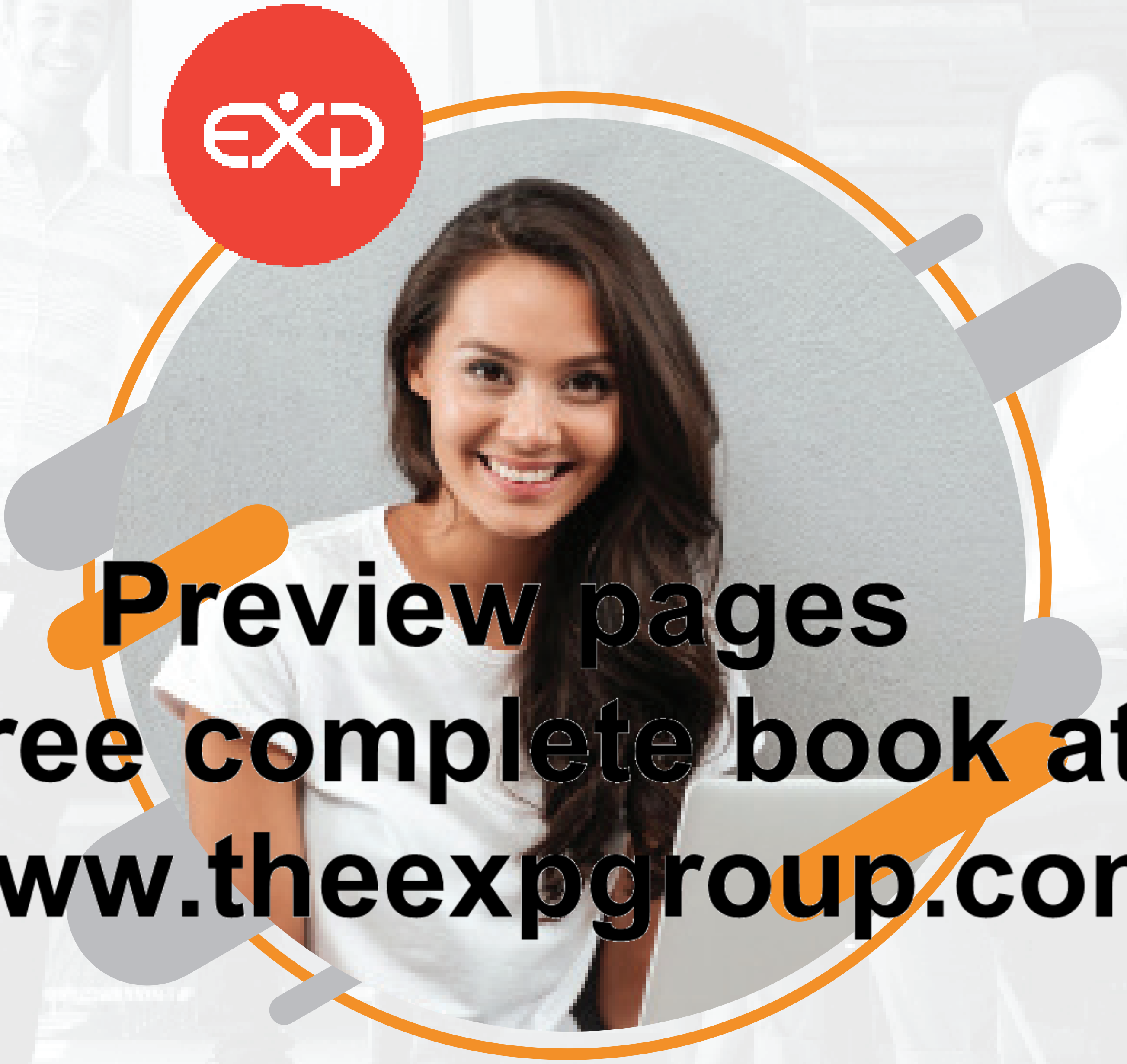

The ExP Group

ACCA SBR | ExPress Notes

Strategic Business Reporting

SBL SBR AFM APM ATX AAA

BT MA FA LW PM TX FR AA FM

Valid for September 2020, December 2020, March 2021 and June 2021 exam sittings

Contents

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“Hello”

Thank you for downloading a copy of these ExPress notes and I hope you find them useful for your studies.

We provide these ExPress notes free of charge to individual students as part of our CSR initiatives. The notes are designed to help students assimilate and understand the most important areas for the exam as quickly as possible.

A word of warning though in that they have not been designed to cover everything in the syllabus so you should only use these notes for either an overview of the key areas before you start your main studies or as part of your final revision in the run up to your exams.

Importantly though, we want you to be successful in your exams so good luck with your studies and please do let us know how you get on.

All the best,

Steve

About The ExP Group

We were born with one passion, with one aim, with one desire. To use technology the way it should be used. To use technology to open up education, and in particular financial education, to whoever needs it regardless of their income, wealth, race, sex, religion or location.

We wanted to use technology to empower individuals to develop themselves through financial expertise, organisations to improve their performance through enhanced human capital and ultimately communities and families to benefit as a result.

We’re on target and since our birth we have had the privilege of working with and learning from inspirational individuals and organisations from all 4 corners of the world in countries as varied as the UK in the north, Singapore in the east, South Africa in the south and the Cayman Islands in the west.

We’re only part way through our journey but we’re doing better than we expected. The best is yet to come though,

Education+Technology=Ethical Empowerment.

Thank you for being part of our story.

01 Group Accounting

The Big Picture

Section A of the SBR exam will consist of two scenario based questions. Group financial statements are likely to be included.

These notes focus on the areas of groups that are new to the SBR paper from the FR paper, though we start with some core definitions and workings that should be familiar from the FR paper.

Consolidation is the process of replacing the single figure for "investment in subsidiary" in the individual financial statements of the parent with more useful information about what assets, liabilities, income and expenditure the parent company controls via its investment, ie:

Consideration transferred to buy subsidiary (as shown in the parent company's individual accounts)

Net assets in the subsidiary's financial statements (ie equity or capital plus reserves) at the acquisition date.

Non-controlling interests' share of the net assets of the subsidiary.

Goodwill arising on acquisition (premium paid to acquire the subsidiary).

Consolidation is basically a double entry to derecognise the carrying value of the investment (Cr Investment in subsidiary) and recognise the individual assets (Dr PP&E, etc), the liabilities (Cr Payables, etc), the non-controlling interest (CR NCI) and recognise goodwill as a balancing, residual, item (normally DR Goodwill).

Key definitions - what group accounting is trying to do

Subsidiary	Any entity that is controlled by another entity, normally by having more than 50% of the voting power, though there is no minimum shareholding.
Parent	An entity that controls one or more entities.
Associate	A company in which the parent has significant influence, but not control nor joint control (as with a joint venture).
Control	An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
Significant influence	The power to participate in, but not control, the financial and operating policy decisions of an entity
Equity	Equity is defined in the Framework document as assets less liabilities. By definition, this is the same as capital and reserves of any company at any date in time. In group accounting, we very frequently use this capital + reserves = net assets. For example, this is used to work out the net assets on the date of acquiring control of a company (as part of the goodwill working) and to work out post-acquisition growth in a subsidiary's assets (ie post-acquisition profit).
Group reserves	The cumulative gains made under the control of the parent. The parent company's reserves, plus the post-acquisition retained gains of all subsidiaries, joint ventures and associates.
Non-controlling interest	Formerly called minority interest. The share of the net assets and gains of a subsidiary that is not owned by the parent.
Goodwill	The premium paid by the parent to acquire its interest in a subsidiary or associate.

Key workings - hopefully familiar from the FR paper, but revise thoroughly

Group retained earnings

Produce one column for each company under the parent company's influence. Then work down the rows methodically, perhaps using the mnemonic **TOP TIP PET** to make sure you haven't forgotten anything. If the question has different types of reserves (eg revaluation reserve as well as retained earnings) you will need to do a separate working like the one below for each reserve to be shown in the group SOFP.

	Parent $'000	Sub 1 $'000	Sub 2 $'000	Assoc $'000
Today	10,000	4,000	3,000	4,500
Omissions/ errors to correct in the individual financial statements of each company	400	200	(50)	
Provision (eg for unrealised profit)	(20)	(50)		-
Time passage effects (eg write-off of fair value adjustments)		(40)	20	
Impairments of goodwill (cumulative)	(30)			
Sub-total	10,350	4,110	2,970	4,500
Pre-acquisition reserves		(2,000)	(1,800)	(4,200)
Post-acquisition	10,350	2,110	1,170	300
x **E**ffective ownership	x 100%	x 60 %	x 40% *	x 40%
	10,350	1,266	468	120
TOTAL	12,204			

** This is not a typo! A subsidiary may still be a subsidiary if an effective ownership of less than 50% still gives the parent control. See multiple groups below.

Non-controlling interests

These show the net assets controlled by the parent and so part of the group, but not actually owned by the parent. There is no need to consider pre- and post-acquisition profits when calculating non-controlling interests in the SOFP.

	Sub 1 $'000	Sub 2 $'000
Capital and share premium at SOFP date	800	400
Reserves, as consolidated (see eg above)	4,110	2,970
Fair value adjustments at acquisition	250	(80)
Less: Any items in the individual company's SOFP not recognised in the group SOFP (see below)	(50)	-
Net assets (ie equity) as consolidated in the group SOFP	5,110	3,290
x NCI %	40%	60%
Non-controlling interest	2,044	1,974
Total non-controlling interest	4,018	

Goodwill on a business combination

Fair value of consideration transferred		2,240
Less: Fair value of identifiable net assets acquired, calculated as:		
Capital and share premium of target	800	
Reserves of target at acquisition date	2,000	
Net assets (equity) of target at target's book value	2,800	
Fair value adjustments to target's net assets	250	
Net assets (equity) of target at fair value	3,050	
X % acquired (60%)		(1,830)
Goodwill arising in books of parent for consolidation		410

Goodwill: gross ("total") or net ("partial")?

The standard double entry working above produces a goodwill figure as it relates to the parent's stake. Imagine that the fair value paid for the subsidiary was the fair value for a 60% stake. Then we deduct 60% of the net assets. This logically gives 60% or thereabouts of the total implied goodwill (eg reputation, client list, motivated staff) of the subsidiary.

IFRS 3 allows groups a choice with each acquisition whether to leave goodwill net as above or gross it up to show the implied total value of goodwill. In order to do the gross up, it is necessary to be given the fair value of the non-controlling interests' stake in the business at the acquisition date. This would be given in the exam.

Example

Non-controlling interest at fair value at acquisition date	1,350
Fair value of consideration transferred for 60% stake	2,240
Implied total value of company	3,590
Less: Fair value of identifiable net assets	(3,050)
Implied total goodwill	540
Partial goodwill automatically recognised (see above)	410
Gross-up required for total goodwill recognition	130

This gross up, if chosen as the accounting policy, would be recognised as:

Dr Goodwill	130	
Cr Non-controlling interests		130

Fair values

When buying a company, its previous owner will only accept the fair value of the company as consideration, or they will not sell!

In order to give a true and fair picture of the actual goodwill purchased, it is therefore necessary to record all the assets and liabilities acquired in the subsidiary at their fair value.

Fair value is defined in IFRS 13 as the price that would be received to sell an asset or paid to transfer liability in an orderly transaction between market participants at measurement date; i.e. it is an exit price or estimated using a valuation technique. A few notable fair value adjustments are:

Consideration paid includes the market value of any shares paid. Any contingent consideration is valued assuming that it will be paid, even if this is not certain.

Acquisition costs are written off immediately.

Contingent liabilities of the subsidiary will be shown in the individual accounts at zero value, but their existence would reduce the amount the acquirer is willing to pay. They are therefore revalued as if they were provisions in the fair value exercise.

Changes in group structure

Disposals

The gain or loss on disposal of anything is the increase or decrease in net assets recognised as a result of the transaction.

Proceeds (what is coming into the SOFP in the transaction)	X
Less: Carrying value derecognised (what leaves the SOFP)	(X)
Profit or loss on disposal (the increase or decrease in net assets)	X

The carrying value of a subsidiary in a group SOFP comprises:

- Individual assets and liabilities of the subsidiary at the SOFP date
- Goodwill remaining from the purchase by the parent
- Non-controlling interests at the SOFP date.

Therefore, the gain or loss on derecognition of a subsidiary is:

Proceeds (what is coming into the SOFP in the transaction)	X
Less:	
Individual assets and liabilities of the subsidiary at the SOFP date	(X)
Goodwill remaining from the purchase by the parent	(X)
Non-controlling interests at the SOFP date	(X)
Group gain or loss on disposal	XX

The same working can be used to calculate gain or loss on partial disposal, where non-controlling interest increases (eg where ownership goes from 80% to 60%).

Where a holding goes from 80% to 40%, the calculation is amended slightly, as in addition to sales proceeds for the partial stake, there will also be a new associate recognised.

Proceeds (what is coming into the SOFP in the transaction)	X
Value of new associate recognised	X
Less:	
Individual assets and liabilities of the subsidiary at the SOFP date	(X)
Goodwill remaining from the purchase by the parent	(X)
Non-controlling interests at the SOFP date	(X)
Group gain or loss on disposal	X

Step acquisitions

Where an acquisition happens in stages (as it often does in reality), the treatment is to treat the acquisition as a purchase on the date when control happens. Also, there is a disposal of any previous holding, which might have been an available-for-sale financial asset or an associate.

This results in an acquisition of a subsidiary and a gain or loss on disposal as part of the same transaction.

In effect, step acquisitions use much the same logic as disposals, but in reverse.

Multiple group structures

You should expect the structure of the group in question 1 in the exam to be a multiple group structure, such as:

Parent

60% ↓

Subsidiary 1

60% ↓

Subsidiary 2

The main additional maters to consider here are:

- What is the nature of the relationship between parent and subsidiary 2? Even if the effective ownership is less than 50% (as it is here), it may still be a subsidiary, as there is effectively a