Mergers, Acquisitions and Corporate Restructuring
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Lecture: 35
Accounting Aspects of M&A - II

Hello friends welcome to another session on mergers acquisitions and corporate restructuring in this particular session we will be continuing with accounting aspects of merges acquisitions first part of the accounting aspects we have discussed in session number the lecture number 34 and lecture number 35 will talking about the rest of the accounting aspects of mergers and acquisitions.

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And in this we have will discuss about how to measure the identify assets and liabilities and also non-controlling interest which is also popularly known as minority interest and we will discuss about how to recognize and measure goodwill and it is there could be chance of goodwill there could chance of again from bargain purchase that means if the you are going to pay less than what you are getting then it will be again.

Or if you are going to pay less you are going to pay more than what you are going to get in the position square it will be taken as a good will. Then we will also talk about how purchase consideration is calculated then we will give an example how 2 Companies financial statements gets combined and one combined final statement gets prepared post amalgamation or post merger for that matter.

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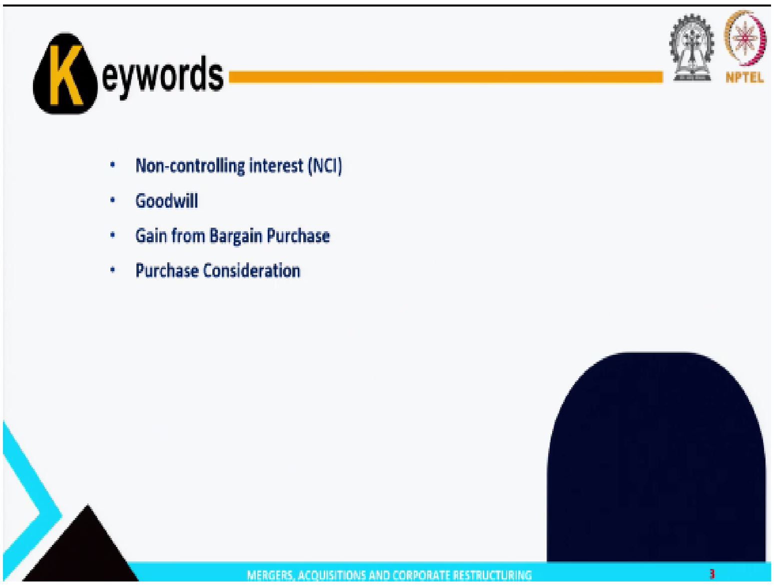

So the keywords that we have non controlling interest NCI, goodwill or gain from bargain purchase and purchase consideration.

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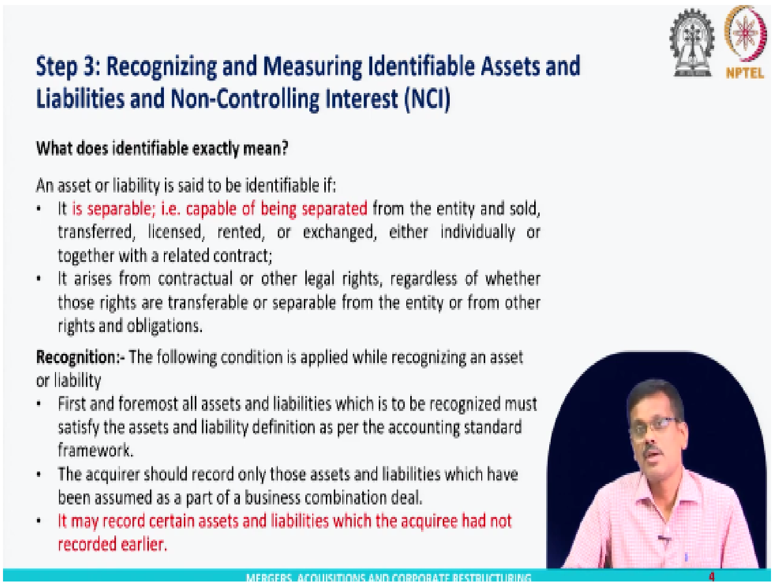

In the previous session we discussed about finding the acquirer and acquiree finding the acquisition date, date of acquisition and in this session the step 3 step 2, 1 and 2 we have discussed in the previous session is step 3 and 4 will talk about this session, so the first step is step 3 is the recognizing and measuring identifiable assets liabilities and non-controlling interest non-conditional minority interest.

So what has happened so what is identifiable exactly mean identifiable means it is in a separate separable asset capable of being separated from the entity and sold so it can be sold it is not aligned mixed with some assets for that matter which can be sold it can be transferred it can be licensed oriented all these things are that means it can simply go from the business from one direction on their business that is called the identifiable asset.

It can also should also arise from contractual other legal right that means the companies who is a transferring master of the legal rights and about those assets for that matter and, recognition is that first and foremost all the assets liabilities which will be recognized must satisfy asset liability conditions definitions as per the relevant accounting standard which is not in the scope of this particular session whatever account standard framework is there for recognition essence liability will be applicable here also.

There is no special recognition policy as far as, accounting for combination is concerned and acquirer has to record only those assets and liabilities which have to be assumed as a part of business combination or that all the asset liabilities would recognize in that whatever has been assumed by the business those will be recognized here and also it is possible it may require certain assets and liabilities of the a query which has not recorded earlier.

It is possible when business combination taking place merger is taking place there are some assets which are not recognized acquiree and the target but they find the assets are they are liabilities also may arise then those has to be recognized by the acquire error. So it is not necessary assets liability must be existing when they are being considered it may be new asset liability because a certain situations which is not recognized earlier by acquiree or the target for that matter.

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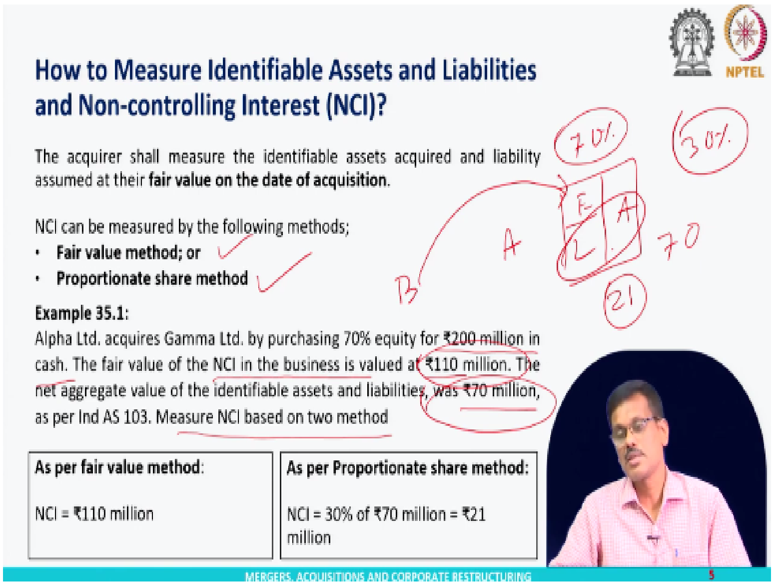

Then another thing is that how to measure identifiable assets and liabilities continue and non-controlling interest so acquirers will measure the identifiable assets and liability assumed at their fair value on the date of acquisition so whatever the fair value is there that will be considered for the calculation, and non controlling interest is calculated by using fair value method or proportionate share method.

Just a simple example we will talk about suppose there is a company is acquired by company b suppose there is a company B is the acquirer company A is the target or acquiree and acquirer. Now A has the assets and liabilities this is let us equity this is liabilities assets. Now if B is acquiring let us say 70 percent in this company A in that is what will happen 30 percent belongs to non controlling interest or minority interest.

So that has to be factored separately because as at the end of the day the business is gets combined with the company that gets added to the acquiring company but in the target company you have another 30 percent people still there which is not giving. So they are still there assessed in that case the non-controllable interest has to be calculated separately and we made part of the balance sheet after the consolidation takes place.

So non controlling interest as per the relevant account standard can be either through fair value or the proportionate share method both the methods are allowed for the company. So for example suppose gamma limited is purchasing, seventy percent equity of 200 million in the cash. Then fair value of the NCI non controlling interest is let us say 110 and the net aggregate value the identifiable assets is 70 million net aggregate means identical asset liability net value that assets minus liability 70 million.

So what will be the NCI non-controlling interest as per both the methods. So as per the first method that is fair value, method it is already given 110 million 110 million with the calculation. Second method is proportionate so 70 million is the net assets of the company that means like this A - L that is still at 70 30 percent is minority interest let us say in that case so 30 percent seventy million comes to 21 million will be taken as minority in pressure non controlling interest. So that will be this example of calculating the non controlling interest as per 2 methods.

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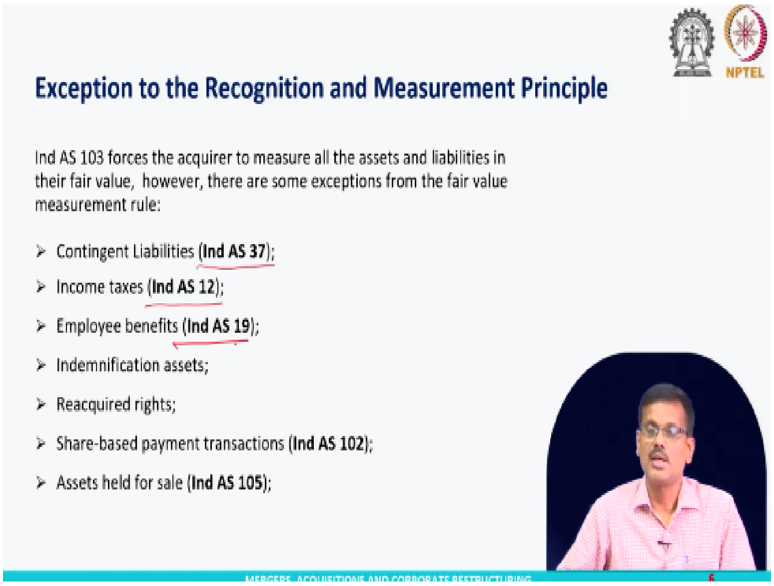

Then when you are looking at the acquisition and merger taking place and their assets are liability being acquired are getting merged into getting added to the acquiring company is accurate for that matter certain assets liability cannot be recognized just like that relevant account standards have to follow like, contingent liabilities there is nothing called we can have a fair value there that fair value is by default method of recognizing the assets and liabilities.

But so other in these cases like contingent liability whatever is Ind AS 103 says we will directly followed income taxes ind AS 12 say that will follow employee benefits in like gratuity pension due all those things the Ind AS 19 those will follow similarly and indemnification assets reacquired rights share based remains and assets held for sale in these cases this fair value is not applicable whatever is relevant account standard or whatever is their values that will be considered as the value of the assets or liabilities.

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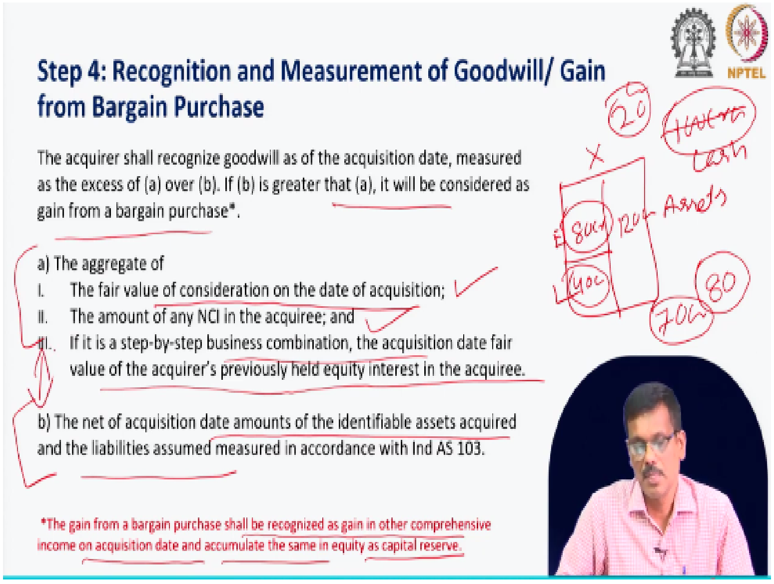

Then next is that next step is that we have to find out the measurement or recognition of goodwill or gain from the organ purchase just to say what is a goodwill as a concept let us say a company is there company X it has got assets of let us say 120 crore it has a liabilities of 40 crore and the equity comes to 80 crore this assets now suppose one company is acquiring this company for cash simply let us say cash.

And for all the equity shareholders are given may be in the form of cash and this cash given to these people these equities elders let us say they are given 100 crore cash that means when the company is merged this company X is merge company Y which is acquiring so company X 120 crore assets gets added to the company Y is balance sheet and company assuming that is the fair value and company x what equal liability gets added to the liability so net assets that comes to the companies 80 crore.

Whereas the company is paying how much 100 crore so assets will net will go down by 100 and increase by 80. So what is this that means companies paying 20 crore extra then the net assets so that 20 crore will be taken as goodwill as a simple example. Suppose in the same case let us into 100 crore they are paying 70 crore not 100 crore and 120 crore assets the fair value, also assets and 40 crore liability also fair value so they should be paying 80 crore they are taking 80 crore equity at half 70 crore.

That means they are paying less so this 10 crore will be taken as gain from a bargain purchase which was earlier known as simply capital reverse so now it will be known in the gain from bargain purchase and this gain from buy again purchase will be recognized as other comprehensive income in the accounting system on the acquisition date and then it will be accumulated as a part of equity known as capital reverse.

So first it will be taken as other companies income then it will be taken as the capital reserve so more about this comprehensive income capitalizer is a part of accounting for that matter so for only for understanding it has been given that if you are paying more than net assets that is goodwill if you are paying less than that it is gain on bargain purchase or capital reserve if you are paying equal amount of whatever the net assets then there is neither good in nor gain from bargain purchase.

Now so what is the gain from the bargain purchase or goodly calculated so first of all what you are getting the aggregate of you are paying the how much you are paying actually purchase consideration then any NCI that is also coming with that is also that belongs someone else and if it is step by step business combination acquisition date fair value of the acquirers anything that they have already taken suppose the acquirer has already acquired some shares earlier so fair value of that all together 3.

That is considered as the payment and whatever net acquisition date identifiable assets and live net of that assessment liability whatever is there in this step and in this step the difference will be taken as either goodwill or gain from bargain purchase.

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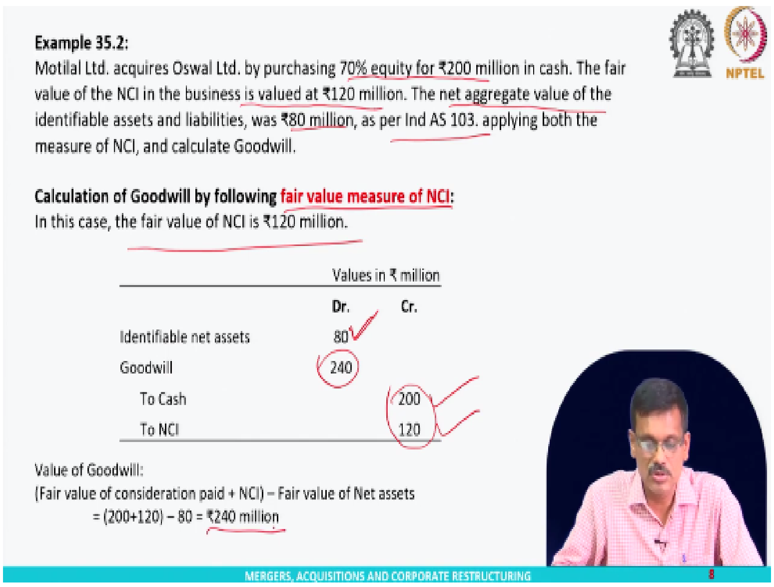

So let us have an exercise for that also so for example Motilal limited is acquiring oswal limited by purchasing 70 percent equity for 200 million in cash and the fair value the asset wherever the NCI non controlling interest is 120 million net aggregate value of the identical assets minus liabilities 80 million so applying both the measure of NCI both as well as fair value as well as the NCI proportionate value both the methods of we have looked at earlier avenue we will find out the good will.

Goodwill be 2 different figures here depending on the method so as per fair value measure of NCI fair value of the NCI 120 million so identifiable net assets are getting 80 that is accounting debit because asset is coming asset is increasing so it is debit then they are paying 200 million cash so cash is going down cash is decreasing so cash credit also non controlling interest like is like a liability of this business to the minority shareholders is like that so 120, million is fair value 320 so they are getting 18 net.

That means 240 extra they are paying means is 240 is taken as goodwill there is no way calculus so when you are looking at fair value measure of NCI that is a goodwill amount. Suppose that is what we have calculated here also.

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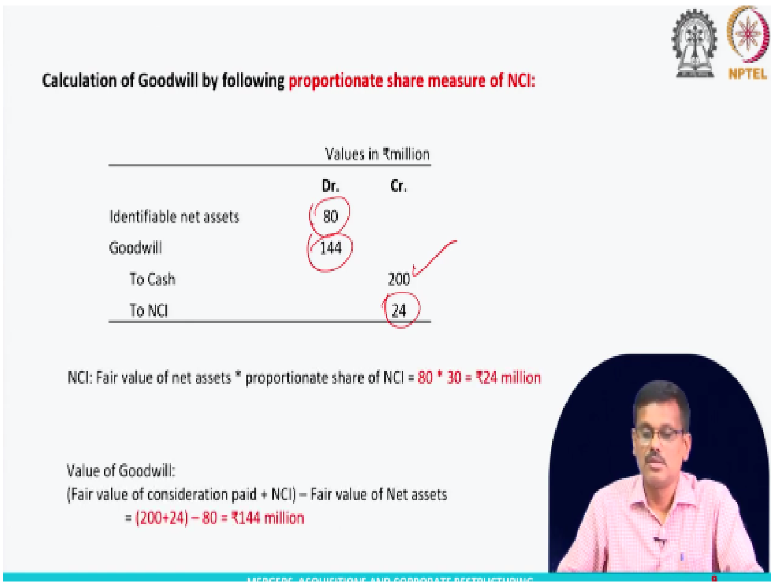

Now suppose it is second proportion let us say proper set share means we got 80 million here proportional share is, 30 percent because 70 percent acquisition mean 30 non-controlling interest so 30% of 80 comes to 24 200 as usual that a cash so 200 plus 24 and 80 is in identified net assets and good will difference is 144. So 2 methods lead to 2 different goodwill calculation. So this is the way the goodwill is calculated.

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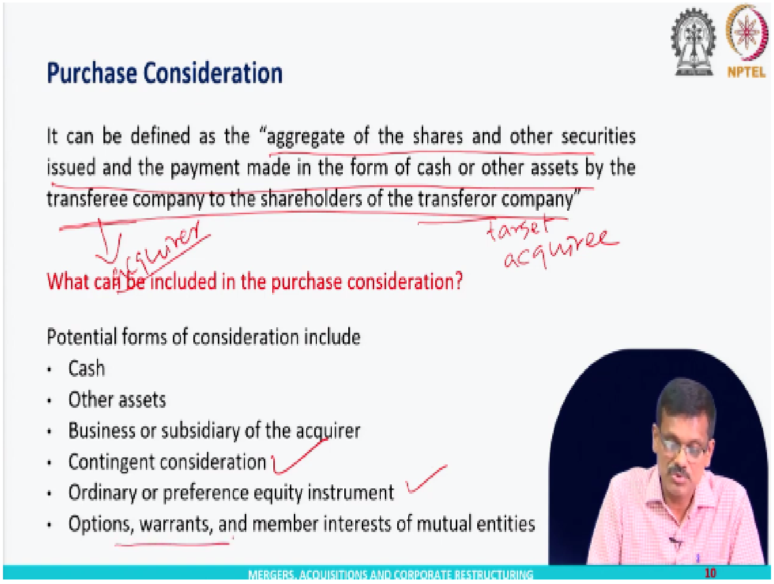

Then we will have another example of calculating the purchase consideration, how to calculate the purchase how much money is paid for the acquisition for that matter so it is defined as the aggregate of the shares and other securities issued and any payment made in the form of cash or other asset whatever has been paid to the targets or acquiree target is a generic term but actually the right accounting term acquiree company shareholders all together will be taken as acquiree or the transferring company for that matter.

By the transferring company that is a transferee means the company which is acquiring transfer means which transferring those things that is that the target or acquiree so trans we call the simplification we can say transfer can be like a target in the general commented sense or it is token as acquiree as per our accounting terms, transferee is acquirer and also acquirer for that matter so whatever has been paid by the acquirer or the transferee component to the transfer of acquiree that will be taken as purchase consideration.

So what can be paid it can be paid in the cash it can be paid in terms of assets it can be maybe a business is also subsidiary the acquirer is also given to them some contingent consideration also can be, that means you they pay something now and they pay something more in future something happening some good thing take place they will like we have discussed in deal structure or not and quantity than value rights so depending on the future performance some extra amount may be given.

So that is equal contingent consideration it can be in ordinary or preference equity instrument it can be in terms options or ends and any member interest in mutual entities all those things together can be in the form of consideration whatever is paid totally will be taken as purchase consideration.

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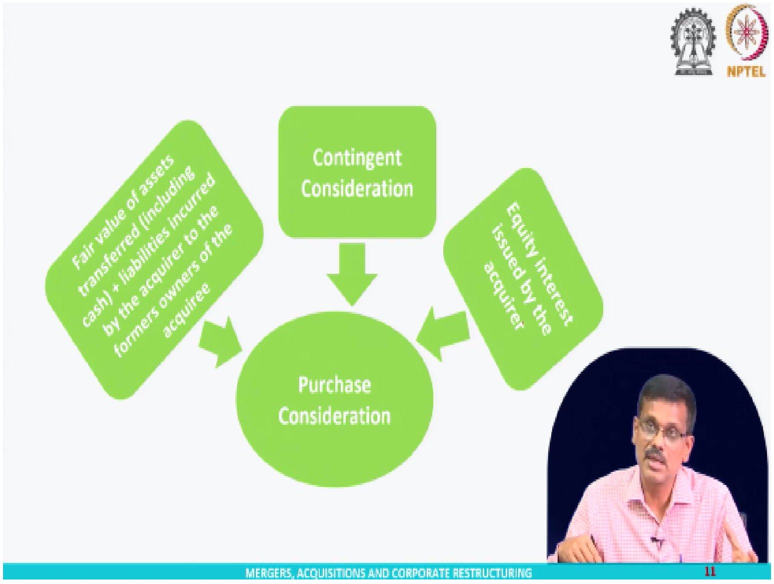

So as you know fair value of assets transfer plus liabilities incurred by the acquirer of the former ownership acquiree contingent consideration and equity interest issued by the acquirer whatever they have, been paid to them plus contingent condition plus equity interest anything is extra suppose it is share and cash both are given cash and schedule structure so cash value and the share value whatever is given all together will be taken as purchase consideration.

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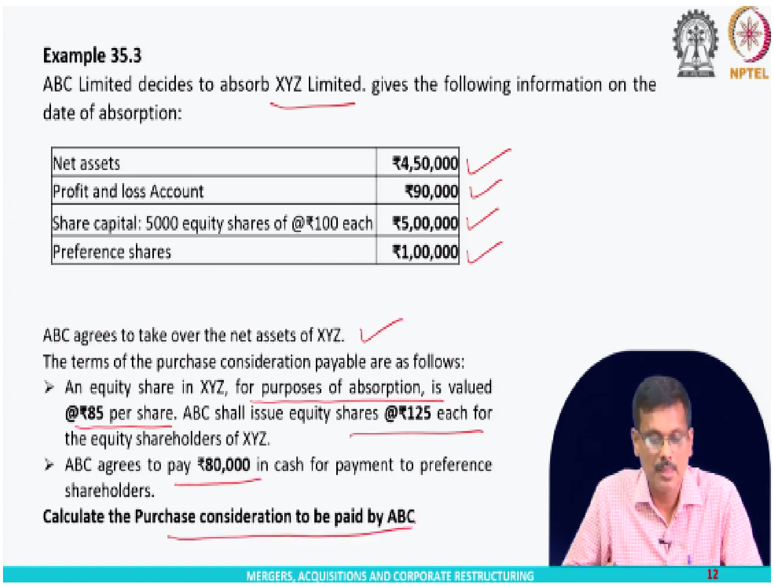

So for example we have net asset the company which is acquiring are being acquired is 45000 they have pl account balance written earnings 90000 and share capital they have 500000 and preferences they have 100000 these are the limited information about the balance sheet of X Y Z limited and ABC is absorbing XYZ ABC exists take over the net address of XYZ and they are going to pay for purposes of absorption the 85 per share and 85 is the valuation they are giving for each share of the target.

Whereas they are going to give ABC companies here which will valid at 125 rupees and ABC also will be giving another 80000 rupees in the form of preference shareholders to this uniform of cash the preference shareholders so what will be the purchase consideration here.

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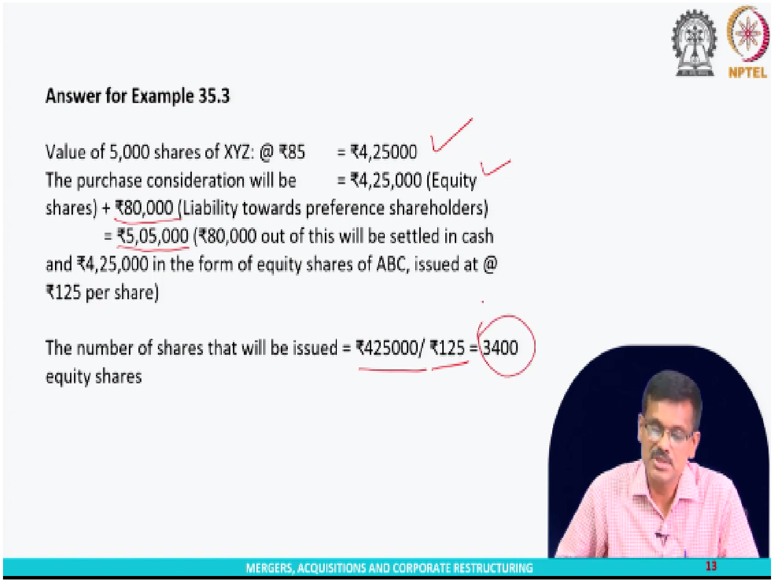

So we have 5000 shares at 85 rupees 425000 so purchase concerns will be now 425000 equity plus 80000 is the liability words the preference error so total comes to 550000 and this 425000 rupees is paid to at 85 but they are going to be issued shares of ABC at 125 so they will be getting 3400 shares in ABC XYZ cells will get 3400 shares in ABC. So that is the answer.

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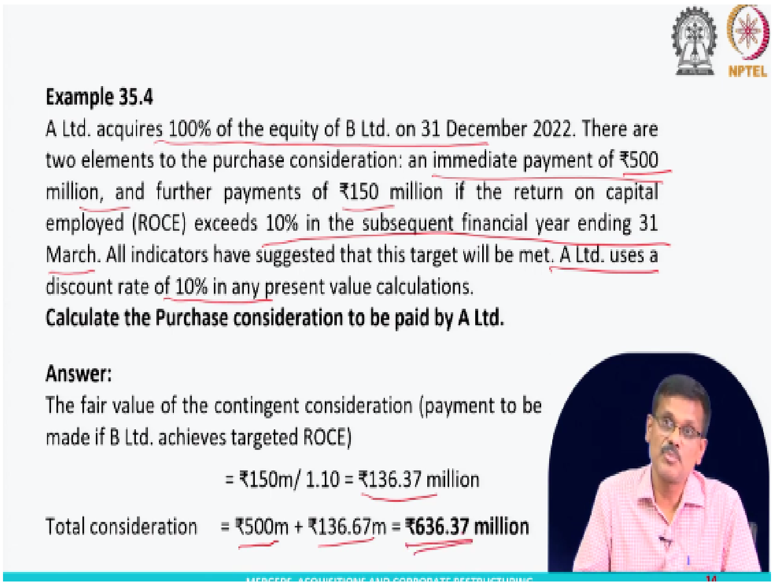

And then that is to calculate the total purchase consideration another example you have A limited acquires 100 percent equity B limit and 31 December 2022 there are 2 elements to the purchase consideration immediate payment of 500 million and further 150 million in the return on capital employed if the return on capital employed in the future exceeds 10 percent in the subsequent final year that is the in the 31st march all indicators have suggested that this target will be this target of 10 percent extra.

10 percent ROCE is going to mate say limited will be giving 150 million for that and they because that is going to paid in the future so they are going to discount at a discounting factors what the purchase consideration. So first of all they are paying 500 million and they are likely to pay 150 million which is, discounted 10% that comes 136. 37 so 500 million plus 136 come to 636.37 percent this is an example where you are making some immediate payment as well as some condition payment and the condition payment is calculated using present value.

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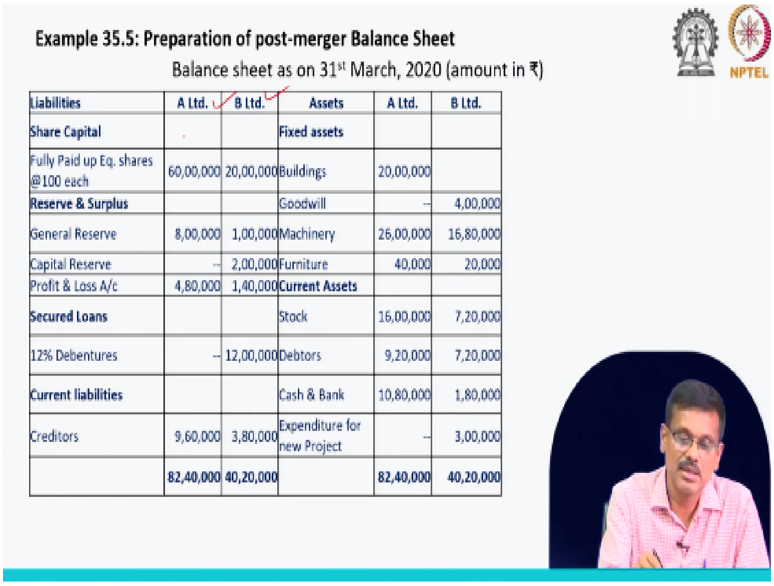

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Share Capital			**Fixed assets**		
Fully Paid up Eq. shares @100 each	60,00,000	20,00,000	Buildings	20,00,000	
Reserve & Surplus			Goodwill	--	4,00,000
General Reserve	8,00,000	1,00,000	Machinery	26,00,000	16,80,000
Capital Reserve	--	2,00,000	Furniture	40,000	20,000
Profit & Loss A/c	4,80,000	1,40,000	**Current Assets**		
Secured Loans			Stock	16,00,000	7,20,000
12% Debentures	--	12,00,000	Debtors	9,20,000	7,20,000
Current liabilities			Cash & Bank	10,80,000	1,80,000
Creditors	9,60,000	3,80,000	Expenditure for new Project	--	3,00,000
	82,40,000	**40,20,000**		**82,40,000**	**40,20,000**

Then we have take one other example which talks about what happens post merger balance sheet when the company is acquired, what happens another a comprehensive example here so we have one company here 2 companies A limited and B limited they have assets and liabilities so these are A limited assets these are B limited assets these are A limited liabilities and equity and these are B limited liabilities and equity.

Now what are what is going to happen what they are going to make the payment what will happen to, assets and liabilities so those are given the subsequent slide.

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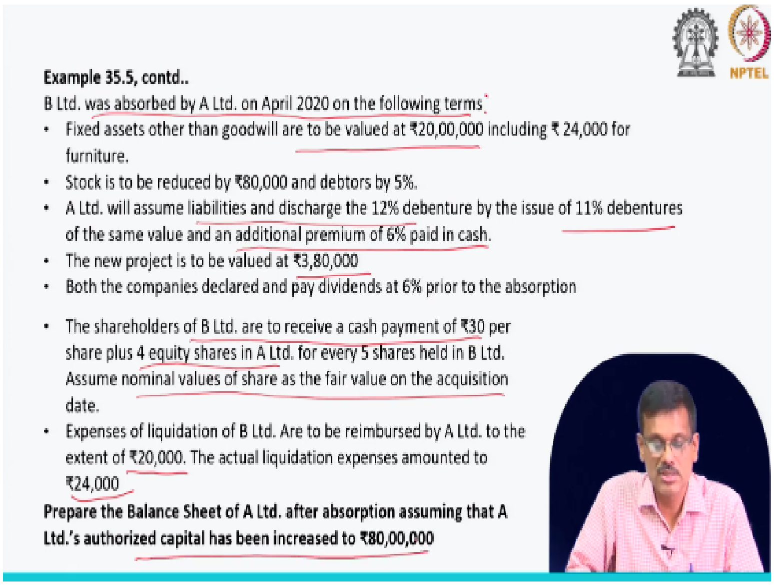

These are the details B limited will be observed is observed on April 2000 on a particular day in April 2020 on the following terms in April fixed assets other than good will be valid at 20 lakh including 24000 for furniture all the fixed as well 20 lakh including to accept the good deal will be that means these assets will be valued. Then so and stock will be reduced by 80000 because the revaluation fair valuation will be there 80000 stock whatever stock is there it is that will be reduced by 80000 stock.

Then data should reduce by 5 percent because possible they do not expect 5 percent to be collected so 5% datas will be reduced A limit will also assume liabilities and discharge to existing 12 percent debentures of B limited they will be now given in terms of 11 percent that means the lenders where debenture holders were getting 12 percent interest debencer they will be issued new debencers in A limited that will carry 11 percent coupon or 11 percent interest at the same value, value will be same and additional they will be paying 6 percent premium in cash to them.

And the new project which is there with the B limited is valued at 380000 and both the companies have declared they are also going to pay 6 percent dividend before the absorption they will be paying 6 percent dividend with respective shareholders and share loss of B limited will be received they will receive they will receive cash payment of 30 rupees per share plus they will also get 4 equity shares in a limited for every 5 shares.

That means somebody has 500 share here she is good they are going to get 400 shares in A limited and nominal values assumed for the fair value on the acquisition rate and expenses liquidation there will be liquidation expenses on the base being liquidated and getting observed with A there will be some expenses and 20000 rupees will be taken care by A limited will pay to B limited whereas actual expense is going to 24000 as far as B is concerned.

So we have to prepare now balancer is limited after absorbing the company and then we would assume that the authorized capital is going to be 80 lakh rupees.

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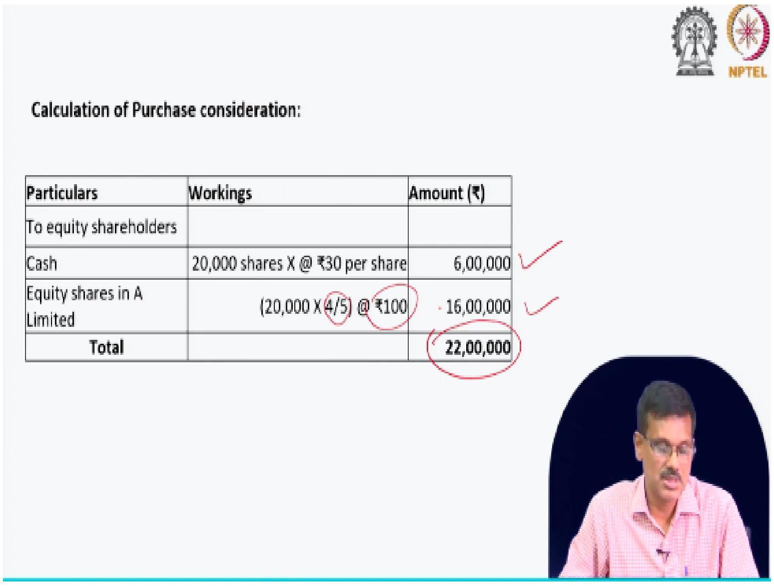

Calculation of Purchase consideration:

Particulars	Workings	Amount (₹)
To equity shareholders		
Cash	20,000 shares X @ ₹30 per share	6,00,000
Equity shares in A Limited	(20,000 X 4/5) @ ₹100	16,00,000
Total		**22,00,000**

So firstly you have to calculate purchase consideration what they are paying they are paying equity shareholders 30 rupees per share that is 6 lakh rupees and 100 rupees nominal value that they give new share twenty thousand shares are there for every 5 they are giving 4 share so 20000 to 4 / 5 comes to 16000 shares which is valued at 100 rupees so 16 lakh rupees 16 lakh plus 6 lakh is 22 lakh is the purchase consideration.

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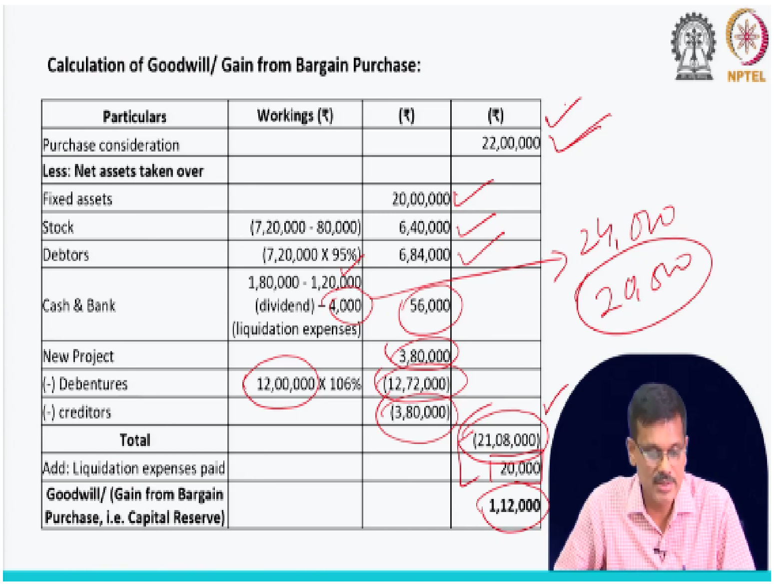

Calculation of Goodwill/ Gain from Bargain Purchase:

Particulars	Workings (₹)	(₹)	(₹)
Purchase consideration			22,00,000
Less: Net assets taken over			
Fixed assets		20,00,000	
Stock	(7,20,000 - 80,000)	6,40,000	
Debtors	(7,20,000 X 95%)	6,84,000	
Cash & Bank	1,80,000 - 1,20,000 (dividend) - 4,000 (liquidation expenses)	56,000	
New Project		3,80,000	
(-) Debentures	12,00,000 X 106%	(12,72,000)	
(-) creditors		(3,80,000)	
Total			(21,08,000)
Add: Liquidation expenses paid			20,000
Goodwill/ (Gain from Bargain Purchase, i.e. Capital Reserve)			1,12,000

Then any good dealer bargain purchase is there let us find it out so what happens the purchase consists 22 lakh, and what they are taking over 20 lakh fixed assets stock 80000 less 720000 they had 720000 - 80000 comes to 640000 debtors they had 720000 but they have said 5% reduction will be then the total value that comes 684000 cash and bank they are having 180000 - 120000 they have to because they have to pay that 6% dividend to the existing shareholders that is gone.

So unlike 80 was there dividend 120000 also this 4000 is nothing but 24000 is got liquidation expenses so 20000 is going to be born by the acquiring company so that 4000 has to born by the target company or the acquiree company. So that case so finally the 56000 cash is there with the acquiree or the B for that matter and new project is valuable 380000 and they have to also 12 lakh rupees will be given to a debentures at 6% premium they have to give where they have to issue that.

They have to give cash and also issue those extra debentures 11% debentures. So that comes to like 72000 they also assume 380000 creators that is there in the balance sheet. So all together if you find it out so what net assets is 2108000 and they are paying how much 22 lakh in purchase conversation so 20000 will be taken said 2108000 and they also have to pay 20000 additional liquidation expenses 20 out of 24 so all together if you look at this minus this plus this that gives so 112000 rupees is the goodwill.

If these 2 figures by chance were more than this particular figure that would have taken as gain from bargain purchase which is also known as capital result. So that we got the 112000 is the goodwill in this case.

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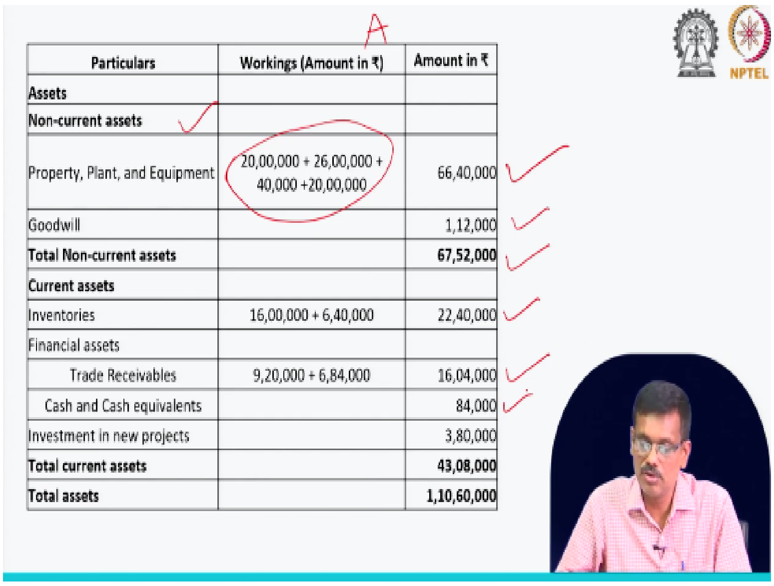

Particulars	Workings (Amount in ₹)	Amount in ₹
Assets		
Non-current assets		
Property, Plant, and Equipment	20,00,000 + 26,00,000 + 40,000 +20,00,000	66,40,000
Goodwill		1,12,000
Total Non-current assets		**67,52,000**
Current assets		
Inventories	16,00,000 + 6,40,000	22,40,000
Financial assets		
Trade Receivables	9,20,000 + 6,84,000	16,04,000
Cash and Cash equivalents		84,000
Investment in new projects		3,80,000
Total current assets		**43,08,000**
Total assets		**1,10,60,000**

The next is that, we have the particulars now of the company A they have what they how they balance is A by alliance balance in non current assets property planned equipment whatever they had existing A as assets plus B together all this added so that comes 6640000 good will be calculated here that is 112000 so total non current assets comes to 6752000 inventory 16 lakh was there with this company A and 6 lakh what is acquired from company B.

So that comes to 2240000 trade receivables they are 920000 they acquires they took 684000 that comes to 1604000 then cash and cash equivalents combined together both the acquiring acquirer company in acquiree company together 84000 investment new projects 380000 so total current assets 4308000 and this one together comes to 11060000 this is total assets we have to we will see that how this 84 terms also calculated we can see in the subsequent slide.

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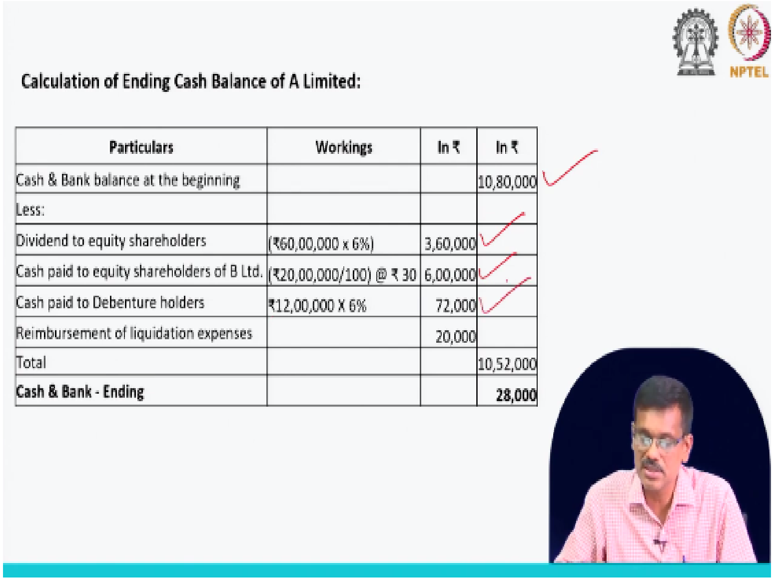

Calculation of Ending Cash Balance of A Limited:

Particulars	Workings	In ₹	In ₹
Cash & Bank balance at the beginning			10,80,000
Less:			
Dividend to equity shareholders	(₹60,00,000 x 6%)	3,60,000	
Cash paid to equity shareholders of B Ltd.	(₹20,00,000/100) @ ₹ 30	6,00,000	
Cash paid to Debenture holders	₹12,00,000 X 6%	72,000	
Reimbursement of liquidation expenses		20,000	
Total			10,52,000
Cash & Bank - Ending			**28,000**

So they had 1080000 cash with them they pay dividend to their shareholder 6 percent 360000 they paid equity shareholders 30 rupees per share to the B limited shareholders 6 lakh they also paid debenture order something extra 6% extra they paid in terms of cash 72000 they also reimburse 20000 rupees as liquidation expenses so total they have got 1052000 and cash and bank ending of a is 28000 plus B together that gives us 84000 together.

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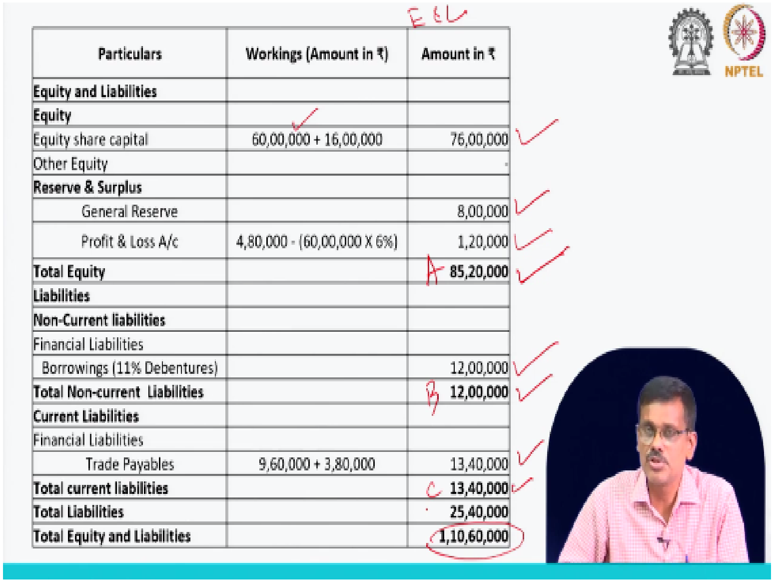

Particulars	Workings (Amount in ₹)	Amount in ₹
Equity and Liabilities		
Equity		
Equity share capital	60,00,000 + 16,00,000	76,00,000
Other Equity		-
Reserve & Surplus		
General Reserve		8,00,000
Profit & Loss A/c	4,80,000 - (60,00,000 X 6%)	1,20,000
Total Equity		A 85,20,000
Liabilities		
Non-Current liabilities		
Financial Liabilities		
Borrowings (11% Debentures)		12,00,000
Total Non-current Liabilities		B 12,00,000
Current Liabilities		
Financial Liabilities		
Trade Payables	9,60,000 + 3,80,000	13,40,000
Total current liabilities		C 13,40,000
Total Liabilities		25,40,000
Total Equity and Liabilities		1,10,60,000

So now we have the liability side of the company A liability side equity and liability of company A post absorption or post merger further matter equity share capital authorization we have not mentioned here but actual circuit they should subscribe paid of capital 60 lakh plus 16 is stored 7600000 76 lakh rupees they are the generalizer 8 lakh and there is/has a professionals account they had, four lakh 80000 and they have paid 6 percent from their extra so that comes to 120000 and total equity comes to 8525000.

And the liabilities they did not have the liabilities now the new liability is there which is issued to the company B these craters the debtors adventure holders that is 12 lakh rupees so non current 12 lakh rupees equity to 8520000 rupees they have trade payable together company A and B together and they have 3040000 so total current level 1340000 so these equity non current liability and the current liabilities that together comes to unlock one 11060000 which was also same figure in the previous when the total assets.

So total assets is matchingly total liabilities plus equity so, this is the way a consolidation takes place this is a just a simple example with limited transactions it is not because accounting for mergers and acquisition involve lot of things only for the understanding purposes for the sensitizen yes there is a accounting procedure certain important aspects are the certain important concepts are there which one has to be actually aware of how it is done, although you have not gone a detailed accounting procedures for margin acquisition.

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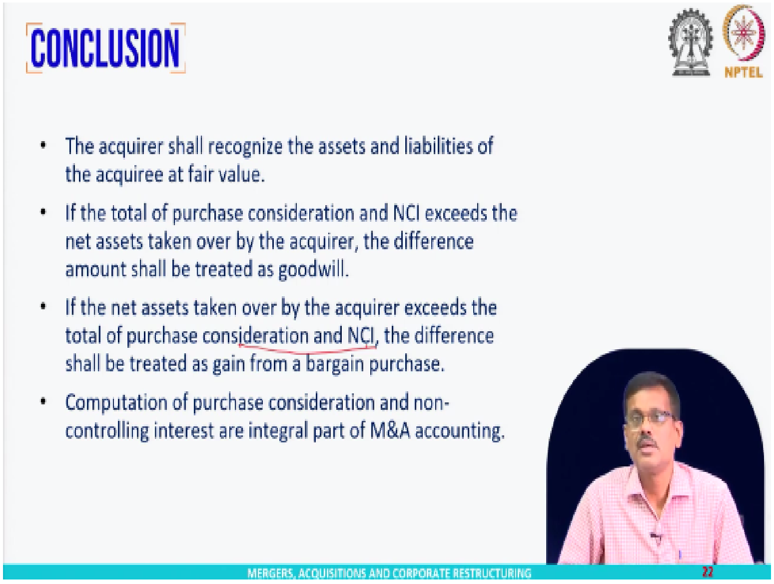

So in the conclusion the acquirer recognize the assassin liabilities of the acquiree at fair value if the total purchase concession plus NCI non controlling interest exceeds the net assets taken over net assessment assets less liabilities was taken over by the acquirer the difference will be will taken as goodwill even other around that net asset taken over by the acquirer exceeds the total purchase consideration that means you are taking more and giving less NCI together that difference is known as gain from bargain purchase.

Which was directly known as capitalizer eraser; now, gain from bargain purchase as you mentioned will be shown as other comprehensive income in the income statement as a financial statement and then that will be subsequently shown as capital reserve as a part of equity computation of purchase consideration and non-controlling interest are integral part of merger location accounting so with this we concluded the legal aspects of marginal acquisition we had 3 sessions on legal aspects like computation commission corporate law.

And semi takeover code and we had 2 sessions on accounting aspects of merger acquisition although it is known as vector weak is known as legal aspects but it is legal as well as accounting as per some other acquisition at the same time margin acquisition legal aspects accounting aspects can be very detailed we have discussed 2 certain major components and major parts of them we have not discussed entire thing a M and A laws and regulation for that, matter thank you and happy learning.