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ACCOUNTING STANDARDS UPDATE

No. 2017-01
January 2017

Business Combinations (Topic 805)

Clarifying the Definition of a Business

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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FASB

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Board is issuing the amendments in this Update to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation.

Many stakeholders provided feedback that the definition of a business in Topic 805, Business Combinations, is applied too broadly, resulting in many transactions being recorded as business acquisitions that to them are more akin to asset acquisitions. In addition, stakeholders said that analyzing transactions under the current definition is difficult and costly. Those concerns about the definition of a business were the primary issues raised in connection with the Post-Implementation Review Report on FASB Statement No. 141 (revised 2007), *Business Combinations* (Statement 141(R)), now codified in Topic 805. The guidance in this Update addresses those concerns.

In addition to concerns about the broad application of the definition of a business, the scope of Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (created as part of the amendments in FASB Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*), raised questions about the interaction of the definition of a business and the term *in substance nonfinancial asset* as it is used in Subtopic 610-20.

Until the amendments in Update 2014-09 are effective, the derecognition of real estate should be accounted for consistently, regardless of whether the real estate is an asset or a business. The amendments in Update 2014-09 remove existing industry- or transaction-specific real estate guidance so that, for purposes of determining what derecognition model to apply in sales transactions with noncustomers, an entity must determine whether a real estate transaction is a sale of a business or a sale of a nonfinancial asset (or an in substance nonfinancial asset[1]).

In a separate Accounting Standards Update (Phase 2 of this project) that is expected to be issued shortly after this Update, the Board provides clarifying guidance for partial sales or transfers of assets within the scope of Subtopic 610-20 and the corresponding accounting for retained interests. In that phase of the

[1]The amendments in Update 2014-09 refer to a business that is an in substance nonfinancial asset. That guidance will be amended in Phase 2 of this project.

project, the Board will clarify the reference to in substance nonfinancial assets in Subtopic 610-20. In a future phase of the project (Phase 3), the Board plans to consider whether there are differences in the acquisition and derecognition guidance for assets and businesses that could be aligned.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect all reporting entities that must determine whether they have acquired or sold a business.

What Are the Main Provisions?

Under the current implementation guidance in Topic 805, there are three elements of a business—inputs, processes, and outputs. While an integrated set of assets and activities (collectively referred to as a "set") that is a business usually has outputs, outputs are not required to be present. In addition, all the inputs and processes that a seller uses in operating a set are not required if market participants can acquire the set and continue to produce outputs, for example, by integrating the acquired set with their own inputs and processes.

The amendments in this Update provide a screen to determine when a set is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated.

If the screen is not met, the amendments in this Update (1) require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) remove the evaluation of whether a market participant could replace missing elements. The amendments provide a framework to assist entities in evaluating whether both an input and a substantive process are present. The framework includes two sets of criteria to consider that depend on whether a set has outputs. Although outputs are not required for a set to be a business, outputs generally are a key element of a business; therefore, the Board has developed more stringent criteria for sets without outputs.

Lastly, the amendments in this Update narrow the definition of the term *output* so that the term is consistent with how outputs are described in Topic 606.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Topic 805 does not specify the minimum inputs and processes required for a set to meet the definition of a business. That lack of clarity led to broad interpretations of the definition of a business. Some stakeholders said that a set may qualify as a business even if no processes are included in the transaction when revenue-generating activities continue after an acquisition. For example, in the real estate industry, a market participant often is capable of acquiring inputs (a building with leases) and combining them with its own processes to continue generating outputs (lease income). Other stakeholders said that the presence of any process can give rise to a business, regardless of the contribution that process makes to that set's ability to create outputs. The amendments in this Update provide the requirements needed for a set to be a business and establish a practical way to determine when a set is not a business.

The definition of outputs currently refers to 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. Many transactions can provide a return in some form (for example, the acquisition of a new machine could be expected to lower costs). Thus, the definition of outputs also contributes to broad interpretations of the definition of a business. The amendments in this Update narrow the definition of outputs and align it with how outputs are described in Topic 606.

The amendments in this Update provide a more robust framework to use in determining when a set of assets and activities is a business. Because the current definition of a business is interpreted broadly and can be difficult to apply, stakeholders indicated that analyzing transactions is inefficient and costly and that the definition does not permit the use of reasonable judgment. The amendments provide more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable.

When Will the Amendments Be Effective?

Public business entities should apply the amendments in this Update to annual periods beginning after December 15, 2017, including interim periods within those periods. All other entities should apply the amendments to annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

The amendments in this Update should be applied prospectively on or after the effective date. No disclosures are required at transition.

Early application of the amendments in this Update is allowed as follows:

1. For transactions for which the acquisition date occurs before the issuance date or effective date of the amendments, only when the transaction has not been reported in financial statements that have been issued or made available for issuance
2. For transactions in which a subsidiary is deconsolidated or a group of assets is derecognized that occur before the issuance date or effective date of the amendments, only when the transaction has not been reported in financial statements that have been issued or made available for issuance.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

The definition of a business in GAAP is currently identical to the definition in IFRS. However, the Board observed that although the definition is identical, it does not appear to be interpreted or applied consistently in practice between jurisdictions that apply GAAP and jurisdictions that apply IFRS. That is, stakeholders have said that in jurisdictions that apply IFRS, the definition of a business generally is not applied as broadly as it is in jurisdictions that apply GAAP. In response to concerns from its stakeholders about the complexity of the definition of a business, the IASB added a project on the definition of a business to its agenda and issued an Exposure Draft, *Definition of a Business and Accounting for Previously Held Interests*, which proposes similar amendments to those in this Update.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–38. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Amend the Master Glossary term *Business,* with a link to transition paragraph 805-10-65-4, as follows:

Business

~~An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. Additional guidance on what a business consists of is presented in paragraphs 805-10-55-4 through 55-9~~<u>Paragraphs 805-10-55-3A through 55-6 and 805-10-55-8 through 55-9 define what is considered a business</u>.

Amendments to Subtopic 805-10

3. Add paragraphs 805-10-55-3A, 805-10-55-5A through 55-5F, and 805-10-55-51 through 55-96 and the related headings, amend paragraphs 805-10-55-4 through 55-5, 805-10-55-6, and 805-10-55-8 through 55-9, and supersede paragraph 805-10-55-7, with a link to transition paragraph 805-10-65-4, as follows:

Business Combinations—Overall

Implementation Guidance and Illustrations

> Implementation Guidance

> > Definition of a Business

805-10-55-3A A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. To be considered a business, an integrated set must meet the requirements in paragraphs 805-10-55-4 through 55-6 and 805-10-55-8 through 55-9.

805-10-55-4 A **{remove glossary link}business{remove glossary link}** 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 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 long-lived assets (including **intangible assets** or rights to use long-lived 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 organized 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 goods or services to customers, investment income (such as dividends or interest), or other revenues~~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~~.

805-10-55-5 To be capable of being conducted and managed for the purposes ~~defined~~described in paragraph 805-10-55-3A, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs.~~inputs, which together are or will be used to create outputs. However, a~~A business need not include all 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~~. However, to be considered a business, the set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. Paragraphs 805-10-55-5A through 55-5C provide a practical screen to determine when a set would not be considered a business. If the screen is not met, further assessment is necessary to determine whether the set is a business. Paragraphs 805-10-55-5D through 55-6 and 805-10-55-8 through 55-9 provide a framework to assist an entity in evaluating whether the set includes both an input and a substantive process.

> > > Single or Similar Asset Threshold

805-10-55-5A 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 set is not considered a business. Gross assets acquired should exclude cash and cash equivalents, deferred tax assets, and goodwill resulting from the effects of deferred tax liabilities. However, the gross assets acquired should include any consideration transferred (plus the fair value of any noncontrolling interest and previously held interest, if any) in excess of the fair value of net identifiable assets acquired.

> > > Single Identifiable Asset

805-10-55-5B A single identifiable asset includes any individual asset or group of assets that could be recognized and measured as a single identifiable asset in a business combination. However, for purposes of this evaluation, the following should be considered a single asset:

a. A tangible asset that is attached to and cannot be physically removed and used separately from another tangible asset (or an intangible asset representing the right to use a tangible asset) without incurring significant cost or significant diminution in utility or fair value to either asset (for example, land and building)
b. In-place lease intangibles, including favorable and unfavorable intangible assets or liabilities, and the related leased assets.

> > > Similar Assets

805-10-55-5C A group of similar assets includes multiple assets identified in accordance with paragraph 805-10-55-5B. When evaluating whether assets are similar, an entity should consider the nature of each single identifiable asset and the risks associated with managing and creating outputs from the assets (that is, the risk characteristics). However, the following should not be considered similar assets:

a. A tangible asset and an intangible asset
b. Identifiable intangible assets in different major **intangible asset classes** (for example, customer-related intangibles, trademarks, and in-process research and development)
c. A financial asset and a nonfinancial asset
d. Different major classes of financial assets (for example, accounts receivable and marketable securities)

e. Different major classes of tangible assets (for example, inventory, manufacturing equipment, and automobiles)
f. Identifiable assets within the same major asset class that have significantly different risk characteristics.

> > > Framework—Inputs, Substantive Processes, and Other Considerations

805-10-55-5D When a set does not have outputs (for example, an early stage company that has not generated revenues), the set will have both an input and a substantive process that together significantly contribute to the ability to create outputs only if it includes employees that form an organized workforce and an input that the workforce could develop or convert into output. The organized workforce must have the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that when applied to another acquired input or inputs is critical to the ability to develop or convert that acquired input or inputs into outputs. An entity should consider the following in evaluating whether the acquired workforce is performing a substantive process:

a. A process (or group of processes) is not critical if, for example, it is considered ancillary or minor in the context of all the processes required to create outputs.
b. Inputs that employees who form an organized workforce could develop (or are developing) or convert into outputs could include the following:
    1. Intellectual property that could be used to develop a good or service
    2. Resources that could be developed to create outputs
    3. Access to necessary materials or rights that enable the creation of future outputs.

    Examples of inputs that could be developed include technology, mineral interests, real estate, and in-process research and development.

805-10-55-5E When the set has outputs (that is, there is a continuation of revenue before and after the transaction), the set will have both an input and a substantive process that together significantly contribute to the ability to create outputs when any of the following are present:

a. Employees that form an organized workforce that has 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. A process (or group of processes) is not critical if, for example, it is considered ancillary or minor in the context of all of the processes required to continue producing outputs.
b. An acquired contract that provides access to an organized workforce that has 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. An entity should assess the substance of an acquired contract and whether it has effectively acquired an organized workforce that performs a substantive process (for example, considering the duration and the renewal terms of the contract).

c. The acquired process (or group of processes) when applied to an acquired input or inputs significantly contributes to the ability to continue producing outputs and cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.
d. The acquired process (or group of processes) when applied to an acquired input or inputs significantly contributes to the ability to continue producing outputs and is considered unique or scarce.

805-10-55-5F If a set has outputs, continuation of revenues does not on its own indicate that both an input and a substantive process have been acquired. Accordingly, assumed contractual arrangements that provide for the continuation of revenues (for example, customer contracts, customer lists, and leases [when the set is the lessor]) should be excluded from the analysis in paragraph 805-10-55-5E of whether a process has been acquired.

805-10-55-6 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. In addition, some transferred sets of assets and activities that are not a business may have liabilities.

805-10-55-7 Paragraph superseded by Accounting Standards Update No. 2017-01.~~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~~
~~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.~~

805-10-55-8 Determining whether a particular set of 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 **{add glossary link}**market participant**{add glossary link}**. 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.

805-10-55-9 ~~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 meets the criteria in paragraphs 805-10-55-5D through 55-5E, the presence of more than an insignificant amount of **goodwill** may be an indicator that the acquired process is substantive and, therefore, the acquired set is a business. However, a business need not have goodwill.

> Illustrations

> > Example 6: Illustrations of the Definition of a Business

805-10-55-51 The Examples in paragraphs 805-10-55-52 through 55-96 illustrate the guidance in paragraphs 805-10-55-4 through 55-6 and 805-10-55-8 through 55-9 on the definition of a business. In each of the Examples, the first step of the analysis is the evaluation of the threshold in paragraphs 805-10-55-5A through 55-5C. 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 set is not a business. If that threshold is not met, an entity should evaluate whether the set includes an input and a substantive process that together significantly contribute to the ability to create outputs. To determine whether both an input and a substantive process are included in the set, an entity should complete its evaluation using the framework (guidance in paragraphs 805-10-55-5D through 55-6 and 805-10-55-8 through 55-9).

> > > Case A: Acquisition of Real Estate

> > > > Scenario 1

805-10-55-52 ABC acquires, renovates, leases, sells, and manages real estate properties. ABC acquires a portfolio of 10 single-family homes that each have in-place leases. The only elements included in the acquired set are the 10 single-family homes and the 10 in-place leases. Each single-family home includes the land, building, and property improvements. Each home has a different floor plan, square footage, lot, and interior design. No employees or other assets are acquired.

805-10-55-53 ABC first considers the threshold guidance in paragraphs 805-10-55-5A through 55-5C. ABC concludes that the land, building, property improvements, and in-place leases at each property can be considered a single asset in accordance with paragraph 805-10-55-5B. That is, the building and property improvements are attached to the land and cannot be removed without incurring significant cost. Additionally, the in-place lease is an intangible asset that should be combined with the related real estate and considered a single asset.

805-10-55-54 ABC also concludes that the 10 single assets (the combined land, building, in-place lease intangible, and property improvements) are similar. Each home has a different floor plan; however, the nature of the assets (all single-family homes) are similar. ABC also concludes that the risks associated with managing and creating outputs are not significantly different. That is, the risks associated with operating the properties and tenant acquisition and management are not significantly different because the types of homes and class of customers are not significantly different. Similarly, the risks associated with operating in the real estate market of the homes acquired are not significantly different. Consequently, ABC concludes that substantially all of the fair value of the gross assets acquired is concentrated in the group of similar identifiable assets; thus, the set is not a business.

> > > > Scenario 2

805-10-55-55 Assume the same facts as in Scenario 1 except that ABC also acquires an office park with six 10-story office buildings leased to maximum occupancy of which all have significant fair value. ABC also acquires the vendor contracts for outsourced cleaning, security, and maintenance. Seller's employees that perform leasing (sales, underwriting, and so forth), tenant management, financing, and other strategic management processes are not included in the set. ABC plans to replace the property management and employees with its own internal resources.

805-10-55-56 ABC concludes that the single-family homes and office park are not similar assets. ABC considers the risks associated with operating the assets, obtaining tenants, and tenant management between the single-family homes and office park to be significantly different because the scale of operations and risks associated with the class of customers are significantly different. Therefore, substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset or group of similar identifiable assets. Thus, ABC must further evaluate whether the set has the minimum requirements to be considered a business.

805-10-55-57 The set has continuing revenues through the in-place leases and, therefore, has outputs. ABC must consider the criteria in paragraph 805-10-55-5E to determine whether the set includes both an input and a substantive process that together significantly contribute to the ability to create outputs.

805-10-55-58 ABC concludes that the criteria in paragraph 805-10-55-5E(a) through (b) are not met because the set does not include employees and the processes performed through the cleaning and security contracts (the only processes acquired) will be considered ancillary or minor in the context of all the processes required to create outputs in the real estate industry. That is, while those outsourcing agreements may be considered to provide an organized workforce that performs cleaning and security processes when applied to the building, the processes performed by the cleaning, security, and maintenance personnel are not considered critical in the context of all the processes required to create outputs.

805-10-55-59 ABC also concludes that the criterion in paragraph 805-10-55-5E(c) is not met because the cleaning and security processes could be easily replaced with little cost, effort, or delay in the ability to continue producing outputs. While the cleaning and security processes are necessary for continued operations of the buildings, these contracts can be replaced quickly with little effect on the ability to continue producing outputs.

805-10-55-60 ABC concludes that the criterion in paragraph 805-10-55-5E(d) is not met because the cleaning and security contracts are not considered unique or scarce. That is, these types of arrangements are readily accessible in the marketplace.

805-10-55-61 Because none of the criteria were met, ABC concludes that the set does not include both an input and substantive processes that together significantly contribute to the ability to create outputs and, therefore, is not considered a business.

> > > > Scenario 3

805-10-55-62 Assume the same facts as in Scenario 2, except that the set includes the employees responsible for leasing, tenant management, and managing and supervising all operational processes.

805-10-55-63 The set has continuing revenues through the in-place leases and, therefore, has outputs. ABC must consider the criteria in paragraph 805-10-55-5E to determine whether the set includes both an input and a substantive process that together significantly contribute to the ability to create outputs.

805-10-55-64 ABC determines that the criterion in paragraph 805-10-55-5E(a) is met because the set includes an organized workforce that performs processes that when applied to the acquired inputs in the set (the land, building, and in-place leases) are critical to the ability to continue producing outputs. That is, ABC concludes that the leasing, tenant management, and supervision of the operational processes are critical to the creation of outputs. Because it includes both an input and a substantive process, the set is considered a business.

> > > Case B: Acquisition of a Drug Candidate

> > > > Scenario 1

805-10-55-65 Pharma Co. purchases from Biotech a legal entity that contains the rights to a Phase 3 (in the clinical research phase) compound being developed to treat diabetes (the in-process research and development project). Included in the in-process research and development project is the historical know-how, formula protocols, designs, and procedures expected to be needed to complete the related phase of testing. The legal entity also holds an at-market clinical research organization contract and an at-market clinical manufacturing organization contract. No employees, other assets, or other activities are transferred.

805-10-55-66 Pharma Co. first considers the guidance in paragraphs 805-10-55-5A through 55-5C. Pharma Co. concludes that 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. Pharma Co. also qualitatively concludes that there is no fair value associated with the clinical research organization contract and the clinical manufacturing organization contract because the services are being provided at market rates and could be provided by multiple vendors in the marketplace. Therefore, all of the consideration in the transaction will be allocated to the in-process research and development project. As such, Pharma Co. concludes that substantially all of the fair value of the gross assets acquired is concentrated in the single in-process research and development asset and the set is not a business.

> > > > Scenario 2

805-10-55-67 Pharma Co. purchases from Biotech a legal entity that contains the rights to a Phase 3 compound being developed to treat diabetes (Project 1) and a Phase 3 compound being developed to treat Alzheimer's disease (Project 2). Included with each project are the historical know-how, formula protocols, designs, and procedures expected to be needed to complete the related phase of testing. The legal entity also holds at-market clinical research organization contracts and at-market clinical manufacturing organization contracts associated with each project. Assume that Project 1 and Project 2 have equal fair value. No employees, other assets, or other activities are transferred.

805-10-55-68 Pharma Co. concludes that Project 1 and Project 2 are each separately identifiable intangible assets, both of which would be accounted for as a single asset in a business combination. Pharma Co. then considers whether Project 1 and Project 2 are similar assets. Pharma Co. notes that the nature of the assets is similar in that both Project 1 and Project 2 are in-process research and development assets in the same major asset class. However, Pharma Co. concludes that Project 1 and Project 2 have significantly different risks associated with creating outputs from each asset because each project has different risks associated with developing and marketing the compound to customers. The projects are intended to treat significantly different medical conditions, and each project has a significantly different potential customer base and expected market and regulatory risks associated with the assets. Thus, Pharma Co. concludes that substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset or group of similar identifiable assets and that it must further evaluate whether the set has the minimum requirements to be considered a business.

805-10-55-69 Because the set does not have outputs, Pharma Co. evaluates the criteria in paragraph 805-10-55-5D to determine whether the set has both an input and a substantive process that together significantly contribute to the ability to create outputs. Pharma Co. concludes that the criteria are not met because the set does not have employees. As such, Pharma Co. concludes that the set is not a business.

> > > Case C: Acquisition of Biotech

805-10-55-70 Pharma Co. buys all of the outstanding shares of Biotech. Biotech's operations include research and development activities on several drug compounds that it is developing (in-process research and development projects). The in-process research and development projects are in different phases of the U.S. Food and Drug Administration approval process and would treat significantly different diseases. The set includes senior management and scientists that have the necessary skills, knowledge, or experience to perform research and development activities. In addition, Biotech has long-lived tangible assets such as a corporate headquarters, a research lab, and lab equipment. Biotech does not yet have a marketable product and, therefore, has not generated revenues. Assume that each research and development project has a significant amount of fair value.

805-10-55-71 Pharma Co. first considers the guidance in paragraphs 805-10-55-5A through 55-5C. The identifiable assets in the set include multiple in-process research and development projects and tangible assets (the corporate headquarters, the research lab, and the lab equipment). Pharma Co. concludes that the in-process research and development projects are not similar assets because the projects have significantly different risks associated with managing the assets and creating the outputs (that is, because there are significantly different development risks in the different phases of development, market risks related to the different customer base, and potential markets for the compounds). In addition, Pharma Co. concludes that there is fair value associated with the acquired workforce because of the proprietary knowledge of and experience with Biotech's ongoing development projects and the potential for creation of new development projects that the workforce embodies. As such, Pharma Co. concludes that substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset or group of similar identifiable assets and that it must further evaluate whether the set has the minimum requirements to be considered a business.

805-10-55-72 Because the set does not have outputs, Pharma Co. evaluates the criteria in paragraph 805-10-55-5D to determine whether the set has both an input and a substantive process that together significantly contribute to the ability to create outputs. Pharma Co. concludes that the criteria are met because the scientists make up an organized 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 product that can be provided to a customer. Pharma Co. also determines that there is a more-than-insignificant amount of goodwill (including the fair value associated with the workforce), which is another indicator that the workforce is performing a critical process. Thus, the set includes both inputs and substantive processes and is a business.

> > > Case D: Acquisition of a Television Station

805-10-55-73 Company A is a television broadcaster whose principal business is the ownership and operation of a television station group in the United States through which it broadcasts its proprietary health-care-related programming. Company B owns and operates several television stations in the western United States. Because of a recent merger, Company B must divest itself of a station in Portland, Oregon (KPOR), and agrees to sell the station to Company A.

805-10-55-74 Company A plans to change KPOR's programming format to its proprietary health-care-related programming. Therefore, Company A will receive only the U.S. Federal Communications Commission license, the broadcasting equipment, and the office building. KPOR will be integrated into Company A's operations, with most of the station processes centralized at Company A's corporate headquarters. Company A will not extend offers of employment to any of KPOR's employees or assume any of KPOR's contractual relationships.

805-10-55-75 Company A first considers the guidance in paragraphs 805-10-55-5A through 55-5C. The U.S. Federal Communications Commission license is an intangible asset that is recognized and measured separately in a business combination, while the broadcast equipment and building are tangible nonfinancial assets in different major classes. Company A concludes that the broadcast equipment and building are not considered a single asset because the equipment is not attached to the building and can be removed without significant cost or diminution in fair value. Furthermore, none of the assets will be considered similar in accordance with paragraph 805-10-55-5C because the U.S. Federal Communications Commission license cannot be considered similar to tangible assets and the tangible assets are in different major asset classes. Each of the separate identifiable assets has significant fair value. Thus, Company A concludes that substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset or group of similar identifiable assets and that it must further evaluate whether the set has the minimum requirements to be considered a business.

805-10-55-76 The set does not have outputs; therefore, Company A considers the criteria in paragraph 805-10-55-5D to determine whether the set includes both an input and a substantive process that together significantly contribute to the ability to create outputs. The set does not include an organized workforce, so it does not meet the criteria in paragraph 805-10-55-5D. Therefore, the set does not include both an input and a substantive process and is not considered a business.

> > > Case E: Acquisition of a Manufacturing Facility

805-10-55-77 Widget Co. manufactures complex equipment and has manufacturing facilities throughout the world. Widget Co. decided to idle a facility in a foreign jurisdiction in a reorganization of its manufacturing footprint and furloughed the assembly line employees.

805-10-55-78 Acquirer enters into an agreement to purchase a manufacturing facility and related equipment from Widget Co. To comply with the local labor laws, Acquirer also must assume the furloughed employees.

805-10-55-79 The assets acquired include the equipment and facility (land and building) but no intellectual property, inventory, customer relationships, or any other inputs.

805-10-55-80 Acquirer first considers the guidance in paragraphs 805-10-55-5A through 55-5C. Acquirer concludes that the equipment in the facility can be removed without significant cost or diminution in utility or fair value because the equipment is not attached to the building and can be used in many types of manufacturing facilities. Therefore, the equipment and building are not a single asset. Furthermore, the equipment and facility are not considered similar assets because they are different major classes of tangible assets. Acquirer determines that there is significant fair value in both the equipment and the facility and, thus, concludes that it must further evaluate whether the set has the minimum requirements to be considered a business.

805-10-55-81 The set is not currently producing outputs because there is no continuation of revenue before and after the transaction; therefore, Acquirer considers the criteria in paragraph 805-10-55-5D and whether the set includes both employees that form an organized workforce and an input that the workforce could develop or convert into output. The set includes employees that have the necessary skills, knowledge, or experience to use the equipment; however, without intellectual property or other inputs that could be converted into outputs using the equipment, the set does not include both an organized workforce and an input that will meet the criteria in paragraph 805-10-55-5D. That is, the equipment itself cannot be developed or converted into an output by those employees. Therefore, the set is not a business.

> > > Case F: License of Distribution Rights

805-10-55-82 Company A is a distributor of food and beverages. Company A enters into an agreement to sublicense the Latin American distribution rights of Yogurt Brand F to Company B, whereby Company B will distribute Yogurt Brand F in Latin America. As part of the agreement, Company A transfers the existing customer contracts in Latin America to Company B and an at-market supply contract with the producer of Yogurt Brand F. Company A retains all of its employees and distribution capabilities.

805-10-55-83 Company B first considers the guidance in paragraphs 805-10-55-5A through 55-5C. The identifiable assets that could be recognized in a business combination include the license to distribute Yogurt Brand F, customer contracts, and the supply agreement. Company B concludes that the license and customer contracts will have fair value assigned to them. Company B concludes that neither asset represents substantially all of the fair value of the gross assets. Company B then considers whether the license and customer contracts are a group of similar intangible assets. Because the license and customer contracts are in different major classes of identifiable intangible assets, they are not considered similar assets. Therefore, substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset or group of similar identifiable assets, and Company B must evaluate whether the set has both an input and a substantive process.

805-10-55-84 The set has outputs through the continuation of revenues with customers in Latin America. As such, Company B must evaluate the criteria in paragraph 805-10-55-5E to determine whether the set includes an input and a substantive process that together significantly contribute to the ability to create outputs. Company B considers whether the acquired contracts are providing access to an organized workforce that performs a substantive process. However, because the contracts are not providing a service that applies a process to another acquired input, Company B concludes that the substance of the contracts are only that of acquiring inputs. The set is not a business because:

a. It does not include an organized workforce that could meet the criteria in paragraph 805-10-55-5E(a) through (b).
b. There are no acquired processes that could meet the criteria in paragraph 805-10-55-5E(c) through (d).
c. It does not include both an input and a substantive process.

> > > Case G: Acquisition of Brands

805-10-55-85 Company A is a global producer of food and beverages. Company A sells the worldwide rights of Yogurt Brand F, including all related intellectual property, to Company B. Company B also acquires all customer contracts and relationships, finished goods inventory, marketing materials, customer incentive programs, raw material supply contracts, specialized equipment specific to manufacturing Yogurt Brand F, and documented processes and protocols to produce Yogurt Brand F. Company B does not receive employees, manufacturing facilities, all of the manufacturing equipment and processes required to produce the product, and distribution facilities and processes.

805-10-55-86 Company B first considers the guidance in paragraphs 805-10-55-5A through 55-5C. The gross assets include intellectual property (the trademark, the related trade name, and recipes) associated with Yogurt Brand F (the intellectual property associated with the brand is determined to be a single intangible asset in accordance with the guidance in paragraph 805-20-55-18), customer contracts and related relationships, equipment, finished goods inventory, and the excess of the consideration transferred over the fair value of the net assets acquired. Company B concludes that substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset or group of similar identifiable assets even though, for purposes of the analysis, the intellectual property is considered to be a single identifiable asset. In addition, because there is significant fair value in both tangible assets and intangible assets, Company B concludes that there is not a group of similar assets that meets this threshold.

805-10-55-87 The set has outputs through the continuation of revenues, and Company B must consider the criteria in paragraph 805-10-55-5E to determine whether the set includes both inputs and a substantive process that together significantly contribute to the ability to create outputs. The set does not include an organized workforce and, therefore, does not meet the criteria in paragraph 805-10-55-5E(a) through (b). However, the acquired manufacturing processes are unique to Yogurt Brand F, and when those processes are applied to acquired inputs such as the intellectual property, raw material supply contracts, and the equipment, they significantly contribute to the ability to continue producing outputs. As such, the criterion in paragraph 805-10-55-5E(c) is met, and the set includes both inputs and substantive processes. Because the set includes inputs and substantive processes that together significantly contribute to the ability to create outputs, it is considered a business.

> > > Case H: Acquisition of Loan Portfolio

> > > > Scenario 1

805-10-55-88 Bank A purchases a loan portfolio from Bank Z. The portfolio of loans consists of residential mortgages with terms, size, and risk ratings that are not significantly different. Bank A does not take over the employees of Bank Z that managed the credit risk of the portfolio and the relationship with the borrowers (such as brokers, vendors, and risk managers).

805-10-55-89 Bank A first considers the guidance in paragraphs 805-10-55-5A through 55-5C. Bank A concludes that the nature of the assets (residential mortgage loans) is similar. Bank A also concludes that the risks associated with managing and creating outputs are not significantly different because the terms, size, and risk ratings of the loans are not significantly different. Because all of the fair value of the gross assets acquired is in a group of similar identifiable assets, the set is not a business.

> > > > Scenario 2

805-10-55-90 Assume the same facts as in Scenario 1 except that the portfolio of loans consists of commercial loans with term, size, and risk ratings that are significantly different.

805-10-55-91 Bank A first considers the guidance in paragraphs 805-10-55-5A through 55-5C. Bank A must consider whether the loans are similar. Bank A concludes that the nature of the assets (commercial loans) is similar; however, because the term, size, and risk ratings of the loans are significantly different, Bank A concludes that the risks associated with managing and creating outputs are significantly different. Thus, Bank A concludes that substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset or group of similar identifiable assets and that it must further evaluate whether the set has the minimum requirements to be considered a business.

805-10-55-92 The set has outputs through the continuation of revenues (interest income). Consequently, Bank A considers the criteria in paragraph 805-10-55-5E to determine whether the set includes both inputs and a substantive process that together significantly contribute to the ability to create outputs. Because the set does not include an organized workforce or acquired processes, the criteria in paragraph 805-10-55-5E are not met and the set is not a business.

> > > > Scenario 3

805-10-55-93 Assume the same facts as in Scenario 2 except that Bank A takes over the employees of Bank Z that managed the credit risk of the portfolio and the relationship with the borrowers (such as brokers and risk managers). Additionally, consideration transferred is significantly higher than Bank A's estimate of the fair value of the loan portfolio.

805-10-55-94 Bank A first considers the guidance in paragraphs 805-10-55-5A through 55-5C. Bank A concludes that the loan portfolio does not consist of similar identifiable assets. Bank A also concludes that there is significant fair value associated with different groups of financial assets and the acquired workforce. As such, Bank A concludes that substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset or group of similar identifiable assets and that it must further evaluate whether the set has met the minimum requirements to be considered a business.

805-10-55-95 The set has outputs through the continuation of revenues (interest income). Consequently, Bank A considers the criteria in paragraph 805-10-55-5E to determine whether the set includes both an input and a substantive process that together significantly contribute to the ability to create outputs.

805-10-55-96 Bank A evaluates the criteria in paragraph 805-10-55-5E and concludes that the criterion in paragraph 805-10-55-5E(a) is met because the set includes an organized workforce that performs processes (customer relationship management and credit risk management) critical to the ability to continue producing outputs; therefore, the set is a business.

4. Add paragraph 805-10-65-4 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*

805-10-65-4 The following represents the transition and effective date information related to Accounting Standards Update No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business:*

a. The pending content that links to this paragraph shall be effective for **public business entities** for annual periods beginning after December 15, 2017, including interim periods within those periods.
b. The pending content that links to this paragraph shall be effective for all other entities for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.
c. Earlier application of the pending content that links to this paragraph is permitted for transactions for which the acquisition date occurs before the issuance date or the effective date of the pending content that links to this paragraph only when the transaction has not been reported in financial statements that have been issued or made available for issuance.
d. Earlier application of the pending content that links to this paragraph is permitted for transactions in which a subsidiary is deconsolidated or a group of assets is derecognized that occur before the issuance date or the effective date of the pending content that links to this paragraph only when the transaction has not been reported in financial statements issued or made available for issuance.
e. An entity shall apply the pending content that links to this paragraph prospectively as of the beginning of the period of adoption.

Amendments to Subtopic 958-805

5. Amend paragraph 958-805-55-41, with a link to transition paragraph 805-10-65-4, as follows:

Not-for-Profit Entities—Business Combinations

Implementation Guidance and Illustrations

Acquisition by a Not-for-Profit Entity

> Implementation Guidance

> > Definition of a Business and a Nonprofit Activity

958-805-55-40 Paragraph 805-10-15-4 uses the term *business* to differentiate an acquisition of an integrated set of activities and assets that is within the scope of Topic 805 from an acquisition of a group of assets that is outside its scope. This Subtopic uses that same definition. In addition to the term *business*, this Subtopic also uses the term *nonprofit activity* to differentiate an acquisition of an integrated set of activities and assets that is within its scope from an acquisition of a group of assets that is outside its scope. It builds on the definition of a *business* in defining a *nonprofit activity*; each is defined as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing benefits. The nature of the benefits provided distinguishes a business from a nonprofit activity. Thus, in applying the guidance in paragraphs 805-10-55-4 through 55-9, references to a *business* or *businesses* also refer to a *not-for-profit activity* or *not-for-profit activities*, and references to the three elements of *input*, *process*, and *output* also include outputs that provide or have the ability to provide goods or services to beneficiaries, customers, or members that fulfill the purpose or mission for which a **not-for-profit entity** (NFP) exists.

958-805-55-41 Furthermore, because an integrated set of activities that is in the development stage might not have outputs, an acquirer should consider, in addition to the factors in paragraph ~~805-10-55-7~~805-10-55-5D, whether the set will be able to obtain access to beneficiaries or members that will purchase or otherwise receive the outputs that fulfill the purpose or mission for which an NFP exists.

Amendments to Status Sections

6. Amend paragraph 205-10-00-1, by adding the following item to the table, as follows:

205-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

7. Amend paragraph 205-20-00-1, by adding the following item to the table, as follows:

205-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

8. Amend paragraph 270-10-00-1, by adding the following item to the table, as follows:

270-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

9. Amend paragraph 350-10-00-1, by adding the following item to the table, as follows:

350-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

10. Amend paragraph 350-20-00-1, by adding the following item to the table, as follows:

350-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

11. Amend paragraph 350-30-00-1, by adding the following item to the table, as follows:

350-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

12. Amend paragraph 360-10-00-1, by adding the following item to the table, as follows:

360-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

13. Amend paragraph 420-10-00-1, by adding the following item to the table, as follows:

420-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

14. Amend paragraph 450-10-00-1, by adding the following item to the table, as follows:

450-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

15. Amend paragraph 460-10-00-1, by adding the following item to the table, as follows:

460-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

16. Amend paragraph 505-60-00-1, by adding the following item to the table, as follows:

505-60-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

17. Amend paragraph 610-20-00-1, by adding the following item to the table, as follows:

610-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

18. Amend paragraph 730-10-00-1, by adding the following item to the table, as follows:

730-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

19. Amend paragraph 730-20-00-1, by adding the following item to the table, as follows:

730-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

20. Amend paragraph 740-10-00-1, by adding the following item to the table, as follows:

740-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

21. Amend paragraph 805-10-00-1, by adding the following items to the table, as follows:

805-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017
805-10-55-3A	Added	2017-01	01/05/2017
805-10-55-4	Amended	2017-01	01/05/2017
805-10-55-5	Amended	2017-01	01/05/2017
805-10-55-5A through 55-5F	Added	2017-01	01/05/2017
805-10-55-6	Amended	2017-01	01/05/2017
805-10-55-7	Superseded	2017-01	01/05/2017
805-10-55-8	Amended	2017-01	01/05/2017
805-10-55-9	Amended	2017-01	01/05/2017
805-10-55-51 through 55-96	Added	2017-01	01/05/2017
805-10-65-4	Added	2017-01	01/05/2017

22. Amend paragraph 805-20-00-1, by adding the following item to the table, as follows:

805-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

23. Amend paragraph 805-30-00-1, by adding the following item to the table, as follows:

805-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

24. Amend paragraph 805-40-00-1, by adding the following item to the table, as follows:

805-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

25. Amend paragraph 805-50-00-1, by adding the following item to the table, as follows:

805-50-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

26. Amend paragraph 805-740-00-1, by adding the following item to the table, as follows:

805-740-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

27. Amend paragraph 810-10-00-1, by adding the following item to the table, as follows:

810-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

28. Amend paragraph 815-10-00-1, by adding the following item to the table, as follows:

815-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

29. Amend paragraph 820-10-00-1, by adding the following item to the table, as follows:

820-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

30. Amend paragraph 840-10-00-1, by adding the following item to the table, as follows:

840-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

31. Amend paragraph 840-30-00-1, by adding the following item to the table, as follows:

840-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

32. Amend paragraph 842-10-00-1, by adding the following item to the table, as follows:

842-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

33. Amend paragraph 842-20-00-1, by adding the following item to the table, as follows:

842-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

34. Amend paragraph 842-50-00-1, by adding the following item to the table, as follows:

842-50-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

35. Amend paragraph 845-10-00-1, by adding the following item to the table, as follows:

845-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

36. Amend paragraph 954-805-00-1, by adding the following item to the table, as follows:

954-805-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

37. Amend paragraph 958-805-00-1, by adding the following items to the table, as follows:

958-805-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017
958-805-55-41	Amended	2017-01	01/05/2017

38. Amend paragraph 985-20-00-1, by adding the following item to the table, as follows:

985-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Business	Amended	2017-01	01/05/2017

The amendments in this Update were adopted by the affirmative vote of six members of the Financial Accounting Standards Board. Ms. Botosan abstained.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Daryl E. Buck
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. The definition of a business affects many areas of accounting, including acquisitions, disposals, goodwill, and consolidation. Stakeholders had concerns about the current definition of a business for the following reasons:

a. Many stakeholders provided feedback that the definition of a business in Topic 805 was applied too broadly, resulting in many transactions being recorded as business acquisitions that to them are more akin to asset acquisitions. In addition, stakeholders said that analyzing transactions under the current definition is difficult and costly. Those concerns about the definition of a business were the primary issues raised in connection with the Post-Implementation Review Report on Statement 141(R).
b. The scope of Subtopic 610-20 raised questions about the interaction of the definition of a business and an in substance nonfinancial asset. The scope of that Subtopic is important to certain industries, such as real estate. Until the amendments in Update 2014-09 are effective, the derecognition of real estate should be accounted for consistently, regardless of whether the real estate is an asset or a business. The amendments in Update 2014-09 remove existing derecognition guidance on real estate. Instead, an entity will derecognize real estate that is not a business (or that is a business, but is an in substance nonfinancial asset) in sales with noncustomers in accordance with Subtopic 610-20 and apply the recognition and measurement guidance in Topic 606. Sales of real estate that are not within the scope of Topic 606 or Subtopic 610-20 will apply the deconsolidation guidance in Subtopic 810-10.

BC3. To address those concerns, the Board added to its agenda a project to clarify the definition of a business with the objective of adding guidance to assist entities in evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or acquisitions (or disposals) of businesses (Phase 1). When the Board added the project, it anticipated clarifying the reference to in substance nonfinancial assets and the accounting for partial sales of nonfinancial assets (Phase 2). Some stakeholders had said that it was not clear what an in substance nonfinancial asset is or how an in substance nonfinancial asset interacts with the definition of a business. The amendments in this Update include guidance to clarify the definition of a business. The amendments in Phase 2 will address the scope of Subtopic 610-20 and the accounting for partial sales and clarify that a business is not within the scope of Subtopic 610-20.

BC4. In Phase 3 of this project, the Board plans to consider whether there are differences in the acquisition and derecognition guidance for assets and businesses that could be aligned. Some Board members, while supportive of the amendments in this Update, indicated that the issue of what is an asset versus what is a business should be addressed more directly by attempting to reduce or eliminate differences in the accounting arbitrage between assets and businesses. However, the Board ultimately decided to begin this project by clarifying the definition of a business to respond to stakeholder concerns about that issue in a timely fashion. The Board was concerned that the alignment of the accounting for the acquisition and derecognition of assets and businesses would be a broader project that would take a significant amount of time to complete because the outreach on how those differences might be aligned has been mixed. Furthermore, many of the differences that will be evaluated are currently converged with IFRS.

BC5. On November 23, 2015, the Board issued proposed Accounting Standards Update, *Business Combinations (Topic 805): Clarifying the Definition of a Business*, for public comment. Broadly, the amendments in that proposed Update (Phase 1) would have required the following:

a. 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 set would not be considered a business.
b. To be considered a business, a set must include, at a minimum, an input and a substantive process that together contribute to the ability to create outputs.
c. A narrower definition of outputs so that the term would be consistent with how outputs are described in Topic 606.

BC6. The Board received 37 comment letters on that proposed Update and performed outreach with various stakeholders. The Board considered the feedback from those stakeholders (as discussed below) during its redeliberations of the issues addressed by the proposed Update.

Benefits and Costs

BC7. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC8. In the Board's view, the amendments in this Update meet the objective of financial reporting by providing more consistency in applying the definition of a business and by reducing costs for preparers. The Board anticipates that clarifying the definition and providing a framework to help in the decision-making process will reduce costs. Furthermore, the threshold discussed in paragraphs BC17–BC34 provides a practical way to determine when a transaction is not a business and is expected to further reduce the amount of work needed to evaluate certain transactions.

BC9. The definition of a business in GAAP currently is identical to the definition in IFRS. However, the Board observed that although the definition is identical, it is not interpreted or applied consistently in practice between jurisdictions that apply GAAP and jurisdictions that apply IFRS. That is, stakeholders have said that in jurisdictions that apply IFRS, the definition of a business generally is not applied as broadly as it is in jurisdictions that apply GAAP. The Board's intent is to narrow the application of the definition in GAAP so that practice under GAAP and IFRS is more closely aligned. The IASB added a project on the definition of a business to its agenda and issued an Exposure Draft, *Definition of a Business and Accounting for Previously Held Interests*, which proposes similar amendments to those in this Update.

BC10. In summary, the Board notes that the benefits (reduced costs, consistency in application, and alignment in practice with IFRS) justify the costs of implementation.

Clarifying the Definition of a Business

BC11. Currently, paragraphs 805-10-55-4 through 55-9 provide implementation guidance on how to evaluate whether an acquired set of activities and assets (collectively referred to as a "set") is a business. Under that implementation guidance, there are three elements of a business—inputs, processes, and outputs. While a set that is a business usually will have outputs, outputs are not required to be present. In addition, all of the inputs and processes that the seller uses in operating a set are not required if market participants are capable of acquiring the set and continuing to produce outputs, for example, by integrating the set with the market participants' own inputs and processes.

BC12. Topic 805 does not specify the minimum inputs and processes required for a set to meet the definition of a business. That lack of clarity has led to broad interpretations in practice of what is a business. Some stakeholders said that a set may qualify as a business even if no processes are included in the transaction when revenue-generating activities continue after an acquisition. For example, in the real estate industry, a market participant often is capable of acquiring inputs (a building with leases) and combining them with its own processes to continue generating outputs (lease income). Other stakeholders said that the presence of any processes can give rise to a business, regardless of significance.

BC13. The definition of outputs in current GAAP refers to 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. Many transactions can provide a return in some form (for example, the acquisition of a new machine could be expected to lower costs). Thus, the definition of outputs can further contribute to broad interpretations of what meets the definition of a business.

BC14. The Board considered various alternatives to address these practice issues. For example, the Board considered some elements of the guidance in Emerging Issues Task Force (EITF) Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," such as the requirement that substantially all of the inputs and processes used by the seller should be included in the set or the requirement that the set needs to have outputs to be a business. The Board noted that those requirements will make the definition too narrow. The Board noted that the basis for changing the definition of a business from the definition used in Issue 98-3 to the definition in Statement 141(R) was that stakeholders said that too many transactions that represented businesses economically did not meet the EITF definition.

BC15. The Board also considered whether the evaluation of a transferred set should continue to be performed from the market participant perspective as stated in paragraph 805-10-55-8. Some stakeholders have indicated that evaluating a transaction from a market participant's perspective makes the application of the definition too broad or that it can be difficult to identify the appropriate market participant. However, the Board noted that this requirement instills discipline into the overall assessment and takes out of the analyses the buyer's and seller's intent of how the set was or will be used. Furthermore, retaining this requirement helps prevent similar transactions being accounted for differently depending on the buyer.

BC16. The Board's intent is to narrow the definition of a business and provide a framework that gives entities a basis for making reasonable judgments about whether a transaction involves an asset or a business. Some stakeholders said that the current definition is biased toward the outcome being a business. The Board is neutral on whether a set should be an asset or a business. The Board also noted that a bias toward either outcome should not influence an entity's conclusions.

Single or Similar Asset Threshold

BC17. The definition of a business in Issue 98-3 allowed for a transferred set of activities to be an asset if all but a de minimis amount of the fair value was represented by a single asset. No such guidance was carried over into Statement 141(R). The Board included a similar threshold as a screen to evaluate when a set is not a business in paragraph 805-10-55-5A of this Update. That is, when this threshold is met, the set would not be a business and an entity would not evaluate the rest of the implementation guidance to determine whether the set includes a substantive process.

BC18. In contrast to the de minimis threshold in Issue 98-3, the Board decided that this screen should be based on whether the fair value of a single identifiable asset or group of similar identifiable assets represents *substantially all* of the fair value of the gross assets acquired. The Board decided to use the term *substantially all* because it is more commonly used throughout GAAP (for example, *substantially all* is used in Topics 810 and 606) and stakeholders indicated that they would be comfortable in applying that concept.

BC19. The assessment could be qualitative if, for example, an entity concludes that all of the fair value will be assigned to one element of the acquisition. For example, if the acquisition includes a license for a drug candidate and an at-market contract and the entity concludes that the at-market contract has at the date of assessment little or no fair value assigned to it or the fair value of a single identifiable asset or group of similar identifiable assets is so significant that it is very clear that the threshold will be met, the entity may conclude that the threshold has been met. If there are multiple assets that the entity concludes will have more than an insignificant value assigned, the entity may be able to qualitatively conclude that there is clearly significant value in assets that are not similar and that the threshold is not met and go on to the rest of the framework. However, an entity must determine the fair value of each asset to allocate the consideration to assets recognized in both an asset acquisition and a business combination. Therefore, the Board does not expect that any quantitative analysis for acquisitions will result in incremental costs or complexity. In addition, an entity also could conclude that the set is not a business by assessing the guidance in paragraphs 805-10-55-5D through 55-6 and 805-10-55-8 through 55-9. The Board noted that if the set is not a business, an entity could choose to document its conclusion in the most cost-effective manner depending on its situation. However, the Board acknowledges that for dispositions, the threshold may result in incremental costs in situations in which a quantitative analysis is necessary.

BC20. An entity compares the fair value of a single identifiable asset or group of similar identifiable assets with the gross assets acquired rather than with the total consideration paid or net assets. The Board reached this conclusion to avoid the existence of debt (for example, a building with a mortgage) or other liabilities affecting the analysis of whether the threshold has been met. That could potentially result in a group of assets that would otherwise be subject to further evaluation under the model bypassing such evaluation solely because a transaction includes liabilities in addition to assets. The Board also intends for goodwill or the amount of consideration transferred in excess of the fair value of the net assets acquired to be included in the denominator. If this amount is excluded from the denominator, the threshold will be inconsistent with the goodwill indicator (discussed below in paragraphs BC56 and BC57) and too many transactions would meet the threshold.

BC21. Some comment letter respondents suggested that the Board consider making the threshold an indicator or making it optional, rather than requiring it to be a determinative factor. Those respondents were concerned that the proposed amendments would result in too many transactions meeting the threshold. Other respondents were concerned that the threshold may provide a different result than what would result from assessing the transaction under paragraphs 805-10-55-5D through 55-5E.

BC22. During redeliberations, the Board considered making the threshold an indicator that the set is not a business. Alternatively, the Board considered providing factors that would overcome the results of the threshold test. The Board concluded, however, that those suggestions would render the threshold less effective and would likely increase the cost and complexity of applying the guidance. In addition, the Board noted that the threshold is consistent with the assessments that would be made under paragraphs 805-10-55-5D through 55-5E (identifying an input and substantive process) because if all of the fair value is concentrated in a single asset or group of similar assets the other elements in the transaction are not substantive and the substance of the transaction is the acquisition of the single asset or group of assets. The Board noted that stakeholders' concerns about too many transactions meeting the threshold will be mitigated by other decisions made in redeliberations, such as the narrowing of the population of what could be considered similar assets as discussed in paragraphs BC28–BC34.

Single Asset

BC23. Under the amendments in the proposed Update, an entity generally would have been expected to use the same unit of account for evaluating the threshold that it would use for identifying assets recognized in a business combination. For example, an entity would look to the examples in Topic 805 that allow for the grouping of certain complementary intangible assets with similar useful lives. However, some tangible assets and intangible assets (such as a license and a nuclear power plant) that could be combined for financial reporting purposes could not be considered a single asset for purposes of analyzing the threshold. Under the proposed amendments, the Board made one exception in which tangible, nonfinancial assets that are attached to and cannot be physically removed and used separately from other tangible, nonfinancial assets without incurring significant cost or significant diminution in utility or fair value to either asset would be considered a single asset for purposes of evaluating the threshold. The Board determined that without this clarification, the threshold could not be applied practically in certain circumstances, such as in the real estate industry where land and buildings are often transferred together.

BC24. Some respondents stated that requiring entities to separately measure assets for purposes of the threshold test when not otherwise required to do so for financial reporting purposes (such as a license and a nuclear power plant) creates unnecessary complexity. For ease of application, the Board decided that an entity should use the same unit of account when assessing the threshold that it would use for identifying assets recognized in a business combination even if it results in some tangible assets and intangible assets being combined into a single asset. That simplifies the guidance so that paragraph 805-10-55-5B only relates to identifying a single asset and paragraph 805-10-55-5C provides guidance on identifying when each asset is considered similar.

BC25. Some respondents suggested that the Board consider whether there are other types of assets that should be combined and considered a single asset for purposes of evaluating the threshold. For example, those respondents observed that there are fact patterns in which a tangible asset is attached to and cannot be used separately from an intangible asset without incurring significant cost and significant diminution in utility or fair value. That is often the case if the entity acquires a building and ground lease or a pipeline and use rights. The Board agreed with those respondents that the entity's decision to lease or obtain a right to use the underlying tangible asset should not result in a different conclusion for purposes of applying the threshold. Thus, the Board clarified that the exception in paragraph 805-10-55-5B for tangible assets attached to each other also should apply to intangible assets representing the right to use an underlying tangible asset.

BC26. The Board decided to make another exception to the general principle, which led to the decision that an entity should consider an in-place lease intangible, including favorable and unfavorable lease assets and liabilities, and the related asset being leased as a single asset. The Board observed in the IFRS Exposure Draft on the definition of a business that real estate and lease assets would be considered a single asset because of differences in accounting for real estate between Topic 805 and IFRS 3, *Business Combinations*. Therefore, more real estate would meet the threshold under the IFRS Exposure Draft than under the amendments in the proposed Update. The Board reasoned that providing this additional exception would create consistency with how real estate transactions are assessed under IFRS and provide more consistency within the real estate industry under GAAP.

BC27. Some respondents requested additional clarification on the interaction of deferred taxes and the threshold. These stakeholders requested that the Board clarify whether goodwill directly created as a result of the transaction, for example, when an entity recognizes a deferred tax liability in a business combination, should be included in the assessment of the threshold. Other respondents suggested combining deferred tax assets or liabilities with their related assets for purposes of identifying a single asset or a similar asset. The Board concluded that deferred taxes should be excluded from the evaluation of the threshold. That is, any value associated with deferred tax assets and the effects of deferred tax liabilities on gross assets would be excluded from gross assets acquired. The Board reasoned that the tax form of the transaction that often dictates the amount of deferred taxes in the transaction should not affect the determination of whether the transaction is a business.

Similar Assets

BC28. Under the amendments in the proposed Update, the Board also decided that the threshold could be met if the fair value is concentrated in a group of similar identifiable assets. If an entity acquires, for example, multiple versions of substantially the same asset type instead of precisely one asset, the Board noted that should not disqualify the acquired items from being considered assets. The Board added that this could help alleviate pressure around what is a single asset because some stakeholders may conclude that they will be required to separate what is typically a single unit of account into multiple units of account (for example, separating a customer list into 1,000 different assets because there are 1,000 different customers).

BC29. Although it was the Board's intent to make the analysis practical, the criteria are intended to weigh the need for practicality with the risk that too many items are grouped together to avoid being considered a business. Therefore, to avoid inappropriate groupings of assets the Board included guidance that explained that certain items, such as intangible assets and tangible assets, are not similar.

BC30. Several comment letter respondents suggested that the Board provide additional guidance on what is considered similar. Those respondents were concerned that the guidance might be interpreted too broadly and that inconsistency in practice could arise without further clarification. In response to the concerns raised by stakeholders, the Board considered whether the use of the threshold should be limited to the evaluation of a single asset rather than a group of similar assets. The Board concluded that applying the threshold to a single asset would be overly limiting to the point of having the threshold, which was to provide a practical way for entities to determine whether a transaction would be the acquisition or disposal of an asset or assets. Instead, the Board decided to clarify that when determining whether a single asset is similar to another single asset, entities should consider the nature of the assets and the risks associated with managing and creating outputs from the assets. The Board clarified that assets within the same major asset class that have significantly different risk characteristics should not be considered similar assets. The Board added this requirement to narrow the population of assets that would be considered similar and avoid the threshold being applied too broadly.

BC31. The Board clarified that the risks to be evaluated should be linked to the risks associated with the management of the assets and creation of outputs because this assessment may be instructive on whether an integrated set of assets and activities has been acquired. That is, when the risks associated with managing and creating outputs from the assets are significantly different, the set would need more sophisticated processes to manage and create outputs. Therefore, the Board concluded that entities should make the assessment on the basis of the existence of the substantive processes rather than relying on the threshold for those fact patterns.

BC32. The Board noted that (a) assessing the nature and risks of the assets requires significant judgment and (b) more detailed guidance about how to make the assessment in all situations is not practical because different types of assets have different risks associated with them. The Board noted that some industries will be more familiar with this assessment than others because similar assessments are made for different accounting purposes. For example, the amendments in FASB Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, provide guidance on the types of risk characteristics considered when grouping financial assets for impairment purposes. However, given the many different types of assets and industries, the Board expects different types of risks to be more important to the analyses for different types of transactions. For example, the Board does not expect an entity acquiring real estate to analyze the same exact risks as an entity acquiring a drug compound.

BC33. However, a few Board members noted that the assessment of *similar* should either:

a. Not be further defined (as was the case in practice before Statement 141(R) under Issue 98-3)
b. Be based on whether assets are similar at the major asset class level.

BC34. Those Board members do not see a reason why an acquisition in which substantially all of the acquisition is made up of assets within a single asset class should be evaluated as a business any more than a single asset meeting the threshold should be evaluated as a business. Furthermore, those Board members stated that evaluating whether groups of otherwise similar assets have significantly different risks may result in very few transactions being able to apply the screen that was added as a practical matter to reduce the cost and complexity of the analysis. For example, evaluating whether the acquisition of 1,000 customers (see paragraph BC28) may require entities to now evaluate the geography, customer class, credit quality, and other characteristics to determine whether the customers represent 1,000 single assets or a group of similar assets greatly reduces the cost effectiveness of the expedient. Nevertheless, those Board members support the amendments in this Update because, taken as a whole, the amendments are an improvement to current GAAP.

Substantive Processes

BC35. In the proposed Update, the Board decided that to be considered a business, a transaction must include, at a minimum, an input and a substantive process in response to the practice issues of determining what processes are required to meet the definition of a business. The Board noted that the existence of a process (or processes) is what distinguishes a business from an asset because all asset acquisitions have inputs, and, therefore, providing additional guidance related to processes should help differentiate between assets and businesses. The input and substantive process together are only required to contribute to the ability to create outputs because not all of the inputs and processes needed to create outputs are required for the set to be a business. In redeliberations, the Board decided to clarify that an input and a substantive process together are required to *significantly* contribute to the ability to create outputs. The Board wanted to emphasize that the process must be important to the ability to create outputs to make sure that the bar is not set too low.

BC36. The Board considered whether additional guidance was necessary to determine whether a transferred set includes a substantive process (that is, whether the clarification that a substantive process must be included in the set is sufficient or whether additional guidance that will describe a substantive process is needed). The Board noted that it is difficult to specifically define a substantive process or determine what processes are substantive because the determination varies significantly from industry to industry and from transaction to transaction.

However, the Board concluded that additional guidance could provide a framework for an entity to make judgments about the existence of a substantive process and increase consistency in application of that guidance.

BC37. The Board also decided that because the amendments in this Update establish minimum requirements for a set to be a business (that is, at a minimum, an input and a substantive process are included that together significantly contribute to the ability to create outputs), the need for the assessment of a market participant's ability to replace any missing elements and to continue producing outputs is diminished. The Board added that eliminating those requirements could reduce the confusion about what elements need to be included in the set versus what a market participant could replace. The Board also noted that the requirements appropriately help focus the analysis on the substance of what was acquired rather than whether a market participant could potentially replace missing elements.

BC38. Depending on whether a set has outputs, paragraphs 805-10-55-5D through 55-5E include two different sets of criteria to consider (that is, depending on whether there is a continuation of revenues before and after the transaction). Because outputs are a key element of a business and paragraph 805-10-55-4 notes that a business usually has outputs, the Board reasoned that when that key element is missing, the other elements should be more significant. As such, the Board developed more stringent criteria on what is required for a set to have a substantive process when outputs are not present.

Transactions Involving Sets with No Outputs

BC39. The Board concluded that when a set does not have outputs (see paragraph 805-10-55-5D), it must include an organized workforce that has the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that when applied to another acquired input or inputs is critical to the ability to develop or convert that acquired input or inputs into output. An entity should consider the following when evaluating whether the acquired workforce is performing a substantive process:

a. A process (or group of processes) is not critical if, for example, it is considered ancillary or minor in the context of all the processes required to create outputs.
b. Inputs that the organized workforce could develop (or is developing) or convert into outputs could include intellectual property that could be developed into a good or service, resources that could be developed to create outputs, or access to necessary materials or rights that enable the creation of future outputs.

BC40. In the Board's view, it is important to clarify that the organized workforce must have input that can lead to output so those elements can work together to contribute to the ability to create output. Furthermore, requiring only an organized workforce might imply that merely hiring a skilled employee and not acquiring any other inputs could be considered a business, which is not the Board's intent.

BC41. The Board added that an organized workforce that has the necessary skills, knowledge, or experience to perform processes that create outputs allows the set to actively perform the process. Some stakeholders stated that it was unclear whether an organized workforce was an input or a process. In response to stakeholder concerns, the Board clarified that the intellectual capacity (that is, the capacity of an organized workforce to perform a process even if the process is not documented) of an organized workforce is a process. If there is no organized workforce to perform an acquired process, the set on its own likely would not be able to actively contribute to the creation of outputs because the acquirer has to provide all of the activities to perform the process. For example, the Board was concerned that without an organized workforce, an entity could conclude that the acquisition of a blueprint for an airplane includes a substantive process. When the set does not have outputs, the Board noted that the process embedded in that blueprint is not substantive unless there is an organized workforce that could make the set active and contribute to the production of the airplane.

BC42. The Board also did not intend for the existence of *any* employee to indicate that a set without outputs is a business but, instead, decided that the organized workforce should be able to perform an acquired process (or group of processes) that is critical to the ability to develop or convert the acquired inputs into outputs. Determining whether an organized workforce is performing a critical process requires judgment and varies from transaction to transaction and from industry to industry. An entity should evaluate whether the process (or group of processes) is critical in the context of all the processes required to create outputs, and if that process (or group of processes) is considered ancillary or minor in that context, it is not critical.

BC43. Paragraph 805-10-55-5D (as described in paragraph BC39) also requires that the set have an input or inputs that the organized workforce could develop (or is developing) or convert into future outputs. The Board noted that the existence of an organized workforce and any input is not sufficient and that the set should include the assets that are intended to eventually be developed into outputs. As such, entities will need to evaluate the nature of the input to which the organized workforce is applying the process to determine if that process is substantive. The Board noted that most entities in the development stage will meet this criterion because there is technology, intellectual property, or other assets that are being developed into a good or service. When a set is currently producing outputs, inputs that are being converted into outputs are already in the transferred set, and, therefore, the type of inputs to which the process is applied is not specifically considered when the set has outputs.

BC44. The amendments in the proposed Update included guidance to clarify that an organized workforce also could be included in the set through acquired contracts. That is because the Board noted that in many industries various processes are performed by vendors through contractual arrangements such as property or asset management.

BC45. Several comment letter respondents requested that the Board provide guidance to assist entities with assessing when a service provided through a contractual arrangement is applying a process to another input in the set and when the contractual arrangement is itself an input. Some respondents expressed disagreement with the notion that a contractual arrangement can be similar to an organized workforce. Those respondents stated that contractual arrangements should only be considered as inputs.

BC46. The Board concluded that the assessment of a contractual arrangement, such as a supply agreement, should be relatively straightforward, meaning those contracts would likely be inputs because the supplier is not applying a process to another input in the set. However, the Board rejected the view that a service provided through a contractual arrangement should never indicate that a substantive process was acquired. The Board observed that there are many industries in which operating activities are outsourced, and the activities performed by a service provider may not be significantly different than the activities that would be performed by employees. The Board acknowledges that in some circumstances, whether an organized workforce accessed through a contractual arrangement performs or provides a process could be subjective and the critical factor to determining whether a set is a business.

BC47. In redeliberations, the Board decided that when outputs are not present, the set would need to include an organized workforce that is made up of employees and that a contractual arrangement that is not involved directly in creating outputs is not on its own substantive enough for the set to be considered a business. That decision is consistent with the Board's previous decision to have a more stringent set of criteria when the set does not have outputs on the basis that a workforce needs to be actively contributing to the development of outputs. The Board noted that without an employee to manage the performance of the vendor, there are inherent limitations on the processes that can be performed in a development capacity without further decision making or actions from an employee. In contrast, when a vendor is actively contributing to and continuously creating outputs (for example, an asset manager that continuously manages an investment portfolio and generates investment revenues), the Board concluded that the process performed by the service provider is more likely to be substantive and should still be a factor to consider when the set has outputs.

BC48. The Board noted that requiring an organized workforce to be made up of employees creates consistency in application because there are diverse views in practice on how to analyze contractual arrangements. The Board also noted that a critical process performed by employees could include the management of service providers. The Board stated that, as an example, an entity should come to consistent conclusions when evaluating a set that has 100 employees and a set that has 20 employees with the equivalent of 80 employees replaced by outsourced service providers because the 20 employees would be responsible for the management and performance of the outsourced employees.

BC49. Comment letter respondents also requested clarification on whether contracts that are entered into between the buyer and the seller at the same time as the acquisition of the set should be considered part of the acquired set. The Board noted that current guidance is silent on this issue and allows entities to assess the substance of the transaction to evaluate whether a contract entered into between the buyer and the seller is a part of the acquired set. The Board considered but decided not to provide guidance on this assessment noting that entities should continue to use judgement to determine what contracts are part of the set.

Transactions Involving Sets with Outputs

BC50. The Board concluded that the following criteria (see paragraph 805-10-55-5E) should be evaluated to determine whether a set with outputs includes a substantive process:

a. Employees that form an organized workforce that has 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. A process (or group of processes) is not critical if, for example, it is considered ancillary or minor in the context of all the processes required to continue producing outputs.
b. An acquired contract that provides access to an organized workforce that has 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. An entity must assess the substance of an acquired contract and whether it has effectively acquired an organized workforce that performs a substantive process (for example, considering the duration and the renewal terms of the contract).
c. The acquired process (or group of processes) when applied to an acquired input or inputs significantly contributes to the ability to continue producing outputs and cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.
d. The acquired process (or group of processes) when applied to an acquired input or inputs significantly contributes to the ability to continue producing outputs and is considered unique or scarce.

BC51. The Board concluded that when a set is generating outputs before and after the transaction, it is more likely that the set includes both an input and a substantive process when compared with a set that is not generating outputs. Therefore, not all of the criteria are required. Instead, if any of the criteria are present the Board noted that a substantive process would be present. Although in the Board's view an organized workforce is an indicator of a substantive process, the Board noted that an organized workforce is not required when outputs are present. For example, an organized workforce might not be required if the set includes automated processes (for example, through acquired technology, infrastructure, or specialized equipment) or other significant processes that contribute to the ability to continue producing outputs.

BC52. To address situations in which a business is transferred without an organized workforce, the Board included two criteria in paragraph 805-10-55-5E to help evaluate when a transferred process is substantive without the related workforce. Paragraph 805-10-55-5E(c) addresses the ability to replace the acquired process (or group of processes) without significant cost, effort, or delay in the ability to continue producing outputs. The Board's reasoning is that processes that are critical often cannot be replaced without significant effort or delay. Paragraph 805-10-55-5E(d) considers the uniqueness, scarcity, or significance of the process to the ability to produce outputs. That criterion considers the importance of the process to the set. A process that is unique or scarce often indicates that the process is substantive.

BC53. The Board decided that when a set generates outputs, a substantive process is present when an organized workforce that performs a critical process is accessed through a contractual arrangement. The Board noted that an entity may need to (a) apply significant judgment to determine when it effectively acquired a workforce and (b) analyze the substance of the arrangement and consider the duration and renewal terms of a contract. Furthermore, the Board noted that the entity needs to consider whether the process performed by the service provider is critical in the same way it assesses whether employees perform a critical process. That is, the contractual arrangement that provides a process will not constitute a substantive process if that process is considered ancillary or minor in the context of all processes needed to create an output.

BC54. In current practice, there is diversity in stakeholder views on whether leases, customer contracts, or other contractual revenue arrangements that result in the continuation of revenues are, in and of themselves, processes. The Board decided to specifically exclude those revenue arrangements from the analysis of whether a substantive process has been acquired. That is, the Board decided that a set is not a business just because there is a contract that provides a continuing revenue stream.

Group of Processes

BC55. The criteria used to evaluate whether a process is substantive reference the *group of processes*. The Board specifically included a reference to a group of processes because a group of processes could represent a substantive process. For example, in some businesses all the individual processes that are used to create outputs may be considered insignificant on their own. However, as a group those processes could be substantive because all of the processes together might not be ancillary or minor and could be difficult to replace without significant cost, effort, or delay in operations.

Goodwill

BC56. In the Board's view, the presumption in paragraph 805-10-55-9 that a set with goodwill is a business could conflict with parts of the analysis required by the amendments in this Update. For example, if a set includes any employees, even if those employees are not performing a critical process, someone could argue that the presence of those employees indicates that there is at least some goodwill, even if it is a negligible amount. The Board did not want an entity to be required to conclude that a set is a business in that circumstance.

BC57. However, the Board added that the presence of more than an insignificant amount of goodwill could help an entity conclude whether an organized workforce is performing a critical process or whether an acquired process in a set that has outputs is considered substantive. The Board did not intend for the consideration of goodwill to create an additional step in the analysis or result in more transactions having goodwill than have had goodwill in the past. The intent of paragraph 805-10-55-9 is only to provide another indicator to assist an entity in evaluating whether a substantive process is included in the set.

Definition of Outputs

BC58. Outputs currently are defined as 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. The Board noted that many asset acquisitions can provide a return in the form of lower costs or other economic benefits. For example, the purchase of new equipment for a manufacturing facility may increase efficiency and lower costs. The Board noted that the current definition of outputs does not appropriately distinguish between an asset and a business. Furthermore, the Board indicated that if the definition of outputs is not narrowed, the effect of the other changes might be mitigated because a substantive process contributes to the creation of outputs.

BC59. The Board decided to narrow the definition of outputs by aligning it with the ability to generate goods or services provided to customers. That is consistent with how outputs are discussed in Topic 606, which describes goods or services that are an output of the entity's ordinary activities. However, the Board noted that not all entities have revenues within the scope of Topic 606 and, therefore, decided to incorporate other types of revenues in the definition. For example, the Board decided to include the reference to investment income in the definition of outputs in the amendments in this Update to ensure that the purchase of an investment company can still qualify as a business combination.

BC60. Some stakeholders suggested that the Board consider aligning the purpose of a business in paragraph 805-10-55-3A with the definition of an output because it is aligned in current GAAP. The Board considered aligning the terms in redeliberations; however, the Board decided that the definition of an output does not change the stated purpose of a business. Paragraph 805-10-55-3A establishes that a business consists of activities and assets and the purpose of those assets and activities, which is to provide a return. The Board observed that providing a return to its investors is what distinguishes a business from a nonprofit activity and indicated that aligning the guidance in that paragraph with goods or services could create additional confusion. In addition, the language in paragraph 805-10-55-3A on the types of returns makes clear that both investor-owned entities and other entities such as mutual entities can be considered a business. Finally, the Board noted that paragraph 805-10-55-3A does not conflict with the rest of the guidance because it specifically states that to be a business, the criteria in the rest of the guidance must be met.

Effective Date and Transition

BC61. The Board decided that the amendments in this Update should be effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those periods. The amendments should be effective for all other entities for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

BC62. The Board decided that the amendments in this Update should be applied prospectively on or after the effective date.

BC63. Prospective application is consistent with other past standards related to business combinations that have resulted in equal or more significant changes. Examples of standards related to business combinations that have been applied prospectively include the following:

a. Statement 141(R)

b. FASB Accounting Standards Update No. 2010-29, *Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations.*
c. FASB Accounting Standards Update No. 2012-06, *Business Combinations (Topic 805): Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution*
d. FASB Accounting Standards Update No. 2014-17, *Business Combinations (Topic 805): Pushdown Accounting*
e. FASB Accounting Standards Update No. 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination.*

BC64. The Board decided not to require retrospective transition because it would be costly and impractical in most situations. A retrospective approach would require an entity to go back and analyze all of its acquisitions and dispositions of both assets and businesses to reevaluate the new definition and its accounting effect. In the Board's view, such an analysis is not practical. Furthermore, requiring retrospective application would add costs that would detract from the benefits of the new guidance.

BC65. The Board decided not to require any disclosures at transition. Determining the effect of the change on the income statement would require an entity to account for all acquisitions and dispositions under both current guidance and the amendments in the proposed Update, and the Board decided that the costs would outweigh the benefits for that disclosure and that any further disclosures would not provide decision-useful information. As such, the Board decided not to require any of the disclosures in paragraphs 250-10-50-1 through 50-3 of the Codification.

BC66. Early application of the amendments in this Update is allowed for transactions for which the acquisition date occurs in a period for which financial statements have not been issued or made available for issuance.

BC67. Early application of the amendments in the Update also is allowed for transactions in which a subsidiary is deconsolidated or a group of assets is derecognized that occur in a period for which financial statements have not been issued or made available for issuance.

BC68. The Board considered whether early application of the amendments in this Update for disposals of a set should be consistent with the early application provisions in Phase 2. The Board concluded that early application of Phase 1 is not dependent on early application of Phase 2, which means that entities could utilize the new definition of a business to determine whether they have disposed of a business and if a transaction is a business, account for the disposition in accordance with current GAAP.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2018 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.