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

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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. Changes in group structure are likely to be tested alongside your ability to incorporate adjustments into draft financial statements using spreadsheets.

These notes focus on the areas of group accounting that are new to the SBR paper compared to 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, incomes and expenditures 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 neither 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 Conceptual Framework 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 frequently use share 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.

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

Goodwill on a business combination

Fair value of consideration transferred
- Cash consideration
- FV of shares transferred
- FV of conditional consideration
- Present value of deferred consideration

Add: NCI at FV or as share of FV of net assets
Less: Fair value of identifiable net assets acquired, calculated as:

- Net assets in individual FS
- FV adjustments

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

If NCI was originally calculated at fair value, then goodwill will be higher because FV typically exceeds the book value due to unrecognized intangible assets (such as reputation, skills, etc.). This is referred to as "full goodwill."

If NCI was originally calculated as a share of the FV of net assets, then goodwill will not include NCI's share of unrecognized intangibles and will therefore be called "partial goodwill."

Fair values

When selling 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 such as legal fees are written off immediately to PL.

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.

Group retained earnings

Group retained earnings comprise:

The parent's retained earnings in full

Plus: The parent's share of the increase in retained earnings of its subsidiaries

Less: Parent's share of accumulated depreciation on fair value (FV) adjustments at acquisition

Less: Provision for unrealized profit (PURP) (Parent's share of PURP if the subsidiary is the seller, or the full value if the parent is the seller)

Less: Accumulated goodwill impairment (only the parent's share if non-controlling interest (NCI) was calculated at FV at the acquisition date; otherwise, the full value of impairment]

Non-controlling interests

These show the share of net assets controlled by the parent and so part of the group, but not actually owned by the parent.

NCI is calculated as:

NCI at the acquisition date

Plus: NCI's share of the increase in net assets of the subsidiary since acquisition

Less: NCI's share of accumulated depreciation on FV adjustments at acquisition

Less: NCI's share of PURP if the subsidiary was the seller

Less: NCI's share of goodwill impairment if NCI was originally calculated at FV

Changes in group structure

Disposals if the control is lost

If as a result of the disposal the Group loses control over the subsidiary (e.g. the share is decreased from 80% to 40% or to 10%) then gain or loss on disposal needs to be found, goodwill relating to the subsidiary is to be derecognized in full, so will be net assets of the subsidiary and the NCI.

Proceeds (what is coming into the SOFP in the transaction)		X
Value of retained interest (associate of investment under IFRS 9)		X
Less:		
Individual assets and liabilities of the subsidiary at the SOFP date	X	
Goodwill at disposal date	X	
Non-controlling interests at disposal date	(X)	
		(X)
Group gain or loss on disposal		X/(X)

Please note that as NCI is increased on credit side of an entry then its disposal will increase the gain.

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.

First, the previously held interest will be revalued to its FV with the difference going to OCI if it was held at FVtOCI, or to PL otherwise.

Then this previously held interest is derecognized and is included in Goodwill calculation:

FV of previously held interest	X
FV of new consideration paid	X
NCI at the date of getting control	X
Less FV of Net Assets acquired	(X)
Goodwill at acquisition	X

Decrease in control

If the control is decreased (e.g. from 80% to 70%) then the transaction is accounted for within equity only:

Cash received	X
Increase in NCI (share of net assets for partial goodwill method and share of net assets and goodwill for full goodwill method)	(X)
Increase/decrease in Other Components of Equity	X/(X)

Increase in control

If the control is increased (e.g. from 70% to 80%) then the transaction is accounted for within equity only:

Cash paid	X
Decrease in NCI (proportionate to the reduction in carrying amount of NCI)	(X)
Decrease/Increase in Other Components of Equity	X/(X)

This means, that if the control has increased from 70% to 80%, then NCI has decreased from 30% to 20%, so by 10%/30% = 1/3. This means that NCI at that date should be calculated, multiplied by 1/3 and that amount would be recorded as Debit NCI in the entry above.

02

IAS 21

The Big Picture

An entity cannot mix currencies when producing financial statements.

E.g. USD + EUR = Nothing useful.

There are two sets of rules to know, depending upon where in the flow of transactions something is happening.

Foreign currency → **Translation rules** → Functional currency → **Presentation rules** → Presentation currency

Functional currency

- Generally, the currency that the entity's trial balance is produced in.
- The currency of the primary economic environment in which the company operates.
- Effectively the currency that the company "thinks in".
- May not be the currency of the country in which the company operates, especially if the company is more like a branch of a foreign parent and depends upon the foreign parent for day-to-day support.
- All other currencies other than the functional currency are a foreign currency.

Key workings/ methods - translation rules

1 Record all transactions in the functional currency. Record all purchases, sales, etc at the spot rate ruling on the date of the translation.

2 At the period end:

Translate monetary assets and liabilities at the closing rate.

Don't retranslate non-monetary items.

3A Exchange difference arising in the year on retranslation of foreign currency loans is reported in profit in finance income/ finance cost.

3B Exchange difference arising in the year on retranslation of foreign currency trade payables and receivables is reported in profit in other operating income/ other operating expenses.

Key workings/ methods - Presentation rules

This is normally examined in the context of group accounting, but it could be examined as a single company only.

An entity may choose any currency it likes for the presentation of its financial statements. Eg a company with a dual listing in the USA and in the European Union is likely to choose the US dollar as its presentation currency and also the euro as its presentation currency.

The basic rules are simple: translate the financial statements using these rules:

- All items in the SOFP: translate at the closing rate.
- All items in the SOCI: translate at the average rate for the period, or spot rate for any large one-off items.

Exchange differences will arise, e.g. imagine the position of Lear Co for the year ended 31 Dec 20x1:

Date	**Euro**
Net assets (equity) at 1 Jan 20x1	10,000
Profit for the year to 31 Dec 20x1	2,000
Other comprehensive income for the year to 31 Dec 20x1	1,000
Dividend declared for the year	(1,500)
Net assets (equity) at 31 Dec 20x1	11,500

Assume these exchange rates (USD per 1 EUR)

1 Jan 20x1	1.2
Average for 20x1	1.25
31 Dec 20x1	1.15

Date	**Euro**	**Exchange rate**	**USD**
Net assets (equity) at 1 Jan 20x1	10,000	1.2	12,000
Profit for the year to 31 Dec 20x1	2,000	1.25	2,500
Other comprehensive income for the year to 31 Dec 20x1	1,000	1.25	1,250
Dividend declared for the year	(1,500)	1.15	(1,725)
Net assets (equity) at 31 Dec 20x1	11,500	1.15	13,225

This does not add up!

The error is an exchange difference arising in the year.

This is not considered to be a realised gain or loss, so is reported directly in equity in the statement of changes in equity. It is not reported as part of other comprehensive income.

So Lear Co's statement of changes in equity for the year ended 31 Dec 20x1 will show:

Date	**USD**
Net assets (equity) at 1 Jan 20x1	12,000
Profit for the year to 31 Dec 20x1	2,500
Other comprehensive income for the year to 31 Dec 20x1	1,250
Dividend declared for the year	(1,725)
Exchange gain on translation arising in the year (balancing item)	(800)
Net assets (equity) at 31 Dec 20x1	13,225

This exchange gain or loss arising on translation in the year is a gain in the reserves of the subsidiary for consolidation. It is therefore split between parent and non-controlling interests.

Groups and foreign currency

It is common to have to translate the financial statements of a subsidiary into the reporting currency of the parent prior to consolidation.

This is simply an additional stage to complete prior to the process of consolidation.

Approach to questions with foreign subsidiaries:

1. Correct the individual accounts of each company for errors/ omissions in the individual accounts.
2. Translate the subsidiary's financial statements into the presentation currency of the parent using the presentation rules.
3. Consolidate as normal.

Further aspects of foreign currency groups

Goodwill

Goodwill on consolidation always arises in the books of the acquirer (ie parent) since it is the property of the parent company. The cost of buying the subsidiary from its previous owners can be broken down into:

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).

The goodwill's value will vary with the exchange rate as the value of the subsidiary's future earnings in the parent's currency will vary with the exchange rate. This means that goodwill must be revalued each year with a consequent revaluation gain or loss.

This means that each year, goodwill must be calculated similarly to how the exchange gain or loss is calculated for the translation of the net assets of the subsidiary:

Date	Euro	Exchange rate	USD
Goodwill at 1 Jan 20x1	1,000	1.2	1,200
Impairment loss in the year to 31 Dec 20x1	(200)	1.25	(250)
Exchange difference in the year	-	Balancing	50
Goodwill at 31 Dec 20x1	800	1.25	1,000

For full goodwill value this difference will be shared with NCI.