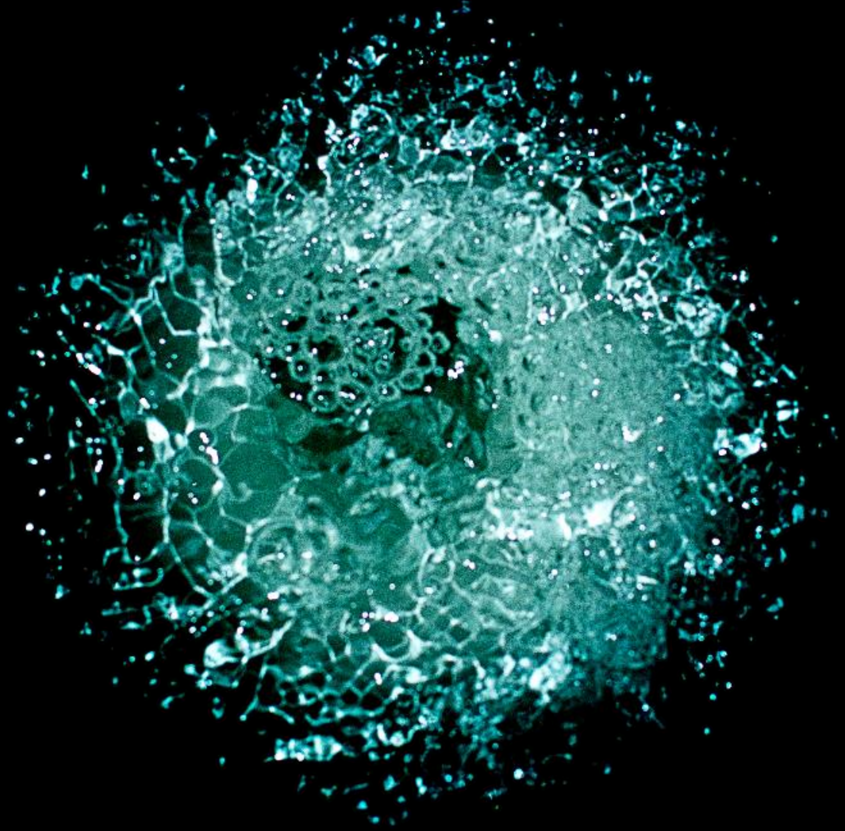
Ind AS 103 Business Combinations
Accounting Challenges and Opportunities



CA Shrenik Baid

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Session Overview

- Key Concepts
  Scope
  Determining Acquisition Date
  Accounting Challenges and Clarifications
  Measurement Period
  Practical Examples
  Key Difference in Accounting of an Asset Acquisition and Business Combination

- Consideration Transferred in Business Combination

- Reverse Acquisition

- Common Control Transaction

- Deferred Tax on Business Combination

- Challenges in Preparing carve out financial statements

Key Concepts

Scope

Step 1 – Determine Potential Transaction Type

- Slump Sale
- Acquisition through Share Purchase
- Amalgamation of entities
- Demerger of Business
- Formation of Joint Venture
- Forward Contract for acquisition of Business
- Itemized Sale

Practical Examples of Type of Arrangements:

✓ Transfer of Particular line of Business (e.g. Loan Against Property Business)

✓ Amalgamation of Wholly Owned Subsidiary with Parent

✓ Acquisition of an asset / group of assets

✓ Demerger of a line of business by a parent and merger of that line of business into subsidiary

✓ Merger of two or more entities

Basic concepts

Applicable Standard

- Ind AS 103 and Ind AS 110

Business combination vs asset acquisition

Types of business combinations

Who is the acquirer?

Definition of control

What is the date of acquisition?

Fair value of purchase consideration?

Fair value of assets and liabilities acquired?

Types of business combinations

- Business combinations
- *Reverse acquisition*
- *Common control transactions*

Criteria to evaluate "control"

- Power of the investee *(current ability to direct the relevant activities)*
- Exposure, or rights, to variable returns from its involvement
- Ability of use its power over the investee to affect the amount of investors returns (P/A)

Understand the purpose of the entity

Scope

Step 2 – Understand Definition of 'Business'

INPUTS
(economic resources)

+

PROCESSES
(systems, standards, etc)

OUTPUTS
(returns)

- Employees
- Materials
- Rights of use
- Non-current assets

- Excludes accounting, billing, payroll and other administrative systems

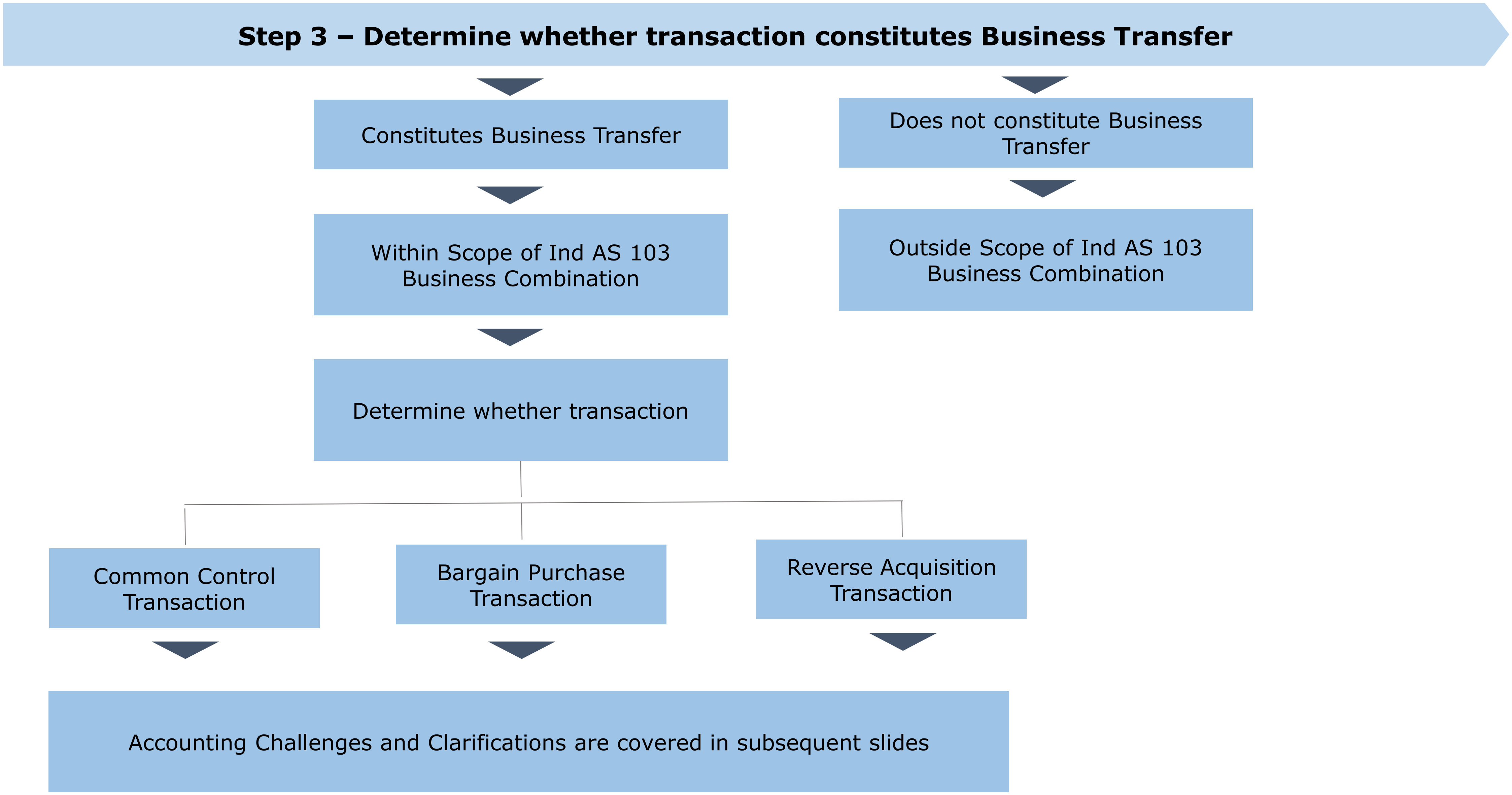
- Dividends
- Lower costs
- Economic benefits to stakeholders

Must be present for a business to exist
Doesn't need to be **all** the inputs and processes required
Must be **capable** of being managed as a business
If goodwill present, presumed to be a business

Outputs are not necessary
Development stage entities can be a business

Note – Definition of Business under IFRS 3 is amended and the amended definition is effective from 1st Jan, 2020

Scope


Step 3 – Determine whether transaction constitutes Business Transfer
Constitutes Business Transfer
Does not constitute Business Transfer
Within Scope of Ind AS 103 Business Combination
Outside Scope of Ind AS 103 Business Combination
Determine whether transaction
Common Control Transaction
Bargain Purchase Transaction
Reverse Acquisition Transaction
Accounting Challenges and Clarifications are covered in subsequent slides

Accounting Challenges and Clarifications

Acquisition Date → Date on which acquirer obtains control of the acquiree → Generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree —the closing date.

Appointed Date as per NCLT Order

- The appointed date as approved by NCLT under the scheme will be the acquisition date.
- ITFG Bulletin 12, issue 8 clarified - If the NCLT approves the scheme with a different appointed date as compared to the acquisition date as per Ind AS 103, acquisition date is the appointed date as approved by NCLT.

MCA Clarification on Appointed Date and Acquisition Date

- The appointed date identified under the scheme = deemed to be the acquisition date and date of transfer of control as per Ind AS 103
- Asset transferred by acquirer and equity interest issued as consideration by the acquirer are fair valued on acquisition date.
- For cases where the appointed date shall be deemed as acquisition date, the fair value of asset acquired and consideration paid needs to be determined on appointed date.
- Note - This guidance is applicable to external business combination, but it is still debatable whether this Clarification is applicable to common control transactions.

Measurement Period

Maximum of one year

Time

Measurement period

Acquisition date

Provisional accounting finalised

Provisional amounts determined

Adjustments:

- Assess whether relates to events after acquisition date (timing, reason)
- Qualifying amounts pushed back to acquisition date

Subsequent adjustments:

- Do not impact business combination accounting, i.e., no goodwill adjustment
- No remeasurement of equity items
- Usually impact profit/loss
- Includes contingent consideration (follow Ind AS 109 if in scope), earn outs, deferred taxes

Accounting Challenges and Clarifications

Whether Carrying amounts of assets and liabilities of combining entities be reflected as per books of the entities transferred or as per books of the Ultimate Parent?

ITFG Bulletin 9, issue 2 clarified:

- **In case of Merger with parent –**

Carrying amount in the combined entity = Carrying amount as appearing in Consolidated Financial statements as appearing before merger.

- **In case of Merger between subsidiaries –**

Carrying amount in the combined entity = Carrying amount as appearing in the standalone financial statements of the entities being combined.

Examples

Scenario 1 –

A Ltd. has two subsidiaries B Ltd. and C Ltd. B Ltd. merges with C Ltd.

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.

Scenario 2 –

B Ltd. is the subsidiary of A Ltd. B Ltd. merges with A Ltd.

Since B Ltd. is merging with A Ltd. (i.e. parent) nothing has changed and the transaction only means that the assets, liabilities and reserves of B Ltd. which were appearing in the consolidated financial statements of Group A immediately before the merger would now be a part of the separate financial statements of A Ltd.

Accordingly, the carrying values pertaining to B Ltd as appearing in the consolidated financial statements of A Ltd.

Key Difference in Accounting of an Asset Acquisition and Business Combination

Areas of Difference	Business Combination	Asset Acquisition
Measurement Period	Acquirer has up to one year to obtain information about facts and circumstances that existed as of the acquisition date and adjust provisional amounts recognized.	No measurement period.
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.
Situations where the fair value of the assets acquired and liabilities assumed exceeds the fair value of consideration transferred (referred to as bargain purchases)	A gain is recognised by the acquirer in other comprehensive income and accumulated in 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.

Key Difference in Accounting of an Asset Acquisition and Business Combination (contd.)

Areas of Difference	Business Combination	Asset Acquisition
Deferred tax accounting	Recorded on temporary differences of assets acquired (other than goodwill) and liabilities assumed in a business combination.	No deferred taxes are recognised for temporary differences on asset acquisitions (on initial recognition). Ind AS prohibits recognition of deferred taxes for temporary differences that arise upon initial recognition of an asset or liability in a transaction that - i. is not a business combination and ii. at the time of the transaction, affects neither accounting nor taxable income.
Transaction costs	Expensed in the period in which such costs are incurred and are not included as part of the consideration transferred	Capitalized as a component of the cost of the assets acquired.
Contingent consideration	Recognized at its acquisition-date fair value as part of the consideration transferred.	Generally recognized when the contingency is resolved (i.e., when the contingent consideration is paid or becomes payable).

Consideration Transferred in Business Combination

Components of Consideration Transferred

Contingent consideration may include additional consideration payable based on earnings of the acquired entity or on reaching certain revenue targets etc.

Consideration transferred

Transaction costs are expenses – next slide

Aggregate of

recognise a gain/loss on remeasurement

Acquisition date fair value of **assets transferred** by the acquirer

Acquisition date fair value of **equity interests** issued by the acquirer

Classification in accordance with Ind AS 32

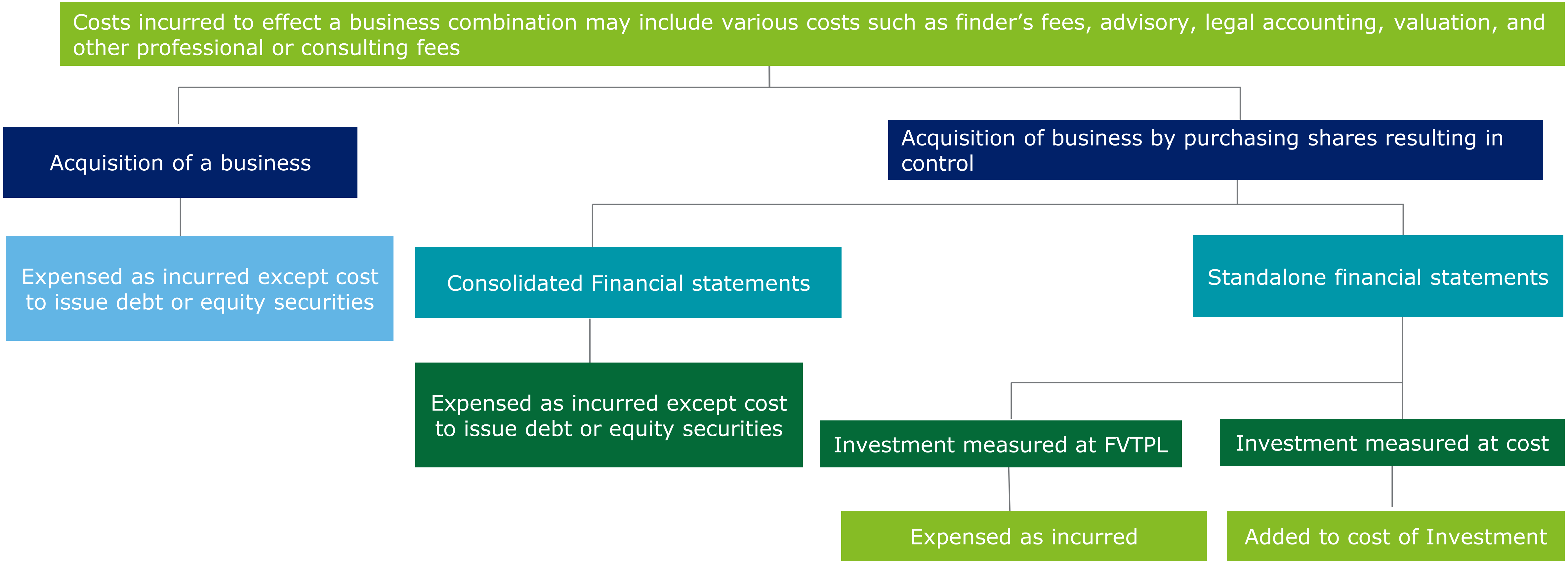
Includes contingent consideration

Acquisition date fair values of **liabilities incurred** by the acquirer to former owners of the acquiree

Market-based measure of **replacement share-based payment transactions (related to pre-combination services)**

Measured in accordance with Ind AS 102

Accounting of Cost of Business Combination



As per Income Tax Act, expenses incurred in relation to amalgamation/ demerger can be amortised over a period of 5 years

Reverse Acquisition

Accounting Clarifications in Reverse Acquisition

Who is Acquirer and Acquiree in Reverse Acquisition?

- Entity that issues securities (the 'legal acquirer') - Acquiree for accounting purposes
- Entity whose equity interests are acquired (the 'legal acquiree') - Acquirer for accounting purposes

Who should meet the definition of Business?

- Accounting acquiree must meet the definition of a business in order for the transaction to be treated as a reverse acquisition under Ind AS 103.

What are indicators of Reverse Acquisition?

- The former shareholders of entity - own majority of shares and control the majority of votes in the combined entity

- **Treatment of Net assets of legal acquiree/ accounting acquirer**
- **Treatment of Net assets of legal acquirer/ accounting acquiree**

- Net assets of legal acquiree/ accounting acquirer- Not restated from pre-combination carrying amounts
- Net assets of legal acquirer/accounting acquiree - Recognised and measured in accordance with the requirements for acquiree under Ind AS 103

Common Control Transaction

Common Control Transactions

Common Control Business Combination	• The combining entities or businesses are ultimately controlled by the same party (or parties) both before and after the transaction
Is Control Transitory?	• No, common control exists only if the ultimate power is not transitory. If the control is transitory then common control does not exist.
Accounting of common control transactions	• Using pooling of interests method
Restatement of Prior Period Financial Information	• Prior period financial statements 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. • If business combination had occurred after that date, the prior period information should be restated only from that date. **Example -** • Company A acquired control in Company B on April 10, 2012. Thus, Company B became a subsidiary of Company A on that date. On April 10, 2016 a court scheme was filed to merge Company B into Company A. The court order was received on March 10, 2017. • As per Ind AS 103, the acquisition date is March 10, 2017. However, as per Appendix C, the business combination will be accounted from April 1, 2015 in the year ended March 31, 2017 financial statements. Considering same example, had Company A acquired control in Company B on June 1, 2015, the business combination will be accounted from June 1, 2015, in the year ended March 31, 2017 financial statements.

Practical Examples

Specific Issues on Common Control Transaction

Can Transaction involving Joint Venture fall under common control transaction?

- ABC Ltd and XYZ Ltd has two joint ventures namely – PQR Ltd and RST Ltd. PQR Ltd and RST Ltd enter into a transfer of business transaction.
- Since PQR Ltd and RST Ltd is jointly controlled by ABC Ltd and XYZ Ltd, transaction between PQR Ltd and RST Ltd fall under common control transaction.

Whether entity is under Common Control when there is no contractual arrangement between individuals?

- A group of individuals are regarded as controlling an entity only when they have contractual arrangements and collectively have the power to govern its financial and operating policies and that ultimate collective power is not transitory.

Example :
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.

Scenario 1 –
Shareholders have entered into a shareholders' agreement in terms of governance of ABC Ltd and XYZ Ltd due to which they exercise joint control. In this case ABC Ltd and XYZ Ltd are considered to be under common control

Scenario 2 –
There are no agreements between any of the shareholders that they will exercise their voting power jointly. In this case ABC Ltd and XYZ Ltd are not considered to be under common control even if there is an established pattern of voting together

Accounting Challenges in Common Control Transaction

Restatement of Prior Period Financial Information in case of Common Control Transaction entered after date of Transition to Ind AS

- ICAI vide its ITFG Bulleting 16 Issue 5 clarified -

Common Control Transaction entered after date of transition to Ind AS

- Accounting Treatment is not prescribed in Court Approved Scheme
  - The transaction to be accounted as per Ind AS 103 and prior period information is to be restated as per Ind AS 103 irrespective of its accounting under previous GAAP.
- Accounting Treatment is prescribed in Court Approved Scheme
  - The prior period information need not be restated. The entity shall follow the treatment prescribed in the scheme (In subsequent years accounting requirement of Ind AS is to be followed which are not in conflict with provision of court scheme)

Note –

If the court approved scheme provides an accounting treatment, then the accounting treatment as provided in the scheme overrides the accounting treatment that would otherwise be required to be followed.

Accounting Challenges in Common Control Transaction

Restatement of Prior Period Financial Information in case of Common Control Transaction entered before the date of Transition to Ind AS

- Ind AS 101 provides exemption from application of Ind AS 103 retrospectively for the business combination entered prior to date of transition.
- ICAI vide its ITFG Bulleting 18 Issue 4 clarified -

Transaction entered before adoption of Ind AS and scheme is approved by NCLT/Court that prescribed a treatment that differs from treatment under Ind AS 103

Whether restatement required?

- Evaluate whether the restatement upon transition to Ind AS is legally permissible
- Where it is evaluated that under law, the scheme approved by the relevant authority does not preclude restatement upon transition to Ind AS, the restatement would be permissible subject to complying with conditions under Ind AS 101

Accounting Challenges in Common Control Transaction

Transaction entered before adoption of Ind AS and scheme is approved by NCLT/Court that prescribed a treatment that differs from treatment under Ind AS 103

- ICAI vide its ITFG Bulleting 16 Issue 5 clarified –
- The council of ICAI has made an announcement that if an item of financial statement is treated differently pursuant to an order made by NCLT/court as compared to treatment by IND AS , following disclosure should be made in the financial statement for the year in which treatment is given differently:
  - A description of accounting treatment made along with the reason that the same has been adopted because of the tribunal/court order
  - Description of the difference between the accounting treatment prescribed in the Ind AS and that followed by company
  - The financial impact, if any, arising due to such a difference

Presenting consideration for prior period in common control transaction

- Consideration in form of cash - The obligation to pay consideration in cash should be recognised as a liability as at the end of the comparative year end.
- Consideration in form of Equity Shares - Presuming that the shareholders will be issued a fixed number of shares, the consideration payable should be classified as equity using an appropriate nomenclature e.g.- Share Pending Issuance

Impact on EPS

- Equity shares issued as consideration in common control transaction shall be included in the calculation of the weighted average number of shares for all periods presented including the comparative period.

Practical Challenges in Common Control Transaction

M/s ABC (Parent Co) has two subsidiaries i.e. M/s PQR and M/s XYZ.

M/s PQR (Demerged Entity) entered into business demerger transaction with M/s XYZ(Resulting Entity).

01

All assets and liabilities and business process of M/s PQR relating to demerging business will be transferred to M/s XYZ

M/s XYZ as a part of consideration would issue shares at fair value to shareholders of M/s PQR (i.e. to M/s ABC)

02

On demerger of business from M/s PQR to M/s XYZ, M/s ABC will write off its investment in M/s PQR

03

Whether transaction is business transfer ?

Whether the transaction is common control transaction?

What are the accounting implication?

Practical Challenges in Common Control Transaction

Analysis

Transaction Analysis -

M/s PQR and M/s XYZ which are subsidiaries of M/s ABC and are under control of M/s ABC, hence the transaction between PQR and XYZ is common control transaction.

Since all the assets and liabilities and related business process of the demerging entity is transferred, it meets the definition of business under Ind AS 103.

Accounting Implication -

Accounting in Books of M/s PQR(Demerged Entity)-

- Reduce the book values of all assets, liabilities and reserves pertaining to demerged undertaking of the demerging company
- The difference, if any, between the net assets and transferred reserves shall be adjusted against the balance in General Reserves

Accounting in Books of M/s XYZ (Resulting Entity)–

- Record the assets, liabilities and reserves at book value
- Securities shall be recorded at nominal value
- Credit to share capital face value of equity shares issued
- Difference, if any, between the amount recorded as share capital issued and the amount of share capital of the demerged company shall be transferred to capital reserve

Accounting in Books of M/s ABC (Parent Entity)–

The investment in resulting company shall be recognized at the value of equity shares received and correspondingly the value of investment in demerged entity will be reduced on account of reduction in value through transfer of business.

Deferred Tax on Business Combination

Deferred Tax on Business Combination

Deferred Tax on Acquisition

- Recognize Deferred Tax (on temporary difference) if fair value of acquired assets and liabilities is different from tax base
- Not fair valued on acquisition date

  Not recognised on initial recognition of goodwill
- Resulting deferred tax will affect
  - The value of the net assets acquired
  - Will impact the calculation of goodwill

Example

i. Company A acquired Company B for Rs.50,000.

ii. Fair value of the identifiable assets and liabilities of Company B was Rs.25,000.

iii. Intangible asset not recognised in books of Company B is of Rs.5,000. The tax base of the intangible asset was nil. (Assuming book base and tax base of other assets and liabilities are same)

iv. A taxable temporary difference of Rs.5,000 exists at the date of acquisition

v. A deferred tax liability of Rs.1,150 is recognised (Rs.5,000 × 23% (assumed tax rate)).

vi. The net assets at the date of acquisition are therefore Rs.23,850 (Rs.25,000 – Rs.1,150) and goodwill of Rs.26,150 (Rs.50,000 – Rs.23,850) is recognised.

Deferred Tax on Business Combination

Deferred Tax on Unused Tax Losses of Acquiree

Consider whether probable to recover deferred tax on unused tax losses of acquiree against the future taxable profit

Might not satisfy the criteria for separate recognition when a business combination is initially accounted but deferred tax benefit realizes after business combination

1. **If carrying amount of Goodwill is not zero –** Reduce the carrying amount of any goodwill on that acquisition by acquired deferred tax benefits recognised within the measurement period
2. **If carrying amount of Goodwill is zero –** Remaining deferred tax benefits shall be recognised in other comprehensive income and accumulated in equity as capital reserve or recognised directly in capital reserve
3. **All other acquired deferred tax benefits realized shall be recognised in profit or loss**

Example

On 31 July 2019 Company A acquired Company C which had trading losses available for deduction against future trading profits of Rs.50,000 at the date of acquisition. These losses did not qualify for recognition as per Ind AS 12 at the date of acquisition.

On 31 March 2020, management considered it probable that future taxable profits will be recognised by Company C sufficient to justify recognition of this deferred tax asset.

Scenario 1: Goodwill of Rs.100,000 was recognised

A deferred tax asset of Rs.11,500 will be recognised (Rs.50,000 × 23% (assumed tax rate)) with corresponding credit to the carrying amount of goodwill.

Scenario 2: No Goodwill was recognised

A deferred tax asset of Rs.11,500 will be recognised (Rs.50,000 × 23% (assumed tax rate)) in other comprehensive income and accumulated in equity as capital reserve or recognised directly in capital reserve.

Challenges In Preparing Carve Out Financial Statements

Carve Out Financial Statement

- Carve out financial statements are the financial statements pertaining to a carve-out business.
- ICAI has given guidance note on preparation of carve out financial statement which details procedures for preparation of the same along with the required disclosure.

Challenges faced in preparation of carve-out financials

Allocation of Centralized/ Common Expenses

Example - Allocation of Payroll of centralized employees, Centralized purchasing, marketing, rent, advertising, legal, insurance, management expenses, etc.

Allocation of Cost

Example - Allocation of brand cost amongst various segments when only one segment is being carved-out while other segments also use the brand

Related Party Transactions

Example - Sales which were previously regarded as 'intra-group' will need to be reexamined to determine whether they relate to entities within the carve-out business or outside it.

Allocation of Expenses accounted for on behalf of the carve-out business by the remaining group

Example - GST, VAT, payroll taxes, certain customers or suppliers common to the carve-out business and the remaining group, and external funding balances.

Allocation of Tax expense

Allocation of transactions or balances that are not directly identifiable to the carve-out assets and liabilities and income and expenses pertaining to carve out business.

Thank You