ENTRI

UNIT 3

Module 4

AMALGAMATION

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

Generally, Amalgamation is done between two or more companies engaged in the same line of activity or has some synergy in their operations. Again the companies may also combine for diversification of activities or for expansion of services

Transfer or Company means the company which is amalgamated into another company; while Transfer Company means the company into which the transfer or company is amalgamated.

Features of Amalgamation

Amalgamation is defined as a combination of one or more companies into a new entity. It is an arrangement where two or more companies consolidate their business to form a new firm or become a subsidiary of any one of the companies. It 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.

Amalgamation is the combination of two or more companies into a new entity by combining the assets and liabilities of both entities into one.

- At Least Two Companies

Two or more existing companies are liquidated. In amalgamation, two or more existing companies are liquidated. Establishment and management charges are reduced.

- Formation of New Company

A new company is formed to take over the business of liquidating companies. A new company is formed to take over the business of liquidating companies. Competitions among the amalgamating companies are eliminated.

- Similar Nature

The nature of the business of existing companies is similar. The terms of amalgamation are finalized by the board of directors of the constituent companies.

- Vendor and Purchasing Company

Liquidating companies are called vendor companies and the new company is called purchasing companies. A new company is formed (where necessary) and issues shares to the shareholders of the transferor company.

- Issue of Share

Generally, purchase consideration is discharged by the issue of equity shares of the purchasing company. Capital amount is increased by a combination of companies. The transferor company is liquidated and all assets and liabilities are taken over by the transferee company.

How is Amalgamation different from a Merger?

Amalgamation is different from Merger because neither of the two companies under reference exists as a legal entity. Through the process of amalgamation a completely new entity is formed to have combined assets and liabilities of both the companies.

Types of Amalgamation

I. Amalgamation in the nature of merger:

In this type of amalgamation, not only is the pooling of assets and liabilities is done but also of the shareholders' interests and the businesses of these companies. In other words, all assets and liabilities of the transferor company become that of the transfer company. In this case, the business of the transfer or company is intended to be carried on after the amalgamation. There are no adjustments intended to be made to the book values. The other conditions that need to be fulfilled include that the shareholders of the vendor company holding atleast 90% face value of equity shares become the shareholders' of the vendee company.

II. Amalgamation in the nature of purchase:

This method is considered when the conditions for the amalgamation in the nature of merger are not satisfied. Through this method, one company is acquired by another, and thereby the shareholders' of the company which is acquired normally do not continue to have proportionate share in the equity of the combined company or the business of the company which is acquired is generally not intended to be continued.

If the purchase consideration exceeds the net assets value then the excess amount is recorded as the goodwill, while if it is less than the net assets value it is recorded as the capital reserves.

Reasons for Amalgamation

a. To acquire cash resources
b. Eliminate competition
c. Tax savings
d. Economies of large scale operations
e. Increase shareholders value
f. To reduce the degree of risk by diversification
g. Managerial effectiveness
h. To achieve growth and gain financially

Procedure for Amalgamation

1. Memorandum of Association

Primarily the Memorandum of Association of the Company must allow for the company to amalgamate. If the MOA does not provide for the same, there is a need to amend such before proceeding with any other step.

2. Board Meeting

A Board Meeting shall then be held to decide on the approval of the amalgamation scheme.

3. Application for order of Meeting

Application for the order of meeting to the tribunal shall be made. The application shall be in Form NCLT-1. In addition to this application a notice of admission and affidavit in the prescribed form, copy of the amalgamation scheme with prescribed disclosure must be made. The requisite fee shall also be remitted. Such fee is prescribed in the Schedule under the Rules.

Joint Applications can also be made by companies. The companies are required to disclose to the tribunal the reason for which the creditors are identified for scheme approval. The Tribunal

then directs with respect to among whom the meeting shall be held, the place and time of the same, the appointment of a chairman, the quorum of the meeting, determination of the value of the creditors and members, meeting notice and advertisement of the same, notice to appropriate authorities, stipulated time within which the report of such meeting shall be submitted and other matters that may be of importance in this regard.

4. Notice of Meeting

The notice of such meeting shall be served in Form CAA 2 to all the creditors, members and debenture holders. The notice will be sent one month prior the meeting date at their address. In addition to the notice, the scheme of the amalgamation along with appropriate disclosure shall be sent too. They include the direction of tribunal, details of the company, date of the meeting in which such scheme was given approval and by whom, statement containing information about the parties, relevant dates, share ratio, gist of the evaluation report and such other relevant details, disclosure regarding the effect of arrangement on various internal and external stakeholders and details of several other documents as mentioned in Rule 6 (ix).

5. Advertisement of Meeting

Advertisements of the notice of the meeting shall be advertised in an English newspaper and a vernacular newspaper in the state wherein the registered office of the Company exists. Companies are required to put the information of the notice on their websites too.

6. Notice to Statutory Authorities

Notice is also required to be sent to several statutory authorities. These authorities include the Central Government, the income-tax authorities, the Reserve Bank of India, the Registrar of Companies, the Official Liquidator, the Competition Commission of India and any such other appropriate authority. Any authority can make any representation regarding the scheme before the expiry of a month to the tribunal.

7. Affidavit

The Chairman or any other person who has been entitled with the duty of sending the notices to all the people and authorities required and issue the advertisement is require to file an affidavit to the tribunal a week before the meeting stating that all the direction that was issued by the tribunal regarding the meeting complied with respect to the notice and the advertisement.

8. Meeting

Pursuant to all the above steps, the meeting shall take place. The meeting shall decide through voting regarding the approval or disapproval of the scheme. A majority vote of three-fourths in the meeting shall decide. Such voting may be through meeting in person by polling or through the usage of electronic machines of voting or through postal ballot or through proxy.

9. Report of Meeting

Report of the meeting that was held shall be submitted by the Chairman of such meeting within the stipulated time, if no time had been stipulated, he shall do so by latest three days post conclusion of the meeting. Submission of report shall lay to the Tribunal. The submission shall be in the prescribed form. The report shall contain within itself the decision of the meeting, the members and creditors who were present at the meeting, how many votes were casted in favour or otherwise, the mode of such voting whether it was through the post, electronic machine or through polling, the value of such votes, all the details are to be put in the reported inaccuracy.

10. Petition

If the scheme has received approval by the required majority be it with or without any change in the scheme of amalgamation, the company or the official liquidator of such company within a week after submission of the report of the meeting, submit to the tribunal a petition in the prescribed form for sanctioning the amalgamation. The petition in this regard will have a prayer for the issuance of appropriate directions from the Tribunal. When the company does not present any other person in relation to the scheme can submit such petition for sanction with the permission of the Court.

11. Date of Hearing

On receipt of such notice the Tribunal shall fixate a hearing date in this regard. Such decided date shall be served in the form of notice at least ten days in prior to the decided date to the persons who object or any representatives or to the statutory authorities who had sent representation regarding the amalgamation. Such date shall also be advertised in the newspaper in which it was published before or any such newspaper that the tribunal deems fit.

12. Order on Petition

The order on the petition is then rendered by the Tribunal. The order shall be in prescribed for either sanctioning the scheme of amalgamation or otherwise. The order shall contain within itself directing any changes to be done in the scheme or not in the interest of smooth working of such amalgamation. After the receipt of this order the Company is required to submit a copy of such order which is certified to the Registrar of Companies within a month.

The date from which such amalgamation will be effective is required to be mentioned in the scheme of amalgamation. The amalgamation will be understood to be effective from such decided date. Till the scheme is completely implemented every year the company is required to make a report to the Registrar of Companies certified by a CA or CS that the scheme is under process in compliance and order of the Tribunal.

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 condition is not satisfied in a process of amalgamation, it will not be considered as amalgamation in the nature of merger.

Amalgamation in the Nature of Purchase

The 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 continue to 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 amalgamations in the nature of purchase.

If any one or more conditions listed in the amalgamation in the nature of merger is not satisfied, it is amalgamation in the nature of purchase.

Accounting of Amalgamation

A. Pooling of Interests Method:

Through this accounting method, the assets, liabilities and reserves of the transfer or company are recorded by the transferee company at their existing carrying amounts.

Breaking Down Pooling of Interests

Essentially, the pooling of interests method involves combining the balance sheets from the two firms into one. The assets and liabilities are recorded according to their respective account balances as recorded on the balance sheet. That is usually followed by a revaluation of the historical financial statements.

One thing to note is that intangible assets are not incorporated in the consolidated balance sheet. The only time such assets are included is if they have already been recognized in the statement of financial position of either one of the firms. As a result, no goodwill is recorded in relation to the business combination. Any expenses incurred during the amalgamation are to be included in the firm's comprehensive income statement.

Advantages

1. Simplicity – The pooling or interest method is simple because it only requires one set of books to maintain for both income and expense records.
2. Minimal Paperwork – The pooling or interest method also records income and expenses on one tax form as opposed to separate forms for each shareholder's respective transactions, which reduces paperwork.
3. Less Expense – Implementing this type of accounting technique may save money because there are not as many tax forms to file.

Disadvantages

1. No Special Rules – The pooling or interest method doesn't have any special tax rules, which makes it less advantageous because the legal structure of the corporation must be compatible with general accounting standards.
2. No Special Tax Benefits – The pooling or interest method produces no special tax benefits, which is another reason to use it only if there are no other alternatives.
3. Social Security Taxes May Apply – Employees who work for closely held corporations cannot take advantage of the exclusion provided by the social security taxes because these types of corporations are not allowed to write off wages as business expenses under this type of accounting technique.

B. Purchase Method:

In this method, the transfer company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual assets and liabilities of the transfer or company on the basis of their fair values at the date of amalgamation.
Total of consideration paid to both equity and preference shareholders in various forms.
Pooling of Interests vs. Purchase Price Method

- Pooling of interests is mainly applied when the process of combining businesses is in the nature of a merger. However, if the process is in the form of a purchase, then the purchase price method is used.
- In pooling of interests, the balance sheet presents assets and liabilities at their book values. However, the purchase price approach records the fair market values of the assets and liabilities.
- Under pooling of interests, the assets and liabilities of the two businesses are combined. However, with the purchase price approach, only the assets and liabilities of the acquirer are noted down.

Advantages of Amalgamation
The following are the advantages of opting for amalgamation.

1. The first and most important advantage of choosing for amalgamation is the elimination of competition in the market. When two or more competing companies come together, the competition automatically gets eliminated.
2. The operating cost of the business can be curtailed by opting amalgamation.
3. Research and development facilities can be improved.
4. The controlled price of goods in the market.
5. Diversification can be achieved.
6. Amalgamation is one of the best ways when a company wants to expand its business.
7. The goodwill of a company increases in the market when it associates with a more prominent company.
8. Managerial effectiveness can be achieved by opting for amalgamation.
9. Amalgamation results in an increased market share of the newly formed company.
10. Diversification can be achieved using amalgamation.
11. Amalgamation is the best solution for reviving the business of failing companies.
12. Amalgamation is an excellent way of creating a monopoly in the market.
13. The last but not least advantage of amalgamation is the tax advantage.

Disadvantages of Amalgamation

1. Amalgamation sometimes eliminates the healthy competition in the market.
2. Amalgamation can also result in increased debt.
3. Companies taking part in amalgamation lose their identity, which affects the goodwill of the company and its products.
4. The monopoly achieved through amalgamation is not always healthy for the market.
5. The amalgamation of two or more companies results in the reduction of the number of employees. That means employees working in the companies become unemployed, which is not healthy for the economy.
6. The management of newly formed companies becomes very complicated.

ABSORPTION
Absorption of companies is when one company absorbs another company to form a single "existing company". Only one company survives absorption, while the others lose their identity. The absorption of an organisation is a type of business transaction in which one company acquires another. The absorbed entity goes through the liquidation procedure. Payment to the absorbed firm could be provided in cash, shares, or even a combination of both. The absorbed company continues to operate as previously; it is just that the employees are working for new management. If the company maintains any fund for its employees, it is taken over by the purchasing company. Absorption can occur for a variety of reasons. One of them is to change the company's reputation in the market.
Features of Absorption

- One or more companies are liquidated.
- No new company is formed.
- The nature of business of both companies is similar.
- Generally, larger company purchase the business of smaller company.

Reasons for Absorption

- Gaining synergy
- For the expansion of the company
- instantaneous growth of the company

Consideration of Purchase in the Acquisition of Businesses
Students have difficulty calculating the amount of Purchase Consideration in absorption problems.
Lump-Sum Amount
When a purchasing entity decides to pay a lump sum payment to the vendor firm, this is referred to as Purchase Consideration.
Net Asset
If the purchasing business does not make the lump sum payment, we must assess the net worth of the assets seized. The asset's net worth is determined at a mutually agreed-upon amount.
Net Payment
Let's suppose the absorption includes compensation to the absorbed company's shareholders, debt holders, and creditors. Then the payment might be made in cash, stock, as well as debentures.
Value of Shares
in this method the purchasing company is buying the vendor company on the basis of the value offered per share. For example, ABC company has 10,000 shares. The company XYZ approached ABC Co. and offered Rs.100 per share which the management has approved and signed the absorption agreement. Purchase consideration = 10,000 x 100 = Rs. 10,00,00

Difference Between Amalgamation and Absorption

BASIS FOR COMPARISON	AMALGAMATION	ABSORPTION
Meaning	The process in which two or more than companies are wound up to form a new company, which acquires their business is known as Amalgamation.	The process in which one company takes over the other company is known as Absorption.
Act	Voluntary	Voluntary or hostile
Minimum number of companies involved	Three	Two
Creation of new company	Yes, a new company is formed	No, new company is not formed
Size of entities	The entities are of the same size.	The bigger the entity overpowers the smaller entity.
How many companies are liquidated?	Minimum 2 companies	Only one, i.e. the merged company

RECONSTRUCTION

Reconstruction, in law, is the transfer of a company's (or several companies') business to a new company. The old company will get put into liquidation, and shareholders will agree to take shares of equivalent value in the new company. When a company is suffering loss for several past years and suffering from financial difficulties, it may go for reconstruction. In other words, when a company's balance sheet shows huge accumulated losses, heavy fictitious and intangible assets or is in financial difficulties or is to over capitalized, and then the process of reconstruction is restored.

Types of reconstruction

Reconstruction may be external or internal

i. External Reconstruction

When a company is suffering losses for the past several years and facing financial crisis, the company can sell its business to another newly formed company. Actually, the new company is formed to take over the assets and liabilities of the old company. This process is called external

reconstruction. In other words, external reconstruction refers to the sale of the business of existing company to another company formed for the purposed. In external reconstruction, one company is liquidated and another new company is formed. The liquidated company is called "Vendor Company" and the new company is called "Purchasing Company". Shareholders of vendor company become the shareholders of purchasing company.
In the case, external reconstruction the losses of an old company can't be set off against the profit of the new company. It refers to the sale of the business of an existing company to another company formed for the purpose. In external reconstruction, one company is liquidated and another new company is formed. This 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.
ii. Internal Reconstruction
Internal reconstruction refers to the internal re-organization of the financial structure of a company. It is also termed as re-organization which permits the existing company to be continued. Generally, share capital is reduced to write off the past accumulated losses of the company. The accounting procedure of internal reconstruction is distinct from that of amalgamation, absorption and external reconstruction.
Accounting For Internal Reconstruction
It's important to note that reconstruction is different from company liquidation and does not result in the formation of a new company but its overhauling of the balances. Overall, internal reconstruction helps to,
1. Reduce inflated share capital/alteration of the shares structure.
2. Show true and fair view of assets by valuation.
3. Reduce overdue outside liabilities.
Alteration Of Share Capital
The company can alter share capital. However, compliance needs to be checked. For instance, if the alteration of share capital is allowed by memorandum and article and association. Usually, the following provisional compliance needs to be made.
1. The article of association should permit alteration.
2. The company should pass resolution in a general meeting.

The share capital can be altered in the following ways.
1. The company issues new shares against receipt of cash.
2. Consolidation of shares to a share of large amount.
3. Division of shares into a smaller amount.
4. Cancellation of unissued capital.
Accounting For Internal Reconstruction
Internal reconstruction is the process of reorganizing affairs of the business in terms of assets revaluation, liability assessment, reducing share capital, restructuring the liability, and varying the rights associated with the equity.
Reconstruction is considered when the business makes consistent losses, and there is a need to review the balance sheet if assets/capital is overstated. For instance, accumulated losses/Debits of the profit and loss account can lead to an overstatement of fictitious assets that have no role in revenue and profit generation.

Further, the process of reconstruction is carried to reflect the true picture of the business performance/status and enhance the use of financial statements for the stakeholders. For instance, if the business has been making consistent losses in recent years, it may indicate that assets of the company are over-valued, fictitious assets have been accumulated, and useless intangibles have been excessively capitalized. So, there is a need to reconstruct the balance sheet items and control capitalization. The concept is mainly applied on the equity side of the financial statement to reflect a true sense of ownership and controls by sub-division of shares and other techniques.

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Let's analyze different aspects of internal construction in terms of accounting treatment.

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The company can alter share capital. However, compliance needs to be checked. For instance, if the alteration of share capital is allowed by memorandum and article and association. Usually, the following provisional compliance needs to be made.

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Accounting Entries For Alteration Of Share Capital

1- Accounting Entry For Issuing Of New Shares Against Cash.

Account	Debit	Credit
Business bank account	****	
Equity share capital A/C		****

The debit impact of the transaction is the receipt of cash recorded in the business bank account. On the other hand, the credit impact of the transaction is the recording of the shares issued.

2- Accounting Entry For Consolidation Of Shares.

Account	Debit	Credit
Equity share capital A/C	***	
Equity share capital A/C		***

The debit impact of the transaction is to remove shares small in value. Similarly, the credit impact is to add shares higher in the value. Further, it's important to note that the total amount of the share capital remains the same.

3- Accounting Entry For Cancellation Of Unissued Share Capital.

No entry is required to be passed for the cancellation of unissued share capital.

Accounting Entries For Variation Of Shareholders Rights

The companies may have different types of equity issued like cumulative preference shares, non-cumulative preference shares, and normal equity, etc. Sometimes, there is a need to change the dividend rate on preference shares and convert cumulative preference to non-cumulative preference and vice versa. These conversions are covered in the variation of rights. Following sample, entries help to understand how variation is accounted for in the books of accounts.

Entry To Change Rate Of Dividend On Preference Shares Of The Business.

Account	Debit	Credit
Old % Cumulative preference share capital A/C	***	
New % Cumulative preference share capital A/C		***

The debit impact of the transaction is the removal of old rate cumulative preference shares, and credit impact is a recording of the new rate preference share. It's important to note that the amount of the preference capital remains the same, and it's just a variation in the interest rate.

Entry For Converting Cumulative Preference Shares To Non-Cumulative.

Account	Debit	Credit
Cumulative preference share capital A/C	***	
Non-Cumulative preference share capital A/C		***

The debit impact of the transaction is the removal of the cumulative preference share, and credit impact is the recording of the non-cumulative preference.

Accounting Entries For Reducing Share Capital And Other Assets

1- Entry For Reducing Share Capital Without Any Impact On Face Value.

Account	Debit	Credit
Share capital A/C	***	
Capital reconstruction A/C		***

The debit impact of the transaction is the reduction of the share capital. On the other side, credit impact is the transfer of amount to the capital reconstruction account. This capital reconstruction account will be adjusted against capital reserves.

2- Entry For Reducing Share Capital With Impact On Face Value.

Account	Debit	Credit
Share capital A/C old balance	***	
Share capital A/C New balance		***
Capital reconstruction A/C (Difference in the value due to changes in FV is recorded via this line item)		***

The debit impact of entry is the removal of the old share capital balance. At the same time, the first credit records a new amount of the share capital. Any difference between old and new capital account is recorded via entry of share capital reconstruction.

3- Entry When Creditors Agree To Reduce Their Receivable From The Business

Account	Debit	Credit
Creditors A/C	***	
Share capital reconstruction A/C		***

The debit impact is the removal of the payable balances, and credit impact reflects its impact in the reconstruction.

4- Entry When The Value Of The Asset Appreciates

Account	Debit	Credit
Asset A/C	***	
Share capital reconstruction A/C		***

Debit records increase in the value of assets and credit is used to reflect impact in the reconstruction account.

t's important to note that we have credited the share capital reconstruction account as there has been an increase in the value of assets and a decrease in the liability. However, if there is an increase in the liability following entry will be posted in the books of account.

5- Entry When The Contingent Liability Of The Business Matures

Account	Debit	Credit
Share capital reconstruction A/C	***	
Liability A/C		***

The balance of Share capital reconstruction A/C is debited as the liability of the business increases.

6- Entry When The Balance Of The Share Capital Reconstruction Account Is Utilized.

Account	Debit	Credit
Share capital reconstruction A/C	***	
Accumulated losses/ Profit and loss A/C		***
Discounts on shares issued A/C		***
Goodwill A/C		***
Copy right/patents A/C		***
Preliminary expenses A/C		***

The fictitious/overstated assets in the business's balance sheet are adjusted against the share capital reconstruction account. However, if some amount is left on the credit side, the balance is transferred to the capital reserves account as given in the following entry.

Account	Debit	Credit
Share capital reconstruction A/C	***	
Capital Reserves A/C		***

The debit impact is removing the share capital reconstruction account as it was not a permanent account in nature, and any balance of the account is transferred to the capital reserves account by credit entry.

ENTRI

Comparison between External reconstruction and Internal reconstruction

Basis of Comparison	**Internal Reconstruction**	**External Reconstruction**
Meaning	internal reconstruction refers to the method of corporate restructuring wherein existing company is not liquidated to form a new one	External reconstruction is one in which the company undergoing reconstruction is liquidated to take over the business of existing company.
New Company	No new company is formed	New company is formed
Use of specific terms in Balance Sheet	Balance Sheet of the company contains "And Reduced"	No specific terms are used in the Balance sheet.
Capital reduction	Capital is reduced and the external liability holders waive their claims.	No reduction in the capital.
Approval of court	Approval of court is must.	No approval of court is required.
Transfer of assets and liabilities	No such transfer takes place.	Assets and liabilities of the existing company is transferred to the new company.