Ind AS 103

Business Combinations

Ind AS 103's scope

- Ind AS 103 applies to a **transaction** or other event that meets the definition of a **business combination.**

Scoped - Out
Formation of joint ventures
Asset acquisition (that do not constitute a business)

Identifying a business combination

Business combination

- Transaction or event in which acquirer obtains CONTROL over one or more BUSINESSES

Control

- Power over the investee
- Exposure, or rights to variable returns
- Ability to use its power over the investee to affect the amount of investor returns

Business

- Integrated set of activities and assets
- Capable of being conducted and managed to provide return
- Returns include dividends and cost savings.

Business

- Business generally consists of

Inputs
(economic resource that creates,
or has the ability to create, outputs)

Process
(Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs.)

Output
(The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners)

Business

- BUT only **inputs and processes are mandatorily required**:
  - Inputs(e.g. employees, non current assets...)
  - Processes (e.g. Strategic/operation management ..)

- Outputs are not mandatorily required for a set of activities and assets to qualify as a business.
  - Development stage activities without outputs may still be businesses

GOODWILL
Presumption is that if goodwill exists, the acquisition is a business.

BUT
A business need not necessarily have goodwill

Definition of a business: meaning of 'capable of'

- A business need not include all the inputs or processes that the seller used in operating that business.
  - If a market participant is capable of utilising the acquired set of activities and assets to produce outputs by integrating the acquired set with its own inputs and processes, the acquired set might constitute a business.
  - If the elements that are missing from an acquired set are not present with a market participant but easily replaced/replicated, the acquired set might still be a business.
  - **However,** in most cases, the acquired set of activities and assets must have **at least some inputs and processes in order to be considered a business.**

Definition of a business: development stage of a set of activities and assets

Is the transferred set of activities and assets a business?

- Factors include but are not limited to whether the set:
  - Has begun its planned principal activities
  - Has employees, intellectual property and other inputs and processes that could be applied to those inputs
  - Is pursuing a plan to produce outputs
  - Will be able to obtain access to customers that will purchase the outputs

- Determination should be based on whether the integrated set is capable of being conducted and managed as a business by a market participant.

Activity 1- Development stage enterprise

Scenario 1

- Biotech A acquires outstanding shares in Biotech B, a start-up with a license for a product candidate.
- Due to loss of funding, Biotech B has no employees, no other assets.
- Neither clinical trials nor development are currently performed. However Biotech A will commence Phase 1 clinical tests .

- **Should the acquisitions be accounted as a business combination or an asset acquisition?**

Response

Not a business,
since there is no process.

- Inputs – license
- Processes – none
- Outputs – none

Activity 1- Development stage enterprise

Scenario 2

- Biotech A acquires outstanding shares in Biotech B, a start-up with a license for a product candidate.
- Phase 1 clinical tests are currently performed by the 3 Biotech B's employees (one of whom founded Biotech B and discover the product candidate)
- **Should the acquisitions be accounted as a business combination or an asset acquisition?**

Response

It is a Business.

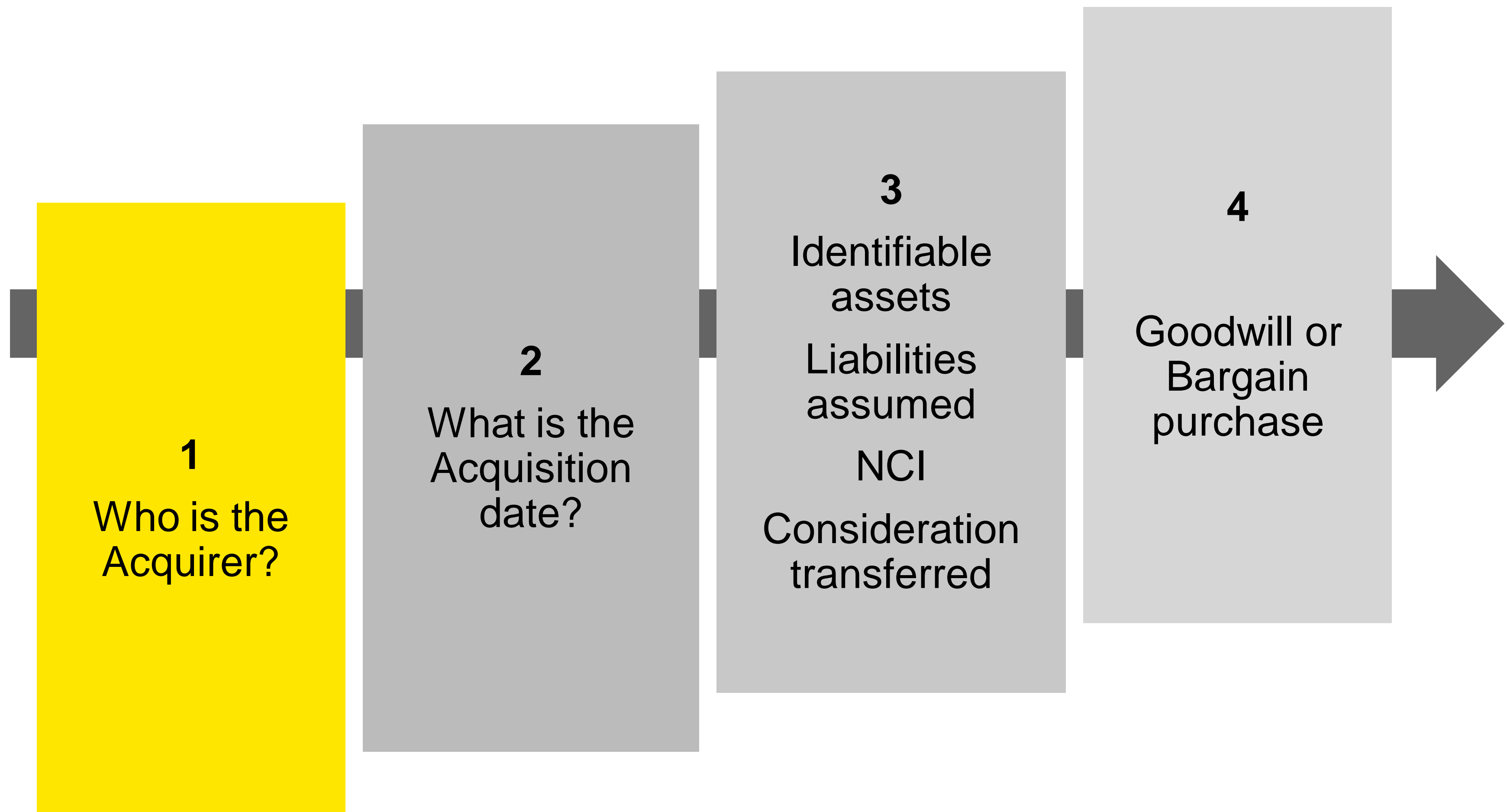
- Inputs – license & employees
- Processes – operational & management processes associated with the performance
  and supervision of the
  technical tests.
- Outputs – none

Example : Differences for accounting for a BC vs. Asset Acquisition

- Entity P acquires 100% of entity V's shares for 1000, incurring transaction costs of 200.
- V has no liabilities. The only assets are 2 buildings (A,B) their book value is 700. The fair value of A and B is 300 and 600 respectively.
- Tax base of buildings is 700 and income tax rate is 20%.

	BC	Asset acquisition
Price paid	1,000	1,000
Transaction costs	P&L- expensed	200 - capitalized
Total consideration	**1,000**	**1,200**
Fair values (BC) /	Relatives FV of	Assets acquired
Asset A	300	400=(1200*300/900)
Asset B	600	800=(1200*600/900)
total	**900**	**1,200**
DTL	40=(900-700)*20%	N/A
Goodwill	140=(1000-900+40)	N/A

Application of the acquisition method – 4 step process



Who is the Acquirer?

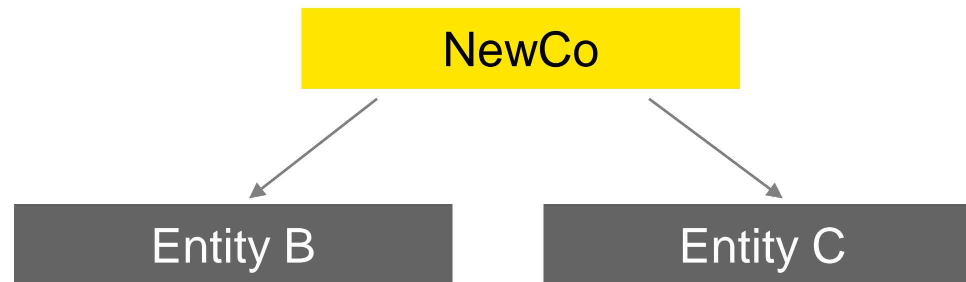
- For each business combination, one of the combining entities shall be identified as the acquirer.
- The entity that obtains control of the acquiree is identified as acquirer in all business combinations.
- Refer IFRS 10 guidance on control for identification of the acquirer.

If applying the guidance in IFRS 10 does not clearly indicate the acquirer, the following factors are considered in making that determination :

- Acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities
- Acquirer is usually the entity that issues its equity interests
- Acquirer normally has the largest portion of the voting rights in the combined entity
- Acquirer will have ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity

Specific case of formation of new entity

- Where a new entity (NewCo) is formed to effect business combination between two or more entities, say B and C, Ind AS 103 identifies two distinct scenarios



- **NewCo issues its equity instruments** in exchange for equity instruments in B and C - **Either B or C should be identified as the acquirer**

- **NewCo transfers cash (or other assets)** in exchange for equity instruments in B and C (e.g. from the proceeds of a debt/ equity issue to new investors) **NewCo may be identified as the acquirer**.

Example 3 – Formation of a new entity

Fact Pattern

- X and Y are two existing entities carrying on business independently.
- The two entities decide to combine their businesses through a new entity Z.
- New entity Z issues equity shares in itself in the proportion two-third to the equity shareholders of X and one-third to the equity shareholders of Y.

Should Z be regarded as an acquirer?

Date of acquisition

- Generally the date on which the acquirer: legally transfers the consideration, acquires the assets; and assumes the liabilities of the acquiree
  - will normally be the closing date.
- However, the acquirer might obtain control on a date that is either earlier or later than the closing date.
  - 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.
- Date on which control is acquired by the acquirer
  - Is the agreement subject to substantive pre-condition, the acquisition date will be the date the last of those pre-condition is satisfied
  - Date when acquirer commences direction of operation and financial policies
  - Date when majority of board members are appointed
  - Date from which the flow of economic benefit changes
  - Date of clearance by competition authority (if any)

Example 4

- Company A has signed a purchase agreement (PA)with Company B on July 1, 20X0.
- PA was filed with the high court for approval on Jan 1, 20X1
- PA provides that subject to the High Court approval of the agreement, any profits or losses arising out of operations of B from July 1, 20X0 will belong to A.
- PA provides that the management of B will run B from the July 1 20X0 as trustee's of A.
- PA also provides that the purchase consideration payable by A to B will be based on B net assets value as at July 1 20X0 and as determined by the independent valuer.
- The High Court approves the transaction on 25 March 20X1 and is filed with the ROC immediately. A is preparing CFS for the year ended 31 March 20X1.

Should CFS include Company B from 1 July 20X0,1 January 20X1 or from 25 March 20X1?

Consideration transferred

- The consideration transferred in a business combination shall be measured at acquisition date fair value, which shall be calculated as the sum of the following:
  - 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.

- Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, contingent consideration, deferred consideration ordinary or preference equity instruments, options, warrants and member interests of mutual entities.

Contingent consideration to be paid by the acquirer

- Additional/ new information becomes available during the measurement period on facts and circumstances that existed at the acquisition date.
- Measurement period is not to exceed one year from acquisition date

Initial treatment	Ind AS 103
Recognition	Always recognise
Measurement	Fair value at acquisition date
Classification	As Financial Instrument in most cases - liability /equity as per IAS 32
Subsequent treatment	**Ind AS 103**
Equity	Not re-measured
Liability	Re-measured at fair value through P&L in accordance with IFRS 9

Example 6 – Contingent consideration

- On January 1, 2007, entity A acquires 100% interest in entity B.
- The consideration for acquisition is payable in the following 2 tranches:
  - an immediate issuance of 1 million shares of entity A having face value of CU10 per share;
  - a further issuance of 0.2 million shares after one year if the profit before interest and tax for the first year following acquisition exceeds CU500,000
- At the date of acquisition, the fair value of shares of entity A is CU20 per share.
- The management has estimated that at the date of acquisition, the fair value of contingent consideration is CU2.5 million.
- At the end of year 1, it is noted that entity A has actually met the condition for issuance of further shares.
- At that date, the fair value of shares of entity A is CU25 per share.

How should be treated the contingent consideration at initial recognition and subsequently?

Response

- At the date of acquisition, consideration payable for acquisition is calculated as below:

Fair value of shares issued (1,000,000 x CU20)	CU20,000,000
Fair value of contingent consideration	CU 2,500,000
Total	CU22,500,000

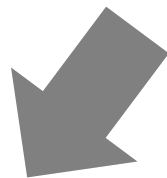
- Regarding contingent consideration:
  - Number of shares to be issued is stated to be fixed
  - No obligation to pay cash
  - Thus, it meets definition of equity as per Ind-AS 32.
- Accordingly, CU2,500,000 would be classified as part of equity.
- Not to be remeasured subsequently or on issuance of shares.
- Amount recognized initially would be split into share capital and share premium upon issuance of shares.

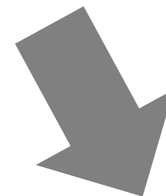
Recognition and measurement principle

- At the acquisition date, the acquirer shall recognize, separately from goodwill:
  - the identifiable assets acquired,
  - the liabilities assumed; and
  - any non-controlling interest in the acquiree
- Measurement at the fair value at acquisition date
- For recognition of identifiable assets acquired/ liabilities assumed as part of the acquisition method, these assets/ liabilities
  - must meet the definitions of assets and liabilities in the Framework at the acquisition date
  - must be part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination transaction

Non-controlling interest

- NCI is equity in a subsidiary not attributable, directly or indirectly to a parent
- Measurement option for NCI at acquisition date:





At Fair Value

At Proportionate share of acquiree's identifiable net assets

Choice is made for **each business combination** (not a policy choice)

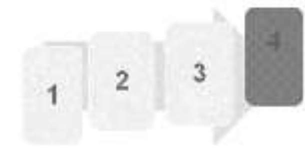
Measurement Period - Provisional allocations

- If the Initial accounting is incomplete by end of the reporting period in which combination occurs, the acquirer shall report provisional amounts
- Measurement period
  - Is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognized for a business combination
  - Ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable.
  - **Shall not exceed one year** from the acquisition date.

- Results in retrospective restatement to **reflect additional information within the measurement period** of goodwill and comparatives

- **After the measurement period ends,** the accounting for a business combination can be amended only as **to correct an error in accordance with IAS 8**

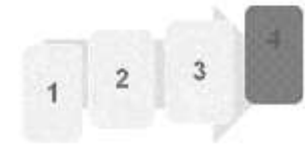
Measurement of goodwill



Goodwill = Consideration + Non Controlling Interests (NCI) + Previously held equity interest − Net assets acquired

Acquisition related costs charged to P&L Except, Debt securities issue cost–incorporated in effective interest rate (IAS 109) and Equity issues cost recognized in equity (IAS 32).

Bargain purchase



- A bargain purchase is one where the goodwill is negative

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

- In such cases, **the acquirer should reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed**

- **If reassessment confirms bargain purchase, any gain is recognized in income statement on the acquisition date.**

Disclosures

- General Information on the business combination
- Consideration Transferred
- Assets acquired and liabilities assumed
- Goodwill or a gain on bargain purchase
- Transactions that are not part of the business combination;
- In which the acquirer holds less than 100 percent of the acquiree;
- Business combinations achieved in stages, i.e., step acquisitions;
- Pro forma information about revenue and profit or loss; and
- Measurement period adjustments and contingent consideration adjustments.

Thank you