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HKFRS Update

Amendments to IFRS 3 - Definition of a Business

Introduction

Amendments to IFRS 3 (The equivalent amendments to HKFRS 3 will soon be issued by the HKICPA) clarify the definition of a 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:

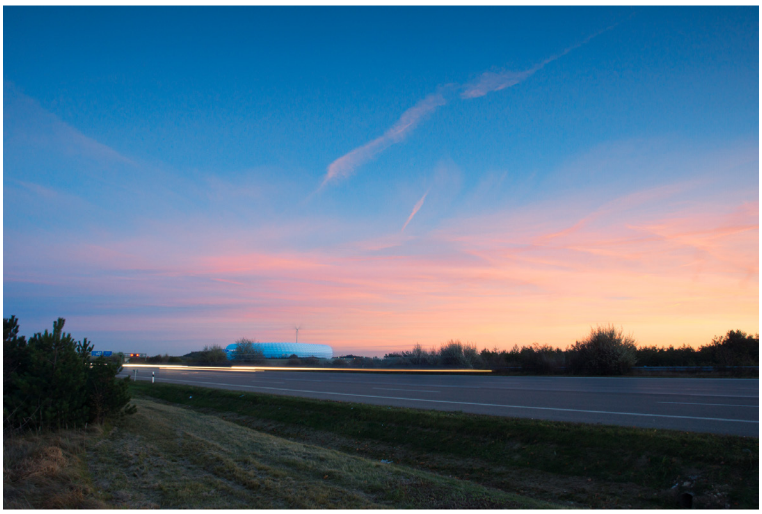
a. add an optional concentration test to determine whether an acquired set of activities and assets is not a business;

b. narrow the definitions of a business and of outputs by focusing on goods and services provided to customers and by removing the reference to an ability to reduce costs;

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

d. remove the assessment of whether market participants are capable of replacing any missing inputs or processes and continuing to produce outputs; and

e. add guidance and illustrative examples to help entities assess whether a substantive process has been acquired.



Effective Date

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.

Summary of Amendments

Concentration test

The Amendments set out an optional concentration test to determine whether an acquired set of activities and assets is not a business. An entity may elect to apply, or not apply, the test. Such an election can be made separately for each transaction.

The concentration test is met 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.

If the concentration test is met, the set of activities and assets is determined not to be a business and no further assessment is needed. If the concentration test is not met, or if the entity elects not to apply the test, the entity shall then perform the assessment as set out below.

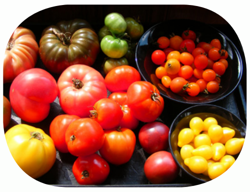
Definitions

A **business** is 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.

An **input** is any economic resource that creates outputs, or has the ability to contribute to the creation of outputs, when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.

A **process** is 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.

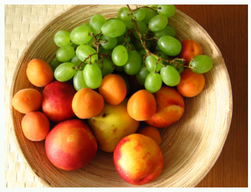
An **output** is the result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities.



Assessment

A business need not include all of the inputs or processes that the seller used in operating that business. However, to be considered a business, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. A business need not have outputs and liabilities.

Determining whether a particular set of activities and assets is a business shall be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. It is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.



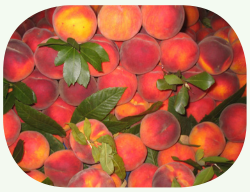
If a set of activities and assets does not have outputs at the acquisition date, an acquired process (or group of processes) shall be considered substantive only if:

a. it is critical to the ability to develop or convert an acquired input or inputs into outputs; and

b. the inputs acquired include both an organised workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) and other inputs that the organised workforce could develop or convert into outputs. Those other inputs could include:

   - intellectual property that could be used to develop a good or service;
   - other economic resources that could be developed to create outputs; or
   - rights to obtain access to necessary materials or rights that enable the creation of future outputs.

   Examples of the inputs include technology, in-process research and development projects, real estate and mineral interests.



If a set of activities and assets has outputs at the acquisition date, an acquired process (or group of processes) shall be considered substantive if, when applied to an acquired input or inputs, it:

a. is critical to the ability to continue producing outputs, and the inputs acquired include an organised workforce with the necessary skills, knowledge, or experience to perform that process (or group of processes); or

b. 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.

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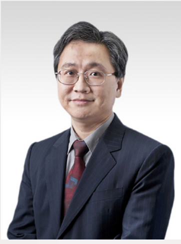

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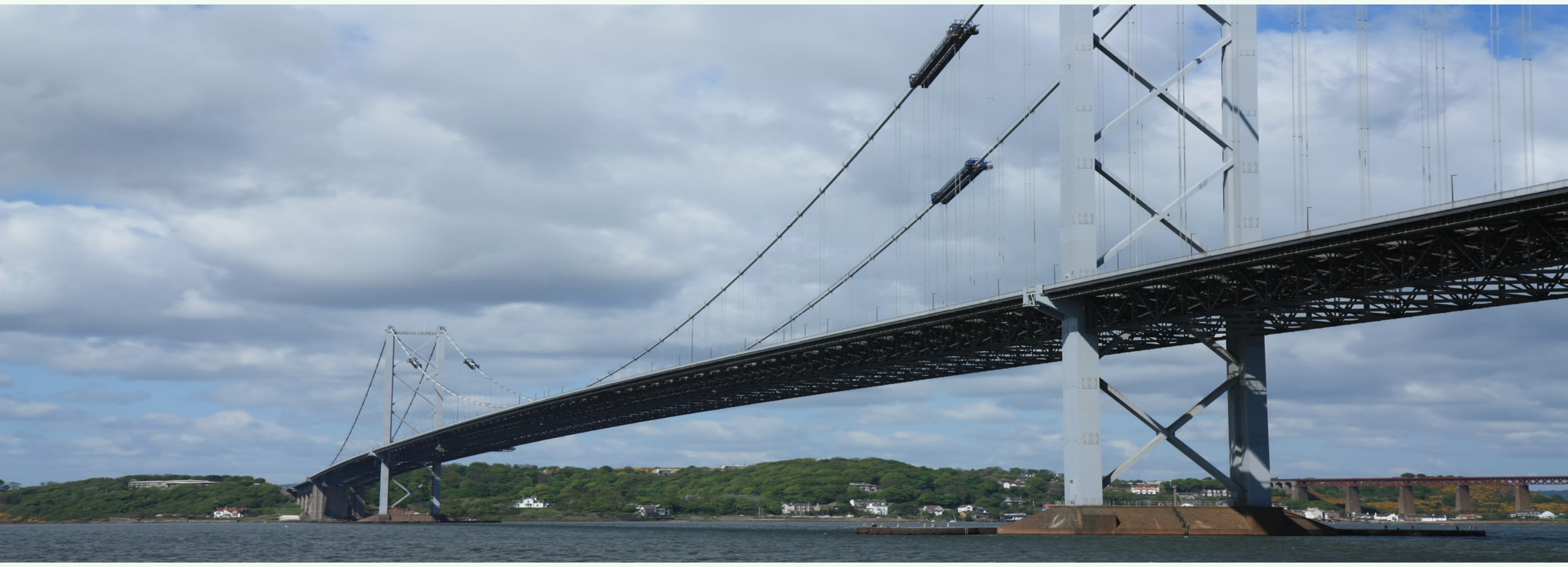

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