UNIT II

SYLLABUS

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

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.

Provided that it may extend to eighteen months where special permission has been granted in that behalf by the registrar.

(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.

Provided further that no person shall be sentenced to imprisonment for any such offence unless it was committed willfully.

(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:

Provided that no person be sentenced to imprisonment for any such offence unless it was committed willfully.

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.

1.5 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	
To Purchases		xxx	xxx
Less: Purchas Returns	xxx	Less: Sales Returns	
To Freight and Carriage	xxx	xxx	
To Wages	xxx	By Closing Stock	
To Coal & Coke	xxx		
To Gross Profit c/d	xxx		
	xxx		
To Salaries	xxx		xxx
To Rent	xxx		xxx
To Discount	xxx		xxx
To Commission	xxx	By Gross Profit b/d	xxx
To Advertisement	xxx	By Interest Received	xxx
To General Expenses	xxx	By Rent Received	xxx
To Directors' Fees	xxx	By Discount	xxx
Too Bad Debts		By Commission	
To Loss on sale of assets		By Profit 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	Xxx	By Net Profit for the year	Xxx

previous year not provided for	Xxx Xxx	b/d	Xxx
To Interim Dividend	Xxx	By Amount withdrawn from General Reserve or any other reserve	Xxx
To Proposed dividend	xxx		
To Surplus (Balance figure) carried to Balance Sheet		By Provision such as Income Tax provision no longer required	xxx

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 31.3.1998 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 on15.6.1998 , it was decided to place Rs20,000 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,31,1998 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 31.3.1998

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 on31.3.1998 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 Rs45, 000 to staff gratuity reserve

To transfer Rs 50,000 to development rebate reserve

To transfer Rs90, 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 31.3.1998

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.	Liabilities (2)	Figures for the current year Rs.	Figures for the previous year Rs.	Assets (5)	Figures for the current year Rs.

(1)		(3)	(4)		(6)
	Share Capital: **Authorized** … shares of Rs. ….each **Issued**: …. Shares of Rs. …. Each **Subscribed:** …. Shares 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			**Fixed Assets:** (a)Goodwill (b)Land (c) Buildings (d) Leaseholds (e) Railway sidings (f) Plant and machinery (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**	

	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 advances **Current Liabilities and Provisions:** **A. Current Liabilities** 1.Acceptances 2.Sundry Creditors 3.Subsidiary Companies 4. Advance			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 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**	

	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				

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-		2,00,000	53,50,000
progress			2,25,200
2. Investments			
3. Current Assets, Loans &		12,00,000	
Advances			
(a) Inventories		12,04,800	
(b) Sundry Debtors		2,75,000	
(c) Cash and Bank		4,27,000	
Balances		31,06,800	
(d) Loans and Advances			
	13,45,000	15,15,000	

Less : Current Liabilities & Provisions :			15,91,800
(a) Current Liabilities	1,70,000		
(b) Provisions		3,00,000	
		58,000	
			3,58,000
4. Miscellaneous Expenditure :			**75,25,000**
(a) Profit and Loss Account			
(b) Miscellaneous Expenses			

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
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3. Fixed assets:

Fixed Assets at WDV 51, 50,000

Add: Depreciation 5, 00,000

56, 50,000
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4. Inventories:

Finished Goods 7, 50,000

Stores 4, 00,000

Loose Tools 50,000

12, 00,000

----

5. 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		By Gross Profit b/d	
To General Expenses	1,45,000		
To Directors' Fees	68,350		15,20,200
To Bad debts	57,250		
21,100			
Add: New Provision			
43,500			
--			

--------- 64,600 Less: Old Provision 35,000 -- --------- To Debenture interest paid 1,80,000 Add: Outstanding 1,80,000 -- ---------- To Depreciation on Plant and Machinery To Preliminary Expenses To Provision for Income Tax To Net Profit c/d To Interim Dividend To Profit Transferred to Balance Sheet	29,600 3,60,000 4,95,000 5,000 1,80,000 1,80,000 15,20,200 3,92,500 **50,000**	By Balance b/d By Net Profit b/d	15,20,200 2,62,500 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

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.

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

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

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

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 :

6,00,000 + 7,50,000 + 7,20,000 + 6,90,000

Average Profits = -- = 6,90,000
4

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.

II. 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

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

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

III. 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 = $\frac{\text{Actual profit}}{\text{Normal rate of return}}$

$= \frac{\text{Rs}1,20,000}{10\%}$

=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 1998

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 Creditors Provision for tax **Net tangible assets**	 58,350 90,500 19,500	 1,68,350 2,81,650
(ii)calculation of adjusted annual average profits **Profits for 5years** (Rs61,000+Rs64,000+Rs71,500+Rs78,000+Rs85,000) Less: 50% income tax **Adjusted profits**		 3,59,500 1,79,750 **1,79,750**

Adjusted annual average profits = 1,79,750 / 5 years

= Rs35,950

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

Total capitalized value of the firm = adjusted profits / Normal rate of return

= 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 1998

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:		8,28,000

12,00,000*60%*115% 12,00,000*405*90%		4,32,000 12,60,000
Less: Current Liabilities Bill payable Creditors Unrecorded liability Less: preference share capital Net asset available for equity shareholders	50,000 1,50,000 10,000	 2,10,000 10,50,000 4,00,000 **6,50,000**

Intrinsic value per share= Net assets for equity shareholders / No. Of Equity shares

= 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 1998

Liabilities	Amount	Assets	Amount
Share capital : 6,000 equity shares of Rs100	 6,00,000	Goodwill	1,65,000

each			
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 bank A/c	3,00,000		
	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 = $\frac{\text{net assets}}{\text{No. of equity shares}}$

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

=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
Reserves	90,000	Goodwill	40,000
Profit & Loss Account	20,000	Current Assets	2,00,000
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.

		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 :

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

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

= 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.

		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 $= \frac{\text{Rs. } 48,150}{4,500} = \text{Rs. } 10.70$

Calculation of value per Equity Share on Dividend Yield Basis Rs.

	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

Expected Profit

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

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

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

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

POSSIBLE QUESTIONS

UNIT II

PART B

1. What is outstanding expenses?
2. What is prepaid expenses?
3. What is preliminary expenses?
4. What is surplus?
5. What is current liability?
6. What is valuation of shares?
7. What is valuation of goodwill?
8. Mention any two methods of valuation of goodwill
9. What is intrinsic method of goodwill?
10. What is average profit method?

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PART C

1."Every Balance Sheet of Company shall give a true and fair view of the state of affairs of the company as at the end of the financial year and shall subject to the provision of Sec 211 of the Companies Act, be in the form set out in

Part I of Schedule VI ....".

Amplify and give the form of Balance Sheet.

2. What are the various heads under which profits are usually appropriated by companies and for what reason?

3. The following is the Trial Balance on March 31, 1998 of the Partial Manufacturing Co. Ltd.

	Rs.	Rs.
Stock on 1st April, 1997	7,500	
Sales		35,000
Purchases	24,500	
Productive wages	5,000	
Discounts	700	500
Salaries	750	
Rent	495	
General expenses (including insurance)	1,705	
Profit and loss account 1st April, 1997		1,503
Dividend paid August 1997	500	
Interim dividend paid February 1998	400	
Capital 10,000 Re.1 shares fully paid		10,000
Debtors and creditors	3,750	1,750
Plant and machinery	2,900	
Cash in hand and at bank	1,620	
Reserves		1,550
Loan to managing director	325	
Bad debts	158	
	50,303	50,303

Stock on 30th June 1960 Rs.8,200.

You are required to make out the Trading Account, Profit and Loss account for the year ended 31st March, 1998, and the Balance Sheet as on that date. You are also to make provision in respect of the following.

(1) Depreciate machinery @10% per annum.

(2) Reserve 5% discount on debtors.

(3) Allow 2½% discount on creditors.

(4) Provide managing director's commission 15% of the net profit before deducting his commission.

(5) One month rent Rs.45 per mensem was due on 30th June.

(6) Six months insurance included in general expenses was unexpired at Rs.75 per annum.

4. Sun Ltd has an authorized capital of Rs. 10,00,000 divided into 10,000 equity shares of Rs.100 each. The following is the Trial balance of the company for the year ended 31st December 2001.

Particulars	**Dr(Rs.)**	**Cr(Rs.)**
Equity Share Capital		5,00,000
Bills Receivable	40,000	
Land & building	1,50,000	
Furniture	1,00,000	
Debtors	1,00,000	
Cash	3,500	
Bank	5,500	
Sundry Creditors		1,10,000
Opening Stock	2,70,000	
Purchases & Sales	8,00,000	10,43,000

Wages	80,000	
Fuel and Power	35,000	
Carriage inwards	16,000	
Discount received		7,000
Auditor's fees	11,000	
Salary	44,000	
Traveling Expenses	14,000	
Purchase returns		8,000
Carriage outwards	4,000	
15% Bank Loan		1,00,000
Interest on Bank Loan	15,000	
Factory Rent	40,000	
Bad Debts	40,000	
	16,68,000	**16,68,000**

Adjustments:

1. Value of stock on 31.12.2001 Rs. 2, 20,000.
2. Provide 5% Provision for Bad Debts on Debtors.
3. Depreciate Land & building at 10%
4. Unpaid wages Rs. 5,000 and Salary Rs. 6,000

Prepare Trading and Profit & Loss A/C and Balance Sheet for the year ended 31.12.2001 and the Balance Sheet as on that date.

5.The XYZ Ltd was formed on 1.4.2007 with an authorized capital of Rs.6,00,000 in shares of Rs.10 each of these 52,000 shares has been issued and subscribed but there were calls in arrear on 100 shares. From the following trail balance as on March 31, 2008, prepare the Trading and profit & Loss Account and the Balance Sheet.

	RS		RS
Cash at bank	1,05,500	Share Capital	5,19,750
Plant	40,000	Sale of silver	1,79,500
Mines	2,20,000	Interest on F.D up to Dec31	3,900
Promotion Expenses	6,000	Dividend on investment	3,200
Advertisement	5,000		
Cartage on plant	1,800		
Furniture & Buildings	20,900		
Advertisement Expenses	28,000		
Repairs to plant	900		
Coal and oil	6,500		
Royalties paid	10,000		
Railway Track and Wagons	17,000		
Wages of Miners	74,220		
Cash	530		
Investment-Share of tin mines	80,000		
Brokerage on above	1,000		
6% F.D in Syndicate Bank	89,000		
	7,06,350		7,06,350

Adjustment:

a) Depreciation on Plant and railways By 10%, Furniture & Buildings by 5%
b) Write off a third of the promotion expenses
c) Value of XYZ on March 31, 2008 Rs. 15,000

d) The directors forfeited on Dec 20, 2007, 100 shares on which only Rs.7.50 has been paid.

6.B Ltd. is a company with an authorized capital of Rs. 5,00,000 divided into 5,000 equity shares of Rs. 100 each on 31.12.2005 of which 2,500 shares were fully called up. The following are the balances extracted from the ledger on 31.12.2005.

Trail Balance of B Ltd

Debt	Rs	Credit	Rs
Opening Stock	50,000	Sales	3,25,000
Purchase	2,00,000	Discount Received	3,150
Wages	70,000	Profit and Loss A/C	6,220
Discount Allowed	4,200	Creditors	35,200
Insurance (upto 31.3.86)	6,720	Reserves	25,000
Salaries	18,500	Loan from managing directors	15,700
Rent	6,000	Share Capital	2,50,000
General Expenses	8,950		
Printing	2,400		
Advertisement	3,800		
Bonus	10,500		
Debtors	38,700		
Plant	1,80,500		
Furniture	17,100		
Bank	34,700		
Bad debts	3,200		
Calls in arrears	5,000		
	6,60,270		6,60,270

You are required to prepare Profit and Loss for the year ended 31.12.2005 and a balance sheet as on the date. The following further information is given.

a) Closing Stock was valued at Rs. 1,91,500
b) Depreciation on plant at 15% and on furniture 10%

A tax provision of Rs.8000 is considered necessary

7.The following is the balance sheet of NSC Ltd as on 31st Dec 1998

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.

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

Liabilities	Rs.	Assets	Rs.

Issued Capital in Rs. 10		Fixed Assets	5,00,000
Shares	4,00,000	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.

9.The following particulars are available in relation to Abinaya 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.

10.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.5,000

11 . Sathya 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.

KARPAGAM ACADEMY OF HIGHER EDUCATION
(Deemed to be University)
(Established Under Section 3 of UGC Act, 1956)
Coimbatore – 641021
B. COM. (PA)
CORPORATE ACCOUNTING - 19PAU201
UNIT - V

S. No.	Questions	Option 1	Option 2	Option 3	Option 4			Answer
1	. ……..is called a factory of cre dit.	Company	Firm	Bank	HUF			Bank
2	Banking companies are governe d in India by ……….	Banking Regu lation Act	Indian Compani es Act	Reserve Bank of India Ac t	Partnership Act			Banking Regulatio n Act
3	CRR stands for …………	Current Reser ve Ratio	Capital Reserve Ratio	Cash Re serve Ra tio	Capital Rede mption Ratio			Cash Res erve Rati o
4	SLR stands for ……………	Savings Level Ratio	Statutory Liquid ity Ratio	Standard Liquidit y Ratio	Standard Level Ratio			Statutory Liquidity Ratio
5	The method of rapidly posting e ntries in the books of banks is c alled as ……….	Single Entry	Cash Method	Slip Syst em	Double Entry			Slip Syst em
6	The P&L A/c of Banking Comp anies are prepared as per …… …….of Banking Regulation Ac t	Form A of Sch edule III	Form B of Sche dule III	Form A of Sched ule VI	Form B of Sc hedule VI			Form B o f Schedul e III
7	…….of profit is transferred to s tatutory reserves.	10%	20%	25%	30%			25%
8	Banks show the provision for in come tax under the head …… ….	Contingent lia bilities	Deposits	Other lia bilities a nd provi sions	Borrowings			Other lia bilities an d provisi ons
9	Rebate on bills discounted is … ……..	An income acc rued but not re ceived	A liability	An expe nse	Income recei ved in advan ce			Income r eceived i n advanc e

10	NPA stands for…………	Non Performing Assets	Normal Performing Assets	National Performing Asset	Notional Performing Assets			Non Performing Assets
11	Schedule 1 is concerned with ……….	Cash and balance with RBI	Capital	Reserves and Surplus	Investments			Capital
12	………… is shown under Schedule 15.	Interest earned	Profit	Interest Expended	Appropriations			Interest Expended
13	Acceptance, endorsements and other obligations come under the head…	Provisions and Contingencies	Contingent liabilities	Deposits	Borrowings			Contingent liabilities
14	Assets are NPAs for a period not exceeding 12 months are called …………	Standard Assets	Substandard Assets	Doubtful Assets	Loss Assets			Substandard Assets
15	Assets are NPAs for a period exceeding 12 months are called ……….	Standard Assets	Substandard Assets	Doubtful Assets	Loss Assets			Doubtful Assets
16	………is a form of agreement between two parties in which one party agrees to make good for loss of another.	Contract	Insurance	Banking	Mutual fund			Insurance
17	In which year, MICR system for cheque was implemented in India?	1987	1996	1990	1993			1987
18	Which is the first bank to introduce Credit card in India?	Bank of India	Global Trust Bank	IndusInd Bank	Central Bank of India			Central Bank of India
19	----------- was not nationalized in 1969	Punjab National Bank	Oriental Bank of Commerce	Bank of Baroda	Union Bank of India			Oriental Bank of Commerce
20	Electronic payment system is an ?	Software	Hardware	Application	Package			Application
21	Which is the first bank to launch Debit card in India?	Standard Chartered Bank	Citi Bank	ABN Amro Bank	American Express Bank			Citi Bank
22	Which was the first Joint Stock Bank established by an Indian establishment?	Bank of Bombay	Oudh Commercial Bank	Bank of Hindustan	Hindustan Commercial Bank			Bank of Hindustan

23	Which is the first change in banking sector of India after independence?	Nationalization of Banks	Social control on Banks	Establishment of SBI	Establishment of RBI			Social control on Banks
24	When were the banks nationalized in our country?	On 1st July 1965	On 19th July 1969	On 19th July 1969 and 15th April 1980	On 16th April 1980 and 1st July 1965			On 19th July 1969 and 15th April 1980
25	What are the major change in banking sector of India after nationalization of Banks?	Expansion of bank branches	Cut throat competition in Banking sector	Introduction of Banking Regulation Act	Establishment of RBI			Expansion of bank branches
26	The following one is absolutely essential for a special crossing	Two parallel transverse lines	Words "And company?	Words "Not negotiable"	Name of a banker			Name of a banker
27	The reasonable period allowed in India for the presentation of a cheque is	1 year	3 months	9 months	depending upon custom			3 months
28	If cheque is crossed an account payee, this is direction of, to	Payee, paying banker	Payee, collecting bank	Drawer, paying bank	Drawer, collecting bank			Drawer, collecting bank
29	Which of the following is not the form of E-banking?	Internet Banking	Direct Deposit in Bank	Electronic cheque conversion	Mobile banking			Direct Deposit in Bank
30	-------is the most favoured technology for secure Internet banking service	Public Key Instructions	Public Key Information	Public Key Infrastructure	People Key Infrastructure			Public Key Infrastructure
31	The electronic funds transfer using a two-way communications system is referred to as a	Pay or cheque	Wire transfer	Depository transfer cheque	Payable through draft			Wire transfer
32	Interest payable on savings bank accounts is?	Regulated by State Governments	De-regulated by RBI	Regulated by RBI	Regulated by Finance Minister			De-regulated by RBI

33	The usual deposit accounts of banks are	Current accounts, electricity accounts and insurance premium accounts	Current accounts, post office savings, bank accounts and term deposit accounts	Loan accounts, savings bank accounts and term deposit accounts	Current accounts, savings bank accounts and term deposit accounts			Current accounts, savings bank accounts and term deposit accounts
34	Fixed deposits and recurring deposits are?	Repayable after an agreed period	Repayable on demand	Not repayable	Repayable on demand or after an agreed period as per bank's choice			Repayable after an agreed period
35	Accounts are allowed to be operated by cheques in respect of?	Both savings bank accounts and fixed deposit accounts	Both Savings bank accounts and current accounts	Both savings bank accounts and loan accounts	Other savings bank accounts and cash accounts only			Both Savings bank accounts and current accounts
36	Which of the following is correct statement?	No interest is paid on current deposit accounts	Interest is paid on current accounts at the same rate as term deposit accounts	The rate of interest on current accounts and savings accounts are the same	No interest is paid on any deposit by the bank			No interest is paid on current deposit accounts
37	When a bank returns a cheque unpaid, it is called?	Payment of the cheque	Drawing of the cheque	Dishonour of the cheque	Taking of the cheque			Dishonour of the cheque
38	Largest shareholder (in percentage shareholding) of a Nationalized bank is ?	RBI	NABARD	Government of India	LIC			Government of India

39	An institution whose principle business is accepting deposits and forwarding loans is called	Mutual Fund Business	Company	Bank	Ombudsman			Bank
40	Which of the following term do not represent any part of Banking technology?	NEFT	RTGS	ITC	EPS			ITC
41	The chief activities of bank do not include	Providing loans	Accepting deposits	Providing lockers	Selling real estate properties			Selling real estate properties
42	Every Banking Company is required to close its accounts on __________________	31st December	31st March	30th June	30th September			31st March
43	The Percentage of profit to be trasferred to statements reserve by the banking company is ____________	25%	15%	20%	10%			25%
44	An Asset which does not generate income to the banker is termed as _____________	Performing Asset	Non Performing Assets	Fixed Asset	Current Asset			Non Performing Assets
45	A Non - banking Asset is _____________	an Investment	an item of office appliances	Any asset acquired from the debtors in satisfaction of claim	Money at call and short notice			Any asset acquired from the debtors in satisfaction of claim
46	Provision for income tax is shown in the Bank Accounts under the head ____________	Borrowings	Other Liabilities	Operating expenses	Contingent Liabilities			Other Liabilities
47	The heading other assets does not include _________	Stationary and Stamps	Interest Accrued	Gold	Silver			Gold
48	Demand Drafts and Telegraphic transfers are shown in the Bank Accounds under the head ______________	Contingent liabilities	Bills Payable	Loans and Advances	Borrowings In India			Bills Payable

49	Letter of Credit and Endorsement are shown in the Bank accouns under the head ______________	Bills Payable	Contingent liabilities	Bills for collection	Other Assets			Contingent liabilities
50	Building acquired in satisfaction of a claim and interest accrues but not due on investments are shown in the Banks Balance Sheet under the head _____________	Fixed Assets	Investments	Advances	Other Assets			Other Assets
51	Banking Companies are governed by the ________________ Act, 1949	Companies	Partneship	Banking Regulations	Banking			Banking Regulations
52	Banks in India are under the general supervision of _______________	SBI	RBI	SEBI	ABI			RBI
53	The bases for recording bank transactions are the ______________ prepared by customers and sometimes by bank staff	Slips	Bills	cheque	drafts			Slips
54	All appropriation of the Profit are shown in Ivth part of ______________	P & L A/c	Balance Sheet	P & L Appropriation A/c	Reveue Account			P & L A/c
55	Lockers rent is shown in the P&L A/c of Bank under the head ________________	Schedule 15	Schedule 12	Schedule 13	Schedule 14			Schedule 14
56	At present, the SLR for a banking company in India, as per the regulations of the Rbi is _____________	25%	15%	20%	10%			25%
57	According to present Regulation of the RBI, a banking company is to maintain a minimum of ____________ Percent as Cash Reserve over its time and demand liabilities	15%	5%	25%	20%			5%
58	Schedule 13 relates to ___________	Interest Expended	Interest Earned	Other Income	Operating Expenses			Interest Earned

59	Schedule 15 relates to ________	Interest Expended	Interest Earned	Other Income	Operating Expenses			Interested Expended
60	Provisions for doubtful debts is shown under 'Provisions for Contingencies' in the _____________ of banking company	P & L A/c	Balance Sheet	P & L Appropriation A/c	Reveue Account			P & L A/c

CHAPTER III

SYLLABUS

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 atleast 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.

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	6,00,000	Land and Buildings	1,60,000

Rs.10	1,00,000	Plant and Machinery	2,80,000
5% Debentures	60,000	Stock	1,60,000
Sundry Creditors	40,000	Debtors	80,000
General Reserve	2,00,000	Cash	20,000
Profit and Loss account		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 :

$$60{,}000 \times \frac{15}{10} = 90{,}000 \text{ shares of Rs. 10 each, Rs. 8 paid up}$$

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.

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	82,500	
To equity share capital A/c		50,000
To 9% preference share capital A/c		32,500
(being payment of purchase price)		
Liquidator of N Ltd A/c Dr	52,500	
To Equity share capital A/c		50,000
To 9% preference share capital A/c		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	67,800
		Less: Dep fund 2,500	
Issued and paid up : 10,000 equity shares of Rs10 each fully paid	1,00,000		27,000
3,500 9% preferences shares of Rs10 each fully paid	35,000		13,200
(all the above shares were issued for consideration other than cash)		Current assets:	4,000
		Stock	
		Debtors	
		Bank	

Current liabilities: Creditors	 7,000		
	1,42,000		**1,42,000**

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.

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)	10,00,000	8,00,000 2,00,000

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

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 To capital reduction A/c	2,40,000	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 Creditors A/c Dr To capital reduction A/c (being reduction of Rs20 per debenture on 5,000 debentures and reduction of creditors as per capital reduction scheme)	1,00,000 50,000	1,50,000

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

POSSIBLE QUESTIONS
UNIT III

PART B

1. What is Amalgamation?
2. Explain 'Capital Reduction'.
3. Mention various types of Amalgamation.
4. What do you understand by the term Capital Profits?
5. List out the methods for computing Purchase Consideration.

PART C

1. M Ltd. And N Ltd. Agreed to amalgamate on the basis of the following Balance Sheet as

on 31-3-1997.

Liabilities	**M Ltd. Rs.**	**N Ltd. Rs.**	**Assets**	**M Ltd. Rs.**	**N Ltd. Rs.**
Share capital Rs.25 each	75,000	50,000	Goodwill	30,000	-
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
TOTAL	**86,000**	**58,500**	**TOTAL**	**86,000**	**58,500**

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

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

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

2. The following scheme of reconstruction has been approved for Divya Ltd

(A) The shareholders to receive in lieu of their present holding of 60,000 shares of Rs.10 each fully paid the following.

(I) Fully paid new equity shares equal to 1/3rd of their holding

(II) 8% preference shares fully paid, to the extent of 1/5th of the above new equity shares

(III) Rs.60,000 8% secured debentures

(B) The debenture holders' total claim of Rs.75,000 to be reduced to Rs.25,000. This will be satisfied by the issue of 2,5000 8% preference shares of Rs.10 each fully paid

(C) An issue of 50,000 6% first debentures was made and allotted, payment for the same having been received in cash.

(D) The goodwill which stood an Rs.3,00,000 was written down to Rs.50,000. Plant & Machinery which stood at Rs.1,00,000 was written down to Rs.75,000

(E) The freehold premises which stood at Rs.1,75,000 was written down by Rs.75,000

Give Journal entries in the books of Divya Ltd. for the above Reconstruction.

3. Raman Ltd., and Sivam Ltd., have agreed to amalgamate. A new Company, Sivaraman Ltd., has been formed to take over the running concern as on 31.12.2005. The following

Balance Sheets show the position of the companies amalgamating

Liabilities	**Raman Ltd. Rs.**	**Sivam Ltd. Rs.**	**Assets**	**Raman Ltd. Rs.**	**Sivam Ltd. Rs.**
Share Capital Rs. 10 each	20,000	50,000	Goodwill	-	6,000
General Reserve	16,000	-	Plant	14,000	20,000
Capital Reserve	-	4,000	Furniture	8,000	12,000
P& L A/c	4,000	-	Stock	16,000	8,000
Loan from Bank	10,000	6,000	Sundry Debtors	10,000	17,000
Creditors	10,000	6,000	Cash at bank	12,000	7,000
			P & L A/c	-	6,000
	60,000	**46,000**		**60,000**	**46,000**

Sivaram Ltd. Took over all the assets and liabilities of both the transferor companies at book values except cash at bank, creditors and the goodwill of Sivan Ltd. which was considered worthless.

The Purchase Consideration was agreed at Rs. 60,000 for Raman Ltd., and Rs. 40,000 for Sivan Ltd., Fully paid Equity Shares of Rs. 10 each were issued to settle the purchase price for both the companies.

Cash at bank of both the companies was exactly sufficient to settle their creditors at 10 % discount and pay the liquidation expenses.

You are required to give important ledger accounts to close the books of the transferor companies and the Journal and Balance Sheet in the books of the transferee company, assuming that the amalgamation is in the nature of Purchase.

4. The summarised Balance Sheet of Ambrose Co. Ltd., as at 31st December, 2008 was as follows :

Liabilities	Amount Rs.	Assets	Amount Rs.
Authorised & Issued Capital : 2,00,000 Equity Shares of Rs. 10 each Fully Paid	20,00,000	Land and Buildings	15,00,000
10,000, 6 % Cumulative Preference Shares of Rs. 100 each fully paid	10,00,000	Plant and Machinery	10,00,000
Bank Overdraft	7,00,000	Goodwill	2,00,000
Sundry Creditors	5,00,000	Patents and Trade Marks	1,00,000
(Note : the Cumulative Preference dividend is in arrear for three years)		Stock	4,00,000
		Sundry Debtors	3,00,000
		Preliminary Expenses	1,00,000
		Profit and Loss A/c	6,00,000
	42,00,000		**42,00,000**

A Scheme of Capital reduction was approved on the following terms:

(i) The Preference Shareholders agreed that their Shares be reduced to fully paid Shares of Rs. 50 each and to accept Equity Shares of Rs. 5 each fully paid in lieu of Dividend Arrears

(ii) The Equity Shareholders agree that their shares be reduced to a fully paid value of Rs. 5 each

(iii) The Authorised Capital of the company is to remain at Rs. 30,00,000 divided into 4,00,000 Equity Shares of Rs. 5 each and 20,000, 6 % Cumulative Preference Shares of Rs. 50 each

(iv) All the Intangible and Fictitious Assets are to be eliminated and Bad Debts of Rs. 50,000 and absolute stock of Rs. 80,000 are to be written off.

Give the necessary Journal Entries to record the Capital Reduction and draw up the revised Balance Sheet.

5. Following a series of losses, XYZ Co. Ltd., resolved to reduce its Capital to 50,000 fully paid Rs. 5 shares and to eliminate Share Premium Account. The companies Balance Sheet prior to implementation of the Scheme was :

Liabilities	**Amount Rs.**	**Assets**	**Amount Rs.**
Share Capital; 50,000 Fully paid Shares of Rs. 10 each	5,00,000	Goodwill	1,00,000
Securities Premium A/c	50,000	Land and Buildings	1,62,000
Creditors	62,000	Plant and Machinery	2,07,000
Bank Overdraft	73,000	Stock	92,000
		Sundry Debtors	74,000
		Profit and Loss A/c	50,000
	6,85,000		**6,85,000**

It was resolved to apply the sum available under the Scheme:

(i) To write off the Goodwill Account

(ii) To write off the debit balances of the Profit and Loss Account

(iii) To reduce the Book values of the Assets by the following Accounts : Land and Building - Rs. 42,000

Plant and Machinery - Rs. 67,000 Stock - Rs. 33,600

(iv) To provide a bad debts reserve of 10 % of the Book value of Debtors

Show the Journal entries to give effect to the scheme and prepare the revised Balance Sheet after its implementation

6. The following are the balance sheets of Sindhu Ltd., and Bindhu Ltd., as on 31-3-2000

Liabilities	Sindhu Ltd Rs.	Bindhu Ltd Rs.	Assets	Sindhu Ltd Rs.	Bindhu Ltd Rs.
Equity share capital (Rs. 10 each)	5,00,000	3,00,000	Fixed Assets	8,00,000	3,50,000
8% Pref. Share capital (Rs.100 each)	2,00,000	1,00,000	Current Assets	4,00,000	2,50,000
General Reserve	1,00,000	50,000			
P&L A/C	50,000	30,000			
12 % Debentures of Rs. 100 each	50,000	20,000			
Current Liabilities	3,00,000	1,00,000			
	12,00,000	**6,00,000**		**12,00,000**	**6,00,000**

Sindhu Ltd., agreed to acquire Bindhu Ltd., on the following terms :

(i) 11 % Preference Shares will be issued to discharge the

Preference Shares in Bindhu Ltd., at 25 % Premium

(ii) Cash of Rs. 2 per Share will be paid and one Equity Shares in Sindhu Ltd., will be issued at agreed value of Rs. 13 per share for every Equity Shares in Bindhu Ltd.

(iii) Bindhu Ltd., 's Debentures are to be paid off in cash

Give Journal Entries in the books of Sindhu Ltd., and prepare its Balance Sheet, if Amalgamation is in the Nature of Merger.

UNIT 1V

SYLLABUS

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

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) Inter company transaction may not be at a fair prices.

3) Minority share holders 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 loose 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.

Such contingent liability may be of two types.

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 :**

i) **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.

1stStep

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.

We can calculate minority interest with following formula

Total share capital of Subsidiary company = XXXXX

Less Investment of Holding company in to subsidiary company = - XXXX

Add proportionate share of the subsidiary company's profit and
Reserves or increase in the value of assets + XXXX

Less proportionate share of the subsidiary company's loss and decrease
In the value of total assets of company - XXXXX

Value of Minority Interest XXXXX

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.

Pre – acquisition profit and reserve shown as capital reserve XXX

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.

Suppose

Closing stock of H 50000
Closing stock of S 50000

____

100000

Less stock reserve

2000

98000

If subsidiary company has also other outsider's shares then holding company makes reserve up to his shares proportion.

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. H Ltd. acquires 70% of the equity shares of S Ltd. on 1st January, 2012. On that date, paid up capital of S Ltd. was 10,000 equity shares of 10 each; accumulated reserve balance was 1,00,000. H Ltd. paid 1,60,000 to acquire 70% interest in the S Ltd. Assets of S Ltd. were revalued on 1.1.2012 and a revaluation loss of

`20,000 was ascertained. The book value of shares of S Ltd. is calculated as shown below:

`

70% of the Equity Share Capital 1,00,000

70,000

70% of Accumulated Reserve 1,00,000 70,000

70% of Revaluation Loss 20,000 (14,000)

1,26,000

So, H Ltd. paid a positive differential of 34,000 i.e (1,60,000 -1,26,000). This differential is also called goodwill and is shown in the balance sheet under the head intangibles.

2. 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 profit 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 3

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 4

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	
(1). Shareholder's Funds		6,00,000
(a) Share Capital		
(b) Reserves and Surplus		3,44,600
		48,150
(2) Minority Interest		
(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(ies) of which reporting date(s) is/are different from that of the parent and the difference in reporting dates.

POSSIBLE QUESTIONS

UNIT IV

PART B

1) What is cost of control?
2) What is Minority Interest?
3) Which is Holding Company as per companies Act 1956?
4) What is capital profit?
5) How you treat Revenue profit?
6) Why date of acquisition of shares by Holding Company is important?

7) Which Accounting standard is issued for preparation of consolidated financial statements?

8) How inter company debts are dealt with?

9) Does issue of Bonus share by Holding Company change value goodwill / capital reverse.

PART C

1. The following are the Balance Sheet of H. Ltd. and S. Ltd. as on March 31st 2011.

Liabilities	H. Ltd. Rs.	S. Ltd.	Assets	H. Ltd. Rs.	S. Ltd.
Equity share capital (Rs. 10 / $ 10)	1,00,00,000	2,00,000	Fixed Assets	11,00,000	3,60,000
Reserve & Surplus			Investment in S. Ltd.	2,10,00,000	
Securities Premium	60,00,000	--	Current Asset	8,50,000	2,40,000
General Reserve	19,00,000	1,20,000			
Profit Loss	15,00,000	1,00,000			

& A/c 10% Debentures Sundry creditors Provisio N for Taxatio n	 17,00,000 9,00,000 9,50,000	 -- 1,20,000 60,000			
	2,29,50,000	6,00,000		2,29,50,000	6,00,000

H. Ltd. acquired 15000 shares in S. Ltd. on January 1st 2011. The balance of General Reserves, a profit and loss A/c on April 1, 2010 was $ 120000 and $ 60,000 respectirely.S Ltd. paid in January 11, an interim dividend @ 20% p.a. out of pre- acquisition profit for 6 months ended on 30th September 2010.S Ltd. remitted amount due to H. Ltd. when rate of exchange was $ 1 = 42. Amount of dividend received by H. Ltd. was credited to profit & Loss A/c.

2.The balance sheet of H Ltd and S Ltd on 31 Dec. 2000 were as follows.

Liabilities	H Ltd Rs.	S Ltd Rs	Assets	H Ltd Rs	S Ltd Rs.
Share Capital: 10% Pref, Share of Rs.100 each Equity share of Rs.100 each	 _ 10,00,000 1,00,000	 1,00,000 4,00,000 50,000	Land and Buildings Machinery less Depreciation 3000 Shares in S	3,10,000 2,70,000 4,50,000 2,20,000	1,60,000 1,35,000 _ 1,50,000
General reserve P&L A/c balance on 1.1.2000 Profit for 2000 Creditors	40,000 2,00,000 1,50,000 14,90,000	30,000 80,000 70,000 7,30,000	ltd Stock at cost Debtors Cash and Bank Balance	1,55,000 85,000 14,90,000	90,000 1,95,000 7,30,000

'H' Ltd acquired 3,000 equity shares in S Ltd. on 1st July

2000. As on the date of acquisition, 'H' Ltd found that the value of Land and Buildings and Machinery of S Ltd should be Rs.1,50,000 and Rs.1,92,500 respectively. Prepare the consolidated Balance Sheet of 'H' Ltd and its subsidiary S Ltd showing the assets at their proper value.

3. M Ltd. acquired 12000 shares in D Ltd for Rs. 1,70,000 on 1.April.2000. the Following were their balance sheet on 31.12.2000

Liabilities	M Ltd Rs	D Ltd Rs	Assets	M Ltd Rs	D Ltd Rs
Share capital (Rs.10	10,00,000	3,00,000	Goodwill	3,00,000	70,000
each)	4,20,000	50,000	Buildings	4,00,000	1,00,000
General Reserve	2,60,000	85,000	Machinery	5,00,000	1,00,000
Profit and Loss A/c	2,40,000	42,000	Stock	2,00,000	40,000
Creditors	80,000	60,000	Book Debts	3,00,000	1,35,000
Bills Payable			Investment	1,70,000	–
			Bills Receivable	50,000	30,000
			Cash and Bank	80,000	62,000
	6,30,000	3,10,000		6,30,000	3,10,000

Additional Information:

1. On Jan 1,2000 the profit and Loss account of D Ltd. stood at Rs.40,000 out of which a dividend of 15% on the then capital of Rs.2,00,000 was paid in june 2000. At the same time a bonus issue of one fully paid shares for every 2 shares held was also made out of general reserve.
2. Bills payable of D Ltd. represent bills issued in Favour of M.Ltd which company still held Rs.40, 000 of the bills accepted by D Ltd.
3. The entire closing stock of D Ltd. represents goods supplied by M Ltd at cost plus 20%
4. M Ltd and D Ltd agreed that for services rendered M Ltd should charge Rs. 500 P.M from D Ltd entries for this

were not made
Prepare consolidated balance sheet of the 2 companies on 31 Dec 2000.

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(Ins-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 a/c ing year in the form “A” and “B’ given in the third schedule to the Act. The amalgamated B/s 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 subs.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.

Format of balancesheet

Explanation of Balance Sheet Items: Items	Schedule No	As on (Current year) Rs. in Crores	As on (Previous year) (Rs. in crores
CAPITAL AND LIABILITIES:			
Capital		1	
Reserves & Surplus		2	
Deposits		3	
Borrowings		4	
Other Liabilities and Provisions		5	
ASSETS:			
Cash and Balances with Reserve Bank of India		6	
Balances with Banks and Money at Call and		7	

Short Notice	
Investments	8
Advances	9
Fixed Assets	10
Other Assets	11
TOTAL	
Contingent liabilities	12
Bills for collection	
Significant Accounting Policies and Notes to Accounts 17 & 18	
Schedules referred to above form an integral part of the Balance Sheet	

PREPARATION OF BANK BALANCE SHEET

Illustration 1:

On 31st dec 1986. 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 1986	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 1986	1550

Prepare balance sheet of bank as on 31st dec 1986.

Solution

Asian Bank Ltd.

Balance sheet as on 31.12.1986

	Schedule No.	As on 31.12.86 (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 (1.1.86)	1350	

Less: dividend for 1985	400	
	950	
Add: net profit for 1986 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	186000
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:

CHART NO: 2

CLASSIFICATION OF ASSETS

Loan Assets

Performing Assets (PA) **Non – Performing Assets (NPA)**

Standard Assets **Substandard** **Doubtful** **Loss**

(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

Balance Sheet Date Category

31-03-1999	Standard
31-03-2000	SubStandard
31-03-2001	SubStandard
31-03-2002	Doubtful-1
31-03-2003	Doubtful-2
31-03-2005 and onwards	Doubtful-3

prudential norms. The minimum amount of provision required to be made against a loan asset is different for different types of asset.

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 is 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.

Now let us examine each of the 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 non-performing 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 Asset - 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.

CURRENTLY, NPA IS DEFINED

□ 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.

NORMS FOR TREATING DIFFERENT ADVANCES AS NON – PERFORMING

The following revised norms are adopted for treating different advances as non-performing with effect from the year ended 31st March, 2004. An account will be treated as NPA if:

Summarized RBI Guidelines For NPAs Recognition:

Loans and Advances **Guidelines applicable from 31-3-2004**

Term loan interest and/or instalment

remains over due for more than 90 days

Overdraft/Cash Credit a/c remains out of order

Bills purchased and discounted remains

over due for more than 90 days

Agricultural loan interest and/or

instalment remains over due for Two harvest seasons but not exceeding

two and half years

Other accounts-any amount to be

received remains over due for more than 90 days

POSSIBLE QUESTION

PART – B (2 MARKS)

1. What do you understand by the term Capital Profits?
2. What do you understand by the term Cash Reserves?
3. State any four business of Banking Companies.
4. Write a short note on Non – performing Assets.
5. What do you understand by the term 'Contingent Liabilities'?
6. What is Rebate on bills discounted?
7. What is statutory reserve?
8. What do you understand by contingent liability?
9. Write a short note on Standard Assets.
10. Write a short note on bills for collection.

PART – C

1. From the following particulars, prepare profit & loss account of Krishna Bank Ltd. for 1999-2000.

	Rs.
Interest on loans	34900
Interest on fixed deposits	36500
Rebate on bills discounted	4800
Commission charged on customers	910
Office expenses	15500
Discount on Bills discounted	19400
Interest on cash credits	22400
Balance of profit & Loss A/c.	1200
Rent & taxes	1800
Interest on overdraft	12800
Director's remuneration	420
Interest on savings deposits accounts	6900
Postal expenses	150
Printing & stationery	390
Other expenses	180

2. From the following particulars, prepare profit & loss account of Mysore Bank Ltd. for the year ended on 31.03.01

	Rs.
Interest on loans	51800
Interest on fixed deposits	55000
Commission received	1600

Salaries and allowances	10800
Discount on bills discounted	29200
Rebate on bills discounted	9800
Interest on cash credits	44600
Interest on current accounts	8400
Rent & Taxes	3600
Interest on overdrafts	30800
Director's fees	600
Auditor's fees	200
Interest on saving bank deposits	13600
Postage & telegrams	300
Printing & stationery	600
Locker rent	200
Transfer fees	100
Depreciation on bank properties	1000
Sundry charges	400

Other Information:

i. Provision for bad debts Rs.8000
ii. Provision for Income tax Rs.30000

3. From the following particulars, prepare profit & loss account of New Bank Ltd. for the year ended 31.03.96

	Rs.
Interest on loans	260000
Interest on cash credits	225000
Interest on fixed deposits	280000
Rent & Taxes	20000
Interest on overdrafts	56000
Commission charged to customers	9000
Director's and Auditor's Fees	4500
Establishment expenses	56000
Interest on saving bank accounts	70000
Discount on bills discounted	200000
Postage & Telegrams	1500
Printing & Advertisement	3000
Sundry charges	1800

3.From the following information your are required to prepare profit & loss account of P.N. Bank for the year ended on 31.03.98 under the provisions of the act applicable thereto:

	Rs. (in'000)
Interest on loans	518
Interest on cash credits	446
Discount on bills discounted	390

Interest on overdrafts	108
Interest on saving bank deposits	220
Interest on fixed deposits	554
Commission, Exchange & Brokerage	16.4
Rent, Taxes & Lighting	36
Auditor's fees	2.4
Postage, telegrams & telephones	2.8
Sundry charges	2
Advertisement & Publicity	1.4
Director's fees	6
Printing & stationery	0.4
Law charges	1.4
Payment to Employees	108
Locker rent	0.7
Transfer fees	1.4
Depreciation on bank property	10

5. From the following information, prepare profit & loss account of Thrifty Bank for the year ended 31.03.98

	Rs. (in '000)
Interest on loans	2590
Interest on fixed deposits	3170
Commission	82
Payment to employees	540
Discount on bills discounted	1060
Interest on Cash credits	2230
Rent, Taxes & Lighting	180
Interest on overdrafts	1540
Director's fees, Allowances & Expenses	30
Auditor's fees & Expenses	12
Interest on Savings Bank deposits	680
Postage, Telegrams & telephones	14
Printing & Stationery	29
Sundry charges	17

Additional Information:

a. Provide for contingences Rs.200000
b. Transfer Rs.1557000 to Reserve fund
c. Transfer Rs.200000 to Central government

6. From the following balances, prepare the Balance Sheet of Lucky Bank Ltd., as on 31.03.02.

	Rs.		Rs.
Share capital (2000 shares)	200000	Money at call	900000
Premises	100000	Profit & Loss A/c. (cr.)	45000
Rebate on Bills Discounted	5000	Investments	700000
Traveller'sCheque	200000	Bills purchased	1500000
Deposits	5600000	Acceptances for customers	500000
Loans	2200000	Bills for collection	400000
Reserves	300000	Depreciation Fund on premises	10000
Cash in hand	30000	Cash with RBI	520000
Cash with other Bank	450000	Pension Fund	40000

The following were completely omitted while the above balances were calculated. They should be adjusted suitably.

a. Travellers Cheque paid Rs.10000
b. Money at call recovered Rs.20000

7. Indian Bank Ltd. presents its ledger balances on 31.03.2015

	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	186000
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.

8. From the following balances extracted from the books of Srinidhi Bank Ltd., prepare Profit & Loss A/c. & Balance Sheet as at 31.03.03.

	Debit	Credit
Share capital		150000
General Reserve		61500
Profit & Loss A/c.		60000
Money at call and short notice	22500	
Deposits		889500
Cash in hand	30000	
Cash with RBI	45000	
Borrowings		90000
Bills Payable		24000
Staff Security Deposits		10500
Investments	96000	
Buildings	68400	
Balance with other banks	57000	
Cash credits	795000	
Interest on deposits and borrowings	118500	
Bills purchased	180000	
Discount on bills		15000
Commission and Brokerage		13500
Interest on loans		175500
Income from investments		8700
Salary and other expenses	72000	
Audit fees	5100	
Postage, printing & stationery	6300	
Depreciation on Assets	2400	
	14,98,200	**14,98,200**

Other Information:

i. Provide Rs.10000 for rebate on bills discounted
ii. Bills for collection Rs.150000 and endorsement Rs.140000
iii. Provide Income Tax @ 40% of Net Profits

9. Following is the Trial Balance of Modern Bank Ltd., as on 31.03.02. Prepare Bank final accounts.

Debit Balance:		**Rs.**
Premises		210000
Money at call and short notice		250000
Furniture		25000
Cash in hand		250000
Cash at Bank		300000
Investments		150000
Loan & cash credit		1123500
Interest on deposits		150000
Audit fees		5000
Salaries		40000
Director's fees		2500
Printing & Stationery		2500
Depreciation		5000
Non-Banking Assets		25000
Other Expenditure		1500
	25,40,000	
Credit Balance:		
Interest & Discount		250000
Share Capital		500000
Reserve fund		250000
Deposit		750000
Telegraphic transfer		250000
Traveller's letter of credit		250000
Pay order and gift cheques		50000
Pension fund		75000
Borrowings from banks		50000
Unclaimed Dividend		30000
Rent		10000
Commission received		40000
Profit & Loss A/c.		30000
Bills payable		5000
	25,40,000	

Other Information:

i. Provide Rs.2500 for rebate on bills discounted
ii. Liabilities on bills rediscounted Rs.5000
iii. Bills for collection amounted to Rs.150000

iv. Provide Rs.500 for bad debts
v. Provide for income tax Rs.2000
vi. Director's proposed 5% dividend on share capital
vii. Liabilities outstanding on forward exchange contract Rs.2500

10. The following are the balances of City Bank Ltd., you are required to prepare the Profit & Loss A/c. & the Balance Sheet as at 31.03.98

	Debit	Credit
Share capital: 2000 Equity shares of Rs.500 each Rs.150 paid up		300000
Bad debts written off	12500	
Reserve fund investments	200000	
General expenses	69500	
Current Accounts		2000000
Interest paid on deposits	16000	
Deposit accounts		700000
Profit & Loss A/c.		25000
Acceptances for customers	150000	
Discount received		58000
Endorsement and Guarantee	7500	
Commission & Exchange		5000
Cash on hand	25000	
Interest Received		25000
Cash in RBI	200000	
Endorsement and Guarantee		7500
Owings by foreign correspondents	20000	
Customers liability for acceptances		150000
Borrowings from banks		650000
Loans and Advances	1550000	
Investments	1000000	
Bills discounted	650000	
Premises	220000	
Statutory Reserve		200000
	41,20,500	**41,20,500**

Other Information:

i. Interim dividend paid during the year Rs.20000
ii. Provide for rebate on bills discounted Rs.6000 and for income tax reserve Rs.15000.

11. From the following Trial Balance of Canara Bank Ltd., prepare the Profit & Loss A/c. for the year ending 31.03.99 & Balance Sheet as on that date

	Debit	Credit
Paid capital		1000000
Money at call and short notice	400000	
Reserve fund		250000
Cash on hand	500000	
Cash with RBI	200000	
Fixed deposits		1200000
Loans, cash creditors etc	1500000	
Investments	200000	
Borrowings from City Bank		300000
Pension fund		100000
Unclaimed Dividend		50000
Furniture less depreciation	80000	
Premises less depreciation	320000	
Rent		10000
Interest & discounts		600000
Commission received		60000
Salaries and allowances	90000	
Interest on deposits and borrowings	310000	
Audit fees	8000	
Directors fees	7000	
Depreciation on Bank property	9000	
Printing & stationery	4000	
Other expenses	2000	
Profit & loss A/c. 01.04.98		60000
	36,30,000	**36,30,000**

Other Information:

i. Provide Rs.5000 for rebate on bills discounted
ii. Provide Rs.22000 for bad debts
iii. Bills for collection on behalf of customers Rs.50000
iv. Provide for taxation Rs.4000.

12. From the following trial balance of Indian Bank Ltd. as on 31.03.02. Prepare Bank Final accounts:

	Debit	Credit
Issued and paid-up capital shares of Rs.100/- each		1500000
Profit & Loss A/c. balance as on 01.04.01		40000

Fixed deposits		2600000
Savings Bank A/c.		2100000
Current A/c.		3400000
Commission & Exchange		102000
Bills Payable		100000
Interest & discount		600000
Investment Reserve		25000
Reserve fund		310000
Investment in government securities	575000	
Cash in hand and with RBI	700000	
Deposit with other banks	1245000	
Money at call and short notice	400000	
Loans, Advances & Overdrafts	7400000	
Furniture	45000	
Buildings	200000	
Salaries and allowances to staff	85000	
Interest on deposits and borrowings	175000	
Unexpired Insurance	450	
Stamps in hand	150	
Contribution to Provident fund	18400	
Director's fees	4500	
Audit fees	1500	
Printing & stationery	3550	
Rent, Rates & Taxes	6450	
Postage & telegram	800	
Branch adjustment		25000
Pension fund		58500
	1,08,60,800	**1,08,60,800**

Other Information:

i. Market value of investments as on 31.03.02 was Rs.548000. The investments were written down to this figure
ii. Provide for:
   a. Taxation Rs.75000
   b. Doubtful debts Rs.50000
   c. Rebate on bills discounted Rs.25000
iii. Acceptances, endorsements and other obligation Rs.250000
iv. Depreciate Building at 2½ %

13. The following is the trial balance extracted from the books of Vysya Bank. You are required to prepare profit & loss A/c. and the balance sheet as at 31.03.04 after taking into consideration the adjustments given below:

	Debit	Credit
60000 Equity shares of Rs.10 each		600000
300000 8% Preferential shares of Rs.10 each		300000
Fixed deposit		350000
Savings Bank account		250000
Current A/c.		600000
Reserve fund		300000
Interest & discount		300000
Money at call & short notice	300000	
Cash in hand	300000	
Cash at bank	360000	
Investment in government	180000	
Loans & cash credits	1348200	
Furniture	30000	
Premises	252000	
Interest on deposits	180000	
Salaries	48000	
Audit fees	6000	
Director's fees	3000	
Depreciation on Bank property	6000	
Printing & stationery	3000	
Non-Banking Assets	30000	
Other Expenditure	1800	
Profit & Loss A/c. 01.04.03		42000
Unclaimed dividend		120000
Pension fund		36000
Borrowings		90000
Rent		12000
Commission		48000
	30,48,000	**30,48,000**

Other Information:

i. Provide for bad debts Rs.10000
ii. Provide for rebate on bills discounted Rs.4000
iii. Acceptance on behalf of customers Rs.500000
iv. Bills for collection Rs.480000.

BCOM (PA)		**2019-2020**
19PAU201	**CORPORATE ACCOUNTING**	**Semester – II** **8H – 6C**

Instruction Hours / week: L: 6 T: 2 P : 0 **Marks: Internal: 40 External: 60 Total: 100**

End Semester Exam: 3 Hours

COURSE OBJECTIVES :
To make the students

1. To understand the accounting process for Share capital and debenture and its application
2. To prepare final accounts for corporate
3. To understand the accounting standard and its application in inter-holding companies
4. To solve problems relating to Holding Company Accounts, Liquidation of Companies and various other Accounts
5. To understand and apply accounting process for Banking industry.

COURSE OUTCOMES:

Learners should be able to

1. Comprehend and apply the accounting process related corporate accounting
2. Prepare final accounts for corporate entity.
3. Understand the accounting standard and apply the same for corporate entity and amalgamation.
4. Understand the difference of banking balance sheet and non-banking balance sheet
5. Enhance the problem-solving skills and analytical skills in the accounting context.

UNIT I 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

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: Simple Problem only

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)

UNIT IV Accounts of Holding Companies/Parent Companies

Preparation of Consolidated Balance Sheet with one Subsidiary Company - Relevant Provisions of Accounting Standard: 21 (ICAI).

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.

Note: Distribution of marks - 20% theory and 80% problems

SUGGESTED READINGS

1. Reddy & Moorthy (2013), "*Corporate Accounting*" Margham Publications, Chennai
2. M.C. Shukla, T.S. Grewal, and S.C. Gupta (2016) *Advanced Accounts*. Vol.-II. – 19th Edition S. Chand & Co., New Delhi.
3. Dr S N Maheshwari, CA Sharad K Maheshwari & Dr Suneel K Maheshwari (2018) *Corporate Accounting*.- 6th Edition Vikas Publishing , New Delhi.
4. Jain, S.P. and K.L. Narang. (2015) *Corporate Accounting*. 8th Edition Vol - I Kalyani Publishers, New Delhi.
5. Jain, S.P. and K.L. Narang. (2014) Advanced Accountancy (*Corporate Accounting)*. 8th Edition Vol - I Kalyani Publishers, New Delhi.
6. CA & Dr. P C Tulsian & CA Bharat Tulsian (2016), *Corporate Accounting 2nd Edition*, S.Chand

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: MRS.R. NAVEENA & MRS.R.JAYALAKSHIMI
SUBJECT NAME: CORPORATE ACCOUNTING SUB.CODE:19PAU201
SEMESTER:II CLASS: I.B.COM PA

UNIT I			
S. No.	**Lecture Duration (Hr)**	**Topics to be covered**	**Support Materials**
1	1	Accounting for Share Capital and Debentures – Introduction to Company	R 1 : Pg. No. 1.2 – 1.13
2	1	Issue of Shares Meaning and Kinds of Shares	R 1 : Pg. No. 1.13 – 1.34
3	1	Problems to be worked out on issue of shares for cash consideration and for consideration other than cash	R 1 : Pg. No. 1.47 – 1.49
4	1	Problems to be worked out on issue of Shares at Par, Discount and Premium	R 1 : Pg. No. 1.52 – 1.63
5	1	Problems to be worked out on Pro-rata Allotment	R 1 : Pg. No. 1.54 – 1.55
6	1	Problems to be worked out on Forfeiture of Shares	R 1 : Pg. No. 1.73 – 1.82
7	1	Problems to be worked out on reissue of forfeited shares - when all forfeited shares were reissued (T)	R 1 : Pg. No. 1.82 – 1.87
8	1	Concept and Process of Book Building	
9	1	Issue of Right and Bonus Shares Buy back of shares	R 1 : Pg. No. 1.34 – 1.46
10	1	Redemption of Preference Shares – Introduction	R 1 : Pg. No. 3.1 – 3.10
11	1	Problems to be worked out on Redemption without fresh issue of shares	R 1 : Pg. No. 3.10 –3.14
12	1	Problems to be worked out on Redemption at a premium, partly out of profits and partly out of fresh issue (T)	R 1 : Pg. No. 3.14 – 3.22

13	1	Issue of Debentures Problems to be worked out on Debentures issued at par, premium and discount(T)	R 1 : Pg. No. 4.1 – 4.8
14	1	Redemption of debentures Problems to be worked out on Redemption by conversion (T)	R 1 : Pg. No. 4.33 – 4.36
15	1	Problems to be worked out on Redemption in installments	R 1 : Pg. No. 4.36 – 4.37
16	1	Problems to be worked out on Redemption out of Profits (T)	R 1 : Pg. No. 4.37 – 4.41
17	1	Problems to be worked out on Open Market Buying Method	R 1 : Pg. No. 4.41 – 4.50
18	1	Problems to be worked out on Open Market Buying Method	R 1 : Pg. No. 4.41 – 4.50
19	1	Recapitulation and discussion of Important questions	
		Total	**19 Hours**
		UNIT - II	
1.	1	**Final Accounts: Introduction**	R 1 : Pg. No. 7.1 – 7.2
2.	1	Preparation of Profit and Loss Account Form of Statement of Profit and Loss Account	R 1 : Pg. No. 7.2 – 7.5
3.	1	Problems to be worked out in Profit and Loss Account	R 1 : Pg. No. 7.33 – 7.82
4.	1	Problems to be worked out in Profit and Loss Account (T)	R 1 : Pg. No. 7.33 – 7.82
5.	1	Preparation of Balance Sheet of Corporate Entities Form of Statement of Balance Sheet	R 1 : Pg. No. 7.5 – 7.15
6.	1	Problems to be worked out in Balance Sheet(T)	R 1 : Pg. No. 7.33 – 7.82
7.	1	Disposal of Company Profits 1. Disposal in the forms of dividend 2. Transferring the profits to reserve funds/retained earnings.	R 1 : Pg. No. 7.15 – 7.24
8.	1	Valuation of Goodwill Introduction	R 1 : Pg. No. 8.1 – 8.11
9.	1	Problems to be worked out in Average Profit Method	R 1 : Pg. No. 8.17 – 8.20
10.	1	Problems to be worked out in Super Profit Method (T)	R 1 : Pg. No. 8.23 – 8.43
11.	1	Problems to be worked out in Capitalisation Method	R 1 : Pg. No. 8.43 – 8.45
12.	1	Valuation of Shares Concepts and Calculation	R 1 : Pg. No. 8.12 – 8.16
13.	1	Problems to be worked out in Net Assets Method Problems to be worked out in Yield Method (T)	R 1 : Pg. No. 8.46 – 8.56
14.	1	Problems to be worked out in Fair Value Method	R 1 : Pg. No. 8.69 – 8.76

15.	1	Recapitulation and discussion of Important questions	
Total			**15 Hours**
UNIT – III			
1	1	**Amalgamation of Companies: Introduction**	R 1 : Pg. No. 10.1 – 10.3
2	1	Concepts and Accounting Treatment as per Accounting Standard: 14 (ICAI)	R 1 : Pg. No. 10.1 – 10.3
3	1	Types of Amalgamation I. Amalgamation in the Nature of Merger II. Amalgamation in the Nature of Purchase	R 1 : Pg. No. 10.3 – 10.4
4	1	Methods of Accounting for Amalgamation 1. Pooling of Interest Method 2. Purchase Method	R 1 : Pg. No. 10.10 – 10.12
5	1	Problems to be worked out in the Nature of Merger	R 1 : Pg. No. 10.31 – 10.51
6	1	Problems to be worked out in the Nature of Merger (T)	R 1 : Pg. No. 10.31 – 10.51
7	1	Problems to be worked out in the Nature of Purchase	R 1 : Pg. No. 10.52 – 10.66
8	1	Problems to be worked out in the Nature of Purchase (T)	R 1 : Pg. No. 10.52 – 10.66
9	1	Internal Reconstruction - Introduction	R 1 : Pg. No. 9.1 – 9.2
10	1	Concepts and Accounting Treatment Accounting entries for Reduction of Capital	R 1 : Pg. No. 9.2 – 9.10
11	1	Problems to be worked out in the Alteration of Share Capital	R 1 : Pg. No. 9.11 – 9.13
12	1	Problems to be worked out in the Alteration of Share Capital (T)	R 1 : Pg. No. 9.11 – 9.13
13	1	Problems to be worked out in the Reduction of Capital (T)	R 1 : Pg. No. 9.13 – 9.32
14	1	Recapitulation and discussion of Important questions	
Total			**14 Hours**
UNIT - IV			
1	1	**Accounts of Holding Companies/Parent Companies : Introduction**	R 1 : Pg. No. 14.1 – 14.3
2	1	Procedure for Preparation of Consolidated Balance Sheet	R 1 : Pg. No. 14.3 – 14.12
3	1	Procedure for Preparation of Consolidated Balance Sheet	R 1 : Pg. No. 14.3 – 14.12

4	1	Format of Consolidated Balance Sheet with one Subsidiary Company	R 1 : Pg. No. 14.16 – 14.17
5	1	Preparation of Consolidated Balance Sheet with one Subsidiary Company	R 1 : Pg. No. 14.16 – 14.17
6	1	Problems to be worked out on Balance Sheet with Goodwill	R 1 : Pg. No. 14.17 – 14.19
7	1	Problems to be worked out on Balance Sheet with Goodwill (T)	R 1 : Pg. No. 14.17 – 14.19
8	1	Problems to be worked out on Balance Sheet with Goodwill	R 1 : Pg. No. 14.17 – 14.19
9	1	Problems to be worked out on Balance Sheet with unrealized profit in stock (T)	R 1 : Pg. No. 14.20 – 14.23
10	1	Problems to be worked out on Balance Sheet with Mutual obligation in bill	R 1 : Pg. No. 14.23 – 14.27
11	1	Problems to be worked out on Balance Sheet with Mutual obligation in bill (T)	R 1 : Pg. No. 14.23 – 14.27
12	1	Problems to be worked out on Balance Sheet with Capital Expenses (T)	R 1 : Pg. No. 14.27 – 14.30
13	1	Relevant Provisions of Accounting Standard: 21 (ICAI).	R 1 : Pg. No. 14.50 – 14.52
14	1	Recapitulation and discussion of Important questions	
Total			14 Hrs
UNIT - V			
1	1	**Accounts of Banking Companies: Introduction**	R 1 : Pg. No. 12.1 – 12.3
2	1	Types of Banking	R 1 : Pg. No. 12.3 – 12.6
3	1	Difference Between Balance sheet of Banking and Non-banking Companies	W 1
4	1	Prudential Norms Asset Structure of a Commercial Bank	W 1
5	1	Non-Performing Assets (NPA)	R 1 : Pg. No. 12.30 – 12.33
6	1	Format of Profit and Loss Account	R 1 : Pg. No. 12.6 – 12.8
7	1	Guidelines of RBI for Profit and Loss Account	R 1 : Pg. No. 12.8 – 12.10
8	1	Guidelines of RBI for Balance Sheet	R 1 : Pg. No. 12.16 – 12.23
9	1	Problems to be worked out on Profit and Loss Account (T)	R 1 : Pg. No. 12.38 – 12.52
10	1	Problems to be worked out on Balance Sheet (T)	R 1 : Pg. No. 12.54 – 12.60
11	1	Cash Flow Statement Concept of Funds	W 1

12	1	Problems to be worked out on Cash Flow Statement (T)	R 1 : Pg. No. 12.54 – 12.60
13	1	Preparation of Cash Flow Statement as per Indian Accounting Standard (Ind- AS): 7	W 1
14	1	Preparation of Cash Flow Statement as per Indian Accounting Standard (Ind- AS): 7 (T)	W 1
15	1	Recapitulation and discussion of Important questions	
16	1	Discussion of previous year End Semester Exam Question Paper	
17	1	Discussion of previous year End Semester Exam Question Paper	
18	1	Discussion of previous year End Semester Exam Question Paper	
Total			18 Hrs

R 1 : Reddy T.S. & Murthy. A. (2013). Corporate Accounting . Chennai. Margham Publications

Websites

W 1 : http://www.allbankingsolutions.com/Banking-Tutor/asset-classification.shtml

UNIT 1

SYLLABUS

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 (Being issue of shares at premium)		Rs. Xxx	Rs. Xxx xxx

Journals **Dr.**
Cr.

At discount

1.	**When issue is at discount:** Bank Account Dr.		Rs. Xxx	Rs. xxx

	Discount on issue of shares Account To Share capital Account (Being the application money on …shares @ Rs……. per share)			

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.		Xxx	xxx

	To Share Capital Account (Being the share allotment money on …. shares @ Rs. …… per share as per resolution dated……….)			
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:** 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	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 known as first call.

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

Sept. 11 Rs. 2.00 in last installment 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 Share Capital Account)		3,00,000	3,00,000
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		2,25,000	

	Dr. To Share First Call Account (Being the receipt of share first call money)			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. 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	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 (Being the receipt of first and final call on 80,000 equity shares @ Rs. 5 per share)		4,00,000	 4,00,000

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		Rs. xxx	Rs. xxx

	Dr. To Share Application Account (Being share application money along with premium received)			
	(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.		60,000	 40,000

	To Share Capital Account To Securities Premium Account (Being allotment money and securities premium due on 20,000 shares @ Rs. 3 per share)			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 (Being the amount received on account of first and final call on 19,960 shares @ Rs. 6 and calls in arrears on allotment)		1,19,940	1,19,760 180
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%		2.25	2.25

	p.a)			

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

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

			Rs.	Rs.
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)		4,500	 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

			Rs.	Rs.
1.	Equity Share Capital Account Dr. To Equity Share Allotment Account To Equity Share First Call Account To Equity Share Second Call Account To Shares Forfeited Account (Being forfeiture of shares of A,B & C)		8,000	 600 1,000 2,000 4,400
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**

JOURNAL

1.	Bank Account Dr.		Rs. 60,000	Rs. 60,000

	To Equity Share Application Account (Being the application money received on 30,000 equity shares @ Rs. 2 per share)			
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 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)		Rs. 2,50,000	Rs. 2,50,000
July.1	10% Preference Shares First Call Account Dr. To 10% Preference Share Capital Account (Being first call money due on 25,000 10% preference shares @ Rs. 7.50 per share, as per Directors resolution)		1,87,500	1.87,500
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

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 2,54,000	2009 Mar.6 April 1-14	By Bank Account By Bank Account	Rs. 2,04,000 50,000 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 Apr.1	By 10% Preference	Rs.

	To Balance c/d	6,25,000		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.

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%

Or,

5 2 ×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

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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		 XXX XXX	

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
❖ 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.		xxx xxx	

	Discount on Issue of Shares Account Dr. To Equity Share Capital Account To Securities Premium Account			xxx 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. To 12% Debentures Account (Being allotment of 10,000 12% debentures of Rs. 100 each)		10,00,000	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		30,00,000	30,00,000

	– the amount uncovered by the face value of the shares issued)			
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	99,000		
Less: Calls in arrear 1,000	1,00,000		
(On 50 shares @ Rs. 20 each)			
Reserves and Surplus:	50,000		
General Reserve	1,51,000		
Dev. Rebate Reserve			
Other Liabilities			
	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		500 800	1,000 300

	preference shares on payment of Rs. 500 and the profit transferred to Capital Reserve Account)			
	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		Fixed Assets: Other assets	 8,10,000

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

Note: Calculation of Cash at Bank :

CASH AT BANK ACCOUNT

	Rs		Rs
To Balance b/d		By Share Issue Expenses	
To Share Capital	90,000	By Preference Shareholders	5,000
To Securities Premium	45,000		1,10,000
To Pref. Shares Calls in Arrears		By Balance c/d	
To Red Pref. Share Capital	4,500		25,800
	800		
	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. Loss on the issue of Debentures Account Dr. To Debentures Account To Premium on Redemption of Debentures		xxx xxx	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.

1.	Entry for amount paid on redemption: Debentures Account Dr.		Rs. xxx	Rs. xxx

	To Bank Account			
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/cis 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.

According to the guidelines issued by SEBI, a company has to create Debenture Redemption Reserve equivalent to 50% of the amount of debentures issued before redemption of debentures commences. Thus, according to this provision redemption of debentures wholly out of capital is now not possible. 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:

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			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.		86,700	86,700

	To Bank Account (Being Debenture holders of Rs. 85,000 (redemption value Rs. 86,700) paid in cash)			
(2)	Total amount required for Redemption is Rs. 4,08,000, i.e., (4,00,000 X 102/100)			

UNIT-I

POSSSIBLE QUESTIONS
PART B

1. What is meant by Share Capital? Explain the different categories of share capital with the help of an illustration.
2. Distinguish between
   A) Over-subscription and under-subscription.
   B) Calls in arrears and calls in advance.
   C) Forfeiture of shares and surrenders of shares.
3. Give the journal entries only with narration of the following:
   a. Forfeiture of shares issued at a premium.
   b. Forfeiture of shares issued at a discount.
   c. Redemption of redeemable preference shares.
   d. Interest on calls in advance.
4. What are the provision of Companies Act, 1956 regarding redemption of redeemable preference shares?
5. What is a debenture? Describe the various methods for redemption of

debentures. Give Illustrations.

6. Explain with the help of journal entries how Sinking Fund Method for redemption of debentures is used.

7. State how will you deal with loss on issue of debentures in the books of accounts.

PART C

1. What are the provision of Companies Act, 1956 regarding Redemption of redeemable preference shares?

2. A limited company offered for subscription 50,000 equity shares of Rs.10 each at a premium of Rs.1.25 per share and 2,500 six per cent cumulative preference shares of Rs.100 each at par. The shares were payable as follows: On application Rs.3.75 per equity share (including the premium) and Rs.25 per preference shares ; on allotment Rs.2.50 per equity share and Rs.25 per preference share; on first and final call the balance due in both cases.

3. The public applied for 80,000 equity shares and 2,000 preference shares. Applications for 5,000 equity shares were declined, the application money being returned. The remaining applicants received allotment for two-thirds of their applications. Applications for preference shares were allotted in full.

4. Give journal entries to record these transactions in the company's books. New Ventures Ltd. made an offer of 1,00,000 Equity Shares of Rs.10 each payable as follows:

On application	Rs.2 per share
On allotment	Rs. 2 per share
On first call	Rs. 3 per share
On second call	Rs.3 per share

Applications were received for 1,60,000 shares and allotments were made pro-rata to the applicants for 1,50,000 shares, the remaining applications being refused and money refunded. Application money paid in excess by the allottees was adjusted with the money due on allotment.

Romesh the holder of 200 shares failed to pay the allotment money and on his failure to pay the first call, the shares were forfeited.

Karim another shareholder to whom 500 shares were allotted failed to pay the first and second call amounts and his shares were also forfeited after making the second call.

Out of the forfeited shares, 600 shares were reissued as fully paid on payment of Rs.9 per share.

You are required to show the journal entries for recording the forfeitures and re-issue of the shares.

5.A company has 4,000 6% redeemable preference shares of Rs.100 each fully paid. The company decides to redeem the shares on December 31, 1998 at a premium of 5 per cent. The company makes the following issues:

(a) 1,000 equity shares of Rs.100 each at a premium of 10 percent.

(b) 1,000 9% 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.

6.Journalise the following transactions :

(a) Debenture issued at 95 payable at 100.

(b) Debenture issued at 95 repayable at 105.

(c) Debenture issued at 100 repayable at 105.

(d) Debenture issued at 105 repayable at 100.

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S.No	QUESTION	Option 1
1	A company should purchase more than ___________shares of another company in order to become a holding company	50%
2	The Profit included in the closing stock on the date of consolidation is known as__________	Unrealised Profit
3	Minority Interest shown on the ________________	Liabilities side of Balance Sheet
4	A contingent liability is shown as a ______________in CBS	Assets side
5	The holding Co., shares of Revenue Profit of the Subsidiary is added to____________	Profit and Losss A/c in balancesheet
6	While Preparing a consolidated Balancesheet investments of the holding company in the equality shares of the subsidiary is replaced by the _________ and _________ of the Subsidiary.	Assets, Liabilities
7	Dividends paid out of Capital Profit must be credited to _____ a/c by the holding company	Bank A/c
8	Interim dividend pertaining to pre-acquisition period is adjusted to ________	Revenue Profit
9	Goods-in-transit and cash in transit should be entered on the ________ of the CBS	Assets side
10	Dividends paid out of Revenue Profit must be credited to _____ a/c by the holding company	Bank A/c
11	Bonus Shares issued out of ________ will have no effect on CBS	Unrealised Profit
12	Pre - acquisition Profit are also called___________	Unrealised Profit
13	Post- acquisition Profit are also called___________	Unrealised Profit
14	Preparation of consolidated Balance Sheet of Holding Co. and its subsidiary company as per	As 11
15	The share of outsiders in the Net Assets in subsidiary company is known as under :	outsiders liability
16	Pre-acquisition profit in subsidiary company is considered as :	Revenue profit
17	Excess of cost of investment over paid up value of the shares is considered as:	Revenue profit
18	Excess of paid up value of the shares over cost of investment is considered as:	Revenue profit
19	Profit earned before acquisition of share is treated as	Capital profit
20	Profit earned after acquisition of share is treated as	Capital profit

21	Preparation of consolidated statement as per AS 21 is	Optional
22	Holding Co. share in revenue profits of subsidiary company is adjusted in :	Cost of control
23	Unrealised profit on goods sold and included in stock is deducted from :	Capital profit
24	Face value debentures of subsidiary co. held by Holding Company is deducted from :	Debentures
25	Consolidated financial statements are prepared on the principle:	In form the companies are one entity; in substance they are separate.
26	Minority Interest includes :	Share in share capital
27	Pre-acquisition dividend received by Holding company is credited to	profit & loss A/c
28	Post Acquisition dividend received by Holding Company is debited to :	Bank A/c
29	A holding company is one which holds more than_____________	2/3rd Share Capital of Subsidiary Company
30	A company in which more than 50% of shares are held by another company is termed as ___________	Holding Company
31	Profit earned by a subsidiary company upto the date of acquisition of shares by the holding company are called___________	Revenue Profit
32	Profits made by a subsidiary company after the date of purchase of shares by the holding company are known as____________	Revenue Profit
33	The term Minority Intrest represents___________	The shareholders holding 50% of shares in subsidiary co
34	The excess price paid by a holding company to acquire 'controlling interest' in the subsidiary company is transferred to___________	Capital Reserve
35	To excess of the share in net assets of the subsidiary over and above the price paid for the investments is shown as__________	Capital Reserve
36	Unrealised profit included in stock is____________________	deducted from stock in Combined Balance Sheet

37	Any loss or Profit on Revaluation of assets and Outside Liabilities is_____________	Treated as revenue profit/Loss
38	Bonus Shares issued out of post acquisition side of CBS	Have no effect on CBS
39	The other Company controls the composition of its board of directors is called____________	Holding Company
40	A company in which more than 50% of shares are held by another company is termed as:	Holding Company
41	Holding company acquires ______________equity shares in a subsidiary, representing the controlling intrest	Majority
42	______________is the excess paid by the holding company to acquire controlling intrest in the subsidiary company	Debentures
43	On acquisition of business, which one of the following item is not taken over by the Purchasing Company _____________	Profit and loss account (debit balance)
44	Abnormal loss which occurred is usually debited to _____________	Profit and loss account
45	____________ refers to the claim of the minority or outside shareholders in the net assets of the subsidiary company	Minority Intrest
46	Consolidated financial statements are prepared by a parent company, merging the accounting data of itself and its__________	Holding Company
47	The revenue from sale to externel customers as reported in the profit and loss account is known as __________	Enterprice Revenue
48	Assets which are acquired for own use and not for resale are known as_________	Fixed Assets
49	Holding companies is also called ___________	Parent Companies
50	___________ are in addition to the separate financial statements of the parent enterprise	Consolidated financial statements
51	A _________ which presents concolidated financial statements should consolidate all subisidiaries, domestic as well as foreign	Parent Enterprise
52	The names of the ___________ of which reporting dates and different from that of the parent and the difference in reporting dates	Subsidiaries
53	Investments in subsidiaries should be accounted for in accordance with _____, accounting for investments	As-13

54	As-21 is applied in the preparation and presentation of ____________ for a group of enterprises.	Profit and Loss A/c
55	____________ is to lay down principles and procedures for preparation and presentation of consolidated financial statements.	AS -22
56	The acquire in a business combination is also called___________	Parent Enterprise
57	For transferring liabilities take over_____________is debited	Assets A/c
58	Bonds represents the _____________	Managers share in the business
59	The long term assets that have no physical existence but are rights that have value is known as ______________	Current Assets
60	The assets that can be converted into cash within a short period are known as ____________	Current Assets

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UNIT 4

Option 2	Option3	Option4	
60%	75%	80%	
Capital Reserve	Capital Reserve	Cost of Control	
Assets side of Balance Sheet	Both the side of Balance Sheet	None of the Above	
Foot note	Liability Side	None of the Above	
Liabilities side of Balance Sheet	Assets side of Balance Sheet	Both the side of Balance Sheet	
Liabilities, Assets	Profit and loss account, Liabilities	Profit and loss account, Assets	
profit & loss A/c	Investment A/c	Dividend A/c	
Cost of control	Capital Reserve	Goodwill	
liabilities side	Both the side of Balance Sheet	None of the Above	
profit & loss A/c	Investment A/c	Dividend A/c	
Capital profit	Realised Profit	Revenue Profit	
Capital profit	Realised Profit	Revenue Profit	
Capital profit	Realised Profit	Revenue Profit	
As 21	As 22	As 23	
Assets	subsidiary company's liability	Minority Interest	
Capital profit	Goodwill	Minority Interest	
Capital profit	Goodwill	Minority Interest	
Capital Reserve	Goodwill	Minority Interest	
Revenue profit	General Reserve	Revaluation Loss	
Revenue profit	General Reserve	Revaluation Loss	

Mandatory for listed Companies	Mandatory for Pvt. Ltd.	Companies Ltd. partnership firm	
Shown on Assets side of Balance sheet	Profit and loss account	Minority Interest	
Revenue profit	General Reserve	Revaluation Loss	
Cost of control	Minority interest	Debentures in consolidated balance sheet	
In form the companies are separate; in substance they are one.	In form and substance the companies are one entity.	In form and substance the companies are separate.	
Share in Capital profit	Share in Revenue profit	All of the above	
Capital profit	Investment A/c	Dividend A/c	
profit & loss A/c	Investment A/c	Dividend A/c	
50% Share Capital of Subsidiary Company	75% Share Capital of Subsidiary Company	2/3rd Share Capital of Government Company	
Subsidiary Company	Government Company	Public Company	
Capital profit	Revaluation Profit	Realisation Profit	
Capital profit	Revaluation Profit	Realisation Profit	
The intrest of outsiders in the subsidiary co	The company which holds more than 50% in subsidiary co	None of the Above	
Goodwill A/C	Capital Reserve	Cost of Control	
Goodwill A/C	Revenue Reserve	Cost of Control	
deducted from P&L A/c balance in Combined Balance Sheet liabilities sides	deducted from P&L A/c balance in Combined Balance Sheet	shown separately in assets side of CBS	

Ignored in CBS	Treated as capital profit/Loss and adjusted in the respective assets/liabilities in CBS	shown separately in assets side of CBS	
Decrease the total of assets side of CBS	Increase the goodwill to the extent of the holding company's share of the bonus.	Decrease the revenue Profit	
Subsidiary Company	Government Company	Public Company	
Subsidiary Company	Government Company	Public Company	
Minority	25% of equity Shares	40% of Equity Shares	
Cost of control	Minority interest	Debentures in consolidated balance sheet	
Cash balance	Bank balance	Bank a/c	
Cash balance	Bank balance	Liabilities side of balancesheet	
Majority Intrest	Cost of control	Debentures	
Subsidiary Company	Government Company	Public Company	
Segment Revenue	Segment Assets	None of the Above	
Wasting Assets	Current Assets	Fictitious Assets	
Subsidiary Company	Government Company	Public Company	
Profit and Loss A/c	Income Statement	Cash flow Statement	
Subsidiary Company	Government Company	Public Company	
Parent Enterprise	Government Company	Public Company	
As-11	As-12	As-14	

Consolidated financial statements	Income Statement	Cash flow Statement	
AS -23	AS -21	AS -24	
Subsidiary Company	Government Company	Public Company	
Realization A/c	Liabilities A/c	None of the Above	
investment by shareholders in business	Long term borrowings of business	trade creditors	
Fixed Assets	Intangible assets	Investments	
Fixed Assets	Intangible assets	Investments	

	Answer
	50%
	Unrealised Profit
	Liabilities side of Balance Sheet
	Foot notes
	Profit and Losss A/c in balancesheet
	Assets, Liabilities
	Investment A/c
	Cost of control
	Assets side
	profit & loss A/c
	Capital profit
	Capital profit
	Revenue Profit
	As 21
	Minority Interest
	Capital profit
	Goodwill
	Capital Reserve
	Capital profit
	Revenue profit

	Mandatory for listed Companies
	Profit and loss account
	Revenue profit
	Cost of control
	In form and substance the companies are one entity.
	All of the above
	Investment A/c
	profit & loss A/c
	50% Share Capital of Subsidiary Company
	Subsidiary Company
	Capital profit
	Revenue Profit
	The intrest of outsiders in the subsidiary co
	Goodwill A/C
	Capital Reserve
	deducted from P&L A/c balance in Combined Balance Sheet

	Treated as capital profit/Loss and adjusted in the respective assets/liabilities in CBS
	Decrease the revenue Profit
	Subsidiary Company
	Holding Company
	Majority
	Cost of control
	Profit and loss account (debit balance)
	Profit and loss account
	Minority Intrest
	Subsidiary Company
	Enterprice Revenue
	Fixed Assets
	Parent Companies
	Consolidated financial statements
	Holding Company
	Subsidiaries
	As-13

	Consolidated financial statements
	AS -21
	Subsidiary Company
	Liabilities A/c
	Long term borrowings of business
	Intangible assets
	Current Assets