Purchase of Business + Merger and Acquisitions

1. Limited Company taking over Partnership firm
2. Limited Company taking over Sole trader business
3. Merger of Sole traders and Formation of partnership
4. Merger of Partnerships and Formation of Limited Company
5. Sale of Business
6. Management Buyout

Conversion of Partnership to limited company

Drawbacks of Partnership

Reasons: No Perpetual Consistency
- No Separate legal identity
- Concept of Agency
- Unlimited liability
- Expansion of business limited to 20 partners.

Modes of Purchase Consideration

- Cash / Bank
- Share capital
  - ordinary [par / premium
  - Preference
- Debentures
- Convertable loan stocks / Convertable Debentures
- Combination of above

\$100000 Debenture after 5 years convert O.S.C @ \$ 2.5 /share

After 5 years

M.V

1. \$2.2 /share
2. \$2.6 /share
3. \$3 /share
4. \$2.5 /share

if Market value > conversion then convert
if market value < conversion then don't convert

E.g:

	\$
Purchase Consideration	100,000
Cash	(20,000)
	80,000
10% Debentures	(30,000)
	50,000
20000 ordinary shares of \$1 each (par)	(50,000)
	—

(50,000) < \$20000 O.S.C [20000 x \$1]; \$30000 S.P [20000 x \$1.5]

$\frac{\$50000}{20000 \text{shares}}$ = \$2.5 each → \$1 par, \$1.5 premium

Purchased Goodwill

As per IAS 38 'Intangibles' purchased goodwill means where a transaction has taken place to determine the value of such goodwill.
It is the price paid over and above fair value of net identifiable assets taken over

Purchased goodwill = Purchase Consideration - Fair Value of Net Assets taken over

Treatment - IAS - 38

Purchased goodwill is recorded as intangible non current asset (in purchaser B/S) and should be ammortized over its useful economic life.
If purchase consideration is less than fair value of Net Asset taken over then negative goodwill arises and it is shown in Assets section as a negative balance.

Non Purchased Goodwill / Inherent Goodwill

As per International Accounting Standard 38 - Intangible Assets, inherent goodwill is the value of business in excess of its identifiable non current assets. It is referred to as internally generated goodwill and it arises over a period of time due to good reputation, location and customer base of the business.
In case of inherent goodwill no financial transaction has taken place to determine the value of such goodwill.

Treatment of inherent goodwill

Businesses are strictly prohibited to retain / show / maintain inherent goodwill in their books of accounts, because as per prudence concept it is an unrealised gain. Goodwill is to be written off as soon as it arises.

E.g:-

	$
fixtures and fittings	200,000
equipment	100,000
inventory	50,000
fair value (market value) of net assets	350,000
Purchase consideration	500,000
Purchased Goodwill	150,000

shown as intangible N.C.A in B/S by purchaser.

Example::

purchase consideration

Paperwala ltd acquired a partnership firm of Adeel and Iqbal for $420,000
The assets and liabilities of Partnership firm are as follows::

	Book Value ($)
land and building	150,000
Plant and Machinery	67,500
Equipment	20,000
vehicles	10,000
inventory	40,000
trade receivables	36,000
Bank	10,000
trade payables	(20,000)

The following adjustments were made relating to acquisation:
1. All assets and liabilities were taken over with the exception of bank balance.
2. The fair value of land and building is $200,000.
3. Plant and machinery was taken over after depreciation of $7500.
4. Equipment was written down by 20%.
5. Vehicles were written down to 80%.
6. Trade receivables include bad debt of $6000
7. The net realisable value of inventory is $26000

Required
i. Calculate the amount paid for goodwill.

Fair value of Net Assets taken over::

	$
land and building	200,000
Plant and machinery [67500 - 7500]	60,000
Equipment [20000 x 80%]	16,000
Motor Vehicles [10000 x 80%]	8,000
Inventory [at NRV]	26,000
Trade receivables [36000 - 6000]	30,000
(-) Trade payables	(20,000)
	320,000

Purchased goodwill = Purchase Consideration - Fair Value of Net Assets taken over
$420,000 (-) $320,000
= $100000

The purchase consideration was settled as follows:
i. Cash payment of $60.000
ii. Sufficient 8% convertable debentures to partner Adeel to ensure that he continues to receive same amount of interest as entitled on his $100000 10% loan to partnership.
iii. The balance of consideration was settled by issue of ordinary shares of ¢50 each at a premium of ¢75.

<u>Required</u>
Calculate the number of ordinary shares issued to partners.

	$
Purchase consideration [P.C]	420,000
Cash	(60,000)
	360,000
8% Debentures	(125,000)
	235,000
Ordinary Shares	(235,000)
	-

loan
100000 x 10% = $10.000

Debentures : 100%
10000 : 8%

Debenture = $10000 \times \frac{100}{8}$ = $125000

Issue value = $0.5 + $0.75 = $1.25
par premium

no. of ordinary shares = $\frac{\$235000}{\$1.25}$ = 188,000 shares

$
235000

par	premium
188000 share	188000 share
x 0.5	x 0.75
94000 +	141.000
OSC	S.P

Required

Prepare journal entries in books of Paperwala ltd to record the purchase of Partnership firm.

	Debit $	Credit $
land and building	200.000	
plant and machinery	60.000	
equipment	16,000	
motor vehicle	8,000	
inventory	26,000	
trade receivables	30.000	
goodwill	100,000	
trade payables		20.000
bank ↓		60,000
8% Debentures		125,000
Ordinary share capital [$0.5 x 188000]		94,000
Share Premium [$0.75 x 188000]		141,000
	440,000	440,000

The statement of financial position of Paperwala Ltd before the acquisation of partnership firm was as follows

	$	$
Assets		
Non Current Assets		
land and building		350,000
Plant and machinery		100,000
fixtures		50,000
Total Non current Assets		500,000
Current Assets		
Inventory	100000	
Trade Receivables	50000	150,000
Total Assets		650,000
Equity and Liabilities		
Equity		
800000 ordinary shares of $0.5 each		400,000
Retained earnings		100,000
Total Equity		500,000
Non Current Liabilities		
6% Debentures		100,000
Current liabilities		
Trade Payables	30000	
Bank overdraft	20000	50000
Total Equity and liabilities		650000

Additional Information

After the acquisation of partnership the limited company carried out the following:

1. Revalued existing land and building at $450,000.
2. Rights issue of 1 share for every 5 held to existing shareholders issued on the same price as issued to partners
3. Repaid $20,000 of 6% Debentures
4. Transferred $30,000 to general reserve

Required

Prepare statement of financial position of limited company after taking over the partnership firm and adjustment of above transactions.

1. Land and building ↑	100000	
Revaluation Reserve ↑		100000

2. Rights issue: Issue of share capital to existing shareholders against cash consideration. It is a source of finance, where shares are issued at proportionate basis. It can be issued at par as well as on premium

$\frac{800000 \text{ shares}}{5} \times 1 = 160,000$ new shares

par + premium = issue value
$0.5 + $0.75 = $1.25

Bank [160000 shares x $1.25]	200,000	
O.S.C [160000 shares x $0.5]		80,000
S.P [160000 shares x $0.75]		120,000

3. 6% Debenture ↓	20000	
Bank ↓		20000

4. Retained Earnings ↓	30000	
General Reserve ↑		30000

The statement of financial position of Paperwala ltd after the acquisation of partnership firm was as follows:

	$	$
Assets		
Non Current Assets		
land and building [350+100+200]		650000
Plant and machinery [100+60]		160000
fixtures		50000
equipment		16000
vehicle		8000
Total tangible Non current Assets		884000
Intangibles - Goodwill		100000
Total Non current Assets		984000
Current Assets		
Inventory [100+26]	126000	
Trade Receivables [50+30]	80000	
Bank [-20 - 60 +200 - 20]	100000	306000
Total Assets		1290000
Equity and Liabilities		
Equity		
[800+ 188+160] = 1148000 ordinary shares of $0.5 each		574000
Share Premium [141+120]		261000
Revaluation Reserve		100000
General Reserve		30000
Retained earnings [100-30]		70000
Total Equity		1035000
Non Current liabilities		
6% Debentures [100-20]	80000	
8% Convertable Debentures	125000	205000
Current liabilities		
Trade Payables [30+20]		50000
Total Equity and liabilities		1290000

Important points to remember:

In the books of Partnership

1. Prepare a dissolution a/c to close partnership books of A/Cs.

2. In some cases a limited Company also takes over bank account so it is closed to dissolution A/C.

3. In some cases trade receivables and trade payables are not taken over by limited company, so partners will make collections and payments from receivables and to payables on their own.

4. Total purchase consideration is recorded on the credit side of dissolution a/c. Cash consideration will be debited to partner's bank a/c and consideration in form of financial instruments will be debited to partners' capital A/C.

5. Shares and debentures will be distributed among partners in their profit / loss sharing ratio or any other method specified.

Sale of Business

In order to close the seller's books of accounts and to calculate gain or loss on sale of business a 'dissolution/liquidation/ Realisation Account' is prepared.

helps to close books of Accounts

Calculate gain/loss on dissolution

Important points to remember/steps to be followed:

Step 1: All assets and current liabilities appearing in partnership firm's books of accounts except bank account will be closed to dissolution account

Note: Bank account will only be closed to dissolution account if ltd company is taking over the bank account.

<u>To close the assets account</u>

Dissolution A/C	xxx	
Assets ↓		xxx

at netbook value

<u>To close current liabilities</u>

current liabilities ↓	xxx	
Dissolution A/C		xxx

at B/s value

Step 2: The loan from partner will be transferred to his capital account

	dr	cr
loan ↓	xxx	
Capital A/C ↑		xxx

Step 3 :: Closure of current a/cs.

If credit balance

current a/c ↓	xxx	
capital a/c ↑		xxx

If debit balance

capital a/c ↓	xxx	
current a/c ↑		xxx

Step 4 :: Purchase consideration

The full amount of purchase consideration is credited to dissolution account. Consideration in form of cash is debited to partners bank account, consideration in form of financial instruments such as shares and debentures will be debited to partners capital account

Note :: Shares and debentures will be distributed between partners in their profit / loss sharing ratios or any other method given by the examiner

	$	
Purchase consideration	400000	→ credited to dissolution a/c
cash / bank	(100000)	→ debited to bank a/c
	300000	
Debentures	(50000)	→ debited to B's capital a/c
	250000	
200000 Shares	250000	→ debited to partners' capital a/c
	-	

$$\frac{\$250000}{200000 \text{ shares}} = \$1.25/\text{share}$$

$1.25 (Issue) = $1 (Par) + $0.25 (Premium)

$250000

$200000 S.C | $50000 Premium

$250000

A (2/5) $100000 | B (2/5) $100000 | C (1/5) $50000

bank ↑	100000	
↓ Capital - Deb.	50000	
↓ Capital - S.C	250000	
		Dissolution A/C 400000

Step 5 : Asset taken over by partner

	dr	cr
Capital A/C	xxx	
dissolution a/c		xxx

[at an agreed valuation at which the asset is taken over]

Step 6 :: Assets not taken over by ltd company but sold by partners

	dr	cr
Bank A/C	xxx	
dissolution a/c		xxx

Step 7 :: Dissolution expenses

	dr	cr
Dissolution A/C	xxx	
bank ↓		xxx

Step 8 :: Gain / loss on dissolution

	dr	cr
• Gain on Dissolution		
dissolution a/c	xxx	
capital a/c		xxx
• loss on dissolution		
capital a/c	xxx	
Dissolution a/c		xxx

Step 9:- Any balances remaining on capital will be settled through bank a/c

Step 10:- Closure of bank a/c.

After the withdrawal or deposit of capital through bank account the bank a/c must close to zero balance

338000 438000

Dissolution A/C

Property		100,000	Trade payables	25,000
Machinery		80,000	Purchase Consideration (XYZ)	400,000
Vehicles		70,000	Capital A/c - C (M.V)	13,000
Inventory		40,000		
Trade Receivables		30,000		
Bank (Dissolution exp.)		18,000		
Gain		100,000		
A (2/5)	40000			
B (2/5)	40000			
C (1/5)	20000			
		438,000		438000

Bank A/C

balance b/d	20000	Dissolution exp.	18,000
XYZ ltd	100,000	Capital - A	95,000
Capital - C	30,000	B	37,000
	150,000		150,000

Capital A/cs

	A	B	C		A	B	C
Current a/c	-	-	12000	balance b/d	150000	125000	25000
debentures (xyz ltd)	-	50000	-	Loan	-	15000	-
O.S.C (xyz ltd)	100000	100000	50000	current a/c	5000	7000	-
Dissolution A/c (m.v)	-	-	13000	dissolution gain	40000	40000	20000
Bank (withdraw)	95000	37000	-	Bank (deposit)	-	-	30000
	195000	187000	75000		195000	187000	75000

INTRODUCTION TO COST AND MANAGEMENT ACCOUNTING

Cost / Expense :- Outflow of resources.

Business Activities

Trading	Manufacturing	Service
• Businesses involved in buying and selling of goods	• Businesses involved in production of goods	• Businesses involved in providing services and services are intangible.
• Deal only in finished goods	• Purchase raw material • Converts them into finished	• Do not hold any inventory

Stages of Manufacturing

1. Input [raw material] → 2. Process → 3. Output [finished goods]

Process → Conversion Cost

Conversion Cost → Labour + Overheads

Labour → manual [labour intensive] / machine operator [capital intensive]

Labour intensive business :- Business organisations dependant on manual labour rather than technology and machinery

Capital intensive business :- Business organisations which are more dependant on machines rather than manual labour.