IFRS Virtual Workshop
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IFRS 3, IFRS 10, IAS 28 and IAS 27

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IFRS 3 Business Combinations - Content

- Introduction
- Identifying a Business Combination
- Acquisition Method
- Other Guidelines on Acquisition Method

IFRS 3 - Introduction

Historically, for business and accounting, two or more entities could form one entity through an acquisition or a merger. An acquisition is distinguished from a merger as follows:

IFRS 3 -Introduction

For practical purpose, a distinction is made between a merger and an acquisition. Before IFRS 3 was issued, the accounting treatment required application of Merger method and Acquisition method respectively.

The challenge was companies preferred the merger method because of a higher level of distributable profits as compared to the acquisition method. The issuance of IFRS 3 was the end of the merger method as IFRS 3 requires all business combinations to be accounted using the acquisition method.

IFRS 3 - Introduction

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IFRS 3: BUSINESS COMBINATIONS - SUMMARY

Acquisition method

Identify the acquirer and account for business combination transaction separately from related transaction	• Entity that obtains control is acquirer • Separate related transactions and apply other IFRS standards
Acquisition date	• Date on which control of net assets and operations is transferred to the acquirer
Consideration transferred	• Use fair value at acquisition date, also for business combination achieved in stages • Costs directly attributable not part of business combination • Contingent consideration
Recognition of identifiable assets and liabilities	• Assets/liabilities recognised separately • Basic recognition: Meet definitions in Conceptual Framework • Classifying or designating • Exceptions (contingent liabilities)
Initial measurement of fair value of identifiable assets and liabilities	• Fair value as at acquisition date • Market values or valuation techniques • Exceptions

IFRS 3 - Identifying a Business Combination

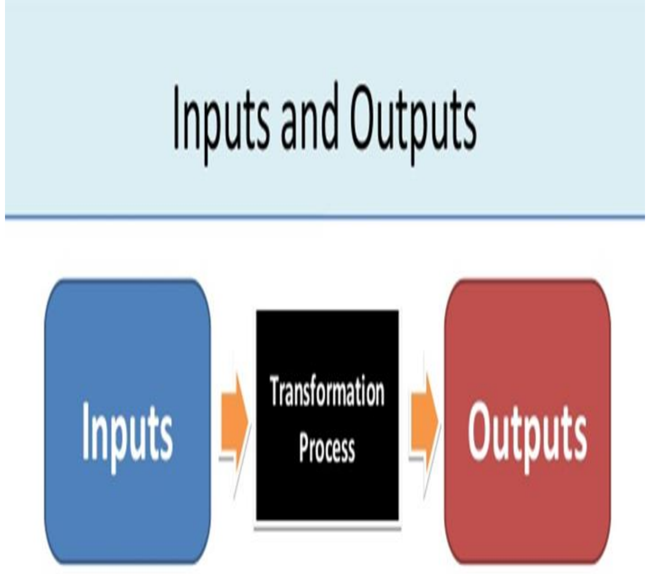
Before we apply the acquisition method, IFRS 3 defines a business combination as a transaction or event in which acquirer obtains control over a business. IFRS 3 provides more guidelines on what a business is (as opposed to a group of assets). The acquisition of a group of assets is not a merger.

Definition of a "Business":

-Integrated set of activities and assets (Inputs, process & outputs)

-Capable of being conducted and managed to provide return

-Returns include dividends and cost savings.



The transformation process describes what happens **inside the business**. This is where **value is added** to inputs to create outputs

IFRS 3 – Acquisition Method – Identify the Acquirer

Additional control criteria under IFRS 3 Appendix B		
Based on consideration transferred	**Based on entity size**	**Based on dominance**
Acquirer is the entity that: • Transfers cash or other assets or incurs liabilities to acquire another entity ▪ Issues shares as purchase consideration ▪ Pays a premium over the fair value of the equity interest	Acquirer is the entity that: • Has the largest relative voting rights in a combined entity • Holds the largest minority voting interest in the combined entity (if no other entity has significant voting interest) • Is relatively larger in size	Acquirer is the entity: • Whose owners have the ability to elect, appoint or remove a majority of directors • Whose management is dominant in the combined entity •Who initiates the business combination

IFRS 3 - Acquisition Method – Identify Acquirer

Definition of "control of an investee"

Control includes, Ownership of more than half the voting right of another entity, Power over more than half of the voting rights by agreement with investors, Power to govern the financial and operating policies of the other entity under statute/ agreement, Power to remove/appoint majority of directors and Power to cast majority of votes.

CONTROL

(i.e. the investor controls the investee IF AND ONLY IF ALL the following three elements are met)

=

Power over the investee

'Power' is defined as 'existing rights that give the current ability to direct the relevant activities'

+

Exposure or rights to variable returns

An investor is exposed or has rights to variable returns from its involvement with the investee

+

Link between power and returns

The investor must have the ability to use its power to affect the amount of the investor's returns from its involvement with the investee

IFRS 3 - Acquisition Method – Determine Acquisition Date

The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree. The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date.

IFRS 3 - Acquisition Method – Cost of Business Combination

Sum of

Assets transferred by the acquirer

- Measured at acquisition-date fair values

Liabilities incurred by the acquirer to former owners of the acquiree

- Measured at acquisition-date fair values

Contingent consideration

- Measured at acquisition-date fair value of contingent consideration

Equity interest issued by acquirer

- Measured at acquisition date fair values.

Exception: Share-based payments to acquiree's employees shall be as per IFRS 2 Share-based Payments

IFRS 3 -Acquisition Method –Recognition & Measurement of subsidiaries assets and liabilities

- IFRS 3 establishes the following principles in relation to the recognition and measurement of items arising in a business combination:

Recognition principle	Measurement principle
• Identifiable assets acquired, liabilities assumed, and non-controlling interests in the acquiree, are recognised separately from goodwill	• All assets acquired and liabilities assumed in a business combination are measured at acquisition-date fair value

- The following exceptions to the above principles apply:
  - Contingent liabilities, Income taxes , Employee benefits, Indemnification assets, Reacquired rights, Share-based payment transactions, Assets held for sale

IFRS 3 - Acquisition Method – Goodwill/Bargain Purchase

Consideration paid

+

Non-controlling interests in the acquiree
(measured either at fair value or at their proportionate share of net asset)

-

Identifiable net asset of the acquiree
(=identifiable assets acquired – liabilities assumed)

If positive amount → Goodwill

If negative amount → Gain from a bargain purchase

IFRS 3 - Acquisition Method – Goodwill/Bargain Purchase

Business Combination with Goodwill

Assume the facts are the same as before. Compute goodwill assuming the following:

1.A acquired 100% of B with the cost of acquisition being $59,000 and fair value of assets being $45,000.

2. A acquired 80% of B with the cost of acquisition being $39,000 and the fair value of assets being $45,000. A does not recognize the goodwill of the non-controlling interest.

3. A acquired 80% of B with the cost of acquisition being $39,000 and the fair value of assets being $45,000. A recognizes the goodwill of the non-controlling interest.

4. A acquired 100% of B with the cost of acquisition being $44,000 and fair value of assets being $45,000.

Solution

	1	2	3	4
Purchase Consideration	59,000	39,000	39,000	44,000
Share of fair Value of Net Assets	(45,000)	(36,000)	(36,000)	(45,000)
Goodwill of A (Bargain Purchase)	6,000	3,000	3,000	(1,000)
Goodwill of NCI – Grossed up*		750		

*If the A's goodwill is $3,000, with 80% of B, then noncontrolling must be $750 at 20%. Therore 100% goodwill is $3,750.

IFRS 10 Consolidated Financial Statements-Content

- Introduction
- Control
- Accounting treatment and exemptions
- Consolidation procedures and other guidelines
- Investment entities

IFRS 10 - Introduction

As provided in IFRS 3, a parent is an entity that exercises control over another entity i.e. its investee or a subsidiary.
The main objective of IFRS 10 is to require the parent to prepare consolidated financial statements i.e. including the results of the subsidiaries. IFRS 10 discusses:

-How to establish control,
-How to prepare the consolidated financial statements,
-Exemptions to consolidated financial statements and
-Lose of control and guidelines for investment entities.

IFRS 10 - Control

An investor determines whether it is a parent by assessing whether it controls the investee. An investor is required continuously to reassess whether it controls an investee. An investor controls an investee if it has all of the following:

Usually Substantive Rights ,but consider:
1. Special relationships
2. Protective Rights
3. Voting Rights
4. De-facto Control

Based on the substance of the arrangement (not the legal form) assesses whether investee returns are variable, and how variable they are.

Power + **Exposure or rights to variable returns** + **Ability to use power to affect returns**

Power: Existing rights that give the current ability to direct the relevant activities of the investee

Exposure or rights to variable returns: Returns that are not fixed and have the potential to vary with performance of the investee

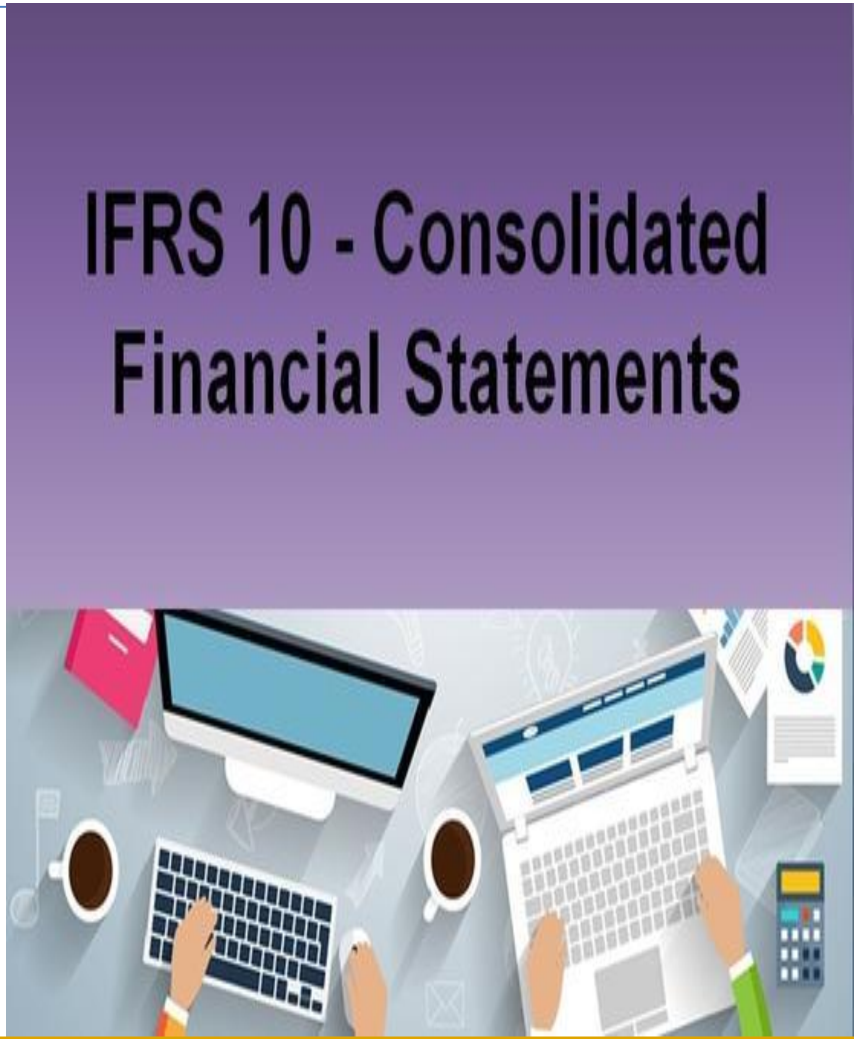
Ability to use power to affect returns: Link between power and returns

IFRS 10 - Accounting Treatment and Exemptions

1. Requirement to Prepare Consolidated Financial Statements

A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.



IFRS 10 - Accounting Treatment and Exemptions

2. Consolidation Procedures

Combine	Combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.
Offset	Offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary.
Eliminate	Eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full).
Only post-acquisition incomes and expense	Includes 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. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date as per IFRS 3 'Business Combinations'.

IFRS 10 - Accounting Treatment and Exemptions

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2. Consolidation Procedures

Same Reporting Dates	The parent and subsidiaries are required to have the same reporting dates, or consolidation based on additional financial information prepared by subsidiary, unless impracticable.
If Impracticable	Where impracticable, the most recent financial statements of the subsidiary are used, adjusted for the effects of significant transactions or events between the reporting dates of the subsidiary and consolidated financial statements.
Maximum Difference	The difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months.

IFRS 10 - Accounting Treatment and Exemptions

2. Consolidation Procedures

NON-CONTROLLING INTERESTS	
Statement of Financial position	A parent presents non-controlling interests in its consolidated statement of financial position within equity, separately from the equity of the owners of the parent.
Statement of Profit and Loss and other noncontrolling Interest	A reporting entity attributes the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests. The proportion allocated to the parent and non-controlling interests are determined on the basis of present ownership interests. The reporting entity also attributes total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non- controlling interests having a deficit balance.

4. Investment Entities

An entity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

Investment entities are prohibited from consolidating particular subsidiaries.

4. Investment Entities

FVTPL	An investment entity is required to measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments.*
Consolidation to related business subsidiary	However, an investment entity is still required to consolidate a subsidiary where that subsidiary provides services that relate to the investment entity's investment activities.
No elimination	Because an investment entity is not required to consolidate its subsidiaries, intragroup related party transactions and outstanding balances are not eliminated.
Special Accounting	Special requirements apply where an entity becomes, or ceases to be, an investment entity.
Exemption Restriction	The exemption from consolidation only applies to the investment entity itself. Accordingly, a parent of an investment entity is required to consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

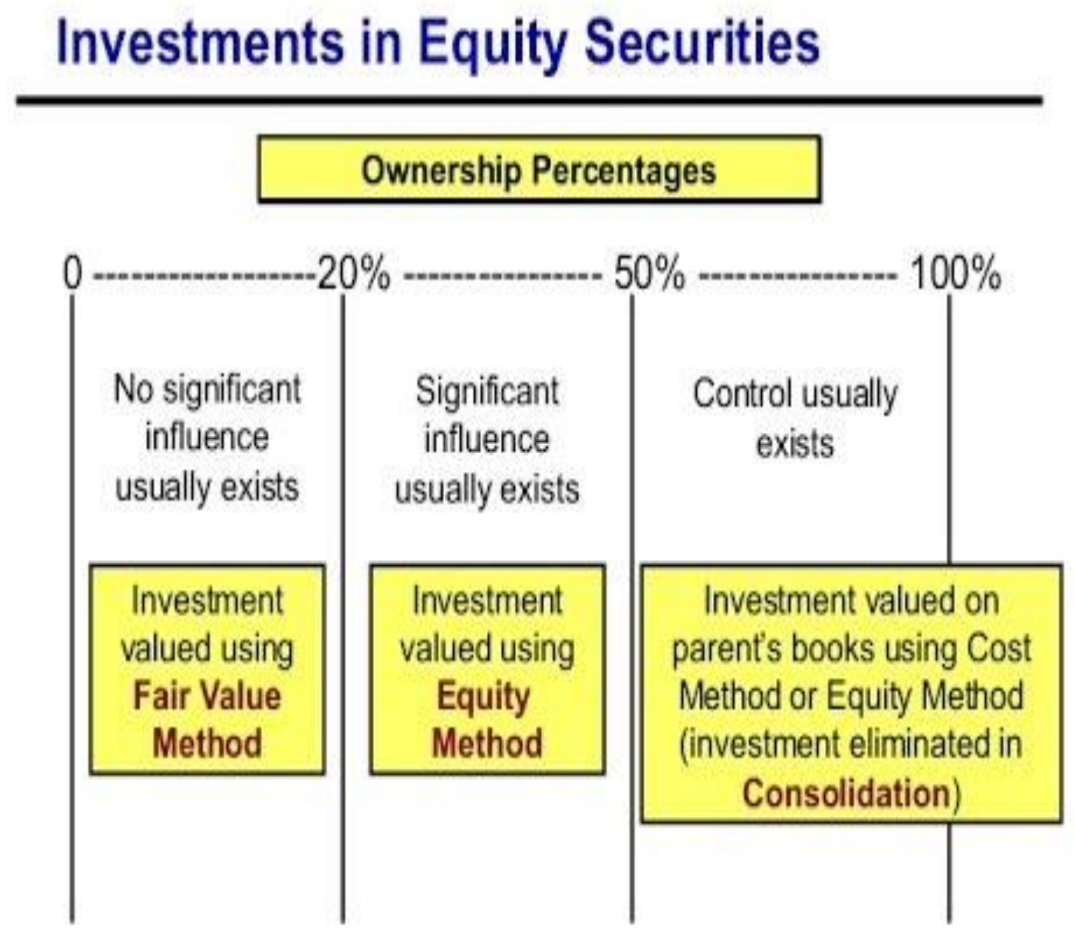
IAS 28 Associate and Joint Arrangements - Content

- Introduction
- Use of the Equity Method
- Disclosures

IAS 28 - Introduction

IAS 28 Defines an Associate Company as follows:

An associate is an entity over which the investor has ***significant influence***. Significant influence is power to participate in financial and operating policy decisions of the Investee, but not control or joint control over those policies. Rebuttable presumption: 20% - 50% shareholding gives rise to significant influence



Concept of "Significant Influence"

- Default assumption:
  - Percentage ownership of ≥ 20% and ≤ 50% of investee's voting rights deemed as giving rise to " significant influence"
  - Investor may depart from threshold if the investor is able to demonstrate that the quantitative threshold is not indicative of significant influence
- Other evidence of "significant influence":
  - Representation on the board of directors;
  - Participation in policy-making processes;
  - Material transactions between the investor and investee;
  - Interchange of managerial personnel; or
  - Provision of essential technical information

IAS 28 – Introduction & Equity Method

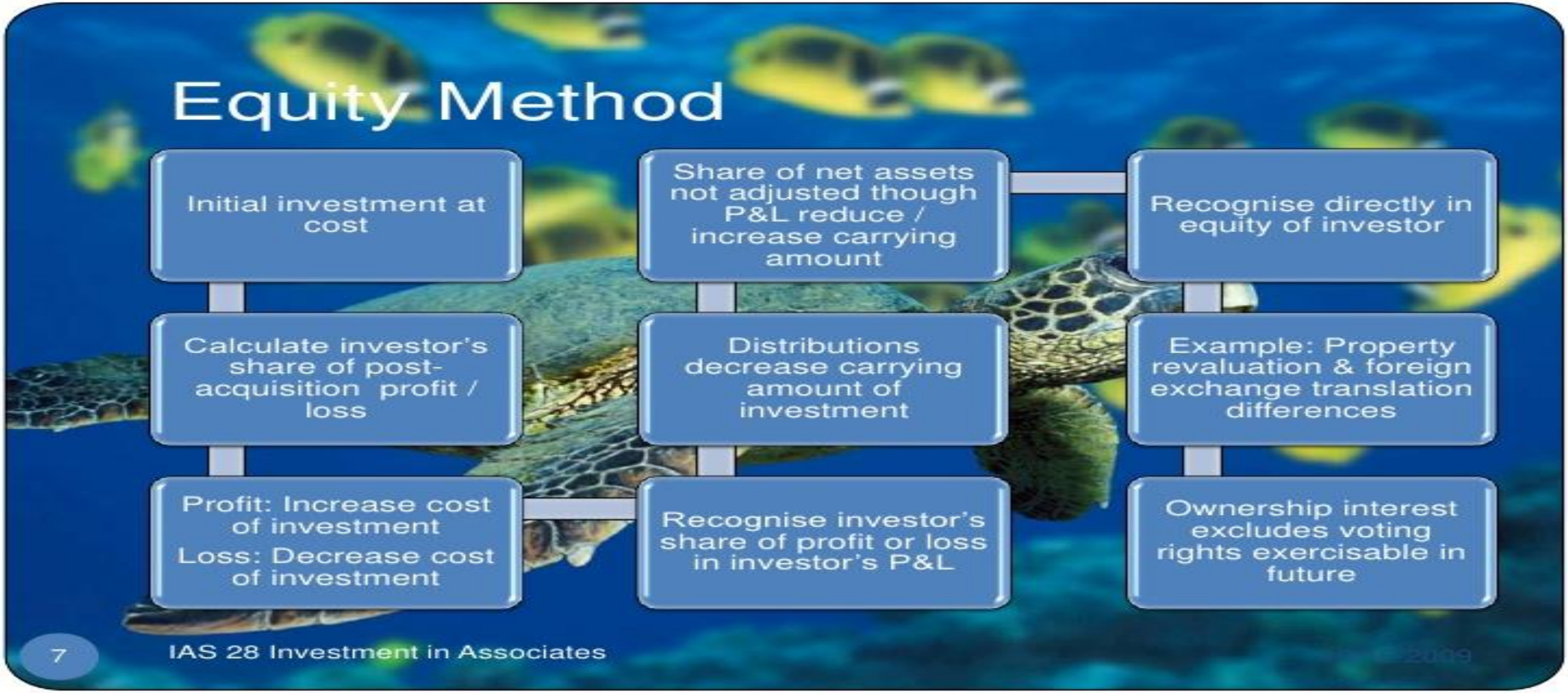
IAS 28 defines a Joint Venture as follows:

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 control is the contractually agreed sharing of control of an arrangement – decisions require the unanimous consent of the parties sharing control. The parties to the Joint Venture are called Joint Venturers

IAS 28 requires the use of equity method in accounting for and reporting investments in Associate Companies and Joint Ventures.

IAS 28 - Use of Equity Method



IAS 28 - Use of Equity Method

Additional guidance in applying the equity method:

1. Potential voting rights are taken into account to determine whether significant influence exists, but equity accounting is based on actual interest only
2. Financial statements of the investor and investee used must not differ by more than 3 months in terms of the reporting date
3. The investors' share in the investee's profits and losses resulting from transactions with the investee are eliminated in the equity accounted financial statements of the parent.

IAS 28 - Use of Equity Method

4. Use uniform accounting policies for like transactions and other events in similar circumstances
5. If an investor's share of losses of an investee exceeds its interest in the investee, discontinue recognising share of further losses. The interest in an investee is the carrying amount of the investment in the investee under the equity method, and any long-term interests that, in substance, form part of the investor's net investment in the investee.

IAS 28 - Use of Equity Method

6. If ownership interest is reduced, but equity method remains, the entity reclassifies to profit or loss the gain or loss that had previously been recognised in OCI.
7. Entities apply IFRS 9 Financial Instruments: Recognition and Measurement to determine whether an impairment loss with respect to its net investment.
8. Goodwill that forms part of the carrying amount of an investment in an investee is not separately recognised and therefore, not tested separately for impairment – instead the entire investment is tested as 'one' in accordance with IAS 36.

IAS 28 - Use of Equity Method

An entity is required to discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:

1. If an investment becomes a subsidiary, the entity follows the guidance in IFRS 3 Business Combinations and IFRS 10
2. If any retained investment is held as a financial asset, the entity applies IFRS 9 Financial Instruments, and recognise in profit or loss the difference between:

IAS 28 - Use of Equity Method

The fair value of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture

3. The carrying amount of investment at date equity method discontinued.
4. Account for all amounts recognized in OCI in relation to that investment on same basis as if investee had directly disposed of related assets and liabilities.

IAS 28 - Use of Equity Method

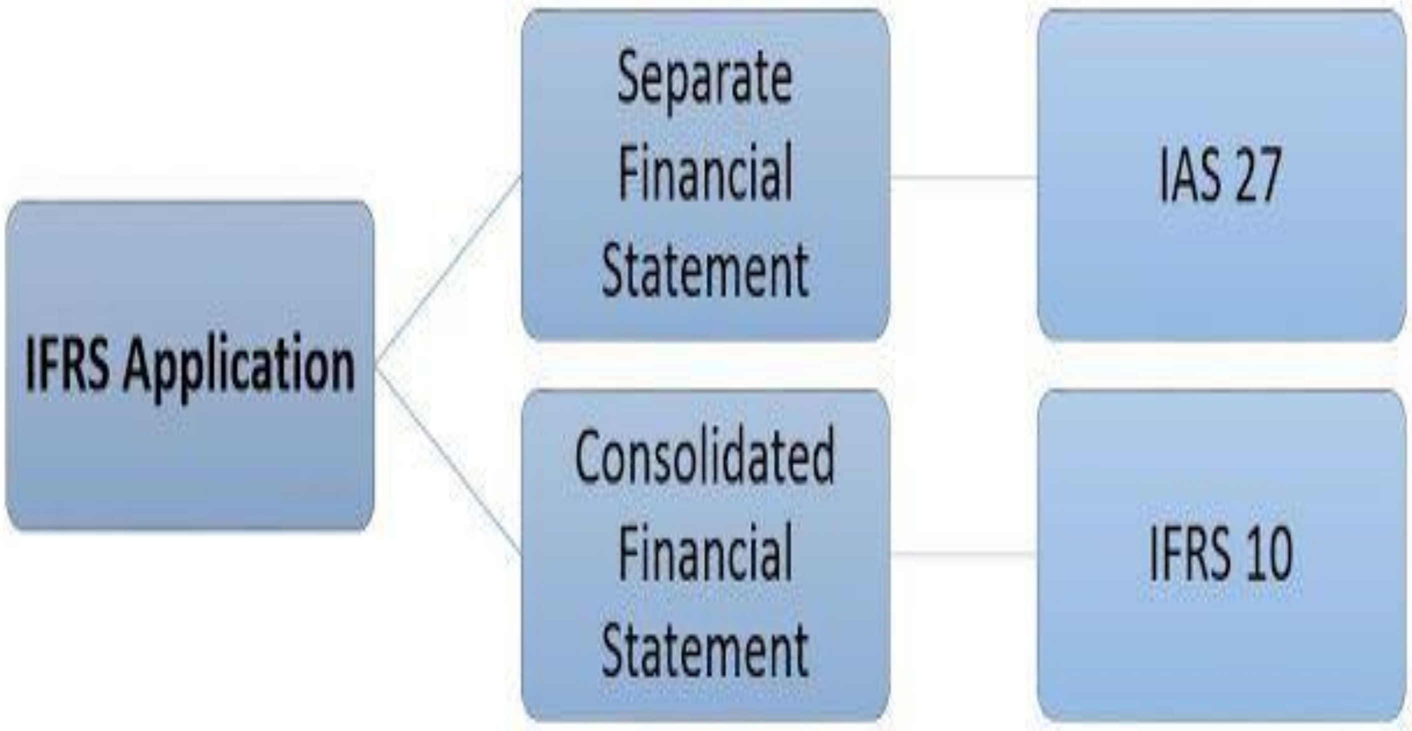
Application of the equity method

Use the equity method except when:

Investment is classified as held for sale (IFRS 5); When no longer classified as held for sale, adjust FS for equity method from date when investment was classified as held for sale.	Parent elects not to prepare consolidated accounts on the basis that the ultimate controlling entity produces consolidated accounts that are available to the public	All group owners are informed and do not object; Debt or equity not traded in a public market; Entity not making arrangements to trade debt or equity in a public market.

IAS 27- Separate Financial Statements - Content

- Introduction
- Separate Financial Statements
- Disclosures



IAS 27 - Introduction

Where an entity owns a subsidiary, Associate company and Jointly controlled entities, then these standards provide the accounting treatment and presentation according to IFRS 10 and IAS 28. IFRS 10 requires the parent to present consolidated financial statements, while IAS 28 required the use if the equity method for Associate Companies and Jointly controlled entities.

IAS 27- Introduction

In consolidation, the procedure requires combining the financial statements elements of both the parent and its subsidiary while excluding intercompany transactions and balances. The equity method requires the entity to add its share of post acquisition reserves in the associate and jointly controlled entity.

These accounting treatment of subsidiaries and associates my make it difficult to evaluate the performance of the entity.

IAS 27 - Introduction

The Purpose of IAS 27 is to provide the guidelines for presenting its own financial statements i.e. separate financial statements.

IAS 27 does not make it mandatory for an entity to present separate financial statements. However, if a company operates in a jurisdiction that makes it mandatory for separate financial statements, then the entity can use IAS 27. In addition, if an entity opts to present separate financial statements, then it should comply with IAS 27.

IAS 27 - Separate Financial Statements

From a general perspective, an entity should present separate financial statements in accordance with the rest of the IFRS. The only issue is on how to account for investment in subsidiary, associate companies and jointly controlled entities in the separate financial statements. In addition, how should the entity report dividends it has received from these entities.

For the entities, we have three approaches:

IAS 27 - Separate Financial Statements

1. Investment in subsidiaries, joint ventures, and Associates Accounted for either:

-At cost,

-At fair value in accordance with IFRS 9, or

-Using the equity method (see IAS 28).

The entity is required to apply the same accounting procedure for each category of investments.

IAS 27 - Separate Financial Statements

2. Investments in subsidiaries, joint ventures, and associates classified as held for sale.

When investments are classified as held for sale or for distribution to owners (or included in a disposal group that is classified as held for sale or for distribution to owners), they are accounted for:

-In accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, if previously accounted for at cost

-In accordance with IFRS 9, if previously accounted for in accordance with IFRS 9.

3. Investments in associates or joint ventures at fair value

Investments in associates or joint ventures that are measured at fair value in accordance with IFRS 9 are required to be measured in the same way in the separate and consolidated financial statements (i.e. at fair value).

IAS 27 - Separate Financial Statements

4. Dividends received

Dividends received from subsidiaries, joint ventures, and associates are recognized when the right to receive the dividend is established and accounted for as follows:

-in profit or loss, if the investment is accounted for at cost or at fair value;

-as a reduction from the carrying amount of the investment, if the investment is accounted for using the equity method.

Summary and Disclosure IFRSs