Semester – II

19CMP206 **DIRECT TAXATION** **4H – 4C**

Instruction Hours / week: L: 3 T:1 P : 0 **Marks: Internal: 40** **External: 60** **Total: 100**

End Semester Exam: 3 Hours

COURSE OBJECTIVES:

To make the students

1. To Understand the Concept of assessment, assessee, Income heads and the Income Tax laws.
2. To learn the tools and techniques to compute the tax for the various income heads.
3. To select the best ways to compute the income tax based on the income heads for various assessee and to gain a lifelong learning for applying the IT calculation for various income heads based on each case of assessee.
4. To communicate orally and in written form the income tax concepts and computations.
5. To be familiar with the laws pertaining to the Income Tax and apply it lifelong.

COURSE OUTCOMES:

Learners should be able to

1. Comprehend on the concepts related to assessment, assesse , Income heads and the Income Tax laws.
2. Compute Income Tax Returns.
3. Formulate the Income Tax calculations by critically analyzing the assessee's situation under various income heads and deductions and acquire a Lifelong practice for computation of Tax under various income heads and deductions for any assessee
4. Communicate orally and in written the Income tax computation under various income heads and deductions.
5. Familiar with the laws pertaining to the Income Tax and its apply it lifelong.

UNIT I BASIC CONCEPTS

An Overview of Income Tax Act, 1961 : Background, Important definitions- Income - Agricultural Income - Assessee - Previous year - Assessment year, Residential Status, Basis of Charge, Scope of Total Income, Tax Rates in accordance with the applicable Finance Act for the relevant assessment year.

UNIT II COMPUTATION OF INCOME UNDER THE HEAD OF SALARY AND COMPUTATION OF INCOME UNDER THE HEAD OF HOUSE PROPERTY

Salary – Coverage, Employer and Employee Relationship, Allowances, Monetary and Non-Monetary Perquisites – Valuation and Taxability, Profits in lieu of Salary, Deductions against Salary, Incomes exempt from Tax and not includible in 'Salary', Deduction to be made from salary in respect of Provident Fund under the provisions of the Provident Fund and Miscellaneous Provisions of Act 1952 and tax treatment of employers' contribution to Provident Fund, Tax Deducted at Source on Salary Income and Compliances.

Computation of Income under the head of House Property : Chargeability, Owner of house property, Determination of Annual Value, Deduction from Net Annual Value, Treatment of Unrealized Rent, Arrears of Rent, Exemptions, Computation of Income from a let out House Property, Self-Occupied Property.

UNIT III COMPUTATION OF INCOME – PROFITS AND GAINS FROM BUSINESS AND PROFESSION :

Profits and Gains from Business and Profession: Business and Profession – An overview, Chargeability, Profits and Losses of Speculation Business, Deductions Allowable, Expenses Disallowed, Deemed Profits u/s 41, Maintenance of Accounts, Tax Audit, Presumptive Base Taxation.

Chargeability, Capital Gains, Capital Assets & Transfer, Types of Capital Gains, Mode of Computation of Capital Gains, Exemptions and Deduction, Special Provision – Slump Sale, Compulsory Acquisition, Fair Market Value, Reference to valuation officer.

UNIT IV COMPUTATION OF INCOME FROM OTHER SOURCES :

Taxation of Dividend u/s 2(22)(a) to (e), Provisions relating to Gifts, Deductions, Other Miscellaneous Provisions.

Exemptions/Deduction, Clubbing provisions, Set Off and/or Carry Forward of Losses, Rebate and Relief : Income's not included in Total Income, Tax holidays, Clubbing of Income, Aggregation of Income, Set off and/or Carry forward of losses, Deductions (General and Specific), Rebates and Reliefs.

UNIT V COMPUTATION OF TOTAL INCOME AND TAX LIABILITY

TDS/TCS, Returns, Refund & Recovery : Tax Deduction at Source 'TDS' & Tax Collection at Source 'TCS', Advance Tax &Self-Assessment Tax 'SAT', Returns, Signatures, E-Filing, Interest for default in furnishing return of Income, Collection, Recovery of Tax, & Refunds, Assessment, Appeals, Revisions, Settlement of Cases, Penalties etc., Assessment, Appeals & Revisions, Settlement of Cases, Penalties, Offences & Prosecution.

Tax Planning & Tax Management : Tax Planning, Tax Management and Tax avoidance though legitimate tax provisions, Various Avenues.

International Taxation – An Overview : Double Taxation Avoidance Agreement 'DTAA', Residency Issues, Tax Heaven, Controlled Foreign Corporation (CFC), Concept of Permanent Establishment, Business Connection, General Anti Avoidance Rules 'GAAR', Advance Ruling – Practical Aspect, Transfer Pricing –An Overview.

Note: Distribution of marks - 30% theory and 70% problems

SUGGESTED READINGS

1. Dr. H.C Malhotra, Dr. S P Goyal (2019), Income Tax Law and Practice, 60th edition, Sathya Bawan Publication, New Delhi.
2. Dr. Girish Ahuja, Dr. Ravi Gupta (2018), Direct Taxes Law and Practices, 10th Edition Wolters Kluwer India Pvt Ltd, New Delhi.
3. CA AtinHarbhajanka (Agarwal) (2018), Income Tax Law and Practice, 2nd Edition Bharat Law House Pvt Ltd, New Delhi.
4. Dr.Vinod.K.Singhania, Dr Kapil Singhania (2018), Direct Taxes Law and Practice, Taxmann Publication Pvt Limited, New Delhi.
5. Monica Singhania Vinod K Singhania (2019), Students Guide To Income Tax including GST, 61st edition, Taxmann Publication Pvt Limited, New Delhi.
6. Direct Tax Law and Practice (2018), The Institute of Company Secretaries of India, MP Printers.

KARPAGAM ACADEMY OF HIGHER EDUCATION
(Deemed to be University)
(Established Under Section 3 of UGC Act 1956)
Coimbatore – 641 021.

LECTURE PLAN

DEPARTMENT OF COMMERCE

STAFF NAME : Dr. K.JOTHI
SUBJECT NAME : DIRECT TAXATION **SEMESTER : II**
SUBJECT CODE : 19CMP206 **CLASS : I M.COM**

UNIT I

SL. No.	Lecture Duration(Hr)	Topics to be Covered	Support Materials
1	1	Income Tax Act 1961 ,History of IT act, Tax, types of tax, Definitions – Agricultural Income, Assessee, Assessment , Previous year, Person, Income	T: 1/3 - 1/11
2	1	Computation of residential status of individuals	T: 1/37- 1/48
3	1	Computation of residential status of individual	T:1/70 – 1/68 T: 1/49-1/98
4	1	Residential status of others HUF, AOP, BOI, Company	T:2/1-2/142
5	1	Scope of income – sums	T: 2/19 – 2/28
6	1	Scope of income – sums	T: -2/29 – 2/48
7	1	Exempted Income u/s 10	T: 2/100- 2/142
8	1	Recapitulation and discussion of important questions	
Total no. Hours planned for Unit - I			**8**

UNIT II

SL. No.	Lecture Duration (Hr)	Topics to be Covered	Support Materials
1	1	Basis of charge , salary, employer – employee relationship	T:2/151-2/162
2	1	Allowances – fully taxable, partially taxable and fully exempted allowances.	T: 2/163- 165
3	1	Perquisites for furnished accommodation and unfurnished accommodation	T: 2/166-179
4	1	Profits in lieu of salary , deductions and exemptions	T: 2/179-2/195 T:2/200-2/207
5	1	Income from house property, Annual Rental Value , Different types	T:2/264-2/273
6	1	General format for computation of ARV	T:2/288-2/308
7	1	Let out and self occupied house , deductions	T:2/288-2/308
8	1	Treatment of unrealized rent, Joint Expenses	T:2/273-2/283
9	1	Recapitulation and discussion of important questions	
Total No. Hours planned for Unit - II			**12**

UNIT III

SL. No.	Lecture Duration (Hr)	Topics to be Covered	Support Materials
1	1	Business income , General format for computation of business income ,	T: 2/349 – 2/364
2	1	Expenses expressly allowed and disallowed Income Expressly allowed and disallowed	T: 2/372 – 2/373 T: 2/396- 2/397
3	1	Computation of business income – Sums	T: 2/398 – 2/402
4	1	Professional income of a doctor , Chartered accountant, – General format – Sums Computation of professional income - sums	T: 2/403-2/410
5	1	Capital gain , Scope of Charge, types of capital assets, Transfer, LTCG and STCG	T: 2/423-2/425
6	1	General format for computation of capital gain Indexing procedure and exempted capital gain	T: 2/430-2/450
7	1	Computation of capital gain – Sums	T: 2/451-2/462
8	1	Recapitulation and discussion of important questions	
Total no. Hours planned for Unit - III			**8**

UNIT IV

SL. No.	Lecture Duration (Hr)	Topics to be Covered	Support Materials
1	1	Taxation of dividend , provision relating to gift	T: 2/489-2/543
2	1	Income from other sources sums	T: 2/544-2/552
3	1	Computation of income from other sources – sums	T: 1/18-1/20
4	1	Set off and carry forward of losses – rules and sums	T: 1/18-1/20
5	1	Rebate and relief : Income not included in total income	T: 2/352 – 2/354
6	1	Exemptions / Deductions and clubbing of income	T: 2/352-2/354
7	1	Recapitulation and discussion of important questions	
Total No. Hours planned for Unit - IV			**12**

UNIT V

SL. No.	Lecture Duration (Hr)	Topics to be Covered	Support Materials
1	1	TDS, E- TDS Software	R3:960-965
2	1	Self assessment tax (SAT)	R3: 960-965
3	1	E- filing procedure and e- filing of income tax returns income tax collection	R3: 967-969
4	1	Tax planning and tax management	Rs: 967-969
5	1	International taxation overviews DTAA residency issues	W1
6	1	Controlled foreign corporation	R3:971-974
7	1	Recapitulation and discussion of important questions	R3:971-974
	1	Total hours planned for unit V	W3
8	1	Discussion of Previous year ESE Questions	R3: 971-974
9	1	Discussion of Previous year ESE Questions	9
10	1	Discussion of Previous year ESE Questions	1
Total No. Hours Planned for Unit - V and Discussion of Previous year ESE Qs			**10**

TEXT BOOK

T: Gaur V P , D.B.Narang, Puja Gaur, Rajeev Puri,(2019) . Income Tax Law and Practice , Kalyani Publishers , Ludhiana, 47th Revised Edition

REFERENCES

R1: Bhagawathi Prasad,(2017), Income Tax Law and Practice , Wiswaprakasam Publishers , New Delhi.
R2: Dinker Pagare, Law and Practice of Income Tax , Sultan Chand & Sons , New Delhi
R3: Reddy and V Hari Prasad Reddy (2017), Income Tax Theory Law and Practice, Margham Publications , Chennai, 16th revised edition.
R4: Jayaprakash Reddy, (2017), Law and Practice of Income Tax, APH Publishing House , Delhi.

WEBSITES

http : \\incometaxindia .org
http: \\www. Du.ac.in
http://www.hire.icsi-org-\material\capitalgains
http://www.incometaxindia.gov in
http://www.di.ac.in\fileadmin\du\academics\coursematerials

UNIT 1

SYLLABUS

Accounting for Share Capital and Debentures: Issue, Forfeiture and Reissue of Forfeited Shares - Concept & Process of Book Building - Issue of Rights and Bonus Shares- Buyback of Shares - Redemption of Preference Shares Issue and Redemption of Debentures.

ACCOUNTING FOR SHARE CAPITAL AND DEBENTURES

Two major limitations of sole-proprietorship concerns and partnership firms are : (i) inadequacy of funds, and (ii) unlimited liability. To overcome these limitations, one of the most convenient forms of organization that grew with expansion of business requiring huge funds is the joint stock company form of organization. In India, joint stock companies are governed by the provisions of the Companies Act, 1956.

Meaning of the Company

A joint stock company is a voluntary association of persons formed for the purpose of some business for profit with common capital, divisible into transferable shares and possessing a corporate legal entity and a common seal. It is created by a process of law and can be put to an end only by a process of law. It is a legal person and is something different from its members. It is, therefore, capable of acting in its own name. But as it has no physical existence, it must act through its agents and all the contracts entered into by its agents must be under the seal of the company. The members as such do not carry on the business of the company. A group of persons who individually called the directors and collectively form the Board of Directors are appointed. The company acts through the Board of Directors or subordinates appointed by the Board for the purpose.

Share capital of a company is divided into parts and each part is called a share. Every person who takes up a share or shares of a company becomes its member and continues to be a member so long as he holds even a single share. He is called a shareholder and is a part-owner of the company. But a person can be both a shareholder and the creditor of the same company and at the same time.

KINDS OF COMPANIES

From the point of view of *formation*, the companies are of three kinds:

(i) Chartered Companies: Those companies which are incorporated under a special charter by the king or sovereign such as East India Company. Such companies are rarely formed now-a-days as trading companies.

(ii) Statutory Companies: These companies are formed by a special Act of the Legislatures or Parliament, e.g., the Reserve Bank of India, Damodar Valley Corporation, etc.

(iii) Registered Companies: Such companies which are incorporated under the Companies Act, 1956 or were registered under the previous Companies Act.

From the point of view of *liability* there are three kinds of companies:

(I)Limited Companies: In case of such companies, the liability of each member is limited to the extent of a face value of shares held by him. Suppose Vishal takes a share of Rs. 100, he remains liable to the extent of that amount. As soon as that amount is paid, he is no more liable.

(ii) Guarantee Companies: The liability of the member of such a company is limited to the amount he has undertaken to contribute to the assets of the company in the event of its wound up. This guaranteed amount is limited by fixed sum which is specified in the memorandum. Chambers of commerce, trade associations and sports clubs is usually guarantee concerns. The object of such companies is not to make profit and distribute dividend.

(iii) Unlimited Companies: They are nothing but large partnerships registered under the Companies Act and the members just like partners have unlimited liability and both their share of contribution as well as their private property are at stake when the company is to be wound up. Such companies are rare these days.

From the point of view of *public investment* company may be of two kinds:

(I)Private Companies: A private company means a company which by its articles (a) restrict the right to transfer its shares, if any (b) Limits the number of members to fifty, excluding past or present employees of the company who are the members of the company and (c) Prohibits any invitation to the public to subscribe for any shares in or debentures of the company

(ii) Public Companies: Public companies are those companies which are not private companies. All the three restrictions are not imposed on such companies.

Books of Accounts: Section 209 of the companies Act, 1956 requires that every company is required to keep at its registered office books of account. These books are to be maintained in such a way so as to disclose (i) the sums of money received and expended by the company and the matter in respect of which the receipt and expenditure has taken place. (ii) All sales and purchases of goods of the company. (iii) All assets and liabilities of the company. In case a company is engaged in production, processing, manufacturing or mining activities, it has also to maintain cost accounting records relating to utilization of material or labor or other items of cost as may be required by the Central Government.

Statutory Books: Statutory books are those which a limited company is under statutory obligation to maintain at its registered office for maintaining a record of its activities in order to safeguard the interest of the shareholders and creditors. The following is the list of such books:

(i) Register of investments not held in company's name.

(ii) Register of fixed deposits.

(iii) Register of mortgage charges.

(iv) Register of members.

(v) Index of members where the number is more than 50 unless the register of member itself affords an index.

(vi) Register of debenture holders.

(vii) Index of debenture holders where their number is more than 50 unless the register of debenture holders itself affords an index.

(vii) Foreign register of member's and debenture holders and their duplicates.

(viii) Minutes books containing minutes of proceeding of general meeting and Board Meetings.

(ix) Register of contracts with companies and firms in whom directors are interested directly or indirectly.

(x) Register of directors, managing directors, manager and secretary.

(xi) Register of directors' shareholdings.

(xii) Register of loans, guarantees etc. to or investments in shares and debentures of the companies in the same group under the same management.

(xiii) Register of renewed and duplicate certificates.

(xiv) Copy of every instrument creating any charge requiring registration.

SHARES

The total capital of the company can be divided into units of small denomination .One of the units into which the capital of the company is divided is called shares. Holders of these shares are called shareholders or members of the company.

There are two types of shares which a company may issue, i.e.,

(1) Preference Shares and

(2) Equity Shares.

1. **Preference Shares:** Shares which enjoy the preferential right as to dividend and repayment of capital in the event of winding up of the company over the equity shares are called preference shares. These shares will get fixed rate of dividend. Preference shares may be:

(a) Cumulative Preference Shares

(b) Non-cumulative Preference Shares

(c) Redeemable Preference Shares

(d) Irredeemable Preference Shares

(e) Convertible Preference Shares

(f) Non-convertible Preference Shares

(g) Participating Preference Shares

(h) Non-participating Preference Shares

2. **Equity Shares:** Equity shares will get dividend and repayment of capital after meeting the claims of preference shareholders. There will be no fixed rate of dividend to be paid to the equity shareholders and this rate may vary from year to year. This rate of dividend is determined by directors and in case of large profits, it may even be more than the rate attached to preference shares. Such shareholders may go without any dividend if no profit is made.

Share capital is shown in the balance sheet under the following categories

Authorized capital:

This is the maximum capital that the company is authorized to raise and this amount is stated in the memorandum of Association. This is also described as 'Registered capital or Nominal capital.

Issued capital:

This represents the capital which is offered to public for subscription .The difference between authorized capital and issued capital represents the unissued capital .

Subscribed capital:

Subscribed capital refers to that part of the issued capital which has been subscribed by the public and also allotted to the directors of the company.

Called up capital:

It refers to that part of the subscribed capital which has been called up by the company for the payment. For example , if 100000 shares of Rs100 each have been subscribed by the public of which Rs50 per share has been called up, .

Paid-up capital:

It refers to that part of the called up capital which has been actually paid up by the shareholders. Some of the shareholders might have defaulted in paying the allotment or call money. Such amount defaulted is known as calls in arrears.

Forfeited shares:

When shares are forfeited for non-payment of calls, the amount already paid is credited to forfeited shares account. The amount standing to the credit of this account is to be added to paid-up capital in the balance sheet.

TERMS OF ISSUE

The terms on which shares are to be issued by the company are given in the prospectus. Shares can be issued either at par or at a premium or at a discount.

- **Shares are said to be issued at par**

When a shareholder is required to pay the face value of the shares to the company. For example, when shares of Rs. 10 are issued at Rs. 10, these are said to be issued at face value.

- **Shares are said to be issued at premium**

when a shareholder is required to pay more than the face value to the company. For example, is shares of Rs. 10 are issued at Rs. 12, then shares are said to be issued at a premium.

- **Shares are said to be issued at discount**

when the shareholder is required to pay less amount than the face value of the share to the company. When the shares of Rs. 10 are issued at Rs. 8, the shares are said to be issued at a discount.

The issue price of shares can be received in

- Issue of shares for immediate , full consideration or one installment
- It can be spread over different installments.

Issue of shares for immediate, full consideration or one installment(cash consideration)

Journals

At par **Dr.** **Cr.**

1.	**When issue at par** Bank Account Dr. To Share capital Account (Being issue of shares on cash @ Rs. ......per share)		Rs. xxx	Rs. xxx

Journals **Dr.** **Cr.**

At premium

1.	**When issue is at premium:** Bank Account Dr. To Share capital Account To share premium Account		Rs. Xxx	Rs. Xxx xxx

	(Being issue of shares at premium)			

Journals **Dr.** **Cr.**

At discount

1.	**When issue is at discount:** Bank Account Dr. Discount on issue of shares Account To Share capital Account (Being the application money on ...shares @ Rs. ......per share)		Rs. Xxx	Rs. xxx

The amount when received in different installments may be paid

On Application:

A Prospectus is issued by the company inviting the public to subscribe for its shares. Advertisements are given in leading newspapers and magazines with extracts from the prospectus. Application forms are made available freely. Member of the public have to fill the application forms and submit them to the company along with the specified application money. Application form for shares contains the name of bankers for the issue. **The amount** which is received on **application** is called the **application money**

On Allotment :

On the expiry of the last date for receiving application, a detailed list of the applicants is prepared showing the number of applicants in different categories, based on number of shares applied by them.

- The directors can proceed with the allotment , if the following are fulfilled;
- The minimum subscription as stated in the prospectus is received.
- The prospectus or a statement in lieu of the prospectus is filed with the registrar of companies in due time.
- Application money of at least 5% of the nominal value of the shares is received (25% for the public issue) Allotment letters are dispatched to those to whom shares are allotted . The allot tees become the shareholders of the company.

- **The amount** which becomes **due on allotment** is called **allotment money.**

Under subscription ands over subscription:
Under subscription:

If total number of shares for which application are received is less than the number of shares issued, it is a situation of under subscription. If the actual application received are more than the minimum subscription, allotment can be made for all the applicants. entries for application allotment and calls can be made for those allot tees only.

Over subscription:

When a company receives application for a larger number of shares than those offered to the public, it is a situation of over subscription .the following are the usual ways of dealing with a situation of over subscription.

Full allotment:

The board of directors may make full allotment to the required number of applicants and reject the other application. The criteria for allotment and rejection may be evolved in consultation with stock exchange where the shares are to be listed.

Selective partial allotment:

Shares may be partially allotted to different categories of application in different ratios. For example , those who have applied for 200 shares or less may get 50% of the shares they applied for and those who have applied for more than 200 shares may get 25% of the shares they applied for.

Pro-rata allotment:

Shares may be allotted proportionate to the application received to all the applicants. It may be possible to reject some application on the basis of some criterion and for the balance applications , proportionate allotment may be made. For example , if 50,000 shares are offered to the public, for which 2,00,000 applications are received ,one share for every four shares applied for may be allotted to all the application , alternatively , application . pro-rata allotment may be made, in the ratio of one share for every two share applied.

In different calls:

Rest of **the amount** may be called in **different calls** according to the requirements and needs of the company. **If it is called in more than one installment**, The **first installment** is called as **first call,**

The **second installment** as the **second call** and

The last installment as the **final call.**

Journal Entries for Issue of Shares:

	Journals		Dr.	Cr.
1.	**On receipt of application money:** Bank Account Dr. To Share Application Account (Being the application money on ...shares @ Rs. ......per share)		Rs. Xxx	Rs. xxx
2.	**On allotment of Shares:** (a)Application money on allotted shares is transferred to share capital account: Share Application Account Dr. To Share Capital Account (Being the application money transferred to Share Capital Account)		xxx	xxx
	(b) Those applicants who could not be allotted any share, their money will be returned: Share Application Account Dr. To Bank Account (Being the application money of shares returned)		xxx	xxx
3.	On the allotment of shares, all allotment money becomes due to the company: Share Allotment Account Dr. To Share Capital Account (Being the share allotment money on .... shares @ Rs. ...... per share as per resolution dated ....)		Xxx	xxx
4.	**On receipt of allotment money:** Bank Account Dr. To Share Allotment Account (Being the receipt of share allotment money)		xxx	xxx
5.	**On making the first call due from the shareholders:**		xxx	

	Share first Call Account Dr. To Share Capital Account (Being the first call money due on ... shares @ Rs. ....per share as per resolution of the directors dated....)			xxx
6.	**On receipt of the first call money:** Bank Account Dr. To Share First Call Account (Being the receipt of share first call money)		xxx	xxx

Note: Similar entries will be passed for second call, third and final call, if any.

Illustration:1

If a company issued 1, 50,000 equity shares of Rs. 10 each in January, Rs. 10 may be called as under:

Jan. 5 Rs.2 with application known as application money.

Feb. 9 Rs.3 on allotting the shares known as allotment money.

May 16 Rs. 1.50 in the first installment had known as first call.

July. 27 Rs. 1.50 in second installment known as second call.

Sept. 11 Rs. 2.00 in last installment has known as final call.

Journal Entries for Issue of Shares:

	Journals		**Dr.**	**Cr.**
Date Jan 5.	On receipt of application money: Bank Account Dr. To Share Application Account (Being the application money on ...shares @ Rs. ......per share)		Rs. 3,00,000	Rs. 3,00,000
Jan 5.	On allotment of Shares: (a)Application money on allotted shares is transferred to share capital account: Share Application Account Dr. To Share Capital Account (Being the application money transferred to		3,00,000	3,00,000

	Share Capital Account)			
Feb 9.	On the allotment of shares, all allotment money becomes due to the company: Share Allotment Account Dr. To Share Capital Account (Being the share allotment money on .... shares @ Rs. ...... per share as per resolution dated ....)		4,50,000	4,50,000
Feb 9	On receipt of allotment money: Bank Account Dr. To Share Allotment Account (Being the receipt of share allotment money)		4,50,000	4,50,000
May16.	On making the first call due from the shareholders: Share first Call Account Dr. To Share Capital Account (Being the first call money due on ... shares @ Rs. ....per share as per resolution of the directors dated....)		2,25,000	2,25,000
May 16.	On receipt of the first call money: Bank Account Dr. To Share First Call Account (Being the receipt of share first call money)		2,25,000	2,25,000
July.27	On making the second call due from the shareholders: Share second Call Account Dr. To Share Capital Account (Being the second call money due on ... shares @ Rs. ....per share as per resolution of the directors dated....)		2,25,000	2,25,000
July.27	On receipt of the second call money: Bank Account Dr. To Share second Call Account (Being the receipt of share second call money)		2,25,000	2,25,000
Sept.11	On making the final call due from the shareholders: Share final Call Account Dr.		3,00,000	

	To Share Capital Account (Being the final call money due on ... shares @ Rs. ....per share as per resolution of the directors dated....)			3,00,000
Sept.11	On receipt of the final call money: Bank Account Dr. To Share final Call Account (Being the receipt of share final call money)		3,00,000	3,00,000

Illustration 2. Vishal Ltd., issued a prospectus inviting applications for 1,00,000 Equity Shares of Rs. 10 each, payable as to Rs. 2 with application, Rs. 3 on allotment and the balance on first and final call. Applications were received for 80,000 shares only. All the applications were accepted in full. The call was also made in the due course of time. All moneys were duly received. Journalize all the above mentioned transactions including cash transactions.

Solution: **Journal** Dr. Cr.

1.	Bank Account Dr. To Equity Share Application A/C (Being the receipt of application money on 80,000 equity shares @ Rs. 2 per share)		Rs. 1,60,000	Rs. 1,60,000
2.	Equity Share Application Account Dr. Equity Share Allotment Account Dr. To Equity Share Capital Account (Being capitalization of application money @ Rs. 2 per share and allotment money due @ Rs. 3 per share on 80,000 equity shares allotted)		1,60,000 2,40,000	4,00,000
3.	Bank Account Dr. To Equity Share Allotment Account (Being the receipt of allotment money on 80,000 equity shares @ Rs. 3 per share)		2,40,000	2,40,000
4.	Equity Share First and Final Call Account Dr. To Equity Share Capital Account (Being the first and final call due on 80,000 equity shares @ Rs. 5 per share)		4,00,000	4,00,000
5.	Bank Account Dr. To Equity Share First and final Call Account		4,00,000	4,00,000

	(Being the receipt of first and final call on 80,000 equity shares @ Rs. 5 per share)			

Issue of Shares for Purchase of Assets:

If the shares have been allotted to any person or firm from whom the company has purchased any assets, the following entry will be passed:

Asset Account	Dr.	xxx	
To Share Capital Account			xxx

(Being ..... shares allotted ..... in consideration of purchase of assets for the company)

Issue of Shares at a Premium:

A company may issue shares at a premium, i.e., at a value greater than its face value. The power to issue shares at a premium need not be given in the Articles of Association. Premium so received shall be credited to a separate account called Securities Premium Account. However, according to guidelines issued by the SEBI, a new company set up the entrepreneurs without a track record can issue capital to public only at par. A new company has been defined by SEBI as one which has completed 12 months of commercial operations and its audited operative results are not available. But where a new company is being set up by the existing companies with a five year track record of consistent profitability, it will be free to price its issue provided:

(i) The participation of the promoting companies is not less than 50% of the equity of the new company.

(ii) The issue price is made applicable to all new investors uniformly; and

(iii) The prospectus or offer document contains justification for issue price.

Section 78 of the Companies Act, 1956 gives the purpose for which securities premium account may be applied by the company. These are:

(i) For the issue of fully paid bonus shares to the members of the company;

(ii) for writing off preliminary expenses of the company;

(iii) For writing off the expenses of the commission paid or discount allowed on any issue of shares or debentures of the company; and

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

Journal Entries:

	Journal		Dr.	Cr.
(a)	If the premium is paid with application money: (i)Bank Account Dr. To Share Application Account (Being share application money along with premium received)		Rs. xxx	Rs. xxx
	(ii) Share Application Account Dr. To Share Capital Account To Securities Premium Account (Being share application transferred to share capital and securities premium account)		xxx	 xxx xxx
(b)	If the securities premium is received along with the allotment: (i)Share Allotment Account Dr. To Share Capital Account To Securities Premium Account (Being the allotment money and securities premium money due on .... shares)		 xxx	 xxx xxx
	(ii) Bank Account Dr. To Share Allotment Account (Being the receipt of allotment money along with securities premium account)		xxx	 xxx

Issue of Shares at a Discount:

A company can issue shares at a discount, i.e., value less than the face value subject to the following conditions:

(i) The issue of shares at a discount is authorized by a resolution by the company in the general meeting and sanctioned by the Central Government.

(ii) The resolution must specify the maximum rate of discount which should not exceed10% of the nominal value of shares or such higher percentage as the Central Government may permit.

(iii) One year must have been elapsed since the date at which the company was allowed to commence business.

(iv) Issue must take place within two months after the date of the sanction by the court or within such extended time as the court may allow.

(v) Every prospectus relating to the issue of shares and every balance sheet after the issue of shares shall contain particulars of the discount allowed and so much of the discount as has not been written off.

Journal Entry: **Dr** **Cr**

1.	**The following journal entry is passed on the issue of the shares at a discount at the time of allotment:** Share Allotment Account Dr. Discount on the Issue of Shares Account Dr. To Share Capital Account		Rs. xxx xxx	Rs. xxx

Calls in Arrears and Calls in Advance:

If any amount has been called by the company either as allotment or call money and a shareholder has not paid that money, this is known as calls in arrears. On shares calls in arrears, if the company directors want and there is a provision in the Articles of Association, the company can charge interest @ 5% for the period for which such amount remained in arrear from the shareholder.

Similarly, if any calls has been made but while paying that call, some shareholders has paid the amount of the rest of calls also, then such amount will be called as calls in advance and will be credited to a separate account known as calls in advance account by passing the following entry.

1.	Bank Account Dr. To Calls in Advance Account		xxx	 xxx

Calls in Advance Account is shown on the liabilities side of the Balance Sheet separately from the paid up capital. Generally interest is paid on such calls according to the provisions of the Articles of Association but such rate should not exceed 6% per annum. Calls in advance are not entitled for any dividend declared by the company.

Illustration 3. On 1st March, 2008, ABC Ltd., makes an issue of 20,000 equity shares of Rs. 10 each payable as below: On application Rs. 2; On allotment Rs. 3 and the first and final call Rs. 6 (three months after allotment).

Applications were received for 26,000 shares and Directors made allotment in full to the applicants demanding ten or more shares and returned money to the applicants for 6,000 shares. One shareholder who was allotted 40 shares paid first and final call with allotment money and another shareholder who was allotted 60 shares did not pay allotment money on his shares, but which he paid with the first and final call. Directors have decided to charge and allow interest, as the case may be, on calls in arrears and calls in advance respectively according to the provisions of Table A. Give the necessary journal entries in the books of the company.

Solution

JOURNAL ENTRIES **Dr** **Cr**

2008 Mar. 1	Bank Account Dr. To Share Application Account (Being application money received on 26,000 shares @ Rs. 2 per share)		Rs. 52,000	Rs. 52,000
Mar. 1	Share Application Account Dr. To Share Capital Account To Bank Account Being application money of 20,000 shares transferred to share capital account and application money of 6,000 shares refunded)		52,000	 40,000 12,000
,,	Share Allotment Account Dr. To Share Capital Account To Securities Premium Account (Being allotment money and securities premium due on 20,000 shares @ Rs. 3 per share)		60,000	 40,000 20,000
,,	Bank Account Dr. To Share Allotment Account To Calls in Advance Account (Being the receipt of allotment money @ Rs 3 on 19,940 shares and advance call money on 40 shares @ Rs. 6 each)		60,060	 59,820 240
June. 1	Share First and Final Call Account Dr. To Share Capital Account (Being the amount due in respect of first and final call on 20,000 shares @ Rs. 6 per share)		1,20,000	 1,20,000
June. 1	Bank Account Dr. To Share First and Final Call Account To Share Allotment Account		1,19,940	 1,19,760 180

	(Being the amount received on account of first and final call on 19,960 shares @ Rs. 6 and calls in arrears on allotment)			
June. 1	Calls in Advance Account Dr. To share First & Final Call Account (Being adjustment of calls in advance against the first and final call)		240	240
June. 1	Interest on Calls in Advance Account Dr. To Bank Account (Being interest paid on calls in advance i.e., on Rs. 240 for 3 months @ 6% p.a)		3.60	3.60
June. 1	Bank Account Dr. To Interest on Calls in Arrears Account (Being receipt of interest on calls in arrears, i.e., Rs. 180 for 3 months @ 5% p.a)		2.25	2.25

Forfeiture of Shares:

When a shareholder fails to pay calls, the company, if empowered by its articles, may forfeit the shares. If a shareholder has not paid any call on the day fixed for payment thereof and fails to pay it even after his allotment is drawn to it by the secretary by registered notice, the Board of Directors pass a resolution to the effect that such shares be forfeited. Shares once forfeited becomes the property of the company and may be sold on such terms as directors think fit. Upon forfeiture, the original shareholder ceases to be a member and his name must be removed from the register of members.

Journal Entries

The following entry is passed at the time of forfeiture of shares.

Share Capital Account Dr. Securities Premium Account Dr. To Share Capital Account To Discount on Issue of Shares Account To Shares Forfeited Account	(with the called amount on such shares as capital) (if not received) (with amount which becomes due but not paid) (if shares are issued at discount) (with the amount already received on such shares)

Surrender of Shares: After the allotment of shares, sometimes a shareholder is not able to pay the further calls and returns his shares to the company for cancellation. Such voluntary return of shares to the company by the shareholder himself is called surrender of shares. Surrender of shares has no separate accounting treatment but it will be like that of forfeiture of shares. The same entries (as are passed in case of forfeiture of shares) will be passed in case of surrender of shares.

Reissue of Forfeited Shares:

Forfeited shares may be reissued by the company directors for any amount but if such shares are issued at a discount then the amount of discount should not exceed the actual amount received on forfeited shares plus original discount on reissued shares, if any. The purchaser of forfeited reissued shares is liable for payment of all future calls duly made by the company.

The following journal entry on such reissue is passed:

Bank Account Dr. Discount on Issue of Shares Account Dr. Shares Forfeited Account Dr. To Share Capital Account To Securities Premium Account	(amount received on such reissue) (with original rate of discount if the shares originally were issued at discount) (loss on reissue of shares) (with face value of shares) (if shares are reissued at premium)

After reissue of all forfeited shares if there is no balance in shares forfeited account, then there will be no capital profit. But where there is profit on the reissue of forfeited shares (i.e., shares forfeited account is showing credit balance after reissue of all forfeited shares) then such profit should be treated as capital profit and will be transferred to capital reserve by passing the following entry:

1.	Shares Forfeited Account Dr. To Capital Reserve Account		xxx	 xxx

Illustration 4: A shareholder was holding 500 equity shares of Rs. 10 each of a company issued at 10% discount. He paid Rs. 2 on application, Rs. 3 on allotment but could not pay the first call of Rs. 3 per share and his shares were forfeited by the directors. The shares were reissued subsequently at a price of Rs. 7 per share. Give the necessary journal entries.

Solution

JOURNAL ENTRIES **Dr** **Cr**

1.	Equity Share Capital Account Dr. To Equity Share First Call Account To Discount on Issue of Shares Account To Shares Forfeited Account (Being forfeiture of 500 equity shares of Rs. 10 each Rs. 9 per share called issued at a discount of 10% for non-payment of first call of Rs. 3 per share; Rs. 5 per share paid forfeited)		Rs. 4,500	Rs. 1,500 500 2,500
2.	Bank Account Dr. Discount on Issue of Shares Account Dr. Shares Forfeited Dr. To Equity Share Capital Account (Being reissue of 500 forfeited shares @ Rs. 7 per share credited as Rs. 9 per share paid-up)		3,500 500 500	 4,500
3.	Shares Forfeited Account Dr. To Capital Reserve (Being profit on reissue of forfeited shares transferred to capital reserve account)		2,000	 2,000

Illustration 5: A holds 200 equity shares of Rs. 10 each on which he paid Re. 1 per share as application money. B holds 300 equity shares of Rs. 10 each on which he has paid Re. 1 and Rs. 3 per share as application and allotment money respectively.

C holds 500 equity shares of Rs. 10 each on which he has paid Re. 1 on application, Rs. 3 on allotment and Rs. 2 on first call. They all fail to pay their arrears and the second call of Rs. 2 per share and the directors, thereafter , forfeited the shares. All these shares were reissued subsequently @ Rs. 11 per share as fully paid. Give the necessary journal entries.

Solution

JOURNAL ENTRIES

1.	Equity Share Capital Account Dr. To Equity Share Allotment Account To Equity Share First Call Account To Equity Share Second Call Account		Rs. 8,000	Rs. 600 1,000 2,000 4,400

	To Shares Forfeited Account (Being forfeiture of shares of A,B & C)			
2.	Bank Account Dr. To Equity Share Capital Account To Securities Premium Account (Being reissue of 1,000 forfeited shares of Rs. 10 each at Rs. 11 per share credited as fully paid-up)		11,000	10.000 1,000
3.	Shares Forfeited Account Dr. To Capital Reserve Account (Being balance of shares forfeited account taking as capital profit transferred to Capital Reserve Account)		4,400	4,400

Forfeiture of Shares when there is Over-subscription and Pro-rata Allotment

It has already been stated that in case of companies of repute, there is possibility of over-subscription. Some applications are rejected altogether and others are allotted on pro-rata basis. When allotted shares on pro-rata basis are forfeited, the problem arises about the amount to be forfeited. In such cases, the following procedure may be adopted:

(a) Calculate the total number of shares applied for on the basis of allotted shares.

(b) Calculate the total amount received on application by multiplying the number of shares with application money. This is the amount which is to be forfeited on default.

(c) Deduct the amount due on application on allotted shares and calculate balance, i.e., money received in advance and to be adjusted on allotment.

(d) Calculate the amount due on allotment on such shares and deduct the amount already received as advance on application. This gives the amount in arrears on allotment and is credited to Share Allotment Account at the time of forfeiture of shares.

Illustration 6: X Ltd., issued for public subscription 20,000 equity shares of Rs. 10 each at a premium of Rs. 2 per share payable as under:

Rs. 2 per share on application; Rs. 5 per share (including premium) on allotment; Rs. 2 per share on first call; Rs. 3 per share on final call. Applications for 30,000 shares were received. Allotment was made pro-rata to the applicants for 24,000 shares, the remaining applications being rejected. Money overpaid on application was utilized towards sums due on allotment. Shri Balaji to whom 800 shares were allotted failed to pay the allotment money, first and second call money abs Shri Murugan of whom 1,000 shares were allotted failed to pay the last two calls. All these forfeited shares were reissued to Shri Vinod as fully paid-up at Rs. 8 per share. Give the necessary journal entries to record the above transactions.

Solution **In the books of X Limited**

JOURNALS

			Rs.	Rs.
1.	Bank Account Dr. To Equity Share Application Account (Being the application money received on 30,000 equity shares @ Rs. 2 per share)		60,000	 60,000
2.	Equity Share Application Account Dr. To Share Capital Account To Equity Share Allotment Account To Bank Account (Being application money transferred to share capital account, share allotment account and the balance refunded to the applicants)		60,000	 40,000 8,000 12,000
3.	Equity Share Allotment Account Dr. To Share Capital Account To Securities Premium Account (Being the allotment money due on 20,000 equity shares @ Rs. 5 per share including premium)		1,00,000	 60,000 40,000
4.	Bank Account (1) Dr. To Equity Share Allotment account (Being the share allotment money received)		88,320	 88,320
5.	Equity Share First Call Account Dr. To Share Capital Account (Being the share first call money due on 20,000 equity shares @ Rs. 2 per share)		40,000	 40,000
6.	Bank Account Dr. To Equity Share First Call Account (Being the receipt of share first call money)		36,400	 36,400
7.	Equity Share Final Call Account Dr. To Share Capital Account (Being the share final call money due on 20,000 equity shares @ Rs. 3 per share)		60,000	 60,000

8.	Bank Account Dr. To Equity Share Final Call Account (Being the receipt of share final call money)		54,600	 54,600
9.	Equity Share Capital Account Dr. Share Premium Account Dr. To Equity Share Allotment Account To Equity Share First Call Account To Equity Share Final Call Account To Share Forfeited Account (Being the forfeiture of 1,800 shares for the non-payment of allotment on 800 shares and first and final call money on 1,800 equity shares)		18,000 1,600	 3,680 3,600 5,400 6,920
10.	Bank Account Dr. Share Forfeited Account Dr. To Equity Share Capital Account (Being the reissue of the forfeited shares as fully paid up @ Rs. 8 per share)		14,400 3,600	 18,000
11.	Share Forfeited Account Dr. To Capital Reserve Account (Being the profit on reissue of forfeited shares transferred to Capital Reserve Account)		3,320	 3,320

Working Note: **Rs.**

(1) Calculation of amount received on allotment

Amount due on allotment		1,00,000
Less: Already received		8,000

		92,000
Less: Amount not received on 800 shares		
Shares Allotted to Shri Balaji 800		
If allotted 5shares applied 6		
If allotted 800 shares applied 960		
Surplus money on application (160 X 2) =	320	
Amount of allotment due = 800 X 5 =	4,000	
Less: Already received	320	
	----------	3,680

		88,320

Illustration 7: On 1st March, 2009 Bama Co Ltd., issued 25,000 10% preference shares of Rs. 25 each payable as to Rs. 4 with application, Rs. 6 on allotment and the balance in two equal calls of Rs. 7.50 per share. Subscription list (which was opened on 6th March, 2009) totaled 51,0000 shares. The Board of Directors rejected one application for 1,000 shares and allotted shares on the remaining applications on pro-rata basis on 1st April, 2009.First calls was made three after allotment where as the second call was made four months after the first call. All moneys were duly received. In each case, a 14 days' notice was served.

Pass journal entries, prepare Cash Book and show Ledger accounts.

Solution:

Dr. Cash Book (Bank Columns only) Cr.

2009		Rs.	2009		Rs.
Mar.6	To 10% Preference Shares Applications & Allotment Account (application money on 51,000 10% preference shares @ RS. 4 per share)	2,04,000		By 10% Preference Share Application Account (refund of application money on 1,000 preference shares @ Rs. 4 per share)	4,000
April 1-14	To 10% Preference Shares allotment Account	50,000		By Balance c/d	6,25,000
July 1-14	To 10% Preference Shares First call account	1,87,500			
Nov 1-14	To 10% Preference Shares Second and Final call	1,87,500			
		6,29,000			6,29.000

Journal **Dr.** **Cr.**

2009			Rs.	Rs.
Apr. 1	10% Preference Share Application & Allotment A/c Dr. To 10% Preference Capital Account (Being application money @ Rs. 4 per share and allotment money @ Rs. 6 per share credited to 10% Preference Capital Account On allotment of 25,000 shares as per Directors resolution)		2,50,000	2,50,000
July.1	10% Preference Shares First Call Account Dr. To 10% Preference Share Capital Account		1,87,500	1.87,500

	(Being first call money due on 25,000 10% preference shares @ Rs. 7.50 per share, as per Directors resolution)			
Nov. 1	10% Preference Share Second and Final Call A/c Dr. To 10% Preference share Capital Account (Being second and final call money due on 25,000 10% preference shares @ Rs. 7.50 per share as per Board of Directors resolution)		1,87,500	 1,87,500

Working Notes:

Share Applied for	Shares Allotted	Application money received	Application money	Appropriation towards Allotment money	Refund
1,000 50,000	-- 25,000	Rs. 4,000 2,00,000	Rs. -- 1,00,000	Rs. -- 1,00,000	Rs. 4,000 --
51,000	25,000	2,04,000	1,00,000	1,00,000	4,000

Rs.

Total allotment money on 25,000 10% Preference shares @ Rs. 6 per share 1,50,000

Less: Amount of application money appropriate towards allotment money 1,00,000

Balance received after allotment 50,000

Ledger Accounts

Dr. 10% Preference Share Application & Allotment Account Cr.

2009 Apr. 1	 To 10% Preference Share Capital account To Bank Account	Rs. 2,50,000 4,000	2009 Mar.6 April 1-14	 By Bank Account By Bank Account	Rs. 2,04,000 50,000

		2,54,000			2,54,000

10% Preference Share first Call Account

2009 July 1	To 10% Preference Share capital Account	Rs. 1,87,500	2009 July 1-14	By Bank Account	Rs. 1,87,500

10% Preference Share Second and Final Call Account

2009 Nov.1	To 10% Preference Share Capital Account	Rs. 1,87,500	2009 Nov. 1-14	By Bank Account	Rs. 1,87,500

10% Preference Share Capital Account

		Rs.	2009		Rs.
	To Balance c/d	6,25,000	Apr.1	By 10% Preference Share Application & Allotment Account	2,50,000
			July 1	By 10% Preference Share First Call Account	1,87,500
			Nov. 1	By 10% Preference Share Second & Final Call Account	1,87,500
		6,25,000			6,25,000
				By Balance b/d	6,25,000

BOOK BUILDING PROCESS

Concept:

Book Building is basically a capital issuance process used in Initial Public Offer (IPO) which aids price and demand discovery. It is a process used for marketing a public offer of equity shares of a company. It is a mechanism where, during the period for which the book for the IPO is open, bids are collected from investors at various prices, which are above or equal to the floor price. The process aims at tapping both wholesale and retail investors. The offer/issue price is then determined after the bid closing date based on certain evaluation criteria.

The Process:

- The Issuer who is planning an IPO nominates a lead merchant banker as a 'book runner'.
- The Issuer specifies the number of securities to be issued and the price band for orders.
- The Issuer also appoints syndicate members with whom orders can be placed by the investors.
- Investors place their order with a syndicate member who inputs the orders into the 'electronic book'. This process is called 'bidding' and is similar to open auction.
- A Book should remain open for a minimum of 5 days.
- Bids cannot be entered less than the floor price.
- Bids can be revised by the bidder before the issue closes.
- On the close of the book building period the 'book runner evaluates the bids on the basis of the evaluation criteria which may include -
    - ✓ Price Aggression
    - ✓ Investor quality
    - ✓ Earliness of bids, etc.
- The book runner the company concludes the final price at which it is willing to issue the stock and allocation of securities.

- Generally, the numbers of shares are fixed; the issue size gets frozen based on the price per share discovered through the book building process.
- Allocation of securities is made to the successful bidders.
- Book Building is a good concept and represents a capital market which is in the process of maturing.
- Book-building is all about letting the company know the price at which you are willing to buy the stock and getting an allotment at a price that a majority of the investors are willing to pay. The price discovery is made depending on the demand for the stock.

Issue of rights:

Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:-

- the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;
- unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;
- After the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the

shares offered, the Board of Directors may dispose of them in such manner which is not dis-advantageous to the shareholders and the company.

Valuation of Rights:

Usually a company offers rights issue at a price which is lower than the market price of the shares so that existing (i.e., old) shareholders may get the monetary benefit of being associated with the company for a long time. Existing shareholders who have been offered right shares and do not want to purchase these offered shares may renounce their right shares in favour of some other persons within the specified period as mentioned earlier. In such a case, the existing shareholders can make a profit by selling his right to such other person. This right can be valued in terms of money as below:

(a) Calculate the market value of shares which an existing shareholder is required to have in order to get fresh shares.

(b) Add to the above price paid for the fresh shares.

(c) Find out the average price of existing shares and fresh shares.

(d) The average price of the share should be deducted from the market price and the difference thus ascertained is value of right.

Illustration 8: A Company is planning to raise funds by making rights issue of equity shares to finance its expansion. The existing equity share capital of the company is ` 50,00,000. The market value of its share is ` 42. The company offers to its shareholders the right to buy 2 shares at ` 11 each for every 5 shares held. You are required to calculate: (i) Theoretical market price after rights issue; (ii) The value of rights; and (iii) Percentage increase in share capital. 2

Solution:

	`
Market value of 5 shares already held by a shareholder @ ` 42	210

Add: Price to be paid by him for acquiring 2 more shares @ ` 11 per share	22
Total price of 7 shares after rights issue	232

(j) Therefore, theoretical market price of one share, (i.e., 232/7) = 33.14

(ii) Value of Rights = Market Price - Theoretical Market Price= ` 42 - ` 33.14. = ` 8.86

(iii) Percentage Increase in Share Capital

Present Capital	50,00,000
Rights Issue ` 50,00,000 × 2/5	20,00,000
% Increase In Share Capital (20,00,000/50,00,000) × 100	40%

Capitalisation:

Capitalisation of profits is the process of converting profits or reserves into paid up capital.

Bonus Shares: A bonus share is a free share issued without any consideration to an existing shareholder in the ratio of number of shares held by that shareholder. Issue of Bonus share — decreases the Reserve & Surplus; Increases the issued capital but does not bring any change in cash flow and net worth.

Way to capitalize profits or reserves:

(a) by paying up amounts unpaid on existing partly paid shares so as to make them fully paid up shares, or (b) by issuing fully paid bonus shares to the existing members.

Sources for fully paid-up bonus shares [Sec 63] As per Sec 63(1), a company may issue fully paid-up bonus shares to its members out of-

- Its Free Reserves
- Its Secutiries Premium Account; or

- Its Capital Redemption Reserve Account Restrictions

- No issue of bonus shares shall be made by capitalizing reserves created by the Revaluation of Assets i.e. Revaluation Reserves. Meaning of Free Reserves: As per Sec 2(43) of the Companies Act, 2013, "Free Reserves" mean such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend.

Exclusions from Free Reserves:

- Any amount representing unrealised gains, notional gains or revaluation of assets, where shown as a reserve or otherwise, or

BONUS ISSUE

Capitalisation:

Capitalisation of profits is the process of converting profits or reserves into paid up capital.

Bonus Shares: A bonus share is a free share issued without any consideration to an existing shareholder in the ratio of number of shares held by that shareholder. Issue of Bonus share

- decreases the Reserve & Surplus;

- Increases the issued capital but does not bring any change in cash flow and net worth.

Way to capitalize profits or reserves:

(a) by paying up amounts unpaid on existing partly paid shares so as to make them fully paid up shares, or (b) by issuing fully paid bonus shares to the existing members.

Sources for fully paid-up bonus shares [Sec 63] As per Sec 63(1), a company may issue fully paid-up bonus shares to its members out of-

- Its Free Reserves
- Its Securities Premium Account; or
- Its Capital Redemption Reserve Account

Restrictions

No issue of bonus shares shall be made by capitalizing reserves created by the Revaluation of Assets i.e. Revaluation Reserves. Meaning of Free Reserves: As per Sec 2(43) of the Companies Act, 2013, "Free Reserves" mean such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend.

Exclusions from Free Reserves:

Any amount representing unrealized gains, notional gains or revaluation of assets, where shown as a reserve or otherwise, or

Any change in carrying amount of an asset or of a liability recognized in equity, including surplus in Profit and Loss Account on measurement of the Asset or the Liability at Fair Value.

Conditions for issue of fully paid-up bonus shares [SEC 63(2)]

(i) A company can issue bonus shares if its Articles expressly authorize to do so.

(ii) A resolution is required to be passed by the Board of Directors recommending its decision to issue bonus shares.

(iii) A resolution is required to be passed by the members in the general meeting to approve the Board's resolution recommending the issue of bonus shares.

Members' resolution —

- Must have an intention to capitalize the profits or reserves, and
- Must mention the amount of profits or reserves to be capitalized.

(iv) The company has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it.

(iv) The Company has not defaulted in respect of payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus.

(v) (vi) The partly-paid shares, if any, outstanding on the date of allotment are made fully paid-up.

(vi) (vii) A Company must comply with Prescribed Conditions. (viii) The bonus shares shall not be issued in lieu of dividend.

SEBI guidelines on issue of bonus issues:

A listed company proposing to issue bonus shares shall comply with the following requirements:

1. - The articles of association of the company must contain a provision for capitalisation of reserves, etc; - If there is no such provision in the articles the company must pass a resolution at its general meeting making provision in the articles of association for capitalization;

2. The company has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption;

3. The company has not defaulted in payment of statutory dues of the employees such as contribution to provident fund, gratuity etc.

4. The partly-paid shares, if any, outstanding on the date of allotment are required to be made fully paid-up.

5. No company shall, pending conversion of FCDs/PCDs, issue any by way of bonus unless similar benefit is extended to the holders of such FCDs/though reservation of shares in proportion to such convertible part of FCDs or PCDs. (b) The shares so reserved may be

issued at the time of conversion(s) of such debentures on the same terms on which the bonus issues were made.

6. The bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash.

7. Reserves created by revaluation of fixed assets shall not be capitalised.

8. The declaration of bonus issue, in lieu of dividend, shall not be made.

9. A company which announces its bonus issue after the approval of the Board of directors must implement the proposal within a period of 15 days from the date of such approval (if Shareholders' approval is not required) or 2 months (if Shareholders' approval is required).

10. Once the decision to make a bonus issue is announced, the same cannot be withdrawn.

Accounting Entries: The various accounting entries relating to bonus issue are given below: Particulars L.F. Dr. (`) Cr. (`)

On issue of fully paid Bonus Shares - Accounting Entries:

The various accounting entries relating to bonus issue are given below

Particulars	L.f	Debit	Credit
On issue of fully paid Bonus Shares			
❖ On Declaration of such bonus Capital Redemption Reserve A/c Dr. Securities Premium A/c Dr. Capital Reserve A/c Dr. (realized in cash only) General Reserve A/c Dr. Profit and Loss A/c Dr. To Bonus to Shareholders A/c		 XXX XXX XXX XXX XXX	 XXX
❖ On issue of fully paid Bonus Shares Bonus to Shareholders A/c Dr. To Share Capital A/c		 XXX	 XXX

BUY BACK OF SHARES

Theory:

i. The term buy back means buying back by company of its equity shares from equity shareholders for immediate cancellation.

ii. According to Section 77 of The Companies Act, 1956, no company having share capital shall have power to buy its own shares except-

a. Redemption of Preference Shares Under Section 80 or

b. Capital Reduction under Section 100-104.

iii. However Section 77A introduced in Companies Act, empowers the company to buyback (Cancel) its equity shares either out of-

a. Fresh Issue of Preference Shares. Or

b. Free Reserves. Or

c. Partly out of Fresh Issue and partly out of free reserves.

iv. A company cannot buy back its equity shares unless it is fully paid.

v. Free reserves utilized for purpose of buy back of equity shares are immediately transferred to an account called as "CRR A/c" (Section 77AA).

vi. Free reserves include not only revenue profits but also **Securities Premium**.

vii. Premium on buy back is a capital loss and can be set out of **Free Reserves**.

REDEMPTION OF PREFERENCE SHARES:

Under section 100 of the Companies Act, a company is not allowed to return to its shareholders the share money without the permission of the Court. But permission of the court is not necessary, if the refund is to be made to the preference shareholders.

When the capital is raised by issuing redeemable preference shares, it is to be paid back by the company to such shareholders after the expiry of stipulated period whether the company is to be wound up or not. The amount of such shares will be paid back within ten years of their issue either out of the profits or proceeds of the issue of fresh shares. The following important provisions regarding redemption of preference shares are given under section 80 of the Companies Act.

(1) Such shares cannot be redeemed unless they are fully paid up. In other words partly paid up shares cannot be redeemed. This provision is made in order to protect the interest of the creditors.

(2) Such shares can be redeemed either out of profits which would be available for dividend or out of the proceeds of a fresh issue of shares made with the object of redemption. These shares cannot be redeemed out of the proceeds of fresh issue of debentures or out of the sale proceeds of any property of the company as it will lead to erosion of available security to the creditors. Capital profits such as shares forfeited account, development rebate account, capital redemption reserve account, securities premium account, profit prior to incorporation and capital reserve are not available for dividend. If shares are to be redeemed at premium, then such premium must be provided either out of the accumulated profits of the company or out of the company's securities premium account. The word 'proceeds' implies the amount received excluding the amount of securities premium if the shares are issued at premium but the net amount if the shares are issued either at a par or at a discount. This clause is inserted in order to protect the interest of the creditors.

(3) When shares are redeemed out of profits available for distribution for dividend, a sum equal to the nominal amount of the shares so redeemed must be transferred out of profits to a reserve account to be called ' Capital Redemption Reserve Account'. This provision is made in order to immobilize profits from being used

for any other purpose such as distribution of dividend, redemption of debentures, etc.

(4) Capital Redemption Reserve Account can be used for issuing fully paid bonus shares to the shareholders. This account cannot be reduced except in accordance with the sanction of the court relating to reduction of share capital.

(5) Redemption of preference shares should not be regarded as a reduction of the authorized capital of the company and as such the reduced shares should remain part of the authorized capital and must be shown in the Balance Sheet.

Procedure for Solving Problems: The following procedure for solving problems is suggested:

1. First of all see whether the redeemable preference shares are fully paid up or partly paid up. If partly paid up, make the following journal entries for making partly paid up as fully paid up.

(a)	Preference Shares Final Call Account Dr. To Preference Share Capital Account		xxx	 xxx
(b)	Bank Account Dr. To Preference Shares Final Call Account		xxx	 xxx

2. Pass entry for the total amount due to preference shareholders including the face value of preference shares and the premium to be paid on redemption of preference shares . The entry is:

	Redeemable Preference Share Capital Account Dr. Premium on Redemption Account Dr. To Preference Shareholders Account or Preference Shares Redemption Account		xxx xxx	 xxx

3. Make entry for issue of equity shares either with premium or without premium in order to provide amount for the purpose of redemption of preference shares by fresh issue.

	Bank Account Dr. Discount on Issue of Shares Account Dr. To Equity Share Capital Account		xxx xxx	 xxx

	To Securities Premium Account			xxx

4. Provide premium to be paid on redemption of preference shares out of securities premium account (from fresh issue or existing balance) or profit and loss account or general reserve etc. by passing the following entry:

	Securities Premium Account or Profit and Loss Account or General Reserve Account Dr. To Premium on Redemption Account		xxx	 xxx

5. Appropriate amount from profit and loss account or general reserve or any other reserve (available for dividend) to meet the deficiency of the amount required for redemption of preference shares (or if redemption is to be made out of profits only) by passing the following entry:

	Profit and Loss Account or General Reserve etc. Dr. To Capital Redemption Reserve Account		xxx	 xxx

6. If liquid assets are not available for making payment to preference shareholders on redemption then current assets may be sold by the company or bank overdraft may be arranged.

	Bank Account Dr. Profit and Loss Account (loss on sale of assets) Dr. To Current Assets A/C or Bank Loan A/C To Profit and Loss A/C (profit on sale of assets)		xxx xxx	 xxx xxx

7. Payment will be made to the preference shareholders by passing the following entry:

	Preference Shareholders Account (Or) Preference Share Redemption Account Dr. To Bank Account		xxx	 xxx

8. If redemption of preference shares is made by conversion of some other shares, then the following entry will be passed:

	Preference Share Capital Account Dr. To New Share Capital Account		xxx	 xxx

9. Sometimes capital redemption reserve account is utilized for issuing fully paid bonus shares. In such a case the following entries will be passed:

(1)	**When decision is taken to issue bonus shares:** Capital Redemption Reserve Account (Or) Any other Reserve (Specifically mentioned in the question) To Bonus to Equity Shareholders Account		xxx	 xxx
(2)	**When issue of bonus shares is made:** Bonus to Equity Shareholders Account Dr. Equity Share Capital Account		xxx	 xxx

10. When right issue is made to the shareholders after redemption of preference shares and issue of bonus shares, then the number of such right shares is calculated after taking into consideration the recent issue of bonus shares. Entries for issue of rights shares will be made on the same lines as are made for issue of equity shares in the ordinary course.

Illustration 1: A company has 40,000 10% redeemable preference shares of Rs. 100 each, fully paid. The company decides to redeem the shares on December 31, 2009 at a premium of 5 per cent. The company makes the following issues : -

(a) 10,000 equity shares of Rs. 100 each at a premium of 10 per cent.

(b) 10,000 12% debentures of Rs. 100 each.

The issue was fully subscribed and all the amounts were received. The redemption was duly carried out. The company has sufficient profits. Give journal entries.

Solution:

Journal entries **Dr.** **Cr.**

2009 Dec. 31	 Bank Account Dr. To Equity Share Capital account To Share Premium Account (Being the allotment of 10,000 shares of Rs.100 each at a premium of Rs. 10 each.)		Rs. 11,00,000	Rs. 10,00,000 1,00,000
Dec. 31	Bank Account Dr.		10,00,000	

	To 12% Debentures Account (Being allotment of 10,000 12% debentures of Rs. 100 each)			10,00,000
Dec. 31	Profit and Loss Account Dr. Share Premium Account Dr. To Premium on Redemption of Preference Shares Account (Being the provision of premium of 5% payable on redemption of 40,000 redeemable preference shares of Rs. 100 each)		1,00,000 1,00,000	2,00,000
Dec. 31	Profit and Loss Account Dr. To Capital Redemption Reserve Account (Being the amount transferred to Capital Redemption Reserve Account – the amount uncovered by the face value of the shares issued)		30,00,000	30,00,000
Dec. 31	10% Redeemable Preference Share Capital Account Dr. Premium on Redemption of Preference shares Account Dr. To Bank Account		40,00,000 2,00,000	42,00,000

Illustration 2: The following is the summarized Balance Sheet of Reliance Limited:

Liabilities		Rs.	Assets	Rs.
Paid up Share Capital			Bank	90,000
Equity Shares:			Other Assets	8,10,000
50,000 shares of Rs. 10 each		5,00,000		
10% Redeemable Pref. Shares				
1,000 shares of Rs. 100				
Each fully called	1,00,000			
Less: Calls in arrear	1,000	99,000		
(On 50 shares @ Rs. 20 each)				
Reserves and Surplus:				
General Reserve		1,00,000		
Dev. Rebate Reserve		50,000		
Other Liabilities		1,51,000		
		9,00,000		9,00,000

The Redeemable Preference Shares were redeemed on the following basis:

(1) Further 4,500 equity shares were issued at a premium of 10 per cent;
(2) Expenses for fresh issue on shares – Rs. 5,000;
(3) Of the 50 preference shares, holders for 40 shares paid the call before the date of redemption. The balance 10 shares were forfeited for nonpayment of calls before redemption. The forfeited shares were reissued as fully paid on receipt of Rs. 500 before redemption;
(4) Preference shares were redeemed at a premium of 10 per cent, and securities premium amount was utilized on full for the purpose.

Show journal entries including those relating to cash and the summarized Balance Sheet after redemption showing rough workings.

Solution: Journal Entries **Dr. Cr.**

			Rs.	Rs.
	Bank Account Dr. To Equity Share Capital Account To Securities Premium Account (Being the issue of 4,500 equity shares at a premium of 10%)		49,500	 45,000 4,500
	Shares Issue Expenses Account Dr. To Bank Account (Being the expenses on the issue of shares)		5,000	 5,000
	Bank Account Dr. To Preference Shares Call in Arrears A/C (Being the receipt of calls in arrears on 40 preference shares @ Rs. 20 each)		800	 800
	Redeemable Preference Share Capital A/c Dr. To Preference Shares Calls in Arrear A/c To Shares Forfeited Account (Being the forfeiture of 10 preference shares for nonpayment of final call of Rs. 20 each)		1,000	 200 800
	Bank Account Dr. Shares Forfeited Account Dr. To Redeemable Preference Share Capital To Capital Reserve Account (Being the reissue of redeemable preference shares on payment of Rs. 500 and the profit transferred to Capital Reserve Account)		500 800	 1,000 300
	Securities Premium Account Dr. General Reserve Account Dr. To Premium on Redemption Account (Being premium on redemption provided out of past accumulated profits & securities premium out of fresh issue)		4,500 5,500	 10,000

	General Reserve Account Dr. To Capital Redemption Reserve A/C (Being the transfer of Rs. 55,000, the amount of shares redeemed out of profit, to Capital Redemption Reserve Account)		55,000	55,000
	Redeemable Preference Share Capital A/C Dr. Premium on Redemption Account Dr. To Preference Shareholders Account (Being the amount due to redeemable preference shareholders on redemption)		1,00,000 10,000	1,10,000
	Preference Shareholders Account Dr. To Bank Account (Being amount paid on redemption of 1,000 Redeemable Preference Shares)		1,10,000	1,10,000

BALANCE SHEET OF RELIANCE LIMITED. (after redemption)

Liabilities	Rs	Assets	Rs.
Share Capital: 54,500 equity shares of Rs. 10 each fully paid.	5,45,000	Fixed Assets: Other assets	8,10,000
Reserves and Surplus:		Current Assets Cash at Bank (see note)	25,800
Capital Reserve	300	Misc. Expenses & Losses	
Capital Redemption Reserve	55,000	Share issue expenses	5,000
General Reserve	39,000		
Dev. Rebate Reserve	50,000		
Current Liabilities: Other Liabilities	1,51,000		
	8,40,800		8,40,800

Note: Calculation of Cash at Bank :

CASH AT BANK ACCOUNT

	Rs		Rs
To Balance b/d	90,000	By Share Issue Expenses	5,000
To Share Capital	45,000	By Preference Shareholders	1,10,000
To Securities Premium	4,500		
To Pref. Shares Calls in Arrears	800	By Balance c/d	25,800
To Red Pref. Share Capital	500		
	1,40,800		1,40,800

REDEMPTION OF DEBENTURES

Meaning of Debentures

A company for its extension and development may require raising funds without increasing its share capital. The company may invite the public by open declaration to lend money for a fixed period at a declared rate to be paid on such money. Debentures is an instrument in writing given by a company acknowledging the liability for the total amount received as a result of issue of debentures and agreeing thereby to pay the money raised after the expiry of the stipulated period at a certain rate of interest per annum The Company Act defines debentures as 'debenture includes debenture stock, bonds or any other securities of a company, whether constituting a charge on the assets of the company or not.'

Difference between Debenture and Debenture Stock

The following are the difference between a debenture and a debenture stock:

(1) Debenture need not be fully paid whereas debenture stock must be fully paid.
(2) Debenture can be transferred wholly whereas debenture stock can be transferred in fractions also.
(3) Debentures are identified by their distinct numbers whereas no such distinct numbers are in case of debenture stock.

Stages of Debentures:

(I) Issue of Debentures
(II) Redemption of Debentures.

Debentures may be redeemed in one of the following three ways:-

(1) **In one lot:** All the debentures may be redeemed in one lot at the end of a specified period of time or even before the expiry of the specified period of time by serving a notice to debenture holders.

(2) **In installments by draw of lots:** The debentures may be redeemed in installments. For example one-tenth of the total debentures may be redeemed every year for ten years by draw of lots. Lot will have to be drawn every year to determine which particular debentures have to be redeemed in that particular year.

(3) **By purchase of debentures in the open market:** A company may reserve the right to buy its debentures in the open market. If the company cancels the debentures so purchased, it will amount to redemption of these debentures.

When debentures are issued with certain conditions at which redemption can be made, there are five cases which are given as follows:

Case	Conditions of Issue	Conditions of Redemption
1.	Issued at par	Repayable at par
2.	Issued at Premium	Repayable at par
3.	Issued at discount	Repayable at par
4.	Issued at par	Repayable at premium
5.	Issued at discount	Repayable at premium

The journal entries to be passed at the time of issue and redemption of debentures in the five cases are given below:

I.	When debentures are issued at par and repayable at per: (a) On issue of debentures: Bank Account Dr. To Debentures Account		Rs. xxx	Rs. xxx
	(b) On redemption of debentures: Debentures Account Dr. To Bank Account		 xxx	 xxx
II.	When debentures are issued at premium and repayable at par: (a) On issue of debentures: Bank Account Dr. To Debentures Account To Premium on Issue of Debentures A/C		 xxx	 xxx xxx
	(b) On redemption of debentures: Debentures Account Dr. To Bank Account		 xxx	 xxx
III.	When debentures are issued at discount and repayable at par: (a) On issue of debentures: Bank Account Dr. Discount on Issue of Debentures A/C Dr. To Debentures Account		 xxx xxx	 xxx
	(b) On redemption of debentures: Debentures Account Dr. To Bank Account		 xxx	 xxx
IV.	When debentures are issued at par and repayable at premium: (a) On issue of debentures: Bank Account Dr.		 xxx xxx	

	Loss on the issue of Debentures Account Dr. To Debentures Account To Premium on Redemption of Debentures			xxx xxx
	(b) On redemption of debentures: Debentures Account Dr. Premium on the redemption of debentures Dr To Bank Account		xxx xxx	 xxx
V.	When debentures are issued at a discount but repayable at a premium: (a) On issue of debentures: Bank Account Dr. Loss on the Issue of Debentures Account Dr. To Debentures Account To Premium on Issue of Debentures A/C		xxx xxx	 xxx xxx
	(b) On redemption of debentures: Debentures Account Dr. Premium on Redemption of Debentures A/c Dr. To Bank account		xxx xxx	 xxx

Sources of Finance for Redemption of Debentures:

(1) Redemption out of Profits:

When debentures are redeemed out of profits, profits of the company are utilized for the purpose of redemption withholding the same for dividend. In such a case the following journal entries will be passed.

			Rs.	Rs.
1.	Entry for amount paid on redemption: Debentures Account Dr. To Bank Account		xxx	 xxx
2.	Entry for transfer of profit: Profit and Loss Appropriation Account Dr. To Debenture Redemption Reserve Account		xxx	 xxx
3.	When balance of D.R.R A/c is not required for redemption and is transferred to General Reserve Account: Debenture Redemption Reserve Account Dr. To General Reserve Account		xxx	 Xxx

(2). **Redemption out of capital**:

If debentures are redeemed out of capital, no amount of divisible profit is kept aside for redeeming debentures. Profits are not utilized for redemption of debentures and may go to the shareholders by way of dividends. Redemption out of capital reduces the liquidity resources available to the company. Therefore, a company may adopt this method only when it has sufficient surplus funds.

However, creation of Debenture Redemption Reserve is not required in the following cases:

1. Debentures with a maturity of 18 months or less.
2. Fully convertible debentures. In case of partly convertible debentures, Debenture Redemption Reserve is to be created for the non-convertible part in the same way as applicable for fully non-convertible debentures.

	When debentures are redeemed out of capital the following entry is made: Debentures Account Dr. To Bank Account		Rs. xxx	Rs. xxx
	Sometimes instead of passing one entry given above, the following two entries are passed: (a) Debentures Account Dr. To Debenture holders (c) Debenture holders Account Dr. To Bank Account		 xxx xxx	 xxx xxx

(3).Redemption by conversion:

Sometimes the debenture holders of a company are given the option to convert their debentures into the shares or new debentures within a stipulated period. Such option is exercised by the debenture holders only when they are very sure about the progress of the company. The new shares or debentures can be issued either at par or at a premium or at a discount. The following entry will be made:

	Old Debentures Account Dr. Discount on the Issue of Shares/Debentures A/C Dr. To New Share Capital / Debentures Account To Premium on Issue of shares/Debentures Account		Rs. xxx xxx	Rs. xxx xxx

Illustration 4: On July 1, 2006 X Ltd. gave notice of its intention to redeem its outstanding Rs. 4,00,000 4 ½ % Debenture Stock on January 1, 2007 at 102 per cent and offered the holders the following options:

(1) To apply the redemption money to subscribe for:
  (a) 6^ Cumulative Preference Shares of Rs. 20 each at Rs. 22.50 per share accepted by the holders of Rs.1,71,000 stock, or
  (b) 6% Debenture stock of Rs. 96 accepted by the holders of Rs. 1,44,000 stock, or
(2) To have their holdings redeemed for cash if neither of the options under (1) was accepted.

You are required to show the journal entries necessary to record the redemption and allotments under (1) and (2) and to state the amount of cash required to satisfy the option.

Solution:

JOURNAL **Dr.** **Cr.**

			Rs.	Rs.
	4 ½ % Debentures Account Dr. Premium on Redemption of Debentures Account Dr. To Debenture holders Account (Being redemption of debentures of Rs. 4,00,000 at 102 per cent)		4,00,000 8,000	 4,08,000
(1)(a)	Debenture holders Account Dr. To 6% Cumulative Preference Share Capital A/c To Securities Premium Account (Being debenture holders of Rs. 1,71,000 (Redemption value Rs. 1,74,420) accepted Cum. Pref. Shares of Rs. 20 each at 22.50 per share)		1,74,420	 1,55,040 19,380
(b)	Debenture holders Account Dr. Discount on Issue of Debentures Account Dr. To 6% Debentures Account (being debenture holders of Rs. 1,44,000 (redemption value Rs. 1,46,880) issued new 6% Debentures at Rs. 96)		1,46,880 6,120	 1,53,000
	Debenture holders Account Dr. To Bank Account (Being Debenture holders of Rs. 85,000 (redemption value Rs. 86,700) paid in cash)		86,700	 86,700
(2)	Total amount required for Redemption is Rs. 4,08,000, i.e., (4,00,000 X 102/100)			

UNIT - II

Final Accounts : Preparation Of Profit And Loss Account And Balance Sheet Of Corporate Entities-Excluding Calculation Of Managerial Remuneration- Disposal Of Company Profits. Valuation of Goodwill And Valuation Of Shares: Concepts And Calculation

FINAL ACCOUNTS OF COMPANIES

A limited company must prepare every year the Profit and Loss Account and the Balance Sheet. Section 209 makes it compulsory for a company to keep certain books of account. Section 210 governs the preparation of the final accounts. The important portions of this section read as follows: -

(1) At every annual general meeting of the company held in pursuance of section 166, the Board of Directors of the company shall lay before the company –
   (a) The balance sheet as at the end of the period specified in sub-section (3); and
   (b) A profit and loss account for the period

(2) In case of a company not carrying on business for profit, an income and expenditure account shall be laid before the company at its annual general meeting instead of profit and loss account, and all references to 'profit and loss account', 'profit' and 'loss' in this section and elsewhere in this Act, shall be construed, in relation to such a company, as references respectively to the 'income and expenditure account', 'the excess of income over expenditure' and 'the excess of expenditure over income'.

(3) The profit and loss account shall relate –
   (a) In the case of the first annual general meeting of the company, to the period beginning with the incorporation of the company and ending with a day which shall not precede the day of the meeting by more than nine months; and
   (b) In the case of any subsequent annual general meeting of the company, to the period beginning with the day immediately after the period for which the account was last submitted and ending with a day which shall not precede the day of the meeting by more than six months, or in case where an extension of time has granted for holding the meeting under the second provision to sub-section (1) of section 166, by more than six months and the extension so granted.

(4) The period to which the account aforesaid relates is referred in this Act as a 'financial year', and it may be less or more than a calendar year, but it shall not exceed fifteen months:

Legal Position Regarding Final Accounts of Companies

Section 210 to 220 of the Companies Act, 1956 deal with the legal position relating to the final accounts of joint stock companies. A brief mention of these legal provisions is given below:

Section 210. It deals with the preparation and presentation of the final accounts of a joint stock company.

Section 211. It deals with form of contents of the Balance Sheet and Profit and Loss Account.

Section 212. It deals with the disclosure of certain particulars in the Balance Sheet of a holding company in respect of its subsidiaries.

Section 213. It makes provision for extension of the financial year of the holding company and subsidiary.

Section 214. It makes provisions regarding rights of holding company's representatives and members to inspect books of accounts kept by any of its subsidiaries.

Section 215. As per this section, the Balance Sheet and Profit and Loss Account of a company shall be authenticated, (i.e., signed) on behalf of the Board of Directors by its manager or secretary, if any, and by not less than two directors of the company, one of whom shall be a managing director, where there is one.

Section 216. As per this section, the Profit and Loss Account shall be treated as an annexure to the Balance Sheet and the auditors' report as an enclosure thereto.

Section 217. The report of the Board of Directors shall be attached to every Balance Sheet laid before the shareholders in general meeting.

Section 218. It provides for penalty for improper issue, circulation or publication of Balance Sheet or Profit and Loss Account.

Section 219. It deals with the right of the member to copies of Balance Sheet and Profit and Loss Account, auditors' report and every other document required by law to be annexed or attached to the Balance Sheet, which is to be presented in the general meeting.

Section 220. According to this section, three copies of Balance Sheet and Profit and Loss Account be filed with the Registrar within 30 days after the annual general meeting.

Preparation and Presentation of the Final Accounts:

In respect of preparation and presentation of the final accounts the requirements of Section 210 of the Companies Act are quoted below:

(1) At every annual general meeting of a company in pursuance of section 166, the Board of Directors of the company shall lay before the company :

 (a) A balance sheet as at the end of the period specified in sub-section (3); and (b) a profit and loss account for that period.

(2) In case of a company not carrying on business for profits, an income and expenditure account shall be laid before the company at its annual general meeting instead of profit and loss account and all references to "profit and loss account", "profit" and "loss" in this and elsewhere in this Act shall be construed, in relating to such a company as references respectively to the "income and expenditure account", "the excess of income over expenditure" and "the excess of expenditure over income".

(3) The profit and loss account shall relate :

 (a) In the case of the first annual general meeting of the company to the period beginning with the incorporation of the company and ending with a day which shall not precede the day of the meeting by more than nine months: and

(b) In the case of any subsequent annual general meeting of the company, to the period beginning with the day immediately after the period for which the account was last submitted and ending with a day which shall not precede the day of the meeting by more than six months or in case where an extension of time has been granted for holding the meeting under the second provision to sub-section (1) of section 166, by more than six months and the extension so granted.

(4) The period to which the account aforesaid relates is referred to in this Act as a financial year and it may be less or more than a calendar year, but it shall not exceed fifteen months.

(5) If any person, being a director of a company, failure to take all reasonable steps to comply with the provisions of this section, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees or with both:

Provided that in case of any proceedings against a person in respect of an offence under this section, it shall be a defense to prove that a competent and reliable person was charged with the duty of seeing that the provision of this section were complied with and was in a position to discharge that duty.

(6) If any person, not being a director of the company, having been charged by the Board of Directors with the duty of seeing that the provisions of this section be complied with, makes default in doing so, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees or with both:

FINAL ACCOUNTS

So far, we have discussed that how the business transactions are recorded in Journal and ledger and how to detect and rectify the errors and how to prepare Trial Balance. Is quite natural that the businessman is interested in knowing whether his business is running on Profit or Loss and also the true financial position of his business. The main aim of Bookkeeping is to inform the Proprietor, about the business progress and the financial position at the right time and in the right way. Preparation of Final accounts is highly possible only after the preparation of Trial Balance.

Final Accounts

Trading & Profit and Loss A/c Balance sheet

1. Trading and Profit and Loss A/c is prepared to find out Profit or Loss.

2. Balance Sheet is prepared to find out financial position a if concern.

Trading and P&L A/c and Balance sheet are prepared at the end of the year or at end of the part. So it is called Final Account.

Revenue account of trading concern is divided into two-part i.e.

1. Trading Account and

2. Profit and Loss Account.

TRADING ACCOUNT

Trading refers buying and selling of goods. Trading A/c shows the result of buying and selling of goods. This account is prepared to find out the difference between the Selling prices and Cost price. If the selling price exceeds the cost price, it will bring Gross Profit. For example, if the cost price of Rs. 50,000 worth of goods are sold for Rs. 60,000 that will bring in Gross Profit of Rs. 10,000. If the cost price exceeds the selling price, the result will be Gross Loss. For example, if the cost price Rs. 60,000 worth of goods are sold for Rs. 50,000 that will result in Gross Loss of Rs.10, 000.

Thus the Gross Profit or Gross Loss is indicated in Trading Account.

Items appearing in the Debit side of Trading Account.

1. **Opening Stock**: Stock on hand at the commencement of the year or period is termed as the Opening Stock.

2. **Purchases:** It indicates total purchases both cash and credit made during the year.

3. **Purchases Returns or Returns out words:** Purchases Returns must be subtracted from the total purchases to get the net purchases. Net purchases will be shown in the trading account.

4. **Direct Expenses on Purchases**: Some of the Direct Expenses are.

i**. Wages**: It is also known as Productive wages or Manufacturing wages.

ii. **Carriage or Carriage Inwards:**

iii. **Octroi Duty:** Duty paid on goods for bringing them within municipal limits.

iv. **Customs duty, dock dues, Clearing charges, Import duty etc.**

v. **Fuel, Power, Lighting charges related to production**.

vi. **Oil, Grease and Waste**.

vii. **Packing charges:** Such expenses are incurred with a view to put the goods in the

Saleable Condition.

Items appearing on the credit side of Trading Account

1. **Sales:** Total Sales (Including both cash and credit) made during the year.

2. **Sales Returns or Return Inwards:** Sales Returns must be subtracted from the Total Sales to get Net sales. Net Sales will be shown.

3. **Closing stock:** Generally, Closing stock does not appear in the Trial Balance. It appears outside the Trial balance. It represents the value of goods at the end of the trading period.

PROFIT AND LOSS ACCOUNT

Trading account reveals Gross Profit or Gross Loss. Gross Profit is transferred to credit

side of Profit and Loss A/c. Gross Loss is transferred to debit side of the Profit Loss Account. Thus Profit and Loss A/c is commenced. This Profit & Loss A/c reveals Net Profit or Net loss at a given time of accounting year.

Items appearing on Debit side of the Profit & Loss A/c

The Expenses incurred in a business is divided in too parts. i.e. one is Direct expenses are

Recorded in trading A/c., and another one is Indirect expenses, which are recorded on the debit side of Profit & Loss A/c. Indirect Expenses are grouped under four heads:

1. **Selling Expenses**: All expenses relating to sales such as Carriage outwards, Travelling

Expenses, Advertising etc.,

2. **Office Expenses**: Expenses incurred on running an office such as Office Salaries, Rent, Tax, Postage, Stationery etc.,

3. **Maintenance Expenses**: Maintenance expenses of assets. It includes Repairs and Renewals, Depreciation etc.

4. **Financial Expenses**: Interest Paid on loan, Discount allowed etc., are few examples for Financial Expenses.

Item appearing on Credit side of Profit and Loss A/c.

Gross Profit is appeared on the credit side of P & L. A/c. Also other gains and incomes of the business are shown on the credit side. Typical of such gains are items such as Interest received, Rent received, Discounts earned, Commission earned.

Preparation Of And Presentation Of Final Accounts Of Joint Stock Companies As Per Company Law Requirements - Performa

SCHEDULE VI, PART II

Form of Profit and Loss Account

Particulars	Rs.	Particulars	Rs.
To Opening Stock	xxx	By Sales xxx	
To Purchases		Less: Sales Returns xxx	xxx
Less: Purchas Returns	xxx	By Closing Stock	
To Freight and Carriage	xxx		
To Wages	xxx		
To Coal & Coke	xxx		
To Gross Profit c/d	xxx		
	xxx		
To Salaries	xxx		xxx
To Rent	xxx	By Gross Profit b/d	xxx
To Discount	xxx	By Interest Received	xxx
To Commission	xxx	By Rent Received	xxx
To Advertisement	xxx	By Discount	xxx
To General Expenses	xxx	By Commission	xxx
To Directors' Fees	xxx	By Profit on sale of Assets	xxx
Too Bad Debts			
To Loss on sale of assets			
To Depreciation			
To Preliminary Expenses			
To Provision for Income Tax			
To Net Profit c/d			
	xxx		xxx

PROFIT AND LOSS APPROPRIATION ACCOUNT:

The profit and loss appropriation account may be separately prepared to give details regarding the balance of profit and loss brought forward from last year , the net profit (loss) earned during year and appropriation made during the year

Proforma Of Profit And Loss Appropriation Account

Profit and loss appropriation account of ……….co. Ltd.

(as on 31 march, 20…………)

particulars	Rs.	particulars	Rs.
To Transfer to Reserves	Xxx	By Last year's Balance b/d	Xxx
To Income Tax for previous	Xxx	By Net Profit for the year b/d	Xxx
year not provided for	Xxx	By Amount withdrawn from	Xxx
To Interim Dividend	Xxx	General Reserve or any other	
To Proposed dividend	Xxx	reserve	Xxx
To Surplus (Balance figure)	xxx	By Provision such as Income	
carried to Balance Sheet		Tax provision no longer	xxx
		required	

PROBLEMS IN PROFIT AND LOSS APPROPRIATION ACCOUNT

Illustration:1

The accounts of the Thackery Ltd an amount of Rs3,00,000 to the credit of profit &loss account on 31.3.2015 out of which the directors decided to place Rs60,000 to general reserve and Rs42,000to debentures redemption fund. At the annual general meeting held on 15.6.2015 , it was decided to place Rs.20,000 to a development reserve and to pay a bonus of 2.5 % of the profit to directors as additional remuneration. The payment of the half-yearly dividends on Rs5,00,000 6% cumulative preference shares on Sept 30,1997 and march,31,2015 was confirmed and a dividend@10% was declared on the equity share capital of the face value of

Rs6,00,000 . The balance of profit & loss account is to be carried forward to next year. Prepare profit& loss Appropriation account showing the above arrangements

Solution:

Profit and loss appropriation account for the year ended 31.3.2015

Particulars	**Amount**	**Particulars**	**Amount**
To general reserve	60,000	By net profit as per P& L A/c	3,00,000
To debenture redemption fund	42,000		
To development reserve A/c	20,000		
To director's remuneration (2.5 % on Rs3,00,000)	7500		
To preference share dividend A/c (6% on Rs5,00,000)	30,000		
To equity share dividend A/c (10% on Rs 6,00,000)	60,000		
To balance of profit carried forward to B/S	80500		
	3,00,000		**3,00,000**

Illustration:2

Klusener Ltd had Rs21, 00,000 profit on31.3.2015 after making provisions for deprecation and taxation Rs1, 30,400 , profit was brought forward from last year . Following recommendation were made by the directors of the company to appropriate the profits:

To transfer Rs6, 30,000 to general reserve

To pay Rs85, 000 as ex-gratia bonus to employees of the company

To declare dividend @5% on equity shares

To transfer Rs.45, 000 to staff gratuity reserve

To transfer Rs 50,000 to development rebate reserve

To transfer Rs.90, 000 to deferred taxation reserve

The company's capital consisted of 1,00,000 equity shares of Rs10 each fully paid. For the year ending at 31.3.98, the directors transferred Rs40, 000 to dividend equalization reserve and Rs30,000 to debenture redemption fund account. Prepare profit & loss Appropriation account.

Solution:

Profit and loss appropriation account for the year ended 31.3.2015

Particulars	**Amount**	**Particulars**	**Amount**
To proposed bonus	85,000	by balance b/d	1,30,400
To proposed transfer to general reserve	6,30,000	By net profit for the year	21,00,000
To proposed dividend 10,00,000*5/100	50,000		
To staff gratuity reserve	45,000		
To development rebate reserve	50,000		
To deferred taxation reserve	90,000		
To dividend equalization reserve	40,000		
To debenture redemption fund A/c	30,000		
To balance carried forward to B/S	12,10,400		
	22,30,400		**22,30,400**

BALANCE SHEET

Trading A/c and Profit & Loss A/c reveals G.P. or G.L and N.P or N.L respectively,

Besides the Proprietor wants

i. To know the total Assets invested in business

ii. To know the Position of owner's equity

iii. To know the liabilities of business.

DEFINITION

The Word 'Balance Sheet' is defined as "a Statement which sets out the Assets and Liabilities of a business firm and which serves to ascertain the financial position of the same on any particular date."On the left hand side of this statement, the liabilities and capital are shown. On the right hand side, all the assets are shown. Therefore the two sides of the Balance sheet must always be equal. Capital arrives Assets exceeds the liabilities.

OBJECTIVES OF BALANCE SHEET:

1. It shows accurate financial position of a firm.

2. It is a gist of various transactions at a given period.

3. It clearly indicates, whether the firm has sufficient assents to repay its liabilities.

4. The accuracy of final accounts is verified by this statement

5. It shows the profit or Loss arrived through Profit & Loss A/c.

SCHEDUL VI, PART I (SECTION 211) FORM OF BALANCE SHEET

A. HORIZONTAL FORM

Balance Sheet of ….. (here enter the name of the company)

As on …….. (here enter the date as at which the balance sheet is made out)

Figures for the previous year Rs. (1)	Liabilities (2)	Figures for the current year Rs. (3)	Figures for the previo us year Rs. (4)	Assets (5)	Figures for the current year Rs. (6)
	Share Capital: **Authorized** … shares of Rs. ….each **Issued**: …. Shares of Rs. …. Each **Subscribed:** …. Shares			**Fixed Assets:** (a)Goodwill (b)Land (c) Buildings (d) Leaseholds (e) Railway sidings (f) Plant and machinery	

	of Rs. ….. each. **Less: Calls Unpaid**: (i) By Directors (ii) By others **Add:** Forfeited Shares **Reserves and Surplus:** 1.Capital Reserve 2.Capital Redemption Reserve 3.Share premium A/c 4. Other Reserves 5. Surplus 6. Proposed additions to Reserve 7. Sinking funds **Secured Loans:** 1.Debentures 2.Loans and advances from Banks 3.Loans and advances from subsidiaries 4. Other loans and advances **Unsecured Loans:** 1Fixed Deposits 2.Loans and advances from subsidiaries 3. Short term Loans and Advances 4. Other loans and			(g) Furniture and Fittings (h) Development of Property (i) Patents, trademarks and designs (j) Livestock (k) Vehicles etc., **Investments:** 1. Investment in Government or trust securities 2. Investments in shares, debentures and bonds 3. Immovable properties 4. Investments in the capital of partnership firms **Current assets, Loans and Advances:** **(A)Current Assets** 1. Interest accrued on investments 2. Stores and Spare Parts 3. Loose tools 4. stock in Trade 5. Work in progress 6. Sundry Debtors 7. Cash in hand and at bank **(B) Loans and Advances:** 8. Advances and loans to subsidiaries 9. Advances and loans to partnership 10. Bills of Exchange 11. Balances with	

	advances **Current Liabilities and Provisions:** **A. Current Liabilities** 1.Acceptances 2.Sundry Creditors 3.Subsidiary Companies 4. Advance payments 5. Unclaimed dividends 6. Other Liabilities 7. Interest accrued but not due on loans **B. Provisions** 1.Provision for Taxation 2.Proposed Dividend 3.For Contingencies 4.For proposed fund scheme 5.For insurance, pension and similar staff benefit schemes 6.For Provident Fund scheme 7. Other Provisions			customs, port trust etc., **Miscellaneous Expenditure:** 1.Preliminary Expenses 2.discount on issue of Shares 3. Underwriting Commission 4. Development Expenditure **Profit and Loss Account**	

VERTICAL FORM OF BALANCE SHEET

Vertical form of Balance sheet inserted as Part B of Part I of Schedule VI to the Companies Act, 1956 by GSRNo.220 (E) dated 12 – 03 – 1979 is as follows:

B. VERTICAL FORM

Name of the Company ……………….

Balance Sheet as at ……………….

(1)	Schedule No. (2)	Figures as at the end of current financial year (3)	Figures as at the end of previous financial year (4)
I.SOURCES OF FUNDS			
(1) Shareholders' Funds:			
(a) Capital			
(b) Reserves and Surplus			
(2) Loan funds:			
(a) Secured Loans			
(b) Unsecured Loans			
II. APPLICATION OF FUNDS			
(1) Fixed assets:			
(a) Gross block			
(b) Less Depreciation			
(c) Net block			
(d)Capital work-in-progress			
(2) Investments			
(3) Current Assets, Loans and Advances:			
(a) Inventories			
(b) Sundry Debtors			
(c) Cash and bank balance			

(d) Other current assets (e) Loans and advances Less: Current liabilities and Provisions (a) Liabilities (b) Provisions **Net Current Assets** (1) (a) Miscellaneous Expenditure to the extent Not written off or Adjusted (c) Profit and Loss Account **Total**			

Illustration 6 : Prepare a Balance Sheet in Vertical form as at 31st March, 2010 from the following information of Goodwill Company Limited as required under Part I B of Schedule VI of the Companies Act, 1956 :

	Rs.
Term loan	10, 00,000
Sundry Creditors	11, 45,000
Advances	3, 72,000
Cash and Bank Balances	2, 75,000
Staff Advances	55,000
Provision for Taxation	1, 70,000
Securities Premium	4, 75,000
Loose tools	50,000
Investments	2, 25,200
Loss for the year	3, 00,000
Sundry Debtors	12, 25,000
Miscellaneous Expenses	58,000
Loans from debtors	2, 00,000
Provision for doubtful debts	20,200
Stores	4, 00,000
Fixed assets (WDV)	51, 50,000
Finished goods	7, 50,000
General Reserve	20, 50,000
Capital work – in – progress	2, 00,000

Additional Information:

(1) Share capital consists of :
  (a) 3,000 Equity Shares of Rs. 100 each fully paid up.
  (b) 10,000 – 10% Redeemable Preference Shares of Rs. 100 each fully paid up.
(2) Term loans are secured
(3) Depreciation on assets Rs. 5,00,000
(4) Schedule need not be given. However, groupings should form part of the answer.

Solution :

Goodwill Company Limited - BALANCE SHEET As on 31st March, 2010

		As on 31-3-10	As on 31-3-10
Sources of Funds			
1. Shareholders' Funds :			
(a) Share Capital		13,00,000	
(b) Reserves and Surplus		25,25,000	38,25,000
2. Loans Funds :			
(a) Secured Loans		10,00,000	
(b) Unsecured Loans		Nil	10,00,000
3. Suspense Account (Balancing figure)			27,00,000
			75,25,000
Application of Funds			
1.Fixed Assets:			
(a) Gross Block		56,50,000	
(b) Less : Depreciation		5,00,000	
(c) Net Block		51,50,000	
(d) Capital work-in-progress		2,00,000	53,50,000
			2,25,200
2. Investments			
3. Current Assets, Loans & Advances			
(a) Inventories		12,00,000	
(b) Sundry Debtors		12,04,800	
(c) Cash and Bank Balances		2,75,000	
(d) Loans and Advances		4,27,000	
		31,06,800	
Less : Current Liabilities & Provisions :			
(a) Current Liabilities	13,45,000	15,15,000	
(b) Provisions	1,70,000		15,91,800

4. Miscellaneous Expenditure : (a) Profit and Loss Account (b) Miscellaneous Expenses		3,00,000 58,000	3,58,000 **75,25,000**

Working Notes: Rs.

1. Share Capital:

3,000 Equity Shares of Rs. 100 each	3, 00,000
10,000 – 10% Redeemable Preference Shares of Rs. 100 each	10, 00,000
	13, 00,000

2. Reserves and Surplus:

Securities Premium	4, 75,000
General Reserve	20, 50,000
	25, 25,000

3. Fixed assets:

Fixed Assets at WDV	51, 50,000
Add: Depreciation	5, 00,000
	56, 50,000

4. Inventories:

Finished Goods	7, 50,000
Stores	4, 00,000
Loose Tools	50,000
	12, 00,000

5. Sundry Debtors:

Sundry Debtors:	12, 25,000
Less: Provision for Doubtful Debts	20,200
	12, 04,800

6. Loans and Advances:

Advances	3, 72,000

Staff Advances	55,000

	4, 27,000
	--------------
7. Current Liabilities :	
Sundry Creditors	11, 45,000
Loans from Debtors	2, 00,000

	13, 45,000

Illustration 7 The Arun Manufacturing Company Limited was registered with a nominal capital of Rs. 60,00,000 in Equity Shares of Rs. 10 each. The following is the list of balances extracted from its books on 31st March 2009:

	Rs.
Calls-in-arrear	75,000
Premises	30,00,000
Plant and Machinery	33,00,000
Interim dividend paid on 1st November, 2008	3,92,500
Stock, 1st April, 2008	7,50,000
Fixtures	72,000
Sundry Debtors	8,70,000
Goodwill	2,50,000
Cash in hand	7,500
Cash at Bank	3,99,000
Purchases	18,50,000
Preliminary Expenses	50,000
Wages	8,48,650
General Expenses	68,350
Freight and Carriage	1,31,150
Salaries	1,45,000
Directors' Fees	57,250
Bad Debts	21,100
Debenture interest paid	1,80,000
Share Capital	40,00,000
12% Debentures	30,00,000
Profit and Loss Account (Credit Balance)	2,62,500
Bills Payable	3,70,000
Sundry Creditors	4,00,000
Sales	41,50,000
General Reserve	2,50,000
Bad debts Provision 1st April, 2008	35,000

Prepare Trading and Profit and Loss Account and Balance Sheet in proper form after making the following adjustments:

(a) Depreciate Plant and Machinery by 15%.
(b) Write off Rs. 5,000 from Preliminary Expenses.
(c) Provide for half year's debenture interest due.
(d) Leave Bad and Doubtful Debts Provision at 5% on Sundry Debtors.
(e) Provide for Income Tax @ 50%.
(f) Stock on 31st March, 2009 was Rs. 9,50,000.

Solution:

Trading and Profit and Loss Account of Arun Manufacturing Company Limited
As on 31st March, 2009

		Rs.		Rs.
To Opening Stock		7,50,000	By Sales	41,50,000
To Purchases		18,50,000	By Closing Stock	9,50,000
To Wages		8,48,650		
To Freight and Carriage		1,31,150		
To Gross Profit c/d		15,20,200		
		51,00,000		51,00,000
To Salaries		1,45,000	By Gross Profit b/d	15,20,200
To General Expenses		68,350		
To Directors' Fees		57,250		
To Bad debts	21,100			
Add: New Provision	43,500			
	64,600			
Less: Old Provision	35,000	29,600		
To Debenture interest paid	1,80,000			
Add: Outstanding	1,80,000	3,60,000		
To Depreciation on Plant and Machinery		4,95,000		
To Preliminary Expenses		5,000		
To Provision for Income Tax		1,80,000		
To Net Profit c/d		1,80,000		
		15,20,200		15,20,200
To Interim Dividend		3,92,500	By Balance b/d	2,62,500
To Profit Transferred to Balance Sheet		**50,000**	By Net Profit b/d	1,80,000

DISPOSAL OF PROFITS

The main objectives of a firm are to maximize the shareholders wealth. Cash generated from the successful operation of business are generally distributed among the shareholders' in the forms of dividend. But a company may also decide not to pay dividend to their shareholders if it is better to put the business's profits to work making the business itself more valuable.

It simply means that a company can dispose their profits in two different ways: Disposal in the forms of dividend; and transferring the profits to reserve funds/retained earnings.

After making provision for bad and doubtful debts, depreciation of assets and all other matters which are usually provided for by bankers, the company may out of its net annual profits declare a dividend. In the process of making dividend decision a company generally consider following factors:

- Transaction cost
- Personal taxation
- Dividend clientele
- Dividend payout ratio
- Dividend cover
- Liquidity
- Divisible profits
- Rate of expansion
- Rate of return
- Stability of earnings
- Stability of dividend
- Legal provisions
- Degree of control and
- Cost of financing

Considering these factors a company can take the decisions regarding dividend. A dividend is generally considered to be a cash payment issued to the holders of company stock. However, there are several types of dividends, some of which do not involve the payment of cash to shareholders. Some of these are:

- Stock dividend
- Property dividend
- Scrip dividend
- Liquidating dividend

Opposite to this, a company might choose to hoard its profit. This is especially true for businesses with cyclical sales and profits. For example, an airplane manufacturer might spend a lot of money one year building or upgrading a factory. It might lose money that year. In a couple of years, when the factory is making lots of planes and selling lots of planes, profits might go up, and so the company will prefer to save that money to buy the next factory.

Similarly, a company that plans to grow much larger might reinvest its profits back into the company so that it's worth more in the near future. You often see this in technology stocks, where acquiring more customers or increasing the value of each customer will hopefully produce even more revenue in the future—and more profits.

A company might also acquire other companies. This is similar to investing in the company. You can see this happen in very large companies, where it's cheaper and easier to buy an established but smaller company than it is to start a new line of business.

Added to these, a company may prefer to retain earning within the company due to the following reasons:

- Financial security of the company
- Expansion activities
- Sources of finance for planned future investment
- Want to maintain/increase working capital
- It is more tax efficient

- To fund pension or remuneration
- Regulatory requirements
- Build up reserves due to concern about future cash flow.

VALUATION OF GOODWILL

Introduction:

Goodwill is the name, fame or reputation earned in business by the company or any form of the business over a period of time. Acquiring goodwill makes the business to attract more and more customers and with passage of time it ultimately results in increase of profits generally. Thus, goodwill fetches some extra salable value to a prosperous business over and above the intrinsic value of net assets. In fact, it is very easy to describe goodwill but very difficult to define. Despite the above limitation there are some very good definitions given below. In the words of 'Spicer and Regler" goodwill may be said to be that element arising from the reputation, connection or other advantages possessed by a business, which enables on the capital represented by the net tangible assets employed in the business.

According to J O Magee 'The capacity of a business to earn profit is basically what is meant by the term goodwill'.

As per Dr. Cannings 'Goodwill is the present value of the firm's anticipated excess earnings'.

According to A V Adamson, 'Just as cement binds together the bricks and other building material into walls, similarly goodwill binds together or unites the other assets and aspects of the business into cohesive whole'.

According to the Institute of Chartered Accountants of India, goodwill is 'an intangible asset arising from business connections or trade name or reputation of an enterprise'.

Nature of Goodwill

Goodwill consists of the advantages a business has in connection with its customers, employees and outside parties with whom it has to contact. That is why it was defined as the probability that the old customers will revert back. Goodwill has been said to be an attractive force which brings in customers. Thus, to determine the nature of goodwill in a particular case, it is necessary to consider the type of business and the type of customers which such a business is inherently likely to attract as well as the particular circumstances of each case. Goodwill of a business is an aggregation of the strength of management, product central policies and attitude toward competition.

Features of Goodwill:

(1) Goodwill may have positive value or negative value. It is positive when the value of business is more than the value of its net identifiable assets and negative when the value of the business is less than the value of its net identifiable assets.

(2) The value of goodwill has no relation to the amount invested and costs incurred in order to build it.

(3) The value of goodwill fluctuates from time to time due to changing circumstances which are internal and external to business.

(4) It is not possible to separately evaluate each of the intangible factors contributing to goodwill.

(5) Goodwill may be purchased or inherent in the business. When a business concern is purchased and the purchase consideration is in excess of the fair value of the identifiable net assets acquired, such excess is recorded as goodwill. However, goodwill is recorded only when an amalgamation is in the nature of purchase and is not a merger, pooling of interests method is followed and goodwill is not recorded.

(6) An objective valuation of goodwill is difficult. Being subjective it differs from estimate to estimate.

Sources of Goodwill: The following are the main sources which generally give rise to goodwill.

(i) The location of the business e.g., a retail shop located in a busy market centre.

(ii) The reputation of the articles sold arising from the high standard or quality of the goods themselves.

(iii) Possession of trademarks patents or copyrights.

(iv) Possession of advantageous contracts or complete or partial monopoly.

(v) The personality and reputation of the owner or management, arising through his/its skill and influence, as in the case of a professional man. For example, a Chartered Accountant.

(vi) Any special advantage like government legislative or other enjoyed by the firm, e.g., inclusion in the list of approved suppliers to Government, Municipal Corporation or C.P.W.D. etc.

(vii) Development of the business and shopping facilities with the changing conditions of the market e.g., provision for the visitor's rest room.

Methods for valuing the Goodwill

It is not very easy to value and account for goodwill unless there is a particular method accepted by all. However there are five methods for valuing goodwill depending upon the situation.

I. Arbitrary Statement

II. Average Profit Method

III. Super Profit Method

IV. Capitalization Method

1. Arbitrary Statement

The valuation of goodwill is arrived at by making a valuation by one of the parties i.e., vendor or purchaser to which the other agrees. The parties may together estimate the value to be placed on the goodwill or an independent party may be called in to give his option as to the value, it being left to the parties to decide whether they will accept or reject the valuation.

This method can be used only when information relating to earning capacity is available. If this information is not available because of non-availability of the profit immediately prior to sale or if the profits are abnormal or unreliable then such data cannot be used as a guide to further profits. Similarly information relating to earning capacity may not be available if the business being acquired may be converted into one of a different nature from that existing prior to date of purchase as in the case of a retail shop dealing in garments is purchased with a vied to converting it to a pharmacy. Consideration should also be given to the question of trading advantages (e.g. quotas) made available to the purchaser by the vendor and licences to import goods up to authorized values. There are really no inter obtainable from the accounting data as to the valuation of such benefits passed on to the purchaser and their worth remain a matter of assessment to be agreed upon by the parties.

2. Average Profit Method

In general all businesses aim for profit and are expected to grow in the future. The buyer of business is also interested to know the present earnings, whether the business will maintain the same profit in the future and if there is scope to increase profit in the future also. If it is not, then the buyer will not pay for goodwill as it would mean purchasing a loss making company. Goodwill is paid for obtaining a future advantage. However, the future is uncertain and is usually estimated on the basis of past. Therefore, in a business what profits are likely to accrue in the future depends upon its average performance in the past and hence the average profits. Therefore, while valuing the goodwill, the buyer always takes the assurance of future, maintainable profits in his mind. Ultimately it results in the earning capacity of the business. Earning capacity of the business depends upon the following factors:

(a) **Nature of Goods.** Profits depend upon nature of goods. If business deals in articles of daily use, profits are likely to be constant. More than constant profits, the more is the goodwill or vice versa.

(b) **Monopolized Business.** A monopolized business will have more goodwill as compared to a business in which many rivals can enter the business.

(c) **Trade Name.**

(d) **Risk Involved.** Greater the risks involved higher are the profits.

(e) Favorable Location and Site.

(f) Possession of Trademarks, Patents and Copyrights.

(g) Access to Suppliers.

(h) **Capital Required.** If two business units earn the same profits with different amounts of capital, the business unit with lesser amount of capital requirements will enjoy more goodwill.

The profit earned by the company may be subscribed to certain adjustments like abnormal loss, abnormal gain, recurring and non recurring income and expenses.

I. Simple Average Profit.

Illustration 1: The following particulars are available in respect of business carried on by Mr. Vishal

Profits earned : 2005 – Rs. 6,00,000
2006 – Rs. 4,80,000
2007 – Rs. 5,70,000

You are required to calculate the value of goodwill on the basis of 2 years purchase of average profit of last 3 years.

Solution :

(i) Average Profits = $\dfrac{6,00,000 + 4,80,000 + 5,70,000}{3} = 5,50,000$

(i) Goodwill is based on the number of years purchase on average profit = Average Profit X Number of years of Purchase
= 5,50,000 X 2 = Rs. 11,00,000

Illustration 2 : From the following calculate the value of goodwill on the basis of 5 years purchase of the average profits of the preceding 7 years:

2003	Profit Rs. 80,000
2004	Profit Rs. 90,000
2005	Profit Rs. 1, 10,000
2006	Loss Rs. 50,000
2007	Profit Rs. 1,00,000
2008	Loss Rs. 60,000
2009	Profit Rs. 85,000

Solution :

Year	**Profit or Loss**
2003	(+) 80,000
2004	(+) 90,000
2005	(+) 1,10,000
2006	(-) 50,000
2007	(+) 1,00,000
2008	(-) 60,000
2009	(+) 85,000
Total Profit	(+) 3,55,000

Average Profits = $\dfrac{\text{Total profits after reducing loss}}{\text{Total No. of years including loss}}$

$= \dfrac{3,55,000}{7} = \text{Rs. } 50,714.2857$

Rounded off to Rs. 50714

Goodwill is based on Number of years of purchase of Average Profit =
Average Profit X Number of years of purchase
50,714 X 5 = Rs. 2,53,570

Illustration 3 : Gurukalam and Co. decided to purchase a business for Rs. 24,00,000. Its profits for the last four years were 2005 – Rs. 6,00,000; 2006 – Rs. 7,50,000; 2007 – Rs. 7,20,000 and 2008 – Rs. 6,90,000. The owner of the business was personally managing it. A manager to replace him has to be paid Rs. 90,000 p.a.

Calculate the value of goodwill if it is valued on the basis of three year's purchase of the average net profit for the last four years.

Solution :

$$\text{Average Profits} = \frac{6{,}00{,}000 + 7{,}50{,}000 + 7{,}20{,}000 + 6{,}90{,}000}{4} = 6{,}90{,}000$$

Average Profit	Rs. 6,90,000
Less: Manager salary paid	Rs. 90,000
Average future maintainable profit	Rs. 6,00,000

Goodwill is based on number of years of average profit =
Average profit X Number of years of purchase
= 6,00,000 X 3 = Rs. 18,00,000

Illustration 4 : The following information is presented for five years ending 31st March, 2010.

Year ending 31st March	Profit After Tax	Taxation	Transfer to Reserve	Director's Remuneration
2006	6,00,000	2,16,000	1,20,000	48,000
2007	6,60,000	2,40,000	1,44,000	54,000
2008	5,76,000	1,80,000	96,000	54,000
2009	7,80,000	3,00,000	1,80,000	60,000
2010	8,64,000	4,20,000	1,80,000	72,000

Fixed assets revalued and same showed an appreciation of Rs. 60,00,000 (depreciation to be provided for @ 10 per cent). The company has 8 per cent preference share capital of Rs. 12,00,000. The current rate of taxation may be taken @ 50 per cent. Calculate the value of goodwill on the basis of four year's purchase of the last five years average profits.

Solution : Calculation of future average maintainable profits.

Year	Profit after Tax	Taxation	Director's Remuneration	Profits before Tax and Director's Remuneration
2006	6,00,000	2,16,000	48,000	8,64,000
2007	6,60,000	2,40,000	54,000	9,54,000
2008	5,76,000	1,80,000	54,000	8,10,000
2009	7,80,000	3,00,000	60,000	11,40,000
2010	8,64,000	4,20,000	72,000	13,56,000
Total Profit				51,24,000

$$\text{Average Profit} = \frac{\text{Total Profit}}{\text{No. of Years}} = \frac{51,24,000}{5} = 10,24,800$$

	Rs.	Rs.
Profit		10,24,800
Less: Common adjustment		
(a) Depreciation @ 10% on 60,00,000	6,00,000	
(b) Director's Remuneration	72,000	
	6,72,000	
Profit before Tax	3,52,800	
Less: Income Tax @ 50%	1,76,400	
Profit after Tax	1,76,400	
Less: Preference Dividend @ 8% on Rs. 12,00,000	96,000	
Future Average Maintainable Profit		80,400

Goodwill is based on number of years of average profit =
Average profit X Number of years of purchase
80,400 X 4 = Rs. 3,21,600

Note: Director's remuneration has been taken as Rs. 72,000 because hereafter it would not be less than this amount in the future.

3. Super profit method

Goodwill, no matter how determined, represents a valuation of future earnings. As per the first definition of goodwill, it presents the value of firm's anticipated 'excess' earnings. If there are no anticipated excess earnings over normal earnings, there can be no goodwill. Thus goodwill is paid by the buyer only if the business that is being purchased is earning profits in excess of normal rate of earnings. So the excess of average profit over normal profit is known as super profit.

Defined in another way, super profit is the excess of profit which can be expected in future years over and above what is necessary for paying a fair return on capital employed, considering the risk involved in that class of business and fair managerial remuneration.

It is such excess profit that is referred to as super profit and represents the difference between the average profit earned by the business and the normal profit based on the normal rate of return for representative firms in the industry. Hence, this method of valuing goodwill will require the following information :

(1) A normal rate of return for representative firm in the industry;
(2) The fair value of capital employed; and
(3) The estimated future earning of the firm, i.e., average of the profits earned in the past three or four years. Each has been discussed below :

(A) Normal Rate of Return. The normal earning is that rate of earning which investors in general expect on their investments in a particular type of industry. This rate of earning differs from industry to industry. The normal rate of earnings is required to be adjusted in the light of certain circumstances such as :

(1) **Higher bank rate.** Any increase in the bank rate increases the expectation of investors and they start hoping higher rate of return.
(2) **General boom.** When there is a boom in industry the investors start expecting More and normal rate of return is to be increased.
(3)**Risk attached to the investment.** The more the risk, more is the rate of return. Risk may also be due to high amount of borrowing made by the business or nature of business.
(4) **Period of investment**. The longer the period of investment, higher is the rate of return.

(B) Capital Employed. The capital invested in the business brings return as in terms of profit. If there is more capital employed one can expect more return since the profit of a firm can be justified in terms of capital employed only

		Rs.
	Assets (other than goodwill and deferred expenditures like Preliminary expenses, discount, etc.) at market value	XXX
Less:	Liabilities due to outside parties (i.e., creditors, bills payable, debentures, taxation, outstanding bills, etc.) at revised values, if any	XXX

	Capital Employed	XXX

Calculation of Super profit. Super profit is a simple difference between average profit and normal profit. Suppose Rs. 5,00,000 is the average profit and normal profit is Rs. 2,80,000. So Super profit = Average profit minus Normal profit = Rs. 2,20,000.

Illustration 5 : The following particulars are available in respect of the business carried on by a trader :

(1) Profits earned :
2007 Rs. 5,00,000; 2007 Rs. 6,00,000; 2008 Rs. 5,50,000
(2) Normal rate of profit 10%
(3) Capital Employed Rs. 30,00,000
(4) Present value of an annuity of one rupee for five years at 10% Rs. 3.78
(5) The profits included non-recurring profits on an average basis of Rs. 40,000 out of which it was deemed that even non-recurring profits had a tendency of appearing at the rate of Rs. 10,000 p.a.

You are required to calculate goodwill : (a) as per five years purchase of super profits, (b) as per capitalization of super profit method, and (c) as per annuity method.

Solution :

Calculation of Average profit :

		Rs.
Profits :	2007	5,00,000
	2008	6,00,000
	2009	5,50,000

		16,50,000

Average Profits (16,50,000 / 3)	5,50,000
Less: Non-recurring profit	40,000
	5,10,000
Add: Non-recurring profit having tendency of Recurring profit	10,000
Average Expected Profits	5,20,000

Calculation of Super Profit:

	Rs.
Average Expected Profits	5,20,000
Less: 10% Normal Profit on Rs. 30,00,000 Capital Employed	3,00,000
Super Profit	2,20,000

(a) Goodwill as per five years purchase of Super Profit (2,20,000 X 5) 11,00,000

(b) Goodwill as per capitalization of Super Profit method

$$2,20,000 \times \frac{100}{10} = \quad 22,00,000$$

(c) Goodwill as per Annuity Method (2,20,000 X 3.78) 8,31,600

4. Capitalization Method

The following are the main steps to be taken in computing goodwill by this method:

(a) Ascertain the average net profit which it is expected will be earned in future;

(b) Capitalize this net profit at the rate which is considered a suitable return on capital invested in a business of the type under consideration;

(c) Find the value of the net tangible assets used in the business, i.e., assets less outside liabilities; and

(d) Deduct the net tangible assets as per (c) from the capitalized profit obtained in (b) and the difference is goodwill.

Illustration 6:A firm earns Rs1,20,000 as its annual profits, the rate of normal profit being 10% .the assets of the firm amount to Rs14,40,000 and liabilities to Rs4,80,000. Find out the value of good will by capitalization method.

Solution:

(i). Total capitalized value of the firm = Actual profit / Normal rate of return

= Rs1,20,000 / 10%

=12,00,000

(ii). Net assets of the firm = total assets-liabilities

= Rs14,40,000-Rs4,80,000

= 960,000

(iii) goodwill = total capital issued value of business-net assets

= Rs12,00,000-Rs9,60,000

= Rs2,40,000

Illustration 7: the following is the balance sheet of Alpha trading Co ltd as on 31st Dec 2015

Liabilities	**amount**	**Assets**	**amount**
Paid up capital : 2,500 equity shares of Rs100 each	2,50,000	Goodwill at cost	25,000
Profit & loss a/c	56,650	Land & building at cost	1,10,000
Bank overdraft	58,350	Plant & machinery at cost less depreciation	1,00,000
Sundry creditors	90,500	Stock at cost	1,50,000
Provision for taxation	19,500	Book debts	90,000
	4,75,000		**4,75,000**

The company commenced operations in 94 with a paid up capital of Rs2,50,000. The profits earned providing taxation have been as follows: 94-Rs61,000; 95-Rs64,000; Rs96-Rs71,500;97-Rs78,000; and 98-Rs85000

You may assume that income tax at the rate of 50% has been payable on these profits.

The average dividend paid by the company for four years is 10% which is taken as reasonable return expected on the capital invested in the business. You are required to ascertain the value of the good will of the company.

Solution:

(i).Calculation of net tangible assets of the business

Particulars	**Amount**	**Amount**
Total assets (less goodwill) (Rs4,75,000-25,000)		4,50,000
Less: Liabilities		
Bank O/D	58,350	
Creditors	90,500	
Provision for tax	19,500	1,68,350
Net tangible assets		2,81,650
(ii)calculation of adjusted annual average profits		
Profits for 5years (Rs61,000+Rs64,000+Rs71,500+Rs78,000+Rs85,000)		3,59,500
Less:		
50% income tax		1,79,750
Adjusted profits		**1,79,750**

$$\text{Adjusted annual average profits} = \frac{1,79,750}{5 \text{ years}}$$

= Rs35,950

(iii)calculation of total capitalized value of the business:

$$\text{Total capitalized value of the firm} = \frac{\text{adjusted profits}}{\text{Normal rate of return}}$$

$$= \frac{Rs35,950}{10\%}$$

$$= 3,59,500$$

(iv)calculation of value of goodwill

Goodwill= total capitalized value of the business –net tangible assets
Rs3,59,500-Rs2,81,650= Rs 77,850

VALUATION OF SHARES

Need for valuation of shares:

- Shares of a limited company have to be valued for different purposes:
- When shares of unquoted private companies should be purchased or sold .
- When controlling number of shares are purchased by a company in another
- When amalgamation or absorption of companies takes place
- For settlement of dissenting shareholders in a reconstruction scheme.
- For assessment of wealth tax, capital gains tax Etc
- For sanctioning loan by financial institution s on the security of shares
- For conversion of preference shares into equity shares
- For advancing loans on the security of shares
- For compensating shareholders on the acquisitions of shares, by the government under a scheme of nationalization.

Factors affecting the value of shares:

The value of shares of a company is greatly affected by the economic, political and social factors, some of which are noted below:

- The economic condition of the country
- The nature of company 's business;
- Other political and economic factors(possibility of nationalization, excise duty on goods produced , etc
- The demand and supply of shares,
- Proportion of liabilities and capital;
- Rate of proposed dividend and past profits of the company,
- Yield of other related shares of the stock exchange etc.

Methods o f valuation of shares

Net asset method	**Yield method**	**Fair value method**
(Or)	(Or)	(Or)
Asset backing method	Market value method	Average of asset backing and yield method
(Or)	(Or)	
Intrinsic value method	Earning capacity method	
(Or)	(Or)	
Breakup value method	Dividend yield method	
(Or)		
Real value method		
(Or)		
Asset –basis method		
(Or)		
Net worth method		

VALUATION OF SHARES

Net Asset Method (or) Intrinsic Value

Illustration 1: The following is the balance sheet of NSC Ltd as on 31st Dec 2015

Liabilities	Amount	Asset	Amount
4,000 `10% pref shares of Rs 100each	4,00,000	Sundry asset at book value	12,00,000
60,000 equity shares of Rs10 each	6,00,000		
Bill payable	50,000		
Creditors	1,50,000		
	12,00,000		**12,00,000**

The market value of 60% of the asset is estimated to be 15% more than the book value and that of the remaining 40% at 10% less than the book value. There is an unrecorded liability of Rs10,000. Find the value of each equity shares (it is to be assumed that preferences shares have no prior claim as to payment of dividend or to repayment of capital.

Solution:

Calculation of Net Asset

Particulars	Amount	Amount
Sundry assets: 12,00,000*60%*115% 12,00,000*405*90%		8,28,000 4,32,000 12,60,000
Less: Current Liabilities	50,000	

Bill payable Creditors Unrecorded liability	 1,50,000 10,000	 2,10,000
		10,50,000
Less: preference share capital		4,00,000
Net asset available for equity shareholders		**6,50,000**

Intrinsic value per share= $\frac{\text{Net assets for equity shareholders}}{\text{No. Of Equity shares}}$

$= \frac{Rs6,50,000}{Rs60,000}$

= Rs10.83

Note: Preference shareholders not having preference does not make any difference here.

Illustration 2: The balance sheet of Saraswati Co Ltd disclosed the following position as on 31st Dec 2015

Liabilities	Amount	Assets	Amount
Share capital : 6,000 equity shares of Rs100 each	 6,00,000	Goodwill	1,65,000
Profit & loss A/c	75,000	Investments	5,25,000
General reserve	2,25,000	Stock	6,60,000
6% debentures	4,50,000	Sundry debtors	3,90,000
Sundry creditors	1,50,000	Cash at bank	60,000
Workmen's savings	3,00,000		

bank A/c			
	18,00,000		**18,00,000**

(i).The profits for the past five years were:

94-Rs30,000; 95- Rs70,000; 96-Rs50,000; 97-Rs55,000; And 98- Rs95,000

(ii).The market value of investment was Rs3,30,000

(iii)Goodwill is to be valued at three years purchase of the average annual profits for the last five years.

Find the intrinsic value of each share.

Solution:

(i)calculation of value of good will

Total profits for 5 years = Rs30,000+Rs70,000+Rs50,000+Rs55,000+Rs95,000

=Rs3,00,000

Average profits per year=Rs3,00,000/5=Rs60,000

Goodwill=Average profits * No of years purchase

=Rs60,000*3years

Rs1,80,000

Calculation of net assets:

Particulars	**Amount**	**Amount**
Asset at market value:		
Goodwill		1,80,000
Investments		3,30,000
Stock		6,60,000
Sundry debtors		3,90,000
Cash at bank		60,000
		16,20,000

Less: Liabilities		
6% debentures	4,50,000	
Sundry creditors	1,50,000	
Workmen's savings bank A/c	3,00,000	9,00,000
Net assets		7,20,000

Calculation of intrinsic value of share = $\dfrac{\text{net assets}}{\text{No. of equity shares}}$

$$= \frac{\text{Rs}7{,}20{,}000}{6{,}000 \text{ shares}}$$

=Rs120

Illustration 3: On 31st March, 2007, the Balance Sheet of a Limited Company disclosed the following position :

Liabilities	Rs.	Assets	Rs.
Issued Capital in Rs. 10 Shares	4,00,000	Fixed Assets	5,00,000
		Goodwill	40,000
Reserves	90,000	Current Assets	2,00,000
Profit & Loss Account	20,000		
5% Debentures	1,00,000		
Current Liabilities	1,30,000		
	7,40,000		**7,40,000**

On 31st March, 2007 the fixed assets were independently valued at Rs. 3,50,000 and goodwill at Rs. 50,000. The net profits for the three years were :

2005 Rs. 51,600; 2006 Rs. 52,000; 2007 Rs. 51,650.

Of which 20% was placed to reserve this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%.

Compute, the value of the company's shares by (a) the assets method, and (b) the yield method.

Solution :

(a) **Value of Shares according to the Assets Method:**

		Rs.
Market value of Fixed Assets		3,50,000
Goodwill (as per valuation)		50,000
Current Assets		2,00,000
Total Value of Assets		6,00,000
Less : Liabilities : 5% Debentures	1,00,000	
Curent Labilités	1, 30,000	
		2, 30,000
Net Assets		3, 70,000

$$\text{Intrinsic Value per share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

$$= \frac{\text{Rs. } 3,70,000}{40,000} = \text{Rs. } 9.25.$$

(b) Value of Shares according to Yield Method :

1. **Calculation of Average Expected Future Profits :**

		Rs.
Profits :	2005	51,600
	2006	52,000
	2007	51,650

	Total Profits for three years	1,55,250

	Average Profits (1,55,250 / 3)	51,750
Less : 20% transferred to reserves (51,750 X 20/100)		10,350

	Average Profits after Reserves	41,400
		-------------

2. **Calculation of Expected Return :**

$$\text{Expected Return} = \frac{\text{Expected Profits}}{\text{Equity Capital}} \times 100$$

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

3. **Calculation of Yield Value of Share :**

$$\frac{\text{Expected Rate}}{\text{Normal Rate}} \times \text{Paid up Value of share}$$

$$= \frac{10.35}{10} \times 10$$

$$= \text{Rs. } 10.35.$$

Illustration 4 : The following particulars are available in relation to Akshaya Ltd. :

(1) Capital : 450 6% preference shares of Rs. 100 each fully paid ; and 4,500 equity shares of Rs. 10 each fully paid.

(2) External liabilities : Rs. 7,500.

(3) Reserves and surplus : Rs. 3,500

(4) The average expected profit (after taxation) earned by the company : Rs. 8,500

(5) The normal profit earned on the market value of equity shares (fully paid) of the same time of companies is 95.

(6) 10% of the profits after tax each year is transferred to reserves.

Calculate the intrinsic value per equity share and the value per equity share according to dividend yield basis. Assume that out of total assets worth Rs. 350 are fictitious.

Solution :

Calculation of Intrinsic Value per Equity Shares

		Rs.
Preference Share Capital		45,000
Equity Share Capital		45,000
Reserves and Surplus		3,500
External Liabilities		7,500
Gross Assets (Equal to total liabilities)		1,01,000
Less : Fictitious Assets	Rs. 350	
External Liabilities	Rs.7,500	7,850
Assets available for Shareholders		93,150
Less : Preference Share Capital		45,000
Assets available for Equity Shareholders		48,150
Number of Equity Shares		4,500

Therefore, Intrinsic Value per Equity Share $= \dfrac{\text{Rs. } 48,150}{4,500} = \text{Rs. } 10.70$

Calculation of value per Equity Share on Dividend Yield Basis

	Rs.
Average Expected Profit (after tax)	8,500
Less : Transfer to Reserve 10%	850

		7,650
Less : Preference Share Dividend	@ 6% on Rs. 45,000	2,700
Expected Profit for Equity Shareholders		4,950

$$\text{Expected Rate of Dividend} = \frac{\text{Expected Profit}}{\text{Equity Share Capital}} \times 100$$

$$= \frac{\text{Rs. } 4{,}950}{\text{Rs. } 45{,}000} \times 100 = 11\%$$

$$\text{Value per Equity Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Profit}} \times \text{Paid up Value of share}$$

$$= \frac{11\%}{9\%} \times \text{Rs. } 10 = \text{Rs. } 12.22$$

KARPAGAM ACADEMY OFHIGHER EDUCATION

DEPARTMENT OFCOMMERCE

I M.COM

DIRECT TAXATION (19CMU206)

QUESTION	OPTION A	OPTION B	OPTION C	OPTION D	ANSWER
Among the five heads of gross total income ------------- income is the first one.	Salary	House property	Business or profession	capital gain	salary
Salary includes---------	Wages	houseproperty	interest	gambling	wages
------------ means payment of gross salary with deducting amount of income tax thereon.	Tax free salary	Taxable salary	Exempted salary	business income	tax free salary
If the employee has completed service of 16 years 6 months and 5 days the number of completed year shall be taken as ---------	16 years	17 years	18 years	22 years	16years
The maximum exemption in case of leave encashment shall be----------	Rs. 2,40,000	Rs.3,50,000	Rs.3,00,000	Rs.5,00,000	Rs.3,00,000
compensation received on voluntary retirement is exempt u/s 10 (10c) to the maximum extent of ------------	Rs. 2,40,000	Rs.3,50,000	Rs.5,00,000	Rs.7,50,000	Rs.5,00,000
Employers contribution to statutory provident fund shall be --------------	fully exempt	exempt upto 12% of salary	Exempt upto 10% of the salary	exempted upto 15% of salary	fully exempt
Employer contribution to Recognized provident fund shall be -----------	fully exempt	fully taxable	exempt upto 12% p.a	exempted upto 15%ofsalary	exempt upto 12% of salary
Interest credited to Recognized Provident	Fully exempt	fully taxable	exempt upto 9.5%	.Exempted upt 14% of	exempt upto 9.5 % of salary

fund shall be -----------			p.a	salary	
Interest credited to unrecognized provident fund shall be----------	Fully exempt	fully taxable	exempt upto 12% p.a	Exempted upt 14% of salary	fully exempt
Payment from statutory provident fund and public provident fund shall be------	taxable	fully exempt	Taxable to the extent of employers contribution and interest thereon.	partly taxable	fully exempt
Pyment from Recognized provident fund after 5 years of service shall be----------	taxable	fully exempt	Taxable to the extent of employers contribution and interest thereon.	partially exempted	taxable to the extemt of empoyers contribution and interest thereon
Pyment from Unrecognized provident fund before 5 years of shall be----------	taxable	fully exempt	Taxable to the extent of employers contribution and interest thereon.	partially exempted	fully exempt
The payment of Gratuity Act was passed in the year -----------	1972	1927	1952	1955	1972
--------------- is a fixed monetary amount paid by employer to the employee for meeting some particular expenses.	Allowances	Perquisites	Basic salary	medical facility	allowance
--------- is determining on the basis of rising prices of commodities in general.	Dearness allowances	City compensatory allowances	Medical allowances .	uniform allowances	dearness allowance
----------- is given to compensate for the high cost of living in capital city.	Medical allowance	City compensatory allowance	Dearness allowances .	lunch allowances	city compensatory allowance

------------- to cover the service of warden in the case of educational institutions.	Wardens hip allowance	Dearness allowance	Medical allowance	non – practicing allowances	warnership allowance
--------- is given to meet the medical expenses of the employees and his family members.	Medical allowance	Uniform allowance	Daily allowance	lunch allowance	medical allowance
----------- is given by the employer to the employee to meet the expenses in connection with rent of the accommodation.	House rent allowance	City compensatory allowance	Medical allowance.	wardenship allowances	house rent allowance
House rent allowance paid to the judge of supreme court is --------------	fully exempt	fully taxable	partially taxable.	none	fully exempt
Children education allowance is exempted upto ---------- per child upto the maximum of two children.	Rs.100p.m	Rs.200 p.m	Rs.300 p.m	RS. 400 pm	Rs.100 p.m.
Hostel expenditure allowance is exempted upto ---------- per child upto the maximum of two children.	Rs.100p.m	Rs.200 p.m	Rs.300 p.m	Rs.400 pm	Rs.300 p.m.
The amount of exemption for running flight allowance is ---------	70% of such allowance or Rs 3,000 p.m	70% of such allowance or Rs.10,000 p.m	fully exempted	Rs. 1500pm	70% of such allowance or Rs.6,000 p.m.
allowances received by an employer of UNO from his employer is -------------	Fully taxable	Fully exempt	partially taxable.	none	fully exempt
While computing salary income deduction are allowed u/s ---------	16	18	19.	20	16
Salary due on last day of every month means ----------	Last day of the respective month	first day of the month	every 15th of the month	every 10th of the month	last day of the respective month
In salary income all perquisites are given u/s--------------	21(3)	19(4)	17 (2)	18(3)	17(2)

Any benefit or amenity allowed by employer to employee is -------------	allowance	Perquisites	Deduction s,	rebate	perquisites
Bonus received under some legal or contractual obligation is called ------------	Statutory bonus	Gratuitous bonus	recognized bonus	unrecognize d bonus	statutory bonus
Provident fund governed by Provident fund Act 1925 is called as ------------	Statutory Provident fund	Unrecognized provident fund	Public provident fun	Recognized provident fund	Statutory provident fund
Tiffin allowance is a ------------	fully taxable allowance	Partially allowance	Fully exempted allowance.	not an allowances	fully taxable allowance
Foreign allowance given to government employee posted abroad is -----------	Fully exempted	fully taxable	partially taxable	rebate	fully exempt
Lunch allowance is a ---------	fully taxable allowance	Partially allowance	Fully exempted allowance.	not an allowances	fully taxable allowance
Statutory limit u/s 16(ii) for deduction of entertainment allowance in case of Government employee is -------------	Rs.5,000	Rs.7,500	25% of employee salary	50 % of salary	Rs.5,000
Commuted value of pension is fully exempted in case of ------------	Govt. Employee	an employee of private sector	an employee of a public sector undertakin g.	all employees	Govt. Employee
Medical allowance received by an employee is ------------- allowance	fully taxable	fully exempt	exempted upto the amount of actual expenditur e incurred on medical treatment.	not taxable	fully taxable
Reduction admissible from tax liability is known as ------------	exemption	deduction	Rebate.	debate	rebate
While computing the exemption limit for House rent allowance ,	basic pay only	basic pay + DA(enters)	basic pay + DA(enters	all allowances	Basic pay + DA(enters)+com mission (Fixed%)

the term salary means--- ------------			) + commission (fixed %)		
The value of rent free accommodation in case of non-government employee, if population is more than 25 lakhs means----------	20% of salary	15 % of salary	7.5 % of salary	10% of the salary	15% of salary
15 days average salary for gratuity is equal to amount multiplied by------------	15/24	15/26	15/30	15/28	15/26
While computing house property income, deduction for interest on loan for the previous year 2015-16 u/s 24 is ----------	fully allowed	Partially allowed	fully taxable	partially taxable	fully allowed
Annual rental value minus municipal taxes = ----------------	Gross rental value	Net annual value	Fair rental value	MRV	Net annual Value
Allowable standard deduction from net annual value u/s 24 is ---------------	30%	40%	50%	60%	30%
In house property income , joint expenses will be apportioned on the basis of -----------	FRV	ARV	MRV	ERV	MRV
House used for the assesses own business, then the annual value is taken as ----------	Let out property	nil	Self occupied property.	full	Nil
If loan is taken for construction on or before 1-4-99 and construction is completed with in 3 years , the allowable deduction will be -------------	Rs.30,000	Rs1,50,000	Rs.1,80,000	Rs.1,50,000	Rs.30,000
Allowable deduction from self occupied house is ------------	Interest on loan	Standard deduction	Joint expenses	loan from house property	Interest on loan

Allowable deduction from net annual value for let out house property will be ----------	Standard deduction	pension	gratuity	entertainment allowance	Standard deduction
If the property used for own business then the net annual value will be	MRV	FRV	Actual rent received	Nil	Nil
Commuted value of pension is fully exempted in case of ------------	Govt. Employee	an employee of private sector	an employee of a public sector undertaking.	all employees	Govt. Employee
While computing house property income, deduction for interest on loan for the previous year 2015-16 u/s 24 is ----------	fully allowed	Partially allowed	fully taxable	partially taxable	fully allowed
Rent actually reveiced by the owner of the house property from the tenant is called ---	Actual rent received	Real rental value	Fair rental value	Annual rental value	Actual rent received
Value of house property has determined by the municipal authorities for levying municipal taxes is known as ------------	Annual rental value	Fair rental value	Municipal rental value	Anual rental value	Municipal rental value
An amount of rent which a similar property can fetch in a similar locality if it is let out is called --------	MRV	FRV	ERV	KRV	FRV
The rent fixed under rent control act wherever applicable is called --------	Standard rental value	Real rental value	Actual rent	Annual rental value	Standard rental value
A higher amount of MRV and FRV subject to standard rent is -----------------	ERV	FRV	MRV	NRV	ERV
Default in collection of rent from the tenants is termed as -------------	Real rent	Actual rent	Unrealised rent.	Annual rent	Unrealised rent.
The sum for which the house property might	Annual value	Realized rent	Expected rent	Monthly rent	Annual value

reasonably be expected to be let from year to year is known as -------------					
Gross annual value minus municipal taxes paid by the assessee is --------------	Net annual value	Gross annual value	Expected annual value	Annual rental value	Net annual value

UNIT - III

Amalgamation of Companies: Concepts and Accounting Treatment as per Accounting Standard:14 (ICAI) (excluding inter- company holdings). Internal Reconstruction – Concepts and Accounting Treatment Excluding Scheme of Reconstruction

AMALGAMATION OF COMPANIES

Amalgamation:

The term amalgamation is used when two or more companies carrying on similar business go into liquidation and a new company is formed to take over their business.

Amalgamation means formation of a new company to take over atleast two existing companies which go into liquidation. Hence in amalgamation, there is birth of a new company with the closure of at least two companies which wind up their business. The business of the companies going into liquidation are transferred to a new company formed for this purpose, in return for a purchase consideration. Therefore in amalgamation, there are minimum of two companies going into liquidation simultaneously and a new company formed at the same time to take over the business of the liquidated companies.

Amalgamation -Two or more liquidations and one formation

Absorption - One liquidation and no formation

External Reconstruction - One liquidation and one formation

Suppose there are two existing companies viz. X Co. Ltd. and Y Co. Ltd.

- **Amalgamation**: A new company XY Co. Ltd. is formed which takes over the business of X Co. Ltd. and Y Co. Ltd. Both the companies X Co. Ltd. and Y Co. Ltd. go into liquidation.
- **Absorption:** An already exiting company X Co. Ltd. takes over business of Y Co. Ltd., which goes into liquidation.
- **External Reconstruction**: A new company Z Co. Ltd. is formed to take over X Co. Ltd. (or Y Co. Ltd.) which goes into liquidation.

Differences between amalgamation and external reconstruction

1. Amalgamation of companies involves liquidation of two or more companies, while external reconstruction involves liquidation of only one company,

2. Amalgamation of companies results in combination of companies, but external reconstruction does not result in any such combination.

Differences between absorption and external reconstruction

1. Absorption of companies does not involve formation of a new company, however, external reconstruction involves formation of a new company,

2. Absorption of companies results in liquidation of one or more companies while external reconstruction results in liquidation of only one company.

3. Absorption of companies involves combination of companies, whereas external reconstruction does not involve any combination.

Accounting Standard (AS-14) and Amalgamation

The Council of the Institute of Chartered Accountants of India has issued Accounting Standard - 14, 'Accounting for Amalgamation' which states the procedure for accounting for amalgamations. This standard is mandatory in nature and effective from accounting periods commencing on or after 1-4 -1995.

The following terms are used in this statement with the meanings specified:

a) Amalgamation means, an amalgamation pursuant to the provisions of the Companies Act, 1956 or any other status which may be applicable to companies.

b) Transferor company means, the company which is amalgamated into another company.

c) Transferee company means, the company into which a Transfer Company is amalgamated.

d) Reserve means, the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability.

Types of Amalgamation

As per this standard there are two types of amalgamation viz.

1. Amalgamation in the nature of merger.

2. Amalgamation in the nature of purchase.

Figure shows the Types of Amalgamations as follows:

Amalgamation in the nature of merger - An amalgamation is in the nature of merger if following conditions are satisfied:

- All assets and liabilities of Transferor Company are taken over by the Transferee Company.
- The shareholders holding at least 90% or more of the equity shares of the Transferee Company become the equity shareholder of the Transferee Company (shares already held by the transferee Company and its subsidiaries are not counted for the purpose of 90% or more limit.
- Consideration for the amalgamation is paid in equity shares by the Transferee Company to the equity shareholder of the Transferor Company (except fractional shares can be paid in cash.)
- Business of the Transferor Company is intended to be carried on by the Transferee Company.
- No adjustment is made in the book values of the assets and liabilities of the Transferor Company by way of revaluation or otherwise, except the adjustments to ensure uniformity of accounting policies. For example , if Transferor Company follows the straight lines method of depreciation for the

fixed assets whereas the Transferee Company follows the diminishing balance method of depreciation, the Transferee Company can adjust the book value of fixed assets of the Transfer Company only for the difference of depreciation between straight line method and diminishing balance method. Such adjustment in the book value of fixed assets will not be treated as revaluation.

Amalgamation in the nature of purchase - An amalgamation will be considered in the nature of purchase if any of the conditions regarding amalgamation in the nature of merger is not satisfied.

These are amalgamations which are in effect a mode by which one company acquires another company and as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued.

Purchase Consideration

Purchase consideration is the amount which is paid by the purchasing (transferee) company for the purchase of the business of the vendor (transferor) company. The purchasing company agrees to pay certain sum of payments to the vendor company called purchase consideration. While determining the amount of purchase consideration special care should be given to the valuation of assets and liabilities of the vendor (transferor) company. The calculation of purchase consideration is very important and may be calculated in the following ways:

(1) **Lump Sum Method.** When the transferee company agrees to pay a fixed sum to the transferor company, it is called a lump sum payment of purchase consideration. For example, if A Ltd., purchases the business of B Ltd., and agrees to pay Rs. 50,00,000 in all, it is an example of lump sum payment.

(2) **Net Worth (or Net Assets) Method.** According to this method, the purchase consideration is calculated by calculating the net worth of the assets taken over by the

transferee company. The net worth is arrived at by adding the agreed value of assets taken over by the transferee company minus agreed value of liabilities to be assumed by the transferee company. While calculating purchase consideration under this method the following points merit attention:

(a) The term 'Assets' will always include cash in hand and cash at bank unless otherwise specified but shall not include fictitious assets as preliminary expenses, discount on the issue of shares or debentures, underwriting commission, debit balance of Profit & Loss Account, etc.
(b) If the particular asset is not taken over by the transferee company, it should not be included in the purchase consideration.
(c) The term 'Liabilities' will mean all liabilities to third parties (i.e., excluding company and shareholders).
(d) The term 'trade liabilities' will include trade creditors and bills payable. It will exclude other liabilities to third party as bank overdraft, debentures, outstanding expenses, tax liability etc.
(e) If a fund or portion of a fund denotes liability to third parties, the sum must be included in the liability as staff provident fund, workmen's' savings bank account, workmen's' profit sharing fund, workmen's' compensation fund (up to the amount of claim, if any).
(f) The 'term liability' will not include past accumulated profits or reserves such as general reserve, dividend equalization fund, reserve fund, sinking fund, capital reserve, securities premium account, capital redemption reserve account, profit and loss account etc., as these are payable to shareholders and not to third parties.
(g) The term 'business' will always mean both the assets and the liabilities.
(h) If any liability is not taken over by the transferee company, the same should not be included in the purchase consideration.
(i) Goodwill (being an intangible asset) value agreed to be paid by the transferee company is added in the purchase consideration.

(j) The consideration for the amalgamation should include any non-cash element at fair value. In case of issue of securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up. Where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective net book values.

(k) Where the scheme of amalgamation provides for an adjustment to the consideration contingent on one or more future events, the amount of the additional payment should be included in the consideration if payment is probable and a reasonable estimate of the amount can be made. In all other cases, the adjustment should be recognized as soon as the amount is determinable [see Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date].

(l) Treatment of Reserves Specified in a Scheme of Amalgamation. Where the scheme of amalgamation sanctioned under a statute prescribes the treatment to be given to the reserves of the transferor company after amalgamation, the same should be followed.

Net worth or net assets method of purchase consideration may be made clear by the following example :

BALANCE SHEET OF KARPAGAM CO. LTD.

As at 31st March, 2005

Liabilities	Rs.	Assets	Rs.
Share Capital		Goodwill	2,80,000
60,000 Equity Shares of Rs.10	6,00,000	Land and Buildings	1,60,000
5% Debentures	1,00,000	Plant and Machinery	2,80,000
Sundry Creditors	60,000	Stock	1,60,000
General Reserve	40,000	Debtors	80,000
Profit and Loss account	2,00,000	Cash	20,000
		Preliminary Expenses	20,000

	10,00,000		10,00,000

Suppose (i) Company **Providence Ltd.,** takes over the business of Company Karpagam Ltd.,; (ii) The value agreed for various assets is : Land and Buildings Rs. 2,50,000, Plant and Machinery Rs. 2,40,000, Goodwill Rs, 2,20,000, Stock Rs. 1,30,000 and Debtors Rs. 80,000; Providence Company does not take over cash but agrees to assume the liability of Sundry Creditors at Rs. 50,000.

The calculation of purchase consideration will be as follows :

Value of assets taken over by Providence Company Ltd., :

	Rs.
Land and Buildings	2,50,000
Plant and Machinery	2,40,000
Goodwill	2,20,000
Stock	1,30,000
Debtors	80,000

	9, 20,000
Less : Sundry Creditors taken over by Providence Co. Ltd.	50,000

Purchase Consideration	**8,70,000**
	------------

(3) **Net Payment Method.** Under this method purchase consideration is calculated by adding the various payments in the form of shares, securities, cash etc. made by the transferee company. No amount of liabilities is deducted even if these are assumed by the purchasing company. Thus purchase consideration is the total of all the payments whether in shares, securities or cash.

Suppose, in the example given above Providence Ltd., agrees to give for every 10 shares in Karpagam Ltd., 15 shares of Rs. 10 each, Rs. 8 paid up; Providence Ltd., also agrees to pay Rs. 1,50,000 cash to discharge the creditors.

The Purchase Consideration will be calculated as under :

Shareholders of Karpagam Ltd. will get :

$60,000 \times \frac{15}{10}$ = 90,000 shares of Rs. 10 each, Rs. 8 paid up	7,20,000
Cash paid to discharge creditors	1,50,000
Purchase Consideration	8,70,000

(4) **Shares Exchange Method.** Under this method purchase consideration is required to be calculated on the basis of intrinsic value of shares. The intrinsic value of a share is calculated by dividing the net assets available for equity shareholders by the number of equity shares. This value determines the ratio of exchange of the shares between the transferee and transferor companies. In some cases the agreed values of the shares of both the companies are given. In that case the purchase consideration is calculated with reference to the value of shares of two companies involved.

Suppose X Ltd. and Y Ltd. are two companies carrying on business in the same line of activity. Their capital is Rs. 60,00,000 and Rs. 20,00,000 (value of each share , Rs. 100). The two companies decided to amalgamate in XY Ltd. If each share of X Ltd. and Y Ltd.

is valued at Rs. 150 and Rs. 250 respectively for the purpose of amalgamation, then purchase consideration will be as under :

	X Ltd.	Y Ltd.
	Rs.	Rs.
60,000 shares of Rs. 150 each	90,00,000	---
20,000 shares of Rs. 250 each	---	50,00,000

Note : While issuing shares to individual shareholders of the selling company, these may be in fractions. A company cannot issue shares in fractions but it can issue fractional certificates or coupons or pay cash for the fractions.

Difference between Amalgamation in the nature of merger and Amalgamation in the nature of purchase

Merger	Purchase
1. There is a genuine mpooli9ng of assets and liabilities of the transferor companies as well as the share holders' interest. As such the shareholders of all the transferor companies conti9nue to have substantial or proportionate share in the equity or management of Transferee Company.	1. One company acquires another. As a consequencx3, the shareholders of the transferor company normally do not continue to have a proportionate share in the equity management of the transferee company.
2. Assets, liabilities and reserves of the transferor company are recorded by the transferee	2. Assets, liabilities and reserves of the transferor company are recorded by the transferee

company at their book values.	company either at book value or at values revised on the basis of their fair values.
3. The balance of P&L A/c of the transferor company aggregated with the balance of the P&L A/c of the transferee company.	3. The balance of P&L A/c of the transferor company is not included in the books of the transferee company.
4. All reserves whether capital or revenue 0of Transferor Company are merged into the reserves of Transferee Company.	4. Only statutory reserves of Transferor Company are taken in the books of Transferee Company in order to preserve their identity.
5. It is always intended to continue the business of transferor company.	5. It may not be intended to continue the business of Transferor Company.
6. All the assets of Transferor Company become the assets of the transferee company.	6. All the assets of Transferor Company may or may not become the assets of the transferee company.
7. Purchase consideration is usually valued at the par value of the shares issued.	7. Purchase consideration is usually valued at the market price of the shares issued.

AMALGAMATION, ABSORPTION AND EXTERNAL RECONSTRUCTION

ACCOUNTING ENTRIES IN THE BOOKS OF THE TRANSFEROR COMPANY:

The books of the transferor company being wound up will be closed in the same way as the books of a partnership firm being dissolved. The following entries are made:

(1) For transferring assets taken over by the transferee company

Realization Account

To Various Assets (individually at book value)

Note. Assets which are not taken over by the purchasing company as cash, bank balance will not be transferred to Realization Accounts. Fictitious assets like preliminary expenses, discount or commission or expenses on issue of shares or debentures, debit balance of profit and loss account are not to be transferred to realization account. Assets on which some provision has been made are to be transferred to realization account at their gross figures and provisions has been made should be transferred along with liabilities.

(2) For transferring liabilities taken over by the transferee company

Various Liabilities (Individually) Dr. (at book value)

To Realization Account

Note. Only those liabilities are to be transferred which have been assumed by the transferee company. Accumulated profits like credit balance of profit and loss account, general reserve, dividend equalization reserve, sinking fund, capital reserve are not transferred to realization account. If there is any fund which partially represents liability and partially undistributed profit, then that portion which represents liability should be transferred to realization account. Trade liabilities include sundry creditors and bills payable but not outstanding bills.

(3) For purchase consideration

Transferee Company's Account Dr.

To Realization Account

(4) For receiving purchase consideration from the transferee company

Bank Account Dr.

Shares in Transferee Company A/c Dr.

To Transferee Company a/c

(5) For assets sold by the transferor company not taken over by the transferee company

Bank Account Dr.

Realization A/c (if loss on sale of assets) Dr.

To Assets Account

To Realization A/c (if profit on sale of assets)

(6) For liquidation expenses

(a) **If the expenses are to be met by the transferor company**

Realization Account Dr.

To Bank Account

(b) **If the expenses are to be met by the transferee company, there are two alternatives:**

First Alternative – no entry.

Second Alternative – the following two entries will be passed:

(i) Transferee Co.'s A/c Dr.

To Bank Account

(ii) Bank Account Dr.
To Transferee Co.'s A/c

(c) **If liquidation expenses are included in the purchase consideration and not paid separately by the purchasing company**

Realization Account Dr.
To Bank Account

(7) For liabilities not taken over by the transferee company when paid by the transferor company

Various Liabilities A/c Dr.
Realization A/c (if excess payment is made) Dr.
To Bank Account
Or Shares in Transferee co. A/c
To Realization A/c (if less payment is made)

(8) For Closing Realization Account

(a) If Profit

Realization A/c Dr.

To Equity shareholders A/c

(b) If Loss

Equity Shareholders A/c Dr.

To Realization A/c

(9) For transferring Preference Share Capital

Preference Share Capital A/c Dr.

To Preference Shareholders A/c

Note. If arrears of dividend are to be paid to preference shareholders, then such excess amount should be debited to realization account and credit to Preference Shareholders Account. If the preference shareholders have agreed to get less than the amount of capital, then reverse entry is to be passed.

(10) For transferring equity share capital and accumulated profit:

Equity Share Capital A/c	Dr.
General Reserve A/c	Dr.
Debenture Redemption Reserve A/c	Dr.
Dividend Equalization Reserve A/c	Dr.
Share Premium A/c	Dr.
Profit and Loss A/c	Dr.
Accident Compensation Fund	Dr
Share Forfeited A/c	Dr.
Profit Prior to Incorporation A/c	Dr.
Any Other Reserve or Fund A/c	Dr.
To Equity Shareholders A/c	

(11) For transferring accumulated loss and expenses not written off

Equity Shareholders A/c	Dr.
To Profit and Loss A/c	
To Discount or Expenses on issue of shares or debentures	
To Preliminary Expenses	

To Underwriting Commission

(12) For paying shareholders

Preference Shareholders A/c Dr.

Equity Shareholders A/c Dr.

To Bank or Shares in transferee company

ACCOUNTING ENTRIES IN THE BOOKS OF THE TRANSFEREE COMPANY

(1) On amalgamation of business

Business Purchase Account Dr. (with the amount of

To Liquidators of Transferor Co purchase consideration)

(2) For recording assets and liabilities taken over

Sundry Assets (Individually) Account Dr. (with book value)

To Sundry Liabilities A/C (Individually) (with book value)

To Reserve Account (with book value)

To Business Purchase Account (with book value)

The difference between debits and credits is adjusted in the reserves of the transferee company.

Note. As per AS – 14, the balance of the Profit and Loss A/C of the transferor company is transferred to General Reserve. If any.

Instead of passing two entries one combined entry can be passed :

Sundry Assets Account Dr.

To Sundry Liabilities

To Profit and Loss Account

To Reserve Account

To Liquidators of the Transferor Co. A/C

The difference between the above mentioned debits and credits is adjusted against the reserve in the books of transferee company.

(3) For making payment to the liquidator of the transferor company.

Liquidator of the Transferor Co. A/C Dr.

To Bank / Share Capital / Securities Premium (if any)

(4) If liquidation expenses are paid by the transferee company

Profit and Loss Account Dr.

To Bank Account

(5) For the formation expenses of the transferee company

Preliminary Expenses Account Dr.

To Bank Account

Amalgamation –Net assets method

Illustration 1 : M Ltd and N ltd agreed to amalgamate on the basis of the following balance sheets as on 31.3.97

Liabilities	**M Ltd**	**N Ltd**	**Assets**	**M Ltd**	**N Ltd**
Share capital	75,000	50,000	Good will	30,000	-

@Rs25 each					
P & L A/c	7,500	2,500	Fixed Assets	31,500	38,800
Creditors	3,500	3,500	Stock	15,000	12,000
Depreciation fund	-	2,500	Debtors	8,000	5,200
			Bank	1,500	2,500
	86.000	**58,500**		**86,000**	**58,500**

The assets and liabilities are to be taken over by a new company formed called O ltd, at book values. P Ltd 's capital is Rs2,00,000 divided into 10,000equity shares of Rs10 each and 10,000 9% preference shares of Rs10 each . P Ltd issued the equity shares equally to the vendor companies and preferences shares were issued for any balance of purchase price.

Pass journal entries in the books of P Ltd and prepare its balance sheet.

Solution:

Statement showing Purchase Consideration (net Assets)

Particulars	M Ltd(Amount)		N Ltd(Amount)	
Sundry assets taken over		86,000		58,500
Less: Liabilities Creditors Deprecation fund	 3,500 -	 3,500	 3,500 2,500	 6,000
Purchase consideration		82,500		52,500
Less: Equity shares issued Equally (1,00,000/2)		50,000		50,000
Value of preference shares issued		**32,500**		**2,500**

Books of P Ltd (Purchasing Company)

Journal entries

Particulars	Debit (amt)	Credit (amt)
Business purchase A/c Dr To Liquidator of M ltd To Liquidator of N Ltd (being purchase price payable to the vendor companies)	1,35,000	 82,500 52,500
Fixed Assets A/c Dr Stock A/c Dr Debtors A/c Dr Bank A/c Dr Good will A/c Dr To creditors A/c To depreciation fund A/c To business purchase A/c (being assets and liability taken over from M Ltd and N Ltd and good will thereon)	70,300 27,000 13,200 4,000 30,000	 7,000 2,500 1,35,000
Liquidator of M Ltd Dr To equity share capital A/c To 9% preference share capital A/c (being payment of purchase price)	82,500	 50,000 32,500
Liquidator of N Ltd A/c Dr To Equity share capital A/c To 9% preference share capital A/c	52,500	 50,000 2,500

Balance sheet of P Ltd as on 31st March 1997

Liabilities	Amount	Assets	Amount

Share capital:		Fixed assets:		
10,000 equity shares of Rs 10 each	1,00,000	Good will		30,000
10,000 9% preference shares of Rs 10 each	1,00,000	Other fixed assets	70,300	
		Less: Dep fund	2,500	67,800
Issued and paid up : 10,000 equity shares of Rs10 each fully paid	1,00,000	Current assets:		
3,500 9% preferences shares of Rs10 each fully paid	35,000	Stock		27,000
(all the above shares were issued for consideration other than cash)		Debtors		13,200
		Bank		4,000
Current liabilities:				
Creditors	7,000			
	1,42,000			**1,42,000**

Illustration 2

The following is the Balance Sheet of Amrita Ltd

Liabilities	Rs.	Assets	Rs.
Share capital	60000	Goodwill	28000
Debentures	10000	Land & building	16000
Sundry creditors	6000	Plant & Machinery	28000
General reserve	4000	Stock	16000
Profit & Loss A/c	20000	Debtors	8000
		Cash	2000
		Preliminary expenses	2000
	100000		100000

Bangalore Ltd takes over the business of Amrita Ltd. the value agreed for various assets are: Goodwill Rs.22000, Land & Building Rs.25000, Plant and Machinery Rs.24000, Stock Rs.13000 and Debtors Rs.8000. Bangalore Ltd does not take over cash but agrees to assume the liability of sundry creditors at Rs.5000. Calculate the purchase consideration.

Solution:

Calculation of purchase consideration

Value of assets taken over:

Goodwill	22000
Land & Building	25000
Plant and Machinery	24000
Stock	13000
Debtors	8000
	92000

Less: Liabilities taken over:

Sundry creditors	10,000
Debentures	5,000
Purchase consideration	**77,000**

Illustration : 3

The balance sheet of Jay Ltd as on 31 March 2011isas follows:

Liabilities	Rs.	Assets	Rs.
Share capital	200000	Goodwill	40000
General reserve	35000	Land & building	90000

Profit & Loss A/c	20000	Plant & Machinery	75000
Debentures	50000	Stock	52000
Sundry creditors	25000	Debtors	58000
		Cash	15000
	330000		330000

Jay Ltd decides to amalgamate into a new company New Ltd which will take over the assets and liabilities of Jay Ltd in the term that holders of each share of Rs.10 in the company would receive one share of Rs.10 each, Rs.5 paid up and Rs.4 in cash. The liquidation expense of Rs.5000 is met by New Ltd. calculate purchase consideration.

Solution:

Calculation of Purchase Consideration

Holder of each share of Rs.10 each will get one share of Rs. 10 each Rs.5 paid up = 100000 Holder of each equity share will get Rs.4in cash (2000x4)= 80000

Purchase consideration = 180000

(Note: Liquidation expense is not included in purchase consideration)

Illustration 4

X Ltd acquired the business of Y Ltd on 31 March 2011 for a purchase consideration of Rs. 55000 to be paid by fully paid equity shares of Rs.10 each. The balance sheets of both the companies on the date of acquisition were as follows:

Particulars	X Ltd	Y Ltd	Particulars	X Ltd	Y Ltd
Equity shares of Rs.10 each	55000	32500	Land & Building	21500	13500
			Plant & Machinery	40000	25000
10 % Preference shares	………	6000	Furniture	7500	5000

	..				
of Rs.10 each			Investment	12500	8000
General Reserve	17000	11000	Inventories	25000	22500
Development	……… ..	4000	Sundry Debtors	8500	5000
Allowance Reserve			Cash & Bank	3000	1500
P&L A/c	7000	5000	Advance Tax	3500	3000
Work men					
Compensation Fund	3000	1500			
10% Debentures	20000	10000			
Fixed	7500	5000			
Deposit(unsecured)	5000	5500			
Sundry creditors	3000	……..			
Bills Payable	4000	3000			
Provision for tax	121500	83500		121500	83500

Debenture holders of Y Ltd will be issued equity shares in X Ltd. Journalize the transactions in the books of X Ltd sand the Balance sheet after amalgamation assuming that the amalgamation is in the nature of purchase. Also give journal entries in the books of the transferor company to close the books.

Solution:

In the books of Y Ltd

(Transferor Company) Closing entries

	Realization A/c Dr		83500	
	To Land & Building A/c			13500
	To Plant & Machinery A/c			25000
	To Furniture A/c			5000

	To Investment A/c To Inventories A/c To Sundry Debtors A/c To Cash & Bank A/c To Advance Tax A/c (transfer of various assets to Realization A/c)			8000 22500 5000 1500 3000
	10% Debentures A/c Dr Fixed Deposit A/c Dr Sundry creditors A/c Dr Provision for tax A/c Dr To Realization A/c (transfer of various liabilities to Realization A/c)		10000 5000 5500 3000	23500
	X Ltd A/c Dr To Realization A/c (purchase consideration due from X Ltd)		55000	55000
	Equity Shares in X Ltd A/c Dr To X Ltd A/c (purchase consideration received)		55000	55000
	10% Preference share capital A/c Dr To Preference shareholders A/c (amount payable to Preference shareholders		6000	6000
	Preference shareholders A/c Dr To Equity Shares in X Ltd A/c (distribution of equity shares received from X		6000	6000

	Ltd)			
	Equity share capital A/c Dr General reserve A/c Dr Development Allowance reserve A/c dr P&L A/c Dr Workmen compensation Fund A/c Dr To equity shareholders A/c (transfer of equity shareholders funds)		32500 11000 4000 5000 1500	 54000
	Equity shareholders A/c Dr To Realization A/c (transfer of loss on realization)		5000	 5000
	Equity shareholders A/c Dr To Equity shares in X Ltd A/c (distribution of equity shares received from X Ltd)		49000	 49000

Realization A/c

To Land & Building A/c	13500	By 10% Debentures A/c	10000
To Plant & Machinery A/c	25000	By Fixed Deposit A/c	5000
To Furniture A/c	5000	By Sundry creditors A/c	5500
To Investment A/c	8000	By Provision for tax A/c	3000
To Inventories A/c	22500	By X Ltd (PC)A/c	55000
To Sundry Debtors A/c	5000	By Equity shareholders A/c	5000
To Cash & Bank A/c	1500	(realization loss)-Bal. figure	
To Advance Tax A/c	3000		
	83500		83500

X Ltd A/c

To Realisation A/c	55000	By Equity shares in X Ltd. A/c	55000
	55000		55000

Preference shareholders A/c

To Equity shares in X Ltd	6000	By 10%Preference share	6000
A/c	6000	capital A/c	6000

Equity shareholders A/c

To Realisation A/c (loss)	5000	By Equity share capital	3250
To Equity shares in X Ltd.	4900	A/c By General reserve	0
A/c	0	A/c	1100
		By Development	0
		Allowance reserve	4000
		By P&L A/c	
		By Workmen compensation	5000
		Fund A/c	1500
	54000		54000

Opening Entries in the books of X Ltd (Transferee Company)

	Land & Building A/c Dr			13500	
	Plant & Machinery A/c Dr			25000	
	Furniture A/c Dr			5000	
	Investment A/c Dr			8000	
	Inventories A/c Dr			22500	
	Sundry Debtors A/c Dr			5000	
	Cash & Bank A/c Dr			1500	
	Advance Tax A/c Dr			3000	
	To 10% Debentures A/c				10000
	To Fixed Deposit A/c				5000
	To Sundry creditors A/c				5500
	To Provision for tax A/c				3000

To Liquidators of Y Ltd A/c			55000
To Capital Reserve (Bal. figure)			5000
(purchase consideration due and assets and liabilities taken over)			
Liquidators of Y Ltd A/c Dr			
To Equity Share capital A/c		55000	
(payment of purchase consideration in equity shares)			55000
10% Debentures A/c Dr			
To Equity Share capital A/c		10000	
(discharge of debentures by issuing equity shares)			10000
Amalgamation Adjustment A/c Dr		5500	
To Development Allowance reserve			4000
To Workmen compensation Fund			1500
(statutory reserves incorporated)			

Balance Sheet of X Ltd as on 1 April 2011 (after amalgamation)

Share Capital		***Fixed Assets***	
12000 equity shares of		Land & Building	35000
Rs.10 Each	120000	Plant & Machinery	65000
Reserves & Surplus		Furniture	12500
Capital Reserve	5000		20500
General Reserve	17000	***Investments Current Assets***	
Development Allowance		Inventories	47500
reserve	4000	Sundry Debtors	13500

Workmen compensation Fund	4500	Cash & Bank	4500
P & L A/c	7000	Advance Tax	6500
Secured Loan		***Miscellaneous Expenditure***	
10% Debentures	20000	Amalgamation Adjustment A/c	5500
Unsecured loan			
Fixed Deposit	12500		
Current liabilities & Provisions	10500		
Sundry creditors	3000		
Bills Payable	7000		
Provision for tax			
	210500		**210500**

Illustration - 6

A Ltd agrees to sell their undertaking to B Ltd on the following terms. B Ltd will pay them Rs.600000 in cash and allot them two fully paid share of Rs.6 each (market value Rs. 7.50 per share) in exchange of every three shares in their own company. The Balance sheet of A Ltd on the date of amalgamation stood as follows:

Share Capital		*Fixed Assets*	
120000 equity shares of		Land &	450000
Rs.6 Each, fully paid up	720000	Building Plant &	218700
Reserves & Surplus		Machinery	
General Reserve	360000	*Current Assets*	273450
P & L A/c	34168	Stock	229500
Creditors	132500	Sundry Debtors	74280
		Bank	738

	1246668	Cash	**1246668**

A ltd will pay their liquidation expenses themselves which amounted to Rs.9000. close the books of A Ltd and give opening entries in the books of B Ltd assuming that the amalgamation is in the nature of purchase.

Solution:

Calculation of purchase consideration

In cash	600000
In equity shares (120000x2/3x7.50)	600000
Purchase Consideration	1200000

Closing entries in the books of A Ltd

	Realisation A/c Dr		1246668	
	To Land & Building A/c			450000
	To Plant & Machinery A/c			218700
	To Stock A/c			273450
	To Sundry Debtors A/c			229500
	To Bank A/c			74280
	To Cash A/c			738
	(transfer of various assets to Realisation A/c)			
	Sundry creditors A/c Dr		132500	
	To Realisation A/c			132500
	(transfer of sundry creditors to Realisation A/c)			
	B Ltd A/c Dr		1200000	
	To Realisation A/c			1200000
	(purchase consideration due from B Ltd)			

	Cash A/c Dr		600000	
	Equity Shares in B Ltd A/c Dr		600000	
	To B Ltd A/c			1200000
	(purchase consideration received)			
	Equity share capital A/c Dr		720000	
	General reserve A/c Dr		360000	
	P&L A/c Dr		34168	
	To equity shareholders A/c			1114168
	(transfer of equity shareholders funds)			
	Realisation A/c Dr		9000	
	To Cash A/c (liquidation expenses paid)			9000
	Realisation A/c Dr		76832	
	To Equity shareholders A/c			76832
	(transfer of profit on realisation)			
	Equity shareholders A/c Dr		1191000	
	To Equity shares in B Ltd A/c			600000
	To Cash A/c			591000
	(distribution of equity shares and cash received)			

Opening entries in the books of B Ltd

	Land & Building A/c Dr		450000	
	Plant & Machinery A/c Dr		218700	
	Stock A/c Dr		273450	
	Sundry Debtors A/c Dr		229500	
	Bank A/c Dr		74280	
	Cash A/c Dr		738	
	Goodwill A/c (Bal. Fig) Dr		85832	

	To Sundry Creditors A/c			132500
	To Liquidators of A Ltd A/c			1200000
	(purchase consideration due and assets and liabilities taken over)			
	Liquidators of A Ltd A/c Dr		1200000	
	To Equity Share capital A/c			480000
	To Security premium A/c			120000
	To Cash A/c			600000
	(payment of purchase consideration)			

RECONSTRUCTION

It means reconstruction of a company's financial structure. It may take place either with or without the liquidation of the company.

MEANING:

In case of Internal Reconstruction the company's existing financial structure is reorganised without dissolving the existing company and without forming a new company. Taking a wider meaning of the term 'Internal Reconstruction' it includes :

i) Alteration of Share Capital under Section 94 to 97.

ii) Reduction of Share Capital under Section 100 to 105.

iii) Variation of Shareholders' Right under Section 106.

iv) Scheme of Compromise/Arrangement under section 391 to 393 and 394 A.

Internal Reconstruction:

The capital of a company is formed to take over the business of an existing company which will be liquidated. The capital of a company is reorganized to enable it to make a fresh beginning, after eliminating accumulated losses.

- Generally , internal reconstruction is preferred by companies over external reconstruction due to the following reason:
- Liquidation of the existing company and formation of new company involve a large number of legal formalities and are also expensive.
- Accumulated losses of the liquidating company cannot be set off against the profits of the newly formed company though the shareholders may be the same, thus an important tax advantage is lost.
- The time span needed for external reconstruction is generally far more than that of internal reconstruction.

Difference between Internal reconstruction and External reconstruction

Internal reconstruction	External reconstruction
1. The company does not loss its identity	1. The company losses its identity
2. The overvalued assets are revalued at their net worth and the losses written off	2. The newly formed company takes over the assets and liabilities of the liquidated company at agreed values.
3. No new company is formed nor is any existing company liquidated. It is the internal matter of a single company.	3. A new company is formed in place of the old company.
4. Debenture holds, creditors and bank overdraft may continue.	4. These parties will have to be settled.

Forms or Methods of Internal reconstruction

1. Alteration of share capital.
2. Reduction of share capital.
3. Variation of shareholders' rights.
4. Scheme of compromise.

Alteration of Share Capital

According to Sec. 94 of the Companies Act, a limited company can, if authorized by its articles of association, alter the capital clause of its memorandum of association in any of the following ways.

a. By increasing its share capital by issue of new shares.
b. By consolidating existing shares of smaller amounts into shares of larger amo9unts.
c. By subdividing the existing share into shares of smaller amounts.
d. By converting fully paid shares into stock 0or stock into fully paid shares.

Accounting entries for alteration of capital

a. For increasing its share capital
   i. Bank A/c Dr
      To Share Application & Allotment A/c
   ii. Share Application & Allotment A/c Dr
      To Share Capital A/c

b. For consolidation of shares:
   Share Capital (old) A/c Dr
      To Share Capital (New) A/c

c. For subdivision of shares:

Share Capital (old) A/c Dr

To Share Capital (New) A/c

d. For conversion of shares into stock:

Share Capital A/c Dr

To Stock A/c

e. For conversion of stock into shares:

Stock A/c Dr

To Share Capital A/c

Reduction of Share Capital

Reduction of capital is unlawful except when sanctioned by the court because conservation of capital is one of the main principles the Company Act. In order to reduce the share capital, the company must be authorized by its articles of association, a special resolution must be passed at general meeting, and confirmation of court etc. is required. A company can reduce its share capital by any of the following ways:

a. By reducing the liability of the shareholders for uncalled capital.
b. By paying off the surplus capital.
c. By reducing paid up capital which is not represented by available assets.

Accounting entries for reduction of share capital

a. For reducing the liability in respect of uncalled capital:

Share Capital (old) A/c Dr

To Share Capital (New) A/c

b. For paying off surplus capital:

i. Share Capital A/c Dr

To Shareholders A/c

ii. Shareholders A/c Dr

To Bank A/c

c. For reducing or cancelling paid up capital which is not represented by available assets:

i. For reducing paid up capital by changing its face value: Share Capital (old) A/c Dr

To Share Capital (New) A/c

To Capital Reduction A/c

For reducing paid up capital without changing its face value:

Share Capital A/c Dr

(amount of reduced capital)

To Capital Reduction A/c

Capital Reduction Account

Capital Reduction Account is a new account opened for transferring that part of capital which is lost or not represented by the assets. It is a temporary account opened for carrying out internal reconstruction. This account will be closed as soon as the scheme is carried out. The balance in Capital Reduction A/c can be used to write off fictitious assets, past losses and excess value of assets. The entry is as follows:

Capital Reduction A/c Dr

To P&L A/c (Debit balance)

To Goodwill A/c

To Preliminary Expenses A/c

To discount on issue of shares/ debentures A/c

To Patents/ Trademarks A/c

To Plant & Machinery A/c

To other Assets A/c

To Capital Reserve A/c (Bal. Fig)

Accounting entries for reduction of capital:

1 **.** Reducing or completely extinguishing liability of the shareholders for uncalled capital

Example:1 A company whose capital consists of 5,000 shares of RS100 each , Rs75 called and paid , decides to reduce the shares into 5,000 shares of Rs 75 each fully paid.

Journal Entry

Particulars	**Debit(amt)**	**Credit (amt)**
Share capital A/c Dr To share capital A/c (being conversion of 5,000 shares of Rs100 each , Rs75 paid up into 5,000 shares of Rs75 each, fully paid up)	3,75,000	 3,75,000

2. **Refunding surplus capital which is found to be in excess of needs of the company**

Example 2: A company whose paid up capital includes 10,000 equity shares of Rs100 each fully paid decides to return Rs20 per share to the members, thus reducing each shares to Rs80 each ,fully paid .

Journal entry

Particulars	**Debit (amt)**	**Credit (amt)**
Equity share capital (Rs100) A/c Dr To equity share capital (Rs80) A/c To sundry shareholders A/c (being conversion of 10,000 shares of Rs100 each into shares of Rs80 each and the balance to be returned transferred to the members)	10,00,000	 8,00,000 2,00,000
Sundry shareholder A/c Dr To bank A/c (being return of capital to shareholders ad per the scheme)	2,00,000	2,00,000

3.Cancelling or writing off lost capital , not represented by assets

(a) .When face value of the shares is changed or the rate of preference dividend is changed , thus changing the category of the share.

Example 3: 5,000 equity shares of Rs10 each are reduced to fully paid shares of Rs6 each.

Journal entry

Particulars	**Debit (amt)**	**Credit (amt)**
Equity share capital (Rs10) A/c Dr	50,000	
To equity share capital (Rs6)A/c		30,000
To capital reduction A/c		20,000
(being conversion of 5,000 shares of Rs10 each into shares of Rs6 each fully paid, balance transferred to capital reduction A/c)		

When there is no change in the face value of the share or rate of preference dividend, thus resulting in no change in the category of the share.

Example 4: A company decides to reduce Rs3 per share on its 80,000 equity shares of rS10 each , fully paid.

Journal Entry

Particulars	**Debit (amt)**	**Credit (amt)**
Equity share capital A/c Dr	2,40,000	
To capital reduction A/c		2,40,000

4 .when debenture holders or creditors make some sacrifice as a part of capital reduction scheme

Example 5: As per the capital reduction scheme adopted by a company,5,000 7%debentures of Rs100 each and the trade creditors have agreed to reduce their claims by Rs50,000

Journal Entry

Particulars	**Debit (amt)**	**Credit (amt)**
7% debenture A/c Dr	1,00,000	
Creditors A/c Dr	50,000	
To capital reduction A/c		1,50,000
(being reduction of Rs20 per debenture on 5,000 debentures and reduction of creditors as per capital reduction scheme)		

5.When there is appreciation in the value of any of the assets

Example 6: On the date of capital reduction , accompany finds that its buildings have appreciated by Rs40,000 and the value of stock has gone up by Rs30,000

Journal Entry

Particulars	Debit (amt)	Credit (amt)
Buildings A/c Dr Stock A/c Dr To capital reduction A/c (being appreciation in the value of assets credited to capital reduction)	40,000 30,000	 70,000

7 .When capital reduction account is used to write off loses, reduce assets, etc as per the approved scheme

Journal Entry

Particulars	Debit (amt)	Credit (amt)
Capital reduction A/c Dr To profit and loss A/c (Dr balance) To preliminary expenses A/c To discount on issue of shares or debenture To good will A/c To Assets A/c (amount to be reduced) To capital reserve A/c(balance of any) (being losses written off and assets reduced as per capital reduction scheme)	XXX	 XXX XXX XXX XXX XXX XXX

Illustration 7

The following is the balance sheet of Brahma Ltd as on 31 March 2011.

Liabilities	Amount	Assets	Amount
5000 Equity shares of Rs.100 each fully paid 7500 10% Preference	 500000	Plant & Machinery Patents	173000 850000 55000

shares of Rs.100 each	750000	Stock in trade	77000
fully paid Sundry	50000	Sundry debtors	145000
creditors		Profit & Loss A/c	
	1300000		1300000

The company suffered losses and the following scheme was adopted:

i. Equity shares are to be reduced to an equal number of shares of Rs.25 each.
ii. The preference shares to be reduced to an equal number of shares of Rs.50 each.
iii. The amount available to be used to write off Rs.39240 of plant and machinery and Rs.15000 of stock in trade.
iv. Made a provision of Rs.15300 for doubtful debt.
v. The balance being used to write off patents.

Journalize the transactions and prepare the balance sheet after reconstruction.

Solution:

Journals

2011	Equity Share Capital (Rs.100) A/c Dr		500000	
Mar 31	To Equity Share Capital (Rs.25) A/c			125000
	To Capital Reduction A/c (reduction of equity share capital to Rs.25 each)			375000
	10% Preference Share Capital (Rs.100) A/c Dr		750000	
	To Preference Share Capital (Rs.50) A/c			375000
	To Capital Reduction A/c (reduction of preference share capital to Rs.50)			375000

Capital Reduction A/c Dr		750000	
To P&L A/c			145000
To Plant & Machinery A/c			39240
To Stock in trade A/c			15000
To Provision for doubtful debts A/c			15300
To Patents (Bal. Fig)			535460
(utilization of capital reduction A/c)			

Balance Sheet as on 1 April 2011 (after reconstruction)

Liabilities	Amount	Assets	Amount
5000 Equity shares of Rs.25each fully paid	125000	Plant & Machinery (173000- 39240)	133760
7500 10% Preference shares of Rs.50 each fully paid	375000	Patents (850000-535460)	314540
		Stock in trade (55000-15000)	40000
Sundry creditors	50000	Sundry debtors (77000-15300)	61700
	550000		**550000**

Illustration 8

The following is the balance sheet of Jay Ram Ltd as on 31 March 2011

Liabilities	Amount	Assets	Amount
10000 Equity shares of Rs.10 each fully paid	100000	Goodwill	25000
		Other Fixed assets	104000
1000 7% Preference shares of Rs.100 each fully paid	100000	Current assets	95000
		Profit and loss A/c	26000
Sundry creditors	50000		

	250000		250000

It was decided that equity shares of Rs.10 each be reduced to shares of Rs.7 each and 7% preference shares of Rs.100 each be reduced to 8% preference shares of Rs.75 each. The number of shares in each case is to remain the same. It was decided that the amount so available be used for writing of the debit balance in P&L A/c, goodwill A/c and with the balance for writing down the fixed assts. Journalize the transactions and prepare the balance sheet after reconstruction.

Solution:

Journal Entries

2011 Mar 31	Equity Share Capital (Rs.10) A/c Dr To Equity Share Capital (Rs.7) A/c To Capital Reduction A/c (reduction of equity share capital to Rs.7 each)		100000	 70000 30000
	7% Preference Share Capital (Rs.100) A/c Dr To 8%Preference Share Capital(Rs.75)A/c To Capital Reduction A/c (reduction of preference share capital to Rs.75)		100000	 75000 25000
	Capital Reduction A/c Dr To P&L A/c To Goodwill A/c To Fixed assets A/c (utilization of capital reduction A/c)		55000	 26000 25000 4000

Balance Sheet as on 1 April 2011 (after reconstruction)

Liabilities	Amount	Assets	Amount
10000 Equity shares of Rs.7each fully paid	70000	Fixed assets (104000-4000)	100000
1000 8% Preference shares of Rs.75 each fully paid	75000	Current assets	95000
Sundry creditors	50000		
	195000		195000

KARPAGAM ACADEMY OFHIGHER EDUCATION

DEPARTMENT OFCOMMERCE

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DIRECT TAXATION (19CMU206)

UNIT III

QUESTION	OPTION A	OPTION B	OPTION C	OPTION D	ANSWER
Any trade, commerce, manufacture or any adventure in the nature of trade commerce manufactured is defined as ----------------	Business	Profession	Commerce	non-business	business
------------ refers to those activities where the livelihood is earned by the person through their intellectual or manual skill.	Business	Trade.	Profession	commerce	profession
Profession includes,----------	doctor	business	trading	distribution	doctor
The accounting system under which any income which relates to the current year is taken into consideration for computing business profit is called as --------	Mercantile system	cash system	Credit system	debit system	cash system
The accounting system under which transactions are recorded on the basis of receipts and payments whether it is relating to current year or not is called ------	Mercantile system	cash system	Credit system	debit system	Mercantile system
Income tax wealth tax and advance income tax are ---------	disallowed expenses	Allowed expenses	Deductions	rebate	disallowed expenses
Cultivation expenses are ----------	disallowed expenses	Allowed expenses	Deductions	rebate	disallowed expensed
Expenditure incurred for acquiring know-how and patents shall qualify for depreciation @ -----------	20%	25%	30%	40%	25%
While computing business income speculation loss is ------------	Allowed expenditure	Disallowed expenditure	Not an expenditure.	None	disallowed expenditure
In a business if any payment more than Rs.20,000 is made in cash the disallowed deduction will be -----------	25%	30%	75%	100%	100%

--					
Patent right is --------	Tangible asset	Intangible asset	An allowance	fixed asset	Intangible asset
Profit on sale of license is taxable under the head-----------	Profits and gains of business or profession	House property	Capital gain	other sources	house property
Any expenditure incurred to acquire technical know-how developed in India by an approved institution can be depreciated @---------	20%	25%	30%	40%	25%
Amount of expenditure incurred on or after 01.04.1998 on preliminary expenses cannot exceed------------- of the cost of project	2%	4%	5%	7%	2%
copy right is --------	Tangible asset	Intangible asset	An allowance	fixed asset	Intangible asset
Depreciation is allowed on professional books -----------	100%	50%	60%	40%	60%
Consultancy fee received by a lawyer is ---------- income	Taxable	Non- taxable	Not a fee	exempted	taxable
All those assets to which one rate of depreciation is applicable are known as ---------	Block of assets	Exempted assets	Deductable assets	total assets	block of assets
The actual cost of acquisition of asset minus depreciation equal to -------	WDV	Annuity value	Block of assets	exempted assets	WDV
Balance amount of depreciation not deductible due to insufficiency of income during any particular year is called ------------	Absorbed depreciation	unabsorbed depreciation	Total depreciation	depreciati on	absorbed depreciation
Under Section ---------- following are the income chargeable to tax under the head Profits or Gains from Business or profession	25	26	27	28	28
Profits and Gains of any business or profession that is carried on by the assessee at any time during the --------- ------	assessment year	financial year	fiscal year	previous year	previous year
While determining the depreciation on fixed assets ------- value is taken into consideration	Straight line	written down	annuity	sinking fund	written down

Rate of additional depreciation is charged at --------	10%	20%	30%	40%	20%
disallowed expenses under business income Is ------	income tax	sales tax	excise duty	customs duty	income tax
Household expenses under busiess income is ----	Allowed expenditure	Disallowed expenditure	allowed income	disallowed income	disallowed expenditure
------------ refers to those activities where the livelihood is earned by the person through their intellectual or manual skill.	Business	Trade.	Profession	commerce	Profession
Rate of depreciation on furniture and fittings is @ -------	5%	10%	15%	20%	10%
Rate of depreciation on computers is @ -------	20%	40%	60%	80%	60%
Rate of depreciation on books used for business or profession is @ -------	20%	40%	60%	80%	60%
Expenses, which are debited, to profit & loss a/c, but disallowed by the Income Tax Act and either fully or partially are ------------ with net profit	Added	deduct	multiply	divide	add
Capital gain is classified into ---------- types	Two	Three	Four	five	two
A capital asset held by an assessee for not more than 36 months immediately preceding the date of transfer is called as ------------	Short term capital asset	Long term capital asset	medium capital asset	total capital gain	Short term capital asset
Shares held by an assessee for less than 12 months is termed as ----------	Short term capital asset	Long term capital asset	medium capital asset	total capital gain	Short term capital asset
Capital asset held by an assessee for more than 36 months immediately preceding the date of its transfer ------------	Long term capital asset	Short term capital asset	Medium capital asset	total capital gain	Long term capital asset
Share held by an assessee for more than 12 months is termed as -----------	Short term capital asset	Long term capital asset	medium capital asset	total capital gain	Long term capital asset
Amount of gain arising from the transfer of capital asset is called as ----------------	Capital gain	Profit	Income	receipt	capital gain
Transfer includes,------------	Sale	purchases	distribution	supply	sale

The price which the assessee has incurred for acquisition of capital asset is termed as--------------	Cost of acquisition	cost of improvement	Cost of inflation	selling price	cost of acquistion
Capital expenditure incurred in making any additions or alterations to the capital asset is -----------	Cost of improvement	Cost of inflation	Cost of acquisition	selling price	cost of improvement
Capital assets includes,	purchases	sales	building	trade expenses	building
Capital asset does not include-----------	Stock in trade	Gold bonds	both	none	Stock in trade
Capital gain = _______________ - cost of acquisition (indexed) + cost of improvement	Sale price	Purchase price	Transfer price	total price	sale price
In case of short term capital asset ------------	No indexing	to be indexed	Conversion required	improvem ent	No indexing
In the case of individual and HUF , capital gain arising from the compulsory acquisition of self-cultivated urban land shall be -------------	Fully taxable	Partially taxable	Fully exempted	taxable	Fully exempted
A short term capital asset is the one held for not more than ----------------	48 months	36 months	60 months	72 months	36months
A long term capital gain is the one held the assets for more than --------------	48 months	36 months	60 months	75months	36 months
Rate of tax for long term capital gain is ------------	10%	20%	30%	40%	20%
In capital gain, Exempted assets are given u/s -------------	54	55	56.	60%	55
Rate of tax for short term capital gain (subject to STT) is --------------	10%	15%	30%	40%	15%
Capital gains arising from the transfer of agriculture land owned for 5 years in a rural area are ------------	Taxable as short term capital gain	Taxable as long term capital gain	Exempted from tax	assets	exempted from tax
Gain arising on the transfer of short term capital asset is known as ---------	Short term capital gain	Long term capital gain	Medium term capital gain	liabilities	short term capital gain
Gain arising on the transfer of long term capital asset is known as ----------	Short term capital gain	Long term capital gain	Medium term capital gain	total capital gain	long term capital gain
Amount of gain arising from the transfer of capital asset is called as ----	Capital gain	Profit	Income	receipt	capital gain

------------					
As asset which does not cost anything to the assessee in terms of money in its creation or acquisition is called as ---------	Depreciable assets	Self generated assets	Capital assets	all of the above	depreciable assets
An example to self generated asset is -----------	Goodwill	Land	plant	machinery	goodwill
Transfer of an under taking for a lump sum consideration without assigning values to individual assets and liabilities is termed as -------------	Slump sale	Transfer	Extinguishments	relinquish ments	slump sale
The term ------------- means, aggregate value of total assets minus value of liabilities appearing in balance sheet.	Net asset	Net liability	Net worth	total worth	net asset
Capital gain is taxable to ---------------	all assesses	only residents	only citizens	NRI	all assessees
Long term capital loss can be set off from --------------	short term capital gain	long term capital gain	both long and short term capital gain.	any income	long term capital gain

UNIT- 1V

Accounts of Holding Companies/Parent Companies: Preparation of Consolidated Balance Sheet with One Subsidiary Company – Relevant Provisions of Accounting Standard: 21(ICAI)

ACCOUNTS OF HOLDING COMPANIES/ PARENT COMPANIES

INTRODUCTION

One of the popular firms of business combination is by means of holding company or Parent Company. A holding company is one which directly or indirectly acquires either all or more than half the number of Equity shares in one or more companies so as to secure a controlling interest in such companies, which are then known as subsidiary companies. Holding companies are able to nominate the majority of the directors of subsidiary company and therefore control such companies. Holding company meet directly from such subsidiary company or it may acquired majority OR shares in existing company. Such company also considered as subsidiary company in which holding company acquired majority shares.

MEANING UNDER COMPANIES ACT 1956

A holding company is the company that holds either the whole of the share capital or a majority of the shares in one or more companies so as to have a controlling interest in such companies. Such other companies are known as subsidiary companies. Unlike in amalgamation or absorption, the subsidiary companies retain their identities because they do businesses in their own names.

Section 4 of the companies Act, 1956 defines a subsidiary company. A company is a subsidiary of another if and only if –

a) That other company controls the composition of its Board of Directors; or

b) That other –

i) Where the first mentioned company is an existing company in respect of which the holders of Preference shares issued before the commencement of this Act have the same voting rights in all respect as the holders of Equity shares exercises or controls more than half of the total voting power of such company.

ii) Where the first mentioned company is any other company, holds more than half in nominal value of its Equity share capitals. OR

iii) The company is a subsidiary of any company which is that other company's subsidiary.

ADVANTAGES OF HOLDING COMPANIES

Following are the advantages of Holding Company:

1) Subsidiary company maintained their separate identity.

2) The public may not be aware the existence of combination among the various company.

3) Holding company need not to be invest entire amount in the share capital in subsidiary company still enjoy controlling power in such company.

4) It would be possible to carry forward losses for income tax purposes.

5) Each subsidiary company prepares its own accounts and therefore financial position and profitability of each undertaking is known.

6) Holding company may additional acquired or disposed of and the shares in subsidiary company in market whenever if desired.

DISADVANTAGES OF HOLDING COMPANIES

1) There is a possibility of fraudulent manipulation of accounts.

2) Intercompany transaction may not be at fair prices.

3) Minority share holder's interest may not be properly protected.

4) The accounts of various companies may be made upon different dates to, manipulate profit or financial position of Group companies.

5) The shareholders in the holding company may not be aware of true financial position of subsidiary company.

6) Creditors and outsiders shareholder in the subsidiary company may not be aware of true financial position of subsidiary company.

7) The Subsidiary Companies may be force to appoint person of the choice of holding company such as Auditors, Directors other officers etc. at in dually high remuneration.

8) The Subsidiary Company may be force for purchases or sale of goods, certain assets etc. as per direction of holding company.

PRESENTATION OF ACCOUNTS BY HOLDING COMPANIES

As laid down in section (212) of the companies Act, 1956. A holding company requires to attach its balance sheet. The following documents and present the same to its shareholders.

a) A copy of the Balance Sheet of the subsidiary.

b) A copy of the Profit and Loss Account of the subsidiary.

c) A copy of the Report of the Board of Directors of the subsidiary.

d) A copy of the Auditors Report of subsidiary.

e) A statement indicating the extent of holding company's interest in the subsidiary at the end of the accounting year of the subsidiary.

f) Where the financial year of the subsidiary company does not coincident with the financial year of the holding company. A statement showing the following.

i) Whether there are any changes in holding companies interest in subsidiary company since the close of financial year of the subsidiary company.

ii) Details of material changes which have occurred between the end of the financial year or the subsidiary company an end of the financial year of the holding company.

1.6 AS. 21 – Consolidation of Financial statement

AS. 21 come into effect in respect of accounting periods commencing on or after 1st April i.e. for year ending 31st March 2002. The A.S. 21 is applicable to all the enterprises that prepare consolidated financial statement. It is mandatory for Listed companies and Banking companies.

As per AS 21, The Consolidated financial statements would include:

i) Profit & Loss A/c

ii) Balance sheet

iii) Cash flow statement

iv) Notes of Accounts except typical notes.

v) Segment reporting

AS 21 also desire various import terms, as well as treatment and same while preparing consolidated financial statement. Consolidated financial statements should be prepared for both domestic as well as foreign subsidiaries.

CONSOLIDATION OF BALANCE SHEET

A holding company is required to present to its shareholders consolidated balance sheet of holding company and its subsidiaries. Consolidated balance sheet is nothing but addicting of up or combining the balance sheet of holding and its subsidiary together. However assets and liabilities are straight forward, i.e. added line to line and combination of share capital, reserves, and accumulated losses are not directly added in consolidated balance sheet.

Preparation of Consolidated Balance Sheet.

The following points need special attention while preparing consolidated balance sheet.

1) Share of holding company and share of minority (outside shareholders).

2) Date of Balance sheet of holding company and that of various subsidiary companies must be same. If they are not so necessary adjustment must be made before consolidation.

3) Date of Acquisition of control in subsidiary companies.

4) Inter company owing.

5) Revaluation of fixed assets as on date of acquisition, depreciation, adjustment on revaluation amount etc. which are discussed here in after.

- **COST OF CONTROL / GOODWILL / CAPITAL RESERVE :**

The holding company acquires more than 50% of the shares of the subsidiary company. such shares may be acquired at a market price. Which may be at a premium or at discount. This amount is reflected in the balance sheet of holding company of the assets side as investment in the shares of subsidiary company. This is the price paid for shares in net assets of subsidiary company as on date of its acquisition. Net assets of the subsidiary company consist of share capital, accumulated profits and reserve after adjustment, accumulated losses as on the date of acquisition.

If the amount paid by the holding company for the shares of subsidiary company is more than its proportionate share in the net asset of the subsidiary company as on the date of acquisition, the difference is considered as goodwill.

If there is excess of proportionate share in net assets of subsidiary company intrinsic of shares acquired and cost of shares acquired by holding company there will be capital reserve in favour of holding company.

It goodwill already exists in the balance sheet of holding company or both the goodwill thus calculated, will be added up to the existing goodwill. Capital Reserve will be deducted from Goodwill. In short, net amount resulting from goodwill and capital Reserve will be shown in the consolidated Balance sheet.

• MINORITY INTEREST:

The claim of outside shareholders in the subsidiary company has to be assessed and shown as liability in the consolidated balance sheet. Minority interest in the net assets of the company is nothing but the proportionate share of aggregation of share capital, reserve surpluses funds etc. proportionate share of all assets should be deducted from the minority interest.

Thus, minority interest is the share of outsider in the following.

1) Share in share capital in subsidiary.

2) Share in reserves (Both pre and post acquisition of subsidiary).

3) Share in accumulated losses should be deducted.

4) Proportionate share of profit or loss on revaluation of assets.

5) Preference share capital of subsidiary company held by outsiders and dividend due on such share capital, if there are profits. Minority interest means outsiders interest. It is treated as liability and shown in consolidated Balance sheet as current liability. This amount is basically intrinsic value of shares held by minority.

• CAPITAL PROFITS AND REVENUE PROFITS :

The holding company may acquire the shares in the subsidiary company either on the balance sheet date or any date earlier than balance sheet date. All the profit earned by the subsidiary company till the date of acquisition of shares by holding company have to be taken as capital profits for the holding company.

Such reserves lose their individual identity and considered as capital profits. In case, the holding company acquired shares on a date other than balance sheet date of subsidiary, the profits of subsidiary company will have to be apportioned between capital profits and Revenue profits from the point of view of the holding company. Thus any profit earned by subsidiary company before the date of acquisition is the capital profit, while any profit earned by subsidiary company after the date of acquisition is Revenue profits.

While preparing the consolidated balance sheet share in capital profits should be adjusted with the cost of control and Revenue profits / Reserves should be merged with the balances in the Reserve and surpluses of the holding company.

• ELIMINATION OF INVESTMENTS IN SHARES OF SUBSIDIARY COMPANY

Investment in shares in subsidiary company represents the cost paid by the holding company to acquire the shares of the subsidiary company. The investment in shares of the subsidiary company entitles the holding company to share the net assets of the subsidiary company. While preparing consolidated balance sheet all the assets and liabilities of subsidiary company have to be merged with those of the holding company and therefore it is logical to eliminate investments of the holding company in the shares of the subsidiary company. Share in net assets of the outside shareholders should treat as the minority interest it is shown in the balance sheet on the liability side of holding company.

• MUTUAL OWING / INTER COMPANY TRANSACTIONS :

The holding company and the subsidiary company may have number of inter company transactions in any one or more of the following matters.

1. Loan advanced by the holding company to the subsidiary company or vice versa.

2. Bill of Exchange drawn by holding company on subsidiary company or vice versa.

3. Sale or purchase of goods on credit by holding company form subsidiary company or vice versa.

4. Debentures issued by one company may be held by the other.

As a result of these inter company transactions, certain accounts appear in the balance sheet of the holding company as well as the subsidiary company. In the consolidated balance sheet all these common accounts should be eliminated.

For e.g.

1. S Ltd. has taken loan of Rs. 20,000 from H Ltd. then S ltd. balance sheet shows a liability of Rs. 20,000 while H Ltd. balance sheet shows on assets of Rs. 20,000.
2. H Ltd. draws a bill of Rs. 50,000 on S Ltd., then H Ltd. books it will show bills receivable Rs. 50,000 while S Ltd. books will show bills payable Rs. 50,000.
3. S Ltd. issued debentures of Rs. 1,00,000 which are held by H Ltd. then S Ltd. balance sheet will show a liability of Rs. 50,000 while H Ltd. books will show an assets of Rs. 50,000.

All the above inter company transactions have to be eliminated while preparing the consolidated balance sheet. These can be done by deducting inter company transactions from the respective items on both sides of balance sheet.

• UNREALIZED PROFIT:

The problem of unrealized profit arises in those cases where the companies of the same group have sold goods to each other at the profits and goods still remain unsold at the end of the year company to whom the goods are sold. While preparing the consolidated balance sheet, unrealized profit has to be eliminated from the consolidated balance sheet in the following manner.

1. Unrealized profits should be deducted from the current revenue profits of the holding company.

2. The same should be deducted from the stock of the company consolidated balance sheet. Minority shareholders will not be affected in any way due to unrealized profits.

• CONTINGENT LIABILITIES:

As 29 defines a contingent liabilities as:

A possible obligation that arises from past events and whose existence will be confirmed only by occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity or a present obligation that arises from the past events but not recognized / provided.

Types of contingent liability

a) External contingent liability.

b) Internal contingent liability.

Internal contingent liability relates in respect of transactions between holding and subsidiary company and it will not be shown as foot note in the consolidated balance sheet, as they appear as actual liability in the consolidated balance sheet.

• REVALUATION OF ASSETS AND LIABILITIES :

The holding company may decide to revalue the assets and liabilities of the subsidiary company on the date of acquisition of share in the subsidiary company. Any profit or loss on such revaluation is a capital profit or loss.

Profit on revaluation of assets of the subsidiary company whether before or after date of acquisition of shares by the holding company, the same must be shared by the holding company, and the minority share holders in proportion to their respective holding. The minority share holders share should be added to the minority interest. But the holding company share should be treated as capital profits and considered in cost of control.

Further readjustment for depreciation on increase in the value of assets should be made in the profit and loss account in the subsidiary company. And same should be deducted from the Revenue profits of the subsidiary company.

• **PREFERENCE SHARES IN SUBSIDIARY COMPANY :**

In case the subsidiary company has also Preference share capital, its treatment on consolidation will be as follows:

a) Nominal value of non participating Preference share capital of the subsidiary company is held by the holding company should be adjusted in cost of control against the cost of Preference shares.

b) Preference shares held by outsiders. Paid up value of such Preference shares should be included in Minority interest.

• **BONUS SHARES:**

The issue of bonus shares by the subsidiary company will increase the number of shares held by the holding company as well as by the minority share holders without any additional cost. However ratio of holding will not change. Issue of bonus shares may or may not affect the cost of control depending upon whether such shares are issued out of capital profits or revenue profits.

i) Issue of bonus shares out of pre acquisition profits (capital profits): In case the subsidiary company issues bonus shares out of capital profits the cost of control remains unaffected in the consolidated balance sheet on account of issue of bonus shares. As share capital increases by the amount of bonus and capital profits decreases by the same amount. Hence, there is not effect on cost of control when bonus shares are issued from pre acquisition profits.

ii) Issue of bonus share of post acquisition profits (Revenue profits): In this case, a part of revenue profits will get capitalized resulting decrease in cost of control or increase in capital reserve. Issue of bonus shares whether out of capital profits or revenue profits will not affect on minority interest. Minority interest will remain unaffected.

• **TREATMENT OF DIVIDEND :**

Dividend paid: When subsidiary company pays dividend, the holding company will naturally receive its due share. On receipt the holding company will debit bank account. However account to be credited depends upon whether dividend received out of pre-acquisition profit or out of post acquisition profit. Dividend received by the holding company out of Pre-acquisition profit should be credited to investment account. Only the dividend out of post acquisition profit should be treated as Revenue income and credited to profit and loss account.

ii) **Proposed dividend :**

In case the subsidiary company has proposed dividend on its shares which is not accounted by the holding company for such dividend due on their investment in subsidiary company profits. Profit may be then analysed between capital Revenue in the usual manner.

iii) **Dividend payable :**

In case subsidiary company has declared dividend and the holding company taken credits for such dividend in its account, following treatments should be given.

1. No adjustment in respect of such dividend should be done in the subsidiary company book.

2. In the holding company books dividend out of pre-acquisition profit should be credited investment account. Dividend out of post acquisition profit should be credited to profit and loss account.

3. In the consolidated Balance-sheet the amount of dividend payable by the subsidiary company will be cancelled against the amount of dividend receivable by the holding company. Dividend payable to minorities may be either included in the minority interest or be shown separately as liability in the consolidated balance sheet.

iv) Intension to propose dividend: In case subsidiary company as intension to propose dividend, such proposed dividend given in adjustment may be completely ignored while preparing the consolidated balance sheet. Alternatively proposed dividend on share capital held by minority may be deducted from minorities' interest and shown separately liability in the consolidated balance sheet.

• **PRELIMINARY EXPENSES:**

The preliminary expenses of subsidiary company may be taken as capital loss or the amount may be added with the amount of preliminary expenses of the holding company.

• **PROVISION FOR TAXATION:**

Any provision for taxation provided by the subsidiary company should be taken to the consolidated balance sheet and be shown on the liability side.

• **PURCHASE OF SHARES IN INSTALLMENT**:

A holding company may purchase shares of the subsidiary company in installments. In such circumstances division of profit between pre and post acquisition will depend upon the lots in which shares are purchased. However, if small purchases are made over the period of time then date of purchase of shares which results in acquiring in controlling interest may be taken as cut of line for division of profits between capital and Revenue.

• **SALE OF SHARES:**

When a holding company disposed off a part of its holding in the subsidiary company and the relationship of holding and subsidiary company continues as it holds majority of shares of subsidiary. Sale of shares by holding company may be treated as follows.

a) Profit or loss on sale of shares should be ascertained and it should be adjusted while ascertaining goodwill or capital reserve. In brief, such loss or gain on sale of share should be considered in cost of control.

b) The minority interest and cost of control should be ascertained on the basis of number of shares held by the holding company and the minority on the date of consolidated balance sheet.

How to prepare Consolidated Balance Sheet of Holding Company

Steps for preparing consolidated balance Sheet of the holding company and its subsidiary company.

1st Step - Add all the assets of subsidiary company with the assets of holding company. But Investment of holding company in Subsidiary company will not shown in consolidated balance sheet because, investment in subsidiary company will automatically adjust with the amount of share capital of subsidiary company in holding company.

2nd step - Add all the liabilities of subsidiary company with the liabilities of holding company. But Share capital of subsidiary company in holding company will not shown in the consolidated balance sheet in the books of holding company. Because, this share capital automatically adjust with the amount of the investment of holding company in to subsidiary company.

3rd Step - Calculate of Minority Interest - First of all we should know what minority interest is. Minority interest is the shareholder but there is not holding company's shareholder. So, when holding company shows consolidated balance sheet, it is the duty of accountant to show minority interest in the liability side of consolidated balance sheet.

4th Step – Calculate cost of capital / Goodwill or Capital Reserve - If holding company purchase_shares of subsidiary company at premium, then the value of premium will be deemed as goodwill or cost of capital and shows as goodwill on the assets side of consolidated balance sheet. But if holding company purchases the shares of subsidiary company at discount, then this value of discount will be capital reserve and show in the liability side of consolidated balance sheet.

5th Step - Treatment of Pre – Acquisition of reserve and profit - Pre – acquisition profit and reserve of subsidiary company will be shown as capital reserve in consolidated balance sheet but the value of minority interest's profit or reserves deducts from it and add in minority interest value.

Total profit before acquisition of subsidiary company = XXXX

Less share of minority interest – XXXX

Value of profit X minority interest's value of shares in subsidiary company / total share capital of subsidiary company.

6th Step - Calculate post acquisition profits - After the date of purchasing the shares of subsidiary company , profit of subsidiary company will also deem of holding company and it include in the profit of holding company and we also separate the part of profit of minority interest and add in minority interest's value and shown in liability side .

7th Step- Elimination of common transactions- All common transaction between holding company and subsidiary company will not show in the consolidated balance. There following common transaction

1. goods sold and goods purchase on credit and the value of debtor or creditor either subsidiary company or holding company will not shown in consolidated balance sheet
2. Value of bill payable or bill receivable of holding company on subsidiary company will also not shown but if some bills value is discounted from third party then either of both company's payable value shown as liability in the consolidated balance sheet .

8th Step-Treatment of Unrealized profit- If subsidiary company sells the goods to holding company or holding company sells the goods to subsidiary company at profit and if such goods will not sold in third party , then the profit will not realized , so such unrealized profit will not credited to profit and loss account . At this time a stock reserve account is opened and all amounts of unrealized profit transfers to this account and this accounts total amount is deducted from closing stock of consolidated balance sheet.

9th Step - Treatment of dividend - If holding company gets the dividends from subsidiary company, then this will divide into two parts. If subsidiary company declare dividend out of capital profits, then this will add in capital reserves in consolidated balance sheet. But, if subsidiary company has declared the profit out of revenue gains, then this dividend will add in general profit and loss account and will shown in the liability side of consolidated balance sheet.

1. A Ltd. acquired 70% interest in B Ltd. On 1.1.2012. On that date, B Ltd. had paid-up capital of 1, 00,000 consisting of 10,000 equity shares of 10 each and accumulated balance in reserve and surplus of 1, 00,000. On that date, assets and liabilities of B Ltd. were also revalued and revaluation profits of 20,000 were calculated. A Ltd. paid 1,30,000 to purchase the said interest.

In this case, the book value of Shares of B Ltd. is calculated as shown below:

70% of the Equity Share Capital 1,00,000	70,000
70% of Reserves and Surplus 1,00,000	70,000
70% of Revaluation Profit 20,000	14,000
	1,54,000

So, H Ltd. enjoyed negative differential of `24,000 i.e. (1,54,000 – 1,30,000).

Illustration 2

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 2012 at a cost of 70 lakhs. The following information is available from the balance sheet of Zed Ltd. as on 31st March, 2012:

Consolidated Financial Statements of Group Companies	in lakhs
Fixed Assets	120
Investments	55
Current Assets	70
Loans & Advances	15
15% Debentures	90
Current Liabilities	50

The following revaluations have been agreed upon (not included in the above figures):

Fixed Assets	Up by 20%
Investments	Down by 10%

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 2012. Exe Ltd. purchased the shares of Zed Ltd. @ 20 per share.

Calculate the amount of goodwill/capital reserve on acquisition of shares of Zed Ltd.

Solution

Revalued net assets of Zed Ltd. as on 31st March, 2012	in lakhs	in lakhs
Fixed Assets [120 X 120 %]	144.0	
Investments [55 X 90 %]		49.5
Current Assets		70.0
Loans and Advances		15.0
Total Assets after revaluation		278.5

Less:		
15% Debentures	90.0	
Current Liabilities	50.0	(140.0)
Equity / Net Worth		138.5
Exe Ltd.'s share of net assets (70%)		96.95
Exe Ltd.'s cost of acquisition of shares of Zed Ltd.		
(70 lakhs – 7 lakhs*)		63.00
Capital reserve		33.95

* Total Cost of 70 % Equity of Zed Ltd	70 lakhs
Purchase Price of each share	20
Number of shares purchased [70/20]	3.5 lakhs
Dividend @ 20 % i.e. 2 per share	7 lakhs

Since dividend received is for pre acquisition period, it has been reduced from the cost of investment in the subsidiary company

Illustration 3

From the following summarized balance sheets of H Ltd. And its subsidiary S Ltd. drawn up at 31st March, 2012, prepare a consolidated balance sheet as at that date, having regard to the following:

(i) Reserves and Profit and Loss Account of S Ltd. stood at 25,000 and 15,000 respectively. In the year 2007, the minority's share of losses actually comes to1,50,000. But since minority interest as on 31.12.2006 was less than the share of loss, the excess of loss of 21,000 is to be added to A Ltd.'s share of losses. Similarly for the year 2008, the entire loss of B Ltd Is to be adjusted against A Ltd.'s profits for the purpose of consolidation. Therefore, upto 2008, the minority's share of B Ltd's losses of 57,000 are to be borne by A Ltd. Thereafter, the entire profits of B Ltd. will be allocated to A Ltd. unless the minority's share of losses previously absorbed (`57,000) has been recovered. Such recovery is fully made in 2011 and therefore minority interest of `33,000 is shown after adjusting fully the share of losses of minority previously absorbed by A Ltd date of acquisition of its 80% shares by H Ltd. on 1st April, 2011.

(ii) Machinery (Book-value `1,00,000) and Furniture (Book value `20,000) of S Ltd. were revalued at `1,50,000 and `15,000 respectively on 1.4.2011 for the purpose of fixing the price of its shares.

[Rates of depreciation: Machinery 10%, Furniture 15%.]

Summarized Balance Sheet of H Ltd. as on 31st March, 2012

	H Ltd	**S Ltd**	**Assets**	**H Ltd**	**S Ltd**
Equity and Liabilities			**Non-current assets**		
Shareholders' funds Share Capital Shares of Rs.100 each	6,00,000	1,00,000	Fixed assets Machinery Furniture Other non-current assets	 3,00,000 1,50,000 4,40,000	 90,000 17,000 1,50,000
Reserves Profit and Loss Account Trade Payables	2,00,000 1,00,000 1,50,000	75,000 25,000 57,000	Non-current Investments Shares in S Ltd.: 800 share 200 each	1,60,000	
	10,50,000	**2,57,000**		**10,50,000**	**2,57,000**

Solution

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2012

Particulars	**Note No**	**Rs**
I. Equity and Liabilities (1). Shareholder's Funds	 1	

(a) Share Capital		6,00,000
(b) Reserves and Surplus		3,44,600
(2) Minority Interest		48,150
(3) Current Liabilities		
(a) Trade Payables	2	2,07,000
Total		**11,99,750**
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets	3	5,97,750
(ii) Intangible assets	4	12,000
(b) Other non- current assets	5	5,90,000
Total		**11,99,750**

ACCOUNTING STANDARD (AS)21

Accounting Standard (AS) 21, 'Consolidated Financial Statements', issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 1-4-2001. An enterprise that presents consolidated financial statements should prepare and present these statements in accordance with this Standard.2 The following is the text of the Accounting Standard.

The objective of this Statement is to lay down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented by a parent (also known as holding enterprise) to provide financial information about the economic activities of its group. These statements are intended to present financial information about apparent and its subsidiary(ies) as a single economic entity to show the economic resources controlled by the group, the obligations of the group and results the group achieves with its resources

Scope

1. This Statement should be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.

2. This Statement should also be applied in accounting for investments in subsidiaries in the separate financial statements of a parent.

Consolidation Procedures

In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries should be combined on a line by line basis by adding together like items of assets, liabilities, income and expenses8. In order that the consolidated financial statements present financial information about the group as that of a single enterprise, the following steps should be taken:

- ❖ the cost to the parent of its investment in each subsidiary and the parent's portion of equity of each subsidiary, at the date on which investment in each subsidiary is made, should be eliminated;
- ❖ any excess of the cost to the parent of its investment in a subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made, should be described as goodwill to be recognized as an asset in the consolidated financial statements;

- ❖ when the cost to the parent of its investment in a subsidiary is less than the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made, the difference should be treated as a capital reserve in the consolidated financial statements;

- ❖ minority interests in the net income of consolidated subsidiaries for the reporting period should be identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent; and

- ❖ minority interests in the net assets of consolidated subsidiaries should be identified and presented in the consolidated balance sheet separately from liabilities and the equity of the parent's shareholders. Minority interests in the net assets consist of:

(a) the amount of equity attributable to minorities at the date on which investment in a subsidiary is made; and

(b) the minorities' share of movements in equity since the date the parent-subsidiary relationship came in existence.

Where the carrying amount of the investment in the subsidiary is different from its cost, the carrying amount is considered for the purpose of above computations.

- ❖ Intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.9

- ❖ Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting

- ❖ In a parent's separate financial statements, investments in subsidiaries should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments

Disclosure:

In addition to disclosures required by paragraph 11 and 20, following disclosures should be made:

(a) in consolidated financial statements a list of all subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held;

(b) in consolidated financial statements, where applicable:

(i) The nature of the relationship between the parent and a subsidiary, if the parent does not own, directly or indirectly through subsidiaries, more than one-half of the voting power of the subsidiary;

(ii) The effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period; and

(iii)The names of the subsidiary (ie s) of which reporting date(s) is/are different from that of the parent and the difference in reporting dates.

COMPUTATION OF CONSOLIDATED BALANCESHEET

Illustration 1:

The following are the liabilities and assets of the holding company H Ltd. and its subsidiary S Ltd. as on 31st December 2014:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital: Shares of Rs. 10 each	400000	200000	Sundry Assets	260000	240000
Profit and Loss Account	80000	20000	Investments: 20000 shares in S Ltd.	300000	
General Reserve	40000	16000			
Current Liabilities	40000	4000			
	560000	240000		560000	240000

H Ltd. acquired the shares of S Ltd. on 31st December 2014. Prepare the

Consolidated Balance Sheet.

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd as on 31st December 2014

Particulars	Note No.	Amount (Rs.)
A. Equity and Liabilities		
Shareholders' Fund		
a. Share Capital	1	400000
b. Reserves and Surplus	2	120000
Current Liabilities		
H Ltd. 40000		
S Ltd. 4000		44000
Total		***564000***
B. Assets		
Non-current Assets		
Fixed Assets		
Tangible Assets – Sundry Assets		
H Ltd. 260000		
S Ltd. 240000		500000
Intangible Assets – Goodwill		64000
Current Assets		Nil
Total		***564000***

Notes to Accounts

Note No.	Particulars	Amount (Rs.)
1.	**Share Capital**	
	Issued and Subscribed	
	40000 Equity shares of Rs. 10 each	**400000**
2.	**Reserves and Surplus**	
	General Reserve	40000
	P & L A/c	80000
		120000

Working Note:

Calculation of Goodwill or Cost of Control:

	Rs.	Rs.
Cost of Shares in S Ltd.		300000
Less: Face value of shares in S Ltd.	200000	
Profit and Loss Account	20000	
General Reserve	16000	236000
Goodwill or Cost of Control		64000

Illustration 2:

The liabilities and assets of the holding company A Ltd. and its subsidiary B Ltd. as on 31st December 2014 are as follows:

Liabilities	A Ltd. Rs.	B Ltd. Rs.	Assets	A Ltd. Rs.	B Ltd. Rs.
Share Capital: Shares of Re. 1 each	72000	36000	Sundry Assets	120000	72000
Profit and Loss Account	18000	12000	Investments: 36000 shares in B Ltd.	45000	
General Reserve	12000	6000			
Current Liabilities	63000	18000			
	165000	72000		165000	72000

A Ltd. acquired the shares in B Ltd. on 31st December 2014. Prepare the Consolidated Balance Sheet.

Solution:

Consolidated Balance Sheet of A Ltd. and its Subsidiary B Ltd. as on 31st December 2014

Particulars	Note No.	Amount (Rs.)
A. Equity and Liabilities		
Shareholders' Fund		
a. Share Capital	1	72000
b. Reserves and Surplus	2	39000
Current Liabilities		
A Ltd. 63000		

B Ltd. 18000		81000
Total		***192000***
B. Assets		
Non-current Assets		
Fixed Assets		
Tangible Assets – Sundry Assets		
A Ltd. 120000		
B Ltd. 72000		192000
Intangible Assets		Nil
Current Assets		Nil
Total		***192000***

Notes to Accounts

Note No.	Particulars	Amount
		(Rs.)
1.	**Share Capital**	
	Issued and Subscribed	
	72000 Equity shares of Re. 1 each	**72000**
2.	**Reserves and Surplus**	
	Capital Reserve	9000
	General Reserve	18000
	P & L A/c	12000
		39000

Working Note:

	Rs.	Rs.
Calculation of Capital Reserve:		45000
	36000	
Cost of Shares in B Ltd.	12000	
Less: Face value of shares in B Ltd.	6000	54000
Profit and Loss Account		9000
General Reserve		
Capital Reserve		

Illustration 3: The following are the liabilities and assets of the holding company P Ltd. and its subsidiary Q Ltd. as on 31st December 2014. P Ltd. acquired 12000

shares in Q Ltd on 31st December 2014. Prepare the Consolidated Balance Sheet.

Liabilities	P Ltd. Rs.	Q Ltd. Rs.	Assets	P Ltd. Rs.	Q Ltd. Rs.
Share Capital: Shares of Re. 1 each Sundry Liabilities	 36000 24000	 15000 9000	Sundry Assets Investments: 12000 shares in Q Ltd.	48000 12000	24000
	60000	24000		60000	24000

Solution:

Share of holdings by P Ltd.in Q Ltd. = 12000 shares out of 15000 shares = 80%
Share of holdings by Outsiders in Q Ltd. = 3000 shares out of 15000 shares = 20%
Consolidated Balance Sheet of P Ltd. and its Subsidiary Q Ltd. as on 31st December 2014

Particulars	Note No.	Amount (Rs.)
A. Equity and Liabilities		
Shareholders' Fund		
a. Share Capital	1	36000
b. Reserves and Surplus		Nil
Minority Interest		3000
Current Liabilities		
P Ltd. 24000		
Q Ltd. 9000		33000
Total		***72000***
B. Assets		
Non-current Assets		
Fixed Assets		
Tangible Assets – Sundry Assets		
P Ltd. 48000		
Q Ltd. 24000		72000
Intangible Assets		Nil
Current Assets		Nil
Total		***72000***

Notes to Accounts

Note No.	Particulars	Amount (Rs.)
1.	**Share Capital** Issued and Subscribed 36000 Equity shares of Re. 1 each	**36000**

Working Note:

Calculation of Minority Interest = 3000 shares of Re. 1 each
= Rs. 3000

Illustration 4: The following are the liabilities and assets of the holding company H Ltd. and its subsidiary S Ltd. as on 31st December 2014:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital: Shares of Rs. 10 each	800000	400000	Sundry Assets	640000	480000
Profit and Loss Account	80000	40000	Investments: 32000 shares in S Ltd. @ Rs. 10 each	320000	
Current Liabilities	80000	40000			
	960000	480000		960000	480000

H Ltd. acquired the shares in S Ltd. on 31st December 2014.
Prepare the Consolidated Balance Sheet.

Solution:

Share of holdings by H Ltd.in S Ltd. = 32000 shares out of 40000 shares = 80%
Share of holdings by Outsiders in S Ltd. = 8000 shares out of 40000 shares = 20%

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as on 31st December 2014

Particulars	Note No.	Amount (Rs.)
A. Equity and Liabilities		
Shareholders' Fund		

a. Share Capital	1	800000
b. Reserves and Surplus	2	112000
Minority Interest		88000
Current Liabilities H Ltd. 80000 S Ltd. 40000		120000
Total		***1120000***
B. Assets **Non-current Assets** **Fixed Assets** Tangible Assets – Sundry Assets H Ltd. 640000 S Ltd. 480000		1120000
Intangible Assets		Nil
Current Assets		Nil
Total		***1120000***

Notes to Accounts

Note No.	Particulars	Amount (Rs.)
1.	**Share Capital** Issued and Subscribed 80000 Equity shares of Rs. 10 each	 **800000**
2.	**Reserves and Surplus** Capital Reserve P & L A/c	 32000 80000 **112000**

Working Notes:

Calculation of Capital Profit:
Profit and Loss Account balance in S Ltd. = Rs. 40000
Share of capital profit due to H Ltd. = 40000x80% = Rs. 32000
Share of capital profit due to Outsiders in S Ltd. =

40000x20% = Rs. 8000

	Rs.	Rs.
of Shares in S Ltd.		320000
Less: Face value of shares in S Ltd.	320000	
Capital Profit	32000	352000
Capital Reserve		32000

Calculation of Capital Reserve:

Calculation of Minority Interest:

	Rs.
Paid up value of Shares held by outsiders in S Ltd. (8000 x10)	80000
Add: Share of capital profit due to Outsiders in S Ltd.	8000
Minority Interest	88000

Illustration 5: The following are the liabilities and assets of the holding company H Ltd. and its subsidiary S Ltd. as on 31st December 2014:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital: Equity Shares of Rs.10 Each	120000	50000	Fixed Assets Current Assets Cash and Bank	100000 115000 70000	60000 20000 10000
8% Preference Shares of Rs. 10 each	40000	10000			
Profit and Loss a/c	25000	10000			
Sundry Creditors	100000	20000			
	285000	90000		285000	90000

H Ltd. acquired 90% of the equity shares of S Ltd. at Rs. 15 per share on 1st January 2015. Prepare the Consolidated Balance Sheet as on 1st January 2015.

Solution:

Share of holdings by H Ltd.in S Ltd. = 90% Share of holdings by Outsiders in S Ltd. = 10%

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as on 1st January 2015

Particulars	Note No.	Amount (Rs.)
A. Equity and Liabilities		
Shareholders' Fund		
a. Share Capital	1	160000
b. Reserves and Surplus	2	25000
Minority Interest		16000
Current Liabilities – Sundry Creditors		
H Ltd. 100000		
S Ltd. 20000		120000
Total		***321000***
B. Assets		
Non-current Assets		
Fixed Assets		
Tangible Assets – Fixed Assets		
H Ltd. 100000		
S Ltd. 60000		160000
Intangible Assets - Goodwill		13500
Current Assets		
Cash & Bank		
H Ltd. (70000 – 67500) 2500		
S Ltd. 10000		12500
Other Current Assets		
H Ltd. 115000		
S Ltd. 20000		135000
Total		***321000***

Notes to Accounts

Note No.	Particulars	Amount (Rs.)

1.	**Share Capital** Issued and Subscribed 12000 Equity shares of Rs. 10 each 4000, 8% Preference Shares of Rs. 10 each	 120000 40000 **160000**
2.	**Reserves and Surplus** Profit and Loss Account	 **25000**

Working Notes:

Calculation of Capital Profit:
Profit and Loss Account balance in S Ltd. = Rs. 10000
Share of capital profit due to H Ltd. = 10000x90% = Rs. 9000
Share of capital profit due to Outsiders in S Ltd. =
10000x10% = Rs. 1000

Calculation of Goodwill:

	Rs.	Rs.
Cost of Shares in S Ltd. (5000x90%x15)		67500
Less: Face value of shares in S Ltd.	45000	
Capital Profit	9000	54000
Goodwill		13500

Calculation of Minority Interest:

	Rs.	Rs.
Paid up value of Shares held by outsiders in S Ltd.		5000
(5000x10%x10)	1000	
Add: Share of capital profit due to Outsiders in S Ltd.	10000	11000
8% Preference Share Capital in S Ltd		16000
Minority Interest		

Illustration 6: The liabilities and assets of the holding company H Ltd. and its subsidiary S Ltd. as on 31st December 2014 are as follows:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital: Shares of Rs. 10	 1200000	 600000	Sundry Assets Investments:	720000	756000
each Profit and Loss a/c General Reserve	 120000 120000	 48000 60000	48000 shares in S Ltd.	780000	

Current Liabilities	60000	48000			
	1500000	756000		1500000	756000

H Ltd. acquired shares in S Ltd. on 1st January 2014. On that date the Profit and Loss Account had a credit balance of Rs. 12000 and in Reserve Rs. 36000. Prepare the Consolidated Balance Sheet.

Solution:

Share of holdings by H Ltd.in S Ltd. = 48000 shares out of 60000 shares = 80%
Share of holdings by Outsiders in S Ltd. = 12000 shares out of 60000 shares = 20%

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as on 31st December 2014

Particulars		**Note No.**	**Amount (Rs.)**
A. Equity and Liabilities			
Shareholders' Fund			
a. Share Capital		1	1200000
b. Reserves and Surplus		2	288000
Minority Interest			141600
Current Liabilities			
H Ltd.	60000		
S Ltd.	48000		108000
Total			***1737600***
B. Assets			
Non-current Assets			
Fixed Assets			
Tangible Assets – Sundry Assets			
H Ltd.	720000		
S Ltd.	756000		1476000
Intangible Assets - Goodwill			261600
Current Assets			Nil
Total			***1737600***

Notes to Accounts

Note No.	Particulars	Amount (Rs.)
1.	**Share Capital** Issued and Subscribed 120000 Equity shares of Rs. 10 each	 **1200000**
2.	**Reserves and Surplus** Profit and Loss Account: H Ltd. 120000 S Ltd. 28800 General Reserve: H Ltd. 120000 S Ltd. 19200	 148800 139200 **288000**

Working Notes:

Calculation of Capital Profit in S Ltd.:

	Rs.
Profit and Loss Account balance on 01/01/2014	12000
General Reserve	36000
Capital Profit	48000

Share of capital profit due to H Ltd. = 48000x80% = Rs. 38400
Share of capital profit due to Outsiders in S Ltd. =
48000x20% = Rs. 9600 Calculation of Revenue Profit:

(a) Profit and Loss Account (48000-32000) = Rs. 36000
H Ltd. = 36000x80% = Rs. 28800
Outsiders in S Ltd. = 36000x20% = Rs. 7200

(b) General Reserve (60000-36000) = 24000
H Ltd. = 24000x80% = Rs. 19200
Outsiders in S Ltd. = 24000x20% = Rs. 4800

Calculation of Goodwill:

	Rs.	Rs.
Cost of Shares in S Ltd.		780000
Less: Face value of shares in S Ltd.	480000	
Capital Profit	38400	518400

Goodwill	261600

Calculation of Minority Interest:

	Rs.	Rs.
Paid up value of Shares held by outsiders in S Ltd.		120000
Add: Share of capital profit due to Outsiders in S Ltd.	9600	
Share of revenue profit due to Outsiders in S Ltd (7200+4800)	12000	21600
Minority Interest		141600

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DIRECT TAXATION (19CMU206)

UNIT - IV

QUESTION	OPTION A	OPTION B	OPTION C	OPTION D	ANSWER
An acknowledgement of debt or claim in the form of debentures and bonds are called as ---------------	Securities Market	Capital market	Money market	Stock market	securities market
Securities of a company which is registered in any one of stock exchanges in India is termed as ----------------	Listed debentures	Unlisted debentures	Tax free debentures	Taxable debentures	Listed debentures
Securities of a company which is not registered in any one of stock exchanges in India is termed as ----------------	Listed debentures	unlisted debentures	Tax free debentures	taxable debentures	unlised debentures
The securities on which interest is receivable with out deduction of tax at source is called -------------	Tax free securities	Taxable securities	Listed securities	not an income	taxable securites
The securities on which interest is receivable after deduction of tax at source is ---------	Tax free securities	Less tax securities	Taxable securities	TDS	tax free securities
Conversion of net interest into gross interest by applying specified rate of TDS is known as ----------	Grossing up	Net value	Total value	Value	Grossing up
Interest on securities after deducting the tax at source is -----------	Net interest	Gross interest	Total interest	Net worth	Net interest

Interest on securities before deducting the tax at source is --------	Net interest	Gross interest	Total interest	Nil value	gross interest
The fifth and residuary head of income as per Income Tax Act 1961 is ------------	Salary	House property	Income from other sources	Capital gain	income from other source
Under the head income from other sources the specified income is given u/s---------	56(1)	56(2)	56(3)	56(4)	56(2)
Under the head income from other sources the general income is given u/s---------	56(1)	56(2)	56(3)	56(4)	56(1)
Standard deduction out of family pension is allowed upto 33 1/3 % of such pension or Rs.------------------ which ever is less	Rs.15,000	Rs.20,000	Rs.30,000	Rs.40,000	Rs.15,000
Remuneration for delivering lectures or writing articles is --------------	General income	Specified income	Gross income	net income	General income
Interest on securities is ------------	General income	Specified income	Gross income	net income	General income
Rate of TDS for listed debentures of a company is ------------	10%	20%	30.00%	40%	10%
Rate of TDS for casual income is ------------	10%	20%	30.00%	40%	30%
Rate of TDS for unlisted debentures with surcharge is ------------	10%	20%	30.00%	40%	10%
Rate of TDS for interest on government securities is ---------------	10%	20%	No TDS	TDS	No TDS
Dividend received from Indian company is --------------	Fully taxable	Partially taxable	Fully exempted	none	fully exempted

Winning from Lotteries, cross word puzzles, horse races and other races et are casual income and hence -----------	Fully exempted	Exempted upto Rs.5,000	Fully taxable	exempted up to RS.15,000	exempted upto Rs.5,000
If total income of individual exceeds Rs. 10,00,000, add surcharge @ --------------	5%	12%	15%	20%	12%
Share of income received by a member of HUF out of HUF income is ------------	Taxable income	Exempted income	Rebate able income	deductable income	exempted income
Bonus shares received by a dealer of shares is a -----------	Capital receipt	Revenue receipt	Exempt income.	taxable income	capital receipt
Rate of TDS on bank interest is ---------------	10%	20%	30%	40%	10%
Income from letting of plant and machinery is taxable under the head -----------	House property	Salary	Income from other sources	capital gain	income from other source
Dividend from foreign company is taxable under the head -------------	Income from other sources	House property	business income	capital gain	Income from other sources
Company formed and registered under companies Act 1956 is called --------------	Indian company	Foreign company	not a company	private company	Indian company
A Company which is not a domestic company is ----------------	Domestic company	Foreign company	Indian company	private company	Foreign company
Gift is taxable under the head income from other sources, if its value exceeds --------	Rs.25000	Rs. 50, 000	Rs.60,000	Rs.80,000	Rs.50,000
Dividend from foreign company is taxable under the head -------------	Income from other sources	House property	business income	capital gain	Income from other sources

Adjustment of any loss against any income with the previous year is called as ----------- of losses	Set off	Carry forward	set off and carry forward	cannot be carried forward	set off
Transfer of unadjusted loss of any previous year to succeeding years to set off against any income is called as ------------- of losses	Set off	Carry forward	set off and carry forward	cannot be carried forward	carry forward
Setting off of losses between the various years within the previous year itself is known as ------------	Interhead adjustment	Intra head adjustment	salary	capital gain	Interhead adjustment
Loss on account of owing and maintaining the race horse can be carried forward for ------	8 years	4 years	Indefinite period	5 years	4 years
Loss under the head house property ---------------	Can be carry forward for 8 years	can not be carried forward	Can be carried forward for 4 years	can be carried forward to 10 years	Can be carry forward for 8 years
Speculation loss can be carried forward for the maximum of -----------	8 years	10 years	4 years	5 years	4 years
Long term capital loss of particular assessment year cab be setoff in the same assessment year from-------------	Short term or long term capital gain	Long term capital gain only	Short term capital gain.	salary income	Long term capital gain only
Short term capital loss of particular assessment year cab be setoff in the same assessment year from-------------	Short term or long term capital gain	Long term capital gain only	Short term capital gain.	total capital gain	Short term or long term capital gain
Loss under the head capital gain in a particular assessment year can -----------	Set off form any other head of income in the same assessment	be carried forward	Neither be setoff not be carried forward	not adjustable	be carried forward

	year				
Section ---------- of Income tax act deal with the provisions regarding set off and carry forward and setoff of losses.	70-79	60-69	80-89	90-95	60-69
Casual income includes ,-------------	house property	interest	gambling	salary	gambling
Speculation loss can be set off from -------------	Speculation gain	capital gain	Business income.	salary income	Speculation gain
Speculation gain can be used to set off ------------	speculation loss only	any other losses also	salary loss	business loss	any other losses also
Expenses on horses for race purpose can be set off only from------------	Capital gain	House property income	Race course winning	salary income	race course winning
Loss from house property can be set off from ------------	Any other head	only house property income	Agriculture income	salary income	any other income
Unrealized rent from house property can be set off only income of -------	Income of another house property	Business income	Income from other sources	other sources income	income of another house property
Loss under the head profits and gains can not be set off from income under the head ---------------	Salaries	House property	Capital gain	professional income	salaries
Short term capital loss can be set off from --------------	short term and long term capital gain	Short term capital gain only	Long term capital gain	total capital gain	short term and long term capital gain
Long term capital loss can be set off only from -------------	Long term capital gain	short term capital gain	Business income	salary	Long term capital gain
There can be no loss under the head ------------	house property	Salary	Capital gain	business income	Salary
Loss under the head house property can be carried forward for ---------	8years	4years	2 years	1 year	8years

Business loss can be carried forward for ------------	4 years	8 years	12 years	10 years	8 years
Unabsorbed depreciation can be carried forward for--------	8 years	10 years	till it is fully adjusted	15 years	till it is fully adjusted
Short term capital loss can be carried forward for ---------------	4 years	8 years	12 years	4 years	8 years
long term capital loss can be carried forward for ---------------	4 years	8 years	12 years	15 years	8 years
Payment of LIC premium can be claimed as deduction u/s ________	80c	80ccc	80D	80DDD	80c
Clubbing of income means ________________.	Addition income of two partners	Collection of income	Inclusion of income of other person in assessee income	Total of income of various heads	Inclusion of income of other persons in assessees income
Premium paid for life insurance is allowed for deductions u/s 80 C up ro	10% of sum assured	20% of sum assured	30% of sum assured	40% of sum assured	20% of sum assured
Mr. Sharma contributed to a political party, he can avail deduction under _________	.Section 80G	Section 80GGB	Section 80GGC	Section 80GGD	Section 80GGB
Deduction on interest on loan taken for studies fall under ______.	80 CC	80 C	80 E	80 D	80E

UNIT V

Accounts of Banking Companies : Difference Between Balance Sheet of Banking and Non – Banking Companies – Prudential Norms – Asset Structure of a Commercial Bank – Non – Performing Assets (NPA). Cash Flow Statement - Concept of Funds - Preparation of Cash Flow Statement as per Indian Accounting Standard (Ind-AS) : 7

Accounts of Banking Companies

Section 5 of banking regulation act defines banking as “the accepting, for the purpose of lending or investment, of deposit of money from the public repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise.

The Banking Regulation Act was passed as the Banking Companies Act 1949 and came into force with effect from 16.3.49. It had originally ten parts, each dealing with a specific topic. Every Banking company incorporated in India , in respect of all business transacted by it and through its branches in India, shall prepare a Balance Sheet and P/L a/c as on the last working day of the accounting year in the form “A” and “B” given in the third schedule to the Act. The amalgamated Balance sheet and P/L should be signed by the CMD and at least three Directors where there are more than three directors, by all the directors. In case of banking companies incorporated outside India. It should be signed by the principal officer of the company in India. The provisions of Companies Act also apply to banking companies in so far as they are not inconsistent with the provisions of the Act Banks also prepare balance sheet on 30th Sept which is not subjected to audit. Subsequently it was changed to Banking Regulations Act 1949 with effect from 01.03.66. The main aspects of the Act relating to final a/cs are:

- Every bank has to publish its balance sheet as on March 31st (Sec29).
- Balance sheet is to be got audited from qualified auditors. Sec (30 (i))
- Publish balance sheet and auditor’s report within 3 months from the end of period to which they refer. RBI may extend the period by further three months. Sec(31)

- Prevents banks from producing any confidential information to any authority under Industrial Disputes Act. (34A).
- RBI authorised to undertake inspection of banks (Sec 35).
- Certain returns are also required to be sent to RBI by banks such as monthly return of liquid assets and liabilities (24-3), quarterly return of assets and liabilities in India (25), return of unclaimed deposits i.e. 10 years and above (26) and monthly return of assets and liabilities (27-1)

Features of Banking Company

- The borrowing, raising, or taking up of money.
- The lending or advancing of money either upon or without security.
- The granting and issuing of letters of credit, travelers cheques and circular notes.
- The buying and selling of bullion.
- The buying and selling of foreign exchange including foreign bank notes.
- Contracting for public and private loans negotiating and issuing the same.
- Undertaking and executing trust
- The acquisition, constructing, maintenance and alternation of any building or works necessary or convenient for the purpose of the company.
- Carrying on and transacting every kind of guarantee and indemnity business.
- The collecting and transmitting of money and securities.
- Undertaking the administration of estates as executor, trustee or otherwise

General Information

- No banking company can carry on business in India unless its subscribed capital is not less than one- half of the authorized capital and its paid up capital is not less than one – half of subscribed capital.
- A banking company cannot create any charge upon its uncalled capital.
- Every banking co. shall transfer a sum equal to 25% of profits to statutory reserve.
- A bank can open a branch only at the permission or reserve bank

Difference between of Banking and Non –Banking Companies

1.Governing Act: Banking companies are Governed by Banking Companies Act, 1949. Non banking companies are Governed by RBI Act,

2. License: Banking companies must obtain license from RBI for commencement. No license is required for NBCs.

3. Ceiling on deposits: No ceiling on deposits mobilization in banking company. Whereas for NBCs there is a ceiling on acceptance of deposits which is based on the net worth of the company.

4. Capital Structure: For a banking company, Capital structure is decided by RBI, which has a two-tier 1. core capital and 2. Risk-weighted capital. But for NBCs, Capital structure is decided by RBI, which is purely based on business such as lending or Hire Purchase finance or leasing, etc.

5. Balance Sheet: The Balance sheet proforma should be as per the format provided by RBI for a banking company. But for non banking company, the balance sheet is as per the Companies Act.

6. Negotiable instruments: There is use of negotiable instruments such as cheque, bill of exchange for various transactions in a bank. But Negotiable instruments cannot be used for withdrawal of money from Non Banks.

7. Credit Rating: Credit rating is not required for accepting deposits in a banking company. But NBCs has a mandatory requirement of Credit rating for accepting deposits from the public.

8. Types of Accounts: Different types of accounts can be opened by a bank for the benefit of customers in a banking company. A non-banking company can only accept deposits of different duration as prescribed by RBI.

9. Interest on deposit: The interest charged by a bank` on deposits is decided by the banks themselves. It is based on Prime Lending Rate (it is the interest rate charged by the banks while lending on Government securities which have no risks). But for a non banking company, the interest rate on deposits is decided by RBI.

10. Insurance coverage on deposit: All bank deposits are insured up to a certain limit compulsorily with Deposit Insurance Credit Guarantee Corporation. But there is no insurance cover for non banking company deposits.

11. Lending policy: The lending policy of commercial banks is influenced by the monetary policy of RBI. But for the other, Lending policy is more decided by the security offered by the borrower.

12. Joint Operation: All banking companies are necessarily joint stock companies. NBCs can be in the form of Nidhis, Benefit societies etc. However, partnership firms are prohibited now.

13. FOREX Transaction: Commercial banks can undertake transactions in foreign exchange as Authorized Dealers. NBCs cannot undertake transactions in foreign exchange unless they are licensed by RBI.

14. Suspension of operations: Banking companies' operations can be suspended only by RBI. But for NBCs, RBI will only notify the cancellation of registration from accepting deposits in leading newspapers

15. Merger of banks: A banking company can be merged with other commercial banks as per RBI orders. Merger of non-banking will be as per the Companies Act.

16. Periodical Inspection: There can be inspection of banks by RBI periodically. No such approval is required from RBI. But, non banks should comply with the provisions of the Companies Act.

17. Appointment of Chairman & Directors: Appointment of Chairman, and Managing directors in a banking company requires prior approval of RBI. But no such approval is required from RBI for a NBC. But, they should comply with the provisions of the Companies Act.

18. Audit: All commercial banks will come under statutory audit, in addition to RBI audit. For a non banking company, audit is as per the Companies Act.

19. Public Sector: There are public sector commercial banks. But there are no public sector non-banking companies.,

20. Type of Advertisements: Commercial banks can choose any type of advertisement for inviting public deposits. For non banks, advertisements for inviting public deposits should be as per RBI regulations.

21. Customer grievance: For a banking company, consumers' Grievance Cell of respective banks will look after the grievance of customers. Company Law Board is the regulatory authority for non-banking companies in case of non refund of deposits.

22. Recovery of bad debts: Debt-recovery Tribunals are set up by banks for the recovery of bad debts. No such provisions are there for non banking companies.

23. Rate of Interest: Consumer credit is cheaper with banks as interest charged is on a declining rate of interest. But hire purchase finance of NBCs has a flat rate of interest and hence costlier.

24. Legal disputes: Banks are covered under the Bankers' Book Evidence Act by which the statement provided by banks will be taken as an ultimate evidence in any legal dispute. But only provisions of Companies Act are applicable for non banks.

25. Evidence between banker and customer: Savings account and current account are operated in a bank and entries of the savings account are recorded in the pass book and the pass book is regarded as the conclusive evidence between a banker and customer. But there are no such accounts in non-banking companies.

26. Public vs Private limited: All banks have to be necessarily public limited companies. There can be private limited non banking companies.

Accounting System

The accounting system of a banking company is different from that of a trading or manufacturing company. The main features of a bank's accounting system are as follows:

1. Entries in the personal ledgers are made directly from the vouchers
2. From such entries in the personal ledgers each day summary sheets in total are prepared which are posted to the control accounts in the general ledger.
3. The general ledger's trial balance is extracted and agreed every day.

4. All entries in the personal ledgers and summary sheets are checked by persons other than those who have recorded entries. It helps in detection of mistakes.
5. A trial balance of detailed personal ledgers is prepared periodically and gets agreed with the general ledger control accounts.
6. Two vouchers are prepared for every transaction not involving cash.

Books maintained by banks

1. Receiving Cashier's Counter Cash Book.
2. Paying Cashier's Counter Cash Book.
3. Current Accounts Ledger.
4. Saving Bank Accounts Ledger.
5. Fixed Deposit Accounts Ledger.
6. Investment ledger.
7. Bills Discounted and Purchased Ledger.
8. Loan Ledger.
9. Cash Credit Ledger.
10. Customers' Acceptances, endorsements and Guarantee Ledger.
11. Recurring Deposits Accounts Ledger, etc.

The Slip System

This is not a system of book keeping, but a method of rapidly posting entries to books kept on double entry system. In this system, posting is made from slips prepared inside the organization itself or from slips filled in by its customers. In a banking company, the main slips are pay-in-slips, withdrawal slips and cheques and all these slips are filled in by clients of the bank.

Advantages of Slip system

1. It makes accounts reliable.
2. Slips are the basis of auditing.
3. The bank saves a lot of clerical labour as most of the slips are filled in by its customers.
4. There is no need for keeping subsidiary books.

Disadvantages of Slip system

1. Slips may be lost, destroyed or misappropriated as these are loose.
2. In the absence of subsidiary books, books cannot be verified.
3. It is very difficult and expensive to keep date wise record of a large number of slips.
4. Customers feel difficulty on account of slip system.

FINAL ACCOUNTS OF BANKS

As per Section 29, a banking comp[any incorporated in India, is required to prepare, at the end of each accounting year, a Balance sheet and profit and Loss Account as on the last working day of the year.

Profit and Loss Account

A banking company is required to prepare its Profit and Loss Account according to Form B in the Third Schedule to the Banking Regulation Act, 1949. Form B is given as follows:

Form B

Form of Profit & Loss Account for the year ended 31st March

	Schedule No	Year ended 31.3..(Current Year)	Year ended 31.3.(Previous Year)
I. Income			
Interest earned	13		
Other income	14		
Total			
II. Expenditure			
Interest expended	15		
Operating expenses	16		
Provisions and contingencies			
Total			

III. Profit/ Loss			
Net profit / loss for the year(I-II) Profit/loss brought forward			
Total			
IV. Appropriations			
Transfer to statutory reserves Transfer to other reserves Transfer to government/ proposed Dividend			
Balance carried over to Balance sheet			
Total			

SCHEDULE 13 –INTEREST EARNED

Particulars	Year ended 31.3..(Current Year)	Year ended 31.3.(Previous Year)
I. Interest/ discount on advances/bills		
II. Income on investments		
III. Interest on balances with Reserve Bank of India and other inter-bank funds		
IV. Others		
Total		

SCHEDULE 14 – OTHER INCOME

Particulars	Year ended 31.3..(Current Year)	Year ended 31.3.(Previous Year)
I. Commission, exchange and brokerage		
II. Profit on sale of investments Less: Loss on sale of investments		
III. Profit on revaluation of investments Less: Loss on revaluation of investments		
IV. Profit on sale of land, buildings and other assets Less: Loss on sale of land, buildings and other Assets		
V. Profit on exchange transactions Less: Loss on exchange transactions		
VI. Income earned by way of dividends etc. from subsidiaries/ companies and/or joint ventures abroad/in India		
VII. Miscellaneous income		
Total		

Note: Under items II to V loss figures may be shown in brackets

SCHEDULE 15 – INTEREST EXPENDED

Particulars	Year ended 31.3..(Current Year)	Year ended 31.3.(Previous Year)
I. Interest on deposits II. Interest on Reserve Bank of India/ inter- bank borrowings		
III. Others Total		

SCHEDULE 16– OPERATING EXPENSES

Particulars	Year ended 31.3..(Current Year)	Year ended 31.3.(Previous Year)
I. Payments to and provisions for employees II. Rent, taxes and lighting III. Printing and stationary IV. Advertisement and publicity V. Depreciation on bank's property VI. Directors' fees, allowances and expenses		
VII. Auditor's fees, allowances and expenses (including branch auditors) VIII. Law charges		

IX. Postages, telegrams, telephones, etc		
X. Repairs and maintenance		
XI. Insurance		
XII. Other expenditure		
Total		

Illustration 1

Following figures have been obtained from the books of Rai Bank Ltd for the year ending 31st March 2011(figures in '000):

Issued and subscribed capital Rs.1000, Interest and discount earned Rs.3800, Commission and exchange earned Rs.195, Interest paid Rs.2000, Salaries and wages Rs.210, Directors fees Rs.35, Rent and taxes Rs.70, Postage and telegrams Rs.61, Profit on sale of investments Rs.240, Loss on sale of investments Rs.38, Rent received Rs. 62, Depreciation Rs.31, Stationary Rs.60 and Auditors fees Rs.8.

Additional information:

a. The profit and loss account had a balance of Rs.10,00,000 on 1st April 2010.
b. An advance of Rs.12,00,000 has become doubtful and it is expected that only 50% of the amount due can be recovered from the security.
c. The provision of tax is made at 50%.
d. A dividend of 10% is proposed.

Prepare Profit and Loss Account of Rai Bank Ltd for the year ending 31st March 2011.

Solution:

Rai Bank Ltd Profit and Loss Account For the year ending

31st March 2011 (000s omitted)

Particulars	Schedule No	Year ended 31.3.2011	Year ended 31.3.2010
I. Income			
Interest earned	13	3800	
Other income	14	459	
Total		4259	
II. Expenditure			
Interest expended	15	2000	
Operating expenses	16	475	
Provisions and contingencies		1192	
Total		3667	
III. Profit/ Loss			
Net profit / loss for the year(I-II)		592	
Profit/loss brought forward		1000	
Total		1592	
Appropriations			
Transfer to statutory Reserves (592x25%)		148	
Transfer to other reserves		-----	
Proposed Dividend		100	
Balance carried over to Balance sheet		1344	
Total		1592	

SCHEDULE 13 – INTEREST EARNED (000s omitted)

	Year ended 31.3.2011	Year ended 31.3.2010
I. Interest/ discount on advances/bills	3800	
Total	3800	

SCHEDULE 14 –OTHER INCOME(000s omitted)

	Year ended 31.3.2011	Year ended 31.3.2010
I. Commission, exchange and brokerage	195	
II. Profit on sale of investments	240	
Less: Loss on sale of investments	(38)	
	62	
III. Miscellaneous income (Rent received)	459	
Total		

SCHEDULE 15 – INTEREST EXPENDED (000s omitted)

	Year ended 31.3.2011	Year ended 31.3.2010
I. Interest on deposits	2000	
Total	2000	

SCHEDULE 16– OPERATING EXPENSES

	Year ended 31.3.2011	Year ended 31.3.2010
I. Payments to and provisions for employees	210	
II. Rent, taxes and lighting	70	
III. Printing and stationary	60	
IV. Depreciation on bank's property	31	
V. Directors' fees, allowances and expenses	35	
VI. Auditor's fees, allowances and expenses (including branch auditors)	8	
VII. Postages, telegrams, telephones, etc	61	
Total	475	

Illustration 2

From the following information, prepare the Profit and loss Account of the National Bank for the year ended 31st March 2011(figures in '000):

Interest on loans Rs.518, Interest on cash credits Rs.446, Discount on bills discounted (net) Rs.390, Interest on Overdrafts Rs.108, Interest on Savings bank Account Rs.220, Interest on fixed deposits Rs.554, Commission, exchange and brokerage Rs.16.40, Rent, taxes and lighting Rs.36, Auditors fees Rs.2.40, Postage, telegrams and telephones Rs.2.80, Sundry charges Rs.2, Directors fees Rs.6, Printing and stationery Rs.0.40, Law charges Rs.1.40, payment to employees Rs.108, Locker rent Rs.0.70, Transfer fees Rs.1.40, Depreciation on bank's property Rs.10 and Advertisement an publicity Rs.1.40.

Additional information: Rebate on bills discounted Rs.98000 and provide for bad debts Rs.58000.

Solution:

National Bank Ltd Profit and Loss Account

For the year ending 31st March 2011

Particulars	Schedule No	Year ended 31.3.2011	Year ended 31.3.2010
I. Income			
Interest earned	13	1364.00	
Other income	14	18.50	
Total		1382.50	
II. Expenditure			
Interest	15	774.00	
expended	16	170.40	
Operating expenses		58.00	
Provisions and		1002.40	
contingencies			
Total			
III. Profit/ Loss			

Net profit / loss for the year(I-II) Profit/loss brought forward		380.10 --------	
Total		380.10	

IV. Appropriations			
Transfer to statutory reserves (380.10x25%)		95.03	
Transfer to other reserves		-----	
Transfer to government/ proposed Dividend		-----	
Balance carried over to Balance sheet		285.07	
Total		380.10	

SCHEDULE 13 – INTEREST EARNED (000s omitted)

	Year ended 31.3.2011	Year ended 31.3.2010
I. Interest/ discount on advances/bills(518+446+390+108-98)	1364.00	
II. Income on investments	----	
III. Interest on balances with Reserve Bank of India and other inter-bank funds	-----	
IV. Others	-----	
Total	1364.00	

SCHEDULE 14 –OTHER INCOME (000s omitted)

	Year ended 31.3.2011	Year ended 31.3.2010
I. Commission, exchange and brokerage	16.40	
II. Lockers Rent	0.70	
III. Transfer fees	1.40	
Total	18.50	

SCHEDULE 15 – INTEREST EXPENDED (000s omitted)

	Year ended 31.3.2011	Year ended 31.3.2010
I. Interest on deposits(220+554)	774.00	
Total	774.00	

SCHEDULE 16– OPERATING EXPENSES (000s omitted)

Particulars	**Year ended 31.3.2011**	**Year ended 31.3.2010**
I. Payments to and provisions for employees	108.00 36.00	
II. Rent, taxes and lighting	0.40	
III. Printing and stationary	1.40	
IV. Advertisement and publicity	10.00	
V. Depreciation on bank's property	6.00	
VI. Directors' fees, allowances and expenses	2.40	
VII. Auditor's fees, allowances and expenses (including branch	1.40	

auditors)	2.80	
VIII. Law charges	2.00	
IX. Postages, telegrams, telephones, etc		
X. Other expenditure		
Total		
	170.40	

Balance Sheet

The balance sheet of a banking company is prepared according to Form A in Third Schedule which is as follows:

BALANCE SHEET OF …… (Here enter name of the banking company) as on 31st March (Year) (000s omitted)

	Schedule No	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
Capital & Liabilities			
Capital	1		
Reserves & Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities and Provisions	5		
Total			
Assets			

Cash and balances with RBI	6		
Balances with banks & money at call and short notice	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
Total			
Contingent liabilities	12		
Bills for collection			

SCHEDULE 1 – CAPITAL

Particulars	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
I. For Nationalized Banks Capital (Fully owned by Central Government Total II. For Banks Incorporated Outside India Capital (The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head) Amount of deposit kept with the RBI under section 1(2) of Banking Regulations Act, 1949		
Total For other Banks Authorised capital ……. Shares of Rs….. each Issued capital ……. Shares of Rs….. each Subscribed capital…. Shares of Rs….. each Called up capital ……. Shares of Rs….. each Less: Calls unpaid Add: Forfeited shares		

SCHEDULE 2 – RESERVES & SURPLUS

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
I. Statutory Reserves Opening Balance Additions during the year Deductions during the year II. Capital Reserves Opening Balance Additions during the year Deductions during the year III. Securities Premium Opening Balance Additions during the year Deductions during the year IV. Revenue & Other Reserves Opening Balance Additions during the year Deductions during the year V. Balance in Profit and Loss Account Total (I+II+III+IV+V)		

SCHEDULE 3 – DEPOSITS

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
A. I. Demand Deposits (i) From Banks (ii) From Others II. Saving Bank Deposits III. Term Deposits (i) From Banks		

(ii) From Others		
Total		
(I+II+III) B. (i) Deposits of branches in India (ii) Deposits of branches outside India		
Total		

SCHEDULE 4 – BORROWINGS

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
I. Borrowings in India (i) Reserve Bank of India (ii) Other banks (iii) Other institutions and agencies II. Borrowings outside India		
Total		

Secured borrowings included in I & II above – Rs.

SCHEDULE 5 – OTHER LIABILITIES AND PROVISIONS

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
I. Bills payable II. Inter-office adjustments (net) III. Interest accrued IV. Others (including provisions)		
Total		

SCHEDULE 6 – CASH AND BALANCES WITH RESERVE BANK OF INDIA

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)

I. Cash in hand (including foreign currency notes) II. Balances with Reserve Bank of India (i) In current accounts (ii) In other deposit accounts		
Total (I &II)		

SCHEDULE 7 – BALANCES WITH BANKS & MONEY AT CALL & SHORT NOTICE

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
I. In India (i) Balances with banks (a) In current accounts (b) In other deposit accounts (ii) Money at call and short notice		
(a) With banks (b) With other institutions Total		
II. Outside India (i) In current accounts (ii) In other deposit accounts (iii) Money at call and short notice Grand Total (I+II)		

SCHEDULE 8 – INVESTMENTS

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)

I. Investments in India in (i) Government securities (ii) Other approved securities (iii) Shares (iv) Debentures and bonds (v) Subsidiaries and/or joint ventures (vi) Others (to be specified)		
Total		
II. Investments outside India in (i) Government securities (including local authorities) (ii) Subsidiaries and/or joint ventures abroad		
(iii) Other investments (to be specified) Total		
Grand Total (I+II)		

SCHEDULE 9 – ADVANCES

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
A. (i) Bills purchased and discounted (ii) cash credits, overdrafts and loans repayable on demand		
(iii) Term loans Total		
B. (i) secured by tangible assets (ii)covered by bank/Government guarantees		
(iii) unsecured Total		
C. I. Advances in India (i) priority sectors (ii) public sector		
(iii) banks		

(iv) others		
Total		
II. Advances outside India		
(i) Due from banks		
(ii) Due from others		
(a) Bills purchased and discounted		
(b) Syndicated loans		
(c) Others		
Total		
Grand Total (CI+CII)		

SCHEDULE 10 – FIXED ASSETS

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
I. Premises At cost on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date II. Other fixed Assets (including furniture and fixtures) At cost on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date		
Total		

SCHEDULE 11 – OTHER ASSETS

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
I. Inter-office adjustments (net) II. Interest accrued III. Tax p[aid in advance/ tax deducted at source IV. Stationery and stamps V. Non-banking assets acquired in satisfaction of claims VI. Others		
Total		

SCHEDULE 12 – CONTINGENT LIABILITIES

	As on 31.3..(Current Year)	As on 31.3.(Previous Year)
I. Claims against the bank not acknowledged as debts II. Liability for partly paid investments III. Liability on account of outstanding forward exchange contracts IV. Guarantees given on behalf of constituents (i) In India (ii) Outside India V. Acceptances, endorsements and other obligations VI. Other items for which the bank is contingently liable		
Total		

Explanation of some items relating to Balance Sheet

1. **Money at call and short notice:** It represents temporary loans to bill brokers, stock brokers and other banks. If the loan is given for one day, it is called "money at call" and if the loan cannot be called back on demand and will require at least a notice of three days for calling back, it is called "money at short notice".
2. **Advances:** Advances include Bills discounted and purchased, loans, cash credit and overdraft.
3. **Inter - office adjustments:** Every head office will have a number of transactions with its branches. The head office makes necessary adjustments in its books on the receipt of information from the branches. On the date of balance sheet some transaction may remain unadjusted in the books of the head office. Such entries are recorded in the balance sheet under the sub-heading 'Branch Adjustments' and may appear on the assets side under the heading 'Other Assets' if it has a

debit balance and on t e liabilities side under the heading 'Other Liabilities' if it has a credit balance.

4. **Bills for Collection:** When the bank receives bills receivables from its customers for collection, it keeps them till maturity. On the date of maturity when bills are collected, customers account is credited with the amount collected. If some bills remain outstanding, such bills are treated by the banks as outstanding bills for collection. It is shown as 'Contingent Liability (Schedule 12)'.
5. **Acceptance, endorsement and other obligation**: This represents bank's liability on account of bills endorsed or accepted on behalf of its customers. For greater security, the drawer of bill wants acceptance of the drawee's bank. The bank incurs a liability by accepting bills on behalf of customers. On the maturity of bill, the bank pays and collects the amount from its customers. At the end of the accounting period, if tee is any outstanding bills it is shown on the 'Contingent Liability (Schedule 12)'.

Illustration 1:

On 31st Dec 2015. The following balance stood in the books of Asian Bank Ltd., after preparation of its profits and loss account.

	Rs. (in '000)
Share capital: Issued and subscribed	4000
Reserve fund (under sec 17)	6200
Fixed deposit	42,600
Savings bank deposit	19000
Current account	23200
Money at call and short notice	1800
Investments	25000
P&L a/c (cr) 1st jan 2015	1350
Dividend for 1985	400
Premises	2950
Cash in hand	380
Cash with RBI	10000
Cash with other banks	6000
Bills discounted and purchased	3800
Loans, cash credit and overdrafts	51000
Bills payable	70
Unclaimed dividend	60
Rebate on bills discounted	50
Short loans (borrowing from other banks)	4750
Furniture	1164
Other assets	336

Net profit for 2015	1550

Prepare balance sheet of bank as on 31st Dec 2015.

Solution

Asian Bank Ltd. Balance sheet as on 31.12.2015

	Schedule No.	As on 31.12.2015 (Rs. In '000)
Capital and Liabilities		
Capital	1	4000
Reserve and surplus	2	8700
Deposits	3	84800
Borrowings	4	4750
Other Liabilities & provisions	5	180
Total		**102430**
Assets		
Cash and balance with RBI	6	10380
Balance with banks & money at call and short notice	7	7800
Investments	8	25000
Advances	9	54800
Fixed assets	10	4114
Other assets	11	336
Total		**102430**
Contingent Liabilities	12	NIL

Bills for collection	-	NIL

WORKING NOTES:

SCHEDULE 1 CAPITAL (Rs. In' 000)

Issued and subscribed share capital 4000

SCHEDULE 2 RESERVE AND SURPLUS

Reserve fund		6200
P&L A/c (1.1.2015)	1350	
Less: dividend for 1985	400	
	950	
Add: net profit for 2015 after deducting statutory reserve [15,50000-(15,50,000*25%)]	1162.5	
		2112.5
Statutory reserve		387.5
		8700

Note: Transfer to statutory reserve now is at 25% of Net profit.

SCHEDULE 3 DEPOSITS

Fixed deposits	42600
Savings bank deposits	19000
Current accounts	23200
Total	84800

SCHEDULE 4 BORROWINGS

Short loans	4750

SCHEDULE 5 OTHER LIABILITIES AND PROVISIONS

Bills payable	70
Unclaimed dividend	60
Rebate on bills discounted	50
total	180

SCHEDULE 6 CASH AND BALANCES WITH RBI

Cash in hand	380
Cash with RBI	10000
total	10380

SCHEDULE 7 BALANCE WITH BANKS AND MONY AT CALL AND SHORT NOTICE

Money at call and short notice	1800
Cash with other banks	6000
Total	7800

SCHEDULE 8 INVESTMENTS

Investments	25000

SCHEDULE 9 ADVANCES

Bills discounted and Purchased	3800
Loans ,cash credits and overdrafts	51000
Total	54800

SCHEDULE 10 FIXED ASSETS

Premises	2950
Furniture	1164
Total	4114

SCHEDULE 11 OTHER ASSETS

Other assets	336

SCHEDULE 12 CONTINGENT LIABILITIES

Bills for collection	NIL

Illustration 2:

Indian Bank Ltd. presents its ledger balances on 31.03.01

	Rs.
Loans	400000
Cash credits	100000
Overdrafts	70000
Premises	100000
Investments	800000
Salaries	56000
General Expenses	54000
Rent, Rates & Taxes	4600
Director’s fees	3600
Stock of Stationery	17000
Bills purchased	92000
Cash in hand	200000

Cash with RBI	12015000
Money at Call	160000
Share capital	1000000
Reserve fund	500000
Current A/c.	200000
Fixed deposit	250000
S.B. Deposit	50000
Cash certificates	50000
Profit/Loss A/c. 01.04.00 (Cr.)	32000
Interest & Discounts	256000
Interim Dividend	34000
Shares in company	100000
Recurring Deposits	40000

Other Information:

i. Provide for doubtful debts Rs.10000
ii. Interest receivable on investments Rs.16000
iii. Unexpired discounts Rs.760
iv. Interim dividend declared was 4% actual
v. Endorsement and guarantee Rs.200000
vi. Additions made to premises during the year Rs.10000
vii. Depreciate premises at 5% on opening balance.

Prepare Profit & Loss A/c. and Balance Sheet.

PRUDENTIAL ACCOUNTING NORMS

Prior to the financial sector reforms in the year 1992-93, banks used to debit interest to the loan account on accrual basis and recognized the same as income even in accounts with poor record of recovery. Recognizing income on accrual basis in accounts where the realization is in doubt is not a prudential practice. As per the recommendation of the Narsimham committee, as stated earlier, the Reserve Bank of India introduced prudential accounting norms applicable from the financial year 1992-93, interest is not to be debited on the accrual basis but on the cash basis. The prudential accounting norms are based on the NPA concept, N for No income, P for Provisioning and A for Asset classification. The prudential accounting norms comprise of the following:

1. Income Recognition
2. Asset Classification
3. Provisioning

1. INCOME RECOGNITION

For the purpose of income recognition, banks are required to classify their loan account into two categories:

a) Performing asset (PA)

b) Non-performing asset (NPA)

If the asset is 'performing', income is recognized on an accrual basis. If the asset is 'non-performing', interest thereon is to be recognized only on cash basis, i.e. when it is actually realized.

As per the RBI guidelines, applicable from 1992-93 onwards, once a loan account is identified as NPA, the bank should do the following:

- Not to charge / debit interest to the account on accrual basis.
  - To charge interest to the account only when it is actually received.
  - To reverse the amount of interest already charged on accrual basis in the accounting period to the extent it remains un-recovered on the date of the

classification it is NPA. If any performing asset of the previous period has become NPA in the current period, all interest income relating to that NPA credited to the Profit and Loss Account of the previous period, to the extent unrealized, should be reversed along with current period unrealized interest (Unrealized interest means excess of total debit in the account during the year by way of interest minus total credit genuine normal in the account). The unrealized interest is to be transferred from income account to interest suspense account, where maintained, or credited to party's account. This applies to unrealized interest on Government guaranteed accounts too.

- Other items of income such as fees, commission, locker rent etc. are transaction-oriented and hence may be recognized as income only on realization. If income such as fees, commission etc., is booked on accrual basis, in the case of an account that has turned NPA, the same should be reversed.
- In case of NPA where interest income has ceased to accrue, the fees, commission, and similar receipts should neither be debited to the account nor credited as income and even if credited, should be reversed or provided for to the extent to which it is uncollected.
- Any amount recovered even partially towards interest in case of an account can be recognized as income, provided such credits in the account towards interest are not out of fresh/additional facilities sanctioned.
- In case of rescheduling or negotiation of a loan, the fees, interest, commission, etc., should be recognized on accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit. Thus

the income would be recognized on accrual basis from the date of re schedulment, as in a fresh account.

2. ASSET CLASSIFICATION

Loan assets of the banks are broadly classified as performing and non performing while non- performing asset (NPA) is further classified into substandard, doubtful and loss assets. The classification of assets into the above categories should be done taking into account the following:

(1) Status of the account – PA/ NPA.

(2) Degree of well defined credit weakness/ risks.

(3) Age of NPA for classification into substandard and doubtful category.

Standard Asset

- Standard asset is a credit facility, which is not classified as NPA and which does not disclose any problem and also does not carry more than the normal credit risk attached to a business.
- Central Government guarantee advances, if overdue, are classified as standard asset (unless Government repudiates its guarantee, when invoked) though interest on such advance is not to be taken to the income account if it is not realized. However, where such a guarantee, whether Central Government or State Government, is repudiated, when invoked, banks treat such advances as NPAs (doubtful or loss asset in case security is inadequate or not available, as the case may be) for all purposes, i.e. income recognition, asset classification, and provisioning norms (valid till 31st December, 2004).
- In case of advances guaranteed by a State Government where the guarantee has been invoked by the bank and the default of more than 90 days persist in the account, such account is to be classified as NPA in the normal course and necessary provision is to be made but if the guarantee has not been invoked, although overdue should not be treated as NPA.

- For the year ending 31-03-2005 State Government guaranteed advances, should be classified as sub-standard or doubtful or loss, after principal/any other amount due to the bank remains overdue for more than 180 days. With effect from the year ending 31-03-006 such accounts will be NPA if interest/principal/other dues remain overdue for more than 90 days. With respect to the income recognition norms no change is given.

Sub-Standard Asset

- Substandard asset is a credit facility, which has been classified as NPA for period not exceeding two years. However, with effect from March 31, 2001, an asset may remain in substandard category for 18 months. This period has further been reduced to 12 months with effect from 31st March, 2005.
- However, an NPA account, where there are potential threats to recovery on account of erosion in the value of security or non-availability of security and existence of other factors, such as, frauds committed by the borrower, should be straight away classified as doubtful or loss asset.
- An asset where the terms of the loan agreement regarding interest and principal have been renegotiated or rescheduled after commencement of production, should be classified as substandard and should remain in such category for at least two years of satisfactory performance under the renegotiated or rescheduled terms. However, the period of two years has been reduced to one year with effect from the year ended March 31,1999.

Doubtful Asset

- In the mid-term review of monetary and credit policy for 1998-99, RBI has decided that an asset should be classified as doubtful, if it has been remained in the substandard category for 18 months instead of 24 months, by March 31,2001.
- A loan classified as doubtful has all the weakness inherent in a substandard account within the added characteristic that the weakness make collection or liquidation in full highly questionable on the basis of currently known facts, conditions, and value.
- A term loan which deserves to be classified as doubtful asset can not be upgraded to a standard asset by just reschedulement of principal and interest and thereby notionally wiping out the overdues. After reschedulement, the account will continue to be classified as doubtful assetfor at least one year.
- For the purpose of provisioning, a doubtful asset is again classified into the following three sub-categories:

Loss Asset

- ❖ A loss asset is a credit facility where the bank's internal or external auditors or the RBI inspectors have identified as loss but the amount hasn't been written off, wholly or partly. In other words, such an asset is considered un-collectible and of such title value that it's continuance as a bankable asset is not warranted although there may be some salvage or recovery value.
- ❖ Accounts, where guarantee from DICGC/ECGC is available, they shouldn't be classified as loss asset, unless the claims are not enforceable. A term loan is sanctioned on 09.09.1998 with monthly installments and without any moratorium period. If in the account, there is no recovery at all and the value of realizable security is sufficient, this asset will be classified as follows:

3. PROVISIONING

After proper classification of loan assets the banks are required to make sufficient provision against each of the NPA account for possible loan losses as per

Category Status as doubtful asset Status as NPA

a) Doubtful-1(DF-1) Up to 1year Up to 2 ½ years

b) Doubtful-2(DF-2) More than 1to3 years Between 2 ½ to 4 ½ years

c) Doubtful-3(DF-3) More than 3 years More than 4 ½ years

Standard Asset

At present, no provision is required. However, banks were expected to make a general provision of a minimum of 0.25 percent against standard assets for the year ending March 31, 2000 and onwards. In this connection the Reserve Bank of India clarified that:

(a) The general provision of 0.25 percent on standard assets should be made on global loan portfolio basis and not on domestic advances alone;

(b) The provisions towards standard assets need not be netted from gross advances but shown separately as "contingent liabilities and provisions others" in Schedule V of the balance sheet; and

(c) Provisions on standard assets should not be reckoned for arriving at net NPAs.

Sub-Standard Asset

A general provision of 10 percent of the total outstanding is required to be made without making any further allowance for DICGC/ECGC guarantee cover and securities available against such advances.

Doubtful Asset

The quantum of provision in case of doubtful assets depends upon the realizable value of security and the age of doubtfulness of the asset. Provision required is:

 100 percent of the security shortfall, i.e. the extent to which the advances is not covered by the realizable value of security to which the Bank has the valid recourse and the realizable value is estimated on realistic basis; plus

 10 percent to 50 percent of the secured portion depending upon the period for which the asset has remained doubtful.

Category	Provision on the secured portion
1 Doubtful – 1	20 %
2 Doubtful - 2	30 %
3 Doubtful - 3	50 %

 Additional – provisioning consequent upon the change in the definition of doubtful assets effective from 31st March, 2001 has to be made in phases under:

(a) As on 31-03-2001, 50 percent of the additional provisioning requirement on the assets, which became doubtful on account of new norm of 18 months for transition from ; Sub-standard assets to doubtful category.

(b) As on 31-03-2002, balance of the provisions not made during the previous year in addition to the provisions needed as on 31-03-2002.

With a view to bringing down the divergence arising out of difference in assessment of the value of security, in case of NPAs with balance of Rs. 5 crore and above, stock audit at annual intervals by external agencies appointed as per the guidelines approved by the board would be mandatory in order to enhance the reliability of stock valuation.

Collaterals such as immovable properties charged in favour of the bank should be got valued once in three years by valuers appointed as per the guidelines approved by the board of directors. The Reserve bank of India has decided that from the year 1995-96, while arriving at the provision required to be made, realizable value of the securities should be deducted from the outstanding balance in respect of advances guaranteed by ECGC/DICGC.

Loss Assets

Provision required is 100 percent of the outstanding balance of the loss asset.

Asset Structure of Commercial Banks

Assets structure will reflect the deployment of sources of funds of commercial banks. The main source of funds of commercial banks is deposits. The other sources of funds are borrowings from other banks, capital, reserves and surplus. The deposits of commercial banks are from savings deposits, current account deposits and term deposits. These deposits constitute 80 percent of the total sources of funds. Out of the total deposits, term deposits constitute 50 per cent. Borrowings are around 5 percent of the total liabilities of the commercial banks. These sources are deployed by the commercial banks mainly on its financial assets i.e, loans and advances which constitute 48.6per cent of the total assets of the banks.

The investments are another important component of the assets of commercial banks which is around 40 per cent of the total assets of the banks during the year 2005. This is because of pre-emptions like SLR and CRR requirements in the banking sector. The investments in commercial banks have increased also because of surplus liquidity in Indian banks during this period due to reduction of SLR and CRR to 25 and 4.5 respectively during that period and less demand for loans and advances from credit-worthy customers. This scenario is changing in India due to increasing demand in credit from industrial, agriculture sector and also the growth of FMCG market.

The assets structure of the banks is governed by certain principles, like liquidity, profitability, shiftability and risklessness. The other factors which influence the assets structure of commercial banks are nature of money market, economic growth of the country, policies and vision of the governments. In the countries like India, China, Russia, North Korea and Brazil there is a boom in the growth of the economy hence naturally there will be heavy demand for the credit.

Important Assets of the Commercial Bank.

1. Cash in hand and balances with RBI

From the point of the liquidity in the commercial banks cash in hand is a very important asset but it is idle and it will not fetch any earnings to the banks. Cash in commercial banks depends upon various factors like uncertainty in the economy due to wars, famine, internal disturbance, the growth of banking system, network of branches, networking of banks, automation in banks and so on. The cash reserve requirements in the commercial banks was more during pre-reform period it was 15 per cent during the year 1994-95. Gradually RBI reduced it to 4 per cent based on the requirements of credit and it is now 5 per cent on Net Demand and Time Liabilities.

2. Money at Call and Short Notice.

It is second line of defense of the commercial banks in cases of emergencies. If the call money market is well developed the commercial banks can lend their surplus funds in the call market for a day or up to 14 days it is called call market or over night market without keeping their surplus money idle. It canal so lend for short period, where the borrower has to return the money borrowed from the banks when short notice is given by the banks. This is becoming a good business in the money market and constitutes around 4 per cent of the total assets of the commercial banks. The banks instead of keeping the money idle lend their surplus funds for short periods in the call market.

3. Investments.

Investments constitute one of the important assets of the bank next to loans and advances. A bank makes investments for the purpose of earning profits. First, it keeps primary and secondary reserves to meet its liquidity requirements. Banks invest in securities either for fulfillment of SLR/CRR requirements or for earning profit on the idle funds. Banks invest in "approved securities" (predominantly Government securities) and "others" (shares, debentures and bonds). The values/rates of these securities are subject to change depending on the market conditions. Some securities are transacted frequently and some are held till maturity. Total investments during the year 2005 by the commercial banks in India were Rs. 8,43,081 crores which is 37 per cent of the total assets. During the month of February and March 2006 the investments in Indian commercial banks have reduced because of heavy demand for credit. Some banks even sold their surplus investments in government securities which was more than SLR requirements and converted them into cash for lending.

4. Loans and Advances.

The commercial banking industry in India has been playing a very important role in intermediating between the economic units, which have surpluses and deficits in their current budgets. By mobilizing financial surpluses in the economy and by channeling these resources into various sectors and segments of the economy, they are guiding the pattern of utilization of a large proportion of the economy. The Government of India which owns a large segment of the industry, and the RBI, which is the central banking authority of the country, have been persuading the commercial banks to deploy larger and larger volumes of financial resources into certain identified priority sectors, for the purpose of accelerating the growth of these sectors. The total advances of commercial banks include bills purchased and discounted, cash credits, overdrafts, loans, unsecured loans, and priority sector advances. The component of loans and advances in the total assets of commercial banks is 48 to 50 per cent—in fact still growing in India. The management of this asset is a very important aspect in the banking sector. The nonperforming assets in banks is increasing. In addition to this banks are exposed to various risks such as credit risk, liquidity risk, market risk and operational risk.

5. Fixed Assets and other assets.

The component of fixed assets and other assets do not form an important aspect in the funds of commercial banks since deals are more in financial assets than real assets.

NON-PERFORMING ASSETS - NPA

A nonperforming asset (NPA) refers to a classification for loans on the books of financial institutions that are in default or are in arrears on scheduled payments of principal or interest. In most cases, debt is classified as nonperforming when loan payments have not been made for a period of 90 days. While 90 days of nonpayment is the standard period of time for debt to be categorized as nonperforming, the amount of elapsed time may be shorter or longer depending on the terms and conditions set forth in each loan.

BREAKING DOWN 'Non-Performing Asset - NPA '

Banks usually categorize loans as nonperforming after 90 days of nonpayment of interest or principal, which can occur during the term of the loan or for failure to pay principal due at maturity. For example, if a company with a $10 million loan with interest-only payments of $50,000 per month fails to make a payment for three consecutive months, the lender may be required to categorize the loan as nonperforming to meet regulatory requirements. A loan can also be categorized as nonperforming if a company makes all interest payments but cannot repay the principal at maturity.

The Effects of NPAs

Carrying nonperforming assets, also referred to as nonperforming loans, on the balance sheet places three distinct burdens on lenders. The nonpayment of interest or principal reduces cash flow for the lender, which can disrupt budgets and decrease earnings. Loan loss provisions, which are set aside to cover potential losses, reduce the capital available to provide subsequent loans. Once the actual losses from defaulted loans are determined, they are written off against earnings.

Recovering Losses

Lenders generally have four options to recoup some or all of the losses resulting from nonperforming assets. When companies are struggling to service debt, lenders can take proactive steps to restructure loans to maintain cash flow and avoid classifying loans as nonperforming. When defaulted loans are collateralized by assets of borrowers, lenders can take possession of the collateral and sell it to cover losses to the extent of its market value.

Lenders can also convert bad loans into equity, which may appreciate to the point of full recovery of principal lost in the defaulted loan. When bonds are converted to new equity shares, the value of the original shares is usually wiped out. As a last resort, banks can sell bad debts at steep discounts to companies that specialize in loan collections. Lenders typically sell defaulted loans that are not secured with collateral or when the other means of recovering losses are not cost-effective.

Concepts of NPA

- As an advance where interest and / or installment of principal remains Over due for a period of more than 90 days in respect of a term loan;
- The account remains "out of order" for a period of more than 90 days, in respect of an overdraft/cash credit;
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted;

- Interest and / or installment of principal remains overdue for two harvest seasons for short-term and one harvest season for long-term crop loans in the case of an advance granted for agricultural purpose (from 05-04-2004); and
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

Causes of NPAs

The various Committees have found the following causative factors for loan accounts turning NPAs. The over – regulated environment, both in the real as well as financial sector was one of the chief reasons, however, there are other important causes also as well:

- Diversion of funds, mostly for expansion/ diversification/ modernization/ new projects of business or for promoting associate concerns. This was coupled with the recessionary trends and failure to tap funds from the capital market and debt market.
- Factors internal to business like product/ marketing failure, inefficient management, inappropriate technology, labour unrest, product obsolescence, etc.
- Change in the macro-environment like recession, infrastructure bottlenecks, natural calamities, etc.
- Time/ cost overruns during project implementation stage.
- Government policies like changes in excise duties, pollution control, etc.
- Willful default, fraud, and misappropriation, promoters/ directors disputes.
- Deficiencies on the part of banks like delay in release of sanctioned limits, under finance or over finance, delay in release of payments / subsidies by government.

CASH FLOW STATEMENT

Cash flow statement is another important technique of financial analysis. It involves preparation of Cash flow statement for identifying sources and applications of cash. A cash flow statement is a statement depicting change in cash position from one period to another. For example, if the cash balance of business is shown by its Balance sheet on 31st December, 1978 at Rs. 20,000 while the cash balance as per its balance sheet on 31st December, 1979 is Rs. 30,000. There has been an inflow of cash of Rs. 10,000 in the year 1979 as compared to the year 1978. The cash flow statement explains the reasons for such inflows or outflows of cash, as the case may be. It also helps management in making plans for the immediate future.

A cash flow statement can be prepared on the same pattern on which a funds flow statement is prepared. The change in the cash position from one period to another is computed by taking into account "Sources" and "Application" of cash.

Format of a Cash Flow Statement

A cash flow statement can be prepared in the following form:

Cash Flow Statement

			For the year ending on ...
Balance as on 1.1.19...			
Cash balance	......		
Bank balance	......		
Issue of Shares			.....
Raising of long-term loans			......
Sale of fixed assets			......
Short-term borrowings			......
Cash from operation		......	
Profit as per Profit and Loss Account		......	
Add/Less : Adjustment for non-cash items			

Add: Increase in current liabilities		
Decrease in current assets	......	
Less: Increase in current assets	.....	
Decrease in current liabilities	......	
Total cash available (1)		
Less: Application of Cash:		
Redemption of redeemable preference shares		......
Redemption of long-term loans		......
Purchase of fixed assets		......
Decrease in deferred payment liabilities		......
Cash outflow on account of operation		......
Tax paid		......
Dividend paid		......
Decrease in unsecured loans, deposits etc.,		......
Closing balances*		
Cash balance		......
Bank Balance		......

* There total should tally with the balance as shown by (1) – (2)

DIFFERENCE BETWEEN CASH FLOW ANALYSIS AND FUNDS FLOW ANALYSIS

Following are the points of difference between a Cash Flow Analysis and a Funds analysis.

1. A cash flow statement is concerned only with the change in cash position while a funds flow analysis is concerned with changed in working capital position between two balance sheet dates. Cash is only one of the constituents of working

capital besides several other constituents such as inventories, accounts receivable, prepaid expenses.

2. A cash flow statement is merely a record of cash receipts and disbursements. Of course, it is valuable in its own way but if fails to bring to light many important changes involving he disposition of resources. While studying the short-term solvency of a business one is interested not only in cash balance but also in the assets which are easily convertible into cash.
3. Cash flow analysis is more useful to the management as a tool of financial analysis in short period as compared to funds flow analysis. It has rightly been said that shorter the period covered by the analysis, greater is the importance of cash flow analysis. For example, if it is to be found out whether the business can meet it obligations maturing after 10 years from now, a good estimate can be made about firm’s capacity to meet its long-term obligations if changes in working capital position on account of operations are observed. However, if the firm’s capacity to meet a liability maturing after one months is to be seen, the realistic approach would be to consider the projected change in the cash position rather than an expected change in the working capital position.
4. Cash is part of working capital and, therefore, an improvement in cash position results in improvement in the funds position but the reverse is not true. In other words, “inflow of cash” results in ‘inflow of funds’ but inflow of funds may not necessarily result in “inflow of cash”. Thus, a sound funds position does not necessarily mean a sound position but a sound cash position generally means a sound funds position.
5. Another distinction between a cash flow analysis and a funds flow analysis can be made on the basis of the techniques of their preparation. An increase in a current liability or decrease in a current asset results in decrease in working capital and vice verse. While an increase in a current liability or decrease in a current asset (other than cash) will result in increase in cash and vice versa.

Some people, as stated before, use of term “funds” in a very narrow sense of ‘cash’ only. In such an event the two terms ‘Funds’ and ‘Cash’ will have synonymous meaning.

UTILITY OF CASH FLOW ANALYSIS

1. Helps in efficient cash management
2. Helps in internal financial management
3. Discloses the movement of cash

4. Discloses success or failure of cash planning

LIMITATIONS OF CASH FLOW ANALYSIS

1. Cash flow statement cannot be equated with the Income Statement. An income statement takes into account both cash as well as non-cash items and, therefore, net cash flow does not necessarily mean net income of the business.
2. The cash balance as disclosed by the cash flow statement may not represent the real liquid position of the business since it can be easily influenced by postponing purchases and other payments.
3. Cash flow statement cannot replace the Income Statement or the Funds flow statement. Each of them has a separate function to perform.

Illustration 1

From the following balances you are required to calculate cash from operations:

Debtors	1987	1988
	Rs.	Rs.
Bills receivable	50,000	47,000
Creditors	10,000	12,000
Bills payable	20,000	25,000
Outstanding expenses	8,000	6,000
Prepaid expenses	1,000	1,200
Prepared expenses	800	700
Accrued Income	600	750
Income received in advance	300	250
Profit made during the year	....	1,30,000

CASH FROM OPERATIONS

Profit made during the year	....	1,30,000
Add:		
Decrease in Debtors	3000	
Increase in Creditors	5000	
Increase in outstanding expenses	100	8300
Less:		
Increase in Bills Receivable	2500	
Decrease in Bills payable	2000	
Increase in Accrued Income	150	
Decrease in Income received in advance	50	4700
Cash from operation		133600

Illustration 2:

Balance Sheets of A and B on 1.1.1988 and 31.12.1988 were as follows:

BALANCE SHEET

	1.1.88	31.12.88		1.1.88	31.12.88
Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors	40,000	44,000	Cash	10,000	50,000
Mrs. A's Loan	25,000	....	Debtors	30,000	50,000
Loan from Bank	40,000	50,000	Stock	35,000	25,000
Capital	1,25,000	1,53,000	Machinery	80,000	55,000

			Building	35,000	60,000
	2,30,000	2,47,000		2,30,000	2,47,000

During the year of a machine costing Rs. 10,000 (accumulated depreciation Rs. 3,000) was sold for Rs. 5,000. The provision for depreciation against Machinery as on 1.1.1988 was Rs. 25,000 and on 31.12.1988 Rs. 40,000. Net profit for the year 1988 amounted to Rs. 45,000. You are required to prepare Cash Flow Statement.

Solution

Cash Flow Statement

Cash balance as on 1.1.1988		Rs. 10,000
Add: Sources		
Cash from Operations Rs.	59,000	
Loan from Bank	10,000	
Sale of Machines	5,000	74,000
		8,400
Less: Applications:		
Purchase of Land	10,000	
Purchase of Building	25,000	
Mrs. A's Loan repaid	25,000	
Drawings	17,000	77,000
Cash Balance as on December 31, 1988		7,000

Working Notes

CASH FROM OPERATIONS

Profit made during the year		Rs. 45,000
Add: Depreciation on Machinery	18,000	
Loss on Sale of Machinery	2,000	
Decrease in Stock	10,000	
Increase in Creditors	4,000	34,000
		79,000
Less: Increase in Debtors		20,000
Cash from Operation		59,000

Machinery Account (At Cost)

To Balance b/d	1,05,000	By Bank	5,000
		By Loss on Sale of machinery	2,000
		By provision for Depreciation	3,000
		By balance c/d	95,000
	1,05,000		1,05,000

PROVISION FOR DEPRECIATION

To machinery A/c	3,000	By balance b/d	25,000
To balance c/d	40,000	By P & L A/c	18,000
		(depreciation charged – balancing figure)	
	43,000		43,000

KARPAGAM ACADEMY OFHIGHER EDUCATION

DEPARTMENT OFCOMMERCE

I M.COM

DIRECT TAXATION (19CMU206)

UNIT – V

QUESTION	OPTION A	OPTION B	OPTION C	OPTION D	ANSWER
”Tax planning is a moral way of tax saving, in it a tax payer reduce tax liability honestly and it's a long term process.” This definition is given by-	Prof. Coldar	Prof. Dalton	Alderson	Andrew	prof Dalton
Nature of tax planning includes-	Legal l	Mora	Honest effort	All of these	legal
Object of tax planning is-	Avoidance of tax	Minimize of tax liability	Payment of tax at time	Differment of tax	minimise of tax liability
In the tax avoidance the provisions law-	Not abided	Misused	Wrong interpretation	All of above	not abited
Causes of tax evasion-	Higher tax rates	Complex of provisions	Corruption	All of above	All of above
Expand TDS	Tax dilution at source	Taxes distribution source	Tax Deducted at source	tax disturbed at source	tax deducted at source
Advance payment of tax otherwise known as	arrear tax	TDS	TIN	Pay as you earn	pay as you earn
Advance tax arises only where the amount of tax payable by the assessee during the year exceeds Rs.	10,000	20,000	30,000	40,000	Rs.10,000
Amount not less Than 30% of advance tax is to be paid on or before ------------ for all assessee except company assessee	15th August	15th September	15th October	15th November	15th September
Amount not less tah 60% of advance tax is to be paid on2nd installment s on or before ------------	15th September	15th October	15th November	15th December	15th December
Entire balance amount of advance tax is to be paid as 3rd installments on or before ------------	15th January	15th February	15th March	15th April	15th March

In case of short fall in payment of advance tax of more than 10% then the rate of interest is to be charged at ------ of tax	1%	2%	3%	4%	1%
Expand PAN	Permanent account number	personal account number	Permanent assessee number	personal assessee number	Permanent account number
Rate of TDS on interest on securities at --------	10%	20%	30%	40%	10%
The aggregare of dividend payavble on shares in the financial year does not exceed Rs.2,500, the rate of TDS is	5%	10%	15%	No TDS	No TDS
The rate of TDS on Winning from lotteries or cross word puzzles at	10%	20%	30%	40%	30%
Any income by way of winning from horse races an amount exceeding Rs.5,000 shall be paid tax at the rate of	10%	20%	30%	40%	30%
A -------------- means waste or not usable because of breakage, cutting up , wear and other reasons	breakage	waste	scrap	unusable	scrap
The ---------- of tax can be claimed by the person who has paid exces tax	TDS	refund	tax	TIN	refund
If refund claims upto Rs.10,00,000, prior permission from ------------------ of income tax shall be obtained	Chief commissioner	commissio ner	assistant commissio ner	deputy commissio ner	commissio ner
Refund claim exceeding Rs. 50,00,000 prior permission from -------------- is necessary	CBDT	Chief commissio ner	commissio ner	assistant commissio ner	CBDT
An ------------------ refers to an act of referring the case to a higher authority against the order passed to a lower authority in respect of any case	refund	appeal	payment of tax	tax	appeal
An appellate authority under Income tax is ---------------	IT Dept	Assessing officer	appellate tribunal	supreme court	supreme court
A -------------- is code number issued by the IT department to every assessee	PAN	TAN	TIN	PIN	PAN
The PAN is a ------------code	Alpha	numeric	Alpha numeric	Special characters	alpha numeric
PAN code having ----------- characters and issued in the form of a	5	10	15	20	10

laminated card					
If total income exceeds the exemption limit in any previous year, the time limit for applying PAN is on or before	30th June	31st July	31st August	31st May	31st May
Expand e-TDS	Electronic TDS	Email TDS	Excel TDS	Excess TDS	Electronic TDS
User must pass the e-TDS /TCS return file generatd using RPU through the	File Validation Utility	Email TDS	special characters	Scrap	file validation utility
Expand TIN	Taxpayers Identification Number	Tax Include Number	Tax imported number	Tax Important Number	Tax payers Identificati on Number
A ------------- means electronic tax deducted at source	E-TDS	TDS	TIN	TAN	e-TDS
Expand NSDL	National Securities Depository Ltd	National Savings Scheme	National Depository Ltd	National Saving Ltd	National Securities Depository Ltd
First step for filing of e-TDS return is ---------	choose the format	tax avoidance	tax evasion	filling of e-TDS	Choose the format
Final step for filing of e-TDS return is ---------	choose the format	tax avoidance	tax evasion	filling of e-TDS	
The ------------- involves planning in order to avail all exemptions, deductions and rebates provided in Act	Tax planning	tax avoidance	tax evasion	tax exemption	tax planning
The ---------------means reducing your tax liability without breaking any law.	Tax planning	tax avoidance	tax evasion	tax exemption	tax avoidance
When any individual make false claims to reduces his total income or by not providing any information regarding his total income then its called -----------------	Tax planning	tax avoidance	tax evasion	tax exemption	tax evasion
Objective of Tax planning is to--------------	increase tax liability	decrease the tax liability	no change	tax evasion	decreases tax liability
A -------------- means the planning thought of and executed at the end of the income year to reduce taxable income in a legal way.	short term planning	long term planning	permissive term planning	purposive tax planning	short term planning

A----------------- means a plan chaled out at the beginning or the income year to be followed around the year.	short term planning	long term planning	permissive term planning	purposive tax planning	long term planning
A----------------means making plans which are permissible under different provisions of the law, such as planning of earning income covered by Sec.10,	short term planning	long term planning	permissive term planning	purposive tax planning	permissive tax planning
It means making plans with specific purpose to ensure the availability of maximum benefits to the assessee through correct selection of investment	short term planning	long term planning	permissive term planning	purposive tax planning	purposive tax planning
Tax Planning is resorted to maximize the cash inflow and minimize the cash -------------	inflow	outflow	no change	increase	outflow
Logical analysis of a financial situation or plan from a tax perspective, to align financial goals with ---------------	Tax planning	tax avoidance	tax evasion	tax exemption	tax planning
Transaction in shares exceeding Rs.50,000. ------------ is necessary	PAN	WAN	LAN	TAN	PAN
Dividend from foreign company is taxable under the head -------------	Income from other sources	House property	business income	capital gain	Income from other sources
The sum for which the house property might reasonably be expected to be let from year to year is known as -------------	Annual value	Realized rent	Expected rent	Monthly rent	annual value
Gross annual value minus municipal taxes paid by the assessee is -------------	Net annual value	Gross annual value	Expected annual value	Annual rental value	Net annual value
Every year the residential status of an assessee -----------	may change	will certainly change	will not change	none	May change
Rate of TDS for listed debentures of a company is ------------	10%	20%	30.00%	40%	10%
Rate of TDS for casual income is ------------	10%	20%	30.00%	40%	30%
Rate of TDS for unlisted debentures with surcharge is ------------	10%	20%	30.00%	40%	20%
Rate of TDS for interest on government securities is ---------------	10%	20%	No TDS	TDS	10%

PAN code having ----------- characters and issued in the form of a laminated card	5	10	15	20	10
If total income exceeds the exemption limit in any previous year, the time limit for applying PAN is on or before	30th June	31st July	31st August	31st May	31st May
Nature of tax planning includes-	Legal l	Mora	Honest effort	All of these	legal
Object of tax planning is-	Avoidance of tax	Minimize of tax liability	Payment of tax at time	Different of tax	minimize of tax liability
A -------------- Means the planning thought and executed at the end of the income year to reduce taxable income in a legal way.	short term planning	long term planning	permissive term planning	purposive tax planning	short term planning
A --------------- is code number issued by the IT department to every assessee	PAN	TAN	TIN	PIN	PAN
Entire balance amount of advance tax is to be paid as 3rd installments on or before ------------	15th January	15th February	15th March	15th April	15th March