STAFF PAPER

April 2017

IASB® Meeting

Project	**Definition of a business**
Paper topic	Analysis of the comments received on the screening test

CONTACT(S) Leonardo Piombino lpiombino@fondazioneoic.it +39 06 6976 6834

Purpose of the paper

1. In June 2016, the Board published the Exposure Draft *Definition of a Business and Accounting for Previously Held Interests* (the ED) (ED/2016/1). The ED includes a proposal to consider a set of activities and assets acquired 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. This proposal is often called a 'screening test' because it is intended as a simple test to minimise the need for a more detailed assessment in some circumstances.

2. The purpose of this paper is to discuss whether the screening test should be modified.

3. We will provide an analysis of the comments received on the other proposals included in the ED at a future meeting.

Structure of the paper

4. This paper:

   (a) explains the proposed screening test;

   (b) summarises the feedback received on the proposed screening test;

   (c) reports the US Financial Accounting Standards Board's (FASB) decision on this issue;

(d) reports a summary of the March 2017 meetings of the Accounting Standards Advisory Forum (ASAF) and of the Capital Markets Advisory Committee (CMAC);

(e) analyses the feedback received on the proposed screening test; and

(f) recommends changing the proposed screening test into an optional test.

The screening test proposed in the ED

5. The Board proposed that a set of activities and assets should be considered 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. If that condition is met, no further assessment would be undertaken. If that condition is not met, an entity would assess whether a substantive process has been acquired.

6. In the rest of this paper, we use the phrase ‘determinative screening test’ to describe a screening test that:

(a) leads to **no** further assessment if the condition is **met**; and

(b) leads to **further assessment** if the condition is **not** met.

7. The Board also proposed that for the screening test the fair value of the gross assets acquired:

(a) includes the fair value of any acquired input, contract, process, workforce and any other intangible asset even if it is not identifiable; and

(b) may be determined by adding to the fair value of the consideration paid the fair value of the liabilities assumed (plus the fair value of any non-controlling interest and previously held interest, if any).

8. As explained in paragraph BC19 of the ED, the Board proposed a determinative screening test, because it believes that this test will reduce the cost of applying the definition of a business without changing the outcome. The Board believes that, in most cases, the proposed guidance on substantive processes and this screening test would lead to the same conclusion. The Board expects that, usually, the fair value of a

substantive process would be more than insignificant, even if some or all of the acquired processes are not recognised as an asset. Consequently, if the acquired set includes a substantive process, then the fair value of the gross assets acquired would usually not be concentrated in a single asset or a group of similar assets.

Summary of the comments received

9. The Board received 81 comment letters on the ED and 75 respondents commented on the proposed screening test. In February 2017, the Board discussed a summary of feedback received on the ED[1].

10. Most respondents to the ED agreed overall with the proposed screening test. Comments received in favour of the proposed screening test include the following:

    (a) We welcome the upfront test that 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 "screening test"), then the set of activities and assets is not a business. This addresses our concern raised in our previous response that it was very difficult to view an acquisition as anything other than a business under IFRS 3[2].

    (b) it is important that a practical distinction [is made] between the acquisition of an asset and the acquisition of what constitutes a business for the purpose of applying IFRS 3. The clarification will assist preparers and is likely to simplify the work involved and costs incurred in applying IFRS 3. The G100 considers that the existence of the 'screening test' is a practical and useful mechanism for determining whether a business has been acquired[3].

[1] See AP 13 http://www.ifrs.org/Meetings/MeetingDocs/IASB/2017/February/AP13-Definition-of-a-business.pdf

[2] See CL65 The 100 Group

[3] See CL21 The Group of 100

(c) We agree that a business would comprise at least an identifiable asset (or assets) and other items to which more than an insignificant proportion of total fair value would be ascribed. We believe that the assessment of concentration of fair value in a single asset or group of similar assets should be relatively straightforward to apply in practice[4]

The screening test may result in inappropriate conclusions

11. Some respondents commented that the proposed screening test is rule-based, does not allow the exercise of judgement and may sometimes result in inappropriate conclusions (ie the screening test might not lead to the same conclusion as assessing whether an acquired process is substantive). Consequently, they suggested different solutions, for example by changing the determinative screening test into an indicator, or a rebuttable presumption, or an optional test. Comments received on this topic include the following:

(a) the IASB should consider changing the screening test from a quantitative preliminary pass / fail test to one of the following: i) an optional test, or ii) a test that considers both qualitative and quantitative factors. The use of a screening test, as it is currently contemplated, may not be appropriate in all circumstances[5].

(b) A determinative screening test should be retained if its relative simplicity can be maintained while avoiding inappropriate outcomes… 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…We recommend that the IASB consider ways to take pressure off the test - for example by changing it into either an indicator or a rebuttable presumption… The screening test should not be required in cases where it is

[4] See CL80 BP

[5] See CL52 Canadian Bankers Association (CBA).

clearly evident that the acquired set meets the general definition of a business[6].

(c) We are of the opinion that if substantially all the fair value of the gross assets is concentrated in a single asset or group of similar assets [that] is an indicator that the acquired set is not a business, but is not determinative on its own. In practice, this might not give the right result in all circumstances. For example, acquisitions of a shopping mall, or a fund are most likely to include one significant asset (the property for the mall) or a group of similar assets (the financial assets for the fund) and processes that are outsourced (property management, asset management, etc.) which might be considered substantive, and the acquired set in each case is capable of producing outputs. However, both cases are likely to fail the first step analysis of the proposed assessment as the outsourcing contracts are expected to be at market conditions and rates and thus have nil value[7].

(d) Another key comment refers to the fair value concentration test, which is in our view a rule-based approach rather than a principle-based approach. Therefore, ANC considers more appropriate to turn the test into a rebuttable presumption instead of proposing a binary and binding conclusion. The purpose of our proposal is to ensure that, based on judgment, all types of transactions are adequately accounted for without having to cope with a rule defining a stringent dividing line[8].

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

12. Some respondents asked the Board to reconsider how deferred tax assets and deferred tax liabilities should be considered in performing the proposed screening test. Some of

---

[6] See CL76 EFRAG.

[7] See CL30 RSM International.

[8] See CL81 ANC.

them suggested that the Board should consider excluding the effects of deferred tax from the screening test.

13. Comments received on this topic include the following:

(a) … the tax attributes of the acquired assets and liabilities should not influence the outcome of the test. Accordingly, in our 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[9].

(b) The proposed wording for the screening test does not discuss the treatment of deferred tax and whether this should be included in the test. We recommend that the IASB make this clear. The exercise to compute deferred tax is only relevant if you have a business acquisition and is a significant piece of work for preparers. In our view, the IASB should clarify that deferred tax is excluded from the screening test[10].

The guidance on "a single asset" should be clarified

14. A few respondents asked the Board to clarify whether leasehold land and a building attached to the land should be considered a single identifiable asset for the screening test. Comments received on this topic include the following:

> It is unclear whether this guidance would apply, when one of the acquired assets is a right-of-use asset under IFRS 16 *Leases*, such as leasehold land and the building thereon, which are common in acquisitions involving real estate in certain parts of the world. Right-of-use assets are neither intangible assets nor an item of property, plant and equipment. While IFRS 16 specifies that right-of-use assets are generally accounted for applying the depreciation requirements in IAS

[9] See CL76 EFRAG.

[10] See CL65 The 100 Group.

16 *Property, Plant and Equipment*, it has also deleted the existing guidance on leased assets in IAS 16[11].

The meaning of "similar assets" should be clarified

15. Some respondents asked for additional guidance on how to determine what would be considered "similar assets" for the screening test. Comments received on this topic include the following:

(a) 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[12].

(b) We propose that the final standard includes a principle which specifies when a group of similar assets is sufficiently homogeneous to constitute a group of similar identifiable assets. Such principle could help to understand whether the list of items in paragraph B11C of the ED represents an exhaustive list or rather an indicative list of examples. … We urge the IASB to further explain the interaction with the guidance on similar assets in paragraph 36 of IAS 38 *Intangible Assets* (e.g. guidance on recognition of an intangible asset acquired in a business combination together with the related item). Furthermore, ESMA notes that the term 'class' is already defined for measurement purposes in paragraph 37 of IAS 16 *Property, Plant and Equipment* and

[11] See CL29 Singapore Accounting Standards Council.

[12] See CL76 EFRAG.

paragraph 73 of IAS 38, as well as for disclosure purposes in paragraph 6 of IFRS 7 *Financial Instruments: Disclosures*, paragraph 73 of IAS 16 and paragraph 119 of IAS 38. Therefore, the final standard should clarify whether these definitions of classes apply also in the context of assessment of concentration of fair value[13].

FASB decisions

16. In January 2017, the FASB finalised its project on this topic, by issuing Accounting Standards Update 2017-01, *Clarifying the Definition of a Business* (the FASB ASU).

17. During its redeliberations the FASB[14]:

    (a) confirmed that the screening test should be determinative (ie no further assessment if the condition is met, but further assessment if the condition is not met);

    (b) clarified that deferred tax assets, and goodwill resulting from the effects of deferred tax liabilities, should be excluded from the gross assets acquired;

    (c) clarified that a single identifiable asset includes 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; and

    (d) clarified that identifiable assets within the same major asset class that have significantly different risk characteristics should not be considered similar assets.

18. We reproduce below a paragraph of the FASB ASU Basis for Conclusions.

> BC22. During redeliberations, the Board considered making the threshold an indicator that the set is not a business.

[13] See CL13 ESMA.

[14] For further details see http://www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176168433604

> 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.

ASAF members advice

19. In March 2017, we asked ASAF members for their advice on whether the screening test should be determinative, or a rebuttable presumption, or an indicator.

20. ASAF members had mixed views on this topic. Some members supported the determinative screening test proposed by the Board. Those members observed that the screening test would help preparers in applying the guidance on the definition of a business. They also suggested the Board should remain converged with the FASB on their respective amendments.

21. Other ASAF members expressed concerns on the proposed screening test. In particular:

    (a) one member questioned whether the proposed screening test would be simple to apply and suggested changing the screening test to an indicator. In that member's view, a rebuttable presumption would add complexity, because entities would be required to see whether the presumption is rebutted.

(b) some members observed that some transactions that are currently accounted for as business combinations would be considered as asset purchases because of the proposed screening test. This may imply an overestimation of the value of some assets acquired when the total cost is allocated to the individual identifiable assets. Consequently, they would prefer a rebuttable presumption or an indicative screening test.

(c) one member stated that the proposed screening test is too stringent and would prefer a rebuttable presumption. The transfer of the workforce should be considered as a criterion to rebut the conclusion.

(d) another member observed that the proposed screening test is rule-based, while IFRS Standards are principle-based. If the IASB confirms the screening test as proposed, it should clarify how to apply this rule.

22. ASAF members generally agreed with the staff proposal to:

(a) clarify that assets that have different risks are not "similar" assets for the purpose of the screening test; and

(b) exclude the effect of deferred taxes from the screening test.

CMAC members advice

23. In March 2017, we presented to CMAC members an example (ie the acquisition of a fully-leased shopping mall and the employees that perform a substantive process[15]) to illustrate the accounting consequences of the proposed screening test. We presented this example, because some respondents observed that in this case the screening test may not give the right result.

[15] The fair value associated with the acquired workforce is insignificant, so the fair value is concentrated in the building and according to the proposed screening test the transaction is not a business combination. For further details see AP5 http://www.ifrs.org/Meetings/MeetingDocs/CMAC/March/AP5-Definition-of-a-Business.pdf

24. We asked CMAC members whether they find the results of the proposed screening test useful for the example presented. Members expressed the following concerns on the results of the proposed screening test:

    (a) according to the screening test the transaction described in the example is not a business combination. However, CMAC members thought that it should be considered a business combination, because the asset acquired has its own customers (ie it generates revenues);

    (b) the screening test may be difficult to apply in practice, because it may require the entity to measure at fair value the acquired workforce; and

    (c) the acquisition of the workforce indicates that the transaction described in the example is a business combination.

25. Some members questioned whether a deferred tax liability should be recognised in the example presented[16]. They observed that the real issue is whether this deferred tax liability makes sense from a user's perspective and whether and how users should evaluate it.

26. Some members expressed the view that having a distinction between an asset purchase and a business combination creates confusion; goodwill/synergies are the key difference. How a particular asset or liability is acquired in a particular case should not drive its basis of recognition.

27. One accounting difference between asset purchases and business combinations is the treatment of deferred tax. Agenda paper 19A[17] of the Board meeting in May 2016 contains an example (example 5) exploring implications of that difference.

28. We note that some respondents to the ED, and some CMAC members, suggested the Board should investigate whether some accounting differences between asset purchases and business combinations could be eliminated. In addition, some comments by CMAC members indicate more general concerns about the information conveyed by the recognition of deferred tax. We think that investigating these

---

[16] The example supposed that if the transaction is considered a business combination the acquirer recognises a deferred tax liability (due to the difference between the carrying amount of the building and its tax base) and goodwill, which is mostly due to the deferred tax liability.

[17] http://www.ifrs.org/Meetings/MeetingDocs/IASB/2016/May/AP19A-Income-Taxes.pdf

suggestions and concerns is not within the scope of this project. This investigation, in our view, would require a separate research project.

Staff analysis

29. Before discussing individual points raised by respondents, it is worth emphasising the role the screening test is intended to play and the implications this has for the design of the test:

    (a) The Board intends the test to make it easier, simpler and less costly for preparers to determine whether what they have acquired is just a set of assets or a business, without changing the outcome of the decision.

    (b) To achieve that objective, the test needs to be easy to understand, simple to operate and less costly than applying the full decision process. So the test must not be over-engineered.

    (c) The screening test identifies some transactions as asset purchases. For all other transactions, the entity must go on to perform the full decision process. The screening test never identifies any transaction as a business combination.

    (d) In some cases, a screening test might not reach the same outcome as the full decision process described in the Standard. The consequence of not reaching the same outcome are as follows:

        (i) Case 1 False positive: The screening test identifies a transaction as an asset purchase, but the full decision process would identify it as a business combination. In this case, the entity will account for the transaction as an asset purchase, and this has accounting consequences discussed further in paragraph 30 below.

        (ii) Case 2 False negative: The screening test does not identify a transaction as an asset purchase, but the full decision process would identify it as an asset purchase. This error will have no accounting consequences; because the entity is required to go on to carry out the full assessment. The only additional cost imposed by the test in this case is that the entity has been required to carry out the screening test unnecessarily.

(e) The Board can reduce the risk of a false positive by calibrating the test narrowly so that it identifies few transactions as asset purchases. Or it can calibrate the test broadly to identify more transactions as asset purchases. In calibrating the test, the Board needs to balance the different risks of those two cases.

(i) A narrow calibration reduces the risk of false positives, and the risk of accounting consequences. On the other hand, it increases the risks of false negatives that mean the entity will also have to perform the full decision process and that the screening test will increase costs, not reduce them.

(ii) A broad calibration increases the risk of false positives, and the risk of accounting consequences. On the other hand, it reduces the risks of false negatives—and so reduces the risks that the entity will have to perform the full decision process and that the screening test will increase costs, not reduce them.

(f) The screening test focuses on a single asset or a single group of similar assets. There is no conceptual reason to focus on a single asset (or group) rather than two dissimilar assets or 100 dissimilar assets. The advantage of focussing on a single asset is that it deals with a scenario that is reasonably common and reasonably easy to explain. The disadvantage of such a narrow focus is that it calibrates the screening test fairly narrowly and so is subject to a relatively high risk of false negatives; thus, it means that the full decision process must be used in some cases that will then be identified as asset purchases.

(g) In some cases, as some respondents pointed out, the screening test will increase costs, not reduce them:

(i) In some of those cases, an entity can reach a conclusion more easily and with less cost by applying the full process without using the screening test.

(ii) In some cases, it is clear that the screening test will not identify the transaction as an asset purchase. In those cases, applying the screening test will serve no purpose and will increase costs.

(h) If the screening test is made optional, that could have accounting consequences only in cases where the screening test could produce a false positive. If the screening test is calibrated narrowly, that outcome will be uncommon.

30. In assessing any adverse consequences of a false positive, it is worth considering what the accounting consequences would be:

(a) The entity would fail to recognise ‘core goodwill’ that is economically present in a business combination but is not present in an asset purchase. Paragraphs BC313-BC318 of the Basis for Conclusions on IFRS 3 describe ‘core goodwill’.[18]

(b) Some other accounting consequences would arise from differences in the accounting requirements, rather than from differences in the underlying economics of the two types of transaction. For example:

(i) The identifiable assets and liabilities acquired in a business combinations are measured initially at fair value, but assets and liabilities acquired in asset purchases are measured initially at cost. This means that a gain on a bargain purchase is recognised in a business combination, but not in asset purchases (though cost may often be close to fair value at that date);

(ii) deferred tax assets and deferred tax liabilities arising from the initial recognition of assets and liabilities are recognised in business combinations, but not in asset purchases;

(iii) contingent consideration is recognised at fair value in the case of business combinations, but in the case of asset purchases there is no specific guidance on the accounting for contingent consideration;

[18] Those paragraphs also note that because goodwill is measured as a residual, the carrying amount of goodwill includes several other factors as well as core goodwill.

(iv) acquisition-related costs are included in the cost of the assets acquired in the case of asset purchases, but recognised as an expense in the case of business combinations, with the exception of costs to issue debt or equity securities.

The Board's current work plan does not include a project to consider whether and how these accounting differences could be reduced. However, as a result of the 2015 Agenda Consultation, the Board added to its research pipeline a project on Variable and Contingent Consideration.

(c) The entity would not be required to provide all disclosures required by IFRS 3 for a business combination. We note that this potential loss of information concerned some CMAC members

Changing the proposed screening test into a mandatory indicator, or a rebuttable presumption

31. Some respondents, including some ASAF members, suggested changing the proposed screening test into a mandatory indicator, or a rebuttable presumption.

32. We think that the Board proposed a determinative screening test, because it believes that this test will reduce the cost of applying the definition of a business without changing the outcome in most cases. Indeed, paragraph BC19 of the ED states that:

> The Board […] believes that this initial screening will reduce the cost of applying the definition of a business without changing the Board's intended outcome. The Board believes that, in most cases, the proposed guidance on substantive processes and this screening test would lead to the same conclusion. The Board expects 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.

33. In our view, changing the screening test to a mandatory indicator, or a rebuttable presumption would be inconsistent with the intended purpose of the proposed test, that is to reduce the cost and complexity of applying the guidance on the definition of a business in cases that are straightforward. This is because a mandatory indicator or rebuttable presumption would require an entity to:

    (a) first perform the screening test; and

    (b) then if the fair value of the assets acquired is concentrated in a single asset (or group of similar assets), any way apply the rest of the guidance to confirm that the acquired set is not an asset or to rebut this indication or presumption. The ED does not require this additional analysis.

34. Consequently, we think that the screening test should not be changed to a mandatory indicator or a rebuttable presumption.

Changing the proposed screening test into an optional test

35. Some respondents, including some ASAF members, stated that in some circumstances the proposed screening test may result in inappropriate conclusions. They were concerned that certain transactions that are currently (and appropriately) accounted for as business combinations would be classified as asset purchases because of the proposed screening test. They also observed that the screening test might lead to a conclusion that is inconsistent with what would be concluded by assessing whether an acquired process is substantive.

36. Some respondents suggested that the screening test should not be required when it is evident that the acquired set meets the definition of a business. A few of them suggested that if an organised workforce is transferred the screening test should not be required.

37. We think that an entity should be permitted on a transaction-by-transaction basis to assess whether a substantive process has been acquired if this assessment would be more efficient or result in a conclusion that better reflects the economics of a particular transaction.

38. We think that the screening test should be optional and that this choice should be on a transaction-by-transaction basis, because in some cases the screening test will not serve its purpose of decreasing costs. For example when:

    (a) an entity can reach a conclusion more easily applying the guidance on substantive processes without using the screening test (eg when all of the inputs and processes needed to create outputs have been acquired); or

    (b) it is clear that the fair value is not concentrated in a single asset or group of similar assets (eg when there is significant fair value associated with both tangible and intangible assets).

39. However, to serve its purpose of decrease costing, the test, if selected, should continue to be determinative. That is, if an entity chooses to apply the screening test and concludes that the transaction is an asset purchase, it should not carry out further assessment that might change that conclusion.

40. We note that:

    (a) this approach would create a difference between the future amendments to IFRS 3 and the FASB ASU issued in January 2017; and

    (b) most respondents to the ED encouraged the IASB and FASB to reach converged solutions on their respective amendments and use similar/identical wording whenever possible.

41. Nevertheless, we think that this difference would not impair significantly the consistency in the application of the definition of a business between entities that apply US GAAP and entities that apply IFRS Standards, because we expect that in most cases the guidance on substantive processes and the screening test would lead to the same conclusion.

42. We also think that the existing situation (ie same definition of a business) does not produce comparability, because we have been informed that currently the definition of a business is not interpreted consistently in practice between entities that apply US GAAP (before the recent amendment) and entities that apply IFRS Standards (ie under US GAAP more transactions are considered as business combinations compared with IFRS practice).

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

43. Some respondents asked the IASB to clarify whether deferred tax assets and deferred tax liabilities should be considered in performing the proposed screening test. Most of them suggested that the IASB should consider excluding deferred tax from the screening test.

44. We agree with this suggestion, because we think that the tax base of the assets acquired should not affect the determination of whether the transaction is a business or a group of assets that do not constitute a business. In our view, this clarification would simplify the application of the screening test, because an entity should only be required to estimate the fair values of the assets acquired, without calculating deferred taxes and without considering goodwill resulting from the effects of deferred tax liabilities.

45. For example, suppose that an entity pays CU105[19] for assets that include a licence (with a fair value of CU100 and a tax base of CU20, and subject to an income tax rate of 30%), and no liabilities. The entity applies the screening test as follows:

    (a) the gross assets acquired exclude goodwill resulting from the effects of deferred tax liabilities. In this example, the deferred tax liability is CU24[20]. In a business combination, the entity would recognise that liability, with a corresponding increase in the carrying amount of goodwill. (In this fact pattern, the carrying amount of the goodwill would be approximately CU24 and would result wholly or mainly from the recognition of the deferred tax liability);

    (b) the gross assets acquired are determined by adding the consideration of CU105 to the liabilities of nil,[21] giving a total of CU105;

    (c) the entity concludes that the licence's fair value of CU100 is substantially all of the fair value of the gross assets acquired (CU105). Thus, the entity concludes that the fair value is concentrated in a single asset and treats the

---

[19] In this Staff Paper, currency amounts are denominated in 'currency units' (CU).

[20] (CU100-CU20)*30%

[21] The liabilities of nil exclude the deferred tax liability that would result in goodwill.

acquisition as an asset purchase. (The entity would allocate the consideration of CU105 across the licence and any other assets acquired.)

46. Consequently, we think that for the screening test the gross assets acquired should exclude both:

(a) deferred tax assets; and

(b) goodwill resulting from the effects of deferred tax liabilities.

The FASB excluded those same items in finalising its amendments.

The guidance on "a single asset" should be clarified

47. A few respondents asked the Board to clarify whether acquired leasehold land and an acquired building attached to the land should be considered a single identifiable asset for the screening test. They stated that it is unclear whether the proposed guidance in paragraph B11B of the ED would identify the right to use the land (leasehold land) and the building on that land as a "single asset".

48. We note that paragraph B11B of the ED states that:

> A single identifiable asset, for the test in paragraph B11A, is any asset or group of assets that would be recognised and measured as a single identifiable asset in a business combination. In addition, for this assessment, 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, shall be considered a single identifiable asset.

49. We think that according to paragraph B11B of the ED a building and the underlying land are considered a single asset for the screening test and that it would be appropriate for this to apply even when one of the acquired assets is a right-of-use asset under IFRS 16 *Leases*.

50. We note that paragraph B11B of the ED requires the two assets to both be tangible and paragraph B11C states that separately identifiable tangible and intangible assets shall not be combined into a single identifiable asset. IFRS 16 does not specify that a right-of-use asset is tangible or intangible. Consequently, we think that the Board

should amend the wording in paragraph B11B of the ED to clarify that it also applies when one of the acquired assets is a right-of-use asset as described in IFRS 16 *Leases*. This clarification would be consistent with a clarification made by FASB on its amendments.

The meaning of "similar assets" should be clarified

51. Many respondents stated that additional guidance would be needed to determine what would be considered "similar assets" for the screening test. They suggested clarifying 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), so that the assessment of the concentration of fair value can be consistently applied in practice.

52. We agree with this suggestion, because we understand that many respondents support the screening test, but are concerned that the term "similar" might be interpreted too broadly and that divergence in practice could arise without further clarification. We also note that this suggestion is consistent with the clarification made by FASB on its amendments.

53. Consequently, we think that the Board should clarify that when assessing whether assets are similar, an entity should consider the nature of each single asset and the risks associated with managing and creating outputs from the assets. We also think that this clarification would reduce the risk of a false positive and would address the concern that too many transactions will be considered asset purchases because of the screening test.

Interactions with existing guidance

54. A few respondents asked the Board to clarify the interaction between the proposed guidance on what assets may be considered a single asset or a group of similar assets for the screening test and paragraph 36 of IAS 38 *Intangible Assets*, which states that:

> An intangible asset acquired in a business combination might be separable, but only together with a related contract, identifiable asset or liability. In such cases, the acquirer

> recognises the intangible asset separately from goodwill, but together with the related item.

55. We think that the intangible asset and its related item would be considered a single asset according to paragraph B11B of the ED, which states:

> A single identifiable asset, for the test in paragraph B11A, is any asset or group of assets that would be recognised and measured as a single identifiable asset in a business combination…

56. These respondents also observed that the term ‘class’ is already defined in paragraph 37 of IAS 16 *Property, Plant and Equipment,* paragraph 73 of IAS 38 and paragraph 6 of IFRS 7 *Financial Instruments: Disclosures*. They suggested that the final amendments should clarify whether these definitions of classes apply also in the context of assessment of concentration of fair value.

57. Paragraph 73 of IAS 38 states that:

> A class of intangible assets is a grouping of assets of a similar nature and use in an entity’s operations. …

58. Paragraph 37 of IAS 16 states that:

> A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity’s operations…

59. Paragraph 6 of IFRS 7 states that:

> When this IFRS requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments

60. We think that the guidance on classes of tangible, intangible and financial assets reported above is applicable also in the context of assessment of concentration of fair value. We think that we may clarify that these amendments to IFRS 3 are not

intended to modify the existing guidance on similar assets in paragraph 36 of IAS 38 and the term “class” in IAS 16, IAS 38 and IFRS 7.

Staff recommendations

61. Having considered the comments received, we recommend that the Board should:

(a) Make the screening test optional on a transaction-by-transaction basis;

(b) Confirm that the screening test is determinative. This means that if an entity has carried out the screening test and concluded that the fair value of the gross assets acquired is concentrated in a single asset (or in a group of similar assets), the entity shall treat the transaction as an asset purchase, without carrying out further assessment that might change that conclusion. If the screening test does not identify such a concentration, the entity shall continue with the rest of the assessment;

(c) Specify that deferred tax assets and deferred tax liabilities should not be considered when performing the screening test. Consequently, the gross assets considered in the screening test exclude:

(i) goodwill resulting from the effects of deferred tax liabilities; and;

(ii) deferred tax assets;

(d) Modify the wording in paragraph B11B of the Exposure Draft, to clarify that this guidance on what is considered “a single asset” when performing the screening test also applies when one of the acquired assets is a right-of-use asset, as described in IFRS 16 *Leases* (for example leasehold land and the building on it are considered a single asset for the screening test);

(e) Clarify that when assessing whether assets are considered ‘similar’ for the screening test, an entity should consider the nature of each single asset and the risks associated with managing and creating outputs from the assets;

(f) Clarify that the new guidance on what assets may be considered a single asset or a group of similar assets is not intended to modify the existing guidance on similar assets in paragraph 36 of IAS 38 and the term “class” in IAS 16, IAS 38 and IFRS 7.

Question for Board members

1. Do Board Members agree with the staff recommendations listed in paragraph 61 of this paper?