COLLEGE OF ACCOUNTING

FINANCIAL REPORTING | ADVANCED

Video Transcription: Subsidiaries – Part 1: Acquisitions and Increased Shareholdings

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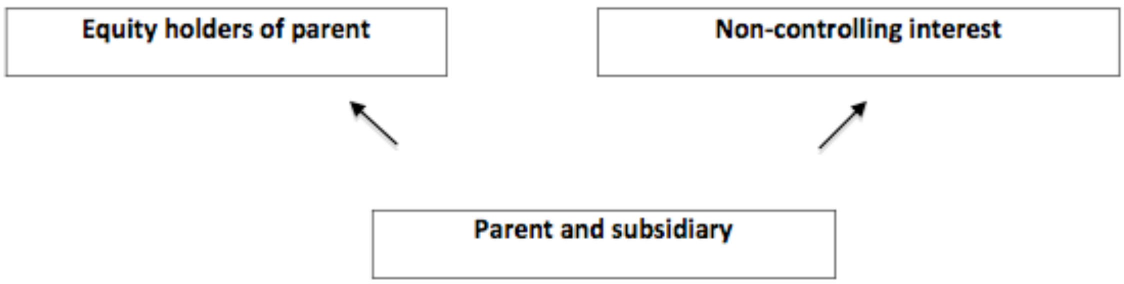
A: Introduction

Mergers and acquisitions are a big deal. Think Facebook's acquisition of WhatsApp or closer to home, Bidvest increasing its stake in Adcock Ingram to stymie an acquisition attempt by a Chilean pharmaceutical group.

This video looks at how a parent's group financial statements reports the implications of a parent acquiring or losing control in a subsidiary as well as those transactions where the parent maintains control.

Remember that a group is a parent and its subsidiaries and the owners of the group are those parties that hold equity, in group entities namely, the equity holders of the parent and the non-controlling interest (for subsidiaries that are not wholly owned):



So let's address the aim of this video through some examples:

B: Theory and Examples

The group reports changes in shareholding like any other transaction i.e. the period in which the transaction occurred, consistent with the objective of financial reporting and in line with the accounting treatment of assets, liabilities and equity.

1. Parent acquires control over a subsidiary (a business combination)

Let's start with the basics, a scenario you ought to be reasonably familiar with – an acquisition of a subsidiary that is not wholly owned. A parent acquired control of a subsidiary in a single transaction. Let's say A Ltd acquired an 80% controlling interest in the equity of B Ltd for R10 000 cash, when B's assets were fairly valued at R12 000, its liabilities at R3 000 and the 20% non-controlling interest was measured at its fair value of R2 000. At the acquisition date, A's group financial statements would reflect:

Assets	-	Liabilities	=	Equity			
				Equity holders of parent			NCI
				P/L	OCI	Directly to equity	
+R10 000 (cash)							+R2 000
- R12 000		+R3 000					
+R3 000 (goodwill)							

After the acquisition date, 80% of the changes in equity of B are attributable to the equity holders of A and 20% to the non-controlling interest.

2. A parent acquires control over a subsidiary in a step acquisition

What would happen if A already owned shares in B and then acquired additional shares that resulted in it gaining control? A now has control but it did not obtain it in a single transaction – this is commonly referred to as a step acquisition or a business combination, achieved in stages.

Let's say A owned 30% of the equity of B and that B was an associate. Then A increased its shareholding to a controlling 80% interest in B. There's nothing new here – up to the date of buying more shares, A's group financial statements will reflect an equity-accounted investment in associate and after the transaction a consolidated subsidiary. Let's focus specifically on the impact at the date of acquisition of A's controlling interest in B.

A Ltd acquired its 50% interest in the equity of B Ltd for R6 000 cash. At that date, its equity-accounted investment in B had a carrying amount of R3 000 and a fair value of R4 000. B's assets are fairly valued at R12 000, its liabilities at R3 000 and the 20% non-controlling interest is measured at its fair value of R2 000.

A’s group financial statements would reflect the step acquisition as follows:

Assets		-	Liabilities	=	Equity			
					Equity holders of parent			NCI
					P/L	OCI	Directly to equity	
+ R1 000	**a**				**R 1000**			+ R2 000
- R 4 000 (Investment in associate)								
- R 6 000 (cash)			+ R 3000					+ R 2 000
+ R 12 000								
+ R 3 000	**b**							

In effect, two things have happened:

a. Firstly, the A group no longer has an associate and the investment in associate balance must be derecognised. Any difference between the carrying amount of the investment in associate balance and the fair value is recognised in group profit or loss. In addition, all other effects relating to disposing an associate, which may be required such as transferring reserves realised on disposal of a revalued item of PPE of the associate, etc. must also be reflected in the group financial statements.

b. Secondly, A acquired control over B. It has done so by giving up cash and the investment in associate. By giving up these resources, the group has acquired the assets of B, assumed the liabilities and as there is equity in B. As B is not a wholly-owned subsidiary, non-controlling interest will be recognised (measured at its fair value of R2 000) and goodwill of R3 000 (in this case).

After the date control is gained, 80% of the changes in equity of TC are attributable to the equity holders of AC and 20% to the non-controlling interest.

3. A increases its shareholding in B (maintains control)

A now owns a controlling 80% interest in the equity of B and, after the acquisition date, 80% of the changes in equity of B would have been attributed to the equity holders of A and 20% to the non-controlling interest.
Let's assume A acquired an additional 5% of the equity of B for R1 000, when B's equity was R25 000. The non-controlling interest had a carrying amount immediately before this transaction of R5 000.
A's group financial statements would reflect A's purchase of the 5% in B as follows:

Assets	-	Liabilities	=	Equity			
				Equity holders of parent			NCI
				P/L	OCI	Directly to equity	
- R 1 000 (cash)						+ R 250	- R 1 250 (R5000 x 5/20)

- This increased A's shareholding, but did not change the nature of its investment in B i.e. B was and continues to be a subsidiary.
- The 5% equity of B that A acquired, would have been reflected in the non-controlling interest's balance in A's group financial statements (if the non-controlling interest's carrying amount of R5 000 reflected a 20% interest in the equity of B, then the 5% interest is R1 250).
- The non-controlling interest balance therefore needs to be reduced by R1 250 i.e. a portion of the non-controlling interest balance is derecognised.
- To the extent that A paid more or less than the non-controlling interest balance derecognised, this amount is recognised directly in equity as an "equity adjustment". Think about why this makes sense – this is transaction between the group and the owners of equity i.e. the non-controlling interest has received cash in exchange for giving up some of the equity, which had been attributed to it. In this case, A paid R250 less than the non-controlling interest it now acquired.

After this transaction, 85% of the changes in equity of B are attributable to the equity holders of A and 15% to the non-controlling interest