IND AS 103 - BUSINESS COMBINATION

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 as equipment and patent relate to a product that has just recently been commercialised

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).

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.

Illustration 4 - Potential voting rights – (MTP May'23)

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. **(5 Marks)**

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.

Illustration 5 - *(RTP - Nov 2020)*

Veera Limited and Zeera Limited are both in the business of manufacturing and selling of Lubricant. Veera Limited and Zeera Limited shareholders agree to join forces to benefit from lower delivery and distribution costs. The business combination is carried out by setting up a new entity called Meera Limited that issues 100 shares to Veera Limited's shareholders and 50 shares to Zeera Limited's shareholders in exchange for the transfer of the shares in those entities. The number of shares reflects the relative fair values of the entities before the combination. Also respective company's shareholders gets the voting rights in Meera Limited based on their respective shareholding.

Determine the acquirer by applying the principles of Ind AS 103 'Business Combinations'.

Solution:

As per para B15 of Ind AS 103, 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:

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.

Based on above mentioned para, acquirer shall be either of the combining entities (i.e. Veera Limited or Zeera Limited), whose owners as a Group retain or receive the largest portion of the voting rights in the combined entity.

Hence, in the above scenario Veera Limited's shareholder gets 66.67% share (100 / 150 x 100) and Zeera Limited's shareholder gets 33.33% share in Meera Limited. Hence, Veera Limited is acquirer as per the principles of Ind AS 103.

Illustration 6

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.

Illustration 7

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 8

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 9 - 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 effective from 1st January, 20X1 and that ABC Ltd. is entitled to all profits after that date. In addition, the purchase price is based on XYZ Ltd.'s net asset position as at 1st January, 20X1. What is the date of acquisition?

Solution

IND AS 103 provides that acquisition date is the date on which the acquirer obtains control of the acquiree.

Further 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, 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 acquire - 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 10 - 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 acquire - 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.

Illustration 11 - (MTP Oct'20, RTP May'24)

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:

	(₹ in crore)
Share of profit or loss	700
Share of exchange difference in OCI	100
Share of revaluation reserve of PPE in OCI	50

The carrying amount of the investment in the associate on 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:

	(₹ in crore)
Fair value of the 30% interest already owned	9,000
Fair value of XYZ's identifiable net assets	30,000

How should such business combination be accounted for? **(8 marks)**

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:

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

Working Notes:

1. **Calculation of Goodwill**

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

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:

	₹ in crore
Fair Value of 30% interest in XYZ Ltd. at 1st April, 20X2	9,000
Carrying amount of interest in XYZ Ltd. at 1st April, 20X2	(8,850)
	150
Unrealised gain previously recognised in OCI	100
Gain on previously held interest in XYZ Ltd. recognised in profit or loss	**250**

Illustration 12 - Business Combination Achieved by Contract Alone

Sita Ltd and Beta Ltd decides to combine together for forming a Dual Listed Corporation (DLC). As per their shareholder's agreement, both the parties will retain original listing and Board of DLC will be comprised of 10 members out of which 6 members will be of Sita Ltd and remaining 4 board members will be of Beta Ltd.

The fair value of Sita Ltd is ₹ 100 crores and fair value of Beta Ltd is ₹ 80 crores. The fair value of net identifiable assets of Beta Limited is ₹ 70 crores. Assume non-controlling Interest (NCI) to be measured at fair value.

You are required to determine the goodwill to be recognised on acquisition.

Solution:

Sita Ltd has more Board members and thereby have majority control in DLC. Therefore, Sita Ltd is identified as acquirer and Beta Ltd as acquiree.

Since no consideration has been transferred, the goodwill needs to be calculated as the difference of Part A and Part B:

Part A:

1) Consideration paid by Acquirer. - Nil

2) Controlling Interest in Acquiree – ₹ 80 crores

3) Acquirer's previously held interest - Nil

Part B:

Fair value of net identifiable asset – ₹ 70 crores

Goodwill is recognised as ₹ 10 crores (80 – 70 crores) in business combination achieved through contract alone when NCI is measured at fair value.

Illustration 13

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 14

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.

Illustration 15

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 lakhs 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 16

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.

Illustration 17

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 Company 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. Hence customer list should be recorded as an intangible in a business combination.

Illustration 18

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.

Illustration 19

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 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 20

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.

Illustration 21

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?

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)).

Illustration 22

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 23

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.

Illustration 24

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.

Recommend the accounting for such litigation liability at the time of business combination of Progressive Ltd. and Regressive Ltd.

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.

Illustration 25

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 26 - 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.

Illustration 27

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 year (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.

Determine the accounting for the above replacement award

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.

Illustration 28

P 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).

Determine the accounting for market-based measure of the award

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.

Illustration 29

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:

(₹ in crores)

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

*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(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:

(₹ in Crores)

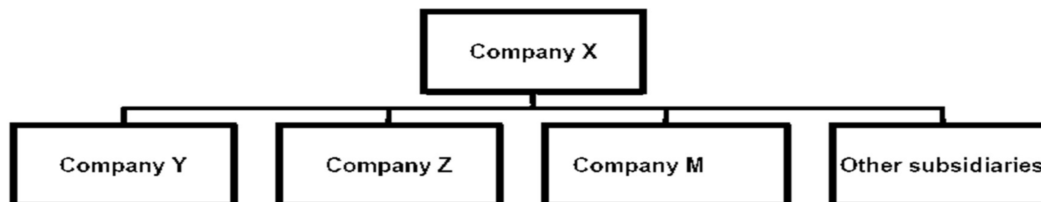
Identifiable net assets at fair value	Dr	150	
Goodwill*	Dr	7.5	
To Non-controlling interest (40% x 150) Cr			60
To Investment in Natural Ltd. Cr			97.5

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

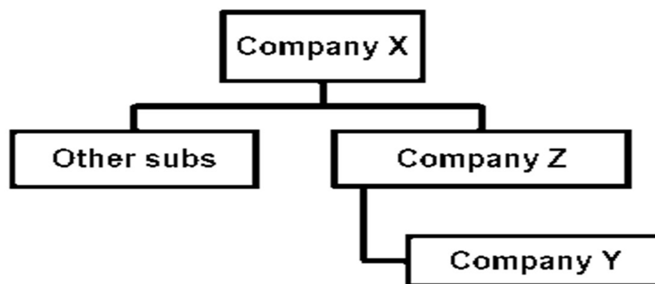
Illustration 30

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



After-Reorganisation



Analyse the above transaction

Solution

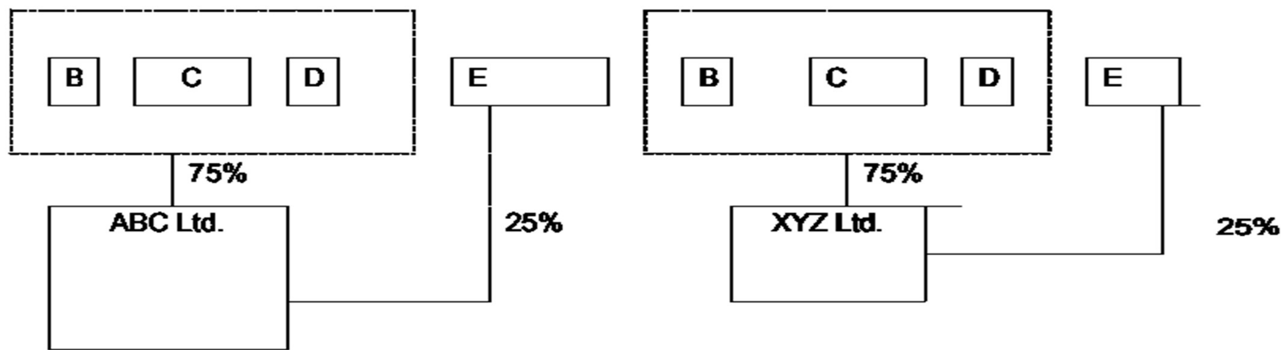
In this situation, Company Z pays consideration to Company X to obtain control of Company Y. The transaction meets the definition of a business combination. Prior to the reorganisation, each of the parties are controlled by Company X. After the reorganisation, although Company Y are now owned by Company 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 31

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 32

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.

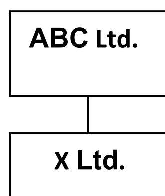
In the present case, there is no contractual arrangement between the shareholders who exercise control collectively over either company. Thus, ABC Ltd. and XYZ Ltd. are not considered to be under common control even if there is an established pattern of voting together.

Illustration 33

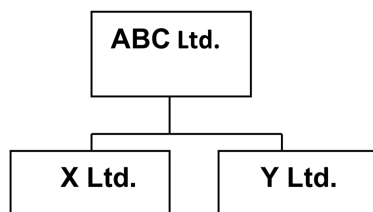
ABC Ltd. had a subsidiary, namely, X Ltd. which was acquired on 1st April, 2XX0. ABC Ltd. acquires all of the shares of Y Ltd. on 1st April, 2X17. ABC Ltd. transfers the shares in Y Ltd. to X Ltd. on

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.?

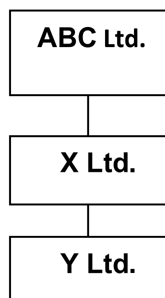
Before:



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 ABC shortly before the transaction.

Illustration 34

How will the financial statement of the prior periods be restated under common control in the following scenarios:

a) Common Control period extends beyond the start of comparative period

XYZ Ltd acquired PQR Ltd in a common control transaction on 1 October 20X9. The year-end of XYZ Ltd is 31 March. Both XYZ Ltd and PQR Ltd have been controlled by shareholders since their incorporation.

b) Common Control period started in the comparative period

ABC Ltd acquired DEF Ltd in a common control transaction on 1 October 20X9. The year end of ABC Ltd is 31 March. Both ABC Ltd and DEF Ltd are controlled by shareholder A. A made investment in ABC Ltd in 20X0 and made investment in DEF Ltd on 1 October 20X8.

Solution:

Paragraph 9(iii) of Appendix C to Ind AS 103 states that the financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

a) In accordance with Paragraph 9(iii) above, the entity will be required to restate its financial statements as if the business combination had occurred from the beginning of the preceding period in the financial statements, accordingly in the present case XYZ Ltd will have to restate its comparatives for the financial year 20X8-20X9 as if the acquisition had occurred before 1 April 20X8. Additionally, the results of current year of PQR Ltd will be required to include XYZ's financial statements for the period from 1 April 20X9 to 30 September 20X9.
b) In accordance with paragraph 9(iii) above, ABC Ltd will have to restate its comparatives for the financial year ended 20X8-20X9 as if the acquisition had occurred on 1 October 20X8, but not earlier. Additionally, the results of current year of DEF Ltd will be required to include the financial statements of ABC Ltd for the period from 1 April 20X9 to 1 October 20X9

Illustration 35

Entity A owns 100% equity shares of entity B since 01.04.20X1. Entity A arranges loan funding from a financial institution in a new wholly-owned subsidiary called “Entity C”. The loan is used by Entity C to acquire 100% shareholding in entity B, for cash consideration of ₹ 2,00,000. Entity A applies Ind AS 103 to account for common control transactions and Entity C will adopt the same policy. Fair Value of Net identifiable Assets is ₹ 1,50,000 and Carrying Value of Net Identifiable Assets is ₹ 1,00,000.

How will Entity C apply acquisition accounting in its consolidated financial statements?

Solution:

As per para 2 of appendix C of Ind AS 103, 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.

In the above scenario, the Entity A controls Entity B before and after the acquisition. After acquisition, entity A controls entity B through entity C.

As per para 8 of appendix C of Ind AS 103, Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method.

As per para 9(i) of appendix C of Ind AS 103, the pooling of interest method is considered to involve the assets and liabilities of the combining entities are reflected at their carrying amounts.

Based on the above analysis, Entity C cannot be the acquirer. Entity A has created Entity C and is the seller, so Entity C has effectively been formed and issued shares to effect the business combination. Entity C is not a business and the transaction between entity B and Entity C is not a business combination. It is a reorganisation of entity B. As a result, entity B's assets and liabilities are included in Entity C consolidated financial statements at their pre-combination carrying amounts without a fair value uplift.

Illustration 36 – (Past Exam – May 2018), (MTP – March 2021)

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

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

(₹ in crores)

		Laptops	Mobiles	Total
Property, Plant and Equipment cost		250	500	750
Depreciation		(225)	(400)	(625)
Net Property, Plant and Equipment	(A)	25	100	125
Current assets:		200	500	700
Less: Current liabilities		(25)	(400)	(425)
	(B)	175	100	275
Total	(A+B)	**200**	**200**	**400**
Financed by:				
Loan funds		-	300	300
Capital : Equity ₹ 10 each		25	-	25
Surplus		175	(100)	75
Total		**200**	**200**	**400**

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. **(10 Marks)**

Solution:

Journal of Enterprise Ltd.

(₹ in crores)

			Dr.	***Cr.***
(1)	Loan Funds	Dr.	300	
	Current Liabilities	Dr.	400	
	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)

ASSETS	**Note No.**	**Amount**
Non-current assets		
Property, Plant and Equipment		25
Current assets		
Other current assets		200
		225
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)		25
Other equity (Surplus)		175
Liabilities		
Current liabilities		
Current liabilities		25
		225

Notes to Accounts

		(₹ in crores)
1.	**Other Equity**	
	Surplus (175-100)	75
	Add: Capital Reserve on reconstruction	100
		175

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)

ASSETS	**Note No.**	**Amount**
Non-current assets		
Property, Plant and Equipment		100
Current assets		
Other current assets		500
		600
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	10

Other equity	2	(110)
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		300
Current liabilities		
Current liabilities		400
		600

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)]	**15** **(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 37

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

		Maxi division	Mini division	Total (in crores)
Property, Plant and Equipment				
Cost		600	300	900
Depreciation		(500)	(100)	(600)
W.D.V.	(A)	100	200	300
Current assets		400	300	700
Less: Current liabilities		(100)	(100)	(200)
	(B)	300	200	500
Total	(A+B)	400	400	800
Financed by :				
Loan funds	(A)	–	100	100
(secured by a charge on property, plant and equipment)				
Own funds:				
Equity capital				50
(fully paid up ₹ 10 per share)				
Other Equity				650

	(B)	?	?	700
Total	(A+B)	400	400	800

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)

		(₹ in crores)	
		Dr.	***Cr.***
Current liabilities A/c	Dr.	100	
Loan fund (secured) A/c	Dr.	100	
Provision for depreciation A/c	Dr.	100	
Loss on reconstruction (Balancing figure)	Dr.	300	
To Property, Plant and Equipment A/c			300
To Current assets A/c			300
(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.

		(₹ in crores)	
		Dr.	***Cr.***
Property, Plant and Equipment (300-100) A/c	Dr.	200	
Current assets A/c	Dr.	300	
To Current Liabilities A/c			100
To Secured loan funds A/c			100

To Equity share capital A/c			50
To Capital reserve			250
(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

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

Notes to Accounts

		After Reconstruction	*Before Reconstruction*
1.	**Other Equity**		
	Other Equity	650	650
	Less: Loss on reconstruction	(300)	–
		350	650
2.	**Property, Plant and Equipment**	600	900
	Less: Depreciation	(500)	(600)
		100	300

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

ASSETS	Note No.	After reconstruction
Non-current assets		
Property, Plant and Equipment		200

Current assets		
Other current assets		300
		500
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)		50
Other equity (capital reserve)		250
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		100
Current liabilities		
Current liabilities		100
		500

Notes to Account

	(₹ in crores)
1. Share Capital:	
Issued and paid up :	
5 crores Equity shares of ₹ 10 each fully paid up	50
(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.)	

b) Net Asset Value of an equity share

	Pre-demerger	Post-demerger
Maxi Mini Ltd. :	₹ 700 crores / 5 crores = ₹ 140	₹ 400 crores / 5 crores = ₹ 80
Mini Ltd.:	-	₹ 300 crores / 5 crores = ₹ 60

c) Demerger into two companies has had no impact on "net asset value" of shareholding. Pre- demerger, 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 38 – (Past Exam Dec'21) (MTP May'23)

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

(₹ in '000)

ASSETS	Note No.	AX Ltd	BX Ltd
Non-current assets			
Property, Plant and Equipment		8,500	7,500
Financial assets			
Investment		1,050	550
Current assets			
Inventory		1,250	2,750
Trade receivables		1,800	4,000

Cash and Cash equivalent		450	400
		13,050	**15,200**
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
		13,050	**15,200**

Note:

1.	**Other equity**	**AX Ltd**	**BX Ltd**
	General Reserve	1,500	2,000
	Profit & Loss	1,000	500
	Investment Allowance Reserve	500	100
	Export Profit Reserve	50	100
		3,050	**2,700**

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:

Assets	**AX Ltd. (‘000)**	**BX Ltd. (‘000)**
Property, Plant and Equipment	9,500	1,000
Inventory	1,300	2,900
Fair value of the business	11,000	14,000

Note: (In Exam, Only Part B was asked) **(14 Marks)**

Solution:

a) (Assumption: Common control transaction)

1) Calculation of Purchase Consideration

		AX Ltd.		***BX Ltd.***
		₹ ’000		*₹ ’000*
Assets taken over:				
Property, Plant and Equipment		85,00		75,00

Investment		10,50		5,50
Inventory		12,50		27,50
Trade receivables		18,00		40,00
Cash & Cash equivalent		4,50		4,00
Gross Assets		130,50		152,00
Less : Liabilities				
12% Debentures	30,00		40,00	
Trade payables	10,00	(40,00)	15,00	(55,00)
Net Assets taken over		90,50		97,00
Less: Other Equity:				
General Reserve	15,00		20,00	
P & L A/c	10,00		5,00	
Investment Allowance Reserve	5,00		1,00	
Export Profit Reserve	50	(30,50)	1,00	(27,00)
Purchase Consideration		**60,00**		**70,00**

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 =

$$\frac{\text{Net Assets taken over of AX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}} \times \text{Purchase Consideration}$$

No. of shares to be issued to BX Ltd =

$$\frac{\text{Net Assets taken over of BX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}} \times \text{Purchase Consideration}$$

	AX Ltd.	BX Ltd.
	₹ '000	₹ '000
$130,00 \times \frac{90,50}{187,50}$ = 6,27,500 * Equity shares of ₹ 10 each	62,75	
$130,00 \times \frac{97,00}{187,50}$ = 6,72,500 Equity shares of ₹ 10 each		67,25

Note: 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.

Balance Sheet of ABX Ltd. as on 1.1.20X2

₹ in '000

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		16,000
Financial assets		
Investments		1,600
Current assets		
Inventory		4,000
Trade receivable		5,800
Cash and Cash equivalent		850

		28,250
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	13,000
Other equity	2	5,750
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings	3	7,000
Current liabilities		
Trade payable		2,500
		28,250

Notes to Accounts

	(₹ 000)	(₹ 000)
1. Share Capital		
13,00,000 Equity Shares of ₹ 10 each		130,00
2. Other Equity		
General Reserve (15,00 + 20,00)	35,00	
Profit & Loss (10,00 + 5,00)	15,00	
Investment Allowance Reserve (5,00 + 1,00)	6,00	
Export Profit Reserve (50 + 1,00)	1,50	57,50
3. Long Term Borrowings		
12% Debentures		70,00

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:

(In '000s)

	AX Ltd.	BX Ltd.
Fair Value	11,000	14,000
Value per share	10	10
No. of shares	1,100	1,400
i.e. Total No. of shares in ABX Ltd. = 2,500 thousand shares		
Thus, % Held by each Company in Combined Entity	44%	56%

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

₹ in '000

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

Notes to Accounts

		(₹ 000)	*(₹ 000)*
1.	**Share Capital**		
	1,250,000 Equity Shares of ₹10 each (700,000 to BX Ltd and 550,000 as computed above to AX LTD)		1,25,00
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:

Assets:	**₹ in 000s**
Property, Plant and Equipment	9,500
Investment	1,050
Inventory	1,300
Trade Receivable	1,800
Cash & Cash Equivalent	450
Total Assets	14,100
Less : Liabilities:	
Borrowings	3,000
Trade Payable	1,000
Net Assets	10,100
Purchase Consideration	11,000
Goodwill	900

Illustration 39

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 10th June, 20X2, the shareholders of Ram Ltd approved the terms of the merger. On 15th June, the shares were allotted to the shareholders of Ram Ltd.

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

Date	Price per share
9th April	70
10th May	75
15th May	60
31st May	70
2nd June	80
10th June	85
15th June	90

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 aquiree. In the above scenario, the acquisition date will the date on which the shares were allotted to the shareholders of Ram Ltd. Although the shareholder approval was obtained on 10th June, 20X2 but the shares were issued only on 15th June, 20X2. Accordingly, the purchase consideration will be on the basis of ₹ 90 ie. the market price on that date. Hence total purchase consideration would be ₹ 10,80,000 (ie 12,000 shares x ₹ 90).

Illustration 40 – (MTP – April, 2021), (Past Exam May'22)

The balance sheet of Professional Ltd. & Dynamic Ltd. as of 31st March, 20X2 is given below: **(₹ in Lakhs)**

Assets	**Professional Ltd**	**Dynamic Ltd**
Non-Current Assets:		
Property, plant and equipment	300	500
Investment	400	100
Current assets:		
Inventories	250	150
Financial assets		
Trade receivables	450	300
Cash and cash equivalents	200	100
Others	400	230
Total	**2,000**	**1,380**
Equity and Liabilities		
Equity		
Share capital- Equity shares of ₹ 100 each of Dynamic Ltd. and ₹ 10 each of Professional Ltd.	500	400
Other Equity	810	225
Non-Current liabilities:		
Long term borrowings	250	200
Long term provisions	50	70
Deferred tax	40	35
Current Liabilities:		
Short term borrowings	100	150
Trade payables	250	300
Total	**2,000**	**1,380**

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. **(15 Marks)**

Solution:

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

	Amount
Assets	
Non-Current Assets:	
Property, plant and equipment	650
Investment	500
Current assets:	
Inventories	400
Financial assets:	
Trade receivables	750
Cash and cash equivalents	300
Others	630
Total	3,230
Equity and Liabilities	
Equity	
Share capital- Equity shares of ₹ 100 each	514
Other Equity	1,128.62
NCI	154.95
Non-Current liabilities:	
Long term borrowings	450
Long term provisions (50+70+28.93)	148.93
Deferred tax	28.5
Current Liabilities:	
Short term borrowings	250
Trade payables	550
Provision for Law suit Damages	5
Total	3,230

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. Since the fair value of the award on the acquisition date is 8 lakhs, the balance of 5.5 lakhs (8 – 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. (Para B59 of Ind AS 103)

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

Particulars		Amount
Share capital of Dynamic Ltd		4,00,00,000
Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value Rs. per share		40
		Rs. in lakhs
PC (2,00,000 x 70% x ₹ 40 per share) (A)		56.00
Deferred consideration after discounting ₹ 35 lakhs for 2 years @ 10% (B)		28.93
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)		2.50
PC in lakhs (A+B+C)		87.43

2. Allocation of Purchase price

Particulars	Book value (A)	Fair value (B)	FV adjustment (A-B)
Property, plant and equipment	500	350	(150)
Investment	100	100	-
Inventories	150	150	-
Financial assets:			-
Trade receivables	300	300	-
Cash and cash equivalents	100	100	-
Others	230	230	
Less: Long term borrowings	(200)	(200)	-
Long term provisions	(70)	(70)	-
Deferred tax	(35)	(35)	-
Short term borrowings	(150)	(150)	-
Trade payables	(300)	(300)	-
Contingent liability	-	(5)	(5)

Net assets (X)	625	470	(155)
Deferred tax Asset on FV adjustment (155 x 30%) (Y)		46.50	155
Net assets (X+Y)		516.5	
Non-controlling interest (516.50 x 30%) rounded off		154.95	
Capital Reserve (Net assets – NCI – PC)		274.12	
Purchase consideration (PC)		87.43	

3. Computation of consolidated amounts of Consolidated financial statements

	Professional Ltd	***Dynamic Ltd (pre-acquisition)***	***PPA Allocation***	***Total***
Assets				
Non-Current Assets:				
Property, plant and equipment	300	500	(150)	650
Investment	400	100		500
Current assets:				
Inventories	250	150		400
Financial assets:				
Trade receivables	450	300		750
Cash and cash equivalents	200	100		300
Others	400	230		630
Total	2,000	1,380	(150)	3230

Equity and Liabilities				
Equity				
Share capital- Equity shares of ₹ 100 each Shares allotted to Dynamic Ltd. (2,00,000 x 70% x ₹ 10 per share)	500		14	514
Other Equity	810		318.62	1128.62
Replacement award			2.5	2.5
Security Premium (2,00,000 sharesx70%x₹ 30)			42	42
Capital Reserve			274.12	274.12
Non-controlling interest	0		154.95	154.95
Non-Current liabilities:				
Long term borrowings	250	200		450
Long term provisions	50	70	28.93	148.93
Deferred tax	40	35	(46.5)	28.5
Current Liabilities:				
Short term borrowings	100	150		250
Trade payable	250	300	0	550
Liability for lawsuit damages			5	5
Total	2,000	755	475	3230

Illustration 41 – (Past Exam – Nov 2020)

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 accounting under acquisition method for business combination by Company A. **(8 Marks)**

Solution:

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:

Cash consideration	₹ 59,00,000
Equity shares issued (1,00,000 x 10 i.e., at fair value)	₹ 10,00,000
Contingent consideration (at fair value)	₹ 3,00,000
Fair value of previously held interest	₹ 20,00,000

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.

Determination of goodwill or gain on bargain purchase

Goodwill should be calculated as follows:

Total consideration	92,00,000
Recognised amount of any non-controlling interest	7,50,000
Less: fair value of Lila-Domestic's net identifiable assets	(60,00,000)
Goodwill	**39,50,000**

Illustration 42

On 31st December, 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 31st December, 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 31st December, 20X1 are the same as their carrying amounts, except that the fair value of Entity A's non- current assets at 31st December, 20X1 is ₹ 1,500.

The balance sheets 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**

Calculate the fair value of the consideration transferred measure goodwill and prepare consolidated balance sheet as on 31st December, 20X1

Solution:

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:

Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated balance sheet at 31st December, 20X1

The consolidated balance sheet immediately after the business combination is:

Current assets [700 + 500]	1,200
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [600 + 300]	900
Non-current liabilities [1,100 + 400]	1,500
Total liabilities	2,400
Shareholders' equity	
Issued equity 250 ordinary shares [600 + 1,600]	2,200
Retained earnings	1,400
Total shareholders' equity	3,600

Total liabilities and shareholders' equity	6,000

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.

Note: In above question, PC Should be bifurcated between Share Capital & Securities Premium, but ICAI has not given the bifurcation so we have ignored the same. In exam you can give bifurcation.

Illustration 43

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.

Solution:

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.

Illustration 44

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

Solution:

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%)

Illustration 45

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.

Solution:

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.

Illustration 46

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.

Solution:

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.

(₹)

Identifiable net assets	1,00,00,000
Less: Consideration transferred	(50,00,000)
NCI (10 million x 30%)	(30,00,000)
Gain on bargain purchase	20,00,000

Illustration 47

Entity A and entity B provide construction services in India. Entity A is owned by a group of individuals, none of whom has control and does not have a collective control agreement. Entity B is owned by a single individual, Mr. Ram. The owners of entities A and B have decided to combine their businesses. The consideration will be settled in shares of entity B. Entity B issues new shares, amounting to 40% of its issued share capital, to its controlling shareholder, Mr. Ram. Mr. Ram then transfers the shares to the owners of entity A in exchange for their interest in entity A. At this point Mr. Ram controls both entities A and B, owning 100% of entity A and 71.42% of entity B. Mr. Ram had a controlling interest in both entity A and entity B before and after the contribution. Is the combination of entities A and B a combination of entities under common control?

Solution:

No. This is not a business combination of entities under common control. Mr. Ram's control of both entities before the business combination was transitory. The substance of the transaction is that entity B has obtained control of entity A. Entity B accounts for this transaction as a business combination under Ind AS 103 using acquisition accounting.

Illustration 48

On 1 April 20X1, Alpha Ltd. acquires 80 percent of the equity interest of Beta Pvt. Ltd. in exchange for cash of ₹ 300. Due to legal compulsion, Beta Pvt. Ltd. had to dispose of their investments by a specified date. Therefore, they did not have sufficient time to market Beta Pvt. Ltd. to multiple potential buyers. The management of Alpha Ltd. initially measures the separately recognizable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirement of Ind AS 103. The identifiable assets are measured at ₹ 500 and the liabilities assumed are measured at ₹ 100. Alpha Ltd. engages on independent consultant, who determined that the fair value of 20 per cent non-controlling interest in Beta Pvt. Ltd. is ₹ 84.

Alpha Ltd. reviewed the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non controlling interest in Beta Pvt. Ltd. and the consideration transferred. After the review, it decided that the procedures and resulting measures were appropriate.

Calculate the gain or loss on acquisition of Beta Pvt. Ltd. and also show the journal entries for accounting of its acquisition. Also calculate the value of the non-controlling interest in Beta Pvt. Ltd. on the basis of proportionate interest method, if alternatively applied?

Solution:

The amount of Beta Pvt. Ltd. identifiable net assets [₹ 400, calculated as ₹ 500 - ₹ 100) exceeds the fair value of the consideration transferred plus the fair value of the non controlling interest in Beta Pvt. Ltd. [₹ 384 calculated as 300 + 84]. Alpha Ltd. measures the gain on its purchase of the 80 per cent interest as follows:

		₹ in lakh
Amount of the identifiable net assets acquired (₹ 500 - ₹ 100)		400
Less: Fair value of the consideration transferred for Alpha Ltd. 80 per cent interest in Beta Pvt. Ltd.	300	
Add: Fair value of non controlling interest in Beta Pvt. Ltd.	84	(384)
Gain on bargain purchase of 80 per cent interest		16

Journal Entry

	₹ in lakhs	**₹ in lakhs**
Identifiable assets acquired Dr.	500	
To Cash		300
To Liabilities assumed		100
To OCI/Equity-Gain on the bargain purchase		16
To Equity-non controlling interest in Beta Pvt Ltd.		84

If the acquirer chose to measure the non controlling interest in Beta Pvt. Ltd. on the basis of its proportionate interest in the identifiable net assets of the acquire, the recognized amount of the non controlling interest would be ₹ 80 (₹ 400 x 0.20). The gain on the bargain purchase then would be ₹ 20 (₹ 400- (₹ 300 + ₹ 80)

Illustration 49 - (RTP Nov'18), (Past Exam May'22), (MTP May'24)

ABC Ltd. prepares consolidated financial statements upto 31st March each year. On 1st July 20X1, ABC Ltd. acquired 75% of the equity shares of JKL Ltd. and gained control of JKL Ltd. the issued shares of JKL Ltd. is 1,20,00,000 equity shares. Details of the purchase consideration are as follows:

- On 1st July, 20X1, ABC Ltd. issued two shares for every three shares acquired in JKL Ltd. On 1st July, 20X1, the market value of an equity share in ABC Ltd. was ₹ 6.50 and the market value of an equity share in JKL Ltd. was ₹ 6.

- On 30th June, 20X2, ABC Ltd. will make a cash payment of ₹ 71,50,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 20X1. On 1st July, 20X1, ABC Ltd. would have to pay interest at an annual rate of 10% on borrowings.

- On 30th June, 20X3, ABC Ltd. may make a cash payment of ₹ 3,00,00,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 20X1. This payment is contingent upon the revenues of ABC Ltd. growing by 15% over the two-year period from 1st July, 20X1 to 30th June, 20X3. On 1st July, 20X1, the fair value of this contingent consideration was ₹ 2,50,00,000. On 31st March, 20X2, the fair value of the contingent consideration was ₹ 2,20,00,000.

On 1st July, 20X1, the carrying values of the identifiable net assets of JKL Ltd. in the books of that company was ₹ 6,00,00,000. On 1st July, 20X1, the fair values of these net assets was ₹ 7,00,00,000. The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 31st March, 20X2, JKL Ltd. had a poorer than expected operating performance. Therefore, on 31st March, 20X2 it was necessary for ABC Ltd. to recognise an impairment of the goodwill arising on acquisition of JKL Ltd., amounting to 10% of its total computed value.

Compute the impairment of goodwill in the consolidated financial statements of ABC Ltd. under both the methods permitted by Ind AS 103 for the initial computation of the non- controlling interest in JKL Ltd. at the acquisition date. **(5 to 6 Marks)**

Solution:

Computation of goodwill impairment

	NCI at fair value	**NCI at of net assets**
	₹ in '000	₹ in '000
Purchase Consideration		
Share exchange (12,000 x 75% x 2/3 x ₹ 6.50)	39,000	39,000
Deferred consideration (7,150 / 1.10)	6,500	6,500
Contingent consideration	25,000	25,000
Non-controlling interest at date of acquisition:		
Fair value – 3000 x ₹ 6	18,000	
% of net assets – 68,000 (Refer W.N.) x 25%		17,000
Net assets on the acquisition date (Refer W.N.)	(68,000)	(68,000)
Goodwill on acquisition	20,500	19,500
Impairment @ 10%	2,050	1,950

Working Note:

Net assets on the acquisition date	**₹ '000**
Fair value at acquisition date	70,000
Deferred tax on fair value adjustments [20% x (70,000 – 60,000)]	(2,000)
	68,000

Illustration 50 – (RTP MAY'19, Nov'22)

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

1. On 1 April 20X1, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:
   a) an immediate issuance of 10 lakhs shares of A Ltd. having face value of INR 10 per share;
   b) a further issuance of 2 lakhs shares after one year if the profit before interest and tax of B Ltd. for the first year following acquisition exceeds INR 1 crore.
      i) The fair value of the shares of A Ltd. on the date of acquisition is INR 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is ₹ 25 lakhs.
      ii) During the year ended 31 March 20X2, the profit before interest and tax of B Ltd. exceeded ₹ 1 crore. As on 31 March 20X2, the fair value of shares of A Ltd. is ₹ 25 per share.
2. Continuing with the fact pattern in (a) above except for:
   c) The number of shares to be issued after one year is not fixed.
   d) Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to ₹ 40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds ₹ 1 crore. A Ltd. issued shares with ₹ 40 lakhs after a year.

Solution:

Paragraph 37 of Ind AS 103, inter alia, provides that the consideration transferred in a business combination should be measured at fair value, which should be calculated as the sum of (a) the acquisition-date fair values of the assets transferred by the acquirer,(b) the liabilities incurred by the acquirer to former owners of the acquiree and (c) the equity interests issued by the acquirer.

Further, paragraph 39 of IndAS 103 provides that the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

With respect to contingent consideration, obligations of an acquirer under contingent consideration arrangements are classified as equity or a liability in accordance with Ind AS 32 or other applicable Ind AS, i.e., for the rare case of non-financial contingent consideration. Paragraph 40 provides that the acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, Financial Instruments: Presentation. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration.

1. In the given case the amount of purchase consideration to be recognized on initial recognition shall be as follows:

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

Subsequent measurement of contingent consideration payable for business combination

In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

(a) There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavorable conditions (for the issuer of the instrument).

(b) If the instrument will or may be settled in the issuer's own equity instruments, then it is:

(i) a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or

(ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration classifiedas equity should not be re-measured and its subsequent settlement should be accounted for within equity.

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

2. The amount of purchase consideration to be recognized on initial recognition is shall be as follows:

Fair value shares issued (10,00,000 x ₹20)	₹2,00,00,000
Fair value of contingent consideration	₹25,00,000
Total purchase consideration	**2,25,00,000**

Subsequent measurement of contingent consideration payable for business combination

The contingent consideration will be classified as liability as per Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration not classified as equity should be measured at fair value at each reporting date and changes in fair value should be recognized in profit or loss.

As at 31 March 20X2, (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of 15,00,000 (40,00,000 - 25,00,000) should be recognized in the profit or loss for the period. A Ltd. would recognize issuance of 160,000 (₹40,00,000/25) shares at a premium of ₹ 15 per share.

Illustration 51

As part of its business expansion strategy, KK Ltd. is in process of setting up a pharma intermediates business which is at very initial stage. For this purpose, KK Ltd. has acquired on 1st April, 20X1, 100% shares of ABR Ltd. that manufactures pharma intermediates. The purchase consideration for the same was by way of a share exchange valued at ₹ 35 crores. The fair value of ABR Ltd.' s net assets was ₹ 15 crores, but does not include:

i) A patent owned by ABR Ltd. for an established successful intermediate drug that has a remaining life of 8 years. A consultant has estimated the value of this patent to be ₹ 10 crores. However, the outcome of clinical trials for the same are awaited. If the trials are successful, the value of the drug would fetch the estimated ₹ 15 crores.

ii) ABR Ltd. has developed and patented a new drug which has been approved for clinical use. The cost of developing the drug was ₹12 crores. Based on early assessment of its sales success, the valuer has estimated its market value at ₹ 20 crores.

iii) ABR Ltd.'s manufacturing facilities have received a favourable inspection by a government department. As a result of this, the Company has been granted an exclusive five-year license to manufacture and distribute a new vaccine. Although the license has no direct cost to the Company, its directors believe that obtaining the license is a valuable asset which assures guaranteed sales and the value for the same is estimated at ₹ 10 crores.

KK Ltd. has requested you to suggest the accounting treatment of the above transaction under applicable Ind AS.

Solution:

As per para 13 of Ind AS 103 'Business Combination', the acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. This may be the case when the asset is developed by the entity internally and charged the related costs to expense.

Based on the above, the company can recognise following Intangible assets while determining Goodwill / Bargain Purchase for the transaction:

i) **Patent owned by ABR Ltd.:** The patent owned will be recognised at fair value by KK Ltd. even though it was not recognised by ABR Ltd. in its financial statements. The patent will be amortised over the remaining useful life of the asset i.e. 8 years. Since the company is awaiting the outcome of the trials, the value of the patent cannot be estimated at ₹ 15 crore and the extra ₹ 5 crore should only be disclosed as a Contingent Asset and not recognised.

ii) **Patent internally developed by ABR Ltd.:** As per para 18 of Ind AS 103 'Business Combination', the acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition date fair values. Since the patent developed has been approved for clinical use, it is an identifiable asset, hence the same will be measured at fair value ie ₹ 20 crore on the acquisition date.

iii) **Grant of Licence to ABR Ltd. by the Government:** As regards to the five-year license, applying para 18 of Ind AS 103, grant asset will be recognised at fair value on the acquisition date by KK Ltd. On acquisition date, the fair value of the license is Rs. 10 crore. However, since the question does not mention about the fair value of the identifiable liability with respect to grant of license for the acquirer, it is assumed that no conditions with respect to compliance of grant (if any) have been passed to the acquirer. Hence, the fair value of the liability with respect to grant, for acquirer would be nil. Only, the grant asset (license) would be recognised at ₹ 10 crore in the books of acquirer KK Ltd.

Hence the revised working would be as follows:

	₹
Fair value of net assets of ABR Ltd.	15 crore
Add: Patent (10 + 20)	30 crore
Add: License	10 crore
Less: Grant for License	(Nil)
	55 crores
Purchase Consideration	(35 crores)
Bargain purchase	20 crore

Illustration 52 - (MTP March'19) (RTP Nov'19)

H Ltd. acquired equity shares of S Ltd., a listed company, in two tranches as mentioned in the below table:

Date	Equity stake purchased	Remarks
1st November, 2016	15%	The shares were purchased based on the quoted price on the stock exchange on the relevant dates.
1st January, 2017	45%	

Both the above-mentioned companies have INR as their functional currency. Consequently, H Ltd. acquired control over S Ltd. on 1st January, 2017. Following is the Balance Sheet of S Ltd. as on that date:

Particulars	Carrying value (Rs. in crore)	Fair value (Rs. in crore)
ASSETS:		
Non-current assets		
(a) Property, plant and equipment	40.0	90.0
(b) Intangible assets	20.0	30.0
(c) Financial assets	100.0	350.0
- Investments		
Current assets		
(a) Inventories	20.0	20.0
(b) Financial assets		
- Trade receivables	20.0	20.0
- Cash held in functional currency	4.0	4.0
(c) Other current assets		
Non-current asset held for sale	4.0	4.5
TOTAL ASSETS	**208**	
EQUITY AND LIABILITIES:		
Equity		
(a) Share capital (face value Rs.100)	12.0	50.4
(b) Other equity	141.0	Not applicable
Non-current liabilities		
(a) Financial liabilities- Borrowings	20.0	20.0
Current liabilities		
(a) Financial liabilities - Trade payables	28.0	28.0
(b) Provision for warranties	3.0	3.0
(c) Current tax liabilities	4.0	4.0
TOTAL EQUITY AND LIABILITIES	**208.0**	

Other information:

Following is the statement of contingent liabilities of S Ltd. as on 1st January, 2017:

Particulars	Fair value (Rs. in crore)	Remarks
Law suit filed by a customer for a claim of Rs. 2 crore	0.5	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim. Any amount which would be paid in respect of law suit will be tax deductible.
Income tax demand of Rs. 7 crore raised by tax authorities; S Ltd. has challenged the demand in the court.	2.0	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim.

In relation to the above-mentioned contingent liabilities, S Ltd. has given an indemnification undertaking to H Ltd. up to a maximum of Rs. 1 crore.

Rs. 1 crore represents the acquisition date fair value of the indemnification undertaking.

Any amount which would be received in respect of the above undertaking shall not be taxable.

The tax bases of the assets and liabilities of S Ltd. is equal to their respective carrying values being recognised in its Balance Sheet.

Carrying value of non-current asset held for sale of Rs. 4 crore represents its fair value less cost to sell in accordance with the relevant Ind AS.

In consideration of the additional stake purchased by H Ltd. on 1st January, 2017, it has issued to the selling shareholders of S Ltd. 1 equity share of H Ltd. for every 2 shares held in S Ltd. Fair value of equity shares of H Ltd. as on 1st January, 2017 is Rs. 10,000 per share.

On 1st January, 2017, H Ltd. has paid Rs. 50 crore in cash to the selling shareholders of S Ltd. Additionally, on 31st March, 2019, H Ltd. will pay Rs. 30 crore to the selling shareholders of S Ltd. if return on equity of S Ltd. for the year ended 31st March, 2019 is more than 25% per annum. H Ltd. has estimated the fair value of this obligation as on 1st January, 2017 and 31st March, 2017 as Rs. 22 crore and Rs. 23 crore respectively. The change in fair value of the obligation is attributable to the change in facts and circumstances after the acquisition date.

Quoted price of equity shares of S Ltd. as on various dates is as follows:

As on November, 2016	Rs. 350 per share
As on 1st January, 2017	Rs. 395 per share
As on 31st March, 2017	Rs. 420 per share

On 31st May, 2017, H Ltd. learned that certain customer relationships existing as on 1st January, 2017, which met the recognition criteria of an intangible asset as on that date, were not considered during the accounting of business combination for the year ended 31st March, 2017. The fair value of such customer relationships as on 1st January, 2017 was Rs. 3.5 crore (assume that there are no temporary differences associated with customer relations; consequently, there is no impact of income taxes on customer relations).

On 31st May, 2017 itself, H Ltd. further learned that due to additional customer relationships being developed during the period 1st January, 2017 to 31st March, 2017, the fair value of such customer relationships has increased to Rs. 4 crore as on 31st March, 2017.

On 31st December, 2017, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and that more information is not obtainable.

H Ltd. and S Ltd. are not related parties and follow Ind AS for financial reporting. Income tax rate applicable is 30%.

You are required to provide your detailed responses to the following, along with reasoning and computation notes:

(a) What should be the goodwill or bargain purchase gain to be recognised by H Ltd. in its financial statements for the year ended 31st March, 2017. For this purpose, measure non- controlling interest using proportionate share of the fair value of the identifiable net assets of S Ltd.

(b) Will the amount of non-controlling interest, goodwill, or bargain purchase gain so recognised in (a) above change subsequent to 31st March, 2017? If yes, provide relevant journal entries.

(c) What should be the accounting treatment of the contingent consideration as on 31st March, 2017?

Solution:

(i) The requirements in Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', do not apply in determining which contingent liabilities to recognise as of the acquisition date as per Ind AS 103 'Business Combination'. 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. Hence H Ltd. will recognize contingent liability of Rs. 2.5 cr.

Since S Ltd. has indemnified for Rs. 1 cr., H Ltd. shall recognise an indemnification asset at the same time for Rs. 1 cr.

As per the information given in the question, this indemnified asset is not taxable. Hence, its tax base will be equal to its carrying amount. No deferred tax will arise on it.

(ii) As per Ind AS 103, non-current assets held for sale should be measured at fair value less cost to sell in accordance with Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'. Therefore, its carrying value as per balance sheet has been considered in the calculation of net assets.

(iii) Any equity interest in S Ltd. held by H Ltd. immediately before obtaining control over S Ltd. is adjusted to acquisition-date fair value. Any resulting gain or loss is recognised in the profit or loss of H Ltd.

Calculation of purchase consideration as per Ind AS 103 **Rs**. in lakh

Investment in S Ltd.			
On 1st Nov. 2016	15%	[(12/100) x 395 x 15%]	7.11
On 1st Jan. 2017	45%		
Own equity given		10,000 x 12% x 45% x 1/2	270
Cash			50
Contingent consideration			22
			349.11

(iv) Calculation of defer tax on assets and liabilities acquired as part of the business combination, including current tax and goodwill.

Item	**Rs. in crore**				
	Book value	**Fair value**	**Tax base**	**Taxable (deductible) temporary diff.**	**DTA / (DTL) @ 30%**
Property, plant and equipment	40	90	40	50	(15)
Intangible assets	20	30	20	10	(3)
Investments	100	350	100	250	(75)
Inventories	20	20	20	-	-
Trade receivables	20	20	20	-	-
Cash held in functional currency	4	4	4	-	-
Non-current asset held for sale	4	4	4	-	-
Indemnified asset	-	1	1	-	-
Borrowings	20	20	20	-	-
Trade payables	28	28	28	-	-
Provision for warranties	3	3	3	-	-
Current tax liabilities	4	4	4	-	-
Contingent liability		0.5	-	(0.5)	0.15
Deferred tax Liability					(92.85)

(v) Calculation of identifiable net assets acquired

	Rs. in crore	Rs. in crore
Property, plant and equipment	90	
Intangible assets	30	
Investments	350	
Inventories	20	
Trade receivables	20	
Cash held in functional currency	4	
Non-current asset held for sale	4	
Indemnified asset	1	
Total asset		519
Less: Borrowings	20	
Trade payables	28	
Provision for warranties	3	
Current tax liabilities	4	
Contingent liability (2 + 0.5)	2.50	
Deferred tax liability (W.N.2)	92.85	(150.35)
Net identifiable assets		368.65

(a) Calculation of NCI by proportionate share of net assets

Net identifiable assets of S Ltd. on 1.1.2017 (Refer W.N.3) = 372.85 crore

NCI on 1.1.2017 = 368.65 crore x 40% = 147.46 crore

Calculation of Goodwill as per Ind AS 103

Goodwill on 1.1.2017 = Purchase consideration + NCI – Net assets

= 349.11 + 147.46 – 368.65

= 127.92 crore

(b) As per para 45 of Ind AS 103 'Business Combination', if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date.

During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date.

The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

Further, as per para 46 of Ind AS 103, the measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the fo llowing as of the acquisition date in accordance with the requirements of this Ind AS:

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

(b) …..

(c) ……; and

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

Para 48 states that the acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of a decrease (increase) in goodwill.

Para 49 states that during the measurement period, the acquirer shall recognise adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date.

Para 50 states that after the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with Ind AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

On 31st December, 2017, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and the more information is not obtainable. Therefore, the measurement period for acquisition of S Ltd. ends on 31 st December, 2017.

On 31st May, 2017 (ie within the measurement period), H Ltd. learned that certain customer relationships existing as on 1st January, 2017 which met the recognition criteria of an intangible asset as on that date were not considered during the accounting of business combination for the year ended 31st March, 2017. Therefore, H Ltd. shall account for the acquisition date fair value of customer relations existing on 1st January, 2017 as an identifiable intangible asset. The corresponding adjustment shall be made in the amount of goodwill.

Accordingly, the amount of goodwill will be changed due to identification of new asset from retrospective date for changes in fair value of assets and liabilities earlier recognised on provisional amount (subject to meeting the condition above for measurement period). NCI changes would impact the consolidated retained earnings (parent's share). Also NCI will be increased or decreased based on the profit during the post-acquisition period.

Journal entry

	Dr.	Cr.
Customer relationship	Dr. 3.5 crore	
To NCI		1.4 crore
To Goodwill		2.1 crore

However, the increase in the value of customer relations after the acquisition date shall not be accounted by H Ltd., as the customer relations developed after 1st January, 2017 represents internally generated intangible assets which are not eligible for recognition on the balance sheet.

(c) Since the contingent considerations payable by H Ltd is not classified as equity and is within the scope of Ind AS 109 'Financial Instruments', the changes in the fair value shall be recognised in profit or loss. Change in Fair value of contingent consideration (23 -22) Rs. 1 crore will be recognized in the Statement of Profit and Loss.

Illustration 53 – (RTP Dec'21), (MTP Nov'22)

Company X is engaged in the business of exploration & development of Oil & Gas Blocks.

Company X currently holds participating interest (PI) in below mentioned producing Block as follows:

Block Name	Company X	Company Y	Company Z	Total
AWM/01	30%	60%	10%	100%

For the above Block, Company X, Y & Z has entered into unincorporated Joint Arrangement.

Company Y is the Operator of the Block AWM/01. Company X & Company Z are the Joint Operators. Company Y incurs all the expenditure on behalf of Joint Venture and raise cash call to Company X & Company Z at each month end in respect of their share of expenditure incurred in Joint Venture. All the manpower and requisite facilities / machineries owned by the Joint venture and thereby owned by all the Joint Operators.

For past few months, due to liquidity issues, Company Z defaulted in payment of cash calls to operators. Therefore, company Y (Operator) has issued notice to company Z for withdrawal of their participating right from on 01.04.20X1. However, company Z has filed the appeal with arbitrator on 30.04.20X1.

Financial performance of company Z has not been improved in subsequent months and therefore company Z has decided to withdraw participating interest rights from Block AWM/01 and entered into sale agreement with Company X & Company Y. As per the terms of the agreement, dated 31.5.20X1, Company X will receive 33.33% share & Company Y will receive 66.67% share of PI rights owned by Company Z.

Company X is required to pay ₹ 1 Lacs against 33.33% share of PI rights owned by Company Z.

After signing of sale agreement, Operator (company Y) approach government of India for modification in PSC (Production Sharing Contract) i.e. removal of Company Z from PSC of AWM/01 and government has approved this transaction on 30.6.20X1. Government approval for the modification in PSC is essential given the industry in which the joint operators operate.

Balance sheet of Company X & Company Z are as follows:

Particulars	Company X		Company Z	
	31.5.20X1	30.6.20X1	31.5.20X1	30.6.20X1
	₹	₹	₹	₹
Assets				
Non-Current Assets				
Property, Plant & Equipment	5,00,000	10,00,000	1,50,000	3,00,000
Right of Use Asset	1,00,000	2,00,000	10,000	20,000
Development CWIP	50,000	1,00,000	50,000	1,00,000
Financial Assets				
Loan receivable	25,000	50,000	25,000	50,000
Total Non-Current Assets	**6,75,000**	**13,50,000**	**2,35,000**	**4,70,000**
Current assets				
Inventories	1,00,000	2,00,000	15,000	30,000
Financial Assets				
Trade receivables	1,50,000	3,00,000	50,000	1,00,000
Cash and cash equivalents	2,00,000	4,00,000	1,00,000	2,00,000
Other Current Assets	2,25,000	50,000	25,000	50,000
Total Current Assets	**6,75,000**	**9,50,000**	**1,90,000**	**3,80,000**
Total Assets	**13,50,000**	**23,00,000**	**4,25,000**	**8,50,000**
Equity and Liabilities				
Equity				
Equity share capital	3,00,000	3,00,000	1,00,000	1,00,000
Other equity	2,00,000	3,00,000	75,000	2,50,000
Total Equity	**5,00,000**	**6,00,000**	**1,75,000**	**3,50,000**
Liabilities				
Non-Current Liabilities				
Provisions	4,00,000	8,00,000	1,00,000	2,00,000
Other Liabilities	1,50,000	3,00,000	50,000	1,00,000
Total Non-Current Liabilities	**5,50,000**	**11,00,000**	**1,50,000**	**3,00,000**
Current Liabilities				
Financial Liabilities				
Trade Payables	3,00,000	6,00,000	1,00,000	2,00,000
Total Current Liabilities	**3,00,000**	**6,00,000**	**1,00,000**	**2,00,000**
Total Liabilities	**13,50,000**	**23,00,000**	**4,25,000**	**8,50,000**

Additional Information:

1. Fair Value of PPE & Development CWIP owned by Company Z as per Market participant approach is ₹ 5,00,000 & ₹ 2,00,000 respectively.
2. Fair Value of all the other assets and liabilities acquired are assumed to be at their carrying values (except cash & cash equivalent). Cash and cash equivalents of Company Z are not to be acquired by Company X as per the terms of agreement.
3. Tax rate is assumed to be 30%.
4. As per Ind AS 111, it is a joint operation whereby every operator records their share of assets and liabilities in their books.

You need to determine the following:

1. Whether the above acquisition falls under business or asset acquisition as defined under business combination standard Ind AS 103?
2. Determine the acquisition date in the above transaction?
3. Prepare Journal entries for the above-mentioned transaction?
4. Draft the Balance Sheet for Company X based on your analysis in Part 1 above as at acquisition date.

(20 Marks)

Solution

(1) 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 goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

For a transaction to meet the definition of a business combination (and for the acquisition method of accounting to apply), the entity must gain control of an integrated set of assets and activities that is more than a collection of assets or a combination of assets and liabilities.

To be capable of being conducted and managed for the purpose identified in the definition of a business, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs.

Therefore, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output.

In the aforesaid transaction, Company X acquired share of participating rights owned by Company Z for the producing Block (AWM/01). The output exist in this transaction (Considering AWM/01) is a producing block. Also all the manpower and requisite facilities / machineries are owned by Joint venture and thereby all the Joint Operators. Hence, acquiring participating rights tantamount to acquire inputs (Expertise Manpower & Machinery) and it is critical to the ability to continue producing outputs. Thus, the said acquisition will fall under the Business Acquisition and hence standard Ind AS 103 is to be applied for the same.

(2) As per paragraph 8 of Ind AS 103, 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.

An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date. Since government of India (GOI) approval is a substantive approval for Company X to acquire control of Company Z's operations, the date of acquisition cannot be earlier than the date on which approval is obtained from GOI. This is pertinent given that the approval from GOI is considered to be a substantive process and accordingly, the acquisition is considered to be completed only on receipt of such approval. Hence acquisition date in the above scenario is 30.6.20X1.

(3) Journal entry for acquisition

Particulars		Amount (₹)	Amount (₹)
Property Plant & Equipment	Dr.	1,66,650	
Right-of-use Asset	Dr.	6,666	
Development CWIP	Dr.	66,660	
Financial Assets - Loan Receivables	Dr.	16,665	
Inventories	Dr.	9,999	
Trade Receivables	Dr.	33,330	
Other Current Assets	Dr.	16,665	
To Provisions			66,660
To Other Liabilities			33,330
To Trade Payables			66,660
To Deferred Tax Liability			29,997
To Cash & Cash Equivalent (purchase consideration)			1,00,000
Gain on bargain purchase (Other Comprehensive Income)			19,988
(Being assets acquired and liabilities assumed from Company Z recorded at fair value along gain on bargain purchase)			

(4) **Balance Sheet of Company X as at 30.6.20X1**

(Pre & Post Acquisition of PI rights pertaining to Company Z)

Particulars	Pre- Acquisition	Adjustments	Post-Acquisition
	30.6.20X1		**30.6.20X1**
Assets			
Non - Current Assets			
Property Plant & Equipment	10,00,000	1,66,650	11,66,650
Right of Use Asset	2,00,000	6,666	2,06,666
Development CWIP	1,00,000	33,330	1,66,660
Financial Assets			
Loan receivable	50,000	16,665	66,665
Total Non-Current Assets	**13,50,000**		**16,06,641**
Current assets			
Inventories	2,00,000	9,999	2,09,999
Financial Assets			
Trade receivables	3,00,000	33,330	3,33,330
Cash and cash equivalents	4,00,000	(1,00,000)	3,00,000
Other Current Assets	50,000	16,665	66,665
Total Current Assets	**9,50,000**		**9,09,994**
Total Assets	**23,00,000**		**25,16,635**
Equity and Liabilities			
Equity			
Equity share capital	**3,00,000**		**3,00,000**

Other equity	**3,00,000**		**3,00,000**
Capital Reserve (OCI)		19,988	**19,988**
Total Equity	**6,00,000**		**6,19,988**
Liabilities			
Non-Current Liabilities			
Provisions	**8,00,000**	66,660	**8,66,660**
Other Liabilities	**3,00,000**	33,330	**3,33,330**
Deferred Tax Liability		29,997	**29,997**
Total Non-Current Liabilities	**11,00,000**		**12,29,987**
Current Liabilities			
Financial liabilities			
Trade Payables	**6,00,000**	66,660	**6,66,660**
Total Current Liabilities	**6,00,000**		**6,66,660**
Total Equity and Liabilities	**23,00,000**		**25,16,635**

Working Notes

1. Determination of Company Z's balance acquired by Company X on 30.6.20X1 (Acquisition Date)

Particulars	**As per Company Z Books**	**Carrying Value 33.33% Share**	**Acquisition Date Value**	**Remarks**
	30.6.20X1			
	₹	**₹**	**₹**	
Assets				
Non-Current Assets				
Property Plant & Equipment	3,00,000	99,990	1,66,650	Note 1
Right of Use Asset	20,000	6,666	6,666	
Development CWIP	1,00,000	33,330	66,660	Note 2
Financial Assets				
Loan receivable	50,000	16,665	16,665	
Total Non-Current Assets	4,70,000	1,56,651	2,56,641	
Current assets				
Inventories	30,000	9,999	9,999	
Financial Assets				
Trade receivables	1,00,000	33,330	33,330	
Cash and cash equivalents	2,00,000	66,660	66,660	
Other Current Assets	50,000	16,665	16,665	
Total Current Assets	**3,80,000**	**1,26,654**	**1,26,654**	
Liabilities				
Non-Current Liabilities				
Provisions	2,00,000	66,660	66,660	
Other Liabilities	1,00,000	33,330	33,330	
Total Non-Current Liabilities	3,00,000	99,990	99,990	

Current Liabilities				
Financial liabilities				
Trade Payables	2,00,000	66,660	66,660	
Total Current Liabilities	**2,00,000**	**66,660**	**66,660**	

Note 1: Fair Value of PPE:

Fair Value of PPE in Company Z Books	₹ 5,00,000
33.33% Share acquired by Company X	₹ 1,66,650

Note 2: Fair Value of Development CWIP:

Fair Value of PPE in Company Z Books	₹ 2,00,000
33.33% Share acquired by Company X	₹ 66,660

2. Computation Goodwill/Bargain Purchase Gain

Particulars	As at 30.6.20X1 (₹)
Total Non - Current Assets	2,56,641
Total Current Assets (Except Cash & Cash Equivalent of ₹ 66,660) (1,26,654 – 66,660)	59,994
Total Non-Current Liabilities	(99,990)
Total Current Liabilities	(66,660)
Total Deferred Tax Liability (Refer Working note 3)	(29,997)
Net Assets Acquired	1,19,988
Less: Consideration Paid	(1,00,000)
Gain on Bargain Purchase (To be transferred to OCI)	19,988

*In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the value of net assets 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 clear and evidence exist. If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, then the gain shall be recognised directly in equity as capital reserve. Since in above scenario it is clearly evident that due to liquidity issues, Company Z has to withdraw their participating right from AWM/01. The said bargain purchase gain should be transferred to other comprehensive income on the acquisition date.

3. Computation of Deferred Tax Liability arising on Business Combination

Particulars	Acquisition Date Value (₹)
Total Non - Current Assets	2,56,641
Total Current Assets (Except Cash & Cash Equivalent of ₹ 66,660)	59,994
Total Non-Current Liabilities	(99,990)
Total Current Liabilities	(66,660)
Net Assets Acquired at Fair Value	**1,49,985**
Book value of Net Assets Acquired	(49,995)
Temporary Difference	**99,990**
DTL @ 30% on Temporary Difference	**29,997**

Note: As per Ind AS 103, in case an entity acquires another 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.

If a business combination is 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.

Since in the above transaction, company X does not hold any prior interest in Company Z & company holds only 30% PI rights in Block AWM/01 trough unincorporated joint arrangement, this is not a case of step acquisition.

Illustration 54

Entity X acquired entity Y in a business combination as per Ind AS 103. There is an existing share-based plan in entity Y with a vesting condition for 3 years in which 2 years have already lapsed at the date of such business acquisition. Entity X agrees to replace the existing award for the employees of combined entity. The details are as below -

Acquisition date fair value of share-based payment plan	₹300
No. of years to vest after acquisition	1 year
Fair Value of award which replaces existing plan	₹400

Calculate the share-based payment values as per Ind AS 102?

Solution:

Pre-acquisition period = 2

Post-acquisition period = 1

Total fair value at acquisition date = ₹ 300

Value to be recorded as per business combination under Ind AS 103 = ₹ 300/3 x 2 = ₹ 200

Value to be recorded as per Ind AS 102 (**A**) = ₹ 300/3 x 1 = ₹ 100

Fair value of the replacement of such award = ₹ 400

Difference from acquisition date fair value (**B**) = ₹ 400 - ₹ 300 = ₹ 100

Total value to be accounted over vesting period as per Ind AS 102 = A + B = ₹ 100 + ₹ 100 = ₹ 200.

MOCK TEST PAPER / REVISION TEST PAPER / PAST EXAM

Question 1 - (MTP Aug'18)

In March 2018, Pharma Ltd. acquires Dorman Ltd. in a business combination for a total cost of Rs. 12,000 lakhs. At that time Dorman Ltd.'s assets and liabilities are as follows:

Item	Rs. in lakhs
Assets	
Cash	780
Receivables (net)	5,200
Plant and equipment	7,000
Deferred tax asset	360
Liabilities	
Payables	1,050
Borrowings	4,900
Employee entitlement liabilities	900
Deferred tax liability	300

The plant and equipment has a fair value of Rs. 8,000 lakhs and a tax written down value of Rs. 6,000 lakhs. The receivables are short-term trade receivables net of a doubtful debts allowance of Rs. 300 lakhs.

Bad debts are deductible for tax purposes when written off against the allowance account by Dorman Ltd. Employee benefit liabilities are deductible for tax when paid.

Dorman Ltd. owns a popular brand name that meets the recognition criteria for intangible assets under Ind AS 103 'Business Combinations'. Independent valuers have attributed a fair value of Rs. 4.300 lakhs for the brand. However, the brand does not have any cost for tax purposes and no tax deductions are available for the same.

The tax rate of 30% can be considered for all items. Assume that unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts at the acquisition date.

You are required to:

(i) Calculate deferred tax assets and liabilities arising from the business combination (do not offset deferred tax assets and liabilities)

(ii) Calculate the goodwill that should be accounted on consolidation.

SOLUTION:

Breakdown of assets and liabilities acquired as part of the business combination, including deferred taxes and goodwill.

Item	Rs. In lakhs				
	Book value	**Fair value**	**Tax base**	**Taxable (deductible) temporary difference**	**Deferred tax asset (liability) @ 30%**
Cash	780	780 1)	780 1)	-	-
Receivables	5,200	5,200 1)	5,500 3)	(300)	90
Plant and equipment	7,000	8,000 2)	6,000 4)	2,000	(600)
Brands		4,300 2)	- 5)	4,300	(1,290)
Goodwill (Balancing figure)		2,100 9)			
Deferred tax asset	360	3,60 7)			

Total assets		**20,740**			
Payables	(1,050)	(1,050) [1]	(1,050) [1]		
Borrowings	(4,900)	(4,900)[1]	(4,900)[1]		
Employee Entitlement liabilities	(900)	(900)[1]	-[6]	(900)	270
Deferred tax liability	(300)	(1,890)[8]			
Total liabilities		**(8,740)**			
Consideration paid		**12,000**			

Notes

(1) This amount has been derived from Dorman Ltd.'s Balance Sheet as it is stated that 'unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts in Dorman Ltd.'s Balance Sheet at the acquisition date'.

(2) Stated fair value in the fact pattern (different to the carrying amount in Dorman Ltd.'s Balance Sheet at the acquisition date).

(3) Because bad debts are only deductible when written off against the allowance account by Dorman Ltd. the tax base of the receivables is their gross value, i.e., (Rs. 5,200 + Rs. 300) lakhs allowance account.

(4) Tax written down value of the plant and equipment as stated in the fact pattern.

(5) As the brand name does not have a cost for tax purposes and no tax deduction is available in relation to it, its tax base is nil.

(6) As the employee entitlement liabilities are only deductible for tax purposes when paid, their tax base is nil.

(7) The aggregate deferred tax asset is Rs. 360 lakhs, comprised of Rs.90 lakhs in relation to the receivables and Rs.270 lakhs in relation to the employee entitlement liabilities.

(8) The aggregate deferred tax liability is Rs. 1,890 lakhs calculated as follows:

Rs. In lakhs	**DTL amount in Dorman Ltd.'s Balance Sheet**	**Deferred tax impact of fair value adjustments**	**Total DTL in Pharma Ltd's consolidated financial statements**
Plant and equipment	300 ([7,000-6,000] × 30%)	300 ([1,000 × 30%)	600
Brand names	0	1,290 (4,300 × 30%)	1,290
TOTAL	**300**	**1,590**	**1,890**

(9) Goodwill is effectively the 'balancing item' in the equation, applying the requirements of Ind AS 103, para 32. The consideration transferred is Rs. 12,000 lakhs and the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103, including the deferred tax assets and liabilities arising, is Rs. 9,900 lakhs.

Question 2 - (RTP - November 2018)

Smart Technologies Inc. is a Company incorporated in India in 1998 having business in the field of development and installation of softwares, trading of computer peripherals and other IT related equipment and provision of cloud computing services along with other services incidental thereto. It is one of the leading brands in India.

After witnessing immense popularity and support in its niche market, Smart Technologies further grew by bringing its subsidiaries namely:

Company Name	Principle Activity
Cloudustries India Private Limited	Provision of cloud computing services.
MicroFly India Private Limited	Trading of computer peripherals like mouse, keyboard, printer etc.

Smart Technologies started preparing its financial statements based on Ind AS from 1st April, 2015 on voluntary basis. The Microfly India Pvt. Ltd. is planning to merge the business of Cloudstries India Pvt. Ltd. with its own for which it presented before the members in the meeting the below extract of latest audited Balance Sheet of Cloudustries (prepared on the basis of Ind AS) for the year ended 31st March, 2017:

Balance Sheet as at March 31, 2017 (₹in crores)

Assets	
Non-current assets	
Property, plant and Equipment	15.00
Current Assets	15.00
(a) Financial assets	
Trade Receivables	10.00
Cash and cash equivalents	10.00
Other current assets	8.00
	28.00
Total	**43.00**
Equity and Liabilities	
Equity	
Equity Share Capital	**45.00**
Other Equity	
Reserves and Surplus (Accumulated Losses)*	**(24.80)**
Liabilities	**20.20**
Non-current Liabilities	
Financial liabilities	
Borrowings	**2.80**
Current Liabilities	**20.00**
	22.80
Total	**43.00**

*The Tax Loss carried forward of the company is ₹ 27.20 crores

On September 5, 2017, the merger got approved by the Directors. The purchase consideration payable by MicroFly to Cloudustries was fixed at ₹ 18.00 crores payable in cash and that MicroFly take over all the assets and liabilities of Cloudustries.

Present the statement showing the calculation of assets/liabilities taken over a per Ind AS. Also mention the accounting of difference between consideration and assets/liabilities taken over.

Solution

Before the merger, Cloudustries and MicroFly are the subsidiary of Smart Technologies Inc. As the control is not transitory, the proposed merger will fall under the category of Business combination of entities under

common control, it will be accounted as per Appendix C of Ind AS 103 “Business Combination” and Pooling of Interest Method would be applied.

Statement showing the calculation of assets/liabilities taken over and treatment of difference between consideration and assets/liabilities taken over:

(a) Net asset taken over: **(in crore)**

Assets taken over:	
Property, Plant and Equipment	15.00
Cash and cash equivalents	10.00
Other current assets	8.00
Trade Receivables	10.00
Total - A	**43.00**
Less: Liabilities taken over:	
Borrowings	2.80
Current Liabilities	20.00
Total - B	**22.80**
Net Asset taken over (A-B)	**20.20**

(b) Treatment of difference between consideration and assets/liabilities taken over:

Net Asset taken over - A	20.20
Less: Purchase Consideration - B	18.00
Difference (A – B)	**2.20**

The difference between consideration and assets/liabilities taken over of ₹ 1.80 crore shall be transferred to capital reserve

Note: In this question, ideally as it is common control, reserves should also be taken over, but since ICAI has NOT taken over the reserves, we have ignored the same. In exam, you should ideally take over reserves as it is common control

Question 3 - (PAST EXAM - Nov 2019)

Parent A holds 100% in its subsidiary B. Parent A had acquired B, 10 years back and had decided to account for the acquisition under the purchase method using fair values of the subsidiary B in its consolidated financial statements.

During the current year, A decides to merge B with itself.

For the purpose of this proposed merger, what values of B should be used for accounting under the Ind AS? **(4 Marks)**

Solution:

Reference to be included to Appendix C of Ind AS 103

The acquisition of B Ltd. by A Ltd. is business combination under common control. In such a situation, pooling of interest method should be applied. However, B Ltd. is 100% subsidiary of A Ltd. and A Ltd. in its Consolidated financial statements use to give the carrying values of assets and liabilities of B Ltd. at fair value (as per acquisition under purchase method). Hence the carrying value for the purpose of pooling of interest method will be the values given in Consolidated financial statements and not in Separate financial statements.

In other words, since B Ltd. is merging with A Ltd. (i.e. parent) nothing has changed and the transaction only means that the assets, liabilities and reserves of B Ltd. which were appearing in the consolidated financial statements of Group A immediately before the merger would now be a part of the separate financial statements of A Ltd. Accordingly, it would be appropriate to recognise the carrying value of the

assets, liabilities and reserves pertaining to B Ltd as appearing in the consolidated financial statements of A Ltd.

Question 4 - (RTP May'21)

Bima Ltd. acquired 65% of shares on 1 June, 20X1 in Nafa Ltd. which is engaged in production of components of machinery. Nafa Ltd. has 1,00,000 equity shares of ₹ 10 each. The quoted market price of shares of Nafa Ltd. was ₹ 12 on the date of acquisition. The fair value of Nafa Ltd.'s identifiable net assets as on 1 June, 20X1 was₹ 80,00,000.

Bima Ltd. wired ₹ 50,00,000 in cash and issued 50,000 equity shares as purchase consideration on the date of acquisition. The quoted market price of shares of Bima Ltd. on the date of issue was ₹ 25 per share.

Bima Ltd. also agrees to pay additional consideration of ₹ 15,00,000, if the cumulative profit earned by Nafa Ltd. exceeds ₹ 1 crore over the next three years. On the date of acquisition, Nafa Ltd. assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is ₹ 9,80,000. Nafa Ltd. incurred ₹ 1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value.

How will the acquisition of Nafa Ltd. be accounted by Bima Ltd., under Ind AS 103? Prepare detailed workings and pass the necessary journal entry.

Solution:

Computation of Goodwill / Capital reserve on consolidation as per Ind AS 103

Particulars	₹
Cost of investment:	
Share exchange (50,000 x 25)	12,50,000
Cash consideration	50,00,000
Contingent consideration	9,80,000
Consideration transferred at date of acquisition [A]	72,30,000
Fair value of non-controlling interest at date of acquisition [B] (1,00,000 x 35% x 12)	4,20,000
Total [C] = [A] + [B]	76,50,000
Net assets acquired at date of acquisition [D]	(80,00,000)
Capital Reserve [D] – [C]	3,50,000

In a business combination, acquisition-related costs (including stamp duty) are expensed in the period in which such costs are incurred and are not included as part of the consideration transferred. Therefore, ₹ 1,50,000 incurred by Nafa Ltd. in relation to acquisition, will be ignored by Bima Ltd.

Journal entry at the date of acquisition by Bima Limited as per Ind AS 103:

	₹	₹
Identifiable net assets Dr.	80,00,000	
To Equity share capital (50,000 x 10)		5,00,000
To Securities Premium (50,000 x 15)		7,50,000
To Cash		50,00,000
To Provision for contingent consideration to Nafa Ltd.		9,80,000
To Non-controlling Interest		4,20,000
To Capital Reserve		3,50,000

Question 5 (RTP May'22)

Entity A acquires entity B. Entity A agrees with the former shareholders of entity B to pay ₹ 900, with an additional payment of ₹ 500 if the subsequent earnings of entity B reach a specified target in three years. The former shareholders also become employees. On the acquisition date, the fair value of the net assets of entity B amount to ₹ 850, and the fair value of additional payment is estimated at ₹ 200. At the acquisition date, the outflow of additional payment is not probable.

Over the next three years, the cumulative earnings of entity B (before considering the effects of the additional payments) amount to ₹ 1,050. At the end of year three, entity A pays ₹ 500 as the conditions were met.

State the impact on the financial position and results of classifying the payments as remuneration and contingent consideration.

Solution:

The impact on the financial position and results of classifying the payments as remuneration and contingent consideration is tabulated as follows:

	Additional Payment is classified as	
	Remuneration	**Contingent consideration**
Consideration	900	900
Fair value of additional payment	0	200
Total consideration	**900**	**1,100**
Fair value of net assets	(850)	(850)
Goodwill at acquisition date	**50**	**250**
Subsequent changes in additional payment	0	0
Total Goodwill	**50**	**250**
Cumulative earnings (before considering additional payment)	1,050	1,050
Impact of additional payment	(500)	(300)
Reported results across three years	**550**	**750**

Question 6 - (Past Exam Nov'19, July'21) (RTP May'19)

MNC Ltd. is in process of setting up a medicine manufacturing business which is at very initial stage. For this purpose, MNC Ltd. as part of its business expansion strategy acquired on 1st April, 2019, 100% shares of Akash Ltd., a company that manufactures pharmacy products. The purchase consideration for the same was by way of a share exchange valued at ₹ 38 crore. The fair value of Akash Ltd.'s assets and liabilities were ₹ 68 crore and ₹ 50 crore respectively, but the same does not include the following:

i) A patent owned by Akash Ltd. for an established successful new drug that has a remaining life of 6 years. A consultant has estimated the value of this patent to be ₹ 8 crore. However, the outcome of clinical trails for the same are awaited. If the trails are successful, the value of the drug would fetch the estimated ₹ 12 crore.
ii) Akash Ltd. has developed and patented another new drug which has been approved for clinical use. The cost of developing the drug was ₹ 13 crore. Based on early assessment of its sales success, a reputed valuer has estimated its market value at ₹ 19 crore.
iii) Akash Ltd.'s manufacturing facilities have received a favourable inspection by a government department. As a result of this, the company has been granted an exclusive five-year license on 1st April, 2018 to manufacture and distribute a new vaccine. Although the license has no direct cost to the Company, its directors believe that obtaining the license is valuable asset which assures guaranteed sales and the cost to acquire the license is estimated at ₹ 7 crore of remaining period of life. It is expected to generate at least equivalent revenue.

Suggest the accounting treatment of the above transactions with reasoning under applicable Ind AS in the books of MNC Ltd. **(8 Marks) / (5 Marks)**

Solution:

As per para 13 of Ind AS 103 'Business Combination', the acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. This may be the case when the asset is developed by the entity internally and charged the related costs to expense.

Based on the above, the company can recognise following Intangible assets while determining Goodwill / Bargain Purchase for the transaction:

i) Patent owned by Akash Ltd.: The patent owned will be recognised at fair value by MNC Ltd. even though it was not recognised by Akash Ltd. in its financial statements. The patent will be amortised over the remaining useful life of the asset i.e. 6 years. Since the company is awaiting the outcome of the trials, the value of the patent should be valued at ₹ 8 crore. It cannot be estimated at ₹ 12 crore and the extra ₹ 4 crore should only be disclosed as a contingent asset and not recognised.

ii) Patent internally developed by Akash Ltd.: Further as per para 75 of Ind AS 38 'Intangible Assets', after initial recognition, an intangible asset shall be carried at revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be determined by reference to an active market.
There is no active market for patents since the fair value is based on early assessment of its sale success. Hence it is suggested to use the cost model and recognise the patent at the actual development cost of ₹ 13 crore.

iii) Grant of Licence to Akash Ltd. by the Government: As regards to the five-year license, para 44 of Ind AS 38 requires to recognize grant asset at fair value by MNC Ltd. It can recognize both the asset (license) and the grant at ₹ 7 crore to be amortised over 4 remaining years of useful life i.e; ₹ 1.75 crore per annum

Hence the revised working would be as follows:

Fair value of net assets of Akash Ltd. (68-50)	₹ 18 crore
Add: Patent (8 + 13)	₹ 21 crore
Add: License	₹ 7 crore
Less: Grant for License	(₹ 7 crore)
	₹ 39 crores
Purchase Consideration	₹ 38 crores
Capital Reserve (Gain on Bargain Purchase)	**₹ 1 crore**

Note: This Question is same as Illustration 51 but the treatment of Govt Grant and Adjustment (ii) Intangible Asset is different. In Exam, You can give alternative answers to be on a safer side or write a note for whatever treatment you have followed.

Question 7 (RTP May 23)

'High Speed Limited' manufactures and sells cars. The Company wants to foray into the two-wheeler business and therefore it acquires 30% interest in Quick Bikes Limited for ₹ 5,00,000 as at 1st November, 20X1 and an additional 25% stake as at 1st January, 20X2 for ₹ 5,00,000 at its fair value.

Following is the Balance Sheet of Quick Bikes Limited as at 1st January, 20X2:

Liabilities	Carrying value	Fair value	Assets	Carrying value	Fair value

Share capital	1,00,000		Plant and equipment	3,50,000	7,50,000
Reserves	5,50,000		Investment in bonds	4,00,000	5,00,000
Trade payables	1,50,000 1,50,000		Trade Receivables	50,000	50,000
Total	**8,00,000**		**Total**	**8,00,000**	

Quick Bikes Limited sells the motorcycles under the brand name 'Super Start' which has a fair value of ₹ 3,50,000 as at 1st January, 20X2. This is a self- generated brand therefore Quick Bikes Limited has not recognized the brand in its books of accounts.

Following is the separate balance sheet of High Speed Limited as at 1st January, 20X2:

Liabilities	**Amount**	**Assets**	**Amount**
Share capital	5,00,000	Plant and equipment	13,50,000
Reserves	15,00,000	Investment in Quick Bike	10,00,000
Short term loans	4,00,000	Trade Receivables	80,000
Trade payables	3,00,000	Cash and bank balances	5,20,000
Other liabilities	2,50,000		
Total	**29,50,000**	**Total**	**29,50,000**

In relation to the acquisition of Quick Bikes Limited, you are required to:

(i) Pass the necessary journal entries to give effect of business combination in accordance with Ind AS 103 as at acquisition date 1st January, 20X2. NCI is measured by the entity at fair value. Provide working notes, Ignore deferred tax implication; and

Prepare a consolidated balance sheet of High Speed Limited as at 1st January, 20X2.

Solution:

(i) **Journal Entry**

	₹	₹
Plant and Equipment Dr.	7,50,000	
Investment in bonds Dr.	5,00,000	
Trade Receivables Dr.	50,000	
Brand Dr.	3,50,000	
Goodwill (balancing figure) Dr.	5,00,000	
To Investment in Quick Bikes		10,00,000
To Profit or loss A/c (W.N.1)		1,00,000
To Trade Payables		1,50,000
To NCI (W.N.3)		9,00,000
(Being assets and liabilities acquired at fair value and previous investment considered at fair value on the acquisition date)		

Working Notes:

1) Calculation of fair value of shares on the acquisition date 1st January, 20X2

25% Shares purchase on 1st January, 20X2 (fair value)	₹ 5,00,000
30% Shares purchase on 1st November, 20X1 at	₹ 5,00,000
Fair value = [(5,00,000 / 25%) x 30%]	₹ 6,00,000
Total consideration at fair value on acquisition date	₹ 11,00,000
Less: Cost of investment (5,00,000 + 5,00,000)	(₹ 10,00,000)
Gain recognised to Profit or Loss/OCI (as appropriate)	₹ 1,00,000

2) Computation of Net Identifiable Assets at fair value

	₹
Plant and Equipment	7,50,000
Investment in bonds	5,00,000
Trade Receivables	50,000
Self-generated Brand	3,50,000
	16,50,000
Less: Trade Payables	(1,50,000)
Net Identifiable Assets at fair value	15,00,000

3) Measurement of Non-controlling Interest (on fair value basis)

Share of NCI (100- 30-25)	45%
Taking fair value of shares on 1st January, 20X2 as a base [(11,00,000/ 55%) x 45%]	₹ 9,00,000

(ii) Consolidated Balance Sheet of High Speed Limited as at 1st January, 20X2

	Note No.	₹
Assets		
Non-current assets		
(a) Property, plant and equipment	1	21,00,000
(b) Intangible asset	2	8,50,000
(c) Investment in bonds		5,00,000
Current Assets		
(a) Financial assets		
(i) Trade receivables	3	1,30,000
(ii) Cash and cash equivalents	4	5,20,000
		41,00,000
Equity and Liabilities		
Equity		
(a) Equity share capital		5,00,000
(b) Other Equity	5	16,00,000
Non-controlling Interest (W.N.3)		9,00,000
Current Liabilities		
(a) Financial liabilities		
(i) Borrowings	6	4,00,000

(ii) Trade Payables	7	4,50,000
(b) Other Current Liabilities	8	2,50,000
		41,00,000

Notes to Accounts

S. No.		₹	₹
1.	Property, plant and equipment		
	High Speed Ltd.	13,50,000	
	Quick Bikes Ltd.	7,50,000	21,00,000
2.	Intangible asset		
	Goodwill	5,00,000	
	Brand value of Quick Bikes Ltd.	3,50,000	8,50,000
3.	Trade Receivables		
	High Speed Ltd.	80,000	
	Quick Bikes Ltd.	50,000	1,30,000
4.	Cash and cash equivalents		
	Quick Bikes Ltd.		5,20,000
5.	Other Equity - Reserves		
	High Speed Ltd.	15,00,000	
	Add: Gain on investment in Quick Bikes Ltd.	1,00,000	16,00,000
6.	Borrowings		
	Short term loans of High Speed Ltd.		4,00,000
7.	Trade Payables		
	High Speed Ltd.	3,00,000	
	Quick Bikes Ltd.	1,50,000	4,50,000
8.	Other Current Liabilities		
	High Speed Ltd.		2,50,000

Question 8 (RTP Nov'23)

Mini Limited is a manufacturing entity in textile industry. Mini Limited decided to reduce the cost of manufacturing by setting up its own power plant for their captive consumption. As per market research report, there was non-operational power plant in nearby area. Hence, it decided to acquire that power plant which was having capacity of 80MW along with all entire labour force. This Power entity was owned by another entity Max Limited. Mini Limited approached Max Limited for acquisition of 80MW power plant at following terms:

(i) Mini Limited will seek an independent valuation for determining fair value of 80MW power plant.

(ii) Value of other Non-current assets acquired, and Non–current financial liabilities assumed is ₹ 11.10 million and ₹ 32 million respectively.

(iii) Consideration agreed between both the parties is at ₹ 51 million.

Both the parties agreed to the terms and entered into agreement on 1st April, 20X1 with immediate effect.

Due to unavoidable circumstances, valuation could not be completed by the time Max Limited finalizes its financial statements for the year ending 31st March, 20X1.

Max Limited's annual financial statements records the fair value of 80 MW Power Plant at ₹ 46.90 million with remaining useful life at 40 years.

Max Limited also has license to operate that power plant unrecorded in books. As on 31st March, 20X1, it has fair value of ₹ 5 million.

Six months after acquisition date, Mini Limited received the independent valuation, which estimated the fair value of 80MW Power Plant as ₹ 54.90 million.

CFO of Mini Limited, wants you to work upon following aspects of the transaction:

a) Determine whether transaction should be accounted as asset acquisition or business combination.

b) Calculate Goodwill / Bargain Purchase due to the above acquisition.

c) Pass necessary journal entities in the books of Mini Limited as per Ind AS 103 and prepare balance sheet as on date of acquisition.

d) Determine whether any adjustment is required in case of valuation received subsequent to acquisition. If yes, pass the necessary entries in the books of Mini Limited.

Balance Sheet of Mini Limited as at 31st March, 20X1

Particulars	(₹ in Million)
ASSETS	
Non-current assets	
Property, plant and equipment	2,158
Capital work-in-progress	12
Deferred Tax Assets (Net)	324
Other non-current assets	25
Total non-current assets	**2,519**
Current assets	
Inventories	368
Financial assets	
(i) Investments	45
(ii) Trade Receivables	762
(iii) Cash and Cash Equivalents	110
(iv) Bank balances other than (iii) above	28
(v) Other financial assets	267
Total current assets	**1,580**
Total assets	**4,099**
EQUITY AND LIABILITIES	
Equity	
Equity Share Capital	295
Other equity	
Equity component of compound financial instruments	717
Reserves and surplus	2,481
Total equity	3,493
Liabilities	
Non-current liabilities	
Financial Liabilities	
Borrowings	268
Total non-current liabilities	**268**
Current liabilities	
Financial Liabilities	
(i) Trade payables	302

Other current liabilities	36
Total current liabilities	**338**
Total liabilities	**606**
Total equity and liabilities	**4,099**

Solution:

(a) 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 goods and services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

In the given scenario, acquisition of power plant along with its labour force will be considered as integrated set of activity as it is capable of being generating power.

Hence, transaction will be considered as business combination and not asset acquisition and acquisition method of accounting will be applied.

Thus, following will be the case:

(i) Acquirer – Mini Ltd;

(ii) Acquiree – Max Ltd;

(iii) Acquisition date – 1st April, 20X1

(b) Calculation of Goodwill:

Particulars		₹ in Million
Purchase consideration	(A)	51
Fair Value of Power Plant – PPE		46.90
Fair Value of other non-current assets		11.10
Fair Value of Intangible Asset (License) – Refer Note 1 below		5
Non-Current Liabilities assumed		(32)
Value of net assets acquired	(B)	31
Goodwill		20

Note 1: The licence to operate power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill though acquirer cannot sell or transfer it separately from the acquired power plant. Intangible Assets needs to be recorded by the acquirer at the time of accounting for acquisition though not recorded by the acquiree in its book.

(c) Journal Entries for acquiring power plant

Particulars		₹ in Million	₹ in Million
Fair Value of Power Plant	Dr.	46.90	
Fair Value of other assets	Dr.	11.10	
Fair Value of License acquired	Dr.	5	
Goodwill	Dr.	20	
To Liabilities assumed			32
To Bank (PC paid)			51

Balance Sheet of Mini Limited as at 1st April, 20X1

Particulars	**Notes to**	**₹ in Million**

	Accounts	
ASSETS		
Non-current assets		
Property, plant and equipment	1	2,204.90
Intangible Asset (License acquired in business combination)		5.00
Capital work-in-progress		12.00
Goodwill on acquisition		20.00
Deferred Tax Assets (Net)		324.00
Other non-current assets	2	36.10
Total non-current assets		**2,602.00**
Current assets		
Inventories		368.00
Financial assets		
(i) Investments		45.00
(ii) Trade Receivables		762.00
(iii) Cash and Cash Equivalents	3	59.00
(iv) Bank balances other than (iii) above		28.00
(v) Other financial assets		267.00
Total current assets		**1,529.00**
Total assets		**4,131.00**
EQUITY AND LIABILITIES		
Equity		
Equity Share Capital		295.00
Other equity		
Equity component of compound financial instruments		717.00
Reserves and surplus		2,481.00
Total equity		**3,493.00**
Liabilities		
Non-current liabilities		
Financial Liabilities		
Borrowings	4	300.00
Total non-current liabilities		**300.00**
Current liabilities		
Financial Liabilities		
(i) Trade payables		302.00
Other current liabilities		36.00
Total current liabilities		**338.00**
Total liabilities		**638.00**
Total equity and liabilities		**4,131.00**

Notes to Accounts

1) **Property, Plant and Equipment**

Particulars	₹ in Million
PPE value as on 1st April, 20X1	2,158.00
Add: Fair Value of Power Plant acquired	46.90
Total	**2,204.90**

2) Other Non-current Assets

Particulars	₹ in Million
Other non-current assets value as on 1st April, 20X1	25.00
Add: Fair Value of Non-current assets acquired	11.10
Total	**36.10**

3) Cash and Cash equivalents

Particulars	₹ in Million
Cash and Cash equivalents as on 1st April, 20X1	110
Less: Payment of Purchase consideration transferred	(51)
Total	**59**

4) Non-current Liabilities

Particulars	₹ in Million
Non-current Liabilities value as on 1st April, 20X1	268
Add: Non-current liabilities assumed in acquisition	32
Total	**300**

(d) Subsequent Accounting: Ind AS 103 provides a measurement period window, wherein if all the required information is not available on the acquisition date, then entity can do price allocation on provisional 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 on the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. Any change i.e. increase or 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.

Accordingly, in the financial statements for half year ending 30th September, 20X1, Mini Limited will retrospectively adjusts the prior year information as follows:

(i) the carrying amount of PPE (including power plant) as of 1st April, 20X1 is increased by ₹ 8 million (i.e. ₹ 54.90 million minus ₹ 46.90 million). The adjustment is measured as the fair value adjustment at the acquisition date less the additional depreciation that would have been recognised if the asset's fair value at the acquisition date had been recognised from that date [(80,00,000/40) x (6/12) = 0.1 million]

(ii) the carrying amount of goodwill as of 1st April, 20X1 is decreased by ₹ 8 million; and

(iii) depreciation expense for the period ending 30th September, 20X1 will increase by ₹ 0.1 million

(iv) disclose in its financial statements of 1st April, 20X1, that the initial accounting for the business combination has not been completed because the valuation of property, plant and equipment has not yet been received;

(v) disclose in its financial statements of 30th September, 20X1, the amounts and explanation of the adjustments to the provisional values recognised during the current reporting period. Therefore, Mini Limited discloses that comparative information is adjusted retrospectively to increase the fair value of

the item of property, plant and equipment at the acquisition date by ₹ 8 million, offset by decrease in goodwill of ₹ 8 million.

Journal Entries

(1) PPE (Power Plant)	Dr.	₹ 8 Million	
To Goodwill			₹ 8 Million
(2) Depreciation	Dr.	₹ 0.1 Million	
To Provision for Depreciation			₹ 0.1 Million

Question 9 (Past Exam May'23)

The draft balance sheets of Swan Limited and Duck Limited as at 31st March 2023 is as under:

Amount ₹ in lakhs

Particulars	**Swan Limited**	**Duck Limited**
Assets		
Non-Current Assets		
Property, Plant and Equipment	800	1,000
Investments	900	240
Current Assets		
Inventories	360	260
Financial Assets		
- Trade Receivables	1,040	540
- Cash & Cash Equivalents	520	290
Other Current Assets	700	350
Total	**4,320**	**2,680**
	Swan Limited	**Duck Limited**
Equity and Liabilities		
Equity		
Share Capital		
- Swan Limited: Equity Shares of ₹ 10 each	1,200	-
- Duck Limited: Equity Shares of ₹ 100 each	-	900
Other Equity	1,450	420
Non-Current Liabilities		
Financial Liabilities		
- Long-Term Borrowings	700	500
Long-Term Provisions	140	200
Deferred Tax	80	-
Current Liabilities		
Financial Liabilities		
- Short-Term Borrowings	250	290
- Trade Payables	500	370
Total	**4,320**	**2,680**

On 1st April 2023, Swan Limited acquired 80% equity shares of Duck Limited.

Swan Limited agreed to pay to each shareholder of Duck Limited, ₹ 20 per equity share in cash and to issue five equity shares of ₹ 10 each of Swan Limited in lieu of every six shares held by the shareholders of Duck Limited. The fair value of the shares of Swan Limited was ₹ 100 per share as on the date of acquisition.

Swan Limited also agreed to pay an additional consideration being higher of ₹ 90 lakhs and 30% of any excess profits in the first year, after acquisition, over Duck Limited's profits in the preceding 12 months (financial year 2022-2023) made by Duck Limited.

The additional amount will be due in 3 years post the date of acquisition. Duck Limited earned ₹ 30 lakhs profit in the preceding year and expects to earn ₹ 40 lakhs in financial year 2023-2024.

The fair value exercise resulted in the following:

(i) Fair value of Property, Plant and Equipment and Investments of Duck Limited on 1st April, 2023 was ₹ 1,200 lakhs and ₹ 300 lakhs respectively.

(ii) Duck Limited owns a popular brand name that meets the recognition criteria for Intangible Assets under Ind AS 103 'Business Combinations'. Independent valuers have attributed a fair value of ₹ 250 lakhs for the brand. However, the brand does not have any cost for tax purposes and no tax deductions are available for the same.

(iii) Following is the statement of contingent liabilities of Duck Limited as on 1st April, 2023:

Particulars	Fair Value (₹ in lakhs)	Remarks
Lawsuit filed by a customer for a claim of ₹ 20 lakhs	5	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim. Any amount which would be paid in respect of lawsuit will be tax deductible.
Income tax demand of ₹ 70 lakhs raised by tax authorities. Duck Limited	20	It is not probable that an outflow of resources embodying economic has challenged the demand in the High Court benefits will be required to settle the claim.

(iv) Duck Limited had certain equity settled share-based payment awards (original award) which were replaced by the new awards issued by Swan Limited. As per the terms of original awards, the vesting period was 5 years and as of the acquisition date the employees of Duck Limited had already served 2 years of service. As per the new awards, the vesting period has been reduced to 1 year (1 year from the acquisition date). The fair value of the award on acquisition date was as follows:

Original Awards: ₹ 12 lakhs

New Awards: ₹ 18 lakhs.

(v) Further, Swan Limited has also agreed to pay one of the founder shareholder of Duck Limited a sum of ₹ 15 lakhs provided he stays with the Company for two years after the acquisition.

(vi) The acquisition cost of Swan Limited for Duck Limited was ₹ 26 lakhs.

(vii) The applicable tax rate for both the companies is 30%.

(viii) Assume 10% per annum discount rate.

(ix) Also, assume, unless stated otherwise, all items have a fair value and tax base equal to their carrying amounts at the acquisition date.

You are required to prepare opening Consolidated Balance Sheet of Swan Limited as on 1st April 2023. Working Notes should form part of your answer. **(15 Marks)**

Solution:

Consolidated Balance Sheet of Swan Ltd as on 1st April, 2023

	Notes No.	₹ in lakhs
Assets		
Non-current assets		
Property, plant and equipment	9	2,000.00
Intangible assets	10	250.00
Financial assets		
Investment	11	1,200.00
Current assets		
Inventories	12	620.00
Financial assets:		
Trade receivables	13	1,580.00
Cash and cash equivalents	14	640.00
Other current assets	15	1,050.00
Total		**7,340.00**

Equity and Liabilities		
Equity		
Share capital - Equity shares of ₹ 10 each	1	1,260.00
Other equity	2	2,475.18
Non-controlling interest (W.N.4)		330.70
Non-current liabilities		
Financial liabilities		
Long-term borrowings	3	1,200.00
Long-term provisions	4	407.62
Deferred tax liability	5	231.50
Current Liabilities		
Financial liabilities		
Short-term borrowings	6	540.00
Trade payables	7	870.00
Short-term provision	8	25.00
Total		**7,340.00**

Notes to Accounts (All figures are ₹ in lakhs)

1. Equity Share capital

Equity shares of ₹ 10 each as per the balance sheet before acquisition of Duck Ltd.	1,200	
Shares allotted to Duck Ltd. (7,50,000 x 80% x ₹ 10)	60	1,260

2. Other Equity

As per the balance sheet before acquisition of Duck Ltd.	1,450		
Less: Acquisition cost	(26)	1,424	
Replacement award		4.80	
Security Premium (7,50,000 shares x 80% x ₹ 90)		540	
Capital Reserve (W.N.5)		506.38	2,475.18

3. Long-term borrowings

As per the balance sheet before acquisition of Duck Ltd.	700	
Duck Ltd.	500	1,200

4. Long-term provisions

As per the balance sheet before acquisition of Duck Ltd.	140	
Deferred consideration	67.62	
Duck Ltd.	200	407.62

5. Deferred tax liability

As per the balance sheet before acquisition of Duck Ltd.	80	
Deferred tax impact due to acquisition of Duck Ltd. (W.N.2)	151.50	231.50

6. Short term borrowings

As per the balance sheet before acquisition of Duck Ltd.	250	
Duck Ltd.	290	540

7. Trade payables

As per the balance sheet before acquisition of Duck Ltd.	500	
Duck Ltd.	370	870

8. Short-term provisions

Lawsuit damages Income-tax demand	5 20	 25

9. Property, plant and equipment

As per the balance sheet before acquisition of Duck Ltd. Duck Ltd.	800 1,200	 2000

10. Intangible assets

Brand of Duck Ltd. acquired	250

11. Investment

As per the balance sheet before acquisition of Duck Ltd. Duck Ltd.	900 300	 1,200

12. Inventories

As per the balance sheet before acquisition of Duck Ltd. Duck Ltd.	360 260	 620

13. Trade receivables

As per the balance sheet before acquisition of Duck Ltd. Duck Ltd.	1,040 540	 1,580

14. Cash and cash equivalents

As per the balance sheet before acquisition of Duck Ltd. Less: Acquisition cost paid Less: Paid to Duck Ltd. Duck Ltd.	520 (26) (144) 	 350 290	 640

15. Other current assets

As per the balance sheet before acquisition of Duck Ltd. Duck Ltd.	700 350	 1,050

Working Notes:

1. **Computation of Purchase Consideration**

Particulars	No. of shares	₹ in lakhs
Share capital of Duck Ltd.		900
Number of shares	9,00,000	
Shares to be issued (5 shares against 6 shares of Duck Ltd.)	7,50,000	
Fair value of Swan Ltd.'s share is ₹ 100 per share		
Purchase consideration		
Shares issued (7,50,000x 80% x ₹ 100 per share) (A)		600
Cash payment (₹ 20 x 9,00,000 x 80%) (B)		144
Deferred consideration (discounting ₹ 90 lakhs for 3 years @10%) (C)		67.62
Replacement award [Market based measure of the acquiree award (12) x ratio of the portion of the vesting period completed (2) / greater of the total vesting period (3) or the original vesting period (5) of the acquire award (ie 12 x 2/5)] (D)		4.80
Purchase consideration for 70% shares (A + B + C + D)		816.42

2. **Computation of deferred tax impact due to change in fair value of asset and liabilities acquired**

Particulars	Book	Fair value	FV

	value (A)	(B)	adjustment (A-B)
Property, plant and equipment	1,000	1,200	200
Intangible assets (Brand)	-	250	250
Investment	240	300	60
		1,750	510
Less: Contingent liability acquired			
Provision for lawsuit damages			(5)
Net difference in fair value			505
Deferred tax liability @ 30%			151.5

3. Computation of fair value of net identifiable assets acquired from Duck Ltd.

Particulars		Book value
Total assets as per the balance sheet		2,680
Add: Fair value adjustment in PPE and Investment (200+60)		260
Add: Intangible assets (Brand)		250
Fair value of total identifiable assets		3,190
Less: Total liabilities as per the balance sheet (500+200+290+370)		(1,360)
Less: Contingent liability acquired		
Lawsuit damages	5	
Income tax demand	20	(25)
Less: Defer tax liability (W.N.2)		(151.50)
Fair value of net identifiable assets (100%)		1,653.50

4. Computation of non-controlling interest in Duck Ltd. (Proportionate share basis)

Non-controlling interest (1,653.50 x 20%) = 330.70

5. Computation of capital reserve on acquisition of Duck Ltd.

Particulars	Book value
Fair value of net identifiable assets	1,653.50
Less: Purchase consideration	(816.42)
Less: NCI (W.N.4)	(330.70)
Capital reserve	506.38

Notes:

a) 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, ₹ 4.8 lakh (12 x 2/5) is considered as a part of purchase consideration and is credited to Swan Ltd.'s equity as this will be settled in its own equity. Since the fair value of the award on the acquisition date is ₹ 18 lakh the balance of (18 - 4.8) ₹ 13.2 lakh will be recorded as employee expense in the books of Duck Ltd. over the remaining life, which is 1 year in this scenario.

b) With respect to deferred consideration, ₹ 90 lakh is the minimum payment to be paid after 3 years. The other element is if company meet certain target then they will get 30% of that or ₹ 90 lakh 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%.

c) The additional consideration of ₹ 15 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 statement of profit and loss of Duck Ltd.

Question 10 (MTP Nov'23, May'24)

On 1st April, 20X1, Johansen Ltd. acquired a new subsidiary, Bosman Ltd., purchasing all 150 million shares of Bosman Ltd. The terms of the sale agreement included the exchange of four shares in Johansen Ltd. for every three shares acquired in Bosman Ltd. On 1 st April, 20X1, the market value of a share in Johansen Ltd. was ₹ 10 and the market value of a share in Bosman Ltd. ₹ 12

The terms of the share purchase included the issue of one additional share in Johansen Ltd. for every five acquired in Bosman Ltd., if the profits of Bosman Ltd. for the two years ending 31st March, 20X3 exceeded a target figure. Current estimates are that it is 80% probable that the management of Bosman Ltd. will achieve this target.

Legal and professional fees associated with the acquisition of Bosman Ltd. shares were ₹ 12,00,000, including ₹ 2,00,000 relating to the cost of issuing shares. The senior management of Johansen Ltd. estimates that the cost of their time that can be fairly allocated to the acquisition is ₹ 2,00,000. This figure of ₹ 2,00,000 is not included in the legal and professional fees of ₹ 12,00,000 mentioned above.

The individual Balance Sheet of Bosman Ltd. at 1st April, 20X1 comprised net assets that had a fair value at that date of ₹ 1,200 million. Additionally, Johansen Ltd. considered Bosman Ltd. possessed certain intangible assets that were not recognized in its individual Balance Sheet:

- Customer relationships – reliable estimate of value ₹ 100 million. This value has been derived from the sale of customer databases in the past.
- An in-process research and development project that had not been recognised by Bosman Ltd. since the necessary conditions laid down in Indian Accounting Standards for capitalisation were only just satisfied at 31st March, 20X2. However, the fair value of the whole project (including the research phase) is estimated at ₹ 50 million.
- Employee expertise – estimated value of Director employees of Bosman Ltd. is ₹ 80 million. • The market value of a share in Johansen Ltd. on 31st March, 20X2 was ₹ 11.

Compute the goodwill on consolidation of Bosman Ltd. that will appear in the consolidated Balance Sheet of Johansen Ltd. at 31st March, 20X2 with necessary explanation of adjustments therein. Also state the treatment of contingent consideration as on 31st March, 20X2 **(12 Marks)**

Solution:

Calculation of purchase consideration:

Particulars	₹ in million
Market value of shares issued (150 million x 4/3 x ₹ 10)	2,000
Initial estimate of market value of shares to be issued (150 million x 1/5 x ₹ 10)	300
Total consideration	2,300

Contingent consideration is recognized in full if payment is probable.

As per para 53 of Ind AS 103, 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

Statement of fair value of identifiable net assets at the date of acquisition

Particulars	₹ in million

As per Bosman Ltd.'s Balance Sheet	1,200
Fair value of customer relationships	100
Fair value of research and development project	50
Total net assets acquired	1,350

As per Ind AS 38 'Intangible assets', intangible assets can be recognized separately from goodwill provided they are identifiable, are under the control of the acquiring entity, and their fair value can be measured reliably.

Customer relationships that are similar in nature to those previously traded, pass these tests but employee expertise fail the 'control' test. Both the research and development phases of in process project can be capitalised provided their fair value can be measured reliably.

Statement of computation of goodwill

Particulars	₹ in million
Fair value of consideration given	2,300
Fair value of net assets acquired	(1,350)
Goodwill on acquisition	950

Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration. In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

- There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavourable conditions (for the issuer of the instrument).
- If the instrument will or may be settled in the issuer's own equity instruments, then it is:
  - a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or
  - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfillment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.

SOLVED EXAMPLE

Example 1: Reverse Acquisition

The Balance Sheets of Entity A and Entity B immediately before business acquisition are as follows:

	Amount (₹ in thousands)	
Particulars	**Entity A**	**Entity B**
Current Assets	600	800
Non Current Assets	1,200	2,900
Total Assets	1,800	3,700
Current Liabilities	400	200
Non - Current Liabilities	300	1200
Total Liabilities	700	1400
Equity		
30,000 Shares of ₹ 10 Each	300	
60,000 Shares of ₹ 10 Each		600
Retained Earnings	800	1700
Total Equity	1100	2300
Total Equity and Liability	1800	3700

On 31 March 20X1, Entity A issues 2.5 shares in exchange for each share of Entity B. All of entity B's shareholders exchange their shares. Therefore, Entity A issues 1,50,000 shares in exchange for all 60,000 shares of entity B. Entity A legally owns 100% of entity B.

The shareholders of Entity B own 83.33% (1,50,000/1,80,000) of the combined entity. The directors of entity B are appointed 6 out of 8 positions in combined entity's board. In accordance with Ind AS 103, Entity B (Legal Acquiree) is the accounting acquirer and Entity A (Legal Acquirer) is the accounting acquiree as Entity B shareholders control over combined entity.

The quoted market price of Entity B's share as at 31st March, .20X1 is ₹ 105 per share and Entity A's share price as at 31st March, 20X1 is ₹ 20 per share.

Assume the fair value of Entity A's identifiable net assets as at 31st March, 20X1 are the same as carrying values and ignore tax effect.

The acquisition date fair value (i.e. at 31st March, 20X1) of the accounting acquirer equity instrument is generally used to determine the amount of consideration transferred for business combination. In this case it is 105 per share (Entity B).

So if the business combination had taken place in the form of Entity B issuing additional shares to Entity A's shareholders in exchange for their shares in Entity A, Entity B would have to issue 12,000 shares (30,000 / 2.5) for the ratio of ownership interest in the combined entity to be same. (12,000/72,000). Therefore, the consideration for the business combination effectively transferred by Entity B is ₹ 12, 60,000 (12000 Shares x 105).

Calculation of Goodwill:

Fair value of Assets less Liabilities Assumed (Entity A) -	₹ 11,00,000
Consideration transferred (by Entity B) -	(₹ 12,60,000)
Goodwill -	**₹ 1,60,000**