RECOMMENDED ACCOUNTING PRACTICE **RAP 12**

Merger Accounting for Common Control Combinations for financial statements prepared under Part IX of the Fifth Schedule to the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005

The Statement of Recommended Accounting Practice, RAP 12, was approved by the Council of the Institute of Singapore Chartered Accountants (formerly known as Institute of Certified Public Accountants of Singapore) in December 2006.

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Although the provisions for this Recommended Accounting Practice (RAP) are not mandatory, entities falling within their scope are encouraged to comply with the recommendations set out in this RAP.

This RAP serves to address the revised “Financial Information” requirements for consolidated or combined financial statements under Part IX of the Fifth Schedule to the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005 ["SFR"]. Listing aspirants have to comply with the revised “Financial Information” requirements for prospectuses lodged on or after 15 April 2006.

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Introduction

1. This RAP serves to address only the revised "Financial Information" requirements for consolidated or combined financial statements under Part IX of the Fifth Schedule to the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005 ["SFR"]. Listing aspirants have to comply with the revised "Financial Information" requirements for prospectuses lodged on or after 15 April 2006. This RAP sets out the basic principles and procedures of merger accounting when recognising a common control combination. If there is any inconsistency between this RAP and any Financial Reporting Standard or Interpretation (collectively referred to as "FRSs"), that Standard or Interpretation is to be followed. Certain FRSs may contain guidance or requirements that are relevant for the accounting for a common control combination using merger accounting. For example, FRS 8 requires accounting policies to be applied consistently for similar transactions, FRS 27 *Consolidated and Separate Financial Statements* addresses consolidation principles and the treatment of a disposal of a subsidiary and FRS 37 *Provisions, Contingent Liabilities and Contingent Assets* addresses provisions for restructuring. Accordingly, an entity should apply that guidance or those requirements, instead of, or in addition to, the guidance set out in this RAP when applying merger accounting.

2. For annual periods beginning on or after 1 July 2004, Financial Reporting Standard (FRS) 103 *Business Combinations* applies to all business combinations except where a combination is specifically excluded from its scope. For those business combinations outside the scope of FRS 103, for example, business combinations involving entities or businesses under common control, there is no specific accounting standard addressing the appropriate accounting treatment.

3. FRS 103 (paragraphs 10 to 13) defines a business combination involving entities or businesses under common control as "a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory". Such business combinations are referred to hereafter in this RAP as "common control combinations" to distinguish them from other business combinations which fall within or outside the scope of FRS 103.

4. FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, paragraphs 10-12, contain requirements for the selection of accounting policies in the absence of a Standard or an Interpretation that specifically applies to an issue. Common control combinations fall outside the scope of FRS 103. Accordingly, an entity selects an appropriate accounting policy in accordance with the requirements set out in FRS 8 and many entities consider that merger accounting is an appropriate accounting policy for common control combinations.

The principles

5. The concept underlying the use of merger accounting to account for a business combination is that no acquisition has occurred and there has been a continuation of the risks and benefits to the controlling party (or parties) that existed prior to the business combination. Use of merger accounting recognises this by accounting for the combining entities or businesses as though the separate entities or businesses were continuing as before.

6. In applying merger accounting, financial statement items of the combining entities or businesses for the reporting period in which the common control combination occurs, and for any comparative periods disclosed, are included in the consolidated financial statements of the combined entity as if the combination had occurred from the date when the combining entities or businesses first came under the control of the controlling party or parties.

7. Where the combining entities or businesses include an entity or a business previously acquired from a third party, the financial statement items of such entity or business are only included in the consolidated financial statements of the combined entity from the date of the previous acquisition using the acquisition values recognised at that date.

8. A single uniform set of accounting policies is adopted by the combined entity. Therefore, the combined entity recognises the assets, liabilities and equity of the combining entities or businesses at the carrying amounts in the consolidated financial statements of the controlling party or parties prior to the common control combination. If consolidated financial statements were not previously prepared by the controlling party or parties, the carrying amounts are included as if such consolidated financial statements had been prepared, including adjustments required for conforming the combined entity's accounting policies and applying those policies to all periods presented. These carrying amounts are referred to below as ***existing book values from the controlling parties' perspective***. There is no recognition of any additional goodwill or excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of the common control combination to the extent of the continuation of the controlling party or parties' interests. Similarly, in accordance with FRS 27, the effects of all transactions between the combining entities or businesses, whether occurring before or after the combination, are eliminated in preparing the consolidated financial statements of the combined entity.

The procedures

9. The practical effects of merger accounting are that:

   (a) the net assets of the combining entities or businesses are consolidated using the existing book values from the controlling parties' perspective (see paragraph 9). The assets and liabilities of the acquired entity or business should be recorded at the book values as stated in the financial statements of the controlling party (i.e. it will require recording of the fair value of the identifiable assets and liabilities of the acquired entity or business at the date of original acquisition from third parties by the controlling party, any remaining goodwill arising on the previous acquisition and minority interests recorded in the consolidated financial statements of the controlling party). When the controlling party does not prepare financial statements, the carrying amounts of the acquired entity are included as if such consolidated financial statements had been prepared;

   (b) no amount is recognised as consideration for goodwill or excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of common control combination, to the extent of the continuation of the controlling party or parties' interests; and

   (c) comparative amounts in the financial statements are presented using the principles as set out in paragraph 10(a) above as if the entities or businesses had been combined at the previous balance sheet date unless the combining entities or businesses first came under common control at a later date.

10. The consolidated income statement includes the results of each of the combining entities or businesses from the earliest date presented (ie. including the comparative period) or since the date when the combining entities or businesses first came under the control of the controlling party or parties, where this is a shorter period, regardless of the date of the common control combination. The consolidated income statement also takes into account the profit or loss attributable to the minority interest recorded in the consolidated financial statements of the controlling party.

11. Expenditure incurred in relation to a common control combination that is to be accounted for by using merger accounting is recognised as an expense in the period in which it is incurred. Such expenditure includes professional fees, registration fees, costs of furnishing information to shareholders, and salaries and other expenses involved in achieving the common control combination. It also includes any costs or losses incurred in combining operations of the previously separate businesses.

12. Consolidation is performed in accordance with FRS 27. The principal consolidation entries are as follows:

    (a) the effects of all transactions between the combining entities or businesses, whether occurring before or after the common control combination, are eliminated; and

    (b) since the combined entity will present one set of consolidated financial statements, a uniform set of accounting policies is adopted which may result in adjustments to the assets, liabilities and equity of the combining entities or businesses.

Accounting period covered by a newly formed parent

13. A common control combination may be effected by setting up a new parent which acquires the issued shares or equity of the combining entities or businesses in exchange for the issue of its own shares. In such cases, the first accounting period of the new parent will frequently be a period of less than a year, ending on the balance sheet date chosen for the group. This will normally be the existing balance sheet date of one or more of the combining entities or businesses.

14. Frequently, the date of formation of the new parent will not coincide with the beginning or end of the group's accounting periods. Strictly, if the parent is a Singapore incorporated company, Section 200(1) of the Companies Act, Cap. 50 requires the consolidated financial statements to cover the accounting period of the parent. It could be argued that this requirement prevents the disclosure of comparative information. In substance, however, where the combining entities or businesses are continuing to trade as before, but with a new legal parent, it is appropriate to prepare consolidated financial statements as if the parent had been in existence throughout the reported periods presented with a prominent footnote explaining the basis on which consolidated financial statements are prepared.

15. Where the combining entities or businesses have been under common control but have not formed a legal group as at the end of the group’s latest reporting period, the financial statements of the entities or businesses may, if meaningful, be presented on a combined basis (as distinct from consolidated financial statements) provided that the common control combination under which the legal group is formed is completed before the date of approval of the combined financial statements by the directors.

Disclosures in addition to those required by applicable FRSs

16. Entities shall disclose the accounting policy applied in accounting for a common control combination by using the principles of merger accounting. Details of the accounting policy shall include, but not be limited to, a discussion of the specific principles and bases applied under merger accounting.

17. Bearing in mind the necessity of showing a true and fair view, entities applying this RAP shall disclose in their consolidated financial statements significant details of the common control combinations.

18. For each common control combination accounted for by using merger accounting, the following information shall be disclosed:

    (a) the names of the combining entities (other than the reporting entity);

(b) the date of the common control combination;

(c) the composition of the consideration and fair value of the consideration other than shares issued;

(d) the nature and amount of significant accounting adjustments made to the net assets and net profit or loss of any entities or businesses to achieve consistency of accounting policies, and an explanation of any other significant adjustments made to the net assets and net profit or loss of any entity or business as a consequence of the common control combination; and

(e) a statement of the adjustments to consolidated reserves.

Earnings per share

19. Ordinary shares issued as part of a common control combination which is accounted for using merger accounting are included in the calculation of the weighted average number of shares for all periods presented because the consolidated financial statements of the combined entity are prepared as if the combined entity had always existed. Therefore, the number of ordinary shares used for the calculation of basic earnings per share in a common control combination which is accounted for using merger accounting is the aggregate of the weighted average number of shares of the entity whose shares are outstanding after the combination.

APPENDIX 1

Numerical Example

This Appendix does not form part of the RAP and is included for illustrative purposes only. The examples are not intended to cover all possible scenarios.

Background information

Entity P has a number of subsidiaries. This example looks at three subsidiaries – Entity X, Entity Y and Entity A.

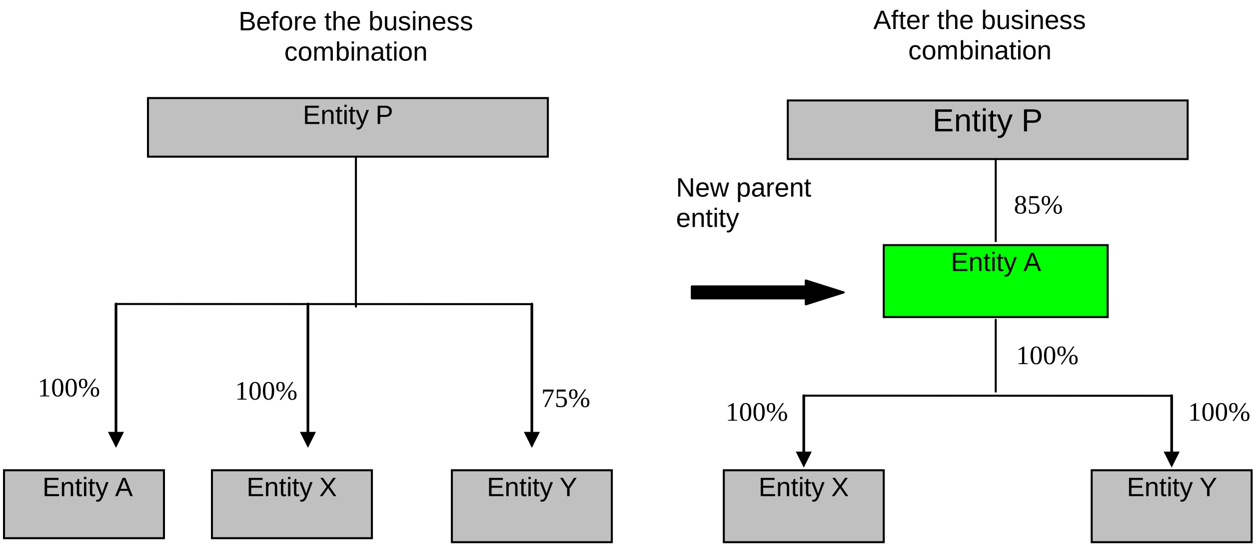
Entity P acquired 100% of Entity X for $18,000 many years ago. At that time, Entity P recorded goodwill of $3,000 and fair value of identifiable assets acquired of $15,000 (which is equal to the then carrying amounts of the assets acquired).

Entity P set up Entity Y with a party outside the group, Shareholder S, many years ago. Entity P's cost of investment in Entity Y was $15,000, being 75% of the share capital of Entity Y.

On 1 January 20X0, Entity P formed a new entity, Entity A, through share capital injection of $10,000.

On 31 December 20X1, Entity A acquired 100% shareholdings in Entity X and Entity Y from Entity P and Shareholder S. In return, Entity A issued 7,000 and 3,000 ordinary shares with par value of $1 each to Entity P and Shareholder S, respectively. Entity A, Entity X and Entity Y have financial year ends of 31 December. The fair values of assets and liabilities of Entity Y as at 31 December 20X1 are equal to their carrying values.

Ignore any tax effect arising from the business combination.



The income statements of Entity A, Entity X and Entity Y for the year ended 31 December 20X1 are:

	Entity A	Entity X	Entity Y
	$	$	$
Revenue	2,000	40,000	50,000
Profit or loss	(4,000)	20,000	20,000

The balance sheets of Entity A, Entity X and Entity Y as at 31 December 20X1 are:

	Entity A (before issue of shares)	Entity A (after issue of shares#)	Entity X	Entity Y
	$	$	$	$
Investment in subsidiaries	-	223,000	-	-
Other assets	5,000	5,000	100,000	120,000
Net assets	5,000	228,000	100,000	120,000
Capital (including share premium)	10,000	233,000	10,000	20,000
Accumulated profits (losses)	(5,000)	(5,000)	90,000	100,000
	5,000	228,000	100,000	120,000

\# The 10,000 new shares issued by Entity A as consideration are recorded at a value equal to the deemed cost of acquiring Entity X and Entity Y ($223,000). The deemed cost of acquiring Entity X is $103,000, being the existing book values of net assets of Entity X as at 31 December 20X1 ($100,000) plus remaining goodwill arising on the acquisition of Entity X by Entity P ($3,000). The deemed cost of acquiring Entity Y is $120,000, being the existing book values of net assets of Entity Y as at 31 December 20X1. The deemed cost used in this example is for illustrative purposes only and does not necessarily represent the value to be reported in the individual financial statements of Entity A as the cost of acquiring the subsidiaries.

The income statements of Entity A, Entity X and Entity Y for the year ended 31 December 20X0 are:

	Entity A	Entity X	Entity Y
	$	$	$
Revenue	1,000	38,000	45,000
Profit or loss	(2,000)	15,000	12,000

The balance sheets of Entity A, Entity X and Entity Y as at 31 December 20X0 are:

	Entity A	Entity X	Entity Y
	$	$	$
Net assets	9,000	80,000	100,000
Capital (include share premium)	10,000	10,000	20,000
Accumulated profits (losses)	(1,000)	70,000	80,000
	9,000	80,000	100,000

Analysis

As Entity A, Entity X and Entity Y are under the common control of Entity P before and after the business combination, the business combination is specifically excluded from the scope of FRS 103.

The directors of Entity A choose to account for the acquisition of the shareholdings in Entity X and Entity Y using the principles of merger accounting.

Under the principles of merger accounting, the assets and liabilities of Entity X and Entity Y are consolidated in the financial statements of Entity A using the existing book values as stated in the consolidated financial statements of Entity P immediately prior to the combination. This procedure requires recording of goodwill arising on the original acquisition of Entity X by Entity P and minority interests in Entity Y as stated in the consolidated financial statements of Entity P immediately prior to the combination. There is no recognition of any additional goodwill or excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of this combination.

The consolidated income statement of Entity A for the year ended 31 December 20X1 is:

	Entity A	Entity X	Entity Y	Adjustment		Consolidated
	$	$	$	$	Adj	$
Revenue	2,000	40,000	50,000			92,000
Profit or loss	(4,000)	20,000	20,000			36,000
Attributable to the former minority interest in Entity Y				5,000	(Y1) Y	(5,000)
Attributable to the equity holders of Entity A						31,000

Adjustment:

(Y1) Being an adjustment to reflect the profit attributable to the minority interest in Entity Y prior to the combination.

The consolidated balance sheet of Entity A as at 31 December 20X1 is:

	Entity A	Entity X	Entity Y	Adjustments		Consolidated
	$	$	$	$	Adj	$
Goodwill				3,000	(X1)	3,000
Investments in Entity X and Entity Y	223,000	-	-	(103,000) (120,000)	(X3) (Y5)	-
Other assets	5,000	100,000	120,000			225,000
Net assets	228,000	100,000	120,000			228,000
Capital (include share premium)	233,000	10,000	20,000	(10,000) (20,000)	(X3) (Y5)	233,000
Other reserve	-	-	-	(85,000) (75,000)	(X3) (Y5)	(160,000)
Accumulated profits (losses)	(5,000)	90,000	100,000	(5,000) (25,000)	(X2) (Y4)	155,000
	228,000	100,000	120,000			228,000

Adjustments

Relating to Entity X:

(X1) Being an adjustment to record goodwill arising on the original acquisition of Entity X by Entity P as stated in the consolidated financial statements of Entity P immediately prior to the combination ($3,000).

(X2) Being an adjustment to eliminate the accumulated profits of Entity X generated prior to the original acquisition of Entity X by Entity P ($5,000).

(X3) Being an adjustment to eliminate the share capital of Entity X against the related investment cost of Entity A. An adjustment of $85,000 has been made to a separate reserve in the consolidated financial statements of Entity A.

Relating to Entity Y:

(Y4) Being an adjustment to reflect the profits attributable to the minority interest in Entity Y prior to the combination.

(Y5) Being an adjustment to eliminate the share capital of Entity Y against the related investment cost of Entity A. An adjustment of $75,000 has been made to a separate reserve in the consolidated financial statements of Entity A.

The consolidated income statement of Entity A for the year ended 31 December 20X0

	Entity A	Entity X	Entity Y	Adjustment		Consolidated
	$	$	$	$	Adj	$
Revenue	1,000	38,000	45,000			84,000
Profit or loss	(2,000)	15,000	12,000			25,000
Attributable to the minority interest				3,000	(Y1)	(3,000)
Attributable to the equity holders of Entity A						22,000

Adjustment:

(Y1) Being an adjustment to reflect the profit attributable to the minority interest in Entity Y.

The consolidated balance sheet of Entity A as at 31 December 20X0 is:

	Entity A	Entity X	Entity Y	Adjustments		Consolidated
	$	$	$	$	Adj	$
Goodwill				3,000	(X2)	3,000
Investments in Entity X and Entity Y	-	-	-	193,000	(1)	-
				(103,000)	(X4)	
				(90,000)	(Y5)	
Other assets	9,000	80,000	100,000			189,000
Net assets	9,000	80,000	100,000			192,000
Capital (include share premium)	10,000	10,000	20,000	193,000	(1)	203,000
				(10,000)	(X4)	
				(20,000)	(Y5)	
Other reserve	-	-	-	(85,000)	(X4)	(160,000)
				(75,000)	(Y5)	
Minority interests	-	-	-	25,000	(Y5)	25,000
Accumulated profits /(losses)	(1,000)	70,000	80,000	(5,000)	(X3)	124,000
				(20,000)	(Y5)	
	9,000	80,000	100,000			192,000

Note: The comparative figures are restated as if the entities had been combined at the previous balance sheet date. The consolidated share capital represents the share capital of Entity A adjusted for the share capital issued for the purposes of the business combination.

<u>Adjustments</u>

(1) Being an adjustment to push back the capital issued for the purposes of the business combination ($193,000, of which $103,000 relating to Entity X and $90,000 relating to Entity Y). The aim of the consolidated financial statements in merger accounting is to show the combining entities' results and financial positions as if they had always been combined. Consequently, the share capital in respect of 7,000 shares issued for the purposes of the business combination has to be shown as if it had always been issued.

Relating to Entity X:

(X2) Being an adjustment to record goodwill arising on the original acquisition of Entity X by Entity P as stated in the consolidated financial statements of Entity P immediately prior to the combination ($3,000).

(X3) Being an adjustment to eliminate the accumulated profits of Entity X generated prior to the original acquisition of Entity X by Entity P ($5,000).

(X4) Being an adjustment to eliminate the share capital of Entity X against the related investment cost of Entity A. An adjustment of $85,000 has been made to a separate reserve in the consolidated financial statements of Entity A.

Relating to Entity Y:

(Y5) Being an adjustment to eliminate the share capital of Entity Y against the related investment cost of Entity A. Prior to the business combination, Entity P only had 75% equity interest in Entity Y. Minority interests of $25,000 was recorded as at 31 December 20X0. An adjustment of $75,000 has been made to a separate reserve in the consolidated financial statements of Entity A.

Earnings per share

Based on the same facts as per the above example, the calculation of basic earnings per share for each period presented in the consolidated financial statements of Entity A is based on the consolidated profit (excluding the profit attributable to the minority interests), and on the 20,000 shares (comprising 10,000 shares of Entity A in issue throughout the two years ended 31 December 20X1 and 10,000 shares of Entity A issued on 31 December 20X1 as consideration for the equity interests in Entity X and Entity Y).

APPENDIX 2

Examples of situations where this RAP may be applicable

The following are some examples:

a. An entity incorporates a newly formed entity and then transfers some or all of its business to that newly incorporated entity.

b. A parent company transfers the business of a wholly owned subsidiary into the parent company and liquidates the subsidiary. That transaction is a change in legal organisation but not a change in the reporting entity.

c. A parent company transfers its interest in several partially owned subsidiaries to a new wholly owned subsidiary. That also is a change in legal organisation but not in the reporting entity.

d. A parent company exchanges its ownership interests or the business of a wholly owned subsidiary for additional shares issued by the parent's partially owned subsidiary, thereby increasing the parent's percentage of ownership in the partially owned subsidiary but leaving all of the existing minority interest outstanding.