Accounting for Business Combinations: Contrasting IFRS 3 Converged IND AS 103 with AS 14

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ABSTRACT

Business combinations have become the most preferred route for business houses to achieve growth at a faster pace, given today’s intensely competitive global business environment. In regard to accounting for business combinations, the paper aims to compare and contrast the provisions of old Accounting Standard (AS) 14 on ‘Accounting for Amalgamations’ issued by the Institute of Chartered Accountants of India (ICAI) in 1995 with that of new International Financial Reporting Standard (IFRS) 3 converged Indian Accounting Standard (Ind AS) 103 on ‘Business Combinations’ issued by ICAI and notified as ‘standards’ by the Ministry of Corporate Affairs (MCA) in 2011. The paper showcases extensive coverage in Ind AS 103 vis-à-vis AS 14 not only in respect of accounting method, valuation of assets and liabilities, nature of consideration, measurement of non-controlling interest, treatment of goodwill / capital reserve or bargain purchase to mention a few, but also in its reference to various types of business combinations, including that of reverse acquisitions and business combinations under common control.

Keywords: Inorganic growth, merger, absorption, acquisition, consolidation, common control business combinations, fair value, non-controlling interest, bargain purchase.

1.0 Introduction

‘Growth’ is the sine qua non for sustaining the viability, dynamism and value-enhancing capability of a business enterprise in today’s intensely competitive global business village. Unquestionably, growth increases company’s profit and enhances its shareholders’ value, unfolds job enrichment and rapid career development opportunities for the most talented executives, and helps in image-building and amassing vast economic powers for the business entity.

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There are essentially two ways by which a company can pursue growth. One is through the *organic route* in which the company can undertake new projects in existing or related or totally unrelated lines of business and build up capacities by itself. But as organic growth involves a long gestation period, the growth rate is quite slow in such a strategy. The other strategy to achieve growth, but at a faster pace, is through the *inorganic route* in which the company undergoes corporate restructuring i.e. *business combinations* either by acquiring production facilities or other physical or human or managerial resources of other firms, or by combining its operations with other firms, or taking over other firms. Apart from being a less time-consuming process, this inorganic growth strategy carries the benefits of synergy, economies of scale, economies of scope, increased market share, risk diversification, foreclosing competition etc. and leads to creativity and innovativeness, and a widened horizon of opportunities in the business world.

The several decisional issues concerning business combinations are the basis for determination of exchange ratio, means of financing the purchase deal, legal aspects, tax implications, accounting and reporting issues, and the combined entity’s performance post combination. Given the complexity in the various forms of business combinations and its implications for the firm’s stakeholders and the society at large, proper accounting for business combinations holds the key to success in such deals (Lewis and Pendrill 2000).

In India, the apex body responsible for ensuring uniformity and consistency in the computation, compilation and presentation of economic data in the financial statements of different corporate enterprises so as to facilitate proper decision-making by the users of such statements is the Institute of Chartered Accountants of India (ICAI), and it does so by issuing Guidance Notes, Statements on Accounting Matters, and Accounting Standards (ASs) from time to time. In consonance, the ICAI has, for the first time, issued *Accounting Standard (AS) 14 on ‘Accounting for Amalgamations’* in respect of business combinations and made it mandatory to account for all amalgamations taking place in India on or after 1st April, 1995 in the manner specified in the standard. However, with increasing globalization and liberalization of world economies and the resultant removal of trade barriers and free flow of capital, labour and other resources, and goods or services across countries over the past one and half decades, a company’s stakeholder group has no longer remained confined within a particular geographical territory (Benston et al. 2006). In order to cater for such diverse stakeholder’ needs, the global accounting regulatory body – the International Accounting Standards Board (IASB) has issued a single comprehensive set of high quality generally accepted International Financial Reporting Standards (IFRSs) for either adoption or convergence,
with necessary modifications, into their national systems by the member countries. India has followed the convergence route with the ICAI issuing 35 IFRS – compatible Indian Accounting Standards, referred to as ‘Ind AS’, on 14th January 2011 and the Ministry of Corporate Affairs (MCA) subsequently notifying them as ‘standards’ after making certain amendments on 25th February 2011. In spite of agreeing on a phase-wise implementation of Ind AS so as to ensure a smooth transition for all companies and their stakeholders, the MCA has deferred the implementation schedule as originally planned and remains non-committal on any new deadline. Under the new standard regime, the relevant international standard is IFRS 3, and the IFRS converged Indian standard is Ind AS 103 in respect of business combinations.

A thorough examination of both the old standard AS 14 and the new one Ind AS 103 suggests that the new accounting standard on business combinations is extensive, and there are certain vital areas of differences between the two. Also, Ind AS 103 is not wholly the same as IFRS 3 issued by IASB, and there are such changes in Ind AS 103 which are not even covered by IFRS 3. Accordingly, the aim and scope of this paper is to highlight the key differences between Ind AS 103 and AS 14, and the areas where Ind AS 103 is an improvement over IFRS 3 and hence to identify the accounting challenges resulting there from.

The remainder of the paper is organised as follows. Section 2 primarily addresses the various differences between Ind AS 103 and the old AS 14, and also the changes in Ind AS 103 in respect to IFRS 3 through several sub-sections. Section 3 concludes the article with the challenges posed by the new accounting standard – Ind AS 103 on business combinations to the accountants.

2.0 Ind AS 103, AS 14 and IFRS 3 – A Comparison

Apart from having the difference in their title i.e. AS 14 titled as ‘Accounting for Amalgamations’ whereas Ind AS 103 on ‘Business Combinations’, a comparison of IFRS 3 converged Ind AS 103 with AS 14 reveals the following variations in accounting for business combinations between them.

- Types of Business Combinations
- Method of Accounting
- Valuation of Assets and Liabilities
- Measurement of Non-Controlling Interest
- Nature of Consideration
Accounting for Business Combinations

- Treatment of Difference between Consideration and Value of Net Identifiable Assets Acquired in a Business Combination
- Treatment of Acquisition Related Costs
- Accounting for Business Combinations under Common Control
- Accounting for Reverse Acquisitions

Each one of the above areas is taken up individually in the following sub-sections to showcase the contrasting features between Ind AS 103 and AS 14.

2.1 Types of Business Combinations

As is evident from the title itself, Ind AS 103 is much wider in scope as it explicitly covers all known types of business combinations such as merger, absorption, acquisition, takeover, step acquisition, consolidation, and also combination of entities under common control and reverse acquisition, whereas AS 14 demarcates only between amalgamation in the nature of merger and amalgamation in the nature of purchase.

A merger is a type of business combination where all the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity thereby necessitating liquidation of all the combining entities. This kind of combination is sometimes referred to as a roll-up or put-together transaction. In contrast, one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners in absorption without requiring the formation of any new entity but necessitating liquidation of the transferor entity. When one entity (referred to as the ‘acquirer’ or ‘acquiring / transferee’ company) obtains effective control of another entity (referred to as the ‘acquiree’ or ‘acquired / transferor’ company) either by purchasing the whole or part of the assets, which may also include purchasing only the brand of the acquiree, or by acquiring the whole or a strategic stake in the acquiree to control its management, it is known as acquisition, or also as takeover in the latter case. Acquisition, as such, does not involve any ‘combination’ of acquirer and acquiree in literal sense of the term, and unlike the above two forms of combination, the acquiree or the transferor company is not dissolved and its independent and separate legal entity continues to exist, although there is a change in the control of such company. Also, an acquirer entity, holding a non-controlling equity interest in acquiree entity, can acquire additional equity interest in such acquiree so as to obtain the control of the acquiree. This kind of transaction is referred to as a business combination achieved in stages, or step acquisition.
Ind AS 103 covers *consolidation* as well in which one or more business entities become subsidiaries of an acquirer i.e. parent entity through a transfer/sale of the majority ownership / voting rights, or the net assets of one or more business entities are legally merged into the acquirer. All the above-mentioned forms of business combinations are also covered in IFRS 3. ‘Business Combinations under common control’ and ‘reverse acquisition’ covered by Ind AS 103 are dealt separately in subsequent sections.

In contrast, the old AS 14 differentiates amalgamation in the nature of merger from amalgamation in the nature of purchase. As per AS 14, an amalgamation is said to be in the nature of *merger* when –

(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 face value of equity shares of transferor company (excluding those already held by transferee company, or its subsidiaries or nominees immediately before amalgamation) become equity shareholders of transferee company by virtue of amalgamation;

(iii) consideration for amalgamation is discharged by the transferee company wholly by issue of its equity shares (excepting that cash is paid in respect of any fractional shares) to those equity holders of transferor company who agree to become equity shareholders of transferee company after amalgamation;

(iv) business of transferor company is intended to be carried on, after amalgamation, by the transferee company, and

(v) no adjustment is intended to be made to the book values of assets and liabilities of transferor company when they are incorporated in the financial statements of transferee company except to ensure uniformity of accounting policies.

An amalgamation which does not fulfil any one or more of the above five conditions is amalgamation in the nature of *purchase*.

2.2 Method of Accounting

AS 14 recommends *pooling of interests method* of accounting for amalgamation in the nature of merger, and *purchase / acquisition method* for amalgamation in the nature of purchase. The ‘pooling of interests’ method is so named because it involves a genuine pooling not merely of the assets and liabilities of the transferor company, but also of the shareholders’ interest and business of such company into the transferee company (White et al. 2004). In contrast, only those identifiable assets and liabilities of the acquiree / transferor company that are acquired and assumed by the acquirer /
transferee company are carried to the acquirer’s financial statement in ‘purchase / acquisition’ method.

However in line with IFRS 3, Ind AS 103 dispenses with the ‘pooling of interests’ method and prescribes using only the acquisition method of accounting for each type of business combinations (Ministry of Corporate Affairs 2011).

2.3 Valuation of Assets and Liabilities

Under ‘acquisition method’ of accounting, Ind AS 103, like IFRS 3, requires all the identifiable assets and liabilities of the acquiree that are taken over by the acquirer to be measured at their fair values as on the date of acquisition (Ministry of Corporate Affairs 2011). Since such fair value measurement takes into account the uncertainty in future cash flows on assets acquired like contractual cash flows on receivables / loans that may be uncollectible in future or contingent cash flows that may arise in future, there is no need for the acquirer to recognize a separate valuation allowance for such uncertainties in cash flows on the assets acquired in a business combination as on the acquisition date.

As per Ind AS 103, the acquirer must also recognize, separately from goodwill, the acquired identifiable intangible assets like brand name, trademark, patent, literary and other artistic works, royalty agreement, customer list etc. generated internally but not recognized by the acquiree in its financial statements except for expensing the costs incurred for its development. Such intangible assets acquired in a business combination are considered ‘identifiable’ if they meet separability criterion or contractual-legal criterion (Ministry of Corporate Affairs 2011). An acquired intangible asset is said to meet ‘separability criterion’ if such asset is capable of being separated from the acquiree and sold, transferred, licensed, rented or exchanged either individually, or together with a related contract, identifiable asset or liability, regardless of whether the acquirer actually intends to sell, license or otherwise exchange it. As for example, customer and subscriber lists, documented but unpatented technical expertise associated with a registered trademark to manufacture a product etc. Even if the acquired intangible asset is not transferable or separable from the acquiree or from other rights and obligations, it can be regarded as ‘identifiable’ and recognized separately from goodwill based on ‘contractual – legal criterion’. As for example, operating lease on the acquiree’s manufacturing facility, or the license to operate a nuclear power plant cannot be transferred or sold separately from the acquired facility or power plant respectively, but can be fair valued and recorded distinctly as intangible asset from the asset acquired by the acquirer based on contractual – legal criterion. However, the acquirer is not required to recognize the assembled work force of the acquiree as it is not an identifiable asset to
be recognized separately from goodwill, and also any under – negotiation contract of the acquiree which may materialize in the post combination period. Both their values are assumed to remain subsumed in goodwill arising on such combination. Again, the acquirer and the acquiree may have contractual pre-existing business relationship such as that of franchisee arrangement, agency contract, operating or finance lease agreement, supply / service contract etc. before the business combination takes place or they may enter into such relationship during the negotiation for such business combination. Ind AS 103 requires that such assets and liabilities of the acquiree which, in effect, settle any past dues between the acquirer and acquiree, or remunerate employees or former owners of the acquiree for future services, or reimburse the acquiree or its former owners for paying the acquirer’s acquisition related costs are regarded as separate transactions and hence are not to be included in the list of assets acquired and liabilities assumed in business combination.

As regards contingent liabilities of the acquiree, the acquirer is to recognize the same in a business combination under Ind AS 103 if it is a present obligation arising out of past events and its fair value can be readily measured as on the date of acquisition. This implies that the costs which 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 contingent liabilities at the acquisition date. Hence, the acquirer is not required to recognize such costs while applying the acquisition method. Instead, the acquirer can recognize those costs as and when they occur in its post-combination financial statements in accordance with other Indian Accounting Standards.

As against the above, the old AS 14 provides no scope to recognize fair values of assets and liabilities taken over whether under purchase method of accounting applicable for amalgamation in the nature of purchase, or under pooling of interests method applicable to amalgamation in the nature of merger. In purchase method under AS 14, only those assets and liabilities of the acquiree / transferor company as taken over are recorded at their existing carrying amounts, or alternatively the purchase consideration is allocated to the individual identifiable assets and liabilities taken over on the basis of their fair values at the date of amalgamation, and aggregated with their corresponding balances in the books of the acquirer / transferee company thereby indicating partial aggregation only (Chakraborty 2011). Reserves (including the balance of profit and loss account, but excepting statutory reserves which are required to be maintained under any relevant statute) of the transferor / acquiree are not to be incorporated in the financial statements of the acquirer / transferee under purchase method (Chakrabarti 1998). In contrast, the identity of all assets, liabilities, as well as
reserves (whether capital or revenue or arising on revaluation) of the transferor company or acquiree is preserved after amalgamation and hence are recorded by the transferee or the acquirer in the same form and at their existing carrying amounts as they appear in the books of the transferor / acquiree as on the date of amalgamation under pooling of interests method. Though, suitable adjustments may be made to such carrying amounts of assets and liabilities in order to bring uniformity in conflicting accounting policies adopted by transferor and transferee companies following amalgamation. So it can be said that the assets, liabilities and reserves of the transferee / acquirer company are mere aggregates of the corresponding balances in the books of the transferor and transferee companies before amalgamation under pooling of interests method thereby exhibiting total aggregation of financial figures unlike purchase method (Chakraborty 2011).

Further, AS 14 does not explicitly recognize internally generated intangibles and contingent liabilities of acquiree / transferor unlike Ind AS 103. AS 14, however, does specifically provide for treatment of pre-existing debts between transferor and transferee companies by requiring the transferee company to set off such mutual debts with the transferor company, cancel the amount of unrealized profit included in stock in case of inter-company purchase and sale of goods prior to amalgamation, and adjust the purchase consideration for pre-amalgamation inter-company stock holdings after amalgamating by way of merger or purchase.

2.4 Measurement of Non-Controlling Interest

Non-controlling interest refers to the present ownership interests in a company that entitle its holders to a proportionate share of the company’s net assets in the event of liquidation, but who are interested in company’s results only and whose collective voting rights do not hold much sway on company’s resolutions or in controlling the management of the company (Ministry of Corporate Affairs, 2011). Thus, non-controlling interest is akin to ‘minority stake’ in the company.

As per Ind AS 103, such non-controlling interest in the acquiree company is to be measured by the acquirer company either at the acquisition date fair value or at the non-controlling interest’s proportionate share in the recognized amounts of the acquiree’s identifiable net assets, and shown under ‘Shareholders’ Equity’ in the financial statements of the acquirer (Ministry of Corporate Affairs, 2011). However, AS 14 does not recognize non-controlling interest as such. The old AS 21 recognizes ‘minority interest’ in the event of ‘consolidation’ only at the amount of equity of subsidiary attributable to minorities at the date on which investment in the subsidiary is made by the holding company, and requires its disclosure outside ‘shareholders’ equity’ in the balance sheet of holding company.
2.5 Nature of Consideration

The consideration for obtaining control of the acquiree can be met by the acquirer in any of the following ways.

- Transferring cash, cash equivalents, or other assets which may include net assets or non-monetary assets that constitute a part of the business of the acquirer, or even the entire business or a subsidiary of the acquirer.
- Incurring liabilities i.e. issuing debt instruments.
- Issuing equity interests in the form of ordinary or preference shares, options, warrants etc.
- Following any combination of the above types.
- Contingent consideration such as the amount that is contingently paid to the acquiree’s employees or management or selling shareholders in exchanging the share-based payment awards i.e. stock options held by them in the acquiree for the acquirer’s own share based awards.

Ignored in AS 14, Ind AS 103 covers cases where an acquirer can obtain control of an acquiree even without transferring consideration (Ministry of Corporate Affairs 2011). Such circumstances can arise when the:
- acquirer already has an existing ownership interest in the acquiree, and the acquiree repurchases a sufficient number of its own shares for the acquirer to obtain control of the acquiree; or
- minority veto rights lapse that has previously kept the acquirer away from controlling the acquiree in spite of the acquirer holding majority voting rights in the acquiree; or
- acquirer and acquiree agree to combine their businesses together by contract alone such as in a stapling arrangement or forming a dual listed corporation; here the acquirer transfers no consideration in exchange for control of the acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously; all of the equity interests held by the owners of the acquiree prior to combination are regarded as non-controlling interest by the acquirer in its post-combination financial statements, and are entitled to a proportionate share of only the acquiree’s net assets recognized post combination.

Both AS 14 and Ind AS 103 require measurement of amalgamation / acquisition date fair value of consideration excepting share – based payment transactions which are to be measured as a liability or an equity instrument by the acquirer at the acquisition
date in accordance with the method prescribed under Ind AS 102 for Share-based Payment.

2.6 Treatment of difference between Consideration and Value of Net Identifiable Assets Acquired in a Business Combination

Ind AS 103 differs from AS 14 in the accounting treatment of the difference between the aggregate of:

(i) acquisition — date fair value of consideration transferred by the acquirer / transferee;
(ii) fair value of non-controlling interest, if any, in the acquiree (not considered in AS 14), and
(iii) acquisition — date fair value of acquirer’s previously held equity interests in the acquiree in case the business combination is achieved in stages (not covered by AS 14)

and net of acquisition — date fair values of the acquiree’s identifiable assets acquired and liabilities assumed.

If the above difference turns out to be positive, the acquirer / transferee recognizes it as ‘goodwill’ on the acquisition date under both Ind AS 103 and AS 14 (for amalgamation in the nature of purchase). However, AS 14 requires such ‘goodwill’ to be amortized to income for a period not exceeding 5 years, while Ind AS 103 demands its annual impairment test in accordance with Ind AS 36. In order to determine the amount of goodwill (in accordance with the formula as mentioned in the preceding paragraph) in a business combination in which no consideration is transferred by the acquirer, Ind AS 103 further provides that the acquirer shall use the acquisition — date fair value of the acquirer’s interest in the acquiree determined using an appropriate valuation technique in place of the acquisition — date fair value of the consideration transferred.

If the difference as mentioned in the first paragraph is negative, then AS 14 requires the same to be recognized as ‘capital reserve’ by the transferee and recorded in ‘Shareholders’ Equity’ in its financial statements under purchase method of accounting only. In case of Ind AS 103, if the business combination is in the nature of bargain purchase i.e. a forced sale in which the seller / acquiree is acting under compulsion, then such negative difference is to be recognized as ‘gain from bargain purchase’ in ‘Other Comprehensive Income’ on the acquisition date and accumulated in ‘Shareholders’ Equity’ as ‘capital reserve’ in the acquirer’s financial statements. However, IFRS 3 recognizes such ‘gain from bargain purchase’ in ‘Profit and Loss Statement’ only. If there is no clear evidence of the business combination being in the nature of bargain
purchase, such negative difference is to be directly recognized as ‘capital reserve’ in ‘Shareholders’ Equity’ by the acquirer as per Ind AS 103.

In contrast, neither ‘goodwill’ nor ‘capital reserve’ are recognized under pooling of interests method of accounting applicable for amalgamation in the nature of merger under AS 14.

2.7 Treatment of Acquisition Related Costs

Ind AS 103 provides that acquisition – related costs i.e. the costs that acquirer incurs to effect a business combination such as finder’s fees like advisory, legal, accounting, valuation and other professional or consulting fees, and general administrative costs including the costs of maintaining an internal acquisitions department are to be expensed in the period in which such costs are incurred and the services are received (Ministry of Corporate Affairs 2011). However, the costs of registering and issuing debt and equity securities, though being part of acquisition – related costs, are to be recognized by the acquirer in accordance with Ind AS 32 and Ind AS 39. On the contrary, the old AS 14 does not provide any specific guidance on treatment of acquisition related costs.

2.8 Accounting for Business Combinations 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 such control is not transitory (Ministry of Corporate Affairs 2011). As for example, transfer of subsidiaries or businesses between entities within a group like merger of Reliance Power and Reliance Natural Resources in recent times is a case of common control business combination. It is to be noted that 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 involves entities under common control or not. Even a partially owned subsidiary is, nevertheless, under the control of the parent entity. This is because a group of individuals is regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and such ultimate collective power is not transitory.

Such common control business combinations are outside the scope of even IFRS 3, and nor does AS 14 prescribe accounting for such transactions different from other amalgamations. Ind AS 103 specifically recommends pooling of interests method of
Accounting for such business combinations under common control, as against the ‘acquisition method’ prescribed in general for all other types of business combinations.

Under the pooling of interests method to account for business combinations under common control, all the assets, liabilities and reserves of the combining entities retain their identity in the combined entity and are reflected at their carrying amounts in the combined entity’s financial statements. No adjustments are made to such carrying amounts to reflect their fair values, or to recognize any new assets or liabilities, excepting that adjustments are to be made only to harmonize the diverge accounting policies of the combining entities. The consideration for such business combinations under common control can be met with securities, cash or other assets and hence to value the same, securities are to be measured at their nominal values while assets other than cash are to be considered at their fair values. Ind AS 103 further provides that the excess, if any, between the aggregate of the amount of share capital of the combined entity issued as consideration and any additional consideration in the form of cash or other assets, and the pre-combination amount of share capital of the combining entities is to be recognized as ‘goodwill’ in the financial statements of the combined entity. In case of any deficiency in such difference, the same is to be treated as ‘capital reserve’ by the combined entity.

2.9 Accounting for Reverse Acquisitions

Reverse acquisition is the technique by which a private operating company, who intends to raise capital from the public without being registered as a public company, arranges for a publicly traded company, which is usually a shell company i.e. one with an organizational structure but negligible business activity, to acquire its equity interests in exchange for the equity interests of the public company. The private company, in turn, installs its own management team in the public company and renames it. Such reverse acquisitions are usually done to avoid the extensive legal process, stringent regulations time and costs involved in getting converted into a public company and coming out with an initial public offer (IPO), and yet obtain a stock exchange listing. The Indian example of reverse acquisition is the recent merger of ICICI Bank with ICICI. In reverse acquisitions, the entity that issues securities i.e. the public company is regarded as the legal acquirer / parent, but as the acquiree for accounting purposes, and the private company whose equity interests are acquired by the public company is identified as the legal acquiree / subsidiary, or the accounting acquirer. Such an acquisition is termed as ‘reverse’ acquisition because the accounting acquirer i.e. private company usually issues no consideration for the accounting acquiree i.e. public company; instead the accounting acquiree issues its equity shares to the owners of accounting acquirer. Accordingly, the
acquisition – date fair value of the consideration effectively transferred by the accounting acquirer / legal acquiree or subsidiary i.e. private company, for its interest in the accounting acquiree / legal acquirer or parent i.e. public company is to be calculated based on the number of equity shares that the private company / accounting acquirer would have had to issue to give the owners of the public company / accounting acquiree the same percentage equity interest in the combined entity that results from reverse acquisition.

After reverse acquisition, the consolidated financial statements are prepared and issued in the name of accounting acquiree / public company, but they represent a continuation of the financial statements of the accounting acquirer / private company with the exception of share capital which is adjusted to reflect the capital of the accounting acquiree / public company. Accordingly, the assets and liabilities in the consolidated financial statements following reverse acquisition are the aggregates of assets and liabilities of the accounting acquirer / private company at their corresponding pre-combination carrying amounts, and assets and liabilities of the accounting acquiree / public company recognized and measured at their corresponding fair values. ‘Reserves’ reflected in consolidated financial statements are those of the accounting acquirer / private company before the business combination. In order to determine the issued equity interests in the consolidated financial statements post reverse acquisition, the issued equity capital of the accounting acquirer / private company outstanding immediately before the business combination is added to the fair value of the consideration effectively transferred by the accounting acquirer to the accounting acquiree. However, the equity structure (i.e. number and type of equity interests issued) appearing in the consolidated financial statements reflects the equity structure of the accounting acquiree / public company, including the number of equity interests issued by the accounting acquiree / public company to effect the combination. To do so, the equity structure of the accounting acquirer / private company is restated using the exchange ratio established in the acquisition agreement to reflect the number of shares of the accounting acquiree / public company issued in reverse acquisition.

In a reverse acquisition, non-controlling interest refers to those owners of the accounting acquirer / private company who are not willing to exchange their equity interests for equity interests of the accounting acquiree / public company i.e. they have no interest in the results and net assets of the combined entity, but are interested in the results and net assets of the accounting acquirer only. On the other hand, even though the legal acquirer / public company is the acquiree for accounting purposes, all its owners have an interest in the results and net assets of the combined entity. Therefore, unlike other business combinations where non-controlling interest is measured at acquisition
date’s fair value, the non-controlling interest in a reverse acquisition is measured as the non-controlling shareholders’ proportionate share of the pre-combination carrying amounts of the accounting acquirer’s net assets.

Goodwill is recognized in the consolidated financial statements post reverse acquisition and is measured as the excess of the fair value of consideration effectively transferred by the accounting acquirer / private company less net amount of fair values of recognized identifiable assets and liabilities of the accounting acquiree / public company.

It may be noted that accounting for reverse acquisitions is outside the purview of old AS 14.

3.0 Conclusion

An incisive analysis of the two standards – the old AS 14 vis-à-vis the IFRS 3 converged Ind AS 103, thus suggests that accounting for business combinations has become a challenge to the accountants in Ind AS era. With the growing complexity in different forms of business combinations, understanding the structure and nature of each such combination is becoming critical to begin with. Ind AS 103 demands a sound knowledge base of the accountants as an essential pre-requisite to recognizing, measuring and properly classifying the assets acquired and liabilities assumed in a business combination and accounting for them subsequently in the light of appropriate IFRS converged Indian Accounting Standards (Ind ASs). Unlike AS 14, Ind AS 103 calls for recognition and valuation of internally generated intangible assets of acquiree in post combination financial statements, which in the absence of any specific guidance before may throw open new areas of challenge before the accountants. Measuring non-controlling interest in the acquiree is another key area of challenge due to the inclusion of a control premium in the per-share value of the acquirer’s interest in the acquiree, and a discount for lack of control in the per-share value of the non-controlling interest in the acquiree. This apart, IFRS converged Ind AS 103 stresses on fair valuation of all assets (including internally generated intangibles of acquiree) acquired and liabilities assumed in a business combination, including that of non-controlling interest and consideration transferred to effect the combination. The most widely accepted definition of *fair value* is that it is the amount for which an asset could be exchanged or liability settled between two knowledgeable, willing parties in an arm’s length transaction. Market value is the best reference of fair value, in the absence of which fair value is to be determined using an appropriate valuation model depending upon the intended use of the asset. This necessitates that accountants should not only confine themselves to their field of
specialization, but should be well conversant with the complex valuation models available in finance literature as well so as to arrive at the fair values of assets and liabilities taken over, non-controlling interest and consideration transferred in a business combination. Since it is impractical to expect an accountant to be equally proficient in the field of finance, the new IFRS converged Ind AS 103 creates a platform for the accountants and finance professionals of an organization to cooperate and complement each other in accounting for business combinations. Undoubtedly, the challenges posed by Ind AS 103 are stiff, yet it judiciously covers all such issues which have until been outside the purview of Indian accounting standards, given the global nature of doing business and the resultant complexity in business combinations.

References


