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AMALGAMATION

Learning Objectives

After studying this chapter, you will be able to

- ◆ Understand the term amalgamation and the methods of accounting for amalgamations.
- ◆ Appreciate the concept of transferee Company and the transferor company.
- ◆ Calculate purchase consideration under both the methods of amalgamation as per AS 14.
- ◆ Pass the entries to close the books of the vendor company.
- ◆ Pass the journal entries in the books of purchasing company to incorporate the assets and liabilities of the vendor company and also giving effect to other adjustments.

1. Meaning of Amalgamation

In an amalgamation, two or more companies are combined into one by merger or by one taking over the other. Therefore, the term 'amalgamation' contemplates two kinds of activities:

- (i) two or more companies join to form a new company or
- (ii) absorption and blending of one by the other.

Thus, amalgamations include absorption.

The purpose of companies joining together is to secure various advantages such as economies of large scale production, avoiding competition, increasing efficiency, expansion etc.

The companies going into liquidation or merged companies are called vendor companies or transferor companies. The new company which is formed to take over the liquidated companies or the company with which the transferor company is merged is called transferee or vendee.

In the case of amalgamation the assets and liabilities of transferor company(s) are amalgamated and the transferee company becomes vested with all such assets and liabilities.

Accounting

Wherever an undertaking is being carried on by a company and is in substance transferred, not to an outsider, but to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company, there is external reconstruction. Such external reconstruction is essentially covered under the category 'amalgamation in the nature of merger' in AS 14.

Basis	Amalgamation	Absorption	External Reconstruction
Meaning	Two or more companies are wound up and a new company is formed to take over their business	In this case an existing company takes over the business of one or more existing companies	In this case, a newly formed company takes over the business of an existing company.
Number of Companies involved	Two or more companies are wound up	An existing company takes over the business of one or more existing companies	Newly formed company takes over the business of the existing company
Number of resultant companies	Two companies are wound up to form a single resultant company	No new resultant company is formed	Under this case a newly formed company takes over the business of an existing company
Example	A Ltd and B Ltd amalgamate to form C Ltd	A Ltd takes over the business of another existing company B Ltd	B Ltd is formed to take over the business of an existing company A Ltd

2. Types of Amalgamation

The Companies Act, 1956 has not specifically defined the term 'amalgamation'. However, from several legal decisions, the definition of amalgamation may be inferred. The Institute of Chartered Accountants of India has introduced Accounting Standard -14 (AS 14) on 'Accounting for Amalgamations'. The standard recognizes two types of amalgamation –

- (a) Amalgamation in the nature of merger and
- (b) Amalgamation in the nature of purchase.

Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

- (i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
- (ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their

nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

- (iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
- (iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
- (v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

If any one or more of the above conditions are not satisfied in an amalgamation, such amalgamation is called **amalgamation in the nature of purchase**.

3. Purchase Consideration

For the purpose of accounting for amalgamations, we are essentially guided by AS-14 'Accounting for Amalgamations'. Para 3(g) of AS 14 defines the term purchase consideration as the *"aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company"*. In simple words, it is the price payable by the transferee company to the transferor company for taking over the business of the transferor company.

It is notable that purchase consideration **does not include** the sum which the transferee company will directly pay to the creditors of the transferor company.

The purchase consideration essentially depends upon the fair value of its elements. For example, when the consideration includes securities, the value fixed by the statutory authority may be taken as the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up or in the absence of market value, book value of the assets are considered.

Sometimes adjustments may have to be made in the purchase consideration in the light of one or more future events. When the additional payment is probable and can be reasonably estimated it is to be included in the calculation of purchase consideration.

Illustration 1

Let us consider the Balance Sheet of X Ltd. as on 31st March, 2011:

Liabilities	Rs.('000)	Assets	(Rs.'000)
Share Capital:		Land & Buildings	50,00
Equity Shares of Rs. 10 each	75,00	Plant & Machinery	45,00
14% Preference Shares of		Furniture	10,50

Accounting

Rs. 100 each	25,00	Investments	5,00
General Reserve	12,50	Stock	23,00
12% Debentures	40,00	Debtors	24,00
Sundry Creditors and other		Cash & Bank balance	15,00
Current liabilities	<u>20,00</u>		
	<u>172,50</u>		<u>172,50</u>

Other Information:

- (i) Y Ltd. takes over X Ltd. on 10th April, 2011.
- (ii) Debentureholders of X Ltd. are discharged by Y Ltd. at 10% premium by issuing 15% own debentures of Y Ltd.
- (iii) 14% Preference Shareholders of X Ltd. are discharged at a premium of 20% by issuing necessary number of 15% Preference Shares of Y Ltd. (Face value Rs. 100 each).
- (iv) Intrinsic value per share of X Ltd. is Rs. 20 and that of Y Ltd. Rs. 30. Y Ltd. will issue equity shares to satisfy the equity shareholders of X Ltd. on the basis of intrinsic value. However, the entry should be made at par value only. The nominal value of each equity share of Y Ltd. is Rs. 10.

Compute the purchase consideration.

Solution

Computation of Purchase consideration	(Rs. in '000)	Form
For Preference Shareholders of X Ltd.	3,000	30,000 15% preference Share in Y Ltd.
For equity shareholders of Y Ltd. ($\frac{2}{3} \times 7,50,000$) $\times$ Rs. 10 of Rs. 10 each	5,000	5,00,000 equity shares of Y Ltd.
Total Purchase consideration	<u>8,000</u>	

Note : Consideration for debenture holders should not be included above. Such debentures will be taken over by Y Ltd. and then discharged.

4. Methods of Accounting for Amalgamations

There are two main methods of accounting for amalgamation:

- (a) The pooling of interests method, and
- (b) The purchase method.

The *first method* is used in case of *amalgamation in the nature of merger* and the *second method* is used in case of *amalgamation in the nature of purchase*.

Pooling of Interest Method

Under pooling of interests method, the assets, liabilities and reserves of the transferor company will be taken over by Transferee Company at existing carrying amounts unless any adjustment is required due to different accounting policies followed by these companies. As a result 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 Transferor Company should be adjusted in reserves.

Purchase Method

Assets and Liabilities: the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

Reserves: no reserves, other than statutory reserves, of the transferor company should be incorporated in the financial statements of transferee company. Statutory reserves of the transferor company should be incorporated in the balance sheet of transferee company by way of the following journal entry.

Amalgamation Adjustment A/c	Dr.
To Statutory Reserves	

When the above statutory reserves will no longer be required to be maintained by transferee company, such reserves will be eliminated by reversing the above entry.

The balance of Profit and Loss account of the transferor company is not recorded at all.

Difference between the Purchase Consideration and Net Assets transferred: any excess of the amount of purchase consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognised as goodwill in the financial statement of the transferee company. Any short fall should be shown as capital reserve. Goodwill should be amortised over period of five years unless a somewhat longer period can be justified.

Illustration 2

Consider the following balance sheets of X Ltd. and Y Ltd.

Balance Sheet as on 31st March, 2012					
<i>Liabilities</i>	<i>X Ltd.</i>	<i>Y Ltd.</i>	<i>Assets</i>	<i>X Ltd.</i>	<i>Y Ltd.</i>
	<i>Rs.'000</i>	<i>Rs.'000</i>		<i>Rs.'000</i>	<i>Rs.'000</i>
<i>Equity Share Capital</i>	50,00	30,00	<i>Land & Building</i>	25,00	15,50
<i>(Rs. 10 each)</i>			<i>Plant & Machinery</i>	32,50	17,00

Accounting

14% Preference Share	22,00	17,00	Furniture & Fittings	5,75	3,50
Capital (Rs. 100 each)			Investments	7,00	5,00
General Reserve	5,00	2,50	Stock	12,50	9,50
Export Profit Reserve	3,00	2,00	Debtors	9,00	10,30
Investment Allowance		1,00	Cash & Bank	7,25	5,20
Reserve					
Profit & Loss A/c	7,50	5,00			
13% Debentures	5,00	3,50			
(Rs. 100 each)					
Trade Creditors	4,50	3,50			
Other Current Liabilities	<u>2,00</u>	<u>1,50</u>			
	<u>99,00</u>	<u>66,00</u>		<u>99,00</u>	<u>66,00</u>

X Ltd. takes over Y Ltd. on 1st April, 2012. X Ltd. discharges the purchase consideration as below:

- Issued 3,50,000 equity shares of Rs. 10 each at par to the equity shareholders of Y Ltd.
- Issued 15% preference shares of Rs. 100 each to discharge the preference shareholders of Y Ltd. at 10% premium.

The debentures of Y Ltd. will be converted into equivalent number of debentures of X Ltd. The statutory reserves of Y Ltd. are to be maintained for 2 more years.

Show the balance sheet of X Ltd. after amalgamation on the assumption that:

- the amalgamation is in the nature of merger.
- the amalgamation is in the nature of purchase.

Solution:

(a) Amalgamation in the nature of merger:

Balance Sheet of X Ltd.

	Particulars	Notes	Rs. in '000
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	12,570
b	Reserves and Surplus	2	1,930

Amalgamation

2	Non-current liabilities		
a	Long-term borrowings	3	850
3	Current liabilities		
a	Trade Payables		800
b	Other current liabilities		350
	Total		16,500
	Assets		
1	Non-current assets		
a	Fixed assets		
	Tangible assets	4	9,925
b	Non-current investments		1,200
2	Current assets		
a	Inventories		2,200
b	Trade receivables		1,930
c	Cash and cash equivalents		1,245
	Total		16,500
Notes to accounts			
			Rs. in '000
1	Share Capital		
	Equity share capital		
	85,000 Equity Shares of Rs. 100 each		8,500
	Preference share capital		
	18,700 15% Preference Shares of Rs. 100 each		1,870
	22,000 14% Preference Shares of Rs. 100 each		2,200
	Total		12,570
2	Reserves and Surplus		
	General Reserve*	750	
	Adjustment for amalgamation	(670)	80
	Export Profit Reserve		500
	Investment Allowance Reserve		100
	Surplus (Profit & Loss A/c)		1,250
	Total		1,930

Accounting

3 Long-term borrowings

Secured

8,500 13% Debentures of Rs. 100 each	850
Total	850

4 Tangible assets

Land & Buildings	4,050
Plant & Machinery	4,950
Furniture & Fittings	925
Total	9,925

*The difference between the amount recorded as share capital issued and the amount of share capital of transferor company should be adjusted in reserves. Thus,

General Reserve = Rs. '000 [7,50 – (53,70 – 47,00)] = Rs. ('000) 80

(b) Amalgamation in the nature of purchase :

Balance Sheet of X Ltd.

	Particulars	Notes	Rs. in'000
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	12,570
b	Reserves and Surplus	2	2,230
2	Non-current liabilities		
a	Long-term borrowings	3	850
3	Current liabilities		
a	Trade Payables		800
b	Other current liabilities		350
	Total		16,800
	Assets		
1	Non-current assets		
a	Fixed assets		
	Tangible assets	4	9,925
b	Non-current investments		1,200
c	Other non-current assets	5	300

Amalgamation

2 Current assets

a	Inventories	2,200
b	Trade receivables	1,930
c	Cash and cash equivalents	1,245
Total		16,800

Notes to accounts**Rs. in'000****1 Share Capital**

Equity share capital

85,000, Equity Shares of Rs. 100 each 8,500

Preference share capital

18,700, 15% Preference Shares of Rs. 100 each 1,870

22,000, 14% Preference Shares of Rs. 100 each 2,200

Total **12,570****2 Reserves and Surplus**

Capital Reserve 380

General Reserve 500

Export Profit Reserve 500

Investment Allowance Reserve 100

Surplus (Profit & Loss A/c) 750

Total **2,230****3 Long-term borrowings**

Secured

8,500 13% Debentures of Rs. 100 each 850

Total **850****4 Tangible assets**

Land & Buildings 4,050

Plant & Machinery 4,950

Furniture & Fittings 925

Total **9,925**

Accounting

5. Other non-current asset

Amalgamation adjustment account (assumed to be maintained for more than a year)	300
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Workings: Capital Reserve arising on Amalgamation:

(A) Net Assets taken over :	Rs. ('000)	Rs. ('000)
Sundry Assets		66,00
Less : 13% Debentures	3,50	
Trade Creditors	3,50	
Other current liabilities	<u>1,50</u>	
		<u>8,50</u>
		<u>57,50</u>
(B) Purchase consideration :		
To Equity Shareholders of Y Ltd.		35,00
To Preference Shareholders of Y Ltd.		<u>18,70</u>
		<u>53,70</u>
(C) Capital Reserve (A – B)		<u>3,80</u>

Illustration 3

S. Ltd. is absorbed by P. Ltd. The balance sheet of S. Ltd. is as under :

Balance Sheet

Share Capital :	Rs.	Rs.
2,000 7% Preference shares of Rs. 100 each (fully paid-up)	2,00,000	
5,000 Equity shares of Rs. 100 each (fully paid-up)	5,00,000	
Reserves	3,00,000	
6% Debentures	2,00,000	
Trade creditors	<u>1,00,000</u>	
	<u>13,00,000</u>	<u>13,00,000</u>

P. Ltd. has agreed :

- (i) *to issue 9% Preference shares of Rs. 100 each, in the ratio of 3 shares of P. Ltd. for 4 preference shares in S. Ltd.*

- (ii) to issue to the debenture-holders in S. Ltd. 8% Mortgage Debentures* at Rs. 96 in lieu of 6% Debentures in S. Ltd. which are to be redeemed at a premium of 20%;
- (iii) to pay Rs. 20 per share in cash and to issue six equity shares of Rs. 100 each (market value Rs. 125) in lieu of every five shares held in S. Ltd.; and
- (iv) to assume the liability to trade creditors.

Solution

The purchase consideration will be

	Rs.	Form
Preference shareholders : $2,000 \times \frac{3}{4} \times 100$	1,50,000	9% Pref. Shares
Equity shareholders : $5,000 \times 20$	1,00,000	Cash
$5,000 \times \frac{6}{5} \times 125$	<u>7,50,000</u>	Equity Shares
	<u>10,00,000</u>	

Supposing the total number of fractions arising on exchange aggregate to 20 shares (equivalent to equity shares in P. Ltd.) each will have to be paid for them @ Rs. 125 per share; the remaining amount will be settled by the issue of equity shares. Alternatively, fraction certificates are issued; these are converted into shares on presentation - the holder of the fraction certificates must buy more such certificates or sell those held by him.

Illustration 4

Y Ltd. decides to absorb X Ltd. The Balance Sheet of X Ltd. is as follows:

	Rs.		Rs.
3,000 Equity shares of		Net Assets	2,90,000
Rs. 100 each (fully paid)	3,00,000	Profit and Loss Account	70,000
Preference shares	<u>60,000</u>		<u> </u>
	<u>3,60,000</u>		<u>3,60,000</u>

Y Ltd. agrees to take over the net assets of X Ltd. An equity share in X Ltd., for purposes of absorption, is valued @ Rs. 70. Y Ltd. agrees to pay Rs. 60,000 in cash for payment to preference

* According to AS 14, 'consideration' for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the **shareholders** of the transferor company. Therefore, debentures issued to the debenture holders will not be included in purchase consideration. Like trade creditors, the liability in respect of debentures of S. Ltd. will be taken by P Ltd., which will then be settled by issuing new 8% debentures.

Accounting

shareholders and the balance in the form of its equity shares valued at Rs. 120 each. Calculate purchase consideration to be paid by Y Ltd. and how will it be discharged?

Solution

Value of 3,000 shares of X Ltd. @ Rs. 70 = Rs. 2,10,000

The purchase consideration will be:

= Rs. 2,10,000 for equity shares + Rs. 60,000 for Liability towards preference shareholders

= Rs. 2,70,000

Rs. 60,000 out of the above will be in cash and Rs. 2,10,000 in the form of equity shares of Y Ltd., issued at Rs. 120 per share; the number of shares that will be issued = $2,10,000/120 = 1,750$ equity shares.

5. Journal Entries to close the books of vendor company

The journal entries will be illustrated with the following case.

Wye Ltd. acquires the business of Z Ltd. whose balance sheet on 31st December, 2008 is as under :

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Share capital divided into		Goodwill	2,00,000
shares of Rs. 100 each		Land & Buildings	4,00,000
6% Preference share capital	4,00,000	Plant and Machinery	6,00,000
Equity share capital	8,00,000	Patents	50,000
Capital Reserve	1,00,000	Stock	1,50,000
Profit & Loss A/c	50,000	Books Debts	1,80,000
6% Debentures	2,00,000	Cash at Bank	70,000
Interest outstanding on above	12,000	Underwriting Commission	40,000
Workmen's Compensation Reserve			
(Expected liability Rs. 5,000)	8,000		
Trade Creditors	<u>1,20,000</u>		
	<u>16,90,000</u>		<u>16,90,000</u>

Wye Ltd. was to take over all assets (except cash) and liabilities (except for interest due on debentures) and to pay following amounts :

- (i) Rs. 2,00,000 7% Debentures (Rs. 100 each) in Wye Ltd. for the existing debentures in Zed Ltd.; for the purpose, each debenture of Wye Ltd. is to be treated as worth Rs. 105.
- (ii) For each preference share in Zed Ltd. Rs. 10 in cash and one 9% preference share of Rs. 100 each in Wye Ltd.

Amalgamation

- (iii) For each equity share in Zed Ltd. Rs. 20 in cash and one equity share in Wye Ltd. of Rs. 100 each having the market value of Rs. 140.
- (iv) Expense of liquidation of Zed Ltd. are to be reimbursed by Wye Ltd. to the extent of Rs. 10,000. Actual expenses amounted to Rs. 12,500.

Wye Ltd. valued Land and building at Rs. 5,50,000 Plant and Machinery at Rs. 6,50,000 and patents at Rs. 20,000.

Purchase Consideration:

		Rs.	Form
(i) Preference Shares: Rs. 10 per share	40,000		Cash
Preference shares	<u>4,00,000</u>	4,40,000	Preference shares
(ii) Equity shares: Rs. 20 per share	1,60,000		Cash
8,000 equity shares in			
Wye Ltd. @ Rs. 140	<u>11,20,000</u>	<u>12,80,000</u>	Equity shares
		<u>17,20,000</u>	

Steps to close the Books of the Vendor Company

1. Open Realisation Account and transfer all assets at book value.

Exception: If cash is not taken over by the purchasing company, it should not be transferred.

Note: Profit and Loss Account (Dr.) and expenses not written off are not assets and should not be transferred to the Realisation Account.

The journal entry in the above case is:

	Rs.	Rs.
Realisation A/c	Dr. 15,80,000	
To Sundries —		
Goodwill		2,00,000
Land & Building		4,00,000
Plant & Machinery		6,00,000
Patents		50,000
Stock		1,50,000
Book debts		1,80,000

(Transfer of assets to Realisation Account on sale of business to Wye Ltd.)

Accounting

2. Transfer to the Realisation Account the liabilities which the purchasing company is to take over. In case of the provisions, the portion which represents liability expected to arise in future should be so transferred and the portion which is not required (*i.e.*, the reserve portion) should be treated as profit. Accordingly, the following entry will be recorded:

		Rs.	Rs.
6% Debentures in Wye Ltd.	Dr.	2,00,000	
Workmen's Compensation Reserve	Dr.	5,000	
Trade Creditors	Dr.	1,20,000	
To Realisation A/c			3,25,000
(Transfer of liabilities taken over by Wye Ltd. to Realisation A/c)			

For liabilities not take over by the purchasing company, the profit or loss on discharge of such liabilities shall be transferred to Realisation Account.3. Debit purchasing company and credit Realisation Account with the purchase consideration.

Wye Ltd.-	Dr.	17,20,000	
To Realisation A/c			17,20,000
(Amount receivable from Wye Ltd. for sale of business)			

4. On receipt of the purchase consideration debit what is received (cash, debentures, shares etc.) and credit the purchasing company. Thus —

Cash	Dr.	2,00,000	
9% Preference shares in Wye Ltd.	Dr.	4,00,000	
Equity shares in Wye Ltd.	Dr.	11,20,000	
To Wye Ltd.			17,20,000
(Receipt of purchase consideration from the purchase company)			

5. *Expenses of liquidation* have to be dealt with according to the circumstances of each case.

- (a) If the vendor company has to bear and pay them:

Realisation Account should be debited and Cash Account credited.

- (b) If the expenses are to be borne by the purchasing company, the question may be dealt within one of the two ways mentioned below:

- (i) It may be ignored in the books of the vendor company.

(ii) If the expenses are to be paid first by the vendor company and afterwards reimbursed by the purchasing company, the following two entries will be passed :

- (a) Debit Purchasing company and credit Cash Account when expenses are paid by the vendor company; and
- (b) Debit Cash Account and credit purchasing company (on the expenses being reimbursed).

In the above mentioned case Wye Ltd. has to pay maximum of Rs. 10,000 only whereas, the amount spent is Rs. 12,500. Hence Rs. 2,500 is to be borne by Zed Ltd.; the entries required will be :

		Rs.	Rs.
Wye Ltd.	Dr.	10,000	
Realisation A/c	Dr.	2,500	
To Cash A/c			12,500
(Liquidation expenses out of which Rs. 10,000 is payable by Wye Ltd.)			
Cash A/c	Dr.	10,000	
To Wye Ltd.			10,000
(Account reimbursed by Wye Ltd. for expense)			

6. Liabilities not assumed by the purchasing company, have to be paid off. On payment, debit the liability concerned and credit cash. Any difference between the amount actually paid and the book figure must be transferred to the Realisation Account. Zed Ltd. shall pass the following entries in this respect :

		Rs.	Rs.
Interest Outstanding	Dr.	12,000	
To Debentureholders A/c			12,000
(Amount due to debenture holders for debentures interest)			
Debentureholders	Dr.	12,000	
To Cash A/c			12,000
(Debentureholders paid cash Rs. 12,000 for outstanding interest)			

7. Credit the preference shareholders with the amount payable to them, debiting Preference Share Capital with the amount shown in the books, transferring the difference between the two, if any, to the Realisation Account. Thus —

6% Pref. Share Capital A/c	Dr.	4,00,000
Realisation A/c	Dr.	40,000

Accounting

To Preference Shareholders A/c	4,40,000
(The amount due to preference shareholders for capital and the extra amount payable under the scheme of absorption)	

Note : In the absence of any indication to the contrary, preference shareholders will be entitled only to the capital contributed by them. But if funds available after paying off creditors are not sufficient to satisfy the claim of preference shareholders fully, they will have to suffer a loss to the extent of the deficit.⁸ Pay off preference shareholders by debiting them and crediting whatever is given to them. The entry in the above case is :

		Rs.	Rs.
Preference shareholders A/c	Dr.	4,40,000	
To Cash A/c			40,000
To 9% Preference shares in Wye Ltd.			4,00,000
(Cash and preference shares in Wye Ltd. given to preference shareholders)			

9. Transfer equity share capital and account representing profit or loss (including the balance in Realisation Account) to Equity Shareholders Account. This will determine the amount receivable by the equity shareholders. Zed Ltd. shall pass the following entries in this regard :

		Rs.	Rs.
Equity Share Capital A/c	Dr.	8,00,000	
Capital Reserve A/c	Dr.	1,00,000	
Profit and Loss A/c	Dr.	50,000	
Workmen's Compensation Reserve A/c	Dr.	3,000	
Realisation A/c	Dr.	4,22,500*	
To Sundry Equity Shareholders A/c			13,75,500
(Various accounts representing capital and profit transferred to Equity Shareholders Account)			

*The Realisation Account will appear as follows :

Realisation Account			
	Rs.		Rs.
To Sundry Assets	15,80,000	By Sundry Liabilities	3,25,000
To Cash (excess expenses of liquidation)	2,500	By Wye Ltd.	17,20,000
To Preference Shareholders	40,000		
To Equity Shareholders A/c - profit transferred	4,22,500		
	<u>20,45,000</u>		<u>20,45,000</u>

Amalgamation

Equity Shareholders A/c	Dr.	40,000	
To Underwriting Commission A/c			40,000
(Underwriting Commission A/c closed by transfer to Equity Shareholders A/c)			

10. On satisfaction of the claims of the equity shareholders, debit their account and credit whatever is given to them. Hence:

Equity Shareholders A/c	Dr.	13,35,500	
To Equity Shares in Wye Ltd.			11,20,000
To Cash A/c**			2,15,500

6. Entries in the books of Purchasing Company

1. Debit Business Purchase Account and Credit Liquidator of the vendor company with the account of the purchase consideration. Thus -

		Rs.	Rs.
Business Purchase A/c	Dr.	17,20,000	
To Liquidator of Zed Ltd.			17,20,000
(Amount payable to Zed Ltd. as per agreement dated....)			

2. (i) Debit assets acquired (except goodwill) at the value placed on them by the purchasing company;
- (ii) Credit liabilities taken over at agreed values and credit Business Purchase Account with the amount of purchase consideration; and
- (iii) Credit the account showing shares held in the company, if any, with the cost of such shares.
- (iv) If the creditors as per (ii) and (iii) above exceed debits as per (i) above, the difference should be debited to Goodwill Account, in the reverse case, the difference should be credited to Capital Reserve.

Note : The amount of Goodwill or Capital Reserve that shall be included will be the amount as has been arrived at only in foregoing manner.

In the above case the entry to be passed shall be:

		Rs.	Rs.
Sundries	Dr.		
Land and Building A/c		5,50,000	
Plant and Machinery A/c		6,50,000	

** The students should prepare Cash Account to ascertain the cash balance.

Accounting

Patents A/c	20,000
Stock A/c	1,50,000
Sundry Debtors	1,80,000
Goodwill	5,05,000
To Sundries	
Provision for Workmen's Compensation A/c	5,000
Trade Creditors	1,20,000
Debentures in Z Ltd.	2,10,000
Business Purchases Account	17,20,000

(Various assets and liabilities taken over from Zed Ltd. Goodwill ascertained as a balancing figure)

3. On the payment to the vendor company the balance at its credit, the entry to be made by Wye Ltd. shall be:

		Rs.	Rs.
Liquidator of Zed Ltd.	Dr.	17,20,000	
To Cash			2,00,000
To 9% Preference Share Capital A/c			4,00,000
To Equity Share Capital A/c			8,00,000
To Securities Premium A/c			3,20,000

(Payment of cash and issue of shares in satisfaction of purchase consideration)

4. Debentures in Z Ltd. A/c Dr. 2,10,000
- | | | |
|------------------------------|--|----------|
| To 7% Debentures A/c | | 2,00,000 |
| To Premium on Debentures A/c | | 10,000 |

5. If the purchasing company is required to pay the expenses of liquidation of the vendor company, the amount should be debited to the Goodwill or Capital Reserve Account, as the case may be. In the instant case, the entry shall be:

Goodwill Account	Dr.	10,000	
To Cash Account			10,000

(Amount paid towards liquidation expenses on Zed Ltd.)

Entries at par value - The students will note that purchasing company is left with a large debit in the Goodwill Account (Step No. 2) accompanied by quite a large amount in the Securities Premium Account (Step No. 3). The two cannot be adjusted. However, it would be permissible to negotiate on the basis to the market value of the shares but to make entries only on the basis of par of

shares of purchasing company. This will mean that Goodwill Account (or Capital Reserve) will be automatically adjusted for the share premium.

Inter Company-owing - Should the purchasing company owe an amount to the vendor company or *vice versa*, the amount will be included in the book debts of one company and creditors of the other. This should be adjusted by the entry:

Sundry Creditors	Dr.
To Sundry Debtors	

The entry should be made after the usual acquisition entries have been passed. At the time of preparing the Realisation Account and passing the business purchase entries, no attention need be paid to the fact that the two companies involved owed money mutually.

Adjustment of the value of stock - Inter-company owings arise usually from purchase and sale of goods; it is likely, therefore, that at the time, of the sale of business, the debtor company also has goods in stock which it purchased from the creditor company - the cost of the debtor company will include the profit made by the creditor company. After the takeover of the business it is essential that such a profit is eliminated. The entry for this will be made by the purchasing company. If it is the vendor company which has such goods in stock, at the time of passing the acquisition entries, the value of the stock should be reduced to its cost to the company which is acquiring the business; automatically goodwill or capital reserve, as the case may be, will be adjusted. But if the original sale was made by the vendor company and the stock is with the company acquiring the business, the latter company will have to debit Goodwill (or Capital Reserve) and credit stock with the amount of the profit included in the stock.

Illustration 5

The following Balance Sheets are given as on 31st March, 2012:

	(Rs. in lakhs)			(Rs. in lakhs)	
	Best Ltd. Rs.	Better Ltd. Rs.		Best Ltd. Rs.	Better Ltd. Rs.
Share Capital:			Fixed Assets	25	15
Shares of Rs. 100, each			Investments	5	—
fully paid	20	10	Current Assets	20	5
Reserve and Surplus	10	8			
Other Liabilities	20	2			
	50	20		50	20

The following further information is given —

- (a) Investments of Best Ltd. includes Rs. 3 lakhs representing shares in Better Ltd. having a face value of Rs. 2 lakhs.

Accounting

- (b) Better Limited issued shares on 1st April, 2012, in the ratio of one share for every two held, out of Reserves and Surplus.
- (c) It was agreed that Best Ltd. will take over the business of Better Ltd., on the basis of the latter's Balance Sheet, the consideration taking the form of allotment of shares in Best Ltd.
- (d) The value of shares in Best Ltd. was considered to be Rs. 150 and the shares in Better Ltd. were valued at Rs. 100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.
- (e) Liabilities of better Ltd., included Rs. 1 lakh due to Best Ltd., for purchases from it, on which Best Ltd., made profit of 25% of the cost. The goods of Rs. 50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet.

Make the closing ledger in the Books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 2012 after the takeover.

Solution

LEDGER OF BETTER LIMITED

Fixed Assets Account

	Rs.		Rs.
To Balance b/d	<u>15,00,000</u>	By Realisation A/c (transfer)	<u>15,00,000</u>

Current Assets Account

	Rs.		Rs.
To Balance b/d	<u>5,00,000</u>	By Realisation A/c (transfer)	<u>5,00,000</u>

Liabilities Account

	Rs.		Rs.
To Realisation A/c	<u>2,00,000</u>	By Balance b/d	<u>2,00,000</u>

Realisation Account

To Fixed Assets A/c	15,00,000	By Liabilities A/c	2,00,000
" Current Assets A/c	5,00,000	" Best Limited	15,00,000
		(Purchase Consideration)	
		" Shareholders' A/c	3,00,000
		(Loss on Realisation)	
	<u>20,00,000</u>		<u>20,00,000</u>

Amalgamation

Share Capital Account			
To Sundry shareholders		By Balance b/d	10,00,000
A/c - (transfer)	15,00,000	" Reserves & Surplus A/c (Bonus issue)	<u>5,00,000</u>
	<u>15,00,000</u>		<u>15,00,000</u>
Reserves & Surplus A/c			
To Share Capital (Bonus issue)	5,00,000	By Balance b/d	8,00,000
" Sundry Shareholders	<u>3,00,000</u>		<u>8,00,000</u>
	<u>8,00,000</u>		
Best Ltd.			
To Realisation A/c - Purchase Consideration	15,00,000	By Sundry Shareholders (1/5 of Purchase Consideration)	3,00,000
	<u>15,00,000</u>	" Shares in Best Ltd.	<u>12,00,000</u>
			<u>15,00,000</u>
Shares in Best Ltd.			
To Best Ltd.	12,00,000	By Sundry Shareholders A/c	12,00,000
Sundry Shareholders A/c			
To Realisation A/c	3,00,000	By Share Capital A/c	15,00,000
(Loss)		" Reserves & Surplus A/c	3,00,000
" Best Ltd.	3,00,000		
" Share in Best Ltd.	<u>12,00,000</u>		<u>18,00,000</u>
	<u>18,00,000</u>		
Journal of Best Ltd.			
2012		<i>Dr.</i>	<i>Cr.</i>
		<i>Rs.</i>	<i>Rs.</i>
Apr. 1	Fixed Assets A/c	Dr.	15,00,000
	Current Assets A/c	Dr.	5,00,000
	To Liabilities A/c		2,00,000
	To Liquidator of Better Ltd.		12,00,000
	To Capital Reserve A/c		3,00,000
	To Shares in Better Ltd.		3,00,000
(Assets & Liabilities of Better Ltd. taken over for an agreed purchase consideration of Rs. 12,00,000 and cancellation of investments, held in Better Ltd., at Rs. 3,00,000 as per agreement dated....)			

Accounting

Liquidator of Better Ltd.	Dr.	12,00,000	
To Share Capital A/c			8,00,000
To Securities Premium A/c			4,00,000
(Discharge of Purchase consideration by the issue of equity shares of Rs. 8,00,000 at a premium of Rs. 50 per share as per agreement)			
Sundry Creditors A/c	Dr.	1,00,000	
To Sundry Debtors A/c			1,00,000
(Amount due from Better Ltd., and included in its creditors taken over, cancelled against own sundry debtors)			
Capital Reserve A/c	Dr.	10,000	
To Current Asset (Stock) A/c			10,000
(Unrealized profit on stock included in current assets of Better Ltd. written off to Reserve Account)			

Working Note :

Calculation of Purchase consideration:

	Rs.
Issued Capital of Better Ltd. (after bonus issue) at Rs. 100 per share	15,00,000
Less : held by Best Ltd.	<u>3,00,000</u>
Held by outsiders, valued at Rs. 100 per share	<u>12,00,000</u>
Purchase consideration has been discharged by Best Ltd. by the issue of shares for Rs. 8,00,000 at a premium of Rs. 4,00,000. This gives the value of Rs. 150 per share.	

Balance Sheet of Best Ltd. (After absorption)

	Particulars	Notes	Rs.
Equity and Liabilities			
1	Shareholders' funds		
a	Share capital	1	28,00,000
b	Reserves and Surplus	2	16,90,000
2	Current liabilities		21,00,000
	Total		<u>65,90,000</u>
Assets			
1	Non-current assets		
a	Fixed assets		
	Tangible assets	3	40,00,000

Amalgamation		
b	Non-current investments	2,00,000
2	Current assets	23,90,000
	Total	65,90,000
Notes to accounts		
		Rs.
1	Share Capital	
	Equity share capital	
	Issued & Subscribed	
	28,000 shares of Rs. 100	
	(Of the above 8,000 shares have been issued for consideration other than cash)	28,00,000
	Total	28,00,000
2	Reserves and Surplus	
	Capital Reserve	2,90,000
	Securities Premium	4,00,000
	Other reserves and surplus	10,00,000
	Total	16,90,000
3	Tangible assets	
	Fixed Assets	25,00,000
	Acquired during the year	15,00,000
	Total	40,00,000

Illustration 6

K Ltd. and L Ltd. amalgamate to form a new company LK Ltd. The financial position of these two companies on the date of amalgamation was as under:

	K Ltd. Rs.	L Ltd. Rs.		K Ltd. Rs.	L Ltd. Rs.
Share Capital			Goodwill	80,000	
Equity Shares			Land & Building	4,50,000	3,00,000
of Rs. 100 each	8,00,000	3,00,000	Plant & Machinery	6,20,000	5,00,000
7% Preference Share			Furniture and		
of Rs. 100 each	4,00,000	3,00,000	Fittings	60,000	20,000
5% Debentures	2,00,000	—	Sundry Debtors	2,75,000	1,75,000
General Reserve	—	1,00,000	Stores & Stock	2,25,000	1,40,000
Profit and Loss			Cash at Bank	1,20,000	55,000

Accounting

Account	4,31,375	97,175	Cash in hand	41,375	17,175
Sundry Creditors	1,00,000	2,10,000	Preliminary		
Secured Loan	—	2,00,000	Expenses	60,000	
	<u>19,31,375</u>	<u>12,07,175</u>		<u>19,31,375</u>	<u>12,07,175</u>

The terms of amalgamation are as under:

- (A) (1) The assumption of liabilities of both the Companies.
- (2) Issue of 5 Preference shares of Rs. 20 each in LK Ltd. @ Rs. 18 paid up at premium of Rs. 4 per share for each preference share held in both the Companies.
- (3) Issue of 6 Equity shares of Rs. 20 each in LK Ltd. @ Rs. 18 paid up at a premium of Rs. 4 per share for each equity share held in both the Companies. In addition, necessary cash should be paid to the Equity Shareholders of both the Companies as is required to adjust the rights of shareholders of both the Companies in accordance with the intrinsic value of the shares of both the Companies.
- (4) Issue of such amount of fully paid 6% debentures in LK Ltd. as is sufficient to discharge the 5% debentures in K Ltd. at a discount of 5% after takeover.
- (B) (1) The assets and liabilities are to be taken at book values stock and debtors for which provisions at 2% and 2 ½ % respectively to be raised.
- (2) The sundry debtors of K Ltd. include Rs. 20,000 due from L Ltd.
- (C) The LK Ltd. is to issue 15,000 new equity shares of Rs. 20 each, Rs. 18 paid up at premium of Rs. 4 per share so as to have sufficient working capital. Prepare ledger accounts in the books of K Ltd. and L Ltd. to close their books.

Solution

Books of K Ltd.

Realisation Account

	Rs.		Rs.
To Goodwill	80,000	By 5% Debentures	2,00,000
To Land & Building	4,50,000	By Sundry creditors	1,00,000
To Plant & Machinery	6,20,000	By LK Ltd.	15,60,000
To Furniture & Fitting	60,000	(Purchase consideration)	
To Sundry debtors	2,75,000	By Equity shareholders A/c	51,375
To Stores & Stock	2,25,000	(loss)	
To Cash at Bank	1,20,000		
To Cash in hand	41,375		
To Preference shareholders			
(excess payment)	<u>40,000</u>		
	<u>19,11,375</u>		<u>19,11,375</u>

Amalgamation

Equity Shareholders A/c

	Rs.		Rs.
To Preliminary Expenses	60,000	By Share capital	8,00,000
To Realisation A/c (loss)	51,375	By Profit & Loss A/c	4,31,375
To Equity Shares in LK Ltd.	10,56,000		
To Cash	<u>64,000</u>		
	<u>12,31,375</u>		<u>12,31,375</u>

LK Ltd. A/c

	Rs.		Rs.
To Realisation A/c	15,60,000	By Equity Shares in LK Ltd.	
		For Equity	10,56,000
		Pref.	<u>4,40,000</u>
		By Cash	<u>64,000</u>
	<u>15,60,000</u>		<u>15,60,000</u>

Books of L Ltd.

Realisation Account

	Rs.		Rs.
To Land & Building	3,00,000	By Sundry creditors	2,10,000
To Plant & Machinery	5,00,000	By Secured loan	2,00,000
To Furnitures & Fittings	20,000	By LK Ltd. (Purchase	
To Sundry debtors	1,75,000	consideration)	7,90,000
To Stock of stores	1,40,000	By Equity shareholders A/c—	
To Cash at bank	55,000	Loss	37,175
To Cash in hand	17,175		
To Pref. shareholders	<u>30,000</u>		
	<u>12,37,175</u>		<u>12,37,175</u>

Equity Shareholders Account

	Rs.		Rs.
To Equity shares in LK Ltd.	3,96,000	By Share Capital	3,00,000
To Realisation	37,175	By Profit & Loss A/c	97,175
To Cash	<u>64,000</u>	By Reserve	<u>1,00,000</u>
	<u>4,97,175</u>		<u>4,97,175</u>

LK Ltd. Account

	Rs.		Rs.
To Realisation A/c	7,90,000	By Equity shares in LK Ltd.	

Accounting

	For Equity	3,96,000	
	Preference	<u>3,30,000</u>	7,26,000
	By Cash		<u>64,000</u>
			<u>7,90,000</u>

Working Notes:

(i) Purchase consideration

	<i>K Ltd.</i> Rs.	<i>L Ltd.</i> Rs.
Payable to preference shareholders:		
Preference shares at Rs. 22 per share	4,40,000	3,30,000
Equity Shares at Rs. 22 per share	10,56,000	3,96,000
Cash [See W.N. (ii)]	<u>64,000</u>	<u>64,000</u>
	<u>15,60,000</u>	<u>7,90,000</u>

(ii) Value of Net Assets

	<i>K Ltd.</i> Rs.	<i>L Ltd.</i> Rs.
Goodwill	80,000	
Land & Building	4,50,000	3,00,000
Plant & Machinery	6,20,000	5,00,000
Furniture & Fittings	60,000	20,000
Debtors less 2.5%	2,68,125	1,70,625
Stock less 2%	2,20,500	1,37,200
Cash at Bank	1,20,000	55,000
Cash in hand	<u>41,375</u>	<u>17,175</u>
	18,60,000	12,00,000
Less : Debentures	2,00,000	—
Creditors	1,00,000	2,10,000
Secured Loans	<u>—</u>	<u>2,00,000</u>
	15,60,000	7,90,000
Payable in shares	<u>14,96,000</u>	<u>7,26,000</u>
Payable in cash	<u>64,000</u>	<u>64,000</u>

Illustration 7

The following are the summarized Balance Sheets of A Ltd. and B Ltd. as on 31.3.2012:

	(Rs. in thousands)	
Liabilities	A Ltd.	B Ltd.
Share capital:		
Equity shares of 100 each fully paid up	2,000	1,000

Amalgamation

Reserves	800	---
10% Debentures	500	---
Loans from Banks	250	450
Bank overdrafts	---	50
Sundry creditors	300	300
Proposed dividend	200	---
Total	4,050	1,800
Assets		
Tangible assets/fixed assets	2,700	850
Investments (including investments in B Ltd.)	700	---
Sundry debtors	400	150
Cash at bank	250	---
Accumulated loss	---	800
Total	4,050	1,800

B Ltd. has acquired the business of A Ltd. The following scheme of merger was approved:

- (i) Banks agreed to waive off the loan of Rs.60 thousands of B Ltd.
- (ii) B Ltd. will reduce its shares to Rs.10 per share and then consolidate 10 such shares into one share of Rs.100 each (new share).
- (iii) Shareholders of A Ltd. will be given one share (new) of B Ltd. in exchange of every share held in A Ltd.
- (iv) Proposed dividend of A Ltd. will be paid after merger to shareholders of A Ltd.
- (v) Sundry creditors of B Ltd. includes Rs.100 thousands payable to A Ltd.
- (vi) A Ltd. will cancel 20% holding in B Ltd. as investment, which was held at a cost of Rs.250 thousands.

Pass necessary entries in the books of B Ltd. and prepare Balance Sheet after merger.

Solution

Calculation of purchase consideration

One share of B Ltd. will be issued in exchange of every share of A Ltd. (i.e. 20,000 equity shares of B Ltd will be issued against 20,000 equity shares of A Ltd.)	20,000 shares
Less: Shares already held (20% of 10,000 shares)	
2,000 shares converted in new equity shares	<u>200 shares</u>
Number of shares to be issued by B Ltd to shareholders of A Ltd.	<u>19,800 shares</u>

Journal Entries in the books of B Ltd.

Date			(Rs. in thousands)	
			Dr.	Cr.
2012				
March,31	Loan from bank A/c	Dr.	60	
	To Reconstruction A/c			60
	(Being loan from bank waived off to the extent of Rs. 60 thousand)			
	Equity share capital A/c (Rs.100)	Dr.	1,000	
	To Equity share capital A/c (Rs.10)			100
	To Reconstruction A/c			900
	(Being equity shares of Rs. 100 each reduced to Rs.10 each)			
	Equity share capital A/c (Rs.10)	Dr.	100	
	To Equity share capital A/c (Rs.100 each)			100
	(Being 10 equity shares of Rs. 10 each consolidated to one share of Rs.100 each)			
	Reconstruction A/c	Dr.	960	
	To Profit and loss A/c			800
	To Capital reserve A/c			160
	(Being accumulated losses set off against reconstruction A/c and balance transferred to capital reserve account)			
	Business purchase A/c	Dr.	1,980	
	To Liquidator of A Ltd.			1,980
	(Being purchase of business of A Ltd.)			
	Fixed asset A/c	Dr.	2,700	
	Investment A/c (700 – 250)	Dr.	450	
	Sundry debtors A/c	Dr.	400	
	Cash at bank A/c	Dr.	250	
	To Sundry creditors A/c			300
	To Proposed dividend A/c			200
	To Loans from bank A/c			250
	To 10% Debentures A/c			500

Amalgamation

	To Business purchase A/c		1,980
	To Reserves A/c (800 – 230)		570
	(Being assets, liabilities and reserves taken over under pooling of interest method)		
	Liquidator of A Ltd. A/c	Dr.	1,980
	To Equity share capital A/c		1,980
	(Being payment made to liquidators of A Ltd. by allotment of 19,800 new equity shares)		
	Sundry creditors A/c	Dr.	100
	To Sundry debtors A/c		100
	(Being mutual owing cancelled)		
	Proposed dividend A/c	Dr.	200
	To Bank A/c		200
	(Being dividend paid off)		

Balance Sheet of B Ltd. after merger as on 31.3.2012

	Particulars	Notes	Rs. in '000
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	2,080
b	Reserves and Surplus	2	730
2	Non-current liabilities		
a	Long term borrowings	3	1,140
3	Current liabilities		
a	Trade payables		500
b	Short term borrowings	4	50
	Total		4,500
	Assets		
1	Non-current assets		
a	Fixed assets		
	Tangible assets		3,550
b	Non-current investments		450
2	Current assets		
a	Trade receivables		450

Accounting

b	Cash and cash equivalents		50
	Total		4,500
Notes to accounts			
			Rs.
1 Share Capital			
20,800, Equity shares of Rs.100 each fully paid			2,080
(Out of the above, 19,800 shares have been issued for consideration other than cash)			
2 Reserves and Surplus			
Capital reserve	160		
General reserve	570		
	Total		730
3 Long Term Borrowings			
10% Debentures	500		
Loan from Bank (250+450-60)	640		1,140
4 Short term borrowings			
Bank overdraft			50

Illustration 8

Given below are the summarized balance sheets of Huge Ltd and Big Ltd. as on 31.12.2012. Big Ltd. was merged with Huge Ltd. with effect from 1.1.2013.

Balance Sheets as on 31.12.2012

(Rs.)

Liabilities	Huge Ltd.	Big Ltd.	Assets	Huge Ltd.	Big Ltd.
Share capital :			Sundry fixed assets	9,50,000	4,00,000
Equity shares of Rs. 10 each	7,00,000	2,50,000	Investments (Non-trade)	2,00,000	50,000
General reserve	3,50,000	1,20,000	Stock	1,20,000	50,000
Profit and loss A/c	2,10,000	65,000	Debtors	75,000	80,000
Export profit reserve	70,000	40,000	Advance tax	80,000	20,000
12% Debentures	1,00,000	1,00,000	Cash and bank	2,75,000	1,30,000
Sundry creditors	40,000	45,000	Preliminary expenses	10,000	
Provision for taxation	1,00,000	60,000			
Proposed Dividend	1,40,000	50,000			
	<u>17,10,000</u>	<u>7,30,000</u>		<u>17,10,000</u>	<u>7,30,000</u>

Amalgamation

Huge Ltd. would issue 12% debentures to discharge the claims of the debenture holders of Big Ltd. at par. Non-trade investments of Huge Ltd. fetched @ 25% while those of Big Ltd. fetched @ 18%. Profit of Huge Ltd. and Big Ltd. during 2010, 2011 and 2012 were as follows:

Year	Huge Ltd. Rs.	Big Ltd. Rs.
2010	5,00,000	1,50,000
2011	6,50,000	2,10,000
2012	5,75,000	1,80,000

Goodwill may be calculated on the basis of capitalization method taking 20% as the normal rate of return. Purchase consideration is discharged by Huge Ltd. on the basis of intrinsic value per share. Both companies decided to cancel the proposed dividend.

Pass Journal Entries and prepare the balance sheet of Huge Ltd. after the merger.

Solution

Balance Sheet of M/s. Huge Ltd. after merger

	Particulars	Notes	Rs.
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	9,24,000
b	Reserves and Surplus	2	14,90,960
2	Non-current liabilities		
a	Long term borrowings	3	2,00,000
3	Current liabilities		
a	Trade payables		85,000
b	Short term provisions	4	1,60,000
	Total		28,59,960
	Assets		
1	Non-current assets		
a	Fixed assets		
	Tangible assets		13,50,000
	Intangible assets	5	3,80,000
b	Non-current investments		2,50,000
c	Other non-current assets	8	40,000
2	Current assets		
a	Inventories		1,70,000

Accounting

b	Trade receivables		1,55,000
c	Cash and cash equivalents		4,04,960
d	Short term loans and advances	6	1,00,000
e	Other current assets	7	10,000
	Total		28,59,960

Notes to accounts

Rs.

1 Share Capital

92,400 Equity shares of Rs. 10 each

9,24,000

(of which 22,400 shares were issued for consideration other than cash)

2 Reserves and Surplus

Securities premium

6,80,960

General reserve

3,50,000

Profit and loss A/c

2,10,000

Add: Proposed dividend

Cancelled

1,40,000

3,50,000

Export profit reserve (70,000 + 40,000)

1,10,000

Total

14,90,960

3 Long Term Borrowings

Secured

12% Debentures (1,00,000+1,00,000)

2,00,000

4 Short term provisions

Provision for tax (1,00,000+60,000)

1,60,000

5 Intangible assets

Goodwill (W.N.3C)

3,80,000

6 Short term loans and advances

Advance tax (80,000+20,000)

1,00,000

7 Other current assets

Preliminary expenses

10,000

8 Other non-current asset

Amalgamation Adjustment A/c

40,000

Working Notes:**1. Calculation of purchase consideration:**

Equity shares of Big Ltd.	25,000 shares
Intrinsic value per share of Big Ltd. (W.N.2)	Rs. 36.2
Value of shares	Rs. 9,05,000
Intrinsic value per share of Huge Ltd. (W.N.2)	Rs. 40.4
No. of shares to be issued by Huge Ltd. $\text{Rs. } 9,05,000 / \text{Rs. } 40.4 = 22,400.99$ shares	
i.e 22,400 shares and cash for fraction i.e. $.99 \times \text{Rs. } 40.4 = \text{Rs. } 40$	

Accounting for Amalgamations and Corporate Restructuring

Purchase consideration

i.	22,400 shares @ Rs. 40.4		
	Capital [Rs.10 / Share]	2,24,000	
	Premium [Rs. 30.4 / Share]	<u>6,80,960</u>	Rs. 9,04,960
ii.	Cash for fraction		Rs. <u>40</u>
iii.	Total purchase consideration payable		Rs. <u>9,05,000</u>

2. Intrinsic value per share:

	Huge Ltd.		Big Ltd	
	Rs.	Rs.	Rs.	Rs.
Assets				
i. Goodwill (W.N.3)	13,65,000		3,80,000	
ii. Sundry fixed assets	9,50,000		4,00,000	
iii. Investments	2,00,000		50,000	
iv. Stock	1,20,000		50,000	
v. Debtors	75,000		80,000	
vi. Advance tax	80,000		20,000	
vii. Cash and bank balance	<u>2,75,000</u>	30,65,000	<u>1,30,000</u>	11,10,000
Liabilities				
i. 12% Debentures	1,00,000		1,00,000	
ii. Sundry creditors	40,000		45,000	
iii. Provision for tax	<u>1,00,000</u>	<u>(2,40,000)</u>	<u>60,000</u>	<u>(2,05,000)</u>
Net assets		<u>28,25,000</u>		<u>9,05,000</u>

Accounting

No. of shares		70,000		25,000
Intrinsic value per share (upto one decimal)		40.4		36.2

3. Valuation of goodwill

A. Capital Employed

	Huge Ltd.		Big Ltd.	
	Rs.	Rs.	Rs.	Rs.
Assets				
i. Sundry fixed assets	9,50,000		4,00,000	
ii. Investment (Non-trade)	-		-	
iii. Stock	1,20,000		50,000	
iv. Debtors	75,000		80,000	
v. Advance tax	80,000		20,000	
vi. Cash and bank balance	<u>2,75,000</u>	15,00,000	<u>1,30,000</u>	6,80,000
Liabilities:				
i. 12% Debentures	1,00,000		1,00,000	
ii. Sundry creditors	40,000		45,000	
iii. Provision for tax	1,00,000	<u>(2,40,000)</u>	60,000	<u>(2,05,000)</u>
Capital employed		<u>12,60,000</u>		<u>4,75,000</u>

B. Average pre-tax profit:

Particulars	Huge Ltd. Rs.	Big Ltd. Rs.
2007	5,00,000	1,50,000
2008	6,50,000	2,10,000
2009	<u>5,75,000</u>	<u>1,80,000</u>
Total (a+b+c)	<u>17,25,000</u>	<u>5,40,000</u>
Simple Average [(a) ÷ 3]	5,75,000	1,80,000
Less: Non-trading income		
(2,00,000 @ 25%)	(50,000)	
(50,000 @ 18%)		<u>(9,000)</u>
Average profit	<u>5,25,000</u>	<u>1,71,000</u>

C. Computation of goodwill:

Rs.

Particulars	Huge Ltd.	Big Ltd.
Capitalised value of average profits $\left[\frac{5,25,000}{.20}, \frac{1,71,000}{.20} \right]$	26,25,000	8,55,000
Capital employed	<u>12,60,000</u>	<u>4,75,000</u>
Goodwill	<u>13,65,000</u>	<u>3,80,000</u>

Summary

1. Amalgamation means joining of two or more existing companies into one company, the joined companies lose their identity and form themselves into a new company.
2. In absorption, an existing company takes over the business of another existing company. Thus there is only one liquidation and that is of the merged company.
3. A company which is merged into another company is called a transferor company or a vendor company.
4. A company into which the vendor company is merged is called transferee company or vendee company or purchasing company.
5. In amalgamation in the nature of merger there is genuine pooling of:
 - a) Assets and liabilities of the amalgamating companies,
 - b) Shareholders' interest,

Also the business of the transferor company is intended to be carried on by the transferee company.
6. In amalgamation in the nature of purchase, one company acquires the business of another company.
7. Purchase Consideration can be defined as the aggregate of the shares and securities issued and the payment made in form of cash or other assets by the transferee company to the share holders of the transferor company.
8. There are two main methods of accounting for amalgamation:
 - a) The pooling of interests method, and
 - b) The purchase method.

Accounting

9. Under pooling of interests method, the assets, liabilities and reserves of the transferor company will be taken over by transferee company at existing carrying amounts.
10. Under purchase method, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation