Nexia SAB&T

Training and Technical

IFRS 3 Business Combinations – New definition of Business

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In October 2018 the IASB issued amendments to IFRS 3 'Business Combinations' clarifying the definition of a business. These amendments are effective for financial years commencing 1 January 2020.

The changes are to be applied prospectively to business combinations and asset acquisitions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020.

Amendments were made to the definition of a 'business', with the aim of helping entities to determine whether a transaction should be accounted for as an asset acquisition or a business combination in terms of IFRS 3.

The changes narrow the definition by:

- focusing on providing goods and services to customers
- removing the emphasis from providing a return to shareholders
- removing the reference to 'lower costs or other economics benefits'

At initial recognition, when an enity **gains control** over a business or acquires a business**, an entity needs to consider whether IFRS 3 is applicable** to the transaction.

Goodwill is ONLY recognised when the *new definition of a business* is met AND the purchase price for the business is more in consideration of the fair value thereof as measured in accordance with IFRS 3.

The effect of this amendment is that far less "business combinations" will be recognised and therefore far less recognition of "goodwill".

Where an entity concludes that it is not acquiring a business, the individual assets and liabilities acquired are recognised at acquisition.

New Definition of a business	Previous definition of a 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.***	An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing ***a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.***

In summary, the following changes were made:

- clarify the minimum attributes that the acquired set of activities and assets must have to be considered a business
- remove the assessment of whether market participants are able to replace missing inputs or processes and continue to produce outputs
- narrow the definition of a business and the definition of outputs
- add an **optional concentration test** that allows a simplified assessment to determine that an acquired set of activities and assets is not a business

Five steps in determining whether an acquisition is a business combination:

Step 1 Consider whether to apply the concen-tration test

Step 2 Consider what assets have been acquired

Step 3 Consider how the fair value of gross assets acquired is concen-trated

Step 4 Consider whether the acquired set of activities and assets has outputs

Step 5 Consider if the acquired process is substan-tive

The optional concentration test is not an accounting policy or a professional judgement but it can assist entities to determine whether an integrated set of activities acquired is NOT meeting the definition of a business and is therefore outside the scope of IFRS 3.

As this is optional, an entity can decide to use it for one type of acquisition and ignore it for the next. **If applied, when the concentration test is POSITIVE, then the acquisition is NOT a business combination.**

Concentration test criteria:

Is all or substantially all of the Fair Value of the Gross Assets acquired concentrated in a **single identifiable asset**, or a group of **similar identifiable assets?**

YES

NOT a Business therefore **IFRS 3 is NOT applied**

NO

Apply full assessment in accordance with IFRS 3 to determine if definition of business is met

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