CHAPTER 9

OTHER ACCOUNTING STANDARDS

UNIT 1: ACCOUNTING STANDARD 12 ACCOUNTING FOR GOVERNMENT GRANTS

LEARNING OUTCOMES

After studying this unit, you will be able to comprehend the –

- Accounting Treatment of Government Grants
- Capital Approach versus Income Approach
- Recognition of Government Grants
- Non-monetary Government Grants
- Presentation of Grants:
  - Related to Specific Fixed Assets
  - Related to Revenue
  - In the nature of Promoters' contribution
- Refund of Government Grants
- Disclosures.

1.1. INTRODUCTION

AS 12 deals with accounting for government grants such as subsidies, cash incentives, duty drawbacks, etc. and specifies that the government grants should not be recognised until there is reasonable assurance that the enterprise will comply with the conditions attached to them, and the grant will be received.

The standard also describes the treatment of non-monetary government grants; presentation of grants related to specific fixed assets and revenue and those in the nature of promoters' contribution; treatment for refund of government grants etc.

This Standard does not deal with:

(i) The special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature.

(ii) Government assistance other than in the form of government grants.

(iii) Government participation in the ownership of the enterprise.

The receipt of government grants by an enterprise is significant for preparation of the financial statements for two reasons. Firstly, if a government grant has been received, an appropriate method of accounting therefore is necessary. Secondly, it is desirable to give an indication of the extent to which the enterprise has benefited from such grant during the reporting period. This facilitates comparison of an enterprise's financial statements with those of prior periods and with those of other enterprises.

1.2 GOVERNMENT GRANTS

Government grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.

1.3 ACCOUNTING TREATMENT OF GOVERNMENT GRANTS

Two broad approaches may be followed for the accounting treatment of government grants:

- the 'capital approach', under which a grant is treated as part of shareholders' funds, and
- the 'income approach', under which a grant is taken to income over one or more periods.

It is generally considered appropriate that accounting for government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds. Income approach may be more appropriate in the case of other grants.

1.4 RECOGNITION OF GOVERNMENT GRANTS

A government grant is not recognised until there is reasonable assurance that:

- the enterprise will comply with the conditions attaching to it; and
- the grant will be received.

Receipt of a grant is not of itself conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

Example:

X Ltd applies for a grant from the local authority towards a social cause. X Ltd. is required to meet certain conditions to be eligible for the receipt of grant. There is a reasonable assurance that X Ltd will receive the grant in time. However, after having applied for the grant, there is a likelihood that X Ltd may not be able to meet all the conditions attached to the grant.

In such case, X Ltd should not recognise the grant in its books until there is a reasonable assurance that it would be able to meet all conditions attached to the grant.

1.5 NON-MONETARY GOVERNMENT GRANTS

Government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value.

Example

X Convent wishes to open a school in locality A. It applies to the State authority for grant of land. The State authority grants the land for construction of the the purposes of the school construction. The market value of the land is ₹ 20 crore whereas However, the authority provides the land at a nominal cost of ₹ 50 lakhs including cost of registration. The State authority requires that free education must be provided to the poor children by way of reserving 20% of the seats in the school for such children. There is a reasonable assurance that X Convent has a reason to believe it can will meet that the above stated condition attached to the grant.

Thus, X Convent needs to would recognise the cost of the land at its acquisition cost of ₹ 50 lakhs.

1.6 PRESENTATION OF GRANTS RELATED TO SPECIFIC FIXED ASSETS

Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets. Other conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Example

The Central Government is planning to generate large employment in rural and backward regions. Thus, it is planning to give grants for the same to entities who will meet the required conditions. F Ltd applied for a grant to the Central Government. The Government will give the grant on the condition that, F Ltd will be required to construct a factory where it would need to employ at least 500 workers for 5 years. Total cost of the construction is expected to be ₹ 50 crore. The amount of the grant is ₹ 30 crore.

F Ltd will be able to recognise the grant only if there is reasonable assurance that it will meet ~~o~~ the condition of employing 500 workers for next 5 years.

Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives.

Method I :

- The grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value.
- The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.
- Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

Illustration 1

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset.

Solution

Journal in the books of Z Ltd.

Year	Particulars		₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account	Dr.	50,00,000	
	To Bank Account			50,00,000
	(Being Fixed Assets purchased)			
	Bank Account	Dr.	10,00,000	
	To Fixed Assets Account			10,00,000
	(Being grant received from the government)			

	Depreciation Account Dr. To Fixed Assets Account (Being Depreciation charged on SLM)	7,00,000	7,00,000
	Profit & Loss Account Dr. To Depreciation Account (Being Depreciation transferred to P&L Account)	7,00,000	7,00,000
2nd	Depreciation Account Dr. To Fixed Assets Account (Being Depreciation charged on SLM)	7,00,000	7,00,000
	Profit & Loss Account Dr. To Depreciation Account (Being Depreciation transferred to P&L Account)	7,00,000	7,00,000

Method II:

- Grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.
- Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets.
- If a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income.

Illustration 2

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income.

Solution

Journal in the books of Z Ltd.

Year	Particulars	₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account Dr. To Bank Account (Being fixed assets purchased)	50,00,000	50,00,000
	Bank Account Dr. To Deferred Government Grant Account (Being grant received from the government)	10,00,000	10,00,000
	Depreciation Account Dr. To Fixed Assets Account (Being depreciation charged on SLM)	9,00,000	9,00,000
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to P/L Account)	9,00,000	9,00,000
2nd	Deferred Government Grants Account Dr. To Profit & Loss Account (Being proportionate government grant taken to P/L	2,00,000	2,00,000
	Depreciation Account Dr. To Fixed Assets Account (Being depreciation charged on SLM)	9,00,000	9,00,000
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to P/L Account)	9,00,000	9,00,000
	Deferred Government Grant Account Dr. To Profit & Loss Account (Being proportionate government grant taken to P/L	2,00,000	2,00,000

Illustration 3

Santosh Ltd. has received a grant of ₹ 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed ₹ 2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct.

Solution

As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not available for distribution of dividend.

In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the elements of the grant is incorrect as per AS 12.

1.7 PRESENTATION OF GRANTS RELATED TO REVENUE

Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense.

Illustration 4

X Ltd. runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local Government grants a lumpsum payment of `90 lakhs to meet the salary expense for a period of next 5 years.

You are required to pass the necessary journal entries in the books of the company for first year of the grant and present in the statement of profit & loss when the grant is:

(a) Shown separately as Other Income; and

(b) Deducted against the Salary costs.

Solution

Journal Entries

Particulars	**₹ (Dr.)**	**₹ (Cr.)**
Bank Account Dr.	90,00,000	
To Deferred Income Account		90,00,000
(Being receipt of grant from government)		
Salary Expense Account Dr.	30,00,000	
To Bank Account		30,00,000

(Being Salary expense paid for the year)		
Deferred Income Account Dr. To Profit & loss Account (Being Year 1 Grant income recognised in Profit & Loss)	18,00,000	 18,00,000

Note: The grant has been spread on a straight-line basis over a period of 5 years [₹90,00,000/5 years = ₹ 18,00,000].

Statement of Profit & Loss Account (Extract)

(a) Shown separately as Other Income**:**

Particulars	***Notes***	***(₹)***
Other Income		18,00,000

(b) Deducted against the Salary costs**:**

Particulars		***(₹)***
Salary cost	30,00,000	
Less: Deferred Government Grant	(18,00,000)	12,00,000

1.8 PRESENTATION OF GRANTS OF THE NATURE OF PROMOTERS' CONTRIBUTION

Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Illustration 5

Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment, for which no repayment was ordinarily expected. Moreover, *there was no condition that the company should purchase any specified assets for this subsidy. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets received ₹ 10 crore from the Government in January, 20X2 (accounting period being 20X1-20X2). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 20X2.*

Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

Solution

As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment desired by the company is not proper.

Illustration 6

How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area. This subsidy is in nature of nature of promoters' contribution.

Solution

(i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.

1.9 REFUND OF GOVERNMENT GRANTS

- Government grants sometimes become refundable because certain conditions are not fulfilled and are treated as an extraordinary item (AS 5).
- The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.
- The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.

- Where a grant which is in the nature of promoters' contribution becomes refundable, in part or in full, to the government on non-fulfillment of some specified conditions, the relevant amount recoverable by the government is reduced from the capital reserve.

1.10 DISCLOSURE

(i) The accounting policy adopted for government grants, including the methods of presentation in the financial statements;

(ii) The nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

Illustration 7

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs (This amount was reduced from the cost of fixed asset). Grant was considered as refundable in the end of 2nd year to the extent of ₹ 7,00,000. Pass the journal entry for refund of the grant as per the first method.

Solution

Fixed Assets Account	Dr.	₹ 7,00,000	
To Bank Account			₹ 7,00,000
(Being government grant on asset refunded)			

Illustration 8

A fixed asset is purchased for ₹ 20 lakhs. Government grant received towards it is ₹ 8 lakhs. Residual Value is ₹ 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 5 lakhs due to non-compliance with certain conditions. Pass journal entries for first two years.

Solution

Journal Entries

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Fixed Asset Account	Dr.	20	
	To Bank Account			20
	(Being fixed asset purchased)			
	Bank Account	Dr.	8	
	To Fixed Asset Account			8
	(Being grant received from the government reduced the cost of fixed asset)			
	Depreciation Account (W.N.1)	Dr.	2	
	To Fixed Asset Account			2
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss Account	Dr.	2	
	To Depreciation Account			2
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)			
2	Fixed Asset Account	Dr.	5	
	To Bank Account			5
	(Being government grant on asset partly refunded which increased the cost of fixed asset)			

	Depreciation Account (W.N.2)	Dr.	3.67	
	To Fixed Asset Account			3.67
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)			
	Profit & Loss Account	Dr.	3.67	
	To Depreciation Account			3.67
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

Working Notes:

1. Depreciation for Year 1

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Depreciation $\left[\frac{12-4}{4}\right]$	2

2. Depreciation for Year 2

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Less: Depreciation for the first year $\left[\frac{12-4}{4}\right]$	2
	10
Add: Government grant refundable	5
	15
Depreciation for the second year $\left[\frac{15-4}{3}\right]$	3.67

Illustration 9

On 1.4.20X1, ABC Ltd. received Government grant of ₹ 300 lakhs for acquisition of machinery costing ₹ 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 20X4 due to non-fulfillment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd. assuming that the company did not charge any depreciation for year 20X4?

Solution

According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing deferred income balance, as appropriate, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(₹ in lakhs)
1st April, 20X1	Acquisition cost of machinery (₹ 1,500 – ₹ 300)	1,200.00
31st March, 20X2	Less: Depreciation @ 20%	(240.00)
	Book value	960.00
31st March, 20X3	Less: Depreciation @ 20%	(192.00)
	Book value	768.00
31st March, 20X4	Less: Depreciation @ 20%	(153.60)
1st April, 20X4	Book value	614.40
May, 20X4	Add: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting ₹ 914.40 lakhs is to be provided prospectively over the residual useful life of the asset.

Illustration 10

A Ltd. purchased a machinery for ₹40 lakhs. (Useful life 4 years and residual value ₹8 lakhs) Government grant received is ₹16 lakhs.

Show the Journal Entry to be passed at the time of refund of grant in the third year and the value of the fixed assets, if:

(1) the grant is credited to Fixed Assets A/c.

(2) the grant is credited to Deferred Grant A/c.

Solution

In the books of A Ltd.

Journal Entries (at the time of refund of grant)

(1) If the grant is credited to Fixed Assets Account:

		₹	₹
I.	Fixed Assets A/c Dr.	16 lakhs	
	To Bank A/c		16 lakhs
	(Being grant refunded)		

II. The balance of fixed assets after two years depreciation will be ₹16 lakhs (W.N.1) and after refund of grant it will become (₹16 lakhs + ₹16 lakhs) = ₹32 lakhs on which depreciation will be charged for remaining two years. Depreciation = (32-8)/2 = ₹12 lakhs p.a. will be charged for next two years.

(2) If the grant is credited to Deferred Grant Account:

As per para 14 of AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (₹16 lakhs /4 years) = ₹4 lakhs p.a. x 2 years = ₹8 lakhs were credited to Profit and Loss Account and ₹8 lakhs was the balance of Deferred Grant Account after two years.

Therefore, on refund in the 3rd year, following entry will be passed:

		₹	₹
I	Deferred Grant A/c Dr.	8 lakhs	
	Profit & Loss A/c Dr.	8 lakhs	
	To Bank A/c		16 lakhs
	(Being Government grant refunded)		

II Deferred grant account will become Nil. The fixed assets will continue to be shown in the books at ₹24 lakhs (W.N.2) and depreciation will continue to be charged at ₹8 lakhs per annum for the remaining two years.

Working Notes:

1. Balance of Fixed Assets after two years but before refund (under first alternative)

Fixed assets initially recorded in the books = ₹40 lakhs – ₹16 lakhs

= ₹24 lakhs

Depreciation p.a. = (₹24 lakhs – ₹8 lakhs)/4 years = ₹4 lakhs per year

Value of fixed assets after two years but before refund of grant

= ₹24 lakhs – (₹4 lakhs x 2 years) = ₹16 lakhs

2. Balance of Fixed Assets after two years but before refund (under second alternative)

Fixed assets initially recorded in the books = ₹40 lakhs

Depreciation p.a. = (₹40 lakhs – ₹8 lakhs)/4 years = ₹8 lakhs per year

Book value of fixed assets after two years = ₹40 lakhs – (₹8 lakhs x 2 years)

= ₹24 lakhs

Note: Value of fixed assets given above is after refund of government grant.

Illustration 11

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of `90 lakhs to meet the salary expense for a period of next 5 years.

At the start of Year 4, Co X is unable to meet the conditions attached to the grant and is required to refund the entire grant of 90 lakhs.

You are required to pass the necessary journal entries in the books of the company for refund of the grant if the grant was shown separately as Other Income.

Solution

			₹	₹
	Deferred Grant A/c	Dr.	36 lakhs	
	Profit & Loss A/c	Dr.	54 lakhs	
	To Bank A/c			90 lakhs
	(Being Government grant refunded)			

Workings:

Total grant received:	₹ 90 Lakhs
Grant recognised as income for first 3 years:	₹ 18 lakhs × 3
	= ₹ 54 lakhs
Remaining Deferred Income	= ₹ 90 Lakhs – 54 lakhs
	= ₹ 36 lakhs

Reference: The students are advised to refer the full text of AS 12 "Accounting for Government Grants".

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *To encourage industrial promotion, IDCI offers subsidy worth ₹ 50 lakhs to all new industries set up in the specified industrial areas. This grant is in the nature of promoter's contribution. How such subsidy should be accounted in the books?*

   (a) Credit it to capital reserve

   (b) Credit it as 'other income' in the profit and loss account in the year of commencement of commercial operations

   (c) Both (a) and (b) are permitted

   (d) Credit it to general reserve

2. *Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the purpose of giving immediate financial support to the enterprise with no further related costs, should be*

   (a) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable as an ordinary item.

   (b) recognised and disclosed in the Statement of Profit and Loss of the period in which the losses or expenses were incurred.

   (c) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item if appropriate as per AS 5.

   (d) disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item

3. *Which of the following is an acceptable method of accounting presentation for a government grant relating to an asset?*

   (a) Credit the grant immediately to Income statement

   (b) Show the grant as part of Capital Reserve

   (c) Reduce the grant from the cost of the asset or show it separately as a deferred income on the Liability side of the Balance Sheet.

   (d) Show the grant as part of general Reserve

4. *X Ltd. has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd has a policy to recognise the grant as a deduction from the cost of the asset. The expected remaining useful life of the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight-line. The amount of annual depreciation to be charged as an expense in Profit and Loss Statement will be:*

   (a) ₹ 10 crore

   (b) ₹ 6 crore

   (c) ₹ 2 crore

   (d) ₹ 8 crore

5. *X Ltd has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd. has a policy to recognise the grant as deferred income. The expected remaining useful life of the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight-line. The amount of other income to be to be recognised in Profit and Loss Statement will be:*

   (a) ₹ 10 crore

   (b) ₹ 6 crore

   (c) ₹ 2 crore

   (d) ₹ 8 crore

Theoretical Questions

6. *AS 12 deals with recognition and measurement of government grants. Please elaborate the parameters which are required to be met before an entity can recognise government grants in its books?*

Scenario based Questions

7. *Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 20X1-20X2 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 20X2-20X3, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full.*

Elucidate the current accounting treatment, with reference to the provisions of AS-12

8. *Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. The company, however, failed to comply with the said conditions and consequently was required to refund the said amount in 2024. The company debited the said amount to its machinery account in 2024 on payment of the same. It also reworked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the year 2024 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not.*

ANSWERS/SOLUTIONS

Answer to the Multiple Choice Questions

1.	(a)	**2.**	(c)	**3.**	(c)	**4.**	(b)	**5.**	(c)

Answer to the Theoretical Questions

6. A government grant is recognised when there is reasonable assurance that:

- the enterprise will comply with the conditions attaching to it; and
- the grant will be received.

Receipt of a grant is not of itself conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

Answer to the Scenario based Questions

7. As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the present case, the amount of refund of government grant should be first adjusted against the unamortised deferred income in the books and the excess if any will be debited to profit & loss account of the company as an extraordinary item in the year 20X2-20X3.

8. As per the facts of the case, Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions. In such circumstances, AS 12, "Accounting for Government Grants", requires that the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. The Standard further makes it clear that in the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

UNIT 2: ACCOUNTING STANDARD 14 ACCOUNTING FOR AMALGAMATIONS

LEARNING OUTCOMES

After studying this unit, you will be able to comprehend the –

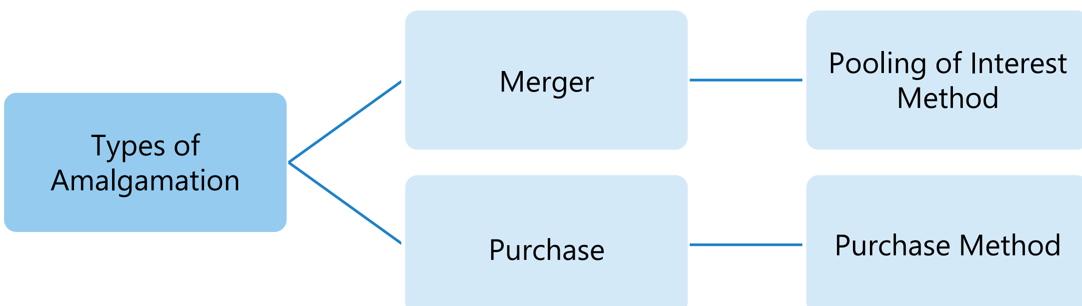
- Types of amalgamation – merger and purchase;
- Accounting for amalgamation – Pooling of interest method and purchase method;
- Computation of Purchase consideration;
- Amalgamation post balance sheet date;
- Disclosure requirements of AS 14;

2.1 INTRODUCTION

AS 14 (Revised) deals with the accounting to be made in the books of Transferee company in the case of amalgamation and the treatment of any resultant goodwill or reserve.

An amalgamation may be either in the nature of merger or purchase. The standard specifies the conditions to be satisfied by an amalgamation to be considered as amalgamation in nature of merger or purchase.

An amalgamation in nature of merger is accounted for as per pooling of interests method and in nature of purchase is dealt under purchase method.



The standard describes the disclosure requirements for both types of amalgamations in the first financial statements. We will discuss the other amalgamation aspects in detail in subsequent paragraphs of this unit.

> **Note:**
>
> AS 14 (Revised) does not deal with cases of acquisitions. The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

2.2 DEFINITION OF THE TERMS USED IN THE STANDARD

- **Amalgamation** means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies and includes 'merger'.
- **Transferor company** means the company which is amalgamated into another company.
- **Transferee company** means the company into which a transferor company is amalgamated.

2.3 TYPES OF AMALGAMATIONS

Amalgamations fall into two broad categories.

Types of amalgamations
- Merger
- Purchase

- **Merger -** In amalgamations where there is a genuine pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of these companies.
- **Purchase** - In amalgamations which are in effect a mode by which one company acquires another company and as a consequence:

- the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or
- the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase'.

2.4 AMALGAMATION IN THE NATURE OF MERGER

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

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

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

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

Example: X Ltd and Y Ltd are both in telecom business. As per the arrangement X Ltd will get merged with Y Ltd and their shareholders will get shares in Y Ltd. X Ltd operations will going to be continued under Y ltd.

2.5 AMALGAMATION IN THE NATURE OF PURCHASE

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

2.6 METHODS OF ACCOUNTING FOR AMALGAMATIONS

There are two main methods of accounting for amalgamations.

- For an amalgamation in the nature of merger - pooling of interests method and
- For an amalgamation in the nature of purchase - purchase method.

2.6.1 Pooling of Interests Method

Pooling of interests is a method of accounting for amalgamations the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts

If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5.

2.6.2 Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either

- By incorporating the assets and liabilities at their existing carrying amounts or

- By allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

2.7 CONSIDERATION

Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. In determining the value of the consideration, an assessment is made of the fair value of its elements.

Clarification Chart:

Method I – Net Payment Method	**Method II – Net Assets Method**
Note: We need to compute P.C. by Net Payment Method only. If it cannot be computed by Net Payment Method – then Net Assets Method will be applicable.	
Situation I – If it is a Merger	**Situation I – if it is a Merger**
Equity shares issued to ESH (cash may be paid in case fraction arises) + Any form of payment given to PSH	Assets at Book value - Liabilities at Book value - Reserves and Surplus = ESC + PSC
Situation II – If it is a case of Purchase	**Situation II – If it is a case of Purchase**
Any form of payment given to ESH + Any form of payment given to PSH	Assets at agreed value - Liabilities at agreed value

Many amalgamations recognise that adjustments may have to be made to the consideration in the light of one or more future events. When the additional payment is probable and can reasonably be estimated at the date of amalgamation, it is included in the calculation of the consideration. In all other cases, the adjustment is recognised as soon as the amount is determinable

2.8 TREATMENT OF RESERVES OF THE TRANSFEROR COMPANY ON AMALGAMATION

If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company.

Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company. As a result of preserving the identity, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation.

2.9 ADJUSTMENTS TO RESERVES - AMALGAMATION IN THE NATURE OF MERGER

When an amalgamation is accounted for using the pooling of interests method, the reserves of the transferee company are adjusted to give effect to the following:

- A uniform set of accounting policies should be adopted following the amalgamation and, hence, the policies of the transferor and the transferee are aligned.

- 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 the transferor company.

2.10 ADJUSTMENTS TO RESERVES - AMALGAMATION IN THE NATURE OF PURCHASE

If the amalgamation is an 'amalgamation in the nature of purchase', the identity of the reserves, other than the statutory reserves is not preserved. The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company. If the result of the computation is negative, the difference is debited to goodwill arising on amalgamation and if the result of the computation is positive, the difference is credited to Capital Reserve.

Certain reserves may have been created by the transferor company pursuant to the requirements of, or to avail of the benefits under, the Income-tax Act, 1961; for example, Development Allowance Reserve, or Investment Allowance Reserve or any other statutory reserve. The Act requires that the identity of the reserves should be preserved for a specified period. Likewise, certain other reserves may have been created in the financial statements of the transferor company in terms of the requirements of other statutes. Though normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made in respect of reserves of the aforesaid nature (referred to hereinafter as 'statutory reserves') and such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute. This exception is made only in those amalgamations where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with.

In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Reserve') which is presented as a separate line item. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

The Standard gives a title, which reads as "Reserve". This gives rise to following requirements.

1. The corresponding debit is "also" to a Reserve Account
2. That Reserve account will show a negative balance
3. But it has to be shown as a separate line item - Which implies, that this debit "cannot be set off against Statutory reserve taken over".

So the presentation will be as follows:

Notes to Accounts for "Reserves and Surplus"

Description	**Amount (Current year)**	**Amount (Previous Year)**
Statutory Reserve (taken over from transferor company) General Reserve Profit and Loss or Retained Earnings Amalgamation Adjustment Reserve (negative balance)	(--)	(--)

2.11 TREATMENT OF GOODWILL ARISING ON AMALGAMATION

Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life. Due to the nature of goodwill, it is frequently difficult to estimate its useful life with reasonable certainty. Such estimation is, therefore, made on a prudent basis. Accordingly, it is considered appropriate to amortise goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

Factors which may be considered in estimating the useful life of goodwill arising on amalgamation include:

(a) the foreseeable life of the business or industry

(b) the effects of product obsolescence, changes in demand and other economic factors

(c) the service life expectancies of key individuals or groups of employees

(d) expected actions by competitors or potential competitors

(e) legal, regulatory or contractual provisions affecting the useful life

2.12 BALANCE OF PROFIT AND LOSS ACCOUNT

In the case of an 'amalgamation in the nature of merger', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company. Alternatively, it is transferred to the General Reserve, if any.

In the case of an 'amalgamation in the nature of purchase', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company, whether debit or credit, loses its identity.

2.13 DISCLOSURES

For all amalgamations, the following disclosures are considered appropriate in the first financial statements following the amalgamation:

a. Names and general nature of business of the amalgamating companies;

b. Effective date of amalgamation for accounting purposes;

c. The method of accounting used to reflect the amalgamation; and

d. Particulars of the scheme sanctioned under a statute.

For amalgamations accounted for under the pooling of interests method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

a. Description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;

b. The amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

For amalgamations accounted for under the purchase method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

a. Consideration for the amalgamation and a description of the consideration paid or contingently payable; and

b. The amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.

2.14 AMALGAMATION AFTER THE BALANCE SHEET DATE

When an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation disclosure is made in accordance with AS 4 'Contingencies and Events Occurring After the Balance Sheet Date' but the amalgamation is not incorporated in the financial statements. In certain circumstances the amalgamation may also provide additional information affecting the financial statements themselves for instance by allowing the going concern assumption to be maintained.

Illustration 1

A Ltd. take over B Ltd. on April 01, 20X1 and discharges consideration for the business as follows:

(i) Issued 42,000 fully paid equity shares of ₹ 10 each at par to the equity shareholders of B Ltd.

(ii) Issued fully paid up 15% preference shares of ₹ 100 each to discharge the preference shareholders (₹ 1,70,000) of B Ltd. at a premium of 10%.

(iii) It is agreed that the debentures of B Ltd. (₹ 50,000) will be converted into equal number and amount of 13% debentures of A Ltd.

Determine the amount of purchase consideration as per AS 14.

Solution

Particulars	**₹**
Equity Shares (42,000 x 10)	4,20,000
15% Preference Share Capital	1,70,000
Add: Premium on Redemption	17,000
Purchase Consideration	6,07,000

Note: As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Thus, payment to debenture holders are not covered by the term 'consideration'.

Illustration 2

A Ltd. and B Ltd. were amalgamated on and from 1st April, 20X1. A new company C Ltd. was formed to take over the business of the existing companies. A Ltd. and B Ltd. have the following ledger balances as on 31st March, 20X1:

	A Ltd. (₹ in lakhs)	***B Ltd. (₹ in lakhs)***
Land and Building	*550*	*400*
Plant and Machinery	*350*	*250*
Investments (Non-current)	*150*	*50*
Inventory	*350*	*250*
Trade Receivables	*300*	*350*
Cash and Bank	*300*	*200*
Share Capital:		
Equity Shares of ₹ 100 each	*800*	*750*
12% Preference shares of ₹ 100 each	*300*	*200*
Reserves and Surplus:		
Revaluation Reserve	*150*	*100*
General Reserve	*170*	*150*
Investment Allowance Reserve	*50*	*50*

Profit and Loss Account	*50*	*30*
Secured Loans:		
10% Debentures (₹ 100 each)	*60*	*30*
Trade Payables	*420*	*190*

Additional Information:

(1) 10% Debenture holders of A Ltd. and B Ltd. are discharged by C Ltd. issuing such number of its 15% Debentures of ₹ 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 ₹ 150 per share (face value of ₹ 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 @ ₹ 30 each, having a face value of ₹ 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, 20X1 after the amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.

Solution

Balance Sheet of C Ltd. as at 1st April, 20X1

Particulars	**Note No.**	**(₹ in lakhs)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,200
(b) Reserves and Surplus	2	1,650
(2) Non-Current Liabilities		
Long-term borrowings	3	60
(3) Current Liabilities		
Trade payables	8	610
Total		3,520

II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	1,550
(b) Intangible assets	5	20
(c) Non-current investments	6	200
(2) Current assets		
(a) Inventory (350 + 250)		600
(b) Trade receivables	7	650
(c) Cash and bank balances (300 + 200)		500
Total		3,520

Notes to Accounts

		(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital		
	Equity share capital (W.N.1)		
	70,00,000[1] Equity shares of ₹ 10 each	700	
	5,00,000[2] Preference shares of ₹ 100 each	500	
	(all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)		1,200
2.	Reserves and surplus		
	Securities Premium Account (W.N.3) (950 + 700)	1,650	

[1] 40,00,000 + 30,00,000

[2] 3,00,000 + 2,00,000

	Investment Allowance Reserve (50 + 50)	100	
	Amalgamation Adjustment Reserve (50 + 50)	*(100)*	*1,650*
3.	Long-term borrowings		
	15% Debentures		60
4.	Property, Plant and Equipment		
	Land and Building (550 + 400)	950	
	Plant and Machinery (350 + 250)	600	1,550
5.	Intangible assets		
	Goodwill [W.N. 2] (110 – 90)		20
6.	Non-current Investments		
	Investments (150 + 50)		200
7.	Trade receivables (300 + 350)		650
8.	Trade payables (420 + 190)		610

Working Notes:

		(₹ in lakhs)	
		A Ltd.	*B Ltd.*
(1)	Computation of Purchase consideration		
	(a) Preference shareholders:		
	$\left(\frac{3,00,00,000}{100} \text{ i.e. } 3,00,000 \text{ shares}\right) \times ₹\,150 \text{ each}$	450	
	$\left(\frac{2,00,00,000}{100} \text{ i.e. } 2,00,000 \text{ shares}\right) \times ₹\,150 \text{ each}$		300
	(b) Equity shareholders:		
	$\left(\frac{8,00,00,000 \times 5}{100} \text{ i.e. } 40,00,000 \text{ shares}\right) \times ₹\,30 \text{ each}$	1,200	
	$\left(\frac{7,50,00,000 \times 4}{100} \text{ i.e. } 30,00,000 \text{ shares}\right) \times ₹\,30 \text{ each}$	____	900
	Amount of Purchase Consideration	1,650	1,200

(2)	Net Assets Taken Over			
	Assets taken over:			
	Land and Building		550	400
	Plant and Machinery		350	250
	Investments		150	50
	Inventory		350	250
	Trade receivables		300	350
	Cash and bank		300	200
			2,000	1,500
	Less: Liabilities taken over:			
	Debentures	40		20
	Trade payables	420		190
			460	210
	Net assets taken over		1,540	1,290
	Purchase consideration		1,650	1,200
	Goodwill		110	___
	Capital reserve			90
(3)	Computation of securities premium			
	On preference share capital			
	A Ltd.- 3,00,000 x 50		150	
	B Ltd.- 2,00,000 x 50			100
	On equity share capital			
	A Ltd.- 40,00,000 x 20		800	
	B Ltd.- 30,00,000 x 20		___	600
	Total		950	700

Note: For problems based on practical application of AS 14 (Revised) students are advised to refer Chapter 14 'Accounting for Amalgamation of Companies' of the study material.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Which of the following statement is correct:*

   (a) *In case of merger – ESH can be issued only equity shares as a part of Purchase consideration.*

   (b) *In case of purchase – ESH can be issued Preference shares also as a part of Purchase consideration.*

   (c) *Both (a) and (b) are correct.*

   (d) *Both (a) and (b) are incorrect.*

2. *State which statement is correct:*

   (a) *In case of merger – assets and liabilities can only be taken over at book values.*

   (b) *In case of purchase – assets and liabilities can be taken over at book values or agreed values.*

   (c) *Both (a) and (b) are correct.*

   (d) *Both (a) and (b) are incorrect.*

3. *State which statement is correct:*

   (a) *In case of merger – All Reserves and surplus of vendor company are taken over by Purchasing company.*

   (b) *In case of Purchase – None of the Reserves and surplus of vendor company are taken over by Purchasing company.*

   (c) *Both (a) and (b) are correct.*

   (d) *Only (a) is correct.*

4. *State which statement is correct:*

   (a) *In case of merger – We use pooling of interest method for accounting.*

(b) *In case of Purchase We use purchase method or pooling of interest method depending upon whether it is take over at agreed values or book values.*

(c) *Both (a) and (b) are correct.*

(d) *Only (a) is correct.*

5. *State which statement is incorrect:*

(a) *In case of merger – We can issue either preference shares or equity shares to PSH.*

(b) *In case of Purchase – We can issue either preference shares or equity shares to PSH.*

(c) *In case of merger – We can issue only preference shares to PSH.*

(d) *none of the above.*

Theoretical Questions

6. *Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14 (Revised).*

7. *List the conditions to be fulfilled as per AS 14 (Revised) for an amalgamation to be in the nature of merger, in the case of companies.*

8. *Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.*

Scenario based Questions

9. *X Co. Ltd. having share capital of ` 50 lakhs divided into equity shares of ` 10 each was taken over by Y Co. Ltd. Y Co. Ltd. issued 11 equity shares of ` 10 each for every 10 shares of X Co. Ltd.*

Explain how the difference will be adjusted in the books of Y Co. Ltd. for the shares issued under the 'Pooling of interests method' of amalgamation as per AS 14.

10. On 1st April, 2018, Tina Ltd. take over the business of Rina Ltd. and discharged purchase consideration as follows:

(i) Issued 50,000 fully paid Equity shares of ₹ 10 each at a premium of ₹ 5 per share to the equity shareholders of Rina Ltd.

(ii) Cash payment of ₹ 50,000 was made to equity shareholders of Rina Ltd.

(iii) Issued 2,000 fully paid 12% Preference shares of ₹ 100 each at par to discharge the preference shareholders of Rina Ltd.

(iv) Debentures of Rina Ltd. 20,000) will he converted into equal number and amount of 10% debentures of Tina Ltd.

Calculate the amount of Purchase consideration as per AS-14 and pass Journal Entry relating to discharge of purchase consideration in the books of Tina Ltd.

ANSWERS/SOLUTIONS

Answer to the Multiple Choice Questions

1.	(b)	**2.**	(c)	**3.**	(d)	**4.**	(d)	**5.**	(c)

Answer to the Theoretical Questions

6. The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 (Revised) on Accounting for Amalgamation. Refer Para 2.5 for details.

7. According to AS 14 "Accounting for Amalgamations", Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

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

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

8. As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

The Pooling of Interest Method

Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the necessary adjustments).

If at the time of amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

The Purchase Method

Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

Answer to the Scenario based Questions

9.

Particulars	₹
Purchase consideration = 5,00,000 x 11/10 = 55,000 shares of ₹ 10 each	55,00,000
Less: Share capital of X Co. Ltd.	50,00,000
Difference Adjusted through General Reserve	5,00,000

10. As per AS 14, consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Computation of Purchase Consideration

Particulars	₹
Equity Shares (50,000x 15)	7,50,000
Cash payment	50,000
12% Preference Share Capital	2,00,000
Purchase Consideration	10,00,000

Note: Payment to debenture holders are not covered by the term 'consideration'.

Journal entry

Particulars	₹	₹
Liquidation of Rina Ltd. A/c	10,00,000	
To Equity share capital A/c		5,00,000
To 12% Preference share capital A/c		2,00,000
To Securities premium A/c		2,50,000
To Bank/Cash A/c		50,000
(Being payment of cash and issue of shares for discharge of purchase consideration)		