Fair value of identifiable net assets	60	45	15
Goodwill on combination	40	30	10

In this example, consideration paid by the acquirer for its controlling stake is exactly equal to its share of the fair value of the acquiree as a whole. Consequently the goodwill on combination is allocated rateably between the parent (75% of C$40 million) and the non-controlling interest (25% of C$40 million). The issue is how the goodwill on combination should be allocated when the acquirer pays more or pays less than its share of the fair value of the acquiree as a whole.

1.2 Control Premium

In a business combination based on arm's length transaction, it is not uncommon for the acquirer to pay a premium over and above the fair value of the acquiree as a whole in order for it to gain effective control. For example, an acquirer of a listed acquiree often pays a premium over the market price of the acquiree to gain control. The Standard clarifies that when a *control premium* is evident, the fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per-share basis might differ. In such cases, the goodwill on combination is not allocated rateably between the parent and the non-controlling interest but shall be allocated in the following manner:

(i) First, allocate the goodwill to the acquirer based on the difference between the fair value of the consideration given (including any premium paid) and the acquirer's share in the fair value of the identifiable assets and liabilities of the acquiree; and

(ii) Then, the balance of the goodwill is allocated to the non-controlling interest.

Note that in the case of a control premium, the aggregate of the fair value of net assets acquired and goodwill recognised would exceed the fair value of the acquiree as a whole, by the amount of the premium paid. Hence, the goodwill recognised would exceed the *inherent goodwill* of the acquiree (i.e. the goodwill that would otherwise be determined based on the difference between the fair value of the acquiree as a whole and the fair value of its identifiable net assets).

The control premium is paid by the acquirer and hence it should be included in the goodwill on combination allocated to the parent only. If non-controlling interest is measured at its acquisition-date fair value, by default, the goodwill allocated to the non-controlling interest will be equal to its share of the inherent goodwill only.

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Example 3.1

On 1 January 20x9, Eastin Ltd acquired a 60% interest in the equity shares of Westin Ltd. On this date, the quoted market price of Westin Ltd's 100 million ordinary shares was C$3.00 per share. Eastin Ltd, however, paid a premium of 20% over the market price i.e. C$3.60 per share, and the total consideration paid was C$216 million.

Eastin Ltd paid a premium after negotiations with the controlling shareholders of Westin Ltd and concluded that it could extract synergies from Westin Ltd by combining their operations. However, because the balance of the shares not owned by Eastin Ltd was widely spread among the investing public minority shareholders, the price paid by Eastin Ltd was not necessarily representative of the amount that other knowledgeable unrelated willing parties would pay for Westin Ltd as a whole. Eastin estimated that the fair value of Westin Ltd as a whole on acquisition date, based on market price, was C$300 million.

The net carrying amount of the identifiable assets and liabilities of Westin Ltd on acquisition date was C$120 million. However, a fair value adjustment of C$40 million was made to increase the fair value of certain landed properties of Westin Ltd.

The summarised statements of financial position of the two companies on acquisition date are as follows:

	Eastin Ltd	Westin Ltd
	C$'m	C$'m
Share capital of C$1 each	200	100
Retained profits	200	20
	400	120
Investment in Westin Ltd	216	–
Sundry net assets	184	120
	400	120

Required:

(i) Compute the inherent goodwill by comparing the fair value of Westin Ltd as a whole and the fair value of its identifiable net assets.

(ii) Compute the goodwill on combination and allocate the goodwill to the parent and the non-controlling interest.

(iii) Show the consolidation journals to recognise the goodwill, fair value adjustment and non-controlling interest at the acquisition date. Using a worksheet, prepare the consolidated statement of financial position as at the acquisition date.

Lada's borrowing cost on acquisition date was 8% per annum. Business combination expenses totalling C$500,000 have not been paid.

The summarised accounts of the two companies for the year ended 31 December 20x6 are as follows:

Statements of Profit or Loss and Other Comprehensive Income & Retained Profits

	Lada Ltd	Sada Ltd
	C$'000	C$'000
Profit before taxation	100,000	90,000
Taxation	(28,000)	(25,200)
Profit after taxation	72,000	64,800
Retained profits brought forward	128,000	120,000
Retained profits carried forward	200,000	184,800

Statements of Financial Positions

	Lada Ltd	Sada Ltd
	C$'000	C$'000
Property, plant and equipment	690,000	324,800
Investment in Sada (cash paid)	10,000	
Current assets	400,000	200,000
	1,100,000	524,800
Share capital of C$1 each	250,000	100,000
Share premium account	100,000	50,000
Retained profits	200,000	184,800
	550,000	334,800
Long-term loans	200,000	80,000
Deferred tax liabilities	50,000	30,000
Current liabilities	300,000	80,000
	1,100,000	524,800

The parties to the business combination have agreed on the following terms:

(a) The food segment of Sada's businesses was in a dire need for a reorganisation. Liabilities for terminating and reducing the activities of this segment were estimated at C$10,000,000, and this consisted mainly of termination benefits that would be paid to executives and other employees whose services would be terminated following the business combination. Future operating losses and other costs to reorganise this segment and that would be incurred as a result of this combination were estimated at C$15,000,000. During the financial year ended 31 December 20x6, Sada paid the termination benefits and recognised them as an expense in its income statement.

(b) As at 1 January 20x6, Sada's textile segment had a five-year contract with Bayer to be its exclusive supplier of textile materials. Using a discounted cash flow method, the fair value of this contract was estimated at C$40,000,000.

(c) As at 1 January 20x6, a claim of C$10,000,000 by a third party against Sada was disclosed as a contingent liability in the financial statements. This claim arose from a dispute, which has been filed in court by the third party. Using a discounted cash flow method and taking into consideration the probabilities of a range of future possible cash flows, Lada estimated the fair value of this contingent liability at C$5,000,000. The former owners of Sada have given a guarantee to reimburse Lada for any eventual settlement in excess of C$5,000,000. On 31 December 20x6, the parties concerned have agreed to settle this dispute out of court for an amount of C$8,000,000.

(d) As at 1 January 20x6, the carrying amount of Sada's manufacturing plant was C$40,000,000. On this date, the fair value of the plant was assessed at C$60,000,000. Depreciation on this plant was on the straight-line method. On that date, the plant had a remaining useful life of 20 years.

(e) Income tax rate was 25% and it applied to recognition of assets and liabilities, and to fair value adjustments. Deemed interest cost of contingent consideration was not an allowable tax expense.

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Required:

(a) Compute the cost of combination and the goodwill on combination.

(b) Prepare the consolidated accounts of Lada for the financial year ended 31 December 20x6.

Solution 3.3

(a) Cost of combination and goodwill

	C$'000	C$'000
Aggregate of:		
Fair value of consideration transferred:		
Initial cash consideration		10,000
Present value of contingent consideration [172,800/(1.08)¹]		160,000
Equity shares at market value 100,000 x C$3		300,000
Cost of combination		470,000
Non-controlling interest at fair value (20% x 500 m)		100,000
		570,000
Fair value of identifiable net assets:		
Carrying book value of net assets	270,000	
Fair value adjustment to manufacturing plant	20,000	

the economic substance of an arrangement. It uses a "rights and obligations" approach in which parties to an arrangement recognise their rights and obligations arising from the arrangement. It is thus a principle-based standard that provides for consistency in the accounting that would enhance comparability of financial statements.

The criteria of joint control remain largely the same as the former IAS but with added clarification that the sharing of control is based on decisions about the relevant activities (relying on those developed in IFRS 10).

IFRS 11 distinguishes two types of joint arrangements i.e. either joint venture or joint operation. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have *rights to the net assets* of the arrangement. A party having joint control in such an arrangement is known as a joint venturer. In contrast, a joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have *rights to the assets*, and *obligations for liabilities*, relating to the arrangement. A party having joint control in such an arrangement is known as a joint operator.

If the arrangement is a joint operation, a joint operator accounts for the assets, liabilities, revenues and expenses related to its interest in the joint operation in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses [IFRS 11.20]. These may include share of any assets held jointly and share of any liabilities incurred jointly.

If the arrangement is a joint venture, a joint venturer recognises its interest in the joint venture as an investment and accounts for that investment using the equity method (referenced to the revised IAS 28) [IFRS 11.24]. The proportionate consolidation is disallowed in such joint arrangement.

The accounting treatment would thus depend on the classification of the joint arrangement i.e. whether it is a joint operation or a joint venture. This classification is determined by assessing the rights and obligations of the parties arising from the particular arrangement [see IFRS 11.14].

A separate vehicle may be created in a joint arrangement. The Standard defines a separate vehicle as a separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.

Typically, if a joint arrangement is not structured through a separate vehicle, it would be classified as a joint operation in this IFRS. A joint operator accounts directly for the assets, liabilities, revenues and expenses related to the joint operation.

However, if a joint arrangement is structured through a separate vehicle, a reporting entity needs to consider the legal form and the terms of the

contractual arrangement, and if relevant, other facts and circumstances to determine whether the arrangement is a joint operation or a joint venture [IFRS 11.17].

This requirement means that even if the arrangement takes the form of a legal separate entity (such as a registered company), it is not necessarily classified as a joint venture. If the assessment determines that the arrangement through a separate vehicle is a joint operation, the operator would still need to account for its share of the respective assets, liabilities, revenues and expenses (based on its rights and obligations) in the separate vehicle. In this respect, the accounting treatment is similar to the proportionate consolidation of the former IAS 31, albeit on a slightly different basis. When applying the proportionate consolidation, the former IAS required a line-by-line constant per cent addition of the line items in the financial statements. This new IFRS requires addition of each line item in the financial statements based on the operator's rights to an asset item or obligation incurred on a liability item.

1.3 Implications of IFRS 11 on Practice

Operations that were termed as jointly controlled assets and jointly controlled operations under the former IAS 31 would most likely be classified as joint operations in this new IFRS. There will be no change to the accounting for such joint arrangements.

In a straightforward case of joint ventures, where joint venturers share the results and net assets based on equity interest held or agreed percentages, joint venturers who currently use the proportionate consolidation shall henceforth apply the equity method. This is likely to be the most significant change resulting from the adoption of IFRS 11.

However, some separate vehicles, classified as joint ventures under the former IAS 31 may be classified as joint operations under IFRS 11. This is not just a semantic change, as it would require that these separate vehicles be accounted for under a method similar to proportionate consolidation. However, the IASB acknowledges that the percentage share of each asset, liability, revenue and expense recognised in the financial statements could differ from the percentage interest that would have been used for proportionate consolidation.

Entities which do not have a legal personality along with some entities which only manufacture for the parties to the joint arrangement in specified proportions should now be classified as joint operations. In contrast, autonomous legal entities which bear their own risks and which have their own customers would be classified as joint ventures.

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The changes in accounting will thus be in one of three possibilities depending on which option the reporting entity currently uses to account for its joint ventures. These are:

(a) Joint ventures (as defined in IFRS 11) which are currently accounted for using the proportionate consolidation method shall henceforth be accounted for using the equity method;

(b) Legally separate vehicles which are classified as joint operations (as defined in IFRS 11), and currently accounted for using the equity method, shall henceforth be accounted for by recognising share of the assets, liabilities, revenues and expenses directly; and

(c) Legally separate entities which are classified as joint operations (as defined in IFRS 11) and which are currently accounted for using the proportionate consolidation shall henceforth be accounted for by recognising share of assets, liabilities, revenues and expenses directly (the percentage or percentages may be different from the percentage interest previously used for proportionate consolidation).

1.4 IAS 28 (revised), Investments in Associates and Joint Ventures

1.4.1 *Summary of the Changes*

The revised IAS 28 incorporates the requirement to apply the equity method for joint arrangements classified as joint ventures in accordance with IFRS 11. Apart from this semantic change, there are no other significant changes to the requirements for the equity method for investments in joint ventures or associates.

Some additional guidance is provided on discontinuation of the equity method when there is a loss of joint control or significant influence, and these are summarised as follows:

(a) If the investment in a joint venture or an associate becomes a subsidiary, an entity applies the requirements of IFRS 3 and IFRS 10 accordingly;

(b) If the retained interest in the former associate or joint venture is a financial asset, the entity shall remeasure the retained interest at fair value. The fair value of the retained interest shall be regarded as its fair value on the initial recognition as a financial asset in accordance with IFRS 9. Any difference between the fair value and carrying amount at the date the equity method was discontinued shall be recognised in profit or loss.

(c) When the equity method is discontinued an entity shall account for all amounts previously recognised in other comprehensive income (OCI) in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities i.e. the related reserve shall be recycled to profit or loss or transferred directly to retained profits in accordance with the applicable IFRSs.

(d) However, if an investment in an associate becomes an investment in a joint venture or vice versa, the entity continues to apply the equity method and does not remeasure the retained interest.

(e) If the ownership interest in an associate or a joint venture is reduced, but the entity continues to apply the equity method, the entity shall reclassify to profit or loss the *proportion* of the gain or loss that had previously been recognised in OCI relating to that reduction in ownership interest if that gain or loss would be required to be reclassified to profit or loss on the disposal of the related assets or liabilities.

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2 Principles of Investments in Joint Arrangements

Criterion of Joint Control

A joint arrangement is defined in IFRS 11 as an arrangement of which two or more parties have joint control. The central criterion for distinguishing joint arrangements from subsidiaries and associates is the existence of joint control. The Standard defines *joint control* as "the contractually agreed sharing of control of an arrangement, which exists only when the decisions about the relevant activities require the unanimous consent of the parties sharing control".

Joint arrangements may take different forms and structures. The Standard specifies that a joint arrangement may be either a joint operation or a joint venture.

What is a Joint Operation?

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities, relating to the arrangement. A joint operator is a party to a joint operation that has joint control of that operation. An example of a joint operation is when two or more joint operators combine their operations, resources and expertise in order to produce, market and distribute jointly a particular product, such as an aircraft or a ship. Another example of a joint operation is when two or more oil and gas joint operations jointly own, control and operate an oil pipeline. Each joint operator uses the pipeline to transport its own products in return for which it bears an agreed proportion of the expenses of operating the pipeline.

For example, when the test of probable inflows of economic benefits related to the deferred tax asset is not met. The potential benefit of the acquiree's tax loss carry-forwards or other deferred tax assets might not satisfy the criteria for separate recognition when a business combination is initially accounted for but might be realised subsequently. In such cases, IAS 12 requires that an entity shall recognise acquired deferred tax benefits that it realises after the business combination as follows:

(a) Acquired deferred tax benefits recognised within the measurement period that results from new information about facts and circumstances that existed at the acquisition date shall be applied to reduce the carrying amount of any goodwill related to that acquisition. If the carrying amount of that goodwill is reduced to zero, and remaining deferred tax benefits shall be recognised in profit or loss;

(b) All other acquired deferred tax benefits realised shall be recognised in profit or loss (or, if this Standard so requires, outside profit or loss) [see IAS 12.68].

Example 7.32

On 1 April 20x1, Intria Ltd acquires a 100% interest in the equity capital of Satria Ltd for a cash consideration of C$40 million. On this date, the fair value of the identifiable net assets of Satria Ltd is C$30 million.

On 1 April 20x1, Satria Ltd has unused tax losses of C$100 million for which no deferred tax asset is recognised. On the date of the acquisition, Intria Ltd concludes that it is not probable for the deferred tax asset to be realised in the future periods.

Goodwill on combination is carried at cost less accumulated impairment losses. The post-acquisition performance of Satria Ltd indicates that the company is turning around and reporting profits. For the year ended 31 December 20x1, it reports an accounting profit before tax of C$20 million. On 31 December 20x1, Intria Ltd reassesses the potential tax benefits of the unused tax losses of Satria Ltd and concludes that there would be sufficient taxable profits in the future to realise the tax benefits. Income tax rate is 25%.

Required:

(a) Calculate the goodwill on combination as at 1 April 20x1.

(b) Calculate the adjustments required when the deferred tax asset related to the unused tax losses is subsequently recognised on 31 December 20x1.

Solution 7.32

(a) Goodwill on combination = C$40 m - C$30 m = C$10 m.

On consolidation, the journal entries in the initial accounting are as follows:

	C$'m	C$'m
Dr Goodwill on combination	10	
Cr Revaluation reserve		10
- to recognise goodwill on combination.		

Dr Share capital and pre-acquisition reserve	30	
Dr Revaluation reserve – goodwill	10	
Cr Cost of combination		40
- to eliminate cost of investment.		

(b) On 31 December 20x1, the deferred tax asset, which was not recognised on the initial accounting date, should be recognised as a measurement period adjustment, as follows:

	C$'m	C$'m
In the books of the subsidiary:		
Dr Deferred tax asset	25	
Cr Deferred tax income in profit or loss		25
- to recognise tax benefit of unused tax losses brought forward.		
Dr Deferred tax expense – current year (25% x 20)	5	
Cr Deferred tax asset		5
- to record reversal of tax benefits in profit or loss.		

As part of consolidation adjustment:

As a measurement period adjustment, the deferred tax asset is treated as if it were recognised on the initial accounting date. The goodwill recognised initially is C$10 million. The adjustment to the goodwill is to reduce it to zero and balance of C$15 million recognised as a gain in profit or loss. Thus, the consolidation adjustment is revised as follows:

	C$'m	C$'m
Dr Deferred tax income of subsidiary in profit or loss	10	
Dr Share capital and pre-acquisition reserve	30	
Cr Cost of combination		40
- to eliminate cost of investment.		

The portion of the deferred tax income in profit or loss not eliminated represents the amount in excess of the initially recognised goodwill. The amount eliminated represents the increase in pre-acquisition reserves of the subsidiary as at the acquisition. Thus, in the subsequent year, the consolidation adjustment would simply be:

	C$'m	C$'m
Dr Share capital and pre-acquisition reserve (30+10)	40	
Cr Cost of combination		40
- to eliminate cost of combination.		

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10 Disclosure Requirements

IFRS 3 requires that an acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:

(a) during the current reporting period; or

(b) after the end of the reporting period but before the financial statements are authorised for issue [IFRS 3.59].

Also, the acquirer shall disclose information that enable users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods [IFRS 3.61].

Example of Disclosure on Paragraphs IFRS 3.59 – IFRS 3.63

Note on Business Combinations

Paragraph reference

B64(a to e) On 1 March 2012, the Company acquired a controlling 80% interest in the equity shares of Halia Ltd. Halia Ltd operates in the agriculture industry, with oil palm cultivation as its core business and rearing broilers as its supplementary business. Its businesses are conducted mainly in Malaysia. As a result of the acquisition, the Group is expected to be a leading producer of crude palm oil in the oil palm business. By combining the plantation operations of Halia Ltd, the Group expects to extract synergies for the combined operations, which would lead to cost reductions and other economies of scale.

B64(f) The acquisition-date fair value of the total consideration transferred amounted to C$200 million, and this consists of following components:

		C$'m
(i)	Cash consideration	75
(ii)	50 million ordinary shares of the Company	150
(iii)	Liability for contingent consideration	(25)
		200

B64(f)(iv) The fair value of the 50 million ordinary shares issued as part of the consideration paid for Halia Ltd (C$150 million) was determined on the basis of the closing market price of the Company's ordinary shares on the acquisition date.

B64(g) The liability for contingent consideration of C$25 million represents the present value of an estimated amount of C$27.5 million payable on 31 March 2013 to the former shareholders of Halia Ltd if it achieves

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the guaranteed maintainable profits after tax of C$40 million for the 12-month period ending 28 February 2013. If the actual profit is above or below the guaranteed level, the amount payable is increased or decreased by the excess or shortfall in profit. The contingent amount payable is in the range of C$26 million to C$29 million.

IFRS3.63 A segment of Halia Ltd's is in the operation of rearing broilers. The Group has decided to dispose of this operation as management is of the view that the broiler business is not compatible with the other core businesses of the Group. The assets and liabilities attributable to this operation form a disposal group and have been classified under non-current assets held for sale.

B64(i) The recognised amounts of classes of assets, liabilities and continent liabilities of Halia Ltd at the acquisition are as follows:

As at 1 March 2012	C$'m
Goodwill on combination	125
Property, plant and equipment	100
Identifiable intangible assets	30
Inventories	35
Trade and other receivables	45
Cash and cash equivalents	10
Total assets	345
Long-term borrowings	50
Provisions and deferred liabilities	15
Trade and other payables	30
Total liabilities	95
B64(o)(i) Non-controlling interest measured at fair value	50
	145
Consideration transferred	200
	345

B64(h) The fair value of the trade and other receivables is an undiscounted amount after adjustment for probable uncollectibility. The gross contractual amount of the receivables is C$52 million of which C$7 million is not expected to be collected.

B64(o)(ii) The fair value of the non-controlling interest represents its share of the fair value of Halia Ltd at the acquisition date, estimated using the Price-Earnings ratio method. The fair value of Halia Ltd's ordinary shares are estimated at C$250 million by capitalising an estimated profit of C$40 million with a price-earnings ratio of 6.25 times.

B64(k) The goodwill on combination is not deductible for tax purposes.

B64(e) Halia Ltd owns substantial non-contractual customer relationships with its overseas buyers. However, the fair value of this intangible asset cannot be measured reliably because of the absence of comparable market transactions and the fact that a separate valuation would require significant inputs which are not observable in the market. Accordingly, this intangible asset is subsumed in the amount determined for goodwill.

B64(l) Included in the administrative expenses is an amount of C$5 million that represents a severance payment made to the former CEO of Halia Ltd, following the request of the Company to terminate the employment of the CEO. This amount is excluded from the business combination accounting.

B64(m) Acquisition-related costs of the business combination amounted to C$4 million, of which C$3 million is recognised as administrative expense in profit or loss and C$1 million relating to share issue is charged directly to equity.

B67 Provisional fair values are assigned to the property, plant and equipment and to the identifiable intangible assets, pending receipts of the final valuations of those assets. Professional consultants have been commissioned to undertake valuation of those assets. The initial accounting for this subsidiary is expected to complete by the first quarter of the following financial year.

B64(q) The amounts of Halia Ltd's revenue and profit included in the Group's consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2012 are as follows:

	10-month actual results from 1 March to 31 December 2012
	C$'000
Revenue	35,000
Profit after tax	3,000

If the results of Halia Ltd had been consolidated from the beginning of the year, 1 January 2012, to 31 December 2012, the consolidated results of the Group for the year ended 31 December 2012 would have been as follows:

	Pro forma results of Group
	C$'000
Revenue	145,000
Profit after taxation	13,800

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11 Model Questions and Answers

Practice Question

On 1 January 20x5, Asli Ltd acquires a 10% non-controlling interest in the equity shares of Bali Ltd for a cash consideration of C$5 million. The investment is classified as an available-for-sale asset. As the fair value of Bali Ltd could not be measured reliably then, the investment is carried at cost in accordance with IAS 39.

On 1 January 20x7, Asli Ltd acquires another 60% interest in the equity shares of Bali Ltd paying cash consideration of C$95 million. It assumes control of Bali Ltd on this date. The stake is acquired from two former controlling shareholders of Bali Ltd with the following terms:

(a) Asli Ltd shall pay another C$2 million to the former controlling shareholders for the business combination related-costs incurred by them;

(b) Bali Ltd shall pay C$5 million severance benefit to its former CEO. The former CEO of Bali Ltd had an employment contract that entitled him to the severance benefit in the event the company is acquired by another entity;

(c) Asli Ltd shall retain the service of one of the former controlling shareholders as the new CEO for two years. The remuneration payable per year is C$10 million. However, it is agreed that C$5 million of the remuneration per year is not dependent on the continuing employment or affected by termination of the new CEO. This amount payable shall be adjusted for interest at 8% per annum.

Apart from recording the cash paid to acquire the controlling stake, Asli Ltd has not recognised any of the above terms in the financial statements. Its cost of borrowing at the acquisition date is 8% per annum.

The parties to the business combination have agreed that neither the market price of Asli Ltd nor the acquisition-date fair value of the identifiable net assets of Bali Ltd is indicative of the acquisition-date fair value of Bali Ltd as a whole. Using a discounted cash flow approach, an independent advisor places a valuation of C$110 million on the ordinary shares of Bali Ltd at the acquisition date.

The summarised accounts of the two companies for the current financial year ended 31 December 20x7 are as follows:

Statements of Profit or Loss and Other Comprehensive Income & Retained Profits

	Asli Ltd	Bali Ltd
	C$'000	C$'000
Revenue	68,700	58,000
Expenses	(26,000)	(30,000)
Termination benefits		(8,000)
Profit before taxation	42,700	20,000
Taxation	(10,700)	(5,600)

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3.2 Goodwill on Combination

As in the previous Standards, the goodwill on combination in IFRS 3 is still a "balancing amount" in an accounting equation rather than a fair value measurement, although it now may include a portion attributable to non-controlling interests. Conceptually, it is possible to measure the fair value of goodwill as the difference between the fair value of a business as a whole and the fair value of the identifiable net assets. For example, if the market price of an entity is C$100 million and the fair value of its identifiable net assets is C$80 million, the inherent goodwill of the entity is C$20 million. When this entity is acquired, a possible measurement of the goodwill on combination is based on the market or fair value, in which case, the goodwill on combination would be equal to the inherent goodwill.

However, IFRS 3 does not apply this approach because the consideration transferred by an acquirer may include a control premium or an NCI discount. The resulting goodwill could either be more or less than its fair value. This means that the goodwill on combination is not accorded the same fair value measurement as applied to other assets acquired. Just as in previous Standards, goodwill remains a "mysterious" asset in the statement of financial position.

3.3 Mergers of Equals and Fresh-Start Method

IFRS 3 presumes that an acquirer can always be identified in a business combination. It does not provide for a rebuttal of that presumption. Although it is true that an acquirer can always be identified in most business combinations, the Standard does not provide for the rare circumstance where an acquirer truly cannot be identified. For example, in a merger of equals (a merger of two entities that are of the same size and both entities have equal representation on the board of directors), an acquirer must still be identified for the purpose of the business combination accounting even though it is clear that neither party is the acquirer. The consolidation results might be very different depending on which entity is identified as the acquirer. If the merger method is allowed in such rare circumstance, it may result in a more faithful representation of the business combination.

In a fresh-start combination, combining entities transfer their respective assets and liabilities to a new entity that assumes control over them such that none of the combining entities is viewed as having survived the combination as an independent reporting entity. The history of the new entity therefore begins with the business combination. In such combination, the acquirer cannot be identified or is substantially modified by the transaction. IFRS 3 does not provide for a fresh-start method of accounting in such rare type

of combination but requires an acquirer to be identified even when none survives the combination.

3.4 Combinations involving Entities under Common Control

The revised IFRS 3 continues to scope out such business combinations. It is therefore unclear whether the acquisition method shall also be applied in such business combinations or whether they could be accounted for by the merger method. We are of the view that for business combinations involving entities under common control, it is necessary to test the substance of the combination and assess which accounting method would be more appropriate in the particular circumstance. Merger accounting may be appropriate if it clearly reflects the substance of the internal arrangement.

3.5 Changes in Stakes after Control is Obtained

Both the revised IFRS 3 and IAS 27 take a dichotomous view for changes in stakes without loss of control and for changes in stakes with loss of control. For changes in stakes that do not result in loss of control, they shall be treated as equity transactions between the controlling (parent) interest and the non-controlling interests. In the circumstance where a wholly-own subsidiary makes an initial public offer (IPO) of shares to the investing public, there was no non-controlling interest prior to the public offer. It appears illogical that this IPO can be viewed as a transaction between the parent interest and the non-controlling interest, when in fact, the non-controlling interest did not exist in the first instance.

Also, the revised Standards take the view that a significant economic event occurs only when control is lost and thus requires a deconsolidation of the former subsidiary. Parent entities that nurture subsidiaries prior to listing them on stock exchanges are only able to recognise gains in their profit or loss when control is lost. In order words, parent entities must forgo their subsidiaries if they want to recognise their efforts as gains in profit or loss. Such treatment may be argued as counter-productive for economic decisions. A listing of a subsidiary on a stock exchange without a loss of control is still a significant economic event but no gain can be recognised in profit or loss under the revised Standards.

3.6 Measurement of Cost or Fair Value of Investment in an Investee

Unlike the original IFRS 3, cost of investment in an investee is no longer prescribed as a standard in the revised IFRS 3. The revised Standard only clarifies that the consideration transferred by the acquirer should be measured at fair value (with limited exceptions) and that expenses incurred in connection with the business combination should be recognised as an

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expense in profit or loss (except for those expenses which are transaction costs of issuing financial instruments).

IAS 127 prescribes that the investment in a subsidiary, associate or joint venture shall be accounted for either: (a) at cost; or (b) at fair value in accordance with IFRS 9 [see IFRS 27.10]. This Standard does not define the cost basis or clarify on the measurement of cost. By implications of the guidance in the revised IFRS 3, most would take the view that cost of investment in an investee should be measured at the fair value of the consideration transferred, but exclude expenses incurred in connection with the business combination. However, there are some who take the view that the requirements in the revised IFRS 3 apply only to business combinations for the purpose of determining goodwill; they do not relate to the measurement of cost in IAS 27. Proponents of this latter view argue that the "normal cost attachment" principle should apply to measure the cost of investment in an investee, which means that directly attributable expenses are capitalised in the cost of investment in the separate financial statements of the investor.

Also, if an investor avails the fair value measurement, the fair value of the investment in an investee would be determined by reference to its market price, or if that price is unavailable, by reference to a separate valuation. That fair value might be different from the cost amount and this gives rise to a difference on the initial recognition of the investment in the separate financial statements of the investor. For example, the fair value of the investment will be lower than the cost amount if a control premium is paid, and conversely, the fair value will be higher than the cost amount if a minority interest discount is obtained. IAS 27 does not deal with such initial recognition differences. It is unclear, whether the initial recognition difference, which may be either a gain or a loss, should be recognised in profit or loss immediately.

3.7 Reclassification Adjustments

The consolidation requirement of IFRS 10 for the statement of profit or loss and other comprehensive income is based on the entity concept. This means that revenue, expenses, gains and losses, including components of other comprehensive income, are aggregated a 100% to reflect the performance of a group as a single economic entity. The comprehensive income is then allocated to the parent and the non-controlling interests based on their respective ownership interests. IFRS 12 requires new disclosures about non-controlling interests to provide more useful information to non-controlling shareholders, and in particular, their share of the results in the group.

However, when a partly-owned subsidiary is derecognised (for example, on disposal), the Standards restrict the gain or loss on derecognition to the parent only. This means that the reclassification adjustments to profit or loss of the previously recognised components of other comprehensive income (such as exchange translation reserve) are restricted to the parent's portions only. The NCIs' portions of the components of other comprehensive income are derecognised but should not be recycled to profit or loss. The net effect of this requirement is that the derecognition event is reported in the statement of profit or loss and other comprehensive income using a proprietary concept (i.e. only the parent's portions), which is contrary to the entity concept used for consolidation of comprehensive income.

4 Reciprocal Shareholdings between Parent and Subsidiaries

Technically, a reciprocal shareholding between a parent and its subsidiary arises when the subsidiary holds equity shares in the parent. In some jurisdictions, the company laws may prohibit a subsidiary company from being a member of its holding company. In other words, a subsidiary company cannot hold any equity share in its parent company as this would be tantamount to a reduction of capital. Note that shares of a parent company held by a subsidiary company as a personal representative or as a trustee in which the parent company or the subsidiary company has no beneficial interest is outside the scope of this prohibition. In other jurisdictions, reciprocal shareholdings between a parent and its subsidiaries are permitted provided certain conditions are met.

4.1 Methods of Accounting for Reciprocal Shareholdings

Accounting standards to date generally do not address the issues of reciprocal shareholdings within a group. For example, IAS 1 requires that "an entity shall disclose for each class of share capital, shares in the entity held by the entity or by its subsidiaries or associates" but does not prescribe the accounting treatment. This is probably because such reciprocal shareholdings are rare in practice, even in some developed economies, which permit such holdings. Some limited guidance can be assessed from the practices in the United States of America.

Conceptually, shares of a parent that are held by its subsidiary are no longer outstanding (i.e. no longer in issue) from the viewpoint of the consolidated entity and should be reflected as such. The equivalent of this is as if the parent company has bought back its own shares. Thus, the accounting issue is not on whether or not the parent's equity shares held by the subsidiary should be eliminated upon consolidation, but it is on how the equity shares should be eliminated in the consolidated accounts.

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