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

THREE (3) POSSIBILITIES / SITUATIONS

Shares may be held by -

(I) The Transferee Co. in the Transferor Co.

(II) The Transferor Co. in the Transferee Co.

(III) Both Companies in each other.

SITUATION I

- In this situation, the **purchase consideration has to be adjusted** for the **shares already held** by the Transferee Co.
- The reason behind this is that the **Purchasing co.** is the **owner of the proportionate assets** of the **Transferor Co.**
- Adjustment in the purchase consideration depends on the **method of calculation** of purchase consideration.
- If it is **net assets method**, then purchase consideration is calculated in **two phases / steps** –

(i) *First*, it is calculated for the **entire undertaking** and

(ii) *Subsequently*, it is **proportionately reduced** on the basis of **transferee co.'s holdings in the transferor co.**

- Under **net payment method**, it is calculated on the basis of outside shareholders.

SITUATION I : ACCOUNTING TREATMENT IN THE BOOKS OF TRANSFEROR CO.

● The entries for **(i)** purchase consideration due and **(ii)** for receiving the purchase consideration are passed with the amount of purchase consideration **payable to outside shareholders**, in the books of transferor co.

● **Example** : Suppose, S Ltd., having 100,000 shares of Rs. 10 each, is taken over by B Ltd. under an agreement for the absorption. B Ltd. **already holds** 20,000 shares of S Ltd., which are acquired by it during the last few years. It is agreed that **outside shareholders** in S Ltd. be given Rs.10 shares, **issued at par** by B Ltd. on the basis of such shares being worth Rs.16 each and the shares in S Ltd. being worth Rs.5 each. Calculate purchase consideration.

SITUATION I : ACCOUNTING TREATMENT IN THE BOOKS OF TRANSFEROR CO.

- **Solution** :

Step 1. Number of shares of S Ltd. held by outsider shareholders

= 100,000 – 20,000 = 80,000

Step 2. Value of shares held by outside shareholders

= 80,000 x Rs.5 = Rs. 400,000

Step 3. Number of shares of B Ltd. to be issued to outside shareholders

= Rs. 400,000/Rs. 16 = 25,000 shares

Step 4. Therefore, Purchase consideration

= 25,000 shares x Rs.10

= Rs. 250,000

SITUATION I : ACCOUNTING TREATMENT IN THE BOOKS OF TRANSFEROR CO.

- To add further, as the transferor co. is **not receiving** purchase consideration (from transferee co.) for **that part of its share capital** which is **already held** by the transferee co., it will **not be required to pay out** such share capital. Therefore, **this part** of share capital account is **closed by transfer to the Realisation Account** by passing following entry with the **paid up capital value** of **shares held by transferee co.** –

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	Share Capital A/c Dr.			
	To Realisation A/c			

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SITUATION I : ACCOUNTING TREATMENT IN THE BOOKS OF TRANSFEREE CO.

● Since the transferee company's investment in the shares and debentures of the transferor has got **no value after take over**, the **investment account** for these investments is **closed** by making the following entry with the cost of investment–

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	Goodwill (or Capital Reserve) A/c Dr.			
	To Investment in Transferor Co. A/c			

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SITUATION I : ACCOUNTING TREATMENT IN THE BOOKS OF TRANSFEREE CO.

Alternative Treatment

► At the time of passing entry for the acquisition of business, the **"Investment in Transferee Co. A/c"** may be **credited** with the cost of the investment and

► Goodwill (or Capital Reserve) is determined thereafter.

SITUATION II

One should always remember that in case of take over, i.e. when the business of **transferor co.**(say **S Ltd.**) is acquired by another company, that is, **transferee co.**(say, **B Ltd.**), the shares **already held by S Ltd. of the B Ltd.** shall like other assets **neither be transferred to B Ltd. nor** it should be transferred to the **Realisation account**.

(Contd..)

SITUATION II

Rather, these shares which are already held by the **transferor co.** (*say*, **old shares**) along with the shares received now by it from the **transferee co.**in purchase consideration (*say*, **new shares**) will be transferred to **equity shareholders account** in paying off their claims.

(Contd..)

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SITUATION II

● In case, the value of shares **already held** (say, **old shares**) by the **transferor co.**is different from the value of shares received now (say, **new shares**) **in the purchase consideration**, then the shares (i.e. **old shares**) already held by **transferor co.** should be **revalued on the basis of new shares** and

● Any **profit** *or* **loss on revaluation** will be transferred to **Realisation account** *or* directly to **Equity Shareholders account**.

SITUATION II

(1) When Purchase Consideration is determined by Net Payment Method

Step 1 : Determine the **number of shares** to be received by the **transferor co.** from **transferee co.** on exchange ratio basis or any other basis (as given in the problem).

Step 2 : **Deduct** from **step 1**, number of shares **already held** by the **transferor co.**in the **transferee co.**

Step 3 : **Multiply** the figure obtained in **step 2** by the **issue price** of shares of transferee co. to find the amount of purchase consideration.

SITUATION II

(1) When Purchase Consideration is determined by Net Payment Method

Example : **B Ltd.** absorbs **S Ltd.** by issuing 10 shares of Rs.10 each at Rs.12, for every 8 shares in **S Ltd.** The balance sheet of **S Ltd.** as on the date of absorption shows its share capital of Rs.400,000 (being divided into 40,000 shares of Rs.10 each). It's assets side shows an investment of Rs.80,000 in 8,000 shares of **B Ltd.** Calculate purchase consideration.

SITUATION II

(1) When Purchase Consideration is determined by Net Payment Method

SOLUTION

Step 1 : Shares to be issued by **B Ltd.**
= 40,000 x 10/8 = 50,000 shares.

Step 2 : Number of shares as per Step no. 1 (-) Shares already held by **S Ltd.**
= 50,000 (-) 8,000 = 42,000 shares.

Step 3 : Purchase Consideration = **42,000 shares x Rs.12** = **Rs. 504,000.**

SITUATION II

(2) When Purchase Consideration is determined by Net Assets Method

Step 1 : Calculate **intrinsic value** of shares of **transferee co.**

Step 2 : **Multiply step 1**, with number of shares **already held** by the **transferor co.**in the **transferee co.** and find the value of these shares.

Step 3 : **Include** the value obtained in **step 2** in the assets of the **transferor co.** for determining its **net assets.**

Step 4 : **Deduct shares already held by transferor co.** from the **shares to be received** in **purchase consideration** from the **transferee co.**

Step 5 : Multiply **step no.4** with **step no.1** and get the amount of **purchase consideration**.

REFERENCE BOOKS

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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)**
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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!