ADVANCED FINANCIAL ACCOUNTING

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CHAPTER 4

Sale of a Firm to a Limited Company

Sale of a firm to a company refers to, the sale of a partnership firm to company or purchasing of a partnership by a company.

The sale of firm to a company will be for a consideration , payable in various forms.

The firm which is being sold to a company is called the **Vendor Firm** and the company
which is purchasing the firm is called **Purchasing Company.**

Accounting for Sale of Firm to a Company or Conversion of a firm into a Company

The following are the steps involved in accounting for sale or conversion of a firm into a company.

i) Calculation of **Purchase Consideration**
ii) Ascertaining the **form** of discharge of purchase consideration.
iii) Closing the books of Vendor Firm by passing **journal entries or by preparing ledger account.**
iv) Passing incorporation entries in the books of purchasing company and preparing Balance Sheet in Horizontal or Vertical form.

Step I : Calculation of Purchase Consideration

The price or consideration payable by the purchasing company for taking Over assets and liabilities of the vendor firm is called **" Purchase Consideration."**

Methods of calculating Purchase Consideration

The purchase consideration payable by the purchasing company to the vendor firm may be calculated under any of the following methods:

1) Lumpsum Method.
2) Net Asset Method.
3) Net Payment Method.

1) Lumpsum Method:- Under this method , a fixed amount or lumpsum is paid by the purchasing company for the assets and liabilities taken over from the vendor.

2) Net Asset Method:-Under this method the purchase consideration is calculated as follows.

Particulars	Rs.
Total Assets taken over at an agreed value by the purchasing company.	XXX
Less: Total liabilities taken over at an agreed value by the purchasing company.	XXX
Purchase Consideration	XXX

3) Net Payment Method: Under this method, actual payment made by the purchasing company against each item of the liability would be specified. The payment may be in cash or shares or debentures or in any combination of the three.

Step ii: Ascertaining the form of discharge of purchase consideration.

The purchase consideration may be discharged by the purchasing company in any of the following ways:

1. Completely in Cash.
2. Completely in Shares.
3. Completely in Debentures.
4. Partly in Cash and partly in Shares
5. Partly in Cash and partly in Debentures.
6. Partly in Shares and partly in Debentures.
7. Combination of Cash, Shares and Debentures.

Step iii: Closing the books of Vendor Firm

When the firm is sold to a company or is converted into a company, its books of accounts have to be closed. The following are the journal entries passed to close the books of accounts of the vendor firm.

1. **When assets are transferred at Book values:**

   Realisation Account Dr
   To Concerned Asset Account

2. **When liabilities are transferred at their Book Values:**

   Concerned Liabilities Account Dr
   To Realisation Account

3. **When purchase consideration is due:**

   Purchasing Company Account Dr
   To Realisation Account

4. When Purchase consideration is received:

Cash/Bank Account	Dr.
Shares in purchasing company Account	Dr.
Debentures in purchasing company Account	Dr.
To Purchasing company Account	

5. When realisation expenses are payment:

Realisation Account	Dr.
To Cash/Bank Account	

6. When assets not taken over by the purchasing company are sold

Cash/Bank Account	Dr.
To Realisation Account	

7. When liabilities not taken over by the purchasing company are paid:

Realisation Account Dr.
To Cash/Bank Account

8. When assets are taken over by the partners:

Partner's Capital Account Dr.
To Realisation Account

9. When liabilities are taken over by partners:

Realisation Account Dr.
To Partner's Capital Account

10. When Realisation Account is Closed:

a) In case of profit:
Profit and Loss Account Dr.
To Partner's Capital/Current Account

b) In case of loss
Partner's Capital/Current Account Dr.
To Profit and Loss Account

11. When Reserves are transferred:

Reserve Account Dr.
To Partner’s Capital/Current Account

12. When Undistributed Profit/ Loss is Transferred

a) In case of profit:
Profit and Loss Account Dr.
To Partner’s Capital/Current Account
b) In case of loss
Partner’s Capital/Current Account Dr.
To Profit and Loss Account

13. When Partner’s loan is paid

Partner’s Loan Account Dr.
To Bank Account

Step iv: Passing incorporation entries and preparing Balance Sheet.

Entries in the books of purchasing company:

1. **When Purchase Consideration is due:**

   Business Purchase Account Dr.

   To Vendor Firm Account

2. **When Assets and Liabilities are taken over(at agreed value)**

   Individual Assets Account Dr.

   To Individual Liabilities Account

   To Business Purchase Account

Note: When the total of liabilities and business purchase is more than assets the difference is treated as goodwill and when total assets are more than the total of liabilities and business purchase, the difference is treated as Capital Reserve.

3. When Purchase consideration is paid:

Vendor Firm Account Dr.
To Cash/Bank Account
To Share Capital Account
To Share Premium Account (if any)
To Debentures Account

Note: When the shares and Debentures are issues at premium at the discount to the vendor firm, premium should be transferred to Share Premium Account and discount should be transferred to discount on issue of shares or debenture account.