

[www.pwc.com](http://www.pwc.com)

*Are you  
planning a  
holding  
company  
structure?*



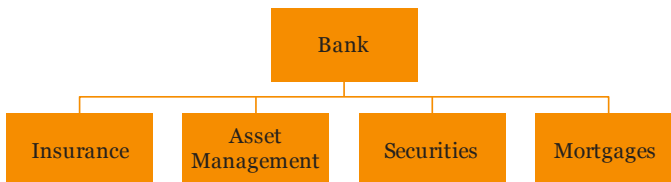
**pwc**

## Introduction

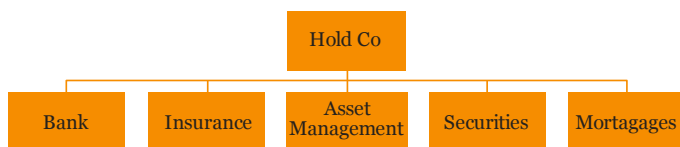
As part of its initiatives to reform the Nigerian financial system, the Central Bank of Nigeria (“CBN”) is currently reviewing its Universal Banking Policy. The CBN has published several circulars containing proposals to achieve the reform, including the “Regulation on the scope of banking activities and ancillary matters, no. 3”. The regulations contained in this circular will radically overhaul the banking sector in Nigeria as it currently operates.

These regulations, which came into effect on 15 November 2010, require all banks to divest from non-banking business. In an earlier draft circular – “Review of the universal banking model” published in March, the CBN did however acknowledge that some banking groups may wish to retain non-core banking businesses; and as such have proposed that these groups evolve into a new holding company model, whereby a non-operating holding company (“HoldCo”) holds the investments in the bank and each non-core banking operation in a subsidiary arrangement. These groups will be required to comply with the CBN’s guidelines for the establishment of HoldCos, which will include a detailed business case for engaging in any non-core banking operation. Subsidiary banks will be licensed and regulated by the CBN and each other subsidiary (non-core banking business) will be licensed and regulated by the relevant functional Regulator. The main aim of the CBN’s proposed new model is the protection of depositors by “ring fencing” banking business from non -banking activities.

Although the current corporate structure of the banking groups in Nigeria may vary, it is common for the bank to be the parent company of the group, as illustrated below.



This structure would however not be allowed in accordance with the new proposals and in its draft circular issued in March 2010, the CBN proposed the following illustrative holding company structure:



The above structure can be achieved through a number of restructuring options available to banking groups, each of which will have different accounting implications on the various entities within the group. In addition to the changes proposed by the CBN, banks will also have to take cognisance of the changes to the financial reporting landscape in order to assess these accounting implications.

### ***Why do I need to consider IFRS when planning a Holding Company structure?***

Adoption of International Financial Reporting Standards (“IFRS”) is a reality in Nigeria and any restructuring activities carried out in order to achieve the desired holding company structure will likely be accounted for in accordance with IFRS. All listed and significant public interest entities (including banks) are required to adopt IFRS for years ending on or after 1 January 2012. The adoption of IFRS does not only entail preparing financial statements in conformity with IFRS for the first time in 2012, but also the preparation of an opening IFRS balance sheet on transition date and IFRS compliant comparative information. The first IFRS financial statements of a bank with a December year-end will therefore include a Statement of financial position (Balance sheet) as at 31 December 2012, 31 December 2011 and 1 January 2011, the date of transition to IFRS.

In preparing the first set of IFRS financial statements, an entity is required to apply IFRS 1 – “First time adoption of IFRS”. The key principle of this standard is full retrospective application of all IFRS accounting standards effective at the first IFRS reporting date. IFRS 1 provides limited exemptions from full retrospective application, including an exemption to restate business combinations that occurred prior to transition date. Group reorganisations occurring subsequent to transition date should however be accounted for in accordance with IFRS and thus the requirements of IFRS 3(Revised) “Business combinations” should be considered. Accounting for a transaction in accordance with IFRS 3R requires significant effort and disclosure. The CBN has indicated in the March draft circular that it will allow a fifteen month grace period from when these proposals become effective, for all banks to transition to the HoldCo structure, indicating that most of these

activities will be undertaken in the period between transition date and the first IFRS reporting date. It is therefore imperative for banks to carefully consider how the restructuring is undertaken and whether IFRS 3R will be applicable. IFRS 3R is applicable to transactions or other events in which an acquirer obtains control of one or more businesses, but the standard scopes out a combination of entities under common control.

The CBN specifically requires the holding company to be a non-operating company who will only be allowed to acquire, hold and administer permitted investments. The current guidelines issued by the CBN do not prescribe how the holding company structure should be achieved, but a number of options are available to the banks. These include;

1. The formation of a new HoldCo, which will acquire the Bank through a share-for-share exchange. The HoldCo will subsequently acquire each of the Bank's non-core banking subsidiaries by way of purchase or through a dividend in specie declared by the Bank. The subsequent acquisition of these subsidiaries by the HoldCo can also be achieved by implementing a capital reduction scheme under the Companies and Allied Matters Act ("CAMA") that is settled by transfer of shares in subsidiaries to the Bank's shareholders (now the Holdco).
2. The Bank, being the current parent company of the group can set up a new bank which obtains an appropriate banking license as a subsidiary company. The Bank then transfers all its banking assets and liabilities to the new company, surrenders its current banking license and applies for a holding company license from the CBN. The Bank (now the non-operating holding company) remains the parent of all the other non-core banking subsidiaries.

Although the second option may be popular due to its relative simplistic implementation, the restructuring activities required for each banking group may vary, depending on their existing group structure. In most instances however, the reorganisation will require the transfer of ownership of both the banking and non-core banking subsidiaries. The accounting treatment of these transactions in the stand-alone financial statements of the Bank and the holding company will be dependent on, and vary according to how the reorganizational activities are undertaken.

However, this article will focus on the rationale and considerations in arriving at the ultimate consolidated position of the banking group,

and does not aim to address all the accounting implications for each of the individual subsidiary undertakings and holding company. Each of the reorganizational options mentioned is separately considered below.

### ***Option one: Formation of a new HoldCo***

When evaluating the accounting implications of such a reorganisation, it is important to determine under which standard it should be accounted for. Transactions where an entity obtains control of another entity (which is generally evidenced by voting rights attached to ownership) should be considered in the framework of IFRS 3R. Because the reorganisation will require the transfer of ownership of the banking and non-core banking subsidiaries, the scope of IFRS 3R is firstly considered. IFRS 3R specifically scopes out a business combination between “*entities or businesses under common control*”. A combination between entities or businesses under common control is defined in IFRS 3R 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*”. In order for the reorganisation to be regarded as a common control transaction, the controlling party of the current parent should therefore also be the controlling party of the new Holdco after the reorganisation. The controlling party has the “*power to govern the financial and operating policies of the entity, so as to obtain benefits from its activities*”. In a scenario where the shareholding of the Bank is dispersed amongst a number of shareholders, as typically the case with listed entities would be, the group of individuals is regarded as controlling the Bank **only** when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies. Therefore, in order for this exemption to apply to the formation of the new HoldCo structure as described above, there has to be more than a common body of shareholders before and after the reorganisation. In the absence of a contractual arrangement between shareholders, the exemption for common control transactions does not apply to the formation of the new HoldCo structure.

### ***Applying IFRS 3 (Revised)***

Following from the conclusion that the formation of the new HoldCo structure would likely not meet the definition of a common control transaction, the requirements of IFRS 3R is further considered. IFRS 3R requires business combinations to be accounted for using the

acquisition method. The acquisition method views the business combination from the perspective of the acquirer. Applying this method therefore firstly involves identifying the acquirer. The standard provides guidance for the identification of this party, but also contains an explicit statement that if a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination will need to be identified as the acquirer. In the likely scenario where a new HoldCo is placed on top of the existing group as discussed above, the new HoldCo will not be regarded as the acquirer in terms of the standard.

However, it is unlikely that the new HoldCo will meet the definition of a business contained in IFRS 3R, which is defined as: “*a business consists of inputs and processes applied to those inputs that have the ability to create outputs*”. Because the HoldCo is required by the new CBN regulations to be a non-operating entity and on formation does not have any inputs or processes it will not be regarded as a business, and ***as such this transaction is not a business combination***, as the standard require the acquiree to be a business. Rather, it is a reorganisation of the existing reporting entity and should be accounted for as such.

There is no specific guidance in IFRS when a new entity is placed on top of an existing group in this manner. From the ultimate consolidated group's perspective the transfer of ownership of the Bank and non-core banking subsidiaries to a new HoldCo lacks commercial substance as there has been no change in the assets and liabilities of the group; and the shareholders' absolute and relative interest in the group's net assets remains unchanged by the transaction. Consequently, the consolidated assets and liabilities of the banking group before and after the transaction would remain unchanged as it would not be adjusted to fair value.

In order to reflect the substance of the transaction, the consolidated financial statements of the new HoldCo would be presented using the values from the previous group holding company (i.e Bank consolidated level), whilst reflecting the equity structure (the issued share capital) of the new HoldCo.

### ***Option two: Formation of a new subsidiary bank***

When considering option two, it is apparent that the formation of a new banking subsidiary below the existing parent (the Bank) does not impact on the ultimate consolidated group position, as the consolidated net assets of the group remains unchanged. Whether

the banking assets and liabilities are held in the Bank (now the non-operating Holdco after obtaining the holding company licence), or in the new banking subsidiary, the ultimate consolidated position remains unchanged.

### ***Keeping it in the group***

For entities opting to achieve the holding company model through the reorganisation outlined in option one, further consideration should be given to the subsequent transfer of the non-core banking subsidiaries to the new HoldCo. Following from the initial formation of the HoldCo and acquisition of the Bank, the transfer of the non-core banking subsidiaries to the new HoldCo can be achieved by either a purchase, by means of a dividend in specie from the Bank to the HoldCo or by means of a scheme of capital reduction under CAMA that is settled by transfer of shares in the subsidiaries. The transfer of ownership within the group does not have an impact on the ultimate consolidated financial statements. These transactions will not be regarded as business combinations as the group already controls the non-core banking subsidiaries.

### ***What about stand alone and consolidated intermediate holding company financial statements?***

The accounting implications of the reorganizational activities should however also be considered for stand-alone financial statements, and consolidated financial statements prepared by intermediate holding companies. When control of subsidiaries is transferred between intermediate holding companies, these transactions may be regarded as common control transactions from the perspective of the consolidated intermediate group. Transactions involving entities and activities under common control remain outside the scope of IFRS 3R. In the absence of explicit guidance under another standard, the acquirer may elect to apply fair value measurement by reference to the current standard (IFRS 3R) “Acquisition accounting”, or the historical book values of the acquired assets and liabilities, without recognising goodwill, known as predecessor “Predecessor accounting”. This constitutes an accounting policy choice, which should be consistently applied to similar transactions. Companies transferring ownership are however required to apply the explicit requirements of IFRS and in particular the loss of control guidance in IAS 27 (Revised) “Consolidated and Separate Financial Statements”. These requirements are not addressed in the article.

A number of other factors, such as ease of implementation, may an

compel a banking group to transfer the ownership by means of a dividend in specie distribution. Distributions to owners of this nature are generally accounted for in the stand alone financial statements of the distributing entity in accordance with a specific interpretation of IFRS, IFRIC 17 – “Distributions of non-cash assets to owners”. However, this interpretation also scopes out distributions of non-cash assets that are ultimately controlled by the same party. Hence, an entity can elect to apply the requirements in IFRIC 17 and recognise the distribution at fair value. Alternatively, an entity will be allowed to account for the distribution at the carrying amount of the investment before the distribution. Whichever accounting policy is selected should be applied consistently to other similar transactions.

A banking group may also wish to avoid the potential tax impact of an in specie dividend payment and opt for a reorganisation (capital reduction) scheme under Nigerian company law and settle the refund of capital by transfer of its equity interest in the subsidiaries to its shareholders (the Holdco). The substance of the transaction would be a distribution of non-cash assets to owners which would be accounted for in accordance with IFRIC 17 as described above.

### **Conclusion**

Many banks in Nigeria are faced with a potential reorganisation as a result of the new regulations by the CBN. In addition to the ever increasing regulations, banks are also required to convert to IFRS. Accounting for these reorganisations under IFRS can be complex; and may differ significantly from bank to bank based on the way in which the reorganisation is executed. Banks will therefore need to consider the accounting implications of all potential restructuring options available, taking into account the existing group structure, the bank's strategy and the desired business model. In its March draft circular, the CBN outlined its expectation that the transition to a holding company structure will be completed in a period of twelve to eighteen months. This is a relatively short time frame to assess and implement such a reorganisation programme. Without having the luxury of time, the management of banks will need to take appropriate action now.

### **Contact:**

**Tony Oputa**

Partner

Phone: +234 01 2711700 ext. 4203

E-mail: [tony.oputa@ng.pwc.com](mailto:tony.oputa@ng.pwc.com)