***Business Combination (Questions)***

**SUMMARY EXTRACT FROM AGREEMENT OF SALE OF PURCHASE OF LF**

The payment for the combination will consist of the following:

* Issue of 10,000 CIL shares. The market price of CIL shares as at 1 July 2010 was €20.20. Issue costs incurred amount to €0.20 per share. The shares were originally issued at €15.00.
* A cash payment of €288,000. The amount has been borrowed from the National Bank at an interest rate of 3% per annum. Total costs of €6,000 were incurred in obtaining the loan for bank administration fees, cost of financial reports submitted to the bank and time spent by management with the bank.
* Contingent consideration of up to €67,000. A cash payment of €32,000 will be made by CIL after one year if the profit before interest and tax for the first year following acquisition exceeds €170,000. A further cash payment of €35,000 will be granted after two years if the profit before interest and tax for the second year following acquisition exceeds €190,000. As at the date of acquisition, the fair value of these two payments is assessed as €60,000.
* A further contingent payment of €20,000 will be made by CIL to key employees of LF provided that they remain in employment for the three years following the acquisition date. If they leave LF prior to that date, the payment will automatically be forfeited.
* Reimbursement of acquisition-related costs sustained by LF on behalf of CIL as detailed in the attached invoice.

**INVOICE - 123**

**Chamonix Consulting Services Ltd, 191, av Ravanel Is Rouge, Les Bossons**

**74400 chamonix , France**

**Valuation of factory building TOTAL: €2,450**

**INVOICE - 453**

**Mont Blanc Accountancy Ltd , 119.** Impasse **Du Montenvers. ,** Charnonix, FR. **74402**

Due **diligence of books - TOTAL: €7,550**

**Question 1 :-**

If CIL purchases 80% of LF, then \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ (control / no control) over the net assets and activities will be obtained.

The activities and assets are \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ (capable / not capable) of providing return to CIL and economic benefits and thus it \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ (is , is not) a business.

**Question 2 :-**

IF CIL purchases the brand name , then \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ (control / no control) over the productive capacity of LF would be obtained.

The brand name is \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ (capable / not capable) of providing a return to CIL by itself and therefore it \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ (is / is not) a business.

**Question 3 - Mention - (included / excluded)**

Shares issued by the acquirer \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ .

 Cash Paid \_\_\_\_\_\_\_\_\_\_\_\_\_ .

 Contingent consideration based on future profits of LF \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ .

 Administrative Costs of the Acquisition Department \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

 Valuation fees for valuing a factory \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ .

 Due Diligence costs incurred by CIL \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ .

 Finance Arrangement Costs \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ .

 Costs incurred for the issue of equity shares \_\_\_\_\_\_\_\_\_\_\_\_\_\_.

 Payments to key employees of LF which are contingent on continuing employment for three years post acquisition. Payments are automatically forfeited if employee terminates \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

**Question 4**

The shares issued are valued at their \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ (Cost - 150000 / Fair Value - 202000 / Market Value - 204000)

The cash component of the price is included at an amount of \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ (288000 excluding / 294000 including) the

Finance costs.

Contingent consideration based on future profits of LF in the following two years included for its \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ (Fair Value of 60000 / Nominal Amount of 67000)

**Question 5 - Open Question for All the teams**

|  |  |
| --- | --- |
| **Linda Foods Inc** |  |
| **Statement of Financial Position as at 1 July 2010** | **€** |
| **ASSETS** |  |
| **Non Current Assets** |  |
| Property, plant and equipment (includes Trademark  at carrying amount of € 30450) | 200,000 |
| Investment property | 90,000 |
| Franchise agreement | 10,000 |
| **Current Assets** |  |
| Accounts receivable | 175,000 |
| Inventories | 85,000 |
| Cash | 25,000 |
| **TOTAL ASSETS** | 615,450 |
| **EQUITY AND LIABILITIES** |  |
| **Capital and Reserves** |  |
| Share capital and premium | 175,000 |
| Retained earnings | 227,100 |
| **Non Current Liabilities** |  |
| Long term loan | 80,500 |
| **Current Liabilities** |  |
| Accounts payable and accruals | 94,300 |
| Provisions | 38,550 |
| **TOTAL EQUITY AND LIABILITIES** | 615,450 |

**Additional notes:**

* 1. Property, plant and equipment - a valuation certificate from the valuers states that the fair value of factory and administration building is €300,000. The fair value of the factory contents and equipment is €105,000.

* 1. Inventories - a valuation certificate states that the fair value of inventories is €94,000.

* 1. The trademark is for the Linda hot chocolate name. The trademark was acquired 3 years ago. There is no active market for the trademark. Management has obtained an independent valuation for the trademark of €35,450.

* 1. Accounts receivable - the fair value of the amount expected to be received is €172,250. A doubtful debt allowance of €5,000 is included in the accounts receivable balance in the Statement of Financial Position.

* 1. The fair value of the investment property had not been determined at the acquisition date (because the valuation had not yet been finalised) and was provisionally estimated as €100,000.

* 2. The long term loan period is for 3 years and is paid back annually. The loan is linked to a variable interest rate of 3.03%. The fair value of the loan is €73,600.

* 1. The payment terms for accounts payable and accruals are 30 days and are recorded at their present value (which approximates their fair value).

* 1. Provisions are recorded at their present values in the Statement of Financial Position. If the provisions had not been discounted, the nominal value of the provisions would have been €42,350. The present value of the provisions approximates their fair value.

* 1. The following valuations have been provided by an independent appraiser:
     + order backlog (€4,000) that arises from sale orders already received by customers;
     + licensed customer list (€5.000) – there are no terms of confidentiality or other agreements which prohibit CIL from selling information about these customers;
     + operating lease agreement - LF has the right of use of a small shop located near Chamonix, where its factory is located. It entered into a non –transferrable 12-year operating lease with an independent party 5 years ago. Since that date the location has developed into a prime shopping area. As a result, at the acquisition date, the terms of the lease are favorable compared to market terms by €2.000. The terms of the operating lease explicitly prohibit transfer of the lease;
     + potential contracts with prospective new customers (€ 10.000) - LF is still in negotiation as at the acquisition date; and
     + documented but unpatented technical expertise used to make the trademarked LF hot chocolate (€3,000). To transfer ownership of trademark, CIL is also required to transfer this expertise for the new owner to produce hot chocolate that is indistinguishable from that produced by LF.

**Question 5 - Continued…… The table below shall help you in answering the question**

|  |  |  |  |
| --- | --- | --- | --- |
| **Calculate the Net Asset Value of LF** |  |  | |
| Recognition and measurement of LF Inc's fair value of net assets at the acquisition date (1 July 2010) | | | |
| **Particulars** | **Carrying amount in the statement of financial position**  **at 1 July 2010** | | **Fair value**  **at 1 July 2010** |
| **ASSETS** |  | |  |
| **Non Current Assets** |  | |  |
| Property, plant and equipment | 200,000 | |  |
| Investment property | 90,000 | |  |
| Franchise agreement | 10,000 | |  |
| Trademark - 'Famous Hot Chocolate' | 30,450 | |  |
| *Other identifiable assets:* |  | |  |
|  |  | |  |
|  |  | |  |
|  |  | |  |
|  |  | |  |
| **Current Assets** |  | |  |
| Accounts receivable | 175,000 | |  |
| Inventories | 85,000 | |  |
| Cash | 25,000 | |  |
| **TOTAL ASSETS** | 615,450 | |  |
| **EQUITY AND LIABILITIES** |  | |  |
| **Capital and Reserves** |  | |  |
| Share capital and premium | 175,000 | |  |
| Retained earnings | 227,100 | |  |
| **Non Current Liabilities** |  | |  |
| Long term loan | 80,500 | |  |
| **Current Liabilities** |  | |  |
| Accounts payable and accruals | 94,300 | |  |
| Provisions | 38,550 | |  |
| **TOTAL EQUITY AND LIABILITIES** | 615,450 | |  |

**Question 6**

**Details of pre-existing relationships between CIL and LF Inc**

**1. Chocolate powder**

- CIL purchases chocolate powder from LF Inc under a five-year supply contract at fixed rates. Currently, the fixed rates are higher than the rates at which CIL could purchase similar chocolate powder from another supplier.

- The supply contract allows CIL to terminate the contract before the end of the initial five-year term but only by paying a €6,000 penalty. At the acquisition date (1 July 2010) there are still three years remaining under the supply contract.

- A third party appraiser determined the fair value of LF’ supply contract with CIL as €8,000. The €8,000 represents a €3,000 component that is ‘at market’ because the pricing is comparable to pricing for current market transactions for the same or similar items (selling effort, customer relationships and so on) and a €5,000 component for pricing that is unfavourable to CIL because it exceeds the price of current market transactions for similar items.

- LF Inc has no other identifiable assets or liabilities related to the supply contract, and CIL has not recognised any assets or liabilities related to the supply contract before the business combination

Loss on settlement of Pre-existing Relationship Dr. 5000

Consideration Cr. 5000

(Lower of settlement amount and off market component)

**2. White Chocolate**

- CIL purchases white chocolate from LF Inc under a ten-year supply contract at fixed rates. Currently, the fixed rates are higher than the rates at which CIL could purchase similar white chocolate from another supplier.

- The supply contract allows CIL to terminate the contract before the end of the initial five-year term but only by paying a €7,000 penalty. At the acquisition date (1 July 2010) there are still six years remaining under the supply contract.

- A third party appraiser determined the fair value of LF’s supply contract with CIL as €10,000. The €10,000 represents a €4,000 component that is ‘at market’ because the pricing is comparable to pricing for current market transactions for the same or similar items (selling effort, customer relationships and so on) and a €6,000 component for pricing that is unfavourable to Snowy Chocolates because it exceeds the price of current market transactions for similar items.

- LF Inc has no other identifiable assets or liabilities related to the supply contract. As the agreement met the definition of an onerous contract under IAS 37, CIL had recognised a liability of € 7,000 for the supply contract before the business combination.

 Provision for Onerous Contract Dr. 7000

To Gain on Settlement of Contract Cr. 1000

To Consideration Transferred Cr. 6000

What shall be the impact on Business Combination Accounting and Gain / Loss that would be booked in both the case?

**Question 7**

|  |  |
| --- | --- |
| **To:** user@snw.com | **From:** Hilda.Bergmann@snw.com |
| **Subject:** Fair value of investment property and earn-out |  |
| Hi,    Since you're helping us with the reporting date accounting for our combination with LF, I am asking one more question.    If you remember at the acquisition date (6 months ago) the investment property held by LF was accounted for provisionally as we couldn't determine a final fair value, and a provisional value of €100,000 was used when we fair valued Pilatus’ net assets.    The value of the investment property has now been finalised. The value of the investment property as at 1 July 2010 is €105,000.    In addition, as part of the purchase agreement, CIL agreed to make a payment of up to a maximum of €67,000 to the former owners of Pilatus Inc. This consideration was contingent on Pilatus achieving specific targets based on profit before interest and tax for the two years following the acquisition. As of the acquisition date (1 July 2010) the fair value of this payment was assessed as €60,000 and included in the consideration transferred. Since that date Pilatus has been more profitable than anticipated and the contingent consideration payable has been remeasured to €62,000.    Is it possible to make an adjustment to the fair value of both the investment property and the contingent consideration? What shall be the amount adjusted? |  |

**Question 8**

**Charlie Inc acquired a 70% controlling interest in Echo Inc in two stages:**

* At the end of 20X1, Charlie Inc acquired a 20% equity interest for cash consideration of €20,000.
* In 20X2, Charlie Inc acquired a further 50% equity interest for cash consideration of €80,000. Charlie Inc identified net assets of Echo Inc with a fair value of €70,000. Charlie Inc elected to measure NCI at their share of net assets. On the date of acquisition, the previously-held 20% interest had a fair value of €25,000