IFRS IN PRACTICE 2019/2020

Distinguishing between a business combination and an asset purchase in the extractives industry

TABLE OF CONTENTS

1. INTRODUCTION

A critical step in determining the appropriate accounting approach to be followed for an acquisition transaction in the extractives industry is to determine whether the acquisition meets the definition of a business (and therefore within the scope of IFRS 3 *Business Combinations*), or is instead an asset or group of assets that do not constitute a business with the transaction being outside the scope of IFRS 3.

Differentiating a business from an asset acquisition is key to applying an appropriate accounting treatment for acquisitions of operations in the exploration, development and pre-production phases. This can involve significant judgement and a detailed analysis of what inputs and processes have been acquired. Consequently, clear disclosures should be made in the financial statements to reflect the assumptions and judgments applied to determine the classification.

Major differences between the accounting requirements for a business combination accounted for in accordance with IFRS 3, and an asset acquisition, are set out below:

	Acquisition of a business	Acquisition of an asset
Goodwill	Goodwill or bargain purchase gain recognised.	No goodwill or bargain purchase gain recognised.
Initial measurement of assets and liabilities	Most assets and liabilities acquired are measured at their fair values.	Assets and liabilities are assigned a carrying amount based on relative fair values.
Transaction costs	Transaction costs are expensed.	Transaction costs are capitalised.
Deferred taxes	Deferred tax assets and liabilities arise if the tax base is different from the accounting base.	Initial recognition exemption in IAS 12 *Income Taxes* is applied so no deferred tax assets and liabilities arise if the tax base is different from the accounting base.
Non-controlling interest (NCI)	Non-controlling Interest (NCI) is recognised in the investor's consolidated financial statements if the business is not wholly owned.	NCI is recognised in the investor's consolidated financial statements if the acquisition is of an entity that is to be consolidated in accordance with IFRS 10 *Consolidated Financial Statements*.
Consideration paid in the form of equity instruments ***(That meet the definition of an equity instrument)***	Consideration paid in the form of equity instruments, (with the instruments meeting the definition of an equity instrument from the acquirer's perspective as per IAS 32), is measured at the fair value of the equity instruments at the point control is obtained. Transaction is in the scope of IFRS 3, not IFRS 2 (see IFRS 2.5).	Consideration paid in the form of equity instruments is a share based payment within the scope of IFRS 2 *Share-based Payment* and the measurement is determined by reference to the fair value of the asset acquired. The fair value of the assets acquired would be measured at the point control is obtained.

	Acquisition of a business	Acquisition of an asset
Consideration paid in the form of equity instruments ***(That do not meet the definition of an equity instrument)***	Measurement is in the scope of IFRS 3, not IFRS 2. Consideration paid in the form of equity instruments that do not meet the definition of equity is determined at the fair value of the equity instruments at the point control is obtained and is remeasured to fair value at each reporting date until settled (with changes in fair value being recorded in profit or loss).	Consideration paid in the form of equity instruments is a share based payment within the scope of IFRS 2 *Share-based Payment* and the measurement is determined by reference to the fair value of the asset acquired. The fair value of the assets acquired would be measured at the point control is obtained.
Contingent consideration	Contingent consideration (including royalty streams) is required to be measured at fair value.	Contingent consideration in an asset acquisition was discussed at the March 2016 IFRS Interpretations Committee (IFRIC) meeting. An accounting policy choice exists, therefore an entity may recognise a liability for the expected variable payments at the time control of the underlying asset is obtained or they may only recognise such a liability as the related activity that gives rise to the variability occurs.
Changes in the fair value of contingent consideration	After initial recognition at the acquisition date fair value, changes in the fair value of contingent consideration that meets the definition of a liability are recognised in profit or loss.	Based on the March 2016 IFRIC meeting, IFRS is not clear about the accounting approach to be followed for the movement in the fair value of contingent consideration for an asset acquisition. Depending on the circumstances, and on the accounting policy choice selected, movements in the fair value of deferred consideration may be either: – Recognised in profit or loss; or – Capitalised as part of the asset.

	Acquisition of a business	Acquisition of an asset
Measurement period	The acquisition of a business may be accounted for based on provisional amounts if the accounting is incomplete by the end of the reporting period. Subsequent to this date, the acquirer must retrospectively adjust the provisional amounts recognised as the accounting is finalised (i.e. reallocations between goodwill and separately identifiable intangible assets, differences in fair value estimates, etc.). The measurement period cannot exceed one year from the acquisition date.	No measurement period exists.

Figure 1 – Significant differences between the accounting for a business combination compared with the accounting for an asset acquisition.

2. AMENDMENTS TO IFRS 3 (OCTOBER 2018)

In October 2018, the IASB issued 'Definition of a Business (Amendments to IFRS 3)' which was aimed at resolving difficulties that arise when an entity determines whether it has acquired a business or a group of assets (see BDO IFR Bulletin 2018/07 on BDO's IFRS Reporting site). The amendments are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period. The amended definition of a business has a narrower definition of 'outputs' and a 'business' that focus on returns from selling goods and services to customers, rather than on cost reductions. The definition includes the concept of a substantive process. In order to be considered a business, an acquired set of activities and assets must include, as a minimum, an input and a substantive process.

The amendments also introduce an optional concentration test as a short-cut to concluding that certain types of acquisitions are not business combinations. An entity may elect to apply, or not apply, the test separately for each transaction or event. Under the concentration test, if substantially all of the fair value of the gross assets acquired are concentrated in a single identifiable asset, or group of similar identifiable assets, then it is an asset acquisition and no further analysis is required. If the optional concentration test is not met, then a detailed analysis of the definition of a business and substantive processes must be completed.

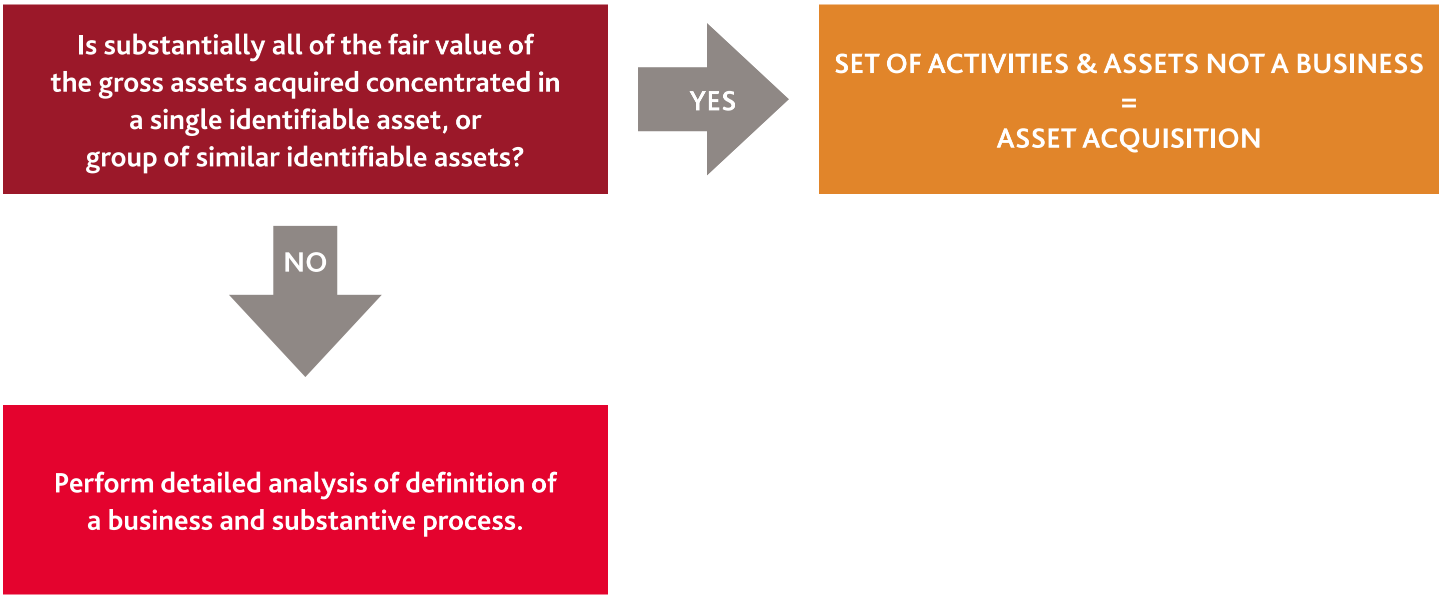

Figure 2: Amendments to IFRS 3 introduce an optional concentration test.

Guidance on the optional concentration test is provided in IFRS 3.B7A to B7B. The fair value of the gross assets acquired includes any consideration transferred (plus the fair value of any non-controlling interest and the fair value of any previously held interest) in excess of the fair value of net identifiable assets acquired.

The fair value of gross assets acquired may normally be determined using the following formula:

Fair value of the gross assets **=**

+ Fair value of consideration transferred
+ Fair value of any non-controlling interest
+ Fair value of any previously held interest
+ Fair value of the liabilities assumed (other than deferred tax liabilities)
- Cash and cash equivalents
- Deferred tax assets
- Goodwill resulting from the effects of deferred tax liabilities

Single Identifiable asset includes any asset or group of assets that would be recognised and measured as a single identifiable asset in a business combination. If a tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset or from an underlying asset subject to a lease, without incurring significant cost, or significant diminution in utility or fair value to either asset (for example, land and buildings), those assets are required to be considered a single identifiable asset.

Group of similar identifiable assets are those that are similar in nature and have similar risk associated with managing and creating outputs for the assets. The following are not considered similar assets:

(i) A tangible asset and an intangible asset;
(ii) Tangible assets in different classes (for example, inventory, manufacturing equipment and automobiles) unless they are considered a single identifiable asset (see above for the requirements);
(iii) Identifiable intangible assets in different classes (for example, brand names, licences and intangible assets under development);
(iv) A financial asset and a non-financial asset;
(v) Financial assets in different classes (for example, accounts receivable and investments in equity instruments); and
(vi) Identifiable assets that are within the same class of asset but have significantly different risk characteristics.

Example 1 – Acquisition of a company that owns a mine (share purchase)

Company A has a long established producing mine. It has an established processing facility and a rail head.

Company B owns a mine that is in the exploration stage valued at CU 1.4 million.

Company A acquires 100% of the share capital of Company B for CU 1 million cash.

Company A also acquires:

- Assets: Cash CU 0.25 million, Goodwill CU 0.1 million;
- Liabilities: Deferred Tax Liability CU 0.1 million related to the Goodwill, Bank Loan CU 0.65 million;
- Processes: Mine plan;
- Outputs: None.

Analysis

Assume Company A elects to do the optional concentration test. The fair value of the gross assets is the sum of the consideration transferred (CU 1 million) and the fair value of the liabilities assumed other than the deferred tax liabilities (CU 0.65 million) less cash (CU 0.25 million). The fair value of the gross assets is therefore CU 1.4 million. This is represented by the fair value of the mine asset of CU 1.4 million.

Therefore, the fair value of the gross assets acquired is concentrated in a single identifiable asset, which is the mine.

BDO comment

In the extractives sector companies will often acquire a land lease and related mineral rights. We believe that the mineral rights should generally be combined with the land lease rights to be considered a single asset. Acquisitions in this sector may also include certain production equipment. It is necessary to consider whether the cost to remove the equipment and use it separately is significant, and therefore, whether it is required to be grouped with the land lease and considered to be a single identifiable asset.

For companies in the extractives sector, the answer to the question of whether a group of acquired assets represent a group of similar assets is likely to depend on the related risk characteristics. For example, if an entity acquires a group of properties that include both exploration and evaluation (E&E) stage and producing properties, the company will need to assess whether the risk characteristics of the two types of assets are similar. Although typically we would expect that exploration stage and producing properties would have significantly different risk characteristics, that presumption may be overcome in limited circumstances based on factors such as whether the properties are in the same geographic area, preliminary studies indicate that the exploration stage properties are expected to show results consistent with the producing properties.

3. DEFINITION OF A BUSINESS

If an entity elects to apply the optional concentration test to a particular transaction or other event, and it is determined that substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset, or a group of similar identifiable assets, then it must carry out a detailed analysis of the definition of a business described below. A detailed analysis must also be carried out if the entity does not elect to apply the optional concentration test.

A business is defined in IFRS 3 *Business Combinations* as:

> *'An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.' (IFRS 3 Appendix A).*

IFRS 3.2(b) excludes asset acquisitions that do not meet the definition of a business from the scope of IFRS 3.

A business consists of inputs, and processes applied to those inputs, that have the ability to contribute to the creation of outputs.

An input and a process are the essential elements that have to be present in order to be classified as a business. Although a business usually has outputs, outputs are not required for an integrated set of assets to qualify as a business (for example, a start-up or early stage business might not yet have outputs). From an acquirer's perspective, a business does not need to include all of the inputs or processes that the seller used in operating that business. However, to be considered a business, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output.

Figure 3: Required elements to meet the definition of a business.

The elements of a business are described in IFRS 3.B7 as follows:

Inputs (IFRS 3.B7(a))	Processes (IFRS 3.B7(b))	Outputs (IFRS 3.B7(c))
Any economic resource that creates outputs, or has the ability to contribute to the creation of outputs when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.	*Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates outputs or has the ability to contribute to the creation of outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but the intellectual capacity of an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)*	*The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities.*

The determination of whether a set of acquired integrated assets meets the definition of a business is not dependent upon how the vendor has used, or how the acquirer intends to use that set of integrated assets.

IFRS 3.B11 notes that:

> *'Determining whether a particular set of activities and assets is a business shall be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. Thus, in evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.'*

BDO comment

From the definition of a business in IFRS 3 above, the following observations can be made:

- *Acquisitions of entities/projects involved solely in E&E activities are likely to be asset acquisitions, not business combinations, although care will be required for entities/projects for which E&E work has been carried out and, in addition, there are proven and probable reserves and a plan for site development (even if development work has not yet commenced);*
- *Acquisitions where substantially all of the fair value of the gross assets acquired is concentrated in a single asset are likely to be asset acquisitions or may be accounted for as asset acquisitions if the optional concentration test is satisfied regardless of whether it would otherwise meet the definition of a business;*
- *Acquisitions of entities/projects in the development phase will require careful analysis, as these may constitute the acquisition of a business if they have an organised, skilled workforce that has the necessary skills, knowledge or experience to develop the project into outputs; and*
- *Acquisitions of entities/projects in the production phase are likely to constitute the acquisition of a business.*

This analysis is based on the characteristics of entities and their activities in the extractive sector, because the ultimate output is the mined commodity. This means that in order for the acquisition to be classified as a business, the acquired set of assets and processes are required to be capable of providing goods to customers, generating investment income, or generating other income from ordinary activities.

If certain aspects of one or more of the elements are missing, this does not mean that the group of assets and liabilities under consideration fails the definition of a business. However, to be considered a business, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. Even if those attributes exist in an acquisition of a group of E&E activities, if the acquirer elects to apply the optional concentration test, it may result in a conclusion that the acquisition is not a business combination if substantially all of the fair value of the gross assets acquired is concentrated in a group of similar identifiable assets. Therefore, if an acquisition satisfies the concentration test, an entity may account for it as an asset acquisition (i.e. outside the scope of IFRS 3) even when it would meet the definition of a business if a detailed assessment were performed.

Some argue that the focus should be on the returns that an entity expects to derive from its activities when determining whether its assets, liabilities and activities (or components thereof) represent a business. For example, it is sometimes suggested that, from the perspective of entities that will only ever carry out E&E activities and generate benefit through their sale, the outputs from the assets, liabilities and activities that they own should be regarded as being the resultant dividend streams that will be generated. However, this analysis confuses the activities and outputs of the parent (or owner of the business(es)), which are to derive value from E&E activities that are applied to various mining assets, and the activities and outputs of the mining assets themselves. Further, the revised definition of outputs supports a conclusion that the inputs and processes must result in goods or services to customers, investment income or revenue from ordinary activities.

A common issue in the extractives sector is when a junior explorer obtains a listing by 'backing' into a listed shell company. The listed shell company typically has no business, employees or assets other than perhaps a cash balance. The value of the company lies primarily in the fact that it is listed. The transaction is usually structured as a share for share exchange, whereby the listed shell company issues shares to (in legal form) acquire the junior explorer. This transaction is not in the scope of IFRS 3 because it does not involve the (reverse) acquisition of a business, since the listed shell lacks a substantive process. Instead of being accounted for as a business combination, the acquisition is required to be accounted for in accordance with IFRS 2 Share-based Payment.

4. WHAT IS A SUBSTANTIVE PROCESS?

Entities that are in their development stage, including operations in the extractives sector that involve E&E activities, typically have no outputs.

To be considered a business, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs.

Paragraphs B12A-B12D of IFRS 3 explain how to assess whether an acquired process is substantive if the acquired set of activities and assets does not have outputs (Paragraph B12B) and if it does have outputs (Paragraph B12C) at the acquisition date.

Is the acquired process substantive?

No outputs at acquisition date

The process is critical to the ability to develop or convert an acquired input (or inputs) into outputs;
AND
The inputs acquired include **both** an organised workforce that has the skills, knowledge or experience to perform that process, as well as **other inputs** that the organised workforce could develop and convert into outputs.

Outputs at acquisition date

The process is critical to continue to produce outputs, and the inputs acquired include an organised workforce that has the skills, knowledge or experience to perform that process;
OR
It significantly contributes to the ability to continue producing outputs and is considered unique, or cannot be replaced without significant cost, effort or delay in the ability to continue producing outputs.

Examples of **other inputs** that the organised workforce could develop and convert into outputs include:
- Intellectual property that could be used to develop a good or service;
- Other economic resources that could be developed to create outputs; or
- Rights to obtain access to necessary materials or rights that enable the creation of future outputs.

Figure 4: Determining whether acquired processes are substantive.

BDO comment

It is very common for explorers and junior mining entities not to have outputs, as they have not yet reached the production stage. Careful consideration will be required to determine whether the acquisition of assets not yet in production meets the definition of a business if the processes acquired are substantive. As a result, if those acquisitions do not include an organised workforce, they will not meet the definition of a business and will instead be accounted for as asset acquisitions. Consequently, acquirers will need to consider whether an acquired workforce is capable of developing the working interests into producing assets (e.g. producing wells or mines). For example, if an entity acquires a group of E&E or unproven properties, and the seller accepts employment with the acquirer in order to help identify and acquire additional properties, it is likely that this set would not meet the definition of a business because the sole acquired employee does not have the requisite skills or experience to develop the unproven properties. Alternatively, had the acquired set included employees actively engaged in developing the properties, such as petroleum engineers and geologists, then it is likely that the acquired set would meet the definition of a business.

Many companies that invest in extractive companies that are in the production phase operate those properties through Joint Operating Agreements ('JOAs'). Although JOAs include administrative processes (such as accounting and billing guidelines), they also include operational and strategic management processes such as a plan of operations for drilling and development and a named operator in charge of supervising the properties. We believe that the existence of a JOA from a non-operator's perspective would generally meet the definition of a substantive process.

In the extractives sector, acquisitions may include a mixture of producing and non-producing properties. IFRS 3 is silent regarding scenarios where an acquired set includes a significant asset with outputs and another significant asset without outputs. We believe that when an acquired set includes producing properties, the analysis should be performed assuming the set has outputs unless the value of the producing properties is a clearly insignificant component of the overall value of the acquired set, in which case the analysis should be performed assuming the set has no outputs.

5. EXAMPLES IN THE EXTRACTIVE INDUSTRY

Example 2

Mine Co. has a long established gold mine located in Australia, with an established processing facility and a rail head. Mine Co. acquires 100% of the share capital of GoldDigger Co. GoldDigger owns the mineral rights to a prospective gold deposit in West Africa. GoldDigger has undertaken limited geological work, and has not yet determined the existence of either reserves or resources. GoldDigger employs no geologists directly, and instead uses a third party to carry out drilling and exploration activities.

Through its acquisition of GoldDigger, Mine Co. acquires the exploration licence for a specified area in West Africa where there are no proven or probable reserves and limited geological data. It also acquires the outsourced exploration plan. Note that this plan is outsourced to third party geologists. There are no outputs of GoldDigger.

Analysis

Mine Co. elects to apply the optional concentration test. Mine Co. concludes that substantially all of the fair value of the gross assets acquired is concentrated in the exploration license. Therefore, the acquired set is not considered a business and no further analysis is required.

Example 3

O&G Company acquires a 100% operating interest in a mostly unproven location, with a small amount of older, proven and developed producing properties, mineral interests and production facilities (for the proven producing properties). No employees or other assets are acquired. The fair value of the unproved locations represents approximately 95% of the fair value of the gross assets acquired.

Analysis

O&G elects to apply the optional concentration test. O&G concludes that the unproven location is a single asset. That is, the leases associated with the location should be combined with the mineral interests and considered one asset.

O&G Company concludes that substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset (the unproven location). Therefore, the set is not considered a business and no further analysis is required.

Example 4

Exploration and Production Company ('E&P Co.') has a producing mine in Western Canada with an established processing facility and a rail head. E&P acquires 100% of the shares of FindersKeepers Co. FindersKeepers owns five land sites in the E&E phase. Each site is in a different geographic area.

Through its acquisition of FindersKeepers, E&P acquires the mineral rights to all five sites. It also obtains the mine processing plan. FindersKeepers has no outputs.

Analysis

E&P Co. elects to apply the optional concentration test. It concludes that the sites are not similar identifiable assets because they each have different risks associated with them since they are in different geographic areas. Therefore, substantially all of the fair value of the gross assets acquired is not concentrated within a single identifiable asset or a group of similar identifiable assets.

E&P Co. must consider whether the assets acquired meet the definition of a business by assessing whether the acquired set includes both an input and a substantive process that together significantly contribute to the ability to create an output.

Since there are no outputs nor any substantive processes acquired, the set is not considered a business. As the set of activities acquired do not have outputs, B12B is applied to determine if the acquired process or processes are substantive. The acquired processes of FindersKeepers are not substantive because the inputs acquired do not include an organised workforce that has the necessary skills, knowledge or experience to perform the process (i.e. the development of the mineral interests acquired).

Example 5

Explorers R Us acquires a 100% operating interest in an unproven location, several hundred proven undeveloped oil and gas reserves (proven undeveloped reserves or 'PUDs') and proven producing properties (containing dozens of producing wells), mineral interests and producing facilities (for the proven producing properties). No employees or other assets were acquired. The fair value of the unproven location constitutes approximately 80% of the fair value of the gross assets acquired, while the value of the PUDs represents approximately 15% of the fair value of the gross assets.

Analysis

Explorers R Us elects to apply the optional concentration test. It concludes that the unproven location is a single asset. That is, the lease(s) associated with the location should be combined with the mineral interests and considered one asset.

Explorers R Us concludes that each of the proven producing properties and the production facilities are a single asset. That is, the lease production facilities are attached to the wells and the associated mineral interests and cannot be removed without a significant decrease in utility of the tangible assets.

Explorers R Us also concludes that the unproven location, the PUDs and the proven producing properties along with the associated lease production facilities are not similar. Explorers R Us considers the risk characteristics to be significantly different between the unproven location and the PUDs and proven producing properties because no test wells have yet been drilled in the unproven location, and the unproven location covers a different geological zone. Therefore, substantially all of the fair value of the gross assets acquired is not concentrated within a single identifiable asset or a group of similar identifiable assets as the unproven properties make up 80% of the fair value of the gross assets acquired, while the proven properties represent 15% of the fair value of the gross assets acquired. Explorers R Us must now determine whether the acquired set meets the definition of a business.

To do this, Explorers R Us must determine whether the acquired set includes both an input and a substantive process that together significantly contribute to the ability to create an output. Although the set contains outputs, Explorers R Us concludes that the vast majority of the value resides in the unproven properties and PUDs that contain no outputs. Since Explorers R Us did not acquire a workforce, the set is not considered to be a business.

Example 6

RockHard Consulting is a geological consulting business. It acquires the back office geological/exploration department from Big Miner Ltd, a large mining company.

The geological consulting business was an internal department within Big Miner, which did not sell services to any third parties. Subsequent to acquisition, RockHard will contract the services of these geologists back to Big Miner as well as integrating the acquired division into its ongoing business operations. The former team from Big Miner is particularly strong in exploration in the Greenstone belt in West Africa, an area where RockHard was previously weak.

Through the acquisition of the department, RockHard acquires all of the geological data held by the department, including specialist modelling tools, together with the hardware and software to enable the geologists to perform their work. The entire skilled workforce of the department transfers to RockHard, including the exploration and consulting knowledge, with RockHard assuming all associated employment liabilities. The outputs obtained are geological reports and consulting reports.

Analysis

RockHard elects to apply the optional concentration test. The fair value of the gross assets acquired is based on the geological data, modelling tools, hardware and software, and the skilled workforce.

RockHard concludes that substantially all of the fair value of the gross assets acquired is not concentrated in a single identifiable asset or a group of similar identifiable assets. RockHard must now determine whether the acquired set meets the definition of a business.

To do this, RockHard must determine whether the acquired set includes both an input and a substantive process that together significantly contribute to the ability to create an output. As the set of activities and assets has outputs, B12C is applied to determine if the acquired process or processes are substantive. RockHard has acquired inputs, including an organised workforce that can utilise the existing skills and knowledge to continue producing outputs. The organised workforce has the relevant skills and knowledge to convert the other inputs (e.g. geological data, modelling tools, etc.) into outputs, as they produce geological reports, regardless of the fact that these were not sold to third parties prior to the acquisition. Consequently, RockHard concludes that the acquisition meets the definition of a business.

Example 7

Miners Co. has a long established producing mine with a processing facility and a rail head.

NickNack Co. has an abandoned mine that used to produce nickel. It stopped operating the mine two years ago when nickel prices declined. Miners acquires 100% of the shares of NickNack and intends to resume production. It acquires the mineral rights, mining equipment, processing and storage equipment, and the rail head.

Analysis

Miners elects not to apply the optional concentration test and, in consequence, it carries out a detailed analysis of inputs, outputs, and substantive processes. Since there are no outputs at the acquisition date, in order for the processes to be substantive there must be an organised workforce and other inputs that the organised workforce could develop and convert into outputs. Since neither of these exist, the transaction is an asset acquisition.

Under the revised definition of a business, in evaluating whether the abandoned mine is a business, it is not relevant that NickNack previously operated it or whether Miners intends to operate the mine as a business.

Example 8

Silver Sands Co. acquires a 75% operating interest in a silver mine that is in the production stage. It also acquires the mineral interest, production equipment and a processing plant (that is also processing 3rd party minerals). Employees associated with the management of the processing facility are included in the acquired set. It does not acquire a workforce associated with the mine itself. The fair value of the processing facility represents approximately 60% of the fair value of the gross assets acquired.

Analysis

Silver Sands elects to apply the optional concentration test. It concludes that the producing mine and the processing plant are not similar assets because they are in different major asset classes and have significantly different risk characteristics because the processing plant is also processing 3rd party volumes. Silver Sands therefore concludes that the optional concentration test is not met. SilverSands must now determine whether the acquired set meets the definition of a business.

To do this, Silver Sands must determine whether the acquired set includes both an input and a substantive process that together significantly contribute to the ability to create an output. The set contains outputs in the form of production from the silver producing mine and revenues from processing the silver.

Although Silver Sands did not acquire a workforce associated with the silver producing mine, it did acquire a workforce associated with the processing plant. Therefore, Silver Sands concludes that a substantive process is acquired because the workforce acquired is critical to the ability to continue to produce outputs, and thus the set is considered to be a business. In addition, the set includes a process facilitated by the lease production equipment and the processes associated with the plant that significantly contribute to the ability to continue producing silver and cannot be replaced without significant cost. As such, SilverSands concludes that the acquisition meets the definition of a business.

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