Amalgamation of Companies

Meaning:

Amalgamation is the process through which two or more entities are joined together to form a new entity. In simple language, when two or more companies join hands together to form a new and larger company, it is termed as amalgamation. Amalgamation generally happens between two or more companies engaged in the same line of business or those that share some similarity in operations. Companies may combine to diversify their activities or to expand their range of services. Since two or more companies are merging together, an amalgamation results in the formation of a larger entity. The transferor company or the weaker company is absorbed into the stronger transferee company, thus forming an entirely different company. This leads to a much stronger and larger customer base, and also means the newly formed entity has more assets. Amalgamations generally take place between larger and smaller entities, where the larger one takes over smaller firms.

In accounting, AS 14 deals with amalgamation of companies including mergers and acquisitions though this standard does not deal with acquisition of stake of one entity by another entity. Accounting for such acquisitions are covered by AS 21, AS 23 and AS 27 depending on the degree of control acquired. AS 21 covers accounting for holding and subsidiary companies, AS 23 covers joint ventures while AS 27 deals with accounting for associates.

**AS 14** – Accounting for Amalgamation not only deals with amalgamations but also with the cases of absorption and external reconstruction and all of these three are covered under one head i.e. amalgamation. Though AS 14 does not distinguish among these three terms, they are different from each other in reality.

When two or more companies are combined together to form a new company and when the combining entities lose their existence and in their place, a new company is created, it is called amalgamation.

When two companies are combined together in such a way that one company is merged in to another company and loses its existence and the other company continues to exist, it is called absorption. In other words, in absorption at least one company loses its identity though no new company is created.

External reconstruction is simply the process by which one company changes the name by which it operates and thus it does not have much relevance from accounting point of view.

**AS 14** is mandatory for all types of enterprise. It has been notified by the central government with effect from accounting periods commencing on or after 7th December 2006.

As per AS 14, Amalgamation is an arrangement whereby a company (Transferor Company) is amalgamated into another company (Transferee Company) and loses its existence. It is defined as “an amalgamation pursuant to the provisions of the Companies Act, 1956, or any other statute which may be applicable to companies.

Objectives of Amalgamation:

Amalgamation of companies happens in order to achieve the following objectives-

1. **Avoidance of Competition**: As mentioned earlier amalgamation generally happens in case of companies having similar line of business. It means, amalgamation results in consolidating two or more entities engaged in the similar line of business in to one single entity thereby resulting in elimination of competition between the combining entities.
2. **Reduction in Cost**: when the resources of two or more companies are combined as a result of amalgamation, the new entity formed will have larger resource base. This in turn reduces cost of production as a consequence of economies of large scale operation providing the new entity with the operating cost advantage.
3. **Financial Gain**: As the amalgamated company will have larger resource base, it derives financial gain in the form of tax advantage, higher credit worthiness and lower rate of borrowing.
4. **Achieving Growth**: As the pooled resources of the amalgamated company can be used for the purpose of its internal growth, it becomes easier for the company to prevent the emergence of a new competitor.
5. **Diversification and Risk Reduction**: The amalgamated company, due to its larger resource base is able to diversify its activities in to two or more industrial lines. At times, it may act as hedging the weak operation with a stronger operation thereby resulting in reduction of risk of failure.
6. **Achieving Monopoly**: Amalgamation may also be initiated between two competitor companies to achieve monopoly in particular area of operation thereby making them eligible to enjoy the advantages of monopoly situation.

Provisions as per AS 14:

AS mentioned earlier Accounting Standard 14 deals with Amalgamation of Companies. The important provisions relating to amalgamation of companies as per AS 14 are as follows-

**Types of Amalgamation:**

AS 14 classifies amalgamation in to two types i.e. amalgamation in the nature of merger and amalgamation in the nature of purchase.

An amalgamation is called amalgamation in the nature of merger if it satisfies all of the following five conditions-

1. All assets and liabilities of transferor company becomes assets and liabilities of transferee company after amalgamation.
2. Shareholders holding not less than 90% of face value of equity shares of transferor company become shareholder of transferee company
3. Consideration for equity shareholders who agree to become equity shareholders of transferee company is discharged wholly by issue of equity shares, except cash may be paid in respect of fractional shares.
4. Business of transferor company is intended to be carried on by the transferee company after such amalgamation.
5. No adjustment is intended to be made to the assets and liabilities of transferor company except to ensure uniformity in accounting policy.

An amalgamation which does not satisfy any one or more of the conditions specified for an amalgamation in the nature of merger is called amalgamation in the nature of purchase.

Generally, amalgamation in the nature of purchase is a mode by which one company acquires another company and, as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued.

**Methods of Accounting for Amalgamation:**

As per AS 14, accounting for amalgamation can be done using either of the two methods namely pooling of interest method and purchase method.

**Pooling of interest method** is used for amalgamation in the nature of merger. The accounting procedure under this method is as follows-

1. Record assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of transferor company at their existing carrying amounts and in the same form as at the date of the amalgamation
2. Aggregate the balance of the Profit and Loss Account of the transferor company with the corresponding balance of the transferee company or transfer it to the General Reserve, if any
3. Adopt uniform accounting policies following amalgamation in case of conflicting accounting policies at the time of amalgamation. Effect on financial statements of any changes in accounting policies to be reported in accordance with AS 5
4. Difference between amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and amount of share capital of transferor company should be adjusted in reserves

**Purchase method** is applied in case of amalgamation in the nature of purchase. The accounting procedure under this method is follows-

1. In preparing transferee company’s financial statements, the assets and liabilities of transferor company should be incorporated either: at their existing carrying amounts or at adjusted values.
2. Reserves (whether capital or revenue or arising on revaluation) of the transferor company; other than statutory reserves, should not be included in the financial statements of the transferee company.
3. Where statutory reserves recorded in books of transferee company, corresponding debit should be given to a suitable account head (e.g., ‘Amalgamation adjustment account’. When identity of such reserves no longer required, entry should be reversed.
4. If consideration exceeds the value of net assets of the transferor company recognise excess as goodwill arising on amalgamation.
5. Goodwill to be amortised to income on a systematic basis over its useful life. Amortisation period should not exceed five years unless a somewhat longer period can be justified.
6. If value of net assets of transferor company exceeds consideration, recognise excess as capital reserve arising on amalgamation.

 Accounting Treatment for Amalgamation:

The accounting treatment for amalgamation involves the following-

1. Determining Purchase Consideration,
2. Accounting treatment in the books of the Transferor Company or Vendor Company to close its books of accounts and
3. Accounting treatment in the books of Transferee Company or Purchasing Company after amalgamation.

Determination of Purchase Consideration:

Consideration for amalgamation refers to the price payable by the transferee company to the transferor company for acquiring its business. According to AS 14, consideration for amalgamation means the aggregate of shares and other securities issued and payment made in the form of cash or other assets by the transferee company to the shareholders of transferor company. The following points should be kept in mind while determining purchase consideration-

1. Only the payments made to the shareholders are to be taken in to consideration while determining purchase consideration.
2. Consideration in the form of payments made to the creditors or debenture holders or any payments to settle third party liability of the transferor company is not included in purchase consideration.
3. Moreover, consideration for amalgamation does not include liquidation expenses, cost absorption etc.

Method of Calculating purchase consideration:

Net Payment Method:

Under net payment method, purchase consideration is the amount which is arrived at as an aggregate of all payments made in the form of shares, debentures or other securities and cash to the shareholders of Transferor Company.

Net Asset Method:

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

Lump Sum Method:

The purchasing company may agree to pay a lump-sum to the vendor company on account of the purchase of its business. In fact, this method is not based on any scientific thoughts and techniques. This method is an unscientific and non-mathematical method of ascertaining purchase consideration.

#### Intrinsic Value Method (Shares Exchange Method):

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

(Note: For accounting entries to be passed in the books of transferor company and transferee company, kindly follow B.B. Dam book).

Accounting for Amalgamation of Companies under Ind AS regime:

Under the Ind AS regime, accounting for amalgamation is covered by Ind AS 103 ‘Business Combination.’ The major differences in accounting treatment under the two regimes are as follows-

1. Ind AS 103 prescribes mandatory use of purchase method of accounting whereas under AS 14, accounting for amalgamations could be done under pooling of interest method as well as purchase method.
2. Under Ind AS 103, transaction cost is treated as an expense and is transferred to profit and loss account which is included in the cost of acquisition under AS 14.
3. Under the Ind AS 103, the amount of contingent consideration is calculated using fair value method on the date of acquisition itself and is transferred to profit and loss account which is not considered relevant under AS 14.
4. Ind AS 103 requires testing of goodwill arising on amalgamation for impairment whereas the same normally needs to be amortized over a period of five years under AS 14.