



## **IASB IASB proposes amendments to clarify the Definition of a Business and the Accounting for Previously Held Interests**

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## Why are amendments being proposed?

### Definition of a business

In 2014, the IASB conducted a Post-implementation Review (PIR) of IFRS 3. As part of this process, respondents raised concerns about difficulties in applying the definition of a business as it is currently set out in IFRS 3. The concerns noted that the definition of a business is broad and there is limited guidance to assess whether an acquired set of activities and assets is a business. The IASB decided to address these concerns and proposes to amend IFRS 3 to clarify the definition of a business.

### Observations

IFRS 3 and the business combination requirements under U.S. GAAP are substantially converged. Following its own PIR project, the FASB issued an Exposure Draft in November 2015 to amend the definition of a business under U.S. GAAP. The IASB indicates that although the wording proposed by the FASB is different from the one proposed by the IASB, in both cases the proposed amendments are intended to achieve similar results.

### Accounting for previously held interests in a joint operation

The IASB separately identified that there is diversity in practice in accounting for previously held interests in the asset and liabilities of a joint operation when an entity acquires an additional participation and obtains control or joint control; or when the entity retains joint control. The IASB is proposing to amend IFRS 3 and IFRS 11 to clarify the accounting for such transactions.

## What are the proposed amendments?

### Definition of a business

The IASB proposes 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. To perform this assessment, an entity must perform the following steps:

#### **Step 1: Determine whether the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets**

The amendments will require that an entity must first assess at the transaction date 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. If this is the case, then the set of activities and assets will not be considered a business and no further analysis is needed.

The amendments defined a single identifiable asset as any asset or group of assets that would be recognized and measured as a single identifiable

asset in a business combination. In addition, any asset that cannot be used separately from other asset without incurring significant costs should be considered a single asset.

### **Observations**

The proposed amendments indicate that 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 (and, as a result, would form part of the value of goodwill recognised in a business combination). It also indicates that an entity may determine the fair value of the gross assets acquired by adding the fair value of the liabilities assumed to the fair value of the consideration paid.

Consequently, entities may need to conduct some type of fair value exercise to determine whether the 'concentration' criterion is met.

### **Step 2: Determine whether an acquired set of activities and assets include an input and a substantive process that together contribute to the ability to create outputs**

If the acquired set of activities and assets is not precluded from being considered a business in the first step, an entity then needs to determine whether that acquiree includes an input and a substantive process that together contribute to the ability to create outputs. In making that assessment, the following key definitions apply:

**Input:** Any economic resource that creates, or has the ability to contribute to the creation of outputs when one or more processes are applied to it.

**Process:** Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to contribute to the creation of outputs.

**Output:** The result of inputs and processes applied to those inputs that provide goods or services to customers, investment income (such as dividends or interest) or other revenues.

### **Evaluating whether an acquired process is substantive**

The assessment (to be performed at acquisition date) of whether an acquired process is substantive will vary dependent on whether the set of activities and assets (the "set") has outputs.

**If the set has outputs,** the amendments state that the set is a business if either:

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

(ii) the set includes an organised workforce with necessary skills, knowledge, or experience to perform an acquired process that when applied to an acquired input is critical to the ability to continue producing outputs.

### **Observations**

The Board considers that there are only limited circumstances in which a set of activities could be a business without an on organised workforce. These circumstances are when: (i) the set has outputs; and (ii) the process acquired is unique or scarce, or difficult to replace. The Board believes that such processes are usually valuable and indicative that the process is substantive.

**If the set does not have outputs**, the amendments requires that two conditions must be met for the set to be considered a business (i) the set includes an organised workforce with the necessary skills, knowledge and experience to perform an acquired substantive process; and (ii) the acquired substantive process must be critical to the ability to develop or convert 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 output.

### **Observations**

The Board considers that an organised workforce is an input to a business but not a business in its own right. On the other hand, 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.

The Board believes that the lack of outputs requires more persuasive evidence that the set of activities is a business. Accordingly, it is more critical to consider the type of inputs acquired. The amendments provide examples of inputs that an organised workforce could develop or convert into outputs: (i) intellectual property that could be used to develop a good or service; (ii) other economic resources that could be developed to create outputs; or (iii) rights to access necessary materials or rights that enable the creation of future outputs.

Other proposed amendments to clarify the definition of a business are:

(i) To remove the presumption that the presence of goodwill is indicative that the set of activities is a business. Instead, the amendments propose that 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.

(ii) To remove the statement that a set of activities and asset is a business if market participants can replace the missing elements and continue to produce outputs.

(iii) To clarify that an acquired contract is not a substantive process (unless the contract provides the entity access to an organised workforce)

### **Accounting for previously held interests in a joint operation**

The amendments proposed the following:

- (i) amending IFRS 3 to clarify that upon obtaining control of a joint operation that meets the definition of a business, an entity should remeasure any previously held interest in the joint operation (as would be the case for any other stepped acquisition under IFRS 3); and
- (ii) amending IFRS 11 to clarify that an entity that is a joint operator should not remeasure any previously held interest in the joint operation when it acquires an additional stake in a joint operation whilst either retaining or gaining joint control.

### **Observations**

The IASB believes that obtaining control of a business that is a joint operation is a business combination achieved in stages. This is because the transaction is considered a significant economic event that changes the nature of any interest in the joint operation. On the other hand, the IASB believes that acquiring or retaining joint control does not result in a change in the group boundaries or the method of accounting for the previously held interests in the joint operation.

### **Effective date, transition requirements and comment period**

The exposure draft does not specify an effective date for the proposed amendments. The IASB will determine the effective date as part of considering the comments they receive on this exposure draft.

The exposure draft proposes that the amendments to IFRS 3 are to be applied for 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. The amendments to IFRS 11 are to be applied for transactions for which an entity obtains joint control on or after the first annual reporting period beginning on or after the effective date. In both cases, earlier application is permitted.

Comments on the ED are due by 31 October 2016.



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