Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard*

Section 19 *Business Combinations and Goodwill* without mark-up

Purpose of this document

On 8 September 2022, the International Accounting Standards Board (IASB) published Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard.*

The IASB is proposing amendments to Section 19 *Business Combinations and Goodwill* to align with the acquisition method of accounting in IFRS 3 *Business Combinations.* The text of Section 19 in the Exposure Draft is shown in mark-up, however, there are substantial changes to that text.

To facilitate readability of the IASB's proposals in Section 19 of the Exposure Draft this document sets out the proposed Section 19 without mark-up. The marked-up Section 19, as set out in the Exposure Draft, should always be cited as the primary source and the first document for reference.

Section 19
Business Combinations and Goodwill

Scope of this section

19.1 This section applies to a transaction or other event that meets the definition of a **business combination** (see paragraph 19.3). It establishes principles and requirements for how the **acquirer**:

(a) recognises and measures in its financial statements the identifiable **assets** acquired, the **liabilities** assumed and any **non-controlling interest** in the **acquiree**; and

(b) recognises and measures the **goodwill** acquired (both at the time of a business combination and subsequently) or a gain from a bargain purchase.

19.2 This section does not apply to:

(a) combinations of entities or **businesses** under common **control**. Common control means that all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

(b) formations of a **joint arrangement** in the financial statements of the joint arrangement itself.

(c) acquisitions of an asset or a group of assets that does not constitute a business.

Business combinations defined

19.2A An entity shall determine whether a transaction or other event is a business combination by applying the definition in paragraph 19.3, which requires that the assets acquired and the liabilities assumed constitute a business. If the assets acquired do not constitute a business, the **reporting entity** shall account for the transaction or other event as an asset acquisition. Paragraphs 19A.1–19A.10 provide guidance on the definition of a business.

19.3 A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses. An acquirer might obtain control of an acquiree in a variety of ways, for example:

(a) by transferring **cash, cash equivalents** or other assets (including net assets that constitute a business);

(b) by incurring liabilities;

(c) by issuing equity instruments; or

(d) by providing more than one type of consideration.

19.4 A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:

(a) one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;

(b) one combining entity transfers its net assets, or its **owners** transfer their equity instruments, to another combining entity or its owners;

(c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity; or

(d) a group of former owners of one of the combining entities obtains control of the combined entity.

19.5 [Deleted]

Accounting

19.6 An entity shall account for each business combination by applying the acquisition method.

19.7 Applying the acquisition method requires:

(a) identifying the acquirer;

(aa) determining the acquisition date;

(b) recognising and measuring identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and

(c) recognising and measuring goodwill or a gain from a bargain purchase.

Identifying the acquirer

19.8 For each business combination, one of the combining entities shall be identified as the acquirer.

19.9 The requirement in Section 9 *Consolidated and Separate Financial Statements* shall be used to identify the acquirer—that is, the entity that obtains control of the acquiree.

19.10 If a business combination has occurred but applying the requirements in Section 9 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs 19A.11–19A.15 shall be considered in making that determination.

Determining the acquisition date

19.10A The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Recognition principle

19.10B At the acquisition date, the acquirer shall recognise, separately from the goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree, if, and only if, the conditions in paragraph 19.10C are met.

19.10C To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must:

(a) meet the definitions of assets and liabilities in Section 2 *Concepts and Pervasive Principles* at the acquisition date; and

(b) be part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination transaction rather than the result of separate transactions (see paragraph 19.19A).

Measurement principle

19.10D The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.

19.10E For each business combination, the acquirer shall measure at the acquisition date any non-controlling interests in the acquiree at the non-controlling interest’s proportionate share of the recognised amounts of the acquiree’s identifiable net assets.

Exceptions to the recognition or measurement principles

19.10F Paragraphs 19.10G–19.10L provide exceptions to the recognition and measurement principles set out in paragraphs 19.10B–19.10E and specify both the particular items for which exceptions are provided and the nature of those exceptions.

19.10G In accordance with paragraph 18.8, an acquirer shall recognise an **intangible asset** acquired in a business combination, that meets the recognition principles set out in Section 18 *Intangible Assets other than Goodwill*, if its fair value can be measured reliably without undue cost or effort at the acquisition date.

19.10H For liabilities and **contingent liabilities** that would be within the scope of Section 21 *Provisions and Contingencies* if they were incurred separately rather than assumed in a business combination, an acquirer shall apply paragraph 21.6 to determine whether at the acquisition date a present obligation exists as a result of past events for a **provision** or contingent liability.

19.10I Paragraph 19.10J applies to a present obligation identified in accordance with paragraph 19.10H that meets the definition of a contingent liability as set out in paragraph 21.12 (that is, when it is a present obligation that exists but would not be recognised in accordance with Section 21 because it fails to meet one or both of the conditions (b) and (c) in paragraph 21.4).

19.10J At the acquisition date, the acquirer shall recognise a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to paragraphs 21.4(b) and 21.12, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that the acquirer will be required to transfer economic benefits in settlement.

19.10K A **deferred tax asset** or **deferred tax liability** arising from the assets acquired and liabilities assumed in a business combination shall be recognised and measured in accordance with Section 29 *Income Tax*.

19.10L A liability (or asset, if any) related to the acquiree's **employee benefit** arrangements shall be recognised and measured in accordance with Section 28 *Employee Benefits*.

Recognising and measuring goodwill or a gain from a bargain purchase

19.10M The acquirer shall recognise goodwill as of the acquisition date measured as the excess of (a) over (b) below:

(a) the aggregate of:

(i) the consideration transferred measured in accordance with paragraph 19.11, which generally requires acquisition-date fair value;

(ii) the amount of any non-controlling interest in the acquiree measured in accordance with paragraph 19.10E; and

(iii) in a business combination achieved in stages (see paragraphs 19.13B–19.13C), the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

(b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with paragraphs 19.10D–19.10L.

Bargain purchases (sometimes referred to as 'negative goodwill')

19.10N Occasionally, an acquirer will make a bargain purchase, which is a business combination in which the amount in paragraph 19.10M(b) exceeds the aggregate of the amounts specified in paragraph 19.10M(a). If that excess remains after applying paragraph 19.10O, the acquirer shall recognise the resulting gain in profit or loss on the acquisition date. The gain shall be attributed to the acquirer.

19.10O Before recognising a gain on a bargain purchase, the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognise any additional assets or liabilities that are identified in that reassessment. The acquirer shall then review the procedures used to measure the amounts required to be recognised at the acquisition date for all of the following:

(a) the identifiable assets acquired and the liabilities assumed;

(b) for a business combination achieved in stages, the acquirer's previously held equity interest in the acquiree; and

(c) the consideration transferred.

Consideration transferred

19.11 The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity instruments issued by the acquirer. Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, **contingent consideration**, ordinary or preference equity instruments, options and warrants.

Contingent consideration

19.12 The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement (see paragraph 19.11). The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree if it can be measured reliably.

19.13 However, if the acquisition-date fair value of contingent consideration cannot be measured reliably without undue cost or effort, the acquirer shall recognise, at the acquisition date, an estimate of the most likely amount of contingent consideration.

19.13A The acquirer shall classify an obligation to pay contingent consideration that meets the definition of a **financial instrument** as a **financial liability** or as **equity** on the basis of the definitions of an equity instrument and a financial liability in Section 22 *Liabilities and Equity*. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 19.23B provides guidance on the subsequent accounting for contingent consideration.

A business combination achieved in stages (so-called 'step acquisition')

19.13B An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. If this is the case, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss.

19.13C When a party to a joint arrangement obtains control of a business that is a jointly controlled operation or a jointly controlled asset immediately before the acquisition date, the transaction is a business combination achieved in stages. The acquirer shall therefore apply the requirements for a business combination achieved in stages, including remeasuring its entire previously held interest in the jointly controlled operation or the jointly controlled asset in accordance with paragraph 19.13B.

19.14 [Deleted]

19.15 [Deleted]

19.16 [Deleted]

19.17 [Deleted]

19.18 [Deleted]

Measurement period

19.19 If the initial accounting for a business combination is incomplete by the end of the **reporting period** in which the combination occurs, the acquirer shall recognise in its **financial statements** provisional amounts for the items for which the accounting is incomplete. Within twelve months after the acquisition date, the acquirer shall retrospectively adjust the provisional amounts recognised as assets and liabilities at the acquisition date (ie account for them as if they were made at the acquisition date) to reflect new information obtained about any relevant facts and circumstances that existed at the acquisition date. Any adjustments made will affect the goodwill acquired or a gain from a bargain purchase recognised. Beyond twelve months after the acquisition date, adjustments to the initial accounting for a business combination shall be recognised only to correct an **error** in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

Acquisition-related costs

19.19A Acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs are to be accounted for separately from the business combination. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception: the cost to issue debt or equity securities shall be recognised in accordance with Section 11 and Section 22, respectively.

Subsequent measurement and accounting

19.19B In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination in accordance with the applicable sections of this Standard. However, paragraphs 19.23–19.23B provide guidance on subsequently measuring and accounting for:

(a) goodwill;

(b) contingent liabilities recognised as of the acquisition date; and

(c) contingent consideration.

19.20 [Deleted]

19.21 [Deleted]

Goodwill

19.22 [Deleted]

19.23 After its initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less accumulated **amortisation** and accumulated **impairment losses**:

(a) the acquirer shall follow the principles in paragraphs 18.19–18.24 for amortisation of goodwill. If the **useful life** of goodwill cannot be established reliably, the life shall be determined based on management's best estimate but shall not exceed ten years.

(b) the acquirer_shall follow Section 27 *Impairment of Assets* for recognising and measuring the impairment of goodwill.

Contingent liabilities

19.23A After their initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognised in a business combination at the higher of:

(a) the amount that would be recognised in accordance with Section 21; and

(b) the amount initially recognised less, if appropriate, the cumulative amount of **income** recognised in accordance with the principles of Section 23 *Revenue from Contracts with Customers*.

Contingent consideration

19.23B Except for those changes in the amount of contingent consideration that are measurement period adjustments in accordance with paragraph 19.19, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the amount of contingent consideration that are not measurement period adjustments as follows:

(a) contingent consideration classified as equity shall not be remeasured and its subsequent settlement shall be accounted for within equity.

(b) other contingent consideration that:

(i) is within the scope of Part II of Section 11 *Other Financial Instrument Issues* (whose fair value can be measured reliably without undue cost or effort) shall be measured at fair value at each reporting date with changes in fair value recognised in profit or loss.

(ii) is not within the scope of Part II of Section 11 (whose fair value cannot be measured reliably without undue cost or effort (see paragraph 19.13)) shall be reviewed at each reporting date and adjusted to reflect the current estimate of the most likely amount of the contingent consideration at that reporting date. Any adjustments to the amounts previously recognised shall be recognised in profit or loss.

19.24 [Deleted]

Disclosures

For business combination(s) during the reporting period

19.25 For each business combination during the period, the acquirer shall disclose the following:

(a) the name and description of the acquiree;

(b) the acquisition date;

(c) the percentage of voting equity instruments acquired;

(d) the acquisition-date fair value of the total consideration transferred and a description of the components of that consideration (such as cash, equity instruments and debt instruments);

(da) for contingent consideration arrangements:

(i) the amount recognised as of the acquisition date;

(ii) a description of the arrangement and the basis for determining the amount of the payment; and

(iii) if the acquisition-date fair value of contingent consideration cannot be measured reliably without undue cost or effort (see paragraph 19.13), at the acquisition date, the acquirer shall disclose that fact and the reasons why a reliable fair value measurement would involve undue cost or effort;

(e) the amounts recognised at the acquisition date for each class of the acquiree's assets and liabilities;

(f) for a bargain purchase, the amount of any gain recognised in profit or loss in accordance with paragraph 19.10N and the line item in the statement of comprehensive income (and in the **income statement**, if presented) in which the gain is recognised;

(g) a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets not recognised in accordance with paragraph 19.10G or other factors; and

(h) for each contingent liability that is not recognised in accordance with paragraph 19.10J because its fair value cannot be measured reliably, the acquirer shall disclose the information required by paragraph 21.15.

For all business combinations

19.26 An acquirer shall disclose the useful lives used for goodwill and a reconciliation of the **carrying amount** of goodwill at the beginning and end of the reporting period. The reconciliation should show separately:

(a) additional goodwill recognised during the reporting period arising from new business combinations;

(b) impairment losses recognised during the reporting period applying Section 27;

(c) goodwill relating to previously acquired businesses derecognised during the reporting period; and

(d) other changes.

This reconciliation need not be presented for prior periods.

For each reporting period after the acquisition date

19.26A For each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires, the entity shall disclose for each material business combination and in aggregate for individually immaterial business combinations that are material collectively:

(a) any changes in the recognised amounts, including any differences arising upon settlement; and

(b) the valuation techniques and key model inputs used to measure contingent consideration.

Appendix A to Section 19
Application guidance

This application guidance is an integral part of Section 19.

Definition of a business (application of paragraph 19.2A)

19A.1 A business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. The three elements of a business are defined as follows:

(a) input: any economic resource that creates outputs, or has the ability to contribute to the creation of outputs when one or more processes are applied to it. Examples include non-current 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 outputs or has the ability to contribute to the creation of outputs. Examples include strategic management processes, operational processes and resource management processes.

(c) output: the result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income or generate other income from ordinary activities.

Optional test to identify concentration of fair value

19A.2 Paragraph 19A.3 sets out an optional concentration test to permit a simplified assessment of whether an acquired set of activities and assets is not a business. An entity may elect to apply, or not apply, the test. An entity may make such an election separately for each transaction or other event. The concentration test has the following consequences:

(a) if the concentration test is met, the set of activities and assets is determined not to be a business and no further assessment is needed.

(b) if the concentration test is not met, or if the entity elects not to apply the test, the entity shall then perform the assessment set out in paragraphs 19A.4–19A.10.

19A.3 The concentration test is met if substantially all of the fair value of the gross assets (not net assets) acquired is concentrated in a single identifiable asset or group of similar identifiable assets. For the concentration test:

(a) gross assets acquired shall exclude cash and cash equivalents, deferred tax assets, and goodwill resulting from the effects of deferred tax liabilities;

(b) the fair value of the gross assets acquired shall include any consideration transferred (plus the non-controlling interest's proportionate share in the recognised amounts of the acquiree's net identifiable assets and the fair value of any previously held interest) in excess of the fair value of net identifiable assets acquired;

(c) a single identifiable asset shall include any asset or group of assets that would be recognised and measured as a single identifiable asset in a business combination;

(d) if a tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset, without incurring significant cost, or significant diminution in utility or fair value to either asset (for example, land and buildings), those assets shall be considered a single identifiable asset; and

(e) when assessing whether assets are similar, an entity shall consider the nature of each single identifiable asset and the risks associated with managing and creating outputs from the assets (that is, the risk characteristics).

Elements of a business

19A.4 Although businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as a business. To be capable of being conducted and managed for the purpose identified in the definition of a business, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs. A business need not include all of the inputs or processes that the seller used in operating that business. However, to be considered a business, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. Paragraphs 19A.7–19A.10 specify how to assess whether a process is substantive.

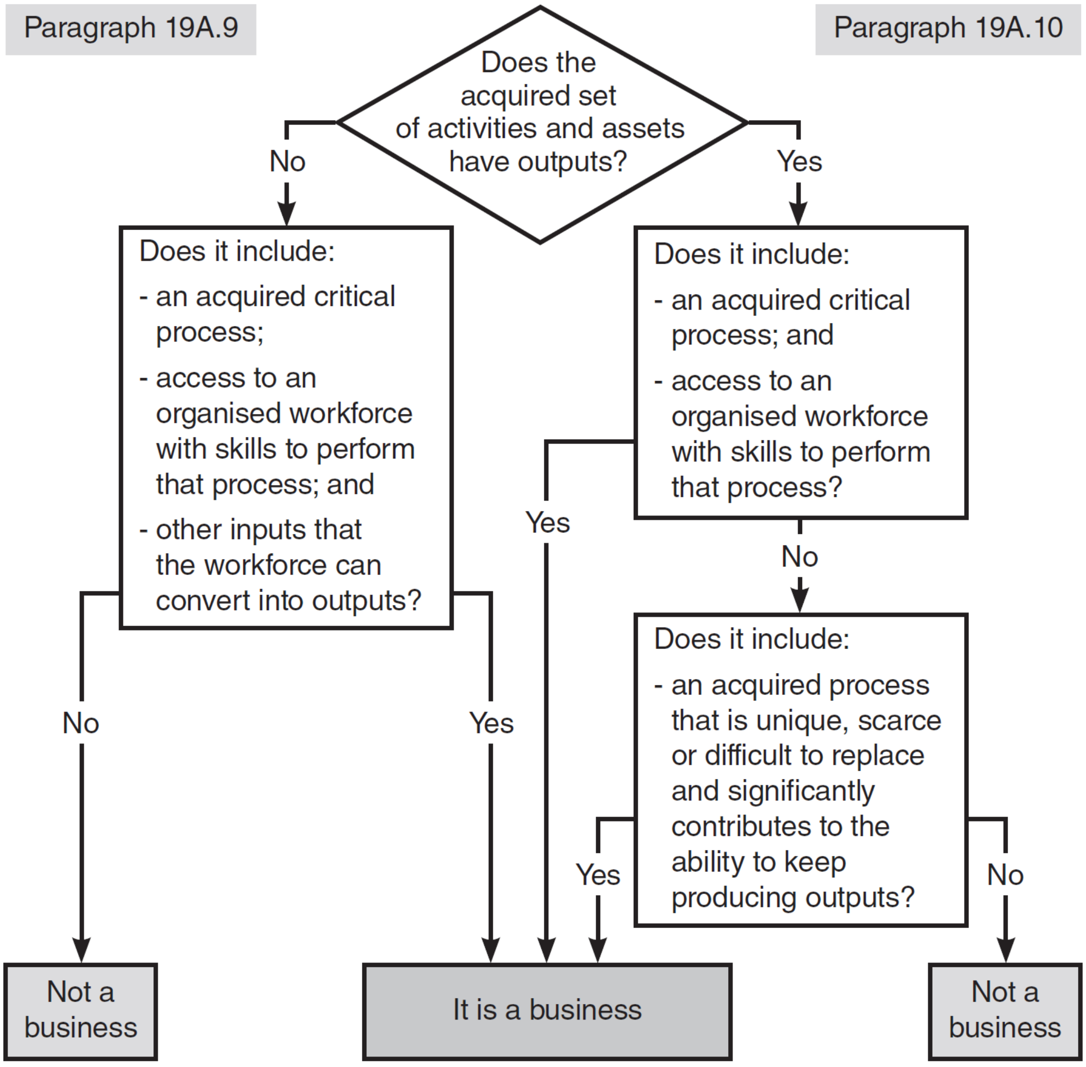
19A.5 If an acquired set of activities and assets has outputs, continuation of revenue does not on its own indicate that both an input and a substantive process have been acquired.

19A.6 Determining whether a particular set of activities and assets is a business shall be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. 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.

Assessing whether an acquired process is substantive

19A.7 Paragraphs 19A.8–19A.10 explain how to assess whether an acquired process is substantive if the acquired set of activities and assets does not have outputs (paragraph 19A.9) and if it does have outputs (paragraph 19A.10). Diagram 19.1 summarises how an entity assesses whether an acquired process is substantive.

Diagram 19.1: How an entity assesses whether an acquired process is substantive



19A.8 An example of an acquired set of activities and assets that does not have outputs at the acquisition date is an early-stage entity that has not started generating revenue. Moreover, if an acquired set of activities and assets was generating revenue at the acquisition date, it is considered to have outputs at that date, even if subsequently it will no longer generate revenue from external customers, for example because it will be integrated by the acquirer.

19A.9 If a set of activities and assets does not have outputs at the acquisition date, an acquired process (or group of processes) shall be considered substantive only if:

(a) it is critical to the ability to develop or convert an acquired input or inputs into outputs; and

(b) the inputs acquired include both an organised workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) and other inputs that the organised workforce could develop or convert into outputs. Those other inputs could include:

  (i) intellectual property that could be used to develop a good or service;

  (ii) other economic resources that could be developed to create outputs; or

  (iii) rights to obtain access to necessary materials or rights that enable the creation of future outputs.

Examples of the inputs mentioned in (b)(i)–(iii) include technology, in-process research and development projects, and real estate.

19A.10 If a set of activities and assets has outputs at the acquisition date, an acquired process (or group of processes) shall be considered substantive if, when applied to an acquired input or inputs, it:

(a) is critical to the ability to continue producing outputs, and the inputs acquired include an organised workforce with the necessary skills, knowledge or experience to perform that process (or group of processes); or

(b) significantly contributes to the ability to continue producing outputs and:

  (i) is considered unique or scarce; or

  (ii) cannot be replaced without significant cost, effort or delay in the ability to continue producing outputs.

Identifying the acquirer (application of paragraphs 19.8–19.10)

19A.11 In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

19A.12 In a business combination effected primarily by exchanging equity instruments, the acquirer is usually the entity that issues its equity instruments. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity instruments. For example, the acquirer is usually the combining entity:

(a) whose owners as a group retain or receive the largest portion of the voting rights in the combined entity, after the business combination;

(b) whose single owner or organised group of owners holds the largest minority voting interest in the combined entity, if no other owner or organised group of owners has a significant voting interest;

(c) whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity;

(d) whose (former) management dominates the senior management of the combined entity; and

(e) that pays a premium over the pre-combination fair value of the equity instruments of the other combining entity or entities.

19A.13 The acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.

19A.14 In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.

19A.15 A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraph 19.10 and paragraphs 19A.11–19A.14. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

Appendix B to Section 19
Illustrative examples

The examples accompany, but are not part of, Section 19. They illustrate application of the guidance in paragraphs 19A.1–19A.10.

Definition of a business (application of paragraph 19.2A)

Example A—acquisition of real estate

Scenario 1—Background

19B.1 An entity (Purchaser) purchases a portfolio of 10 single-family homes that each have an in-place lease. The fair value of the consideration paid is equal to the aggregate fair value of the 10 single-family homes acquired. Each single-family home includes the land, building and property improvements. Each home has a different floor area and interior design. The 10 single-family homes are located in the same area and the classes of customers (for example, tenants) are similar. The risks associated with operating in the real estate market of the homes acquired are not significantly different. No employees, other assets, processes or other activities are transferred.

Scenario 1—Application of requirements

19B.2 Purchaser elects to apply the optional concentration test set out in paragraph 19A.3 and concludes that:

(a) each single-family home is considered a single identifiable asset in accordance with paragraph 19A.3 for the following reasons:

(i) the building and property improvements are attached to the land and cannot be removed without incurring significant cost; and

(ii) the building and the in-place lease are considered a single identifiable asset, because they would be recognised and measured as a single identifiable asset in a business combination.

(b) the group of 10 single-family homes is a group of similar identifiable assets because the assets (all single-family homes) are similar in nature and the risks associated with managing and creating outputs are not significantly different. This is because the types of homes and classes of customers are not significantly different.

(c) consequently, substantially all of the fair value of the gross assets acquired is concentrated in a group of similar identifiable assets.

19B.3 Therefore, Purchaser concludes that the acquired set of activities and assets is not a business.

Scenario 2—Background

19B.4 Assume the same facts as in Scenario 1 except that Purchaser also purchases a multi-tenant corporate office park with six 10-storey office buildings that are fully leased. The additional set of activities and assets acquired includes the land, buildings, leases and contracts for outsourced cleaning, security and maintenance. No employees, other assets, other processes or other activities are transferred. The aggregate fair value associated with the office park is similar to the aggregate fair value associated with the 10 single-family homes. The processes performed through the contracts for outsourced cleaning and security are ancillary or minor within the context of all the processes required to create outputs.

Scenario 2—Application of requirements

19B.5 Purchaser elects to apply the optional concentration test set out in paragraph 19A.3 and concludes that the single-family homes and the office park are not similar identifiable assets, because the single-family homes and the office park differ significantly in the risks associated with operating the assets, obtaining tenants and managing tenants. In particular, the scale of operations and risks associated with the two classes of customers are significantly different. Consequently, the fair value of the gross assets acquired is not substantially all concentrated in a group of similar identifiable assets, because the fair value of the office park is similar to the aggregate fair value of the 10 single-family homes. Thus Purchaser assesses whether the set meets the minimum requirements to be considered a business in accordance with paragraphs 19A.4–19A.10.

19B.6 The set of activities and assets has outputs because it generates revenue through the in-place leases. Consequently, Purchaser applies the criteria in paragraph 19A.10 to determine whether any processes acquired are substantive.

19B.7 Purchaser concludes that the criterion in paragraph 19A.10(a) is not met because:

(a) the set does not include an organised workforce; and

(b) Purchaser considers that the processes performed by the outsourced cleaning, security and maintenance personnel (the only processes acquired) are ancillary or minor within the context of all the processes required to create outputs and, therefore, are not critical to the ability to continue producing outputs.

19B.8 After considering the only processes acquired, those performed by the outsourced cleaning, security and maintenance personnel, Purchaser also concludes that the criteria in paragraph 19A.10(b) are not met. Either of the following reasons justifies that conclusion:

(a) the processes do not significantly contribute to the ability to continue producing outputs.

(b) the processes are readily accessible in the marketplace. Thus, they are not unique or scarce. In addition, they could be replaced without significant cost, effort or delay in the ability to continue producing outputs.

19B.9 Because none of the criteria in paragraph 19A.10 is met, Purchaser concludes that the acquired set of activities and assets is not a business.

Scenario 3—Background

19B.10 Assume the same facts as in Scenario 2, except that the acquired set of activities and assets also includes the employees responsible for leasing, tenant management, and managing and supervising all operational processes.

Scenario 3—Application of requirements

19B.11 Purchaser elects not to apply the optional concentration test set out in paragraph 19A.3 and therefore assesses whether the set meets the minimum requirements to be considered a business in accordance with paragraphs 19A.4–19A.10.

19B.12 The acquired set of activities and assets has outputs because it generates revenue through the in-place leases. Consequently, Purchaser applies the criteria in paragraph 19A.10.

19B.13 Purchaser concludes that the criterion in paragraph 19A.10(a) is met because the set includes an organised workforce with the necessary skills, knowledge or experience to perform processes (that is, leasing, tenant management, and managing and supervising the operational processes) that are substantive because they are critical to the ability to continue producing outputs when applied to the acquired inputs (that is, the land, buildings and in-place leases). Furthermore, Purchaser concludes that the criterion in paragraph 19A.4 is met because those substantive processes and inputs together significantly contribute to the ability to create output. Consequently, Purchaser concludes that the acquired set of activities and assets is a business.

Example B—acquisition of a drug candidate

Scenario 1—Background

19B.14 An entity (Purchaser) purchases a legal entity that contains:

(a) the rights to an in-process research and development project that is developing a compound to treat diabetes and is in its final testing phase (Project 1). Project 1 includes the historical know-how, formula protocols, designs and procedures expected to be needed to complete the final testing phase.

(b) a contract that provides outsourced clinical trials. The contract is priced at current market rates and a number of vendors in the marketplace could provide the same services. Therefore, the fair value associated with this contract is nil. Purchaser has no option to renew the contract.

No employees, other assets, other processes or other activities are transferred.

Scenario 1—Application of requirements

19B.15 Purchaser elects to apply the optional concentration test set out in paragraph 19A.3 and concludes that:

(a) Project 1 is a single identifiable asset because it would be recognised and measured as a single identifiable intangible asset in a business combination; and

(b) because the acquired contract has a fair value of nil, substantially all of the fair value of the gross assets acquired is concentrated in Project 1.

19B.16 Consequently, Purchaser concludes that the acquired set of activities and assets is not a business.

Scenario 2—Background

19B.17 Assume the same facts as in Scenario 1 except that the acquired set of activities and assets also includes another in-process research and development project that is developing a compound to treat Alzheimer's disease and is in its final testing phase (Project 2). Project 2 includes the historical know-how, formula protocols, designs and procedures expected to be needed to complete the final phase of testing. The fair value associated with Project 2 is similar to the fair value associated with Project 1. No employees, other assets, processes or other activities are transferred.

Scenario 2—Application of requirements

19B.18 Purchaser elects to apply the optional concentration test set out in paragraph 19A.3 and concludes that:

(a) Project 1 and Project 2 are identifiable intangible assets that would each be recognised and measured as a separate identifiable asset in a business combination.

(b) Project 1 and Project 2 are not similar identifiable assets because significantly different risks are associated with managing and creating outputs from each asset. Each project has significantly different risks associated with developing, completing and marketing the compound to customers. The compounds are intended to treat significantly different medical conditions, and each project has a significantly different potential customer base.

(c) consequently, the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets. Therefore, Purchaser assesses whether the set meets the minimum requirements to be considered a business in accordance with paragraphs 19A.4–19A.10.

19B.19 The acquired set of activities and assets does not have outputs because it has not started generating revenue. Thus, Purchaser applies the criteria in paragraph 19A.9. Purchaser concludes that those criteria are not met for the following reasons:

(a) the set does not include an organised workforce; and

(b) although the contract that provides outsourced clinical trials might give access to an organised workforce that has the necessary skills, knowledge or experience to perform processes needed to carry out the clinical trials, that organised workforce cannot develop or convert the inputs acquired by Purchaser into outputs. Successful clinical trials are a pre-condition for producing output, but carrying out those trials will not develop or convert the acquired inputs into outputs.

Consequently, Purchaser concludes that the acquired set of activities and assets is not a business.