



2

*The IFRS for SMEs*

**Section 9 Consolidated and Separate Financial Statements**

**Section 19 Business Combinations and Goodwill**

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**Day 3 13:30 to 15:30**

3

**Section 9 – scope**

**Section 9**

- specifies the circumstances in which an entity presents consolidated financial statements (CFSs)
- describes the procedures for preparing consolidated financial statements
- provides guidance on separate financial statements & combined financial statements

4

**Section 9 – consolidated statements**

- Consolidated financial statements (CFSs) present financial information about the **group** as a single economic entity
- A group = a parent and all its **subsidiaries (Sub)**
- A Sub is an entity that is **controlled** by another entity (known as the parent)
  - a Sub need not be incorporated (eg partnership)

5

**Section 9 – who prepares CFSs?**

- A parent presents CFSs unless:
  - (i) no Subs other than Sub acquired to disposing of within 1 yr (account for at FV if publicly traded, otherwise cost-impairment model); or
  - (ii) if both:
    - the parent is itself a subsidiary, &
    - its ultimate parent (or any intermediate parent) produces CFS that comply with full IFRSs or the *IFRS for SMEs*

6

**Section 9 – who prepares? examples**

**Entity A owns 75% of B.**

**Entity B owns 80% of C.**

***In each scenario below, is B required to prepare CFS?***

- **i:** A complies with the *IFRS for SMEs*.
- **ii:** A complies with full IFRSs.
- **iii:** A prepares local GAAP CFSs.
- **iv:** B is a venture capital organisation.

## Section 9 – control

7

**Control is the power to govern the financial & operating policies of an entity so as to obtain benefits from its activities**

- **Identifying control requires judgement**
- **Rebuttable presumption**
  - A controls B if it owns (directly or indirectly through its Subs) >50% of B's voting power
- **Need not own shares to control**
  - eg special purpose entity (SPE)



## Section 9 – control continued

8

- **Control exists if A owns <50% & has power:**
  - over >50% of B's voting power;
  - to govern B under statute or agreement;
  - to appoint or remove >50% of members of board that controls B; or
  - to cast >50% of votes at board meetings.
- **Control can also be achieved through currently exercisable options or convertible instruments**



## Section 9 – control? examples

9

**In the absence of evidence to the contrary, in each scenario below, does A control Z?**

- **i:** A owns 100% of Z.
- **ii:** A owns 51% of Z.
- **iii:** A owns 50% of Z.
- **iv:** A owns 50% of Z and holds currently exercisable options to acquire another 100 shares in Z.
- **v:** Same as Ex iv except B owns the options.



## Section 9 – example SPE

10

- **A pharmaceutical manufacturer (entity A) established a viral research centre (RC) at a university.**
  - A determined sole & unalterable purpose of RC = research & develop immunisation & cures for viruses that cause human suffering.
  - RC is owned and staffed by the university.



## Section 9 – example SPE continued

11

- **All costs of establishing & running RC are paid by the university from the proceeds of a grant from A.**
  - the budget for the research centre is approved by A yearly in advance.
- **A benefits from the research centre:**
  - by association with the university; &
  - through exclusive right to patent any immunisations & cures developed.



## Section 19 – business combinations

12

**A business combination is the bringing together of separate entities or businesses into one reporting entity.**

One entity (the acquirer) obtains control of one or more other businesses (the acquiree).  
Acquisition date = date on which the acquirer effectively obtains control of the acquiree.



## Section 19 – accounting

13

- **Purchase method used for all Bus Coms**
  - 1<sup>st</sup> identify the acquirer
  - 2<sup>nd</sup> measure the cost of the Bus Com (A)
  - 3<sup>rd</sup> allocate the cost of the Bus Com to the assets acquired and liabilities & contingent liabilities assumed (B)
  - 4<sup>th</sup> recognise asset (goodwill) = the excess of (A) over the acquirer's interest in (B)



## Section 19 – identifying the acquirer

14

- **Sometimes difficult to identify acquirer. Acquirer usually is the entity:**
  - with the greater pre-Bus Com fair value
  - paying cash (if settling in cash)
  - that issues the shares (if settling in shares). BUT reverse acquisitions
  - whose management is able to dominate the combined entity



## Section 19 – examples identify acquirer

15

### Who is the acquirer?

- **i:** Entities A & B combine their businesses by forming entity C. C issues 30 & 20 shares to A's & B's shareholders respectively in exchange for A's & B's businesses.
- **ii:** Same as i, except 20 shares issued to each of A's & B's shareholders. C had 9 board members 5 appointed by A's shareholders (4 by B's).



## Section 19 – examples identify acquirer

16

### Who is the acquirer?

- **iii:** On 31/12/20X0 A has 100 shares in issue.  
On 1/1/20X1 A issued 200 new A shares to the owners of B in exchange for all of B's shares.



## Section 19 – cost of a Bus Com

17

- **Cost of a Bus Com:**
  - FV of assets given, liabilities incurred or assumed, & equity instruments issued by the acquirer, in exchange for control of the acquiree; plus
  - costs directly attributable to the Bus Com, eg directly attributable advisory, legal, accounting, valuation & other professional or consulting fees.



## Section 9 – cost of a Bus Com

18

### What is the cost of the Bus Com?

- i: Entity A acquires 75% of entity B in exchange for CU85,000 cash & 1,000 entity A shares (fair value = CU10,000) issued for the transfer. Entity A incurred CU5,000 advisory and legal costs directly attributable to the business combination & CU1,000 share issue expenses.**



### Section 19 – adjust cost of Bus Com

19

- **When Bus Com agreement provides for contingent (on future events) consideration**
  - if probable measured reliably: include in cost of the Bus Com at acquisition date
  - otherwise exclude from cost of Bus Com
    - but if subsequently becomes probable & can be measured reliably, adjustment to the cost of the combination



### Section 19 – allocate cost of Bus Com

20

- At acquisition date, allocate cost of a Bus Com by:
  - recognising the acquiree's identifiable assets & liabilities & (if FV can be measured reliably) contingent liabilities at their fair values (on date of acquisition)
  - any difference between the cost of the Bus Com & the acquirer's interest in the net FV of the identifiable assets, liabilities & provisions for contingent liabilities recognised as goodwill or 'negative goodwill'.



### Section 19 – 'negative goodwill'

21

- **If, at acquisition date, acquirer's interest in net FV of the identifiable assets, liabilities & contingent liabilities recognised > cost of Bus Com:**
  - reassess the identification & measurement of the acquiree's assets, liabilities & provisions for contingent liabilities & the measurement of the cost of the combination
  - recognise immediately in profit or loss any excess remaining after that reassessment.



### Section 9 – allocate cost of Bus Com Ex

22

- i: Entity A pays 1,100 for 100% of entity B. On acq. date net FV of B's identifiable assets, liabilities & contingent liabilities = 1,000.**
- ii: Same as i except A pays 900.**
- iii: Same as i except A acquires 90% of B (still pays CU1,100).**



### Section 19 – goodwill after acquisition

23

- **After initial recognition, measure goodwill at cost less accumulated amortisation and accumulated impairment losses:**
  - if cannot estimate reliably useful life of goodwill, it is presumed to = 10 yrs.
  - see Section 27 for impairment.
- **Note: do not recognise internally generated goodwill**



### Section 9 – examples goodwill

24

- i: On 1/1/20X1 entity A pays 1,100 for 100% of entity B. On acq. date net FV of B's identifiable assets, liabilities & contingent liabilities = 1,000. Est useful life of goodwill = 5 yrs**
- ii: Same as i except useful life = 20 yrs.**
- iii: Same as i except cannot estimate useful life of goodwill.**



## Section 19 – provisional amounts

25

- If initial accounting for Bus Com is not complete at first reporting date after Bus Com recognises provisional amounts:
  - if new info <12 months after acquisition date, retrospectively adjust provisional amounts recognised
  - thereafter, adjust initial accounting for Bus Com only to correct material prior period error (see Section 10).



## Section 9 – examples provisional am'ts

26

- i: 1/9/20X1 entity A acquires 100% of entity B in exchange for CU100,000 cash when the fair value of B's assets less FV of B's liabilities & contingent liabilities = CU90,000, including provisional valuation of CU20,000 for a plot of land.  
Useful life of goodwill = 10 yrs.  
On 1/6/20X2 receive independent valuation of land at 1/9/20X1 = CU25,000.



## Section 9 – examples provisional am'ts

27

- ii: Same as i except independent valuation of land received on 1/12/20X2.
- iii: Same as i except independent valuation of land received on 1/2/20X3.
- iv: Same as i except on 1/2/20X3 the entity discovered that in error it had omitted the land from the initial accounting for the business combination.



## Section 19 – goodwill disclosure

28

- Disclose a reconciliation of CA of goodwill at the beginning & end of the reporting period, showing separately
    - changes arising from new Bus Coms
    - impairment losses
    - disposals of previously acquired businesses
    - other changes
- Need not present comparatives



## Section 19 – Bus Coms disclosure

29

- For each Bus Com in the period disclose:
  - names & descriptions of combining businesses
  - acquisition date (control date)
  - % of voting equity instruments acquired
  - cost of the Bus Com & describe components (eg cash & shares)
  - amounts recognised at acquisition date for each class of the acquiree's assets, liabilities, contingent liabilities & goodwill.
  - amount of 'negative goodwill' & line item in income statement (or SOCI or SOI&RE)



## Section 9 – consolidation procedures

30

- Principle: Group = 1 economic entity
- Consolidation procedures:
  - combine financial statements parent & its Subs line by line
  - eliminate parent's invest in Sub & the parent's portion of equity of each Sub
  - allocate non-controlling interest (NCI) their share of comprehensive income & net assets of Subs & present separately from the interest of owners of the parent (even if NCI becomes a deficit balance)
  - eliminate intragroup balances & transactions



### Section 9 – example: procedures

31

- **i. On 1/1/20X1 entity A acquires 100% of entity B for CU1,000 when B's share capital & reserves = CU700 (net FV of B's assets, & liabilities = CU800). B has no contingent liabilities. The CU100 difference between CA & FV is i.r.o. a machine with 5 yrs remaining useful life and nil residual value.**

**B's profit for the year ended 31/12/20X1 = CU400.**

**In 20X1 A sold inventory which cost it 100 to B for 150. At 31/12/20X1 B's inventory included CU60 inventory bought from A.**

**Ignore taxation effects.**



### Section 9 – example: eliminate investment

32

- **i. continued: proforma journal entry at acquisition to eliminate A's investment in B; recognise goodwill; & eliminate B's share capital & reserves accumulated before it became part of the group.**

Property, plant & equipment	100	
B's at-acquisition share capital & reserves	700	
Goodwill (asset)	200	
A's investment in B		1,000



### Section 9 – example: adjusting consolidated depreciation

33

- **i. continued: proforma journal entry to increase depreciation to group values (remaining estimated useful life = 5 yrs):**

Profit or loss	20	
Property, plant & equipment		20



### Section 9 – example: amortise goodwill

34

- **i. continued: proforma journal entry to amortise goodwill (assumed useful life = 10 years):**

Profit or loss	20	
Goodwill (asset)		20



### Section 9 – example: unrealised profit

35

- **i. continued: proforma journal entry to eliminate intragroup sale of inventory and the unrealise profit in inventories (ignoring tax effects):**

Profit or loss (revenue)	150	
Profit or loss (COS)		150
Profit or loss (COS)	20	
Inventory (asset)		20



### Section 9 – non-controlling interest

36

- **Non-controlling interest (NCI) in net assets consists of:**
  - the amount of the NCI recognised in accounting for Bus Com at date of acquisition; plus
  - the NCI's share of recognised changes in equity (ie recognised changes in Sub's net assets) since the date of the combination.



### Section 9 – example: NCI

37

- **i.** On 1/1/20X1 entity A acquires 75% of entity B for CU1,000 when B's share capital & reserves = CU700 (net FV of B's assets, & liabilities = CU800). B has no contingent liabilities). The CU100 difference between CA & FV is i.r.o. a machine with 5 yrs remaining useful life and nil residual value.



### Section 9 – example: NCI continued

38

- **i. continued:**  
**B's profit for the year ended 31/12/20X1 = CU400.**  
**In 20X1 A sold inventory which cost it 100 to B for 150. At 31/12/20X1 B's inventory included CU60 inventory bought from A.**



### Section 9 – example: eliminate investment

39

- **i. continued:** proforma journal entry at acquisition is.

Property, plant & equip.	100	
B's at-acquisition share capital & reserves	700	
Goodwill	400	
Non-controlling interest		200
A's investment in B		1,000



### Section 9 – example: adjusting consolidated depreciation

40

- **i. continued:** proforma journal entry to increase depreciation to group values (remaining estimated useful life = 5 yrs):

Profit or loss	20	
Property, plant & equipment		20



### Section 9 – example: amortise goodwill

41

- **i. continued:** proforma journal entry to amortise goodwill (assumed useful life = 10 years):

Profit or loss	40	
Goodwill (asset)		40



### Section 9 – example: allocate profit

42

- **i. continued:** proforma journal entry allocating the NCI their share of B's profit for the year:

NCI profit allocation	95	
NCI (equity)		95

Calculation:	
Profit	400
Depreciation adjust	(20)
	<u>380</u>
25% attributable to NCI	<u>95</u>



### Section 9 – example: NCI

43

- **i. continued:** proforma journal entry to eliminate **downstream** intragroup sale of inventory and the unrealised profit in inventories (ignoring tax effects):

Profit or loss (revenue)	150	
Profit or loss (COS)		150
Profit or loss (COS)	20	
Inventory (asset)		20



### Section 9 – example: NCI upstream sale

44

- **ii. continued:** Same as i except **upstream sale of inventory (ie from B to A)**
- Same proforma journal entries as in example i & an additional journal entry (below) to eliminate from NCI their share of the unrealised profit:

NCI (equity)	5	
NCI profit allocation		5



### Section 9 – other consolidation issues

45

- **Uniform reporting date** (unless impracticable)
- **Uniform accounting policies**
- **Income & expenses of a Sub are included in CFS from the acquisition date until the date on which the parent ceases to control the Sub.**
- **Presentation currency**



### Sections 9 & 30 – presentation currency

46

- Entity's **functional currency** (measurement currency) is determined in accordance with ¶30.2–30.5 but can choose any **presentation currency**
- When a group contains individual entities with different functional currencies
  - income & expense and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented



### Sections 9 & 30 – translate foreign operations

47

- **Translate foreign operations into presentation currency of CFSs**
  - translate assets & liabilities at the closing rate on reporting date;
  - translate income & expenses at exchange rates at the dates of the transactions (can use average rate if diff not material); &
  - recognise resulting exchange differences in OCI
    - if partly owned sub allocate part to NCI



### Sections 9 & 30 – example foreign operation

48

- **i: On 1/1/20X1 A paid CU60,000 to acquire 75% of B for FCU7,500 when B's only assets were cash FCU1,000 & machine FCU9,000.**

**CU = functional currency of A & presentation currency of group.**  
**FCU = functional currency of B.**



Sections 9 & 30 – example foreign operation

49

i continued:

Trial balances 31/12/20X1	A	B
	CU	FCU
Share capital	(100)	(1,000)
Opening retained earnings	(80,000)	(9,000)
Profit for the year	(10,000)	(5,000)
Investment in B	60,000	
Machine		6,000
Cash	30,100	9,000



Sections 9 & 30 – example foreign operation

50

i continued: Translate B's trial balance

	FCU	Exch rate	CU
Share capital	(1,000)	× 8 actual	(8,000)
Retained earnings	(9,000)	× 8 actual	(72,000)
Profit for the year	(5,000)	× 7.5 actual	(37,500)
Machine	6,000	× 7 closing	42,000
Cash	9,000	× 7 closing	63,000
Translation difference		Balancing	12,500



Sections 9 & 30 – example foreign operation

51

i continued: Consolidated SOCI (working)

	A	B	Adjust	Consol
Profit	10,000	37,500		47,500
OCI			(12,500)	(12,500)
C income				35,000
<b>Allocation</b>	<b>Owners' of parent</b>		<b>NCI</b>	
Profit	38,125 (ie 10,000A + 75% × 37,500B)		9,375 (ie 25% × 37,500B)	
OCI		(9,375)		(3,125)
		(ie 75% × -12,500)	(ie 25% × -12,500)	



Sections 9 & 30 – example foreign operation

52

i continued: Consolidated SOFP (working)

	A	B	Adjust	Consol
Share capital	100	8,000	(8,000)	100
R earning	90,000	97,000	(78,250)	108,750
NCI			26,250	26,250
Invest in B	60,000		(60,000)	
Machine		42,000		42,000
Cash	30,100	63,000		93,100



Sections 9 & 30 – translate foreign operations

53

Other issues:

- In CFSs exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation are recognised in OCI.
- exchange gains on other intragroup monetary items are recognised in consolidated profit or loss
  - such gains/losses are not eliminated because of exposure to currency fluctuations



Sections 9 & 30 – disposal of subsidiary

54

- **Gain or loss on disposal of a Sub =**
  - proceeds from disposal of Sub; less
  - CA of its net assets measured from group's perspective at the date of disposal (excluding cumulative exchange differences that relate to a foreign subsidiary recognised in equity in accordance with Section 30 *Foreign Currency Translation*)



### Section 9 – disposal of subsidiary

55

- **Entity ceases to be a Sub but still hold investment in former Sub, account for investment as:**
  - financial instrument (Sec 11 & 12);
  - associate (if significant influence); or
  - jointly controlled entity (if joint control)
- **CA of investment at the date that the entity ceases to be a subsidiary is regarded as the cost on initial measurement of the financial asset.**



### Section 19 – consolidation disclosures

56

- **Disclose**
  - fact ‘consolidated financial statements’
  - basis for concluding control exists if parent does not own >50% of voting power
  - differences in reporting dates of parent & Subs
  - nature & extent of significant restrictions on ability of Sub to transfer funds to the parent as cash dividends or to repay loans



### Section 9 – separate financial statements

57

- **IFRS for SMEs does not require presentation of separate financial statements (SFSS)**
- **primary financial statements of an entity that does not have a Sub are not SFSS**
  - entity that is not a parent but is an investor in an Ass or has a **venturer’s** interest in a JV presents its primary financial statements in compliance with Sec 14 or 15 respectively
  - it may also elect to present separate financial statements



### Section 19 – SFSS acc policy choice

58

- **If prepare SFSS described as conforming to the IFRS for SMEs**
  - comply with all of the requirements of the *IFRS for SMEs*
  - account for investments in Subs, Ass & JCEs either:
    - (i) at cost less impairment; or
    - (ii) at FV.
  - can elect different policy for different class (eg only Ass at FV)



### Section 19 – SFSS disclosures

59

- **If prepared, SFSS shall disclose:**
  - fact ‘separate financial statements’
  - description of the methods used to account for the investments in Subs, JCEs & Ass
  - identify the consolidated financial statements or other primary financial statements to which they relate.



### Section 9 – combined financial statements

60

- **IFRS for SMEs does not require presentation of combined financial statements (CombFSs)**
- **CombFSs are a single set of financial statements of two or more entities controlled by a single investor**



## Section 19 – Combined financial statements

61

- **If prepare CombFSs described as conforming to the *IFRS for SMEs***
  - comply with all of the requirements of the *IFRS for SMEs*
  - similar to consolidation, eg eliminate intercompany transactions & balances; same reporting dates (unless impracticable); & uniform accounting policies



## Section 19 – CombFSs disclosures

62

- **If prepared, CombFSs shall disclose:**
  - fact ‘combined financial statements’
  - the reason why prepared.
  - basis for determining which entities are included
  - basis of preparation of the combined financial statements.
  - the related party disclosures required by Section 33.



## Questions or comments?

63

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64

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