DJC3C - CORPORATING ACCOUNTING

Unit I

Issue, forfeiture and re-issue of shares – redemption of preference shares- issue and redemption of debentures – underwriting of shares and debentures

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CORPORATING ACCOUNTING

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- Profit prior to incorporation, valuation of shares and goodwill & Final accounts of company

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- Double Accounts system – Inflation A/c - Human Resource and Social Accounting

CORPORATE ACCOUNTING

I. ISSUE OF SHARES

1. Definition of a company

A Company is defined as “an artificial person recognised by law having a distinctive name, a common seal, a common capital comprised of freely transferable shares carrying limited liability and having a perpetual succession.

Kinds of companies

- **Statutory Companies**
- **Registered Companies**
  - **Private Companies**
  - **Public companies**
- **Government Companies**

Sources of finance:

The company raises its finance through shares and debentures.

2. Meaning of share:

The capital of the Company is divided into different units of fixed amount. These units are called “shares”.

Example: If the Capital of the company is Rs.1,00,000 and it is divided into 10,000 units of Rs.10each Rs.10 each unit shall be called a share of the company.

Kinds of shares

- **Preference shares**
- **Equity Shares**

3. (i). Preference Shares:

The preference shares carry two preferential rights in respect of

a) Payment of dividend
b) Repayment of capital on winding up of the company

These shares carry fixed rate of dividend.

Definition: -

According to sec.85 of the companies Act 1956, Preference shares are those shares on which there is a preferential rights.

a) to get dividend during the life time of the Company &

b) to repay capital at the time of winding up of the company.

Characteristics (features) of Preference shares: -

1) They have the first preference to get dividend at a fixed rate before any dividend paid to equity shareholders.
2) At the time of winding up of the company preference shareholders have the first to get back their capital before any capital paid to equity shareholders.
3) They shall have fixed rate of dividend.
4) They do not have right to share the surplus of profits or assets of the company
5) They do not have any voting Rights and voice in the management of the company affairs.

4. Different classes of preference shares: -

(a) Cumulative preference Shares: -

If any year, the company does not earn sufficient profit dividend on preference shares may not be paid for that year. The unpaid dividend amount is in arrear. These shareholders will have the right to receive the arrear dividend in the subsequent year profits.

(b) Non-Cumulative preference shares: -

If any year the company does not earn sufficient profit, dividend on preference shares may not be paid for that year. The unpaid dividend amount is in arrear. These shareholders will have no right to claim arrear dividend in the subsequent year profit. Here dividend will not be accumulated.

(c) Participating preference Shares: -

In addition to fixed dividend, these shareholders have a right to participate in the surplus profit which remains after payment of dividend to the equity shareholders. At the time of winding up of the company they have the right to participate in the surplus profit which remains after payment of dividend to the equity shareholders. At the time of winding up of the company they have the right to participate in the surplus of assets after payment to equity shareholders.

(d) Non-participating preference shares: -

These shareholders have no right either to participate surplus of profit or surplus of assets after payment to equity shareholders.

(e) Convertible Preference Share: -

These shares can be converted into equity shares after a fixed period

(f) Non-Convertible preference shares: -

These shares have no right to convert their preference share into equity shares.

(g) Redeemable Preference Shares: -

According to sec 90 of the Companies Act Redeemable preference share are those shares which can be redeemed after a specified period or at the discretion of the company.

Conditions for Redemption

1) The redemption must be authorised by articles of association.
2) Fully paid up of this share can be redeemed.
3) It can be redeemed either out of profits of the company or out of fresh issue of equity shares.

(h) Irredeemable preference shares: -

These shares cannot be redeemed during the life time of the company

5. Equity shares (or) Ordinary shares

The word Equity means ownership interest or the interest of shareholders as measured by capital and Reserves. It is the backbone of any Company's Capital

Structure. As per the Companies Act, the shares which are not preference shares are equity shares. Dividend and capital can be paid only after paying preference shares. During the life time of the company, The equity shares capital cannot be returned The equity shareholders are eligible to vote in the annual general body meeting of the company.

6. Share capital

It means the capital raised by the company by the issue of shares.

Types of share capital:

1) **Authorised capital**: It is the maximum capital that the company can raise by way of issue of shares. It is also called as nominal or registered capital.
2) **Issued capital**: It is the part of authorised capital which is issued to the public for subscription
3) **Subscribed capital:** It is the part of issued capital which is subscribed (Purchased) by the public.
4) **Called up capital:** It is part of subscribed capital with regard to which calls have been made.
5) **Paid up capital:** It is the part of subscribed capital for which call money shareholders have actually paid.

Illustration: 1

X Ltd was registered with an authorised capital of 2,00,000 shares of Rs.10 each. 1.40,000 shares were issued to the public. The public subscribed for 1,00,000 shares. The company called up Rs.7 per share. All money called up was duly received with the exception of a call of Rs.2 per share on 1000 shares. Show the amounts of various types of shared capital.

Solution:

Balance sheet of X Ltd

Liabilities		Assets	
Share capital			
1) Authorised Capital			
2,00,000 shares of Rs.10 each	20,00,000	cash at Bank	6,98,000
2)Issued capital			
140000 shares of Rs. 10 each	14,00,000		
3) Subscribed capital			
100000shares of Rs10 each	10,00,000		
4) Called up capital			
1,00,000 shares 7,00,000 of Rs 7 each Less calls in arrears 1000 shares of 2000 Rs 2 each	6,98,000		
	6,98,000		6,98,000

Mode of Issue of Share

Par **Discount** **Premium**

Mode of Issue of Share

7. Issue of shares at Par: -

When the shares of a company are issued at the face value, they are said to be shares are issued "at par" (nominal value)

Eg. Rs.10 face value of a share issued at Rs.10 only. It is at par value.

Accounting entries for issue of shares at par:

1) Application money received:

Bank a/c Dr.	xxx	
To share supplication a/c		xxx
(Being application money received)		

2) Transfer of application money:

Share application a/c Dr	xxx	
To share capital a/c		xxx

3) Application money rejected: (refunded)

Share application a/c Dr	xxx	
To Bank a/c		xxx

4) Allotment money due:

Share allotment a/c Dr	xxx	
To share capital a/c		xxx

5) Allotment money received

Bank a/c Dr	xxx	
To Share allotment a/c		xxx

6) Share I call money due:

Share I call a/c Dr	xxx	
To share capital a/c		xxx

7) **Share I call money received**

Bank a/c Dr	xxx	
To share I call a/c		xxx

8) Share II & final call due

Share II & final call a/c Dr	xxx	
To Share capital a/c		xxx

9) Share II call money received

Bank a/c Dr	xxx	
To Share II call a/c		xxx

Illustration: 2

Aarthy Co., Ltd issued 20000 equity shares of Rs.10 each payable as to Rs.2 on application Rs.3 on allotment Rs.3 on I call and Rs.2 on final call.

All money was duly received on issued shares. Pass journal entries prepare ledger accounts and show Balance sheet.

Solution:

1) Application money received

Bank a/c	Dr	40,000	
To share application a/c			40,000
(20000 shares x Rs.2)			

2) Transfer of application money

Share application a/c	Dr	40,000	

To share capital a/c			40,000
3)Share allotment due:			
Share allotment a/c	Dr	60,000	
To share capital a/c			60000
4)Allotment money Received:			
Bank a/c	Dr	60,000	
To share allotment			60,000
5)Share I call due:			
Share I call a/c	Dr	60,000	
To share capital (20,000* Rs3)			60,000
6)I call money received:			
Bank a/c	Dr	60,000	
To Share I call a/c			40,000
7)Share & final call due:			
Share II & final call a/c	Dr	40,000	
To Share Capital			40,000
(20,000xshares xRs.2)			
8)II call Money Received			
Bank a/c	Dr	40,000	
To Share II call a/c			40,000

Aarthy Co Ltd Ledger Accounts

Bank Account

To Share application	40,000	By Balance c/d	2,00,000
To Share allotment	60,000		
To Share I call	60,000		
To Share II call	40,000		
	2,00,000		2,00,000
To balance b/d	2,00,000		

Share Application Account

To Share Capital	40,000	By Bank	40,000
	40,000		40,000

Share Allotment Account

To Share capital	60,000	By Bank	60,000
	60,000		60,000

Share I call Account

To Share Capital	60,000	By Bank	60,000
	60,000		60,000

Share II & final call account

To Share Capital	40,000	By Bank	40,000
	40,000		40,000

Share capital account

To balance c/d	2,00,000	By Share Application a/c	40,000
		By Share allotment a/c	60,000
		By Share I call a/c	60,000
		By Share II & final call	40,000
	2,00,000		2,00,000
		By Balance b/d	2,00,000

8. Issue of Shares at Discount (Sec. 79)

A Company can issue Shares at a price which is less than the face value is called as shares are issued at a Discount.

E.g. If a share of Rs.10 is issued for Rs.9 then it is issued at 10% discount

Conditions: (Sec 79)

The following conditions are to be satisfied by the company before issuing shares at discount.

1) Issue of shares at a discount is authorised by a resolution passed by the company in general meeting and sanctioned by Central Government
2) The Rate of discount should not be more than 10% of the face value of the share Higher rate is allowed only when permitted by the central Government
3) One year must have been elapsed after the commencement of the business.

4) Issue must take place within 2 months after the date of the sanction of the company Law Board.
5) Every prospectus relating to the issue of shares and every balancesheet issued after the issue of shares shall contain particulars of the discount allowed and so much of the discount as has not been written off.
6) The Shares must belong to a class already issued

Journal Entry: Issue of shares at a discount

Share allotment a/c	Dr	xxx	
Discount on issue of Share a/c	Dr	xxx	
To share capital a/c			xxx

Note: i) Discount on issue of shares is a capital loss and will be shown on the assets side of the Balancesheet till it is completely written off from P & L a/c

ii) Discount can be allowed only at the time of allotment due.

9. Issue of Share at a premium:

When a share is issued at a price which is above its face value then it is said that it has been issued at premium.

E.g. If a share of Rs.10 is issued for Rs.11 then Rs.1 is the premium on the share.

Journal Entry:

Share allotment a/c Dr (including the amount of premium)	xxx	
To Share Capital a/c		xxx
To Share premium a/c		xxx

Share premium is a capital profit it will be used to written off capital losses. It will be shown on the Liability side of the Balancesheet.

Utilisation of share premium u/s 78

Under section 78 of the companies Act 1956, the share premium received is a capital profit and can be used for the following purposes.

1) For the issue of fully paid bonus shares to the shareholders of the company.
2) For writing off the preliminary expenses of the company.
3) For writing off the expenses or underwriting commission or discount on issue of shares or debentures of the Company.

4) For providing premium payable on the redemption of any redeemable preference shares or any debentures of the company.

10. Minimum subscription:

The minimum subscription stated in the prospectors. The application money should be at least 5% of the face value of the shares applied for otherwise no allotment shall be made on any issue of shares of a company

5% face value of application money Received – Minimum subscription

Minimum Subscription amount must be received within 120 days from the date of prospectus otherwise whole application money has to be refunded to the applicants within next 10 days.

11. Pro- rata allotment (over subscription)

If the number of shares applied is more than the number of shares issued it is said to be oversubscribed.

E.g. Application Received **-** Eligible issue = over subscription

15000 shares **-** 10000 shares = 5000 shares

But the company can allot only 10000 shares equal to 10000shares issued by it. In that case the directors may either totally reject 5000 applications or they may be allot share on "prorate basis" and hence it is known as prorata allotment.

Pro-rata will arise only on over subscription. At that time the company need not refund the excess application money received but the same can be adjusted on allotment money and call money due.

Entry: Share application a/c Dr xxx

To share allotment a/c xxx

Formula:

i) Allotment to a particular applicant:

$$\frac{\text{Total Shares allotment}}{\text{Toal Shares applied}} \times \text{Shares applied by a particular applicant.}$$

E.g. M.X has applied 150 shares, how many shares are allotted to him by the company

$$\text{M.X will get} = \frac{10{,}000 \text{ shares}}{15000 \text{ shares}} \times 150 \text{ shares} = 100 \text{ shares.}$$

ii) Calls in advance and calls in arrears:

a) Call in advance: The money received by the company in excess of what has bee called up is known as calls – in – advance.

Entry: Bank/a/c Dr xxx

To Calls in advance a/c xxx

(Being advance will be shown on the liabilities side of the balance sheet till it is closed 6% p.a Interest is allowed as a maximum as per Articles of association.)

Transfer: When particular calls are made, calls in advance is transferred to particular call a/c

Calls in advance a/c Dr xxx

To Particular call a/c xxx

b) Calls in arrears: Any amount called by the company but not paid by the shareholders is known as calls in arrears. It should be deducted from called up capital till it is realised.

E.g. Bank a/c Dr xxx

Calls in arrears a/c Dr xxx

To share I call a/c xxx

(Being calls in arrear in share I call)

5% Interest is charged as a maximum as per articles of association when it is paid.

12. Forfeiture of shares:

It means cancellation of shares by the company. If a shareholder fails to pay any call money on shares made by the company these shares may be cancelled by the company is called forfeiture of shares.

Conditions: - 1) Articles must permit.

2) At least 14 days notice must be served.

Entry:

Share capital a/c Dr (No of shares cancelled x amount called up) xxx

To Share call a/c (No. of shares cancelled x amount unpaid) xxx

To Forfeited shares a/c (No. of shares forfeited x amount already paid) xxx

Share forfeited account is a capital profit and should be shown on the liabilities side of the Balancesheet.

Illustration: 3

Mr."A" shareholder who holds 200 equity shares of Rs.10 each. He paid Rs.2 on application Rs.3 on allotment but could not pay the first call Rs.3 and final call Rs.2 per share and his share were forfeited by the directors. Pass Journal entries.

Solution: Share capital a/c Dr 2000(200x10)

To share I call a/c 600(200 x3)

To share II & final call a/c 400(200 x2)

To share forfeited a/c 1000(200 x5)

(Being forfeiture of 200 equity shares of Rs.10 each)

Share forfeited account is a capital Profit. It should be transferred to capital Reserve a/c

Entry; Share forfeited a/c Dr 1000

To Capital Reserve a/c 1000

13. Re-issue of shares:

Forfeited shares can be re-issued at a price less than face value. But it should not be less than the called up value. The loss on the reissue of forfeited share is debited to share forfeited account and if there is any balance in share forfeited account will be a capital profit and should be transferred to capital Reserve account.

Entry: -

Bank a/c Dr. xxx

(No. of shares Reissued x Reissue price)

Share forfeited a/c Dr. xxx

(No. of shares reissued x Difference between face value and reissue price)

To share capital a/c (No. of shares reissued x face value) xxx

Any balance in share forfeited account will be transferred to capital reserve

Share forfeited a/c Dr xxx

To capital Reserve a/c xxx

Illustration: 4

Mr. ‘A’ shareholders who holds 200 equity shares of Rs.10 each. He paid Rs.2 on application and Rs.3 on allotment, But could not pay the first call Rs.3 and final call Rs.2 per share call Rs.2 per share and his share were forfeited by the directors. These 200 shares are re-issued at Rs.7 each. Pass journal entries.

Solution:

1) Forfeiture of 200 shares:

Share capital a/c Dr.	2000(2000x10)	
To share first call		600(200 x 3)
To share II final call		400 (200 x 2)
To share forfeited a/c		1000(200 x 5) (2 +3)

2) Re-issue of 200 shares of Rs.7 per share:

Bank a/c Dr	1400 (200 X 7)	
Share forfeited a/c Dr	600(200 x3) (10 -7)	
To Share capital a/c		2000 (200x10)

3) Share forfeited account transferred:

Share forfeited a/c	Dr	400	
To Capital Reserve a/c			400 (200x2) (5-3)

Note: Share forfeited ac Cr	1000 (200 x5)	
Less: Share forfeited a/c	600 (200 x3)	
	400	

Illustration: 5

The directors of Arun Ltd resolved on 1st May 2017, that 2000 ordinary shares of Rs.10 each Rs.7.50, paid be forfeited for non payment of final call of Rs.2.50 on June 10, 2017, 1800 of the above shares were reissued for Rs.6 per share show the final entries required to give effect to the above transaction.

Solution: -

1. Forfeiture of 2000 shares:

Share Capital a/c Dr. 20,000 (2000 x100)

To calls in arrears a/c 5000 (2000 x2.50)

To share forfeited a/c 15000 (2000 x 7.50)

2. Re- issue of 1800 shares of Rs.6 each

Bank a/c Dr 10800 (1800 x6)

Share forfeited a/c Dr 7200 (1800 x4)

To share capital a/c 18000 (1800 x10)

3. Share forfeited a/c – transferred:

Share forfeited a/c Dr 6300

To Capital Reserve a/c 6300

Capital reserve:

2000 Shares forfeited (Cr)	15000
1800 shares forfeited (Cr) (1800 x 7.50)	13500
Less: Reissued (1800 x4)	7200
Capital Reserve*	6300

14. Surrender of Shares:

After allotment of shares, sometimes a share- holder is not able to pay further calls and returns his shares to the company for cancellation. Such voluntary return of shares to the company by the shareholder himself is called surrender of shares.

Entry: - Surrender of shares

Share capital a/c Dr xxx

To share call a/c xxx

To share forfeited a/c xxx

15. Issued of share for consideration other than cash (Issue of shares to vendors)

Shares can also be issued to vendors who sell some asset to the company It is called shares are issued for consideration other than cash.

Entry:

1) Sundry Assets a/c Dr xxx

    To vendor a/c xxx

    (Being Assets purchased from vendor)

2) Vendor a/c Dr xxx

    To share capital a/c xxx

    (Shares are issued to vendors for the purchasing of assets)

16. Right Issue: U/S 81.

A company wants to make a further issue of shares, the issue must first be offered to the existing share holders in proportion to their present holding of shares. This offer is known as Right Issue. The right shares can also be sold by the shareholders.

Calculation of value of Right Shares:

$$= \frac{\text{New Right Shares x Market price of Share – New right price of share}}{\text{Total shares (including Right shares)}}$$

The value of right share is calculated with reference to market value of shares. The market value of shares is high the right to buy more share is valuable

Example:

A Company offers to its shareholders the right to buy one share Rs.100 each Rs.125 for every 3 shares of Rs.100 each held. The market value of share is Rs.195. Calculate the value of right issue.

Solution:

Value of right issue$= \frac{\text{1 shares}}{\text{4shares (3 + 1)}} \text{ x } 195 - 125 = \text{Rs.}17.50$

Conditions:

1. The right issue must first be offered to existing shareholders in proportion to their present holding of shares.

2. The issue take place after the expiry of 2 years from the date of its incorporation or after the expiry of 1 year from the date of allotment of shares for the first time whichever is earlier.

3. The Company must serve a notice to the existing shareholders regarding the right issue. If the existing shareholders failed to accept the offer within 15 days or such further time as may be extended then the company can offer the issue to the public.

Illustration: 6

A Ltd invited applications for 10000 shares of Rs.100 each at a discount of 5% payable as follows

On application – Rs. 25

On application – Rs.34

On first and final cal –Rs.36

The applications were received for 90000 shares and all of these were accepted. Al money due were received except the first and final call on 200 shares which forfeited. 100 shares were reissued @ Rs.90 as fully Paid. You are required to prepare journal entries for the above transactions.

Solution:

In the books of A Ltd.

1) Application money received for 9000 shares of Rs.25 each

Bank a/c Dr	2,25,000	
To Share application a/c (9000 x 25)		2,25,000

2) Application money transferred:

Share application a/c Dr	2,25,000	
To Share capital a/c		2,25,000

3) Allotment due – with 5% discount:

Share allotment a/c Dr (9000 x 34)	3,06,000	
Discount a/c Dr (9000 x5)	45,000	
To Share capital (9000 x 39)		3,51,000

4) Allotment money receive:-

Bank a/c Dr	3,06,000	
To Share allotment a/c		3,06,000

5) Share I & final call due:-		
Share I & final call a/c Dr	3,24,000	
To Share capital (9000x36)		3,24,000
6) I call money received except 200 shares		
Bank a/c Dr (8800 x 36)	3,16,800	
Calls in arrears a/c Dr (200 x36)	7,200	
To share capital a/c (9000 x36)		3,24,000
7) Forfeiture of 200 shares (200 பங்குள் ஒறுப்பிழப்பு)		
Share capital a/c Dr (200 x100)	20,000	
To Calls in arrear a/c (200x 36)		7,200
To share forfeited a/c 200 x59 (25+34)		11,800
To Discount a/c (200 x 5)		1,000
8) Re issue of 100 shares of Rs.90 each		
Bank a/c Dr (100 x90)	9,000	
Discount a/c Dr (10 x5)	500	
Share forfeited a/c Dr (500 x5)	500	
To Share capital a/c (100 x100)		10,000
9) Share forfeited a/c transferred: -		
Share forfeited a/c Dr	5,400	
To Capital reserve		5,400

Calculation of Capital Reserve

200 shares forfeited credit balance (200 x59)	11,800	
100 Shares forfeited (100 x59)		5,900
எனவே **Less:** 100 shares reissued		500
100 shares ஒ றுப்பிழப்பு இலாபம் (Capital Reserve)		5,400

Balance Sheet

Liabilities		Assets		
Share capital 8900 shares		Cash at Bank		8,56,800
of Rs.100 each	8,90,000	Discount (9000 x5)	45,000	
Share forfeited a/c		**Less:** forfeited (200x5)	1,000	
(1000 shares x 59)	5,900		44,000	
		Less: Re-issued(100x5)	500	44,500
Capital reserve	5,400			
	9,01,300			9,01,300

Illustration: 7

A Company made an issue of 10000 shares of Rs.10 each payable Rs.3 on application Rs.3 on allotment Rs.2 on first call and Rs.2 on second and final call.

All these shares were subscribed. Directors made both the calls. All moneys were received except from one shareholder who holds 100 shares failed to pay the first and final call. The directors forfeited these shares and reissued them at Rs.8 per share as fully paid up pass journal entries in the book of the company

Solution **In the books of a company**

			Dr	Cr
1.	**Application money received**			
	Bank a/c	Dr	30000	
	To Share application a/c			30000
2.	**Application money transferred:**			
	Share application a/c	Dr	30000	
	To share capital a/c			30000
3.	**Share allotment due:**			
	Share allotment a/c	Dr	30000	
	To share capital a/c			30000
4.	**Allotment money received:**			
	Bank a/c Dr		30000	
	To share allotment a/c			30000
5.	**Share I call due:**			
	Share I call a/c	Dr	20000	
	To share capital a/c			20000
6.	**I call money received except 100 shares :**			

	share I call a/c (9900 shares x Rs.2)	Dr	19800	
	Calls in arrears a/c(100 shares x Rs.2)	Dr	200	
	To Share capital a/c (10000 shares x Rs.2)			20000
7.	**Share II & final call due :**			
	Share II & final call a/c	Dr	20000	
	To Share capital a/c(10000 shares x Rs.2)			200000
8.	**Share II call money received except 100 shares:**			
	Bank a/c (9900x2)	Dr	19800	
	Calls in arrears a/c		200	
	To share II & final call a/c (10000 x2)			20000
9.	**Forfeiture of 100 shares :**			
	Share capital a/c (100 shares x Rs.10)	Dr	1000	
	To share forfeited a/c			600
	(100 shares x Rs.6)			
	To call in arrears a/c (Rs.2 +2)(100x4)			400
10.	**Reissue of 100 shares**			
	Bank a/c (100 shares x Rs.8 per share)	Dr	800	
	Share forfeited a/c	Dr.	200	
	To share capital a/c (100 share x Rs.10)			1000
11.	**Shares forfeited a/c –transferred**			
	Share forfeited a/c	Dr	400	
	To capital reserve			400
	Share forfeited showed credit balance	Rs.600		
	Share forfeited showed debit balance	Rs.200		
	Net credit – capital profit	Rs.400		

Ledger

Cash at Bank

To share application a/c	30000	By balance c/d	100400
To share allotment a/c	30000		
To share I call a/c	19800		
To share II call a/c	19800		
To share capital a/c	800		
(Reissued)			
	100400		**100400**

Balance sheet

Liabilities	Rs.	Assets	Rs.
Share capital		Cash at bank	100400
Authorised capital	100000		
10000 shares x Rs.10			
Issued & Subscribed capital			
10000 shares of Rs.10 each	10000		
Capital Reserve	400		.
	100400		**100400**

REDEEMABLE PREFERENCE SHARE

17. Meaning of Redeemable preference shares:

Are those shares which can be redeemed after the expiry of a stipulated period.

The Conditions for the redemption of redeemable preference shares U/S 80

1. Only fully paid shares can be redeemed.
2. Partly paid –up shares cannot be redeemed.
3. Such shares can be redeemed either out of profit or out of the proceeds of a fresh issue of shares.
4. Such shares cannot redeem out of the proceeds of a fresh issue of Debentures or out of sale proceeds of any assets of the company.
5. If the shares are redeemed out of profits then equal redemption amount should be transferred to capital redemption reserve account.
6. Capital redemption reserve account is available for issuing bonus shares the shareholders.
7. If shares are redeemable at premium then such premium must provided for out of profits or share premium account.

Accounting Entries:

1) Redemption of Redeemable preference shares out of fresh issue of shares:

Bank a/c Dr

To Equity share capital a/c

2) Redemption out of profits

Profit & Loss a/c Dr

General Reserve a/c Dr

To Capital Redemption Reserve a/c

3) Redeemed at premium

Share premium a/c Dr (or)

Profit & Loss a/c Dr

To Premium on redemption of preference shares a/c

4) Amount payable

Redeemable preference share capital a/c Dr

Premium on redemption of preference shares a/c Dr

To Redeemable preference shareholders a/c

5) Amount paid

Redeemable preference shareholders a/c Dr

To Bank a/c

Illustration: 8

Following is the Balancesheet of R Ltd as at 31st December 2000.

Share capital 5000 Equity share of Rs.100 Each fully paid up	5,00,000	Sundry Assets	6,10,000
2000 6% Redeemable Preference share of Rs. 100 each fully paid	2,00,000	Bank	3,80,000
profit and loss a/c	2,40,000		
Creditors	50,000		
	9,90,000		9,90,000

on the above date the preference shares are redeemed at a premium of 5% Journalise and give the amended.

1) Redemption out of profits:

Profit and loss a/c Dr 2,00,000

To Capital Redemption Reserve 2,00,000

2) Redeemed at 5% premium (2,00,000 x 5/100 =10,000)

Profit and Loss a/c Dr 10,000

To premium on Redemption of preference shares a/c 10,000

3) Amount paid (redemption)

6% Redeemable preference Share capital a/c Dr 2,00,000

Premium on redemption of Preference shares a/c Dr 10,000

To Bank a/c 2,10,000

Balance sheet after Redemption

Share capital			Sundry Assets		6,10,000
5000 Equity share of			Bank	3,80,000	
Rs.100 each fully paid up		5,00,000	**Less:** Redemption	2,10,000	1,70,000
Profit and Loss a/c	2,40,000				
Less: Redemption	2,00,000				
	40,000				
Less: premium	10,000	30,000			
Creditors		50,000			
Capital Redemption Reserve a/c		2,00,000			
		7,80,000			7,80,000

Illustration: 9

The following is the Balance sheet of a Limited co. as on 31.12.2017

Share Capital 100 6% redeemable		Fixed assets	3,10,000
Pref. Shares of Rs.100 each fully paid	1,00,.000	cash at Bank	1,40,000
20,000 equity shares profit & Loss a/c	1,20,000		
Sundry Creditors	30,000		
	4,50,000		4,50,000

The company resolved to redeem its preference shares at a premium of 2% out of profits. Pass the necessary journal entries.

Solution: -

1) Redemption out of Profits: -

Profit & Loss a/c Dr 1,00,000

To Capital Redemption reserve a/c 1,00,000

2) Redeemed at a premium 2% out of profits:

Profit & Less a/c Dr 2000

To premium on redemption of preference share a/c 2000

[Premium = 100000 share capital x 2/100= 2000]

3) Amount due:

6% Redeemable Preference Share Capital a/c	Dr	100000	
Premium on redemption of preference Share a/c	Dr	2000	
To Redeemable Preference Shareholders a/c			1,02,000

4) Amount paid: -

Redeemable Preference Shareholder a/c	Dr	102000	
To Bank a/c			102000

Balance Sheet after redemption

Share capital		Fixed assets	3,10,000
20000 equity shares	2,00,000	Cash at Bank	38,000
Sundry Creditors	30,000	(140000-102000)	
Capital Redemption Reserve a/c	1,00,000		
Profit & Loss a/c	18,000		
(120000-102000)	3,48,000		3,48,000

18. Methods of Redeeming Redeemable Preference Shares:

Preference shares can be redeemed out of

a) Fresh issue of equity shares

b) By the creating of Capital Redemption Reserve account

c) By declaration of Bonus Shares

d) By conversion of shares.

19. Meaning of capital redemption reserve

This reserve is created at the time of redemption of redeemable preference shares. This reserve is created out of general reserve or Revenue Profits. It can be utilised for declaring bonus shares to the share holders. This account cannot be reduced the share capital and will appear on the liabilities side of the balance sheet.

20. Bonus Shares: - Meaning

Bonus shares are those shares which can be issued to the existing shareholders at a free of cost. A company having large amount of profits and save cash may issue shares to its shareholders without receiving any money in proportion to their holdings. such shares are known as bonus shares.

Guidelines for issuing Bonus shares: -

1) Articles of association of the company permit the issue of bonus shares.
2) Declaration of a bonus issue instead of dividend is not allowed.
3) Bonus shares are permitted only fully paid up shares.
4) The company should pass a resolution at General body Meeting for issuing bonus shares.
5) Bonus shares are issued only out of free reserve.
6) A Company is permit to issue such shares once in 3 years only.

21. Issue of Debentures

Debenture Is A Long Term Promissory Note for raising loan capital. The purchases of debentures are called Debenture holders. Debenture holders are the creditors of the company. The rate of interest on debenture is fixed.

1) Meaning of Debenture:-

Debenture is a document which either creates a debt or acknowledgement of a debt A debenture is a document issued by the company under its common seal acknowledging the debt by it to its holders.

2) Definition of Debenture.

Sec 2 (12) of the Companies act defines debentures as "debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not"

22. Type of debentures:

1) Registered debenture:

The names and addresses of debenture holders are registered in the company is called registered debenture. This debenture can be transferred through Registration.

2. Bearer debenture:

The name and addresses of debenture holders are not registered in the register of debentures of the company. This debenture are payable to bearer are called bearer debenture.

3) Secured debenture:

This debenture which are secured by charge over the assets of the company. These debentures having company assets as security.

4) Unsecured debenture:

The debentures which are not secured by charge over the assets of the company are called un-secured debentures. They do not have any security.

5) Redeemable debentures;

These debentures which are repayable after a specified period.

6) Irredeemable debentures:

The debenture which are not repayable during the life time of the company are called irredeemable debenture.

7) Convertible debentures:

Debenture which are convertible into equity shares or preference share after a specified period are called convertible debenture.

8) Non- Convertible debenture:

The debentures which are not convertible into equity shares or preference shares after a specified period are called non convertible debenture.

9) First debenture:

Debenture which are paid first at the time of winding up of the company

10) Ordinary (second) debenture:

The debentures which are paid after the first debenture at the time of winding up of the company are called ordinary or second debentures.

11) Equitable Debentures:

The debentures which are secured by deposit of title deeds of the property with a memorandum creating charge are called Equitable debenture.

12) Legal debenture:

The debenture which are secured by actual transfer of the legal ownership of the property from the company to the holder are called legal debentures.

13) Debentures with paripasu clause: -

The Secured debenture which are discharged rateably through issued at different dates are called debentures with paripasu clause.

23. Mode of Issue of debentures

I) Debentures issued for cash

Bank a/c Dr xxx

To Debenture a/c xxx

II) Debentures issued to vendors for purchasing assets

Assets a/c Dr xxx

To vendor a/c xxx

(Purchase Assets)

III) Vendor a/c Dr xxx

To debenture account xxx

III. Debentures issued as collateral security:

Debentures issued as an additional security to principal Security. It can be issued only when the principal security fails to pay the amount of loan.

Entry:

Debenture suspense a/c Dr xxx

To Debenture a/c xxx

Debenture suspense a/c will appear on the assets side and debenture a/c will appear on the liabilities side of the balance sheet

24.From price point of view Debentures can be issued in three ways

1) When Debentures are issued at par (face value)

Bank a/c	Dr	xxx	
To Debenture a/c			xxx

2) When Debentures are issued at discount

Bank a/c	Dr	xxx	
Discount on Debenture a/c	Dr	xxx	
To Debenture a/c			xxx

3) When Debentures are issued at premium

Bank a/c	Dr	xxx	
To Debenture a/c			xxx
To premium on Debenture a/c			xxx

Illustration: 10

X Ltd took over assets of Rs.5,00,000 and liabilities Rs. 40,000 of the Ram company for the purchase consideration of Rs.5,50,000 The X Ltd paid the purchase consideration by issuing debentures of Rs.100 each at 10% premium. Give Journal entries in the books of X Ltd.

Solution:

1) Sundry Assets a/c	Dr	5,00,000	
Goodwill a/c (b.f)	Dr.	90,000	
To Liabilities a/c			40,000
To Ram company (vendor)			5,50,000

(Being purchase of assets and liabilities of the Ram company)

2) Ram company a/c	Dr	5,50,000	
To Debenture a/c			5,00,000
To Premium Debenture a/c			50,000

(Being issue of debentures at 10% premium)

25. From conditions of redemption point of view

Conditions of issue	Conditions of Redemption
1) Issued at par	redeemable at par

2) Issued at discount redeemable at par

3) Issued at premium redeemable at par

4) Issued at par redeemable at premium

5) Issued at discount redeemable at premium

1) When Debenture issued at par and redeemable at par: -

Issue	**Redemption**
Bank a/c Dr	Debenture a/c Dr
To Debenture a/c	To Bank a/c

2) When debentures issued at discount and redeemable at par

Bank a/c Dr	Debenture a/c Dr
Discount a/c Dr	To Bank a/c
To Debenture a/c	

3) When Debenture issued at premium and redeemable at par

Bank a/c Dr `	Debenture a/c Dr
To Debenture a/c	To Bank a/c
To premium on Debenture a/c	

4) When Debenture issued at par and redeemable at premium: -

Bank a/c Dr	Debenture a/c Dr
Loss on issue of debenture a/c Dr	Premium on redemption of
To Debenture a/c	Debenture a/c Dr
To premium on redemption	To Bank a/c
of debenture a/c	

5) When Debenture issued at discount and redeemable at premium:

Bank a/c Dr	Debenture a/c Dr
Loss on issue of debenture a/c Dr	premium redemption of
To Debenture a/c	Debenture a/c Dr
To premium on redemption	To Bank a/c
of debenture a/c	

Illustration: 11

Give journal entries for the following: -

1) Issue of Rs.5,00,000, 11% Debentures at par and redeemable at par
2) Issue of Rs.5,00,000 11% Debentures at premium of 5% and redeemable at par
3) Issue of Rs.5,00,000 11% Debentures at discount of 5% and redeemable at a par.
4) Issue of Rs.5,00,000 11% Debentures at par but repayable at 5% premium
5) Issue of Rs.5,00,000 11% Debentures at par but repayable at 5% premium

Issue Redemption

i) issue Rs.5,00,000 Debentures at par and Redeemable at par:

Bank a/c Dr	5,00,000		11% Debentures a/c Dr	5,00,000	
To 11% Debentures		5,00,000	To Bank a/c		5,00,000

ii) Issued at 5% premium redeemed at par:

Bank a/c Dr	5,25,000		Debenture a/c Dr	5,00,000	
To 11% Debenture a/c		5,00,000	To Bank		5,00,000
To premium an Debenture		25,000			

iii) Issued at 5% discount redeemed at par

Bank a/c Dr	4,75,000		Debenture a/c Dr	5,00,000	
Discount on issue of			To Bank		5,00,000
Debenture a/c Dr	25,000				
(25000 + 25000)					
To Debenture a/c		5,00,000			

iv) Issued at par redeemed at premium

Bank a/c Dr	5,00,000		Debenture a/c Dr	5,00,000	
Loss on issue of			Premium as redemption		
Debenture Dr	25,000		of Debenture a/c Dr	25,000	
To Premium on			To Bank a/c		5,25,000
redemption of debenture		25,000			
To Debenture		5,00,000			

V) Issued at discount redeemed at premium

Bank a/c Dr 4,75,000
Loss on issue of
Debenture a/c Dr 50,000
To Debenture a/c 5,00,000
To Premium on redemption
of debenture 25,000

Debenture a/c Dr 5,00,000
Premium on redemption of
debenture a/c Dr 25,000
To Bank a/c 5,25,000

26. Accounting Treatment – Issue of Debenture

Journal entries

1) On receipt of Debenture Application money: -

Bank a/c Dr xxx
To Debenture application a/c xxx

2) Application money transferred:

Debenture application a/c Dr xxx
To Bank a/c xxx

3) Excess application money refunded:

Debenture application Dr xxx
To Bank a/c xxx

4) Allotment Due:

Debenture Allotment a/c Dr xxx
To Debenture a/c xxx

5) Allotment money received:

Debenture Allotment a/c Dr xxx
To Debenture a/c xxx

6) When Debenture I call due:

Debenture I call a/c Dr xxx
To Debenture a/c xxx

7) When I call money received:

Bank a/c Dr xxx

To Debenture a/c xxx

8) When II & Final call due:

Debenture II & Final call a/c Dr xxx

To Debenture a/c xxx

9) II call money received:

Bank a/c Dr xxx

To Debenture II call a/c xxx

27. Debenture Discount –written off:

Discount on debentures should be written off during the life of the debentures. i.e. Total discount is spread over the life of debentures equally

eg. If debentures are issued for 5 years, the total discount is divided by 5, the discount may be written off over 5 years

Entry: - Profit & Loss a/c Dr xxx

To Discount on debenture a/c xxx

Illustration: 12

Rs.200000 debentures are issued at a discount of 6% repayable at the rate of Rs.40000 at the end of each year.

Solution:

Total discount = 2,00,000 x6/100 = 12000

	Outstanding Amount	**Ratio**
I Year	2,00,000	5
II Year	1,60,.000	4
III Year	1,20,000	3
IV year	80,000	2
V year	40,000	1
	Total	15

Discount to be written off each year being

1 year = 12000x 5/15	4,000
2year = 12000 x 4/15	3,200
3 year = 12000x 3/15	2,400
4 year = 12000 x2/15	1,600
5 year = 12000 x 1/15	800
	12,000

28. Interest on debentures: -

Interest on debenture is a charged against profits of the company.

Entry: Interest due

Debenture Interest a/c Dr (Gross Interest)

To Income tax a/c (Income tax amount)

To Debenture holders a/c (Net Amount)

2) Interest paid

Debenture holders a/c Dr

To Bank a/c

29. Provision for Redemption of Debenture:

When debentures are to be redeemed the company has to arrange a large amount of money for payment for this purpose the company has to make a provision for setting up sinking fund method

Sinking fund for Redemption of Debentures

Year beginning

1) Bank a/c Dr xxx

To Debenture a/c xxx

(Issue of debenture)

2)1st year end

Profit & Loss appropriation a/c Dr xxx

To Sinking fund a/c xxx

(Amount set aside)

3) Amount set aside is invested:

Sinking fund Investment a/c	Dr	xxx	
To Bank a/c			xxx

4) At the end of 2 and subsequent years;

Bank a/c	Dr	xxx	
To Sinking fund a/c			xxx

(Interest received on investment)

5) Annual amount set aside

Profit & loss appropriation a/c	Dr	xxx	
To Sinking fund a/c			xxx

6) Investment (including interest)

Sinking fund Investment a/c	Dr	xxx	
To Bank a/c			xxx

At the end of last year

1) Interest received

Bank a/c	Dr	xxx	
To sinking fund a/c			xxx

2) Annual amount set aside

Profit & Loss appropriation a/c	Dr	xxx	
To sinking fund a/c			xxx

3) Sale of Investment

Bank a/c	Dr	xxx	
To sinking fund Investment a/c			xxx

4) a. profit on sale of investment

sinking fund Investment a/c	Dr	xxx	
To sinking fund a/c			xxx

4) b. Loss on sale of investment

Sinking fund a/c	Dr	xxx	
To Sinking fund investment a/c			xxx

5. Balance in sinking fund a/c transferred

Sinking fund a/c	Dr	xxx	
To General Reserve a/c			xxx

6. Redemption of debenture

Debenture a/c	Dr	xxx	
To Debenture holders a/c			xxx

7. Amount paid

Debenture holders a/c	Dr	xxx	
To Bank a/c			xxx

Illustration: 12

Gokul Ltd had Rs.5,00,000/- 10% Debentures outstanding on January 1,2000. On that date the Debenture Redemption fund has Rs.4,50,000 invested in Rs.4,65,000 8% (2005) Government Loan Bonds. The annual appropriation form profits to the fund was Rs.52800. on December 31,2000 the Interest on Investments has been collected. The bank balance was Rs.102,000 after interest on investment has been received. The debentures were redeemed by realising the bonds at 87% show all relevant ledger Account.

Solution:

1) Debenture Redemption fund Account

Dec.2000		2000	
To Debenture Redemption fund Investment a/c (Loss on sale)	45,450	Jan By Balance b/d	4,50,000
		Dec 31 By interest 465000 x8/100	37,200
To General Reserve	4,94,550	By Profit & Loss appropriation a/c	52,800
	5,40,000		5,40,000

2) Debenture Redemption fund Investment Account

2000		By Bank	4,04,550
Jan 1 To balance b/d	4,50,000	(4,65,000*87/100)	
		By Debenture redemption	
		fund a/c (loss)	45,450
	4,50,000	b.f	4,50,000

3)Debentures Account

2000		2000	
Dec.31 To Bank	5,00,000	By Balance b/d	5,00,000

4)Cash at Bank

To Balance b/d	1,02,000	By Debentures	5,00,000
To Debenture		By balance c/d	6,550
Redemption fund	4,04,550		
Investment a/c			
	5,06,550		5,06,550

30. Own Debenture:

When a company purchases its own debentures in the open market, these debentures can be either cancelled by the company or be kept as an investment called own debenture

Purchase of debentures kept as an Inestment: -

Own debenture a/c Dr xxx

To Bank a/c xxx

Own Debenture a/c will be shown on the assets side of the Balancesheet: Debenture a/c will continue to be shown on the liabilities Side of the Balance sheet.

Cancellation of own Debentures:

Debentures a/c Dr xxx

Loss on redemption of Debentures a/c (loss) Dr xxx

To Own Debentures a/c xxx

To Profit on redemption of Debentures a/c (Profit) xxx

31) Redemption of Debentures

Redemption of debentures refers to the discharge of liability on account of debentures (repayment of debentures)

Sources of finance:

Debentures can be redeemed

i) Out or profits

ii) Out of capital

iii) Out of provision made for redemption

iv) Converting debentures into shares or new debentures.

Entry:

1) Redemption of debenture:

Debentures a/c Dr xxx

To Bank a/c xxx

2) Debenture redemption reserve is created out of profits:

Profit & Loss appropriation a/c Dr xxx

To Debenture Redemption Reserve a/c xxx

3) Balance in reserve a/c not required for redemption – transferred

Debenture Redemption Reserve a/c Dr xxx

To General Reserve a/c xxx

32) Redemption out of capital:

Entry:

Redemption of debentures a/c Dr xxx

To Debenture holders a/c xxx

Debenture holders a/c Dr xxx

To Bank a/c xxx

33) Redemption by conversion:

Sometime the debenture holders of a company are given option to convert their debentures into the shares or debentures within a stipulated period

Entry:

Old Debentures a/c Dr xxx

To New share capital a/c (or) xxx

To new Debentures a/c xxx

34) Procedure for redeeming Debentures:

1) Time: Debentures are redeemed on the date of maturity. (Or) by drawing a lot.

2) Amount: Debentures are redeemed either at par or at premium

If debentures are redeemed by purchasing them in the open market then the price paid depends upon the Market price (it can be at par or at discount or at premium.

3) Sources of finance: Debentures can be redeemed either

i) Out of profits

ii) Out of capital

iii) Out of provision

iv) by conversion

4) By purchase of own debentures in the open market as investment or cancellation purpose.

35) Ex-interest and cum- interest

Ex-interest:

The price paid for the debentures excludes interest For recording purpose interest is calculated and added separately to the quotation. It is otherwise known as without interest

Cum-Interest:

The price paid for the debentures includes interest and for recording purpose interest and for recording purpose interest is deducted from the total price paid. It is otherwise known as with interest.

UNDERWRITING OF SHARES AND DEBENTURES

1) Meaning of underwriting

Underwriting is an agreement whereby the underwriter ensures the Company that in case the shares and debentures- offered to the public are not subscribed by the public to the taken up by the underwriter.

2) Underwriter:

The person or Institution who underwrites the issue are known as underwriter

3) Underwriting commission:

For this service, the underwriter charges an agreed commission calculated on the issue price of shares and debentures: -

Conditions (Sec.76)

a) The articles must permit the payment of underwriting commission

b) The rate of commission should not exceed 5% on issue price of shares or ate authorised by articles whichever is less.

c) The commission paid or agreed to be paid must be shown in the prospectus.

4) Marked Applications

When the public get the application form through underwriters, they put a seal (their name) on the application form, such stamped application when received are called marked application.

5) Unmarked Applications:

When the public do not get the application form through underwriters but they send them directly to the company such forms do not bear any seal, (their name) and are called unmarked applications.

6) Types of underwriting:

1) Pure underwriting:

Under this type of contract, underwriters under take to subscribe for shares and debentures which are not fully subscribed by the public.

2) Firm Underwriting:

Under firm underwriting contract, underwriter agrees to buy a outright purchase of shares and debentures whether the issue will be

Oversubscribed or under subscribed. They will get priorities over the general public. If shares and debentures are oversubscribed.

7. Distinguish between underwriters and brokers.

Underwriters	Brokers
1.The underwriter undertake the responsibility for shares and debentures not subscribed by the public.	The Brokers procuring subscription for a shares and debentures through him and do not take up any shares.
2. Their remuneration is called underwriting commission	Their remuneration is called brokerage
3.Commission is paid for guaranteeing the subscription to the company	Brokerage is paid for the Service of placing the shares without any responsibility

Illustration: 4

SP Co Ltd was formed with a capital of Rs.1,00,000 in s. 10,000 shares.

The whole amount being issued to the public. The underwriting of these shares was as follows:

M-3,500 shares - N- 3,000 shares

O-2,000 shares - P- 1,000 shares

Q- 300 shares - R – 200 shares

The application forms marked by the underwriter were:

M-1,000, N-2,250, O-2,000 P-750, Q-500, R-Nil

	M	N	O	P	Q	R
Gross Liability	3500	3000	2000	1000	300	200
Less: Unmarked application (10,000-6500) apportioned in the ratio of gross liability						
35 : 30 20: 10: 3: 2	-1225	-1050	-700	-350	-105	-70

Balance	2275	1950	1300	650	195	130
Less: Marked applications	-1000`	2250	2000	750	500	NIL
	1275	-300	-700	-100	-305	130
Excess of N,O,P,Q apportioned in the ratio of gross liability 300+700+100+305 =1405 to M & R	-1330	+300	+700	+100	+305	-75
M’s surplus transferred to R	+55					-55
Net Liability	----	----	----	----	----	----

Unit I

Important Questions

1. Explain the following:

shares issued at par b)shares issued at premium and c). Shares issued at discount.

2. What do you understand by over subscription and under subscription of shares?

3. What is forfeiture and reissue of shares?

4. What conditions must be a company satisfy for issuing shares at discount?

5. What do you mean by sharepremium? State the utilisation of sharepremium account.

6. What is the Right issues of share. State the leaglimplications.

7. Discuss the conditions to be satisfied for issue of bonus

8. What do you mean by Bonous shares.state the conditions for issuing bonous shares?

9.What do you meanby Redeemable prefrence shares? State the conditions for redemptions of Redeembale prefrence shares.

10. What do you understand by capital Redemption Reserve?

11. Can partly paid up preference shares be redeemed what is the procedure for it?

12. Write notes on

a) Issue of debenture at discount b) Debenture issued as collateral security.

c) Ex-interest and d) Cum interest

13. How are debentures classified?

14. Distinguish between a share and a debenture.

15. Give different considerations for which debentures may be issued.

16. State the various methods of redemption of debentures.

17. What is under writing agreement?

18. What are the types of under writing?

Unit - 2

Acquisition of Business and Profits Prior to Incorporation

1. Meaning of acquisition of Business:

When a company takes over (purchase) the business of sole trading concern or partnership firm is called acquisition of business.

Purchase Consideration : It is the amount which is paid by the company for the purchase of business. This amount is given in the form of shares, Debetures and cash.

i) Purchase of business: -

Business purchase a/c	Dr	xxx	
To vendor a/c			xxx

ii) For Recording assets and liabilities taken over

Various assets a/c	Dr	xxx	
To Various liabilities a/c			xxx
To Business purchase a/c			xxx

If the debit side amount is more than the credit side the difference amount is debited to Goodwill a/c

If credit side amount is more that the debit side the difference amount is credited to capital reserve a/c

iii) Purchase consideration is paid:

Vendor a/c	Dr	xxx	
To cash			xxx
To share capital			xxx
To Debenture account			xxx

2. Vendor suspense Account:

Sometimes, a company does not take over the debtors and creditors of the vendors, but purchasing company agrees to collect the debts and pay creditors on behalf of the vendors. A separate account is opened to deal with debtors and creditors is called vendor suspense account. The company will charge commission to the vendor for this service Any profit or loss resulting from such collection and payments should be transferred to vendor's suspense account This account should be closed by paying the balance to the vendor or receiving the balance from the vendor as the case may be.

3. Profit prior to Incorporation

Meaning:

The profit which may arise from a business which has been purchased by the company before it was incorporated is known as profit prior to incorporation. It is a capital profit and should be transferred to capital reserve account.

eg:

A company incorporated on 1 April 2000, may purchase a business from 1st January 2000 and accounts are closed on 31 December 2000. Profit prior to incorporation period = 9 months (1.4.2000 to 31.12.2000). It there is any loss prior incorporation such loss is a capital loss and is debited to goodwill account.

4. Calculation of profit or loss prior to incorporation:

1. Time ratio:

It is the ration between prior and after incorporation period.

e.g: A Company incorporated on 1.4.2000 and purchased b business from 1.1.2000 and accounts are closed on 31.12.2000 calculate time ratio.

Time ratio	prior incorporation	After incorporation
	1.1.2000	1.4.2000
	1.4.2000	31.12.2000
	3 months	9 months

Salary rent, audit fees, Insurance, depreciation Interest should be allocated on the basis of time.

2. Sales ratio:

It is the ratio between sales made during the period of prior and after incorporation eg. If sales of prior incorporation period is 2,00,000 and that of after incorporation period Rs.5,00,000 Calculate sales ratio.

Sales ratio	prior incorporation	After incorporation
	2,00,000	5,00,000
	2:5	

Gross profit, selling expenses like bad debts, advertising should be apportioned on the basis of sales ratio.

3	**Allocation of Expenses**	**Basis**
1.	Gross Profit	Sales ratio
2.	Advertising, Bad debts	Sales ratio
3.	Rent, Salary, interest	Time ratio
	preliminary Expenses	After incorporation period
4.	Director fees, donation	
	Interest on debentures	
5.	Partner's salary interest on Capital	pre incorporation
6.	Interest paid to vendors	Ratio between pre and after incorporation periods

Illustration: 1

A. Ltd was incorporated on 1.5.1999. It took over the business of a going concern from 1-1-1999.

The following is the profit and loss account for the year ending 31.12.1999

	Rs		Rs
To rent and Taxes	12,000	By Gross Profit	1,55,000
Insurance	3,000		
Electricity charges	2,400		
Salaries	36,000		
Director's Fee	3,000		
Auditor's Fee	1,600		
Commission	6,000		
Advertisement	4,000		

Discount	3,500	
Office expenses	7,500	
Carriage	3,000	
Bank charges	1,500	
Preliminary expenses	6,500	
Baddebts	2,000	
Interest on Loan	3,000	
Net Profit	**60,000**	
	1,55,000	1,55,000

The total turnover for the year ending 31.12.1999 was Rs.5,00,000 divided into Rs.1,50,000 for the period upto may, 1, 1999 and Rs.3,50,000 for the remaining period. Calculate, the profit prior to incorporation and after incorporation.

Solution:

Time Ratio	Prior incorporation	After incorporation from
	From 1.1.99 to 30.04.99	1.5.99 to 31.12.99
	4 months	8 months
Sales Ratio	Rs.1,50,000	Rs.3,50,000
	15	35
	3	7

PROFIT AND LOSS A/CFOR THE PERIOD 31ST 1999

To Rent and Taxes				By Gross profit			
-Rs.12,000	Time ratio 1:2	4,000	8,000	155000	Sales ratio	46500	108500
Insurance	Time	1,000	2,000				
Electricy charges	Time	800	1,600				
Salaries	Time	12,000	24,000				
Director's Fee	Actual	----	3,000				
Auditor's fee	Time	533	1,067				
Commission	Sales 3:7	1,800	4,200				
Advertisement	sales	1,200	2,800				
Discount	Sales	1,050	2,450				
Office expenses	Time	2,500	5,000				
Carriages	Time	900	2,100				
Bank chares	Time	500	1,000				
Preliminary Expenses	Actual	--	6,500				
Baddebts	Sales	600	1,400				
Interest on loan	Time	1,000	2,000				
Capital Profit		18,617	--				
Revenue profit			41,383			46,500	108500
		46,500	1,08,500				

Director's fee, preliminary expenses After incorporation;

Illustration: 2

The business is carried on by Ravi under the name Ravi and Co was taken over a running business with effect from 1st July 2000 by Krishna and Co. which was incorporated on 1st October 2000. The same set of books was continued since there was no change in type of business and the following particulars of profits for the year ended 30th June 2001

Sales:

Company period	40000	
Less: Prior period	10000	50000
selling expenses	2000	
preliminary expenses written off	1200	
Salaries	3600	
Director's fee	1200	
Interest on capital upto (30.09.2000)	700	
Variable expenses	1500	
Depreciation	2800	
Rent	4800	
Purchases	25000	
carriage inwards	1019	43819
Net profit		6181

The purchase price (including carriage inwards for the company period) had increased by 10% compared to pre incorporation period. No stocks were carried either at the beginning or at the end. You are required to draw a statement showing the amount the pre and post incorporation profit stating the basis of allocation of expenses.

Solution: Pre incorporation after incorporation

Rs Rs.

1) Sales ratio sales = 10,000 : 40,000

1 : 4

2) Time ratio From1 july 2000 to From 1 October2000 to

3months 9months

1 : 3

3) Purchase and carriage inwards are sales ratio After incorporation period purchase price 10% increased

Sales = 10: 40 or 1: 4

After incorporation 10% increase $= \frac{40}{100} x\, 110 = 44$

Sales ratio 10: 44

Purchase and carriage inwards are sales ratio 10: 44

Selling expenses are sales ratio = 10 : 40

Profit and Loss account for the year ended 30 June 2001

	Basis	**Prior**	**After**			**prior**	**After**
		incorpo	incorpo		Basic	incorpo	incorpo
Ty Purchase	Sales 10:44	4630	20370			ration	Ration
Carriage	sales	189	830	By Sales	Actual		
Salaries	Time	900	2,700			10000	40000
Director's Fee	Actual	----	1,200				
Interest on	Actual	700	----				
Capital							
Variable	sales	300	1,200				
Preliminary expenses	Actual	---	1200				
Depreciation	Time	700	2100				
	1:3						
Rent	Time						
	1:3	1,200	3,600				
Selling	sales	400	1,600				
Expenses	1:4						
capital profit		981	----				
Net profit		----	5,200				
		10,000	40,000			10,000	40,000

Illustration: 3

Mohan Company Ltd. was incorporated on 30th June 2001. to take over the business of Mr.K.Mohan as from 1st January 2001. The financial account of the business for the year ended 31st December 2001 disclosed the following information.

	Rs	Rs
Sales:		
January to June	1,20,000	
July to December	1,80,000	3,00,000
Less: Purchases		
January to June	75,000	
July to December	1,20,000	1,95,000
Gross Profit		1,05,000
Less: salaries	15,000	
Selling Expenses	3,000	
Depreciation	1,500	
Director's remuneration	750	
Debenture Interest	90	
Administration expenses	4,500	24840
Profit for the year		80160

Your are required to prepare a statement apportioning the balance of profit between the periods prior to and after incorporation and show the profit and loss appropriation account for the year ended 31st December 2001.

Solution

1. Calculation of Time ratio

Prior incorporation	:	**After incorporation**
1.1.2001 to	:	1.7.2001 to
30.06.2001	:	31.12.2001
6 months	:	6months
Time ratio 1	:	1

2. Calculation of sales ratio

	Prior incorporation	:	**After incorporation**
	Rs.1,20,000	:	Rs.1,80,000
	12	:	18
Sales ratio	2	:	3

Profit & Loss account of Mohan company Ltd for the year ending 31st December 2001

	Basis	**Prior incorporation**	**After incorporation**		**Basis**	**Prior incorporation**	**After incorporation**
To Salaries	Time 1:1	7,500	7,500	By Gross Profit	Sales 2:3	42,000	63,000
Selling Expenses	sales 2:3	1,200	1,800				
Depreciation	Time	750	750				
Director's remuneration	Actual	-	750				
Debenture Interest	Actual	-	90				
Administration Expenses	Time	2,250	2,250				
Capital Reserve		30,300	-				
Net Profit			49860				
		42,000	63,000			42,000	63,000

COMPANY FINAL ACCOUNTS

Final Accounts

Trading a/c | **Profit & Loss a/c** | **Balancesheet**

Profit & Loss appropriation a/c

Balance sheet (Sec 2(11) Schedule VI Part –I (Specimen)

Form of Balancesheet

Liabilities		**Assets**		
I. Share capital:		**I. Fixed Assets:**		
Authorised Capital		Goodwill		
Issued	Xx	Land & Building	x x	
Subscribed	x x	Plant & machinery	x x	
called up capital	x x	live stock	x x	
Less calls in arrear	x x	Vehicles	x x	
	xx			
Add Forfeited shares	xx			
II.Reserves and surplus		**II. Investments**		
i)Capital Reserve		Investment in Govt :		
ii)Capital Redemption Reserve		Securities	x x	
iii)share premium Account		Investment in shares		
iv)Other Reserves		debentures or bonds		x
				x
Less Debit balance in Profit & Loss		Immovable properties		x x
v)Surplus from P & L appropriation		**III. Current Assets Loans and**		
a/c				
vi)proposed Dividend		**Advances**		
vii)Sinking fund		a)current Assets:		
III. Secured Loans		i)Outstanding interest on		
Debentures		Investment		
Loans & Advances from Banks		ii) Stores and spare parts		
Loans & Advances from	x	iii)Loose Tools		
Subsidiaries		iv)stock in Trade	x	

other loans & advances	x	v)work in progress		x
(v)Unsecured Loan		vi)Sundry Debtors		x
(i)Fixed deposits	x	a)Debts outstanding for a period		x
(ii)Loans & advances from	x	exceeding 6 months		x
Subsidiaries	x	b)Other debts		x x
iii)Short term loans and advances	x	Less: provisions	x	x
iv)Loan from Directors	x	Cash in hand		x
(v)Current Liabilities and provision		**B) Loans and Advances**		
A)Current liabilities:		i)Advances and Loans to		
Bills payable	x	Subsidiaries		x
Sundry creditors	x	ii)Advances and loans to		X
		partnership		x
Unclaimed dividend	x			
Dutstanding interest on loan	x	iii)Bills of Exchange		x
B)Provisions		iv)Balance with customs port trust		
i)Provision for taxation	x	**4)Miscellaneous Expenditure**		
ii)Proposed dividend	x	i)Preliminary Expenses		x
iii)Provident fund scheme pension scheme	x	ii)Underwriting commission, Brokerage		x
		iii)Discount on issue		
		Debentures		x
	Xxx	**5)Profit and Loss account**		x

2)Profit and Loss Appropriation Account –Specimen

To General Reserve	x	By balance b/d		x
To proposed dividend	x	By Net profit b/d		x
To Interim Dividend	x	(from P & L a/c)	xx	
To surplus Carried to				
Balance sheeet	x			

9. Difference between profit and Loss a/c and profit & Loss approritetion a/c

1. It is prepared to findout the net profit or Net Loss of a business	1.It is prepared to find out surplus profit inorder to distribute the profit to the shareholders.
2.It is compulsory.	2.It is compulsory.
3.It is must be prepared even if it is a loss.	3.It is prepared if the business earn profit
4.It is prepared before the preparation of appropriation account	4.It is prepared after the preparation of profit & loss a/c
5.If there is a surplus, will be transferred to appropriation a/c If there is a loss will be shown in Balance sheet liabilities side	5.surplus amount will be shown on the liabilities side of the balance sheet under the heading of Reserve and surplus.

10. Contingent liabilities:

Contingent liabilities are those liabilities which may or may not arise in future. It will appear as a footnote under the liabilities side of the Balancesheet

examples:

1. Arrears of cumulative preference shares dividends
2. Uncalled liability on shares partly paid.
3. claims against the company not acknowledged as debts
4. Bills discounted likely to be dishonoured.

11. Interim Dividend:

It is a dividend which is paid between two annual general meeting. It is paid before the final dividend is declared. It is paid when there is a sufficient profit available as final dividend to the share holders. It is appeared on the debit side of the P & L appropriation a/c and will be shown on the liability side of the Balancesheet under the

2. Other items:

1) Preliminary Expenses;- Balance sheet – Assets side under the heading of Miscellaneous Expenditure.

2) Unclaimed Dividend – Balancesheet Liabilities side under the heading of current Liabilities and provisions.

3) Calls in arrears - Balancesheet – Liabilities side under the heading of share capital deducted from called up capital

4) Share forfeited – Balance sheet –liabilities side –Added with share capital

5) Provision for tax - Balancesheet liabilities side – Under the heading of Reserves and surplus

6) Share premium – Balance sheet –Liabilities side –Under the heading of current Liabilities & provisions.

7) Bills Receivable – Balancesheet –Asset side **-** under the heading of current Assets Loans advances.

8) Loose Tools – Balancesheet – Asset side under the heading of current Assets Loans advances.

9) Live stock – Balancesheet – Assets side under the heading of Fixed assets.

10) Work in progress – Balancesheet Assets side – under the leading of current assets Loans and advances.

11) Pattents –Balancesheet – Assets side**-** Under the heading of Fixed assets.

13. What is capital profits give examples?

Capital profits are those profits which are not earned during the regular course of business. They are non – recurring profits. It is a causal profits. are used to write off capital losses and balance amount will be transferred to capital reserve account.

14. What is capital Reserve?

Capital reserves are those reserves which are created out of capital profits. This reserve should not be distributed as dividend to the share holders. It can be used to write off capital losses.

14.a Dividend : It is a share in the profits of the comapny distributed among its shareholders. It is calculated on the paidup capital.

Utilisation of capital reserve

1. To write off capital losses like preliminary Expenses, Discount on issue of shares Debentures, Goodwill etc.
2. To issue Bonus Shares.

15a. Distinguish between capital Reserve and Reserve Capital:-

Capital reserve	Reserve Capital
1. It is created out of capital profits	1.It is a profits of Authorised Capital
2. It can be used write off capital losses	2. The uncalled capital can be called upon in the event of winding up of a company

15b.. Distinguish between capital Reserve and Reserve Capital:-

	Dividend	Reserve
1	proposed dividend exceeds 10% but less than 12.5%	Create 2.5% Reserve out of the current profits.
2.	From 12.5% but less than 15%	5%
3.	From 15% but less than 17.5%	7 ½ %
4.	More then 20% paidup capital	10%

Valuation of Goodwill

I) Valuation of Goodwill

1. Meaning of Goodwill :

what is goodwill goodwill means reputation carried by a business house. It is an Intangible assets. Goodwill is the present value of a firm's anticipated excess earnings. It is the attracive force which brings in customers. It in not visible. It does not become obsolut.

2. Definition of Goodwill:

Goodwill as the present value of expected future income in excess of a normal return on the Investments in tangible assets.

3. What are the factors determing the value of Goodwill?

1. Profitability:

The profit earning capacity of the business depends upon

i] Nature of goods

ii] Location of business

iii] Efficiency of management and employees.

2. Capital employed: capital employed to earn the expected profits in valuation of goodwill

3. Return [income] expect by investors.

4. Other factors: Market conditions,. Competition, Better financial relationship Risk in busines

17. Need for valuation of goodwill

Need for valuation of goodwill

Sole proprietorship	partnership firm	Joint stock company
a]. Sale of business	a] change in profit sharing ratio	a] Amalgamation absorption of companies
b] Taxation purpose	b] Admission partner	b] Valuation of shares
	c]sale to a company	c] Acquisition of business.
	d] Retirement and Death of partner	

18. Methods of valuation of goodwill

1. Average profit method   2. Super profit method

3. Capitalisation method   4. Annuity method.

1. Average profit method.

This method is adopted by sole traders and partnership firm a number of years of net profits earned in the past by business are averaged and goodwill is calculated as a certain number of years purchase of such average net profits.

2. Super profit method:-

Super profit is the difference between average profits and normal profits.

Goodwill = -Super profit x Number of year purchase

Super profit = Average profit – Normal profit

Normal profit = capital employed x Normal rate of return

Capital employed = Assets at [Market price]	x x	
Less: liabilities	x x	
Capital employed	x x	
Less ½ of current year profits		x x
Average capital employed	x x	

3. Capitalisation Method:

Under this method the present value of capital employed is determined on the basis of actual profits earned into normal rate of return.

$$\text{Goodwill} = \frac{\text{super profit}}{\text{Normal rate of return}} \times 100$$

4. Annuity method:

Under annuity method the super profit are capitalised to ascertain the present value of super profit

Goodwill = Super profit x Reference to annuity Table.

Illusration: 5

From the following information calculate the value of Good will:

a] Average capital employed in the business Rs.7,00,000

b] Net Trading profits of the firm for the past three yars rs.1,07,600 Rs90,700 and Rs.1,12,500 respectively

c]Rate of interest expected from capital 12%

d]Remuneration to partners for their services Rs.12,000/- per annum.

e] sundary assets of the firm Rs.7,54,762/- sundry liabilities Rs31,329/-

Solution:

Calculation of Average Profit:

Net Trading Profits for the last three year		1,07,600
		90,700
		1,12,500
	Total profit for 3 years	3,10,800

Average profits = $\frac{3,10,800}{3}$ = 1,03,600

Less: Remuneration paid to partners 12,000

Average profits 91,600

Normal profit = Capital employed x Normal rate of return

7,00,000 x 12/100 = 84,000

Super profit = Average profit – Normal profit

Rs. 91,600 – 84,000 –Rs. 7,600

Goodwill = Super profit x No.of years purchase

Rs. 7,600 x 3 years [assumed]

. Goodwill = 22,800

Illusration: 6

The following particulars are available in respect of the business carried on by a trader.

1)Profit earned

1995 Rs.48,000 : 1996 Rs.54,000j 1997- Rs.45,000

2]Normal rate of profit 10%

3]Capital employed Rs.3,0,000

4]present value of an annuity one rupee for five years at 10% Rs.3.78

5]The profit included non-recurring profits on an average basis Rs.6.000 out of which it was deemed that even non- recurring profits had a ten dency of appearing at the rate of 2000 p.a youare required togoodwill.

a] as per five years purchase of super profit

b] as per capitalisation of super profit method

c] as per annuity method

solution:

1] Calculation of average profits.

Profit 1995	-	Rs. 48,000
1996	-	Rs .54,000
1997	-	Rs.45,000
Total 3 years profit		Rs.1.47,000

Average profit = $\frac{\text{Rs.1,47,000}}{3}$ 49,000

Less: Non- recurring Profit 6,000

43,000

Add: Recurring Profit 45,000

Normal Profit = Capital Employed x Normal rate of return

$$\frac{3,00,000 \times 10}{100} = 30,000$$

Super profits = Average profits – Normal rate of return

= 45,000 – 30,000

Super profit = Rs.15,000

a] Goodwill = super profit x No. of years purchase

=Rs.15000 x 5 years = Rs.75,000

b] Goodwill as per capitalisation of super profit method:-

$$\text{Goodwill} = \frac{\text{super profit x 100}}{\text{Normal rate of return}}$$

=15,000 x 100/10 = Rs.1,50,000

C] Goodwill as per annuity method: -

Goodwill = super profit x as per annuity Table (reference)

=Rs.15,000 x 3.78 = Rs.56,700

Illusration: 7

The Following particulars are available in respect of the business carried on by Mithilsh kumar

1] Capital invested Rs.50,000

2] Trading results Rs.

1994 profit Rs.15,000 : 1995 profit 16,000

1996 Loss Rs.3,000 : Profit 20,000

3] Market rate of interest on investment 10%

4] Rate of Risk return on capital invested in business 2%

5] Remuneration from alternative employment of the proprietor [if not engaged in business] 4,000 per annum

You are required to compute the value of goodwill on the basis of 3 years purchase of super profits of the business calculated on the average profits of the last four years.

Solution:

Calculation of average profits		**Rs.**
Trading profits	1994	15,000
	1995	16,000
	1997	20,000
		51,000
Less: Trading loss	1996	3,000
Total profits for four years		48,000

Average profits = $\frac{48,000}{4}$ = Rs.12,000

Less: Remuneration of the proprietor = Rs.4,000

Adjusted Average Profits = Rs.8,000

Normal Profits:-

Capital employed x Normal rate of return

50,000 x12/100 = Rs.6,000

Normal rate of returns = market rate of interest + rate of Risk

(10%+2%=12%)

Super profit =8,000 – 6,000 =Rs.2,000

Goodwill = Super profit x No. of year purchase

= Rs.2,000 x 3 years = Rs.6,000

Illustration: 8

Mr Viswanath has invested Rs.4,00,000 in a business. His Net profit before tax at 50% is Rs.1,60,000 which includes Rs.12,000 annual rent of own building (not charged) used as business premises annual Rs.24,000 as his salary (not charged) since he has resigned from a join the salary of which , was 2000 P.M. before starting this business he has invested this amount on 10% securities fair compensation for the risk involved is 2% calculate the value of goodwill on the basis of three year purchase of the average annual super profits.

Solution:

Goodwill under super profit method

Goodwill = Super profit x number of year of purchase

Super profit = Average profit - Normal profit

Average profit

Profit before tax		1,60,000	
Less: Recurring Expenditure			
Annual rent	12000		
Salary	24000		36,000
Profit before tax			1,24,000
Less 50% Tax			62,000
Average Profit			62,000

Goodwill = 14000 x3 years = Rs.52,000

19. Valuation of shares

1. Need and Importance of valuation of shares

Shares must be valued due to the following reasons:-

1. For the purpose of purchase and sale of business in private companies
2. For estate duty and wealth tax purpose
3. For the purpose of Amalgamation and Absorption of companies
4. For the purpose of issuing bonus shares or making rights issue.
5. For the purpose of transfer of shares.
6. Holding company purpose.
7. When shares are pledged as a security against loan
8. Unquoted shares in the stock exchange market.
9. When shares of one class are convented into another class.
10. For the purpose of assessing the value of assets of finance and government trusts.

2. What are the factors affecting the valuation of shares?

a] Profitability b] yield Expected by the Investors

c] Capital employed d] other factors [political, economical and social conditions. Govt policies]

3. Methods of valuation of shares.

i)Net assets method ii) Yield method

iii) Earning capacity method iv)Fair value method.

i) Net Asset Method [Intrinsic value or breakup value method]-;-

Under this method net assets of the company are divided by the number of share to arrive at the net asset value of each share.

$$\text{Value per Equity share} = \frac{\text{Amount Available to equity shareholder}}{\text{Number of Equity shares}}$$

ii) Yield Method or Income method or market value method

Yield an effective rate of return from similar types of securities. The yield as prevailing in the industry is known as normal rate of return and is considered as a base while ascertaining the market value of shares.

$$\text{Value per share} = \frac{\text{Expected Rate}}{\text{Normal rate}} \text{ x paid up value per equity share}$$

$$\text{Expected Rate} = \frac{\text{Profit available to equity shareholders}}{\text{Paid up equity share capital}} * 100$$

Profit available to Equity shareholders:

Expected profits		xx x
Less provision for Income tax	xx x	
Profit after tax	xxx	
Less Transferred to Reserve	xxx	
Less Preference share dividend		xxx
profit available to equity shareholders	xxx	xxx

iii) Earning Capacity method:

Size of profits in relation to the capital employed to earn is a important factor in valuation of shares.

$$\text{Value per share} = \frac{\text{Rate of Earnings}}{\text{Normal rate}} \times \text{Paid up value per share}$$

$$\text{Rate of earning} = \frac{\text{Profit earned}}{\text{Capital employed}} \times 100$$

Profit earned = profit	x x
Less: Interest debenture	x
Less: Tax	x x
Profit after tax	x x
Less: Reserve	x x
Less: preference share dividend	x x
Profit earned	x x

Capital employed = Assets – Liabilities at market value.

iv) Fair value method = Fair value is the Net asset and yield method

$$\text{Value per share} = \frac{\text{Net asset method + yield method}}{2}$$

VALUATION OF SHARES

Illustration: 9

Following is the Balancesheet of Moore Ltd as on 31.12.1981

Liabilities		Assets	
Equity share capital		Fixed assets	45,00,000
Share of Rs.100 each	50,00,000	Current assets	24,50,000
Reserves	14,00,000	Goodwill	10,00,000
Profit & Loss a/c	1,00,000		
5%Debentures	12,00,000		
Current Liabilities	2,50,000		
	79,50,000		79,50,000

The fixed Assets were valued at rs.40,00,000 and good will Rs.2,00,000 the net profits forthe past three years were Rs. 1,50,000 Rs.2,10,000 and Rs.3,40,000respectively Fair Return On Investments May be taken as 14% for companies enganged in similar business compute the Value of shares by a]Net asset method b] yield method.

Solution:

1] Valuation of Equity share according to Net asset method Asset at market value:

Fixed assets = 40,00,000

Current assets = 24,50,000.

Goodwill = 2,00,000

Total Assets = 66,50,000

Less: Liabilities

5% Debentures =12,00,000

Current Liabilities = 2,50,000

Amount available to equity = 14,50,000

shareholder (net assets) = 52,00,000

Value per Equity share= Amount available to Equity shareholders

Number of Equity shares

$=\text{Rs.}\frac{52,00,000}{50,000 \text{ shares}} = \text{Rs.}104$ $\quad \frac{\text{Rs.}50,00,000}{100 \text{ per share}} = 50,000\text{shares}$

2] Valuation of Equity share according to yield method value per Equity share:

$=\frac{\text{Expected rate of return}}{\text{Normal rate of return}} \times \text{paid up value per share}$

To calculate expected rate of return:

$=\frac{\text{Profit available to Equity shareholders}}{\text{paid up Equity share capital}} \times 100$

Net Profits for the past three years 1,50,000

2,10,000

3,40,000

7,00,000

Average profit $\frac{7,00,000}{3}$ =RS 2,33,333

Profit available to Equity shareholders = Rs.2,33,333/-

Expected rate of return = $\frac{2,33,333 \times 100}{50,00,000} = 4.66$

Value per share = $\frac{\text{Expected rate x paid up per share}}{\text{Normal rate}}$

$= \frac{4.66}{14} \times 100 = \text{Rs.}33.33$

3) Fair value per share

=Value as per Net assets method + Value as per yield method

$=\frac{\text{Rs. }104+33.33}{2} = \frac{137}{2} = \text{Rs.}68.66$

Illustration: 10

From the following information calculate value of Equity shares.

1. 4000 8% preference shares of Rs.100 each Rs.4,00,000
2. 5000 equity shares of Rs.20 each at Rs.16 per share paid up Rs.8,00,000
3. Expected profits for the year before tax Rs.5,00,000
4. Rate of tax 50%
5. Trans to General reserve 20% of the profits
6. Normal rate of earnings (Return) 14%

Solution:

Calculation of profit available to Equity shareholders

Expected profits	Rs.5,00,000
Less: 50% Income tax	Rs.2,50,000
Profit after tax	Rs.2,50,000
Less: 20% Transfer to General reserve Rs.2,50,000 x $\frac{20}{100}$	Rs. 50,000
	Rs.2,00,000
Less: Preference dividend 4,00,000 x 8/100 =	32,000
Profit available to Equity shareholders	1,68,000

Expected Rate of Return

$$= \frac{\text{Profit available to Equity shareholders}}{\text{paid up equity capital}} \times 100$$

$$= \frac{1,68,0000}{8,00,000} \times 100 = 21\%$$

Value per equity share as per yield method.

$$\text{Value per equity share} = \frac{\text{Expected rate of return}}{\text{Normal rate of return}} \times \text{paid up value per share}$$

$$= \frac{21}{14} \times 16 = \text{Rs.}24$$

Illustration: 11

B Ltd has 10000 equity shares of Rs.10 each (Rs.8 paid) and 1,00,000/- 6% preference shares of RS.10 each fully paid. The company has a practice of transferring 20% of the profit to general reserve every year. If the expected profit before tax is Rs.2,00,000/- and the rate of tax is 50% calculate the value of equity shares (Normal rate of dividend is 20%)

Solution:

Profit available to Equity shareholders

Expected profits	2,00,000
Less: 50% tax (2,00,000 x 50/100)	1,00,000
Profit after tax	1,00,000
Less: 20% Profit transferred to general Reserve	20,000
(1,00,000x20/100)	80,000
Less: Dividend paid to preference shares holders	60,000
Profit available to Equity shares holders	20,000

Calculation of Expected rate of return

$$\text{Expected rate} = \frac{\text{profit available}}{\text{Paidup Equity capital}} \times 100$$

Paid up Equity capital = 10,000/- shares x Rs.8 = Rs. 80,000

$$= \frac{20,000}{80,000} \times 100 = \text{Rs.}10$$

Value per Equity share as per yield method

$$\text{Value per Equity share} = \frac{\text{Expected rate of return}}{\text{Normal rate of return}} \times \text{paid up value per share}$$

$$= \frac{25}{20} \times \text{Rs.}8 = \text{Rs.}10$$

Illustration: 12

On 31st December 1994, the balance sheet of a limited company disclosed the following position

Issued capital

In Rs.10 shares	4,00,000	Fixed Assets	5,00,000
Reserves	90,000	Current assets	2,00,000
Profit & Loss a/c	20,000	Goodwill	40,000
6% debentures	1,00,000		
Current liabilities	1,30,000		
	7,40,000		7,40,000

On 31st December 1994, the fixed assets were independently valued at Rs.3,50,000 and goodwill at Rs.50,000 The net profit for the three years were 1992 Rs.51,600, 1993 Rs.52,000 and 1994 Rs.51650 of which 20% was placed to Reserve, this proportion being considered reasonable in the industry in which the comapny is enganged and fair investment written may be taken at 10%. Compute value company's share by Yield method.

Value per Equity share as per yield method

$$\text{Value per Equity share} = \frac{\text{Expected rate of return}}{\text{Normal rate of return}} \times \text{paid up value per share}$$

Calcualtion of Expected rate :-

Profit 1999 = 51600

Profit 2000 = 52000

Profit 2001 = 51650

1,55,250 / 3 = 51,750

Average profits = 51750

Less :20% Reserve 51750*20/100= 10350

41,400

Calculation of Expected rate of return

$$\text{Expected rate} = \frac{\text{profit available}}{\text{Paidup Equity capital}} \times 100$$

$$= \frac{41\,400}{4,00,000} \times \text{Rs. } 100 = \text{Rs.}10.35\ \%$$

Value per Equity Share = 10.35/10*10 =10.35

Questions: -

1. What is acquisition of business?

2. What is purchase consideration?

3. Explain various method of calculation of purchase consideration.

4. Write short notes on

 1. Capital profit   2.revenu profit   3.time ratio   4.sales ratio

5. What are the ratios used to calculate profit prior to incorporation?

6. How do you treat pre-and post incorporation profit?

7. Draw a specimen of company balance sheet?

8. Statue the various method of valuing shares of the company?

9. Define goodwill. Describe the various factors affecting goodwill.

10. Discuss the various method of valuation of goodwill

11. What are the factors that influence valuation of shares?

12. What are the circumstances in which there may be a need for valuation of shares?

Unit - 3

AMALGAMATION, ADSORPTION, AND RECONSTRUCTION

1. Explain the term Amalgamation, Absorption and Reconstruction:

i) Amalgamation (merger):-

When two or more companies doing similar business go into liquidation and to form a new company to taken over their business it is called Amalgamation.

e.g.:

A company and 'B' company are liquidated and AB company newly formed to take over the business of A and B company. In this case A and B company are liquidator of vendor company and AB company is a purchasing new company.

ii)Absorption:

When one existing company purchase the business of another company carrying on similar business. It is called absorption.

Example:

A company takes over the business of B Company. B Company is absorbed company and A is a absorbing company . Here there is no new company at all.

iii) Reconstruction :

When a company has financially suffered due to heavy accumulated loss. For this purpose the company financial structure is reorganised is called Reconstruction.

Reconstruction may be two types.

a) External Reconstruction:

One existing company goes into liquidation and a new company is formed to take over the business of the liquidated company which is similarly named and owned by the same shareholders.

b) Internal Reconstruction:

It is neither liquidation nor formation of a new company. It means reduction of share capital and rearrangement of share capital and reorganation. In this case the capital structure of company is being reorganised. Thus internal reconstruction means reduction of capital to cancel any paid up share capital which is lost or unrepresented by available assets.

2. Purchase consideration:

It is amount paid by the purchasing company to the vendor company for the purpose of taking over the business. The purchasing company may pay purchase price in the form of cash, shares debentures of a company.

Calculation of purchase consideration:

a) **Net asset method:**

Under this method value of all assets taken over less amount of liabilities taken over by the purchasing company.

b) **Net payment method:-**

The purchasing company discharge purchase price by issuing shares, debentures & cash.

If the purchase price must be compared with the net asset purchased. If the amount paid is in excess of net asset the difference amount is debited to Goodwill. If the amount paid is less than net asset purchased the difference amount is credited to Capital Reserve.

3. Difference between External Reconstruction and Internal Reconstruction

External Reconstruction	Internal Reconstruction
1. One company goes into liquidation (closed)	A company is to recorgaganise is capital structure or reduction of share.
2. New company is formed	No new company
3. Share capital is not reduced due to Reconstruction	Capital is reduced due to construction.
4. External arrangement	Internal arrangement.
5. It takes over other company assets and liabilities	It does not take over other company assets and liabilities.

4. Difference between Amalgamation, Absorption and Reconstruction

Amalgamation	Absorption	Reconstruction
1. When two or more companies go into liquidation	When one existing company take over the business of one or more existing companies	In case of external Reconstruction one new company goes into liquidation.
2. New company is formed	New company is not formed	In case of External Re-Construction new company is formed.
3. To take over other company assets liabilities	to take over other company assets & liabilities	In case of internal Re-construction new company is not formed. In case of External Reconstruction one company selling its assets to another newly formed company which is generally similarly named and owned by the same share holders.
4. There will be a purchase consideration	There will be a purchase consideration	No purchase consideration in case of internal reconstruction

5. Journal entries:

Amalgamation, Absorption, and External Reconstruction:

In the books of Liquidator of vendor company

- ✓ **Assets taken over by purchasing company**

    Realisation a/c Dr.

    To Assets a/c (Book value)

- ✓ **Liabilities taken over: -**

    Sundry creditors a/c Dr

    Bills payable a/c Dr

    To Realisation a/c

- ✓ **Purchase consideration due**

    Purchasing Company a/c Dr

    To Realisation a/c

(Purchase Consideration amount)

- ✓ **Purchase Consideration Paid**:

  Cash a/c Dr.

  Debenture a/c Dr

  Shares a/c Dr.

  To purchasing company a/c

- ✓ **Realisation Expenses:**

  a) Paid by vendor Company:

  Realisation a/c Dr.

  To Cash a/c

  b) **Paid by purchasing company**:

  No Entry

- ✓ **Debentures – Paid (Redemption)**

  Debentures a/c Dr.

  To cash a/c

- ✓ **Realisation Profit transferred:**

  Realisation a/c Dr

  To Equity Shareholders a/c

- ✓ **Realisation Loss:**

  Equity shareholders a/c Dr

  To Realisation a/c

- ✓ **Accumulated Losses transferred:**

  Equity shareholders a/c Dr

  To Profit and Loss a/c

  To Preliminary Expenses a/c

- ✓ **Accumulated Profits transferred:**

  Equity share capital a/c Dr

  Profit and Loss a/c Dr

  General Reserve a/c Dr

  To Equity Shareholders a/c

- ✓ **Amount paid to Equity shareholders :**

Equity shareholders a/c Dr

To Cash a/c

To Shares a/c

Ledger:

1) Realisation account 2) Cash account 3) Equity Shareholders account.

In the books of purchasing company (New company)

1) Purchase consideration payable

Business purchase a/c Dr

To Liquidator of vendor company a/c (Purchase consideration amount)

2) Assets and Liabilities – recorded

Various assets a/c Dr (Revised value)

To Liabilities a/c

To Business Purchase a/c

3) Purchase consideration paid :

Liquidator of Vendor Company a/c Dr

To Cash a/c

To Share Capital a/c

To Debenture a/c

4) Realisation Expenses paid

Goodwill a/c Dr (OR) Capital Reserve a/c Dr

To cash a/c

6. **Journal Entries**

Internal Reconstruction (capital Reduction)

Journal Entries :-

1) Reduction of Equity share Capital :

For Example Equity share capital reduced to Rs.60 each. (face value Rs.100 each)

Old Equity Share capital a/c Dr	100	
To New Equity share capital a/c		60
To capital Reduction a/c (100-60)		40

2) Reduction of preference share capital

If Preferences share capital reduced by Rs.25

Old Preferencfe share capital a/c Dr.100

To New Preference share capital (100-25) 75

To Capital Reduction a/c 25

3) Debenture holders or Creditors forego (sacrifice) the amount

Creditors a/c Dr xx

Debenture a/c Dr xx

To Capital Reduction a/c xx

4) Appreciate the fixed assets

Assets a/c Dr

To capital Reduction a/c

5) **Utilisation of capital Reduction Account**:

Capital reduction a/c Dr

To Profit & Loss a/c (Loss)

To Goodwill a/c

To Preliminary Expenses a/c

To Underwriting Commission a/c

To Discount a/c

To Machinery a/c (Depreciation)

To Patents rights a/c

To Capital Reserve a/c (balance transferred)

Absorption

Illustration: 1

White Ltd agreed to acquire the business to Green Ltd as an 31st December 1986, The Balancesheet of Green Ltd on that date was a follows:

Share capital in fully paid shares of Rs.10	6,00,000	Goodwill	1,00,000
General Reserve	1,70,000	Land and Buildings	6,40,000
Profit & Loss a/c	1,10,000	Stock	1,68,000
6% Debentures	1,00,000	Debtors	36,000
Creditors	20,000	Cash	56,000
	10,00,000		10,00,000

The consideration payable by White Ltd was agreed as follows

a) A cash payment equivalent to Rs 2.50 for every Rs.10 shares in Green Ltd.2

b) The issue of Rs. 90,000, Rs.10 shares fully paid in white Ltd having an agreed value of Rs.15 per share.

c) The issue of such an amount of fully paid 5% Debenture of white Ltd at 96% as is sufficient to discharge the 6% Debentures of Green Ltd at a premium of 20%. The directors of white Ltd valued Land and Buildings at Rs.850000 and created 5% provision on debtors. Expenses of Liquidation Rs.6000 were paid by white Ltd.,

Show the calculation of the purchase consideration and pass acquisition entries in the books of white Ltd.

Green Ltd – Liquidator of Vendor company

White Ltd – Purchasing company

Solution:

Calculation of purchase consideration:

Form		Amounts
1) Cash 60000 shares x Rs.2.50	=	1,50,000
2) Equity shares 90000 shares x Rs.15	=	13,50,000
3) 5% Debentures 100000x120/100	=	1,20,000
Purchase consideration	=	**16,20,000**

Journal entries:

In the books of Green Ltd (Liquidator of Vendor company)

1) Assets taken over by white Ltd (Book value)

		Dr	Cr
Realisation a/c Dr		10,00,000	
To Good will a/c			1,00,000
To Land and Building a/c			6,40,000
To stock a/c			1,68,000
To debtors a/c			36,000
To cash a/c			56,000

2) For Liabilities taken over by white Ltd

		Dr	Cr
Creditors a/c Dr		20,000	
To Realisation a/c			20,000

3) Purchase consideration due from white ltd:

		Dr	Cr
White Ltd a/c Dr		16,20,000	
To Realisation a/c			16,20,000

4) Purchase consideration

		Dr	Cr
Cash a/c	Dr	1,50,000	
Equity shares a/c	Dr	13,50,000	
5% Debentures a/c	Dr	1,20,000	
To white Ltd a/c			16,20,000

5) Realisation expenses paid by white Ltd: -

No Entry

6) a) 6% debentures is discharged by issuing 5% Debentures in white Ltd:

6% Debenture a/c Dr	1,00,000	
Realisation a/c Dr (Loss)	20,000	
To Debenture holders a/c		1,20,000

b) **Transfer:**

Debenture holders a/c Dr	1,20,000	
To 5% Debenture a/c		1,20,000

Realisation Account

To Goodwill	1,00,000	By creditors	20,000
To Land & Buildings	6,40,000	By white Ltd	1,62,000
To stock	1,68,000		
To Debtors	36,000		
To cash	56,000		
To Debenture holders (loss)	20,000		
To Equity shareholders (profit) (b.f.)	6,20,000		
	16,40,000		16,40,000

7) Profit on Realisation transferred:

Realisation a/c Dr	6,20,000	
To Equity shareholders a/c		6,20,000

8) Accumulated profits and share capital transferred:

General Reserve a/c Dr	1,70,000	
Profit and Loss a/c Dr	1,10,000	
Equity share capital a/c Dr	6,00,000	
To Equity shareholders a/c		8,80,000

Equity shareholders A/c

To Cash	1,50,000	By General Reserve	1,70,000
To shares in white Ltd., (b.f)	13,50,000	By Profit & Loss a/c	1,10,000
		By Equity share capital	6,00,000
		By Realisation (profit)	6,20,000
	15,00,000		15,00,000

9) Amount paid to equity shareholders

Equity shareholders a/c Dr. 15,00,000

To Cash a/c 1,50,000

To Shares in white Ltd 13,50,000

White Ltd A/c

To Relisation a/c	16,20,000	By cash	1,50,000
		By shares	13,50,000
		By 5% Debentures	1,20,000
	16,20,000		16,20,000

In the books of White Ltd., (purchasing company)

1) **Purchase consideration to be paid**

Business purchase a/c Dr 16,20,000

To Liquidator of Green Ltd 16,20,000

2) **Assets and Liabilities recorded at revised value**

Land and Buildings a/c Dr 8,50,000

Stock a/c Dr 1,68,000

Debtors a/c Dr

36000x5/100 = 1800 34,200

Cash a/c Dr 56,000

**Goodwill a/c Dr (b.f) 5,31,800*

To creditors a/c 20,000

To Business purchase a/c 16,20,000

16,40,000 – 1108200 = 531800

3. Purchase consideration paid:

Liquidator of Green Ltd. a/c Dr 16,20,000

Discount on issue of debenture a/c Dr 5,000

(125000 – 120000)

To Equity share capital (90000x10) 9,00,000

To share premium (90000 shares xRs.5) 4,50,000

To Cash 1,50,000

To 5% Debentures 120000x100 / 96 1,25,000

4. Liquidation expenses paid:

Goodwill a/c Dr 6,000

To Cash a/c 6,000

Internal reconstruction

Illustration: 2

A Ltd company was incorporated on 1993. The working of the company was not satisfactory.

The Balancesheet of the company on 31-12-1995 was as follows

Authorised capital 20000 shares of Rs. 100 each	20,00,000	Land and Buildings	1,00,000
Subscribed capital 19000 Share of Rs.10 each	19,00,000	Machinery	2,60,000
Creditors	1,00,000	Furniture	20,000
Due to Muthu & Co.,	1,00,000	Stock	3,70,000
		Debtors	1,80,000
		Goodwill	2,00,000
		Profit & Loss a/c	9,70,000
	21,00,000		21,00,000

The following scheme of reconstruction was followed

a) The 19000 shares of Rs.100 each are to be reduced to an equal number of fully paid shares of Rs.40 each.
b) The amount Rs.1,00,000 due to Muthu & Co., was also to be reduced the remaining 1000 unissued shares being issued to them as fully paid up shares of Rs.40 each in full settlement of the amount due to them.
c) The amount available by the above reduction is to be utilised in wiping off the goodwill, profit and Loss a/c and in writing down the value machinery.

Assuming the above scheme was carried out pass necessary journal entries and prepare the Balance sheet.

Solution:

1. **19000 shares are reduced to Rs.40each**

Old Equity sharecapital a/c Dr	19,00,000 (19000x100)	
To New Equity share capital a/c		7,60,000 (19000x40)
To capital Reduction a/c		11,40,000 (19000x60)

2. **Muthu & Co., a/c settled by issuing 1000 shares of Rs.40 each**

Muthu & Co., a/c Dr	100000	
To Equity share capital (1000 shares xRs.40)		40,000
To capital reduction a/c (1000 hsaresxRs.60)		60,000

3. Utilisation of capital Reduction account:-

Capital Reduction a/c Dr	12,00,000	
To Goodwill a/c		2,00,000
To profit & Loss a/c		9,70,000
To Machinery a/c		30,000

Balance sheet and Reduced

Authorised capital			
20000 shares of Rs.100 each	20,00,000	Land & Building	1,00,000
		Machinery	2,30,000
Subscribed capital :		Furniture	20,000
20000 share of Rs.40 each	8,00,000	Stock	3,70,000
		Debtors	1,80,000
Creditors	1,00,000		
	9,00,000		9,00,000

Illustration: 3

ABC Ltd Passed a resolution and got court permission for the reduction of its share capital by Rs.5,00,000 for the purpose mentioned as under.

a) to write off the debit balance of profit and loss account Rs.2,10,000.
b) to reduce the value of plant and machinery by Rs.90,000 and good will by Rs.40,000
c) to reduce the value of the investments by Rs.80,000

The reduction was made by converting 50,000 preference shares Rs.20 each fully paid to the same number of preference shares of Rs.15 each fully paid and by converting 50,000 equity shares of Rs.20 each Rs.15 paid up into equal number of equity shares of Rs.10 each fully paid up pass journal entries to record the capital reduction.

Solution:

(i) 50000 Preference shares reduced from Rs.20 to Rs.15 each:

Old Preference share capital a/c Dr	10,00,000 (50,000xRs.20)	
To New Preference share capital a/c (50,000xRs.15)		7,50,000
To capital reduction a/c (50,000x5)		2,50,000

(ii) 50000 equity shares reduced from Rs.15 to Rs.10 each:-

Old Equity share capital a/c	Dr	7,50,000 (50,000xRs.15)	
To New Equity share capital a/c (50,000 xRs.10)			5,00,000
To Capital reduction a/c (50,000x5)			2,50,000

iii) Utilisation of capital reduction account:

Capital reduction a/c	Dr	5,00,000	
To Profit and Loss a/c			2,10,000
To Plant & Machinery a/c			90,000
To Goodwill a/c			40,000
To Investments a/c			80,000
To Capital Reserve a/c (bal. Figure)			80,000

Illustration: 4

The following in the Balance sheet of X Ltd as on 31 March 1992

20000 6% preference shares of Rs.20each	4,00,000	Good will	40,000
12500 Equity shares of Rs.40 each	5,00,000	Premises	2,20,000
Loan from B	50,000	Plant & Machinery	2,60,000
Sundry creditors	1,00,000	Investments	30,000
		Patents	3,00,000
		stock	70,000
		Debtors	44,300
		Bank	39,000
		Preliminary Expenses	10,000
		Profit and loss account	36,700
	10,50,000		10,50,000

The company suffered losses. The following scheme of reconstruction was adopted.

a) The preference shares to be reduced to an equal number of share Rs.10 each fully paid.
b) The Equity shares to be reduced to an equal number of shares of Rs.10 each fully paid.
c) Loan Creditor B had agreed to accept Rs. 30,000 cash and to forfeit the balance.

The amount thus rendered available is to be used to. Write off premises Rs.20,000, plant and machinery Rs.60,000, debtors Rs.14300 and stock by 20% and to write out Goodwill, patents and other fictitious assets.

Journalise the transactions and prepare the Balance sheet of the company after the reconstruction has been carried out.

Solution:

1) **20000 preference shares reduced from Rs.20 to Rs.10**

Old 6% preference share capital a/c Dr	4,00,000 (20,000x20)		
To New 6% pref.share capital a.c (20,000x10)			2,00,000
To Capital reduction a/c			2,00,000

2) **12500 Equity shares reduced from Rs.40 to Rs.10**

Old Equity share capital a/c	Dr	5,00,000 (12,500x40)	
To New Equity share capital a/c (12500x10)			1,25,000
To Capital Reduction a/c (12500x30)			3,75,000

3) **Creditor agreed to accept Rs.30,000 and sacrifice the balance amount**

B a/c	Dr	50,000	
To cash a/c			30,000
To Capital reduction a/c			20,000

4) Utilisation of capital reduction account :-

Capital reduction a/c	Dr. 5,95,000	
To Goodwill a/c		40,000
To Profit & Less a/c		36,700
To Preliminary Expenses a/c		10,000
To Patents		3,00,000
To premises		20,000
To plant & Machinery		60,000
To Debtors		14,300
To Stock (70,000x20/100)		14,000
To Capital Reserve (bal.fig.)		1,00,000

Balance sheet

20000 6% preference shares of Rs.10each	2,00,000	Premises	2,00,000
		Plant & Machinery	2,00,000
12500 Equity shares of Rs.10each	1,25,000	Investments	30,000
		Stock	56,000
Capital Reserve	1,00,000	Debtors	30,000
Sundry Creditors	1,00,000	Bank (39,000-30,000 paid to B Loan a/c)	9,000
	5,25,000		5,25,000

Illustration: 5

Kumar Company Ltd passed necessary resolution and received sanction of the court for the reduction of its share capital by Rs.2,50,000 for the purpose encumerated here under

(i) To write off the profit and Loss account Rs.1,05,000

(ii) To reduce the value of plant & Machinery by Rs.45000 and of goodwill by Rs.20,000

(iii) To reduce the value of investments to market value by writing off Rs.40,000.

The reduction was made by converting 25000 Preference shares of Rs.20 each fully paid to the same number of Preference Shares of Rs.15 each fully paid and by converting 25000 equity shares of Rs.20 each Rs.15 paid up into 25000 equity shares of Rs.10 each fully paid.

Show journal entries necessary in relation to the reduction of share capital

Solution:

1. **Preference share Capital reduced by Rs.5 each (Rs.20-15)**

Old preference Share capital a/c Dr (25,000x20)	5,00,000	
To New Preference Share capital a/c(25,000*15)		3,75,000
To Capital Reduction a/c(25,000x5)		1,25,000

2. **Equity Share capital reduced by Rs.5 each (Rs.15-10)**

Old Equity Share capital a/c Dr (25,000x15)	3,75,000	
To New Equity Share capital a/c (25,000x10)		2,50,000
To capital Reduction a/c (25,000x5)		1,25,000

3. **Utilisation of capital reduction a/c:-**

Capital Reduction a/c Dr	2,50,000	
To profit & Loss a/c		1,05,000
To Goodwill a/c		20,000
To plant & Machinery a/c		45,000
To Investments a/c		40,000
To Capital Reserve (balancing figure) a/c		40,000

Illustration: 6

The Balance sheet of XYZ Ltd. as on 31-12-1998 was as follows

Liabilities	Rs.	Assets	Rs.
Share capital 2000 Preference shares of Rs.100 each	2,00,000	Goodwill	15,000
4,000 Equity shares of Rs.100 each	4,00,000	Freehold property	2,00,000
5% Mortgage Debentures	1,00,000	Plant and Machinery	3,00,000
Bank Overdraft	50,000	Stock	50,000
Creditors	1,00,000	Debtors	40,000
		Profit and Loss a/c	2,45,000
	8,50,000		**8,50,000**

The company got the following scheme of capital reduction approved by the court:

i) The preference shares to be reduced to Rs.75 per share, fully paid and the equity share to Rs.37.50.

ii) The debenture holders took over the stock and debtors in full satisfaction of the amount due to them.

iii) Goodwill a/c is to be eliminated.

iv) The freehold properties to be depreciated by 50%

v) The value of Plant and Machinery to be increased by Rs 50,000 Give Journal entries for the above and prepare the revised balance sheet.

Solution **Internal Reconstruction**

1) Pref. share capital reduced to Rs.75

Old. Pref. share capital a/c Dr (2000x100) 2,00,000

To New pref. share capital a/c (2000x75) 1,50,000

To capital Reduction a/c (2000x25) 50,000

2) Equity share capital reduced to Rs.37.50

Old Equity share capital a/c Dr (4000x100)	4,00,000	
To New Eq. Share capital (4,000x37.50)		1,50,000
To Capital reduction a/c (4,000x62.50)		2,50,000

3) Debenture holder took over stock & Debtors

5% Debenture a/c Dr	1,00,000	
To Stock		50,000
To Debtors		40,000
To Capital reduction a/c		10,000

4) Plant & machinery value increased by Rs50,000

Plant & Machinery a/c Dr	50,000	
To Capital reduction a/c		50,000

5) Utilisation of capital reduction account

Capital reduction a/c Dr	3,60,000	
To Profit & Loss a/c		2,45,000
To Good will a/c		15,000
To Freehold property (2,00,000x50/100)		1,00,000

Balance Sheet and Reduced

Share capital 2000 pref. share of Rs.75 each	1,50,000	Freehold Property (2,00,000) – 1,00,000)	1,00,000
4000 Eq. shares of Rs.37.50	1,50,000	Plant and Machinery (3,00,000+50,000)	3,50,000
Bank Overdraft	1,50,000		
Creditors	1,00,000		
	4,50,000		4,50,000

LIQUIDATOR'S FINAL STATEMENT OF ACCOUNTS

Meaning of Liquidation:-

Liquidation is the legal procedure by which the company comes to an end. It is a process by which a company is dissolved and its assets realised and applied in paying off the liabilities of the company.

Thus a company is the creation of law. It can be dissolved only by law.

Modes of winding up (Liquidation)

A company can be liquidated in any of the following three ways:

1. Compulsory winding up by the court
2. Voluntary winding up by the
   i) Members voluntary winding up
   ii) Creditors voluntary winding up
3. Winding up under the supervision of the court

8. Liquidator – meaning

Liquidator is a person appointed by the court or by the members or by the creditors to perform liquidation work of the company.

Liquidator's final statement of account:

It is the duty of the liquidator to realise the assets and settle the claim of the company. For this purpose he prepares a cash book for recording receipts and payments and submit the same to the court or members or creditors of the company as the case may be. He is required to prepare a statement which shows total cash received and amount distributed to creditors, debenture holders and share holders of the company.

Such a statement is known as Liquidator's final statement of account

Liquidator final statement of account (specimen)

Specimen form of Liquidator final statement of account Liquidators final statement of Account

Receipts		Payments	
To balance b/d			
Opening balance of cash in hand	xx	By secured creditors	xx
Cash at Bank	xx	By Liquidation expenses	xx
To assets Realised	xx	By Liquidator's Remuncration	xx
To stock	xx	% on amount realised	xx
To Machinery	xx	% on amount distributed to unsecured creditors	xx
To furniture	xx	By Debenture holders	xx
To Debtors	xx	By preferential creditors	xx
Surplus from securities	xx	By unsecured creditors	
		By preference share holders	
		By Equity share holders	
	xx		xx

9. Contributory:

Contributory is a member who is liable to pay amount of the company at the time of liquidation of a company. He may be present members or past members.

Preferential creditors: are those creditors having priority of claims over other unsecured creditors. They are 1) any amount due to Government 2) Salary payable employees. 3) All sums due to compensation under the workmen compensation act 4) All sums due to an employee from provident fund, pension fund.

Liquidator's final statement of Account.

Illustration: 7

The following particulars relate to a limited company which has gone into voluntary liquidation. Prepare the liquidator's final account allowing for his remuneration at 2% on the amount realised and 2% on the amount distributed among unsecured creditors other than preferential creditors.

	Rs
Preferential creditors	10,000
Unsecured creditors	32,000
Debentures	10,000

The assets realised the following sums:

Building	20,000
Machinery	18,650
Furniture	1,000

The Liquidation expenses amount to Rs.100

Solution:

Liquidator's final statement of Account

To assets realised	Rs	Order of payments	Rs
Building	20000	By Liquidation expenses	1000
Machinery	18650	Liquidator's Remuneration	
Furniture	1000	2% on amount realised	
		39650x2/100 = 793	
		2% on amount paid to	
		unsecured creditors* 350	1143
		Debenture holders	10000
		Preferential creditors	10000
		Unsecured creditors**	17507
	39650		**39650**

Calculation of amount paid to unsecured creditors:

Amount available to unsecured creditors:

Total Receipts			39650
Less: Payments Liquidation expenses		1000	
Liquidator's Remuneration amount realised		793	
Debenture holder-paid	10000		
Preferential creditors-pai	10000		21793
Amount available to unsecured creditors			17857

Calculation of Liquidators remuneration 2% on amount distributed among unsecured creditor:

Commission = Amount Available x 2/102

17857 x 2/102 = 350

Amount paid to unsecured creditors 17857 – 350 = 17507**

Illustration: 8

Kannan Ltd was liquidated o 31-12-2001 Balancesheet as on 31-12-2001.

Liabilities	Rs.	Assets	Rs.
Share capital	1,00,000	Land and Building	60,000
8% Debenture	1,00,000	Plant and Machinery	60,000
Mortgage Loan (Secured loan on Building)	50,000	Stock	60,000
Sundry Creditors	80,000	Debtors	70,000
		Cash in hand	5,000
		Profit and Loss a/c	75,000
	3,30,000		3,30,000

Assets realised as follows :

a) Land and Building Rs.55,000

b) b) Stock Rs.20,000

c) plant & Machinery Rs.25,000

d) Half of the debtors were bad and the balance realised 60% book value.

e) Liquidator was entitled to a commission of 3% on amount realised other than cash and 2% on the amount paid to unsecured creditors.

f) Preferential creditors amount to Rs.10000 (included in sundry creditors)

g) Liquidation expenses amount to Rs.970. Prepare liquidator's final statement of account.

Solution :

Liquidator's final statement of Accounts

Liabilities		Rs.	Assets	Rs.
To cash in hand		5000	By secured creditors (mortgage Loan)	50,000
To assetsRealised:			Liquidation expenses	970
Land & Building	55000		Liquidator's Remuneration	
Stock	20000		3% on amount realised.	
Plant &Machinery	25000		except cash 12600x3/100=	3,780
			Amount paid to debenture holders Balanced available amount	71,250
	21000	1,21,000		1,26,000

Note : 1) Debtors Realised :

Debtors 70000

Less: 50% Bad 35000

Balance 60% realised 35000

35000x60/100=21000*

Illustration: 9

The following particulars relate to a company which has gone into liquidation. you are required to prepare the liquidator's final statement of account allowing for his remuneration of 3% as amounts paid to unsecured creditor other than preferential creditors.

Preferential creditors Rs.12000

Unsecured creditors Rs.40000

Debentures Rs.14000

Assets realised Rs.40000 liquidation expenses amounted Rs.4000

Solution :

Liquidator's final statement of account

Receipts	Rs.	Order of payments	Rs.
Assets realised	40000	1. Liquidation expenses	4000
		2. Liquidator's Remuneration 3% amount paid to unsecured creditors	291
		3. Debentures	14000
		4. Preferential creditors	12000
		5. Unsecured creditors	9709
	40,000		40,000

1) **Calculation Of Commission Payable To Liquidator**

Commission = Amount available x 3/103

Amount available :

	Total Receipts		40,000
Less:	Payments liquidation expenses	4,000	
	Debentures	14,000	
	Preferential creditors	12,000	30,000
			10,000

10000x3/103=291*

ii) Amount payable to unsecured creditors

Amount available	10000
Less: Commission	291

	9709*

Questions

1. What is amalgamation?
2. What do you mean by absorption?
3. What is purchase consideration?
4. Explain the various methods of ascertaining purchase consideration
5. What is external reconstruction?
6. Compare the amalgamation absorption and external reconstruction.
7. What is Internal Reconstruction?
8. Distinguish between internal and External reconstruction.
9. What is liquidation?
10. Who are called as liquidator?
11. Explain the various mode of winding up.
12. Draw a specimen of liquidator final statement of account.

Unit - 4

Banking Company Accounts

1. Definition of Banking

Banking Regulation Act 1948 defines Banking as "The accepting for the purpose of lending or Investment of deposits of money from the public repayable on demand or otherwise and with draw able by cheque draft order or otherwise.

2. Legal Requirements

1. Prescribed form:

As per sec 29 to 33 of the Banking Regulation Act every banking company is required to prepare. A Balance sheet in accordance with form A set out in the Third Schedule and a profit & loss account in accordance with form B set out in the Third schedule.

2. Accounting year:

A Banking company closes its accounts an 31 March every year.

3. Prohibition of Trading:

A banking company cannot directly or indirectly deal with buying selling or bartering of goods.

4. Non – Banking assets: -

A banking company can not held any immovable property except certain assets charged due to failure of debtor repay loan on time. It can be disposed off by the banking company within 7years of its purchase. It is termed as non-Banking assets.

5.Share capital: - Minimum capital of Rs.20 lakhs if the bank has a place of business in Mumbai or Kolkatta city and if the bank has a place of business other than Mumbai or Kolkatta city is Rs.15 Lakhs.

6. Reserve fund:-

It is obligator for a banking company in India to create a reserve fund and 25% of its profits. Statutory Reserve is created 25% of its annual profits.

7. Payment of commission, Brokerage: A banking company can pay any commission brokerage, discount or remuneration in respect of shares by it not exceeding 2 ½ % paid up value of the shares.

8. Enraged on uncalled capital:

A banking company cannot create any charge upon its uncalled capital and any such charge shall be void.

9. Payment of Dividend:

A Banking company cannot pay dividend on its shares until all its capitallised expenses (preliminary expenses) have been completely written off.

10. Cash Reserve: **-**

Every scheduled Bank has to maintain a sum equal to atleast 3% of its time and demand liabilities as cash Reserve with Reserve Bank of India.

11. Statutory Reserve: -

It is compulsory for every banking company to create a statutory Reserve fund of 25% of its annual profits.

12. Statutory Liquidity Ratio (SLR)

In addition to the cash reserve every banking company is required to maintain in India in cash, Gold and unencumbered securities an amount which shall not be less than 25% of its time and demand Liabilities. It is known as statutory liquidity Reserve.

13. Loans and advances:-

As per Banking Regulation Act 1949, imposes certain restriction on loans granted by banks to the following persons any of its directors – any firm – any company, It cannot lend on the security of its own shares.

3. Licensing of banking companies:-

Every banking can function in India only after obtain licence from Reserve Bank of India. Even to open branches in India or overseas.

Specimen of profit & Loss account of a Bank for the year ended 31 March

Form B – Third Schedule **Rs.'000**

		Schedule No	Year ended 31-03-........ Current year	Year ended 31-03-....... Previous year
I	**INCOME**			
	Interest earned	13	xx	xx
	other Income	14	xx	xx
II	**EXPENDITURE:**			
	Interest expended	15	xx	xx
	Operating Expenses	16	xx	xx
	Provisions and contingencies		xx	xx
			xxx	xxx
III	**Profit / Loss**			
	Net profit / Loss for the year		xx	xx
	Profit / Loss brought forward		xx	xx
	Total		xx	xx
IV	**Appropriations**			
	Transfer to statutory Reserve		xx	xx
	Transfer to other reserve		xx	xx
	Transfer to Govt/Proposed Dividend		xx	xx
	Balance carried over to Balance sheet		xx	xx
	Total		xx	xx

Schedule 13 – Interest Earned

		Year ended 31-03- current year	Year ended 31-03---- Previous year
1.	Interest / Discount an advance	xx	xx
2.	Interest on Investment	xx	xx
3.	Interest on balance with RBI	xx	xx
4.	Others	xx	xx
	Total	xx	xx

Schedule 14 Other Income

		Year ended 31-03- current year	**Year ended 31-03---- Previous year**
1.	Commission Exchange & brokerage	xx	Xx
2.	Profit on sale of Investments **Less**: Loss on sall of Investments	xx	Xx
3.	Profit on revaluation of investment **Less;** loss on revaluation of Investments	xx	Xx
4.	Profit on sale of land, Building and other assets **Less :** Loss on sale of land, Building and other assets.	xx xx	Xx Xx
5.	Profit an exchange Transaction **Less:** Loss on exchange of Transaction	xx xx	xx xx
6.	Income earned by way of dividend	xx	Xx
7.	Miscellaneous Income	xx	Xx
	Total	xx	Xx

Schedule 15 Interest Expended

S.No.		**Year ended 31-03- current year**	**Year ended 31-03--- Previous year**
1.	Interest on deposits	xx	Xx
2.	Interest on RB1/Inter Bank Borrowings	xx	Xx
3.	Others	xx	Xx
	Total	xx	Xx

Schedule – 16 Operating Expenses

SNo.		Year ended 31-03-current year	Year ended 31-03---Previous year
1)	Payments to and provision for employees	xx	Xx
2)	Rent taxes and lighting	xx	Xx
3)	Printing & Stationery	xx	Xx
4)	Advertisements	xx	Xx
5)	Depreciation on Bank Property	xx	Xx
6)	Director fees allowances & expenses	xx	Xx
7)	Auditor fees allowances & expenses	xx	Xx
8)	Law charges	xx	Xx
9)	Postage Telegrams Telephone	xx	Xx
10)	Repairs & Maintenance	xx	Xx
11)	Insurance	xx	Xx
12)	Other expenditure	xx	Xx
	Total	xx	Xx

Illustration: 1

Prepare profit & Loss a/c for the year ended 31-03-2017 of Aarthy Bank Ltd from the following

Particulars	Rs.	Particulars	Rs.
Interest on loan	350	Interest on overdraft	70
Director fee	20	Rent taxes Insurance	5
Interest on cash credit	160	Interest on fixed Deposit	190
Payment to Employees	150	Discount on Bills discounted	50
Interest on savings a/c	150	Audit fee	10
Commission exchange and brokerage	25		

Solution:

Aarthy Bank Ltd Profit and Loss account for the year ended 31-03-2017

S.No.		Schedule No	Year ended 31-03-17 (Rs.000)	Year ended 31-03-16 (Rs.000)
I	**Income**			
	Interest Rerned	13	630	--
	Other income	14	25	--
	Total		655	
II	**Expenditure**			
	Interest expended	15	340	--
	Operating expenses	16	195	--
III	**Profit / Loss**			
	Net profit for the year (I-II)		120	--
	Profit brought forward		--	--
	Total		120	---
IV	**Appropriation**			
	Transfer to statutory Reserve 120x25/100		30	
	Transfer to other Reserve		--	--
	Transfer to Govt / Proposed Dividend		--	--
	Total		90	--

Working Notes:

Schedule 13 – Interest earned Rs. 000

Interest on Loan	350
Interest on overdraft	70
Interest on cash credit	160
Discount on bills discounted	50

	630

Schedule 14 - Other Income

	(Rs.000)
Commission exchange and brokerage	25

Total	25

Schedule 15 ---Interest expended

	(Rs.000)
Interest on savings account	150
Interest on fixed Deposit	190

	340

Schedule 16 Operating systems

	(Rs.000)
Payment to employees	150
Rent taxes insurance	5
Audit fee	20
Director's fee	20

	195

Illustration: 2

From the following details relating to Banking company findout profit balance carried over to Balance sheet

Interest earned	Rs. 550000
Other Income	Rs. 330650
Interest expended	Rs.215000
Operating expenses	Rs.185250
Profit forwarded from previous year	Rs.145880
Transfer to the statutory reserve at 25%	

Solution:

Profit & Loss a/c of Banking company

		Schedule No.		Amount
I	Income			
	Interest Earned	13		550000
	Other Income	14		330650

			Total	880650

II.	Expenditure			
	Interest Expended	15		215000
	Operating Expenses	16		185250
	Provision for contingencies			

			Total	400250

III.	Profit / Loss			
	Net profit (I-II)			480400
	Profit brought forward			145880

				626280
IV	Appropriation:			
	Transfer to statutory Reserve			
	480400x25/100			120100
	Balance carried to Balance sheet			506180

				626280

Illustration: 3

From the given details prepare profit & Loss a/c of Arun Aanandh bank for the year ended 31-03-2017.

	(Rs.0000)
Interest Earned	820
Interest Expended	420
Provisions	80
Other Income	180
Operating Expenses	100
Transfer to statutory reserve	25%

Solution

Profit & Loss a/c of Arun Anandh Bank for the year ended 31-03-2017

	Schedule No.	Amount (Rs 000)
I. Income		
Interest earned	13	820
Other Income	14	180

Total		1000

II.**Expenditure**		
Interest Expended	15	420
Operating Expenses	16	100
Provision and contingencies		80

Total		580

III. **Profit / Loss**

Net profit for the year (I-II)	420
Profit brought forward	--

	420

IV. **Appropriation**

Transfer to statutory reserve 420x25/100	105
Balance carried to Balance sheet	315

	420

Specimen Form of Balance sheet

Balance sheet of .... (name of the Bank) us on 31st March 20............. (Rs.000)

	Schedule No.	**As on 31-03.....current year**	**As on 31-03-........previous year**
Capital & Liabilities:			
Capital	1	xx	xx
Reserve & Surplus	2	xx	xx
Deposits	3	xx	xx
Borrowings	4	xx	xx
Other Liabilities & Provisions	5	xx	xx
Total		xx	xx
Assets			
Cash and balance with Reserve Bank of India	6	xx	xx
Balance with banks and money at call and short notice	7	xx	xx
Investments	8		
Advances	9	xx	xx
Fixed assets	10	xx	xx
Other assets	11	xx	xx
		xx	xx
Total		xx	xx
Contingent Liabilities Bills for collection.	12	xx	xx

Schedule – 1 capital

Schedule 1 capital	Current year	Previous year
I. For nationalised Banks Capital (fully owned by central Government)	Xx	xx
II. For Banks in corporate out side India	Xx	xx
III. For other Banks		
Authorised capital	xx	xx
Issued capital	xx	xx
Subscribed capital	xx	xx
Called up capital	xx	xx
Less calls unpaid	xx	xx
Add for feited shares	xx	xx

Schedule 2 – Reserve & Surplus

	Current year	Previous year
I. Statutory Reserves		
Opening balance	xx	xx
Additions during the year	xx	xx
Deductions during the year	xx	xx
II. Capital Reserves		
Opening Balance	xx	xx
Additions during the year	xx	xx
Deductions during the year	xx	xx
III. Securities premium		
Opening Balance	xx	xx
Additions during the year	xx	xx
Deductions during the year	xx	xx
IV. Revenues and other reserves		

	Opening Balance Additions during the year Deductions during the year	xx xx xx	xx xx xx
V.	Balance in profit & Loss account Total (I, II, III, IV, V)	Xx	xx

Schedule – 3 Deposits

		Current year	Previous year
I.	Demand Deposits From Banks From Others	 xx xx	 xx xx
II.	Savings Bank Deposits	xx	xx
III.	Terms Deposits From Banks From Others	 xx xx	 xx xx
	Total (I, II, III)	xx	xx
	B. I) Deposits of branches in India	xx	xx
	ii) Deposits of branches outside India	xx	xx

Schedule - Borrowings

		Current year	Previous year
I.	**Borrowing in india**	xx	xx
	Borrowing in RBI	xx	xx
	Other banks	xx	xx
	Other Institutional Agencies	xx	xx
II.	Borrowings Outside India		
	Total (I, II,III,IV)	xx	xx

Schedule -5 Other Liabilities and Provisions

	Current year	Previous year
III. Bills Payable	xx	xx
IV. Inter – Office adjustment (Net)	xx	xx
V. Interest accured	xx	xx
VI. Others	xx	xx
Total (I, II,III,IV)	xx	xx

Schedule – 6 Cash and Balance with Reserve Bank of India

	Current year	Previous year
I. Cash in hand	xx	xx
II. (including foreign exchange notes)	xx	xx
II. Balance with Reserve Bank of India		
1. In current accounts	xx	xx
2. in other accounts	xx	xx
Total (I, II)	xx	xx

Schedule – 7 Balance with Banks & Money at call and short notice

I. In India

	Current year	Previous year
i) Balance with banks		
a) In current accounts	xx	xx
b) In other deposit account	xx	xx
ii) Money at call & short notice		
a) With banks	xx	xx
b) With other institutions	xx	xx
Total (i & ii)	xx	xx

II. Outside India

	Current year	Previous year
i) In current accounts	xx	xx
ii) In other Deposit accounts	xx	xx
iii) Money at call and short notice	xx	xx
Total (i, ii, iii)	xx	xx
Grand Total (I, II)	xx	xx

Schedule 8 – Investments

I. Investments in India in

	Current year	Previous year
i) Government securities	xx	xx
ii) Other approved securities	xx	xx
iii) Shares	xx	xx
iv) Debentures and Bonds	xx	xx
v) Subsidiaries / Joint ventures	xx	xx
vi) Others	xx	xx
Total	xx	xx

II Investments outside India in

	Current year	Previous year
i) Government securities	xx	xx
ii) Subsidiaries / Joint ventures	xx	xx
iii) Other investments	xx	xx
Total	xx	xx
Grand Total (I and II)	xx	xx

Schedule 9 Advances

	Current year	**Previous year**
A) i) Bills purchased and discounted ii) Cash credit, overdraft and Loans repayable on demand. iii) Term loans	xx xx xx	xx xx xx
Total	xx	xx
B) i) Secured by Tangible assets ii) Covered by Bank / Govt. guarantees. iii) un secured	xx xx xx	xx xx xx
Total	xx	xx
C) Advances in India i) Priority Sectors ii) Public sectors iii) Banks iv) Others	 xx xx xx xx	 xx xx xx xx
Total	xx	xx
II. Advances out side India		
i) Due from Banks ii) Due from others a) Bills purchased and discounted b) Syndicated Loans c) Others	xx xx xx xx xx	xx xx xx xx xx
Total	xx	xx
Grand Total (C I and II)	xx	xx

Schedule 10 – Fixed Assets

		Current year	Previous year
I.	Premises		
	Opening Balance	xx	xx
	Additions during the year	xx	xx
	Deduction during the year	xx	xx
	Depreciation to date	xx	xx
II.	Other Fixed Assets		
	Opening Balance	xx	xx
	Additions during the year	xx	xx
	Deductions during the year	xx	xx
	Depreciation to date	xx	xx
	Total	xx	Xx

Schedule 11 other assets

		Current year	Previous year
I.	Inter office adjustments (net)	xx	Xx
II.	Interest accrued	xx	xx
III.	Tax paid in advance / tax deducted at source	xx	xx
IV.	Stationery and stamps	xx	xx
V.	Non – banking assets acquired in satisfaction of claims	xx	xx
VI.	Others	xx	xx
	Total	xx	xx

Schedule 12 Contingent Liabilities

	Current year	Previous year
I. Claims against the bank acknowledged as debt	xx	xx
II. Liability for partly paid Investment	xx	xx
III. Liability on account of outstanding forward exchange contracts	xx	xx
IV. Guarantee given on behalf of constituents	xx	xx
a) India	xx	xx
b) Outside India.	xx	xx
V. Acceptance, Endorsements and other obligations	xx	xx
VI. Other items for which the bank is contigently liable	xx	xx
Total (I, II, III, IV V, VI)	xx	xx

Illustration: 4

From the following particulars of Mithilesh Kumar Bank Ltd. prepare a Balance sheet as on 31-03-2017

	(Rs. in 000)
Authorised capital	10000
Subscribed capital	9000
Investments	7000
Bills discounted	15000
Profit & Loss a/c (cr)	850
Endorsement on bills for collection	100
Money at call and short notice	11000

Cash in hand	4000
Liability for customers for acceptances	5000
Cash with RBI	6000
Statutory Reserve	4000
Cash with State Bank of India	4000
Letters of credit issued	500
Telegraphic transfer payable	800
Bank draft payable	1200
Short loans	40
Rebate on bills discounted	10
Acceptance for customers	5000
Loans and advances	12000
cash credit	10000
Overdraft	1000
Bills purchased	1000
Current and deposit accounts	60000
Investment fluctuation fund	100
Bills for collection	100
Buildings	5000

Solution:

Schedule 1 Share capital

Subscribed capital 9000

Schedule 2 Reserve & Surplus

Profit & Loss a/c 850

Statutory reserve 4000

Investment

fluctuation fund 100

4950

Schedule 3 Deposits

Current Deposit A /cs	60000

Schedule 4 Borrowings

Short Loan	40

Schedule 5 Other liabilities

Telegraphic Transfer	800
Bank draft payable	1200
Rebate in bills discounted	10

	2010

Schedule 6 Cash balance with RBI

Cash in hand	4000
Cash with RBI	6000

	10000

Schedule 7 Money at call & short notice

Money at call and short notice	11000
Cash with state Bank of India	4000

	15000

Schedule 8 Investment

Investment	7000

Schedule 9 – Advances

Bills discounted	15000
Loans & advances	12000
Cash credit	10000
Overdraft	1000
Bills purchased	1000

	39000

Schedule 10 Fixed Assets

Building	5000

Schedule -11 Other Assets

NIL

Schedule 12 - Contingent Liabilities

Endorsement for bill	-	100
Liability for customers	-	5000
Letter of credit issued	-	500

		5600

Note: Acceptance for customer is not a liability hence it will not be taken into account.

Balance sheet of Mithiles Kumar Bank Ltd for the year ended 31-03-2017

I. Capital and Liabilities	Schedule	As on 31-03-2017
Share capital	1	9000
Reserve and surplus	2	4950
Deposits	3	60000
Borrowing (Short term)	4	40
Other liabilities and provision	5	2010
Total		76000
II. Assets		
Cash in hand	6	10000
Money at call and short notice	7	15000
Investment	8	7000
Advances	9	39000
Fixed assets	10	5000
Other assets	11	NIL
Total		76000
Contingent Liabilities	12	5600

4. What do you mean by non performing assets? (NPA)

A Bank earns interest from customers through term loans, cash credit and overdrafts. If the interest or instalment of principal or both from customer is delayed and not received before the specified time it is called as Non performing assets. The specified time to receive Interest or principal is 180 days in case of term loan, cash credit and overdraft.

Assets classification and provisions for Doubtful debts:

Banks are required to classify the advances into four category.

i) **Standard Assets:**

A standard asset is one which **is not a non-performing** assets which does not show any problem. The banks have to make a general provisions of 0.25% on standard assets.

ii) Sub – standard Assets:

It is a non-performing asset for a period not exceeding 18 months for this a provision of 10% of total outstanding is made.

iii) Doubtful Assets:

It is a non performing asset for a period exceeding 12 months.

A Provision for doubtful debts against such advances has to be created as follows:

a) First year: 100% of unsecured portion +20% of secured portion.

b) Second and Third year: 100% of unsecured portion + 30% of secured portion.

c) Beyond 3 years: 100% of unsecured portion +50% of secured portion.

iv) Loss assets: These assets are not controllable for this purpose the entire assets should be written off or 100% provision should be made.

5. What do you understand by the term Rebate on Bills Discounted?

When a bill is discounted, it credits the full amount of discounts on all bills to discount account.

Journal entry

Bill Discounted a/c (full amount) Dr	xx	
To customer a/c (face value – (Discount)		xx
To Discount a/c (discount)		xx

Sometimes the discounted bills may not be maturing by the end of the year. The discount relating to the unexpired portion of the bill is strictly not earned for the current year hence it should be carried forward to the next year. All such discount relating to unexpired time of such bill is debited to discount on bill a/c and credited to rebate on bills discounted account.

Entry :-

Discount a/c Dr	xx	
To Rebate on Bills discounted a/c		xx

It is an Income received in advance and it should be shown schedule 5 under the head other liabilities of the Balance sheet. It is known as Rebate on Bills discounted.

Illustration: 5

Calculate Rebate on Bills discounted as on 31-03-2008

Bill Date	Amount	Period	Rate of Discount
15-01-08	25000	5Months	8%
10-02-08	15000	4Months	7%
25-02-08	20000	4Months	7%
20-03-08	30000	3 Months	9%

Solution:

Calculation of Rebate on Bills discounted

Bill Date	amount	Due Date	No. of days	Rate	Amount
15-01-2008	25000	18-06-08	79	8%	433
10-02-2008	15000	13-06-08	74	7%	213
25-02-2008	20000	28-06-08	89	7%	341
20-03-2008	30000	23-06-08	84	9%	621
	Rebate on Bill discounted Amount				1608

Note: add 3days as grace entry:

Illustration: 6

On 31 March 2007 pranesh Bank Ltd had the following unmeasured Bills.

Date of Bill	Amount	Term Months	Discount (pa)
12-01-2007	30000	6	12%
07-02-2007	70000	4	11%
02-03-2007	20000	3	10%

Calculate the Rebate on Bills discounted and record necessary entry on 31 March 2007.

Solution:

Calculation of Rebate on Bills Discounted

Date of Bill	Due date	No days after 31 March	Amount	Rebate on Bill
12-01-2007	15-07-2007	106	30000	1045.48
07-02-2007	10-06-2007	71	70000	1497.81
02-03-2007	15-06-2007	66	20000	361.44
			Total	2904.73

Entry:

Discount a/c Dr 2904.73

To Rebate on Bills discounted 2904.73

6. Non Banking Assets:

A Bank lends money to a borrower against security of assets. If the borrower makes default, the bank will take over such assets offered as security by the borrower. These assets are known as Non banking assets. Until these assets are disposed of they must be shown schedule 11 under the heading of other assets on the asset side of the Balance sheet.

INSURANCE COMPANY ACCOUNTS

Insurance is a contract whereby insurance agree to compensate for specific loss to the insured who in consideration agrees to pay a sum of money called premium. The insurance company agree to pay compensation is known as insurer and the person who is taking policy from the insurance company is known as policy holder or insured.

Definition of Insurance:- Insurance is a contract in which a sum of money is paid to the insured in consideration of insurers incurring the risk of paying a large sum upon a given contingency – Justice Tindle.

8. Kinds of Insurance:

There are two types of Insurance

1) Life Insurance 2) General Insurance

1) Life Insurance:

It is a contract between the insured and the Insurance company in which the insurance company agrees to pay the policy amount on the death of the insured or maturity of policy whichever is earlier. Hence the policy holder agrees to pay amount is called premium.

2) **General Insurance:** All insurance contracts other than Life insurance are known as General insurance: example: Fire Insurance, Marine Insurance.

It is governed by General Insurance Act 1972.

9. Difference between Life Insurance and General Insurance.

	Life Insurance	General Insurance
1)	It is a contract of certainity	It is a contract of Indemnity.
2)	It is a long term Lontract	It is one year contract
3)	It is governed by LIC Act	It is Governed by GIC Act
4)	Life policy can be assigned to others	It cannot be assigned to others
5)	It comprises of Investment and protection	It consists of only protection
6)	Insurable Interest must exist at the time of proposal.	It must exist from the date of proposal to the end of contract.
7)	Surrender value is possible	No surrender value
8)	Policy amount will be received in the event of death or maturity date whichever is earlier.	Policy amount will be received in the event of risk or loss occurred.

9. Final Accounts of life Insurance companies

1) Revenue account
2) Profit & loss account
3) Balance sheet

Specimen form of Revenue account of LIC for the year ended 31-03-20.....

Policy holders account particulars	**Schedule No**	**Current year (Rs.000)**	**Previous year (Rs.000)**
Premium earned (Net)	1		
a) Premium		xx	
b) Reinsurance ceded		xx	
c) Reinsurance accepted.		xx	
Income from Investments:			
a) Interest, Divident & Rent Gross		xx	
b) Profit ansale/redemption of Investments.		xx	
c) Loss on sale/redemption of Investments			
d) Transfer/Gain on revaluation / change in fair value other Income		xx	
		xx	
Total (A)		xx	xx

Policy holders account particulars	**Schedule No**	**Current year (Rs.000)**	**Previous year (Rs.000)**
Commission	2	xx	xx
operating Expenses	3	xx	xx
Provision for doubtful debts		xx	xx
Baddebts written off		xx	xx
Provision of Tax		xx	xx
Provision (other than taxation)			
a) For diminution in the value of		xx	xx
Investments (Net)		xx	xx
b) Others		xx	xx
Total B		xx	xx
Benefits paid (Net)	4	xx	xx

Interim Bonus paid change in valuation of liability of life policies a) Gross b) Amount ceed in Reinsurance c) Amount accepted in reinsurance		xx xx xx xx xx	xx xx xx xx xx
Total C		xx	xx
Surplus (or) Deficit (D) = (A-B-C)		xx	xx
Appropriations Transfer to share holders account Transfer to other Reserve Balance being fund for future Appropriations	xx xx xx	xx xx xx	xx xx xx
Total D	xx	xx	xx

Specimen form

Form – A-PL

Profit & Loss account for the year ended 31 March 2017 shareholders account

(Non-Technical Account)

Particulars	**Schedule**	**Current Year (Rs.000)**	**Previous year (Rs.000)**
Amount transferred from/to policy holders account Income from Investments a) Interest, Divident & rent gross b) Profit on sale/redemption of Investments c) Loss on sale/redemption of Investments Other Income Total (A)		xx xx xx xx xx -------- xx --------	Xx xx xx xx xx ---------- xx -----------

Expenses other than those directly related to Insurance business			
Bad debts written off			
Provisions (other than taxation)	xx	xx	xx
a) For diminution in the value of Investments (Net)	xx	xx	xx
b) Provisions for doubtful debts	xx	xx	xx
c) Others	xx	xx	xx
Total(B)	xx	xx	xx
Profit/Loss before Tax	xx	xx	xx
Provision for taxation	xx	xx	xx
Profit/Loss after tax	xx	xx	xx
Appropriation			
a) Balance at the beginning of the year	xx	xx	xx
b) Interim Dividend paid during the year	xx	xx	xx
c) Proposed final Dividend	xx	xx	xx
d) Dividend Distribution tax	xx	xx	xx
e) Transfer to reserve/Other accounts profit carried to Balance sheet	xx	xx	xx
	xx	xx	xx

Schedule forming part of financial statements

Schedule – 1 Premium

S.No.		Current year	Previous year
1.	First year Premiums	xx	xx
2.	Renewal Premiums	xx	xx
3.	Single premium	xx	xx
	Total Premiums	xx	xx

Schedule 2 – Commission Expenses

S.No.		Current year	Previous year
1.	Commission paid	xx	xx
	Directo – First year premiums	xx	xx
	Renewal premiums	xx	xx
	Single Premiums	xx	xx
	Add Commission on reinsurance Accepted	xx	xx
	Less commission on reinsurance ceded	xx	xx
	Net Commission	xx	xx

Schedule -3 Operating Expenses related to Insurance Business

S.No.		Current year	Previous year
1.	Employees remuneration & welfare Benefits	xx	xx
2.	Travel expenses	xx	xx
3.	Training Expenses	xx	xx
4.	Rent & Rates	xx	xx
5.	Repairs	xx	xx
6.	Printing stationery	xx	xx
7.	Legal charges	xx	xx
8.	Medical fees	xx	xx
9.	Auditor fees	xx	xx
10.	Advertisement	xx	xx
11.	Interest charges	xx	xx
12.	Depreciation	xx	xx
		xx	xx

Schedule – 4 Benefits paid (Net)

S.No.		Current year	Previous year
1.	**Insurance claim**		
	a) claims by Death	xx	xx
	b) Claims by Maturity	xx	xx
	c) Annuities	xx	xx
	d) Other benefits	xx	xx
2.	**Amount ceed in Reinsurance**		
	a) claim by Death	xx	xx
	b) Claim by Maturity	xx	xx
	c) Annuities	xx	xx
	d) Other benefits	xx	xx
3.	**Amount accepted in reinsurance**		
	a) Claim by Death	xx	xx
	b) Claim by Maturity	xx	xx
	c) Annuities	xx	xx
	d) Other benefits	xx	xx
	Total	**xx**	**xx**

Details of schedule

Schedule of premium Earned (Net)

Particulars	Current Year	Previous Year
Premium from Direct Business		
Add Premium on reinsurance accepted		
Less Premium on reinsurance ceded		
Net premium		
Adjustment for change in reserve for unexpired risk		
Total Premium earned (Net)		

Schedule 2 – Claims incurred (Net)

Particulars	Current Year	Previous Year
Claims paid Direct **Add** Reinsurance accepted **Less** Reinsurance ceded Net Claim Paid **Add** Claim outstanding at the end of year **Less** Claim outstanding at beginning		
Total Claims incurred		

Schedule 3 – Commission

Particulars	Current Year	Previous Year
Commission Paid Direct **Add** Reinsurance Accepted **Less** Reinsurance ceded		
Net Commission		

Schedule 4 Operating Expenses related to insurance Business

Particulars	Current Year	Previous Year

Employees Remuneration and Welfare Benefits Travel Expenses Training Expenses Auditor fee Advertisement Interest & Bank charges Depreciation		
Total		

Schedule 5- Share capital

Particulars	Current Year	Previous Year
Authorised Capital Issued Capital Subscribed Capital Called up Capital (-) Calls Unpaid (+) Share forfeited (-) Preliminary Expenses		
Total		

Schedule – 6 Reserves and Surplus

Particulars	Current Year	Previous Year
Capital Reserve		
Capital Redemption Reserve		
Share Premium		
General Reserve		
Balance of Profit in profit & loss a/c		
Total		

Schedule – 7 Borrowings

Particulars	Current Year	Previous Year
Debentures		
Banks		
Financial Institutions		
Others		

Schedule – 8 Investments

Particulars	Current Year	Previous Year
Longterm Investments		
Shortterm Investments		

Schedule – 9 Loans

Particulars	Current Year	Previous Year
1.Security wise classification:		
a) Secured		
b) Unsecsured		
Total		
2.Borrower wise classification:		
a) Control & State Govt.		
b) Banks & Financial Institutions		
c) Others		
Total		
3. Performance wise classification:		
a) Loan classified as standard		
b) Non standard Loans Less provisions		
Total		
4. Maturity wise classification:		
a) Short term		
b) Long term		
Total		

Schedule -10 – Fixed assets (Rs.000)

Particulars	Cost / Gross Block				Depreciation			As at year end	Net Block	
	Opening	Additions	Deductions	Closing	Up to Last Year	For the year	On Sales/ Adjustment		As at year end	Previous year
Goodwill Intangibles Freehold Land Leasehold property Buildings Furniture Information Technology Equipment Vehicles Office Equipment										
Total										
Work in progress Grand Total										
Previous Year										

Schedule -11 Cash and Bank Balances

Particulars	Current Year	Previous Year
1.Cash		
2.Bank Balance		
a) Deposit A\c		
b) Current A\c		
Others		
3. Money at call & short notice		
4. Others		
Total		

Schedule -12 – Advances and other Assets

Particulars	Current Year	Previous Year
Advances		
1.Reserve Deposits with ceding companies		
2.Application money for Investments		
3.Prepayments		
4.Advances to Directors		
5.Others		
Total(A)		
Particulars	**Current Year**	**Previous Year**

<u>Other Assets</u>		
1.Income accrued on Investments		
2.Outstanding Premium		
3.Agents Balance		
4.Foreign Agencies Balances		
5.Reposits with RBI		
Total(B)		
Grand Total (A+B)		

Schedule -13 – Current Liabilities

Particulars	**Current Year**	**Previous Year**
1.Agents Balances		
2.Balance due to other Insurance Companies		
3.Deposits held on reinsurance ceded		
4.Premium received in advance		
5. Unallocated Premium		
6. Sundry creditors		
7.Claims outstanding		
Total		

Schedule -14 – Provisions

Particulars	**Current Year**	**Previous Year**
Reserve for unexpired Risk		
For taxation		
For proposed dividends		
For dividend distribution tax		
Others		
Total		

Schedule -15 – Miscellaneous Expenditure

Particulars	**Current Year**	**Previous Year**
Discount allowed issue to shareholders		
Others		
Total		

10. Some Important Terms:

1) **Claims:**

When the insured makes a statement for the loss on the date of happening of an event or on the date of maturity of the policy to the insurer the statement is known as claims.

2) **Premium:**

It means the consideration received by Insurance Company in Consideration of the risk undertaken by it. It should be shown in revenue account

3) Bonus:

It is a share of profit which a policy holder gets from the LIC.

4) Reinsurance:

It means transferring the whole or a part of the risk undertaken by insurer to another Insurer.

5) Commission on Reinsurance ceded:

It is a gain to the insurance company. Insurance Companies earn commission from other insurance companies for giving them business under Reinsurance contract.

6) Commission on Reinsurance Accepted:

It is an expense to the Insurance Company. Insurance Companies paid commission to other insurance companies for giving them business under Reinsurance contract.

11. Reserve for unexpired Risk:

It is a reserve created to meet the risk which is associated with all such policies. In fire Insurance 50% net premium is transferred and in marine Insurance 100% of Net Premium is too transferred to Reserve for unexpired Risk.

Problem: 7 **Fire Revenue Account**

From the following particulars you are required to prepare fire Revenue account for the year ending 31 March 2017.

Claims outstanding 31.3.2017	280000	Expenses on Management	1268000
Claims outstanding 1.4.2016	160000	Premium received	484800
Commission	800000	Commission reinsurance accepted	20000
Claims paid	1920000	Provision for unexpired Risk1.4.2016 (Firefund)	1680000
Reinsurance Premium	480000		
Commission on reinsurance ceded	40000		
Additional provision for unexpired risk	80000		

Solution:

Fire Revenue Account for the year ending 31.03.2017

Particulars	Schedule	Current Year
1.Premium Earned (Net)	1	4368000
2. Others		
3. Changes in provision for unexpired Risk(2184000 – 1680000)		(-) 504000
Total (A)		3864000
1.Claims incurred (Net)	2	2040000
2. Commission	3	780000
3. Operating Expenses	4	1268000
4. Others		
Total(B)		4088000
Operating Loss (C)=(A-B)		(-) 224000

Workings:

Schedule – 1- Premium earned (Net)

Premium received	4848000
Less Reinsurance premium	480000
Total	4368000

Schedule – 2 – Claims incurred (Net)

Claims paid	1920000
Add Outstanding 31.3.17	280000
	2200000
Less Outstanding 1.4.16	160000
TotalClaims paid	760000

Schedule – 3 – Commission

Commission	800000
Add Commission on reinsurance	20000
LessCommission on reinsurance ceded	820000
	40000
Total	780000

Fire Revenue Account for the year ending 31.03.2017

Particulars	Schedule	Current Year
1.Premium Earned (Net)	1	4368000
2. Others		-
3. Changes in provision for unexpired Risk(2184000 – 1680000)		(-) 504000
4. Interest Dividend rent Gross		
Total (A)		3864000
1.Claims incurred (Net)	2	2040000
2. Commission	3	780000
3. Operating Expenses	4	1268000
4. Others		
Total(B)		4088000
Operating Loss (C)=(A-B)		(-) 224000

Marine Revenue Account

Problem : 8

From the following balance of united India Insurance Company as on 31.03.2017 prepare a Marine Revenue account.

Legal charges	2400	Communication	10000
Commission paid	216000	Printing Stationary	24000
Marine fund opening	1640000	Claims paid & outstanding	760000
Premium received	2160000		
Commission earned on		Expenses of management	800000
reinsurance ceded	120000		

Solution:

Schedule – 1- Premium earned (Net)

Premium received	2160000
Total	2160000

Schedule – 2 – Claims incurred (Net)

Claims paid & outstanding	760000
Total	760000

Schedule – 3 – Commission

Commission paid	216000
Less Commission earned on reinsurance ceded	120000
	960000
Total	

Schedule – 4 – Operating Expenses

Expenses of Management	800000
Legal Charges	2400
Communication	10000
Printing & Stationary	24000
Total	836400

Marine Revenue Account for the year ended 31-03-2017

Particulars	Schedule	Current Year
1)Premium Earned(Net)	1	2160000
2) Profit/loss on sale /Redemption of Investment		-
3)Change in provision of unexpired risk		(-)520000
4)Interest, Dividend & Rent Gross		-
Total (A)		1640000
1.Claims incurred (Net)	2	760000
2. Commission	3	96000
3. Operating Expenses Related to Insurance Business	4	836400
Total (B)		1692400
Operating loss (C) = (A-B)		52400

Fire and Marine Revenue account and profit & Loss Account

Problem:9

From the following Balance of Indian General Insurance co Ltd on 31.03.2017 prepare a) Five Revenue account b)Marine Revenue account c) Profit & Loss account.

	Rs.		**Rs.**
Survey Expenses(Fire)	10000	Commission paid& outstanding (Marine)	380000
Additional Reserve opening (fire)	50000	Commission paid(Fire)	90000
Commission paid (marine)	108000	Baddebts recovered	1200
Claims paid and outstanding(Fire)	180000	Share transfer fee	800
Fire fund opening	250000	Director fee	5000
Marine fund opening	820000	Auditor's fee	1200
Commission on reinsurance ceded (Fire)	30000	Commission earned on reinsuranceceded(marine)	60000
Management Expenses (Fire)	145000	Marine Premium Less Reinsurance	1080000
Management Expenses (Marine)	400000	Fire premium less reinsurance	600000
Profit on sale of Land	60000	Depreciation	35000
Miscellaneous receipts	5000	Bad debts(marine)	12000
Difference in Exchange(or)	300	Bad debts(fire)	5000
Interest Dividend received	14000		

In addition to usual reserves, additional reserve in case of fire insurance is to be increased by 5% of Net Premium.

Solution:

Schedule -1- Premium Earned (Net)

	Fire	Marine
Premium	600000	1080000
Total Net Premium	600000	1080000

Schedule -2- Claim incurred (Net)

	Fire	Marine
Claim paid	180000	380000
Add Survey Expenses	10000	-
Total Claim paid	190000	380000

Schedule -3- Commission

	Fire	Marine
Commission – Direct	90000	108000
Less Reinsurance ceded	30000	60000
Total	60000	48000

Schedule -4- Operating Expenses

	Fire	Marine
Managerial Remuneration	145000	400000
Other - Baddebts	5000	12000
Total	150000	412000

Fire Revenue Account for the year ended 31.03.2017

Particulars	Schedule	Current Year
Premium Earned (Net)	1	600000
Change in provision for unexpired risk		(-) 80000
Total(A)		520000
Claims incurred (Net)	2	190000
Commission	3	60000
Operating Expenses related to Insurance Business	4	150000
Total (B)		400000
Operating Profit (C) = A-B		120000

Workings

1) Reserve for unexpired risk(31.03.2017)

50% Net Premium	300000
Add Additional Reserve	80000
	380000

2) Change in provision for unexpired risk

Opening Balance	300000
Less Closing Balance	380000
Total	80000

Marine Revenue account for the year ended 31.03.2017

Particulars	Schedule	Current Year
Premium Earned (Net)	1	1080000
Change in provision for unexpired risk		(-) 260000
Total (A)		820000
Claims incurred (Net)	2	380000
Commission	3	48000
Operating expenses	4	412000
Total (B)		840000
Operating Profit (C) = (A-B)		(-) 20000

Workings

1) Reserve for unexpired risk 1080000

2) **Change in provision for unexpired risk**

Opening Balance	820000
Less: Closing Balance	1080000
Total	260000

Profit & Loss account for the year ended 31.03.2017

1)Operating Profit/Loss:	
a) Fire Insurance	120000
b) Marine Insurance	(-)20000
2)Income from Investment:	
Interest, Dividend, Rent Gross	14000
Profit on sale of Land	60000
3)Other Incomes:	
a) Transfer fees	800
b) Bad debts recovered	1200
c) Miscellanceous Receipts	5000
d) Difference in Exchange	300
Total (A)	181300
Other Expenses:	
1) Auditor fees	1200
2) Director fees	5000
Depreciation	35000
Total(B)	41200
Profit Before Tax (A-B)	140100
Provision for taxation	-
Profit after tax	140100
Appropriations:	
Balance of profit(Loss brought Forward from last year	-
Balance carried forward to Balancesheet	140100

Problem : 10

The following were the balances extracted from the trial Balance of Aarthy Life insurance co., Ltd for the year 31 March 2017.

Balance of account at the beginning of the year	Rs.800000
Profit on realisation of assets	Rs. 1000
Claims under policies by death	Rs. 30000
Claims under polices by Maturity	Rs. 50000
Premium (Other than single)	Rs.100000
Single Premiums	Rs. 40000
Consideration for annuities granted	Rs. 25000
Interest Received	Rs. 35000
Depreciation on furniture	Rs. 1500
Administrative Expenses	Rs.18000
Salaries	Rs. 1500
Surrenders	Rs.10000
Auditor fee	Rs. 750
Legal Expenses	Rs. 500
Advertising	Rs. 700
Printing	Rs. 5400
Director fee	Rs. 150
Commission paid	Rs. 12000

Solution: **Aarthy Insurance Co., Ltd**

Revenue account for the year ended 31-03-2017.

	Schedule	**31-03-17**
Premium Earned – Net	1	140000
Income from Investment		35000
Interest, Divident Transfer/gain on revalution		1000
other income – consideration for annuities		25000
iranted		------------
Total (A)		201000

Commission		12000
Operating Expenses	2	28500
	3	-----------
Total (B)		40500

Benefits paid (Net)	4	90000
Interim Bonus paid		--

Total (c)		90000
Surplus (P) = A-B-C		70500
Appropriations		-----
Balance being funds for future		
Appropriations		**70500**

Workings:

Schedule 1 Premium Earned (Net)	31-03-17
Premium (other than single)	100000
Single Premium	40000
Total	140000

Schedule 2 Commission Expenses

Commission paid	12000

	12000

Schedule 3 operating Expenses

Adminstrative Expenses	18000
Salaries	1500
Auditor fee	750
Director's fee	150
Legal Expenses	500
Advertising	700
Printing	5400
Depreciation on furniture	1500

Total	28500

Schedule – 4 Benefits paid (Net)

Claims under policies by death	30000
Claims under policies by Maturity	50000
Surrenders	10000

Total	90000

Specimen form Life Insurance Balancesheet

Form A-Bs

Balance sheet as on 31 March 20 ....

Particulars	**Schedule**	**Current Year**	**Previous Year**
Sources of Funds			
Share holders funds			
Share capital	5		
Reserves & surplus	6		
Credit / Debit fair value			
Change account			
Sub Total			
	7		
Borrowings			
Policy holders funds			
Credit/Debit fair value			
Change account			
Policy Liabilities			
Insurance Reserves			
Provision for linked Liabilities			
Sub total			
Funds for future Appropriations			

Application of funds Investments

Particulars	Schedule	Current Year	Previous Year
Application of funds			
Investments			
Shareholders	8		
Policy holders	8A		
Assets held to cover linked Liabilities	8B		
Loans	9		
Fixed Assets	10		

Current Assets (A)			
Cash and Bank Balances	11		
Advance and other Assets	12		
Sub total (A)			
Current Liabilities (B)	13		
Provisions	14		
Sub Total (B)			
Net current Asset C=A-B			
Miscellaneous Expenditure			
Debit balance in profit & Loss	15		
Account (shareholders account)			
Total (Application funds & New current assets)			

Workings **Schedule – 5 Share capital**

S.No.	Share capital	Current Year	Previous year
1.	Authorised capital	xx	xx
2.	Issued capital	xx	xx
3.	Subscribed capital	xx	xx
4.	Called up capital	xx	xx
	Less: calls unpaid Add: Share forfeited Less : preliminary Expenses	xx	xx
	Total	xx	xx

Schedule – 6Reserves surplus

S.No.		Current Year	Previous year
1.	Capital Reserve	xx	xx
2.	Capital Redemption Reserve	xx	xx
3.	Share Premium	xx	xx
4.	Revaluation Reserve	xx	xx
5.	General Reserve	xx	xx
6.	Balance of profit in P& L a/c	xx	xx
	Total	xx	xx

Schedule – 7 Borrowings

S.No.	Borrowings	Current Year	Previous year
1.	Debentures	xx	xx
2.	Banks	xx	xx
3.	Fiancial Institutions	xx ------- 	xx -------
	Total	xx	xx

Schedule – 8 Investments – Shareholders

S.No.	Share holders	Current Year	Previous year
1.	Long term Investment	xx	xx
2.	Short term Investment	xx	xx
	Total	xx	xx

Schedule – 8A Investments – Policy holders

S.No.		Current Year	Previous year
1.	Long term Investments	xx	xx
2.	Short term Investments	xx	xx
	Total	xx	xx

Schedule – 8BAssets held to cover linked liabilities

S.No.		**Current Year**	**Previous year**
1.	Long term Investments	xx	xx
2.	Short term Investments	xx	Xx
	Total	xx	xx

Schedule – 9 Loans

S.No.		Current Year	Previous year
1.	Security wise classifications	xx	xx
	Secured	xx	xx
	Unsecured	xx	xx
	Total	xx	xx
2.	Borrower wise classification		
	a) Control & state Govt	xx	xx
	b) Banks & Financial Institutions	xx	xx
	c) Others	xx	xx
3.	Performance wise classification		
	a) Loan classified as standard	xx	xx
	b) Non-standard Less provisions	xx	xx
	Total	xx	xx
4.	Maturity – wise classification		
	a) Short term	xx	xx
	b) Long term	xx	xx
	Total	xx	xx

Schedule – 10 Fixed Assets

Particulars	Cost / Gross Block				Depreciation				Net Block	
	Opening	Additions	Deductions	Closing	Up to Last year	Current Year	on sales	To date	at year end	Previous year
Good will										
Land – free hold										
Lease hold property										
Buildings										
Furniture										
Vehicles										
Office Equipment										
Total										
Work in Porgress										
Grand Total										
Previous year										

Schedule – 11   Cash and Bank Balance

S.No.		Current Year	Previous year
1.	Cash	xx	xx
2.	Bank Balances	xx	xx
3.	Money at call & shortnotices	xx	xx
4.	Others	xx	xx
	Total	xx	xx

Schedule – 12   Advances and other Assets

S.No.	Advances	Current Year	Previous year
1.	Reserve Deposits	xx	xx
2.	Appliation Money	xx	xx
3.	Prepaymaents	xx	xx
4.	Advances to Directors	xx	xx
5.	Advance Tax Paid	xx	xx
	Total (A)	xx	xx

Other Assets

S.No.		Current Year	Previous year
1.	Income accured on Investments	xx	xx
2.	Outstnading Premium	xx	xx
3.	Agent Balance	xx	xx
4.	Foreign Agencies Business	xx	xx
5.	Deposits with RBI	xx	xx
	Total (B)	xx	xx
	Total (A+B)	xx	xx

Schedule 13 – Current Liabilities

S.No.		Current Year	Previous year
1.	Agents Balance	xx	xx
2.	Balance due to other insurance business	xx	xx
3.	Deposits held on reinsurance ceded	xx	xx
4.	Premium received in advance	xx	xx
5.	Sundry creditors	xx	xx
6.	Claims outstanding	xx	xx
7.	Annuities Due	xx	xx
	Total	xx	xx

Schedule 14 – Provisions

S.No.		Current Year	Previous year
1.	For taxation	xx	xx
	Proposed Dividend	xx	xx
	Dividend Distribution tax	xx	xx
	Others	xx	xx
	Total	xx	xx

Schedule – 15 Miscellaneous Expenditure

S.No.		Current Year	Previous year
1.	Discount allowed on issue to shares	xx	xx
2.	Others	xx	xx
	Total	xx	xx

General Insurance Business

Form B – RA

Specimen form Revenue Account for the year ended 31-03...............

S.No.	Particulars	Schedule	Current Year	Previous Year
1.	Premium earned (Net)	1		
2.	Profit/Loss on sale/redemption of Investments			
3.	Change in provision for unexpired risk			
4.	Interest , Dividend Rent – Gross			
	Total (A)			
1.	Claim incurred (Net)	2		
2.	Commission	3		
3.	Operating Expenses related to Insurance Business	4		
	Total(B)			
	Operating profit/Loss from fire/marine Miscellaneous Business C=A-B			
	Appropriations:			
	Transfer to shareholders Account			
	Transfer to catastrophe Reserve			
	Transfer to other reserve			
	Total(c)			

Form B – PL

Profit & Loss account for the year ended 31-03.......

S.No.	Particulars	Schedule	Current year	Previous years
1.	Operating profit/loss a) Fire Insurance b) Miscellaneous Insurance			
2.	Income from Investment a) Interest, Dividend – Rent gross b) Profit on sale of Investments.			
3.	Other Income			
	Total (A)			
4.	Provisions (Other than taxation) a) diminution in value of Investments b) doubtful debts c) others			
5.	Other expenses a) Expenses not related to Insurance business b) Bad debts c) Others			
	Total (B)			
	Profit before Tax Provision for taxation Appropriations a) Interim Dividend paid b) Proposed Dividend c) Dividend Distribution tax d) Transfer to any Reserve			

Form B – BS
Balance sheet as on 31 March ....

Particulars	Schedule	Current Year	Previous Year
Soruces of funds			
Share capital	5		
Reserves & Surplus	6		
Fair value change account			
Borrowings	7		
Total (A)			
Application of funds			
Investments	8		
Loans	9		
Fixed Assets	10		
Current Assets (A)			
Cash and Bank Balances	11		
Advances and other assets	12		
Sub Total (A)			
Current Liabilities (B)	13		
Provisions	14		
Sub Total (B)			
Net current Assets			
c=(A-B)	15		
Miscellaneous Expenditure			
Debit Balance in profit a loss a/c			
Total (Appl. of funds +NCA)			

12. Ascertainment of Profit

In Life Insurance business, profit is to be ascertained after expiry of 2 years for this purpose a valuation Balance sheet is prepared.

Valuation Balance sheet as on ....

Liabilities		Assets	
To Net liability as per actuarial valuation	xx	By Balance of life Insurance fund	xx
Surplus if any	xx	Deficiency if any	xx

Distribution statement Amount payable to policy holders

Surplus as per valuation Balancesheet	xx
Add interim Bonus	xx
Policy share holders 95%	xx
Less Interim Bonus paid	xx
Amount due to polcy holders for bonus	xx

Problem :11

From the following particulars of the Life Insurance company for the year ended 31-03-2017 you are required to prepare valuation Balancesheet as on 31-03-2017 and distribution statement as on that date:

Life Insurance fund as on 31-03-2017	38,00,000
Net Liability as per valuation	30,00,000
Interim Bonus paid	5,00,000

Solution

Life Insurance company

Valuation Balance sheet as on 31-03-2017

Liabilities		Assets	
To Net Liability	30,00,000	By Life Insurance	38,00,000
Surplus	8,00,000		
	38,00,000		38,00,000

Distribution statement as on 31-03-2017

Surplus as per valuation statement	8,00,000
Add Interim Bonus	5,00,000

	13,00,000

Policy holders 95% share 1300000x95/100	1235000
Less Interim Bounus	500000
Amount due to Policy holders	--------------
for bonus	**735000**

ACCOUNTS OF HOLDING COMPANIES

1. Meaning:

A Company that holds either the whole of the share capital or majority of the shares of another company so as to have a controlling interest in such companies. The controlling company is called as the holding company and the company so controlled is called as a subsidiary company.

2. Definition:

Section 4 of the companies Act 1956 defines a company shall be deemed to be the holding company of another, if that other is its subsidiary".

1. By holding more than 50% of the face value of the equity shares of the other company.
2. By controlling the composition of Board of directors of the other company.
3. By controlling a holding company which controls another subsidiary company.

For example:

If X Ltd is a subsidiary of Y Ltd and Y Ltd is a subsidiary of Z Ltd, then X Ltd is also considered to be subsidiary of Z Ltd.

3. Advantages of Holding company:

1) The object of holding companies is to promote combination movement and eliminate competition.

2) Enjoying economics in production and management may be secured.

3) Subsidiary companies retain their identies. Hence no liquidation is possible.

4) Holding companies getting advantages existing of goodwill of is possible subsidiary companies and also control is exercised on the affairs of subsidiary companies.

4. Disadvantages:

Manipulation of accounts, Manipulation of Intercompany transactions, oppression of minority shareholders, and exploitation of subsidiary companies by holding company are possible in the system of holding companies formation.

5. Procedure for preparing consolidated balance sheet, and consolidated profit & loss a/c:

Consolidated financial statement include consolidated balance sheet profit & loss account

This statement is to show the financial position and trading results of both holding & subsidiary companies.

In consolidated Balance sheet in which assets and liabilities of all the subsidiaries are given along with the assets and liabilities of holding company in one single Balance sheet.

6. **Preparation of the consolidated Balancesheet**

Step 1: Wholly owned / partly owned subsidiary company:

The shares in the subsidiary company held by the holding company as Investment. The Investment of the holding company in the subsidiary company are replaced by Net assets of subsidiary company.

Example: From the following Balancesheet of holding company and subsidiary company prepare a consolidated balance sheet of holding company and its subsidiary company.

Problem : 12

Balance sheet as on 31st March, 2017

	H Rs.	S Rs.		H Rs.	S Rs.
Share Capital in Re.1 shares	12,000	5,000	Sundry Assets	15,000	8,000
Sundry Liabilities	8,000	3,000	Investments : 5,000 shares in S Ltd	5,000	----
	20,000	8,000		20,000	8,000

Solution :

Consolidated Balance sheet as on 31st March, 2017

	H Rs.	S Rs.		H Rs.	S Rs.
Share capital of H Company		12,000			
Sundry liabilities			Sundry Assets		
H	8,000		H	15,000	
S	3,000	11,000	S	8,000	23,000
		23,000			23,000

Step 2: Minority Interest:

When some of the shares of the subsidiary company are held by outsiders, they will have a right to get a proportionate share in the assets and liabilities of that company their interest known as minority interest. The shares of the outsiders in the subsidiary company is called minority interest. The Amount of minority is shown on the liabilities side of the balance sheet of the holding company.

Calculation of minority interest:

	Paid up value of shares held by outsiders		xxx
Add:	Proportionate share of subsidiary company Profits & Reserves	xxx	
	Proportionate increase the value of assets of	<u>xxx</u>	

Subsidiary company. xxx

Less: Proportionate share of subsidiary company's Losses xxx

Proportionate decrease in the value of assets &

Subsidiary company xxx

Value of minority interest xxx

Problem 13:

From the Balancesheet of given below prepare a consolidated balance sheet.

Balance sheet as on 31st March 2017

	A Rs.	**B Rs.**		**A Rs.**	**B Rs.**
Share Capital in Re.1 shares	12,000	5,000	Sundry Assets Investments	16,000	8,000
Sundry Liabilities	8,000	3,000	4,000 shares in B Ltd.,	4,000	---
	20,000	8,000		20,000	8,000

Solution:

Consolidated Balance sheet as on 31st March, 2017

	A Rs.		**B Rs.**
Share capital of A Co.,	12,000	Sundry assets	
Minority Interest (1)	1,000	A 16,000	
Sundry Liabilities		B 8,000	24,000
A 8,000	11,000		
B 3,000	24,000		24,000

Calculation of Minority interest Rs.

1/5th share in the assets of B co. 1,600

Less 1/5 share in the liabilities 600

Share of minority of interest 1,000

Step 3: Cost of control (or) Goodwil:

If the holding company purchases the shares of the subsidiary company at a price which is more than the paid up value of the shares, the excess amount paid represents payment of goodwill or cost of control.

For e.g.: If 10000 Shares of Rs.10 each are purchased at Rs.120000, the excess amount of Rs. 20,000 (120000 – 100000) is goodwill and will be shown in consolidated Balancesheet asset side.

Problem 14:

The Balance Sheets of A Ltd and B Ltd as on 31st December, 2017 were as follows:

Liabilities	A Ltd	B Ltd	Assets	A Ltd	B Ltd
Share capital in Rs.10 fully paid			Fixed Assets	10,000	6,000
shares	12,000	5,000	Current Assets	11,500	2,000
Equity shares	4,000	1,000	Cash at Bank	7,000	1,000
Preference shares	2,500	1,000			
Profit and Loss A/c	10,000	2,000			
Creditors					
	28,500	9,000		28,500	9,000

On 1st January, 2018, A Ltd acquired 90% of share capital of B Ltd at 15 per share. Prepare the consolidated Balance Sheet as on 1st Jan, 2018

Solution:

Consolidated Balance Sheet of A Ltd and its subsidiary B Ltd as on 1st January 2018

Liabilities		Assets	A Ltd
Share capital		Cost of control	1,350
(Rs.10 fully paid)	12,000	Fixed Assets	
Preference share	4,000	A Ltd 10,000	16,000
Profit and Loss A/c	2,500	B Ltd 6,000	
Minority interest	1,600	Current Assets	
creditors		A Ltd 11,500	
A 10,000		B Ltd 2,000	13,500
B 2,000	12,000	Cash at Bank	
		A Ltd 250	
		B Ltd 1,000	1,250
	32,100		32,100

(1) Ascertainment of cost of control

Investment A/c. (450 shares at Rs.15)		6,750
Less: Paid up value of 450 share	Rs. 4,500	
90% of pre-acquisition Profits i.e.90% of 1,000	900	5,450
Cost of control		1,300

(2) Minority Interest:

Paid up value of 50 Equity shares @ Rs.10	500
Paid up value of Preference shares	1,000
10% of Profits and Loss A/c balance	100
Minority interest	1,600

Step 4: Pre-acquisition profits (or) capital profits

The profits of the subsidiary company earned up to the date of acquisition of shares by holding company are pre-acquisition profits. (Capital profits). These profits are shared by outsiders and holding company according to their proportionate shares held by them. Capital profits of the holding company are shown as capital reserve in the consolidated Balancesheet and share of capital profit belonging to minority interest is added to be amount of minority interest.

In case of cost of control, share of such profit belonging to the holding company is adjusted to cost of control and reduce cost of control.

Similarly, loss of the subsidiary company shown in the Balance sheet on the date of purchase of share, share holding company is added to cost of control.

From the Balance sheet gives below prepare a consolidated Balancesheet of A Ltd and its subsidiary of B Ltd.

Problem: 15

Balance sheets as on 31st March, 2017

Liabilities	H	S	Assets	H	S
Share Capital in Re.1 fully paid shares	12,000	6,000	Sundry Assets Invesments	20,000	12,000
Reserve	3,000	2,000	6,000 shares in S Ltd	7,500	----
Profit and Loss A/c	2,000	1,000			
Sundry liabilities	10,500	3,000			
	27,500	12,000		27,500	12,000

H Ltd. has acquired shares on 31st March, 2017

Solution:

Calculation of capital reverses:

Equity purchased in the subsidiary	
Share Capital	6,000
Reserve	2,000
Profit and Loss A/c	1,000
Total	9,000
Less Price paid for investment	7,500
Capital Reserve	1,500

Consolidated Balance sheet as on 31st March 2017

Share capital			Sundry assets		
Re.1 fully paid shares		12,000	H	20,000	
Capital reserve		1,500	S	12,000	32,000
Reserve (H Ltd)		3,000			
Profit & Loss A/c (H Ltd)		2,000			
H	10,500				
S	3,000	13,500			
		32,000			32,000

Step 5: Post acquisition of profits (Revenue profits)

Profits of the subsidiary company earned after the date of purchase of shares by the holding company are treated as revenue profits. Holding company's share is added to the profits of the holding company and shares of such profit belonging to the minority interest is added to the amount of minority interest.

Problem :16

Calculation of Capital and Revenue profits

Balance sheet as on 31st March, 2005

Liabilities	H	S	Assets	H	S
Share Capital in Re.1 fully paid shares	12,000	5,000	Sundry Assets Invesments	20,000	8,000
Reserve	5,000	1,000	5,000 shares in S Ltd	6,500	----
Profit and Loss A/c	2,000	1,000			
Sundry liabilities	7,500	1,000			
	26,500	8,000		26,500	8,000

Shares were acquired by H Ltd. on 30th September, 2016

S Ltd transferred Rs.500 from profits to reserve on 31st March 2017.

Prepare the consolidated balance sheet.

Solution:

(1) Calculation of Revenue profits of the subsidiary

P&L A/c balance as on 31-03-2017	1,000
Add Transfer to reserve	500
Total profits earned for the year	1,500
Less Profits of the first 6 months	
(From 01-04-2016 to 30-09-2017);	
Profits prior to date of	750
Purchase (Capital profit)	--------
Revenue profit	750

(2) Capital profit

Reserve balance	1000
Less Transferred from current profits	500
Reserve as on 1st April 2016 capital profit	500

(3) Cost of Control

Share capital purchased		5,000
Add Pre-acquisition profits		
Capital Profit Reserve as on 01-04-2016	500	
Revenue Profit	750	1,250
Total		6,250
Price paid for the investment		6,500
Less: Equity share purchased in the subsidiary		6,250
Cost of control		250

(B) Consolidated Balance Sheet as on 31st March, 2017

Share capital in Re.1 fully Paid shares		12,000	Goodwill		250
Reserve H Ltd		5,000	Sundry Assets		
P & L A/c H	2,000		H	20,000	
S	750	2750	S	8,000	28000
Sundry liabilities H	7,500				
S	1,000	8,500			
		28,250			28,250

Problem : 17

Balance Sheet as on 31st December, 2004

Liabilities	X	Y	Assets	X	Y
Share capital in Re.1 fully paid shares	10,000	5,000	Sundry assets	16,000	10,000
General reserve	5,000	---	5,000 Shares of		
Creditors	3,000	3,250			
P & L A/c	4,000	1,800	Y Ltd	6,000	----
	22,000	**10,000**		**22,000**	**10,000**

Shares were purchased by X Ltd. in Y Ltd on 30th June, 2004. On 1st January, 2004 the balance sheet of Y Ltd. showed loss of Rs. 3,000 which was written off out of the profits earned during 2004. Prepare consolidated balance sheet.

Solution:

Calculation of X Ltd's share of Revenue profits: Rs.

Profit of Y Ltd as per balance sheet	1,800
Add Loss written off	3,000
Profits made during the year	4,800
Profits from 30th June to 31st December (4,800x1/2)	2,400
Pre-acquisition loss: (Capital loss)	
Profits earned to June 2004 (ie ½ of Rs. 4,800)	2,400
Less Loss on 1st January 2004	3,000
Net Loss as on 30th June 2004	600

Calculation of cost of control

Share Capital	5,000	
Less Loss on the date of acquisition	600	4,400
Price paid for the investment		6,000
Cost of control		1,600

Consolidated Balance sheet as on 31st December, 2004

Share capital in Re.1 fully Paid shares		10,000	Goodwill		1,600
General reserve (X)		5,000	Sundry Assets		
Creditors X	3,000		H	16,000	
Y	3,200	6200	S	10,000	26,000
Profit & Loss A/c X	4,000				
Y	2,400	6,400			
		27,600			27,600

Step 6: Elimination of common transactions:

While preparing consolidated Balancesheet, some common transactions appearing in both Balancesheet of holding company and subsidiary company should be eliminated.

Example: 1) Goods sold on credit by the holding company to the subsidiary company and vice versa 2) Bill drawn by one company and accepted by another company. 3) Loan advanced by holding company to subsidiary company and vice versa. 4) Debentures issued by one company and held by another company.

Step 7: Treatment of unrealised profits:

If the goods sold at a profit by H to S company or S to H company remain unsold at end of the year, profit charged by the company on unused goods remain unrealised. In this connection stock reserve is created and profit is reduced by unrealised profit. Further stock reserve is also reduced by share of minority interest. Stock reserve will be reduced on the liability side.

E.g. H Ltd purchased from S Ltd goods of the value of Rs.40000 on which S Ltd had charged a profit 20% on cost and goods worth Rs.12000 remained unsold at the end of the year.

Unrealised profit = 12000 x 20/120 = Rs.2000

Suppose H Ltd holds 75% equity shares of the subsidiary company

Stock reserve = 2000 x 75/100 = 1500 s.1500 will be deducted from stock on asset side and 1500 will be deducted from P& L a/c on the liabilities side.

Step 8: Treatment of Contingent Liabilities:

Contingent liability is that liability which arises or may not arise. Its payment depends on the occurrence of a future transaction which is not certain. Such a liability is shown by way of a footnote in the Balancesheet.

Example:

i) Arrears of dividend on cumulative preference shares.

ii) Claims against the company not acknowledged debt as yet.

iii) Bills discounted likely to be dishonoured.

iv) Amount uncalled on partly paid shares held.

Step 9: Revaluation of Assets and Liabilities:

If assets and liabilities of subsidiary company are revalued at the time of purchase of shares in the subsidiary company, profit or loss on account of such revaluation is treated as capital profit or capital loss and shared by minority shareholders and holding company according to the proportions of shares held by them. Holding company's share of capital profit is transferred to capital reserve, deducted from cost of control If there is loss on revaluation. Share of profit of minority shareholders is added to minority interest and deduction is made from the minority interest if there is a loss on revaluation.

Step 10: Bonus Shares:

Bonus shares may be issued out of capital profits or revenue profits or reserves of the subsidiary company. There are two methods of issuing Bonus shares: They are:

a) Treatment of Issue of Bonus shares out of capital profits:

Issue of Bonus shares out of capital profits (Pre-acquisition profits) will have no effect on the consolidated Balance sheet.

b) Treatment of Issue of Bonus shares out of Revenue profits:

Issue of Bonus shares out of revenue profits will have effect on the consolidated Balance sheet. The share of revenue profit earned by the holding company will be reduced and paid up value of shares held by the holding company will increase.

Unit IV

1. What is rebate on bills discounted?
2. What do you mean by non-banking assets?
3. What are non-performing assets?
4. Give a proforma of profit and loss a/c of a Banking company?
5. Give a proforma of Balance sheet of a Banking company
6. Write short notes on holding company and subsidiary company?
7. What is cost of control? How is it calculated?
8. What is Minority interest? How is it calculated?
9.How would you deal with the revaluation of assets and liabilities of subsidiary while
10.preparing a consolidated balance sheet?
11. Explain the term Insurance.
12. Distinguish between General Insurance and life Insurance.
13. Distinguish between fire insurance and Marine Insurance.
14. What is commission on re-insurance ceded?
15. Explain commission on re-insurance accepted?
16. Draw a specimen of revenue account of life insurance business
17. Draw a specimen of fire revenue and marine revenue account
18. Define Insurance State the difference between Life Insurance and General Insurance.
19. Draw a specimen of Fire Insurance Revenue Account.
20. Draw a Specimen of Marine Insurance Revenue Account.
21. Explain the terms (i) Claims (ii) Premiums.

Unit - 5

DOUBLE ACCOUNT SYSTEM

Double account is a system of accounting and presenting annual accounts by public utility undertakings like Gas companies, Electricity, Railway Companies, Tramways which operate under special Acts of parliament. They are rendering service to the society at a reasonable price. These companies require a large amount of fixed capital invested in fixed assets.

Under Double account system the balance sheet is divided into two parts.

i) Receipts and payments on capital account.

ii) General Balance sheet.

and also prepare Revenue account and Net Revenue account.

Objects:-

This account is to show the amount of fixed capital raised from the public and the manner in which the fixed capital has been utilised in the purchase of fixed assets.

2. Features of Double account system:-

1. Double accounting system is a system of presenting final accounts.
2. These system is adopted by Railways, Electricity, Gas Companies formed under special Act of parliament.
3. In this system Revenue A/c. Net Revenue A/c Capital A/c and General Balances sheet are prepared.
4. Its main object is to show the amount of fixed capital raised from the public and the manner in which fixed capital has been used in the purchase of fixed assets.
5. A revenue account, prepared to show income and expenses of the company.
6. A Net revenue A/c is prepared to show the net profit of the company.
7. Under this system fixed assets are shown in the capital a/c at original cost.
8. Discount and premium on issue of shares and Debenture is deducted from shares and debentures and Net amount is shown in capital a/c.
9. Loans and debentures are treated as capital and shown in the credit side of the capital a/c.

10. General reserve, investment fluctuation reserve are shown in the general Balance sheet on the liabilities side.

3. Merits (Advantages) of Double Account system:-

1) This accounting system will be easy to understand by shareholders and debenture holders capital a/c shows the total amount of receipts by way of shares, Debentures and Loans and expenses incurred for purchasing fixed assets.

2) Creation of appreciation fund will be useful to replace fixed assets.

3) Public utility companies render better services to the public at a reasonable price.

4) Revenue and Net revenue accounts are shown pure operating results of the company.

5) It helps in preparation of various statistical returns in a quick manner.

6) It helps in comparison of floating assets and floating liabilities.

7) In this system the Government exercises necessary control over Public Utility Company.

8) Under Double accounting system fixed assets are shown as original cost under capital accounts and current assets are shown in General Balance sheet.

4. Demerits (Disadvantages):

1) In this system interest paid (or) received is not included in revenue a/c. Hence revenue a/c does not show true and fair view of operating results.

2) It is very difficult to understand by general public.

3) Capital a/c does not show true position.

4. In this system fixed assets are shown at cost price in capital a/c. Hence Balance sheet does not show true and fair view of the financial position of the company.

5. It is very difficult to decide whether the expenditure is capital or revenue nature.

5. Difference between Double entry system and Double account system:-

S.No.	Double entry system	Double Account system
1)	It is a method of book keeping	It is a method of presenting final accounts.
2)	fixed assets are shown at cost less depreciation in the balance sheet.	Fixed assets are shown at cost price in capital a/c and Depreciation fund is shown in Balance sheet.
3)	Interest is charged to P&L a/c	Interest is charged to Net Revenue a/c.
4)	It consists of P&L A/c. P& L appropriation a/c and Balance sheet.	It consists of Revenue Net Revenue a/c. capital a/c General Balance sheet.
5)	Fixed assets and fixed liabilities are shown in the Balance sheet.	Only fixed assets and fixed liabilities are shown in the capital a/c.

6. Difference between Double account and single account system :

S.No.	Double A/c system	Single A/c. System
1)	It is used by only public utility undertakings	It is used by all the companies.
2)	It consists of revenue a/c Net Revenue a/c. capital a/c and general Balance sheet	It consists of P&L a/c P&L appropriation and Balance sheet.
3)	Balance sheet is presented into two parts : capital a/c and general Balance sheet.	Only one Balance sheet is presented.
4)	Share capital , Debentures will appear in capital a/c	They are appear in Balance sheet.
5)	Fixed assets are shown at cost price.	It is shown at cost less depreciation.
6)	Its purpose is to how the capital is raised and how the same has been invested in fixed assets.	It s purpose is to show the financial position of the company.

Specimen form of Revenue account

Dr. **Revenue account** **Cr.**

To cost of generating	xx	By sale of energy	xx
Electricity	xx	Sale lighting	xx
To cost of distribution of electricity	xx	By Transfer fees	xx
To Management expenses	xx	By Rent Received	xx
To Legal expenses	xx		
To Depreciation	xx		
To Balance carried to net revenue a/c	xx		
	xx		xxx

Dr. **Net Revenue account** **Cr.**

To Interest on Loans	xx	By balance b/d	xx
Contingency reserve	xx	By balance brought from revenue a/c.	xx
Interest on debenture	xx	Interest on bank	xx
Dividend	xx		
Balance carried to Balance sheet	xx		
	xx		xx

Receipts and Expenditure on capital account

Expenditure	Previous year	Current year	Total	Receipts	Previous year	Current year	Total
To land	xx	xx	xx	Equity	xx	xx	xx
Building	xx	xx	xx	Share capital	xx	xx	xx
Machinery	xx	xx	xx	Pref. share	xx	xx	xx
main	xx	xx	xx	capital	xx	xx	xx
Total Expenses	xx	xx	xx	Debentures Loans	xx	xx	xx
Balance of capital a/c. transferred to Balance sheet.	xx	xx	xx	Total Receipts	xx	xx	xx
	xx	xx	xx		xx	xx	xx

General Balance sheet

Liabilities		**Assets**	
Balance of capital a/c	xx	Balance of capital a/c.	xx
Sundry creditors	xx	Stores	xx
Net Revenue a/c	xx	Sundry Debtors	xx
Reserve fund	xx	Preliminary Expenses	xx
Depreciation fund	xx	Cash balance	xx

Problem: 1

The following are the balances on 31 March 2017 in the books of Arun Aanand Vellore Electric company Ltd.

Particulars	Dr	Cr
Land (01-04-16)	60,000	----
Land expended during the year	2000	----
Machinery (01-04-16)	240000	----
Machinery expended during the year	2000	----
Mains	80000	----
Mains expended during the year	20400	----
Ordinary shares	----	219600
Debentures	----	80,000
Creditors	-----	400
Depreciation fund a/c	16000	1,00,000
Sundry Debtors for current supplied	----	
Other debtors	200	---
Cash	2000	----
Cost of generation of electricity	14000	---
Cost of distribution of electricity	2000	----
Rent & Rates	2000	----
Management Expenses	4800	---
Depreciation	8000	---
Sale of current	---	52000
Rent of meters	----	2000
Interest on debentures	4000	----
Interim Dividend	8000	----
Balance of Net Revenue a/c (01-04-16)	---	11400
Total	**4,65,400**	**4,65,400**

From the above Trial balance prepare

i_ Revenue a/c ii) Net Revenue a/c iii) Capital a/c v) General Balance sheet.

Solution:

1. Revenue Account for the year ended 31-03-2017.

To cost of generation of electricity	14000	By sale of current	52000
To cost of Distribution of electricity	2000	By Rent of meter	2000
To Rent & Rates	2000		
To Management Expenses	4800		
To Depreciation	8000		
Balance carried Net Revenue a/c	23200		
	54000		54000

2) Net Revenue account for the year ended 31-03-2017

To Interest on debentures	4000	By balance b/d	11400
Interim Dividend	8000	By balance from Revenue	23200
Balance carried to General Balance sheet	22600		
	34500		34500

3) Receipts & Expenditure on capital account for the year ended 31-03-2017

Expenditure	**Upto 31-03-16**	**Up to 31-03-17**	**Total**	**Receipts**	**Upto 31-03-16**	**Upto 31-03-17**	**Total**
To Land	60000	2000	**62000**	By Equity share capital	219600	----	**219600**
Machinery	240000	2000	**242000**	By Debentures	80000	---	**80000**
Main	80000	20400	**100400**				
Total Expenses	380000	24400	**404400**	Total Receipts	299600	----	**299600**
				By balance c/d			**104800**
			404400				**404400**

4) General Balance sheet as on 31-03-2017

Liabilities		Assets	
Total capital Receipts	299600	Total capital Expenses	404400
Creditors	400	Sundry Debtors	16000
Depreciation fund a/c	100000	Other debtors	200
Net Revenue a/c	22600	Cash	2000
	422600		422600

7. Replacement of Asset

Replacement of asset means old asset is replaced and new asset is purchased.

Journal entries

1. New works a/c Dr. (capitalised value) xx

   Replacement a/c Dr (estimated cost) xx

   To Bank a/c xx

   (Being amount paid for replacement of assets)

2) New works a/c Dr xx

To Replacement a/c xx

(Being old materials used in new works)

3) Bank a/c Dr xx

To Replacement a/c xx

(Being old materials sold)

4) Revenue a/c Dr. xx

To Replacement a/c xx

(Being Amount Transfered to revenue profit a/c)

Problem No: 2

A Railway station had to be replaced by a new station. The cost of New station is Rs.800000. The old one had cost Rs.210000 Labour forming 3/10 of total expenditure and material accounting for the rest. Prices of raw materials have doubled and wage rates have gone by 250% materials of the old station Rs.38000 were used in the new station and the sale proceeds of the old station materials were Rs.11000 These materials were obtained by pulling down the old station. **Pass Journal entries**

Solution

1) New works A/c Dr. 285500

Replacement a/c Dr. 514500

To bank a/c 800000

2) New works a/c Dr 38000

To Replacement a/c 38000

(Being old materials used in New works)

3) Bank a/c Dr 11000

To Replacement a/c 11000

(Being old materials sold)

4) Revenue a/c Dr 465500

To Replacement a/c 465500

(Being Replacement a/c. transferred)

Working notes: Amount to be capitalised:

Cost of New works	800000
Less estimated Replacement cost	614500
Capitalised amount	285500

Problem: 3

The Indian Gas company rebuilt of their works with double the capacity at a cost of Rs.800000/-. The cost of the part of old works was Rs.350000. In working new works old materials of Rs.15000 was reused and Material Rs.25000 was sold away. The cost of Labour and Materials are 50% higher now than when the old works were built. Pass Journal entries.

Solution:

1) New works a/c Dr. 275000

Replacement a/c Dr. 525000

To Bank 800000

(Being amount paid for replacement)

2) New works a/c or 15000

To Replacement a/c 15000

(Being old materials used)

3) Bank a/c or 25000

To Replacement a/c 25000

4) Revenue a/c Dr 485000

To Replacement a/c 485000

(Being balance transferred to Revenue a/c)

Workings

Cost of new works	-	800000
Less Estimated Cost	-	525000

Amount to be capitalised		275000

INFLATION ACCOUNTING:

Inflation accounting is a system of accounting which purports to record as a built –in mechanism all economic events in terms of current cost.Inflation accounting is the accounting which takes into account the price level changes.

It is also known as price level accounting. It is a technique of accounting by which transactions are recorded at current values. Hence it is the system of accounting in which all items of financial statements are recorded at their current values.

Features of inflation accounting: -

1) Financial transactions are recorded automatic.
2) The unit of measurement is not assumed to be static
3) Realisation principles are not followed rigidly.

9. Advantages of inflation accounting: -

1) In this system depreciation is charged on current value of asset.
2) It shows real profit.
3) Balance sheet shows true and fare view of the state of affairs of the company because they are shown at their current value.

4) In this system sales and purchases shows current price because matching principle is followed.
5) It helps to replace fixed assets.
6) Under this system, financial statements show real profit.
7) Employees are eligible to receive bonus.

Limitation of Inflation Accounting: -

1. It is not free from prejudices.
2. In this system depreciation is charged at current value. It is against the concept of depreciation.
3. This system show profit are not realistic
4. It is irrational to add together various asset purchased at different points of time at their purchase costs.
5. It creates problem at the time of Replacement of Assets.
6. Charging depreciation on replacement cost will not be accepted by Income Tax authorities.
7. It is not easily understood by general public
8. It is not easy to determine replacement cost.

10. Methods of inflation Accounting.

1) Current purchasing power method (CPP)
2) Current cost Accounting method (CCA)
3) Hybrid method.

i) Current purchasing power method (CPP)

Under this method, all the items in the financial statements are restated at current purchasing power. It takes into account changes in general purchasing power of money. It is also known as General Price Level approach.

Advantages of CPP method: -

1) This system by taking into account the price changes adopts the same unit of measurement.
2) The system facilitates the calculation of gain or loss in purchasing power.
3) CPP statements are prepared on supplementary basis.
4) Monetary loss organs is determined.

Demerits of CPP method:

1) Selection of suitable Index is very difficult work.
2) It is based on Index numbers which are statistical averages.
3) It deals with changes in general price level and not with changes in prices of individual prices which happens to move in step with general price index.

ii) Current cost Accounting method (CCA)

Under CCA method items in P&L a/c and Balance sheet are shown at their current cost. The assets are valued at current cost Current cost is the cost at the which the assets can be replaced as on a date.

Merits of CCA:

1) It is a rational and comprehensive system of accounting.
2) It gives more information to the investors for comparision.
3) It is more realistic and practice.
4) Matching concept is followed.
5) The Balance sheet by showing assets at their value to the business is more information to investors.
6) Decision taken by management based on current cost statements are more meaningful.

Demerits of CCA:

1) This method ignores gains or losses on monetary items.
2) Income Tax authorities do not accept CCA method.
3) The system does not deal with the maintenance of financial capital in general purchasing power terms.
4) This method provides instability.

iii) Hybrid method

It is a mixture of both CPP and CCA method. In this method the adjustments of fixed assets and inventories are to be made with reference to specific indices in place of a general index as is the case under current purchasing power method.

HUMAN RESOURCE ACCOUNTING

Definition:-

Human Resource Accounting is a process of identifying and measuring data about human resources and communicating this information to interested parties – American Accounting society committee.

It means accounting for people as organisational resources. It is the measurement of the cost and value of people to organisation.

HRA involves measuring the costs incurred by business concern and other organisation to recruit select hire train and develop human assets.

HRA is a tool to measure the cost of human resources in the organisation – Eric.

12. Objectives of HRA

1) To utilise human resources properly.
2) To evaluate the return on investment of human resources.
3) To provide data take managerial decision.
4) To record cost – value date about human resources in the books of organisation.
5) To treat human resources as an economic asset.
6) To evaluate the return on investment on human capital.
7) To measure the costs incurred on human resources by firms.
8) To communicate the value of human resources to the organisation and the society at large.
9) To allow management personnel to monitor effectively the use of human resources.

13. Merits of Human Resource Accounting.

1) It helps management in taking appropriate decisions regarding the use of human assets in an organisation.

2) It helps to determine standard costs of recruitment, selection, training of people in an organisation.
3) HRA recognizes the importance of an individual and thereby contributes to the intellectual growth of employees.
4) To make efficient control over human resources.
5) HRA may help to improve the motivation and morale of employees.
6) HRA helps to make long term investment decision.
7) HRA helps to increase productivity of personnel.
8) HRA brings in awareness in the employees about their levels of efficiency and performance.
9) It provides information for planning the human resources.
10) It helps the management to take decision regarding transfer, promotion, training and retrenchment of human resource.

14. Disadvantages of HRA:

1) Human asset is different from other physical assets. The value of human resource asset will not decrease day by day but its value will be increased.

2) Human resource is not recognised as an asset by tax laws.

3) HRA is only theoretical concept.

4) HRA will not provide specific and correct guidelines to find out cost and value of human resources of an organisation.

5) The life of human resource is uncertain.

6) It is an expensive method and not suitable to small organisation.

7) The attitude of human resource cannot be predicted.

8) It is not appropriate method to adopt for promotion and training policies.

15. Valuation of Human Resource:

There are two methods used to evaluate the human resource.

I. On the basis of cost of the resource.

II. On the basis of value of the resource.

I. Valuation of Human resource on the basis of cost.

Following are the cost based method for valuing human resources.

1) **Historical cost method:**

Under this method the actual cost incurred on recruiting selecting training developing human resources are capitalised. The capitalised cost is written off over the expected useful life of the human resource.

2) **Replacement cost method:**

Under this method the human resources are valued at their replacement cost. This cost involves in recruiting hiring, training and developing the replacement to the present level of presidency.

3) **Opportunity cost: -**

Opportunity cost is the value of an asset when there is an alternative of it. Thus the human resources are valued on the basis of their alternative use. If an employee has no alternative then he has no value. The opportunity cost of an employee in one department is calculated on the basis of the offers by other departments for those employees.

4) **Standard cost Approach:-**

Under this method standard cost of recruiting hiring, training and developing per grade of employees are determined year after year.

5) **Total cost method :-**

Under this method the total expenditure incurred for education and training of an employee are considered as the value of an employee.

II. Valuation of Human Resource under value Accounting on the basis of value of Human Resource:

The value of human resource of an organisation is determined to their present value to the organisation.

1) **Present value of future earnings method:-**

Under this method present value of an employee is measured inorder to determine the total value of a firm's Labour force.

2) **Present value method:-**

Under this method the value of human resources of an organisation is determined according to their present value to the organisation.

3) **Reward valuation method:-**

Under this method the ultimate measure of an individual value to an organisation is his expected realisable value. The realisable value is estimated on the basis of present worth of set of future service he is expected to provide during the period of likely to remain with the organisation.

4) **Net Benefit Method: -**

Under this method the value of human resource its equivalent to the present value of net benefits derived by the organisation from the service of is employees.

5) **Aggregate payment method: -**

In this method human resources are to be valued as a group and not an individual basis.

6) **Certainty equivalent net benefit method :-**

Under this method, the value of human resources is determined by taking into consideration the certainty with which net benefits in future will accrue to the enterprises.

SOCIAL RESPONSIBILITY ACCOUNTING

Definition of SRA

Modification and application of conventional accounting to the analyse and solution of problem of a social nature seedier.

Meaning:

Social responsibility accounting is concerned with the measurement and disclosure of costs and benefits to the society as a result of operating activities of a business enter prise for communicating to various groups both within and out side the business.

Objectives of SRA:

1) SCA aims at identifying and measuring the Reriodic net social contribution of a firm.
2) It helps in determining whether the firms strategies and policies are consistent with the legitimate individual aspirations and also with the overall priorities of the community and the society.
3) It is useful to make available information of a firm to all segments of the society.

17. Forms of Accounting:

1) **Social statement Approach:-**

   Under this approach two statements namely social income statement and social balance sheet are prepared.

2) **Operating statement Approach**:-

   Under this approach, firms present the positive aspects of social activities as a result of operation.

3) **Narrative approach** :-

   Under this approach the information regarding social costs and social benefits is made in a narrative form.

4) **Goal oriented approach :-**

   Under this approach the firm prepares a list of its social and economic goals.

5) **Pictorial Approach :-**

   In this approach social activities undertaken by enterprise are presented in the form of pictures

Questions

1. What is double accounts system?
2. What are the advantages of double accounts system?
3. What are the disadvantages of double accounts system
4. Distinguish between double entry system and double account system
5. Distinguish between double account system and single account system
6. What is Inflation Accounting?
7. What is current cost accounting?
8. What is current purchasing power accounting?
9. Describe the different methods of inflation Accounting
10. Explain Human Resource Accounting.
11. What do you mean by Human Resource Accounting? State its objectives
12. Discuss the merits and Demerits of HRA
13. Discuss different method of evaluating of human resources under cost method.
14. Explain the different methods suggested for valuing human resource under value method.
15. What is SRA? State is objectives.