Request for Information, the IASB did not seek views on aligning Section 19 of the *IFRS for SMEs* Standard with the requirements in IFRS 3:

(a) …;
(b) …;
(c) …; and
(d) **providing additional guidance on reacquired rights**.

Although the IASB acknowledged that not aligning Section 19 with some parts of IFRS 3 would result in the *IFRS for SMEs* Standard diverging from the acquisition method of accounting it considered this approach struck a balance between simplicity and faithful representation.

The IASB reasoned that goodwill acquired in a business combination is amortised over its useful life applying the *IFRS for SMEs* Standard. Consequently, intangible assets acquired in the business combination that are not recognised separately are amortised through the annual amortisation of goodwill. Therefore, it is less critical to separately recognise intangible assets with finite useful lives.

Additional guidance on reacquired rights

Staff's proposal

The staff think that reacquired rights might be common amongst SMEs—for example, in the retail industry such rights include a right to use the acquirer's trade name under a franchise agreement.

The staff, therefore, note that particularly, as set out in paragraphs B36 and B53 of IFRS 3, if the terms of the contract giving rise to a reacquired right are **favourable** or **unfavourable** relative to the terms of current market transactions for the same or similar items, the acquirer shall recognise**, separately from the business combination, a settlement gain or loss**—to recognise settlement of pre-existing relationship. Paragraph B52 of IFRS 3 provides guidance for measuring that settlement gain or loss, including the Illustrative Examples paragraphs IE54–IE56 of IFRS 3.

In the staff's view, introducing this additional guidance—on reacquired rights, particularly the application guidance as set out in paragraphs B36 and B53 of IFRS 3—would provide users of SMEs' financial statements with an improved understanding of the cost of the business combination (**as such settlement gain or loss, if any, should be accounted for separately from the business combination**).

Question for SMEIG members

Q2 Do SMEIG members think reacquired rights are **relevant*** to business combination transactions undertaken by SMEs?

That is, should Section 19 include guidance on reacquired rights, particularly the application guidance as set out in paragraphs B36 and B53 of IFRS 3?

* As set out in paragraph 33 of the Request for Information, relevance to SMEs is determined by assessing whether the problem addressed by an IFRS Standard would make a difference in the decisions of users of financial statements prepared applying the *IFRS for SMEs* Standard.

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