

## IFRS Developments

# IASB proposes clarifications to definition of a business and accounting for previously held interests in a joint operation

### What you need to know

- ▶ The ED proposes to clarify:
  - ▶ The application of the definition of a business
  - ▶ How an entity accounts for previously held interests when it obtains control or joint control over a joint operation that meets the definition of a business.
- ▶ Comments are due by 31 October 2016.

## Highlights

On 28 June 2016, the International Accounting Standards Board (IASB) issued an exposure draft *Definition of a Business and Accounting for Previously Held Interests (Proposed amendments to IFRS 3 and IFRS 11)*, (the ED). The proposed amendments aim to:

- ▶ Clarify the application of the definition of a business
- ▶ Eliminate diversity in practice in accounting for previously held interests in the assets and liabilities of a joint operation that meets the definition of a business for transactions in which an entity obtains control or joint control of the joint operation

## Clarification of the definition of a business

In response to stakeholder concerns raised during the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*, the IASB has proposed amendments that clarify how to apply the definition of a business in IFRS 3. The proposed amendments aim to provide additional guidance to help distinguish between the acquisition of a business and the acquisition of a group of assets. The US Financial Accounting Standards Board (FASB) also issued a proposal<sup>1</sup> in response to similar feedback in its PIR regarding difficulties in applying the definition of a business. The FASB and the IASB jointly discussed the clarifications to the definition of a business in IFRS 3 and the FASB's Accounting Standards Codification (ASC) 805 which are substantially converged. The IASB's proposed amendments are discussed below:

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<sup>1</sup> The Proposed Accounting Standards Update *Clarifying the Definition of a Business*, issued November 2015.

**The fair value of the assets acquired is concentrated in a single asset.** The ED proposes a screening test designed to simplify the evaluation of whether an integrated set of activities and assets constitutes a business. Under the proposed amendments, an integrated set of activities and assets is not a business 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. The proposed screening test is based on the fair value of the gross assets acquired, rather than the fair value of the total consideration paid or the net assets. Thus, the significance of a single asset or a group of similar assets acquired is assessed without considering how they are financed.

If this screening test indicates that a integrated set of activities and assets is not a business, then an entity would not have to evaluate the other guidance included in the definition of a business.

The proposed amendments would clarify the minimum requirements for an integrated set of activities and assets to be a business.

**Minimum requirements to be a business.** The IASB decided that in order to be considered a business, an acquisition must include, at a minimum, an input and a substantive process that together have the ability to contribute to the creation of outputs. However, not all of the inputs and processes necessary to create outputs have to be acquired for the integrated set of activities and assets to qualify as a business.

**Evaluating whether the acquired process is substantive.** The ED proposes guidance to assist entities in determining whether a substantive process has been acquired. The proposed amendments include different criteria for consideration, depending on whether the acquired integrated set of assets and activities has outputs. When it does not, at the acquisition date, have outputs, then 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 outputs and another input (or inputs) that is intended to be developed into outputs. In contrast, when the acquired set of activities and assets at the acquisition date has outputs, an organised workforce is not required if the acquired set includes a process (or group of processes) that is unique or scarce or is difficult to replace.

**Market participant capable of replacing missing elements.** The IASB decided that the ability of a market participant to replace any missing elements by integrating the acquired set of activities and assets into its own and continuing to produce outputs is no longer a consideration in determining whether the acquisition is a business combination. The Board believes that the assessment should be based on what has been acquired, rather than what a market participant could replace.

**Revise the definition of outputs.** The ED proposes to narrow the definition of outputs to focus on goods and services provided to customers. Thus, the proposed definition excludes returns in the form of lower costs and other economic benefits provided directly to investors or other owners, members, or participants. The IASB believes that the current definition of outputs does not sufficiently distinguish between an asset and a business. For example, many asset acquisitions (e.g., the purchase of new equipment for a manufacturing facility) may result in lower costs even though they do not involve the acquisition of activities and processes.

## Other clarifications

The ED also proposes to clarify that an acquired contract is not a substantive process. However, an acquired outsourcing agreement may provide access to an organised workforce that performs a substantive process.

The ED also states that the presence of goodwill may be an indicator that a business has been acquired. However, 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.

The Board also proposes to add illustrative examples to IFRS 3 to assist with the interpretation of what is considered a business.

## Accounting for previously held interests

The IASB observed diversity in practice in the accounting for transactions in which an entity obtains control or joint control of a joint operation when the joint operation meets the definition of a business. In order to reduce that diversity, the ED proposes to amend IFRS 3 and IFRS 11 to require that:

Previously held interests in the assets and liabilities of a joint operation are remeasured at fair value when an entity obtains control over a joint operation.

- ▶ When an entity obtains control over a joint operation, in which the entity is already either a joint operator or a party to a joint operation, the previously held interests in the assets and liabilities of the joint operation are remeasured at fair value. In reaching this conclusion, the IASB observed that obtaining control of a business that is a joint operation is a business combination achieved in stages and remeasurement of previously held interests is consistent with the fair value measurement requirements of IFRS 3.
- ▶ When an entity increases its interest in a joint operation, in which the entity is already a joint operator, but joint control is maintained, the previously held interests in the assets and liabilities of that joint operation are not remeasured. Previously held interests also are not remeasured when an entity that is already a party to a joint operation increases its interest and obtains joint control of that joint operation. In reaching this conclusion, the IASB observed that, although the transaction changes the nature of any interests in the assets and liabilities of the joint operation, it does not result in a change in the group boundaries or the method of accounting of previously held interests in the joint operation.

## Transition

The ED 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.

The entity would be required to apply the proposed amendments to IFRS 11 to transactions in 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 amendments.

The effective date of the amendments has not yet been decided, but early application would be permitted.

## Next steps

The comment period closes on 31 October 2016. We encourage stakeholders to provide feedback to the IASB on the proposed amendments.

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ED None

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