Snapshot

by Capital Markets & Accounting Advisory Services

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The new definition of a business will likely result in more transactions qualifying as asset acquisitions instead of business combinations

Applicable MFRS	Amendments to MFRS 3 *Business Combinations*: Definition of a Business.
Effective date	Prospectively for transactions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020. Earlier application is permitted.

What are the key impacts

The new definition of business will likely result in more acquisitions being accounted for as asset acquisitions.The accounting impact on acquisition date and post-acquisition between an asset acquisition and a business combination are vastly different.

What would these mean to your financial statements? The table below highlights some of the key differences:

Asset acquisition	**Business combination**
Does not give rise to goodwill	Gives rise to goodwill which needs to be allocated to cash generating units and tested for impairment annually
Assets acquired are initially measured at cost being the fair value of consideration given up in exchange	Assets acquired and liabilities assumed are initially measured at their respective fair values based on market participants' perspective
Does not give rise to deferred tax at initial recognition of assets	Gives rise to deferred tax at initial recognition of assets and liabilities due to fair value uplifts
Directly attributable transaction costs are capitalised as cost of assets	Transaction costs are expensed to profit or loss

What issues do the amendments address?

The amendments clarify the definition of business, with the objective of assisting entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition.

The amendments arose from a Post-implementation Review of IFRS 3 where the IASB noted stakeholders' concerns over the difficulties in applying the definition of business under the existing IFRS 3.

What are the key amendments

- To constitute 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. The nature of the elements of a business varies by industry.The existence of a process(es) is what distinguishes a business from a set of activities and assets that is not a business. The identification of a substantive process is a key distinguishing factor in the amendments.

- To be substantive, the acquired process must be critical to the ability to convert the input(s) into output(s). Where a set of activities and assets does not have output at acquisition date (e.g start-ups), the inputs acquired must include an organised workforce that has the necessary skills, knowledge or experience to perform the process.

- The amendments provide additional guidance on what to consider when assessing whether an acquired process is substantive and remove the assessment of whether market participants are capable of replacing any missing inputs or processes and continue to produce output. Therefore, an acquirer shall base its assessment on what has been acquired in its current condition.

- The revised definition of output is narrower, focusing on goods or services provided to customers, investment returns and other income from ordinary activities. This is because the current definition, which focuses on returns in the form of lower costs and other economic benefits to the investors, does not adequately distinguish between an asset and a business acquisition as many asset acquisitions may be made with the motive to lower costs.

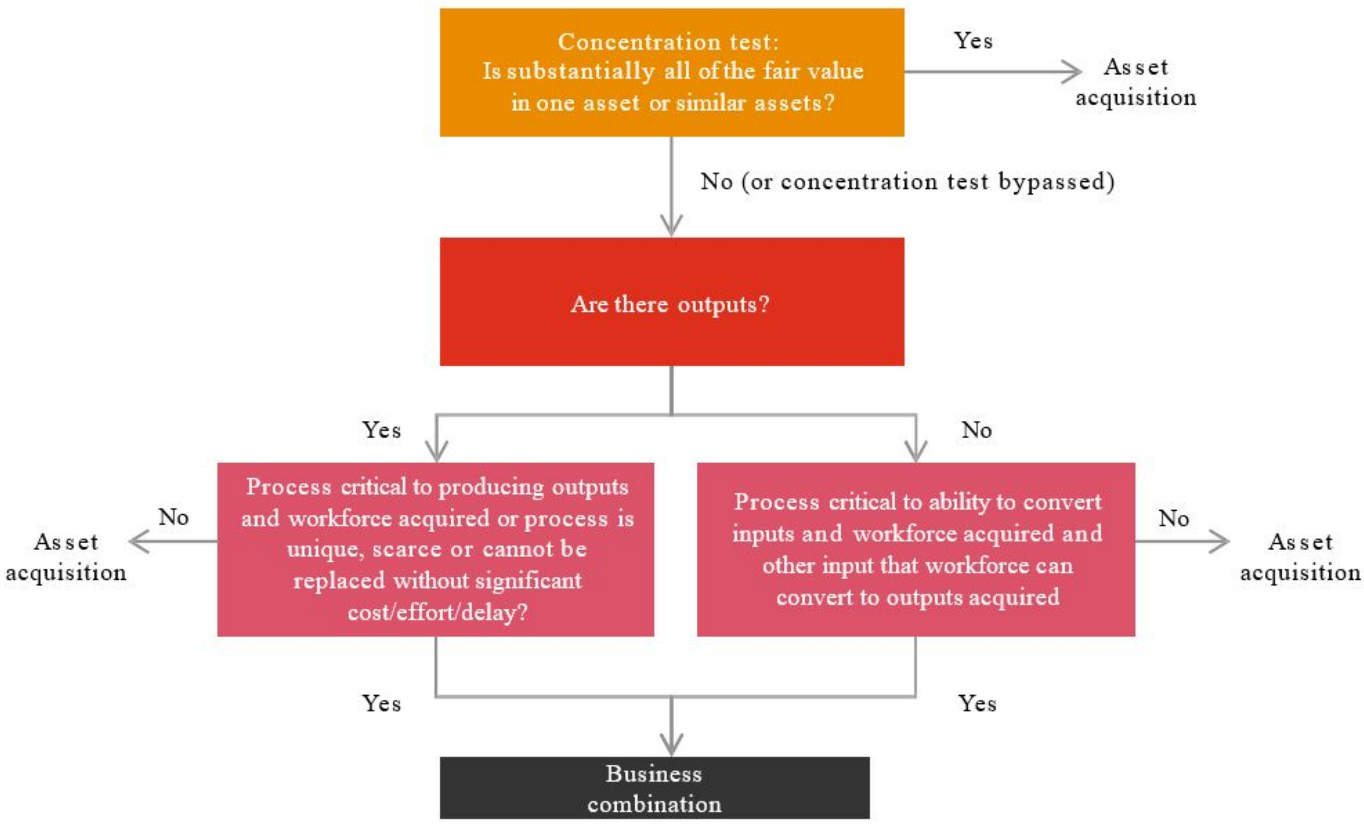
New introduction: Optional simplified approach

The amendments introduce an optional concentration test that is designed to reduce cost and complexity by eliminating the need for a detailed assessment on whether the definition of business is met.

Under the concentration test, an acquirer determines if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar assets.

- If the concentration test is met, the set of activities and assets is not a business and no further assessment under MFRS 3 is required.
- If the concentration test is not met, further assessment shall then be made to ascertain if the definition of business is met. Gross assets acquired exclude cash, deferred tax assets and any goodwill resulting from the effects of deferred tax liabilities.

In summary:



Practical insights

The introduction of the optional concentration test could have a more significant impact to certain industries, particularly the real estate and oil and gas industries. In the real estate industry for example, acquisitions commonly involve portfolio of real estates. When applying the concentration test, an entity should carefully assess if the portfolio of real estates could be aggregated to form a group of similar assets considering their risk characteristics.

Entities may wish to consider earlier application to take advantage of the concentration test introduced.

Future developments

One significant aspect arising from the Post-implementation review of IFRS 3 which relates to goodwill and impairment is not addressed in these amendments. The IASB is currently exploring alternatives to accounting for goodwill post-acquisition, mainly whether to retain the current impairment model or to reintroduce the amortisation model. It is also considering simplifying the requirements for goodwill impairment testing.

Do you have any further questions on this topic?	Contact: Chew Lam Koon Assurance Director from PwC Malaysia CMAAS Email: lam.koon.chew@pwc.com Tel: +60 (3) 2173 0779
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