# THE ANNUAL INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) WEEK & IPSAS WEEK

## Business Combinations
## &
## Consolidated Financial Statements

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# Applicable IFRSs

IFRS 3: Business Combinations

IFRS 10: Consolidated Financial Statements

IFRS 13: Fair Value measurement

# Other IFRSs

IFRS 28: Investments in associates and joinyt ventures

IFRS 11: Joint arrangements

IFRS 12: Disclosure of interests in other entities

# Introduction

•In a group, each individual entity maintains its own accounting records, but

•Consolidated financial statements are needed to present the entities together as a single economic entity for general-purpose financial reporting.

•Consolidated financial statements often represent the only means of obtaining a clear picture of the total resources of the combined entity that are under the control of the parent.

# IFRS 10: Consolidated Financial Statements

# Introduction

- Issued in May 2011 and applies to annual periods beginning on or after 1 January 2013.

- Establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

- Includes unincorporated entities such as partnership within definition of subsidiary

# Key Definitions

| | |
|---|---|
| **Consolidated financial statements** | **The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity** |
| **Control of an investee** | An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee |
| **Investment entity*** | An entity that:<br>1. obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services<br>2. commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both, and<br>3. measures and evaluates the performance of substantially all of its investments on a fair value basis. |

# Who presents consolidated financial statements?

- An entity that has one or more subsidiaries (a parent)

# Who need not present consolidated financial statements?

- A parent if it meets all of the following conditions:
  - It is a subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about (and do not object to), the parent not presenting consolidated financial statements;
  - its securities are not publicly traded,
  - not in the process of becoming publicly traded, and

# Who need not present consolidated financial statements?...

- Its ultimate or any intermediate parent produces consolidated financial statements that comply with the IFRSs and are available for public use.

- An investment entity need not present consolidated financial statements but rather measure all of its subsidiaries at fair value through profit or loss.

- Post-employment plans or other long-term employee benefit plans to which IAS 19 applies

# Principle

Consolidated financial statements present the financial position and results of operations for a parent (controlling entity) and one or more subsidiaries (controlled entities) as if the individual entities actually were a single company or entity.

# Remember

- “You can’t own yourself.”
- “You can’t owe yourself money.”
- “You can’t make money selling to yourself.”

# Preparation of Consolidated Financial Statements

**Consolidation procedures**

- Combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries

- Offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (IFRS 3 *Business Combinations* explains how to account for any related goodwill)

# Preparation of Consolidated Financial Statements…

- Eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows

- Profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and property, plant and equipment, are eliminated in full.

- Include the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the reporting entity ceases to control the subsidiary

# IFRS 3: Business Combination

# Introduction

- A business combination is a transaction or other event in which a reporting entity (the acquirer) obtains control of one or more businesses (the acquiree).

- IFRS 3 does not apply to the following:

  -the formation of a joint venture

  -the acquisition of an asset or group of assets that is not a business as defined

  -a combination of entities or businesses under common control

# The acquisition Method

- Business combinations are accounted for using the acquisition method, -
  - identifying the acquirer;
  - determining the acquisition date;
  - Acquirer recognises and measure the identifiable assets acquired and the liabilities assumed and any non-controlling interest in the acquiree; and
  - Acquirer recognises and measures any goodwill acquired or a gain from a bargain purchase.

# Recognition and measurement

- Recognition principle
  - separate recognition of identifiable assets acquired, liabilities **and contingent liabilities** assumed
- Measurement principle
  - assets and liabilities that qualify for recognition are measured at their acquisition-date fair values

# Consideration transferred

- Measured at the fair value of the sum of assets transferred and liabilities assumed

- Acquisition-related costs excluded- must be recognized as an expense at the time of acquisition

- Contingent consideration is included at its fair value at acquisition date (subsequent changes in fair value are not included in the consideration transferred at acquisition-date

# Goodwill

- IFRS (revised ) views the group as an economic entity and therefore treats all providers of equity- including non-controlling interest as shareholders in the group.

- Consequently, goodwill will also arise on the non-controlling interest

# Goodwill

- Measured as the difference between the consideration transferred  excluding transaction costs plus value of non-controlling interest  in exchange for the acquiree's identifiable assets, liabilities and contingent liabilities

- If the value of acquired identifiable assets and liabilities exceeds the consideration transferred and value of the non-controlling interest, the acquirer immediately recognises a gain (bargain purchase)

- Goodwill is not amortised, but is subject to an impairment test.

# Negative Goodwill

May arise due:

- -errors in measuring the fair value of either the cost of combination or the acquiree's identifiable assets, liabilities, or contingent liabilities
- -future costs such as losses being taken into account, or
- -there has been a bargain purchase

Where negative goodwill arises, IFRS 3 requires parent companies to review the fair value exercise to ensure that no assets are overstated and no liabilities are understated.

# Goodwill Calculation

| | | |
|---|---|---|
| Consideration transferred | | X |
| Non-controlling interest | | X |
| Net assets acquired represented by | | |
| Ordinary share capital | X | |
| Share premium | X | |
| Retained earnings on acquisition | X | (x) |
| Goodwill | | X |

# Non-controlling interest (NCI) continued

- If less than 100% of the equity interests of another entity is acquired in a business combination, non-controlling interest is recognised.

- Choice in each business combination to measure

- non-controlling interest either at fair value or

- non-controlling interest's proportionate share of the (fair value of the) acquiree's identifiable net assets.

# Measurement of Non-controlling interest (NCI) continued

## Method 1

- NCI to be measured at the proportionate share of the net assets of the subsidiary as at the date of acquisition.

- At each subsequent reporting date the non-controlling interest is measured as its percentage share of the subsidiary's net assets.

# Illustration

On 1 January 2017, R Ltd acquired 80% of the 10,000,000 Sh.1 Ordinary shares of T Ltd for Ksh.1.50 per share in cash and so gained control. The fair value of T Ltd's net assets at that date was the same as their book value. The retained earnings as at that date amounted to Ksh. 4,000,000.

**Required:**

Compute the goodwill acquired on acquisition and the non-controlling interest as at that date

# Calculation of goodwill
# (Partial goodwill method)

| | | Ksh'000' |
|---|---|---|
| Parent Company investment in T Ltd | (80% X 10,000,000 X 1.50) | 12,000 |
| Non-controlling interest : | (20% X 14,000,000) | 2,800 |
| | | 14,800 |
| Less: Net assets acquired | | (14,000) |
| Goodwill | | 800 |
| | | |

# Calculation of Non-Controlling interest in T Ltd

| | |
|---|---|
| Non-controlling interest in Share capital (20% X 10,000,000) | 2,000 |
| Non-controlling interest in retained earnings as at date of acquisition (20% X 4,000,000) | <u>800</u> |
| Representing the non-controlling interest in TLtd's net assets. | <u>2,800</u> |

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# Measurement of Non-controlling interest (NCI) continued

## Method 11

- NCI to be measured at fair value as at the date of acquisition.

Note: Using fair value rather than percentage of book value may give rise to a difference for goodwill

- At each subsequent reporting date the non-controlling interest is measured as the total of the net assets of the subsidiary, plus goodwill

# Possible Impact of Method 11

- Higher value of goodwill because of recognition of goodwill on non-controlling interest.
- Reduction in earnings due to increase in any impairment charges of goodwill arising in subsequent years

# Illustration

On 1 January 2017, R Ltd acquired 80% of the 10,000,000 Sh.1 Ordinary shares of T Ltd for Ksh.1.50 per share in cash and so gained control. The fair value of T Ltd's net assets was the same as their book value. The retained earnings as at that date amounted to Ksh. 4,000,000.

The fair value of the non-controlling interest as at 1 January 2017 was Ksh.2, 900,000

**Required:**

Compute the amount of goodwill to be presented on the Consolidated Statement of Financial Position and the non-controlling interest as at that date

# Calculation of goodwill on Non-Controlling interest in T Ltd

| | |
|---|---|
| Fair value of non-controlling interest at date of acquisition | 2,900 |
| Non-controlling interest in Share capital (20% X 10,000,000) | 2,000 |
| Non-controlling interest in retained earnings as at date of acquisition (20% X 4,000,000) | 800 |
| Representing the non-controlling interest in TLtd's net assets. | 2,800 |
| Goodwill attributable to non-controlling interest | 100 |

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# Calculation of goodwill
# (Full goodwill method)

| | Ksh'000' |
|---|---|
| Parent Company investment in T Ltd (80% X 10,000,000 X 1.50) | 12,000 |
| Non-controlling interest at fair value | 2,900 |
| | 14,800 |
| Less: Net assets acquired | (14,000) |
| Goodwill | 900 |
| | |

# Calculation of goodwill
## (Full goodwill method)

| | |
|---|---|
| Goodwill attributable to the parent | 800 |
| Goodwill attributable to non-controlling interest | 100 |
| | 900 |

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# Non-controlling interest at year end (Fair value method)

- Valuing non-controlling interest at fair value applies only at acquisition

- At year end:

| | |
|---|---|
| Non- controlling interest at fair value at acquisition | XX |
| Non-controlling interest share of Subsidiary's post acquisition reserves | XX |
| | XX |

# Disclosure

- No disclosures specified in IFRS 10.

- IFRS 12 *Disclosure of Interests in Other Entities* outlines the disclosures required.

# Remember

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Thank You

# Questions