

Accounting Standard (AS) 14

Accounting for Amalgamations

Bangalore Branch of SIRC of ICAI
Study Circle Meeting - 08 September 2009

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Introduction

AS14 deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves

AS14 does not deal with:

- Acquisition by purchase of shares; or
- Acquisition by purchase of assets;

The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

Definitions

Key terms used in the standard

Amalgamation

Transferor Company

Transferee Company

Reserves

Amalgamation in the nature of merger

Amalgamation in the nature of purchase

Consideration for amalgamation

Fair value

Pooling of interest

Types of amalgamations

Amalgamation fall in two broad categories

Amalgamation in the nature of merger

Conditions for amalgamation in the nature of merger:

- Transfer of all the assets and liabilities of the transferor company;
- At least 90% of equity shareholders of transferor company become equity shareholder of transferee company
- Consideration is discharged wholly by issue of shares (exception – fractional shares)

Amalgamation in the nature of purchase

- The business of the transferor company is intended to be carried on by transferee company
- No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company (exception - uniformity of accounting policies)

Methods of accounting for amalgamations

There are two main methods of accounting of amalgamation

Pooling of interests method

The use of the pooling of interests method is confined for an amalgamation in the nature of merger.

Purchase method

The object of the purchase method is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets. This method is used in accounting for amalgamations in the nature of purchase.

Methods of accounting for amalgamations

Pooling of interests method

- The assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts.
- Apply a uniform set of accounting policies for the transferor and the transferee companies
- Disclose effects of any changes in accounting policies in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

Methods of accounting for amalgamations

Purchase method: Two options to account for amalgamation

Carrying value basis

- Incorporate the assets and liabilities at their existing carrying amounts

Fair value basis

- Allocate the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation

- The identifiable assets and liabilities, may include assets and liabilities not recorded in the financial statements of the transferor company.

Methods of accounting for amalgamations

Purchase method: Fair value basis

Fair value basis

Determination of fair values of assets and liabilities may be influenced by the intentions of the transferee company.

For example,

- specialised use for an asset
- intention to change the activities of the transferor company
- planned employee termination
- plant relocation costs.

Consideration

Consideration may consist of securities, cash or other assets

In determining the value of the consideration, an assessment is made of the fair value of its elements.

A variety of techniques is applied in arriving at fair value.

- the value fixed by the statutory authorities (when the consideration includes securities)
- the market value of the assets given up
- net book values (when market value cannot be reliably assessed)

Consideration

Consideration dependent on future events

Adjustments may have to be made to the consideration in the light of one or more future events.

- When the additional payment is probable and can reasonably be estimated at the date of amalgamation, it is included in the calculation of the consideration.
- In all other cases, the adjustment is recognised as soon as the amount is determinable.

Treatment of reserves on amalgamation

Treatment of reserves depends on nature of amalgamation

Amalgamation in the nature of merger

In case of amalgamation in the nature of merger,

- the identity of the reserves is preserved
- reserves appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company.
- reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation

Amalgamation in the nature of purchase

- the difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company is adjusted in reserves in the financial statements of the transferee company.

Treatment of reserves on amalgamation

Example: amalgamation in the nature of merger

	Transferor Co	Transferee Co	Adjustments	Post amalgamation
Share capital	100	200	-100 +150	350
General reserves	150	50	-50	150
Capital reserve	50	20	-	70
Sub-total	300	270	-	570
Net fixed assets	100	170	-	270
Net current assets	200	100	-	300
Sub-total	300	270	-	570
Consideration by issue of shares – Rs.150				

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Treatment of reserves on amalgamation

Treatment of reserves depends on nature of amalgamation

Amalgamation in the nature of merger

In case of amalgamation in the nature of purchase,

- the identity of the reserves is not preserved except for statutory reserves
- The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company.

Amalgamation in the nature of purchase

- If the result of the computation is negative, the difference is debited to goodwill arising on amalgamation;
- If the result of the computation is positive, the difference is credited to Capital Reserve.

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Treatment of reserves on amalgamation

Treatment of reserves depends on nature of amalgamation

Amalgamation in the nature of merger

Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company.

For example,

- specialised use for an asset,
- intention to effect changes in the activities of the transferor company

Amalgamation in the nature of purchase

- planned employee termination
- plant relocation costs.

Treatment of reserves on amalgamation

Example: amalgamation in the nature of purchase

	Transferor Co	Transferee Co	Adjustments	Post amalgamation
Share capital	100	200	-100; +150	350
General reserves	150	50	-150;	50
Capital reserve	50	20	-50; +200*	220
Sub-total	300	270	-	620
Net fixed assets	100	170	+50	320
Net Current assets	200	100	-	300
Sub-total	300	270	-	620
<ul style="list-style-type: none"> • Consideration by issue of shares – Rs.150 • Fair value of net fixed assets – Rs.150 			* Total assets – Rs.350 less consideration Rs.150	

Treatment of reserves on amalgamation

Treatment of statutory reserves

Amalgamation in the nature of merger

In case of amalgamation in the nature of purchase,

- the identity of the reserves is not preserved except for statutory reserves
- reserves created by the transferor company pursuant to the requirements of any statute
- the transferor company is required to comply with requirements of the relevant statute

Amalgamation in the nature of purchase

Such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute. (AS14.18)

Treatment of goodwill arising on amalgamation

Goodwill arising on amalgamation should be amortised over a period not exceeding 5 years

Amortization period to exceed 5 years only if longer period can be justified

Factors to be considered in estimating useful life of Goodwill:

- (a) the foreseeable life of the business or industry;
- (b) the effects of product obsolescence, changes in demand and other economic factors;
- (c) the service life expectancies of key individuals or groups of employees;
- (d) expected actions by competitors or potential competitors; and
- (e) legal, regulatory or contractual provisions affecting the useful life.

Balance in profit and loss account

Treatment of balance in profit and loss account depends on nature of amalgamation

Amalgamation in the nature of merger

- aggregate with the corresponding balance appearing in the financial statements of the transferee company.

Alternatively,

- transfer to the General Reserve, if any.

Amalgamation in the nature of purchase

- balance of the Profit and Loss Account, whether debit or credit, loses its identity.

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Treatment of reserves specified in a scheme of amalgamation

Where the treatment is so prescribed, the same is followed

Statute may prescribe the treatment to be given to the reserves of the transferor company after its amalgamation.

Where the treatment is so prescribed, the same is followed.

Where treatment prescribed is different from the requirements of AS14, following disclosures are to be made in the first financial statements following the amalgamation:

- description of the accounting treatment given to the reserves
- reasons for following the treatment different from that prescribed in this Standard.
- deviations in the accounting treatment as compared to the requirements of AS14.
- the financial effect, if any, arising due to such deviation.

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Disclosure

General disclosures

For all amalgamations, the following disclosures to be given in the first financial statements following the amalgamation:

- names and general nature of business of the amalgamating companies
- effective date of amalgamation for accounting purposes
- the method of accounting used to reflect the amalgamation
- particulars of the scheme sanctioned under a statute.

Disclosure

Additional disclosures in the first financial statements following the amalgamation

For amalgamations accounted for under the pooling of interests method:

- description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation
- the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof

Disclosure

Additional disclosures in the first financial statements following the amalgamation

For amalgamations accounted for under the purchase method:

- consideration for the amalgamation and a description of the consideration paid or contingently payable
- the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof
- the period of amortization of any goodwill arising on amalgamation.

Amalgamation after the balance sheet date

When an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation,

- the amalgamation is not incorporated in the financial statements
- disclosure is made in accordance with AS 4

In certain circumstances, the amalgamation may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

Comparison with IFRS 3 Business Combinations

AS 14 is presently under revision to bring it in line with IFRS 3

- There are significant and fundamental differences
- IFRS 3 provides extensive guidance on accounting of business combinations.
- All business combinations are accounted using purchase method
- There are significant differences in application of purchase method
- IFRS 3 goes beyond legal form
- IFRS 3 applies to all business combinations while AS 14 applies to only amalgamations



Questions