Financial accounts

Topic 3: **Amalgamation Absorption and Reconstruction**

AMALGAMATION

When two or more companies same in all respects go into liquidation and the new company is formed to take over their business is called amalgamation

- **Transferor Company (Acquired company/ Vendor Company)**

means the company which is amalgamated into another company; while

Transferee Company (Purchasing Company/ vendee Company)

means the company into which the transferor company is amalgamated. The company which acquires the business of another.

Real Examples of Amalgamation

Maruti Motors operating in India and **Suzuki** based in Japan amalgamated to form a new company called **Maruti Suzuki (India) Limited.**

Tata Sons operating in India and **AIA Group** based in Hong Kong amalgamated to form a new company called **TATA AIG Life Insurance.**

ABSORPTION

Under absorption, no new company is formed, whereas an existing company purchases another existing company, it is called absorption.

A company takes over the business of B Company. B Company is absorbed company and A is a absorbing company. Here there is no new company at all.

RECONSTRUCTION

When a company has financially suffered due to heavy accumulated loss. For this purpose the company financial structure is reorganised is called Reconstruction.

Reconstruction may be two types

1- External Reconstruction

2- Internal Reconstruction

1-External Reconstruction:

One existing company goes into liquidation **and a new company is formed** to take over the business of the liquidated company which is similarly named and owned by the same shareholders.

2-Internal Reconstruction:

It is **neither liquidation nor formation of a new company**. It means reduction of share capital and rearrangement of share capital and reorganation. In this case the capital structure of company is being reorganised

Difference between Amalgamation, Absorption and Reconstruction

Basic	Amalgamation	Absorption	External reconstruction
Meaning	Two or more companies are wound up and **a new company** is formed to take over their business.	In this case an **Existing company** take over the business of **one or more** existing company	In this case ,**a newly formed company** takes over the business of an **existing company**.
Minimum number of companies involved	At least three companies are involved	At least two companies are involved	Only two companies are involved
Number of new resultant companies	Only one resultant company is formed. Two companies are wound up to form a single resultant	No new resultant company is formed	Only one resultant company is formed under this case **a newly company takes over the business**

	company.		**of an existing company**
Objectives	Amalgamation is done to cut competition and reap the ecnomic in large scale	Absorption is done to cut competition and reap the ecnomic in the large scale.	External reconstruction is done reorganise the financial structure of the company

OBJECTIVES OF AMALGAMATION

→ To have a better control over the market and also to increase the market share and area of operations.

→ To eliminate the cut-throat competition and rivalry among competing the amalgamating companies.

→ To enjoy the economies of large scale production.

→ To utilize the services of professional experts.

→ To increase the availability of funds for the future investment plans.

→ To achieve all other advantages of combination.

TYPES OF AMALGAMATION

1.AMALGAMATION IN THE NATURE OF MERGER

2.AMALGAMATION IN THE NATURE OF PURCHASE

1.Amalgamation in the nature of merge

Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

a) Transfer of all assets and liabilities

b) Same equity shareholders holding 90%

c) Purchase consideration in equity shares

d) Same business will be carried on

e) Recording of Assets and liabilities at book value

2.Amalgamation in the nature of purchase

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

METHODS OF ACCOUNTING FOR AMALGAMATION IN THE NATURE OF MERGER

POOLING OF INTEREST METHOD:

It includes:

- Recording of assets and liabilities
- Recording of Reserves(whether capital or revenue or arising on revaluation)
- Recording of balance of profit & loss A/c
- Difference between the purchase consideration and the amount of share capital of the transferor Co.
- Uniform set of Accounting policies

METHODS OF ACCOUNTING FOR AMALGAMATION IN THE NATURE OF PURCHASE

PURCHASE METHOD:

It includes:

• Recording of assets and liabilities.

• Recording of statutory reserves.

• Recording of reserves other than statutory reserves.

• Balance of profit & loss A/c.

• Difference between the purchase consideration and the net asset of the transferor Co.

DIFFERENCE BETWEEN AMALGAMATION IN THE NATURE OF MERGER AND AMALGAMATION IN THE NATURE OF PURCHASE.

Best of distinction	**Amalagation in the nature of merger**	**Amalagation in the nature of purchase**
a)Transfer of asets and libilities	There is transfer of all assets & liabilities.	There need not be transfer for all assets & liabilities.
b)Share holder of transferor company	Equity shareholders holding 90% equity shares in transferor company become shareholders of transferee company.	Equity shareholders need not become shareholders of transferee company.
c)Purchase	Purchase consideration is	Purchase consideration

consideration	discharged wholly by issue of equity shares of transferee company (except cash only for fractional shares)	need not be discharged wholly by issue of equity shares.
e)Same business	The same business of the transferor company is intended to be carried on by the transferee company	The business of the transferor company need not be intended to be carried on by the transferee company.
d)Recording of assets and liabilities	The assets & liabilities taken over are recorded at their existing carrying amounts except where adjustment is required to ensure uniformity of accounting policies.	The assets & liabilities taken over are recorded at their existing carrying amounts or the basis of their fair values.
e)Methode of accounting	Journal entries for recording the merger are passed by pooling of interest method.	Journal entries for recording the purchase of business are passed by purchase method.

PURCHASE CONSIDERATION

Purchase Consideration is the amount which is paid by the transferee company for the purchase of the business of the transferor company. In other words, consideration for amalgamation means the aggregate of the shares and other securities issued and payment in cash or other assets by the transferee company to the shareholders of the transferor company.

TYPES OF PURCHASE CONSIDERATION

1- Lump sum Payment Method:

When the transferee company agrees to pay a fixed sum to the transferor company, it is called a lump sum payment of purchase consideration.

For example, if A Ltd. purchases the business of B Ltd. and agrees to pay Rs. 25,00,000 in all.

2-Net Assets Method:

According to this method, the purchase consideration is calculated by calculating the net worth of the assets taken over by the Transferee

Company. The net worth is calculated by adding the agreed value of assets taken over by the transferee company

Following points should be taken care of:

- Value of only those assets is included which are acquired by the transferee company.
- Value of only those liabilities will be deducted which have been taken over by the Transferee Company.
- Cash Balance is normally included in assets but if it is not taken over it will not be included. Goodwill is an intangible but valuable asset and as such is included in assets.
- Fictitious assets not written off should not be added.
- This method is used only when the Net Payment cannot be adopted.

3-Net Payment Method:

Under this method, purchase consideration is calculated by adding the various payments in the form of shares, securities, cash, etc. made by the transferee company. No amount of liabilities is deducted even if these are assumed by the purchasing company. Thus, purchase consideration is the total of all the payments whether in shares, securities, or cash.

Net Payment Method:

For example,

Y Ltd having 6000 Equity shares. X Ltd. agrees to give for every 10 shares of Y Ltd. 15 shares of Rs. 10 each, Rs. 8 paid up. X Ltd. agrees to pay Rs. 15, 000 cash to discharge the creditors. The purchase consideration is calculated as follows:

Shareholders of Y Ltd. will get:

of Rs. 10 each,

6,000x15/10 = 9,000 shares of Rs. 10 each,

9000 Shares X Rs.8 (Paid up)= 72000

Cash Paid =15000

Purchase Consideration =87000

4-Intrinsic worth/value Method:

This method is just an extension of net assets methods. Under method, purchase consideration is required to be calculated on the basis of intrinsic value of shares. The intrinsic value of a share is calculated by dividing the net assets available for equity shareholders by the number of equity shares.