SUGGESTED SOLUTION

CA FINAL NOV'19

SUBJECT- F.R.

Test Code – FNJ 7232

BRANCH - () (Date :)

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ANSWER-1

Paragraph 37 of Ind AS 103, inter alia, provides that the consideration transferred in a business combination should be measured at fair value, which should be calculated as the sum of (a) the acquisition-date fair values of the assets transferred by the acquirer, (b) the liabilities incurred by the acquirer to former owners of the acquiree and (c) the equity interests issued by the acquirer.

Further, paragraph 39 of Ind AS 103 provides that the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

With respect to contingent consideration, obligations of an acquirer under contingent consideration arrangements are classified as equity or a liability in accordance with Ind AS 32 or other applicable Ind AS, i.e., for the rare case of non-financial contingent consideration. Paragraph 40 provides that the acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, Financial Instruments: Presentation. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration.

(i) In the given case the amount of purchase consideration to be recognized **<u>on initial recognition</u>** shall be as follows:

Fair value of shares issued (10,00,000 x Rs.20)	Rs.2,00,00,000
Fair value of contingent consideration	<u>Rs.25,00,000</u>
Total purchase consideration	Rs.2,25,00,000

<u>Subsequent measurement of contingent consideration payable for business combination</u>

In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

(a) There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavorable conditions (for the issuer of the instrument).

(b) If the instrument will or may be settled in the issuer's own equity instruments, then it is:

  (i) a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or

  (ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed num ber of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

(6 MARKS)

As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.

Here, the obligation to pay contingent consideration amounting to Rs.25,00,000 is recognized as a part of equity and therefore not re-measured subsequently or on issuance of shares.

(ii) The amount of purchase consideration to be recognized **on initial recognition** is shall be as follows:

Fair value shares issued (10,00,000 x Rs.20)	Rs.2,00,00,000
Fair value of contingent consideration	Rs.25,00,000
Total purchase consideration	Rs.2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

The contingent consideration will be classified as liability as per Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration not classified as equity should be measured at fair value at each reporting date and changes in fair value should be recognized in profit or loss.

As at 31 March 2017, (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of Rs.15,00,000 (Rs.40,00,000 - Rs.25,00,000) should be recognized in the profit or loss for the period. A Ltd. would recognize issuance of 160,000 (Rs.40,00,000/25) shares at a premium of Rs.15 per share.

(4 MARKS)

ANSWER-2

Before the merger, Cloudustries and MicroFly are the subsidiary of Smart Technologies Inc. As the control is not transitory, the proposed merger will fall under the category of Business combination of entities under common control, it will be accounted as per Appendix C of Ind AS 103 “Business Combination” and Pooling of Interest Method would be applied.

Statement showing the calculation of assets/liabilities taken over and treatment of difference between consideration and assets/liabilities taken over:

(a) Net asset taken over: **(Rs. in crore)**

Assets taken over:	
Property, Plant and Equipment	15.00
Cash and cash equivalents	10.00

Other current assets	8.00
Trade Receivables	10.00
Total - A	**43.00**
Less: Liabilities taken over:	
Borrowings	2.80
Current Liabilities	20.00
Total - B	**22.80**
Net Asset taken over (A-B)	**20.20**

(5 MARKS)

(b) Treatment of difference between consideration and assets/liabilities taken over: **(Rs. in crore)**

Net Asset taken over - A	20.20
Less: Purchase Consideration - B	18.00
Difference (A – B)	**1.80**

The difference between consideration and assets/liabilities taken over of Rs. 1.80 crore shall be transferred to capital reserve.

(3 MARKS)

ANSWER-3

Consolidated Balance Sheet of Professional Ltd as on 1st April, 20X2 **(Rs. in Lakhs)**

	Amount
Assets	
Non-Current Assets:	
Property, plant and equipment	650
Investment	500
Current assets:	
Inventories	400
Financial assets:	
Trade receivables	750
Cash and cash equivalents	300
Others	630
Total	3,230

Equity and Liabilities	
Equity	
Share capital- Equity shares of Rs. 100 each	**514**
Other Equity	**1128.62**
NCI	**154.95**
Non-Current liabilities:	
Long term borrowings	**450**
Long term provisions (50+70+28.93)	**148.93**
Deferred tax	**28.5**
Current Liabilities:	
Short term borrowings	**250**
Trade payables	**550**
Provision for Law suit Damages	**5**
Total	**3230**

Notes:

a. Fair value adjustment- As per Ind AS 103, the acquirer is required to record the assets and liabilities at their respective fair value. Accordingly, the PPE will be recorded at Rs. 350 lakhs.

b. The value of replacement award is allocated between consideration transferred and post combination expense. The portion attributable to purchase consideration is determined based on the fair value of the replacement award for the service rendered till the date of the acquisition. Accordingly, 2.5 (5 x 2/4) is considered as a part of purchase consideration and is credited to Professional Ltd equity as this will be settled in its own equity. The balance of 2.5 will be recorded as employee expense in the books of Dynamic Ltd over the remaining life , which is 1 year in this scenario.

c. There is a difference between contingent consideration and deferred consideration. In the given case 35 is the minimum payment to be paid after 2 years and accordingly will be considered as deferred consideration. The other element is if company meet certain target then they will get 25% of that or 35 whichever is higher. In the given case since the minimum what is expected to be paid the fair value of the contingent consideration has been considered as zero. The impact of time value on deferred consideration has been given @ 10%.

d. The additional consideration of Rs. 20 lakhs to be paid to the founder shareholder is contingent to him/her continuing in employment and hence this will be considered as employee compensation and will be recorded as post combination expenses in the income statement of Dynamic Ltd.

Working for Purchase consideration ***Rs. in lakhs***

Particulars		**Amount**
Share capital of Dynamic Ltd		400

Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value per share		40
PC (2,00,000 x 70% x Rs. 40 per share) (A)		56.00
Deferred consideration after discounting Rs. 35 lakhs for 2 years @ 10% (B)		28.93
Replacement award Market based measure of the acquiree award (5) x ratio of the portion of the vesting period completed (2) / greater of the total vesting period (3) or the original vesting period (4) of the acquiree award ie (5 x 2 / 4) (C)		2.50
PC in lakhs (A+B+C)		87.43

(10 MARKS)

Purchase price allocation workings

Particulars	**Book value (A)**	**Fair value (B)**	**FV adjustment (A-B)**
Property, plant and equipment	500	350	(150)
Investment	100	100	-
Inventories	150	150	-
Financial assets:			-
Trade receivables	300	300	-
Cash and cash equivalents	100	100	-
Others	230	230	
Less: Long term borrowings	(200)	(200)	-
Long term provisions	(70)	(70)	-
Deferred tax	(35)	(35)	-
Short term borrowings	(150)	(150)	-

Trade payables	(300)	(300)	-
Contingent liability	-	(5)	(5)
Net assets (X)	625	470	(155)
Deferred tax Asset on FV adjustment (155 x 30%) (Y)		46.50	155
Net assets (X+Y)		516.5	
Non-controlling interest (516.50 x 30%) rounded off		154.95	
Capital Reserve (Net assets – NCI – PC)		274.12	
Purchase consideration (PC)		87.43	

Consolidation workings

	Professional Ltd	*Dynamic Ltd (pre-acquisition)*	*PPA Alloca-tion*	*Total*
Assets				
Non-Current Assets:				
Property, plant and equipment	300	500	(150)	650
Investment	400	100		500
Current assets:				
Inventories	250	150		400
Financial assets:				
Trade receivables	450	300		750
Cash and cash equivalents	200	100		300
Others	400	230		630
Total	2,000	1,380	(150)	3230
Equity and Liabilities				
Equity				

Share capital- Equity shares of Rs. 100 each	500			
Shares allotted to Dynamic Ltd. (2,00,000 x 70% x Rs. 10 per share)			14	514
Other Equity	810		318.62	1128.62
Non-controlling interest	0		154.95	154.95
Non-Current liabilities:				
Long term borrowings	250	200		450
Long term provisions	50	70	28.93	148.93
Deferred tax	40	35	(46.5)	28.5
Current Liabilities:				
Short term borrowings	100	150		250
Trade payable	250	300	0	550
Liability for lawsuit damages			5	5
Total	2,000	755	475	3230
Other Equity				
Other Equity	810			810
Replacement award			2.5	2.5
Security Premium Reserve (2,00,000 shares x 70% x Rs. 30)			42	42
Capital Reserve			274.12	274.12
	810		318.62	1128.62

(10 MARKS)

ANSWER-4

Journal of Enterprise Ltd.

(Rs. in crores)

			Dr.	*Cr.*
(1)	Loan Funds	Dr.	300	
	Current Liabilities	Dr.	400	
	Provision for Depreciation	Dr.	400	
	To Property, Plant and Equipment			500
	To Current Assets			500
	To Capital Reserve			100
	(Being division Mobiles along with its assets and liabilities sold to Turnaround Ltd. for Rs. 25 crores)			

Notes :

(1) Any other alternative set of entries, with the same net effect on various accounts, may be given by the students.

(2) In the given scenario, this demerger will meet the definition of common control transaction. Accordingly, the transfer of assets and liabilities will be derecognized and recognized as per book value and the resultant loss or gain will be recorded as capital reserve in the books of demerged entity (Enterprise Ltd).

Enterprise Ltd.

Balance Sheet after reconstruction ***(Rs. in crores)***

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		25
Current assets		
Other current assets		200
		225
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of Rs. 10 each)		25
Other equity (Surplus)		175
Liabilities		
Current liabilities		

Current liabilities		25
		225

(4 MARKS)

Notes to Accounts

		(Rs. in crores)
1.	**Other Equity**	
	Surplus (175-100)	75
	Add: Capital Reserve on reconstruction	100
		175

Notes to Accounts: Consequent on transfer of Division Mobiles to newly incorporated company Turnaround Ltd., the members of the company have been allotted 1 crore equity shares of Rs. 10 each at a premium of Rs. 15 per share of Turnaround Ltd., in full settlement of the consideration in proportion to their shareholding in the company.

Balance Sheet of Turnaround Ltd.

(Rs. in crores)

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		100
Current assets		
Other current assets		500
		600
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of Rs. 10 each)	1	10
Other equity	2	(110)
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		300
Current liabilities		
Current liabilities		400
		600

Notes to Accounts

		(` in crores)
1.	**Share Capital:**	
	Issued and Paid-up capital	
	1 crore Equity shares of ` 10 each fully paid up	10
	(All the above shares have been issued for consideration other than cash, to the members of Enterprise Ltd. on takeover of Division Mobiles from Enterprise Ltd.)	
2.	**Other Equity:**	
	Securities Premium	15
	Capital reserve [25- (600 – 700)]	(125)
		(110)

Working Note:

In the given case, since both the entities are under common control, this will be accounted as follows:

1. All assets and liabilities will be recorded at book value
2. Identity of reserves to be maintained.
3. No goodwill will be recorded.
4. Securities issued will be recorded as per the nominal value.

(8 MARKS)