

MOORE APAC WEBINAR AMENDMENTS TO IFRS 3 BUSINESS COMBINATIONS – DEFINITION OF A BUSINESS

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Amendments to IFRS 3 – New definition of a business

- What are the effective date and transitional provisional requirements?
- What are the new requirements?
- How to apply the new requirements?



Why was there an amendment to IFRS 3?

- Many stakeholders told the IASB that the current requirements of IFRS 3 as to whether an acquisition was a business combination or an asset acquisition were rather complex.
- Significant accounting differences between business combinations and asset acquisitions:
 - Goodwill/bargain gain recognition
 - Divergent accounting treatments of deferred taxes, contingent consideration and transaction costs etc.

Effective date and transitional provision

- An entity shall apply the amendments to 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.
- Earlier application is permitted.

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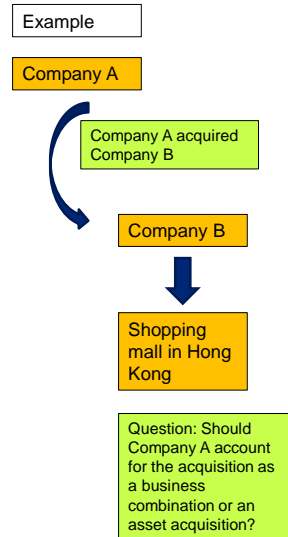
Example 1

- Company A is a December year end entity.
- Company A acquired Company B in 2019. The acquisition in 2019 was treated as a business combination.
- Company A acquired Company C in February 2020.
- Company A shall apply the amendments to IFRS 3 to determine whether the acquisition of Company C should be accounted for as a business combination or an asset acquisition.

- Question: Should Company A apply the amendments to IFRS 3 to the acquisition of Company B in 2019 to determine whether there is any prior year adjustment?
- Response: No. No need to apply the amendments to prior year acquisitions.

What are the key changes?

- 1) The amendments have introduced an optional concentration test – a simplified assessment to determine whether an acquisition is not a business.
- 2) The amendments have revised the definition of a business.
 - Before the amendment, IFRS 3 requires a business to include at least an input and a process.
 - After the amendment, IFRS 3 requires a business to include at least an input and a “substantive” process.



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The optional concentration test

Is **SUBSTANTIALLY ALL** of the fair value of the **GROSS ASSETS** acquired concentrated in **a single identifiable asset or group of similar identifiable assets**?

YES

The test is met → Asset acquisition.

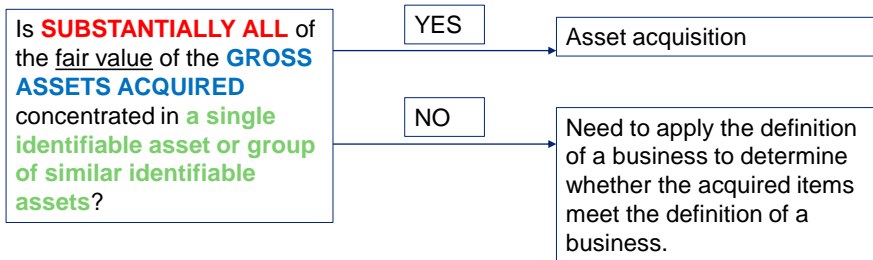
NO

The test is NOT met → Need to do further assessment as to whether the acquisition meets the definition of a business.

- **Accounting policy choice - Entities can choose whether or not to apply the concentration test for each transaction.**
- If entities choose not to apply the concentration test → need to determine whether an acquired set of activities is a business (i.e. still need to apply the definition of a business to determine whether a transaction is an asset acquisition or business combination).

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How to apply the concentration test?



Question 1) What were the GROSS ASSETS acquired?



Question 2) What were the fair values of the GROSS ASSETS at the date of acquisition?



Question 3) Was substantially all of the fair value of the GROSS ASSETS concentrated in a single identifiable asset or a group of similar identifiable assets?

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Question 1: What assets would be considered as 'GROSS ASSETS'?

- **Exclude** cash and cash equivalents.
- **Exclude** deferred tax assets.
- **Exclude** goodwill resulting from the effects of deferred tax liabilities.
- **The fair value of the gross assets acquired shall include:**
 - a) **consideration transferred**
 - b) **+ the fair value of any non-controlling interests and the fair value of the previously held interests**
 - c) **in excess of the fair value of the net identifiable assets acquired. The liabilities assumed do not include "deferred tax liabilities".**



The fair value of the Gross Assets acquired may **NORMALLY** be arrived at by adding a) the fair value of the consideration (plus fair value of NCI and fair value of the previously held interest) to b) the fair value of liabilities (other than DTL), and then exclude i) cash and cash equivalents acquired; ii) deferred tax assets and iii) goodwill resulting from the effects of DTL.

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Example 2

Background

- Company A acquired 100% equity interest in Company B.
- Company A pays CU350 for the 100% equity interest in Company B.
- Company B has the following assets and liabilities at the acquisition date:
 - A building with a fair value of CU500;
 - An identifiable intangible asset (a brand) with a fair value of CU400;
 - Cash and cash equivalents with a fair value of CU100;
 - Financial liabilities with a fair value of CU700; and
 - Deferred tax liabilities of CU160 arising from temporary differences associated with the building and the intangible asset.

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Response

Step 1) Assets acquired	Step 2) Included in Gross Assets? (Yes/No)	Step 3) Fair value of the Gross Assets
Building	Yes	500 ---A
An intangible asset (a brand)	Yes	400 ---B
Cash and cash equivalents	No	-
<div style="border: 1px solid black; background-color: yellow; padding: 5px; width: fit-content;"> This is similar to how to calculate goodwill under IFRS 3. </div>	<p style="color: blue; font-weight: bold;">The excess of “the sum of the consideration transferred plus the fair value of NCI and the fair value of the previously held interest” over the fair value of the <u>NET</u> identifiable assets acquired</p>	<p>350 (consideration) – (500+400+100-700) = 50 ---C</p>
<div style="border: 1px solid black; background-color: yellow; padding: 5px; width: fit-content;"> <ul style="list-style-type: none"> Includes cash and cash equivalent Include financial liabilities Do not include deferred tax liabilities </div>		<p>Fair value of the gross assets acquired = 950 (Sum of A, B and C)</p>

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Question 1: What assets would be considered as 'GROSS ASSETS'?

The fair value of the Gross Assets acquired may NORMALLY be arrived at by adding a) the fair value of the consideration (plus fair value of NCI and fair value of the previously held interest) to b) the fair value of liabilities (other than DTL), and then exclude i) cash and cash equivalents acquired; ii) deferred tax assets and iii) goodwill resulting from the effects of DTL.

Fair value of the consideration (350) + Fair value of liabilities (do not include DTL) (700) – Cash and cash equivalent (100)
= 950

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Question 1) What were the GROSS ASSETS acquired?

Question 2) What were the fair values of the GROSS ASSETS at the date of acquisition?

Question 3) Was substantially all of the fair value of the GROSS ASSETS concentrated in a single identifiable asset or a group of similar identifiable assets?

Concentrated in 'A SINGLE OR GROUP OF SIMILAR IDENTIFIABLE ASSETS'?

- 1) Identifiable assets include any asset or group of assets that would be recognised and measured as a single identifiable asset in a BUSINESS COMBINATION.
- 2) When assessing whether assets are similar, an entity shall consider the nature and risk characteristics of each single identifiable asset.
- 3) If a tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset (e.g. land and buildings), those assets shall be considered as a single identifiable asset.

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Examples

- The following shall not be considered similar assets:
 - A tangible asset and intangible asset;
 - Tangible assets in different classes (e.g. inventory, manufacturing equipment);
 - Identifiable intangible assets in different classes (e.g. brand names, licenses and intangible assets under development);
 - A financial asset and a non-financial asset;
 - Financial assets in different classes (e.g. accounts receivable and equity investments); and
 - Identifiable assets that are within the same class of asset but have significantly different risk characteristics.

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Example 3

Background:

- Company A purchases 10 houses that each have an in-place lease.
- The fair value of the consideration paid is equal to the aggregate fair value of the 10 houses acquired.
- Each house includes the land, building and property improvements. Each house has a different floor area and interior design and all are located in the same area and the classes of customers (e.g. tenants) are similar.
- The risks associated with operating in the real estate market of the houses acquired are not significantly different.
- No employees, other assets, processes or other activities are transferred.

Question: Company A would like to apply the optional concentration test. Should the 10 houses be treated as similar identifiable assets?

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Example 4

Background:

- Company A purchases Company B (a biotech company) that has the rights to (a) an in-process research and development project that is developing a compound to treat diabetes and is in its final testing phase (Project 1) and (b) another in-process research and development project that is developing a compound to treat liver cancer and is in its final testing phase (Project 2).
- Project 1 and Project 2 include the historical know-how, formula protocols, designs and procedures expected to be needed to complete the final testing phase.
- No employees, other assets, other processes or other activities are transferred.
- The fair value associated with Project 2 is similar to the fair value associated with Project 1.

Polling Question 1: Should the 2 R&D projects be treated as similar identifiable assets?

Options:

Option A – Yes

Option B – No

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Example 4 (con't)

Background:

- Company A purchases Company B that has the rights to (a) an in-process research and development project that is developing a compound to treat diabetes and is in its final testing phase (Project 1) and (b) another in-process research and development project that is developing a compound to treat liver cancer and is in its final testing phase (Project 2).
- Project 1 and Project 2 include the historical know-how, formula protocols, designs and procedures expected to be needed to complete the final testing phase.
- The fair value associated with Project 2 is similar to the fair value associated with Project 1.
- No employees, other assets, other processes or other activities are transferred.

Response:

- Project 1 and Project 2 are 2 identifiable intangible assets each of which would be recognized and measured as a separate identifiable asset in a business combination.
- Project 1 and Project 2 are not similar identifiable assets because significantly different risks are associated with managing and creating outputs from each asset. Each project has significantly different risks associated with developing, completing and marketing the compound to customers. The compounds are intended to treat significantly different medical conditions, and each project has a significantly different potential customer base.

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Example 5 (based on Example 2)

Question 3) Was substantially all of the fair value of the GROSS ASSETS concentrated in a single identifiable asset or a group of similar identifiable assets?

1) Assets acquired	2) Gross Assets	3) Identifiable assets
Building	Building – 500 ---A	Building – 500 ---A
An intangible asset (a brand)	An intangible asset (a brand) – 400 ---B	An intangible asset (a brand) – 400 ---B
Cash and cash equivalents	No	Cash and cash equivalent – 100
	<p>The excess of “the sum of the consideration transferred plus the fair value of NCI and the fair value of the previously held interest” over the fair value of the <u>NET</u> identifiable assets acquired</p> <p>= 350 (consideration) – (500+400+100-700)</p> <p>= 50 ---C</p>	Goodwill is not an identifiable asset
	Fair value of the gross assets acquired = 950 (Sum of A, B and C)	<p>Question: Is the fair value of the Gross Assets of 950 substantially concentrated in a single or similar identifiable assets?</p>

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When should we choose to use the concentration test?
(Accounting policy choice for each transaction)

- 1) Read the relevant sale and purchase agreement
- 2) Understand the business model of the acquiree

→ What were the significant assets acquired?
→ Is it just a single identifiable asset? Are they just a group of similar identifiable assets?



YES



Beneficial to apply the concentration test

NO



May NOT be beneficial to apply the concentration test

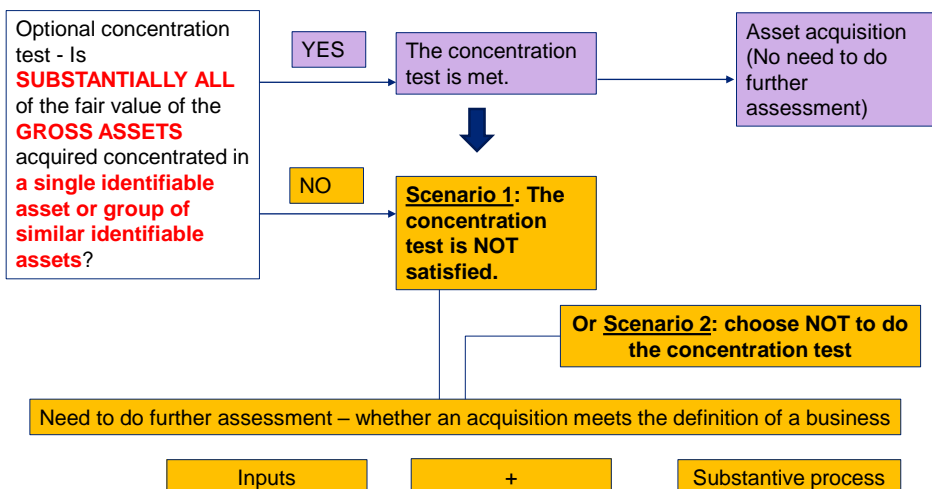
What are the key changes?



Definition of a business has been revised.

Before amendments	After amendments
<p>Business = an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing <u>a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.</u></p> <p>A business consists of <u>inputs and processes</u> applied to those inputs that have the ability to create outputs.</p>	<p>Business = 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.</p> <p>A business must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output.</p>

Scenarios to apply the definition of a business



What is meant by “process”?

Definition of “PROCESS” (Extracted from IFRS 3 (Revised))

- 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.**

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Assessing whether an acquired process is substantive

Does the acquired set of activities and assets have any outputs at the acquisition date?

(Note: If the acquired set of activities and assets was generating revenue at the acquisition date, it is considered to have outputs at that date, even if subsequently it will no longer generate revenue from external customers)

YES

NO

An acquired process is substantive if **EITHER ONE OF THE FOLLOWINGS IS SATISFIED:**

- a) The process is critical in continuing to produce outputs + Inputs acquired include an organized workforce with the necessary skills, knowledge or experience to perform that process.

OR

- b) The process significantly contributes to the ability to continue producing outputs AND is considered unique or scarce or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

An acquired process is substantive **ONLY IF:**

- a) The process is critical to the ability to develop or convert an acquired input or inputs into outputs;

AND

- b) The inputs acquired include **BOTH** an organized workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) AND other inputs that the organized workforce could develop or convert into outputs.

• Those other inputs could include:

- IP that could be used to develop goods or services;
- 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.

Example 6

Background:

- Company A purchases Company B (a biotech company) that has the rights to (a) an in-process research and development project that is developing a compound to treat diabetes and is in its final testing phase (Project 1) and (b) another in-process research and development project that is developing a compound to treat liver cancer and is in its final testing phase (Project 2).
- Project 1 and Project 2 include the historical know-how, formula protocols, designs and procedures expected to be needed to complete the final testing phase.
- The fair value associated with Project 2 is similar to the fair value associated with Project 1.
- No employees, other assets, other processes or other activities are transferred.
- Company B has a contract with another company that provides clinical trials. The contract is priced at current market rates and a number of vendors in the marketplace could provide the same services. Therefore, the fair value associated with the contract is nil. Company B does not have an option to renew the contract.

Project 1 and 2
are not similar
identifiable assets
→ Not to use the
concentration test

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Assessing whether an acquired process is substantive

Does the acquired set of activities and assets have any outputs at the acquisition date?

YES

NO

An acquired process is substantive if
EITHER ONE OF THE FOLLOWINGS
IS SATISFIED:

- The process is critical in continuing to produce outputs + Inputs acquired include an organized workforce with the necessary skills, knowledge or experience to perform that process.
- OR**
- The process significantly contributes to the ability to continue producing outputs AND is considered unique or scarce or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

An acquired process is substantive ONLY IF:

- 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 organized workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) AND other inputs that the organized workforce could develop or convert into outputs.
- Those other inputs could include:
 - IP that could be used to develop goods or services;
 - 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.

Should Company A apply the criteria in yellow or purple box?

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Example 6 (con't)

Polling Question 2:

- Based on the facts and circumstances provided, was there any substantive process acquired?

Options:

Option A – Yes

Option B – No

An acquired process is substantive ONLY IF:

a) The process is critical to the ability to develop or convert an acquired input or inputs into outputs;

AND

b) The inputs acquired include BOTH an organized workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) AND other inputs that the organized workforce could develop or convert into outputs.

• Those other inputs could include:

- IP that could be used to develop goods or services;
- 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.

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Example 6 (con't)

Analysis:

-
- Company B also has a contract that provides clinical trials. The contract is priced at current market rates and a number of vendors in the marketplace could provide the same services. Therefore, the fair value associated with the contract is nil. Company B does not have an option to renew the contract.

The contract that provides outsourced clinical trials may give access to an organized workforce. However, does such workforce have the necessary skills, knowledge or experience to convert inputs into outputs?

An acquired process is substantive ONLY IF:

a) The process is critical to the ability to develop or convert an acquired input or inputs into outputs;

AND

b) The inputs acquired include BOTH an organized workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) AND other inputs that the organized workforce could develop or convert into outputs.

• Those other inputs could include:

- IP that could be used to develop goods or services;
- 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.

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Example 7

Background:

- Company A purchases Company B (a biotech company) that has the rights to (a) an in-process research and development project that is developing a compound to treat diabetes and is in its final testing phase (Project 1) and (b) another in-process research and development project that is developing a compound to treat liver cancer and is in its final testing phase (Project 2).
- Project 1 and Project 2 include the historical know-how, formula protocols, designs and procedures expected to be needed to complete the final testing phase.
- The fair value associated with Project 2 is similar to the fair value associated with Project 1.
- ~~No employees, other assets, other processes or other activities are transferred.~~
- Company B also has a contract that provides clinical trials. The contract is priced at current market rates and a number of vendors in the marketplace could provide the same services. Therefore, the fair value associated with the contract is nil. Company B does not have an option to renew the contract.

A number of employees would be transferred - The senior management and scientists who have the necessary skills, knowledge, or experience to perform research and development activities.

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Example 7 (con't)

Polling Question 3:

- Based on the amended facts and circumstances provided, was there any substantive process acquired?

Options:

Option A – Yes

Option B – No

An acquired process is substantive ONLY IF:

- a) The process is critical to the ability to develop or convert an acquired input or inputs into outputs;

AND

- b) The inputs acquired include BOTH an organized workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) AND other inputs that the organized workforce could develop or convert into outputs.

- Those other inputs could include:

- IP that could be used to develop goods or services;
- 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.

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Example 7 (con't)

An acquired process is substantive ONLY IF:

a) The process is critical to the ability to develop or convert an acquired input or inputs into outputs;

AND

b) The inputs acquired include BOTH an organized workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) AND other inputs that the organized workforce could develop or convert into outputs.

- Those other inputs could include:
 - IP that could be used to develop goods or services;
 - 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.

Analysis:

- **Is there any process acquired?**
 - The definition of process includes “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”.
 - Yes, an organised workforce that has proprietary knowledge of how to develop the projects has been acquired.
- **Is there any substantive process acquired?**
 - Is the workforce acquired critical to convert inputs into outputs?
 - Is there any organised workforce that has the necessary skills, knowledge or experience to convert inputs into outputs?
 - Are there other inputs acquired?

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Example 8

Background:

- Company A purchases Company B which owns an office commercial building and a few blocks of residential buildings that are currently used as “service apartments”.
- The office commercial building and residential buildings are located in the same area.
- No employees, other assets, processes or other activities are transferred. Company B has entered into a contract with another company to outsource the cleaning and security services.
- The commercial building and residential buildings have been generating rental income.
- Company A chooses not to apply the concentration test. Even if Company A chose to apply the concentration test, the concentration test would not be satisfied.

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Assessing whether an acquired process is substantive

Does the acquired set of activities and assets have any outputs at the acquisition date?

YES

NO

An acquired process is substantive if **EITHER ONE OF THE FOLLOWINGS IS SATISFIED:**

a) The process is critical in continuing to produce outputs + Inputs acquired include an organized workforce with the necessary skills, knowledge or experience to perform that process.

OR

b) The process significantly contributes to the ability to continue producing outputs AND is considered unique or scarce or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

An acquired process is substantive ONLY IF:

a) The process is critical to the ability to develop or convert an acquired input or inputs into outputs;

AND

b) The inputs acquired include BOTH an organized workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) AND other inputs that the organized workforce could develop or convert into outputs.

- Those other inputs could include:
 - IP that could be used to develop goods or services;
 - 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.

Should Company A apply the criteria in yellow or purple box?

Example 8 (con't)

An acquired process is substantive if **EITHER ONE OF THE FOLLOWINGS IS SATISFIED:**

a) The process is critical in continuing to produce outputs + Inputs acquired include an organized workforce with the necessary skills, knowledge or experience to perform that process.

OR

b) The process significantly contributes to the ability to continue producing outputs AND is considered unique or scarce or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

Should the outsourced cleaning and security services be considered as “substantive” process?

A number of factors to be considered under IFRS 3 (Revised)

- | | | |
|--|--|---|
| Whether the service is minor or ancillary? | How long is the contract? Any renewal terms? | Is it difficult to replace the workforce? |
|--|--|---|

Given the nature of the services provided, the outsourced contract is just ancillary or minor to create outputs

→ No substantive process has been acquired
→ Not a business

Example 9

Background:

- Company A purchases Company B which owns a office commercial building and a few blocks of residential buildings that are currently used as “as service apartments”.
- The office commercial building and residential buildings are located in the same area.
- ~~No employees, other assets, processes or other activities are transferred.~~ Company B has entered into a contract with another company to outsource the cleaning and security services. Company B has an experienced letting team which will continue to work for Company B after the acquisition.
- The commercial building and residential buildings have been generating rental income.
- Company A chooses not to apply the concentration test. Even if Company A chose to apply the concentration test, the concentration test would not be satisfied.

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Example 9 (con't)

An acquired process is substantive if **EITHER ONE OF THE FOLLOWINGS IS SATISFIED:**

a) The process is critical in continuing to produce outputs + Inputs acquired include an organized workforce with the necessary skills, knowledge or experience to perform that process.

OR

b) The process significantly contributes to the ability to continue producing outputs AND is considered unique or scarce or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.



- Would the experienced letting team together with the documented procedures on how to let a property be considered a critical process in generating rental income?

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What need to be documented in an accounting memo?

Do you apply the optional concentration test?



- If yes, how do you assess whether the concentration test is satisfied?
- Is the fair value of the gross assets acquired substantially concentrated in a single asset or similar identifiable assets?
- What is the conclusion?

- If no, how do you assess whether the definition of a business is met?
- Is there any input?
- Is there any substantive process?
- What is the conclusion?

Thank you!



