

Definition of a Business (Proposed amendments to IFRS 3 *Business Combinations*)

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Before we start...

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1. What is the problem?
2. Our proposed solutions, which include:
 - clarifying the requirements to be a business.
 - narrowing the definition of outputs.
 - introducing new assessments to simplify applying IFRS 3:
 - evaluating the concentration of fair value; and
 - evaluating whether an acquired process is substantive.
 - adding guidance on evaluating whether a substantive process has been acquired through an outsourced workforce.
 - supplying new illustrative examples.

What is the problem?

- The challenge of applying the definition of a business is a primary concern with IFRS 3 raised in the post-implementation review (PIR):
 - the definition of a business is broad;
 - preparers have difficulty assessing the relevance of processes acquired;
 - applying the definition of a business is especially challenging when the entity acquired generates no revenue;
 - the Standard provides little or no guidance on when a set of assets does not constitute a business; and
 - the Standard does not define the term ‘market participant’.

Clarify the requirements to be a business

- An acquisition must include an **input** and a **substantive process** that together **contribute** to the entity's ability to create outputs.
- The term '**contribute**' means that to be defined as a business, the set of assets acquired need not include all inputs and processes necessary for creating outputs.
- A **market participant's ability** to integrate the acquired set of assets would **no longer be a consideration** in determining whether the set is a business.

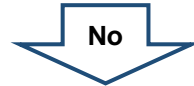
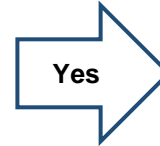
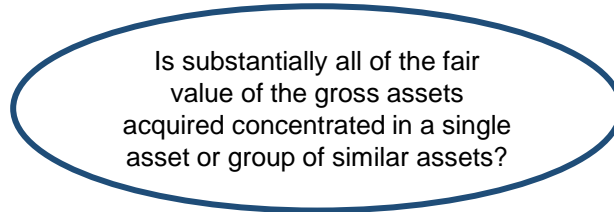
Narrow the definition of outputs

- The new definition of outputs:
 - focuses on goods and services provided to customers (like IFRS 15 *Revenue from Contracts with Customers*);
 - includes investment income and other revenue;
 - excludes other economic benefits provided to investors, other owners, members or participants;
 - excludes returns in the form of lower costs.

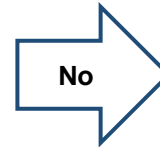
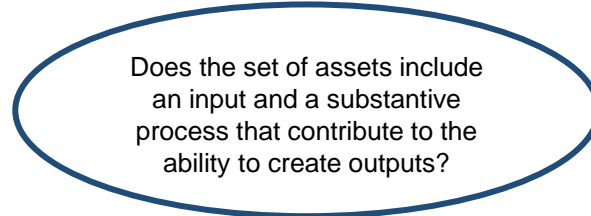
Our proposed solutions

New assessments to simplify applying IFRS 3

Assessment 1:
Evaluate
concentration of fair
value



Assessment 2:
Evaluate whether an
acquired process is
substantive



Assessment 1—evaluate the concentration of fair value

- Is substantially all of the **fair value** of the gross assets acquired **concentrated** in a single asset or group of similar assets?
- Why evaluate the concentration of fair value?
 - a substantive process is likely to have more than an insignificant fair value.
 - if substantially all of the fair value of the gross assets acquired is concentrated in a single asset, or group of similar assets, it is unlikely that a substantive process has been acquired.
- The more difficult assessment of whether a process is substantive is performed only when fair value is not concentrated in a single asset or group of similar assets.

Assessment 1—evaluate the concentration of fair value

- **Gross assets acquired** include any acquired input, contract, process, workforce and any other intangible asset that is not identifiable.
- The **fair value** of the **gross assets acquired** may be determined by adding the fair value of the **liabilities assumed** to the fair value of the **consideration paid**.

Assessment 1—evaluate the concentration of fair value

Single asset:

- any items that would be recognised as a single asset in a business combination; and
- a tangible asset that cannot be physically removed and used separately from other tangible assets.

The following are not groups of similar assets:

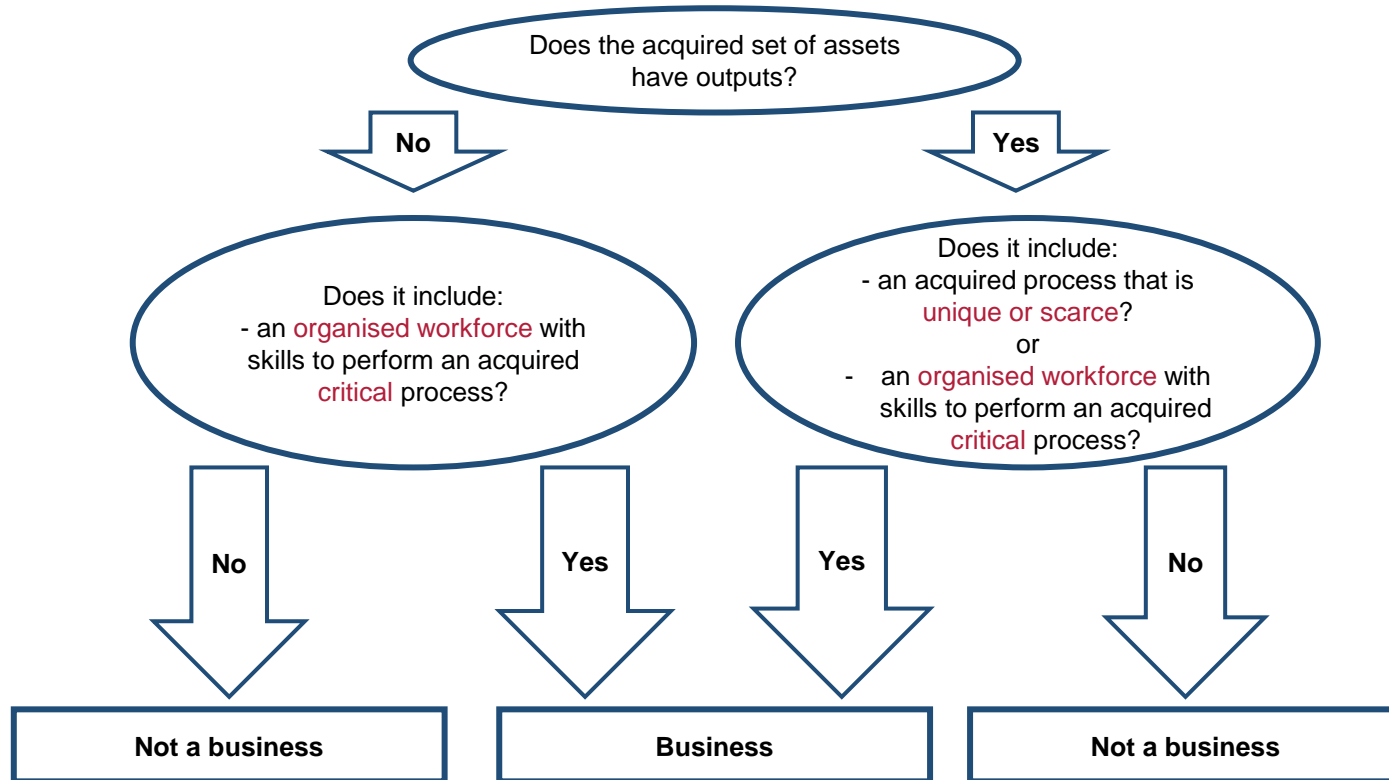
- tangible and intangible assets;
- different classes of tangible assets;
- different classes of intangible assets;
- financial assets and non-financial assets; and
- different classes of financial assets.

Assessment 2—evaluate whether an acquired process is substantive

- Does the set of assets include an input and a **substantive process** that contributes to the ability to create outputs?
- Why provide guidance on evaluating whether an acquired process is substantive?
 - acquiring a substantive process that contributes to the ability to create outputs is necessary for a transaction to be a business combination.
 - assessing whether such a process has been acquired is one of the main challenges in applying the definition of a business.

Our proposed solutions

Assessment 2—evaluate whether an acquired process is substantive



Our proposed solutions

Assessment 2—evaluate whether an acquired process is substantive

- If the set **does not have outputs**, the set is a business only if it includes:
 - an organised **workforce** with the necessary skills to perform an acquired substantive process; **and**
 - the acquired **substantive process** that is **critical to converting** another **acquired input** into outputs.
- A process is not **critical** if it is ancillary or minor within the context of all the processes required to create outputs.
- **Inputs** that the workforce can convert into outputs include:
 - intellectual property;
 - other economic resources that can be developed to create outputs;
 - rights to access materials that allow the creation of outputs.

Assessment 2—evaluate whether an acquired process is substantive

- If the set **has outputs**, the set is a business if it includes:
 - an organised **workforce** with the necessary skills to perform an acquired process that is **critical** to continue producing outputs; **or**
 - a **process**:
 - that contributes to the ability to continue producing outputs; and
 - is **unique or scarce, or cannot be replaced** without significant cost, effort, or delay in the ability to continue producing outputs (ie a workforce is not required)

Assessment 2—evaluate whether an acquired process is substantive

- An acquired process that contributes to the ability to produce outputs can be substantive if:
 - it is **unique** or **scarce**; or
 - it is **critical** to the creation of outputs.
- A **unique** or **scarce** process:
 - one that cannot be replaced without significant cost, effort or delay in the ability to continue producing outputs.
 - usually has significant value, indicating the process is substantive.
- A process is not **critical** if it is ancillary or minor within the context of all processes required to create outputs.
 - a critical process might not be unique or scarce, therefore might not have significant fair value.

Guidance on evaluating whether a substantive process has been acquired through an outsourced workforce

- An entity may purchase a contract that gives it access to an outsourced workforce.
 - The outsourced workforce may perform a substantive process—even though the contract itself is not a substantive process.
- An entity should assess whether the contract for the outsourced workforce gives it control of such a substantive process, that is, whether it has acquired the substantive process.
 - In assessing whether it controls the substantive process, the entity should consider the duration and renewal terms of the contract.

Our proposed solutions

Add examples

- The Exposure Draft includes 11 examples to illustrate the proposed guidance.
- The examples cover different industries, including:
 - real estate
 - pharmaceutical
 - broadcasting
 - manufacturing
 - technology
 - oil & gas
 - banking

- The Exposure Draft can be accessed at:
<http://go.ifrs.org/proposed-amendments-ifs3-ifs11>
- More information can be obtained from the project page:
<http://go.ifrs.org/definition-of-a-business>
- The deadline for comments on the Exposure Draft is **31 October 2016**.

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