

Financial Accounting

(Paper - V)

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Himalaya Publishing House

ISO 9001:2008 CERTIFIED

FINANCIAL ACCOUNTING

**(As per the Revised Syllabus of T.Y.B.Com., 2014-15,
Semester V, University of Mumbai)**

Winner of "Best Commerce Author – 2013-14" by Maharashtra Commerce Association
"State Level Mahatma Jyotiba Phule Excellent Teacher Award 2016"

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First Edition : 2016



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First Edition : 2016

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- Published by** : Mrs. Meena Pandey for **Himalaya Publishing House Pvt. Ltd.**,
"Ramdoot", Dr. Bhalerao Marg, Girgaon, Mumbai - 400 004.
Phone: 022-23860170/23863863, Fax: 022-23877178
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- Branch Offices** :
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- DTP by** : Prerana Enterprises, Mumbai.
- Printed at** : Rose Fine Arts, Mumbai. On behalf of HPH.

PREFACE

We are happy to present this book “*Financial Accounting*” to the students of T.Y.B.Com for Semester Vth. In this edition, an effort has been made to incorporate professional examination questions at relevant places in the book.

The syllabus contains a list of topics covered in each chapter which will avoid controversies regarding the exact scope of the syllabus. The text follows the term-wise chapter topics pattern prescribed in the syllabus. We have preferred to leave the text of the section and rules as it is and thereafter, added the comments with the intention of explaining the subject to the students in a simplified language. While making an attempt to explain in a simplified language, any mistake of interpretation might have crept in. This book is a unique presentation of subject matter in an orderly manner. This is a student-friendly book and tutor at home. We hope the teaching faculty and students community will find this book of great use.

We are extremely grateful to students of T.Y.B.Com and Mr. K.N. Pandey of Himalaya Publishing House Pvt. Ltd. for their devoted and untiring personal attention accorded by them to this publication. I gratefully acknowledge and express my sincere thanks to the following people without whose inspiration, support and constructive suggestions, this book would not have been possible.

- *Mr. Jitendra Singh Thakur (Trustee, Thakur College)*
- *Dr. Chaitaly Chakraborty (Principal, Thakur College)*
- *Mrs. Janki Nishikant Jha*

We welcome suggestions from students and teachers for further improvement of the book.

Authors

SYLLABUS

Financial Accounting and Auditing Paper V: Financial Accounting

Modules at a Glance

Sr. No.	Modules	No. of Lectures
1	Amalgamation of Companies (w.r.t. AS-14, Excluding inter-company holdings)	18
2	Capital Reduction and Internal Reconstruction	10
3	Investment Accounting w.r.t. AS-13	12
4	Preparation of Final Accounts of Companies	15
5	Introduction to IFRS	05
	Total	60

Sr. No.	Modules/Units
1	<p>Amalgamation of Companies (w.r.t. AS-14) (Excluding Inter-company Holdings)</p> <p>(i) In the nature of merger and purchase with corresponding accounting treatments of pooling of interests and purchase methods respectively (ii) Computation and meaning of purchase consideration (iii) Problems based on purchase method of accounting only</p>
2	<p>Capital Reduction and Internal Reconstruction</p> <p>(i) Need for reconstruction and Company Law provisions (ii) Distinction between internal and external reconstructions (iii) Methods including alteration of share capital, variation of shareholder rights, subdivision, consolidation, surrender and reissue/cancellation, reduction of share capital, with relevant legal provisions and accounting treatments for same</p>
3	<p>Investment Accounting w.r.t. AS-13</p> <p>3.1 (a) For Shares (Variable income bearing securities) (b) For Debentures, bonds, etc. (Fixed Income bearing securities)</p> <p>3.2 Accounting for transactions of purchase and sales of investments with ex and cum-interest prices and finding cost of investment sold and carrying cost as per weighted average method</p> <p>3.3 Columnar format for investment account</p>
4	<p>Preparation of Final Accounts of Companies</p> <p>(i) Relevant provisions of Companies Act related Final Account (excluding cash flow statement) (ii) Preparation of Profit and Loss A/c and Balance Sheet as per revised Schedule VI of Companies Act 1956 (iii) AS-1 in relation to final accounts of companies (disclosure of accounting policies)</p>
5	<p>Introduction to IFRS</p> <p>(i) Purpose and objectives of Financial statements — Its framework — Its assumptions, characteristics, elements, recognition and measurement (ii) Convergence and first time adoption of IFRS [IFRS – 1]</p>

QUESTION PAPER PATTERN

SCHEME OF EXAMINATION

Credit Based Grading System Scheme of Examination

● **Internal Assessment – 25%** **25 Marks**

● **Semester End Examinations – 75%** **75 Marks**

Duration: 2½ Hrs.

Maximum Marks: 75

All questions are compulsory carrying 15 marks each.

Questions to be Set: 05

Particulars	Marks
Q.1 Objective Questions (a) Sub-questions to be asked 10 and to be answered any 08 (b) Sub-questions to be asked 10 and to be answered any 07 (*Multiple Choice/True or False/Match the Column, Fill in the Blanks)	15 Marks
Q.2 Full Length Practical Question OR	15 Marks
Q.2 Full Length Practical Question	15 Marks
Q.3 Full Length Practical Question OR	15 Marks
Q.3 Full Length Practical Question	15 Marks
Q.4 Full Length Practical Question OR	15 Marks
Q.4 Full Length Practical Question	15 Marks
Q.5 (a) Theory Questions (b) Theory Questions OR	08 Marks 07 Marks
Q.5 Short Notes To be asked 05 To be answered 03	15 Marks

Note: Full length question of 15 marks may be divided into two sub-questions of 08 and 07 marks.

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4. Preparation of Final Accounts of Companies	198 – 268
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AMALGAMATION OF COMPANIES

With effect from	01.04.1995	
Levels of Enterprises	Companies (AS) Rules, 2006 All types of Companies	Enterprises other than Companies I, II & III

1. DEFINITIONS AND SCOPE

1. **Scope:** AS – 14 is primarily directed at Companies –
 - (a) To account for amalgamations, and
 - (b) To account for any resultant Goodwill or Reserves.

Note: Even though it is primarily directed at Companies, AS – 14 requirements may also apply to Financial Statements of other enterprises.

AS – 14 specifically excludes acquisitions in the nature of purchase by one Company of Shares or assets of another Company, the consideration being paid by way of – (a) Cash, or (b) by issue of shares or other securities in the acquiring Company, or (c) partly in one form and partly in the other.

Particulars	Amalgamation	Acquisition
1. Meaning	It means an amalgamation pursuant to the provisions of the Companies Act, 1956, or any other applicable statute.	Acquisitions arise when there is a purchase by one Company of whole or part of the Shares or assets of another Company.
2. Parties	Transferor Company & Transferee Company.	Acquired Company & Acquiring Company.
3. Entity	Transferor Company ceases to exist after amalgamation.	Acquired Company is not dissolved. It continues to exist as a separate Company.
4. AS – 14	Applicable.	Not Applicable.
5. Governing Statute	Companies Act, 1956	SEBI Act, 1992

Amalgamation vs. Absorption: Amalgamation **Includes** – (a) two or more Companies joining to form a New Company, and or (b) absorption and blending of one by the other. Thus, Amalgamation includes Absorption also.

1. **Amalgamation:** It means an amalgamation pursuant to the provisions of the Companies Act, 1956, or any other statute, which may be applicable to Companies.
2. **Transferor Company:** It means the Company, which is amalgamated into another Company.
3. **Transferee Company:** It means the Company into which a Transferor Company is amalgamated.
4. **Reserve:** It means the portion of earnings, receipts or other surplus of an Enterprise, (whether capital or revenue) appropriated by the Management for a general or specific purpose, other than a provision for depreciation or diminution in the value of assets or for a known liability.

2 • Amalgamation of Companies

5. **Consideration:** 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.
6. **Fair Value:** Fair Value is the amount for which an asset could be exchanged between a knowledgeable, willing Buyer and a knowledgeable, willing Seller, in an arm's length transaction,
7. **Pooling of Interests Method:** It is a method of accounting for amalgamations, the object of which is to account *for* the amalgamation as if the separate businesses of the amalgamating Companies were intended to be continued by the Transferee Company. Accordingly, only minimal changes are made in aggregating the individual Financial Statements of the amalgamating Companies.

Type	Amalgamation in the nature of Merger	Amalgamation in the nature of Purchase
1. Meaning	There is a pooling of assets and liabilities of both Companies, as also the interests of the Shareholders and the businesses of the amalgamating Companies.	One Company acquires another Company, but the Shareholders of the Amalgamating Company do not continue to have a proportionate interest in the Equity or the business of the combined Company.
2. Continuation of business	The business of the Transferor Company is intended to be continued by the Transferee Company.	The business of the Company may not be intended to be continued by the Transferee Company.
3. Carrying amounts	All Assets, Liabilities, Capital and Reserves represent the sum of the relevant figures of the amalgamating Companies.	Assets and Liabilities may not be taken up in full by the Transferee Company in total. In effect, there is no pooling of assets and liabilities.
4. Participation in Management	There is a continuing participation by the Management of the Transferor Company in the Management of the Transferee Company after the amalgamation.	The Transferee Company takes the role of a dominant party after the amalgamation.
5. Method of Accounting	The Pooling of Interests Method is generally used for accounting.	The Purchase Method is normally used for accounting.

Amalgamation in the nature of Merger is an amalgamation, which satisfies all the following conditions

1. **Assets and Liabilities:** All the Assets and Liabilities of the Transferor Company become, after amalgamation, the assets and liabilities of the Transferee Company.
2. **Equity Shareholders:** 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.
3. **Consideration to Equity Shareholders = Equity Shares:** 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.

4. **Continuity of business:** The business of the Transferor Company is intended to be carried on, after the amalgamation, by the Transferee Company.
5. **Book Values of Assets and Liabilities:** 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.

Amalgamation in the nature of purchase is an amalgamation, which does not satisfy any one or more of the conditions specified above.

2. TYPES OF AMALGAMATION AND METHODS OF ACCOUNTING

Method Para Ref.	Pooling of Interests Method 10, 11, 31, 33, 34, 35	Purchase Method 12, 13, 32, 36, 37, 38, 39
1. Used in	Generally used in amalgamations in the nature of Merger .	Normally used in amalgamations in its nature of Purchase .
2. Recording of Assets and Liabilities	Assets, Liabilities and Reserves of the Transferor Company are recorded at their existing Carrying Amounts , subject to adjustments for uniformity in accounting policies.	Assets and Liabilities are recorded either at their – (a) existing Carrying Amounts, or (b) by allocating the consideration to individual assets on the basis of their Fair Values .
3. Profit & Loss Account of the Transferor Company	Balance of the Profit & Loss Account of the Transferor Company should be – * aggregated with the corresponding balance in P&L A/c of the Transferee Company, OR * transferred to the General Reserve, if any, of the Transferee Company.	Balance in the Profit & Loss Account appearing in the Financial Statements of the Transferor Company, whether debit or credit, loses its Identity .
4. Treatment of Non-Statutory Reserves	Capital or Revenue Reserves should be recorded at their existing Carrying Amounts and in the same form as at the date of amalgamation.	Capital or Revenue Reserves. (other than Statutory Reserves) should not be included in the Financial Statements of the Transferee Company. Statutory Reserves are retained at the existing Carrying Amount by the entry –
5. Treatment of Statutory Reserves	Statutory Reserves are retained at the existing Carrying Amount, in the books of the Transferee Company.	Amalgamation Adjustment Account Dr. To Statutory Reserve (by name) A/c When the Statutory Reserve is no longer required to be maintained, the above entry should be reversed.
6. Goodwill Capital Reserve	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 the Transferor Company should be adjusted in Reserves , in the Financial Statements of the Transferee Company. [Note: See EAC Opinion for treatment of Capital Reserve.]	Excess Consideration over the value of the net assets of the Transferor Company should be recognised in the Transferee Company's Financial Statements as Goodwill , which should be amortised to income on a systematic basis over its useful life. (normally five years.) If the consideration is lower than the value of the Net Assets acquired, the difference should be treated as Capital Reserve .

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7. Adjustments to Assets and Liabilities	Adjustments become necessary only, when both Companies have conflicting accounting policies. The effect of changes in accounting policies must be disclosed, as per AS – 4.	Adjustments become necessary to – (a) ensure uniformity in accounting policies, or, (b) record assets not recorded in the books of the Transferor Company, e.g. Know-how or other Intangible Asset, or, (c) record liability not recorded in the books of the Transferor Company, e.g. provision for planned employee termination or plant relocation costs.
8. Management Intervention	There is no domination by the Management of either of the amalgamating Companies in recording Assets and Liabilities.	The Management of the Transferee Company may influence the determination of Fair Values for Assets and Liabilities.

1. **Components:** The consideration for the amalgamation (both in the nature of Merger or Purchase) may consist of – (a) Securities, (b) Cash, or (c) Other Assets.
2. **Valuation of Consideration:** Valuation becomes necessary only when there is a non cash element in the consideration. In determining the value of non cash consideration, an assessment is made of the Fair Value of its elements. A variety of techniques are applied in arriving at Fair Value, e.g. –

Nature of Consideration	Valued at
(a) In case of Securities	Fair Value is the value fixed by the statutory authorities, if any. Alternatively, other techniques may be applied.
(b) In case of other assets	Fair Value is Market Value of the assets given up. When it is not readily available, then respective Net Book Values are considered.

3. **Adjustments:** Consideration may be subject to adjustments in the light of one or more future events, e.g.
 - (a) When the additional payment is probable and can reasonably be estimated at the date of amalgamation, it is included in the calculation of the consideration.
 - (b) In all other cases, the adjustment is recognised as soon as the amount is determinable.

Particulars	Amalgamation in the nature of Merger	Amalgamation in the nature of Purchase
1. Identity of Reserves	The identity of the Reserves is preserved, and they appear in the Financial Statements of the Transferee Company in the same form in which they appeared in the Financial Statements of the Transferor Company.	The identity of the Reserves is not preserved. However, Statutory Reserves to be maintained for a specified period, e.g. Development Allowance Reserve and Investment Allowance Reserve under Income Tax Act, are recorded at the existing Carrying Amounts.
2. Reserves for Dividend Distribution	Reserves, which were available for distribution as dividend before the amalgamation, would also be available for distribution as dividend after the amalgamation.	The identity of the Reserves is not preserved . The question of Dividend Distribution out of Capital Reserve does not arise.

3. Treatment of Consideration	The difference between the consideration and the amount of Share Capital of the Transferor Company is adjusted in the Reserves in the Financial Statements of the Transferee Company. [See Note below for EAC Opinion on Capital Reserve]	The amount of consideration is deducted from the value of the Net Assets of the Transferor Company acquired by the Transferee Company. The treatment is as under (a) When Consideration > Net Assets: Difference is debited to. Goodwill A/c. (b) When Consideration < Net Assets: Difference is credited to Capital Reserve A/c.
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Note: Capital Reserve in case of Amalgamation in the nature of Merger EAC Opinion

<ul style="list-style-type: none"> ● Capital Reserve: The difference between Issued Share Capital of the Transferee Company [i.e. Purchasing Company] and the Share Capital of the Transferor Company (is) [i.e. Selling Company (is)] should be treated as Capital Reserve, in the books of the Transferor Company. ● Restriction: Reserve created on amalgamation is not available for the purpose of distribution to Shareholders as dividend and / or Bonus Shares. ● Applicability: Capital Reserve arises only if the Purchase Consideration (i.e. Shares issued by the Purchasing Company) is less than the Share Capital (Equity + Preference) of the Transferor Companies. 	EAC Opinion (April 2004 CA Journal Page 1042)
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In the case of Amalgamation in the nature of Merger

Treatment of difference between Purchase Consideration & Share Capital of Transferor Companies

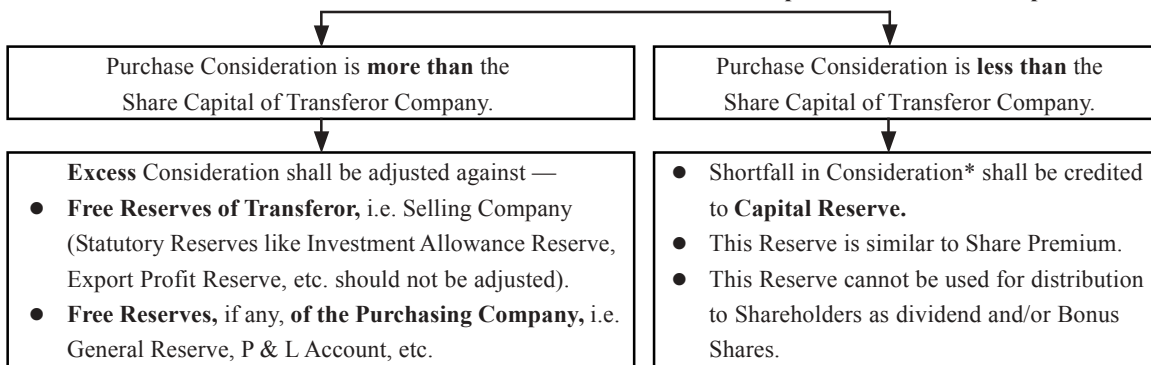


Illustration: Big Ltd. took over Small Ltd. on 1st April, by way of merger, on the date of amalgamation, the Reserves of Small Ltd. were – (a) General Reserve Rs. 100 Lakhs, (b) P & L A/c Rs. 50 Lakhs, (c) investment Allowance Reserve (under IT Act) Rs. 45 Lakhs. Small Ltd. had a Paid-up Capital of Rs. 150 Lakhs in Equity Shares and Rs. 200 Lakhs in Preference Shares. The treatment of Reserves in different situations will be –

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Situation	I	II	III
Purchase Consideration	480	600	300
Paid-Up Capital of Transferor Co.	$150 + 200 = 350$	$150 + 200 = 350$	$150 + 200 = 350$
Difference	Excess 130	Excess 250	Shortfall (50)
Adjustments in –	G/R of Small = 100 P&L of Small = 30 (Bal. figure)	G/R of Small = 100 P&L of Small = 50 G/R / P&L of Big = 100 (Bal. figure)	Capital Reserve = 50 as per EAC Opinion
Balance Reserves of Small Ltd. to be recorded in the books of Big Ltd.	G/R of Small = Nil P&L of Small = 20 Invt Allow Res = 45	G/R of Small = Nil P&L of Small = Nil Invt Allow Res = 45	G/R of Small = 100 P&L of Small = 50 Invt Allow Res = 45 Capital Reserve = 50

3. PRINCIPLES – ACCOUNTING FOR AMALGAMATION

1. **Statute prevails:** Where the scheme of amalgamation sanctioned under a Statute, e.g. Companies Act, 1956, prescribes the treatment to be given to the Reserves of the Transferor Company after amalgamation, the same should be followed.
2. **Disclosures:** Where the Statute prescribes the treatment of Reserves, in the interest of better understanding, the following disclosure should be made in the first Financial Statements following the amalgamation –
 - (a) Description of the accounting treatment given to the Reserves together with the reasons for following a treatment different from that prescribed in AS – 14.
 - (b) Deviations in the accounting treatment given to the Reserves as prescribed by the scheme of amalgamation sanctioned under the Statute, as compared to the requirements of AS – 14 that would have been followed, had no treatment been prescribed by the Statute.
 - (c) The financial effect if any, arising due to such deviation.

Treatment of Goodwill

1. **Recognition of Goodwill:** Any **excess** consideration over the value of the Net Assets of the Transferor Company should be recognised in the Transferee Company's Financial Statements as **Goodwill**. Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life.
2. **Amortisation: Goodwill** arising on amalgamation should be amortised to income on a systematic basis over its useful life. Due to the nature of goodwill, it is generally difficult to estimate its useful life with reasonable certainty, on a reasonable estimation, goodwill should be amortised over a period **not exceeding five years**, unless a longer period is justified.
3. **Factors considered in estimating the useful life of Goodwill**
 - (a) the foreseeable life of the business or industry,
 - (b) the effects of product obsolescence, changes in demand and other economic factors,
 - (c) the service life expectancies of key individuals or group of employees,
 - (d) expected actions by competitors or potential competitors, and
 - (e) legal, regulatory or contractual provisions affecting the useful life.

Example: Tarun Ltd. acquired the Net Assets of Varun Ltd. for a total consideration of Rs. 25 Lakhs. The Fair Value of Net Assets of Varun Ltd. is Rs. 20 Lakhs. Here, the difference of Rs. 5 Lakhs constitutes **Goodwill**, to be amortised by Tarun Ltd. over a five-year period, unless a longer period is justified.

Treatment of Capital Reserve amalgamation in the nature of purchase?

1. **Capital Reserve:** If the consideration paid for amalgamation is **less** than the Net Assets of the Transferor Company, the difference is called **Negative Goodwill**. This should be recognised in the Transferee Company's Financial Statements as **Capital Reserve**.
2. **Example: Dhruva Ltd.** acquired the Net Assets of Uttama Ltd. for a total consideration of Rs. 25 Lakhs. The Fair Value of Net Assets of Uttama Ltd. is Rs. 40 Lakhs. In the above case, the difference of Rs. 15 Lakhs constitutes **Negative Goodwill**. This should be recognised as **Capital Reserve** in the Financial Statements of Dhruva Ltd.

Effect of Amalgamation after the Balance Sheet Date?

Amalgamation is effected	Treatment
<ul style="list-style-type: none"> ● After the Balance Sheet Date, but ● Before the issuance of Financial Statements by either parties. 	<ul style="list-style-type: none"> ● The amalgamation is not incorporated in the ● Financial Statements, but ● Disclosure is made in accordance with AS – 4.

In certain circumstances, the amalgamation may also provide additional information affecting the Financial Statements themselves, for instance, by allowing the going concern concept assumption to be maintained.

Example: As per a scheme sanctioned under the Companies Act, 1956, Kripa Ltd. is amalgamated with Sundari Ltd. with effect from 1st May 2011. Both Companies close their accounts 31st March every year. For the year ended 31st March 2011, the Companies have not yet finalised their accounts. The amalgamation is to be accounted only during the financial year ending 31st March 2012. However, disclosure is made in the accounts for the year ending 31st March 2011, as per AS – 4 requirements,

Balances in the P & L Account treated in the books of the Transferee Company?

Amalgamation in the nature of Merger [Para 21] Amalgamation in the nature of Purchase [Para 22]

Balance in P & L A/c appearing in the Financial Statements of the Transferor Company is – (a) aggregated with the corresponding balance appearing in Financial Statements of the Transferee Company, OR, (b) transferred to the General Reserve, if any.	Balance in P & L A/c appearing in the Financial Statements of the Transferor Company, whether debit or credit, loses its identity .
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4. DISCLOSURE REQUIREMENTS

The First Financial Statements following the Amalgamation should disclose –

For all Amalgamations	Additional disclosures under the Pooling of Interests Method	Additional disclosures under the Purchase Method
Para 24, 43	Para 25, 44	Para 26, 45
<ul style="list-style-type: none"> Names and general nature of business of the Amalgamating Companies, Effective date of amalgamation for accounting purposes, Method of accounting used to reflect the amalgamation, and Particulars of the scheme sanctioned under a Statute. 	<ul style="list-style-type: none"> Description and number of Shares issued, together with the percentage of each Company's Equity Shares exchanged to effect the amalgamation, and Amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof. 	<ul style="list-style-type: none"> Consideration for the amalgamation and a description of the consideration paid or contingently payable, and Amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any Goodwill arising on amalgamation.

SUMMARY OF EAC OPINIONS IN AS – 14

<p>Nature of Capital Reserve: The difference between issued Share Capital of the Transferee Company and the Share Capital of the Transferor Company should be treated as Capital Reserve for AS – 14 purposes. This Reserve is not available for distribution to Shareholders as dividend or as Bonus Shares.</p>	<p>April 2004 CA Journal Pg.1042</p>
<p>Amalgamation of 100% Subsidiary with its 100% Holding Company: Amalgamation of a Subsidiary with its 100% Holding Company satisfies all the conditions for amalgamation in the nature of Merger. Also, a Subsidiary cannot be “acquired” by its Holding Company, since it is already acquired. Hence, it should be accounted under the Pooling of Interests Method only.</p>	<p>EAC Opinion</p>

Steps involved in Accounting for Amalgamations

Step	Procedure
1	<p>See whether the Amalgamation is in the nature of Merger or in the nature of Purchase. (See Q.2 above)</p> <ul style="list-style-type: none"> Determine the Purchase Consideration, i.e. Cash, Securities or Other Assets paid by the Purchasing Company to the Shareholders of the Selling Company.
2	<ul style="list-style-type: none"> Payment made to Debenture holders of the Selling Company or reimbursement of Liquidation Expenses of the Selling Company, does not constitute Purchase Consideration. Purchase Consideration can be determined based on — <ol style="list-style-type: none"> Net Payments basis, i.e. total of shares and cash paid by the Purchasing Company to the Selling Company, or Net Assets basis, i.e. Assets (including Goodwill, if any) Less Liabilities taken over, at the agreed values.

	Verify for special considerations in Shareholdings	
	Situation	Treatment
3	Purchasing Company holding Shares in Selling Company	Purchase Consideration should be calculated for Outsiders' Interests only.
	Selling Company holding Shares in Purchasing Company	Additional Shares will be issued by the Purchasing Company (Total Shares to be issued Less Shares already held by the Selling Company).
	Cross Holdings , i.e. Purchasing and Selling Companies holding Shares in each other	Purchase Consideration (based on Net Assets basis) should be determined using simultaneous equations . (In case of Net Payments based Purchase Consideration, simultaneous equations are not required.)
4	Pass the necessary Journal Entries in the books of the Selling Company, so as to close its books.	
5	Compute Goodwill / Capital Reserve for the Purchasing Company, in case of an amalgamation in the nature of Purchase.	
6	Pass the necessary Journal Entries in the books of the Purchasing Company, and prepare the revised Balance Sheet of the Purchasing Company after absorption / takeover.	

JOURNAL ENTRIES IN THE BOOKS OF SELLING COMPANY

Note: No distinction is made between Amalgamation in the nature of **Merger. or Purchase**, in the books of the Selling Company. The Journal Entries are similar in both cases.

	Transaction	Journal Entry
1.	Transfer of Assets taken over by Purchasing Company	Realisation A/c Dr. To Sundry Assets (individually)(at B/S Value)
	Note: <ul style="list-style-type: none"> ● If Cash is not taken over by the Purchasing Company, it should not be transferred to Realisation A/c. ● If Selling Company already holds Shares in Purchasing Company, such "Investments in Shares of Purchasing Company" A/c, should not be transferred to Realisation A/c. 	
2	Transfer of Liabilities taken over by Purchasing Company	Sundry Liabilities A/c (individually) (at B/S Value) Dr. To Realisation A/c
3	Direct Sale of specific Assets not taken over by Purchasing Company	Cash / Bank A/c (amount received) Dr. Realisation A/c (if sold at Loss) Dr. To Sundry Assets A/c (specified asset) (at B/s Value) To Realisation A/c (if sold at Profit)
4	Direct Settlement of specific Liabilities not taken over by Purchasing Company	Sundry Liabilities A/c (at B/s Value) Dr. Realisation A/c (if settled at Loss) Dr. To Cash / Bank A/c (amount settled) To Realisation A/c (if settled at Profit)
5	Expenses of Liquidation / Realisation met by Selling Company	Realisation A/c Dr To Cash / Bank A/c

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	Note: <ul style="list-style-type: none"> ● If Purchasing Company meets the Realisation Expenses directly, no entry is required in Selling Co.'s Books. ● If the Purchasing Company reimburses the Liquidation Expenses, then "Purchasing Company" Account should be debited instead of "Realisation Account". A separate receipt entry should be passed for the reimbursement received. (Alternatively, the payment of Liquidation Expenses and receipt of reimbursement can be ignored in the books of the Selling Company) ● If the Liquidation Expenses are shared by the Purchasing Company and Selling Company, the Journal Entry in Item 5 should be made only for the Selling Company's Share of Expenses. 	
6	Transfer of Share Capital to Sundry Shareholders Account If Purchasing Co. holds Shares in Selling Co.	Equity Share Capital A/c (Total Amt) Dr. To Sundry Shareholders A/c (Outsiders' Share) To Realisation A/c (Purchasing Co.'s Share, if any)
7	Transfer of Reserves and Surplus (to Sundry Shareholders, i.e. Outsiders' Share only)	Reserves & Surplus A/c Dr. To Sundry Shareholders A/c (fully transferred)
8	Transfer of Accumulated Losses, if any	Sundry Shareholders A/c Dr. To P&L Account / Misc. Expenditure, etc.
9	Recording of Purchase Consideration due	Purchasing Company A/c Dr. To Realisation A/c Cash / Bank A/c Dr.
10	Receipt of Purchase Consideration	Shares in Purchasing Co. A/c Dr. To Purchasing Company A/c
11	Transfer of Profit on Realisation (reverse entry is passed for Loss, if any)	Realisation A/c Dr. To Sundry Shareholders A/c Sundry Shareholders A/c Dr.
12	Final Settlement to Shareholders	To Cash / Bank A/c To Shares in Purchasing Co. A/c

Note:

- 1. Participating Preference Shams:** Generally all Reserves, Accumulated Losses and Profit Loss on Realisation is transferred to Equity Shareholders Account. Preference Shareholders are not entitled for the same. However, in respect of Participating Preference Shares, they are entitled to the Credit Balances in Reserves and Surplus on Realisation, if it is permitted by – (a) Articles of Association, and (b) terms of amalgamation / absorption. In any case, Accumulated Losses/Loss on Realisation will be borne entirely by Equity Shareholders.
- 2. Absorption without Liquidation of Selling Company:** Sometimes, the Purchasing Company may take over all the Assets and liabilities of the Selling Company, **without liquidating the latter**. In such case, the Selling Company will continue to exist as an Investment Company. In accounting for such Takeover —
 - (a) There is no payment / settlement to Shareholders, hence entry 6, 7, 8, 11 and 12 above will not be applicable.
 - (b) Profit on Realisation is transferred to Capital Reserve Account.
 - (c) Loss on Realisation if any, is adjusted against Reserves of the Selling Company.
 - (d) Assets of Selling Company will consist **only** of Shares / Securities of the Purchasing Company.

Format of some Ledger Accounts in the books of Selling Company

1. Realisation Account

Particulars	₹	Particulars	₹
To Sundry Assets A/c (Assets taken over) (individually) (transfer at Book Values)		By Sundry Liabilities (Liab. taken over) (individually) (transfer at Book Values)	
To Cash / Bank (liquidation Expenses met)		By Purchasing Co. A/c (Purchase Consideration Due)	
To Sundry Assets / Liabilities A/c (Assets disposed of at loss if any, Liabilities settled at higher amounts than Book Values, if any)		By Sundry Assets / Liabilities A/c (Assets disposed of at a gain if any, Liabilities settled at lower amounts than Book Values, if any)	
To Sundry Shareholders A/c (Profit on Realisation transferred)		By Equity Share Capital A/c , (Purchasing Co.'s Share in Equity Cap. of Selling Co, if any)	
		By Sundry Shareholders A/c (Loss on Realisation transferred, if any)	
Total		Total	

2. Equity Shareholders' Account / Sundry Shareholders' Account

Particulars	₹	Particulars	₹
To P&L A/c / Misc. Expenditure (Transfer of Accumulated Losses, Dr. Bal. etc.)		By Equity Share Capital (Outside Shareholders Portion of Equity Capital)	
To Realisation A/c (Loss on Realisation, if any)		By Reserves (All Reserves, fully transferred)	
To Cash / Bank (Final Settlement)		By Realisation A/c (Profit on Realisation)	
To Equity Shares in Purchasing Company (Final Settlement)			
Total		Total	

3. Purchasing Company Account

Particulars	₹	Particulars	₹
To Realisation A/c (Purchase Consideration due)		By Cash / Bank (Settlement of Purchase Consideration)	
		By Equity Shares in Purchasing Co. (Settlement of Purchase Consideration)	
Total		Total	

**4. Investment in Equity Shares of Purchasing Company Account
(if Selling Company already holds Shares in Purchasing Company)**

Particulars	₹	Particulars	₹
To balance b/d (Shares already held)		By Sundry Shareholders A/c	
To Purchase Company A/c (Purchase Consideration received now)		(Final Settlement / Distribution to Outside Shareholders)	
Total		Total	

Journal Entries in the Books of Purchasing Company

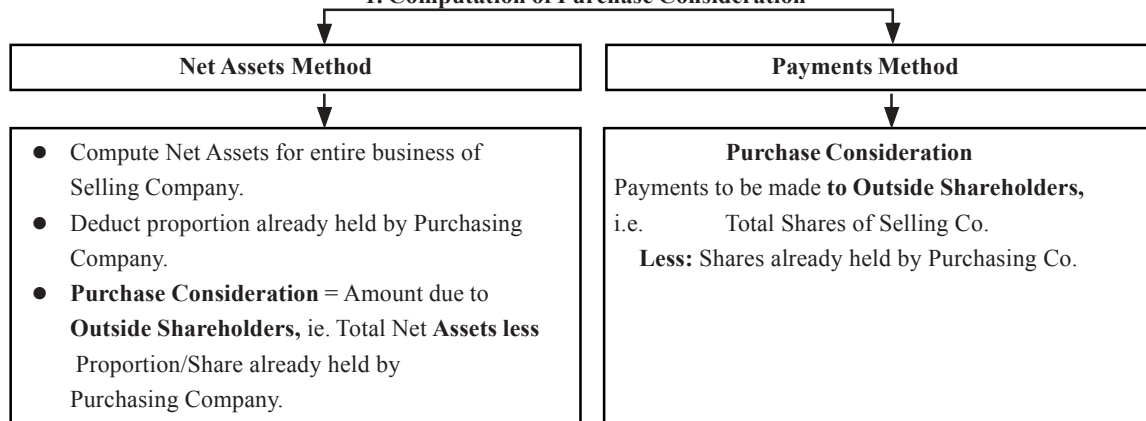
Transaction	Journal Entry
<p>1. Purchase Consideration Due</p> <p>Assets and Liabilities taken over (Note: Where the Purchasing Company already holds some Shares in the Selling Company, the relevant Investment Account is also credited, for Cancellation purposes.)</p> <p><i>Either Goodwill or Capital Reserve will arise as the balancing figure in case of Purchase Method.</i></p>	<p>Business Purchase A/c Dr. To Liquidator of Selling Company A/c</p> <p>A. PURCHASE METHOD: Sundry Assets A/c (at agreed values) Dr. Goodwill A/c (balancing figure, <i>if any</i>) Dr. To Sundry Liabilities A/c (at agreed values) To Business Purchase A/c (Purchase Consideration) To Capital Reserve A/c (balancing figure, <i>if any</i>) (If Purc Consi > Net Assets, Goodwill will arise as bal. fig.) (If Purc Consi < Net Assets, Capital Reserve will arise as b/f)</p> <p>B. MERGER METHOD: (i) When Purchase Consideration > S. Cap of Selling Co. Sundry Assets A/c (at B/s Values) Dr. Reserves A/c (balancing figure, <i>if any</i>) Dr. To Sundry Liabilities A/c (at B/s Values) To Statutory Reserves of Selling Company A/c (<i>if any</i>) To Business Purchase A/c (Purchase Consideration) To Reserves A/c (balancing figure, <i>if any</i>)</p> <p>(ii) When Purchase Consideration < S. Cap of Selling Co. Sundry Assets A/c (at B/s Values) Dr. To Sundry Liabilities A/c (at B/s Values) To Statutory Reserves of Selling Company A/c (<i>if any</i>) To Business Purchase A/c (Purchase Consideration) To Free Reserves of Selling Co. A/c To Capital Reserve A/c (as per EAC Opinion)</p>
<p>2 Excess consideration is adjusted against –</p> <p>(a) Free Reserves (incl. P & L) of Selling Co. (b) Free Reserves of Purchasing Co. and (c) finally, against P & L A/c of Purchasing Co.</p> <p><i>All Reserves (i.e. Statutory and Free) of Selling Company are fully recorded. Shortfall In consideration is credited to Capital Reserve A/c.</i></p>	

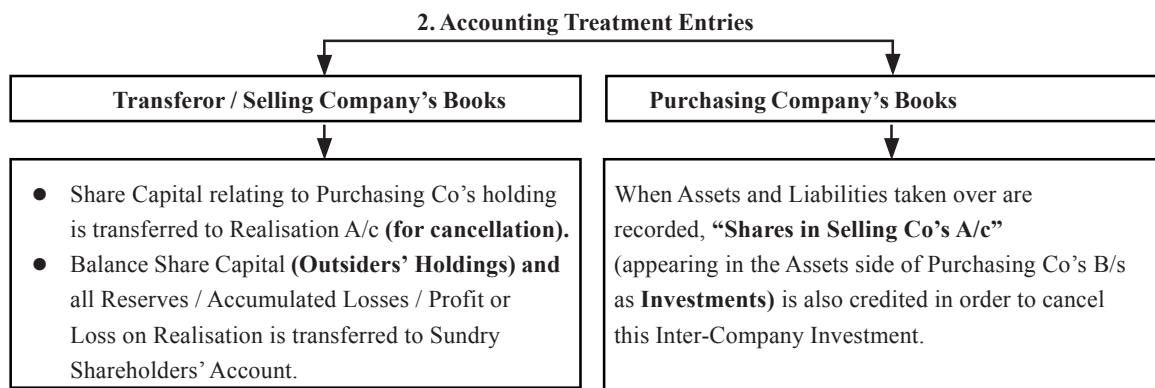
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3	Discharge of Purchase Consideration	Liquidator of Selling Company A/c Dr. To Equity / Preference Share Capital A/c To Securities Premium A/c (if any) To Cash / Bank A/c (for fractions, etc.)
4	Realisation / Liquidation Expenses met reimbursed by Purchasing Company	A. PURCHASE METHOD Goodwill / Capital Reserve A/c Dr. To Cash / Bank A/c
		B. MERGER METHOD P & L Account / Reserves A/c To Cash / Bank A/c
<ul style="list-style-type: none"> ● If Selling Co. meets the Realisation Expenses directly; no entry is required in Purchasing Co's Books. ● If the Realisation Expenses are shared by the Purchasing Company and Selling Company, the Entry in Item 4 should be recorded only for the Purchasing Company's Share of expenses. 		
5	Recording of Statutory Reserves of Selling Company (for amalgamation in the nature of PURCHASE only)	Amalgamation Adjustment A/c Dr. To Statutory Reserve A/c <i>(Note: This entry is Not Applicable for Merger Method)</i>
<ul style="list-style-type: none"> ● Statutory Reserve is shown on the Liabilities Side under "Reserves and Surplus". Amalgamation Adjustment A/c is shown on the Assets Side of the Balance Sheet. ● The above entry is reversed once the statutory time period expires / obligations are completed. 		
6	Elimination of Inter Company Owings	Sundry Creditors / Bills Payable A/c Dr. To Sundry Debtors / Bills Receivable A/c
7	Elimination of Unrealised Profits on Stocks , if any (Note: This is applicable when Purchasing Company has sold goods to Selling Company at a profit, and which remains in the Selling Company's Stock, on the date of takeover.)	A. PURCHASE METHOD Goodwill / Capital Reserve Dr. To Stock Reserve / Stock
		B. MERGER METHOD P & L Account / Reserves A/cDr. To Stock Reserve / Stock

A/cing Treatment when Purchasing Co. already holds Shares in Selling Co.

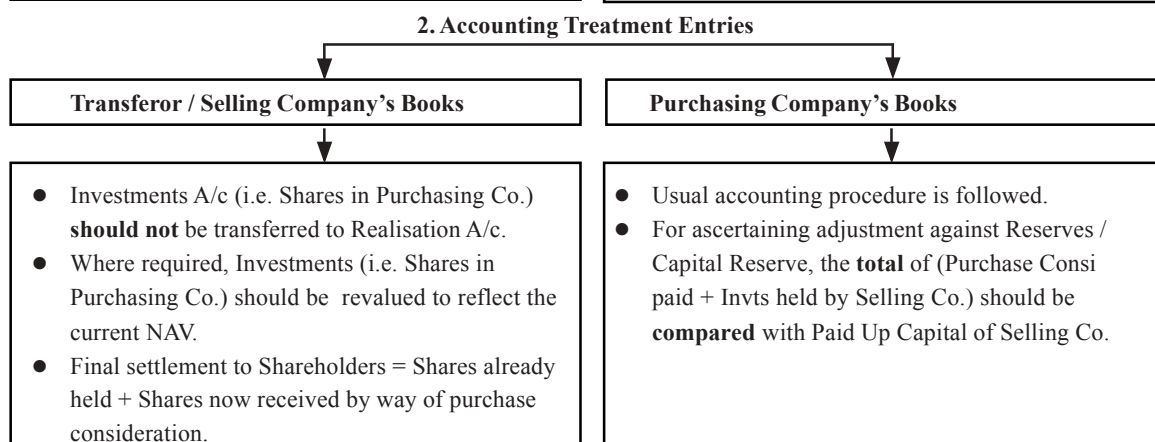
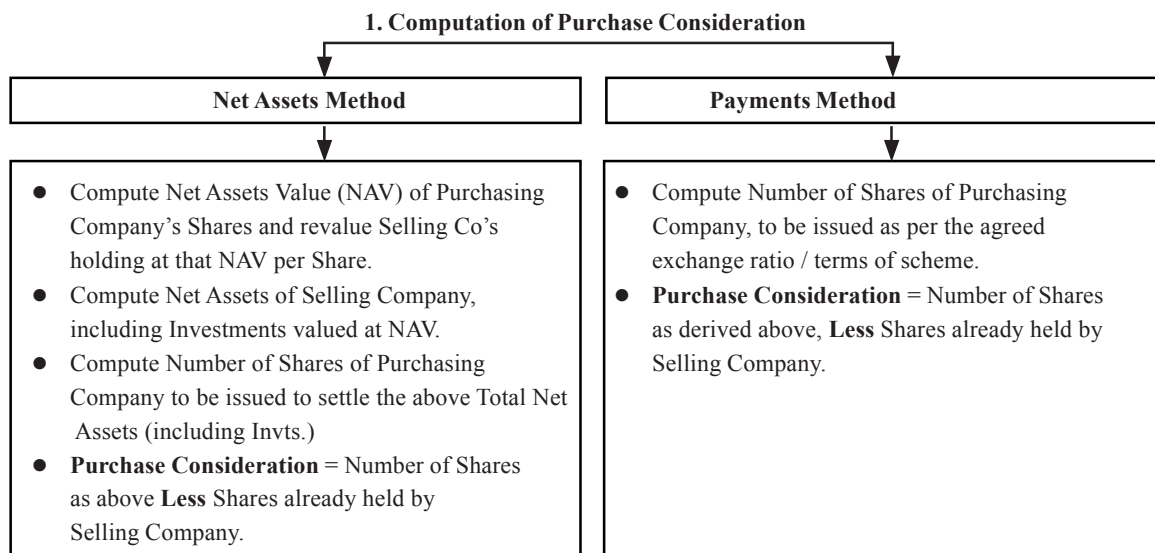
1. Computation of Purchase Consideration





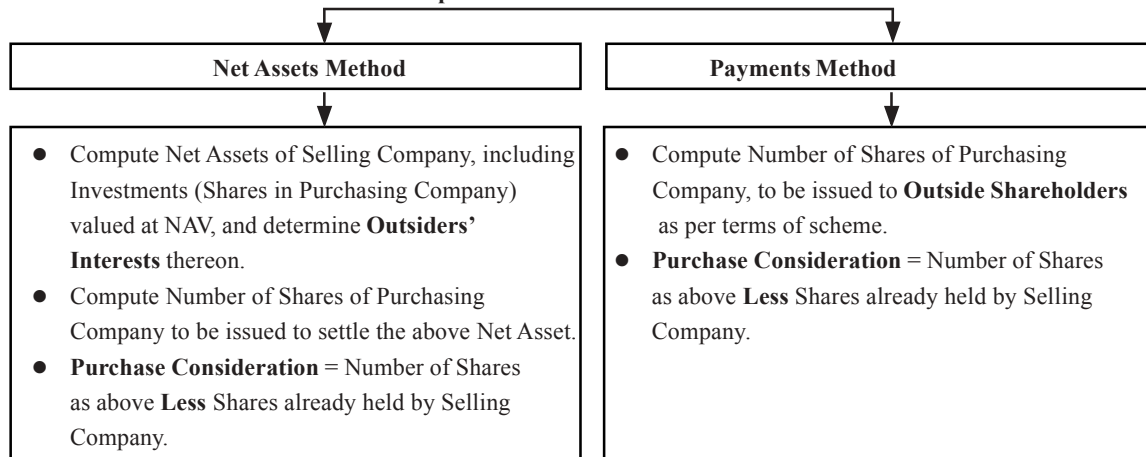
Note: In the Purchasing Company's books, where the scheme of amalgamation requires that the Investments (appearing in Purchasing Company's Books as Assets) be revalued to reflect the current NAV, it is recorded before journalising the assets and liabilities takeovers. Hence cancellation of Investments a/c will be at NAV.

A/cing Treatment when Purchasing Co. already holds Shares in Purchasing Co.

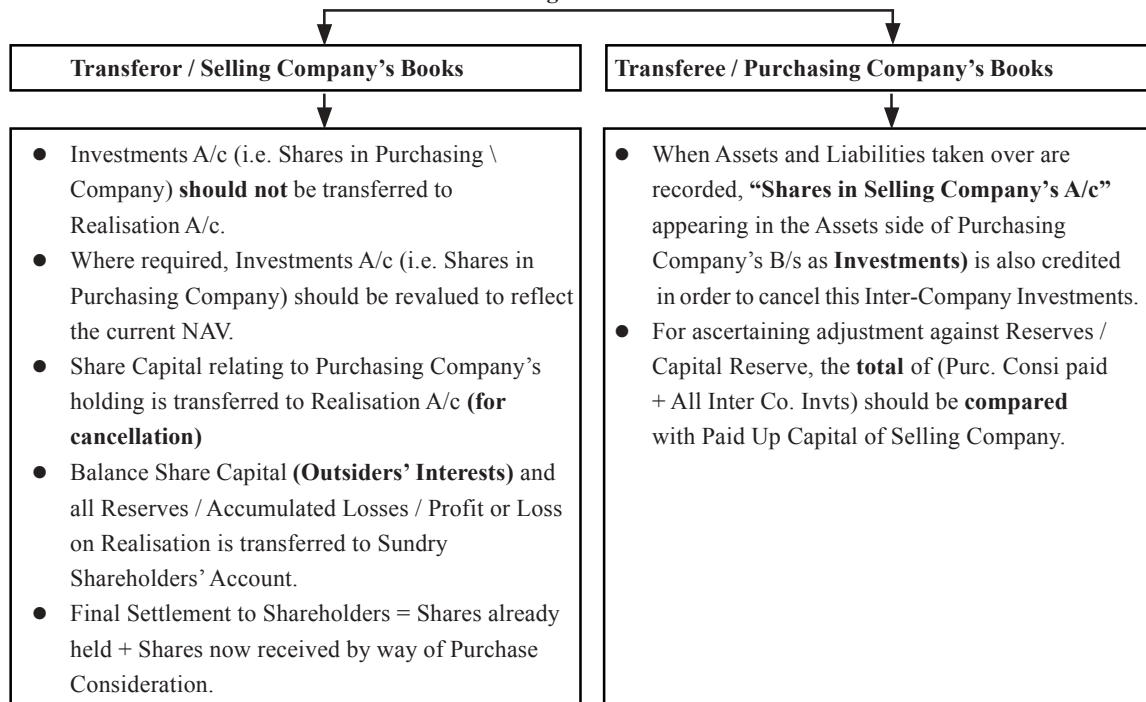


**A/cing Treatment in case of Cross Holdings,
i.e. when Selling Co. already holds Shares in Purchasing Co. and vice-versa**

1. Computation of Purchase Consideration



2. Accounting Treatment Entries



Note: Simultaneous Linear Equations Method should be applied in appropriate situations, Refer Illustrations.

PRACTICAL QUESTIONS – A/CING FOR AMALGAMATIONS**1. COMPUTATION OF PURCHASE CONSIDERATION****Illustration 1 : Computation of Purchase Consideration**

Given below are the Balance Sheets of Ashwathama Ltd. and Bheeshma Ltd. as on 31st December, in which date the Companies were amalgamated and a new Company Chandrachuda Ltd. was formed. (in ₹ 000s)

Liabilities	Ashwathama Ltd.	Bheeshma Ltd.	Assets	Ashwathama Ltd.	Bheeshma Ltd.
Equity Shares of Rs. 10 each	70,00	60,00	Sundry Fixed Assets	85,00	70,60
Reserves	20,00	40,00	Sundry Current Assets	20,00	30,00
Sundry Creditors & Other Current Liabilities	15,00	10,00	Miscellaneous Expenditure	—	10,00
Total	105,00	110,00	Total	+105,00	110,00

It was agreed that Sundry Fixed Assets of Ashwathama Ltd. would be valued at 7,100,00 thousand and that of Bheeshma Ltd. at Rs. 95,00 thousand. Chandrachuda Ltd. would issue the requisite number of Equity Shares of Rs. 10 each at 10% premium to discharge claim of the Equity Shareholders of Ashwathama Ltd. & Bheeshma Ltd. How many shares of Chandrachuda Ltd. should be issued to takeover the business of the two merging Companies?

Solution:

(in Rs. 000s)

Particulars	Ashwathama Ltd.	Bheeshma Ltd.
Sundry Fixed Assets	100,00	95,00
Sundry Current Assets	20,00	30,00
Total Assets	120,00	125,00
Less: Liabilities Taken over	15,00	10,00
Purchase Consideration	105,00	115,00
Total Purchase Consideration	-105,00 + 115,00 = 220,00	

Number of Equity Shares to be issued = Rs. 220,00 thousand + Rs. 11 (including premium) = 20,00 thousand. Hence, Chandrachuda Ltd. will be formed with a Paid Up Capital of Rs. 200,00 thousand and Securities Premium of Rs. 20,00 thousand.

Illustration 2 : Computation of Purchase Consideration

The Balance Sheet of Partha Ltd. as on 31st December is given below.

(in Rs. 000s)

Liabilities	Amount	Assets	Amount
Share Capital: Equity Shares of Rs. 10 each	50,50	Sundry Fixed Assets	50,00
8% Preference Shares	9,60	Stock	20,00
12% Debentures	15,00	Debtors	10,00
Sundry Creditors & Other Liabilities	10,00	Cash & Bank	5,00
Total	85,00	Total	85,00

Krishna Ltd. agrees to take over Partha Ltd., by issuing requisite number of Preference Shares of Rs. 10 each at 5% discount to the Preference Shareholders of Partha Ltd., and requisite number of Equity Shares of Rs. 10 each at par to

the Equity Shareholders of Partha Ltd. Purchase Consideration is settled as per Book Value of the assets, and the Debentures will be taken over by Krishna Ltd. on the agreement that these will be paid off at 10% premium after one year. Debenture holders of Partha Ltd. will accept 12% Debentures of Krishna Ltd. Calculate Purchase Consideration.

Solution: **Purchase Consideration by Net Assets Method** **(in Rs. 000s)**

Particulars	Amt.	Amt.
Book Value of Assets taken over (i.e. Total of Assets Side)		85,00
Less: Liabilities taken over: Debentures	15,00	
Additional Liability for Premium on Redemption at 10%	1,50	
Sundry Creditors & Other Liabilities	10,00	(26,50)
Net Purchase Consideration		58,50

This Purchase Consideration shall be discharged by 8% Preference Shares and Equity Shares of Krishna Ltd. (Issue of Debentures to the Debentureholders of Partha Ltd. shall not be included in Purchase Consideration).

Number of Shares to be issued is computed as under –

(1) Preference Shares to be issued = Rs. 950 thousands + Rs. 9.50 = 100 thousands
(i.e. at a discount)

Balance of Purchase Consideration = Rs. 58.50 thousands – Rs. 950 thousands
= Rs. 49,00 thousand

(2) Equity Shares to be issued = Rs. 49,00 thousands + Rs. 10 = 490 thousands

Illustration 3 : Computation of Purchase Consideration – Mutual Holdings

Arun Ltd. and Bhairav Ltd. decide to amalgamate themselves into Sandhya Limited. The following are their Balance Sheets as on 31st December.

Liabilities	Arun	Bhairav	Assets	Arun	Bhairav
Face Value and Paid Up Capital			Investments		
Share Capital (Rs. 10 each)	5,00,000	4,00,000	1000 Shares in B Ltd.	1,30,000	—
General Reserves	2,00,000	1,00,000	2000 Shares in A Ltd.	—	2,10,000
10% Debentures	2,00,000	1,50,000	Sundry Assets	7,70,000	4,40,000
Total	9,00,000	6,50,000	Total	9,00,000	6,50,000

Compute the amount of Purchase Consideration of each of these Companies under Purchase Method as per AS – 14.

Solution: Since there is Inter Company Shareholding, Simultaneous Equations Method is applied.

Computation of Net Assets

Particulars	Arun	Bhairav
Investment in Equity Shares of B Ltd. (1000 ÷ 4000) = 1/4th	1/4th × B	—
Investment in Equity Shares of A Ltd. (2000 ÷ 5000) = 2/5th	—	2/5th × A
Sundry Assets	7,70,000	4,40,000
<i>Less:</i> 10 % Debentures	(2,00,000)	(1,50,000)
Net Assets (Let Intrinsic Value of Arun Ltd. and Bhairav Ltd. be 'A' & 'B')	A	B

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The two equations are: $A = 5,70,000 + \frac{1}{4} B$ Eqn 1, and $B = 2,90,000 + \frac{2}{5} A$ Eqn 2

By substituting value of A from **Equation 1** in **Equation 2**, we get, $B = 2,90,000 + \frac{2}{5} (5,70,000 + \frac{1}{4} B)$

So, $B = 2,90,000 + 2,28,000 + \frac{1}{10} B$. $B - \frac{1}{10} B = 5,18,000$. i.e. $\frac{9}{10} B = 5,18,000$ $B = 5,18,000 \times \frac{10}{9}$

So, B = Rs. 5,75,556 (approx.)

Upon substituting value of B in **Equation 1**, we get $A = 5,70,000 + \frac{1}{4} (5,75,556) = \text{Rs. 7,13,889}$ (Approx)

Illustration 4 : Computation of Purchase Consideration

The following is the Balance Sheet of Swarna Ltd. as on 31st March:

Liabilities	Rs.	Assets	Rs.
14,000 Equity Shares of Rs. 100 each fully paid	14,00,000	Sundry Assets	18,00,000
General Reserve	10,000	Discount on issue of Debentures	10,000
10% Debentures	2,00,000	Preliminary Expenses	30,000
Sundry Creditors	2,00,000	Profit & Loss A/c	60,000
Bank Overdraft	50,000		
Bills Payable	40,000		
Total	19,00,000	Total	19,00,000

Rajata Ltd. agreed to take over the business of Swarna Ltd. Calculate Purchase Consideration under Net Assets Method. The Market Value of 75% of the Sundry Assets is estimated to be 12% more than the Book Value and that of the remaining 25% at 8% less than the Book Value. The Liabilities are taken over at Book Values. There is an unrecorded liability of Rs. 25,000.

Solution: Computation of Purchase Consideration under Net Assets Method

Particulars	Computation	Rs.
Sundry Assets taken over	$(18,00,000 \times 75\% \times 112\%) + (18,00,000 \times 25\% \times 92\%)$	19,26,000
Less: Liabilities taken over	10% Deb + Sundry Creditors + Bank OD + Bills Payable + New Liabilities $2,00,000 + 2,00,000 + 50,000 + 40,000 + 25,000$	(5,15,000)
	Net Assets Taken Over = Purchase Consideration	14,11,000

Illustration 5 : Computation of Purchase Consideration

The abstract of the Balance Sheet of the Arjun Ltd. as at 31st March are as follows –

Liabilities	Rs.
Equity Share Capital (Rs. 100 each)	15,00,000
12% Preference Share Capital (Rs. 100 each)	8,00,000
13% Debentures	3,00,000

On 31st March, Bagya Ltd. agreed to take over Arjun Ltd. on the following terms:

- For each Preference Share in Arjun Ltd, Rs. 10 in Cash and one 9% Preference Share of Rs. 100 in Bagya Ltd.

2. For each Equity Share in Arjun Ltd., Rs. 20 in Cash and one Equity Share in Bagya Ltd. of Rs. 100 each. It was decided that the Share in Bagya Ltd. will be issued at Market Price Rs. 140 per Share.
3. Liquidation Expenses of Arjun Ltd. are to be reimbursed by Bagya Ltd. to the extent of Rs. 10,000. Actual Expenses amounted to Rs. 12,500.

You are required to compute the amount of Purchase Consideration.

Solution: Computation of Purchase Consideration

Particulars	Rs.
Preference Shares: 9% Preference Shares of Rs. 100 each (8,000 Shares × Rs. 100)	8,00,000
Equity Shares: Equity Shares issued at Premium of Rs. 40 per Share. Rs. 15,00,000 + Rs. 100 = 15,000 Shares. 15,000 Shares issued at Rs. 140 per Share. Therefore, Total Value of Equity Shares (including Premium) (15,000 × Rs. 140)	21,00,000
Cash: For Preference Shares: 8,000 × Rs. 10	80,000
For Equity Shares: 15,000 × Rs. 20	3,00,000
Total Purchase Consideration	32,80,000

Note, Reimbursement of Liquidation Expenses will not form part of Purchase Consideration.

2. MERGER AND PURCHASE – BOTH METHODS OF ACCOUNTING

Illustration 5 : Computation of Purchase Consideration

Arjuna Ltd. and Bhagavan Ltd. amalgamated on and from 1st January. A new Company Kurukshetra Ltd. was formed to take over the business of the existing Companies. Their Balance Sheets as on 31st December was

(in Rs. 000s)

Liabilities	Arjuna	Bhagavan	Assets	Arjuna	Bhagavan
Share Capital: Equity Shares of Rs. 10 each	60,00	70,00	Sundry Fixed Assets	85,00	75,00
General Reserve	15,00	20,00	Investments	10,50	5,50
Profit and Loss Account	10,00	5,00	Stock	12,50	27,50
Investment Allowance Reserve	5,00	1,00	Debtors	18,00	40,00
Export Profit Reserve	50	1,00	Cash & Bank	4,50	4,00
12% Debentures	30,00	40,00			
Sundry Creditors	10,00	15,00			
Total	130,50	152,00	Total	130,50	152,00

Investment Allowance Reserve and Export Profit Reserve are to be statutorily carried over for another 3 years.

Kurukshetra Ltd. issued requisite number of Shares to discharge the claims of the Equity Shareholders of the Transferor Companies. Compute the Purchase Consideration and show the discharge thereof. Also draft the Balance Sheet of Kurukshetra Ltd, assuming amalgamation in the nature of (1) Merger, (2) Purchase.

Solution: **1. Computation of Purchase Consideration** (in Rs. 000s)

Particulars	Arjuna	Bhagavan	Total
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	
Total Assets Taken Over	130,50	152,00	282,50
Less: Sundry Liabilities			
12% Debentures	30,00	40,00	
Sundry Creditors	10,00	15,00	
Net Assets Taken Over	90,50	97,00	18,750
Less: Reserves & Surplus – General Reserve	15,00	20,00	
Profit and Loss Account	10,00	5,00	
Investment Allowance Reserve	5,00	1,00	
Export Profit Reserve	50	1,00	
Net Purchase Consideration (under Merger Method)	60,00	70,00	130,00

2(a) Discharge of Purchase Consideration (under Pooling of Interest Merger Method):

$$\text{Arjuna} \quad 130,00 \times \frac{90,50}{187,50} = 6,27,500 \text{ Equity Shares of Rs. 10 each} = 62,75$$

$$\text{Bhagavan} \quad 130,00 \times \frac{90,50}{187,50} = 6,72,500 \text{ Equity Shares of Rs. 10 each} = 67,25$$

2(b) Discharge of Purchase Consideration (under Purchase Method) (= Net Assets Taken over)

Arjuna 9,05,000 Equity Shares of Rs. 10 each = 90,50

Bhagavan 9,70,000 Equity Shares of Rs. 10 each = 97,00

3. Computation of Capital Reserve Adjustment towards General Reserve (Under Merger Method)

Particulars	Arjuna	Bhagavan
Purchase Consideration	62,75	67,25
Less: Paid up Capital	(60,00)	(70,
Difference	2,75	(2,75)
Treatment	Adjustment towards the General Reserve of the Selling Company	Transfer towards Capital Reserve

General Reserve after making the above adjustment is $15,00 + 20,00 - 275 = 32,25$