ADVANCED CORPORATE ACCOUNTING
II M.COM , III SEMESTER

Dr.R.NIRMALA
ASSISTANT PROFESSOR
DEPARTMENT OF COMMERCE

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ADVANCED CORPORATE ACCOUNTING

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Pre- requisites:

1. The students should have basic knowledge on financial accounting
2. The students should have general idea about companies.

Objectives:

1. To educate students on recent developments in corporate accounting
2. To teach the students on various requirements of corporate reporting.
3. To develop skill in preparation of accounts of companies.
4. To help the students to understand the techniques of restructuring and liquidating corporate entities.
5. To make the students to qualify to get employment in corporate companies

Outcomes:

1. On the successful completion of this course the student will be able to gain knowledge and understand the concepts and practices of company accounts
2. The students shall have a comprehensive understanding on the advanced issues in accounting.
3. The students shall acquire a thorough knowledge in banking accounts. It helps them even to appear for competitive bank examinations.
4. The students shall get an exposure on the accounts of electricity companies

Unit I

Alteration of Share Capital& Amalgamation Absorption and Reconstruction:

Alteration of Share Capital - Procedure for Reducing Share capital. **Amalgamation, absorption and External reconstruction** - Methods of Computing purchase consideration-types of amalgamation. Internal reconstruction Vs External reconstruction – simple problems. **(20L)**

Unit II

Valuation of Goodwill& Liquidation of companies:

Valuation of Goodwill – Factors determining the value of Goodwill-Methods of valuation of Goodwill. **Valuation of shares** – Methods of valuation of shares – **Liquidation of companies** – Liquidators final statement of accounts – simple problems. **(15L)**

Unit III

Accounts of Banking Companies:

Accounts of Banking companies - Rebate on bills discount – Assets classification and provisions – preparation of various schedules and final accounts – Simple problems. **(15L)**

Unit IV

Accounts of Insurance companies:

Accounts of Insurance companies : Life Insurance and General Insurance – Preparation of various schedules and final accounts. Simple problems. **(20L)**

Unit V

Double Accounting & Accounts of Holding Companies:

Double Accounting – Accounts of Electric supply companies (including railways and public utilities). Replacement of assets – preparation of final accounts.**Accounts of Holding companies** : steps involved in preparation of consolidated balance sheet - legal provisions – simple problems. **(20L)**

(Total :90L)

Reference books

Advanced Accountancy ,S.P.Jain and K.L.Narang.

Advanced Accounts,M.C.Shukla, T.S.Grewal, S.C.Gupta

Advanced Corporate accounts – by M.A.Arulanandam, K.S.Raman

Advanced Accountancy, R.L.Gupta, M.Radhaswamy.

AMALGAMATION, ABSORPTION AND EXTERNAL RECONSTRUCTION

Amalgamation :

When two or more companies go into liquidation and a new company is formed to take over the business of the above two or more companies, this process is known as **amalgamation.**

Amalgamation refers to two or more companies merging to form a new company. Example : A Ltd and B Ltd went into liquidation formed a new company (AB Ltd) to take over the business of A Ltd and B Ltd.

In amalgamation, existing two companies are liquidated and a new company is formed.

To avoid competition and to fix the price of an article, amalgamation takes place.

Absorption :

When one or more existing companies go into liquidation and some existing company takes over the business, it is said to be absorption. That is, the business of a small company is absorbed by the big company. Absorption refers to the acquisition of business by an existing company.

Example:

A Ltd (existing company) absorbs the business of B Ltd (existing Company). In absorption, no new company is formed.

Reconstruction :

Reconstruction refers to the reconstruction of a company's financial structure. It may take place with or without the liquidation of the company. If a company goes into liquidation for reconstruction, then it is known as **external reconstruction.**

When one existing company goes into liquidation and a new company is formed inorder to buy its business, it is said to be external reconstruction. When a new company is formed with the same name in order to take over the business of an existing company, it is called **external reconstruction.**

Example : A Ltd goes into liquidation and a new company B Ltd is formed to take over the business A Ltd.

Internal Reconstruction:

Internal Reconstruction is a scheme of arrangement made among the parties in the company for any one or more of the following purposes:

i) Reduction of share capital

ii) Vary the rights of different types of shareholders, debentureholders and creditors

iii) To write off the accumulated losses of the company.

iv) To reduce the over valuation of assets of the company.

Internal reconstruction is also known as capital reduction. In internal reconstruction, no new company is formed. In internal reconstruction, reorganisation of capital structure of a company takes place.

Example :

A company incurred heavy losses. It made a scheme of reconstruction to set off losses. Parties involved in the company (shareholders, debentureholders and creditors) may sacrifice certain amounts to the company to adjust the accumulated losses.

Differences between amalgamation, absorption and Reconstruction:

1) Under amalgamation, two or more companies go into liquidation. In case of absorption, one or more companies go into liquidation. But under external reconstruction only one company goes into liquidation.

2) Under amalgamation, the shareholders of amalgamated company are the shareholders of amalgamating company. In case of absorption, the shareholders of purchasing company become the shareholders of new company. But in reconstruction, the shareholders of the new company are the shareholders of the old company.

3) Under amalgamation, a new company is formed. But in case of absorption, no new company is formed. Existing company takes over the business of another company. In case of reconstruction new company is formed to take over the business of liquidated company.

3

Differences between external reconstruction and Internal reconstruction :

	External Reconstruction	*Internal Reconstruction*
i)	One company goes into liquidation.	One company does not go into liquidation.
ii)	New company is formed.	No new company is formed.
iii)	New company is formed.Therefore, there is no question of capital reduction.	Capital is reduced.

iv)	Accumulated losses of vendor company are transferred to equity shareholder's account.	Accumulated losses are written off through capital reduction.
v)	Court's sanction is not necessary	Court's sanction is necessary
vi)	It involves the liquidation of an old company and formation of a new company.	It involves reorganisation of existing company.
vii)	It is governed by the provisions of Sec 394 of the Companies Act.	It is governed by the provisions of Sec.100 of the Companies Act.

Purchase Consideration:

Accounting Standard - 14 defines the term consideration as follows. "Consideration for amalgamation means the aggregate of the shares and other securities issued and payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company". **Payment made to debentureholders should not be considered as part of purchase consideration.** Purchase consideration should not include the amount of liabilities taken over by the transferee company.

Amount of purchase consideration (amalgamation under merger) can be computed under any one of the following four methods.

1) Lumpsum method 2) Net payment method
3) Net assets method 4) Instrinsic value method

i) Lumpsum method:

Under this method, the transferee company agrees to pay a fixed sum to the transferror company. The purchase price to be paid to shareholders may be stated in the agreement directly.

Example:

If A Ltd purchase the business of B Ltd for a price of Rs. 5,00,000. This Rs. 5,00,000 is the purchase consideration in lumpsum.

ii) Net assets method:

According to this method, the purchase consideration is calculated on the basis of net assets taken over by the transferee company.

Net assets to be taken by the purchasing company is considered to be the purchase consideration.

As per AS -14, purchase consideration has the following implications.

i) Purchase consideration refers to the total amount payable to the shareholders of the selling company only.

ii) Purchase consideration does not include the amount payable to creditors and debentureholders.

iii) Liquidation expenses of selling company paid by the purchasing company are added to the purchase consideration.

AS 14 refers to consideration payable both to the prefrence and equity shareholders of the transferor company.

In some circumstances, liquidation expenses are paid by the selling company and the same amount is reimbursed by the purchasing company.

Calculation of purchase consideration under Net Asset Method :

Assets and Liabilities taken by the purchasing company at an agreed value:

		Rs.
Land and Buildings		xxx
Plant and Machinery		xxx
Debtors		xxx
Stock in trade		xx
Furniture		xx
		xxx
Less : Creditors	xx	
Other Liabilities	xx	xxx
Net Assets		xxx

While calculating net assets, following points are to be considered

i) While calculating net assets, items such as preliminary expenses, debit balance of profit and Loss a/c, discount on issue of shares and debentures etc are to be excluded.

ii) When a company takes over another company or the business of another company, it means that both assets and liabilities to third parties are taken over.

iii) The term trade liabilities implies trade creditors and Bills payables. It excludes bank overdraft, debentures, outstanding expenses, Tax payable etc.

iv) When a company takes over the assets of another company, it implies that purchase consideration includes cash and bank balances. But accumulated losses if any should be excluded.

v) The term liabilities include all amount due to third parties excluding amount payable to shareholders.

vi) While calculating purchase consideration, liabilities which are not taken by the purchasing company are to be excluded.

vii) Assets which are not taken by the purchasing company should not be considered while calculating purchase consideration.

Example:

Total assets to be taken by the purchasing company is Rs. 5,00,000 and its liability amounted to Rs. 50,000. Therefore, purchase consideration is Rs. 5,00,000 – 50,000 = Rs. 4,50,000.

Problem : 1

The company B takes over the business of company A. The value agreed for various assets is goodwill Rs. 32,000, Land and Buildings Rs. 25,000. Plant and Machinery Rs.34,000. Stock Rs. 13,000. Debtors Rs. 8,000. B Company does not take over cash but agrees to assume the liabilities of sundry creditors at Rs. 25,000. Calculate purchase consideration.

Answer :

	Rs.
Agreed value of assets:	
Goodwill	32,000
Land and buildings	25,000
Plant and Machinery	34,000
Stock	13,000
Debtors	8,000
Total assets	1,12,000
Less : Agreed value of liabilities - creditors	25,000
Purchase consideration	87,000

Problem : 2

The balance sheet of A Ltd and B Ltd as on 31st March 2005 were

Liabilities	A Ltd	B Ltd	Assets	A Ltd	B Ltd
Share capital			Goodwill	5,000	2,000
(Rs. 50 each)	50,000	40,000	Buildings	17,000	10,000
General reserve	20,000	-	Machinery	24,000	16,000
P / L a/c	3,000	-	Vehicles	5,000	7,500
Creditors	4,000	8,000	Stock	10,000	7,500
Bank Overdraft	4,000	8,000	Debtors	12,000	7,000
			Cash	8,000	300
			P / L a/c	-	5,700
	81,000	56,000		81,000	56,000

The above two companies wanted to amalgamate and the following scheme of valuation is proposed.

A Ltd 1. Provide 5% on debtors

2. Write off Rs. 400 from stock and 33 1/3 from machinery.

B Ltd 1. Eliminate its goodwill and P/L a/c
2. Write off Rs. 1,000 on debtors as bad and provide 5% on debtors.
3. Write off 10% of machinery and Rs. 1,400 from stock.
Compute purchase consideration.

(M.S.University, November 2005)

Answer : Calculation of purchase consideration

A Ltd : Agreed value of assets:

		Rs.
Goodwill		5,000
Buildings		17,000
Machinery (24,000 - 8,000) 1/3 on 24,000		16,000
Vehicles		5,000
Stock (10,000 - 400)		9,600
Debtors (12,000 - 600)		11,400
Cash		8,000
		72,000
Less : Agreed value of third party liabilities		
Creditors	4,000	
Bank overdraft	4,000	8,000
Purchase consideration		64,000

B Ltd : Agreed value of assets

Buildings		10,000
Machinery (16,000 - 1,600)		14,400
Vehicles		7,500
Stock (7,500 - 1,400)		6,100
Debtors (7,000 - 1,000 = 6,000) - 300 (i.e 5/100 × 6,000)		5,700
Cash		300
Total assets		44,000
Less : Agreed value of third party Liabilities		
Creditors	8,000	
Bank	8,000	16,000
Purchase consideration		28,000

(iii) 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.

The total of payments (in the form of cash or shares or debentures) represents the net payment made by the purchasing company as purchase price for the concern.

Example :

A Ltd agrees to purchase the business of X Ltd, on the following terms.

i) For each of the 10000 shares of Rs. 10 each in X Ltd. 3 shares in A Ltd of Rs. 10 each will be issued at an agreed value of Rs. 12 per share. In addition, Rs. 5 per share cash will be paid.

ii) 10% Debentures worth Rs. 1,00,000 will be issued to settle the Rs. 75,000 9% debentures in X Ltd.

iii) Rs. 20,000 will be paid towards expenses of winding up.

Calculate purchase consideration when the amalgamation is in the nature of merger.

Answer:

	Rs.
Shares issued to shareholder of X Ltd	
10,000 × 3 × 12	3,60,000
Cash paid to shareholders of X Ltd	
(10,000 × 5)	50,000
Purchase consideration	4,10,000

In this the net payment is 3,60,000 + 50,000 = Rs. 4,10,000

Note:

i) Payment to debentureholders should not be included in the purchase consideration.

ii) Payment of expenses of winding up by the purchasing company may be debited to General Reserve in the books of purchasing company.

iii) If any liabilities are taken by purchasing company, such amount should not be considered while calculating purchase consideration.

iv) When the liquidation expenses of selling company are paid by the purchasing company then that expenses should not be considered.

Problem : 3

Calculate purchase consideration.

i) A cash payment equivalent to Rs. 3 for every Rs. 10 share in G Ltd. (No.of shares 1,20,000)

ii) The issue of 90,000 shares of Rs. 10 fully paid in W Ltd having an agreed value of Rs. 12 per share.

iii) The issue of 5% debentures of W Ltd for 6% debentures of the G Ltd (Rs.

1,00,000) at a premium of 20%. (M.S.University, April 2014)

Answer :

Payment of cash @ Rs.3 for every Rs. 10 share =1,20,000 × 3=	3,60,000
90,000 shares of Rs.10 fully paid @ Rs. 12 = 90,000 × 12	= 10,80,000
Purchase consideration	= 14,40,000

iv) Intrinsic value method or shares exchange method:

Under stock exchange method, the purchase consideration is ascertained on the basis of the ratio in which the shares of purchasing company are exchanged for the shares of selling company. Under this method, purchase consideration is required to be calculated on the basis of the ratio in which the shares of the purchasing company are exchanged with those of the selling company. The exchange ratio is calculated on the basis of intrinsic values of the respective companies' shares.

The intrinsic value of a share is calculated by dividing the value of net assets available to equity shareholders by the number of equity shares of the company.

The ratio of exchange may be decided on the basis of the intrinsic or market value of the shares concerned.

$$\text{Intrinsic value} = \frac{\text{Assets available to equity shareholders}}{\text{Number of equity shares}}$$

Example:

X Ltd and Y Ltd are two companies carrying on business in the same line of business. Their capital is Rs. 4,00,000 and Rs. 2,00,000 respectively (face value of each share Rs. 10). The two companies decided to amalgamate in XY Ltd. The two companies shares are valued at Rs. 20 and Rs. 25 respectively for the purpose of amalgamation. Calculate purchase consideration of each company.

Answer:

	X Ltd	Y Ltd
40,000 shares of Rs. 20 each	8,00,000	-
20,000 shares of Rs. 25 each	-	5,00,000

Example :

Arun Ltd was taken over by Rajan Ltd. The following position was mutually agreed upon.

	Arun Ltd.	Rajan Ltd.
No. of shares	60,000	60,000
Face value of share (Rs.)	100	10
Net asset (Rs.)	3,60,00,000	90,00,000

Calculate intrinsic values of the shares, ratio of the shares, ratio of exchange of shares and No.of shares to be issued.

Answer:

	Arun Ltd.	Rajan Ltd.
Net asset (Rs.)	3,60,00,000	90,00,000
No of shares	60,000	60,000
Intrinsic value of shares (Rs.)	600	150
Ratio	1	4

Number of shares issued = 1 share of Arun Ltd is equal to 4 shares of Rajan Ltd.
Hence, number of shares to be issued = 60,000 × 4 = 2,40,000 shares

Problem : 4

B Ltd agreed to absorb A Ltd upon the following terms.

Shares of A Ltd are to be considered worth Rs. 12 each (of which shareholders are to be paid one quarter in cash and the balance in Rs. 100 shares of B Ltd which are to be issued at 25% premium. Total shares were : 10,000 in B Ltd and 20,000 in A Ltd. Ascertain the number of shares to be issued by B Ltd. ***(M.S.University, Nov.2014)***

Answer : Calculation of purchase consideration

Payment of cash	20,000 × 12 × ¼	60,000
Payment of shares	20,000 × 12 × ¾	1,80,000
Purchase consideration		2,40,000

No.of equity shares to be issued by B Ltd to A Ltd = $\frac{1,80,000}{125}$ = 1,440

Issue price of one equity share of B Ltd = 100 + 25 = Rs. 125 per share.

Problem : 5

A purchasing company agrees to issue three shares of Rs. 10 each paid up at market value of Rs. 15 per share for every 5 shares in the vendor company. Find out the number and amount of shares to be issued by the purchasing company if the vendor company has 1,00,000 shares of Rs.10 each Rs. 5 paid up. ***(M.S.University, April 2013)***

Answer :

For every 5 shares of vendor company, shares issue by vendor company = 3
For 1,00,000 shares of vendor company, shares of purchasing company
= 3/5 × 1,00,000 = 60,000

Calculation of purchase consideration :

Amount of shares issued (capital) 60,000 × 10	= 6,00,000
Securities premium = 60,000 × 5	= 3,00,000

Purchase consideration = 9,00,000

Net Asset Method:

Problem : 6

The company B takes over the business of company A. The value agreed for various assets is goodwill Rs.22,000 ; Land and Buildings Rs.25,000 ; Plant & Machinery Rs. 24,000 ; Stock Rs.13,000 ; Debtors Rs. 8,000. B company does not take over cash but agrees to assume the liability of sundry creditors at Rs. 5,000. Calculate purchase considered.

(M.S.University, Nov: 2017)

Answer : Calculation of purchase consideration

	Rs.
Goodwill	22,000
Land and Buildings	25,000
Plant & Machinery	24,000
Stock	13,000
Debtors	8,000
Total assets taken over	92,000
Less : Liabilities taken over	
Sundry creditors	5,000
Purchase consideration	87,000

Problem : 7

The capital of A, B and C partnership firm at the date of purchase by the limited company were Rs.10,000; Rs.6,000 ; Rs. 5,000. The partnership firm was converted into a limited company and assets and liabilities were sold to the company agreed to pay Rs.8,000 more than the book value and machinery which was taken at the Rs.1,000 less than the book value.

Calculate total purchase consideration.

(M.S.University, April 2011, Nov.2011, November 2013)

Answer :

Net Assets = Assets - Liabilities = Capital employed

Purchase consideration = Total capital of A, B & C

Calculation of purchase consideration

		Rs.
A' Capital		10,000
B's Capital		6,000
C's Capital		5,000
		21,000
Less : Increase in value of liabilities	8,000	
Decrease in value of Assets	1,000	9,000

Purchase consideration 12,000

Accounting for Amalgamation - Accounting Standard 14 (AS - 14) :

The concept amalgamation has been modified by the Accounting Standard 14. This standard is applicable in respect of accounting periods commencing on or after 1st April 1995 and is madatory in nature.

Transferor company is one which is amagamated into another company.

Transferree company means the company into which a transferor company is amalgamated.

Types of Amalgamation :

There are two types of amalgamation.

1. Amalgamation in the nature of merger.
2. Amalgamation in the nature of purchase.

1. Amalgamation in the nature of Merger :

It is also known as pooling interests method of amalgamation. Amalgamation in the nature of merger occurs when the following conditions are satisfied.

i) All the assets, liabilities and reserves of the transferror company should be recorded at their existing amount in the books of the transferee company. No adjustments is intended to be made to the book values of the assets and liabilities of the tranferor company.

ii) Shareholders holding not less than 90% of the face value of equity shares of the tranferor company become equity shareholders of the transferee company after amalgamation.

iii) The consideration for amalgamation shall be discharged by the transferee company.

iv) The business of the transferor company is intended to be carried on after, the amalgamation by the transferee company.

v) Any excess amount paid as purchase consideration shall be adjusted in reserves.

vi) The balance of the profit and loss account of the transferor company should be aggregated with the corresponding balance of the transferee company.

Pooling interest method has no specific effect on the book value of the transferor company.

2. Amalgamation in the nature of purchase:

It is also known as purchase method. Under this method when any one or more of the conditions specified for amalgamation in the nature of merger is not satisfied.

Differences between pooling interest method and purchase method:

Pooling Interest Method	Purchase Method
i) It is the amalgamation in the nature of merger.	It is the amalgamation in the nature of purchase.
ii) All the assets and liabilities are transferred at their book values.	All the assets and liabilities are transferred at market value or shown at any value.
iii) All the reserves of the transferor company are recorded in the same form in the transferee company.	The reserves of the transferor company are not transferred to the transferee company.
iv) Any excess amount paid as purchase consideration shall be adjusted in reserves.	Any excess amount paid as purchase consideration is treated as goodwill or shown as capital reserve.
v) Any excess amount paid as purchase consideration shall be adjusted in reserves. So there is no question of treatment of goodwill.	Any excess amount paid as purchase consideration shall be shown as goodwill or capital reserves. In such a case, goodwill is to be written off within 5 years.
vi) Liquidation expenses paid by purchasing company is debited to General Reserve of the purchasing company. Sometimes it may be added to purchase consideration.	Liquidation expenses paid by the purchasing company is debited to Goodwill account.

Journal entries in the books of vendor company or Transferor company:

The books of transferror company being wound up will be closed in the same way as the books of a partnership firm being dissolved.

Journal entries:

Particulars		**Debit**	**Credit**
i) To Transfer assets:			
Realisation a/c	Dr	xx	
To Assets a/c			xx
ii) To Transfer liabilities:			
Creditors a/c	Dr	xx	
B/P a/c	Dr	xx	
Other liabilities a/c	Dr	xx	

To Realisation a/c			xx
iii) Purchase consideration:			
Purchasing company a/c	Dr	xx	
To Realisation a/c			xx
iv) To receive purchase consideration:			
Shares a/c	Dr	xx	
Cash a/c	Dr	xx	
Debentures a/c	Dr	xx	
To Purchasing company a/c			xx
v) Assets not taken by purchasing company sold out			
Cash a/c	Dr	xx	
To Realisation a/c			xx
vi) Liabilities not paid by purchasing company:			
Realisation a/c	Dr	xx	
To cash a/c			xx
vii) Realisation expenses paid:			
Realisation a/c	Dr	xx	
To cash a/c			xx
viii) Realisation expenses paid by purchasing company:			
a) Cash a/c	Dr	xx	
To Purchasing company a/c			xx
b) Purchasing company a/c	Dr	xx	
To cash a/c			xx
ix) Realisation profit:			
Realisation a/c	Dr	xx	
To Shareholders a/c			xx
(If there is any realisation loss-reverse entry is to be followed.)			
x) To transfer loss:			
Shareholders a/c	Dr	xx	
To P & L a/c			xx
xi) To transfer Reserves & Surplus:			
Reserve fund a/c	Dr	xx	
P & L a/c	Dr	xx	
General Reserve a/c	Dr	xx	
To Shareholders a/c			xx
xii) To transfer debenture:			
Debenture a/c	Dr	xx	
Realisation a/c	Dr (premium)	xx	
To debentureholders a/c			xx

xiii) To pay the amount to the debentureholders:			
Debentureholders a/c	Dr	xx	
To Bank a/c			xx
xiv) Shareholders a/c	Dr	xx	
To Cash a/c			xx
To Shares a/c			xx
(Being account Settled)			

Note : As per AS14, while calculating purchase consideration, amount payable to Debentureholders need not be taken into account. It may be settled by the purchasing company individually.

Problem : 8

The balance sheet of X Ltd and Y Ltd as on 31.3.1917 are given below.

Liabilities	A Ltd	B Ltd	Assets	A Ltd	B Ltd
Equity capital			Premises	1,20,000	-
Rs.100 each	4,00,000	3,60,000	Goodwill	-	1,20,000
General			Debtors	80,000	1,60,000
Reserve	75,000	-	Stock	3,00,000	90,000
P & L a/c	38,000	-	Bank	85,000	75,000
Creditors	72,000	1,20,000	P & L a/c	-	35,000
	5,85,000	4,80,000		5,85,000	4,80,000

A new company, XY Ltd was formed to take over the two businesses in entirely on the following terms :

i) X Ltd. Premises to be revalued at Rs. 1,50,000. Debtors to be taken over at 90% and stock at Rs. 3,15,000.

ii) Y Ltd. Goodwill to be taken over at Rs. 16,000. Debtors to be taken over at Rs.1,50,000 and stock at 75,000.

It was decided that the purchase consideration of both X and Y Ltd was discharged by the equity shares of Rs.10 of XY Ltd. Calculate Purchase consideration and Prepare the Balance Sheet of XY Ltd.

(M.S.University, April 2000)

Answer : Calculation of Purchase consideration

Particulars	**X Ltd Rs.**	**Y Ltd Rs.**
Premises	1,50,000	-
Debtors	72,000	1,50,000
Stock	3,15,000	75,000
Bank	85,000	75,000
Goodwill	-	16,000

	6,22,000	3,16,000
Less : Third Parties Liabilities :		
Creditors	72,000	1,20,000
Purchase consideration	5,50,000	1,96,000
No. of share to be received	55,000	19,600

Balance sheet of XY Ltd as on 31.3.1997

	Note No.	Amount
I Equity & Liabilities		
i) Share holder's funds		
Share capital	1	7,46,000
Reserves & Surplus		-
ii) Non-current liabilities :		
Long term borrowing		-
iii) Current Liabilities		
Trade payables	2	1,92,000
Total of (i) (ii) and (iii)		9,38,000
II Assets :		
i) Non-current assets :		
Fixed assets		
Tangible	3	1,50,000
Intangible		16,000
ii) Current Assets :		
Inventories	4	3,90,000
Trade receivables	5	2,22,000
Cash and Cash equivalents	6	1,60,000
		9,38,000

Notes forming part of Balance Sheet : **Rs.**

1) Share capital :		
74,600 shares of Rs.10 each		7,46,000
2) Trade payables:		
Creditors of X		72,000
Creditors of Y		1,20,000
		1,92,000
3) Tangible assets :		
Premises		1,50,000
4) Inventories		
Stock of X		3,00,000
Stock of Y		90,000
		3,90,000
5) Trade Receivables :		

Debtor of X 90% of 80,000	72,000
Debtors of Y	1,50,000
	2,22,000

6) Cash and Cash equivalents :

Bank Balance of X	85,000
Bank Balance of Y	75,000
	1,60,000

Problem : 9 Given below are the balance sheets as on March 31, 2005 of A Ltd and B Ltd. which are amalgamated to form a new company Gama Ltd.

Liabilities	A Ltd Rs.	B Ltd Rs.	Assets	A Ltd Rs.	B Ltd Rs.
Share capital of Rs. 100 eac fully paid	1,00,000	2,00,000	Fixed Assets		
			Good will	-	40,000
			Building	30,000	25,000
Capital reserve	50,000	10,000	Plant	60,000	80,000
General reserv	10,000	-	Furniture	5,000	10,000
P & L a/c	40,000	-	Current assets		
Loans	80,000	60,000	Stock	1,00,000	1,40,000
Other Liabilitie	20,000	80,000	Debtors	1,04,000	13,000
			Cash at Bank	1,000	2,000
			P & L a/c	-	40,000
	3,00,000	3,50,000		3,00,000	3,50,000

The shareholders in the amalgamating companies are to be allotted fully paid equity shares in Gama Ltd for the amount of purchase consideration for which purpose all assets and liabilities are to be taken at book values except Goodwill of B Ltd.

Show the opening balance sheet of the New company.

(M.S.University, April 2014, April 2015)

Answer : Calculation of purchase consideration

	A Ltd Rs.	B Ltd Rs.
Goodwill	-	-
Buildings	30,000	25,000
Plant	60,000	80,000
Furniture	5,000	10,000
Debtors	1,04,000	13,000

Stock		1,00,000		1,40,000	
Cash at Bank		1,000		2,000	
Agreed value of assets		3,00,000		2,70,000	
Less : Liability					
Loans	80,000		60,000		
Other Liabilities	20,000	1,00,000	80,000		1,40,000
Purchase consideration		2,00,000			1,30,000

In the Books of Gama Ltd :

Journal entries :

	Particulars		Debit	Credit
i)	Business purchases a/c	Dr	3,30,000	
	To Liquidator of A Ltd			2,00,000
	To Liquidator of B Ltd			1,30,000
	(Being business purchased)			
ii)	Building a/c	Dr	55,000	
	Plant a/c	Dr	1,40,000	
	Furniture a/c	Dr	15,000	
	Stock a/c	Dr	2,40,000	
	Sundry Debtors a/c	Dr	1,17,000	
	Cash at Bank a/c	Dr	3,000	
	To Loans			1,40,000
	To Other liabilities			1,00,000
	To Business purchases a/c			3,30,000
	(Being assets and liabilities incorporated)			
iii)	Liquidator of A Ltd a/c	Dr	2,00,000	
	Liquidator of B Ltd a/c	Dr	1,30,000	
	To Share Capital a/c			3,30,000
	(Being shares issued to liquidators of A Ltd and B Ltd)			

In the Books of Gama Ltd:

Opening Balance Sheet as on 31.3.2005

I Equity & Liabilities	Note No.	Amount
i) Shareholder's funds		
Share capital	1	3,30,000
ii) Non-current Liabilities		-
iii) Current Liabilities		
Short term borrowings	2	1,40,000
Other liabilities	3	1,00,000
Total		5,70,000

II Assets :

i) Non - current Assets :		
Fixed Assets		
Tangible Assets	4	2,10,000
ii) Current Assets :		
Inventories	5	2,40,000
Trade Receivables	6	1,17,000
Cash and Cash equivalents	7	3,000
Total		5,70,000

Notes forming part of Balance Sheet :

1) Share capital :

3,300 shares of Rs. 100 each	3,30,000

2) Short term borrowings :

Loans - A Ltd	80,000
Loans - B Ltd	60,000
	1,40,000

3) Other Liabilities :

A Ltd	20,000
B Ltd	80,000
	1,00,000

4) Tangible Assets :

Building -	30,000 + 25,000	55,000
Plant -	60,000 + 80,000	1,40,000
Furniture -	5,000 + 10,000	15,000
		2,10,000

5) Inventories :

	1,00,000
Stock of A Ltd	1,40,000
Stock of B Ltd	2,40,000

6) Trade Receivables

	1,04,000
Debtors of A Ltd	13,000
Debtors of B Ltd	1,17,000

7) Cash and Cash equivalents :

	1,000
A Ltd	2,000
B Ltd	3,000

Liabilities	Amount Rs.	Assets	Amount Rs.
Share capital	1,20,000	Land and buildings	90,000
Sundry Creditors	30,000	Plant and Machnery	50,000
Bank overdraft	28,000	Stock	17,000
		Debtors	20,000
		P & L a/c	1,000
	1,78,000		1,78,000

The company went into volundary liquidation and the assets were sold to Y Co. Ltd., for Rs. 1,50,000 payable as to Rs.60,000 in cash and for Rs. 90,000 equity shares. The cash payment Rs. 60,000 is sufficient to discharge creditors. Bank Payables Rs. 2,000 liquidation expenses. Prepare realization a/c.

(M.S.University, April 2014)

Answer :

Purchase consideration - Rs. 1,50,000

Cash - Rs. 60,000

Shares - Rs. 90,000

Realisation a/c

Particulars	*Amount Rs.*	*Particulars*	*Amount Rs.*
To Land & Buildings	90,000	By Y & Co Ltd. a/c	1,50,000
To Plant & Machinery	50,000	By Share holders	29,000
To Stock	17,000		
To Debtors	20,000		
To Cash (Expenses)	2,000		
	1,79,000		1,79,000

Problem : 15

Following is the balance sheet of X company Ltd., as on June 30, 2006.

Balance Sheet

Liabilities	Amount Rs.	Assets	Amount Rs.
12,000 equity shares of Rs. 500 each	60,00,000	Land & Building	27,20,000
2,600 debentures @ Rs. 500 each	13,00,000	Plant and Machinery	30,00,000
P & L a/c	20,000	Furniture & Fittings	1,00,000
Sundry Creditors	5,00,000	Patents and Trade marks	4,00,000

Workman's Savings bank	4,00,000	Stock	20,00,000
Insurance fund	1,30,000	Debtors	6,00,000
General Reserve	6,50,000	Cash at Bank	1,80,000
	90,00,000		90,00,000

Y Company Ltd., agreed to take over X Ltd on the following basis.

i) Payment of cash at Rs.90 for every share in X Ltd.

ii) Payment of cash at Rs.5.50 for every debentureholder in full discharge of debentures.

iii) Exchange of 4 shares of Y Company Ltd., of Rs. 75 each (quoted in the market at Rs.140 each) for every share in X Company Ltd.,

Show necessary ledger accounts in X Ltd.

(M.S.University, April 2010 ,April 2011,Nov.2011,Nov.2012 , April 2013)

Answer : Calculation of purchase consideration:

Payment to equity shareholders

Cash (12,000 × 90)	10,80,000
Shares 4/1 × 12,000 × 75	36,00,000
	46,80,000

In the Book of X Ltd - Ledger accounts

Realisation account

Particulars	***Amount Rs.***	***Particulars***	***Amount Rs.***
To Land & Buildings	27,20,000	By Debentures	13,00,000
To Plant & Machinery	30,00,000	By Workmen savings bank	4,00,000
To Furniture & Fittings	1,00,000		
To Patent & trademark	4,00,000	By Creditors	5,00,000
To Stock	20,00,000	By Y Company Ltd	46,80,000
To Debtors	6,00,000	By Equity shareholders	21,20,000
To Cash at Bank	1,80,000		
	90,00,000		90,00,000

Equity shareholders' a/c

To Realisation a/c	21,20,000	By Share capital	60,00,000
To Bank	10,80,000	By P & L a/c	20,000
To shares	36,00,000	By Insurance fund	1,30,000
		By General reserve	6,50,000
	68,00,000		68,00,000

Y Company Ltd

To Realisation a/c	46,80,000	By Bank	10,80,000
		By Shares in Y Ltd	36,00,000
	46,80,000		46,80,000

Bank a/c

To Y Company Ltd	10,80,000	By Equity share holder	10,80,000
	10,80,000		10,80,000

Problem : 17

On January 1, 1987 the Balance Sheet of Karpagam Ltd was:

Issued Capital :	Rs.		Rs.
15,000 equity shares of Rs. 10 each	1,50,000	Goodwill	40,000
5,000 6% preference shares of Rs. 10 each	50,000	Patents	15,000
6% Debentures	30,000	Sundry assets	1,64,500
Creditors	20,000	Cash	500
Preference dividends in four years	-	P & L a/c	28,000
		Preliminary expenses	2,000
	2,50,000		2,50,000

A Scheme of reconstruction was agreed upon as follows:

a) A new Company to be formed called Krishnan company with an authorised capital of Rs. 3,25,000 all in ordinary shares of Rs. 10 each.

b) One ordinary share Rs. 5 paid, in the new company to be issued for each ordinary share in the old company.

c) Two ordinary shares, Rs. 5 paid, in the new company to be issued for each preference share in the old company.

d) Arrears to be cancelled.

e) Debenturesholders to receive 3,000 ordinary shares in the new company credited as fully paid.

f) Creditors to be taken over by the new company.

g) The remaining unissued shares to be taken up and paid for in full by the directors.

h) The new company to take over the old company's assets, except patents, subject to writing down 'Sundry assets' by Rs. 35,000.

i) Patents were realised by Karpagam company for Rs. 1,000.

ii) The expenses of Karpagam company were Rs. 1,000. Close the books of Karpagam company, and open the books of Krishnan company by means of Journal entries and give balance sheet of Krishnan Company.

(M.S.University, April 1995, April 2010)

Answer : Calculation of purchase consideration

Preference share holders	10,000 × 5 -	50,000 shares
Equity share holders	15,000 × 5 -	75,000 shares
Purchase consideration		1,25,000

Ledger accounts in the books of Karpagam Limited

Realisation a/c

Particulars	*Amount Rs.*	*Particulars*	*Amount Rs.*
To Goodwill	40,000	By Debentures	30,000
To Sundry Assets	1,64,500	By Creditors	20,000
To cash	- 15,000	By Krishnan company	1,25,000
To cash	1,000	By Cash	1,000
To cash	500	By Equity shareholders	45,000
	2,21,000		2,21,000

Equity shareholder's a/c

To Realisation	45,000	By Equity capital	1,50,000
To Profit and Loss a/c	28,000		
To Preliminary exp.	2,000		
To Shares in new company	75,000		
	1,50,000		1,50,000

Krishnan Company a/c

To Realisation	1,25,000	By Equity shares Rs. 5 paid up	1,25,000
	1,25,000		1,25,000

In the books of Krishnan Company - Purchasing Company :

	Particulars		Debit	Credit
i)	Business purchases a/c	Dr	1,25,000	
	To Liquidator of Karpagam Ltd			1,25,000
	(Being business purchased)			
ii)	Sundry Assets a/c	Dr	1,29,500	
	Cash a/c	Dr	500	
	Goodwill a/c	Dr	45,000	
	To Creditors a/c			20,000
	To Debentures a/c			30,000
	To Business purchases			1,25,000
	(Being assets & Liabilities recorded)			

iii)	Liquidator of Karpagam Ltd a/c	Dr	1,25,000	
	To Share capital a/c			1,25,000
	(Being share issued)			
iv)	Debentures a/c	Dr	30,000	
	To Fully paid equity shares capital a/c			30,000
	(Being shares issued to debentures)			
v)	Bank a/c	Dr	45,000	
	To Share capital a/c			45,000
	(Being unissued shares issued)			

In the Books of Krishnan company

Balance Sheet as on 1.1.1997

	Note No.	Amount
I Equity & Liabilities		
i) Share holder's funds		
Share capital	1	2,00,000
ii) Non-current Liabilities		-
iii) Current Liabilities	2	
Trade payables		20,000
Total of (i) (ii) (iii)		2,20,000
II Assets		
i) Non - current Assets :		
Fixed Assets		
Tangible assets	3	1,29,500
Intangible assets	4	45,000
ii) Current assets :		
Cash and Cash equivalents	5	45,500
Total of (i) and (ii)		2,20,000

Notes forming part of Balance Sheet :

	Rs.
1. Share capital	
Issued to equity shareholders	1,25,000
Issued to Debentureholders	30,000
Issued for Cash	45,000
	2,00,000
2. Trade payables	
Sundry Creditors	20,000
3. Tangible assets :	
Sundry assets	1,29,500
4. Intangible assets - Goodwill	45,000

INTERNAL RECONSTRUCTION

Internal Reconstruction:

Internal reconstruction means the reduction of capital to cancel any paid up share capital which is lost or unrepresented by available assets. This is resorted to write off the past accumuated losses of the company. Internal Reconstruction is a scheme of arrangement made among the parties in the company for any one or more of the following purposes:

i) Reduction of share capital.

ii) Vary the rights of different types of shareholders, debenture holders and creditors.

iii) To write off the accumulated losses of the company.

iv) To reduce the over valuation of assets of the company.

Internal reconstruction and reduction of share capital means the same.

Different methods of capital reduction:

There are three methods of capital reduction.

i) Reducing or extinguishing the uncalled liability of members.

ii) Reducing by returning the excess capital.

iii) Reducing the paid up capital.

Provisions relating to capital reduction :

A company can reduce the share capital as per Sec.100 of the Companies Act 1956.

i) Articles of Association of the company must permit the reduction.

ii) A special resolution must be passed at the shareholder's meeting

iii) The reduction must be approved by the Court

iv) If the reduction leads to reduction in the authorised capital of the company, then capital clause of the Memorandum of Association must be altered.

v) Permission from the Registrar of companies must be obtained to alter the capital clause.

vi) After the reduction, the word **and reduced** must be used to its name.

The following reduction does not amount to capital reduction.

i) Forfeiture of shares for non payment of any calls.

ii) Surrender of shares

iii) Omission to issue the unissued share capital.

iv) Redemption of preference shares

v) Payment of interest out of capital

Reduction of share capital means cancellation of any paid up share capital which is lost or unrepresented by available assets.

Journal entries:

Particulars		Debit Rs.	Credit Rs.
i)	Old equity Capital a/c Dr	xx	
	To New equity capital a/c		xx
	To Capital Reduction a/c		xx
	(Being value of equity shares reduced)		
ii)	Old preference share capital a/c Dr	xx	
	To New preference share capital a/c		xx
	To Capital reduction a/c		xx
	(Being value of preference shares reduced)		
iii)	Old Debentures a/c Dr	xx	
	To New Debentures a/c		xx
	To Capital Reduction a/c		xx
iv)	Asset a/c Dr	xx	
	To Capital Reduction a/c		xx
	(Being value of asset appreciated)		
v)	Capital Reduction a/c Dr	xx	
	To Liabilities a/c		xx
	(Being value of liabilities increased)		
vi)	Capital reduction a/c Dr	xx	
	To P&L a/c		xx
	To Goodwill a/c		xx
	To Patents a/c		xx
	To Trade mark a/c		xx
	To Asset a/c		xx
	(Being loss, ficitious assets written off and assets depreciated)		

Capital Reduction account:

Under a scheme of internal reconstruction, if any amount available to write off losses, intangible assets and tangible assets transferred to an account, known as **Capital Reduction** account. Any amount which is left in this account is known as capital reserve.

Problems

1. The following scheme of reconstruction was approved by Royal Ltd. The shareholders to receive in lieu of their present holding of 50,000 shares of Rs.10 each the following;

i) Fully paid ordinary shares equal to 2/5 of their holdings.

ii) 5% preference shares to the extent of 1/5 of the above ordinary shares.

iii) Rs.60,000, 6% debentures

iv) The Goodwill which stood at Rs.3,00,000 was written down to Rs.1,50,000

v) Plant and machinery were written down by Rs.20,000 and Rs.30,000 respectively. Pass journal entries.

(M.S. University Nov.2006, April 2011)

Answer : Journal entries

Particulars		**Debit Rs.**	**Credit Rs.**
) Equity share capital a/c	Dr	5,00,000	
To New equity share capital			2,00,000
To 5% Pre.share capital			40,000
To 6% Debentures a/c			60,000
To Capital reduction a/c			2,00,000
(Being share capital reduced)			
i) Capital reduction a/c	Dr	2,00,000	
To Good will a/c			1,50,000
To Plant a/c			20,000
To Building a/c			30,000
(Being assets written off)			

2. The following scheme of reconstruction approved by A Ltd.

(i) The shareholder to receive in lieu of their present holding of 1,00,000 shares of Rs.10 each the following:

(1) Fully paid ordinary shares equal to 2/5 of their holdings.

(2) 5% Preference shares to the extent of 1/5 the above ordinary shares.

(3) Rs.1,20,000, 6% Debentures.

(ii) The Goodwill which stood at Rs.6,00,000 was written down to Rs.3,00,000.

(iii) Plant and machinery were written down by Rs.40,000 and Rs.60,000 respectively.

Pass journal entries.

(M.S.University April 2012, Nov. 2013, Nov.2017)

Answer : Journal entries

Particulars		Debit Rs.	Credit Rs.
i) Old Equity share capital a/c	Dr	10,00,000	
To New share capital a/c			4,00,000
To 5% Pref.share capital a/c			80,000
To 6% Debentures			1,20,000
To Capital Reduction a/c			4,00,000
(Being old share capital reduced)			
ii) Capital reduction a/c	Dr	4,00,000	
To Goodwill a/c			3,00,000
To Plant			40,000
To Machinery			60,000
(Being value of assets reduced)			

3. The share capital of Z Ltd., considered of the following;

(a) 10,000 6% preference shares at Rs.100 each and

(b) 50,000 Equity shares of Rs.10 each. The shares were fully paid. The company had accumulated losses totaling Rs.3,50,000, besides preliminary expenses Rs.20,000. It was also ascertained that the fixed assets which stood in the books at Rs.14,00,000 were overvalued to the extent of Rs.4,00,000.

(i) 6% Preference shares to be converted into 7% Preference shares at Rs.60 each.

(ii) Equity shares were to be reduced to Rs.2 each journalise.

(Madras University, Nov 2015)

Answer : Journal entries

Particulars		Debit Rs.	Credit Rs.
i) 6% Pre.share capital a/c	Dr	10,00,000	
To 7% Pre.share capital a/c			6,00,000
To Capital reduction a/c			4,00,000
(Being preference share capital reduced)			
ii) Old equity share capital a/c	Dr	5,00,000	
To New equity share capital a/c			1,00,000
To Capital reduction a/c			4,00,000
(Being equity share capital reduced)			
iii) Capital reduction a/c	Dr	8,00,000	
To Profit and loss a/c			3,50,000

To Preliminery expense	20,000
To Fixed asset a/c	4,00,000
To Capital reserve	30,000
(Being capital reduction account written off)	

4. The following is the Balance sheet of VPM Ltd. as on 31.12.2005.

Liabilities	Rs.	Assets	Rs.
10,000 equity shares of Rs. 10 each	10,00,000	Fixed Assets	10,50,000
1,00,000 7% preference shares of Rs. 10 each	10,00,000	Good will	1,50,000
Creditors	2,00,000	Investments	2,00,000
		Debtors	2,50,000
		Profit and Loss A/c	5,50,000
	22,00,000		22,00,000

The Board of directors passed the following resolutions.

i) Equity Share Capital would be reduced by Rs. 4.

ii) Preference Shares reduced by Rs.3.

It was further resolved that the amount so available would be used for writing off goodwill and debit balance of P & L a/c. Pass Journal entries and the revised balance sheet.

(M.S.University, April 2008)

Answer : Journal entries

	Particulars		Debit Rs.	Credit Rs.
i)	Old share capital a/c	Dr	10,00,000	
	To New share capital a/c			6,00,000
	To Capital Reduction a/c			4,00,000
	(Being equity share capital reduced)			
ii)	Old preference share capital a/c	Dr	10,00,000	
	To New Pre.share capital a/c			7,00,000
	To Capital reduction a/c			3,00,000
	(Being preference share capital reduced)			
iii)	Capital Reduction a/c	Dr	7,00,000	
	To Profit and Loss a/c			5,50,000
	To Goodwill a/c			1,50,000
	(Being capital reduction account written off)			

Revised Balance sheet of VPM Ltd as on 31.12.2005

	Note No.	Rs.
I. Equity & Liabilities		
i) Shareholders' funds:		
Share capital	1	13,00,000
ii) Non current liabilities :		
iii) Current liabilities :		
Trade payables	2	2,00,000
Total of equity and liabilities		15,00,000
II. Assets :		
i) Non - current assets :		
Tangible Assets	3	10,50,000
Intangible assets		
ii) Current Assets :		
Investments	4	2,00,000
Debtors	5	2,50,000
Total		15,00,000

Notes to theBalance Sheet:

	Rs.
1. Share capital	
1,00,000 equity shares of Rs.6 each	6,00,000
1,00,000 preference shares of Rs. 7 each	7,00,000
	13,00,000
2. Trade Payables:	2,00,000
Creditors	
3. Tangible assets:	10,50,000
Fixed assets	2,00,000
4. Investments	
5. Trade Receivables	2,50,000
Debtors	

5. The following is the balance sheet of Bharat Ltd on 31.12.1985.

Liabilities	Rs.	Assets	Rs.
Authorised Capital:		Patent at cost	8,50,000
10,000 pref. shares of		Leasehold premises	1,30,800
Rs. 100 each	10,00,000	Plant & Machinery	42,200
10,000 equity shares		Sundry Debtors	76,500
of Rs. 100 each	10,00,000	Stock	55,000
Subscribed Capital:		Discount on issue of shares	18,000
7,500 Pref. shares of		Preliminary expenses	12,000

Rs. 100 each	7,50,000	Profit & Loss a/c	1,15,000
5,000 equity shares of		Cash in hand	500
Rs. 100 each	5,00,000		
Sundry Creditors	30,000		
Bank overdraft	20,000		
	13,00,000		13,00,000

The company suffered losses. The following schemes of capital reduction was adopted:

a) The preference shares to be reduced to an equal number of fully paid shares of Rs. 50 each.

b) The equity shares to be reduced to an equal number of fully paid shares of Rs. 25 each.

c) The amount available to be used to write off Rs. 30,800 off the leasehold premises, Rs. 15,000 stocks, 20% off plant and machinery and sundry debtors and the balance available (after writing off discount on issue of shares, preliminary expenses and P & L a/c completely) patents.

Journalise the transactions and prepare the Balance Sheet after the above Capital reduction.

(M.K.University, April 1987, M.S.University, April 2008, Nov.2012, April 2014)

Answer : Journal entries

	Particulars	Debit	Credit
i)	Old Preference share capital a/c Dr	7,50,000	
	To New preferences share capital a/c		3,75,000
	To Captal reduction a/c		3,75,000
	(Being pre.share capital reduced)		
ii)	Old equity share capital a/c Dr	5,00,000	
	To new equity share capital a/c		1,25,000
	To capital reduction a/c		3,75,000
	(Being equity capital reduced)		
iii)	Capital reduction a/c Dr	7,50,000	
	To Leasehold property a/c		30,800
	To Stock a/c		15,000
	To Machinery a/c		8,440
	To Debtors a/c		15,300
	To Discount on issue of shares a/c		18,000
	To Preliminary expenses a/c		12,000
	To Profit and Loss a/c		1,15,000
	To Patents		5,35,460
	(Being accumulated losses and assets written off)		

Balance sheet of Bharat Ltd., as on 31.12.1985 (reduced).

	Note No.	Rs.
I. Equity & Liabilities		
i) Shareholders' funds:		
Share capital	1	5,00,000
ii) Non current liabilities :		
iii) Current liabilities :		
Trade payables	2	30,000
Short term borrowings	3	20,000
Total of equity and liabilities		5,50,000
II. Assets :		
i) Non - current assets :		
Tangible Assets	4	1,33,760
Intangible assets	5	3,14,540
ii) Current Assets :		
Stock	6	40,000
Trade Receivables	7	61,200
Cash in hand	8	500
Total		5,50,000

Notes to the Balance Sheet:

1. Share capital:

5,000 equity shares of Rs.50 each	1,25,000
7,500 preference shares of Rs. 50 each	3,75,000
	5,00,000

2. Trade Payables:

Sundry creditors	30,000

3. Short term borrowings

Bank overdraft	20,000

4. Tangible assets:

Fixed assets	
Leasehold premises	1,00,000
Plant & Machinery	33,760
	1,33,760

5. Intangible assets

Patents	3,14,540

6. Stock 40,000

7. Trade Receivables

Debtors	61,200

8. Cash in hand 500

6. A company's balance sheet as on 31st March 2007 is given below.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Share Capital	1,00,000	Fixed Assets	80,000
Creditors	50,000	Current Assets	40,000
		P & Loss a/c	25,000
		Goodwill	5,000
	1,50,000		1,50,000

Reduce Rs. 3 per share and write off losses Journalise.

(M.S.University, Nov. 2012)

Answer : Journal entries

Particulars		Debit Rs.	Credit Rs.
i) Old equity share capital a/c	Dr	1,00,000	
To New equity share capital a/c			70,000
To Capital reduction a/c			30,000
(Being old capital reduced)			
ii) Capital reduction a/c	Dr	30,000	
To Profit and Loss a/c			25,000
To Goodwill a/c			5,000
(Being capital reduction a/c written off)			

Note : It is assumed that value per equity share is Rs. 10

Balance sheet of of a company as on 31.03.2007 (and reduced).

	Note No.	Rs.
I. Equity and Liabilities :		
i) Shareholders' funds		
Share capital		70,000
ii) Non current liabilities		Nil
iii) Current liabilities		
Trade payables	1	50,000
Total		1,20,000
II. Assets :		
i) Non current Assets :		
Tangible Assets		80,000
ii) Current Assets		40,000
		1,20,000

CHAPTER 2

Valuation of Goodwill and Shares

Definition of Goodwill

Goodwill refers to a measure of the capacity of a business to earn above normal profits. It represents the advantages a business has in connection with its customers, employees and outside parties with whom it comes in contact. It is the benefit and advantage of a good name, reputation and connection of a business. It is the attractive force which brings in customers. It is the one thing which distinguishes an old and established business from a new business at start. It is an intangible but a real asset.

Goodwill is defined as 'the present value of a firm's anticipated excess earnings.' When a man pays for goodwill, he pays for something which puts him in a position of being able to earn more than he would be able to do by his own unaided efforts (Prof. Dicksee). Goodwill is thus the extra saleable value attached to a prosperous business beyond the intrinsic value of net assets. In the words of Spicer and Pegler, "Goodwill may be said to be that element arising from the reputation, connection, or other advantages possessed by a business which enables it to earn greater profits than the return normally to be expected on the capital represented by the net tangible assets employed in the business."

Valuation of Goodwill

There are various circumstances when it may be necessary to value goodwill. Some of the circumstances are:

(1) In the case of a partnership, when there is an admission, retirement, death or amalgamation, or a change in the profit sharing ratio take place, valuation of goodwill becomes necessary.

(2) In the case of a company, when two or more companies amalgamate, or one company absorbs another company, or one company wants to acquire controlling interest in another company or when the Government takes over the business, valuation of goodwill becomes necessary.

(3) In the case of a sole trader concern, goodwill is valued at the time of selling the business, to decide the purchase consideration.

(4) In the case of individuals, goodwill is valued for purposes of Estate Duty, Death Duty, etc. on the death of a person.

Factors determining the value of Goodwill

Since goodwill of a business represents its capacity to earn above normal profits, all factors which contribute to such profits influence the goodwill of the firm. Some of those factors may be:

(1) **Location factors.** Favourable location influences the earning capacity of the business and enhances its goodwill.

(2) **Time factor.** An older, more established, business enjoys better goodwill than a new business.

(3) **Nature of business.** The nature of goods dealt with, the risks attached, the competition involved, certain special privileges enjoyed by the firm such as special licences, franchise, etc., determine the value of goodwill.

(4) **Efficiency of management.** Planned production, distribution and highly successful marketing of a business leads to better profits and higher value of goodwill.

(5) **Other factors.** General economic conditions, political stability, Government policies, money market conditions, trade cycles, etc., are the other factors influencing the value of goodwill.

Factors determining the value of Goodwill

(1) Goodwill is always paid for the future. The buyer of a business is always interested in knowing whether the business will maintain its profits in the future also. If the advantage is not likely to come to the buyer, the buyer will not be ready to pay anything for goodwill. Therefore, when evaluating the amount of goodwill the buyer always keeps the future in mind and goodwill is the assurance of the future maintainable profits.

(2) The ability to earn future profits is measured by the profits made by the business in the recent past. Hence, analysis of the past profits becomes necessary to determine the average maintainable profits in the future. For the purpose of finding out the average profits likely to be earned in the future: (*a*) all actual expenses and losses not likely to occur in the future are added back to the profits, (*b*) all expenses and losses not incurred in the past, but likely to arise in the future are to be deducted, (*c*) all profits likely to be earned in the future only are to be added and (*d*) profits earned in the past, but not likely to be earned in the future are to be deducted.

After having adjusted profit in the light of the future possibilities, the average maintainable profit is ascertained which forms the basis for the valuation of goodwill.

(3) The future profits are likely to be reduced materially by taxation and hence it is also taken into account for determining the value of goodwill.

Methods of valuing goodwill

Basically there are two methods of valuing goodwill:

(1) Simple profit method and (2) Super-profit method.

(1) Simple Profit Method

There are two methods based on simple profit: (*a*) Purchase of Past Profit Method and (*b*) Capitalisation of Average Profit Method.

(a) Purchase of Past Profit Method. Under this method goodwill is expressed as a purchase of a certain number of years' profit based on the adjusted average profit of a given number of years. This method involves two steps:

(*i*) The profits for an agreed number of years preceding the valuation are averaged so as to arrive at the average annual profit earned during that period. This will have to be adjusted in the light of future possibilities and the average future maintainable profit determined.

If the profits have been fluctuating, a simple average is used. If profits show a steadily increasing or decreasing trend, appropriate weights are used giving greater weightage for profits of the later year.

(*ii*) The average future maintainable profit is multiplied by a certain number of years to find out the value of goodwill. The number of years selected for this purpose is based on the expectation of the number of years' benefit to be derived in the future from the past association. For example, if the average future maintainable profit is Rs. 25,000 and it is expected that this profit would be earned for at least another 3 years, then the goodwill will be:

Goodwill = Average profit $\times$ Number of years

$= 25{,}000 \times 3 =$ Rs. 75,000

The number of years over which the profits are averaged and the number of years' purchase applied may vary considerably in practice but generally falls between one and five years. Estimating future profit beyond a period of say, 5 years would be quite difficult and unrealistic. The method suffers from two defects: (*a*) Difficulty of finding out the right number of years' purchase of profits as it depends on so many factors and (*b*) ignoring capital to be employed in the business.

(b) Capitalisation of Average Profit Method:

The following steps are to be taken in ascertaining the value of goodwill under this method:

(i) Ascertain the average future maintainable profit, as explained already.

(ii) Capitalise this average profit at the normal rate of return on investment on the type of business under consideration. This will give the net worth of the business.

(iii) Find out the value of net tangible assets (i.e., net assets other than goodwill) of the business.

(iv) Deduct the net tangible assets from the capitalised net worth of the business and the difference is goodwill.

Illustration 3

A company desirous of selling its business to another company has earned an average past profit of Rs. 1,60,000 per annum and the same amount of profit is likely to be earned in the future also, except that :

(1) Directors' fees of Rs. 12,000 per annum charged against such profits will not be payable by the purchasing company whose existing Board can manage the new business also.

(2) Rent at Rs. 28,000 pr annum which had been paid by the vendor company will not be incurred in the future since the purchasing company owns its own premises and the necessary accommodation can be provided.

The net assets, other than goodwill, were Rs. 18,00,000 and it was considered that a reasonable return on investment in this type of business would be 10%.

Solution:

			Rs.
	Average Net Profit		1,60,000
Add:	Expenses not likely to be incurred in the future:		
	Directors' fees	12,000	
	Rent	28,000	40,000
	Average future maintainable profit		2,00,000

$$\text{Capitalised net wealth} = \frac{2,00,000 \times 100}{10} = \text{Rs. } 20,00,000$$

Less: Net tangible assets other than Goodwill	Rs.	18,00,000
Goodwill	Rs.	2,00,000

(2) Super-Profit Method

Strictly speaking, goodwill can be attached only to a business which is earning above normal profits or super-profits. If there are no anticipated excess earnings over normal earnings, there can be no goodwill. Such excess profit is known as super-profit and it is the difference between the average profit earned by the business and the normal profit based on the normal rate of return. Hence for finding out the super-profits the following information will be required: (*a*) The estimated average future profits of the firm (ascertained as already explained), (*b*) The normal rate of return on investment and (*c*) The fair value of average capital employed in the business.

Normal rate of return: The normal rate of return refers to the rate of earnings which investor in general expect on their investments in a particular type of industry. It varies depending upon general factors like the bank rate, general economic conditions, political stability, etc., and specific factors like period of investment, risk attached to the investment, etc.

Illustration 4

X. Ltd., declared a dividend of 25% on its shares of Rs. 100 eacn, Rs. 80 paid-up. Its shares are quoted in the market at Rs. 200. Calculate the rate of return.

Solution:

On Rs. 100 the company pays a dividend of Rs. 25

On Rs. 80 the company pays a dividend of 25/100x80 = Rs. 20. Since the shares are quoted and demanded in the market at Rs. 200 the investor expects Rs. 20 for an investment of Rs. 200. In other words his expectation is a return of 10%.

Average Capital Employed: The average capital employed in the business may be ascertained in two ways, *i.e.*, either through the assets side or through the liabilities side.

Asset side approach:

		Rs.
	Assets (other than non-trading assets, goodwill and past expenses and losses) at market value, at the Balance Sheet date.	. . .
Less:	Liabilities to outsiders at revised values, if any	. . .
	Capital employed at the end of the year	. . .
Less:	Half of the profit earned during the year	. . .
	Average capital employed for the year.	. . .

Liabilities side approach :

			Rs.
Add:	Equity share capital		...
	Preference share capital		...
	Reserves and profits		...
	Profit on revaluation of assets and liabilities		...
Less:	Goodwill (Book-value)	...	
	Losses & past expenses not yet written off	...	
Less:	Loss on revaluation	...	...
	Capital employed at the end		...
Less:	$^1/_2$ of the profit		
	Average capital employed		...

Non-trading assets, that is assets acquired because of spare funds such as Government securities are excluded.

Normal profit and Super-profit

If the average capital employed and the normal rate of return are known, the normal profit can be ascertained. For example, if the average capital employed is Rs. 1,00,000 and the normal rate of return is 10%, the normal profit is

$$1,00,000 \times \frac{10}{100} = \text{Rs. } 10,000$$

Super-profit is the simple difference between the actual average profit earned and the normal profit. If in the above example, the average profit is Rs. 25,000, then the super-profit will be Rs. 25,000 – Rs. 10,000 = Rs. 15,0000.

Goodwill based on Super-Profit

There are four methods of calculating goodwill based on super-profit. They are: (1) Purchase of Super-profit Method, (2) Sliding-scale Valuation of Super-profit Method, (3) Annuity of Super-Profit Method and (4) Capitalisation of Super-Profit Method.

(1) Purchase of Super-profit Method:

Goodwill as per this method = Super-profit × Number of years. If, for example, the super-profit is Rs. 15,000 and goodwill is agreed to be 3 years purchase of super-profit, then the goodwill will be Rs. 45,000 (15,000 × 3).

(2) Sliding-scale Valuation of Super-profit Method:

This is only a variation of the first method. It is based on the logic that the greater the amount of super-profit, the more difficult it would be to maintain. Higher profit will naturally attract competition and soon the firm's ability to make super-profit is curtailed. Hence, instead of multiplying the whole super-profit by a certain number of years, a grading scale is adopted as shown below:

		Rs.
First	Rs. 5,000 at 3 years' purchase	15,000
Second	Rs. 5,000 at 2 years' purchase	10,000
Third	Rs. 5,000 at 1 year purchase	5,000
	Goodwill	Rs. 30,000

(3) Annuity of Super-Profit Method:

Under this method, goodwill is calculated by finding the present worth of an annuity paying the super-profit per year, over the estimated period discounted at the given rate of interest. The person worth of an annuity of Re. 1 for *n* years at *r*% is obtained by the formula:

$$Q = \frac{1 - \left(1 + \frac{r}{n}\right)^{n}}{\frac{r}{100}}$$

where Q = the present value of an annuity of Re. 1 for n years at $r\%$
r = rate of interest per annum
n = the number of years.

Usually reference to the Annuity Table will give the present value of annuity for the given number of years and at the given rate of interest.

∴ Goodwill = super-profit × annuity.

For example, if the super-profit is Rs. 15,000 and the annuity of Re. 1 at 10% for 3 years is 2.48,685, then the goodwill is =Rs. 15,000 × 2.48,685 = Rs. 37,302.75.

This method takes into consideration the interest loss involved in paying a lump sum as goodwill in anticipation of future return of profit.

(4) Capitalisation of Super-Profit Method:

This is similar to the Capitalisation of average profit method as already explained. Under this method, the super-profit when capitalised at the normal rate of return will give the value of goodwill.

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

$$= \frac{\text{Rs. } 15{,}000}{10} \times 100 = \text{Rs. } 1{,}50{,}000.$$

This method gives the maximum value for goodwill. Since the contention that super-profit will continue for long is unreasonable, this method is not safe for one to follow.

(VALUATION OF SHARES) (1)

The valuation of shares by the company becomes necessary where there is no market price of the shares, as in the case of a private limited company or a proprietorship company, as the shares of such companies are not quoted in the market or where, for certain reasons, the market price does not reflect the true value of the shares. In addition, the need for the valuation of shares of a company arises in the following circumstances also:

(1) For formulating amalgamation or absorption schemes

(2) For purchase or sale of controlling shares

(3) For reconstruction schemes

(4) For Estate Duty purposes

(5) For pledging shares as a security against loan

(6) When shares are acquired by the Government.

Method of Valuation

There are 3 methods of valuation of shares : (1) Net Assets Method or Intrinsic Value Method, (2) Yield Method or Market Value Method and (3) Earning Capacity Valuation Method.

1. Net Assets Method or Intrinsic Value Method

This method aims at finding out the possible value of the shares in the event of the company going into liquidation. Investors are influenced by security and earnings. Security is indicated by the assets' cover of shares. Therefore, for finding out the real value or intrinsic value the assets' cover is considered. The assets and liabilities, including goodwill, should be revalued first and then the net asset is found out. Net asset is the difference between the realisable value of assets and the liabilities to outsiders. Non-trading assets, if any, should also be included at their market values. The available net asset less the paid-up value of preference shares represents net assets available for equity shareholders. This, divided by the number of equity shares, gives the intrinsic value of each equity share.

Where there are both fully paid equity shares and partly paid equity shares, the amount of uncalled amount on partly paid shares should be added to the funds available to equity shares, thus notionally converting all partly paid shares into fully paid shares. Then intrinsic value of equity shares

$$= \frac{\text{Total funds available for equity shareholders}}{\text{Number of equity shares (both fully paid and partly paid)}}$$

The value of each partly paid shares can be ascertained by deducting the uncalled amount from the value of each fully paid share.

2. Yield Method or Market Value Method

Small investors are generally interested in the income they earn from the company and hence the price they will be prepared to pay will depend upon the yield or the size of the dividends that can be expected.

The formula for calculating the market value, therefore, is:

$$\text{(a) Market value on yield basis} = \frac{\text{Dividend per share in rupees}}{\text{Normal rate of return}} \times 100$$

OR

$$\text{(b) Market value} = \frac{\text{Rate of dividend}}{\text{Normal rate of return}} \times \text{paid-up value per share}$$

For example, a company has issued shares of Rs. 100 each on which Rs. 80 has been paid up and the company declares a dividend of 25%. The amount of dividend per share comes to Rs.20. On the basis of a normal rate of return of 10%, the market value of the share will be

$20/10 \times 100 = 200$ (applying the (*a*) formula)

or $25/10 \times 80 =$ Rs. 200 (applying the (*b*) formula)

For the purpose of calculating the dividend per equity share, the average profit is calculated and the following are deducted therefrom: (*a*) taxes payable, (*b*) transfer to reserves, (*c*) transfer to various funds such as Debenture Redemption Funds, etc. and (*d*) preference dividend payable. The remainder, when divided by the number of equity shares, gives the dividend payable per share. If the dividend per share is knwon, the rate of dividend will be calculated as follows:

$$\text{Rate of dividend} = \frac{\text{Dividend per share}}{\text{Paid-up value per share}} \times 100$$

This method suffers from certain disadvantages:

(1) The market value, under this method, depends, upon the dividend declared by the company and not on its real earning capacity. The dividend declared in any year may be less than the rate of its earning or more than its earning, since dividend paid in a year may be paid out of the company's past earnings. Thus, the value may be misleading.

(2) If this method of valuation is adopted, the shares of a company which observes financial prudence by building up good reserves will be undervalued, whereas the shares of a company which distributes larger profits will be overvalued.

3. Earning Capacity Valuation Method

Under this method the valuation depends upon the comparison of the company's earning capacity and the normal rate of return on capacity employed. Since accumulated profits are likely to be distributed sooner or later, in the form of issue of bonus shares usually, the market price is to be based on the earnings of the company rather than on the dividend declared. This method relates the value of the shares to the real efficiency of the company, as measured by profitability of the company. The formula is

$$\text{Market value on earning basis} = \frac{\text{Rate of Earnings}}{\text{Normal rate of return}} \times \text{paid-up value per share}$$

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

The capital employed for this purpose is the gross capital employed in the business including long-term borrowings.

$\therefore$ Gross capital = Equity share capital + Preference share capital + Reserves and surplus + Debentures and Long Term borrowing

Profit earned is profit before debenture interest and preference dividend but after tax. This method of valuation is quite appropriate for large blocks of shares and is expected to give the fair value of shares.

It is to be understood that the fair value of shares depends on the profit earned by the company and the net assets (capital) available in the company. The Net Assets method takes into consideration the net assets only and ignores the profit earned. The Yield Value method takes into consideration the profit earned and ignores the capital employed in the business to ascertain the value of shares. The Earning Capacity method takes into account both the profit earned and the net assets or capital employed. Hence the value under this method may be considered as the fair value of the share of the company. Fair value is also expressed as

$$\text{Fair Value} = \frac{\text{Intrinsic value} + \text{Yield value}}{2}$$

Advance corporate Accounting

valuation of Good will and shares

Definition of Goodwill:

Good will is defined as the present value of firm is anticipated Excess earning.

valuation of Good will:

factors determining the value of Good will:

1. Location Factors
2. Time Factors
3. Nature of Business
4. Efficiency of management.
5. other Factors.

Methods of valuation of Good will:

There are two methods of valuing goodwill

i simple profit method
ii super profit method.

simple profit method:

i) purchase of past profit method
ii) capitalisation of average profit method.

super profit method:

i) purchase of super profit method
ii) Sliding - scale valution of super profit method.
iii) Annuity of super profit method.
iv) capitalazation of super profit method.

Prob: 1 A trader started a Business on 01.03.1995 with Rs 25000 as capital. His profits for the first two years were Rs 7200 Rs 11700 but for the years ending April 30 1998. The incurred a loss of Rs 1575. He estimated salary of market rate of interest on investment was 10% and of the rate of risk return on capital was 3%. He estimated his salary from an alternative employment at Rs 1500 per year. compute the value of good will of the business of 3 years purchase of super profit. of the three years.

Ans: Good will = 3 x super profit

Super profit = Actual profit - normal profit

normal profit = capital employed x normal rate

normal profit = 25000 x 13/100 = 3250

Calculation of Adjusted profit

	I year profit		7200
	II year profit	11700	
(+)	Abnormal loss	1575	13275
			20475
(-)	Future expenses salary of the propriator		1500
			18975

Average Profit $\frac{18975}{2} = 9487.5$

(-)	Normal profit	3250.
	Super profit	6237.50

Good will = 3x super profit

= 3 x 6237.50

= 18712.50

rob. 2 The net profit of a Business after providing for taxation for the Past 5 years are Rs 80000, 85000, 92000, 105000, 118000. The capital employed in the business is Rs 80000. The normal rate of return expected in this type of business is 10%. It is expected that the Good will be able to ~~mention~~ maintain is super profit for the next 5 year calculate the value of good will on the basis of

A) 5 year purchase of super profit method.

B) Annuity method taking the present value of annuity of Rs 1 for five year at 10% for five year at 10% as 3.78.

C) capitalisation of super profit method.

Ans

Profit for 5 years

80000 + 85000 + 92000 + 105000 + 118000 = 480000

Average profit 480000/5 = 96000

(-) normal profit 800000 × 10/100 80000

Super profit 16000

a) Purchase of super profit method

Good will = super profit × 5 years

= 16000 × 5 = 80000

B) Annuity method

16000 × 3.78 = 60480

$$\frac{16000 \times 100}{10} = 160000$$

16000 x 5 = 80000

C) Capitalisation employment

800000 x 10/100 = 80000

Prob:3 The following particular are available in respect of the business carried on by [redacted]

A) Capital employed Rs 50000

B) Trading result 2009 profit 12200, 2010 profit 15000 2011 loss 2000 2012 profit 21000

C) market rate of Interest on Investment 8%.

D) Rate of Risk return on capital Invested in business 2%.

E) Remuneration from alternative employment of the propriator if not engagged in business Rs 3600 per annum.

compute the value of good will on the basis of 3 year purchase of super profit of the business calculated on the average profit of the last four year.

Ans) Average profit = $\frac{12200 + 15000 - 2000 + 21000}{4}$

$= \frac{46200}{4} = 11550$

Adjusted Average profit = 11550 - 3600

= 7950

Normal profit = Capital employment x Normal rate of return

$= 50000 \times \frac{10}{100}$

= 5000

valuation of shares

Prob 7 on 31.03.1997 the Balence sheet of Join stock Company disclosed the following position

Liabilities		Assets	
Share capital		Good will	40000
40000 Equity share [Rs 10 each fully paid]	4,00000	other fixed Asset	500000
		current Asset	200000
General reserve	90000		
profit & loss A/c	20000		
10% Debenture	100000		
current liabilities	130000		
	740000		740000

on 31st march 1997 the good will of the company was valued at Rs 50000 while other fixed Assets were valued at Rs 350000. The net profit earned by the company amounted to Rs 51600 for 1994-95 ; Rs 52000 for 1995-96 and 51650 for 1996-1997. Every year an amount equal to 20% of profit earned was Transfered general reserve - this being considered reasonable in the industry in which the company is engaged. A return of 10% on the investment considered fair in the Industry.

Compute the valuation of share yield method.

Ans

i) valuation of shares according to yield method

Profit	1994 - 1995	51600
	1995 - 1996	52000
	1996 - 1997	51650
		155250

	Average profit = 155250/3 =	51750
(-)	20% Transfer to reserve 20% on 51750	10350
	Average profit after Transfer to reserve	41400

ii) calculation of Expected Return

$$\text{Expected return} = \frac{\text{Expected profit}}{\text{Equity capital}} \times 100$$

$$= \frac{41400}{400000} \times 100$$

$$= 10.35\%$$

iii) yield value of share

$$= \frac{\text{Expected Rate}}{\text{Normal Rate}} \times \text{paid up value of share}$$

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

$$= 10.35\ Rs$$

Prob: 8 Balence Sheet of mak-ltd as on 31.03.1998

Liabillties		Assets	
share capital		sundry Assets	510000
10000 6% preference share Rs 10 Each Full	100000	Discount on Debenture	10000
30000 ordinary share of Rs 10 Each Fully	300000	prelimanary Exp	30000
Debenture Redemption Fund	30000	profit & loss A/c	60000
7% debenture	50000		
Depreciation Fund	30000		
sundry creditor	100000		
	610000		610000

The sundry Assets are worth Rs 525000 one year. Interest is owing on debentures and divident on preference shares are in arrears for two years. you are required to value of shares on the net Assets method if

A. preference shares have priority to value the shares of Dividend. In the event of Liquidation

B. preference shares have no priority as to capital or arrears of dividend

C. preference have to priority as to payment OF capital only.

D. preference shares have priority as to the payment OF arrear OF dividend only.

Ans calculation OF net Assets

Sundry Assets		525000
(-) Liabilities		
7% debenture	50000	
Interest on debenture	3500	
sundry creditor	100000	153500
Net Assets		371500

Calculation of value of share

a) When preference share have priority as to capital and divident

Net Asset		371500
(-) preference share capital	100000	
(-) Arrears OF dividend	12000	112000
Net Assets to Eq. shares		259500

Intrisic value OF one share : $\frac{259500}{30000} = 8.65$

B. When preference share have no priority as to all ~~dividend only~~

Net Assets 371500

Available to Equity and preference share } $\frac{371500}{40000} = 9.29$.

C. When preference shares have priority as to capital only

Net Assets	371500
(-) preference capital	100000
Net Assets to eq share holder	271500

Intrinsic value of one share } $\frac{271500}{30000}$ = 9.05

D when preference share have priority as to dividend only

Net Assets	371500
(-) Arrears of preference dividend for 2 years	12000
Assets available to share holder	359500

Intrinsic value = $\frac{359500}{40000}$ = 8.99.

prob: 9. The authorised and paid up capital of a company consists of 1000 5% preference shares of Rs 100 each and 20000 Equity Shares of 15 Each all fully paid up. A. person 300 preference share and 2000 Equity Share. Find out value of Eq. shares held by assuming that the normal annual profit of the company Rs 40000 and the normal annual return on similar equity shares 8% perannum Assuming a company transfer 25% of the profit to General reserve and the profit give above the after tax

Net profit	40000
(-) General Reserve 25%	10000
	30000
(-) dividend for preference shares	
$1000 \times 100 = \frac{100000}{100}$	5000
	25000

(-) preference share capital 50000
Arrears of Divident for
4 years
50000 x 10/100 x 4 | 20000 | -70000
195000

(+) Notion call on partly
paid shares
20000 x 3 | 60000
255000

Net Assets for Equity share holders } Net Assets / No. of shares
= 255000

value of share
yield Method

	Liabilities		Asset	
prop: 11	50000 share capital		Land & Building	220000
	of 100 each	500000	plant & mechinary	95000
	profit & loss	103000	Stock	350000
	Bank over draft	20000	Debtor	155000
	Creditor	77000		
	provition for Tax	45000		
	propossed Dividend	75000		
		820000		820000

The profit of the 5 years
2015 - 85000 2019 - 95000
2016 - 96000
2017 - 90000
2018 - 100000

Normal rate of 10%. Calculate value of Equity shares based on yield value.

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

$$\text{Expected rate} = \frac{\dfrac{\text{Profit Available for Eq shares}}{\text{Equity capital}}}{} \times 100$$

$$= \frac{85000 + 96000 + 90000 + 100000 + 95000}{5}$$

$$= \frac{466000}{5} = 93200$$

Average profit = 93200

(-) preference dividend -

profit for Eq shares 93200

$$\text{Expected Rate} = \frac{93200}{500000} \times 100$$

$$= 18.64\%$$

$$\text{Value of share} = \frac{18.64}{10\%} \times 100$$

$$= 186.4 \text{ Rs}$$

LIQUIDATOR'S FINAL STATEMENT

Liquidation of a Company:

A company is an artificial person created by Law and ended by law. That is , a company can be liquidated through the Companies Act. Liquidation is a process through which a company is dissolved. If liquidation procedures are followed, then the company is said to be liquidated. Liquidation process involves the following activities.

i) Assets of the liquidated company are realised

ii) Liabilities to third parties are to be paid off as per the order of repayment.

iii) If there is any deficiency to pay the creditors, then the shareholders have to pay their unpaid capital of their shares.

iv) If there is any surplus of cash after paying off liabilities to third parties, then the amount is to be distributed to contributories according to their rights.

Different modes of liquidation:

The following are the different modes of liquidation:

i) Compulsory winding up

ii) Voluntary winding up
   a) Member's voluntary winding up
   b) Creditor's voluntary winding up

iii) Winding up under the supervision of Court

Liquidator:

A liquidator is a person who is appointed to perform the liquidation work of a company. For the purpose of winding up of a company by the Tribunal, the Tribunal at the time of the passing of the order of winding up, shall appoint an official liquidator or liquidator from the panel maintained under sub section (2) as the company liquidator.
Following are the duties of a liquidator:

1)The liquidator has to conduct the proceedings in winding-up of the company. He has to perform the duties imposed by the

Tribunal.

2) The Company Liquidator shall make an application to the tribunal for constitution of winding up committee within 3 weeks from the date of winding up order.

3) The liquidator shall prepare preliminary report to the tribunal within **sixty days** from the order.

The preliminary report contains the following particulars.

(i) The different components of share capital in the company

(ii) The estimated amount of assets to be realized and the expected liabilities to rank

(iii) Causes for failure of the company, if any.

4) The liquidator has to take into his custody all the property, effects and actionable claims to which the company is entitled.

5) The liquidator has to follow the directions of the Tribunal in relation to any particular matter arising in winding up.

6) The liquidator has to keep proper books for making entries or recording minutes of the proceedings at the meetings and any other matter relating to the winding up.

7) The liquidator shall atleast twice a year submit an account of his receipts and payments in the prescribed form, as a liquidator to the Tribunal.

8) The liquidator shall file a statement duly audited by a qualified auditor of the company to the NCLT within 2 months of the expiry of each year from the commencement of winding up. A copy of the report is to be filed simultaneously with the Registrar of Companies.

The statement shall be filed

i) in the case of winding up by court (NCLT) and

ii) in the case of voluntary winding up with the Registrar.

9) If the winding up of the company is not concluded within one year of the winding up order, the liquidator shall file a statement relating to information about pending liquidation.

Liquidator's final statement of account:

A liquidator is appointed when a company is liquidated. It is the duty of the liquidator to realise the assets and settle the accounts of third parties. After the completion of liquidation process, the liquidator has to prepare a statement which states the total cash realised and the amount disbursed to creditors, debentureholders and shareholders. Such a statement is known as **liquidator's Final Statement or Liquidator's Final account.** The statement should be sent to the Court or the shareholders as the case may be. The statement shows the total receipts and payments of the company after its liquidation. This statement contains the following particulars:

i) Amount realised by him
ii) Payments of various liabilities
iii) Distribution of surplus, if any

Order of Payment:

The amount realised from the assets must be distributed by the liquidator in the following order:

i) Secured creditors
ii) Expenses of winding up
iii) Liquidator's remuneration
iv) Preferential creditors
v) Unsecured creditors
vi) Surplus amount to be distributed to contributories
  a) Preference shareholders
  b) Equity shareholders

Secured creditors:

A secured creditor is a person who holds some security for a debt due to the secured creditor from the company. Secured creditor may be either fully paid secured creditor or partly paid secured creditor.

Fully secured creditors are those whose loan is fully secured by any of the assets of the liquidated company. Any surplus of securities in the hands of fully secured creditors after meeting their claims, if not otherwise discharged, will be realised by liquidator. Example: The amount of loan is Rs. 50,000 and the market value of security given is Rs. 60,000 the loan is said to be fully secured.

Partly secured creditors are those who are not fully secured and have insufficient securities to meet their claims. These are creditors who are neither fully secured nor unsecured. Example: Amount of loan is Rs. 50,000 and the market value of security given is Rs. 40,000. This loan is partly secured. The unsatisfied amount of these creditors is considered to be unsecured creditors.

Contributory:

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

According to Section 428 of the Companies Act 1956, a contributory is "every person liable to contribute to the assets of a company in the event of its being wound up, and includes a holder of fully paid up shares, and also any person alleged to be contributory.

Present members are those persons whose name appears in the Register of members of the company at the time of liquidation. The names of present members are recorded in the List A. Though a member has paid all the money for the shares susbcribed by him, his name is recorded in the List A.

Past members are those persons whose name appear in the List B and whose name have been removed from the Register of members prior to one year from the date of winding up.

Preferential Creditors:

Preferential creditors are those members who have preferential rights over the assets of the company. Preferential creditors have the first priority over the unmortgaged assets of the company. Preferential creditors are in the nature of unsecured creditors who have priority of claims over other unsecured creditors not because of any security by them but because of Section 530 of the Companies Act.

Examples:

i) Tax payable to the Government.

ii) Four months wages and salaries payable to workers or employees for the period of 12 months preceding the liquidation commencement date. But amount payable to an employee or worker does not exceed Rs. 1000.

iii) Amount to be payable as arrears as per Workmen Compensaction Act.

iv) Amount to be payable as arrears under Provident Fund Scheme and Pension Fund Scheme.

v) Amount to be payable as arrears under Employees State Insurance Act.

Specimen form of Liquidator's Final statement of account:

Liquidator's Final Statement of Account

Receipts		Rs.	Payments	Rs.
To Opening Cash		xx	By Secured Creditors	xx
To Assets realised:			By Liquidation expenses	xx
Debtors	xx		By Liquidator's	
Buildings	xx		remuneration	xx
Plant and Machinery	xx		By Debentureholders	xx
Stock	xx	xxx	By Preferential creditors	xx
			By Unsecured creditors	xx
			By Preference shareholders	xx
			By Equity shareholders	xx
		xxx		xxx

Liquidation expenses:

Liquidation cost means any cost incurred by the liquidator during the period of liquidation subject to such regulations as may be specified by the Insolvency and Bankruptcy Board of India. A company shall be liquidated within a period of two years.

Calculation of Liquidator's remuneration:

Generally, the Liquidator is entitled to receive remuneration for the services rendered by him. The liquidator may receive remuneration as a percentage on assets realised and a percentage on the amount distributed to creditors or shareholders.

Commission on Assets realised:

Assets realised x Percentage of commission

Commission on amount distributed to unsecured creditors.

$$\frac{\text{Unsecured creditors x Percentage of commission}}{100}$$

In some circumstances, there may be possibility to have insufficient money to pay off the liabilities of unsecured creditors. In such circumstances, commission will be calculated as follows:

$$\text{Cash available x } \frac{\text{Percentage of commission}}{100 + \text{Percentage of commission}}$$

While calculating commission on unsecured creditors, preferential creditors are also to be included.

While calculating liquidators remuneration on assets realised, the amount of cash in hand and at bank is not included unless it is specifically stated to be included .Surplus amount realised from secured creditors is to be included as assets realised. In the question, if the securities in the hands of secured creditors are to be included as assets realised for the purpose of calculation of remuneration, then the full realisable value of securities is to be included .

Amount realised by the liquidator:

i) Sale proceeds from sale of assets.

ii) Surplus from securities in the hands of secured creditors.

iii) Amount received from contributories (partly paid up shares may be converted into fully paid) to pay off the liabilities of the creditors.

Payment of various liabilities:

i) Legal expenses

ii) Liquidators remuneration

iii) Liquidation expenses

iv) Payment to debenture holders:

Debenture amount and the amount of interest due if any is to be paid off.

v) Payment to preferential creditors

vi) Payment to unsecured creditors

vii) Payment to preference shareholders including arrears of preference dividend.

viii) If there is any surplus amount then it is to be distributed to equity shareholders. Fully paid up shares are to be repaid first. Still if there is any surplus amount it is to be distributed equitably.

Liquidation of companies

order of payment:

A. legal Expenses
B Remuneration of the Liquidator
C cost of winding up
D payment to preferential creditor
E payments to Debenture holder having Floating change of the Assets.
F. payments to unsecured creditor.
G. payments of preference share holder
H payments of Equity share holder

Prop: 13 A company went into Liquidation on 31.03.2015. When the following balance sheet was prepared Liquidator Final statement by taking his Remuneration at 2.5% on ~~liquidators final statement of ...~~ the Amount of paid to unsecured creditor

Liabilities	Amount	Assets	Amount
share capital		Goodwill & patents	100000
Rs 10 each	390000	Fixed Asset including	
Creditor preferential		[Free hold property)	227000
tial	48400	current Assets	243240
partly secured		cash	5000
creditor	110600	profit & loss	197360
[on Free hold property]			
un secured creditor	223580		
	772000		772000

~~Fixed assets~~ asset realised 172000 [Including Free hold property Rs 70000]. current Asset realised 195000 and Liquidation Expenses 2000.

Liquidator's Final Statement of Account.

Receipts	Rs	Payments	Rs
To Fixed Asset 178000 - 70000	108000	By Liquidator's Remuneration	
To current Assets	195000	on Amount realised	9175
To surplus from securities 70000 - 110620 Deficiency 40620		on pre. creditor	968
		on unsecured creditor	4735
To cash	5000	By Liquidation Exp	2000
		By preferential creditor	48400
		By secured creditor	236722
	308000		308000

Calculation of Liquidator Remuneration

Assets Realised:		
Fixed Asset	172000	
current Assets	195000	
	367000	
2 ½ % on 367000 =		9175
Amount available for unsecured creditor	302000	
(-) Liquidation Expences	2000	
	300000	
(-) Paid to preferential creditor	48400	
	251600	
(-) Remuneration on Amount realised	9175	
	242425	
(-) Communication paid on preference creditor	968	
Amount Available for Remuneration & creditor	241457	

Amount to insufficient

so 40620 + 223580 264200

Since insufficient Amount 241457 × $\frac{2}{102}$

= 4735

Total commission = 9175 + 968 + 4735

= 14878

Prop. 14 Bharat company went into Liquidation 31.12.2015 when its Balence sheet was as follows.

Liabilities	Rs	Assets	Rs
Share capital		Free hold property	580000
50000 Eq. sh		machinary	289000
of Rs 10 Each F.P 475000		motor vehicles	57500
less call in Arrear		stock	186000
Rs 25000		Debtor	74000
6000 5% preference		profit & loss	214000
share of Rs 100 Each	600000		
Share premium	50000		
5% Debenture	100000		
Interest on Debenture	2500		
Bank overdraft	58000		
creditors	115000		
	1400500		1400500

Additional Information

1. Preference dividend are in arrear from the year 2012

2. Liquidator realised as follows

Free hold property 700000

machinary 240000
motor vehicle 59000
Stock 150000
Debtor 60000
Call in arrears 25000

creditor were paid less discount of 5%. Debenture were repaid on 31.12.15 together with interest.

Liquidation cost were Rs 3820. Liquidator remuneration was 2% on the Amount realised. prepare Final state ment of Account.

Ans

Liquidation Final Statement of Account

Receipts	Rs	payment	Rs
To Asset realised	700000	By Liquidation Exp	3820
Free hold property		By Liquidator remunaration	24680
Machinary	240000	2% on 234000	
Motor vehicle	59000	By 5% Debenture 100000 + 2500	102500
stock	150000		
Debtor	60000	By unsecured creditor	
call in arrear	25000	Bank over draft	58000
		[115000 - 5750]	
		By Pref. share hrs	
		[600000 + 120000]	720000
		By Equity Share hrs	
		50000 share at Rs 4315	215750
		creditors	109250
	1284000		1284000

Prop: 15 Kannan ltd was Liquatated as on 31.12.1998

Balence sheet as on 31.12.1998

Liabilities	Rs	Assets	Rs
Share capital	100000	land & Building	60000
8% Debenture	100000	plant & machinary	60000
mortage loan secured on land & Building	50000	stock	60000
		Debtor	70000
sundry creditor	80000	cash in hand	5000
		profit & loss Account	75000
	330000		330000

Assest Realised as follows

A. Land and Building 55000

B. stock 20000

C. Plant & machinary 25000

D. Half of the Debtor were bad and balence ralised 60% of Book value.

E. Liqudator was entitled to a commission of 3% on amount realised other than cash and 2% on Amount paid to unsecured creditor

F. preferential creditor amounted Rs 10000 [Include in sundry creditors]

G. Liqudation Expences amounted 970.

Liqudators final statement of All

Receipts	Rs	Payment	Rs
To cash in hand	5000	By secured creditor	50000
To Asset realised		By Liqudation Exp	970
land & Building	55000	By Liqudator remunera tion 3% on 121000	3630
stock	20000		
Plant & machinary	25000	By Debenture hrs	71400
Debtor [60% of Rs35000]	21000		

CHAPTER -3

ACCOUNTS OF BANKING COMPANIES

Meaning of Bank:

Banking companies are regulated by Banking Regulation Act of 1949. A bank is an institution which accepts deposits from the public for the purpose of lending or investment, repayable on demand or otherwise withdrawable by cheque, draft order or otherwise.

Definition of Banking:

The Banking Regulation Act 1949, defines banking as "the accepting for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order, or otherwise".

The Banking Regulation Act is not applicable to a primary agricultural society, a Co-operative Land Mortgage Bank and any other co-operative society except in the manner and to the extent specified in part V of the Act.

Legal Requirements:

The important provisions relating to final accounts of a banking company are as follows:

1) Prescribed form:

As per section 29 to 33 of the Banking Regulation Act, every banking company is required to prepare.

a) a balance sheet in accordance with Form A set out in the Third schedule and

b) a profit and loss account in accordance with Form B set out in the Third schedule.

2) Accounting Year:

Every banking company closes its accounts on 31st March every year.

3) Prohibition of Trading:

According to Sec.8, a banking company can not directly or indirectly involve in the trading activities. That is, it can not deal in the buying, selling or bartering of goods. But it may buy, sell or barter in connecting with bills of exchange received for collection or negotiation.

4) Non Banking assets:

According to section 9, a banking company can not hold any immovable property, except for its own use for any period exceeding seven years from the date of acquisition thereof. At the same time, any gain or loss on sale of immovable property has to be shown separately in the profit and loss account of the banking companies.

5) Share Capital:

Section 11 lays down the following minimum limits of paid up capital and reserves to be compiled with by a banking company..

Capital Requirements of foreign banks :

i) Minimum capital of Rs. 15 lakhs, if the bank has no place of business in Mumbai city or Kolkata.

ii) If it has a place of business in Mumbai city or Kolkata, then the capital is Rs. 20 lakhs.

Capital Requirements of foreign banks :

i) Minimum capital of Rs. 15 lakhs, if the bank has no place of business in Mumbai city or Kolkata.

ii) If it has a place of business in Mumbai city or Kolkata, then the capital is Rs. 20 lakhs.

Capital Requirements of Indian Banks :	Rs.
1. If it has places of business in more than one State	5 lakhs
2. If it has any such place or places of business situated in Mumbai, Kolkata or both	10 lakhs
3. If it has all its places of business in one State none of which is situated in the city of Mumbai or Kolkata in respect of	
i) its principal place of business	Rs. 10 lakh plus
ii) its other place of business situated in the district of principal business	Rs.10,000 plus
iii) each place of business situated elsewhere in the State outside the same district	Rs. 25,000
subject to a total of	Rs. 5 lakhs
iv) it has only one place of business	Rs. 50,000
v) it has all its place of business in one State or one or more of which is or are situated in the city of Mumbai or Kolkata.	Rs. 5,00,000
vi) each place of business situated outside the city of Mumbai or Kolkata	Rs. 25,000
subject to a over all limit of	Rs. 10 lakhs

6) Reserve Fund:

Section 17 of the Banking Regulation Act, 1949 makes it obligatory for a banking company incorporated in India to create a reserve fund and transfer to it atleast **25% of its annual profits.** Such reserve is known as **Statutory Reserve.** It should be transferred even after the aggregate amount of reserve fund and the share premium amount exceeds its paid up capital. Transfer to statutory Reserve has been increased from 20% to 25% .

7) Payment of Dividend:

Section 15 prohibits payment of dividend by any banking company until all of its capitalised expenses (preliminary expenses, formation expenses, share selling commission, brokerage, amount of loss incurred and any other expenditure which is not represented by tangible assets) have been completely written off.

8) Payment of Commission, Brokerage etc:

A banking company, can pay any commission brokerage, discount or remuneration in any form in respect of shares issued by it, not exceeding 2½% of the paid up value of the shares.

9) Charge on uncalled capital:

As per Section 14, a banking company cannot create any charge on uncalled capital.

10) Cash Reserves:

As per Sec.18 of the Banking Regulation Act, a scheduled bank has to maintain with the Reserve Bank a balance equal to 3% of its total time and demand liabilities in India. The present rate of CRR is 4% (October 2018).

11) Statutory Liquidity Reserve (SLR):

In addition to Cash Reserve Ratio, banks are expected to maintain 25% of their net demand and time liabilities in the form of cash, gold and unencumbered approved securities. This is known as "Statutory Liquidity Ratio". Sec 24 (2A). At present , the rate is 19.5%.(October 2018)

12) Loans and advances (Section 20):

Section 20 of the Banking Regulation Act 1949, imposes certain restrictions on the loans granted by banks to the following persons.

i) any of its directors

ii) any firm inwhich any of its directors is interested as a partner employee

iii) any company other than subsidiary of the banking company of which any of the directors of the banking company is a director, manager, employee in which he holds substantial interest.

A banking company cannot lend on the security of its own shares.

13) Licensing of Banking Companies:

Banking Companies can function only after they obtain licence from RB1.

Permission from RB1 is required to open the branches also.

Classification of Bank assets (Provisions for NPA):

1) Standard Asse .s:

It refers to those assets which do not pose any problems and hence, they are considered as 'Performing Assets'. Banks are required to create a provision of 0.25%.

2) Substandard assets:

It is a non-performing asset for a period not exceeding 18 months. Banks are required to create a provision of 10% of total outstanding advances.

3) Doubtful debts:

It is a non performing asset for a period not exceeding 18 months. With effect from March 31, 2005 an asset would be classified as doubtful, if it is remained in the substandard category for 12 months.

Following provision is to be made:

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

ii) Second & third year: 100% of unsecured portion + 30% of secured portion.

iii) Beyond three years- 100% of unsecured portion + 50% of secured portion.

4) Loss Assets:

Loss assets are those which have been identified by the bank or RBI but the amount has not been written off wholly or partly. These assets are uncollectible. 100% provision is required to be made.

Slip system of posting:

Slip system of posting is the process of accounting with the help of slips. Under modernised banking, entries are made from the slips filled by the customers.

Following slips are used in banks:

i) Credit slips ii) Debit slips

iii) Pay in slips iv) withdrawal form

v) Cheques vi) Debit notes

vii) Credit notes

Following are the advantages of Slip system of posting:

i) Slip system of posting reduces the clerical work of bankers.

ii) Posting is done through slip. Hence, subsidiary books are avoided.

iii) Slip system of posting is very convenient and it saves time.

iv) Slips are used by customers as evidences.

Preparation of Profit and Loss account:

Every banking company have to prepare its final accounts for each financial year. The Profit and Loss account of a banking company has to prepare in form 'B' of Schedule III of the Act.

FORM 'B'

THIRD SCHEDULE

Specimen FORM OF PROFIT & LOSS ACCOUNT of a Bank for the year ended 31st March ...... (Rs. in' 000)

	Schedule No.	As on 31-3-20... (Current year)	As on 31-3-20... (Previous year)
I Income			
Interest earned	13	xx	xx
Other income	14	xx	xx
Total :		xx	xx
II Expenditure			
Interest expended	15	xx	xx
Operating expenses	16	xx	xx
Provisions and contingencies		xx	xx
Total :		xx	xx
III Profit / Loss			
Net Profit / Loss (-) for the year		xx	xx
Profit / Loss (-) brought forward		xx	xx
Total :		xx	xx
IV Appropriations			
Transfer to statutory reserves		xx	xx
Transfer to other reserves		xx	xx
Transfer to Government / Proposed dividend		xx	xx
Balance carried over to balance sheet		xx	xx
Total :		xx	xx

Schedule 13 Interest Earned

	Year ended 31.3. ...... Current Year	Year ended 31.3. .... Previous Year
I Interest / Discount on advance	xx	xx

II Income on investments	XX	XX
III Interest on balances with RBI and other inter bank - funds	XX	XX
IV Others	XX	XX
Total	XX	XX

Schedule 14 Other Income

	Current Year	Previous Year
I Commission, exchange and brokerage	XX	XX
II Profit on sale of investments	XX	XX
Less: Loss on sale of investestiments		
III Profit on revaluation of investments	XX	XX
Less : Loss on revaluation of investments		
IV Profit on sale of land, buildings and other assets	XX	XX
Less : Loss on sale of land, buildings and other assets		
V Profit on exchange transactions	XX	XX
Less : Loss on exchange transactions		
VI Income earned by way of dividends etc	XX	XX
VII Miscellaneous Income	XX	XX
Total (I, II, III, IV & V)	XX	XX

If there is loss, in any heading, net result must be calculated.

Schedule 15 Interest expended

I Interest on deposits	XX	XX
II Interest on R B I / inter Bank borrowings	XX	XX
III Others	XX	XX
Total (I, II & III)	XX	XX

Schedule 16 Operating expenses

I Payments to and provisions for employees	XX	XX
II Rent, taxes and lighting	XX	XX
III Printing and Stationery	XX	XX
IV Advertisements	XX	XX
V Depreciation on bank's property	XX	XX
VI Director's fees, allowances and expenses	XX	XX
VII Auditor's fees, and expenses	XX	XX
VIII Law charges	XX	XX
IX Postage, Telegrams, Telephones, etc	XX	XX
X Repairs and maintenance	XX	XX
XI Insurance	XX	XX
XII Other expenditures (licence fees, travel expenses, etc)	XX	XX

Accounts of Banking Companies

Pbm: ① The following balances are extracted from the books of New Delhi Bank Ltd., as on march 31, 1998

	Rs.
Rebate on Bills discounted	15,000
Interest and discount received	40,55,000
Interest paid on deposit	24,04,000
issued and subscribed cap	10,00,000
Reserve u/s 17	7,00,000
Commission, exchange and brokerage	1,80,000
Rent received	60,000
Profit on sale of Invt	1,90,000
Salaries & allowances	2,10,000
Director's fees and allows	24,000
Rent and Rates paid.	1,08,000
stationery, printing	48,000
postage & telegramme	40,000
preliminary exp	10,000
Audit fees	8,000
Depreciation on Bank properties	25,000

The following further information is given:-

(a) A customer to whom a sum of Rs 5,00,000 has been become insolvent & it is expected only 40% can be recovered from his estate. Int due at 15% has not been provided for in the books.

(b) provision for bad & doubtful debts 1,00,000

(c) provide Rs 7,00,000 for income tax.

(d) The directors desire to declare 10% dividend.

Prepare the profit & Loss a/c in accordance with the Law. make the necessary assumptions

PAGE NO.
DATE

Schedule : 13 :

Interest and discount received	40,55,000
	40,55,000

Schedule : 14.

Commission.	1,80,000
Rent received	60,000
Profit on sale of invt.	1,90,000
	4,30,000

Schedule : 15 :-

Interest paid on Deposit.	24,04,000
	24,04,000

Schedule : 16 :-

Salaries & allowances	2,10,000
Directors Fees	24,000
Rent & Rates Paid	1,08,000
Stationary, Printing	48,000
postage & telegram	40,000
Preliminary exp.	10,000
Auditor's Fees	8,000
Depreciation on bank property	25,000
	4,73,000

Provision and Contingencies :-

Bad debts box. 5,00,000	3,00,000
Provision for bad & doubtful debts	1,00,000
Provision for tax	7,00,000
	11,00,000

New Delhi Bank Ltd as on march 31, 1998.
For P&L a/c.

particulars	Schedule	Amount
I. Income:-		
Income earned	13	40,55,000
other income	14	4,30,000
Total		44,85,000
II expenditure:-		
Interest expented	15	24,04,000
operating expenses	16.	4,73,000
provision & contingencies		11,00,000
Total		39,77,000
III profit / Loss a/c.		
Net profit for the year		5,08,000
P&L brought down		-
		5,08,000
IV Appropriation:-		
Transfer to statutory reserve $(5,08,000 \times 25/100)$		1,27,000
Proposed dividend		50,800
Balance carried over to B/S		3,30,200
		5,08,000

Pbm:- From the Following balances, Prepare the P&L a/c of New.

Int received	5,42,260	Int on Deposit	1,60,520
Discount received	2,43,760	General exp	1,82,420
Commission received	44,240	Bad debts	1,28,710

Note: Rebate on Bills discount Rs 64,380

Ans:- P&L a/c of New Bank

particulars	Schedule	Amt
I Income:-		
Int. and Discount received	13	7,21,640
Commission received	14	44,240
Total		7,65,880
II Expenditure:-		
Int expended	15	1,60,520
Operating exp	16.	1,82,420
Provision & contingencies		1,28,710
Total		4,71,650
III Profit & Loss a/c.		
Profit brought Forward		-
Profit for current year		2,94,230
Total		2,94,230
IV Appropriation:-		
Transfer to Reserve (20% of current year profit)		73,558
Balance transfer to B/S		2,20,672
		2,94,230

Schedule: 13:-

$= (5,42,260 + 2,43,760 - 64,380)$

$=$ Rs $7,21,640$

Illustration: 4

The following are the balances of cholan Bank Ltd for the year ended mar 31, 1998.

		Rs
13	Int on Loans	5,18,000
15	Int on fixed deposit	5,50,000
14	Commission received	16,000
16	Salaries and allowances	1,08,000
13	Discount on Bills discounted	8,92,000
	Rebate on bills discounted	98,000
13	Int on cash Crt	4,46,000
15	Int on current accounts	84,000
16	Rent & taxes	36,000
13	Int on overdraft	3,08,000
16	Director's fees	6,000
16	Auditor's fees	2,000
15	Int on Savings bank deposits	1,36,000
16	Postage and telegrams	3,000
16	Printing & Stationery	6,000
14	Locker rent	2,000
14	Transfer fees	1000
16	Depreciations on Bank property	10,000
16	Sundry charges	4,000

other information:-

Provision for Bad debts Rs 80,000

Provision for income tax Rs 3,00,000

From the above information, Prepare the P&L a/c of the Bank for the year ended mar 31, 1998

Schedule: 13.

Int on Loan	5,18,000
Discount on Bills Discount	2,92,000
Int on Cash Crs	4,46000
Int on overdraft	3,08,000
Total	15,64,000

$= \frac{1564000}{1000} = 1,564$

Schedule: 14.

Commission	16,000
Locker rent	2,000
Transfer fees	1000
Sundry charges	4,000 /1000 = 23
	23,000

Schedule: 15

Int on fixed deposit	5,50,000
Int on current a/c	84,000
Int on Saving bank deposit	1,36,000
	7,70,000/1000 = 770

Schedule: 16

Salaries and allowances	1,08,000
Rent & taxes	36,000
Director's fees	6,000
Auditor's Fees	2,000
Postage & telegrammes	3,000
Printing & stationary	6,000
Depreciation on Bank property	10,000
	1,71,000 /1000 = 171

Provision for Bad debts	80,000
Provision for income tax	3,00000
	3,80000

DATE .... ((0-00

From B

Cholan Bank Ltd.

P&L a/c for the year ended 31 mar 1998.

particulars	Schedule	31.3.98 C.Y	31.3 P.Y
I. Income:-			
Interest earned	13	15,64	
other income	14	23	
Total		1587	
II. Expenditure			
Interest expented	15	7,70	
operating exp	16	1,71	
provision & contigencies		3.80	
Total		13,21	
III Profit / Loss			
Net profit for the year		2,66	

From the following balances. Prepare the P&L a/c of Hind Bank Ltd. for the year ending 31.3.98

Commission charges	7,000	Int on current A/c 15	45,000
Discount on Bills discount	1,55,000	Int on overdraft 13	60,000
Director, Auditor Fees	3000	Int on Saving bank a/c 15	72,000
establishment exp	60,000	Postage & Telegrame 16	2000
Int on Loans	2,80,000	Printing & Advertising 16	3000
Int on Fixed Deposit	2,98,000	unexpired discount on bill disc	55,000
Int on Cash Crts A/c	2,40,000	Rent & Taxes 16	22,000
Auditor's fees	2,000	Sundry exp 16	2,000

Make provision of Rs 30,000 for Doubtful Debts.

Hind Bank Ltd for the year ended 31.3.98.

particulars	Schedule	C.y	P.y
I. Income:-			
Income earned	13	7,35,000	
other income	14	7000	
Total		7,42,000	
II. Expenditure:			
Interest expented	15	4,15,000	
operating exp	16	94,000	
Provision & contingencies		30,000	
Total		5,39,000	
III profit & Loss a/c:-			
Net profit for the year I-II		2,03,000	

Schedule : 13

Interest on Loan	2,80,000
Interest on Cash Credit a/c	2,40,000
Interest on over draft	60000
Discount on Bills Discounted	1,55,000
	7,35000

Schedule : 14

Commission charges.	7,000
	17000

Schedule : 15

Interest on Fixed deposit	2,98,000
Interest on Savings bank a/c	72,000
Interest on current a/c	45,0[illegible]
	[illegible]

Schedule : 16

Director's & Auditor's Fees	3,000
establishment exp	60,000
Auditor's Fees	2,000
Postage & Telegrame	2,000
Printing & Advertising	3,000
Rent & Taxes	22,000
Sundry exp	2000
	94,000

Provision for D.D. - 30000

3.34

Pbm: ② The ABC Bank showed the following balances as on 31 march 2007.

1 Paid up Capl	20,00,000	Fixed deposits 3	20,00,000
9 Bills discounted	18,00,000	Loans 9	46,00,000
2 Reserve fund	7,70,000	current & savings deposit 3	38,00,000
9 Cash credit	20,00,000	Furniture 10	40,000
9 overdraft	8,00,000	P&L a/c (Cr) 2	2,20,000
5 unclaimed dividend	10,000	Stamps and stationary 11	10,000
6 Cash in hand	5,00,000	Investment 8	9,50,000
6 Cash with RBI	13,00,000	Loans (Cr) 4	12,00,000
11 Branch Adjustment Dr	1,70,000	Cash Certificates 3	10,00,000
3 Recurring deposit.	10,00,000	contingency reserve 2	1,70,000

The Bank holds securities for debts amounting to Rs 52,00,000 and a personal security of one or more parties for the balance of book debts. Debts due by directors amounted to Rs 2,30,000 and the doubtful debts were 70,000

The rebate on bills discounted amounted to Rs 10,000 credit has been taken for Rs 39,900 as interest on doubtful debts. 5

The bank acceptances on behalf of Customers were Rs 6,50,000. 12

Prepare B/S of the bank on 31. 3.07.

Ans: Workings:-

Schedule: 2

Reserve fund	770
P&L a/c (220-80)	140
Contingency reserve	170
	1080

Schedule: 5

Doubtful interest	39.9
unclaimed dividend	10.0
Rebate on bills discounted	10.0
	59.9

Schedule: 3

Recurring deposit	1000
Fixed deposit	2000
Currents & Saving deposit	3800
Cash Certificates	1000
	7,800

Schedule: 9

Bills discounted		1,800
Cash Credits		2,000
overdraft		800
Loan	46.00	
(-) doubtful	70	
(+) doubtful	39.9	4,569.9
		9,169.9

Schedule: 11

Stamps & Stationary	10
Branch Adjustment (Dr)	170
	180

Ans:-

Balance sheet of ABC Bank as on 31.3.07.

Particulars	Schedule	(Rs in 000) Amt
Capital & Liabilities:		
Capital	1	2,000.0
Reserve & Surplus	2	1,080.0
Deposit	3	7,800.0
Borrowings	4	1,200.0
Other Liabilities and provisions	5	59.9
Total		12,139.9
Assets:-		
Cash and balance with RBI	6	1,800.0
Balance with other banks and - Money at call and short notices	7	-
investments	8	950.0
Advances	9	9,169.9
Fixed assets	10	40.0
Other assets	11	180.0
Total		12,139.9
Contingent Liabilities	12	6.50

DATE

Pbm: The Following are the Ledger balances of x Bank Ltd. Prepare the P&L a/c and B/S of 31 mar 1998 as per the requirement of the banking regul Act

1	Share capital	20,00,000
8, 2	Reserve fund invt	10,00,000
16	General exp	1,82,000
3	Current a/c	2,02,44,000
15	Int Paid	1,61,000
3	Savings Bank a/c	29,20,000
3	Fixed Deposit	40,00,000
P&L	P&L a/c; balance brought forward	2,30,000
13	Discount received.	1,80,000
5	Rebate on bills Discount	64,000
14	Commission, exchange and brokerage	44,000
6	Cash in hand	2,27,000
13	Int received	5,32,000
6	Cash with RBI	20,12,000
7	owing by foreign correspondents	2,00,000
4	short Loans.	64,82,000
9	Loans & advance to customer	1,55,85,000
8	Investment	98,83,000
9	Bills discounted	62,28,000
10	premises	22,18,000

(i) provision for bad & doubtful debt required Rs 1,29,000 5

(ii) The bank had bills for collection for its constructure Rs 5,00,000 & Acceptance, endoresment & guaranies Rs 16,00,000 18

(iii) The P&L a/c balances is the balance left on P&L a/c that account after the payment of interiem dividend amounting to Rs 2,00,000.

x Bank Ltd B/S as on 31st march 1998.

particulars	schedule	Amt.
Capital & Liabilities:-		
capital	1	20.00
Reserve & surplus	2	15.14
Deposit	3	2,71.64
Borrowings	4	64.82
other Liabilities & provision	5	1.93
Total.		3,73.53
Assets:-		
Cash and balance with RBI	6	22.39
balance with bank & money at call		2.00
and short notice	7	[illegible]
Investment	8	1,08.83
Advances	9	2,18.13
Fixed asset	10	22.18
other asset	11	-
Total		3,73.53
Contingent Liabilities.	12	1,600
Bills for Collection.		500

schedule : 2.

Statutory reserve [illegible]

opening balance 10.00 [illegible]

Addition during the yrs (P&L a/c) (appropriation)

Balance in P&L a/c 4.57

15.14

X Bank Ltd P&L a/c for the year ended 31.3.98

particular	Schedule	Amt
I Income:-		
Income earned	13	7,12
Commission	14	44
Total		7,56
II Expenditure:-		
Interest expented	15	1,61
operating exp	16	1,82
Provision & contingencies		1,29
Total		4,72
III P&L a/c.		
Net profit for the year		2,84
profit brought forward		4,30
Total		7,14
IV Appropriation:-		
Transfer to statutory reserve (20% of Rs 2,84,000) (rounded off to the nearest thousand Rs)		57
Interiem divident Paid		2,00
Balance carried to B/S		4,57
Total.		7,14

From the following trail balance of a bank prepare a Balance sheet with schedule number as on 31.12.96.

Debit balance	Asset Rs	Liabil Credit balance	Rs.
current a/c	88.00	1 Sh. Capl	198.00
cash credits	812.10	2 Statutory reserve fund	231.00
cash in hand	160.15	Net profit before	150.00
cash with RBI	37.88	Appropriate P&L	412.00
cash with other bank	155.87	3 Fixed Deposit	517.00
money at call	210.12	3 Savings Deposit	450.00
Gold	55.83	3 current deposit	520.12
Govt Securities	110.17	5 Bills payable	0.10
premises	155.70	4 Borrowings	110.00
Furniture	70.12		
Term Loans.	792.88		
	25,88,22		2588 22

Additional infor :-

Depre charge :- premises 1,10,000

- Furniture 78,000

50% of the term Loans are secured by Govt Guarantees 10% of Cash Credit is un secured.

Ans: Balance sheet as on 31.12.96.

particulars	schedule	Rs.
Capital Liabilities:-		
Capital	1	198.00
Reserve & surplus	2	791.12
Deposit	3	1487.12
Borrowings	4	110.00
other Liabilities & contingencies	5	0.10
Total		2,586.34
Assets:-		
cash & balance with RBI	6	198.03
money at call & short notice	7	365.99
Investment	8	165.40
Advance	9	1,632.98
Fixed assets	10	223.94
other assets	11	-
Total		2,586.34
Contingent Liabilities	12	-

schedule: 2

Net profit before	150.00
Appropriation P&L	412.00
Statutory reserve	231.00
	793.00
(-) Depre	1.88.00
	791.12

Schedule:- 10.

Premises	- 155.70
Furniture	- 70.12
Less:-	
Depre	1.88
	223.94

schedule: 3

F.D	517
S.D	450
C.D	520.12
	1487.12

Schedule:- 9

C.A	22.00
C.C	818.10
T.L	792.88
	1632.98

Pbm: From the following particulars, prepare a Trial balance and then the Balance sheet as on 31.3.02. The Bank is operating in its own premises.

	(000's)		(000's)
8 Invt	6,000	Cash with RBI 6	12000
6 Cash in hand	2000	Reserve fund 2	2,000
5 Rebate on bills discount	10	Loan & advance 9	23,500
3 Deposit	56,000	P&L a/c (Cr) 2	900
1 Authorised Capl	4,00000		
1 paid up Capl	2,00000		
9 Bills discount & purchase			16,000
12 Bills receivable for collection			100
12 Acceptance on behalf of Customer			5,000
2 Investment fluctuation Reserve			90.

Ans:- Trial Balance of a Bank as on 31.3.02.

Debit balance (Asset)	Rs	Credit balance (Liabilities)	Rs.
Cash in hand	2,000	Paid up Capl	2,0000
Cash with RBI	12,000	Reserve fund	2000
Invt	6,000	P&L a/c (Cr)	900
Bills discount & purcha	16,000	Invt fluctuation	90
Loans & advance	23,500	Deposit	56,000
Difference in Trial		Rebate on bill discount	10
Considered as premises	1,500		
	61,000		61,000

Schedule: 2.

Reserve fund	2,000
P&L a/c (Cr)	900
Invt fluctuation	90
	2,990

Schedule: 6

Cash in hand	2,000
Cash with RBI	12,000
	14,000

Balance sheet as on 31.3.02.

Particulars	Schedule	Amt
Liabilities		
Capital	1	2,000
Reserve & surplus	2	2,990
Deposit	3	56,000
Borrowings	4	–
other Liabilities & Contingent	5	10
Total		6[illegible],000
Asset:-		
Cash & bank with RBI	6	14,000
money at Call & Short notice	7	–
Investment	8	6,000
Advance	9	39,[illegible]
Fixed asset	10	[illegible]
other asset	11	–
Total		61,[illegible]
Contingent Liabilities	12	5[illegible]

V.M. Selvaraj

3.21

Rebate on bills discounted:-

Pbm: 1 (3) From the following information of a bank calculate Rebate on bills discounted and give the adjusting entry. The accounts are closed on 31 mar 2007. The following bills were discounted at 10% p.a.

Discounted on	Amount	Tenure of the bill
i) 01.01.07	1,00,000	4 month
ii) 20.12.06	50,000	1 month
iii) 20.11.06	1,00,000	3 month
iv) 02.02.07	50,000	2 month
v) 03.10.06	1,00,000	5 month

Soln:-

Date of bill	Due date of bill	No. of days after 31 mar 2007
01.01.07	4-5.07	30+4 = 34 days
20.12.06	23.1.07	-
20.11.06	23.2.07	-
02.02.07	5-4-07	5 days
03.10.07	6.3.08.	-

Calculation of Rebate on bills discounted:-

It is to be calculated only for two bills dated 1.1.07 and 2.2.07.

Bill dated: 1.1.07:-

Total discounted for Rs 1,00,000 at 10%.

$1,00,000 \times \frac{10}{100} = Rs\ 10,000$

Rebate on bills discounted $= 10,000 \times \frac{34}{365} = 932.$

Bill dated 2.2.07:-

Total discount for Rs 50,000 at 10%

$50,000 \times \frac{10}{100} = Rs\ 5,000$

Rebate on bills discounted $= 5000 \times \frac{5}{365} = Rs$

Total Rebate on bills discounted = 932 + 68 = 1000

Journal entry:-

Discount a/c	Dr	1000	
To Rebate on bills discount a/c			1000
(Being rebate on bills discounted credited)			

3.22.

Pbm:2. Given below is an extract from the trial balance of a bank as on march 31st 200

particular	Debit	Credit
Discounted Bills	12,64,000	
Rebate on bills discounted (Ap2004)		8,340
Discount received during the year		85,912

An analysis of the bills discounted as shown below shows the following:-

Amt	Due Date	Rate of discou
2,10,000	June 4, 2005	5% P.a
6,54,000	June 10, 05	4.5% P.a
6,10,000	June 24, 2005	4% P.a
3,24,000	July 3, 2005	6% P.a

Find out the amt to be recorded in the P&L a/c of the bank for the period to mar 31, 2005

Ans:- Calculate of Rebate on bills discounted:-

Amount	No. of days away from 31.3.08	Amt of discount
8,10,000	65 Days	1,870
6,54,000	71 Days	5,725
6,10,000	85 Days	5,682
3,24,000	94 Days	5,006

Rebate on bills discounted = 18,283

Calculated of amt to be recorded in P&L a/c Amt

op. balance of RBd	8,340
Add:-	
Discount received	85,912
	94,252
Less:-	
clo. balance of RBD	18,283
Amt to be recorded in P&L a/c.	75,969

Pbm: 3 The following is an extract from the trial balance of a Bank as on march 31, 2008.

	Debit	Credit
Bills discounted	75,00,000	
Rebate on bills discounted (1.4.07)		46,000
Discount received		2,17,000

An analysis of the bills discounted as shown above shows the following:-

Date of Bill	Amt	period (month)	Rate of disc
13.1.2008	10,00,000	4	12%
17.2.2008	8,00,000	3	12%
06.3.2008	5,00,000	4	11%
16.3.2008	3,00,000	3	10%

Find out the amt of discount received to be credited to P&L a/c and pass appropriate journal entries for the same.

Soln:-

Calculation of amt of Rebate on bills discounted

Due Date	no. of days away from 31.3.08	Rate of bills discounted
16.5.08	46	15088
20.5.08	50	13,115
9.7.08	100	15,027
19.6.08	80	6,557
Rebate on bills discounted		49,781

Calculation of amt to be recorded in the profit & Loss account:

Rebate on bills discounted on 1.4.07	46,000
(+) Discount received	2,17,000
	2,63,000
(-) Rebate on bills discounted on 31.3.08	49,781
Amt to be recorded in P&L a/c.	2,13,219

Journal entries:-

1.4.07.

Rebate on bills discounted a/c Dr 46,000
To Int & Discount a/c 46,000

31.3.08.

Int & Discount a/c Dr 49781
To Rebate on bills discounted a/c 49781

31.3.08

Int & Discount a/c Dr 2,13,219
To P&L a/c 2,13,219

CHAPTER-4

INSURANCE COMPANIES ACCOUNTS

LIFE INSURANCE

GENERAL INSURANCE

3. **LIFE INSURANCE:**

- TYPES OF ISURANCE

CORPORATION GURANTEES TO PAY A CERTAIN SUM OF MONEY TO THE POLICY HOLDER ON REACHING A CERTAIN AGE OR DEATH WHICHEVER IS EARLIER.

2. **GENERAL INSURANCE:** OTHER TYPES OF INSURANCE EXCEPT LIFE INSURANCE; EX. FIRE,MARINE ,ACCIDENT,FIDELITY, THIRDPARTY AND CONSEQUENTIAL LOSS INSURANCE.

ACCOUNTS

- **<u>TWO TYPES OF BOOKS</u>**
- 1. STATUTORY BOOKS:

    A. REGISTER OF POLICIES

    B. REGISTER OF CLAIMS

    C. THE REGISTER OF LICENCED INSURANCED INSURANCE AGENTS

2. SUBSIDIARY BOOKS

    CASH BOOK, PREMIUM CASH BOOK, BRANCH CASH BOOK, PETTY CASH BOOK,CLAIM CASH BOOK, COMMISSON REGISTER, LAPSED AND CANCELED OLICIES BOOK, INVESTMENT LEDGER.

Annual accounts:
form of revenue account of life insurance

- **DEBIT SIDE**

1.CLAIM

2.ANNUITY

3.SURRENDER VALUE

4.BONUS INCASH

5. BONUS IN REDUCTION OF PREMIUM

6.EXPENSES OF MGT.

7-9.BAD DEBTS,TAXESAND OTHER EXP.

10.LIFE ASSURANCE FUND

- **CREDIT SIDE**

2. LIFE ASSURANCE FUND
3. PREMIUM
4. CONSIDERATION FOR ANNUITIES GRANTED
5. INTEREST, DIVIDEND AND RENT
6. REGISTRATION FEES
7. REINSURANCE

1.CLAIMS

- ALL CLAIMS INTIMATED AND ACCEPTED+NOT ACCEPTED AT THE END+EXPENSES RELATING TO CLAIM-REINSURANCE RECOVERY
- AMOUNT PAYABLE BY INSURANCE COMPANY

2.ANNUITIES

- IT IS AN EXPENSE
- ANNUAL PAYMENTS BY INSURANCE COMPANY TO THE PERSONS FOR A LUMP SUM RECEIVED SOME YEARS BACK

SURRENDER VALUE

- *IF THE PREMIUM CAN NOT BE PAID ANY MORE BY THE PERSON WHO HAD TAKEN INSURANCE THEN HE/SHE IS ALLOWED TO SURRENDER TO THE INSURANCE COMPANY AFTER THREE YEARS FROM THE DATE OF INSURANCE POLICY TAKEN.* **INSURANCE COMPANY PAYS A LUMP SUM BASED ON SOME CALCULATIONS.**

  CALCULATION:SURRENDER-
  REINSURANCE

BONUS IN CASH

- BONUS PAID TO THE POLICY HOLDER BY THE INSURANCE COMPANY
- CALCULATION:(BONUS IN CASH)
  MINUS
  (REINSURANCE FROM OTHER INSURANCE COMPANIES)

BONUS IN REDUCTION OF PREMIUM

- INSURANCE COMPANY MAY REDUCE PREMIUM INSTEAD OF GIVING BONUS IN CASH TO THE POLICY HOLDER

METHODS:1. Bonus is an expense-debit revenue a/c

2. Add to the premium in the credit side with the premium

6.EXPENSES OF MANAGEMENT

- They can be given either in the revenue account or a separate schedule can be prepared and the net amount can be shown in the revenue account

7-9. BAD DEBTS,TAXES AND OTHER EXPENDITURE

- THEY ARE SHOWN SEPARATELY ON THE DEBIT SIDE OF THE REVENUE ACCOUNT

10.LIFE INSURANCE FUND

THE DIFFERENCE BETWEEN THE CREDIT SIDE AND THE DEBIT SIDE IS **NOT PROFIT**.

IT IS KNOWN AS LIFE ASSURANCE FUND

CREDIT SIDE

- **1.LIFE ASSURANCE FUND**:

THE BALANCE IN THE LAST YEAR REVENUE ACCOUNT CREDIT BALANCE

2. premium

- Premium received from policy holder

ADD:

- Premium yet to be received at the end
- BONUS IN REDUCTION OF PREMIUM

LESS:

OUTSTANDING PREMIUM AT THE BEGINNING

PREMIUM PAID FOR REINSURANCE TO OTHER INSURANCE COMPANIES

CONSIDERATION FOR ANNUITIES GRANTED

- LUMPSUM RECEIVED BY INSURANCE COMPANY INORDER TO GIVE ANNUITIES IN FUTURE

- **IT IS AN INCOME**

4. INTEREST DIVIDEND AND RENT RECEIVED /RECEIVABLE

- DEDUCT: INCOME TAX PAID ON SUCH INCOME

REGISTRATION FEES

- APPLICATION FORM FEES COLLECTED
- AGENTS' REGISTRATION FEES COLLECTED

- INCOME

RE-INSURANCE ACCEPTED

- INSURANCE COMPANY ACCEPTS A BUSINESS FROM OTHER COMPANIES AND RECEIVES PREMIUM THEN IT IS AN INCOME
- IF COMPANY RE INSURANCE TO OTHER INSURANCE COMPANY IT PAYS PREMIUM THEN IT IS AN EXPENDITURE
- BUT RECEIVES COMMISSION FOR GIVING BUSINESS TO OTHER COMPANIES THEN THE COMMISSION IS INCOME KNOWN AS COMMISSION ON REINSURANCE CEDED THEN IT IS INCOME

BALANCE SHEET

LIABILITIES

- 1. SHARE CAPITAL
- 2.RESERVE OR CONTINGENCY ACCOUNTS
- 3.BALANCE OF FUND ACCOUNT
- 4. LOANS AND ADVANCES

BALANCE SHEET

- ASSETS
- 1.LOANS GIVEN TO OTHERS
- 2.INVESTMENTS IN GOVERNMENT SECURITIES, SHARES IN OTHER COMPANIES
- 3.AGENTS' BALANCES
- 4.OUTSTANDING PREMIUMS
- 5.**INTEREST, DIVIDENDS AND RENT DUE BUT NOT RECEIVED AT THE END OF THE YEAR**
- 6.AMOUNTS DUE FROM OTHERS AND OTHER INSURANCE COMPANIES FOR COMMISSION OR PREMIUM YET TO BE RECEIVED

LOSS

- TRANSFERRED TO P/L A/C
- DEBIT SIDE CAN NOT BE MORE THAN THE CREDIT SIDE

EXERCISE-1

- COMMISSION TO AGENTS?
- BONUS TO POLICY HOLDERS?
- CONSIDERATION FOR ANNUITIES?
- LIFE ASSURANCE FUND?
- RENT OUTSTANDING?
- BONUS UTILISED IN REDUCTION OF PREMIUM?
- SURRENDERS?

EXERCISE 2

- CLAIMS INTIMATED AND ADMITTED BUT NOT YET PAID?
- CLAIMS INTIMATED BUT NOT ADMITTED?
- PROVISION FOR INCOME TAX?
- INCOME TAX PAID?
- CONSIDERATION FOR ANNUITIES GRANTED?
- REGISTRATION FEES ?
- CONTINGENCY RESERVE?

chapter

Note: Bonus in reduction of premium is income as well as expense. Hence, it is added as well as deducted.

Illustration 2

From the following information, calculate the benefits paid as per the Insurance Regulation Act, 1938.

	₹
Claims by death	4,20,600
Annuities	80,900
Surrenders	1,12,800
Bonus in cash	7,800
Bonus in reduction of premium	10,200

Additional Information:

(a) Further bonus in reduction of premium ₹ 5,000

(b) Claims recovered under reinsurance ₹ 47,500.

Solution:

Benefits Paid

Particulars	*Amount (₹)*
Claims by death	4,20,600
Less: Claims recovered under reinsurance	47,500
	3,73,100
Add: Surrenders	1,12,800
Add: Bonus in cash	7,800
Add: Annuities	80,900
Add: Bonus reduction of premium	10,200
Add: Further bonus in reduction of premium	5,000
Benefits paid	5,89,800

Illustration 3

From the following figures prepare Revenue Account in the statutory form of the Star Assurance Co. Ltd. for the year ended 31-03-2010.

Particulars	₹
Claims by death paid	1,98,800
Claims by maturity paid	98,280
Premiums	19,76,940
Consideration for annuities granted	2,29,600
Bonus paid in cash	6,720
Expenses of management	89,320
Commission	29,796
Interest, dividend and rent	2,73,980

Income tax deducted at source	17,360
Surrenders	36,820
Bonus in reduction of premium	2,520
Dividend paid to shareholders	12,600
Amount of life assurance fund at the beginning of the year	42,63,000
Outstanding death claims at the beginning of the year	30,800
Outstanding death claims at the end of the year	22,400

Solution:

Schedule 1: Premium:

Premium received	19,76,940
Total	19,76,940

Schedule 2: Commission:

Commission	26,796
Total	26,796

Schedule 3: Operating Expenses:

Expenses of management	89,320
Total	89,320

Schedule 4: Benefits Paid:

Claims by death paid	1,98,800
Claims by maturity paid	98,280
Bonus paid in cash	6,720
Surrenders	36,820
Bonus in reduction of premium	2,520
Add: Outstanding claims at the end of the year	22,400
Less: Outstanding claims at the beginning of the year	–(30,800)
Total	3,34,740

Form A: RA

The Star Assurance Company Ltd.

Revenue Account for the year ended 31st March, 2010

Particulars	*Schedule*	*Amount (₹)*
Premium	1	19,74,140
Interest, Dividend and Rent (2,73,980 – 17,360)		2,56,620
Consideration for annuities granted		2,29,600
Total (A)		24,60,360
Commission	2	26,796
Operating expenses	3	89,320
Total (B)		1,16,116
Benefits paid	4	3,34,740
Total (C)		3,34,740
Surplus /Deficit (D) = A – B – C		**20,09,504**

Appropriation:		
Dividend paid		12,600
Balance being funds from future appropriation		19,96,904
Total (D)		20,09,504

Illustration 4

The following Trial Balance was extracted from the books of National Life Assurance Co. Ltd. as on 31st March, 2010

Particulars	Dr. (₹)	Cr. (₹)
Share capital (shares of ₹ 10 each)		96,000
Life Assurance Fund as on 1-4-2009		17,83,380
Dividends paid	9,000	
Bonus to policyholders	18,900	
Premium received		60,900
Claims paid	1,18,200	
Commission paid	5,580	
Management expenses	19,380	
Mortgage in India	2,95,320	
Interest, dividend and rent		67,620
Agent's balance	5,580	
Freehold premises	24,000	
Investments	13,83,000	
Loan against company's policies	1,04,160	
Cash on Deposit	21,600	
Cash in hand and on Current A/c	5,840	
Surrenders	5,600	
	20,07,900	20,07,900

You are required to prepare company's Revenue Account for the year ended 31-3-2010 and its Balance Sheet as on that date taking the following matters into consideration.

(*i*) Management expenses due	120
(*ii*) Interest accrued	11,580
(*iii*) Claims admitted but not paid	₹ 5,580
(*iv*) Premiums outstanding	7,200.

Solution:

Schedule 1: Premium:

Premium received	60,900	
Add: Outstanding premium	7,200	68,100
Total		68,100

Schedule 2: Commission:

Commission expenses		5,580
Total		5,580

Schedule 3: Operating Expenses:

Management expenses	19,380	
Add: Outstanding management expenses	120	19,500
Total		19,500

Schedule 4: Benefits Paid

Claims paid	1,18,200	
Add: Outstanding claims	5,580	1,23,780
Annuities		5,600
Surrenders		18,900
Bonus to policyholders		1,46,880
Total		

Schedule 5: Share Capital:

Share capital (shares of ₹ 10 each)	96,000
Total	96,000

Schedule 8: Investment:

Investments	13,83,000
Total	13,83,000

Schedule 9: Loans:

Mortgage in India	2,95,320
Loan against company's policies	1,04,160
Total	3,99,480

Schedule 10: Fixed Assets:

Freehold premises	24,000
Total	24,000

Schedule 11: Cash and Bank Balance:

Cash in hand and on Current A/c	4,380
Cash on deposits	16,200
Total	20,580

Schedule 12: Advances and Other Assets

Interest accrued	
Outstanding premiums	11,580
Agent's balance	7,200
Total	5,580
	24,360

Schedule 13: Current Liabilities

Claims admitted but not paid	
Management expenses due	5,580
Total	120
	5,700

Form A — RA

Revenue Account for the year ended 31st March, 2010
(The National Life Assurance Company Ltd.)

Particulars	*Schedule*	*Amount (₹)*
Premium earned	1	68,100
Interest and dividend received (67,620 + 11,580)		79,200
Total (A)		1,47,300
Commission	2	5,580
Operating expenses	3	19,500
Total (B)		25,080
Benefits paid		1,46,880
Total (C)	4	1,46,880
Surplus/Deficit (D) = A – B – C		– (24,660)
Appropriation		
Dividend paid		9,000
Total (D)		– (33,660)

Form A – BS

Balance Sheet as at 31st March, 2010

Particular	*Schedule*	*Amount (₹)*	*Amount (₹)*
Sources of Funds			
Share capital	5		96,000
Policyholder's Funds (Life Assurance Fund)			17,83,380
Total deficit			– (33,660)
Total			18,45,720
Application of Funds:			
Investments	8		13,83,000
Loans	9		3,99,480
Fixed Assets	10	24,000	
Cash and bank balance	11	20,580	
Advances and other assets	12	24,360	
		44,940	
Current liabilities	13	– (5,700)	
Net current assets			39,240
Total			18,45,720

Illustration 5

Prepare in the proper statutory form the Revenue Account of the Minister Life Assurance Co. Ltd. for the year ended 31-3-2009 from the following figures.

Particulars	₹
Claims by death	60,912
Claims by maturity	24,088
Premiums	5,64,552
Transfer fees	103
Consideration for annuity granted	65,702
Annuity paid	42,769
Bonus paid in cash	1,933
Expenses of management	25,536
Commission	7,659
Interest, dividend etc.	78,272
Income tax thereon	28,568
Surrenders	10,512
Bonus in reduction of premium	784
Dividend paid to shareholders	4,400
Life assurance fund at the beginning	12,16,800

Paid-up share capital of the above life assurance company is ₹4,00,000. You are required to prepare Revenue Account for the year ended 31-3-2009.

Solution:

Schedule 1: Premium:

Premium received	5,64,552
Total	5,64,552

Schedule 2: Commission:

Commission	7,659
Total	7,659

Schedule 3: Operating Expenses:

Expenses of management	25,536
Total	25,536

Schedule 4: Benefits Paid:

Claims by death	60,912
Claims by maturity	24,088
Annuities paid	42,769
Bonus paid in cash	1,933
Surrenders	10,512
Bonus in reduction of premium	784
	1,40,998

Form A—RA

The Minister Life Assurance Company Ltd.
Revenue A/c for the year ended 31st March, 2009

Particulars	*Schedule*	*Amount (₹)*
Premium	1	5,64,552
Interest, dividend and rent (78,272 – 28,568)		49,704
Consideration for annuities granted		65,702
Transfer fees		103
Total (A)		6,80,061
Commission	2	7,659
Operating expenses	3	25,536
Total (B)		33,195
Benefits paid	4	1,40,998
Total (C)		1,40,998
Surplus/Deficit (D) = A – B – C		**5,05,868**
Appropriation:		
Dividend paid to share holder		4,400
Balance being funds from future appropriation		5,01,468
Total		**5,05,868**

CHAPTER-5

DOUBLE ACCOUNT SYSTEM

Public utility undertakings supplying or operating Electricity, Gas, Water, Power, Railways, Tramways, etc., which operate under Special Acts of Parliament enjoy monopolistic rights in their business of rendering service to the society. These undertakings require huge amount of capital which is mostly fixed or long term capital to be invested on fixed or permanent assets. Most of the capital of such concerns is raised from the public by way of issue of shares and or debentures. These concerns are bound to give information to the public about the sources and application of funds. For this purpose, public utility undertakings prepare double accounts.

Meaning:

At the end of every accounting year, a trading concern will prepare its Trading, Profit and Loss account and a Balance Sheet. But, Public enterprises will prepare its revenue account, net revenue account, capital account and a General Balance Sheet. Instead of preparing a balance sheet, the Public enterprises will prepare a capital account and a General Balance Sheet. The preparation of these two statements is known as Double account system.

The system of presenting balance sheet in two parts is called the 'Double account system'. The object of this system is to reveal the amount of fixed capital raised from the public and the manner inwhich the fixed capital has been utilised in the acquisition of fixed assets.

Features of Double account system:

The features of a double account system are given below:

1) Double account system is only a system of presenting the final accounts.

2) Double account system is a special form of final accounts.

3) Under this system, Revenue account, Net revenue account, Capital account and a General Balance sheet are prepared as final accounts of Public enterprises.

4) Under this system, a balance sheet is divided into two divisions.

   a) Capital account and

   b) General Balance sheet

5) A revenue account is prepared in order to know the total profit of the public enterprise. Expenses and income of a public utility concerns are recorded in this account.

6) A net revenue account is prepared in order to know the net profit

earned from the business. Under this system, interest on debentures and interest on loans is shown on the debit side of Net Revenue account and Interest receivable or received is shown on the credit side of Net Revenue account.

7) Annual accounts are accomplished by several statistical returns.

8) While preparing the General Balance sheet, the words "To" (debit side) and "By" (Credit side) are used.

9) Under this system fixed assets are shown in the capital accounts at original cost. The depreciation is debited to Revenue account and credited to Depreciation Fund account or Depreciation Reserve account.

10) Discount and Premium on issue of debentures or shares are permanently retained as capital items. In case of discount, only net proceeds after such deduction is shown in the capital accounts.

Merits of Double account system:

i) Under double account system, capital account is prepared. The capital account shows the sources from which funds have been raised and the ways inwhich the funds have been spent. It helps the shareholders to have an idea regarding receipts and expenditures of the public enterprises.

ii) In double account system, depreciation provided for fixed assets is invested in securities regularly. The investments are sold when the enterprise wants to replace a fixed asset. The cash position of the bank is not affected due to purchase of fixed assets.

iii) As double account system is followed in public enterprise, the enterprise is able to provide better service at reasonable cost. Public enterprise submits several statistical returns in addition to its final accounts. It helps to know the performance of enterprise.

iv) Under double account system, Depreciation amount is invested in securities and at the end of the life of the fixed assets, these securities are sold. Hence, it helps to replace assets without any difficulty.

v) Double account system helps to compile statistical returns which reflect the services rendered to the public.

vi) Revenue account helps to ascertain pure operating results of public utilities.

vii) The capital account of public utilities help to determine whether the concern is overcapitalised or undercapitalised.

Demerits of Double account system:

The following are the limitations of double account system.

i) A Balance sheet is prepared into Capital account and General Balance Sheet. It is not possible to know the financial position of the enterprise.

ii) Assets are recorded only at cost price and not at depreciated value. It does not disclose a true and fair view of the business

iii) Even though value of fixed assets is completely written off, the fixed assets still appear in the books. That is, it is shown in the capital account.

iv) It is very difficult to make a distinction between revenue and capital.

v) It is very difficult to understand the double account system by all parties.

vi) Some deferred revenue expenditures may be considered as captial expenditures.

Differences between a Single Accounting System and Double Accounting System:

	Single Accounting System	*Double Accounting System*
i)	It is adopted by all concerns	It is adopted by all public enterprises.
ii)	A Balance Sheet is prepared.	A Capital account and a General baalnce sheet is prepared..
iii)	A Balance Sheet is prepared to know the financial position of a business as on a particular date.	Capital account is prepared in order to know the sources of inflow and the application of funds.
iv)	Assets are recorded in a balance sheet at the depreciated value.	Assets are recorded in a balance sheet at book value.
v)	Profit and Loss a/c and Profit and Loss appropriation accounts are prepared.	Revenue account and Net Revenue accounts are prepared.
vi)	Share capital will appear on the liability side of Balance Sheet.	Share Capital will appear in the capital account.
vii)	Trading, profit and loss account and a balance sheet are prepared as its annual accounts.	Revenue account, Net Revenue account, Capital account and a General Balance sheet are prepared as its annual accounts.
viii)	The words "To" and "By" are not used while preparing a Balance sheet.	The words "To" and "By" are not used while preparing a General Balance sheet.
ix)	When an old fixed asset is replaced by new fixed asset, then old fixed assets is completely written off in the books.	Original cost of old asset continues continues to appear in the books, even after replacement.

Meaning of Revenue account:

A public enterprise prepares its revenue account in order to findout the total profit earned from the business. A **revenue account** is prepared which is like the **ordinary profit and loss account.** All expenses relating to the generation of electricity or production of finished articles are recorded on the debit side of a revenue account and the incomes derived from the sale of the article or electricity are recorded on the credit side of a revenue account. The balance of this account is transferred to Net Revenue account.

Specimen form of Revenue account :

Revenue account of .... of the year ended ....

	Rs.		Rs.
To Cost of generating Electricity	xx	By Sale of energy :	
To cost of distribution of electricity	xx	for lighting	xx
	xx	for power	xx.
To maintenance expenses	xx	under special contracts	xx
To management expenses	xx	By Transfer fees	xx
To legal expenses	xx	By Rent received	xx
To Depreciation	xx	By Other items	xx.
To Other expenses	xx	By Reconnection and disconnection fees	xx
To Balance carried to net revenue account	xx		xx
	xx		xx

Meaning of Net Revenue account:

Public enterprises prepare its net revenue account in order to find out the net profit of the business. **Net Revenue account,** is prepared, which is like the ordinary **profit and loss appropriation account.** All amounts which are to be appropriated from the profits are to be recorded on the debit side of the net Revenue account. Income earned during the year, net profit earned during the year and the amount of profit brought forward from the last year are recorded on the credit side of a net revenue account. The balance of this account is transferred to the General Balance Sheet.

Interest on debentures and loans is shown on the debit side of Net Revenue account and Interest receivable or received is shown on the credit side of Net Revenue account.

Specimen form of Net revenue account :

Net Revenue account of --------------- for the year ending ....

	Rs.		Rs.
To interest on loans	xx	By balance b/d	xx
To contingency reserve	xx	By balance brought	xx
To interest on debentures	xx	from revenue a/c	xx
To Dividends	xx	By Interest on bank a/c	xx
To Balance carried to general balance sheet	xx		
	xx		xx
			xx

A Balance sheet is divided into two parts

1) Receipts and Expenditures on capital account.

2) General Balance Sheet

Receipts and Expenditure on capital account:

Capital account shows on the debit side or expenditure side capital expenditure incurred on the acquisition of fixed assets and on the credit side or receipts side, receipts on capital accounts such as shares debentures, premium on issue of shares or debentures, long term loans and calls received in advance.

The capital account is prepared in a columnar form with three columns on either side of the account. The first column is meant for recording the receipts or expenditures, as the case may be, of the items pertaining to the previous financial year. The second column represents the capital receipts or capital expenditures during the current financial year and the third column is meant for the totals of the first two columns. The difference between the two sides of this account is carried to the General Balance Sheet to the appropriate side.

If the total of the credit side of capital account is more than the total of debit side, the balance is transferred to the liabilities of General Balance Sheet. On the other hand, if the total of the debit side of capital account is more than the total of credit side, the balance is transferred to the asset side of the General Balance Sheet.

Specimen form of Receipts and Expenditure on Capital account for the year ended December 31, ...

Expenditure	Expenditure at the end of previous year Rs.	Expenditure during the year Rs.	Total Expenditure Rs.	Receipts	Receipts at the end of the previous year Rs.	Receipts during the year Rs.	Total Receipts Rs.
To Land	xx	xx	xx	By Share	xx	xx	xx
To Building	xx	xx	xx	By Debentures	xx	xx	xx
To Balance transferred to general balance sheet			xx	By Loans	xx	xx	xx
			xx		xx	xx	xx

General Balance Sheet:

A General Balance Sheet contains the details of other assets and liabilities and the balance of the capital account.

General Balance Sheet will be prepared in the usual method. That is, General Balance sheet is divided into two sides as assets and liabilities. On the liability side,

i) Current liabilities (Bank overdraft, Bills payable, creditors, etc.)

ii) Depreciation Fund

iii) General Reserve, Reserve fund etc. are recorded.

On the asset side:

i) Current assets (Sundry Debtors, Cash, Stock etc.)

ii) Other debit balances which do not take place in Revenue account, Net Revenue account, and capital account are recorded.

Specimen form of General balance sheet

General Balance Sheet as on ....

Liabilities	Rs.	Assets	Rs.
Balance of capital a/c	xx	Balance of capital a/c	xx
Sundry creditors	xx	Stores	xx
Net revenue a/c	xx	Materials	xx
Reserve fund	xx	Sundry Debtors	xx
Depreciation fund	xx	Preliminary expenses	xx
Other items	xx	Cash balance	xx
	xx		xx

Unit: V

Double Accounting

Format of Receipts and Expenditure on Capital Account

Expenditure	Exp at previous year	Exp during year	Total Exp	Receipts	Previous year	during current year	Total
To land	xxx	xxx	xxx	By share	xxx	xxx	xxx
To Building	xxx	xxx	xxx	By Debenture	xxx	xxx	xxx
To Balance Transfered to Gr. B/S			xxx	By Loans	xxx	xxx	xxx
			xxx		xxx	xxx	xxx

Net Revenue Account

To Interest on Loans	xxx	By Balance B/d	xxx
To contingency reserve	xxx	By Balance brought from revenue A/c	xxx
To Int on Debenture	xxx	By Int on bank A/c	xxx
To Dividents	xxx		
To Balance carried to general Balance sheet	xxx		
	xxx		xxx

~~Net Revenue Account for the year~~

Revenue Account For year ended.

To cost of generating Electricity	xxx	By sale of energy	
To cost of distribution Electricity	xxx	For Lighting	xxx
To maintanance Expences	xxx.	For Power	xxx.
To management Expences	xxx	under special contract	
To legal Expences	xxx	By Trans For Fees	xxx
To Depreciation	xxx	By Rent received	xxx
To other Expences	xxx	By other item	xxx
		By Reconnection & Disconnection Fees	xxx
	xxx		xxx

prob: 1

From the following particular draw up the capital account & General balance Sheet as on 31.12.1994 on double accounting system.

Authorised capital 8000 shares of Rs 100 each

Issued capital of Rs 4000 of shares of Rs 100 each fully paid [Including 500 shares during the year] 8% debenture of Rs 200000.

There Trade creditor Rs 50000, Reserve fund Rs 100000 The Trade Debtor Rs 90000 ~~each~~ cash at Bank Rs 50000 Reserve fund Invt at cost Rs 100000 market value 110000 stock Rs 60000.

Fixed Assets:

Expenditure on January 1

machinary 300000

Buildings 200000

Depreciation Fund:

machinary 60000

Building 20000

Net Revenue A/c 40000

Additional During the year machinary 70000.

Answer:

Receipts & Expenditure on capital account
For the year ended on 31.12.1994

Expenditure	1.1.94	Add	Total	Receipts	1.1.94	Add	Total
To Buildings	200000	-	200000	By capital	350000	50000	400000
To machinary	300000	70000	370000	By Debenture	200000	-	200000
To Investment	100000	-	100000	By Balance c/A/c			70000
	600000	70000	670000		550000	50000	600000
				By Balance b/d capital a/c			70000

General Balance Sheet:

Liabilities		Assets	
Capital a/c receipt	600000	Capital A/c Expenditure	670000
Reserve Fund	100000	Trade Debtor	90000
Trade creditor	50000	Cash at Bank	50000
Depreciation Fund:		Stock	60000
machinary	60000		
Building	20000		
Net Revenue	40000		
	870000		870000

prob. 2 From The Following Trail Balence of an Electricity supply company on 31.12.92 prepare Final a/c under double accounting system.

Debit Balance		Credit Balence	
Land & Building 1.1.92	180000	Eq. Share capital	500000
Addition 1992	40000	6% Debenture	200000
Plant & machinary	800000	Loan From Govt	400000
Addition 1992	20000	Reserves	80000
mains 1.1.92	300000	Sundry creditor	120000
Addition 1992	30000	Sale of Electricity	850000
Power generation Exp	430000	Rent received on	
Distribution Exp	70000	equipement	40000
Rent, Rates & Tax	20000	provision ~~a/c~~ for	
Sundry Debtor	128000	apreciation	160000
stores in hand	168000	Net revenue A/c	82000.
cash in hand	12000		
management Exp	165000		
Interest on Debenture	9000		
Interim divident	60000		
	2432000		2432000

provide Depreciation on
Equipements , Plant & machinary Rs 30000
mains Rs 20000 Land & Building 2000

Ans

Revenue Account For the year ended

Partialar	Rs	Particular	Rs
To Power generation	430000	By sale of Electricity	850000
To Distribution Exp	70000	By Rent received	40000
To Rent & Rates	20000		
To management Exp	165000		
To Depreciation on Plant machinary	30000		
mains	20000		
Land	2000		
To Balence	~~52000~~ 153000		
	890000		890000

Net Revenue Account

To Interest on Debenture	9000	By Balence c/d	82000
To Interim divident	60000	By Balence of revenue	153000
To Balence Transfered to Balence sheet	166000		
	235000		235000

Capital Account

Expenditure	1.1.94 upto	Addi	Total	Receipts	1.1.94	Add	Total
Land & Building	180000	40000	220000	Sha capital	500000	-	500000
Plant & machinary	800000	20000	820000	b's Debenture	200000	-	200000
mains	300000	30000	330000	Loan From Govt	400000	-	400000
	1280000	90000	1370000		1100000		1100000
				Balence			270000
							1370000

General Balance sheet

Liabilities		Assets	
Total receipts	1100000	Total Expenditure	1370000.
net Revenue A/C	166000	sundry Debtor	128000.
Reserves	80000.	stores in hand	168000
sundry creditor	120000	cash in hand	12000.
plant	160000.		
machinary	30000.		
Land	2000.		
Mainy	20000.		
	1678000		1678000

Prob. 3 From the Following Traial balence of Mahanathi electricity Company as on 31.12.1997, prepare Revenue account, net Revenue Account, capital account & General Balence sheet.

Debit		credit	
sundry Debtor	240000	Eq. share capital	2000000
other Debtor	50000	Net Revenue A/C	205000.
cash in hand	45000	7% Debenture	1000000
Electricity generation Exp	320000	sundry creditor	25000
		Sale of Electricity	1300000.
Electricity Distributi Expenses	60000.	Rent received on Equipment	60000.
Rent & Rate Taxes	30000	Depreciation Fund	720000.
Management Exp	315000		
Mains & Lines	2600000		
Line expended during The year	200000.		
Land & Building	500000		
Equipments	800000		
Additional : Equipement during	150000		
	5310000		5310000

i) Depreciation fund : Land & Building 5%.
Equipement 170000 , mains & Lines 250000
ii) Interim Dividend paid during 1997 6%.

Ans

Revenue account For year end 31.12.97

To Electricity generation Exp	320000	By sale of Electricity	1300000
To Distribution Exp	60000	By rent received	60000
To Rent & Taxes	30000		
To mgt Exp	315000		
To Depreciation			
Land	25000		
Equipement	170000		
Mains	250000		
To Balence	190000		
	1360000		1360000

Net Revenue Account

Interim Divident	100000	By Balence B/d	205000
To Balance carried to B/S	295000	By profit during the year	190000
	395000		395000

Capital Account

Expenditure	upto 1.1.97	Addition	Total	Receipt	1.1.97	paid	Total
Mains & Lines	2600000	200000	2800000	By Eq capital	200000	-	200000
Land & Building	500000	-	500000	By Debenture	100000	-	1000000
Equipement	800000	150000	950000		3000000		3000000
	3900000	350000	4250000	By Balence			1250000
			4250000				4250000

General Balance sheet

Liabilities		Assets	
Total Receipts	3000000	Total Expenditure	4250000
sundry creditor	25000	sundry Debtor	240000
Depreciation Fund	720000	other Debtor	50000
Land	25000	cash in hand	45000
Equipement	170000		
Mains	250000		
net Revenue A/c	~~100000~~ 295000		
Interim Dividend	100000		
	4585000		4585000

prob: 4 The following Balance appeared in the books of universal Electric supply corporation ltd as on 31. 3. 1998

Equity shares		600000
Debenture		200000.
Land on march 31.1997	150000	
land purchasing during the year	60000	
mains Including cost of laying to 31.03.1997	160000.	
mains Expended during the year	76000	
machinary on march 31.97	550000	
machinary purchased during the year	66000	
sundry creditor		1000
Depreciation Fund A/c		250000
sundry debtor for current supplied	40000	
other book debts	500	
stores on hand	6000	
cash in hand	4000	

cost of genration of Electricity	30000	
cost of distribution of electricity	9000	
sale of current		150000
meter rent		5000
Rent rates and taxes	12000	
Establishment Exp	21000	
Int on Debenture	10000	
Interim dividend	20000	
Depreciation	20000	
Net Revenue Account Balance on march 31.1997		28900
	1234500	1234500

From the above balance prepare the Revenue Account, Net Revenue Account, capital Account and General Balance Sheet.

Ans

universal Electricity supply corporation ltd
Revenue account for the year ended 31.03.98

To cost of generation of electricity	30000	By sale of current	150000
To cost of distribution	9000	By meter rent	5000
To Rent Rates Taxes	12000		
To Establishment Exp	21000		
To Depreciation	20000		
	155000		155000

Net Revenue Account For year ended 31.03.98

To Interest on Deb	10000	By Balance b/d	28500
To Interim divident	20000	By Revenue A/c	63000
To Balance carried to General B/S	61500		
	91500		91500

Receipts & Expenditure on capital Account
For year ended March 31. 1998

Expenditure	upto 31.3.97	Addi	Total	Receipts	31.3.97	Addi	Total
To land	150000	60000	210000	By Eq. shares	600000	-	600000
To mains	160000	76000	236000	By Debenture	200000	-	200000
To machinary	550000	66000	616000				
Total Expenditure	860000		1062000	Total receipt	800000		800000
				By Balence			262000

General Balence sheet March 31.98

Total capital receipts	800000	Total capital Expendi	1062000
sundry creditor	1000	sundry Debtor	40000
net revenue A/c	61500	other book debts	500
Depreciation Fund	250000	stores on hand	6000
		cash in hand	4000
	1112500		1112500

Prob'. 5.

The following balences are extracted from the books of city Light supply corporation Ltd as on 31.1998

Equity share		164700
Debenture		60000
sundry creditor on open account		300
Depreciation Account		75000
capital expenditure to march 31.1997	285000	
capital Expenditure during 1997-98	18300	
sundry Debtor For current supplied	12000	
other Debtor	150	

stores in hand	1500	
cash on hand	1500	
cost of generation electricity	9000	
cost of distribution of electricity	1500	
Management Exp	3600	
Rent Rates & Expenses	1500	
Depreciation	6000	
Int on Debenture	3000	
Interim Dividend ~~sale of current~~	6000	
Sale of current		39000
meter rent		1500
Balance of net Revenue Account as on 31.03.1997		8550
	349050	349050

a) capital account b) Revenue Account c) net Revenue A/c d) General B/S

Ans

Revenue account of City Light supply corporation ltd. For year ended 31.03.1998

To cost of generation of electricity	9000	By sale of current	39000
To cost distribution electricity	1500	By meter rent	1500
To management Exp	3600		
To Rent Rates Taxes	1500		
To Depreciation	6000		
To Balance carried to net Revenue A/c	18900		
	40500		40500

Net Revenue Account For year ended 31.03.1998

To Interest on Debenture	3000	By Balance b/d	8550
To Interim dividend	6000	By Balance brought From Revenue A/c	18900
To Balance carried to General B/S	18450		
	27450		27450

Receipts & Expenditure Account For year 31.03.1998

Expenditure	31.3.98	Add	Total	Receipt	31.3.97	Additi	Total.
To capital Expenditure	285000	18300	303300	By Equity	164700	-	164700
				By Debenture	60000	-	60000
Total Expendi	285000		303300	Total Recip	224700		224700
				By Balance			78800
							303300

General Balance sheet

Liabilities		Assets	
Total receipts	224700	Total Expenditure	303300
creditor	3000	Sundry Debtor	12000
Net Revenue A/c	18450	Other Debtor	150
Depreciation A/c	75000	stores in hand	1500
		cash on hand	1500
	318450		318450

prob. 6. A Railways station had to replaced by a new station. The cost of New station Rs 800000 The old one had cost Rs 210000 Labour Forming 3/10 th total expenditure and material accounting For the rest. prices of raw materials have doubles and wage rates have gone by 250% material of the old station worth Rs 38000 were used in the new station and the sale proceeds of the old station material were Rs 11000. These material

were obtained by pulling down the old station. pass Journal entries.

New works A/c Dr 285000
Replacement A/c 514500
To Bank A/c 800000
[Being Amount paid For replacement).

New works A/c Dr 38000
To Replacement A/c 38000
[Being old material used in new works]

Bank A/c Dr 11000
To Replacement A/c 11000
[Being old material sold]

Revenue A/c Dr 465500
To Replacement A/c 465500
[Being Amount debited to Revenue A/c]

workings:

		Material		Labour	Total
original cost	7	147000	3	63000	210000
(+) Increase		147000		157500	304500
Total		294000		220500	514500

calculation of Amount charged to revenue

Estimate replacement cost		514500
(-) old material reused	38000	
old material sold	11000	49000
Amount charged to Revenue		465000

Amount to be capitalised:

cost of new work	800000
(-) Estimated replacement cost	514500
	285000

Prob. 7 A water supply company had to replace a quarter of the mains and lay an auxilary main for the remaining length in order to augment supplies of water to a locality. The Total cost of the original main was 200000. The auxilary main cost 900000 and the new main cost 350000. It is estimated that the cost of laying a main has gone up by 30%. Part of the old main realised Rs 30000.

You are required to make the allocation between capital and revenue and give Journal entries.

Ans

Estimated Replacement cost = 200000 + 30% of 200000
= 260000

Calculation of amount charged to revenue

Estimated replacement cost	260000
(-) old material realised	30000
Amount charged to revenue	230000

Amount to be capitalised:

Cost of new works 900000 + 350000 =	1250000
(-) Estimated cost of replacement	260000
Amount to be capitalised.	990000

New works A/c Dr	990000	
Replacement A/c Dr	260000	
To Bank		1250000
(Being Amount paid for replacement)		

Bank A/c Dr	30000	
To Replacement A/c		30000
[Being old material sold]		

Revenue A/c Dr 230000
To Replacement A/c 230000
[Being Amount Debited to revenue A/c]

Prob. 8 A railway station was build in 1947 at a Cost OF Rs 600000 it was replaced in 1995 by a New railway station at a cost OF Rs 3200000 since 1947 prices OF meterial have risen by 250% and the labour rate have tribled. The proportion of meterial and labour in the old station was 2:3. old meterial valued Rs 50000 are used in the construction OF the new station and included in the cost of Rs 3200000 Rs 84000 is realised by the sale OF old meterial Give Journal entries to recorded the above transaction

Calculation of estimated Replacement Cost

	meterial	labour	Total
original Cost	240000	360000	600000
(+) increase	600000	720000	1320000
	840000	1080000	1920000

Amount charged to revenue } 1920000 - 50000 - 84000 = 1786000.

Amount charged to capital } = 3200000 - 1920000 = 1280000

New works A/c Dr 1230000
Replacement A/c Dr 1920000
To Bank 3150000
[Being Amount paid]

New works A/c		50000	
To Replacement A/c			50000
[Being old meterial used in new works]			
Bank A/c Dr		84000	
To Replacement A/c			84000.
[Being old meterial sold]			
Revenue A/c		1786000	
To Replacement A/c			1786000
[Being amount Transfered to revenue A/c]			

Prob: 9 The Indian Gas company rebuilt and re equipped part of their works at cost Rs 5000000. The part of the old works thus superseded cost Rs 3000000. The capacity of the new works is double the capacity of the old Rs 250000 as realised by the sale of old meterial and old meterial worth Rs 150000 are used in the construction of the new works in addition in the Total cost of Rs 5000000. mentioned above. The cost of labour and meterial are 25% higher now than when the old works were build Journalise the entries.

original cost of the old work	3000000
(+) Increse in cost cost of meterial & Labour 25%	750000
Estimated cost	3750000
Actual cost of new works	5000000
(−) Estimated cost	3750000
Amount capitalised.	1250000

	Estimated cost	2050000	3750000
(–)	material sold	250000	
	material used	150000	400000
	charged to Revenue		3350000

Works A/c Dr	1250000	
Replacement A/c Dr	3750000	
To Bank A/c		5000000
[Amount paid for replacement allocated between capital and revenue]		
Works A/c Dr	150000	
To Replacement A/c		150000
[cost of old material used in new works]		
Bank A/c	250000	
To Replacement A/c		250000
[Sale proceeds of old material]		
Revenue A/c	3350000	
To Replacement		3350000
[Amt charged to Revenue Account)		

In The ledger

Works Account

To Balance b/d	3000000	By Balance c/d	4400000
To Bank (cost of new plant)	1250000		
To Replacement A/c [old plant used]	150000		
	4400000		4400000

Replacement Account

To Bank A/c [current cost of Replacement]	3750000	By Bank [sale of old material]	250000
		By works A/c [old material used]	~~300~~150000
		By Revenue A/c	3350000
	3750000		3750000

Computation of capital Base :
capital Base is calculated as followes

i)	Book value of Fixed asset	xxx	
(-)	cost service lines contributed by consumers	xxx	xxx
ii)	cost of Intangible Assets (good will, under writing, commission, prilimanary Exp)		xxx
iii)	original work in progress		
iv)	Investmest made compulsorily on account of contigency reserve		xxx
v)	Amount of working capital		xxx

less : i) Depreciation provide on tangible and Intangible assets
ii) Amount of Loan Advanced by Electricity Board
iii) Amount of Debenture issued by the Company
iv) Amount of Loan borrowed From approved institution
v) security Deposites by customer hold in cash
vi) credit balance in the Tariffs and dividend control Reserve.

vii)	credit Balance in the Develope ment Reserve at the end of the year	
viii)	Amount carried Forward in the consumer benifit Reserve	———
	capital Base	xxx

Calculation OF clear profit

Expenditure on Generation	xxx	Income From Receipt	
Distribution and sale of energy	xxx	From sale of energy less discount	xxx
Interest on loans	xxx	Rent of meters etc	xxx
Interest on security debosites	xxx	sale & repair of Lamps Rent	xxx
legal charges	xxx	Rent	xxx
Bad debts	xxx	Transfer Fees	xxx
Auditor Fees	xxx	Investment Fixed card & call Deposits	xxx
Management Expences	xxx	Bank Balances	xxx
Depreciation	xxx	other receipts	xxx
other Expenses	xxx		
contribution to PF Gratuity	xxx		
specific appropriation	xxx		
Total	xxx		xxx

1) The madurai Electricity company earned a profit of Rs 2000000 during the year ended march 31. 2006. after paying Interest on Debenture @ 7% on Rs 500000 with the help of the figure given below show the disposal of the profit

original cost of Fixed Assets	30000000
Formation and other Exp	1000000
monthly Average of current Asset	3500000
Reserve Fund Invt at 5%	2000000

Contingency reserve fund Invt	500000
Loan from Electricity Board	6000000
Depreciation written off the date	6000000
Tariff & Dividend control Reserve	200000
Security Deposite from customer	300000
Developement Reserve	500000.

Assume the Bank rate to be 6%.

i) Calculate of Capital Base:

original cost of Fixed Asset		30000000
Formation & other Exp		1000000
Monthly Average of Current Assets		3500000
contingency Reserve Fund Invt		500000.
		35000000.
(-) Depreciation written off	6000000	
Loan from Electricity Board	6000000	
7% Debenture	500000	
Tariff and Divident Control Reserve	200000.	
Security from Deposite	300000.	
Developement Reserve	500000	13500000.
Capital Base		21500000

ii) Reasonable Return

8% on Capital Base Rs 21500000 (6% + 2%).	1720000.
½ on Development Reserve	2500
½ on Loan from Electricity	30000
½ on Debentures	2500
Income from Reserve Fund. Invt	100000
Reasonable Return	1855000

	Clear profit	2000000
	Surplus (Clear profit - Reasonable Return)	145000.

2 City Electricity ltd earn a profit Rs 845000 during the year ended 31st march 2004. after Debenture Interest @ 7 1/2 on Rs 250000 with the help of the figures given below show the disposal of profit.

original cost of Fixed Asset	10000000
Formation of other ~~Asset~~ Exp	500000
Monthly Average of current asset	2500000
Reserve Fund [represented by 4% Govt securities]	1000000
contingency Reserve Fund Invt	250000
Loan from Electricity Board	1500000
Total Depreciation written to date	20 00000
Tarriff and Dividend control Reserve	50000
Security deposists received from customer	200000

Assume Bank rate to be 6%.

Ans Calculation of capital Base:

	original cost of fixed asset		10000000
	Formation and other expenses		500000
	monthly Average of current Asset		2500000
	contigency reserve fund Invt		250000
			13250000
Less:	Depreciation written off	2000000	
	Loan from Electricity Board	1500000	
	7 1/2 Debentures	250000	
	Tarriff and Dividend control Reserve	50000	
	security Deposite from customer	200000	4000000
	capital Base.		9250000

2\. Calculation of reasonable Rate of Return.

8% on capital Base of Rs 92,50,000	740000
1/2% on Loan From E.B	7500
1/2% on Debentures	1250
Income From Reserve Fund	40000
Reasonable return	788750

C. Calculation of surplus

clear profit	845000
Reasonable Return	788750
Surplus	56250

Holding Companies

Balance Sheet as on 31.12.90

Share capital	20000	10000	Fixed Asset	20000	10000
General reserve	5000	3000	Current Asset	13000	12000
P&L A/C	3000	2000	share in 2 ltd	10000	-
sundry creditor	5000	2000			
10% Debenture	10000	5000			
	43000	22000		43000	22000

Y ltd acquire share capital of 2 ltd on 3.12.90 when the Balance sheet of the companies an above. you are require the consolidated Balance sheet as on 31.12.90.

Consolidated Balance sheet as on 31.

Equity & Liability

i) share holder's share		
share capital	1	20000
Reserve & surplus	2	9250
ii minority Interest	3	3750

iv.	non current Liabilities		
	Long term borrowing	4	15000
v.	current Liabilities		
	sundry creditor	5	7000
II	Asset Total		55000
i)	non current Asset		
	Tangible Asset	6	30000
ii)	current Asset	7.	25000.
	Total Assets.		55000

	Notes to Balence sheet.		
i)	Share capital		
	Share capital of Y ltd.		20000
2	Reserve & surplus		
	General Reserve of Y	5000	
	P&L A/c of Y ltd	3000	
	capital Reserve	1250	9250.
3.	Minority Interest		
	1/4th share capital		
	10000 x 1/4	2500	
	pre acquisition General Reserve 3000 x 1/4	750	
	Pre acquisition P/L 2000 x 1/4	500	3750
4.	long term Borrowings		
	10% Debentures of Y ltd	10000	
	10% Debentures of x ltd	5000	15000

2. From the Balence sheet given below prepare a consolidated Balence sheet

Balance sheet as on 31.03.2010.

Liabilities	H ltd	S ltd.	Assets	H ltd	S ltd.
Share capital of ₹ 10 Each	800000	300000	Land & Building	400000	200000
			Plant & machinery	200000	200000
creditor	350000	210000	Furniture	50000	20000
Bills payable	40000	20000	Invt in shares of B ₹ 10 each	200000	-
			Stock	190000	50000.
			sundry debtors	100000	40000.
			Bank Balance	50000	20000
	1190000	530000		1190000	530000

Ans

Consolidated Balance sheet as on 31.3.2010

	notes	Amount
i) Equity and Liabilities		
share capital	1	800000
ii) minority Interest	2	120000
iii) current Liabilities		
creditor	3	560000.
Bills payable	4	60000
Total Liabilities.		1540000
Assets		
i) non current Asset.		
Tangible Asset :-		
Land & Building	5	600000
Plant & machinary	6	400000
Furniture & Fixtures	7	70000.
ii) Intangible Asset :		
Good will	8	20000.
iii) current Assets :		
Stock	9	240000.
sundry debtor	10	140000.
Bank Balance	11	70000
		1540000

Notes to Balance Sheet

i)	Share capital		800000
ii)	Minority Interest.		
	paid up capital for 12000		
	12000 x 10		120000
iii)	creditors:		
	H ltd	350000	
	S ltd	210000	
		560000	
iv)	Bills payable		
	H ltd	40000	
	S ltd	20000	60000
v)	Land & Building:		
	H ltd.	400000	
	S ltd	200000	600000
vii)	Furniture & Fixtures		
	H ltd	50000	
	S ltd	20000	70000
viii)	Good will		20000
ix)	stock H ltd	190000	
	S ltd	50000	240000
x)	sundry debtors ~~H ltd~~		
	H ltd	100000	
	S ltd	40000	140000.
xi)	Bank Balance:		
	H ltd	50000	
	S ltd	20000	70000

HOLDING COMPANIES

Business combinations have occured in order to derive the benefits of large scale production. Formation of holding company is also one kind of business combination. The Holding company method of business combination facilities creation of closely linked group of companies with interest in mutual well being.

Sometimes a company may acquire either the whole or majority of the shares of another company inorder to control such a company or companies. The controlling company is known as the holding company and the company which is controlled by the Holding company is known as subsidiary company.

Holding Companies are those companies which are able to nominate the majority of the directors of some other company. The holding company holds the majority of the paid up equity capital of the Subsidiary Company. A holding company is also known parent company.

A holding company is one which acquires all or a working majority of the equity shares of another company in order to control the affairs of such other body corporate.

Definition:

Section 4 of the Companies Act, 1956 defines a subsidiary company. According to this section, a holding company may be formed in any one of the following three ways:

i) By holding more than 50% of the nominal value of the equity shares of another company.

ii) By controlling the composition of the Board of Directors of the other company, so that the holding company can appoint or remove the majority of the directors of the subsidiary company.

iii) By controlling, a holding company which controls another subsidiary company.

From the above definition, it can be inferred that a holding company is one which controls one or more other companies by means of :

i) holding majority shares or

ii) controlling the composition of Board of directors or

iii) controlling a holding company with subsidary

Example:

A Ltd company acquires 60% of the equity shares of B Ltd. In this example, A Ltd is a holding company and B Ltd is a subsidiary company.

B Ltd is a subsidiary of A Ltd and C Ltd is a subsidiary of B Ltd.

Subsidiary Company:

Subsidiary Company is a Company which is controlled by a holding company.

Example :

A subsidiary company may be classified into two types:

i) Wholly owned Subsidiary Company

ii) Party owned Subsidiary Companies

A Wholly owned subsidiary company is one in which all the shares are owned by the holding company. That is , the holding company's share is 100%.

A Partly owwned subsidiary company is one in which the holding company holds more than 50% of the shares owned by the subsidiary company.

Example :

X company has 10,000 shares of Rs. 10 each. Y company purchases 7000 shares of X company at Rs.10 each.

The holding company's share is 7,000/10,000 X 100=70%

X is a partly owned subsidiary company (70%)

The remaining 30% shares of Y company is held by outsiders.That outsiders are known as minority interest.

As - 21 on consolidated Financial Statements gives the following definitions:

A subsidiary is an enterprise that is controlled by another enterprise (known as parent) A parent is an enterprise that has one or more subsidiaries.

A group is a parent and all subsidiaries AS - 21 calls holding company, a parent company.

Objects of holding company:

The objects of a holding company are

i) to promote combination movement in order to avoid competition.

ii) to get the advantages of monopoly.

iii) to ensure smooth supply of raw materials

iv) to get an assured market for the products of the company.

v) to secure the benefits of large scale production

vi) to reduce cost through economical purchase

vii) to utilise the available resources effectively

viii) to control the market

ix) to eliminate competition of the same line of companies.

x) to avail tax benefits.

Advantages of Holding Companies :

i) Subsidiary companies are able to maintain its separate identity and good will.

ii) Holding companies can enjoy monopoly rights.

iii) Losses may be carried forward for Income Tax purpose.

iv) Financial position and profitability of each company is known.

v) Holding company may be able to secure economies in production and Management.

Disadvantages of Holding Companies :

Disadvantages of holding Companies are given below :

1. There is possibility of fraudulent manipulation of accounts.

2. There is the danger of the oppression of minority shareholders.

3. The true financial position of the subsidiary company may not be known to shareholder, creditors and outsiders of the holding company. Like this the true financial position of the holding company may not be known to the creditors, share holders and outsiders of the subsidiary company.

4. The creditors and outsiders may not be able to know the financial position of the subsidiary companies.

5. Sometimes, operating expenses of subsidiary companies may be high.
6. It is very difficult to analyse the financial position of the companies.

Legal requirements relating to presentation of accounts:

Section 212 deals with the presentation of accounts of a holding company.

1) As per section 212, following documents must be attached with the Balance sheet of a holding company.

i) a copy of the Balance sheet of the subsidiary company/subsidiary companies.

ii) a copy of the profit and loss account.

iii) a copy of the report of its Board of directors.

iv) a copy of the report of its auditors.

v) a) a statement of the holding company's interest in the subsidiary.

b) the profits of the company as far as they concern the holding company.

2) If the financial years of the holding company and subsidiary companies concide with each other, subsidiary company's Balance sheet and other documents mentioned above must be attached to the Balance Sheet of the holding company.

Requirements of Schedule VI:

The Balance Sheet of Holding Company must disclose the following items in the prescribed form of the Balance Sheet as per Schedule VI:

On the assets side:

1) Under Investments:

Investment in shares, debentures or bonds of subsidiary companies.

2) Under Unsecured Loans:

Loans and advances from subsidiaries

3) On the liability side of Balance sheet.

i) Under the heading 'secured loans' Loans and advances from subsidiaries

ii) Under the heading unsecured loans, Loans and advances from subsidiaries

iii) Under the heading 'Current liabilities and Provisions;

Amount due from subsidiaries

Consolidated Balance Sheet and Profit and Loss account:

Consolidation of Profit and Loss account and Balance Sheet implies preparation of a single Profit and Loss account of a holding company and its subsidiaries. Consolidation is done by aggregating all items of Incomes, expenses, assets and liabilities of the holding company and its subsidiary consolidation of final accounts is known as Group accounts. This consolidation is compulsory in England. But in India, it is only for conveniency, it is done.

The main purpose of this consolidation is to show the financial position and operating results of a group consisting of a holding company and one or more subsidiaries.

Preparation of Consolidated Balance Sheet:

1) Elimination of investment account:

The amount of shares subscribed by the holding company from the share capital of a subsidiary company is an investment of the holding company. This investment is shown on the asset side of the Balance Sheet of the holding company. At the time of consolidation this investment is to be proportionate replaced. Instead of this investment, the proportionate net assets and liabilities of the subsidiary company are liabilities of the subsidiary company are included in the consolidated Balance Sheet of the company.

This is the central idea behind the preparation of the consolidated Balance Sheet.

In case of wholly owned subsidiary company (a holding company owns all the equity shares of a subsidiary) the investment account is replaced by the net assets and liabilites of subsidiary company.

Problem : 1 (Holding company holds 100% control over subsidiary company - elimination of investments)

From the following Balance sheets of holding company and subsidiary company, Prepare a consolidated Balance sheet of holding company and its subsidiary company.

Balance Sheet as on 31.3.2010

Liabilities	Holding Company Rs.	Subsidiary Company Rs.	Assets	Holding Company Rs.	Subsidiary Company Rs.
Share capital in Shares of Rs. 10 each	20,00,000	10,00,000	Assets	25,00,000	12,00,000
Liabilities	15,00,000	2,00,000	Investment 1,00,000 of Rs.10 each of the subsidiary company (All the shares held)	10,00,000	--
	35,00,000	12,00,000		35,00,000	12,00,000

Answer : Consolidated Balance Sheet of ------ company as on 31.3.2010

	Notes	*Amount*
I Equity and Liabilities :		
(i)Shareholder's funds		
Share capital	1	20,00,000
ii)Minority interest		Nil
iii) Current Liabilities	2	17,00,000
Total		37,00,000
II Assets :		
i) Non current Assets :		
Tangible Assets	3	37,00,000
Total		37,00,000
Notes to Balance sheet :		
1) Share capital	1	
Shares of Rs. 10 each		20,00,000
2) Current Liabilites	2	
Holding Company		15,00,000
Subsidiary company		2,00,000
		17,00,000
3) Tangible Assets	3	
Holding company		25,00,000
Subsidiary company		12,00,000
		37,00,000

Preparation of consolidated Balance Sheet::

Following steps are to be followed to prepare consolidated Balance sheet:

1) Elimination of investment
2) Calculation of minority interest
3) Calculation of cost of control.
4) Calculation of preacquisition profit or capital profit.
5) Calculation of post acquistion profit or revenue profit
6) Calculation of capital losses and revenue losses
7) Inter company transactions and its elimination
8) Revaluation of assets and liabilities
9) Unrealised profits of inter-company.
10) Preference shares in subsidiary company
11) Bonus shares issued by subsidiary company
12) Dividend from subsidiary company
13) Contingent liabilities
    i) Internal contingent liability
    ii) External contingent liability

As per the revised schedule VI of the Companies Act, Balance sheet of a company is to be prepared in vertical form.

2) Minority Interest:

Generally, the subsidiary company may not be wholly owned by the holding company. The holding company holds only a majority shares. Remaining shares in the subsidiary companies are held by outsiders. Such holdings are known as **Minority shareholdings.** The interest of such outsiders is known as **Minority interest.**

That is the share of outsiders in the subsidiary company is known as **minority interest.**

When the shares are subscribed by outsiders then their interest in the company is known as Minority interest.

The share of minority interest is a liability and as such it should be shown on the liability side of the Balance sheet.

It may be shown as the last item on the liabilities side of the holding company.

Capital of subsidiary company is not shown in the consolidated Balance sheet because

i) its some part is adjusted in or capital reserve and
ii) the remaining part is shown in Minority interest.

Example :

B, Ltd a subsidiary company has 10,000 shares of Rs.10 each. A Ltd subscribed 8,000 shares of Rs.10 each. The remaining 2,000 shares of Rs. 10 are subscribed by outsiders. The holding of this 2,000 shares is known as Minority interest. Minority interest consists of

i) Amount of shares subscribed by the outsiders.
ii) Share of profits and reserves before acquisition of shares held by outsiders.
iii) Share of profits on appreciation of the assets of the subsidiary company.
iv) Share of loss incurred by subsidiary company.

Calculation of Minority interest :		**Rs.**
Paid up value of shares held by outsiders		xx
Add : Proportionate share of capital profits of the subsidiary company		xx
Add : Proportionate share of revenue profits of the subsidiary company		xx
Add: Proportionate share of profit on Revaluation of Assets & Liabilities of the Subsidiary company		xx
		xxx
Less : Proportionate share of the loss of the Subsidiary company	xx	
Less : Proportionate share of the loss on revaluation of Assets & Liabilities	xx	xx
Minority interest		xx

If preference shares are held by the outsiders, the face value of such shares with the dividend due thereon will be included in the minority interest.