



Project:	Definition of a Business	Meeting	November 2018 (M168)
Topic:	Consider how to finalise ED 275	Agenda Item:	11.1
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Objective of this paper

- 1 The objective of this paper is for the Board to decide on whether to vote out-of-session on the Australian-equivalent of the recent IFRS Standard *Definition of a Business (Amendments to IFRS 3)*, which was released by the IASB in October 2018.

Reasons for bringing this paper to the Board

- 2 The IASB has issued amendments to IFRS 3 *Business Combinations* finalising its Definition of a Business project. In accordance with the Board's policy to issue Australian-equivalent IFRS Standards within 2 months of issuance, the Board will be required to vote on the Standard before the next Board meeting. Staff were unable to obtain a copy of the word version of the IFRS Standard in time to present a Ballot draft of the Australian equivalent Standard for the Board to vote at this meeting, however Staff considered that the Board could still consider the amendments that the Board would vote on out-of session and the extent to which the amendments are different from the IASB ED/2016/1 *Definition of a Business and Accounting for Previously Held Interests* (issued in June 2016). Staff expect to provide the Board with the ballot draft of the AASB equivalent Standard out-of-session within by the end of November 2018.

Summary of staff recommendations

- 3 Staff recommend that the Board approves the ballot draft of the Australian equivalent Standard incorporating the IASB amending Standard *Definition of a Business (Amendments to IFRS 3)*, when it is provided to the Board for voting out of session.

Attachments

- 11.2 IASB Amending Standard *Definition of a Business (Amendments to IFRS 3)*

Background

- 4 AASB ED 275 incorporated IASB ED/2016/1 *Definition of a Business and Accounting for Previously Held Interests* (issued in June 2016), which included proposed amendments to IFRS 3 *Business Combinations* and IFRS 11 *Joint Arrangements* to clarify:
 - (a) the definition of a business and the related application guidance; and
 - (b) the accounting for previously held interests in particular situations¹.
- 5 The IFRS Standard *Definition of a Business* issued by the IASB in October 2018 only deals with the clarification relating to part (a) above.

Summary of feedback received on the ED and the IASB's response

- 6 The AASB decided at its August 2016 meeting not to make a submission to the IASB on ED/2016/1, generally agreeing with the proposed amendments.
- 7 The AASB received one Australian-specific comment letter on ED 275, from The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)². HoTARAC broadly agreed with and supported the proposed amendments to the definition of business, however, noted that the new definition might need an amendment or implementation guidance for the application to the not-for-profit public sector. This is addressed further in paragraphs 18-21.
- 8 The IASB received 80 comment letters on ED/2016/1 from its worldwide constituents³, of which two of the submissions were from Australia – CPA Australia and The Group of 100. Both organisations supported the proposed amendments overall, however CPA Australia highlighted some issues, as noted in paragraphs 10-15 below.
- 9 The IASB considered the comments received on ED/2016/1 at its February, April, June and October 2017 meetings. Overall, the proposals were supported by most respondents and no substantial issues were identified⁴. Some smaller issues were raised and addressed by the IASB, as listed in paragraphs 10-17 below, however as noted in the IASB's assessment of its due process, no substantial changes were made between the ED and the final Standard.

¹ The IASB (and subsequently the AASB) has finalised the proposals relating the accounting for previously held interests in AASB 2018-1 *Amendments to Australian Accounting Standards – Annual Improvements 2015–2017 Cycle*. Those proposals are not addressed in this agenda item.

² The comment letters on ED 275 are available on the [AASB's website](#).

³ The comment letters on IASB ED/2016/1 are available on the [IFRS Foundation's website](#).

⁴ The summary of the comments received is available on the [IFRS Foundation's website](#).

Specific issues considered by the IASB

- 10 *The proposed amendments to the definition of a business.* Most respondents agreed with the proposed amendments in IFRS 3, saying that the proposed amendments would improve the definition of business.
- 11 *Assessment of concentration of fair value (the screening test).* The IASB proposed that a set of activities and assets should be considered not to be a business if, at the transaction date, substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar assets. Most respondents agreed with the proposal. However, some respondents, including CPA Australia, requested clarifications on the proposed screening test, and noted that the screening test seemed rule based which might cause inappropriate conclusions. In response to these comments, the IASB decided to:
- (a) make the screening test optional and determinative (ie if the screening test identifies an asset purchase, no other consideration is required); and
 - (b) provide clarifications on various aspects of the test, including when assets are 'similar' for the purpose of the test.
- 12 *Evaluating whether an acquired process is substantive.* The IASB proposed to add guidance to assist entities to decide if a process that has been acquired is substantive, instead of developing a single definition of what substantive process is. Most respondents supported this, however, many of them asked for additional clarifications. Some respondents suggested the board simplify the guidance and provide additional examples. In response, the IASB decided to provide clarifications on its original decisions, and also decided to remove the existing statement that a set of assets and activities in which goodwill is present is presumed to be a business, to allow a more principles based approach.
- 13 *Clarifying the illustrative examples.* Most respondents supported the illustrative examples and noted that it helped with the interpretation of what is considered a business. However, some respondents and some ASAF members suggested that the examples could be improved and clarified. In response, the IASB clarified and added an additional example on outsourcing agreements, but did not change the conclusions reached in the examples.
- 14 *Convergence with FASB proposals.* Given that IFRS 3 was the result of a joint project between the IASB and the Financial Accounting Standards Board (FASB), and similar issues were being raised about the definition of a business in the respective jurisdictions, the two Boards were encouraged by most of the respondents and ASAF members to reach a joined solution wherever possible on their respective proposed amendments, to ensure there was no divergence in practice between the jurisdictions. In the final Standards the FASB and the IASB definitions do differ slightly, however both definitions were based on conclusions similar to each other, and the IASB and FASB expect their respective amendments will lead to more consistency overall.

- 15 *Definition of an output.* CPA Australia raised a concern that the proposed definition of outputs did not include cost reductions and other efficiencies. The IASB considered this comment, however the IASB decided not to include these within the final definition, as it felt that many asset purchases (eg the purchase of new equipment) may lower costs even though they do not involve the acquisition of activities and processes. Thus, the IASB noted that including cost reductions might cause confusion in the distinction.

Other issues raised by Australian constituents but not addressed by the IASB

- 16 CPA Australia also raised the following points that were not addressed by the IASB Staff or IASB Board in finalising the proposals:
- (a) It is not clear what fair value measurement criteria will apply to non-identifiable assets that are part of the gross assets, as CPA Australia does not believe the IFRS 13 *Fair Value Measurement* requirements apply in these circumstances. Further guidance to assist with this determination was suggested.
 - (b) the fair value of the gross assets can be determined by adding the fair value of the liabilities acquired to the fair value of the consideration paid. In our view, this alternative can prove problematic in the case of bargain purchases. We suggest the IASB develops and includes further guidance that adequately applies the criteria in bargain purchase scenarios.
 - (c) The existence of an organised workforce is part of the proposed assessment criteria for determining whether the acquisition is a business. Operations that are entirely or substantially automated and operations that are entirely technology based may not always have an organised workforce as envisaged. We recommend introducing further guidance that addresses these possibilities.
- 17 Staff do not consider that the additional issues raised by CPA Australia require further consideration or action by the Board in accordance with the Standard-Setting Framework. Staff note that:
- (a) the comments were sent directly to the IASB, which was subject to the due process of the IASB;
 - (b) the issues are not Australian-specific;
 - (c) the issues do not appear to be substantive issues, thus the costs of non-compliance with IFRS Standards would likely far outweigh the Board considering the issues further.

Australian-specific issue

- 18 In its comment letter to the AASB on ED 275, HoTARAC noted its view that the revised definition of a business would require Australian-specific amendment or guidance. The reason for this was:
- (a) the current definition of structures of administrative arrangements in AASB 1004 *Contributions* refers to the definition of a business; and
 - (b) the proposed guidance on the meaning of ‘output’⁵ (which is a component of the definition of a business) removed the reference to outputs providing ‘economic benefits’.
- 19 Although not specified in the submission, Staff understand that HoTARAC was concerned that the narrower view of an output (ie to provide goods or services, investment income or other revenues) might cause issues for the NFP and public sector, should the reference to revenues be read to mean revenue within the scope of AASB 15 *Revenue from Contracts with Customers*, because NFP and public sector entities often produce outputs that provide economic benefits beyond this scope.

Staff recommendation

- 20 Staff do not consider this to be an issue because the definition of revenue (as defined in AASB 15 *Revenue from Contracts with Customers*) refers to income, which includes other economic benefits within its definition⁶. Staff also note that the IASB’s reference to ‘other revenues’ is was not intended to capture only revenues within the scope of AASB 15, but rather any other income from ordinary activities.
- 21 The IASB has also clarified the revised guidance to refer to ‘other income’ rather than ‘other revenue’, which Staff consider will alleviate any ambiguity over whether the reference to revenue was intended to mean revenue within the scope of AASB 15.

New Zealand Accounting Standards Board (NZASB)

- 22 The NZASB staff will be seeking approval of the IASB amending standard *Definition of a Business* at the NZASB December meeting. At the time of finalising this Board paper, AASB Staff are not aware of any issues that the NZASB Staff will be raising with their Board. AASB Staff understand that NZASB staff will recommend to the NZASB members to vote on the Standard.

⁵ ED 275 proposed the following amendment to the guidance on ‘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.

⁶ AASB 15 Appendix A defines income as “increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity”

Staff recommendations

- 23 AASB staff generally support the amendments made by the IASB. Staff are not aware that the proposed amendments would cause any significant issues for Australian entities. Staff do not consider that any not-for-profit (NFP) or public sector specific modification is needed as the amendments are clarifications to existing requirements that apply to both for-profit and not-for-profit entities, and Staff do not consider the specific issue raised by HoTARAC to be of concern.
- 24 Acknowledging the feedback received by the AASB and the basis for the IASB's decisions, staff recommend the AASB finalise the project by making an amending standard incorporating the IASB's Standard *Definition of a Business (Amendments to IFRS 3)*.
- 25 Therefore, Staff recommend that the Board approves the forthcoming ballot draft incorporating the IASB amending Standard *Definition of a Business (Amendments to IFRS 3)* when it is provided to the Board out of session

Next steps

- 26 Staff expect to provide the pre-ballot draft of the Australian equivalent Standard out-of-session to the Board before the end of November 2018. The IASB has also released even more recently the amending Standard *Definition of Material (Amendments to IAS 1 and IAS 8)*, which will also be provided to the Board for out-of-session at such a time. The definition of material amendments will be accompanied by a Staff analysis similar to this paper.

Questions to the Board

Does the Board agree with staff recommendation to approve the forthcoming ballot draft of an Australian equivalent Standard incorporating the IFRS Standard *Definition of a Business (Amendments to IFRS 3)*?