Advanced Group Accounting (RIKA)

Block 1

Foto: Thomas Müller Ivan Reimann

Team

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Professor of Financial Accounting and Corporate Governance
At Goethe sine 2022
Prior: LSE, WHU, Frankfurt School of Finance & Management, University of Oldenburg, Commerzbank
Research interests: financial disclosure, disclosure regulation, sustainability reporting

Inga Meringdal
PhD Candidate Accounting Department

Research interests: firms' transparency, sustainability and non-financial reporting, firms' disclosure decisions, firms' learning processes, NGO campaigns, ESG labor market

Tim Detrois
PhD Candidate Accounting Department

Research Interests: firms' transparency, sustainability and non-financial reporting, sustainability information systems, ESG Compensation Incentives

Get in touch!

If…

- You cannot access/find material on Moodle;
- You cannot access/find the textbook;
- You need more material on a given topic;
- You have any other questions:

Get in touch as soon as possible so we can find a solution!

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Course Organization

- 6 blocks
  - Lectures and hands-on exercises/case studies

Date	Block	Topic
		Preparation: recap double-entry bookkeeping (online, self-study)
25.04.	1	Key Concepts
02.05.	2	Capital Consolidation
09.05.	3	Revenue/Expense Consolidation, Intra-Group Transactions, Cash Flow
16.05.	4	Subsequent Consolidation, Goodwill Impairment
23.5.	5	Joint Arrangement and Investments at Equity, Changes in Control
30.5.	6	Analyzing Consolidated F/S

  - End of semester: summarizing case study with PwC, exam prep session

- Credits: 100% final exam (90 minutes)

- Course <u>can</u>, but does not have to, be combined with PIKA

Moodle: one-stop shop for all lecture material

https://moodle.studiumdigitale.uni-frankfurt.de/moodle/course/view.php?id=6134

Rechnungslegung im Konzernabschluss

Startseite / Meine Kurse / RIKA

Bearbeiten einschalten

Navigation

- Startseite
  - Dashboard
  - Website
  - Meine Kurse
    - HOB1_W25
    - PIKA
    - **RIKA**
      - Teilnehmer/innen
      - Badges
      - Bewertungen
      - Welcome to the course!
      - Recap: Double Entry Bookkeeping (Self-Study Material)
      - Block 1: Key Concepts
      - Block 2: Acquisition Model
      - Block 3: Consolidation

Welcome to the course!

Alles einklappen

Ankündigungen

Learning Goals and Competencies

- Students learn the basic principles governing the accounting for M&A transactions in firms' financial statements under IFRS and are able to use these statements for decision-making in capital markets.

Module Description

This course focuses on consolidated financial statements prepared under International Financial Reporting Standards (IFRS). It will cover the following topics:

- Introduction to the underlying economics of different types of M&A deals.
- Overview of methodologies relevant for reflecting M&A deals in a firm's financial statements.
- Steps involved in accounting for subsidiaries (full consolidation).
- Steps involved in accounting for joint ventures, associates, and other financial investments.
- Critical evaluation of the effects of M&A deals for the analyses and use of consolidated financial statements.

What is this course about?

Book value of EQ vs. market value of EQ

comparisons over time + with peers

language of business

Holding company + investment

subsidiaries

Accounting in Business Groups

multi-segment business

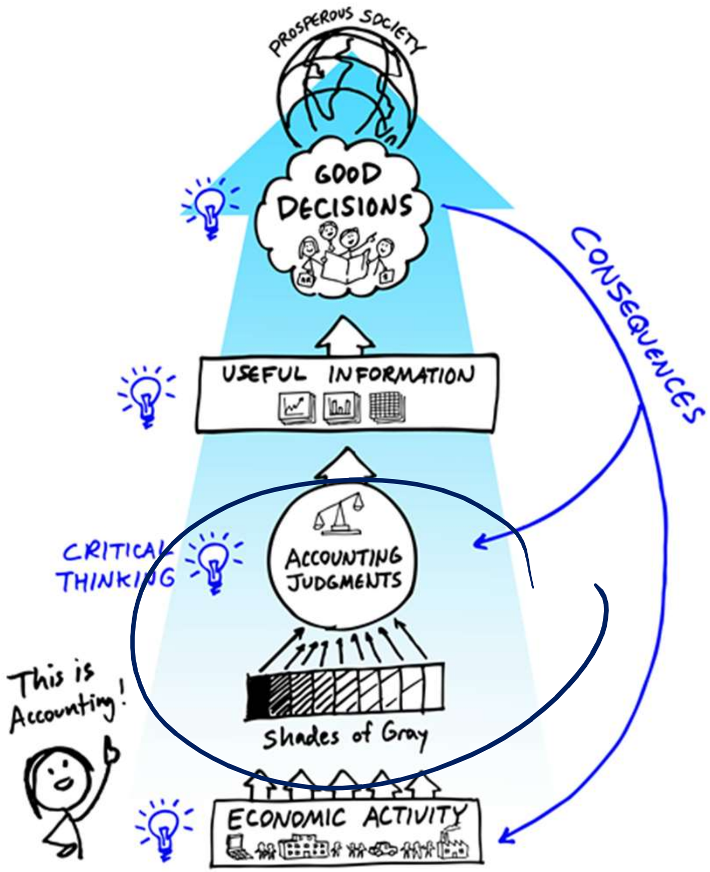
consolidation

financial accounting

investment decisions

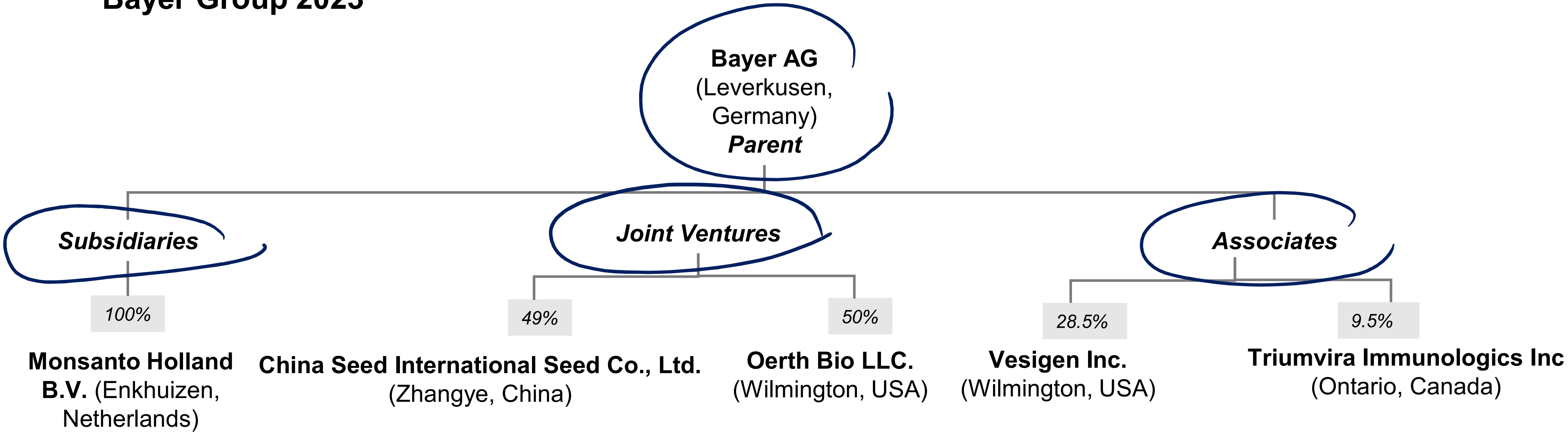
investors

"Accounting"…


PROSPEROUS SOCIETY
GOOD DECISIONS
CONSEQUENCES
USEFUL INFORMATION
CRITICAL THINKING
ACCOUNTING JUDGMENTS
This is Accounting!
Shades of Gray
ECONOMIC ACTIVITY

… "in Business Groups"

Bayer Group 2023



B 5.1/1

Change in the Number of Consolidated Companies

Bayer AG and consolidated companies	Germany	Other countries	Total
January 1, 2022	46	328	374
Changes in scope of consolidation	(2)	(12)	(14)
Additions[1]	–	1	1
Retirements	–	(7)	(7)
December 31, 2022	**44**	**310**	**354**

[1] Acquisitions, newly established companies and acquisition of control

- *Selected subsidiaries, joint ventures and associates only; number in italics indicate equity interest in %
- Source: Bayer AG Subsidiaries and affiliated companies (2023)

Course Structure

Block	Topic
	Preparation: recap double-entry bookkeeping (online, self-study)
1	Key Concepts
2	Acquisition Model
3	Consolidation
4	Subsequent Consolidation, Goodwill Impairment
5	Joint Arrangement and Investments at Equity, Changes in Control
6	Analyzing Consolidated F/S

Course Structure

Block	Topic
1	Key Concepts
1.1	**Economics of M&A Transactions**
1.2	Institutional Foundations of M&A Transactions
1.3	Consolidated Financial Statements
1.4	Obtaining Control and Scope of Consolidation

- Why do companies engage in M&A transactions?
- Under which conditions do M&A transactions create value for the acquiring company?

Bayer's assets in 2018 vs.2017: What happened?

€ million	Note	Dec. 31, 2017	Dec. 31, 2018
Noncurrent assets			
Goodwill	[14]	14,751	38,146
Other intangible assets	[14]	11,674	36,746
Property, plant and equipment	[15]	7,633	12,944
Investments accounted for using the equity method	[16]	4,007	515
Other financial assets	[17]	1,634	2,212
Other receivables	[20]	400	511
Deferred taxes	[11]	4,915	4,278
		45,014	**95,352**
Current assets			
Inventories	[18]	6,550	10,961
Trade accounts receivable	[19]	8,582	11,836
Other financial assets	[17]	3,529	1,166
Other receivables	[20]	1,276	1,875
Claims for income tax refunds		474	809
Cash and cash equivalents		7,581	4,052
Assets held for sale	[5.3]	2,081	234
		30,073	**30,933**
Total assets		**75,087**	**126,285**

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Bayer's assets in 2018 vs.2017: What happened?

5. Scope of consolidation; subsidiaries and affiliates

5.1 Changes in the scope of consolidation

Changes in the scope of consolidation in 2018 were as follows:

B 5.1/1

Change in the Number of Consolidated Companies

Bayer AG and consolidated companies	Germany	Other countries	Total
December 31, 2017	50	187	237
Changes in scope of consolidation	+ 4	+ 2	+ 6
Additions	+ 2	+ 194	+ 196
Retirements	– 1	– 18	– 19
December 31, 2018	**55**	**365**	**420**

The *increase* in the total number of consolidated companies in 2018 was primarily due to the acquisition of the Monsanto Group.

Bayer’s acquisition of Monsanto

The Big Read Bayer AG + Add to myFT

Lex In Depth: Bayer’s €50bn blunder

With the disastrous purchase of Monsanto and plummeting shares, some question if it is time to break up the German group

- Please describe Bayer’s **business model** (as of 2018).
- What were Bayer’s **motives** for purchasing Monsanto?
- Which **risks** were stemming from the acquisition?
- What would have been **alternative** business strategies (other than buying Monsanto)?

Discussion starts 3:30 pm

Break ends 4:10 pm

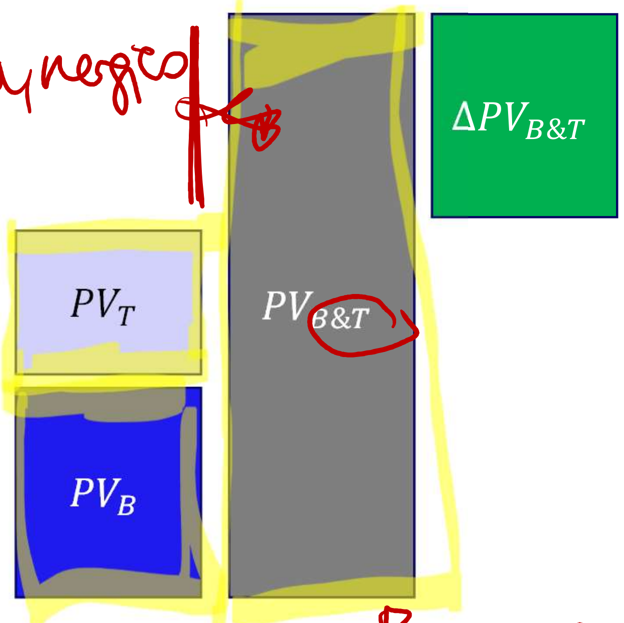
Article publicly available at: https://www.ft.com/content/a139ef68-b07c-11e9-bec9-fdcab53d6959 (last accessed 02.04.2025)

How can M&A transactions create value (and for whom)?

- Acquisition creates benefits if present value (PV) of combined entity (B&T) exceeds the sum of stand-alone values of Buyer (B) and Target (T)

$$Benefit = PV_{B\&T} - (PV_B + PV_T) = \Delta PV_{B\&T}$$

Synergies

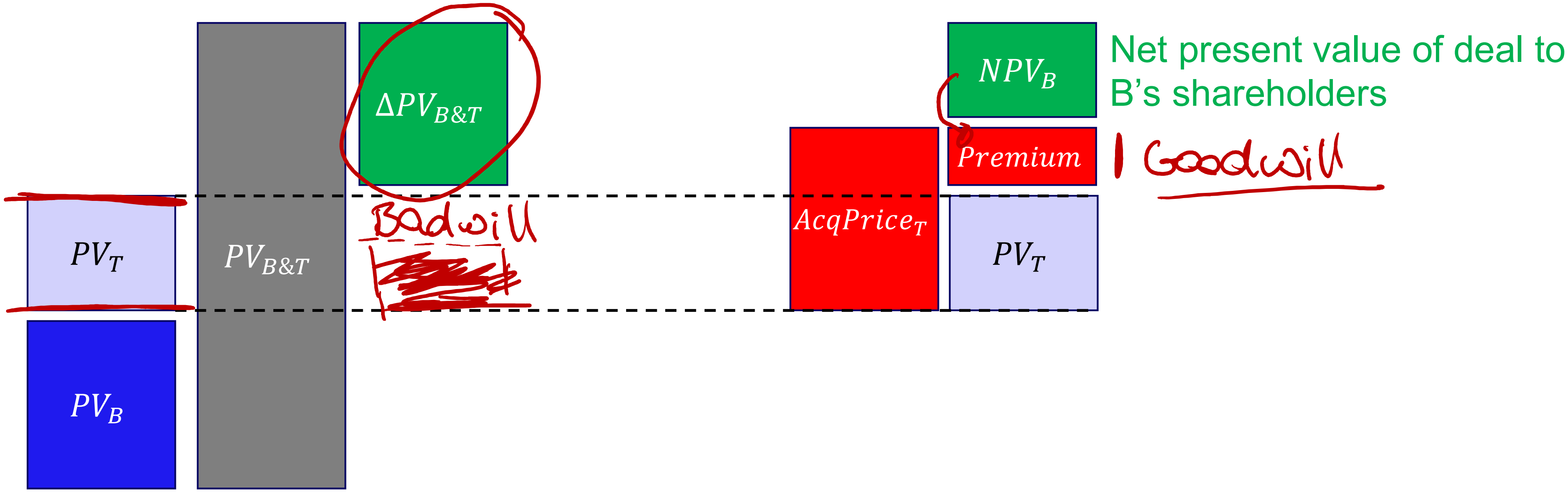


But: benefits are distributed between B and T's shareholders

combined entity

How can M&A transactions create value (and for whom)?

- Target's shareholders participate in the benefit of the transaction via an acquisition premium
- From B' shareholders perspective, the transaction creates value if and only if the benefits exceed the stand-alone value of T plus the premium



Motives for M&A Transactions

- Economies of scale and scope
  - Savings from high volume production
  - Savings from the combination of the marketing and distribution of different types of related products

- Vertical integration
  - Improved coordination by aligning the goals of two or more firms

- Expertise
  - Access to experienced employees (with knowledge on specific markets, technologies etc.)

- Monopoly gains
  - Reduction of competition

Motives for M&A Transactions

- Efficiency gains
  - Increase in operating efficiency of the target (e.g., through elimination of redundant resources)

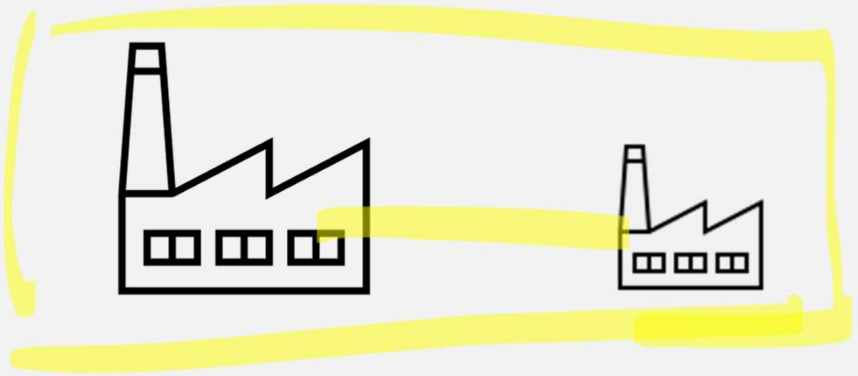
- Tax savings from operating losses
  - Loss of one firm might be offset by the profit of another firm

- Diversification
  - Benefits from risk reduction, lower cost of debt, increased debt capacity, or liquidity enhancements
  - But also greater coordination costs
  - Shareholders might be better at diversifying

- Managerial motives
  - Motives resulting from agency conflicts (e.g., incentive for empire-building)
  - Overconfidence

Types of M&A Transactions – by industrial relations

Horizontal merger acquirer and target in **same industry**



Vertical merger acquirer and target in **related industries** (customers / suppliers)

Course Structure

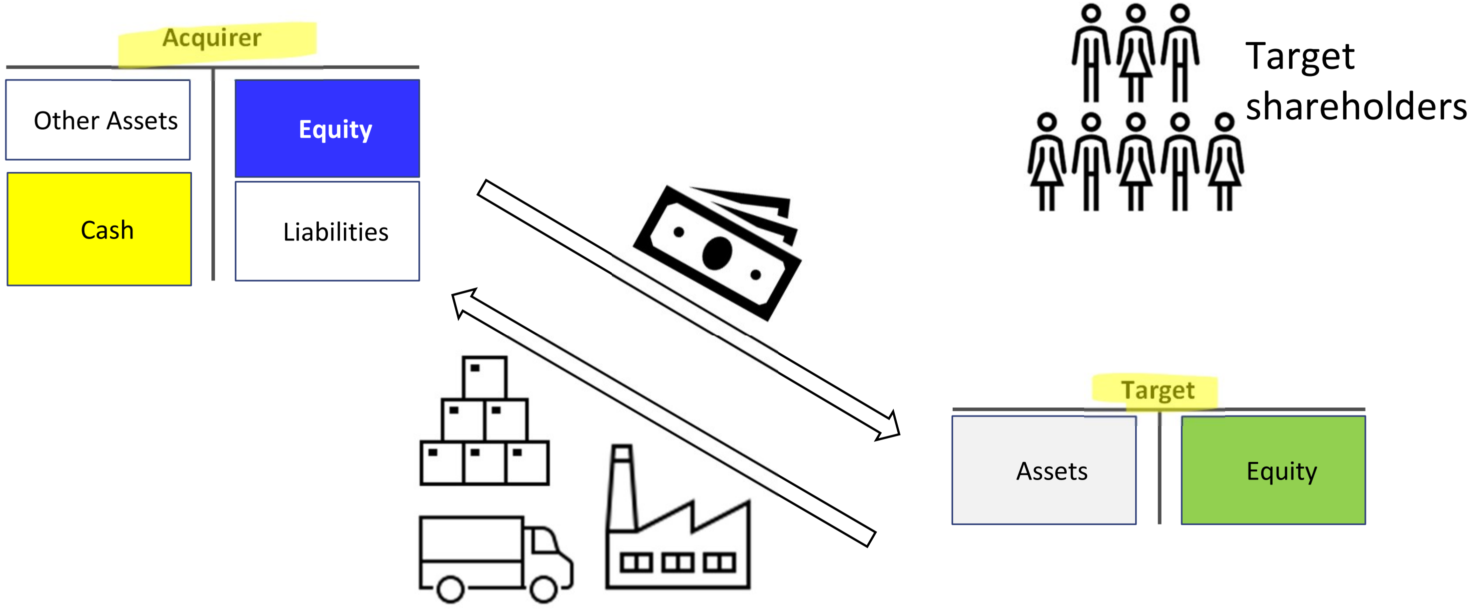
Block	Topic
1	Key Concepts
1.1	Economics of M&A Transactions
1.2	**Deal Structures**
1.3	Consolidated Financial Statements
1.4	Obtaining Control and Scope of Consolidation

- What does the M&A process look like?
- What are possible financial arrangements for M&A transactions?

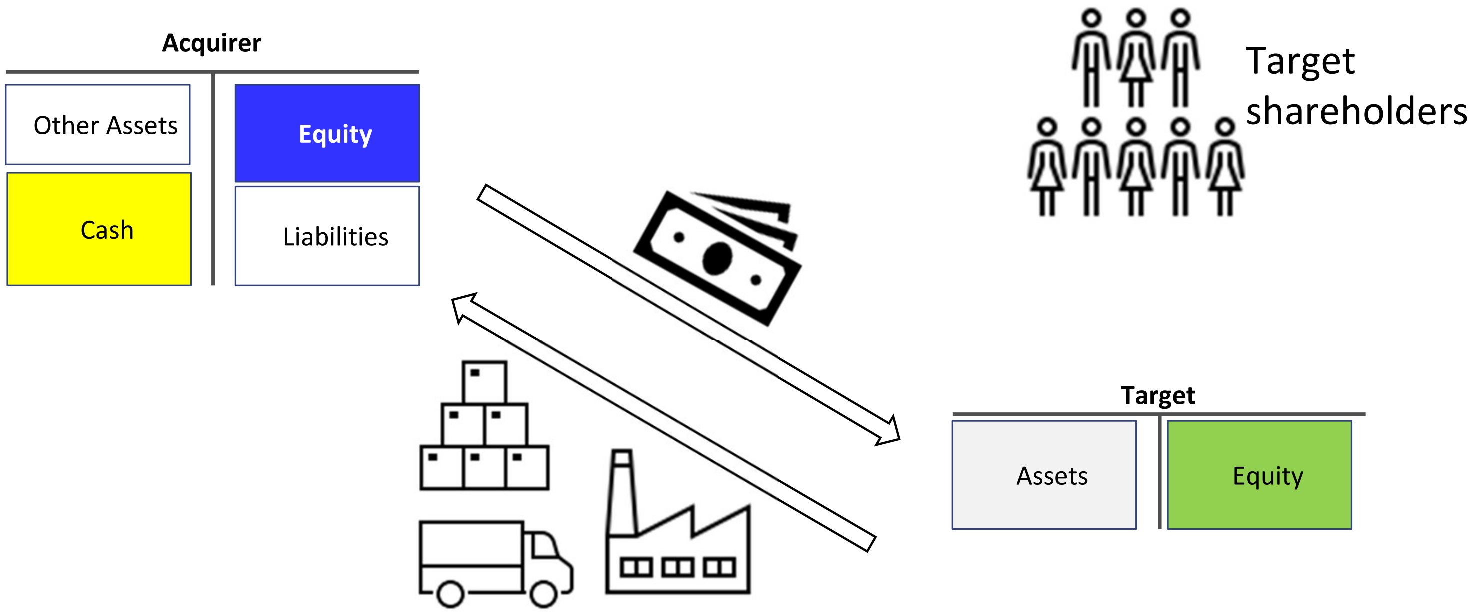
M&A Process

Negotiation and Pre-Deal	Due Diligence	Closing	Post-Deal Integration
▪ Screening and target selection ▪ First evaluation ▪ Indicative offer ▪ Non-Disclosure Agreement (NDA)	▪ Data room ▪ Preparation of financial model and valuation ▪ Legal due diligence and review of documents ▪ Decision on financing and structuring of the transaction	▪ Binding offer ▪ Structuring of the transaction (incl. financing) ▪ Signing of Sale and Purchase Agreements (SPA) ▪ Determination of purchase price for accounting purposes	▪ Integration of operations ▪ Accounting integration

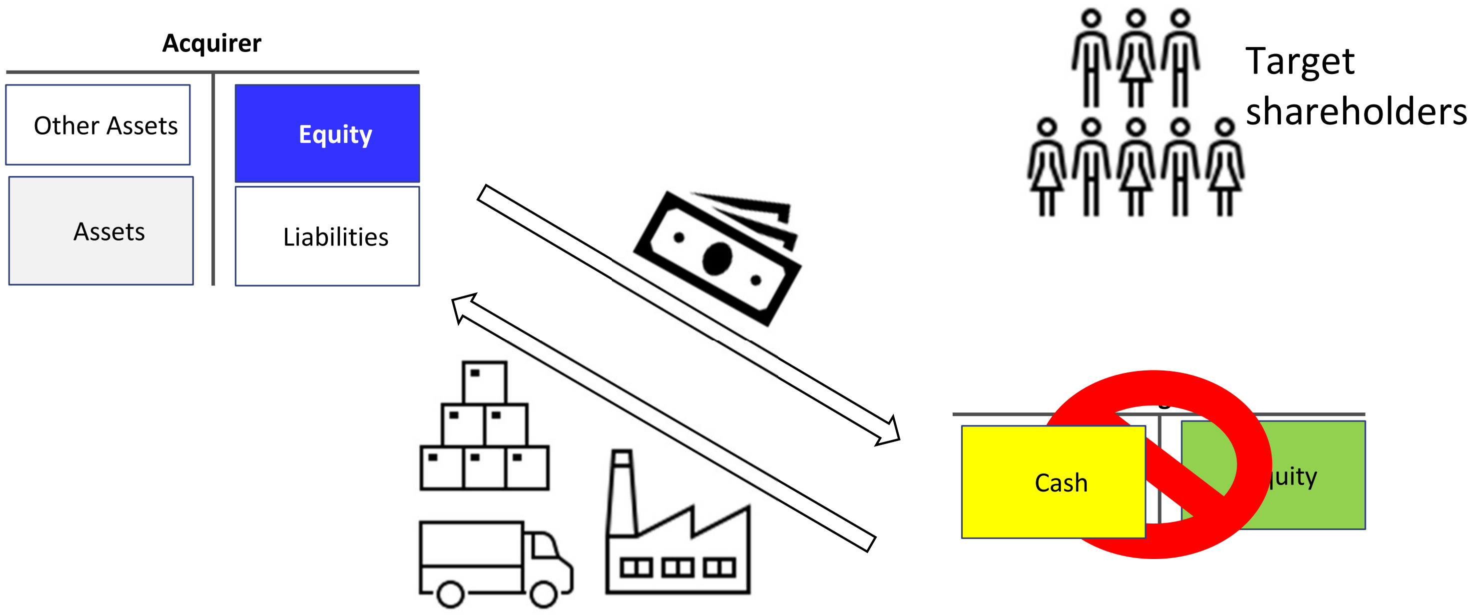
Types of M&A Transactions – by deal structure
Asset Deal



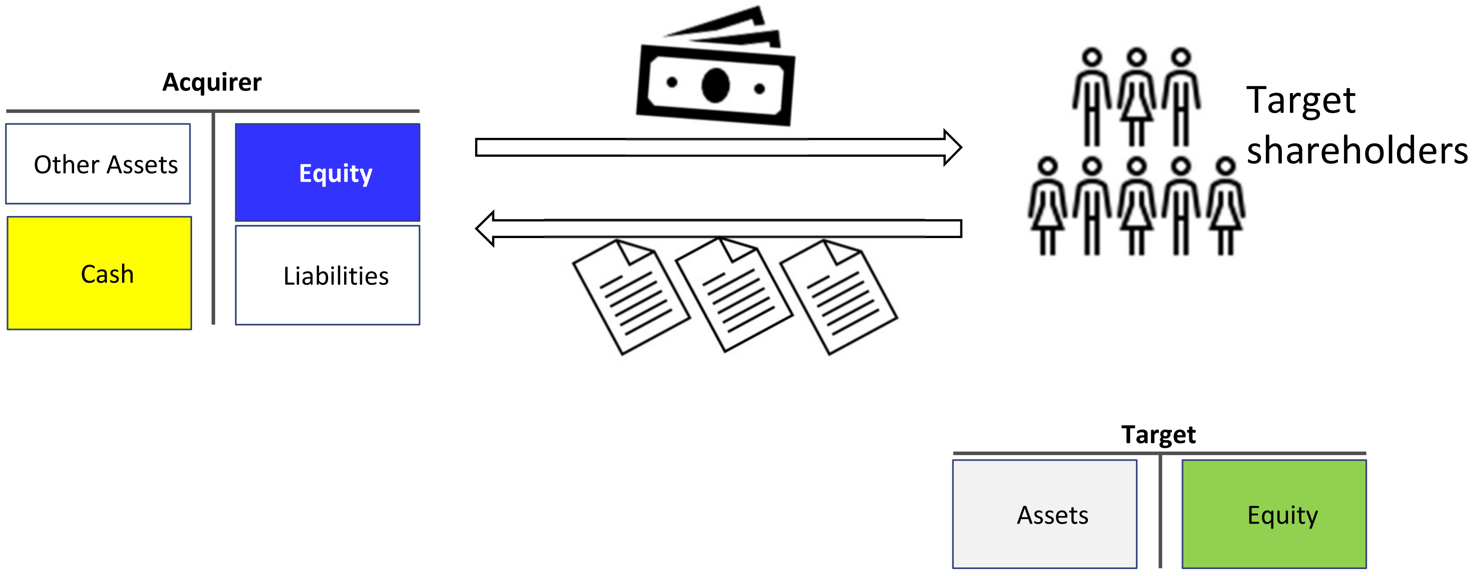
Types of M&A Transactions – by deal structure
Asset Deal



Types of M&A Transactions – by deal structure
Asset Deal

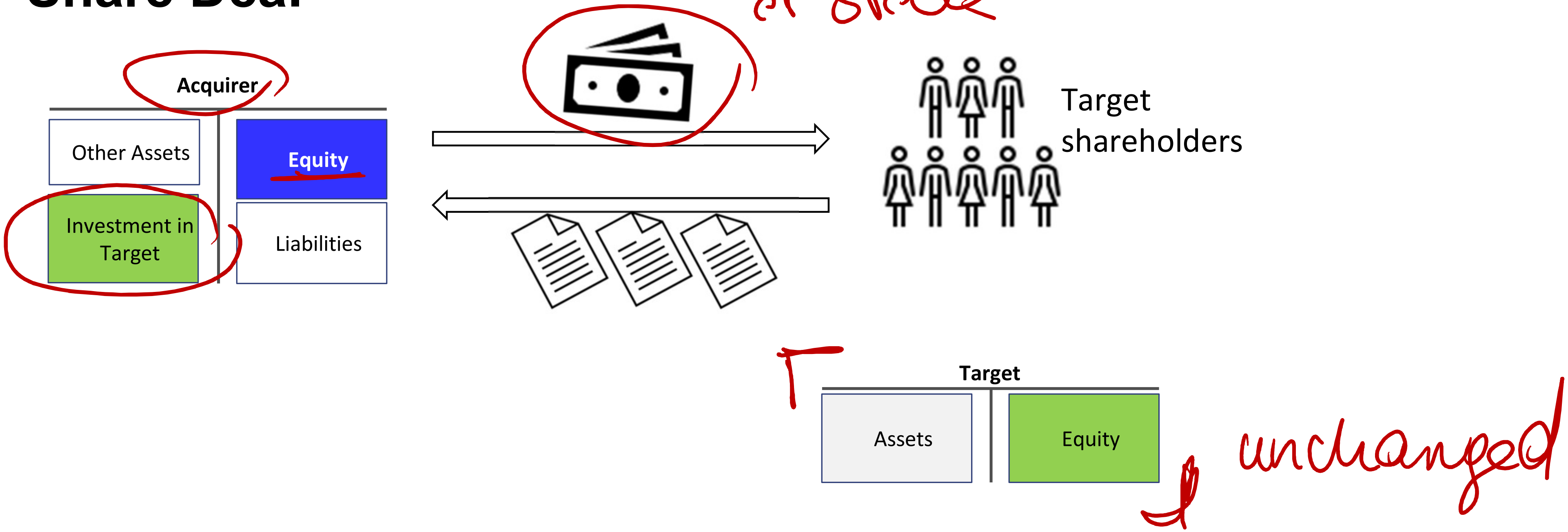


Types of M&A Transactions – by deal structure
Share Deal



Types of M&A Transactions – by deal structure
Share Deal

or Stock



Financing of a Share Deal

Share Deal Ways to pay for Target's shares:		
Cash	Cash / stock mix	Acquirer's own shares (stock-for-stock acquisition / stock financing)
		• Newly issued shares • Treasury shares

Asset Deal versus Share Deal
Summary

Asset Deal	Share Deal
Acquirer interacts with Target‘s management	Acquirer interacts with Target‘s shareholders (hostile takeover possible)
Acquirer gets ownership of target’s assets.	Acquirer obtains control over target (typically, by acquiring the majority of voting rights).
Target typically ceases to exist as a separate legal entity after the transactions.	Target can continue to exist as a legal entity after the transaction.
No need for consolidation – all assets are already on Acquirer’s balance sheet	Need for consolidation – investment shown in Acquirer’s balance sheet does not reflect economic fundamentals of the business group
Stock financing uncommon	Stock financing possible to mitigate overpayment / undervaluation

Course Structure

Block	Topic
1	Key Concepts
1.1	Economics of M&A Transactions
1.2	Deal Structures
1.3	**Consolidated Financial Statements**
1.4	Obtaining Control and Scope of Consolidation

- Why do we need consolidated financial statements?
- What are the accounting differences between consolidated and unconsolidated financial statements?

Why do we need consolidated financial statements?

- Two balance sheets of L'Oreal – what's the difference?

ASSETS

€ millions (net values)	Notes	31.12.2023	31.12.2022	31.12.2021
Intangible assets	11	4,258.1	4,876.4	4,607.4
Tangible assets	12	439.2	625.3	573.4
Financial assets	13	20,353.0	17,274.6	19,272.1
Non-current assets		**25,050.3**	**22,776.3**	**24,452.9**
Inventories		0.9	135.6	102.3
Prepayments to suppliers		12.5	11.6	6.4
Trade accounts receivable	15	722.9	1,030.9	770.2
Other current assets	15	347.8	513.6	515.0
Marketable securities and cash instruments	14	72.0	76.8	33.4
Cash and cash equivalents	26	347.1	618.0	0.6
Current assets		**1,503.2**	**2,386.5**	**1,427.9**
Prepaid expenses		61.0	90.8	84.4
Bond redemption premiums		7.4	0.0	0.0
Unrealised exchange losses	20	45.4	59.6	188.2
TOTAL ASSETS		**26,667.3**	**25,313.3**	**26,153.4**

ASSETS

€ millions	Notes	31.12.2023	31.12.2022	31.12.2021
Non-current assets		**35,529.7**	**32,794.5**	**30,937.6**
Goodwill	7.1	13,102.6	11,717.7	11,074.5
Other intangible assets	7.2	4,287.1	3,640.1	3,462.8
Right-of-use assets	3.2	1,692.4	1,482.7	1,507.6
Property, plant and equipment	3.2	3,867.7	3,481.7	3,266.2
Non-current financial assets	9.3	11,631.6	11,652.8	10,920.2
Investments accounted for under the equity method	8	27.0	18.4	9.9
Deferred tax assets	6.3	921.2	801.1	696.5
Current assets		**16,325.4**	**14,049.6**	**12,075.8**
Inventories	3.3	4,482.4	4,079.4	3,166.9
Trade accounts receivable	3.3	5,092.7	4,755.5	4,021.0
Other current assets	3.3	2,270.6	2,423.2	2,037.9
Current tax assets		191.6	173.9	136.2
Cash and cash equivalents	9.2	4,288.1	2,617.7	2,713.8
TOTAL		**51,855.1**	**46,844.2**	**43,013.4**

Why do we need consolidated financial statements?

Unconsolidated / Parent Company F/S
(French GAAP)

ASSETS

€ millions (net values)	Notes	31.12.2023	31.12.2022	31.12.2021
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TOTAL ASSETS		**26,667.3**	**25,313.3**	**26,153.4**

Note 13. Financial assets

€ millions	31.12.2021	31.12.2022	Allocation of technical merger losses	Acquisitions/ Subscriptions	Disposals/ Reductions	Partial asset contributions[5]	Other movements	31.12.2023
Equity investments[1]	11,066.1	17,832.8	-	997.8	-155.9	781.7	-71.8	19,384.6
Loans and other receivables[2]	33.6	223.2	-	6,425.6	-2,851.6	-5.5	-38.1	3,753.6
L'Oréal shares[3]	8,904.0	0.0	-	500.0	-	-	-500.0	0.0
Others	5.4	4.9	-	4.2	-0.9	-3.9	-	4.3
Gross value	**20,009.1**	**18,060.9**	**-**	**7,927.6**	**-3,008.4**	**772.3**	**-609.9**	**23,142.5**
Equity investments[4]	736.4	785.6	-	2,107.9	-63.8	-	-40.4	2,789.3
Loans and other receivables	0.4	0.4	-	0.4	-0.4	-0.4	-	0.0
Others	0.2	0.3	-	-	-	-0.1	-	0.2
Impairment	737.0	786.3	-	2,108.3	-64.2	-0.5	-40.4	2,789.5
NET VALUE	**19,272.1**	**17,274.6**	**-**	**5,819.3**	**-2,944.2**	**771.8**	**-569.5**	**20,353.0**

(1) Acquisitions essentially corresponded to Aēsop UK securities for €968.2 million.
Disposal/reduction: these mainly concerned the capital reduction of L'Oréal Brazil and the disposal of Sanoflore and L'Oréal Venezuela shares.
Other movements included the disposal of L'Oréal Côte d'Ivoire and LOA3 (UTA) securities.

(2) Movements on loans and other receivables correspond to loans granted and repaid during the year to Finval. During the 2023 financial year, L'Oréal S.A. set up long-term loans with Finval for €4,750 million, with maturities ranging from 2025 to 2028. €1,000 million was repaid early in 2023.

(3) On 27 July 2023, the Board of Directors resolved, in connection with the authorisation approved by the Annual General Meeting of 21 April 2023, to buy back L'Oréal shares in the maximum amount of €500 million. The shares thus bought back for €500 million were cancelled in line with the Board of Directors' decision on 7 December 2023.

(4) Mainly corresponds to the provision for impairment of L'Oréal Singapore securities.

(5) Financial assets contributed as part of partial contributions of assets and securities received as remuneration for contributions (L'Oréal France and L'Oréal International Distribution).

The table of subsidiaries and holdings is included at the end of the parent company financial statements.

Why do we need consolidated financial statements?

Consolidated / Group F/S
(IFRS)

€ million 2023	31.12.2022	Acquisitions/ Depreciation	Disposals/ Reversals	Changes in the scope of consolidation[2]	Other movements[1]	Translation difference	31.12.2023
Brands with indefinite useful life[3]	2,589.7	0.1		507.3	-0.1	-49.1	3,047.9
Amortisable brands and product ranges	93.9			-8.7	6.0	-2.8	88.4
Licences and patents	771.4	1.8	-6.6	42.1	5.3	-0.5	813.5
Software	1,624.7	46.6	-169.9	16.5	80.8	-32.5	1,566.2
Customer relationships	658.0			-7.4	-13.8	-22.2	614.6
Assets under construction	416.8	296.7			-79.3	-2.4	631.8
Others	32.9	10.0	-2.8	0.8	-1.6	-1.1	38.2
Gross value	**6,187.1**	**355.1**	**-179.3**	**550.6**	**-2.7**	**-110.7**	**6,800.1**
Brands with indefinite useful life	403.5	19.8		-14.5		-13.8	395.0
Amortisable brands and product ranges	79.6	2.1		-8.7	4.7	-2.8	74.9
Licences and patents	210.3	20.3	-6.6	-12.8	3.0	-0.6	213.6
Software	1,241.3	155.0	-169.7	12.3	7.7	-24.1	1,222.5
Customer relationships	586.8	18.9		-10.0	0.5	-21.3	574.9
Others	25.5	10.0	-2.7	0.8	-0.6	-0.9	32.1
Depreciation and provisions	**2,547.0**	**226.2**	**-179.0**	**-32.9**	**15.3**	**-63.5**	**2,513.0**
OTHER INTANGIBLE ASSETS – NET	**3,640.1**	**128.9**	**-0.2**	**583.5**	**-18.1**	**-47.2**	**4,287.1**

(1) Other movements mainly consisted of the reduction in the gross value of the recognized customer relationship following the finalization of the allocation of the price paid for the Skinbetter Science acquisition (-€13.8 million).
(2) Changes in scope of consolidation mainly correspond to the provisional allocation of Aēsop goodwill to the brand (€521.8 million), technology (€54.9 million) and software for (€4.2 million).
(3) At end-2023, the gross value of brands with an indefinite useful life span breaks down as follows:

ASSETS

€ millions	Notes	31.12.2023	31.12.2022	31.12.2021
Non-current assets		**35,529.7**	**32,794.5**	**30,937.6**
Goodwill	7.1	13,102.6	11,717.7	11,074.5
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Other current assets	3.3	2,270.6	2,423.2	2,037.9
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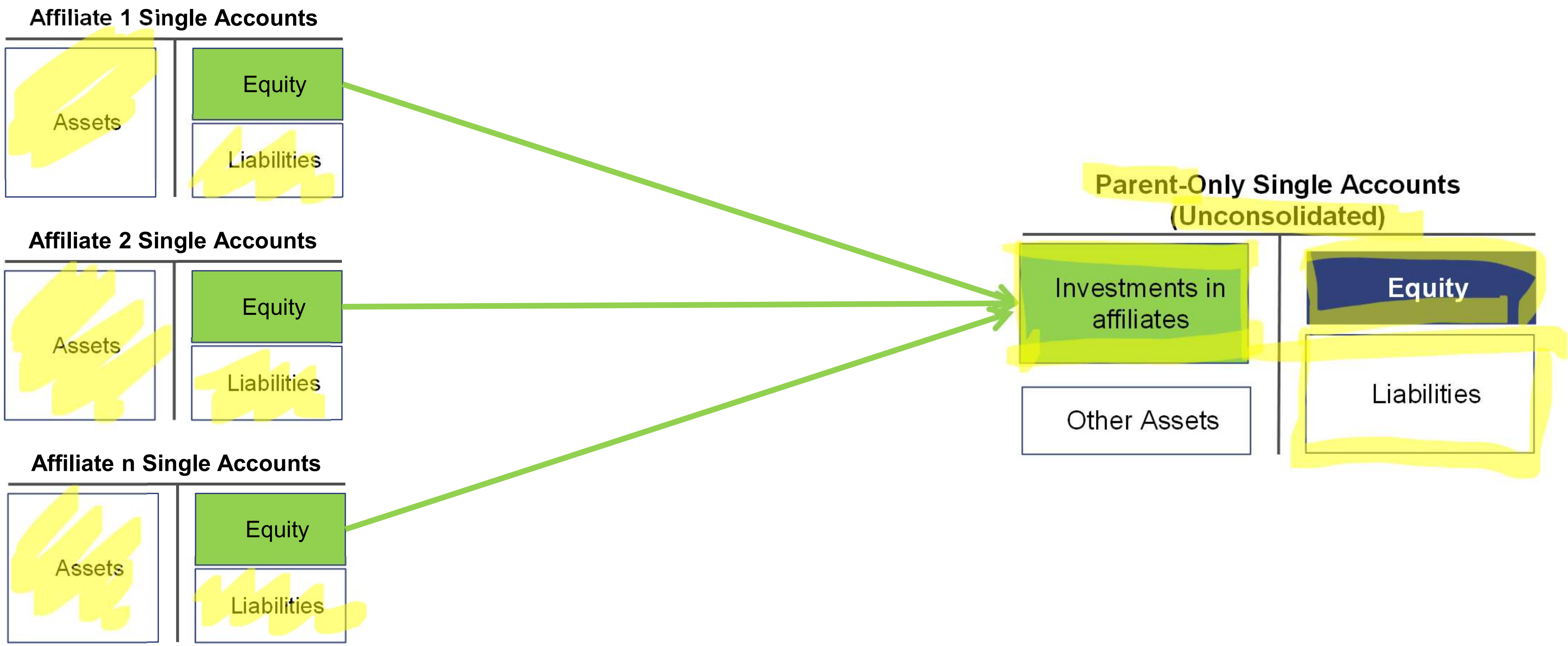
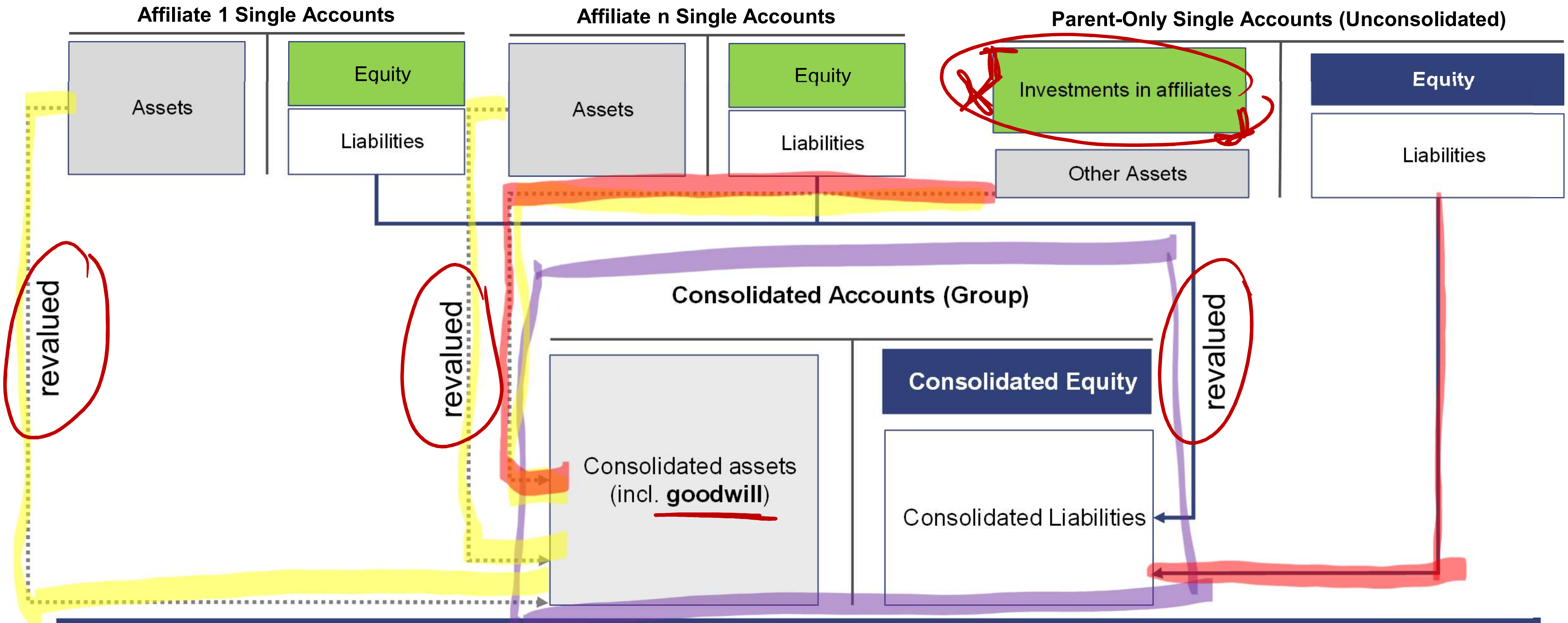
Cash and cash equivalents	9.2	4,288.1	2,617.7	2,713.8
TOTAL		**51,855.1**	**46,844.2**	**43,013.4**

Accounting for M&A Transactions From Unconsolidated Accounts…



Accounting for M&A Transactions
… To Consolidated Financial Statements



Consolidated financial statements depict a group's assets, liabilities, equity, income, expenses and cash flows as those of a single economic entity.

Our focus: consolidated reporting under International Financial Reporting Standards (IFRS)

What are the IFRS?

- Global accounting standards
- Applicable in more than 100 jurisdictions
- Tool for quick and easy access to standards:
  IFRS® Standards Navigator Video
  https://www.ifrs.org/issued-standards/list-of-standards/

Who develops IFRS?

- International Accounting Standards Board (IASB)
  - For sustainability: International Sustainability Standards Board (ISSB)
- Private organization (Foundation)

YEAR ENDED 31 DECEMBER 2022

	Note	2022 £'000	2021 £'000
Income			
Contributed revenue	3	32,499	17,325
Earned revenue	4	15,972	11,091
Other income	4	213	370
		48,684	28,786

Quelle: IFRS Foundation, Annual Report 2022

- Due process for standard setting
- EU endorsement

Who needs to disclose IFRS consolidated financial statements?

EU

	Consolidated F/S	**Unconsolidated F/S**
Public* companies	IFRS (mandatory)	IFRS or national GAAP (option)
Private companies	IFRS or national GAAP (option)	IFRS or national GAAP (option)

Germany

	Consolidated F/S	**Unconsolidated F/S**
Public companies	IFRS (mandatory)	<u>Disclosure</u>: IFRS or national GAAP (choice) But: <u>preparation</u> requirement for national GAAP (dividends and other legal consequences)
Private companies	IFRS or national GAAP (choice)	

* Companies listed on an EU regulated market (e.g., Eurex; not: open market (“Freiverkehr”))

(Some) relevant accounting standards for preparing consolidated financial statements

IFRS 10 Consolidated Financial Statements

Follow

Standard 2024 Issued

Objective

1 The objective of this IFRS is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

Meeting the objective

2 To meet the objective in paragraph 1, this IFRS:

(a) requires an entity (the *parent*) that controls one or more other entities (*subsidiaries*) to present consolidated financial statements;

(b) defines the principle of *control*, and establishes control as the basis for consolidation;

(c) sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee;

(d) sets out the accounting requirements for the preparation of consolidated financial statements; and

(e) defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

3 This IFRS does not deal with the accounting requirements for business combinations and their effect on consolidation, including goodwill arising on a business combination (see IFRS 3 *Business Combinations*).

IFRS 3 Business Combinations

Follow

Standard 2024 Issued

Objective

1 The objective of this IFRS is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a *business combination* and its effects. To accomplish that, this IFRS establishes principles and requirements for how the *acquirer*:

(a) recognises and measures in its financial statements the *identifiable* assets acquired, the liabilities assumed and any *non-controlling interest* in the *acquiree*;

(b) recognises and measures the *goodwill* acquired in the business combination or a gain from a bargain purchase; and

(c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

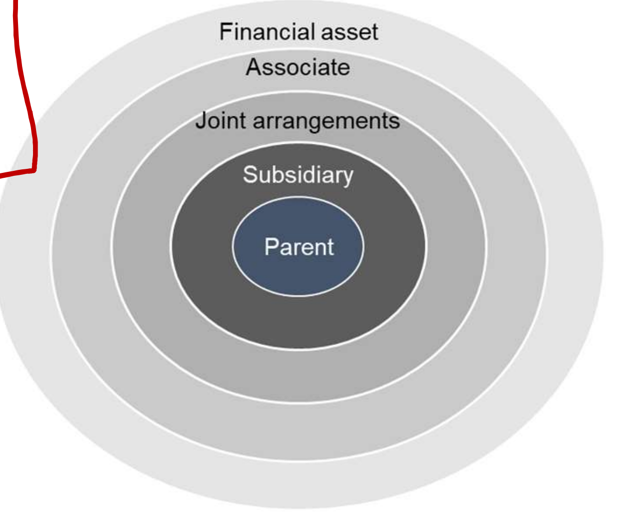
Course Structure

Block	Topic
1	Key Concepts
1.1	Economics of M&A Transactions
1.2	Deal Structures
1.3	Consolidated Financial Statements
1.4	**Obtaining Control and Scope of Consolidation**

- Which entities are included in the consolidated financial statements?

Relevant IFRS standards, by intensity of business combination

- **Business combination**: “A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as ‘true mergers’ or ‘mergers of equals’ are also business combinations as that term is used in this IFRS.” (IFRS 3.A)
  - **Control**: “investor 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.” (IFRS 10.A)
- **Joint arrangement**: “An arrangement of which two or more parties have **joint control**.” (IFRS 11.A)
- **Associate**: “An associate is an entity over which the investor has significant influence.” (IAS 28.3)
- **Financial asset**: “A financial asset is any asset that is: (a) cash; (b) an equity instrument of another entity; (c) […]” (IAS 32.11)



IFRS 10: Defining Control

Power-so-as-to-benefit model

IFRS 10 Consolidated Financial Statements

Follow

Standard 2024 Issued

Control

5 An investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee.

6 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.

7 Thus, an investor controls an investee if and only if the investor has all the following:

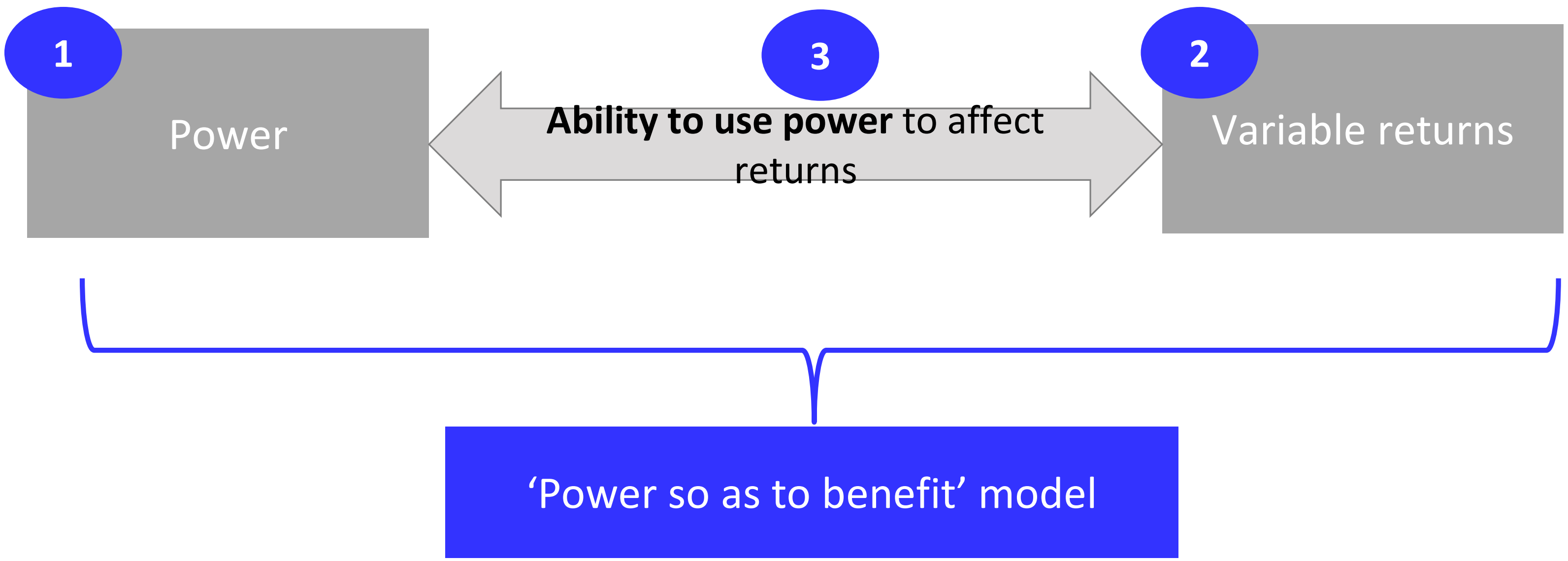
(a) power over the investee (see paragraphs 10–14);

(b) exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and

(c) the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs 17 and 18).

Control

Control exists when an investor has all of the following three elements:



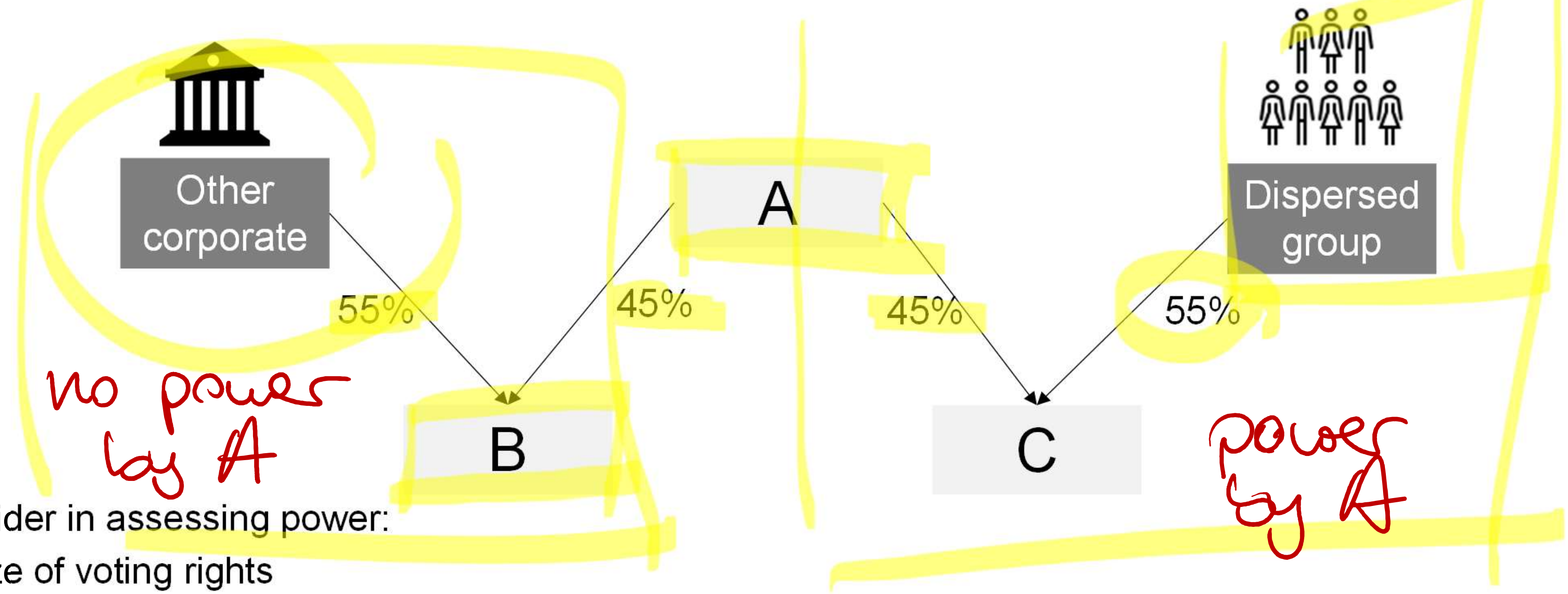
Power

1

Power = current ability to direct relevant activities

- Majority of substantive voting rights (equity instruments)
  - No further assessment needed
- Other (contractual) arrangements
  - Case-by-case assessment

Power in the absence of majority holdings



Factors to consider in assessing power:

- (relative) size of voting rights
- dispersion of other shareholdings
- level of disorganization / apathy among other shareholders
- attendance at annual general meetings
- contractual arrangements

Power and potential voting rights

- Potential voting rights = ‘rights to obtain voting rights of an investee, such as those within an option or convertible instrument.’ (IFRS 10.B47)

- Substantive or protective?
  – Substantive rights: allow investor to direct current relevant activities
    Considering benefits from and barriers to exercising these rights
  – Protective rights: exercisable only in exceptional circumstances / upon fundamental changes in investee

Potential voting rights
Benefits and barriers

- Examples:
  - A has a call option in B, which is currently in the money.

    benefits from exercising → substantive

  - A has a call option in B, but would need to borrow additional capital to exercise this option.

    barrier to exercising → protective

  - A holds a debt instrument in B, which includes a covenant that B must not engage in substantial M&A activities. If the covenant is violated, A has a right to claim its debt.

    no

  - A holds a convertible debt instrument in B, which currently is out of the money. If converted, A would hold the majority of voting rights in B. A's and B's businesses are closely related and directing B's activities would allow A to realize synergies.

    depends on net benefit

    ds

Potential voting rights
Timing

- Substantive rights: allow investor to direct *current* relevant activities
  - Investor needs to be able to exercise right when decisions about relevant activities are made at the investee
  - For a right to be substantive, it does not need to be currently exercisable

- Example:
  - A holds a forward contract to acquire the majority share in B, which is exercisable in 30 days. Currently, there are two other shareholders each holding 10% of the voting rights in B. The next Annual General Meeting (AGM) is in 8 months.
  - Version 1: No other arrangements
  - Version 2: Shareholders holding more than 5% can call Special Meetings within 25 days.

Structured entities

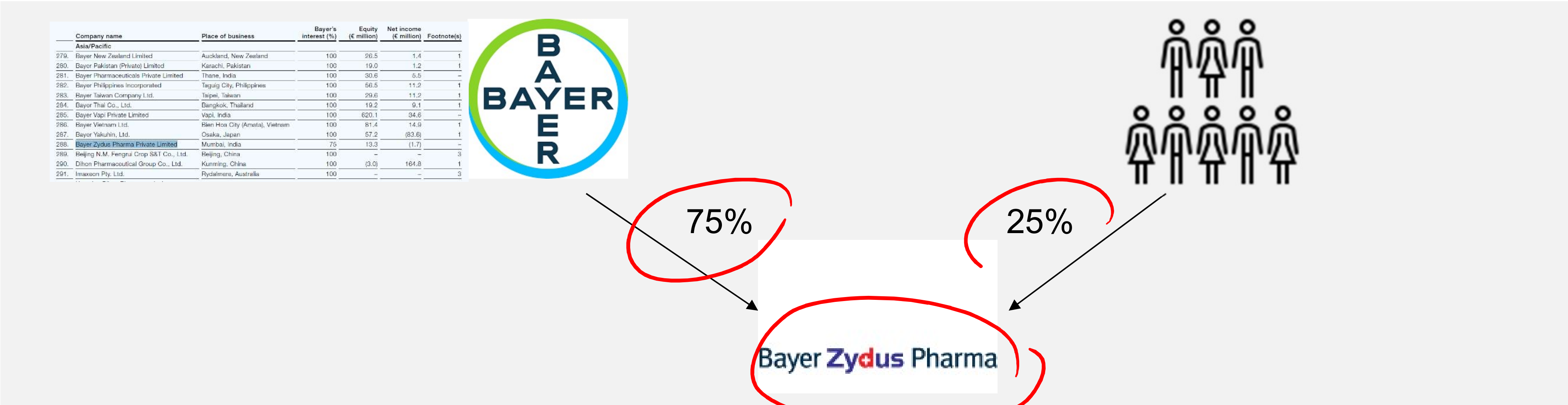
- Power-so-as-to-benefit model is a “single consolidation model”
  - It applies to unstructured entities (control via voting rights) and structured entities alike.

- Structured entities: voting rights are not the dominant factor establishing control
  - Examples: securitization vehicles, asset-backed financing, some investment funds
  - Voting rights relating to administrative tasks

- Disclosures (IFRS 12)

Non-controlling interests

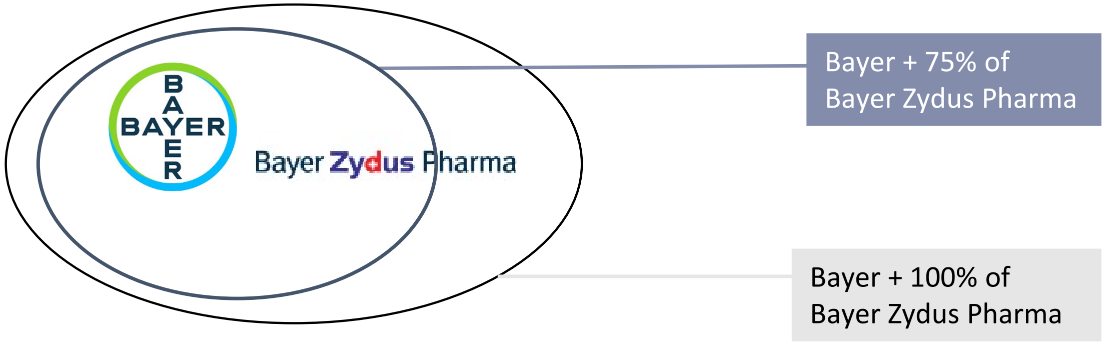
- Control can be obtained with <100% of target's shares
- Example:



	Company name	Place of business	Bayer's interest (%)	Equity (€ million)	Net income (€ million)	Footnote(s)
	Asia/Pacific					
279.	Bayer New Zealand Limited	Auckland, New Zealand	100	26.5	1.4	1
280.	Bayer Pakistan (Private) Limited	Karachi, Pakistan	100	19.0	1.2	1
281.	Bayer Pharmaceuticals Private Limited	Thane, India	100	30.6	5.5	–
282.	Bayer Philippines Incorporated	Taguig City, Philippines	100	56.5	11.2	1
283.	Bayer Taiwan Company Ltd.	Taipei, Taiwan	100	29.6	11.2	1
284.	Bayer Thai Co., Ltd.	Bangkok, Thailand	100	19.2	9.1	1
285.	Bayer Vapi Private Limited	Vapi, India	100	620.1	34.6	–
286.	Bayer Vietnam Ltd.	Bien Hoa City (Amata), Vietnam	100	81.4	14.9	1
287.	Bayer Yakuhin, Ltd.	Osaka, Japan	100	57.2	(83.6)	1
288.	Bayer Zydus Pharma Private Limited	Mumbai, India	75	13.3	(1.7)	–
289.	Beijing N.M. Fengrui Crop S&T Co., Ltd.	Beijing, China	100	–	–	3
290.	Dihon Pharmaceutical Group Co., Ltd.	Kunming, China	100	(3.0)	164.8	1
291.	Imaxeon Pty. Ltd.	Rydalmere, Australia	100	–	–	3

- How to treat the 25% (so-called "non-controlling interests") that are not held by Bayer (parent company)?
  - Essentially: How to set the boundaries of the corporate group

Treating non-controlling interests: theoretical underpinnings



Parent company theory	Entity theory
▪ Business group presented as extension of parent company's financial statements, including its fractional ownership in subsidiary ▪ Non-controlling shareholders are external debt capital providers	▪ Business group presented as one economic entity ▪ Accounting for subsidiary in consolidated group accounts ▪ Non-controlling shareholders are equity holders in the consolidated group; their equity stake is part of consolidated equity

Non-controlling interests in Bayer's financial statements

- "The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity." (IFRS 10, Appendix A)
  - Full consolidation of assets and liabilities
  - Separate presentation of equity attributable to non-controlling interests

Bayer Group 2022

B 3

€ million	Note	Dec. 31, 2021	Dec. 31, 2022
Equity	[21]		
Capital stock		2,515	2,515
Capital reserves		18,261	18,261
Other reserves		12,244	17,997
Equity attributable to Bayer AG stockholders		33,020	38,773
Equity attributable to noncontrolling interest		148	153
		33,168	38,926

Preview: Application of parent company theory and entity theory

Parent company theory

Entity theory

Partial consolidation

Equity method

Block 2

Acquisition method

Proportional revaluation method
(not permitted under IFRS)

Revaluation method

Full goodwill method

Block 1: Key take-aways

- M&A transactions create value if the value of the combined entity exceeds the sum of the stand-alone values of the acquirer and the target.
  - By paying a transaction premium, the acquirer shares some of the value with the (former) shareholders of the target.
- M&A transaction can take place in form of an asset deal or a share deal. Share deals can be financed in cash or through stocks of the combined entity. Stock financing mitigates overpayment / undervaluation because the premium is tied to the value of the combined entity.
- The consolidated financial statement reflects the economic activities of a business group as one economic entity.
  - The business group consists of the parent company and the entities under its control.
- The consolidated financial statements reflect 100% of assets and liabilities of controlled entities (subsidiaries), even if some of their equity is attributable to non-controlling interests.