Company Accounts

Chapter- Amalgamation
B.Com.
Second Semester- (Sec. A)

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What is Amalgamation?

Amalgamation is defined as the combination of one or more companies into a new entity. It includes:

i. Two or more companies join to form a new company
ii. Absorption or blending of one by the other

Thereby, amalgamation includes absorption. However, one should remember that Amalgamation as its name suggests, is nothing but two companies becoming one. On the other hand, Absorption is the process in which the one powerful company takes control over the weaker company.

Transferor Company means the company which is amalgamated into another company; while Transferee Company means the company into which the transferor company is amalgamated.

Procedure for Amalgamation

1. The terms of amalgamation are finalized by the board of directors of the amalgamating companies.
2. A scheme of amalgamation is prepared and submitted for approval to the respective High Court.
3. Approval of the shareholders of the constituent companies is obtained followed by approval of SEBI.
4. A new company is formed and shares are issued to the shareholders of the transferor company.
5. The transferor company is then liquidated and all the assets and liabilities are taken over by the transferee company at their book value.

Amalgamation vs. Absorption vs. External Reconstruction

The brief discussion of the term amalgamation, absorption and external reconstruction are shown in the following smart chart -

Amalgamation	Existing companies A and B are wound up and a new company AB Ltd. is formed to take over the businesses of A and B
Absorption	Existing company B takes over the business of another existing company A which is wound up
External Reconstruction	External reconstruction takes place when an existing company goes into liquidation for the express purpose of selling its assets and liabilities to a newly formed company which is generally owned and named alike.

Types of Amalgamation

According to AS-14, Amalgamation is of two types:

1. Amalgamation in the nature of merger
2. Amalgamation in the nature of purchase

1. Amalgamation in the nature of Merger

According to AS-14 on Accounting for Amalgamation, the following conditions must be satisfied for an amalgamation in the nature of merger:

A. After amalgamation, all the assets and liabilities of the transferor company becomes 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 become the equity shareholders of the transferee company by virtue of amalgamation.

C. The business of the transferor company is intended to be carried on after the amalgamation by the transferee company.

D. Purchase consideration should be discharged only by issue of equity shares in the transferee company except that cash may be paid in respect of any fractional shares.

E. No adjustments are required to be made in the book values of the assets and liabilities of the transferor company, when they are incorporated in the financial statements of the transferee company.

If any one of the conditions is not satisfied in a process of amalgamation, it will not be considered as amalgamation in the nature of merger.

2. Amalgamation in the nature of Purchase

An amalgamation will be treated as “Amalgamation in the nature of purchase” if any of the above-mentioned conditions is not satisfied.

Categories of Mergers

1.**Cogeneric Merger** – Within same industries and at the same level of economic activity

a) **Horizontal Merger** – Merger between business competitors who are manufactures or distributors of the same type of products or who render similar or same type of services for profit. Horizontal Mergers result in the reduction in number of competing companies in an industry; increase the scope for economies of scale and elimination of duplicate facilities.

b) **Vertical Merger** – It occurs which are complementary to each other. In this merger the two companies merge and control the production and marketing of the same product.

2. **Conglomerate Merger** – This type of merger involves coming together of two or more companies engaged in different industries and/or services. Their businesses lack commonalty either in their end product, or in the rendering of any specific type of services to the society.

Methods of Accounting for Amalgamations

There are two main methods of accounting for amalgamations:

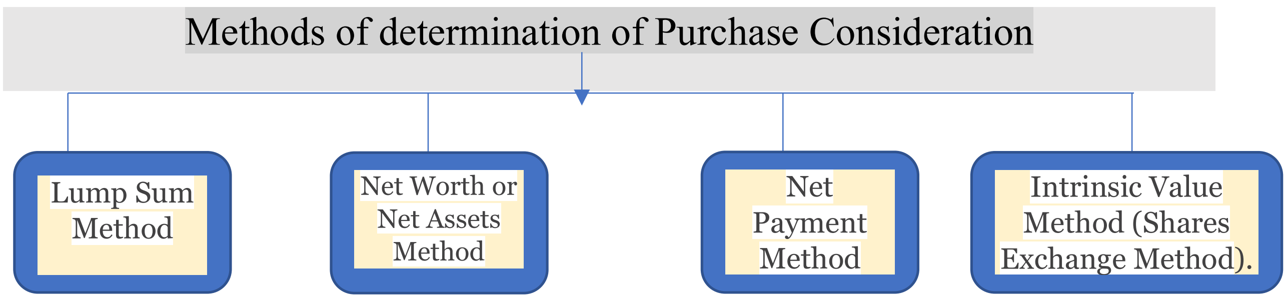
a) the pooling of interests' method; and
b) the purchase method.

a. The pooling of Interest Method - the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts. If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

b. The Purchase Method - the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company. Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company.

Determination of Purchase Consideration

In case of amalgamation, purchase consideration is the agreed amount which transferee company (Purchasing company) pays to the transferor company (Vendor company) in exchange of the ownership of the transferor company. It may be in form of cash, shares or any other assets as agreed between both the companies. The amount of purchase consideration can be computed under any of the following four methods:-



1. **Lump Sum Method:** The purchasing company may agree to pay a lump-sum to the vendor company on account of the purchase of its business. In fact, this method is not

based on any scientific thoughts and techniques. This method is an unscientific and non-mathematical method of ascertaining purchase consideration.

2. **Net Worth or Net Assets Method:** Under this method, purchase consideration is calculated by adding up the values of various assets taken over by the purchasing company and then deducting there from the values of various liabilities taken over by the purchasing company. The values of assets and liabilities for the purpose of calculation of purchase consideration are those which are agreed upon between the purchasing company and the vendor company and not the values at which the various assets and liabilities appear in the Balance Sheet of the vendor company.

   (Agreed value of Assets taken over) – (Agreed value of liabilities taken over) = Net Assets

   The following relevant points are to be noted while ascertaining the purchase price under this method:

   a) If the transferee company agrees to take over all the assets of the transferor company, it would mean inclusive of cash and Bank balances.
   b) The term all assets, however, does not include fictitious assets, like Debit balance of Profit and Loss Account, Preliminary Expenses Account, Discount and other expenses on issue of shares and Debentures, Advertising Expenses Account etc.
   c) Any specific asset, not taken over by transferee company, should be ignored while computing the purchase price,
   d) If there is any goodwill, pre-paid expenses etc. the same are to be included in the assets taken over unless otherwise stated,
   e) The term liabilities will always signify all liabilities to third parties. Trade liabilities are those incurred for the purchase of goods such as Trade Creditors or Bills Payable,
   f) Other liabilities like Bank Overdrafts, Tax payable, Outstanding expenses etc. are not a part of trade liabilities.
   g) Liabilities do not include accumulated or undistributed profits like, General Reserve, Securities Premium, Workmen Accident Fund, Insurance Fund, Capital Reserve, Dividend Equalization Fund etc.

3. **Net Payment Method:** The agreement between selling company and purchasing company may specify the amount payable to the share-holders of the selling company in the form of cash or shares or debentures in purchasing company. AS – 14 states that consideration for amalgamation means the aggregate of shares and other securities issued and the payment made in the form of cash or other assets by transferee company to the share-holders of transferor company. Thus, under net payment method purchase consideration is the total of shares, debentures and cash which are to be paid for claims of Equity and Preference share-holders of the transferor company.

   The following points are to be noted while ascertaining the purchase price under net payment method:

   (i) The assets and liabilities taken over by the transferee company and the values at which they are taken over are not relevant to compute the purchase consideration.

(ii) All payments agreed upon should be added, whether it is for equity shareholders or preference share-holders.

(iii) If any liability is taken over by purchasing company to be discharged later on, such amount should not be deducted or added while computing purchase consideration.

(iv) When liabilities are not taken over by the transferee company, they are neither added or deducted while computing consideration.

(v) Any payment made by transferee company to some other party on behalf of transferor company are to be ignored.

4. **Intrinsic Value Method (Shares Exchange Method):** Under this method, net value of assets is calculated according to net assets method and it is divided by the value of one share of transferee company which gives the total number of shares to be received by the share-holders of transfer or company from the transferee company. When the number of shares to be received by the transferor company is known then it is divided by the existing shares of the transferor company and thus the ratio of shares can be found out.

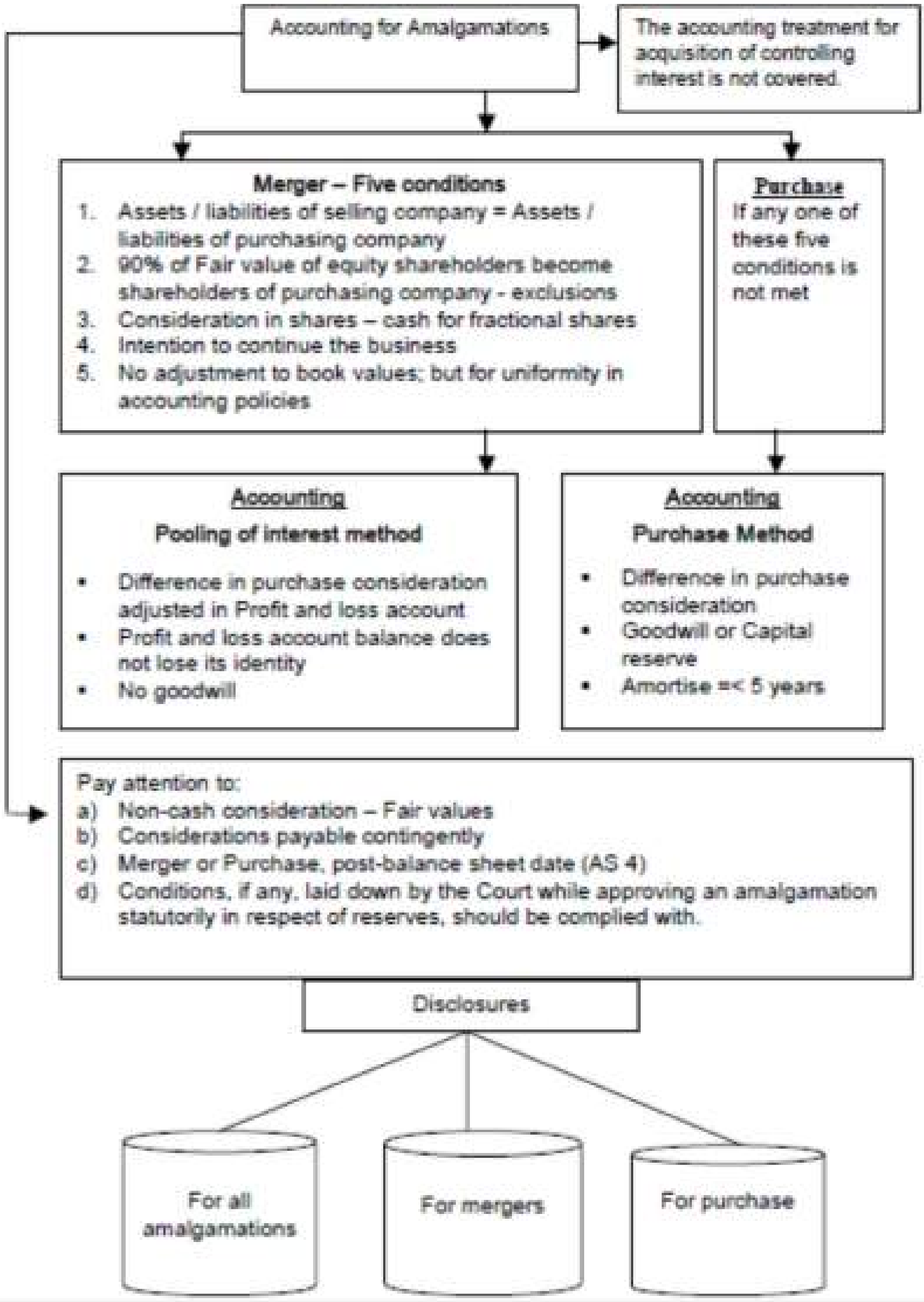
   Intrinsic Value = Assets available for equity shareholders/Number of equity shares

AS 14 and Companies Act

The Standard itself refers to the term "amalgamations" to mean an amalgamation pursuant to the provisions of the Companies Act. Section 394 of Companies Act, 1956 is relevant. Section 394 provides that a "transferor company" includes any body corporate, whether a company within the meaning of Companies Act, or not.

No disclosures are specified under Schedule VI for financial statements, after amalgamation of two or more companies. However, AS-14 prescribes disclosures in the areas of (a) name and general nature of business of amalgamating companies, (b) effective date of amalgamation, (c) method of accounting used to reflect the amalgamation, and (d) particulars of scheme sanctioned by statute. It also requires further disclosures based on the method followed for accounting for amalgamations.

AS 14 : A diagrammatic representation



Treatment of Balance of Profit and Loss Account on Amalgamation

- In the case of an 'amalgamation in the nature of merger', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company. Alternatively, it is transferred to the General Reserve, if any.
- In the case of an 'amalgamation in the nature of purchase', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company, whether debit or credit, loses its identity

Treatment of Goodwill Arising on Amalgamation

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 amortized to income on a systematic basis over its useful life. Due to the nature of goodwill, it is frequently difficult to estimate its useful life with reasonable certainty. Such estimation is, therefore, made on a prudent basis. Accordingly, it is considered appropriate to amortize goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

Benefits achieved from Merger and Amalgamation

Amalgamation is one of the tools that can help companies avoid competition among them and add to the market offerings. It is for the mutual advantage of the acquirer and acquired companies. It serves as an apt method of corporate restructuring to bring about a change for the better and make business environment competitive. Following are the key advantages of amalgamation-

- Coming together to produce a new or enhanced effect.
- Reduction in the average cost of production and hence in the unit costs when output is increased, to enable to offer products at more competitive prices and thus to capture a larger market share.
- Reduction in production, administrative, selling, legal and professional expenses.
- Mutual benefit by reducing competition, saving costs by reducing overheads, capturing larger market, pooling technical or financial resources.
- Optimum Use of capacities and factors of production
- Tax advantage – Carry forward and setoff of losses of a loss – making amalgamating company against profits of a profit – making amalgamated company
- Financial constraints for expansion can be removed
- Diversification
- Advantage of Brand – Equity
- Survival
- Revival of Sick Company
- Substantial Growth

Disadvantages of Amalgamation

- Amalgamation may lead to elimination of healthy competition
- Reduction of employees may take place
- There could be additional debt to pay

- Business combination could lead to monopoly in the market, which is not always positive
- The goodwill and identity of the old company is lost

Examples of Amalgamations

1. Maruti Motors operating in India and Suzuki based in Japan amalgamated to form a new company called Maruti Suzuki (India) Limited.
2. Gujarat Gas Ltd (GGL) is an amalgamation of Gujarat Gas Company Ltd (GGCL) and GSPC Gas.
3. Satyam Computers and Tech Mahindra Ltd
4. Tata Sons and the AIA group of Hongkong amalgamated to form Tata AIG Life Insurance.

Accounting Entries for Amalgamation

Journal Entries

(1) In the books of the transferor company

(2) In the books of the transferee company

(A) Amalgamation in the nature of merger

(B) Amalgamation in the nature of purchase

(1) Journal entries in the books of Transferor Company

Either amalgamation in the nature of merger or in the nature of purchase, in both the conditions the following journal entries are made in the books of the transferor company

(1) When all fixed assets, current assets and intangible assets are transferred to realisation account at book value then,

Realisation A/c ....Dr.
To Various Assets A/c
(Being various assets transferred to realisation account)

Note : If the transferee company does not take over cash and bank balance, then these balances are brought down in debit side of cash account or bank account.

(2) When misc. expenditures or fictitious assets like Discount on shares and debentures, Preliminary expenses, Underwriting commission, Expenses of issue of shares and debentures, debit balance of profit and loss account etc. are transferred to equity shareholders account, then :

Equity Shareholders' A/c ...Dr
To Discount on Shares and Debentures A/c
To Preliminary Expenses A/c
To Underwriting Commission A/c
To Expenses on Issue of Shares and Debentures A/c
To Statement of Profit & Loss (Dr. Bal)
(Being balance of above accounts transferred to equity shareholders account)

(3) If any assets is disposed off by the transferor company, then,

Bank A/c ...Dr.
To Realisation A/c
(Being sale of assets)

(4) For those liabilities which are taken by transferee company,

Various liabilities A/c ...Dr.
To Realisation A/c
(Being balance of various liabilities transferred to realisation a/c)

(5) For those liabilities which are discharged by transferor company,

Various liabilities A/c ...Dr.
To Bank A/c
(Being payment of liability made)

(6) If above liabilities are discharged at premium, then the following entry is made for premium,

Realisation A/c ...Dr.
To Liability Concerned A/c
(Being record of premium on ___ liability)

(7) If above liabilities are discharged at discount, then the following entry is made for discount,

Liability Concerned A/c ...Dr.
To Realisation A/c
(Being record of discount on ......liability)

(8) For purchase consideration receivable,

Transferee Company A/c ...Dr
To Realisation A/c
(Being purchase consideration receivable)

(9) For receipt of purchase price,

Shares in Transferee Company A/c ...Dr.
Debentures in Transferee Company a/c ...Dr.
Bank A/c ...Dr.
To Transferee Company A/c
(Being purchase consideration received)

(10) For transfer of purchase consideration,

Equity Shareholders' A/c ...Dr.
To Shares in Transferee Company A/c
To Debentures in Transferee Company A/c
To Bank A/c
(Being distribution of purchase consideration)

(11) When balance of preference share capital is transferred to preferential shareholders A/c, then,

Preference Share Capital A/c ...Dr.
To Preference Shareholders' A/c
(Being balance transferred to Pref. Shareholders' a/c)

(12) If preference shares are redeemed at premium, then for this premium,

Realisation A/c ...Dr.
To Preference Shareholders' A/c
(Being record of premium on preference shares)

(13) If preference shares are redeemed at a discount, then for this discount,

Preference Shareholders' A/c ...Dr.
To Realisation A/c
(Being record of discount on preference shares)

(14) After the above records (if any) entry for payment to preference shareholders,

Preference Shareholders' A/c ...Dr.
To Bank A/c
(Being payment made to pref. shareholders)

(15) If there is profit in realisation account, then

Realisation A/c ...Dr.
To Equity Shareholders' A/c
(Being profit on realisation transferred to equity shareholders' a/c)

(16) If there is loss in realisation account, then,

Equity Shareholders' A/c ...Dr.
To Realisation A/c
(Being loss on realisation transferred to equity shareholders' a/c)

(17) If expenses of winding up are paid by the transferor company, then,

Realisation A/c ...Dr.
To Bank A/c
(Being expenses of liquidation paid)

(18) If expenses of winding-up are paid by the transferee company, then,

(i) There is no need for record.

(ii) If it is necessary to maintain the record then, the following two entries are made :

(A) Transferee Company A/c ...Dr.
To Bank A/c
(Being liquidation expenses paid on behalf of the transferee company)

(B) Bank A/c ...Dr.
To Transferee Company A/c
(Being reimbursement of liquidation expenses)

(19) For transfer of share capital, Reserves and Funds and credit balance of Profit & Loss :

Equity Share Capital A/c ...Dr.
Various Reserves and Funds A/c ...Dr.
Securities Premium Reserve A/c ...Dr.
Statement of Profit & Loss (Surplus) ...Dr.
To Equity Shareholders' A/c
(Being the balance of above accounts transferred to equity shareholders' a/c)

(20) In last, when balance of bank account transferred to equity shareholders account, then

Equity Shareholders' A/c ...Dr.
To Bank A/c
To Shares in Transferee Co. A/c
(Being final payment made to equity shareholders and account closed.)

(2) Journal entries in the books of Transferee Company

(A) When amalgamation is in the nature of merger then the following entries are made by the pooling of interest method in the books of the transferee company.

(1) For record of purchase consideration

Business Merger A/c ...Dr.
To Liquidators of Transferor Company A/c
(Being consideration payable to liquidators of transferee company)

(2) For assets, liabilities and reserves are taken over from the transferor company

Various Assets A/c ...Dr.
To Various Liabilities A/c
To Various Reserves and Funds A/c
To Business Merger A/c
To General Reserve A/c (Balancing figure)
(Being various assets, liabilities and reserves taken over from transferor company and balancing figure credited to general reserve)

Or

Various Assets A/c ...Dr.
General Reserve A/c (Balancing Figure) ...Dr.
To Various Liabilities A/c
To Various Reserves and Funds A/c
To Business Merger A/c
(Being various assets, liabilities and reserves taken over from the transferor company and balancing figure debited to general reserve)

(3) For discharge of purchase consideration

Liquidators of Transferor Company A/c ...Dr
To Equity Share Capital A/c
To Bank A/c
(Being the discharge of purchase consideration)

(4) For expenses of liquidation of transferor company paid by the transferee company

Expenses of Liquidation A/c ...Dr.

To Bank A/c

(Being expenses of liquidation paid)

(5) When expenses of liquidation is written off with General reserve, then,

General Reserve A/c ...Dr.

To Expenses of Liquidation A/c

(Being exp. of liquidation written off with general reserve)

(6) For preliminary expenses of transferee company

Preliminary Expenses A/c ...Dr.

To Bank A/c

(Being preliminary expenses paid)

(7) When discharge of debentures of the transferor company by the transferee company by conversion or allotment of its own debentures, then

Debentures of Transferor Company A/c ...Dr.

To Debentures (of Transferee Company) A/c

(Being Debentures of transferor company, converted into Debentures of transferee company)

(B) When amalgamation is in the nature of purchase, then the following entries are made by the purchase method in the books of the transferee company

(1) For record of purchase consideration

Business Purchase A/c ...Dr.

To Liquidators of Transferee Company A/c

(Being consideration payable to liquidator of transferor company)

(2) For assets and liabilities are taken over from the transferor company

Various Real Assets A/c ...Dr.

Goodwill A/c (Balancing figure)

To Various Liabilities A/c

To Business Purchase A/c

(Being various assets and liabilities taken over from the transferor company and balancing figure debited to goodwill A/c)

or

Various real assets A/c ...Dr.

To Various Liabilities A/c

To Business Purchase A/c

To Capital Reserve A/c (Balancing Figure)

(Being various assets and liabilities taken over from the transferor company and balancing figure credited to capital reserve)

(3) For discharge of purchase consideration

Liquidators of Transferor Company A/c ...Dr.

To Equity Share Capital A/c

To Preference Share Capital A/c

To Debentures A/c

To Bank A/c

(Being the discharge of purchase consideration)

(4) For record of only statutory reserves of the transferor company

Amalgamation Adjustment A/c ...Dr.

To Various Statutory Reserves A/c

(Being incorporation of statutory reserves of the transferor company)

(5) For discharge of debenture of the transferor company by the transferee company by conversion or allotment of its own debentures

Debentures of Transferor Company A/c ...Dr.

To Debentures (of Transferee Co.) A/c

(Being allotment of Debentures to discharge of debentures of transferor company)

(6) For expenses of liquidation of the transferor company paid by the transferee company

Expenses of Liquidation A/c ...Dr.

To Bank A/c

(Being payment of liquidation expenses)

(7) When expenses of liquidation are written off by goodwill or capital reserve, then,

Goodwill/ Capital Reserve A/c ...Dr.

To Expenses of Liquidation A/c

(Being written off exp. of liquidation)

(8) For preliminary expenses paid by the transferee company

Preliminary Expenses A/c ...Dr.

To Bank A/c

(Being preliminary expenses paid)

NECESSARY LEDGER ACCOUNTS

(A) Necessary accounts in the books of the transferor company

Following are the four necessary accounts which are opened in the books of the transferor company :

(1) Realisation Account
(2) Transferee Company Accounts
(3) Bank Account
(4) Shareholders' Account.

(B) Necessary accounts in the books of the transferee company

Following are the two necessary accounts which are opened in the books of the transferee company :

(1) Business Purchase Account

(2) Liquidators of transferor company's Accounts.

What is Demerger?

Demerger is a form of corporate restructuring in which the entity's business operations are segregated into one or more components. It is the converse of a merger or acquisition. Demergers can be undertaken for various business and non-business reasons, such as government intervention, by way of anti-trust law, or through decartelization.