A Presentation
on

BUSINESS PURCHASE

AT

S.Y.B.COM (SEMESTER – III)

BJVM COMMERCE COLLEGE

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INTRODUCTION

- Sometimes, the company acquires the whole running business owned by a sole proprietor or a partnership firm. In such a situation, it takes over all the assets and liabilities of the firm and issues its shares and debentures to the owners of the firm as purchase consideration thereof.
- Similarly when partners of a firm decide to convert the partnership firm into a limited company, they transfer all assets and liabilities of the firm to the newly formed company and take the shares and debentures of that company in lieu thereof.
- Such an arrangement is termed as 'purchase of business' by a company.
- From the accounting point of view, this involves the ascertainment of the purchase consideration and making the necessary entries in the books of the company for the assets and liabilities taken over and for the payment of the purchase consideration.

MEANING OF BUSINESS PURCHASE

- A purchase of business refers to the acquisition of a running business.
- Such business may be owned by a corporate body like a joint stock company or by a non-corporate body like a proprietary concern or a partnership firm.
- In the context of company accounts, when the business acquired by a company is owned by another company, it is called 'absorption' or 'merger' which involves a cumbersome legal process and a-highly specialized accounting treatment.
- **Here, the term 'purchase of business' is confined to the acquisition of running business owned by a sole proprietor or by a partnership firm.**

NEED FOR BUSINESS PURCHASE

Why should a company go in for acquiring an existing business instead of starting its own business?

- The answer is very simple. If a company wants to start a new business of its own, it will have to buy land at a suitable location, construct buildings, and identify and install plant and machinery which may take many years.
- Hence, in order to save time, effort and money, the management may decide to acquire an existing business provided such an opportunity is available.
- Purchase of business involves the taking over of assets and liabilities of a firm for an agreed amount of purchase consideration.

PURCHASE CONSIDERATION

- The important question in case of purchase of business is to determine the purchase consideration. For this purpose both the parties come to an agreement in respect of values of assets and then purchase consideration is determined.
- Purchase consideration refers to the amount of price payable by the purchasing company to vendors of the running business. This amount may be mutually agreed to by the purchasing company and the vendors on the basis of the assets and liabilities taken over.

Generally purchase consideration is calculated by either of the following two methods:

1. Consideration Method
2. Net Assets Method

1. CONSIDERATION METHOD

- The amount of purchase price may be given in the example in which case there is no question of finding out the amount of purchasing price.
- Sometimes, the consideration payable against purchase price in the form of shares, debentures or cash is given, and the purchase price can easily be ascertained by totaling the consideration agreed upon.
- If however, the example mentions the values of shares, debentures etc. and states that cash is paid for the balance, then purchase consideration cannot be found by Consideration Method, as the amount of cash given is not known. Hence, Net Assets Method has to be used for ascertaining purchase price.

1. CONSIDERATION METHOD

- For example, a company which has taken over the business of a firm agrees to issue 10,000 shares of Rs. 10 each at a premium of Re. 1 per share, 500 , debentures of Rs. 100 each at a discount of 5% and pay Rs. 30,000 in cash to the partners of the firm. In this case, the purchase consideration shall be worked out as follows:

• 10000 Shares of Rs. 10 each (at a premium of Re. 1 per share)	1,10,000
• 500 Debenture of Rs. 100 each (at a discount of 5%)	47,500
• Cash	30,000
Purchase Consideration	1,87,500

2. NET ASSETS METHOD

- Where neither the lump sum amount of purchase consideration is given nor the details of shares, debenture etc., issued to the owners and the creditors are available, the purchase consideration shall be worked out on the basis of the net assets (Assets (-) Liabilities taken over by the company).
- For this purpose, we shall take into account the agreed value (not the book value) of the assets and liabilities taken over by the company. To this we shall add the agreed amount of goodwill, if any.
- Sometimes, the assets and liabilities taken over by the company are not clearly specified. In such a situation, the assets like goodwill, patents, etc. are also included. But, the fictitious assets like debit balance of P& L A/C, the unwritten off amount of deferred revenue expenditure, etc. are not included.

2. NET ASSETS METHOD

Thus, purchase consideration under net assets method is calculated as follows.

Particulars	**Rs.**
Agreed Value Of Assets Taken Over	
Agreed Value Of Goodwill	
(Less)	
Agreed Value Of Liabilities Taken Over	
Purchase Consideration	

After determining the purchase price by Net Assets Method, the statement of payment of purchase consideration must be prepared as follows:

Particulars	**Rs.**
1. Number of Equity Shares x Issue Price	xxxx
2. Debentures Issued	xxxx
3. Balance in Cash	xxxx
Purchase Consideration	**xxxx**

GOODWILL

- When the purchase consideration is calculated on the basis of net assets acquired, the amount of goodwill is clearly stated. But, when the purchase consideration is given as a lump sum amount or it is calculated on the basis of net payments made, the goodwill can be ascertained by comparing the purchase consideration with the amount of net assets acquired.
- If the amount of purchase consideration is more than the value of net assets acquired, the difference is attributed to goodwill.
- (Generally goodwill is valued at 3 to 5 times the Super Profit of the business).

GOODWILL

For Eg. Suppose the assets and liabilities of the business are as follows:

Particulars	Rs.	Particulars	Rs.
Land and Building	50000	Debtors	20000
Plant and Machinery	40000	Stock	50000
Furniture	10000	Creditors	15000

The purchase consideration is fixed at Rs. 200,000. Calculate Goodwill.

Sundry Assets :		
Land and Building	50000	
Plant and Machinery	40000	
Furniture	10000	
Debtors	20000	
Stock	50000	
		1,70,000
(Less) Liabilities:		
Creditors		15,000
Net Assets		**1,55,000**
Goodwill + Purchase Consideration (-) Net Assets		
= Rs. 200,000 (-) Rs. 1,55,000 = Rs. 45,000		

CAPITAL RESERVE

- If the value of net assets acquired is more than the purchase consideration, the difference may be treated as Capital Reserve. It represents a provision against the possible fall in the value of some assets whose values could not be ascertained at this stage.
- A running business, if not profitable may be purchased at the value which is less than its Net Assets. In this case, the Purchasing Company makes a profit which is equal to difference between Net Assets and Purchase Price. The profit is transferred to Capital Reserve Account which can be utilized in writing off shares etc.
- Suppose in the above case, the business is purchased at Rs. 1,40000, then the Capital Reserve will be as follows:

Capital Reserve = Net Assets (-) Purchase Consideration

= Rs. 1,55,000 (-) Rs. 1,40,000

= Rs. 15,000.

ENTRIES IN THE BOOKS OF THE PURCHASE COMPANY

1.	**For Recording the Purchase of Business : (Business Agreement is Made)**	
	Business Purchase A/c Dr.	(Purchase Consideration)
	To Vendor's A/c	
2.	**For Bringing into Books Assets and Liabilities taken over :**	
	Various Assets (taken over) A/c Dr.	(At the Value agreed upon)
	To Various Liabilities (taken over) A/c	(At the Value agreed upon)
	To Business Purchase A/c	(Purchase Consideration)
	(Instead of two entries 1 & 2 above only (one entry may be passed)	
	Various Assets (taken over) A/c Dr.	(Assets taken over at Agreed Values)
	To Various Liabilities (taken over) A/c	(Liabilities taken over at Agreed Values)
	To Vendor's A/c	(Purchase Consideration)
Note:	(1) The Goodwill or Capital Reserve is brought into books with this entry. The amount missing on the debit side will be the Goodwill. If the credit side is less, then the difference is Capital Reserve.	
	(2) It must be very carefully noted that Assets and Liabilities taken over must be brought into books at New Values agreed upon and not at Book Values of the Old Business.	

ENTRIES IN THE BOOKS OF THE PURCHASE COMPANY

3.	**On Payment of Purchase Consideration:**	
	Vendor's A/c	(Purchase Consideration)
	To Share Capital A/c	(If Shares are issued)
	To Securities Premium A/c	(If Shares are issued at a premium)
	To Debentures A/c	(If Debentures are issued)
	To Cash / Bank A/c	(If Cash is paid)
	Note: (1) When the company issues shares in payment of purchase price, it will credit 'Share Capital Account' and not 'Shares Account'. If shares are issued at a premium, the proportionate premium amount must be credited to Share Premium Account whereas share capital should be credited at its face value.	
	(2). When the market value of company's shares is more than the face value, then the shares are issued to vendors at a market value. The difference between market value and face value is credited to Share Premium Account.	

Generally, the example requires Two things:

(A) Passing Journal entries in the books of the Company.

(B) Preparing Balance Sheet of the Company.

(A) Transactions for making Journal Entries:

1. When Business Purchase Agreement is made, an entry for Business Purchase.
2. An entry for taking over of Assets and Liabilities.
3. An entry for Payment of Purchase Price.
4. An entry for payment of Preliminary expenses.
5. An entry for Issuing Shares to the Public.
6. Entries for collection of Debtors and Payment to Creditors on behalf of Vendors.

(B) The Balance Sheet of the Company will be prepared as follows:

Balance Sheet

Liabilities	Rs..	Assets	Rs.
Share Capital: i. Shares Issued for Purchase Price ii. Shares Issued to the Public		Goodwill (Computed as above)	
Securities Premium (if the shares are issued at a Premium)		Land, Building, Machinery etc. taken over at New Values.	
Capital Reserve (If Purchase price is less)		Current Assets taken over (e.g. Stock, Debtors)	
Debentures (if Debentures are given for Purchase Price)		Final Balance of Cash/Bank giving effect to necessary adjustments.	
Current Liabilities take over (e.g. Creditors, Bills Payable, Bank Overdraft etc.)		Fictitious Assets e.g. Preliminary Expenses, Debenture Discount (if Debenture are Issued at a discount)	

Ex. 1 The following is the Balance Sheet presented by 'A' and 'B' on the basis of which their Business will be taken over by 'AB' Ltd.

Balance Sheet

Liabilities	**Rs.**	**Assets**	**Rs.**
Capital Accounts: "A' 80000 'B' 60000	140000	Goodwill	10000
Mrs. "A' Loan	35000	Plant & Machinery	50000
Creditors	25000	Land & Building	40000
		Stock	30000
		Debtors	40000
		Cash & Bank	30000
	200000		**200000**

The company pays Rs. 225,000 for the business on account of purchase consideration but does not take over Mrs. A's loan. Calculate the amount of goodwill or Capital Reserve. Will you answer be the same if the purchase consideration is taken as Rs. 150,000.

Ex. 2 A. B and C carrying on business in the same line decided to combine and form a private limited company to take over various assets and liabilities of each of them as at 1st January. The share capital of the company is to be Rs. 150,000 divided into 15,000 equity shares of Rs. 10 each to be issued as fully paid to all the three vendors in proportion to the interest handed over.

A - Stock Rs. 25000, Debtors Rs. 53000, cash and bank Rs. 15000, Creditors Rs. 42000, Bills Payable Rs. 16000 and Reserve Fund Rs. 14000.

B - Stock Rs. 11000, Debtors Rs. 12000, Bills Receivable Rs. 4500, cash and bank Rs. 6000, Creditors Rs. 9500 and Bills Payable Rs. 6500.

C - Stock Rs. 22700, Debtors Rs. 26500, Bills Receivable Rs. 24500, Bank Overdraft Rs. 4200, Creditors Rs. 11500 and Bills Payable Rs.5500.

Draft the opening entries in the books of the Company to record the above and prepare the Balance Sheet as at 1st January. Preliminary expenses Rs. 1000 had been paid.

Ex. 3 The following is the Balance Sheet of M/s Kiran Brothers as at 31.3.2019:

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Capital Account : Mukesh 50000 Anil 30000	80000	Patent	3000
General Reserve	4000	Goodwill	7000
Creditors	10000	Machinery	56000
Bank Loan	12000	Motor Car	15000
Bills Payable	8000	Stock	10000
		Cash and Bank	10000
		Prepaid Expenses	5000
		Advertisement Suspense A/c	8000
	114000		**114000**

On 1.4.2019 Balaji Ltd. purchases the business on following conditions:

1. The purchase consideration was fixed at Rs. 80000.
2. Purchase consideration is to be paid by 5000 Equity shares of Rs. 10 each at a price of Rs. 15 and the remaining amount to be paid in cash.
3. The company has not taken over Motor Car and Bills Payable.
4. The Machinery is valued at Rs. 50000.
5. The remaining 5000 Equity shares are issued by the company to the public at a premium of Rs. 5 each.

Draft Journal entries in the books of company and prepare its Balance Sheet as on 1.4.2019.

Ex. 4 Ravishankar Ltd. was formed on 1st January, 2019 with an authorized capital of Rs. 500,000 divided into 20,000 10% Cumulative Preference Shares of Rs. 10 each and 30,000 Equity Shares of Rs. 10 each to acquire the going concern of Ravishankar. The Balance Sheet of the firm was as under on that day:

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Shiv Capital	150000	Land & Building	50000
Shankar Capital	100000	Plant & Machinery	70000
Reserve Fund	30000	Furniture & Fittings	10000
Creditors	20000	Patents	30000
		Stock	80000
		Debtors 50000 (-) B. D. Res. 1000	49000
		Cash & Bank Bal.	11000
	300000		300000

The Company agreed to pay the purchase price by issuing 20,000 Equity Shares of Rs. 10 each fully paid and 12,000 Preference Shares of Rs. 10 each. The balance of both kinds of shares were issued to the public and paid for by them with the exception of 1000 shares on which Rs. 3 per share was not paid. Pass necessary Journal entries to record the above transactions and prepare the Balance Sheet of the Company.

EXAMPLE – 5

The balance sheet of Anand and Ajay on 31-3-2006 is as follows :

Liabilities		Rs.	Assets		Rs.
Capital Accounts :			Goodwill		8,000
Anand	60,000		Building		90,000
Ajay	40,000	1,00,000	Machinery		25,000
General Reserve		22,000	Stock		35,000
Anand's Loan		12,000	Debtors	35,000	
Bank Loan		50,000	*Less* : Bad		
Creditors		35,000	Debts reserve	3,000	32,000
Workmen Savings Bank A/c		6,000	Bills receivable		17,000
Provident Fund		14,000	Investments		14,000
Workmen's Compensation Fund		6,000	Cash & Bank		24,000
		2,45,000			2,45,000

Jagruti Ltd. was incorporated to take over the above business with an authorised capital of 30,000 Equity Shares of Rs. 10 each. The terms of purchase of business are as follows :

(1) Goodwill of the firms to be valued at Rs. 10,500.

(2) All the liabilities except Anand's Loan are to be accepted by the Company.

(3) The company took over all the assets of the firm except cash balance Rs. 8,000.

(4) The assets were valued as follows :

  (i) Fixed Assets were to be purchased at 20% more than the book value.

  (ii) Stock to be purchased at 20% less than the book value.

  (iii) Debtors to be taken over with a provision of Bad-debts Reserve at 10%.

(5) Firm's dissolution expenses Rs. 1,000 which was borne by the company.

(6) Purchase consideration is to be paid in 10,000 fully paid up Equity Shares at 10% premium, 12% 400 Debentures each of Rs. 100 at 10% discount and the rest of the amount in cash.

(7) The remaining shares are issued to the public at a premium of 10% which were all taken up and paid for.

(8) Preliminary expenses of the company amounted to Rs. 1,200.

Draft journal entries in the books of Jagruti Ltd. and prepare opening Balance sheet of the new company.

EXAMPLE – 6

The business of Kailas was acquired by Ketan Company Ltd. with effect from 1st January, 2006. All the assets were taken over with the exception of book debts Rs. 60,000 which the company undertook to collect on behalf of the vendor. The company also undertook to pay off the creditors of the vendor of Rs. 20,000 out of the realisation from his debtors. For this service the company is to charge a commission of 3% on amount realised from debtors and 1% on amount paid to creditors.

The company had realised total book debts for Rs. 58,000 while creditors were paid at a cash discount of 5%.

The company had paid amount due to vendors in cash.

You are required to pass necessary Journal entries and to show the relevant ledger accounts in the books of the company.

EXAMPLE – 7

The following was the Balance-sheet of Vishnu as at January 1, 2006 :

Liabilities	Rs.	Assets	Rs.
Capital	1,50,000	Goodwill	6,000
Creditors	20,000	Machinery	30,000
		Building	20,000
		Stock	20,000
		Debtors	44,000
		Investments	45,000
		Cash	5,000
	1,70,000		1,70,000

The Assets and Liabilities except debtors and creditors were taken over by Dinesh Ltd. at their book figures. The company however agreed to collect the debtors and pay the creditors as agent for the vendor. For this service the company was entitled to get Rs. 2,000 from the vendor.

The company could collect only Rs. 41,000 from debtors in full settlement and paid Rs. 18,500 to creditors in full settlement.

The purchase consideration was paid by issuing 12,200 Equity Shares of Rs. 10 each

Prepare Vendor's Suspense Account (assume that the remaining balance was paid by the company) and a new Balance-Sheet in the books of Dinesh Ltd.

THANK

YOU