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FINAL MAY 2019 EXAM

SUBJECT- FR

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BRANCH - () (Date :)

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Answer 1:

Breakdown of assets and liabilities acquired as part of the business combination, including deferred taxes and goodwill.

Item	Rs. In lakhs				
	Book value	**Fair value**	**Tax base**	**Taxable (deductible) temporary difference**	**Deferred tax asset (liability) @ 30%**
Cash	780	780[1)]	780[1)]	-	-
Receivables	5,200	5,200[1)]	5,500[3)]	(300)	90
Plant and equipment	7,000	8,000[2)]	6,000[4)]	2,000	(600)
Brands		4,300[2)]	-[5)]	4,300	(1,290)
Goodwill (Balancing figure)		2,100[9)]			
Deferred tax asset	360	3,60[7)]			
Total assets		**20,740**			
Payables	(1,050)	(1,050)[1)]	(1,050)[1)]		
Borrowings	(4,900)	(4,900)[1)]	(4,900)[1)]		
Employee Entitlement liabilities	(900)	(900)[1)]	-[6)]	(900)	270
Deferred tax liability	(300)	(1,890)[8)]			
Total liabilities		**(8,740)**			
Consideration paid		**12,000**			

(4 marks)

Notes

(1) This amount has been derived from Dorman Ltd.'s Balance Sheet as it is stated that 'unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts in Dorman Ltd.'s Balance Sheet at the acquisition date'.

(2) Stated fair value in the fact pattern (different to the carrying amount in Dorman Ltd.'s Balance Sheet at the acquisition date).

(3) Because bad debts are only deductible when written off against the allowance account by Dorman Ltd. the tax base of the receivables is their gross value, i.e., (Rs. 5,200 + Rs. 300) lakhs allowance account.

(4) Tax written down value of the plant and equipment as stated in the fact pattern.

(5) As the brand name does not have a cost for tax purposes and no tax deduction is available in relation to it, its tax base is nil.

(6) As the employee entitlement liabilities are only deductible for tax purposes when paid, their tax base is nil.

(7) The aggregate deferred tax asset is Rs. 360 lakhs, comprised of Rs.90 lakhs in relation to the receivables and Rs.270 lakhs in relation to the employee entitlement liabilities.

(8) The aggregate deferred tax liability is Rs. 1,890 lakhs calculated as follows:

Rs. In lakhs	DTL amount in Dorman Ltd.'s Balance Sheet	Deferred tax impact of fair value adjustments	Total DTL in Pharma Ltd's consolidated financial statements
Plant and equipment	300 ([7,000-6,000] × 30%)	300 ([1,000 × 30%)	600
Brand names	0	1,290 (4,300 × 30%)	1,290
TOTAL	300	1,590	1,890

(4 marks)

(9) Goodwill is effectively the 'balancing item' in the equation, applying the requirements of Ind AS 103, para 32. The consideration transferred is Rs. 12,000 lakhs and the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103, including the deferred tax assets and liabilities arising, is Rs. 9,900 lakhs. **(2 marks)**

Answer 2:

When 100% shares sold to independent party

Consolidated Balance Sheet of Preet Pvt. Ltd. and its remaining subsidiaries as on 31st March, 2018

Particulars	Note No.	(Rs. in million)
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	1,900
(ii) Goodwill	2	200
(2) Current Assets		
(i) Inventories	3	100
(ii) Financial Assets		
(a) Trade Receivables	4	800
(b) Cash & Cash equivalents	5	5,100
Total Assets		**8,100**
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	6	1,600
(ii) Other Equity	7	4,700
(2) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	8	1,800
Total Equity & Liabilities		**8,100**

(5 marks)

Notes to Financial Statements:

			(Rs. in million)
1.	**Property Plant & Equipment**		
	Land & Building		
	Group	3,240	
	Less: Stuti Pvt. Ltd.	(1,340)	1,900
2.	Intangible Assets		

	Goodwill		
	Group	380	
	Less: Stuti Pvt. Ltd.	(180)	200
3.	**Inventories**		
	Group	140	
	Less: Stuti Pvt. Ltd.	(40)	100
4.	**Trade Receivables**		
	Group	1,700	
	Less: Stuti Pvt. Ltd.	(900)	800
5.	**Cash & cash equivalents**		
	Group (WN 2)	5,100	5,100
8.	**Trade Payables**		
	Group	2,700	
	Less: Stuti Pvt. Ltd.	900	1,800

(7 marks)

Statement of Changes in Equity:

6. Equity Share Capital

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
1600	0	1600

7. Other Equity

	Share application money	Equity component	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Securities Premium	
Balance at the beginning				4,260		4,260
Total comprehensive income for the year			0			
Dividend			0			
Total comprehensive income attributable to the parent			0			
Gain on disposal of Stuti Pvt. Ltd.				440		440
Balance at the end of the reporting period			0	4,700		4,700

(1 mark)

Working Notes:

1. When sold, the carrying amount of all assets and liabilities attributable to Stuti Pvt. Ltd. were eliminated from the consolidated statement of financial position.

2. Cash in hand (in million) **(1 mark)**

Cash before disposal of Stuti Pvt. Ltd. *Less:* Stuti Pvt. Ltd. Cash Add: Cash realized from disposal	3,100 (1,000) 3,000
Cash in hand	5,100

3. Gain / Loss on disposal of entity (in million) **(1 mark)**

Proceeds from disposal *Less:* Net assets of Stuti Pvt. Ltd.	3,000 (2,560)
Gain on disposal	440

4. Retained Earnings (in million) **(1 mark)**

Retained earnings before disposal *Add:* Gain on disposal	4,260 440
Retained earnings after disposal	4,700

Answer 3:

Identifying the acquirer **(2 marks)**

As a result of Entity A issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e., 150 of the 250 total issued shares). The remaining 40 per cent are owned by Entity A's shareholders. Thus, the transaction is determined to be a reverse acquisition in which Entity B is identified as the accounting acquirer while Entity A is the legal acquirer.

Calculating the fair value of the consideration transferred **(2 marks)**

If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B — 60 per cent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is 1,600 (40 shares with a fair value per share of 40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. Here, the quoted market price of Entity A's shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares — 100 shares with a fair value per share of 16.

Measuring goodwill **(2 marks)**

Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and		

liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated statement of financial position at September 30, 20X1 **(6 marks)**

The consolidated statement of financial position immediately after the business combination is:

Current assets [700 + 500]	1,200
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [600 + 300]	900
Non-current liabilities [1,100 + 400]	1,500
Total liabilities	2,400
Shareholders' equity	
Issued equity 250 ordinary shares [600 + 1,600]	2,200
Retained earnings	1,400
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

The amount recognised as issued equity interests in the consolidated financial statements (2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (600) and the fair value of the consideration effectively transferred (1,600). However, the equity structure appearing in the consolidated financial statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Earnings per share **(2 marks)**

Earnings per share for the annual period ended December 31, 20X1 is calculated as follows:

Number of shares deemed to be outstanding for the period from January 1, 20X1 to the acquisition date (i.e., the number of ordinary shares issued by Entity A (legal parent, accounting acquiree) in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to December 31, 20X1	250
Weighted average number of ordinary shares outstanding [(150 × 9/12) + (250 × 3/12)]	175
Earnings per share [800 / 175]	4.57

Restated earnings per share for the annual period ended December 31, 20X0 is 4.00 [calculated as the earnings of Entity B of 600 divided by the number of ordinary shares Entity A issued in the reverse acquisition (150)].

Answer 4:

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 recognise 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. **(2 marks)**

i) In the given case the amount of purchase consideration to be recognised on initial recognition shall be as follows: **(1 mark)**

Fair value of 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

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:

❖ 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 unfavourable conditions (for the issuer of the instrument).

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

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

  ▪ 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 number of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

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 recognised as a part of equity and therefore not re-measured subsequently or on issuance of shares. **(4 marks)**

ii) The amount of purchase consideration to be recognised 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 recognised 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 recognised in the profit or loss for the period. A Ltd. would recognise issuance of 160,000 (Rs. 40,00,000/ 25) shares at a premium of Rs. 15 per share. **(3 marks)**