Chapter 5

Absorption Accounts

INTRODUCTION

- In the previous chapter, we have seen accounts relating to amalgamation of companies. In absorption, one of the existing companies, purchase the business of another company and it includes the assets and liabilities of the vendor company in its own assets and liabilities.
- In Amalgamation, two or more existing companies go into voluntary liquidation and they form a new company to take over the business of existing companies. Thus in amalgamation, the existing companies lose their existence and a newly formed company comes into existence. Absorption is amalgamation of business of two companies, in which only one company loses its existence. One of the existing companies takes over the business of the other company.
- The accounts are written in the same way, as those of amalgamation, except that the books of vendor company are to be closed, while the books of purchasing company are continued.

INTRODUCTION

- Thus, the accounts of absorption are divided into two parts: (1) Closing books of one company whose business is taken over, (i.e., Vendor Company or Absorbed Company), and (2) Making entries for purchase of business in the books to the other company (i.e., Purchasing Company or Absorbing Company).
- The main point to be noted in case of Absorption is that the Purchasing Company is one of the old and existing companies whereas in case of Amalgamation, a new company is formed to take over the business of two or more companies. Thus in case of Absorption, the Purchasing Company will absorb the assets and liabilities of Vendor Company into its own assets and liabilities.

6. **Following is the balance sheet of Payal Ltd. as on 31-3-2021 :**

Particulars	Note	Rs.
I. EQUITY AND LIABILITIES :		
(1) Shareholders' Funds :		
(a) Share Capital :		
Equity Share Capital of Rs. 10 each		1,00,000
(b) Reserves and Surplus :		
General Reserve		20,000
Profit & Loss A/c		10,000
Workmen's Compensation Fund		20,000
(2) Non-Current Liabilities :		
(a) Long Term Borrowings : 11% Debentures		40,000
(b) Long Term Provisions : Provident Fund		10,000
(3) Current Liabilities :		
(a) Trade Payables :		
Creditors		30,000
Bills Payables		20,000
Total		2,50,000

II. ASSETS :

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(1) Non-Current Assets :		
(a) Fixed Assets :		
(i) Tangible Assets :		
Land & Building		60,000
Plant & Machinery		50,000
Motor Car		30,000
(ii) Intangible Assets : Goodwill		20,000
(2) Current Assets :		
(a) Inventories : Stock		40,000
(b) Trade Receivables : Debtors		35,000
(c) Cash and Cash Equivalents : Bank balance		15,000
Total		2,50,000

On above mentioned date, Zankar Ltd. absorbed Payal Ltd. with following conditions :

(1) Zankar Ltd. will give 4 equity shares of Rs. 10 each at market price of Rs. 12 against 5 equity shares of Payal Ltd.

(2) Rs. 5 in cash will be paid to each equity share of Payal Ltd.

(3) Zankar Ltd. will give 11% debentures at 12% discount, in such amount, so that debenture-holders Payal Ltd. can get 10% premium.

(4) Zankar Ltd. agrees to pay absorption expenses upto Rs. 2,000.

(5) Zankar Ltd. has taken over all assets (except motor car) and liabilities.

Payal Ltd. sold the motor car at Rs. 35,000. Liabilities regarding workmen compensation is Rs. 8,000. Payal Ltd. paid this amount. Actual absorption expenses incurred are Rs. 4,500.

Zankar Ltd. valued the assets as under :

Land & Building	Rs. 70,000
Plant & Machinery	Rs. 45,000
Stock	Rs. 35,000

Debtors subject to 10% Bad Debts Reserve.

From above particulars :

(a) Prepare in books of Payal Ltd.

(1) Realisation A/c (2) Equity Shareholders' A/c

(3) 11% Debentures A/c (4) Bank/Cash A/c.

(b) Write Journal entries in books of Zankar Ltd.

- **Solution: Step – 1: Net Assets = Total Assets – Total Liabilities**

Total Assets			₹
Land & Building			70,000
Plant & Machinery			45,000
Stock			35,000
Debtors	35,000		
- 10% B.D.R.	3,500		31,500
Bank Balance			15,000
Total Assets			1,96,500
Less: Total Liabilities			
11% Debentures	40,000		
+ 10% Premium	4,000	44,000	
Provident Fund		10,000	
Creditors		30,000	
Bills Payable		20,000	
			1,04,000
Net Assets			**92,500**

Step – 2: Calculation of Purchase Consideration.

Particulars	₹
Equity Share Capital	
Old New	
5 4	
10,000 (?) (8,000 shares of ₹ 10)	80,000
Security Premium (8,000 shares at ₹ 2)	16,000
Cash	
For every 1 shares ₹ 5	
so for 10,000 shares (?)	50,000
Total Purchase Consideration	**1,46,000**

Step – 3: Goodwill or Capital Reserve:

Goodwill = Purchase Consideration – Net Assets

= ₹ 1,46,000 – ₹ 92,500

= **₹ 53,500**

10. The balance sheet of Palak Company Ltd. as on 31-3-2021 is as under :

Particulars	Note	Rs.
I. EQUITY AND LIABILITIES :		
(1) Shareholders' Funds :		
(a) Share Capital :		
4,000 Equity Shares of Rs. 100 each		4,00,000
(b) Reserves and Surplus :		
General Reserve		20,000
Profit & Loss A/c		10,000
Worker's Accident Compensation Fund		10,000
(2) Non-Current Liabilities :		
(a) Long Term Borrowings : 8% Debentures		1,50,000
(b) Long Term Provisions : Provident Fund		10,000
(3) Current Liabilities :		
(a) Trade Payables :		
Creditors		20,000
Bills Payable		5,000
Total		6,25,000

II. ASSETS :		
(1) Non-Current Assets :		
(a) Fixed Assets :		
(i) Tangible Assets :		
Building		2,00,000
Furniture		50,000
Machinery		1,50,000
(ii) Intangible Assets : Goodwill		25,000
(b) Non-Current Investments		20,000
(2) Current Assets :		
(a) Trade Receivables :		
Debtors		80,000
Bills Receivable		60,000
(b) Cash and Cash Equivalents :		
Cash & Bank balance		40,000
Total		6,25,000

The Kanika Ltd. absorbed The Palak Ltd. on following conditions from 1-4-2021 :

(1) To take over all assets except investments and bills receivable.

(2) To take over liabilities except bills payable.

(3) Discharge the debenture debt at a discount of 5% by issue of 10% debentures in Kanika Ltd.

(4) The equity shareholders of Palak Ltd. to be allotted 12 equity shares of Kanika Ltd. of Rs. 10 each at a premium of Rs. 2 per share for every share held by equity shareholders.

(5) Liquidation expenses Rs. 6,500 of Palak Ltd., are borne by Kanika Ltd.

(6) Value of fixed assets are 50% more than its book value.

(7) Palak Ltd. sold the investments for Rs. 25,000 and Rs. 50,000 was realised from bills receivable.

(8) Bills payable paid in full.

You are required to prepare :

Ledger Accounts in the books of Palak Ltd. and calculate the amount of goodwill or capital reserve.

- **Solution: Step – 1: Net Assets = Total Assets – Total Liabilities**

Total Assets			₹
Building	2,00,000		
+ 50% more	1,00,000		3,00,000
Furniture	50,000		
+ 50% more	25,000		75,000
Machinery	1,50,000		
+ 50% more	75,000		2,25,000
Debtors			80,000
Cash & Bank Balance			40,000
Total Assets			7,20,000
Less: Total Liabilities			
8% Debentures	1,50,000		
- 5% Discount	7,500	1,42,500	
Provident Fund		10,000	
Creditors		20,000	
			1,72,500
Net Assets			**5,47,500**

Step – 2: Calculation of Purchase Consideration.

Particulars				₹
Equity Share Capital				
	Old	New		
	1	12		
	4,000	(?)	(48,000 shares of ₹ 10)	4,80,000
Security Premium (48,000 shares at ₹ 2)				96,000
Total Purchase Consideration				**5,76,000**

Step – 3: Goodwill or Capital Reserve:

Goodwill = Purchase Consideration – Net Assets

= ₹ 5,76,000 – ₹ 5,47,500

= **₹ 28,500**

16. The following are the Balance Sheets of Anisa Ltd. and Hamida Ltd. as on 31-3-2021 :

Balance Sheets

Particulars	Note	Anisa Ltd. Rs.	Hamida Ltd. Rs.
I. EQUITY AND LIABILITIES :			
(1) Shareholders' Funds :			
(a) Share Capital :			
Equity Shares of Rs. 100 each fully paid up		7,00,000	—
Equity Shares of Rs. 100 each Rs. 50 paid up		—	5,00,000
(b) Reserves and Surplus :			
General Reserve		90,000	1,00,000
(2) Non-Current Liabilities :			
(a) Long Term Borrowings :			
12% Debentures		3,00,000	2,00,000
(3) Current Liabilities :			
(a) Trade Payables :			
Creditors		2,50,000	1,00,000
Bills Payable		60,000	48,000
Total		14,00,000	9,48,000
II. ASSETS :			
(1) Non-Current Assets :			
(a) Fixed Assets : Tangible Assets		9,60,000	5,50,000
(b) Non-Current Investments : (M. V. Rs. 1,50,000)		—	1,10,000
(c) Other Non-Current Assets : Preliminary Expenses		50,000	28,000
(2) Current Assets		3,90,000	2,60,000
Total		14,00,000	9,48,000

On 1-4-2021, Anisa Ltd. agreed to absorb Hamida Ltd., on the following conditions :

(1) The Fixed Assets of Anisa Ltd. as shown in the books are 20% less than the market value, whereas the Current Assets of Hamida Ltd. includes stock worth Rs. 92,000 which is overvalued by 15%.

(2) The purchase consideration was to be satisfied by issue of 4 fully paid equity shares of Anisa Ltd. in exchange of 10 equity shares of Hamida Ltd. on the basis of intrinsic value of their shares and balance amount in cash.

Prepare necessary accounts in the books of Hamida Ltd. and pass necessary entries in the books of Anisa Limited.

- **Solution: Step – 1: Net Assets = Total Assets – Total Liabilities**

Total Assets		Anisa Ltd. ₹		Hamida Ltd. ₹
Fixed Assets				
(9,60,000 × 100 / 80)		12,00,000		5,50,000
Non-Current Investment (M. V.)		---		1,50,000
Current Assets		3,90,000		---
Current Assets other than stock		---	(2,60,000 – 92,000)	1,68,000
Stock		---	(92,000 × 100 / 115)	80,000
Total Assets		15,90,000		9,48,000
Less: Total Liabilities				
12% Debentures	3,00,000		2,00,000	
Creditors	2,50,000		1,00,000	
Bills Payable	60,000	6,10,000	48,000	3,48,000
Net Assets		**9,80,000**		**6,00,000**

$$\text{Intrinsic Value of Share} = \frac{Net\ Assets}{No.\ of Equity\ Shares} \qquad = \frac{9{,}80{,}000}{7{,}000} \qquad = \frac{6{,}00{,}000}{10{,}000}$$

= ₹ 140 **= ₹ 60**

Step – 2: Calculation of Purchase Consideration.

Hamida Ltd.'s Shares, 10,000 shares × ₹ 60 intrinsic value

= **₹ 6,00,000** total purchase consideration

Payment of Purchase Consideration:

Equity Share Capital				
	Old	New		
	10	4		
	10,000	(?)	(4,000 shares of ₹ 100)	4,00,000
Security Premium (4,000 shares at ₹ 40)				1,60,000
Cash (Balance amount) (6,00,000 – 5,60,000)				40,000
Total Purchase Consideration				**6,00,000**