FINANCIAL REPORTING WORKSHOP, MOMBASA

Consolidated Financial Statements and Business Combinations -IFRS 10, IFRS 11 IFRS 3 & IPSAS 40

Presentation by:

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Agenda

1. IFRS 10 – Consolidated Financial Statements
2. IFRS 11 – Joint Arrangements
3. IFRS 3 – Business combinations
4. IPSAS 40- Public Sector combinations

IFRS 10 – Consolidated Financial Statements

Introduction:
-Principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities

IFRS 10 supersedes IAS 27 Consolidated and Separate Financial Statements and SIC – 12 Consolidation – Special Purpose Entities

Became effective for periods beginning on or after 1 January 2013

IFRS 10 - Consolidated Financial Statements

Control :

The principle of control sets out the following three elements of control:

1. Power over the investee;
2. Exposure, or rights, to variable returns from involvement with the investee; and
3. The ability to use power over the investee to affect the amount of the investor's returns

Power over investee

The relevant activities are directed by means of contractual arrangements

- In circumstances involving agency relationships

- In circumstances when the investor has control over specified assets of an investee

Structured entity

An entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity

- Such as when any voting rights relate to administrative tasks only and
- The relevant activities are directed by means of contractual arrangements

NB: An investor that holds only protective rights does not have power over an investee

Exclusion from consolidation

Must meet all the following conditions to be exempt from preparing consolidated FS:

- Debt or Equity instruments are not traded
- Not in process of filing its FS with a regulatory organisation to issue any class of instruments
- Ultimate or intermediate parent produces consolidated financial statements
- Post-employment benefit plans or other long-term employee benefit plans

Same consolidation procedure

- Use uniform accounting policies
- Intra-group balances and transactions must be eliminated
- Non-controlling interests in subsidiaries must be presented separately from the equity of the owners of the parent

Goodwill including Non controlling interest

Accounted at full fair value (recognise share of goodwill)

Consolidation of goodwill

Fair value of consideration paid		XX
Add: Fair value of non-controlling interest	XX	
Less: Fair value of identifiable net assets	(XX)	
Full goodwill		XX

Positive goodwill

- ✓ Evaluate impairment annually
- ✓ Allocate impairment loss to controlling and non controlling interest
- ✓ No revaluation upward

Negative goodwill

- ✓ Reassess the valuation of net assets acquired
- ✓ Recognise negative goodwill immediately as other operating income

1.) Consolidation begins from date the investor obtains control of the investee

2.) Consolidation ceases when the investor loses control of the investee

3.) Changes in a parent's ownership interest in a subsidiary that does not result in the parent losing control of the subsidiary are equity transactions

4.) Profit on disposal only recognised if control is lost

IFRS 10 in a nutshell

Control = **Power** + **Exposure to variability in returns** + **Link between power and returns**

To have power, it is necessary for investor to have existing rights that give it the ***current ability*** to direct the activities that significantly affect the investee's returns, i.e. the ***relevant activities***

Control assessed on *continuous* basis

Separate financial statements

- **In parent's separate financial statements investments in subsidiaries must be accounted for at:**
  - cost; or
  - in accordance with IAS 39
- **Must disclose:**
  - that the FS are separate FS
  - list of significant investments in subsidiaries, jointly controlled entities and associates
  - accounting policy adopted

IFRS 11 - Joint Arrangements

Supersedes IAS 31 Interest in Joint ventures and SIC – 13 Jointly Controlled Entities – Non – Monetary Contributions by Venturers

Effective for annual periods beginning on or after 1 January 2013

Joint Arrangements

Exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control

Types of joint arrangements

Two types – joint operations and joint ventures

- **A joint operation** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the **assets,** and obligations for the **liabilities,** relating to the arrangement.
- **A joint venture** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the **net assets** of the arrangement.

Joint operator and Joint venturer

Joint operator

To recognise and measure the assets and liabilities (and recognise the related revenues and expenses) in relation to its interest in the arrangement in accordance with relevant IFRSs applicable to the particular assets, liabilities, revenues and expenses

Joint venturer

To recognise an investment and to account for that investment using the equity method in accordance with IAS 28 Investment in Associates and Joint Ventures, unless the entity is exempted from applying the equity method

What is a business combination?

A *business combination* is a transaction or other event in which an acquirer obtains *control* of one or more *businesses*

When does IFRS 3 apply?

IFRS 3 applies to all business combinations

IFRS 3 does not apply to:

- **Formation of a joint arrangement**
- **Common control transactions**
- **Acquisition of asset / group of assets that is not a business**
  - **Cost allocated to identifiable assets / liabilities on basis of relative fair values**

What is a business?

A *business* is an integrated set of activities and assets capable of being managed to provide a return to investors via dividends, lower costs or other economic benefits

Inputs

Processes

Ability to create outputs

Rebuttable presumption that a group of assets in which goodwill is present is a business

Steps to acquisition accounting

Step 1: Identify the acquirer

Step 2: Determine the acquisition date

Step 3: Identify and measure consideration transferred

Step 4: Identify and measure identifiable net assets

Step 5: Measure NCI

Step 6: Determine goodwill or gain on a bargain purchase

Step 7: Recognise any measurement period adjustments

NCI = non-controlling interests

Overview of the acquisition method

Goodwill = Consideration transferred + NCI − Fair value of net identifiable assets

Option to measure NCI at acquisition date

Step 1: Identify the acquirer

The *acquirer* is the entity that obtains control of the business

Use IFRS 10 to determine who has control → **Consider additional factors identified in IFRS 3**

- Relative voting rights in combined entity
- Existence of large minority voting interest in combined entity
- Composition of governing body and senior management of combined entity
- Terms of exchange of equity interests
- Relative size entities

Step 2: Determine the acquisition date

The *acquisition date* is the date on which acquirer obtains control of acquiree

Date on which fair values of identifiable assets acquired and liabilities assumed are determined and goodwill is measured

Date from which profit or loss and other comprehensive income of the acquiree is included in the consolidated financial statements of acquirer

Step 3: Identify and measure consideration transferred

Consideration transferred is measured at *fair value* at the acquisition date, and includes:

- **Assets transferred**
- **Liabilities incurred to previous owners**
- **Equity instruments issued**

Acquisition-related costs excluded from consideration transferred, and expensed as incurred

Costs related to issue of equity or debt recognised in accordance with financial instruments standards

Contingent consideration

Contingent consideration **is an obligation of acquirer to transfer additional assets / equity interests to former owners as part of exchange for control if specified future events occur/conditions are met**

Recognised at fair value at acquisition date

Classified as liability or equity according to IAS 32

May be an asset

Step 4: Measure identifiable net assets

Recognition	**Must meet definition of asset / liability at acquisition date**
	Must be exchanged as part of acquisition
Classification and designation	**Made at acquisition date, irrespective of classification made by acquiree**
	Exception for leases, contingent liabilities and deferred taxes
Measurement	**Measured at fair value at acquisition date**

Fair value measurement in a business combination

Fair value **is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date**

Market approach

Income approach

Cost approach

i.e. market-based measurement

Intangible assets

All *identifiable* intangible assets recognised separately from goodwill

Separable

or

Arises from contractual or other legal rights

Measured at fair value without consideration of intended use

Step 5: Measure NCI

NCI are measured either at:

Their proportionate interests in fair value of identifiable net assets

Fair value

Election made on a transaction-by-transaction basis

Step 6: Determine goodwill or gain on bargain purchase

Option 1: NCI measured at fair value

Goodwill = Considera-tion transferred + NCI at FV

Fair value of net identifiable assets

Option 2: NCI measured at their proportionate interest in identifiable net assets

Goodwill = Considera-tion transferred + NCI based on net assets − Fair value of net identifiable assets

Step 7: Recognise any measurement period adjustments

***Measurement period* is period after acquisition date when entity can adjust preliminary business combination accounting**

- If new information obtained about facts and circumstances that existed at acquisition date
- Ends when information obtained or determined not available
- Cannot exceed one year

IPSAS 40-Public Sector Combinations

- A public sector combination is the bringing together of separate operations into one public sector entity

- Provides for two types of public sector combinations:
  - (a) amalgamations; and
  - (b) acquisitions.

Scope of IPSAS 40

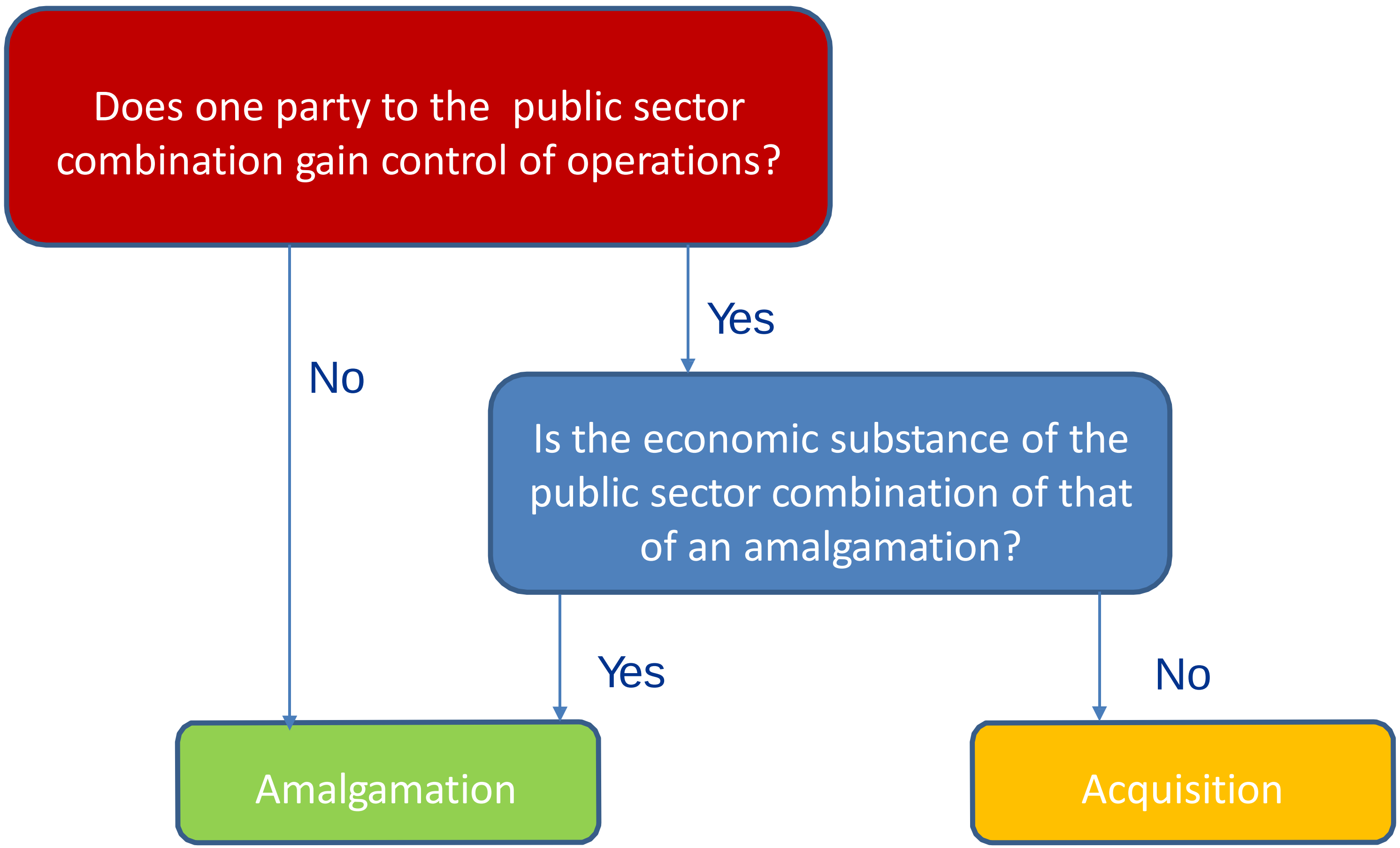
- Applicable to entities that prepare financial statements under accrual basis of accounting.

- Naturalizations; Purchases, Seizures and bailouts
- Reorganisations of local or regional governments
- Transfer of operations from one government to another
- Restructuring of central government ministries

Outside Scope of IPSAS 40

- Transactions that do not include operations
- Join Arrangements

Classification of Business Combination



Economic Substance

Consideration

-other than to compensate for transfer of net assets

-No consideration paid

-No (former) owners

• Decision making

-Under common control

-Imposed by third party

Approval by referenda

Amalgamation

- Gives rise to a resulting entity and is either:

A public sector combination in which no party to the combination gains control of one or more operations; or

A public sector combination in which one party to the combination gains control of one or more operations, and in which there is evidence that the combination has the economic substance of an amalgamation

Acquisition

- A public sector combination in which one party to the combination gains control of one or more operations, and there is evidence that the combination is not an amalgamation

Accounting for Business Combinations

Accounting	Amalgamation	Acquisistion
Method	Modified Pooling	Acquisition
Perspective	Perspective of each of the combining operations and their owners	Perspective of the Acquirer
Entity	Resulting Entity	Acquirer
Assets and Liabilities Recognised	Those recognised by Combining Operations	Identifiable assets and liabilities

Accounting for Business Combinations

Accounting	Amalgamation	Acquisistion
Measurement	Carrying Amount	Fair Value
Difference between consideration (if any) assets and liabilities transferred	Recognised in Net Assets/ Equity Components not specified	Goodwill (consideration) Loss: Gain on Bargain Purchase

Issued

- January 2017

Effective Date

- Reporting periods beginning on or after January 1, 2019(early application permitted)

Application

- Applied prospectively, no restatement

ICPAK
Uphold Public Interest

Questions?