CHAPTER - 12

AMALGAMATION OF COMPANIES

Sometimes, companies carrying on similar business combine together to achieve economies of large-scale production and avoid competition. In regard to amalgamation of companies, it is essential to understand the meaning of the following words:

Amalgamation: When two or more companies doing similar business go into liquidation and a new company is formed to take over their business, it is known as amalgamation.

Absorption: When an existing company purchases another existing company, it is known as absorption. There, no new company is formed under absorption. Generally, the absorbing or purchasing company is a large company whereas the absorbed or selling company is smaller in size.

Reconstruction: Reconstruction is entirely of a different nature. The object of reconstruction is not to bring about a combination of companies but merely to reorganise a company which has suffered huge losses which have to be written off. Reconstruction may be of two types: (1) External, and (2) Internal.

(1) **External Reconstruction**: It is similar to amalgamation although it is not exactly the same. In external reconstruction, a new company is formed for the express purpose of taking over the business of an existing sick company which has incurred huge losses and is facing financial difficulties. The existing company is wound up by selling its business to the newly formed company which is generally having a similar name and is owned by the same shareholders to a great extent.

(2) **Internal Reconstruction**: In a scheme of internal reconstruction, there is neither liquidation nor formation of a new company to take over any existing business. The existing company continues in its legal entity form and is only reorganised internally. In the case of a company having huge accumulated losses and overvalued assets, a scheme of capital reduction and

other means of internal reconstruction are adopted. Under this scheme, share capital, debentures, creditors etc. are written down to their real values, and the amount so reduced is utilised to wipe off the accumulated losses, fictitious assets etc. and to reduce the over-valued assets.

From accounting point of view, there is no difference between Amalgamation, Absorption, and External Reconstruction because in all these three cases the accounting procedure is the same. In the case of Internal Reconstruction, however, the accounting procedure is entirely different.

Meaning of 'Purchase Consideration'

Purchase consideration is the price which is paid by the transferee company to the transferor company for the amalgamation of business. As per AS-14, "Consideration for amalgamation means the aggregate of shares and other securities issued, and the payment made in the form of cash and other assets by the transferee company to the shareholders of the transferor company." It is thus clearly stated in AS-14 that purchase consideration would never include the payments made by the transferee company for the payment of debenture holders or any other outside liabilities which shall be presumed to have been taken over and then discharged by the transferee company. However, if it is clearly expressed that a liability has not been taken over by the transferee company, it will be paid by the transferor company.

There are four methods in which purchase consideration may be calculated: (1) Lump sum method; (2) Net payment method; (3) Net assets method; and (4) Intrinsic worth method.

(1) Lump Sum method:- In this method, the transferee company makes a lump sum payment to the transferor company for ~~the~~ amalgamating its business. For example, if A Ltd. purchases the business of B Ltd. and agrees to pay Rs 20,00000 in all, it is an example

of lump sum payment. In such a case, it will be presumed that this payment is meant for shareholders only because the term 'business' means acquiring the assets as well as liabilities of the transferor company.

2) Net Payment method :- As per AS-14, purchase consideration is primarily based on the net payment method. Under this method, purchase consideration is calculated as follows:

(i) All payments made for shareholders of the transferor company are included in purchase consideration. Such payments may be made for equity or preference shareholders and may be in the form of shares and cash.

ii) Purchase consideration will never payments made to debenture holders and other outside liabilities since these are presumed to be taken over and then paid by the transferee company. Hence, the payment is ignored for the calculation of purchase consideration.

iii) The payment made by the transferee company for the cost of winding up is also not included in the purchase consideration.

) Net Assets method :- Under 'Net Assets method', purchase consideration is calculated by adding the agreed values of only those assets which have been taken over by the transferee company and deducting therefrom the agreed values of only those liabilities which have been taken over by the transferee company.

Purchase Consideration = Sundry Assets (taken over by the transferee company at an agreed value)

− Sundry Liabilities (taken over by the transferee company at an agreed value)

While calculating purchase consideration under this method, the following points should be taken into consideration:

i) Agreed values of only those assets are added which have been taken over by the transferee company.

(ii) Agreed values of only those liabilities are deducted, which have been taken over by the transferee company.

(iii) Cash balance is normally included in assets but if it is not taken over, it will not be included. Goodwill is ~~not~~ an intangible but valuable asset and as such, it is also included in assets. Prepaid expenses should also be included.

(iv) Fictitious assets or expenses not written off such as underwriting commission and other expenses incurred on the issue of shares and debentures, discount on the issue of debentures etc. should never be added.

(v) It should be carefully observed whether the 'Assets' are taken over or the 'Business' is taken over by the transferee company. The term 'Business' refers to assets as well as liabilities payable to outsiders.

(vi) The 'Net Assets method' is adopted only when the Net Payment method cannot be adopted.

(4) Intrinsic Worth method :- Sometimes it is agreed that the purchase consideration is to be calculated on the basis of the intrinsic value of shares of the transferor company. Intrinsic value of a share is calculated by dividing the net assets (i.e. assets − outside liabilities) by the number of shares of the subscribed capital of the company. Purchase consideration is calculated by multiplying the intrinsic value per share by number of shares. For example, A Ltd amalgamates B Ltd. Supposing that the intrinsic value ~~of~~ per share in B Ltd. is calculated as Rs 15 and its subscribed capital consists of 4,00,000 equity shares of Rs 10 each, the purchase consideration will be equal to Rs 60,00,000.

Accounting Treatment in the Books of Transferor Company (5)

Since the transferor company ceases to function as a separate entity, all accounts shown in its balance sheet must be closed. The profit or loss on the transfer of assets and liabilities is ascertained through the preparation of Realisation A/C.

1) For the transfer of assets taken over by the transferee company to Realisation A/C at their book values:

Realisation A/C --Dr.
To Sundry Assets A/c-- Cr.

It may be noted that—

(a) If the transferee company does not take over cash and bank balances, these should not be transferred to Realisation A/C.

(b) Fictitious assets such as expenses on the issue of shares commission paid on the issue of shares and debentures etc. are not to be transferred to Realisation A/C. These are rather directly transferred to Equity Shareholders A/C.

(c) Goodwill, and other intangible assets such as trade-mark, patent, prepaid expense etc. are always transferred to Realisation A/C at their book values.

(d) If some provision has been made against some asset, such asset is transferred to Realisation A/C at its gross value, and the provision is transferred along with other liabilities. (6)

(2) For the transfer of liabilities taken over by the transferee company to Realisation A/C at their book values:

Liabilities A/Cs --Dr.
To Realisation A/C --Cr.

It may be noted that—

(a) As purchase consideration means for amalgamation the aggregate of shares and securities issued and payment in cash made by the transferee company to the transferor company's shareholders, it is presumed that outside liabilities including debentures have been taken over and then discharged by the transferee company. Therefore, debentures and other liabilities are transferred to Realisation A/C to be subsequently transferred to the transferee company for payment.

(b) Accumulated profits such as Surplus A/C, General Reserve, Dividend Equalisation Reserve, Capital Reserve etc. are not to transferred to Realisation A/C. Rather, these are directly transferred to Equity Shareholders' A/C.

(c) If any fund denotes liability, then only it should be transferred to Realisation Account. If there is any fund which partially represents liability and partially undistributed profit, the portion which represents liability should be transferred to Realisation A/C while the portion representing undistributed profit is to be transferred to Equity ⑦ Shareholders' Account.

(2) For recording the purchase consideration to be paid by transferee company:

Transferee company--Dr.

To Realisation A/c--Cr.

(3) For the purchase consideration received:

Bank A/c --- Dr.

Shares in transferee company-Dr.

To Transferee Co.-- Cr.

(5) On sale of assets not taken over by the transferee Co.:

Bank A/c ---Dr.

Realisation A/c--Dr.

(in the case of loss on sale of such assets)

To Assets A/c --- Cr.

(6) For the payment of liabilities not taken over by transferee company:

Liabilities A/cs --Dr.

Realisation A/c --Dr.

(if excess payment is made)

To Bank A/c ---Cr.

(7)(a) For the payment of liquidation expenses (to be borne by the transferor company itself):

Realisation A/c--Dr.

To Bank A/c --Cr.

(b) When liquidation expenses are both paid and borne by the transferee Co.:

No entry is to be passed for such expenses.

(c) When liquidation expenses are first paid by the transferor company and subsequently reimbursed by the transferee company:

I. For the liquidation expenses first paid by the transferor Co.:

Transferee Co. A/c --Dr.

To Bank A/c ---Cr.

II. For the liquidation expenses subsequently received from the transferee Co.:

Bank A/c --Dr.

To Transferee Co.--Cr.

(8) For the payment of unrecorded liabilities (not shown in the Balance Sheet):

Realisation A/c --Dr.

To Bank A/c--Cr.

(9) For profit on realisation transferred to Equity Shareholders' A/c:

Realisation A/c--Dr.

To E.S. A/c ---Cr.

(10) For the transfer of loss on realisation to Equity Shareholders' A/c:

Equity Shareholders' A/c ---Dr.

To Realisation A/c-Cr.

(11) For the transfer of accumulated profits and reserves:

E.S. Capital A/c --Dr.

Reserve Fund A/c--Dr.

Contingency Fund A/c-Dr.

Dividend Equalisation Fund A/c--Dr.

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Workmens' Compensation Fund A/C --Dr.
Insurance Fund A/C--Dr.
Surplus A/C ----Dr.
To Equity Shareholders' A/C --Cr.

(12) For the transfer of accumulated losses and fictitious assets:
Equity Shareholders' A/C-Dr.
To Surplus A/C ----Cr.
To Expenses on the issue of shares A/C-Cr.
To Discount on the issue of shares A/C--Cr.

(13) For payment to shareholders in cash and shares:
Equity shareholders A/C-Dr.
To Bank A/C ----Cr.
To Shares in transferee Co.--Cr.

Accounting Treatment in the Books of Transferee Co.

As such, there are two methods of accounting in the books of transferee company—
(A) Pooling of interests method;
(B) Purchase method.

(A) Pooling of interests method :- This method is adopted when the amalgamation is in the nature of merger. In such a case, minimal changes are made in aggregating assets and liabilities of the amalgamating companies

(9) The following entries are made in the books of the transferee company—
(1) For the purchase consideration becoming due:
Business Purchase A/C--Dr.
To Liquidator of Transferor Co. ----Cr.

(2) For recording the assets, liabilities and reserves of the transferor company taken over by the transferee company:
Sundry Assets A/C--Dr. (with book values)
To Sundry Liabilities ---Cr. (with book values)
To Provision for bad and doubtful debts etc.--Cr.
To Surplus A/C ----Cr. (with book value)
To Reserves A/C ---Cr. (at adjusted values)
To Business Purchase A/C--Cr. (with purchase consideration)

The difference between the debits and credits of the above entry is adjusted to reserves.

(3) On the discharge of purchase consideration:
Liquidator of the Transferor Co. --Dr. (with the purchase consideration)
To Bank A/C -----Cr.
To Share Capital A/C --Cr.
To Security Premium A/C-Cr.

(4) For the liquidation expenses of the transferor company being borne by the transferee company:
General Reserve A/C-Dr.
To Bank A/C ---Cr.

(5) For the formation expenses incurred by the transferee Co.:
Expenses on the issue of shares A/C-Dr.
To Bank A/C -----Cr.

(B) Purchase Method :- This method is adopted when the amalgamation is in the nature of purchase. The following entries are made in the books of the transferee company —

(1) For recording the purchase consideration:

Business Purchase A/c - Dr.
To Liquidator of the Transferor Co. - - Cr.

(2) For recording the assets and liabilities taken over:

Sundry Assets A/c . . . . Dr.
(at revised values)
Goodwill A/c - - - . Dr.
(for the excess of credit total over debit total)
To Sundry Liabilities A/c Cr.
(at revised values)
To Business Purchase A/c Cr.
(with the purchase consideration)
To Capital Reserve A/c - - Cr.
(for the excess of debit total over credit total)

(3) On the payment of purchase consideration:

Liquidator of Transferor Co. Dr.
To Bank A/c - - - - Cr.
To Share Capital A/c - - Cr.
To Security Premium A/c - - Cr.

(4) For recording the statutory reserves of the Transferor Company:

Amalgamation Adjustment A/c - Dr.
To Statutory Reserves A/c - - Cr.

(5) For the liquidation expenses of the Transferor Company being borne by the Transferee Company:

Goodwill A/c /
Capital Reserve A/c - Dr.
To Bank A/c - - - Cr.

(6) For the formation expenses incurred by the Transferee Company:

Preliminary Expenses A/c - - Dr.
To Bank A/c - - - Cr.

(7) For setting off Goodwill against Capital Reserve (if both are existing):

Capital Reserve A/c - Dr.
To Goodwill A/c - - Cr.

(8) For writing off Preliminary Expenses (to be written off in the same year in which they are incurred)

Capital A/c /
Capital Reserve A/c /
Surplus A/c - - - Dr.
To Preliminary Expenses A/c - - Cr.