CHAPTER 12

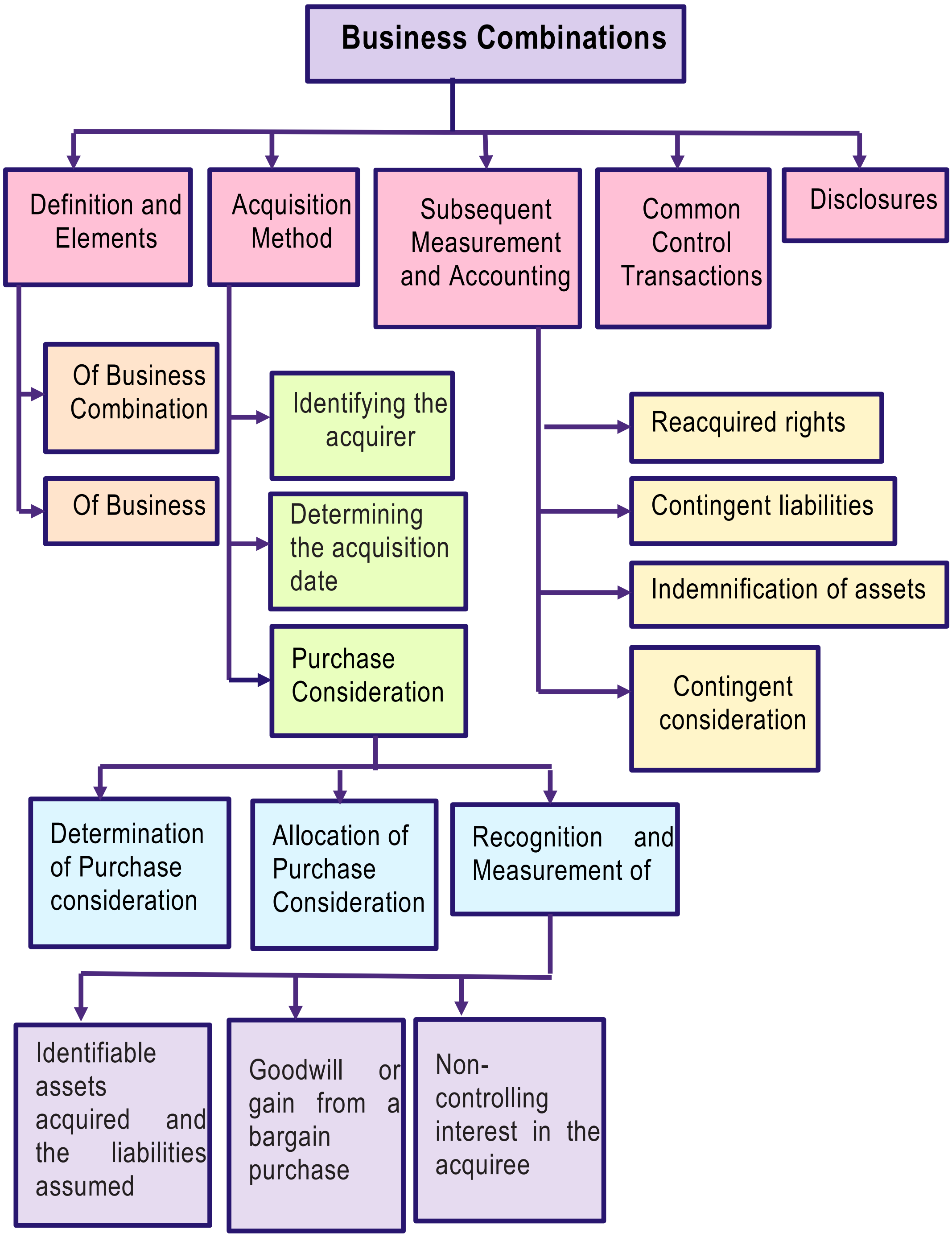
INDIAN ACCOUNTING STANDARD 103: BUSINESS COMBINATIONS

LEARNING OUTCOMES

After studying this chapter, you would be able to:

- Explain various terms used in Ind AS 103 "Business Combinations"
- Examine the key differences between Ind AS 103 and Accounting Standard 14
- Identify the acquiring enterprise
- Determine the acquisition date, purchase consideration under various situations and contingent consideration
- Allocate the purchase price
- Recognize the assets and liabilities of the acquired entity
- Examine the measurement principles
- Calculate goodwill or bargain purchase
- Evaluate contingent payments to employee shareholders and acquirer share-based payment awards exchanged for awards held by the acquiree's employees
- Integrate subsequent measurement and accounting principles for reacquired rights, contingent liabilities, indemnification assets and contingent consideration
- Appraise the disclosure requirements in case of Business Combination
- Account for distribution of non-cash assets to owners as dividend in accordance with Appendix A Distribution of Non-Cash Assets to Owners of Ind AS 10 Events after the Reporting Period.

CHAPTER OVERVIEW



1. INTRODUCTION

The necessity of a standard on Business Combination in India assumes importance considering the fact that Indian companies are increasingly stretching their business in foreign countries for best-fit business combinations. Presently in India, Accounting Standard (AS) 14 'Accounting for Amalgamation' lays out specific treatment for Amalgamation and AS 21, 'Consolidated Financial Statements' are applied for consolidation. However, it is not matching the global financial reporting standards requirements.

After convergence of IFRS as Ind AS, Ind AS 103 which is in line with IFRS 3 takes care of the global requirements in case of business combinations worldwide.

A **business combination** is a transaction in which the acquirer obtains control of another business (the acquiree).

The term **'business'** is defined as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing ***goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.***

Business combinations are most common form of business transactions through which companies grow in size rather than organic activities.

Business combination or acquisition is different from asset acquisition. The following are the key differences in accounting of an asset acquisition and a business combination:

Particulars	**Business Combination**	**Acquisition of group of assets under Ind AS**
Intangible assets, including goodwill	Intangible assets are recognised at fair value, if they are separately identifiable. Goodwill is recognised as a separate asset.	Intangible assets acquired as part of a group of assets would be recognised and measured based on an allocation of the overall cost of the transaction with reference to their relative fair values. No goodwill would be recognised.
Transaction Costs	In a business combination, acquisition-related costs (including stamp duty) are	Transaction costs are capitalised as a component of the cost of the assets acquired.

	expensed in the period in which such costs are incurred and are not included as part of the consideration transferred.	
Deferred Tax Accounting	Deferred taxes are recorded on temporary differences of assets acquired (other than goodwill) and liabilities assumed in a business combination.	Ind AS prohibits recognition of deferred taxes for temporary differences that arise upon initial recognition of an asset or liability in a transaction which (i) is not a business combination and (ii) at the time of the transaction, affects neither accounting nor taxable income. [Ind AS 12 paragraph 15]. Accordingly, no deferred taxes are recognised for temporary differences on asset acquisitions (on initial recognition).
Situations where the fair value of the assets acquired and liabilities assumed exceeds the fair value of consideration Transferred (referred to as gain on bargain purchases)	If the fair value of the assets acquired and liabilities assumed exceeds the fair value of the consideration transferred (plus the amount of non-controlling interest and the fair value of the acquirer's previously held equity interests in the acquiree), a gain is recognised by the acquirer in other comprehensive income and accumulate the same in equity as capital reserve.	The assets acquired and liabilities assumed are measured using an allocation of the fair value of consideration transferred based upon relative fair values. As a result, no gain is recognised for a bargain purchase.
Contingent liabilities assumed	To be recognised if represents present obligation that arises from past events and its fair value can be measured reliably with subsequent changes to profit or loss.	Not recognised, subject to Ind AS 37.

Illustration 1: Asset acquisition

An entity acquires an equipment and a patent in exchange for ₹ 1,000 crore cash and land. The fair value of the land is ₹ 400 crore and its carrying value is ₹ 100 crore. Fair values of the equipment and patent are estimated to be ₹ 500 crore and ₹ 1,000 crore, respectively. The equipment and patent relate to a product that has just recently been commercialised. The market for this product is still developing.

Assume the entity incurred no transaction costs. For ease of convenience, the tax consequences on the gain have been ignored.

State how should the transaction be accounted for.

Solution

As per paragraph 2(b) of Ind AS 103, the standard does not apply to "the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in Ind AS 38, Intangible Assets) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill". In the given case, the acquisition of equipment and patent does not represent acquisition of a business as equipment and patent relate to a product that has just recently been commercialised.

The cost of the asset acquisition is determined based on the fair value of the assets given, unless the fair value of the assets received is more reliably determinable. In the given case, the fair value measurement of the land appears more reliable than the fair value estimate of the equipment and patent. Thus, the entity should record the acquisition of the equipment and patent as ₹ 1,400 crore (the total fair value of the consideration transferred).

Thus, the fair value of the consideration given, i.e., ₹ 1,400 crore is allocated to the individual assets acquired based on their relative estimated fair values. The entity should record a gain of ₹ 300 crore for the difference between the fair value and carrying value of the land.

The equipment is recorded at its relative fair value ((₹ 500 / ₹ 1,500) × ₹ 1,400 = ₹ 467 crore).

The patent is recorded at its relative fair value ((₹ 1,000 / ₹ 1,500) × ₹ 1,400 = ₹ 933 Crore).

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2. SCOPE UNDER IND AS 103

This Indian Accounting Standard applies to a transaction or other event that meets the definition of a business combination. This Indian Accounting Standard does not apply to:

(a) the formation of a joint arrangement.

(b) the acquisition of an asset or a group of assets that does not constitute a business i.e. it is an asset acquisition.

3. DEFINITION OF BUSINESS COMBINATION

Under Ind AS 103, Business combination occurs when an entity obtains **control** of a **business** by acquiring net assets or acquiring its significant equity interest. An entity can obtain control of a business by contract only in which case the acquirer would neither have acquired net assets nor equity interest. In such a case, while preparing balance sheet, controlling interest would be zero and non-controlling interest will be 100%.

- As such, two elements are required for a transaction to be a business combination under Ind AS 103:
  - the acquirer obtains control of an acquiree ("control" as defined in Ind AS 110); and
  - the acquiree is a business
- An acquirer might obtain control of an acquiree in a variety of ways, for example:
  - by transferring cash, cash equivalents or other assets (including net assets that constitute a business);
  - by incurring liabilities;
  - by issuing equity interests;
  - by providing more than one type of consideration; or
  - without transferring consideration, including by contract alone.

- A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:
  - one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;
  - one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;
  - all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or
  - a group of former owners of one of the combining entities obtains control of the combined entity.

4. DEFINITION AND ELEMENTS OF BUSINESS

4.1 Definition of Business

As per paragraph B7 of the application guidance of Ind AS 103, a business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. Although businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as a business.

Analysis: Ind AS 103 defines business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

For a transaction to meet the definition of a business combination (and for the acquisition method of accounting to apply), the entity must gain control of an integrated set of assets and activities that is more than a collection of assets or a combination of assets and liabilities. It will be straightforward in most cases to determine whether a business has been acquired. A business would normally be carrying out a continuing trade with identifiable revenue. This means that the assets or combination of assets and liabilities of the acquired entity interact with each other and, importantly, with the people who operate the assets as a business. However, determining whether a business has been acquired may not be easy and in some cases will require judgement.

4.2 Elements of Business

The three elements of a business are defined as follows:

(a) **Input**: Any economic resource that creates outputs or has the ability to contribute to the creation of outputs, when one or more processes are applied to it.

> **Example:**
>
> Non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.

(b) **Process**: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates output or has the ability to contribute to the creations of outputs.

> **Example:**
>
> Strategic management processes, operational processes and resource management processes.

These processes typically are documented, but the intellectual capacity of an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)

(c) **Output**: The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities.

4.3 Further Assessment

To be capable of being conducted and managed for the purpose identified in the definition of a business, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs.

Therefore, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output.

Substantive Process:

To determine whether acquired process is substantive, following has to be considered:

(1) If a set of activities and assets does not have output at the acquisition date, an acquired process (or group of processes) shall be considered substantive only if-

(a) It is critical to the ability to develop or convert an acquired input or inputs into outputs; and

(b) The inputs acquired include both an organised workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) and other inputs that the organised workforce could develop or convert into outputs.

Those other inputs could include-

(i) Intellectual property that could be used to develop a good or service;

(ii) Other economic resources that could be developed to create outputs; or

(iii) Rights to obtain access to necessary materials or rights that enable the creation of future Outputs.

(2) If a set of activities and assets has outputs at the acquisition date, an acquired process (or group of processes) shall be considered substantive if, when applied to an acquired input or inputs, it-

(a) is critical to the ability to continue producing outputs, and the inputs acquired include an organised workforce with the necessary skills, knowledge, or experience to perform that process (or group of processes); or

(b) significantly contributes to the ability to continue producing outputs and-

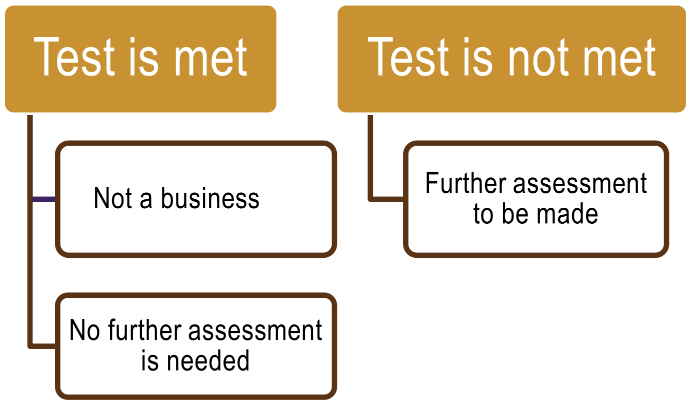
(i) is considered unique or scarce; or

(ii) cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

4.4 Concentration Test

As per paragraph B7A of the application guidance of Ind AS 103, an optional test (the concentration test) has been introduced to permit a simplified assessment of whether an acquired set of activities and assets is not a business.

On the basis of the above test, following will be the consequences:



Following conditions should be present to meet concentration test:

As per paragraph B7A of the application guidance of Ind AS 103, the concentration test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. For the concentration test:

(a) gross assets acquired shall exclude cash and cash equivalents, deferred tax assets, and goodwill resulting from the effects of deferred tax liabilities;

(b) the fair value of the gross assets acquired shall include any consideration transferred (plus the fair value of any non-controlling interest and the fair value of any previously held interest) in excess of the fair value of net identifiable assets acquired.

(c) a single identifiable asset shall include any asset or group of assets that would be recognized and measured as a single identifiable asset in a business combination;

(d) if a tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset (or from an underlying asset subject to a lease, as defined in Ind AS 116, Leases), without incurring significant cost, or significant diminution in utility or fair value to either asset (for example, land and buildings), those assets shall be considered a single identifiable asset;

(e) when assessing whether assets are similar, an entity shall consider the nature of each single identifiable asset and the risks associated with managing and creating outputs from the assets (that is, the risk characteristics);

(f) the following shall not be considered similar assets:

(i) a tangible asset and an intangible asset;

(ii) tangible assets in different classes unless they are considered a single identifiable asset in accordance with the criterion in subparagraph (d);

(iii) identifiable intangible assets in different classes

(iv) a financial asset and a non-financial asset;

(v) financial assets in different classes; and

(vi) identifiable assets that are within the same class of asset but have significantly different risk characteristics.

Notes:

1. Concentration test is optional test and the decision to apply is made on a transaction to transaction basis.

2. Does not prohibit an entity from performing a detailed test assessment using definition of business given in this standard.

3. 3 Step process for concentration test:

(a) Measure the Fair Value of Gross Assets acquired.

(b) Identify the single identifiable assets or group of similar identifiable asset.

(c) Determine if substantially all of the value determined in point (a) is concentrated in the value determined in point (b) then it is an asset acquisition otherwise needs to assess business definition as per Ind AS 103.

Fair value of gross assets shall be determined as follows (i + ii – iii):

(i) Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held)

(ii) Fair value of liabilities assumed.

(iii) Cash and cash equivalent and deferred tax assets and goodwill resulting from DTL’s.

Example 1: On Concentration test

Entity A holds 20% interest in Entity B. Subsequently Entity A, further acquires 50% share in Entity B by paying ₹ 300 Crores.

The fair value of assets acquired and Liabilities assumed are as follows:

Building	- ₹ 1000 Crores
Cash and Cash Equivalent	- ₹ 200 Crores
Financial Liabilities	- ₹ 800 Crores
DTL	- ₹ 150 crores

Fair value of Entity B is ₹ 400 Crores and Fair value of NCI is ₹ 120 Crores (400 x 30%)

Fair value of Entity A's previously held interest is ₹ 80 Crores (400 x 20%)

Entity A needs to determine whether acquisition is an asset acquisition as per concentration test.

i) Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held) = 300 + 120 + 80 = ₹ 500 Crores

ii) Fair value of liability assumed (excluding deferred tax) – ₹ 800 crores

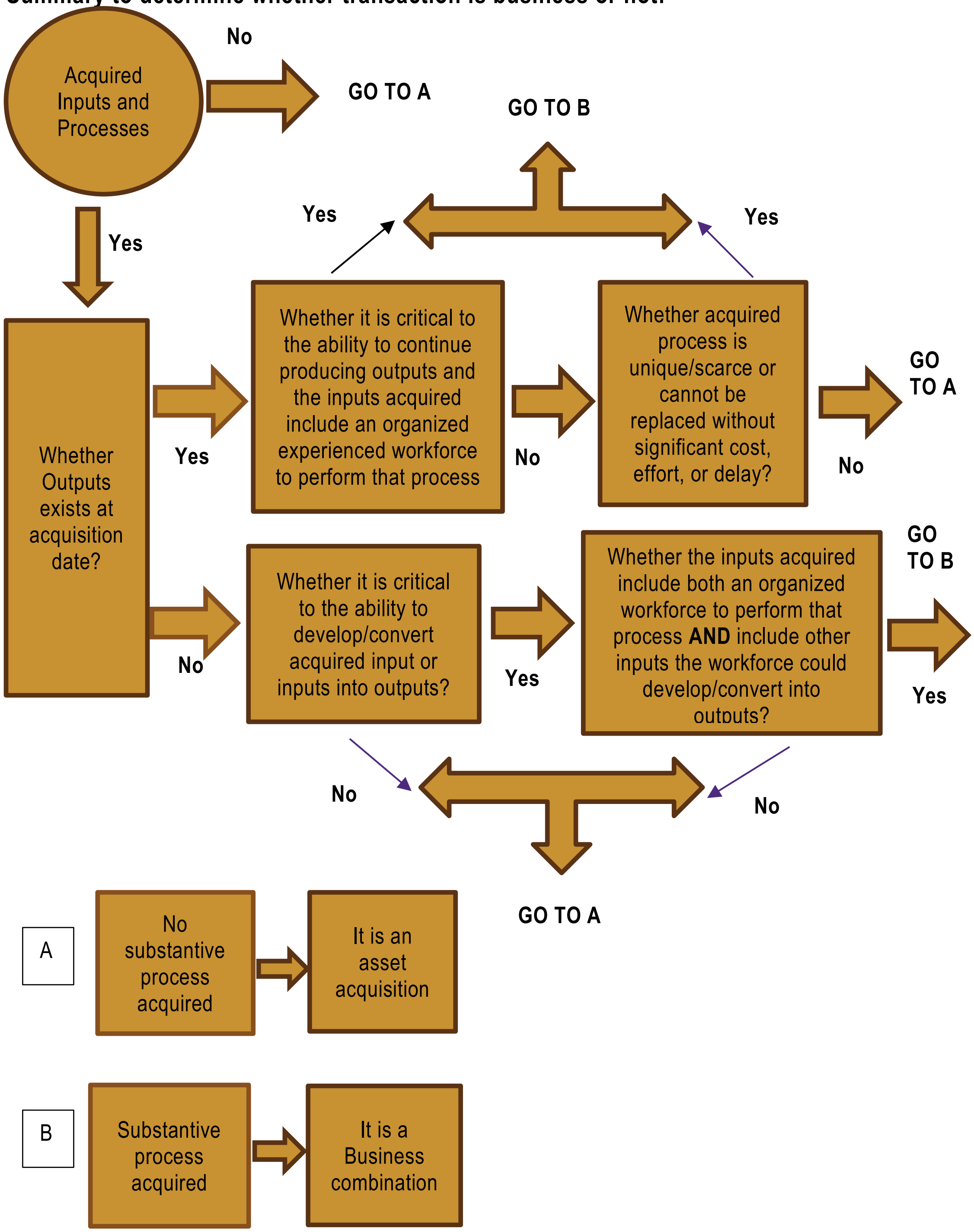
iii) Cash and cash equivalent – ₹ 200 crores.

Fair value of gross assets acquired - ₹ 1,100 Crores

In the above scenario, substantially all fair value of gross assets acquired is concentrated in a single identifiable asset i.e. building. Hence it should be asset acquisition. (1,000 / 1,100 = 91% of value of gross assets is concentrated into single identifiable asset i.e. building). A Judgement is required to conclude on the word substantially as the same is not defined in the standard.

In our view we have considered 91% of the value as substantial to conclude the above transaction as asset acquisition.

Summary to determine whether transaction is business or not:



Example 2: Simple-business combination

Company X is a liquor manufacturer and has traded for a number of years. The company produces a wide variety of liquor and employs a workforce of machine operators, testers, and other operational, marketing and administrative staff. It owns and operates a factory, warehouse, machinery and holds raw material inventory and finished products.

On 1st January, 20X1, Company Y pays USD 80 million to acquire 100% of the ordinary voting shares of Company X. No other type of shares has been issued by the Company X. On the same day, the four main executive directors of the Company Y take on the same roles in the Company X.

In this case, it is clear that the Company X is a business. It operates a trade with a variety of assets that are used by its employees in a number of related activities. These assets and activities are necessarily integrated in order to create and sell the company's products. As per definition the above acquisition includes an input (including four main executive directors of Company X) and thus it can be concluded as the significant process acquired along with the other inputs.

Thus, Company Y obtains control on 1st January, 20X1 by acquiring 100% of the voting rights.

The application of the definition is less clear in situations as illustrated in the following examples:

Example 3: Investment in a development stage entity

Company D is a development stage entity that has not started revenue-generating operations. The workforce consists mainly of research engineers who are developing a new technology that has a pending patent application. Negotiations to license this technology to a number of customers are at an advanced stage. Company D requires additional funding to complete development work and commence planned commercial production.

The value of the identifiable net assets in Company D is ₹ 750 million. Company A pays ₹ 600 million in exchange for 60% of the equity of Company D (a controlling interest).

Although Company D is not yet earning revenues (an example of 'outputs') there are a number of indicators that it has a sufficiently integrated set of activities and assets that are capable of being managed to produce a return for investors. In particular, Company D:

- employs specialist engineers developing the know-how and design specifications of the technology.
- is pursuing a viable plan to complete the development work and commence production.
- has identified and will be able to access customers willing to buy the outputs.

In addition, Company A has paid a premium (or goodwill) for its 60% interest. In the absence of evidence to the contrary, Company D is presumed to be a business.

Example 4: Acquisition of an entity holding investment properties

Company A acquires 100% of the equity and voting rights of Company P, a subsidiary of a property investment group. Company P owns three investment properties. The properties are single-tenant industrial warehouses subject to long-term leases. The leases oblige Company P to provide basic maintenance and security services, which have been outsourced to third party contractors. The administration of Company P's leases was carried out by an employee of its former parent company on a part-time basis but this individual does not transfer to the new owner.

In most cases, an asset or group of assets and liabilities that are being capable of generating revenues, combined with all or many of the activities necessary to earn those revenues, would constitute a business. However, investment property is a specific case in which earning a return for investors is a defining characteristic of the asset. Accordingly, revenue generation and activities that are specific and ancillary to an investment property and its tenancy agreements should therefore be given a lower 'weighting' in assessing whether the acquiree is a business.

Further process (i.e. Basic maintenance, security services and administration) is not critical to the ability to continue producing outputs. Also process (i.e. Basic maintenance, security services and administration) is not unique and it can be replaced easily without significant cost.

In our view the purchase of investment property with tenants and services that are purely ancillary to the property and its tenancy agreements should generally be accounted for as an asset purchase.

Example 5: Acquisition of an entity holding investment properties

Company A acquires 100% of the equity and voting rights of Company Q, which owns three investment properties. The properties are multi-tenant residential condominiums subject to short-term rental agreements that oblige Company Q to provide substantial maintenance and security services, which are outsourced with specialist providers. Company Q has five employees who deal directly with the tenants and with the outsourced contractors to resolve any non-routine security or maintenance requirements. These employees are involved in a variety of lease management tasks (e.g. identification and selection of tenants; lease negotiation and rent reviews) and marketing activities to maximise the quality of tenants and the rental income.

In this case, Company Q consists of a group of revenue-generating assets, together with employees and activities that clearly go beyond activities ancillary to the properties and their tenancy agreements.

Further process (i.e. identification and selection of tenants; lease negotiation and rent reviews) is critical to the ability to continue producing outputs (i.e. in terms to maximise quality of tenants and the rental income).

The assets and activities are clearly integrated so Company Q is considered a business.

Example 6: Seller retains some activities and assets

Company S is a manufacturer of a wide range of products. The company's payroll and accounting system is managed as a separate cost centre, supporting all the operating segments and the head office functions.

Company A agrees to acquire the trade, assets, liabilities and workforce of the operating segments of Company S but does not acquire the payroll and accounting cost centre or any head office functions. Company A is a competitor of Company S.

In this case, the activities and assets within the operating segments are capable of being managed as a business and so Company A accounts for the acquisition as a business combination. The payroll, accounting cost centre and administrative head office functions are typically not used to create outputs and so are generally not considered an essential element in assessing whether an integrated set of activities and assets is a business or not.

Example 7: Acquisition of a shell company

Company A is a property development company with a number of subsidiary companies, each of which holds a single development. After completion of the development, Company A sells its equity investment because the applicable tax rate is lower than that applicable to the sale of the underlying property.

Company A is planning to start the development of a large new retail complex. Rather than incorporating a new company, Company A acquires the entire share capital of a 'shell' company.

The shell company does not contain an integrated set of activities and assets and so does not constitute a business. Consequently, Company A should account for the purchase of the shell company in the same way as the incorporation of a new subsidiary. In the consolidated financial statements, any costs incurred will be accounted for in accordance with their nature and applicable Ind AS. No goodwill is recognised.

Illustration 2

Company A is a pharmaceutical company. Since inception, the Company had been conducting in-house research and development activities through its skilled workforce and recently obtained an intellectual property right (IPR) in the form of patents over certain drugs. The Company's has a production plant that has recently obtained regulatory approvals. However, the Company has *not earned any revenue so far and does not have any customer contracts for sale of goods. Company B acquires Company A.*

Determine whether Company A constitute a business in accordance with Ind AS 103.

Solution

The definition of business requires existence of inputs and processes. In this case, the skilled workforce, manufacturing plant and IPR, along with strategic and operational processes constitutes the inputs and processes in line with the requirements of Ind AS 103.

When the said inputs and processes are applied as an integrated set, the Company A will be capable of producing outputs; the fact that the Company A currently does not have revenue is not relevant to the analysis of the definition of business under Ind AS 103. Basis this and presuming that Company A would have been able to obtain access to customers that will purchase the outputs, the present case can be said to constitute a business as per Ind AS 103.

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Illustration 3

Modifying the above illustration, if Company A had revenue contracts and a sales force, such that Company B acquires all the inputs and processes other than the sales force, then whether the definition of the business is met in accordance with Ind AS 103?

Solution

Though the sales force has not been taken over, however, if the missing inputs (i.e., sales force) can be easily replicated or obtained by the market participant to generate output, it may be concluded that Company A has acquired business. Further, if Company B is also into similar line of business, then the existing sales force of the Company B may also be relevant to mitigate the missing input. As such, the definition of business is met in accordance with Ind AS 103.

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5. THE ACQUISITION METHOD

The following key steps are involved in the acquisition accounting for business combinations:

Step 1: Identifying the acquirer.

Step 2: Determining the acquisition date.

Step 3: Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and

Step 4: Recognising and measuring goodwill or a gain from a bargain purchase.

Ask Following questions to account a business combination transaction:

Who is Acquirer?

When business is Acquired ?

Which assets are acquired and liabilities assumed ?

At What value above assets, liabilties and NCI are acquired ?

Check for any Goodwill/Gain from bargain purchase.

6. IDENTIFYING ACQUIRING ENTERPRISE

6.1 The Acquiring Enterprise

All business combination within the scope of Ind AS 103 are accounted under the acquisition method (also known as purchase method). In order to apply the purchase method, the parties involved has to identify the acquirer i.e the entity that obtains the control of another entity. The entity on whom the control is established is termed as acquiree. This is because the acquiree's assets and liabilities are accounted as per the recognition and measurement principles of the standard.

The acquiring enterprise is the enterprise which obtains control and the determination of control is as per the guidance given in Ind AS 110. It may so happen that guidance in Ind AS 110 does not clearly indicate which of the combining entity is the acquirer. In such a case, Ind AS 103 provides additional guidance on identifying the acquirer.

As per Ind AS 110 'Consolidated Financial Statements', an investor controls an investee if and only if the investor has all the following:

(a) power over the investee;

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

(c) the ability to use its power over the investee to affect the amount of the investor's returns.

The above definition is very wide and control assessment does not depend only on voting rights instead it depends on the following as well:

- Potential voting rights;
- Rights of non-controlling shareholders; and
- Other contractual right of the investor if those are substantive in nature.

Control assessment has been discussed in detail in the chapter of Consolidated Financial Statements. One example on potential voting rights and its implication on assessment of control is provided below for the students to understand the concept of control.

In order to ascertain control do not look at the voting rights only. Evaluate other factors also like board control, potential voting rights etc.

Indicator of Control		
More than 50% voting rights	**Power to appoint and remove board of directors**	**Investor have currently excersiable potential voting rights**

Illustration 4: Potential voting rights

Company P Ltd., a manufacturer of textile products, acquires 40,000 equity shares of Company X (a manufacturer of complementary products) out of 1,00,000 shares in issue. As part of the same agreement, the Company P purchases an option to acquire an additional 25,000 shares. The option is exercisable at any time in the next 12 months. The exercise price includes a small premium to the market price at the transaction date.

After the above transaction, the shareholdings of Company X's two other original shareholders are 35,000 and 25,000. Each of these shareholders also has currently exercisable options to acquire 2,000 additional shares.

Assess whether control is acquired by Company P.

Solution

In assessing whether it has obtained control over Company X, Company P should consider not only the 40,000 shares it owns but also its option to acquire another 25,000 shares (a so-called potential voting right). In this assessment, the specific terms and conditions of the option agreement and other factors are considered as follows:

- the options are currently exercisable and there are no other required conditions before such options can be exercised
- if exercised, these options would increase Company P's ownership to a controlling interest of over 50% before considering other shareholders' potential voting rights (65,000 shares out of a total of 1,25,000 shares)
- although other shareholders also have potential voting rights, if all options are exercised Company P will still own a majority (65,000 shares out of 1,29,000 shares)
- the premium included in the exercise price makes the options out-of-the-money. However, the fact that the premium is small and the options could confer majority ownership indicates that the potential voting rights have economic substance.

By considering all the above factors, Company P concludes that with the acquisition of the 40,000 shares together with the potential voting rights, it has obtained control of Company X.

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6.2 Acquisitions through payment of cash or incurring of liability

In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

6.3 Acquisitions through issue of equity instrument

In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree. Reverse acquisition has been dealt in a separate section of this chapter.

Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

a) ***The relative voting rights in the combined entity after the business combination:*** The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.

Illustration 5

Veera Limited and Zeera Limited are both in the business of manufacturing and selling of Lubricant. Shareholders of Veera Limited and Zeera Limited agreed to join forces to benefit from lower delivery and distribution costs. The business combination is carried out by setting up a new entity called Meera Limited that issues 100 shares to Veera Limited shareholders and 50 shares to Zeera Limited shareholders in exchange for the transfer of the shares in those entities. The number of shares reflects the relative fair values of the entities before the combination. Also respective company's shareholders get the voting rights in Meera Limited based on their respective shareholdings.

Determine the acquirer by applying the principles of Ind AS 103 'Business Combinations'

Solution

As per para B15 of Ind AS 103, in a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

The relative voting rights in the combined entity after the business combination - The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity.

Based on above mentioned para, acquirer shall be the either of the combining entities (i.e. Veera Limited or Zeera Limited) whose owners as a Group retain or receive the largest portion of the voting rights in the combined entity.

Hence in the above scenario Veera Limited shareholder gets 67% Share [(100/150) x100] and Zeera Limited shareholder gets 33.33% share in Meera Limited. Hence Veera Limited is acquirer as per the principles of Ind AS 103.

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b) ***The existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest:*** The acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.

c) ***The composition of the governing body of the combined entity:*** The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.

d) ***The composition of the senior management of the combined entity:*** The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.

e) ***The terms of the exchange of equity interests:*** The acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities.

f) ***The acquirer is usually the combining entity*** whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities. In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.

Examples 8 & 9

8. Company A and Company B operate in power industry and both entities are operating entities. Company A has much larger scale of operations than Company B. Company B merges with Company A such that the shareholders of Company B would receive 1 equity share of Company A for every 1 share held in Company B. Such issue of shares would comprise 20% of the issued share capital of the combined entity. After discharge of purchase consideration, the pre-merger shareholders of Company A hold 80% of the capital in Company A.

In this transaction, Company A is the acquirer for the purposes of accounting for business combination as per Ind AS 103. This is because, by merging the entire shareholding of Company B, Company A has acquired control over Company B. Further, the shareholders of erstwhile Company B do not obtain control over Company A on account of shares received as part of purchase consideration, as they hold only 20% of the paid-up capital of Company A.

9. Company A and Company B operate in power industry and both entities are operating entities. Company A has much smaller scale of operations than Company B. Company B merges Company A such that the shareholders of Company B would receive 10 equity share of Company A for every 1 share held in Company B. Such issue of shares would comprise 70% of the issued share capital of the combined entity. After discharge of purchase consideration, the pre-merger shareholders of Company A hold 30% of capital of Company A. Post-acquisition, the management of Company B would manage the operations of the combined entity.

In this transaction, Company B is the acquirer for the purposes of accounting for business combination as per Ind AS 103. This is because, after merger, the shareholders of erstwhile Company B would have a controlling interest and management of the combined entity. As such, in substance, Company B has acquired control over Company A.

It is important to note that the Company B would be considered as an acquirer for accounting purposes only (i.e., accounting acquirer). For legal purposes as well as for reporting purposes, it is the Company A that would be considered as an acquirer (i.e., legal acquirer).

Appropriate identification of an acquirer is relevant, as the net assets of the accounting acquiree (rather than that of the accounting acquirer) are recognised at fair value.

Illustration 6

ABC Ltd. incorporated a company Super Ltd. to acquire 100% shares of another entity Focus Ltd. (and therefore to obtain control of the Focus Ltd.). To fund the purchase, Super Ltd. acquired a loan from XYZ Bank at commercial interest rates. The loan funds are used by Super Ltd. to acquire entire voting shares of Focus Ltd. at fair value in an orderly transaction. Post the acquisition, Super Ltd. has the ability to elect or appoint or to remove a majority of the members of the governing body of the Focus Ltd. and also Super Ltd.'s management is in a power where it will be able to dominate the management of the Focus Ltd.

State whether Super Ltd. be identified as the acquirer in this business combination.

Solution

Paragraph 6 of Ind AS 103 states that for each business combination, one of the combining entities shall be identified as the acquirer.

While paragraph 7 states that the guidance in Ind AS 110 shall be used to identify the acquirer that is the entity that obtains control of another entity called the acquiree. If a business combination has occurred but applying the guidance in Ind AS 110 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 of Ind AS 103 shall be considered in making that determination.

Further, paragraph B15 provides that, in a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

(a) **The relative voting rights in the combined entity after the business combination:** The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.

(b) **The existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest:** The acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.

(c) **The composition of the governing body of the combined entity:** The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.

(d) **The composition of the senior management of the combined entity:** The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.

(e) **The terms of the exchange of equity interests:** The acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities.

The key drivers of the accounting are identifying the party on whose behalf the new entity has been formed and identifying the business acquired. In this scenario, as Super Ltd. has the ability to elect or appoint or to remove a majority of the members of the governing body of the Focus Ltd. and has the ability to dominate the management of the Focus Ltd. Accordingly, Super Ltd. will be identified as the acquirer unless there are conditions to conclude to the contrary.

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6.4 Acquisition involving Shell Company and Reverse Acquisition

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the **legal acquirer** because it issued its equity interests, and the private entity is the **legal acquiree** because its equity interests were acquired. However, application of the guidance given in above paragraph results in identifying:

a) the public entity as the **acquiree** for accounting purposes (the accounting acquiree); and

b) the private entity as the **acquirer** for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles of Ind AS 103, including the requirement to recognise goodwill, will apply.

Example 9: Reverse Acquisition

The Balance Sheets of Entity A and Entity B immediately before business acquisition are as follows:

	Amount (₹ in thousands)	
Particulars	**Entity A**	**Entity B**
Current Assets	600	800
Non Current Assets	1,200	2,900
Total Assets	1,800	3,700
Current Liabilities	400	200
Non - Current Liabilities	300	1200
Total Liabilities	700	1400
Equity		
30,000 Shares of ₹ 10 Each	300	
60,000 Shares of ₹ 10 Each		600
Retained Earnings	800	1700
Total Equity	1100	2300
Total Equity and Liability	1800	3700

On 31 March 20X1, Entity A issues 2.5 shares in exchange for each share of Entity B. All of entity B's shareholders exchange their shares. Therefore, Entity A issues 1,50,000 shares in exchange for all 60,000 shares of entity B. Entity A legally owns 100% of entity B.

The shareholders of Entity B own 83.33% (1,50,000/1,80,000) of the combined entity. The directors of entity B are appointed 6 out of 8 positions in combined entity's board. In accordance with Ind AS 103, Entity B (Legal Acquiree) is the accounting acquirer and Entity A (Legal Acquirer) is the accounting acquiree as Entity B shareholders control over combined entity.

The quoted market price of Entity B's share as at 31st March, 20X1 is ₹ 105 per share and Entity A's share price as at 31st March, 20X1 is ₹ 20 per share.

Assume the fair value of Entity A's identifiable net assets as at 31st March, 20X1 are the same as carrying values and ignore tax effect.

The acquisition date fair value (i.e. at 31st March, 20X1) of the accounting acquirer equity instrument is generally used to determine the amount of consideration transferred for business combination. In this case it is 105 per share (Entity B).

So if the business combination had taken place in the form of Entity B issuing additional shares to Entity A's shareholders in exchange for their shares in Entity A, Entity B would have to issue 12,000 shares (30,000 / 2.5) for the ratio of ownership interest in the combined entity to be same. (12,000/72,000). Therefore, the consideration for the business combination effectively transferred by Entity B is ₹ 12,60,000 (12,000 Shares x ₹ 105).

Calculation of Goodwill:

Fair value of Assets less Liabilities Assumed (Entity A)	₹ 11,00,000
Consideration transferred (by Entity B)	(₹ 12,60,000)
Goodwill	₹ 1,60,000

Example 11: New parent pays cash to effect a business combination

Company A decided to spin-off two of its existing businesses (currently housed in two separate entities, Company B and Company C). To facilitate the spin-off, Company A incorporates a new entity (Company D) with nominal equity and appoints independent directors to the board of Company D. Company D signs an agreement to purchase Companies B and C in cash, conditional on obtaining sufficient funding. To fund these acquisitions, Company D issues a prospectus offering to issue shares for cash.

At the conclusion of the transaction, Company D has owned 99% by the new investors with Company A retaining only a 1% non-controlling interest.

In this situation, a set of new investors paid cash to obtain control of Company D in an arm's length transaction. Company D is then used to effect the acquisition of 100% ownership of Companies B and C by paying cash. Company A relinquishes its control of Companies B and C to the new owners of Company D.

Although Company D is a newly formed entity, Company D is identified as the acquirer not only because it paid cash but also because the new owners of Company D have obtained control of Companies B and C from Company A.

Identification of the acquiring enterprise is very critical and the accounting may change significantly if the accounting acquirer is different than legal acquirer. .

7. DETERMINING THE ACQUISITION DATE

The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree — the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

The acquisition date is a very important step in the business combination accounting because it determines when the acquirer recognises and measures the consideration, the assets acquired and liabilities assumed. The acquiree's results are consolidated from this date. The acquisition date materially impacts the overall acquisition accounting, including post-combination earnings.

Acquisition date will be the date on which the acquirer obtains control.

The acquisition date is often readily apparent from the structure of the business combinations and the terms of the sale and purchase agreement (if applicable) but this is not always the case.

Example 12

Company A acquired 80% equity interest in Company B for cash consideration. The relevant dates are as under:

✓ Date of shareholder agreement	1st June, 20X1
✓ Appointed date as per shareholder agreement	1st April, 20X1
✓ Date of obtaining control over the board representation	1st July, 20X1
✓ Date of payment of consideration	15th July, 20X1
✓ Date of transfer of shares to Company A	1st August, 20X1

In this case, as the control over financial and operating policies are acquired through obtaining board representation on 1st July, 20X1, it is this date that is considered as the acquisition date. It may be noted that the appointed date as per the agreement is not considered as the acquisition date, as the Company A did not have control over Company B as at that date.

Illustration 7

Can an acquiring entity account for a business combination based on a signed non-binding letter of intent where the exchange of consideration and other conditions are expected to be completed with 2 months?

Solution

No. as per the requirement of the standard a non- binding Letter of Intent (LOI) does not effectively transfer control and hence this cannot be considered as the basis for determining the acquisition date.

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Illustration 8

On 1st April, X Ltd. agrees to acquire the share of B Ltd. in an all equity deal. As per the binding agreement X Ltd. will get the effective control on 1st April. However, the consideration will be paid only when the shareholders' approval is received. The shareholder's meeting is scheduled to happen on 30th April. If the shareholders' approval is not received for issue of new shares, then the consideration will be settled in cash.

Determine the acquisition date.

Solution

The acquisition date in the above case is 1st April. This is because, in the above scenario, even if the shareholders don't approve the shares, consideration will be settled through payment of cash.

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Illustration 9 : Business Combination without a Court approved scheme

ABC Ltd. acquired all the shares of XYZ Ltd. The negotiations had commenced on 1st January, 20X1 and the agreement was finalised on 1st March, 20X1. While ABC Ltd. obtains the power to control XYZ Ltd.'s operations on 1st March, 20X1, the agreement states that the acquisition is effective from 1st January, 20X1 and that ABC Ltd. is entitled to all profits after that date. In addition, the purchase price is based on XYZ Ltd.'s net asset position as at 1st January, 20X1.

Determine the date of acquisition.

Solution

Paragraph 8 of Ind AS 103 provides that acquisition date is the date on which the acquirer obtains control of the acquiree.

Further paragraphs 6 and 7 of Ind AS 110, Consolidated Financial Statements, inter alia, state that 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. Thus, an investor controls an investee if and only if the investor has all the following:

(a) power over the investee;

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

(c) the ability to use its power over the investee to affect the amount of the investor's returns.

Further, paragraph 9 of Ind AS 103 clarifies that the date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date.

Therefore, in this case, notwithstanding that the price is based on the net assets as at 1st January, 20X1 and that XYZ Ltd.'s shareholders do not receive any dividends after that date, the date of acquisition for accounting purposes will be 1st March, 20X1. It is only on 1st March, 20X1 and not 1st January, 20X1, that ABC Ltd. has the power to direct the relevant activities of XYZ Ltd. so as to affect its returns from its involvement with XYZ Ltd. Accordingly, the date of acquisition is 1st March, 20X1.

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Illustration 10 : Acquisition date- Regulatory approval

ABC Ltd. and XYZ Ltd. are manufacturers of rubber components for a particular type of equipment. ABC Ltd. makes a bid for XYZ Ltd.'s business and the Competition Commission of India (CCI) announces that the proposed transaction is to be scrutinised to ensure that competition laws are not breached. Even though the contracts are made subject to the approval of the CCI, ABC Ltd. and XYZ Ltd. mutually agree the terms of the acquisition and the purchase price before competition authority clearance is obtained.

Can the acquisition date in this situation be the date on which ABC Ltd. and XYZ Ltd. agree the terms even though the approval of CCI is awaited? Assume that the approval of CCI is substantive.

Solution

Paragraph 8 of Ind AS 103 provides that acquisition date is the date on which the acquirer obtains control of the acquiree.

Further, paragraph 9 of Ind AS 103 clarifies that the date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree — the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date.

For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

Since CCI approval is a substantive approval for ABC Ltd. to acquire control of XYZ Ltd.'s operations, the date of acquisition cannot be earlier than the date on which approval is obtained from CCI. This is pertinent given that the approval from CCI is considered to be a substantive process and accordingly, the acquisition is considered to be completed only on receipt of such approval.

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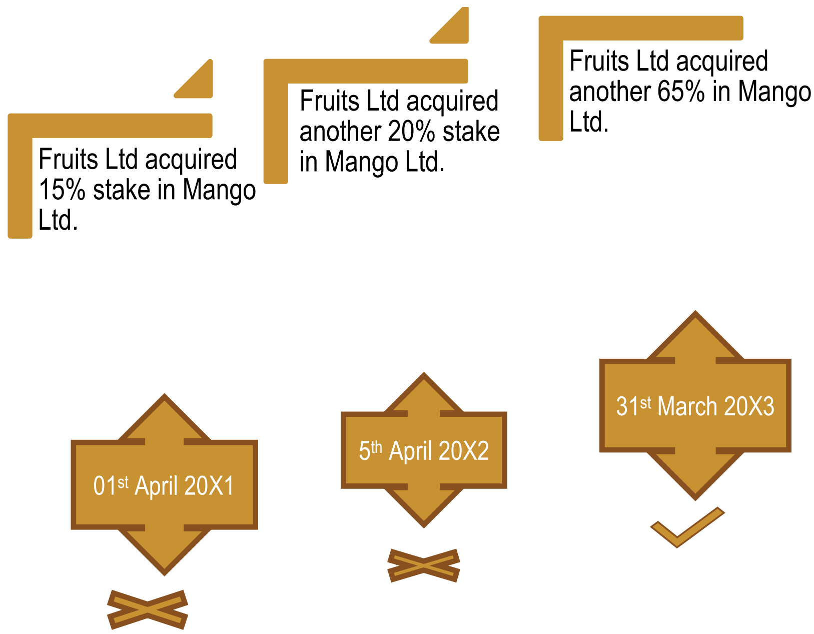
8. STEP ACQUISITIONS

In the case an entity acquires an entity step by step through series of purchase then the acquisition date will be the date on which the acquirer obtains control. Till the time the control is obtained the Investment will be accounted as per the requirements of other Ind AS 109, if the investments are covered under that standard or as per Ind AS 28, if the investments are in Associates or Joint Ventures.

If a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

Below is the example for acquisition of business in case of stake acquired in stages:



Control is acquired on 31st March 20X3 in above example because total stake as on that date will be 90%.

Assumption: Control is acquired in form of total stake, unless otherwise stated.

9. DETERMINATION OF THE PURCHASE CONSIDERATION

The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the total of the acquisition-date fair values of the assets (including cash) transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, *contingent consideration*, ordinary or preference equity instruments, options, warrants and member interests of *mutual entities*.

Exception to the fair value in determination of Purchase consideration

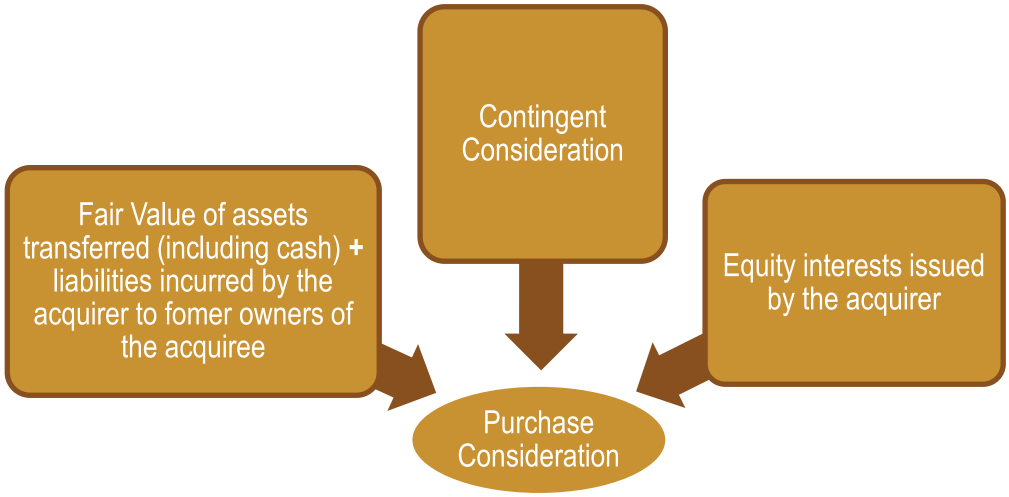
However, any portion of the acquirer's share-based payment awards exchanged for awards held by the acquiree's employees that is included in consideration transferred in the business combination shall be measured in accordance with the requirements of Ind AS 102, Share Based payments.

The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a business of the acquirer). If so, the acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in the statement of profit and loss.

This means that if the acquirer has transferred a land as a part of the business combination arrangement to the owners of the acquiree then the fair value of the land will be considered in determining the fair value of the consideration. Consequently, the land will be de-recognised in the financial statements of the acquirer and the difference between the carrying amount of the land and the fair value considered for purchase consideration will be recorded in profit and loss.

However, sometimes the transferred assets or liabilities remain within the combined entity after the business combination (for example, because the assets or liabilities were transferred to the acquiree rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in statement of profit and loss on assets or liabilities it controls both before and after the business combination. Although no gain or loss is recognised by the transferring entity, the asset transferred will affect the amount of NCI and goodwill that is recognised.

Purchase Consideration can be summarized as:



9.1 A Business Combination achieved in Stages (Step Acquisition)

An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date.

Example 13

On 31st December 20X1, Entity A holds a 35 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity B. This transaction is referred as a business combination achieved in stages, sometimes also referred to as a step acquisition.

In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. As per Ind AS 109 or Ind AS 27, an entity can elect to measure investments in equity instruments at fair value through other comprehensive income. However, once elected all gains and losses on that investment even on sale is recognized in OCI. Therefore, if the investment is designated as fair value through OCI, the resulting gain or loss, if any, will be recognized in OCI.

When a party to a joint operation, obtains control of a joint operation business, the transaction will be considered as a business combination achieved in stages. The acquirer should re-measure its previously held interest in the joint operation at fair value at the acquisition date.

Illustration 11

On 1st April, 20X1, PQR Ltd. acquired 30% of the voting ordinary shares of XYZ Ltd. for ₹ 8,000 crore. PQR Ltd. accounts its investment in XYZ Ltd. using equity method as prescribed under Ind AS 28. At 31st March, 20X2, PQR Ltd. recognised its share of the net asset changes of XYZ Ltd. using equity accounting as follows:

	(₹ in crore)
Share of profit or loss	*700*
Share of exchange difference in OCI	*100*
Share of revaluation reserve of PPE in OCI	*50*

The carrying amount of the investment in the associate on 31st March, 20X2 was therefore ₹ 8,850 crore (8,000 + 700 + 100 + 50).

On 1st April, 20X2, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash ₹ 25,000 crore. The following additional information is relevant at that date:

	(₹ in crore)
Fair value of the 30% interest already owned	*9,000*
Fair value of XYZ's identifiable net assets	*30,000*

Determine the accounting such business combination.

Solution

Paragraph 42 of Ind AS 103 provides that in a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in statement of profit and loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognized changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

Applying the above, PQR Ltd. records the following entry in its consolidated financial statements:

		(₹ in crore)	
		Debit	Credit
Identifiable net assets of XYZ Ltd.	Dr.	30,000	
Goodwill (W.N.1)	Dr.	4,000	
Foreign currency translation reserve	Dr.	100	
PPE revaluation reserve	Dr.	50	
To Cash			25,000
To Investment in associate -XYZ Ltd.			8,850
To Retained earnings (W.N.2)			50
To Gain on previously held interest in XYZ recognised in Profit or loss (W.N.3)			250
(To recognise acquisition of XYZ Ltd.)			

Working Notes:

1. **Calculation of Goodwill**

	₹ in crore
Cash consideration	25,000
Add: Fair value of previously held equity interest in XYZ Ltd.	9,000
Total consideration	34,000
Less: Fair value of identifiable net assets acquired	(30,000)
Goodwill	4,000

2. The credit to retained earnings represents the reversal of the unrealized gain of ₹ 50 crore in Other Comprehensive Income related to the revaluation of property, plant and equipment. In accordance with Ind AS 16, this amount is not reclassified to profit or loss.

3. The gain on the previously held equity interest in XYZ Ltd. is calculated as follows:

	₹ in crore
Fair Value of 30% interest in XYZ Ltd. at 1st April, 20X2	9,000
Carrying amount of interest in XYZ Ltd. at 1st April, 20X2	(8,850)
	150
Unrealised gain previously recognised in OCI	100
Gain on previously held interest in XYZ Ltd. recognised in profit or loss	250

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9.2 A Business Combination achieved without the transfer of Consideration

An acquirer sometimes obtains control of an acquiree without transferring consideration. The acquisition method of accounting for a business combination applies to those combinations. Such circumstances include:

(a) The acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control.

(b) Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights.

(c) The acquirer and acquiree agree to combine their businesses by contract alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual listed corporation.

In a business combination achieved by contract alone, the acquirer shall attribute to the owners of the acquiree the amount of the acquiree's net assets recognised in accordance with this Indian Accounting Standard. In other words, the equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity interests in the acquiree are attributed to the non-controlling interest.

Illustration 12: Business Combination Achieved by Contract Alone

Sita Ltd and Beta Ltd decides to combine together for forming a Dual Listed Corporation (DLC). As per their shareholder's agreement, both the parties will retain original listing and Board of DLC will be comprised of 10 members out of which 6 members will be of Sita Ltd and remaining 4 board members will be of Beta Ltd.

The fair value of Sita Ltd is ₹ 100 crores and fair value of Beta Ltd is ₹ 80 crores. The fair value of net identifiable assets of Beta Limited is ₹ 70 crores. Assume non-controlling Interest (NCI) to be measured at fair value.

Determine the goodwill to be recognised on acquisition.

Solution

Sita Ltd has more Board members and thereby have majority control in DLC. Therefore, Sita Ltd is identified as acquirer and Beta Ltd as acquiree.

Since no consideration has been transferred, the goodwill needs to be calculated as the difference of Part A and Part B:

Part A:

1)	Consideration paid by Acquirer.	– Nil
2)	Controlling Interest in Acquiree	– ₹ 80 crores
3)	Acquirer's previously held interest	– Nil

Part B:

Fair value of net identifiable asset – ₹ 70 crores

Goodwill is recognised as ₹ 10 crores (80 crores – 70 crores) in business combination achieved through contract alone when NCI is measured at fair value.

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9.3 Direct Cost of Acquisition

The direct cost of acquisition is not included in the determination of the purchase consideration. Costs which includes like finder's fees, due diligence cost accounting, legal fees, investment banker fees, even bonuses paid to employees for doing a successful acquisition will not be included in the cost of acquisition.

Illustration 13

Should stamp duty paid on acquisition of land pursuant to a business combination be capitalised to the cost of the asset or should it be treated as an acquisition related cost and accordingly be expensed off?

Solution

As per Ind AS 103, the acquisition-related costs incurred by an acquirer to affect a business combination are not part of the consideration transferred.

Paragraph 53 of Ind AS 103 states that, acquisition-related costs are costs the acquirer incurs to affect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception.

Note: The costs to issue debt or equity securities shall be recognised in accordance with Ind AS 32 and Ind AS 109.

The stamp duty payable for transfer of assets in connection with the business combination is an acquisition-related cost as described under paragraph 53 of Ind AS 103. Stamp duty is a cost incurred by the acquirer in order to affect the business combination and it is not part of the fair value exchange between the buyer and seller for the business. In such cases, the stamp duty is incurred to acquire the ownership rights in land in order to complete the process of transfer of assets as part of the overall business combination transaction, but it does not represent consideration paid to gain control over business from the sellers.

It may be noted that the accounting treatment of stamp duty incurred for separate acquisition of an item of property, plant and equipment (i.e. not as part of business combination) differs under Ind AS 16, Property, Plant and Equipment. Unlike Ind AS 16, the acquisition accounting as per Ind AS 103 requires assets and liabilities acquired in a business combination to be measured at fair value. While incurred in connection with a business combination, stamp duty does not increase the future economic benefits from the net assets comprising the business (which would be recognised at fair value) and hence cannot be capitalised. The examples of costs given in paragraph 53 is only an inclusive list; they are only indicative and do not preclude any other cost to be considered as acquisition-related cost. In the given case, the transfer of land and the related stamp duty is required to be accounted as part of the business combination transaction as per requirements of Ind AS 103 and not as a separate transaction under Ind AS.

Accordingly, stamp duty incurred in relation to land acquired as part of a business combination transaction are required to be recognised as an expense in the period in which the acquisition is completed and given effect to in the financial statements of the acquirer.

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Illustration 14

ABC Ltd. acquires PQR Ltd. on 30th June, 20X1. The assets acquired from PQR Ltd. include an intangible asset that comprises wireless spectrum license. For this intangible asset, ABC Ltd. is required to make an additional one-time payment to the regulator in PQR's jurisdiction in order for the rights to be transferred for its use.

Whether such additional payment to the regulator is an acquisition-related cost?

Solution

As per Ind AS 103, the acquisition-related costs incurred by an acquirer to affect a business combination are not part of the consideration transferred.

Paragraph 53 of Ind AS 103 states that, acquisition-related costs are costs the acquirer incurs to affect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with Ind AS 32 and Ind AS 109.

The payment to the regulator represents a transaction cost and will be regarded as acquisition related cost incurred to affect the business combination. Applying the requirements of para 53 of Ind AS 103, it should be expensed as it is incurred. Transfer of rights in the instant case cannot be construed to be separate from the business combination because the transfer of the rights to ABC Ltd. is an integral part of the business combination itself.

It may be noted that had the right been acquired separately (i.e. not as part of business combination), the transaction cost is required to be capitalised as part of the intangible asset as per the requirements of Ind AS 38, Intangible Assets.

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9.4 Contingent Consideration

The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

The acquirer shall classify an obligation to pay contingent consideration as a liability or as equity on the basis of the definitions of an equity instrument and a financial liability in accordance with the requirement of Ind AS 32 'Financial Instruments: Presentation', or other applicable Indian Accounting Standards. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met.

Fair value of the assets transferred or liability incurred should be measured on the acquisition date to determine the fair value. Any direct cost of acquisition should be recorded directly in profit and loss account and should not be included in purchase consideration.

Example 14:

Company A acquires Company B in April, 20X1 for cash. The acquisition agreement states that an additional ₹ 20 million of cash will be paid to B's former shareholders if B succeeds in achieving certain specified performance targets. A determines the fair value of the contingent consideration liability to be 15 million at the acquisition date. At a later date, the probability of meeting the said performance target becomes lower.

As certain consideration is based on achieving certain performance parameters in future, the consideration is contingent on achieving those parameters. As such, the transaction involves contingent consideration. Further, since the consideration is to be settled for a variable amount in cash, such consideration would be in the nature of financial liability rather than equity.

As at the acquisition date, the acquirer should consider the acquisition date fair value of contingent consideration as part of business combination. Accordingly, such recognition would increase goodwill (or reduce gain on bargain purchase, as the case may be).

In the above example, if the chance of meeting the performance criteria becomes less probable, then in such a case, the contingent consideration in the nature of financial liability should be remeasured and the impact for the change in the fair value should be recognised in statement of profit and loss.

10. PURCHASE PRICE ALLOCATION

10.1 Recognition of Assets and Liabilities of the Acquired Entity

As of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree.

The most important principle in a purchase price allocation exercise is to recognize and measure all the assets and liabilities acquired on the acquisition date.

10.1.1 Recognition

Following conditions have to be considered while recognising the assets and liabilities of the acquire:

- To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards* issued by the Institute of Chartered Accountants of India at the acquisition date. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post combination financial statements in accordance with other Ind AS.
- Acquirer should only record the assets and liabilities recorded as a part of the business combination which means only those assets and liabilities which have been assumed as a part of the business combination deal should only be recorded and not any other assets which are not related to the acquisition to which other applicable Ind AS should be applied.
- When the acquirer applies the recognition principle under business combination it may record certain assets and liabilities which the acquiree had not recorded earlier in their financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

There are certain exceptions to specific assets and liabilities which have been discussed below.

- The assets and liabilities have to be classified as per the requirement of applicable Ind AS which will depend on the contractual terms, economic conditions etc.
- In some situations, Ind AS provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or

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* For this Standard, acquirers are required to apply the definitions of an asset and a liability given in *Framework for Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards* rather than the *Conceptual Framework for Financial Reporting under Indian Accounting Standards issued in 2021*.

designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:

- ➢ classification of particular financial assets and liabilities as measured at fair value through profit or loss or at amortised cost, or as a financial asset measured at fair value through other comprehensive income in accordance with Ind AS 109, Financial Instruments;
- ➢ designation of a derivative instrument as a hedging instrument in accordance with Ind AS 109; and
- ➢ assessment of whether an embedded derivative should be separated from a host contract in accordance with Ind AS 109 (which is a matter of 'classification' as this Ind AS uses that term).

The only exception to the above principle is that classification of lease contract (in which acquiree is the lessor as either an operating lease or a finance lease) will be based on the basis of the conditions existing at inception and not on acquisition date. Therefore, such leas contracts are not reassessed at the acquisition date, unless they are modified at that date.

10.2 Measurement Principle

The assets and liabilities recognized based on the aforesaid recognition principles has to be measured based on the following principles:

- ♦ The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.
- ♦ For each business combination, the acquirer shall measure at the acquisition date components of non-controlling interest (under existing AS it is called as minority interest) in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:
  - ➢ fair value; or
  - ➢ The present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets
- ♦ All other components of non-controlling interests shall be measured at their acquisition date fair values, unless another measurement basis is required by Ind AS.

10.2.1 Exception to the recognition or measurement principle

The exception principles laid out in this standard for recognition or measurement of certain assets and liabilities are only limited to acquisition date accounting and may be different than the requirements of other accounting standards. The application of the above principles may result in two scenarios:

- An asset or liability which otherwise would not have been recorded gets recorded.
- The assets and liabilities are measured at a value other than the acquisition date fair values.

<table>
<tr><th>Items</th><th>Guidance under Ind AS 103</th></tr>
<tr><td>Contingent liability</td><td>Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, defines a contingent liability as:
(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
(b) a present obligation that arises from past events but is not recognised because:
i. it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
ii. the amount of the obligation cannot be measured with sufficient reliability.
The requirements in Ind AS 37 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to Ind AS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
Summary of above:
<table>
<tr><th>Outcome</th><th>Ind AS 37</th><th>Business Combination</th></tr>
<tr><td>Possible obligation</td><td>Not recognised</td><td>Not recognised</td></tr>
<tr><td>Present obligation – not probable that an outflow of economic benefits will occur.</td><td>Not recognised</td><td>Recognised if reliably measured</td></tr>
<tr><td>Present obligation –</td><td>Not recognised</td><td>Not recognised</td></tr>
</table>
</td></tr>
</table>

	probable that an outflow of economic benefits will occur, but cannot be measured reliably		

Example 15

A suit for damages worth ₹ 10 million was filed on Company B for alleged breach of certain contract provisions. Company B had disclosed the same as a contingent liability in its financial statements, as it considered that it is a present obligation for which it was not probable that the amount would be payable. Company A acquire Company B and determines the fair value of the contingent liability to be ₹ 2 million.

Company A would recognise ₹ 2 million in its financial statements as part of acquisition accounting, even if it is not probable that payment will be required to settle the obligation.

Income taxes	As per the requirement of Ind AS 12, no deferred tax consequence should be recorded on initial recognition of deferred tax **except** assets and liabilities acquired during business combination. Accordingly, the acquirer shall recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with Ind AS 12, Income Taxes. The acquirer shall account for the potential tax effects of temporary differences and carry forwards of an acquiree that exist at the acquisition date or arise as a result of the acquisition in accordance with Ind AS 12.
Employee benefits	The acquirer records the fair value of the obligations for any post-retirement obligation as per the principles of Ind AS 19 which is an exception of the general fair value rule.
Indemnification assets	The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts.

Example 16:

Company A acquires Company B in a business combination on 1st April, 20X1. B is being sued by one of its customers for breach of contract for ₹ 250. The sellers of B provide indemnification to A for the reimbursement of any losses greater than ₹ 100. There are no collectability issues around this indemnification. At the acquisition date, Company A determined that there is a present obligation and therefore the fair value of the contingent liability of ₹ 250 is recognised by A in the acquisition accounting. In the acquisition accounting A also recognises an indemnification asset of ₹ 150 (₹ 250 – ₹ 100).

Illustration 15

ABC Ltd. acquired a beverage company PQR Ltd. from XYZ Ltd. At the time of the acquisition, PQR Ltd. is the defendant in a court case whereby certain customers of PQR Ltd. have alleged that its products contain pesticides in excess of the permissible levels that have caused them health damage.

PQR Ltd. is being sued for damages of ₹ 2 crore. XYZ Ltd. has indemnified ABC Ltd. for the losses, if any, due to the case for amount up to ₹ 1 crore. The fair value of the contingent liability for the court case is ₹ 70 lakh.

How should ABC Ltd. account for the contingent liability and the indemnification asset? What if the fair value of the liability is ₹ 1.2 crore instead of ₹ 70 lakh.

Solution

In the current scenario, ABC Ltd. measures the identifiable liability of entity PQR Ltd. at ₹ 70 lakh and also recognises a corresponding indemnification asset of ₹ 70 lakhs on its consolidated balance sheet. The net impact on goodwill from the recognition of the contingent liability and associated indemnification asset is nil.

However, in the case where the liability's fair value is more than ₹ 1 crore ie. ₹ 1.2 crore, the indemnification asset will be limited to ₹ 1 crore only.

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Illustration 16

ABC Ltd. pays ₹ 50 crore to acquire PQR Ltd. from XYZ Ltd. PQR Ltd. manufactured products containing fiber glass and has been named in 10 class actions concerning the effects of these fiber glass. XYZ Ltd. agrees to indemnify ABC Ltd. for the adverse results of any court cases up to an amount of ₹ 10 crore. The class actions have not specified amounts of damages and past experience suggests that claims may be up to ₹ 1 crore each, but that they are often settled for small amounts.

ABC Ltd. makes an assessment of the court cases and decides that due to the potential variance in outcomes, the contingent liability cannot be measured reliably and accordingly no amount is recognised in respect of the court cases.

How should indemnification asset be accounted for?

Solution

Since no liability is recognised in the given case, ABC Ltd. will also not recognise an indemnification asset as part of the business combination accounting.

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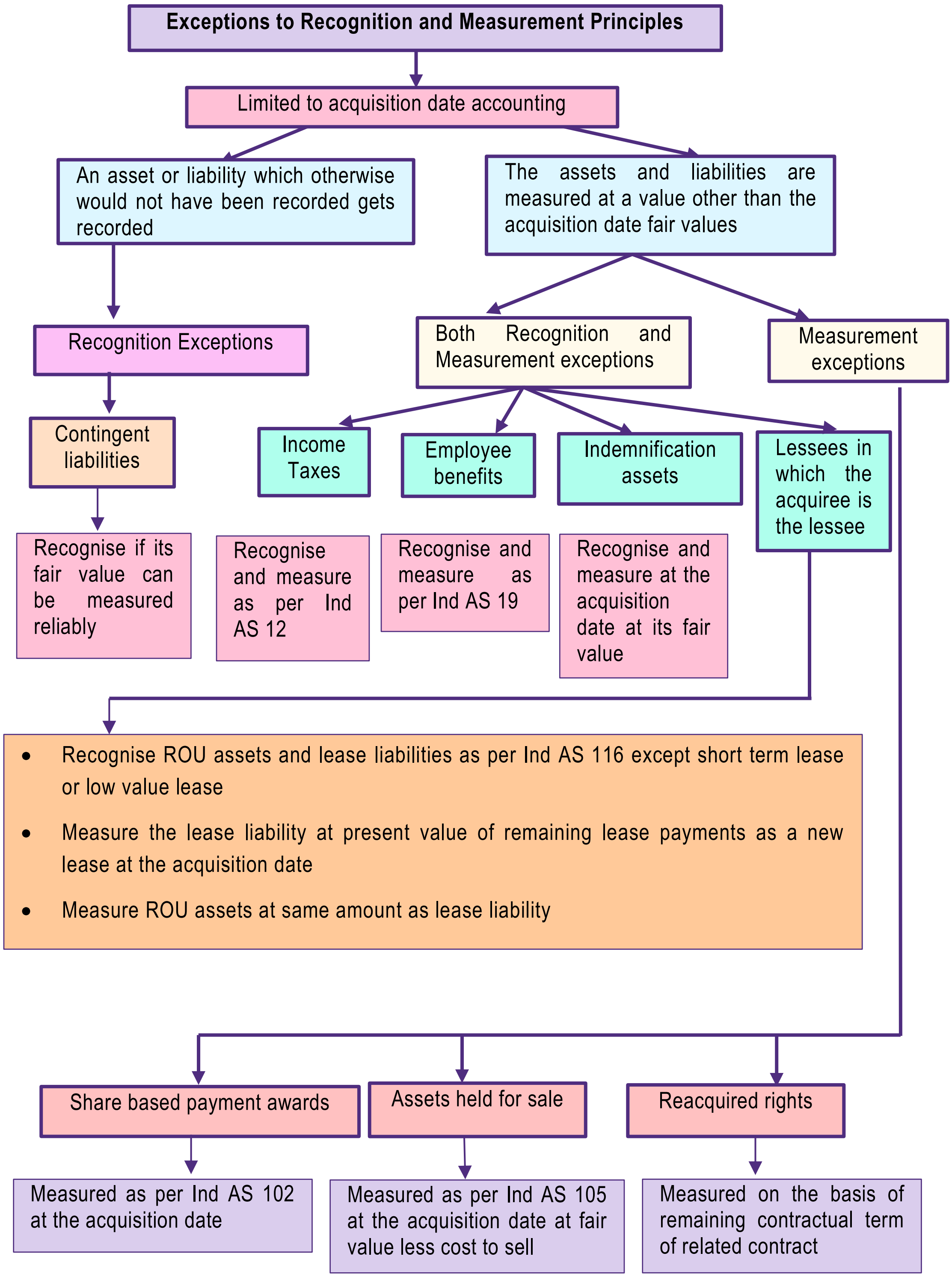
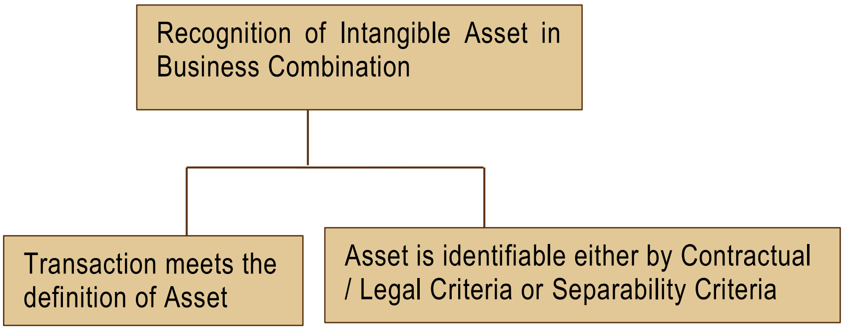
Reacquired rights	These are the rights which the acquirer before acquisition may have granted to the acquiree to use certain assets which belongs to the acquirer. It does not matter whether the asset was recorded in the financial statement of the acquirer or not. For example, license to use the brand name, Franchisee rights etc. if an acquirer acquires an acquiree which had certain rights granted to it by the acquirer then the business combination results in settlement of the right and accordingly any settlement gain or loss should be considered as a separate transaction from business combination and will be recorded in the financial statement of the acquirer. The acquirer shall measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the related contract without considering the effect of potential renewals.
Intangible assets	The acquirer shall record separately from Goodwill, the identifiable intangible acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion. (Refer a section below on intangible asset highlighting detailed guidance on recognition and measurement criteria)
Share based payment transactions	The acquirer shall measure a liability or an equity instrument related to share-based payment transactions of the acquiree or the replacement of an acquiree's share-based payment transactions with share-based payment transactions of the acquirer in accordance with the method in Ind AS 102, Share-based Payment, at the acquisition date.
Assets held for sale	The acquirer shall measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, at fair value less costs to sell in accordance with that Ind AS.
Insurance contracts	***The acquirer shall measure a group of contracts within the scope of Ind AS 117 Insurance Contracts, acquired in a business combination, and any assets for insurance acquisition cash flows as defined in Ind AS 117, as a liability or asset in accordance with Ind AS 117, at the acquisition date.***

Leases	**Acquiree is a lessee** • The acquirer shall recognise right-of-use assets and lease liabilities for leases identified in accordance with Ind AS 116. • The acquirer is not required to recognise right-of-use assets and lease liabilities for: (a) leases for which the lease term ends within 12 months of the acquisition date; or (b) leases for which the underlying asset is of low value. • The acquirer shall measure the lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the acquisition date. • The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms. **Acquiree is a lessor** In measuring the acquisition-date fair value of an asset, the acquirer shall take into account the terms of the lease. The acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms.
Assembled workforce	The acquirer subsumes into Goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date. An assembled workforce does not represent the intellectual capital of the skilled workforce—the (often specialised) knowledge and experience that employees of an acquiree bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognised separately from goodwill, any value attributed to it is subsumed into goodwill.


Exceptions to Recognition and Measurement Principles
Limited to acquisition date accounting
An asset or liability which otherwise would not have been recorded gets recorded
The assets and liabilities are measured at a value other than the acquisition date fair values
Recognition Exceptions
Both Recognition and Measurement exceptions
Measurement exceptions
Contingent liabilities
Income Taxes
Employee benefits
Indemnification assets
Lessees in which the acquiree is the lessee
Recognise if its fair value can be measured reliably
Recognise and measure as per Ind AS 12
Recognise and measure as per Ind AS 19
Recognise and measure at the acquisition date at its fair value
Recognise ROU assets and lease liabilities as per Ind AS 116 except short term lease or low value lease
Measure the lease liability at present value of remaining lease payments as a new lease at the acquisition date
Measure ROU assets at same amount as lease liability
Share based payment awards
Assets held for sale
Reacquired rights
Measured as per Ind AS 102 at the acquisition date
Measured as per Ind AS 105 at the acquisition date at fair value less cost to sell
Measured on the basis of remaining contractual term of related contract

10.3 Intangible Assets

As explained above an intangible asset should be recorded separately from Goodwill if either the separability criteria is met or it arises out of contractual legal criterion.



10.3.1 Contractual Legal criterion

An intangible asset that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations.

For example:

a. an acquiree owns and operates a nuclear power plant. The licence to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

b. an acquiree owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future revenue in foreign exchange. Both the technology patent and the related licence agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related licence agreement separately from one another would not be practical.

10.3.2 Separability criteria

The separability criterion means that an acquired intangible asset is **capable** of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability. An intangible asset that the acquirer would be able to sell, license or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, license or otherwise exchange it. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them.

Example 17:

Customer and subscriber lists are frequently licensed and thus meet the separability criterion. Even if an acquiree believes its customer lists have characteristics different from other customer lists, the fact that customer lists are frequently licensed generally means that the acquired customer list meets the separability criterion. However, a customer list acquired in a business combination would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers.

An intangible asset that is not individually separable from the acquiree or combined entity meets the separability criterion if it is separable in combination with a related contract, identifiable asset or liability.

For example:

a. market participants exchange deposit liabilities and related depositor relationship intangible assets in observable exchange transactions. Therefore, the acquirer should recognise the depositor relationship intangible asset separately from goodwill.

b. an acquiree owns a registered trademark and documented but unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquiree or combined entity and sold if the related trademark is sold, it meets the separability criterion.

Accordingly, as per the guidance above it follows that identification of intangible asset will be judgemental and will vary in each case.

Following are the possible sources of information and broad indicator to be used to identify any possible intangible separately from goodwill:

A. Internal sources:

- ♦ **Financial statements of the acquiree-**
  - ➢ Significant R&D cost may be indicator that there may be possible technology related intangible.

- Significant sales promotion or marketing cost- this is a strong indicator of marketing related intangible like distributor network, Marketing collaterals etc.
- Customer acquisition cost- lot of companies spend money to acquire new customers like online e-commerce companies provide incentive to register a customer as a first- time user or download their app. This may be a strong indicator of existence of customer list as an intangible.

- **Share purchase agreement-** This can also be a strong indicator of existence of intangible in the form of any technical know-how, trademarks or patent which are included in the agreement.
- **Purpose of acquisition-** The reason for acquisition may also indicate the possible intangible to be recorded. For e.g. Coca Cola acquired Thumps Up with an intention to close the brand which will result in increase in its market share. Accordingly, this will also be a possible intangible asset.

Illustration 17

Company A, FMCG company acquires an online e-commerce company E, with the intention to start its retail business. The e-commerce company has over the period have 10 million registered users. However, the e-commerce company E does not have any intention to sell the customer list.

Should this customer list be recorded as an intangible in a business combination?

Solution

In this situation the customer database does not give rise to legal or contractual right. Accordingly, the assessment of its separability will be assessed. The database can be useful to other players and Company E has the ability to transfer this to them. Accordingly, the intention not to transfer will not affect the assessment whether to record this as an intangible or not. Hence customer list should be recorded as an intangible in a business combination.

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Illustration 18

ABC Ltd. a pharmaceutical group acquires XYZ Ltd. another pharmaceutical business. XYZ Ltd. has incurred significant research costs in connection with two new drugs that have been undergoing clinical trials. Out of the two drugs, one drug has not been granted necessary regulatory approvals. However, ABC Ltd. expects that approval will be given within two years. The other drug has recently received regulatory approval. The drugs' revenue-earning potential was one of the principal reasons why entity ABC Ltd. decided to acquire entity XYZ Ltd.

Whether the research and development on either of the drugs be recognised as an intangible asset in the books of ABC Ltd.?

Solution

Ind AS 38, Intangible Assets provides explicit guidance on recognition of acquired in-process research and development.

Paragraph 21 of Ind AS 38 provides guidance regarding general recognition conditions which require it to be probable that expected future economic benefits will flow to the entity before an intangible asset can be recognised and for the cost to be measured reliably.

As per paragraph 33 of Ind AS 38, both of the standard's general recognition criteria, i.e. probability of benefits and reliable measurement, are always considered to be satisfied for intangible assets acquired in a business combination.

The fair value of an intangible asset reflects expectations about the probability of these benefits, despite uncertainty about the timing or the amount of the inflow. There will be sufficient information to measure the fair value of the asset reliably if it is separable or arises from contractual or other legal rights. If there is a range of possible outcomes with different probabilities, this uncertainty is taken into account in the measurement of the asset's fair value.

Paragraph 34 of Ind AS 38, provides that in accordance with this Standard and Ind AS 103, an acquirer recognises at the acquisition date, separately from goodwill, an intangible asset of the acquiree, irrespective of whether the asset had been recognised by the acquiree before the business combination.

This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset. An acquiree's in-process research and development project meets the definition of an intangible asset when it:

(a) meets the definition of an asset; and

(b) is identifiable, i.e. is separable or arises from contractual or other legal rights.

In accordance with above,

(i) The fair value of the first drug reflects the probability and the timing of the regulatory approval being obtained. As per the standard, the recognition criterion of probable future economic benefits is considered to be satisfied in respect of the asset acquired accordingly an asset is recognised. Subsequent expenditure on an in-process research or development project acquired separately is to be dealt with in accordance with paragraph 43 of Ind AS 38.

(ii) The rights to the second drug also meet the recognition criteria in Ind AS 8 and are recognised. The approval means it is probable that future economic benefits will flow to ABC Ltd. This will be reflected in the fair value assigned to the intangible asset.

Thus, recognising in-process research and development as an asset on acquisition applies different criteria to those that are required for internal projects. The research costs of internal R&D projects may under no circumstances be capitalised as an intangible asset. It may be pertinent to note that entities will be required to recognise on acquisition some research and development expenditure that they would not have been able to recognise if it had been an internal project. Although the amount attributed to the project is accounted for as an asset, Ind AS 38 requires that any subsequent expenditure incurred after the acquisition of the project is to be accounted for in accordance with paragraphs 54 to 62 of Ind AS 38.

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10.3.3 Assembled workforce and other items that are not identifiable

The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date.

An assembled workforce does not represent the intellectual capital of the skilled workforce — the (often specialised) knowledge and experience that employees of an acquiree bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognised separately from goodwill, any value attributed to it is subsumed into goodwill.

The acquirer also subsumes into goodwill any value attributed to items that do not qualify as assets at the acquisition date. For example, the acquirer might attribute value to potential contracts the acquiree is negotiating with prospective new customers at the acquisition date. Because those potential contracts are not themselves assets at the acquisition date, the acquirer does not recognise them separately from goodwill. The acquirer should not subsequently reclassify the value of those contracts from goodwill for events that occur after the acquisition date. However, the acquirer should assess the facts and circumstances surrounding the events occurring shortly after the acquisition to determine whether a separately recognisable intangible asset existed at the acquisition date.

After initial recognition, an acquirer accounts for intangible assets acquired in a business combination in accordance with the provisions of Ind AS 38, Intangible Assets. However, as described in paragraph 3 of Ind AS 38, the accounting for some acquired intangible assets after initial recognition is prescribed by other Ind AS.

The identifiability criteria determine whether an intangible asset is recognised separately from goodwill. However, the criteria neither provides guidance for measuring the fair value of an intangible asset nor restrict the assumptions used in measuring the fair value of an intangible asset. For example, the acquirer would take into account the assumptions that market participants would use when pricing the intangible asset, such as expectations of future contract renewals, in measuring fair value. It is not necessary for the renewals themselves to meet the identifiability criteria.

10.4 Reacquired Rights

As part of a business combination, an acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer's recognised or unrecognised assets. Examples of such rights include a right to use the acquirer's trade name under a franchise agreement or a right to use the acquirer's technology under a technology licensing agreement. A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill.

If the terms of the contract giving rise to a reacquired right are favourable or unfavourable relative to the terms of current market transactions for the same or similar items, the acquirer shall recognise a settlement gain or loss.

Illustration 19

Vadapav Ltd. is a successful company has number of own stores across India and also offers franchisee to other companies. Efficient Ltd. is one of the franchisee of Vadapav Ltd. and it operates number of store in south India. Vadapav Ltd. decided to acquire Efficient Ltd. due to its huge distribution network and accordingly purchased the outstanding shares on 1st April, 20X2. On the acquisition date, Vadapav Ltd. determines that the license agreement reflects current market terms.

Determine the accounting for franchisee right by Vadapav Ltd. at the time of acquisition of business.

Solution

Vadapav will record the franchisee right as an intangible asset (reacquired right) while doing purchase price allocation and since it is at market terms no gain or loss will be recorded on settlement.

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Illustration 20

ABC Ltd. acquires PQR Ltd. for a consideration of ₹ 1 crore. Four years ago, ABC Ltd. had granted a ten-year license allowing PQR Ltd. to operate in Europe. The cost of the license was ₹ 2,50,000. The contract allows either party to terminate the franchise at a cost of the unexpired initial fee plus 20%. At the date of acquisition, the settlement amount is ₹ 1,80,000 [(₹ 2,50,000 x 6/10) + 20%].

ABC Ltd. has acquired PQR Ltd., because it sees high potential in the European market and wishes to exploit it. ABC Ltd. calculates that under current economic conditions and at current prices it could grant a six-year franchise for a price of ₹ 4,50,000.

How is the license accounted for as part of the business combination?

Solution

Paragraph B51 of Ind AS 103 provides that "the acquirer and acquiree may have a relationship that existed before they contemplated the business combination, referred to here as a 'pre-existing relationship'. A pre-existing relationship between the acquirer and acquiree may be contractual (for example, vendor and customer or licensor and licensee) or non-contractual (for example, plaintiff and defendant)."

Further, paragraph B52 of Ind AS 103 provides that "if the business combination in effect settles a pre-existing relationship, the acquirer recognises a gain or loss, measured as follows:

(a) for a pre-existing non-contractual relationship (such as a lawsuit), fair value.

(b) for a pre-existing contractual relationship, the lesser of (i) and (ii):

(i) the amount by which the contract is favourable or unfavourable from the perspective of the acquirer when compared with terms for current market transactions for the same or similar items. (An unfavourable contract is a contract that is unfavourable in terms of current market terms. It is not necessarily an onerous contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.)

(ii) the amount of any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavourable.

If (ii) is less than (i), the difference is included as part of the business combination accounting.

The amount of gain or loss recognised may depend in part on whether the acquirer had previously recognised a related asset or liability, and the reported gain or loss therefore may differ from the amount calculated by applying the above requirements."

Based on the above in the instant case, the license is recognised at ₹ 4,50,000, the fair value at market rates of a license based on the remaining contractual life.

The gain or loss on settlement of the contract is the lower of:

- ₹ 3,00,000, which is the amount by which the right is unfavorable to ABC Ltd. compared to market terms. This is the difference between the amount that ABC Ltd. could receive for granting a similar right, ₹ 4,50,000, compared to the carrying value (or the unamortised value) that it was granted for, ₹ 1,50,000 (2,50,000 X 6/10).

- ₹ 1,80,000, which is the amount that ABC Ltd. would have to pay to terminate the right at the date of acquisition.

The loss on settlement of the contract is ₹ 1,80,000. Therefore, out of the ₹ 1 crore paid, ₹ 98.2 lakh is accounted for as consideration for the business combination and ₹ 1,80,000 is accounted for separately as a settlement loss on the re-acquired right.

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10.5 Goodwill – Recognition and Measurement

The acquirer shall recognise Goodwill as of the acquisition date measured as the excess of (a) over (b) below:

a) the aggregate of:

   i. the purchase consideration transferred at acquisition-date fair value;

   ii. the amount of any non-controlling interest in the acquiree measured in accordance with this Ind AS (refer non-controlling section); and

   iii. in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Ind AS.

In a business combination in which the acquirer and the acquiree (or its former owners) exchange only equity interests, the acquisition-date fair value of the acquiree's equity interests may be more reliably measurable than the acquisition-date fair value of the acquirer's equity interests. If so, the acquirer shall determine the amount of goodwill by using the acquisition-date fair value of the acquiree's equity interests instead of the acquisition-date fair value of the equity interests transferred. To determine the amount of goodwill in a business combination in which no consideration is transferred, the acquirer shall use the acquisition-date fair value of the acquirer's interest in the acquiree in place of the acquisition-date fair value of the consideration transferred (paragraph 32(a)(i)).

10.6 Bargain Purchase

In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the value of net assets acquired in a business combination exceeds the purchase consideration.

The acquirer shall recognise the resulting gain in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve, if the reason for bargain purchase gain is clear and evidence exist. If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, then the gain shall be recognised directly in equity as capital reserve.

The gain shall be attributed to the acquirer and there will no allocation to the non-controlling shareholders.

A bargain purchase might happen, for example, in a business combination that is a forced sale in which the seller is acting under compulsion.

The Ind AS itself acknowledges that it is very rare that a bargain purchase in a business combination will arise and accordingly the standard re-emphasises the above point by requiring the entities to reassess and identify the clear reason why it is a bargain purchase business combination. For e.g. acquisition of business in a bankruptcy sale, or sale of business due to a regulatory requirement.

Example 18:

Entity X is one of the largest liquor manufacturing company in the world and it acquires another Entity Y which has significant presence in India and UK. However, the competition commission in UK has issued orders to sell one division of the UK assets of Entity Y in order to comply with the local competition regulation in UK within a specified timeline. Entity Z another boutique liquor manufacturer realises the opportunity and purchase the assets of Entity Y from Entity X.

In the given case above it is more likely than not that there could be an element of bargain purchase as the Entity X was under compulsion to sell the assets within a specified timeline.

As mentioned above before recognising a gain on a bargain purchase, the acquirer shall determine whether there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase. If such evidence exists, the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognise any additional assets or liabilities that are identified in that review.

The acquirer shall then review the procedures used to measure the amounts this Ind AS requires to be recognised at the acquisition date for all of the following:

- the identifiable assets acquired and liabilities assumed;
- the non-controlling interest in the acquiree, if any;
- for a business combination achieved in stages, the acquirer's previously held equity interest in the acquiree; and
- the consideration transferred.

The objective of the review is to ensure that the measurements appropriately reflect consideration of all available information as of the acquisition date.

Illustration 21

On 1st January, 20X1, A Ltd. acquires 80 per cent of the equity interests of B Ltd. in exchange for cash of ₹ 15 crore. The former owners of B Ltd. were required to dispose off their investments in B Ltd. by a specified date, and accordingly they did not have sufficient time to find potential buyers. A qualified valuation professional hired by the management of A Ltd. measures the identifiable net assets acquired, in accordance with the requirements of Ind AS 103, at ₹ 20 crore and the fair value of the 20 per cent non-controlling interest in B Ltd. at ₹ 4.2 crore. How should A Ltd. recognise the above bargain purchase?

Solution

The amount of B Ltd.'s identifiable net assets i.e., ₹ 20 crore exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in B Ltd. i.e. ₹ 19.2 crore. Therefore, A Ltd. should review the procedures it used to identify and measure the net assets acquired and the fair value of non-controlling interest in B Ltd. and the consideration transferred. After the review, A Ltd. decides that the procedures and resulting measures were appropriate. A Ltd. measures the gain on its purchase of the 80 per cent interest at ₹ 80 lakh, as the difference between the amount of the identifiable net assets which is ₹ 20 crore and the sum of purchase consideration and fair value of non-controlling interest, which is ₹ 19.2 crore (cash consideration of ₹ 15 crore and fair value of non-controlling interest of ₹ 4.2 crore).

Assuming there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, the gain on bargain purchase of 80 per cent interest calculated at ₹ 80 lakh, which will be recognised in other comprehensive income on the acquisition date and accumulated the same in equity as capital reserve.

If the acquirer chose to measure the non-controlling interest in B Ltd. on the basis of its proportionate share of identifiable net assets of the acquiree, the recognised amount of the non-controlling interest would be ₹ 4 crore (₹ 20 crore × 0.20). The gain on the bargain purchase then would be ₹ 1 crore (₹ 20 crore – (₹ 15 crore + ₹ 4 crore)).

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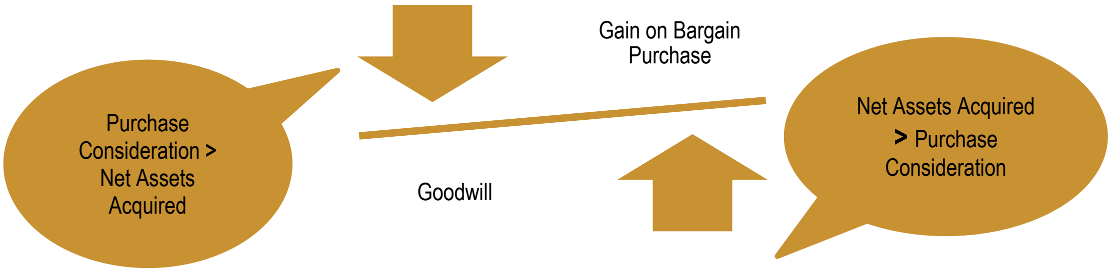

10.7 Measurement Period

Ind AS 103 provides a measurement period window wherein if all the required information is not available on the acquisition date then the entity will be required to do the purchase price allocation on a provision basis. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date.

During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date.

The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this Ind AS:

- the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;
- the consideration transferred for the acquiree (or the other amount used in measuring goodwill);
- in a business combination achieved in stages, the equity interest in the acquire previously held by the acquirer; and
- the resulting goodwill or gain on a bargain purchase.

Any change i.e. increase or decrease in the net assets acquired due to new information available during the measurement period which existed on the acquisition date will be adjusted against goodwill.

However, after the measurement period ends, any change in the value of assets and liabilities due to an information which existed on the valuation date will be accounted as an error as per Ind AS 8, Accounting policies, Changes in Accounting Estimates and Errors.

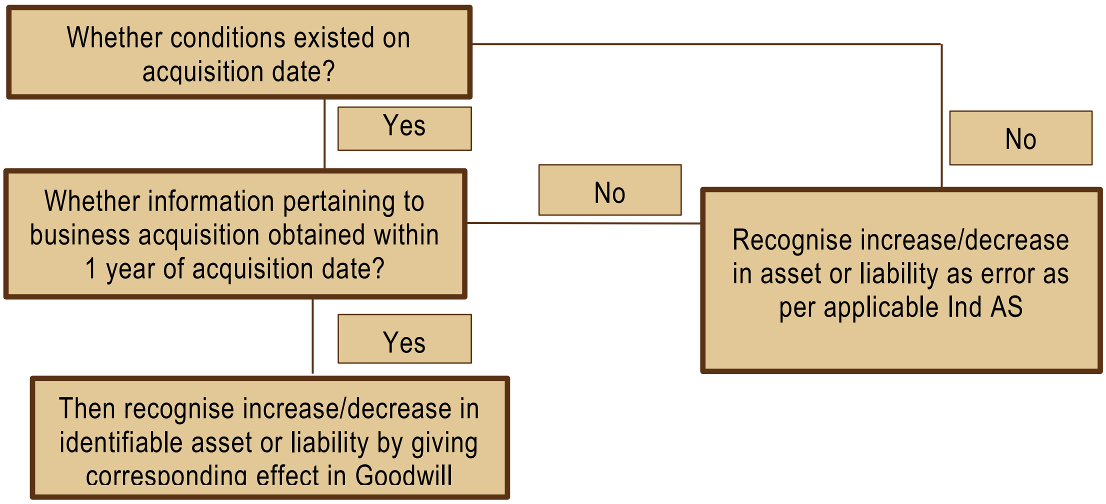

Illustration 22

Entity X acquired 100% shareholding of Entity Y on 1st April, 20X1 and had completed the preliminary purchase price allocation and accordingly recorded net assets of ₹ 100 million against the purchase consideration of 150 million. Entity Y had significant carry forward losses on which deferred tax asset was not recorded due to lack of convincing evidence on the acquisition date. However, on 31st March, 20X2, Entity Y won a significant contract which is expected to generate enough taxable income to recoup the losses. Accordingly, the deferred tax asset was recorded on the carry forward losses on 31st March, 20X2.

Whether the aforesaid losses can be adjusted with the Goodwill recorded based on the preliminary purchase price allocation?

Solution

No, as per the requirement of Ind AS 103, changes to the net assets are allowed which results from the discovery of a fact which existed on the acquisition date. However, change of facts resulting in recognition and de-recognition of assets and liabilities after the acquisition date will be accounted in accordance with other Ind AS. In the above scenario deferred tax asset was not eligible for recognition on the acquisition date and accordingly the new contract on 31st March, 20X2 will tantamount to change of estimate and accordingly will not impact the Goodwill amount.

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Illustration 23

ABC Ltd. acquires XYZ Ltd. in a business combination on 15^{th} January, 20X1. Few days before the date of acquisition, one of XYZ Ltd.'s customers had claimed that certain amounts were due by XYZ Ltd. under penalty clauses for completion delays included in the contract.

ABC Ltd. evaluates the dispute based on the information available at the date of acquisition and concludes that XYZ Ltd. was responsible for at least some of the delays in completing the contract. Based on the evaluation, ABC Ltd. recognises ₹ 1 crore towards this liability which is its best estimate of the fair value of the liability to the customer based on the information available at the date of acquisition.

In October, 20X1 (within the measurement period), the customer presents additional information as per which ABC Ltd. concludes the fair value of liability on the date of acquisition to be 2 crore.

ABC Ltd. continues to receive and evaluate information related to the claim after October, 20X1. Its evaluation doesn't change till February, 20X2 (i.e. after the measurement period), when it concludes that the fair value of the liability for the claim at the date of acquisition is ₹ 1.9 crore. ABC Ltd. determines that the amount that would be recognised with respect to the claim under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets as at February, 20X2 is ₹ 2.2 crore.

How should the adjustment to the provisional amounts be made in the financial statements during and after the measurement period?

Solution

The consolidated financial statements of ABC Ltd. for the year ended 31^{st} March, 20X1 should include ₹ 1 crore towards the contingent liability in relation to the customer claim.

When the customer presents additional information in support of its claim, the incremental liability of ₹ 1 crore (₹ 2 crore – ₹ 1 crore) will be adjusted as a part of acquisition accounting as it is within the measurement period. In its financial statements for the year ending on 31^{st} March, 20X2, ABC Ltd. will disclose the amounts and explanations of the adjustments to the provisional values recognized during the current reporting period. Therefore, it will disclose that the comparative information for the year ending on 31^{st} March, 20X1 is adjusted retrospectively to increase the fair value of the item of liability at the acquisition date by ₹ 1 crore, resulting in a corresponding increase in goodwill.

The information resulting in the decrease in the estimated fair value of the liability for the claim in February, 20X2 was obtained after the measurement period. Accordingly, the decrease is not recognised as an adjustment to the acquisition accounting. If the amount determined in accordance with Ind AS 37 subsequently exceeds the previous estimate of the fair value of the liability, then ABC Ltd. recognises an increase in the liability. As the change has occurred after the end of the measurement period, the increase in the liability amounting to ₹ 20 lakh (₹ 2.2 crore – ₹ 2 crore) is recognised in profit or loss.

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10.8 Determining what is part of the Business Combination Transaction

The acquirer and the acquiree may have a pre-existing relationship or other arrangement before negotiations for the business combination began, or they may enter into an arrangement during the negotiations that is separate from the business combination. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination, i.e. amounts that are not part of the exchange for the acquiree. The acquirer shall recognise as part of applying the acquisition method only the consideration transferred for the acquiree and the assets acquired and liabilities assumed in the exchange for the acquiree. Separate transactions shall be accounted for in accordance with the relevant Ind AS.

A transaction entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquiree (or its former owners) before the combination, is likely to be a separate transaction. The following are examples of separate transactions that are not to be included in applying the acquisition method:

- a transaction that in effect settles pre-existing relationships between the acquirer and acquiree;
- a transaction that remunerates employees or former owners of the acquiree for future services; and
- a transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.

The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, in determining whether the transaction is separate from Business combination:

I. **The reasons for the transaction**- Understanding the reasons why the parties to the combination (the acquirer and the acquiree and their owners, directors and managers - and their agents) entered into a particular transaction or arrangement may provide insight into whether it is part of the consideration transferred and the assets acquired or liabilities assumed. For example, if a transaction is arranged primarily for the benefit of the acquirer or the combined entity rather than primarily for the benefit of the acquiree or its former owners before the combination, that portion of the transaction price paid (and any related assets or liabilities) is less likely to be part of the exchange for the acquiree. Accordingly, the acquirer would account for that portion separately from the business combination.

II. **Who initiated the transaction**—Understanding who initiated the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquiree or its former owners before the combination. On the other hand, a transaction or arrangement initiated by the acquiree or its former owners is less likely to be for the benefit of the acquirer or the combined entity and more likely to be part of the business combination transaction.

III. **The timing of the transaction**—The timing of the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction between the acquirer and the acquiree that takes place during the negotiations of the terms of a business combination may have been entered into in contemplation of the business combination to provide future economic benefits to the acquirer or the combined entity. If so, the acquiree or its former owners before the business combination are likely to receive little or no benefit from the transaction except for benefits they receive as part of the combined entity.

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Illustration 24

Progressive Ltd. is being sued by Regressive Ltd. for an infringement of its Patent. At 31st March, 20X2, Progressive Ltd. recognised a ₹ 10 million liability related to this litigation.

On 30th July, 20X2, Progressive Ltd. acquired the entire equity of Regressive Ltd. for ₹ 500 million. On that date, the estimated fair value of the expected settlement of the litigation is ₹ 20 million.

Recommend the accounting for such litigation liability at the time of business combination of Progressive Ltd. and Regressive Ltd.

Solution

In the above scenario the litigation is in substance settled with the business combination transaction and accordingly ₹ 20 million being the fair value of the litigation liability will be considered as paid for settling the litigation claim and will be not included in the business combination. Accordingly, the purchase price will reduce by ₹ 20 million and the difference between ₹ 20 million and ₹ 10 million will be recorded in income statement of the Progressive limited as loss on settlement of the litigation.

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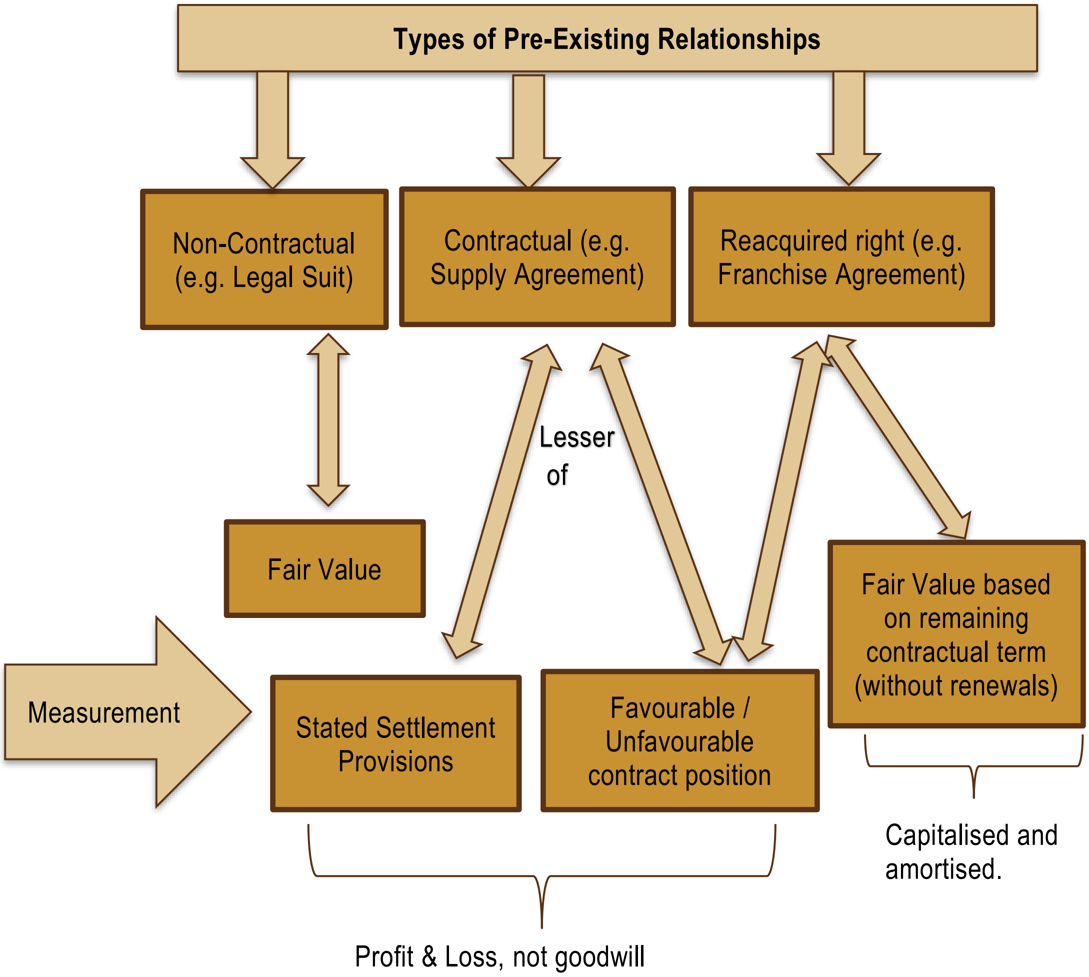
Summary of accounting for a pre-existing relationship:



10.9 Contingent Payments to Employees or Selling Shareholders

Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions depends on the nature of the arrangements. Understanding the reasons why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement.

If it is not clear whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree or is a transaction separate from the business combination, the acquirer should consider the following indicators:

a) **Continuing employment—**The terms of continuing employment by the selling shareholders who become key employees may be an indicator of the substance of a contingent consideration arrangement. The relevant terms of continuing employment may be included in an employment agreement, acquisition agreement or some other document. A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.

b) **Duration of continuing employment —** If the period of required employment coincides with or is longer than the contingent payment period, that fact may indicate that the contingent payments are, in substance, remuneration.

c) **Level of remuneration —** Situations in which employee remuneration (other than the contingent payments) is at a reasonable level in comparison with that of other key employees in the combined entity may indicate that the contingent payments are additional consideration rather than remuneration.

d) **Incremental payments to employees —** If selling shareholders who do not become employees receive lower contingent payments on a per-share basis than the selling shareholders who become employees of the combined entity, that fact may indicate that the incremental amount of contingent payments to the selling shareholders who become employees is remuneration.

e) **Number of shares owned—**The relative number of shares owned by the selling shareholders who remain as key employees may be an indicator of the substance of the contingent consideration arrangement. For example, if the selling shareholders who owned substantially all of the shares in the acquiree continue as key employees, that fact may indicate that the arrangement is, in substance, a profit-sharing arrangement intended to provide remuneration for post-combination services. Alternatively, if selling shareholders who continue as key employees owned only a small number of shares of the acquiree and all selling shareholders receive the same amount of contingent consideration on a per-share basis, that fact may indicate that the contingent payments are additional consideration. The pre-acquisition ownership interests held by parties related to selling shareholders who continue as key employees, such as family members, should also be considered.

f) **Linkage to the valuation—**If the initial consideration transferred at the acquisition date is based on the low end of a range established in the valuation of the acquire and the contingent formula relates to that valuation approach, that fact may suggest that the contingent payments are additional consideration. Alternatively, if the contingent payment formula is consistent with prior profit-sharing arrangements, that fact may suggest that the substance of the arrangement is to provide remuneration.

g) **Formula for determining consideration—**The formula used to determine the contingent payment may be helpful in assessing the substance of the arrangement. For example, if a contingent payment is determined on the basis of a multiple of earnings, that might suggest that the obligation is contingent consideration in the business combination and that the formula is intended to establish or verify the fair value of the acquiree. In contrast, a contingent payment that is a specified percentage of earnings might suggest that the obligation to employees is a profit-sharing arrangement to remunerate employees for services rendered.

h) **Other agreements and issues —** The terms of other arrangements with selling shareholders (such as agreements not to compete, executory contracts, consulting contracts and property lease agreements) and the income tax treatment of contingent payments may indicate that contingent payments are attributable to something other than consideration for the acquiree. For example, in connection with the acquisition, the acquirer might enter into a property lease arrangement with a significant selling shareholder. If the lease payments specified in the lease contract are significantly below market, some or all of the contingent payments to the lessor (the selling shareholder) required by a separate arrangement for contingent payments might be, in substance, payments for the use of the leased property that the acquirer should recognise separately in its post-combination financial statements. In contrast, if the lease contract specifies lease payments that are consistent with market terms for the leased property, the arrangement for contingent payments to the selling shareholder may be contingent consideration in the business combination.

Illustration 25

KKV Ltd acquires a 100% interest in VIVA Ltd, a company owned by a single shareholder who is also the KMP in the Company, for a cash payment of USD 20 million and a contingent payment of USD 2 million. The terms of the agreement provide for contingent payment 2 years after the acquisition if, the following conditions are met:

- *the EBIDTA margins of the Company after 2 years post-acquisition is 21%.*
- *the former shareholder continues to be employed with VIVA Ltd for at least 2 years after the acquisition. No part of the contingent payment will be paid if the former shareholder does not complete the 2 year employment period.*

Determine the purchase consideration in the above case.

Solution

In the above scenario the former shareholder is required to continue in employment and the contingent consideration will be forfeited if the employment is terminated or if he resigns. Accordingly, only USD 20 million is considered as purchase consideration and the contingent consideration is accounted as employee cost and will be accounted as per the other Ind AS.

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Illustration 26 : Contingent consideration- Payments to employees who are former owners of acquiree

ABC Ltd. acquires all of the outstanding shares of XYZ Ltd. in a business combination. XYZ Ltd. had three shareholders with equal shareholdings, two of whom were also senior-level employees of XYZ Ltd. and would continue as employee post-acquisition of shares by ABC Ltd.

- *The employee shareholders each will receive ₹ 60,00,000 plus an additional payment of ₹ 1,50,00,000 to 2,00,00,000 based on a multiple of earnings over the next two years.*
- *The non-employee shareholders each receive ₹ 1,00,00,000.*

The additional payment of each of these employee shareholders will be forfeited if they leave the employment of XYZ Ltd. at any time during the two years following its acquisition by ABC Ltd. The salary received by them is considered reasonable remuneration for their services.

How much amount is attributable to post combination services?

Solution

Paragraph B55(a) of Ind AS 103 provides an indication that a contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services.

Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.

In accordance with the above, in the instant case, the additional consideration of ₹ 1,50,00,000 to ₹ 2,00,00,000 represents compensation for post-combination services, as the same represents that part of the payment which is forfeited if the former shareholder does not remain in the employment of XYZ Ltd. for two years following the acquisition - i.e., only ₹ 60,00,000 is attributed to consideration in exchange for the acquired business.

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10.10 Acquirer Share Based Payment Awards Exchanged for Awards held by the Acquiree's Employees

- An acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree.
- The above share-based payment awards will include vested and unvested shares.

- Exchanges of share options or other share-based payment awards in conjunction with a business combination are accounted for as modifications of share-based payment awards in accordance with Ind AS 102, Share based Payment.
- If the acquirer replaces the acquiree awards, either all or a portion of the market-based measure of the acquirer's replacement awards shall be included in measuring the consideration transferred in the business combination. Market based measure means that awards will be re-measured on the acquisition date as per the requirements of Ind AS 102.
- In situations in which acquiree awards would expire as a consequence of a business combination and if the acquirer replaces those awards when it is not obliged to do so, all of the market-based measure of the replacement awards shall be recognised as remuneration cost in the post-combination financial statements in accordance with Ind AS 102. That is to say, none of the market-based measure of those awards shall be included in measuring the consideration transferred in the business combination. The acquirer is obliged to replace the acquiree awards if the acquiree or its employees have the ability to enforce replacement.

  For example, for the purposes of applying this guidance, the acquirer is obliged to replace the acquiree's awards if replacement is required by:

  (a) the terms of the acquisition agreement;

  (b) the terms of the acquiree's awards; or

  (c) applicable laws or regulations.
- To determine the portion of a replacement award that is part of the consideration transferred for the acquiree and the portion that is remuneration for post-combination service, the acquirer shall measure both the replacement awards granted by the acquirer and the acquiree awards as of the acquisition date in accordance with Ind AS 102. The portion of the market-based measure of the replacement award that is part of the consideration transferred in exchange for the acquiree equals the portion of the acquiree award that is attributable to pre-combination service.
- The portion of the replacement award attributable to pre-combination service is the market-based measure of the acquiree award multiplied by the ratio of the portion of the vesting period completed to the greater of the total vesting period or the original vesting period of the acquiree award. The vesting period is the period during which all the specified vesting conditions are to be satisfied. Vesting conditions are defined in Ind AS 102.

- The portion of a non-vested replacement award attributable to post-combination service, and therefore recognised as remuneration cost in the post-combination financial statements, equals the total market-based measure of the replacement award less the amount attributed to pre-combination service. Therefore, the acquirer attributes any excess of the market-based measure of the replacement award over the market-based measure of the acquiree award to post-combination service and recognises that excess as remuneration cost in the post-combination financial statements.
- The acquirer shall attribute a portion of a replacement award to post-combination service if it requires post combination service, regardless of whether employees had rendered all of the service required for their acquiree awards to vest before the acquisition date.
- The portion of a non-vested replacement award attributable to pre-combination service, as well as the portion attributable to post-combination service, shall reflect the best available estimate of the number of replacement awards expected to vest.

Example 19

If the market-based measure of the portion of a replacement award attributed to pre-combination service is ₹ 100 and the acquirer expects that only 95 per cent of the award will vest, the amount included in consideration transferred in the business combination is ₹ 95.

- Changes in the estimated number of replacement awards expected to vest are reflected in remuneration cost for the periods in which the changes or forfeitures occur not as adjustments to the consideration transferred in the business combination. Similarly, the effects of other events, such as modifications or the ultimate outcome of awards with performance conditions, that occur after the acquisition date are accounted for in accordance with Ind AS 102 in determining remuneration cost for the period in which an event occurs.
- The same requirements for determining the portions of a replacement award attributable to pre-combination and post-combination service apply regardless of whether a replacement award is classified as a liability or as an equity instrument in accordance with the provisions of Ind AS 102. All changes in the market-based measure of awards classified as liabilities after the acquisition date and the related income tax effects are recognised in the acquirer's post-combination financial statements in the period(s) in which the changes occur.
- The income tax effects of replacement awards of share-based payments shall be recognised in accordance with the provisions of Ind AS 12, Income Taxes.

The above guidance on Share based payment as per the Ind AS 103 can be summarized as follows:

ACQUIRER SHARE BASED PAYMENT AWARDS EXCHANGED FOR AWARDS HELD BY THE ACQUIREE'S EMPLOYEES

Business combination transaction → An acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree

Nature of awards → The above share-based payment awards will include **vested and unvested** shares

Type of Accounting → Exchanges of share options or other share-based payment awards in conjunction with a business combination are **accounted for as modifications of share-based payment awards** as per Ind AS 102

Objective of Accounting → *To allocate the replacement award's value* between the amounts attributable to:

- **pre-combination service** (treated as part of consideration transferred)
- **post-combination service** (accounted for as compensation expense in the post combination financial statements)

Accounting

- Pre-combination period service cost = Market-based measure of the acquiree award × Completed vesting period as on the acquisition date ÷ Greater of total original vesting period or total revised vesting period
- Post-combination period service cost = Market-based measure of the replacement award − Amount attributed to pre-combination service

Market based measure means that awards will be re-measured on the acquisition date as per the requirements of Ind AS 102

Important Notes

- The acquirer shall attribute a portion of a replacement award to post-combination service if it requires post-combination service, regardless of whether employees had rendered all of the service required for their acquiree awards
- Changes in the estimated number of replacement awards expected to vest are **reflected in remuneration cost for the periods in which the changes or forfeitures occur not as adjustments to the consideration transferred in the business combination.**
- Modifications or the ultimate outcome of awards with performance conditions, that occur after the acquisition date are accounted for as per Ind AS 102 in determining **remuneration cost for the period in which an event occurs**
- Requirements for determining the portions of a replacement award attributable to pre-combination and post-combination service **apply regardless of whether a replacement award is classified as a liability or as an equity instrument** as per Ind AS 102
- Recognise income tax effects of replacement awards as per Ind AS 12

Illustration 27

Green Ltd acquired Pollution Ltd. As a part of the arrangement Green Ltd. had to replace the Pollution Ltd.'s existing equity-settled award. The original awards specify a vesting period of five years. At the acquisition date, Pollution Ltd employees have already rendered two years of service.

As required, Green Ltd replaced the original awards with its own share-based payment awards (replacement award). Under the replacement awards, the vesting period is reduced to 2 year (from the acquisition date).

The value (market-based measure) of the awards at the acquisition date are as follows:

- *original awards: ₹ 500*
- *replacement awards: ₹ 600*

As of the acquisition date, all awards are expected to vest.

Determine the accounting for the above replacement award.

Solution

Pre-combination period

The value of the replacement awards will have to be allocated between the pre-combination and post combination period. As of the acquisition date, the fair value of the original award (₹ 500) will be multiplied by the service rendered upto acquisition date (2 years) divided by greater of original vesting period (5 years) or new vesting period (4 years). Accordingly, ₹ 500 x 2/5= ₹ 200 will be considered as pre-combination service and will be included in the purchase consideration.

Post- combination period

The fair value of the award on the acquisition date is ₹ 600 which means the difference between the replacement award which is ₹ 600 and the amount allocated to pre-combination period (₹ 200) is ₹ 400 which will be now recorded over the remaining vesting period which is 2 years as an employee compensation cost.

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10.11 Non-replacement Awards

The acquiree may have outstanding share-based payment transactions that the acquirer does not exchange for its share-based payment transactions. If vested, those acquiree share-based payment transactions are part of the non-controlling interest in the acquiree and are measured at their market-based measure. If unvested, they are measured at their market-based measure as if the acquisition date were the grant date in accordance with paragraphs 19 and 30.

The market-based measure of unvested share-based payment transactions is allocated to the non-controlling interest on the basis of the ratio of the portion of the vesting period completed to the greater of the total vesting period and the original vesting period of the share-based payment transaction. The balance is allocated to post-combination service.

The above means that the acquiree's existing award will be settled in its own shares and the consequential shareholders will become the Non-controlling shareholders. The above principles can be summarized as follows:

Vested shares -

- the value credited to Share based payment reserve is classified as NCI.

Unvested-

- Pre-combination period is considered as a part of NCI
- Post-combination period- is recorded as employee cost and the credit forms part of the NCI in the balance sheet.

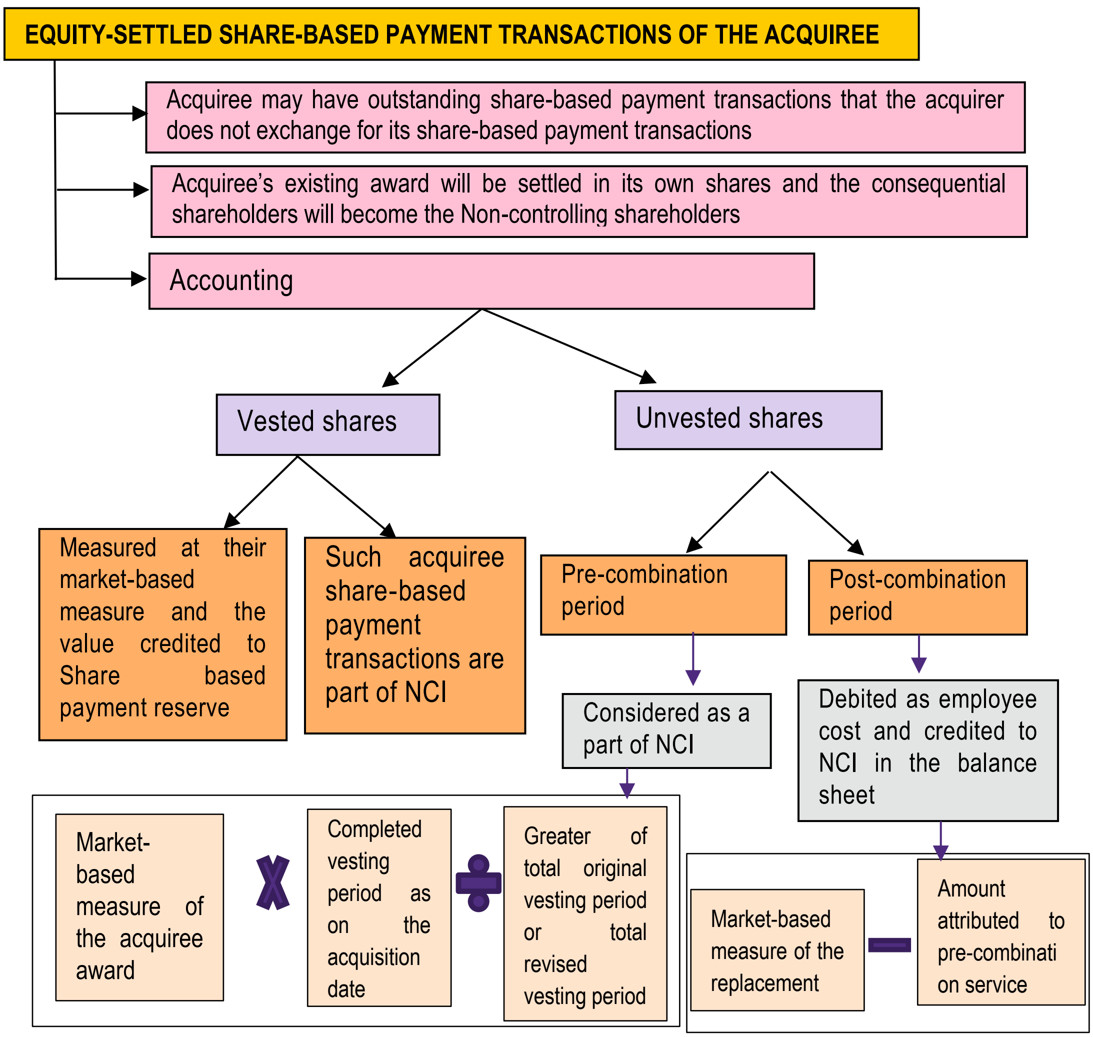


Illustration 28

P Ltd. a real estate company acquires Q Ltd. another construction company which has an existing equity settled share-based payment scheme. The awards vest after 5 years of employee service. At the acquisition date, Company Q's employees have rendered 2 years of service. None of the awards are vested at the acquisition date. P did not replace the existing share-based payment scheme but reduced the remaining vesting period from 3 years to 2 years. Company P determines that the market-based measure of the award at the acquisition date is ₹ 500 (based on measurement principles and conditions at the acquisition date as per Ind AS 102).

Determine the accounting for market-based measure of the award.

Solution

The market-based measure or the fair value of the award on the acquisition date of 500 is allocated to NCI and post combination employee compensation expense. The portion allocable to pre-combination period is ₹ 500 x 2/5 = ₹ 200 which will be included in pre-combination period and is allocated to NCI on the acquisition date. The amount is computed based on original vesting period.

The remaining expense which is ₹ 500 – ₹ 200 = ₹ 300 is accounted over the remaining vesting period of 2 years as compensation expenses.

*****

10.12 Non-controlling Interest in an Acquiree

Ind AS 103 allows the acquirer to measure a non-controlling interest in the acquiree at its fair value at the acquisition date. Sometimes an acquirer will be able to measure the acquisition-date fair value of a non-controlling interest on the basis of a quoted price in an active market for the equity shares (ie those not held by the acquirer). In other situations, however, a quoted price in an active market for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the non-controlling interest using other valuation techniques.

The fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree or, conversely, the inclusion of a discount for lack of control (also referred to as a non-controlling interest discount) in the per-share fair value of the non-controlling interest if market participants would take into account such a premium or discount when pricing the non-controlling interest.

Illustration 29

Classic Ltd. acquires 60% of the ordinary shares of Natural Ltd. a private entity, for ₹ 97.5 crore. The fair value of its identifiable net assets is ₹ 150 crore. The fair value of the 40% of the ordinary shares owned by non-controlling shareholders is ₹ 65 crore. Carrying amount of Natural Ltd.'s net assets is ₹ 120 crore.

Measure the non-controlling interest.

Solution

Paragraph 19 of Ind AS 103 states that for each business combination, the acquirer shall measure at the acquisition date components of non-controlling interest in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:

(a) fair value; or

(b) the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets.

All other components of non-controlling interests shall be measured at their acquisition-date fair values, unless another measurement basis is required by Ind AS.

In accordance with above, non-controlling interests will be measured in either of the following manner:

(a) Non-controlling interests are measured at fair value

Under this method, goodwill represents the difference between the fair value of Natural Ltd. and the fair value of its identifiable net assets.

Thus, Classic Ltd. will recognise the business combination as follows: (₹ in crores)

Identifiable net assets at fair value	Dr.	150	
Goodwill*	Dr.	12.5	
To Non-controlling interest			65
To Investment in Natural Ltd.			97.5

*Note: Goodwill is calculated as 97.5 + 65 - 150 = 12.5 or 162.5 - 150 = 12.5

(b) Non-controlling interests are measured at proportionate share of identifiable net assets

Under this method, goodwill represents the difference between the total of the consideration transferred less the fair value of the acquirer's share of net assets acquired and liabilities assumed. The non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the Natural Ltd 's net assets in the event of liquidation (i.e. the ordinary shares) are measured at the non-controlling interest's proportionate share of the identifiable net assets of Natural Ltd.

Thus, Classic will recognise the business combination as follows:

(₹ in Crores)

Identifiable net assets at fair value	Dr.	150	
Goodwill*	Dr.	7.5	
To Non-controlling interest (40% x 150)			60
To Investment in Natural Ltd.			97.5

***Note:** Goodwill is calculated as 97.5+60-150 = 7.5 or 97.5-(150 x 60%) = 7.5

*****

11. SUBSEQUENT MEASUREMENT AND ACCOUNTING

In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination in accordance with other applicable Ind AS for those items, depending on their nature. However, this Ind AS provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination:

a) reacquired rights;

b) contingent liabilities recognised as of the acquisition date;

c) indemnification assets; and

d) Contingent consideration.

11.1 Reacquired Rights

A reacquired right recognised as an intangible asset shall be amortised over the remaining contractual period of the contract in which the right was granted. An acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

11.2 Contingent Liabilities

After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognised in a business combination at the higher of:

(a) the amount that would be recognised in accordance with Ind AS 37; and

(b) the amount initially recognised less, if appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115, Revenue from Contracts with Customers.

11.3 Indemnification Assets

At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognised at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount and, for an indemnification asset that is not subsequently measured at its fair value, management's needs to do assessment of the collectability of the indemnification asset. The acquirer shall derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

11.4 Contingent Consideration

Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date.

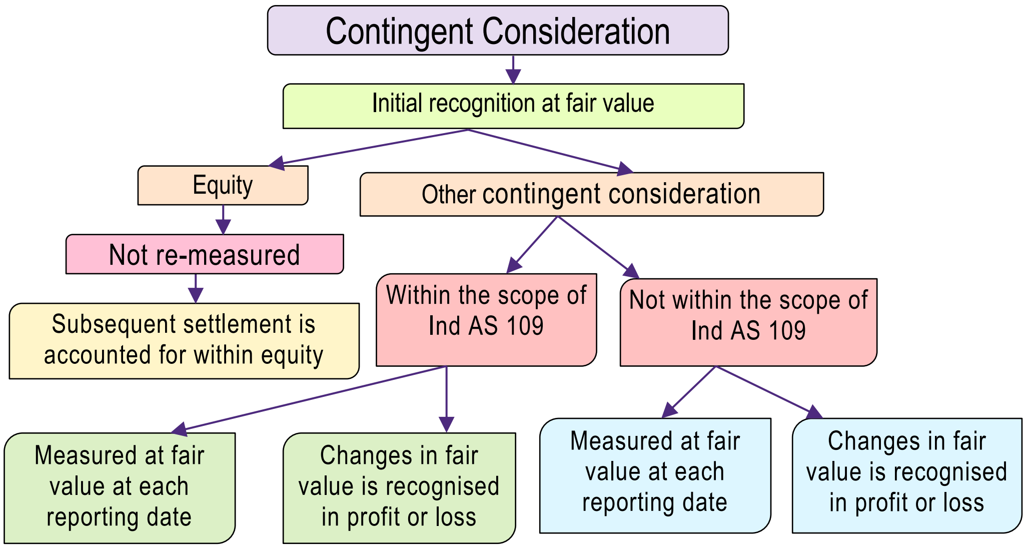
Such changes are measurement period adjustments to the extent it is on account of conditions which existed as of the acquisition date will be adjusted against goodwill. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:

(a) Contingent consideration classified as equity shall not be re-measured and its subsequent settlement shall be accounted for within equity.

(b) Other contingent consideration that:

   i. is within the scope of Ind AS 109 shall be measured at fair value at each reporting date and changes in fair value shall be recognised in profit or loss in accordance with Ind AS 109.

ii. is not within the scope of Ind AS 109 shall be measured at fair value at each reporting date and changes in fair value shall be recognised in profit or loss.



12. DISCLOSURES

The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:

a) during the current reporting period; or

b) after the end of the reporting period but before the financial statements are approved for issue.

Ind AS 103 requires detailed disclosures on Business Combination. The acquirer shall disclose the following information for each business combination that occurs during the reporting period:

a. the name and a description of the acquiree.

b. the acquisition date.

c. the percentage of voting equity interests acquired.

d. the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.

e. a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.

f. the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:

   I. cash;

   II. other tangible or intangible assets, including a business or subsidiary of the acquirer;

   III. liabilities incurred, for example, a liability for contingent consideration; and

   IV. equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.

g. for contingent consideration arrangements and indemnification assets:

   i. the amount recognised as of the acquisition date;

   ii. a description of the arrangement and the basis for determining the amount of the payment; and

   iii. an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.

h. for acquired receivables:

   i. the fair value of the receivables;

   ii. the gross contractual amounts receivable; and

   iii. the best estimate at the acquisition date of the contractual cash flows not expected to be collected. The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.

i. the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.

j. for each contingent liability recognised, the information required in paragraph 85 of Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets. If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose:

i. the information required by paragraph 86 of Ind AS 37; and

ii. the reasons why the liability cannot be measured reliably.

k. the total amount of goodwill that is expected to be deductible for tax purposes.

l. for transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the business combination:

i. a description of each transaction;

ii. how the acquirer accounted for each transaction;

iii. the amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised; and

iv. if the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.

m. the disclosure of separately recognised transactions required by (l) shall include the amount of acquisition-related costs and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of profit and loss in which those expenses are recognised. The amount of any issue costs not recognised as an expense and how they were recognised shall also be disclosed.

n. in a bargain purchase (see paragraphs 34–36A):

i. the amount of any gain recognised in other comprehensive income in accordance with paragraph 34;

ii. the amount of any gain directly recognised in equity in accordance with paragraph 36A; and

iii. a description of the reasons why the transaction resulted in a gain in case of (i) above.

o. for each business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date:

i. the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and

ii. for each non-controlling interest in an acquiree measured at fair value, the valuation technique(s) and significant inputs used to measure that value.

p. in a business combination achieved in stages:

  i. the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date; and

  ii. the amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination (see paragraph 42) and the line item in the statement of profit and loss in which that gain or loss is recognised.

q. Following additional information:

  i. the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of profit and loss for the reporting period; and

  ii. the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

If disclosure of any of the information required by this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. This Ind AS uses the term 'impracticable' with the same meaning as in Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

If the acquisition date of a business combination is after the end of the reporting period but before the financial statements are approved for issue, the acquirer shall disclose the information required as above unless the initial accounting for the business combination is incomplete at the time the financial statements are approved for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made.

To meet the objective of the Ind AS 103 disclosure requirements, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:

a) if the initial accounting for a business combination is incomplete for particular assets, liabilities, non-controlling interests or items of consideration and the amounts recognised in the financial statements for the business combination thus have been determined only provisionally:

  i. the reasons why the initial accounting for the business combination is incomplete;

ii. the assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete; and

iii. the nature and amount of any measurement period adjustments recognised during the reporting period.

b) for each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:

i. any changes in the recognised amounts, including any differences arising upon settlement;

ii. any changes in the range of outcomes (undiscounted) and the reasons for those changes; and

iii. the valuation techniques and key model inputs used to measure contingent consideration.

c) for contingent liabilities recognised in a business combination, the acquirer shall disclose the information required by paragraphs 84 and 85 of Ind AS 37 for each class of provision.

d) a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period showing separately:

i. the gross amount and accumulated impairment losses at the beginning of the reporting period.

ii. additional goodwill recognised during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations.

iii. adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period

iv. goodwill included in a disposal group classified as held for sale in accordance with Ind AS 105 and goodwill derecognised during the reporting period without having previously been included in a disposal group classified as held for sale

v. impairment losses recognised during the reporting period in accordance with Ind AS 36. (Ind AS 36 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.)

vi. net exchange rate differences arising during the reporting period in accordance with
Ind AS 21, The Effects of Changes in Foreign Exchange Rates.

vii. any other changes in the carrying amount during the reporting period.

viii. the gross amount and accumulated impairment losses at the end of the reporting period.

e) the amount and an explanation of any gain or loss recognised in the current reporting period that both:

i. relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period; and

ii. is of such a size, nature or incidence that disclosure is relevant to understand the combined entity's financial statements.

The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or in previous reporting periods.

13. COMMON CONTROL TRANSACTIONS INCLUDING MERGER

Common control transaction accounting guidance is included in Appendix C of Ind AS 103.

13.1 Definitions

Transferor means an entity or business which is combined into another entity as a result of a business combination.

Transferee means an entity in which the transferor entity is combined.

Reserve means the portion of earnings, receipts or other surplus of an entity (whether capital or revenue) appropriated by the management for a general or a specific purpose other than provision for depreciation.

Common control business combination means a business combination involving entities or businesses in which all 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.

13.2 Common Control Business Combinations

Common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group.

The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant in determining whether the combination involves entities under common control. This is because a partially-owned subsidiary is nevertheless under the control of the parent entity.

An entity can be controlled by an individual, or by a group of individuals acting together under a ***contractual arrangement***, and that individual or group of individuals may not be subject to the financial reporting requirements of Ind AS. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business combination to be regarded as one having entities under common control.

A group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory.

Common control combinations are the most frequent. Broadly, these are transactions in which an entity obtains control of a business (hence a business combination) but both combining parties are ultimately controlled by the same party or parties both before and after the combination. These combinations often occur as a result of a group reorganisation in which the direct ownership of subsidiaries changes but the ultimate parent remains the same. However, such combinations can also occur in other ways and careful analysis and judgement are sometimes required to assess whether some combinations are covered by the definition (and the scope exclusion). In particular:

- an assessment is required as to whether common control is 'transitory' (if so, the combination is not a common control combination and Ind AS 103 applies). The term transitory is not explained in the standard. In our view it is intended to ensure that Ind AS 103 is applied when a transaction that will lead to a substantive change in control is structured such that, for a brief period before and after the combination, the entity to be acquired/sold is under common control. However, common control should not be considered transitory simply because a combination is carried out in contemplation of an initial public offering or sale of combined entities.

- when a group of two or more individuals have control before and after the transaction, an assessment is needed as to whether they exercise control collectively as a result of a contractual agreement.

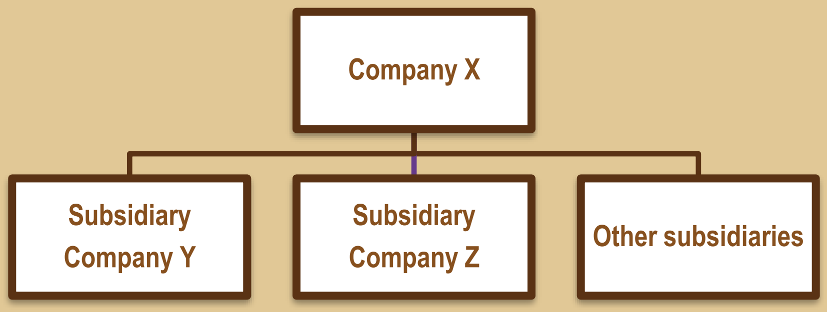
  Examples of common control transaction

  - Merger between fellow subsidiaries
  - Merger of subsidiary with parent
  - Acquisition of an entity from an entity within the same group
  - Bringing together entities under common control in a corporate legal structure

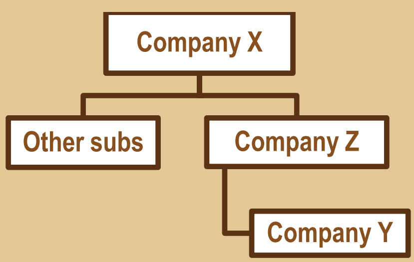
Illustration 30

Company X, the ultimate parent of a large number of subsidiaries, reorganises the retail segment of its business to consolidate all of its retail businesses in a single entity. Under the reorganisation, Company Z (a subsidiary and the biggest retail company in the group) acquires Company X's shareholdings in its one operating subsidiary, Company Y by issuing its own shares to Company X. After the transaction, Company Z will directly control the operating and financial policies of Company Y.

Before Reorganisation



After Reorganisation



Analyse the above transaction.

Solution

In this situation, Company Z pays consideration to Company X to obtain control of Company Y. The transaction meets the definition of a business combination. Prior to the reorganisation, each of the parties are controlled by Company X. After the reorganisation, although Company Y is now owned by Company Z, all two companies are still ultimately owned and controlled by Company X. From the perspective of Company X, there has been no change as a result of the reorganisation. This transaction therefore meets the definition of a common control combination and is within the scope of Ind AS 103.

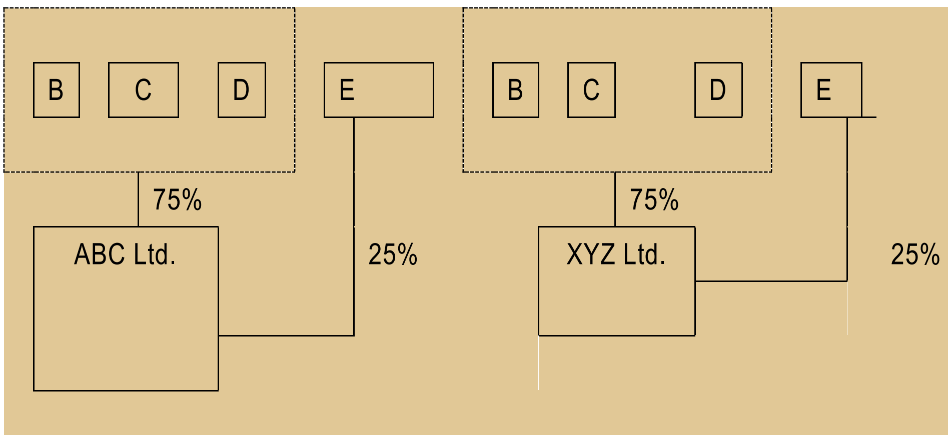
*****

Illustration 31

ABC Ltd. and XYZ Ltd. are owned by four shareholders B, C, D and E, each of whom holds 25% of the shares in each company. Shareholders B, C and D have entered into a shareholders' agreement in terms of governance of ABC Ltd. and XYZ Ltd. due to which they exercise joint control.

Determine whether ABC Ltd. and XYZ Ltd. are under common control.

Solution



Appendix C to Ind AS 103 defines common control business combination as a business combination involving entities or businesses in which all 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.

As per paragraphs 6 and 7 of Appendix C to Ind AS 103, an entity can be controlled by an individual, or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of

Ind AS. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business combination to be regarded as one having entities under common control. Also, a group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory.

In the instant case, both ABC Ltd. and XYZ Ltd. are jointly controlled by group of individuals (B, C and D) as a result of contractual arrangement. Therefore, in the current scenario, ABC Ltd. and XYZ Ltd. are considered to be under common control.

*****

Illustration 32

ABC Ltd. and XYZ Ltd. are owned by four shareholders B, C, D and E, each of whom holds 25% of the shares in each company. However, there are no agreements between any of the shareholders that they will exercise their voting power jointly.

Determine whether ABC Ltd. and XYZ Ltd. are under common control.

Solution

Appendix C to Ind AS 103 defines 'Common control business combination' as business combination involving entities or businesses in which all 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.

Further as per paragraphs 6 and 7 of Appendix C to Ind AS 103, an entity can be controlled by an individual, or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of Ind AS. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for control. Also a group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory.

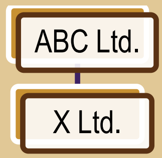
In the present case, there is no contractual arrangement between the shareholders who exercise control collectively over either company. Thus, ABC Ltd. and XYZ Ltd. are not considered to be under common control even if there is an established pattern of voting together.

*****

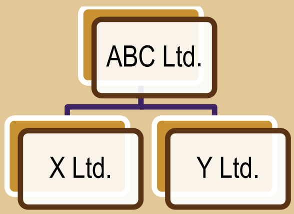
Illustration 33

ABC Ltd. had a subsidiary, namely, X Ltd. which was acquired on 1st April, 2XX0. ABC Ltd. acquires all of the shares of Y Ltd. on 1st April, 2X17. ABC Ltd. transfers the shares in Y Ltd. to X Ltd. on 2nd April, 2X17. How should the above transfer of Y Ltd. into X Ltd. be accounted for in the consolidated financial statements of X Ltd.?

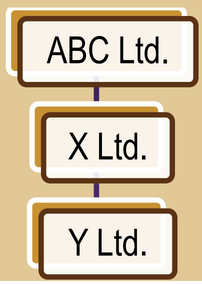
Before:



Intermediate:



After:



Solution

Appendix C to Ind AS 103 defines common control business combination as business combination involving entities or businesses in which all 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.

As per paragraph 7 of Appendix C to Ind AS 103, a group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory.

The term 'transitory' has been included as part of Appendix C to Ind AS 103.

The word 'transitory' has been included in the common control definition to ensure that acquisition accounting applies to those transactions that look as though they are combinations involving entities under common control, but which in fact represent genuine substantive business combinations with unrelated parties.

Based on above, if the intermediate step had been omitted and instead X Ltd. had been the ABC group's vehicle for the acquisition of Y Ltd. - i.e. going straight to the 'after' position - then X Ltd. would have been identified as the acquirer.

Considering X Ltd. and Y Ltd. are under common control (with common parent), it might seem that acquisition accounting is not required because of the specific requirement for common control business combination. However, X Ltd. should be identified as the acquirer and should account for its combination with Y Ltd. using acquisition accounting. This is because X Ltd. would have applied acquisition accounting for Y Ltd. if X Ltd. had acquired Y Ltd directly rather than through ABC Ltd. Acquisition accounting cannot be avoided in the financial statements of X Ltd. simply by placing X Ltd. and Y Ltd. under the common control ABC Ltd shortly before the transaction.

*****

13.3 Method of Accounting for Common Control Business Combinations

Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method.

The pooling of interest method is considered to involve the following:

(i) The assets and liabilities of the combining entities are reflected at their carrying amounts.

(ii) No adjustments are made to reflect fair values or recognise any new assets or liabilities. The only adjustments that are made is to harmonise accounting policies.

(iii) The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the earliest period presented in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

The consideration for the business combination may consist of securities, cash or other assets. Securities shall be recorded at nominal value. In determining the value of the consideration, assets other than cash shall be considered at their fair values.

The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.

The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor. Thus, for example, the General Reserve of the transferor entity becomes the General Reserve of the transferee, the Capital Reserve of the transferor becomes the Capital Reserve of the transferee and the Revaluation Reserve of the transferor becomes the Revaluation Reserve of the transferee. As a result of preserving the identity, reserves which are available for distribution as dividend before the business combination would also be available for distribution as dividend after the business combination.

The difference, if any, between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes.

The acid test in assessing common control transaction is that before and after the reorganisation the entity should be controlled by the same shareholders.

Illustration 34

How will the financial statement of the prior periods be restated under common control in the following scenarios:

a) Common Control period extends beyond the start of comparative period

XYZ Ltd acquired PQR Ltd in a common control transaction on 1 October 20X9. The year-end of XYZ Ltd is 31 March. Both XYZ Ltd and PQR Ltd have been controlled by shareholders since their incorporation.

b) Common Control period started in the comparative period

ABC Ltd acquired DEF Ltd in a common control transaction on 1st October 20X9. The year-end of ABC Ltd is 31st March. Both ABC Ltd and DEF Ltd are controlled by shareholder A. A made investment in ABC Ltd in 20X0 and made investment in DEF Ltd on 1st October 20X8.

Solution

Paragraph 9(iii) of Appendix C to Ind AS 103 states that the financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

a) In accordance with Paragraph 9(iii) above, the entity will be required to restate its financial statements as if the business combination had occurred from the beginning of the preceding period in the financial statements, accordingly in the present case XYZ Ltd will have to restate its comparatives for the financial year 20X8-20X9 as if the acquisition had occurred before 1st April 20X8. Additionally, the results of current year of PQR Ltd will be required to include XYZ's financial statements for the period from 1st April 20X9 to 30th September 20X9.

b) In accordance with paragraph 9(iii) above, ABC Ltd will have to restate its comparatives for the financial year ended 20X8-20X9 as if the acquisition had occurred on 1st October 20X8, but not earlier. Additionally, the results of current year of DEF Ltd will be required to include the financial statements of ABC Ltd for the period from 1 April 20X9 to 1st October 20X9.

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Illustration 35

Entity A owns 100% equity shares of entity B since 01.04.20X1. Entity A arranges loan funding from a financial institution in a new wholly owned subsidiary called "Entity C". The loan is used by Entity C to acquire 100% shareholding in entity B, for cash consideration of ₹ 2,00,000. Entity A applies Ind AS 103 to account for common control transactions and Entity C will adopt the same policy. Fair value of net identifiable assets is ₹ 1,50,000 and carrying value of net identifiable assets is ₹ 1,00,000.

How will Entity C apply acquisition accounting in its consolidated financial statements?

Solution:

As per para 2 of appendix C of Ind AS 103, Common control business combination means a business combination involving entities or businesses in which all 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 the above scenario, Entity A controls Entity B before and after the acquisition. After acquisition, entity A controls entity B through entity C.

As per para 8 of appendix C of Ind AS 103, Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method.

As per para 9(i) of appendix C of Ind AS 103, the pooling of interest method is considered to involve the assets and liabilities of the combining entities are reflected at their carrying amounts.

Based on the above analysis, Entity C cannot be the acquirer. Entity A has created Entity C and is the seller, so Entity C has effectively been formed and issued shares to effect the business combination. Entity C is not a business and the transaction between entity B and Entity C is not a business combination. It is a reorganisation of entity B. As a result, entity B's assets and liabilities are included in Entity C consolidated financial statements at their pre-combination carrying amounts without a fair value uplift.

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Illustration 36

Enterprise Ltd. has 2 divisions Laptops and Mobiles. Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses.

On 31st March, 20X2, the division-wise draft extract of the Balance Sheet was: ***(₹ in crores)***

		Laptops	Mobiles	Total
Property, Plant and Equipment cost		250	500	750
Depreciation		(225)	(400)	(625)
Net Property, Plant and Equipment	(A)	25	100	125
Current assets:		200	500	700
Less: Current liabilities		(25)	(400)	(425)
	(B)	175	100	275
Total	(A+B)	200	200	400
Financed by:				
Loan funds		-	300	300
Capital : Equity ₹ 10 each		25	-	25
Surplus		175	(100)	75
		200	200	400

Division Mobiles along with its assets and liabilities was sold for ₹ 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of Enterprise Ltd. was holding 52% shareholding of the Company.

Assuming that there are no other transactions, you are asked to:

(i) Pass journal entries in the books of Enterprise Ltd.

(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).

(iii) Prepare the Balance Sheet of Turnaround Ltd.

Solution

Journal of Enterprise Ltd.

(₹ in crores)

			Dr.	Cr.
(1)	Loan Funds	Dr.	300	
	Current Liabilities	Dr.	400	
	Provision for Depreciation	Dr.	400	
	To Property, Plant and Equipment			500
	To Current Assets			500
	To Proft and Loss			100
	(Being division Mobiles along with its assets and liabilities sold to Turnaround Ltd. for ₹ 25 crores)			

Notes :

(1) Any other alternative set of entries, with the same net effect on various accounts, may be given by the students.

(2) In the given scenario, this demerger will meet the definition of common control transaction. Accordingly, the transfer of assets and liabilities will be derecognized and recognized as per book value and the resultant loss or gain will be recorded in the profit and loss in the books of demerged entity (Enterprise Ltd).

Enterprise Ltd.
Balance Sheet after reconstruction ***(₹ in crores)***

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		25
Current assets		
Other current assets		200
		225

EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)		25
Other equity (Surplus)		175
Liabilities		
Current liabilities		
Current liabilities		25
		225

Notes to Accounts

		(₹ in crores)
1.	**Other Equity**	
	Surplus (175-100)	75
	Add: Capital Reserve on reconstruction	100
		175

Notes to Accounts: Consequent on transfer of Division Mobiles to newly incorporated company Turnaround Ltd., the members of the company have been allotted 1 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share of Turnaround Ltd., in full settlement of the consideration in proportion to their shareholding in the company.

Balance Sheet of Turnaround Ltd.

(₹ in crores)

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		100
Current assets		
Other current assets		500
		600
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	10
Other equity	2	(110)

Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings			300
Current liabilities			
Current liabilities			400
			600

Notes to Accounts

		(₹ in crores)
1.	**Share Capital:**	
	Issued and Paid-up capital	
	1 crore Equity shares of ₹ 10 each fully paid up	10
	(All the above shares have been issued for consideration other than cash, to the members of Enterprise Ltd. on takeover of Division Mobiles from Enterprise Ltd.)	
2.	**Other Equity:**	
	Securities Premium	15
	Capital reserve [25- (600 – 700)]	(125)
		(110)

Working Note:

In the given case, since both the entities are under common control, this will be accounted as follows:

- All assets and liabilities will be recorded at book value
- Identity of reserves to be maintained.
- No goodwill will be recorded.

Illustration 37

Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as at 31st October, 20X2 was as under:

		Maxi division	Mini division	Total (in crores)
Property, Plant and Equipment				
Cost		600	300	900
Depreciation		(500)	(100)	(600)
W.D.V.	(A)	100	200	300
Current assets		400	300	700
Less: Current liabilities		(100)	(100)	(200)
	(B)	300	200	500
Total	(A+B)	400	400	800
Financed by :				
Loan funds	(A)	–	100	100
(secured by a charge on property, plant and equipment)				
Own funds:				
Equity capital				50
(fully paid up ₹ 10 per share)				
Other Equity		-	-	650
	(B)	?	?	700
Total (A+B)		400	400	800

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division.

Accordingly, Mini Ltd. was incorporated to take over at Balance Sheet figures, the assets and liabilities of that division. Mini Ltd. is to allot 5 crore equity shares of ₹ 10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.

(a) *You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 20X2, showing corresponding previous year's figures.*

(b) *The directors of the 2 companies ask you to find out the net asset value of equity shares pre and post demerger.*

(c) *Comment on the impact of demerger on "shareholders wealth".*

Solution

Demerged Company: Mini Division of "Maxi Mini Ltd"

Resulting Company: "Mini Ltd."

(a) Journal of Maxi Mini Ltd. (Demerged Company)

		(₹ in crores)	
		Dr.	**Cr.**
Current liabilities A/c	Dr.	100	
Loan fund (secured) A/c	Dr.	100	
Provision for depreciation A/c	Dr.	100	
Loss on reconstruction (Balancing figure)	Dr.	300	
To Property, Plant and Equipment A/c			300
To Current assets A/c			300
(Being the assets and liabilities of Mini division taken out of the books on transfer of the division to Mini Ltd., the consideration being allotment to the members of the company of one equity share of ₹ 10 each of that company at par for every share held in the company vide scheme of reorganisation)			

Note: Any other alternatives set of entries, with the same net effect on various accounts, may be given by the students. In the absence of additional information on fair value of the assets transferred it has been assumed that the group of shareholders control both the demerged and the resultant entity. It is expected that students should evaluate all reorganization from common control parameters and aptly highlight the assumptions in the note while solving the question.

Journal of Mini Ltd.

		(₹ in crores)	
		Dr.	**Cr.**
Property, Plant and Equipment (300-100) A/c	Dr.	200	
Current assets A/c	Dr.	300	
To Current Liabilities A/c			100
To Secured loan funds A/c			100
To Equity share capital A/c			50
To Capital reserve			250
(Being the assets and liabilities of Mini division of Maxi Mini Ltd. taken over and allotment of 5 crores equity shares of ₹ 10 each at part as fully paid up to the members of Maxi Mini Ltd.)			

Maxi Mini Ltd.

Balance Sheet as at 1st November, 20X2

₹ in crore

ASSETS	**Note No.**	**After Reconstruction**	**Before Reconstruction**
Non-current assets			
Property, Plant and Equipment	1	100	300
Current assets			
Other current assets		400	700
		500	1,000
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of ₹ 10 each)		50	50
Other equity	2	350	650
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings		-	100
Current liabilities			
Current liabilities		100	200
		500	1,000

Notes to Accounts

		After Reconstruction	*Before Reconstruction*
1.	**Property, Plant and Equipment**	600	900
	Less: Depreciation	(500)	(600)
		100	300
2.	**Other Equity**		
	Other Equity	650	650
	Less: Loss on reconstruction	(300)	–
		350	650

Notes to Accounts: Consequent on reconstruction of the company and transfer of Mini division to newly incorporated company Mini Ltd., the members of the company have been allotted 5 crores equity shares of ₹ 10 each at part of Mini Ltd. The demerged entity and the resultant entity are common control and accordingly the transaction has been accounted at book values of the assets transferred in both the entity.

Mini Ltd.

Balance Sheet as at 1st November, 20X2 *₹ in crore*

ASSETS	Note No.	After reconstruction
Non-current assets		
Property, Plant and Equipment		200
Current assets		
Other current assets		300
		500
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)		50
Other equity (capital reserve)		250
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		100
Current liabilities		
Current liabilities		100
		500

Notes to Account

	(₹ in crores)
1. Share Capital:	
Issued and paid up:	
5 crores Equity shares of ₹ 10 each fully paid up	50
(All the above shares have been issued for consideration other than cash, to the members of Maxi Mini Ltd., on takeover of Mini division from Maxi Mini Ltd.)	

(b) Net asset value of an equity share

	Pre-demerger	*Post-demerger*
Maxi Mini Ltd. :	$\frac{₹\ 700\text{ crores}}{5\text{ crores}} = 140$	$\frac{₹\ 400\text{ crores}}{5\text{ crores}} = ₹\ 80$
Mini Ltd.:		$\frac{₹\ 300\text{ crores}}{5\text{ crores}} = ₹\ 60$

(c) Demerger into two companies has had no impact on "net asset value" of shareholding. Pre-demerger, it was ₹ 140 per share. After demerger, it is ₹ 80 plus ₹ 60 i.e. ₹ 140 per original share.

It is only yield valuation that is expected to change because of separate focusing on two distinct businesses whereby profitability is likely to improve on account of demerger.

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Illustration 38

AX Ltd. and BX Ltd. amalgamated from 1st January, 20X2. A new Company ABX Ltd. with shares of ₹ 10 each was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-20X1

₹ in '000

ASSETS	***Note No.***	***AX Ltd***	***BX Ltd***
Non-current assets			
Property, Plant and Equipment		*8,500*	*7,500*
Financial assets			
Investment		*1,050*	*550*

Current assets			
Inventory		*1,250*	*2,750*
Financial assets			
Trade receivables		*1,800*	*4,000*
Cash and Cash equivalent		*450*	*400*
		13,050	*15,200*
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of ₹ 10 each)		*6,000*	*7,000*
Other equity	*1*	*3,050*	*2,700*
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings (12% Debentures)		*3,000*	*4,000*
Current liabilities			
Financial liabilities			
Trade payables		*1,000*	*1,500*
		13,050	*15,200*

Note:

1.	***Other equity***	***AX Ltd***	***BX Ltd***
	General Reserve	*1,500*	*2,000*
	Profit & Loss	*1,000*	*500*
	Investment Allowance Reserve	*500*	*100*
	Export Profit Reserve	*50*	*100*
		3,050	*2,700*

ABX Ltd. issued a requisite number of shares to discharge the claims of the equity shareholders of the transferor companies. Also new debentures were issued in exchange of the old series of both the companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of ABX Ltd:

a. Assuming that both the entities are under common control

b. Assuming BX Ltd is a larger entity and their management will take control of the entity ABX Ltd.

The fair value of net assets of AX and BX limited are as follows:

Assets	***AX Ltd. ('000)***	***BX Ltd. ('000)***
Property, Plant and Equipment	*9,500*	*1,000*
Inventory	*1,300*	*2,900*
Fair value of the business	*11,000*	*14,000*

Solution

(a) 1. Calculation of Purchase Consideration

		AX Ltd.		***BX Ltd.***
		₹ '000		*₹ '000*
Assets taken over:				
Property, Plant and Equipment		85,00		75,00
Investment		10,50		5,50
Inventory		12,50		27,50
Trade receivables		18,00		40,00
Cash & Cash equivalent		4,50		4,00
Gross Assets		130,50		152,00
Less : Liabilities				
12% Debentures	30,00		40,00	
Trade payables	10,00	(40,00)	15,00	(55,00)
Net Assets taken over		90,50		97,00
Less: Other Equity:				
General Reserve	15,00		20,00	
P & L A/c	10,00		5,00	
Investment Allowance Reserve	5,00		1,00	
Export Profit Reserve	50	(30,50)	1,00	(27,00)
Purchase Consideration		60,00		70,00

Total Purchase Consideration = 130,00 (60,00 of AX Ltd. & 70,00 of BX Ltd.)

2. Discharge of Purchase Consideration

No. of shares to be issued to AX Ltd =

$$\frac{\text{Net Assets taken over of AX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}} \text{ x Purchase Consideration}$$

No. of shares to be issued to BX Ltd =

$$\frac{\text{Net Assets taken over of BX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}} \text{ x Purchase Consideration}$$

	AX Ltd. ***₹'000***	***BX Ltd.*** ***₹'000***
$130{,}00 \times \frac{90{,}50}{187{,}50} = 6{,}27{,}500$	62,75	
* Equity shares of ₹ 10 each		
$130{,}00 \times \frac{97{,}00}{187{,}50} = 6{,}72{,}500$		67,25
Equity shares of ₹ 10 each		

Balance Sheet of ABX Ltd. as on 1.1.20X2 ***₹ in '000***

ASSETS	**Note No.**	**Amount**
Non-current assets		
Property, Plant and Equipment		16,000
Financial assets		
Investments		1,600
Current assets		
Inventory		4,000
Trade receivable		5,800
Cash and Cash equivalent		850
		28,250

* The total purchase consideration is to be discharged by ABX Ltd. in such a way that the rights of the shareholders of AX Ltd. and BX Ltd. remain unaltered in the future profits of ABX Ltd.

EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	13,000
Other equity	2	5,750
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings	3	7,000
Current liabilities		
Trade payable		2,500
		28,250

Notes to Accounts

		(₹ 000)	*(₹ 000)*
1.	**Share Capital**		
	13,00,000 Equity Shares of ₹ 10 each		130,00
2.	**Other Equity**		
	General Reserve (15,00 + 20,00)	35,00	
	Profit & Loss (10,00 + 5,00)	15,00	
	Investment Allowance Reserve (5,00 + 1,00)	6,00	
	Export Profit Reserve (50 + 1,00)	1,50	57,50
3.	**Long Term Borrowings**		
	12% Debentures		70,00

(b) Assuming BX Ltd is a larger entity and their management will take the control of the entity ABX Ltd.

In this case BX Ltd. and AX Ltd. are not under common control and hence accounting prescribed under Ind AS 103 for business combination will be applied. A question arises here is who is the accounting acquirer ABX Ltd which is issuing the shares or AX Ltd. or BX Ltd. As per the accounting guidance provided in Ind AS 103, sometimes the legal acquirer may not be the accounting acquirer. In the given scenario although ABX Ltd. is issuing the shares but BX Ltd. post-merger will have control and is bigger in size which is a clear indicator that BX Ltd. will be an accounting acquirer. This can be justified by the following table:

(In '000s)

	AX Ltd.	BX Ltd.
Fair Value	11,000	14,000
Value per share	10	10
No. of shares	1,100	1,400
i.e. Total No. of shares in ABX Ltd. = 2,500 thousand shares		
Thus, % Held by each Company in Combined Entity	44%	56%

Note: It is a case of Reverse Acquisition.

Accordingly, BX Ltd.'s assets will be recorded at historical cost in the merged financial statements.

(1) Calculation of Purchase Consideration (All figures are in thousands)

We need to calculate the number of shares to be issued by BX Ltd. to AX Ltd. to maintain the same percentage i.e. 56%:

Thus, 700 thousand shares of BX Ltd. (given in the balance sheet) represents 56%. This means that total no. of shares would be 1,250 thousand shares ie 700 thousand shares / 56%.

This implies BX Ltd. would need to issue 550 thousand shares (1,250 less 700) to AX Ltd.

Purchase Consideration = 550 thousand shares x ₹ 20 per share (ie. 14,000 thousand / 700 thousand shares) = ₹ 11,000 thousand.

Balance Sheet of ABX Ltd. as on 1.1.20X2 *₹ in '000*

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment (9,500 + 7,500)		17,000
Goodwill (Refer Working Note)		900
Financial assets		
Investment (1,050 + 550)		1,600
Current assets		
Inventory (1,300 + 2,750)		4,050
Trade receivables (1,800 + 4,000)		5,800

Cash and Cash equivalent (450 + 400)		850
		30,200
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	12,500
Other equity	2	8,200
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings (12% Debentures)	3	7,000
Current liabilities		
Trade payables		2,500
		30,200

Notes to Accounts

		(₹ 000)	(₹ 000)
1.	**Share Capital**		
	1,250,000 Equity Shares of ₹ 10 each (700,000 to BX Ltd and 550,000 as computed above to AX LTD)		1,25,00
2.	**Other Equity**		
	General reserve of BX Ltd	20,00	
	P&L of BX Ltd	5,00	
	Export Profit Reserve of BX Ltd	1,00	
	Investment Allowance Reserve of BX Ltd	1,00	
	Security Premium (550 shares x 10)	5,500	8,200
3.	**Long Term Borrowings**		
	12% Debentures		70,00

Working Note:

Goodwill Computation:

Assets:	₹ in 000s
Property, Plant and Equipment	9,500
Investment	1,050

Inventory	1,300
Trade Receivable	1,800
Cash & Cash Equivalent	450
Total Assets	14,100
Less : Liabilities:	
Borrowings	3,000
Trade Payable	1,000
Net Assets	10,100
Purchase Consideration	11,000
Goodwill	900

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Illustration 39

On 9th April, 20X2, Shyam Ltd. a listed company started to negotiate with Ram Ltd, which is an unlisted company about the possibility of merger. On 10th May, 20X2, the board of directors of Shyam Ltd. authorized their management to pursue the merger with Ram Ltd. On 15th May, 20X2, management of Shyam Ltd. offered management of Ram Ltd. 12,000 shares of Shyam Ltd. against their total share outstanding. On 31st May, 20X2, the board of directors of Ram Ltd accepted the offer subject to shareholder's vote. On 2nd June, 20X2 both the companies jointly made a press release about the proposed merger.

On 10th June, 20X2, the shareholders of Ram Ltd approved the terms of the merger. On 15th June, the shares were allotted to the shareholders of Ram Ltd.

The market price of the shares of Shyam Ltd was as follows:

Date	*Price per share*
9th April	*70*
10th May	*75*
15th May	*60*
31st May	*70*
2nd June	*80*
10th June	*85*
15th June	*90*

What is the acquisition date and what is purchase consideration in the above scenario?

Solution

As per paragraph 8 of Ind AS 103, the acquirer shall identify the acquisition date, which is the date on which it obtains control of the aquiree. In the above scenario, the acquisition date will the date on which the shares were allotted to the shareholders of Ram Ltd. Although the shareholder approval was obtained on 10th June, 20X2 but the shares were issued only on 15th June, 20X2. Accordingly, the purchase consideration will be on the basis of ₹ 90 ie. the market price on that date. Hence total purchase consideration would be ₹ 10,80,000 (ie 12,000 shares x ₹ 90).

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Illustration 40

The balance sheet of Professional Ltd. and Dynamic Ltd. as of 31st March, 20X2 is given below:

₹ in lakhs

Assets	***Professional Ltd***	***Dynamic Ltd***
Non-Current Assets:		
Property, plant and equipment	*300*	*500*
Investment	*400*	*100*
Current assets:		
Inventories	*250*	*150*
Financial assets		
Trade receivables	*450*	*300*
Cash and cash equivalents	*200*	*100*
Others	*400*	*230*
Total	*2,000*	*1,380*
Equity and Liabilities		
Equity		
Share capital- Equity shares of ₹ 100 each of Dynamic Ltd. and ₹ 10 each of Professional Ltd.	*500*	*400*
Other Equity	*810*	*225*
Non-Current liabilities:		
Financial liabilities		
Long term borrowings	*250*	*200*
Long term provisions	*50*	*70*
Deferred tax	*40*	*35*

Current Liabilities:		
Financial liabilities		
Short term borrowings	*100*	*150*
Trade payables	*250*	*300*
Total	*2,000*	*1,380*

Other information

1. *Professional Ltd. acquired 70% shares of Dynamic Ltd. on 1st April, 20X2 by issuing its own shares in the ratio of 1 share of Professional Ltd. for every 2 shares of Dynamic Ltd. The fair value of the shares of Professional Ltd was ₹ 40 per share.*

2. *The fair value exercise resulted in the following: (all nos. in Lakh)*

   a. *Fair value of PPE on 1st April, 20X2 was ₹ 350 lakhs.*

   b. *Professional Ltd also agreed to pay an additional payment as consideration that is higher of ₹ 35 lakh and 25% of any excess profits in the first year, after acquisition, over its profits in the preceding 12 months made by Dynamic Ltd. This additional amount will be due after 2 years. Dynamic Ltd has earned ₹ 10 lakh profit in the preceding year and expects to earn another ₹ 20 Lakh.*

   c. *In addition to the above, Professional Ltd also agreed to pay one of the founder shareholders a payment of ₹ 20 lakh provided he stays with the Company for two years after acquisition.*

   d. *Dynamic Ltd had a certain equity settled share-based payment award (original award) which was replaced by the new awards issued by Professional Ltd. As per the original terms, the vesting period was 4 years and as of the acquisition date the employees of Dynamic Ltd have already served 2 years of service. As per the replaced awards the vesting period has been reduced to one year (one year from the acquisition date). The fair value of the award on the acquisition date was as follows:*

      i. *Original award- ₹ 5 lakh*

      ii. *Replacement award-₹ 8 lakh.*

   e. *Dynamic Ltd had a lawsuit pending with a customer who had made a claim of ₹ 50 lakh. Management reliably estimated the fair value of the liability to be ₹ 5 lakh.*

3. *The applicable tax rate for both entities is 30%.*

You are required to prepare opening consolidated balance sheet of Professional Ltd as on 1st April, 20X2. Assume 10% discount rate.

Solution

Consolidated Balance Sheet of Professional Ltd as on 1st April, 20X2 (₹ in Lakhs)

	Amount
Assets	
Non-Current Assets:	
Property, plant and equipment	650
Investment	500
Current assets:	
Inventories	400
Financial assets:	
Trade receivables	750
Cash and cash equivalents	300
Others	630
Total	3,230
Equity and Liabilities	
Equity	
Share capital- Equity shares of ₹ 10 each	514
Other Equity	1,128.62
NCI	154.95
Non-Current liabilities:	
Long term borrowings	450
Long term provisions (50+70+28.93)	148.93
Deferred tax	28.5
Current Liabilities:	
Short term borrowings	250
Trade payables	550
Provision for Lawsuit Damages	5
Total	3,230

Notes:

a. As per Ind AS 103, the acquirer is required to record the assets and liabilities acquired at their respective fair value. Accordingly, the PPE of Dynamic Ltd. will be recorded at ₹ 350 lakhs.

b. The value of replacement award is allocated between consideration transferred and post combination expense. The portion attributable to purchase consideration is determined based on the fair value of the replacement award for the service rendered till the date of the acquisition. Accordingly, ₹ 2.5 lakhs (5 x 2/4) is considered as a part of purchase consideration and is credited to Professional Ltd equity as this will be settled in its own equity. Since the fair value of the award on the acquisition date is ₹ 8 lakhs, the balance of ₹ 5.5 lakhs (8 – 2.5) will be recorded as employee expense in the books of Dynamic Ltd over the remaining life, which is 1 year in this scenario. (Para B59 of Ind AS 103)

c. There is a difference between contingent consideration and deferred consideration. In the given case, ₹ 35 lakhs is the minimum payment to be paid after 2 years and accordingly will be considered as deferred consideration. The other element is if a company meet certain target then they will get 25% of that or ₹ 35 lakhs whichever is higher. In the given case, the minimum what is expected to be paid has been considered and the fair value of the contingent consideration has been considered as zero. The impact of time value on deferred consideration has been given @ 10%.

d. The additional consideration of ₹ 20 lakhs to be paid to the founder shareholder is contingent to him/her continuing in employment and hence this will be considered as employee compensation and will be recorded as post combination expenses in the income statement of Dynamic Ltd.

Working Notes:

1. Computation for Purchase consideration

Particulars		Amount
Share capital of Dynamic Ltd		4,00,00,000
Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value ₹ per share		40
		₹ in lakhs
PC (2,00,000 x 70% x ₹ 40 per share) (A)		56.00
Deferred consideration after discounting ₹ 35 lakhs for 2 years @ 10% (B)		28.93
Replacement award Market based measure of the acquiree award (5) x ratio of the portion of the vesting period completed (2) / greater of the total vesting period (3) or the original vesting period (4) of the acquiree award i.e. (5 x 2/4) (C)		2.50
PC in lakhs (A+B+C)		87.43

2. Allocation of Purchase price

Particulars	Book value (A)	Fair value (B)	FV adjustment (A-B)
Property, plant and equipment	500	350	(150)
Investment	100	100	-
Inventories	150	150	-
Financial assets:			-
Trade receivables	300	300	-
Cash and cash equivalents	100	100	-
Others	230	230	
Less: Long term borrowings	(200)	(200)	-
Long term provisions	(70)	(70)	-
Deferred tax	(35)	(35)	-
Short term borrowings	(150)	(150)	-
Trade payables	(300)	(300)	-
Contingent liability	-	(5)	(5)
Net assets (X)	625	470	(155)
Deferred tax Asset on FV adjustment (155 x 30%) (Y)		46.50	155
Net assets (X+Y)		516.5	
Non-controlling interest (516.50 x 30%) rounded off		154.95	
Purchase consideration (PC)		87.43	
Capital Reserve (Net assets – NCI – PC)		274.12	

3. Computation of consolidated amounts of Consolidated financial statements

	Professional Ltd.	*Dynamic Ltd. (pre-acquisition)*	*PPA Allocation*	*Total*
Assets				
Non-Current Assets:				
Property, plant and equipment	300	500	(150)	650
Investment	400	100		500

Current assets:				
Inventories	250	150		400
Financial assets:				
Trade receivables	450	300		750
Cash and cash equivalents	200	100		300
Others	400	230		630
Total	2,000	1,380	(150)	3230
Equity and Liabilities				
Equity				
Share capital- Equity shares of ₹ 10 each	500			
Shares allotted to Dynamic Ltd. (2,00,000 x 70% x ₹ 10 per share)			14	514
Other Equity	810			
Replacement award (W.N.1)			2.5	2.5
Security Premium (2,00,000 shares x 70% x ₹ 30) (W.N.1)			42	42
Capital Reserve (W.N.2)			274.12	274.12
Non-controlling interest (W.N.2)	0		154.95	154.95
Non-Current liabilities:				
Financial liabilities				
Long term borrowings	250	200		450
Long term provisions (W.N.1)	50	70	28.93	148.93
Deferred tax (W.N.2)	40	35	(46.5)	28.5
Current Liabilities:				
Financial liabilities				
Short term borrowings	100	150		250
Trade payable	250	300	0	550
Liability for lawsuit damages			5	5
Total	2,000	755	475	3230

14. EXTRACTS FROM THE FINANCIAL STATEMENTS OF LISTED ENTITIES

Relevant Extracts from Financial Statements of selected Listed Companies:

1. ***Annual Report of Hindustan Unilever Ltd. for the year ending 31 March 2021: Amalgamation of GlaxoSmithKline Consumer Healthcare Ltd.:***

Disclosure in Standalone Financial Statements:

Amalgamation of GlaxoSmithKline Consumer Healthcare Limited

On 1st April, 2020, the Company completed the merger of GlaxoSmithKline Consumer Healthcare Limited ['GSK CH'] via an all-equity merger under which 4.39 shares of HUL (the Company) were allotted for every share of GSK CH. With this merger the Company acquired the business of GSK CH including the Right to Use asset of brand Horlicks and Intellectual property rights of brands like Boost, Maltova and Viva. The Company also acquired the Horlicks intellectual property rights, being the legal rights to the Horlicks brand for India from GlaxoSmithKline Plc.

The scheme of merger("scheme") submitted by the Company was approved by Hon'ble National Company Law Tribunal by its order dated 24th September, 2019 (Mumbai bench) and 12th March, 2020 (Chandigarh bench). The Board of Directors approved the scheme between the Company and GSK CH, on 1st April, 2020. The scheme was filed with Registrar of Companies on the same date. Accordingly, 1st April, 2020 is considered as the acquisition date, i.e. the date on which control is transferred to the Company.

The merger was in line with HUL's strategy to build a sustainable and profitable Foods & Refreshment (F&R) business in India by leveraging the megatrend of health and wellness. GSK CH was one of the key players in this category with iconic brands such as 'Horlicks' and 'Boost' and comprised of a wide product portfolio.

The merger has been accounted for using the acquisition accounting method under Ind AS 103 – Business Combinations. All identified assets acquired, and liabilities assumed on the date of merger were recorded at their fair value.

(A) Purchase consideration transferred:

The total consideration paid was ₹40,242 crores which comprised of shares of the Company, valued based on the share price of the Company on the completion date. Refer to the details below:

As per the scheme, the Company issued its shares in favour of existing shareholders of GSK CH such that 4.39 of Company's shares were allotted for every share of GSK CH as below.

Total number of GSK CH shares outstanding	4,20,55,538
Total number of Company's shares issued to GSK CH shareholders i.e. 4.39 of Company's shares per share of GSK CH	18,46,23,812
Value of the Company share (closing price of the Company share on NSE as on 1st April, 2020)	2,179.65
Total consideration paid to acquire GSK CH (₹ crores)	**40,242**

(a) Total costs relating to the issuance of shares amounting to ₹44 crores have been recognised against equity.

(b) Transaction cost of ₹146 crores that were not directly attributable to the issue of shares are included under exceptional items in the standalone Statement of Profit and Loss.

(All amounts in ₹ crores, unless otherwise stated)

NOTE 40 BUSINESS COMBINATION (CONTINUED)

(B) Details of major assets acquired, and liabilities assumed:

	Amount
Specified Tangible Asset	
Property, Plant and Equipment	
Owned Assets	1,133
Leased Assets	76
Capital Work-in-progress	30
Specified Intangibles Assets	
Right of Use Horlicks	19,274
Boost Trademark	4,800
Others	62
Other Assets	
Trade and other receivables	651
Inventories	470
Cash and cash equivalents	300
Bank Balances other than cash and cash equivalents	3,855
Indemnification asset	608
Tax assets	186
Total identifiable assets (A)	**31,445**
Specified liabilities	
Trade payables	533
Other liabilities	400
Provision for employee benefits	86
Other Provisions (including ₹64 crores provision created against contingent liabilities)	343
Direct Tax Provision against contingent liabilities	974
Deferred tax labilities	6,132
Total identifiable liabilities (B)	**8,468**
Total identifiable net assets acquired (A) - (B)	22,977
Goodwill	17,265
Total Net Assets	**40,242**

The main assets acquired were Right to use Horlicks and Boost brand which were valued using the income approach model by estimating future cashflows generated by these assets and discounting them to present value using rates in line with a market participant expectation.

In addition, as applicable, Property plant & equipment have been valued using the market comparison technique and replacement cost method.

The gross contractual value and fair value of trade and other receivables as at the dates of acquisition amounted to ₹651 crores which is expected to be fully recoverable.

(All amounts in ₹ crores, unless otherwise stated)

(C) Acquisition of Horlicks Brand:

The Company also acquired the Horlicks intellectual property rights (IPR), being the legal rights to the Horlicks brand for India from GlaxoSmithKline Plc for a consideration of ₹3,045 crores. The transaction has been accounted as an asset acquisition in line with Ind AS 38 (Intangible asset).

The Company incurred transaction cost of ₹91 crores for the above asset acquisition which was capitalised along with Horlicks IPR. Total value of ₹3,136 crores is recognised under Intangible assets in the standalone financial statements.

(D) Goodwill:

Goodwill of ₹17,265 crores was recognised upon giving effect to the Scheme of Merger, which primarily can be attributable to the synergies expected to be achieved from integrating GSK CH into the Company's existing business and the value of GSK CH India's overlapping distribution network and assembled workforce i.e. the value of the acquired experienced and skilled employees, who have been instrumental to the GSK CH success.

Pursuant to amendment by Finance Act, 2021, Goodwill has been held as non-tax deductible asset effective 1st April, 2020.

(E) Details of contingent liabilities recognised:

GSK CH had direct/indirect tax related matters under litigation, for which contingent liability was determined amounting to ₹3,583 crores. Provision for these contingencies have been created at a fair value of ₹1,038 crores. There are several matters being disputed and, in each case, we believe that the likelihood that the Company will ultimately prevail is more likely than not. We expect that most of these disputes will not be resolved for several years. Further the Company has recognised Indemnification assets of ₹608 crores.

GlaxoSmithKline Plc, GlaxoSmithKline Pte. Ltd., Horlicks Ltd and the Company have entered into a contract to indemnify the Company for any exposure in relation to select taxation matters for a period of 10 years from date of acquisition i.e. till 31st March, 2030 and for a maximum value of USD 150 million.

(F) Analysis on cash flows of acquisition:

Purchase cost of Brand Horlicks of ₹3,045 crores and related transaction cost of ₹91 crores is included under Cash flow from investing activities.

Transaction cost attributable to issuance of equity shares ₹44 crores is included under cash flows from investing activities.

Transaction cost of ₹146 crores that were not directly attributable to the issue of shares are included under cash flow from operating activities.

(G) Impact of acquisition on the results

For the 12 months ended 31st March, 2021, GSK CH contributed revenue of ₹4,752 crores, EBITDA of ₹1,512 crores and EBIT of ₹1,406 crores to the Company's results.

Comparable period

The results for the year ended 31st March, 2021 include the impact of the acquisitions of VWash and GSK CH and accordingly are not comparable with previous year to that extent.

(Source: Annual report for 2020-2021 of Hindustan Unilever Ltd.)

2. *Annual Report of Larsen and Toubro Ltd. for the year ending 31 March 2020: Acquisition of Majority Stake in Mindtree Ltd.:*

Stake in Mindtree acquired through further acquisition: 28.86% existing stake + 31.20% acquired through open offer:

Notes forming part of the Consolidated Financial Statements (contd.)

NOTE [44]

Disclosure pursuant to Ind AS 103 "Business Combinations":

(a) Acquisition of Mindtree Limited:

(i) Pursuant to completion of Open Offer on July 2, 2019, the Company acquired 60.06% stake in Mindtree Limited, which is a multinational information technology and outsourcing company headquartered in Bengaluru, India and New Jersey, USA. The stake was acquired in stages through direct share purchase, open market purchases and open offer.

The acquisition is in line with the Company's strategy of expanding its asset light services business portfolio.

(ii) Assets acquired and liabilities recognised on the date of acquisition are as follows:

₹ crore

	Mindtree Limited	
Assets		
Non-current assets		
Customer relationships	2826.40	
Customer contracts	189.20	
Trade names	297.00	
Property, plant and equipment	377.70	
Fair value of land/building over book value	177.78	
Other non-current assets	974.95	4843.03
Current assets		
Trade receivables	1315.30	
Cash and bank balances	190.00	
Other current assets	1314.40	2819.70
Total Assets		7662.73
Liabilities		
Non-current liabilities		
Deferred tax liabilities	1126.18	
Other non-current liabilities	512.30	1638.48
Current Liabilities		
Trade payables	235.00	
Other current financial liabilities	294.10	
Other current liabilities	400.44	
Contingent liability taken over [Note(vi)]	26.85	956.39
Total Liabilities		2594.87
Net Assets acquired		5067.86

(iii) Calculation of Goodwill:

₹ crore

	Mindtree Limited
Purchase consideration for 31.20% stake purchased in open offer (A)	5038.57
Fair valuation of existing 28.86% stake (B)	4333.96
Total consideration (C)=(A+B)	9372.53
Add: Non-controlling interest	2023.88
Less: Fair value of net assets acquired	5067.86
Goodwill	6328.55

Notes forming part of the Consolidated Financial Statements (contd.)

NOTE [44] ***(contd.)***

(iv) Goodwill is attributable to future growth of business out of synergies from this acquisition and assembled workforce. The goodwill is not deductible for income tax purposes.

(v) The transaction cost of ₹ 96.39 crore *(including ₹ 12.12 crore in previous year)* have been expensed in the Statement of Profit and Loss .

(vi) Contingent liability of ₹ 26.85 crore has been recognised in respect of certain claims (mainly tax disputes) which have not been acknowledged as debt.

(vii) The non-controlling interest (39.94% ownership in Mindtree Limited) recognised at the acquisition date was measured at proportionate share of Mindtree Limited's net assets.

(viii) The Company fair valued its acquisition date stake of 28.86% as on July 2, 2019 and consequently, a loss of ₹ 329.89 crore was recognised in other comprehensive income.

(ix) MIndtree Limited has reported revenue of ₹ 5917.18 crore and profit after tax of ₹ 538.17 crore from the date of acquisition till March 31, 2020. Had the entity been acquired from April 1, 2019, it would have reported revenue of ₹ 7764.25 crore and profit after tax of ₹ 630.87 crore during 2019-20.

(x) Out of the ₹ 1315.30 crore trade receivables acquired, ₹ 1249.54 crore have been collected during the year.

(Source: Annual reports for 2020-2021 of Larsen and Turbo td.)

3. *Annual Report of Larsen and Toubro Ltd. for the year ending 31 March 2020: Acquisition of Majority Stake in L&T Gulf Private Ltd.:*

Notes forming part of the Consolidated Financial Statements (contd.)

NOTE [44] ***(contd.)***

(d) Acquisition of further stake in L&T Gulf Private Limited

(i) On November 20, 2019, the Group has acquired further 50% stake in L&T Gulf Private Limited. The entity has become a wholly owned subsidiary. It operates in the Hydrocarbon segment.

(ii) Assets acquired and liabilities recognised on the date of acquisition are as follows:

₹ crore

	L&T Gulf Private Limited	
Assets		
Non-current assets		
Property, plant and equipment	0.41	
Deferred tax assets	0.48	
Other non-current assets	0.85	1.74
Current assets		
Trade receivables	4.66	
Cash and bank balances	19.76	
Other current assets	3.47	27.89
Total Assets		29.63
Liabilities		
Current liabilities		
Trade payables	3.43	
Other current liabilities	1.78	5.21
Total Liabilities		5.21
Net Assets acquired		24.42

(iii) Calculation of Goodwill:

₹ crore

	L&T Gulf Private Limited
Purchase consideration paid in cash for 50% stake (A)	25.00
Fair valuation of existing 50% stake (B)	25.00
Total (C=A+B)	50.00
Less: Fair value of net assets acquired	24.42
Goodwill	25.58

(iv) Goodwill is attributable to future growth of business out of synergies from this acquisition and assembled workforce. The goodwill is not deductible for income tax purposes.

(v) The entity has reported revenue of ₹ 12.13 crore and profit after tax of ₹ 8.65 crore from the date of acquisition till March 31, 2020. Had the entity been acquired from April 1, 2019, it would have reported revenue of ₹ 14.76 crore and profit after tax of ₹ 1.63 crore during 2019-20.

(vi) Out of ₹ 4.66 crore of trade receivables acquired, ₹ 3.40 crore have been collected during the year.

(e) The Hon'ble National Company Law Tribunal, Chennai Bench vide order dated March 10, 2020 and the Hon'ble National Company Law Tribunal, Mumbai Bench vide order dated April 24, 2020 have approved the scheme of amalgamation of L&T Shipbuilding Ltd (wholly-owned subsidiary) with the Company ('the Scheme'), the appointed date being April 1, 2019. Accordingly, the effect of the Scheme has been given in the standalone financials of the Company for the year 2019-20 and 2018-19.

(f) The Hon'ble National Company Law Tribunal, Mumbai Bench vide its order dated April 23, 2020 approved the composite scheme of arrangement between L&T Realty Limited, L&T Construction Equipment Limited and L&T Construction Machinery Limited (all wholly-owned subsidiaries of the Company) and their respective shareholders and creditors ('the Scheme'), the appointed date being April 1, 2018. Accordingly, the effect of the Scheme has been given in the standalone financials of the respective companies for the year 2019-20 and 2018-19.

(Source: Annual reports for 2019-2020 of Larsen and Turbo Ltd.)

15. SIGNIFICANT DIFFERENCES BETWEEN IND AS 103 AND AS 14

- **Under the existing Indian GAAP**, there is no comprehensive standard that addresses accounting for acquisitions where one entity obtains control of another entity. The accounting for such transactions is largely dependent on the form of the acquisition. For example, the accounting treatment may differ depending on whether the acquired company is retained as a separate legal entity or whether it is legally merged with the acquirer.

  To add to the complexity and confusion, if the acquired company is merged with the acquirer through a court-approved scheme, the scheme itself may prescribe an accounting treatment that is required to be followed, which may be in variation with the accounting standards. Indian GAAP still permits the use of the pooling-of-interest method whereby the entire transaction is accounted based on carrying values and no goodwill arises.

  Further, the current principles (AS 21, Consolidated Financial Statements) provide guidance on accounting for acquisition of a subsidiary in the entity's consolidated financial statements by adding, on a line-by-line basis, all assets and liabilities of the acquiree at the carrying values as appearing in the acquiree' s financial statement (subject to adjustment for alignment of accounting policies).

- **Under Ind AS 103**, Business Combination, is a more widely used term than just in relation to mergers and amalgamations and encompasses a wide range of arrangements (unless excluded from scope of Ind AS 103). Ind AS 103 provides principles for identifying what constitutes a business combination, prescribes the accounting treatment for business combinations with greater emphasis on the use of fair values in accounting for a business combination.

  The core principle of Ind AS 103 requires an acquirer of a business to recognise the assets acquired and the liabilities assumed at their acquisition date fair values and to disclose information that enables users to evaluate the nature and financial effects of the acquisition.

S. No.	Basis	Ind AS	Accounting Standards
1.	**Applicability**	Ind AS 103 applies to all types of business combinations (as defined in the standard) except formation of joint venture and acquisition of assets which do not constitute business. Ind AS 103 is wider in scope	AS 14 deals with amalgamation and mergers.
2.	**Methods of accounting**	Ind AS 103 prescribes only the acquisition method for every business combination, except for business combinations involving entities or businesses under common control	Under AS 14, there are two methods of accounting for amalgamation *viz* the pooling of interest method and the purchase method.

		which shall be accounted for using the pooling of interests method.	(Paragraph 7 of AS 14)
3.	**Effective date**	As per Ind AS 103, the date on which the acquirer obtains control of the acquiree is the acquisition date i.e. Effective date.	AS 14 mentions but does not define date of amalgamation. In practice generally the date of amalgamation / acquisition mentioned in the court scheme (the Appointed date) is considered as the acquisition date.
4.	**Valuation base**	Ind AS 103 requires the acquired identifiable assets liabilities and non-controlling interest to be recognised at fair value under acquisition method. (Paragraphs 18-19 of Ind AS 103)	Under AS 14, the acquired assets and liabilities are recognised at their existing book values or at fair values under the purchase method. (Paragraph 12 of AS 14)
5.	**Accounting of non-controlling interest / minority interest**	Ind AS 103 requires that for each business combination, the acquirer shall measure any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. (Paragraph 19 of Ind AS 103)	AS 21 states that the minority interest is the amount of equity attributable to minorities at the date on which investment in a subsidiary is made and it is shown outside shareholders' equity. (Paragraph 13(e) of AS 21)
6.	**Amortisation of Goodwill**	Under Ind AS 103, the goodwill is not amortised but tested for impairment on annual basis in accordance with Ind AS 36.	AS 14 requires that the goodwill arising on amalgamation in the nature of purchase is amortised over a period not exceeding five years.
7.	**Reverse acquisition**	Ind AS 103 provides guidance on accounting for reverse acquisitions.	AS 14 does not deal with the same.
8.	**Contingent consideration**	Ind AS 103 deals with the contingent consideration in case of business combination, i.e., an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met.	AS 14 does not provide specific guidance on this aspect.
9.	**Bargain purchase gain**	Ind AS 103 requires bargain purchase gain arising on business combination to	Under AS 14, the excess amount is treated as capital

	/ capital reserve and its presentation	be recognised in other comprehensive income and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as capital reserve. (Paragraph 34 of Ind AS 103)	reserve under the head reserves and surplus. (Paragraph 17 of AS 14)
	Accounting for common control transactions	Appendix C of Ind AS 103 deals with accounting for common control transactions, which prescribes pooling of interest method of accounting, which is different from accounting for other business combinations as prescribed under Ind AS 103.	AS 14 does not differentiate and prescribe accounting for such transactions different from other amalgamations.

16. CARVE OUT IN IND AS 103 FROM IFRS 3

As per IFRS: IFRS 3 requires bargain purchase gain arising from a business combination to be recognised in profit or loss as income.

Carve out: Ind AS 103 requires the bargain purchase gain to be recognised in other comprehensive income and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as capital reserve. A similar carve-out is made in Ind AS 28, Investments in Associates and Joint Ventures.

Reasons: Since bargain purchase gain occurs at the time of acquiring a business, these are considered as capital reserve in continuation of the practice then prevailing in the Indian GAAP.

17. CARVE-IN IN IND AS 103 FROM IFRS 3

As per IFRS: IFRS 3 excludes from its scope business combinations of entities under common control.

Carve-in: Appendix C of Ind AS 103, *Business Combinations* gives guidance in this regard. Therefore, this is additional guidance under Ind AS that is not available under IFRS Standards.

FOR SHORTCUT TO IND AS WISDOM: SCAN ME!

TEST YOUR KNOWLEDGE

Questions

1. Company A and Company B are in power business. Company A holds 25% of equity shares of Company B. On 1st November, Company A obtains control of Company B when it acquires a further 65% of Company B's shares, thereby resulting in a total holding of 90%. The acquisition had the following features:

   - **Consideration:** Company A transfers cash of ₹ 59,00,000 and issues 1,00,000 shares on 1st November. The market price of Company A's shares on the date of issue is ₹ 10 per share.

   - **Contingent consideration:** Company A agrees to pay additional consideration of ₹ 7,00,0g12000 if the cumulative profits of Company B exceed ₹ 70,00,000 over the next two years. At the acquisition date, it is not considered probable that the extra consideration will be paid. The fair value of the contingent consideration is determined to be ₹ 3,00,000 at the acquisition date.

   - **Transaction costs:** Company A pays acquisition-related costs of ₹ 1,00,000.

   - **Non-controlling interests (NCI):** The fair value of the NCI is determined to be ₹ 7,50,000 at the acquisition date based on market prices. Company A elects to measure non-controlling interest at fair value for this transaction.

   - **Previously held non-controlling equity interest:** Company A has owned 25% of the shares in Company B for several years. At 1st November, the investment is included in Company A's consolidated balance sheets at ₹ 6,00,000, accounted for using the equity method; the fair value is ₹ 20,00,000.

The fair value of Company B's net identifiable assets at 1st November is ₹ 60,00,000, determined in accordance with Ind AS 103.

Determine the accounting under acquisition method for the business combination by Company A.

2. On 31st December, 20X1, Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. All of Entity B's shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B.

The fair value of each ordinary share of Entity B at 31st December, 20X1 is ₹ 40. The quoted market price of Entity A's ordinary shares at that date is ₹ 16.

The fair values of Entity A's identifiable assets and liabilities at 31st December, 20X1 are the same as their carrying amounts, except that the fair value of Entity A's non- current assets at 31st December, 20X1 is ₹ 1,500.

The balance sheets of Entity A and Entity B immediately before the business combination are:

	Entity A (legal parent, accounting acquiree)	**Entity B (legal subsidiary, accounting acquirer)**
Current assets	500	700
Non-current assets	1,300	3,000
Total assets	1,800	3,700
Current liabilities	300	600
Non-current liabilities	400	1,100
Total liabilities	700	1,700
Shareholders' equity		
Retained earnings	800	1,400
Issued equity		
100 ordinary shares	300	
60 ordinary shares		600
Total shareholders' equity	1,100	2,000
Total liabilities and shareholders' equity	1,800	3,700

Assume that Entity B's earnings for the annual period ended 31st March, 20X1 were ₹ 600 and that the consolidated earnings for the annual period ended 31st March, 20X2 were ₹ 800. Assume also that there was no change in the number of ordinary shares issued by Entity B during the annual period ended 31st March, 20X1 and during the period from 1st January, 20X1 to the date of the reverse acquisition on 31st December, 20X1.

Calculate the fair value of the consideration transferred measure goodwill and prepare consolidated balance sheet as on 31st December, 20X1.

3. **Scenario 1: New information on the fair value of an acquired loan**

Bank F acquires Bank E in a business combination in October, 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives Borrower B's financial statements for the year ended 30th September, 20X1, which indicate significant decrease in Borrower B's income from operations. Basis this, the fair value of the loan to B at the acquisition date is determined to be less than the amount recognised earlier on a provisional basis.

Scenario 2: Decrease in fair value of acquired loan resulting from an event occurring during the measurement period.

Bank F acquires Bank E in a business combination in October, 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives information that Borrower B has lost its major customer earlier that month and this is expected to have a significant negative effect on B's operations.

Comment on the treatment done by Bank F.

4. Company A acquired 90% equity interest in Company B on 1st April, 20X1 for a consideration of ₹ 85 crores in a distress sale. Company B did not have any instrument recognised in equity. The Company appointed a registered valuer with whose assistance, the Company valued the fair value of NCI and the fair value identifiable net assets at ₹ 15 crores and ₹ 100 crores respectively.

Find the value at which NCI has to be shown in the financial statements.

5. On 1st April, 20X1, Company A acquired 5% of the equity share capital of Company B for 1,00,000. A accounts for its investment in B at Fair Value through OCI (FVOCI) under Ind AS 109, *Financial Instruments: Recognition and Measurement*. At 31st March, 20X2, A carried its investment in B at fair value and reported an unrealised gain of ₹ 5,000 in

other comprehensive income, which was presented as a separate component of equity. On 1st April, 20X2, A obtains control of B by acquiring the remaining 95 percent of B.

Comment on the treatment to be done based on the facts given in the question.

6. Company A acquires 70 percent of Company S on 1st January, 20X1 for consideration transferred of ₹ 5 million. Company A intends to recognise the NCI at proportionate share of fair value of identifiable net assets. With the assistance of a suitably qualified valuation professional, A measures the identifiable net assets of B at ₹ 10 million. A performs a review and determines that the business combination did not include any transactions that should be accounted for separately from the business combination.

   State whether the procedures followed by A and the resulting measurements are appropriate or not. Also calculate the bargain purchase gain in the process

7. Entity A and Entity B provide construction services in India. Entity A is owned by a group of individuals, none of whom has control and does not have a collective control agreement. Entity B is owned by a single individual, Mr. Ram. The owners of entities A and B have decided to combine their businesses. The consideration will be settled in shares of entity B. Entity B issues new shares, amounting to 40% of its issued share capital, to its controlling shareholder, Mr. Ram. Mr. Ram then transfers the shares to the owners of entity A in exchange for their interest in entity A. At this point Mr. Ram controls both entities A and B, owning 100% of entity A and 71.42% of entity B. Mr. Ram had a controlling interest in both entity A and entity B before and after the contribution.

   Is the combination of entities A and B a combination of entities under common control?

8. On 1 April 20X1, Alpha Ltd. acquires 80 percent of the equity interest of Beta Pvt. Ltd. in exchange for cash of ₹ 300. Due to legal compulsion, Beta Pvt. Ltd. had to dispose of their investments by a specified date. Therefore, they did not have sufficient time to market Beta Pvt. Ltd. to multiple potential buyers. The management of Alpha Ltd. initially measures the separately recognizable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirement of Ind AS 103. The identifiable assets are measured at ₹ 500 and the liabilities assumed are measured at ₹ 100. Alpha Ltd. engages on independent consultant, who determined that the fair value of 20 per cent non-controlling interest in Beta Pvt. Ltd. is ₹ 84.

   Alpha Ltd. reviewed the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non controlling interest in Beta Pvt. Ltd. and the consideration transferred. After the review, it decided that the procedures and resulting measures were appropriate.

Calculate the gain or loss on acquisition of Beta Pvt. Ltd. and also show the journal entries for accounting of its acquisition. Also calculate the value of the non-controlling interest in Beta Pvt. Ltd. on the basis of proportionate interest method, if alternatively applied?

9. ABC Ltd. prepares consolidated financial statements upto 31st March each year. On 1st July 20X1, ABC Ltd. acquired 75% of the equity shares of JKL Ltd. and gained control of JKL Ltd. the issued shares of JKL Ltd. is 1,20,00,000 equity shares. Details of the purchase consideration are as follows:

- On 1st July, 20X1, ABC Ltd. issued two shares for every three shares acquired in JKL Ltd. On 1st July, 20X1, the market value of an equity share in ABC Ltd. was ₹ 6.50 and the market value of an equity share in JKL Ltd. was ₹ 6.
- On 30th June, 20X2, ABC Ltd. will make a cash payment of ₹ 71,50,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 20X1. On 1st July, 20X1, ABC Ltd. would have to pay interest at an annual rate of 10% on borrowings.
- On 30th June, 20X3, ABC Ltd. may make a cash payment of ₹ 3,00,00,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 20X1. This payment is contingent upon the revenues of ABC Ltd. growing by 15% over the two-year period from 1st July, 20X1 to 30th June, 20X3. On 1st July, 20X1, the fair value of this contingent consideration was ₹ 2,50,00,000. On 31st March, 20X2, the fair value of the contingent consideration was ₹ 2,20,00,000.

On 1st July, 20X1, the carrying values of the identifiable net assets of JKL Ltd. in the books of that company was ₹ 6,00,00,000. On 1st July, 20X1, the fair values of these net assets was ₹ 7,00,00,000. The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 31st March, 20X2, JKL Ltd. had a poorer than expected operating performance. Therefore, on 31st March, 20X2 it was necessary for ABC Ltd. to recognise an impairment of the goodwill arising on acquisition of JKL Ltd., amounting to 10% of its total computed value.

Compute the impairment of goodwill in the consolidated financial statements of ABC Ltd. under both the methods permitted by Ind AS 103 for the initial computation of the non-controlling interest in JKL Ltd. at the acquisition date.

10. How should contingent consideration payable in relation to a business combination be accounted for on initial recognition and at the subsequent measurement as per Ind AS in the following cases:

On 1st April 20X1, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:

a. an immediate issuance of 10 lakhs shares of A Ltd. having face value of ₹ 10 per share;

b. a further issuance of 2 lakhs shares after one year if the profit before interest and tax of B Ltd. for the first year following acquisition exceeds ₹ 1 crore.

   i. The fair value of the shares of A Ltd. on the date of acquisition is ₹ 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is ₹ 25 lakhs.

   ii. During the year ended 31st March 20X2, the profit before interest and tax of B Ltd. exceeded ₹ 1 crore. As on 31st March 20X2, the fair value of shares of A Ltd. is ₹ 25 per share.

   iii. Continuing with the fact pattern in (a) above except for:

c. The number of shares to be issued after one year is not fixed.

d. Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to ₹ 40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds ₹ 1 crore. A Ltd. issued shares with ₹ 40 lakhs after a year.

Answers

1. ***Identify the acquirer***

In this case, Company A has paid cash consideration to shareholders of Company B. Further, the shares issued to Company B pursuant to the acquisition do not transfer control of Company A to erstwhile shareholders of Company B. Therefore, Company A is the acquirer and Company B is the acquiree.

Determine acquisition date

As the control over the business of Company B is transferred to Company A on 1st November, that date is considered as the acquisition date.

Determine the purchase consideration

The purchase consideration in this case will comprise the following:

Cash consideration	₹ 59,00,000
Equity shares issued (1,00,000 x 10 i.e., at fair value)	₹ 10,00,000
Contingent consideration (at fair value)	₹ 3,00,000
Fair value of previously held interest	₹ 20,00,000

As such, the total purchase consideration is ₹ 92,00,000.

Acquisition cost incurred by and on behalf of the Company A for acquisition of Company B should be recognised in the Statement of profit and loss. As such, an amount of ₹ 1,00,000 should be recognised in Statement of profit and loss.

Determine fair value of identifiable assets and liabilities

The fair value of identifiable net assets is determined at ₹ 60,00,000.

Measure NCI

The management has decided to recognise the NCI at its fair value. As such, the NCI will be recognised at ₹ 7,50,000.

Re-measure previously held interests in case business combination is achieved in stages

In this case, the control has been acquired in stages i.e., before acquisition to control, the Company A exercised significant influence over Company B. As such, the previously held interest should be measured at fair value and the difference between the fair value and the carrying amount as at the acquisition date should be recognised in Statement of Profit and Loss. As such, an amount of ₹ 14,00,000 (i.e., 20,00,000 less 6,00,000) will be recognised in Statement of profit and loss.

Determination of goodwill or gain on bargain purchase

Goodwill should be calculated as follows:

	(₹)
Total consideration	92,00,000
Recognised amount of any non-controlling interest	7,50,000
Less: Fair value of Company B's net identifiable assets	(60,00,000)
Goodwill	**39,50,000**

2. Identifying the acquirer

As a result of Entity A issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e., 150 of the 250 total issued shares). The remaining 40 per cent are owned by Entity A's shareholders. Thus, the transaction is determined to be a reverse acquisition in which Entity B is identified as the accounting acquirer while Entity A is the legal acquirer.

Calculating the fair value of the consideration transferred

If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B — 60 per cent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is ₹ 1,600 (40 shares with a fair value per share of ₹ 40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. Here, the quoted market price of Entity A's shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's 100 shares with a fair value per share of ₹ 16.

Measuring goodwill

Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

	₹	₹
Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated balance sheet at 31st December, 20X1

The consolidated balance sheet immediately after the business combination is:

	₹
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
Current assets [700 + 500]	1,200
Total assets	6,000
Shareholders' equity	
Issued equity 250 ordinary shares [600 + 1,600]	2,200
Retained earnings	1,400
Total shareholders' equity	3,600
Non-current liabilities [1,100 + 400]	1,500
Current liabilities [600 + 300]	900
Total liabilities	2,400
Total liabilities and shareholders' equity	6,000

The amount recognised as issued equity interests in the consolidated financial statements (₹ 2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (600) and the fair value of the consideration effectively transferred (₹ 1,600). However, the equity structure appearing in the consolidated financial statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to affect the combination.

3. **Scenario 1:** The new information obtained by F subsequent to the acquisition relates to facts and circumstances that existed at the acquisition date. Accordingly, an adjustment (i.e., decrease) to in the provisional amount should be recognised for loan to B with a corresponding increase in goodwill.

Scenario 2: Basis this, the fair value of the loan to B will be less than the amount recognised earlier at the acquisition date. The new information resulting in the change in the estimated fair value of the loan to B does not relate to facts and circumstances that existed at the acquisition date, but rather is due to a new event i.e., the loss of a major customer subsequent to the acquisition date. Therefore, based on the new information, F should determine and recognise an allowance for loss on the loan in accordance with Ind AS 109, *Financial Instruments: Recognition and Measurement*, with a corresponding charge to profit or loss; goodwill is not adjusted.

4. In this case, Company A has the option to measure NCI as follows:

- Option 1: Measure NCI at fair value i.e., ₹ 15 crores as derived by the valuer;
- Option 2: Measure NCI as proportion of fair value of identifiable net assets i.e., ₹ 10 crores (100 crores x 10%)

5. At the acquisition date A recognises the gain of ₹ 5,000 in OCI as the gain or loss is not allowed to be recycled to income statement as per the requirement of Ind AS 109. A's investment in B would be at fair value and therefore does not require remeasurement as a result of the business combination. The fair value of the 5 percent investment (1,05,000) plus the fair value of the consideration for the 95 percent newly acquired interest is included in the acquisition accounting.

6. The amount of B's identifiable net assets exceeds the fair value of the consideration transferred plus the fair value of the NCI in B, resulting in an initial indication of a gain on a bargain purchase. Accordingly, A reviews the procedures it used to identify and measure the identifiable net assets acquired, to measure the fair value of both the NCI and the consideration transferred, and to identify transactions that were not part of the business combination.

Following that review, A concludes that the procedures followed and the resulting measurements were appropriate.

	(₹)
Identifiable net assets	1,00,00,000
Less: Consideration transferred	(50,00,000)
NCI (10 million x 30%)	(30,00,000)
Gain on bargain purchase	20,00,000

7. No. This is not a business combination of entities under common control. Mr. Ram's control of both entities before the business combination was transitory. The substance of the transaction is that entity B has obtained control of entity A. Entity B accounts for this transaction as a business combination under Ind AS 103 using acquisition accounting.

8. The amount of Beta Pvt. Ltd. identifiable net assets [₹ 400, calculated as ₹ 500 - ₹ 100) exceeds the fair value of the consideration transferred plus the fair value of the non controlling interest in Beta Pvt. Ltd. [₹ 384 calculated as 300 + 84]. Alpha Ltd. measures the gain on its purchase of the 80 per cent interest as follows:

		₹ in lakh
Amount of the identifiable net assets acquired (₹ 500 - ₹ 100)		400
Less: Fair value of the consideration transferred for Alpha Ltd.		

80 per cent interest in Beta Pvt. Ltd.	300	
Add: Fair value of non-controlling interest in Beta Pvt. Ltd.	84	(384)
Gain on bargain purchase of 80 per cent interest		16

Journal Entry

	₹ in lakh	₹ in lakh
Identifiable assets acquired Dr.	500	
To Cash		300
To Liabilities assumed		100
To OCI/Equity-Gain on the bargain purchase		16
To Equity-non controlling interest in Beta Pvt Ltd.		84

If the acquirer chose to measure the non controlling interest in Beta Pvt. Ltd. on the basis of its proportionate interest in the identifiable net assets of the acquire, the recognized amount of the non controlling interest would be ₹ 80 (₹ 400 x 0.20). The gain on the bargain purchase then would be ₹ 20 (₹ 400- (₹ 300 + ₹ 80)

9. Computation of goodwill impairment

	NCI at fair value	NCI at of net assets
	₹ in '000	**₹ in '000**
Cost of investment		
Share exchange (12,000 x 75% x 2/3 x ₹ 6.50)	39,000	39,000
Deferred consideration (7,150 / 1.10)	6,500	6,500
Contingent consideration	25,000	25,000
Non-controlling interest at date of acquisition:		
Fair value – 3000 x ₹ 6	18,000	
% of net assets – 68,000 (Refer W.N.) x 25%		17,000
Net assets on the acquisition date (Refer W.N.)	(68,000)	(68,000)
Goodwill on acquisition	20,500	19,500
Impairment @ 10%	2,050	1,950

Working Note:

Net assets on the acquisition date	**₹ '000**
Fair value at acquisition date	70,000
Deferred tax on fair value adjustments [20% x (70,000 – 60,000)]	(2,000)
	68,000

10. Paragraph 37 of Ind AS 103, inter alia, provides that the consideration transferred in a business combination should be measured at fair value, which should be calculated as the sum of (a) the acquisition-date fair values of the assets transferred by the acquirer, (b) the liabilities incurred by the acquirer to former owners of the acquiree and (c) the equity interests issued by the acquirer.

Further, paragraph 39 of Ind AS 103 provides that the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

With respect to contingent consideration, obligations of an acquirer under contingent consideration arrangements are classified as equity or a liability in accordance with Ind AS 32 or other applicable Ind AS, i.e., for the rare case of non-financial contingent consideration. Paragraph 40 provides that the acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, Financial Instruments: Presentation. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration.

(i) In the given case the amount of purchase consideration to be recognized **on initial recognition** shall be as follows:

	₹
Fair value of shares issued (10,00,000 x ₹20)	2,00,00,000
Fair value of contingent consideration	25,00,000
Total purchase consideration	2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

(a) There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavorable conditions (for the issuer of the instrument).

(b) If the instrument will or may be settled in the issuer's own equity instruments, then it is:

(i) a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or

(ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.

Here, the obligation to pay contingent consideration amounting to ₹ 25,00,000 is recognized as a part of equity and therefore not re-measured subsequently or on issuance of shares.

(ii) The amount of purchase consideration to be recognized **on initial recognition** shall be as follows:

	₹
Fair value of shares issued (10,00,000 x ₹20)	2,00,00,000
Fair value of contingent consideration	25,00,000
Total purchase consideration	2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

The contingent consideration will be classified as liability as per Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration not classified as equity should be measured at fair value at each reporting date and changes in fair value should be recognized in profit or loss.

As at 31 March 20X2, (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of ₹ 15,00,000 (₹ 40,00,000 – ₹ 25,00,000) should be recognized in the profit or loss for the period. A Ltd. would recognize issuance of 160,000 (`40,00,000/25) shares at a premium of ₹ 15 per share.