SUPPLEMENTARY

IND AS 103

PAPER - 17

Ind AS 103: Business Combination

Part - B

Now we may consider a case of bargain purchase.

Illustration 5.

On 1 January 20X5 M Ltd. acquires 80 per cent of the equity interests of P Ltd in exchange of cash of ₹250. The identifiable assets are measured at ₹350 and the liabilities assumed are measured at ₹50. The fair value of the 20 per cent non controlling interest in P is ₹43.

Answer:

Amount of the identifiable net assets acquired (₹350 – ₹50)		₹300
Less: Consideration	₹250	
Less: Fair value of non-controlling interest	₹43	₹293
Gain on bargain purchase of 80 per cent interest		₹7

M would record its acquisition of P in its consolidated financial statements as follows:

Journal entry

Particulars		Dr. (₹)	Cr. (₹)
Identifiable Assets Acquired A/c	Dr.	350	
To, Cash A/c			250
To, Liabilities assumed			50
To, Gain on the bargain purchase			7
To, Non-controlling Interest in P			43

The gain on bargain purchase will be recognised in other comprehensive income and accumulated in equity as Capital Reserve.

6. In para 1 we defined business combination. We may elaborate the concept here.

Control of business can be obtained by —

a) acquiring assets and assuming liabilities (such assets and liabilities must constitute a business, otherwise it is not a business combination).[1] if no NCI and [2] if NCI exists.
b) by acquisition of shares.[2] or
c) by other legal process.[2]

[1] Recording be done in the financial statements of the Acquirer.
[2] Recording be done in the consolidated financial statements of the Acquirer.

[It may be pointed out that AS-14 deals with accounting of (a)[1] cases, Ind AS 103 takes up the cases (a)[2] , (b) and (c) also.]

7. An entity shall account for each business combination by applying the acquisition method, similar to 'Purchase method'. (It does not include 'business combination under common control', which is accounted under 'Pooling of Interest' method.)

8. Applying the acquisition method requires:
(a) identifying the acquirer;
(b) determining the acquisition date;
(c) recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and
(d) recognising and measuring goodwill or a gain from a bargain purchase.

In the first chapter we started with discussion and illustrations on clauses (c) and (d) of para 8 because they are closely related to accounting. In para 9 and 10 we shall discuss clauses (a) and (b) of para 8.

9. Identifying the Acquirer:
- For each Business Combination one of the combining entities shall be identified as the acquirer.
- Acquirer is the entity that obtains control of business.
- The guidance in Ind AS 110 shall be used to identify the acquirer — the entity that obtains control of another entity, i.e. the acquiree.

[When it is not clear from Ind AS 110, the following factors should be considered under Ind AS 103:
B14 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.
B15 In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests.

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.

B16 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.
B17 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.
B18 A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraphs B13–B17. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.]

10. Determining the acquisition date: It is the date on which the acquirer obtains control of the acquiree i.e.,legally transfers the consideration, acquires the assets and assumes the liability of the acquiree.

11. Consideration transferred should also be measured as per the requirement of this standard.

- The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer.
- 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 recognize the resulting gains or losses, if any, in profit or loss.
- Further, any items that are not part of the business combination be accounted separately from business combination (example: acquisition related costs)
- Contingent consideration (Obligation by the acquirer to transfer additional assets or equity interest, if specified future events occur or conditions are met), if any, should also be measured at fair value at acquisition date.

Illustration 6.

D has acquired 100% of the equity of F on March 31, 20X7. The purchase consideration comprises of an immediate payment of ₹10 lakhs and two further payments of ₹1.21 lakhs if the Return on Equity exceeds 20% in each of the subsequent two financial years. A discount rate of 10% is used. Compute the value of total consideration at the acquisition date.

Answer:

	₹ lakhs
Immediate cash payment	10.00
Fair value of contingent consideration ($1.21/1.1 + 1.21/1.1^2$)	2.10
Total purchase consideration	12.10

Illustration 7.

C Ltd acquires 60% share in D Ltd. for cash payment of ₹200,000. The fair value of non-controlling interest is ₹1,00,000. This amount was determined with reference of market price of D's ordinary shares before the acquisition date.

Calculate NCI and goodwill following:

i. **Fair Value approach**
ii. **Proportionate shares of identified net asset in acquiree approach when on the acquisition date, the aggregate value of D's identifiable net assets is:**
   (a) ₹2,40,000;
   (b) ₹3,30,000.

Answer:

	(ia) ₹	(ib) ₹	(iia) ₹	(iib) ₹
Consideration (1)	2,00,000	2,00,000	2,00,000	2,00,000
NCI (2)	1,00,000	1,00,000	96,000[x]	1,32,000[y]
Net assets (3)	2,40,000	3,30,000	2,40,000	3,30,000
Goodwill (1+2-3)	60,000		56,000	2,000
Gain on Bargain Purchase (3-1-2)		30,000		

[x] 40% × 240000 = 96,000
[y] 40% × 330000 = 1,32,000

[Under Ind AS 103, Goodwill is not amortised but tested for annual impairment in accordance with Ind AS 36.]

12. Additional explanations and guidance for accounting of business combination by the acquirer under Acquisition method are provided in the following section.

13. Contingent liability: 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. (Ind AS 37 do not apply)

Illustration 8:

Z Company acquired C Company on April 1, 201X. For a lawsuit contingency C has a present obligation as on April 1, 201X and the fair value of the obligation can be reliably measured as ₹50,000. As of the acquisition date it is not believed that an out flow of cash or other assets will be required to settle this matter. What amount should be recorded by Z Company under Ind AS for this contingent liability of C Company?

Answer:

Contingent liabilities of the Acquiree are recognized as of the acquisition date if there is a present obligation (even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, contrary to Ind AS 37) and the fair value of the obligation can be measured reliably. Hence, a liability of ₹50,000 would be recorded by Z.

14. A business combination achieved in stages:

An acquirer sometimes obtains control of an acquiree in which it already held an equity interest. For example, on 31 March 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 is a business combination achieved in stages or 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 or other comprehensive income, as appropriate.

Illustration 9.

Entity A acquired 35 % of Entity B in 2015 for ₹35,000. In 2016, fair value of shares of entity B is ₹42,000, thus ₹7,000 reported under OCI
In 2016, A further acquired 40% stake in B. Consideration paid ₹60,000. Entity A identifies the net assets of B as ₹120,000, value 35% shares at ₹45,000. NCI is valued at proportionate net assets.

Show workings and Journal entries.

Answer:

A will make transfer to P&L:

Gain on disposal of 35% investment ₹ (45,000 – 42,000)	=	₹3,000
Gain previously reported in OCI ₹(42,000 – 35,000)	=	₹7,000
Total transfer to P & L		₹10,000

A will measure goodwill as follows:

Fair Value of consideration given for controlling interest	₹60,000
Non-controlling interest (25% × ₹1,20,000)	₹30,000
Fair Value of previously-held interest	₹45,000
	₹1,35,000
Less : Fair value of net assets of acquiree	₹1,20,000
Goodwill	**₹15,000**

Particulars		Dr. (₹)	Cr. (₹)
Investment A/c	Dr.	3,000	
OCI A/c	Dr.	7,000	
To, P&L A/c			10,000
Net Assets A/c	Dr.	1,20,000	
Goodwill A/c	Dr.	15,000	
To, Consideration A/c			60,000
To, Investment A/c			45,000
To, NCI A/c			30,000

Note: If we already have control of the acquiree (e.g. already own 70% of the equity and purchase the remaining 30%) then this is NOT a step acquisition.

15. Business combination under common control (mentioned in para 3, introductory discussion)

Appendix C deals with accounting for combination of entities or businesses under common control. 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.

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 to 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.

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

16. Reverse acquisition (introductory discussion)

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 in paragraphs B13–B18 of Ind AS 103 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 in Ind AS103, including the requirement to recognise goodwill, apply.

17. Disclosure (mentioned in clause c of para 3)

An acquirer should disclose information that enables users to evaluate the ***nature and financial effect of business combinations*** that were affected. This information includes:

(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.

(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; and
  (iv) equity interests of the acquirer
(g) information for contingent consideration arrangements
(h) information for each contingent liability recognised
(i) The amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless impracticable. If impracticable, fact must be disclosed.

18. Difference between Ind AS 103 and AS 14.

Scope: Ind AS 103 has a wider scope than AS 14 [See para 6].

Method of accounting: Ind AS 103 prescribe only acquisition method for every business combination whereas AS 14 states two method of accounting: Pooling of interest method and Purchase method.

Recognition and measurement: Ind AS 103 recognises acquired identifiable assets liabilities and non-controlling interest at fair value. AS 14 allows choice of Book value or FV.

Goodwill: Under Ind AS 103, Goodwill is not amortised but tested for annual impairment where as AS 14 require goodwill to be amortised over a period not exceeding 5 years.

Non Controlling Interest: Ind AS 103 provide for accounting of NCI, AS 14 do not.

Recording for consolidated financial statements: It is provided in Ind AS 103, not in AS 14.

Common control transactions: Appendix C deals with accounting for common control transactions, which prescribes Pooling of interest method of accounting. AS14 do not prescribe any different accounting for such transactions.

Contingent Consideration: Ind AS 103 recognise contingent consideration, AS 14 do not.

Reverse acquisitions: Ind AS 103 deal with reverse acquisitions, AS 14 do not.