CA BUSINESS SCHOOL
POSTGRADUATE DIPLOMA IN BUSINESS FINANCE AND STRATEGY

SEMESTER 1: Financial Statements Analysis

Business Combinations

[Group /Consolidation FS]

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Introduction

Business combinations has become a very popular phenomena since most of the entities find difficulties to carry out business alone due to many reasons especially in a highly competitive business environment.

When one entity **obtain direct control** over another entity or few with the **intention of gaining benefit**, such arrangement will be treated as a "Business Combination". Hence the key feature should be "Direct Control".

Key criteria to be satisfied;

- Obtain direct control
- Intention of gaining benefit
- Control financial and operational activities

Combined entities are expected to enjoy synergy (benefit) as a result of the combination.

Identification of the Acquirer

Based on the provisions available in the particular accounting standard, **the acquirer** will be an entity which obtain control over another entity or few with the intention of gaining benefit.

Key criteria of determining acquirer;

a. Acquisition of more than 50% of ordinary share capital which entail voting rights. (directly or indirectly)

Following events will also be determined the acquirer;

a. Significant control of routine financial and operational policies of a particular entity.

b. Representing the majority members of the board of a particular entity.

c. Representing the minority members (dominant) of the board of a particular entity.

Identification of the Acquirer

It is crucial/pivotal to identify the acquirer in every business combination since **group accounts/consolidation financial statements should prepare and present from the view point of the acquirer** at all times.

Following are some of the other criteria to identify the acquirer;

- An entity which frequently transfer assets including cash to another entity or few.
- An entity which recorded highest market value when calculating respective entities independently.

But these shall not be used much since justification is quite difficult by nature.

Calculation of Cost/Purchase Considerations

Cost/Purchase Consideration of the acquisition will be the fair value of total cost incurred in order to obtain control of another entity or few.

Total purchase consideration shall comprise;

- Cash

Payment made by means of cash.

- Assets

In certain circumstances, assets (NCA) will be part of purchase consideration.

- Liabilities

Non – current liabilities including contingent liabilities will also be part of purchase consideration.

Calculation of Cost/Purchase Considerations

In order to properly determine goodwill/gain from bargain purchase, it is essential to calculate purchase consideration accurately.

Example:

1. ABC limited acquire 70% of ordinary share capital of PQR limited for the value of 260 million LKR. What is LKR 260 Million?
2. Calculate the purchase consideration by using following data.

Payment by cash	- 32.5 LKR Mn.
Transfer of assets	- 40 LKR Mn.
Transfer of Bank Loan	- 4 LKR Mn.

Fair value of the asset and bank loan is LKR 38 and LKR 3.9 million respectively.

Determination of Benefit of Acquisition

It is essential to determine and calculate the benefit of acquisition separately once determined the acquirer and the purchase consideration.

Following to be considered;

a. Determining ownership

It is key to determine and calculate the ownership of acquirer over other entities accurately. (percentage with absolute number of shares)

b. Ascertain the date of acquisition

Benefits of acquisition should be calculated as at the date of the original acquisition on which direct control came into force/effect. Hence, it is key to ascertain such acquisition date properly.

c. Ascertain the net assets of acquire

Net assets of the acquire should be calculated accurately as at the date of acquisition.

NA = (Total Assets –Total Liabilities)

NA = (O/Sc + S/premium + Reserves + P&L) (sometimes P/Sc also)

Determination of Benefit of Acquisition

In addition to satisfy the above requirement, it is also important to ascertain the fulfillment of following requirements in the event of determining/calculating benefit of acquisition;

- **Fair value of the identified net assets** of acquire should be able to measure reliably.
- Future economic benefits **should flow in to the acquirer** as a result of the **acquisition of assets**.
- Future economic benefits **should flow out from the acquirer** as a result of the **acquisition of liabilities**.

Recognition of Goodwill/Gain from a Bargain Purchase

It is compulsory to **recognize goodwill or gain from a bargain purchase as at the date of the acquisition/business combination**.

Goodwill

Goodwill will be recognized when the aggregate of purchase consideration and non-controlling interest calculated as per the SLFRSs in excess of net of the amounts identified as assets/liabilities of the acquire at the acquisition date and calculated as per the SLFRSs.

Gain from a bargain purchase (negative goodwill)

Gain from a bargain purchase will be recognized when net of the amounts identified as assets/liabilities of the acquire at the acquisition date and calculated as per the SLFRSs in excess of the aggregate of purchase consideration and non-controlling interest calculated as per the SLFRSs.

Accounting for Goodwill/Gain from a Bargain Purchase

Based on the recognition criteria discussed in above, goodwill/gain from a bargain purchase should be calculated and accounted for later.

Generally, COC (cost of control) account will be opened in acquirer's books of accounts in order to calculate the goodwill/gain from a bargain purchase traditionally.

Accounting Treatment:
Goodwill should be treated as an intangible assets and as such it should be appeared in the consolidated balance sheet while gain from a bargain purchase should be treated as an income in the period in which it arise and as such should be identified in the consolidated income statement.

Goodwill is subject to adjustment for impairment at least annually.

Accounting for Goodwill/Gain from a Bargain Purchase

Example:

On 31st March 2012, ABC Ltd acquired 80% of the Ordinary Share Capital of PQR Ltd for the total consideration of LKR 6,000,000

1. The transaction cost of LKR 100,000 is also incurred
2. The fair value of the net assets of PQR Ltd as at the date of acquisition is LKR 4,000,000
3. The fair value of Non Controlling Interest is LKR 1,200,000 (rare)

Calculate the goodwill/gain from a bargain purchase.

There are 03 ways including existing method which is no more valid.

Exemptions

It is mandatory to identify the events in which parent company and/or subsidiary company exclude from business combinations.

- In what circumstance parent company should exclude?

- In what circumstance subsidiary company should exclude?

Disclosures

- Date(s) of the business combinations
- Basis of business combination
- Different entities comprised business combination/group and their nature of operational activities
- Goodwill/gain from a bargain purchase
- Any exemptions with the reasons
- Any impairment of goodwill