Amalgamation

Accounting for amalgamation

- Computation of purchase consideration
- Accounting Treatment in books of Transferor Company.
- Accounting Treatment in books of Transferee Company according to the type of amalgama-tion.

Purchase Consideration:

- Purchase consideration means the price payable by Transferee Company to the Transferor Company for acquiring its business. According to AS-14, “Consideration for amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by Transferee Company to the shareholders of the transferor company.”

- 1. Only payments to shareholders are to be taken into consideration.
- 2. Considerations for debenture holders and liquidation expenses or cost absorption are not included in the Purchase Consideration.

Method of Calculating Purchase Consideration:

- There are two methods of calculating the purchase consideration:

Net Payment Method

. Net Assets Method

The choice of method depends on availability of information. If information is available on all modes of discharging the purchase consideration (e.g. preference shares, equity shares or cash payable to shareholders of Transferor Company) along-with their amounts, then Net Payment Method should be used. In other cases ‘Net Assets’ Method should be used.

- Net Payment Method:
- ‘Purchase Consideration’ under this method is taken as the aggregate of all payments made in the form of shares, debentures, other securities and cash to the shareholders of the transferor company.

Net Payment Method:

- ‘Purchase Consideration’ under this method is taken as the aggregate of all payments made in the form of shares, debentures, other securities and cash to the **shareholders** of the transferor company.

Payment	Form of payment	Amount
Equity Shareholder	CASH EQUITY SHARES PREFERENCE SHARES OTHER SECURTIES	
Preference shareholder	CASH EQUITY SHARES PREFERENCE SHARES OTHER SECURTIES	

Example

- X Ltd. is acquired by Y Ltd., the consideration being the takeover of liabilities; the payment of cost of acquisition as a part of purchase consideration not exceeding Rs. 20,000 (actual cost Rs. 17,000); the payment of the debentures Rs. 1,00,000 at a premium of 10% in 9% debentures issued at par; and the payment of Rs. 16 per share in cash and allotment of one 145 preference share of Rs. 10 each and 6 equity shares of Rs. 10 each fully paid for every 4 shares in X Ltd. The number of shares of the vendor company (X Ltd.) is 2, 00,000 of Rs. 10 each fully paid. Calculate purchase consideration as per AS-14.

Solution:

Payment to Equity Shareholders Rs.

1. Cash Rs. 16 x 2, 00,000 = 32, 00,000
2. 14% Preference Shares—2, 00,000/4 x Rs. 10 = 5, 00,000
3. Equity Shares 2, 00,000/4 x 6 x Rs. 10 = 30, 00,000

Total = 67, 00,000

Net Assets Method

- Net Assets Method is used when all the modes of discharging the purchase consideration (e.g. Pref. Shares, Equity shares or cash payable to shareholders of transferor company) are not given and hence where Net Payment Method cannot be adopted. Under this Method, purchase consideration is ascertained by aggregating the agreed values of only those assets which have been taken over by the transferee company and deducting it from the agreed value of liabilities taken over.

Example

- The Balance Sheet of ABC Ltd on 31st March, 2013 was as under:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Land and Buildings	4,00,000
75,000 Equity Shares of ₹ 20 each fully paid	1,50,000	Plant and Machinery	2,56,000
10% Debentures	4,00,000	Sundry Debits	1,60,000
Outstanding interest on debentures	40,000	Debenture fund investments	80,000
Sundry Creditors	1,20,000	Cash	4,000
General Reserve	80,000	Preliminary Expenses	20,000
Debenture Redemption Fund (sinking fund)	80,000		
Profit & Loss Account	50,000		
	9,20,000		9,20,000

Sumant Ltd. absorbs Digvijay Ltd. on the following terms:

1. Sumant Ltd. to take over sundry creditors.

2. It will also take over land and buildings, Plant and Machinery and investments at 120% of book values, sundry debtors at 90% of book values and goodwill at Rs. 70,800.

3. Liability to debentures including interest to be met by issue of Rs. 5,00,000, 15% debentures by Sumant Ltd.

Calculation of Purchase Consderation

Solution: Agreed value of Assets taken over:		₹
Land and Building		4,80,000
Plant and Machinery		3,07,200
Sundry Debtors		1,44,000
Debentures Fund Investments		96,000
Goodwill		70,800
		10,98,000
Less: Agreed Value of Liabilities taken over:		
Sundry Creditors	1,20,000	
10% Debentures	4,00,000	
Debenture Interest	40,000	–5,60,000
Purchase consideration		5,38,000

Accounting Treatment in the Books of Transferor/Vendor Company:

- All the accounts will be closed with the help of Realisation account, Equity shareholder Account, Prefernce shareholder account and Transfree Company Account
- following steps (along with their journal entries) are required:

Step 1:

Open a Realisation Account, transfer all assets and liabilities (excluding fictitious assets) to this account.

Journal Entry:

1. For transferring different assets to Realisation Account.

Realisation A/c Dr. (with total)

To Sundry assets (individually) (with their individual values)

Points to be noted:

(a) Fictitious assets, such as preliminary expenses, discount on issue of shares and debentures, debit balance of Profit and Loss Account etc. are not transferred to Realisation Account.

(b) In tangible assets such as goodwill, patents, trademarks etc. are also transferred to Realisation Account.

(c) The cash and bank balances should not be transferred to Realisation Account if these are not taken over by the purchasing company.

(d) An asset against which a provision or reserve has been created should be transferred at its gross figure and not at its net figure e.g. debtors.

Step 2:

2. For transferring different liabilities to Realisation Account.

Sundry Liabilities Dr. [with their individual book values]

To Realisation A/c [with the total]

Points to be noted:

(i) Items in the nature 'Provisions' (e.g. Provision for taxation, Employees provident fund, Pension Fund, Provision for doubtful debts, Provision for Depreciation) should be transferred to Realisation Account.

(ii) Items in the nature of 'Reserve' are not to be transferred to Realisation Account. These are directly transferred to sundry shareholders account (e.g. workmen compensation fund, credit balance of profit and loss account).

(iii) A liability against which a provision or reserve has been created should be transferred at its gross figure e.g. creditors.

Step 3 For making purchase Consideration due

Transfree Company Dr.

To Realisation A/c

Step 4:

For realising assets which have not been taken over by the purchasing company.

Cash or Bank Account Dr. (with the amount realised)

To Realisation account

For discharging liabilities, which have not been taken over by the purchasing company.

Realisation A/c Dr. (with the amount paid)

To Cash

- Step 5: To record liquidation expenses

(*a*)	If these expenses are borne by the transferor company	**Journal Entry** Realisation Account To Bank	 Dr.

(*b*)	If these expenses are paid by the purchasing companies directly	No Entry	
(*c*)	If these expenses are first paid by the transferor company and later reimbursed by the transferee company		
	1. On Payment by the transferor company	Transferee company's account To Realisation Account	Dr.
	2. On reimbursement	Bank Account To Realisation Account	Dr.

- **Step 6:**
- **For Receiving Purchase Consideration**

Cash/Bank Account	Dr.	With cash received.
Preference Shares in Purchasing Company	Dr.	With issue price of preference shares
Equity Shares in Purchasing Company	Dr.	With issue price of equity shares
To Transferee Company		With the total

Discharge the claims of preference shareholders and transfer the difference between the amount actually payable and the book figure to Realisation Account

Journal Entries for making the payment due:

If Preference shareholders are discharged at a premium		
Preference Share Capital Account	Dr.	With book value of preference share capital
Realisation Account	Dr.	With premium payable to preference shareholders
To Preference shareholders Account		With total
If Preference shareholders are discharged at a discount		
Preference Share Capital Account	Dr.	With book value of preference shares
To Realisation Account		With discount
To Preference Shareholders Account		
If Preference shareholders are discharged at par		
Preference Share Capital Account	Dr.	With book value of preference shares
To Preference shareholders Account		

For making payment to Preference Shareholders:

Preference Shareholders Account	Dr.	
To Cash/Bank Account		With cash paid
To Preference shares in Transferee Company		With issue price of preference shares given to preference shareholders

Step 8:

Ascertain the profit/loss on realisation and transfer the same to equity shareholders account

In case of Profit	Realisation Account (with profit)
	To Equity Shareholders Account
In case of loss	Equity Shareholders Account
	To Realisation Account (with loss)

Step 9:

Transfer Equity share capital, Accumulated profits and Reserves shown in the Balance Sheet (just before date of amalgamation) to Equity Shareholders Account

Equity Share Capital Account	Dr.	With paid up value of share capital
Profit and Loss Account	Dr.	With credit balance of profit and loss Account
General Reserve Account	Dr.	If any

Workmen Compensation Fund Account	Dr.	If any
Capital Reserve Account	Dr.	If any
Dividend Equalisation Fund Account	Dr.	If any
Securities Premium Account	Dr.	If any
Debenture Redemption Reserve Account	Dr.	If any
Capital Redemption Reserve Account	Dr.	If any
To Equity Shareholders Account		With total

Step 10: Transfer Accumulated losses (shown on debit side of Balance Sheet just before amalgamation)

Equity Shareholders Account	Dr.	
To Profit and Loss Account		Debit balance
To Preliminary Expenses Account		If any
To Discount on issue of shares/debentures		If any
To Deferred Revenue Expenditure Account		If any

Step 11: Make the final payment to equity shareholders

Equity Shareholders Account	Dr.	With total
To Equity Shares in transferee company's Account		No. of shares issued X issue price per share
To Cash/Bank Account		With cash paid

Notes

1. After passing the above mentioned entries in books of Transferor Company, all the accounts will be closed and not a single account will show any balance.

2. The net amount payable to equity shareholders must be equal to the amount of shares in Transferee Company and cash and bank balance left after the discharge of all outsiders’ liabilities and claims of preference shareholders.

Accounting Treatment in Books of Transferee Company or Purchasing Company:

Accounting treatment in books of Transferee Company depends upon the type of amalgamation.

As per AS-14, there are two methods of accounting for amalgamation:

1. Pooling of Interest Method:

Applicable in case of Amalgamation in the nature of merger.

2. Purchase Method:

Applicable in case of Amalgamation in the nature of Purchase.

Pooling of Interest Method (as per AS-14):

1. All assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (book values) except in cases where these are to be adjusted to follow uniform set of accounting policies.

2. The identity of the reserves is preserved as they appear in financial statements of the transferee company. For example, the general reserve of the transferor company becomes the general reserve of the transferee company, the capital reserve of the transferor company becomes the capital reserve of the transferee company and the revaluation reserve of the transferor company becomes the capital reserve of the transferee company.

3. No goodwill account should be accounted for as a result of amalgamation in the books of the transferee company.

4. The difference between the amount of share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of Transferor Company should be adjusted in reserves in the financial statements of the transferee company.

5. The balance of profit and loss account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company.

6. Although AS-14 does not specifically state, the purchase consideration under this method is to be valued at par value of shares issued. The logic is that this method considers book values and not the fair values.

1.	**For amalgamation of the business**	Business Purchase Account	Dr.	With the amount of purchase consideration
		To Liquidator of Transferor Company's A/c		
2.	**For acquisition of assets, liabilities and reserves**	Sundry Assets Account	Dr.	With individual amounts at book value
		To Sundry Liabilities Account		Individually at book values
		To Reserves Account		See note below
		To Profit and Loss Account		
		To Business Purchase Account		With purchase consideration
Note: In this entry if the value of assets (debits) is more than the amount of liabilities and reserves (credits), the difference is added to reserves. Conversely, if the value of debits is less than the credits, the difference is debited to the reserves. It means any difference in the amount of debits and credits in this entry is suitably adjusted to reserves.				
3.	**For Payment of Purchase Consideration**	Liquidator of the Transferor Company's A/c	Dr.	With total
		Discount on issue of shares Account	Dr.	If any
		To Equity share Capital Account		With paid up value of equity shares issued
		To Preference Share Capital Account		With paid value of preference shares issued
		To Securities Premium Account		With securities premium
		To Cash Account/Bank Account		For fractional shares and for dissenting shareholders
Note: The shares issued by way of purchase consideration must be recorded at their paid up values (and not at their issued price) after giving due credit to Securities Premium Account (in case the shares have been issued at premium) or after giving due debit to 'Discount on issue of shares Account' (in case the shares have been issued at discount).				
4.	**For formation expenses of the new company (if formed) and reimbursement of the liquidation expenses of the vendor company (if paid by the transferee company)**	Preliminary Expenses Account	Dr.	For formation expenses
		Profit and Loss Account	Dr.	Reimbursed liquidation expenses
		To Cash Account/Bank Account		

Purchase Method:

1. Recording of assets and liabilities:

The assets and liabilities of the transferor company should be incorporated at their existing carrying values or, alternatively, at their fair values (revised values) on date of amalgamation.

2. Recording of reserves:

(i) Statutory Reserves:

Are those reserves which are required to be maintained as per the legal provisions, and there is restriction on its usage. If a statutory reserve is appearing in the Balance Sheet of a transferor company, the same should appear in the Financial Statements of the transferee company.

For this purpose ‘Amalgamation Adjustment Account’ is debited and ‘Statutory Reserve Account’ is credited. Amalgamation Adjustment Account is shown on the assets side as a part of “Miscellaneous Expenditure” or other similar category in the Balance Sheet.

When identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account should be reversed. Examples of Statutory Reserves are: Investment allowance reserve; development rebate reserve, export profit reserve etc.).

(ii) Reserves other than statutory reserves:

The reserves (whether capital or revenue or arising on revaluation) of the transferor company, other than the statutory reserves, should not be included in the financial statements of the transferee company.

3.

Any excess of purchase consideration over net assets of the transferor company should be recognized as goodwill in the financial statements of Transferee Company. If the amount of consideration is lower than the value of net assets acquired, the difference should be treated as Capital Reserve.

4. Goodwill arising on amalgamation should be authorized systematically over its useful life. The authorization period should not exceed 5 years unless a somewhat longer period is justified.

Accounting Treatment in the Books of Transferee Company:

1. For recording the acquisition of business from the Vendor Company:

Business Purchase A/c	Dr.	(with purchase consideration)
To liquidator of the Vendor Co.		

2. To record the Assets and Liabilities taken over at their respective agreed values and Debit Goodwill A/c if purchase consideration exceeds the net assets taken over or credit the Capital Reserve A/c if net assets taken over exceed the purchase consideration.

Individual Assets A/c	Dr.	(with respective agreed values of assets taken over)
Goodwill A/c	Dr.	(with excess of purchase consideration over the net assets) if any
To Individual Liabilities A/c		(with respective agreed values)
To Business Purchase A/c		(with purchase consideration)
To Capital Reserve		(with excess of Net Assets over the Purchase consideration)

3. For incorporation of Statutory Reserves:

Amalgamation Adjustment A/c	Dr.	[with total]
To Statutory Reserves A/c		[with the respective book values]

4. For discharge of Purchase consideration (same as in case of pooling of interest method).
5. For formation expenses of new company and to record the reimbursement of the liquidation expenses of the Vendor Company:

Preliminary expenses A/c	Dr.	(Formation expenses of Transferee Company)
Goodwill A/c		(Liquidation expenses of transferor company)
To Bank A/c		

Example

Following is the Balance Sheet of Star Ltd. as on 31st March, 2013:

Liabilities	(₹)	Assets	(₹)
Share Capital:		Plant and Machinery	9,00,000
1,20,000 Equity Shares of ₹ 10 each	12,00,000	Furniture and Fittings	1,50,000
Capital Reserve	20,000	Stock	4,00,000
Long-term Loan	3,60,000	Debtors	2,20,000
Creditors	3,00,000	Bank	1,00,000
		Profit and Loss Account	1,10,000
	18,80,000		18,80,000

- On 1st April, 2013 a new company Suraj Ltd was incorporated which took over fixed assets and stock of Star Ltd for Rs. 12,60,000 payable as Rs. 9,00,000 in the form of 1,80,000 equity shares of Rs. 5 each and Rs. 3,60,000 in the form of 3,600, 12% Mortgage Debentures of Rs. 100 each. Lender accepted the debentures in Suraj Ltd in discharge of the loan.
- Debtors realised Rs. 2, 05,000. Expenses of liquidation amounted to Rs. 8,000 and were met by Star Ltd. The available cash was distributed among creditors in full satisfaction of their claim. Show necessary Ledger Account to close the books of Moon Ltd. and draw the opening Balance Sheet of Suraj Ltd.

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- Debtors realised Rs. 2, 05,000. Expenses of liquidation amounted to Rs. 8,000 and were met by Star Ltd. The available cash was distributed among creditors in full satisfaction of their claim. Show necessary Ledger Account to close the books of Moon Ltd. and draw the opening Balance Sheet of Suraj Ltd.

Solution:

(*i*) Calculation of Goodwill/Capital Reserve **(*ii*) Calculation of Purchase Consideration**

Liabilities	(₹)	(₹)	Assets	(₹)
Assets taken over:			Equity Shares: 1,80,000 × ₹ 5	9,00,000
Plant and Machinery	9,00,000		Issue of 12% mortgage debentures to pay-off loan is not to be included while calculating purchase consideration. Such loan will be taken over by Suraj Ltd. and then discharged.	
Furniture and Fixture	1,50,000			
Stock	4,0,000	14,50,000		
Less: Liabilities taken over:				
Long-term Loan		3,60,000		
Net Assets taken over		10,90,000		
Less: Purchase Consideration		9,00,000		
Capital Reserve		1,90,000		

In the Books of Star Ltd.

Realisation Account

Dr. | Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2013 April 1	To Plant and Machinery A/c	9,00,000	2013 April 1	By Loan A/c	3,60,000
	To Furniture and Fixture A/c	1,50,000		By Suraj Ltd. A/c	9,00,000
	To Stock A/c	4,00,000		By Creditors A/c (Profit on payment)	3,000
	To Debtors A/c (Loss on realisation)	15,000		By Sundry Equity Shareholders A/c (Profit on realisation)	2,10,000
	To Bank A/c (Realisation expenses)	8,000			
		14,73,000			14,73,000

Suraj Ltd. Account

Dr. | Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2013 April 1	To Realisation A/c	9,00,000	2013 April 1	By Equity shares in Suraj Ltd. A/c	9,00,000

Equity Shares in Suraj Ltd. Account

Dr. | Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2013 April 1	To Suraj Ltd. A/c	9,00,000	2013 April 1	By Equity Shareholders A/c	9,00,000

Debtors Account

Dr. | Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2013 April 1	To Balance b/d	2,20,000	2013 April 1	By Bank A/c	2,05,000
				By Realisation A/c	15,000
		2,20,000			2,20,000

Bank Account

Dr. | Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2013 April 1	To Balance b/d	1,00,000	2013 April 1	By Realisation A/c (expenses)	8,000
	To Debtors A/c	2,05,000		By Creditors A/c	2,97,000
		3,05,000			3,05,000

Creditors Account

Dr. | Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2013 April 1	To Bank A/c	2,97,000	2013 April 1	By Balance c/d	3,00,000
	To Realisation A/c	3,000			
		3,00,000			3,00,000

Sundry Equity Shareholders Account

Dr. | Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2013 April 1	To Profit and Loss A/c	1,10,000	2013 April 1	By Equity Share Capital A/c	12,00,000
	To Equity Shares in Suraj Ltd. A/c	9,00,000		By Capital Reserve A/c	20,000
	To Realisation A/c	2,10,000			
		12,20,000			12,20,000