BUSINESS COMBINATION AND CORPORATE RESTRUCTURING

LEARNING OUTCOMES

After studying this chapter, you would be able to:

- Understand various terms used in Ind AS 103 “Business Combination”
- Examine the key differences between Ind AS 103 and Existing Accounting Standards
- Identify the acquiring enterprises
- Determine the acquisition date, purchase consideration under various situations and contingent consideration
- Allocate the purchase price
- Recognize the assets and liabilities of the acquired entity
- Examine the measurement principles
- Calculate the goodwill or bargain purchase
- Evaluate contingent payments to employee shareholders and acquirer share-based payment awards exchanged for awards held by the acquiree’s employees
- Integrate subsequent measurement and accounting principles for reacquired rights, contingent liabilities, indemnification assets and contingent consideration
- Appraise the disclosure requirements in case of Business Combination
- Account for distribution of non-cash assets to owners as dividend in accordance with Appendix A Distribution of Non-Cash Assets to Owners of Ind AS 10 Events after the Reporting Period.
BUSINESS COMBINATION

DEFINITION AND ELEMENTS

ACQUISITION METHOD

SUBSEQUENT MEASUREMENT AND ACCOUNTING

COMMON CONTROL TRANSACTIONS

DISCLOSURES

OF BUSINESS COMBINATION

OF BUSINESS

IDENTIFYING THE ACQUIRER

DETERMINING THE ACQUISITION DATE

PURCHASE CONSIDERATION

REACQUIRED RIGHTS

CONTINGENT LIABILITIES

INDEMNIFICATION OF ASSETS

CONTINGENT CONSIDERATION

DETERMINATION OF PURCHASE CONSIDERATION

ALLOCATION OF PURCHASE CONSIDERATION

RECOGNITION AND MEASUREMENT OF NON-CONTROLLING INTEREST IN THE ACQUIREE

IDENTIFIABLE ASSETS ACQUIRED AND THE LIABILITIES ASSUMED

GOODWILL OR GAIN FROM A BARGAIN PURCHASE

NON-CONTROLLING INTEREST IN THE ACQUIREE

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1. INTRODUCTION

Restructuring is the corporate management term for the act of reorganizing the legal, ownership, operational, or other structures of a company for the purpose of making it more profitable, or better organized for its present needs. Alternate reasons for restructuring include a change of ownership or ownership structure, demerger, or a response to a crisis or major change in the business such as bankruptcy, repositioning, or buyout. Restructuring may also be described as corporate restructuring, debt restructuring and financial restructuring.

Corporates are now restructuring and repositioning their folios to meet the challenges and seize opportunities thrown open by the multilateral trade agenda and emergence of the World Trade Organisation (WTO).

Most of the diversified multi-product companies are restructuring their corporate operations into more homogenous units to achieve synergy in operations. This entails transfer of business units from one company to the other or breaking up of a large group into smaller ones. On the other hand, smaller companies are forming alliances and joint ventures for their survival and growth. The exercise involves strategic planning to cope with the complex changes in the ownership and control and comply with a variety of business laws.

The underlying object of corporate restructuring is efficient and competitive business operations by increasing the market share, brand power and synergies. In the emerging scenario, joint ventures, alliances, mergers, amalgamations and takeovers are becoming the easiest and quickest way to expand capacities and acquire dominance over the market.

While asset and capital restructuring can be termed as external, organisational restructuring may be referred to as internal; this is based on the significance and impact of the restructuring process on a company’s internal or external stakeholders.

2. MERGERS AND DEMERGERS

2.1 Mergers

It is a legal process by which two or more companies are joined together to form a new entity or one or more companies are absorbed by another company and as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of the new or amalgamated company.

2.2 Demergers

Demerger is an arrangement whereby some part /undertaking of one company is transferred to another company which operates completely separate from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company.

Demerger is undertaken basically for following reasons:

- The first as an exercise in corporate restructuring and
3. BUSINESS COMBINATION AS PER IND AS 103

‘BUSINESS COMBINATION’

The necessity of a standard on Business Combination in India assumes importance considering the fact that Indian companies are increasingly stretching their business in foreign countries for best-fit business combinations. Presently in India, Accounting Standard (AS) 14 ‘Accounting for Amalgamation’ lays out specific treatment for Amalgamation and AS 21, ‘Consolidated Financial Statements’ are applied for consolidation. However, it is not matching the global reporting standards requirements.

After convergence of IFRS as Ind AS, Ind AS 103 which is in line with IFRS 3 takes care of the global requirements in case of business combinations worldwide.

A business combination is a transaction in which the acquirer obtains control of another business (the acquiree).

The term ‘business’ is defined 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.

Business combinations are most common form of business transaction through which companies grow in size rather than organic activities.

Business combination or acquisition is different from asset acquisition. The following are the key differences in accounting of an asset acquisition and a business combination:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Business Combination</th>
<th>Acquisition of group of assets under Ind AS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intangible assets, including goodwill</td>
<td>Intangible assets are recognised at fair value, if they are separately identifiable. Goodwill is recognised as a separate asset.</td>
<td>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.</td>
</tr>
<tr>
<td>Transaction Costs</td>
<td>In a business combination, acquisition-related costs (including stamp duty) are expensed in the period in which such costs are incurred and are</td>
<td>Transaction costs are capitalised as a component of the cost of the assets acquired.</td>
</tr>
</tbody>
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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 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 gain on 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.

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.

Illustration 1: Asset acquisition

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

Solution

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 ₹ 1,400 crore (the total fair value of the consideration transferred).

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

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

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

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4. SCOPE UNDER IND AS 103

This Indian Accounting Standard applies to a transaction or other event that meets the definition of a business combination. This Indian Accounting Standard does not apply to:

(a) the formation of a joint venture.

(b) the acquisition of an asset or a group of assets that does not constitute a business i.e. it is an asset acquisition.

5. DEFINITION OF BUSINESS COMBINATION

Under Ind AS 103, Business combination occurs when an entity obtains control of a business by acquiring net assets or acquiring its significant equity interest. An entity can obtain control of a business by contract only in which case the acquirer would neither have acquired net assets nor equity interest. In such a case, while preparing balance sheet, controlling interest would be zero and non-controlling interest will be 100%.

- As such, two elements are required for a transaction to be a business combination under Ind AS 103:
  - the acquirer obtains control of an acquiree (“control” as defined in Ind AS 110); and
  - the acquiree is a business
- An acquirer might obtain control of an acquiree in a variety of ways, for example:
  - by transferring cash, cash equivalents or other assets (including net assets that constitute a business);
  - by incurring liabilities;

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A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:

- one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;
- one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;
- all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or
- a group of former owners of one of the combining entities obtains control of the combined entity.

6. DEFINITION AND ELEMENTS OF BUSINESS

6.1 Definition of Business

As per paragraph B7 of the application guidance of Ind AS 103, 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.

**Analysis:** 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.

6.2 Elements of Business

The three elements of a business are defined as follows:

(a) **Input:** Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it.

**Example:**
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.

(b) **Process:** Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs.
Example:
Strategic management processes, operational processes and resource management processes.

These processes typically are documented, but an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)

(c) 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.

Example: Simple-business combination
Company X is a liquor manufacturer and has traded for a number of years. The company produces a wide variety of liquor and employs a workforce of machine operators, testers, and other operational, marketing and administrative staff. It owns and operates a factory, warehouse and machinery and holds raw material inventory and finished products.

On 1st January, 20X1, Company Y pays USD 80 million to acquire 100% of the ordinary voting shares of Company X. No other type of shares has been issued by Company X. On the same day, the four main executive directors of Company Y take on the same roles in Company X.

In this case, it is clear that Company X is a business. It operates a trade with a variety of assets that are used by its employees in a number of related activities. These assets and activities are necessarily integrated in order to create and sell the company’s products. Company X obtains control on 1st January, 20X1 by acquiring 100% of the voting rights.

The application of the definition is less clear in situations as illustrated in the following examples:

Example: Investment in a development stage entity
Company D is a development stage entity that has not started revenue-generating operations. The workforce consists mainly of research engineers who are developing a new technology that has a pending patent application. Negotiations to license this technology to a number of customers are at an advanced stage. Company D requires additional funding to complete development work and commence planned commercial production.

The value of the identifiable net assets in Company D is ₹ 750 million. Company A pays ₹ 600 million in exchange for 60% of the equity of Company D (a controlling interest).

Although Company D is not yet earning revenues (an example of ‘outputs’) there are a number of indicators that it has a sufficiently integrated set of activities and assets that are capable of being managed to produce a return for investors. In particular, Company D:

- employs specialist engineers developing the know-how and design specifications of the technology.
- is pursuing a viable plan to complete the development work and commence production.
has identified and will be able to access customers willing to buy the outputs. In addition, Company A has paid a premium (or goodwill) for its 60% interest. In the absence of evidence to the contrary, Company D is presumed to be a business.

**Example : Acquisition of an entity holding investment properties**

Company A acquires 100% of the equity and voting rights of Company P, a subsidiary of a property investment group. Company P owns three investment properties. The properties are single-tenant industrial warehouses subject to long-term leases. The leases oblige Company P to provide basic maintenance and security services, which have been outsourced to third party contractors. The administration of Company P’s leases was carried out by an employee of its former parent company on a part-time basis but this individual does not transfer to the new owner.

In most cases, an asset or group of assets and liabilities that are capable of generating revenues, combined with all or many of the activities necessary to earn those revenues, would constitute a business. However, investment property is a specific case in which earning a return for investors is a defining characteristic of the asset. Accordingly, revenue generation and activities that are specific and ancillary to an investment property and its tenancy agreements should therefore be given a lower 'weighting' in assessing whether the acquiree is a business. In our view the purchase of investment property with tenants and services that are purely ancillary to the property and its tenancy agreements should generally be accounted for as an asset purchase.

**Example : Acquisition of an entity holding investment properties**

Company A acquires 100% of the equity and voting rights of Company Q, which owns three investment properties. The properties are multi-tenant residential condominiums subject to short-term rental agreements that oblige Company Q to provide substantial maintenance and security services, which are outsourced with specialist providers. Company Q has five employees who deal directly with the tenants and with the outsourced contractors to resolve any non-routine security or maintenance requirements. These employees are involved in a variety of lease management tasks (eg identification and selection of tenants; lease negotiation and rent reviews) and marketing activities to maximise the quality of tenants and the rental income.

In this case, Company Q consists of a group of revenue-generating assets, together with employees and activities that clearly go beyond activities ancillary to the property and their tenancy agreements. The assets and activities are clearly integrated so Company Q is considered a business.

**Example : Seller retains some activities and assets**

Company S is a manufacturer of a wide range of products. The company’s payroll and accounting system is managed as a separate cost centre, supporting all the operating segments and the head office functions.

Company A agrees to acquire the trade, assets, liabilities and workforce of the operating segments of Company S but does not acquire the payroll and accounting cost centre or any head office functions. Company A is a competitor of Company S.

In this case, the activities and assets within the operating segments are capable of being managed as a business and so Company A accounts for the acquisition as a business combination. The payroll and accounting cost centre and administrative head office functions are typically not used...
to create outputs and so are generally not considered an essential element in the assessment of whether an integrated set of activities and assets is a business.

**Example: Acquisition of a shell company**

Company A is a property development company with a number of subsidiary companies, each of which holds a single development. After completion of the development, Company A sells its equity investment because the applicable tax rate is lower than that applicable to the sale of the underlying property.

Company A is planning to start the development of a large new retail complex. Rather than incorporating a new company, Company A acquires the entire share capital of a ‘shell’ company. The shell company does not contain an integrated set of activities and assets and so does not constitute a business. Consequently, Company A should account for the purchase of the shell company in the same way as the incorporation of a new subsidiary. In the consolidated financial statements, any costs incurred will be accounted for in accordance with their nature and applicable Ind AS. No goodwill is recognised.

**Point to remember**

**Illustration 2**

Company A is a pharmaceutical company. Since inception, the Company had been conducting in-house research and development activities through its skilled workforce and recently obtained an intellectual property right (IPR) in the form of patents over certain drugs. The Company’s has a production plant that has recently obtained regulatory approvals. However, the Company has not earned any revenue so far and does not have any customer contracts for sale of goods. Company B acquires Company A.

**Does Company A constitute a business in accordance with Ind AS 103?**

**Solution**

The definition of business requires existence of inputs and processes. In this case, the skilled workforce, manufacturing plant and IPR, along with strategic and operational processes constitutes the inputs and processes in line with the requirements of Ind AS 103.
When the said inputs and processes are applied as an integrated set, the Company A will be capable of producing outputs; the fact that the Company A currently does not have revenue is not relevant to the analysis of the definition of business under Ind AS 103. Basis this and presuming that Company A would have been able to obtain access to customers that will purchase the outputs, the present case can be said to constitute a business as per Ind AS 103.

Illustration 3

Modifying the above illustration, if Company A had revenue contracts and a sales force, such that Company B acquires all the inputs and processes other than the sales force, then whether the definition of the business is met in accordance with Ind AS 103?

Solution

Though the sales force has not been taken over, however, if the missing inputs (i.e., sales force) can be easily replicated or obtained by the market participant to generate output, it may be concluded that Company A has acquired business. Further, if Company B is also into similar line of business, then the existing sales force of Company B may also be relevant to mitigate the missing input. As such, the definition of business is met in accordance with Ind AS 103.

7. THE ACQUISITION METHOD

The following key steps are involved in the acquisition accounting for business combinations:

Step 1: Identifying the acquirer.
Step 2: Determining the acquisition date.
Step 3: Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and
Step 4: Recognising and measuring goodwill or a gain from a bargain purchase.

8. IDENTIFYING ACQUIRING ENTERPRISE

8.1 The Acquiring Enterprise

All business combination within the scope of Ind AS 103 are accounted under the acquisition method (also known as purchase method). In order to apply the purchase method, the parties involved has to identify the acquirer i.e the entity that obtains the control of another entity. The another entity on whom the control is established is termed as acquiree. This is because the acquiree’s assets and liabilities is what is accounted as per the recognition and measurement principles of the standard.
The acquiring enterprise is the enterprise which obtains control and the determination of control is as per the guidance given in Ind AS 110. It may so happen that guidance in Ind AS 110 does not clearly indicate which of the combining entity is the acquirer. In such a case, Ind AS 103 provides additional guidance on identifying the acquirer.

As per Ind AS 110 'Consolidated Financial Statements', 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.

The above definition is very wide and control assessment does not depend only on voting rights instead it depends on the following as well:

- Potential voting rights;
- Rights of non-controlling shareholders; and
- Other contractual right of the investor if those are substantive in nature.

Control assessment has been discussed in detail in the chapter of Consolidated Financial Statements. One example on potential voting rights and its implication on assessment of control is provided below for the students to understand the concept of control.

In order to ascertain control do not look at the voting rights only. Evaluate other factors also like board control, potential voting rights etc.

<table>
<thead>
<tr>
<th>Indicator of Control</th>
</tr>
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<tbody>
<tr>
<td>More than 50% Voting rights</td>
</tr>
<tr>
<td>Power to appoint and remove board of directors</td>
</tr>
<tr>
<td>Investor have currently exercisable potential voting rights</td>
</tr>
</tbody>
</table>

Illustration 4: Potential voting rights

Company P Ltd., a manufacturer of textile products, acquires 40,000 of the equity shares of Company X (a manufacturer of complementary products) out of 1,00,000 shares in issue. As part of the same agreement, Company P purchases an option to acquire an additional 25,000 shares. The option is exercisable at any time in the next 12 months. The exercise price includes a small premium to the market price at the transaction date.
After the above transaction, the shareholdings of Company P’s two other original shareholders are 35,000 and 25,000. Each of these shareholders also has currently exercisable options to acquire 2,000 additional shares. Assess whether control is acquired by Company P.

Solution

In assessing whether it has obtained control over Company X, Company P should consider not only the 40,000 shares it owns but also its option to acquire another 25,000 shares (a so-called potential voting right). In this assessment, the specific terms and conditions of the option agreement and other factors are considered:

- the options are currently exercisable and there are no other required conditions before such options can be exercised
- if exercised, these options would increase Company P’s ownership to a controlling interest of over 50% before considering other shareholders’ potential voting rights (65,000 shares out of a total of 1,25,000 shares)
- although other shareholders also have potential voting rights, if all options are exercised Company P will still own a majority (65,000 shares out of 1,29,000 shares)
- the premium included in the exercise price makes the options out-of-the-money. However, the fact that the premium is small and the options could confer majority ownership indicates that the potential voting rights have economic substance.

By considering all the above factors, Company P concludes that with the acquisition of the 40,000 shares together with the potential voting rights, it has obtained control of Company X.

8.2 Acquisitions through payment of cash or incurring of liability

In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

8.3 Acquisitions through issue of equity instrument

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. Reverse acquisition has been dealt in a separate section of this chapter.

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.

f) *The acquirer is usually the combining entity* whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities. In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.

**Example:**

Company A and Company B operate in power industry and both entities are operating entities. Company A has much larger scale of operations than Company B. Company B merges with Company A such that the shareholders of Company B would receive 1 equity share of Company A for every 1 share held in Company B. Such issue of shares would comprise 20% of the issued share capital of the combined entity. After discharge of purchase consideration, the pre-merger shareholders of Company A hold 80% of the capital in Company A.

In this transaction, Company A is the acquirer for the purposes of accounting for business combination as per Ind AS 103. This is because, by merging the entire shareholding of Company B, Company A has acquired control over Company B. Further, the shareholders of erstwhile Company B do not obtain control over Company A on account of shares received as part of purchase consideration, as they hold only 20% of the paid-up capital of Company A.

**Example:**

Company A and Company B operate in power industry and both entities are operating entities. Company A has much smaller scale of operations than Company B. Company B merges Company A such that the shareholders of Company B would receive 10 equity share of Company A for every 1 share held in Company B. Such issue of shares would comprise 70% of the issued share capital of the combined entity. After discharge of purchase consideration, the pre-merger shareholders
of Company A hold 30% of capital of Company A. Post-acquisition, the management of Company B would manage the operations of the combined entity.

In this transaction, Company B is the acquirer for the purposes of accounting for business combination as per Ind AS 103. This is because, after merger, the shareholders of erstwhile Company B would have a controlling interest and management of the combined entity. As such, in substance, Company B has acquired control over Company A.

It is important to note that the Company B would be considered as an acquirer for accounting purposes only (i.e., accounting acquirer). For legal purposes as well as for reporting purposes, it is the Company A that would be considered as an acquirer (i.e., legal acquirer).

Appropriate identification of an acquirer is relevant, as the net assets of the accounting acquiree (rather than that of the accounting acquirer) are recognised at fair value.

**Illustration 5**

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?

**Solution**

Paragraph 6 of Ind AS 103 states that for each business combination, one of the combining entities shall be identified as the acquirer.

While paragraph 7 states that the guidance in Ind AS 110 shall be used to identify the acquirer that is the entity that obtains control of another entity called 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 of Ind AS 103 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. 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 drivers of the accounting are identifying the party on whose behalf the new entity has been formed and identifying the business acquired. 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.

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8.4 Acquisition involving Shell Company and Reverse Acquisition

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired. However, application of the guidance given in above paragraph 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 of Ind AS 103, including the requirement to recognise goodwill, will apply.

Example: New parent pays cash to effect a business combination

Company A decided to spin-off two of its existing businesses (currently housed in two separate entities, Company B and Company C). To facilitate the spin-off, Company A incorporates a new
entity (Company D) with nominal equity and appoints independent directors to the board of Company D. Company D signs an agreement to purchase Companies B and C in cash, conditional on obtaining sufficient funding. To fund these acquisitions, Company D issues a prospectus offering to issue shares for cash.

At the conclusion of the transaction, Company D has owned 99% by the new investors with Company A retaining only a 1% non-controlling interest.

In this situation, a set of new investors paid cash to obtain control of Company D in an arm’s length transaction. Company D is then used to effect the acquisition of 100% ownership of Companies B and C by paying cash. Company A relinquishes its control of Companies B and C to the new owners of Company D.

Although Company D is a newly formed entity, Company D is identified as the acquirer not only because it paid cash but also because the new owners of Company D have obtained control of Companies B and C from Company A.

Identification of the acquiring enterprise is very critical and the accounting may change significantly if the accounting acquirer is different than legal acquirer.

9. DETERMINING THE ACQUISITION DATE

The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

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.

The acquisition date is a very important step in the business combination accounting because it determines when the acquirer recognises and measures the consideration, the assets acquired and liabilities assumed. The acquiree’s results are consolidated from this date. The acquisition date materially impacts the overall acquisition accounting, including post-combination earnings.

The acquisition date is often readily apparent from the structure of the business combinations and the terms of the sale and purchase agreement (if applicable) but this is not always the case.

Acquisition date will be the date on which the acquirer obtains control.
Example
Company A acquired 80% equity interest in Company B for cash consideration. The relevant dates are as under:

- Date of shareholder agreement: 1st June, 20X1
- Appointed date as per shareholder agreement: 1st April, 20X1
- Date of obtaining control over the board representation: 1st July, 20X1
- Date of payment of consideration: 15th July, 20X1
- Date of transfer of shares to Company A: 1st August, 20X1

In this case, as the control over financial and operating policies are acquired through obtaining board representation on 1st July, 20X1, it is this date that is considered as the acquisition date. It may be noted that the appointed date as per the agreement is not considered as the acquisition date, as Company A did not have control over Company B as at that date.

Illustration 6
Can an acquiring entity account for a business combination based on a signed non-binding letter of intent where the exchange of consideration and other conditions are expected to be completed with 2 months?

Solution
No. as per the requirement of the standard a non-binding Letter of Intent (LOI) does not effectively transfer control and hence this cannot be considered as the basis for determining the acquisition date.

Illustration 7
On 1st April, X Ltd. agrees to acquire the share of B Ltd. in an all equity deal. As per the binding agreement X Ltd. will get the effective control on 1st April. However, the consideration will be paid only when the shareholders’ approval is received. The shareholders meeting is scheduled to happen on 30th April. If the shareholders’ approval is not received for issue of new shares, then the consideration will be settled in cash. What is the acquisition date?

Solution
The acquisition date in the above case is 1st April. This is because, in the above scenario, even if the shareholders don’t approve the shares, consideration will be settled through payment of cash.

Illustration 8 : Business Combination without a Court approved scheme
ABC Ltd. acquired all the shares of XYZ Ltd. The negotiations had commenced on 1st January, 20X1 and the agreement was finalised on 1st March, 20X1. While ABC Ltd. obtains the power to control XYZ Ltd.'s operations on 1st March, 20X1, the agreement states that the acquisition is
What is the date of acquisition?

Solution

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 that 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. 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.

Therefore, in this case, notwithstanding that the price is based on the net assets at 1st January, 20X1 and that XYZ Ltd.’s shareholders do not receive any dividends after that date, the date of acquisition for accounting purposes will be 1st March, 20X1. It is only on 1st March, 20X1 and not 1st January, 20X1, that ABC Ltd. 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 1st March, 20X1.

Illustration 9 : Acquisition date- Regulatory approval

ABC Ltd. and 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)?

Solution

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.

*****

10. STEP ACQUISITIONS

In the case an entity acquires an entity step by step through series of purchase then the acquisition date will be the date on which the acquirer obtains control. Till the time the control is obtained the investment will be accounted as per the requirements of other Ind AS 109, if the investments are covered under that standard or as per Ind AS 28, if the investments are in Associates or Joint Ventures.

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.

11. DETERMINATION OF THE PURCHASE CONSIDERATION

The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the total of the acquisition-date fair values of the assets (including cash) transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, contingent consideration, ordinary or preference equity instruments, options, warrants and member interests of mutual entities.

Exception to the fair value in determination of Purchase consideration

However, any portion of the acquirer's share-based payment awards exchanged for awards held by the acquiree's employees that is included in consideration transferred in the business combination shall be measured in accordance with the requirements of Ind AS 102, Share Based payments.
The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a business of the acquirer). If so, the acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in profit or loss.

This means that if the acquirer has transferred a land as a part of the business combination arrangement to the owners of the acquiree then the fair value of the land will be considered in determining the fair value of the consideration. Consequently, the land will be de-recognised in the financial statements of the acquirer and the difference between the carrying amount of the land and the fair value considered for purchase consideration will be recorded in profit and loss.

However, sometimes the transferred assets or liabilities remain within the combined entity after the business combination (for example, because the assets or liabilities were transferred to the acquiree rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in profit or loss on assets or liabilities it controls both before and after the business combination.

### 11.1 A Business Combination achieved in Stages (Step Acquisition)

An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date.

**Example:**

On 31st December 20X1, Entity A holds a 35 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity B. This transaction is referred as a business combination achieved in stages, sometimes also referred to as a step acquisition.

In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. As per Ind AS 109 or Ind AS 27, an entity can elect to measure investments in equity instruments at fair value through other comprehensive income. However, once elected all gains and losses on that investment even on sale is recognized in OCI. Therefore, if the investment is designated as fair value through OCI, the resulting gain or loss, if any, will be recognized in OCI.

*When a party to a joint operation, obtains control of a joint operation business, the transaction will be considered as a business combination achieved in stages. The acquirer should re-measure its previously held interest in the joint operation at fair value at the acquisition date.*
Illustration 10

On 1st April, 20X1, PQR Ltd. acquired 30% of the voting ordinary shares of XYZ Ltd. for ₹ 8,000 crore. PQR Ltd. accounts its investment in XYZ Ltd. using equity method as prescribed under Ind AS 28. At 31st March, 20X2, PQR Ltd. recognised its share of the net asset changes of XYZ Ltd. using equity accounting as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>₹ (in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of profit or loss</td>
<td>700</td>
</tr>
<tr>
<td>Share of exchange difference in OCI</td>
<td>100</td>
</tr>
<tr>
<td>Share of revaluation reserve of PPE in OCI</td>
<td>50</td>
</tr>
</tbody>
</table>

The carrying amount of the investment in the associate on 31st March, 20X2 was therefore ₹ 8,850 crore (8,000 + 700 + 100 + 50).

On 1st April, 20X2, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash ₹ 25,000 crore. The following additional information is relevant at that date:

<table>
<thead>
<tr>
<th>Description</th>
<th>₹ (in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of the 30% interest already owned</td>
<td>9,000</td>
</tr>
<tr>
<td>Fair value of XYZ's identifiable net assets</td>
<td>30,000</td>
</tr>
</tbody>
</table>

How should such business combination be accounted for?

Solution

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 recognized 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:

<table>
<thead>
<tr>
<th>Description</th>
<th>₹ (in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>Dr.</td>
<td>Dr.</td>
</tr>
<tr>
<td>Identifiable net assets of XYZ Ltd.</td>
<td>30,000</td>
</tr>
<tr>
<td>Goodwill (W.N.1)</td>
<td>4,000</td>
</tr>
<tr>
<td>Foreign currency translation reserve</td>
<td>100</td>
</tr>
<tr>
<td>PPE revaluation reserve</td>
<td>50</td>
</tr>
<tr>
<td>To Cash</td>
<td>25,000</td>
</tr>
<tr>
<td>To Investment in associate -XYZ Ltd.</td>
<td>8,850</td>
</tr>
<tr>
<td>To Retained earnings (W.N.2)</td>
<td>50</td>
</tr>
</tbody>
</table>
To Gain on previously held interest in XYZ recognised in Profit or loss (W.N.3)
(To recognise acquisition of XYZ Ltd.)

Working Notes:
1. Calculation of Goodwill

<table>
<thead>
<tr>
<th>₹ in crore</th>
<th>₹ in crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash consideration</td>
<td>25,000</td>
</tr>
<tr>
<td>Add: Fair value of previously held equity interest in XYZ Ltd.</td>
<td>9,000</td>
</tr>
<tr>
<td>Total consideration</td>
<td>34,000</td>
</tr>
<tr>
<td>Less: Fair value of identifiable net assets acquired</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Goodwill</td>
<td>4,000</td>
</tr>
</tbody>
</table>

2. The credit to retained earnings represents the reversal of the unrealized gain of ₹ 50 crore 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:

<table>
<thead>
<tr>
<th>₹ in crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair Value of 30% interest in XYZ Ltd. at 1st April, 20X2</td>
</tr>
<tr>
<td>Carrying amount of interest in XYZ Ltd. at 1st April, 20X2</td>
</tr>
<tr>
<td>Unrealised gain previously recognised in OCI</td>
</tr>
<tr>
<td>Gain on previously held interest in XYZ Ltd. recognised in profit or loss</td>
</tr>
</tbody>
</table>

11.2 A Business Combination achieved without the Transfer of Consideration

An acquirer sometimes obtains control of an acquiree without transferring consideration. The acquisition method of accounting for a business combination applies to those combinations. Such circumstances include:

(a) The acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control.

(b) Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights.

(c) The acquirer and acquiree agree to combine their businesses by contract alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity
interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual listed corporation.

In a business combination achieved by contract alone, the acquirer shall attribute to the owners of the acquiree the amount of the acquiree’s net assets recognised in accordance with this Indian Accounting Standard. 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.

11.3 Direct Cost of Acquisition

The direct cost of acquisition is not included in determination of the purchase consideration. Cost which include like finder’s fees, due diligence cost accounting, legal fees, investment banker fees, even bonuses paid to employees for doing a successful acquisition will not be included in the cost of acquisition.

Illustration 11

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?

*****

Solution

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.

Note: 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.

Illustration 12

ABC Ltd. acquires PQR Ltd. on 30th June, 20X1. 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?

Solution

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 payment to the regulator represents a transaction cost and will be regarded as acquisition related cost incurred to effect the business combination. Applying the requirements of para 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 to be capitalised as part of the intangible asset as per the requirements of Ind AS 38, Intangible Assets.

11.4 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.

The acquirer shall classify an obligation to pay contingent consideration as a liability or as equity on the basis of the definitions of an equity instrument and a financial liability in accordance with the requirement of Ind AS 32 Financial Instruments: Presentation, or other applicable Indian Accounting Standards. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met.

**Example:**

Company A acquires Company B in April, 20X1 for cash. The acquisition agreement states that an additional ₹ 20 million of cash will be paid to B’s former shareholders if B succeeds in achieving certain specified performance targets. A determines the fair value of the contingent consideration liability to be 15 million at the acquisition date. At a later date, the probability of meeting the said performance target becomes lower.

As certain consideration is based on achieving certain performance parameters in future, the consideration is contingent on achieving those parameters. As such, the transaction involves contingent consideration. Further, since the consideration is to be settled for a variable amount in cash, such consideration would be in the nature of financial liability rather than equity.

As at the acquisition date, the acquirer should consider the acquisition date fair value of contingent consideration as part of business combination. Accordingly, such recognition would increase goodwill (or reduce gain on bargain purchase, as the case may be).

In the above example, if the chance of meeting the performance criteria becomes less probable, then in such a case, the contingent consideration in the nature of financial liability should be remeasured and the impact for the change in the fair value should be recognised in statement of profit and loss.
12. PURCHASE PRICE ALLOCATION

12.1 Recognition of Assets and Liabilities of the Acquired Entity

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.

The most important principle in a purchase price allocation exercise is to recognize and measure all the assets and liabilities acquired on the acquisition date.

12.1.1 Recognition

Following conditions have to be considered while recognising the assets and liabilities of the acquire:

- To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards issued by the Institute of Chartered Accountants of India at the acquisition date. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post combination financial statements in accordance with other Ind AS.

- Acquirer should only record the assets and liabilities recorded as a part of the business combination which means only those assets and liabilities which have been assumed as a part of the business combination deal should only be recorded and not any other assets which are not related to the acquisition to which other applicable Ind AS should be applied.

- When the acquirer applies the recognition principle under business combination it may record certain assets and liabilities which the acquiree had not recorded earlier in their financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

There are certain exceptions to specific assets and liabilities which have been discussed below.

- The assets and liabilities has to be classified as per the requirement of applicable Ind AS which will depend on the contractual terms, economic conditions etc.

- In some situations, Ind AS provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:
• classification of particular financial assets and liabilities as measured at fair value through profit or loss or at amortised cost, or as a financial asset measured at fair value through other comprehensive income in accordance with Ind AS 109, Financial Instruments;

• designation of a derivative instrument as a hedging instrument in accordance with Ind AS 109; and

• assessment of whether an embedded derivative should be separated from a host contract in accordance with Ind AS 109 (which is a matter of ‘classification’ as this Ind AS uses that term).

The only exception to the above principle is that for lease contract (in which acquiree is the lessor as either an operating lease or a finance lease) and insurance contracts classification will be based on the basis of the conditions existing at inception and not on acquisition date.

12.2 Measurement Principle

The assets and liabilities recognized based on the aforesaid recognition principles has to be measured based on the following principles:

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

• For each business combination, the acquirer shall measure at the acquisition date components of non-controlling interest (under existing AS it is called as minority 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:
  
  • fair value; or

  • 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.

12.2.1 Exception to the recognition or measurement principle

The exception principles laid out in this standard for recognition or measurement of certain assets and liabilities are only limited to acquisition date accounting and may be different than the requirements of other accounting standards. The application of the above principles may result in two scenarios:

• An asset or liability which otherwise would not have been recorded gets recorded.

• The assets and liabilities are measured at a value other than the acquisition date fair values.

<table>
<thead>
<tr>
<th>Items</th>
<th>Guidance under Ind AS 103</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contingent liability</td>
<td>Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, defines a contingent liability as:</td>
</tr>
</tbody>
</table>
(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) a present obligation that arises from past events but is not recognised because:

i. it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

ii. the amount of the obligation cannot be measured with sufficient reliability.

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.

Example
A suit for damages worth ₹ 10 million was filed on Company B for alleged breach of certain contract provisions. Company B had disclosed the same as a contingent liability in its financial statements, as it considered that it is a present obligation for which it was not probable that the amount would be payable. Company A acquire Company B and determines the fair value of the contingent liability to be ₹ 2 million.

Company A would recognise ₹ 2 million in its financial statements as part of acquisition accounting, even if it is not probable that payment will be required to settle the obligation.

Income taxes
As per the requirement of Ind AS 12, no deferred tax consequence should be recorded on initial recognition of deferred tax except assets and liabilities acquired during business combination. Accordingly, the acquirer shall 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.
The acquirer shall account for the potential tax effects of temporary differences and carry forwards of an acquiree that exist at the acquisition date or arise as a result of the acquisition in accordance with Ind AS 12.

| Employee benefits | The acquirer records the fair value of the obligations for any post retirement obligation as per the principles of Ind AS 19 which is an exception of the general fair value rule. |
| Indemnification assets | 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. |

**Example:**

Company A acquires Company B in a business combination on 1st April, 20X1. B is being sued by one of its customers for breach of contract for ₹ 250. The sellers of B provide an indemnification to A for the reimbursement of any losses greater than ₹ 100. There are no collectability issues around this indemnification. At the acquisition date, Company A determined that there is a present obligation and therefore the fair value of the contingent liability of ₹ 250 is recognised by A in the acquisition accounting. In the acquisition accounting A also recognises an indemnification asset of ₹ 150 (₹ 250 - ₹ 100).

**Illustration 13**

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

How should ABC Ltd. account for the contingent liability and the indemnification asset? What if the fair value of the liability is ₹ 1.2 crore instead of ₹ 70 lakh.
Solution

In the current scenario, ABC Ltd. measures the identifiable liability of entity PQR Ltd. at ₹ 70 lakh and also recognises a corresponding indemnification asset of ₹ 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 ₹ 1 crore ie. ₹ 1.2 crore, the indemnification asset will be limited to ₹ 1 crore only.

Illustration 14

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

Solution

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.

Reacquired rights

These are the rights which the acquirer before acquisition may have granted to the acquiree to use certain assets which belongs to the acquirer. It does not matter whether the asset was recorded in the financial statement of the acquirer or not. For example, license to use the brand name, Franchisee rights etc. if an acquirer acquires an acquiree which had certain rights granted to it by the acquirer then the business combination results in settlement of the right and accordingly any settlement gain or loss should be considered as a separate transaction from business combination and will be recorded in the financial statement of the acquirer.

The acquirer shall measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the related contract without considering the effect of potential renewals.
| Intangible assets | The acquirer shall record separately from Goodwill, the identifiable intangible acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion. (Refer a section below on intangible asset highlighting detailed guidance on recognition and measurement criteria) |
| Share based payment transactions | The acquirer shall measure a liability or an equity instrument related to share-based payment transactions of the acquiree or the replacement of an acquiree’s share-based payment transactions with share-based payment transactions of the acquirer in accordance with the method in Ind AS 102, Share-based Payment, at the acquisition date. |
| Assets held for sale | The acquirer shall measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, at fair value less costs to sell in accordance with that Ind AS. |
| Leases | **Acquiree is a lessee**  
- The acquirer shall recognise right-of-use assets and lease liabilities for leases identified in accordance with Ind AS 116.  
- The acquirer is not required to recognise right-of-use assets and lease liabilities for:  
  (a) leases for which the lease term ends within 12 months of the acquisition date; or  
  (b) leases for which the underlying asset is of low value.  
- The acquirer shall measure the lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the acquisition date.  
- The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms.  
**Acquiree is a lessor**  
In measuring the acquisition-date fair value of an asset, the acquirer shall take into account the terms of the lease. The acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms. |
| Assembled workforce | 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.

<table>
<thead>
<tr>
<th>Unearned revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unearned revenue arises because of the application of the revenue recognition criteria applied by the acquiree. It should be evaluated whether there is any obligation on the acquisition date to be fulfilled and accordingly an asset or liability against it should be recorded.</td>
</tr>
</tbody>
</table>

![Diagram](image)
12.3 Intangible Assets

As explained above an intangible asset should be recorded separately from Goodwill if either the separability criteria is met or it arises out of contractual legal criterion.

12.3.1 Contractual Legal criterion

An intangible asset that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations.

For example:

a. an acquiree owns and operates a nuclear power plant. The licence to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

b. an acquiree owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future revenue in foreign exchange. Both the technology patent and the related licence agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related licence agreement separately from one another would not be practical.

12.3.2 Separability criteria

The separability criterion means that an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability. An intangible asset that the acquirer would be able to sell, license or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, license or otherwise exchange it. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them.

Example:

Customer and subscriber lists are frequently licensed and thus meet the separability criterion. Even if an acquiree believes its customer lists have characteristics different from other customer lists, the fact that customer lists are frequently licensed generally means that the acquired customer list meets the separability criterion. However, a customer list acquired in a business combination would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers.

An intangible asset that is not individually separable from the acquiree or combined entity meets the separability criterion if it is separable in combination with a related contract, identifiable asset or liability.
For example:

a. market participants exchange deposit liabilities and related depositor relationship intangible assets in observable exchange transactions. Therefore, the acquirer should recognise the depositor relationship intangible asset separately from goodwill.

b. an acquiree owns a registered trademark and documented but unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquiree or combined entity and sold if the related trademark is sold, it meets the separability criterion.

Accordingly, as per the guidance above it follows that identification of intangible asset will be judgemental and will vary in each case.

Following are the possible sources of information and broad indicator to be used to identify any possible intangible separately from goodwill:

A. Internal sources:

- **Financial statements of the acquiree**- significant R&D cost may be indicator that there may be possible technology related intangible.

- Significant sales promotion or marketing cost- this is a strong indicator of marketing related intangible like distributor network, Marketing collaterals etc.

- Customer acquisition cost- lot of company spend money to acquire new customers like online e-commerce companies provide incentive to register a customer as a first time user or download their app. That may be a strong indicator of existence of customer list as an intangible.

- **Share purchase agreement**- This can also be a strong indicator of existence of any technical know-how, trademarks or patent which are included in the agreement can provide a indicator of an existence of an intangible.

- **Purpose of acquisition**- The reason for acquisition may also indicate the possible intangible to be recorded. For e.g. Coca Cola acquired Thumps Up with an intention to close the brand which will result in increase in its market share. Accordingly, this will also be a possible intangible asset.

**Illustration 15**

*Company A, FMCG company acquires an online e-commerce company E, with the intention to start doing retailing. The e-commerce company has over the period have 10 million registered users. However, the e-commerce company E does not have any intention to sale the customer list. Should this customer list be recorded as an intangible in a business combination?*
Solution

In this situation the customer database does not give rise to legal or contractual right. Accordingly, the assessment of its separability will be assessed. The database can be useful to other players and E has the ability to transfer this to them. Accordingly, the intention not to transfer will not affect the assessment whether to record this as an intangible or not.

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Illustration 16

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.?

Solution

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

Paragraph 21 of Ind AS 38 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 8 and are recognised. The approval means it is probable that future economic benefits will flow to ABC Ltd. 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.

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12.3.3 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.

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.

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.

After initial recognition, an acquirer accounts for intangible assets acquired in a business combination in accordance with the provisions of Ind AS 38, Intangible Assets. However, as described in paragraph 3 of Ind AS 38, the accounting for some acquired intangible assets after initial recognition is prescribed by other Ind AS.
The identifiability criteria determine whether an intangible asset is recognised separately from goodwill. However, the criteria neither provides 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.

### 12.4 Reacquired Rights

As part of a business combination, 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. Examples of such rights include a right to use the acquirer’s trade name under a franchise agreement or a right to use the acquirer’s technology under a technology licensing agreement. A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill.

If the terms of the contract giving rise to a reacquired right are favourable or unfavourable relative to the terms of current market transactions for the same or similar items, the acquirer shall recognise a settlement gain or loss.

**Illustration 17**

Vadapav Ltd. is a successful company has number of own stores across India and also offers franchisee to other companies. Efficient Ltd. is one of the franchisee of Vadapav Ltd. and is and operates number of store in south India. Vadapav Ltd. decided to acquire Efficient Ltd due to its huge distribution network and accordingly purchased the outstanding shares on 1st April, 20X2. On the acquisition date, Vadapav Ltd. determines that the license agreement reflects current market terms.

**Solution**

Vadapav will record the franchisee right as an intangible asset (reacquired right) while doing purchase price allocation and since it is at market terms no gain or loss will be recorded on settlement.

**Illustration 18**

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

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

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

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 `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:

- `3,00,000, which is the amount by which the right is unfavorable to ABC Ltd. compared to market terms. This is the difference between the amount that ABC Ltd. could receive for granting a similar right, `4,50,000, compared to the carrying value (or the unamortised value) that it was granted for, `1,50,000 (2,50,000 X 6/10).

- `1,80,000, which is the amount that ABC Ltd. would have to pay to terminate the right at the date of acquisition.

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

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12.5 Goodwill – Recognition and Measurement

The acquirer shall recognise Goodwill as of the acquisition date measured as the excess of (a) over (b) below:

a) the aggregate of:
   i. the purchase consideration transferred at acquisition-date fair value;
   ii. the amount of any non-controlling interest in the acquiree measured in accordance with this Ind AS (refer Non-controlling section); 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.

b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Ind AS.

In a business combination in which the acquirer and the acquiree (or its former owners) exchange only equity interests, the acquisition-date fair value of the acquiree’s equity interests may be more reliably measurable than the acquisition-date fair value of the acquirer’s equity interests. If so, the acquirer shall determine the amount of goodwill by using the acquisition-date fair value of the acquiree’s equity interests instead of the acquisition-date fair value of the equity interests transferred. To determine the amount of goodwill in a business combination in which no consideration is transferred, the acquirer shall use the acquisition-date fair value of the acquirer’s interest in the acquiree in place of the acquisition-date fair value of the consideration transferred (paragraph 32(a)(i)).

12.6 Bargain Purchase

In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the net assets value acquired in a business combination exceeds the purchase consideration.

The acquirer shall recognise the resulting gain in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve, if the reason for bargain purchase gain is not clear. The gain shall be attributed to the acquirer and there will no allocation to the non-controlling shareholders.

A bargain purchase might happen, for example, in a business combination that is a forced sale in which the seller is acting under compulsion.

The Ind AS itself acknowledges that it is very rare that a bargain purchase in a business combination will arise and accordingly the standard re-emphasise the above point by requiring the entities to reassess and identify the clear reason why it is a bargain purchase business combination. For e.g. acquisition of business in a bankruptcy sale, or sale of business due to a regulatory requirement.

Example:

Entity X is one of the largest liquor manufacturing company in the world and it acquires another Entity Y which has significant presence in India and UK. However, the competition commission
in UK has issued orders to sell one division of the UK assets of Entity Y in order to comply with the local competition regulation in UK within a specified timeline. Entity Z another boutique liquor manufacturer realises the opportunity and purchase the assets of Entity Y from Entity X. In the given case above it is more likely than not that there could be an element of bargain purchase as the Entity X was under compulsion to sell the assets within a specified timeline.

As mentioned above 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:

- the identifiable assets acquired and liabilities assumed;
- the non-controlling interest in the acquiree, if any;
- for a business combination achieved in stages, the acquirer’s previously held equity interest in the acquiree; and
- 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.

Illustration 19

On 1st January, 20X1, A Ltd. acquires 80 per cent of the equity interests of B Ltd. in exchange for cash of ₹ 15 crore. 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 ₹ 20 crore and the fair value of the 20 per cent non-controlling interest in B Ltd. at ₹ 4.2 crore. How should A Ltd. recognise the above bargain purchase?

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Solution

The amount of B Ltd.’s identifiable net assets i.e., ₹ 20 crore exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in B Ltd. i.e. ₹ 19.2 crore. 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 ₹ 80 lakh, as the difference between the amount of the identifiable net assets which is ₹ 20 crore and the sum of purchase consideration and fair value of non-controlling interest, which is ₹ 19.2 crore (cash consideration of ₹ 15 crore and fair value of non-controlling interest of ₹ 4.2 crore).
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 ₹ 80 lakh, 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 ₹ 4 crore (₹ 20 crore × 0.20). The gain on the bargain purchase then would be ₹ 1 crore (₹ 20 crore – (₹ 15 crore + ₹ 4 crore)).

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12.7 Measurement Period

Ind AS 103 provides a measurement period window wherein if all the required information is not available on the acquisition date then the entity will be required to do the purchase price allocation on a provision basis. 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.

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.

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:

• the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;
• the consideration transferred for the acquiree (or the other amount used in measuring goodwill);
• in a business combination achieved in stages, the equity interest in the acquire previously held by the acquirer; and
• the resulting goodwill or gain on a bargain purchase.

Any change i.e. increase and decrease in the net assets acquired due to new information available during the measurement period which existed on the acquisition date will be adjusted against goodwill.

However, after the measurement period ends, any change in the value of assets and liabilities due to an information which existed on the valuation date will be accounted as an error as per Ind AS 8, Accounting policies, Changes in Accounting Estimates and Errors.
Illustration 20

Entity X acquired 100% shareholding of Entity Y on 1st April, 20X1 and had completed the preliminary purchase price allocation and accordingly recorded net assets of ₹ 100 million against the purchase consideration of 150 million. Entity Y had significant carry forward losses on which deferred tax asset was not recorded due to lack of convincing evidence on the acquisition date. However, on 31st March, 20X2, Entity Y won a significant contract which is expected to generate enough taxable income to recoup the losses. Accordingly, the deferred tax asset was recorded on the carry forward losses on 31st March, 20X2. Whether the aforesaid losses can be adjusted with the Goodwill recorded based on the preliminary purchase price allocation?

Solution

No, as per the requirement of Ind AS 103, changes to the net assets are allowed which results from the discovery of a fact which existed on the acquisition date. However, change of facts resulting in recognition and de-recognition of assets and liabilities after the acquisition date will be accounted in accordance with other Ind AS. In the above scenario deferred tax asset was not eligible for recognition on the acquisition date and accordingly the new contract on 31st March, 20X2 will tantamount to change of estimate and accordingly will not impact the Goodwill amount.

Illustration 21

ABC Ltd. acquires XYZ Ltd. in a business combination on 15th January, 20X1. 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 ₹ 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, 20X1 (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 ₹ 2 crore.

ABC Ltd. continues to receive and evaluate information related to the claim after October, 20X1. Its evaluation doesn’t change till February, 20X2 (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 ₹ 1.9 crore. ABC Ltd. 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, 20X2 is ₹ 2.2 crore.

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

Solution

The consolidated financial statements of ABC Ltd. for the year ended 31st March, 20X1 should include ₹ 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 ₹ 1 crore (₹ 2 crore – ₹ 1 crore) 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 31st March, 20X2, ABC Ltd. will disclose the amounts and explanations of the adjustments to the provisional values recognized during the current reporting period. Therefore, it will disclose that the comparative information for the year ending on 31st March, 20X1 is adjusted retrospectively to increase the fair value of the item of liability at the acquisition date by ₹ 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, 20X2 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 ₹ 20 lakh (₹ 2.2 crore– ₹ 2 crore) is recognised in profit or loss.

12.8 Determining what is part of the Business Combination Transaction

The acquirer and the acquiree may have a pre-existing relationship or other arrangement before negotiations for the business combination began, or they may enter into an arrangement during the negotiations that is separate from the business combination. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination, ie amounts that are not part of the exchange for the acquiree. The acquirer shall recognise as part of applying the acquisition method only the consideration transferred for the acquiree and the assets acquired and liabilities assumed in the exchange for the acquiree. Separate transactions shall be accounted for in accordance with the relevant Ind AS.

A transaction entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquiree (or its former owners) before the combination, is likely to be a separate transaction. The following are examples of separate transactions that are not to be included in applying the acquisition method:

- a transaction that in effect settles pre-existing relationships between the acquirer and acquiree;
- a transaction that remunerates employees or former owners of the acquiree for future services; and
- a transaction that reimburses the acquiree or its former owners for paying the acquirer’s acquisition-related costs.

The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, in determining whether the transaction is separate from Business combination:
I. **The reasons for the transaction**—Understanding the reasons why the parties to the combination (the acquirer and the acquiree and their owners, directors and managers and their agents) entered into a particular transaction or arrangement may provide insight into whether it is part of the consideration transferred and the assets acquired or liabilities assumed. For example, if a transaction is arranged primarily for the benefit of the acquirer or the combined entity rather than primarily for the benefit of the acquiree or its former owners before the combination, that portion of the transaction price paid (and any related assets or liabilities) is less likely to be part of the exchange for the acquiree. Accordingly, the acquirer would account for that portion separately from the business combination.

II. **Who initiated the transaction**—Understanding who initiated the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquiree or its former owners before the combination. On the other hand, a transaction or arrangement initiated by the acquiree or its former owners is less likely to be for the benefit of the acquirer or the combined entity and more likely to be part of the business combination transaction.

III. **The timing of the transaction**—The timing of the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction between the acquirer and the acquiree that takes place during the negotiations of the terms of a business combination may have been entered into in contemplation of the business combination to provide future economic benefits to the acquirer or the combined entity. If so, the acquiree or its former owners before the business combination are likely to receive little or no benefit from the transaction except for benefits they receive as part of the combined entity.

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**Illustration 22**

*Progressive Ltd is being sued by Regressive Ltd for an infringement of its Patent. At 31st March, 20X2, Progressive Ltd recognised a `10 million liability related to this litigation.*

*On 30th July, 20X2, Progressive Ltd acquired the entire equity of Regressive Ltd for `500 million. On that date, the estimated fair value of the expected settlement of the litigation is `20 million.*

**Solution**

In the above scenario the litigation is in substance settled with the business combination transaction and accordingly the `20 million being the fair value of the litigation liability will be considered as paid for settling the litigation claim and will be not included in the business combination. Accordingly, the purchase price will reduce by 20 million and the difference between 20 and 10 will be recorded in income statement of the Progressive limited as loss on settlement of the litigation.

*****
12.9 Contingent Payments to Employee Shareholders

Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions depends on the nature of the arrangements. Understanding the reasons why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement.

If it is not clear 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, the acquirer should consider the following indicators:

a) **Continuing employment**—The terms of continuing employment by the selling shareholders who become key employees may be an indicator of the substance of a contingent consideration arrangement. The relevant terms of continuing employment may be included in an employment agreement, acquisition agreement or some other document. 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.

b) **Duration of continuing employment**—If the period of required employment coincides with or is longer than the contingent payment period, that fact may indicate that the contingent payments are, in substance, remuneration.

c) **Level of remuneration**—Situations in which employee remuneration other than the contingent payments is at a reasonable level in comparison with that of other key employees in the combined entity may indicate that the contingent payments are additional consideration rather than remuneration.

d) **Incremental payments to employees**—If selling shareholders who do not become employees receive lower contingent payments on a per-share basis than the selling shareholders who become employees of the combined entity, that fact may indicate that the incremental amount of contingent payments to the selling shareholders who become employees is remuneration.

e) **Number of shares owned**—The relative number of shares owned by the selling shareholders who remain as key employees may be an indicator of the substance of the contingent consideration arrangement. For example, if the selling shareholders who owned substantially all of the shares in the acquiree continue as key employees, that fact may indicate that the arrangement is, in substance, a profit sharing arrangement intended to provide remuneration for post-combination services. Alternatively, if selling shareholders who continue as key employees owned only a small number of shares of the acquiree and all selling shareholders receive the same amount of contingent consideration on a per-share basis, that fact may indicate that the contingent payments are additional consideration. The pre-acquisition ownership interests held by parties related to selling shareholders who continue as key employees, such as family members, should also be considered.
f) **Linkage to the valuation**—If the initial consideration transferred at the acquisition date is based on the low end of a range established in the valuation of the acquire and the contingent formula relates to that valuation approach, that fact may suggest that the contingent payments are additional consideration. Alternatively, if the contingent payment formula is consistent with prior profit-sharing arrangements, that fact may suggest that the substance of the arrangement is to provide remuneration.

g) **Formula for determining consideration**—The formula used to determine the contingent payment may be helpful in assessing the substance of the arrangement. For example, if a contingent payment is determined on the basis of a multiple of earnings, that might suggest that the obligation is contingent consideration in the business combination and that the formula is intended to establish or verify the fair value of the acquiree. In contrast, a contingent payment that is a specified percentage of earnings might suggest that the obligation to employees is a profit sharing arrangement to remunerate employees for services rendered.

h) **Other agreements and issues**—The terms of other arrangements with selling shareholders (such as agreements not to compete, executory contracts, consulting contracts and property lease agreements) and the income tax treatment of contingent payments may indicate that contingent payments are attributable to something other than consideration for the acquiree. For example, in connection with the acquisition, the acquirer might enter into a property lease arrangement with a significant selling shareholder. If the lease payments specified in the lease contract are significantly below market, some or all of the contingent payments to the lessor (the selling shareholder) required by a separate arrangement for contingent payments might be, in substance, payments for the use of the leased property that the acquirer should recognise separately in its post-combination financial statements. In contrast, if the lease contract specifies lease payments that are consistent with market terms for the leased property, the arrangement for contingent payments to the selling shareholder may be contingent consideration in the business combination.

**Illustration 23**

KKV Ltd acquires a 100% interest in VIVA Ltd, a company owned by a single shareholder who is also the KMP in the Company, for a cash payment of USD 20 million and a contingent payment of USD 2 million. The terms of the agreement provide for payment 2 years after the acquisition if the following conditions are met:

- the EBIDTA margins of the Company after 2 years after the acquisition is 21%.
- the former shareholder continues to be employed with VIVA Ltd for at least 2 years after the acquisition. No part of the contingent payment will be paid if the former shareholder does not complete the 2 year employment period.

**Solution**

In the above scenario the former shareholder is required to continue in employment and the contingent consideration will be forfeited if the employment is terminated or if he resigns.
Accordingly, only USD 20 million is considered as purchase consideration and the contingent consideration is accounted as employee cost and will be accounted as per the other Ind AS.

****

**Illustration 24: Contingent consideration- Payments to employees who are former owners of acquiree**

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

**Solution**

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

****

**12.10 Acquirer Share Based Payment Awards Exchanged for Awards held by the Acquiree’s Employees**

- An acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree.
- The above share based payment awards will include vested and unvested shares.
- Exchanges of share options or other share-based payment awards in conjunction with a business combination are accounted for as modifications of share-based payment awards in accordance with Ind AS 102, Share based Payment.
• If the acquirer replaces the acquiree awards, either all or a portion of the market-based measure of the acquirer’s replacement awards shall be included in measuring the consideration transferred in the business combination. Market based measure means that awards will be re-measured on the acquisition date as per the requirements of Ind AS 102.

• In situations in which acquiree awards would expire as a consequence of a business combination and if the acquirer replaces those awards when it is not obliged to do so, all of the market-based measure of the replacement awards shall be recognised as remuneration cost in the post-combination financial statements in accordance with Ind AS 102. That is to say, none of the market-based measure of those awards shall be included in measuring the consideration transferred in the business combination. The acquirer is obliged to replace the acquiree awards if the acquiree or its employees have the ability to enforce replacement.

For example, for the purposes of applying this guidance, the acquirer is obliged to replace the acquiree’s awards if replacement is required by:

(a) the terms of the acquisition agreement;
(b) the terms of the acquiree’s awards; or
(c) applicable laws or regulations.

• To determine the portion of a replacement award that is part of the consideration transferred for the acquiree and the portion that is remuneration for post-combination service, the acquirer shall measure both the replacement awards granted by the acquirer and the acquiree awards as of the acquisition date in accordance with Ind AS 102. The portion of the market-based measure of the replacement award that is part of the consideration transferred in exchange for the acquiree equals the portion of the acquiree award that is attributable to pre-combination service.

• The portion of the replacement award attributable to pre-combination service is the market-based measure of the acquiree award multiplied by the ratio of the portion of the vesting period completed to the greater of the total vesting period or the original vesting period of the acquiree award. The vesting period is the period during which all the specified vesting conditions are to be satisfied. Vesting conditions are defined in Ind AS 102.

• The portion of a non-vested replacement award attributable to post-combination service, and therefore recognised as remuneration cost in the post-combination financial statements, equals the total market-based measure of the replacement award less the amount attributed to pre-combination service. Therefore, the acquirer attributes any excess of the market-based measure of the replacement award over the market-based measure of the acquiree award to post-combination service and recognises that excess as remuneration cost in the post-combination financial statements.

• The acquirer shall attribute a portion of a replacement award to post-combination service if it requires post combination service, regardless of whether employees had rendered all of the service required for their acquiree awards to vest before the acquisition date.
• The portion of a non-vested replacement award attributable to pre-combination service, as well as the portion attributable to post-combination service, shall reflect the best available estimate of the number of replacement awards expected to vest.

For example, if the market-based measure of the portion of a replacement award attributed to pre-combination service is ₹ 100 and the acquirer expects that only 95 per cent of the award will vest, the amount included in consideration transferred in the business combination is ₹ 95.

• Changes in the estimated number of replacement awards expected to vest are reflected in remuneration cost for the periods in which the changes or forfeitures occur not as adjustments to the consideration transferred in the business combination. Similarly, the effects of other events, such as modifications or the ultimate outcome of awards with performance conditions, that occur after the acquisition date are accounted for in accordance with Ind AS 102 in determining remuneration cost for the period in which an event occurs.

• The same requirements for determining the portions of a replacement award attributable to pre-combination and post-combination service apply regardless of whether a replacement award is classified as a liability or as an equity instrument in accordance with the provisions of Ind AS 102. All changes in the market-based measure of awards classified as liabilities after the acquisition date and the related income tax effects are recognised in the acquirer’s post-combination financial statements in the period(s) in which the changes occur.

• The income tax effects of replacement awards of share-based payments shall be recognised in accordance with the provisions of Ind AS 12, Income Taxes.

The above guidance on Share based payment as per the Ind AS 103 can be summarized as follows:

### Pre-combination period

- **Computation**: Market-based measure multiplied by ratio of the vesting period completed as on the acquisition date to the greater of original vesting period or revised vesting period (refer example below)
- **The value as computed above is included in Purchase consideration.**

### Post-combination

- **Computation**: The difference between the fair value of the award on the date of acquisition date and the value allocated to pre-combination period
- **The incremental amount is allocated to post combination period as a service cost over the remaining vesting period.**
Illustration 25

Green Ltd acquired Pollution Ltd. as a part of the arrangement Green Ltd had to replace the Pollution Ltd.’s existing equity-settled award. The original awards specify a vesting period of five years. At the acquisition date, Pollution Ltd employees have already rendered two years of service.

As required, Green Ltd replaced the original awards with its own share-based payment awards (replacement award). Under the replacement awards, the vesting period is reduced to 2 years (from the acquisition date).

The value (market-based measure) of the awards at the acquisition date are as follows:

- original awards: ₹ 500
- replacement awards: ₹ 600.

As of the acquisition date, all awards are expected to vest.

Solution

Pre-combination period

The value of the replacement awards will have to be allocated between the pre-combination and post combination period. As of the acquisition date, the fair value of the original award (₹ 500) will be multiplied by the service rendered upto acquisition date (2 years) divided by greater of original vesting period (5 years) or new vesting period (4 years). Accordingly, 500 x 2/5 = 200 will be considered as pre-combination service and will be included in the purchase consideration.

Post- Combination period

The fair value of the award on the acquisition date is 600 which means the difference between the replacement award which is 600 and the amount allocated to pre-combination period (200) is 400 which will be now recorded over the remaining vesting period which is 2 years as an employee compensation cost.

12.11 Non-replacement Awards

The acquiree may have outstanding share-based payment transactions that the acquirer does not exchange for its share-based payment transactions. If vested, those acquiree share-based payment transactions are part of the non-controlling interest in the acquiree and are measured at their market-based measure. If unvested, they are measured at their market-based measure as if the acquisition date were the grant date in accordance with paragraphs 19 and 30.

The market-based measure of unvested share-based payment transactions is allocated to the non-controlling interest on the basis of the ratio of the portion of the vesting period completed to the greater of the total vesting period and the original vesting period of the share-based payment transaction. The balance is allocated to post-combination service.

The above means that the acquiree’s existing award will be settled in its own shares and the consequential shareholders will become the Non-controlling shareholders. The above principles can be summarized as follows:
Vested shares-
- the value credited to Share based payment reserve is classified as NCI.

Unvested-
- Pre-combination period is considered as a part of NCI
- Post-combination period- is recorded as employee cost and the credit forms part of the NCI in the balance sheet.

Illustration 26

A real estate company acquires Q another construction company which has an existing equity settled share based payment scheme. The awards vest after 5 years of employee service. At the acquisition date, Company Q’s employees have rendered 2 years of service. None of the awards are vested at the acquisition date. P did not replace the existing share-based payment scheme but reduced the remaining vesting period from 3 years to 2 year. Company P determines that the market-based measure of the award at the acquisition date is ₹ 500 (based on measurement principles and conditions at the acquisition date as per Ind AS 102).

Solution

The market based measure or the fair value of the award on the acquisition date of 500 is allocated NCI and post combination employee compensation expense. The portion allocable to pre-combination period is 500 x 2/5 = 200 which will be included in pre-combination period and is allocated to NCI on the acquisition date. The amount is computed based on original vesting period.

The remaining expense which is 500-200= 300 is accounted over the remaining vesting period of 2 years as compensation expenses.

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12.12 Non-controlling Interest in an Acquiree

Ind AS 103 allows the acquirer to measure a non-controlling interest in the acquiree at its fair value at the acquisition date. Sometimes an acquirer will be able to measure the acquisition-date fair value of a non-controlling interest on the basis of a quoted price in an active market for the equity shares (ie those not held by the acquirer). In other situations, however, a quoted price in an active market for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the non-controlling interest using other valuation techniques.

The fair values of the acquirer’s interest in the acquiree and the non-controlling interest on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer’s interest in the acquiree or, conversely, the inclusion of a discount for lack of control (also referred to as a non-controlling interest discount) in the per-share fair value of the non-controlling interest if market participants would take into account such a premium or discount when pricing the non-controlling interest.
Illustration 27

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

How will the non-controlling interest be measured?

Solution

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:

<table>
<thead>
<tr>
<th>(₹ in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifiable net assets at fair value</td>
</tr>
<tr>
<td>Goodwill*</td>
</tr>
<tr>
<td>To Non-controlling interest</td>
</tr>
<tr>
<td>To Investment in Natural Ltd.</td>
</tr>
</tbody>
</table>

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

(b) **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.

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(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:

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifiable net assets at fair value</td>
<td>Dr 150</td>
</tr>
<tr>
<td>Goodwill*</td>
<td>Dr 7.5</td>
</tr>
<tr>
<td>To Non-controlling interest (40% x 150) Cr</td>
<td>Dr 60</td>
</tr>
<tr>
<td>To Investment in Natural Ltd. Cr</td>
<td>Cr 97.5</td>
</tr>
</tbody>
</table>

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

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### 13. 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, this Ind AS 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.

#### 13.1 Reacquired Rights

A reacquired right recognised as an intangible asset shall be amortised over the remaining contractual period of the contract in which the right was granted. An acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

#### 13.2 Contingent Liabilities

After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognised in a business combination at the higher of:

(a) the amount that would be recognised in accordance with Ind AS 37; and

(b) 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.
13.3 Indemnification Assets

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 collectability 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.

13.4 Contingent Consideration

Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date.

Such changes are measurement period adjustments to the extent it is on account of conditions which existed as of the acquisition date will be adjusted against goodwill. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. 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 re-measured 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.
14. DISCLOSURES

The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:

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

Ind AS 103 requires detailed disclosures on Business Combination. The acquirer shall disclose the following information for each business combination that occurs during the reporting period:

a. the name and a description of the acquiree.
b. the acquisition date.
c. the percentage of voting equity interests acquired.
d. the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
e. a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.
f. the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
   I. cash;
   II. other tangible or intangible assets, including a business or subsidiary of the acquirer;
   III. liabilities incurred, for example, a liability for contingent consideration; and
   IV. equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.

g. for contingent consideration arrangements and indemnification assets:
   i. the amount recognised as of the acquisition date;
   ii. a description of the arrangement and the basis for determining the amount of the payment; and
   iii. an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.

h. for acquired receivables:
   i. the fair value of the receivables;
   ii. the gross contractual amounts receivable; and
iii. the best estimate at the acquisition date of the contractual cash flows not expected to be collected. The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.

i. the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.

j. for each contingent liability recognised, the information required in paragraph 85 of Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets. If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose:
   i. the information required by paragraph 86 of Ind AS 37; and
   ii. the reasons why the liability cannot be measured reliably.

k. the total amount of goodwill that is expected to be deductible for tax purposes.

l. for transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the business combination:
   i. a description of each transaction;
   ii. how the acquirer accounted for each transaction;
   iii. the amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised; and
   iv. if the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.

m. the disclosure of separately recognised transactions required by (l) shall include the amount of acquisition-related costs and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of profit and loss in which those expenses are recognised. The amount of any issue costs not recognised as an expense and how they were recognised shall also be disclosed.

n. in a bargain purchase (see paragraphs 34–36A):
   i. the amount of any gain recognised in other comprehensive income in accordance with paragraph 34;
   ii. the amount of any gain directly recognised in equity in accordance with paragraph 36A; and
   iii. a description of the reasons why the transaction resulted in a gain in case of (i) above.

o. for each business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date:
   i. the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and
   ii. for each non-controlling interest in an acquiree measured at fair value, the valuation technique(s) and significant inputs used to measure that value.
p. in a business combination achieved in stages:
   i. the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date; and
   ii. the amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination (see paragraph 42) and the line item in the statement of profit and loss in which that gain or loss is recognised.

q. Following additional information:
   i. the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of profit and loss for the reporting period; and
   ii. the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

If disclosure of any of the information required by this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. This Ind AS uses the term ‘impracticable’ with the same meaning as in Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

If the acquisition date of a business combination is after the end of the reporting period but before the financial statements are approved for issue, the acquirer shall disclose the information required as above unless the initial accounting for the business combination is incomplete at the time the financial statements are approved for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made.

To meet the objective of the Ind AS 103 disclosure requirement, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:

a) if the initial accounting for a business combination is incomplete for particular assets, liabilities, non-controlling interests or items of consideration and the amounts recognised in the financial statements for the business combination thus have been determined only provisionally
   i. the reasons why the initial accounting for the business combination is incomplete;
   ii. the assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete; and
   iii. the nature and amount of any measurement period adjustments recognised during the reporting period.

b) for each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:
i. any changes in the recognised amounts, including any differences arising upon settlement;

ii. any changes in the range of outcomes (undiscounted) and the reasons for those changes; and

iii. the valuation techniques and key model inputs used to measure contingent consideration.

c) for contingent liabilities recognised in a business combination, the acquirer shall disclose the information required by paragraphs 84 and 85 of Ind AS 37 for each class of provision.

d) a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period showing separately:

i. the gross amount and accumulated impairment losses at the beginning of the reporting period.

ii. additional goodwill recognised during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations.

iii. adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period

iv. goodwill included in a disposal group classified as held for sale in accordance with Ind AS 105 and goodwill derecognised during the reporting period without having previously been included in a disposal group classified as held for sale

v. impairment losses recognised during the reporting period in accordance with Ind AS 36. (Ind AS 36 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.)

vi. net exchange rate differences arising during the reporting period in accordance with Ind AS 21, The Effects of Changes in Foreign Exchange Rates.

vii. any other changes in the carrying amount during the reporting period.

viii. the gross amount and accumulated impairment losses at the end of the reporting period.

e) the amount and an explanation of any gain or loss recognised in the current reporting period that both:

i. relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period; and

ii. is of such a size, nature or incidence that disclosure is relevant to understanding the combined entity’s financial statements.

The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods.
15. COMMON CONTROL TRANSACTIONS INCLUDING MERGER

Common control transaction accounting guidance is included in Appendix C of Ind AS 103.

15.1 Definitions

Transferor means an entity or business which is combined into another entity as a result of a business combination.

Transferee means an entity in which the transferor entity is combined.

Reserve means the portion of earnings, receipts or other surplus of an entity (whether capital or revenue) appropriated by the management for a general or a specific purpose other than provision for depreciation.

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.

15.2 Common Control Business Combinations

Common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group.

The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant to determining whether the combination involves entities under common control. This is because a partially-owned subsidiary is nevertheless under the control of the parent entity.

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 AS. 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.

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.

Common control combinations are the most frequent. Broadly, these are transactions in which an entity obtains control of a business (hence a business combination) but both combining parties are ultimately controlled by the same party or parties both before and after the combination. These combinations often occur as a result of a group reorganisation in which the direct ownership of subsidiaries changes but the ultimate parent remains the same. However, such combinations can also occur in other ways and careful analysis and judgement are sometimes required to assess whether some combinations are covered by the definition (and the scope exclusion). In particular:
an assessment is required as to whether common control is ‘transitory’ (if so, the combination is not a common control combination and Ind AS 103 applies). The term transitory is not explained in the standard. In our view it is intended to ensure that Ind AS 103 is applied when a transaction that will lead to a substantive change in control is structured such that, for a brief period before and after the combination, the entity to be acquired/sold is under common control. However, common control should not be considered transitory simply because a combination is carried out in contemplation of an initial public offering or sale of combined entities.

when a group of two or more individuals has control before and after the transaction, an assessment is needed as to whether they exercise control collectively as a result of a contractual agreement.

Examples of common control transaction

- Merger between fellow subsidiaries
- Merger of subsidiary with parent
- Acquisition of an entity from an entity within the same group
- Bringing together entities under common control in a corporate legal structure

Illustration 28

Company X, the ultimate parent of a large number of subsidiaries, reorganises the retail segment of its business to consolidate all of its retail businesses in a single entity. Under the reorganisation, Company Z (a subsidiary and the biggest retail company in the group) acquires Company X’s shareholdings in its one operating subsidiary, Company Y by issuing its own shares to Company X. After the transaction, Company X will directly control the operating and financial policies of Companies Y.

Before-Reorganisation

- Company X
- Company Y
- Company Z
- Company M
- Other subsidiaries
After- Reorganisation

Solution

In this situation, Company Z pays consideration to Company X to obtain control of Company Y. The transaction meets the definition of a business combination. Prior to the reorganisation, each of the parties are controlled by Company X. After the reorganisation, although Company Y are now owned by Company Z, all two companies are still ultimately owned and controlled by Company X. From the perspective of Company X, there has been no change as a result of the reorganisation. This transaction therefore meets the definition of a common control combination and is within the scope of Ind AS 103.

Illustration 29

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?

Solution
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.

As per paragraphs 6 and 7 of Appendix C to Ind AS 103, 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 AS. 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. Also, 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. Therefore, in the current scenario, ABC Ltd. and XYZ Ltd. are considered to be under common control.

*****

**Illustration 30**

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?

**Solution**

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 as per paragraphs 6 and 7 of Appendix C to Ind AS 103, 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 AS. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a control. Also 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. Thus, ABC Ltd. and XYZ Ltd. are not considered to be under common control even if there is an established pattern of voting together.

*****
Illustration 31

ABC Ltd. had a subsidiary, namely, X Ltd. which was acquired on 1st April, 2XX0. ABC Ltd. acquires all of the shares of Y Ltd. on 1st April, 2X17. ABC Ltd. transfers the shares in Y Ltd. to X Ltd. on 2nd April, 2X17. How should the above transfer of Y Ltd. into X Ltd. be accounted for in the consolidated financial statements of X Ltd.?

Before:

Intermediate:

After:

Solution

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.

As per paragraph 7 of Appendix C to Ind AS 103, 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.

15.3 Method of Accounting for Common Control Business Combinations

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

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

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

(ii) No adjustments are made to reflect fair values, or recognise any new assets or liabilities. 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 earliest period presented 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.

The consideration for the business combination may consist of securities, cash or other assets. Securities shall be recorded at nominal value. In determining the value of the consideration, assets other than cash shall be considered at their fair values.

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.

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
The 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.

\[
\text{The acid test in assessing common control transaction is that before and after the reorganisation the entity should be controlled by the same shareholders.}
\]

16. **SIGNIFICANT DIFFERENCES BETWEEN IND AS 103 AND AS 14**

- **Under the existing Indian GAAP**, there is no comprehensive standard that addresses accounting for acquisitions where one entity obtains control of another entity. The accounting for such transactions is largely dependent on the form of the acquisition. For example, the accounting treatment may differ depending on whether the acquired company is retained as a separate legal entity or whether it is legally merged with the acquirer.

  To add to the complexity and confusion, if the acquired company is merged with the acquirer through a court-approved scheme, the scheme itself may prescribe an accounting treatment that is required to be followed, which may be in variation with the accounting standards. Indian GAAP still permits the use of the pooling-of-interest method whereby the entire transaction is accounted based on carrying values and no goodwill arises.

  Further, the current principles (AS 21, Consolidated Financial Statements) provide guidance on accounting for acquisition of a subsidiary in the entity’s consolidated financial statements by adding, on a line-by-line basis, all assets and liabilities of the acquiree at the carrying values as appearing in the acquiree’s financial statement (subject to adjustment for alignment of accounting policies).

- **Under Ind AS 103**, Business Combination, is a more widely used term than just in relation to mergers and amalgamations and encompasses a wide range of arrangements (unless excluded from scope of Ind AS 103). Ind AS 103 provides principles for identifying what constitutes a business combination, prescribes the accounting treatment for business combinations with greater emphasis on the use of fair values in accounting for a business combination.

  The core principle of Ind AS 103 requires an acquirer of a business to recognise the assets acquired and the liabilities assumed at their acquisition date fair values and to disclose information that enables users to evaluate the nature and financial effects of the acquisition.
<table>
<thead>
<tr>
<th>S. No.</th>
<th>Basis</th>
<th>Ind AS</th>
<th>Accounting Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Business combinations are accounted for in compliance with Ind AS 103.</td>
<td>Note: There is no specific guidance which comprehensively covers all types of business combination transactions</td>
</tr>
<tr>
<td>2.</td>
<td>Amalgamations</td>
<td>• All business combinations are accounted by using the acquisition method with limited exceptions.</td>
<td>▪ <strong>Amalgamation in the nature of purchase:</strong> Either identifiable assets and liabilities recorded at their existing carrying amount or fair value at the date of amalgamation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• All identifiable assets and liabilities are recognised and measured at acquisition date fair values with limited exceptions.</td>
<td>▪ <strong>Amalgamations in the nature of merger:</strong> Accounted under 'Pooling of interests method' where the assets, liabilities and reserves of the</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Purchase consideration is recognised at acquisition date fair value.</td>
<td>parent.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Non-controlling interests in the acquiree is measured either at fair value or at the non-controlling interest’s proportionate share of the</td>
<td></td>
</tr>
<tr>
<td>S. No.</td>
<td>Basis</td>
<td>Ind AS</td>
<td>Accounting Standards</td>
</tr>
<tr>
<td>-------</td>
<td>------------------------------</td>
<td>----------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
</tbody>
</table>
|       | acquiree’s identifiable net assets.  
  • Pooling of interests method to record business combination is prohibited. | transferor company are recorded by transferee company at their existing carrying amount.  
  ▪ **Others:**  
  • In case of transaction that do not meet the definition of amalgamation, assets and liabilities of acquiree are recorded in the consolidated financial statements at their existing carrying amounts on the date of acquisition. |
<p>| 3.    | <strong>Asset acquisition</strong>         | Similar to Indian GAAP.                                               | The transactions that do not meet the definition of amalgamation / acquisition of a subsidiary, are accounted as asset acquisitions without any goodwill or capital reserve recognised separately and the consideration is apportioned to the various assets on a fair value basis as determined by competent valuers. |
| 4.    | <strong>Acquisition related costs</strong> | Acquisition related costs such as finder’s fee, due diligence costs, etc. are expensed as incurred. | There is no specific guidance, but they are generally capitalised. |</p>
<table>
<thead>
<tr>
<th>S. No.</th>
<th>Basis</th>
<th>Ind AS</th>
<th>Accounting Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.</td>
<td>Goodwill or capital reserve (gain on bargain purchase)</td>
<td>Gain on bargain purchase is recognised in OCI if there is sufficient evidence that shows the appropriateness of bargain purchase gain. Goodwill is not amortised but tested for impairment annually.</td>
<td>Difference between the purchase consideration and the net assets acquired is recorded as goodwill or capital reserve (presented as equity) as the case may be. Goodwill arising on amalgamation is amortised over its useful life not exceeding five years unless a longer period is justified. There is no specific guidance on goodwill arising on subsidiaries acquired which are not amalgamations. In practice, such goodwill is not amortised but tested for impairment.</td>
</tr>
</tbody>
</table>
| 6.    | Contingent consideration                        | Initially recognised at acquisition date fair value Subsequent measurement  
- Contingent consideration classified as equity is not remeasured.  
- Contingent consideration classified as liability generally remeasured at fair value with changes at every reporting period end until settlement, with changes in fair value | Contingent consideration is included in the purchase consideration as at the date of amalgamation, if payment is probable and a reasonable estimate of the amount can be made. In other cases, the adjustment is recognised in the profit and loss account as and when it becomes determinable. Others: There is no specific guidance. In |
<table>
<thead>
<tr>
<th>S. No.</th>
<th>Basis</th>
<th>Ind AS</th>
<th>Accounting Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>recognised in profit or loss.</td>
<td>practice, contingent consideration is recognised when the contingency is resolved.</td>
</tr>
<tr>
<td>7.</td>
<td>In-process research and development</td>
<td>• Initially recognised at acquisition date fair value.</td>
<td>• There is no specific guidance.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Subsequently measured in accordance with Ind AS 38.</td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>Measurement period</td>
<td>Ind AS 103 provides for a measurement period after the acquisition date for the acquirer to adjust the provisional amounts recognised to reflect the additional information that existed as at the date of acquisition. The measurement period is limited to one year from the acquisition date.</td>
<td>There is no specific guidance.</td>
</tr>
<tr>
<td>9.</td>
<td>Business combination achieved in stages (step acquisition)</td>
<td>Any equity interest in the acquiree held by the acquirer immediately before the obtaining control over the acquiree is adjusted to acquisition-date fair value. Any resulting gain or loss is recognised in the profit or loss.</td>
<td>If two or more investments are made over a period of time, the equity of the subsidiary at the date of investment is generally determined on a step-by-step basis.</td>
</tr>
<tr>
<td>10.</td>
<td>Transactions between entities under common control</td>
<td>Appendix C to Ind AS 103 provides detailed guidance on which is very similar to the pooling of interest method as specified by AS 14.</td>
<td>There is no specific guidance. In practice, the accounting is generally determined by the scheme approved through a court order.</td>
</tr>
</tbody>
</table>
Illustration 32

Enterprise Ltd. has 2 divisions Laptops and Mobiles. Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses.

On 31\textsuperscript{st} March, 20X2, the division-wise draft extract of the Balance Sheet was:

\[
\begin{array}{l|c|c|c}
 & \text{Laptops} & \text{Mobiles} & \text{Total} \\
\hline
\text{Property, Plant and Equipment cost} & 250 & 500 & 750 \\
\text{Depreciation} & -225 & -400 & -625 \\
\text{Net Property, Plant and Equipment} & 275 & 100 & 375 \\
\hline
\text{Current assets:} & & & \\
\hline
\text{Current liabilities} & -25 & -400 & -425 \\
\hline
\text{Total} & 200 & 200 & 400 \\
\hline
\text{Financed by:} & & & \\
\hline
\text{Loan funds} & - & 300 & 300 \\
\text{Capital : Equity ₹ 10 each} & 25 & - & 25 \\
\text{Surplus} & 175 & -100 & 75 \\
\hline
\text{Total} & 200 & 200 & 400 \\
\end{array}
\]

Division Mobiles along with its assets and liabilities was sold for ₹25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of ₹10 each at a premium of ₹15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of the Enterprise Ltd. was holding 52% shareholding of the Company.

Assuming that there are no other transactions, you are asked to:

(i) Pass journal entries in the books of Enterprise Ltd.
(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).
(iii) Prepare the Balance Sheet of Turnaround Ltd.

Solution

**Journal of Enterprise Ltd.**

\[
\begin{array}{l|c|c}
\text{(₹ in crores)} & \text{Dr.} & \text{Cr.} \\
\hline
(1) & \text{Loan Funds} & Dr. & 300 \\
 & \text{Current Liabilities} & Dr. & 400 \\
\hline
\end{array}
\]
Provision for Depreciation  

Dr. 400  
To Property, Plant and Equipment 500  
To Current Assets 500  
To Capital Reserve 100  
(Being division Mobiles along with its assets and liabilities sold to Turnaround Ltd. for ₹ 25 crores)

Notes:

1. Any other alternative set of entries, with the same net effect on various accounts, may be given by the students.

2. In the given scenario, this demerger will meet the definition of common control transaction. Accordingly, the transfer of assets and liabilities will be derecognized and recognized as per book value and the resultant loss or gain will be recorded as capital reserve in the books of demerged entity (Enterprise Ltd).

Enterprise Ltd.

Balance Sheet after reconstruction  (₹ in crores)

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Note No.</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td></td>
<td>25</td>
</tr>
<tr>
<td>Current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other current assets</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td></td>
<td></td>
<td>225</td>
</tr>
<tr>
<td>EQUITY AND LIABILITIES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity share capital (of face value of ₹ 10 each)</td>
<td></td>
<td>25</td>
</tr>
<tr>
<td>Other equity (Surplus)</td>
<td></td>
<td>175</td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td>25</td>
</tr>
<tr>
<td></td>
<td></td>
<td>225</td>
</tr>
</tbody>
</table>

Notes to Accounts

<table>
<thead>
<tr>
<th>(₹ in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Other Equity</td>
</tr>
<tr>
<td>Surplus (175-100)</td>
</tr>
<tr>
<td>Add: Capital Reserve on reconstruction</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>
Notes to Accounts: Consequent on transfer of Division Mobiles to newly incorporated company Turnaround Ltd., the members of the company have been allotted 1 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share of Turnaround Ltd., in full settlement of the consideration in proportion to their shareholding in the company.

Balance Sheet of Turnaround Ltd.

(₹ in crores)

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Note No.</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other current assets</td>
<td></td>
<td>500</td>
</tr>
<tr>
<td></td>
<td></td>
<td>600</td>
</tr>
<tr>
<td>EQUITY AND LIABILITIES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity share capital (of face value of ₹ 10 each)</td>
<td>1</td>
<td>10</td>
</tr>
<tr>
<td>Other equity</td>
<td>2</td>
<td>(110)</td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td></td>
<td>300</td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td>400</td>
</tr>
<tr>
<td></td>
<td></td>
<td>600</td>
</tr>
</tbody>
</table>

Notes to Accounts

(₹ in crores)

1. Share Capital:
   Issued and Paid-up capital
   1 crore Equity shares of ₹ 10 each fully paid up
   (All the above shares have been issued for consideration other than cash, to the members of Enterprise Ltd. on takeover of Division Mobiles from Enterprise Ltd.)
   10

2. Other Equity:
   Securities Premium
   Capital reserve [25- (600 – 700)]
   (125)
   (110)
Working Note:
In the given case, since both the entities are under common control, this will be accounted as follows:
- All assets and liabilities will be recorded at book value
- Identity of reserves to be maintained.
- No goodwill will be recorded.
- Securities issued will be recorded as per the nominal value.

Illustration 33
Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as at 31st October, 20X2 was as under:

<table>
<thead>
<tr>
<th></th>
<th>Maxi division</th>
<th>Mini division</th>
<th>Total (in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, Plant and Equipment</td>
<td>600</td>
<td>300</td>
<td>900</td>
</tr>
<tr>
<td>Cost</td>
<td>(500)</td>
<td>(100)</td>
<td>(600)</td>
</tr>
<tr>
<td>Depreciation</td>
<td>100</td>
<td>200</td>
<td>300</td>
</tr>
<tr>
<td>W.D.V.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets</td>
<td>400</td>
<td>300</td>
<td>700</td>
</tr>
<tr>
<td>Less: Current liabilities</td>
<td>(100)</td>
<td>(100)</td>
<td>(200)</td>
</tr>
<tr>
<td>Total</td>
<td>300</td>
<td>200</td>
<td>500</td>
</tr>
<tr>
<td>(B)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (A+B)</td>
<td>400</td>
<td>400</td>
<td>800</td>
</tr>
</tbody>
</table>

Financed by:
- Loan funds (A) — 100
  (secured by a charge on property, plant and equipment)

Own funds:
- Equity capital (fully paid up ₹ 10 per share) 50
- Other Equity 650

Total (A+B) 700

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division. Accordingly, Mini Ltd. was incorporated to take over at Balance Sheet figures, the assets and liabilities of that division. Mini Ltd. is to allot 5 crore equity shares of ₹ 10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.
(a) You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 20X2, showing corresponding previous year’s figures.

(b) The directors of the 2 companies ask you to find out the net asset value of equity shares pre and post demerger.

(c) Comment on the impact of demerger on “share holders wealth”.

**Solution**

**Demerged Company: Mini Division of “Maxi Mini Ltd”**

**Resulting Company: “Mini Ltd.”**

(a) **Journal of Maxi Mini Ltd. (Demerged Company)**

<table>
<thead>
<tr>
<th>(₹ in crores)</th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current liabilities A/c</td>
<td>Dr.</td>
<td>100</td>
</tr>
<tr>
<td>Loan fund (secured) A/c</td>
<td>Dr.</td>
<td>100</td>
</tr>
<tr>
<td>Provision for depreciation A/c</td>
<td>Dr.</td>
<td>100</td>
</tr>
<tr>
<td>Loss on reconstruction (Balancing figure)</td>
<td>Dr.</td>
<td>300</td>
</tr>
<tr>
<td>To Property, Plant and Equipment A/c</td>
<td></td>
<td>300</td>
</tr>
<tr>
<td>To Current assets A/c</td>
<td></td>
<td>300</td>
</tr>
</tbody>
</table>

(Being the assets and liabilities of Mini division taken out of the books on transfer of the division to Mini Ltd., the consideration being allotment to the members of the company of one equity share of ₹ 10 each of that company at par for every share held in the company vide scheme of reorganisation)

**Note:** Any other alternatives set of entries, with the same net effect on various accounts, may be given by the students. In the absence of additional information on fair value of the assets transferred it has been assumed that the group of shareholders control both the demerged and the resultant entity. It is expected that students should evaluate all reorganization from common control parameters and aptly highlight the assumptions in the note while solving the question.
Journal of Mini Ltd.

<table>
<thead>
<tr>
<th>(₹ in crores)</th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, Plant and Equipment (300-100) A/c</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Current assets A/c</td>
<td>300</td>
<td>0</td>
</tr>
<tr>
<td>To Current Liabilities A/c</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>To Secured loan funds A/c</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>To Equity share capital A/c</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>To Capital reserve</td>
<td>250</td>
<td></td>
</tr>
</tbody>
</table>

(Being the assets and liabilities of Mini division of Maxi Mini Ltd. taken over and allotment of 5 crores equity shares of ₹ 10 each at part as fully paid up to the members of Maxi Mini Ltd.)

Maxi Mini Ltd.

Balance Sheet as at 1st November, 20X2

₹ in crore

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Note No.</th>
<th>After Reconstruction</th>
<th>Before Reconstruction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td>2</td>
<td>100</td>
<td>300</td>
</tr>
<tr>
<td>Current assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other current assets</td>
<td></td>
<td>400</td>
<td>700</td>
</tr>
<tr>
<td></td>
<td></td>
<td>500</td>
<td>1,000</td>
</tr>
<tr>
<td>EQUITY AND LIABILITIES</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity share capital (of face value of ₹ 10 each)</td>
<td></td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Other equity</td>
<td></td>
<td>350</td>
<td>650</td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td>-</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td></td>
<td></td>
<td>500</td>
<td>1,000</td>
</tr>
</tbody>
</table>
Notes to Accounts

<table>
<thead>
<tr>
<th>Note</th>
<th>After Reconstruction</th>
<th>Before Reconstruction</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Other Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Equity</td>
<td>650</td>
<td>650</td>
</tr>
<tr>
<td>Less: Loss on reconstruction</td>
<td>(300)</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>350</td>
<td>650</td>
</tr>
<tr>
<td>2. Property, Plant and Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td>600</td>
<td>900</td>
</tr>
<tr>
<td>Less: Depreciation</td>
<td>(500)</td>
<td>(600)</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>300</td>
</tr>
</tbody>
</table>

Notes to Accounts: Consequent on reconstruction of the company and transfer of Mini division to newly incorporated company Mini Ltd., the members of the company have been allotted 5 crores equity shares of ₹ 10 each at part of Mini Ltd. The demerged entity and the resultant entity are common control and accordingly the transaction has been accounted at book values of the assets transferred in both the entity.

Mini Ltd.

Balance Sheet as at 1st November, 20X2 ₹ in crore

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Note No.</th>
<th>After reconstruction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td>Current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other current assets</td>
<td></td>
<td>300</td>
</tr>
<tr>
<td></td>
<td></td>
<td>500</td>
</tr>
<tr>
<td>EQUITY AND LIABILITIES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity share capital (of face value of ₹ 10 each)</td>
<td></td>
<td>50</td>
</tr>
<tr>
<td>Other equity (capital reserve)</td>
<td></td>
<td>250</td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td></td>
<td></td>
<td>500</td>
</tr>
</tbody>
</table>
Notes to Account

<table>
<thead>
<tr>
<th>(₹ in crores)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Share Capital:</strong></td>
<td></td>
</tr>
<tr>
<td>Issued and paid up:</td>
<td></td>
</tr>
<tr>
<td>5 crores Equity shares of ₹ 10 each fully paid up</td>
<td>50</td>
</tr>
<tr>
<td>(All the above shares have been issued for consideration other than cash, to the members of Maxi Mini Ltd., on takeover of Mini division from Maxi Mini Ltd.)</td>
<td></td>
</tr>
</tbody>
</table>

(b) Net asset value of an equity share

<table>
<thead>
<tr>
<th>Pre-demerger</th>
<th>Post-demerger</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maxi Mini Ltd.: ( \frac{₹ 700 \text{ crores}}{5 \text{ crores}} = ₹ 140 )</td>
<td>₹ 400 crores = ₹ 80</td>
</tr>
<tr>
<td>Mini Ltd.: ( \frac{₹ 300 \text{ crores}}{5 \text{ crores}} = ₹ 60 )</td>
<td></td>
</tr>
</tbody>
</table>

(c) Demerger into two companies has had no impact on “net asset value” of shareholding. Pre-demergery, it was ₹ 140 per share. After demerger, it is ₹ 80 plus ₹ 60 i.e. ₹ 140 per original share.

It is only yield valuation that is expected to change because of separate focusing on two distinct businesses whereby profitability is likely to improve on account of demerger.

*****

Illustration 34

AX Ltd. and BX Ltd. amalgamated on and from 1st January, 20X2. A new Company ABX Ltd. with shares of ₹ 10 each was formed to take over the businesses of the existing companies.

**Summarized Balance Sheet as on 31-12-20X2**

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Note No.</th>
<th>AX Ltd</th>
<th>BX Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-current assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td>8,500</td>
<td>7,500</td>
<td></td>
</tr>
<tr>
<td>Financial assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td>1,050</td>
<td>550</td>
<td></td>
</tr>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>1,250</td>
<td>2,750</td>
<td></td>
</tr>
<tr>
<td>Trade receivables</td>
<td>1,800</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>Cash and Cash equivalent</td>
<td>450</td>
<td>400</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>13,050</td>
<td>15,200</td>
<td></td>
</tr>
</tbody>
</table>
### EQUITY AND LIABILITIES

#### Equity
- Equity share capital (of face value of ₹ 10 each) 6,000 7,000
- Other equity 1 3,050 2,700

#### Liabilities

**Non-current liabilities**
- Financial liabilities
  - Borrowings (12% Debentures) 3,000 4,000

**Current liabilities**
- Trade payables 1,000 1,500

<table>
<thead>
<tr>
<th></th>
<th>AX Ltd</th>
<th>BX Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Other equity</td>
<td></td>
</tr>
<tr>
<td></td>
<td>General Reserve</td>
<td>1,500</td>
</tr>
<tr>
<td></td>
<td>Profit &amp; Loss</td>
<td>1,000</td>
</tr>
<tr>
<td></td>
<td>Investment Allowance Reserve</td>
<td>500</td>
</tr>
<tr>
<td></td>
<td>Export Profit Reserve</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3,050</td>
</tr>
</tbody>
</table>

Note:

ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies. Also the new debentures were issued in exchange of the old series of both the companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of ABX Ltd:

a. Assuming that both the entities are under common control
b. Assuming BX Ltd is a larger entity and their management will take the control of the entity ABX Ltd.

The fair value of net assets of AX and BX limited are as follows:

<table>
<thead>
<tr>
<th>Assets</th>
<th>AX Ltd. (‘000)</th>
<th>BX Ltd. (‘000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, Plant and Equipment</td>
<td>9,500</td>
<td>1,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>1,300</td>
<td>2,900</td>
</tr>
<tr>
<td>Fair value of the business</td>
<td>11,000</td>
<td>14,000</td>
</tr>
</tbody>
</table>
Solution
(a) (Assumption: Common control transaction)

1. Calculation of Purchase Consideration

<table>
<thead>
<tr>
<th></th>
<th>AX Ltd.</th>
<th>BX Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets taken over:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td>85,00</td>
<td>75,00</td>
</tr>
<tr>
<td>Investment</td>
<td>10,50</td>
<td>5,50</td>
</tr>
<tr>
<td>Inventory</td>
<td>12,50</td>
<td>27,50</td>
</tr>
<tr>
<td>Trade receivables</td>
<td>18,00</td>
<td>40,00</td>
</tr>
<tr>
<td>Cash &amp; Cash equivalent</td>
<td>4,50</td>
<td>4,00</td>
</tr>
<tr>
<td><strong>Gross Assets</strong></td>
<td>130,50</td>
<td>152,00</td>
</tr>
<tr>
<td><strong>Less: Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12% Debentures</td>
<td>30,00</td>
<td>40,00</td>
</tr>
<tr>
<td>Trade payables</td>
<td>10,00</td>
<td>(40,00)</td>
</tr>
<tr>
<td><strong>Net Assets taken over</strong></td>
<td>90,50</td>
<td>97,00</td>
</tr>
<tr>
<td><strong>Less: Other Equity:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Reserve</td>
<td>15,00</td>
<td>20,00</td>
</tr>
<tr>
<td>P &amp; L A/c</td>
<td>10,00</td>
<td>5,00</td>
</tr>
<tr>
<td>Investment Allowance Reserve</td>
<td>5,00</td>
<td>1,00</td>
</tr>
<tr>
<td>Export Profit Reserve</td>
<td>50</td>
<td>(30,50)</td>
</tr>
<tr>
<td><strong>Purchase Consideration</strong></td>
<td>60,00</td>
<td>70,00</td>
</tr>
</tbody>
</table>

Total Purchase Consideration = 130,00 (60,00 of AX Ltd. & 70,00 of BX Ltd.)

2. Discharge of Purchase Consideration

**No. of shares to be issued to AX Ltd =**

\[
\text{No. of shares to be issued to AX Ltd} = \frac{\text{Net Assets taken over of AX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}} \times \text{Purchase Consideration}
\]

**No. of shares to be issued to BX Ltd =**

\[
\text{No. of shares to be issued to BX Ltd} = \frac{\text{Net Assets taken over of BX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}} \times \text{Purchase Consideration}
\]
**BUSINESS COMBINATION AND CORPORATE RESTRUCTURING**

<table>
<thead>
<tr>
<th>AX Ltd. ₹’000</th>
<th>BX Ltd. ₹’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>62,75</td>
<td>67,25</td>
</tr>
</tbody>
</table>

130,00 × \[\frac{90,50}{187.50}\] = 6,27,500 * Equity shares of ₹ 10 each

130,00 × \[\frac{97,00}{187.50}\] = 6,72,500 Equity shares of ₹ 10 each

---

**Balance Sheet of ABX Ltd. as on 1.1.20X2**

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Note No.</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td></td>
<td>16,000</td>
</tr>
<tr>
<td>Financial assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td></td>
<td>1,600</td>
</tr>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td></td>
<td>4,000</td>
</tr>
<tr>
<td>Trade receivable</td>
<td></td>
<td>5,800</td>
</tr>
<tr>
<td>Cash and Cash equivalent</td>
<td></td>
<td>850</td>
</tr>
<tr>
<td><strong>Total Current assets</strong></td>
<td></td>
<td>28,250</td>
</tr>
<tr>
<td><strong>EQUITY AND LIABILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity share capital (of face value of ₹ 10 each)</td>
<td>1</td>
<td>13,000</td>
</tr>
<tr>
<td>Other equity</td>
<td>2</td>
<td>5,750</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Non-current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td>3</td>
<td>7,000</td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade payable</td>
<td></td>
<td>2,500</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td></td>
<td>28,250</td>
</tr>
</tbody>
</table>

* The total purchase consideration is to be discharged by ABX Ltd. in such a way that the rights of the shareholders of AX Ltd. and BX Ltd. remain unaltered in the future profits of ABX Ltd.*
Notes to Accounts

<table>
<thead>
<tr>
<th></th>
<th>(₹ 000)</th>
<th>(₹ 000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13,00,000 Equity Shares of ₹ 10 each</td>
<td></td>
<td>130,00</td>
</tr>
<tr>
<td>Other Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Reserve (15,00 + 20,00)</td>
<td>35,00</td>
<td></td>
</tr>
<tr>
<td>Profit &amp; Loss (10,00 + 5,00)</td>
<td>15,00</td>
<td></td>
</tr>
<tr>
<td>Investment Allowance Reserve (5,00 + 1,00)</td>
<td>6,00</td>
<td></td>
</tr>
<tr>
<td>Export Profit Reserve (50 + 1,00)</td>
<td>1,50</td>
<td>57,50</td>
</tr>
<tr>
<td>Long Term Borrowings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12% Debentures</td>
<td></td>
<td>70,00</td>
</tr>
</tbody>
</table>

(b) Assuming BX Ltd is a larger entity and their management will take the control of the entity ABX Ltd.

In this case BX Ltd. and AX Ltd. are not under common control and hence accounting prescribed under Ind AS 103 for business combination will be applied. A question arises here is who is the accounting acquirer ABX Ltd which is issuing the shares or AX Ltd. or BX Ltd. As per the accounting guidance provided in Ind AS 103, sometimes the legal acquirer may not be the accounting acquirer. In the given scenario although ABX Ltd. is issuing the shares but BX Ltd. post-merger will have control and is bigger in size which is a clear indicator that BX Ltd. will be an accounting acquirer. This can be justified by the following table:

<table>
<thead>
<tr>
<th>(In ‘000s)</th>
<th>AX Ltd.</th>
<th>BX Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair Value</td>
<td>11,000</td>
<td>14,000</td>
</tr>
<tr>
<td>Value per share</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>No. of shares</td>
<td>1,100</td>
<td>1,400</td>
</tr>
<tr>
<td>i.e. Total No. of shares in ABX Ltd. = 2,500 thousand shares</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thus, % Held by each Company in Combined Entity</td>
<td>44%</td>
<td>56%</td>
</tr>
</tbody>
</table>

Note: It is a case of Reverse Acquisition.

Accordingly, BX Ltd. assets will be recorded at historical cost in the merged financial statements.

(1) Calculation of Purchase Consideration (All figures are in thousands)

We need to calculate the number of shares to be issued by BX Ltd. to AX Ltd. to maintain the same percentage i.e. 56%:
Thus, 700 thousand shares of BX Ltd. (given in the balance sheet) represents 56%. This means that total no. of shares would be 1,250 thousand shares ie 700 thousand shares / 56%.

This implies BX Ltd. would need to issue 550 thousand shares (1,250 less 700) to AX Ltd.

Purchase Consideration = 550 thousand shares x ₹ 20 per share (ie. 14,000 thousand / 700 thousand shares) = ₹ 11,000 thousand.

Balance Sheet of ABX Ltd. as on 1.1.20X2

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Note No.</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goodwill (Refer Working Note)</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment (9500+7500)</td>
<td>17,000</td>
<td></td>
</tr>
<tr>
<td>Financial assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment (1050+550)</td>
<td></td>
<td>1,600</td>
</tr>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory (1300+2750)</td>
<td></td>
<td>4,050</td>
</tr>
<tr>
<td>Trade receivables (1800+4000)</td>
<td>5,800</td>
<td></td>
</tr>
<tr>
<td>Cash and Cash equivalent (450+400)</td>
<td>850</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>850</td>
</tr>
<tr>
<td><strong>EQUITY AND LIABILITIES</strong></td>
<td></td>
<td>30,200</td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity share capital (of face value of ₹  10 each)</td>
<td>1</td>
<td>12,500</td>
</tr>
<tr>
<td>Other equity</td>
<td>2</td>
<td>8,200</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Non-current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowings (12% Debentures)</td>
<td>3</td>
<td>7,000</td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade payables</td>
<td></td>
<td>2,500</td>
</tr>
</tbody>
</table>

Notes to Accounts

<table>
<thead>
<tr>
<th>(₹ 000)</th>
<th>(₹ 000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Share Capital</td>
<td></td>
</tr>
</tbody>
</table>

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2. Other Equity
   General reserve of BX Ltd  20,00
   P&L of BX Ltd  5,00
   Export Profit Reserve of BX Ltd  1,00
   Investment Allowance Reserve of BX Ltd  1,00
   Security Premium (550 shares x 10)  5,500  8,200

3. Long Term Borrowings
   12% Debentures  70,00

Working Note:

Goodwill Computation:

<table>
<thead>
<tr>
<th>Assets:</th>
<th>₹ in 000s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, Plant and Equipment</td>
<td>9,500</td>
</tr>
<tr>
<td>Investment</td>
<td>1,050</td>
</tr>
<tr>
<td>Inventory</td>
<td>1,300</td>
</tr>
<tr>
<td>Trade Receivable</td>
<td>1,800</td>
</tr>
<tr>
<td>Cash &amp; Cash Equivalent</td>
<td>450</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>14,100</strong></td>
</tr>
<tr>
<td><strong>Less : Liabilities:</strong></td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td>3,000</td>
</tr>
<tr>
<td>Trade Payable</td>
<td>1,000</td>
</tr>
<tr>
<td><strong>Net Assets</strong></td>
<td><strong>10,100</strong></td>
</tr>
<tr>
<td>Purchase Consideration</td>
<td>11,000</td>
</tr>
<tr>
<td><strong>Goodwill</strong></td>
<td><strong>900</strong></td>
</tr>
</tbody>
</table>

Illustration 35

On 9th April, 20X2, Shyam Ltd. a listed company started to negotiate with Ram Ltd, which is an unlisted company about the possibility of merger. On 10th May, 20X2, the board of directors of Shyam Ltd. authorized their management to pursue the merger with Ram Ltd. On 15th May, 20X2, management of Shyam Ltd. offered management of Ram Ltd. 12,000 shares of Shyam Ltd. against their total share outstanding. On 31st May, 20X2, the board of directors of Ram Ltd accepted the offer subject to shareholder’s vote. On 2nd June, 20X2 both the companies jointly made a press release about the proposed merger.
On 10\textsuperscript{th} June, 20X2, the shareholders of Ram Ltd approved the terms of the merger. On 15\textsuperscript{th} June, the shares were allotted to the shareholders of Ram Ltd.

The market price of the shares of Shyam Ltd was as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Price per share</th>
</tr>
</thead>
<tbody>
<tr>
<td>9\textsuperscript{th} April</td>
<td>70</td>
</tr>
<tr>
<td>10\textsuperscript{th} May</td>
<td>75</td>
</tr>
<tr>
<td>15\textsuperscript{th} May</td>
<td>60</td>
</tr>
<tr>
<td>31\textsuperscript{st} May</td>
<td>70</td>
</tr>
<tr>
<td>2\textsuperscript{nd} June</td>
<td>80</td>
</tr>
<tr>
<td>10\textsuperscript{th} June</td>
<td>85</td>
</tr>
<tr>
<td>15\textsuperscript{th} June</td>
<td>90</td>
</tr>
</tbody>
</table>

What is the acquisition date and what is purchase consideration in the above scenario?

Solution

As per paragraph 8 of Ind AS 103, the acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree. In the above scenario, the acquisition date will be the date on which the shares were allotted to the shareholders of Ram Ltd. Although the shareholder approval was obtained on 10\textsuperscript{th} June, 20X2 but the shares were issued only on 15\textsuperscript{th} June, 20X2. Accordingly, the purchase consideration will be on the basis of ₹ 90 i.e. the market price on that date. Hence total purchase consideration would be ₹ 10,80,000 (i.e, 12,000 shares x ₹ 90).

Illustration 36

The balance sheet of Professional Ltd. and Dynamic Ltd. as of 31\textsuperscript{st} March, 20X2 is given below:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Professional Ltd</th>
<th>Dynamic Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Current Assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>300</td>
<td>500</td>
</tr>
<tr>
<td>Investment</td>
<td>400</td>
<td>100</td>
</tr>
<tr>
<td>Current assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td>250</td>
<td>150</td>
</tr>
<tr>
<td>Financial assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade receivables</td>
<td>450</td>
<td>300</td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>200</td>
<td>100</td>
</tr>
<tr>
<td>Others</td>
<td>400</td>
<td>230</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,000</strong></td>
<td><strong>1,380</strong></td>
</tr>
</tbody>
</table>
Other information

a. Professional Ltd. acquired 70% shares of Dynamic Ltd. on 1st April, 20X2 by issuing its own shares in the ratio of 1 share of Professional Ltd. for every 2 shares of Dynamic Ltd. The fair value of the shares of Professional Ltd was ₹40 per share.

b. The fair value exercise resulted in the following: (all nos in Lakh)
   a. Fair value of PPE on 1st April, 20X2 was ₹350 lakhs.
   b. Professional Ltd also agreed to pay an additional payment as consideration that is higher of 35 lakh and 25% of any excess profits in the first year, after acquisition, over its profits in the preceding 12 months made by Dynamic Ltd. This additional amount will be due after 2 years. Dynamic Ltd has earned ₹10 lakh profit in the preceding year and expects to earn another ₹20 lakh.
   c. In addition to above, Professional Ltd also had agreed to pay one of the founder shareholder a payment of ₹20 lakh provided he stays with the Company for two year after the acquisition.
   d. Dynamic Ltd had certain equity settled share based payment award (original award) which got replaced by the new awards issued by Professional Ltd. As per the original term the vesting period was 4 years and as of the acquisition date the employees of Dynamic Ltd have already served 2 years of service. As per the replaced awards the vesting period has been reduced to one year (one year from the acquisition date). The fair value of the award on the acquisition date was as follows:
      i. Original award- ₹5 lakh
      ii. Replacement award- ₹8 lakh.
e. Dynamic Ltd had a lawsuit pending with a customer who had made a claim of ₹ 50 lakh. Management reliably estimated the fair value of the liability to be ₹ 5 lakh.

f. The applicable tax rate for both entities is 30%.

You are required to prepare opening consolidated balance sheet of Professional Ltd as on 1st April, 20X2. Assume 10% discount rate.

Solution

Consolidated Balance Sheet of Professional Ltd as on 1st April, 20X2  (₹ in Lakhs)

<table>
<thead>
<tr>
<th>Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-Current Assets:</strong></td>
<td></td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>650</td>
</tr>
<tr>
<td>Investment</td>
<td>500</td>
</tr>
<tr>
<td><strong>Current assets:</strong></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td>400</td>
</tr>
<tr>
<td>Financial assets:</td>
<td></td>
</tr>
<tr>
<td>Trade receivables</td>
<td>750</td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>300</td>
</tr>
<tr>
<td>Others</td>
<td>630</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3,230</td>
</tr>
</tbody>
</table>

**Equity and Liabilities**

<table>
<thead>
<tr>
<th>Equity</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital- Equity shares of ₹ 100 each</td>
<td>514</td>
</tr>
<tr>
<td>Other Equity</td>
<td>1,128.62</td>
</tr>
<tr>
<td>NCI</td>
<td>154.95</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Non-Current liabilities:</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term borrowings</td>
<td>450</td>
</tr>
<tr>
<td>Long term provisions (50+70+28.93)</td>
<td>148.93</td>
</tr>
<tr>
<td>Deferred tax</td>
<td>28.5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Current Liabilities:</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term borrowings</td>
<td>250</td>
</tr>
<tr>
<td>Trade payables</td>
<td>550</td>
</tr>
<tr>
<td>Provision for Law suit Damages</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3,230</td>
</tr>
</tbody>
</table>
Notes:

a. Fair value adjustment- As per Ind AS 103, the acquirer is required to record the assets and liabilities at their respective fair value. Accordingly, the PPE will be recorded at ₹350 lakhs.

b. The value of replacement award is allocated between consideration transferred and post combination expense. The portion attributable to purchase consideration is determined based on the fair value of the replacement award for the service rendered till the date of the acquisition. Accordingly, 2.5 (5 x 2/4) is considered as a part of purchase consideration and is credited to Professional Ltd equity as this will be settled in its own equity. The balance of 2.5 will be recorded as employee expense in the books of Dynamic Ltd over the remaining life, which is 1 year in this scenario.

c. There is a difference between contingent consideration and deferred consideration. In the given case 35 is the minimum payment to be paid after 2 years and accordingly will be considered as deferred consideration. The other element is if company meet certain target then they will get 25% of that or 35 whichever is higher. In the given case since the minimum what is expected to be paid the fair value of the contingent consideration has been considered as zero. The impact of time value on deferred consideration has been given @ 10%.

d. The additional consideration of ₹20 lakhs to be paid to the founder shareholder is contingent to him/her continuing in employment and hence this will be considered as employee compensation and will be recorded as post combination expenses in the income statement of Dynamic Ltd.

Working Notes:

1. Computation for Purchase consideration

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital of Dynamic Ltd</td>
<td>₹4,00,00,000</td>
</tr>
<tr>
<td>Number of shares</td>
<td></td>
</tr>
<tr>
<td>Shares to be issued 2:1</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Fair value Rs. per share</td>
<td>40</td>
</tr>
<tr>
<td>PC (2,00,000 x 70% x ₹40 per share) (A)</td>
<td>56.00</td>
</tr>
<tr>
<td>Deferred consideration after discounting ₹35 lakhs for 2 years</td>
<td></td>
</tr>
<tr>
<td>@ 10% (B)</td>
<td>28.93</td>
</tr>
<tr>
<td>Replacement award Market based measure of the acquiree award (5 x ratio of the portion of the vesting period completed (2) / greater of the total vesting period (3) or the original vesting period (4) of the acquiree award ie (5 x 2 / 4) (C)</td>
<td>2.50</td>
</tr>
<tr>
<td>PC in lakhs (A+B+C)</td>
<td>87.43</td>
</tr>
</tbody>
</table>
2. Allocation of Purchase price

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Book value (A)</th>
<th>Fair value (B)</th>
<th>FV adjustment (A-B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>500</td>
<td>350</td>
<td>(150)</td>
</tr>
<tr>
<td>Investment</td>
<td>100</td>
<td>100</td>
<td>-</td>
</tr>
<tr>
<td>Inventories</td>
<td>150</td>
<td>150</td>
<td>-</td>
</tr>
<tr>
<td>Financial assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade receivables</td>
<td>300</td>
<td>300</td>
<td>-</td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>100</td>
<td>100</td>
<td>-</td>
</tr>
<tr>
<td>Others</td>
<td>230</td>
<td>230</td>
<td></td>
</tr>
<tr>
<td>Less: Long term borrowings</td>
<td>(200)</td>
<td>(200)</td>
<td>-</td>
</tr>
<tr>
<td>Long term provisions</td>
<td>(70)</td>
<td>(70)</td>
<td>-</td>
</tr>
<tr>
<td>Deferred tax</td>
<td>(35)</td>
<td>(35)</td>
<td>-</td>
</tr>
<tr>
<td>Short term borrowings</td>
<td>(150)</td>
<td>(150)</td>
<td>-</td>
</tr>
<tr>
<td>Trade payables</td>
<td>(300)</td>
<td>(300)</td>
<td>-</td>
</tr>
<tr>
<td>Contingent liability</td>
<td></td>
<td>(5)</td>
<td>(5)</td>
</tr>
<tr>
<td>Net assets (X)</td>
<td>625</td>
<td>470</td>
<td>(155)</td>
</tr>
<tr>
<td>Deferred tax Asset on FV adjustment (155 x 30%) (Y)</td>
<td>46.50</td>
<td>155</td>
<td></td>
</tr>
<tr>
<td>Net assets (X+Y)</td>
<td></td>
<td>516.5</td>
<td></td>
</tr>
<tr>
<td>Non-controlling interest (516.50 x 30%) rounded off</td>
<td>154.95</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Reserve (Net assets – NCI – PC)</td>
<td>274.12</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase consideration (PC)</td>
<td></td>
<td>87.43</td>
<td></td>
</tr>
</tbody>
</table>

3. Computation of consolidated amounts of Consolidated financial statements

<table>
<thead>
<tr>
<th></th>
<th>Professional Ltd</th>
<th>Dynamic Ltd (pre-acquisition)</th>
<th>PPA Allocation</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Non-Current Assets:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>300</td>
<td>500</td>
<td>(150)</td>
<td>650</td>
</tr>
</tbody>
</table>
### Investment
- 400
- 100
- 500

### Current assets:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount 1</th>
<th>Amount 2</th>
<th>Amount 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventories</td>
<td>250</td>
<td>150</td>
<td>400</td>
</tr>
<tr>
<td>Financial assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade receivables</td>
<td>450</td>
<td>300</td>
<td>750</td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>200</td>
<td>100</td>
<td>300</td>
</tr>
<tr>
<td>Others</td>
<td>400</td>
<td>230</td>
<td>630</td>
</tr>
</tbody>
</table>

**Total**
- 2,000
- 1,380
- (150)
- 3230

### Equity and Liabilities

#### Equity
- Share capital- Equity shares of ₹ 100 each: 500

#### Non-current liabilities:
- Long term borrowings: 250
- Long term provisions: 50
- Deferred tax: 40

#### Current liabilities:
- Short term borrowings: 100
- Trade payable: 250
- Liability for lawsuit damages: 5

**Total**
- 2,000
- 755
- 475
- 3230

### 17. CARVE OUT IN IND AS 103 FROM IFRS 3

**As per IFRS:** IFRS 3 requires bargain purchase gain arising on business combination to be recognised in profit or loss as income.
Carve out: Ind AS 103 requires the bargain purchase gain 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. A similar carve-out is made in Ind AS 28, Investments in Associates and Joint Ventures.

Reasons: At present, since bargain purchase gain occurs at the time of acquiring a business, these are considered as capital reserve. Recognition of such gains in profit or loss would result into recognition of unrealised gains, which may get distributed in the form of dividends. Moreover, such a treatment may lead to structuring through acquisitions, which may not be in the interest of the stakeholders of the company. "

18. CARVE-IN IN IND AS 103 FROM IFRS 3

As per IFRS: IFRS 3 excludes from its scope business combinations of entities under common control.

Carve-in: Appendix C of Ind AS 103, Business Combinations gives guidance in this regard.
TEST YOUR KNOWLEDGE

Questions

1. Company A and Company B are in power business. Company A holds 25% of equity shares of Company B. On 1st November, Company A obtains control of Company B when it acquires a further 65% of Company B’s shares, thereby resulting in a total holding of 90%. The acquisition had the following features:
   - **Consideration:** Company A transfers cash of ₹ 59,00,000 and issues 1,00,000 shares on 1st November. The market price of Company A’s shares on the date of issue is ₹ 10 per share. The equity shares issued as per this transaction will comprise 5% of the post-acquisition equity capital of Company A.
   - **Contingent consideration:** Company A agrees to pay additional consideration of ₹ 7,00,000 if the cumulative profits of Company B exceed ₹ 70,00,000 over the next two years. At the acquisition date, it is not considered probable that the extra consideration will be paid. The fair value of the contingent consideration is determined to be ₹ 3,00,000 at the acquisition date.
   - **Transaction costs:** Company A pays acquisition-related costs of ₹ 1,00,000.
   - **Non-controlling interests (NCI):** The fair value of the NCI is determined to be ₹ 7,50,000 at the acquisition date based on market prices. Company A elects to measure non-controlling interest at fair value for this transaction.
   - **Previously held non-controlling equity interest:** Company A has owned 25% of the shares in Company B for several years. At 1st November, the investment is included in Company A’s consolidated balance sheets at ₹ 6,00,000, accounted for using the equity method; the fair value is ₹ 20,00,000.

The fair value of Company B’s net identifiable assets at 1st November is ₹ 60,00,000, determined in accordance with Ind AS 103.

Determine the accounting under acquisition method for the business combination by Company A.

2. On 30th September, 20X1 Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. All of Entity B’s shareholders 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 30th September, 20X1 is ₹ 40. The quoted market price of Entity A’s ordinary shares at that date is ₹ 16.

The fair values of Entity A’s identifiable assets and liabilities at 30th September, 20X1 are the same as their carrying amounts, except that the fair value of Entity A’s non-current assets at 30th September, 20X1 is 1,500.

The statements of financial position of Entity A and Entity B immediately before the business combination are:
### Entity A (legal parent, accounting acquiree) | Entity B (legal subsidiary, accounting acquirer)
---|---
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 | | 600
Total shareholders’ equity | 1,100 | 2,000
Total liabilities and shareholders’ equity | 1,800 | 3,700

Assume that Entity B’s earnings for the annual period ended 31st December, 20X0 were 600 and that the consolidated earnings for the annual period ended 31st December, 20X1 were 800. Assume also that there was no change in the number of ordinary shares issued by Entity B during the annual period ended 31st December, 20X0 and during the period from 1st January, 20X1 to the date of the reverse acquisition on 30th September, 20X1.

Calculate the fair value of the consideration transferred measure goodwill and prepare consolidated balance sheet as on September 30, 20X1. Also compute Earnings per share as on December 30, 20X1.

3. **Scenario 1: New information on the fair value of an acquired loan**

Bank F acquires Bank E in a business combination in October, 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives Borrower B’s financial statements for the year ended 30th September, 20X1, which indicate significant decrease in Borrower B’s income from operations. Basis this, the fair value of the loan to B at the acquisition date is determined to be less than the amount recognised earlier on a provisional basis.
Scenario 2: Decrease in fair value of acquired loan resulting from an event occurring during the measurement period

Bank F acquires Bank E in a business combination in October, 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives information that Borrower B has lost its major customer earlier that month and this is expected to have a significant negative effect on B's operations.

Comment on the treatment done by Bank F.

4. Company A acquired 90% equity interest in Company B on 1st April, 20X1 for a consideration of ₹ 85 crores in a distress sale. Company B did not have any instrument recognised in equity. The Company appointed a registered valuer with whose assistance, the Company valued the fair value of NCI and the fair value identifiable net assets at ₹ 15 crores and ₹ 100 crores respectively.

Find the value at which NCI has to be shown in the financial statements.

5. On 1st April, 20X1, Company A acquired 5% of the equity share capital of Company B for 1,00,000. A accounts for its investment in B at Fair Value through OCI (FVOCI) under Ind AS 109, Financial Instruments: Recognition and Measurement. At 31st March, 20X2, A carried its investment in B at fair value and reported an unrealised gain of ₹ 5,000 in other comprehensive income, which was presented as a separate component of equity. On 1st April, 20X2, A obtains control of B by acquiring the remaining 95 percent of B.

Comment on the treatment to be done based on the facts given in the question.

6. Company A acquires 70 percent of Company S on 1st January, 20X1 for consideration transferred of ₹ 5 million. Company A intends to recognise the NCI at proportionate share of fair value of identifiable net assets. With the assistance of a suitably qualified valuation professional, A measures the identifiable net assets of B at ₹ 10 million. A performs a review and determines that the business combination did not include any transactions that should be accounted for separately from the business combination.

State whether the procedures followed by A and the resulting measurements are appropriate or not. Also calculate the bargain purchase gain in the process.

Answers

1. **Identify the acquirer**

In this case, Company A has paid cash consideration to shareholders of Company B. Further, the shares issued to Company B pursuant to the acquisition do not transfer control of Company A to erstwhile shareholders of Company B. Therefore, Company A is the acquirer and Company B is the acquiree.

**Determine acquisition date**

As the control over the business of Company B is transferred to Company A on 1st November, that date is considered as the acquisition date.
**Determine the purchase consideration**

The purchase consideration in this case will comprise the following:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash consideration</td>
<td>59,00,000</td>
</tr>
<tr>
<td>Equity shares issued (1,00,000 x 10 i.e., at fair value)</td>
<td>10,00,000</td>
</tr>
<tr>
<td>Contingent consideration (at fair value)</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Fair value of previously held interest</td>
<td>20,00,000</td>
</tr>
</tbody>
</table>

As such, the total purchase consideration is ₹ 92,00,000.

Acquisition cost incurred by and on behalf of the Company A for acquisition of Company B should be recognised in the Statement of profit and loss. As such, an amount of ₹ 1,00,000 should be recognised in Statement of profit and loss.

**Determine fair value of identifiable assets and liabilities**

The fair value of identifiable net assets is determined at ₹ 60,00,000.

**Measure NCI**

The management has decided to recognise the NCI at its fair value. As such, the NCI will be recognised at ₹ 7,50,000.

**Re-measure previously held interests in case business combination is achieved in stages**

In this case, the control has been acquired in stages i.e., before acquisition to control, the Company A exercised significant influence over Company B. As such, the previously held interest should be measured at fair value and the difference between the fair value and the carrying amount as at the acquisition date should be recognised in Statement of Profit and Loss. As such, an amount of ₹ 14,00,000 (i.e., 20,00,000 less 6,00,000) will be recognised in Statement of profit and loss.

Assume that Entity B’s earnings for the annual period ended 31st December, 20X0 were 600 and that the consolidated earnings for the annual period ended 31st December, 20X1 were 800. Assume also that there was no change in the number of ordinary shares issued by Entity B during the annual period ended 31st December, 20X0 and during the period from 1st January, 20X1 to the date of the reverse acquisition on 30th September, 20X1.

**Determination of goodwill or gain on bargain purchase**

Goodwill should be calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total consideration</td>
<td>92,00,000</td>
</tr>
<tr>
<td>Recognised amount of any non-controlling interest</td>
<td>7,50,000</td>
</tr>
<tr>
<td>Less: fair value of Lila-Domestic's net identifiable assets</td>
<td>(60,00,000)</td>
</tr>
<tr>
<td><strong>Goodwill</strong></td>
<td><strong>39,50,000</strong></td>
</tr>
</tbody>
</table>
2. **Identifying the acquirer**

As a result of Entity A issuing 150 ordinary shares, Entity B’s shareholders own 60 per cent of the issued shares of the combined entity (i.e., 150 of the 250 total issued shares). The remaining 40 per cent are owned by Entity A’s shareholders. Thus, the transaction is determined to be a reverse acquisition in which Entity B is identified as the accounting acquirer while Entity A is the legal acquirer.

**Calculating the fair value of the consideration transferred**

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 1,600 (40 shares with a fair value per share of 40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. Here, the quoted market price of Entity A’s shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A’s shares — 100 shares with a fair value per share of 16.

**Measuring goodwill**

Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group’s interest in Entity A) over the net amount of Entity A’s recognised identifiable assets and liabilities, as follows:

<table>
<thead>
<tr>
<th>Consideration effectively transferred</th>
<th>1,600</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net recognised values of Entity A’s identifiable assets and liabilities</td>
<td></td>
</tr>
<tr>
<td>Current assets</td>
<td>500</td>
</tr>
<tr>
<td>Non-current assets</td>
<td>1,500</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>(300)</td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td>(400)</td>
</tr>
<tr>
<td>Goodwill</td>
<td>(1,300)</td>
</tr>
</tbody>
</table>

**Consolidated statement of financial position at 30th September, 20X1**

The consolidated statement of financial position immediately after the business combination is:

<table>
<thead>
<tr>
<th>Current assets [700 + 500]</th>
<th>1,200</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets [3,000 + 1,500]</td>
<td>4,500</td>
</tr>
<tr>
<td>Goodwill</td>
<td>300</td>
</tr>
<tr>
<td>Total assets</td>
<td>6,000</td>
</tr>
<tr>
<td>Current liabilities [600 + 300]</td>
<td>900</td>
</tr>
</tbody>
</table>
The amount recognised as issued equity interests in the consolidated financial statements (2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (600) and the fair value of the consideration effectively transferred (1,600). However, the equity structure appearing in the consolidated financial statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

**Earnings per share**

Earnings per share for the annual period ended 31st December, 20X1 is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of shares deemed to be outstanding for the period from 1st January, 20X1 to the acquisition date (i.e., the number of ordinary shares issued by Entity A (legal parent, accounting acquiree) in the reverse acquisition)</td>
<td>150</td>
</tr>
<tr>
<td>Number of shares outstanding from the acquisition date to 31st December, 20X1</td>
<td>250</td>
</tr>
<tr>
<td>Weighted average number of ordinary shares outstanding</td>
<td>175</td>
</tr>
<tr>
<td>[(150 x 9/12) + (250 x 3/12)]</td>
<td></td>
</tr>
<tr>
<td>Earnings per share [800/175]</td>
<td>4.57</td>
</tr>
</tbody>
</table>

Restated earnings per share for the annual period ended 31st December, 20X0 is 4.00 [calculated as the earnings of Entity B of 600 divided by the number of ordinary shares Entity A issued in the reverse acquisition (150)].

3. **Scenario 1:** The new information obtained by F subsequent to the acquisition relates to facts and circumstances that existed at the acquisition date. Accordingly, an adjustment (i.e., decrease) to in the provisional amount should be recognised for loan to B with a corresponding increase in goodwill.

**Scenario 2:** Basis this, the fair value of the loan to B will be less than the amount recognised earlier at the acquisition date. The new information resulting in the change in the estimated fair value of the loan to B does not relate to facts and circumstances that existed at the acquisition date, but rather is due to a new event i.e., the loss of a major customer subsequent to the acquisition date. Therefore, based on the new information, F should determine and recognise an allowance for loss on the loan in accordance with Ind AS 109, *Financial Instruments: Recognition and Measurement*, with a corresponding charge to profit or loss; goodwill is not adjusted.
4. In this case, Company A has the option to measure NCI as follows:
   - Option 1: Measure NCI at fair value i.e., ₹ 15 crores as derived by the valuer;
   - Option 2: Measure NCI as proportion of fair value of identifiable net assets i.e., ₹ 10 crores (100 crores x 10%) 

5. At the acquisition date A recognises the gain of ₹ 5,000 in OCI as the gain or loss is not allowed to be recycled to income statement as per the requirement of Ind AS 109. A’s investment in B would be at fair value and therefore does not require remeasurement as a result of the business combination. The fair value of the 5 percent investment (1,05,000) plus the fair value of the consideration for the 95 percent newly acquired interest is included in the acquisition accounting.

6. The amount of B’s identifiable net assets exceeds the fair value of the consideration transferred plus the fair value of the NCI in B, resulting in an initial indication of a gain on a bargain purchase. Accordingly, A reviews the procedures it used to identify and measure the identifiable net assets acquired, to measure the fair value of both the NCI and the consideration transferred, and to identify transactions that were not part of the business combination.

Following that review, A concludes that the procedures followed and the resulting measurements were appropriate.

\[
\begin{array}{|c|c|}
\hline
\text{Identifiable net assets} & ₹1,00,00,000 \\
\hline
\text{Less: Consideration transferred} & (₹50,00,000) \\
\hline
\text{NCI (10 million x 30%)} & (₹30,00,000) \\
\hline
\text{Gain on bargain purchase} & ₹20,00,000 \\
\hline
\end{array}
\]