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Project	**Definition of a Business**
Paper topic	Responding to feedback on proposed concentration of fair value test

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Introduction

1. In November 2015 the US Financial Accounting Standards Board (FASB) published the Proposed Accounting Standards Update *Clarifying the Definition of a Business* (the FASB ED).
2. In June 2016, the International Accounting Standards Board (IASB) published the Exposure Draft *Definition of a Business and Accounting for Previously Held Interests* (the IASB ED) (ED/2016/1).
3. In January 2017, the FASB finalised its project issuing the Accounting Standards Update 2017-01, *Clarifying the Definition of a Business* (the FASB ASU).
4. The aim of both boards is to clarify the definition of a business and the related application guidance in FASB's Topic 805 *Business Combinations* and IFRS 3 *Business Combinations,* which are substantially converged standards.

Purpose of this session

5. The purpose of this session is to obtain ASAF members' advice on one of the specific areas of feedback on the IASB's ED.
6. Agenda Paper 2A provides a summary of the feedback received on the IASB ED. The IASB plans to discuss this paper at its February 2017 meeting. The paper is provided for background information.

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7. This paper:

   (a) explains the proposal to consider a set of activities and assets not to be a business if the fair value of the gross assets acquired is concentrated in a single asset or group of similar assets (ie the proposed screening test);

   (b) summarises the comments received from ASAF members on the proposed screening test;

   (c) reports the FASB decision on this issue; and

   (d) asks ASAF members' advice on this issue.

8. This paper focuses on the proposed screening test; in our view this part of the proposed amendments attracted the greatest level of attention, including from ASAF members, in the comment letters received.

9. Extracts from comment letters from ASAF members on the proposed screening test are reproduced in Appendix A of this paper.

The proposed screening test

10. The IASB proposed to consider a set of activities and assets not to be a business if, at the transaction date, 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 IASB proposed that if substantially all of the fair value of the gross assets acquired is concentrated in this way, further assessment of whether a set of activities and assets is a business would not be appropriate. In other words, the IASB proposed a determinative screening test, rather than an indicator or a rebuttable presumption.

11. The IASB also proposed to clarify that:

    (a) the fair value of the gross assets acquired includes the fair value of any acquired input, contract, process, workforce and all other intangible assets, including those that are not identifiable; and

    (b) the fair value of the gross assets acquired may be determined by adding the fair value of the liabilities assumed to the fair value of the

consideration paid (plus the fair value of any non-controlling interest and any previously held interest, if any).

12. The IASB explained in paragraph BC19 of the IASB ED that it proposed a determinative screening test, because it believed that this test would reduce the cost of applying the definition of a business without changing the IASB's intended outcome. The IASB believed that, in most cases, the proposed guidance on substantive processes and this screening test would lead to the same conclusion. The Board expected that, usually, the fair value of a substantive process would be more than insignificant, even if an asset is not recognised for some or all of the acquired processes. Consequently, in those cases, if the acquired set includes a substantive process, then the fair value of the gross assets acquired would not be concentrated in a single asset or a group of similar assets.

Main comments received

The screening test may result in inappropriate conclusions

13. Some respondents to the IASB ED, including some ASAF members, commented that the proposed screening test does not allow the exercise of judgement and may sometimes result in inappropriate conclusions (ie the screening test might lead to a conclusion that is inconsistent with what would be concluded through the assessment of whether an acquired process is substantive). They are concerned that certain transactions that are currently accounted for as business combinations would be considered asset purchases because of the proposed screening test. An example given by some respondents is the purchase of a fully-leased shopping mall including the employees responsible for leasing and tenant management when the fair value is concentrated in the building.

14. Consequently, these respondents suggested different solutions, for example by changing the screening test to an indicator, or a rebuttable presumption, or an optional test. Some respondents, including an ASAF member, observed that the proposed screening test should not be required 'in cases where it is clearly evident that the acquired set meets the general definition of a business'.

Should deferred taxes be included in the fair value of the gross assets acquired?

15. Some respondents, including ASAF members, asked the IASB to clarify whether deferred tax assets and deferred tax liabilities should be considered in performing the proposed screening test. Some ASAF members suggested that the IASB consider excluding the effects of deferred tax from the screening test, on the basis that the tax attributes of the acquired assets and liabilities should not influence the outcome of the test.

The meaning of "similar assets" should be clarified

16. Some ASAF members asked the IASB to clarify what would be considered "similar". They suggested the IASB to clarify in a principle-based manner when assets can be deemed similar for the purpose of the screening test (for example, a group of assets could be considered a group of similar assets if the nature, risks and characteristics of the assets are similar).

FASB decisions

17. During its redeliberations the FASB confirmed that the screening test should be determinative and provided some clarifications. We report below the decision reached at the August FASB meeting.

> *Threshold*[1]
>
> The Board affirmed its decision to include the threshold as a practical screen. When applying the threshold, the set is not a business if substantially all the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. If the threshold is not met, an entity would evaluate the rest of the implementation guidance to determine whether the set is the acquisition or disposition of a business or an asset or assets.

[1] Revised Minutes of the 24 August 2016 FASB Board Meeting on Clarifying the Definition of a Business

When applying the threshold, the Board clarified that:

1. A single identifiable asset includes any asset that could be recognized and measured as a single identifiable asset under Topic 805, Business Combinations*,* for financial reporting purposes with the following exceptions:

a. A tangible asset that is attached to and cannot be physically removed and used separately from other tangible assets (or intangible asset representing the right to use a tangible asset), without incurring significant cost, significant diminution in utility, or fair value to either asset

b. In-place lease intangible assets (including favorable or unfavorable lease assets and liabilities) and related real estate assets should be considered a single asset.

2. Deferred tax assets and the effects of deferred tax liabilities should be excluded from the gross assets acquired.

3. Identifiable assets within the same major asset class that have significantly different risk characteristics should not be considered similar assets.

18. An extract from the FASB final amendment to Topic 805 in respect of the screening test is included in Appendix B.

Questions to ASAF members

1. What advice do the ASAF members have for the IASB in respect of: a. The comments received on whether the screening test should be determinative or a rebuttable presumption or an indicator? b. The requests for further guidance on the meaning of 'similar assets'? c. The suggestions from respondents that deferred tax assets and deferred tax liabilities should be excluded from the assessment of concentration of fair value?

Appendix A – Extracts from ASAF members' comment letters on the proposed screening test

A1. In the following paragraphs, we report the comments received from ASAF members on the proposed screening test.

A2. The Accounting Standards Committee of Germany observed that:

> …While we acknowledge and welcome the general aim of the screening test, i.e. to have a simpler determination of sets and activities acquired that do not constitute a business, we have concerns regarding either of the two steps of the test. As far as the assessment of concentration of fair value is concerned, we suggest deleting the definition of fair value in paragraph B11A (sentences three and four), as we fail to see how the definition would help in determining whether a set of activities constitutes a business or not. Especially, the reference to the existence of any other intangible asset that is not identifiable , which we presume is goodwill and may be – in accordance with B12 – an indicator for having a business, does not help in determining when the group is not a business and is therefore rather confusing within this paragraph.
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> It is further unclear to us what exactly constitutes a single identifiable asset or a group of similar assets. From our point of view, this would require clarification of the unit of account, which is not defined in IFRSs. Also, it is not sufficiently clear what similar itself exactly means. For instance, and referring to example A, it is not clear to us why single-family homes with a different floor area and different interior design are necessarily similar. Thus, a clarification of these terms would be of help, irrespective of the fact that any clarification should still be principles-based.
>
> In addition, we believe that the example for assets that cannot be combined into a single identifiable asset or a group of similar identifiable assets in paragraph B11C(e) is

> too simplistic. Whilst we agree with the outcome that the acquisition of cash, accounts receivable and marketable securities does not constitute a business and should not be accounted for as such, we feel uneasy about the fact that such result is only yielded with failing the second step of the screening test. It seems to us that candidates to be accounted for as obvious asset acquisitions should be discarded early on in any test so that entities get to the intuitive result quicker. Therefore, we think that the IASB should not prescribe an order for the screening test, but simply state that both conditions must be met and leave the order in which they are tested to the entity. Since both conditions of the assessment process must be met, logically, they should always lead to the same conclusion; hence, there is no need to prescribe the order of the screening test.

A3. EFRAG observed that:

> We appreciate the difficulties in drafting a practical solution that is easy to apply, addresses concerns that the existing definition of a business captures some asset acquisitions and reaches the appropriate conclusion in every possible set of facts and circumstances. However, we are concerned that a determinative screening test as currently drafted may in some instances result in inappropriate conclusions. In particular, we consider that there may be instances in which an acquired set meets the requirements of the screening test such that the transaction is treated as an asset purchase, even though other evidence indicates that the acquired set meets the definition of a business based on the general definition. In other words, the fair value of the acquired assets could be concentrated in a single asset (or group of similar assets) in some situations when the acquired set is nonetheless a business.
>
> EFRAG believes that the screening test should be retained as a determinative assessment only if its relative simplicity can be maintained while avoiding inappropriate outcomes.

If this cannot be accomplished, EFRAG recommends that the IASB consider ways to take pressure off the test - for example by changing it into either an indicator or a rebuttable presumption. EFRAG also suggests that the screening test should not be required in cases where it is clearly evident that the acquired set meets the general definition of a business.

Should the IASB decide to retain the screening test in its current form, we consider that the following concerns should be addressed in order to ensure that the test is operational and applied in a consistent manner:

(a) *Impact of deferred tax on the screening test*: EFRAG observes that when applying the screening test, the identifiable assets are those which would qualify for recognition in accordance with IFRS 3, and that paragraph 25 of IFRS 3 requires recognition of deferred tax assets and liabilities for temporary differences on the acquired assets and liabilities. In EFRAG's opinion the IASB should consider excluding the effects of deferred tax from the screening test, on the basis that the tax attributes of the acquired assets and liabilities should not influence the outcome of the test. Accordingly, in EFRAG's view the gross assets acquired should exclude deferred tax asset for the purpose of the screening test. Also, when calculating fair value of the acquired assets as the sum of the fair values of the consideration and the liabilities assumed, deferred tax liabilities should be excluded from the latter. We understand that the FASB has tentatively decided to exclude deferred tax effects from the calculation.

(b) *Structure of the guidance on the screening test*: EFRAG believes that it is confusing to have the definition of fair value in paragraph B11A when this paragraph intends to explain when a transaction is not a business. We suggest moving this part of paragraph B11A to a separate paragraph. In addition, we consider it may

improve the understandability of the guidance if the guidance on a single and similar identifiable asset(s) were to be moved under a subheading 'Single or similar identifiable asset(s)' and the guidance on determining the fair value of the gross assets under a subheading 'Fair value of gross assets'.

(c) *Measurement of fair value of gross assets*: the ED presents the measurement of the fair value of the gross assets by adding the fair value of the liabilities acquired to the transaction price as one solution amongst others. We believe this solution is a pragmatic way to determine fair value, making the screening test a straightforward assessment. For the avoidance of doubt, we recommend the IASB to clarify whether they have other solutions in mind on how the fair value of gross assets could be determined.

(d) *Similar identifiable assets*: The ED does not define the term 'similar', and only indicates in paragraph B11C assets that shall not be combined into a single identifiable asset or considered a group of similar identifiable assets. In order to ensure that the screening test is applied consistently, we recommend that the IASB articulate in a more principle-based manner when assets can be deemed similar for this purpose. This should clarify which factors play a role in the assessment (for example, that the nature, risks and characteristics of the assets should be similar) without broadening the scope of the proposed screening test. We understand that the FASB has tentatively decided to provide such a clarification.

(e) *Interactions with existing guidance*: EFRAG recommends the IASB to explain the interactions with existing guidance, including the guidance on similar assets (paragraph 36 of IAS 38 Intangible Assets) and on the term 'class' (paragraphs 37 and 73 of IAS 16 Property, Plant and Equipment, 6 of IFRS 7 Financial Instruments: Disclosures, 119 of IAS 38).

A4. The Organismo Italiano di Contabilità (OIC) (Italian Standard Setter) observed that:

> However, OIC has some concerns with paragraph B11A concerning the assessment of concentration of fair value, because it seems to introduce an option in the determination of the fair value of the gross asset acquired that may lead to different results.
>
> Notably, B11A states that: “a transaction is not a business combination if the transaction is primarily a purchase of a single asset or group of assets ( ). The fair value of the gross assets acquired may be determined by adding the fair value of the liabilities assumed to the fair value of the consideration paid (plus the fair value of any non-controlling interest and previously held interest, if any).”
>
> We understand that this paragraph allows entity to determine the fair value of the gross assets acquired both directly (ie measuring the fair value of the assets acquired) and indirectly (adding the fair value of the liabilities assumed to the fair value of the consideration paid).
>
> We think that, in some circumstances, the consideration paid plus the fair value of liabilities assumed may differ from the fair value of the assets acquired, for example because of goodwill and deferred taxes arising in the purchase price allocation.
>
> For this reason, OIC suggests to substitute the expression “the fair value of the gross assets acquired may be determined by” with “the fair value of the gross assets acquired is determined by” and to clarify whether deferred tax assets and deferred tax liabilities should be excluded from the gross assets acquired.

A5. The Group of Latin American Standard-Setters (GLASS) observed that:

> Yes, we agree with the need to establish a definition of a Business as has been done by the IASB.

A6. The South African Financial Reporting Standards Council (SAFRSC) observed that:

i. Concentration of fair value

B11A focuses on whether a transaction comprises the purchase of a single asset or group of assets, and concludes that a concentration of fair value in a single asset or group of similar assets is not a business. We do not believe this will be true in all circumstances. For example an acquisition of a debtors book with a collection process may be considered a business under the current requirements in IFRS 3 as the acquiree has inputs and processes which are used to generate outputs. Applying the proposed amendments, the acquiree will only be considered a business if the collection process/ workforce has a fair value that is significant in relation to the debtor's book. If not, the fair value will be concentrated in a group of similar assets.

Although the fair value of the collection process may not be significant in relation to the debtor's book, the operation (which is managed as a business prior to acquisition) should not change its nature to an asset acquisition.

Further to this, we are concerned that certain acquisitions that should be regarded as businesses would not be business as identified below:

- A service entity producing a single service as most of the value would be concentrated in the assembled workforce. This would therefore not be regarded as a business under B11A.

- Acquisition of two identical activities and assets consisting of the same operations, buildings, acquired organised workforce and processes, the only difference is the fair value of the property it is situated on. Assume for instance that the fair value of the second property is significantly higher than the first as such the fair value of the second property is substantially all of the fair value of

the gross assets acquired and is therefore concentrated in a single asset. Based on this, the second scenario would not meet the requirements of B11A to B11C as explained in more detail below:

1. An entity purchases a shopping mall that is fully leased. The acquired set of activities and assets includes, the land, buildings, leases, employees responsible leasing and tenant management. The shopping mall is situated in an area with moderate property prices, the fair value of the purchase can be attributed to both the identifiable and not identifiable assets. In this scenario the purchase would meet the criteria included in paragraph B11A to B11C.

2. Assume the same facts as example 1, however the shopping mall is situated in an area where property is purchased at a premium, when determining whether substantially all the fair value of the gross assets acquired is concentrated in a single identifiable asset, the purchase of the land and building would be substantially all the fair value of the acquired assets, even though the fair value of gross assets purchased includes, contracts, processes and an organised workforce. Therefore the purchase would not meet the criteria of B11A to B11C.

We note also that the illustrative examples only refer to an assembled workforce as an example of a non-identifiable asset, we request that the board include other examples.

ii. Similar identifiable assets

B11A also applies to groups of similar assets identifiable assets we ask that the board clarify the factors that would result in a group assets being classified as similar. This may include geographic location, risk profile, customer base, amongst others.

This comment is relevant to Example A regarding the acquisition of single-family homes in IE74. The example concludes that a group of 10 single-family homes is a group of similar assets as they are similar in nature. We

question whether this conclusion is appropriate if the homes are in separate geographic locations (for example, different regions, cities or countries). By contrast, if the properties were shopping malls in different areas of a city, and they had different tenants or customer profiles, they could be considered similar in nature (shopping malls) and geographic location (city), but have different risk profiles.

We recommend the following be included within the definitions or as guidance:

Similar identifiable assets, would include assets that are based on similar risk profiles, geographic locations or nature. For example an investment portfolio with similar risk profiles, freestanding houses based in the same location and block of apartments consisting of simplex units.

Group of assets, consist of assets both identifiable and not identifiable, which may or may not be recognised in terms of IFRS. These assets will be taken into account when determining whether the fair value of the gross assets acquired is concentrated in a single identifiable asset.

iii. Alignment with IFRS 3

IFRS 3-B7 notes that, because an assembled workforce is not an identifiable asset, any value attributable to it is subsumed into goodwill. This is also the case for other items that are subsumed into goodwill.

Paragraph B11A of the ED notes that the fair value of the gross assets acquired includes the fair value of any acquired input, contract, process, workforce and any other intangible asset that is not identifiable. Therefore, in order to establish whether an entity is a business, an acquirer may need to perform a valuation of an assembled workforce and acquired processes, which may not be recognised as assets and be fair valued in terms of IFRS 3. This seems to be an onerous requirement as it would result in entities fair valuing such assets, to prove

existence of goodwill, and then subsuming this amount into the overall goodwill calculation if a business is identified. This would essentially require entities to perform a purchase price allocation to establish a single asset acquisition or not.

A7. The Asian-Oceanian Standard-Setters Group (AOSSG) observed that:

> Some members think that the assessment of the concentration of fair value is too rigid and it does not allow for consideration of qualitative factors which might be crucial in assessing the substance of the acquired set of activities and assets. In these members view, the consideration for qualitative factors should be included because the proposed assessment opens the door to structuring and the concentration of fair value could be manipulated. This matter could also be resolved by removing the assessment of the concentration of fair value as the first step of the assessment and requiring a more holistic assessment that incorporates qualitative as well as quantitative testing. The assessment of the concentration of fair value may be one of the quantitative testing.
>
> Some members think the consideration for right-of-use assets should be clarified, to the extent that they meet the principles underlying the proposed condition in paragraph B11B of IFRS 3 in the ED, tangible assets that are attached to, and cannot be physically removed and used separately from, other tangible assets without incurring significant cost, or significant diminution in utility or fair value to either asset , because right-of-use assets are neither intangible assets nor an item of property, plant and equipment.
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> Some members think that, although paragraph B11C of IFRS 3 in the ED lists the assets that should not be combined into a single identifiable asset or considered a group of similar identifiable assets, the IASB should clarify what type of assets can be considered a group of similar

identifiable assets in a more principle-based manner (e.g., based on nature, risks and characteristics, regardless of external forms), so that the assessment of the concentration of fair value can be consistently applied in practice.

Some other members think that, paragraph B11C(a) of IFRS 3 in the ED may lead to different conclusions for production lines that are a combination of software (intangible assets) and hardware (tangible assets). In addition, in cases where an acquired set of activities and assets contains the land and the building may be troublesome because, in their jurisdictions, an entity normally obtains the right to use land for a fixed number of years by paying a land transferring fee or by being allocated by the state, and that right to use would be accounted for as intangible assets.

Some members are of the view that the IASB should consider including a provision that requires qualitative factors to be considered if the assessment of the concentration of fair value does not reflect the economics of the transactions, because the assessment may result in transactions which are in substance business acquisitions being unintentionally accounted for as asset acquisitions, especially in the case where substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets while the acquisition contains minimal organised workforce which is critical to the generation of outputs but has an insignificant fair value (e.g., in an acquisition of a high-technology and substantially automated operation, or an acquisition of a shopping centre).

Some members think the assessment of the concentration of fair value may lead to unintended conclusions on whether the acquired set of activities and assets is a business, because the fair value of the gross assets acquired includes the fair value of any acquired process

and workforce and any other intangible assets that is not identifiable (as stated in paragraph B11A of IFRS 3 in the ED), which is difficult to be measured in practice. These members think the consideration paid could be used as a proxy of the fair value in practice and the amount of consideration paid could affect the result of the assessment of the concentration of fair value.

A8. The Accounting Standards Board of Canada (AcSB) observed that:

> We agree with the proposed amendments, that if substantially all the fair value of the gross assets acquired (i.e., the identifiable assets and non-identifiable assets) is concentrated in a single identifiable asset or group of similar identifiable assets, then the set of activities and assets is not a business, for the reasons identified in paragraphs BC18-BC19. We commend the IASB for including a diagram in paragraph B8A that summarizes the assessment process to determine if the definition of a business is met. We think it provides clarity and will be helpful in applying the proposed amendments. We suggest expanding the diagram to clearly articulate the thought process a stakeholder must follow when evaluating whether an acquired process is substantive as set out in paragraphs B12-B12C. We also commend the IASB for providing clear guidance on how to practically determine the fair value of the gross assets acquired in paragraph B11A. We think it clearly articulates how to practically calculate the fair value of the gross assets acquired. We also think that the screening test represents an improvement for the reasons identified in paragraphs BC18-BC19.
>
> However, we are concerned with the lack of guidance relating to the terms single asset or group of similar assets. We think that the terms are too broad and diversity in practice may arise because we think the necessary guidance to apply the screening test is not included as part of the authoritative guidance. We also think that the broad

> nature of these terms does not practically assist stakeholders in determining if a set of activities and assets is not a business.

A9. The Accounting Standards Board of Japan (ASBJ) commented:

> The ED proposed language that includes adjectives such as s*ubstantive*, *similar* or *significant*, but these terms require judgement in their application. considering the IFRSs are used in various jurisdictions in various languages, we are concerned that these terms may cause diversity in practice. We believe that the IASB should provide additional guidance that is sufficient to achieve consistent application in practice.

Appendix B – Extract from FASB final amendment to subtopic 805-10 published January 2017

B1. The following is an extract from the FASB final amendment to subtopic 805-10 in respect of the concentration of fair value practical screen.

> > > 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 in the same major asset class that have significantly different risk characteristics.