

COURSE STRUCTURE (CONT.)

Lecture 3 – Wednesday, 2 May 2023

- Raising Funds in Limited Liability Companies
 - Debt vs Equity
 - Dividends
- The statement of cash flows
 - Profit vs cash
 - Analysing the statement of cash flows into operating, financing and investing activities
- Group accounts
 - Subsidiary vs associate: control vs significant influence
 - Salient points to keep in mind when looking at group accounts

WHY BUSINESSES FAIL

- Data shows that approximately 20% of new businesses fail during the first two years of being open, 45% during the first five years, and 65% during the first 10 years.
- Only 25% of new businesses make it to 15 years or more.

U.S. Bureau of Labor Statistics

Finance is one of the key backbones of any business and is absolutely critical to its success, often determining its survival and stability.

WHY BUSINESSES FAIL

Reasons Businesses Fail

		
<p>Not satisfying a need</p>	<p>Bad business plan</p>	<p>Lack of financing</p>
		
<p>Bad location</p>	<p>Inflexibility</p>	<p>Rapid expansion</p>

 Investopedia

Investopedia / Ellen Lindner

Raising Funds in Limited Liability Companies

LET'S CONSIDER THIS SCENARIO

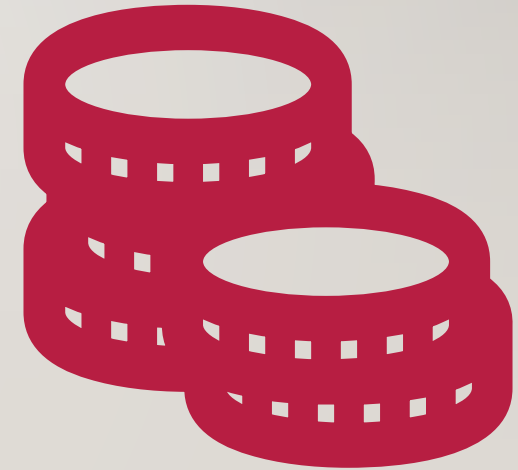
XT Ltd is planning an expansion of its business operations. The company is considering whether to use equity or debt finance to raise the €2m needed by the business expansion.

Should the company use debt or equity finance to raise the funds needed for the expansion?

RAISING NEW FINANCE

When selecting an appropriate source of finance for a new project, a company is faced with 3 questions: -

- Can the finance be raised from internal resources or will new finance have to be raised outside the business?
- If finance needs to be raised externally, should it be debt or equity?
- If external debt or equity is to be used, where should it be raised from and in which form?



INTERNAL SOURCES



- Can the necessary finance be provided from internal sources?
- If not, then the company has to consider raising finance externally

THE EQUITY OR DEBT DECISION (1)

Cost of finance

- Debt finance is usually cheaper than equity finance. Why?

The current capital gearing of the business

- If too much is borrowed then the company may not be able to meet interest and principal payments and liquidation may follow

Business risk

- Companies with highly volatile operating profit should avoid high levels of borrowing - where operating profit falls, they may not be able to meet their interest obligations

THE EQUITY OR DEBT DECISION (2)

Operating gearing

- Companies with high operating gearing tend to have volatile operating profits. Generally, it is a high-risk policy to combine high financial gearing with high operating gearing.

Dilution of earnings per share (EPS)

- Large issues of equity could lead to the dilution of EPS if profits from new investments are not immediate. This may lead to falling share prices.

Voting Control

- A large issue of shares to new investors could alter the voting control of a business.

THE EQUITY OR DEBT DECISION (3)

- **The current state of equity markets**

In a period of falling share prices many companies will be reluctant to sell new shares. This will dilute the wealth of the existing owners.

RAISING FINANCE THROUGH EQUITY

Initial Public Offering (IPO)

- The first occasion on which shares are offered to the public.
- The company issues a prospectus, describing the shares being offered for sale, and including matters such as a description of the company's business, recent financial statements, details of the directors and their remuneration.

Rights issue

- Existing shareholders are offered new shares in proportion to existing holdings.
- The Companies Act requires that if a company wishes to increase its share capital, it must first make an offer to its existing shareholders. The company is only allowed to issue new shares immediately to new shareholders if agreed by the existing shareholders in a general meeting.
- The shares are offered at below their current market value to make the offer look attractive but above the nominal value
- Cheaper than a public share issue

SHARE CAPITAL

Ordinary share capital

- Equity in the balance sheet

Preference share capital

- Irredeemable: equity in the balance sheet
- Redeemable: non-current liabilities in the balance sheet (SOFP)

NEW ISSUE OF SHARES

At nominal value

Dr Bank (issue price x no. of shares)

Cr Ordinary share capital (nominal value x no. of shares)

At a premium

Dr Bank (issue price x no. of shares)

Cr Ordinary share capital (nominal value x no. of shares)

Cr Share premium (premium per share x no. of shares)

Statements of financial position

For the year ended 31 December 2021

	Note	The Group		The Bank	
		2021 €000	2020 €000	2021 €000	2020 €000
EQUITY					
Called up share capital	31	583,849	583,849	583,849	583,849
Share premium account		49,277	49,277	49,277	49,277
Revaluation reserves	32	58,438	55,477	58,326	55,365
Retained earnings	32	434,721	388,522	358,254	329,347
Total Equity		1,126,285	1,077,125	1,049,706	1,017,838

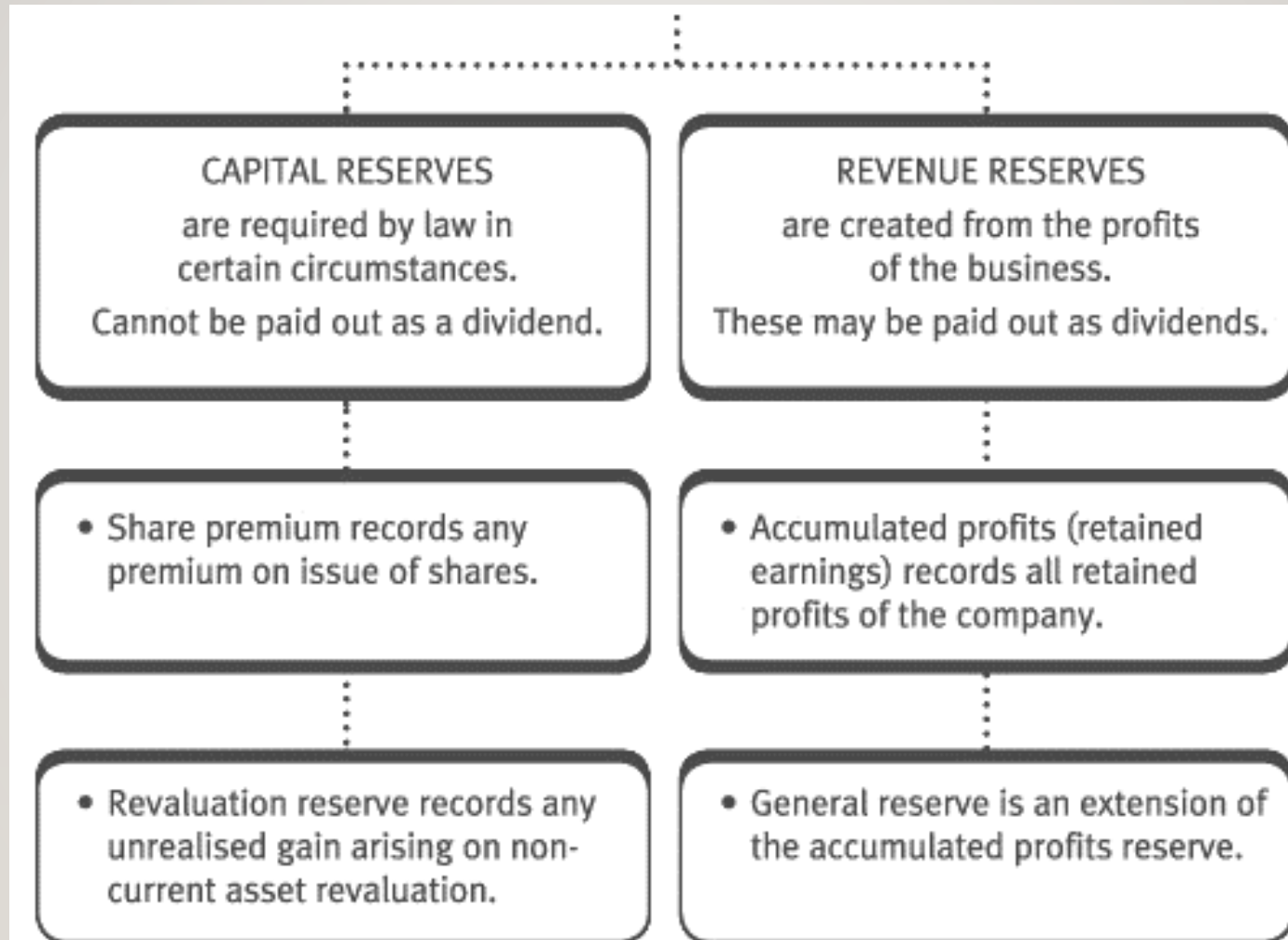
Bank of Valletta plc
Annual Report 2021 pg. 46
www.bov.com

	The Bank	
	2019	2018
	€000	€000
31. SHARE CAPITAL AND SHARE PREMIUM		
Share capital		
Authorised:		
1,000,000,000 Ordinary shares of €1.00 each	1,000,000	1,000,000
(2018: 1,000,000,000 Ordinary shares of €1.00 each)		
Issued and paid up:		
583,849,000 Ordinary shares of €1.00 each fully paid	583,849	530,772
(2018: 530,772,000 Ordinary shares of €1.00 each fully paid)		

During the financial year ended 31 December 2018 ordinary share capital increased by €5,772,000 (57,772,000 shares at €1.00) as a result of the scrip dividend programme. On 11 June 2019, the Bank made a bonus issue of 53,077,200 fully paid ordinary shares of a nominal value of €1.00 per share, representing 1 bonus share for every 10 shares held, thereby increasing the issued share capital from 531 million shares to 584 million shares, resulting in a paid up capital of €584 million.

Bank of Valletta plc
Annual Report 2021 pg. 109
www.bov.com

CAPITAL VS REVENUE RESERVES



Source: Kaplan Financial Knowledge Bank Chapter 15

DIVIDENDS

Ordinary dividend:

- An apportionment of the profits attributable to owners of the business
- Not an expense
- Deducted from retained earnings in the SOCIE

Redeemable preference dividend:

- An expense – finance cost



Statements of Changes in Equity (continued)
for the year ended 31 October 2019

COMPANY	Share capital	Retained earnings	Total
	€	€	€
At 31 October 2017	1,164,687	1,453,416	2,618,103
Profit for the year	-	2,014,290	2,014,290
Total comprehensive expense for the year	-	2,014,290	2,014,290
Dividends paid	-	(2,016,667)	(2,016,667)
At 31 October 2018	1,164,687	1,451,039	2,615,726
Adjustment from the adoption of new IFRSs retrospectively	-	(1,677)	(1,677)
Adjusted balance as at 1 November 2018	1,164,687	1,449,362	2,614,049
Profit for the year	-	5,406,218	5,406,218
Total comprehensive expense for the year	-	5,406,218	5,406,218
Dividends paid	-	(4,250,000)	(4,250,000)
Redemption of preference shares	(1,162,357)	-	(1,162,357)
Capitalisation of profits	1,162,357	(1,162,357)	-
At 31 October 2019	1,164,687	1,443,223	2,607,910

<https://axgroup.mt/wp-content/uploads/sites/6/2020/02/2.pdf>

Statements of changes in equity

For the year ended 31 December 2019

The Group	Share Capital €000	Share Premium Account €000	Revaluation Reserves €000	Retained Earnings €000	Total €000
Scrip Dividend	5,772	3,850	-	(9,622)	-
Dividends to equity holders	-	-	-	(17,678)	(17,678)

Bank of Valletta plc
Annual Report 2021 pg. 71
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LOAN NOTES / BONDS



Loan notes – **non-current liability** in the financial statements



The obligation to redeem the loan notes at a specified date/s



The interest incurred is included as a **finance cost** in the statement of profit or loss

CHARACTERISTICS OF LONG-TERM DEBT

Advantages to the investor:

Low risk ... low return acceptable

Disadvantages to the investor:

No voting right ... no control

CHARACTERISTICS OF LONG-TERM DEBT

Advantages to the company:

Cheap

Interest is tax deductible

No dilution of control

Predictable cash outflows

Disadvantages to the company:

Inflexible

Increases gearing – financial risk

Must normally be repaid

EXAMPLE FROM NOTES TO THE ACCOUNTS

By virtue of an offering memorandum dated 31 July 2017, the Company issued €20million Bonds (2017-2027), having a nominal value of €100 each, bearing interest at the rate of 3.5% per annum.

These bonds are unsecured pursuant and subject to the terms and conditions in the prospectus dated 31 July 2017. The quoted market price as at 31 January 2021 for the 3.5% Bonds 2017 - 2027 was €105.53.

Simonds Farsons Cisk plc,
Annual Report, 2020/2021, pg. 94

www.farsons.com

The Statement of Cash Flows

THE STATEMENT OF CASH FLOWS

- a good consolidated indicator of a business's cash inflow and outflow
- breaks down these cash flows into three distinct categories:
 - operating activities
 - investing activities, and
 - financing activities

Each of these sections give us useful information about an entity's performance.

THE IMPORTANCE OF THE STATEMENT OF CASH FLOWS

- monitoring company debt
- preventing unnecessary expenditures from interest, late payment penalties and debt costs
- ensuring timely investment and cash available for investment opportunities
- ensuring timely payment of expenses and debts
- ensuring a level of regular business income without relying on outside investment or cash borrowing

AIM OF ANALYSING THE STATEMENT OF CASH FLOWS

- To understand the different sections of the statement and
- To understand the implications for the business

Year ended 31 January					
		Group		Company	
		2021	2020	2021	2020
Notes		€'000	€'000	€'000	€'000
Cash flows from operating activities					
	31	26,408	17,047	10,738	12,890
		-	-	3	7
		(224)	(276)	(7)	(16)
		(1,022)	(1,094)	(944)	(1,081)
		(618)	(1,497)	-	-
		24,544	14,180	9,790	11,800
Cash flows from investing activities					
		(10,138)	(10,702)	(9,008)	(9,103)
		155	200	120	142
		2,500	-	2,500	-
		(33)	(122)	-	-
		(7,516)	(10,624)	(6,388)	(8,961)
Cash flows from financing activities					
		2,700	1,300	2,700	1,300
		(2,997)	(3,746)	(2,997)	(3,746)
		(1,379)	(1,033)	(144)	(138)
		-	(4,000)	-	(4,000)
		(1,676)	(7,479)	(441)	(6,584)
		15,352	(3,923)	2,961	(3,745)
		1,796	5,719	(297)	3,448
	11	17,148	1,796	2,664	(297)

31. Cash generated from operations

Reconciliation of operating profit to cash generated from operations:

	Group		Company	
	2021	2020	2021	2020
	€'000	€'000	€'000	€'000
Operating profit	5,673	13,690	4,764	10,284
Adjustments for:				
Depreciation of property, plant and equipment (Note 5)	7,814	7,796	6,701	6,734
Depreciation of right-of-use assets (Note 6)	1,405	1,327	1	2
Profit on disposal of property, plant and equipment (Note 23)	(149)	(200)	(120)	(142)
Rent rebates	(138)	-	-	-
Amortisation of intangible assets (Note 7)	41	44	-	-
Amortisation of institutional grant (Note 23)	(154)	(154)	(154)	(154)
Amortisation of bond issue costs (Note 18)	32	32	32	32
Increase/(decrease) in provision for impairment of trade and other receivables (Note 10)	(1,787)	668	1,682	417
Provision for termination benefits (Note 21)	(13)	92	13	92
	16,324	23,295	12,919	17,265
Changes in working capital:				
Inventories	3,020	(1,607)	1,162	(893)
Trade and other receivables	5,882	(5,927)	(4,675)	(4,119)
Trade and other payables	1,182	1,286	1,332	637
Cash generated from operations	26,408	17,047	10,738	12,890

ILLUSTRATION (3)

11. Cash and cash equivalents

For the purposes of the statements of cash flows, the cash and cash equivalents at the end of the reporting period comprise the following:

	Group		Company	
	2021	2020	2021	2020
	€'000	€'000	€'000	€'000
Cash at bank and in hand	17,148	8,409	2,664	1,002
Bank overdrafts (Note 18)	-	(6,613)	-	(1,299)
	17,148	1,796	2,664	(297)

Simonds Farsons Cisk plc,
Annual Report, 2020/2021 pg. 92

FIRST POINT: THE CHANGE IN CASH AND CASH EQUIVALENTS

- An increase in cash and cash equivalents at the end of the period does not necessarily mean that the entity has performed well in the year. WHY?
- An entity may be struggling to generate cash in a period and is forced to sell its owned premises and rent them back in order to continue.
 - entity's overall cash position increases in the period, but
 - fewer assets owned by the entity in the future.Its ability to secure future borrowing may be limited.

What are the reasons behind the movement in cash and cash equivalents? How is the entity performing?

CASH FLOWS FROM OPERATING ACTIVITIES

Cash generated from operations

How much cash the business can generate from its core activities, before looking at one-off items such as asset purchases/sales and raising money through debt or equity.

The cash generated from operations figure is effectively the **cash profit from operations**. The cash generated from operations figure should be compared to the profit from operations to show the quality of the profit.

CASH VS PROFIT GENERATED FROM OPERATIONS

- The closer the cash and the profit generated from operations are together, the better the quality of profit.
- If the profit from operations is **significantly larger** than the cash generated from operations, it shows that the business is not able to turn that profit into cash, which could lead to problems with short-term liquidity.

The cash generated from operations figure should be a positive figure. This ensures that the business generates enough cash to cover the day to day running of the company.

INCOME STATEMENTS

	Year ended 31 January				
	Notes	Group		Company	
		2021	2020	2021	2020
	€'000	€'000	€'000	€'000	
Revenue	4	73,016	103,491	41,391	55,310
Cost of sales	23	(47,004)	(62,950)	(23,028)	(27,204)
Gross profit		26,012	40,541	18,363	28,106
Selling and distribution costs	23	(8,912)	(12,602)	(6,689)	(9,492)
Administrative expenses	23	(11,427)	(14,249)	(6,910)	(8,330)
Operating profit		5,673	13,690	4,764	10,284
Finance income	26	-	-	25	7
Finance costs	27	(1,246)	(1,370)	(975)	(1,096)
Profit before tax		4,427	12,320	3,814	9,195
Tax (expense)/income	28	(1,094)	(451)	(934)	706
Profit for the year		3,333	11,869	2,880	9,901
Basic and diluted earnings per share for the year attributable to shareholders	30	€0.111	€0.396		

Simonds Farsons Cisk plc,
Annual Report,
2020/2021, pg. 68

CASH GENERATED FROM OPERATIONS

Movements in working capital

- **Large increases in receivables and inventories** could mean problems for the cash flow of the business.
 - The company may have potential irrecoverable debts, or may be that a large customer has been taken on with increased payment terms. Either way, the company should have enough cash to pay the payables on time.
- If a company has **positive cash generated from operations** but a **significant increase in the payables balance** compared to everything else, it may be that the company is delaying paying its suppliers in order to improve its cash flow position at the end of the year.

CASH GENERATED FROM OPERATIONS

Interest and tax payments

- The cash generated from operations should be sufficient to cover the interest and tax payments, as the company should be able to cover these core payments without taking on extra debt, issuing shares or selling assets.

CASH GENERATED FROM OPERATIONS

‘Free cash’

- Any cash left over after paying the tax and interest liabilities is thought of as ‘**free cash**’, and attention should be paid as to where this is spent.
 - Ideally, a dividend would be paid out of this free cash, so that a firm does not have to take out longer sources of finance to make regular payments to its shareholders.
 - Other good ways of using this free cash would be to invest in further non-current assets (as this should generate returns into the future) and paying back loans (as this will reduce further interest payments).

CASH FLOWS FROM INVESTING ACTIVITIES

- These cashflows mainly relate to **non-current assets**.
 - E.g. sales of assets can be a good thing if those assets are being replaced. However, if a company is selling off its premises and is now renting , this makes the financial position significantly weaker, and banks will be less willing to lend as there are less assets to secure a loan against.
- The sale of assets should not be used to finance the operating side of the business or to pay dividends.
 - Poor cash management, as a company will not be able to continue selling assets in order to survive. This is an indication that a company is shrinking and not growing.
- This section also includes **interest received** or **dividends received** from investments the entity holds.

FUNDING NON-CURRENT ASSETS

- The sources of financing any increases in assets should be considered.
- If this can be financed out of operations, then this is the best scenario as it shows the company is generating significant levels of excess cash.
- Funding these out of long term sources (i.e. loans or shares) is also fine, as long-term finances are sensible to use for long term assets.

CASH FLOWS FROM FINANCING ACTIVITIES

How are the funds raised through a share or a loan stock issue being used?

- When **raising long term finance**, it is useful to consider the future consequences.
 - Taking out **loans** will lead to higher interest charges going forward. This will increase the level of gearing in the entity. Hence, finance providers may charge higher interest rates due to the increased risk. Also loan providers are reluctant to provide further finance if the entity already has significant levels of debt.
- Raising funds from **issuing shares** will not lead to interest payments and will not increase the level of risk associated with the entity.
 - However, issuing shares will lead to more shareholders and possibly higher total dividend payments in the future.

STATEMENT OF CASH FLOWS - BENEFITS

1. Cash flow information is **harder to manipulate** as it just reflects cash in and cash out, it isn't affected by accounting policies or accruals.
2. The statement of cash flows provides information about **all cash inflows and outflows**, from all sources.
3. Cash flow information can provide more detail about the **quality of the entity's revenue**, for example, whether customers are (in general) paying their bills.
4. Cash accounting methods used in the statement of cash flows can be **easier for non-accountants to understand**.

STATEMENT OF CASH FLOWS – LIMITATIONS

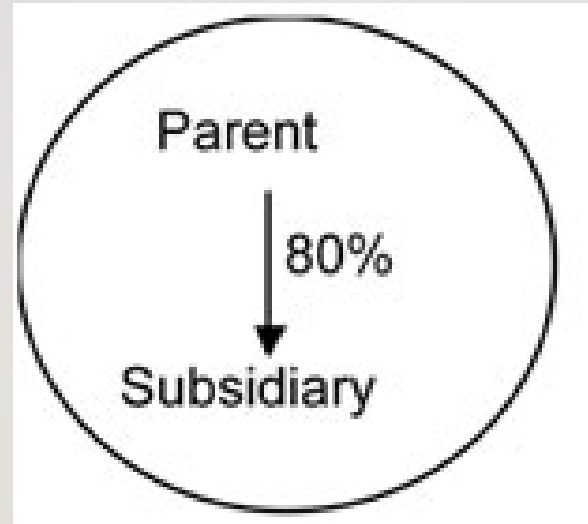
1. How can information can be manipulated in the statement of cash flows?
 - Management can delay paying suppliers to increase the net cash inflows
 - Management can buy goods using leasing arrangements, to avoid paying cash
2. Cash flows do not reflect the earnings of the entity
3. The statement of cash flows on its own does not show a full view of the entity's performance. Users of the financial statements should consider all parts of the financial statements together, and also other non-financial information about the company to assess its performance

Group Accounting

THE MAIN PRINCIPLES OF CONSOLIDATED FINANCIAL STATEMENTS

- **Consolidated 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
- **Subsidiary:** an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent)
- **Parent:** an entity that controls one or more entities
- **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
- **Non-controlling interest:** Equity in a subsidiary not attributable, directly or indirectly, to a parent.

A SIMPLE ILLUSTRATION OF A TYPICAL GROUP STRUCTURE



Control exists if the parent company has more than 50% of the ordinary (equity) shares – i.e. giving them more than 50% of the voting power.

However, there are examples where a holding of less than 50% of the ordinary shares can still lead to control existing.

CONTROL: OTHER SITUATIONS

Power may be evidenced by all or some of the following:

- the power over more than 50% of the voting rights by virtue of agreement with other investors
- the power to govern the financial and operating policies of the entity under statute or an agreement
- the power to appoint or remove the majority of the members of the board of directors, or
- the power to cast the majority of the votes at meetings of the board of directors.

TIME TO THINK!

G Co owns the following investments in other companies:

	Equity shares	Non-equity shares held
X Co	80%	Nil
Y Co	25%	80%
Z Co	45%	25%

G Co also has appointed five of the seven directors of Z Co.

Which of the following investments are accounted for as subsidiaries in the consolidated accounts of G Co Group?

ANSWER

- **X Co** – by looking at the equity shares, G Co has more than 50% of the voting shares – i.e. an 80% equity holding. This gives them control and, therefore, X Co is a subsidiary.
- **Y Co** – despite having the majority of the non-equity shares, these do not give voting power. As G Co only has 25% of the equity shares, they do not have control and, therefore, Y Co is not a subsidiary.
- **Z Co** – G Co has less than half of the voting rights. However, by looking at the fact that G Co has appointed five of the seven directors, effectively they have the power, and ability to use that power, to affect the decision making in the company which will impact on the returns to be made. This should make you conclude that Z Co is a subsidiary.

EXAMPLE

Acquisition of controlling stake in subsidiary

On 31 December 2019, GO entered into an agreement to acquire 51% of the issued share capital of Connectedcare Limited for a consideration of €50,000. Connectedcare Limited is principally engaged in providing electronic and mobile care solutions, a service offering that is ancillary to services currently provided by GO. The impact of this acquisition on GO's consolidated and stand-alone financial statements was insignificant.

Go plc, Annual Report 2020 pg. 112

PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

- A parent prepares consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.
- However, a parent need not present consolidated financial statements if it meets a number of conditions.

PRESENTATION OF CONSOLIDATED FINANCIAL STATEMENTS

A parent needs not present consolidated financial statements if it meets **all** of the following conditions:

1. it is a **wholly-owned subsidiary or is a partially-owned subsidiary of another entity** and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements
2. its **debt or equity instruments are not traded** in a public market
3. it **did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation** for the purpose of issuing any class of instruments in a public market, and
4. its **ultimate or any intermediate parent of the parent** produces financial statements available for public use that comply with IFRSs

CONSOLIDATION PROCEDURES

Consolidated financial statements:

1. **combine like items** of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries
2. **offset (eliminate) the carrying amount of the parent's investment in each subsidiary** and the **parent's portion of equity** of each subsidiary
3. **eliminate in full intragroup** assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group.

Statements of financial position

	Notes	Group		Company	
		As at 31 December			
		2020 €000	2019 €000	2020 €000	2019 €000
ASSETS					
Non-current assets					
Property, plant and equipment	5	161,727	147,091	112,393	104,750
Right-of-use assets	6	45,633	50,131	38,929	42,028
Intangible assets	7	62,294	71,035	5,531	6,777
Investments in subsidiaries	8	-	-	50,877	50,077
Investments in associates	9	2,188	18	-	-
Loans receivable from subsidiary	11	-	-	-	4,549
Other investments	12	406	-	-	-

Go plc, Annual Report 2020 pg. 50

FURTHER CONSOLIDATION POINTS

A parent presents **non-controlling interests** in its consolidated statement of financial position within **equity, separately** from the equity of the owners of the parent.

In consolidated accounts, **unrealised profit** has to be eliminated. This arises when profits are made on intra-group trading and the related inventories have not subsequently been sold to customers outside the group. Until inventory is sold to entities outside the group, any profit is unrealised and should be eliminated from the consolidated accounts.

Statements of financial position - continued

		Group		Company	
		As at 31 December			
	Notes	2020 €000	2019 €000	2020 €000	2019 €000
EQUITY AND LIABILITIES					
EQUITY					
Share capital	17	58,998	58,998	58,998	58,998
Reserves	18	36,564	37,544	4,043	4,096
Retained earnings		17,578	13,853	57,169	51,630
Total capital and reserves attributable to owners of the Company		113,140	110,395	120,210	114,724
Non-controlling interests		13,221	15,175	-	-
Total equity		126,361	125,570	120,210	114,724

Go plc, Annual Report 2020 pg. 51

TIME TO THINK!

	P Co €	S Co €
Trade Receivables	50,000	30,000
Trade Payables	70,000	42,000

As a result of trading during the year, P Co's receivables balance included an amount due from S Co of €4,600.

ANSWER

- P Co has control over S Co. This should mean that you immediately consider adding together 100% of P Co's balances and S Co's balances to reflect control.
- However, the intra-group balances at the year end need to be eliminated, as the consolidated accounts need to show the group as a single economic entity. The group statement of financial position should only include amounts owed and owing to entities outside the group. As P Co shows a receivable of €4,600, then in S Co's individual accounts there must be a corresponding payable of €4,600.
- When these balances are eliminated, the consolidated figures become:
- Receivables $(€50,000 + €30,000 - €4,600) = €75,400$
- Payables $(€70,000 + €42,000 - €4,600) = €107,400$

ASSOCIATE

- **Associate:** an entity over which the investor has significant influence
- **Significant influence:** the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies
- Where an entity holds **20% or more of the voting power on an investee**, it will be presumed the investor has significant influence unless it can be clearly demonstrated that this is not the case.
- If the holding is less than 20%, the entity will be presumed not to have significant influence unless such influence can be clearly demonstrated.
- A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

EXAMPLE

On 2 December 2020, BMITT entered into an agreement to acquire a 15% shareholding in EBO Ltd (EBO) for a consideration of €1,542,000. Further costs amounting to €25,000 which are directly attributable to this acquisition were incurred by the Company and were capitalised as part of the cost of the investment.

The Group are classifying this interest as an investment in associate, despite holding an effective shareholding of 15%. BMITT has a right to appoint one director out of a maximum of seven directors. As at 31 December 2020, BMITT had appointed one director out of a total of three acting directors and this was deemed to constitute significant influence in terms of voting rights at Board level.

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EQUITY ACCOUNTING

Under the equity method:

1. on initial recognition the investment in an associate is recognised **at cost**
2. the carrying amount is **increased or decreased** to recognise the investor's **share of the profit or loss** of the investee after the date of acquisition.

ANY QUESTIONS?