CHAPTER 2

Recognition of assets and liabilities under common control business combinations

This article aims to discuss the key accounting considerations when a subsidiary merges with its parent



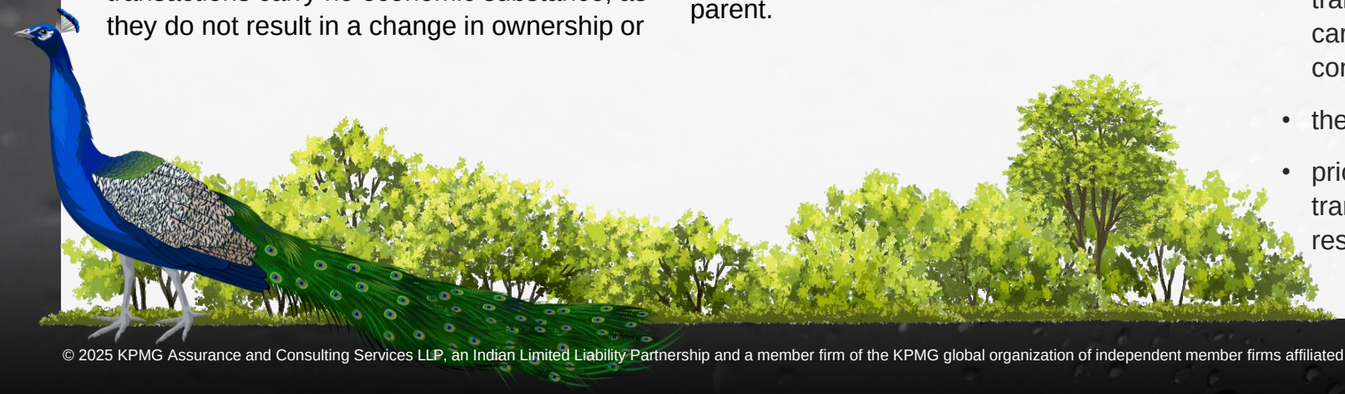
Background

In India, business combinations involving companies within the same group are becoming increasingly prevalent, driven by strategic initiatives aimed at cost optimisation, tax efficiency and simplification of group structures.

Ind AS 103, *Business Combinations* through Appendix C provides guidance for such intra-group combinations where both the transferor and transferee entities are under common control. A common control business combination involves entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and where the control is not transitory. At the group level, these transactions carry no economic substance, as they do not result in a change in ownership or control. Instead, they represent a reallocation of interests within the group, leaving the group's overall assets, liabilities, and net worth unchanged.

Common examples of such transactions include merger of subsidiaries with its parent or mergers between two fellow subsidiaries. Unlike external acquisitions, these transactions are accounted for using the pooling of interests method under Appendix C to Ind AS 103, which differs from the acquisition method used in business combinations involving unrelated parties.

This article outlines the key accounting considerations relevant to such common control mergers, with a particular focus on cases where a subsidiary merges with its parent.



Accounting approach– pooling of interests method

When a subsidiary merges with its parent, the transaction falls under the scope of Appendix C to Ind AS 103, as the control remains unchanged both before and after the merger. Since this is an intra-group transaction, it is eliminated in the consolidated financial statements prepared in accordance with Ind AS 110, *Consolidated financial statements*.

Therefore, the accounting impact is confined to the parent's standalone financial statements.

Under the pooling of interests method, following key principles apply:

- assets, liabilities and reserves of the transferor company are recorded at their carrying amounts, reflecting the continuity of control.
- the identity of the reserves is preserved.
- prior period financial statements of the transferee company are retrospectively restated as if the business combination had occurred from the later of:

a) the beginning of the earliest period presented or
b) the date when the control of subsidiary was acquired.

- the excess of net assets over the consideration, if any, is credited to capital reserve.
- if the consideration exceeds net assets, the shortfall is adjusted against available revenue reserves or capital reserves (subject to the approvals required, if any, e.g. for capital reduction). If the parent has insufficient reserves, then such shortfall is to be transferred to amalgamation adjustment deficit reserve.

Since merger of a subsidiary with its parent merely rearranges interests within the group, this does not lead to goodwill recognition or fair valuation of assets and liabilities of the subsidiary.

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Measurement choice: determining appropriate carrying amounts

While Appendix C to Ind AS 103 states that assets, liabilities and reserves of the combining entities be recorded at their carrying amounts, it does not specify the source of these carrying amounts. This often presents a practical challenge: should the carrying amounts be taken from the subsidiary's standalone financial statements, or from the parent's consolidated financial statements?

To discuss this in detail, following two scenarios are considered:

Scenario 1: Merger of a subsidiary set up by its parent

In transactions where a subsidiary (set up by its parent) merges with the parent, the carrying amounts in the subsidiary's standalone financial statements match those in the parent's consolidated financial statements. In such cases, the question of whether to use standalone or consolidated values becomes largely irrelevant, since both sources reflect the same amounts.

Similar approach applies to mergers between fellow subsidiaries since both entities are under common control of an ultimate parent, and their financial statements are generally prepared using consistent accounting policies.

Scenario 2: Merger of an acquired subsidiary with its parent

In contrast, merger of an acquired subsidiary with its parent presents more nuanced accounting challenges in determining the appropriate source of carrying amounts.

In most scenarios, post-acquisition, the consolidated financial statements of the parent reflect:

- Goodwill arising from the acquisition;
- Fair value uplifts to the subsidiary's assets and liabilities; and
- Impairment or other group level adjustments.

However, the subsidiary's standalone financial statements would continue to reflect historical carrying amounts without incorporating the acquisition (fair value) adjustments. This results in a mismatch between the subsidiary's standalone carrying amounts and post-acquisition (adjusted) carrying amounts in the parent's consolidated financial statements.

Using the subsidiary's standalone financial statements in such cases may not reflect the economic substance of the transaction. Therefore, the parent should carefully assess which source of carrying amounts – standalone or consolidated – is more appropriate.
To arrive at this judgement, consider following factors:

- the principles of continuity of control under Appendix C to Ind AS 103;
- the economic substance of the transaction; and
- the published guidance provided by relevant authorities.

This decision will significantly impact the parent's standalone financial statements upon merger of the acquired subsidiary with the parent as:

- the investment in subsidiary is derecognised in the parent's standalone financial statements; and
- the subsidiary's assets and liabilities are recognised at the chosen carrying amounts.

The treatment of goodwill in the parent's post-merger standalone financial statements also hinges on this choice:

- If the carrying amounts as per subsidiary's standalone financial statements are used, no goodwill is recognised.
- If the carrying amounts as presented in parent's consolidated financial statements are used, the original acquisition goodwill is recognised in the parent's standalone financial statements.

To address this practical challenge, guidance has been issued by the Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 9 and a '2024 opinion' issued by the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India. Both sources emphasise that the **nature of the transaction** determines the appropriate source of carrying amounts.



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ITFG Bulletin 9 - Issue 2 specifically addressed this issue in context of two situations:

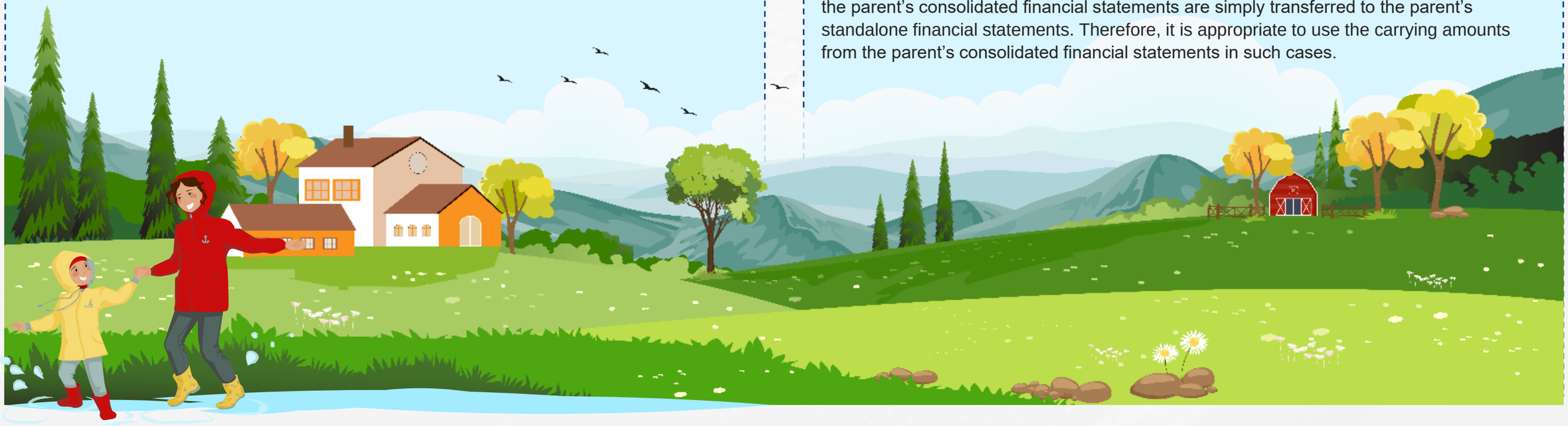
Situation 1: Merger of fellow subsidiaries

Both B Ltd. and C Ltd. are subsidiaries of A Ltd. and B Ltd. merges with C Ltd. In this case, as per the ITFG, the carrying amounts from the standalone financial statements of B Ltd. and C Ltd. should be used to prepare the financial statements of the merged entity, in line with Appendix C to Ind AS 103. This approach reflects continuity of control and is consistent with the pooling of interests method.

Situation 2: Merger of subsidiary with its parent

B Ltd. is a subsidiary of A Ltd. and B Ltd. merges with A Ltd. In this case, the ITFG clarifies that the carrying amounts from A Ltd.'s consolidated financial statements should be recognised in A Ltd.'s standalone financials post-merger. This reflects the fact that the transaction is a continuation of the consolidated group, and the subsidiary's balances are already part of the group's financial statements.

The ITFG further clarified that such mergers do not result in any change at the consolidated group level. The subsidiary's assets, liabilities and reserves which were already a part of the parent's consolidated financial statements are simply transferred to the parent's standalone financial statements. Therefore, it is appropriate to use the carrying amounts from the parent's consolidated financial statements in such cases.



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Additionally, in the 2024 EAC opinion, further insights were provided, with particular deliberation upon the treatment of goodwill in such common control mergers[1], reinforcing the importance of evaluating the economic substance of the transaction when determining the measurement basis. The EAC considered the below case:

Facts of the case

A listed Indian company is engaged in manufacture of steel tubes and pipes and has 11 manufacturing plants spread across India (Company). It has 5 subsidiaries and 1 step-down subsidiary. The Hon'ble National Company Law Tribunal approved the merger of a wholly owned subsidiary and a step-down subsidiary with the Company. Both entities were acquired, and goodwill was recognised in the Company's pre-merger consolidated financial statements. Following the merger, the Company chose to carry forward this goodwill into its post-merger standalone financial statements. This raises a question:

whether goodwill recognised in the pre-merger consolidated financial statements of the Company continue to be recognised post-merger in the standalone and consolidated financial statements of the Company.



Considerations

The EAC considered the following:

- Appendix C to Ind AS 103 requires assets and liabilities to be recorded at carrying amounts, with no fair value adjustments.
- Paragraph 9(ii) of Appendix C to Ind AS 103 permits to harmonise the accounting policies only, implying that the carrying amounts should be sourced from the subsidiary's standalone financial statements.
- Accordingly, if goodwill is not recognised in the subsidiary's standalone financial statements, it should not be recognised post-merger as Appendix C to Ind AS 103 does not mandate this.

However, the EAC also acknowledged ITFG's clarification in its Bulletin 9 and Question 43 of the Educational Material on Ind AS 103 which suggests that there is no change at consolidated group level due to the merger of a subsidiary with its parent. In view of this, it would be appropriate to carry forward the values of the assets, liabilities and reserves, including goodwill, from parent's pre-merger consolidated financial statements to the parent's post-merger standalone financial statements.

Accordingly, the EAC in this situation concluded that both accounting treatments are tenable.

A combined reading of the ITFG and EAC Opinion suggests that, in cases where a subsidiary merges with its parent, the carrying amounts may be drawn either from the subsidiary's standalone financial statements or from the parent's consolidated financial statements. While both these choices for determining the carrying amounts of the subsidiary's net assets are acknowledged, they do not provide guidance on the specific circumstances under which one choice may be more suitable than the other.

1. EAC Opinion on Accounting treatment and disclosure of Debit Balance of Capital Reserve arising on merger under Ind AS framework dated 11 July 2023 (EAC Opinion)

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Key disclosures in common control mergers to enhance transparency

In the case of merger of a subsidiary with the parent, the parent is required to provide specific disclosures in its annual financial statements and where applicable, in interim financial statements or results. Appendix C to Ind AS 103 outlines certain minimum disclosures for common control transactions to ensure transparency and consistency. These disclosures are essential to help users of financial statements understand the nature, rationale and impact of the transaction - even though there is no change in ultimate control. Some of the key disclosures include:

- Names of the combining entities, along with a brief description of the nature of their businesses.
- The effective date of the combination, typically the beginning of the reporting period with restatement of prior period comparatives.
- A clear statement that the transaction is a common control business combination, accounted for using the pooling of interests method.
- Details of number of shares issued, if any, together with the percentage of equity exchanged to effect the business combination.
- Explanation of difference, if any, between the consideration and the net assets, including how such difference has been accounted for.

Additionally, providing reconciliation tables showing adjustments to prior-period figures can significantly enhance users' understanding of the transaction.



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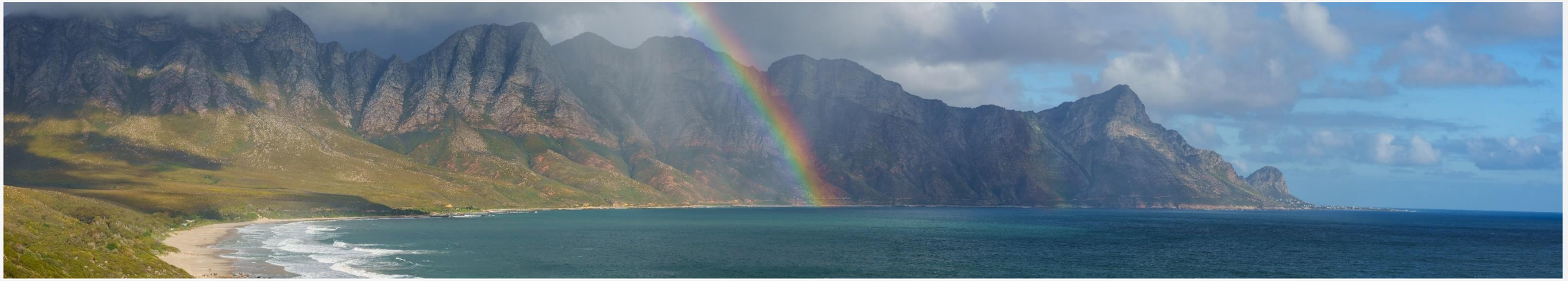
Bottomline

In today's dynamic corporate environment, common control mergers - especially between a parent and subsidiary have evolved beyond compliance exercises. They are now strategic levers to reshape group structures and unlock long-term value. While Ind AS 103 provides a foundational framework, the real challenge lies in determining the appropriate carrying amounts, which can significantly impact parent's standalone financial statements.

Guidance from ITFG and EAC underscores the importance of aligning accounting treatment with the transaction's economic substance and the principle of continuity of control. To ensure effective execution of these mergers, companies should:

- Evaluate minority interest implications, particularly if the subsidiary is not wholly owned pre-merger.
- Address the considerations around carrying values early, during drafting of merger schemes, to ensure alignment between legal structuring and financial reporting.
- Integrate tax considerations with accounting choices, as these decisions may affect availability of tax benefits.
- Ensure auditor certifications are anchored to the chosen accounting policy for regulatory submissions.
- Communicate proactively with investors and rating agencies, especially when equity movements result in negative capital reserves.
- Provide robust disclosures in its financial statements to support transparency and regulatory compliance.

Ultimately, a transparent and well-documented approach, supported by strong disclosures - helps reinforcing governance, enhancing transparency, and enabling smoother execution of complex reorganisations.



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