

The IFRS Masterclass Business Combinations & Consolidated financial statements

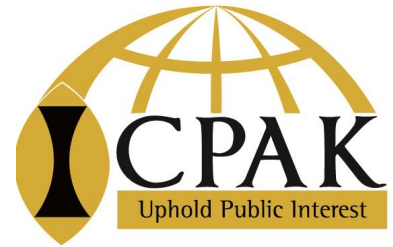
**By Ferdinand Othieno
19 July 2021**

Credibility.

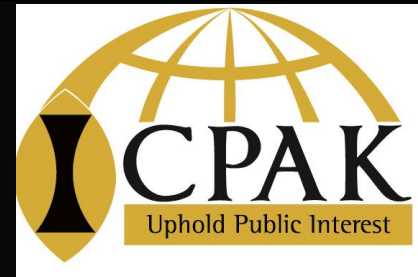
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Agenda



- 1. IFRS 3: Business Combinations**
- 2. IFRS 10: Consolidated Financial Statements**
- 3. IFRS 8: Segment reporting**
- 4. Other standards**
 - IAS 28: Investment in Associates**
 - IFRS 11: Joint Arrangements**
 - IFRS 12: Disclosure of interests in other entities**



IFRS 3: Business Combinations

By Ferdinand Othieno

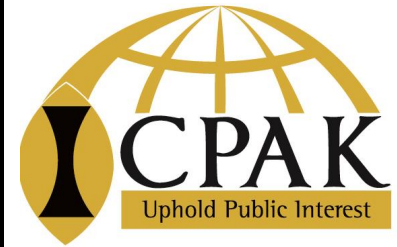
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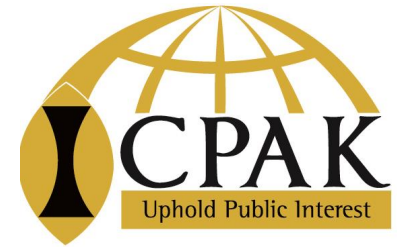
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What is a business combination?



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



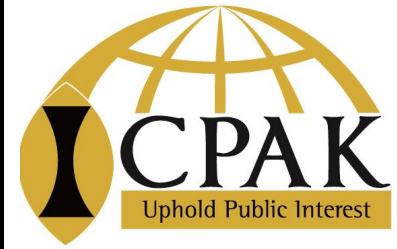
Processes



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

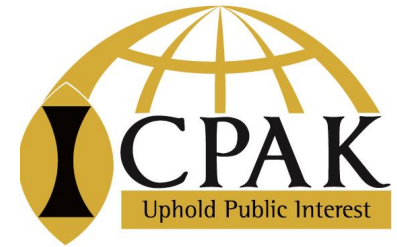
Existence of large minority voting interest in combined entity

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

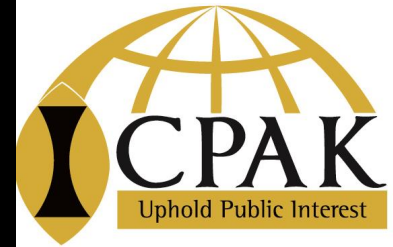


Date on which fair values of identifiable assets acquired and liabilities assumed are determined and goodwill is measured



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

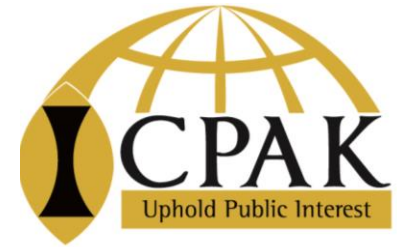


Equity instruments issued

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

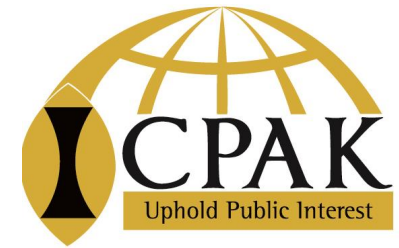
Fair value measurement under IFRS 3

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



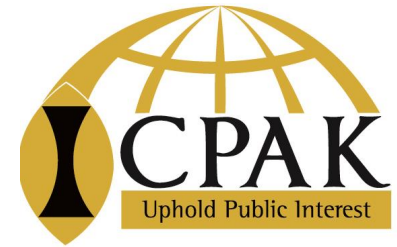
NCI are measured either at:

**Their
proportionate
interests in fair
value of
identifiable net
assets**

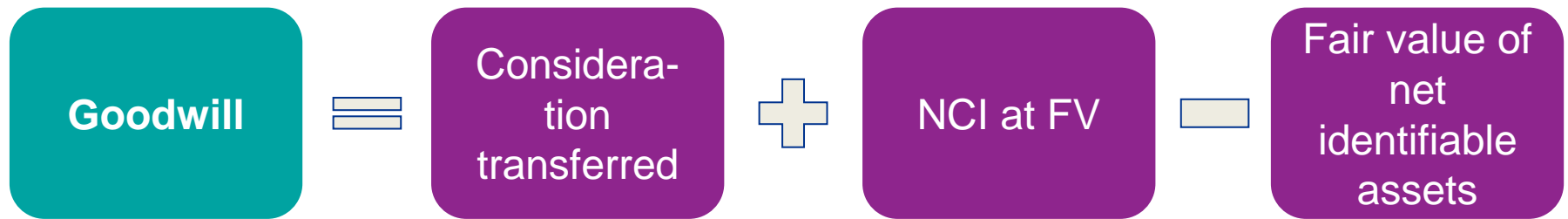
Fair value

Election made
on a
transaction-
by-transaction
basis

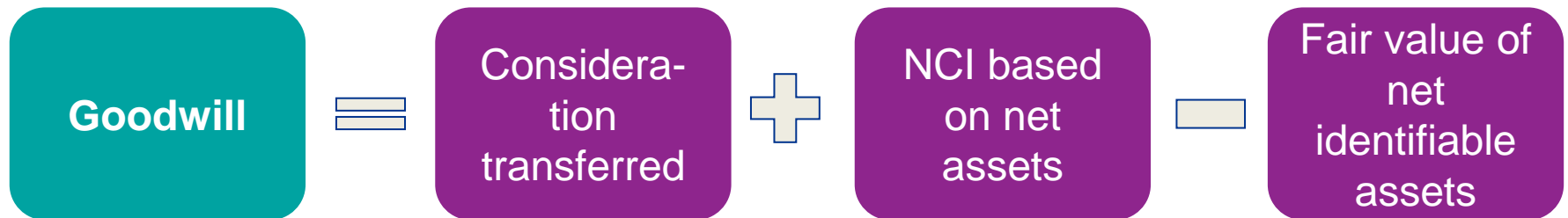
Step 6: Determine goodwill or gain on bargain purchase



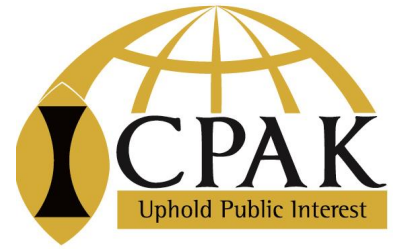
Option 1: NCI measured at fair value



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



Step 7: Recognise any measurement period adjustments



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



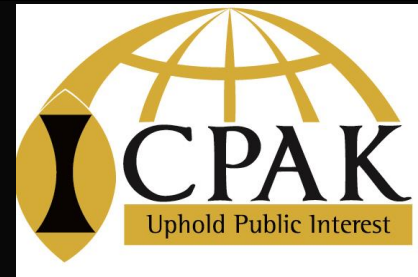
If new information obtained about facts and circumstances that existed at acquisition date



Ends when information obtained or determined not available



Cannot exceed one year



IFRS 10: Consolidated Financial Statements

By Ferdinand Othieno

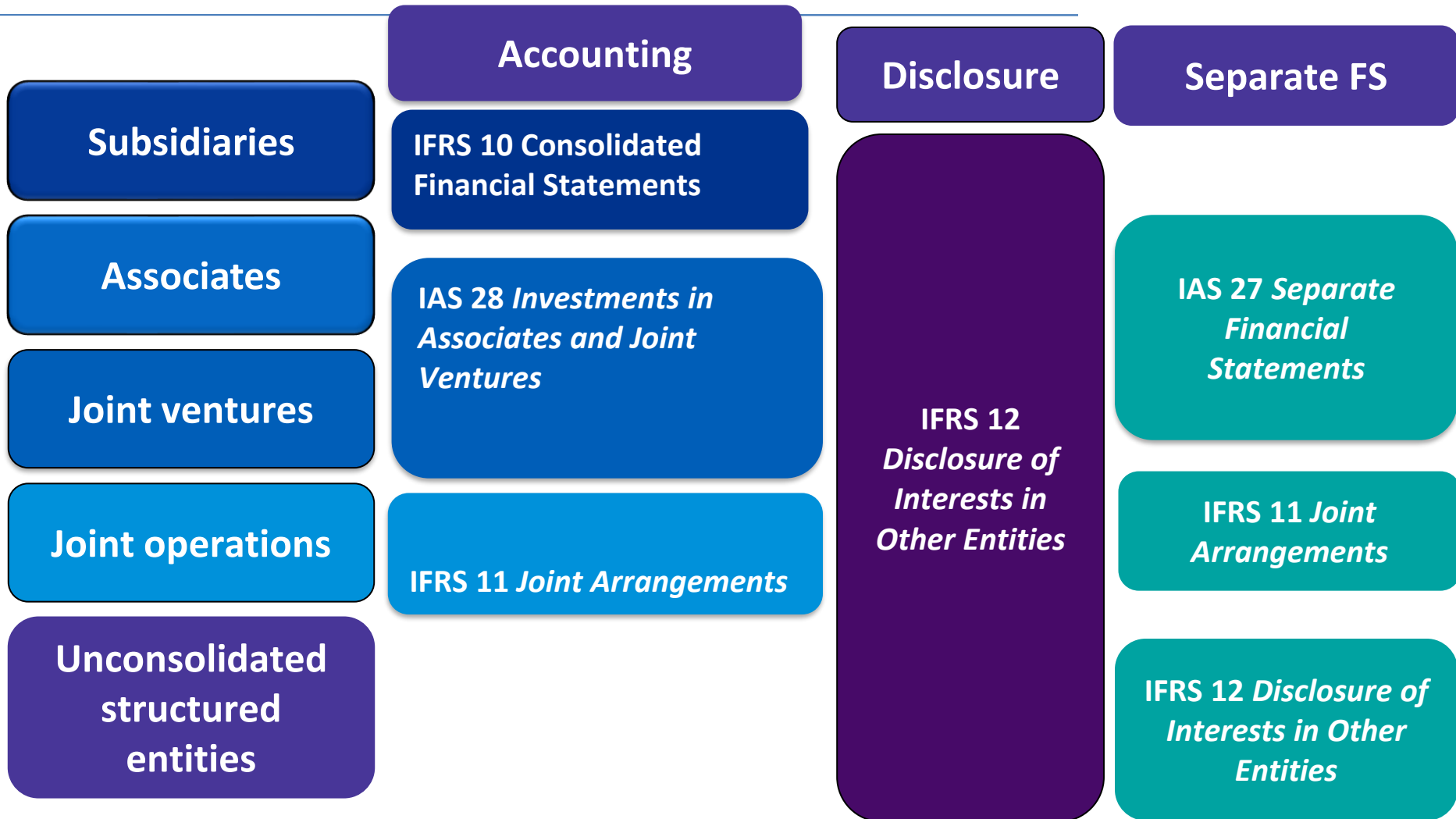
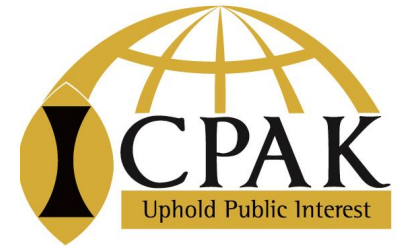
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Credibility.

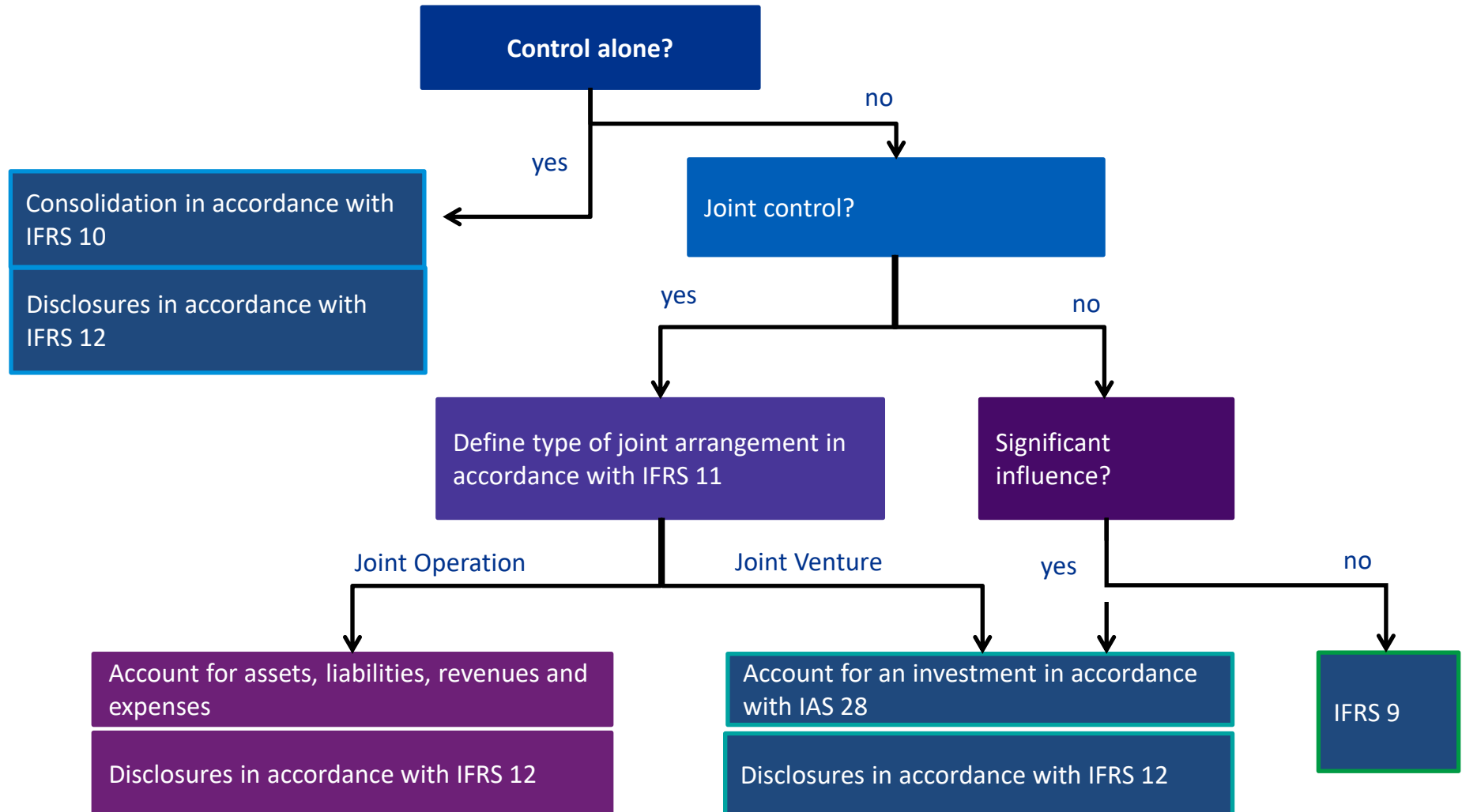
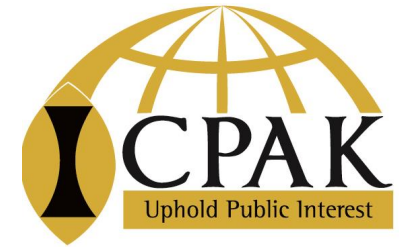
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Consolidation standards



Interaction of consolidation standards



IFRS 10: Objective

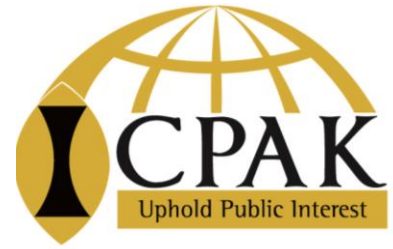
Objective

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

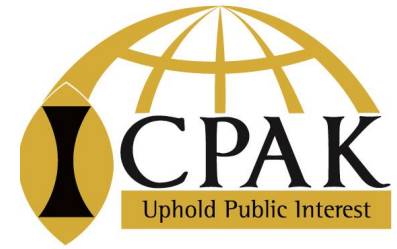
IFRS 10: Scope



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



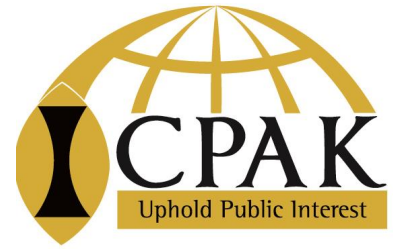
Consolidate

Control assessed on a continuous basis

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

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

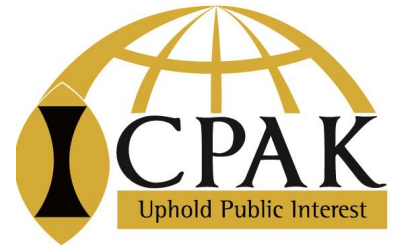
Control principle



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

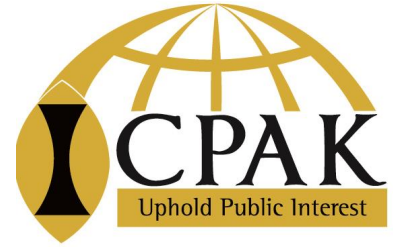
EXPOSURE

Exposure
(or rights) to
variable
returns of
the investee

LINK

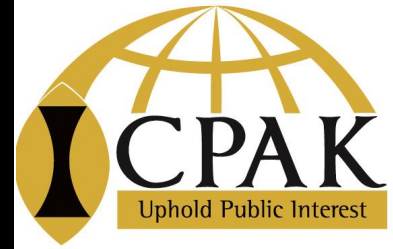
Ability to
use power
over the
investee to
affect its
own returns

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?

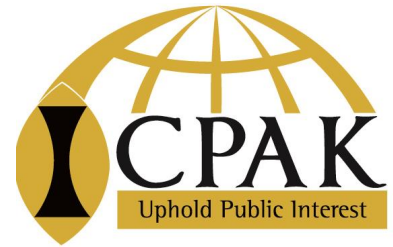


Example 2: Power (Do rights give power?)

- 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?

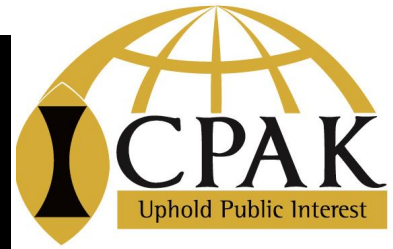
Example 3: Power (Do rights give power?)



- 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?

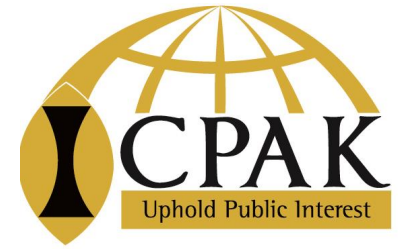
Example 4: Power (ability to direct the relevant activities)



- 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

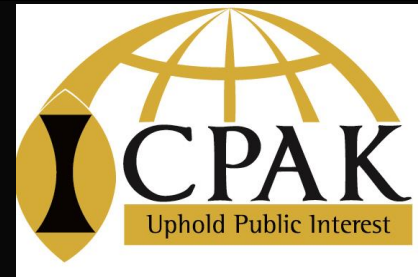
consider:

Agreements with other vote holders

Other contractual agreements

Potential voting rights

De facto power



IFRS 8: Operating Segments

By Ferdinand Othieno

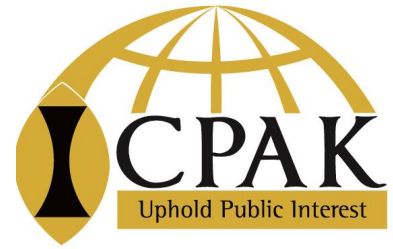
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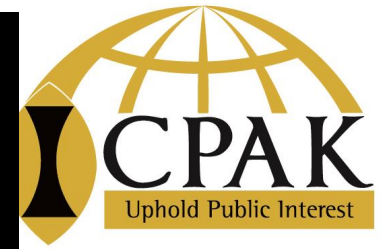
Core principle



The core principle of IFRS 8 is:

- ◆ The disclosure of information that enables users of an entity's financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates.
- ◆ The core principle should be considered when forming judgements about how and what information should be disclosed.

Scope of IFRS 8



Mandatory for entities

- Traded in public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets)
- File or in process of filing financial statements with a securities commission or other regulatory organisation for purpose of issuing any class of instruments

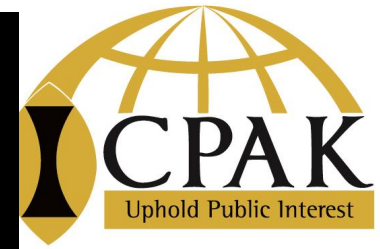
Applies to

- Consolidated financial statements
- Company only financial statements
- If both sets of financial statements presented in a report, then include segment information in consolidated financial statements only

Voluntary

- Other entities – but must apply IFRS 8 in its entirety

Overview of “management approach”



Step 1

Identify the CODM

Step 2

Identify operating segments

Step 3

Aggregate operating segments

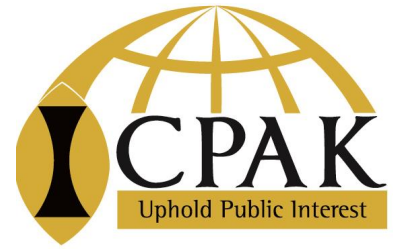
Step 4

Determine reportable segments

Step 5

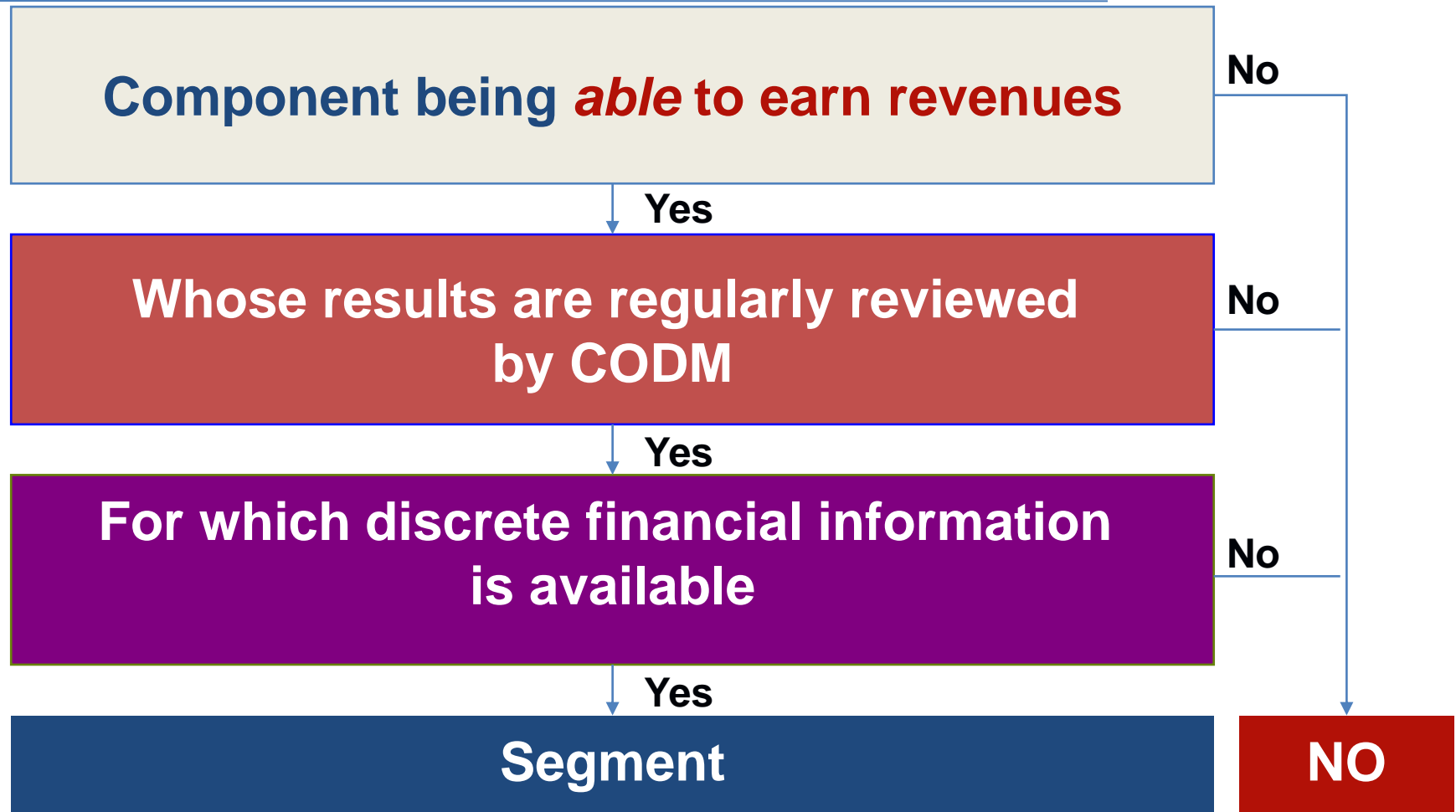
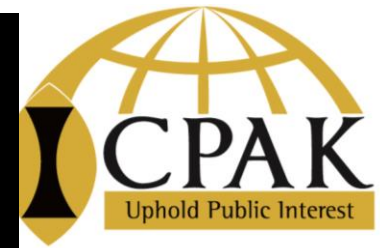
Disclose information

Step 1: Chief Operating Decision Maker (CODM)

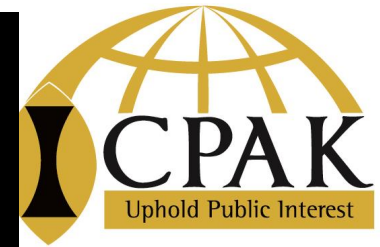


- ◆ **Highest level of management responsible for**
 - Resource allocation
 - Performance assessment
- ◆ **CODM is a function not a title**
- ◆ **CODM can be a body (e.g., a committee) or a person**
- ◆ **A reporting entity can have only one CODM**

Step 2: Operating segment – definition



Step 3: Aggregate operating segments



Consistent with the **core principle**

Yes

Similar economic characteristics

Yes

Similar in each of the following:

- Nature of products and services
- Nature of production process
- Types of customers
- Methods of distribution
- Nature of the regulatory environment

Yes

Aggregate

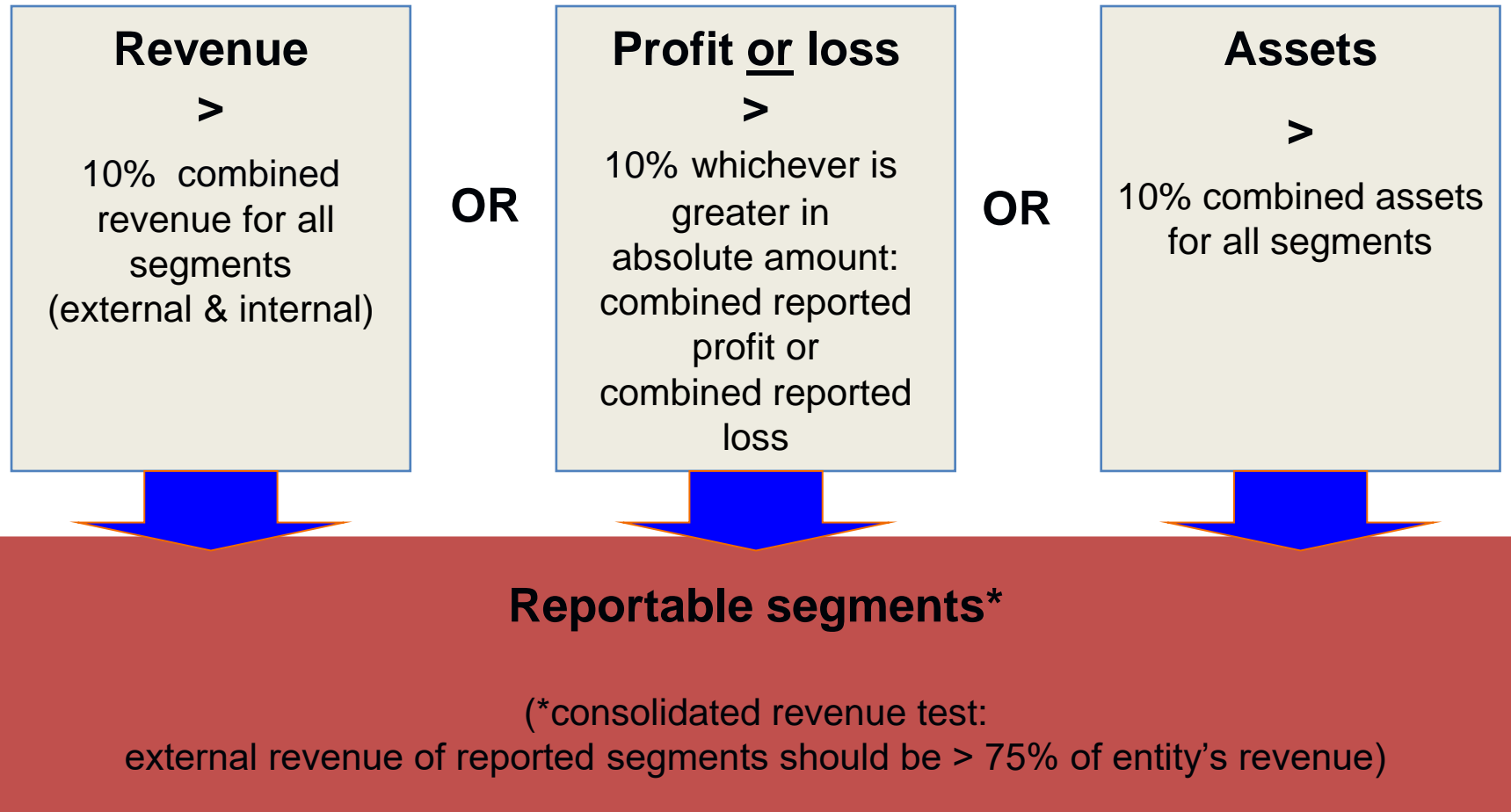
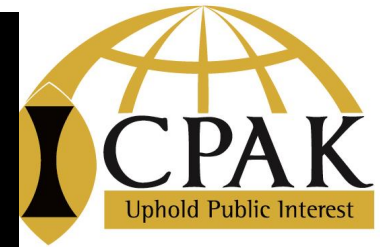
No

No

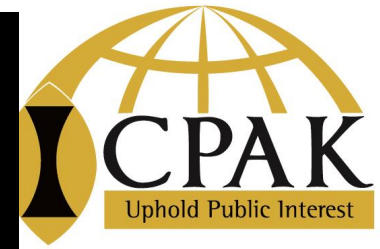
No

NO

Step 4: Identify reportable segments (threshold tests)



Step 5: Disclose segment information



- ◆ Factors used to identify entity's reportable segments, including the basis of organisation
- ◆ Types of products and services from which each reportable segment derives its revenues
- ◆ Information about revenues, profit or loss, assets and liabilities
- ◆ Reconciliations
- ◆ Other material items
- ◆ Restatement of previously reported information

Note! No exemptions for “competitive harm”

IFRS 12: Disclosure of interests in other entities

By Ferdinand Othieno

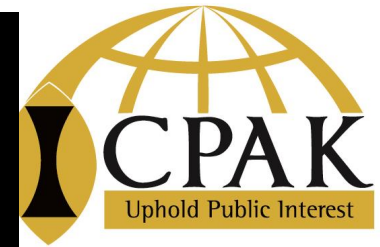
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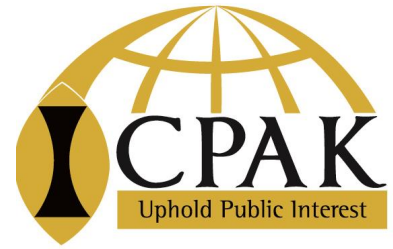
Disclosure information required under IFRS 12



Objective

- An entity is required to disclose information that enables users of its consolidated financial statements to understand:
 - The composition of the group; and
 - The interest that non-controlling interests have in the group's activities and cash flows; and

Disclosure information required under IFRS 12

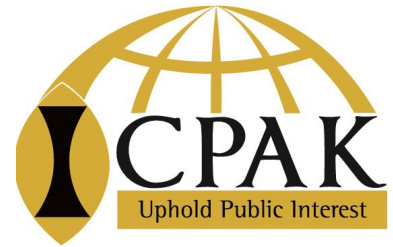


Interest in Subsidiaries

Evaluate

- The nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group;
- The nature of, and changes in, the risks associated with its interests in consolidated structured entities;
- The consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control; and
- The consequences of losing control of a subsidiary during the reporting period.

Disclosure information required under IFRS 12

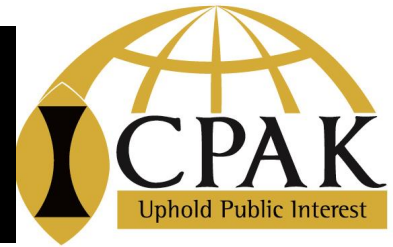


Interest in Subsidiaries

1. Non-controlling interests in group activities and cash flows

- For each of its subsidiaries that have a non-controlling interest
 - The name of the subsidiary
 - The principal place of business and country of incorporation of the subsidiary
 - The proportion of ownership interests held by non-controlling interests
 - The proportion of voting rights held by non-controlling interests, if different from the proportion of ownership interests held
 - The profit or loss allocated to non-controlling interests of the subsidiary during the reporting period
 - Accumulated non-controlling interests of the subsidiary at the end of the reporting period
 - Summarised financial information about the subsidiary

Disclosure information required under IFRS 12

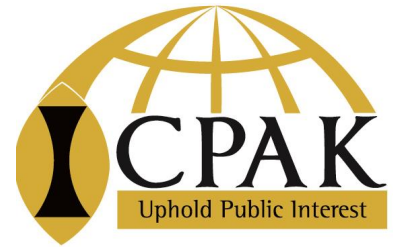


Interest in Subsidiaries

2. Nature of risks in consolidated structured entities

- When a parent, subsidiary relationship exists, the following is required to be disclosed in the group financial statements:
 - Terms of any contractual arrangements that could require the parent or its subsidiaries to provide financial support to a consolidated structured entity, including events or circumstances that could expose the reporting entity to a loss
 - If during the reporting period, financial or other support is provided to a consolidated structured entity, without having a contractual obligation to do so
 - i. The type and amount of support provided
 - ii. The reasons for providing the support
 - If financial or other support has been provided to a previously unconsolidated structured entity that resulted in control, an explanation of the relevant factors in reaching that decision
 - Any current intentions to provide financial or other support to a consolidated structured entity, including intentions to assist the structured entity in obtaining financial support

Disclosure information required under IFRS 12

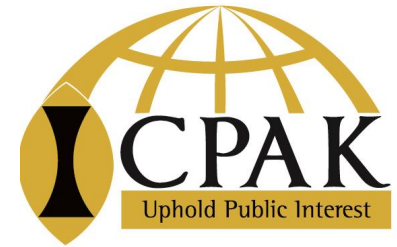


Consequences of losing control of a subsidiary during reporting period

An entity shall disclose the gain or loss, if any, calculated in accordance with IFRS 10, and:

- (a.) the portion of that gain/loss attributable to measuring any investment retained in the former subsidiary at its fair value at the date when control is lost; and
- (b.) the line item(s) in profit or loss in which the gain or loss is recognized

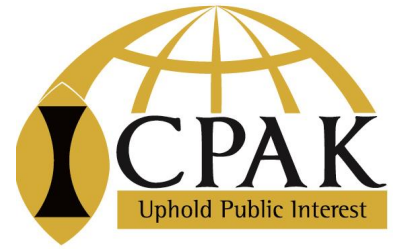
Disclosure information required under IFRS 12



Interest in unconsolidated subsidiaries (Investment entities)

- An investment entity shall disclose the following for each unconsolidated subsidiary:
 - The name of the subsidiary;
 - The principal place of business and country of incorporation of the subsidiary; and
 - The proportion of ownership interests held by the investment entity and if different, the proportion of voting rights held.
- The above disclosures shall also be provided by an investment entity parent for investments that are controlled by its investment entity subsidiary.
- An investment entity shall also disclose:
 - The nature and extent of any significant restrictions on the ability of an unconsolidated subsidiary to transfer funds to the investment entity in the form of cash dividends, or to repay loans or advances made by the investment entity; and
 - Any current commitments or intentions to provide or assist in obtaining financial or other support to an unconsolidated subsidiary.

Disclosure information required under IFRS 12



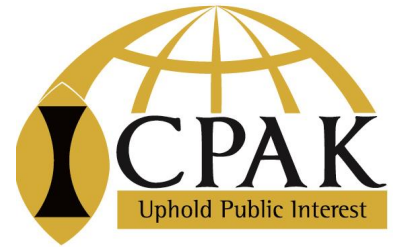
Interest in Joint arrangements and Associates

Objective

An entity is required to disclose information that enables users of its financial statements to evaluate:

- The nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates; and
- The nature of, and changes in, the risks associated with its interests in joint ventures and associates.

Disclosure information required under IFRS 12



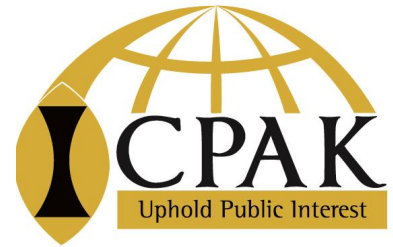
Interest in Joint arrangements and Associates

Disclose

For each joint arrangement and associate that is material to the reporting entity

- The name of the joint arrangement or associate
- The nature of the entity's relationship with the joint arrangement or associate
- The principal place of business and country of incorporation of the joint arrangement or associate
- The proportion of ownership interest or participating share held by the entity and if different, the proportion of voting rights held (if applicable)

Disclosure information required under IFRS 12



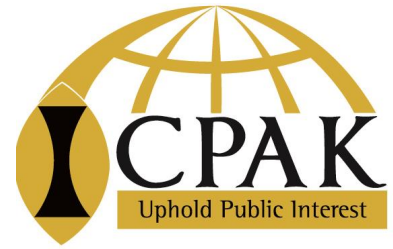
Interest in Joint arrangements and Associates

Disclose

- **For each joint venture and associate that is material to the reporting entity:**
 - Whether the investment is measured using the equity method or fair value
 - Summarised financial information about the joint venture or associate as specified
 - If there is a quoted market price for the investment and the joint venture or associate is accounted for using the equity method, the fair value of its investment in the joint venture or associate
- **Financial information about the entity's investments in joint ventures and associates that are not individually material:**
 - In aggregate for all individually immaterial joint ventures
 - In aggregate for all individually immaterial associates

Note: Joint ventures and Associates should be aggregated in two separate groups.

Disclosure information required under IFRS 12

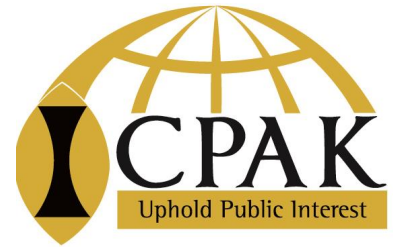


Interest in Joint arrangements and Associates- Further disclosures

An entity shall also disclose

- The nature and extent of any significant restrictions on the ability of joint ventures or associates to transfer funds to the entity in the form of cash dividends, or to repay loans or advances made by the entity
- Where there is a difference in the reporting date or period of a joint venture or associate's financial statements used in applying the equity method
 - The date of the end of the reporting period of that joint venture or associate and
 - The reason for using the different date or period
- The unrecognised share of losses of a joint venture or associate, both for the reporting period and cumulatively, if the entity has stopped recognising its share of losses of the joint venture or associate when applying the equity method

Disclosure information required under IFRS 12

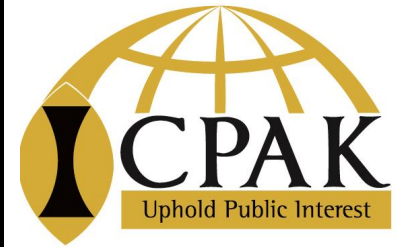


Interest in unconsolidated structured entities

Objective

- An entity is required to disclose information that enables users of its financial statements to:
 - Understand the nature and extent of its interests in unconsolidated structured entities; and
 - Evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities.

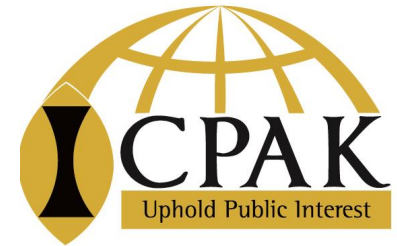
Disclosure information required under IFRS 12



Interest in unconsolidated structures entities

Nature of interest	<ul style="list-style-type: none">▪ An entity is required to disclose qualitative and quantitative information about its interests in unconsolidated structured entities. This includes but is not limited to the nature, purpose, size, activities and how the structured entity is financed.▪ If an entity has sponsored an unconsolidated structured entity for which it does not provide information required (for example, because it does not have an interest in the entity at the reporting date), it must disclose:<ul style="list-style-type: none">i. how it has determined which structured entities it has sponsoredii. income from those structured entities during the reporting period, including a description of the types of income presented andiii. the carrying amount (at the time of transfer) of all assets transferred to those structured entities during the reporting period
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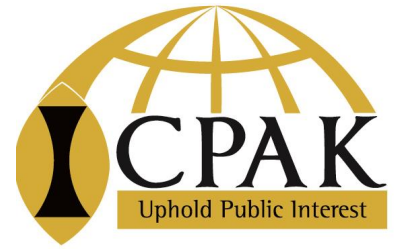
Disclosure information required under IFRS 12



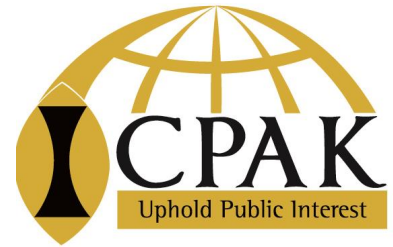
Interest in unconsolidated structures entities

Nature of risks	<ul style="list-style-type: none">■ An entity is required to disclose, a summary of:<ul style="list-style-type: none">– The carrying amounts of the assets and liabilities recognised in its financial statements relating to its interests in unconsolidated structured entities.– The line items in the statement of financial position in which those assets and liabilities are recognized– The entity's maximum exposure to loss from its interests in unconsolidated structured entities if determinable and how that exposure is determined.– A comparison of the carrying amounts of the assets and liabilities of the entity that relate to its interests in unconsolidated structured entities and the entity's maximum exposure to loss from those entities
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Thank you



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