MERGERS AND ACQUISITIONS OF COMPANIES

Merger

According to Indian companies act Merger refers to an arrangement wherein, one company (existing or newly formed) one or more business entities (companies), which may results in combination of companies.

Acquisition

Acquisition refers to taking over controlling "stake in a company" by another company, an individual or group of individuals, employees, leaders or any other person. It is popularly called as "Takeover".

Absorption

Absorption is a process of an existing company take over the business of another existing company. Usually a big corporate body takes over the small corporate body.

Ex: 'X' an existing company takes over the business of 'Y' company

External Reconstruction

An existing company go into liquidation and a new company is formed for the purpose of to business of the liquidating company.

Amalgamation

Amalgamation refers to two or more existing companies and carrying either identical business or related business combined together and formed a new company. During this process the existing companies are liquidated and a new company is formed to take over their business.

Types of Amalgamation

According to AS-14 issued by ICAI, there are two types of Amalgamations. They are:

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

Amalgamation in the nature of merger

The following conditions to be satisfied to consider amalgamation in the nature of merger:

A. All assets and liabilities of the transferor company, after amalgamation becomes the assets and liabilities of the transferee company.

B. Shareholders not less than 90% of the face value of 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 share holders of the transferee company by virtue of the amalgamation.

C. The consideration for the amalgamation receivable by the 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 in the transferee company, except that cash may be paid in respect of any fractional shares.

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

E. No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statement of the transferee company except to ensure uniformity accounting policies.

Amalgamation in the nature of purchase

It is an amalgamation which does not satisfy all the five conditions specified for amalgamation in the nature of merger. In this, the equity shareholders of the combining company do not continue to have proportionate share in the equity of the amalgamated company and the business of the acquired company is not intended to be continued after the amalgamations.

Accounting for Amalgamation of Companies

There are two methods of accounting for amalgamation. They are:

1. Pooling interest method
2. Purchase method

Pooling interest method

This is a method of accounting for amalgamation, under which assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts and in the same form as at the date of amalgamation. The balance of the profit and loss account of the transferor company clubbed with the balance of the transferee company or even to the general reserve if there is any. At the time of amalgamation, if the company's involved have different accounting policies a uniform set of accounting policies is adopted following amalgamation.

Purchase method

This is a method of accounting for amalgamation, under which assets, liabilities of the transferor company are recorded at by the transferee company at their agreed values. No reserves (except statutory reserves) of the transferor company will be taken over or recorded in the transferee company. Statutory reserves are included in the financial statements of the transferee company with the help of the following journal entry:

Amalgamation Adjustment A/C…….…….Dr

To Appropriate statutory reserve A/C…….

Differences between pooling interest method and purchasing method

Sl. No.	Pooling interest method	Sl. No.	Purchase method
1	This method is applicable to amalgamation in the **nature of merger.**	1	This method is applicable to amalgamation in the **nature of purchase.**
2	All assets and Liabilities including reserves and profit and loss A/C of transferor company re incorporated in the books of transferee company.	2	Only those assets and liabilities taken over by the transferee company are incorporated.
3	The assets and liabilities are incorporated in the books of transferee company at their **book values**	3	The assets and liabilities taken over by the transferee company at their **agreed values**
4	Any difference between the purchase consideration and the value of assets and liabilities taken over should be adjusted **against reserves**	4	Any difference between the purchase consideration and the value of assets and liabilities taken over should be treated as **Good Will /Capital Reserve** as he case may be
5	When liquidation expanses of transferor company paid by the transferee company **general reserve or profit and loss A/C is debited**	5	When liquidation expanses of transferor company paid by the transferee company **Good Will or Capital reserve A/C is debited**

Distinguish between Amalgamation and Absorption

a. Amalgamation involves formation of a new company; however, absorption of companies does not involve formation of any new company.
b. Two or more companies are liquidated in case of amalgamation; where as in absorption involves liquidation of one or more companies.

Comparison between Amalgamation, Absorption and External Reconstruction.

Sl. No.	Point of comparison	Amalgamation	Absorption	External Reconstruction
1	Liquidation of companies	two or more companies will be liquidated	one or more companies will be liquidated	only one company will be liquidated
2	formation of new company	a new company will be formed	no new company will be formed	a new company will ne formed
3	combination of companies	Results in combination of companies	Results in combination of companies	does not results in any combination

Statutory Reserves

It refers to the reserves to be maintained as per the requirement of any law or legislation. Statutory reserves are **Investment Allowance Reserve, Development Rebate Reserve, Workmen Compensation Fund, Foreign Project Reserve and Export Profit Reserve.**

Objectives of Amalgamation

- To eliminate competition between companies
- To secure the benefits of large scale operation
- To stabilize the market price by regulating output
- To make optimum utilization of scarce resources
- To obtain the benefits of the services of skilled managerial personnel in the fields such as technical financial and marketing
- To promote research and development activities

Accounting procedure for Amalgamation, Absorption and External Reconstruction.

1. Calculation of purchase consideration
2. Ascertainment of discharge of purchase consideration
3. Closing the books of vendor company or transferor company
4. Passing opening entries in the books of purchasing company or transferee company

Step: 01- Calculation of purchase consideration

Purchase Consideration

Meaning

It is the price payable by the Purchasing Company to the Vendor Company for taking over its business. The consideration may be discharged in cash, equity shares, preference shares, debentures etc.,

Definition

Para 3(g) of AS-14 defines the term purchase consideration as the "aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the Transferee Company to the shareholders of Transferor Company".

Methods of Purchase Consideration

There are three methods. They are

- ✓ Lump sum method
- ✓ Net asset method
- ✓ Net payment method

Lump sum method

Strictly speaking this is not a method of purchase consideration. When purchase consideration amount is mentioned in the problem itself, it is called **lump sum consideration**.

Net asset method of purchase consideration

Under this method purchase consideration is calculated by aggregating the agreed value of assets taken over by the purchasing company from that deducts the agreed value of liabilities taken over.

Net payment method

As per AS-14 any payment made by the transferee company to the shareholders of transferor company in the form of cash, shares, debentures etc. such aggregate payments constitutes purchase consideration.

Step: 02- Discharge of purchase consideration

Discharge of purchase consideration refers to the form in which, the purchase consideration is discharged by Transferee Company. Under net payment method, calculation and discharge of purchase consideration would be one and the same. Under net assets method and lump sum method, based on the information in the problem, the mode of discharge must be ascertained.

Step: 03- closing the books of Vendor Company or Transferor Company

Closing the transferor books involves the following steps and entries

1. **For transferring assets taken over by the transferee company:**

Realization A/c	Dr.	at book values
To various Assets(individually) A/c		

Note: Assets not taken over shall not be considered.

2. **For transferring liabilities (including statutory reserves) taken over by the transferee company:**

Various Liabilities (individually) A/c	Dr.	at book values
Statutory Reserve A/c	Dr.	
To Realization A/c		

Note: Liabilities not taken over shall not be considered.

3. **For purchase consideration due:**

Purchasing company A/c	Dr.	Amount of PC
To Realization A/c		

4. **For receiving purchase consideration:**

Bank A/c	Dr.
Shares in purchasing co. A/c	Dr.
Debentures in purchasing co. A/c	Dr.
To Purchasing Co. A/c	

5. **For assets not taken over by the purchasing company & sold by vendor company:**

Bank A/c	Dr.
Realization A/c (if loss on sale)	Dr.
To Asset A/c	
To Realization A/c (if profit on sale)	

6. **For liquidation expenses paid by vendor company:**

Realization A/c	Dr.
To Bank A/c	

Note: if the expenses paid by the purchasing co. no entry is to be passed in the books of vendor co.

7. **For liabilities not taken over by the purchasing co. paid by the vendor company:**

Concerned liabilities A/c	Dr.
Realization A/c (if excess payment is made)	Dr.
To Bank A/c	
To Realization A/c (if less payment is made)	

8. **For Premium or discount on discharging of preference shareholders:**

Realization A/c (premium) Dr.
To Preference shareholders A/c

Or

Preference shareholders A/c Dr
To Realization A/c (discount)

9. **For closing of Realization Account:**
   a. **If profit:**

Realization A/c Dr.
To Equity share holders A/c

   b. **If loss:**

Equity share holders A/c Dr.
To Realization A/c

10. **For transferring preference share capital to preference shareholders account:**

Preference share capital A/c Dr.
To preference shareholders A/c

11. **For transferring equity share capital, reserves and surplus to equity share holders A/c**

Equity share capital A/c Dr.
General Reserve A/c Dr.
Capital Reserve A/c Dr.
Workmen compensation fund A/c Dr.
Dividend equalization fund A/c Dr.
Security premium A/c Dr.
Profit and loss A/c Dr.
To equity share holders A/c

12. **For transferring accumulated losses and expenses not written off:**

Equity share holders A/c Dr.
To Profit and loss A/c
To preliminary expenses A/c
To Under writing commission A/c
To discount on issue of shares or debentures A/c

13. **For discharging preference share holders:**

Preference share holders A/c Dr.
To Bank or shares or debentures in purchasing co. A/c

14. **For discharging equity share holders:**

Equity share holders A/c Dr.
To Bank or shares or debentures in purchasing co. A/c

Step: 04- Passing opening entries in the books of purchasing company

The following entries will be passed in the books of Transferee Company in the case of Amalgamation:

1. **For purchasing of business:**

Business purchases A/c Dr.
To liquidators of vendor co. A/c

2. **For incorporating assets and liabilities taken over from vendor co.:**

Individual assets A/c Dr.
To Individual liabilities A/c
To Business purchases A/c

Note: the difference between debit and credit should be transferred to good will (if credit is more) or Capital reserve account (if debit is more)

3. **For incorporating statutory reserves:**

Amalgamation adjustment A/c Dr.
To Statutory Reserve A/c

4. **For discharging of purchase consideration:**

Liquidator of vendor's co. A/c Dr.
To Bank A/c
To Share capital A/c
To Security premium A/c

5. **For payment of liquidation expenses of vendor's co.**

Good will / Capital Reserve A/c Dr.
To Bank A/c

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