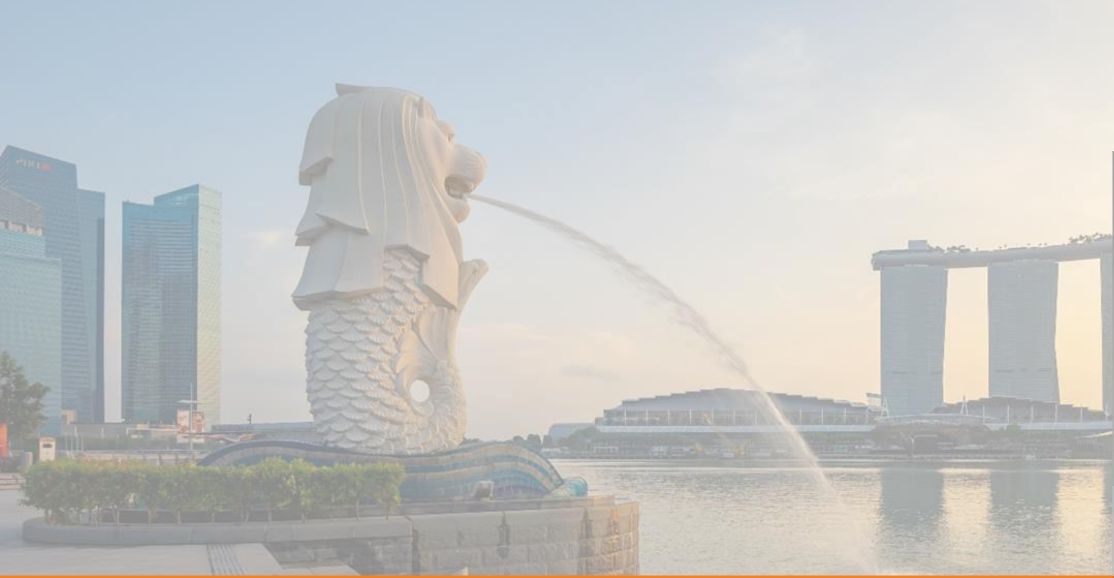

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Subsequent accounting in a business combination

AUGUST 2019

Our previous newsletter discussed one of the most critical accounting aspects of a business combination; components of the purchase consideration. In continuance with our discussions on business combination, this month we shall delve into subsequent accounting in a business combination. The newsletter discusses a few post combination accounting concepts under SFRS(I) 3: Business Combinations and IFRS 3: Business Combinations (jointly referred to as “reporting standards”).

MEASUREMENT PERIOD ADJUSTMENT

Instances where a company cannot record the acquisition transaction before the end of the reporting period due to either a delay in receipt or unavailability of sufficient data or simple paucity of time, reporting standards allow concession to such companies for a period of one year from the date of the transaction to complete the accounting of the transaction.

For example, a company with its financial year ending on December 31, 2018 makes an acquisition on December 16, 2018. The purchase price allocation (“PPA”) exercise is yet to be completed at the time of finalization of the financial statements. In such a scenario, the company may record a provisional amount of goodwill equal to excess of the purchase consideration over the net assets of the target company. The provisional goodwill amount will be revised as a measurement period adjustment when the PPA exercise is performed. The company has time until December 15, 2019 to complete the PPA exercise.

Any adjustments that arise based on information received post the reporting date are referred to as measurement period adjustments. However, not all information that is received can be considered for modifying the draft purchase price allocation. The reporting standards specifically allow the use of only information which existed as on the date of transaction but was quantified or discovered within the measurement period. Any information that came into light post the transaction date is to be disregarded for making any measurement period adjustments.

To summarize, the factors to consider while determining whether new information gives rise to measurement period adjustments include:

- Timing of the receipt of information
- Reason for measurement period adjustment

For example, at the acquisition date, the acquirer may recognize a provision for a liability arising from a lawsuit that a target is involved in. After 6 months, the target company loses the lawsuit, however the amount of compensation is higher than the previously recorded liability. The adjustment to the liability would be considered as a measurement period adjustment as the same relates to events or circumstances that existed as on the valuation date.

On the other hand, a depreciation in value of identified customer relationships due to loss of top customer shall not be treated as a measurement period adjustment as it does not relate to events or circumstances existing at the acquisition date. It shall be treated as an impairment in the value of the intangible asset.

ACCOUNTING FOR MEASUREMENT PERIOD ADJUSTMENTS

A measurement period adjustment is given effect in the asset or liability concerned with a corresponding increase/decrease in goodwill. The period in which a measurement period adjustment is affected for depends on the reporting standard under which the acquisition is accounted for - per SFRS(I) 3/IFRS 3, the measurement period adjustments are to be accounted for as retrospective adjustments to the provisional amounts recognized at the acquisition date.

CHANGES IN FAIR VALUE OF CONTINGENT CONSIDERATION

Contingent consideration is recognized and measured at fair value in accordance with the reporting standards. Changes in the fair value of contingent consideration may be either of following two types:

- Changes as a result of additional information obtained after the acquisition date pertaining to events and circumstances existing as at the valuation date - such changes are measurement period adjustments and are accounted for as discussed in the previous section.

- Changes resulting from events occurring after the acquisition date - the accounting for such changes is determined by the classification of contingent consideration as an asset, liability or equity per the reporting standards pertaining to financial instruments i.e. SFRS(I) 9/IFRS 9. The accounting in the post-combination period is as follows:

  - Asset/Liability: The contingent consideration is measured initially and subsequently at each reporting date. The changes in the fair value are recorded in the profit or loss account.

  - Equity: Equity classified contingent consideration is measured initially at fair value and not subsequently remeasured. The settlement is accounted within equity.

POST-ACQUISITION ACCOUNTING OF INTANGIBLE ASSETS

- **Re-classification of intangible assets between indefinite-lived and finite-lived categories:**

  The useful life of an intangible asset that is not being amortised shall be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate.

  In accordance with SFRS(I) 1-36/IFRS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment.

  To summarize, when the intangible asset is reclassified from indefinite-lived to finite-lived, test the asset for impairment prior to commencing amortization. For example, on acquisition, the acquirer may intend to continue the operate the business of the target under the latter's tradename and shall consequently classify the same as an indefinite lived intangible asset. However, 2 years after the acquisition, the acquirer decides to discontinue the use of the tradename and consolidate the business under its own brand name. In this scenario, the tradename shall be reclassified from indefinite to finite life and the accounting shall be as discussed above.

- **Impairment testing:**

  Post-acquisition, impairment testing requirements arise for both definite-lived as well as indefinite-lived intangible assets. The requirements can be summarised as follows:

  - It is mandatory to test Indefinite lived intangible assets and goodwill for impairment need to be tested at least annually for impairment.
  - In case of definite lived intangible assets, an impairment testing is necessitated when conditions indicating impairment exist.

ASSIGNMENT OF RECORDED GOODWILL TO REPORTING UNITS

Goodwill recorded as a result of acquisition accounting must be assigned to one or more cash generating units as of the acquisition date. Per the reporting standards, the determining factor for assignment of goodwill to a particular cash generating unit is the expected benefits from the synergies of the business combination notwithstanding whether other assets or liabilities have been allocated to the unit.

As much as propriety in accounting for a business combination is a must, post combination accounting merits equal importance. The myriad issues and challenges in post combination accounting render it a topic that cannot be overlooked.

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