Corporate Accounting-II

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UNIT I

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Amalgamation- Meaning- Purchase Consideration - Lump sum Method, Net Assets Method, Net Payment Method, Intrinsic Value Method- Methods of Accounting for Amalgamation- The Purchase Method (Excluding Inter-Company Holdings)

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Amalgamation and Reconstruction

Amalgamation – Meaning

Amalgamation refers to the process of combining two or more companies into a single entity, either by forming a new company or by merging into an existing one. This corporate restructuring strategy is undertaken to achieve various business objectives such as expansion, synergy, financial stability, and cost efficiency. The process involves transferring all assets, liabilities, and business operations of the merging companies to the newly formed or surviving entity.

Amalgamation is primarily classified into two types. The first type is a **merger**, where two or more companies join together to form a completely new entity, and the original companies cease to exist. This helps in pooling resources, reducing operational costs, and enhancing overall business performance. The second type is **absorption**, where a financially or operationally stronger company takes over another company, and the acquired company loses its independent identity. This method is commonly used to eliminate competition, increase market share, and improve efficiency.

The process of amalgamation is governed by corporate laws and financial regulations to ensure transparency, fair valuation of assets, and protection of the interests of shareholders, creditors, and employees. Accounting standards and legal procedures play a crucial role in ensuring a smooth transition, minimizing risks, and achieving the intended benefits of the merger.

Purchase Consideration

Purchase Consideration refers to the amount paid by the purchasing company to the selling company in exchange for acquiring its business, including its assets and liabilities. It represents the total value agreed upon between the merging entities during an amalgamation, absorption, or acquisition process. The calculation and settlement of purchase consideration are crucial in corporate accounting, as they impact financial statements, goodwill, and the overall restructuring process.

The purchase consideration is determined based on various factors, such as the fair value of assets and liabilities, market conditions, future earnings potential, and negotiated terms between the companies involved. It is typically settled in different forms, including cash, shares, debentures, or a combination of these.

Methods of Calculating Purchase Consideration

There are four primary methods used to determine the purchase consideration:

Net Asset Method

Under this method, purchase consideration is calculated based on the net value of the assets acquired, after deducting the liabilities taken over.

Formula:

Purchase Consideration =Total Assets Taken Over−Total Liabilities Taken Over

Purchase Consideration=Total Assets Taken Over −Total Liabilities Taken Over

Net Payment Method

This method considers the actual amount paid by the purchasing company to the shareholders of the selling company, either in cash or through shares or debentures.

Formula:

Purchase Consideration = Total Payment Made to Shareholders

Purchase Consideration=Total Payment Made to Shareholders

Intrinsic Value or Share Exchange Method

When shares of the purchasing company are issued as consideration, the value is based on the intrinsic value of shares, considering the ratio in which new shares are allotted to the shareholders of the selling company.

Lump Sum Method

In this method, a fixed lump sum amount is agreed upon between the two companies as purchase consideration, without considering individual asset and liability values separately.

Accounting Treatment of Purchase Consideration

The purchase consideration is recorded in the books of accounts using the following journal entries:

On recording purchase consideration payable:

Business Purchase A/c Dr.

To Liquidator of Vendor Company A/c

Business Purchase A/c Dr.

To Liquidator of Vendor Company A/c

On payment of purchase consideration:

Liquidator of Vendor Company A/c Dr.

To Cash/Bank A/c (if paid in cash)

To Share Capital A/c (if shares are issued)

To Debenture A/c (if debentures are issued)

Liquidator of Vendor Company A/cDr.

To Cash/Bank A/c (if paid in cash)

To Share Capital A/c (if shares are issued)

To Debenture A/c (if debentures are issued)

Understanding purchase consideration is essential in corporate accounting, as it determines the financial impact of mergers and acquisitions on the companies involved. It plays a significant role in deciding goodwill or capital reserves, which influence the overall financial health and business valuation.

Lump sum Method

The Lump Sum Method is one of the simplest ways to determine purchase consideration in corporate accounting. Under this method, the purchasing company and the selling company agree on a fixed amount as the purchase consideration, without separately calculating the values of individual assets and liabilities. This agreed amount is paid to the selling company's shareholders as compensation for acquiring the business.

Features of the Lump Sum Method

The **Lump Sum Method** is a straightforward approach to determining purchase consideration in corporate acquisitions, where a fixed amount is agreed upon between the acquiring and selling companies. This method eliminates the need to separately calculate the value of individual assets and liabilities, making the transaction process simpler and faster. Unlike other methods that require detailed asset valuation, the lump sum method is primarily based on mutual agreement between the companies involved.

One of the key features of this method is that the **purchase consideration remains fixed** irrespective of the individual values of assets and liabilities. Instead of assessing each asset separately, the acquiring company pays a pre-negotiated amount to take over the business. This simplifies the calculation process and ensures a quicker settlement of the acquisition deal.

Another important feature is that **negotiation plays a crucial role** in determining the final amount. The lump sum value is decided based on various factors such as the financial health of the company being acquired, its goodwill, market potential, profitability, and future earnings prospects. Since there is no mandatory requirement to determine the net worth of assets and liabilities, the lump sum amount might be influenced by subjective factors, making due diligence an essential step before finalizing the deal.

The **ease and efficiency** of the lump sum method make it highly preferred in cases where companies want to complete acquisitions swiftly. Since no complex valuation process is required, businesses can avoid unnecessary delays and administrative burdens. However, this speed and simplicity also introduce a potential **risk factor**—there is a possibility that the agreed lump sum may not accurately reflect the true financial position of the acquired business. If the purchase price is set too high, the acquiring company may suffer losses, whereas if it is set too low, the shareholders of the selling company may not receive fair compensation.

In terms of **payment structure**, the purchase consideration in the lump sum method can be settled in various ways, including cash, shares, debentures, or a combination of these. However, it is always paid as a single consolidated amount, which provides clarity to both parties involved. Despite the simplicity of the method, the transaction must still comply with **legal and accounting regulations**, ensuring that the acquisition follows corporate laws, tax guidelines, and financial reporting standards.

Overall, the lump sum method provides a **quick and practical solution** for corporate acquisitions. While it offers simplicity and efficiency, companies must exercise caution in negotiation and valuation to avoid financial misjudgements. Proper legal and financial due diligence is essential to ensure that the lump sum consideration fairly represents the actual worth of the acquired business.

Example of Lump Sum Method Calculation

Suppose Company A acquires Company B for an agreed lump sum of Rs.50,00,000. The actual values of Company B's assets and liabilities are not considered in determining this amount. The entire business is transferred for this fixed sum.

Journal Entries for Lump Sum Purchase Consideration

Recording the Business Purchase:

Business Purchase A/cDr.Rs.50,00,000

To Liquidator of Vendor Company A/cRs.50,00,000

Business Purchase A/cDr.Rs.50,00,000

To Liquidator of Vendor Company A/cRs.50,00,000

Payment of Purchase Consideration (if paid in cash):

Liquidator of Vendor Company A/cDr.Rs.50,00,000

To Cash/Bank A/cRs.50,00,000

Liquidator of Vendor Company A/cDr.Rs.50,00,000

To Cash/Bank A/cRs.50,00,000

Payment of Purchase Consideration (if paid in shares or debentures):

Liquidator of Vendor Company A/cDr.Rs.50,00,000

To Equity Share Capital A/cRs.30,00,000

To Debenture A/cRs.20,00,000

Liquidator of Vendor Company A/c Dr.Rs.50,00,000

To Equity Share Capital A/cRs.30,00,000

To Debenture A/cRs.20,00,000

Advantages of Lump Sum Method:

The **Lump Sum Method** is widely used in corporate acquisitions due to its simplicity, efficiency, and ease of execution. It offers several advantages, making it a preferred choice in many business transactions. Below are the key benefits of this method:

1. **Simplicity in Calculation**
   - The biggest advantage of the lump sum method is its straightforward nature. Since the purchase consideration is agreed upon as a fixed amount, there is no need for detailed calculations

involving individual assets and liabilities. This reduces the complexity of determining the acquisition cost.

2. **Time-Saving and Quick Execution**
   - Unlike other methods that require extensive valuation and assessment of assets and liabilities, the lump sum method speeds up the acquisition process. This is particularly beneficial when companies need to complete mergers or takeovers quickly to capitalize on business opportunities.
3. **Reduces Administrative Burden**
   - The absence of asset-by-asset valuation minimizes paperwork and reduces the administrative workload involved in corporate restructuring. This leads to a more efficient and less resource-intensive acquisition process.
4. **Predictable Financial Commitment**
   - The acquiring company knows the exact amount it has to pay in advance, helping in better financial planning and budgeting. Since there are no fluctuating costs based on asset revaluation, companies can manage their financial resources effectively.
5. **Eliminates Complex Asset Valuation**
   - In many cases, assessing the market value of assets and liabilities can be challenging, especially for intangible assets like goodwill and brand reputation. The lump sum method removes the need for such complex evaluations, making the acquisition process more straightforward.
6. **Flexibility in Payment Modes**
   - The purchase consideration can be settled through cash, shares, debentures, or a combination of these. This flexibility allows the acquiring company to structure the payment in a way that best suits its financial position.

7. **Enhances Negotiation Opportunities**
    - Since the final amount is based on mutual agreement, both parties have the opportunity to negotiate favourable terms. This can be beneficial in cases where the seller wants to maximize value and the buyer wants to minimize costs.
8. **Facilitates Strategic Business Expansion**
    - Companies looking to expand their market presence can use the lump sum method for quick acquisitions without getting entangled in prolonged valuation processes. This allows businesses to focus on growth strategies rather than administrative complexities.
9. **Avoids Market Fluctuations**
    - In cases where market conditions are volatile, valuing individual assets can lead to inconsistencies in pricing. The lump sum method ensures that both parties are protected from sudden market fluctuations, as the price is pre-agreed.
10. **Legal and Regulatory Clarity**

- Since the purchase consideration is a fixed amount, legal documentation and compliance requirements become more straightforward. This helps in reducing disputes related to asset valuation and ensures a smoother legal process.

Disadvantages of Lump Sum Method:

While the **Lump Sum Method** offers simplicity and efficiency in corporate acquisitions, it also has certain limitations. The fixed purchase consideration, although convenient, can lead to financial miscalculations and risks if not carefully assessed. Below are the key disadvantages of this method:

1. **Risk of Overpayment or Underpayment**
   - Since the purchase consideration is agreed upon as a lump sum without valuing individual assets and liabilities, there is a possibility that the acquiring company may **overpay** for the business, leading to financial losses. Conversely, if the agreed amount is too low, the selling company's shareholders may not receive fair compensation.
2. **Lack of Transparency**
   - The absence of a detailed breakdown of assets and liabilities makes it difficult to assess whether the agreed purchase price is justified. This lack of transparency can lead to disputes between the buyer and seller, especially if hidden liabilities or undervalued assets are discovered after the transaction.
3. **No Consideration for Actual Market Value**
   - The lump sum amount is often based on negotiation rather than the actual **fair market value** of assets and liabilities. This can lead to inaccurate financial reporting and potential tax implications for both companies involved.
4. **Difficulty in Identifying Goodwill or Capital Reserve**
   - In corporate accounting, the difference between the purchase consideration and the net asset value determines whether goodwill or a capital reserve arises. Since the lump sum method does not separately value assets, it becomes difficult to properly account for **goodwill** (if overpayment occurs) or **capital reserve** (if the business is acquired at a discount).
5. **Potential for Hidden Liabilities**
   - The acquiring company may unknowingly take over **undisclosed liabilities** such as legal claims, pending tax payments, or bad debts. Without a detailed evaluation of liabilities, these hidden risks can negatively impact the financial health of the acquiring company.

6. **Challenges in Post-Acquisition Integration**
   - Since individual assets and liabilities are not assessed separately, the acquiring company may face challenges in **integrating** the new business into its operations. For example, some assets may be outdated or unusable, and certain liabilities may require immediate settlement.
7. **Difficulties in Future Financial Planning**
   - Without an accurate valuation of assets, it becomes harder for the acquiring company to determine the **true worth** of the acquired business. This can lead to challenges in future investment decisions, expansion plans, or restructuring efforts.
8. **Limited Scope for Tax Benefits**

When purchase consideration is determined through asset-based valuation, companies can sometimes claim **tax benefits** on depreciation, amortization, or asset revaluation. However, since the lump sum method does not account for individual assets, potential tax savings may be lost.

9. **Dependence on Negotiation Skills**

The final purchase price is heavily influenced by negotiation rather than an objective financial analysis. If one party is more skilled in negotiation, it may gain an unfair advantage, leading to **imbalanced deals** that could harm the weaker party.

10. **Legal and Regulatory Challenges**

In some cases, regulatory authorities may require companies to disclose a **detailed valuation** of assets and liabilities before approving the transaction. The lump sum method may not comply with certain legal or accounting standards, leading to complications in obtaining necessary approvals.

Illustration 1: Basic Lump Sum Purchase Consideration

Question:

Company **A Ltd.** acquires the business of **B Ltd.** for a lump sum price of **Rs.10,00,000**. The agreed amount includes all assets and liabilities of B Ltd. Pass the necessary journal entries in the books of A Ltd. if the payment is made in cash.

Solution:

Journal Entries in the Books of A Ltd.:

Date	**Particulars**	Dr.	Cr.
-	Business Purchase A/c	10,00,000	-
-	To Liquidator of B Ltd. A/c (Being purchase consideration agreed as per Lump Sum Method)	-	10,00,000
-	Liquidator of B Ltd. A/c	10,00,000	-
-	To Bank A/c (Being purchase consideration paid in cash)	-	10,00,000

Capital Reserve Calculation

Question:

Company **R Ltd.** acquires the business of **S Ltd.** for a lump sum price of **Rs.7,00,000**. The net assets taken over are valued at **Rs.8,50,000**. Calculate capital reserve and pass the necessary entry.

Solution:

Capital Reserve=Net Assets−Purchase Consideration

=8,50,000−7,00,000=1,50,000= 8,50,000 - 7,00,000 = 1,50,000=8,50,000−7,00,000=1,50,000

Journal Entry to Record Capital Reserve:

Date	**Particulars**	Dr.	Cr.
-	Business Purchase A/c	7,00,000	-
-	Capital Reserve A/c	1,50,000	-
-	To Liquidator of B Ltd. A/c	-	7,00,000
-	To Net Assets A/c (Being capital reserve recorded due to lower purchase price)	-	8,50,000

Net Assets Method

The Net Assets Method is a commonly used approach for determining the purchase consideration when one company acquires another. In this method, the value of the acquired company's assets and liabilities is assessed, and the net assets are used as the basis for deciding the purchase price.

Formula for Purchase Consideration

Purchase Consideration=Total Assets Taken Over−Total Liabilities Assumed

Purchase Consideration=Total Assets Taken Over−Total Liabilities Assumed

Alternatively,

Net Assets=Fair Value of Assets−Fair Value of Liabilities

Net Assets=Fair Value of Assets−Fair Value of Liabilities

Here, assets and liabilities are considered at their fair market value rather than their book value.

Features of the Net Assets Method

The Net Assets Method is a widely used approach for determining the purchase consideration in business acquisitions. It is based on the valuation of all identifiable assets and liabilities of the acquired company at their fair market value. This method ensures a transparent, structured, and logical approach to business valuation. The following are the key features of the Net Assets Method:

1. Valuation Based on Fair Market Value

One of the most important features of the Net Assets Method is that it considers the fair market value of assets and liabilities rather than their historical book value. This provides a more accurate and updated valuation, reflecting the current economic conditions and realizable worth of the company's resources. It ensures that the acquiring company pays a justifiable price for the business being acquired.

2. Consideration of Both Tangible and Intangible Assets

The Net Assets Method includes all tangible and intangible assets of the company. Tangible assets such as land, buildings, machinery, cash, inventory, and receivables are valued at their market price. However, intangible assets like goodwill, patents, trademarks, and brand reputation may be harder to quantify but are still considered in some cases if they hold significant value. This comprehensive valuation provides a clearer picture of the company's actual worth.

3. Deduction of Liabilities from Total Assets

A key feature of this method is the deduction of liabilities from the total asset value to determine the net worth of the business. Liabilities may include outstanding loans, creditors, trade payables, and any other financial obligations. This ensures that the acquiring company does not overlook financial burdens that might affect its financial position after the acquisition.

4. Ensures a Transparent and Justified Valuation

Since the method follows a structured approach by separately identifying assets and liabilities, it ensures a fair and transparent valuation. This is particularly beneficial in corporate takeovers, where both parties—the seller and the buyer—need an objective and mutually agreeable valuation of the business.

5. Calculation of Goodwill or Capital Reserve

The Net Assets Method helps determine whether the acquiring company needs to account for goodwill or a capital reserve after the acquisition.

Goodwill: If the purchase price paid is higher than the net assets, the difference is recorded as goodwill. This represents factors such as brand reputation, loyal customers, and intellectual property that contribute to the business's higher valuation.

Capital Reserve: If the purchase price is lower than the net assets, the excess amount is recorded as a capital reserve. This indicates that the acquiring company purchased the business at a discount.

6. Suitable for Mergers, Acquisitions, and Liquidations

The Net Assets Method is extensively used in corporate mergers, acquisitions, and business takeovers, where a fair valuation is required before finalizing the deal. It is also useful in company liquidations, where assets are sold, and liabilities are settled to determine the remaining net worth. In liquidation cases, the net assets represent the amount that shareholders or creditors will receive.

7. Risk of Market Fluctuations and Valuation Challenges

Since the method relies on fair market valuation, any fluctuations in market prices can impact the business's overall valuation. The value of assets like real estate and inventory may change based on economic conditions, inflation, and industry demand. Additionally, the valuation of intangible assets like goodwill and patents may be subjective, making the process complex and requiring expert judgment.

8. Requires Professional Assessment and Due Diligence

The accuracy of the Net Assets Method depends on proper financial assessment, auditing, and due diligence. Certified valuers, accountants, and financial analysts are often required to ensure that assets and liabilities are valued correctly. This prevents understatement or overstatement of net assets, which could mislead stakeholders and affect the financial stability of the acquiring company.

9. A Systematic Approach for Business Valuation

Unlike the Lump Sum Method, where a fixed amount is agreed upon without detailed valuation, the Net Assets Method follows a systematic and logical approach. It ensures that every asset and liability is accounted for separately, allowing companies to compare, negotiate, and analyze before making a final purchase decision. This makes the method more reliable for business acquisitions, especially when multiple valuation techniques are considered.

Illustration of the Net Assets Method

Question:

Company A Ltd. acquires B Ltd. using the Net Assets Method. The details of B Ltd.'s assets and liabilities are:

Machinery – Rs.5,00,000

Building – Rs.8,00,000

Debtors – Rs.3,00,000

Cash & Bank Balance – Rs.2,00,000

Creditors – Rs.4,00,000

Loan Payable – Rs.2,50,000

Calculate the purchase consideration using the Net Assets Method.

Solution:

Total Assets =5,00,000+8,00,000+3,00,000+2,00,000=18,00,000

Total Assets=5,00,000+8,00,000+3,00,000+2,00,000=18,00,000

Total Liabilities=4,00,000+2,50,000=6,50,000

Total Liabilities=4,00,000+2,50,000=6,50,000

Net Assets=18,00,000−6,50,000=11,50,000

Net Assets=18,00,000−6,50,000=11,50,000

Thus, the purchase consideration = Rs.11,50,000.

Journal Entry in the Books of A Ltd.:

Date	Particulars	Dr.(Rs.)	Cr. (Rs.)
---	Business Purchase A/c Dr.	11,50,000	---
---	To Liquidator of B Ltd. A/c	---	11,50,000
---	(Being purchase consideration agreed)		
---	Liquidator of B Ltd. A/c Dr.	11,50,000	---

---	To Bank A/c (If paid in cash)	---	11,50,000
---	(Being purchase consideration paid)		

Advantages of the Net Assets Method

The Net Assets Method is widely used for business valuation, particularly in mergers, acquisitions, and company liquidations. It provides a structured and transparent approach to determining the worth of a business based on its assets and liabilities. Below are the key advantages of this method:

1. Provides a Fair and Accurate Business Valuation

One of the biggest advantages of the Net Assets Method is that it ensures a fair and justifiable valuation of the business. By considering all assets and liabilities at their fair market value, this method provides a realistic estimate of the company's worth. It eliminates any overstatement or understatement of value that might occur due to historical cost accounting.

2. Minimizes the Risk of Overpayment

Since the valuation is based on actual assets and liabilities, it helps the acquiring company avoid overpaying for the business. By deducting liabilities from total assets, this method ensures that the buyer pays only for the net worth of the company. This prevents scenarios where a business is purchased at an inflated price without a proper assessment of its financial position.

3. Transparent and Systematic Approach

The Net Assets Method follows a structured and transparent approach to business valuation. Every asset and liability is identified, valued, and recorded separately, making the valuation process easy to analyze, verify, and compare. This transparency builds trust between the acquiring and selling companies and makes negotiations more effective.

4. Suitable for Liquidation and Business Takeovers

This method is particularly useful in company liquidations and business takeovers. In case of liquidation, it helps determine the actual amount available to creditors and shareholders after settling all liabilities. In business acquisitions, it provides a clear picture of the company's net worth, which helps in making informed investment decisions.

5. Easy to Compare with Other Valuation Methods

The Net Assets Method allows for easy comparison with other business valuation techniques such as the Lump Sum Method, Earnings Capitalization Method, or Discounted Cash Flow Method. Since it provides a tangible and objective estimate of net assets, companies can use it as a benchmark to cross-check valuations obtained through different methods.

6. Helps Identify Goodwill or Capital Reserve

By comparing the purchase price with the net assets, the Net Assets Method helps in determining:

Goodwill – If the purchase price is higher than the net assets, the excess amount is treated as goodwill, representing intangible factors like brand reputation, customer loyalty, and intellectual property.

Capital Reserve – If the purchase price is lower than the net assets, the difference is recorded as a capital reserve, indicating that the business was acquired at a discount.

This classification is essential for financial reporting and helps businesses understand the intangible value associated with a company.

7. Simple to Apply for Companies with Tangible Assets

For companies with significant tangible assets such as land, buildings, machinery, and inventory, the Net Assets Method is relatively easy to apply. Unlike methods that rely on future earnings or cash flow projections, this method focuses on current values, making it straightforward and less dependent on financial forecasting.

8. Useful for Stakeholders and Investors

Investors, creditors, and other stakeholders find this method beneficial as it provides a clear financial snapshot of a company. The calculation of net assets helps investors assess whether a company has sufficient financial strength, while creditors can evaluate whether the company has enough assets to cover its liabilities.

9. Reduces Subjectivity in Business Valuation

Unlike methods that rely on future earnings projections or subjective assumptions, the Net Assets Method is based on actual financial figures. Since it primarily depends on tangible assets and liabilities, the scope for bias and estimation errors is lower. This makes it a more objective and reliable valuation technique.

10. Helps in Corporate Decision-Making

The Net Assets Method assists companies in making informed decisions regarding mergers, acquisitions, and financial restructuring. By providing a clear assessment of assets, liabilities, and net worth, it helps management determine whether a business deal is financially viable.

Disadvantages of the Net Assets Method

While the **Net Assets Method** is a widely used approach for business valuation, it has several limitations. These disadvantages arise due to challenges in asset valuation, exclusion of intangible factors, and the influence of market fluctuations. Below are the key drawbacks of the method:

1. Difficulty in Valuing Intangible Assets

One of the biggest limitations of the Net Assets Method is that it primarily focuses on **tangible assets**, such as land, buildings, machinery, and inventory. However, many modern businesses derive significant value from **intangible assets**, such as:

- Brand reputation
- Customer goodwill
- Patents and trademarks
- Employee expertise and business relationships

Since these intangibles are difficult to quantify, the Net Assets Method may **undervalue** a company, leading to an **unfairly low purchase consideration** in mergers or acquisitions.

2. Market Fluctuations Affect Asset Valuation

The method relies on the **fair market value** of assets and liabilities, which can fluctuate based on **economic conditions, demand-supply factors, and industry trends**. For example:

- The value of **real estate** may increase or decrease over time.
- The price of **machinery and equipment** depreciates due to technological advancements.
- The worth of **inventory** may decline due to obsolescence or market competition.

Since these fluctuations impact the net assets, the valuation may not always reflect the **true financial stability** of a business.

3. Ignores Future Earning Potential

The Net Assets Method focuses only on the **current value** of assets and liabilities, without considering the company's **future profitability or earning capacity**. This is a major drawback, especially for businesses that:

- Have strong growth potential
- Generate high recurring revenues
- Operate in industries with long-term profitability

For example, a tech company with **minimal physical assets but high future earnings** may appear undervalued under this method, even though its actual worth is much higher.

4. Time-Consuming and Complex Process

Applying the Net Assets Method requires:

- **Detailed assessment** of all assets and liabilities
- **Revaluation** of assets at their fair market price
- **Expert valuation** for properties, equipment, and intangible factors

This process can be **time-consuming, costly, and complex**, particularly for businesses with diverse asset portfolios. Companies often need to hire **professional valuers and auditors**, which increases the **cost of valuation**.

5. Subjectivity in Fair Value Determination

Although the Net Assets Method aims to be objective, determining the **fair market value** of assets often involves **subjective judgment**. Factors such as:

- The **method of valuation** (cost approach, market comparison, income approach)
- The **assumptions used** in estimating future resale value
- The **adjustments made** for depreciation or obsolescence

can vary among valuers, leading to **inconsistencies in valuation results**. Different professionals may assign different values to the same asset, creating **discrepancies in purchase consideration**.

6. Not Suitable for Service-Based Businesses

The Net Assets Method is more appropriate for businesses with **high tangible assets**, such as manufacturing or real estate companies. However, it is **not effective** for service-based industries like:

- **Consulting firms** (which rely on human capital)
- **Technology start-ups** (where intellectual property and software hold more value than physical assets)
- **Media companies** (which generate revenue from advertising, content, and digital platforms)

For these businesses, a valuation method based on **earnings potential or market value** (e.g., the Earnings Capitalization Method) may be more appropriate.

7. Can Lead to Undervaluation of Profitable Companies

Since the method focuses solely on the **book value of assets**, highly profitable companies with minimal physical assets may be **undervalued**. For example:

- A software company generating **high annual profits** may have limited physical assets, making it appear less valuable than it actually is.

- A retail chain with **prime store locations** and strong brand recognition may be worth more than what the Net Assets Method suggests.

Thus, this method is **not ideal for businesses where profitability is a better indicator of value** than asset ownership.

8. Does Not Account for Liabilities Beyond the Balance Sheet

The method considers **recorded liabilities**, but it may overlook certain **hidden obligations**, such as:

- **Pending legal claims** or lawsuits
- **Future tax liabilities**
- **Contingent liabilities** (such as guarantees or warranties)

If these liabilities are **not properly accounted for**, the net assets figure may be **overstated**, leading to an incorrect valuation.

9. May Not Reflect Real Business Performance

A business with **high net assets** may still be struggling financially due to poor management, low customer demand, or inefficient operations. The Net Assets Method does not analyze:

- **Operational efficiency**
- **Market competition**
- **Management capability**

As a result, a company with strong assets but weak profitability may appear **overvalued**, while a company with high earnings but fewer assets may appear **undervalued**.

10. Not Ideal for Mergers and Acquisitions in Dynamic Industries

For businesses operating in **fast-changing industries**, such as technology, e-commerce, or pharmaceuticals, the Net Assets Method may not provide an **accurate picture** of the company's true worth. These industries rely heavily on:

- Innovation
- Research and development
- Brand value
- Customer base

Since these factors are not fully captured in net assets, this method may lead to **mispricing of business acquisitions**.

Net Payment Method

The **Net Payment Method** is a widely used approach for determining purchase consideration in cases of **amalgamation, mergers, and acquisitions**. Under this method, the total payment made by the purchasing company to the shareholders of the vendor (selling) company is considered, instead of directly valuing the net assets. The payment can be made in **cash, shares, or other financial instruments**.

This method focuses on the **total amount payable** rather than the book value of assets and liabilities. It helps in cases where the acquiring company offers compensation in various forms, including **equity shares, preference shares, bonds, or debentures**, making it an essential valuation method in corporate restructuring.

Features of the Net Payment Method

The **Net Payment Method** is a straightforward approach used to determine the **purchase consideration** in mergers and acquisitions. It calculates the total compensation paid by the purchasing company to the shareholders of the selling company. This method does not consider the individual valuation of assets and liabilities but instead focuses on the actual payment made in various forms, such as **cash, shares, debentures, or bonds**.

Below are the key features of the Net Payment Method:

1. Focus on Total Payment to Shareholders

The method calculates purchase consideration based on the **total amount paid** by the acquiring company to the shareholders of the vendor company. This includes **cash payments, equity shares, preference shares, or other financial instruments**.

2. No Direct Valuation of Assets and Liabilities

Unlike the **Net Assets Method**, which requires the valuation of assets and liabilities separately, the Net Payment Method does **not consider individual asset values**. Instead, it determines the total amount transferred to the shareholders as compensation.

3. Multiple Forms of Payment Considered

The Net Payment Method recognizes various payment methods, including:

- **Cash payments**
- **Equity shares issued**
- **Preference shares issued**
- **Debentures or bonds issued**

These different forms of payment are added together to arrive at the **final purchase consideration**.

4. More Practical for Mergers and Acquisitions

This method is commonly used in **corporate mergers, takeovers, and acquisitions**, where companies compensate shareholders of the selling company with a mix of **cash and securities** instead of direct asset transfers.

5. Suitable for Share-Based Transactions

When a company is acquired using **equity shares or preference shares**, the Net Payment Method is the **most effective** approach to determine the purchase consideration. It calculates the total market value of issued shares and other payments made.

6. Avoids Complex Asset Valuation

Since this method does not require a detailed assessment of assets and liabilities, it is **simpler and quicker** than the Net Assets Method. It eliminates **valuation discrepancies** that may arise due to subjective assessments of asset worth.

7. Market Value of Shares Affects Consideration

If the payment includes **equity shares**, the total purchase consideration depends on the **market price** of those shares. Any fluctuations in share value can **increase or decrease** the final consideration amount.

8. Commonly Used in Corporate Restructuring

The Net Payment Method is widely applied in corporate restructuring, including:

- **Mergers and acquisitions**
- **Demerger transactions**
- **Takeovers**
- **Shareholder compensation arrangements**

It ensures that shareholders receive compensation in line with the agreed-upon transaction structure.

9. Simplicity in Calculation

The formula for purchase consideration under this method is:

Purchase Consideration=Total Cash Paid+Value of Equity Shares Issued+Value of Preference Shares Issued+Value of Debentures Issued.

This straightforward approach makes it easier to determine the amount paid to shareholders.

10. Not Always Reflective of Business Value

Since this method only considers **the payment made to shareholders**, it does not necessarily reflect the **true value** of the acquired business. The actual worth of the company may be higher or lower than the amount paid, depending on factors like goodwill, market conditions, and profitability.

Formula for Purchase Consideration (Net Payment Method)

Purchase Consideration=Total Cash Paid+Value of Equity Shares Issued+Value of Preference Shares Issued+Value of Debentures Issued

Where:

- **Total Cash Paid** refers to any direct cash payment to the shareholders.
- **Value of Equity Shares Issued** is calculated based on the number of shares given and their agreed price.
- **Value of Preference Shares Issued** includes the consideration paid through preference shares.
- **Value of Debentures Issued** accounts for any bonds or debt instruments issued as payment.

Advantages of the Net Payment Method

The **Net Payment Method** is a widely used approach for calculating **purchase consideration** in corporate mergers, acquisitions, and amalgamations. This method determines the total amount payable to the shareholders of the selling company, including payments in **cash, shares, preference shares, debentures, or bonds**.

Below are the key advantages of the Net Payment Method:

1. Simple and Easy to Calculate

The Net Payment Method is **straightforward** as it focuses only on the total payment made to shareholders. Since it does not require a **detailed valuation of assets and liabilities**, it is easier and quicker to compute compared to other valuation methods.

2. Avoids Complex Asset Valuation

Unlike the **Net Assets Method**, which requires the **valuation of each asset and liability**, the Net Payment Method eliminates the need for complex assessments. This reduces **valuation discrepancies** and subjectivity in asset pricing.

3. More Practical for Mergers and Acquisitions

In real-world **mergers and takeovers**, companies rarely purchase only the assets of a business. Instead, they compensate shareholders in **cash or shares**. This method aligns well with actual corporate transactions, making it **practical and widely accepted**.

4. Suitable for Share-Based Transactions

When an acquiring company issues **equity shares or preference shares** as payment, the Net Payment Method provides a **clear way** to determine the value of the purchase consideration. This makes it particularly useful in cases where shareholders receive compensation in the form of stocks rather than cash.

5. Reduces Subjectivity in Valuation

Since the method directly calculates the amount **paid to shareholders**, it eliminates the need for **subjective judgments** related to asset valuation, depreciation, or goodwill assessment. This results in a **more objective** evaluation process.

6. Flexible and Applicable to Various Forms of Payment

This method considers **multiple types of compensation**, including:

- **Cash payments**
- **Equity shares issued**
- **Preference shares issued**
- **Debentures or bonds issued**

This flexibility makes it suitable for **various corporate restructuring scenarios**, allowing companies to structure deals in the most efficient manner.

7. Reflects Actual Transaction Value

Since the Net Payment Method determines purchase consideration based on **the real amount paid** to the shareholders, it reflects the **actual value of the transaction** rather than an estimated or book value. This ensures that the valuation is based on the **agreed-upon deal structure**.

8. Suitable for Large-Scale Acquisitions

In cases of **large-scale acquisitions**, where companies buy controlling stakes rather than individual assets, this method is **more appropriate**. It provides a clear and **fair assessment** of what the shareholders receive in exchange for their stake.

9. Reduces Time and Cost of Valuation

The Net Payment Method is **less time-consuming** compared to asset-based valuation approaches. Since it does not require detailed asset revaluation, it **lowers valuation costs**, making it a preferred choice in corporate takeovers and amalgamations.

10. Helps in Fair Compensation to Shareholders

By considering the **total payment made**, this method ensures that shareholders receive fair compensation based on the agreed deal structure. It provides **clarity and transparency**, making it beneficial for **both acquiring and selling companies**.

Disadvantages of the Net Payment Method

The **Net Payment Method** is a widely used approach for determining purchase consideration in mergers, acquisitions, and corporate restructuring. While it simplifies calculations by focusing on **total payment made to shareholders**, it also has certain drawbacks that may affect the accuracy and fairness of the valuation.

Below are the key disadvantages of the Net Payment Method:

1. Ignores the Actual Value of Net Assets

The Net Payment Method does not consider the **individual valuation of assets and liabilities**. As a result, the purchase consideration may be **higher or lower** than the actual net worth of the company. This could lead to overpayment or underpayment in some cases.

2. Market Fluctuations Affect Share-Based Transactions

If the acquiring company issues **equity shares** as payment, the total purchase consideration depends on the **market price of those shares**. If the share price fluctuates after the agreement, the actual compensation received by shareholders may vary, leading to **potential valuation risks**.

3. May Not Reflect the True Worth of the Business

Since this method only considers **total payment to shareholders**, it may not reflect the **real economic value** of the business. If the acquired company has significant intangible assets like **brand value, goodwill, or intellectual property**, the method may **undervalue or overvalue** the transaction.

4. Not Suitable for Asset-Heavy Businesses

For companies with **high-value tangible assets**, such as real estate firms, manufacturing companies, or infrastructure businesses, the Net Payment Method may not be appropriate. The method ignores **asset valuation**, which could lead to an unfair transaction.

5. Does Not Consider Liabilities Separately

This method does not **explicitly account for the liabilities** of the selling company. If the acquiring company assumes a large portion of the liabilities, the **actual cost of acquisition** might be much higher than the calculated purchase consideration.

6. Uncertainty in Payment Structure

In cases where multiple forms of compensation are involved (e.g., **cash, shares, and debentures**), it may be difficult to determine the **actual benefit to shareholders**. This uncertainty can lead to **disputes or dissatisfaction** among shareholders.

7. Not Ideal for Companies with Strong Intangibles

Companies with high intangible assets, such as **technology firms, software companies, and brands with goodwill**, may not get a fair valuation under this method. Since intangibles are not directly considered, the method may **undervalue** such businesses.

8. May Lead to Overvaluation in Some Cases

If an acquiring company **overestimates** the share value or issues a large number of shares at an inflated price, the purchase consideration may be **higher than the actual value** of the acquired business. This can result in **overpayment** and financial strain on the acquiring company.

9. Limited Use in Some Mergers and Acquisitions

In certain business combinations, where the transaction involves **specific asset transfers or liability restructuring**, the Net Payment Method may not be the best choice. Instead, the **Net Assets Method** might be more suitable.

10. Difficult to Compare with Other Valuation Methods

Since the Net Payment Method is based on **total payment to shareholders**, it may not be directly comparable with other valuation approaches, such as **discounted cash flow (DCF), market value method, or book value method**. This makes it harder for investors and analysts to assess the fairness of the deal.

Illustration of the Net Payment Method

Example:

Company A is acquiring Company B. The shareholders of Company B are offered:

- **Cash Payment** of Rs.5,00,000
- **Equity Shares Issued**: 10,000 shares at Rs.50 per share = Rs.5,00,000
- **Preference Shares Issued**: 2,000 shares at Rs.100 per share = Rs.2,00,000
- **Debentures Issued**: 1,000 debentures at Rs.200 each = Rs.2,00,000

Purchase Consideration Calculation:

Total Purchase Consideration=Rs.5,00,000+Rs.5,00,000+Rs.2,00,000+Rs.2,00,000=Rs.14,00,000\text{Total Purchase Consideration} = Rs.5,00,000 + Rs.5,00,000 + Rs.2,00,000 + Rs.2,00,000 = Rs.14,00,000Total Purchase Consideration=Rs.5,00,000+Rs.5,00,000+Rs.2,00,000+Rs.2,00,000=Rs.14,00,000

Thus, the **total purchase consideration under the Net Payment Method is Rs.14,00,000.**

Intrinsic Value Method

The **Intrinsic Value Method** is a valuation approach used to determine the true worth of a company, stock, or asset based on its **fundamental financials**, rather than relying on market prices. It focuses on **tangible and intangible factors** that contribute to the business's actual value.

This method is widely used in **mergers and acquisitions, investment analysis, and financial decision-making**, as it helps assess whether a company is **overvalued or undervalued**.

Features of the Intrinsic Value Method

The **Intrinsic Value Method** is a valuation approach used to determine the **true worth of a company, asset, or stock** based on its **fundamental financial and economic factors**, rather than relying on market prices. This method helps in assessing whether a business or investment is **overvalued or undervalued** by considering its **earnings potential, assets, and liabilities**.

Below are the key features of the Intrinsic Value Method:

1. Based on Fundamental Analysis

The Intrinsic Value Method relies on **detailed financial analysis**, including a company's **earnings, assets, liabilities, cash flows, and growth potential**. It focuses on the **underlying financial strength** rather than short-term market movements.

2. Independent of Market Fluctuations

Unlike **market value**, which depends on external factors such as **investor sentiment and stock market trends**, intrinsic value is based purely on **financial and operational data**. This makes it **less volatile** and more stable over time.

3. Uses Discounted Cash Flow (DCF) Analysis

One of the most common techniques for calculating intrinsic value is the **Discounted Cash Flow (DCF) method**. This approach estimates **future cash flows** and discounts them to their **present value**, helping to determine what an investment is truly worth.

4. Considers Both Tangible and Intangible Assets

The method takes into account both:

- **Tangible assets**: Land, buildings, machinery, cash reserves, and inventory.
- **Intangible assets**: Goodwill, brand reputation, patents, intellectual property, and future earnings potential.

This comprehensive approach ensures a **more accurate valuation**.

5. Helps in Long-Term Investment Decision-Making

The Intrinsic Value Method is widely used by **long-term investors** and **value investors** (like Warren Buffett) to identify **undervalued stocks**. If an asset's **intrinsic value is higher than its market price**, it may be a **good investment opportunity**.

6. Suitable for Mergers and Acquisitions

Companies use this method during **mergers, acquisitions, and corporate restructuring** to assess the **actual worth** of a target business. It helps acquirers **avoid overpaying** for a company based on temporary market conditions.

7. Considers Future Growth Potential

Unlike methods that rely only on **current financials**, the Intrinsic Value Method factors in **expected future earnings and cash flows**. This makes it useful for valuing businesses with **strong growth prospects**.

8. Risk and Discount Rate Adjustments

Since future cash flows involve **uncertainty**, this method applies a **discount rate** to account for:

- **Time value of money (TVM)**
- **Business risks**
- **Industry trends**
- **Inflation effects**

This ensures that future earnings are valued at their **present worth**.

9. Helps in Avoiding Overpriced Investments

By focusing on real financial performance rather than market speculation, this method helps **investors avoid overpriced stocks or assets** that are driven by hype rather than fundamentals.

10. Provides a More Stable Valuation

Since intrinsic value is **not influenced by short-term market fluctuations**, it provides a **more stable and reliable valuation**. This makes it useful for **long-term financial planning** and corporate strategy.

Advantages of the Intrinsic Value Method

The **Intrinsic Value Method** is widely used in **investment analysis, corporate valuation, and financial decision-making** to determine the **true worth** of a company or asset. It helps investors and businesses assess whether an investment is **overvalued or undervalued** based on fundamental financial factors rather than short-term market trends.

Here are the key advantages of the Intrinsic Value Method:

1. Provides a True and Fair Valuation

The Intrinsic Value Method estimates the **actual worth** of an asset by analyzing **financial statements, future earnings, and asset values**, rather than relying on market speculation. This makes the valuation **more reliable and objective**.

2. Independent of Market Fluctuations

Unlike market value, which is influenced by **investor sentiment, speculation, and short-term demand**, intrinsic value is based on **fundamental business performance**. This makes it **more stable and accurate** for long-term financial planning.

3. Helps Identify Undervalued or Overvalued Stocks

By comparing a company's **intrinsic value with its current market price**, investors can determine whether a stock is **undervalued (good buying opportunity) or overvalued (potentially overpriced investment)**.

4. Useful for Long-Term Investment Decisions

Since this method focuses on **fundamentals and future cash flows**, it is highly beneficial for **long-term investors** and value investors who seek **sustainable growth and profitability**.

5. Accounts for Future Growth Potential

Unlike some valuation methods that consider only current financials, the **Intrinsic Value Method includes expected future earnings and business expansion**, making it suitable for companies with **high growth potential**.

6. Suitable for Mergers and Acquisitions

Businesses use this method during **mergers, acquisitions, and corporate restructuring** to ensure they are paying a **fair price** for the target company. It helps avoid **overpaying or underpaying** in transactions.

7. Considers both Tangible and Intangible Assets

The Intrinsic Value Method evaluates **all aspects of a business**, including:

- **Tangible assets** (real estate, machinery, inventory)
- **Intangible assets** (brand value, goodwill, patents, intellectual property)

This comprehensive approach leads to a **more accurate valuation**.

8. Reduces Investment Risks

By focusing on **fundamental financial health rather than market speculation**, the method helps investors make **safer and more informed decisions**, reducing the risk of losses due to market volatility.

9. Helps in Avoiding Overpriced Investments

Since this method evaluates a company's **true economic value**, it prevents investors from buying assets that are **inflated due to market trends, hype, or investor speculation**.

10. Provides a Stable Basis for Financial Planning

Since intrinsic value does not change drastically with short-term market fluctuations, it offers **a stable basis for long-term financial strategies**, making it useful for:

- Corporate financial planning
- Investment decision-making
- Business expansion strategies

Disadvantages of the Intrinsic Value Method

The **Intrinsic Value Method** is widely used for **investment analysis, business valuation, and financial decision-making**. However, despite its advantages, it has certain limitations that investors and analysts should consider.

1. Requires Complex Calculations

The Intrinsic Value Method often involves detailed financial models, such as **Discounted Cash Flow (DCF) analysis**. This requires:

- Forecasting future cash flows
- Selecting an appropriate discount rate
- Adjusting for risk factors

Since these calculations are complex, small errors in assumptions can lead to **significant variations in valuation**.

2. Highly Dependent on Assumptions

Intrinsic value calculations rely on **future projections**, including:

- Expected earnings growth

- Discount rates
- Market trends

If these assumptions are inaccurate, the valuation may **not reflect reality**. Different analysts may arrive at **different intrinsic values** for the same asset.

3. Ignores Market Sentiment and External Factors

While intrinsic value focuses on **fundamental financial data**, it does not consider:

- Market demand and investor sentiment
- Economic conditions and industry trends
- Competitor strategies

Since real-world stock prices are influenced by these factors, intrinsic value alone **may not always indicate the right investment decision**.

4. Difficult to Apply to New or High-Growth Companies

For companies with **limited financial history** or those in **rapidly evolving industries**, intrinsic valuation is challenging because:

- Their earnings are unpredictable.
- They may have **high intangible assets** (e.g., brand value, technology).
- Traditional valuation models **may not capture their full potential**.

Startups and tech firms often have **low intrinsic value** using traditional methods, even though they may be highly successful in the long run.

5. Sensitive to Discount Rate Selection

The **discount rate** (used to adjust future cash flows) has a major impact on intrinsic value.

- A **high discount rate** lowers the valuation.
- A **low discount rate** inflates the valuation.

Selecting the **right discount rate** is subjective and may lead to **overvaluation or undervaluation**.

6. Time-Consuming Process

Unlike simple valuation methods (such as market price comparisons), the intrinsic value approach:

- Requires **detailed financial statement analysis**.
- Involves long-term **data collection and forecasting**.
- Demands expertise in **financial modelling**.

This makes it **less practical for quick investment decisions**.

7. May Not Reflect Short-Term Market Conditions

While intrinsic value is useful for long-term investments, it does not account for **short-term price movements** driven by:

- Market speculation

- Supply and demand imbalances
- Temporary economic conditions

As a result, stocks may **remain undervalued or overvalued for long periods**, making it difficult for investors to act on intrinsic value alone.

8. Not Always Useful for Cyclical Industries

Industries like **real estate, commodities, and energy** have earnings that fluctuate due to external factors such as:

- Economic cycles
- Inflation and interest rates
- Government policies

Intrinsic valuation may not accurately capture the **true investment potential** of such industries.

9. Different Methods Give Different Results

There are multiple ways to calculate intrinsic value, including:

- **Discounted Cash Flow (DCF) Model**
- **Net Asset Value (NAV) Method**
- **Earnings-Based Valuation**

Since each method has its own **assumptions and limitations**, the final valuation can **vary significantly**, leading to confusion.

10. Over-Reliance Can Lead to Missed Opportunities

Since intrinsic value ignores **market psychology and momentum investing**, investors relying solely on this method may **miss profitable opportunities** in stocks that are gaining momentum due to positive market sentiment.

Formula for Intrinsic Value Calculation

One common approach is the **Discounted Cash Flow (DCF) Model**, which calculates intrinsic value as:

Intrinsic Value= $\sum CFt/(1+r)^t$

Where:

CFt= Expected Cash Flow in Year t

r = Discount Rate (Cost of Capital)

t = Time Period

Another approach is the Net Asset Method, which calculates intrinsic value as:

Intrinsic Value=Total Assets−Total Liabilities

Methods of Accounting for Amalgamation-

When two or more companies merge or one company acquires another, the financial statements must be adjusted to reflect the new structure. The **accounting treatment of amalgamation** is governed by **Accounting Standard (AS) 14** in India and **IFRS 3 (Business Combinations)** globally. There are two primary methods of accounting for amalgamation:

1. Pooling of Interests Method

Meaning

Under this method, the amalgamating companies are treated as if they have **merged their interests** rather than one acquiring the other. The assets, liabilities, and reserves of both companies are combined at their existing **book values**, without any revaluation.

Key Features

- Used in cases of **merger-type amalgamations**, where there is continuity in ownership and management.
- Assets and liabilities are recorded at their **existing book values**.
- No goodwill or capital reserves are created.
- The shareholders of the merging companies continue to hold a stake in the new entity.
- The balance sheets of the merging companies are combined without making significant adjustments.

Accounting Treatment

- All **assets, liabilities, and reserves** of the transferor company (the company being merged) are recorded at **book value** in the books of the transferee company (the company that survives).
- **No new goodwill or capital reserves** are recognized.

- The difference, if any, between the share capital of the merging companies is adjusted against **reserves**.

Suitability

This method is ideal for cases where the amalgamation meets the conditions of a **merger**, meaning:

1. The shareholders of the merging companies become **owners of the new company**.
2. The business continues with **little or no changes** in operations and policies.

2. Purchase Method

Meaning

Under the purchase method, the amalgamation is treated as a **takeover or acquisition**. The transferee company (the acquiring company) purchases the assets and liabilities of the transferor company (the company being acquired) and records them at **fair value** or purchase price.

Key Features

- Used in cases of **acquisition-type amalgamations**, where one company **takes control** over another.
- The transferee company **records assets and liabilities at their fair market value** instead of book value.
- The difference between the purchase price and the net assets acquired is adjusted as **Goodwill (if positive)** or **Capital Reserve (if negative)**.
- The identity of the transferor company **does not continue**, and its assets and liabilities are absorbed into the transferee company.

Accounting Treatment

1. **Assets and Liabilities**: The transferee company records the assets and liabilities acquired from the transferor company at their **fair market value**.
2. **Purchase Consideration**: The amount paid by the transferee company to acquire the transferor company is recorded.
3. **Goodwill or Capital Reserve**:
   - If **Purchase Consideration > Net Assets Acquired**, the excess amount is recorded as **Goodwill**.
   - If **Purchase Consideration < Net Assets Acquired**, the difference is credited to the **Capital Reserve**.

Suitability

This method is applied when one company acquires another, and there is **no continuity in shareholding** or management. It is common in cases of:

- **Hostile takeovers**
- **Acquisitions of financially weak companies**
- **Strategic business purchases**

The Purchase Method (Excluding Inter-Company Holdings)

The **Purchase Method** is an accounting approach used when one company acquires another. It is commonly applied in cases where the amalgamation is **not a merger of equals** but rather a **takeover** or **acquisition**. Under this method, the acquiring company (transferee) records the assets and liabilities of the acquired company (transferor) at **fair value**, rather than their book value.

When inter-company holdings are **excluded**, it means that **any pre-existing ownership stakes** (such as shares held by the acquiring company in the target company before the acquisition) are **not considered in purchase consideration calculations**. This ensures a **clear and fair valuation** of the acquired company's assets and liabilities.

Features of the Purchase Method (Excluding Inter-Company Holdings)

1. **Recognition at Fair Value**
   - The transferee company records the **assets and liabilities** of the transferor company at their **fair market value**, instead of book value.
   - This reflects the **true economic worth** of the acquired company.
2. **Exclusion of Inter-Company Holdings**
   - If the acquiring company already **owns shares** in the transferor company before the acquisition, those holdings are **ignored** while determining the purchase consideration.
   - This prevents **double counting** and ensures accurate reporting.
3. **Goodwill or Capital Reserve Recognition**
   - If the purchase price paid by the transferee company **exceeds** the net assets acquired, the excess is recorded as **Goodwill** (indicating the premium paid for intangible benefits such as brand value, customer base, etc.).
   - If the purchase price is **lower** than the net assets acquired, the difference is credited to a **Capital Reserve**.
4. **Reserves of Transferor Company Not Retained**
   - Unlike the Pooling of Interests Method, the reserves of the acquired company are **not carried forward** into the books of the transferee company.

5. **Business Identity of the Transferor Company Ceases**
   - After the amalgamation, the acquired company **loses its separate legal identity**, and its financial statements are merged with those of the acquiring company.
6. **Consideration in Cash or Shares**
   - The acquiring company may pay for the purchase in the form of **cash, shares, or other financial instruments**.

Accounting Treatment Under the Purchase Method

1. **Calculation of Purchase Consideration**
   - The total amount paid by the transferee company to acquire the transferor company, excluding any pre-existing inter-company shareholding.
2. **Fair Valuation of Assets and Liabilities**
   - The assets and liabilities of the acquired company are recorded in the books of the acquiring company at their **fair market value**, not their historical book value.
3. **Goodwill or Capital Reserve Treatment**
   - **Goodwill** is recognized if the purchase price is **higher** than the net assets acquired.
   - **Capital Reserve** is recorded if the purchase price is **lower** than the net assets acquired.
4. **Adjustment for Inter-Company Holdings**
   - If the acquiring company already holds shares in the target company, those holdings are **ignored** in the valuation process, ensuring fair and accurate calculations.

Illustration of the Purchase Method (Excluding Inter-Company Holdings)

Example

Company A acquires Company B for **Rs 10 crore**. The fair value of Company B's **net assets** (total assets – total liabilities) is **Rs 8.5 crore**.

- **Step 1: Calculate Purchase Consideration**
  - The agreed purchase price = **Rs 10 crore**
- **Step 2: Determine Net Assets Acquired**
  - Fair Value of Assets = **Rs 12 crore**
  - Liabilities Taken Over = **Rs.3.5 crore**
  - Net Assets Acquired = **Rs.12 crore – Rs.3.5 crore** = **Rs.8.5 crore**
- **Step 3: Identify Goodwill or Capital Reserve**
  - Purchase Consideration = **Rs.10 crore**
  - Net Assets Acquired = **Rs.8.5 crore**
  - **Goodwill** = Rs.10 crore – Rs.8.5 crore = **Rs.1.5 crore**

Journal Entries in the Books of Company A (Acquirer)

Date	**Particulars**	**Dr (Rs.)**	**Cr (Rs.)**
On Acquisition	Assets (At Fair Value)	Rs.12,00,00,000	
	Liabilities Taken Over		Rs.3,50,00,000
	Goodwill (Balancing Figure)	Rs.1,50,00,000	
	To Purchase Consideration		Rs.10,00,00,000

Date	Particulars	Dr (Rs.)	Cr (Rs.)
On Payment	Purchase Consideration A/c	Rs.10,00,00,000	
	To Bank A/c (or Share Capital, if paid in shares)		Rs.10,00,00,000

Key Observations

- The assets and liabilities of Company B are recorded at their **fair market values**.
- **Goodwill of Rs.1.5 crore** is recorded as an **intangible asset**.
- Any pre-existing **shareholding of Company A in Company B is ignored** in purchase consideration calculations.

Advantages of the Purchase Method (Excluding Inter-Company Holdings)

The **Purchase Method**, when applied **excluding inter-company holdings**, ensures a more transparent and accurate representation of the amalgamation process. By ignoring pre-existing shareholdings between the acquiring and acquired companies, this method provides several benefits:

1. Fair and Accurate Valuation

- The assets and liabilities of the acquired company are recorded at **fair market value**, ensuring that the financial statements reflect the **true economic worth** of the business.
- This approach eliminates any distortions caused by outdated **book values**.

2. Avoids Double Counting

- By excluding inter-company holdings, the acquiring company does **not count its pre-existing stake** in the target company as part of the purchase consideration.
- This ensures that the transaction is **not overstated**, preventing misrepresentation of financial data.

3. Transparent Financial Reporting

- Since the assets and liabilities are revalued, the financial statements of the acquiring company provide a **clear and true picture** of its financial position.
- Stakeholders, including investors and regulators, receive more **reliable financial information**.

4. Recognition of Goodwill or Capital Reserve

- If the purchase price **exceeds** the fair value of net assets acquired, the excess amount is recorded as **Goodwill**, reflecting the premium paid for intangible benefits such as brand reputation, customer loyalty, or strategic advantages.
- If the purchase price is **lower** than the net assets acquired, the difference is credited to a **Capital Reserve**, ensuring that the company does not overstate its expenses.

5. Compliance with Accounting Standards

- The **Purchase Method** aligns with **Accounting Standard (AS) 14 in India** and **IFRS 3 (Business Combinations)**, making it globally acceptable and ensuring regulatory compliance.
- By excluding inter-company holdings, the method prevents **manipulative accounting practices**, such as inflating purchase consideration.

6. Helps in Tax Planning

- Since the assets are recorded at their **fair value**, the acquiring company may benefit from higher depreciation claims, leading to potential **tax savings**.
- The goodwill recorded in the books can also be **amortized in some jurisdictions**, further aiding tax efficiency.

7. Ensures Proper Control over the Acquired Entity

- By eliminating pre-existing shareholdings, the method ensures that the acquiring company **gains full control** over the acquired business.
- This simplifies management and integration, making post-acquisition operations **smoother and more efficient**.

8. Suitable for Large-Scale Acquisitions

- The method is widely used in cases of **hostile takeovers, strategic acquisitions, and business expansions**, where the acquiring company **does not initially hold a controlling stake** in the target company.

Disadvantages of the Purchase Method (Excluding Inter-Company Holdings)

While the **Purchase Method (Excluding Inter-Company Holdings)** ensures fair valuation and transparency, it also has certain limitations. These drawbacks primarily relate to **complex accounting treatments, valuation challenges, and financial impacts** on the acquiring company.

1. Complex and Time-Consuming Valuation Process

- The **fair market valuation** of assets and liabilities requires expert judgment, market research, and financial analysis.
- This process can be **time-consuming and costly**, especially if external valuation experts are required.

2. Subjectivity in Fair Value Assessment

- Determining the **fair market value** of assets and liabilities can be **highly subjective**.
- Different valuation methods (cost approach, income approach, market approach) may result in **varied asset valuations**, leading to potential **disputes or inconsistencies**.

3. Recognition of Goodwill May Distort Financial Statements

- If the purchase consideration **exceeds** the net assets acquired, the excess amount is recorded as **Goodwill**.
- Goodwill is an **intangible asset** that does not contribute directly to cash flow and may lead to **financial overstatement** if not properly amortized or impaired.
- If the acquired business does not perform well, the goodwill may need to be **written off**, negatively impacting the acquiring company's financial health.

4. Immediate Impact on Profitability

- The acquiring company must **write off acquisition costs**, such as legal fees, consultant fees, and valuation charges, which **reduces net profit** in the short term.
- If significant goodwill is recorded, future **impairment losses** may further impact profitability.

5. Exclusion of Inter-Company Holdings Can Distort True Ownership

- While excluding inter-company holdings prevents **double counting**, it can also create a **discrepancy in ownership structure reporting**.
- If the acquiring company previously held a stake in the target company, this exclusion **may not fully reflect its original investment value** in the acquired business.

6. Loss of Historical Business Identity

- Under the Purchase Method, the **reserves and surplus of the acquired company are not carried forward**.
- This results in the **loss of historical financial records**, which may affect investor confidence, particularly if the acquired company had a strong financial history.

7. Increased Financial Risk for the Acquirer

- The acquiring company takes on **all liabilities** of the transferor company, including **contingent liabilities** (such as pending lawsuits or tax disputes).
- These risks may not always be **fully disclosed** or estimated accurately during valuation, leading to potential **financial burdens** in the future.

8. Possible Tax Implications

- If a large portion of the purchase consideration is allocated to goodwill, it may **not be tax-deductible** in some jurisdictions.
- Fair value adjustments can lead to **higher taxable income**, impacting the company's overall **tax burden**.

Internal & External Reconstruction

Reconstruction of a company refers to the process of reorganizing its financial and structural framework to improve efficiency, reduce financial burden, or comply with legal requirements. This process can be classified into two main types: **Internal Reconstruction** and **External Reconstruction**. Both approaches aim to restructure a company but differ in their methods and implications.

Internal Reconstruction

Internal reconstruction is a process where a company reorganizes its financial structure without dissolving its legal entity. It is carried out when a company faces financial difficulties, such as accumulated losses, excessive liabilities, or capital reduction, and wants to revive its operations. Internal reconstruction is usually performed through capital restructuring methods such as capital reduction, debt restructuring, and compromise agreements with creditors and shareholders.

Methods of Internal Reconstruction

Internal reconstruction involves restructuring the financial and capital structure of a company without dissolving its legal entity. The objective is to eliminate accumulated losses, reorganize liabilities, and restore financial stability. Several methods are used for internal reconstruction, including capital reduction, compromise arrangements, and liability adjustments.

1. Alteration of Share Capital

The company can modify its share capital structure as permitted under the Companies Act. This can be done in the following ways:

- **Increase in Share Capital** – The company may issue new shares to raise additional funds.
- **Consolidation of Shares** – Smaller shares are combined into larger denomination shares.
- **Subdivision of Shares** – Large denomination shares are divided into smaller values to increase liquidity.
- **Conversion of Shares into Stock** – Fully paid shares may be converted into stock, providing flexibility in transferring ownership.

2. Reduction of Share Capital

A company can reduce its share capital to eliminate accumulated losses or adjust capital to a realistic value. This process requires approval from shareholders, creditors, and regulatory authorities. It can be done through:

- **Cancelling Paid-up Capital** – A portion of the paid-up capital is cancelled to adjust against losses.
- **Reducing the Face Value of Shares** – The nominal value of shares is reduced to reflect the actual worth of the company.
- **Refunding Excess Capital** – If the company has surplus capital, it may refund part of it to shareholders.

3. Writing Off Accumulated Losses and Assets

Accumulated losses may be written off by adjusting them against capital, reserves, or fresh capital infusion. Non-productive and obsolete assets can also be written off to reflect the true financial position of the company.

4. Reorganization of Liabilities

To ease financial burdens, the company may restructure its liabilities by:

- **Settlement with Creditors** – Creditors may agree to accept partial payments or convert debt into equity.
- **Rescheduling Loan Repayments** – The company can negotiate longer repayment periods or lower interest rates with lenders.
- **Conversion of Debentures into Shares** – Debenture holders may be offered shares instead of repayment, reducing debt obligations.

5. Compromise or Arrangement with Stakeholders

A company may enter into agreements with shareholders, debenture holders, or creditors to restructure financial obligations. Such arrangements often involve debt reduction, extended repayment schedules, or equity participation. This process is governed by legal provisions under company law.

6. Utilization of Reserves and Surplus

The company may use its reserves, such as capital reserves, securities premium, or general reserves, to cover accumulated losses and improve its financial health.

7. Internal Amalgamation

Two or more divisions of the same company may be merged to streamline operations, eliminate redundancies, and improve efficiency without changing the company's legal identity.

Advantages of Internal Reconstruction

Internal reconstruction is a strategic process that helps financially distressed companies reorganize their capital structure and liabilities without dissolving the business. It offers several advantages, including financial stability, continued operations, and stakeholder confidence.

1. Helps in Reviving the Company

By eliminating accumulated losses, restructuring liabilities, and reducing capital, internal reconstruction allows a company to regain financial health and continue its business operations.

2. Retains the Company's Identity

Unlike external reconstruction, where a new entity is formed, internal reconstruction enables the company to retain its existing legal identity, brand reputation, and business goodwill.

3. Avoids Liquidation

Instead of shutting down the business, internal reconstruction provides an opportunity to restructure finances and continue operations, protecting employees, shareholders, and creditors from losses.

4. Improves Financial Position

By reducing excessive liabilities, writing off non-performing assets, and restructuring capital, the company can improve its balance sheet, making it more financially stable and attractive to investors.

5. Reduces Debt Burden

Negotiating with creditors and converting debt into equity or extending repayment terms can ease the financial burden, allowing the company to manage its liabilities more effectively.

6. Increases Shareholder and Creditor Confidence

By implementing a well-structured reconstruction plan, the company can restore stakeholder trust and attract further investments, ensuring long-term sustainability.

7. Enables Efficient Utilization of Resources

Through asset restructuring and capital adjustments, the company can allocate resources more efficiently, leading to improved productivity and profitability.

8. Legal and Tax Benefits

Internal reconstruction may offer tax advantages, such as the ability to carry forward losses and claim deductions, reducing the overall tax burden on the company.

9. No Need for Complex Legal Processes

Unlike mergers, acquisitions, or external reconstructions, internal restructuring is relatively simpler and requires fewer legal formalities, making it a cost-effective alternative.

Disadvantages of Internal Reconstruction

While internal reconstruction provides a company with an opportunity to restructure its financial position without liquidation, it also has certain drawbacks. The process involves legal complexities, stakeholder dissatisfaction, and financial risks that must be carefully managed.

1. Requires Approval from Multiple Stakeholders

Internal reconstruction needs approval from shareholders, creditors, and regulatory authorities. Gaining consensus from all parties can be time-consuming and challenging.

2. Possible Loss for Shareholders

Existing shareholders may face losses due to capital reduction, where the face value of shares is decreased. This can lower their investment value and create dissatisfaction.

3. Dissatisfaction Among Creditors

Creditors may be required to accept reduced payments or convert their loans into equity, which may not always be favourable to them. This can lead to disputes and legal challenges.

4. Complex Legal and Regulatory Procedures

Internal reconstruction involves legal formalities such as obtaining approval from courts, regulatory bodies, and creditors. This increases the time and effort required for implementation.

5. Uncertain Financial Outcome

Even after restructuring, there is no guarantee that the company will regain profitability. If the business continues to struggle, reconstruction efforts may fail, leading to further financial distress.

6. Negative Market Perception

Investors and customers may perceive internal reconstruction as a sign of financial instability. This can lead to a loss of confidence, making it difficult to attract new investments and retain business partners.

7. Impact on Employee Morale

During reconstruction, cost-cutting measures such as salary reductions, layoffs, or changes in employee benefits may be implemented. This can negatively affect employee morale and productivity.

8. Costs Involved in Restructuring

Though internal reconstruction avoids liquidation, it still involves expenses such as legal fees, consultancy charges, and regulatory compliance costs, which can be significant.

9. Limited Scope for Raising Funds

Since internal reconstruction primarily focuses on restructuring existing liabilities rather than raising fresh capital, the company may still struggle with liquidity issues after the process.

External Reconstruction

External reconstruction involves the dissolution of an existing company and the creation of a new company to take over its business. This is generally done when a company is financially distressed and unable to revive through internal measures. Instead of going through liquidation, a new company is formed to take over assets and liabilities, giving the business a fresh start.

Process of External Reconstruction

External reconstruction involves dissolving an existing company and transferring its business to a newly formed company. This process is undertaken when a company faces financial difficulties that cannot be resolved through internal restructuring. The newly formed company acquires the assets and liabilities of the old company, allowing it to continue operations with a fresh start. The process of external reconstruction involves several steps, as outlined below:

1. Formation of a New Company

A new company is incorporated under the Companies Act to take over the business of the financially struggling company. This new entity may have the same or a different name but is legally distinct from the old company.

2. Approval from Stakeholders

The old company's board of directors, shareholders, and creditors must approve the external reconstruction plan. Shareholders must pass a special resolution, and creditors must agree to the transfer of assets and liabilities.

3. Agreement for Transfer of Assets and Liabilities

A formal agreement is drafted between the old company and the new company, specifying the terms of transfer. This includes details of the assets, liabilities, and any consideration (such as shares or cash) provided to shareholders and creditors.

4. Valuation of Assets and Liabilities

An independent valuation is conducted to determine the fair market value of the old company's assets and liabilities. This ensures that the new company takes over the business at an appropriate price.

5. Settlement with Creditors and Shareholders

- **Creditors** – The new company may offer creditors repayment options, such as issuing shares, extending repayment terms, or offering reduced settlements.
- **Shareholders** – Existing shareholders may receive shares in the new company in exchange for their holdings in the old company.

6. Approval from Regulatory Authorities

External reconstruction requires approval from regulatory bodies such as the National Company Law Tribunal (NCLT) and the Registrar of Companies (ROC). The process must comply with the Companies Act and other relevant financial regulations.

7. Transfer of Business and Dissolution of the Old Company

Once approvals are obtained, the old company's assets and liabilities are officially transferred to the new company. After the transfer, the old company is dissolved as per legal procedures, and the new company takes over operations.

8. Issue of New Shares or Securities

To compensate shareholders and creditors, the new company may issue shares, debentures, or other financial instruments. This helps in capital restructuring and ensures the smooth transition of ownership.

9. Commencement of Business by the New Company

After completing all legal formalities, the new company begins its operations with a restructured financial position, allowing it to regain profitability and sustain long-term growth.

Advantages of External Reconstruction

External reconstruction helps a financially distressed company restart its operations under a new legal entity. It offers several advantages, including financial stability, business continuity, and stakeholder confidence.

1. Provides a Fresh Start

The formation of a new company allows for the elimination of past financial difficulties, giving the business a chance to operate with a clean financial structure.

2. Retains Business Continuity

Unlike liquidation, external reconstruction ensures that the business continues its operations under a new entity, preserving jobs, customer relationships, and market presence.

3. Restores Financial Stability

By restructuring liabilities and assets, the new company can eliminate losses and improve its financial health, making it more attractive to investors and lenders.

4. Increases Stakeholder Confidence

Shareholders, creditors, and employees gain renewed confidence in the company's future, as the restructuring process aims to improve profitability and sustainability.

5. Facilitates Debt Restructuring

Creditors may agree to revised repayment terms, debt conversion into equity, or other arrangements that reduce financial burden on the new company.

6. Attracts New Investments

With a reorganized financial structure, the new company has a better chance of attracting fresh capital from investors, which can be used for expansion and operational improvements.

7. Legal and Tax Benefits

The process may offer tax benefits, such as carrying forward previous losses or restructuring tax liabilities, reducing the overall financial burden on the new entity.

8. Improves Market Perception

A new company with a fresh financial start improves its reputation in the market, helping it regain customer trust and supplier support.

9. Simplifies Asset and Liability Transfer

Unlike mergers or acquisitions, external reconstruction allows for a smooth transfer of only selected assets and liabilities, enabling efficient restructuring without unnecessary obligations.

Disadvantages of External Reconstruction

Although external reconstruction offers a fresh start for struggling businesses, it also has several drawbacks. The process involves legal complexities, financial risks, and operational challenges that companies must carefully manage.

1. Lengthy and Complex Legal Process

External reconstruction requires approvals from shareholders, creditors, and regulatory authorities, making it a time-consuming and legally complex process.

2. High Costs Involved

The process involves significant expenses such as legal fees, valuation costs, and restructuring charges, which may add financial strain to the company.

3. Uncertainty in Business Continuity

There is no guarantee that the new company will succeed, as it may still face market challenges, operational inefficiencies, or financial difficulties.

4. Possible Resistance from Stakeholders

Creditors, shareholders, and employees may oppose the reconstruction process due to potential losses, changes in ownership structure, or revised financial agreements.

5. Impact on Shareholders

Existing shareholders may lose their investments if their shares in the old company are cancelled or if they receive shares in the new company at a lower value.

6. Loss of Brand Identity

If the new company changes its name or structure, it may lose brand recognition, customer trust, and market goodwill built over the years.

7. Disruptions in Operations

The transfer of assets, liabilities, and workforce to the new entity may lead to temporary operational disruptions, affecting productivity and business performance.

8. Employee Uncertainty and Layoffs

Employees may face job losses, changes in salary structures, or revised employment terms, leading to dissatisfaction and reduced morale.

9. Market and Investor Perception Issues

External reconstruction may signal financial weakness to investors, suppliers, and customers, making it harder to regain market confidence and attract new business opportunities.

Conversion of Stock

The term "conversion of stock" can be understood in various contexts within corporate finance, particularly when discussing capital restructuring or internal reconstruction. It generally refers to the process by which one form of stock or equity instrument is transformed into another, often to facilitate changes in the company's capital structure, improve liquidity, or align with a broader strategic restructuring plan.

1. Conversion of Fully Paid-Up Shares into Stock

In certain jurisdictions, companies might opt to convert their fully paid-up shares into stock. This process entails changing registered shares into negotiable instruments or stock certificates that are easier to transfer and trade. By doing so, the company can:

- **Enhance Liquidity:** Converting shares into stock often increases the ease with which these instruments can be traded on the market, thereby enhancing market liquidity.
- **Simplify Transfer Process:** Stock certificates tend to have fewer restrictions on transfers, making it simpler for shareholders to buy or sell their holdings.
- **Support Internal Reconstruction:** As part of internal reconstruction, converting fully paid-up shares can help a company adjust its capital structure without altering its legal identity. This conversion can be crucial when the objective is to reorganize capital, write off losses, or restructure liabilities.

2. Conversion of Convertible Securities

Another common form of stock conversion is the conversion of convertible securities—such as convertible debentures or convertible bonds—into common shares. This process allows the holders of these instruments to exchange their debt securities for equity shares according to predetermined conversion ratios. Key aspects include:

- **Debt-to-Equity Conversion:** By converting debt instruments into equity, a company reduces its outstanding liabilities, thereby improving its balance sheet and lowering the risk of insolvency.
- **Incentivizing Investors:** Investors may be attracted to convertible securities because they offer the potential for equity upside while initially providing the safety of debt.
- **Facilitating Restructuring:** As part of a broader restructuring plan, this conversion can help the company realign its capital structure, reduce interest burdens, and attract further investment.

3. Regulatory and Procedural Considerations

Conversion of stock, whether it involves the transformation of fully paid-up shares into stock or the conversion of convertible securities, is governed by statutory regulations and company law. The process typically involves:

- **Board and Shareholder Approvals:** The decision to convert stock usually requires the approval of the board of directors and, in many cases, a special resolution passed by the shareholders.
- **Compliance with Legal Frameworks:** Companies must ensure that the conversion process adheres to the regulatory requirements set out by governing bodies such as the Registrar of Companies or equivalent authorities.
- **Clear Conversion Terms:** Detailed terms of the conversion—including conversion ratios, effective dates, and implications for voting rights—must be clearly communicated to all stakeholders to ensure transparency and mitigate future disputes.

4. Strategic Advantages of Stock Conversion

Conversion of stock is not merely a technical change but a strategic tool that can offer several benefits:

- **Optimizing Capital Structure:** By converting debt into equity or restructuring shares, companies can streamline their financial base, which might lead to improved financial ratios and a stronger balance sheet.
- **Enhanced Market Perception:** A simplified and more liquid share structure can improve investor confidence, potentially leading to a better market valuation.
- **Flexibility in Financial Planning:** The ability to adjust the form of equity or debt instruments provides companies with greater flexibility in financial planning and long-term strategy implementation.

Increase of Capital

An increase in capital allows a company to raise additional funds for expansion, investment, debt repayment, or improving liquidity. Companies can increase capital through various methods:

1. Issuance of New Shares

- The company can issue new shares to existing shareholders (rights issue) or the public (public issue) to raise fresh funds.
- This increases the company's share capital and enhances financial stability.

2. Rights Issue

- Existing shareholders are given the right to purchase additional shares at a discounted price before they are offered to the public.
- This helps raise capital while maintaining control within the current shareholder group.

3. Private Placement

- Shares are offered to a selected group of investors, such as institutional investors or venture capitalists.
- This method helps companies raise funds without the complexities of a public offering.

4. Bonus Shares

- Companies issue additional shares to existing shareholders without charging them, using their retained earnings.
- While it does not raise new funds, it helps in restructuring capital and improving market perception.

5. Conversion of Debentures or Loans into Equity

- Companies may convert convertible debentures or loans into shares, reducing debt obligations while increasing equity capital.
- This method helps reduce interest burden and improves the company's financial position.

6. Employee Stock Option Plan (ESOP)

- Companies may offer shares to employees as an incentive, increasing capital while improving employee engagement and retention.

Decrease of Capital

A decrease in capital is generally undertaken when a company needs to restructure its finances, eliminate accumulated losses, or return surplus funds to shareholders. It helps in improving financial efficiency and optimizing the capital structure.

1. Capital Reduction

- A company reduces its share capital by cancelling unissued shares, reducing the face value of shares, or repurchasing shares.
- This is often done to adjust the capital structure and eliminate losses.

2. Buyback of Shares

- The company repurchases its own shares from shareholders, reducing outstanding equity.
- This method is used when a company has surplus cash and wants to improve earnings per share (EPS) or stabilize share prices.

3. Forfeiture of Shares

- If shareholders fail to pay the required share capital instalments, the company may forfeit their shares and reduce issued capital.
- This strengthens financial discipline among investors.

4. Redemption of Preference Shares

- If a company has issued redeemable preference shares, it can reduce its capital by repaying the amount to shareholders.
- This method helps in reducing financial obligations.

5. Adjustment against Losses

- Companies may reduce capital to write off accumulated losses from past financial years.
- This improves the company's financial position and allows it to attract new investors.

Reserve Liability

Reserve liability refers to the unpaid portion of a company's capital that shareholders may be required to contribute under specific circumstances, such as company liquidation. This liability applies primarily to companies with partly paid shares or those that have adopted limited liability structures.

Key Aspects of Reserve Liability

1. Meaning and Concept

- Reserve liability represents the amount that shareholders must pay if the company faces financial distress or liquidation.
- It ensures that a company has additional financial backing in case of emergencies.

2. Applicable to Limited Liability Companies

- In companies with limited liability, shareholders are only responsible for paying the amount unpaid on their shares.
- If a shareholder has partly paid shares, they must pay the remaining amount when called upon.

3. Usage in Liquidation

- In the event of liquidation, reserve liability helps in settling outstanding debts.
- Creditors can claim unpaid amounts from shareholders to recover dues.

4. Difference between Reserve Liability and General Reserves

- **Reserve Liability** is a contingent obligation on shareholders, arising only under specific conditions.
- **General Reserves** are funds set aside from profits to strengthen financial stability and future growth.

Example of Reserve Liability

Consider a company that issues shares with a face value of Rs.10 each, but shareholders have paid only Rs.6 per share. In this case:

- The remaining Rs.4 per share represents **reserve liability** for shareholders.
- If the company is liquidated, shareholders must pay Rs.4 per share to meet liabilities.

Importance of Reserve Liability

Reserve liability plays a crucial role in corporate finance, particularly in ensuring financial security and protecting stakeholders in case of a company's financial distress or liquidation. It serves as a backup source of funds, ensuring that shareholders fulfil their obligations when required.

1. Protects Creditors' Interests

- Reserve liability ensures that creditors have a claim on the unpaid portion of share capital if the company faces liquidation.
- This reduces the risk of financial loss for creditors and helps maintain trust in corporate dealings.

2. Strengthens Financial Stability

- By keeping a portion of capital unpaid, reserve liability ensures that additional funds are available when needed.
- This enhances the company's ability to manage financial crises or unforeseen liabilities.

3. Ensures Shareholder Responsibility

- Shareholders with partly paid shares are obligated to pay the remaining amount if called upon.
- This promotes financial discipline among investors and ensures they remain committed to the company's financial well-being.

4. Supports Business Continuity

- In times of financial distress, reserve liability can provide additional capital without needing external funding.
- This can help companies stabilize operations without excessive borrowing.

5. Legal and Regulatory Compliance

- Many corporate laws require companies with partly paid shares to maintain reserve liability, ensuring transparency and financial accountability.
- It aligns with governance standards and protects stakeholders' interests.

6. Enhances Investor Confidence

- Investors and potential shareholders feel more secure knowing that the company has a financial safeguard in place.
- This can attract more investment, as reserve liability reduces the risk of sudden financial collapse.

7. Reduces Risk of Bankruptcy

- If a company is on the verge of bankruptcy, the unpaid capital from shareholders can be used to settle outstanding obligations.
- This can prevent premature liquidation and provide an opportunity for recovery.

Accounting Treatment of External Reconstruction

External reconstruction involves winding up an existing company and transferring its assets, liabilities, and business operations to a newly formed entity. This process requires specific accounting adjustments to ensure proper recording of transactions.

1. Close the Books of the Old Company

Since the old company ceases to exist, its accounts must be closed, and balances transferred appropriately.

(a) Realization Account

A **Realization Account** is prepared to record the transfer of assets and liabilities.

Journal Entries:

1. **Transfer of Assets to Realization Account**

Realization A/c Dr.

To Assets A/c

(All assets transferred at their book value)

Transfer of Liabilities to Realization Account

Liabilities A/c Dr.

To Realization A/c

(All liabilities transferred at their book value)

Receipt of Consideration from New Company

New Company A/c Dr.

To Realization A/c

(Consideration received from the new company)

Settlement of Expenses Related to Reconstruction

Realization A/c Dr.

To Bank A/c

(Reconstruction expenses paid)

Transfer of Profit or Loss on Realization

If there is a **profit**, transfer it to the **Equity Shareholders' Account**:

Realization A/c Dr.

To Equity Shareholders' A/c

(Profit on realization transferred)

If there is a loss**, charge it to the Equity Shareholders' Account**:

Equity Shareholders' A/c Dr.

To Realization A/c

(Loss on realization adjusted)

(b) Transfer of Shareholders' Claims

- **Settlement of Shareholders' Claims with Shares in the New Company**

Equity Shareholders' A/c Dr.

To New Company's Share Capital A/c

(Shareholders allotted shares in the new company)

Settlement of Shareholders' Claims with Cash Consideration

Equity Shareholders' A/c Dr.

To Bank A/c

(Cash payment made to shareholders)

2. Open the Books of the New Company

The new company must record the acquisition of assets and liabilities and the issue of shares or cash consideration to shareholders.

(a) Assets and Liabilities Taken Over

Assets A/c Dr.

Goodwill A/c Dr. (if applicable)

To Liabilities A/c

To Vendor's A/c (Old Company)

(Assets and liabilities recorded in the books of the new company)

(b) Settlement of Consideration

Vendor's A/c Dr.

To Share Capital A/c

To Bank A/c

(Consideration settled by issuing shares and cash)

3. Adjustments for Differences in Asset and Liability Values

- If the new company agrees to take over assets at a revised value (higher or lower than the book value), the difference is adjusted through **Capital Reserve** or **Goodwill** in the new company's books.

If assets are acquired at a value lower than the book value:

Capital Reserve A/c Dr.

To Assets A/c

(Adjustment for reduction in asset value)

If assets are acquired at a value higher than the book value:

Goodwill A/c Dr.

To Assets A/c

(Adjustment for increase in asset value)

ACCOUNTINGPROCEDUREFOREXTERNALRECONSTRUCTION

The accounting procedure in case of external reconstruction is the same as in case of amalgamation or absorption in the nature of purchase. However, there are no different kinds in this case, unlike in case of amalgamation or absorption, which were of two kinds viz, in nature of merger and in the nature of purchase. The steps in accounting for external reconstruction are outlined below:

1. Calculation of purchase consideration:

2. Ascertainment of discharge of purchase consideration
3. Closing the books of Vendor Company
4. Passing/opening entries in the books of purchasing company

I. Purchase Consideration:

Purchase Consideration refers to the consideration payable by the purchasing company to the vendor company for taking over the assets and liabilities of Vendor Company.

Accounting Standard – 14 defines the term purchase consideration as the "aggregate of the shares and other securities issued and the payment made in the for mofachorother assets by the transferee company to the shareholders of the transferor company". Although, purchase consideration refers to total payment made by purchasing company to the shareholders of Vendor Company, its calculation could be in different methods, as explained below:

a. Lump sum method
b. Net payments method
c. Net Assets Method
d. Other basis for purchase consideration

a).Lump sum Method:

Strictly speaking, this is not a method. Where the purchase consideration amount is mentioned in the agreement directly, it is called Lump Sum consideration. This method, does not involve any calculation regarding purchase consideration.

b) Net Payments Method:

Under this method, the purchase consideration will be the total of payments made (in any form) by purchasing company to vendor company, on any basis. Generally, purchasing company decides the payment to be made towards liabilities of Vendor Company, not taken over and towards expenses. The total of such payment s will be the purchase consideration.

C) Net Assets Method:

Under this method, purchase consideration will be the excess of value of assets taken over by the purchasing company, over the value of liabilities taken over. That is, under this method, the purchase consideration will be calculated using the formula

Purchase Consideration =Assets taken over (at taken over values) -Liabilities taken over (at taken over value)

d) Intrinsic value method:

Under this method, the purchase consideration is ascertained on the basis of ration in which shares of the purchasing company are exchanged with those of the selling company. The exchange ratio is generally, determined on the basis of intrinsic values of the respective companies' shares.

<u>Accounting Entries in the books of Transferor Company or Vendor Company:</u>

1. **For transferring Assets to Realisation A/c**

Realisation Account Dr.

To Sundry Asset Account

2. For transferring Liabilities to Realisation A/c

Liabilities Account Dr.

To Realisation Account

3. For purchase consideration due

Purchasing company account Dr.

To Realisation Account

4. For receiving the purchase consideration

BankA/c Dr.

Share in Purchase Co.A/c Dr

Debenture in purchasing Co.A/c Dr

To Purchasing Co;s A/c

5. For realization assets not taken over

Bank A/c Dr

To Realisation A/c

6. For payment of liabilities not taken over

Liability A/c Dr.

Realisation A/c (Premium) Dr.

To Bank A/c

To Realisation A/c (Discount)

***7.* For the payment of realization expenses**

(a) If a Expenses paid by Transferor company:

Realisation Account Dr.

To Cash/ Bank Account

(b) If Expenses paid by purchasing company:

Purchasing company account Dr.

To cash/bank account

***8.* For discharging the debentures**

i) Payable at Premium

Debenture account Dr. (with face value)

Realisation Account Dr.

To Debenture Account

ii) Payable at Discount

Debenture Account Dr.

To Realisation Account

To Debenture Account

***9.* For payment to debenture holders**

Debenture holders A/c Dr.

To Bank A/c

To Debenture in purchasing Co.

***10.* For discharge of preference share capital**

i. Payable at Premium

Preference Share Capital Account	Dr. (with face value)
Realisation Account	Dr.
To Preference Shareholders Account	

ii. Payable at Discount

Preference Share Capital Account Dr.

To Realisation Account

To Preference Shareholders Account

***11.* For closing realization account**

i. In case of profit

Realisation Account Dr.

To Equity Share Holders Account

ii. In case of loss

Equity Share Holders Account Dr.

To Realisation Account

***12.* For final payment to the equity shareholders**

Equity shareholder A/c Dr.

To Bank A/c

To Share in purchasing Co.

<u>Accounting Entries in the books of Transferee Company or Purchasing company</u>

***1.* For Purchase consideration payable**

Business purchase A/c Dr.

To liquidator of Transfere Co.,

***2.* For Assets and Liabilities taken over**

Sundry Assets A/c Dr.

Goodwill A/c Dr.

To Sundry Liabilities A/c

To Business Purchase A/c

To Capital Reserve A/c

3. **For payment of purchase price**

Liquidator of selling Co.A/c Dr.

To BankA/c

To Share capital A/c

To Securities premium A/c

To Debenture A/c

4. **For Expense of liquidation paid by Transferee Co.**

Good will A/c Dr.

To Bank A/c

5. **For Formation expenses of Transferee Co.**

Preliminary expenses A/c Dr.

To Bank A/c

6. **For Statutory reserve of the Transferor Co. to be continued**

Amalgamation adjustment A/c Dr.

To Statutory Reserve A/c

7. **For settlement of debenture holder or creditors of Transferor Co.**

Debenture holder A/c Dr.

Creditors A/c Dr.

To Bank A/c

Illustrations

1. Raman Ltd., agrees to purchase the business of Krishnan Ltd., on the following terms:

   (a) For each of the 10000 shares of Rs.10 each in Krishnan Ltd. 2 shares in Raman Ltd., of Rs.10 each will be issued at an agreed value of Rs, 12 per share. In addition, Rs.4 per share cash also will be paid.

   (b) 8% debentures worth Rs.80000 will be issued to settle the Rs.60000 9%debentures in Krishnan Ltd.,

   (c) Rs.10000willbepaidtowardsexpensesofwindingup.

   Calculate the purchase consideration.

   Solution:

To calculate the **purchase consideration** for the business of Krishnan Ltd. by Raman Ltd., we need to consider the following points based on the terms provided:

(a) Shares to be issued:

- Krishnan Ltd. has 10,000 shares of Rs.10 each.
- For each share in Krishnan Ltd., Raman Ltd. will issue 2 shares of Rs.10 each at an agreed value of Rs.12 per share.

Total shares to be issued = 10,000 shares * 2 = 20,000 shares

Value of shares issued = 20,000 shares * Rs.12 = Rs.2,40,000

Cash payment per share = Rs.4 per share

Total cash to be paid = 10,000 shares * Rs.4 = Rs.40,000

(b) Debenture settlement:

- Krishnan Ltd. has 9% debentures worth Rs.60,000.
- Raman Ltd. will issue 8% debentures worth Rs.80,000 to settle these 9% debentures.

The **value of debentures issued** = Rs.80,000

(c) Winding-up expenses:

- Rs.10,000 will be paid for the winding-up expenses.

Total Purchase Consideration:

Now, we add up all these components:

1. **Value of shares issued**: Rs. 2,40,000
2. **Cash to be paid**: Rs. 40,000
3. **Value of debentures issued**: Rs. 80,000
4. **Winding-up expenses**: Rs. 10,000

Total Purchase Consideration = Rs. 2,40,000 + Rs. 40,000 + Rs. 80,000 + Rs. 10,000 = **Rs. 3,70,000**

Thus, the total purchase consideration for the business of Krishnan Ltd. by Raman Ltd. is **Rs. 3,70,000**

Bottom of Form

2. Following is the balance sheet of Samy Ltd., as on 31-3-2014

Liabilities	Rs.	Assets	Rs.
Share capital:		Fixed assets	16,25,000
8% preference shares of		Investments	3,00,000
Rs.100each	3,75,000	Current assets	2,50,000
Equity shares of Rs.10each	7,50,000		
General Reserve	4,50,000		
7% debentures	3,50,000		
Current liabilities	2,50,000		
Total	**21,75,000**	Total	**21,75,000**

Romy Ltd., agreed to take over the business of Samy Ltd.,

(A) Calculate purchase consideration under Net assets method on the basis of the following:

(i) Romy ltd., agreed to discharge7%debentures at a premium of 10% by issuing 9% debentures of Romy ltd.,

(ii)Fixedassetsaretobevaluedat10%abovebookvalue, the investments at par, current assets at 10% discount and current liabilities at book value.

(iii)

(B) Calculatepurchaseconsiderationundernetpaymentmethodonthebasisofthe following:

(i) Romy ltd., agrees to discharge the7% debentures at a premium of 10% by issuing 9% debentures of Romy ltd.,

(ii) Preference shares are discharged at a premium of 10% by issuing10% preference shares of Rs.100 each in romy ltd.,

(iii) For every 2 equity share in samy ltd., Equity shares of Rs.10 each in Romy ltd., will be issued in addition to cashpaymentofRs.3per equity share in samy ltd.,

Solution:

(A) Purchase Consideration under Net Assets Method

Fixed Assets: Rs. 16,25,000 * 1.10 (10% above book value) = Rs. 17,87,500

Investments: Rs. 3,00,000 (valued at par)

Current Assets: Rs. 2,50,000 * 0.90 (10% discount) = Rs. 2,25,000

Current Liabilities: Rs. 2,50,000 (book value)

Calculation of Net Assets:

Net Assets = Fixed Assets + Investments + Current Assets - Current Liabilities

Net Assets = Rs. 17,87,500 + Rs. 3,00,000 + Rs. 2,25,000 - Rs. 2,50,000 = Rs. 20,62,500

Debentures (7% debentures of Samy Ltd.): Rs. 3,50,000 * 1.10 (10% premium) = Rs. 3,85,000

Purchase Consideration under Net Assets Method: Net Assets + Debentures = Rs. 20,62,500 + Rs. 3,85,000 = Rs. 24,47,500

(B) Purchase Consideration under Net Payment Method

Debentures (7% debentures of Samy Ltd.): Rs. 3,50,000 * 1.10 (10% premium) = Rs. 3,85,000

Preference Shares: Rs. 3,75,000 * 1.10 (10% premium) = Rs. 4,12,500

Equity Shares: Rs. 7,50,000 / Rs. 10 (equity shares in Samy Ltd.) = 75,000 equity shares in Samy Ltd.

For every 2 equity shares, Romy Ltd. will issue 1 equity share.

Equity Shares in Romy Ltd. = 75,000 / 2 = 37,500 equity shares

Cash payment = Rs. 3 * 75,000 = Rs. 2,25,000

Total Purchase Consideration under Payment Method: Rs. 3,85,000 (debentures) + Rs. 4,12,500 (preference shares) + Rs. 37,500 * Rs. 10 (equity shares in Romy Ltd.) + Rs. 2,25,000 (cash) = Rs. 3,85,000 + Rs. 4,12,500 + Rs. 3,75,000 + Rs. 2,25,000 = Rs. 14,97,500

3. M ltd., and N ltd., agreed to amalgamate on the basis of the following balance sheet as on 31-3-2014.

Liabilities	M Ltd Rs.	N Ltd Rs.	Assets	M Ltd Rs.	N Ltd Rs.
Share capital at Rs.25 each	75,000	50,000	Goodwill	30,000	---
			Fixed assets	31,500	38,800
P & L A/c	7,500	2,500	Stock	15,000	12,000
Creditors	3,500	3,500	Debtors	8,000	5,200
Depreciation fund	---	2,500	Bank	1,500	2,500
Total	**86,000**	**58,500**	Total	**86,000**	**58,500**

The assets and liabilities are to be taken over by a new company formed called P ltd., at book values. P ltd., capital is Rs.2,00,000 divided into10,000 equity shares of Rs.10 each and 10,000 9% preference shares of Rs.10 each.

P ltd., issued the equity shares equally to the vendor companies and preference shares were issued for any balance of purchase price.

Pass journal entries in the books of P ltd., and prepare its balance sheet, if the amalgamation is in the nature of purchase.

Solution:

Journal Entries in the Books of P Ltd.

1. For Taking Over the Assets and Liabilities:

    - Fixed Assets A/c Dr. 70,300
    - Stock A/c Dr. 27,000
    - Debtors A/c Dr. 13,200
    - Bank A/c Dr. 4,000
    - Goodwill A/c Dr. 30,000
    - To Creditors A/c 7,000
    - To Depreciation Fund A/c 2,500
    - To M Ltd. A/c 82,500
    - To N Ltd. A/c 53,500

2. For Issuing Shares:

    - M Ltd. A/c Dr. 82,500
    - N Ltd. A/c Dr. 53,500

- To Equity Share Capital A/c 62,500
- To 9% Preference Share Capital A/c 73,500

Balance Sheet of P Ltd. After Amalgamation

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Equity Share Capital (Rs.10 each)	62,500	Fixed Assets	70,300
9% Preference Share Capital (Rs.10 each)	73,500	Stock	27,000
Creditors	7,000	Debtors	13,200
Depreciation Fund	2,500	Bank	4,000
		Goodwill	30,000
Total	1,45,500	Total	1,45,500

This represents the financial position of P Ltd. after taking over the assets and liabilities of M Ltd. and N Ltd.

4. X ltd., and Y ltd., agree to amalgamate as from 31-3-2014 on which date their respective balance sheet were as follows:

Liabilities	X Ltd Rs.	Y Ltd Rs.	Assets	X Ltd Rs.	Y Ltd Rs.
<u>Share capital:</u>			Cash in hand	100	50
Shares of Re.1each	80,000	25,000	Cash at bank	3,400	450

Sundry creditors	3,000	1,000	Sundry debtors	22,500	6,000
Reserves	7,500	4,000	Plant	12,000	4,500
Profit&loss A/c	2,500	1,000	Stock	15,000	7,000
			Premises	30,000	10,000
			patents	10,000	3,000
Total	**93,000**	**31,000**	**Total**	**93,000**	**31,000**

Draw up the balance sheet of the new company 'XY' ltd., which was incorporated to take over the amalgamated concerns and state the number of shares in the new company which will be allotted to the shareholders of the old companies. (Assume the same face value).

Solution:

Balance Sheet of XY Ltd. after Amalgamation (as on 31-03-2014)

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Share Capital (Re.1 each)	1,05,000	Cash in Hand	150
Reserves	11,500	Cash at Bank	3,850

Profit & Loss A/c	3,500	Sundry Debtors	28,500
Sundry Creditors	4,000	Plant	16,500
		Stock	22,000
		Premises	40,000
		Patents	13,000
Total	**1,24,000**	**Total**	**1,24,000**

Number of Shares Issued in XY Ltd.

- X Ltd. Shareholders: 80,000 shares
- Y Ltd. Shareholders: 25,000 shares
- Total Shares Issued: 1,05,000 shares

This balance sheet reflects the financial position of XY Ltd. after the amalgamation of X Ltd. and Y Ltd.

5. Rajltd., and Gopi ltd., agreed upon an amalgamation. The balance sheet of both the companies were as follows:

Liabilities	**Raj ltd Rs.**	**Gopi ltd Rs.**	**Assets**	**Raj ltd., Rs.**	**Gopi ltd Rs.**
Issued capital			Furniture	9,000	6,300
(Rs.10 each)	30,000	24,000	Debtors	14,400	18,000
Reserve	---	1,500	Bank	18,360	12,240
Profit & loss A/c	---	3,600	Profit & loss A/c	1,140	---

Sundry creditors	12,900	7,440			
Total	**42900**	**36,540**	**Total**	**42,900**	**36,540**

The assets of Raj ltd., are to be taken over at book values except furniture which is to be written down by Rs.3060. Gobi ltd., assets are to be taken over at book values except debtors which are to be considered worth 9,900. The share capital of the combined company is to be 2400 preference shares of Rs.10 each fully paid and ordinary shares of Rs.5eachfully paid. The allocation of the shares is equal except that the surplus capital of Raj ltd., is to be satisfied by preference shares.

Solution:

Journal Entries for the Amalgamation

1. For Taking Over Assets and Liabilities

Furniture A/c Dr. 5,940

Debtors A/c Dr. 14,400

Bank A/c Dr. 18,360

Profit & Loss A/c Dr. 1,140

To Sundry Creditors A/c 12,900

To Business Purchase A/c 26,940

(Being assets and liabilities of Raj Ltd. taken over)

Furniture A/c Dr. 6,300

Debtors A/c Dr. 9,900

Bank A/c Dr. 12,240

To Sundry Creditors A/c 7,440

To Business Purchase A/c 21,000

(Being assets and liabilities of Gopi Ltd. taken over)

2. For Discharge of Purchase Consideration

Business Purchase A/c Dr. 47,940

To Preference Share Capital A/c (Rs.10 each) 24,000

To Equity Share Capital A/c (Rs.5 each) 23,940

(Being shares issued to Raj Ltd. and Gopi Ltd. shareholders)

Balance Sheet of the New Company after Amalgamation

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Preference Share Capital (Rs.10 each)	24,000	Furniture	12,240
Equity Share Capital (Rs.5 each)	23,940	Debtors	24,300
Sundry Creditors	20,340	Bank	30,600
		Profit & Loss A/c	1,140
Total	68,280	Total	68,280

This final balance sheet reflects the new company's position after the amalgamation of Raj Ltd. and Gopi

Ltd.

6. Show the balance sheet of the new company P ltd., and Q ltd., propose to amalgamate.

Their balance sheet as on 31-3-14wereasfollows:

Liabilities	P ltd Rs.	Q ltd., Rs.	Assets	P ltd., Rs.	Q ltd., Rs.
Equity share capital	4,00,000	1,50,000	Fixed assets	3,30,000	100000
General reserve	1,80,000	15,000	Investment (face		
Profit &loss A/c	60,000	23,000	valuesRs.80000)	72,000	---
creditors	1,04,500	24,500	Stock	1,60,000	40,500
			Debtors	93,500	50,000
			cash	89,000	22,000
Total	**7,44,500**	**2,12,500**	**Total**	**7,44,500**	**2,12,500**

Profit after tax	P Ltd., Rs.	Q Ltd., Rs.
1991	1,23,000	41,500
1990	1,09,500	31,500
1989	99,000	27,000

Goodwill may be taken at 4 years purchase of average super profits of 3years from trading on the bases of 10% normal trading profit on closing capital invested. B ltd., is formed for the purpose of amalgamation of both companies.

Prepare balance sheet of B ltd., as on year ended.

Solution:

Computation of Goodwill

1. Average Profit Calculation:

- P Ltd.: (1,23,000 + 1,09,500 + 99,000) / 3 = 1,10,500
- Q Ltd.: (41,500 + 31,500 + 27,000) / 3 = 33,333

2. Capital Employed:

- P Ltd.: 4,00,000 + 1,80,000 + 60,000 = 6,40,000
- Q Ltd.: 1,50,000 + 15,000 + 23,000 = 1,88,000

3. Normal Profit @ 10% on Capital Employed:

- P Ltd.: 10% of 6,40,000 = 64,000
- Q Ltd.: 10% of 1,88,000 = 18,800

4. Super Profit Calculation:

- P Ltd.: 1,10,500 - 64,000 = 46,500
- Q Ltd.: 33,333 - 18,800 = 14,533

5. Goodwill @ 4 Years Purchase of Super Profits:

- P Ltd.: 46,500 × 4 = 1,86,000
- Q Ltd.: 14,533 × 4 = 58,132

Total Goodwill = 1,86,000 + 58,132 = 2,44,132

Journal Entries in the Books of B Ltd.

1. For Taking Over Assets and Liabilities

Fixed Assets A/c Dr. 4,30,000

Investments A/c Dr. 72,000

Stock A/c Dr. 2,00,500

Debtors A/c Dr. 1,43,500

Cash A/c Dr. 1,11,000

Goodwill A/c Dr. 2,44,132

To Creditors A/c 1,29,000

To Business Purchase A/c 10,72,132

(Being assets and liabilities taken over)

2. For Discharge of Purchase Consideration

Business Purchase A/c Dr. 10,72,132

To Equity Share Capital A/c (at Rs.10 each) 10,72,132

(Being shares issued to shareholders of P Ltd. and Q Ltd.)

Balance Sheet of B Ltd. as on 1st April 2014

Liabilities	**Amount (Rs.)**	**Assets**	**Amount (Rs.)**
Equity Share Capital (Rs.10 each)	10,72,132	Fixed Assets	4,30,000
Creditors	1,29,000	Investments	72,000
		Stock	2,00,500
		Debtors	1,43,500
		Cash	1,11,000
		Goodwill	2,44,132
Total	**12,01,132**	**Total**	**12,01,132**

This completes the balance sheet for B Ltd. after the amalgamation.

7. The companies carrying on similar business enter into a contract to amalgamate a new company called 'A' co. ltd., being formed to take over the assets and liabilities of each. The following are the respective balance sheets, showing the values of the assets as agreed in the contract, and it is provided then fully paid Rs.50 shares shall be issued by the new company to the value of the net asset of each of the old companies.

E Company Ltd., Balance sheet as on 31st December 2013

Liabilities	Rs.	Assets	Rs.
Share capital:		Property	75,000
2000 shares of Rs.100each	2,00,000	Machinery	1,00,000
Sundry creditors	30,000	Stock	45,000
Reserve fund	50,000	Debtors	35,000
Profit & loss A/c	10,000	Cash in hand	35,000
Total	2,90,000	Total	2,90,000

S. Company Ltd., Balance sheet as on 31-12-2013

liabilities	Rs.	` Assets	Rs.
Share capital:		Property	95,000

2500 shares of Rs.100 each	2,50,000	Machinery	90,000
Sundry creditors	41,000	Stock	75,000
		Cash at bank	11,000
		Profit & loss	20,000
Total	**2,91,000**	**Total**	**2,91,000**

State what shares the liquidator of each company will receive from the new company. Give the opening entries in the books of the new company and give its balance sheet.

Solution:

Computation of Net Assets

Particulars	E Ltd. (Rs.)	S Ltd. (Rs.)
Total Assets	2,90,000	2,91,000
Less: Liabilities (Creditors)	30,000	41,000
Net Assets	2,60,000	2,50,000

Since shares are issued at Rs.50 each, the number of shares to be issued is:

- **E Ltd.**: 2,60,000 / 50 = 5,200 shares
- **S Ltd.**: 2,50,000 / 50 = 5,000 shares

Total shares issued by A Co. Ltd. = 10,200 shares.

Journal Entries in the Books of A Co. Ltd.

1. **For Taking Over Assets and Liabilities**

Property A/c Dr. 1,70,000

Machinery A/c Dr. 1,90,000

Stock A/c Dr. 1,20,000

Debtors A/c Dr. 35,000

Cash A/c Dr. 46,000

To Creditors A/c 71,000

To Business Purchase A/c 5,10,000

(Being assets and liabilities taken over from E Ltd. and S Ltd.)

For Discharge of Purchase Consideration

Business Purchase A/c Dr. 5,10,000

To Equity Share Capital A/c (10,200 shares of Rs.50 each) 5,10,000

(Being shares issued to E Ltd. and S Ltd. shareholders)

Balance Sheet of A Co. Ltd. as on 1st January 2014

Liabilities	**Amount (Rs.)**	**Assets**	**Amount (Rs.)**
Equity Share Capital (Rs.50 each)	5,10,000	Property	1,70,000
Creditors	71,000	Machinery	1,90,000
		Stock	1,20,000
		Debtors	35,000
		Cash	46,000
Total	**5,81,000**	**Total**	**5,81,000**

This finalizes the journal entries and the balance sheet after the amalgamation.

8. X Co., Ltd., and Y co., Ltd., agreed to amalgamate and from a new company XY Ltd., which takes over assets and liabilities (with certain exceptions) of the existing companies. On 31st December2013 the balance sheet of the two companies was as under.

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**
Capital:			Property	1,05,000	60,000
15000 shares	1,50,000	---	Plant	25,000	15,000
8000 shares	---	80,000	Vehicle	10,000	---

General reserve	80,000	---	Stock	60,000	78,000
P &LA/c	20,000	20,000	Debtors	82,000	21,000
5%debentures	---	60,000	cash	43,000	18,000
creditors	75,000	32,000			
Total	**3,25,000**	**1,92,000**	**Total**	**3,25,000**	**1,92,000**

The assets and liabilities are to be taken over at book values with the following exceptions:

(i) Goodwill of X Co., and Y Co., is to be valued at Rs.80000 and Rs.30000 respectively.

(ii) Vehicle of X Ltd., is to be valued at Rs.30000

(iii) Debentures of Y co., are to be discharged at premium of 5% by the issue of 5% debentures of XY co.,

(iv) Debtors and cash of Y co.,, are to be retained by the liquidator and creditors are to be paid out of the proceeds there of.

Compute the basis on which shares in XY co., will be issued to shareholders in the existing companies. Pass entries in the books of XY Ltd., and draw up the balance sheet of the XY Co., as at 1st January 1994.

Computation of Purchase Consideration

Particulars	X Ltd. (Rs.)	Y Ltd. (Rs.)
Book Value of Net Assets	3,25,000	1,92,000
Add: Goodwill	80,000	30,000
Adjusted Net Assets	4,05,000	2,22,000
Total Purchase Consideration	6,27,000	

The shares of XY Ltd. will be issued based on the proportion of adjusted net assets.

- **X Ltd.**: (4,05,000 / 6,27,000) * Total Equity Shares Issued
- **Y Ltd.**: (2,22,000 / 6,27,000) * Total Equity Shares Issued

Assuming shares are issued at Rs.10 each, the number of shares to be issued is:

- X Ltd.: 40,500 shares
- Y Ltd.: 22,200 shares

Journal Entries in the Books of XY Ltd.

1. **For Taking Over Assets and Liabilities**

Property A/c Dr. 1,65,000

Plant A/c Dr. 40,000

Vehicle A/c Dr. 30,000

Stock A/c Dr. 1,38,000

Goodwill A/c Dr. 1,10,000

To Creditors A/c 75,000

To 5% Debentures A/c 63,000

To Business Purchase A/c 6,27,000

(Being assets and liabilities taken over and goodwill recognized)

2 Property A/c Dr. 1,65,000

Plant A/c Dr. 40,000

Vehicle A/c Dr. 30,000

Stock A/c Dr. 1,38,000

Goodwill A/c Dr. 1,10,000

To Creditors A/c 75,000

To 5% Debentures A/c 63,000

To Business Purchase A/c 6,27,000

(Being assets and liabilities taken over and goodwill recognized)

For Discharge of Purchase Consideration

Business Purchase A/c Dr. 6,27,000

To Equity Share Capital A/c (62,700 shares of Rs.10 each) 6,27,000

(Being shares issued to X Ltd. and Y Ltd. shareholders)

For Discharge of Y Ltd.'s Debentures at 5% Premium

5% Debentures A/c Dr. 60,000

Premium on Redemption A/c Dr. 3,000

To 5% Debentures (XY Ltd.) A/c 63,000

(Being debentures issued at 5% premium to discharge Y Ltd.'s Debenture Holders)

Balance Sheet of XY Ltd. as on 1st January 1994

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Equity Share Capital (Rs.10 each)	6,27,000	Property	1,65,000
5% Debentures	63,000	Plant	40,000
Creditors	75,000	Vehicle	30,000
Goodwill	1,10,000		
Stock	1,38,000		
Total	**7,65,000**	**Total**	**7,65,000**

This finalizes the journal entries and the balance sheet after the amalgamation.

9. Raman ltd and Sivan ltd., have agreed to amalgamate. A new company, Sivaram ltd., has been formed to take over the running concerns as on 31.3.2014. The following balance sheet shows the position of the companies amalgamating.

Liabilities	Raman ltd Rs.	Sivan ltd Rs.	Assets	Raman ltd Rs.	Sivan ltd Rs.
Share capital			Goodwill	---	6,000
Rs.10 each	20,000	50,000	Plant	14,000	20,000
General	16,000	----	Furniture	8,000	12,000
Reserve Capital	---	4,000	Stock	16,000	8,000
Reserve P&l a/c	4,000	----	Sundry debtors	10,000	17,000
Loan from	10,000	16,000	Cashat bank	12,000	7,000
Bank creditors	10,000	6,000	P&l A/c	---	6,000
Total	**60,000**	**76,000**	**Total**	**60,000**	**76,000**

Sivan ltd. took over all the assets and liabilities of both the transfer and companies at book values except cash at bank, creditors and the goodwill of sivan ltd., which was considered worth less.

The purchase consideration was agreed at Rs.60000 for Raman ltd., and Rs.40000 for Sivan ltd. Fully paid equity shares of Rs.10 each were issued to settle the purchase price for both the companies.

Cash at bank of both the companies was exactly sufficient to settle their creditor's at10% discount and pay the liquidation expenses.

You are required to give important ledger accounts to close the books of the transferor companies and the journal entries and balance sheet in the books of the transferee company, assuming that the amalgamation is in books of the transferee company, assuming that the amalgamation is in the nature of purchase.

10. The following is the balance sheet of Suma Ltd., which is absorbed by Kusum ltd.,

liabilities	Rs.	Assets	Rs.
Equity shares(Rs.10each)	6,00,000	Fixed Assets:	
Pref., share(Rs.100each)	2,00,000	Machinery	3,40,000
Current liabilities	1,00,000	Building	1,60,000
10% debentures	3,00,000	Current Assets:	
		Stock	4,00,000
		Debtors	2,00,000
		Profit & LossA/c	1,00,000
Total	12,00,000	Total	12,00,000

Kusum Ltd., takes over Suma Ltd., on the following terms:

(a) Take the fixed assets at10% depreciation, stock at Rs.300000 and debtors after a provision of 25%.

(b) Debentures are to be settled by issuing them 9% debentures in Kusum Ltd., current liabilities will be taken over at book values.

(c) The consideration will be discharged by issue of 10000 equity shares of Rs.10 each in Kusum Ltd., at an agreed value of Rs.15 per share and the balance in cash.

(d) Expenses of liquidation of Rs.20000 will be reimbursed by Kusum Ltd.,

You are required to Prepare

(a) Journal entries to close the books of Suma Ltd.,

(b) Journal entries to record the acquisition assuming it is in the nature of purchase.

Solution:

Journal Entries in the Books of Suma Ltd.

1. Transfer of Assets to Realisation A/c

Realisation A/c	Dr.	10,30,000	
To Machinery A/c			3,06,000
To Building A/c			1,44,000
To Stock A/c			3,00,000
To Debtors A/c			1,50,000

(Fixed assets recorded after 10% depreciation, stock at agreed value, and debtors after 25% provision)

2. Transfer of Liabilities to Realisation A/c

Current Liabilities A/c Dr. 1,00,000

10% Debentures A/c Dr. 3,00,000

To Realisation A/c 4,00,000

(Transfer of liabilities to realisation account)

3. Consideration Received from Kusum Ltd.

Equity Shares in Kusum Ltd. A/c Dr. 1,50,000

Cash A/c Dr. 3,80,000

To Realisation A/c 5,30,000

(Consideration settled by issuing 10,000 equity shares at Rs. 15 each and balance in cash)

4. Payment of Liquidation Expenses (Reimbursed by Kusum Ltd.)

Realisation A/c Dr. 20,000

To Bank A/c 20,000

(Liquidation expenses paid)

5. Profit or Loss on Realisation Transferred to Equity Shareholders

Realisation A/c Dr. 50,000

To Equity Shareholders A/c 50,000

(Profit on realisation transferred to equity shareholders)

6. Settlement of Equity and Preference Shareholders

Equity Shareholders A/c Dr. 6,50,000

Preference Shareholders A/c Dr. 2,00,000

To Equity Shares in Kusum Ltd. A/c 1,50,000

To Cash A/c 7,00,000

(Settlement of shareholders by distributing consideration)

Journal Entries in the Books of Kusum Ltd.

1. Recording Assets and Liabilities Taken Over

Machinery A/c Dr. 3,06,000

Building A/c Dr. 1,44,000

Stock A/c Dr. 3,00,000

Debtors A/c Dr. 1,50,000

Goodwill A/c Dr. 30,000

To 9% Debentures A/c 3,00,000

To Current Liabilities A/c 1,00,000

To Purchase Consideration A/c 5,30,000

(Recording the acquisition of assets and liabilities)

2. Settlement of Purchase Consideration

Purchase Consideration A/c Dr. 5,30,000

To Equity Share Capital A/c 1,00,000

To Securities Premium A/c 50,000

To Bank A/c 3,80,000

(Settlement of purchase consideration by issuing shares and paying balance in cash)

3. Reimbursement of Liquidation Expenses

Goodwill A/c Dr. 20,000

To Bank A/c 20,000

(Liquidation expenses reimbursed to Suma Ltd.)

This completes the journal entries for closing Suma Ltd. and recording the acquisition in the books of Kusum Ltd.

11. **The following is the balance sheet of Ram Ltd., as on 31st December2013.**

liabilities	**Rs.**	**Assets**	**Rs.**
Equity Share capital:		Goodwill	20,000
(Rs.10 each)	1,50,000	Plant Stock	1,50,000
6%preferenceshares(Rs.10 each)	1,00,000	Debtors	80,000
5%debentures	50,000	Cash at bank P &	1,20,000
Employees profit sharing A/c	14,000	L A/c	8,800

Bank Over draft	20,000	Preliminary expenses	40,200
Creditors	91,500	Commission on issue of shares	5,000
Interest on drawing due	2,500		4,000
Contingent liabilities:			
Arrears of preference dividendRs.12000	----		
Total	**4,28,000**	**Total**	**4,28,000**

Raj ltd., agreed to absorb Ram Ltd., from1-7-93onthefollowingterms;

(a) Raj ltd., is to take over all tangible assets except cash.

(b) Itistopaythedebentureholdersatapremiumof10%byissueofits 6% preference shares of Rs.10 each

(c) It is to issue one equity share of Rs.10 each and make a payment of Rs.4 in cash in exchange of every two equity shares in Ram ltd.,

(d) Creditors will receive 90% of the sums due to the min fully paid equity shares of 10 each in Raj ltd., in full settlement of their claims.

(e) Preference shareholders will be issued 5% debentures in Raj ltd.,

Pass the journal entries in the books of Raj ltd., to record this take over. Also show the necessary ledger account sto close the books of Ram ltd., the absorption may be taken as in the nature to purchase.

Solution:

Journal Entries in the Books of Raj Ltd.

1. For Purchase Consideration Payable:

Business Purchase A/c Dr. 3,48,700

To 6% Preference Share Capital A/c 55,000

To Equity Share Capital A/c 93,000

To 5% Debentures A/c 100,000

To Bank A/c 10,000

To Creditors A/c 82,200

(Being purchase consideration recorded)

2. For Taking Over the Assets and Liabilities of Ram Ltd.:

Goodwill A/c Dr. 20,000

Plant A/c Dr. 1,50,000

Stock A/c Dr. 80,000

Debtors A/c Dr. 1,20,000

Preliminary Expenses A/c Dr. 8,800

Commission on Issue of Shares A/c Dr. 5,000

To 5% Debentures A/c 55,000

To Employees Profit Sharing A/c 14,000

To Business Purchase A/c 3,48,700

(Being assets and liabilities of Ram Ltd. taken over)

3. For Settlement of Debenture Holders:

5% Debentures A/c Dr. 50,000

Premium on Redemption A/c Dr. 5,000

To 6% Preference Shares A/c 55,000

(Being debentures settled at 10% premium by issuing preference shares)

4. For Settlement of Creditors:

Creditors A/c Dr. 91,500

To Equity Share Capital A/c 82,200

To Bank A/c 9,300

(Being creditors settled by issuing 90% in shares and 10% in cash)

5. For Settlement of Equity Shareholders:

Equity Share Capital A/c Dr. 1,50,000

To Equity Share Capital (Raj Ltd.) A/c 75,000

To Bank A/c 30,000

(Being equity shares settled in Raj Ltd. in the ratio of 2:1 with Rs.4 in cash per share)

Ledger Accounts in the Books of Ram Ltd.

Realisation Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Goodwill	20,000	By 5% Debentures	50,000
To Plant	1,50,000	By Employees Profit Sharing	14,000
To Stock	80,000	By Creditors	91,500
To Debtors	1,20,000	By Raj Ltd. (Purchase Consideration)	3,48,700
To Preliminary Expenses	8,800		
To Commission on Issue of Shares	5,000		

Total	3,53,800	Total	3,53,80

Equity Shareholders Account

Particulars	**Amount (Rs.)**	**Particulars**	**Amount (Rs.)**
To Equity Shares in Raj Ltd.	75,000	By Equity Share Capital	1,50,000
To Cash	30,000		
Total	1,05,000	Total	1,05,000

Bank Account

Particulars	**Amount (Rs.)**	**Particulars**	**Amount (Rs.)**
To Raj Ltd. (Cash Received)	10,000	By Creditors (Settlement)	9,300
To Raj Ltd. (Equity Holders Cash)	30,000	By Equity Shareholders	30,000
Total	40,000	Total	40,000

This finalizes the journal entries and ledger accounts for the absorption of Ram Ltd. by Raj Ltd.

12. The following are the balance sheets of Honey ltd., and stark ltd., as on 31-3-2014

Liabilities	Honey ltd. Rs.	Stark ltd., Rs.	Assets	Honey ltd., Rs.	Stark ltd., Rs.
Share capital:			Fixed assets	240000	500000
Shares of Rs.10each	200000	400000	Debtors	40000	20000
General reserve	80000	120000	Stock	60000	80000
P & LA/c	20000	---	cash	20000	20000
Creditors	60000	100000			
Total	**360000**	**620000**	**Total**	**360000**	**620000**

Stark ltd., agreed to absorb Honey ltd., on the following terms;

Stark ltd., to give one share of Rs.10 each, at an agreed value of Rs.30 per quoted in the market at Rs.45 per share.

The trade liability is to be taken over.

Give the required journal entries in the books stark ltd., and the balance sheet after the absorption is completed if the amalgamation in the nature of purchase.

Solution:

Journal Entries in the Books of Stark Ltd.

1. For Purchase Consideration Payable to Honey Ltd.:

Business Purchase A/c Dr. 360,000

To Equity Share Capital A/c (Rs.10 each at Rs.30 per share) 120,000

To Securities Premium A/c 240,000

(Being purchase consideration recorded)

2. For Taking Over the Assets and Liabilities of Honey Ltd.:

Fixed Assets A/c Dr. 240,000

Debtors A/c Dr. 40,000

Stock A/c Dr. 60,000

Cash A/c Dr. 20,000

To Creditors A/c 60,000

To Business Purchase A/c 360,000

(Being assets and liabilities of Honey Ltd. taken over)

3. For Settlement of Purchase Consideration:

Equity Share Capital A/c Dr. 120,000

Securities Premium A/c Dr. 240,000

To Equity Shareholders A/c 360,000

(Being issue of shares in full settlement to Honey Ltd. shareholders)

Balance Sheet of Stark Ltd. After Absorption

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Equity Share Capital (Rs.10 each)	520,000	Fixed Assets	740,000
Securities Premium	240,000	Debtors	60,000
General Reserve	120,000	Stock	140,000
Creditors	160,000	Cash	40,000
Total	**1,040,000**	**Total**	**1,040,000**

This final balance sheet reflects the position of Stark Ltd. after absorbing Honey Ltd. under the purchase method of amalgamation.

Problem

Moon Ltd., having a share capital of Rs.3,00,000 divided into 3,000 shares of Rs.100 each, resolves to sub-divide the shares into 30,000 shares of Rs.10 each. Pass the necessary journal entry.

Books of Moon Ltd.

Journal Entry

Date	Particulars	L.F	Dr.	Cr.
	Share Capital (Rs.100) A/c Dr		3,00,000	
	To Share Capital (Rs.10) A/c			3,00,000
	(Being 3,000 shares of Rs.100 each sub-Divided in to 30,000 shares of Rs.10 each as per Board's resolution dated)			

Problem

The following is the Balance Sheet of Star Ltd as on 31.03.2021

Liabilities	Rs.	Assets	Rs.
1,00,000 equity shares of		Land	1,00,000
Rs.10 each	10,00,000	Plant & Machinery	2,30,000
Sundry Creditors	1,73,000	Furniture & Fittings	68,000
		Stock	1,50,000
		Debtors	70,000

		Cash at Bank	5,000
		P & L a/c	5,50,000
	11,73,000		11,73,000

Scheme of Capital Reduction was:

a) The equity shares to be reduced to Rs.4 per share.

b) Plant and Machinery to be written down to Rs.1,50,000.

c) Stock to be revalued at Rs.1,40,000.

d) The provision on debtors for doubtful debts to be created Rs.2,000.

e) Land to be revalued at Rs.1,42,000.

Pass journal entries to give effect to the above arrangement and also prepare reconstruction a/c.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Equity Share Capital a/c(Rs.10)	Dr.		10,00,000	
	To Equity Share Capital a/c (Rs.4)				4,00,000
	To Capital Reduction a/c				6,00,000
	(Being the Rs. 10 equity shares converted into Rs.4 equity share and the balance transferred to capital reduction a/c)				
	Land a/c	Dr.		42,000	
	To Capital Reduction a/c				42,000
	(Being the appreciation of Land taken for Capital reduction)				
	Capital Reduction a/c	Dr.		6,42,000	
	To Profit & Loss a/c				5,50,000
	To Plant & Machinery a/c				80,000
	To Stock a/c				10,000
	To Provision for Doubtful Debts a/c				2,000
	(Being the accumulated loss written off				

	and the assets were reduced)			

Capital Reduction a/c

Particulars	Rs.	Particulars	Rs.
To Plant and Machinery a/c	80,000	By Equity Share Capital a/c	6,00,000
To Stock a/c	10,000	By Land a/c	42,000
To Provision for Doubtful debts a/c	2,000		
To Profit & Loss a/c	5,50,000		
	6,42,000		6,42,000

Problem

The Balance sheet of Anbu Ltd on 31.12.2019 was as follows.

Liabilities	Rs.	Assets	Rs.
Authorized capital 20,000 shares of Rs.100 each	20,00,000	Land and Buildings	1,00,000
Subscribed capital 19,000 Share of Rs.10 each	19,00,000	Machinery	2,60,000
Creditors	1,00,000	Furniture	20,000
Due to Raju & 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 Raju & 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 utilized in writing off the goodwill, profit and Loss a/c and in writing down the value machinery.

Pass necessary journal entries and prepare the Balance sheet.

Solution:

1. 19,000 shares are reduced to Rs.40 each

Old Equity share capital a/c Dr 19,00,000 (19000 x 100)

To New Equity share capital a/c 7,60,000 (19000 x 40) To

capital Reduction a/c 11,40,000 (1900 x 60)

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

Raju & Co., a/c Dr 100000

To Equity share capital (1000 shares x Rs.40) 40,000

To Capital reduction a/c (1000 shares x Rs.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)

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

External Reconstruction

13. Kala Ltd., Balance sheet showed the following position on31st March 2014

Liabilities	Rs.	Assets	Rs.
10000 equity shares of Rs.100each	1000000	Fixed assets	800000
		Current assets	400000
Capital reserve	200000	Cash at bank	200000
Bank loan	200000	Profit & loss A/c	300000
Trade creditors	300000		
Total	**1700000**	**Total**	**1700000**

Mala ltd., was in corporate to take the fixed assets and 60% of the current assets at an agreed value of Rs.900000 to be paid as to Rs.740000 inequity shares of Rs.10 each and the balance in 9% debentures. The debentures were accepted by bank in settlement of loan. Remaining current assets realized Rs.90000. After meeting Rs.20000 expenses of liquidation, all the remaining cash was paid to the creditors in full settlement.

Give journal entries in the books of both the companies and prepare the initial balance sheet of Mala ltd., if the amalgamation is in the nature of purchase.

Solution:

Journal Entries in the Books of Kala Ltd. (Vendor Company)

1. Transfer of Assets and Liabilities to Realisation Account:

Realisation A/c Dr. 1,200,000

To Fixed Assets A/c 800,000

To Current Assets A/c (60% of 400,000) 240,000

To Cash at Bank A/c 200,000

(Being assets transferred to Realisation A/c)

2. Consideration Received from Mala Ltd.:

Mala Ltd. A/c Dr. 900,000

To Equity Shares in Mala Ltd. A/c 740,000

To 9% Debentures in Mala Ltd. A/c 160,000

(Being purchase consideration received)

3. Discharge of Bank Loan using Debentures:

Bank Loan A/c Dr. 200,000

To 9% Debentures in Mala Ltd. A/c 160,000

To Cash A/c (Balance settled in cash) 40,000

(Being loan settled using debentures and cash)

4. Realisation of Remaining Current Assets:

Cash A/c Dr. 90,000

To Realisation A/c 90,000

(Being remaining current assets realized)

5. Payment of Liquidation Expenses:

Realisation A/c Dr. 20,000

To Cash A/c 20,000

(Being liquidation expenses paid)

6. Payment to Creditors in Full Settlement:

Trade Creditors A/c Dr. 300,000

To Cash A/c 300,000

(Being creditors settled in full)

7. Closing Realisation Account (Profit/Loss Transferred to Equity Shareholders):

Realisation A/c Dr. (Balancing Figure)

To Equity Shareholders A/c (Balancing Figure)

8. Settlement of Equity Shareholders:

Equity Shareholders A/c Dr. (Final Amount)

To Equity Shares in Mala Ltd. A/c 7 40,000

To Cash A/c (If any balance remains)

(Being settlement made to shareholders)

Journal Entries in the Books of Mala Ltd. (Purchasing Company)

1. Recording the Purchase of Assets:

Fixed Assets A/c Dr. 800,000

Current Assets A/c Dr. 240,000

To Realisation A/c 1,040,000

(Being assets taken over from Kala Ltd.)

2. Recording the Liability of Consideration:

Realisation A/c Dr. 900,000

To Equity Share Capital A/c 7 40,000

To 9% Debentures A/c 1 60,000

(Being purchase consideration settled)

Initial Balance Sheet of Mala Ltd.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)

Equity Share Capital (Rs.10 each)	740,000	Fixed Assets	800,000
9% Debentures	160,000	Current Assets	240,000
Total	900,000	Total	1,040,000

This concludes the accounting process for the amalgamation of Kala Ltd. into Mala Ltd.

14. The following is the balance sheet of X C p., ltd. As on 31st Dec 2013

Liabilities	Rs.	Assets	Rs.
Share capital:		Land & building	90000
12000 shares of Rs.10 each	120000	Machinery	50000
Fully paid		Stock	17000
Sundry creditors	30000	Sundry debtors	20000
Bank overdraft	28000	Profit & loss A/c	1000
Total	**178000**	**Total**	**178000**

The company went into voluntary liquidation and the assets were sold to Y co., ltd. For Rs.150000 payable as to Rs.60000 in cash (which sufficed to discharge creditors and bank overdraft and to pay off the winding up expenses of Rs.2000) and as to Rs.90000 by the allotment of 12000shares of Rs.10each of the Y co.Ltd.Rs.750 per share paid up. Draw up the important ledger accounts to close the books of X ltd., and the journal entries for recording these transactions in the books of Y ltd.,

Solution:

Realisation Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Land & Building	90,000	By Y Co. Ltd. (Consideration)	1,50,000
To Machinery	50,000		
To Stock	17,000		
To Sundry Debtors	20,000		
To Bank (Winding up Expenses)	2,000		
To Equity Shareholders (Profit)	9,000		
Total	1,88,000	Total	1,88,000

Bank Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Y Co. Ltd. (Cash Received)	60,000	By Sundry Creditors	30,000
		By Bank Overdraft	28,000
		By Realisation A/c (Winding Up)	2,000
Total	60,000	Total	60,000

Sundry Creditors Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Bank	30,000	By Balance b/d	30,000
Total	30,000	Total	30,000

Bank Overdraft Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Bank	28,000	By Balance b/d	28,000
Total	28,000	Total	28,000

Equity Shareholders Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Realisation A/c (Profit)	9,000	By Share Capital	1,20,000
To Shares in Y Co. Ltd.	90,000		
To Cash (if any)	21,000		
Total	1,20,000	Total	1,20,000

Books of X Co. Ltd.

Journal Entries in the Books of Y Co. Ltd.

1. For Purchase of Assets and Liabilities:

Realisation A/c Dr. 1,50,000

To Bank A/c 60,000

To Share Capital A/c (12,000 shares at Rs. 7.50 paid-up) 90,000

(Being purchase of assets and liabilities from X Co. Ltd.)

2. For Issuing Shares to X Co. Ltd.:

Share Capital A/c Dr. 90,000

To Equity Shareholders A/c 90,000

(Being shares issued to X Co. Ltd.)

This completes the liquidation process of X Co. Ltd. and records the acquisition in Y Co. Ltd.

Methods of Accounting for Amalgamation

There are two main methods of accounting for amalgamation.

i) The pooling of interest method and

ii) The purchase method.

Internal Reconstruction Vs External Reconstruction

Internal Reconstruction	External Reconstruction
A company is tore organize is capital structure or reduction of share.	One company goes in to liquidation (closed).
No new company is formed	New company is formed
Capital is reduced due to construction.	Share capital is not reduced due to reconstruction.
Internal arrangement	External arrangement

It does not takeover other company assets and liabilities	It takes over other company assets and liabilities

Accounting Treatment for Amalgamation

In the books of Transfer or company or Selling company

Model Journal entries in the books of Selling Company (or) transferor company

1. Transferring all the assets at book value

Realisation a/c Dr

To Assets a/c (Book value)

(Being various assets transferred to realization a/c)

2. Liabilities taken over:-

Liabilities a/c Dr.

To Realisation a/c (Book value)

(Being various liabilities transferred to realization a/c)

3. Purchase consideration due

Purchasing Company a/c Dr

To Realisation a/c

(Being the Purchase Consideration due)

4. For receiving the purchase consideration

Banka/c Dr

Shares in purchasing company a/c Dr

Debenture in the purchasing company a/c Dr

To Purchasing company a/c

(Being the purchase consideration received)

5. ***For assets sold by the vendor company not taken over by the purchasing company***

Bank a/c Dr

To Realization a/c

(Being the Assets sold)

6. Liabilities paid by the vendor company not taken over by the purchasing company

Liabilities a/c Dr

Realisation a/c Dr

To Bank a/c

(Being repayment of liabilities)

7. a) Realisation Expenses paid by vendor company

Realisation a/c Dr.

To Bank a/c

(Being the liquidation expenses paid)

b) Realisation expenses paid by purchasing

company No Entry

c) Liquidation expenses are reimbursed by the purchasing company

i) For payment of expenses

Purchasing company a/c Dr

To Bank a/c

ii) Forgetting the expenses reimbursed

Banka/c Dr

To Purchasing company a/c

8. For settlement of pref. shareholder

a) To transfer the preference share capital

If excess payment is made:

Preference Share Capital a/c Dr

Realisation a/c Dr

To Pref. Shareholders a/c (or)

If agree to accept less than the amount due:

Preference Share Capital a/c Dr

To Preference Shareholders a/c

To Realisation a/c

b) For Settlement of the amount:

Preference Shareholders a/c Dr

To Bank

9. Transfer of Profit or Loss on realization account: For Profit

Realisation a/c Dr

To Equity shareholders a/c (or)

For Loss:

Equity Shareholders a/c Dr

To Realisation a/c

10. For transferring the equity share capital, accumulated profit setc.

Equity Share Capital a/c Dr

General Reserve a/c Dr

Dividend Equalization Fund a/c Dr

Share Premium a/c Dr

Profit & Loss a/c Dr

Any other reserve or Profit a/c Dr

To Equity shareholders a/c

(Being all the accumulated profits and capital transferred)

11. For transferring the accumulated losses and expenses not yet written off, if any

Equity shareholders a/c Dr

To Profit & Loss (loss) a/c To

Preliminary expenses a/c To

Discount on shares a/c

To Discount on Debentures a/c (Being

all accumulated losses transferred)

12. For final settlement

Equity Shareholders a/c Dr

To Shares in purchasing company a/c

To Debenture in the purchasing company a/c To

Bank a/c

(Being the final settlement)

Model Journal Entries in the Books of Purchasing Company (or) Transferee Company

1. For the purchase consideration due

Business Purchase a/c Dr

To Liquidators of the vendor company. (Being

the purchase consideration due)

2. For recording the assets and liabilities taken over

Various Assets a/c Dr

*Goodwill a/c (Bal.Fig.)

To Various Liabilities a/c To

Business Purchase a/c

To Capital Reserve a/c*(Bal. Fig.)

(Being the assets and liabilities taken over recorded)

Note:"Only one item will appear

3. For settlement of the purchase consideration

Liquidators of the vendor company a/c Dr.

To Equity Share Capital a/c

To Debenture a/c

To Bank a/c

(Being the final settlement made)

Note: If the shares and debentures are issued at a premium or at a discount appropriate entry should be passed)

4. For meeting the liquidation expenses of the vendor company directly

Goodwill a/c Dr

To Bank a/c

(Being the liquidation expenses paid)

I) Amalgamation in the nature of merger, under pooling of interests method:

1. For purchase consideration payable

Business Purchase A/c Dr

To Liquidator of Transferor company

[Being purchase price payable]

2. For Assets and Liabilities

Sundry Assets A/c Dr

(Each asset separately at their book values)

To Sundry Liabilities

(Each liability separately at their book values)

To Business Purchase A/c

To Profit and loss A/c

To Reserves

(Each reserve separately)

[Being assets and liabilities taken over and reserves of transfer or company recorded]

3. For Payment of purchase price

Liquidator of transferor Company A/c Dr To

Bank A/c

To Share Capital A/c

To Securities Premium A/c

[Being shares issued to settle the purchase consideration]

Note: In pooling of interests method cash is paid for fractions of shares alone.

4. For expenses of winding up paid by Transferee company

General Reserve A/c Dr

To Bank

[Being expenses of transferee co., paid as per agreement]

5. For Formation Expenses paid

Preliminary expenses A/c Dr

To Bank A/c

[Being formation expenses paid]

6. For payment of any Debentures of transfer or company

Debentures (Transferor Co.,) A/c Dr

To Debentures A/c

To Bank A/c

[Being payment made to debenture holders of Transferor Co., as per agreement]

7. For payment to creditors of Transferor Co.

Creditors (Transferor Co.,) A/c Dr

To Bank A/c

[Being payment as per agreement]

(II) In case of Amalgamation in the nature of purchase, under Purchase Method:

1. For Purchase consideration payable

Business purchase A/c Dr

To Liquidator of Transferor Co.,

[Being purchase price payable]

2. For Assets and Liabilities taken over

Sundry Assets A/c

(Each asset separately) Dr

Goodwill A/c Dr

To Sundry Liabilities A/c

(Each liability separately)

To Business purchase A/c

To Capital Reserve A/c

[Being assets and liabilities taken over and goodwill/ capital reserve there on] Note:

In the above entry, either goodwill or capital reserve will be the Balancing figure.

3. For Payment of Purchase price

Liquidator of Selling Co. A/c Dr

To Bank A/c

To Share Capital A/c

To Securities Premium A/c

To Debentures A/c

[Being purchase price paid in the form of cash, shares and debentures]

4. For expenses of Liquidation agreed to be paid by Transferee Co.

Goodwill A/c Dr

To Bank A/c

[Being expenses agreed to be paid]

5. For Formation expenses of Transferee Co.,

Preliminary expenses A/c Dr

To Bank A/c

[Being formation expenses paid]

6. For statutory reserves of the Transferor Co. to be continued

Amalgamation adjustment A/c Dr

To Statutory Reserves A/c

[Being reserves to be continued]

7. For settlement of Debentures holders or creditors of Transferor Co.,

Debentures (transferor co.) A/c Dr

Creditors (transferorco.) A/c Dr

To Debentures A/c To

Bank A/c

[Being settlement of Transferor company's liabilities as per agreement]

Problem:

A Co. Ltd. agreed to acquire the assets excluding cash as on 31st December 2020 of B Co.Ltd. The balance sheet of B Ltd. as on that date was:

Liabilities	Rs.	Assets	Rs.
EquitycapitalRs.10each	3,00,000	Goodwill	60,000
General reserve	60,000	Land &Building	1,20,000
Debentures	50,000	Plant & Machinery	2,00,000
Creditors	10,000	Stock	80,000
Profit & Loss	80,000	Debtors	30,000
		Bank	10,000
	5,00,000		5,00,000

The consideration was as follows:

a) A cash payment of Rs.4 for every shares of B Ltd.

b) The issues of one share of Rs.10 each (Market value Rs.12.50) in the A Co. Ltd. For every share in B Co. Ltd.

c) The issue of 1100 debentures of Rs. 50 each in A Co. Ltd. To enables B Ltd to discharge its debentures at a premium of 10%.

d) The expenses of liquidation of B Ltd. Amounting to Rs.4000 were to be met by themselves.

Give the journal entries in the books of both the companies.

Solution:

Journal Entries in the Books of B Co. Ltd.

1.	Realisation a/c	Dr	4,90,000	
	To Goodwill			60,000
	To Land & building			1,20,000
	To Plant & machinery			2,00,000
	To Stock			80,000
	To Debtors			30,000
2.	Creditors a/c	Dr	10,000	
	To Realisation			10,000
3.	Debentures a/c	Dr	50,000	
	Realisation a/c	Dr	5,000	
	To Debenture holders a/c			55,000
4.	White Co. Ltd.	Dr	4,75,000	
	To Realisation			4,75,000
5.	Banka/c	Dr	1,20,000	
	Shares a/c	Dr	3,00,000	
	Debentures a/c	Dr	55,000	
	To White Co. Ltd			4,75,000
6.	Realization a/c	Dr	10,000	

	To bank a/c			10,000
7.	Share capital a/c	Dr	3,00,000	
	General reserve a/c	Dr	60,000	
	Profit & Loss a/c	Dr	80,000	
	To Shareholders a/c			4,40,000
8.	Shareholders a/c	Dr	24,000	
	To Realisation a/c			24,000
9.	Shareholders a/c	Dr	4,16,000	
	To Shares			3,00,000
	To Bank			1,16,000
10.	Debenture holders a/c	Dr	55,000	
	To Debentures			55,000
11.	Realisation a/c	Dr	4,000	
	To Cash			4,000

Journal Entries in the Books of A Co. Ltd.

1.	Business purchase a/c	Dr	4,75,000	
	To Liquidator of B co. a/c			4,75,000
2.	Goodwill	Dr	45,000	

	Land & building Dr	1,20,000	
	Plant& machinery Dr	2,00,000	
	Stock Dr	80,000	
	Debtors Dr	30,000	
	To Business purchase a/c		4,75,000
3.	Liquidator of B co. a/c Dr	4,75,000	
	To Sharecapital		2,40,000
	To Share premium		60,000
	To Debenture		55,000
	To Bank		1,20,000

Problem

The following is the balance sheet of Ambika Ltd.

Liabilities	Rs.	Assets	Rs.
20,000 10% Pref. shares of Rs.10 each	2,00,000	Goodwill	50,000
2,000equityshares of Rs.100 each	2,00,000	Other Fixed Assets	1,80,000
Creditors	30,000	Stock	50,000
		Debtors	60,000
		P & L a/c	90,000
	4,30,000		**4,30,000**

The following resolutions were passed and the scheme was duly approved by the court:

i) Equity shares of Rs.100 each be reduced to fully paid up shares of Rs.50 each.

ii) 10% Pref. shares of Rs.10 each be reduced to10% Pref. shares of Rs.6 each fully paid up.

iii) Goodwill and debit balance of Profit & Loss a/c fully written off.

iv) The balance of the amount be used to write off other fixed assets.

Give journal entries and revised Balance Sheet of the company. Also prepare Capital Reduction Account.

Solution:

Journal Entries in the Books of Ambika Ltd.

1.	Old Equity Share Capital a/c	Dr	2,00,000	
	To New Eq. Share capital a/c			1,00,000
	To Capital Reduction a/c			1,00,000
2.	Old Pref. share capital a/c	Dr	2,00,000	
	To New Pref. share capital a/c			1,20,000
	To Capital Reduction a//c			80,000
3.	Capital Reduction a/c	Dr	1,80,000	
	To Goodwill a/c			50,000
	To Profit & Loss a/c			90,000
	To Fixed assets a/c			40,000

Capital Reduction Account

	Rs.		Rs.

To Goodwill a/c	50,000	By Eq. share capital	1,00,000
To P/La/c	90,000	By Pref. share capital	80,000
To Fixed Assets a/c	40,000		
	1,80,000		**1,80,000**

Balance Sheet of Ambika Ltd.

	Rs.		**Rs.**
Pref. share capital	1,20,000	Fixedassets	1,40,000
Equitysharecapital	1,00,000	Stock	50,000
Creditors	30,000	Debtors	60,000
	2,50,000		**2,50,000**

Absorption

Problem

White Ltd agreed to acquire the business to Green Ltd as an 31st December 2020, The Balance sheet of Green Ltd on that date was as follows:

Liabilities	Rs.	Assets	Rs.
Share capital in fully paid shares of Rs.10	6,00,000	Goodwill	1,00,000
General Reserve	1,70,000	Land and Buildings	3,00,000
Profit & Loss a/c	1,10,000	Plant	3,40,000
6% Debentures	1,00,000	Stock	1,68,000
Creditors	20,000	Debtors	36,000
		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.

b) The issue of Rs. 90,000 Rs.10 shares fully paid in white Ltd having an agreed value of Rs.12.50pershare.

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.4,00,000 and created 5% provision on debtors. Expenses of Liquidation Rs.6,000 were paid by white Ltd.

Give journal entries to close the books of Green Ltd. And to record the acquisition of business in the books of white Ltd.

Solution: **Calculation of purchase consideration:**

Form		**Amounts**
1)Cash 60,000 shares x Rs.2.50	=	1,50,000
2)Equity shares 90,000 shares x Rs.12.50	=	11,25,000
3)5% Debentures 1,00,000 x 20/100	=	1,20,000
Purchase consideration	**=**	**13,95,000**

Journal entries:

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

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

Realisation a/c Dr		10,00,000	
To Goodwill 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

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

3)Purchase consideration due from white ltd:

White Ltd a/c Dr		13,95,000	
To Realisation a/c			13,95,000

4)Purchase consideration

Cash a/c	Dr	1,50,000	
Equity shares a/c	Dr	11,25,000	
5% Debentures a/c	Dr	1,20,000	

To white Ltd a/c 13,95,000

5) 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

6) **Transfer:**

Debenture holders a/c Dr 1,20,000

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

7) 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 share holders a/c 8,80,000

8)Profit on realisation

Realisation a/c Dr 3,95,000

To Equity shareholders a/c 3,95,000

9) Final payment made

Equity shareholders a/c Dr 12,75,000

To Shares in White Ltd a/c 11,25,000

To Bank a/c 1,50,000

Realisation Account

To Goodwill	1,00,000	By Creditors	20,000
To Land & Buildings	3,00,000	By white Ltd	13,95,000
To Plant	3,40,000		
To Stock	1,68,000		
To Debtors	36,000		
To Cash	56,000		
To Debenture holders (loss)	20,000		
To Equity share holders (profit)(b.f.)	3,95,000		
	14,15,000		14,15,000

In the books of White Ltd., (Purchasing Company)

1) **Purchase consideration to be paid**

Business purchase a/c Dr 13,95,000

To Liquidator of Green Ltd 13,95,000

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

Land and Buildings a/c Dr 4,00,000

Stock a/c	Dr	1,68,000	
Plant a/c	Dr	3,40,000	
Debtors a/c	Dr	56,000	
Cash a/c	Dr	36,000	
Goodwill a/c (b.f)	Dr	4,17,800	
To Creditors a/c			20,000
To Provision for doubtful debts			2,800
To Business purchase a/c			13,95,000

3) Purchase Consideration paid

Liquidators of Green Ltd. a/c	Dr	13,95,000	
Discount on issue of Debenture a/c	Dr	5,000	
To Equity Share Capital			9,00,000
To Share premium			2,25,000
To 5% Debenture			1,25,000
To Bank			1,50,000

4) Liquidation expenses paid

Goodwill a/c	Dr	6,000	
To Bank			6,000

UNIT II

UNIT II

Accounting of Banking Companies

Final Statements of Banking Companies (As per New Provisions)-Non- Performing Assets - Rebate on Bills Discounted - Profit and Loss alc - Balance Sheet as per Banking Regulation Act 1949

Accounting of Banking Companies

Final Statements of Banking Companies (As per New Provisions)

Banking companies in India are required to prepare their **final accounts** in compliance with the **Banking Regulation Act, 1949**, **Companies Act, 2013**, and **Reserve Bank of India (RBI) guidelines**. The final statements of banks must be prepared in accordance with the **new provisions prescribed by RBI and applicable accounting standards (Ind AS & IFRS)**.

1. Legal & Regulatory Framework for Banking Financial Statements

The preparation of final accounts of banking companies follows:

- **Banking Regulation Act, 1949 (Section 29 & 30)**
- **Companies Act, 2013 (Schedule III – Division III for NBFCs & Banks)**
- **Reserve Bank of India (RBI) Guidelines & Master Circulars**
- **Indian Accounting Standards (Ind AS 109, 32, 107, etc.)**

2. Components of Final Accounts of Banking Companies

A. Balance Sheet (As per Schedule III of the Banking Regulation Act, 1949)

The **Balance Sheet** of a banking company includes the following:

i) Liabilities Side

1. **Capital** – Paid-up capital of the bank.
2. **Reserves & Surplus** – Statutory reserves, general reserves, and retained earnings.
3. **Deposits** – Savings, current, and fixed deposits.
4. **Borrowings** – Loans from RBI, other banks, and international sources.
5. **Other Liabilities & Provisions** – Tax provisions, contingent liabilities, etc.

ii) Assets Side

1. **Cash & Cash Equivalents** – Cash in hand and balances with RBI & other banks.
2. **Investments** – Government securities, bonds, and mutual funds.
3. **Advances (Loans & Advances)** – Loans given to customers, businesses, and other banks.
4. **Fixed Assets** – Land, buildings, computers, etc.
5. **Other Assets** – Deferred tax assets, prepaid expenses, etc.

B. Profit & Loss Account (As per Banking Regulation Act, 1949)

The **Profit & Loss Account** records banking revenues and expenses.

i) Income Section

1. **Interest Earned** – Interest on loans, investments, and interbank deposits.
2. **Other Income** – Fees, commissions, forex income, and investment gains.

ii) Expenditure Section

1. **Interest Expended** – Interest paid on deposits and borrowings.
2. **Operating Expenses** – Salaries, rent, legal expenses, etc.

3. **Provisions & Contingencies** – Provision for NPAs, bad debts, depreciation, etc.
4. **Net Profit (Loss)** – Profit before tax (PBT) and Profit after tax (PAT).

C. Cash Flow Statement (As per Ind AS 7)

- **Operating Activities** – Cash from deposits, loans, interest income, and expenses.
- **Investing Activities** – Cash used in investments, securities, and asset purchases.
- **Financing Activities** – Borrowings, dividend payments, and capital issuance.

D. Notes to Accounts (As per RBI &Ind AS 107, 32, 109)

- **Risk disclosures** – Credit risk, liquidity risk, and market risk.
- **Non-Performing Assets (NPA) classification & provisioning**.
- **Capital adequacy as per Basel III norms**.
- **Related party transactions & contingent liabilities**.

3. Key Changes in Banking Financial Statements (New Provisions)

1. **Implementation of Ind AS (Indian Accounting Standards) for Banks**.
2. **Revised NPA Classification & Provisioning Norms** under RBI guidelines.
3. **Basel III Capital Adequacy Reporting**.
4. **Stricter Asset Quality Review (AQR) by RBI** for transparency.
5. **Inclusion of Digital Banking & Fintech-related disclosures**

Non- Performing Assets

A **Non-Performing Asset (NPA)** refers to a loan or advance where the borrower fails to make **principal or interest payments** for a **specified period**. As per the **Reserve Bank of India (RBI) guidelines**, an asset is classified as an **NPA** if the repayment remains overdue for more than **90 days** in the case of **term loans, cash credit, and overdraft accounts**.

Classification of NPAs (As per RBI Norms)

NPAs are categorized based on the duration of default:

1. Substandard Assets

- Loans that remain NPA for **up to 12 months**.
- Carry **higher credit risk** due to uncertainty in repayment.

2. Doubtful Assets

- Loans that remain NPA for **more than 12 months**.
- **Higher risk** as chances of full recovery are low.

3. Loss Assets

- Loans identified as **irrecoverable** by the bank or auditors.
- Yet to be **fully written off** from the bank's books.

Causes of NPAs

1. **Economic slowdown** – Reduced business profitability affects loan repayment.
2. **Poor credit appraisal** – Banks granting loans without proper verification.
3. **Willful default** – Borrowers intentionally avoiding repayments.
4. **Industry-specific issues** – Decline in demand or policy changes.
5. **Natural calamities** – Disrupting businesses and farmers' ability to repay loans.
6. **Political & legal delays** – Affecting recovery proceedings.

Impact of NPAs on Banks

1. **Reduces profitability** – Banks have to set aside funds for loan loss provisions.
2. **Affects credit expansion** – Banks become cautious in lending.
3. **Loss of investor confidence** – Rising NPAs lower stock prices.
4. **Weakens banking system** – Higher NPAs increase financial instability.

Measures to Control NPAs

1. Preventive Measures

- **Stronger credit assessment** before loan sanctioning.
- **Stringent monitoring of loans** through early warning signals.
- **Use of technology & AI** to detect risk-prone accounts.

2. Corrective Measures

- **Restructuring of loans** – Revising repayment terms.
- **One-Time Settlement (OTS)** – Allowing defaulters to repay at a discount.
- **SARFAESI Act, 2002** – Banks can seize assets of defaulters.
- **Insolvency & Bankruptcy Code (IBC), 2016** – Faster resolution of bad loans.

Rebate on Bills Discounted

Rebate on Bills Discounted refers to the **unearned discount** on bills that are discounted by a bank but have **not yet matured** at the end of an accounting period. It represents **future income** and is treated as a **liability** in the bank's books until the bill reaches maturity.

Accounting Treatment of Rebate on Bills Discounted

1. **At the end of the accounting year:**

- The rebate on **outstanding discounted bills** is calculated.
- It is recorded as an **expense** in the Profit & Loss Account.
- The amount is shown as a **liability** in the Balance Sheet under "Other Liabilities".

Journal Entry:

Interest & Discount A/c Dr.

To Rebate on Bills Discounted A/c

(Being rebate on unearned discount transferred to liability)

At the beginning of the next accounting year:

- The previous year's rebate is **reversed**, as it now becomes **earned income**.

Journal Entry:

Rebate on Bills Discounted A/c Dr.

To Interest & Discount A/c

(Being rebate on bills reversed as income)

Formula for Rebate on Bills Discounted

Rebate=Bill Amount×Discount Rate×Remaining Days /365

Where:

- **Bill Amount** = Total value of bills outstanding.
- **Discount Rate** = Agreed rate of discount.
- **Remaining Days** = Number of days left until bill maturity.

Example Calculation

- A bank discounts a bill of **Rs.50,000** at **10% per annum** on **December 1, 2024**, for **90 days**.
- The financial year ends on **December 31, 2024**.
- The remaining period after year-end = **60 days** (from Jan 1 to March 1, 2025).

Rebate=50,000×10×60/365×100

=50,000×10×60/36,500

=Rs.821.92

Thus, **Rs.821.92** is recorded as **Rebate on Bills Discounted (Liability)**.

Importance of Rebate on Bills Discounted

1. Ensures Accurate Profit Calculation

Rebate on bills discounted represents **unearned income** from bills that will mature in the next financial period. By accounting for this, banks **do not overstate their income**, ensuring accurate **net profit or net loss** calculation.

2. Compliance with Accounting Standards

As per the **accrual accounting principle**, income should be recognized only when earned. The **rebate on bills discounted** prevents premature income recognition, ensuring compliance with **GAAP (Generally Accepted Accounting Principles) and IFRS (International Financial Reporting Standards).**

3. Reflects True Financial Position

By treating unearned discount as a **liability**, the balance sheet provides a **fair representation of actual income and liabilities**. This helps banks and stakeholders understand the **true financial position** of the institution.

4. Prevents Overstatement of Earnings

If the rebate on bills discounted is not accounted for, a bank may report **higher profits**, leading to **misleading financial statements**. Proper accounting prevents **artificial inflation of earnings** and ensures financial transparency.

5. Helps in Regulatory Compliance

Banks are required to maintain **accurate financial records** as per the **Banking Regulation Act, 1949**, and **Reserve Bank of India (RBI) guidelines**. Proper recognition of rebate on bills discounted ensures **compliance with regulatory norms**.

6. Useful for Investors & Analysts

Investors and financial analysts rely on bank financial statements to make **investment decisions**. The correct treatment of rebate on bills discounted ensures **fair valuation** of income, helping stakeholders make **informed decisions**.

7. Smoothens Financial Reporting

Since some bills extend beyond the financial year, recognizing the rebate **smoothens income recognition**, avoiding fluctuations in reported profits between financial periods.

Profit and Loss alc

The **Profit and Loss Account (P&L A/c)** is a financial statement that records a company's **revenues, expenses, profits, or losses** over a specific period (usually a financial year). It helps in determining the **net profit or net loss** of a business by comparing **income and expenditures**.

Objectives of Profit & Loss Account

The **Profit & Loss Account (P&L A/c)** is a financial statement that summarizes a company's **revenues, expenses, profits, or losses** over a specific period. It is essential for evaluating financial performance and making informed business decisions.

1. To Determine Net Profit or Net Loss

The primary objective of a **P&L Account** is to calculate whether a business has **earned a profit or incurred a loss** during the financial period by comparing total **income with total expenses**.

2. To Assess Financial Performance

The P&L Account helps businesses evaluate their **profitability trends** over time. A consistent **profit** indicates a stable business, while continuous **losses** may signal financial distress.

3. To Facilitate Decision-Making

By analyzing revenues and expenses, business owners and managers can **identify cost-saving opportunities**, improve efficiency, and decide on **future investments, pricing strategies, and cost control measures**.

4. To Help in Tax Calculation

The **net profit** recorded in the Profit & Loss Account is used to compute **income tax liability**. Proper maintenance of this account ensures accurate tax payments and avoids legal penalties.

5. To Compare with Previous Periods

A business can compare its **current year's profit or loss** with previous years to analyze growth patterns, identify strengths, and address weaknesses. This helps in **forecasting and setting financial goals**.

6. To Provide Transparency to Stakeholders

Investors, creditors, and financial institutions review a company's P&L Account to assess its **financial health, profitability, and sustainability** before making investment or lending decisions.

7. To Comply with Legal and Regulatory Requirements

Companies are required to prepare and present **Profit & Loss Accounts** as per the **Companies Act, 2013**, **Income Tax Act**, and **Accounting Standards (AS/IFRS/GAAP)**. Compliance ensures **legal credibility and avoids financial discrepancies**.

8. To Assist in Dividend Distribution

The P&L Account determines the **profits available for distribution as dividends** to shareholders. Higher profits may lead to **higher dividend pay-outs**, attracting more investors.

Format of Profit and Loss Account

1. Debit Side (Expenses & Losses)

- **Operating Expenses:** Salaries, Rent, Electricity, and Advertisement.

- **Cost of Goods Sold (COGS):** Raw materials, factory expenses.
- **Financial Charges:** Interest on loans, bank charges.
- **Depreciation & Amortization:** Reduction in asset value.
- **Provisions & Taxes:** Bad debts, income tax, deferred tax.

2. Credit Side (Incomes & Gains)

- **Revenue from Sales:** Main income source.
- **Other Income:** Commission, rent received, interest income.
- **Gains from Investments:** Profit from stocks, real estate, or other investments.
- **Discounts & Miscellaneous Incomes.**

Format (Example)

Profit & Loss Account for the Year Ended 31st March 202X

Dr. (Debit Side)	Rs.	Cr. (Credit Side)	Rs.
Salaries & Wages	50,000	Sales Revenue	3,00,000
Rent & Utilities	20,000	Interest Income	10,000
Depreciation	10,000	Discount Received	5,000
Advertising Expense	15,000		
Interest Paid	5,000		
Tax & Provisions	30,000		

Dr. (Debit Side)	Rs.	Cr. (Credit Side)	Rs.
Net Profit (Balancing Figure)	1,85,000	**Total**	3,15,000

Steps to Prepare a Profit & Loss Account

1. **Transfer Gross Profit from the Trading Account.**
2. **Record all operating and non-operating expenses.**
3. **List all incomes and gains earned during the year.**
4. **Calculate Net Profit or Net Loss:**
   - **If income > expenses → Net Profit**
   - **If expenses > income → Net Loss**
5. **Transfer Net Profit to Capital Account (for proprietorships) or Retained Earnings (for companies).**

Importance of Profit & Loss Account

1. **Evaluates Business Performance** – Helps measure profitability.
2. **Aids Financial Planning** – Helps in budgeting and decision-making.
3. **Assists in Tax Calculation** – Determines income tax liability.
4. **Useful for Investors & Lenders** – Shows business profitability and financial health.
5. **Regulatory Compliance** – Required under **Companies Act, 2013** and **Income Tax Act**.

Balance Sheet as per Banking Regulation Act 1949

The **Balance Sheet of a bank** is prepared in accordance with **Schedule III of the Banking Regulation Act, 1949**. It provides a summary of the **financial position** of a bank, listing its **assets and liabilities** on a specific date. The format ensures **uniformity, transparency, and compliance** with regulatory requirements.

Format of a Bank's Balance Sheet

As per Schedule III of the Banking Regulation Act, 1949

1. Liabilities (Sources of Funds)

1. **Capital** – Paid-up share capital of the bank.
2. **Reserves & Surplus** – Statutory reserves, retained earnings, etc.
3. **Deposits** –
   - Demand Deposits (Current Account, Savings Account).
   - Time Deposits (Fixed Deposits, Recurring Deposits).
4. **Borrowings** – Loans taken from RBI, other banks, financial institutions.
5. **Other Liabilities & Provisions** – Tax provisions, interest payable, bills payable.

2. Assets (Application of Funds)

1. **Cash & Bank Balances** – Cash in hand, balances with RBI and other banks.
2. **Investments** – Government securities, bonds, treasury bills.
3. **Advances** – Loans, cash credit, overdrafts, and bills discounted.
4. **Fixed Assets** – Land, buildings, furniture, and equipment.
5. **Other Assets** – Accrued interest, prepaid expenses, tax assets, deferred revenue expenditure.

Format (Example)

Balance Sheet of XYZ Bank Ltd. as on 31st March 202X

Liabilities	Rs.	Assets	Rs.
Capital	5,00,000	**Cash & Bank Balances**	2,00,000
Reserves & Surplus	3,00,000	**Investments**	8,00,000
Deposits	20,00,000	**Advances (Loans & Advances)**	10,00,000
Borrowings	10,00,000	**Fixed Assets**	3,00,000
Other Liabilities & Provisions	2,00,000	**Other Assets**	2,00,000
Total Liabilities	**40,00,000**	**Total Assets**	**40,00,000**

Key Provisions of Banking Regulation Act, 1949 for Balance Sheet

1. **Uniform Format** – All banks must follow Schedule III guidelines.
2. **Minimum Capital & Reserves** – Banks must maintain adequate capital reserves.
3. **Provisioning for NPAs** – Banks must set aside reserves for **Non-Performing Assets (NPAs)**.
4. **Disclosure of Investments & Advances** – Details of loan classification and investments must be disclosed.
5. **Statutory Liquidity Ratio (SLR) & Cash Reserve Ratio (CRR)** – Banks must maintain required reserves with RBI.

Importance of Bank's Balance Sheet

1. **Ensures Regulatory Compliance** – Fulfills RBI and Banking Regulation Act requirements.
2. **Reflects Financial Position** – Shows liquidity, solvency, and profitability.
3. **Aids Decision-Making** – Helps management, investors, and stakeholders.
4. **Ensures Transparency** – Provides a clear view of assets, liabilities, and reserves.

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

ABankingcompanyclosesitsaccountson31stMarcheveryyear.

3. Prohibition of Trading

A banking company cannot directly Orin directly deal with buying (or) 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 of by the banking company within 7 years 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. Charge 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 capitalized expenses (preliminary expenses) have been completely written off.

10. Cash Reserve:-

Every scheduled Bank has to maintain a sum equal to at least 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.

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	xxx	
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 /can 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.

Non-performing assets (NPA)

A Bank earns interest from customers through term loans, cash credit and overdrafts. If the interest or installment 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 categories.

i) Standard Assets:

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

ii) Sub–standard Assets:

Itisanon-performingassetforaperiodnotexceeding18 months for this a provision of10% of total outstanding is made.

iii) Doubtful Assets:

It is an on performing asset for a period exceeding12 months.

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

a) First year: 100%ofunsecuredportion+20%ofsecuredportion.

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

c) Beyond 3years: 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 or100% provision should be made.

Licensing of banking companies:-

Every banking can function in India only after obtain license 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

31st March ----- Form B –Third Schedule Rs.'000

		Schedule No	Year ended 31-03-........ Currentyear	Year ended 31-03-....... Previousyear
I	**INCOME**			
	Interestearned	13	xx	xx
	OtherIncome	14	xx	xx
II	**EXPENDITURE:**			
	Interestexpended	15	xx	xx
	OperatingExpenses	16	xx	xx
	Provisionsandcontingencies		xx	xx
			xxx	xxx
III	**Profit/Loss**			
	Netprofit/Lossfortheyear Profit/Loss		xx	xx
	brought forward		xx	xx
	Total		xx	xx
IV	**Appropriations**			
	Transfertostatutoryreserve		xx	xx
	Transfer to other reserve		xx	xx
	TransfertoGovt./Proposed Dividend		xx	xx
	BalancecarriedovertoBalance 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 on advances / Bills	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 sale 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	xx xx	xx xx

	Other assets.		
5.	Profit on exchange transaction **Less:** Loss on exchange 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 RBI/ Inter Bank Borrowings	xx	xx
3.	Others	xx	xx
	Total	xx	xx

Schedule–16 O per ating Expenses

S No.		Year ended 31-03 Current year	Y Pr
1)	Payments to and provision for Employees	xx	
2)	Rent, taxes and lighting	xx	
3)	Printing & Stationery	xx	
4)	Advertisements	xx	
5)	Depreciation on Bank Property	xx	
6)	Director fees, allowances & expenses	xx	
7)	Auditor fees, allowances & expenses	xx	
8)	Law charges	xx	
9)	Postage, Telegrams & Telephone	xx	
10)	Repairs & Maintenance	xx	
11)	Insurance	xx	
12)	Other expenditure	xx	
	Total	xx	

Problem

Prepare the profit & Loss a/c for the year ended 31-03-2022 of SBI ban

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SBI Bank Ltd

Profit and Loss account for the year ended 31-03-2022

Interest o
Interest o
Interest o
Interest o
Interest o
Payment t

Solution:

S.No.	Particulars	Schedule No	Year ended 31-03-22 (Rs.000)	Year ended 31-03-21 (Rs.000)

I	**Income**			
	Interest Earned	13	520	--
	Other income	14	15	--
	Total		535	
II	**Expenditure**			
	Interest expended	15	340	--
	Operating expenses	16	185	--
	Total		525	
III	**Profit/Loss**			
	Net profit for the year (I-II)		10	--
	Profit brought forward		--	--
	Total		10	---
IV	**Appropriation**			
	Transfer to statutory		2.5	
	Reserve 10 x 25/ 100			
	Transfer to other reserve		--	--
	Transfer to Govt./Proposed Dividend		--	--
	Balance carried over to balance sheet		7.5	--
	Total		10	--

Working Notes:

Schedule13–Interest earned

(Rs.'000)

Interest on Loans	250
Interest on overdraft	70
Interest on cash credit	160
Discount on bills discounted	40
	520

Schedule 14- Other Income

, exchange and brokerage 15

	Total	15

Schedule 15- Interest expended (Rs.'000)

Interest on savings account	150
Interest on fixed Deposit	190
	340

Schedule - 16O per ating expenses

(Rs.'000)

Payment to employees	150
Rent, taxes & insurance	5
Audit fee	10
Director's fee	20
	185

Commission

Problem

From the following particulars, Prepare the profit & Loss a/c of Dena bank ltd., for the year ending 31.03.2020.

Interest oı
Commissi
Interest oı
Sundry cł
Rent and '
Establishr

Dena Bank Ltd

Profit and Loss account for the year ended 31-03-2020

Solution:

S.No.	Particulars	Schedule No	Year ended 31-03-22 (Rs.000)	Year ended 31-03-21 (Rs.000)
I	**Income**			
	Interest Earned	13	7,900	--
	Other income	14	100	--
	Total		8,000	
II	**Expenditure**			
	Interest expended	15	3,200	--
	Operating expenses	16	1,151	--
	Total		4,351	
III	**Profit/ Loss**			
	Net profit for the year (I-II)		3,649	--

	Profit brought forward		--	--
	Total		3,649	---
IV	**Appropriation** Transfer to statutory Reserve 3,649x25/100 Transfer to other Reserve Transfer to Govt /Proposed Dividend Balance carried over to balance sheet		912.30 -- -- 2,736.70	 -- -- --
	Total		3,649	--

Working

Notes:

Schedule 13– Interest earned

(Rs.'000)

Interest on Loans	2,490
Interest on overdraft	1,600
Interest on cash credit	2,320
Discount on bills discounted	1,490
	7,900

Schedule 14- Other Income

	(Rs.'000)
Commission	100
Total	100

Schedule 15- Interest expended

	(Rs.'000)
Interest on deposits	3,200
	3,200

Schedule 16 Operating expenses

	(Rs.'000)
Sundry charges (Dr)	100
Rent, taxes & insurance	200
Establishment	500

Audit fees	35
Director's fees	16
Bad debts to be written off	300
	1,151

Specimen Form of Balance sheet

Balance sheet of ....(name of the Bank) as on 31st March20.............

(Rs.000)

	Schedule No.	**As on 31-03-…. Current year**	**As on 31-03-.... Previous year**
Capital & Liabilities:			
Capital	1	xx	xx
Reserves & 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	6	xx	xx

Bank of India Balance with banks and money at call and short notice	7	xx	xx
Investments	8	xx	xx
Advances	9	xx	xx
Fixed assets	10	xx	xx
Other assets	11	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 Nationalized Banks Capital(fully owned by central Government)	xx	xx
II. For Banks incorporate outside India	xx	xx

III. For other Banks		
Authorized capital	xx	xx
Issued capital	xx	xx
Subscribed capital	xx	xx
Called up capital	xx	xx
Less: Calls unpaid	xx	xx
Add: Forfeited shares	xx	xx

Schedule2–Reserves & Surplus

	Current year	**Previous year**
I. <u>Statutory Reserves</u>		
Opening balance	xx	xx
Additions during the year	xx	xx
Deductions during the year	xx	xx
II. <u>Capital Reserves</u>		
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**	xx	xx
	Opening Balance	xx	xx
	Additions during the year	xx	xx
	Deductions during the year		
V.	Balance in Profit & Loss account	xx	xx
	Total (I,II,III,IV,V)		

Schedule– 3 Deposits

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

India		
ii)Deposits of branches outside India	xx	xx

Schedule- 4 Borrowings

	Currentyear	**Previousyear**
I. Borrowings in	xx	xx
India Borrowings in	xx	xx
RBI 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 accrued	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 II. (including foreign exchange notes)	xx xx	xx xx
II. Balance with Reserve Bank of India 1. In current accounts 2. In other accounts	xx xx	xx xx
Total (I,II)	xx	xx

chedule – 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 b) In other deposit account	xx xx	xx xx
ii) Money at call & short notice a) With banks b) With other institutions	xx xx	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

	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

	Current year	Previous year
i) Government securities ii) Subsidiaries/ Joint ventures iii) Other investments	xx xx xx	xx 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) Unsecured	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 outside 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 (CI and II)	xx	xx

Schedule 10 –Fixed Assets

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

Problem

From the following particulars of Lakshmi Bank Ltd. Prepare a Balance sheet as on 31-03-2017

	(Rs.in'000)
Authorized capital	10,000
Subscribed capital	9,000
Investments	7,000
Bills discounted	15,000
Profit & Loss a/c(Cr)	850
Endorsement on bills for collection	100
Money at call and short notice	11,000

Cash in hand	4,000
Liability for customers for acceptances	5,000
Cash with RBI	6,000
Statutory Reserve	4,000
Cash with State Bank of India	4,000
Letters of credit issued	500
Telegraphic transfer payable	800
Bank draft payable	1,200
Short loans	40
Rebate on bills discounted	10
Acceptance for customers	5,000
Loans and advances	12,000
Cash credit	10,000
Overdraft	1,000
Bills purchased	1,000
Current and deposit accounts	60,000
Investment fluctuation fund	100
Bills for collection	100
Buildings	5,000

Solution:

Schedule 1 Share capital

Subscribed capital 9,000

Schedule 2 Reserves & Surplus

Profit & Loss a/c	850
Statutory reserve	4,000
Investment	
Fluctuation fund	100
	4,950

chedule 3 Deposits

Current Deposit A/c's 60,000

Schedule 4 Borrowings

Short Loan 40

Schedule 5 Other liabilities

Telegraphic Transfer	800
Bank draft payable	1,200

Rebate in bills discounted	10
	2,010

Schedule 6 Cash balance with RBI

Cash in hand	4,000
Cash with RBI	6,000
	10,000

Schedule 7 Money at call & short notice

Money at call and short notice	11,000
Cash with State Bank of India	4,000
	15,000

Schedule 8 Investment

Investment	7,000

Schedule 9 Advances

Bills discounted	15,000
Loans & advances	12,000
Cash credit	10,000
Overdraft	1,000
Bills purchased	1,000
	39,000

Schedule 10 Fixed Assets

Building	5,000

Schedule 11 Other Assets

NIL

Schedule 12 Contingent Liabilities

Endorsement for bill	-	100
Liability for customers	-	5,000
Letter of credit issued	-	500
		5,600

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

Balance sheet of Lakshmi Bank Ltd for the year ended31-03-2017

I. Capital and Liabilities	Schedule	Ason31-03-2017
Share capital	1	9,000
Reserves and surplus	2	4,950
Deposits	3	60,000
Borrowing (Short term)	4	40
Other liabilities and provision	5	2,010
Total		76,000
II. Assets		
Cash in hand	6	10,000
Money at call and short notice	7	15,000
Investment	8	7,000
Advances	9	39,000
Fixed assets	10	5,000
Other assets	11	NIL
Total		76,000
Contingent Liabilities	12	5,600

Problem

Calculate Rebate on Bills discounted as on 31-03-2018

Bill Date	Amount	Period	Rate of Discount
15-01-2018	25,000	5 Months	8%
10-02-2018	15,000	4 Months	7%
25-02-2018	20,000	4 Months	7%
20-03-2018	30,000	3 Months	9%

Solution:

Calculation of Rebate on Bills discounted

Bill Date	Amount	Due Date	No. of days	Rate	Amount
15-01-2018	25,000	18-06-18	79	8%	433
10-02-2018	15,000	13-06-18	74	7%	213
25-02-2018	20,000	28-06-18	89	7%	341
20-03-2018	30,000	23-06-18	84	9%	621
	Rebate on Bills discounted Amount				1,608

Note: add 3 days as grace entry:

Problem

On 31st March, 2020 Indus Bank Ltd had the following unmeasured Bills.

Date of Bill	Amount	Term Months	Discount (pa)
12-01-2017	30,000	6	12%
07-02-2017	70,000	4	11%
02-03-2017	20,000	3	10%

Calculate the Rebate on Bills discounted and record necessary entry on 31st March 2017.

Solution:

Calculation of Rebate on Bills Discounted

Date of Bill	Due date	No. of days after 31^{st}March	Amount	Rebate on Bill
12-01-2017	15-07-2017	106	30,000	1045.48
07-02-2017	10-06-2017	71	70,000	1497.81
02-03-2017	15-06-2017	66	20,000	361.44
			Total	2904.73

Entry:

Discount a/c Dr 2904.73

To Rebate on Bills discounted a/c 2904.73

Problem

On 31^{st}March 2020, South India Bank Ltd., finds its advances classified as follows:

		Rs.
Standard assets		14,91,300
Sub–Standard assets		92,800
Doubtful assets (secured)		
	Doubtful for one year	25,660
	Doubtful for one year to 3 years	15,640
	Doubtful for more than 3 years	6,580
Loss assets		10,350

Calculate the amount of provisions to be made by the bank against the above mentioned advances.

Solution:

Particulars	Amount (Rs.)	% required as provision	Provision (Rs.)
Standard assets	14,91,300	0.25	3,728
Sub–Standard assets	92,800	10	9,280
Doubtful assets (secured)			
Doubtful for one year	25,660	20	5,132
Doubtful for one year to 3 years	15,640	30	4,692
Doubtful for more than 3 years	6,580	50	3,290
Loss assets	10,350	100	10,350
Total provision required			36,472

Problem

While closing its books of accounts, a commercial bank has its advances classified as follows:

	Rs.
Standard assets	16,000
Sub–Standard assets	1,300
Doubtful assets (secured)	
Doubtful for one year	700
Doubtful for one year to 3years	400

Doubtful for more than 3years 200

Loss assets 500

You are required to calculate the amount of provisions to be made by the bank against the above mentioned advances.

Solution:

Particulars	Amount (Rs.)	% required as provision	Provision (Rs.)
Standard assets	16,000	0.25	40
Sub–Standard assets	1,300	10	130
Doubtful assets (secured)			
Doubtful for one year	700	20	140
Doubtful for one year to 3 years	400	30	120
Doubtful for more than 3years	200	50	100
Loss assets	500	100	500
Total provision required			1,030

Problem

While closing its books of accounts, a commercial bank has its advances classified as follows: Rs.

Standard assets 48,000

Sub–Standard assets 2,400

Doubtful assets (unsecured)

Doubtful for one year 1,600

Doubtful for one year to 3years1,200

Doubtfulformorethan3years800

Loss assets 1,800

You are required to calculate the amount of provisions to be made by the bank against the above mentioned advances.

Solution:

Particulars	**Amount (Rs.)**	**% required as provision**	**Provision (Rs.)**
Standard assets	48,000	0.25	120
Sub–Standard assets	2,400	10	240
Doubtful assets (secured)			
Doubtful for one year	1,600	100	1,600
Doubtful for one year to 3 years	1,200	100	1,200
Doubtful for more than 3years	800	100	800
Loss assets	1,800	100	1,800
Total provision required			5,760

UNIT III

UNIT III

Insurance Company Accounts:

Meaning of Insurance- Principles- Types- Preparation of Final Accounts of Insurance Companies- Accounts of Life Insurance Business - Accounts of General Insurance Companies - New Format.

Insurance Company Accounts:

Insurance is a financial arrangement in which an individual or business (the insured) pays a premium to an insurance company (the insurer) in exchange for financial protection against potential losses or risks. It is a risk management tool that provides compensation for covered losses, helping to mitigate financial uncertainties.

Insurance is a financial arrangement that provides protection against potential risks and uncertainties. It helps individuals, businesses, and organizations safeguard themselves from unexpected financial losses by transferring the risk to an insurance company. The insurer agrees to compensate for the loss in exchange for a periodic payment known as a **premium**. The concept of insurance is based on mutual cooperation, where many individuals contribute to a common fund, which is used to support those who suffer from unforeseen events.

The key features of insurance highlight its purpose, structure, and operational mechanisms. Understanding these features helps policyholders and businesses make informed decisions while selecting an insurance policy.

1. Risk Coverage

One of the primary features of insurance is that it provides protection against various risks, such as accidents, theft, fire, health issues, property damage, and natural disasters. Different types of insurance policies cover different kinds of risks. For example, **life insurance** covers the financial needs of dependents in case of the policyholder's death, while **health insurance** covers medical expenses. **General insurance** policies cover non-life risks such as motor insurance, fire insurance, and business insurance. By covering these risks, insurance reduces the financial burden on individuals and businesses.

2. Contractual Agreement

Insurance is a **legal contract** between the insurer (insurance company) and the insured (policyholder). This contract, known as the **insurance policy**, specifies the terms and conditions, including the amount of coverage, premium payment schedule, duration, and claim procedures. Since insurance is based on a contract, it is legally binding and enforceable under the applicable insurance laws and regulations. Both parties must adhere to the terms mentioned in the contract to ensure smooth claim settlements.

3. Payment of Premium

To avail of insurance benefits, the policyholder must pay a **premium** to the insurance company. This premium can be paid on a monthly, quarterly, half-yearly, or annual basis, depending on the terms of the policy. The amount of premium is determined based on several factors, such as the type of insurance, the sum assured, the age and health of the insured, and the risk involved. For example, in health insurance, an older person or someone with pre-existing medical conditions may have to pay a higher premium than a young and healthy individual.

4. Pooling of Risks

Insurance works on the principle of **risk pooling**, where a large number of individuals contribute premiums into a common fund. This fund is managed by the insurance company and is used to pay for claims made by policyholders who suffer a loss. The idea is that while many people contribute, only a few will need compensation at any given time. This system helps spread the risk among a broader group, making it financially viable for insurance companies to cover large claims without burdening a single policyholder.

5. Claim Settlement

The primary purpose of insurance is to provide financial relief in times of need. When a covered loss occurs, the policyholder or their beneficiaries can file a **claim** with the insurance company. The insurer then verifies the claim details, assesses the loss, and disburses the compensation as per the policy terms. The efficiency of claim settlement is a crucial factor when choosing an insurance provider, as it directly impacts the financial security of the insured. A smooth and timely claim settlement process ensures that policyholders get the necessary financial support without unnecessary delays.

6. Principle of Indemnity

The **principle of indemnity** states that an insurance policy should only compensate the insured for the actual financial loss incurred and not allow them to make a profit. This feature applies to non-life insurance policies such as health, motor, and property insurance. For example, if a car is insured for Rs.5 lakh and suffers damage worth Rs.2 lakh, the insurance company will only pay Rs.2 lakh, not the full sum insured. This principle ensures fairness and prevents policyholders from misusing insurance to make financial gains. However, **life insurance does not follow this principle**, as the sum assured is paid to the beneficiary regardless of the actual financial loss.

7. Principle of Utmost Good Faith

Insurance contracts are based on **trust and honesty**. Both the insured and the insurer must disclose all relevant information truthfully. The insured must provide complete and accurate details while purchasing a policy, such as age, medical history, and existing health conditions (for health and life insurance). Similarly, the insurer must clearly outline the policy's terms, including exclusions and limitations. If any party fails to disclose critical information, the insurance contract may be declared void, and claims may be denied.

8. Legal Protection and Compliance

Insurance policies operate under **legal regulations** to protect policyholders and ensure fair claim settlements. Different countries have regulatory bodies overseeing insurance companies to maintain transparency, prevent fraud, and safeguard policyholders' rights. In India, for example, the **Insurance Regulatory and Development Authority of India (IRDAI)** regulates and supervises the insurance industry to ensure ethical practices. This legal framework ensures that insurance companies fulfil their obligations and policyholders receive rightful compensation.

9. Transfer of Risk

Insurance allows individuals and businesses to **transfer financial risks** to the insurer. Instead of bearing the entire financial burden of an unforeseen event, the insured pays a small premium to the insurance company, which assumes the responsibility of compensating for losses. This feature provides financial security and peace of mind, allowing individuals and businesses to focus on their growth without worrying about potential risks.

10. Encouragement of Savings and Investment

Certain types of insurance, such as **life insurance and pension plans**, serve as long-term savings and investment instruments. Policies like **endowment plans, unit-linked insurance plans (ULIPs), and retirement plans** offer both life coverage and financial growth. These policies help policyholders accumulate wealth over time, ensuring financial security for the future. Additionally, tax benefits on insurance premiums encourage individuals to invest in insurance as part of their financial planning.

Principles of Insurance

Insurance operates on several fundamental principles that ensure fairness, transparency, and efficiency in risk management. These principles govern the contractual relationship between the insurer and the insured, ensuring that both parties fulfil their obligations ethically and legally. Understanding these principles helps policyholders and insurance providers maintain trust and accountability.

1. Principle of Utmost Good Faith (UberrimaeFidei)

The principle of **utmost good faith** states that both the insured and the insurer must provide complete and truthful information while entering into an insurance contract.

- The insured must disclose all material facts, such as age, health conditions, financial status, and risks associated with the insured property.
- The insurer must clearly state the terms, conditions, coverage, and exclusions of the policy.

If any party hides or misrepresents information, the contract may be declared void, and the claim may be denied. For example, if a person with a pre-existing heart condition fails to disclose it while purchasing health insurance, the insurer may reject their claim later.

2. Principle of Insurable Interest

Insurable interest means that the insured must have a **financial or legal stake** in the subject matter of insurance.

- In **life insurance**, a person can take a policy on their own life, their spouse, or close family members.
- In **property insurance**, the policyholder must own the property or have a financial interest in it.
- In **business insurance**, a company can insure its assets, employees, or key executives.

If insurable interest does not exist, the insurance contract becomes invalid. For example, a person cannot take out insurance on a stranger's house or car, as they have no financial loss in case of damage.

3. Principle of Indemnity

The principle of **indemnity** states that insurance is meant to compensate the insured for the actual financial loss suffered, not to provide a profit.

- The insured is restored to their original financial position before the loss occurred.

- This principle applies to **general insurance policies** like health, fire, and motor insurance, but not to life insurance.

For example, if a factory suffers fire damage worth Rs.10 lakh, but the insured sum is Rs.15 lakh, the insurer will only pay Rs.10 lakh, ensuring that the insured does not make a profit from the claim.

4. Principle of Contribution

If an insured person has taken multiple insurance policies for the same asset from different insurers, the **principle of contribution** applies.

- The insured cannot claim the full amount from all insurers and profit from the loss.
- Each insurer will pay a proportionate amount of the claim based on the sum insured under their policy.

For example, if a business has fire insurance of Rs.10 lakh from two companies (Rs.5 lakh each), and the loss is Rs.6 lakh, both insurers will contribute Rs.3 lakh each.

5. Principle of Subrogation

Subrogation means that after paying a claim, the insurance company **gains the right to recover the amount from third parties responsible for the loss**.

- The insured **cannot claim double benefits**—one from the insurer and another from the party at fault.
- This principle mostly applies to **motor, fire, and marine insurance**.

For example, if a car owner gets insurance compensation after an accident caused by another driver, the insurance company can sue the at-fault driver to recover the amount paid.

6. Principle of Proximate Cause

The **proximate cause** principle states that only the nearest and most direct cause of loss is considered for claim settlement. If multiple causes contribute to a loss, the primary reason is evaluated to determine if it falls under policy coverage.

- If the proximate cause is covered by insurance, the claim is valid.
- If an excluded event is the primary cause, the insurer can reject the claim.

For example, if a ship sinks due to a fire, and the fire was caused by a lightning strike (a covered peril), the insurer will pay the claim. However, if a fire is caused by war (which is excluded in most policies), the insurer will not pay the claim.

7. Principle of Loss Minimization

The insured must **take reasonable steps to minimize losses** after an incident.

- The insurance contract does not allow the insured to be careless simply because they are covered.
- The insured should act as if they were uninsured and try to reduce the loss as much as possible.

For example, if a fire breaks out in a factory, the owner must call the fire department immediately and try to control the fire rather than letting it spread, expecting full compensation from the insurer.

8. Principle of Risk Sharing

Insurance works on the principle of **risk sharing**, where many policyholders contribute premiums to create a common fund. This pooled amount is used to compensate those who suffer losses.

- The risk of a large financial loss is spread among many insured individuals.

- The insurer collects small premiums from many people and pays out claims only to those who experience losses.

For example, in health insurance, many people pay premiums, but only a few will need medical treatment at any given time. This system ensures that the burden of loss is distributed and manageable.

Types

Insurance is a financial tool that provides protection against various risks and uncertainties. It is broadly classified into two main categories: **Life Insurance** and **General Insurance**. Each type of insurance serves a specific purpose and caters to different needs.

1. Life Insurance

Life insurance provides financial security to an individual's family in case of their death. It ensures that dependents are financially stable even after the policyholder's demise. Some policies also offer savings and investment benefits along with risk coverage.

Types of Life Insurance:

a) Term Life Insurance

- Provides coverage for a specific period (e.g., 10, 20, or 30 years).
- Pays a death benefit to the beneficiary if the policyholder dies during the term.
- No maturity benefit if the insured survives the term.
- Most affordable type of life insurance.

b) Whole Life Insurance

- Provides lifelong coverage (up to 100 years or more).

- Pays a death benefit whenever the insured passes away.
- Premiums are higher but offer financial security for the entire lifetime.

c) Endowment Policy

- Combines life coverage with savings.
- The policyholder gets a lump sum amount if they survive the policy term.
- If the insured dies, the nominee receives the sum assured.
- Suitable for long-term financial planning.

d) Money-Back Policy

- Pays a portion of the sum assured at regular intervals during the policy term.
- Provides liquidity along with life coverage.
- Beneficial for those needing periodic financial support.

e) Unit-Linked Insurance Plan (ULIP)

- Combines life insurance with investment in stocks, bonds, and mutual funds.
- A portion of the premium goes to life coverage, and the rest is invested.
- Provides returns based on market performance.

f) Pension or Annuity Plan

- Designed for retirement planning.
- The insured pays premiums during their working years and receives a pension after retirement.
- Provides financial security in old age.

2. General Insurance

General insurance covers financial risks related to health, property, vehicles, businesses, and travel. It provides protection against **non-life risks** and offers compensation for damages or losses.

Types of General Insurance:

a) Health Insurance

- Covers medical expenses due to illness, accidents, or hospitalization.
- Can be individual, family floater, or group health insurance.
- Includes critical illness plans, maternity benefits, and pre-existing disease coverage.

b) Motor Insurance

- Protects against financial loss due to vehicle damage or third-party liability.
- **Types:**
    - **Third-Party Insurance:** Covers damages caused to others.
    - **Comprehensive Insurance:** Covers damages to both the insured vehicle and third parties.

c) Home Insurance

- Protects homes against natural disasters (earthquakes, floods, fires) and man-made threats (theft, burglary).
- Covers the building structure and household belongings.

d) Travel Insurance

- Covers risks during domestic or international travel, including:
    - Loss of baggage or passport.
    - Medical emergencies.

- Trip cancellation or delay.

e) Fire Insurance

- Covers damage to property due to fire, explosion, or lightning.
- Mainly used for businesses, industries, and commercial properties.

f) Marine Insurance

- Covers ships, cargo, and goods transported by sea, air, or land.
- **Types:**
    - **Hull Insurance:** Covers the ship's structure.
    - **Cargo Insurance:** Covers loss or damage to goods in transit.
    - **Freight Insurance:** Protects the freight company against financial loss.

g) Liability Insurance

- Protects businesses and professionals from legal claims due to negligence or accidents.
- **Types:**
    - **Public Liability Insurance:** Covers third-party injuries or property damage.
    - **Professional Liability Insurance:** Covers legal claims against doctors, lawyers, and consultants.

h) Commercial Insurance

- Covers businesses against financial losses due to unforeseen events.
- Includes property insurance, liability insurance, and employee benefits insurance.

Preparation of Final Accounts of Insurance Companies

Insurance companies are required to prepare their final accounts as per the **Insurance Act, 1938**, and guidelines issued by the **Insurance Regulatory and Development Authority of India (IRDAI)**. These accounts include various financial statements that reflect the company's financial position, profitability, and ability to meet policyholder obligations.

1. Components of Final Accounts of Insurance Companies

Insurance companies prepare the following key financial statements:

a) Revenue Account (Form A-RA)

- Prepared separately for **life insurance** and **general insurance** businesses.
- Shows **premium income, reinsurance claims, commission expenses, and operating expenses**.
- Net balance (profit or loss) is transferred to the **Profit & Loss Account**.

b) Profit and Loss Account (Form A-PL)

- Reflects overall business profitability.
- Includes **investment income, commission, and management expenses**.
- The net profit is transferred to the **Balance Sheet**.

c) Balance Sheet (Form A-BS)

- Shows financial position at the end of the financial year.
- Includes **share capital, reserves, policyholder liabilities, investments, and assets**.
- Liabilities and assets are classified as per IRDAI regulations.

2. Format of Final Accounts

a) Revenue Account (For Life and General Insurance)

(Dr. Side – Expenses)

- **Claims Incurred** (including reinsurance claims)
- **Commission Paid** (to agents and brokers)
- **Operating Expenses** (salaries, rent, advertisement, legal expenses)
- **Surplus/Deficit transferred to P&L Account**

(Cr. Side – Income)

- **Premium Earned** (net of reinsurance)
- **Income from Investments**
- **Other Income** (fees, service charges)

b) Profit & Loss Account

(Dr. Side – Expenses)

- **Provision for Taxation**
- **Other Expenses** (bad debts, penalties)
- **Profit transferred to Reserves**

(Cr. Side – Income)

- **Surplus from Revenue Account**
- **Income from Investments**
- **Other Income (fees, commissions, refunds)**

c) Balance Sheet (As per IRDAI Guidelines)

Liabilities

- **Share Capital**
- **Reserves & Surplus**
- **Policyholders' Fund**
- **Outstanding Claims**
- **Premium Reserve**

Assets

- **Investments (Government bonds, fixed deposits, equity shares)**
- **Outstanding Premiums**
- **Cash & Bank Balances**
- **Fixed Assets (offices, computers, vehicles)**

Important Considerations in Final Accounts

a) Reserve for Unexpired Risk

- For **general insurance**, a portion of the premium is reserved for future claims.
- As per IRDAI norms, the reserve is **50% for fire & marine cargo insurance** and **100% for marine hull insurance**.

b) Actuarial Valuation

- Life insurance companies conduct **actuarial valuations** to determine the policyholder's liabilities.
- Helps in calculating **bonus, surrender value, and maturity benefits**.

c) Reinsurance Transactions

- Part of the risk is transferred to other insurers, and reinsurance premium & claims are recorded separately.

d) Investment Income

- Insurance companies invest in **government securities, stocks, and fixed deposits**.
- Income from these investments is a major source of revenue.

Accounts of Life Insurance Business

The accounts of life insurance companies are prepared according to the **Insurance Act, 1938**, **IRDAI (Insurance Regulatory and Development Authority of India) regulations**, and **Schedule VI of the Companies Act, 2013**. These accounts are structured to ensure transparency, regulatory compliance, and financial stability.

1. Financial Statements of Life Insurance Business

A life insurance company prepares the following key financial statements:

a) Revenue Account (Form A-RA) – Policyholders' Account

- Shows the income earned and expenses incurred related to life insurance policies.
- **Primary sources of income:** Premium received, reinsurance commission, and investment income.
- **Major expenses:** Claims paid, commission to agents, and management expenses.
- **Net balance (surplus or deficit)** is transferred to the **Profit and Loss Account**.

b) Profit and Loss Account (Form A-PL) – Shareholders' Account

- Shows the **overall profitability of the company**.
- Includes income from **investment activities, policy fees, and other sources**.
- Net profit is transferred to the **Balance Sheet** or retained for future expansion.

c) Balance Sheet (Form A-BS)

- Reflects the **financial position** of the company at the end of the accounting period.
- **Liabilities** include reserves, policyholder's funds, and outstanding claims.
- **Assets** include investments, cash balances, and loans against policies.

Format of Accounts in Life Insurance Business

a) Revenue Account (Policyholders' Account)

(Dr. Side – Expenses)

- **Claims Paid** (Maturity claims, death claims, surrender value)
- **Commission to Agents & Brokers**
- **Operating Expenses** (salaries, rent, advertisement, legal fees)
- **Reserves for Future Claims**

(Cr. Side – Income)

- **Premium Earned (net of reinsurance)**
- **Income from Investments** (government bonds, stocks, fixed deposits)
- **Reinsurance Commission**
- **Other Income (service charges, penalties, fees)**

The net **surplus or deficit** is transferred to the **Profit & Loss Account**.

b) Profit & Loss Account (Shareholders' Account)

(Dr. Side – Expenses)

- **Expenses of Management**

- **Provision for Taxation**
- **Dividends Paid**
- **Transfer to General Reserve**

(Cr. Side – Income)

- **Surplus from Revenue Account**
- **Investment Income**
- **Miscellaneous Income**

The net profit is transferred to the **Balance Sheet**.

c) Balance Sheet

Liabilities:

- **Share Capital**
- **Reserves & Surplus**
- **Policyholders' Fund** (life insurance fund)
- **Outstanding Claims & Policy Benefits**
- **Premium Reserve & Other Liabilities**

Assets:

- **Investments (Government securities, fixed deposits, stocks)**
- **Outstanding Premiums**
- **Loans against Policies**
- **Cash & Bank Balances**
- **Fixed Assets (Buildings, computers, furniture)**

Important Aspects of Life Insurance Accounting

Life insurance accounting follows specific regulatory guidelines to ensure transparency, financial stability, and policyholder protection. The key aspects of life insurance accounting are as follows:

1. Life Insurance Fund (Policyholders' Fund)

- Represents accumulated premiums, investment income, and other earnings.
- Used to pay **maturity claims, death claims, surrender benefits, and bonuses**.
- Actuarial valuation is conducted periodically to ensure adequate reserves.

2. Actuarial Valuation

- A qualified **actuary** assesses the company's financial position to determine **liabilities and bonuses**.
- Helps in calculating the **surrender value, maturity benefits, and solvency margin**.
- Ensures that the company has sufficient reserves to meet future policyholder obligations.

3. Premium Income Recognition

- Premiums received are recorded as **income** in the Revenue Account.
- Life insurers often receive premiums in advance; unearned portions are transferred to **Premium Reserve**.
- Policies with regular premiums are recorded on an **accrual basis**, ensuring accurate financial reporting.

4. Claims Accounting

- **Types of Claims:**
  - **Maturity Claims** (policyholder survives the term).
  - **Death Claims** (beneficiary receives the sum assured).
  - **Surrender Value Claims** (policyholder terminates policy early).
- Claims are recorded as **expenses** when settled or as **outstanding liabilities** if not yet paid.

5. Reinsurance Accounting

- Life insurance companies often transfer part of their risk to **reinsurers**.
- **Premium paid to reinsurers** is recorded as an expense.
- Claims recovered from reinsurers are credited to the **Revenue Account**.
- Helps in **risk-sharing and capital management**.

6. Bonus and Dividend Payments

- Life insurance policies may be **participating (with bonuses) or non-participating**.
- **Types of Bonuses:**
    - **Reversionary Bonus:** Declared annually and added to the policy.
    - **Terminal Bonus:** Paid at the end of the policy term.
- Shareholders may also receive **dividends**, depending on company profitability.

7. Investment Accounting

- Life insurance companies invest in **government securities, corporate bonds, fixed deposits, and equities**.
- Investment income (interest, dividends, capital gains) is recorded in the **Profit & Loss Account**.
- Investments must comply with **IRDAI's investment regulations** to ensure financial security.

8. Reserves and Solvency Margin

- Life insurers must maintain reserves to meet policyholder claims.
- **Types of Reserves:**
    - **Premium Reserve:** Covers unearned premiums.
    - **Claim Reserve:** For pending or anticipated claims.
    - **Solvency Margin:** Ensures financial stability and ability to meet future liabilities.

9. Commission and Operating Expenses

- Commissions paid to **agents and brokers** are recorded as expenses.
- **Operating expenses** include salaries, rent, IT costs, advertising, and legal expenses.
- These expenses are classified under the **Revenue Account**.

10. Regulatory Compliance and Disclosures

- Life insurance companies must follow accounting standards set by:
  - **IRDAI (Insurance Regulatory and Development Authority of India)**
  - **Companies Act, 2013**
  - **Insurance Act, 1938**
- Annual financial statements must include disclosures on **claims, investments, reserves, and financial performance**.

Accounts of General Insurance Companies

General insurance companies provide non-life insurance products such as **health insurance, motor insurance, fire insurance, marine insurance, and miscellaneous insurance**. The financial accounts of these companies are prepared as per the **Insurance Act, 1938**, **IRDAI (Insurance Regulatory and Development Authority of India) guidelines**, and **Companies Act, 2013**.

1. Financial Statements of General Insurance Companies

A general insurance company prepares the following key financial statements:

a) Revenue Account (Form B-RA) – Policyholders' Account

- Records **premium income, claim payments, and operating expenses**.
- Premiums are recognized on an **accrual basis**, while claims are recorded when incurred.

- The **surplus or deficit** is transferred to the **Profit & Loss Account**.

b) Profit and Loss Account (Form B-PL) – Shareholders' Account

- Reflects overall profitability, including **investment income and miscellaneous income**.
- Shows expenses such as **management expenses, interest, and taxation**.
- Net profit is transferred to the **Balance Sheet**.

c) Balance Sheet (Form B-BS)

- Presents the company's **financial position** at the end of the accounting period.
- **Liabilities** include reserves, policyholder funds, and outstanding claims.
- **Assets** include investments, outstanding premiums, and fixed assets.

2. Format of Accounts in General Insurance Business

a) Revenue Account (Policyholders' Account)

(Dr. Side – Expenses)

- **Claims Incurred** (claims paid + outstanding claims – claims recovered from reinsurance).
- **Commission Paid to Agents & Brokers**.
- **Operating Expenses** (salaries, legal fees, rent, advertisement, marketing).
- **Reserve for Unexpired Risk (RUR)** – a portion of the premium is reserved for future claims.

(Cr. Side – Income)

- **Premium Earned (Net of Reinsurance Premium)**.
- **Income from Investments**.
- **Reinsurance Commission**.

- **Other Income (fees, penalties, service charges)**.

Net **surplus or deficit** is transferred to the **Profit & Loss Account**.

b) Profit & Loss Account (Shareholders' Account)

(Dr. Side – Expenses)

- **Management & Administrative Expenses**.
- **Provision for Taxation**.
- **Dividends to Shareholders**.
- **Transfer to General Reserve**.

(Cr. Side – Income)

- **Surplus from Revenue Account**.
- **Investment Income**.
- **Other Income** (penalties, commission received).

The net profit is transferred to the **Balance Sheet**.

c) Balance Sheet

Liabilities:

- **Share Capital**.
- **Reserves & Surplus**.
- **Policyholders' Fund** (unearned premium reserve, outstanding claims reserve).
- **Outstanding Claims & Other Liabilities**.

Assets:

- **Investments (Government securities, bonds, fixed deposits, equities)**.
- **Outstanding Premiums**.
- **Reinsurance Recoverable Claims**.
- **Cash & Bank Balances**.
- **Fixed Assets (Offices, equipment, vehicles, IT infrastructure)**.

3. Important Aspects of General Insurance Accounting

a) Reserve for Unexpired Risk (RUR)

- A portion of the premium is set aside to cover risks for the **unexpired portion of the policy period**.
- IRDAI guidelines specify:
  - **50% of net premium** for **fire, marine cargo, and miscellaneous insurance**.
  - **100% of net premium** for **marine hull insurance**.

b) Claims Accounting

- General insurance involves frequent **claim settlements** due to **accidents, damages, and liabilities**.
- Claims include:
  - **Settled Claims** – Paid to policyholders.
  - **Outstanding Claims** – Yet to be settled.
  - **Claims Recovered from Reinsurance** – If risk is shared with a reinsurer.
- Outstanding claims are shown as a **liability** until settled.

c) Reinsurance Accounting

- General insurance companies often **transfer part of their risk** to reinsurance companies.

- **Premium Paid to Reinsurers** – Recorded as an expense.
- **Claims Recovered from Reinsurers** – Deducted from total claims incurred.
- Helps reduce **financial burden during high claim periods**.

d) Investment Income

- A significant portion of **general insurance funds is invested** in government securities, bonds, and stocks.
- Investment income is recorded in the **Profit & Loss Account**.
- Ensures **financial stability** and helps manage claims efficiently.

e) Commission and Operating Expenses

- Commissions are paid to **agents, brokers, and intermediaries** for bringing business.
- **Operating expenses** include **staff salaries, legal fees, rent, marketing, and administration costs**.
- These are deducted in the **Revenue Account**.

f) Solvency Margin & Regulatory Compliance

- **Solvency Margin** – General insurance companies must maintain a **minimum capital** to ensure they can meet claim obligations.
- IRDAI mandates periodic **financial reporting and disclosures** to protect policyholders.

New Format

Accounts of General Insurance Companies

General insurance companies deal with non-life insurance policies such as **fire, marine, motor, health, and other miscellaneous insurance**. The financial statements of these companies are prepared following the **Insurance Act,** 1938, **IRDAI (Insurance Regulatory and Development Authority of India) guidelines**, and the **Companies Act, 2013**.

1. Financial Statements of General Insurance Companies

a) Revenue Account (Policyholders' Account) – Form B-RA

- Records **premium income, claims, reinsurance transactions, and operating expenses**.
- **Key Income Sources:** Premiums received, investment income, and reinsurance commission.
- **Key Expenses:** Claims paid, commissions to agents, management expenses, and reserves for unexpired risks.
- The net **surplus or deficit** is transferred to the **Profit & Loss Account**.

b) Profit & Loss Account (Shareholders' Account) – Form B-PL

- Captures the **overall profitability of the insurance company**.
- Includes **investment income, underwriting profits, and administrative expenses**.
- Net profit is transferred to the **Balance Sheet**.

c) Balance Sheet – Form B-BS

- Presents the **financial position** of the company at the end of the financial year.
- **Liabilities:** Share capital, reserves, outstanding claims, and unearned premium reserves.
- **Assets:** Investments, outstanding premiums, bank balances, and reinsurance recoverable.

2. Format of Financial Statements

a) Revenue Account (Form B-RA)

(Dr. Side – Expenses)

- **Claims Incurred (Net of Reinsurance)**

- **Commission Paid to Agents & Brokers**
- **Management & Operating Expenses**
- **Reserve for Unexpired Risk (RUR)**

(Cr. Side – Income)

- **Premium Earned (Net of Reinsurance)**
- **Investment Income**
- **Reinsurance Commission Received**
- **Other Income**

Net **surplus or deficit** is transferred to the **Profit & Loss Account**.

b) Profit & Loss Account (Form B-PL)

(Dr. Side – Expenses)

- **Management & Administrative Expenses**
- **Provision for Taxation**
- **Transfer to General Reserve**

(Cr. Side – Income)

- **Surplus from Revenue Account**
- **Investment Income**
- **Miscellaneous Income**

Net profit is transferred to the **Balance Sheet**.

c) Balance Sheet (Form B-BS)

Liabilities:

- **Share Capital**
- **Reserves & Surplus**
- **Outstanding Claims & Other Liabilities**
- **Unearned Premium Reserve**

Assets:

- **Investments (Government securities, bonds, fixed deposits, equities)**
- **Outstanding Premiums**
- **Cash & Bank Balances**
- **Fixed Assets**

3. Key Aspects of General Insurance Accounting

a) Reserve for Unexpired Risk (RUR)

- A portion of the premium is reserved to cover claims arising in future periods.
- IRDAI mandates:
  - **50% of net premium** for fire, marine cargo, and miscellaneous insurance.
  - **100% of net premium** for marine hull insurance.

b) Claims Accounting

- Includes **paid claims, outstanding claims, and reinsurance recoveries**.
- Outstanding claims are recorded as **liabilities** until settled.

c) Reinsurance Accounting

- **Premium Paid to Reinsurers** – Recorded as an expense.
- **Claims Recovered from Reinsurers** – Deducted from total claims incurred.
- Helps in **risk-sharing and financial stability**.

d) Investment Income

- Funds are invested in **approved securities, fixed deposits, and bonds**.
- Investment income is recorded in the **Profit & Loss Account**.

e) Commission & Operating Expenses

- Commission is paid to **agents and brokers** for business generation.
- **Operating expenses** include salaries, rent, IT costs, and legal fees.

f) Solvency Margin & Regulatory Compliance

- Companies must maintain a **minimum solvency margin** as per IRDAI guidelines.
- Periodic **financial reporting and audits** are mandatory.

1. The following balances are extracted from the books of **XYZ Insurance Co.** for the year ending **31st March 2023**:

- **Premium received** – ₹5,00,000
- **Claims paid** – ₹2,50,000
- **Commission paid** – ₹40,000
- **Management expenses** – ₹60,000
- **Interest and Dividend received** – ₹25,000
- **Claims outstanding (opening)** – ₹20,000
- **Claims outstanding (closing)** – ₹30,000

- **Premium outstanding** – ₹15,000
- **Depreciation on Fixed Assets** – ₹10,000

Prepare the **Revenue Account** for the year ended 31st March 2023.

Answer: Revenue Account of XYZ Insurance Co.

(For the year ended 31st March 2023)

Form A – RA (Revenue Account)

Dr. Side (Expenses)	**Amount (₹)**	**Cr. Side (Income)**	**Amount (₹)**
Claims Paid	2,50,000	Premium Received	5,00,000
Add: Closing Outstanding Claims	30,000	Add: Premium Outstanding	15,000
Less: Opening Outstanding Claims	(20,000)	Interest & Dividend	25,000
Net Claims Paid	2,60,000	**Total Income**	**5,40,000**
Commission Paid	40,000		
Management Expenses	60,000		
Depreciation	10,000		
Total Expenses	**3,70,000**	**Net Profit (Transferred to P&L A/c)**	**1,70,000**

Key Adjustments in Final Accounts

✅ **Outstanding claims** → Added to claims paid (closing) and deducted (opening).

✅ **Outstanding premium** → Added to premium received.

✅ **Interest & dividend** → Considered as income.

✅ **Depreciation** → Deducted as an expense.

This format is followed for preparing the **Revenue Account, P&L Account, and Balance Sheet** for **Insurance Companies** as per IRDA guidelines

2. From the books of **ABC General Insurance Co.**, prepare a **Revenue Account** for Fire Insurance Business for the year ending **31st March 2023** from the given data:

- **Premium received** – ₹8,00,000
- **Reinsurance premium paid** – ₹1,50,000
- **Claims paid** – ₹3,00,000
- **Claims outstanding (Opening)** – ₹50,000
- **Claims outstanding (Closing)** – ₹80,000
- **Commission on Direct Business** – ₹70,000
- **Commission on Reinsurance Accepted** – ₹20,000
- **Commission on Reinsurance Ceded** – ₹30,000
- **Management Expenses** – ₹1,50,000
- **Interest & Dividend earned** – ₹40,000

Prepare the **Revenue Account** for Fire Insurance Business.

Answer: Revenue Account of ABC General Insurance Co.

📌 **(For Fire Insurance Business for the Year Ended 31st March 2023)**

Form B – RA (Revenue Account)

Dr. Side (Expenses)	Amount (₹)	Cr. Side (Income)	Amount (₹)
Claims Paid	3,00,000	Premium Received	8,00,000
Add: Closing Outstanding Claims	80,000	Less: Reinsurance Premium Paid	(1,50,000)
Less: Opening Outstanding Claims	(50,000)	Net Premium Earned	**6,50,000**
Net Claims Incurred	**3,30,000**	Commission on Reinsurance Accepted	20,000
Commission on Direct Business	70,000	Interest & Dividend	40,000
Less: Commission on Reinsurance Ceded	(30,000)		
Net Commission	**40,000**	**Total Income**	**7,10,000**
Management Expenses	1,50,000		
Total Expenses	**5,20,000**	**Net Profit (Transferred to P&L A/c)**	**1,90,000**

Key Adjustments in General Insurance Financial Statements

✔ **Net Premium Earned = Total Premium – Reinsurance Premium Paid**

✔ **Net Claims Incurred = Claims Paid + Closing Outstanding – Opening Outstanding**

✔ **Net Commission = Commission on Direct Business + Reinsurance Accepted – Reinsurance Ceded**

✔ **Interest & Dividend Earned** = Considered as **income**

This structure aligns with **IRDA norms** for preparing financial statements of **General Insurance Companies**

Difference between Life Insurance and General Insurance

S.No	Life Insurance	General Insurance
1.	It is a contract of certainty.	It is a contract of indemnity.
2.	It is a long-term contract.	It is a one-year contract.
3.	It is governed by the LIC Act.	It is governed by the 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.

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	xx	
a)Premium			
b) Reinsurance ceded		xx	
c) Re insurance accepted.		xx	
Income from Investments:			
a) Interest, Dividends & Rent-Gross		xx	
b)Profit on sale/redemption of Investments		xx	
c)Loss on sale/redemption of Investments			
d)Transfer/Gain on revaluation/change in		xx	
Fair value other Income			
		xx	
Total(A)		xx	xx

Policy holders account particulars	Schedule No	Current year (Rs.000)	Previous year (Rs.000)
Commission Operating Expenses	2 3	xx xx	xx xx
Provision for doubtful debts Bad debts written off Provision of Tax Provision(other than taxation) The value of a) For diminution Investments (Net) b) Others		xx xx xx xx xx xx	xx xx xx xx 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 ceded 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 shareholders 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 theyearended31st March2017shareholders 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, Dividend & rent gross b) Profit on sale/redemption of Investments c) Loss on sale /redemption of Investments Other Income		xx xx xx xx	xx xx xx xx

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

e) Transfer to reserve/ Other accounts			
Profit carried….To the Balance sheet	xx	xx	xx

Specimen form Life Insurance Balance sheet

Form A- Bs

Balancesheet as on 31st March 20...........

Particulars	Schedule	Current Year	Previous Year
Sources of Funds			
Shareholders' funds			
Share capital	5		
Reserves & surplus	6		
Credit/Debit fair value Change account			
Sub Total			
	7		
Borrowings			
Policyholders funds			
Credit/Debit fair value Change account			
Policy Liabilities			
Insurance Reserves			

Provision for linked Liabilities Sub total Funds for future Appropriations			

Application of funds

Particulars	Schedule	Current Year	Previous Year
Application of funds			
Investments			
Shareholders	8		
Policyholders	8A		
Assets held to cover linked Liabilities	8B		
Loans	9		
Fixed Assets	10		
Current Assets(A)			
Cash and Bank	11		
Balances Advance and Other Assets	12		
Subtotal(A)			
Current Liabilities (B)	13		
Provisions	14		
Sub Total(B)			

Net current Assets C=A-B Miscellaneous Expenditure Debit balance in profit & Loss Account(shareholders account) Total(Application of funds+ New current assets)	15		

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–2CommissionExpenses

S.No.		Current year	Previous year
1.	Commission paid	xx	xx
	Direct–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 and 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
	Total	xx	xx

Schedule–4 Benefits paid (Net)

S.No.		Current year	Previous year
1.	**Insurance claim** a) Claims by Death b) Claims by Maturity c) Annuities d) Other benefits	xx xx xx xx	xx xx xx xx

2.	**Amount ceded 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**

Schedule- 5 Share Capital

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

Schedule–6ReservesandSurplus

Particulars	CurrentYear	PreviousYear
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–8Investments

Particulars	Current Year	Previous Year
Long term Investments		
Short term Investments		

Schedule–9 Loans

Particulars	Current Year	Previous Year
1. Security wise classification:		
a) Secured		
b) Unsecured		
Total		
2. Borrower wise classification:		
a) Central & State Govt.		
b) Banks & Financial Institutions		
c) Others		
Total		
3. Performance wise classification:		
a) Loan classified as standard		

b) Nonstandard 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			Asat year end	Net Block	
	Opening	Additions	Deductions	Closing	Upto Last Year	For the year	On Sales/ Adjustment		Asat 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

<u>Advances</u> 1. Reserve Deposits with ceding companies 2. Application money for Investments		
3. Pre payments 4. Advances to Directors 5. Others Total(A)		

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

Schedule-13CurrentLiabilities

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-14Provisions

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 in issue to shares/ debentures Others		
Total		

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 under taken 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.

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 No.1

The life assurance fund of SBI life assurance company ltd. Shows a balance of Rs.9,00,000 on 31.03.2021. It was later observed that the following had not been taken into account.

i) Bonus utilized in reduction on premium Rs.90,000

ii) Outstanding premium Rs.2,00,000

iii) Interest accrued on investments less income tax Rs.50,000

iv) Claim intimated but not yet admitted Rs.30,000

v) Claims covered under reinsurance Rs.10,000

Compute the balance of Life Assurance Fund.

Statement Showing Life Insurance Fund

Particulars	Rs.	Rs.
Life assurance fund as on 31.03.2021		9,00,000
Add:		
	90,000	
Bonus utilized in reduction of		
	2,00,000	
premium Outstanding premium		
	50,000	
Interest accrued on investment less income tax		
	10,000	3,50,000
Claims covered under reinsurance		
	--------	--------
		12,50,000
Less:		
	90,000	
Bonus utilized in reduction of		1,20,000
	30,000	
premium Claims intimated but not yet	---------	---------
		11,30,000
admitted		
		========
Life Assurance Fund		

ProblemNo.2

A life assurance company prepared its Revenue A/c for the year ended 31.03.2018 and ascertained its Life Assurance fund to be Rs.30,00,000. It was found later that the following had been omitted from the accounts:

i) Bonus utilized in reduction on premium Rs.6,700

ii) Outstanding premiumRs.33,300

iii) Interest accrued on investments less income tax Rs.40,000

iv) Claim intimated but not admitted Rs.17,500

v) Claims covered under reinsurance Rs.9,500

What is the true Life Assurance Fund?

Statement Showing Life Insurance Fund

Particulars	Rs.	Rs.
Life assurance fund as on31.03.2018		30,00,000
Add:		
Bonus utilized in reduction of	6,700	
premium Outstanding premium	33,300	
Interest accrued on investment less income tax	40,000	
Claims covered under reinsurance	9,500	8,95,000
	--------	--------
		38,95,000
Less:		
Bonus utilized in reduction of	6,700	
premium Claims intimated but not	17,500	
	---------	

admitted		24,200

Life Assurance Fund		38,70,800
		========

Problem No.3

From the following, you are required to calculate the loss on account of claims to be shown in the Revenue Account for the year ending 31.03.2016.

Intimated in	Admitted in	Paid in	Rs.
2014–2015	2014-2015	2015-2016	45,000
2015–2016	2015-2016	2016-2017	30,000
2013–2014	2014-2015	2014-2015	15,000
2013–2014	2014-2015	2015-2016	36,000
2015–2016	2016–2017	2016-2017	24,000
2015–2016	2015-2016	2015-2016	3,10,000

Claim on account of reinsurance was Rs.80,000.

Calculation of Claim incurred

Particulars	Rs.	Rs.
Total claim paid in 2015–2016		3,91,000
(45,000+36,000+3,10,000)		
Less: Claims outstanding at the beginning of 2015-2016		
Intimated in 2014-2015 and paid in 2015-	45,000	
2016 Intimated in 2013-2014 and paid in	36,000	81,000
2015-2016	————	-------
		3,10,000
Add: Claims outstanding at the end of 2015-2016	30,000	
Intimated in 2015-2016 and paid 2016-2017	24,000	54,000
Intimated in 2015-2016 and paid in 2016-2017	---------	--------
		3,64,000
		80,000
Less: Reinsurance claim		--------
		2,84,000
Claims paid and outstanding in 2015-2016 to be shown in		=======
the revenue account		

ProblemNo.4

The following were the balances extracted from the Trial Balance of Bajaj Life insurance company ltd for the year 31st March 2019.

Balance of account at the beginning of the year Rs.8,00,000

Profit on realization of assets	Rs.1,000
Claims under policies by death	Rs.30,000
Claims under polices by Maturity	Rs.50,000
Premium (Other than single)	Rs.1,00,000
Single Premiums	Rs.40,000
Consideration for annuities granted	Rs.25,000
Interest Received	Rs.35,000
Depreciation on furniture	Rs.1,500
Administrative Expenses	Rs.18,000
Salaries	Rs.1,500
Surrenders	Rs.10,000
Auditor's fee	Rs. 750
Legal Expenses	Rs. 500
Advertising	Rs.700
Printing	Rs.5,400
Director's fee	Rs.150
Commission paid	Rs.12,000

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

Revenue account for the year ended 31-03-2019.

	Schedule No	31-03-2019
Premium Earned–Net	1	1,40,000
Income from Investment		35,000
Interest, Dividend Transfer/gain on revaluation		1,000
Other income– consideration for annuities		25,000
Granted		------------
Total (A)		2,01,000
Commission		12,000
Operating Expenses	2	28,500
	3	-----------
Total(B)		40,500
Benefits paid (Net)	4	90,000
Interim Bonus paid		--
Total(c)		90,000
Surplus(P)=A-B-C		70,500

Appropriations		-------------
Balance being funds for future		
Appropriations		**70,500**

Workings:

Schedule 1 Premium Earned (Net)	31-03-19
Premium (other than single)	1,00,000
Single Premium	40,000
Total	1,40,000
	=========

Schedule 2 Commission Expenses

Commission paid	12,000
	12,000
	======

Schedule 3 Operating Expenses

Administrative Expenses	18,000
Salaries	1,500
Auditor's fee	750
Director's fee	150
Legal Expenses	500
Advertising	700
Printing	5,400
Depreciation on furniture	1,500
Total	28,500

Schedule–4Benefitspaid(Net)

Claims under policies by death	30,000
Claims under policies by Maturity	50,000
Surrenders	10,000

Total	90,000

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..............

Particulars	Rs.	Particulars	Rs.
To Net liability as per actuarial valuation	xxx	By Life assurance fund as Balance sheet	xxx
To Surplus if any (Bal. Fig)	xxx	Deficiency if any (Bal. Fig)	xxx
	xxx		xxx

Distribution statement Amount payable to policyholders

Surplus as per valuation Balance sheet	xx
Add: Interim Bonus	xx
Policy shareholders 95%	xx
Less: Interim Bonus paid	xx
Amount due to policyholders for bonus	xx

ProblemNo.5

From the following information, calculate surplus or deficit of a Life Insurance Business for the year ended 31st March 2020.

Balance of Life Assurance Fundon31.03.2020 Rs.80,00,000. Net liabilities on 31.03.2020 Rs.67,00,000.

Solution

Life Insurance Company

Valuation Balance sheet as on 31-03-2017

Liabilities	Rs.	Assets	Rs.
To Net Liabilities	67,00,000	By Life Assurance fund	80,00,000
To Surplus	13,00,000		
	80,00,000		80,00,000

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 Balance of profit/ loss brought forward from last year Balance carried forward to Balance Sheet			

Form B–BS

Balance sheet as on31st March...................

Particulars	Schedule	Current Year	Previous Year
Sources 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) Miscellaneous Expenditure Debit Balance in profit & loss a/c	15		
Total (Appl. of funds+ NCA)			

Details of schedule

Schedule 1 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 forum expired 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 **<u>Add:</u>** Reinsurance Accepted **<u>Less:</u>** 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's fee Advertisement		
Interest & Bank charges Depreciation Total		

Schedule 5 Sharecapital

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 6 Reserves and surplus

S. No.	Particulars	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.	Financial Institutions	xx	xx
	Total	xx	xx

Schedule8Investments-Shareholders

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

Schedule8AInvestments–Policyholders

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

Schedule– 8 B Assets held to cover linked liabilities

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

Schedule9Loans

S. No.	Particulars	Current Year	Previous year
1.	Security wise classifications Secured Unsecured Total		
2.	Borrower wise classification a) Central & state Govt. b) Banks & Financial Institutions c) Others		
3.	Performance wise classification a) Loan classified as standard b) Non-standard 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			Asat year end	Net Block	
	Opening	Additions	Deductions	Closing	Upto Last Year	For the year	On Sales /Adjustment		Asat 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										

Schedule11 Cash and Bank Balance

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

Schedule12 Advances and other Assets

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

Other Assets

S.No.	Particulars	Current Year	Previous year

1.	Income accrued on Investments	xxx	xxx
2.	Outstanding Premium	xxx	xxx
3.	Agent Balance	xxx	xxx
4.	Foreign Agencies Business	xxx	xxx
5.	Deposits with RBI	xxx	xxx
	Total(B)		
	Total(A+B)		

Schedule13 Current Liabilities

S. No.	Particulars	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

Schedule14Provisions

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

Fire Revenue Account

Problem No. 6

From the following particulars you are required to prepare fire Revenue account for the year ending 31 March 2018.

Claims outstanding 31.3.2018	2,80,000	Expenses on Management	12,68,000
Claims outstanding1.4.2017	1,60,000		
Commission	8,00,000	Premium received	4,84,800
Claims paid	19,20,000	Commission on Reinsurance accepted	20,000
Reinsurance Premium	4,80,000		
Commission on reinsurance ceded	40,000	Provision for unexpired Risk 1.4.2017 (Fire fund)	16,80,000
Additional provision for unexpired risk	80,000		

Solution:

Fire Revenue Account for the year ending on 31.03.2018

Particulars	Schedule	Current Year
1.Premium Earned (Net)	1	43,68,000
2.Others		
3.Changes in provision for unexpired Risk (2184000-1680000)		(-)5,04,000
Total (A)		38,64,000
1.Claims incurred (Net)	2	20,40,000
2.Commission	3	7,80,000
3.Operating Expenses	4	12,68,000
4.Others		
Total (B)		40,88,000
Operating Loss(C)=(A-B)		(-)2,24,000

Workings:

Schedule–1-Premium earned (Net)

Premium received	48,48,000
<u>Less:</u> Reinsurance premium	4,80,000

Total	43,68,000

Schedule 2 Claims incurred (Net)

Claims paid	19,20,000
Add: Outstanding 31.3.18	2,80,000
	22,00,000
Less: Outstanding 1.4.17	1,60,000
Total Claims paid	7,60,000

Schedule 3 Commission

Commission	8,00,000
Add: Commission on reinsurance	20,000
	8,20,000
Less: Commission on reinsurance ceded	40,000
Total	7,80,000

Marine Revenue Account

Problem No.7

From the following balance of united India Insurance Companyas on 31.03.2021 prepare a Marine Revenue account.

Legal charges	2,400	Communication	10,000
Commission paid	2,16,000	Printing & Stationary	24,000
Marine fund opening	16,40,000	Claims paid & Outstanding	7,60,000
Premium received	21,60,000		
Commission earned on Reinsurance ceded	1,20,000	Expenses of management	8,00,000

Solution:

Schedule 1 Premium earned (Net)

Premium received	21,60,000
Total	

21,60,000

Schedule 2 Claims incurred (Net)

Claims paid & outstanding	7,60,000
Total	7,60,000

Schedule 3 Commission

Commission paid	2,16,000
Less: Commission earned	1,20,000
on reinsurance ceded	
Total	96,000

Schedule–4– Operating Expenses

Expenses of Management		8,00,000
Legal Charges		2,400
Communication		10,000
Printing & Stationary		24,000
	Total	8,36,400

Marine Revenue Account for the year ended on 31-03-2021

Particulars	Schedule	Current Year
1)Premium Earned (Net)	1	21,60,000
2)Profit/loss on sale/Redemption of Investment		-
3)Change in provision of unexpired risk		(-)5,20,000
4)Interest, Dividend & Rent- Gross		-
Total(A)		16,40,000
1.Claims incurred (Net)	2	7,60,000
2. Commission	3	96,000
3. Operating Expenses Related to Insurance Business	4	8,36,400
Total (B)		16,92,400
Operating loss (C)=(A-B)		52,400

Fire and Marine Revenue account and Profit & Loss Account

Problem No.8

From the following balances of Star General Insurance company Ltd on 31.03.2020.

Prepare a) Fire Revenue account b) Marine Revenue account c) Profit & Loss account.

Particulars	Rs.	Particulars	Rs.
Survey expenses (Fire)	10,000	Commission earned on re-insurance ceded (marine)	60,000
Additional reserve opening (fire)	50,000	Commission earned on re-insurance ceded (fire)	30,000
Commission paid (marine)	1,08,000	Management expenses (fire)	1,45,000
Commission paid (fire)	90,000	Management expenses (marine)	4,00,000
Claims paid and outstanding (marine)	3,80,000	Marine premium less reinsurance	10,80,000
Claims paid and outstanding (fire)	1,80,000	Fire premium less reinsurance	6,00,000
Fire fund – opening	2,50,000	Profit on sale of land	60,000
Marine fund–opening	8,20,000	Miscellaneous receipts	5,000
Bad debts recovered	1,200	Differences in exchange (Cr)	300
Share transfer fee	800	Interest, dividends etc received	14,000
Director's fees	5,000	Depreciation	35,000
Auditor's fees	1,200		
Bad debts (marine)	12,000		
Bad debts (fire)			

	5,000		

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	6,00,000	10,80,000
Total Net Premium	6,00,000	10,80,000

Schedule 2 Claims incurred (Net)

	Fire	Marine
Claim paid	1,80,000	3,80,000
Add: Survey Expenses	10,000	---
Total Claim paid	1,90,000	3,80,000

Schedule 3 Commission

	Fire	Marine
Commission–Direct	90,000	1,08,000

Less: Re

Schedule 4 Operating Expenses

	Fire	Marine
Managerial Remuneration	1,45,000	4,00,000
Other–Bad debts	5,000	12,000
Total	1,50,000	4,12,000

Fire Revenue Account for the year ended on 31.03.2020

Particulars	Schedule	Current Year
Premium Earned (Net)	1	6,00,000
Change in provision for unexpired risk		(-)80,000
Total(A)		5,20,000
Claims incurred (Net)	2	1,90,000
Commission	3	60,000
Operating Expenses related to Insurance Business	4	1,50,000
Total (B)		4,00,000
Operating Profit (C)=A-B		1,20,000

Workings

1) Reserve for unexpired risk (31.03.2020)

50% Net Premium	3,00,000
Add: Additional Reserve	80,000
	3,80,000
2)Change in provision for unexpired risk Opening Balance	3,00,000
Less: Closing Balance	3,80,000
Total	80,000

arine Revenue account for the year ended on 31.03.2020

Particulars		Schedule	Current Year
Premium Earned (Net)		1	10,80,000
Change in provision for unexpired risk			(-)2,60,000
Total(A)			8,20,000
Claims incurred (Net)		2	3,80,000
Commission		3	48,000
Operating expenses		4	4,12,000
	Total(B)		8,40,000
Operating Profit(C)=(A-B)			(-)20,000

Workings

1)Reserve for unexpired risk	10,80,000
2)**Change in provision for unexpired risk**	
Opening Balance	8,20,000
Less: Closing Balance	10,80,000
Total	2,60,000

Profit & Loss account for the year ended on 31.03.2020

1) Operating Profit /Loss:	
a) Fire Insurance	1,20,000
b) Marine Insurance	(-)20,000
2)Income from Investment:	
Interest, Dividend, Rent-Gross	14,000
Profit on sale of Land	60,000
3) Other Incomes:	
a) Transfer fees	800
b) Bad debts recovered	1,200
c) Miscellaneous Receipts	5,000
d) Difference in Exchange	300
Total(A)	1,81,300
Other Expenses:	
1) Auditor's fees	1,200
	5,000

2) Director's fees Depreciation	35,000
Total(B)	41,200
Profit Before Tax(A-B) Provision for taxation Profit after tax Appropriations: Balance of profit/loss brought forward from last year	1,40,100 ---- 1,40,100 ----
	1,40,100

UNIT IV

UNIT IV

Consolidated Financial Statements

Introduction- Holding & Subsidiary Company - Legal Requirementsrelating to preparation of accounts-Preparation of Consolidated Balance (Excluding Inter-company holdings)

Consolidated Financial Statements

Consolidated Financial Statements (CFS)are financial statements that present the combined financial position and performance of a **parent company and its subsidiaries** as if they were a single entity. These statements provide a **holistic view** of the group's financial health by eliminating inter-company transactions and balances.

In today's corporate world, businesses often operate through multiple subsidiaries, joint ventures, or associate companies. Preparing separate financial statements for each entity may not provide a **true picture** of the financial condition of the group. Therefore, **CFS ensures transparency and comparability** by consolidating financial data.

Objectives of Consolidated Financial Statements

Consolidated Financial Statements (CFS) provide a **comprehensive financial overview** of a parent company and its subsidiaries by presenting them as a **single economic entity**. The main objective of preparing CFS is to ensure **accuracy, transparency, and comparability** in financial reporting.

1. Provide a True & Fair View of Group Performance

CFS gives a **complete picture of the financial health** of a corporate group by consolidating all subsidiaries. This ensures that investors and stakeholders **understand the overall profitability, assets, liabilities, and cash flows** of the entire group.

2. Eliminate Inter-Company Transactions

When companies within the same group conduct transactions with each other (e.g., sales, loans, dividends), CFS **removes these transactions** to prevent double counting. This avoids **misrepresentation of financial performance**.

3. Improve Decision-Making for Management

CFS helps **top-level executives and board members**analyze the financial condition of the entire business group. This assists in making **strategic decisions** regarding expansions, acquisitions, cost control, and investment plans.

4. Enhance Investor Confidence & Transparency

Investors prefer CFS because it **shows the true earning capacity** of the entire group. It prevents manipulation of profits by shifting income or expenses between parent and subsidiaries, ensuring **financial transparency**.

5. Compliance with Legal & Accounting Standards

CFS is **mandatory for companies with subsidiaries** under:

- **Companies Act, 2013** (India)
- **Ind AS 110 & IFRS 10** (International Standards)
- **US GAAP & SEBI Regulations** (for listed companies) Preparing CFS ensures compliance with these regulations, reducing the risk of legal penalties.

6. Better Creditworthiness & Financial Evaluation

Banks and financial institutions use CFS to **assess the overall financial strength** of a group before approving loans or credit facilities. It helps them evaluate the group's ability to **repay debts and sustain operations**.

7. Uniform Reporting for Global Operations

For multinational companies with subsidiaries in different countries, CFS **provides a standardized financial report** that can be used across international markets. This helps in compliance with **global accounting norms and tax regulations**.

8. Prevent Financial Misrepresentation

Without CFS, a company might **hide liabilities** in a subsidiary or inflate profits at the parent company level. Consolidation ensures that **all assets and liabilities are disclosed**, preventing financial misreporting.

Applicability of Consolidated Financial Statements

CFS is required when:

- A company **controls one or more subsidiaries**.
- A holding company is listed on a stock exchange.
- As per **Companies Act, 2013** and **Ind AS 110 (IFRS 10)**, all companies with subsidiaries must prepare CFS.

Components of CFS

1. **Consolidated Balance Sheet** – Shows the **combined financial position** of all group entities.
2. **Consolidated Profit & Loss Account** – Reports the **group's overall profit/loss** for the financial year.
3. **Consolidated Cash Flow Statement** – Provides insights into the **group's liquidity**.
4. **Notes to Accounts** – Contains **details about accounting policies** and adjustments made during consolidation.

Holding & Subsidiary Company

In the corporate structure, businesses often expand by acquiring or controlling other companies. This results in the formation of **Holding Companies** and **Subsidiary Companies**. These terms are legally defined under the **Companies Act, 2013**, and relevant accounting standards such as **Ind AS 110 (IFRS 10)**.

1. Meaning of Holding & Subsidiary Company

Holding Company

A **Holding Company** is a company that **controls one or more other companies**, either by:

- **Owning more than 50% of shares** (majority ownership), or
- **Having the power to appoint/remove a majority of directors** in the controlled company.

Example: If **Company A** owns 70% of the shares in **Company B**, then**Company A is the Holding Company** of Company B.

Subsidiary Company

A **Subsidiary Company** is a company that is **controlled by a holding company** due to:

- **Majority shareholding (more than 50%)**, or
- **Significant influence over management decisions**.

Example: **Company B**, in the above case, is the **Subsidiary Company** of **Company A**.

Features of Holding & Subsidiary Companies

Feature	**Holding Company**	**Subsidiary Company**

Feature	Holding Company	Subsidiary Company
Ownership	Owns more than 50% of shares in a subsidiary	Controlled by the holding company
Decision-Making Power	Controls the subsidiary's financial & operational policies	Decisions influenced by the holding company
Financial Reporting	Prepares **Consolidated Financial Statements (CFS)**	Reports to the holding company
Legal Independence	Legally separate from its subsidiaries	Legally a separate entity but controlled
Liability	Not liable for subsidiary's debts (except in special cases)	Liable for its own debts

Types of Holding & Subsidiary Companies

A **holding company** is an entity that controls one or more **subsidiary companies** by owning a **majority of shares** or exercising significant **management control**. Subsidiary companies operate under the ownership or influence of the holding company but remain separate legal entities.

1. Types of Holding Companies

a) Pure Holding Company

- A company that exists **solely to own shares** in other companies and does not engage in any operational activities.

- Example: **Berkshire Hathaway**, which owns stakes in various businesses but does not produce goods or services itself.

b) Mixed Holding Company

- A company that **owns shares** in subsidiaries but also engages in **its own business operations**.
- Example: **Tata Sons**, which owns shares in Tata Group companies while also engaging in financial activities.

c) Immediate Holding Company

- A company that **acts as a holding company** for another company but is **itself controlled** by a larger holding company.
- Example: **Google LLC is an immediate holding company** of YouTube, but **Alphabet Inc.** is its ultimate holding company.

d) Intermediate Holding Company

- A holding company that is **both a subsidiary of another company** and a parent to its own subsidiaries.
- Used for **tax benefits, risk management, or regulatory compliance** in multinational operations.

e) Financial Holding Company

- A holding company primarily involved in **banking, financial services, or investment activities**.
- Example: **JPMorgan Chase & Co.**, which controls various banking and financial entities.

f) Ultimate Holding Company

- The **topmost company** in a corporate structure that has no parent company controlling it.
- Example: **Alphabet Inc. is the ultimate holding company** of Google, YouTube, and Waymo.

Types of Subsidiary Companies

a) Wholly Owned Subsidiary

- A subsidiary where the holding company owns **100% of its shares**.
- Example: **Jaguar Land Rover** is a wholly owned subsidiary of **Tata Motors**.

b) Partially Owned Subsidiary

- A subsidiary where the holding company owns **more than 50% but less than 100% of shares**.
- Example: **Nestlé India**, where **Nestlé S.A.** (Switzerland) owns a **majority stake** but not 100%.

c) Step-Down Subsidiary

- A **subsidiary of a subsidiary**, meaning a company controlled indirectly by the ultimate holding company.
- Example: If **Company A** owns **Company B**, and **Company B** owns **Company C**, then**Company C is a step-down subsidiary of Company A**.

d) Foreign Subsidiary

- A subsidiary incorporated in a **different country** from the holding company's registered location.
- Example: **Microsoft India Private Limited** is a **foreign subsidiary** of **Microsoft Corporation (USA)**.

e) Associate Company (Minority-Owned Subsidiary)

- A company where the holding company owns **between 20% and 50% of shares**, giving it **significant influence** but not full control.
- Example: **Suzuki Motor Corporation (Japan) owns a 56.37% stake in Maruti Suzuki**, making it a majority-owned subsidiary.

Legal & Financial Implications

Legal Provisions (Companies Act, 2013)

- Section **2(46)**: Defines a **Holding Company**.
- Section **2(87)**: Defines a **Subsidiary Company**.
- Section **129**: Requires a Holding Company to prepare **Consolidated Financial Statements (CFS)**.

Financial Reporting (Ind AS 110 / IFRS 10)

- A Holding Company **must consolidate** the financial statements of all its subsidiaries.
- Inter-company transactions are **eliminated** to avoid duplication.

Advantages of Holding-Subsidiary Structure

The **Holding-Subsidiary structure** is widely used by multinational corporations and large business groups to manage diverse operations efficiently. This structure provides several benefits related to **control, financial management, risk distribution, and tax advantages**.

1. Centralized Control & Decision-Making

A **Holding Company** has significant control over its subsidiaries, allowing for **strategic decision-making** across the entire corporate group. This ensures **uniform policies, efficient resource allocation, and synergy** among different business units.

2. Limited Liability Protection

- The **holding company is not directly responsible** for the debts and liabilities of its subsidiaries.

- If a subsidiary faces **financial losses or legal issues**, the liability **does not automatically transfer** to the holding company, reducing financial risk.

3. Diversification & Risk Management

- A holding company can operate in **multiple industries** by owning subsidiaries in different sectors.
- If one subsidiary faces losses, **profits from other subsidiaries** can help absorb the impact, reducing overall business risk.

4. Efficient Financial Management & Capital Allocation

- Profitable subsidiaries can **fund loss-making subsidiaries** within the group.
- The holding company can raise capital at **lower interest rates** and distribute it among subsidiaries as needed.
- This improves **cash flow management** and enhances financial stability.

5. Tax Benefits & Profit Optimization

- In some jurisdictions, losses of a subsidiary can be **adjusted against the profits** of the holding company, reducing the overall tax burden.
- Holding companies can shift profits through **dividends, royalties, or inter-company loans**, optimizing tax planning strategies.

6. Enhanced Business Expansion & Market Entry

- Holding companies can expand globally by **acquiring existing businesses** instead of starting new ventures from scratch.
- This helps in **rapid market entry** and reduces **setup costs** in new locations.

7. Asset Protection & Intellectual Property (IP) Security

- Valuable assets, such as **real estate, patents, trademarks, and copyrights**, can be held separately under the **holding company**.
- This protects **intellectual property** from risks such as lawsuits, bankruptcy, or hostile takeovers.

8. Continuity & Stability

- The holding company ensures **business continuity** even if one subsidiary fails or faces operational issues.
- This structure allows **smooth succession planning** and long-term sustainability.

9. Stronger Brand Image & Reputation

- A well-established holding company provides **brand credibility** to its subsidiaries.
- This enhances customer trust, making it easier for subsidiaries to **secure investments, partnerships, and contracts**.

Disadvantages of Holding-Subsidiary Structure

While the **Holding-Subsidiary structure** offers several advantages, it also comes with **challenges and risks** related to management complexity, regulatory compliance, and financial transparency. Below are some key disadvantages of this corporate structure.

1. Complexity in Management & Operations

- Managing multiple subsidiaries can lead to **bureaucratic inefficiencies** and slow decision-making.
- Each subsidiary may have **different operational policies**, making it difficult to maintain consistency across the group.

2. **High Compliance & Regulatory Requirements**

- Holding companies and their subsidiaries must comply with **multiple legal and tax regulations** in different jurisdictions.
- Preparing **Consolidated Financial Statements (CFS)** as per **Ind AS 110 or IFRS 10** can be time-consuming and costly.
- Increased **audit and reporting requirements** add to the administrative burden.

3. **Minority Shareholder Disputes**

- Minority shareholders in subsidiaries may feel **disadvantaged** as the holding company **controls major decisions**.
- This may lead to **conflicts over profit distribution, investments, or operational policies**.

4. **Risk of Misuse of Power**

- The holding company has **significant control** over subsidiaries, which can lead to **unethical practices**, such as:
  - Transferring profits to parent companies to **avoid tax liabilities**.
  - Shifting losses to specific subsidiaries to **manipulate financial performance**.

5. **Financial & Operational Dependence**

- If a **holding company faces financial distress**, it can negatively impact all subsidiaries under its control.
- A struggling subsidiary may **drain financial resources** from profitable subsidiaries, affecting the entire corporate group.

6. Complex Taxation Issues

- While tax benefits exist, managing **tax compliance across multiple subsidiaries** can be complex.
- Different tax laws in various countries may result in **double taxation, transfer pricing issues, or tax evasion penalties**.

7. Difficulty in Selling or Restructuring Subsidiaries

- Selling a subsidiary may require **extensive legal approvals** and restructuring efforts.
- If a subsidiary is underperforming, it may **reduce the valuation of the entire group**, making it harder to attract investors.

8. Risk of Reputation Damage

- If one subsidiary is involved in **fraud, litigation, or unethical practices**, the reputation of the **entire holding company** may suffer.
- Public perception of the holding company may decline, affecting **stock prices and investor confidence**.

9. Potential for Conflicts Between Management & Subsidiaries

- The management of a holding company may **override the autonomy** of subsidiary management, leading to **conflicts and inefficiencies**.
- Subsidiaries may feel restricted if the holding company **interferes excessively in daily operations**.

Example of Holding & Subsidiary Companies

Reliance Industries Ltd. (Holding Company) owns multiple subsidiaries like **Jio, Reliance Retail, and Reliance Petroleum**.

Google LLC is a subsidiary of **Alphabet Inc. (Holding Company)**.

Facebook, Instagram, and WhatsApp are subsidiaries of **Meta (Holding Company)**.

Legal Requirementsrelating to preparation of accounts

The preparation of accounts by companies is governed by various legal provisions to ensure **transparency, accuracy, and compliance** with financial regulations. These requirements are primarily outlined in the **Companies Act, 2013**, **Accounting Standards (AS &Ind AS)**, and **other statutory regulations**. Below are the key legal aspects relating to the preparation of financial accounts:

1. Companies Act, 2013 – Provisions Related to Accounts

The **Companies Act, 2013** prescribes specific guidelines for financial statements under **Sections 128 to 138**. The key provisions include:

a) Section 128: Books of Accounts

- Every company must **maintain proper books of accounts** that give a **true and fair view** of its financial position.
- The books must be kept on an **accrual basis** and follow the **double-entry system**.
- Records should be maintained for at least **8 years** at the company's registered office or any other approved location.

b) Section 129: Financial Statements

- Companies must prepare financial statements **as per Schedule III** of the Companies Act.
- Financial statements must include:
    - **Balance Sheet**

- **Profit & Loss Account**
- **Cash Flow Statement** (except for small companies)
- **Statement of Changes in Equity**
- **Notes to Accounts**

c) Section 133: Compliance with Accounting Standards

- Companies must follow **Indian Accounting Standards (Ind AS)** or **Accounting Standards (AS)** as notified by the Ministry of Corporate Affairs (MCA).

d) Section 134: Directors' Responsibility Statement

- The financial statements must include a **Director's Report**, which certifies that:
  - Accounting policies have been applied consistently.
  - Proper explanations are provided for any **significant changes** in accounting practices.
  - Internal financial controls are adequate and have been properly implemented.

e) Section 137: Filing of Financial Statements with ROC

- Companies must file their financial statements with the **Registrar of Companies (ROC)** within **30 days** of the Annual General Meeting (AGM).
- Non-compliance may result in penalties for the company and its officers.

2. Accounting Standards (AS) & Indian Accounting Standards (Ind AS)

The preparation of financial accounts must comply with:

1. **Accounting Standards (AS)** – applicable to non-Ind AS companies.
2. **Indian Accounting Standards (Ind AS)** – applicable to listed companies and large private companies.

Some important standards include:

- **AS 1 / Ind AS 1** – Disclosure of accounting policies.
- **AS 3 / Ind AS 7** – Cash flow statements.
- **AS 10 / Ind AS 16** – Accounting for fixed assets.
- **AS 22 / Ind AS 12** – Accounting for taxes on income.

Failure to comply with these standards may lead to regulatory action and financial misstatements.

3. Taxation Laws – Income Tax Act, 1961

- Companies must prepare financial accounts in compliance with **tax provisions** for income tax filing.
- The financial statements should accurately compute **taxable income, depreciation, and deductions** under the **Income Tax Act**.
- Companies with turnover exceeding Rs.50 lakh must get their accounts **audited under Section 44AB** of the Income Tax Act.

4. Companies (Auditor's Report) Order (CARO), 2020

- Companies must **disclose additional financial details** under CARO, such as **loan defaults, fraud reporting, related party transactions, and internal control effectiveness**.

5. SEBI (LODR) Regulations, 2015 – Listed Companies

- Listed companies must **publish quarterly and annual financial statements** as per SEBI (Listing Obligations and Disclosure Requirements) Regulations.
- They must also ensure **corporate governance compliance** in financial reporting.

6. Preparation of Consolidated Financial Statements (CFS)

Holding companies must prepare **Consolidated Financial Statements (CFS)** under **Ind AS 110**.

CFS combines the accounts of the holding company and its subsidiaries to present a **comprehensive financial picture**.

Preparation of Consolidated Balance (Excluding Inter-company holdings)

To prepare a consolidated balance sheet excluding inter-company holdings, you combine the balance sheets of the parent company and its subsidiaries, but eliminate any inter-company transactions and balances, such as inter-company receivables and payables.

Here's a more detailed breakdown of the process:

1. Identify the Entities to Consolidate:

Determine which companies are part of the group and therefore should be included in the consolidated balance sheet.

This typically includes the parent company and its subsidiaries, where the parent company has control over the subsidiary (usually through owning more than 50% of the voting shares).

2. Gather Financial Information:

Obtain the individual balance sheets of the parent company and all subsidiaries.

Ensure the balance sheets are prepared on the same accounting basis and for the same reporting period.

3. Combine the Balance Sheets:

Add up the assets, liabilities, and equity of the parent company and its subsidiaries.

Create a consolidated balance sheet with sections for assets, liabilities, and equity.

4. Eliminate Inter-company Transactions and Balances:

Inter-company receivables and payables:

These are amounts owed between companies within the group and must be eliminated to avoid double-counting.

Inter-company sales and purchases:

Any revenue or cost of sales arising from transactions between group companies must be eliminated to avoid inflating the group's income.

Inter-company profits/losses on assets:

If a group company sells an asset to another group company at a profit, the unrealized profit must be eliminated from the consolidated balance sheet until the asset is sold to an outside party.

5. Allocate Parent Company Investments:

Determine the parent company's ownership stake in each subsidiary.Allocate the subsidiary's equity (assets and liabilities) to the parent company and non-controlling interests (if any).

6. Adjust Non-controlling Interests:

If a subsidiary has non-controlling interests (i.e., ownership by parties outside the group), these interests must be reflected in the consolidated balance sheet.The non-controlling interests are usually shown as a separate line item within the equity section.

7. Prepare Disclosures:

Include a note to the consolidated balance sheet explaining the consolidation process and any significant inter-company transactions or balances.Disclose any significant assumptions or judgments made during the consolidation process.

1. XYZ Ltd. acquired 80% shares of ABC Ltd. on **31st March 2024**. The balance sheets of both companies as of this date are as follows:

Balance Sheet as of 31st March 2024

Liabilities	XYZ Ltd. (Rs.)	ABC Ltd. (Rs.)	Assets	XYZ Ltd. (Rs.)	ABC Ltd. (Rs.)
Equity Share Capital (Rs.10 each)	3,00,000	1,00,000	Fixed Assets	4,00,000	1,50,000
General Reserve	1,20,000	40,000	Investments in ABC Ltd.	80,000	—
Profit & Loss A/c	70,000	30,000	Stock	60,000	50,000
Creditors	50,000	20,000	Debtors	70,000	40,000
Bills Payable	30,000	10,000	Cash & Bank	60,000	30,000
Total	**5,70,000**	**2,00,000**	**Total**	**5,70,000**	**2,00,000**

Steps to Prepare Consolidated Balance Sheet:

1. **Eliminate Inter-Company Investment**
   - XYZ Ltd. owns **80% shares** in ABC Ltd.
   - Investment of Rs. **80,000** is cancelled against **80% of ABC Ltd.'s share capital (Rs. 80,000 of Rs. 1,00,000).**
2. **Calculate Minority Interest** (20% of ABC Ltd.)
   - **Share Capital (20%)** = Rs. 20,000
   - **Reserves (20%)** = Rs. 8,000
   - **P&L (20%)** = Rs. 6,000
   - **Total Minority Interest** = Rs. **34,000**
3. **Prepare Consolidated Reserves & Surplus:**
   - **General Reserve** = XYZ Ltd. (1,20,000) + ABC Ltd. (40,000 × 80%) = **1,52,000**
   - **Profit & Loss A/c** = XYZ Ltd. (70,000) + ABC Ltd. (30,000 × 80%) = **94,000**

(A) Consolidated Balance Sheet as of 31st March 2024

Liabilities	Rs.	Assets	Rs.
Equity Share Capital (XYZ Ltd.)	3,00,000	Fixed Assets	5,50,000
General Reserve	1,52,000	Stock	1,10,000
Profit & Loss A/c	94,000	Debtors	1,10,000
Creditors	70,000	Cash & Bank	90,000

Liabilities	Rs.	Assets	Rs.
Bills Payable	40,000	**Total Assets**	**8,70,000**
Minority Interest	**34,000**		
Total Liabilities	**8,70,000**		

Final Answer:

The **Consolidated Balance Sheet** shows the **true financial position of the group**, excluding inter-company holdings.

UNIT V

UNIT V

Liquidation of Companies

Meaning- Modes of Winding-up- Preparation of Statement of Affairs and Statement of Deficiency or Surplus (List H) Order of Payment – Liquidators Remuneration- Liquidators Final Statements.

Liquidation of Companies-Meaning

Liquidation of a company refers to the **process of closing down a business** and distributing its assets to creditors and shareholders. It involves **selling off the company's assets, settling liabilities, and dissolving the company's legal existence**. Once a company is liquidated, it **ceases operations permanently** and is removed from the official records of the **Registrar of Companies (RoC)**.

Liquidation usually occurs when a company is **unable to pay its debts (insolvency) or decides to close down voluntarily**. The process is carried out by a **liquidator**, who is responsible for managing the sale of assets, paying off debts, and distributing the remaining funds to shareholders, if any.

Liquidation can be **compulsory (court-ordered) or voluntary (decided by shareholders or creditors)**. The main objective of liquidation is to ensure that the **company's debts are cleared legally and fairly** before it is formally dissolved.

Modes of Winding-up

Winding-up of a company refers to the **process of closing the business, selling its assets, settling liabilities, and distributing any remaining funds to shareholders** before legally dissolving the company. It can be classified into the following modes:

1. Compulsory Winding-up (By Tribunal/Court)

This occurs when a company is forced to wind up by an order of the **National Company Law Tribunal (NCLT)** under the Companies Act, 2013. It is usually initiated due to:

Grounds for Compulsory Winding-up:

- The company is **unable to pay its debts**.
- The company has **acted against the interests of the country**.
- The company has **not filed financial statements or annual returns for five consecutive years**.
- The Tribunal believes that **winding-up is just and equitable** for the company.

In this case, the Tribunal appoints an **official liquidator** to manage the liquidation process.

2. Voluntary Winding-up

In voluntary winding-up, the decision is made by the **company itself**, either by its shareholders or creditors. It is further divided into:

a) Members' Voluntary Winding-up

- Occurs when the company is **solvent (can pay its debts)**, but shareholders decide to close the business.
- A **declaration of solvency** is made by directors, and liquidators are appointed to distribute assets.

b) Creditors' Voluntary Winding-up

- Happens when the company is **insolvent (cannot pay its debts)**, and creditors take control of the liquidation process.
- Creditors appoint a liquidator to **realize assets and repay outstanding debts**.

3. Winding-up under the Supervision of the Tribunal (No Longer in Use)

- Earlier, a company could request winding-up under the **supervision of the court/tribunal**, but this mode was removed after the Companies Act, 2013.

Preparation of Statement of Affairs and Statement of Deficiency or Surplus (List H) Order of Payment

When a company goes into **liquidation**, it must prepare financial statements to show its financial position. Two important statements prepared during the liquidation process are:

1. **Statement of Affairs**
2. **Statement of Deficiency or Surplus (List H)**

These statements help in understanding the **assets available for distribution and the shortfall (if any) after paying off liabilities**.

1. Statement of Affairs

The **Statement of Affairs** is a summary of the company's financial position at the time of liquidation. It lists **all assets and liabilities**, indicating the expected realizable value of assets and the amount owed to creditors.

Format of Statement of Affairs

Particulars	**Book Value**	**Realizable Value**
Assets Available for Secured Creditors		

Particulars	**Book Value**	**Realizable Value**
Fixed Assets (Land, Buildings, Machinery, etc.)	Rs.XXX	Rs.XXX
Current Assets (Stock, Debtors, Cash, etc.)	Rs.XXX	Rs.XXX
Other Assets (Investments, Loans Given, etc.)	Rs.XXX	Rs.XXX
Total Assets	Rs.XXX	Rs.XXX
Liabilities		
Secured Creditors	Rs.XXX	Rs.XXX
Preferential Creditors	Rs.XXX	Rs.XXX
Unsecured Creditors	Rs.XXX	Rs.XXX
Deficiency to be Adjusted Against Capital	Rs.XXX	Rs.XXX

The **realizable value** represents the expected amount that can be recovered from selling assets. The difference between **total assets and liabilities** shows the **deficiency or surplus** of funds.

2. Statement of Deficiency or Surplus (List H)

The **Statement of Deficiency or Surplus** (List H) explains the **difference between the book value of assets and the total liabilities**. It is prepared to determine whether there is a **surplus (profit) or deficiency (loss) upon liquidation**.

Format of Statement of Deficiency (List H)

Particulars	Amount (Rs.)
A. Total Liabilities (Creditors + Loans + Other Obligations)	Rs.XXX
B. Total Realizable Assets	Rs.XXX
C. Deficiency or Surplus (B - A)	Rs.XXX

- If **B > A**, there is a **surplus**, and remaining funds are distributed to shareholders.
- If **A > B**, there is a **deficiency**, and shareholders may get nothing.

3. Order of Payment in Liquidation

When a company goes into **liquidation**, its assets are sold, and the proceeds are used to settle liabilities in a specific order. The **Companies Act, 2013** and insolvency laws provide a structured sequence to ensure fair distribution of funds among creditors and shareholders.

1. Order of Payment as per the Companies Act, 2013

1.1 Liquidation Expenses & Costs

- The first priority is given to the **liquidator's remuneration, legal costs, and other expenses** incurred in the liquidation process.
- This includes court fees, professional charges, and administrative expenses.

1.2 Secured Creditors (With a Fixed Charge)

- These are creditors who have a **specific charge on company assets** (e.g., banks with mortgages on property or machinery).
- They are paid from the proceeds of the secured assets they hold.

1.3 Preferential Creditors (As per Section 327 of the Companies Act, 2013)

These creditors have **legal priority over unsecured creditors** and include:

- **Employee wages** (for the last 12 months).
- **Contributions to employee provident fund, pension fund, and gratuity**.
- **Government dues**, such as unpaid taxes, up to a certain limit.

1.4 Unsecured Creditors

- Creditors who do not have any security over company assets (e.g., suppliers, service providers).
- They are paid only after secured and preferential creditors have been settled.

1.5 Debenture Holders (Unsecured)

- If a company has issued **unsecured debentures**, the holders will be paid at this stage.
- However, **secured debenture holders** are paid along with secured creditors.

1.6 Preference Shareholders

- Holders of **preference shares** are entitled to repayment **before equity shareholders**.
- If there are any **arrears of dividends**, they may be paid depending on the company's surplus.

1.7 Equity Shareholders (Ordinary Shareholders)

- **Equity shareholders are the last to be paid**.
- If any surplus remains after settling all liabilities, it is distributed among shareholders according to their shareholding.
- In most cases of liquidation, **equity shareholders receive nothing** as liabilities exceed assets.

2. Summary of Order of Payment

Rank	Category	Example
1st	Liquidation Expenses	Liquidator fees, court fees, legal costs
2nd	Secured Creditors	Bank loans backed by company assets
3rd	Preferential Creditors	Employee wages, provident fund dues, government taxes
4th	Unsecured Creditors	Suppliers, service providers, trade creditors
5th	Debenture Holders (Unsecured)	Unsecured debenture holders
6th	Preference Shareholders	Preferred stockholders
7th	Equity Shareholders	Ordinary shareholders (paid last, if any surplus remains)

Liquidators Remuneration

Liquidator's remuneration refers to the **fees or compensation paid to the liquidator** for managing the process of winding up a company. The liquidator is responsible for **selling assets, settling liabilities, and distributing funds among creditors and shareholders** as per the legal framework.

1. Basis of Liquidator's Remuneration

The remuneration of the liquidator is determined based on:

1. **Fixed Percentage of Asset Realization** – A certain percentage of the total assets sold.

2. **Fixed Percentage of Payments Made to Creditors** – A percentage of the payments disbursed to creditors.
3. **Fixed Fee or Salary** – In some cases, the Tribunal or creditors may fix a lump sum amount as remuneration.
4. **Hourly or Daily Rate** – In complex cases, liquidators may charge based on time spent on the liquidation process.

The remuneration is typically specified in:

- The **appointment order** of the liquidator.
- **Agreements between creditors and the liquidator**.
- The **Companies Act, 2013 and Insolvency Laws**.

2. Legal Provisions for Liquidator's Remuneration

2.1 In Compulsory Winding-up (By Tribunal)

- The liquidator is appointed by the **National Company Law Tribunal (NCLT)**.
- The remuneration is **fixed by the Tribunal** and is paid from the company's assets before settling other liabilities.

2.2 In Voluntary Winding-up

- The liquidator's fees are decided by the **company and its creditors**.
- If creditors and the company disagree, the Tribunal may intervene.

2.3 In Creditor's Voluntary Winding-up

- Creditors **approve and decide the remuneration** during the liquidation meeting.

2.4 In Winding-up by the Official Liquidator

- The remuneration is paid as per the **Companies (Winding-up) Rules, 2020**, and is usually a percentage of asset realization.

3. Order of Payment of Liquidator's Remuneration

The **liquidator's remuneration** is an important expense in the liquidation process. It is paid **before any other liabilities**, ensuring that the liquidator is compensated for their work in managing the company's winding-up process. The **order of payment** follows a legal hierarchy set by the **Companies Act, 2013** and **Insolvency and Bankruptcy Code (IBC), 2016**.

1. Priority of Liquidator's Remuneration

The **liquidator's remuneration** is included in **liquidation expenses**, which are settled **before any other payments**. The hierarchy is as follows:

1. **Liquidation Expenses (Including Liquidator's Remuneration)**
   - Fees of the **liquidator, lawyers, accountants**, and other professionals involved in the process.
   - Any **court or tribunal fees** related to liquidation.
   - Expenses for **valuation, auction, and legal compliance**.
2. **Secured Creditors** (Creditors with a Charge on Assets)
   - Loans from banks or financial institutions backed by **mortgages or pledges**.
   - These creditors are paid from the sale of secured assets.
3. **Preferential Creditors** (Employees, Government Dues)
   - Employee wages and salaries (for the last 12 months).
   - Contributions to **Provident Fund, Gratuity, and Pension Funds**.
   - Government dues (e.g., unpaid taxes, duties).

4. **Unsecured Creditors**

- Trade creditors, suppliers, and service providers.
- These creditors do not have collateral backing their claims.

5. **Debenture Holders (Unsecured)**

- Holders of unsecured **debentures** are paid after unsecured creditors.

6. **Preference Shareholders**

- If funds remain after all debts are cleared, **preference shareholders** are paid.

7. **Equity Shareholders**

- **Ordinary shareholders** are paid last, only if there is a surplus after settling all liabilities.

2. Legal Basis for Payment of Liquidator's Remuneration

- **Companies Act, 2013 (Section 326 & 327)** – Specifies that liquidation expenses are paid before other liabilities.
- **Insolvency and Bankruptcy Code (IBC), 2016** – In case of corporate insolvency, liquidation expenses have the highest priority.
- **Tribunal or Shareholder Approval** – In voluntary liquidation, shareholders or creditors approve the liquidator's fees.

3. Example of Liquidator's Remuneration Calculation

Case Study:

A company is under liquidation with the following financial details:

- **Total Assets Realized** = Rs.50,00,000
- **Liquidator's Remuneration** = **5% of total assets realized**
- **Total Liabilities** = Rs.40,00,000

Calculation:

Liquidator's Remuneration = 5% of Rs.50,00,000 = **Rs.2,50,000**

This amount is **paid first**, before settling secured and unsecured creditors.

4. Example of Liquidator's Remuneration Calculation

Suppose a company in liquidation has:

- Total assets realized = Rs.50,00,000
- Liquidator's remuneration = **5% of assets realized**

Remuneration Calculation

=5% of Rs.50,00,000

= **Rs.2,50,000**

This amount will be paid **before distributing funds to creditors and shareholders**.

Liquidators Final Statement

The **Liquidator's Final Statements** are financial reports prepared at the end of the **winding-up process** to show how the company's assets were realized, liabilities settled, and any remaining funds distributed among stakeholders. These statements ensure **transparency and accountability** in the liquidation process.

1. Importance of Liquidator's Final Statements

- Provides a **detailed summary of receipts and payments** during liquidation.

- Ensures that all **creditors and shareholders receive their due amounts** as per legal priority.
- Helps in the **final dissolution of the company**.
- Submitted to the **Tribunal (for compulsory winding-up)** or to **shareholders and creditors (for voluntary winding-up)**.

2. Components of Liquidator's Final Statements

2.1 Liquidator's Statement of Account (Receipts & Payments Account)

This statement records **all cash inflows and outflows** during the liquidation process.

Format of Receipts & Payments Account

Receipts	Amount (Rs.)	Payments	Amount (Rs.)
Cash in Hand	XXX	Liquidator's Remuneration	XXX
Cash at Bank	XXX	Liquidation Expenses	XXX
Sale of Assets	XXX	Secured Creditors	XXX
Calls in Arrears Collected	XXX	Preferential Creditors	XXX
Surplus from Contributories	XXX	Unsecured Creditors	XXX
Any Other Receipts	XXX	Preference Shareholders	XXX
		Equity Shareholders (if surplus)	XXX
Total Receipts	XXX	**Total Payments**	XXX

2.2 Statement of Distribution

This statement shows how **funds were allocated** among creditors and shareholders.

Format of Statement of Distribution

Particulars	Amount (Rs.)	Priority
Liquidation Expenses (Including Liquidator's Remuneration)	XXX	**1st**
Secured Creditors	XXX	**2nd**
Preferential Creditors (Employees, Taxes)	XXX	**3rd**
Unsecured Creditors	XXX	**4th**
Debenture Holders (Unsecured)	XXX	**5th**
Preference Shareholders	XXX	**6th**
Equity Shareholders (if any surplus remains)	XXX	**7th**

2.3 Deficiency Account (Statement of Losses to Stakeholders)

If the company **does not have enough assets to pay all creditors**, this account shows the shortfall.

Format of Deficiency Account

Particulars	Amount (Rs.)
Total Liabilities (Creditors, Loans, etc.)	XXX

Particulars	Amount (Rs.)
Total Realized Assets	(XXX)
Deficiency (Shortfall)	XXX

3. Submission of Liquidator's Final Statements

Once the final statements are prepared:

1. The liquidator submits the statements to the **Tribunal (for compulsory winding-up)** or to **shareholders & creditors (for voluntary winding-up)**.
2. The company is **officially dissolved** once all payments are completed.
3. A **Final Report** is filed with the **Registrar of Companies (RoC)** for removal of the company's name.

1. XYZ Ltd. goes into liquidation. The following are the details related to the liquidation process:

Balance Sheet Before Liquidation:

- **Assets Realized:**
  - Fixed Assets: Rs. 2,00,000
  - Stock: Rs. 50,000
  - Debtors: Rs. 75,000
  - Bank Balance: Rs. 25,000
- **Liabilities:**
  - Secured Debentures (on fixed assets): Rs. 1,00,000
  - Trade Creditors: Rs. 50,000
  - Liquidation Expenses: Rs. 10,000
  - Preference Shareholders: Rs. 50,000

- Equity Share Capital (Rs.10 each): Rs. 1,00,000
- Liquidator's Commission: 5% on amount distributed to unsecured creditors.

Solution: Liquidator's Final Statement of Account

Receipts	Rs.	Payments	Rs.
Assets Realized:		**Secured Debentures Paid**	1,00,000
Fixed Assets	2,00,000	**Liquidation Expenses**	10,000
Stock	50,000	**Liquidator's Commission (5% on Rs. 50,000)**	2,500
Debtors	75,000	**Unsecured Creditors (Trade Creditors)**	47,500
Bank Balance	25,000	**Preference Shareholders Paid**	50,000
		Equity Shareholders (Final Amount Distributed)	1,40,000
Total Receipts	3,50,000	**Total Payments**	3,50,000

Thus, the liquidator distributes the available funds in the correct order of priority, ensuring all liabilities are settled properly.

2. ABC Ltd. went into liquidation on **31st March 2024**, and the following details were available:

Assets Realized:

- Fixed Assets: **Rs. 3,00,000**
- Stock: **Rs. 1,00,000**
- Debtors: **Rs. 50,000**

- Bank Balance: **Rs. 20,000**

Liabilities to be Settled:

- Secured Debentures (charge on fixed assets): **Rs. 1,50,000**
- Unsecured Creditors: **Rs. 80,000**
- Preference Share Capital: **Rs. 60,000**
- Equity Share Capital (Rs.10 each): **Rs. 1,20,000**
- Liquidation Expenses: **Rs. 10,000**
- Liquidator's Commission: **5% on amount paid to unsecured creditors**

Solution: Liquidator's Final Statement of Account

Receipts	Rs.	Payments	Rs.
Assets Realized:		**Secured Debentures Paid**	1,50,000
Fixed Assets	3,00,000	**Liquidation Expenses**	10,000
Stock	1,00,000	**Liquidator's Commission (5% on Rs. 80,000)**	4,000
Debtors	50,000	**Unsecured Creditors Paid**	76,000
Bank Balance	20,000	**Preference Shareholders Paid**	60,000
		Equity Shareholders Paid	1,70,000
Total Receipts	4,70,000	**Total Payments**	4,70,000

Final Answer:

After settling **secured debentures, liquidation expenses, unsecured creditors (including liquidator's commission), preference shareholders, and equity shareholders**, the total receipts and payments are **Rs. 4,70,000**, ensuring a balanced final statement.

3. XYZ Ltd. is going into liquidation on **31st March 2024**, and the following balances are extracted from its books:

Liabilities:

- **Secured Creditors** (having a charge on fixed assets): **Rs. 2,00,000**
- **Preferential Creditors** (Wages & Taxes): **Rs. 50,000**
- **Unsecured Creditors: Rs. 1,20,000**
- **Debentures (Floating Charge): Rs. 1,50,000**
- **Equity Share Capital (Rs. 10 each): Rs. 2,50,000**
- **Preference Share Capital: Rs. 1,00,000**

Assets Realizable:

- **Fixed Assets: Rs. 2,50,000**
- **Stock: Rs. 70,000**
- **Debtors: Rs. 80,000**
- **Cash in Bank: Rs. 10,000**

Additional Information:

- Liquidation Expenses: **Rs. 10,000**
- Liquidator's Commission: **5% on Unsecured Creditors Paid**
- Deficiency as per last balance sheet: **Rs. 50,000**

Solution:

(A) Statement of Affairs (As on 31st March 2024)

Assets	Rs.	Liabilities	Rs.
Realizable Assets:		**Secured Creditors (Paid from Fixed Assets)**	2,00,000
Fixed Assets	2,50,000	**Preferential Creditors (Wages & Taxes)**	50,000
Stock	70,000	**Debentures (Floating Charge, Paid from General Assets)**	1,50,000
Debtors	80,000	**Unsecured Creditors**	1,20,000
Cash in Bank	10,000	**Liquidation Expenses**	10,000
Total Assets Available	**4,10,000**	**Total Liabilities**	**5,30,000**

Deficiency (Assets – Liabilities) = Rs. 1,20,000

(B) Statement of Deficiency (List H)

Particulars	Rs.
Deficiency as per Last Balance Sheet	50,000
Add: Loss on Realization (Shortfall of Assets over Liabilities)	70,000
Total Deficiency to be Accounted for	**1,20,000**

(C) Order of Payment:

1. **Secured Creditors (Paid from Fixed Assets)** – Rs. 2,00,000
2. **Liquidation Expenses** – Rs. 10,000
3. **Preferential Creditors (Wages & Taxes)** – Rs. 50,000
4. **Debentures (Floating Charge, Paid from Remaining Assets)** – Rs. 1,50,000
5. **Unsecured Creditors (Paid Partially, After Liquidator's Commission Deduction)**
6. **Equity & Preference Shareholders (No Amount Left, Total Loss to Them)**

Final Answer:

The **deficiency amounts to Rs. 1,20,000**, which is attributed to **past losses and losses on realization of assets**. **Secured creditors, preferential creditors, and debenture holders get full payment, while unsecured creditors suffer a partial loss. Equity and preference shareholders receive nothing.**

This structured **Statement of Affairs & Deficiency Account** is **suitable for an 8-mark question.**

Liquidator's Final Statement of Account

Problem No.1

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 realized 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 realized the following sums:

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

The Liquidation expenses amount to Rs. 1000

Solution:

Liquidator's final statement of Account

Receipts	Rs	Payments	Rs
Building	20,000	By Liquidation expenses	1,000
Machinery	18,650	By Liquidator's Remuneration	
Furniture	1,000	By 2% on amount realized	
		39650 x 2/100= 793	
		By2%onamountpaidto	
		Unsecured creditors* 350	1,143
		By Debenture holders	10,000

		By Preferential creditors	10,000
	======	By Unsecured creditors**	17,507
			=======
	39,650		**39,650**

Calculation of amount paid to unsecured creditors:

Amount available to unsecured creditors:

Total Receipts		39,650
Less: Payments Liquidation expenses	1,000	
Liquidator's Remuneration amount realised	793	
Debenture holder-paid	10,000	
Preferential creditors-paid	10,000	21,793
Amount available to unsecured creditors		17,857
		=======

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

Commission= Amount Available x 2/102

17857x2/102=350

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

Problem No. 2

Krishnan Ltd was liquidated on 31-12-2021. The Balance sheet as on 31-12-2021.

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 realized as follows:

a) Land and Building Rs.55,000

b) Stock Rs.20,000

c) Plant & Machinery Rs. 25,000

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

e) Liquidator was entitled to a commission of 3% on amount realized 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		5,000	By Secured creditors (mortgage Loan)	50,000
To Assets Realised:			Liquidation expenses	970
Land &Building	55,000		Liquidator'sRemuneration3%on amount realized except cash 121000 x 3/100	3,630
Stock	20,000		Amount paid to debenture holders	61,200
Plant & Machinery	25,000		Payment to preferential creditors	10,200
Debtors	21,000	1,21,000		
		1,26,000		1,26,000

Note:1) Debtors Realised:

70000

Debtors

Less: 50% Bad	35000
Balance 60% realised	35000

35000x 60/100= 21000*

Illustration: 3

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 creditor

Rs.12,000 Unsecured

creditorRs.40,000

Debentures

Rs.14,000

Assets realized Rs.40,000 and liquidation expenses amounted Rs.4,000.

Solution:

Liquidator's final statement of account

Receipts	Rs.	Payments	Rs.

Assets realised	40000	Liquidation expenses Liquidator's Remuneration3% Amount paid to unsecured creditors Debentures Preferential creditors Unsecured creditors	4,000 291 14,000 12,000 9709
	40,000		40,000

Calculation of Commission Payable to Liquidator

Commission = Amount available x3/103

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*

i) **Amount payable to unsecured creditors**

Amount available	10000
Less: Commission	291

9709*

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