

ACCOUNTING FOR CORPORATE RESTRUCTURING

BASIC CONCEPTS

Corporate restructuring (CR) is a broad term to denote significant reorientation or realignment of the investment (assets) and/or financing (liabilities) structure of a company through conscious management action with a view to drastically alter the quality and quantum of its future cash flow streams. This broad definition includes such corporate actions as mergers, acquisitions/ amalgamations/ absorption, divestitures, demergers (spin-offs) and debt-equity changes.

The different methods of restructuring and their implications are discussed below:

- (1) External Restructuring
 - (a) Asset-based (portfolio) restructuring
 - (b) Financial or capital restructuring
- (2) Internal Restructuring
 - (a) Portfolio restructuring (Cost reduction through closure of units, redundancy programmes etc.)
 - (b) Organisational restructuring (Management or organisational restructuring involving decentralisation, delayering, product-market based divisionalisation, matrix structure etc.)
- (3) Amalgamation, absorption or external reconstruction.

Asset-based Restructuring

(i) Mergers and Acquisitions (M & A)

In the Indian context the term merger is used to denote consolidation of separate legal entities, not necessarily of similar sizes, into one through a statutory process of amalgamation. the motives of merger or acquisition are the same and both involve transfer of ownership and control of assets and the right to manage corporate cash flows.

For Example-Reliance Natural and Reliance Power Merger

(ii) Divestitures and Asset Swaps

Divestiture refers to disposal (in favour of third party) of business units, subsidiary

Financial Reporting

companies or significant holdings in associates, often for cash. Asset swap, on other hand, entails simultaneous divesting and acquisition of each others' business by two companies, settling the difference in valuation, if any in cash.

(iii) Demergers or Spin-offs

Demerger involves spinning off (profitable or robust) parts of a diversified company into a new company and undertaking free distribution of the shares of the new (spun-off) company to the shareholders of the original company. For Example-RIL gets split among several companies between two brothers-Mukesh and Anil Ambani.

Unlike in a divestiture, the "parent" company or group does not receive any proceeds from a demerger as the demerged company's shares are directly distributed to the "parent" company's shareholders.

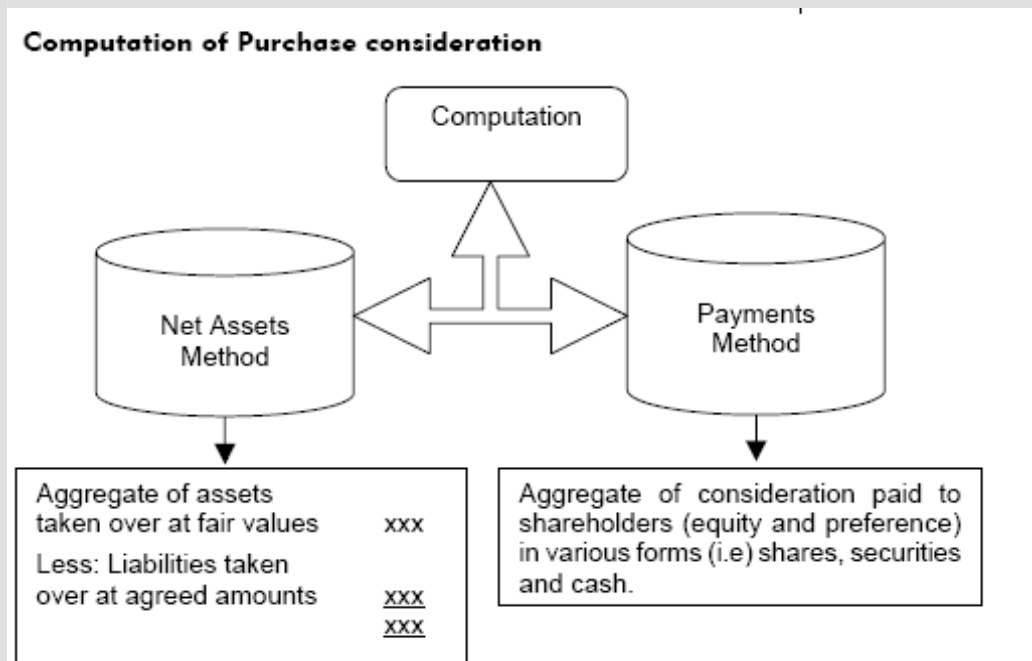
Capital and Financial Restructuring

This type of restructuring includes buy back of shares, debt to equity conversions etc.

Purchase Consideration

In the problem information for PC will be available in two ways. Firstly, list of the various consideration paid is given, one should take care to add only those items paid to the members of the company and not to any outsider.

Secondly, assets and liabilities taken over are given in the problem. Purchase consideration in this case will be the net assets taken over by the amalgamated company.



Discharge of Purchase Consideration

The purchase consideration in the case of amalgamation is payable to the shareholders, both preference and equity, of the transferor company. This may be discharged by issuing preference and/or equity shares of the transferee company and partly by cash. Often the transferee company discharges claims of the preference shareholders of the transferor company at a premium or at a discount by issuing preference shares. Similarly, claims of the equity shareholders of the transferor company may also be discharged by issuing equity shares of the transferee company either at par or at premium or at discount. Debentures paid to shareholders of the transferor company will be considered as the part of purchase consideration but debentures paid to the debenture holders or to the sundry creditors of the transferor company will not form part of purchase consideration.

Methods of Accounting for Amalgamation

There are two main methods of accounting for amalgamations:

- (a) The Pooling of Interests Methods (for amalgamation in the nature of merger), and
- (b) The Purchase Method (for amalgamation in the nature of purchase).

The first method is applied in case of amalgamation in the nature of merger and the second method in case of amalgamation in the nature of purchase.

- **The Pooling of Interests Method:** Under this method the assets, liabilities and all reserves of the transferor company are recorded by transferee company at their existing carrying amounts unless the carrying amounts are to be adjusted to follow a uniform set of accounting policies. The balance of the profit and loss account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to general reserve, if any.

The 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 transferor company should be adjusted in reserves.

Therefore, no 'goodwill' arises in case of amalgamations in the nature of merger.

- **The Purchase Method :** Here the assets and liabilities of the transferor company should be incorporated in the transferee company's financial statements in either of the following two ways:
 - (i) at their existing carrying amounts; or
 - (ii) the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

Treatment of Difference of Purchase Consideration and Asset and Liabilities Taken over

If It is in the nature of purchase

(It is considered appropriate to amortize goodwill over a period not exceeding five years unless a somewhat longer period can be justified.)

If It is in the nature of merger

Consideration < Net Asset value = CAPITAL RESERVE

The reserves of the transferor company, other than statutory reserves, should not be included in the financial statements of the transferee company. In case of statutory reserves (i.e., Development Allowance Reserve, Investment Allowance Reserve etc.) where the maintenance of such reserves for a specific period is required by statute, these should be recorded in the financial statements of the transferee company with the help of the following entry:

To Statutory Reserves A/c

-

Question 1

The Balance Sheet of Z Ltd. as at 31st March, 2010 is given below. In it, the respective shares of the company's two divisions namely S Division and W Division in the various assets and liabilities have also been shown.

	(All amounts in crores of Rupees)		
	S Division	W Division	Total
<i>Fixed Assets:</i>			
Cost	875	249	
Less: Depreciation	<u>360</u>	<u>81</u>	
Written-down value	<u>515</u>	<u>168</u>	683
Investments			97
<i>Net Current assets:</i>			
Current Assets	445	585	
Less: Current Liabilities	<u>270</u>	<u>93</u>	
	<u>175</u>	<u>492</u>	<u>667</u>
			<u>1,447</u>
<i>Financed by:</i>			
Loan funds		15	417
Own funds:			
Equity share capital: shares of Rs. 10 each			345
Reserves and surplus			<u>685</u>
			<u>1,447</u>

Loan funds included, inter alia, Bank Loans of Rs. 15 crore specifically taken for W Division and Debentures of the paid up value of Rs. 125 crore redeemable at any time between 1st October, 2009 and 30th September, 2010.

On 1st April, 2010 the company sold all of its investments for Rs. 102 crore and redeemed all the debentures at par, the cash transactions being recorded in the Bank Account pertaining to S Division.

Then a new company named Y Ltd. was incorporated with an authorized capital of Rs. 900 crore divided into shares of Rs. 10 each. All the assets and liabilities pertaining to W Division were transferred to the newly formed company; Y Ltd. allotting to Z Ltd.'s shareholders its two fully paid equity shares of Rs. 10 each at par for every fully paid equity share of Rs. 10 each held in Z Ltd. as discharge of consideration for the division taken over.

Y Ltd. recorded in its books the fixed assets at Rs. 218 crore and all other assets and liabilities at the same values at which they appeared in the books of Z Ltd.

Financial Reporting

You are required to:

- (i) Show the journal entries in the books of Z Ltd.
- (ii) Prepare Z Ltd.'s Balance Sheet immediately after the demerger and the initial Balance Sheet of Y Ltd. (Schedules in both cases need not be prepared).
- (iii) Calculate the intrinsic value of one share of Z Ltd. immediately before the demerger and immediately after the demerger; and
- (iv) Calculate the gain, if any, per share to the shareholders of Z Ltd. arising out of the demerger.

Answer

(i) Journal Entries in Z Ltd.'s Books

(Rs. in crores)		
	Dr.	Cr.
	Amount	Amount
	Rs.	Rs.
Bank Account (Current Assets)	Dr. 102	
To Investments		97
To Profit and Loss Account (Reserves and Surplus)		5
(Sale of investments at a profit of Rs. 5 crore)		
Debentures (Loan Funds)	Dr. 125	
To Bank Account (Current Assets)		125
(Redemption of debentures at par)		
Current Liabilities	Dr. 93	
Bank Loan (Loan Funds)	Dr. 15	
Provision for Depreciation	Dr. 81	
Reserves and Surplus (Loss on Demerger)	Dr. 645	
To Fixed Assets		249
To Current Assets		585
(Assets and liabilities pertaining to W Division taken out of the books on transfer of the division to Y Ltd.)		

Accounting For Corporate Restructuring

(ii)	(a)	Z Ltd.'s Balance Sheet after demerger		
			<i>Rs. in crores</i>	<i>Rs. in crores</i>
		Fixed Assets		
		Gross Block	875	
		Less: Depreciation	<u>360</u>	515
		Net Current Assets		
		Current Assets	422	
		Less: Current Liabilities	<u>270</u>	<u>152</u>
				<u>667</u>
		Financed by		
		Shareholders' Funds		
		Equity Share Capital	345	
		Reserves and Surplus	<u>45</u>	390
		Loan Funds		<u>277</u>
				<u>667</u>
		Working Notes:		
				<i>Rs. in crores</i>
		1. Reserves and Surplus		
		Balance as on 31st March, 2010		685
		Add: Profit on sale of investments		<u>5</u>
				690
		Less: Loss on demerger		<u>645</u>
		Balance shown in balance sheet after demerger		<u>45</u>
		2. Loan Funds		
		Balance as on 31st March, 2010		417
		Less: Bank Loan transferred to Y Ltd.	15	
		Debentures redeemed	<u>125</u>	<u>140</u>
		Balance shown in balance sheet after demerger		<u>277</u>
		3. Current Assets		
		Balance as on 31st March, 2010		445
		Add: Cash received from sale of investments		<u>102</u>
				547
		Less: Cash paid to redeem debentures		<u>125</u>
		Balance in balance sheet after demerger		<u>422</u>

Financial Reporting

(b) Initial Balance Sheet of Y Ltd.

	<i>Rs. in crores</i>	<i>Rs. in crores</i>
Fixed Assets		218
Net Current Assets		
Current Assets	585	
Less: Current Liabilities	<u>93</u>	<u>492</u>
		<u>710</u>
Financed by		
Shareholders' funds:		
Capital (Issued for acquisition of business)		690
Capital Reserve*		5
Loan Funds		<u>15</u>
		<u>710</u>

(iii) Calculation of intrinsic value of one share of Z Ltd.

	<i>Rs. in crores</i>
<i>Before demerger</i>	
Fixed Assets	683
Net current assets Rs.(667 + 102 – 125)	<u>644</u>
	1,327
Less: Loan funds Rs.(417 – 125)	<u>292</u>
	<u>1,035</u>
Intrinsic Value per share = Rs. $\frac{1,035 \text{ crores}}{34.5 \text{ crores}}$ = Rs.30 per share	
<i>After demerger</i>	
Fixed Assets	515
Net Current Assets Rs.(175 + 102 – 125)	<u>152</u>
	667
Less: Loan funds	<u>277</u>
	<u>390</u>
Intrinsic Value of one share = Rs. $\frac{390 \text{ crores}}{34.5 \text{ crores}}$ = Rs. 11.30 per share	

* Capital Reserve has been calculated as

	<i>Rs. in crores</i>
Purchase consideration	690
Less: Assets transferred	710
Loan funds transferred	<u>(-15)</u>
Capital reserve	<u>5</u>

Accounting For Corporate Restructuring

(iv) Gain per share to Shareholders:

After demerger, for every share in Z Ltd. the shareholder holds 2 shares in Y Ltd.

	Rs.
Value of one share in Z Ltd.	11.30
Value of two shares in Y Ltd. (Rs. 10 × 2)	<u>20.00</u>
	31.30
Less: Value of one share before demerger	<u>30.00</u>
Gain per share	<u>1.30</u>

The gain per share amounting Rs. 1.30 is due to appreciation in the value of fixed assets by Y Ltd.

Question 2

Ksha Ltd. and Yaa Ltd. are two companies. On 31st March, 2009 their Balance Sheets were as under:

	(Rs. in crores)			
	Ksha Ltd.		Yaa Ltd.	
	Rs.	Rs.	Rs.	Rs.
<i>Sources of funds:</i>				
<i>Share Capital:</i>				
Authorised:		<u>500</u>		<u>500</u>
Issued: Equity shares of Rs. 10 each fully paid up		300		200
<i>Reserves and surplus:</i>				
Capital reserves	40		20	
Revenue reserves	700		425	
Surplus	<u>10</u>	<u>750</u>	<u>5</u>	<u>450</u>
Owners' funds		1,050		650
Loan funds		<u>250</u>		<u>350</u>
		<u>1,300</u>		<u>1,000</u>
<i>Fund employed in:</i>				
<i>Fixed assets:</i>				
Cost	1,000		700	
Less: Depreciation	<u>400</u>	600	<u>300</u>	400
<i>Net current assets:</i>				
Current assets	2,000		1,500	
Less: Current liabilities	<u>1,300</u>	<u>700</u>	<u>900</u>	<u>600</u>
		<u>1,300</u>		<u>1,000</u>

Financial Reporting

Ksha Ltd. has 2 divisions very profitable division A and loss making division B. Yaa Ltd. similarly has 2 divisions very profitable division B and loss making division A.

The two companies decided to reorganize. Necessary approvals from creditors and members and sanction by High Court have been obtained to the following scheme:

1. Division B of Ksha Ltd. which has fixed assets costing Rs. 400 crores (written down value Rs. 160 crores), Current assets Rs. 900 crores, Current liabilities Rs. 750 crores and loan funds of Rs. 200 crores is to be transferred at Rs. 125 crores to Yaa Ltd.
2. Division A of Yaa Ltd. which has fixed assets costing Rs. 500 crores (depreciation Rs. 200 crores), Current assets Rs. 800 crores, Current liabilities Rs. 700 crores, and loan funds Rs. 250 crores is to be transferred at Rs. 140 crores to Ksha Ltd.
3. The difference in the two considerations is to be treated as loan carrying interest at 15% per annum.
4. The directors of each of the companies revalued the fixed assets taken over as follows:
 - (i) Division of A of Yaa Ltd. taken over: Rs. 325 crores.
 - (ii) Division B of Ksha Ltd. taken over: Rs. 200 crores.

All the other assets and liabilities are recorded at the balance sheet values.

- (a) The directors of both the companies ask you to prepare the balance sheets after reconstruction (showing the corresponding figures before reconstruction).
- (b) Master Richie Rich, who owns 50,000 equity shares of Ksha Ltd. and 30,000 equity shares of Yaa Ltd. wants to know whether he has gained or lost in terms of net asset value of equity shares on the above reorganizations.

Answer

(a)

Ksha Ltd.

Balance Sheet as at 31st March, 2009

		(Rs. in crores)			
		Schedule	After reconstruction	Before reconstruction	
I	SOURCES OF FUNDS				
(1)	Shareholders' funds:				
(a)	Capital	A	300	300	
(b)	Reserves and surplus	B	<u>800</u>	1,100	<u>750</u> 1,050
(2)	Loan funds	C	<u>315</u>	<u>250</u>	

Accounting For Corporate Restructuring

TOTAL	<u>1,415</u>	<u>1,300</u>
II APPLICATION OF FUNDS		
(1) Fixed assets:		
(a) Gross block	925	1,000
(b) Less: Depreciation	<u>160</u>	<u>400</u>
(c) Net block	765	600
(2) Investments	—	—
(3) Current assets	1,900	2,000
Less: Current liabilities	<u>1,250</u>	<u>1,300</u>
Net current assets	<u>650</u>	<u>700</u>
TOTAL	<u>1,415</u>	<u>1,300</u>

Schedules to Balance Sheet

(Rs. in crores)

	<i>After reconstruction</i>	<i>Before reconstruction</i>
A. Share Capital		
Authorised:		
50 crores equity shares of Rs. 10 each	<u>500</u>	<u>500</u>
Issued and subscribed:		
30 crores equity shares of Rs. 10 each fully paid up	<u>300</u>	<u>300</u>
B. Reserves and surplus		
Capital reserves	40	40
Add: Capital profit on reconstruction	<u>50</u>	—
	90	40
Revenue reserves	700	700
Surplus	<u>10</u>	<u>10</u>
	<u>800</u>	<u>750</u>

Financial Reporting

C. Loan funds

Yaa Ltd. (Interest @ 15% p.a.)	15	—
Others	<u>300</u>	<u>250</u>
	<u>315</u>	<u>250</u>

Yaa Ltd.

Balance Sheet as at 31st March, 2009

				(Rs. in crores)	
	Schedule	After reconstruction	Before reconstruction		
I SOURCES OF FUNDS					
(1) Shareholders' funds:					
(a) Capital	A	200	200		
(b) Reserves and surplus	B	<u>465</u>	<u>450</u>	665	650
(2) Loan funds (others)		<u>300</u>			<u>350</u>
TOTAL		<u>965</u>			<u>1,000</u>
II APPLICATION OF FUNDS					
(1) Fixed assets:					
(a) Gross block		400	700		
(b) Less: Depreciation		<u>100</u>	<u>300</u>		
(c) Net block			300		400
(2) Investments			—		—
(3) Current assets, loans and advances					
(a) Current assets		1,600	1,500		
(b) Loan to Ksha Ltd.		<u>15</u>	—		
		1,615	1,500		
Less: Current liabilities		<u>950</u>	<u>900</u>		
Net current assets			<u>665</u>		<u>600</u>
TOTAL		<u>965</u>			<u>1,000</u>

Accounting For Corporate Restructuring

Schedules to Balance Sheet

	<i>(Rs. in crores)</i>	
	<i>After reconstruction</i>	<i>Before reconstruction</i>
A. Share Capital		
Authorised:		
50 crores equity shares of Rs. 10 each	<u>500</u>	<u>500</u>
Issued and subscribed:		
20 crores equity shares of Rs. 10 each fully paid up	<u>200</u>	<u>200</u>
B. Reserves and surplus		
Capital reserves	20	20
Add: Capital profit on reconstruction	<u>15</u>	<u>—</u>
	35	20
Revenue reserves	425	425
Surplus	<u>5</u>	<u>5</u>
	<u>465</u>	<u>450</u>

(b) Net asset value of Master Riche Rich's holdings

	<i>Pre- reorganisation Rs.</i>	<i>Post- reorganisation Rs.</i>	<i>Change (Gain) Rs.</i>
Net asset value of one equity share:			
(Refer to working notes)			
Ksha Ltd.	35.00	36.67	1.67
Yaa Ltd.	32.50	33.25	0.75
Net asset value of equity shares owned by Master Riche Rich			
Ksha Ltd. (50,000 shares)	17,50,000	18,33,500	83,500
Yaa Ltd. (30,000 shares)	<u>9,75,000</u>	<u>9,97,500</u>	<u>22,500</u>
	<u>27,25,000</u>	<u>28,31,000</u>	<u>1,06,000</u>

Master Riche Rich has gained in terms of net asset value of his holdings as indicated in the last column.

Financial Reporting

Working Notes:

(1) Ksha Ltd.

(i)

Amounts (Rs. in crores)

	<i>Pre-re- organisatio n figures</i>	<i>Sale of divisio n B</i>	<i>Purchas e of division A of Yaa Ltd.</i>	<i>Post-re- organisation figures</i>
	(a)	(b)	(c)	(d) = (a) – (b) + (c)
Fixed assets:				
Cost	1,000	400	325	925
Depreciation	<u>(400)</u>	<u>(240)</u>	—	<u>(160)</u>
Written down value (I)	<u>600</u>	<u>160</u>	<u>325</u>	<u>765</u>
Current assets	2,000	900	800	1,900
Current liabilities	<u>(1,300)</u>	<u>(750)</u>	<u>(700)</u>	<u>(1,250)</u>
Net current assets (II)	<u>700</u>	<u>150</u>	<u>100</u>	<u>650</u>
Funds employed [(I) + (II)]	1,300	310	425	1,415
Loan funds:				
Others (III)	(250)	(200)	(250)	(300)
Yaa Ltd. (balance payable on transfers of divisions i.e. 140 – 125) (IV)	—	—	—	<u>(15)</u>
Net worth (I + II – III – IV)	<u>1,050</u>	<u>110</u>	<u>175</u>	<u>1,100</u>

(ii) Sale of division B (Rs. in crores)

Transfer price	125
Cost of the division (160 + 150 – 200)	<u>110</u>
Capital Profit	<u>15</u>

(iii) Purchase of division A of Yaa Ltd. (Rs. in crores)

Agreed value of assets less liabilities taken over (325 + 100 – 250)	175
Less: Transfer price	<u>140</u>
Capital Profit	<u>35</u>

Accounting For Corporate Restructuring

(iv)		(Rs. in crores)
Pre-reorganisation net worth		1,050
Add: Capital profit on		
Sale	15	
Acquisition	<u>35</u>	<u>50</u>
Post-reorganisation net worth		<u>1,100</u>
No. of equity shares	30 crores	
Net asset value of equity share:	Rs.	
Pre-reorganisation	1,050/30 = 35.00	
Post-reorganisation	1,100/30 = 36.67 (rounded off)	

(2) Yaa Ltd.

(i)	Amounts (Rs. in crores)			
	<i>Pre-re- organisation figures</i>	<i>Sale of division A</i>	<i>Purchase of division B of Ksha Ltd.</i>	<i>Post-re- organisation figures</i>
	(a)	(b)	(c)	(d) = (a) – (b) + (c)
Fixed assets:				
Cost	700	500	200	400
Depreciation	<u>(300)</u>	<u>(200)</u>	—	<u>(100)</u>
Written down value (I)	<u>400</u>	<u>300</u>	<u>200</u>	<u>300</u>
Current assets	1,500	800	900	1,600
Current liabilities	<u>(900)</u>	<u>(700)</u>	<u>(750)</u>	<u>(950)</u>
Net current assets (II)	<u>600</u>	<u>100</u>	<u>150</u>	<u>650</u>
Funds employed [(I) + (II)]	1,000	400	350	950
Loan funds—others (III)	<u>(350)</u>	<u>(250)</u>	<u>(200)</u>	<u>(300)</u>
	650	150	150	650
Ksha Ltd. (balance on account of transfers of divisions) (IV)	—	—	—	<u>15</u>
Net worth (I + II – III + IV)	<u>650</u>	<u>150</u>	<u>150</u>	<u>665</u>

Financial Reporting

(ii)	Purchase of division B of Ksha Ltd.	Sale of division A
Value of assets less liabilities	150	150
(Value to Yaa Ltd.) (200 + 900 – 750 – 200)		(300 + 800 – 700 – 250)
Less: Transfer Price	<u>125</u>	<u>140</u>
Capital Profit	<u>25</u>	<u>(10)</u>
(iii) Pre-reorganisation net worth		650
Add: Capital profit on acquisition	25	
Sale	<u>(10)</u>	<u>15</u>
Post-reorganisation net worth		<u>665</u>
No. of equity shares	20 crores	
Net asset value of equity share:	Rs.	
Pre-reorganisation	650/20 = 32.50	
Post-reorganisation	665/20 = 33.25	

Question 3

The Balance Sheet of Gunshot Ltd. as on 31.3.2010 is given:

		(Rs. in '000)
Liabilities	Amount	Assets Amount
Share Capital :		Fixed Assets 2,700
Equity shares of Rs. 10 each	800	Non-trade Investments 300
Securities Premium	100	Stock 600
General Reserve	780	Sundry Debtors 360
Profit and Loss Account	120	Cash and Bank 160
10% Debenture	2,000	
Creditors	<u>320</u>	
	<u>4,120</u>	<u>4,120</u>

Gunshot Ltd. buy back 16,000 shares of Rs. 20 per share. For this purpose, the Company sold its all non-trade investments for Rs. 3,20,000. Give Journal Entries with full narrations effecting the buy back.

Answer

Journal Entries for Buy-back of shares of Gun Shot Ltd.

		Rs.	Rs.
(i)	Bank A/c	Dr. 3,20,000	
	To Non-trade Investments		3,00,000
	To Profit & Loss A/c		20,000
	(Being the entry for sale of Non-trade Investments)		
(ii)	Shares Buy back A/c (16,000 x Rs. 20)	Dr. 3,20,000	
	To Bank A/c		3,20,000
	(Being purchase of 16,000 shares @ Rs.20 per share)		
(iii)	Equity Share Capital A/c (16,000 x Rs.10)	Dr. 1,60,000	
	Buy-back Premium (16,000 x Rs.10)	Dr. 1,60,000	
	To Shares Buy-back A/c		3,20,000
	(Being cancellation of shares bought back)		
(iv)	Securities Premium A/c	Dr. 1,00,000	
	General Reserve	Dr. 60,000	
	To Buy-back Premium		1,60,000
	(Being adjustment of buy-back premium)		
(v)	General Reserve	Dr. 1,60,000	
	To Capital Redemption Reserve		1,60,000
	(Being the entry for transfer of General Reserve to Capital Redemption Reserve to the extent of face value of equity shares bought back)		

Question 4

A Ltd. and B Ltd. were amalgamated on and from 1st April, 2010. A new company C Ltd. was formed to take over the business of the existing companies. The Balance Sheets of A Ltd. and B Ltd. as on 31st March, 2010 are given below:

				(Rs. in lakhs)	
Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Share Capital			Fixed Assets		
Equity Shares of Rs. 100 each	800	750	Land and Building	550	400

Financial Reporting

12% Preference shares of Rs.100 each	300	200	Plant and Machinery	350	250
Reserves and Surplus			Investments	150	50
Revaluation Reserve	150	100	Current Assets, Loans and Advances		
General Reserve	170	150			
Investment Allowance Reserve	50	50	Stock	350	250
Profit and Loss Account	50	30	Sundry Debtors	250	300
Secured Loans			Bills Receivable	50	50
10% Debentures (Rs. 100 each)	60	30	Cash and Bank	300	200
Current Liabilities and provisions					
Sundry Creditors	270	120			
Bills Payable	<u>150</u>	<u>70</u>			
	<u>2,000</u>	<u>1,500</u>		<u>2,000</u>	<u>1,500</u>

Additional Information:

- (1) 10% Debentureholders of A Ltd. and B Ltd. are discharged by C Ltd. issuing such number of its 15% Debentures of Rs. 100 each so as to maintain the same amount of interest.
- (2) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of C Ltd. at a price of Rs. 150 per share (face value of Rs. 100).
- (3) C Ltd. will issue 5 equity shares for each equity share of A Ltd. and 4 equity shares for each equity share of B Ltd. The shares are to be issued @ Rs. 30 each, having a face value of Rs. 10 per share.
- (4) Investment allowance reserve is to be maintained for 4 more years.

Prepare the Balance Sheet of C Ltd. as on 1st April, 2010 after the amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.

Answer

Balance Sheet of C Ltd. as at 1st April, 2010

Liabilities	Amount	Assets	(Rs. in lakhs) Amount
SHARE CAPITAL		FIXED ASSETS	
70,00,000 Equity shares of Rs.10 each	700	Goodwill	20
		Land and Building	950

Accounting For Corporate Restructuring

5,00,000 Preference shares of Rs. 100 each (all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)	500	Plant and Machinery	600
		INVESTMENTS	200
RESERVES AND SURPLUS		CURRENT ASSETS, LOANS AND ADVANCES	
Securities Premium Account	1,650	A Current Assets	
Investment Allowance Reserve	100	Stock	600
SECURED LOANS		Sundry debtors	550
15% Debentures	60	Cash and Bank	500
UNSECURED LOANS	—	B Loans and Advances	
CURRENT LIABILITIES AND PROVISIONS		Bills Receivable	100
A Current Liabilities		MISCELLANEOUS EXPENDITURE (to the extent not written off or adjusted)	
Acceptances	220	Amalgamation Adjustment Account	100
Sundry Creditors	390		
B Provisions	—		
	<u>3,620</u>		<u>3,620</u>

Working Notes:

(Rs. in lakhs)
A Ltd. B Ltd.

(1) Computation of Purchase consideration

(a) Preference shareholders:

$\left(\frac{3,00,00,000}{100} \right)$ i.e. 3,00,000 shares × Rs. 150 each	450	
$\left(\frac{2,00,00,000}{100} \right)$ i.e. 2,00,000 shares × Rs. 150 each		300

(b) Equity shareholders:

$\left(\frac{8,00,00,000 \times 5}{100} \right)$ i.e. 40,00,000 shares × Rs. 30 each	1,200
---	-------

Financial Reporting

	$\left(\frac{7,50,00,000 \times 4}{100} \right)$ i.e. 30,00,000 shares × Rs. 30 each		<u>900</u>
	Amount of Purchase Consideration	<u>1,650</u>	<u>1,200</u>
(2)	Net Assets Taken Over		
	Assets taken over:		
	Land and Building	550	400
	Plant and Machinery	350	250
	Investments	150	50
	Stock	350	250
	Sundry Debtors	250	300
	Bills receivable	50	50
	Cash and bank	<u>300</u>	<u>200</u>
		2,000	1,500
	Less: Liabilities taken over:		
	Debentures	40	20
	Sundry Creditors	270	120
	Bills payable	<u>150</u>	<u>70</u>
		<u>460</u>	<u>210</u>
	Net assets taken over	1,540	1,290
	Purchase consideration	<u>1,650</u>	1,200
	Goodwill	<u>110</u>	
	Capital reserve		<u>90</u>

Question 5

The following are the Balance Sheets of Big Ltd. and Small Ltd. for the year ending on 31st March, 2010. (Figures in crores of rupees):

	Big Ltd.	Small Ltd.
Equity share capital – in equity shares of Rs. 10 each	50	40
Preference share capital – in 10% preference shares of Rs. 100 each	–	60
Reserves and Surplus	<u>200</u>	<u>150</u>
	250	250

Accounting For Corporate Restructuring

<i>Loans – Secured</i>	<u>100</u>	<u>100</u>
<i>Total funds</i>	<u>350</u>	<u>350</u>
<i>Applied for: Fixed assets at cost less depreciation</i>	150	150
<i>Current assets less current liabilities</i>	<u>200</u>	<u>200</u>
	<u>350</u>	<u>350</u>

The present worth of fixed assets of Big Ltd. is Rs. 200 crores and that of Small Ltd. is Rs. 429 crores. Goodwill of Big Ltd. is Rs. 40 crores and of Small Ltd. is 75 crores.

Small Ltd. absorbs Big Ltd. by issuing equity shares at par in such a way that intrinsic net worth is maintained.

Goodwill account is not to appear in the books. Fixed assets are to appear at old figures.

- (a) Show the Balance Sheet after absorption.
 (b) Draft a statement of valuation of shares on intrinsic value basis and prove the accuracy of your workings.

Answer

(a) Small Ltd.

Balance Sheet as at 1st April, 2010

	Schedule No.	(Rs. in crores)
I SOURCES OF FUNDS		
(1) Shareholders' funds:		
(a) Capital	A	125
(b) Reserves and surplus	B	<u>375</u>
		500
(2) Loan funds:		
Secured loans	C	<u>200</u>
TOTAL		<u>700</u>
II APPLICATION OF FUNDS		
(1) Fixed assets:		
Net block	D	300
(2) Investments		–
(3) Net current assets	E	<u>400</u>
TOTAL		<u>700</u>

Financial Reporting

(Rs. in Crores)

Schedules to Accounts:

A	Share Capital:	
	6.5 crores equity shares of Rs. 10 each (of the above shares, 2.5 crores equity shares are allotted as fully paid-up for consideration other than cash)	65
	60 lakhs 10% Preference shares of Rs. 100 each	<u>60</u>
		<u>125</u>
B	Reserves and Surplus:	
	As per last Balance Sheet	150
	Capital Reserve	<u>225</u>
		<u>375</u>
C	Secured Loans:	
	As per last Balance Sheet	100
	Taken over on absorption of Big Ltd.	<u>100</u>
		<u>200</u>
D	Fixed Assets:	
	As per last Balance Sheet	150
	Taken over on absorption of Big Ltd.	<u>150</u>
		<u>300</u>
E	Net Current Assets:	
	As per last Balance Sheet	200
	Taken over on absorption of Big Ltd.	<u>200</u>
		<u>400</u>

(b) Valuation of shares on intrinsic value basis

(i)	<i>Big Ltd.</i>	<i>Small Ltd.</i>
		(Rs. in crores)
Equity share capital	50	40
Reserves and Surplus	<u>200</u>	<u>150</u>
	250	190
Goodwill agreed upon	40	75
Increase in the value of fixed assets		
(Present worth less book value)	<u>50</u>	<u>279</u>
	<u>340</u>	<u>544</u>

Accounting For Corporate Restructuring

(ii)	<i>Big Ltd.</i>	<i>Small Ltd.</i>
Number of Equity shares	5 crores	4 crores
Intrinsic value per equity share	Rs. 68	Rs. 136
(iii)	Ratio of intrinsic value of shares in the two companies	1 : 2
	Since the shares are to be issued at par, the number of equity shares of Rs. 10 each to be issued to maintain the intrinsic net worth = 5 crores / 2 = 2.5 crores	
(iv)	Statement to prove the accuracy of workings	
	(Rs. in crores)	
(1)	Equity share capital (after absorption)	65
	Reserves and Surplus (after absorption)	<u>375</u>
		440
	Add: Unrecorded value of goodwill (40 + 75)	115
	Add: Unrecorded incremental value of fixed assets (50+279)	<u>329</u>
		<u>884</u>
(2)	Number of equity shares	6.5 crores
(3)	Intrinsic value of an equity share (884/6.5)	Rs. 136

Working Note:

Calculation of Capital Reserve on Absorption

	(Rs. in crores)
Fixed Assets taken over	150
Net current assets taken over	<u>200</u>
	350
Less: Secured loans taken over	<u>100</u>
Net Assets taken over	250
Less: Purchase consideration	<u>25</u>
	<u>225</u>

Financial Reporting

Question 6

Given below is the Balance Sheet of H Ltd. as on 31.3.2009:

(Figures in Rs. lakhs)

Equity share capital	4.00	Block assets less depreciation to date	6.00
(in equity shares of Rs. 10 each)		Stock and debtors	5.30
10% preference share capital	3.00	Cash and bank	0.70
General reserve	1.00		
Profit and loss account	1.00		
Creditors	<u>3.00</u>		
	<u>12.00</u>		<u>12.00</u>

M Ltd. another existing company holds 25% of equity share capital of H Ltd. purchased at Rs. 10 per share.

It was agreed that M Ltd. should take over the entire undertaking of H Ltd. on 30.9.2009 on which date the position of current assets (except cash and bank balances) and creditors was as follows:

Stock and debtors	4 lakhs
Creditors	2 lakhs

Profits earned for half year ended 30.09.2009 by H Ltd. was Rs. 70,500 after charging depreciation of Rs. 32,500 on block assets. H Ltd. declared 10% dividend for 2008-09 on 30.08.2009 and the same was paid within a week.

Goodwill of H Ltd. was valued at Rs. 80,000 and block assets were valued at 10% over their book value as on 31.3.2009 for purposes of take over. Preference shareholders of H Ltd. will be allotted 10% preference shares of Rs. 10 each by M Ltd. Equity shareholders of H Ltd. will receive requisite number of equity shares of Rs. 10 each from M Ltd. valued at Rs. 10 per share.

- Compute the purchase consideration.
- Explain, how the capital reserve or goodwill, if any, will appear in the Balance Sheet of M Ltd. after absorption.

Answer

(a) Calculation of Purchase Consideration (for net assets of H Ltd. taken over)

Assets taken over:	Rs.
Goodwill as agreed	80,000
Block Assets at 10% over their book value as on 31.3.2009	6,60,000

Accounting For Corporate Restructuring

(agreed value for purposes of take over)		
Stock and Debtors		4,00,000
Cash and Bank (See Working Note)		<u>1,33,000</u>
		12,73,000
Less: Liabilities taken over:		
Creditors		<u>2,00,000</u>
		<u>10,73,000</u>
<i>Calculation of Shares Allotted:</i>		<i>Rs.</i>
Net Assets taken over		10,73,000
Less: Allotment of 10% preference shares to preference shareholders of H Ltd.		<u>3,00,000</u>
		7,73,000
Less: Belonging to M Ltd. ($\frac{1}{4} \times 7,73,000$)		<u>1,93,250</u>
Payable to other equity shareholders		<u>5,79,750</u>
Number of equity shares of Rs. 10 each to be issued (valued at Rs. 10 each) = 57,975		
<i>Calculation of Capital Reserve:</i>		<i>Rs.</i>
Net Assets taken over		10,73,000
Less: Preference shares to be allotted	3,00,000	
Equity shares to be allotted	5,79,750	
Cost of investments	<u>1,00,000</u>	<u>9,79,750</u>
Capital Reserve		<u>93,250</u>
Alternatively, Capital Reserve may be computed as follows:		
Value of investments in H Ltd.		1,93,250
Less: Cost of investments		<u>1,00,000</u>
		<u>93,250</u>

(b) Balance Sheet of M Ltd. as at 30th September, 2009 (Extract)

		<i>Rs.</i>
Capital Reserve	93,250	
Less: Goodwill	<u>80,000</u>	13,250

Financial Reporting

Working Note:

Ascertainment of Cash and Bank Balances as on 30th September, 2009

Balance Sheet as at 30th September, 2009

	Rs.		Rs.
Equity Share Capital	4,00,000	Block Assets	6,00,000
10% Preference Share Capital	3,00,000	Less: Depreciation	<u>32,500</u>
General Reserve	1,00,000	Stock and Debtors	4,00,000
Profit and Loss Account:		Cash and Bank	1,33,000
Balance brought forward	1,00,000	(Balancing figure)	
Add: Profit for the first half	<u>70,500</u>		
	1,70,500		
Less: Dividend on preference			
share capital paid	30,000		
Dividend on			
equity share			
capital paid	<u>40,000</u> <u>70,000</u>		
Creditors	<u>2,00,000</u>		
	<u>11,00,500</u>		<u>11,00,500</u>

Question 7

AB Ltd. and MB Ltd. decide to amalgamate and to form a new company AM Ltd. The following are their balance sheets as at 31.3.2010:

Liabilities	AB Ltd.	MB Ltd.	Assets	AB Ltd.	MB Ltd.
Share Capital			Fixed Assets	7,50,000	2,00,000
(Rs. 100) each	10,00,000	6,00,000	Investments:		
General Reserve	1,00,000	50,000	1,500 Shares in MB	3,50,000	—
Investment Allowance			4,000 Shares in AB	—	5,00,000
Reserve	40,000	30,000			
12% Debentures			Current Assets	4,00,000	1,00,000
(Rs. 100 each)	3,00,000	1,00,000			
Sundry Creditors	<u>60,000</u>	<u>20,000</u>			
	<u>15,00,000</u>	<u>8,00,000</u>		<u>15,00,000</u>	<u>8,00,000</u>

Calculate the amount of purchase consideration for AB Ltd. and MB Ltd. and draw up the balance sheet of AM Ltd. after considering the following:

- (a) Assume amalgamation is in the nature of purchase.
- (b) Fixed assets of AB Ltd. are to be reduced by Rs. 50,000 and that of MB Ltd. are to be taken at Rs. 3,00,000.
- (c) 12% debentureholders of AB Ltd. and MB Ltd. are discharged by AM Ltd. by issuing such number of its 15% debentures of Rs. 100 each so as to maintain the same amount of interest.
- (d) Shares of AM Ltd. are of Rs. 100 each.

Also show, how the investment allowance reserve will be treated in the Financial Statement assuming the Reserve will be maintained for 3 years.

Answer

Calculation of Purchase consideration

- (i) Value of Net Assets of AB Ltd. and MB Ltd. as on 31st March, 2010

		AB Ltd. Rs.		MB Ltd. Rs.
Assets taken over:				
Fixed Assets	7,00,000		3,00,000	
Current Assets	<u>4,00,000</u>	11,00,000	<u>1,00,000</u>	4,00,000
Less: Liabilities taken over:				
Debentures	2,40,000*		80,000**	
Sundry Creditors	<u>60,000</u>	<u>3,00,000</u>	<u>20,000</u>	<u>1,00,000</u>
		<u>8,00,000</u>		<u>3,00,000</u>

$$* 3,00,000 \times \frac{12}{100} \times \frac{100}{15} = \text{Rs. } 2,40,000$$

$$** 1,00,000 \times \frac{12}{100} \times \frac{100}{15} = \text{Rs. } 80,000$$

- (ii) Value of Shares of AB Ltd. and MB Ltd.

The value of shares of AB Ltd. is Rs. 8,00,000 plus 1/4 of the value of the shares of MB Ltd.

Similarly, the value of shares of MB Ltd. is Rs. 3,00,000 plus 2/5 of the value of shares of AB Ltd.

Let 'a' denote the value of shares of AB Ltd. and 'm' denote the value of shares of MB Ltd. then

Financial Reporting

$$a = 8,00,000 + \frac{1}{4} m ; \text{ and}$$

$$m = 3,00,000 + \frac{2}{5} a.$$

Substituting the value of m,

$$a = 8,00,000 + \frac{1}{4} (3,00,000 + \frac{2}{5} a)$$

$$a = 8,00,000 + 75,000 + \frac{1}{10} a$$

$$\frac{9}{10} a = 8,75,000$$

$$a = 9,72,222$$

$$m = 3,00,000 + \frac{2}{5} (9,72,222)$$

$$m = 6,88,889$$

(iii) Amount of Purchase Consideration

	<i>AB Ltd.</i>	<i>MB Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Total value of shares (as determined above)	9,72,222	6,88,889
Less: Internal investments:		
2/5 for shares held by MB Ltd.	3,88,889	
1/4 for shares held by AB Ltd.	<u> </u>	<u>1,72,222</u>
Amount due to outsiders	<u>5,83,333</u>	<u>5,16,667</u>

Purchase Consideration will be satisfied by AM Ltd. as follows:

	<i>AB Ltd.</i>	<i>MB Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
In shares (of Rs. 100 each)	5,83,300	5,16,600
In cash	33	67

(iv) Net Amount of Goodwill/Capital Reserve

	<i>Rs.</i>	<i>Rs.</i>
Total Purchase Consideration		
AB Ltd.	5,83,333	
MB Ltd.	<u>5,16,667</u>	11,00,000
Less: Net Assets taken over		
AB Ltd.	8,00,000	
MB Ltd.	<u>3,00,000</u>	<u>11,00,000</u>
		<u>Nil</u>

(Alternatively, the calculations may be made separately for both the companies)

Balance Sheet of AM Ltd.

as at 31st March, 2010

<i>Liabilities</i>	<i>Amount</i>	<i>Assets</i>	<i>Amount</i>
	<i>Rs.</i>		<i>Rs.</i>
Share Capital 10,999 shares of Rs. 100 each	10,99,900	Goodwill	—
(All the above shares are allotted as fully paid-up for consideration other than cash)		Fixed Assets Investments	10,00,000
Investment Allowance Reserve	70,000	Current Assets	4,99,900
15% Debentures	3,20,000	(5,00,000 – 33 – 67)	
Sundry Creditors	80,000	Miscellaneous Expenditure	
		(to the extent not written off or adjusted):	
		Amalgamation Adjustment Account	70,000
	<u>15,69,900</u>		<u>15,69,900</u>

Treatment of Investment Allowance Reserve

According to para 39 (read with para 18) of AS 14 on Accounting for Amalgamations, where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are to be complied with, the statutory reserves of the transferor company should be recorded in the financial statements of the transferee company. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Account') which should be disclosed as a part of 'miscellaneous expenditure' or other similar category in the balance sheet. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account should be reversed.

Question 8

The summarised Balance Sheets of R Ltd. and P Ltd. for the year ending on 31.3.2010 are as under:

	<i>R Ltd.</i>	<i>P Ltd.</i>		<i>R Ltd.</i>	<i>P Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>		<i>Rs.</i>	<i>Rs.</i>
Equity share Capital (in shares of Rs. 10 each)	24,00,000	12,00,000	Fixed Assets	55,00,000	27,00,000
			Current Assets	25,00,000	23,00,000

Financial Reporting

8% Preference Share Capital (in shares of Rs. 10 each)	8,00,000	–		
10% Preference Share Capital (in shares of Rs. 10 each)	–	4,00,000		
Reserves	30,00,000	24,00,000		
Current Liabilities	<u>18,00,000</u>	<u>10,00,000</u>		
	<u>80,00,000</u>	<u>50,00,000</u>	<u>80,00,000</u>	<u>50,00,000</u>

The following information is provided:

		R Ltd. Rs.	P Ltd. Rs.
(1)	(a) Profit before tax	10,64,000	4,80,000
	(b) Taxation	4,00,000	2,00,000
	(c) Preference dividend	64,000	40,000
	(d) Equity dividend	2,88,000	1,92,000
(2)	The equity shares of both the companies are quoted in the market. Both the companies are carrying on similar manufacturing operations.		
(3)	R Ltd. proposes to absorb P Ltd. as on 31.3.2010. The terms of absorption are as under:		
	(a)	Preference shareholders of P Ltd. will receive 8% preference shares of R Ltd. sufficient to increase the income of preference shareholders of P Ltd. by 10%.	
	(b)	The equity shareholders of P Ltd. will receive equity shares of R Ltd. on the following basis:	
	(i)	The equity shares of P Ltd. will be valued by applying to the earnings per share of P Ltd. 75% of price earnings ratio of R Ltd. based on the results of 2009-2010 of both the companies.	
	(ii)	The market price of equity shares of R Ltd. is Rs. 40 per share.	
	(iii)	The number of shares to be issued to the equity shareholders of P Ltd. will be based on the above market value.	
	(iv)	In addition to equity shares, 8% preference shares of R Ltd. will be issued to the equity shareholders of P Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2009-2010.	

Accounting For Corporate Restructuring

- (4) *The assets and liabilities of P Ltd. as on 31.3.2010 are revalued by professional valuer as under:*

	<i>Increased by</i>	<i>Decreased by</i>
	<i>Rs.</i>	<i>Rs.</i>
<i>Fixed Assets</i>	<i>1,00,000</i>	<i>–</i>
<i>Current Assets</i>	<i>–</i>	<i>2,00,000</i>
<i>Current Liabilities</i>	<i>–</i>	<i>40,000</i>

- (5) *For the next two years, no increase in the rate of equity dividend is expected.*

You are required to:

- (i) *Set out in detail the purchase consideration.*
- (ii) *Give the Balance Sheet as on 31.3.2010 after absorption.*

Note: Journal entries are not required.

Answer

(i) Computation of Purchase Consideration

	<i>Rs.</i>
(a) <i>Preference Shareholders</i>	
Current income of preference shareholders of P Ltd.	40,000
Add: 10% increase thereof	<u>4,000</u>
	<u>44,000</u>
Preference shares to be issued	
$= 44,000 \times \frac{100}{8} =$	5,50,000

- (b) *Equity Shareholders*
 (1) *Issue of Equity Shares*
 P/E ratio in R Ltd.

	<i>Rs.</i>
Profit before tax	10,64,000
Less: Tax	<u>4,00,000</u>
	6,64,000
Less: Preference dividend	<u>64,000</u>
Profit available for equity shareholders	<u>6,00,000</u>

Financial Reporting

$$\text{Earnings per share (EPS)} = \frac{6,00,000}{2,40,000} = \text{Rs. } 2.50$$

$$\text{Price earnings ratio (P/E)} = \frac{40}{2.50} = \text{Rs. } 16$$

EPS of P Ltd:

	Rs.
Profit before tax	4,80,000
Less: Tax	<u>2,00,000</u>
Profit after tax	2,80,000
Less: Preference dividend	<u>40,000</u>
Profit available for equity shareholders	<u>2,40,000</u>
EPS = $\frac{2,40,000}{1,20,000}$	= Rs. 2

Valuation of equity shares of P Ltd:

$$= 1,20,000 \text{ shares} \times (\text{Rs. } 2 \times 16 \times 0.75 \text{ i.e. Rs. } 24)$$

$$= \text{Rs. } 28,80,000$$

Number of equity shares to be issued:

$$= \frac{28,80,000}{40} = 72,000$$

	Rs.
Equity Share Capital	7,20,000
Securities Premium	<u>21,60,000</u>
	<u>28,80,000</u>

(2) *Issue of Preference Shares*

	Rs.
Current equity dividend	1,92,000
Less: Expected equity dividend from R Ltd. (Rs. 7,20,000 × 2,88,000/24,00,000)	<u>86,400</u>
Loss in income	<u>1,05,600</u>

$$8\% \text{ Preference Shares to be issued} = \frac{1,05,600}{0.08} = \text{Rs. } 13,20,000$$

Accounting For Corporate Restructuring

Total Purchase Consideration:		Rs.
Preference shares to be issued	5,50,000	
	<u>13,20,000</u>	18,70,000
Equity shares to be issued (at premium)		<u>28,80,000</u>
		<u>47,50,000</u>

(ii)

R Ltd.

Balance Sheet as at 31st March, 2010 (after absorption)

Schedule No. Rs.

SOURCES OF FUNDS

(1) Shareholders' funds:			
(a) Capital	A	57,90,000	
(b) Reserves and Surplus	B	<u>51,60,000</u>	1,09,50,000
(2) Loan funds			--
Total			<u>1,09,50,000</u>

APPLICATION OF FUNDS

(1) Fixed assets:			
Net block	C	91,10,000	
(2) Investments			—
(3) Net Current assets	D	<u>18,40,000</u>	
Total			<u>1,09,50,000</u>

Schedules to Balance Sheet

Rs.

A. Share Capital:	
3,12,000 Equity Shares of Rs. 10 each (of the above shares, 72,000 equity shares are allotted as fully paid up for consideration other than cash)	31,20,000
2,67,000 8% Preference Shares of Rs. 10 each (of the above, 1,87,000 are allotted as fully paid up for consideration other than cash)	<u>26,70,000</u>
	<u>57,90,000</u>
B. Reserves and Surplus:	
As per last Balance Sheet	30,00,000

Financial Reporting

Securities Premium	<u>21,60,000</u>
	<u>51,60,000</u>
C. Fixed Assets:	
As per last Balance Sheet	55,00,000
Taken over on absorption of P Ltd.	<u>28,00,000</u>
	83,00,000
Goodwill	<u>8,10,000</u>
	<u>91,10,000</u>
D. Net Current Assets:	
As per last Balance Sheet	7,00,000
Taken over on absorption of P Ltd.	<u>11,40,000</u>
	<u>18,40,000</u>

Working Note:

Calculation of Goodwill on Absorption

		Rs.
Purchase consideration		47,50,000
Fixed assets taken over	28,00,000	
Current assets taken over	<u>21,00,000</u>	
	49,00,000	
Less: Current liabilities	<u>9,60,000</u>	
Net assets taken over		<u>39,40,000</u>
Goodwill		<u>8,10,000</u>

Question 9

The Balance Sheets of O Ltd. and P Ltd. as on 31st March, 2010 are as under:

				(Rs. in lakhs)	
Liabilities	O	P	Assets	O	P
Equity Shares of Rs.10 each	25.00	50.00	Fixed Assets	110.00	50.00
Reserves	131.00	29.25	Investments	16.25	25.00
12% Debentures	11.00	5.50	Current Assets	40.25	3.25
Creditors	8.00	2.75	Miscellaneous Expenditure	8.50	9.25
	<u>175.00</u>	<u>87.50</u>		<u>175.00</u>	<u>87.50</u>

Accounting For Corporate Restructuring

Investments of O Ltd. represent 1,25,000 shares of P Ltd. Investments of P Ltd. are considered worth Rs. 30 lakhs.

P Ltd. is taken over by O Ltd. on the basis of the intrinsic value of shares in their respective books of account.

Prepare a statement showing the number of shares to be allotted by O Ltd. to P Ltd. and the Balance Sheet of O Ltd. after absorption of P Ltd.

Answer

Balance sheet of O Ltd. (after absorption)

Liabilities	Amount	Assets	(Rs. in lakhs) (Amount)
SHARE CAPITAL		FIXED ASSETS	
3,43,750 Equity Shares of Rs. 10 each	34.375	Fixed Assets	110.000
(Of the above shares, 93,750 equity shares are allotted as fully paid-up for consideration other than cash)		Add: Taken over INVESTMENT	<u>50.000</u> 160.000 30.000
RESERVES AND SURPLUS			
As per last Balance Sheet	131.00	CURRENT ASSETS, LOANS AND ADVANCES	
Capital Reserve	2.500	Current Assets	40.250
Securities Premium	<u>46.875</u>	Add: Taken over	<u>3.250</u> 43.500
	180.375	MISCELLANEOUS EXPENDITURE	8.500
SECURED LOANS			
12% Debentures	11.000		
Add: Taken over	<u>5.500</u>		
	16.500		
CURRENT LIABILITIES AND PROVISIONS			
Creditors	8.000		
Add: Taken over	<u>2.750</u>		
	<u>10.750</u>		
	<u>242.000</u>		<u>242.000</u>

Financial Reporting

Working Notes:

(a) (i) Calculation of Net Assets	(Rs. in lakhs)	
	<i>O Ltd.</i>	<i>P Ltd.</i>
Fixed Assets	110.00	50.00
Investments	18.75*	30.00
Current Assets	<u>40.25</u>	<u>3.25</u>
	<u>169.00</u>	<u>83.25</u>
12% Debentures	11.00	5.50
Creditors	<u>8.00</u>	<u>2.75</u>
	<u>19.00</u>	<u>8.25</u>
Net Assets	<u>150.00</u>	<u>75.00</u>
	<i>O Ltd.</i>	<i>P Ltd.</i>
(ii) Number of equity shares	2.50 lakhs	5.00 lakhs
Intrinsic Value	Rs. 60.00	Rs. 15.00
* 1.25 lakhs shares × Rs. 15		
(b) Calculation of Shares Allotted	(Rs. in lakhs)	
Net assets taken over		75.00
Less: Belonging to O Ltd. $\left(\frac{1,25,000}{5,00,000} \times 75 \text{ lakhs} \right)$		<u>18.75</u>
Payable to other equity shareholders		<u>56.25</u>
Number of equity shares of Rs. 10 each to be issued = $\frac{\text{Rs. } 56,25,000}{\text{Rs. } 60}$		
= 93,750 shares (valued at Rs. 60 each)		
Credit to share capital		Rs. 9,37,500
Credit to securities premium		Rs. 46,87,500

Question 10

A Ltd. agreed to take over B Ltd. as on 1st October, 2009. No Balance Sheet of B was prepared on that date:

Balance Sheets of A and B as at 31st March, 2009 were as follows:

	A Rs.	B Rs.		A Rs.	B Rs.
Share Capital:			Fixed Assets	12,50,000	8,75,000
Equity shares of Rs. 10 each fully paid up	15,00,000	10,00,000	Current Assets:		
Reserves and Surplus:			Stock	2,37,500	1,87,500
Reserve	4,15,000	2,56,000	Debtors	3,90,000	2,56,000
Profit and Loss	1,87,500	1,50,000	Bank	2,93,750	1,50,000
Creditors	93,750	75,000	Miscellaneous		
			Expenditure:		
			Preliminary Expenses	<u>25,000</u>	<u>12,500</u>
	<u>21,96,250</u>	<u>14,81,000</u>		<u>21,96,250</u>	<u>14,81,000</u>

Additional information available:

- (i) *For the six months period from 1st April, 2009, A made a profit of Rs. 4,20,000 after writing off depreciation at 10% per annum on its fixed assets.*
- (ii) *For the same period, B made a net profit of Rs. 2,04,000 after writing off depreciation at 10% p.a. on its fixed assets.*
- (iii) *Both the companies paid on 1st August, 2009, equity dividends of 15%. Tax at 10% on such payments was also paid by each of them.*
- (iv) *Goodwill of B was valued at Rs. 1,20,000 on the date of take-over; stock of B, subject to an abnormal item of Rs. 7,500 to be fully written off, would be appreciated by 25% for purpose of take-over:*
- (v) *A to issue to B's shareholders fully paid equity shares of Rs. 10 each, on the basis of the comparative intrinsic values of the shares on the take-over date.*

Draft the Balance Sheet of A after absorption of B. All workings are to form part of your answer.

Financial Reporting

Answer

Balance Sheet of A Ltd. (after absorption of B Ltd.)

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>	<i>Rs.</i>
<i>Share Capital</i>		<i>Fixed Assets</i>		
2,56,000 Equity Shares of Rs. 10 each fully paid (1,06,000 shares allotted as fully paid without payment being received in cash)	25,60,000	Goodwill		1,20,000
		Other Fixed Assets	21,25,000	
		(12,50,000 + 8,75,000)		
		Less: Depreciation	<u>1,06,250</u>	20,18,750
<i>Reserves and Surplus</i>		<i>Current Assets, Loans and Advances</i>		
Securities Premium	5,30,000	Stock		
Reserves	4,15,000	(2,37,500 + 2,25,000)		4,62,500
Profit and Loss Account	3,60,000	Debtors		
<i>Current Liabilities</i>		(3,90,000 + 2,56,000)		6,46,000
Creditors	1,68,750	Bank Balance		
		(5,28,750 + 2,32,750)		7,61,500
		<i>Miscellaneous Expenditure</i>		
		Preliminary Expenses		<u>25,000</u>
	<u>40,33,750</u>			<u>40,33,750</u>

Working Notes:

(1) Bank Balance on 1.10.2009

	<i>A Ltd.</i>	<i>B Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Bank Balance as on 31.3.2009	2,93,750	1,50,000
Add: Net Profit	4,20,000	2,04,000
Depreciation	<u>62,500</u>	<u>43,750</u>
	7,76,250	3,97,750
Less: Dividend	<u>2,25,000</u>	<u>1,50,000</u>
	5,51,250	2,47,750
Less: Dividend Tax	<u>22,500</u>	<u>15,000</u>
Bank Balance as on 1.10.2009	<u>5,28,750</u>	<u>2,32,750</u>

Accounting For Corporate Restructuring

(2) Profit and Loss Account as on 1.10.2009

	<i>A Ltd.</i>	<i>B Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Balance as on 31.3.2009	1,87,500	1,50,000
Add: 6 months' profit	<u>4,20,000</u>	<u>2,04,000</u>
	6,07,500	3,54,000
Less: Dividend	2,25,000	1,50,000
Dividend tax	<u>22,500</u>	<u>15,000</u>
	<u>3,60,000</u>	<u>1,89,000</u>

(3) **Balance Sheets of A Ltd. and B Ltd.**

as on 1st October, 2009 (before absorption)

	<i>A Ltd.</i>	<i>B Ltd.</i>		<i>A Ltd.</i>	<i>B Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>		<i>Rs.</i>	<i>Rs.</i>
Share Capital	15,00,000	10,00,000	Fixed Assets	12,50,000	8,75,000
Reserves	4,15,000	2,56,000	Less: Depreciation	<u>(62,500)</u>	<u>(43,750)</u>
Profit and Loss	3,60,000	1,89,000	Net Fixed Assets	11,87,500	8,31,250
Creditors*	93,750	75,000	Current Assets		
			Stock*	2,37,500	1,87,500
			Debtors*	3,90,000	2,56,000
			Bank	5,28,750	2,32,750
			Miscellaneous		
			Expenditure		
			Preliminary		
			Expenses	<u>25,000</u>	<u>12,500</u>
	<u>23,68,750</u>	<u>15,20,000</u>		<u>23,68,750</u>	<u>15,20,000</u>

*It is assumed that these amounts as on 1st October, 2009 are same in the absence of any other information.

(4) Purchase consideration

	<i>A Ltd.</i>	<i>B Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Goodwill	—	1,20,000
Fixed Assets	11,87,500	8,31,250
Stock	2,37,500	2,25,000
Debtors	3,90,000	2,56,000

Financial Reporting

Bank Balance	<u>5,28,750</u>	<u>2,32,750</u>
	23,43,750	16,65,000
Less: Creditors	<u>93,750</u>	<u>75,000</u>
Net Assets	<u>22,50,000</u>	<u>15,90,000</u>
Number of Shares	1,50,000	1,00,000
Intrinsic value	15.00	15.90

Purchase consideration Rs. 15,90,000 in the form of Share capital Rs. 10,60,000 and securities premium Rs. 5,30,000.

Question 11

The following are the Balance Sheets of A Ltd. and B Ltd. as on 31st December, 2009:

Liabilities	A Ltd. Rs.	B Ltd. Rs.	Assets	A Ltd. Rs.	B Ltd. Rs.
Share Capital			Fixed Assets	7,00,000	2,50,000
Equity Shares of Rs. 10 each	6,00,000	3,00,000	Investment:		
10% Pref. Shares of Rs. 100 each	2,00,000		6,000 Shares of B Ltd.	80,000	—
			5,000 Shares of A Ltd.	—	80,000
Reserves and Surplus	3,00,000	1,00,000			
		2,00,000			
Secured Loans:			Current Assets:		
12% Debentures	2,00,000	1,50,000	Stock	2,40,000	3,20,000
Current Liabilities:			Debtors	3,60,000	1,90,000
Sundry Creditors	2,20,000	1,25,000	Bills Receivable	60,000	20,000
Bills Payable	<u>30,000</u>	<u>25,000</u>	Cash at Bank	<u>1,10,000</u>	<u>40,000</u>
	<u>15,50,000</u>	<u>9,00,000</u>		<u>15,50,000</u>	<u>9,00,000</u>

Fixed Assets of both the companies are to be revalued at 15% above book value. Stock in Trade and Debtors are taken over at 5% lesser than their book value. Both the companies are to pay 10% Equity dividend, Preference dividend having been already paid.

After the above transactions are given effect to, A Ltd. will absorb B Ltd. on the following terms:

- (i) 8 Equity Shares of Rs. 10 each will be issued by A Ltd. at par against 6 shares of B Ltd.

Accounting For Corporate Restructuring

- (ii) 10% Preference Shareholders of B Ltd. will be paid at 10% discount by issue of 10% Preference Shares of Rs. 100 each at par in A Ltd.
- (iii) 12% Debentureholders of B Ltd. are to be paid at 8% premium by 12% Debentures in A Ltd. issued at a discount of 10%.
- (iv) Rs. 30,000 is to be paid by A Ltd. to B Ltd. for Liquidation expenses. Sundry Creditors of B Ltd. include Rs. 10,000 due to A Ltd.

Prepare:

- (a) Absorption entries in the books of A Ltd.
- (b) Statement of consideration payable by A Ltd.

Answer

(a) Absorption Entries in the Books of A Ltd.

		Dr. Rs.	Cr. Rs.
Fixed Assets	Dr.	1,05,000	
To Revaluation Reserve			1,05,000
(Revaluation of fixed assets at 15% above book value)			
Bank Account	Dr.	6,000	
To Reserves and Surplus			6,000
(Dividend received from B Ltd. on 6,000 shares)			
Reserve and Surplus	Dr.	60,000	
To Equity Dividend			60,000
(Declaration of equity dividend @ 10%)			
Equity Dividend	Dr.	60,000	
To Bank Account			60,000
(Payment of equity dividend)			
Business Purchase Account	Dr.	3,60,000	
To Liquidator of B Ltd.			3,60,000
(Consideration payable for the business taken over from B Ltd.)			
Fixed Assets (115% Rs. 2,50,000)	Dr.	2,87,500	
Stock (90% Rs. 3,20,000)	Dr.	3,04,000	
Debtors	Dr.	1,90,000	

Financial Reporting

Bills Receivable	Dr.	20,000	
Cash at Bank	Dr.	15,000	
(Rs. 40,000 – Rs. 30,000 dividend paid + Rs. 5,000 dividend received)			
To Provision for Bad Debts (5% of Rs.1,90,000)			9,500
To Sundry Creditors			1,25,000
To 12% Debentures in B Ltd.			1,62,000
To Bills Payable			25,000
To Business Purchase Account			3,90,000
To Investments in B Ltd.			80,000
To Capital Reserve (Balancing figure)			25,000
(Incorporation of various assets and liabilities taken over from B Ltd. at agreed values and cancellation of investment in B Ltd. account, profit being credited to capital reserve)			
Liquidator of B Ltd.	Dr.	3,60,000	
To Equity Share Capital			2,70,000
To 10% Preference Share Capital			90,000
Discharge of consideration for B Ltd.'s business)			
Capital Reserve	Dr.	30,000	
To Bank Account			30,000
(Payment of liquidation expenses)			
12% Debentures in B Ltd. (Rs. 1,50,000 × 108%)	Dr.	1,62,000	
Discount on Issue of Debentures		18,000	
To 12% Debentures			1,80,000
(Allotment of 12% Debentures to debenture holders at a discount of 10% to discharge the liability on B Ltd. debentures)			
Sundry Creditors	Dr.	10,000	
To Sundry Debtors			10,000
(Cancellation of mutual owing)			
(b) Statement of Consideration payable by A Ltd.			
For equity shares held by outsiders			
Shares held by them 30,000 – 6,000 = 24,000			

Accounting For Corporate Restructuring

Shares to be allotted $\frac{24,000}{6} \times 8 = 32,000$

as 5,000 shares are already with B Ltd; i.e. A Ltd. will now issue only 27,000 shares of Rs. 10 each i.e. Rs. 2,70,000 (i).

For 10% preference shares, to be paid at 10% discount

Rs. $\frac{1,00,000 \times 90}{100}$ Rs. 90,000 (ii)

Consideration amount [(i) + (ii)] Rs. 3,60,000

Note: It has been assumed that dividend on equity shares have been paid by both the companies.

Question 12

The following are the Balance Sheets of RS Ltd. and XY Ltd. as on 31.3.2010:

	Rs. in '000s				
Liabilities	RS Ltd.	XY Ltd.	Assets	RS Ltd.	XY Ltd.
	Rs.	Rs.		Rs.	Rs.
Share Capital:			Fixed Assets net of		
Equity Shares of Rs. 100 each fully paid up	2,000	1,000	depreciation	2,700	850
			Investments	700	—
Reserves and Surplus	800	—	Sundry Debtors	400	150
10% Debentures	500	—	Cash and Bank	250	—
Loan from Financial Institutions	250	400	Profit and Loss Account	—	800
Bank Overdraft	—	100			
Sundry Creditors	300	300			
Proposed Dividend	<u>200</u>	<u>—</u>			
Total	<u>4,050</u>	<u>1,800</u>	Total	<u>4,050</u>	<u>1,800</u>

It was decided that XY Ltd. will acquire the business of RS Ltd. for enjoying the benefit of carry forward of business loss. After acquisition, XY Ltd. will be renamed as XYZ Ltd. The following scheme has been approved for the merger:

- (i) XY Ltd. will reduce its shares to Rs. 10 and then consolidate 10 such shares into one share of Rs. 100 each (New Share).

Financial Reporting

- (ii) Financial institutions agreed to waive 15% of the loan of XY Ltd.
- (iii) Shareholders of RS Ltd. will be given one new share of XY Ltd. in exchange of every share held in RS Ltd.
- (iv) RS Ltd. will cancel 20% holding of XY Ltd. Investments were held at Rs. 250 thousands.
- (v) After merger the proposed dividend of RS Ltd. will be paid to the shareholders of RS Ltd.
- (vi) Authorised Capital of XY Ltd. will be raised accordingly to carry out the scheme.
- (vii) Sundry creditors of XY Ltd. includes payable to RS Ltd. Rs. 1,00,000.

Pass the necessary entries to implement the scheme in the books of RS Ltd. and XY Ltd. and prepare a Balance Sheet of XYZ Ltd.

Answer

Journal Entries in the books of RS Ltd.

	(Rs. '000)	
	Dr.	Cr.
	Rs.	Rs.
10% Debentures Account	Dr. 500	
Loan from Financial Institutions Account	Dr. 250	
Sundry Creditors Account	Dr. 300	
Proposed Dividend Account	Dr. 200	
Realisation Account	Dr. 2,800	
To Fixed Assets Account		2,700
To Investments Account		700
To Sundry Debtors Account		400
To Cash and Bank Account		250
(Transfer of assets and liabilities to realisation account)		
Share Capital Account	Dr. 2,000	
Reserve and Surplus Account	Dr. 800	
To Equity Shareholders Account		2,800
(Transfer of share capital, reserve and surplus to shareholders account)		
Equity Shareholders Account	Dr. 250	
To Realisation Account		250
(Cancellation of 20% holding of XY Ltd. held as investments)		

Accounting For Corporate Restructuring

Shares in XYZ Ltd.	Dr. 2,000	
To Realisation Account		2,000
(Issue of shares by XYZ Ltd. in the ratio of 1 : 1)		
Equity Shareholders Account	Dr. 550	
To Realisation Account		550
(Transfer of loss on realisation)		
Equity Shareholders Account	Dr. 2,000	
To Shares in XYZ Ltd.		2,000
(Distribution of Shares of XYZ Ltd. among the shareholders)		

Journal Entries in the books of XY Ltd.

			(Rs. '000)
		Dr.	Cr.
		Rs.	Rs.
Equity Share Capital (Face value – Rs. 100) Account	Dr.	1,000	
To Equity Share Capital (Face value – Rs. 10) Account			100
To Reconstruction Account			900
(Face value of equity shares of Rs. 100 each reduced to Rs. 10 each)			
Equity Share Capital (Face value – Rs. 10 each) A/c	Dr.	100	
To Equity Share Capital Account			100
(Face value – Rs. 100 each)			
(Consolidation of 10,000 equity shares of Rs. 10 each to 1,000 equity shares of Rs. 100 each)			
Loan from Financial Institutions Account	Dr.	60	
To Reconstruction Account			60
(Waiver of 15% of loan by financial institutions)			
Reconstruction Account (900 + 60)	Dr.	960	
To Profit and Loss Account			800
To Capital Reserve			160
(Utilisation of Reconstruction account balance to write off the Profit and Loss Account)			

Financial Reporting

Proposed Dividend Account	Dr.	200	
To Bank Account			200
(Payment of Proposed dividend to shareholders of RS Ltd.)			
Fixed Assets Account	Dr.	2,700	
Other Investments Account	Dr.	450	
Sundry Debtors Account	Dr.	400	
Cash and Bank Account	Dr.	250	
To Reserves Account			570
To 10% Debentures Account			500
To Loan from Financial Institutions Account			250
To Sundry Creditors Account			300
To Proposed Dividend Account			200
To Business Purchase Account			1,980
(Incorporation of various assets and liabilities acquired from RS Ltd. after cancellation of investment held by RS Ltd. in XY Ltd., profit on acquisition credited to Reserves Account)			
Business Purchase Account	Dr.	1,980	
To Liquidator of RS Ltd.			1,980
(Consideration Payable on business acquired from RS Ltd.)			
Liquidator of RS Ltd.	Dr.	1,980	
To Equity Share Capital of XYZ Ltd.			1,980
(Discharge of purchase consideration in the form of equity shares of XYZ Ltd.)			
Sundry Creditors Account	Dr.	100	
To Sundry Debtors Account			100
(Cancellation of intercompany owings)			

Balance Sheet of XYZ Ltd.

as on 31st March, 2010 (immediately after acquisition)

(Rs. in 000's)

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets net of depreciation	3,550
20,800 Equity Shares @ Rs. 100		Investments	450

Accounting For Corporate Restructuring

each (1,980 + 20 + 80)	2,080	Sundry Debtors	450
Capital Reserve	160		
General Reserve	570		
10% Debentures	500		
Loan from financial institutions	590		
Bank Overdraft (100 – 250 + 200)	50		
Sundry Creditors	<u>500</u>		<u> </u>
	<u>4,450</u>		<u>4,450</u>

Working Notes:

		Rs.
1. Original Share Capital of XY Ltd.		
10,000 Equity Shares of Rs. 100 each		10,00,000
Share Capital of XY Ltd. after Reduction		
10,000 Equity Shares of Rs. 10 each		1,00,000
2. Share Capital of XY Ltd. after Reconsolidation		
1,000 Equity Shares of Rs. 100 each		1,00,000
3. Reduced value of holdings of RS Ltd. in XY Ltd.		
RS Ltd. was holding 20% of XY Ltd., that is,		
2,000 Equity Shares of Rs. 100 each		2,00,000
which has now reduced to 200 Equity Shares of Rs. 100 each		20,000
4. Calculation of Purchase Consideration		
Equity Share Capital of RS Ltd. 20,000 Equity Shares of Rs. 100 each		20,00,000
Exchange Ratio = 1 : 1		
No. of Equity Shares to be given	20,000	
Less: No. of Equity Shares already held by RS Ltd.	<u>200</u>	
	<u>19,800</u>	
Purchase consideration		
19,800 Equity Shares of Rs. 100 each	19,80,000	

Financial Reporting

5.	Aggregate Reserves in the new company on acquisition	
	Reserves of RS Ltd. acquired	8,00,000
	Less: Loss on investments held by RS Ltd.	
	Value of investments cancelled	2,50,000
	Less: Reduced value of shares of XY Ltd.	<u>20,000</u>
		2,30,000
	Amount of Reserves to be carried to Balance Sheet	<u>5,70,000</u>
6.	Share Capital in Combined Balance Sheet of XYZ Ltd.	
	Holding of RS Ltd. (200 Equity Shares @ Rs. 100 each)	20,000
	Other Existing Shares (800 Equity Shares of Rs. 100 each)	80,000
	Given as Purchase Consideration (19,800 equity shares @ Rs.100 each)	<u>19,80,000</u>
		<u>20,80,000</u>
7.	It has been assumed that the bank overdraft and cash balance can be netted of.	

Alternative Solution:

The candidates may pass a journal entry in the books of XY Ltd. for cancellation of shares held by RS Ltd.

In that case the first three entries in books of XY Ltd. will remain the same, further:-

		(Rs. '000)
	Dr.	Cr.
	Rs.	Rs.
Equity Share Capital Account	Dr. 20	
To Reconstruction Account		20
Equity Share Capital (Rs.10) Account	Dr. 80	
To Equity Share Capital Account (Rs.100)		80
Reconstruction Account	Dr. 980	
To Profit and Loss Account		800
To Capital Reserve		180
Fixed Assets Account	Dr. 2,700	
Other Investments Account	Dr. 450	
Sundry Debtors Account	Dr. 400	

Accounting For Corporate Restructuring

Cash and Bank Account	Dr.	250	
To Reserves Account			550
To 10% Debentures Account			500
To Loan from Financial Institutions Account			250
To Sundry Creditors Account			300
To Proposed Dividend Account			200
To Business Purchase Account			2,000
Business Purchase Account	Dr.	2,000	
To Liquidator of RS Ltd.			2,000
Liquidator of RS Ltd.	Dr.	2,000	
To Equity Shares (Rs.10 each)			2,000

Note: In the Balance Sheet, capital reserve will go up by Rs.20,000 and general reserve will come down by Rs. 20,000.

Question 13

The following are the Balance Sheets of C Ltd. and D Ltd. on 31st March, 2009:

Balance Sheets

Liabilities	C Ltd. Rs.	D Ltd. Rs.	Assets	C Ltd. Rs.	D Ltd. Rs.
Equity Shares of Rs. 100 each fully paid	45,00,000	15,00,000	Fixed Assets	30,00,000	1,50,000
General Reserve	4,00,000	3,00,000	Investments		
Profit and Loss A/c	7,34,000	30,000	3,000 shares in D Ltd.	4,50,000	—
14% Debentures	—	9,00,000	9,000 Shares in C Ltd.	—	15,00,000
Current Liabilities	6,00,000	2,70,000	Debtors	8,70,000	4,50,000
			Stock	14,40,000	6,30,000
			Bank Balance	4,74,000	2,70,000
	<u>62,34,000</u>	<u>30,00,000</u>		<u>62,34,000</u>	<u>30,00,000</u>

Stock of C Ltd. includes goods worth Rs. 3,00,000 purchased from D Ltd., which made a profit of 20% on selling price. As on 31.3.2009, C Ltd. owes to D Ltd. Rs. 1,20,000. C Ltd. absorbs D Ltd. on the basis of the intrinsic value of the shares of both companies as on 31st March, 2009. Before absorption C Ltd. has declared a dividend of 12%. Dividend tax is 10%.

Show the Balance Sheet of C Ltd. after the absorption of D Ltd. and the working for the number of shares issued.

Financial Reporting

Answer

(a) (i) Computation of Net Assets excluding Inter-Company Investments.

	<i>C Ltd</i> Rs.	<i>D Ltd</i> Rs.
<i>A Total Assets</i>		
Tangible Assets	57,84,000	15,00,000
Dividend Receivable	<u>-</u>	<u>1,08,000</u>
	<u>57,84,000</u>	<u>16,08,000</u>
<i>B. External Liabilities</i>		
Current Liabilities	6,00,000	2,70,000
Proposed Dividend	5,40,000	-
Dividend Tax	54,000	-
14% Debentures	<u>-</u>	<u>9,00,000</u>
	<u>11,94,000</u>	<u>11,70,000</u>
<i>C. Net Assets (A – B)</i>	<u>45,90,000</u>	<u>4,38,000</u>

(ii) Intrinsic value of equity shares.

Assume 'a' is the intrinsic value (net assets including inter company investments) of equity shares of C Ltd and 'b' is the intrinsic value of equity shares of D Ltd.

$$a = \text{Rs.} 45,90,000 + \frac{1}{5} \times b \quad (1)$$

$$b = \text{Rs.} 4,38,000 + \frac{1}{5} \times a \quad (2)$$

$$\text{or } b = \text{Rs.} 4,38,000 + \frac{1}{5} \left(45,90,000 + \frac{1}{5} \times b \right)$$

$$\text{or } b = \text{Rs.} 4,38,000 + 9,18,000 + \frac{b}{25}$$

$$\text{or } \frac{24}{25} \times b = \text{Rs.} 13,56,000$$

$$\text{or } b = \frac{\text{Rs.} 13,56,000}{24} \times 25 = \text{Rs.} 14,12,500$$

Putting the value of b in equation (1) we get,

$$a = \text{Rs.} 45,90,000 + \frac{1}{5} \times 14,12,500 = \text{Rs.} 48,72,500$$

Accounting For Corporate Restructuring

Intrinsic value of share of C Ltd. = $\frac{\text{Rs } 48,72,500}{45,000}$ = Rs. 108.278 approximately

Intrinsic value of share of D Ltd = $\frac{\text{Rs } 14,12,500}{15,000}$ = Rs.94.167 approximately.

(iii) Calculation of Purchase consideration

Value of shares held by outside shareholders in D Ltd: $\frac{\text{Rs. } 14,12,500 \times 12,000}{15,000}$
= Rs 11,30,000

Shares to be issued by C Ltd on the basis of intrinsic value of shares = Rs.11,30,000 x (45,000 / 48,72,500)	10,436.12
Less: Shares held by D Ltd	<u>9,000.00</u>
Number of shares to be issued	<u>1,436.12</u>
Total purchase price for outside shareholders	Rs.
Additional shares in C Ltd. (1,436 x Rs.108.278)	1,55,487*
Cash for fractional shares (0.12 x Rs. 108.278)	13*
Value of 3000 shares held by C Ltd	<u>2,82,500</u>
	<u>4,38,000</u>

(iv) General Reserve (C Ltd)

	Rs.
As per Balance sheet	4,00,000
Less: Reduction in value of shares held in D Ltd (Rs. 4,50,000 - 2,82,500)	<u>1,67,500</u>
	<u>2,32,500</u>

(v) Bank Balance

	C Ltd. Rs.	D Ltd. Rs.
As per Balance Sheet	4,74,000	2,70,000
Add: Dividend received	<u> </u>	<u>1,08,000</u>
	4,74,000	3,78,000
Less: Dividend 5,40,000		
Dividend tax 54,000		
Cash for fractional shares <u>13</u>	<u>5,94,013</u>	<u> </u>
	<u>(1,20,013)</u>	<u>3,78,000</u>
		= Rs. 2,57,987.

Financial Reporting

Balance Sheet of C Ltd (after absorption of D Ltd)

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Share Capital :		Goodwill	60,000
Issued and Subscribed		Other Fixed Assets	31,50,000
46,436 shares of Rs.100 each fully paid (1,436 shares allotted to vendors for consideration other than cash)	46,43,600	Current Assets, Loans and Advances:	
Reserves and Surplus:		Stock	20,70,000
General Reserve	2,32,500	Less: Unrealised Profit (Goodwill)	<u>60,000**</u>
Profit and Loss Account		Bank Balance	2,57,987
(Rs.7,34,000 – Rs.5,40,000 – Rs.54,000)	1,40,000	Debtors	13,20,000
Securities Premium		Less: Inter Co. dues	<u>1,20,000</u>
(Rs.1,55,487 – Rs.1,43,600)	11,887		12,00,000
Secured Loans:			
14% Debentures	9,00,000		
Current Liabilities and Provisions:			
Current Liabilities	Rs. 8,70,000		
Less: Inter-Co. dues	Rs. <u>1,20,000</u>		
	<u>7,50,000</u>		
	<u>66,77,987</u>		<u>66,77,987</u>

* Appropriate figures have been considered

**Alternatively this sum can also be adjusted against the balance in the Profit and Loss Account.

Question 14

The summarized Balance sheets of X Ltd. and its subsidiary Y Ltd. as at 31.3.2010 were as follows:

<i>Liabilities</i>	<i>X Ltd.</i>	<i>Y Ltd.</i>	<i>Assets</i>	<i>X Ltd.</i>	<i>Y Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>		<i>Rs.</i>	<i>Rs.</i>
Share capital	50,00,000	10,00,000	Fixed assets	60,00,000	18,00,000
(Share of Rs.10 each)			Investment in Y Ltd. (60,000 shares)	6,00,000	---
General reserves	50,00,000	20,00,000	Sundry debtors	35,00,000	5,00,000
Profit and Loss			Inventories	30,00,000	25,00,000

Accounting For Corporate Restructuring

account	20,00,000	15,00,000		
Secured loan	20,00,000	2,50,000	Cash and bank	39,00,000 2,00,000
Current liabilities	<u>30,00,000</u>	<u>2,50,000</u>		
	<u>1,70,00,000</u>	<u>50,00,000</u>	<u>1,70,00,000</u>	<u>50,00,000</u>

X Ltd. holds 60% of the paid-up capital of Y Ltd. and the balance is held by a foreign company.

A memorandum of understanding has been entered into with the foreign company by X Ltd. to the following effect:

- (i) The shares held by the foreign company will be sold to X Ltd. at a price per share to be calculated by capitalizing the yield at 15%. Yield, for this purpose, would mean 50% of the average of pre-tax profits for the last 3 years, which were Rs.12 lakhs, 18 lakhs and 24 lakhs respectively. (Average tax rate was 40%).
- (ii) The actual cost of shares to the foreign company was Rs.4,40,000 only. Gains accruing to the foreign company are taxable at 20%. The tax payable will be deducted from the sale proceeds and paid to government by X. 50% of the consideration (after payment of tax) will be remitted to the foreign company by X Ltd. and also any cash for fractional shares allotted.
- (iii) For the balance of consideration, X Ltd. would issue its shares at their intrinsic value.

It was also decided that X Ltd. would absorb Y Ltd. Simultaneously by writing down the Fixed assets of Y Ltd. by 10%. The Balance Sheet figures included a sum of Rs.1,00,000 due by Y Ltd. to X Ltd. and stock of X Ltd. included stock of Rs.1,50,000 purchased from Y Ltd., who sold them at cost plus 20%.

The entire arrangement was approved and put through by all concern effective from 1.4.2010.

You are required to indicate how the above arrangements will be recorded in the books of X Ltd. and also prepare a Balance Sheet after absorption of Y Ltd. Workings should form part of your answer.

Answer

X Ltd.

Balance Sheet as at 1st April, 2010

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Share Capital:			
Shares	5,00,000	Fixed Assets	78,00,000

Financial Reporting

Shares issued in lieu of purchase consideration	<u>33,466</u>		Less :Revaluation loss	<u>1,80,000</u>	76,20,000
(Shares of Rs.10 each)	5,33,466	53,34,660	Sundry Debtors		
			(35,00,000+5,00,000)	40,00,000	
General Reserve		50,00,000	Less: Mutual Debts	<u>1,00,000</u>	39,00,000
Capital Reserve		13,20,000			
Profit and Loss Account	20,00,000		Inventories		
			(30,00,000+25,00,000)	55,00,000	
Less: unrealized profit on stock	<u>25,000</u>	19,75,000	Less: Unrealised profit on stock	<u>25,000</u>	54,75,000
Securities Premium (33,466×20)		6,69,320			
Secured Loans (20,00,000 + 2,50,000)		22,50,000	Cash at Bank		27,03,980
Current Liabilities (30,00,000 + 2,50,000)	32,50,000				
Less: Mutual Debts	<u>1,00,000</u>	<u>31,50,000</u>			
		<u>1,96,98,980</u>			<u>1,96,98,980</u>

Working Notes:

(1) Yield of Y Ltd.

$$\text{Average of Pre Tax Profit} = \frac{12 + 18 + 24}{3} = \text{Rs.18 lakhs}^*$$

$$\text{Yield} = 18 \times \frac{50}{100} = \text{Rs.9 lakhs}$$

(2) Price per share of Y Ltd:-

$$\text{Capitalised value of yield of Y Ltd.} = \frac{9 \text{ lakhs}}{15} \times 100 = 60 \text{ lakhs.}$$

* By setting the trend, weighted average profit can also be calculated.

$$\text{Price per share} = \frac{60 \text{ lakhs}}{1 \text{ lakh}} = \text{Rs.60 per share}$$

$$= 1,00,000 \times 60 \times \frac{40}{100} = \text{Rs.} 24,00,000$$

$$\text{Intrinsic value per share} = \frac{\text{Net Assets}}{\text{No. of Shares}} = \frac{\text{Rs.150,00,000}}{5,00,000} = \text{Rs.30 per share}$$

Financial Reporting

(iii)	Cash Payment [50% of (24 – 3.92) = 10.04 lakhs]	---	10,04,000	10,04,000
(iv)	Cash for fractional shares = 0.6666×30	---	20	20
	Total		<u>10,03,980</u>	<u>13,96,020</u>
				<u>24,00,000</u>

(6) Calculation for Goodwill/Capital Reserve to X Ltd.

		Rs.
Total of Assets as per Balance Sheet of Y Ltd.		50,00,000
Less: 10% Reduction in the value of Fixed Assets		
	$\left(\frac{10}{100} \times 18,00,000 \right)$	<u>1,80,0000</u>
		48,20,000
Less: Secured Loan	2,50,000	
Current Liabilities	<u>2,50,000</u>	<u>5,00,000</u>
Net Assets		43,20,000
Less: Purchase consideration (outside shareholders)		<u>24,00,000</u>
		19,20,000
Less: Investment in Y Ltd. as per Balance Sheet of X Ltd.		<u>6,00,000</u>
Capital Reserve		<u>13,20,000</u>

(7) Cash and Bank Balance of X Ltd. after acquisition of shares

		Rs.
Opening Balance (X Ltd.)		39,00,000
Cash and Bank Balance of Y Ltd.		<u>2,00,000</u>
		41,00,000
Less: Remittance to the foreign company		<u>10,04,020</u>
		30,95,980
Less: T.D.S. paid to Government		<u>3,92,000</u>
		<u>27,03,980</u>

(8) Unrealized profit included in stock of X Ltd. = $1,50,000 \times \frac{20}{120} = \text{Rs.} 25,000$

Question 15

The following are the Balance sheets (as at 31.3.2010) of A Ltd. and B Ltd.:

Liabilities	A Ltd. Rs.	B. Ltd. Rs.	Assets	A Ltd. Rs.	B. Ltd. Rs.
Share Capital:			Fixed Assets	50,00,000	30,00,000
Equity Shares of Rs.10 each	36,00,000	18,00,000	Investments	5,00,000	5,00,000
10% Preference shares of Rs.100 each	12,00,000	-	Current Assets		
12% Preference shares of Rs.100 each	-	6,00,000	Stock	18,00,000	12,00,000
			Debtors	15,00,000	12,00,000
			Bills receivable	50,000	10,000
			Cash at Bank	1,50,000	90,000
Reserve and Surplus:					
Statutory Reserve	1,00,000	1,00,000			
General Reserve	25,00,000	17,00,000			
Secured Loan					
15% Debentures	5,00,000	-			
12% Debentures	-	5,00,000			
Current Liabilities					
Sundry creditors	10,80,000	12,80,000			
Bills payable	<u>20,000</u>	<u>20,000</u>			
	<u>90,00,000</u>	<u>60,00,000</u>		<u>90,00,000</u>	<u>60,00,000</u>

Contingent liabilities for bills receivable discounted Rs.20,000.

(A) The following additional information is provided to you:

	A Ltd. Rs.	B Ltd. Rs.
Profit before Interest and Tax	14,75,000	7,80,000
Rate of Income-tax	40%	40%
Preference dividend	1,20,000	72,000
Equity dividend	3,60,000	2,70,000
Balance profit transferred to Reserve account.		

Financial Reporting

- (B) *The equity shares of both the companies are quoted on the Mumbai Stock Exchange. Both the companies are carrying on similar manufacturing operations.*
- (C) *A Ltd proposes to absorb business of B Ltd. as on 31.3.2010. The agreed terms for absorption are:*
- (i) 12% Preference shareholders of B Ltd. will receive 10% Preference shares of A Ltd. sufficient to increase their present income by 20%.*
 - (ii) The Equity shareholders of B Ltd. will receive equity shares of A Ltd. on the following terms:*
 - (a) The Equity shares of B Ltd. will be valued by applying to the earnings per share of B Ltd. 60 per cent of price earnings ratio of A Ltd. based on the results of 2009-10 of both the Companies.*
 - (b) The market price of Equity shares of A Ltd. is Rs.40 per share.*
 - (c) The number of shares to be issued to Equity shareholders of B Ltd. will be based on the 80% of market price.*
 - (d) In addition to Equity shares, 10% Preference shares of A Ltd. will be issued to the equity shareholders of B Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2009-2010.*
 - (iii) 12% Debentureholders of B Ltd. are to be paid at 8% premium by 15% debentures in A Ltd. issued at a discount of 10%.*
 - (iv) Rs.16,000 is to be paid by A Ltd. to B Ltd. for liquidation expenses. Sundry Creditors of B Ltd. include Rs.20,000 due to A Ltd. Bills receivable discounted by A Ltd. were all accepted by B Ltd.*
 - (v) Fixed assets of both the companies are to be revalued at 20% above book value. Stock in trade is taken over at 10%; less than their book value.*
 - (vi) Statutory reserve has to be maintained for two more years.*
 - (vii) For the next two years no increase in the rate of equity dividend is anticipated.*
 - (viii) Liquidation expense is to be considered as part of purchase consideration.*

You are required to:

- (i) Find out the purchase consideration.*
- (ii) Give journal entries in the books of A Ltd.*
- (iii) Give the Balance Sheet as at 31.3.2010 after absorption.*

Answer

(i) Computation of Purchase Consideration	Rs.
<i>For Preference Shareholders</i>	
Present Income of Preference Shareholders of B Ltd.	72,000
Add : Required 20% increase	<u>14,400</u>
	<u>86,400</u>
10% Preference Shares to be issued of Rs. 8,64,000 (86,400/10x 100)	
<i>For Equity Shareholders</i>	
Valuation of Equity Shares of B Ltd. =	
Number of shares x Value of one share (i.e. EPS of B Ltd. x P/E ratio of A Ltd. x 60/100)	
$= 1,80,000 \times \left(\text{Rs.} 2 \times 20 \times \frac{60}{100} \right) = 1,80,000 \times 24 = \text{Rs.} 43,20,000$	
<i>Issue of Equity Shares</i>	
No. of Equity Shares to be issued at 80% of Market Price i.e.	
80% of Rs.40 = Rs.32	
$\frac{43,20,000}{32} = 1,35,000 \text{ shares}$	
Equity Share Capital = 1,35,000 x Rs.10 = Rs.13,50,000	
Securities Premium = 1,35,000 x Rs. 22 = <u>Rs.29,70,000</u>	
	<u>Rs.43,20,000</u>
<i>Issue of Preference Shares</i>	
Present Equity Dividend	2,70,000
Less: Expected Equity Dividend from A Ltd.	
$\left(13,50,000 \times \frac{10}{100} \right)$	<u>1,35,000</u>
Loss in income	<u>1,35,000</u>
10% Preference Shares to be issued of Rs. 13,50,000	
(1,35,000/10x 100)	
Purchase Consideration	
Preference Shares Capital [Rs.8,64,000 + Rs.13,50,000]	22,14,000
Equity Share Capital (1,35,000 shares of Rs.10 each at Rs.32 per share)	43,20,000
Liquidation Expenses (in cash)	<u>16,000</u>
	<u>65,50,000</u>

Financial Reporting

(ii) Journal Entries in the Books of A Ltd.

	Particulars		Dr. (Rs.)	Cr. (Rs.)
1.	Fixed Assets A/c	Dr.	10,00,000	
	To Revaluation Reserve			10,00,000
	(Being Revaluation of Fixed assets at 20% above book value)			
2.	Business Purchase A/c	Dr.	65,50,000	
	To Liquidator of B Ltd.			65,50,000
	(Being purchase consideration payable for the business taken over from B Ltd.)			
3.	Fixed Assets A/c	Dr.	36,00,000	
	Investment A/c	Dr.	5,00,000	
	Stock A/c	Dr.	10,80,000	
	Debtors A/c	Dr.	12,00,000	
	Bills Receivable A/c	Dr.	10,000	
	Cash at Bank A/c	Dr.	90,000	
	Goodwill A/c (Balancing figure)	Dr.	19,10,000	
	To 12% Debentures in B Ltd.			5,40,000
	To Creditors			12,80,000
	To Bills Payable			20,000
	To Business Purchase A/c			65,50,000
	(Being incorporation of different assets and liabilities of B Ltd. taken over at agreed values and balance debited to goodwill account)			
4.	Liquidator of B Ltd.	Dr.	65,50,000	
	To Equity Share Capital A/c			13,50,000
	To Securities Premium A/c			29,70,000
	To Preference Share Capital A/c			22,14,000
	To Bank A/c			16,000
	(Being discharge of consideration for B Ltd's business)			

Accounting For Corporate Restructuring

5.	12% Debentures in B Ltd.	Dr.	5,40,000	
	Discount on issue of Debentures	Dr.	60,000	
	To 15% Debentures			6,00,000
	(Being allotment of 15% Debentures to debenture holders at a discount of 10% to discharge liability of B Ltd. debentures)			
6.	Sundry Creditors A/c	Dr.	20,000	
	To Sundry Debtors A/c			20,000
	(Being cancellation of Mutual owing)			
7.	Amalgamation Adjustment A/c	Dr.	1,00,000	
	To Statutory Reserve A/c			1,00,000
	(Being statutory reserve account is maintained under statutory requirements)			
8.	Securities Premium A/c	Dr.	60,000	
	To Discount on issue of Debentures A/c			60,000
	(Being discount on issue of Debentures written off out of securities premium)			

(iii) **Balance Sheet of A Ltd (after absorption of B Ltd.)**

as on 31.3.2010

<i>Liabilities</i>	<i>Amount</i>	<i>Assets</i>	<i>Amount</i>
	<i>Rs.</i>		<i>Rs.</i>
<i>Share Capital:</i>		<i>Fixed Assets:</i>	
4,95,000 Equity Shares of	49,50,000	Goodwill	19,10,000
Rs. 10 each fully paid (1,35,000 shares have been allotted as fully paid up for consideration other than cash)		Other Fixed Assets (60,00,000+36,00,000)	96,00,000
10% Preference Shares of Rs.100 each fully paid	34,14,000	<i>Investment</i>	
		(5,00,000+5,00,000)	10,00,000
<i>Reserve & Surplus:</i>		<i>Current Assets:</i>	
Statutory Reserve	2,00,000	Stock	28,80,000
Revaluation Reserve	10,00,000		
General Reserve	25,00,000	Debtors	26,80,000
		(15,00,000+12,00,000-20,000)	

Financial Reporting

Securities Premium	29,10,000	Bills Receivable	60,000
<i>Secured Loan:</i>		(50,000+10,000)	
15% Debentures	11,00,000	Cash at Bank	2,24,000
(5,00,000 + 6,00,000)		(1,50,000 + 90,000-16,000)	
<i>Current Liabilities and</i>			
<i>Provisions:</i>		Amalgamation Adjustment	1,00,000
Creditors		A/c	
(10,80,000+12,80,000-20,000)	23,40,000		
Bills Payable (20,000 + 20,000)	<u>40,000</u>		
	<u>1,84,54,000</u>		<u>1,84,54,000</u>

Note: No footnote will appear for contingent liability as it has been converted into actual liability after absorption of B Ltd.

Working Notes:

1. Calculation of EPS & P/E ratio

	<i>A Ltd.</i>	<i>B Ltd.</i>
	Rs.	Rs.
Profit before Interest and Tax	14,75,000	7,80,000
Less: Interest on debentures	<u>75,000</u>	<u>60,000</u>
Profit before tax	14,00,000	7,20,000
Less: Tax @ 40%	<u>5,60,000</u>	<u>2,88,000</u>
	8,40,000	4,32,000
Less: Preference Dividend	<u>1,20,000</u>	<u>72,000</u>
Earnings available for equity shareholders	<u>7,20,000</u>	<u>3,60,000</u>
Number of shares	3,60,000 shares	1,80,000 shares
EPS (Earnings/ No. of shares)	2	2
Market Price	Rs.40	Not given
P/E ratio	40/2 = 20	N.A.

2. Computation of Goodwill/Capital Reserve on absorption:

		Rs.
Purchase Consideration		65,50,000
Fixed Assets taken over	30,00,000	
Add: Increase by 20%	<u>6,00,000</u>	36,00,000
Investments		5,00,000

Accounting For Corporate Restructuring

Current Assets:			
Stock	12,00,000		
Less: Reduction in value by 10%	<u>1,20,000</u>		
	10,80,000		
Debtors	12,00,000		
B/R	10,000		
Cash at Bank	<u>90,000</u>	<u>23,80,000</u>	
		64,80,000	
Less: Outside Liabilities:			
12% Debentures at premium	5,40,000		
Sundry Creditors	12,80,000		
Bills Payable	<u>20,000</u>	<u>18,40,000</u>	<u>46,40,000</u>
Goodwill			<u>19,10,000</u>

Question 16

The Balance Sheets of Strong Ltd. and Weak Ltd. as on 31.03.2009 is as below:

Balance Sheet as on 31.03.2009

Liabilities	Strong Ltd. Rs.	Weak Ltd. Rs.	Assets	Strong Ltd. Rs.	Weak Ltd. Rs.
Equity Share Capital (Rs.100 each)	50,00,000	30,00,000	Fixed Assets other than Goodwill	30,00,000	20,00,000
Reserve	4,00,000	2,00,000	Stock	8,00,000	6,00,000
P/L A/c	6,00,000	4,00,000	Debtors	14,00,000	9,00,000
Creditors	5,00,000	3,00,000	Cash & Bank	12,00,000	3,50,000
			Preliminary Expenses	<u>1,00,000</u>	<u>50,000</u>
	<u>65,00,000</u>	<u>39,00,000</u>		<u>65,00,000</u>	<u>39,00,000</u>

Strong Ltd. takes over Weak Ltd. on 01.07.09. No Balance Sheet of Weak Ltd. is available as on that date. It is however estimated that Weak Ltd. earns estimated profit of Rs.2,00,000 after charging proportionate depreciation @ 10% p.a. on fixed assets, during April-June, 2009.

Financial Reporting

Estimated profit of Strong Ltd. during these 3 months is Rs.4,00,000 after charging proportionate depreciation @ 10% p.a. on fixed assets.

Both the companies have declared and paid 10% dividend within this 3 months' period. Goodwill of Weak Ltd. is valued at Rs.2,00,000 and Fixed Assets are valued at Rs.1,00,000 above the estimated book value. Purchase consideration is to be satisfied by Strong Ltd. by shares at par. Ignore Income-tax.

You are required to calculate the following:

- (i) *No. of shares to be issued by Strong Ltd. to Weak Ltd. against purchase consideration;*
- (ii) *Net Current Assets of Strong Ltd. and Weak Ltd. as on 01.07.2009;*
- (iii) *P/L A/c balance of the Strong Ltd. as on 01.07.2009;*
- (iv) *Fixed Assets as on 01.07.2009;*
- (v) *Balance Sheet of Strong Ltd. as on 01.07.2009 after take over of Weak Ltd.*

Answer

- (i) **Number of shares to be issued by Strong Ltd. to Weak Ltd. against purchase consideration**

<i>Weak Ltd.</i>	<i>Rs.</i>	<i>Rs.</i>
Goodwill		2,00,000
Fixed Assets	20,00,000	
Less: Depreciation	<u>50,000</u>	
	19,50,000	
Add: Appreciation	<u>1,00,000</u>	20,50,000
Stock		6,00,000
Debtors		9,00,000
Cash and Bank balances	3,50,000	
Add: Profit after depreciation	2,00,000	
Add: Depreciation (non-cash)	<u>50,000</u>	2,50,000
Less: Dividend	<u>(3,00,000)</u>	<u>3,00,000</u>
		40,50,000
Less: Creditors		<u>3,00,000</u>
Purchase Consideration		<u>37,50,000</u>

- (ii) **Calculation of Net Current Assets as on 01.07.2009**

	<i>Strong Ltd.</i>	<i>Weak Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Current assets:		
Stock	8,00,000	6,00,000

Accounting For Corporate Restructuring

Debtors		14,00,000		9,00,000
Cash and Bank	12,00,000		3,50,000	
Less: Dividend	(5,00,000)		(3,00,000)	
Add: Profit before depreciation	<u>4,75,000</u>	<u>11,75,000</u>	<u>2,50,000</u>	<u>3,00,000</u>
		33,75,000		18,00,000
Less: Creditors		<u>5,00,000</u>		<u>3,00,000</u>
		<u>28,75,000</u>		<u>15,00,000</u>

(iii) Profit and Loss Account balance of Strong Ltd. as on 1.07.2009

	Rs.
P & L A/c balance as on 31.03.2009	6,00,000
Less: Dividend paid	<u>5,00,000</u>
	1,00,000
Add: Estimated profit for 3 months after charging depreciation	<u>4,00,000</u>
	<u>5,00,000</u>

(iv) Fixed Assets as on 01.07.2009

Fixed Assets of Strong Ltd. as on 31.03.2009	30,00,000
Less: Depreciation for 3 months	<u>75,000</u>
	29,25,000
Fixed assets taken over of Weak Ltd. as on 31.03.2009	20,00,000
Less: Proportionate depreciation for 3 months on fixed assets	<u>50,000</u>
	19,50,000
Add: Appreciation above the estimated book value	<u>1,00,000</u>
	<u>20,50,000</u>
	<u>49,75,000</u>

(v) Balance Sheet of Strong Ltd. as on 01.07.2009 (after Take Over)

Liabilities	Rs.	Assets	Rs.
Equity Share capital:		Goodwill	2,00,000
87500 (50,000+ 37,500)		Fixed assets	49,75,000
shares of Rs.100 each	87,50,000	[as computed in (iv)]	
Reserves	4,00,000	Stock	14,00,000
Profit and Loss Account	5,00,000	(8,00,000 + 6,00,000)	
[as computed in (iii)]		Debtors	23,00,000

Financial Reporting

Creditors (5,00,000 + 3,00,000)	8,00,000 (14,00,000 + 9,00,000)	
	Cash and Bank (11,75,000+ 3,00,000)	14,75,000
	Preliminary expenses	<u>1,00,000</u>
	<u>1,04,50,000</u>	<u>1,04,50,000</u>

Question 17

T. Ltd. and V. Ltd. propose to amalgamate. Their balance sheets as at 31st March, 2008 were as follows:

Liabilities	T. Ltd. Rs.	V. Ltd. Rs.	Assets	T. Ltd. Rs.	V. Ltd. Rs.
Share capital:			Fixed assets		
Equity shares of Rs.10 each	15,00,000	6,00,000	Less: Depreciation	12,00,000	3,00,000
General reserve	6,00,000	60,000	Investments (face value of Rs.3 lakhs, 6% tax free G.P. notes)	3,00,000	-
Profit & Loss A/c	3,00,000	90,000	Stock	6,00,000	3,90,000
Creditors	3,00,000	1,50,000	Debtors	5,10,000	1,80,000
			Cash and bank balances	<u>90,000</u>	<u>30,000</u>
	<u>27,00,000</u>	<u>9,00,000</u>		<u>27,00,000</u>	<u>9,00,000</u>

Their net profits (after taxation) were as follows:

Year	T. Ltd.	V. Ltd.
2005-06	3,90,000	1,35,000
2006-07	3,75,000	1,20,000
2007-08	4,50,000	1,68,000

Normal trading profit may be considered as 15% on closing capital invested. Goodwill may be taken as 4 years' purchase of average super profits. The stock of T. Ltd. and V. Ltd. are to be taken at Rs.6,12,000 and Rs.4,26,000 respectively for the purpose of amalgamation. W. Ltd. is formed for the purpose of amalgamation of two companies.

- Suggest a scheme of capitalization of W. Ltd. and ratio of exchange of shares; and
- Draft the opening balance sheet of W. Ltd. [£]

[£] The question involves the application of calculation of goodwill. Therefore, students are advised to go through this problem after preparing Chapter 9.

Answer

(a) Scheme of capitalization of W. Ltd. and ratio of exchange of shares

Computation of Net Assets of amalgamating companies

	<i>T. Ltd.</i>	<i>V. Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Goodwill (W.N.2)	3,19,200	1,21,200
Fixed Assets	12,00,000	3,00,000
6% investments (Non-trade)	3,00,000	-
Stock	6,12,000	4,26,000
Debtors	5,10,000	1,80,000
Cash and Bank Balances	<u>90,000</u>	<u>30,000</u>
	30,31,200	10,57,200
Less: Creditors	<u>3,00,000</u>	<u>1,50,000</u>
Net Assets	<u>27,31,200</u>	<u>9,07,200</u>
No. of Equity shares	1,50,000	60,000
Intrinsic value of a share	Rs. 18.208	Rs. 15.12
No of shares to be issued by W. Ltd to		
T. Ltd 1,50,000 x 18.208/10	2,73,120 shares	
V. Ltd 60,000 x 15.12/10		90,720 shares
In total 2,73,120 + 90,720 i.e. 3,63,840 shares will be issued by W. Ltd.		

Ratio of exchange of shares will be as follows:

1. Holders of 1,50,000 equity shares of T Ltd. will get 2,73,120 shares in W. Ltd.
2. Similarly, holders of 60,000 equity shares of V Ltd. will get 90,720 shares in W. Ltd.

(b) Opening Balance Sheet of W. Ltd.

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Share Capital:		Fixed Assets:	
3,63,840 Equity shares of Rs. 10 each	36,38,400	Goodwill (W.N.2) (3,19,200 + 1,21,200)	4,40,400
(Issued for consideration other than cash, pursuant to scheme of amalgamation)		Other fixed Assets (12,00,000+ 3,00,000)	15,00,000

Financial Reporting

Current Liabilities:		Investments in 6% Tax free G.P. Notes	3,00,000
Creditors	4,50,000	Current Assets:	
		Stock (6,12,000 + 4,26,000)	10,38,000
		Debtors (5,10,000 + 1,80,000)	6,90,000
		Cash and bank balance (90,000 + 30,000)	<u>1,20,000</u>
	<u>40,88,400</u>		<u>40,88,400</u>

Working Notes:

1. Calculation of closing trading capital employed on the basis of net assets

	<i>T. Ltd.</i>	<i>V. Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Fixed Assets	12,00,000	3,00,000
Stock	6,12,000	4,26,000
Debtors	5,10,000	1,80,000
Cash and Bank Balances	<u>90,000</u>	<u>30,000</u>
	24,12,000	9,36,000
Less: Creditors	<u>3,00,000</u>	<u>1,50,000</u>
Net Assets	<u>21,12,000</u>	<u>7,86,000</u>

2. Calculation of value of goodwill

(i) Average Trading Profit	<i>T. Ltd.</i>	<i>V. Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
2005-06	3,90,000	1,35,000
2006-07	3,75,000	1,20,000
2007-08	<u>4,50,000</u>	<u>1,68,000</u>
Profit after tax	<u>12,15,000</u>	<u>4,23,000</u>

Accounting For Corporate Restructuring

Profit before tax (40%)*	20,25,000	7,05,000
Add : Under valuation of closing stock	<u>12,000</u>	<u>36,000</u>
	<u>20,37,000</u>	<u>7,41,000</u>
Average of 3 years' profit before tax	6,79,000	2,47,000
Less: Income from non-trade investments (3,00,000 x 6%)	<u>18,000</u>	<u>-</u>
Average profit before tax	6,61,000	2,47,000
Less: 40% tax	<u>2,64,400</u>	<u>98,800</u>
Average profit after tax	<u>3,96,600</u>	<u>1,48,200</u>
(ii) Super Profits		
Average trading profit	3,96,600	1,48,200
Less: Normal Profit		
T. Ltd. Rs. 21,12,000 x 15%	3,16,800	
V. Ltd Rs. 7,86,000 x 15%	<u> </u>	<u>1,17,900</u>
	<u>79,800</u>	<u>30,300</u>
(iii) Value of goodwill at 4 years' purchase of super profits	<u>3,19,200</u>	<u>1,21,200</u>

Question 18

The following are the Balance Sheets of Andrew Ltd. and Barry Ltd., as at 31.12.2009:

Andrew Ltd.

(in Rs. '000s)

Liabilities	Assets
Share capital	Fixed assets
3,00,000 Equity shares of Rs.10 each	3,000 Stock (pledged with secured loan creditors)
10,000 Preference shares of Rs.100 each	1,000 Other Current assets
General reserve	Profit and Loss account
Secured loans (secured against pledge of stocks)	400
	16,000

* Tax rate of 40% has been assumed. The candidates may assume some other tax rate and give the solution accordingly.

Financial Reporting

Unsecured loans	8,600	
Current liabilities	13,000	
	<u>42,000</u>	<u>42,000</u>

Barry Ltd.

(in Rs.'000s)

Liabilities	Assets	
Share capital	Fixed assets	6,800
1,00,000 Equity shares of Rs.10 each	1,000 Current assets	9,600
General reserve	2,800	
Secured loans	8,000	
Current liabilities	<u>4,600</u>	
	<u>16,400</u>	<u>16,400</u>

Both the companies go into liquidation and Charlie Ltd., is formed to take over their businesses. The following information is given:

- All Current assets of two companies, except pledged stock are taken over by Charlie Ltd. The realisable value of all Current assets are 80% of book values in case of Andrew Ltd. and 70% for Barry Ltd. Fixed assets are taken over at book value.
- The break up of Current liabilities is as follows:

	Andrew Ltd.	Barry Ltd.
	Rs.	Rs.

Statutory liabilities (including Rs.22 lakh in case of Andrew Ltd. in case of a claim not having been admitted shown as contingent liability)	72,00,000	10,00,000
Liability to employees	30,00,000	18,00,000

The balance of Current liability is miscellaneous creditors.

- Secured loans include Rs.16,00,000 accrued interest in case of Barry Ltd.
- 2,00,000 equity shares of Rs.10 each are allotted by Charlie Ltd. at par against cash payment of entire face value to the shareholders of Andrew Ltd. and Barry Ltd. in the ratio of shares held by them in Andrew Ltd. and Barry Ltd.
- Preference shareholders are issued Equity shares worth Rs. 2,00,000 in lieu of present holdings.

Accounting For Corporate Restructuring

- (f) Secured loan creditors agree to continue the balance amount of their loans to Charlie Ltd. after adjusting value of pledged security in case of Andrew Ltd. and after waiving 50% of interest due in the case of Barry Ltd.
- (g) Unsecured loans are taken over by Charlie Ltd. at 25% of Loan amounts.
- (h) Employees are issued fully paid Equity shares in Charlie Ltd. in full settlement of their dues.
- (i) Statutory liabilities are taken over by Charlie Ltd. at full values and miscellaneous creditors are taken over at 80% of the book value.

Show the opening Balance Sheet of Charlie Ltd. Workings should be part of the answer.

Answer

Balance sheet of Charlie Ltd. as at 31st December, 2009

(in Rs. '000s)

Liabilities	Assets	
Share Capital	Goodwill (W.N.4)	9,470
Issued, subscribed & Paid up:	Other Fixed Assets (3,400 + 6,800)	10,200
7,00,000 equity shares of Rs.10 each, fully paid up (W.N. 5)	Current Assets(2,880 + 6,720)	9,600
(of the above 5,00,000 shares have been issued for consideration other than cash)	Cash at Bank	2,000
Secured loans (1,280 + 7,200)		8,480
Unsecured Loans (25% of 8,600)		2,150
Current Liabilities		
(7,200 + 1,000 + 4,000 +1,440)		13,640
		31,270
		31,270

Working Notes:

1. Value of miscellaneous creditors taken over by Charlie Ltd.

(in Rs. '000s)

	Andrew Ltd. Rs.	Barry Ltd. Rs.
Given in balance sheet	13,000	4,600
Less: Statutory liabilities	5,000	1,000
Liability to employees	<u>3,000</u>	<u>1,800</u>
Miscellaneous creditors	<u>5,000</u>	<u>1,800</u>
80% thereof	<u>4,000</u>	<u>1,440</u>

Financial Reporting

2. Value of total liabilities taken over by Charlie Ltd.

	Andrew Ltd.		Barry Ltd.	
	Rs.	Rs.	Rs.	Rs.
<i>Current liabilities</i>				
Statutory liabilities	7,200		1,000	
Liability to employees	3,000		1,800	
Miscellaneous creditors (W.N.1)	<u>4,000</u>	14,200	<u>1,440</u>	4,240
<i>Secured loans</i>				
Given in Balance sheet	16,000		8,000	
Interest waived	-		<u>800</u>	7,200
Value of Stock (80% of Rs.184 lakhs)	<u>14,720</u>	1,280		
<i>Unsecured Loans</i> (25% of Rs. 86 lakhs)		<u>2,150</u>		-
		<u>17,630</u>		<u>11,440</u>

3. Assets taken over by Charlie Ltd.

	Andrew Ltd.	Barry Ltd.
	Rs.	Rs.
Fixed Assets (Assumed on book value basis)	3,400	6,800
Current Assets 80% and 70% respectively of book value	<u>2,880</u>	<u>6,720</u>
	<u>6,280</u>	<u>13,520</u>

4. Goodwill / Capital Reserve on amalgamation

Liabilities taken over (W.N. 2)	17,630	11,440
Equity shares to be issued to Preference Shareholders	<u>200</u>	-
A	17,830	11,440
Less: total assets taken over (W.N. 3)	B <u>6,280</u>	<u>13,520</u>
	A-B <u>11,550</u>	(2,080)
	Goodwill	Capital Reserve
Net Goodwill	9,470	

5. Equity shares issued by Charlie Ltd.

	Number
(i) For Cash	2,00,000
For consideration other than cash	
(ii) In Discharge of Liabilities to Employees	4,80,000

Accounting For Corporate Restructuring

(iii) To Preference shareholders	<u>20,000</u>	<u>5,00,000</u>
		<u>7,00,000</u>
Value of shares (Rs.10x 7,00,000)	Rs. 70 Lakhs	

Question 19

Agni Ltd. and Bayu Ltd. both engaged in similar merchanting activities since 2006, decide to amalgamate their businesses. A holding company, Chandrama Ltd. would be formed on 1st January, 2008 to acquire the entire shares in both the companies.

From the information given below you are required to prepare:

- (a) *A statement of purchase consideration, supported by requisite working notes.*
- (b) *Balance Sheet of Chandrama Ltd. after the transactions have been completed.*
 - (i) *The terms of the offer were:*
 - *Rs.100, 15 per cent debentures for every Rs.100 of net assets owned by each company on 31st December, 2007.*
 - *Rs.100 equity shares based on two years purchase of profit before taxation. The profit is to be determined by taking weighted average profits of 2006 and 2007, weights being 1 and 2 respectively.*
 - (ii) *It was agreed that the accounts of Bayu Ltd. for the two years ended 31st December, 2007 be adjusted, where necessary, to conform to the accounting policies followed by Agni Ltd.*
 - (iii) *The Pre-tax profits, including investment income, of the two companies were as follows:*

	2006	2007
	Rs.	Rs.
Agni Ltd.	16,38,000	16,36,000
Bayu Ltd.	17,88,300	25,74,000

- (iv) *Agni Ltd. values its stock on FIFO basis while Bayu Ltd. used a different basis. To bring Bayu Ltd.'s values in line with those of Agni Ltd, value of its stock will require to be reduced by Rs.36,000 at the end of 2006 and Rs.1,02,000 at the end of 2007.*
- (v) *Both the companies use straight line method of depreciation.*
- (vi) *Bayu Ltd. deducts 1 per cent from trade debtors as a general provision against doubtful debts.*
- (vii) *Prepaid expenses in Bayu Ltd. include advertisement expenditure carried forward of Rs.1,80,000 in 2006 and Rs.90,000 in 2007, being part of initial advertising in 2006,*

Financial Reporting

which is being written off over three years. Similar expenditure in Agni Ltd. has been fully written off in 2006.

(viii) To bring Director's remuneration on to a comparative basis, the profits of Bayu Ltd. are to be reduced by Rs.1,20,000 in 2006 and Rs.1,80,000 in 2007 and the net assets are also to be adjusted accordingly.

Balance Sheets as at 31st December, 2006 and 2007 were as follows:

Agni Ltd.					
Liabilities	2006	2007	Assets	2006	2007
	Rs.	Rs.		Rs.	Rs.
Share capital issued and subscribed: 12,000 shares of Rs.100 each, fully paid	12,00,000	12,00,000	Fixed assets: Furniture and Fixtures: at cost	6,90,000	6,90,000
Reserves and Surplus			Less: depreciation	(69,000)	(1,38,000)
Capital reserve	-	2,10,000	Investments: Quoted investments at market value	-	7,80,000
Revenue reserve	7,98,300	16,74,000	Current assets:		
Current Liabilities and provisions:			Stock at cost	18,30,000	21,75,000
Sundry creditors	15,02,700	18,21,000	Sundry debtors	18,00,000	22,20,000
Provision for taxation	8,40,000	9,60,000	Prepaid expenses	30,000	42,000
			Cash at bank	60,000	96,000
	<u>43,41,000</u>	<u>58,65,000</u>		<u>43,41,000</u>	<u>58,65,000</u>
Bayu Ltd.					
Liabilities	2006	2007	Assets	2006	2007
	Rs.	Rs.		Rs.	Rs.
Share capital: Issued and subscribed 15,000 equity shares of Rs.100 each, fully paid	15,00,000	15,00,000	Fixed assets: Furniture and fixture at cost	9,60,000	9,60,000
Reserves and surplus:			Less: depreciation	(1,44,000)	(2,88,000)
Revenue reserve	8,58,000	21,42,000	Investments:		

Accounting For Corporate Restructuring

<i>Current liabilities and provisions:</i>			<i>Quoted investments (Market value Rs. 14,70,000)</i>		
<i>Sundry creditors</i>	14,70,000	14,82,000			- 12,00,000
<i>Bank overdraft</i>	-	5,10,000	<i>Current assets:</i>		
<i>Provision for taxation</i>	9,30,000	12,90,000	<i>Stock at cost</i>	17,91,000	22,26,000
			<i>Sundry debtors</i>		
			<i>Less: provision</i>	17,82,000	26,73,000
			<i>Prepaid expenses</i>	2,16,000	1,44,000
			<i>Cash at bank</i>	1,53,000	9,000
	<u>47,58,000</u>	<u>69,24,000</u>		<u>47,58,000</u>	<u>69,24,000</u>

Answer

(a) **Statement of Purchase Consideration**
Agni Ltd. Bayu Ltd. (Refer W.N. 1)

Year	PBT (Rs.)	Weight	Rs.	PBT (Rs.)	Weight	Rs.
2006	16,38,000	1	16,38,000	15,18,300	1	15,18,300
2007	18,36,000	2	36,72,000	27,63,000	2	55,26,000
Total Profit			<u>53,10,000</u>			<u>70,44,300</u>
Weighted average profit (Divided by 3)			17,70,000			23,48,100
(i) Two years' purchase of average profits			35,40,000			46,96,200
(ii) Net assets (Refer working notes 2 and 3)			<u>30,84,000</u>			<u>35,43,000</u>
			<u>66,24,000</u>			<u>82,39,200</u>
(iii) Discharge of purchase consideration						
82,362 Shares will be issued for goodwill amounting Rs. 82,36,200 (Rs.35,40,000 + Rs. 46,96,200)						
66,270 15% Debentures will be issued for net assets amounting Rs. 66,27,000 (30,84,000 +35,43,000)						
Total purchase consideration will amount to Rs.148,63,200.						

Financial Reporting

(b) Balance Sheet of Chandrama Ltd. as on 1st January, 2008

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
<i>Share Capital- issued and subscribed</i>		<i>Investments</i>	
82,362 shares of Rs.100 each, fully paid up	82,36,200	Shares in Agni Ltd.	66,24,000
(Issued for consideration other than cash)		Shares in Bayu Ltd.	82,39,200
<i>Secured Loans</i>			
66,270 15% debentures of Rs.100 each, fully paid	66,27,000		
	<u>1,48,63,200</u>		<u>1,48,63,200</u>

Working Notes:

1. Statement of adjusted Net Profits of Bayu Ltd.

	<i>Year 2006</i>		<i>Year 2007</i>	
	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
Net Profit as given		17,88,300	-	25,74,000
Add: Provision for Bad Debts-Note (a)	18,000		27,000	
Advertising	-		90,000	
Depreciation- Note(b)	48,000		48,000	
Appreciation in Investment	-		2,70,000	
Value of Opening Stock	-	66,000	<u>36,000</u>	<u>4,71,000</u>
		18,54,300		30,45,000
Less: Value of Closing Stock	36,000		1,02,000	
Advertising	1,80,000		-	
Directors' Remuneration	1,20,000	3,36,000	1,80,000	2,82,000
		<u>15,18,300</u>		<u>27,63,000</u>

Note:

	<i>Rs.</i>	<i>Rs.</i>
	<i>Year 2006</i>	<i>Year 2007</i>
(a) Sundry Debtors as per Balance sheet	17,82,000	26,73,000
Provision created		
1% of (Rs. 17,82,000 / .99)	18,000	
1% of (Rs. 26,73,000 / .99)		27,000

- (b) Rate of depreciation under straight line method for Agni Ltd. is $(Rs.69,000/6,90,000) \times 100 = 10\%$. Rate of depreciation under straight line method for Bayu Ltd. is $(Rs.1,44,000/9,60,000) \times 100 = 15\%$
 Difference of 5% in depreciation amount i.e. (5% of Rs.9,60,000 = Rs. 48,000) has been added back to ensure uniform accounting policies.

2. Statement of Net Assets of Agni Ltd.

	Rs.	Rs.
Total Assets		58,65,000
Less: Sundry Creditors	18,21,000	
Provision for Taxation	<u>9,60,000</u>	27,81,000
		<u>30,84,000</u>

3. Statement of Adjusted Net Assets of Bayu Ltd.

	Rs.	Rs.
Furniture and Fixtures	9,60,000	
Less: Depreciation at 10% p.a. for two years	<u>1,92,000</u>	7,68,000
Quoted investments at market value		14,70,000
Stock (Rs.22,26,000 – Rs.1,02,000)		21,24,000
Sundry Debtors after Reversal of Provision (Rs.26,73,000 + Rs.27,000)		27,00,000
Prepaid Expenses (Rs.1,44,000 – 90,000)		54,000
Cash at Bank		<u>9,000</u>
		71,25,000
Less: Sundry Creditors	14,82,000	
Bank Overdraft	5,10,000	
Liability for Directors' Remuneration	3,00,000	
Provision for Taxation	<u>12,90,000</u>	35,82,000
		<u>35,43,000</u>

Question 20

Small Ltd. and Little Ltd., two Companies in the field of speciality chemicals, decided to go in for a follow on Public Offer after completion of an amalgamation of their businesses. As per agreed terms initially a new company Big Ltd. will be incorporated on 1st January, 2010 with an authorized capital of Rs.2 crore comprised of 20 lakh equity shares of Rs.10 each. The holding company would acquire the entire shareholding of Small Ltd. & Little Ltd. and in turn would issue its shares to the outside holders of these shares. It is also agreed that the

Financial Reporting

consideration would be a multiple of the average P/E ratio for the period 1st January, 2009 to 31st March, 2009 times the rectified profits of each company, subject to necessary adjustments for complying with the terms of the share issue.

The following information is supplied to you:

	Small Ltd.	Little Ltd.
Ordinary Shares of Rs.10 each (Nos.)	40 lakhs	20 lakhs
10% Preference shares of Rs.100 each (Nos.)	2 lakh	Nil
10% Preference shares of Rs.10 each (Nos.)	Nil	2 lakh
5% debentures of Rs.10 each (Nos.)	4 lakh	4 lakh
<i>Investments Held</i>		
(a) 4 lakh ordinary shares in Small Ltd.	-	Rs.40 lakhs
(b) 2 lakh ordinary shares in Little Ltd.	Rs.20 lakhs	-
Profit before Interest & Tax (PBIT) after considering impact of Inter-company Transactions and Holdings.	Rs.50 lakhs	Rs.25 lakhs
Average P/E ratio January, 2009 to March, 2009	10	8

The following additional information is also furnished to you in respect of adjustments required to the profit figure as given above:

1. The profits of the respective companies would be adjusted for half the value of contingent liabilities as on 31st March, 2009.
2. Debtors of Small Ltd. include an irrecoverable amount of Rs.2 lakh against which Rs.1 lakh was recovered but kept in Advance account.
3. Little Ltd. had omitted to provide for increased FOREX liability of US\$10,000 on loan availed in financial year 2005-06 for purchase of Machinery. The machinery was acquired on 1st January, 2006 and put to use in Financial year 2006-07. The additional liability arose due to change in exchange rates and is arrived at in conformity with prevailing provisions of AS 11. The exchange rate is US \$ 1 = INR 50.
4. Small Ltd. has omitted to invoice a sale that took place on 31st March, 2009 of goods costing Rs.2,50,000 at a mark up of 15 per cent instead the goods were considered as part of closing inventory.
5. Closing Inventory of Rs.45 lakhs of Little Ltd. as on 31st March, 2009 stands undervalued by 10 per cent.
6. Contingent liabilities of Small Ltd. and Little Ltd. as on 31st March, 2009 stands at Rs.5 lakhs and Rs.10 lakhs respectively.

The terms of the share issue are as under:

- (i) *Shares in Big Ltd. will be issued at a premium of Rs.13 per share for all external shareholders of Small Ltd. The Premium will be Rs.15 per share for shares in Big Ltd. issued to all external shareholders of Little Ltd.*
- (ii) *No shares in Big Ltd. will be issued in lieu of the investments (intercompany holdings) of both companies. Instead the shares so held shall be transferred to Big Ltd. at the close of the financial year ended 31st March, 2010 at Par Value consideration payable on date of transfer.*
- (iii) *Big Ltd. would in addition to the issue of shares to outside shareholders of Small Ltd. and Little Ltd. make a preferential allotment on 31st March, 2010 of 2 lakhs ordinary shares at a premium of Rs.28 per share to Virgin Capital Ltd. (VCL). These shares will not be eligible for any dividends declared or paid till that date.*
- (iv) *Big Ltd. will go in for a 18 per cent unsecured Bank overdraft facility to meet incorporation costs of Rs.16 lakhs and towards management expenses till 31st March, 2010 estimated at Rs.14 lakhs. The overdraft is expected to be availed on 1st February, 2010 and closed on 31st March, 2010 out of the proceeds of the preferential allotment.*
- (v) *It is agreed that interim dividends will be paid on 31.03.2010 for the period January, 2010 to March, 2010 by Big Ltd. at 2 per cent; Small Ltd. at 3 per cent and Little Ltd. at 2.5 per cent. Ignore Dividend Distribution tax.*
- (vi) *The prevailing Income Tax Rate is 25 per cent.*

You are required to compute the number of shares to be issued to the shareholders of each of the companies and prepare the projected Profit and Loss Account for the period from 1st January, 2010 to 31.03.2010 of Big Ltd. and its Balance Sheet as on 31st March, 2010.

Answer

Computation of number of shares issued

Calculation of Rectified Profits and Purchase consideration

	Rs.	Rs.
Small Ltd.		
Given profits		50,00,000
Less: Irrecoverable Debtors	1,00,000	
50% Contingent Liability	<u>2,50,000</u>	<u>3,50,000</u>
		46,50,000
Add: Profit on omitted sale (15% of Rs.2,50,000)		<u>37,500</u>

Financial Reporting

	46,87,500
Less: Debenture interest	<u>2,00,000</u>
	44,87,500
Less: Income Tax @ 25%	<u>11,21,875</u>
Profits after Tax (PAT)	33,65,625
Less: Preference Dividend (10% of Rs.2,00,00,000)	<u>20,00,000</u>
Rectified Profits	<u>13,65,625</u>
Average PE ratio = 10	
Total consideration for all equity shareholders (Average PE ratio × Profit)	136,56,250
Less: 10% thereof for shareholders of Little Ltd.	<u>13,65,625</u>
Balance available for other shareholders of Small Ltd.	<u>122,90,625</u>
Little Ltd.	
Given profits	25,00,000
Less: Increase in FOREX liability (US\$10,000 × 50)	5,00,000
50% Contingent Liability	<u>5,00,000</u>
	10,00,000
	15,00,000
Add: Undervaluation of inventory (45,00,000 × 10/90)	<u>5,00,000</u>
	20,00,000
Less: Debenture interest	<u>2,00,000</u>
	18,00,000
Less: Income Tax @ 25%	<u>4,50,000</u>
Profits after Tax (PAT)	13,50,000
Less: Preference Dividend (10% of Rs.20,00,000)	<u>2,00,000</u>
Rectified Profits	<u>11,50,000</u>
Average PE ratio = 8	
Total consideration for all equity shareholders (Average PE ratio × Profit)	92,00,000
Less: 10% thereof for shareholders of Small Ltd.	<u>9,20,000</u>
Balance available for other shareholders of Little Ltd.	<u>82,80,000</u>

Accounting For Corporate Restructuring

Statement showing Disposal of Purchase Consideration

	<i>Small Ltd.</i>	<i>Little Ltd.</i>	<i>Total</i>
	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
Number of shares [Purchase consideration/(Face Value + Securities Premium)]	<u>5,34,375</u>	<u>3,31,200</u>	<u>8,65,575</u>
Share Capital	53,43,750	33,12,000	86,55,750
Securities Premium	<u>69,46,875</u>	<u>49,68,000</u>	<u>1,19,14,875</u>
Purchase Consideration	<u>122,90,625</u>	<u>82,80,000</u>	<u>2,05,70,625</u>

Projected Profit and Loss Account of Big Ltd. for the period 1st January, 2010 to 31st March, 2010

	<i>Rs.</i>
Dividends received from Subsidiaries (12,00,000 + 5,00,000)	17,00,000
Less: Management expenses	14,00,000
Interest on Bank O/D	<u>90,000</u>
Net profit for the period	2,10,000
Less: Proposed Dividend (2% of Rs.86,55,750)	<u>1,73,115</u>
Balance of Profit and Loss Account carried forward	<u>36,885</u>

Projected Balance Sheet of Big Ltd. as on 31st March, 2010

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
<i>Equity Share Capital</i>		<i>Investments</i>	
<i>Authorised</i>		Shares in Subsidiaries (W.N. 4)	2,65,70,625
20 lakhs shares of Rs.10 each	<u>2,00,00,000</u>	<i>Current Assets</i>	
Issued & Paid up		Cash at Bank (W.N. 3)	36,885
10,65,575 shares of Rs.10 each (out of the above 8,65,575 shares have been issued for consideration other than cash)	1,06,55,750	<i>Miscellaneous Expenditure</i>	
		Preliminary expenses	16,00,000
<i>Reserves & Surplus</i>			
Securities Premium	1,75,14,875		
(1,19,14,875 + 56,00,000)			
Profit and loss Account	<u>36,885</u>		
	<u>2,82,07,510</u>		<u>2,82,07,510</u>

Financial Reporting

Working Notes:

1. Shares issued by Big Ltd. to Virgin capital Ltd. (VCL)

Number of shares issued	2,00,000
	Rs.
Face Value of Share Capital @ Rs.10 each	20,00,000
Securities Premium @ Rs.28 each	<u>56,00,000</u>
Total cash received from VCL	<u>76,00,000</u>

2. Overdraft of Big Ltd. as on 31.3.2010

	Rs.
Towards Incorporation expenses i.e. preliminary expenses	16,00,000
Towards Management expenses	<u>14,00,000</u>
Total Bank Overdraft availed	<u>30,00,000</u>
Interest @ 18% p.a. for 2 months	<u>90,000</u>

3. Bank balance of Big Ltd. as on 31.3.2010

Bank Account of Big Ltd.

			Rs.				Rs.
01.02.2010	To	Overdraft	30,00,000	01.02.2010	By	Incorporation expenses	16,00,000
31.03.2010	To	VCL	76,00,000	31.03.2010	By	Management expenses	14,00,000
31.03.2010	To	Dividend		31.03.2010	By	Interest on Overdraft	90,000
		Small	12,00,000 ¹	31.03.2010	By	Overdraft	30,00,000
		Little	5,00,000 ²	31.03.2010	By	Dividend paid	1,73,115 ³
				31.03.2010	By	Shares in Small Ltd. bought from Little Ltd.	40,00,000
				31.03.2010	By	Shares in Little Ltd. bought from Small Ltd.	20,00,000
					By	Balance c/d (Balancing figure)	<u>36,885</u>
			<u>123,00,000</u>				<u>123,00,000</u>

¹ (40,00,000 x 10) x 3% = 12,00,000.

² (20,00,000 x 10) x 2.5% = 5,00,000.

³ [(5,34,375 + 3,31,200) x 10] x 2% = 1,73,115.

4. Investments of Big Ltd. in Projected Balance Sheet	Rs.
Purchase consideration paid for acquiring shares of outside holders of-	
Small Ltd	122,90,625
Little Ltd.	82,80,000
Consideration paid in cash for acquiring cross holdings	
From Small Ltd. (shares of Little Ltd.)	20,00,000
From Little Ltd. (shares of Small Ltd.)	<u>40,00,000</u>
	<u>2,65,70,625</u>

Question 21

Dawn Ltd. was incorporated to take over Arun Ltd., Brown Ltd. and Crown Ltd. Balance Sheets of all the three companies as on 31.03.2008 are as follows:

<i>Particulars</i>	<i>Arun Ltd.</i>	<i>Brown Ltd.</i>	<i>Crown Ltd.</i>
<i>Liabilities :</i>			
<i>Equity Share Capital (Share of Rs. 10 each)</i>	1,800	2,100	900
<i>Reserve</i>	300	150	300
<i>10 % Debentures</i>	600	---	300
<i>Other Liabilities</i>	<u>600</u>	<u>450</u>	<u>300</u>
<i>Total</i>	<u>3,300</u>	<u>2,700</u>	<u>1,800</u>

<i>Particulars</i>	<i>Arun Ltd.</i>	<i>Brown Ltd.</i>	<i>Crown Ltd.</i>
<i>Assets :</i>			
<i>Net Tangible Block</i>	2,400	1,800	1,500
<i>Goodwill</i>	-	150	-
<i>Other Assets</i>	<u>900</u>	<u>750</u>	<u>300</u>
<i>Total</i>	<u>3,300</u>	<u>2,700</u>	<u>1,800</u>

From the following information you are to:

- (a) *Work out the number of Equity shares and Debentures to be issued to the shareholders of each company.*

Financial Reporting

(b) Prepare the Balance Sheet of Dawn Ltd. as on 31.03.2008.

Information:

(i) Assets are to be revalued and the revalued amount of Tangible Block and other Assets are as follows:

	Tangible Block	Other Assets
Arun Ltd.	Rs. 30,00,000	Rs. 10,50,000
Brown Ltd.	Rs. 15,00,000	Rs. 4,20,000
Crown Ltd.	Rs. 18,00,000	Rs. 2,40,000

(ii) Normal profit on capital employed is to be taken at 10%

(iii) Average amount of profit for three years before charging interest on Debentures are:

Arun Ltd.	Rs. 5,40,000
Brown Ltd.	Rs. 4,32,000
Crown Ltd.	Rs. 3,12,000

(iv) Goodwill is to be calculated at three years' purchase of average super profits for three years, such average is to be calculated after adjustment of 10% depreciation on Increase/ Decrease on revaluation of Fixed Assets (Tangible Block) .

(v) Capital employed being considered on the basis of net revaluation of Tangible Assets.

(vi) Equity Shares of Rs. 10 each fully paid up in Dawn Ltd. are to be distributed in the ratio of average profit after adjustment of depreciation on revaluation of Tangible Block.

(vii) 10% Debentures of Rs. 100 each fully paid up are to be issued by Dawn Ltd. for the balance due.

(viii) The ratio of issue of Equity shares and debentures of Dawn Ltd. are to be maintained at 3:1, towards the take over companies.

(ix) The amount required for preliminary expenses of Rs. 1,50,000 and for payment to existing Debenture holders, were provided by issuing Equity shares of Rs. 10 each in Dawn Ltd.

Answer

(a) Number of Equity shares and Debentures to be issued to the shareholders of each company

	<i>Arun Ltd.</i>	<i>Brown Ltd.</i>	<i>Crown Ltd.</i>	<i>Total paid by Dawn Ltd. in 3:1</i>
	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
Equity shares of Rs.10/- each in the ratio of adjusted profits (420:462:252)	20,65,000	22,71,500	12,39,000	55,75,500
10% Debentures [Balance of purchase consideration] –Refer W.N. 2	<u>11,90,000</u>	<u>1,43,500</u>	<u>5,25,000</u>	<u>18,58,500</u>
	<u>32,55,000</u>	<u>24,15,000</u>	<u>17,64,000</u>	<u>74,34,000</u>
No. of shares of Rs.10 each	2,06,500	2,27,150	1,23,900	5,57,550
10% Debentures of Rs.100 each in numbers	11,900	1,435	5,250	18,585

(b) Balance Sheet of Dawn Ltd.as at 31.3.2008

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Share capital		Goodwill	16,74,000
6,62,550 shares of Rs.10- each, fully paid up (Including 5,57,550 shares of Rs.10 each issued for consideration other than cash)	66,25,500	Tangible Assets Block	63,00,000
		Current Assets	17,10,000
18,585, 10% Debentures of Rs.100 each	18,58,500	Preliminary Expenses	1,50,000
Current Liabilities	<u>13,50,000</u>		
	<u>98,34,000</u>		<u>98,34,000</u>

Working Notes:

1. Computation of Goodwill

	<i>Arun Ltd.</i>	<i>Brown Ltd.</i>	<i>Crown Ltd.</i>	<i>Total</i>
	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
Profit	5,40,000	4,32,000	3,12,000	12,84,000
Debenture Interest	<u>(60,000)</u>	<u>-</u>	<u>(30,000)</u>	<u>(90,000)</u>
Profit after Debenture Interest	4,80,000	4,32,000	2,82,000	11,94,000

Financial Reporting

Adjustment for increase/decrease in depreciation due to revaluation	<u>(60,000)</u>	<u>30,000</u>	<u>(30,000)</u>	<u>(60,000)</u>
	4,20,000	4,62,000	2,52,000	11,34,000
Less: Normal Profit @ 10% on Capital employed as per Working Note 2	<u>2,85,000</u>	<u>1,47,000</u>	<u>1,44,000</u>	<u>5,76,000</u>
Super Profits	<u>1,35,000</u>	<u>3,15,000</u>	<u>1,08,000</u>	<u>5,58,000</u>
Goodwill on 3 years of super profits	<u>4,05,000</u>	<u>9,45,000</u>	<u>3,24,000</u>	<u>16,74,000</u>

2. Statement showing calculation of Capital Employed and Purchase Consideration

	<i>Arun Ltd.</i>	<i>Brown Ltd.</i>	<i>Crown Ltd.</i>	<i>Total</i>
	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
Fixed Assets	30,00,000	15,00,000	18,00,000	63,00,000
Current Assets	<u>10,50,000</u>	<u>4,20,000</u>	<u>2,40,000</u>	<u>17,10,000</u>
	40,50,000	19,20,000	20,40,000	80,10,000
Less: Debentures	6,00,000	---	3,00,000	9,00,000
Current Liabilities	<u>6,00,000</u>	<u>4,50,000</u>	<u>3,00,000</u>	<u>13,50,000</u>
Capital Employed	28,50,000	14,70,000	14,40,000	57,60,000
Goodwill as per (i)	<u>4,05,000</u>	<u>9,45,000</u>	<u>3,24,000</u>	<u>16,74,000</u>
Purchase consideration	<u>32,55,000</u>	<u>24,15,000</u>	<u>17,64,000</u>	<u>74,34,000</u>

3. Total number of equity shares issued

	<i>Equity Shares</i>
For purchase consideration	5,57,500
preliminary expenses (Rs. 1,50,000/ Rs. 10)	15,000
payment of existing debenture holders (Rs. 6,00,000 + Rs. 3,00,000) /Rs. 10	<u>90,000</u>
	<u>6,62,550</u>

Question 22

The following are the Balance Sheets of H Ltd. and S Ltd. as at 31.03.09:

			Rs. in lakhs	
	H Ltd.	S Ltd.	H Ltd.	S Ltd.
	Rs.	Rs.	Rs.	Rs.
Share capital			60	18
Share of Rs.10 each	50	10	6	-
General reserve	50	20	35	5
Profit and Loss	20	15	30	25
Secured loan	20	3	39	2
Current liabilities	<u>30</u>	<u>2</u>		
	<u>170</u>	<u>50</u>	<u>170</u>	<u>50</u>

H Ltd. holds 60% of the paid up capital of S Ltd. and balance is held by a foreign company. The foreign company agreed with H Ltd. as under:

- (i) The shares held by the foreign company will be sold to H Ltd. at Rs. 50 above than nominal value of per share.
- (ii) The actual cost per share to the Foreign Company was Rs. 11, gain accruing to Foreign Company is taxable @ 20 % . The tax payable will be deducted from the sale proceeds and paid to Government by H Ltd. 50% of the consideration (after payment of tax) will be remitted to Foreign Company by H Ltd. and also any cash for fractional shares allotted.
- (iii) For the Balance of consideration H Ltd. would issue its shares at their intrinsic value.

It was also decided that H Ltd. would also absorb S Ltd. simultaneously by writing down the fixed assets of S Ltd. by 10 %. The Balance Sheet figure included a sum of Rs. 1 lakh due by S Ltd. to H Ltd, included stock of Rs. 1.5 lakhs purchased from S Ltd. who sold them at cost plus 20 %.

Pass Journal entries in the books of H Ltd. to record the above arrangement on 31.03.09 and prepare the Balance Sheet of H Ltd. after absorption of S Ltd. Workings should form part of your answer.

Answer

Journal Entries in the books of H Ltd.

		Rs.	Rs.
1.	Business Purchase A/c	Dr.	24,00,000
	To Foreign Company		24,00,000
	(Being business purchased)		
2.	Fixed Assets A/c	Dr.	16,20,000
	Debtors A/c	Dr.	5,00,000

Financial Reporting

Inventories A/c	Dr.	25,00,000	
Cash at Bank A/c	Dr.	2,00,000	
To Current Liabilities A/c			2,00,000
To Secured Loan A/c			3,00,000
To Investment in S Ltd. A/c			6,00,000
To Business Purchase A/c			24,00,000
To Capital Reserve A/c (B.F.)			13,20,000
(Being various assets and liabilities taken over)			
3. Profit and Loss A/c	Dr.	25,000	
To Inventories A/c			25,000
(Being elimination of unrealized profit)			
4. Current Liabilities A/c	Dr.	1,00,000	
To Debtors A/c			1,00,000
(Being elimination of mutual owing)			
5. Foreign Company	Dr.	24,00,000	
To Tax Payable A/c			3,92,000
To Bank A/c(Rs.10,04,000 + Rs.20)			10,04,020*
To Equity Share Capital A/c			3,34,660
To Securities Premium A/c			6,69,320
(Being payment made to foreign company)			
6. Tax Payable A/c	Dr.	3,92,000	
To Bank A/c			3,92,000
(Being tax paid to Government)			

Balance Sheet of H Ltd. (After Absorption)

Liabilities	Rs.	Assets	Rs.
5,34,466 Shares of Rs.10 each	53,34,660	Fixed Assets	76,20,000
(out of above, 33,466 shares issued for consideration other than cash)		(60,00,000+16,20,000)	
General Reserve	50,00,000	Sundry Debtors	39,00,000
Profit & Loss (20,00,000– 25,000)	19,75,000	(35,00,000 – 1,00,000)	
Capital Reserve	13,20,000	+5,00,000)	
Securities Premium	6,69,320		

* It is assumed that payment of fractional shares has also been routed through Bank A/c along with 50% payment remitted to Foreign Company.

Accounting For Corporate Restructuring

Secured Loan (20,00,000+3,00,000)	23,00,000	Inventories (30,00,000-25,000+25,00,000)	54,75,000
Current Liabilities (30,00,000+2,00,000-1,00,000)	31,00,000	Cash at Bank (39,00,000+2,00,000- 10,04,020-3,92,000)	27,03,980
	<u>196,98,980</u>		<u>196,98,980</u>

Working Notes:

1. Amount payable to foreign company

Price per share of S Ltd. = Rs.50 + Rs.10 (Nominal value) = Rs.60

Value of 40% shares held by foreign company = $10,00,000 \times 40\% \times \frac{60}{10}$ = Rs. 24,00,000

Capital gain = Rs.24,00,000 - $\left(4,00,000 \times \frac{11}{10}\right)$ = Rs.19,60,000

Tax on capital gain = Rs.19,60,000 × 20% = Rs.3,92,000

Amount payable to Foreign Company after tax = Rs.24,00,000 - Rs.3,92,000 = Rs.20,08,000

50% of Rs.20,08,000 = Rs.10,04,000 to be remitted to foreign company.

2. Intrinsic value of shares of H Ltd. and balance payment to foreign company

	Rs.	Rs.
Total assets (Excluding Investment in S Ltd.)		1,64,00,000
Add: Investment in S Ltd. (60,000 shares × Rs.60)		<u>36,00,000</u>
		2,00,00,000
Less: Liabilities:		
Secured Loan	20,00,000	
Current Liability	<u>30,00,000</u>	<u>50,00,000</u>
		<u>1,50,00,000</u>
No. of equity shares		5,00,000
Intrinsic value per share		Rs.30
Number of shares to be issued for payment of 50% balance amount		
$\frac{\text{Rs.10,04,000}}{30}$		= 33,466 shares
Cash for fractional shares = Rs.10,04,000 - (33,466 × Rs.30)		= Rs.20

EXERCISES**Question 1**

The summarized Balance Sheets of A Ltd. and its subsidiary B Ltd. as on 31.3.2010 are as follows:

	A Ltd. Rs.	B Ltd. Rs.
Shares of Rs. 10 each	1,00,00,000	20,00,000
Reserves and Surplus	1,40,00,000	60,00,000
Secured Loans	40,00,000	—
Current Liabilities	<u>60,00,000</u>	<u>20,00,000</u>
	<u>3,40,00,000</u>	<u>1,00,00,000</u>
Fixed Assets	1,20,00,000	35,00,000
Investment in B Ltd.	7,40,000	—
Sundry Debtors	70,00,000	10,00,000
Inventories	60,00,000	50,00,000
Cash and Bank	<u>82,60,000</u>	<u>5,00,000</u>
	<u>3,40,00,000</u>	<u>1,00,00,000</u>

A Ltd. holds 76% of the paid up capital of B Ltd. The balance shares in B Ltd. are held by a Foreign Collaborating company. A memorandum of understanding has been entered into with the foreign company providing for the following:

- The shares held by the foreign company will be sold to A Ltd. The price per share will be calculated by capitalizing the yield at 16%. Yield, for this purpose, would mean 40% of the average of pre-tax profits for the last 3 years, which were Rs. 35 lakhs, Rs. 44 lakhs and Rs. 65 lakhs.
- The actual cost of shares to the foreign company was Rs. 2,40,000 only. The profit that would accrue to them would be taxable at an average rate of 30%. The tax payable be deducted from the proceeds and A Ltd. will pay it to the Government.
- Out of the net consideration, 50% would be remitted to the foreign company immediately and the balance will be an unsecured loan repayable after one year. It was also decided that A Ltd. would absorb B Ltd. simultaneously by writing down the Fixed Assets of B Ltd. by 5%. The Balance Sheet figures included a sum of Rs. 1,50,000 due by B Ltd. to A Ltd.

The entire arrangement was approved by all concerned for giving effect to on 1.4.2010.

You are required to show the Balance Sheet of A Ltd. as it would appear after the arrangement is put through on 1.4.2010.

[Answer: Total of the balance sheet of A Ltd. Rs. 410.99 Lakhs; Yield of B Ltd.: Rs. 19.2 lakhs; Price per share of B Ltd. = Rs. 60; Purchase consideration for 24% of share capital of B Ltd. = Rs. 28.80 lakhs; Capital Reserve to A Ltd. Rs. 42.05 lakhs; Cash and bank balance of A Ltd. after acquisition of shares Rs. 69.24 lakhs.

Discharge of Purchase Consideration:

- (i) as Tax :Rs. 7.92 lakhs
- (ii) 50% of (28.80 – 7.92 i.e. Rs. 20.88 lakhs) = Rs. 10.44 lakhs (to be remitted immediately)
- (iii) Balance 50% = Rs. 10.44 lakhs (to be retained as unsecured loan)]

Question 2

Travels & Tours Ltd. has two divisions – 'Inland' and 'International'. The Balance Sheet as at 31st December, 2009 was as under:

	Inland (Rs. crores)	International (Rs. crores)	Total (Rs. crores)
Fixed Assets:			
Cost	600	600	1,200
Depreciation	<u>500</u>	<u>200</u>	<u>700</u>
W.D.V. (written down value) (A)	100	400	500
Net Current Assets:			
Current assets	400	300	700
Less: Current liabilities	<u>200</u>	<u>200</u>	<u>400</u>
(B)	<u>200</u>	<u>100</u>	<u>300</u>
Total (A + B)	<u>300</u>	<u>500</u>	<u>800</u>
Financed by:			
Loan funds:			
(Secured by a charge on fixed assets)	—	100	100
Own Funds:			
Equity capital (fully paid up Rs. 10 shares)			50
Reserves and surplus	<u>—</u>	<u>—</u>	<u>650</u>
	<u>?</u>	<u>?</u>	<u>700</u>
Total	<u>300</u>	<u>500</u>	<u>800</u>

It is decided to form a new company 'IT Ltd.' for international tourism to take over the assets and liabilities of international division.

Financial Reporting

Accordingly 'IT Ltd.' was formed to takeover at Balance Sheet figures the assets and liabilities of international division. 'IT Ltd.' is to allot 5 crore equity shares of Rs. 10 each in the company to the members of 'Travels & Tours Ltd.' in full settlement of the consideration. The members of 'Travels & Tours Ltd.' are therefore to become members of 'IT Ltd.' as well without having to make any further investment.

- (a) You are asked to pass journal entries in relation to the above in the books of 'Travels & Tours Ltd.' and also in 'IT Ltd.'. Also show the Balance Sheets of both the companies as on 1st January, 2010 showing corresponding figures, before the reconstruction also.
- (b) The directors of both the companies ask you to find out the net asset value of equity shares pre and post-demerger.
- (c) Comment on the impact of demerger on "shareholders wealth".

[Answer: Loss on reconstruction Rs. 400 crores, Total of the balance sheet of Travels & Tours Ltd. before and after reconstruction would be Rs. 800 crores and Rs. 300 crores respectively.]

Net Asset Value of an equity share	Pre-Demerger	Post-Demerger
Travels & Tours Ltd.	= Rs. 140	= Rs. 60]

Question 3

System Ltd. and HRD Ltd. decided to amalgamate as on 01.04.2010. Their Balance Sheets as on 31.03.2010 were as follows: (Rs. in '000)

Particulars	System Ltd.	HRD Ltd.
Source of Funds :		
Equity share capital (Rs. 10 each)	150	140
9% preference share Capital (Rs. 100 each)	30	20
Investment allowance Reserve	5	2
Profit and Loss Account	10	6
10 % Debentures	50	30
Sundry Creditors	25	15
Tax provision	7	4
Equity Dividend Proposed	<u>30</u>	<u>28</u>
Total	<u>307</u>	<u>245</u>
Application of Funds :		
Building	60	50
Plant and Machinery	80	70
Investments	40	25

Accounting For Corporate Restructuring

Sundry Debtors	45	35
Stock	36	40
Cash and Bank	40	25
Preliminary Expenses	<u>6</u>	<u>—</u>
Total	<u>307</u>	<u>245</u>

From the following information, you are to prepare the draft Balance Sheet as on 01.04.2010 of a new company, Intranet Ltd., which was formed to take over the business of both the companies and took over all the assets and liabilities:

- (i) 50 % Debenture are to be converted into Equity Shares of the New Company.
- (ii) Out of the investments, 20% are non-trade investments.
- (iii) Fixed Assets of Systems Ltd. were valued at 10% above cost and that of HRD Ltd. at 5% above cost.
- (iv) 10 % of sundry Debtors were doubtful for both the companies. Stocks to be carried at cost.
- (v) Preference shareholders were discharged by issuing equal number of 9% preference shares at par.
- (vi) Equity shareholders of both the transferor companies are to be discharged by issuing Equity shares of Rs. 10 each of the new company at a premium of Rs. 5 per share.

Amalgamation is in the nature of purchase.

[Answer: Value of equity shares issued to System Ltd. 1,98,500 and to HRD Ltd. 1,78,500]

Cash paid for fraction of shares = Rs. 1,98,500 less Rs. 1,98,495 = Rs. 5 to System Ltd.

Cash paid for fraction of shares = Rs. 25,000 less Rs. 24,990 = Rs. 10 to HRD Ltd.

Total of M/s Intranet balance sheet as at 1.4.2010 Rs. 5,64,985]

Question 4

The Balance Sheet of Munna Ltd as on 31st March, 2009 is as follows:

Liabilities	Rs.	Assets	Rs.
Authorised and issued Share capital		Goodwill	2,00,000
20,000 equity shares of Rs.100 each, fully paid	20,00,000	Plant & Machinery	18,00,000
10,000, 7% Preference shares of Rs.100 each	10,00,000	Stock	3,00,000
Sundry creditors	7,00,000	Debtors	7,50,000

Financial Reporting

Bank overdraft	3,00,000	Cash	1,50,000
		Preliminary expenses	1,00,000
		Profit and Loss Account	7,00,000
	40,00,000		40,00,000

Additional Information:

Two years' preference share dividend is in arrears. The company had bad time during the last two years and hopes for better business in future, earning profit and paying dividend, provided the capital base is reduced.

An internal reconstruction scheme, agreed to by all concerned, is as follows:

- (i) Creditors agreed to forego 50% of their claim.
- (ii) Preference shareholders withdrew arrear dividend claim. They also agreed to lower down their capital claim by 20% by reducing nominal value in consideration of 9% dividend effective after reconstruction, in case equity shareholder's loss exceeded 50% on the application of the scheme.
- (iii) Bank has agreed to convert overdraft into term loan to the extent required for making current ratio to 2:1.
- (iv) Revalued amount for plant and machinery was accepted as Rs.15,00,000.
- (v) Debtors to the extent of Rs.4,00,000 were considered as good.
- (vi) Equity shares shall be exchanged for the same number of equity shares at a revised denomination as required after the reconstruction.

You are required to show the following:

- (a) Total loss to be borne by the equity and preference shareholders for the reconstruction.
- (b) Share of loss to the individual class of shareholders.
- (c) New structure of share capital after reconstruction.
- (d) Working capital of the reconstructed company, and
- (e) A Performa Balance Sheet after reconstruction.

[Answer: Loss to be borne by Equity and Preference Shareholders Rs.13,00,000; New structure of share capital after reorganization Rs.17,00,000; Working capital of the reorganized company Rs. 4,25,000; Balance Sheet (total) of Munna Ltd. (and reduced) Rs. 23,50,000]