Educational Material on Indian Accounting Standard (Ind AS) 103, *Business Combinations*

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Foreword

The Institute of Chartered Accountants of India (ICAI) is making every possible effort to bring the financial reporting in India in parity to the practices followed internationally. In this direction, the ICAI played a key role in formulating Indian Accounting Standards (Ind AS) substantially converged with IFRS standards. Transition to Ind AS, a comprehensive set of principle based standards, involves huge efforts. ICAI has played an effective role in smooth transition of these Standards by issuing guidance and conducting trainings for implementation of these Standards. The Ind AS Implementation Group of ICAI is playing an active role in educating the members and providing guidance on practical issues that are being faced by the members and other stakeholders.

Moving forward in this direction, the Ind AS Implementation Group has come out with Educational Material on Ind AS 103, *Business Combinations* which by way of Frequently Asked Questions (FAQs) explains the principles enunciated in the Standard. This publication will provide significant guidance to the stakeholders in how to account for the Business Combinations and its disclosures.

I convey my heartfelt thanks to CA. Nihar Niranjan Jambusaria, Convenor of the Group, CA. Dhinal Ashvinbhai Shah, Deputy Convenor of the Group and other members of the Ind AS Implementation Group for their valuable technical contribution and cooperation. I also congratulate CA. S.B. Zaware, Chairman and CA. M. P. Vijaykumar, Vice-chairman, Accounting Standards Board of ICAI for their support. I am of the firm belief that this Educational Material will be a useful publication for all who are getting ready for transition from existing Accounting Standards to Ind AS and also for those who will audit the financial statements in accordance with Ind AS.

I am confident that all these efforts of Ind AS Implementation Group will play a very significant and enabling role in smooth implementation of Ind AS in India.

New Delhi **CA. Naveen N D Gupta**

April 03, 2018 ***President, ICAI***

Preface

The implementation of Ind AS has already begun in the country with Phase I and Phase II companies which have already implemented Ind AS. The Institute of Chartered Accountants of India (ICAI) through its Ind AS Implementation Group constituted under Accounting Standards Board is making every possible effort to ensure that Ind AS are implemented in the same spirit in which these have been formulated. For this purpose, the Ind AS Implementation Group is working to provide guidance to the members and other stakeholders by issuing Educational Materials on Ind AS, issuing timely clarifications on issues being faced by the members through Ind AS Transition Facilitation Group (ITFG) Clarification bulletins, addressing queries through Support-desk for implementation of Ind AS, conducting Certificate Course on Ind AS, developing e-learning modules on Ind AS, workshops, seminars, awareness programmes on Ind AS and series of webcasts on Ind AS etc.

We are glad that the Group has brought out the Educational Material on Indian Accounting Standard (Ind AS) 103, *Business Combinations*. This Standard lays down the principles for accounting of business combinations by acquisitions/ mergers. This Standard also deals with accounting for combination of entities or businesses under common control. This Educational Material contains summary of Ind AS 103 discussing the key requirements of the Standard and the Frequently Asked Questions (FAQs) covering the issues, which are expected to be encountered frequently while implementing this Standard.

We may mention that the views expressed in this publication are the views of the Ind AS Implementation Group and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of examples. However, while applying Ind AS in a practical situation, reference should be made to the full text of the Standards.

We would like to convey sincere gratitude to our Hon'ble President CA. Naveen N D Gupta and Vice-President CA. Prafulla Premsukh Chhajed for providing us this opportunity of bringing out implementation guidance on Ind AS in the form of Educational Materials. We are thankful to CA. Sanjay Vasudeva for his support and guidance. We sincerely appreciate the efforts

put in by CA. Archana Bhutani, Co-convenor and members of the Group CA. Sandip Khetan, CA. Vilas Paranjape, CA. Ramesh Iyer and CA. Rohit Bansal for preparing the draft of this Educational Material. We would also like to thank all the members of the Ind AS Implementation Group for their invaluable suggestions and contributions for finalising this publication.

We sincerely appreciate CA. Geetanshu Bansal, Secretary, Ind AS Implementation Group and CA. Prachi Jain, Executive Officer for their technical and administrative support in bringing out this publication. We would also like to thank CA. Vidhyadhar Kulkarni, Head, Technical Directorate, for his guidance.

We sincerely believe that this Educational Material will be of great help in understanding the provisions of Ind AS 103 and in the practical implementation of the same.

CA. Nihar Niranjan Jambusaria
Convenor
Ind AS Implementation Group

CA. Dhinal Ashvinbhai Shah
Deputy convenor
Ind AS Implementation Group

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I Ind AS 103 - Summary

Objective of Ind AS 103

Ind AS 103 provides principles and requirements for how the acquirer:

- recognises and measures identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
- recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and
- disclosure requirements

Scope

Ind AS 103 does not apply to the following:

- the formation of a joint arrangement.
- the acquisition of an asset or group of assets that is not a business as defined acquisition by an investment entity.

(Though IFRS 3, *Business Combinations* scopes out the accounting for combination of entities or business under common control but Ind AS 103 has included this in Appendix C).

Identifying a business combination

An entity shall determine whether a transaction or other event is a business combination in accordance with this Ind AS, which requires that the assets acquired and liabilities assumed constitute a business.

If the assets acquired are not a business, then the same shall be accounted for as an asset acquisition.

Business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this Ind AS.

An acquirer might obtain control of an acquiree in a variety of ways, for example by transferring cash, cash equivalents or other assets, 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.

A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

The three elements of a business are defined as follows:

Input: Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include 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.

Process: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes and resource management processes.

Output: The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

A business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.

Acquisition Method

Business combinations are accounted for using the acquisition method which requires:

(a) identifying the acquirer (the acquirer is the entity that obtains control of another entity);

(b) determining the acquisition date (the date on which the acquirer obtains control);

(c) recognise and measure the identifiable assets acquired and the liabilities assumed and any non-controlling interest; and

(d) recognise and measure any goodwill or bargain purchase.

For each business combination, one of the combining entities shall be identified as the acquirer. The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

Recognition and Measurement Principle

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.

To qualify for recognition, the identifiable assets acquired and liabilities assumed by the acquirer must meet the definitions of assets and liabilities in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standard at the acquisition date.

The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.

Recognising particular assets acquired and liabilities assumed

Operating leases- The acquirer shall recognise no assets or liabilities related to an operating lease in which the acquiree is the lessee.

The acquirer shall recognise an intangible asset if the terms of an operating lease are favourable relative to market terms and a liability if the terms are unfavourable relative to market terms.

Intangible assets- The acquirer shall recognise, separately from goodwill, the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion.

Reacquired rights- 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. A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill.

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.

Exceptions to the Recognition Principles

(a) Contingent Liabilities

- the acquirer shall recognise if it is a present obligation that arises from past events and its fair value can be measured reliably.

(b) Exceptions to the Recognition and Measurement Principles

- Income taxes
  - deferred tax assets or liabilities arising from acquired assets or liabilities accounted in accordance with Ind AS 12.
- Employee benefits
  - accounted in accordance with Ind AS 19.
- Indemnification assets
  - shall be measured and recognised on the basis of the indemnified item.

(c) Exceptions to the Measurement Principles

- Reacquired rights
  - measured at fair value based on remaining contractual term ignoring the fair value effect of renewal.
- Share-based payment transactions
  - measured in accordance with Ind AS 102 (Market Based Measure).
- Assets held for sale

- measured in accordance with Ind AS 105 (i.e., fair value less costs to sell).

Recognition and measurement of Goodwill or Bargain Purchase

Goodwill is measured as the difference between the consideration transferred in exchange for the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

Bargain purchase

In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination, where the value of acquired identifiable assets and liabilities exceeds the consideration transferred; the acquirer shall recognise a gain (bargain purchase). The gain shall be recognised by the acquirer in Other Comprehensive Income on the acquisition date and accumulate the same in equity as capital reserve, if there exists a clear evidence of the underlying reasons for classifying the business combination as a bargain purchase.

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.

Reverse Acquisitions

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting. 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.

In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer.

Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition.

Consideration transferred

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.

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.

Applying the acquisition method to particular types of business combinations

(I) 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 in profit or loss or other comprehensive income, as appropriate.

(II) A business combination achieved without the transfer of consideration

The acquirer shall attribute to the owners of the acquiree the amount of the acquiree's net assets recognised in accordance with this Ind AS. 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.

Measurement Period

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized and additional assets and liabilities that existed at the acquisition date to reflect new information obtained.

The measurement period ends as soon as the acquirer receives the information it was seeking or learns that more information is not obtainable.

The measurement period shall not exceed one year from the acquisition date.

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, Ind AS 103 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.

Disclosures

The acquirer shall disclose information of a business combination that occurs either:

- during the current reporting period; or
- after the end of the reporting period but before the financial statements are approved for issue.

The acquirer shall disclose information for each business combination that occurs during the reporting period such as:

- the name and a description of the acquiree.
- the acquisition date.
- the percentage of voting equity interests acquired.
- the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
- a qualitative description of the factors that make up the goodwill recognised.
- the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration.

- and other disclosures as prescribed in the standard.

Business combinations of entities 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.

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:

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

(b) 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.

(c) 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.

(d) 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.

(e) 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.

(f) The difference, if any, between the amounts 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.

II Frequently Asked Questions

The Frequently Asked Questions included in this Educational Material are only for the accounting purpose. The commercial substance of the transaction and other legal and regulatory aspects has not been considered and may have to be evaluated on case to case basis.

Identification of Business

Question 1

Whether the following development stage entities will qualify as a business?

a) Company B is a development stage pharma company with a license to develop a new drug. Company A acquires all of the outstanding shares in Company B. Due to lack of funds, Company B has no employees and no other assets. Clinical trials and/or development are not being performed and Company A has no intention to peruse the plan to produce outputs in future. Company A plans to raise funds in the entity and commence initial clinical trials for the drug. Whether Company B represents a business?

b) Company D is a development stage pharma company that has a license for a new drug, final clinical trials are currently being performed by Company D's employees (one of whom founded Company D and discovered the drug) and it has a plan to eventually produce the drug. Company D's administrative and accounting functions are performed by contract employees. Company C acquires all of the shares in Company D. Whether Company D represents a business?

Response

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 a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

Paragraph 3 of Ind AS 103 states that, "an entity shall determine whether a transaction or other event is a business combination by applying the definition in this Ind AS, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition."

Paragraph B7 of Ind AS 103, *inter alia*, provides that a business consists of inputs and processes applied to those inputs that have the **ability to create outputs**. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

Further, paragraph B10 of Ind AS 103 provides some factors which are including but not limited, to consider in determining whether an integrated set of activities and assets in the development stage is a business:

- planned principal activities have commenced;
- there are employees, intellectual property and other inputs and there are processes that could be applied to those inputs;
- a plan to produce outputs is being pursued; and
- there will be an ability to obtain access to customers who will purchase the outputs.

Not all of these factors need to be present for the acquired set to be considered a business.

a) In this scenario, while Company B has an input (license to develop a new drug), however, it lacks processes to apply to the license in order to create outputs. Also, Company B has no employees and is not pursuing a plan to produce outputs as presently no research and development is being performed. Therefore Company B does not represent a business and accordingly Company A should account for this as an asset acquisition as prescribed in paragraph 3 of Ind AS 103.

b) Company D is performing final clinical trials and is pursuing a plan to produce outputs (i.e. a commercially developed drug to be sold or licensed). Accordingly, acquisition of shares in Company D results in Company C acquiring inputs (license for drug and employees) and processes (operational and management processes associated with the performance and supervision of the clinical trials). Hence, in the given scenario, the acquisition of shares in Company D represents a business combination.

Question 2

Whether group of assets in the following cases constitutes a business?

a) Development stage entity

Company ABC acquires Company PQR, which is engaged in software development business. PQR's main operation was to build customised software for banking industry. Currently PQR is engaged in researching and developing its first product and creating an active market for the software. PQR has not generated any revenues and has no existing customers. PQR's workforce is composed primarily of software engineers and programmers. PQR has the intellectual property, software and fixed assets required to develop the customised software for banks.

Whether the above acquisition is to be treated as a business and consequently accounted for as a business combination or whether acquisition should be accounted for as an asset acquisition?

b) Investment Property

Company A Ltd. purchases five investment properties that are fully rented to tenants. A Ltd. also takes over the contract with the property management company, which has unique knowledge related to investment properties in the area and makes all decisions, both of strategic nature and related to the daily operations of the property. Ancillary activities necessary to fulfill the obligations arising from these lease contracts are also in place, specifically activities related to maintaining the building and administering the tenants. Whether the acquired set constitutes a business or not?

Response

Paragraph B7 of Ind AS 103, *inter alia*, provides that a business consists of inputs and processes applied to those inputs that have the **ability to create outputs**. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

Further, paragraph B8 of Ind AS 103 states that, "to be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes."

a) Development stage entity

In the instant case, the elements in the acquisition seems to contain both inputs and processes.

Inputs being the intellectual property used to design the customised software, fixed assets and employees. The processes being the strategic and operational process for developing the software.

Accordingly, given that Company PQR has access to inputs and processes necessary to manage and produce outputs, acquisition of Company PQR can be considered to be a business combination. The lack of outputs, such as revenue and a product, does not prevent the entity from being considered a business.

b) Investment Property

As per paragraph 14A of Ind AS 40, *Investment Property,* judgement is required to decide whether the acquisition of set of investment properties meets the definition of a business (to be accounted for as per Ind AS 103) or whether it is an acquisition of investment properties (to be accounted for under Ind AS 40). In applying judgement to determine whether an acquired set of investment properties qualifies as a business, reference should be made to Ind AS 103. Factors that may be relevant in making the determination include whether property management services are acquired and the nature of those services, and the level and nature of ancillary services - e.g. security, cleaning and maintenance.

In the instant case, the acquired set of investment properties can be construed to be a business because it contains all of the inputs and processes necessary for it to be capable of creating outputs to provide a return to A Ltd.

Inputs: Non-current assets (land and buildings) and contracts.

Processes: Management with unique knowledge related to investment properties in the area.

Outputs: The intended outputs include rental income.

In contrast, if the property management contract is not taken over, then the group of assets might not be a business. The acquired set might not represent an integrated set of activities and assets because the key element of the infrastructure of the business, i.e. property management, is not taken over. If so, then A Ltd. would account for the transaction as the purchase of individual investment properties, and not as the purchase of a business.

Deciding whether acquisition of investment properties in the given case constitutes a business is a matter of professional judgement which requires careful assessment of facts and circumstances.

Question 3

What are the key differences in accounting of an asset acquisition and a business combination?

Response

The following are the key differences in accounting of an asset acquisition and a business combination:

Topic	**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. [Ind AS 103 paragraphs 13, 32]	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. [Ind AS 103 paragraph 2(b)]
Transaction costs	In a business combination, acquisition-related costs (including stamp duty) are expensed in the period in which such costs are incurred and are not included as part of the consideration transferred. [Ind AS 103 paragraph 53]	Transaction costs are capitalised as a component of the cost of the assets acquired.
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 that (i) is not a business combination and (ii) at the time of the transaction, affects neither accounting nor

Topic	Business combination	Acquisition of group of assets under Ind AS
		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 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 accumulated in capital reserve. [Ind AS 103 paragraph 34]	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. [Ind AS 103 paragraph 2(b)]

Question 4

Which of the following scenario represents a Business Combination?

a) Case A: On 1 January 2012, ABC Ltd. owns a majority share of its investee's voting equity interests. The other investors in the investee hold contractual rights (for example, board membership rights accompanied by veto rights on operating matters, or other substantive participation rights) which preclude ABC Ltd. from exercising control over the investor. The contractual rights of other investors were for 5 years which lapsed on 31 December 2016 as per the terms of the contract.

b) Case B: PQR Ltd. owns an equity investment in an investee that gives it significant influence but not control. During the year, the investee repurchased its own shares from other parties and the same were extinguished which resulted in an increase in the PQR Ltd.'s proportional interest in the investee (to 60% of the voting rights), which results in PQR Ltd. acquiring control of the investee.

Response

Pursuant to requirement of paragraphs B80-B85 of Ind AS 110, *Consolidated Financial Statements*, the investee needs to evaluate control on a continuous basis. Both of the above scenarios represent business combination because of the following:

a) In Case A, on 1 January 2017, it represents a change in the rights of other shareholders (elimination or expiration of the contractual rights precluding control) which result in ABC Ltd. obtaining control of the investee and qualifying as a business combination.

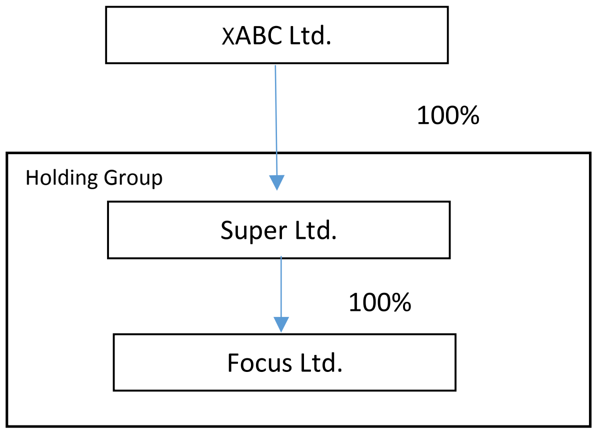
b) In Case B, the repurchase by investee of its own shares from other parties results in PQR Ltd. obtaining control of the investee (presuming no other indicator impacting control). This transaction qualifies as a business combination and the acquisition method would be applied by PQR Ltd.

It has been presumed that in both the cases above, the activities of the investee meet the definition of business.

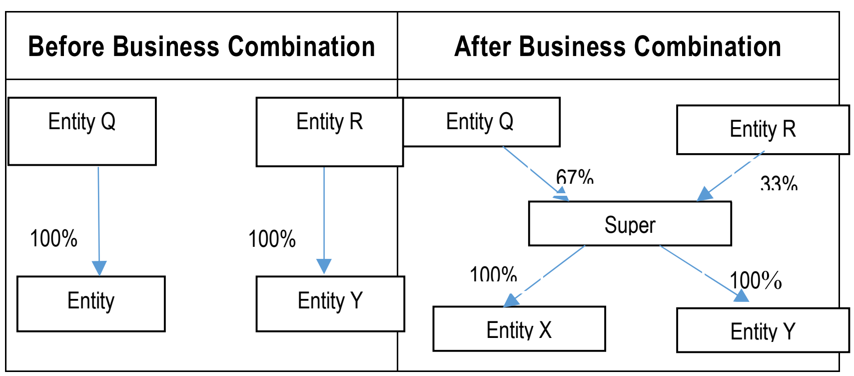
Identification of an acquirer- Business Combination effected by a newly incorporated company

Question 5

a) 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. Can Super Ltd. be identified as the acquirer in this business combination?



b) To capitalise on economies of scale and other synergies, Entity Q contributes its wholly-owned subsidiary, Entity X and Entity R contributes its wholly-owned subsidiary, Entity Y, to a newly incorporated company Super Ltd. Super Ltd. issues 200 shares to Entity Q and 100 shares to Entity R in exchange for the transfer of the shares in their respective subsidiaries. The number of shares reflects the relative sizes of the entities before the combination.



Can Super Ltd. be identified as the acquirer in a business combination and apply acquisition method of accounting in its consolidated financial statements? If Super Ltd. is not the acquirer then which entity is considered as acquirer and how should the combination be accounted for?

Response

The relevant paragraphs of Ind AS 103 are as follows:

"6 For each business combination, one of the combining entities shall be identified as the acquirer.

7 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. 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 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. Paragraphs B19–B27 provide guidance on accounting for reverse acquisitions. 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 step in analysing how a transaction involving a newly incorporated company should be accounted for is establishing whether a business combination has occurred. This analysis involves understanding the economic drivers and rationale behind the transaction(s) - e.g. tax considerations or a restructuring of business activities before a listing transaction - which will vary from case to case. In effect, the key drivers of the accounting are identifying the party on whose behalf the new entity has been formed and identifying the business acquired.

a) 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.

b) Paragraph B18 of Ind AS 103 provides that 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.

   In this scenario, Super Ltd. is not the acquirer. The transaction brings together Entity X and Entity Y. Legally, it has been effected by Super Ltd. acquiring Entity X and Entity Y, rather than one of these entities acquiring the other. However, to determine the acquirer in effect, it is necessary to look at all the facts. Based on the evidence and in the absence of any other information for the purpose of consolidated financial statement at Super Ltd. it seems that Entity X is the acquirer – it is the largest company and its previous owners (Entity Q) control the combined group (with 67% of the shares that is 200/300) through Super Ltd. The transaction results in Entity R losing control over Entity Y (post the transaction it has only 33% shares in the combined group). Super Ltd's consolidated financial statements reflect Entity X as the acquirer, using Entity X's book values. Entity Y is the acquiree and the acquisition accounting is applied to Entity Y's assets and liabilities.

Acquisition date- Agreements with retroactive effect

Question 6

Business Combination without a Court approved scheme

Company ABC Ltd. acquired all the shares of Company XYZ Ltd. The negotiations had commenced on 1 January 2016 and the agreement was finalised on 1 March 2016. While ABC Ltd. obtains the power to control XYZ's operations on 1 March 2016, the agreement states that the acquisition is effective from 1 January 2016 and that ABC Ltd. is entitled to all profits after that date. In addition, the purchase price is based on XYZ's net asset position as at 1 January 2016. What is the date of acquisition?

Response

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 as follows:

> *"*6 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.
>
> 7 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. 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.

Therefore, in this case, notwithstanding that the price is based on the net assets at 1 January 2016 and that XYZ's shareholders do not receive any dividends after that date, the date of acquisition for accounting purposes will be 1 March 2016. It is only on 1 March 2016 and not 1 January 2016, that ABC 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 1 March 2016.

Acquisition date- Regulatory approval

Question 7

Company ABC Ltd. and Company 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)?

Response

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.

Acquisition date- Acquirer consulted on major decisions

Question 8

X Ltd. makes an offer (subject to the satisfactory completion of due diligence) to buy all of the shares in Y Ltd. which is wholly owned by Z Ltd. Pending transfer of shares to X, the parties agree that X Ltd. should be consulted on any major business decisions. Whether offer date can be considered to be the date of acquisition?

Response

As per paragraph 8 of Ind AS 103, the 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.

Hence, in the given case, X Ltd. cannot be considered to have the power to direct the relevant activities of Y Ltd. only due to the fact that it will be **consulted** on major decisions. X Ltd. does not have the power to impose its decisions on Y Ltd. Accordingly, based on the above, the offer date cannot be considered to be the date of acquisition.

Contingent consideration - Contingent Consideration payable by acquirer- Recognition as a part of Equity and Liability

Question 9

How should contingent consideration payable in relation to a business combination be accounted for on initial recognition and at the subsequent measurement in the following cases:

a) On 1 April 2016, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:

- an immediate issuance of 10 lakhs shares of A Ltd. having face value of INR 10 per share;
- 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 INR 1 crore.

The fair value of the shares of A Ltd. on the date of acquisition is INR 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is INR 25 lakhs.

During the year ended 31 March 2017, the profit before interest and tax of B Ltd. exceeded INR 1 crore. As on 31 March 2017, the fair value of shares of A Ltd. is INR 25 per share.

b) Continuing with the fact pattern in (a) above except for:

- The number of shares to be issued after one year is not fixed.
- Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to INR 40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds INR 1 crore.

Response

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 recognise 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 ASs, 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.

a) In the given case, the amount of purchase consideration to be recognised on initial recognition shall as follows:-

Fair value shares issued (10,00,000 X INR 20)	INR 2,00,00,000
Fair value of contingent consideration	INR 25,00,000
Total purchase consideration	INR 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:

- 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 unfavourable conditions (for the issuer of the instrument).
- If the instrument will or may be settled in the issuer's own equity instruments, then it is:
    - a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or

- **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 fulfillment 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.

In the given case, the obligation to pay contingent consideration amounting to INR 25,00,000 is recognised as a part of equity and therefore not re-measured subsequently or on issuance of shares.

b) In the given case, the amount of purchase consideration to be recognised on initial recognition is as follows-:

Fair value shares issued (10,00,000 X INR 20)	INR 2,00,00,000
Fair value of contingent consideration	INR 25,00,000
Total purchase consideration	INR 2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

In the given case, 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 recognised in profit or loss.

As at 31 March 2017 (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of INR 15,00,000 (INR 40,00,000 - INR 25,00,000) should be recognised in the profit or loss for the period. A Ltd. would recognise issuance of 160,000 (INR 40,00,000/ 25) shares at a premium of INR 15 per share.

Subsequent Measurement and Accounting - Contingent Consideration

Question 10

ABC Ltd. acquires PQR Ltd. in September 2016 for cash. Additionally, ABC Ltd. agrees to pay the selling shareholder an amount equivalent to 10% of profits in excess of INR 10 crores generated over the next two years in cash in lumpsum at the end of the three years. ABC Ltd. determines the fair value of the contingent consideration liability to be INR 1 crores at the date of acquisition.

A year after the acquisition, PQR Ltd. has performed better than initially projected by ABC Ltd. and a higher payment is now expected to be made at the end of year two. The fair value of this financial liability is INR 2.5 crores at the end of the first year.

Whether there should be any adjustment in the acquisition accounting? If yes, by what amount?

Response

Paragraph 58 of Ind AS 103, *inter alia*, provides that 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 remeasured 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.

In accordance with the above, where contingent consideration is not classified as equity, the changes in its fair value that are not measurement period adjustment should be remeasured to fair value at each reporting date until the contingency is settled. Such changes in fair value are required to recognised in profit or loss (in accordance with Ind AS 109 where such contingent consideration is within the scope of the standard).

Thus, ABC Ltd. should re-measure contingent consideration at the end of the year i.e. 31 March 2017 as follows:

Profit and loss A/c	Dr	1,50,00,000	
Liability for contingent consideration	Cr		1,50,00,000

Similarly, the adjustment to the financial liability to reflect the final settlement amount (final fair value) is required to be recognised in profit or loss if the amount differs from the fair value estimate at the end of the first year.

Contingent consideration- Contingent consideration- Escrow arrangements

Question 11

Entity ABC Ltd. acquired entity PQR Ltd. for INR 5 crores. To protect ABC for false representations and warranties (if any) asserted by the sellers of entity PQR Ltd. the acquisition agreement provides that ABC Ltd. will pay INR 4.5 crores at the acquisition date and place the balance INR 50 Lakhs in an escrow account (being a protective clause). If no violation of the representations and warranties is reported or noticed within one year of the acquisition date, the amount of INR 50 Lakhs in the escrow account will be released to the sellers. Should INR 50 Lakhs lying in escrow be accounted for as contingent consideration by entity ABC Ltd.?

Response

Ind AS 103 defines contingent consideration as follows:

Usually, 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. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.

In the present case, the funds lying in escrow are released to the sellers based on the validity of conditions that existed at the acquisition date and are not dependent on the future performance of entity PQR Ltd. Further, as the escrow arrangement is only protective in nature. Therefore, INR 50 Lakhs will not be considered as a contingent consideration. It is instead required to be treated as part of the consideration for the business combination on the date of acquisition and consequently should be considered for computation of goodwill in relation to the acquisition.

Subsequently, based on paragraph 45 of Ind AS 103, adjustments, if any, to the amount in escrow would be accounted, for as a measurement period adjustment that impacts goodwill given that they result from new information that is obtained after the acquisition date about facts and circumstances that existed as of the acquisition date.

Contingent consideration - Contingent consideration-Working capital adjustments

Question 12

ABC Ltd. agrees to acquire PQR Ltd. for INR 60 crores as per an agreement dated 15 March 2017. The acquisition is however subject to the successful completion of the closing conditions. As per the agreement between ABC Ltd. and PQR Ltd., to the extent the working capital (that is, inventory, receivables and payables) at the acquisition date (on successful completion of closing conditions) exceeds a specified minimum level of 10 crores, ABC Ltd. will pay additional consideration to the seller. For instance, if PQR's working capital is INR 11 crores, ABC will pay an additional INR 1 crores. Should ABC Ltd. account for the working capital adjustment as contingent consideration?

Response

Paragraph 45 of Ind AS 103, *inter alia*, provides that if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer should 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.

The working capital adjustment mentioned above in relation to ABC Ltd.'s acquisition of PQR Ltd. is a mechanism to determine the working capital as of the acquisition date. While the working capital computation may be completed post the acquisition date, the computation does not consider the impact of any future event, conditions, contingencies etc.

Accordingly, given that the working capital adjustment reflects the consideration to be paid as of the acquisition date, the same may not be treated as contingent consideration.

Contingent consideration- Contingent consideration arrangement forfeited on the termination of employment

Question 13

ABC Ltd. (the acquiree) is owned by Mr. S who is also the chief executive officer of the company. ABC Ltd. is purchased by PQR Ltd. (the acquirer) in a business combination. As per the purchase agreement, PQR Ltd. will pay Mr. S an additional consideration for the acquisition based upon ABC Ltd. achieving specific earnings before interest, tax, depreciation and amortisation (EBITDA) levels over the two-year period following the acquisition. The additional payment is based on PQR Ltd's belief that retaining the services of Mr. S for at least two years is critical to transition of ABC Ltd's ongoing business. Accordingly, any rights to the additional consideration will be forfeited, if Mr. S is not an employee of ABC Ltd. at the end of the two years. Should the arrangement be treated as remuneration for the post-combination services or does it represent contingent consideration for the acquisition of ABC Ltd.?

Response

An acquirer may enter into an arrangement for payments to employees or selling shareholders of the acquiree that are contingent on a post-acquisition event. The accounting for such arrangements depends on whether the payments represent contingent consideration issued in the business combination (which are included in the acquisition accounting), or are separate transactions (which are accounted for in accordance with other relevant Ind AS).

Paragraph B55 of Ind AS 103 provides indicators to be evaluated when determining 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. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration. However, judgement will be required for such evaluation.

Further, paragraph B55 (a) of Appendix B to Ind AS 103, inter alia, provides an indication that a contingent consideration arrangement in which payments are automatically forfeited if employment terminates is remuneration for post-combination services.

Therefore, in the given case, the arrangement should be treated as remuneration for the post-combination services as the right to the additional consideration will be forfeited if Mr. S quits before the stipulated period of time.

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

Question 14

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 INR 60,00,000 plus an additional payment of INR 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 INR 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?

Response

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 INR 1,50,00,000 to INR 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 for two years following the acquisition - i.e., only INR 60,00,000 is attributed to consideration in exchange for the acquired business.

Consideration transferred- Deferred consideration

Question 15

ABC Ltd. acquired the entire equity share capital of PQR Ltd. for INR 8 crores. ABC Ltd. paid INR 2 crores in cash and the balance INR 6 crores has been agreed to be paid to the seller in 5 years as a deferred consideration. How should the deferred consideration be valued for determining the consideration transferred in relation to computation of goodwill?

Response

Paragraph 37 of Ind AS 103 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.

Based on above, the deferred consideration issued is required to be measured at its fair value. The deferred consideration will be valued at its net present value determined with reference to an appropriate discount rate (e.g. the rate at which entity ABC Ltd. could issue the same amount of debt in a separate market transaction with the appropriate adjustment for credit rating) for the purpose of computation of the consideration transferred.

Subsequent unwinding of the discounting discussed above is required to be recognised as finance cost in the respective years' statement of profit and loss.

Contingent consideration- Interaction with Ind AS 101

Question 16

ABC Ltd. has availed the exemption of not restating past business combination as available in Ind AS 101 *First-time Adoption of Indian Accounting Standards*. ABC Ltd. in one of its acquisitions (merger of an unrelated entity) prior to the date of transition has agreed to pay an additional amount on fulfilment of identified contingencies 5 years from the date of acquisition. The date for determination of the contingencies is subsequent to the date of transition. ABC Ltd. under previous GAAP, did not recognise the contingent consideration given that the payment of the same was not considered to be probable on both the date of acquisition. Whether ABC Ltd. is required to record contingent consideration at the date of transition? If yes, whether fair value of contingent consideration will be recorded as an adjustment to retained earnings?

Response

Once a first-time adopter has determined which business combinations under previous GAAP will not be restated on the adoption of Ind AS, the following steps are relevant:

- maintain previous GAAP classification;
- **determine whether any additional assets or liabilities are to be recognised;**
- determine whether any assets or liabilities recognised in accordance with previous GAAP but that do not qualify for recognition under Ind AS are to be derecognised;
- **remeasure the assets and liabilities after the business combination, if appropriate;**
- adjust the measurement of goodwill, if appropriate; and
- eliminate any balance of negative goodwill.

Paragraph C4(b) of Ind AS 101, *inter alia*, provides that the first-time adopter shall recognise all its assets and liabilities at the date of transition to Ind ASs that were acquired or assumed in a past business combination, other than:

(i) some financial assets and financial liabilities derecognised in accordance with previous GAAP ; and

(ii) assets, including goodwill, and liabilities that were not recognised in the acquirer's consolidated Balance Sheet in accordance with previous GAAP and also would not qualify for recognition in accordance with Ind ASs in the separate Balance Sheet of the acquiree.

The first-time adopter shall recognise any resulting change by adjusting retained earnings (or, if appropriate, another category of equity), unless the change results from the recognition of an intangible asset that was previously subsumed within goodwill.

In accordance with the above, even if the accounting for a business combination is carried forward from previous GAAP, the general requirements of Ind AS 101 in respect of the recognition of assets and liabilities still apply.

Further paragraph C4 (f) of Ind AS 101 provides that, if an asset acquired, or liability assumed, in a past business combination was not recognised in accordance with previous GAAP, it does not have a deemed cost of zero in the opening Ind AS Balance Sheet. Instead, the acquirer shall recognise and measure it in its consolidated Balance Sheet on the basis that Ind ASs would require in the Balance Sheet of the acquiree.

Ind AS 101 provides that the first-time adopter shall recognise any resulting adjustment in opening retained earnings unless otherwise indicated.

In accordance with the above, contingent consideration that was not recognised in an un-restated business combination and is determined to be liability-classified at the date of transition in accordance with Ind AS should be recognised in the opening Ind AS balance sheet with a corresponding adjustment to retained earnings. The measurement of the liability-classified contingent consideration at the date of transition, and subsequently, should be based on the fair value of such contingent consideration as of the respective date on which the contingent consideration is being measured (with the changes in the fair value being recognised in the profit and loss account).

Acquirer share-based payment awards exchanged for acquiree awards- Mandatory replacement of acquiree awards

Question 17

On 1 April 2014, Company ABC Ltd. granted equity-settled share-based payment awards with a grant-date fair value of INR 1,00,000 to its employees which is subject to a three-year service condition.

Company XYZ Ltd. acquires entire shares of ABC Ltd. on 1 April 2016 and as part of the acquisition agreement, it is required to issue equity-settled replacement awards to ABC's employees. At the date of acquisition, the market-based measure of the original awards is 1,80,000; the market-based measure of the replacement awards is 2,00,000. The replacement awards have a one-year vesting condition.

Determine the amount attributable to the pre-combination service and post-combination service in a situation where all employees are expected to meet the service condition?

Response

Paragraph B56 to B62B of Ind AS 103 provides application guidance on acquirer's share-based payment awards exchanged for awards held by the acquiree's employees.

In accordance with above, in its consolidated financial statements, XYZ Ltd. will record the following entries.

Consideration payable	1,20,000	
To Employee Stock Option Plan Outstanding Account		1,20,000

(To recognise replacement awards attributable to pre-combination service as part of consideration transferred)

Employee Remuneration Cost	80,000	
To Employee Stock Option Plan Outstanding Account		80,000

(To recognise replacement awards attributable to post-combination service in accordance with Ind AS 102, *Share-based Payment*)

(80,000 x (1 year / 1 year))

Note 1: Amount attributable to pre-combination service

1,80,000[(1)] x 67% (2 years / 3 years) [(2)] = 1,20,000

Note 2: Amount attributable to post-combination service

2,00,000 [(3)] – 1,20,000 [(4)] = 80,000

1. Market based measure of acquiree awards at the date of acquisition.

2. Ratio of service rendered as at 1 April 2016 compared with the greater of the original vesting period (3 years) and the sum of the pre-combination period for which service has been provided (2 years) plus the post combination vesting period (1 year), both periods are three years.

3. Market based measure of replacement awards at the date of acquisition.

4. Amount attributable to pre-combination service.

Acquisition related cost

Question 18

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?

Response

As per Ind AS 103, the acquisition-related costs incurred by an acquirer to effect 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 effect 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 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 effect 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.

Question 19

ABC Ltd. acquires PQR Ltd. on 30 June 2017. 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?

Response

As per Ind AS 103, the acquisition-related costs incurred by an acquirer to effect 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 effect 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.*

Similar to discussion in question 18 above, the payment to the regulator represents a transaction cost and hence will be regarded as acquisition-related cost incurred to effect the business combination. Applying the requirements of paragraph 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 have been capitalised as part of the intangible asset as per the requirements of Ind AS 38, *Intangible Assets*.

Assets and liabilities acquired in a business combination – Contingent liability

Question 20

ABC Ltd. is in the process of acquiring PQR Ltd., an entity engaged in the business of software related products and services. PQR Ltd. has been sued for one of the software licenses it uses in its business. The entity's lawyer has advised that, in his opinion, it is probable that the case could be successfully defended. Accordingly, no provision has been included in the PQR Ltd.'s financial statements immediately prior to the acquisition. However, post-acquisition, ABC Ltd.'s management has decided that the case should be settled out of court in order to avoid a protracted court case.

Should the acquirer recognise the contingent liability?

Response

Paragraph 23 of Ind AS 103 states that 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. Paragraph 56 provides guidance on the subsequent accounting for contingent liabilities.

In accordance with the above, in the given case, although the case is probable to be successfully defended, the contingent liability will have a fair value on the assumption that there is some risk that the case may not be successfully defended. To the extent that the fair value can be reliably measured, the contingent liability would be recognised as part of the business combination accounting. The financial effect of the acquirer's decision not to defend the case would be reflected as a current –that is, post combination event.

Subsequent Measurement and Accounting - Subsequent Accounting - Indemnification Asset

Question 21

ABC Ltd. is fully indemnified for any obligation arising from a contingent liability assumed in the acquisition of PQR Ltd. The fair value of the contingent liability recognised at the date of acquisition was INR 2 crores. Since, there were no concerns about the collectability of the indemnification asset ABC Ltd. also recognised an indemnification asset of INR 2 crores at the date of acquisition.

Post the acquisition, ABC Ltd. obtains new information about events subsequent to the date of acquisition and, based on this new information, concludes that the contingent liability would now be measured at an amount of INR 1.5 crores under Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*; however it does not impact the measurement of the contingent liability at the date of acquisition. ABC Ltd. still has no concerns about the collectability of the indemnification asset. At what amount should indemnification asset be recognised?

Response

Paragraphs 56 and 57 of Ind AS 103 deal with subsequent measurement of contingent liabilities and indemnification assets.

Paragraph 56 of Ind AS 103 specifies that the acquirer should measure a contingent liability recognised in a business combination at the higher of the amount that would be recognised in accordance with Ind AS 37 and 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*.

Further paragraph 57 states that, 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 assessment of the collectibility 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.

Since, on acquisition date, the fair value of the contingent liability of INR 2 crores is higher than the amount of INR 1.5 crores which is measured in accordance with Ind AS 37, the carrying amount of the liability will continue to remain at INR 2 crores. Further, in accordance with paragraph 57 as stated above, as in the current case, there are no concerns over the collectability of the indemnification asset or contractual limitations on the amount of the indemnification, ABC Ltd. continues to recognise the indemnification asset at INR 2 crores.

Exceptions to recognition and measurement principles - Indemnification assets

Question 22

a) 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 INR 2 crores. XYZ Ltd. has indemnified ABC Ltd. for the losses, if any, due to the case for amount up to INR 1 crore. The fair value of the contingent liability for the court case is INR 70 lakhs.

How should ABC Ltd. account for the contingent liability and the indemnification asset?

b) ABC Ltd. acquires PQR Ltd. in July 2017. PQR Ltd. is in dispute with local tax authorities over its tax return for 2015. ABC Ltd. receives an indemnity from the selling shareholder(s) of PQR Ltd. to cover the outcome of the tax dispute. ABC Ltd. ascertains that an outflow in relation to the tax case is probable and estimates the amount expected to be paid as INR 25 lakhs i.e., the full amount being claimed by the tax authorities. The fair value of the liability is INR 17.4 lakhs.

Paragraph 24 of Ind AS 103 requires the acquirer to 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.* Thus, ABC Ltd. recognised a liability of INR 25 lakhs. If the tax authorities require this amount to be paid, the seller of PQR Ltd. will pay ABC Ltd. the full INR 25 lakhs. ABC Ltd. considers the credit worthiness of selling shareholders' of PQR Ltd. to be such that the indemnification asset is fully collectible. How should indemnification asset be accounted for?

c) ABC Ltd. pays INR 50 crores 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 INR 10 crores. The class actions have not specified amounts of damages and past experience suggests that claims may be up to INR 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?

Response

Paragraph 27 of Ind AS 103 states that 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. Therefore, if the indemnification relates to an asset or a liability that is recognised at the acquisition date and measured at its acquisition-date fair value, the acquirer shall recognise the indemnification asset at the acquisition date measured at its acquisition-date fair value. For an indemnification asset measured at fair value, the effects of uncertainty about future cash flows because of collectibility considerations are included in the fair value measure and a separate valuation allowance is not necessary.

In accordance with the above, an acquirer recognises indemnification asset at the same time and measures them on the same basis as the indemnified item, subject to contractual limitations and adjustments for collectability, if applicable.

a) In the current scenario, ABC Ltd. measures the identifiable liability of entity PQR Ltd. at INR 70 lakhs and also recognises a corresponding asset of INR 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 INR 1 crore (for example INR 1.2 crores), the asset will be limited to INR 1 crore.

b) ABC Ltd. recognises an indemnification asset of INR 25 lakhs which is measured on the same basis as the indemnified liability as no adjustment has been required for collectability or contractual limitations on the indemnified amount.

c) 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.

Further, ABC Ltd. is required to make the necessary disclosures for contingent consideration arrangements and indemnification assets as required by paragraph B64 (g) of Ind AS 103.

Measurement after acquisition accounting - Adjustments to provisional amounts

Question 23

ABC Ltd. acquires XYZ Ltd. in a business combination on 15 January 2017. 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 INR 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 2017 (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 INR 2 crores.

ABC Ltd. continues to receive and evaluate information related to the claim after October 2017. Its evaluation doesn't change till February 2018 (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 INR 1.9 crores. ABC 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 2018 is INR 2.2 crores.

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

Response

Paragraphs 45 and 46 of Ind AS 103 state as follows:

"45 If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. 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 and, if known, would have resulted in the recognition of those assets and liabilities as of that 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.**

46 The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. 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:

(a) the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;

(b) the consideration transferred for the acquiree (or the other amount used in measuring goodwill);

(c) in a business combination achieved in stages, the equity interest in the acquiree previously held by the acquirer; and

(d) the resulting goodwill or gain on a bargain purchase."

Accordingly, the effects of information that first becomes available during the measurement period and that provides evidence of conditions or circumstances that existed at the date of acquisition are reflected in the accounting at the date of acquisition. All other changes to amounts included in the acquisition accounting that occur after the date of acquisition, including those occurring within the measurement period, do not generally affect the acquisition accounting.

Based on the above guidance:

- The consolidated financial statements of ABC Ltd. for the year ended 31 March 2017 should include INR 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 INR 1crore (INR 2,00,00,000 – INR 1,00,00,000) 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 March 2018, ABC will disclose the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, it will disclose that the comparative information for the year ending on 31 March 2017 is adjusted retrospectively to increase the fair value of the item of liability at the acquisition date by INR 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 2018 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 INR 20 lakhs (INR 2.2 crores– INR 2 crores) is recognised in profit or loss.

Measurement after acquisition accounting - Provisional accounting-Adjustment of comparatives

Question 24

ABC Ltd. acquired XYZ Ltd. on 28 February 2017. As part of the acquisition accounting, ABC Ltd. recognised a provisional amount of INR 1 crore in respect of a patent developed by XYZ Ltd. However, the technology covered by the patent was new and ABC Ltd. expected the cash flows to be generated by the patent to increase beyond those being generated at the time. Accordingly, ABC Ltd. sought an independent valuation report from a third party consultant, which was not expected to be finalised for several months. ABC Ltd. assessed the useful life of the patent to be 10 years. Goodwill of INR 1.2 crores was recognised in the provisional accounting.

The consolidated financial statements of ABC Ltd. as at 31 March 2017 included appropriate disclosures about the provisional accounting. The valuation report is finalised subsequent to the issuance of the financial statements of the year 2016-17 but before the end of the measurement period. Based on the valuation, ABC Ltd. concludes that the fair value of the patent was INR 1.5 crores. Management does not revise the estimated useful life of the patent, which remains at 10 years.

Whether ABC Ltd. is required to restate the comparative information for the year 2016-17 presented in the financial statements of the year 2017-18?

Response

Paragraph 45 of Ind AS 103 provides that if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer should report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer should **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.

In accordance with above, the acquirer should revise comparative information for prior periods presented in financial statements as required, including making any change in depreciation, amortisation or other income effects recognised in completing the initial accounting.

Based on above, the comparative information presented in the financial statements for the year 2017-18 needs to be restated for the measurement period adjustment as follows:

	31 March 2017	
	As stated originally	**Revised**
Profit or loss (patent amortisation)	83,333 *(1)*	125,000 *(2)*
Goodwill	1,20,00,000	70,00,000 *(3)*
Patent	99,16,667 *(4)*	1,48,75,000 *(5)*

Notes: 1. 1,00,00,000 x 1 /10 x 1 / 12

2. 1,50,00,000 *x 1 / 10 x 1 / 12*

3. 1,20,00,000 – 50,00,000

4. 1,00,00,000 – 83,333

5. 1,50,00,000 – 125,000

Measurement of NCI

Question 25

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

How will the non-controlling interest be measured?

Response

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:

(INR in crores)

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

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

Option 2 –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:

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

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

Assets and liabilities assumed

Question 26

Do the following acquired items qualify as assets which can be recognised in a business combination:

a) Assembled workforce

b) Contingent assets

c) Potential contracts with new customers

d) Future contract renewals

Response

Paragraphs B37, B38 and B40 of Ind AS 103 state as follows:

"B37 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.

B38 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 events occurring shortly after the acquisition to determine whether a separately recognisable intangible asset existed at the acquisition date.

B40 The identifiability criteria determine whether an intangible asset is recognised separately from goodwill. However, the criteria neither provide 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. (However, see paragraph 29, which establishes an exception to the fair value measurement principle for reacquired rights recognised in a business combination.) Paragraphs 36 and 37 of Ind AS 38 provide guidance for determining whether intangible assets should be combined into a single unit of account with other intangible or tangible assets."

In accordance with above, the following may be noted-

- **Assembled workforce** is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the date of acquisition. Although individual employees might have employment contracts with the employer, the collection of employees, as a whole, does not have such a contract. In addition, an assembled workforce is not separable; it cannot be sold, transferred, licensed, rented or otherwise exchanged without causing disruption to the acquirer's business. Therefore, it is not an identifiable intangible asset to be recognised separately from goodwill. Nor does the assembled workforce represent the intellectual capital of the skilled workforce, which is the (often specialised) knowledge and experience that employees of an acquiree bring to their jobs.

- **Contingent assets**: If the acquiree has a contingent asset, it should not be recognised unless it meets the definition of an asset.
- **Potential contracts with new customers**: The acquirer does not recognise them separately from goodwill because those potential contracts are not themselves assets at the acquisition date. Nor should the acquirer subsequently reclassify the value of those contracts from goodwill for events that occur after the acquisition date.
- **Future contract renewals**: Future contract renewals by themselves may not meet the identifiability criteria as prescribed under paragraph B40 of Ind AS 103. However, any value attributable to the expected future renewal of the contract is reflected in the value of, for example, the customer relationship, rather than being subsumed within goodwill.

  In measuring the fair value of an intangible asset, the acquirer would take into account assumptions that market participants would use when pricing the intangible asset, such as expectations of future contract renewals (except in the case of reacquired rights).

Identification of intangible assets acquired - Research and Development

Question 27

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.?

Response

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

Paragraph 21 of Ind AS 38, *Intangible Assets* 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 38 and are recognised. The approval means it is probable that future economic benefits will flow to entity ABC. 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.

Application of measurement requirements - Asset valuation allowances

Question 28

Whether the acquirer can recognise a separate provision or impairment allowance on a financial asset measured at fair value while accounting for the business combination at the date of acquisition?

Response

Paragraph B41 of Ind AS 103 states that the acquirer shall not recognise a separate valuation allowance as of the acquisition date for assets acquired in a business combination that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because this Ind AS requires the acquirer to measure acquired receivables, including loans, at their acquisition-date fair values in accounting for a business combination, the acquirer does not recognise a separate valuation allowance for the contractual cash flows that are deemed to be uncollectible at that date or a loss allowance for expected credit losses.

Hence, the above paragraph prohibits recognition at the date of acquisition of a separate valuation allowance on assets acquired in a business combination that are measured at fair value because the effects of the uncertainty about future cash flows are included in the fair value measure. For example, because trade receivables acquired in a business combination are recognised at fair value at the date of acquisition, they cannot be recognised in the balance sheet at their gross amounts (contractual amount of the receivable without taking into account credit risk) less a separate impairment allowance on the date of acquisition (considered by the acquirer based on estimated uncollectible cash flows).

However, as per paragraph B64 (h) of Ind AS 103, the acquirer is required to disclose separately the fair value of the receivables acquired, as well as their gross contractual amounts and the best estimate of the amounts of the contractual cash flows that the acquirer does not expect to collect.

Question 29

a) ABC Ltd. acquires PQR Ltd. in a business combination. PQR Ltd's assets include a manufacturing plant which ABC Ltd. plans to phase out over the next three to five years. PQR Ltd. carries the manufacturing plant at historical cost less accumulated depreciation. ABC Ltd. also plans to align the customer warranties of PQR Ltd. with its own more favorable terms.

   ABC Ltd. proposes to record the plant at a nominal amount in the business combination and to recognise a warranty provision based on its intended settlement terms. Is the management contention tenable?

b) ABC Ltd. has acquired PQR Ltd., a competitor, in a business combination to increase its market share by taking its competitor's brand out of the market. The management has, therefore, proposed to measure the brand at a minimal value as it will be removed from the market shortly after the acquisition. Is the management's proposal appropriate?

Response

a) Paragraph B43 of Ind AS 103 provides that to protect its competitive position, or for other reasons, the acquirer may intend not to use an acquired non-financial asset actively, or it may not intend to use the asset according to its highest and best use. For example, that might be the case for an acquired research and development intangible asset that the acquirer plans to use defensively by preventing others from using it. Nevertheless, the acquirer should measure the fair value of the non-financial asset assuming its highest and best use by market participants in accordance with the appropriate valuation premise, both initially and when measuring fair value less costs of disposal for subsequent impairment testing.

   Thus, the fair value attributed to assets and liabilities is not affected by the acquirer's specific intention rather it is based on market participant assumptions. So, if the acquirer intends to put that asset to a use that would realise less value than the fair value or intends not to use the asset at all, this does not affect its fair value at the time of the business combination. The acquirer's intention or subsequent use of the asset will, however, affect its useful life (for amortisation) and its value in use (for impairment purpose) after the acquisition date.

Therefore, in the present case, the plant should be recorded initially at fair value. However, the decision of ABC Ltd. to phase out the facility is a trigger for impairment testing after the acquisition date as well as for reassessing useful economic life.

The acquirer's intention/plan to provide more generous warranty settlements is not recognised in the business combination. The warranty provision is valued based on contractual terms at the acquisition date. The warranty provision is increased only when an obligation exists, with a corresponding charge to the profit and loss account.

b) The proposed approach is not appropriate in these circumstances. As mentioned in (a) above, as per paragraph B43 of Ind AS 103, the fair value attributed to assets and liabilities is not affected by the acquirer's intention rather it is based on market participant assumptions. This means that the acquirer's entity-specific intentions are not relevant when measuring an asset's fair value. If the acquirer intends to put that asset to a use that would realise less value than the fair value or intends not to use the asset at all, this does not affect its fair value at the time of the business combination.

The value of the brand name is based on assumptions that would be made by market participants in determining the price at which they would transact. Buying a brand to 'take it out of the market' has a cost associated with it. It is not appropriate to assign a low fair value to the brand in the purchase price allocation.

An entity's intentions and subsequent use of the asset will affect its useful life after the acquisition date. Direct benefits will be received as long as the asset is directly used. However, an entity may continue to receive indirect benefits from an asset (after taking the asset out of service) if it prevents the asset from being used by others. The useful life should reflect the acquiring entity's consumption of the asset's expected benefits. This life is the time period over which the asset is expected to contribute directly or indirectly to the acquiring entity's future cash flows. It will neither be appropriate for such assets to be expensed immediately at the date of acquisition, nor can such assets be expected to have an indefinite useful life.

These intangible assets will need to be reviewed and tested for impairment when appropriate in the post combination period as per the provisions of Ind AS 36, *Impairment of Assets*.

Measurement of an asset acquisition

Question 30

An entity acquires an equipment and a patent in exchange for INR 1,000 crores cash and land. The fair value of the land is INR 400 crores and its carrying value is INR 100 crores. The fair values of the equipment and patent are estimated to be INR 500 crores and INR 1,000 crores, 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. How should the transaction be accounted for?

Response

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.

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 INR 1,400 crores (the total fair value of the consideration transferred).

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

The equipment is recorded at its relative fair value ((INR 500 / INR 1,500) × INR1,400 = INR 467 crores).

The patent is recorded at its relative fair value ((INR 1,000 / INR 1,500) × INR1,400 = INR 933 Crores).

Business combination achieved in stages

Question 31

On 1 April 2016, Company PQR Ltd. acquired 30% of the voting ordinary shares of Company XYZ Ltd. for INR 8,000 crores. PQR Ltd. accounts its investment in XYZ Ltd. using equity method as prescribed under Ind AS 28, *Investments in Associates and Joint Ventures*. At 31 March 2017, PQR Ltd. recognised its share of the net asset changes of XYZ Ltd. using equity accounting as follows:

	(Amounts in INR-crores)
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 31 March 2017 was therefore 8,850 (8,000 + 700 + 100 + 50).

On 1 April 2017, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash of INR 25,000 crores. The following additional information is relevant at that date

	(Amount in INR-crores)
Fair value of the 30% interest already owned	9,000
Fair value of XYZ's identifiable net assets	30,000

How should such business combination be accounted for?

Response

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 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.

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

(Amounts in INR-crores)

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

(*To recognise acquisition of XYZ Ltd.)*

Notes:

1. Goodwill calculated as follows:

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

2. The credit to retained earnings represents the reversal of the unrealised gain of INR 50 crores 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:

	INR
Fair Value of 30% interest in XYZ Ltd. at 1 April 2017	9,000
Carrying amount of interest in XYZ Ltd. at 1 April 2017	(8,850)
	150
Unrealised gain previously recognised in OCI	100
Gain on previously held interest in XYZ Ltd. recognised in profit or loss	250

Pre-existing relationships - Reacquired rights

Question 32

Entity ABC acquires entity PQR for a consideration of INR 1 crore. Four years ago, Entity ABC had granted a ten-year license allowing entity PQR to operate in Europe. The cost of the license was INR 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 INR 1,80,000 ((INR 2,50,000 X 6/10) + 20%).

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

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

Response

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 INR 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:

- INR 3,00,000, which is the amount by which the right is unfavorable to entity ABC compared to market terms. This is the difference between the amount that entity ABC could receive for granting a similar right, INR 4,50,000, compared to the carrying value (or the unamortised value) that it was granted for, INR 1,50,000 (2,50,000 X 6/10).
- INR 1,80,000, which is the amount that entity ABC would have to pay to terminate the right at the date of acquisition.

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

Reverse Acquisition

Question 33

The Balance sheet of Entity A and Entity B immediately before the business combination on 30 September 2017 are as below:

	Entity A (Legal acquirer /Accounting acquiree) (in crores)	Entity B (Legal acquiree/ Accounting acquire) (in crores)
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		60
Total shareholders' equity	1,100	2,000
Total liabilities and shareholders' equity	1,800	3,700

On 30th September 2017, A Ltd. issues 2.5 ordinary shares for each ordinary share of Entity B. All shareholders of Entity B 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 30 September 2017 is INR 40. The quoted market price of ordinary shares of Entity A at that date is INR 16.

The fair values of the identifiable assets and liabilities of Entity A at 30 September 2017 are the same as their carrying amounts, except that the fair value of its non-current assets at 30 September 2017 is INR 1,500 crores.

How should the above acquisition be accounted?

Response

Paragraphs B19 and B20 of Ind AS 103 state as follows:

"B19 A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes on the basis of the guidance in paragraphs B13–B18. 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 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 this Ind AS, including the requirement to recognise goodwill, apply.

B20 In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer. Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition. The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquiree."

In accordance with the above, a reverse acquisition is a business combination in which the legal acquirer (i.e., the entity that issues the securities) becomes the acquiree for accounting purposes and the legal acquiree becomes the acquirer for accounting purposes. It is the application of the guidance in Ind AS 103 on identifying the acquirer that results in the identification of the legal acquiree as the accounting acquirer in a reverse acquisition.

The guidance on accounting for a reverse acquisition applies only to the consolidated financial statements of the combined entities. In its separate financial statements the legal acquirer accounts for its investment in the legal acquiree.

Accordingly, in the instant case, as a result of Entity A (legal acquirer, accounting acquiree) issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e. 150 of 250 issued shares). The remaining 40 per cent are owned by the shareholders of Entity A. 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 INR 1,600 crores (40 shares with a fair value per share of INR 40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. In this example, the quoted price of Entity A's shares in the principal (or most advantageous) market for the shares provides a more reliable basis for measuring the consideration effectively transferred than the fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares, i.e., 100 shares with a fair value per share of INR 16.

The goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in A Ltd.) over the net amount of A Ltd.'s recognised identifiable assets and liabilities.

In the instant case, the fair value of the consideration effectively transferred is INR 1,600 crores and the net recognised values of Entity A's identifiable assets and liabilities are as below:

Current assets	500
Non-current assets	1,500
Current Liabilities	(300)
Non-current liabilities	(400)
Total	**1,300**

Therefore, the goodwill shall be measured at INR 300 crores (1,600-1300).

Based on paragraph B21-B22 of Ind AS 103, the consolidated balance sheet immediately after the business combination will be as below:

Particulars	**INR in crores**
Current assets (INR 700+ INR 500)	1,200
Non-current assets (INR 3,000+ INR 1,500)	4,500
Goodwill	300
Total assets	**6,000**
Current liabilities (INR 600+INR 300)	900
Non-current liabilities (INR 1,100+ INR 400)	1,500
Total liabilities	2,400
Shareholders' equity	
Retained earnings	1,400
Issued equity	
250 ordinary shares (INR 600+ INR 1,600)	2,200
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

The amount recognised as issued equity interests in the consolidated financial statements (INR 2,200 crores) is determined by adding the issued equity of the legal acquiree immediately before the business combination (INR 600 crores) and the fair value of the consideration effectively transferred (INR 1,600 crore). However, the equity structure appearing in the consolidated financial statements (ie the number and type of equity interests issued) must reflect the equity structure of the legal acquirer, including the equity interests issued by the legal acquirer to effect the combination.

Operating lease acquired- Acquiree is lessee

Question 34

On 1 April 2017, ABC Ltd. acquires PQR Ltd. in a business combination. PQR Ltd. entered into an operating lease for a building as the lessee during April 2015. The rent under the agreement is fixed for five years and is substantially lower than market rates at the date of acquisition. The contract has a fair value estimated at 50 crores, which includes consideration of renewal options. How should the lease acquired in a business combination be accounted for?

Response

Paragraphs B28-B29 of Ind AS 103 state as follows:

"B28 The acquirer shall recognise no assets or liabilities related to an operating lease in which the acquiree is the lessee except as required by paragraphs B29 and B30.

B29 The acquirer shall determine whether the terms of each operating lease in which the acquiree is the lessee are favourable or unfavourable. The acquirer shall recognise an intangible asset if the terms of an operating lease are favourable relative to market terms and a liability if the terms are unfavourable relative to market terms. Paragraph B42 provides guidance on measuring the acquisition-date fair value of assets subject to operating leases in which the acquiree is the lessor.

B31 The acquirer shall recognise, separately from goodwill, the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion."

In accordance with above, if the acquiree is the lessee in an operating lease, then the underlying asset that is the subject of the lease is not recognised by the acquiree or the acquirer. However, the acquirer recognises a separate intangible asset or liability in respect of operating leases of the acquiree that are acquired in a business combination; in respect of an asset, these lease agreements meet the contractual-legal criterion. The lease contract asset or liability is recognised at its fair value at the date of acquisition. Factors that affect the fair value include, for example, the lease not being priced at market rates at the date of acquisition, the existence of renewal options (however assuming that such renewable options do not result in the lease being classified as a finance lease) and the difficulty in securing such a lease. Leasehold improvements of the acquiree are recognised as tangible assets at their fair values at the date of acquisition.

Based on the above principles, ABC Ltd. will recognises an intangible asset of 50 crores separately from goodwill and does not recognise the underlying building.

Measurement principle- Investment in subsidiaries

Question 35

On 1 April 2017, the PQR Ltd. merges with ABC Ltd. The net assets of PQR Ltd. includes investment in two wholly owned subsidiaries- P Ltd. and Q Ltd. On merger, how will these investments be accounted for in the separate financial statements of ABC Ltd.?

Response

Paragraph 18 of Ind AS 103 states as follows:

"18 The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values."

Based on the above referred general principle, the identifiable assets acquired and liabilities assumed of the acquiree are measured at the acquisition date fair values, with certain limited exceptions. In the absence of any exception for valuation of investment in subsidiaries getting acquired as a part of identified assets, the general measurement principles as stated above will be applied, i.e. the acquired investment in subsidiaries will be measured at acquisition date fair value. Accordingly, fair value of the subsidiary will now be the new cost.

Gain on bargain purchases

Question 36

On 1st January 2017, A Ltd. acquires 80 per cent of the equity interests of B Ltd. in exchange for cash of INR 15 crores. 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 INR 20 crores and the fair value of the 20 per cent non-controlling interest in B Ltd. at INR 4.2 crores.

How should A Ltd. recognise the above bargain purchase?

Response

Paragraph 34 of Ind AS 103 provides that "in extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Ind AS exceeds the aggregate of the amounts specified, i.e.:

(i) the consideration transferred measured in accordance with this Ind AS, which generally requires acquisition-date fair value ;

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

If that excess remains after applying the requirements in paragraph 36, the acquirer should recognise the resulting gain in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve. The gain will be attributed to the acquirer.

Further, paragraph 35 of Ind AS 103 provides that a bargain purchase might happen, for example, in a business combination that is a forced sale in which the seller is acting under compulsion. However, the recognition or measurement exceptions for particular items discussed in paragraphs 22–31 may also result in recognising a gain (or change the amount of a recognised gain) on a bargain purchase."

In accordance with above, the bargain purchase may arise for a number of reasons; these include a forced liquidation or distressed sale or because of applying the measurement requirements of Ind AS 103, which require in certain instances measurement of the identifiable assets acquired and liabilities assumed at amounts other than fair value. A business combination does not, however, need to exhibit any particular characteristics such as evidence of a forced or distressed sale in order for a bargain purchase to be recognised. Such a gain is the result of applying the formula, regardless of other factors, such as the economic rationale for the transaction.

Further paragraphs 36 and 36A state as follows:

"36 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:

(a) the identifiable assets acquired and liabilities assumed;

(b) the non-controlling interest in the acquiree, if any;

(c) for a business combination achieved in stages, the acquirer's previously held equity interest in the acquiree; and

(d) 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.

36A If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, the acquirer shall apply the requirements of reassessment and review described in paragraph 36. The excess, if any, as determined in accordance with paragraph 32 after applying the said requirements of paragraph 36, shall be recognised directly in equity as capital reserve."

In the instant case, the amount of B Ltd.'s identifiable net assets i.e., INR 20 crores exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in B Ltd. i.e. INR 19.2 crores. 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 INR 80 lakhs, as the difference between the amount of the identifiable net assets which is INR 20 crores and the sum of purchase consideration and fair value of non-controlling interest, which is INR 19.2 crores (cash consideration of INR 15 crores and fair value of non-controlling interest of INR 4.2 crores).

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 INR 80 lakhs, which will be recognised in other comprehensive income on the acquisition date and accumulated the same in equity as capital reserve.

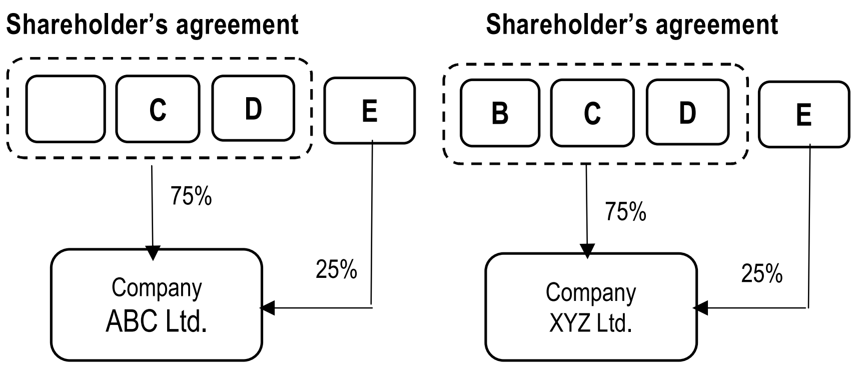
If the acquirer chose to measure the non-controlling interest in B Ltd. on the basis of its proportionate share of identifiable net assets of the acquiree, the recognised amount of the non-controlling interest would be INR 4 crores (INR 20 crores × 0.20). The gain on the bargain purchase then would be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

Common control business combination

Common control transactions- Shareholders' Agreement

Question 37

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.



Whether ABC Ltd. and XYZ Ltd. are under common control?

Response

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.

Further paragraphs 6 and 7 of Appendix C to Ind AS 103 state as follows:

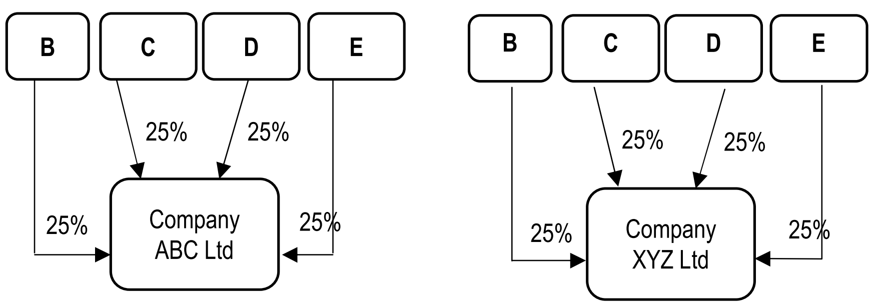
"6 An entity can be controlled by an individual, or by a **group of individuals acting together under a contractual arrangement**, and that individual or group of individuals may not be subject to the financial reporting requirements of Ind ASs. Therefore, it is not necessary for combining entities to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

7 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. Accordingly, in the current scenario, ABC Ltd. and XYZ Ltd. are considered to be under common control.

Question 38

In the following group structure, 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.



Whether ABC Ltd. and XYZ Ltd. are under common control?

Response

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 paragraphs 6 and 7 of Appendix C to Ind AS 103 state as follows:

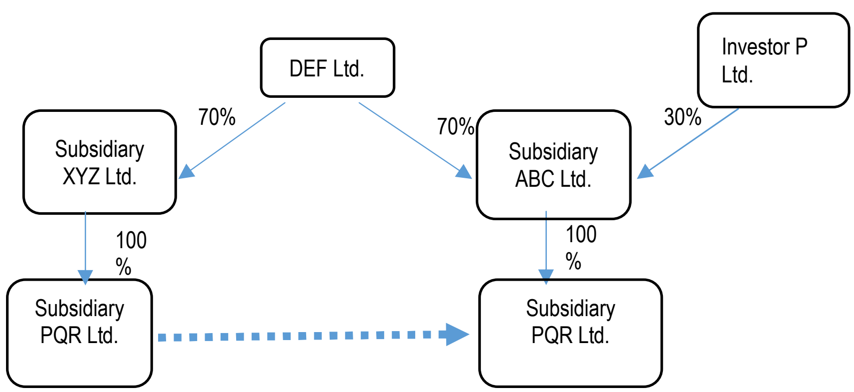
"6 An entity can be controlled by an individual, or by a **group of individuals acting together under a contractual arrangement**, and that individual or group of individuals may not be subject to the financial reporting requirements of Ind ASs. Therefore, it is not necessary for combining entities to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

7 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 which is the requirement of paragraph 6 and 7 above. Thus, ABC Ltd. and XYZ Ltd. are not considered to be under common control even if there is an established pattern of voting together.

Question 39

In the following group structure, ABC Ltd. acquires all of the shares in the subsidiary PQR Ltd. in a common control transaction. Investor P Ltd. which is unrelated to DEF Ltd. has a 30% interest in ABC Ltd. but no interest in PQR Ltd. before the acquisition (assuming P Ltd. is covered under Ind AS roadmap). Whether the transaction is a common control transaction from the perspective from Investor P Ltd. and how should the same be accounted for?



Response

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 paragraph 6 of Appendix C to Ind AS 103 states as follows:

"6 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 ASs. 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"

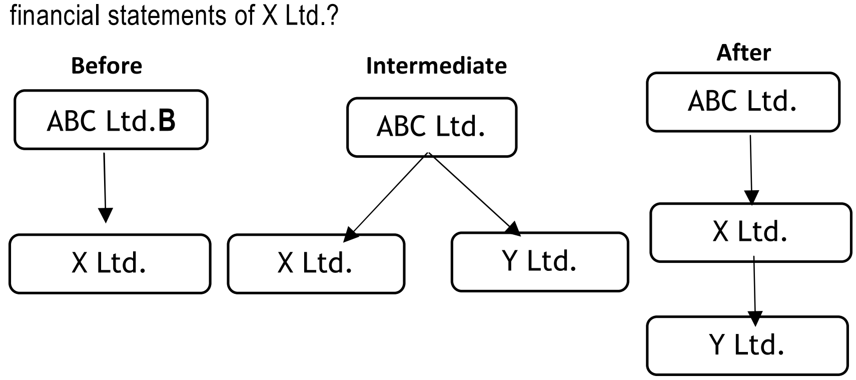
From the perspective of statutory consolidated financial statements of ABC Ltd. the transaction will be considered to be a common control transaction and in accordance with paragraph 9 (a) (i) of Appendix C of Ind AS 103, the carrying values of the assets and liabilities as appearing in the separate financial statements of PQR Ltd. shall be recognised.

Given that Investor P Ltd. does not control ABC Ltd. and PQR Ltd., the arrangement will not be treated as a common control transaction from Investor P Ltd.'s perspective. Accordingly, for the purposes of application of equity method of consolidation for the consolidated financial statements of Investor P Ltd. the acquisition of PQR Ltd. shall be accounted for as a business combination as per requirements of Ind AS 103 (and not as a common control transaction).

Common control transactions - Transitory Common Control - Intermediate Acquisition

Question 40

ABC Ltd. had a subsidiary, namely, X Ltd. which was acquired on 1 April 2000. ABC Ltd. acquires all of the shares of Y Ltd. on 1 April 2017. ABC Ltd. transfers the shares in Y Ltd. to X Ltd. on 2 April 2017. How should the above transfer of Y Ltd. into X Ltd. be accounted for in the consolidated financial statements of X Ltd.?



Response

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 paragraph 7 of Appendix C to Ind AS 103 states as follows:

"7 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 of P shortly before the transaction.

This question deals only with the reporting entity, i.e. X Ltd. and does not deal with the accounting treatment in the books of ABC Ltd.

Common control transactions- Restatement of the financial information in the financial statements

Question 41

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 2016. 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 1 October 2016. The year end of ABC Ltd. is 31 March. Both ABC Ltd. and DEF Ltd. are controlled by shareholder A. A made investment in ABC Ltd. in 2007, and made investment in DEF Ltd. on 1 October 2015.

Response

Paragraph 9 of Appendix C to Ind AS 103 states as follows:

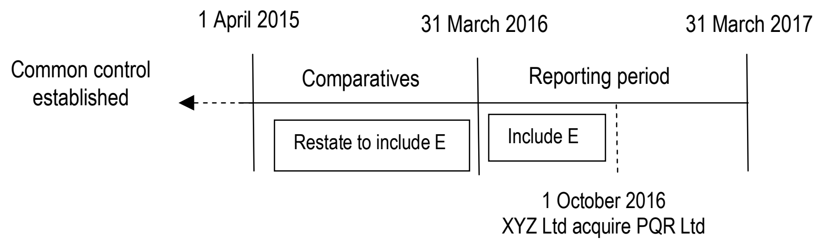
"9 The pooling of interest method is considered to involve the following:

(i)……..

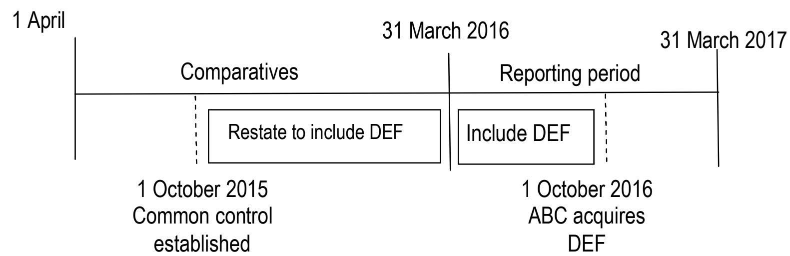
(ii)……..

(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 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 2015-16 as if the acquisition had occurred before 1 April 2015. Additionally, the results of current year of PQR Ltd. will be required to include XYZ's financial statements for the period from 1 April 2016 to 30 September 2016.



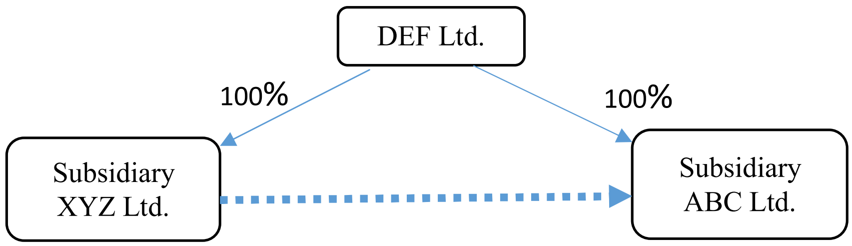
b) In accordance with paragraph 9(iii) above, ABC Ltd. will have to restate its comparatives for the financial year ended 2015-16 as if the acquisition had occurred on 1 October 2015, but not earlier. Additionally, the results of current year of DEF Ltd. will be required to include the financial statements of ABC Ltd. for the period from 1 April 2016 to 1 October 2016.



Question 42

In the following group structure DEF Ltd. has two wholly owned subsidiaries XYZ Ltd. and ABC Ltd. DEF Ltd. had acquired XYZ Ltd. and ABC Ltd. on 1 April 2000 and 1 April 2001 respectively. DEF Ltd., XYZ Ltd. and ABC Ltd. are covered under Phase II of MCA roadmap for companies and hence Ind AS is applicable to them from the financial year commencing on or after 1 April 2017.

Pursuant to a court scheme filed with the NCLT, XYZ Ltd. was merged into ABC Ltd. from an appointed date of 1 April 2017. The consideration paid for the above merger by ABC Ltd. was INR 150 crores. The net assets of XYZ Ltd. on 1 April 2016 was INR 160 crores, which further increased to INR 200 crores on 31 March 2017. How will the capital reserve be computed for the said transaction?



Response

Paragraph 9 of Appendix C to Ind AS 103 states as follows:

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

(i) ....

(ii) ....

(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 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."**

In accordance with paragraph 9 (iii) above, ABC Ltd. 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 i.e., 1 April 2016 (being the transition date). Accordingly, in the present case ABC Ltd. should restate its comparatives for the financial year 2016-17 as if the acquisition had occurred on 1 April 2016. The resultant credit of INR 10 crores (INR 160 crores – INR 150 crores) will be recognised in capital reserve.

Common control transactions - mergers/acquisitions

Question 43

A Ltd. acquired the shares of B Ltd. on April 1, 2010. A Ltd. chooses to retrospectively adopt the requirements of Ind AS 103. Below are the details of purchase price allocation:

Particulars	As per AS-14	As per Ind AS 103
	(figures in crores)	(figures in crores)
Purchase price	100	100

Net assets in the books of B Ltd.	60	80
Intangible assets	-	10
General reserve/ Goodwill	40	10

On 1 April 2013, B Ltd. merged with A Ltd. for zero consideration under a scheme of amalgamation.

For the year ended March 2014, A Ltd. had applied pooling of interest method under AS 14 and recognised the excess of consideration over net assets in general reserve. On date of transition to Ind AS, since A Ltd. has chosen to apply Ind AS 103 retrospectively, how should such excess be accounted for in the separate financial statements of A Ltd.?

Response

Paragraphs 9, 11 and 12 of Appendix C of Ind AS 103, state as follows:

"9 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 are 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 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.

11 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.

12 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 amounts 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."

In the instant case, though B Ltd. is merging with A Ltd. (its parent), in substance nothing has changed; the transaction only represents that the assets, liabilities and reserves of B Ltd. which were appearing in the consolidated financial statements of Group A immediately before the merger will now be a part of the separate 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.

If A Ltd. opts to apply requirements of Ind AS 103 retrospectively **(subject to legal considerations)**, it will account for the business combination using acquisition accounting on 1 April 2010. Consequently, following the purchase price allocation requirements of Ind AS 103, Entity A will recognise intangibles at INR 10 crores and goodwill at INR 10 crores.

Question 44

ABC Ltd. is the holding company of XYZ Ltd. and owns 60% equity share of XYZ Ltd. which it acquired on 1 April 2000. During the year ended 31 March 2017, XYZ Ltd. merged in ABC Ltd. (common control business combination).

While restating the comparatives pursuant to paragraph 9 (iii) of Appendix C to Ind AS 103, how will the consideration payable to 40% shareholders of XYZ Ltd. be presented for the comparative period if such consideration has been paid in (i) cash (ii) equity shares?

Response:

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."

In the given case, the merger of XYZ Ltd. with ABC Ltd. is recognised during the year ended 31 March 2017. However, pursuant to paragraph 9(iii) of Appendix C, ABC Ltd. will need to restate its comparatives for the year ended 31 March 2016 for the effect of the merger.

Cash consideration

In such a case, the 40% shareholders will not continue as shareholders of the merged entity. The obligation to pay consideration in cash to these shareholders should be recognised as a liability as at the end of the comparative year end.

Consideration in equity shares

In such a case, the 40% shareholders will continue as shareholders of the merged entity. 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'.

Question 45

If, in a common control business combination, the consideration paid is in excess of the share capital of the transferor and the transferee company does not have any reserves, where should the difference be recognised?

Response:

Paragraph 12 of Appendix C to Ind AS 103 states as follows:

"12 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."

Where the transferee company does not have any reserves (including capital reserve), a literal reading of paragraph 12 of the Appendix C might suggest that the adjustment should be made to capital reserve. However, where the consideration is in excess of the carrying value of the net assets (including the reserves), the difference can be adjusted to either revenue reserve(s) or capital reserve (subject to the approvals required if any e.g. for capital reduction). If the transferee company has no reserves or has inadequate reserves, the debit should be to a account appropriately titled (e.g., Amalgamation Adjustment Deficit Account). The nature of such a reserve is akin to Debit balance in Profit and loss account. The balance in the account should be presented as part of reserves. A disclosure note explaining the nature of this account should be given in the financial statements.

Question 46

Entity A acquires 80% of the share capital of Entity B, which holds a single asset, or a group of assets not constituting a business. The remaining 20% of the share capital is held by Entity M, an unrelated third party. The fair value of the asset is Rs. 20,000. Entity A controls Entity B, as defined in Ind AS 110 *Consolidated Financial Statements*. Cash paid for the acquisition is Rs. 16,000 and fair value of non-controlling interest is Rs. 4,000.

How does an acquirer account for the acquisition of a controlling interest in another entity that is not a business?

Response

Under Ind AS 110, an entity must consolidate all investees that it controls, not just those that are businesses, and recognise any non-controlling interest in non-wholly owned subsidiaries.

When the acquisition of an entity is not a business combination, the requirements of acquisition accounting of Ind AS 103 relating to the allocation of the consideration transferred to the identifiable assets and liabilities and the recognition of goodwill are not applicable.

Paragraph 2(b) of Ind AS 103 states that upon the acquisition of an asset or a group of assets that does not constitute a business, 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. Thus, paragraph 2(b) of Ind AS 103 acknowledges that the cost paid for the assets may differ from the sum of their fair values and hence may need to be allocated to the assets and liabilities acquired.

Ind AS 16, *Property, Plant and Equipment* and Ind AS 38, *Intangible Assets* state that "Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Indian Accounting Standards, e.g. *Ind AS 102, Share-based Payment*". Therefore, when an asset is acquired, its cost is the amount of consideration paid, plus the amount of non-controlling interest (NCI) recorded related to that asset- as this represents a 'claim' relating to that asset.

Paragraph 19 of Ind AS 103 states that "For each business combination, the acquirer shall measure at the acquisition date components of non-controlling interests 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.

Thus, Entity A should recognise assets at cost, which is the sum of consideration given and any NCI recognised. If the NCI has a present ownership interest and is entitled to a proportionate share of net assets upon liquidation, the acquirer has a choice to recognise the NCI at its proportionate share of net assets or its fair value (measured in accordance with Ind AS 113, *Fair Value Measurement*); in all other cases, NCI is recognised at fair value (measured in accordance with Ind AS 113), unless another measurement basis is required in accordance with Ind AS. Additionally, Entity A may also evaluate the implications of Ind AS 36, *Impairment of Asset* for the asset recognised in its books.

With respect to case above, the following entries would be recorded:

Asset	Dr	20,000	
NCI	Cr		4,000
Cash	Cr		16,000

Appendix 1

Note: The purpose of this Appendix is to bring out the major differences, if any between Indian Accounting Standard (Ind AS) 103, Business Combinations and AS 14, Accounting for Amalgamations.

Major differences between Ind AS 103, Business Combinations and AS 14, Accounting for Amalgamations

(i) Ind AS 103 defines a business combination which has a wider scope whereas AS 14 deals with amalgamation and mergers.

(ii) Under AS 14, there are two methods of accounting for amalgamation: the pooling of interest method and the purchase method. Ind AS 103 prescribes only the acquisition method for every business combination. (Paragraph 7 of AS 14)

(iii) Under AS 14, the acquired assets and liabilities are recognised at their existing book values or at fair values under the purchase method. Ind AS 103 requires the acquired identifiable assets liabilities and non-controlling interest to be recognised at fair value under acquisition method. (Paragraph 12 of AS 14 and paragraphs 18-19 of Ind AS 103)

(iv) 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. On the other hand, AS 14 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 and paragraph 19 of Ind AS 103)

(v) 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.

(vi) Ind AS 103 deals with reverse acquisitions, whereas AS 14 does not deal with the same.

(vii) 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.

(viii) Ind AS 103 requires bargain purchase gain arising on business combination 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. Under AS 14, the excess amount is treated as capital reserve. (Paragraph 34 of Ind AS 103 and paragraph 17 of AS 14)

(ix) Appendix C of Ind AS 103 deals with accounting for common control transactions, which prescribes a method of accounting different from Ind AS 103. AS 14 does not prescribe accounting for such transactions different from other amalgamations.

Appendix 2

Note: The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 103 and the corresponding International Financial Reporting Standard (IFRS) 3, Business Combinations, issued by the International Accounting Standards Board.

Major differences between Ind AS 103, *Business Combinations* and IFRS 3, *Business Combinations*

(i) IFRS 3 excludes from its scope business combinations of entities under common control. Ind AS 103 (Appendix C) gives the guidance in this regard.

(ii) IFRS 3 requires bargain purchase gain arising on business combination to be recognised in profit or loss. Ind AS 103 requires the same 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.