CMA Students Newsletter (For Final Students)

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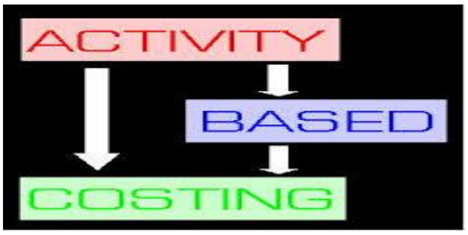
Activity Based Costing

Activity based costing (ABC) assigns manufacturing overhead costs to products in a more logical manner than the traditional approach of simply allocating costs on the basis of machine hours. Activity based costing first assigns costs to the activities that are the real cause of the overhead. It then assigns the cost of those activities only to the products that are actually demanding the activities.



"Activity Based Costing" is defined as "Cost Contribution to cost units on the basis of benefits received from indirect activities, i.e., ordering, setting up, assuring quality etc.

Objective of Activity Based Costing

Remove manufacturing costs from product costing
↓
Determine the single best measure for allocating all overhead costs to products or services
↓
Fully cost products for external reporting purposes.
↓
Understand overhead and the profitability of products, services, and customers.

Need for Activity Based Costing

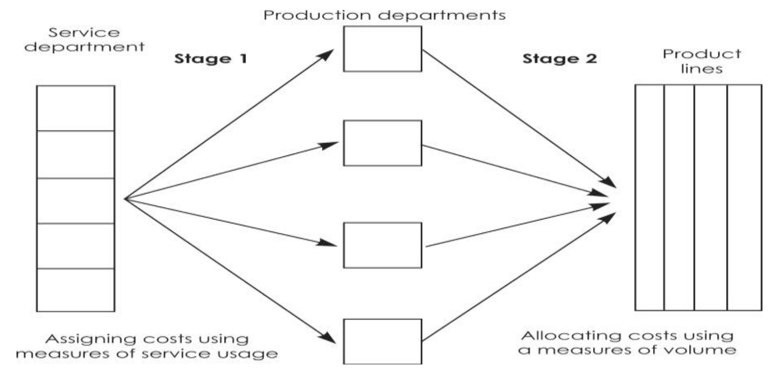
Production overheads are high in relation to direct cost
↓
There is a great diversity in the product range
↓
Products uses very different amount of the overhead
↓
Consumption of overhead resources is not primarily driven by volume

Steps in Activity Based Costing

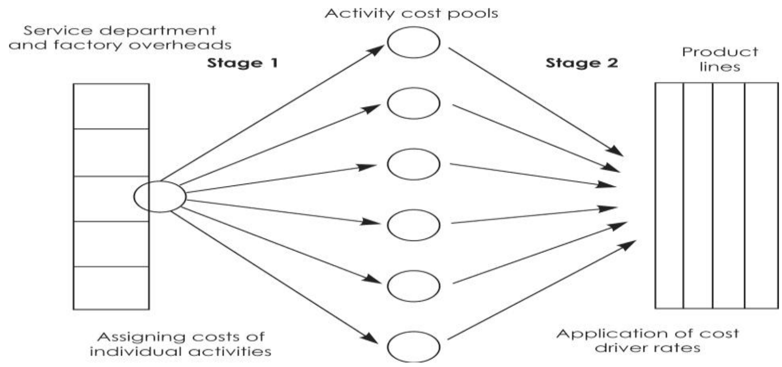
Understanding and analyzing manufacturing process
↓
Studies of the activities involved
↓
Activity Cost Pool
↓
Cost Drivers
↓
Identification of costs with the products

Given below are the two charts outlining how Activity-Based Costing is different from Conventional Cost allocation:

Conventional Allocation of Common Costs



Activity-based Costing



Traditional Volume-based Costing V/s ABC

Example: MN Ltd. produces two products X and Y. Both are produced on the same equipment and use similar processes. The products differ by volume. Product X is a high-volume product, while Y is low-volume product. Details of product input and output and the cost of activities are as follows:

Products	Machine hrs per unit	Direct labour hrs. per unit	Annual output (units)	Total machine hrs.	Total direct labour hrs.	No. of purchase orders	No. of set-ups
Product X	2	4	1,000	2,000	4,000	80	40
Product Y	2	4	10,000	20,000	40,000	160	60
				22,000	44,000	240	100

The Cost Centre costs are ₹4,40,000, but have been further analysed as follows:

Volume-related	₹1,10,000
Purchasing-related	1,20,000
Set-ups-related	2,10,000
	4,40,000

You are required to answer the following:

(a) Considering tradition volume-based costing system is in use:
- **(i)** Overhead rate per machine hour
- **(ii)** Overhead rate per direct labour hour
- **(iii)** Overhead per unit of X and Y

(iv) Total cost of 1,000 products of X and 10,000 products of Y.

(b) Considering ABC system is followed:

(i) Cost per unit consumption for each volume-related, purchase-related and set-up-related activity.

(ii) Total cost traced to products X and Y separately for volume-related activities, purchasing-related activities and set-up-related activities.

(iii) Cost5 per unit of products X and Y.

(c) Offer your comments on the working and product costs arrived at under different systems along with your analysis of the above-mentioned situation.

Solution:

(a) Based on traditional volume-based costing system:

(i) Overhead rate per machine hour = ₹4,40,000/ 22,000 = ₹20

(ii) Overhead rate per direct labour hour = ₹4,40,000/ 44,000 = ₹10

(iii) Cost per unit:

X= ₹40 (i.e., 2 machine hrs. @ ₹20 or 4 DLH × ₹10)

Y = ₹40 (i.e., 2 machine hrs. @ ₹20 or 4 DLH × ₹10)

(iv) Total Cost allocated to products:

X = 1,000 × ₹40 = ₹40,000

Y = 10,000 × ₹4,00,000

(b) ABC System

	Activities		
	Volume-related	Purchasing-related	Se-up-related
Cost traced to activities	₹1,10,000	₹1,20,000	₹2,10,000
Consumption of activities (Cost drivers)	22,000 Machine hrs.	240 purchase orders	100 Ser-ups
(i) Cost per unit of consumption	₹5 per machine hrs.	₹500 per orders	₹2,100 per set-up
(ii) Total Cost traced to:			
X	₹10,000 (2,000 × ₹5)	₹40,000 (80 × ₹500)	₹84,000 (40 × ₹2,100)
Y	₹1,00,000 (20,000 × ₹5)	₹80,000 (160 × ₹500)	₹1,26,000 (60 × ₹2,100)
(iii) Cost per unit:			
X = ₹134, i.e., [(₹10,000 + ₹40,000 + ₹84,000) ÷ 1,000]			
Y = ₹30.60, i.e., [(₹1,00,000 + ₹80,000 + ₹1,26,000) ÷ 10,000]			

(c) Comments:

(i) Traditional Cost system uses one allocation base either machine hours or direct labour hours. In contrast, ABC system uses three second-stage allocation bases (machine hours, number of set-ups and number of purchase orders).

(ii) The product costs under different system are as follows:

	Traditional Costing	ABC System
Product X (Low-volume product)	₹40	₹134.00
Product Y (High-volume product)	₹40	₹30.60

Under traditional system, high-volume product Y costs the same as low-volume product X.
This is because high-volume products in total consume ten times number of machine hours required by their low-volume counterparts. Consequently, ₹4,00,000 overheads are allocated to product Y and ₹40,000 to product X, but since the volume for product Y is ten times higher, the unit costs are the same.
A comparison of product costs under two sets demonstrates how traditional volume-based costing systems over cost high-volume (Y) in relation to their low volume counterparts (X). The reason for this is that the high-volume products consume ten times as many machine hours and direct labour hours as low-volume products. But the high-volume products are ordered only twice as often (160 purchase orders compared with 80) and set-up $1^1/_2$ times as often (60 set-up compared with 40) as low-volume products. The traditional volume-based system ignores these differences in relative consumption of overhead resources. The result is high-volume products are overcosted and low-volume products are undercosted.

CONDITIONS FOR TAXABILITY OF GIFTS OF UNLISTED SHARES RECEIVED BY A CLOSELY HELD COMPANY

1. Conditions for taxability of unlisted shares received by closely held company/firm/LLP

Shares received by a closely held company (company in which public are not substantially interested) or firm shall be taxed as income in its hands under section 56(2)(viia) if the following conditions are satisfied:

- The shares received are shares of a company in which the public is not substantially interested (i.e. unlisted shares).
- The shares are received on or after 1-6-2010.
- These shares may be received from any person or persons.
- The shares are received without consideration and the aggregate FMV of such shares received during a previous year exceeds ₹ 50,000. Alternatively, the shares are received for a consideration which is less than the FMV and the aggregate of differences (between FMV and consideration) of all such shares received during a previous year exceeds ₹ 50,000.
- The shares received may be either equity shares or preference shares - does not matter.
- Such shares are not received by way of a transaction not regarded as transfer under clause (via)/(vib)/(vic)/(vid)/(vii) of section 47.
- 'Fair market value' of a property, being shares of a closely held company, shall have the meaning assigned to it in Explanation to section 56(2)(vii). Thus, FMV of shares of a closely held company shall mean FMV determined in accordance with rules 11U and 11UA.

1.1 Firm

Firm includes LLP. [Section 2(23)(i) of the Act]. Therefore, section 56(2)(viia) also applies to LLP.

1.2 Closely-held company (i.e. company in which public are not substantially interested)

Section 2(18) defines 'company in which public are substantially interested' (i.e. widely-held companies). According to section 2(18) of the Act, a company is said to be a company in which the public are substantially interested (i.e. the company is not a closely-held company) if :

(a) it is owned by the Government or the Reserve Bank of India or in which not less than 40% of the shares are held (whether singly or taken together) by the Government or the Reserve Bank of India or a corporation owned by that bank; or

(aa) if it is registered under section 8 of the Companies Act, 2013; or

(ab) if it is a company having no share capital and it is declared by order of the Board to be a company in which the public are substantially interested; or

(ac) if it is a mutual benefit finance company, that is to say, a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under section 406 of the Companies Act, 2013, to be a Nidhi or Mutual Benefit Society; or

(ad) if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 51% of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant previous year beneficially held by, one or more co-operative societies;

(b) if it is a company which is not a private company as defined in the Companies Act, 2013, and the conditions specified either in item (A) or in item (B) are fulfilled, namely:—

(A) shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) were, as on the last day of the relevant previous year, listed in a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956, and any rules made thereunder;

(B) shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 50% (40% if the company is an Indian company whose business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power) of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant previous year beneficially held by—

(a) the Government, or

(b) a corporation established by a Central, State or Provincial Act, or

(c) any company to which this clause applies or any subsidiary company of such company if the whole of the share capital of such subsidiary company has been held by the parent company or by its nominees throughout the previous year.

If a company does not satisfy the definition of section 2(18) as above, then it is a company in which the public are not substantially interested i.e. closely held company.

2. Comparison of section 56(2)(viia) read with section 56(2)(vii)(c)

The following are the differences in taxability of receipt of shares without consideration or for inadequate consideration in the hands of individuals/HUF under section 56(2)(vii)(c) and in the hands of firm/ closely held companies under section 56(2)(viia):

Sl No.	Points of comparison	Taxability in the hands of individuals/HUFs under section 56(2)(vii)(c)	Taxability in the hands of closely held companies/ firms under section 56(2)(viia)
1.	Introduced by	Finance (No. 2) Act, 2009	Finance Act, 2010
2.	Effective from	1-10-2009	1-6-2010
3.	Shares covered	Shares of both listed and unlisted companies	Shares of only unlisted companies

4.	Whether receipt of other securities taxable?	Yes	No
5.	Whether shares received must be the capital asset of the recipient assessee?	Yes	No such requirement. This is probably because no one would hold unlisted shares as stock-in-trade

TRANSACTIONS EXEMPT FROM TAXABILITY UNDER SECTION 56(2)(viia)

1. Exempt transactions

If shares in unlisted companies are received by a closely-held company or firm under transactions not regarded as transfer under clause (via)/(vic)/(vicb)/(vid)/(vii) of section 47, no tax is attracted under section 56(2)(viia). These exempt transactions covered by clause (via)/(vic)/ (vicb)/(vid)/(vii) of section 47 are as under :

- any transfer in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company [Section 47(via)]
- any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company [Section 47(vic)]
- any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank **[Section 47(vicb)]**
- any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking [Section 47(vid)]
- any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company [Section 47(vii)].

2. Receipt of shares by the amalgamated foreign company in a transaction covered by section 47(via)

If there is any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, the receipt of such shares by the amalgamated foreign company shall not attract tax under section 56(2)(viia) if—

(a) at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and

(b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated.

3. Receipt of shares by the resulting foreign company in a transaction covered by section 47(vic)

If there is any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, the receipt of such shares by the resulting foreign company shall not attract tax under section 56(2)(viia) if—

(a) the shareholders holding not less than 75% in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

4. Receipt of shares in a transaction covered by section 47(vica)

If there is any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor cooperative bank, the receipt of such shares shall not attract tax under section 56(2)(viia) if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank. The expressions 'business reorganisation', 'predecessor co-operative bank' and 'successor co-operative bank' shall have the meanings respectively assigned to them in section 44DB.

5. Receipt of shares in a scheme of demerger - Section 47(vid)

If there is any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company, the receipt of such shares shall not attract tax under section 56(2)(viia) if the transfer or issue is made in consideration of demerger of the undertaking.

6. Receipt of shares in a scheme of amalgamation – Section 47(vii)

If there is any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, the receipt of such shares shall not attract tax under section 56(2)(viia) if—

(a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and

(b) the amalgamated company is an Indian company.

Exemption to Small Scale Industries (SSI)

The threshold exemptions granted to manufacturers under exemption notifications are popularly called SSI exemption notifications are popularly called SSI exemption notifications because originally meant to be an incentive to SSI units. SSI units are eligible for exemption from duty under Notification No. 8/2003-CE dated 1-3-2003.

A manufacturer is eligible for SSI exemption of ₹ 150 lakhs in the current financial year, if —

- the aggregate value of clearances of excisable goods
- for home consumption
- does not exceed ₹ 400 lakhs
- in the preceding financial year.

SSI Units have been given Two Types of Exemptions:

Option 1:

- SSI units can avail full exemption upto ₹ 150 lakhs
- Pay normal duty thereafter.
- Such units can avail Cenvat credit only after reaching turnover of ₹ 150 lakhs in the financial year.

Option 2:

- Pay full 100% duty
- Avail Cenvat credit

Clubbing of Clearances for Computing the Limit of ₹ 400 lakhs/ ₹ 150 lakhs:

1) Where a single manufacturer having two or more factories, the eligibility limit of ₹ 400 lakhs/ ₹ 150 lakhs will be determined after adding up clearances of all such factories.

2) Where a single factory is used by more than one manufacturer, the eligibility limit of ₹ 400 lakhs/ ₹ 150 lakhs will be determined after adding up clearances of all such manufacturers from that factory.

Case Study:

In the case of Muthusavaari Pillai Paper Products (MPPP) v. CCE – 2004 (171) E.L.T. 219 (Tri. – Chennai) it was held that looking after the work of the sister's unit by proprietor of M/s MPPP on day-to-day basis is not a sufficient ground for clubbing of clearances. In the instant case, it was held that when the two units have separate registration with Central Excise Department, Sales Tax and Income-tax Authorities. Regular returns was filed by both units and assessed. The factors of one supervisor working for both units and one unit doing certain finishing processes for another unit is not a basis for clubbing the clearances of the two units. however, one of the members has given a contra view in this regard wherein it was held that since common office, common management, one unit doing certain finishing processes and storing, packing and clearances by one unit on behalf of the other unit was not denied. In this background, it cannot be said that just because, both the units were separately registered for the purpose of Income Tax, Sales Tax etc. both the units are separate legal entities for production and clearances of excisable goods. In these circumstances, the production of both the units is required to be clubbed.

Turnovers to be Excluded for Calculating Limit of ₹ 400 Lakhs/ ₹ 150 Lakhs:

- Export turnover except export to Nepal / Bhutan
- Turnover of non-excisable goods
- Goods manufactured with other's brand name cleared on payment of duty
- Intermediate products / captive consumption when final product eligible for SSI exemption
- Turnover as trader along with own manufactured goods
- Job work amounting to manufacture done under specified notifications
- Job work or any process which does not amount to manufacture
- Strips of plastics used within the factory
- Inputs brought by assessee and cleared as such
- Final products brought back for inspection
- Final products brought back for repairs.

Turnovers to be Included for Calculating Limit of ₹ 400 Lakhs/ ₹ 150 Lakhs:

- Goods manufactured in rural area with other's brand name
- Deemed export but excludible if supplied under CT-3 (obtained from an 100% EOU)
- Export to Nepal / Bhutan
- Goods manufactured even if later rejected and returned
- Goods cleared with payment of duty
- Goods cleared under compounded levy scheme.

Distinction between mode of calculations of ₹ (150/ 400) lakhs: Generally, provisions for calculation of turnover for ₹ 150 lakhs and ₹ 400 lakhs are similar. Major distinction is that if goods are exempt under a notification other than SSI exemption notification or job work exemption notification the turnover will be included for calculating ₹ 400 lakhs limit but not for ₹ 150 lakhs limit. If final product is exempt under job work exemption notification it is not to be considered either for ₹ 150 lakhs or for ₹ 400 lakhs.

'Value' for Calculating Exemption Limit: For calculating the SSI exemption limit of ₹ 400 Lakhs and ₹ 150 Lakhs,

- Assessable value will be transaction value as per section 4 of the Central Excise Act.

- If assessment is done on the basis of MRP provision, value will be determined as per section 4A of the Central Excise Act.
- If goods cleared under compounded levy scheme, value will be determined on the basis of transaction value u/s 4.

Illustration:

S Associates, a small scale unit, had cleared goods of the value of ₹ 890 lakhs during the financial year 2013-14. Records show that the following clearances were included in the total turnover of ₹ 750 lakhs: (i) Total exports during the year - ₹ 300 lakhs (25% of total exports were to Nepal), (ii) Job-work in terms of Notification No. 214/86 - ₹ 60 lakhs, (iii) Job-work in terms of Notification No.83 /94-E - ₹ 70 lakhs, (iv) Clearances of excisable goods without payment of duty to a 100% E.O.U. ₹ 45 lakhs, (v) Goods manufactured in rural area with others brand - ₹ 120 lakhs. Find out whether the unit is eligible to avail concession for the year 2014-15, under Notification No. 8/2003-CE dated 1st March, 2003.

Answer:

Turnover not to be considered for ₹ 400 lakhs - (i) ₹ 225 lakhs (75% of ₹ 300 lakhs), (ii) ₹ 60 lakhs, (iii) ₹ 70 lakhs, (iv) ₹ 45 lakhs. Excluding this turnover, his turnover during 2013-14 was ₹ 490 lakhs. Since it is more than ₹ 400 lakhs, the unit is not eligible for SSI exemption in 2014-15.

Some Procedural Concessions to SSI Units:

- SSI to file quarterly return by 10th of the following month from the end of relevant quarter.
- SSI to pay duty quarterly by 5th/ 6th (in case of e-payment) of the month following the quarter.
- In case of March, duty is payable by 31st March
- SSI can avail entire Cenvat credit in capital goods in the first year.
- Small units, having turnover below ₹ 150 lakhs, which are exempt from duty, are also exempt from provision of registration.
- Even if export turnover exceeds ₹ 150 lakhs, no registration is required if home consumption is less than ₹ 150 lakhs.

Treatment of Goodwill/ Capital Reserve in Amalgamation

I. In Case of Amalgamation in the Nature of Merger —

The difference between purchase consideration paid by the transferee company to the transferor company and the amount of share capital (equity + preference capital) of the transferor company should be adjusted with reserves.

(₹ in Lakhs)

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
	₹	₹		₹	₹
Share capital:			Fixed assets	1,200	1,000
Equity Shares of ₹	1,000	800	Current assets,		
100 each			Loans and		
			Advances	880	565
15% Preference Share	400	300			
Capital of ₹ 100 each					
Reserve and Surplus:					
Revaluation Reserve	100	80			
General Reserve	200	150			
P & L Account	80	60			
Secured Loan:					
12% Debentures of					
₹ 100 each	96	80			
Current Liabilities					
and Provisions	204	95			
	2,080	1,565		2,080	1,565

Other Information:

A. 12% Debenture holders of A Ltd. and B Ltd. are discharged by D Limited by issuing adequate number of 16% Debentures of ₹ 100 each to ensure that they continue to receive the same amount of interest.

B. Preference shareholders of A Ltd. and B Ltd. have received same number of 15% Preference shares of ₹ 100 each of D Limited.

C. D Ltd. has issued 1.5 equity shares for each equity share of A Ltd. and 1 equity share for each equity share of B Ltd. The face value of shares issued by D Ltd. is ₹ 100 each.

Calculation of purchase consideration:

No. of equity shares	10,00,000	8,00,000
Exchange Ratio	1:1.5	1:1
No. of equity shares		
to be issued	15,00,000	8,00,000
Equity Shares capital	₹1,500 Lakhs	₹800 Lakhs
No. of preference shares	4,00,000	3,00,000
Exchange Ratio	1:1	1:1
No. of preference share		
to be issued	4,00,000	3,00,000
Preference Share Capital	₹ 400 Lakhs	₹ 300 Lakhs

Journal entries in the books of transferee:

Particulars	A Ltd.		B Ltd.	
	Debit	Credit	Debit	Credit
	₹	₹	₹	₹
a. For Business Purchase				
Business Purchase A/c Dr.	1,900		1,100	
To Liquidator of Selling Co. A/c		1,900		1,100

Reserves to be incorporated on the Amalgamation:

	Particulars			A Ltd.	B Ltd.
				₹	₹
(i)	Purchase consideration payable			1,900	1,100
(ii)	Total paid up Share capital				
	(a)	Equity Share capital	1,000		
	(b)	Preference Share capital	400	1,400	1,100
(iii)	Excess purchase consideration			500	Nil
(iv)	**Adjustment against reserves of transferee company:**				
	(a)	General reserve		(200)	
	(b)	Profit & Loss A/c Balance		(80)	
	(c)	Profit & Loss A/c debit balance		220	
(v)	**Reserves of transferor company to be incorporated**				
	(a)	Revaluation Reserve		100	80
	(b)	General Reserve		—	150
	(c)	Profit & Loss A/c		—	60

II. In Case of Amalgamation in the Nature of Purchase —

If purchase consideration exceeds the net assets taken over (Net Assets = Assets at their agreed value less liabilities at agreed value), the difference is debited to Goodwill Account. If purchase consideration is less than the net assets taken over, the difference is credited to Capital Reserve Account.

Journal entries in the books of transferee:

Particulars	A Ltd.		B Ltd.	
	Debit	Credit	Debit	Credit

	₹	₹	₹	₹
b. Incorporation of Assets and Liabilities taken over:				
Fixed Assets A/c Dr.	1,200		1,000	
Current Assets A/c Dr.	880		565	
Profit and Loss A/c Dr.	220			
To Current Liabilities A/c		204		95
To 12% Debentures A/c		96		80
To Revaluation Reserve A/c		100		80
To General Reserve A/c		—		150
To Profit and Loss A/c		—		60
To Business Purchase A/c		1,900		1,100

Journal entries in the books of transferee:

Particulars	A Ltd.		B Ltd.	
	Debit	Credit	Debit	Credit
	₹	₹	₹	₹
c. Discharge of Purchase Consideration				
Liquidator of Selling Co. A/c Dr.	1,900		1,100	
To Equity Share Capital A/c		1,500		800
To Preference Share Capital A/c		400		300
d. Discharge of Debentures:				
12% Debentures A/c Dr.	96		80	
To 16% Debentures A/c		72		60
To Profit & Loss A/c (WN # 3)		24		20

1. Amalgamation in the nature of Purchase

The following are the Balance sheets of Fat Ltd. and Thin Ltd. for the year ending on 31st March, 2014.

	(₹ in Crores)	
	Fat Ltd.	Thin Ltd.
Equity Share capital. @ ₹ 10 each	50	40
Preference Share capital - in 12%		
preference shares of ₹ 100 each	–	60
Reserves and surplus	200	150
	250	250
Loan - Secured	100	100
Total	350	350
Fixed assets (at cost less depreciation)		
- Tangible	150	150
Current assets less Current liabilities	200	200
Total	350	350

Note : Secured Loan to repayable within 12 months.

- The present worth of Fixed assets of Fat Ltd. is ₹ 200 crores and that of Thin Ltd. is ₹ 429 crores. Goodwill of Fat Ltd. is ₹ 40 crores and of Thin Ltd. is ₹75 crores.
- Thin Ltd. absorbs Fat Ltd. by issuing equity shares at par in such a way that intrinsic net worth is maintained.
- Goodwill account is not to appear in the books. Fixed assets are to appear at old figures.

Particulars		
	Fat Ltd.	Thin Ltd.
a) Assets :	₹	₹
i. Goodwill	40	75
ii. Fixed assets	200	429
iii.Current asset less		

Current liabilities	200	200
	440	704
b) Liabilities :		
i. Secured Loans	(100)	(100)
ii. 12% Preference Share capital	—	(60)
c) Net Assets attributable		
to Equity shareholders	340	544
Number of Shares (in Crores)	5	4
d) Value per share of ₹ 10 each	₹ 68	₹ 136

Exchange Ratio is based on intrinsic value per share of the companies

		Fat Ltd.	:	Thin Ltd.
i.	Intrinsic value	₹ 68	:	₹ 136
ii.	Exchange ratio	1	:	2

1 share of Thin Ltd. for 2 shares of Fat Ltd.

Therefore, Number of shares to be issued

= Number of shares of Fat Ltd. × %

= 5 crores × 50% (i.e. ratio is 1:2 =50%)

= 2.5 crores

(₹ in Crores)

Particulars		Debit ₹	Credit ₹
1. For Business Purchase			
Business Purchase A/c	Dr.	25	

To Liquidator of Fat Ltd.			25

2. For assets and liabilities taken over :

Fixed Assets A/c	Dr.	150	
Net Current Assets A/c	Dr.	200	
To Secured Loans A/c			100
To Capital Reserve A/c			225
To Business Purchase A/c			25

3. For Discharge of Purchase Consideration :

Liquidator of Fat Ltd. A/c	Dr.	25	
To Equity Share Capital A/c			25

If the Purchase Consideration were ₹255

2. For assets and liabilities taken over :

Fixed Assets A/c	Dr.	150	
Net Current Assets A/c	Dr.	200	
Goodwill A/c	Dr.	5	
To Secured Loans A/c			100
To Business Purchase A/c			255

3. For Discharge of Purchase Consideration :

Liquidator of Fat Ltd. A/c	Dr.	255	
To Equity Share Capital A/c			255