IND AS 103 BUSINESS COMBINATIONS

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REVIEW OF INDIAN GAAP

- Scope of the standard
- Accounting method
  - Pooling of interest method/ merger method
  - Purchase method
- Consideration paid compared with AGREED value/ BOOK value gives Goodwill/ Capital Reserve
- Amortization of goodwill over 5 years
- How to calculate goodwill in case of a subsidiary?

SCOPE OUT

- ❖ Transactions with employee-shareholders (in capacity of shareholders)
- ❖ Transactions under business combination

SCOPE

- ❖ Apply to all transactions or other events that meet the definition of a business combination, except:
  - ❖ Formation of joint venture
  - ❖ Acquisition of an asset (or group of assets) that does not constitute a business
  - ❖ **Combination of entities or businesses under common control (covered in Appendix in Ind AS)**

- ❖ Definition of Business Combination

"a transaction or other events in which an acquirer obtains CONTROL of one or more BUSINESSES".

DEFINITION – BUSINESS (RECENTLY AMENDED)

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

- Consists of inputs and processes applied to those inputs that have ability to contribute in creation of outputs
- Rebuttable presumption that a group of assets in which goodwill is present is a business
- Determination from the view of a market participant, rather than the specific acquirer

OPTIONAL TEST (RECENTLY ADDED)

- Optional test to identify concentration of fair value
- An entity may make such an election separately for each transaction or other event.
- 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.

CASE STUDY

- ❖ IT department is a cost centre to K&K Co a legal firm
- ❖ IT Outsourced Ltd, specialises in the provision of IT services to legal firms
- ❖ K&K Co sells its IT department to IT Outsourced Ltd, consisting of plant and equipment, working capital and staff
- ❖ Assets and staff transferred to IT Outsourced Ltd is capable of being operated as a business

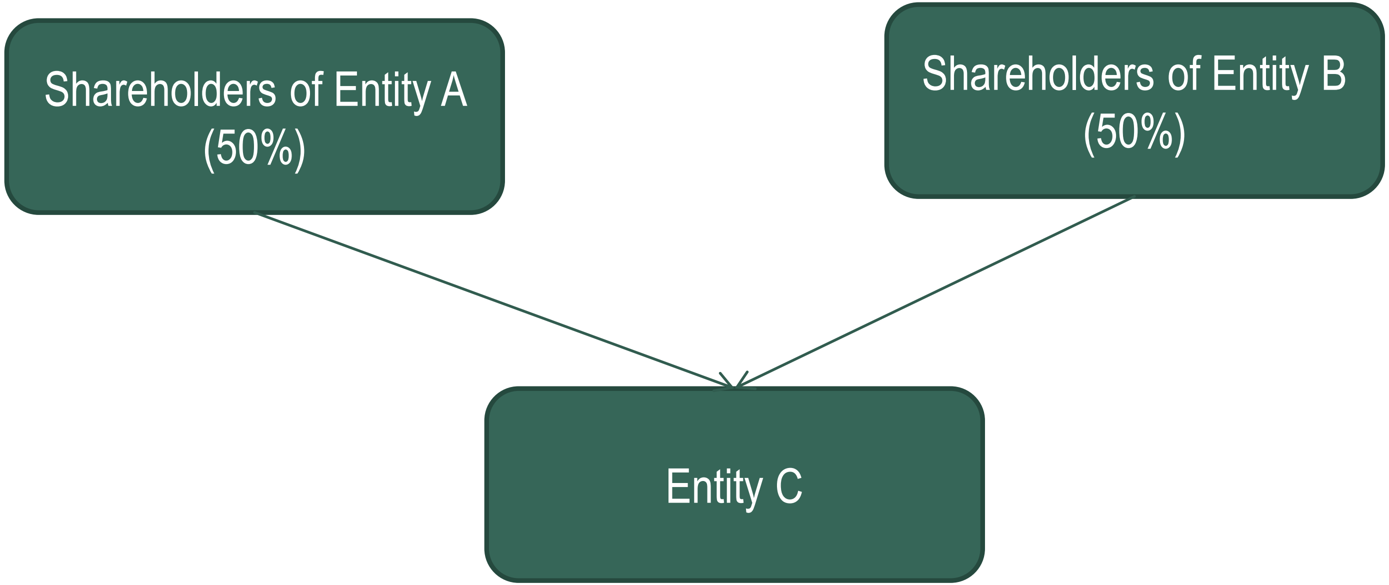
5 STEPS ACCOUNTING FOR BUSINESS COMBINATION

1. Identify acquirer and determine acquisition date
2. Identify and measure consideration transferred
3. Identify and measure identifiable assets and liabilities
4. Measure non-controlling interests
5. Determine goodwill or gain on a bargain purchase

IDENTIFYING THE ACQUIRER

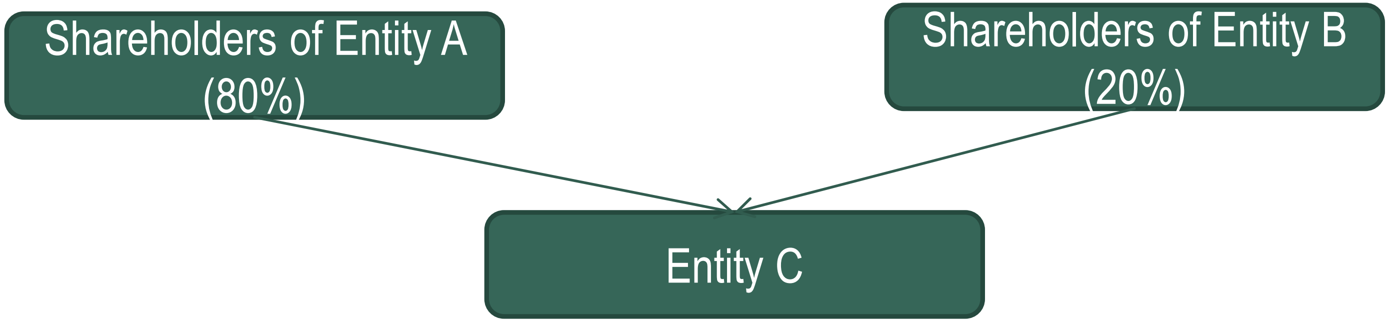
- Entity that obtains control of businesses
- Identified in the following steps:
    - Apply guidance in Ind AS 110 to determine who has control
    - Then additional factors identified in Ind AS 103
- Additional factors in Ind AS 103:
    - Acquirer is usually the entity that transfers cash / assets and incurs liabilities
    - Relative voting rights of combined entity
    - Composition of governing body / senior management of combined entity
    - Relative size of entities
- May result in a reverse acquisition

CASE STUDY



- The chairman of A is appointed as the chairman of C
- Entity A controls Entity C

CASE STUDY



- In substance, Entity A acquires Entity B
- Combination of A & C will be accounted for as capital restructuring, whereby
  - the net assets of A remain at the existing carrying amount
  - the equity of the group shall be that of A plus the fair value of B
  - the share capital of the group, if any, will be that of C the legal parent

ACQUISITION DATE

- Date on which the acquirer obtains control of the acquiree

CASE STUDY

- Suppose A and B commence negotiations on 1 December for A to acquire all of the shares in B
- In January the boards of A and B reach a tentative agreement that the purchase will take place if B can confirm that its land is not disputed
- On 1 March it is concluded that the land is not disputed
- On 1 April a final agreement is signed and Y appoints a new board of directors

CASE STUDY

- A and B commence negotiations on 1 April 2011 for A to acquire all of the shares in B
- On 1 August 2011 the agreement is finalised and A immediately obtains the power to control B's operations
- The agreement states that the acquisition is effective as of 1 April 2011 and that A is entitled to all profits after that date
- The purchase price is determined by reference to B's net asset position at 1 April 2011

CASE STUDY

- A enters into an agreement with the shareholders of B on 1 April 2011 to acquire a controlling interest in B
- The agreement provides that the effective date of transfer is 1 April 2011 and is subject to approval by the shareholders of A at a meeting scheduled for 1 July 2011
- The voting rights are not transferred and the board of directors remains unchanged until the approval of A's shareholders

CASE STUDY

- ❖ A and B are telecom operators. A makes a bid for B's business
- ❖ DOT/ TRAI announce that the proposed transaction is to be scrutinised as it may violate competition laws given that A and B are two of the dominant entities in this sector
- ❖ A and B agree the terms of the acquisition and the purchase price, but the contracts are made subject to competition authority clearance

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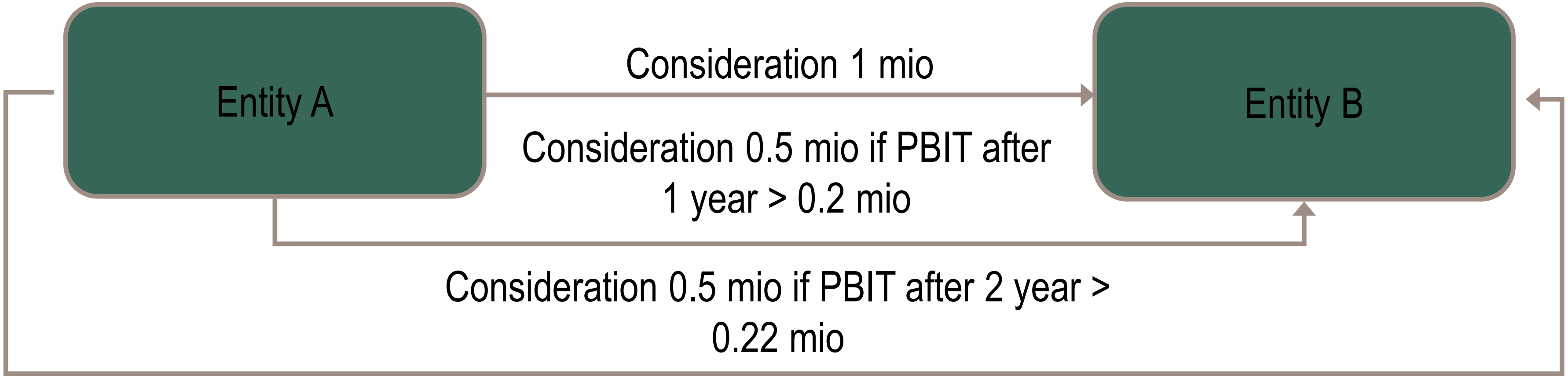
CONSIDERATION TRANSFERRED

- Consideration transferred may include:
  - Assets transferred
  - Liabilities incurred to previous owners
  - Equity instruments issued
- Measure at fair value at the acquisition date
- Required to identify any items that are not part of the business combination and account for such items separately from business combination (e.g. acquisition related costs)
- Also include contingent consideration

CONTINGENT CONSIDERATION

- Obligation by the acquirer to transfer additional assets or equity interest, if specified future events occur or conditions are met
- Recognised at fair value at acquisition date
- A financial instrument is classified as equity or a liability in accordance with Ind AS 32
- May even be an asset, if right to receive on specified future events occur or conditions being met

EXAMPLE



- Two payments are conditional upon the earning targets
- The fair value of the two payments is assessed as 0.25 mio
- Consequently, on the date of acquisition, consideration of 1.25 mio (1mio + 0.25mio) is recognised

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IDENTIFIABLE ASSETS ACQUIRED AND LIABILITIES ASSUMED

- General recognition principle
  - Must meet definition of assets or liabilities at acquisition date
  - Must be exchanged as part of acquisition
  - Recognise even those assets which were not recognised by the acquiree

- General measurement principle
  - Must be measured at fair value at acquisition date

EXCEPTION TO RECOGINITION PRINCIPLE

Contingent liabilities

- Contingent liabilities, as defined in Ind AS 37, comprise the following:
  - a possible obligation that arises from past events 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
  - a present obligation that arises from past events but is not recognized because it is not probable that economic outflow will be required to settle the obligation

- A contingent liability acquired is recognized if
  - It is a present obligation from a past event and;
  - Fair value can be measured reliably

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NON-CONTROLLING INTEREST

- Measured at
  - Proportionate interest in fair value of identifiable net assets; or
  - Fair value

- On a transaction-by-transaction basis

CASE STUDY

- Entity A acquires 80% of Entity B for Rs 100,000
- FV of Entity B net assets at time of acquisition equals Rs. 80,000

SOLUTION

Proportionate interest method

Consideration	100,000
FV of assets acquired (80% of 80,000)	(64,000)
Goodwill	36,000

Journal entry

Dr	Net assets	80,000	
Dr	Goodwill	36,000	
Cr	Consideration		100,000
Cr	NCI (20% of 80,000)		16,000

SOLUTION

Fair value method

Consideration	100,000
FV of NCI (100,000 / 80% * 20%)	25,000
FV of assets acquired	<u>(80,000)</u>
Goodwill	<u>45,000</u>

<u>Journal entry</u>

Dr	Net assets	80,000	
Dr	Goodwill	45,000	
Cr	Consideration		100,000
Cr	NCI		25,000

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GOODWILL

- Measured as the difference between
  - Sum of
    - Fair value of consideration transferred
    - Recognised amount of any NCI in acquiree
    - Fair value of any previously held equity interest in the acquiree

- Recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed

- “Bargain Purchase” if fair value of net assets and NCI exceeds consideration transferred
  - Recognised in profit or loss after reassessment of fair values

INTANGIBLES

- Intangible assets
  - Recognized apart from goodwill
  - Must be either:
    - Resulting from contractual or other legal rights OR
    - Capable of being separated or divided from the acquired enterprise and sold, transferred, licensed, rented or exchanged (regardless of intent)

- Examples
  - Trademarks
  - Customer lists
  - Patented technology

CASE STUDY

- Company A acquires company B
- Company B sells various brands of soaps and shampoos
- However, since it is internally generated, it has not been recognized as assets
- Whether company A can recognize these as assets?

CASE STUDY

- A Ltd. acquired B Ltd. The acquiree has service contracts to supply certain items to railways. Should these service contracts be treated as separate intangible asset?

CASE STUDY

- The acquiree M ltd has two distinct lines of business – manufacture of gear box and headlights.
- It has a supply contract with a passenger car manufacturer, Y ltd, to supply gear box only.
- However Y ltd. purchased headlight from M Ltd as well
- Both the acquirer and the acquiree believe that this customer relationship will continue at least for 5 years

SOLUTION

- Gear box
  - Supply contract for gear box is contractual for which the acquirer should recognise a separate intangible asset

- Head light
  - Sale of headlight is non contractual. But it has a value and as it is separable the acquirer may recognise separate intangible asset and measure it in terms of fair value

ADJUSTMENTS POST COMBINATION

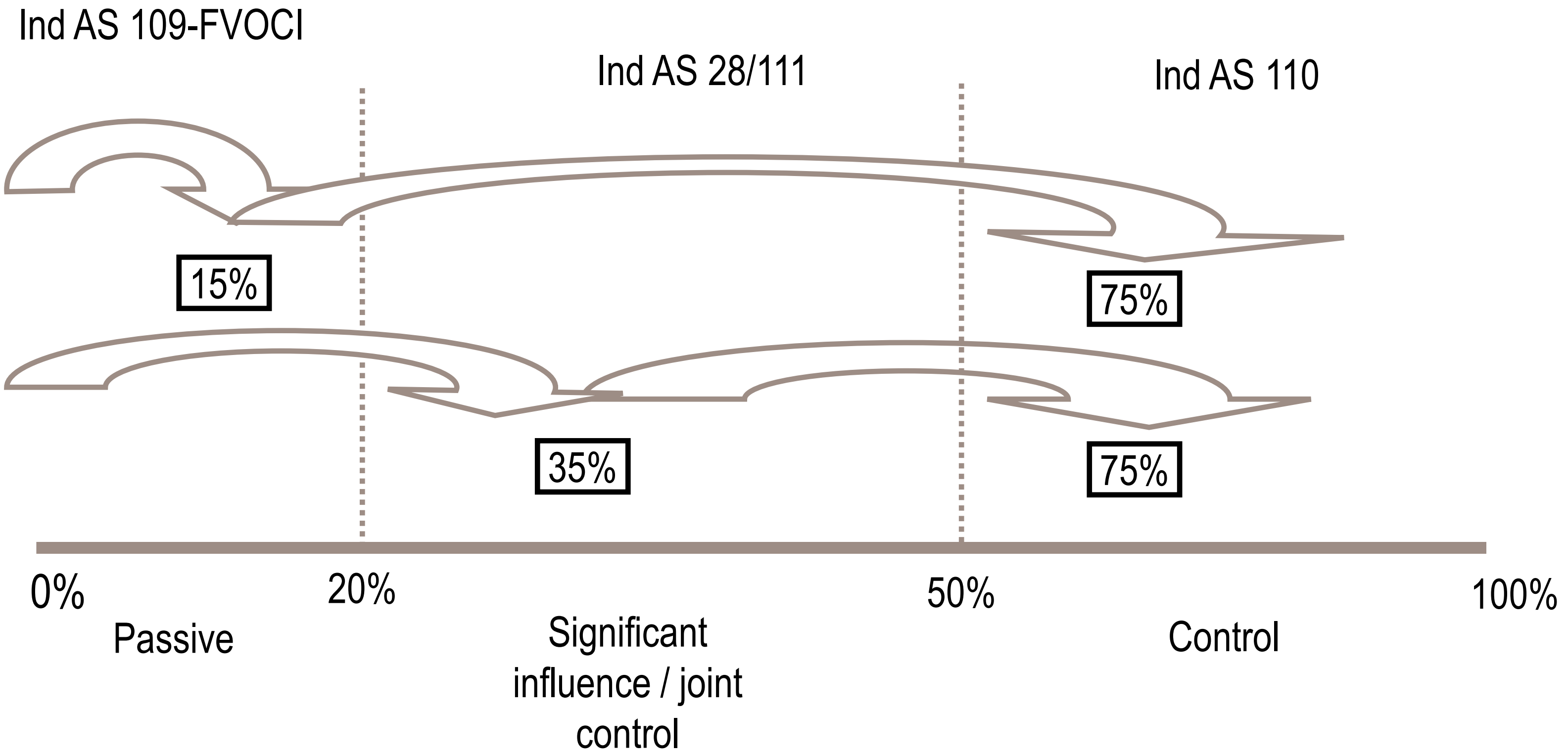
- If new information obtained about facts and circumstances that existed as of acquisition date
- Ends when information obtained or determined not available
- Cannot exceed one year
- Retrospective adjustment
- Once measurement period elapses any business combination accounting adjustment is correction of error (Ind AS 8)

EXAMPLE

Entity A $\xrightarrow{\text{acquires on 1st Jan 2011}}$ Entity B

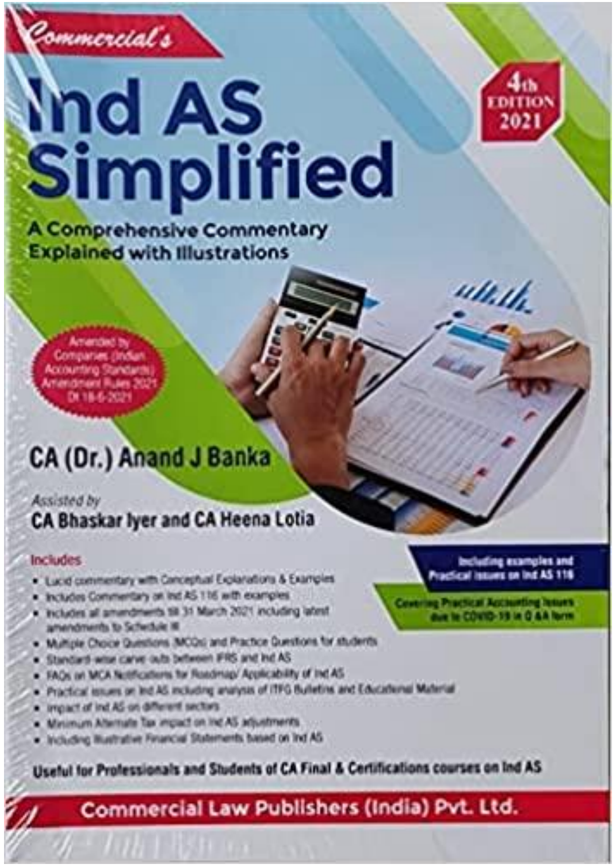
- Entity A seeks an independent valuation for items of PPE acquired
- Valuation was not complete at the time of issue of financial statements as on 31st March 2011
- Provisional Fair value of the assets was considered at 0.2 mio
- In July 2011, fair value obtained was 0.25 mio
- Thus, the financials of 2010-11shall be restated
- Information received after 12 months, effect shall be taken in income statement. No adjustment will be made in Goodwill

STEP ACQUISITION



ACCOUNTING

- Re-measure previously acquired non-controlling equity investment (NCEI) at fair value
  - Adjustment in profit or loss (unless classified as FVOCI – in which case, it remains in reserves)
- Goodwill from previous acquisitions is ignored



Authored Publications	Year
Comprehensive Guide to Indian GAAP	2015
Comprehensive Guide to IND AS Implementation	2015
Ind As Simplified with illustrations, extracts and disclosure checklists	2016
Ind AS Simplified 1st Edition	2018
Ind AS Simplified 2nd Edition	2019
Ind AS Simplified 3rd Edition	2020
Ind AS Simplified 4th Edition	2021