AASB Exposure Draft **ED 275**
June 2016

Definition of a Business and Accounting for Previously Held Interests

Proposed amendments to AASB 3 and AASB 11

Comments to the AASB by 23 September 2016

Australian Government
Australian Accounting Standards Board

How to Comment on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 23 September 2016. This will enable the AASB to consider Australian constituents' comments in the process of formulating any comments to the IASB, which are due by 31 October 2016.

Formal Submissions

Submissions should be lodged online via the "Work in Progress – Open for Comment" page of the AASB website (www.aasb.gov.au/comment) as a PDF document and, if possible, a Word document (for internal use only).

Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: standard@aasb.gov.au
Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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AASB REQUEST FOR COMMENTS

The Australian Accounting Standards Board's (AASB's) policy is to incorporate International Financial Reporting Standards (IFRSs) into Australian Accounting Standards. Accordingly, the AASB is inviting comments on:

(a) any of the proposals in the attached International Accounting Standards Board (IASB) Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft; and

(b) the 'AASB Specific Matters for Comment' listed below.

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

1. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

   (a) not-for-profit entities; and

   (b) public sector entities, including GAAP/GFS implications;

2. whether, overall, the proposals would result in financial statements that would be useful to users;

3. whether the proposals are in the best interests of the Australian economy; and

4. unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

June 2016

Exposure Draft ED/2016/1

Definition of a Business and Accounting for Previously Held Interests

Proposed amendments to IFRS 3 and IFRS 11

Comments to be received by 31 October 2016

IASB®

IFRS®

Definition of a Business and Accounting for Previously Held Interests

(Proposed amendments to IFRS 3 and IFRS 11)

Comments to be received by 31 October 2016

Exposure Draft ED/2016/1 *Definition of a Business and Accounting for Previously Held Interests* (Proposed amendments to IFRS 3 and IFRS 11) is published by the International Accounting Standards Board (Board) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments need to be received by **31 October 2016** and should be submitted in writing to the address below, by email to commentletters@ifrs.org or electronically using our 'Comment on a proposal' page at: http://www.ifrs.org/open-to-comment/Pages/International-Accounting-Standards-Board-Open-to-Comment.aspx.

All comments will be on the public record and posted on our website at www.ifrs.org unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your Personal Data.

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Introduction

In this Exposure Draft, the International Accounting Standards Board (the Board) proposes to amend IFRS 3 *Business Combinations* and IFRS 11 *Joint Arrangements*. The amendments propose to clarify:

(a) the definition of a business; and

(b) the accounting for previously held interests when an entity obtains control of a business that is a joint operation and when it obtains joint control of a business that is a joint operation.

Definition of a business

In 2014 and 2015, the Board carried out a Post-implementation Review (PIR) of IFRS 3. That review identified that stakeholders find it difficult to apply the definition of a business in IFRS 3.

Defining a business is important. This is because the financial reporting requirements for the acquisition of a business are different from the requirements for the purchase of a group of assets that does not constitute a business. The proposed amendments are intended to provide entities with clearer application guidance to help distinguish between a business and a group of assets when applying IFRS 3.

Because IFRS 3 is the result of a joint project between the Board and the US Financial Accounting Standards Board (FASB), the business combinations requirements in IFRS Standards and US Generally Accepted Accounting Principles (US GAAP) are substantially converged. The FASB received similar feedback regarding difficulties in applying the definition of a business in a PIR of the corresponding US Standard. Consequently, the FASB and the Board have worked to respond to this feedback and the proposed amendments to IFRS 3 and the Proposed Accounting Standards Update *Clarifying the Definition of a Business*, issued by the FASB in November 2015, are based on substantially converged tentative conclusions.

Accounting for previously held interests

The Board was informed that there is diversity in practice in accounting for previously held interests in the assets and liabilities of a joint operation in two types of transactions: those in which an entity obtains control of a business that is a joint operation and those in which it obtains joint control of a business that is a joint operation. The proposed amendments to IFRS 3 and IFRS 11 are intended to clarify the accounting for each of these types of transactions.

Invitation to comment

The Board invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

(a) comment on the questions as stated;

(b) indicate the specific paragraph or group of paragraphs to which they relate;

(c) contain a clear rationale; and

(d) include any alternative that the Board should consider.

The Board is not requesting comments on matters in IFRS 3 and IFRS 11 that are not addressed in this Exposure Draft.

Comments should be submitted in writing so as to be received no later than **31 October 2016**.

Questions for respondents

Question 1
The Board is proposing to amend IFRS 3 to clarify the guidance on the definition of a business (see paragraphs B7–B12C and BC5–BC31). Do you agree with these proposed amendments to IFRS 3? In particular, do you agree with the Board's conclusion that if substantially all the fair value of the gross assets acquired (ie the identifiable assets and non-identifiable assets) is concentrated in a single identifiable asset or group of similar identifiable assets, then the set of activities and assets is not a business (see paragraphs B11A–B11C)? Why or why not? If not, what alternative would you propose, if any, and why?

Question 2
The Board and the FASB reached substantially converged tentative conclusions on how to clarify and amend the definition of a business. However, the wording of the Board's proposals is not fully aligned with the FASB's proposals. Do you have any comments regarding the differences in the proposals, including any differences in practice that could emerge as a result of the different wording?

Question 3
To address diversity of practice regarding acquisitions of interests in businesses that are joint operations, the Board is proposing to add paragraph 42A to IFRS 3 and amend paragraph B33C of IFRS 11 to clarify that: (a) on obtaining control, an entity should remeasure previously held interests in the assets and liabilities of the joint operation in the manner described in paragraph 42 of IFRS 3; and (b) on obtaining joint control, an entity should not remeasure previously held interests in the assets and liabilities of the joint operation. Do you agree with these proposed amendments to IFRS 3 and IFRS 11? If not, what alternative would you propose, if any, and why?

Question 4
The Board is proposing the amendments to IFRS 3 and IFRS 11 to clarify the guidance on the definition of a business and the accounting for previously held interests be applied prospectively with early application permitted. Do you agree with these proposed transition requirements? Why or why not?

How to comment

Comments should be submitted using one of the following methods.

Electronically (our preferred method) — Visit the ‘Comment on a proposal’ page, which can be found at: go.ifrs.org/comment

Email — Email comments can be sent to: commentletters@ifrs.org

Postal — IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

All comments will be on the public record and posted on our website unless confidentiality is requested. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

Approval by the Board of Exposure Draft *Definition of a Business and Accounting for Previously Held Interests* (Proposed amendments to IFRS 3 and IFRS 11) published in June 2016

The Exposure Draft *Definition of a Business and Accounting for Previously Held Interests* (Proposed amendments to IFRS 3 and IFRS 11) was approved for publication by the fourteen members of the International Accounting Standards Board.

Hans Hoogervorst	Chairman
Ian Mackintosh	Vice-Chairman
Stephen Cooper	
Philippe Danjou	
Martin Edelmann	
Patrick Finnegan	
Amaro Gomes	
Gary Kabureck	
Suzanne Lloyd	
Takatsugu Ochi	
Darrel Scott	
Chungwoo Suh	
Mary Tokar	
Wei-Guo Zhang	

[Draft] Amendments to IFRS 3 *Business Combinations*

Paragraph 42A is added. Paragraphs 41–42 have not been amended but have been included for ease of reference. New text is underlined.

Additional guidance for applying the acquisition method to particular types of business combinations

A business combination achieved in stages

41 An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. For example, on 31 December 20X1, Entity A holds a 35 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity B. This IFRS refers to such a transaction as a business combination achieved in stages, sometimes also referred to as a step acquisition.

42 In a business combination achieved in stages, 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 or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

42A Obtaining control of a business that is a joint operation (as defined in IFRS 11 *Joint Arrangements*) for which the acquirer held an interest in its assets and liabilities immediately before the acquisition date (either as a joint operator or as a party to a joint arrangement as defined in IFRS 11) is a business combination achieved in stages. Therefore, the acquirer shall apply the requirements for a business combination achieved in stages, including remeasuring previously held interests in the joint operation in the manner described in paragraph 42.

Paragraph 64N is added.

Effective date and transition

Effective date

...

64N [Draft] *Definition of a Business and Accounting for Previously Held Interests* (Amendments to IFRS 3 and IFRS 11) added paragraphs 42A, B8A, B11A–B11C and B12A–B12C, amended paragraphs B7–B8, B9, B11 and B12 and deleted paragraph B10. An entity shall apply those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after [effective date]. Earlier application of the amendments is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

Paragraphs B7–B8, B9 and B11 are amended. Paragraph B12 is amended and its related heading is added. Paragraphs B8A is added. Paragraphs B11A–B11C and their related headings are added. Paragraphs B12A–B12C are added. Paragraph B10 is deleted. New text is underlined. Deleted text is struck through.

Definition of a business (application of paragraph 3)

B7 A business consists of inputs and processes applied to those inputs that have the ability to ~~create~~ contribute to the creation of outputs. Although businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as a business. The three elements of a business are defined as follows:

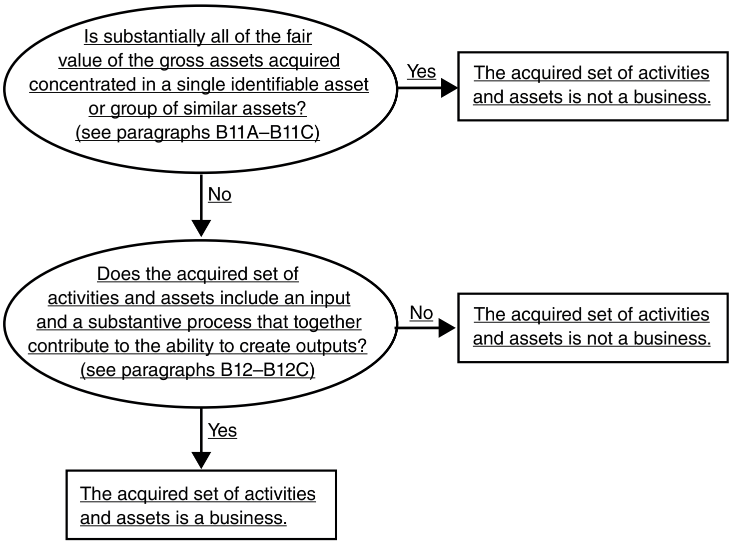
(a) **Input:** Any economic resource that creates, or has the ability to ~~create,~~ contribute to the creation of outputs when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability 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 or has the ability to ~~create~~ contribute to the creation of outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but the intellectual capacity of an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)

(c) **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.

B8 To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. ~~However, a business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.~~ To constitute a business, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together have the ability to contribute to the creation of outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business.

B8A In order to assess whether a transaction is the acquisition of a business, an entity first assesses whether substantially all of the fair value of the gross assets acquired are concentrated in a single asset or group of similar assets. If the fair value is concentrated in this way then the transaction is not the acquisition of a business. If this concentration is not present then a further assessment is performed applying the requirements of paragraphs B12A–B12C. Paragraphs B12A–B12C provide a framework for evaluating whether the acquired set of activities and assets includes a substantive process. The diagram below summarises the assessment process set out in paragraphs B11A–B12C.



B9 The nature of the elements of a business varies by industry and by the structure of an entity's operations (activities), including the entity's stage of development. Established businesses often have many different types of inputs, processes and outputs, whereas new businesses often have few inputs and processes and sometimes only a single output (product). Nearly all businesses also have liabilities, but a business need not have liabilities. Similarly, an acquired set of activities and assets that is not a business might have liabilities.

B10 ~~An integrated set of activities and assets in the development stage might not have outputs. If not, the acquirer should consider other factors to determine whether the set is a business. Those factors include, but are not limited to, whether the set:~~

~~(a) has begun planned principal activities;~~

~~(b) has employees, intellectual property and other inputs and processes that could be applied to those inputs;~~

~~(c) is pursuing a plan to produce outputs; and~~

~~(d) will be able to obtain access to customers that will purchase the outputs.~~

~~Not all of those factors need to be present for a particular integrated set of activities and assets in the development stage to qualify as a business.~~ [Deleted]

B11 Determining whether a particular set of activities and assets ~~and activities~~ is a business should 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.

Assesment of concentration of fair value

B11A A transaction is not a business combination if the transaction is primarily a purchase of a single asset or group of assets. Consequently, if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, then the set of activities and assets is not a business. The fair value of the gross assets acquired includes the fair value of 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 (plus the fair value of any non-controlling interest and previously held interest, if any).

B11B A single identifiable asset, for the test in paragraph B11A, is any asset or group of assets that would be recognised and measured as a single identifiable asset in a business combination. In addition, for this assessment, tangible assets that are attached to, and cannot be physically removed and used separately from, other tangible assets without incurring significant cost, or significant diminution in utility or fair value to either asset, shall be considered a single identifiable asset.

B11C In addition, for the test in paragraph B11A, the following assets shall not be combined into a single identifiable asset or considered a group of similar identifiable assets:

(a) separately identifiable tangible and intangible assets;

(b) different classes of tangible assets (for example, inventory and manufacturing equipment) unless they meet the criterion to be considered a single identifiable asset in paragraph B11B;

(c) identifiable intangible assets in different intangible asset classes (for example, customer-related intangibles, trade marks, and in-process research and development);

(d) financial assets and non-financial assets; and

(e) different classes of financial assets (for example, cash, accounts receivable and marketable securities).

Evaluating whether an acquired process is substantive

B12 ~~In the absence of evidence to the contrary, a particular set of assets and activities in which goodwill is present shall be presumed to be~~ When evaluating whether a set of activities and assets includes a substantive process, the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive and the set of activities and assets is a business. However, a business need not have goodwill. Paragraphs B12A–B12C provide a framework to assist an entity in evaluating whether the set of activities and assets includes a substantive process. Paragraphs B12A and B12B include two different sets of criteria to consider, depending on whether the set of activities and assets has outputs. Paragraph B12A sets out the criteria to consider when the set of activities and assets does not have outputs. Paragraph B12B sets out the criteria to consider when the set of activities and assets has outputs.

B12A If a set of activities and assets does not, at the acquisition date, have outputs (for example, it is an early-stage entity that has not started generating revenues), the set is a business only if it includes an organised workforce (which is an input) with the necessary skills, knowledge, or experience to perform an acquired substantive process (or group of processes). In addition, that acquired substantive process (or group of processes) shall be critical to the ability to develop or convert another acquired input or inputs into outputs. Inputs that the organised workforce could develop (or is developing) or convert into outputs include the following:

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

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

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

Examples of the inputs in paragraphs (a)–(c) include technology, in-process research and development projects, real estate and mineral interests.

A process (or group of processes) is not critical if, for example, it is ancillary or minor within the context of all the processes required to create outputs.

B12B If a set of activities and assets has outputs at the acquisition date (for example, if it generates revenue before the acquisition), the set is a business if either:

(a) the acquired set of activities and assets includes a process (or group of processes) that, when applied to an acquired input or inputs, contributes to the ability to continue producing outputs, even without the acquisition of an organised workforce, and that process (or group of processes) is considered unique or scarce, or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs; or

(b) the acquired set of activities and assets includes an organised workforce with the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that when applied to an acquired input or inputs, is critical to the ability to continue producing outputs.

B12C An acquired contract is not a substantive process. However, an acquired contract may give access to an organised workforce, for example a contract for outsourced property management or outsourced asset management. An entity shall assess whether an organised workforce accessed through such a contractual arrangement performs a substantive process that the entity controls, and thus has acquired (for example, considering the duration and the renewal terms of the contract).

Paragraph B42 is not amended but it is reproduced for ease of reference, because it is mentioned in two Illustrative Examples.

Assets subject to operating leases in which the acquiree is the lessor

B42 In measuring the acquisition-date fair value of an asset such as a building or a patent that is subject to an operating lease in which the acquiree is the lessor, the acquirer shall take into account the terms of the lease. The acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms.

Basis for Conclusions on the proposed amendments to IFRS 3 *Business Combinations*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Accounting for previously held interests

BC1 The IFRS Interpretations Committee informed the Board in 2015 that when an entity obtains control of a business that is a joint operation, there is diversity in practice in accounting for interests that the entity held in the assets and liabilities of the joint operation before obtaining control of the joint operation. This diversity arises because of differing interpretations of the term 'equity interests' in paragraphs 41–42 of IFRS 3. Some entities thought that 'equity interests' do not include interests in the assets and liabilities of a joint operation. Therefore, they thought that the remeasurement requirements for previously held interests do not apply. Other entities thought that the remeasurement requirements would apply if the joint operation was a business.

BC2 The Board observed that obtaining control of a business that is a joint operation is a business combination achieved in stages. It also observed that the transaction results in a significant change in the nature of, and economic circumstances surrounding, any interests in the joint operation. The Board concluded in developing IFRS 3 that these factors warrant remeasurement at fair value of the previously held interests.

BC3 Consequently, the Board proposes to clarify that, when an entity obtains control of a business that is a joint operation, the entity applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation to fair value.

Transition

BC4 The Board proposes that an entity apply paragraph 42A of IFRS 3 to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after the effective date of the amendment, with early application of the amendment permitted. This is because, for transactions occurring before that date, if the previously held interests had not been remeasured retrospective application of this amendment may involve the use of hindsight in determining the acquisition-date fair value of the previously held interests.

Definition of a business

BC5 Following the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*, the Board concluded in 2015 that many stakeholders have concerns about how to interpret and apply the definition of a business, for the following main reasons:

(a) the assessment of the relevance of the processes acquired as part of the acquired set of activities and assets, and the significance of the processes missing from the set, is difficult;

(b) the definition of a business is broad and IFRS 3 has little or no guidance on when an acquired set of activities and assets is not a business;

(c) the wording ‘capable of being conducted as a business’ does not help in determining whether a transaction includes a business;

(d) it is not clear how to apply the definition of a business when the entity acquired does not generate revenues; and

(e) the term ‘market participant’ is not defined in IFRS 3. Some sets of activities and assets may be considered as a business for a specific group of market participants if they could integrate the set in their processes. However, the same set of activities and assets may not be considered as a business from the perspective of other market participants.

BC6 To address those concerns, the Board added to its agenda a project to clarify the definition of a business, with the objective of assisting entities to determine whether a transaction should be accounted for as a purchase of assets or as a business combination.

BC7 IFRS 3 is the result of a joint project between the Board and the FASB, and the business combinations requirements in IFRS Standards and US GAAP are substantially converged. The PIR of IFRS 3 and the PIR of FASB Statement No. 141 *Business Combinations* (revised 2007), identified similar difficulties in applying the definition of a business. The FASB noted that although the definition is identical, it does not appear to be interpreted consistently in practice between jurisdictions that apply US GAAP and jurisdictions that apply IFRS Standards. Consequently, the FASB issued an Exposure Draft in November 2015 containing proposals intended to improve the application of the definition of a business in US GAAP. The amendments proposed by the Board address the issues identified during the PIR of IFRS 3 and, though worded differently, these proposed amendments and those proposed by FASB are based on substantially converged tentative conclusions. The Board also believes that the combined effect of the IASB and FASB proposed amendments should improve consistency in the application of the definition of a business across jurisdictions that apply US GAAP and jurisdictions that apply IFRS Standards.

BC8 In summary, the Board proposes:

(a) to clarify that to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together have the ability to contribute to the creation of outputs;

(b) to remove the statement that a set of activities and assets is a business if market participants can replace the missing elements and continue to produce outputs;

(c) to revise the definition of outputs to focus on goods and services provided to customers and to remove the reference to the ability to reduce costs;

(d) to consider a set of activities and assets not to be a business if, at the transaction date, substantially all of the fair value of the gross assets acquired (that is, the identifiable assets and unidentifiable assets acquired) is concentrated in a single identifiable asset or group of similar identifiable assets;

(e) to add guidance to help determine whether a substantive process has been acquired;

(f) to add examples to help with the interpretation of what is considered a business; and

(g) that an entity would not be required to apply the proposed amendments to transactions that occur before the effective date of the amendments.

Minimum requirements to be a business

BC9 The Board noted that the existence of a process (or processes) is what distinguishes a business from a group of assets. Consequently, the Board decided that to be considered a business, an acquisition must include, at a minimum, an input and a substantive process that together contribute to the ability to create outputs.

BC10 The Board decided that an input and substantive process together are required to contribute to the ability to create outputs, but need not be sufficient to create the outputs. In other words, not all of the inputs and processes needed to create outputs need to be acquired for the set of activities and assets to be a business.

Market participant capable of replacing missing elements

BC11 Many participants to the PIR of IFRS 3 observed that some sets of activities and assets may be considered to be a business for market participants who could integrate the set of activities and assets in their processes. However, the same set of activities and assets may not be considered a business from the perspective of other market participants. Consequently, they observed that the assessment of a market participant's ability to integrate the acquired set of activities and assets can be challenging.

BC12 The Board decided that the ability of some market participants to integrate the acquired set of activities and assets should not be considered in determining whether the acquisition is a business combination. The Board proposed this change, because it believes that the assessment should be based on what has been acquired, rather than on how a market participant could potentially integrate the acquired activities and assets.

BC13 Consequently, the proposed amendments would provide new tests to assess whether the minimum requirements for a set of activities and assets to be a business are met (ie the set must have at least an input and a substantive process that together have the ability to contribute to the creation of outputs).

BC14 The Board also considered whether the evaluation of an acquired set should continue to be performed from a market participant's perspective as stated in paragraph B11. Some participants to the PIR of IFRS 3 indicated that the evaluation of a transaction from a market participant's perspective requires a fact-driven assessment that excludes the business rationale, the strategic considerations and the objectives of the acquirer. The Board believes that the assessment of whether an acquisition includes a business should continue to be a fact-driven assessment. This helps to prevent similar transactions being accounted for differently depending on the intentions of the acquirer. In its view, including the business rationale and the strategic considerations of the acquirer would increase the subjectivity of this assessment and thus the diversity in practice. Consequently, the Board decided not to change paragraph B11 in this regard.

Revise the definition of outputs

BC15 The Board proposes to narrow the definition of outputs to focus on goods and services provided to customers. For example, the proposed definition of outputs excludes returns in the form of lower costs; it also excludes other economic benefits provided directly to investors or other owners, members, or participants. This is consistent with how outputs are discussed in IFRS 15 *Revenue from Contracts with Customers*, which describes goods or services that are an output of an entity's ordinary activities. However, the Board noted that not all entities have revenues that are within the scope of IFRS 15 and, therefore, decided to include in the definition other types of outputs. The proposed changes to the definition of outputs would, however, narrow the types of benefits. The Board believes that the current definition of outputs, which includes lower costs and benefits provided directly to investors, does not help in distinguishing between an asset and a business, because it confuses motivations for the acquisition with an assessment of the characteristics of the assets (and activities) acquired. Many asset purchases (eg the purchase of new equipment for a manufacturing facility) may lower costs even though they do not involve the acquisition of activities and processes.

BC16 Many participants in the PIR indicated that the phrase 'capable of being conducted and managed for the purpose of providing a return' in the current definition of a business is too broad and therefore not helpful in distinguishing businesses from assets. However, the proposals to revise the definition of outputs (combined with the proposals to provide guidance on substantive processes) would narrow the definition of a business. Consequently, the Board believes that it is not necessary to change or clarify the term 'capable of' in the definition of a business.

BC17 The Board noted that in some cases a business would be integrated by the acquirer so that it no longer generated revenue. For example, an entity may acquire a supplier and subsequently consume all the output from the supplier. Although the acquired supplier no longer generates revenue after the transaction, the acquired inputs and processes would still be 'capable of' generating outputs and so could qualify as a business, if the criteria in paragraph B12B are met. The Board believes that this result is appropriate. Accordingly, the Board proposes to retain the term 'capable of' as the basis for assessment.

The fair value of the assets acquired is concentrated in a single asset

BC18 The Board proposes to provide a screening test that will make it simpler in some cases to determine, without further analysis, that a set of activities and assets acquired does not constitute a business. To do this, the Board proposes that further assessment of whether a set of activities and assets is a business would not be appropriate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets.

BC19 The Board decided to propose a test to screen out transactions in which substantially all of the fair value of the assets acquired is concentrated in a single identifiable asset, or group of similar assets, because it believes that this initial screening will reduce the cost of applying the definition of a business without changing the Board's intended outcome. The Board believes that, in most cases, the proposed guidance on substantive processes and this screening test would lead to the same conclusion. The Board expects that, usually, the fair value of a substantive process would be more than insignificant, even if an asset is not recognised for some or all of the acquired processes. Consequently, in those cases, if the acquired set includes a substantive process, then the fair value of the gross assets acquired would not be concentrated in a single asset or a group of similar assets.

BC20 The Board decided that it was not necessary to provide further guidance for application of the term 'substantially all' because that term is already used in several IFRS Standards, such as IAS 23 *Borrowing Costs*, IFRS 9 *Financial Instruments*, IFRS 10 *Consolidated Financial Statements* and IFRS 15.

BC21 The proposed screening test refers to the fair value of the gross assets acquired, rather than to the fair value of the total consideration paid or net assets. Thus, the existence of debt (for example, a building financed by a mortgage loan) or other liabilities will not alter the conclusion. The Board decided that the assessment of the significance of similar assets acquired should be made without considering how they are financed.

Guidance on evaluating whether an acquired process is substantive

BC22 The Board proposes to add guidance to help entities to determine whether a process that has been acquired is substantive, rather than trying to develop a single definition of what a substantive process is. This is because the Board noted that it would be difficult to define a substantive process or determine what processes are substantive across all types of entities. That determination could vary from industry to industry and from transaction to transaction. The Board proposes that this guidance should be considered only when the fair value of the assets acquired is not concentrated in a single asset or group of similar assets.

BC23 The Board's clarifications propose two similar but distinct tests of acquired processes depending on whether the acquired set of activities and assets has outputs. This is because when outputs are not yet being created, the importance of the required elements of a business (ie inputs and processes) to the assessment is greater. For this reason, the Board proposes criteria that require more persuasive evidence in the absence of outputs.

BC24 The Board's clarifications propose that when the acquired set of activities and assets does not have outputs, the definition of a business is met only if the inputs acquired include both an organised workforce that performs a process that is critical to the creation of output and another input (or inputs) that is intended to be developed into outputs. The Board believes that it is important that the set that includes an organised workforce must also have an input that can lead to an output, so those elements can work together to contribute to the creation of outputs. Requiring only an organised workforce might imply that merely hiring a skilled employee and not acquiring any other inputs could be considered acquiring a business, which the Board believes is inconsistent with the definition of a business. The Board believes that an organised workforce is an input to a business, but not a business on its own. Nonetheless, the intellectual capacity of an organised workforce (that is, the capacity of an organised workforce to perform a process even if the process is not documented) is a process. For this reason, the Board also proposes to amend paragraph B7(b).

BC25 In contrast, when the acquired set of activities and assets has outputs, there is more evidence that the set is a business. Because inputs are already being converted into outputs, it is not as important to consider the type of inputs acquired.

BC26 The Board believes that an organised workforce is not required in order to conclude that the set of activities and assets is a business only in some limited circumstances. These circumstances are: (i) the set has outputs and (ii) the acquired set includes a process (or a group of processes) that is unique or scarce, or is difficult to replace. For this reason, the Board proposes the term 'unique or scarce' in paragraph B12B(a) (ie when an organised workforce is not acquired) and the term 'critical' in paragraphs B12A and B12B(b) (ie when an organised workforce is acquired). The Board believes that processes that are unique or scarce are usually valuable and would often indicate that the process is substantive; consequently the Board's proposals do not require that an organised workforce is one of the inputs acquired when a unique or scarce process is acquired. In contrast, some critical processes may not be unique or scarce, but widely available; consequently it is necessary that an organised workforce with the necessary skills to perform that critical process is also acquired in order to conclude that the transaction is a business combination.

BC27 Some IFRS Interpretations Committee members observed that IFRS 3 does not provide sufficient guidance on whether and how inputs and processes that have been outsourced should be considered in the assessment of whether an acquired set of activities and assets constitutes a business. Consequently, the Board proposes to clarify in paragraph B12C that an acquired outsourcing agreement may be considered to provide access to an organised workforce that performs a substantive process.

BC28 The Board proposes to amend paragraph B12 to remove the presumption that the presence of goodwill indicates that the acquired set of activities and assets is a business. This is because the Board believes that an entity may be willing to pay an insignificant premium for an asset or an assembled group of assets in some cases. Consequently, the presence of an insignificant amount of goodwill does not mean that the acquired assets (and activities, if any) should automatically be considered a business.

BC29 The Board proposes to delete paragraph B10 that described the factors to consider when assessing an integrated set of activities and assets in the development stage because paragraph B12A includes the requirements for these types of transactions.

Adding examples

BC30 The Board proposes to add the examples in paragraphs IE74–IE107 to assist with the interpretation of what is considered a business.

Wording of the proposed amendments

BC31 The Board decided to propose amendments to the Application Guidance of IFRS 3 that are worded differently from the amendments exposed by the FASB. The Board believes that the proposed amendments would align the Board's and the FASB's proposed amendments (except when there is already a difference between IFRS Standards and US GAAP) and that the proposed wording could be clearer for its international stakeholders.

Transition

BC32 The Board proposes that an entity would be required to apply the proposed amendments to IFRS 3 to any business combination for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after the effective date of the amendments, with earlier application of the amendments permitted. This is because the retrospective application of these proposals may be costly and impracticable. A retrospective approach would require an entity to go back and analyse all of its acquisitions of both assets and businesses using the new guidance and evaluating its accounting effect. It also could require the use of hindsight to determine fair values of the assets acquired and/or to apply business combination accounting.

[Draft] Amendments to the illustrative examples of IFRS 3 *Business Combinations*

These examples accompany, but are not part of, the proposed amendments.

Paragraphs IE73–IE107 and their related heading have been added. New text is underlined.

Definition of a business

IE73 The examples in paragraphs IE74–IE107 illustrate the guidance in paragraphs B7–B12C on the definition of a business. In each of the examples, the first step of the analysis is an assessment of concentration of fair value described in paragraphs B11A–B11C. If substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, then the set of acquired activities and assets is not a business, and no further analysis is carried out. If no such concentration exists, the entity evaluates, whether the set includes an input and a substantive process that together have the ability to contribute to the creation of outputs.

Example A—acquisition of single-family homes

IE74 An entity (Purchaser) purchases a portfolio of 10 single-family homes that each have an in-place lease. Each single-family home includes the land, building and property improvements. Each home has a different floor area and interior design. No employees, other assets, or other activities are transferred.

IE75 Purchaser first considers the guidance in paragraphs B11A–B11C and concludes that:

(a) each single-family home can be considered a single asset in accordance with paragraph B11B; because (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 asset, because they would be recognised and measured as a single identifiable asset in a business combination (see paragraph B42).

(b) the group of 10 single-family homes is a group of similar assets, because the assets (all single-family homes) are similar in nature.

(c) substantially all of the fair value of the gross assets acquired is concentrated in the group of similar tangible assets.

IE76 Consequently, the set of activities and assets purchased is not a business.

Example B—acquisition of a drug candidate

IE77 An entity (Purchaser) purchases:

(a) an in-process research and development project in its final testing phase. The project acquired includes the know-how, formula protocols, designs, and procedures expected to be needed to complete the final phase of testing; and

(b) a contract that provides outsourced clinical research and a contract that provides outsourced clinical manufacturing. These contracts are priced at current market rates. The fair value associated with these contracts is nil.

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

IE78 Purchaser first considers the guidance in paragraphs B11A–B11C and concludes that:

(a) the in-process research and development project is an identifiable intangible asset that would be accounted for as a single asset in a business combination; and

(b) substantially all of the fair value of the gross assets acquired is concentrated in the single in-process research and development asset.

IE79 Consequently, the set of activities and assets purchased is not a business.

Example C—acquisition of a television station

IE80 An entity (Purchaser) purchases a television station (Station X) from another entity (Seller). The acquired set of activities and assets includes the communications licence, the broadcasting equipment and an office building. No employees, other assets, or other activities are transferred.

IE81 Purchaser first considers the guidance in paragraphs B11A–B11C and concludes that:

(a) the broadcast equipment and building would not be considered a single asset, because the equipment is not attached to the building and can be removed without significant cost or diminution in utility or fair value of either asset;

(b) the licence is a separately identifiable intangible asset, while the broadcast equipment and building are tangible assets in different classes. Consequently, the assets would not be considered similar to each other in accordance with paragraph B11C; and

(c) each of the separate identifiable assets has significant fair value. Thus, the fair value of the gross assets purchased is not concentrated in a single asset or group of similar assets.

Consequently, Purchaser must further evaluate whether the set of activities and assets includes both an input and a substantive process.

IE82 The set of activities and assets does not have outputs; thus, Purchaser applies the criteria in paragraph B12A. The set does not include an organised workforce, so it does not meet the criteria in paragraph B12A. Consequently, the set of activities and assets purchased is not a business.

Example D—acquisition of a manufacturing facility

IE83 An entity (Purchaser) purchases a temporarily closed-down manufacturing facility (land and building) and related equipment from Seller. Purchaser also hires the employees that worked in the facility. No other assets or other activities are transferred.

IE84 Purchaser first considers the guidance in paragraphs B11A–B11C and concludes that:

(a) the equipment in the facility could be removed without significant cost or diminution in utility or fair value of either the equipment or the facility, because the equipment is not attached to the building;

(b) the equipment and facility would not be considered similar assets because they are different classes of tangible assets; and

(c) there is significant fair value in both the equipment and the facility.

Thus, the fair value of the gross assets acquired is not concentrated in a single asset or group of similar assets.

IE85 The purchased set of activities and assets is not currently producing outputs; consequently, Purchaser applies the criteria in paragraph B12A. The set includes an organised workforce, but it does not include another acquired input that the workforce could develop or convert into outputs. This is because the facility and the equipment cannot be developed or converted into outputs. Consequently, the set of activities and assets purchased is not a business.

Example E—acquisition of a biotech entity

IE86 An entity (Purchaser) purchases a biotech entity (Entity Biotech). Entity Biotech's operations include several in-process research and development projects, the scientists that have the necessary skills, knowledge, or experience to perform research and development activities and tangible assets (including a corporate headquarters, a research lab, and testing equipment). Entity Biotech has not yet generated revenues.

IE87 Purchaser first considers the guidance in paragraphs B11A–B11C and concludes that the fair value of the gross assets purchased is not concentrated in a single asset or group of similar assets, because there is significant fair value associated with both tangible and intangible assets. In addition, there is significant fair value associated with the acquired workforce. Consequently, Purchaser must further evaluate whether the set of activities and assets includes both an input and a substantive process.

IE88 The set of activities and assets does not have outputs; thus, Purchaser applies the criteria in paragraph B12A. Purchaser concludes that the criteria in paragraph B12A are met, because the scientists are an organised workforce that has the necessary skills, knowledge, or experience to perform processes that, when applied to the in-process research and development inputs, is critical to the ability to develop those inputs into a good that can be provided to a customer. Thus, the set of activities and assets acquired includes both inputs and substantive processes and is therefore a business.

Example F–licence of distribution rights

IE89 An entity (Purchaser) agrees to purchase from another entity (Seller) the licence to exclusively distribute Product X in a particular jurisdiction. Seller is the manufacturer of Product X. As part of this agreement, Purchaser also purchases the existing customer contracts in the jurisdiction and Purchaser and Seller enter into a supply contract for Purchaser to purchase Product X from Seller. No employees, other assets, or other activities are transferred.

IE90 Purchaser first considers the guidance in paragraphs B11A–B11C and concludes that:

(a) there is significant fair value in both the licence and customer contracts; and

(b) the licence and customer contracts are in different classes of intangible assets, so they cannot be considered similar assets.

Consequently, Purchaser concludes that the fair value of the gross assets purchased is not concentrated in a single identifiable asset or group of similar identifiable assets. Consequently, Purchaser must further evaluate whether the set of activities and assets include an input and a substantive process.

IE91 The set of activities and assets has outputs as it generates revenues from customers. Consequently, Purchaser applies the criteria in paragraph B12B. Because purchased contracts are not a substantive process, the customer contracts and the supply contract are excluded from the determination of whether a process is present in accordance with paragraph B12C. Therefore, the only element in the set of activities and assets to evaluate in order to determine whether a substantive process is present is the licence agreement, which is an input. Purchaser concludes that the set is not a business, because it does not include an organised workforce and there are no acquired substantive processes that could meet the criteria in paragraph B12B.

Example G—acquisition of brands

IE92 Assume the same facts as in Example F, except that Purchaser purchases the worldwide rights to Product X, including all related intellectual property. The purchased set of activities and assets includes all customer contracts and customer relationships, finished goods inventories, marketing materials, raw material supply contracts, specialised equipment specific to manufacturing Product X, documented processes and protocols to produce Product X and copyrights and trademarks. Purchaser does not hire employees.

IE93 Purchaser first considers the guidance in paragraphs B11A–B11C and concludes that the fair value of the gross assets purchased is not concentrated in a single identifiable asset or group of similar identifiable assets, because there is significant fair value in both tangible and intangible assets.

IE94 The set of activities and assets has outputs, so Purchaser applies the criteria in paragraph B12B. The set does not include an organised workforce and, therefore, does not meet the criterion in paragraph B12B(b). However, the purchased manufacturing processes are unique to Product X, and when those processes are applied to purchased inputs, such as the intellectual property and raw material provided under the acquired supply contracts, they contribute to the ability to continue producing outputs. Furthermore, without the manufacturing process and the related specialised equipment, Purchaser would have a significant delay in the ability to continue producing outputs until it designed its own processes and replaced the equipment. Consequently, the criterion in paragraph B12B(a) is met so the set of activities and assets acquired is a business.

Example H—acquisition of investment properties

IE95 An entity (Purchaser) purchases a multi-tenant corporate office park with six 10-storey office buildings that are fully leased. The acquired set of activities and assets includes the land, buildings, leases and contracts for outsourced cleaning and security. No employees, other assets, or other activities are transferred. The contracts for outsourced cleaning and security are ancillary and have a fair value of nil.

IE96 Purchaser first considers the guidance in paragraphs B11A–B11C and concludes that:

(a) the buildings and the land are considered as a single asset for the purpose of assessing the concentration of fair value, because, although they are different classes of tangible assets, the buildings are attached to the land and cannot be removed without incurring significant cost;

(b) the building and the leases are considered as a single asset, because they would be recognised and measured as a single identifiable asset in a business combination (see paragraph B42);

(c) the group of six 10-storey office buildings is a group of similar assets (all office buildings); and

(d) the fair value associated with the acquired contracts for cleaning and security is nil.

IE97 Consequently, the fair value of the gross assets acquired is concentrated in a group of similar assets and so the set of activities and assets purchased is not a business.

Example I—acquisition of investment properties

IE98 Assume the same facts as in Example H except that the purchased set of activities and assets includes the employees responsible for leasing, tenant management, and managing and supervising all operational processes. The purchase price was significantly higher than in Example H because of the employees and processes acquired.

IE99 In this circumstance, Purchaser concludes that there is significant fair value associated with the acquired workforce. Consequently, the fair value of the gross assets purchased is not concentrated in a group of similar identifiable assets.

IE100 The set of activities and assets has outputs as it generates revenues through the in-place leases. Consequently, Purchaser applies the criteria in paragraph B12B to determine whether the set includes both an input and a substantive process.

IE101 Purchaser concludes that the criterion in paragraph B12B(b) is met, because the set includes an organised workforce that performs processes (ie leasing, tenant management, and supervision of the operational processes) critical to the ability to continue producing outputs when applied to the acquired inputs (ie the land, buildings, and in-place leases). Consequently, the set of activities and assets acquired is a business.

Example J—acquisition of oil and gas operations

IE102 An entity (Purchaser) purchases Property X, which is a producing oil field that is generating revenue. The purchased set of activities and assets includes the mineral interests, customer contracts, drilling equipment, a gathering system, and supply contracts. The set also includes operational processes related to extracting and transporting the oil and gas, which are performed through the existing infrastructure. No employees, other assets, or other activities are transferred.

IE103 Purchaser first considers the guidance in paragraphs B11A–B11C and concludes that the fair value of the gross assets purchased is not concentrated in a single identifiable asset or group of similar identifiable assets, because there is significant fair value in different classes of non-financial assets (equipment, the gathering system and mineral interests).

IE104 Because the set of activities and assets has outputs, Purchaser applies the criteria in paragraph B12B to determine whether it acquired both an input and a substantive process. The criterion in paragraph B12B(b) is not met, because Purchaser did not acquire an organised workforce. The criterion in paragraph B12B(a) is met, because replacing the operational processes associated with extracting and transporting the oil and gas would result in significant cost and delay. These processes are being applied to purchased inputs (such as the mineral interest) and contribute to the production of outputs. Because the operational processes are in place and will continue to be performed through the existing infrastructure, replacing those processes would require the operation to shut down and replace the equipment and infrastructure, which would be costly and delay the production of outputs. Consequently, the set of activities and assets acquired is a business.

Example K—acquisition of mortgage loan portfolio

IE105 A bank (Purchaser) purchases a mortgage loan portfolio from another bank (Seller). Purchaser also takes over the employees of Seller that manage the credit risk of the portfolio and the relationships with the borrowers (such as brokers, vendors and risk managers). The purchase price is significantly higher than the Purchaser's estimate of the fair value of the portfolio.

IE106 Purchaser first considers the guidance in paragraphs B11A–B11C and concludes that there is significant fair value associated with both the financial assets and the acquired workforce. Consequently, the fair value of the gross assets acquired is not concentrated in a single identifiable asset or group of similar identifiable assets.

IE107 The set of activities and assets has outputs (interest revenue) arising from the loan portfolio. Consequently, Purchaser applies the criteria in paragraph B12B

<u>and concludes that the criterion in paragraph B12B(b) is met, because the set includes an organised workforce that performs processes (ie customer relationships management and credit risk management) that are critical to the ability to continue producing outputs when applied to the acquired inputs (ie financial assets). Consequently, the set of activities and assets acquired is a business.</u>

[Draft] Amendment to IFRS 11 *Joint Arrangements*

Paragraph B33C has been amended and paragraph C1AB has been added. New text is underlined and deleted text is struck through.

Accounting for acquisitions of interests in joint operations

...

B33C A joint operator or a party that participates in, but does not have joint control of, a joint operation might increase its interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3, by acquiring an additional interest in the joint operation. The joint operator may retain joint control, or the party that participates in, but does not have joint control of, the joint operation may obtain joint control, of the joint operation. In such cases, previously held interests in the assets and liabilities of the joint operation are not remeasured ~~if the joint operator retains joint control~~.

...

Effective date

...

C1AB [Draft] *Definition of a Business and Accounting for Previously Held Interests* (Amendments to IFRS 3 and IFRS 11), issued in [date], amended paragraph B33C. An entity shall apply that amendment to transactions for which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after [effective date]. Earlier application of the amendment is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Basis for Conclusions on the proposed amendment to IFRS 11 *Joint Arrangements*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Accounting for previously held interests

BC1 The IFRS Interpretations Committee informed the Board that, for transactions in which an investor obtains joint control of a business that is a joint operation, there is diversity in practice in accounting for previously held interests in the assets and liabilities of the joint operation. In particular, differing views exist about whether an entity applies the principles on accounting for a business combination achieved in stages to those previously held interests when the investor obtains joint control.

BC2 The Board observed that, although the transaction changes the nature of any interests in the assets and liabilities of the joint operation, the transaction does not result in a change in the group boundaries or the method of accounting for the previously held interests in the joint operation. In this respect, the transaction is analogous to a transaction that results in an investment in an associate becoming an investment in a joint venture and vice versa. For both of these transactions, as stated in paragraph 24 of IAS 28 *Investment in Associates and Joint Ventures*, an investor does not apply the principles on accounting for a business combination achieved in stages to those previously held interests. The Board also observed that remeasuring previously held interests would conflict with the requirements of IFRS 11 for an entity to account for the assets and liabilities relating to its interest in the joint operation in accordance with the applicable IFRS Standards.

BC3 Consequently, the Board proposes that, when an investor obtains joint control of a business that is a joint operation, the entity should not remeasure previously held interests in the assets and liabilities of the joint operation.

Transition

BC4 The Board proposes that an entity apply the proposed amendment to IFRS 11 to transactions for which joint control is obtained on or after the beginning of the first annual reporting period beginning on or after the effective date of the amendment, with earlier application of the amendment permitted. The Board proposes this approach because it believes that the benefits of applying the proposed amendment on a retrospective basis are unlikely to outweigh the costs. This is because a retrospective approach would require an entity to go back and analyse all of its acquisitions of joint operations using the new guidance to evaluate its accounting effect.

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