

Business combinations



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Scope and Key Definitions

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Scope

Scope

- Applies to all transactions or other events that meet the definition of a business combination
- Does not apply to:
 - Formation of joint arrangements
 - Purchase of assets/group of assets
 - Acquisition of subsidiaries by investment companies that are carried at fair value

What is a business combination?

- A transaction or event
- acquirer obtains control*
- of one or more business



Acquisition of
majority equity
stake

Combination by
contract

Unincorporated
business

Legal merger

**** Guidance on control is given in IndAS 110***

What is a business?

*‘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.’*



Input

+



Processes

⇒



**Ability to create
OUTPUTS**

What is a business?

- ❑ Not all processes need to be acquired
- ❑ Administrative, billing, payroll and accounting processes are not required in order for a set of activities and assets to constitute a business for accounting purposes.
- ❑ Nearly all businesses have liabilities as well as assets. However, liabilities do not need to be present for a business to exist.
- ❑ A business consists of inputs and processes applied to the inputs that have the ability to create outputs. Outputs, specifically revenue or saleable products or services, are not required to qualify as a business.

Quick Quiz?

- Computer entity A acquires software development entity B. Entity B has been formed to make hand-held device applications.
- The current activities of the company include researching and developing its first product and creating a market for the product.
- The company has not generated any revenues and has no existing customers.
- Entity B's workforce is composed primarily of programmers. Entity B has the intellectual property, software and fixed assets required to develop applications.

Is this an acquisition of business?

Yes, It is likely that a business has been acquired because entity B has access to the inputs (IP, software and fixed assets) and processes necessary to manage and produce outputs. The lack of outputs, such as revenue and a product, does not prevent the company from being considered a business.

Quick Quiz?

- A shipping & warehousing co. ('X') provides shipping/storage services
- A consumer retail company ('Y') plans to purchase several warehouses from X to use the warehouses to enhance its distribution system.
- Y acquires the land and warehouses from X but does not take over the warehousing contracts with third parties, employees, warehouse equipment, or information technology systems.

Is this an acquisition of business or asset?

Asset

*(Y has only acquired a group of assets. It has not acquired the related inputs and processes **capable** of producing outputs)*

Differences between business combination and asset acquisition

Area	Business combination	Asset or group of assets
Measurement of assets and liabilities	Recorded at fair value.	Recorded at cost; cost is allocated over the group of assets based on relative fair value.
Transaction costs	Expense as incurred.	Capitalised as part of the cost.
Contingent liabilities assumed	Recognised if represents present obligation that arises from past events and its fair value can be measured reliably with subsequent changes to profit or loss.	Not recognised; subject to Ind AS 37.

Differences between business combination and asset acquisition

Area	Business combination	Asset or group of assets
Goodwill	May be recognised.	Not recognised.
Deferred taxes	Deferred tax assets and liabilities, related to any temporary differences, tax carry-forwards and uncertain tax positions are recorded.	Initial recognition exemption applies; deferred tax assets and liabilities for temporary differences are not recognised.
Contingent consideration	Recorded at fair value on the date of acquisition. Subsequent changes in the fair value of contingent consideration not classified as equity are recorded in profit or loss until settled.	Generally recorded at fair value on the date of purchase. An accounting policy election may be made to record the subsequent changes in fair value against the asset's cost (Ind AS 16) or in profit or loss (Ind AS 109).

Acquisition Method

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The acquisition method - the four step approach

Step 1 – Identify the acquirer



Step 2 – Determine the acquisition date



Step 3 – Recognise and measure identifiable assets acquired, liabilities assumed and any non controlling interest

Step 4 – Recognise and measure goodwill or gain from bargain purchase as capital reserve

Step 1 - Identify the acquirer

- Acquirer is the entity that obtains control of the other entity



- Some factors to be considered in determining the acquirer:
 - Entity that transfers the cash or other assets or incurs the liabilities
 - Entity that issues its equity interests (except in the case of reverse acquisitions)
 - Entity that is larger, based on fair value, assets, revenues or profits.

Reverse Acquisition

When the entity that issues securities **(the legal acquirer) is** identified as the **acquiree** for accounting purposes and the entity whose equity interests are acquired **(the legal acquiree) must be the acquirer** for accounting purposes.

For example:

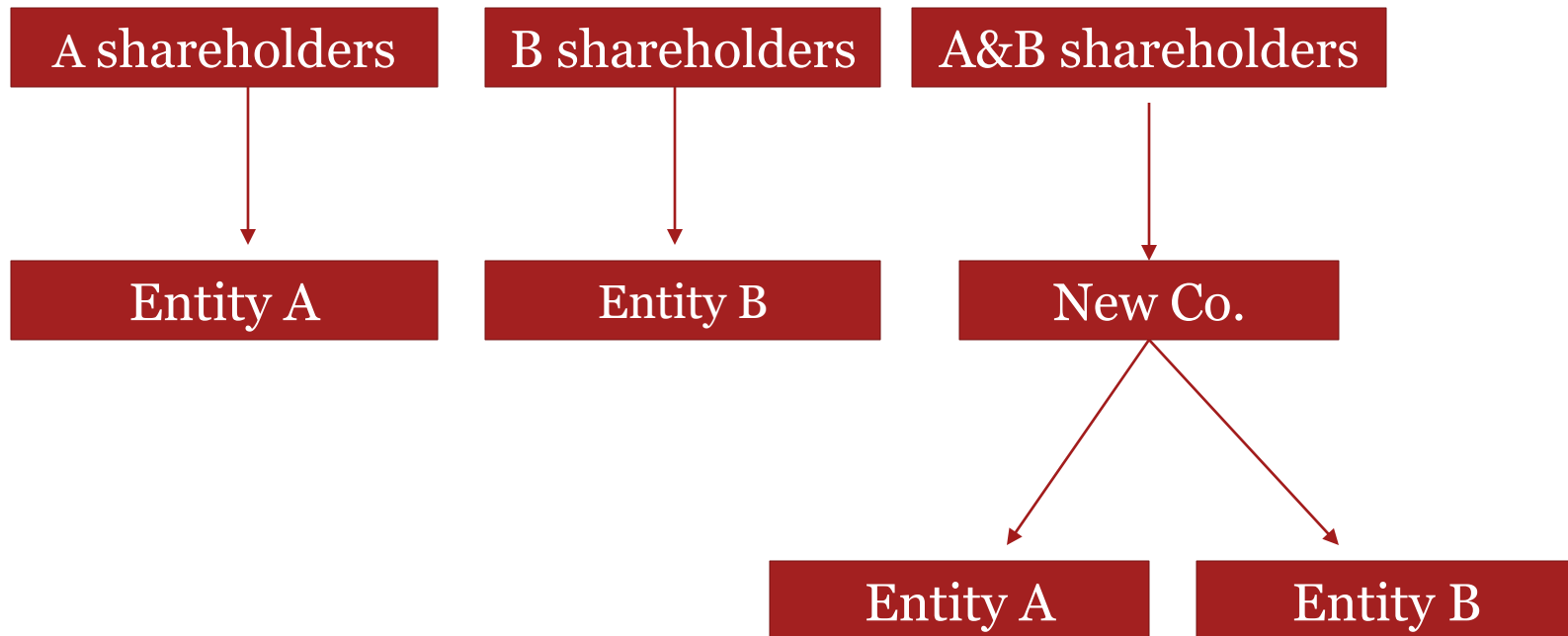
When a private operating entity wants to become a public entity but does not want to register its equity shares. The private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity.

(a) Public entity (Legal Acquirer) – is the acquiree for accounting purposes;

(b) Private entity (Legal Acquiree) – is the acquirer for accounting purposes.

Substance over Form

Identifying the acquirer – New entity formed to effect a business combination (Example)



As New Co is a new entity that has been formed to issue equity instruments to effect a business combination, IND AS 103 para B17 requires one of the combining entities that existed before the combination (that is, entity A or entity B) to be identified as the acquirer on the basis of the evidence available.

Step 2 - Determine the acquisition date



- Date on which the acquirer **obtains control** of the acquiree.
- Generally the date on which the acquirer **legally transfers the consideration**, acquires the assets and assumes the liabilities. However, it could be different.
- If acquisition is subject to substantive pre-conditions – date on which last of those **pre-conditions** is satisfied.
- For guidance on control, reference should be made to IndAS 110 on Consolidation.
- Can get judgmental!

Business Combination without consideration

Such circumstances include:

- a) The acquiree repurchases its own shares that the acquirer manages to gain control

- b) Minority veto rights lapse

The acquisition method applies to such business combinations and the acquisition date for these business combinations is the date control is obtained through the other transaction or event.

Determine the consideration

What forms part of the consideration?

Principles:

- Sum of the assets transferred, the liabilities incurred and equity issued (For eg. Cash, other assets, contingent consideration, equity instruments, options and warrants)
- Measured at fair value (FV) at acquisition date
- Deferred consideration also forms part of the consideration
- Exclude items not part of consideration (transaction costs, settlement of pre-existing relationships)
- Contingent consideration



Contingent consideration

Acquisition date accounting

Recognition

At acquisition date

Measurement

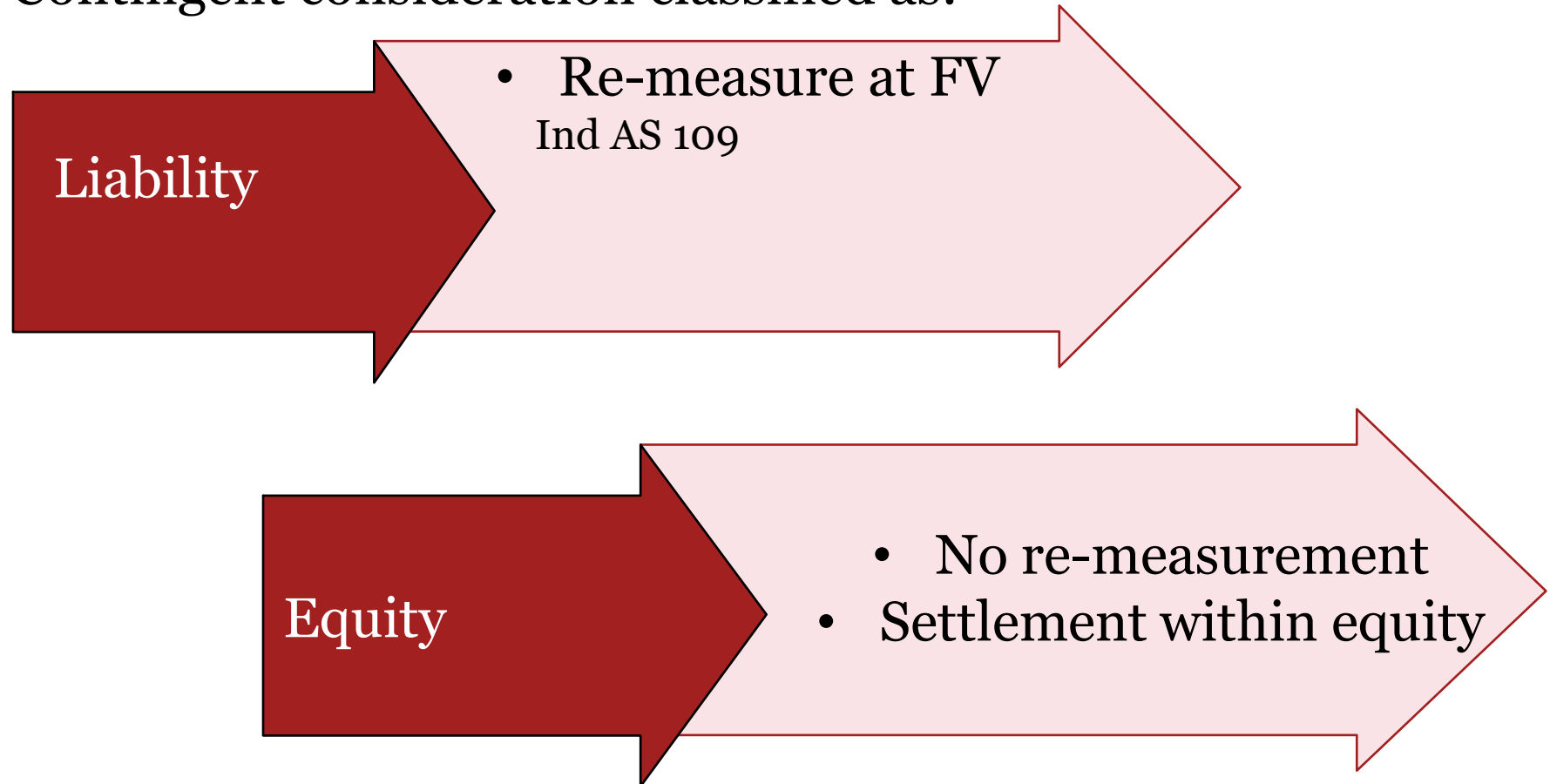
Fair Value

Classification

Debt or Equity

Contingent consideration - Post acquisition accounting

Contingent consideration classified as:



Consideration - Example

On 15 July 2014, Company A agreed with the shareholders of Company B to acquire 100% of B for a total consideration of INR100m. The consideration includes the following:

- Company A will reimburse the shareholders of Company B for transaction costs of INR 2m
- Shareholders (two persons) of company B will work as General Managers in Company B after it is acquired by A for a period of three years. Annual salary for GM position in company A is INR 1m
- B had filed a legal case against company A in 2012 which is still outstanding. A has agreed to settle it for INR 2m

Determine the amount of consideration for the acquisition

Consideration - Example (continued)

	INR'm
Total amount agreed	<u>100</u>
Less:	
Transaction costs	(2)
Remuneration of B's shareholders for future services (INR 1m x 2 x 3)	(6)
Settlement of past legal case with B	(2)
Sub - total	<u>(10)</u>
Consideration for acquisition of Company B	90

Step 3 - Recognise and measure identifiable assets acquired, liabilities assumed and any NCI

Recognition principles

- ☐ Recognize, separately from **goodwill**, the **identifiable assets** acquired, the **liabilities assumed** and any **non-controlling interest (NCI)** in the acquire
- ☐ Recognition of asset or a liability only if it meets the definition of an asset or a liability at the acquisition date.
- ☐ Identifiable assets and liabilities assumed include items not recognized in the acquiree's financial statements.
- ☐ Goodwill in the books of acquiree is not an identifiable asset

Recognition and Measurement exceptions

Recognition exceptions

Contingent liabilities (Ind-AS 37)

Measurement exceptions

Reacquired rights
Share based payment (Ind-AS 102)
Assets held for sale (Ind-AS 105)

Both recognition and measurement exceptions

Income taxes (Ind-AS 12)
Employee benefits (Ind-AS 19)
Indemnification assets

Intangible assets

- Acquirer recognises intangible assets previously not recognised by the acquiree - At fair value
- Intangible asset - To meet the contractual/legal or separability criteria

Marketing-related
Intangible assets
(Ex – Trade marks)

Customer-related
Intangible Assets
(Ex – Customer base)

Artistic-related
Intangible assets
(Ex–Copy rights)

Contract-based
Intangible assets
(Ex – Use rights)

Technology-based
Intangible assets
(Ex - Computer software)

Non-controlling interest (NCI)

- NCI is seen as equity participant providing finance to the acquired business
- Ind AS 103 provides two choices (full or partial goodwill method):
 - Measure NCI at fair value; or
 - Measure NCI at its share of fair value of acquired net assets
- Above choice available for each business combination

Non-controlling interest - example

- AB Limited bought a 40% stake in CD Limited for INR 120m.
- It already holds a 20% interest in CD Limited.
- 100% of the FV of assets, liabilities and contingent liabilities of CD Limited on the date of acquisition is INR 200m.

Calculate goodwill under proportionate share method and fair value method

Non-controlling interest - example

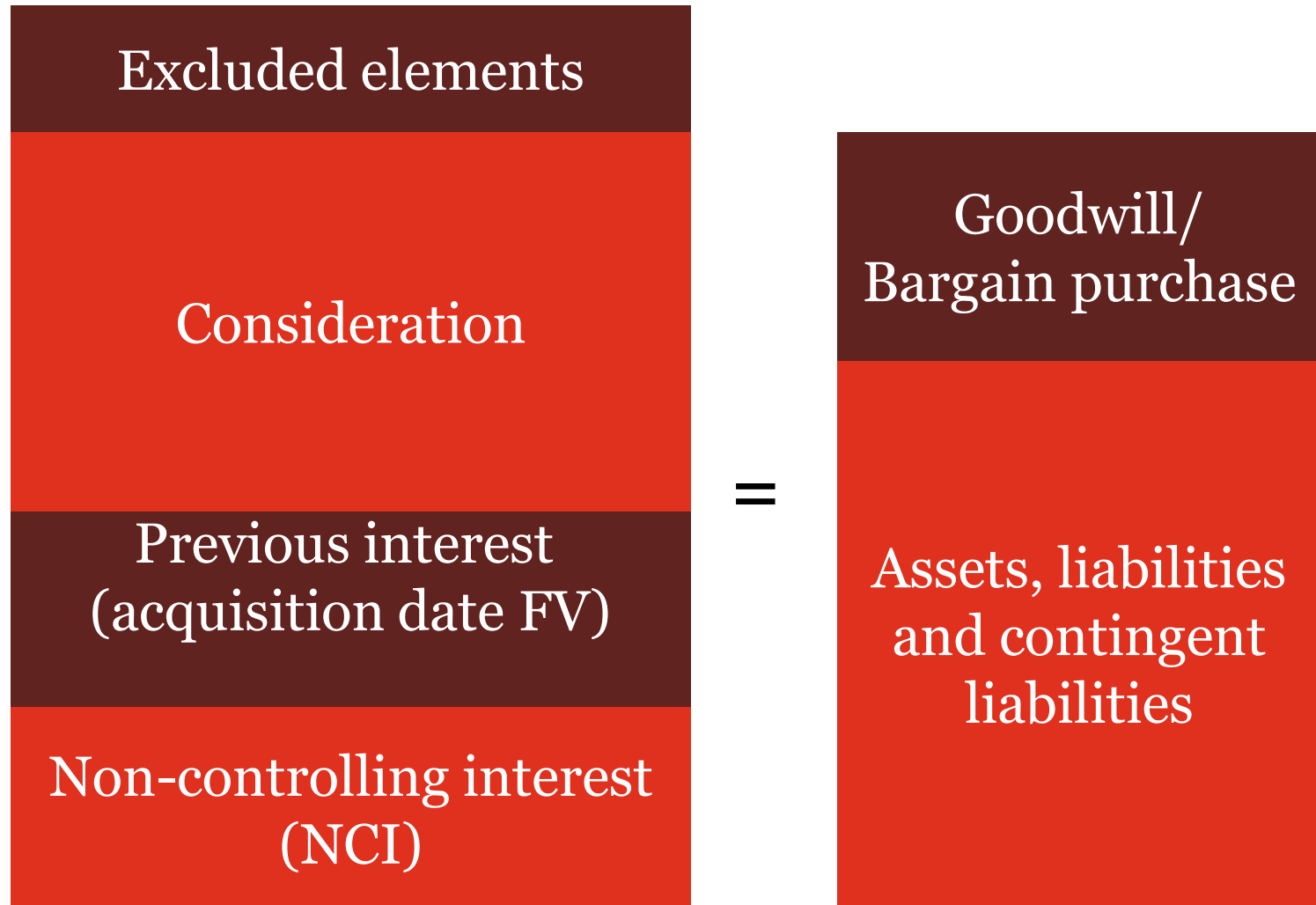
At proportionate value

Consideration (INR120m)	Goodwill (INR 60m)
Previous interest (INR 60m)	Assets, liabilities and contingent liabilities (INR 200m)
NCI (40%) (INR 80m)	

At fair value

Consideration (INR120m)	Goodwill (INR 100m)
Previous interest (INR 60m)	Assets, liabilities and contingent liabilities (INR 200m)
NCI (INR 120m)	

Step 4 - Recognise and measure goodwill or gain from bargain purchase as capital reserve



Goodwill – Key Points

- In the absence of evidence to the contrary, a particular set of assets and activities in which goodwill is present shall be presumed to be a business. (*Rebuttable presumption*)
- The acquirer subsumes into goodwill:
 - (a) value of an acquired intangible asset that is not identifiable
(Example - Assembled workforce)
 - (b) value attributed to items that do not qualify as assets
(Example - potential contracts)

Bargain Purchase – Key Points

- In extremely rare circumstances
- Before recognising a gain –
 - i. Reassess whether all of the assets acquired and all of the liabilities assumed are correctly identified
 - ii. Review the procedures used to measure :
 - a) the identifiable assets acquired and liabilities assumed;
 - b) the non-controlling interest in the acquiree, if any;
 - c) the acquirer's previously held equity interest in the acquiree; and
 - d) the consideration transferred.
- **Clear evidence of the underlying reasons** exists - recognise the resulting gain in **OCI and accumulate the same in equity** as capital reserve;
Otherwise recognise directly in equity as capital reserve

Other key concepts

3

Watch out! – Step acquisitions

- Accounted for as a business combination on gaining control
- Previously held equity interest is measured at fair value on acquisition date and taken to P&L



Once control is established, any further acquisition of interest is treated as transaction with shareholders and impact taken to equity

Step acquisition - Example

- In 2014 AB Ltd acquired 40% stake in CD Ltd for INR 4m.
- In 2015, AB's carrying value of its 40% stake in CD is INR 5.5m.
- In 2015, AB Ltd. acquires the remaining 60% stake for INR 12m and gains control.

Determine gain/loss to be recognised in this business combination.

Step acquisition - Example

In 2014 AB Ltd acquires
40% stake in CD Limited
for INR 4m

In 2015 AB acquires
remaining 60% stake
for INR 12m

2015: 40% stake carrying value
INR 5.5m.

2015: FV of 40% was INR 8m



GAIN on re-
measurement of
associate INR 2.5m in
income statement

Loss of control

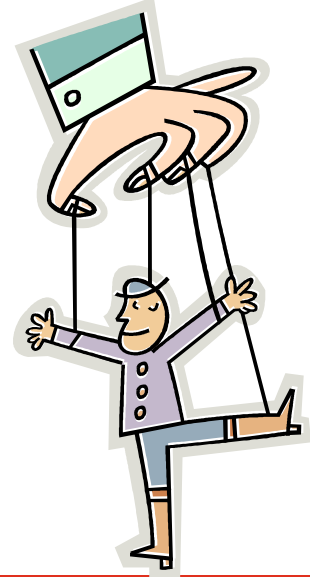
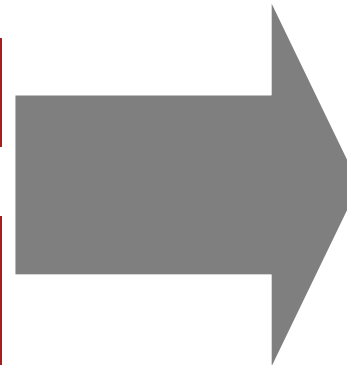
De-recognise assets (inc. goodwill)
and liabilities

De-recognise NCI

Recognise consideration received

Recognise at FV any investment
retained

Reclassify to statement of profit
and loss, any gain or loss
previously recognised in other
comprehensive income



Difference to income
statement

Other key concepts

Measurement period adjustments

- Acquirer to finalise the accounting for a business combination at the earlier of:
 - The date on which it receives all the information; or
 - One year after acquisition date
- Adjustments that do not qualify as measurement period adjustments are recorded in the income statement

Common control transactions

- Accounted for using the pooling of interests method
- All Assets and liabilities are reflected at their previous carrying values
- No adjustments are made to reflect any fair values. Nor are any new assets recognised.
- Only adjustment permitted is adjustment towards uniform accounting policies.

Some disclosure requirements

- Name and a description of the acquiree and the acquisition date
- Percentage of voting equity interests acquired
- Primary reasons for the business combination and how the acquirer obtained control
- Qualitative description of the factors that make up the goodwill recognised
- Acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration
- Purchase price allocations
- Estimates involved in contingent consideration arrangements and indemnification assets

The above list is not complete. Please go through the standard for complete list of disclosures!

Key differences from IFRS 3



Business combinations between entities under common control

Accounting for bargain purchase gain

No transitional provisions in IndAS 103

Key differences from AS 14

Area	Ind AS 103	AS 14
Scope	Wider scope	Only amalgamations and mergers
Methods of accounting	Acquisition method except common control business combinations	2 methods - Purchase method - Pooling of interest method
Non controlling interest	2 methods - Fair value - Proportionate share in net assets	Amount of equity attributable to NCI
Goodwill	Tested for impairment	Amortised
Reverse acquisitions	Specific guidance	Not dealt with

Key differences from AS 14

Area	Ind AS 103	AS 14
Contingent consideration	Specific guidance	Not dealt with
Bargain purchase gain	Capital reserve either through OCI or directly	Capital reserve
Common control business combination	Specific guidance different from acquisition method	No separate treatment

Questions

Thank You