July 2021 Q 3 answers

(a) Proposal 1

Purchase of first 20%

According to LKAS 28, if an entity holds, directly or indirectly, 20% or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Representation of the board of directors is one of the ways that the existence of significant influence by an entity is usually evidenced. Accordingly, having a 20% shareholding together with the ability to appoint one director to the Board is sufficient to establish that the XE has significant influence over CBE. Therefore, the investment in CBE should be considered as an investment in associate and accounted using equity method.

Under the equity method, initial recognition of the investment in the associate should be recognised at cost (i.e. at Rs. 400 million and thereafter the carrying amount should be increased or decreased by the investor's share of profit or loss**.**

On acquisition of the investment, any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the entity's share of the associate or joint venture's profit or loss in the period in which the investment is acquired.

Accordingly the carrying amount of the investment as at 31 March 2022 is as follows.

Cost	- Rs. 400 million
Excess of NA acquired over cost / Gain on Bargain purchase (Rs. 535.9-400)	- Rs. 135.9 million
Share of profit (Rs. 360.9*20%)	- Rs. 72.18 million
Carrying value as at 31 March 2022	- Rs. 608.09 million

Excess of net assets acquired over the cost of investment should be recognised as income of XE at the date of investment.

<u>Purchase of the balance 20%</u>

As per SLFRS 10, an investor controls an investee if and only if the investor has all the following:

(a) power over the investee

(b) exposure, or rights, to variable returns from its involvement with the investee and

(c) the ability to use its power over the investee to affect the amount of the investor's returns

With XE buying the balance 20% of CBE, the contractual arrangement facilitates XE to direct sufficient vote holders on how to vote, to enable XE to make decisions about the main activities that significantly affect CBE's profit or loss. Further, the CEO of XE will be appointed as the CEO of CBE and majority of the Board members of CBE will be appointed by XE. These give XE power to direct the relevant activities of CBE. Accordingly, XE gets the control and become the parent of CBE.

Since this is a business combination achieved in stages, XE shall remeasure its previously held equity interest in CBE at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. Accordingly, Rs. 183.08 million (Rs. 425 million – Rs. 608.09 million) to be recognised as a loss in the profit or loss.

XE needs to compute goodwill or gain on bargain purchase, measured as the excess of (1) over (2) below:

1. the aggregate of:

(i) the consideration transferred measured in accordance with SLFRS 3, which generally requires acquisition-date fair value;

(ii) the amount of any non-controlling interest in the acquiree measured in accordance with this SLFRS; and

(iii) in a business combination achieved in stages (see paragraphs 41 and 42), the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

2. the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this SLFRS.

It was assumed that NCI is measured at fair value.

			Rs'mn
FV of consideration			
Cash			500
Deferred consideration			165.29
Ordinary shares (2mn*Rs. 230)			460
			1,125.29
Fair value of existing 20%			425
FV of NCI			1,400
			2,950.29
FV of net assets			
Net assets	3,040.48		
DT asset on losses	(163)		
Intangible asset	10	2,887.48	
Goodwill			**62.81**

As per LKAS 12, deferred tax asset on tax losses that cannot be utilized against future taxable profits should not be recognised.

SLFRS 3 requires an acquirer to recognise identifiable intangible assets acquired in a business combination separately from goodwill. Accordingly, fair value of the intangible asset arising from favorable terms of the franchise agreement should be separately recognised.

Plan to restructure a subsidiary following an acquisition is not a present obligation of the acquiree at the acquisition date. Therefore, a liability cannot be recognised.

Accordingly, XE is required to prepare consolidated financial statements for the year ending 31 March 2022 consolidating the results of CBE.

(b) Proposal 2

According to SLFRS 11, a joint arrangement is an arrangement of which two or more parties have joint control. A joint arrangement has the following characteristics;

- The parties are bound by a contractual arrangement

- The contractual arrangement gives two or more of those parties joint control of the arrangement.

Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. According to para 10, a party with joint control can prevent other parties from controlling the arrangement.

Analysis

There is a contractual arrangement and the arrangement requires at least 51 per cent voting rights to make decisions about the main activities of the Business School. Since each party has 50% of the voting rights, the parties have implicitly agreed that they have **joint control over the arrangement** because decisions about the main activities of the business school (which are the relevant activities) cannot be made without both parties agreeing to it.

Accordingly, the arrangement is a **joint arrangement**.

In this case the joint arrangement is structured through a separate vehicle (separate entity). According to the contractual terms, all the assets and obligations for liabilities of the business school, are of the new company and not the assets and liabilities of the parties, and each party is entitled to a share of profit or loss of the new company equivalent to each party's ownership interest in the company. Based on the above terms, the arrangement provides the parties to the arrangement with rights to the **net** assets and the contractual arrangement establishes each party's share in the profit or loss relating to the activities of the arrangement. Accordingly, this arrangement is a **joint venture**.

CBE requiring to provide guarantees to the bank. if XCBE requires additional financing does not, by itself, determine that the arrangement is a joint operation or joint venture. Since the obligation for liabilities is with the parties, CBE providing a guarantee to obtain financing does not change the above conclusion.

Financial Impact (in Rs.'mn)

SLFRS 11 requires the joint venturer to recognise its interest in a joint venture (i.e in the new company) as an investment and shall account for that investment using the equity method.

Investment (50%* 1,000,000)	= 500
Share of profit (50%)	= 351.45
Carrying value as at 31 March 2022	= 851.45

(c) Share Buyback

Paragraph 33 of LKAS 32 states that if an entity reacquires its own equity instruments, those instruments shall be deducted from equity. No gain or loss shall be recognised in profit or loss on the purchase, sale or issue or cancellation of an entity's own equity instrument.

Accordingly, CBE should debit Rs. 925 million to equity and credit the same to cash.

Since, these share will be subsequently cancelled, it has an impact on EPS.

Transfer of PPE by CBE

CBEPL requires to derecognize the carrying value of the PPE transferred. Since this is a downstream transaction from the investor to its JV, the investor's share of the gain/loss resulting from the transaction should be eliminated. Accordingly the balance gain/loss should be recognised.

Computation		(Rs'mn)
FV of the consideration (i.e. value of the investment)		500
Carrying Value	500	
Loss		Nil

Revaluation surplus of Rs. 30mn may be transferred to retained earnings .