Educational Material on
Indian Accounting Standard (Ind AS) 103,
Business Combinations

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Foreword

The Institute of Chartered Accountants of India (ICAI) is making every possible effort to bring the financial reporting in India in parity to the practices followed internationally. In this direction, the ICAI played a key role in formulating Indian Accounting Standards (Ind AS) substantially converged with IFRS standards. Transition to Ind AS, a comprehensive set of principle based standards, involves huge efforts. ICAI has played an effective role in smooth transition of these Standards by issuing guidance and conducting trainings for implementation of these Standards. The Ind AS Implementation Group of ICAI is playing an active role in educating the members and providing guidance on practical issues that are being faced by the members and other stakeholders.

Moving forward in this direction, the Ind AS Implementation Group has come out with Educational Material on Ind AS 103, *Business Combinations* which by way of Frequently Asked Questions (FAQs) explains the principles enunciated in the Standard. This publication will provide significant guidance to the stakeholders in how to account for the Business Combinations and its disclosures.

I convey my heartfelt thanks to CA. Nihar Niranjan Jambusaria, Convenor of the Group, CA. Dhinal Ashvinbhai Shah, Deputy Convenor of the Group and other members of the Ind AS Implementation Group for their valuable technical contribution and cooperation. I also congratulate CA. S.B. Zaware, Chairman and CA. M. P. Vijaykumar, Vice-chairman, Accounting Standards Board of ICAI for their support. I am of the firm belief that this Educational Material will be a useful publication for all who are getting ready for transition from existing Accounting Standards to Ind AS and also for those who will audit the financial statements in accordance with Ind AS.

I am confident that all these efforts of Ind AS Implementation Group will play a very significant and enabling role in smooth implementation of Ind AS in India.

New Delhi **CA. Naveen N D Gupta**

April 03, 2018 ***President, ICAI***

Preface

The implementation of Ind AS has already begun in the country with Phase I and Phase II companies which have already implemented Ind AS. The Institute of Chartered Accountants of India (ICAI) through its Ind AS Implementation Group constituted under Accounting Standards Board is making every possible effort to ensure that Ind AS are implemented in the same spirit in which these have been formulated. For this purpose, the Ind AS Implementation Group is working to provide guidance to the members and other stakeholders by issuing Educational Materials on Ind AS, issuing timely clarifications on issues being faced by the members through Ind AS Transition Facilitation Group (ITFG) Clarification bulletins, addressing queries through Support-desk for implementation of Ind AS, conducting Certificate Course on Ind AS, developing e-learning modules on Ind AS, workshops, seminars, awareness programmes on Ind AS and series of webcasts on Ind AS etc.

We are glad that the Group has brought out the Educational Material on Indian Accounting Standard (Ind AS) 103, *Business Combinations*. This Standard lays down the principles for accounting of business combinations by acquisitions/ mergers. This Standard also deals with accounting for combination of entities or businesses under common control. This Educational Material contains summary of Ind AS 103 discussing the key requirements of the Standard and the Frequently Asked Questions (FAQs) covering the issues, which are expected to be encountered frequently while implementing this Standard.

We may mention that the views expressed in this publication are the views of the Ind AS Implementation Group and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of examples. However, while applying Ind AS in a practical situation, reference should be made to the full text of the Standards.

We would like to convey sincere gratitude to our Hon'ble President CA. Naveen N D Gupta and Vice-President CA. Prafulla Premsukh Chhajed for providing us this opportunity of bringing out implementation guidance on Ind AS in the form of Educational Materials. We are thankful to CA. Sanjay Vasudeva for his support and guidance. We sincerely appreciate the efforts

put in by CA. Archana Bhutani, Co-convenor and members of the Group CA. Sandip Khetan, CA. Vilas Paranjape, CA. Ramesh Iyer and CA. Rohit Bansal for preparing the draft of this Educational Material. We would also like to thank all the members of the Ind AS Implementation Group for their invaluable suggestions and contributions for finalising this publication.

We sincerely appreciate CA. Geetanshu Bansal, Secretary, Ind AS Implementation Group and CA. Prachi Jain, Executive Officer for their technical and administrative support in bringing out this publication. We would also like to thank CA. Vidhyadhar Kulkarni, Head, Technical Directorate, for his guidance.

We sincerely believe that this Educational Material will be of great help in understanding the provisions of Ind AS 103 and in the practical implementation of the same.

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Convenor
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Educational Material on Indian Accounting Standard (Ind AS) 103 *Business Combinations*

I Ind AS 103 - Summary

Objective of Ind AS 103

Ind AS 103 provides principles and requirements for how the acquirer:

- recognises and measures identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
- recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and
- disclosure requirements

Scope

Ind AS 103 does not apply to the following:

- the formation of a joint arrangement.
- the acquisition of an asset or group of assets that is not a business as defined acquisition by an investment entity.

(Though IFRS 3, *Business Combinations* scopes out the accounting for combination of entities or business under common control but Ind AS 103 has included this in Appendix C).

Identifying a business combination

An entity shall determine whether a transaction or other event is a business combination in accordance with this Ind AS, which requires that the assets acquired and liabilities assumed constitute a business.

If the assets acquired are not a business, then the same shall be accounted for as an asset acquisition.

Business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

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

An acquirer might obtain control of an acquiree in a variety of ways, for example by transferring cash, cash equivalents or other assets, by incurring liabilities, by issuing equity interests, by providing more than one type of consideration; or without transferring consideration, including by contract alone.

A business combination may be structured in a variety of ways for legal, taxation or other reasons.

A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

The three elements of a business are defined as follows:

Input: Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.

Process: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes and resource management processes.

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

A business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.

Acquisition Method

Business combinations are accounted for using the acquisition method which requires:

(a) identifying the acquirer (the acquirer is the entity that obtains control of another entity);

(b) determining the acquisition date (the date on which the acquirer obtains control);

(c) recognise and measure the identifiable assets acquired and the liabilities assumed and any non-controlling interest; and

(d) recognise and measure any goodwill or bargain purchase.

For each business combination, one of the combining entities shall be identified as the acquirer. The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

Recognition and Measurement Principle

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.

To qualify for recognition, the identifiable assets acquired and liabilities assumed by the acquirer must meet the definitions of assets and liabilities in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standard at the acquisition date.

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

Recognising particular assets acquired and liabilities assumed

Operating leases- The acquirer shall recognise no assets or liabilities related to an operating lease in which the acquiree is the lessee.

The acquirer shall recognise an intangible asset if the terms of an operating lease are favourable relative to market terms and a liability if the terms are unfavourable relative to market terms.

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

Reacquired rights- An acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer's recognised or

unrecognised assets. A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill.

Assembled workforce and other items that are not identifiable

The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date.

Exceptions to the Recognition Principles

(a) Contingent Liabilities

- the acquirer shall recognise if it is a present obligation that arises from past events and its fair value can be measured reliably.

(b) Exceptions to the Recognition and Measurement Principles

- Income taxes
  - deferred tax assets or liabilities arising from acquired assets or liabilities accounted in accordance with Ind AS 12.
- Employee benefits
  - accounted in accordance with Ind AS 19.
- Indemnification assets
  - shall be measured and recognised on the basis of the indemnified item.

(c) Exceptions to the Measurement Principles

- Reacquired rights
  - measured at fair value based on remaining contractual term ignoring the fair value effect of renewal.
- Share-based payment transactions
  - measured in accordance with Ind AS 102 (Market Based Measure).
- Assets held for sale

- measured in accordance with Ind AS 105 (i.e., fair value less costs to sell).

Recognition and measurement of Goodwill or Bargain Purchase

Goodwill is measured as the difference between the consideration transferred in exchange for the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

Bargain purchase

In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination, where the value of acquired identifiable assets and liabilities exceeds the consideration transferred; the acquirer shall recognise a gain (bargain purchase). The gain shall be recognised by the acquirer in Other Comprehensive Income on the acquisition date and accumulate the same in equity as capital reserve, if there exists a clear evidence of the underlying reasons for classifying the business combination as a bargain purchase.

If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, then the gain shall be recognised directly in equity as capital reserve.

Reverse Acquisitions

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting. 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.

In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer.

Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition.

Consideration transferred

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.

Contingent consideration

The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

Applying the acquisition method to particular types of business combinations

(I) 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 in profit or loss or other comprehensive income, as appropriate.

(II) A business combination achieved without the transfer of consideration

The acquirer shall attribute to the owners of the acquiree the amount of the acquiree's net assets recognised in accordance with this Ind AS. In other words, the equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity interests in the acquiree are attributed to the non-controlling interest.

Measurement Period

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized and additional assets and liabilities that existed at the acquisition date to reflect new information obtained.

The measurement period ends as soon as the acquirer receives the information it was seeking or learns that more information is not obtainable.

The measurement period shall not exceed one year from the acquisition date.

Subsequent measurement and accounting

In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination in accordance with other applicable Ind AS for those items, depending on their nature. However, Ind AS 103 provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination:

(a) reacquired rights;

(b) contingent liabilities recognised as of the acquisition date;

(c) indemnification assets; and

(d) contingent consideration.

Disclosures

The acquirer shall disclose information 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.

The acquirer shall disclose information for each business combination that occurs during the reporting period such as:

- the name and a description of the acquiree.
- the acquisition date.
- the percentage of voting equity interests acquired.
- the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
- a qualitative description of the factors that make up the goodwill recognised.
- the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration.