How to Handle an Internal Merger between Two Subsidiaries

with SAP® Financial Consolidation 10.0, Starter Kit for IFRS?

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INTRODUCTION

This practical guide is part of a new series of seven guides dedicated to help deal with the most frequent consolidation M&A requirements when using the SAP® Financial Consolidation 10.0, starter kit for IFRS. A first series was published to help deal with those cases when using SAP® Planning and Consolidation 10.0, starter kit for IFRS, version for SAP NetWeaver.

In this paper internal merger between two subsidiaries is explained through a real use case scenario and presented in three steps:

- what the IFRS text says,
- how the business use case is handled in Financial Consolidation,
- and what impact the CFO should expect on her/his company's financial statements.

You can use this new paper to demonstrate SAP's supremacy in addressing customers' most complex and frequent business requirements.

SAP solutions for consolidation, part of SAP enterprise performance management (EPM) solutions, include SAP Financial Consolidation and SAP Business Planning and Consolidation. A starter kit for IFRS has been developed for each solution to perform, validate and publish a statutory consolidation in accordance with IFRS. These starter kits are based on a dynamic configuration easy to customize to specific requirement. They are provided with documentations.

To know more:

You will find further indications on how to deal with outgoing entities in the SAP® Financial consolidation 10.0, Starter kit for IFRS Operating guide.

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WHAT ARE THE REGULATION REQUIREMENTS?

The restructuring of a group of companies under common control is a business combination that doesn't result in a change of overall control, therefore it is excluded from IFRS3. IFRS doesn't deal specifically with business combinations involving entities under common control.

In our case, we will apply the "predecessor accounting method"

- ✓ No restatement of assets and liabilities to their fair value
- ✓ No goodwill recognition,
- ✓ Differences that may arise between the consideration given and the book value of assets and liabilities should be included in retained earnings

So, a merger between two 100% full consolidated subsidiaries shouldn't affect the consolidated financial statements of the group.

Whatever accounting method is chosen to deal with an internal merger (predecessor method or another one), the process to be handled in the software would be similar. Only manual journal entries would be different.

PRESENTATION OF THE BUSINESS CASE

This business case is included in the set of data provided with the IFRS starter kit SP3. It is possible to retrieve it using the following settings:

- CATEGORY: A- ACTUAL,

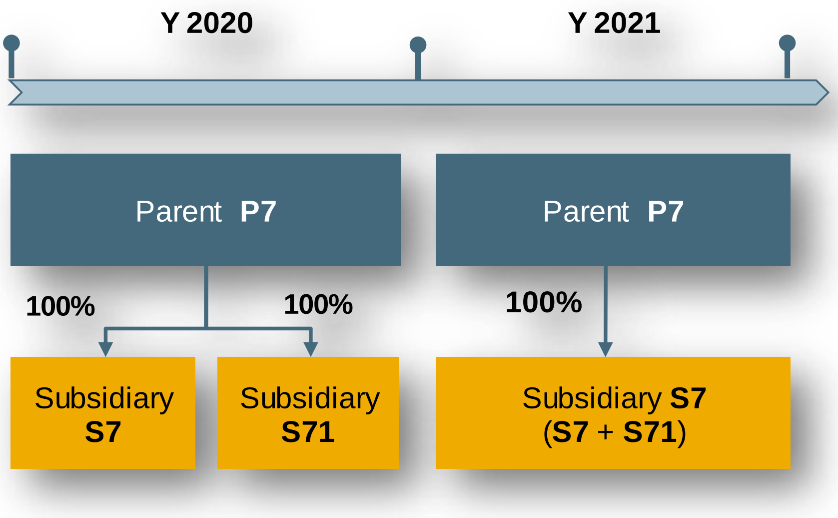
- DATA ENTRY PERIOD: 2021.12,

- CONSOLIDATION CURRENCY: USD

- SCOPE: CASE7,

- VERSION: IFRSYTD,

- REPORTING UNIT: P7, S71, S72



Year 2020

P7 owns 100% interests of subsidiary S7 and 100% interest of subsidiary S71

A fair value adjustment has been accounted for in S71:

(USD6 000 – 33% deferred tax = USD4 000)

A goodwill of USD6 000 has been posted on S71

Year 2021

S71 net income = USD15 000

At the end of Year 2021, S71 is merged into S7

S7 increases its share capital with 2 000 shares (nominal value of USD10) → USD20 000

S7 accounts for a share premium of USD65 000 (= Total equity USD85 000 – increase in share capital USD20 000)

P7 individual accounts in 2021 (including intercompany accounts)

	Merger of S71 into S7	
	Before	After
Investment S7	80 000	120 000
Investment S71	40 000	
Trade receivable	10 000	10 000
Cash and cash equivalents	10 000	10 000
Total assets	**140 000**	**140 000**
Issued capital	120 000	120 000
Retained earnings	20 000	20 000
Total equity and liabilities	**140 000**	**140 000**

		Merger		
		Before	F70	After
Investment	S7	80 000	40 000	120 000
	S71	40 000	-40 000	0
		120 000	**0**	**120 000**
Trade receivable	S7		5 000	5 000
	S71	5 000	-5 000	0
	TP999	5 000	0	5 000
		10 000	**0**	**10 000**

S71 individual accounts in 2021 (including intercompany accounts)

	Opening	Merger of S71 into S7	
		Before	After
Lands & buildings	50 000	50 000	
Lands & buildings, depr.	-5 000	-5 000	
Trade receivable	25 000	25 000	
Cash and cash equivalents	10 000	25 000	
Total assets	**80 000**	**95 000**	
Issued capital	30 000	30 000	
Retained earnings	40 000	55 000	
Trade payables	10 000	10 000	
Total equity and liabilities	**80 000**	**95 000**	

		Merger	
		Before	After
Trade receivable	S7	10 000	
	TP999	15 000	
		25 000	**0**
Trade payable	P7	5 000	
	TP999	5 000	
		10 000	**0**

Detailed merger of S71 into S7:

	S71 Flow F99	S7 Flow F70
Lands & buildings	50 000	50 000
Lands & buildings, depreciation	-5 000	-5 000
Trade receivable	25 000	15 000
Partner S7	*10 000*	*0*
TP999	*15 000*	*15 000*
Cash and cash equivalents	25 000	25 000
Total assets	**95 000**	**85 000**
Issued capital	30 000	20 000
Share premium		65 000
Retained earnings	55 000	
Trade payables	10 000	0
Partner P7	*5 000*	*5 000*
Partner S71		*-10 000*
Partner TP999	*5 000*	*5 000*
Total equity and liabilities	**95 000**	**85 000**

S7 individual accounts in 2021 (including intercompany accounts)

	Merger of S71 into S7	
	Before	After
Lands & buildings		50 000
Lands & buildings, depr.		-5 000
Trade receivable	15 000	30 000
Cash and cash equivalents	80 000	105 000
Total assets	**95 000**	**180 000**
Issued capital	80 000	100 000
Share premium		65 000
Retained earnings	5 000	5 000
Trade payable	10 000	10 000
Bank overdraft		
Total equity and liabilities	**95 000**	**180 000**

		Merger	
		Before	After
Trade payable	P7		5 000
	S71	10 000	
	TP999	10 000	5 000
		10 000	**10 000**

HOW TO HANDLE AN INTERNAL MERGER BETWEEN TWO SUBSIDIARIES IN THE IFRS STARTER KIT?

REMINDER

The amounts stored in the database are identified thanks to a set of elements called dimensions.

The main dimensions are listed below:

- The account dimension indicates which item of the balance sheet or P&L is impacted.
- The flow dimension is used to identify and analyze the changes between the opening (flow *F00*) and closing (flow *F99*) balances.
- The audit ID dimension identifies the origin of the data for input data, local adjustments, manual and automatic journal entries.
- The in-built dimension (Journal entry number) provides a full audit trail as it retrieves the number of the manual or automatic journal entry. The use of this feature is illustrated in the section “Retrieval of Consolidated Data” where we show screenshots of the analysis reports that can be accessed by drill down from the financial statements.

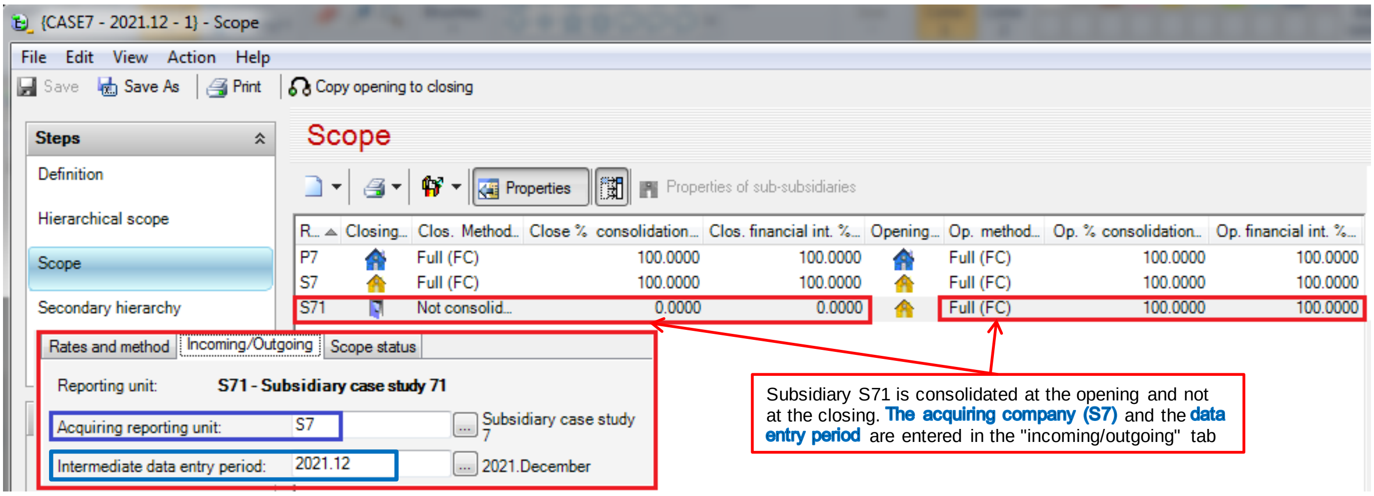
OVERVIEW OF THE OPERATING PROCESS

The actions to perform to deal with an internal merger between two subsidiaries are listed hereafter. A tick mark indicates which apply to case#7. In this business case, we will focus on year 2021.

		Lab #7
Package data entry		
Acquiree:	Merged at the opening → no package needed	
	Merged during the period → package needed to account for all the movements (balance sheet and P&L) until the merger	✓
Acquirer:	Account for the assets, equity and liabilities received on flow F70 and if needed post a result on the merger on a dedicated P&L account (P1620)	✓
	Reverse the opening intercompany declarations towards the merged company on flow F70	✓
Partners:	Reclassify their intercompany declarations from the acquired to the acquiring partner on flow F70	
Consolidation scope		
	The acquiree is outgoing of the scope	✓
	The code of the acquiring company must be entered	✓
	In case of a merger during the period, the date of the package must be entered	✓
Manual journal entries:		
Acquirer:	All the manual journal entries previously posted on the acquiree should be analyzed and possibly posted on the acquirer, except for the goodwill. (fair values, deferred taxes, internal gains or losses, adjustments to group GAAP)	✓
	If needed, eliminate the gain or loss on the merger accounted for in the individual statements on account P1620, flows Y99 and F70 → audit ID ADJ91	
Consolidation:		
	Run the consolidation processing	✓
Report navigator:		
	Validate the scope change accounting with several preconfigured reports	✓

CONSOLIDATION SCOPE

In the consolidation scope, S71 is not consolidated at closing whereas it was consolidated using the full consolidation method at the opening. The “Incoming / Outgoing” tab enables you to specify that data entered for S71 in 2021.12 should be merged into reporting unit S7 during the consolidation process.



AUTOMATIC JOURNAL ENTRIES

When a reporting unit exits the scope and an acquiring reporting unit is specified the scope builder, the consolidation engine reverses all the balance sheet data (assets, liabilities and equity) for this entity:

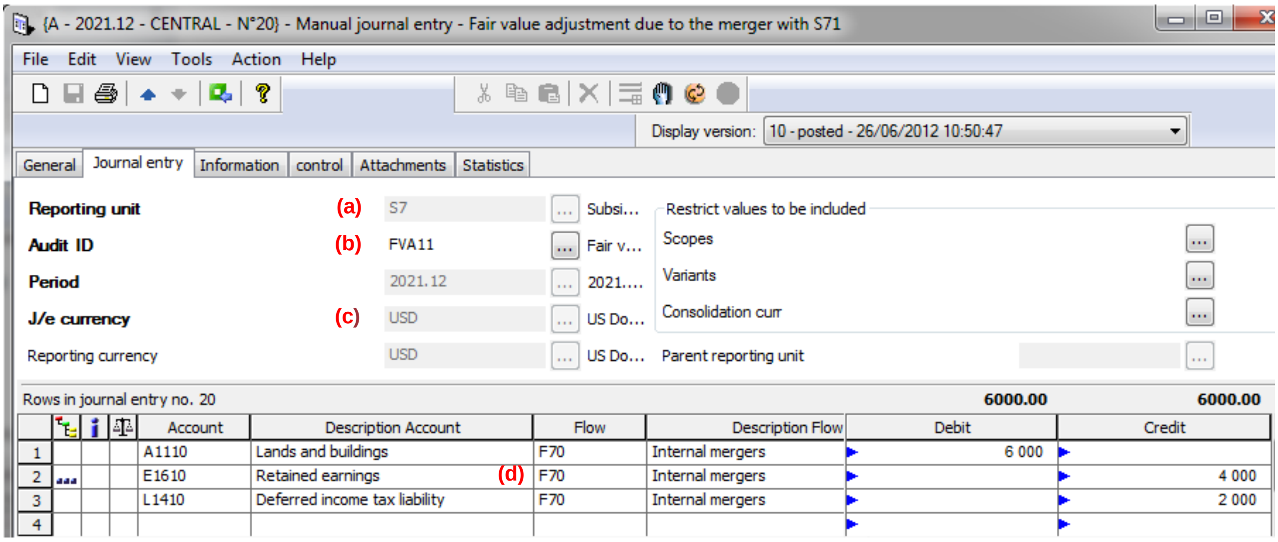
- If the merger occurs at the opening of the year, the reversal is triggered on flow F70 (internal merger) based on the opening position (flow F00) for package data, manual journal entries without restrictions and automatic journal entries.
- If the merger occurs during the period, the reversal is triggered on the same flow F70, but based on the opening position (flow F00) plus the movements of the period:

Automatic journal entries transfer the goodwill (gross and impairment) previously stored in the acquired entity to the acquiring entity, using flow F70 and audit ID GW10

At partners, intercompany declarations towards the acquired entity will be reclassified towards the acquiring entity, using flow F70.

MANUAL JOURNAL ENTRIES

The fair value adjustment posted on S71 in 2020 should be posted on S7 as follows:



(a) Posted on S7
(b) Using a dedicated audit ID for fair values «FVA11 - Fair value for incoming entities - Central - M»
(c) In S7 currency (USD)
(d) On flow F70 Internal merger

RETRIEVAL OF CONSOLIDATED DATA

After running the consolidation, the consolidated balance sheet is as follows:

Figure 1- Report C31-05: Balance Sheet by flow

	F00 Opening	F10 Net profit (loss) for the period	F15 Net variation	F70 Internal mergers	F99 Closing
Assets	(a)			(b)	
A1110 Lands and buildings	56 000			0	56 000
A1111 Lands and buildings, Depreciation	-5 000			0	-5 000
A1310 Goodwill	6 000			0	6 000
A1810 Investments in subsidiaries, JV and associates	0				(c) 0
A181HC Elimination of investments in subsidiaries - Held company	-120 000			0	-120 000
A181OC Elimination of investments in subsidiaries - Owner company	120 000				120 000
A2210 Trade receivables, Gross	35 000			0	35 000
A2610 Cash on hand	100 000		(d) 15 000	0	115 000
Assets	**192 000**		**15 000**	**0**	**207 000**
Equity and liabilities					
E1110 Issued capital	120 000			0	120 000
E1210 Share premium				0	0
E1610 Retained earnings	65 000	(d) 15 000		0	80 000
L1410 Deferred income tax liability	2 000			0	2 000
L2310 Trade payables	5 000			0	5 000
L23CL Clearing account - Receivables and payables	0			0	0
Equity and liabilities	**192 000**	**15 000**		**0**	**207 000**

(a) Flow F00 shows the consolidated opening balance sheet
(b) Flow F70 is fully balanced (each account = 0)
→ Opening balance sheet of S71 is reversed on flow F70
→ Data entered on flow F70 at S7 side (package + MJE) balance the reversal of S71
→ The internal merger doesn't have any impact on the consolidated balance sheet
(c) Clearing accounts used to post the investment elimination are balanced at consolidation level
(d) S71 net income before the merger

The equity movements are explained below:

Figure 2- Report C31-12: Balance Sheet by flow, audit ID and reporting unit

			F00 Opening	F10 Net profit (loss) for the period	F70 Internal mergers	F99 Closing
Equity and liabilities						
E1110 Issued capital						
PACK01 Package data	P7		120 000			120 000
PACK01 Package data	S7	(b)	80 000		20 000	100 000
PACK01 Package data	S71	(a)	30 000		-30 000	
CONS10 Elimination of subsidiaries' capital and share premium	S7	(b)	-80 000		-20 000	-100 000
CONS10 Elimination of subsidiaries' capital and share premium	S71	(a)	-30 000		30 000	
Total Issued capital			**120 000**		**0**	**120 000**
E1210 Share premium						
PACK01 Package data	S7	(b)			65 000	65 000
CONS10 Elimination of subsidiaries' capital and share premium	S7				-65 000	-65 000
Total Share premium					**0**	**0**
E1610 Retained earnings						
PACK01 Package data	P7		20 000			20 000
PACK01 Package data	S7		5 000			5 000
PACK01 Package data	S71	(a)	40 000	15 000	-55 000	
FVA11 Fair value for incoming entities (central) - Man.	S7	(b)			4 000	4 000
FVA11 Fair value for incoming entities (central) - Man.	S71	(a)	4 000		-4 000	
CONS10 Elimination of subsidiaries' capital and share premium	S7	(b)	80 000		85 000	165 000
CONS10 Elimination of subsidiaries' capital and share premium	S71	(a)	30 000		-30 000	
GW10 Booking of goodwill and bargain purchase - Auto.	S7	(c)			6 000	6 000
GW10 Booking of goodwill and bargain purchase - Auto.	S71	(a)	6 000		-6 000	
INV10 Elimination of investments - Auto.	S7	(d)	-80 000		-40 000	-120 000
INV10 Elimination of investments - Auto.	S71	(a)	-40 000		40 000	
Total Retained earnings			**65 000**	**15 000**	**0**	**80 000**

(a) Opening amounts and net income from S71 are reversed on flow F70 (internal merger)

(b) S7 data entered (audit Ids PACK01, FVA11) and calculated (audit ID CONS10) on flow F70

(c) Goodwill is automaticaly posted on S7

(d) Investment elimination reversal trigerred by P7

Flow F70 doesn't have any impact on the equity

Analysis of account *E1610 Retained earnings*

Figure 3- Report C32-05: General Ledger by audit ID, share, JE number

Audit ID	Ledger - Number	Journal entry detail	F00 Opening	F10 Net profit (loss) for the period	F70 Internal mergers	F99 Closing
PACK01 - Package data	-	-	65 000	15 000	(a) -55 000	25 000
FVA11 - Fair value for incoming entities (central) - Man.	-	-	4 000		(a) -4 000	
FVA11 - Fair value for incoming entities (central) - Man.	CENTRAL - 20	Fair value adjustment due to the merger with S71 -			(b) 4 000	4 000
CONS10 - Elimination of subsidiaries' capital and share premium	-	-	110 000		(a) -30 000	80 000
CONS10 - Elimination of subsidiaries' capital and share premium	AUTOCO - 11	Reclassification of capital and share premium in retained			(c) 85 000	85 000
GW10 - Booking of goodwill and bargain purchase - Auto.	-	-	6 000		(a) -6 000	
GW10 - Booking of goodwill and bargain purchase - Auto.	AUTOCO - 5	Goodwill booking (gross and impairment) - F70 - GW-510			(c) 6 000	6 000
INV10 - Elimination of investments - Auto.	-	-	-120 000		(a) 40 000	-80 000
INV10 - Elimination of investments - Auto.	AUTOCO - 6	Elimination of investments - F70 - INV-710			(c) -40 000	-40 000
Total			**65 000**	**15 000**	**0**	**80 000**

Share analysis

Audit ID	Ledger - Number	Journal entry detail	Share	F00 Opening	F10 Net profit (loss) for the period	F70 Internal mergers	F99 Closing
GW10 - Booking of goodwill and bargain purchase - Auto.	-	-	P7	6 000		(a) -6 000	
GW10 - Booking of goodwill and bargain purchase - Auto.	AUTOCO - 5	Goodwill booking (gross and impairment) - F70 - GW-510	P7			(c) 6 000	6 000
INV10 - Elimination of investments - Auto.	-	-	P7	-120 000		(a) 40 000	-80 000
INV10 - Elimination of investments - Auto.	AUTOCO - 6	Elimination of investments - F70 - INV-710	P7			(c) -40 000	-40 000
Total				**-114 000**		**0**	**-114 000**

(a) Automated reversal of S71 amounts on flow F70 processed by the consolidation engine
(b) Manual JE n° 20 recognizing the fair value adjusment previously posted on S71
(c) Automated entry processed by rules and detailed by shares
→ Goodwill (Auto 5)
→ Investment elimination (Auto 6)
→ Reclassification capital, share premium (Auto 11)

HOW DOES THE INTERNAL MERGER AFFECT FINANCIAL STATEMENTS?

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

The internal merger between subsidiaries held at 100% doesn't affect the net equity and the changes that appear only come from the net income of the year.

Figure 4- Report C11-05: Statement of financial position

	F99 Closing	F00 Opening
Property, plant and equipment	51 000	51 000
Investment property		
Goodwill	6 000	6 000
Intangible assets		
Investments accounted for using equity method		
Biological assets		
Non-current receivables		
Deferred tax assets		
Other non-current financial assets	0	0
Other non-current assets		
Non-current assets	**57 000**	**57 000**
Inventories		
Trade and other current receivables	35 000	35 000
Current tax assets		
Current biological assets		
Other current financial assets		
Other current assets		
Cash and cash equivalents	115 000	100 000
Current assets other than non-current assets held for sale	**150 000**	**135 000**
Non-current assets or disposal groups classified as held for sale or as held for distribution to owners		
Current assets	**150 000**	**135 000**
Total assets	**207 000**	**192 000**

	F99 Closing	F00 Opening
Issued capital	120 000	120 000
Share premium	0	
Treasury shares		
Other reserves		
Retained earnings	80 000	65 000
Equity attributable to owners of parent	**200 000**	**185 000**
Non-controlling interests		
Total equity	**200 000**	**185 000**
Non-current provisions for employee benefits		
Other long-term provisions		
Non-current payables		
Deferred tax liabilities	2 000	2 000
Other non-current financial liabilities		
Other non-current liabilities		
Non-current liabilities	**2 000**	**2 000**
Current provisions for employee benefits		
Other short-term provisions		
Trade and other current payables	5 000	5 000
Current tax liabilities		
Other current financial liabilities		
Other current liabilities		
Current liabilities other than liabilities included in disposal groups	**5 000**	**5 000**
Liabilities included in disposal groups classified as held for sale		
Current liabilities	**5 000**	**5 000**
Total liabilities	**7 000**	**7 000**
Total equity and liabilities	**207 000**	**192 000**

As expected, the variation between opening and closing balance sheet comes from the net income of S71 (USD15,000)

STATEMENT OF CHANGES IN EQUITY

Figure 5- Report C11-30: Statement of Changes in Equity

	Issued capital	Share premium	Treasury shares	Other reserves	Retained earnings	Equity attributable to owners of parent	Non-controlling interests	Total equity
Balance at opening	120 000				65 000	185 000		185 000
Balance at opening as restated	**120 000**				**65 000**	**185 000**		**185 000**
Comprehensive income								
Balance at closing 2020.12	**120 000**				**65 000**	**185 000**		**185 000**
Balance at opening	120 000				65 000	185 000		185 000
Balance at opening as restated	**120 000**				**65 000**	**185 000**		**185 000**
Profit (loss)					15 000	15 000		15 000
Comprehensive income					**15 000**	**15 000**		**15 000**
Other movements	0	0			0	0		0
Balance at closing 2021.12	**120 000**	**0**			**80 000**	**200 000**		**200 000**

As expected, the internal merger doesn't impact in any way the consolidated financial statements.
The only variation comes from S71's net income of the year

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