CORPORATE ACCOUNTING (UG, 2ND SEMISTER)

Presentation

By

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VALUATION OF SHARES AND GOODWILL

- Valuation of shares is the process of knowing the value of company's shares. Share valuation is done based on quantitative techniques and share value will vary depending on the market demand and supply
- Asset-based Approach- the company's net assets value is divided by the number of shares to arrive at the value of each share
- Income-based Approach - Value per share is calculated on the basis of profit of the company available for distribution. This profit can be determined by deducting reserves and taxes from net profit

Market -based Approach of share valuation

- The market-based approach generally uses the share prices of comparable public traded companies and the asset or stock sales of comparable private companies
- Earning Yield - Shares are valued on the basis of expected earning and the normal rate of return
- Dividend Yield - Under this method, shares are valued on the basis of expected dividend and the normal rate of return

Factors affecting valuation of shares

- Demand and supply Demand and supply of securities influence price of securities.
- Bank rate
- Market players
- Dividend announcements
- Management profile
- Trade cycle
- Speculation
- Political factors
- Industrial relations
- Stability of government
- General market sentiments
- Actions of institutional investors

AMALGAMATION

- Term amalgamation is used when two or more existing companies into liquidation and new co. is formed to takeover their business. For e.g. If a new co XY Ltd. Is formed to take over the business of two existing companies, X Ltd. and Y Ltd. ,it is a case of amalgamation

ABSORPTION

- Term absorption is used when one or more existing company goes into liquidation and some existing company takes over its business. Foe e.g. if the business of existing co X Ltd. Is taken over by another co. Y Ltd. ,it is a case of absorption

External Reconstruction

- External reconstruction :- Term is used when one existing company goes into liquidation and a new co. is formed to take over its business. Foe e.g. if a new company X (New) Ltd. Is formed to take over the business of an existing co. X Ltd. Then it is a case of External reconstruction

TYPES OF AMALGAMATION

- Amalgamation in the nature of merger
- Amalgamation in the nature of purchase

Amalgamation in the nature of merger

- It includes:-

1. Transfer of all assets and liabilities
2. Same equity shareholders holding 90%
3. Purchase consideration in equity shares
4. Same business
5. Recording of Assets and liabilities at book value

Methods of Accounting for Amalgamation in the nature of Merger

POOLING OF INTEREST METHOD:- It includes:-

- Recording of assets and liabilities
- Recording of Reserves(whether capital or revenue or arising on revaluation)
- Recording of balance of profit & loss A/c
- Difference between the purchase consideration and the amount of share capital of the transferor Co.
- Uniform set of Accounting policies

Amalgamation in the nature of Purchase

- It is an amalgamation which does not satisfy anyone or more of the condition specified for amalgamation in the nature of merger.

Methods of Accounting for Amalgamation in the nature of Purchase

PURCHASE METHOD:- It includes,

1. Recording of assets and liabilities.
2. Recording of statutory reserves.
3. Recording of reserves other than statutory reserves.
4. Balance of profit & loss A/c.
5. Difference between the purchase consideration and the net asset of the transferor Co.

Purchase 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 asset by the transferee Co. to the shareholders of the transferor Co.

" Payment made by the transferee Co. to discharge the debenture holders and other outside liabilities and the cost of winding up of transferor Co. shall not be considered as part of purchase consideration"

Methods of calculating Purchase Consideration

Cases	Basis of purchase consideration
1. If all the modes of discharging purchase consideration are given along with their individual amount	“Net payment to shareholders basis” should be used
2. In other cases	“ Net Assets taken over basis” should be used

Statement showing the computation of purchase consideration
(According to Net Assets taken over basis)

Particulars	Rs.
A. Total asset taken over at their agreed values	xxx
B. Less: Total liabilities taken over at their agreed amounts	xxx
C. PURCHASE CONSIDERATION (A-B)	xxx

$$\text{No. of shares to be issued by Purchasing Co.} = \frac{\text{Amount to be discharged by issue of shares}}{\text{Issue Price of a share}}$$

Statement showing the computation of purchase consideration
(According to Net Payment basis)

Mode of discharging purchase consideration	No. of shares	Issue price	Rs.
A. Preference shares	xxx	xxx	xxx
B. Cash for preference shareholders	----	----	xxx
C. Equity shares	xxx	xxx	xxx
D. Cash for equity shareholders	----	----	xxx
E. Total Purchase consideration (A+B+C+D)			xxx

Treatment of difference between the purchase consideration and the net assets of the transferor Co. arising on amalgamation in the nature of purchase

1. The excess of purchase consideration over the value of net assets acquired should be treated as **GOODWILL** ARISING ON AMALGAMATION . Such goodwill should be amortized on a systematic basis over a period not exceeding 5 years unless longer period can be justified

2. The excess of net assets acquired over the Purchase Consideration should be treated as **CAPITAL RESERVE** arising on Amalgamation.

Accounting treatment in the books of transferor company or vendor company (Old Co.)

Step-1 Open a realization A/c

Realization A/c Dr. (with the total)

To Sundry Assets (individually) (book Value)

Step-2 Transfer only those third party liabilities which are taken over by the purchasing co., at their respective book figures.

Sundry Liabilities (individually) Dr. (Book Value)

To Realization A/c (with the total)

Step-3 Make due the purchase consideration from the purchasing co.

Purchasing Co. A/c Dr. (with the P.C. due)

To Realization A/c

Step-4 Receive the purchase consideration from the purchasing co.

Cash/Bank A/c Dr. (with cash received)

Pref. shares in purchasing Co Dr. (with issue price of pref. share)

Equity shares in purchasing Co Dr. (with issue price of equity share)

To purchasing Co (with the total)

Step-5 Do the treatment of Liquidation/Realization Expenses

If the expenses are to be paid borne and paid by the vendor company	Realization A/c Dr. To Bank
If expenses are to be reimbursed by purchasing Co 1. On payment by vendor co 2. On reimbursement	Purchasing Co Dr.(agreed amt) Realization Dr.(with excess) To Bank (with the total) Bank Dr. To purchasing Co

Step-6 Realize those assets which have not been taken over by the purchasing Co

Bank A/c Dr.

To realization A/c

Step-7 Discharge those liabilities which have not been taken over by the purchasing co

Respective liability A/c Dr. (with book figure)

Realization A/c Dr. (with the loss)

To Bank (actual payment)

To Realization (with the profit)

Step-8 Discharge the claims of preference shareholders

On due

Preference share capital a/c Dr. (with book figure)

Realization A/c Dr. (with the loss)

To Preference shareholders A/c (actual payment)

To Realization A/c (with the profit)

- ***On making payment:-***

Preference share holders A/c Dr

To bank

To preference shares in purchasing Co

Step-9 Ascertain the profit and loss on realization and transfer the same to the equity shareholders a/c.

In case of profit on realization	Realization A/c Dr. To equity shareholders A/c
In case of loss on realization	Equity shareholder a/c Dr. To Realization

Step-10 Transfer the equity share capital A/c, Accumulated Profits, Reserves and losses to equity shareholders A/c

For transfer of equity share capital, Accumulated profit and reserves	Equity share capital Dr Profit & Loss A/c Dr General Reserves A/c Dr Dividend equalization Reserve Dr Workmen compensation res Dr Capital reserve Dr Securities Premium Dr Debenture redemption reserve Dr Capital redemption reserve Dr To equity Shareholder A/c
For transfer of accumulated losses	Equity shareholders A/c Dr To Profit & Loss A/c To preliminary expenses To underwriting comm. To Dis. of issue of shares To deferred Revenue exp.

Step-11 Make final payment to equity shareholders

Equity shareholders A/c	Dr	(with the total)
To Equity shares in purchasing Co		
To Cash / Bank A/c		

Accounting treatment in the books of transferee Co. or purchasing Co. (New Co.)

Step-1 Record the acquisition of business from the vendor Co.

Business purchase A/c Dr (with purchase consideration)
To Liquidator of the vendor

Step-2 In case the amalgamation in the nature of merger

Assets (Individually)	Dr	(Book Value)
To Liabilities		(Book Value)
To provision for doubtful debts		(Book Value)
To Provision for depreciation		(Book Value)
To Reserves (Other then revenue reserve)		(Book Value)
To General Reserve		(balancing figure)
To business Purchase		(Purchase consideration)

- **Step-2 (A) In case of amalgamation in the nature of purchase**

Assets (individually)	Dr	(Respective agreed values)
Goodwill	Dr	(Excess of P.C over the net assets)
To Liabilities (individually)		(Respective agreed values)
To Business purchase		(Purchase consideration)
To Capital reserve		(excess of net assets over the purchase consideration)

Step-2 (b) In case of amalgamation in the nature of purchase

" Record the statutory reserves of the transferor company"

Amalgamation adjustment A/c	Dr.	(with the total)
To statutory Reserves A/c		(Respective book balance)

Step-3 Make payment to vendor company

Liquidator of vendor Co. A/c	Dr	(with the total)
Discount of issue of shares	Dr	(Discount allowed on shares)
To Equity share capital		(Paid up value of equity shares)
To preference share capital		(Paid up value of Pref. shares)
To Securities premium		(with Securities premium)
To Cash/Bank		(Cash payment)

Step-4 Record then issue of debentures to discharge the existing debenture holders of vendor Co

Debentures in Vendor Co Dr (amount of debenture)

Dis. on issue of deb. in purchasing Co Dr. (Debenture discount)

To Debentures in purchasing Co (Nominal value)

To Securities Premium (Debenture Premium)

Step-5 Record the reimbursement of the liquidation expenses of the vendor Co

Profit & Loss A/c (Merger) Dr

Goodwill A/c (Purchase) Dr

To Bank

Step 7 **Eliminate the inter company Owings.**

To eliminate the debts owed by vendor Co.	Sundry creditors of vendor Co Dr To sundry debtors
To eliminate the debts owed by purchasing Co.	Sundry Creditors Dr To Sundry Debtors of vendor
To eliminate the bills drawn and retained by vendor Co. upon purchasing Co.	Bills Payable A/c Dr To Bills Receivables of vendor
To eliminate the bills drawn and retained by Purchasing Co. upon vendor Co.	Bills payable of Vendor Co. Dr To Bills Receivable A/c
To eliminate the debentures held by Vendor Co. in purchasing Co.	Debentures A/c Dr To Investment in Debentures A/c
To eliminate the debentures held by purchasing Co. in vendor Co.	Debentures in Vendor Co. Dr To investment in debenture

- **Set off goodwill against Capital reserve**

  Capital Reserve A/c Dr

  To Goodwill A/c

CASH FLOW ANALYSIS

- **INTRODUCTION**
- **STATEMENT OF CASH FLOW**
- **ANALYSIS IMPLICATIONS OF CASHFLOWS**
- **ANALYSIS OF CASH FLOWS**
- **SPECIALISED CASH FLOW RATIOS**
- **ANALYTICAL CASH FLOW WORKSHEET**

INTRODUCTION

- **OBJECTIVES**
  - Provide users of financial statements the basis for assessing the co. ability to generate cash and cash equivalents and needs of the company to utilize those cash flows.
  - Used to make economic decisions.
  - Provide historical movements in cash and cash equivalents.

INTRODUCTION

- **DEFINITIONS**
  - **Cash** comprises of cash on hand, and demand deposits (including those in foreign currencies) net of bank overdrafts.
  - **Cash equivalents** are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are not subject to any significant risk of changes in value.
  - They include short-term securities; investments that have a short maturity of three months or less from the specified redemption date

INTRODUCTION

- **DEFINITIONS, CONT'D**
  - **Cash flows:** Net cash flows, or simply *cash flows,* refers to the current period's cash inflows less cash outflows
  - Cash flows are different from accrual income measures of performance
  - Cash flow measures recognize inflows when cash is received but not necessarily earned, and they recognize outflows when cash is paid but the expenses not necessarily incurred

INTRODUCTION

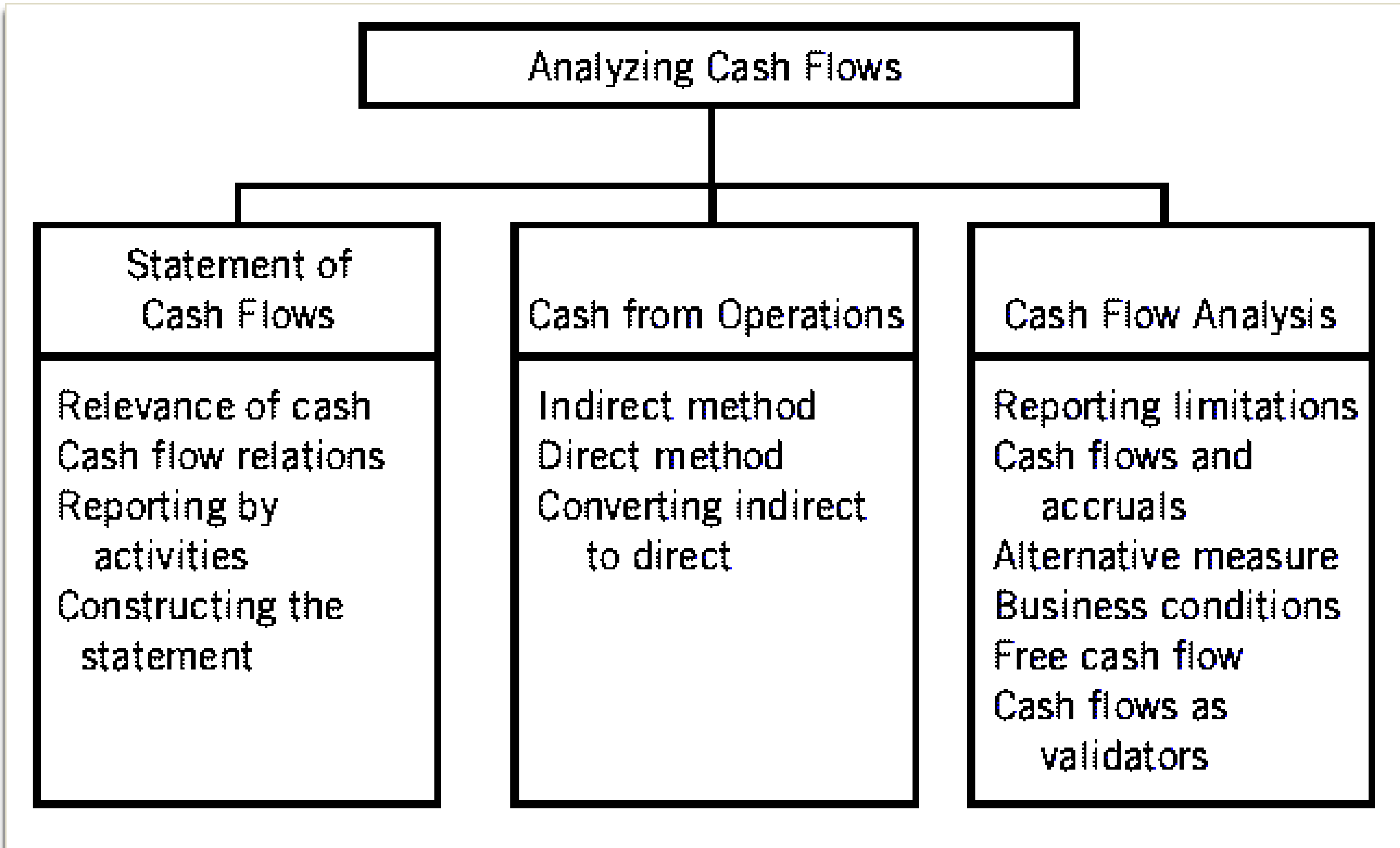
Questions addressed by users of cash flow statements

- How much cash is generated from/ used in operations?
- What expenses are made with cash from ops?
- How are dividends paid when confronting an operating loss?
- What’s the source for cash for debt payments?
- How is increase in investments financed?
- What’s the source of cash for new plant assets?
- What’s the use of cash received from new financing.

STATEMENT OF CASH FLOW

- **PURPOSE OF STATEMENT OF CASH FLOW**
- **RELEVANCE OF CASH**
- **REPORTING BY ACTIVITIES DETAILED**
- **CONSTRUCTING THE STATEMENT OF CASH FLOW**
- **SPECIAL TOPICS**

STATEMENT OF CASH FLOW



STATEMENT OF CASH FLOW

- **PURPOSE OF STATEMENT OF CASH FLOW**
  - Provide information about the sources and application of cash inflows and outflows for a given accounting period by separating them into three main business activities
    - Operating
    - Investing
    - Financing
  - It presents the changes in cash resulting from the business activities.
  - It communicates information about the financial adaptability of an enterprise for a given period of time.

STATEMENT OF CASH FLOW

- **RELEVANCE OF CASH**
  - It is cash, not income, that ultimately repays loans, replaces equipment, expands facilities, and pays dividends
  - Cash flow analysis helps in assessing liquidity, solvency, and financial flexibility.
    - **Liquidity** is the nearness to cash of assets and liabilities
    - **Solvency** is the ability to pay liabilities when they mature
    - **Financial flexibility** is the ability to react and adjust to opportunities and adversities

STATEMENT OF CASH FLOW

- **REPORTING BY ACTIVITIES**
  - **Operating activities** are the main revenue-producing activities that are not investing or financing activities. They include:
    - Cash receipts from sale of goods.
    - Cash payments to and on behalf of employees.
    - Cash receipts from royalties, fees, commissions & other revenue.
    - Cash receipts and payments under contracts held for dealing/ trading purposes.
    - Cash receipts and payments of insurance premium and benefits, annuities and other liabilities arising from policies underwritten.
    - Cash payments/ refunds of income taxes, unless they can specifically be classified within the investment/financing activities.

STATEMENT OF CASH FLOW

- **REPORTING BY ACTIVITIES**
  - **Investing activities** are those that represent expenditures that have been made for resources intended to generate future income and cash flows. E.gs
    - Cash advances & loans to 3rd parties.
    - Charges arising from loan repayment and advances to 3rd parties
    - Payments for purchase of tangible fixed assets, intangible assets & payments to capitalized development costs & work performed by the company for its property, plant & equipment.
    - Payments under forward contracts, futures, options & swap transactions except contracts held on grounds of dealing/ trading routine.

STATEMENT OF CASH FLOW

- **REPORTING BY ACTIVITIES**
  - **Financing activities** are means of contributing, withdrawing, and servicing funds to support business activities. They include:
    - Cash reimbursements for funds borrowed.
    - Cash receipts for issuance of shares/equity instruments.
    - Payments to owners for the purchase / redeem of shares
    - Cash receipts from issuing debentures, loans, bonds, mortgage ballots and other funds borrowed.

STATEMENT OF CASH FLOW

• Indirect Method

Profit before interest and income taxes	xx,xxx
Add back depreciation	xx,xxx
Add back amortization of goodwill	xx,xxx
Increase in receivables	xx,xxx
Decrease in inventories	xx,xxx
Increase in trade payables	xx,xxx
Interest expense	xx,xxx
Less Interest accrued but not yet paid	xx,xxx
Interest paid	xx,xxx
Income taxes paid	xx,xxx
Net cash from operating activities	**xx,xxx**

□ Direct Method

	Sh.	Sh.
Cash flows from operating activities:		
Cash receipts from customers	XX	
Cash paid to suppliers and employees	(XX)	
Cash generated from operations	XX	
Income taxes paid	(XX)	
Net cash from operating activities		XX
Cash flows from investing activities		
Dividends received	XX	
Proceeds from sale of marketable securities	XX	
Purchase of marketable securities	(XX)	
Purchase of plant and equipment	(XX)	
Proceeds from sale of equipment	XX	
Net cash from investing activities		XX
Cash flows from financing activities		
Proceeds from issue of share capital	XX	
Proceeds from long term borrowing	XX	
Interest paid	(XX)	
Dividends paid	(XX)	
Net cash from financing activities		XX
Change in cash and cash equivalents		XX
Add: Cash and cash equivalents at beginning of period		XX
Cash and cash equivalents at end of period		XX

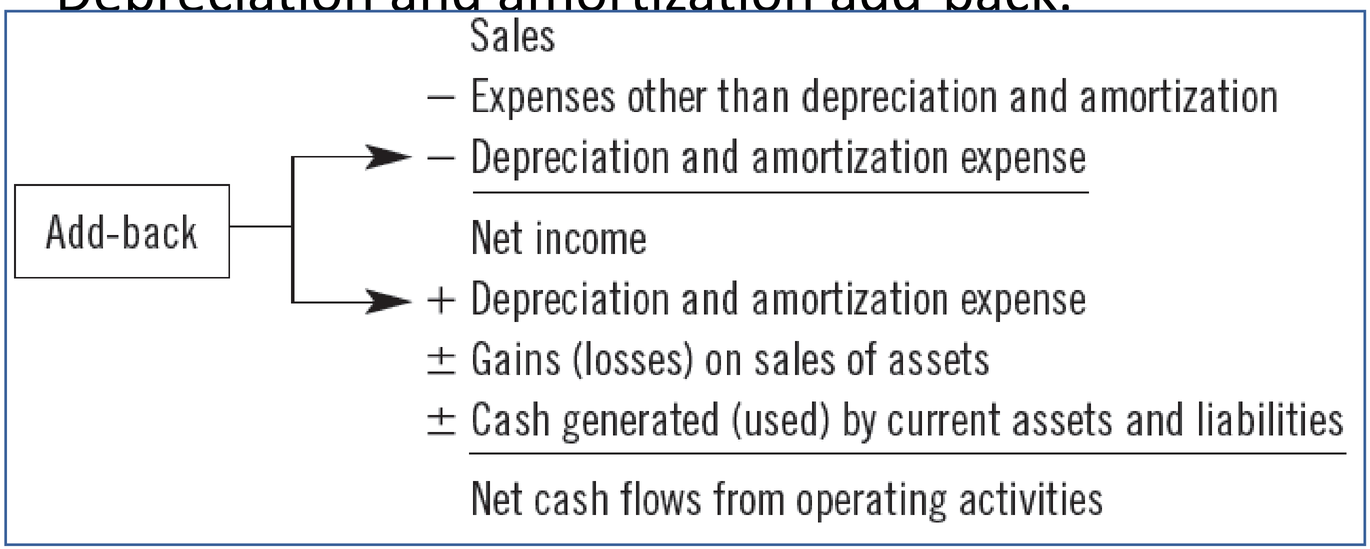
STATEMENT OF CASH FLOW

- **CONSTRUCTING THE STATEMENT OF CASH FLOW (Indirect Method)**
  - Consider first the net cash from operations

	Net income
+	Depreciation and amortization expense
±	Gains (losses) on sales of assets
±	Cash generated (used) by current assets and liabilities
	Net cash flows from operating activities

STATEMENT OF CASH FLOW

- **CONSTRUCTING THE CASH FLOW STATEMENT (Indirect Method)**
  - Depreciation and amortization add-back.



STATEMENT OF CASH FLOW

- **CONSTRUCTING THE CASH FLOW STATEMENT (Indirect Method)**
  - Adjustments for changes in balance sheet accounts can be summarized as follows:

Account	Increase	Decrease
Assets.............	Cash Outflow	Cash Inflow
Liabilities.........	Cash Inflow	Cash Outflow

STATEMENT OF CASH FLOW

- **STEPS IN CONSTRUCTING THE CASH FLOW STATEMENT**
  - Start with Net Income
  - Adjust Net Income for non-cash expenses and gains
  - Recognize cash inflows (outflows) from changes in current assets and liabilities
  - Sum to yield net cash flows from operations
  - Changes in long-term assets yield net cash flows from investing activities
  - Changes in long-term liabilities and equity accounts yield net cash flows from financing activities
  - Sum cash flows from operations, investing, and financing activities to yield net change in cash
  - Add net change in cash to the beginning cash balance to yield ending cash

STATEMENT OF CASH FLOW

GOULD CORPORATION
Statement of Cash Flows
For Year Ended December 31, Year 2

Net income	$ 84,000	
Add (deduct)		
Depreciation and amortization expense	35,000	
Gain on sale of assets	(5,000)	
Accounts receivable	(9,000)	
Inventories	6,000	
Prepaid expenses	3,000	
Accounts payable	(5,000)	
Accrued expenses	4,000	
Net cash flow from operating activities		$113,000
Purchase of equipment	(70,000)	
Sale of equipment	7,000	
Net cash flows from investing activities		(63,000)
Mortgage payable	(150,000)	
Preferred stock	175,000	
Dividends	(51,000)	
Net cash flows from financing activities		(26,000)
Net increase in cash		24,000
Beginning cash		51,000
Ending cash		$ 75,000

Note: Assets costing $30,000 were purchased during Year 2 and were financed in whole by the manufacturer.

HOLDING COMPANY

- A **holding company is a company or firm that owns other** companies' outstanding stock.
- It usually refers to a company which does not produce goods or services itself, rather its *only purpose is owning shares of other* companies.
- Holding companies allow the reduction of risk for the owners and can allow the ownership and control of a number of different companies.

Consolidated Financial Statements

- Consolidated financial statements present the financial position and results of operations for a parent and one or more subsidiaries, as if they were a single company.
- Consolidation is **required** when a corporation owns a majority of another corporation's outstanding common stock.
- Same accounting principles apply for a consolidated company.

Consolidated Financial Statements

- Two companies are considered to be related companies when one controls the other company.

- Consolidated financial statements are generally considered to be more useful than the separate financial statements of the individual companies when the companies are related

- Holding Company is a company which has a control over another company by either of the following:

- ❑ Controls the composition of it’s Board of Directors.
- ❑ Holds more than half in nominal value of it’s Equity share capitals.
- ❑ It is the Holding Co for it’s Subsidiary’s Subsidiary Co.

Consolidation of P&L A/c

- The consolidated profit & loss a/c of the holding Co and it's subsidiaries are prepared to show the operating activities of the Cos.
- The items appearing in the P&L a/c of both individual companies are aggregated in the consolidated P&L a/c.

Cost of Control

- The holding company acquires more than 50% of shares which may be either at a premium or at a discount price.
- If the amount paid by the holding company for the shares of subsidiary company is more than its proportionate share in the net asset of subsidiary company, the difference is considered as goodwill.

Minority Interest

- Minority interest is the share of the outsider in the following:

❑ Share in share capital of subsidiary.

❑ Share in reserves.

❑ Share in accumulated loss should be deducted.

❑ Proportionate share of profit or loss on revaluation of assets.

Capital and Reserve Profit

- Any profit earned by subsidiary company before the date of acquisition is the capital profit.
- Any profit earned by subsidiary company after the date of acquisition is the revenue profit.

Bonus Shares

- Issue of bonus shares out of pre-acquisition profits :
- ❑ The cost of control remains unchanged as the share capital increases by
- ❑ the amount of bonus and capital profits decreases by the same amount
- ❑ when bonus shares are issued out of pre-acquisition profits.
- Issue of bonus shares out of post-acquisition profits :
- ❑ This will result either in decrease in cost of control or increase in capital reserve.

Inter Company Transactions

- The holding and the subsidiary company may have a number of inter company transactions. Some are:

- ❑ Loan advanced by the holding company to the subsidiary company or vice versa.
- ❑ Sale or purchase of goods on credit by the holding company from the subsidiary company or vice versa.
- ❑ Debentures issued by one company may be held by the other.