Important Aspects in Accounting of Business Reorganisation

- Pratiq Shah

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Contents

Group Restructuring

What is Group Restructuring?

Restructuring → **in a group**

… organising components of the whole in a different way

… organising entities or business within the group in a different way

= Transferring entities or businesses between existing or newly created entities under common control.

Such transfers should be either

Business Combinations under common control

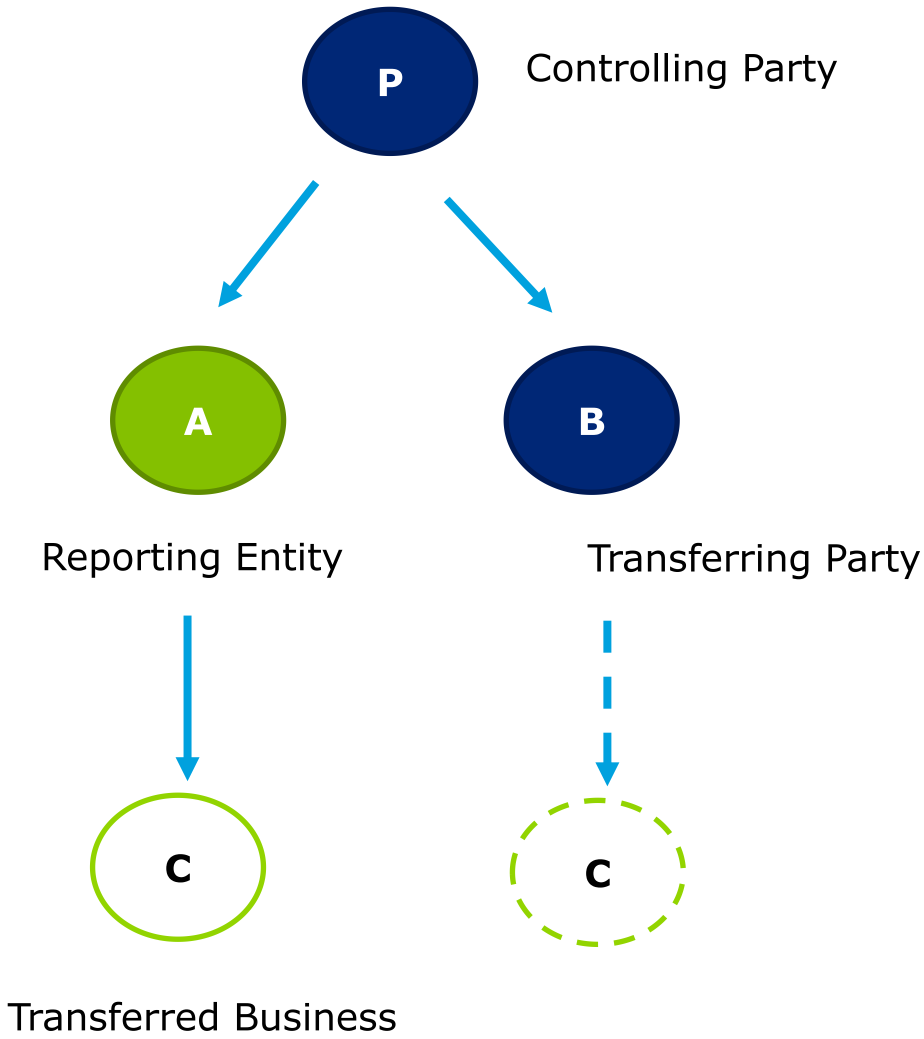
OR

Not a Business Combination under common control

‘Group Restructuring’-Example ?

- Entity A, Entity B and Entity C are controlled by Entity P.
- Entity A and Entity C are businesses
- Entity A acquires Entity C from Entity B

Business Combinations under common control

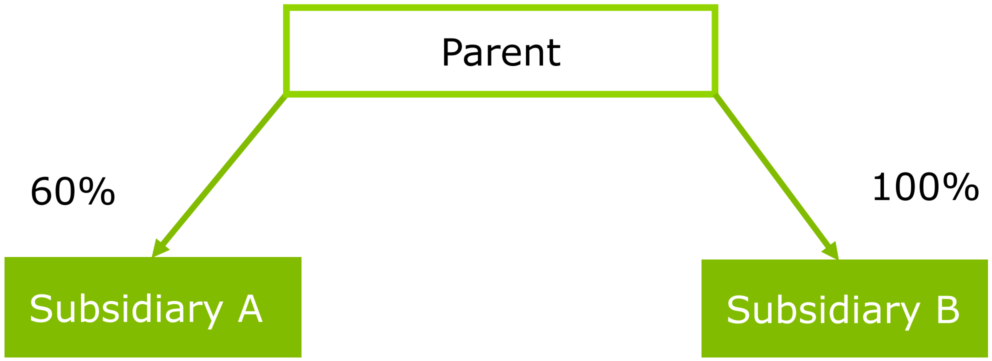


Common Control Transactions

Common control transactions

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.

Example of Common Control



Parent controls Subsidiary A with its 60 percent voting equity interest and Subsidiary B with its 100 percent voting equity interest. Because Parent controls both A and B, they are under the common control of Parent.

Common control transactions

- A business combination involving common control transactions is a transaction in which

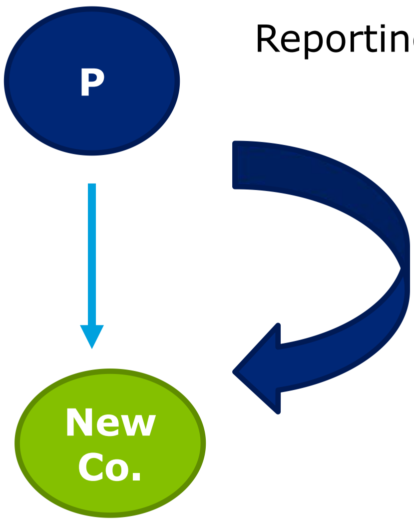
  - The combining entities or businesses are ultimately controlled by the same party (or parties) both before and after the transaction, and
  - Control is not transitory

- The extent of <u>non-controlling interests</u> in each of the combining entities before and after the business combination is not relevant

- Make sure to consider contractual arrangements when evaluating whether the same group of individuals has control before and after the transaction

Examples of Common Control

An entity charters a newly formed entity and then transfers some or all of its net assets to that newly chartered entity.



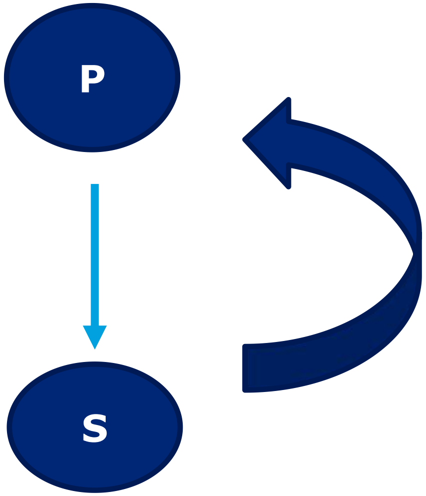
Reporting Entity

Net Assets (business)
transferred by forming New Co

Examples of Common Control

A parent transfers the net assets of a wholly owned subsidiary into the parent and liquidates the subsidiary. That transaction is a change in legal organization but not a change in the reporting entity.

Reporting Entity



Transfer the net Assets (business) into the parent and liquidates the subsidiary

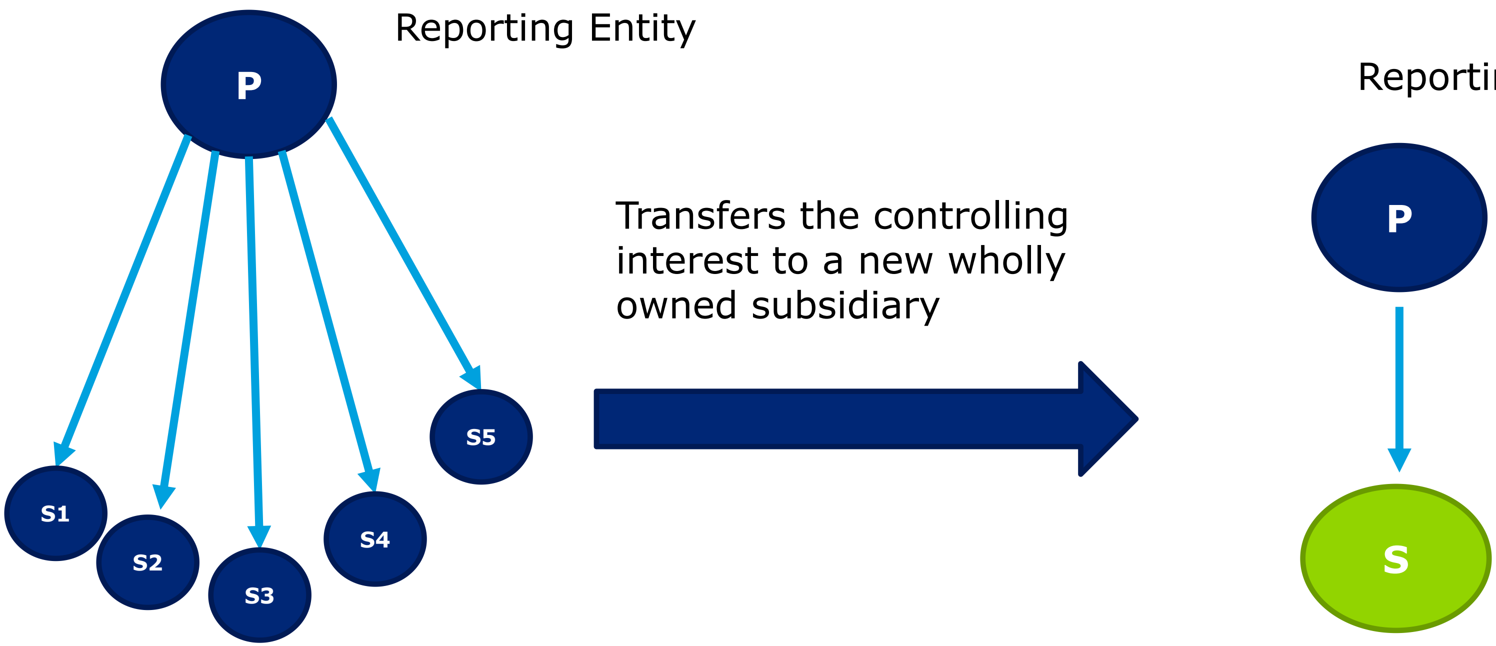
Wholly owned
Subsidiary

Examples of Common Control

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

Before

After

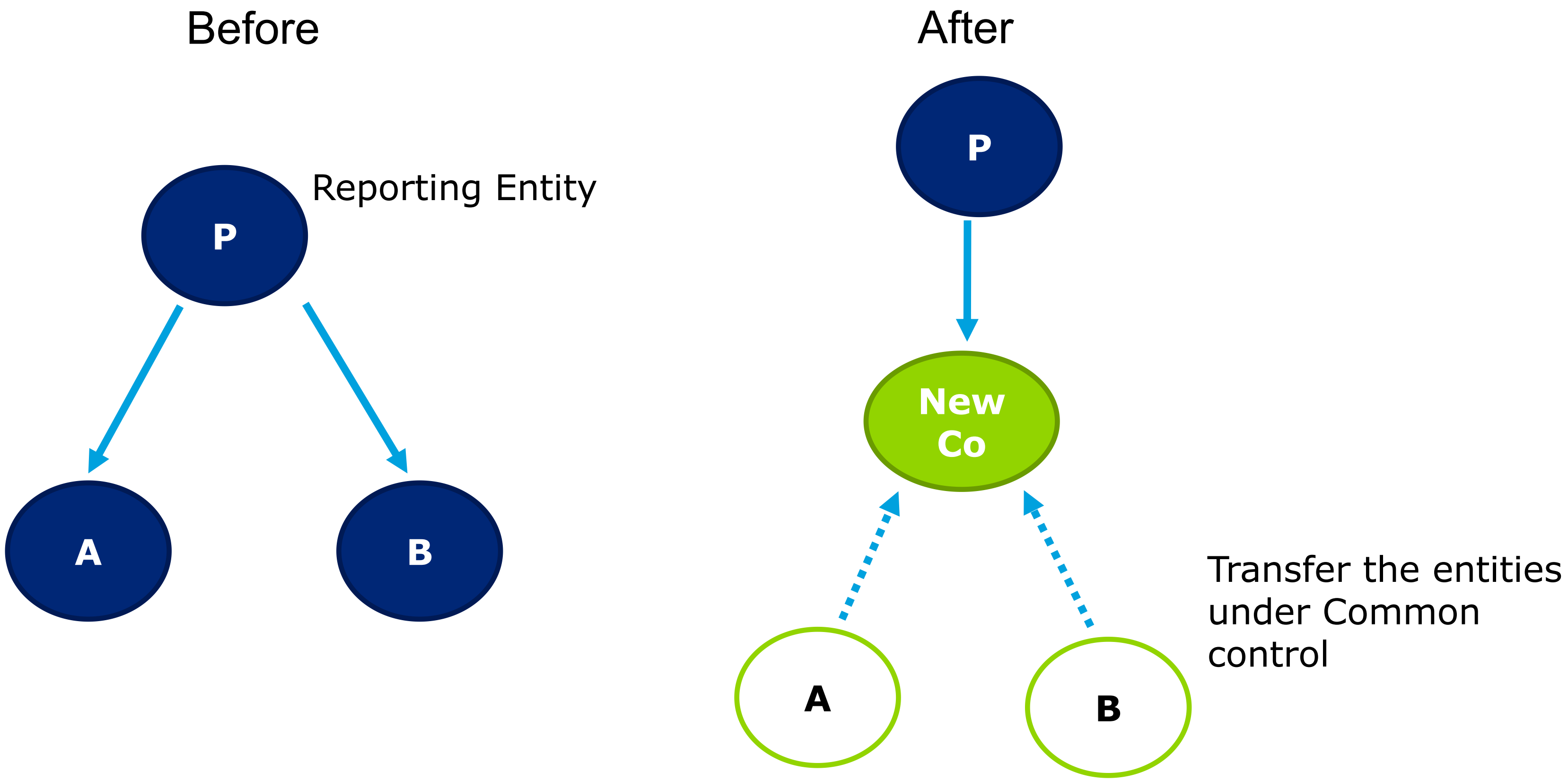


Has invested in several partially owned subsidiaries

Forms a wholly owned new Subsidiary

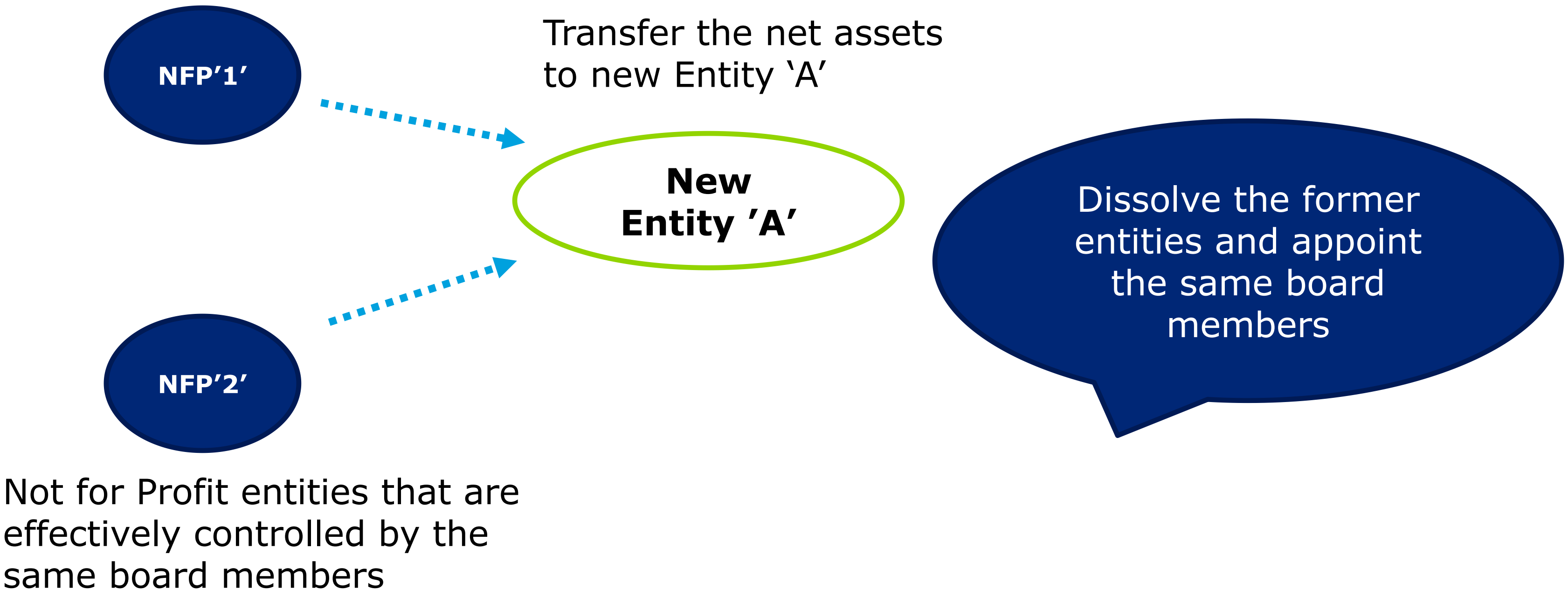
Examples of Common Control

A limited liability company is formed by combining entities under common control.



Examples of Common Control

Two or more not-for-profit entities (NFPs) that are effectively controlled by the same board members transfer their net assets to a new entity, dissolve the former entities, and appoint the same board members to the newly combined entity.



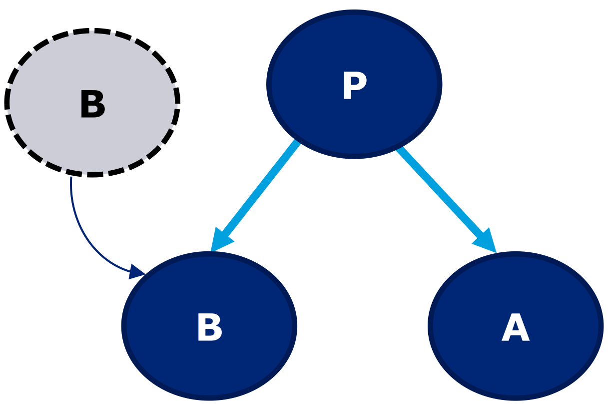
Examples of Common Control

Before	Transaction	Observation

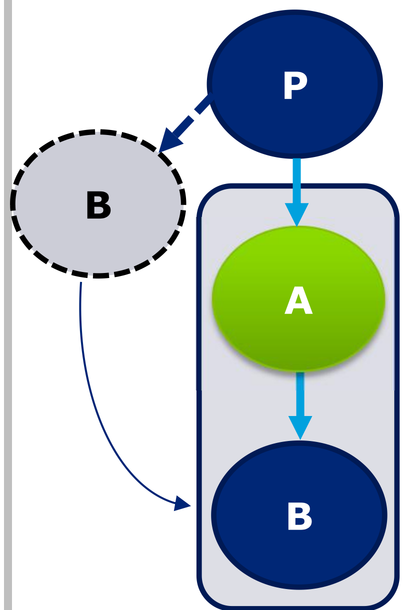
Entity A is controlled by Entity P.

Entity P acquires Entity B from external parties.

Both Entity A and Entity B are businesses.



Entity A acquires Entity B from Entity P.



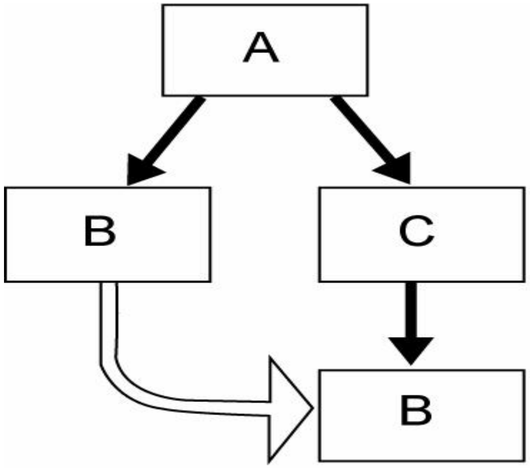
Accounting by **Entity A** is....

In scope

regardless of whether the transaction:

- is preceded by an external acquisition of one or more combining parties; and/or
- followed by an external sale of the combining parties.

Examples of Common Control



B and C are wholly-owned subsidiaries of A.

A transfers its equity interest in B to C. In exchange, C issues further equity shares to A.

The transaction is a common control transaction since both B and C are under the common control of A.

Transitory Control

Guidance on Transitory Control

IFRS 3 / Ind AS 103 excludes common control business combinations from its scope only if common control is not ‘transitory’.

‘Transitory’ is not defined by IFRS but its general meaning is ‘brief’ or ‘short-lived’. IFRS includes the ‘transitory’ assessment so that acquisition accounting cannot be avoided simply by structuring transactions to include a brief common control phase.

For example, a transaction might be structured such that for a brief period before and after the combination, two combining entities are both controlled by the same special purpose vehicle. This transaction would fall within the scope of IFRS 3 because common control is transitory.

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 the combining entities.

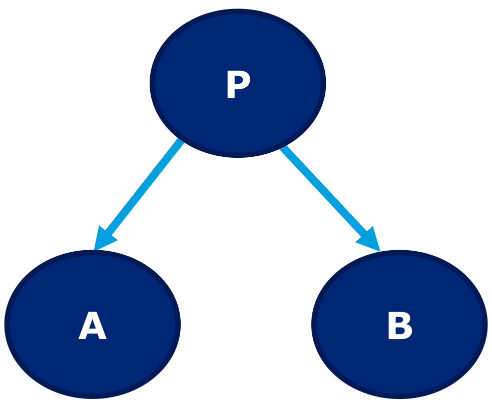
Judgement may be required to assess whether or not common control is transitory.

Example on transitory common control

Before

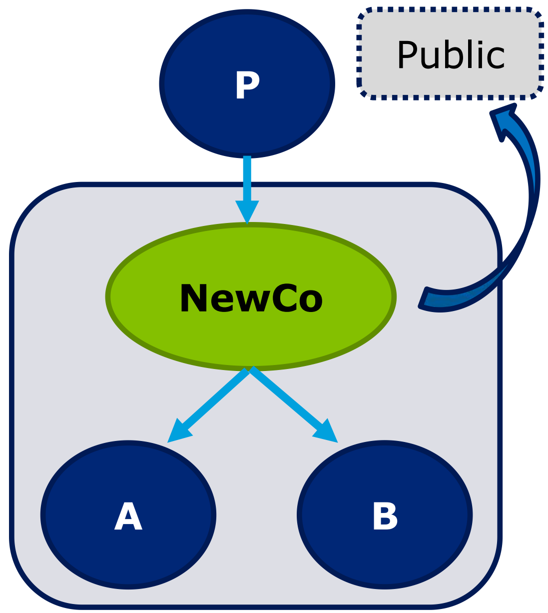
Entity A and Entity B are controlled by Entity P.

Entity A and Entity B are businesses



Transaction

Entity A acquires Entity B.



Observation

Accounting by **NewCo** is….

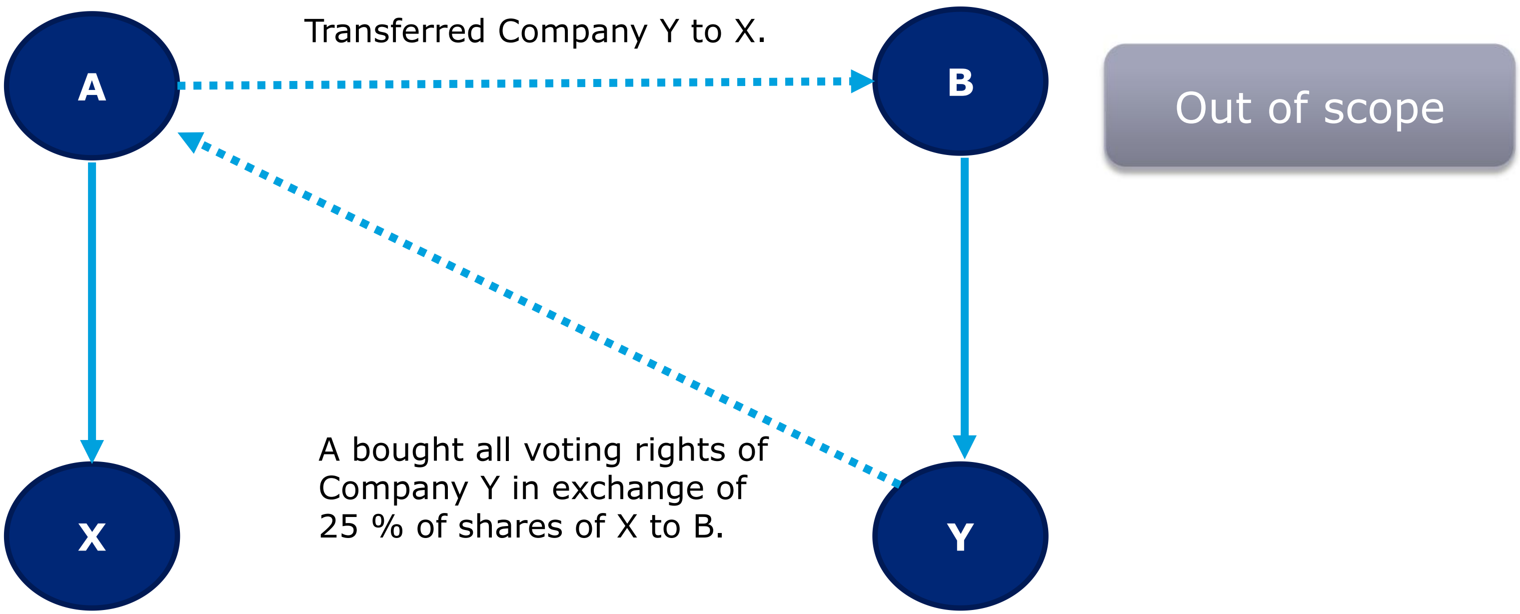
In scope

regardless of whether the transaction:

- is effect in preparation for an IPO; or
- is conditional on are success of NewCo's IPO.

Example on transitory common control

Two individuals, A and B, own competing grocery businesses, Company X and Company Y, respectively. A agreed to acquire B's business by acquiring all of Company Y's voting shares in his own name in exchange for 25% of his shares in Company X. Two months after this transaction, A transferred Company Y to Company X.



Accounting Treatment

Accounting Treatment for common control transactions

Treatment as per Ind AS 103

- Pooling of interest method

  Per para 9 of Appendix C to Ind AS 103,

  - The assets and liabilities at their carrying amounts;
  - No adjustments are made to reflect fair values, or recognise any new assets or liabilities;
  - The only adjustments that are made are to harmonise accounting policies;
  - Restatement of prior period information, if applicable; and
  - Reserves carried as it is.

Accounting Treatment for common control transactions – US GAAP

Treatment as per US GAAP

Common-control transaction is similar to a business combination for the entity that receives the net assets or equity interests; however, such a transaction does not meet the definition of a business combination because there is no change in control over the net assets by the parent. Therefore, the accounting and reporting for a transaction between entities under common control is outside the scope of the business combinations guidance in ASC 805-10,1 ASC 805-20, and ASC 805-30 and is addressed in the "Transactions Between Entities Under Common Control" subsections of ASC 805-50. Since there is no change in control over the net assets from the parent's perspective, there is no change in basis in the net assets.

ASC 805-50 requires that the receiving entity recognize the net assets received at their historical carrying amounts, as reflected in the parent's financial statements.

When accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interests shall initially measure the recognized assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer.

Accounting Treatment for common control transactions - IFRS

Treatment as per IFRS

IFRS 3 – Business combination does not apply to a business combination of entities or businesses under common control. A group of individuals shall be 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.

Therefore, common control business combination is outside the scope of IFRS 3.

IFRS Standards gives option to account for the transfer by acquisition (purchase) method or pooling of interest method.

Accounting Treatment for common control transactions - Transferor

Accounting in the books of transferor :

- The standards provides measurement guidance for the receiving entity but not for the transferring entity. Because of this lack of authoritative guidance, practice has developed such that the transferring entity's measurement generally follows the receiving entity's.

- The transferring entity derecognizes the net assets transferred at their carrying amounts and generally recognizes no gains or losses. A difference between any proceeds received and the carrying amounts of the net assets transferred is recognized in equity in the transferring entity's separate financial statements.

Consideration of appointed / effective date

Flow of transactions

- ABC Limited (Company) has the financial year from 1 April 20XX to 31 March 20XX.
- One of the business ("X") of the Company – is demerging into a New Co which is a newly formed subsidiary of the Company. This is the example of common – control transaction.
- The appointed date as per the Scheme filed by the Company – is 1 April 2017. The scheme if filed with NCLT / High Court, the approval is received on 30 September 2017.
- Relevant date for the purpose of accounting as per Ind AS 103 – will be "Appointed date" mentioned in the approved scheme of demerger.
- Relevant date for the purpose of accounting as per IFRS 3 – will be "Effective date" i.e. the date on which Court / NCLT approval is received.

Accounting Treatment for non -common control transactions

- As of the acquisition date, the acquirer recognises, separately from goodwill: - The identifiable assets acquired - The liabilities assumed - Any Non Controlling interest (NCI) in the acquire.

- The acquired assets and liabilities are required to be measured at their acquisition-date fair values.

- There are certain exceptions to the recognition and/or measurement principles which cover contingent liabilities, income taxes, employee benefits, indemnification assets, reacquired rights, share-based payments and assets held for sale.

- NCI that represent ownership interests and entitle their holders to a proportionate share of the entity’s net assets in the event of liquidation (e.g. shares) are measured at acquisition-date fair value or at the NCI’s proportionate share in net assets.

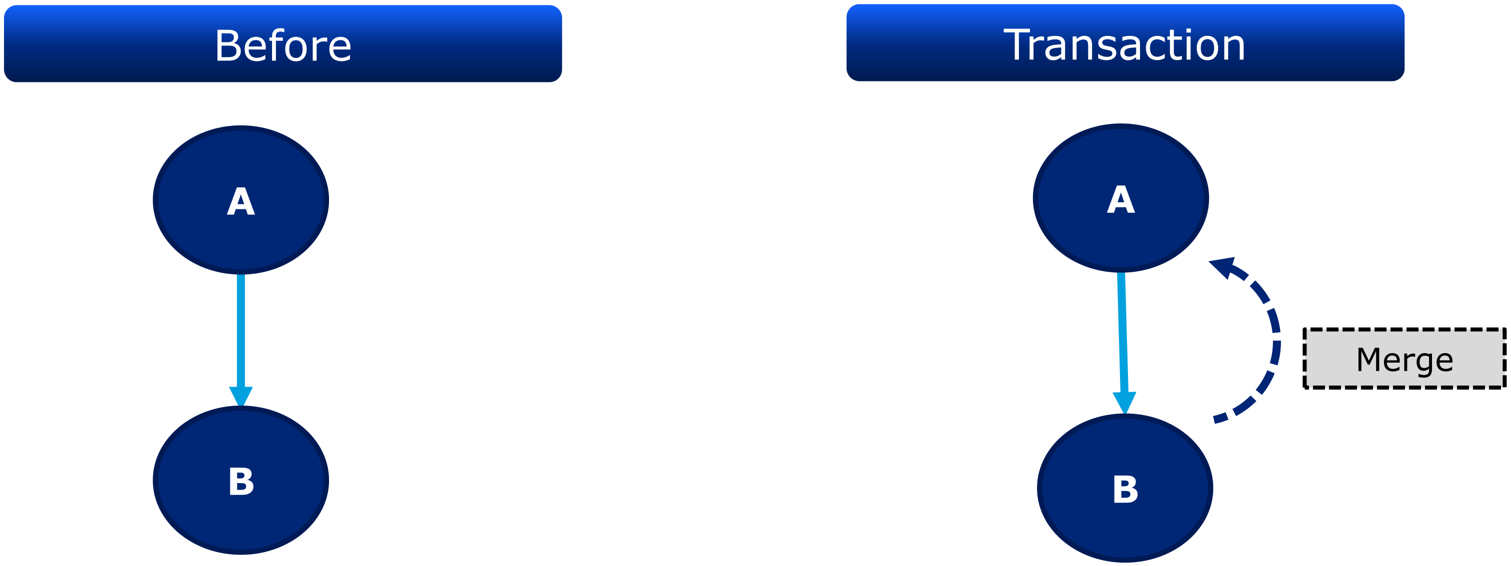
- Goodwill is recognised as the excess between: - The aggregate of the consideration transferred, any non controlling interest in the acquiree and, in a business combination achieved in stages, the acquisition-date fair value of the acquirer’s previously held equity interest in the acquiree - The identifiable net assets acquired (including any deferred tax balances)

ITFG References

ITFG 9 - Issue 2

<u>**Issue**</u> **:** As per Appendix C, *Business Combinations of Entities under Common Control* of Ind AS 103, *Business Combinations*, in case of common control business combinations, the assets and liabilities of the combining entities are reflected at their carrying amounts.

<u>**Situation 1**</u>: B Ltd. is the subsidiary of A Ltd. B Ltd. merges with A Ltd

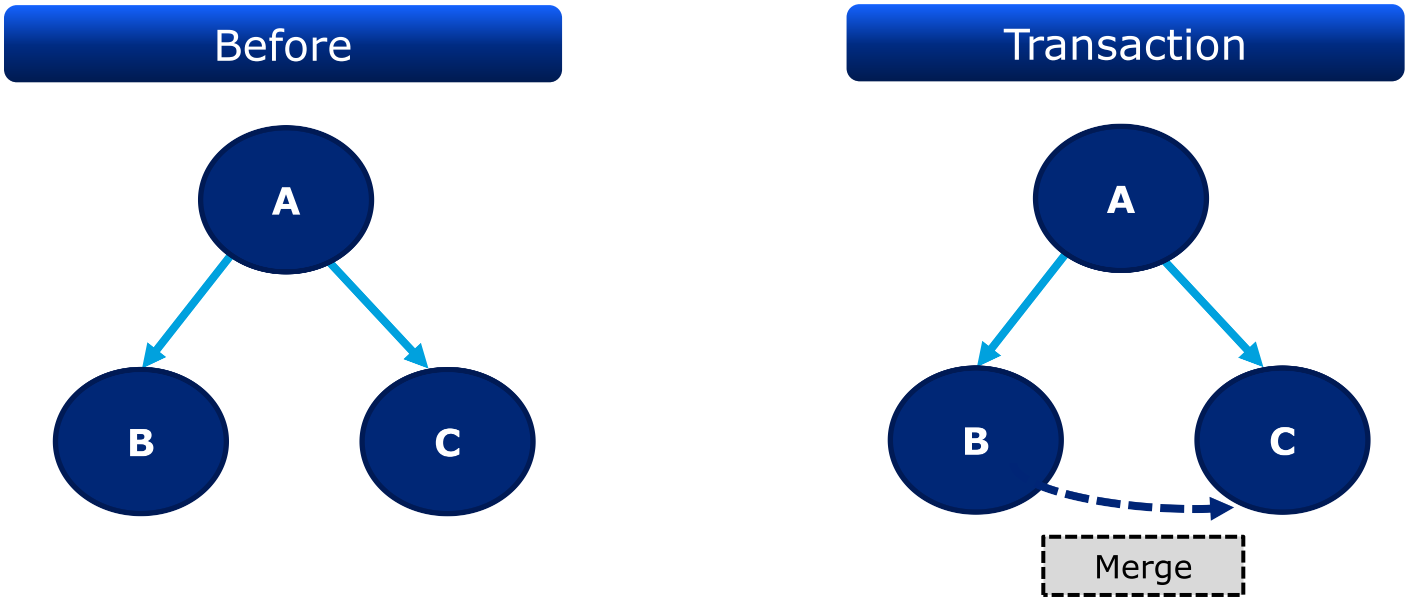


Suggestion by ITFG - It would be appropriate to recognise the **carrying value** of the assets, liabilities and reserves pertaining to B Ltd as appearing in the consolidated financial statements of A Ltd. Separate financial statements to the extent of this common control transaction shall be considered as a continuation of the consolidated group.

Accordingly, in both the given situations, the **effect of legal merger** should be **eliminated** while preparing consolidated financial statements of A Ltd.

ITFG 9 - Issue 2

<u>Situation 1</u>: A Ltd. has two subsidiaries B Ltd. and C Ltd. B Ltd. merges with C Ltd.



Suggestion by ITFG – In the separate financial statements of C Ltd., the **carrying values of the assets and liabilities** as appearing in the standalone financial statements of the entities being combined i.e., B Ltd. & C Ltd shall be recognised.

Thank You !