

# Accounting in Corporate Restructuring: Concept and Accounting Treatment

## Lesson 6

### KEY CONCEPTS

■ Accounting Standard ■ Ind AS ■ Business Combination ■ Demerger ■ Internal Reconstruction ■ Consideration

### Learning Objectives

#### To understand:

- Accounting for Corporate Restructuring
- Accounting Standard (AS)-14
- Ind AS-103
- Consideration for Amalgamation
- Estimating the useful life of goodwill

### Lesson Outline

- Introduction
- Applicability
- Accounting Standard
- Accounting for Amalgamations
- Methods of accounting for Amalgamations
- Consideration for Amalgamation
- Treatment of Reserves on Amalgamation
- Goodwill on Amalgamation
- Disclosure Requirements
- Amalgamation after Balance sheet date
- Ind AS-103 Business Combination
- Business and Business Combination
- Accounting for Business Combination
- Recognising goodwill or bargain purchase
- IFRS-3 Business combination
- Demerger
- Internal Reconstruction
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- Test Yourself
- List of Further Readings

## REGULATORY FRAMEWORK

### To understand:

- Companies Act, 2013
- Accounting Standards
- IFRS/Ind AS

## INTRODUCTION

Corporate restructuring implies a process by which the legal, ownership or operational or other structures of the company is reorganised to make it more profitable or to make corporate more agile to meet the competition and operational requirements. Restructuring may also happen as a response to major events like buyout, bankruptcy, demerger or due to financial restructuring.

In simple words, Corporate Restructuring is re-arranging business of a company so as to increasing its efficiency and profitability. Restructuring is a method of changing the organizational structure in order to achieve the strategic goals of the organization. It involves dramatic changes in an organization.

The most common forms of corporate restructuring are mergers/amalgamations, acquisitions/takeovers, financial restructuring, divestures/demergers and buy-outs. It is essentially the process of re-designing one or more aspects of the Company.

Accounting for corporate restructuring is dealt with in the following accounting standards:

- (a) Accounting for Amalgamation (AS-14) - Applicable to those who have to comply with Companies (Accounting Standards) Amendent Rules, 2016
- (b) Business Combinations (IND AS-103) - Applicable to those who have to comply with Companies (Indian Accounting Standards) Rules, 2015

Accounting Standard-14 (AS-14) deals with accounting for amalgamations. According to AS-14 amalgamation may be either in the nature of merger or in the nature of purchase. It prescribes certain conditions to be fulfilled for consideration of amalgamation in the nature of merger. It includes aspects relating to transfer of assets, and liabilities, shareholders of transferor companies becoming shareholders of transferee company, consideration for amalgamation, continuity of business of transferor company (ies).

AS-14 further prescribes that amalgamation in the nature of merger should be accounted for under pooling of Interest method and amalgamation in the nature of purchase should be accounted for under the purchase method. It also covers aspects such as treatment of reserves/goodwill in a scheme of amalgamation, amalgamation after the balance sheet date, etc.

Indian Accounting Standard - 103 (IND AS-103) lays down the accounting principles for business combination and not for asset combination. IND AS-103 is substantially different from Accounting for Amalgamation (AS-14). To apply the IND AS-103, there should be transaction which meets the definition of business combination.

## APPLICABILITY

Accounting Standard-14 'Accounting for Amalgamations' lays down the accounting and disclosure requirements in respect of amalgamations of companies and the treatment of any resultant goodwill or reserves.

Business Combinations (IND AS-103) applies to a transaction or other event that meets the definition of a business combination.

**Exception**

This standard does not deal with cases of acquisitions which arise when there is a purchase by one company (acquiring company) of the whole or part of the shares, or the whole or part of the assets, of another company (acquired company) in consideration by payment in cash or by issue of shares or other securities in the acquiring company or partly in one form and partly in the other. The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

Business Combinations (IND AS-103) does not apply to the following:

- (a) The formation of a joint venture.
- (b) 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 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.
- (c) Accounting for combination of entities or business under common control.

Further, in corporate restructuring, for proper and accurate accounting one also need to know and understand following standards:

*Under Indian Accounting Standards (IND AS)*

- Ind AS 110 Consolidated Financial Statements
- Ind AS 111 Joint Arrangements
- Ind AS 112 Disclosure of Interest in other Entity
- Ind AS 28 Investments in Associates and Joint Ventures

*Under Accounting Standards*

- AS 13 Accounting for Investments
- AS 21 Consolidated Financial Statements
- AS 23 Accounting for Investments in Associates in Consolidated Financial Statements
- AS 27 Financial Reporting of Interests in Joint Ventures

**ACCOUNTING STANDARD-14 ACCOUNTING FOR AMALGAMATIONS****Types of Amalgamation**

Accounting Standard (AS)-14 recognizes two types of amalgamation:

- (a) Amalgamation in the nature of merger.
- (b) Amalgamation in the nature of purchase.

An amalgamation should be considered to be an amalgamation in the nature of merger when all the following conditions are satisfied:

- (i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
- (ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation,

by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

- (iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
- (iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
- (v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

An amalgamation should be considered to be an amalgamation in the nature of purchase, when any one or more of the conditions specified above is not satisfied. These amalgamations are in effect a mode by which one company acquires another company and hence, the equity shareholders of the combining entities do not continue to have a proportionate share in the equity of the combined entity or the business of the acquired company is not intended to be continued after amalgamation.

**Example:**

X Ltd. acquire Y Ltd. under the scheme of merger sanctioned by the Tribunal. Y Ltd. ceases to exist. Consideration is discharged by way of issue of equity shares of X Ltd. to the shareholders of Y Ltd. in the ratio 1:1. X Ltd. already held 5% in Y Ltd. as an investment prior to the effective date of merger i.e. 1st October 2022. 86% of the shareholders (by face value) of Y Ltd. excluding X Ltd. agreed to become shareholders of X Ltd. Whether the above case will qualify to be classified as merger as per AS-14.

**Solution:**

Even if we exclude the shares of Y Ltd. already held by X Ltd., consequent to the allotment of shares pursuant to merger, 90% criteria for amalgamation to be classified as merger is being met. Since 90% of the remaining shares i.e. 95% comes out to 85.5% shareholders. Thus the threshold is being met. Hence the above case will qualify as merger.

## METHODS OF ACCOUNTING FOR AMALGAMATION

There are two main methods of accounting for amalgamations:

- (a) the pooling of interests method; and
- (b) the purchase method.

The pooling of interests method is used in case of amalgamation in the nature of merger. The purchase method is used in accounting for amalgamations in the nature of purchase.

### The Pooling of Interests Method

Since merger is a combination of two or more separate business, there is no reason to restate carrying amounts of assets and liabilities. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

In preparing the transferee company's financial statements, the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the date of the amalgamation. The balance of the Profit and Loss Account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to the General Reserve, if any.

If, at the time of the amalgamation, the transferor and the transferee company have conflicting accounting policies, a uniform set of accounting policies should be adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies should be reported in accordance with Accounting Standard (AS-5), Net Profit or Loss for the Period 'Prior Period Items and Changes in Accounting Policies'.

The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted in reserves. It has been clarified that the difference between the issued share capital of the transferee company and share capital of the transferor company should be treated as capital reserve. The reason given is that this difference is a kin to share premium. Furthermore, reserve created on amalgamation is not available for the purpose of distribution to shareholders as dividend and/or bonus shares. It means that if consideration exceeds the share capital of the transferor company (or companies), the unadjusted amount is a capital loss and adjustment must be made, first of all in the capital reserves and in case capital reserves are insufficient, in the revenue reserves. However, if capital reserves and revenue reserves are insufficient, the unadjusted difference may be adjusted against revenue reserves by making addition thereto by appropriation from profit and loss account. There should not be direct debit to the profit and loss account. If there is insufficient balance in the profit and loss account also, the difference should be reflected on the assets side of the balance sheet in a separate heading.

### The Purchase Method

In preparing the transferee company's financial statements, the assets and liabilities of the transferor company should be incorporated at their fair value or, alternatively, the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation. The reserves (whether capital or revenue or arising on revaluation) of the transferor company, other than the statutory reserves, should not be included in the financial statements of the transferee company except as in case of statutory reserve.

Any excess of the amount of the consideration over the fair value of the net assets of the transferor company acquired by the transferee company should be recognized in the transferee company's financial statements as goodwill arising on amalgamation in the nature of purchase. If the amount of the consideration is lower than the negotiated value of the net assets acquired, the difference should be treated as Capital Reserve.

The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life.

The amortization period should not exceed five years unless a somewhat longer period can be justified.

The reserves of the transferor company, other than statutory reserve should not be included in the financial statements of the transferee company. The statutory reserves refer to those reserves which are required to be maintained for legal compliance. The statute under which a statutory reserve is created may require the identity of such reserve to be maintained for a specific period.

Where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with, such statutory reserves of the transferor company should be recorded in the financial statements of the transferee company by crediting the relevant statutory reserve account. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Account') which should be disclosed as a part of "miscellaneous expenditure" or other similar category in the balance sheet as a separate line item. When the identity of the statutory reserves is no longer required to be maintained, both the reserve and the aforesaid account should be reversed.

### Differences between Pooling of Interest Method and Purchase Method

Particulars	Pooling of Interest Method	Purchase Method
Purchase consideration	Consideration will be in the form of shares only.	Consideration may be in the form of equity shares/ other securities / cash/ other assets.
Recording of assets and Liabilities	Under this method assets and liabilities of transferor companies are recorded at Book Value only.	Under this method assets and liabilities of transferor companies are recorded at Fair Value.
Difference in consideration and Net assets taken over	Difference in consideration and Net assets taken over is adjusted in Reserve and surplus.	Difference in consideration and Net assets taken over is recorded in Goodwill or capital reserve.
Reserve	All reserve are incorporated in the books of Transferee company at the same value at which they appeared in the books of transferor.	No reserve are incorporated in the books of Transferee company except statutory reserve.

#### Let us recapitulate

There are two types of amalgamation and two methods of accounting for amalgamations under AS 14. The types of amalgamation are amalgamation in the nature of merger and amalgamation in the nature of purchase. There are two main methods of accounting for amalgamations viz. the pooling of interests method and the purchase method. The pooling of interests method is used in case of amalgamation in the nature of merger. The purchase method is used in accounting for amalgamations in the nature of purchase.

### CONSIDERATION FOR AMALGAMATION

The consideration for amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. In determining the value of the consideration, assessment is made of the agreed value or negotiated value of its various elements.

The consideration for the amalgamation should include any non-cash element at fair value. The fair value may be determined by a number of methods. For example, in case of issue of securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up, and where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective net book values.

While the scheme of amalgamation provides for an adjustment to the consideration contingent on one or more future events, the amount of the additional payment should be included in the consideration if payment is probable and areas on able estimate of the amount can be made. In all other cases, the adjustment should be recognized as soon as the amount is determinable.

#### Example:

A Ltd. acquire B Ltd., on 1<sup>st</sup>April, 2022 and discharges consideration for the business as follows:

- Issued 42,000 fully paid equity shares of Rs.10 each at par to the equity shareholders of B Ltd.
- Issued fully paid up 15% preference shares of Rs.100 each to discharge the preference shareholders (Rs.1,70,000) of B Ltd. at a premium of 10%
- It is agreed that the debentures of B Ltd. (Rs.50,000) will be converted into equal number and amount of 13% debentures of A Ltd.

Calculate the amount of purchase consideration.

**Solution:**

Calculation of purchase consideration:

(a)	42,000 equity shares `Rs. 10 each issued at Rs. 10	= 4,20,000
(b)	15% preference shares of Rs. 1,70,000*110%	= 1,87,000
	Total	= 6,07,000
(c)	Not to be included in purchase considered as it is payment to debenture holders.	

### TREATMENT OF RESERVES ON AMALGAMATION

#### If the amalgamation is an 'amalgamation in the nature of merger'

If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company. As a result of preserving the identity, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company is adjusted in reserves in the financial statements of the transferee company.

**Example:**

X Ltd. having a share capital of Rs. 20 lakhs and Y Ltd. having a share capital of Rs. 30 lakhs. Z Ltd. was formed to take over the business of X Ltd and Y Ltd. at a purchase consideration of Rs. 25 lakhs and Rs. 28 lakhs, payable in shares of Z Ltd. The assets and liabilities were taken at their carrying amounts. Compute the Goodwill or Capital Reserve.

**Solution:**

Since the purchase consideration is payable in shares of the transferee company and all the assets and liabilities are taken over at their carrying amounts, the amalgamation is in the nature of merger, i.e. pooling of interests method.

For X Ltd. Purchase consideration	= Rs. 25 lakhs
Less: Share capital of X Ltd	= Rs. 20 lakhs
Excess of purchase consideration	= Rs. 5 lakhs.
This shall have to be adjusted against the Reserves of Z Ltd.	
For Y Ltd. Purchase Consideration	= Rs. 28 lakhs
Less: Share Capital of Y Ltd	= Rs. 30 lakhs

Since purchase consideration is less than share capital of the transferor company, Rs. 2 lakhs shall be treated as Capital Reserve.

#### If the amalgamation is an 'amalgamation in the nature of purchase'

If the amalgamation is an 'amalgamation in the nature of purchase', the identity of the reserves, other than the statutory reserves is not preserved, dealt within the certain circumstances mentioned below.

Certain reserves may have been created by the transferor company pursuant to the requirements of, or to avail of the benefits under, the Income-tax Act, 1961; for example, Development Allowance Reserve, or

Investment Allowance Reserve. The Act requires that the identity of the reserves should be preserved for a specified period. Likewise, certain other reserves may have been created in the financial statements of the transferor company in terms of the requirements of other statutes. Though, normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made in respect of reserves of the afore said nature (referred to herein after as 'statutory reserves') and such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute. This exception is made only in those amalgamations where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with. In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Account') which is disclosed as a part of 'miscellaneous expenditure' or other similar category in the balance sheet. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company. If the result of the computation is negative, the difference is debited to goodwill arising on amalgamation and dealt with in the manner stated below undertreatment of goodwill on amalgamation. If the result of the computation is positive, the difference is credited to Capital Reserve.

### GOODWILL ON AMALGAMATION

Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life. Due to nature of goodwill, it is difficult to estimate its useful life, but estimation is done on a prudent basis. Accordingly, it should be appropriate to amortise goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

The following factors are to be taken into account in estimating the useful life of goodwill:

- (i) the foreseeable life of the business or industry;
- (ii) the effects of product obsolescence, changes in demand and other economic factors;
- (iii) the service life expectancies of key individuals or groups of employees;
- (iv) expected actions by competitors or potential competitors; and
- (v) legal, regulatory or contractual provisions affecting the useful life.

#### **Example:**

What is goodwill and capital reserve as per AS-14?

#### **Solution:**

Goodwill is the excess of the price paid in a purchase over the fair value of the net identifiable assets acquired. Capital reserve is the excess of the fair value (agreed value) of the net identifiable assets acquired over the purchase price.

### Balance of Profit and Loss Account

In the case of an 'amalgamation in the nature of merger', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company. Alternatively, it is transferred to the General Reserve, if any.

In the case of an 'amalgamation in the nature of purchase', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company, whether debit or credit, loses its identity.

### DISCLOSURE REQUIREMENTS

- (a) For **amalgamations of every type following disclosures** should be made in the:
  - (i) first financial statements after the amalgamation;
  - (ii) names and general nature of business of the amalgamating companies;
  - (iii) effective date of amalgamation for accounting purposes;
  - (iv) the method of accounting used to reflect the amalgamation; and
  - (v) particulars of the scheme sanctioned under a statute.
- (b) In case of **amalgamations accounted for under the pooling of interests method, the following additional disclosures** are required to be made in the first financial statements following the amalgamation:
  - (i) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;
  - (ii) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.
- (c) In case of **amalgamations accounted for under the purchase method the following additional disclosures** are required to be made in the first financial statements following the amalgamations:
  - (i) consideration for the amalgamation and a description of the consideration paid or contingently payable, and
  - (ii) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortization of any goodwill arising on amalgamation.

### Amalgamation after the Balance Sheet Date

While an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure should be made as per the provisions of AS-4, 'Contingencies and Events Occurring after the Balance Sheet Date', but the amalgamation should not be incorporated in that financial statements. In certain circumstances, the amalgamation may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

### INDIAN ACCOUNTING STANDARD 103- BUSINESS COMBINATIONS

Ind AS 103 defines business combination which has a wider scope when compared to AS-14 which deals only with amalgamation. Business combination is the process under which two or more business organisations or their net assets are brought under common control in a single business entity.

### Business and Business Combination as per IND AS 103

**Business:** A business consists of inputs and process applied to those inputs that have the ability to create outputs. Thus, a business has three elements:

- (a) *Input:* An economic resource that creates or has the ability to create outputs when one or more processes are applied to it. Example Non-current assets.

- (b) *Process*: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Example: Strategic management processes.
- (c) *Output*: The results of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividend, lower costs or other economic benefits directly to investors or other owners, members or participants.

### Business Combination

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

A business combination is an act of bringing together of separate entities or business into one reporting unit. The result of business combination is one entity obtains control of one or more businesses. If an entity obtains control over other entities which are not business, the act is not a business combination. In such a case the reporting entity will account it as asset acquisition.

From the definition of Business Combination, it is clear that for business combination, control by one entity of another is sufficient and both the entities can continue to exist.

For example, if X Ltd., acquires 70% shares of Y Ltd., then it is a case of business combination even if X Ltd. and Y Ltd. will continue to exist. X Ltd. becomes a holding company of Y Ltd. and therefore, they become one reporting entity by reporting consolidated financial statements.

### Difference between Ind AS-103 Business Combinations and Ind AS-110 Consolidated Financial statements

It may seem that Ind AS-110 Consolidated Financial statements and Ind AS-103 Business Combinations deal with the same thing which is not accurate. Ind AS 110 deals with accounting aspect of consolidation of businesses whereas Ind AS 103 deals with scope of business combinations.

While Ind AS-110 defines a control and prescribes specific consolidation procedures, Ind AS-103 is more about the measurement of the items in the consolidated financial statements, such as goodwill, non-controlling interest, etc.

While preparing consolidated financial statements, first you have to apply Ind AS-103 for measurement of assets and liabilities acquired, non-controlling interest and goodwill/bargain purchase then the consolidation procedure as per Ind AS-110.

### Acquisition Method of Business Combination as per IND AS 103

An entity shall account for each business combination by applying the acquisition method. Applying the acquisition method requires the following:

- (a) Identifying the acquirer
- (b) Determining the acquisition date
- (c) Identification and measurement of consideration transferred
- (d) Recognising and measuring the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree; and
- (e) Recognising and measuring goodwill or a gain from a bargain purchase.

#### (a) Identifying the acquirer

- For each Business Combination one of the combining entities shall be identified as the acquirer.

- Acquirer is the entity that obtains control of business.
- The guidance in Ind AS 110 shall be used to identify the acquirer — the entity that obtains control of another entity, i.e., the acquiree.

As per Ind AS 110 'Consolidated Financial Statements', an investor controls an investee if and only if the investor has all the following:

- (a) power over the investee;
- (b) exposure, or rights, to variable returns from its involvement with the investee; and
- (c) the ability to use its power over the investee to affect the amount of the investor's returns.

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

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

When it is not clear from Ind AS 110, the following factors should be considered under Ind AS 103:

- In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.
- In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests.
- 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.
- The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.
- 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 acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.

### **(b) Determining the acquisition date**

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

The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date.

For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

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

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

**Example**

Company ABC purchased 51% equity interest in Company XYZ. The consideration is paid in cash. The relevant dates are as under:

Date of agreement with shareholders -1st June, 2022

Appointed date as per agreement -1st April, 2022

Date of obtaining control over the Board -1st July, 2022

Date of payment of consideration -15th July, 2022

In this case, as the control over financial and operating policies are acquired through obtaining control over Board on 1st July, 2022, it is this date that is considered as the acquisition date. It may be noted that the appointed date as per the agreement is not considered as the acquisition date, as the Company ABC did not have control over Company XYZ as at that date.

**Example**

Sony Ltd. and Zee Ltd. are production of films and TV serials. Sony Ltd. makes a bid for Sony 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, Sony Ltd. and Zee 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 Sony Ltd. and Zee Ltd. agree the terms even though the approval of CCI is awaited?

Paragraph 8 of Ind AS 103 provides that acquisition date is the date on which the acquirer obtains control of the acquiree.

Further, paragraph 9 of Ind AS 103 clarifies that the date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date.

For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date. Since CCI approval is a substantive approval for Sony Ltd. to acquire control of Zee 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.

**(c) Identification and measurement of consideration transferred**

The consideration transferred in a business combination is the sum of the fair values of assets transferred, liabilities incurred, and equity issued by the acquirer.

The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer.

- The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a business of the acquirer). If so, the acquirer shall remeasure the transferred assets or liabilities

to their fair values as of the acquisition date and recognize the resulting gains or losses, if any, in profit or loss.

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

- Further, any items that are not part of the business combination be accounted separately from business combination (example: acquisition related costs)
- Contingent consideration (Obligation by the acquirer to transfer additional assets or equity interest, if specified future events occur or conditions are met), if any, should also be measured at fair value at acquisition date. The acquirer shall classify an obligation to pay contingent consideration as a liability or as equity on the basis of the definitions of an equity instrument and a financial liability in accordance with the requirement of Ind AS 32 Financial Instruments: Presentation, or other applicable Indian Accounting Standards.

Company A acquires Company B in April, 2022. The acquisition agreement further states that an additional 20 Crore cash will be paid to B's former shareholders if profits of B after acquisition exceeds Rs. 100 crore for the next two years. The 20 Crore further payable depends upon profit generated by B, hence it is a contingent consideration.

A has to determine the fair value of the contingent consideration and a liability to be recognised at acquisition date.

Further, since the consideration is to be settled in cash, such consideration would be in the nature of financial liability rather than equity.

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

#### **(d) Recognising and measuring the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree**

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

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. For example, the acquirer recognises the 80 acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

**(e) Recognising and measuring goodwill or a gain from a bargain purchase;**

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

- (a) the aggregate of:
  - (i) the consideration transferred;
  - (ii) the amount of any non-controlling interest in the acquiree; and
  - (iii) in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.
- (b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Ind AS.

In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the amount in (b) exceeds the aggregate of the amounts specified in (a). If that excess remains, the acquirer shall recognise the resulting gain (as bargain purchase) in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve. The gain shall be attributed to the acquirer.

**Measurement of Non-Controlling Interest (NCI)**

Non-Controlling Interest (NCI) is the portion of equity ownership in a subsidiary not attributable to the parent company, who has a controlling interest (greater than 50% but less than 100%) and consolidates the subsidiary's financial results with its own.

Ind AS 103 allows the acquirer to measure a non-controlling interest in the acquiree at its fair value at the acquisition date. Sometimes an acquirer will be able to measure the acquisition-date fair value of a non-controlling interest on the basis of a quoted price in an active market for the equity shares (ie those not held by the acquirer). In other situations, however, a quoted price in an active market for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the non-controlling interest using other valuation techniques. The fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree or, conversely, the inclusion of a discount for lack of control (also referred to as a non-controlling interest discount) in the per-share fair value of the non-controlling interest if market participants would take into account such a premium or discount when pricing the non-controlling interest.

**Example**

Amber Ltd. acquires 60% of the equity shares of Natural Ltd. a private entity, for Rs. 150 crore. The fair value of its identifiable net assets is Rs. 120 crore. How will the non-controlling interest be measured?

**Solution**

- (a) Fair value method  
Fair value of 40% of the equity shares owned by non-controlling shareholders =  $150/60\% * 40\% = 100$  crore.
- (b) Proportionate Net Asset value method  
Net asset value of 40% of the equity shares owned by non-controlling shareholders =  $120 * 40\% = 48$  crore.

**(f) Disclosures**

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

- a. the name and a description of the acquiree.

- b. the acquisition date.
- c. the percentage of voting equity interests acquired.
- d. the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
- e. a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.
- f. the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
  - I. cash;
  - II. other tangible or intangible assets, including a business or subsidiary of the acquirer;
  - III. liabilities incurred, for example, a liability for contingent consideration; and
  - IV. equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.
- g. for contingent consideration arrangements and indemnification assets:
  - i. the amount recognised as of the acquisition date;
  - ii. a description of the arrangement and the basis for determining the amount of the payment; and
  - iii. an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.
- h. for acquired receivables:
  - i. the fair value of the receivables;
  - ii. the gross contractual amounts receivable; and
  - iii. the best estimate at the acquisition date of the contractual cash flows not expected to be collected. The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.
- i. the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.
- j. for each contingent liability recognised, the information required as per Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose:

  - i. the information required by paragraph 86 of Ind AS 37; and
  - ii. the reasons why the liability cannot be measured reliably.
- k. the total amount of goodwill that is expected to be deductible for tax purposes.
- l. for transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the business combination:
  - i. a description of each transaction;

- ii. how the acquirer accounted for each transaction;
  - iii. the amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised; and
  - iv. if the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.
- m. the disclosure of separately recognised transactions shall include the amount of acquisition-related costs and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of profit and loss in which those expenses are recognised. The amount of any issue costs not recognised as an expense and how they were recognised shall also be disclosed.
- n. in a bargain purchase (see paragraphs 34–36A):
- i. the amount of any gain recognised in other comprehensive income in accordance with paragraph 34;
  - ii. the amount of any gain directly recognised in equity in accordance with paragraph 36A; and
  - iii. a description of the reasons why the transaction resulted in a gain in case of (i) above.
- o. for each business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date: i. the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and ii. for each non-controlling interest in an acquiree measured at fair value, the valuation technique(s) and significant inputs used to measure that value.
- p. in a business combination achieved in stages:
- i. the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date; and
  - ii. the amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination (see paragraph 42) and the line item in the statement of profit and loss in which that gain or loss is recognised.
- q. Following additional information:
- i. the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of profit and loss for the reporting period; and
  - ii. the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. If disclosure of any of the information required by this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable.

### Step Acquisitions

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

If a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

**Accounting Treatment:**

*Initial Acquisition:* When the acquiring entity first obtains control over the target, it accounts for the transaction using the applicable accounting standards for business combinations (e.g., IFRS 3 or ASC 805).

*Subsequent Acquisitions:* For each subsequent increase in ownership interest, the acquiring entity reassesses its control or significant influence over the target to determine whether consolidation is required.

*Fair Value Adjustments:* Any changes in the fair value of previously held equity interests due to subsequent acquisitions are recognized in the acquirer's profit or loss unless they represent transactions with non-controlling interests.

**Consolidation Considerations:**

*Control Assessment:* The acquiring entity reassesses its control over the target at each step acquisition. Control is generally indicated by the ability to direct the relevant activities of the target to generate returns.

*Significant Influence:* If control is not achieved, the acquiring entity assesses whether it has significant influence over the target. This assessment is based on factors such as representation on the target's board of directors, participation in policy-making decisions, and material transactions between the entities.

*Consolidation Methods:* If control or significant influence is established, the acquiring entity consolidates the target's financial statements using either the acquisition method (for control) or the equity method (for significant influence).

**Financial Reporting:**

*Disclosures:* Acquiring entities are required to provide comprehensive disclosures about step acquisitions in their financial statements. This includes information about the nature and terms of each transaction, the fair value of assets acquired and liabilities assumed, and the impact on the acquirer's financial position, results of operations, and cash flows.

*Segment Reporting:* Step acquisitions may result in changes to the acquirer's reportable segments, which need to be disclosed in accordance with relevant accounting standards (e.g., IFRS 8 or ASC 280).

**Tax Implications:**

*Tax Planning:* Step acquisitions may have significant tax implications for both the acquiring entity and the target, including considerations related to tax basis step-ups, tax attributes utilization, and potential tax liabilities.

*Transfer Pricing:* Transactions between related parties as part of step acquisitions are subject to transfer pricing rules and regulations to ensure compliance with tax laws and regulations.

**Business Combination of Entities under Common Control**

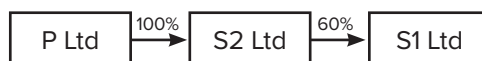
Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

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

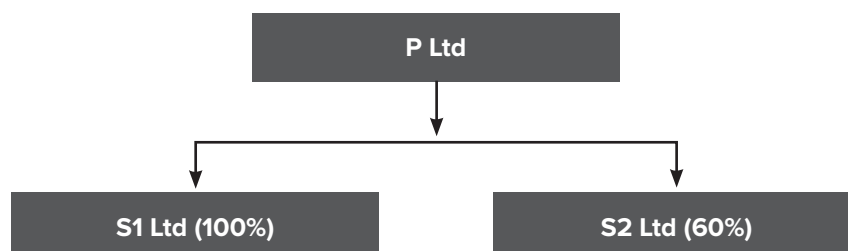
The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant to determining whether the combination is not relevant to determining whether the combination involves entities under common control. This is because of partially-owned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

**Example:**

Consider the following two groups:



P Ltd. acquires from S1 Ltd., its 60% stake in S2 Ltd. for Rs.10 Crores. After that the position of the group will be as below:



### METHOD OF ACCOUNTING FOR COMMON CONTROL BUSINESS COMBINATIONS

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

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

- The assets and liabilities of the combining entities are reflected at their carrying amounts.
- No adjustments are made to reflect fair values or recognise any new assets or liabilities. The only adjustments that are made are to harmonise accounting policies.
- The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the earliest period presented in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, prior period information shall be restated only from that date.

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

The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.

The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor.

The excess, if any, between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor is recognised as goodwill in the financial statements of the transferee entity; in case of any deficiency, the same shall be treated as capital reserve.

### Disclosures

The following disclosures shall be made in the first financial statements following the business combination:

- Names and general nature of business of the combining entities;
- The date on which the transferor obtains control of the transferee;

- (c) Description and number of shares issued, together with the percentage of each entity's equity shares exchanged to effect the business combination; and
- (d) The amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

### Reverse Acquisition

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired. However, application of the guidance in paragraphs B13–B18 of Ind AS 103 results in identifying:

- (a) the public entity as the acquiree for accounting purposes (the accounting acquiree); and
- (b) the private entity as the acquirer for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in Ind AS103, including the requirement to recognise goodwill, apply.

Reverse Acquisitions are often pursued for several reasons:

*Quicker Access to Public Markets:* It provides a faster and less costly route to becoming a publicly traded company compared to an IPO.

*Less Regulatory Scrutiny:* Reverse acquisitions typically involve less regulatory scrutiny and disclosure requirements compared to traditional IPOs.

*Enhanced Credibility:* Being publicly traded can enhance the credibility and visibility of the private company, making it easier to raise capital and attract investors.

*Tax Benefits:* Depending on the structure and jurisdiction, there may be potential tax benefits associated with a reverse acquisition.

However, Reverse Acquisitions also come with potential challenges and risks, including:

*Due Diligence:* It's crucial to conduct thorough due diligence on the target company to assess its financial condition, liabilities, and potential risks.

*Integration:* Integrating the operations and cultures of the two companies can be complex and challenging.

*Market Perception:* Reverse acquisitions may be viewed sceptically by investors, leading to volatility in the company's stock price.

*Regulatory Compliance:* The combined entity must comply with ongoing regulatory requirements and reporting obligations associated with being a public company.

### Examples

1. In 1994 Godrej Soaps, a consumer product manufacturing business did a reverse merger with its loss-making subsidiary unit 'Gujarat Godrej Innovative chemical' and named it 'Godrej Soaps Ltd'.
2. In 2002, ICICI became the first firm to choose a reverse merger when it merged with its arm company, ICICI Bank, and renamed the combined entity ICICI Bank.

### Business Combination after the balance sheet date

When a business combination is effected after the balance sheet but before the approval of the financial statements for issue by either party to the business combination, disclosure is made in accordance with Ind AS 10 Events after the reporting period, but the business combination is not incorporated in the financial statements. In certain circumstances, the business combination may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

Detailed explanation of how such situations are typically handled:

*Disclosure According to Ind AS 10: Events after the Reporting Period:* Ind AS 10 provides guidance on how to treat events that occur after the balance sheet date but before the financial statements are approved for issue. In the case of a business combination, disclosure is made in the financial statements in accordance with this standard. This typically involves disclosing the nature of the business combination, including the entities involved, the acquisition date, and any other pertinent details.

*Non-Incorporation of the Business Combination in Financial Statements:* Despite the occurrence of the business combination, if the financial statements have not been adjusted to reflect the transaction, the assets acquired and liabilities assumed are not recognized in the financial statements. This is because the transaction took place after the balance sheet date, and thus the financial statements reflect the financial position of the entity as of that date.

*Additional Information Affecting Financial Statements:* In certain circumstances, the business combination may provide additional information that impacts the financial statements themselves. For example, if the business combination strengthens the financial position of the entity or provides access to resources that allow the entity to continue operating as a going concern, this information may affect the assessment of the entity's ability to continue its operations for the foreseeable future. In such cases, the going concern assumption may be maintained, which is crucial for preparing the financial statements.

*Management's Responsibility:* It's the responsibility of management to evaluate the impact of the business combination on the financial statements and ensure that appropriate disclosures are made in accordance with accounting standards. Management should assess the materiality of the business combination and its effect on the financial position, results of operations, and cash flows of the entity.

*Subsequent Adjustment and Restatement:* If the business combination is significant and occurs before the financial statements are approved for issue, but after the balance sheet date, adjustments to the financial statements may be necessary. This could involve restating comparative information for prior periods to reflect the impact of the business combination on the entity's financial position and performance.

### RECENT DEVELOPMENT'S IN M&A ACCOUNTING

AS-14 Accounting for amalgamations did not provide guidance in many situations such as demerger, reverse acquisition. In the absence of specific accounting guideline companies were using various alternative accounting alternatives for achieving tax efficiencies.

In the cases court approved mergers and acquisition, the accounting treatment was prescribed by the courts which sometimes used to be contrary to the accounting standard.

With the introduction of IND-AS 103 – Business combination and Companies Act, 2013 accounting treatment of Mergers and Acquisitions have undergone a drastic change.

Section 232 of the Companies Act 2013 provides that accounting treatment prescribed in the court approved scheme for merger, demerger, amalgamation or group restructuring should be in accordance with the notified accounting standards prescribed in the Companies Act, 2013.

Certain other developments in M&A accounting are as below:

**(a) Method of Accounting for business combination**

Under AS-14 many companies were able to account for business combination between commonly controlled enterprises using purchase method. As a result of this, tax benefits for goodwill amortisation was available while computing book profit for MAT purpose.

Under IND AS-103 it is mandatory to use pooling of interest method for business combination between commonly controlled enterprises.

As a result of this accounting alternatives gets restricted and the consequent tax benefits will also be not available.

**(b) Appointed date v. Effective date**

The date from which the scheme of amalgamation comes into force (and is usually specified in the scheme of amalgamation). It also denotes the date on which the amalgamation takes place or, in other words, the property, assets, and liabilities of the Transferor-Company vest in and are transferred to the Transferee Company. In court approved merger, demerger and other restructuring accounting was done from the appointed date once the court order became effective.

The effective date is the date when the amalgamation/merger is completed in all respects after having gone through the formalities involved and the transferor company having been liquidated by the Registrar of Companies, based on the approval of the NCLT and filing the necessary documents thereof with the Registrar of Companies.

With the implementation of IND-AS 103 Business combination this is going to change. As per IND-AS 103 accounting for business combination should be done on the date on which the acquirer obtains control.

**(c) Accounting for goodwill**

AS-14 provided an accounting choice to compute the goodwill at the fair value of the assets taken over or at the net asset value of the assets taken over. However, this choice is not available in IND AS 103 Business combination, as the goodwill has to be computed using the fair value of the net assets taken over.

AS-14 provides for amortisation of goodwill over a period of five years. IND-AS 103 Business combination prohibits amortisation of goodwill and is required to test goodwill for impairment annually. This will result in a volatile profit and loss account.

Goodwill amortisation was available as tax deductible item while computing MAT liability. This will not be available in the IND-AS regime.

**(d) Common control business combinations**

IND AS prescribes specific accounting principles for common control business combinations. It mandates the use of the pooling of interest method with restatement of the comparative period presented for the period the entities were in common control. The requirement to restate comparative may not be fully in sync with the tax treatment of considering the merger or amalgamation only from the appointed date.

**(e) Income Taxes**

As per the requirement of Ind AS 12, no deferred tax consequence should be recorded on initial recognition of deferred tax except assets and liabilities acquired during business combination. Accordingly, the acquirer shall recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with Ind AS 12, Income Taxes.

The acquirer shall account for the potential tax effects of temporary differences and carry forwards of an acquiree that exist at the acquisition date or arise as a result of the acquisition in accordance with Ind AS 12.

**(f) Indemnification assets**

The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts.

**Example**

Sun Pharma Limited acquires Ranbaxy Limited in a business combination on 1st April, 2021. Ranbaxy Limited is being sued by one of its customers for side effects of medicines for Rs. 25,00,000. The sellers of Ranbaxy Limited provide an indemnification to Sun Pharma for the reimbursement of any losses greater than Rs. Rs. 10,00,000. At the acquisition date, Sun Pharma determined recognises the fair value of the contingent liability of Rs. 25,00,000 in the acquisition accounting.

In the acquisition accounting Sun Pharma also recognises an indemnification asset of Rs. ` 15,00,000 (Rs. ` 25,00,000 – Rs. 10,00,000).

**(g) Intangible assets**

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

**(h) Share based payment transactions**

The acquirer shall measure a liability or an equity instrument related to share-based payment transactions of the acquiree or the replacement of an acquiree's share-based payment transactions with share-based payment transactions of the acquirer in accordance with the method in Ind AS 102, Share-based Payment, at the acquisition date.

**(i) Assets held for sale**

The acquirer shall measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, at fair value less costs to sell in accordance with that Ind AS.

**Difference between Ind AS 103 and AS 14**

- **Scope:** Ind AS 103 has a wider scope than AS 14.
- **Method of accounting:** Ind AS 103 prescribe only acquisition method for every business combination whereas AS 14 states two method of accounting: Pooling of interest method and Purchase method.
- **Recognition and measurement:** Ind AS 103 recognises acquired identifiable assets liabilities and non-controlling interest at fair value. AS 14 allows choice of Book value or Fair Value.
- **Goodwill:** Under Ind AS 103, Goodwill is not amortised but tested for annual impairment where as AS 14 require goodwill to be amortised over a period not exceeding 5 years.
- **Non Controlling Interest (NCI):** Ind AS 103 provide for accounting of NCI, AS 14 do not.
- **Recording for consolidated financial statements:** It is provided in Ind AS 103, not in AS 14.

- **Common control transactions:** Appendix C deals with accounting for common control transactions, which prescribes Pooling of interest method of accounting. AS14 do not prescribe any different accounting for such transactions.
- **Contingent Consideration:** Ind AS 103 recognise contingent consideration, AS 14 do not.
- **Reverse acquisitions:** Ind AS 103 deal with reverse acquisitions, AS 14 do not.

### IFRS 3- BUSINESS COMBINATION

**The principles of IND- AS 103 Business combination and IFRS 3 are same to a very great extent.**

There are only few carve out in IND-AS 103 when compared to IFRS 3. They are as follows:

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

IFRS-3 requires bargain purchase gain arising on business combination to be recognised in profit or loss account. IND-AS 103 requires that the bargain purchase gain to be recognised in other comprehensive income and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as capital reserve.

The main reason for this carve out is, the recognition of such gains in profit or loss would result into recognition of unrealised gains as the value of net assets is determined on the basis of fair value of net assets acquired.

### DEMERGER

Demerger is a method of corporate restructuring by which a business unit or subsidiary of a company becomes an independent entity from its parent's entity. The parent firm distributes shares of subsidiary to its shareholders through a stock dividend. In most cases demerger unlocks hidden shareholder value. For the parent company, it sharpens the management focus. For the new entity, it gets independence to make decisions, explore new opportunities based on its strength.

The word demerger has got statutory recognition in the Income Tax Act, 1961. As per Income Tax Act, 1961 demerger in relation to companies, means the transfer, pursuant to a scheme of arrangement under Companies Act, 2013 by a demerged company of its one or more undertakings to any resulting company subject to conditions specified. As per various court decisions AS-14 -Accounting for Amalgamations is not applicable to demergers.

#### Types of Demergers

*Spin-off:* A company creates a new, independent entity and distributes its shares to existing shareholders.

*Split-off:* Existing shareholders exchange their shares in the parent company for shares in the newly formed entity.

*Equity Carve-out:* A parent company sells a portion of its subsidiary's shares through an initial public offering (IPO) while retaining control.

*Asset Divestiture:* The parent company sells specific assets or divisions to another entity.

#### Motivations for Demergers:

*Focus on Core Business:* Allows the parent company to concentrate on its core operations, enhancing operational efficiency and strategic focus.

*Unlocking Shareholder Value:* Shareholders may benefit from increased transparency, improved valuation multiples, and enhanced growth prospects in separate entities.

*Regulatory Compliance:* Demergers can be a response to regulatory requirements or antitrust concerns to ensure compliance with competition laws.

*Tax Efficiency:* Demergers may offer tax advantages, such as realizing tax losses, optimizing capital structures, or achieving tax-free status in certain jurisdictions.

#### **Process of Demergers:**

*Strategic Planning:* The parent company assesses its portfolio and identifies non-core assets or divisions for potential separation.

*Structuring:* Deciding on the type of demerger, determining the ownership structure of the new entity, and establishing governance mechanisms.

*Legal and Regulatory Compliance:* Ensuring compliance with applicable laws, regulations, and corporate governance requirements.

*Financial and Tax Considerations:* Evaluating the financial impact of the demerger, including tax implications, allocation of assets and liabilities, and potential restructuring costs.

*Communication:* Effectively communicating the rationale, benefits, and implications of the demerger to stakeholders, including shareholders, employees, customers, and regulators.

*Implementation:* Executing the demerger plan, which may involve legal filings, shareholder approvals, transfer of assets and liabilities, and listing of shares on stock exchanges.

#### **Impact of Demergers:**

*Financial Reporting:* Demergers result in changes to the financial statements of the parent company and the newly formed entity, including adjustments to assets, liabilities, equity, and related disclosures.

*Employee Relations:* Demergers can affect employee morale, job security, and organizational culture. Companies need to manage employee transitions effectively.

*Market Reaction:* The stock prices of the parent company and the new entity may be impacted by market perceptions of the demerger's strategic rationale, expected synergies, and future prospects.

*Operational Integration:* After the demerger, both entities may need to reorganize their operations, systems, and processes to operate independently and achieve their strategic objectives.

#### **Challenges and Risks:**

*Execution Risks:* Demergers involve complex legal, financial, and operational processes, and failure to execute effectively can result in disruptions, delays, or cost overruns.

*Regulatory Hurdles:* Obtaining regulatory approvals and managing compliance with antitrust, tax, and other regulatory requirements can pose challenges.

*Value Leakage:* The value created through the demerger may be eroded by transaction costs, tax liabilities, or adverse market reactions.

*Integration Challenges:* Separating shared services, IT systems, and other interdependencies between the parent company and the demerged entity can be challenging and costly.

#### **Case 1 – Scheme of arrangement between Sony India Private Limited (Sony India) and Sony Software Centre Private Limited (Sony Software) with reference to transfer of software undertaking of Sony India to Sony Software**

The Delhi High Court, while approving scheme of arrangement between Sony India and Sony Software in 2012 has clarified that AS-14 (i.e., accounting standards issued by the Institute of Chartered Accountants of India) is applicable only to amalgamations and not to demerger. As per the scheme of arrangement, 'Software Undertaking' of Sony India is proposed to be transferred to Sony Software under Sections 391 to 394 of the Companies Act, 1956. One of the conditions of the scheme was that any excess in the value of net assets of software undertaking transferred to the resulting company shall be applicable for distribution to the shareholders of the resulting company.

Regional Director of Northern Region, Ministry of Corporate has raised objection in his affidavit filed with the High Court stating that excess, if any, in the value of the net assets of the software undertaking should be adjusted to the capital reserve as prescribed in AS-14 and not to the general reserve as proposed in the scheme of arrangement.

The petitioners contended that AS-14 is applicable only to amalgamations and not to demerger. It was clarified that AS-14 is applicable only to amalgamations and not to demerger. On a plain reading of the accounting standard under reference, it is clear that the same is applicable only in case of an amalgamation and not in case of demergers. This has also been held by the Gujarat High Court in the case of 2010 1CLJ 351 titled *Gallops Realty (P) Ltd. v. State of Gujarat*.

#### **Case 2- Gallops Realty (P) Ltd. v. State of Gujarat**

High Court of Gujarat in the case of *Gallops Realty (P) Ltd., In re v. K.A. PUJ, J.(2010)*, under Section 391, read with sections 394 and 100, of the Companies Act, 1956 Petitioner-companies, i.e., demerged company and resulting company, sought for sanction of composite scheme of arrangement in nature of purchase of shares and demerger of hotel business of demerged company to resulting company and consequent reconstruction of share capital of demerged company under section 391, read with sections 394, 78 and 100 consisting of reduction of paid-up share capital as well as utilization of share premium account. Regional Director stated that as per scheme, capital profit on demerger would be transferred to general reserve in books of resulting company which was not in consonance with generally accepted accounting principles as also Accounting Standard-14 which provide that any profit arising out of a capital transaction ought to be treated as capital profit and, hence, would be transferred to capital reserve and not to general reserve. It was held that the observation of Regional Director was not in consonance with accounting principles in general and Accounting Standard-14 in particular, as Accounting Standard-14 is applicable only in case of amalgamation and not in case of demerger, as envisaged in instant scheme.

#### **Applicability of IND-AS 103 for Demerger Transactions**

As discussed above the concept of demerger is recognised in the Income Tax Act, 1961. However, tax benefits are available only if the conditions of demerger provided in section 2(19AA) are met. One such condition is that assets and liabilities are to be recorded by the transferee company at the book value of the transferor company.

The requirement to record assets and liabilities at fair value in case of non-common control business combination under IND-AS 103 may create problem in achieving a most tax efficient demerger.

#### **INTERNAL RECONSTRUCTION**

When a company incurs loss for number of years, the balance sheet does not reflect the true position of the business, as a higher net worth is depicted, than that of the real one. In such a company the assets are overvalued and it has many intangible assets and fictitious assets. Such a situation does not depict a true picture of financial statements. Such a situation requires reconstruction. Such a reconstruction may be carried out internally.

In an internal reconstruction, the assets are revalued, liabilities are negotiated, and losses suffered are written-off by reducing the paid-up value of shares and/or varying the rights attached to different classes of shares. Existing company is not liquidated.

Internal reconstruction may be done in the following ways:

- (a) Cost reduction through closure of units.
- (b) Redundancy programmes.
- (c) Management or organisational restructuring involving decentralization.

Internal Reconstruction may be done by ways of:

**(a) Cost Reduction through Closure of Units:**

*Assessment of Underperforming Units:* The company evaluates its business units or operations to identify those that are underperforming or no longer aligned with its strategic objectives.

*Closure or Rationalization:* Underperforming units or operations may be closed down entirely or rationalized to reduce costs. This could involve shutting down unprofitable facilities, discontinuing unproductive product lines, or exiting unprofitable markets.

*Impact Analysis:* The company assesses the financial and operational impact of closure or rationalization, considering factors such as employee layoffs, asset write-offs, lease terminations, and potential restructuring costs.

*Communication and Stakeholder Management:* Transparent communication with employees, suppliers, customers, and other stakeholders is essential to manage the impact of closures effectively. The company may provide support to affected employees and establish a transition plan for suppliers and customers.

*Optimization of Resources:* By closing underperforming units, the company can reallocate resources, including capital, personnel, and management attention, to focus on core businesses or areas with higher growth potential.

**(b) Redundancy Programs:**

*Identification of Redundancies:* The company identifies areas of duplication, inefficiency, or overlap in its operations, such as redundant processes, roles, functions, or departments.

*Voluntary or Involuntary Redundancy Programs:* Redundancy programs may involve offering voluntary retirement packages, early retirement incentives, or severance packages to employees. In some cases, involuntary layoffs or job eliminations may be necessary to streamline operations.

*Skills Assessment and Retention:* The company assesses the skills and capabilities of its workforce to retain critical talent and ensure that the right people are in the right roles post-restructuring.

*Legal and Regulatory Compliance:* Redundancy programs must comply with applicable labor laws, regulations, and collective bargaining agreements. The company may need to consult with employee representatives or unions and provide adequate notice and compensation to affected employees.

*Reorganization and Workforce Planning:* Following redundancy programs, the company may reorganize its workforce and realign roles and responsibilities to optimize efficiency and productivity. Workforce planning ensures that the company has the necessary talent and skills to support its strategic objectives.

**(c) Management or Organizational Restructuring involving Decentralization:**

*Evaluation of Organizational Structure:* The company assesses its existing organizational structure to determine whether it is conducive to agility, innovation, and effective decision-making.

*Decentralization:* Management restructuring may involve decentralizing decision-making authority and empowering lower-level managers or teams to make more autonomous decisions. This could lead to faster responses to market changes, improved customer service, and increased accountability.

*Clarification of Roles and Responsibilities:* Clear delineation of roles, responsibilities, and accountability is essential in decentralized structures to avoid confusion and ensure alignment with organizational goals.

*Communication and Training:* Effective communication is critical to ensure that employees understand the rationale behind decentralization and their roles in the new structure. Training programs may be provided to equip managers and employees with the necessary skills to thrive in a decentralized environment.

*Performance Monitoring and Feedback:* The company establishes performance metrics and feedback mechanisms to evaluate the effectiveness of decentralization and make adjustments as needed. Regular monitoring helps identify bottlenecks, address challenges, and capitalize on opportunities for improvement.

### **Process of Internal Reconstruction:**

*Identify the Objective:* Determine the purpose of the internal reconstruction, whether it's to eliminate accumulated losses, to change the capital structure, or for any other reason.

*Assess the Current Capital Structure:* Review the company's balance sheet to understand the existing capital structure, including share capital, reserves, and surplus.

*Propose Changes:* Decide on the changes to be made to the capital structure to achieve the desired objective. This could involve the conversion of reserves into share capital, the cancellation of accumulated losses against reserves, or other adjustments.

*Journal Entries:* Prepare the necessary journal entries to reflect the changes in the capital structure. Ensure that the total capital remains unchanged throughout the process.

*Disclosure:* Provide adequate disclosure in the financial statements regarding the internal reconstruction, including any notes explaining the changes made and their impact on the company's financial position.

### **LESSON ROUND-UP**

- Accounting Standard-14 'Accounting for Amalgamations' lays down the accounting and disclosure requirements in respect of amalgamations of companies and the treatment of any resultant goodwill or reserves. AS14 is not applicable to demergers. AS 14 provides for two types of amalgamations viz. amalgamation in the nature of merger and amalgamation in the nature of purchase.
- There are two main methods of accounting for amalgamations viz. the pooling of interests method; and the purchase method. The pooling of interests method is used in case of amalgamation in the nature of merger. The purchase method is used in accounting for amalgamations in the nature of purchase.
- The consideration for amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.
- If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company.
- If the amalgamation is an 'amalgamation in the nature of purchase', the identity of the reserves, other than the statutory reserves is not preserved, dealt within the certain circumstances specified.
- Good will arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life.
- When an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure should be made as per the provisions of AS-4, contingencies and events occurring after the Balance Sheet Date, but the amalgamation should not be incorporated in the financial statements.
- While filing for approval of any draft Scheme of amalgamation/merger/reconstruction, etc. with the stock exchange under the listing agreement, the company is also required to file an auditors' certificate to the effect that the accounting treatment contained in the scheme is in compliance with all the Accounting Standards.
- A business combination is an act of bringing together of separate entities or business into one reporting unit. The result of business combination is one entity obtains control of one or more businesses. If an

entity obtains control over other entities which are not business, the act is not a business combination. In such a case the reporting entity will account it as asset acquisition.

- For each business combination, one of the combining entities shall be identified as the acquirer. Most of the time, it is straightforward - the acquirer is usually the investor who acquires an investment or a subsidiary. The acquiree is the business that the acquirer obtains control of in business combination.
- The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquire. The acquirer shall measure the identifiable assets acquired and liabilities assumed at their acquisition date fair values.
- On the acquisition date, the acquirer shall recognise separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. The acquirer shall recognize goodwill as of the acquisition date measured based on the principles discussed above.
- Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method. 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.
- The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either: During the current reporting period; or after the end of the reporting period but before the financial statements are approved for issue.
- Section 232 of the Companies Act 2013 provides that accounting treatment prescribed in the court approved scheme for merger, demerger, amalgamation or group restructuring should be in accordance with the notified accounting standards prescribed in the Companies Act, 2013.
- The consideration for which the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement.

## GLOSSARY

**Acquiree:** An acquiree is a target company that is subject to an acquisition attempt by an acquirer.

**Acquirer:** An acquirer is a person or company that purchases all or a portion of an asset or company.  
**Acquisition Date:** The acquisition date is the date on which the acquirer obtains control of the acquire.

**Appointed date:** Appointed date is the date which is chosen by the management for effecting the Scheme and its accounting entries.

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

**Common control business combination:** Common control business combination means a business combination involving entities or business in which all the combining entities or business are ultimately controlled by the same party or parties both before and after the business combination.

**Effective date:** Effective date is the date from which the Scheme becomes effective in terms of law and the date on which all the necessary approvals have been obtained.

**Goodwill:** Goodwill is an intangible asset which represents non-physical items that add to a company's value but cannot be easily identified or valued.

**Measurement period:** The measurement period is the period after the acquisition date during which the



