

# FASB In Focus

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

### Background

On January 5, 2017, the Financial Accounting Standards Board (FASB) issued a new Accounting Standards Update (ASU) No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*. The ASU clarifies the definition of a business with the objective of adding guidance to assist companies and other reporting organizations with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses.

### Why Is the FASB Issuing This ASU?

The definition of a business affects many areas of accounting, including acquisitions, disposals, goodwill, and consolidation.

The Post-Implementation Review (PIR) Report on FASB Statement No. 141 (revised 2007), *Business Combinations* (Statement 141(R)), now codified in Topic 805 Business Combinations, showed that many stakeholders believe the definition of a business in current GAAP (Topic 805) is applied too broadly. This has resulted in many transactions being recorded as business acquisitions when they are, in fact, more akin to asset acquisitions. In addition, stakeholders said that analyzing transactions under the current definition is difficult and costly.

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.

### What Does the New ASU Do?

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.

### What Are the Main Provisions?

Under the current implementation guidance in GAAP, 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 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

## Main Provisions in the Update

**Screen:** Is substantially all of the fair value of the gross assets acquired (or disposed of) concentrated in a single identifiable asset or a group of similar identifiable assets?

YES

Screen Met → Not a Business

NO

Screen Not Met → Assess the Framework

To be 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

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.

Finally, the amendments in this Update narrow the definition of the term *output* so that the term is consistent with how outputs are described in the upcoming Revenue Recognition guidance (Topic 606).

### What Organizations Are Affected by This ASU?

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

### When Will This ASU Be Effective?

For public companies, the ASU is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. All other companies and organizations 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 ASU should be applied prospectively on or after the effective date. No disclosures are required at transition.

Early application of the amendments in this ASU 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.

### Effective Dates

Entity Type	Annual Periods Beginning After	Interim Periods Within Annual Periods Beginning After
Public Companies	December 15, 2017	December 15, 2017
All other Companies and Organizations	December 15, 2018	December 15, 2019

For more information about the project, please visit the FASB's website at [www.fasb.org](http://www.fasb.org).

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