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Accounting for Corporate Restructuring

1. Introduction

The dictionary meaning of the term 'restructuring' is 'give new structure to; rebuild, rearrange' (the Concise Oxford Dictionary).

Restructuring is the corporate management term for the act of reorganizing the legal, ownership, operational, or other structures of a company for the purpose of making it more profitable, or better organized for its present needs. Alternate reasons for restructuring include a change of ownership or ownership structure, demerger, or a response to a crisis or major change in the business such as bankruptcy, repositioning, or buyout. Restructuring may also be described as corporate restructuring, debt restructuring and financial restructuring.

The continuing corporate restructuring wave that began in the 80s has been mainly triggered off by a renewed commitment to deliver shareholder value. To that extent both shareholder value management and corporate restructuring are inseparable as the end and the important means to that end. In India, the process of economic liberalisation and globalisation has created its own impetus, due to which, business environment has become highly competitive. Corporates are now restructuring and repositioning their folios to meet the challenges and seize opportunities thrown open by the multilateral trade agenda and emergence of the World Trade Organisation (WTO).

Most of the diversified multi-product companies are restructuring their corporate operations into more homogenous units to achieve synergy in operations. This entails transfer of business units from one company to the other or breaking up of a large group into smaller ones. On the other hand, smaller companies are forming alliances and joint ventures for their survival and growth. The exercise involves strategic planning to cope with the complex changes in the ownership and control and comply with a variety of business laws.

The underlying object of corporate restructuring is efficient and competitive business operations by increasing the market share, brand power and synergies. In the emerging scenario, joint ventures, alliances, mergers, amalgamations and takeovers are becoming the easiest and quickest way to expand capacities and acquire dominance over the market.

While asset and capital restructuring can be termed as external, organisational restructuring may be referred to as internal; this is based on the significance and impact of the restructuring process on a company's internal or external stakeholders.

2. Methods

The different methods of restructuring and their implications are as under:

(1) External Restructuring

(a) Asset-based (portfolio) restructuring
(b) Financial or capital restructuring

(2) Internal Restructuring

(a) Portfolio restructuring (Cost reduction through closure of units, redundancy programmes etc.)
(b) Organisational restructuring (Management or organisational restructuring involving decentralisation, delayering, product-market based divisionalisation, matrix structure etc.)

(3) Amalgamation, absorption or external reconstruction.

3. Asset-based Restructuring

(i) Mergers and Acquisitions (M & A): Acquisition of companies/business units or merger with other companies has been one of the most common ways of carrying out restructuring. While acquisition of companies can be "friendly" or "hostile", merger invariably involves friendly pooling of interest, undertaken by managements of companies of roughly comparable sizes. However, in the Indian context the term merger is used to denote consolidation of separate legal entities, not necessarily of similar sizes, into one through a statutory process of amalgamation. Since the motives of merger or acquisition are the same and both involve transfer of ownership and control of assets and the right to manage corporate cash flows and the difference between the two is very often only a matter of technical detail, the term mergers and acquisitions (M & A) is often used interchangeably.

Amalgamation has been dealt with in detail in separate chapter.

(ii) Sell-Off: A sell-off, also known as a divestiture, is the outright sale of a company subsidiary. Normally, sell-offs are done because the subsidiary doesn't fit into the parent company's core strategy. The market may be undervaluing the combined businesses due to a lack of synergy between the parent and subsidiary. As a result, management and the board decide that the subsidiary is better off under different ownership.

(iii) Demergers or Spin-offs: A spinoff occurs when a subsidiary becomes an independent entity. The parent firm distributes shares of the subsidiary to its shareholders through a stock dividend. Since this transaction is a dividend distribution, no cash is generated. Thus, spinoffs are unlikely to be used when a firm needs to finance growth or deals. Like the carve-out, the subsidiary becomes a separate legal entity with a distinct management and board.

In most cases, spinoffs unlock hidden shareholder value. For the parent company, it sharpens management focus. For the spinoff company, management doesn't have to compete for the parent's attention and capital. Once they are set free, managers can explore new opportunities

Unlike in a divestiture, the "parent" company or group does not receive any proceeds from a

demerger as the demerged company's shares are directly distributed to the "parent" company's shareholders.

The word Demerger has received statutory recognition in the Income-Tax Act, 1961 by the insertion of clause (*19AA*) in section 2 by the Finance Act, 1999, w.e.f. 1-4-2000. Section 2(19AA) says that "demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 (1 of 1956), by a demerged company of its one or more undertakings to any resulting company in such a manner that—

(i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;

(ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

(iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis *except where the resulting company itself is a shareholder of the demerged company [inserted by the Finance Act, 2012, w.e.f. 1-4-2013.*

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) the transfer of the undertaking is on a going concern basis;

(vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Explanation 1.—For the purposes of this clause, "undertaking" shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Explanation 2.—For the purposes of this clause, the liabilities referred to in sub-clause (*ii*), shall include—

(*a*) the liabilities which arise out of the activities or operations of the undertaking;

(*b*) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and

(*c*) in cases, other than those referred to in clause (*a*) or clause (*b*), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Explanation 3.—For determining the value of the property referred to in sub-clause (*iii*), any change in the value of assets consequent to their revaluation shall be ignored.

Explanation 4.—For the purposes of this clause, the splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified in the Official Gazette, by the Central Government;

As per section 2(*19AAA*) "demerged company" means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company;

At the same time, the process of demerger is achieved only through the provisions of Sections 391 – 394 of the Companies Act, which deals with the subject of – "Compromise, Arrangements Reconstructions". In other words, every scheme of demerger as defined under the Income-Tax Act should necessarily be drawn through a scheme of arrangement which is subject to the Court's approval. Briefly stated, in a demerger, ownership rights of shareholder are recognised vis-a-vis the assets of the company in such a way that the shareholder becomes, after the approval of the Court is obtained, the owner of shares in certain new companies which are created for the purpose and transferring segregated business by telescoping them into these companies and allotting shares to the shareholders in a proportionate manner. To put it in nutshell, if X is a shareholder of A Limited, a company having two lines of businesses, it can split its two businesses into two companies, viz. A Limited and B Limited and allot to the same shareholders shares in both the companies in lieu of the shares in the original company.

An example of this type of practice is reflected in the demerger of Consumer Products (CP) Division of Godrej Soaps Ltd. as a going concern into Godrej Consumer Products Ltd., a separate company formed for this purpose. This is reproduced from the Scheme of Arrangement entered between the companies :

"Reorganisation of the Equity Share Capital of Godrej Soaps Limited (GSL)

- The subscribed and paid up equity capital of GSL be reorganised from ₹ 52,005,287,800 divided into 59,828,780 equity shares of ₹ 10/- each fully paid up to ₹ 358,972,680 divided into 59,828,780 equity shares of ₹ 6 each.

  The reduction as aforesaid shall be effected as a part of the Scheme only and not in accordance with Section 101 of the Companies Act, 1956 of the Act as the same does not involve either diminution of liability in respect of unpaid share capital or payment to any shareholder of any paid up share capital

- Accordingly, on this Scheme becoming effective the Authorised, Issued and Subscribed

Share Capital of GSL shall be as under :

	₹
Authorised Capital	
133,333,333 Equity shares of ₹ 6 each	799,999,998
100,000,000 Unclassified shares of ₹ 10 each	1,000,000,000
	1,799,999,998
Issued Capital	
59,828,780 Equity shares of ₹ 6 each	358,972,680
	358,972,680

Accounting Treatment in the Books of Godrej Consumer Products Ltd. (GSPL)

- GCPL shall, upon the arrangement becoming operative, record the assets and liabilities of the C P Division of GSL vested in it pursuant to this Scheme, at the respective book values thereof as appearing in the books of GSL, excluding revaluation, at the close of business of the day immediately preceding the Appointed Date.
- GCPL shall credit to its Share Capital Account in its books of account the aggregate face value of the new shares issued by it to the members of GSL pursuant to this Scheme.
- The excess or deficit, if any, remaining after recording the aforesaid entries shall be credited by GCPL to General Reserve or debited to Goodwill, as the case may be.

Accounting Treatment in the Books of GSL

- The difference arising on account of reorganisation of GSL's equity share capital, pursuant to the Scheme, shall be credited to the Capital Reorganisation Account in the books of accounts of GSL.
- The difference arising between value of assets transferred over the value of liabilities, upon vesting of the C P Division in GCPL, pursuant to the Scheme, shall be treated in the books of accounts of GSL, as under :
- To the extent, the aforesaid difference of assets over liabilities pertains to the revaluation of the fixed assets, forming part of the C P Division, shall be debited to the Revaluation Reserve Account.

  The difference remaining after debiting the aforesaid to the Revaluation Reserve Account shall be first debited to the Capital Reorganisation Account and the balance of difference remaining, if any, shall be debited to the General Reserve Account of GSL.

  The balance remaining, if any, in the Capital Reorganisation Account after adjusting the aforesaid difference shall be credited to the General Reserve Account of GSL"

4. Capital and Financial Restructuring

Needless to state that the distinction between, asset-based and purely financial-side restructuring is often blurred as acquisitions or divestiture has strong financial or capital structure consequences. Nonetheless, the distinction is made on the basis of the dominant motives behind a given restructuring transaction. This type of restructuring includes buy back of shares, debt to equity conversions etc.

Illustration 1

The following is the draft Balance Sheet of Diverse Ltd. having an authorised capital of ₹ 1,000 crores as on 31st March, 2012:

		(₹ in crores)
I Equity and Liabilities		
1 Shareholders' funds:		
a. Share capital		
Equity shares of 10 each fully paid up	*250*	
b. Reserves and surplus (Revenue)	*750*	*1,000*
2. Non Current Liabilities		
Long term borrowings		
Secured against: (a) Fixed assets ₹ 300 Cr.		
(b) Working capital ₹ 100 Cr.	*400*	
Unsecured:	*600*	*1,000*
3. Current Liabilities		*2,000*
		4,000
II. Assets		
1. Non –Current Assets		
(a) Fixed assets:		
(i) Tangible Assets		
Gross block	*800*	
Less: Depreciation	*(200)*	*600*
(b) Investments at cost (Market value ₹ 1,000 Cr.)		*400*
2. Current assets		*3,000*
		4,000

Capital commitments: ₹ 700 crores.

The company consists of 2 divisions:

(i) Established division whose gross block was ₹ 200 crores and net block was ₹ 30 crores; current assets were ₹ 1,500 crores and working capital was ₹ 1,200 crores; the entire amount being financed by shareholders' funds.

(ii) New project division to which the remaining fixed assets, current assets and current liabilities related.

The following scheme of reconstruction was agreed upon:

(a) Two new companies Sunrise Ltd. and Khajana Ltd. are to be formed. The

authorised capital of Sunrise Ltd. is to be ₹ 1,000 crores. The authorised capital of Khajana Ltd. is to be ₹ 500 crores.

(b) Khajana Ltd. is to take over investments at ₹ 800 crores and unsecured loans at balance sheet value. It is to allot equity shares of ₹ 10 each at par to the members of Diverse Ltd. in satisfaction of the amount due under the arrangement.

(c) Sunrise Ltd. is to take over the fixed assets and net working capital of the new project division along with the secured loans and obligation for capital commitments for which Diverse Ltd. is to continue to stand guarantee at book values. It is to allot one crore equity shares of ₹ 10 each as consideration to Diverse Ltd. Sunrise Ltd. made an issue of unsecured convertible debentures of ₹ 500 crores carrying interest at 15% per annum and having a right to convert into equity shares of ₹ 10 each at par on 31.3.2017. This issue was made to the members of Sunrise Ltd. as a right who grabbed the opportunity and subscribed in full.

(d) Diverse Ltd. is to guarantee all liabilities transferred to the 2 companies.

(e) Diverse Ltd. is to make a bonus issue of equity shares in the ratio of one equity share for every equity share held by making use of the revenue reserves.

Assume that the above scheme was duly approved by the Honourable High Court and that there are no other transactions. Ignore taxation.

You are asked to:

(i) Pass journal entries in the books of Diverse Ltd., and

(ii) Prepare the balance sheets of the three companies giving all the information required by the Companies Act, 1956 in the manner so required to the extent of available information.

Solution

Journal of Diverse Ltd.

Transactions with Khajana Ltd.

1	Khajana Ltd. A/c	Dr.	200	
	Unsecured loans A/c	Dr.	600	
	To Investments A/c			400
	To Members A/c			400
	(Being transfer of investments at agreed value of ₹ 800 crores, unsecured loans ₹ 600 crores) – WN 1			
2	Members A/c	Dr.	200	
	To Khajana Ltd			200
	Consideration received from Khajana Ltd			
3	Members A/c	Dr	200	
	To Capital Reserve			200
	(Being balance in the member's account transferred)			

Transactions with Sunrise Ltd.

1.	Sunrise Ltd. A/c (1cr equity shares X ₹ 10)	Dr.	10	
	Provision for depreciation A/c (WN 2)	Dr.	30	
	Secured loans against fixed assets A/c	Dr.	300	
	Secured loans against working capital A/c	Dr.	100	
	Current liabilities A/c (WN 2)	Dr.	1,700	
	To Fixed assets A/c (WN 2)			600
	To Current assets A/c (WN 2)			1,500
	To Capital reserve A/c			40
	(Being assets and liabilities of new project division transferred to Sunrise Ltd. along with capital commitments of ₹ 700 crores, the difference between consideration and the book values at which transferred assets and liabilities appeared being credited to capital reserve)			
2.	Equity shares of Sunrise Ltd.	Dr.	10	
	To Sunrise Ltd.			10
	(Being the receipt of one crore equity shares of ₹ 10 each from Sunrise Ltd. in full discharge of consideration on transfer of assets and liabilities of the new project division)			
3.	Investment in debentures A/c	Dr.	500	
	To Bank A/c			500
	(Being issue of unsecured convertible debentures by Sunrise Ltd., subscribed in full)			
4.	Revenue reserves A/c	Dr.	250	
	To Equity share capital A/c			250
	(Being allotment of 25 crores equity shares of ₹ 10 each as fully paid bonus shares to the members of the company by using revenue reserves in the ratio of one equity share for every equity share held)			

Diverse Ltd.
Balance Sheet after the scheme of arrangement

		Note No.		(₹ in crores)
I	Equity and liabilities			
	(1) Shareholders' funds:			
	(a) Share Capital	1	500	
	(b) Reserves and surplus	2	740	1,240
	(2) Current liabilities			300
	Total			1,540
II	Assets			
	(1) Non-current Assets			
	(a) Fixed assets:	3		30
	(b) Non-current investments	4		510
	(2) Current assets(1,500 – 500)			1,000
	Total			1,540
	1. Capital commitments			Nil
	2. Contingent Liability			
	Guarantee given in respect of:			
	Capital commitments by Sunrise Ltd.		700	
	Liabilities transferred to Sunrise Ltd.		2100	
	Liabilities transferred to Khajana Ltd.		600	

Notes to Accounts

(₹ in crores)

1	Share capital:		
	Authorised capital: 100 crores Equity Shares of ₹ 10 each	1,000	
	Issued, subscribed and paid up capital		500
	50 crores Equity Shares of ₹ 10 each fully paid-up		
	Of the above shares, 25 crores fully paid Equity Shares of ₹ 10 each have been issued as bonus shares by capitalization of revenue reserves.		
2	Reserves and Surplus:		
	1. Capital Reserve on transfer of:		
	Investments to Khajana Ltd.	200	
	Business of new project division to Sunrise Ltd.	40	240

	2. Surpluses (profit and loss Account):		
	As per last balance sheet	750	
	Less: Used for issue of fully paid bonus shares	250	500
			740
3	Fixed assets:		
	Gross block:		
	As per last balance sheet	800	
	Less: Transfer to Sunrise Ltd.	(600)	200
	Provision for depreciation:		
	As per last balance sheet	200	
	Less: In respect of assets transferred to Sunrise Ltd.	(30)	(170)
			30
4	Investments (at cost):		
	1. Investment in Equity Instruments		
	In wholly owned subsidiary Sunrise Ltd.		
	1 crore equity shares of ₹ 10 each		10
	Investment in Debentures and bonds		
	15% unsecured convertible debentures		500
			510

Balance Sheet of Sunrise Ltd. after the scheme of arrangement

		Note No.	*(₹ in crores)*	
I	Equity and liabilities			
	(1) Shareholders' funds:			
	(a) Share Capital	1		10
	(2) Non-current liabilities:			
	(a) Long term borrowings			
	Secured loans	2	400	
	Unsecured loans	3	500	900
	(3) Current liabilities			1700
	Total			2,610
II	Assets			
	1. Non-current assets			
	(a) Fixed assets			
	(i) Tangible assets		570	
	(ii) Intangible assets (Goodwill)		40	610
	(2) Current assets			
	(a) Cash and Cash equivalents		500	
	(b) Other current Asset		1,500	2,000
	Total			2,610

	1. Capital commitments			
	2. Guarantee given by Diverse Ltd. in respect of:			
	Capital commitments		700	
	Liabilities		2,100	2,800

Notes to Accounts

(₹ in crores)

1	Share Capital	
	Authorised Capital	
	100 crores Equity Shares of ₹ 10 each	1,000
	Issued, Subscribed and Paid-up capital 1 crore	
	Equity Shares of 10 each fully paid-up	10
	(All the above shares have been issued for consideration other than cash, on takeover of new project division from Diverse Ltd.	
	All the above shares are held by the holding company Diverse Ltd.)	
2	Secured Loans	
	(a) Against fixed assets	300
	(b) Against working capital	100
		400
3	Unsecured Loans	
	15% Unsecured convertible Debentures	500
	- Convertible into equity shares of ₹ 10 each at par on 31.3.2017	

Balance Sheet of Khajana Ltd. after the scheme of arrangement

(₹ in crores)

	Note No.	
I. Equity and liabilities		
(1) Shareholders' funds:		
(a) Share Capital	1	200
(2) Non-current liabilities:		
(a) Long term borrowings		
Unsecured loans		600
Total		800
II. Assets		
Non-current investments		800
Total		800
Guarantee given by Diverse Ltd. in respect of unsecured loans		

Notes to Accounts

		(₹ in crores)
1	Share Capital	
	Authorised	
	50 crores Equity Shares of ₹ 10 each	500
	Issued, Subscribed and Paid-up	
	20 crores Equity Shares of ₹ 10 each fully paid-up	200
	(All the above shares have been issued to members of Diverse Ltd. for consideration other than cash, on acquisition of investments and taking over of liability for unsecured loans from Diverse Ltd.)	

Working Notes:

1. Amount Due from Khajan Ltd.

Investments	800
Less : Unsecured Loans	(600)
Net Consideration	200

2. Segregation of Assets & Liabilities between Established and New Division

As per information in point (i)

	Particulars	Total (A)	Established Division (B)	New Project Division (A-B)
1	Gross Block	800(Given)	200(Given)	600(A-B)
	Net Block	600(Given)	30(Given)	570(A-B)
	Provision for Depreciation	200	170	30
2	Current Assets	3,000(Given)	1,500(Given)	1,500(A-B)
	Working Capital	1,000(Given)	1,200(Given)	(200)(A-B)
	Current Liabilities	2,000	300	1,700

(₹ in crores)

		Established division	New Project division	Total
1.	Fixed assets:			
	Gross block	200	600	800
	Less: Depreciation	(170)	(30)	(200)
		30	570	600
	Current assets	1,500	1,500	3,000

	Less: Current liabilities	(300)	(1,700)	(2,000)
	Employment of funds	1,200	(200)	1,000
2.	Guarantee by Diverse Ltd. against:			
	(a) (i) Capital commitments			700
	(ii) Liabilities transferred to Sunrise Ltd.			
	Secured loans against fixed assets		300	
	Secured loans against working capital		100	
	Current liabilities		1,700	2,100
	(b) Liabilities transferred to Khajana Ltd.			600

Illustration 2

Enterprise Ltd. has 2 divisions Laptops andMobiles.

Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses.

On 31st March, 2012 the division-wise draft Balance Sheet was:

(₹ in crores)

		Laptops	*Mobiles*	*Total*
Fixed assets cost		*250*	*500*	*750*
Depreciation		*(225)*	*(400)*	*(625)*
Net Assets	*(A)*	*25*	*100*	*125*
Current assets:		*200*	*500*	*700*
Less: Current liabilities		*(25)*	*(400)*	*(425)*
	(B)	*175*	*100*	*275*
Total (A+B)		*200*	*200*	*400*
Financed by:				
Loan funds		*-*	*300*	*300*
Capital : Equity ₹ 10 each		*25*	*-*	*25*
Surplus		*175*	*(100)*	*75*
		200	*200*	*400*

Division Mobiles along with its assets and liabilities was sold for ₹ 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company.

Assuming that there are no other transactions, you are asked to :

(i) Pass journal entries in the books of Enterprise Ltd.
(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).
(iii) Prepare the Balance Sheet of Turnaround Ltd.

Solution

Journal of Enterprise Ltd.

(₹ in crores)

			Dr. ₹	Cr. ₹
(1)	Turnaround Ltd.	Dr.	25	
	Loan Funds	Dr.	300	
	Current Liabilities	Dr.	400	
	Provision for Depreciation	Dr.	400	
	To Fixed Assets			500
	To Current Assets			500
	To Capital Reserve			125
	(Being division Mobiles along with its assets and liabilities sold to Turnaround Ltd. for ₹ 25 crores)			
(2)	Capital Reserve	Dr.	25	
	To Turnaround Ltd.			25
	(Being allotment of 1 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share to the members of Enterprise Ltd. in full settlement of the consideration)			

Notes :

(1) Any other alternative set of entries, with the same net effect on various accounts, may be given by the students.

(2) Profit on sale of division may, alternatively, be credited to Profit and Loss Account instead of Capital Reserve, in accordance with the requirements of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and changes in Accounting Policies.

Enterprise Ltd.
Balance Sheet after reconstruction

(₹ in crores)

		Note No.		
I.	Equity and liabilities			
	(1) Shareholders' funds			
	(a) Share Capital		25	
	(b) Reserves and surplus	1	175	200
	(2) Current Liabilities			25
	Total			225

II.	Assets			
	(1) Non-current assets			
	(a) Fixed assets			25
	(2) Current assets			200
	Total			225

Notes to Accounts

		(₹ in crores)
1.	Reserves and Surplus	75
	Add: Capital Reserve on reconstruction	100
		175

Note to Accounts: Consequent on transfer of Division Mobiles to newly incorporated company Turnaround Ltd., the members of the company have been allotted 1 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share of Turnaround Ltd., in full settlement of the consideration in proportion to their shareholding in the company.

Balance Sheet of Turnaround Ltd.

(₹ in crores)

		Note No.		
I.	Equity and liabilities			
	(1) Shareholders' funds			
	(a) Share Capital	1	10	
	(b) Reserves and surplus:			
	Securities Premium		15	25
	(2) Non-current liabilities			
	Long term borrowings			300
	(3) Current liabilities			400
	Total			725
II.	Assets			
	(1) Non-current assets			
	Fixed assets			
	(i) Tangible assets		100	
	(ii) Intangible assets	2	125	225
	(2) Current assets			500
	Total			725

Notes to Accounts

		(₹ in crores)
1.	Share Capital:	
	Issued and Paid-up capital	
	1 crore Equity shares of ₹ 10 each fully paid up	10
	(All the above shares have been issued for consideration other than cash, to the members of Enterprise Ltd. on take over of Division Mobiles from Enterprise Ltd.)	
2.	Intangibles Assets:	
	Goodwill (WN 1)	125

Working Note

1. Calculation of Goodwill/Capital Reserve for Turnaround Ltd.

Assets taken over

Non Current Assets	100
Current Assets	500
Total Assets(A)	600
Loan Funds	300
Current Liabilities	400
Total Liabilities (B)	700
Net Assets C= (A-B)	(100)
Purchase Consideration (given) D	25
Goodwill (D-C)	125

Illustration 3

Kuber Ltd. furnishes you with the following draft Balance Sheet as at 31st March, 2012:

	(₹ in crores)	
Equity and liabilities		
(1) Share holders' funds		
(a) Share Capital :		
Authorised capital	*100*	
Issued, subscribed and paid up capital		
12% Redeemable preference shares of ₹ 100 each fully paid	*75*	
Equity shares of ₹ 10 each fully paid	*25*	*100*
(b) Reserves and surplus:		
Capital reserve	*15*	

Securities premium revenue	*25*	
Surplus (profit and loss account)	*260*	*300*
(2) Current liabilities		*40*
		440
Assets		
1. Non-current assets		
Fixed assets : Cost	*100*	
Less: Provision for depreciation	*(100)*	*Nil*
2. Non-current Investments at cost (market value ₹ 400 Cr.)		*100*
3. Current assets		*340*
		440

The company redeemed preference shares on 1st April, 2012. It also bought back 50 lakh equity shares of ₹ 10 each at ₹ 50 per share. The payments for the above were made out of the huge bank balances, which appeared as part of current assets.

You are asked to :

(i) Pass journal entries to record the above

(ii) Prepare balance sheet

(iii) Value equity share on net asset basis.

Solution

Journal of Kuber Ltd.

(₹ in crores)

		Dr. ₹	Cr. ₹
Redeemable preference share capital	Dr.	75	
To Bank			75
(Being redemption of 12% preference shares pursuant to capital re-organisation)			
Revenue reserves	Dr.	75	
To Capital redemption reserve			75
(Being amount equal to par value of preference shares redeemed out of profits transferred to capital redemption reserve)			
Equity share capital	Dr.	5	
Revenue reserves	Dr.	20	
To Bank			25
(Being buyback of 50 lakh equity shares of ₹ 10 each from the members at a price of ₹ 50 per share, premium paid transferred to revenue reserves)			

Revenue reserves	Dr.	5	
To Capital redemption reserve			5
(Being transfer to capital redemption reserve, as required by Section 77 AA, on buyback out of reserves)			

Kuber Ltd.
Balance Sheet (after reconstruction)

		Note No.	*(₹ in crores)*	
I.	Equity and liabilities			
	(1) Shareholders' funds			
	(a) Share Capital	1.	20	
	(b) Reserves and Surplus	2.	280	300
				-
	(2) Current liabilities			40
	Total			340
II.	ASSETS			
	(1) Non Current Assets			
	(a) Fixed Assets (100 -100)			-
			–	
	(b) Non-current investments (market value: ₹ 400 crores)			100
	(2) Current assets			240
	Total			340

Notes to Accounts

		(₹ in crores)	
1.	Share Capital		
	1. Authorised Capital		100
	2. Issued, Subscribed and Paid-up		
	200 lakhs Equity Shares of ₹ 10 each fully paid up		20
	(50 lakhs Equity Shares of ₹ 10 each have been bought back out of reserves at ₹ 50 per share and 12% 75 lakhs Redeemable Preference Shares of ₹ 100 each fully paid up, have been redeemed on 1st April, 2010)		
2.	Reserves and Surplus		
	(1) Capital Reserve		15
	(2) Capital Redemption Reserve		
	As per last account	–	
	Add: Transfer from		
	Revenue Reserves	80	80

	(3) Securities Premium Revenue		25
	(4) Surplus (profit and loss A/c)		
	As per last account	260	
	Less: Transfer to Capital Redemption Reserve	(80)	
		180	
	Less: Premium on buyback	(20)	160
			280

Net asset value of an equity share

	(₹ in crores)
Investments (at market value)	400
Net current assets	200
Net assets available to equity shareholders	600
No. of equity shares : 2 crores	
Value of an equity share = $\frac{600 \text{ crores}}{2 \text{ crores}}$ =₹ 300	

Note: As regards treatment of loss (profit) on buyback, there is no authoritative pronouncement as to whether the difference between the nominal value and the amount paid should be treated as capital or revenue in nature. In the given case, the debit has been given to revenue reserves.

Also, in the absence of any other information, it has been assumed that shares have been bought back out of free reserves.

Illustration 4

Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft Balance Sheet as at 31st October, 2011 was as under:

		Maxi division ₹	*Mini division* ₹	*Total (in crores)* ₹
Fixed assets:				
Cost		*600*	*300*	*900*
Depreciation		*(500)*	*(100)*	*(600)*
W.D.V.	*(A)*	*100*	*200*	*300*
Net current assets:				
Current assets		*400*	*300*	*700*
Less: Current liabilities		*(100)*	*(100)*	*(200)*
	(B)	*300*	*200*	*500*
	Total (A+B)	*400*	*400*	*800*
Financed by :				
Loan funds	*(A)*	*–*	*100*	*100*

(secured by a charge on fixed assets)			
Own funds:			
Equity capital			*50*
(fully paid up ₹ 10 shares)			
Reserves and surplus			*650*
(B)	*?*	*?*	*700*
Total (A+B)	*400*	*400*	*800*

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division.

Accordingly Mini Ltd. was incorporated to take over at Balance Sheet figures the assets and liabilities of that division. Mini Ltd. is to allot 5 crores equity shares of ₹ 10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.

(a) You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 2011, showing corresponding previous year's figures.

(b) The directors of the 2 companies ask you to find out the net asset value of equity shares pre and post demerger.

(c) Comment on the impact of demerger on "shareholders wealth".

Solution

Demerged Company : Mini Division of "Maxi Mini Ltd"

Resulting Company : "Mini Ltd."

(a) Journal of Maxi Mini Ltd. (Demerged Company)

		(₹ in crores)	
		Dr. ₹	Cr. ₹
Current liabilities A/c	Dr.	100	
Loan fund (secured) A/c	Dr.	100	
Provision for depreciation A/c	Dr.	100	
Loss on reconstruction (Balancing figure)	Dr.	300	
To Fixed assets A/c			300
To Current assets A/c			300
(Being the assets and liabilities of Mini division taken out of the books on transfer of the division to Mini Ltd., the consideration being allotment to the members of the company of one equity share of ₹ 10 each of that company at par for every share held in the company vide scheme of reorganisation.)			

Note : Any other alternatives set of entries, with the same net effect on various accounts, may be given by the students.

Journal of Mini Ltd.

		(₹ in crores)	
		Dr. ₹	Cr. ₹
Fixed assets (300-100) A/c	Dr.	200	
Current assets A/c	Dr.	300	
To Current liabilities A/c			100
To Secured loan funds A/c			100
To Equity share capital A/c			50
To Capital reserve			250
(Being the assets and liabilities of Mini division of Maxi Mini Ltd. taken over and allotment of 5 crores equity shares of ₹ 10 each at part as fully paid up to the members of Maxi Mini Ltd.)			

Maxi Mini Ltd.
Balance Sheet as at 1st November, 2012

		Note No	(₹ in crores) After reconstruction	Before Reconstruction
I.	Equity and liabilities			
	(1) Shareholder's funds			
	(a) Share Capital		50	50
	(b) Reserves and Surplus	1	350	650
			400	700
	(2) Non-current liabilities			
	Secured loan		-	100
	(3) Current liabilities		100	200
	Total		500	1,000
II.	ASSETS			
	(1) Non-Current Assets			
	Fixed assets :	2	100	300
	(2) Current assets		400	700
	Total		500	1,000

Notes to Accounts

		After reconstruction	*Before reconstruction*
1.	Reserves and Surplus	650	650
	Less: Loss on reconstruction	(300)	–
		350	650
2.	Fixed Assets	600	900
	Less: Depreciation	(500)	(600)
		100	300

Note to Accounts : Consequent on reconstruction of the company and transfer of Mini division to newly incorporated company Mini Ltd., the members of the company have been allotted 5 crores equity shares of ₹ 10 each at part of Mini Ltd.

Mini Ltd.
Balance Sheet as at 1 November, 2010

		Note No.	*(₹ in crores)*	
I.	Equity and liabilities			
	(1) Shareholder's funds			
	(a) Share Capital	1.	50	
	(b) Reserves and Surplus		250	300
	(2) Non-current liabilities			
	Secured loans			100
	(3) Current liabilities			100
	TOTAL			500
II.	Assets			
	(1) Non-current assets			
	(a) Fixed assets			200
	(2) Current assets			300
	Total			500

Notes to Account

	(₹ in crores)
1. Share Capital :	
Issued and paid up :	
5 crores Equity shares of ₹ 10 each fully paid up	50
(All the above shares have been issued for consideration other than cash, to the members of Maxi Mini Ltd., on take over of Mini division from Maxi Mini Ltd.)	

(b) Net asset value of an equity share

	Pre-demerger	*Post-demerger*
Maxi Mini Ltd. :	$\frac{₹\ 700\ \text{crores}}{5\ \text{crores}} = ₹\ 140$	$\frac{₹\ 400\ \text{crores}}{5\ \text{crores}} = ₹\ 80$
Mini Ltd.:		$\frac{₹\ 300\ \text{crores}}{5\ \text{crores}} = ₹\ 60$

(c) Demerger into two companies has had no impact on "net asset value" of shareholding. Pre-demerger, it was ₹ 140 per share. After demerger, it is ₹ 80 plus ₹ 60 i.e. ₹ 140 per original share.

It is only yield valuation that is expected to change because of separate focusing on two distinct businesses whereby profitability is likely to improve on account of demerger.

5. Amalgamations – Legal Aspects

5.1 Provisions under the Companies Act, 198: Section 390 to 396A in chapter V is a complete code in itself. It provides the law and procedure to be complied with by the companies for Compromise, arrangement and reconstruction which are all part of restructuring. Rule 67 to 87 of companies rule 1959 provide the court procedure for approval of the government.

Section 391 of companies Act 1956 provides for all matters which the company court should consider and also the condition under which it has to exercise its power. Court for the purpose of section 391 to 394 of the Act would mean the High Court having jurisdiction over the registered office of the company.

Sec 391 provides that where a compromise or arrangement is proposed between company and its creditors and any class of them or member or any class of them, an application is required to be submitted to the court. On the submission of the application the court may direct to hold the meeting of creditor or member or class of them. The scheme must be approved in the meeting by majority in number representing 3/4 in value of the creditors or members. The scheme must disclose all the material fact, financial position and auditors report on the account of the company. The order made by the court should be filled with the ROC within 30 days unless it will not become effective. The copy of the order is also required to attach with all the copy of memorandum of the company, if there is default the person will be liable to punished.

Section 392 empowers the court to give direction and make modification in the order to operate the scheme smoothly. The court has also power to order to wind up the company if it satisfies that the scheme cannot work satisfactory with or without modification.

Section 393 says that that the scheme must disclose all the relative fact as per the prescribe rules otherwise the scheme should not be approved.

Section 394 says that it is necessary to have the report from the ROC in case the scheme involves that the company is being wound up and the report of the liquidator, in case the

scheme involves dissolution of a company to ensure that the affairs of the company is not being conducted in a manner prejudicial to the interest of the member or public.

Section 395 provides that if 90% or more shareholders of a company approve a scheme of arrangement, then the same may be imposed on the remaining shareholders of the company. However, the dissenting shareholders shall have the right to file their objection with the Company Law Board. Unless the Company Law Board orders otherwise, the acquirer shall be entitled to acquire the shares of the target company.

In the case of a listed company, the acquirer has to follow the procedure laid down under the SEBI Substantial Acquisition of Shares and Takeover Regulations and the Listing Agreement with stock exchanges. In particular, an acquirer must comply with clauses 40A and 40B of the listing Agreement which, among other things, require a purchaser acquiring shares of 20 per cent (or more), to make an offer to all the shareholders of the company to acquire their shares at a price at which the acquirer has already acquired or agreed to acquire shares of 10 per cent or more, or at a price which is the average of the high and low of the price quoted on the stock exchange during the preceding six months, whichever is higher.

The Company Law Board would allow the scheme or contract of takeover under Section 395 if the fairness standard is met and the onus to prove otherwise shall be on the dissenting shareholders. In AIG (Mauritius) versus Tata Televentures Holdings Ltd, the Delhi High Court rejected the offer of the acquirer company on the basis that on lifting the corporate veil, the acquirer company was really the same as the approving shareholders of the target company.

Section 396 provides that where the Central Government is satisfied that it is essential in the [public interest that two or more companies should amalgamate, then, notwithstanding anything contained in sections 394 and 395 but subject to the provisions of this section, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution; with such property, powers, rights, interests, authorities and privileges; and with such liabilities, duties, and obligations; as may be specified in the order.

5.2 Meaning of Reconstruction and Amalgamation: The terms amalgamation and reconstruction are not defined in the Companies Act. Generally the expression reconstruction", "reorganisation" or "scheme of arrangement" is used where only one company is involved and the rights of its shareholders and/or creditors are varied. The term amalgamation is used where two or more companies are involved or where one is merged with another or taken over by another. Neither reconstruction nor amalgamation has a precise meaning. Amalgamation is blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry blended undertakings. There may be amalgamation either by the transfer of two or more undertakings to an existing company. The term amalgamation contemplates not only state of things in which two companies are so joined as to form a new company but also the absorption and blending of one by the other.

5.2.1Notice to the Registrar and Central Government : Sub-section 3 of Section 394 makes it obligatory on the part of the company to file a certified copy of the order of the Court sanctioning arrangement or compromise with the Registrar of Companies within 30 days.

Under Section 394 A, the Court shall give notice of every application made to it under sections 391 or 394 to the Central Government and shall take into consideration the representations made to it by that Government before passing any order under any of these sections.

5.2.2Dissenting Shareholders : Dissenting shareholders include a shareholder who has not assented to the scheme or contract and any shareholder who has failed or refused to transfer his shares to the transferee company in accordance with the scheme or contract.

Where a scheme or contract involves transfer of shares or any class of shares of a transferee company to the transferor company, the transferee company has to make offer which should be approved by the holder of not less than nine-tenths in value of such shares on which transfer is involved within 4 months. After expiry of such 4 months period, and within two months time thereafter, the transferee company may give notice in the prescribed manner to any dissenting shareholder that it desires to acquire their shares. When such a notice is given, the transferee company shall, excepting the case where an application has been made by the dissenting shareholders within 1 month from the date on which the notice was given to the court and the court orders otherwise, be entitled and bound to acquire those shares. If there is no court order in response to the application made by the dissenting shareholder, the transferee company must transmit a copy of the notice to the transferor company together with an instrument of transfer executed on behalf of the shareholder by any person appointed by the transferor along with the amounts or other considerations representing price payable to the dissenting shareholders. Any such sum received by the transferee company representing the price of the shares of the dissenting shareholders shall be paid into a separate bank account. The price of shares will be at such rates which has been agreed upon as per the scheme of amalgamation and payable to the other shareholders.

There have been occasions when the minority shareholders have raised objections and have succeeded in preventing the implementation of a scheme of arrangement. Alone minority shareholder of Tainwala Polycontainers Ltd (TPL), Dinesh V Lakhani, had apparently forced the company to call off its merger plans with Tainwala Chemicals and Plastics (India) Ltd (TCPL). Lakhani had opposed the proposed merger on several grounds including allegations of willful suppression of material facts and malafide intention of promoters in floating separate companies (TPL and TCPL).

A division bench of the Bombay High Court had stayed the proposed TPL-TCPL merger. After almost two years of courtroom battle, the company decided to withdraw the amalgamation petition without citing any reasons.

There have however been some instances when shareholders holding a small number of shares, have made frivolous objections against the scheme, just with the objective of deferring the implementation of the scheme. The courts have, on a number of occasions, overruled their objections. But Companies had to bear the consequences in the form of time and cost over-runs

6 Amalgamation – Accounting Aspects

6.1 Purchase Consideration: The consideration paid for the purpose of amalgamation is termed as Purchase Consideration (PC). PC includes anything benefit passed on to the

members of the transferee company from the transferor company in any form i.e. Equity shares, Preference shares, Debentures, Cash etc. There no such restriction with the pricing of the securities issued, it can be at par, premium or at discount. Usually intrinsic value of share is taken into consideration for the said purpose.

Para 3 (g) of AS 14 on Accounting for Amalgamations (explained in para 14 & 15) issued by ICAI defines the term '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.

Consideration may be in the form of

- Securities
- Cash
- Other Assets

Para 14 of AS 14 Determination of Value

Consideration	Valuation
Securities	Value fixed by statutory authorities
Other Assets	a. Fair value with reference to market value or b. Fair Value may be respective net book values

Examination Approach

In the problem information for PC will be available in two ways.

A List of the various consideration paid is given

B On the basis of valuation of assets and liabilities taken over

A List of the various considerations paid

In this case one should take care to add only those items paid to the members of the company and not to any outsider. Please, note that debenture holders are outsiders. Following are few such examples:

A List of the various considerations paid

Case I: A Ltd. take over B Ltd. and discharges consideration for the business as follows:

(i) Issued 42,000 fully paid equity shares of ₹ 10 each at par to the equity shareholders of B Ltd.

(ii) Issued fully paid up 15% preference shares of ₹ 100 each to discharge the preference shareholders worth ₹ 1,00,000 of B Ltd. at a premium of 10%.

(iii) It is agreed that the debentures of B Ltd. will be converted into equal number and amount of 13% debentures of A Ltd.

In the above case our PC will be

For Equity Share holders (42,000 shares X ₹ 10)	₹ 4,20,000
For Preference Share holders (₹ 1,00,000 X 110 %)	₹ 1,10,000
Total Purchase Consideration	₹ 5,30,000

Payment to debenture holders is not to be considered as they are not the shareholders of the transferor company.

B On the basis of valuation of assets and liabilities taken over

Case II: Where net assets taken over is directly given

A Ltd. takes over B Ltd's net assets worth ₹ 2,00,000 at an agreed price of ₹ 2,60,000. A Ltd discharges the PC by allotment of 20,000 equity shares of ₹ 10 each at an agreed value of ₹ 12 each of A Ltd. and by the payment of the balance in cash.

Purchase Consideration = ₹ 2,60,000 i.e. the agreed price.

The payment shall be done as under

Equity shares (20,000 X ₹ 12) = ₹ 2,40,000

Cash ₹ (2,60,000 – 2,40,000) = ₹ 20,000

Case II Given below is the summarized Balance Sheet of AB Ltd. as on 31.12.2011 on which date its assets and liabilities are taken over by CD Ltd.

Equity and Liabilities	*₹ '000*	*Assets*	*₹ '000*
Shareholders' funds		Non-current assets	
Share Capital		Fixed assets	
Equity Shares of ₹ 10 each fully paid up	52,00	Plant and Machinery	26,00
General Reserve	650	Furniture	12,00
12% Debentures	13,50	Stock	24,00
Sundry Creditors and		Debtors	7,50
Other current Liabilities	7,50	Cash	10,00
	79,50		79,50

CD Ltd. agreed to issue 12% Debentures to the debenture holders of AB Ltd. at par.

Assets and liabilities taken over at book values

If all the assets and liabilities are taken over at par then determination of purchase consideration is very simple.

	₹ '000	*₹ '000*
Gross Assets taken over as per Balance Sheet		
Plant and Machinery		26,00
Furniture		12,00

Stock		24,00
Debtors		7,50
Cash		10,00
		79,50
Less: Sundry Liabilities taken over		
12% Debentures	13,50	
Sundry creditors and other current liabilities	7,50	(21,00)
Value of net assets taken over		58,50

Thus, purchase consideration is ₹ 58,50 thousands.

(2) Assets and liabilities taken over at valuation

Suppose that CD Ltd. agreed to take over the asset of AB Ltd. at current values:

Plant and Machinery	30% depreciation
Furniture	20% depreciation
Stock	+20% revaluation
Debtors	10% discount

Purchase consideration is to be determined as follows:

	₹ '000
Value of assets taken over:	
Plant and Machinery	18,20
Furniture	9,60
Stock	28,80
Debtors	6,75
Cash	10,00
	73,35
Less : Sundry liabilities taken over	(21,00)
Purchase Consideration	52,35

Case III: Where Intrinsic value of shares is calculated

Step 1 : Calculate the net worth of the business taken over at revalued figures

Step 2 : Divide net worth by the nos of shares to get intrinsic value

Intrinsic Value = Networth / No. of shares

In the example above, intrinsic value at book value =

	Book Value	After Revaluation
Net worth	₹ 58,50,000	₹ 52,35,000
No. of Shares	5,20,000	5,20,000
Intrinsic Value per share	₹ 11.25 per share	₹ 10.07 per share

(3) When payments are more or less than value of net assets : Often the transferee pays more or less than the value of net assets taken over. Take for example, that CD Ltd. in case issued 600 thousand equity shares of ₹ 10 each at par to the equity shareholders of the transferor company AB Ltd. Then purchase consideration is ₹ 60,00 thousand, not ₹ 58,50 thousand. The difference ₹ 150 thousand is goodwill paid by CD Ltd. It is purchased goodwill.

Also take for example that CD Ltd. issued 565 equity shares of ₹ 10 each to the equity shareholders of AB Ltd. Here purchase consideration becomes ₹ 56,50 thousand, not ₹ 60,00 thousand. The difference ₹ 200 thousand is capital reserve to CD Ltd.

Let us suppose that CD Ltd. agreed to discharge 12% Debentures @ 110 by issuing its own debentures and to issue 550 thousand equity shares to the equity shareholders at a premium of ₹ 2 per share.

	₹'000	*₹'000*
Value of assets taken over:		
as per Balance Sheet value		79,50
Less: Sundry liabilities taken over		
12% Debentures	14,85	
Sundry creditors and other Liabilities	7,50	(22,35)
Book Value of Net Assets		57,15
Purchase Consideration :		
550 thousand equity shares ₹ 10 each at a premium of ₹ 2		66,00
Goodwill paid ('000 ₹)		8,85

(Alternatively, in some text books Purchase consideration is computed as ₹ 6600 thousand + ₹ 14,85 thousand (payment to debenture holders) i.e. ₹ 80,85 thousand which is not the value of net assets taken over in the true sense of the term. As per 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 The payment to debenture holders is not the part of purchase consideration. It is a mode of settling the liability which the transferee company is taking over in the scheme of amalgamation.Therefore correct amount of purchase consideration is ₹ 66,00,000).

6.2 Discharge of Purchase Consideration: As discussed earlier in this unit, the purchase consideration in the case of amalgamation is payable to the shareholders, both preference and equity, of the transferor company. This may be discharged by issuing preference and/or equity shares of the transferee company and partly by cash. Often the transferee company discharges claims of the preference shareholders of the transferor company at a premium or at a discount by issuing preference shares. Similarly, claims of the equity shareholders of the transferor company may also be discharged by issuing equity shares of the transferee company either at par or at premium or at discount.

Given below is an example stating the computational procedure of determining number of shares of the transferee company to be issued in discharge of the purchase consideration.

Example 1

Summarised Balance Sheet of PX Ltd. as on 31.12.2011

Equity and Liabilities	*₹ in '000*	*Assets*	*₹ in '000*
Share Capital:		Sundry Fixed Assets	50,00
Equity shares of ₹ 10 each	50,50	Stock	20,00
		Debtors	10,00
8% Preference shares	9,50	Cash & Bank	5,00
12% Debentures	15,00		
Sundry Creditors & Other Liabilities	10,00		
	85,00		85,00

ZX Ltd. agreed to take over PX Ltd. by issuing requisite number of preference shares of ₹ 10 each at 5% discount to the preference shareholders of PX Ltd. and requisite number of equity shares of ₹ 10 each at par to the equity shareholders of PX Ltd. Purchase consideration is settled as per book value of the assets and the debentures will be taken over by ZX Ltd. on the agreement that such will be paid off at 10% premium after one year. Debenture-holders of PX Ltd. will accept 12% debentures of ZX Ltd.

Purchase Consideration:		*₹ in '000*
Book Value of assets taken over		85,00
Less : Liabilities taken over:		
Debentures	15,00	
Add: Premium on redemption of debentures (1,500 × 10 %)	1,50	
	16,50	
Sundry Creditors & Other Liabilities	10,00	(26,50)
Purchase Consideration		58,50

To be discharged by 8% preference shares and equity shares of ZX Ltd.

Computation of number of shares to be issued:

1) Preference shares to be issued : $\frac{950 \text{ thousand}}{₹\,9.5 \text{ (i.e} ₹\,10 - 5\% \text{ discount)}}$ = 100 thousand

Balance of purchase consideration: ₹ 58,50 thousand - ₹ 950 thousand = ₹ 49,00 thousand

2) Equity shares to be issued $\frac{₹\,49{,}00 \text{ thousand}}{₹\,10}$ = 490 thousand

Example 2

Given below is the summarized Balance Sheet of LMN Ltd. as on 31.12.2011 at which date the company was taken over by PQR Ltd.

Equity and Liabilities	*₹ in '000*	*Assets*	*₹ in '000*
Share Capital		Sundry fixed assets	80,00
Equity Shares	70,00	Sundry current assets	42,00
Preference shares	12,00		

12% Debentures	25,00		
Sundry Creditors	15,00		
	122,00		122,00

Decided that sundry fixed assets of LMN Ltd. will be taken over at a valuation of ₹ 102,00 thousand. 8% preference shareholders of LMN Ltd. are to be discharged by issuing 8% preference shares of the transferee company to the extent of 50% and the balance in cash. Claims of the equity shareholders to be discharged by issuing equity shares of the transferee company to the extent of 60% and the balance in cash. The transferee company will issue preference shares at par but equity shares of ₹ 10 each at a premium of 20%

Purchase Consideration:

	₹ *in '000*
Value of assets taken over	
Sundry fixed assets	102,00
Sundry current assets	42,00
	144,00
Less: Sundry liabilities taken over:	(40,00)
Purchase Consideration	104,00
To be discharged by:	
Preference shares(12,00 X 50 %)	6,00
Equity shares	55,20
Cash	42,80
	104,00

Number of shares to be issued:

Preference Share holders

Preference Shareholders of LMN Ltd.	₹ 12,00,000
50 % by 8 % Preference Shares of PQR Ltd	₹ 6,00,000
Balance by Cash	₹ 6,00,000
No. of Preference Shares (₹ 10 each)	60,000 shares

Equity Shareholders

	₹
Total Purchase Consideration	1,04,00,000
Less : Preference Shareholders portion	12,00,000
Equity Shareholders portion	92,00,000
60 % by Equity shares of PQR Ltd (₹ 10 + 20 % premium = ₹ 12 per share)	55,20,000
Balance By Cash	36,80,000
No. of equity shares	4,60,000 shares (5520 thousand / ₹ 12)

Example 3

Given below are summarized Balance Sheets of A Ltd. & B Ltd. as on 31st Dec. 2011 at which date the companies were amalgamated and a new company C Ltd. was formed.

Balance Sheets of A Ltd. & B Ltd.

Equity and Liabilities	*A Ltd.*	*B Ltd.*	*Assets*	*A Ltd.*	*B Ltd*
	(₹ in '000s)			*(₹ in '000s)*	
Equity Shares of ₹ 10 each	70,00	60,00	Sundry Fixed Assets	85,00	70,00
Reserve	20,00	30,00	Sundry current assets	20,00	30,00
Sundry creditors & other current liabilities	15,00	10,00			
	105,00	100,00		105,00	100,00

Agreed that sundry fixed assets of A Ltd. would be valued at ₹ 100,00 thousand and that of B Ltd. at ₹ 95,00 thousand. C Ltd. would issue requisite number of equity shares of ₹ 10 each at 10% premium to discharge claim of the equity shareholders of A Ltd. & B Ltd. Let us see how many shares of C Ltd. should be issued to take over the businesses of A Ltd. & B Ltd.

Purchase Consideration:

	A Ltd.	B Ltd.
Value of assets taken over	*₹ in '000s*	₹ in '000s
Sundry fixed assets	100,00	95,00
Sundry current assets	20,00	30,00
	120,00	125,00
Less: Liabilities taken over	(15,00)	(10,00)
Purchase Consideration	105,00	115,00

Total Purchase Consideration = 220,00 thousand (105,00 of A + 115,00 of B)

Number of equity shares to be issued by C Ltd.

$$\frac{₹\,22{,}000 \text{ thousand}}{₹\,11\ (₹\,10 + 10\% \text{ premimum})} = 20{,}000 \text{ thousand equity shares}$$

So, C Ltd. will be formed with the paid up capital of ₹ 200,00 thousand and share premium of ₹ 20,00 thousand.

6.3 Types of Amalgamation

The Institute has issued in October, 1994, AS 14 on 'Accounting for Amalgamations'. AS 14 is mandatory in nature and is applicable in respect of accounting periods commencing on or after 1/4/1995. AS 14 deals with accounting for amalgamations and the treatment of any resultant goodwill or reserve. Amalgamations fall into two broad categories.

Amalgamations in the nature of merger; and

Amalgamations in the nature of purchase

In the first category are those amalgamations where there is a genuine pooling not merely of the assets and liabilities of the amalgamated companies but also of the shareholders' interest and of the businesses of these companies. Such amalgamations are called 'amalgamations in the nature of merger'. The basic conditions of these amalgamations are:

(a) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(b) 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.

(c) 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.

(d) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(e) 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.

In the second category are those amalgamations which are in effect a mode by which one company acquires another company and, as a consequence, the shareholders of the company which is acquired normally do not have a proportionate share in the equity of the combined company or the business of the company which is acquired is not intended to be continued. Such amalgamations are called 'amalgamations in the nature of purchase'. In short, those amalgamations which do not satisfy any one or more of the conditions specified in (a) through (e) above are known as amalgamations in the nature of purchase.

6.4 Methods of Accounting for Amalgamation: There are two main methods of accounting for amalgamations:

(a) The Pooling of Interests Methods and
(b) The Purchase Method.

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

- The Pooling of Interests Method: Under this method the assets, liabilities and all reserves of the transferor company are recorded by transferee company at their existing carrying amounts unless the carrying amounts are to be adjusted to follow a uniform set of accounting policies. The effects on the financial statements of the transferee company of any changes in accounting policies are to be reported in accordance with AS 5. The balance of the profit and

loss account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to general reserve, if any.

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.

No goodwill is recognized under the pooling of interest method as there is no acquistion.

'Transferor company' means the company which is amalgamated into another company.

'Transferee company' means the company into which a transferor company is amalgamated.

- The Purchase Method : Here the assets and liabilities of the transferor company should be incorporated in the transferee company's financial statements in either of the following two ways:
  - (i) at their existing carrying amounts; or
  - (ii) the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

The reserves of the transferor company, other than statutory reserves, should not be included in the financial statements of the transferee company. In case of statutory reserves (i.e., Development Allowance Reserve, Investment Allowance Reserve etc.) where the maintenance of such reserves for a specific period is required by statute, these should be recorded in the financial statements of the transferee company with the help of the following entry:

Amalgamation Adjustment A/c Dr.

To Statutory Reserves A/c

The 'Amalgamation Adjustment A/c' should be disclosed as a part of 'miscellaneous expenditure' or other similar category in the balance sheet of the transferee company. Though, Revised Schedule VI does not mention disclosure of "miscellaneous expenditure", since additional line items can be added on the face or in the notes, unamortised portion of such items can be disclosed (both 'current' as well as 'non-current' portion), under the head 'other current/non-current assets' depending on whether the amount will be amortised in the next 12 months or thereafter. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the adjustment account should be reversed.

Any excess of the amount of purchase consideration over the acquired net assets of the transferor company should be recognised in the transferee company's financial statements as goodwill arising on amalgamation. On the other hand if the amount of purchase consideration falls short of the value of net assets acquired, such shortfall should be recognised as capital reserve.

6.5 Treatment of Goodwill Arising on Amalgamation: Goodwill on amalgamation can arise only if 'The Purchase Method' is followed.

The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life. The amortisation period should not exceed five years unless a somewhat longer period can be justified.

6.6 Amalgamation after the Balance Sheet Date: When an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure is made in accordance with AS-4, 'Contingencies and Events Occurring after the Balance Sheet Date', but the amalgamation is not incorporated in the financial statements.

Illustration 5

AX Ltd. and BX Ltd. amalgamated on and from 1st January 2012. A new Company ABX Ltd. was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-2011

Equity and Liabilities	*AX Ltd. ₹ '000*	*BX Ltd. ₹ '000*	*Assets*	*AX Ltd. ₹ '000*	*BX Ltd. ₹ '000*
Share Capital			*Sundry Fixed*		
Equity Shares of			*Assets*	*85,00*	*75,00*
₹ 10 each	*60,00*	*70,00*	*Investment*	*10,50*	*5,50*
General Reserve	*15,00*	*20,00*	*Stock*	*12,50*	*27,50*
P & L A/c	*10,00*	*5,00*	*Debtors*	*18,00*	*40,00*
Investment Allowance			*Cash & Bank*	*4,50*	*4,00*
Reserve	*5,00*	*1,00*			
Export Profit Reserve	*50*	*1,00*			
12% Debentures	*30,00*	*40,00*			
Sundry Creditors	*10,00*	*15,00*			
	130,50	*152,00*		*130,50*	*152,00*

ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of ABX Ltd.

Solution: (Assumption: Amalgamation is in the nature of merger)

(1) Calculation of Purchase Consideration

		AX Ltd. ₹ '000		*BX Ltd. ₹ '000*
Assets taken over:				
Sundry fixed assets		85,00		75,00
Investments		10,50		5,50
Stock		12,50		27,50
Debtors		18,00		40,00
Cash & Bank		4,50		4,00
Gross Assets		130,50		152,00
Less : Sundry Liabilities				
12% Debentures	30,00		40,00	

Sundry Creditors	10,00	(40,00)	15,00	(55,00)
Net Assets taken over		90,50		97,00
Less: Reserves and Surplus:				
General Reserve	15,00		20,00	
P & L A/c	10,00		5,00	
Investment Allowance Reserve	5,00		1,00	
Export Profit Reserve	50	(30,50)	1,00	(27,00)
Purchase Consideration		60,00		70,00

Total Purchase Consideration = 130,00 (60,00 of AX Ltd. & 70,00 of BX Ltd.)

2. Discharge of Purchase Consideration

No. of shares to be issued to AX Ltd = $\frac{\text{Net Assets taken over of AX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}}$ x Purchase Consideration

No. of shares to be issued to BX Ltd = $\frac{\text{Net Assets taken over of BX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}}$ x Purchase Consideration

	AX Ltd. *₹'000*	*BX Ltd.* *₹'000*
$130,00 \times \frac{90,50}{187,50} = 6,27,500$ * Equity shares of ₹ 10 each	62,75	
$130,00 \times \frac{97,00}{187,50} = 6,72,500$ Equity shares of ₹ 10 each		67,25

Balance Sheet of ABX Ltd. as on 1.1.2012

Particulars	*Note No.*	*(₹ 000)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	130,00
(b) Reserves and Surplus	2	57,50
(2) Non-Current Liabilities		
Long-term borrowings	3	70,00
(3) Current Liabilities		
(a) Trade payables (10,00 + 15,00)		25,00
Total		282,50

* The total purchase consideration is to be discharged by ABX ltd. in such a way that the rights of the shareholders of AX Ltd. and BX Ltd. remain unaltered in the future profits of ABX Ltd.

II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets (85,00 + 75,00)		160,00
(b) Non-current Investments (10,50+ 5,50)		16,00
(2) Current assets		
(a) Inventories (12,50 + 27,50)		40,00
(b) Trade Receivables (18,00 + 40,00)		58,00
(c) Cash & Cash equivalents (4,50 + 4,00)		8,50
Total		282,50

Notes to Accounts

		(₹ 000)	*(₹ 000)*
1.	Share Capital		
	13,00,000 Equity Shares of ₹ 10 each		130,00
2.	Reserves and surplus		
	General Reserve (15,00 + 20,00)	35,00	
	Profit & Loss (10,00 + 5,00)	15,00	
	Investment Allowance Reserve (5,00 + 1,00)	6,00	
	Export Profit Reserve (50 + 1,00)	1,50	57,50
3.	Long Term Borrowings		
	12% Debentures (Assumed that new debentures were issued in exchange of the old series) (30,00+40,00)		70,00

Assumption: Amalgamation is in the nature of Purchase

(1) Calculation of Purchase Consideration

		AX Ltd. *₹ '000*		*BX Ltd.* *₹ '000*
Assets taken over:				
Sundry fixed assets		85,00		75,00
Investments		10,50		5,50
Stock		12,50		27,50
Debtors		18,00		40,00
Cash & Bank		4,50		4,00
Gross Assets		130,50		152,00
Less : Sundry Liabilities				
12% Debentures	30,00		40,00	
Sundry Creditors	10,00	(40,00)	15,00	(55,00)
Purchase Consideration		90,50		97,00

(2) Discharge of Purchase consideration:

	AX Ltd. *₹ '000*	*BX Ltd.* *₹ '000*
9,05,000 Equity Shares of ₹ 10 each	90,50	
9,70,000 Equity Shares of ₹ 10 each		97,00

Balance Sheet of ABX Ltd. as on 1.1.2012

Particulars	*Note No.*	*(₹000)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	187,50
(b) Reserves and Surplus	2	7,50
(2) Non-Current Liabilities		
Long-term borrowings	3	70,00
(3) Current Liabilities		
(a) Trade payables (10,00 + 15,00)		25,00
Total		290,00
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets (85,00 + 75,00)		160,00
(b) Non-current Investments (10,50+ 5,50)		16,00
(c) Other non current asset	4	7,50
(2) Current assets		
(a) Inventories (12,50 + 27,50)		40,00
(b) Trade Receivables (18,00 + 40,00)		58,00
(c) Cash & Cash equivalents (4,50 + 4,00)		8,50
Total		290,00

Notes to Accounts

		(₹ 000)	*(₹ 000)*
1.	Share Capital		
	18,75,000 Equity Shares of ₹ 10 each		187,500
2.	Reserves and surplus		
	Investment Allowance Reserve	6,00	
	Export Profit Reserve	1,50	7,50
3.	Long Term Borrowings		
	12% Debentures (Assumed that new debentures were issued in exchange of the old series)		70,00

4.	Other non current assets Amalgmation Adjustment Account		7,50

Note :

(1) Shares are issued by ABX Ltd. on the basis of net assets acquired of AX Ltd. and BX Ltd. Hence, there is no goodwill.

(2) The statutory reserves of AX Ltd. and BX Ltd. are shown in the balance sheet of ABX Ltd. with a corresponding debit in Amalgamation Adjustment Account.

Illustration 6

Long Ltd. and Short Ltd. were amalgamated on and from 1st April, 2012. A new company Moderate Ltd. was formed to take over the businesses of the existing companies. The summarized balance sheets of Long Ltd. and Short Ltd. as on 31st March, 2012 are given below:

(₹ in lakhs)

Equity and Liabilities	*Long Ltd.*	*Short Ltd.*	*Assets*	*Long Ltd.*	*Short Ltd.*
Share Capital:					
Equity shares of ₹100 each	*850*	*725*	*Fixed Assets:*		
14% Preference Shares			*Land & Building*	*460*	*275*
of ₹ 100 each	*320*	*175*	*Plant & Machinery*	*325*	*210*
Reserves and Surplus:			*Investments*	*75*	*50*
Revaluation reserve	*125*	*80*	*Current Assets*		
Capital Reserve	*300*	*200*			
Investment Allowance	*50*	*30*	*Stock*	*325*	*269*
Reserve			*Sundry Debtors*	*305*	*270*
P & L Account	*15*	*12*	*Bills receivable*	*25*	*—*
Secured Loans:			*Cash and Bank*	*385*	*251*
13% Debentures					
(₹ 100 each)	*50*	*28*			
Unsecured Loan:					
Public deposits	*25*	*—*			
Current Liabilities					
and Provisions:					
Sundry creditors	*145*	*75*			
Bills payable	*20*	*—*			
	19,00	*13,25*		*19,00*	*13,25*

Other information

(i) 13% Debenture holders of Long Ltd. and Short Ltd. are discharged by Moderate Ltd. by

issuing such number of its 15% Debentures of ₹ 100 each so as to maintain the same amount of interest.

(ii) Preference Shareholders of the two companies are issued equivalent number of 15% preference shares of Moderate Ltd. at a price of ₹ 125 per share (face value ₹ 100)

(iii) Moderate Ltd. will issue 4 equity shares for each equity share of Long Ltd. and 3 equity shares for each equity share of Short Ltd. The shares are to be issued @ ₹ 35 each, having a face value of ₹ 10 per share.

(iv) Investment allowance reserve is to be maintained for two more years.

Prepare the balance sheet of Moderate Ltd. as on 1st April, 2012 after the amalgamation has been carried out on the basis of the following assumption:

(a) Amalgamation is in the nature of merger.

(b) Amalgamation is in the nature of purchase.

Solution

Para 3 (g) of AS 14 defines the term 'consideration' as the value of shares, other securities and any payment made in the form of cash or other assets by the transferee company to the shareholders of transferor company. Therefore, payments made to debenture holders should not be construed as part of consideration.

Computation of Purchase consideration (Payment Basis)

		(₹ in lakhs))	
		Long Ltd.	*Short Ltd.*
(1)	Preference Shareholders:		
	3,20,000 shares @ ₹ 125 each	400.00	
	1,75,000 shares @ ₹ 125 each		218.75
(2)	Equity Shareholders:		
	(4 × 8,50,000) = 34,00,000 equity shares @ ₹ 35 each	1190.00	
	(3 × 7,25,000) = 21,75,000 equity shares @ ₹ 35 each		761.25
		15,90.00	9,80.00

(a) Amalgamation in the nature of merger

Balance Sheet of Moderate Ltd.
As on 1st April, 2012

Particulars	*Note No.*	*(₹ in lakhs)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,052.50
(b) Reserves and Surplus	2	1,839.90
(2) Non-Current Liabilities		
Long-term borrowings	3	92.60

	(3) Current Liabilities		
	Trade payables	4	240.00
	Total		3,225.00
II.	Assets		
	(1) Non-current assets		
	(a) Fixed assets		
	Tangible assets	5	1,270.00
	(b) Non-current Investments (75+50)		125.00
	(2) Current assets		
	(a) Inventories (325 + 269)		594.00
	(b) Trade Receivables	6	600.00
	(c) Cash & Cash equivalents (385 + 251)		636.00
	Total		3,225.00

Notes to Accounts

		(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital		
	55,75,000 Equity Shares of ₹ 10 each	5,57.50	
	4,95,000 15% Preference shares of 100 each	4,95.00	1,052.50
2.	Reserves and surplus		
	Capital Reserve (WN 1)	NIL	
	Revaluation Reserve (125 + 80)	2,05.00	
	Securities Premium (WN 3)	15,17.50	
	Investment Allowance Reserve (50 + 30)	80.00	
	Profit & Loss (WN 4)	37.40	1,839.90
3.	Long Term Borrowings		
	15% Debentures (WN 2)	67.60	
	Public Deposit (25.00 + 0.00)	25.00	92.60
4.	Trade payables		
	Creditors (145.00 + 75.00)	220.00	
	Bills Payable (20.00 + 0.00)	20.00	240.00
5.	Tangible assets		
	Land & Building (460 + 275)	735.00	
	Plant & Machinery (325 + 210)	535.00	1,270.00
6.	Trade Receivables		
	Debtors (₹ 305 + ₹ 270)	575.00	
	Bills receivables (25.00 + 0.00)	25.00	600.00

Working Notes:

1.	Preference Share Capital	(₹ in lakhs)
	Long Ltd.	320.00
	Short Ltd.	175.00
	Total (A)	495.00
	Equity Share Capital	
	Long Ltd.	850.00
	Short Ltd.	725.00
	Total (B)	1,575.00
	Total Share Capital of transferor (A + B)	2,070.00
	Share Capital Issued by transferee	
	Preference Share Issued including premium	618.75
	Equity Share issued including premium	1951.25
	Total	2,570.00
	Amount to be adjusted in reserves of transferee company	500.00
	Capital Reserves (Long + Short)	500.00
	Net Capital Reserve	NIL

2. Calculation of Debenture to be issued (₹ In Lakhs)

	Long Ltd.	Short Ltd.
13 % Debentures	50.00	28.00
Interest on Debentures (a)	6.50	3.64
Moderate Ltd. Debentures rate of interest (b)	15 %	15 %
Debenture Value to earn above calculated interest (a / b)	43.33	24.27
Total Debentures to be issued (c)		67.60
Existing Liability of Long and Short Ltd (50 + 28) (d)		78.00
Profit on taking over the debenture liability (d-c)		10.40

3. Calculation of Securities Premium

A Equity Shares		
Total number of equity shares issued to		
Long Ltd	34,00,000	
Short Ltd	21,75,000	
Total	55,75,000	

Securities Premium per share (₹ 35 – ₹ 10)	₹ 25	
Total Securities Premium from Equity Shares		1,393.75 lakhs
B Preference Shares		
Total number of preference shares issued to		
Long Ltd	3,20,000	
Short Ltd	1,75,000	
Total	4,95,000	
Securities Premium per share (₹ 125 – ₹ 100)	₹ 25	
Total Securities Premium from Preference Shares		123.75 lakhs
Total Securities Premium		1,517.50 lakhs

4. Profit and Loss Account Balance

P & L of Long Ltd.	15.00
P & L of Short Ltd.	12.00
Profit on taking over of debentures (WN 2)	10.40
Total	37.40

(b) Amalgamation in the nature of Purchase:

Balance Sheet of Moderate Ltd.

As on 1st April, 2012

Particulars	*Note No.*	*(₹ in lakhs)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,052.50
(b) Reserves and Surplus	2	1,919.90
(2) Non-Current Liabilities		
Long-term borrowings	3	92.60
(3) Current Liabilities		
(a) Trade payables	4	240.00
Total		3,305.00
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	5	1,270.00
(b) Non-current Investments (75+50)		125.00

(c) Other non current assets	6	80.00
(2) Current assets		
(a) Inventories (325 + 269)		594.00
(b) Trade Receivables	7	600.00
(c) Cash & Cash equivalents (385 + 251)		636.00
Total		3,305.00

Notes to Accounts

		(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital		
	55,75,000 Equity Shares of ₹ 10 each	5,57.50	
	4,95,000 15% Preference shares of 100 each	4,95.00	1,052.50
2.	Reserves and surplus		
	Capital Reserve (WN 1)	3,22.40	
	Securities Premium	15,17.50	
	Investment Allowance Reserve (50 + 30)	80.00	1,919.90
3.	Long Term Borrowings		
	15% Debentures	67.60	
	Public Deposit	25.00	92.60
4.	Trade payables		
	Creditors	220.00	
	Bills Payable	20.00	240.00
5.	Tangible assets		
	Land & Building	735.00	
	Plant & Machinery	535.00	1,270.00
6	Other Non Current assets		
	Amalgamation Adjustment Account (50 + 30)		80.00
7.	Trade Receivables		
	Debtors (305 + 270)	575.00	
	Bills receivables	25.00	600.00

Working Note

1.				(₹ in lakhs)
		Long Ltd.		Short Ltd.
Assets taken over:				
Land and Building		4,60		2,75

Plant and Machinery		3,25		2,10
Investments		75		50
Stock		3,25		2,69
Sundry Debtors		3,05		2,70
Bills receivable		25		—
Cash and Bank		3,85		2,51
		19,00		13,25
Less : Liabilities taken over:				
13% Debentures	43.33		24.27	
Public Deposits	25.00		—	
Sundry Creditors	1,45.00		75.00	
Bills Payable	20.00	(2,33.33)	-	(99.27)
Net Assets taken over		16,66.67		12,25.73
Less : Purchase consideration		(15,90.00)		(9,80.00)
Capital Reserves		76.67		245.73

Illustration 7

The Massive Company Ltd. was incorporated on 1st July 2012 for the purpose of acquiring North Ltd., South Ltd., and West Ltd.

The summarized balance sheets of these companies as on 30th June 2012 are as follows :

	North Ltd. ₹	*South Ltd.* ₹	*West Ltd.* ₹
Assets			
Tangible fixed assets –at cost less depreciation	*5,00,000*	*4,00,000*	*3,00,000*
Goodwill	*Nil*	*60,000*	*Nil*
Other assets	*2,00,000*	*2,80,000*	*85,000*
	7,00,000	*7,40,000*	*3,85,000*
	North Ltd. ₹	*South Ltd.* ₹	*West Ltd.* ₹
Liabilities			
Issued ordinary share capital shares of ₹ 10 each	*4,00,000*	*5,00,000*	*2,50,000*
P & L A/c	*1,50,000*	*1,10,000*	*60,000*
10% Debentures	*70,000*	*Nil*	*40,000*
Sundry Creditors	*80,000*	*1,30,000*	*35,000*
	7,00,000	*7,40,000*	*3,85,000*

Average annual profits before	*₹*	*₹*	*₹*
Debentures interest (July 2011 to June 2012 inclusive)	*90,000*	*1,20,000*	*50,000*
Professional valuation of tangible assets on 30th June 2012	*6,20,000*	*4,80,000*	*3,60,000*

(1) The directors in their negotiations agreed that : (i) the recorded goodwill of South Ltd. is valueless; (ii) the "Other assets" of North Ltd. are worth ₹ 30,000; (iii) the valuation of 30th June 2012 in respect of tangible fixed assets should be accepted, (iv) these adjustments are to be made by the individual company before the completion of the acquisition.

(2) The acquisition agreement provides for the issue of 12 per cent unsecured Debentures to the value of the net assets of companies North Ltd., South Ltd., and West Ltd., and for the issuance of ₹ 10 nominal value ordinary shares for the capitalized average profit of each acquired company in excess of net assets contributed. The capitalisation rate is established at 10 per cent.

You are required to calculate purchase consideration and show the purchase consideration as discharged.

Solution

Statement of Purchase Consideration

(₹)

Mode	North Ltd.	South Ltd.	West Ltd.	Total
1) 12 % Unsecured Debenture [Basis Net Assets] (WN 1)	5,00,000	6,30,000	3,70,000	15,00,000
2) Shares [Basis Capitalised Average Profits in excess of net assets contributed] (WN 2)	3,30,000	5,70,000	90,000	9,90,000
Total	8,30,000	12,00,000	4,60,000	24,90,000

Working Notes

1 Calculation of Debentures to be issued

	North Ltd. ₹	₹	South Ltd. ₹	₹	West Ltd. ₹	₹
Tangible Fixed assets	6,20,000		4,80,000		3,60,000	
Other Assets	30,000	6,50,000	2,80,000	7,60,000	85,000	4,45,000
Less : Sundry Creditors	80,000		1,30,000		35,000	
10% Debenture	70,000	(1,50,000)	—	(1,30,000)	40,000	75,000
Net assets		5,00,000		6,30,000		3,70,000

2 Calculation of Shares to be issued

	North Ltd. ₹	South Ltd. ₹	West Ltd. ₹
Average Annual Profits Before Debenture Interest	90,000	1,20,000	50,000
Less : Debenture Interest	(7,000) (70,000 X 10 %)	NIL	(4,000) (40,000 X 10 %)
Average Annual Profits after debenture interest	83,000	1,20,000	46,000
Capitalised average profits	8,30,000	12,00,000	4,60,000
Less: Net assets (WN 1)	(5,00,000)	(6,30,000)	3,70,000
Excess to be issued as Shares	3,30,000	5,70,000	90,000

Illustration 8

Given below are the summarized Balance Sheets of AX Ltd. and TX Ltd. as on 31.12.2011. TX Ltd. was merged with AX Ltd. with effect from 1.1.2012 and the merger was in the nature of purchase.

Summarised Balance Sheets as on 31.12.2011

Equity and Liabilities	*AX Ltd.* ₹	*TX Ltd.* ₹	*Assets*	*AX Ltd.* ₹	*TX Ltd.* ₹
Share Capital:					
Equity Shares of ₹ 10 each	*7,00,000*	*2,50,000*	*Sundry Fixed Assets*	*9,50,000*	*4,00,000*
General Reserve	*3,50,000*	*1,20,000*	*Investments*		
Surplus (P & L A/c)	*2,10,000*	*65,000*	*(Non-trade)*	*2,00,000*	*50,000*
Export Profit Reserve	*70,000*	*40,000*	*Stock*	*1,20,000*	*50,000*
12 % Debentures	*1,00,000*	*1,00,000*	*Debtors*	*75,000*	*80,000*
Sundry Creditors	*30,000*	*45,000*	*Advance Tax*	*80,000*	*20,000*
Prov. for Taxation	*1,00,000*	*60,000*	*Cash & Bank Balances*		
Proposed Dividend	*1,40,000*	*50,000*		*2,75,000*	*1,30,000*
	17,10,000	*7,30,000*		*17,00,000*	*7,30,000*

AX Ltd. would issue 12% Debentures to discharge the claims of the debenture holders of TX Ltd. at par. Non-trade investments of AX Ltd. fetched @25% while those of TX Ltd. fetched @18%. Profit before of AX Ltd. and TX Ltd. during 2009, 2010 and 2011 and were as follows:

	AX Ltd. ₹	*TX Ltd.* ₹
2009	*5,00,000*	*1,50,000*
2010	*6,50,000*	*2,10,000*
2011	*5,75,000*	*1,80,000*

Goodwill may be calculated on the basis of capitalisation method taking 20% as normal rate of return for profit before tax. Purchase consideration is discharged by AX Ltd. on the basis of intrinsic value per share. Prepare Balance Sheet of AX Ltd. after merger.

Solution

Balance Sheet of AX Ltd.
(after merger with TX Ltd.)

Particulars	*Note No.*	*(₹)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	9,24,000
(b) Reserves and Surplus	2	13,50,960
(2) Non-Current Liabilities		
Long-term borrowings	3	2,00,000
(3) Current Liabilities		
(a) Trade payables	4	75,000
(b) Other Current Liabilities	5	3,00,000
Total		28,49,960
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	6	13,50,000
Intangible assets (Goodwill) [WN 1]		3,80,000
(b) Non-current Investments (2,00,000+,50,000)		2,50,000
(c) Other non-current assets	7	40,000
(2) Current assets		
(a) Inventories (1,20,000 + 50,000)		1,70,000
(b) Trade Receivables (75,000 + 80,000)		1,55,000
(c) Cash & Cash equivalents (2,75,000 + 1,30,000 – 40)		4,04,960
(d) Other current assets	8	1,00,000
Total		28,49,960

Notes to Accounts

		(₹)	(₹)
1.	Share Capital 92,400 Equity Shares of ₹ 10 each [70,000+22,400] (Of the above shares, 22,400 shares were issued to the vendors otherwise than cash)		9,24,000

2.	Reserves and surplus			
	General Reserve		3,50,000	
	P&L A/c		2,10,000	
	Securities Premium [22,400 × [40.40-10]		6,80,960	
	Export profit reserve	70,000		
	Add: Balance of TX Ltd.	40,000	1,10,000	13,50,960
3.	Long Term Borrowings			
	12% Debentures		1,00,000	
	Add: 12% debentures issued at par other than cash		1,00,000	2,00,000
4.	Trade payables			
	Creditors		30,000	
	Add: Taken over		45,000	75,000
5	Other Current Liabilities			
	Provision for Taxation	1,00,000		
	Add: Provision for Taxation of TX Ltd.	60,000	1,60,000	
	Proposed dividend		1,40,000	3,00,000
6.	Tangible assets			
	Fixed Assets		9,50,000	
	Add: Taken over		4,00,000	13,50,000
7.	Other non-current assets			
	Amalgamation Adjustment A/c [on a/c of export profit reserve]			40,000
8.	Other current assets			
	Advance Tax (80,000 + 20,000)			1,00,000

Working Notes

(1) Valuation of Goodwill

(i) Capital Employed

		AX Ltd.		TX Ltd.
	₹	₹	₹	₹
Sundry-Assets as per Balance Sheet		17,00,000		7,30,000
Less:				
Non-trade Investment		(2,00,000)		(50,000)
Net Assets to be considered for G/w		15,00,000		6,80,000
Less : Sundry Liabilities				
12% Debentures	1,00,000		1,00,000	
Sundry Creditors	30,000		45,000	
Provision for Taxation	1,00,000	(2,30,000)	60,000	(2,05,000)
Capital Employed		12,70,000		4,75,000

(ii) Average Profit Before Tax

		AX Ltd.		TX Ltd.
		₹		₹
2009		5,00,000		1,50,000
2010		6,50,000		2,10,000
2011		5,75,000		1,80,000
		17,25,000		5,40,000
Simple Average		5,75,000		1,80,000
Less : Non-trading income*		(50,000)		(9,000)
		5,25,000		1,71,000
(iii) *Goodwill*				
Capitalised value of average profit	$\frac{5,25,000}{20} \times 100$	26,25,000	$\frac{1,71,000}{20} \times 100$	8,55,000
Less: Capital Employed [From (i)above]		(12,70,000)		(4,75,000)
Goodwill		13,55,000		3,80,000

* For AX Ltd. (2,00,000 @ 25 %) and TX Ltd. (50,000 @ 18 %)

(2) Intrinsic Value per Share

		AX Ltd. ₹		TX Ltd. ₹
Goodwill [WN 1]	13,55,000		3,80,000	
Sundry Other Assets	17,00,000	30,55,000	7,30,000	11,10,000
Less : Liabilities				
12% Debentures	1,00,000		1,00,000	
Sundry Creditors	30,000		45,000	
Provision for Tax	1,00,000	(2,30,000)	60,000	(2,05,000)
Net Assets		28,25,000		9,05,000
Intrinsic value per share [Net Assets / No. of Shares]		$\frac{28,25,000}{70,000}$ = ₹ 40.40 (rounded off)		$\frac{9,05,000}{25,000}$ = ₹ 36.20

(3) Purchase Consideration & discharge

Intrinsic Value of TX Ltd. [a]	₹ 36.20 per share
No. of shares [b]	25,000
Purchase Consideration c= [a x b]	₹ 9,05,000
Intrinsic Value of AX Ltd. [d]	₹ 40.40 per share
No. of shares to be issued [c / d]	22,400.99
No. of shares to be issued [rounded off]	22,400.00
Cash for fractions	₹ 40 [₹ 9,05,000 – (22,400 X 40.40)]

Illustration 9

Smith Ltd. is considering buying the business of B Ltd.; the final accounts of which for the last three years were as follows:

Draft Profit and Loss Accounts for the years ended 31st Dec.

	2009 ₹	2010 ₹	2011 ₹
Sales	2,00,000	1,90,000	2,24,000
Less: Material consumed	1,00,000	95,000	1,12,000
Business expenses	80,000	80,000	82,000
Depreciation	12,000	13,000	14,000
Net Profit	8,000	2,000	16,000

Draft Balance Sheets as at 31st Dec.

	2008 ₹	2009 ₹	2010 ₹	2011 ₹
Fixed Assets, at cost	1,00,000	1,20,000	1,40,000	1,80,000
Less : Depreciation	(70,000)	(82,000)	(95,000)	(1,09,000)
	30,000	38,000	45,000	71,000
Stock-in-trade	16,000	17,000	18,500	21,000
Sundry Debtors	21,000	24,000	26,000	28,000
Cash in hand and at Bank	32,000	11,000	28,000	13,200
Prepaid Expenses	1,000	500	2,000	1,000
	1,00,000	90,500	1,19,500	1,34,200
Equity Capital	50,000	50,000	70,000	70,000
Securities Premium	—	—	5,000	5,000
General Reserve	16,000	24,000	26,000	42,000
Debentures	20,000	—	—	—
Sundry Creditors	11,000	13,000	14,000	14,000
Accrued Business Expenses	3,000	3,500	4,500	3,200
	1,00,000	90,500	1,19,500	1,34,200

Smith Ltd. wishes the offer to be based upon trading cash flows rather than book profits. By trading cash flow is meant cash received from debtors less cash paid to creditors and for business expenses (excluding depreciation), together with an allowance for average annual expenditure on fixed assets of ₹ 15,000 per year.

The actual expenditure on fixed assets is to be ignored, as is any cash received or paid out on the issue or redemption of shares or debentures.

Smith Ltd. wishes the trading cashflow to be calculated for each of the years 2009, 2010 and 2011, and for these to be combined using weighting of 20% for 2009, 30% for 2010 and 50% for 2011 to give an average annual trading cashflow.

Smith Ltd. considers that the average annual trading cashflow should show a return of 10% on its investment.

You are required to calculate:

(a) the trading cashflow for each of the years 2009, 2010 and 2011;
(b) the weighted average annual trading cashflow
(c) the price which Smith Ltd. should offer for the business.

Solution

(a) Trading Cash Flows of B Ltd.

	2009 ₹	2010 ₹	2011 ₹
Profit earned during the years	8,000	2,000	16,000
Add : Depreciation (As given in P & L Statement)	12,000	13,000	14,000
Increase in Creditors	2,000	1,000	—
Increase in Accrued Business Expenses	500	1,000	—
Decrease in Prepaid Expenses	500	—	1,000
(A)	23,000	17,000	31,000
Increase in Stock	1,000	1,500	2,500
Increase in Debtors	3,000	2,000	2,000
Increase in Prepaid Expenses	—	1,500	—
Decrease in Accrued Business Expenses	—	—	1,300
(B)	4,000	5,000	5,800
Gross Trading Cash flow (A)–(B)	19,000	12,000	25,200
Less : Adjustment for allowance for average expenditure in fixed assets	(15,000)	(15,000)	(15,000)
Trading Cash Flow	4,000	(3,000)	10,200

(b) Weighted average annual trading Cashflow

Year	Trading cash flow	Weight	Weighted Trading Cash flow
2009	4,000	20 %	800
2010	(3,000)	30 %	(900)
2011	10,200	50 %	5,100
Total	11,200		5,000

(c) Price Smith Ltd. should offer for the business

Return on Investment = 10 %

Weighted Average annual cash flow = ₹ 5,000

Therefore, the price to be offered will be=

$$\frac{\text{Average Annual Cash Flow}}{\text{Return on Investment}} = \frac{₹\,5,000}{10\%} = ₹\ 50,000$$

Illustration 10

Batliboi & Co. Ltd. carried on manufacturing business. Its products were sold to wholesalers and the company had its own retail shop. Adhikary & Co., Private Ltd. carried on similar manufacturing business, but all goods produced were sold through the company's own retail shops.

The summarised balance sheets of the two companies as at 31st March, 2012 were as follows:

	Batliboi & Co. Ltd.	Adhikary & Co. (P) Ltd.		Batliboi & Co. Ltd.	Adhikary & Co. (P) Ltd.
	₹	₹		₹	₹
Share Capital			Fixed Assets :		
Authorised Equity			Freehold Properties		
Shares of ₹ 10	40,00,000	6,00,000	at cost	10,00,000	2,50,000
Issued & fully paid up	25,00,000	6,00,000	Plant & Machinery at		
P & L A/c	3,40,000	90,000	cost less depreciation	13,00,000	1,00,000
Creditors	4,20,000	70,000	Total Fixed Assets	23,00,000	3,50,000
			Current Assets :		
			Stock	4,80,000	1,20,000
			Debtors	2,30,000	80,000
			Bank	2,50,000	2,10,000
	32,60,000	7,60,000		32,60,000	7,60,000

The original cost of Plant and Machinery was:

Batliboi & Co. Ltd.	₹26,00,000
Adhikary & Co. (P) Ltd.	₹ 2,00,000

The following arrangements were made and carried out on April 1, 2012:

(1) *Batliboi & Co. Ltd purchased from the shareholders of Adhikary & Co. (P) Ltd. all the issued shares @ ₹ 14 per share.*

(2) *The shareholders of Adhikary & Co. (P) Ltd. took over one of the freehold properties of Adhikary & Co. (Private) Ltd. for ₹ 60,000, at the book value of the same. It was agreed that the amount should be set off against the amount due to them under (1) above and the balance due to them to be satisfied by the issue of an appropriate number of equity shares in Batliboi & Co. Ltd. at ₹ 19.50 per share*

The necessary transfer in regard to the setting off the price of the property taken over by the shareholders against the amount due to them from Batliboi & Co. Ltd. were made in the books of the two companies.

(3) *All manufacturing was to be carried on by Batliboi and Co. Ltd. and all retail business is*

to be carried on by Adhikary & Co. (Private) Ltd. in this connection.

(i) Batliboi & Co. Ltd. purchased the whole of Adhikary & Co. (P) Ltd.'s plant and machinery for ₹ 1,50,000 and certain of their free-hold property (cost ₹ 1,00,000) at ₹ 1,20,000.

(ii) Adhikary & Co. (P) Ltd. purchased Batliboi & Co. Ltd's. free-hold retail shop buildings (cost to Batliboi &. Co. Ltd, ₹ 75,000) at ₹ 60,000 and took over the retail stock at ₹ 80,000 at the book value.

(4) Batliboi & Co. Ltd. drew a cheque in favour of Adhikary & Co. (P) Ltd. for the net amount due, taking into account all the matters mentioned above.

(5) Immediately after the transfer of shares in (1) above, Adhikary & Co. (P) Ltd. declared and paid a dividend of ₹ 60,000 (ignore Dividend Distribution Tax).

You are required to prepare the Balance Sheets of Batliboi & Co. Ltd. and Adhikary & Co. (P) Ltd. immediately after the completion of the above transaction.

Solution

Balance Sheet of Batliboi & Co as on 31st March, 2012

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	29,00,000
(b) Reserves and Surplus	2	7,05,000
(2) Current Liabilities		
Trade Payables		4,20,000
Total		40,25,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(b) Tangible assets	4	24,95,000
(c) Non-current Investments	5	7,80,000
(2) Current assets		
(a) Inventories		4,00,000
(b) Trade Receivables		2,30,000
(c) Cash & Cash equivalents		1,20,000
Total		40,25,000

Notes to Accounts

		(₹)	(₹)
1.	Share Capital		
	2,90,000 Shares of ₹10 each fully paid up of which 40,000 shares were issued pursuant to a contract without payment being received in cash		29,00,000

2.	Reserves and surplus			
	Securities Premium Account		3,80,000	
	Profit & Loss Account		3,25,000	7,05,000
3.	Tangible Assets			
	Freehold Properties			
	As per last balance sheet	10,00,000		
	Addition during the year	1,20,000		
		11,20,000		
	Less: Sold during the year	(75,000)	10,45,000	
	Plant & Machinery			
	As per last balance sheet	26,00,000		
	Addition during the year	1,50,000		
		27,50,000		
	Less: Sold during the year	(13,00,000)	14,50,000	24,95,000
4.	Non current Investment			
	Shares in subsidiary company			7,80,000

Working Notes :

(1) Calculation of shares to be issued by Batliboi & Co Ltd. to the shareholders of Adhikary & Co. (P) Ltd. [Basis Point (1) and (2) of the question]

	₹
60,000 shares @ ₹ 14 per share	8,40,000
Less : Value of freehold property	(60,000)
Net amount due	7,80,000
No of shares issued 7,80,000 / ₹ 19.5 = 40,000 shares	
Amount credited to Share Capital	4,00,000
Amount credited to Securities Premium	3,80,000
	7,80,000

(2) Net Amount Payable to Adhikary & Co. (P) Ltd.

Particulars	Amount
Assets taken over by Batliboi & Co. Ltd.	
Plant & Machinery	₹ 1,50,000
Free-hold Property	₹ 1,20,000
Total (A)	₹ 2,70,000
Assets sold to Adhikary & Co. (P) Ltd.	
Freehold Retail shop building	₹ 60,000
Retail Stock	₹ 80,000
Total (B)	₹ 1,40,000
Net Payable (A-B)	₹ 1,30,000

Add : Freehold properties taken over by the shareholders of Adhikary & Co. (P) Ltd (Para 2 of point 2)	₹ 60,000
Net Amount Payable	₹ 1,90,000

(3) ₹ 15,000 loss on the sale of Building to Adhikary & Co. (P) Ltd., has been debited to the Profit & Loss Account of Batliboi & Co..

(4) Investment A/c has been credited by dividend received ₹ 60,000 out of pre-acquisition profit from Adhikary & Co..

(5) Cash Balance:

As given	2,50,000
Add : Dividend received	60,000
	3,10,000
Less : Paid to Adhikary & Co. Ltd. including ₹ 60,000 for assets taken over by its erstwhile shareholders	(1,90,000)
	1,20,000

Balance Sheet of Adhikary & Co. (P) Ltd. as on 31st March, 2012

Particulars	*Note No.*	*(₹)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,00,000
(b) Reserves and Surplus	2	1,00,000
(2) Current Liabilities		
Trade Payables		70,000
Total		7,70,000
II. Assets		
(1) Non-current assets		
Fixed assets		
Tangible assets	4	1,50,000
(2) Current assets		
(a) Inventories		2,00,000
(b) Trade Receivables		80,000
(c) Cash & Cash equivalents		3,40,000
Total		7,70,000

Notes to Accounts

		(₹)	*(₹)*
1.	Share Capital		
	60,000 Shares of ₹10 each fully paid		6,00,000

2.	Reserves and surplus			
	Profit & Loss Account			1,00,000
3.	Tangible Assets			
	Freehold Properties			
	As per last balance sheet	2,50,000		
	Addition during the year	60,000		
		3,10,000		
	Less: Sold during the year	(1,60,000)	1,50,000	
	Plant & Machinery			
	Cost	2,00,000		
	Less: Sold during the year	(2,00,000)	-	1,50,000

Working Notes:

		₹
(1)	Profit & Loss Account (given)	90,000
	Add : Profit on sale of machinery and freehold property	70,000
		1,60,000
	Less: Dividend paid	(60,000)
		1,00,000

(2) Freehold properties have been reduced by ₹ 1,00,000 transferred to Batliboi & Co. & ₹ 60,000 taken over by the shareholders of Adhikari & Co. (P) Ltd.

		₹
(3)	Cash at Bank :	
	Balance as given.	2,10,000
	Add: Received from Batliboi & Co	1,90,000
		4,00,000
	Less : Dividend Paid	(60,000)
		3,40,000

Illustration 11

Rich Ltd. and Poor Ltd. decided to amalgamate their business with a view to a public share issue. A holding company, Mix Ltd., is to be incorporated on 1st May 2011 with all authorised capital of ₹ 60,000,000 in ₹ 10 ordinary shares. The company will acquire the entire ordinary share capital of Rich Ltd. and of Poor Ltd. in exchange for an issue of its own shares.

The consideration for the acquisition is to be ascertained by multiplying the estimated profits available to the ordinary shareholders by agreed price earnings ratio. The following relevant figures are given:

	Rich Ltd. ₹	*Poor Ltd.* ₹
Issued share capital		
Ordinary shares of ₹ 10 each	*30,00,000*	*12,00,000*

6% Cumulative Preference shares of ₹ 100 each	*—*	*10,00,000*
5% Debentures, redeemable in 2015		*8,00,000*
Estimated annual maintainable profits, before deduction of debenture interest & taxation	*6,00,000*	*2,40,000*
Price/earning ratio	*15*	*10*

The shares in the holding company are to be issued to members of the subsidiaries on 1st June 2011, at a premium of ₹ 2.50 a share and thereafter these shares will be marketable on the Stock Exchange.

It is anticipated that the merger will achieve significant economics but will necessitate additional working capital. Accordingly, it is planned that on 31st December 2011, Mix Ltd. will make a further issue of 60,000 ordinary shares to the public for cash at the premium of ₹ 3.75 a share. These shares will not rank for dividends until 31st December 2011.

In the period ending 31st December 2011, bank overdraft facilities will provide funds for the payment of management etc. expenses estimated at ₹ 6,000.

It is further assumed that interim dividends on ordinary shares, relating to the period from 1st June to 31st December 2011 will be paid on 31st December 2011 by Mix Ltd. at 3½ %, by Rich Ltd. at 5% and by Poor Ltd. at 2%.

You are required to project, as on 31st December 2011 for Mix Ltd., (a) the Balance Sheet as it would appear immediately after fully subscribed share issue, and (b) the Profit and Loss Account for the Period ending 31st December 2011.

Assume the rate of corporation tax to be 40%. You can make any other assumption you consider relevant.

Solution

Projected Balance Sheet of Mix Ltd. as on December 31, 2011

Particulars	Note No.	*(₹)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	54,00,000
(b) Reserves and Surplus	2	14,25,000
Total		68,25,000
II. Assets		
(1) Non-current assets		
Non Current Investments	3	60,00,000
(2) Current assets		
Cash & Cash equivalents		8,25,000
Total		68,25,000

Projected Profit and Loss Account for the Period ending December 31, 2011

Particulars		Note No.	(₹)
I. Other Income		4	1,74,000
II. Total Revenue	(A)		1,74,000
I. Expenses			
Management Expenses			6,000
II. Total Expenses	(B)		6,000
Net Profit before Tax (A-B)			1,68,000

Notes to Accounts

		(₹)	(₹)
1.	Share Capital		
	Authorised : 6,00,000 Equity shares of ₹10 each	60,00,000	
	Issued : 5,40,000 (WN1) Equity shares of Rs 10 each	54,00,000	54,00,000
2.	Reserves and surplus		
	Securities Premium Account (WN 1)		14,25,000
	Profit and Loss	1,68,000	
	Deduct Dividend WN 3	(1,68,000)	-
			14,25,000
3.	Non Current Investments		
	Subsidiary Companies shares at cost		60,00,000
4.	Other Income		
	Dividend Received		
	Rich Ltd. (30,00,000 X 5 %)	1,50,000	
	Poor Ltd. (12,00,000 X 2 %)	24,000	1,74,000

Working Notes :

1. Share Capital

	Rich Ltd.	Poor Ltd.
Estimated annual maintainable profits before deduction	₹	₹
of debenture interest and taxation	6,00,000	2,40,000
Deduct Debenture interest	-	(40,000)
	6,00,000	2,00,000
Deduct Corporation tax 40 percent	(2,40,000)	(80,000)
	3,60,000	1,20,000
Deduct Preference dividend	–	(60,000)
Profit for equity shareholders	3,60,000	60,000
P/E Ratio	15	10

Total consideration (Profit x P.E. Ratio)	54,00,000	6,00,000
Share Issue Price (₹ 10 + ₹ 2.5 Premium)	₹ 12.5	₹ 12.5
Number of shares to be issued	4,32,000 shares	48,000 shares
Share capital (₹ 10 X no. of shares to be issued)	43,20,000	4,80,000
Securities premium (₹ 2.50 X no. of shares to be issued)	10,80,000	1,20,000

Total Shares Issued to Rich Ltd. and Poor Ltd. = 4,32,000 + 48,000 = 4,80,000

Shares issued to public = 60,000

Total Shares issued as on 31st Dec 2011 = 5,40,000

Securities Premium Balance

From shares issued to Rich & Poor Ltd. = 4,80,000 X 2.5 = ₹ 12,00,000

From shares issued to public = 60,000 X 3.75 = ₹ 2,25,000

Total Securities Premium = ₹ 14,25,000

(2) Bank Account

	₹		₹
To Shares issued (Dec.31, 2011)		By Management expenses	6,000
60,000 shares at ₹ 13.75 each	8,25,000	By Dividend paid (WN 3)	1,68,000
To Dividends received:		By Balance c/d	8,25,000
Rich Ltd. (30,00,000 X 5 %)	1,50,000		
Poor Ltd. (12,00,000 X 2 %)	24,000		
	9,99,000		9,99,000

3 Dividend to be paid by Mix Ltd.

Total Shares as on 31st Dec 2011	₹ 54,00,000
Less : 60,000 shares not qualifying for dividend	₹ 6,00,000
Shares eligibile for dividend	₹ 48,00,000
Dividend @ 3.5 %	₹ 1,68,000

Illustration 12

A Ltd. agreed to absorb B Ltd. on 31st March 2012, whose summarized balance sheet stood as follows

Equity and Liabilities	₹	*Assets*	₹
Share Capital			
80,000 shares of		*Fixed Assets*	7,00,000
₹ 10 each fully paid	8,00,000	*Investments*	–
Reserves & Surplus		*Current Assets*	
General Reserve	1,00,000	*Loans & Advances*	
Secured Loan	—	Stock in trade	1,00,000

Unsecured Loan	—	Sundry Debtors	2,00,000
Current Liabilities & Provisions			
Sundry Creditors	1,00,000		
	10,00,000		10,00,000

The consideration was agreed to be paid as follows:

(a) A payment in cash of ₹ 5 per share in B Ltd. and

(b) The issue of shares of ₹ 10 each in A Ltd., on the basis of 2 Equity Shares (valued at ₹ 15) and one 10% cum. preference share (valued at ₹ 10) for every five shares held in B Ltd.

The whole of the share capital consists of shareholdings in exact multiple of five except the following holding.

Chopra	*116*	
Karki	*76*	
Amar Singh	*72*	
Malhotra	*28*	
Other individuals	*8*	*(eight members holding one share each)*
	300	

It was agreed that A Ltd. will pay in cash for fractional shares equivalent at agreed value of shares in B Ltd. i.e. ₹ 65 for five shares of ₹ 50 paid.

Prepare a statement showing the purchase consideration receivable in shares and cash.

Solution

(a) Schedule of Fraction

	Holding of Shares (A)	Exchangeable in nearest multiple of five (B)	Exchange in equity (C) = (B) / 5 X 2	Preference Exchangeable (D) = (B) / 5 X 1	Non (E) = (A) – (B)
Chopra	116	115	46	23	1
Karki	76	75	30	15	1
Amarsingh	72	70	28	14	2
Malhotra	28	25	10	5	3
Others	8	-	-	-	8
	300	285	114	57	15

(b) Shares Exchangeable: Equity Shares in A Ltd.

		No.		*No.*
(i)	80,000–300 (Total A above)	79,700	2/5 there of	31,880
	300-15 (Total E Above)	285	2/5 there of	114
		79,985		31,994

Shares Exchangeable: Preference Shares in A Ltd.

Shares held			
as in b (i)	79,700	1/5 there of	15,940
as in b (ii)	285	1/5 there of	57
	79,985		15,997

(c) There are 15 shares in B Ltd. which are not capable of exchange into equity and preference shares of A Ltd. they will be paid $150 \times \frac{65}{50} = ₹\,195$

Purchase Consideration	₹
31,994 Equity Shares @ ₹ 15 each	4,79,910
15,997 Preference shares @₹ 10 each	1,59,970
Cash on 79,985 @ ₹ 5 each	3,99,925
	10,39,805
Add: Cash for 15 shares	195
	10,40,000

Illustration 13

The summarized Balance Sheets of Big Ltd. and Small Ltd. as on 31.03.2012 were as follows:

Summarised Balance Sheet as on 31.03.2012

	Big Ltd.	*Small Ltd.*		*Big Ltd.*	*Small Ltd.*
	(₹)	*(₹)*		*(₹)*	*(₹)*
Equity Share Capital (₹ 10)	*8,00,000*	*3,00,000*	*Building*	*2,00,000*	*1,00,000*
10% Preference Share Capital (₹ 100)	*–*	*2,00,000*	*Machinery*	*5,00,000*	*3,00,000*
General reserve	*2,50,000*	*70,000*	*Furniture*	*1,00,000*	*60,000*
Profit and Loss Account	*2,00,000*	*1,00,000*	*Investment: 6,000 shares of Small Ltd.*	*60,000*	*–*
Creditors	*2,00,000*	*3,00,000*	*Stock*	*1,50,000*	*1,90,000*
			Debtors	*3,50,000*	*2,50,000*
			Cash and Bank	*90,000*	*70,000*
	14,50,000	*9,70,000*		*14,50,000*	*9,70,000*

Big Ltd. has taken over the entire undertaking of Small Ltd. on 30.09.2012, on which date the position of current assets except Cash and Bank balances and Current Liabilities were as under:

	Big Ltd. (₹)	*Small Ltd. (₹)*
Stock	*1,20,000*	*1,50,000*

Debtors	*3,80,000*	*2,50,000*
Creditors	*1,80,000*	*2,10,000*

Profits earned for the half year ended on 30.09.2012 after charging depreciation at 5% on building, 15% on machinery and 10% on furniture, are:

Big Ltd.	*₹ 1,02,500*
Small Ltd.	*₹ 54,000*

On 30.08.2012 both Companies have declared 15% dividend for 2011-12.

Goodwill of Small Ltd. has been valued at ₹ 50,000 and other Fixed assets at 10% above their book values on 31.03.2012. Preference shareholders of Small Ltd. are to be allotted 10% Preference Shares of Big Ltd. and equity shareholders of Small Ltd. are to receive requisite number of equity shares of Big Ltd. valued at ₹ 15 per share in satisfaction of their claims.

Show the Balance Sheet of Big Ltd. as of 30.09.2012 assuming absorption is through by that date.

Solution

BALANCE SHEET OF BIG LTD.

As at 30th September, 2012

Particulars	*Note No.*	*(₹)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	12,96,000
(b) Reserves and Surplus	2	5,90,500
(2) Current Liabilities		
Trade Payables		3,90,000
Total		22,76,500
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(b) Tangible assets	3	12,30,500
(2) Current assets		
(a) Inventories		2,70,000
(b) Trade receivables		6,30,000
(c) Cash & Cash equivalents		1,46,000
Total		22,76,500

Notes to Accounts

		(₹)	*(₹)*
1.	Share Capital		
	1,09,600 Equity shares of ₹10 each	10,96,000	

	10% Preference shares		2,00,000	
	(Of above shares, 29600 equity shares and all preference shares are allotted as fully paid up for consideration other than cash)			12,96,000
2.	Reserves and surplus			
	Capital reserve		1,000	
	Securities Premium Account		1,48,000	
	General Reserve		2,50,000	
	Profit & Loss Account		1,91,500	5,90,500
3.	Tangible Assets			
	Building	2,00,000		
	Less: Depreciation	(5,000)		
		1,95,000		
	Add: Taken over	1,07,500	3,02,500	
	Machinery	5,00,000		
	Less: Depreciation	(37,500)		
		4,62,500		
	Add: Taken over	3,07,500	7,70,000	
	Furniture	1,00,000		
	Less: Depreciation	(5,000)		
		95,000		
	Add: Taken over	63,000	1,58,000	12,30,500

Working Notes:

1. Ascertainment of Cash and Bank Balances as on 30th September, 2012

Balance Sheets as at 30th September, 2012

Liabilities	*Big Ltd. (₹)*	*Small Ltd. (₹)*	*Assets*	*Big Ltd. (₹)*	*Small Ltd. (₹)*
Equity Share Capital	8,00,000	3,00,000	Building (WN 3)	1,95,000	97,500
10% Preference Share Capital	–	2,00,000	Machinery (WN 3)	4,62,500	2,77,500
General reserve	2,50,000	70,000	Furniture (WN 3)	95,000	57,000
Profit and Loss Account WN 2	1,91,500	89,000	Investment	60,000	–
Creditors(Given)	1,80,000	2,10,000	Stock (Given)	1,20,000	1,50,000
			Debtors(Given)	3,80,000	2,50,000
			Cash and Bank (Balancing figure)	1,09,000	37,000
	14,21,500	8,69,000		14,21,500	8,69,000

2 Balance of Profit and Loss Account on 30th September, 2012.

	Big Ltd. (₹)	*Small Ltd.* (₹)
Net profit (for the first half)	1,02,500	54,000
Balance brought forward	2,00,000	1,00,000
	3,02,500	1,54,000
Less: Dividend on Equity Share Capital Paid (15 %)	(1,20,000)	(45,000)
	1,82,500	1,09,000
Less: Dividend on Preference Share Capital Paid	–	(20,000)
	1,82,500	89,000
Add: Dividend received as Big Ltd. holds 6,000 shares in Small Ltd. i.e. 6,000 X ₹ 1.5 or $\left[\frac{1}{5}\times 45,000\right]$	9,000	–
Profit and Loss Account Balance as on 30.09.2012	1,91,500	89,000

3 Fixed Assets on 30th September, 2012 (Before absorption)

	Big Ltd. (₹)	*Small Ltd.* (₹)
(1) Building		
As on 1.4.2012	2,00,000	1,00,000
Less: Depreciation for 6 months (5% p.a.)	(5,000)	(2,500)
	1,95,000	97,500
(2) Machinery		
As on 1.4.2012	5,00,000	3,00,000
Less: Depreciation for 6 months (15% p.a.)	(37,500)	(22,500)
	4,62,500	2,77,500
(3) Furniture		
As on 1.4.2012	1,00,000	60,000
Less: Depreciation for 6 months (10% p.a.)	(5,000)	(3,000)
	95,000	57,000

4 Calculation of Shares Allotted

Assets taken over:		₹
Goodwill		50,000
Building (Book Value as on 31.03.2012)	1,00,000	
Add: 10%	10,000	
	1,10,000	
Less: Depreciation (01.04.2012 to 30.09.2012)	(2,500)	1,07,500
Machinery(Book Value as on 31.03.2012)	3,00,000	
Add: 10%	30,000	
	3,30,000	
Less: Depreciation(01.04.2012 to 30.09.2012)	(22,500)	3,07,500

Furniture (Book Value as on 31.03.2012)	60,000	
Add: 10%	6,000	
	66,000	
Less: Depreciation(01.04.2012 to 30.09.2012)	3,000	63,000
Stock		1,50,000
Debtors		2,50,000
Cash and Bank		37,000
		9,65,000
Less: Liabilities taken over:		
Creditors		(2,10,000)
Net assets taken over		7,55,000
Less: Allotment of 10% Preference Shares to preference shareholders of Small Ltd.		(2,00,000)
		5,55,000
Less: Belonging to Big Ltd.*** $\left[\frac{1}{5} \times 5,55,000\right]$		(1,11,000)
Payable to other Equity Shareholders		4,44,000
Number of equity shares of ₹ 10 each to be Issued (valued at ₹ 15 each)	$\frac{4,44,000}{15}$ = 29,600	

[*** 6,000 shares out of 30,000 shares of Small Ltd. are already with Big Ltd.]

3. Ascertainment of Goodwill / Capital Reserve

			₹
(A)	Net Assets taken over		7,55,000
(B)	Preference shares allotted	2,00,000	
	Payable to other equity shareholders	4,44,000	
	Cost of investments	60,000	(7,04,000)
(C)	Capital Reserve [(A) – (B)]		51,000
(D)	Goodwill taken over		50,000
(E)	Final figure of Capital Reserve [(C) – (D)]		1,000