Mergers, Acquisitions and Corporate Restructuring
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Lecture - 34
Accounting Aspects of M and A - I

Hello friends welcome to another session on mergers acquisitions and corporate restructuring in this particular model we are looking at the legal aspects of acquisitions. We have already covered 3 sessions on that and in this we will have another 2 sessions where we will be talking about the accounting aspects of mergers acquisitions what happens specific things about accounting of merger acquisition we will talk about those things in this session as well as subsequent session.

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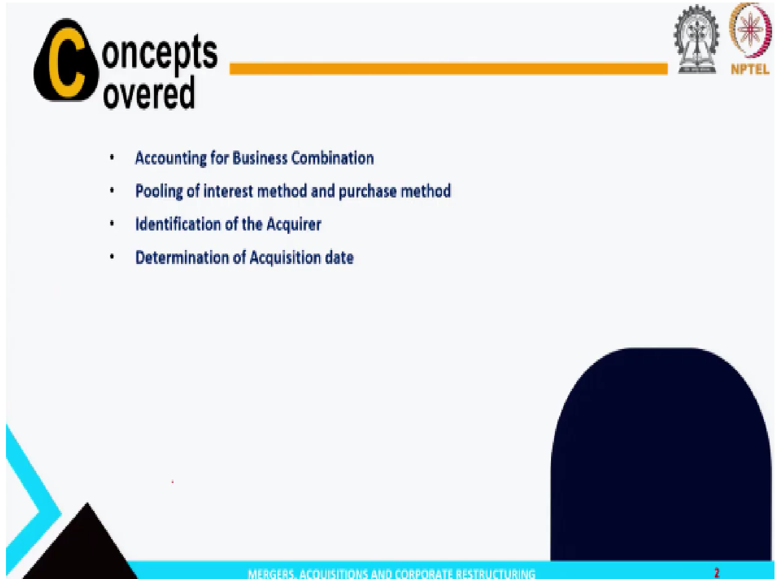

Then these are the concepts that you have accounting for business combination then we will have talk about 2 different methods of accounting in case of mergers and acquisitions that is pooling of interest method and purchase method. Then we also talk about identification how what are the process of identifying an acquirer because in this accounting process we have to identify and acquirer and acquiree that means acquire in the target.

It has to be clearly defined as per the before we go for mergers and acquisitions accounting also another important thing that we have is determination acquisition date. There are other steps also involved in this accounting process those things will be discussed in the subsequent session.

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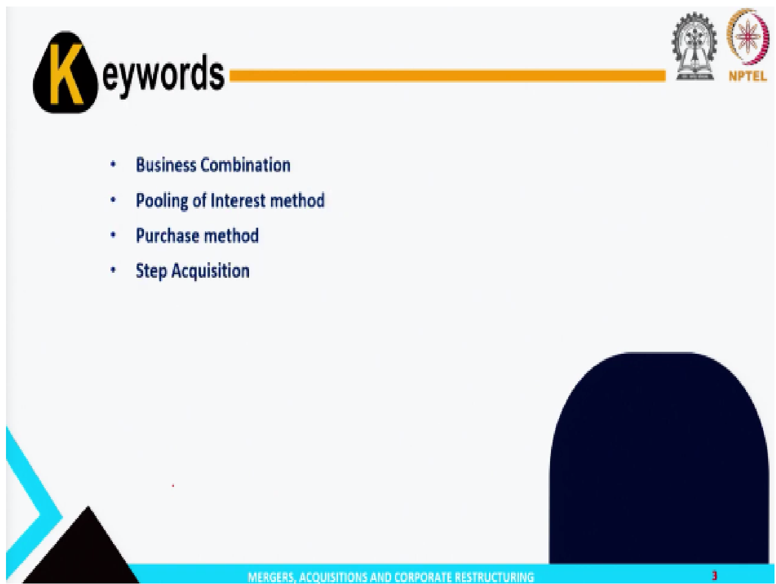

Now coming to the keywords, we have this keywords business combination, pooling of interest method, purchase method and step acquisition.

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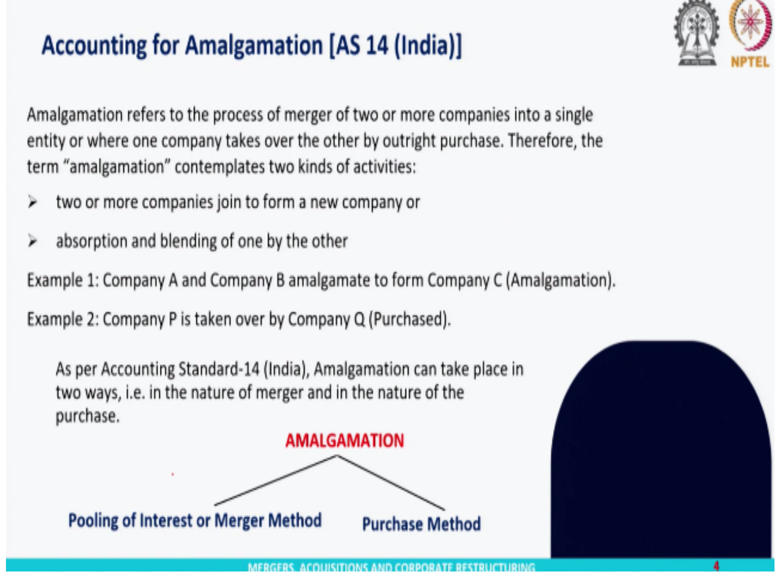

Accounting for amalgamation talk about earlier we had AS 14 accounts under 14 in India and that their time they discuss the term called amalgamation so what is amalgamation assets? Amalgamation is nothing but the processor merger of 2 or more companies into a single entity. So 2 companies come together and become a single entity and 1 company takes over another company. So therefore, amalgamation can be 2 types there are 2 more companies become 2 company new company 2 companies form become a new company.

Another is absorption that means 1 company is observed by another company and then only one company remains. So if a company, A and B amalgamate together and become company C then a new company's form whereas another example is that the company P which is taken

over by company Q. That means company Q is a purchasing company P so that way we have the earlier account standard AS 14 the amalgamation we had a in case of merger the method was followed the pooling of interest method and the in case of purchase it is your purchase method of accounting was considered.

So what are the why these 2 different methods were there what are the differences between them we will discuss in the subsequent slide.

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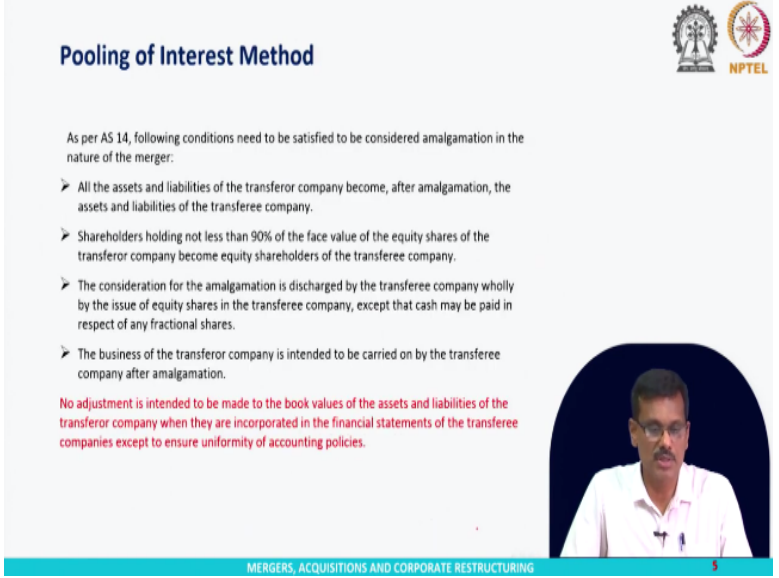

So when you talk about the pooling of interest method the company can take advantage of pooling of interest method or adapter pooling of interest method only if this conditions are satisfied like all the assets and, liabilities of the transferor. Transferor means the target becomes the after amalgamation becomes assets and liability of the transferee that is the acquiring company then shareholders holding not 9 at least 90 percent. The shareholders in the target must become shareholders of the acquiring company.

Then and the purchase consideration which is paid by the acquiring company the target company. It has to be in the form of shares and business of the target will continue as it is if these conditions are fulfilled then only the pooling of interest method is followed and the pooling of interest method what happens all the assets and liabilities of the target company becomes the assets and liability of the acquiring company line by line they get added assets.

And there may be some accounting principle difference between acquiring and target company taking care of that some changes may be there in the recognition assets and

liabilities otherwise assets and liabilities of the acquiring target company becomes the assets and liabilities of the acquiring company. If any of this particular condition is not fulfilled then the companies have to adopt purchase method.

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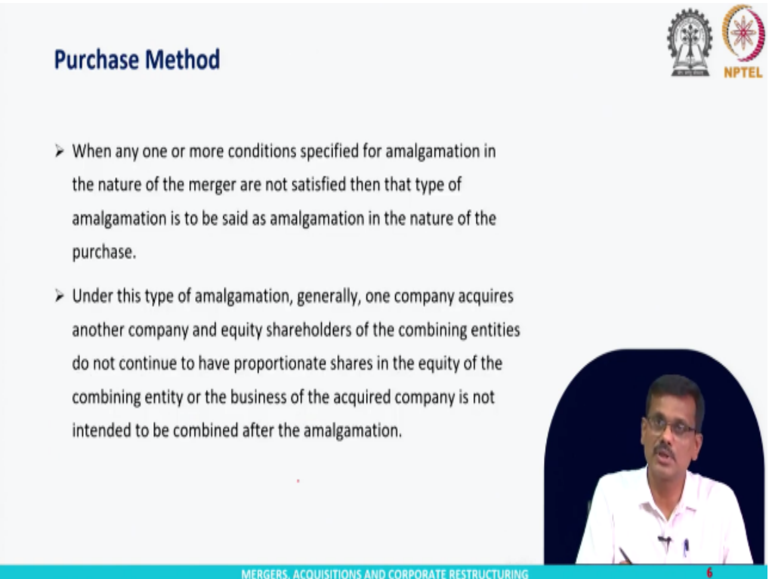

So when as you discuss in 1 or more conditions that you specified earlier for amalgamation the nature of merger that is where you discuss the pooling method is one of the condition is missing or not fulfilled let us say the consideration not in share it is in cash. In that case the pooling method cannot be used. So in that case what will happen 1 company is actually acquires another company and equity share of the company is not necessary that they become the shareholders of the acquiring company.

In the same proportion that they wear in the target company so that case the pooling method has to be used as such and it is not necessary combined actually.

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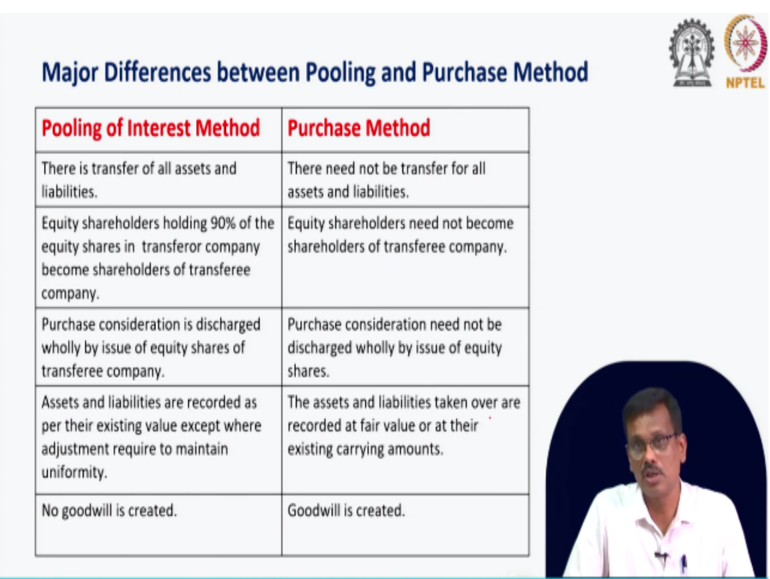

Pooling of Interest Method	Purchase Method
There is transfer of all assets and liabilities.	There need not be transfer for all assets and liabilities.
Equity shareholders holding 90% of the equity shares in transferor company become shareholders of transferee company.	Equity shareholders need not become shareholders of transferee company.
Purchase consideration is discharged wholly by issue of equity shares of transferee company.	Purchase consideration need not be discharged wholly by issue of equity shares.
Assets and liabilities are recorded as per their existing value except where adjustment require to maintain uniformity.	The assets and liabilities taken over are recorded at fair value or at their existing carrying amounts.
No goodwill is created.	Goodwill is created.

So what the major difference is the 2 method treatment because although AS 14 talked about still in the will discuss in the subsequent slide that this pooling method, filling up interest method purchase method has still has relevance although we have 19 IFRS has been implemented but still we have those implications of the system that is why you should know what are the implic difference between 2 methods as in pooling of interest method there is transfer of all assets and liabilities.

And purchase method is not necessary that all the assets and, liabilities are transferred that means if all the assets and liability are not transferred then it pooling of interest method cannot be there. So purchase method has to be allowed and then 90 percent the shares in the transferor comes the target company becomes shareholders of the acquiring company which is not necessary that in the purchase method if that is in suppose a transaction where, the let us say equity shareholders of the target company gets cash.

Get cash instead of shares in that case pooling of interest method will not be applied it will purchase method will be applied and here purchase consideration that the amount is paid specifically to the target company we will discuss at purchase consideration this next session how purchase consideration is calculated is nothing but the, amount paid for the acquiring a company that has to be in the more equity shares but here it may be in equity share it may be in cash is not necessarily in the form of equity shares.

Then assets and liabilities of the balance sheet of target will be become assets and liability of the acquiring company in the terms of their book value. There will not be any change in that

whereas in the purchase method they can be there they will be taken over the fair value or they are carrying value can be calculated then carrying amount can be considered so that is what happens in this method goodwill is not creative what is the goodwill actually something extra is paid than what assets and liabilities net is acquired something extra is paid.

Then that can be taken as good will so this scope of goodwill is not there in pooling of interest method but here goodwill is going to be there so goodwill calculation etcetera will talk in the another session also will give an example for that. So these are the major differences between pooling of interest method and purchase method.

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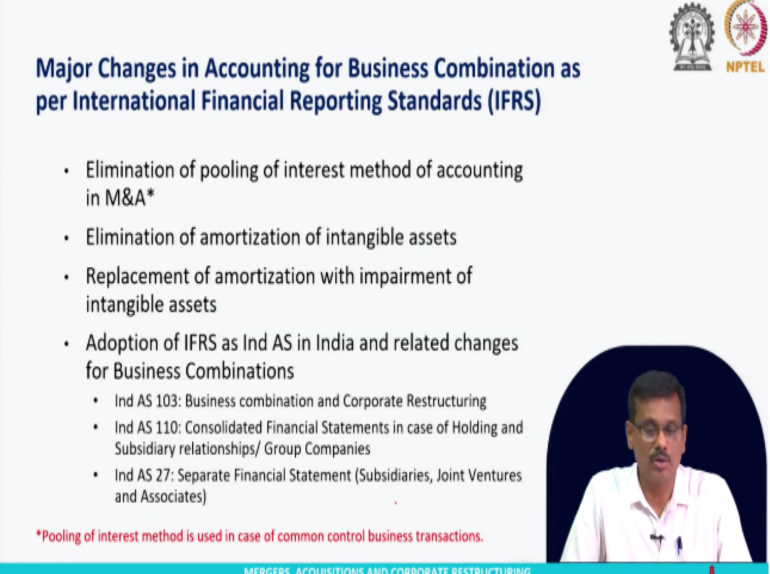

Now what has happened you know with the adoption of IFRS in the present century so across the world there are common changes the pooling of interest method has been now removed. Whereas only in case of common control business transaction pooling of interest still there certain specific cases otherwise more or less pooling of interest method is not there that means by default the companies have to follow purchase method.

Then earlier amortization of intangible asset was there now it is no amortization, you have to actually impair the test for the impairment of the intangible asset and accordingly we can have impairment losses booked in the income statement. So that we that is we have the for example in the earlier cases on the AS 14 the goodwill was created out of merger acquisition because acquisition the goodwill has to could be amortized in maximum period of 5 years.

Now the goodwill amortization is ruled out now goodwill be tested for the impairment there is impairment loss is there then the goodwill be valuable lower assets. So another all things are there that there are 3 different standards which talks about the business combination now in the new accounting standard IFRS which is called Ind AS in India their referred as business combinations. They are not referred as amalgamation or absorption like they will business combination.

So business and combination corporate structures covered Ind AS 103, Ind AS 110 talks about consolidated statement prepare suppose there is a group company there is a parent company there is a subsidiary company so parent company will present its report subsequential presentation report. But also parent company has to present a consolidated statement which will talk about which will be keeping both parent and subsidiary or the holding and subset together as if they are 1 entity.

And they will present the statement that will be asked for the Ind AS 110 then if a company is only one company there is no subsidiary company that is called the individual financial statement. Whereas the company has subsidiary, then that as a group let us say suppose the company A which has got some subsidiary B and C that means A, B and C will be preparing separate financial statement as per Ind AS 27 rare like individual financial statements.

But that is called as separate financial statement as per the law for subsidiary, joint ventures, associates for everything they will prepare separate financial statement and as per Ind AS 110. They will again consolidate and present 1 single statement for a group as per the regulations.

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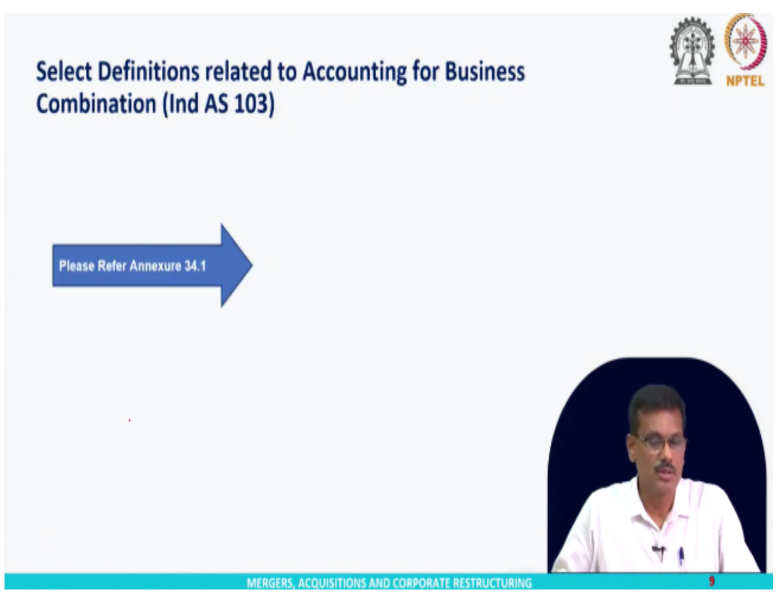

So we have to also understand certain select definitions for because that is very much required as such before we go for merger and acquisition accounting we should know certain definitions.

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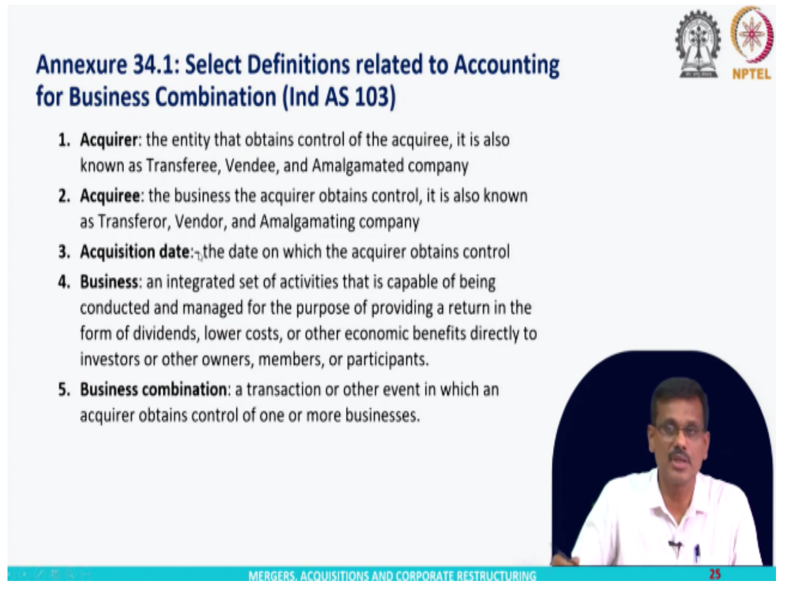

So these are given here in the append annexure in last words last so we have to find out first which in, acquirer who is in acquiree which acquisition date. So 3 things we will discuss here mainly one because M and A accounting has to conclude before accounting takes placement accounting who is the acquirer who is acquiree? Even if they may look like both the companies coming together like they have become 50 percent stakeholder, but still in that case one has to be identified as acquirer another has to be other companies like will identified acquiree.

But that is very much necessary to do that otherwise the next step cannot take place so what will be acquirer the entity that obtains control or of the acquiree it is also known as transferee it is also known as vendor it is also amalgamated company what is acquiree? Acquiree is nothing but the business the acquirer is obtains control that means in a, simple sense we can set target is the acquirer, acquirer is the acquiree assets

So they are also known as transferor, vendor and amalgamating company so we discussed that in the previous session also like amalgamating is same thing like target company. Amalgamated is same like the acquiring company. Then also have to find out what the acquisition date because company may announce an acquisition but the effect may take place sometime later final payment may take place sometime later but acquisition date has to be decided because on that day the consulate that accounting changes will be taking place.

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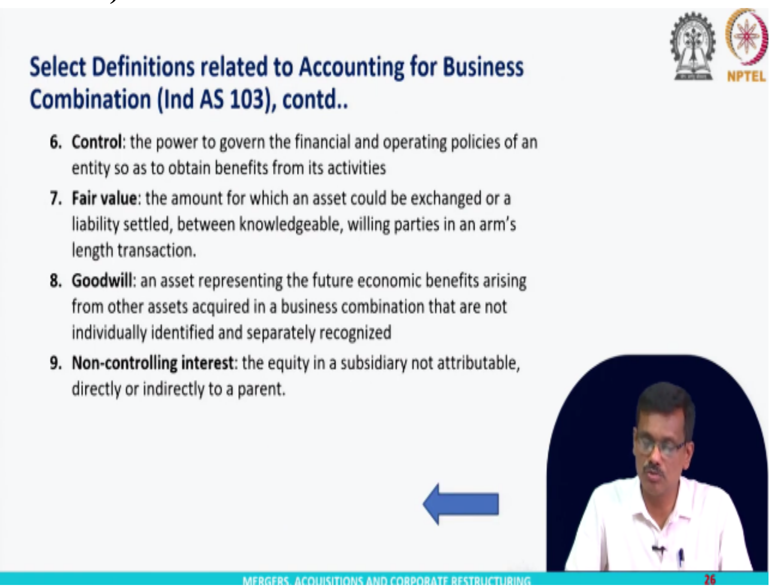

So other definitions are also there in this one can always go through that but in the we will go for the other steps in the M and A accounting process we are talking about control, fair value, goodwill all those things are given here.

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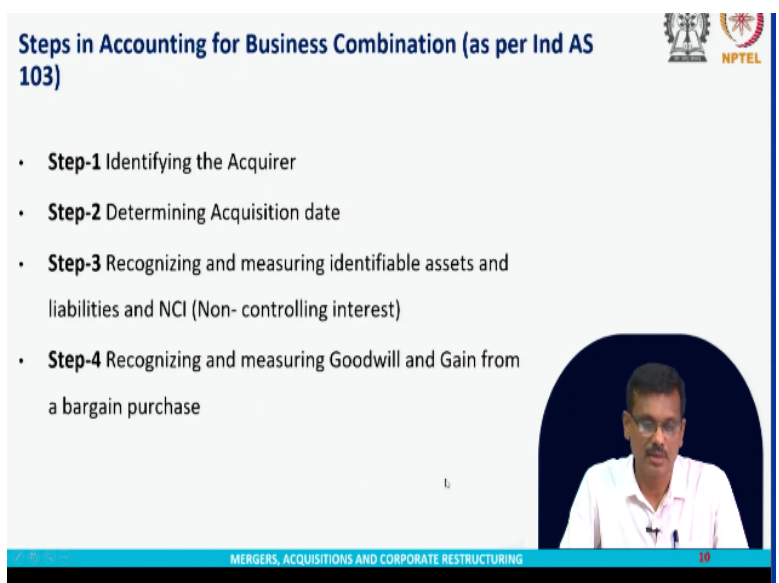

Then what are the major states in the business combination as per Ind AS 103 which is the new account Ind AS as per international finance reporting standard when India has adopted. So first is that 1 has to identify the acquirer that the first step then 1 has to determine the acquisition date then step 3 recognizing measuring, identifiable assets and liabilities and non-controlling interest which is called minority interest.

Suppose somebody has 70 percent stake in the company so raise 30 technology minority interests are non-controlling interest. Then recognizing and measuring goodwill or gain from the bargain purchase. So those things will be this these are the 4 major steps so in this session we will talk about the, first 2 steps identify the acquirer and determine the acquisition date in the subsequent session will talk about recognition and measuring identifiable assets and liabilities and also will talk about the how to measure goodwill and gain or gain from bargain purchase.

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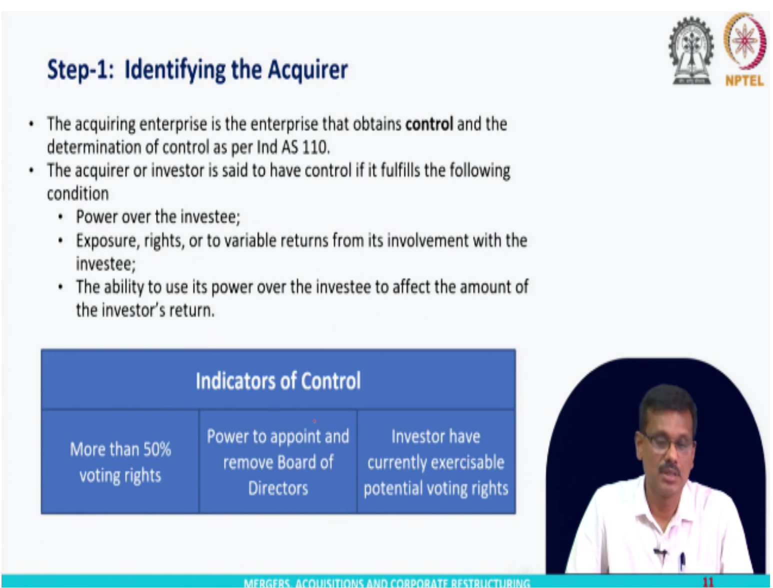

So what is how do you identify the acquirer who is the acquirer? So acquiring enterprise the enterprise that obtains control and the control is defined like this they have the power over the investee. Investee the company is being transferred they have exposure, rights to a variable returns from the involvement with the investee and they have ability use power over the investee to affect the amount of investor's returns they can change they can do the business they can change the business structure.

So they get more return all those things are, there so if these things are fulfilled then as per that company which does that it is called the acquirer. So another thing is another indicator is there they have 50 percent voting rights they have power to appointment or remove the board of directors and they have also currently exercisable potential voting for exercisable potential voting rights in the company. If this 3 thing taken care then, you can say that the company has a control and whoever has that will be taken as whoever fulfilled this condition will be taken as acquiree or acquirer for that matter the other company will taken acquiree.

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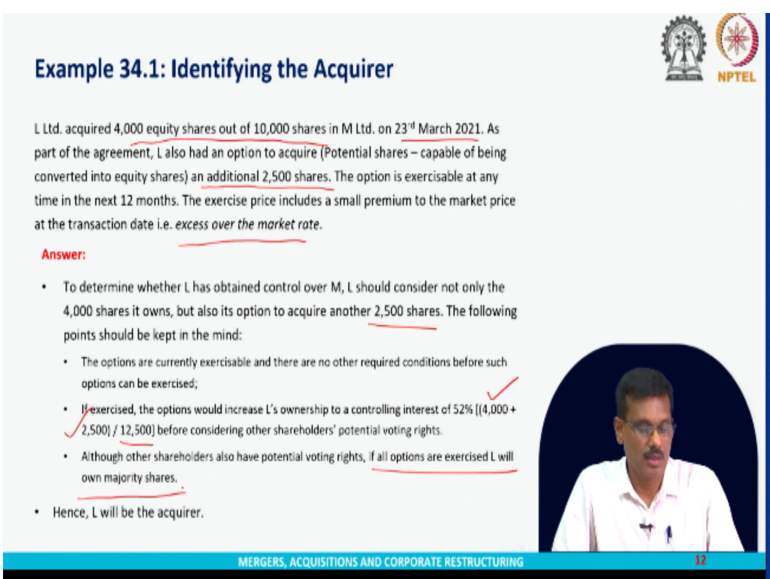

So 1 example we have here L limited acquired 4000 shares out of 10000 M limited on let us say 23rd march and also L also had an option to acquire some more say potential shares which will be converted into equity shares and additional 2500 shares and the option can be exercisable at any time in the next 12 months. So exercise price includes a premium to pay another extra amount over the market price no doubt about that over the market price.

So now can we say who is who is the acquirer here so answer is that so first of all there are 4000 shares up to 10000 that means 40 percent but they have an ability to take another 2500 shares. So in that case what happens 4000 + 2500 that is potential shares 6500 so now total shares will become 10000 earlier they had another 2500 and gets added so total sales become 12500 so for 6500 by 12500 comes to 52 percent. That means they have got now more than 50 percent control so now L limited can be considered as the acquirer assets so that is the another one example so L will be the acquirer.

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And one has to remember because there could be some situations where it will be difficult to find out actually who is the acquirer, who is the acquiree? In that, case there can be ambiguity in that case let us for example in a business combination effected primarily by transferring cash or other assets by incurring liabilities there is no share given assets so the company which is transferring the cash will be taken as acquirer.

Then similarly their exchanging liquid interest so acquirer some other exchange of equity is there the company which is actually, issuing this here they will be considered as the acquirer and in case a business combination more than 2 entities and where because there is still some ambiguity. So relatively whichever company is bigger that will be taken as the acquirer companies. So these are some special conditions which can help us remove the ambiguity to find out where who will be the acquirer company because, acquirer and acquiree identification is very much necessary before and for the merger acquisition accounting.

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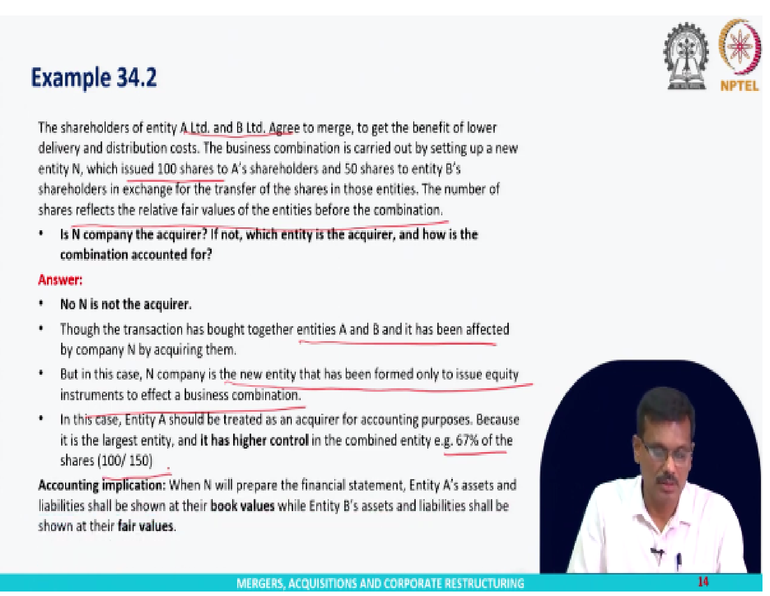

So we have one example here the shareholders of company A and B they agree to merge to get the benefit or lower on delivery distribution because like synergy they are going to get. The business combination carried out by setting up a new entity, a new entity is being formed 100 shares is given to A shareholders 50 shares given to entity B shareholders the number of shares reflects the relative fair value is the entity before the combination.

So now we will talk about who is acquirer here new company is form new company issuing shares N company who is the acquired here. So acquire is no N is not the acquirer and the A and B and coming together assets. So, in this case N company in the new entity that has been formed to only to issue the equity shares to effect a business combination. So, A is stated as acquirer because they have got 100 by 150 say that means two thirds here.

So 67 percent they have a stake so for this purpose entity A will be considered as the acquirer and other company to consider as the acquiree. So but when accounting implication entity A is assets and liabilities, will be shown at the book values. Whereas entity B is and assets will be shown as at the fair value that means as if here the purchase method is followed as if here the pooling of interest is method is followed that is the implication accounting here assets.

So because A is coming to N B also coming driven but A is assets will be coming at the book value whereas B is the assets and liability will come out the fair values that are the implication here.

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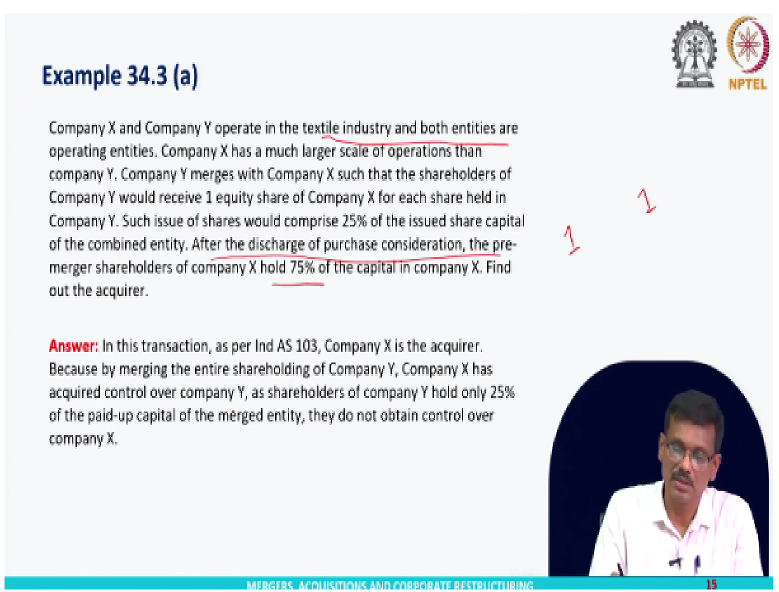

So, let us look at another example where you to identify the acquirer so in this particular example we have company X and company Y. They are operating textile industry and both are actually operating entities is not like something securely being taken over not like that and company X has a little bit in X and Y company X has a much larger scale of operations than company Y and Y is merging with company X so that every shareholder of Y gets another share in X.

So 1 is to 1 ratio but post-merger what happens Y shareholders will be having 25% the share capital of X. Then after discharge of the purchase consideration the pre-merger shareholders of company X who are there earlier in company X. Now new people have come they will, have 75 percent those people are already there in company X whereas the Y is shareholders who have been given shares in X they will have 25 percent assets.

So, in that case for this purpose since the company X shareholders have more voting rights more shareholding as well they are also larger in scale of operation. So they will be identify the acquirer and company will be considered as the acquiree.

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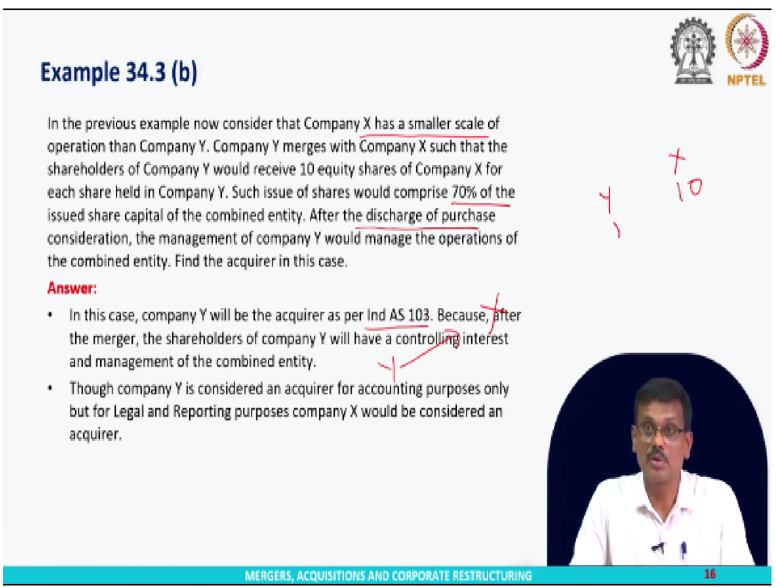

Then another variation of this particular example is that let us say same X and Y but X is having smaller scale of operation and Y has a larger scale of operation. So that the company X will be giving now and Y is being more with X. So Y is getting more with X and that means Y not survive X will survive, but for every share of Y 1 share of Y, 10 shares of X are given in that such a manner that post-merger Y shareholders will have 70% stake in the combined entity or somebody share capital combined entity.

So after a discharge of the purchase consideration management of Y is going to actually manage the company of the company X so what will be the acquirer here. The answer is that you have company Y with acquirer not the company X as per Ind AS 1 for accounting purposes whereas from the legal point of view company X will be the acquirer because X is surviving Y is not surviving from the accounting point of view X is going to acquirer.

Because there are certain implications of finding out who is acquirer and who is acquiree like we saw in previous example. So some of the company's assets and liabilities will be taken as at the book value. Some of the another company assets and liabilities taken as the fair value so that makes the difference between saying who is acquirer and who is acquiree?

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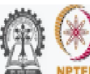
Step:- 2 Identifying Date of Acquisition



- The date on which acquiring enterprise obtains the control of the acquiree is simply known as the date of acquisition (DOA).
- It is the date on which the usually company transfers the consideration and acquires the assets and liabilities; it is also known as the closing date.
- However, the control can be obtained before or after the closing date. And the date on which it obtains control is referred to as DOA.

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Then next step that we have in the merger acquisition accounting process with the date of acquisition packages because there could be several events before the actual M and A takes place company will come and sit together and have a negotiation. Then they have an agreement then, share exchange may take place all those steps are there when is actually considered date of acquisition because from that day accounting will be effective and the whatever change in the balance your income statement will take place that day only from that day onward.

So the date on which the acquiree compare your acquiree enterprise obtains the control of the acquiree that will be taken to the date of acquisition it is the date which usually company transfer the consideration usually that is the case and the asset liabilities which is also known as the closing date. However the control can be obtained before or after the closing date so in that case if the control is up happening after before closing date. Then the contract acquisition there is going to be different than the closing date.

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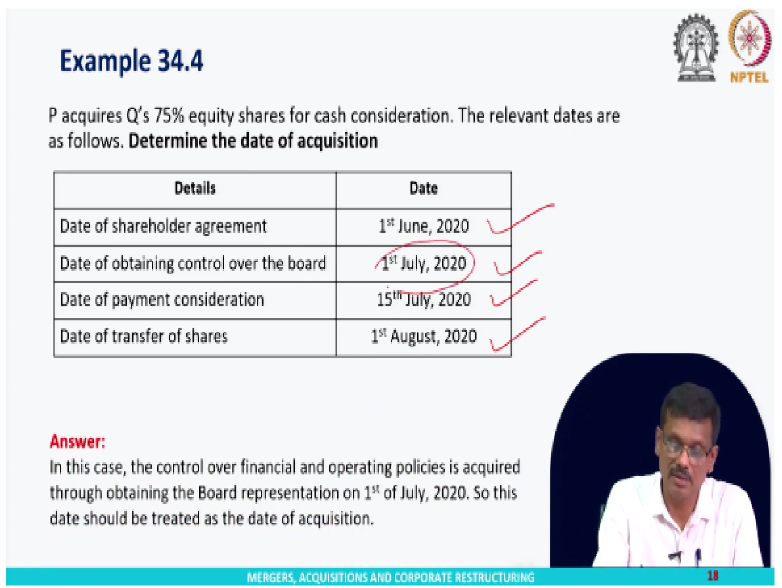

So let us have an example here 2 companies came together and they had a agreement to combine shareholder agreements on first June 2020 let us say, but the control over the board was obtained on first July. Payment was made the consideration were transporter share for share or cash per whatever that maybe it was done in 15 July actual transfer of shares took place on first August there are 4 dates as such so since the control was obtained on first of July. So that will be taken of the date of acquisition neither first June nor 15th July nor first August. So this is the way that is why the example of how these things can be different.

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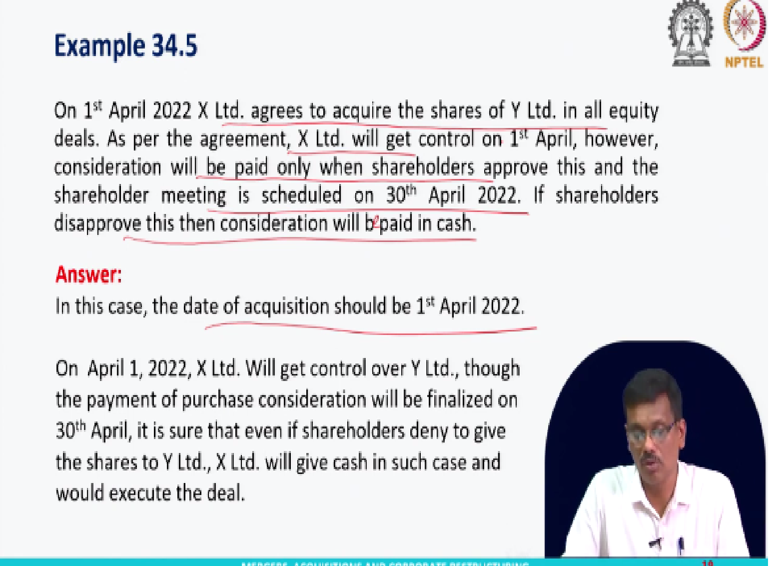

Similarly, we have another example in first April 2022 X limited is agrees to acquire the shares Y limited in all equity deals that will be equity for equity. As per the agreement X limited will get control on first April, however consideration will be paid only when shareholders approve this and the shareholder meeting is scheduled on 30th April. If shareholders disapprove this; then consider will be paid in cash.

So in that case, date of acquisition is first April because on first April that is mentioned the company will get the control. So, since they are going to get a control though the payment is going to take place on 30th April. It is sure that even if shareholders deny to give this as to Y limited X will anyway get the cash will give the X will anyway give the cash in such case so and that means the deal is going to be executed. So that way first step will be considered as the date of acquisition not 30th April where actual payment or conservation exchange is going to take place.

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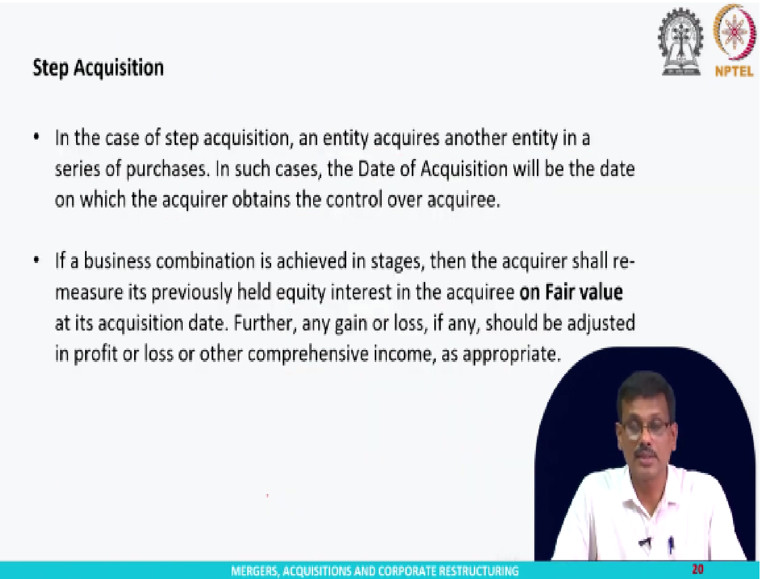

Then what happen in certain cases there will be some companies which will be acquiree the stakes in another company in phased manner that means some today 5% after some time for 10 percent like that it will be acquiree. So which will be considered as the date of acquisition those cases are called stay packages and or also in the M and A term we talked about earlier in the first module creeping average like a creeper they will be acquiree small stakes in the company.

In that case what will happen so in a business combination is achieved in stages then acquirers shall be re-measure its previously held equity interest already they must have some stake on a fair value basis on acquisition date and then any gain or loss will be also adjusted as a comprehensive income, but the date of acquisition will be the date where acquiree company gets the control of the acquiree.

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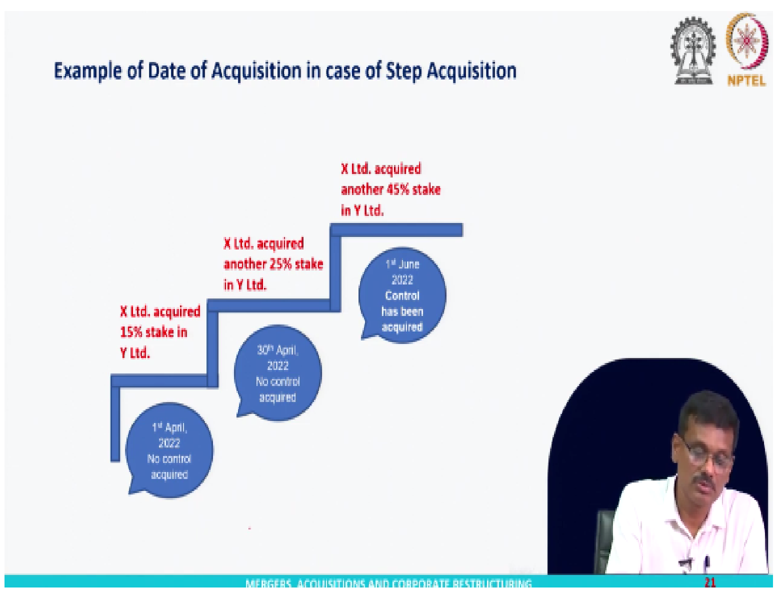

So as an example, if you have here that on first April 2022 X limited acquiree 15 percent stake on 30th April they acquired another 25 percent stake and then on first June they acquired for another 45 percent stake. So in that case what is the date of control? Date of control is going to be first of June 2022 because 25 + 15 was 40 percent may be that time they are not a measurative stake, but another 45 means 45 + 40 85 percent stake which is more than 50 percent stake so that day will be taken as the; consider it will be considered as the date of acquisition.

Although the company started acquiree shares in on first April 2022 so other things like how to what will be the how will the assets and library measured and the assets level to transport the company is it going to lead to goodwill or it is going suppose there goodwill will be arising when the company is paying more than what they acquired net, assets and liability and if that is other way around that means company has got more of net assets and they paid less that will be taken as a gain.

So that will be taken as a gain on bargain purchase which is something like the capital deserve so all those things will be discussing in the subsequent session.

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CONCLUSION

- Ind AS 103 deals with accounting for business combinations. Earlier AS 14 dealt with accounting for amalgamations.
- Identification acquirer, determination of date of acquisition are integral part of accounting for combinations.
- Although as per AS 14, companies could choose from among Pooling of interest and purchase method of accounting subject to the guidelines, Ind AS 103 suggests only purchase method of accounting.

So in the conclusion Ind AS 103 deals with accounting for business combinations. Earlier accounting standard AS 14 dealt with accounting for amalgamations now it is called business combination. Identification of acquirer and determination the date of acquisition integral part of accounting for combinations. Although as per AS 14 companies could choose from among pooling of interest in purchase method.

Normally as per Ind AS 103 or as after the implication IFRS it is suggested that purchase method of accounting is going to be applied. So pooling of interest method is actually not going to be there. Pooling of interest method may have certain loopholes or advantage over the other methods, but it was consider that it is not more no more technically feasible that means not correct so that is the account standard boards they have decided to only adopt the purchase method of accounting.

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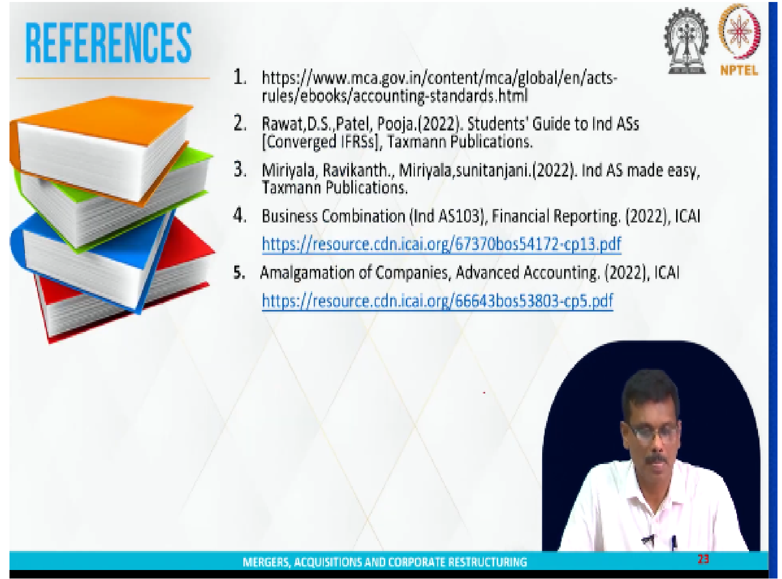

So with this we conclude this session. Thank you and happy learning