

Session : 2019-20
M.COM.- FIRST YEAR
(II SEMESTER)

CORPORATE FINANCIAL ACCOUNTING
(I-2002)

**UNIT – I : AMALGAMATION &
RECONSTRUCTION**

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LEARNING OBJECTIVES

After you have gone through this unit, you should be able to describe –

- Meaning of Amalgamation & Absorption;
- Types of Amalgamation & Reconstruction;
- Difference between '**Amalgamation in the nature of Merger**' and '**Amalgamation in the nature of Purchase**';
- Purchase Consideration and its methods;
- Accounting treatment in the books of Transferor Company (Vendor) and Transferee Company (Buyer);
- Difference between '**External Reconstruction**' and '**Amalgamation**';
- Accounting for External Reconstruction

INTER-COMPANY OWINGS & INTER-COMPANY HOLDINGS

INTRODUCTION

- Amalgamation or absorption usually take place between those companies which had some business dealings.
- It is usual to find **inter-co. indebtedness** and **inter-co. stocks**, resulting from purchases and sales transactions taking place between these companies **or** from loans or bills of exchange given by one co. to another co.
- Therefore, in case of merger, it becomes **necessary to remove the effect of such transactions** by passing suitable adjustment entries.

EFFECT ON TRANSFEROR CO.
(i.e. VENDOR CO. or AMALGAMATING CO.)

No Effect

(of inter-co. owings and inter-co. holdings is taken **in the books of transferor co.**)

EFFECT ON TRANSFEREE CO.
(i.e. BUYER CO. or AMALGAMATED CO.)

Inter-co. owings and inter-co. holdings **effects** the books of transferee co., as such, **set-off entries** (*in addition to entries for **purchase of business** and **payment of purchase consideration***) are made to **eliminate the effect** of –

- (1) Mutual Indebtness** and
- (2) Unrealised Profit in stocks.**

Entries in the books of Transferee Co.

(I) INTER-COMPANY OWINGS

- If the transferor co. is owing an amount **to or from** the transferee co., the amount will be included in the **debtors** of one co. and **creditors** of the other. **At the time of merger**, this should be adjusted by making the following entry in the books of transferee co., with the amount of inter-co. owings-

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	Sundry Creditors A/c		20,000	
	To Sundry Debtors A/c			20,000

Entries in the books of Transferee Co.

(II) INTER-COMPANY BILLS OF EXCHANGE

- In case of mutual acceptances, the transferee company will pass the following adjustment entry with the amount of inter-company bills of exchange held-

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	Bills Payable A/c		10,000	
	To Bills Receivables A/c			10,000

Entries in the books of Transferee Co.

(III) INVESTMENT IN INTER-COMPANY DEBENTURES

- If at the date of takeover, the transferor co. or transferee co. has as investment certain debentures issued by the other co.(i.e. transferee co. or transferor co.), the following adjustment entry will be passed to eliminate such inter-co. transaction -

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	Debentures A/c (with the par value)		_____	
	To Investment in Debentures A/c (with cost of investment)			_____

Entries in the books of Transferee Co.

(III) (A) : If the INVESTMENT IN DEBENTURES is NOT AT PAR but is MORE THAN THE PAR VALUE

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	Debentures A/c (with the par value)	Dr.	50,000	
	Goodwill A/c (Balancing Figure)	Dr.	15,000	
	To Investment in Debentures A/c (with cost of investment)			65,000

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Entries in the books of Transferee Co.

(III) (B) If the INVESTMENT IN DEBENTURES is NOT AT PAR but is LESS THAN THE PAR VALUE

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	Debentures A/c (with the par value)	Dr.	50,000	
	To Investment in Debentures A/c (with cost of investment)			38,000
	To Capital Reserve A/c (Balancing Figure)			12,000

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In the books of Transferee Co.

(IV) INTER-COMPANY STOCKS

- If at the date of takeover, the transferee co. and/or transferor co. hold stocks out of goods sold by one co. to the other co. (i.e. by transferor co. or transferee co.) at a profit, the unrealized profit included in such goods must be adjusted in the books of the transferee co.

SITUATION 1

- If the **stock of transferor co.** includes goods out of **purchases made by it from the transferee co.** –

Treatment in the books of accounts of Transferee Co.

The figure of the stock of the transferor co. be **reduced by** the **amount of unrealized profit** while passing **entry for acquisition of business** in the books of transferee co.

Example: Suppose, X Ltd. agreed to absorb Y Ltd. Among other assets, the stock of Y Ltd. is Rs.50,000. It includes stock worth Rs.10,000 purchased by them from X Ltd., which were sold to them at a profit of 20% of sale price. In such case, X Ltd. will **debit Stock A/c** (while passing entry for acquisition of business of Y Ltd.) by Rs.50,000 (-) [20% of 10,000] = Rs.50,000 (-) 2,000 = **Rs.48,000.**

SITUATION 1

- Alternatively, on acquisition of business, stock account may be debited by Rs.50,000. But in that case, a separate entry will have to be passed with the unrealized profit element (i.e.. Rs.2,000) in the books of transferee co.-

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	Capital Reserve A/c Dr.		2,000	
	To Stock A/c			2,000

SITUATION 2

- If the **stock of transferee co.** includes goods purchased from the **transferor co. at profit**, the following **adjustment entry** will be passed **by the transferee co.** with the amount of **unrealized profit to eliminate it** –

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	Goodwill Dr. (or Capital Reserve A/c) {As the case may be}			
	To Stock A/c			

IMPORTANT POINT TO REMEMBER

- *Some authors are of the view that there is **no need for adjusting such stock** because -*
 - (i) the absorption of the company **does not cancel the transaction** which results in the past and*
 - (ii) the shareholders of the transferor company **will not surrender their profit.***

But this approach is **not** followed here.

REFERENCE BOOKS

1. **Warren/Reeve/Duchac's Corporate Financial Accounting 13E and CengageNOW™v2! Market-leading Corporate Financial Accounting (ISBN-13: 978-1285868783 ISBN-10: 1285868781)**
2. **International Journal of Accounting and Finance (ISSN online:1752-8232 ISSN print: 1752-8224)**
3. **Shukla S.M. & Gupta K.L., Corporate Financial Accounting (Sahitya Bhawan Publications)**
4. **Gupta K.G., Corporate Financial Accounting (K.G.Publications)**
5. **Gupta R.L. Advanced Financial Accounting, (S.Chand & Co.)**

REFERENCE BOOKS

6. Maheshwari S.N., Advanced Accounting – Vol.II, (**Vikas Publishing House**)
7. Shukla M.C. & T.S.Grewal, Advanced Accountancy (**Sultan Chand & Co.**)
8. Jain & Narang, Financial Accounting (**Kalyani Publishers**)

THANKS!

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