IFRS 3/Ind AS 103

BUSINESS COMBINATIONS

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What we will be learning today..

- What is Business Combination?
- Comparison with IAS 22/AS 14
- Business acquisition Vs. Asset acquisition
- Difference: Ind AS 103 "Business Combination" and Ind AS 110 "Consolidated Financial Statements"
- Accounting for Business Combination
- Business combination achieved in stages
- Initial Accounting determined Provisionally
- Business combination of entities under common control
- Comparison with IFRS 3- Business Combinations

What is Business Combination?

What is Business Combination?

- Two or more **business** organizations or their **net assets are bought under common control** in a single business entity
- Similar type of business or similar line of activities
- Objective: Economies of large scale production and to minimize the possibility of cut throat competition
- **Other terms** in market: **Merger and acquisition**

  Merger: Companies of similar nature combines willingly

  Acquisition: Bigger Company takes over a Smaller Company

Broad comparison with IAS 22/AS 14

IAS 22/AS 14

- **IAS 22:** Business Combinations , Issued in 1998
- Use of either Pooling of interest method or the acquisition method (purchase method)
- No guidance about reverse acquisition
- Goodwill arising on amalgamation in the nature of purchase has to be amortised over a period of max 5 years

IFRS 3/ Ind AS 103

- **IFRS 3** Superseded IAS 22 effective March 31 2004
- The new standards allow only the use of the Purchase method
- The new standard deals with reverse acquisition
- Goodwill is not amortised but tested for impairment on annual basis in accordance with IND AS 36 on impairment of assets.

Broad comparison with IAS 22/AS 14

IAS 22/AS 14	IFRS 3/ Ind AS 103
▪ Deals only with merger and amalgamations ▪ Under the existing AS 14, the acquired assets and liabilities are recognised at their existing book values or at fair values under the purchase method.	▪ Defines Business combination which has a wider scope ▪ Ind AS 103 requires the acquired identifiable assets, liabilities and non-controlling interest to be recognised at fair value under acquisition method.

What is Business Combination?

Appendix A of Ind AS 103 defines Business Combination:

"**A Transaction or other event in which an acquirer obtains Control of one or more businesses**".

Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this Ind AS.

- An act of bringing together of separate entities or businesses into ***one reporting unit***.
- **One entity** (the Acquirer) **obtains control of one or more businesses**.
- If an entity obtains controls over another entity which are not businesses, the act is not a business combination.

Case study 1

Big Company Limited acquires 70% shares of Small Company Limited and both the Companies continues to exist.

Whether it is a business combination as per Ind AS 103?

Solution:

From the definition of Business Combination, it is clear that for Business combination, the control by one entity of another is sufficient and both the Company may continue to exist. Here Big Company Limited becomes a holding (Parent) Company of Small Compan Limited and therefore, they becomes one reporting entity by reporting Consolidated Financial Statements.

Yes, it is a case of Business combination as per Ind AS 103

Case study 2

“Zomato has acquired the Indian operations of Uber Eats, the food delivery biz run by Uber”

Whether it is a business combination as per Ind AS 103?

Solution:

Yes , it is a business combination as per Ind AS 103 as Uber Eats will ceased to exist as a separate brand locally and users on its platform will be redirected to Zomato’s app.

Zomato has **acquired control** of Indian **business** of Uber Eats. The combined entity of Zomato and Uber Eats India is expected to corner more than a 50-55% market in terms of the number and value of orders, pulling it ahead of Swiggy.

Here a bigger Company (Zomato) took over a Smaller Company (Uber Eats) to minimize the possibility of cut throat competition and both the Companies continues to exist as only one business i.e. Indian food delivery business is acquired/taken under control.

Case study 3

“FMCG India Limited is into manufacturing of toiletries and running factories at four locations. One of the entity in Tata group acquires one factory of FMCG India Limited and wants to utlilize all assets in their line of business.”

Whether it is a business combination as per Ind AS 103?

Solution:

No, this is a case of assets transfer/purchase of assets. This is not a business combination as the business of that factory is not taken over by Tata thus here one of the basic requirement of business combination “One entity (the Acquirer) obtains control of one or more businesses” is missing.

This is a case of Asset transfer not Business combination.

Business acquisition Vs. Assets acquisition

Meaning of Business

A business consists of three elements:

Input	Any economic resources that creates or can create outputs when one or more processes are applies to it, e.g., non-current assets etc.
Process	Any system, standard, protocol, or rule that when applied to an input(s) create output(s) e.g. Management processes, workforce etc.
Output	The result of inputs and processes applied to those inputs that provide or can provide a return in the form of dividend, lower costs, benefits directly to investors/owners.

Business acquisition Vs. Assets acquisition

Determine

- Whether a particular set of assets and activities is a business ?
- Whether the integrated set is capable of being conducted and managed as a business by the market participant?

If yes, it is case of business acquisition

If no, then it is mere a collection of assets or a combination of assets and liabilities

Ind AS 103 “Business Combination” does not apply to acquisition of assets or a group of assets that does not constitute a business.

Case study 4

XYZ Ltd. is a company which is live, but due to some reasons, is not running any business from last couple of years. Now, Motaba Limited acquired all assets (majorly land in its Balance Sheet) and liabilities of XYZ Ltd.

Whether it is a business combination as per Ind AS 103?

Solution:

No, this is a case of assets transfer/purchase of assets. This is not a business combination as there is no business which is taken over by Motaba with an intention to carry over it thus here one of the basic requirement of business combination "One entity (the Acquirer) obtains control of one or more businesses" is missing.

This is a case of Asset transfer not Business combination

Case study 5

PQ Ltd is a garment manufacturer and has been in operation from last 10 years. The Company produces a wide range of garments and employs a workforce of designers, machine operators, quality checkers and other operational, marketing and administrative staff. It owns and operates a factory, warehouse and machinery and hold raw material inventory and finished goods. On April 1, 2017, RS Ltd. paid Rs. 150 Crores to acquire 100% of the ordinary voting shares of PQ Ltd. No other type of shares has been issued by PQ Ltd.

Whether it is a business combination as per Ind AS 103?

Case study 5

Solution:

In this case, it is clear that PQ Ltd 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. The acquisition of shares of PQ Ltd by RS Ltd to obtain control on April 1, 2017 is acquisition of business.

It is a business combination as per Ind AS 103

Business acquisition Vs. Assets acquisition

Area	Business combination	Asset or group of assets acquisition
Measurement of assets and liabilities	Recorded at fair value	Recorded at cost, cost is allocated over the group of assets based on relative fair value
Transaction costs	Expenses as incurred	Capitalized as part of the cost
Contingent liabilities assumed	Recognized if represents present obligation that arises from past events and its fair value can be measured reliably with subsequent changes to profit or loss	Not recognized, subject to Ind AS 37
Goodwill	May be recognized	Not recognized

Difference between

Ind AS 103 “Business Combinations”
and
Ind AS 110 “Consolidated Financial Statement”

Ind AS 103 Vs. Ind AS 110

Both standards deals with business combinations and their financial statements?

Yes but that is not the whole truth.

But while **Ind AS 110 defines a control** and prescribe specific **consolidation procedures**

Ind AS 103 is more about the measurement of the items in the consolidated financial statements, such as goodwill, non-controlling interest etc.

So, if you need to deal with the Consolidation, **first** you have to **apply Ind AS 103** for measurement of assets and liabilities acquired, non-controlling interest and goodwill/bargain purchase **then** the Consolidation procedure as per **Ind AS 110**.

Accounting for Business Combinations

Accounting for Business Combinations

1. Identify the Acquirer

2. Determine the acquisition date

3. Recognizing an measuring the identifiable assets acquired and liabilities assumed and any non-controlling interest in the acquiree

4. Recognizing and measuring goodwill or gain from bargain purchase

5. Disclosures

1. Identify the Acquirer

Most of the time: Acquirer is *usually* the investor *who acquires an investment or a subsidiary*.

Sometimes, it is not clear. When two Companies merge together and create just one Company, the acquirer is usually the biggest one- with larger fair value.

The following factors as describes in Ind AS 103 shall be considered in making the determination:

- Acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.
- Acquirer is usually the entity that issues its equity interests.
- Acquirer is usually the combining entity whose relative size (assets, revenue or profits) is significantly greater than that of the other combining entity/entities.

1. Identify the Acquirer

A reverse acquisition

When an entity whose equity interest are acquired (the legal acquiree) must be the acquirer for the accounting purposes

Example: 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.

Here,

Private entity is the legal acquiree but considered as acquirer for accounting purposes

Public entity is the legal acquirer but considered as acquiree for accounting purposes

2. Determine the acquisition date

Date on which the acquirer **obtains control** of the acquiree.

Generally the date on which the acquirer legally transfers the consideration (the payment for the investment), acquires the assets and assumes the liabilities of the acquiree-the closing date.

However, it ***can be earlier or later*** than the closing date, too. It depends on the contractual arrangement in the written agreements, if something like that exists.

3. Recognize and measure assets, liabilities and NCI

An **acquirer** shall **recognize** all identifiable assets acquired, liabilities assumed and Non-Controlling Interests (NCI) in the acquiree separately from goodwill.

What is to be recognized?

All ***identifiable*** assets acquired, liabilities assumed and non-controlling interests

How to be recognized?

All assets and liabilities are measured at ***acquisition date fair value.***

Often investors/acquirer need to perform " fair value adjustments" because assets and liabilities are valued in a different way-at cost less acc. Depreciation or at amortized cost.

4. Recognize and measure Goodwill/gain on bargain purchase

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized.

Goodwill is **measured at the acquisition date** as the **excess of** 1 or 2 below:

1. The aggregate of
   - The fair value of consideration transferred
   - The amount of any non-controlling interest recognized
   - In a business combination achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree.

2. The assets and liabilities recognised in accordance with Ind AS 103.

4. Recognize and measure Goodwill/gain on bargain purchase

Consideration transferred is measured at **fair value, including any contingent consideration**. Subsequent change in a consideration transferred is accounted for depending on the initial recognition of the contingent consideration.

Goodwill may arise in the acquiring group's **consolidated financial statements** when a new subsidiary is acquired.

Goodwill can also arise in the **separate financial statements** of an acquiring entity where it purchases the business and assets of another company.

Goodwill is measured as a residual.

Where an entity acquires less than 100% of a business, goodwill could be one of two different amounts depending on the choice an entity makes when it decides how to measure non-controlling interest-Fair value method or Proportionate share method.

4. Recognize and measure Goodwill/gain on bargain purchase

What is gain from bargain purchase?

If the goodwill is negative, then it is a gain on bargain purchase.

Negative goodwill is recognized as a gain directly in equity as capital reserves (**Carve-out**)

5. 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:

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

Business combination achieved in stages

Business combination achieved in stages

The acquirer shall **re-measure** its previously held equity interest in the acquiree at its **acquisition date fair value** and recognize the resulting gain or loss, if any, in profit or loss or another comprehensive income, as appropriate.

Initial accounting determined provisionally

Initial accounting determined provisionally

Provisional accounting

- If accurate figures cannot be assigned to elements of the business combinations then provisional values are assigned to those elements at the date of acquisition.
- Any new information that becomes available, relating to acquisition date assets and liabilities, is retrospectively adjusted against the initial provisional amounts recognized as long as the information is known with the ***measurement period.***

The measurement period is the period after the acquisition date during which the parent may adjust the provisional amounts recognized in respect of the acquisition of a subsidiary. The measurement period ***cannot exceed one year after the acquisition date***.

Business combination of Entities under common control

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All the combining entities or the businesses are **ultimately controlled by same party** or parties **both before and after** the business combination.

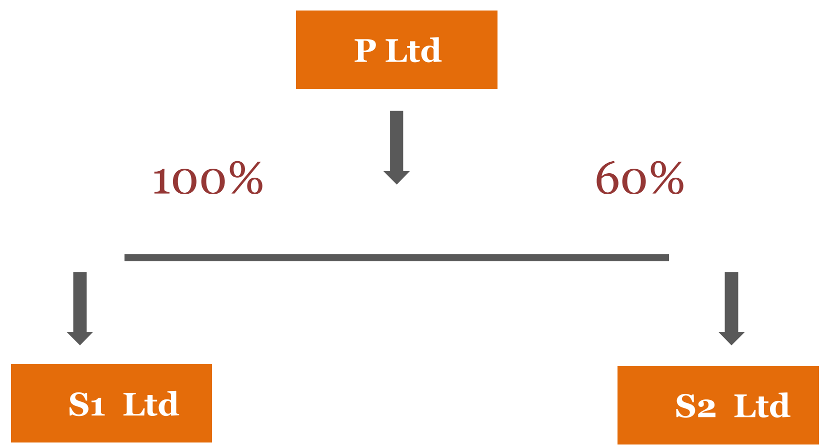
Common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group.

Example

Consider the following two groups

Now, P Ltd acquires from S1 ltd its 60% stake in S2 for Rs. 200 Million.

After that position of the group will be



Business combination of Entities under common control

Pooling of interests method

- The assets and liabilities are reflected at their carrying amounts
- No adjustments for fair values
- No new assets or liabilities
- The **only adjustment** is to harmonize accounting policies
- The balances of retained earnings of the transferor is aggregated with the corresponding balance appearing in the financial statements of transferee.
- 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.

Difference, if any shall be transferred to **capital reserves** and should be presented separately from the other capital reserves with disclosure of its nature and purpose in the notes.

Comparison with IFRS 3 Business combination

Comparison with IFRS 3 “Business combination”

IFRS 3	IND AS 103
IFRS 3 excludes from its scope business combination of entities under common control	Ind AS 103 (Appendix C) gives the guidance in this regard
IFRS 3 requires the gain on bargain purchase to be recognized in Profit or loss.	Ind AS 103 requires the same to be recognized in other comprehensive income and accumulated in equity as capital reserves, unless there is no clear evidence for the underlying reason for the classification of the business combination as a bargain purchase, in which case, it shall be recognized directly in equity as capital reserves.


ANY QUESTIONS?