Financial Reporting Week - 2019
Consolidated financial statements

By Ferdinand Othieno
10 September 2019

Agenda

1. **IFRS 3: Business Combinations**
2. **IFRS 10: Consolidated Financial Statements**
3. **IPSAS 40: Public sector combinations**
4. **Other issues**

IFRS 3: Business Combinations

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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*

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

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 Noncontrolling Interest

Step 6: Determine goodwill or gain on a bargain purchase

Step 7: Recognise any measurement period adjustments

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: 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

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 under IFRS 3

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**

- **Fair value of *identifiable net assets***
- ***Identifiable*** **intangible assets recognised separately from goodwill;**

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

IFRS 3: Proposed changes

The changes proposed in ED/2019/3 Reference to the Conceptual Framework (Proposed amendments to IFRS 3)

- Update IFRS 3 so that it refers to the 2018 *Conceptual Framework* instead of the 1989 *Framework*;
- Add to IFRS 3 a requirement that, for transactions and other events within the scope of IAS 37 or IFRIC 21, an acquirer should apply IAS 37 or IFRIC 21 (instead of the Conceptual Framework) to identify the liabilities it has assumed in a business combination; and
- Add to IFRS 3 an explicit statement that an acquirer should not recognise contingent assets acquired in a business combination.

Comments on the proposed changes are requested by 27 September 2019

IFRS 10: Consolidated Financial Statements

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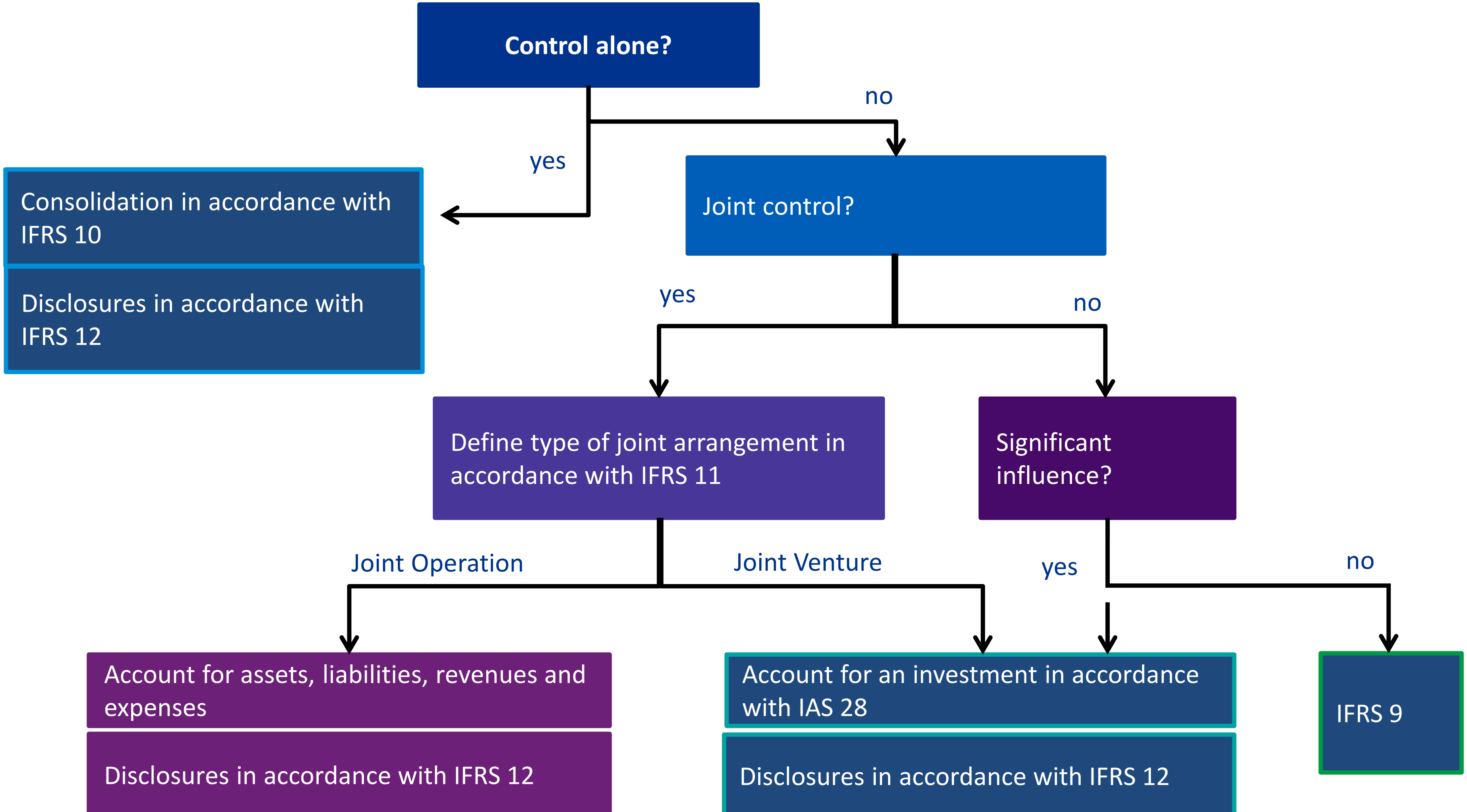
Consolidation standards

	Accounting	Disclosure	Separate FS
Subsidiaries	IFRS 10 Consolidated Financial Statements	IFRS 12 *Disclosure of Interests in Other Entities*	
Associates	IAS 28 *Investments in Associates and Joint Ventures*		IAS 27 *Separate Financial Statements*
Joint ventures			
Joint operations	IFRS 11 *Joint Arrangements*		IFRS 11 *Joint Arrangements*
Unconsolidated structured entities			IFRS 12 *Disclosure of Interests in Other Entities*

Interaction of consolidation standards



IFRS 10: Objective

Objective

To establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities

IFRS 10

- Requires the parent entity to consolidate the financial statement of all of its controlled subsidiaries
- Defines and establishes the principle of Control in much detail
- Sets out how to apply the principle of control for
- identifying control of investor over investee
- Sets out accounting requirement for the preparation of consolidated financial statement

IFRS 10: Scope

A Parent Company need not to prepare consolidated financial statement if it satisfies the mentioned conditions

- It is a Partially owned subsidiary of another entity
- Its debt or equity instruments are not traded in a public market whether domestic or foreign
- It didn't file or in the process of filing any financial documents to the securities commission or other regulatory body.
- Its ultimate or intermediate parent produces consolidated financials statements that are available for public use and comply with IFRS requirement

Control model

Understand the investee → Power analysis + Variability of returns + Link between power and variability = Consolidate

Control assessed on a continuous basis

Different from previous models under IAS 27 and SIC-12

In many cases (e.g. many conventional operating companies) no change in conclusion

But beware:
financial services, funds, financing vehicles, extreme auto-pilot

Control principle

An Investor controls an investee if and only if the investor has

- Power over the investee
- Exposure or rights to variable returns from its involvement with the investee and
- The ability to use its power over the investee to affect the amount of the investor's return

Assessing control of an investee

POWER

- Rights
- Relevant activities

EXPOSURE

- Exposure (or rights) to variable returns of the investee

LINK

- Ability to use power over the investee to affect its own returns

Example 1: Power (Do rights give power?)

- Investor A holds 45% of the voting rights of an investee.
- Two other investors each hold 26% of the voting rights.
- Remaining voting rights are held by three other shareholders (each with 1%).
- No other arrangements that affect decision-making.

Question: Does Investor A have power?

Example 2: Power (Do rights give power?)

- Investor A holds 40% of the voting rights of an investee.
- Twelve other investors each hold 5% of the voting rights.
- Shareholder agreement: investor A has the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. Two-thirds majority vote of the shareholders is required to change the agreement.

Question: Does Investor A have power?

Example 3: Power (Do rights give power?)

- Investor A holds 70% of the voting rights of an investee.
- Investor B has 30% of the voting rights of the investee as well as an option to acquire half of Investor A's voting rights.
- Option exercise = any time in next two years, fixed price (deeply out of the money and is expected to remain so)
- Investor A: exercises its votes and actively directs relevant activities of the investee.

Question: Does Investor A have power?

Example 4: Power (ability to direct the relevant activities)

- Investor A, whose business is the production and sale of cheese, establishes and initially owns 100% of an operation (Investee B), which also produces and sells cheese.

- Investor A then decides to make Investee B a publicly traded entity, retaining 30% of voting rights (the other 70% are widely distributed among thousands of investors , none individually holding more than 1%).

- Investor A also signed a contract with Investee B to manage and operate all of the activities of Investee B. Investee B has no employees of its own.

- A supermajority vote of 75% is required to cancel the management and operations contract.

Question: Does Investor A have power?

Power analysis: Where voting rights are relevant

Majority of voting rights

consider:

Rights held by others

Ability to cast *majority* voting rights *when* decisions are made

Less than a majority of voting rights

consider:

Agreements with other vote holders

Other contractual agreements

Potential voting rights

De facto power

IPSAS 40: Public sector combinations

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IPSAS 40: Public Sector Combinations

IPSAS 40 provides the first international accounting requirements that specifically address the needs of the public sector when accounting for combinations of entities and operations.

The standard establishes requirements for classifying, recognizing and measuring public sector combinations

IPSAS 40: Public Sector Combinations

- The standard classifies public sector combinations as either amalgamations or acquisitions.
  - For amalgamations, the standard requires use of the "modified pooling of interests" method of accounting, which is a variation of the pooling of interests method of accounting (also referred to as "merger accounting"), in which the amalgamation is recognized on the date it takes place.
  - For acquisitions, IPSAS 40 requires use of the "acquisition" method of accounting, applying the same approach as in IFRS 3, Business Combinations. This is supplemented with additional guidance for public sector specific situations.

Thank you

Contact details

Ferdinand Okoth Othieno

Dean, Strathmore Institute of Mathematical Sciences

fothieno@strathmore.edu

fokoth@gmail.com

+254 721 722 872

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