Definition of a Business (Proposed amendments to IFRS 3 Business Combinations)
Before we start…

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• The views expressed are those of the presenters, not of the Board or IFRS Foundation
Session overview

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’.
Our proposed solutions

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.
Our proposed solutions

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
Is substantially all of the fair value of the gross assets acquired concentrated in a single asset or group of similar assets?
Yes
Not a business
No

Assessment 2: Evaluate whether an acquired process is substantive
Does the set of assets include an input and a substantive process that contribute to the ability to create outputs?
Yes
Business
No
Not a business
Our proposed solutions

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.
Our proposed solutions

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.
Our proposed solutions

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.
Our proposed solutions

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.
Assessment 2—evaluate whether an acquired process is substantive

- Does the acquired set of assets have outputs?
  - No
    - Does it include:
      - an organised workforce with skills to perform an acquired critical process?
        - No
          - Not a business
        - Yes
          - Business
  - Yes
    - Does it include:
      - an acquired process that is unique or scarce?
        - Yes
          - Business
        - No
          - Not a business
      - or
        - an organised workforce with skills to perform an acquired critical process?
          - Yes
            - Business
          - No
            - Not a business
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.
Our proposed solutions

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)
Our proposed solutions

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.
Our proposed solutions

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
Further information

• The Exposure Draft can be accessed at: http://go.ifrs.org/proposed-amendments-ifrs3-ifrs11

• 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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