CHAPTER 9
STEP ACQUISITION

Three situations:

- Basic investment becomes a subsidiary
- Associate becomes a subsidiary
- Increases stake in subsidiary

Basic Principles

Piecemeal acquisition – acquisition in stages resulting in control

Guidance is provided by IFRS3 which requires the recalculation of goodwill when an enterprise becomes a subsidiary whatever its previous status i.e., where a subsidiary is acquired in stages, its reserves should not be capitalized until control is achieved.

Basic investment becomes a subsidiary

An investment becomes a subsidiary on the date when control passes to its new parent company. On this date goodwill arising on consolidation has to be ascertained as under: -

	Partial	Full
	Rs.	Rs.
Acquisition date fair value of acquirer's previously held equity interest	X	X
Acquisition date fair value of consideration transferred	X	X
Proportionate share/fair value of non-controlling interest	X	X
	XX	XX
Fair value of net assets at the acquisition date	(X)	(X)
Goodwill at the date of acquisition	XX	XX

The gain/loss on re-measurement of previously held equity interest should be transferred to income statement of the parent.

Example-1

A group made an investment of 10% in a company in 20X0 and the cost was Rs.3m. In 20X4 it makes a further investment in the company of 50% for Rs.30m to bring its total investment to 60% and thereby acquire control. The fair value of previously acquired equity interest is Rs. 5 million. The fair value of the company's identifiable net assets at acquisition in 20X4 is Rs.40m. The fair value of NCI at the date of acquisition was Rs. 20 million. The statement of financial position of the company at 20X0 and 20X4 when the investments were made is as follows:

	20X0	**20X4**
	Rs.(m)	**Rs.(m)**
Net assets (also FV)	25	40
Share capital	10	10
Retained profits	15	30
	25	40

Calculate Goodwill on acquisition and NCI under both accounting policies i.e. if NCI is taken as proportionate share of net assets or at fair value of NCI?

An associate becomes a subsidiary

When an investment is treated as an associate, a proportion of its profits (post-acquisition) would have been included within the consolidated accumulated profits and consolidated statement of financial position under equity method. The investment in associate has also been tested annually for impairment (IFRS3/IAS28).

IFRS3 states that goodwill should be calculated and separately recognized when the control is obtained neither before nor after. The above formula will be used for calculation of goodwill. The difference between the fair value of previously held equity interest and carrying value of investment under IAS-28 will be transferred to income statement.

Example-2

A group made an investment of 30% in a company in 19w5 for Rs.12m having fair value of Rs.18 million at the time of acquisition. In 20x1 it makes a further investment in the company of 50% for Rs.42m, to bring its total investment to 80%. The fair value of NCI at the date of acquisition is Rs.17 million. The statement of financial position of the company in 19w5 and 20x1 when the investments were made is as follows:

	19.w5	**20.X1**
	Rs.(m)	**Rs.(m)**
Net assets (also FV)	50	68
Share capital	10	10
Retained profits	40	58
	50	68

Calculate Goodwill on acquisition and NCI under both accounting policies i.e. if NCI is taken as proportionate share of net assets or at fair value of NCI?

Parent increases stake in subsidiary

IFRS3 states that when a group increases its shareholding in a company that is already its subsidiary; the goodwill will not change and remain the same as of the date of acquisition. IAs-27 states that changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (i.e. transactions with owners in their capacity as owners). In such circumstances the carrying amounts of the controlling and non-controlling interests shall be adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received shall be recognized directly in equity and attributed to the owners of the parent

Example-3

A group makes an investment of 60% in a company in 19w5 for Rs.50m when the fair value of its net assets was Rs.60m. The fair value of NCI at the date of acquisition was Rs.35 million. In 20X1 the group purchases a further 30% interest in the subsidiary for Rs.40m when the fair value of its net assets was Rs.160m; the increase in fair value of net assets between the original investment in 19w5 and 20X1 is due to revaluation increases of Rs.80m and retained profits of Rs.20m.

The statement of financial position of the company in 19x5 and 20X1 when the investments were made is as follows:

	19w5	**20X1**
	Rs.(m)	**Rs.(m)**
Net assets	60	80
Share capital	10	10
Revaluation surplus	-	80
Retained profits	50	70
	60	160

Calculate Goodwill on acquisition and NCI under both accounting policies i.e. if NCI is taken as proportionate share of net assets or at fair value of NCI?

Q-1

Increase in stake in existing subsidiary

Statement of financial position at June 30, 20X0

	Teeny	Tiny
	Rs. (000)	Rs. (000)
Investment in Tiny	16,400	--
Non-current assets	15,000	16,000
Net current assets	5,100	6,000
	36,500	22,000
Issued share capital	12,000	15,000
Accumulated profits	24,500	7,000
	36,500	22,000

Income statement for the year ended June 30, 20X0

Revenue	18000	6000
Operating cost	(12000)	(4000)
Profit before tax	6000	2000
Tax	(1500)	(500)
Profit after tax	4500	1500

Note:

a) The investments in Tiny were made as under: -
9 million shares on 30-06-W4, when accumulated profits of Tiny were Rs. 2.5 million. The cost of investment was Rs. 11.5 million. The fair value of NCI at the date of acquisition was Rs.7.5 million.
3 million shares on December 31, W9 and cost of investment were Rs.4.9 million.

b) At 31-12-W9, the fair value of the net assets of Tiny exceeded their carrying value by Rs. 600,000. This excess was due to a piece of land that was not depreciated. At the date of original investment the fair value exceeded the carrying value by Rs. 400,000. Assets that were the subject of a fair value adjustment when original investment was made remained in the financial statements on Tiny at 30-06-X0.

Required: - Prepare consolidated income statement and statement of financial position at June 30,20X0.

Q-2

Increase in stake from associate to subsidiary

The facts are same except the investments were made as under: -

- 6 million shares on 30-06-W4 when accumulated profits of Tiny were Rs. 2.5 million and cost of investment was Rs. 7.4 million. The fair value of previously held equity interest at the subsequent purchase is Rs. 9 million.
- 6 million shares on December 31, W9 and cost of investment were Rs.9 million. The fair value of NCI was Rs. 6 million.

Q-3

Increase in stake from trade investment to subsidiary during the year

The facts are same except the investments were made as under: -

- 1.5 million Shares on 30-06-W4 when accumulated profits of Tiny were Rs. 2.5 million and cost of investment was Rs. 1.75 million. The fair value of previously held equity interest at the subsequent purchase is Rs. 3.5 million.
- 10.5 million Shares on December 31, W9 and cost of investment were Rs.14.65 million. The fair value of NCI was Rs. 6 million.

Q-4

Increase in stake from sub-associate to subsidiary

Statement of financial positions of P, Q and R are as follows at December 31, 20X0: -

	P	Q	R
	Rs.(000)	**Rs.(000)**	**Rs.(000)**
Investment in subsidiaries			
Q	25,200		
R	10,000	10,600	
Property, plant and equipment	53,800	53,400	49,000
Current assets	24,000	21,000	15,000
	113,000	85,000	64,000
Equity-Ordinary share capital of Rs. 1 each	30,000	20,000	16,000
Share premium	20,000	10,000	8,000
Accumulated profits	35,000	30,000	20,000
	85,000	60,000	44,000
Loans	20,000	18,000	15,000
Current liabilities	8,000	7,000	5,000
	113,000	85,000	64,000

Details regarding intra group investments are as follows: -

Companies	**No. of shares acquired**	**Date share acquired**	**Accumulated profits balance at acquisition date**
	(000)		**Rs. (000)**
P in Q	12,000	1-1-W6	10,000
P in R	4,000	1-1W8	12,000
Q in R	4,800	1-1-W7	8,000

All share premium accounts arose prior to 1-1-W6. There has been no impairment of goodwill on consolidation in respect of any acquisition. The fair value of investment held by Q in R at the date, when P acquired share holding in R is Rs.12,500. The group has the policy of measuring NCI at fair value. The fair value of NCI at the date acquisition of Q was Rs. 20,000. The fair value of NCI in R at the date acquisition was Rs. 19,500.

Required: - Consolidated statement of financial position at December 31, 20X0

Q-5

The draft statement of financial position of Oceana Global Limited (OGL) and its subsidiary Rivera Global Limited (RGL) as of March 31, 2011 are as follows: -

	OGL	**RGL**
Assets	**Rs.(m)**	**Rs.(m)**
Property, plant and equipment	700	200
Intangible assets	4	
Investment in RGL opening balance	23	--
Investment in RGL acquired during the year	108	--

Current assets	350	150
	1,185	350
Equity and liabilities		
Share capital (Ordinary shares of Rs. 100 each)	300	100
Retained earnings	550	80
Faire value gain	3	--
	853	180
Non-current liabilities	150	40
Current liabilities	182	130
	1,185	350

The details of OGL's investments in RGL are as under: -

Acquisition date	**Face value of shares acquired Rs. (m)**	**Purchase consideration Rs. (m)**
July 01, 2009	10	20
October 1, 2010	45	108

Other information relevant to the preparation of the consolidated financial statements is as under: -

i) On October 01, 2010 the fair value of RGL's assets was equal to their carrying value except for non-depreciable land which had a fair value of Rs. 35 million as against the carrying value of Rs. 10 million.

ii) On October 01, 2010 the fair value of RGL's shares that were acquired by OGL on July 01, 2009 amounted to Rs. 28 million.

iii) RGL's retained earnings on October 01, 2010 amounted to Rs. 60 million.

iv) Intangible assets represent amount paid to a consultant for rendering professional services for the acquisition of 45% equity in RGL.

v) During February 2011 RGL sold goods costing Rs. 25 million to OGL at a price of Rs. 30 million. 25% of these goods were included in OGL's closing inventory and 50% of the amount was payable by OGL as of March 31, 2011.

vi) OGL follows a policy of valuing NCI at its fair value. The fair value of NCI in RGL, on the date of acquisition, amounted to Rs. 70 million.

Required: -

Prepare a consolidated statement of financial position for Oceana Global Limited as of March 31, 2011 in accordance with IFRS. ***(2011 Summer 16 marks)***