CORPORATE ACCOUNTING (DBC36) (BACHELOR OF COMMERCE)

ACHARYA NAGARJUNA UNIVERSITY

CENTRE FOR DISTANCE EDUCATION

NAGARJUNA NAGAR,

GUNTUR

ANDHRA PRADESH

Chapter – 1

ACCOUNTING STANDARDS

Objectives :

After reading this unit you should be able to

- understand the meaning of accounting standard
- distinguish national and international accounting standards
- go through certain important accounting standards issued by Accounting Standards Board in India

Structure :

1.1 INTRODUCTION

Accounting standards are definitive statements for the purpose of preparing financial statements. They are the rules to be adopted for the accounting treatment of various items of financial statements.

1.1.1 Accounting Standard – Definition:

Accounting to Kchler, “Accounting Standard is a mode of conduct, imposed by customs, law or professional body for the benefit of public accountants and accountants generally.”

1.1.2 Accounting Standard and GAAP:

Accounting standards are different from Generally Accepted Accounting Principles (GAAP) or Accounting concepts. GAAP or accounting concepts are the generally accepted accounting principles to achieve comparability and uniformity of the financial statements. They provide a number of alternative treatments for the same item. But accounting standards provide solutions to specific issues. Accounting standards narrow down the areas of differences in accounting principles. They provide standard accounting norms to be followed by accountants.

1.1.3 Purposes of Accounting Standards:

Accounting standards serve the following purposes:

1. **Provide norms:** Accounting standards provide the norms on the basis of which financial statements should be prepared.
2. **Ensure Uniformity:** They ensure uniformity in the preparation and presentation of financial statements, by removing the effect of diverse accounting practices. Accounting standards make financial statements more meaningful and comparable.
3. **Resolve Potential financial conflicts:** They provide a useful system to resolve potential financial conflicts of interest between various groups.
4. **Help in audit of accounts:** They help auditors in the audit of accounts.

With the liberalisation and globalisation of business in recent years and opening up of markets to international investors, huge amounts of capital has been flowing across the national borders. Much of this cross-border flow has been in the form of easily tradeable securities, bonds, equities or other negotiable instruments. Accounting is the language of business, but every country has its own language which is called as generally accepted accounting principles (GAAP). As such, there is a need to hormonise national standards with international standards. Accounting standards helps in the interpretation of financial statements by any user around the world.

Rational investors, domestic as well as international, normally make their investment decisions on the basis of published financial statements, in addition to a wide variety of factors. Uniformity in accounting standards, policies and practices is, therefore, an imperative necessity for a meaningful inter-firm comparison and evaluation.

1.2 INTERNATIONAL ACCOUNTING STANDARDS (IAS)

Keeping in view the importance of uniform accounting standards, policies and procedures 16 accounting bodies from nine nations* formed the International Accounting Standards Committee (IASC) on June 29, 1973 with its headquarters at London. Since 1983, IASC's members have included all the professional accounting bodies that are members of the International Federation of Accountants (IFAC). As of January, 1996 there where 118 member bodies in 85 countries. Both the Institute of Chartered Accountants of India (ICAI) and the Institute of Cost and Works Accountants of India (ICWAI) are the members of IASC.

The responsibility of IASC is to improve the quality and soundness of financial reporting in member countries all over the world. Its other responsibility is to keep the member bodies informed of the latest developments and standards by issuing exposure drafts from time to time. Looking to the objectives and aims of IASC, accountancy bodies from different countries have

* The nine nations are: The USA, Canada, the UK and Ireland, Australia, France, Germany, Japan, Mexico and Netherlands

joined IASC to enable them to have upto date information on international accounting matters and to take guidance from these in laying down their own standards.

1.2.1 Objectives of IASC:

The objectives of IASC are:

(a) to formulate and publish accounting standards to be observed in the presentation of financial statements and to promote their world wide acceptance and observation; and

(b) to work for the improvement and harmonisation of regulations accounting standards and procedures relating to the presentation of financial statements.

Standards framed by Committee so far:

The committee has so for laid down standards regarding the following matters.

IAS – 1	Disclosure of accounting policies
IAS – 2	Valuation and presentation of inventories
IAS – 3	Consolidated financial statements
IAS – 4	Depreciation Accounting
IAS – 5	Information to be disclosed in financial statements
IAS – 6	Accounting responses to changing prices
IAS – 7	Statement of changes in financial position
IAS – 8	Unusual and prior period items and changes in accounting policies
IAS – 9	Accounting for research and developmental activities
IAS – 10	Contingencies and events occurring after balance sheet date
IAS – 11	Accounting for construction contracts
IAS – 12	Accounting for taxes on income
IAS – 13	Presentation of current assets and current liabilities
IAS – 14	Reporting of financial information by segments
IAS – 15	Information reflecting the effects of changing prices
IAS – 16	Accounting for property, plant and equipment
IAS – 17	Accounting for lease
IAS – 18	Revenue recognition
IAS – 19	Accounting for retirement benefits in the financial statements of employees
IAS – 20	Accounting for government grants and disclosure of government assistance
IAS – 21	Accounting for effects of changes in foreign exchange rates

IAS – 22	Accounting for business combinations
IAS – 23	Capitalisation of borrowing costs
IAS – 24	Related party disclosures
IAS – 25	Accounting for investments
IAS – 26	Accounting and reporting of retirement benefit plans
IAS – 27	Consolidated financial statements and accounting for investment in subsidiaries
IAS – 28	Accounting for investment in associates
IAS – 29	Financial reporting in hyper-inflationary economies
IAS – 30	Disclosure in the financial statement of banks and similar financial institution
IAS – 31	Financial reporting of interests in joint ventures
IAS – 32	Financial instruments : disclosure and presentation
IAS – 33	Earnings per share
IAS – 34	Interim financial reporting
IAS – 35	Discounting operations
IAS – 36	Impairment of assets
IAS – 37	Provisions, contingent liabilities and contingent assets
IAS – 38	Intangible assets
IAS – 39	Financial instruments, recognition and measurement
IAS – 40	Investment Property
IAS – 41	Agriculture

1.3 NATIONAL AND INTERNATIONAL STANDARDS

Let us now discuss the relationship between the National (Indian) and International Standards.

i. Within each country the issue of financial statements is governed by the local regulations. Neither the Indian accounting standard nor the International Accounting Standard can apply, if it is consistent with local regulations. The preface to the statements of Accounting Standard issued, in India clearly states, “The accounting standards by their very nature cannot and do not override the local regulations which govern the preparation and presentation of financial statements in our country.” However, the Institute will determine the extent of disclosure to be made in financial statements and the related auditor’s reports. Such disclosure may be by way of appropriate notes explaining the treatment of particular items. Such explanatory notes will be only in the nature of clarification and therefore need not be treated as adverse comments on the related financial statements.

ii. Within the country the Local Accounting Standard prevail over the International Accounting Standards – particularly when such local standards are mandatory.

iii. The main purpose of IAS is to harmonise as far as possible the diverse accounting standards and accounting policies of different countries. It concentrates on essentials, and, therefore, does not make it complex so that it can be applied effectively on a world-wide basis. This serve as a basis for a local standards.

iv. The idea of issuing the International Standards is to ensure that financial statements comply with such standards in all material respects and disclose the fact of such compliance. Where local regulation requires deviation from International Standards, the local members of IASC endeavour to persuade the relevant authorities of the benefits of harmonisation with International Accounting Standards. From this it also follows that local standards should deviate from international standards only if local circumstances or local laws necessitate deviations.

v. Where there is no local standard, International Standard should be followed by the Public Accountants.

1.3.1 Gaps between Indian and International Accounting Standards:

The variations between the Indian and International accounting standards are much too significant to be comfortably ignored. What adds another dimension is the absence of an Indian framework that sets out the concepts that underline the preparation and presentation of financial statements. The disturbing outcome of this is that the consistency of accounting standards within an overall framework is unclear.

Further, IASC has made a number of revisions and improvements in the IAS under the “compatibility and improvement project. It has issued 41 revised international accounting standards by November, 2001. So far in India by this time only 29 standards were prepared. But a similar comprehensive exercise of reviewing the Indian accounting standards has not been undertaken so far. As a result, differences exist in a number of situations between the Indian and International accounting standards.

In contrast to the international accounting standards, preparation of consolidated accounts of a group company is optional in India. It is because of this the assessment of the real financial health of the group becomes difficult. Similarly lack of segmentwise business reporting in India leads to inadequate performance appraisal of business. Absence of disclosure of earnings per share (EPS) provides only insufficient information to investors in India. Further, real value of the fixed assets are not reflected in financial statements as minimum rates of depreciation are used; wide disparities in inventory valuation are taking place since AS-2 on Inventory valuation is not mandatory. Lack of deferred tax accounting distorts the reported profits. Lack of disclosure of current portion of the long term debt leads to incorrect assessment of the liquidity position of the company. These are some of the issues to be resolved.

1.3.2 Need for Harmonisation of International Accounting Standards:

Accounting standards differ from country to country due to various factors. With the emergence of multinationals and globalisation of economies, it is desired that financial statements should be widely acceptable all over the world. The need to harmonise accounting standards arise due to following reasons.

1. Accounting practices and policies are different in different countries.
2. Multinational corporations have a different view point than national enterprises. There is a need to harmonise accounting standards to make the financial statements of multinational corporations reliable and easily understandable.
3. There is a widespread diversity of accounting practices in different countries. Harmonisation is required to evolve a uniform accounting standard for their world-wide applications.
4. Within a country itself, there may be a number of different accounting practices pertaining to a questions. Harmonisation will ensure standardization of accounting practices in the particular country.

Thus, the harmonisation of accounting standards all over the world is the need of the hour. It will make international financial information easier, valuable and comparable. Further, it will save time and money that is currently involved in analysing different financial statements. Multinational corporations will find it easy to report their information. However, harmonisation does not mean that accounting standards do permit flexibility to make the necessary adjustments to suit their purpose. With the globalization of a national economy, harmonization of accounting standards is becoming indispensable to broaden the field of international accounting.

1.4. ACCOUNTING STANDARDS BOARD – INDIA

Accounting Standards Board (ASB) has been set up in India by the Council of the Institute of Chartered Accountants of India with a view to form Indian Accounting Standards. The Council was set up in April, 1977. While formulating the standards, the board attempts to harmonise the diverse accounting policies and practices in India and also takes into account the applicable laws, customs, usages and business environment in the country. While formulating the Accounting Standards, ASB will give due consideration to standards issued by IASC (International Accounting Standard Committee) and try to integrate them to the extent possible in the light of the conditions and practices prevailing in India.

To issue accounting standards authority lies with the Council, ASB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statements. ASB will issue guidance notes on Accounting Standards and give classification on issue arising there from ASB will also review the Accounting Standards at periodical intervals.

1.4.1 The Accounting Standards – setting process :

The accounting standard setting, by its very nature, involves reaching an optimal balance of the requirements of financial information for various interest groups having a stake in financial reporting. With a view to reach consensus, to the extent possible, as to the requirements of the relevant interest groups and thereby bringing about general acceptance of the Accounting Standards among such groups, considerable research, consultations and discussions with the representatives of the relevant interest groups at different stages of standard formulation becomes necessary. The standard setting procedure of the ASB, as briefly outlined below, is designed in such a way so as to ensure such consultation and discussions :

1. Identification of the broad areas by the ASB for formulating the Accounting Standards
2. Constitution of the study groups by the ASB for preparing the preliminary drafts of the proposed Accounting Standards.
3. Consideration of the preliminary draft prepared by the study group by the ASB and revision if any, of the draft on the basis of deliberations at the ASB
4. Circulation of the draft, so revised, among the Council members of the ICAI and 12 specified outside bodies such as Standing Conference of Public Enterprises (SCOPE), Indian banks Association, Confederation of Indian Industry (CII), Securities and Exchange Board of India (SEBI), Comptroller and Auditor General of India (C & AG), and Department of Company Affairs for comments.
5. Meeting with the representatives of specified outside bodies to ascertain their views on the draft of the proposed Accounting Standard.
6. Finalization of the Exposure Draft of the proposed Accounting Standard on the basis of comments received and discussion with the representatives of specified outside bodies.
7. Issuance of the Exposure Draft inviting public comments.
8. Consideration of the comments received on the Exposure draft and finalization of the draft Accounting Standard by the ASB for submission to the Council of the ICAI for its consideration and approval for issuance.
9. Consideration of the draft Accounting Standard by the Council of the Institute, and if found necessary, modification of the draft in consultation with the ASB.
10. The Accounting Standard, so finalized, is issued under the authority of the Council.

1.4.2 Present status of Accounting Standards in India in harmonization with the International Accounting Standards :

As indicated earlier, Accounting standards are formulated on the basis of the International Financial Reporting Standards (IFRSs)/International Accounting Standards (IASS) issued by the IASB. Of the 41 IASs issued so far 31 are at present in force, the remaining standards have been withdraw. Apart from this 8 IFRSs have also been issued by the IASB, `Corresponding to the IASs/IFRss, so far 32 Indian Accounting Standards on the following subjects have been issued.

Accounting Standards Issued by
Accounted Standards Board (India)

No.		Title	Mandatory from accounting period beginning on or after
AS-1		Disclosure of Accounting Policies	1-4-1991
AS-2	(Revised)	Valuation of inventories	1-4-1999
AS-3	(Revised)	Cash flow statements	1-4-2001
AS-4	(Revised)	Contingencies and Events occurring after the Balance sheet date	1-4-1995
AS-5	(Revised)	Net profit or loss, prior period items and changes in accounting policies	1-4-1996
AS-6	(Revised)	Depreciation Accounting	1-4-1995
AS-7	(Revised)	Accounting for Construction Contracts	1-4-2003
AS-8		Accounting for Research and Development	1-4-1991
AS-9		Revenue Recognition	1-4-1991
AS-10		Accounting for Fixed Assets	1-4-1991
AS-11	(Revised 2003)	Accounting for the Effects of changes in Foreign Exchange Rates	1-4-2004
AS-12		Accounting for Government Grants	1-4-1994
AS-14		Accounting for Amalgamations	1-4-1994
AS-15		Accounting for Retirement Benefits in the Financial Statements of Employers	1-4-1995
AS-16		Borrowing Costs	1-4-2000
AS-17		Segment Reporting	1-4-2001
AS-18		Related Party Disclosures	1-4-2001
AS-19		Leases	1-4-2001
AS-20		Earnings per share	1-4-2001
AS-21		Consolidated Financial Statements	1-4-2001
AS-22		Accounting for Taxes on Income	1-4-2001
AS-23		Accounting for Investment in Associates in Consolidated Financial Statements	1-4-2002
AS-24		Discounting Operations	1-4-2004
AS-25		Interim Financial Reporting	1-4-2002
AS-26		Intangible Assets	1-4-2003
AS-27		Financial Reporting of Interests in Joint Venture	1-4-2002
AS-28		Impairment of Assets	1-4-2004
AS-29		Provisions, Contingent Liabilities & Contingent Assets	1-4-2004

Now let us go through these standards one by one.

1. Disclosure of Accounting Policies – (AS-I) :

Accounting Policies refer to specific accounting principles and the method of applying those principles adopted by the enterprises in preparation and presentation of the financial statements.

2. Valuation of Inventories – (AS-2) :

The objective of this standard is to formulate the method of computation of cost of inventories/stock, determine the value of closing stock/inventory at which the inventory is to be shown in balance sheet till it is not sold and recognized as revenue.

3. Cash Flow Statements – (AS- 3) :

Cash flow statement is additional information to user of financial statement. This statement exhibits the flow of incoming and outgoing cash. This statement assesses the ability of the enterprise to generate cash and to utilize the cash. This statement is one of the tools for assessing the liquidity and solvency of the enterprise.

4. Contingencies and Events occurring after the balance sheet date – (AS – 4) :

In preparing financial statement of a particular enterprise, accounting is done by following accrual basis of accounting and prudent accounting policies to calculate the profit or loss for the year and to recognize assets and liabilities in balance sheet. While following the prudent accounting policies, the provision is made for all known liabilities and losses even for those liabilities/events, which are probable. Professional judgement is required to classify the likelihood of the future events occurring and, therefore, the question of contingencies and their accounting arises.

Objective of this standard is to prescribe the accounting of contingencies and events, which take place after the balance sheet date but before approval of balance sheet by Board of Directors. The Accounting Standard deals with Contingencies and Events occurring after the balance sheet date.

5. Net Profit or Loss for the Period, Prior Period Items and change in Accounting Policies (AS-5) :

The objective of this accounting standard is to prescribe the criteria for certain items in the profit and loss account so that comparability of the financial statement can be enhanced. Profit and loss account being a period statement covers the items of the income and expenditure of the particular period. This Accounting Standard also deals with change in accounting policy, accounting estimates and extraordinary items.

6. Depreciation Accounting (AS-6) :

It is a measure of wearing out, consumption or other loss of value of a depreciable asset arising from use, passage of time. Depreciation is nothing but distribution of total asset over its useful life.

7. Construction Contracts (AS-7) :

Accounting for long term construction contracts involves question as to when revenue should be recognized and how to measure the revenue in the books of contractor. As the period of construction contract is long, work of construction starts in one year and is completed in another year or after 4-5 years or so. Therefore question arises how the profit or loss of construction contract by contractor should be determined. There may be following two ways to determine profit or loss; on year-to-year basis based on percentage of completion or on completion of the contract.

8. Revenue Recognition (AS – 9) :

The standard explains as to when the revenue should be recognized in profit and loss account and also states the circumstances in which revenue recognition can be postponed. Revenue means gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise such as: The sale of goods, Rendering of Services, and Use of enterprises resources by other yielding interest, dividend and royalties. In other words, revenue is a charge made to customers/clients for goods supplied and services rendered.

9. Accounting for Fixed Assets (AS-10) :

It is an asset, which is: Held with intention of being used for the purpose of producing or providing goods and services. Not held for sale in the normal course of business. Expected to be used for more than one accounting period.

10. The Effects of changes in Foreign Exchange Rates (AS-11) :

Effect of Changes in Foreign Exchange Rate shall be applicable in Respect of Accounting Period commencing on or after 1-4-2004 and is mandatory in nature. This accounting Standard applicable to accounting for transaction in Foreign currencies in translating in the Financial Statement of Foreign operation Integral as well as non-integral and also accounting for forward exchange. Effect of Changes in Foreign Exchange Rate, an enterprises should disclose following aspects:

- Amount Exchange Difference included in Net profit or Loss;
- Amount accumulated in foreign exchange translation reserve;
- Reconciliation of opening and closing balance of Foreign Exchange translation reserve.

11. Accounting for Government Grants (AS-12) :

Government Grants are assistance by the Government in form of cash or kind to an enterprise in return for past or future compliance with certain conditions. Government assistance, which cannot be valued reasonably, is excluded from Govt. grants,. Those transactions with Government, which cannot be distinguished from the normal trading transactions of the enterprises, or not considered as Government grants.

12. Accounting for Investments (AS-13) :

It is the assets held for earning income by way of dividend, interest and rentals, for capital appreciation or for other benefits.

13. Accounting for Amalgamation (AS-14) :

This accounting standard deals with accounting to be made in the books of Transferee company in case of amalgamation. This accounting standard is not applicable to cases of acquisition of shares when one company acquires / purchases the share of another company and the acquired company is not dissolved and its separate entity continues to exist. The standard is applicable when acquired company is dissolved and separate entity ceased exist and purchasing company continues with the business of acquired company

14. Employee Benefits (AS-15) :

Accounting Standard has been revised by ICAI and is applicable in respect of accounting periods commencing on or after 1st April 2006. The scope of the accounting standard has been enlarged, to include accounting for short-term employee benefits and termination benefits.

15. Borrowing Costs (AS-16) :

Enterprises are borrowing the funds to acquire, build and install the fixed assets and other assets, these assets take time to make them useable or saleable, therefore the enterprises incur the interest (cost on borrowing) to acquire and build these assets. The objective of the Accounting Standard is to prescribe the treatment of borrowing cost (interest + other cost) in accounting, whether the cost of borrowing should be included in the cost of assets or not.

16. Segment Reporting (AS-17) :

An enterprise needs in multiple products/services and operates in different geographical areas. Multiple products/services and their operations in different geographical areas are exposed to different risks and returns. Information about multiple products / services and their operation in different geographical areas are called segment information. Such information is used to assess the risk and return of multiple products/services and their operation in different geographical areas. Disclosure of such information is called segment reporting.

17. Related Party Disclosure (AS-18) :

Sometimes business transactions between related parties lose the feature and character of the arms length transactions. Related party relationship affects the volume and decision of business of one enterprise for the benefit of the other enterprise. Hence disclosure of related party transaction is essential for proper understanding of financial performance and financial position of enterprise.

18. Accounting for leases (AS-19) :

Lease is an arrangement by which the lesser gives the right to use an asset for given period of time to the lessee on rent. It involves two parties, a lessor and a lessee and an asset which is to be leased. The lessor who owns the asset agrees to allow the lessee to use it for a specified period of time in return of periodic rent payments.

19. Earning Per Share (AS-20) :

Earning per share (EPS) is a financial ratio that gives the information regarding earning available to each equity share. It is very important financial ratio for assessing the state of market price of share. This accounting standard gives computational methodology for the determination and presentation of earning per share, which will improve the comparison of EPS. The statement is applicable to the enterprise whose equity shares or potential equity shares are listed in stock exchange.

20. Consolidated Financial Statements – (AS-21) :

The objective of this statement is to present financial statement of a parent and its subsidiary (ies) as a single economic entity. In other words the holding company and its subsidiary (ies) are treated as one entity for the preparation of these consolidated financial statements. Consolidated profit/loss account and consolidated balance sheet are prepared for disclosing the total profit/loss of the group and total assets and liabilities of the group. As per this accounting standard, the consolidated balance sheet if prepared should be prepared in the manner prescribed by this statement.

21. Accounting for Taxes on Income (AS-22) :

This accounting standard prescribes the accounting treatment for taxes on income. Traditionally, amount of tax payable is determined on the profit/loss computed as per income tax laws. According to this accounting standard, tax on income is determined on principles of accrual concept. According to this concept, tax should be accounted in the period in which corresponding revenue and expenses are accounted. In simple words tax shall be accounted on accrual basis; not on liability to pay basis.

22. Accounting for Investments in Associates in consolidated financial statements (AS-23) :

The Accounting standard was formulated with the objective to set out the principles and procedures for recognizing the investment in associates in the consolidated financial statements of the investor, so that the effect of investment in associates on the financial position of the group is indicated.

23. Discontinuing Operations (AS-24) :

The objective of this standard is to establish principles for reporting information about discounting operations. This standard covers “discontinuing operation” rather than “discontinued operation”. The focus of the disclosures of the Information is about the operations which the enterprise plans to discontinue rather than disclosing on the operations which are already discontinued. However, the disclosure about discontinued operation is also covered by this standard.

24. Interim Financial Reporting (IFR) (AS-25) :

Interim financial reporting is the reporting for periods of less than a year generally for a period of 3 months. As per clause **41** of listing agreement the companies are required to publish the financial results on a quarterly basis.

25. Intangible Assets (AS-26) :

An Intangible Asset is an Identifiable non-monetary Asset without physical substance held for use in the production or supplying of goods or services for rentals to other or for administrative purpose.

26. Financial Reporting of Interest in joint ventures (AS-27) :

Joint Venture is defined as a contractual arrangement whereby two or more parties carry on an economic activity under **‘joint control.** Control is the power to govern the financial and operating policies of an economic activity so as to optime benefit from it. ‘Joint control’ is the contractually agreed sharing of control over economic activity.

27. Impairment of Assets (AS-28) :

The dictionary meaning of ‘impairment of asset’ is weakening in value of asset. In other words when the value of asset decreases, it may be called impairment of an asset. As per AS-28 asset is said to be impaired when carrying amount of asset is more than its recoverable amount.

28. Provisions, Contingent Liabilities And Contingent Assets (AS-29) :

Objective of this standard is to prescribe the accounting for Provisions, Contingent Liabilities, and Contingent Assets. Provision for restructuring cost.

Provision : It is a liability, which can be measured only by using a substantial degree of estimation.

Liability: A liability is present obligation of the enterprise arising from past events the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

29. Financial Instrument (AS-30) :

Recognition and Measurement, issued by The Council of the Institute of Chartered Accountants of India, comes into effect in respect of Accounting periods commencing on or after 1-4-2009 and will be recommendatory in nature for an initial period of two years. This Accounting Standard objective will become mandatory in respect of Accounting periods commencing on or after 1-4-2011 for all commercial, industrial and business entities except to a Small and Medium-sized Entity. The objective this Standard is to establish principles for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in Accounting Standard.

30. Financial Instrument presentation (AS-31) :

The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial asset and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains and the circumstances in which financial assets and financial liabilities should be offset. The principles in this Standard complement the principles for recognizing and measuring financial assets and financial liabilities in Accounting Standard Financial Instruments:

31. Financial Instruments, Disclosures and Limited revision to accounting standards (AS-32) :

The objective this Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:

- The significance of financial instruments for the entity's financial position and performance; and
- The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risk

1.5. SOME IMPORTANT ACCOUNTING STANDARDS

Le us now discuss some important Accounting Standards being issued by the Chartered Accountants of India.

1.5.1 Disclosure of Accounting Policies (AS-1):

This statement deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements.

1. **Purpose:** The purpose of this statement is to promote better understanding of financial statements by establishing through an accounting standard the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the financial statements. Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

2. **Issued covered:**
   (i) All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.
   (ii) The disclosure of the significant accounting policies should form part of the financial statements and the significant accounting policies should normally be disclosed one place.
   (iii) Any change in the accounting policies which has material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statement is affected by such change should also be disclosed to the extent

ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

(iv) If the fundamental accounting assumptions, viz., Going Concern, Consistency and Accrual are followed in financial statements specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

1.5.2 Accounting Standard – 2 (AS-2):

This revised standard supersedes AS-2, valuation of Inventories, issued in June, 1981. The primary issue in accounting for inventories is the determination of the value at which inventories are carried in the financial statements until the related revenues are recognised. This standard deals with the determination of such value. Including the ascertainment of cost of inventories, and any write down thereof to net realisable value.

The financial statements should disclose:

1. the accounting policies adopted in measuring inventories, including the cost formula used; and
2. the total carrying cost of inventories and its classification appropriate to the enterprise. Common Classification of inventories as raw materials and components, work-in-progress, finished goods, stores and spares, and loose tools etc.

1.5.3 Cash Flow Statement (As-3):

In the initial years, this accounting standard will be recommendatory in character. During this period this standard is recommended for use by companies listed on a recognised stock exchange and other commercial, industrial and business enterprises in the public and private sectors.

Objectives:

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilize those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certain of their generation.

The Statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating investing and financing activities.

Scope:

1. An enterprise should prepare a cash flow statement and should present it for each period for which financial statements are presented.

2. Users of an enterprise's financial statements are interested in how the enterprise generates and users cash and cash equivalents. This is the case regardless of the nature of the enterprise, as may be case with a financial enterprise. Enterprise need cash for essentially the same reasons, however different their principal revenue producing activities might be. They need cash to conduct their operations, to pay their obligations and to provide returns to their investors.

Cash Flow Statement: The Cash flow Statement should include the following.

1. Cash Flows from Operating Activities
2. Cash Flows from Investing Activities
3. Cash Flows from Financing Activities

1.5.4 Contingencies and events occurring after the Balance Sheets (AS-5):

This standard deals with the treatment of contingencies and events occurring after the balance sheet date, but before preparation and presentation of financial statements. This accounting standard deals with two items i.e.,

i. Contingencies
ii. Events occurring after the Balance Sheet date.

This standard should be applied by an enterprise in presenting Profit or Loss from ordinary activities, extra ordinary items and prior period items in the statement of profit and loss, in accounting for changes, estimates and in disclosure of changes in accounting policies.

These standards deals with among other matters, the disclosure of certain items of net profit or loss for the period. These disclosures are made in addition to any other disclosures required by other Accounting Standards.

1.5.5 Depreciation Accounting (AS-6):

This standard deals with depreciation accounting and applied to all depreciable assets except the following items to which special considerations apply.

(i) forests, plantations and similar regenerative nature resources;
(ii) wasting assets including expenditure on the exploration for and extraction of minerals, oils, naturals gas and similar non-regenerative resources;

(iii) expenditure on research and development;
(iv) goodwill;
(v) live stock.

This standard is also not applicable to land unless it has a limited useful life for the enterprise.

Different accounting policies for depreciation are adopted by different enterprises. Disclosure of accounting policies for depreciation followed by an enterprise is necessary to appreciate the view presented in the financial statements of the enterprise.

1.5.6 Accounting for Amalgamations (AS-14):

This standard deals with accounting for amalgamations and treatment of any resultant goodwill or reserve. The standard classifies amalgamation into two categories i.e., (i) Amalgamation in the nature of merger; and (ii) Amalgamation in the nature of purchase.

Amalgamation in the nature of merger:

An amalgamation should be considered to be an amalgamation in the nature of merger when all the following conditions are fulfilled.

a. All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
b. Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than equity shares already held therein, immediately before the amalgamation by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.
c. The consideration of the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
d. The business of the transferor company is intended to be carried on, after amalgamation, by the transferee company.
e. No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Amalgamation in the nature of purchase:

Amalgamations which do not satisfy one or more conditions specified for amalgamations in the nature of merger should be treated as ‘Amalgamations in the nature of purchase’. Thus, in amalgamation in the nature of purchase.

a. All the assets and liabilities of the selling company may not be taken over.
b. Less than 90% of the selling company's shareholders may become shareholders in the purchasing company.
c. Consideration payable to shareholders of selling company may be in the form of shares or cash or in any other from agreed upon.
d. Selling company's business may or may not be carried on in future.
e. Assets and liabilities taken over by the purchasing company may be shown at values other than values at the discretion of the purchasing company.

Methods of Accounting for Amalgamation:

There are two main methods of accounting for amalgamation.

a. The pooling of interests method; and
b. The purchase method.

1.5.7 Consolidated Financial Statement (AS-21):

Accounting Standard (AS-21), 'Consolidated Financial Statements' issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 1-4-2001. An enterprise that presents consolidated financial statements should prepare and present these statements in accordance with this standard.

Objectives:

The objective of these Statements is to lay down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented by a parent (also known as holding enterprise) to provide financial information about the economic activities of its group. These statements are intended to present financial information about a parent and its subsidiary (ies) as a single economic entity to show the economic resources controlled by the group, the obligations of the group and results the group achieves with its resources.

Scope:

1. This Statement should be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.
2. This Statement should also be applied in accounting for investments in subsidiaries in the separate financial statements of a parent.
3. In the preparation of consolidated financial statements, other Accounting Standards also apply in the same manner as they apply to the separate financial statements.
4. This Statement does not deal with:
   a. methods of accounting for amalgamations and their effects on consolidation, including goodwill arising on amalgamation.

b. accounting for investments in associates
c. accounting for investments in joint ventures.

AS-21 Terms a holding company as ‘Parent Company’ which has one or more subsidiaries and a ‘Subsidiary’ as an enterprise that is controlled by another enterprise known as ‘parent’. A ‘group’ is a parent and all its subsidiaries. AS-21 should be applied in the preparation and presentation of consolidated Financial Statements for a group of enterprises under the control of a parent.

1.6 SELF ASSESSMENT QUESTIONS

A. Short Answer Questions

1. Accounting Standard
2. International Accounting Standards
3. Accounting Standards Board
4. AS-3
5. AS-6
6. AS-14

B. Essay Questions :

1. What is the purpose of Accounting Standards?
2. Explain the need for Accounting Standards
3. Explain in brief the accounting standards issued by ICAI
4. Explain briefly the provisions of ‘Disclosure of Accounting Policies’ (AS-1)
5. What are the provisions regarding ‘contingencies and events occurring after the balance sheet date” as set out by AS-4?
6. Bring out the coverage of AS-6 regarding Depreciation Accounting.
7. State clearly the provisions contained in the Accounting Standard in respect of Amalgamation.
8. What is meant by generally accepted Accounting principles?
9. Explain convention of conservation.
10. What is the need for providing depreciation? Also write about depreciable assets.
11. What are the objectives of International Accounting Standards Committee?
12. Explain the procedure for issuing Accounting Standards?
13. Mention any five Accountancy Standards.
14. Compute and contrast Indian accounting standards with international accounting standards.
15. Enumerate the Accounting Standards formulated by Accounting Standards Board of India (ICAI).
16. What are the Indian Accounting Standards?
17. What is the need for Accounting Standards?

18. Specimen form of Accounting Policies
19. Explain the need for accounting standards
20. Explain the international accounting standard with regard to consolidation of balance sheet.
21. Functions of Accounting Standards Board in India
22. Compare Indian accounting standards with international accounting standards.
23. Income concept for financial reporting.
24. Explain the need for International accounting standards
25. Indian and International Accounting Standards
26. Explain the Accounting Standard relating to Depreciation Accounting.
27. Significance of account standards.
28. Define Accounting Standards. What are the Indian Accounting Standards.

1.7 REFERENCE BOOKS

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Chapter – 2

VALUATION OF SHARES

Objectives :

After reading this unit you should be able to :

- Understand the need for valuation of shares
- Discuss the methods of valuation of shares
- Go through the valuation of shares under intrinsic method, yield method and fair value method

Structure:

2.1 VALUATION OF SHARES

Valuation of shares is one of the important issues in accounting calling for accountant's judgement experience and knowledge.

2.1.1 Need for Valuation of shares:

The need for the valuation of shares arises due to the following reasons.

1. For amalgamation and absorption purpose.
2. For wealth tax purpose – to be valued every year.
3. When a block of shares are purchased
   i. To acquire controlling interest i.e., merger, take over etc.
   ii. In case, where there is no interest in acquiring controlling interest.
4. For selling shares of a shareholder to a purchaser in the absence of stock exchange quotation.
5. For conversion of one class of shares to another class of shares.
6. For payment of compensation to a company consequent upon nationalization.

7. When shares are to be taken as a security against loan.
8. On death of the owner for the purpose of distribution of shares of heirs.
9. When partners in a firm jointly hold some shares of a company for distribution among partners on dissolution on the basis of valuation of shares made.
10. For ascertaining capital gains tax at the time of sale or transfer of shares.

2.2 METHOD OF VALUATION OF SHARES

2.2.1 Factors affecting the value of shares:

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

a. The economic condition of the country
b. The nature of company's business
c. Other political and economic factors (e.g., possibility of nationalization, excise duty on goods produced, etc.)
d. The demand and supply of shares
e. Proportion of liabilities and capital
f. Rate of proposed dividend and past profits of the company
g. Yields of other related shares of the stock exchange etc.

2.2.2 Methods of Valuation of Shares :

There are three methods in the valuation of shares. These are:

i. Intrinsic Method
ii. Yield Method
iii. Fair Value Method

2.3. INTRINSIC METHOD OR NET ASSET METHOD

This method is also known as **assets backing method, balance sheet method, real value method or break-up value method**. Under this method, the valuation may be made either: (i) On a going concern basis or (ii) Break-up value basis. In the case of going concern basis, utility of the assets to the business is to be considered. But in the case of Break-up value basis the realizable value i.e., market value of assets should be taken into consideration for the purpose of valuation of shares.

Net Assets Method of Valuing Shares

	Rs	Rs.
Goodwill		x x x
Land		x x x
Buildings		x x x
Plant		x x x
Furniture		x x x
Stock		x x x
Debtors		x x x
Bills receivable		x x x
Cash and Bank		x x x
Total Assets		x x x
Less: Payments in the event of Liquidation		
Debentures	x x x	
Creditors	x x x	
Other Liabilities	x x x	x x x
Net Assets of the business		x x x
Less: Preference share capital with arrears of dividend		x x x
Balance available for equity shareholders		x x x

$$\text{Value of equity share} = \frac{\text{Amount available to equity shareholders}}{\text{No.of equity shares}}$$

Alternatively the value of equity share under this method may be ascertained in the following way.

	Rs.	Rs.
Equity share capital		x x x
Reserves		x x x
Other surpluses		x x x
Profit on revaluation		x x x
Gross equity		x x x
Less: Loss on revaluation	x x x	
Miscellaneous expenditure and losses	x x x	x x x
Net equity		x x x

$$\text{Value of equity per share} = \frac{\text{Net equity}}{\text{No.of equity shares}}$$

2.3.1 Factors to be considered in valuing the assets :

1. In valuation of company assets, goodwill should be valued at current cost and therefore any book value appearing as a result of purchase of goodwill must be eliminated.
2. Fictitious assets such as debit balance of profit and loss account, discount on issue of shares and debentures, preliminary expenses, etc., should be excluded.
3. All other assets (including non-trading assets such as investments) should be taken at their market values. In the absence of information in the question regarding the market values of the different assets, book values may rightly be taken as the market values of the different assets.
4. While calculating the value of inventories, finished goods may be valued at market price and raw materials, stocks and work in progress should be valued at cost price.
5. In case of book debts, it must be valued after making provision for bad and doubtful debts.

2.3.2 Valuation of Liabilities :

1. Generally liabilities are to be taken at book values. However, due consideration is to be given for contingent liabilities. Similarly it is necessary to provide adequate provision for outstanding expenses.
2. It is necessary to provide adequate provision for taxation and dividends, so that these are included in the liabilities
3. In case the share capital comprises both equity shares and preference shares, it is necessary to deduct preference share capital from the assets.
4. In case, the preference shares are participating preference shares, their claim for surplus should also be deducted from the value of the assets,

Illu.1: On December 31, 2009. The Balance Sheet of a limited company disclosed the following position:-

Liabilities	Rs.	Assets	Rs.
Issued capital in Rs.10 shares	**8,00,000**	**Fixed Assets**	**10,00,000**
Reserves	**1,80,000**	**Current Assets**	**4,00,000**
Profit and Loss A/c	**40,000**	**Goodwill**	**80,000**
5% Debentures	**2,00,000**		
Current Liabilities	**2,60,000**		
	14,80,000		**14,80,000**

On December 31, 2009 the fixed assets were independently valued at Rs.7,00,000 and goodwill at Rs.1,00,000. The net profits for the three years were, 2007 Rs.1,03,200, 2008 Rs.1,04,000, 2009 Rs.1,03,000 of which 20% was placed to reserve, this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%. Compute the value of company's share by Net assets method

Solution:

Value of company's share by Net Assets Method

Particulars	Rs.	Rs.
Assets:-		
Goodwill		1,00,000
Fixed Assets		7,00,000
Current Assets		4,00,000
		12,00,000
Less: Liabilities:-		
5% Debentures	2,00,000	
Current Liabilities	2,60,000	
		4,60,000
Net Assets		**7,40,000**

$$\text{No.of Equity shares} = \frac{\text{Equity share capital}}{\text{Value of equity share}} = \frac{8,00,000}{10} = 80,000 \text{ shares}$$

$$\text{Intrinsic value of the share} = \frac{\text{Net Assets}}{\text{Total No. of Equity shares}}$$

$$= \text{Rs.}\frac{7,40,000}{80,000} = \text{Rs.}9.25$$

Illu.2: From the following balance sheet, you required to value of the equity share.

Liabilities	Rs.	Assets	Rs.
2,000 6% preference shares of Rs.100 each	**2,00,000**	**Assets at book value**	**6,00,000**
30,000 equity shares of Rs.10 each	**3,00,000**		
Liabilities	**1,00,000**		
	6,00,000		**6,00,000**

The market value of ½ of the assets is considered at 10% more than the book values and that of remaining half at 5% less than the book value. There was a liability of Rs.5,000 which remain unrecorded. Assume Preference share have no priority as to payment of capital or dividend.

Solution :

Valuation of equity share by net assets method

	Rs.	Rs.
First half assets value (Rs.6,00,000 x ½)	3,00,000	
Add : Increase in Assets value (Rs.3,00,000 x 10/100)	30,000	3,30,000
Second half assets value (Rs.6,00,000 x ½)	3,00,000	
Less : Decrease in asset value (Rs.3,00,000 x 5/100)	15,000	2,85,000
		6,15,000
Less : Liabilities	1,00,000	
Unrecorded liability	5,000	1,05,000
Net Assets		5,10,000
Less : Amount available to preference shareholders (Rs.5,10,000 x 2,00,000/5,00,000)		2,04,000
Amount available to Equity shareholders		3,06,000

$$\text{Value of equity share} = \frac{\text{Amount avilable to equity shareholders}}{\text{No. of equity shares}} = \frac{3,06,000}{30,000} = \text{Rs.}10.20$$

Intrinsic value of equity share = Rs.10.20

Illu.3: The following is the summarised Balance Sheet of a company as at 31st December, 2009.

	Rs.		Rs.
Share Capital:		**Fixed Deposits:**	**38,00,000**
10,000 5% pref. shares of		**Investments**	**10,25,000**
Rs.100 each fully paid	**10,00,000**		
2,00,000 equity shares of		**Current Assets:**	
Rs.10 each fully paid	**20,00,000**	**Stock-in-Trade**	**5,72,000**
Reserves & Surplus:		**Sundry Debtors**	
General Reserve	**15,00,000**	**Less: Provisions**	**12,78,000**
P & L Account	**12,00,000**	**Cash and Bank balances**	**2,25,000**
Secured Loans:			
6% Debentures	**8,00,000**		
Current Liabilities:			
Sundry Creditors	**2,75,000**		
Liabilities for expenses	**1,25,000**		
	69,00,000		**69,00,000**

For purposes of valuation of shares, Fixed Assets are to be depreciated by 10 per cent and investments are to revalued at Rs.10,80,000. Debtors will realize Rs.12,14,000.

Interest on Debentures is accrued due for 9 months and preference dividend for the year ending 31st December, 2008 is also due; neither of these has been provided for in the Balance Sheet. Calculate the value of each Equity Share.

Solution:

Valuation of equity share by Net Assets method

	Rs.	Rs.
Fixed Assets		34,20,000
Investments as per revaluation		10,80,000
Stock-in-trade		5,72,000
Sundry Debtors		12,14,000
Cash and Bank Balances		2,25,000
		65,11,000
Less: Liabilities		
6% Debentures	8,00,000	
Sundry Creditors	2,75,000	
Liabilities for Expenses	1,25,000	
Interest on Debentures (accrued for 9 months)	36,000	
		12,36,000
Net Assets		52,75,000
Less: Preference Share Capital	10,00,000	
Preference Share Dividend @ 5% on Rs.10,00,000	50,000	
		10,50,000
Amount available to equity shareholders		42,25,000

$$\text{Intrinsic value of equity share} = \frac{\text{Rs.}42{,}25{,}000}{2{,}00{,}000} = \text{Rs.}21.13$$

2.3.3 Treatment of partly paid-up equity shares :

When there are fully paid-up and partly paid-up equity shares, it is necessary to convert partly paid-up shares into fully paid-up shares by making a notional call and uncalled amount should be added to net assets, before dividing the same by the number of shares. The value of each partly paid up share will then be the value of each fully paid up share minus the amount due on it.

2.3.4 Valuation of preference shares :

In India, preference shares have priority as to payment of dividend and repayment of capital over equity shares in the event of company's winding up. They are taken as cumulative but non-participating unless otherwise stated. Their valuation generally on ``Dividend basis'' according to the following formula :

$$\text{Paid up value} \times \frac{\text{Average maintainable dividend rate}}{\text{Normal rate of return}}$$

In case of dividend on cumulative preference shares is in arrears, the present value of such arrears of dividend (if there is a possibility of their payment) should be added to the value of a preference share calculated as above. The dividend basis for valuation of preference shares is useful only in those cases where the preference share capital has adequate assets backing and the company is a going concern. In case the preference share capital does not have adequate assets backing or the company is going into liquidation it will be appropriate to value preference shares according to the net asset method.

In case of participating preference shares of companies in liquidation, their share in the surplus assets remaining after payment to the equity shareholders is taken into account.

Applicability of the method :

1. The method is particularly applicable when the shares are valued at the time of amalgamation, absorption and liquidation of companies, and
2. The permanent investors determine the value of shares under this method at the time of purchasing the shares
3. This method is also applicable when shares are acquired with control motives.

Illu.4: The following information are obtained from the books of Sunrise Company Limited, as on 31 December, 2009:

Capital:	**Rs.**
20,000 A Equity Shares of Rs.10 each fully paid up	**2,00,000**
20,000 B Equity Shares of Rs.10 each, Rs.7.50 per share called and paid up	**1,50,000**
20,000 C Equity Shares Rs.10 each, Rs.5 per share called and paid up	**1,00,000**
General Reserve	**2,70,000**
Liabilities to Sundry Parties	**1,10,000**
Fixed Assets *less* Depreciation	**3,34,000**
Commission on Issue of Shares	**12,000**
Preliminary Expenses	**18,000**
Floating Assets	**4,66,000**

Calculate the values of each type of share by the assets backing method (excluding goodwill)

Solution:

Valuation of Equity Shares of a company by Net Assets Method

	Rs.	Rs.
Tangible Assets:		
Fixed Assets *less* Depreciation	3,34,000	
Floating Assets	4,66,000	8,00,000
Less: Liabilities		
Sundry Creditors		1,10,000
		6,90,000
Add: Notional Call:		
(a) On B Equity Shares: 20,000 @ Rs.2.50	50,000	
(b) On C Equity Shares: 20,000 @ Rs.5.00	1,00,000	1,50,000
Net Assets		**8,40,000**

$$\text{Value per fully paid share} = \frac{\text{Rs.}8{,}40{,}000}{60{,}000} = \text{Rs.}14.00$$

Rs.7.50 Equity share value paid up = Rs.14.00 – 2.50 = Rs.11.50
Rs.5.00 equity share value paid up = Rs.14.00 – 5.00 = Rs.9.00
The value of each A Equity Share = Rs.14
The value of each B Equity Share = Rs.11.50 (i.e., Rs.14.00 – Rs.2.50)
The value of each C Equity Share = Rs.9 (i.e., Rs.14.00 – Rs.5.00)

Illu.5: Given below is the Balance Sheet of Victory Co. Ltd. as on 31st December, 2009:

BALANCE SHEET

Liabilities	Rs.	Assets	Rs.
1,000 8% Preference Shares of Rs.100 each fully paid	**1,00,000**	**Building**	**1,30,000**
2,000 Equity Shares of Rs.100 each fully paid	**2,00,000**	**Machinery**	**1,20,000**
General Reserve	**1,10,000**	**Furniture**	**20,000**
Profit & Loss Account	**40,000**	**Investments in 6% Govt. Securities**	**90,000**
Creditors	**1,00,000**	**Stock**	**1,00,000**
		Debtors	**60,000**
		Cash and Bank Balance	**20,000**
		Preliminary Expenses	**10,000**

	5,50,000		**5,50,000**

You are given the following information:

(1) The present value of Building is Rs.1,80,000 and that of Machinery is Rs.80,000

(2) Companies doing similar business show profit earning capacity of 10% on market value of their shares.

(3) The average annual profit after 50% tax of last three years is Rs.48,000.

(4) The company has held 6% Govt. Securities for last 3 years and the interest on the Govt. Securities is liable to tax.

(5) Goodwill of the company is to be taken at 5 years' purchase of super profits.

Calculate the fair value of the share of the company.

Solution :

Calculation of Goodwill :

		Rs.	Rs.
I.	Capital employed :		
	Buildings		1,80,000
	Machinery		80,000
	Furniture		20,000
	Stock		1,00,000
	Debtors		60,000
	Cash and bank balances		20,000
	Total Assets		4,60,000
	Less : Creditors		1,00,000
	Capital employed		**3,60,000**
II.	Calculation of Super profits :		
	Average annual profit after 50% tax		48,000
	Less : Interest on Govt. Securities		
	(Rs.1,00,000 x 6/100)	6,000	
	Less : Tax 50%	3,000	3,000
			45,000
	Less : Normal profit (Rs.3,60,000 x 10/100)		36,000
	Super profit		**9,000**

iii. Calculation of Goodwill :

Goodwill = Super profits x 5 years = Rs.9,000 x 5 = Rs.45,000

Valuation of share by Net Assets Method

	Rs.
Goodwill (calculated value)	45,000
Add : Govt. Securities	90,000
Add : Other Net Assets [as per (i)]	3,60,000
Total Net Assets	4,95,000
Less : Preference share capital	1,00,000
Net assets available to equity shareholders	3,95,000

$$\text{Intrinsic value of share} = \frac{\text{Net assets available to equity shareholders}}{\text{No. of equity shares}}$$

$$= \frac{3,95,000}{2,000} = Rs.197.50$$

Valuation of share by Yield Method :

	Rs.
Average annual profit	48,000
Less : Preferential dividend (Rs.1,00,000 x 8/100)	8,000
Profits available to equity shareholders	40,000

$$\text{Earning rate} = \frac{\text{Profits available to equity shareholders}}{\text{Equity share capital}} \times 100 = \frac{40,000}{2,00,000} \times 100 = 20\%$$

$$\text{Share market value} = \frac{\text{Earning rate}}{\text{Normal rate of return}} \times \text{paid up value of share}$$

$$= \frac{20}{10} \times 100 = \text{Rs.}200$$

Calculation of fair value of share :

$$\text{Fair value of share} = \frac{\text{Intrinsic value of share} + \text{Market value of share}}{2}$$

$$= \frac{197.50 + 200}{2} = \text{Rs.}198.75$$

2.4. YIELD METHOD

Yield is the effective rate of return on the investment made in the shares by the investors. It is always expressed in terms of percentages. Since the valuation of shares is made on the basis of yield, and therefore, it is called **Yield method.**. This method of valuation should be used in all but exceptional cases. Since an investor is much concerned with the return that he expects, this method is valuable. While investing funds, the investor's main point of view is the return, although asset backing is also important because it provides the security. A genuine investor who finds that a company has low dividend rate but high asset backing never invests in the company with a view to liquidating the company and getting the benefit of high asset backing.

Under this method, the future maintainable profit for equity dividend is estimated by reference to past performance. This is adjusted by eliminating non-recurring incomes, deducting income tax, making allocation to reserves and preference dividend. The adjusted profit is capitalized at the normal rate of return in similar business. The yield method of valuation may taken any of the following forms.

(i) Return on capital employed (ROCE) or
(ii) Expected future dividends

The first method is adopted in case of majority holding, whereas the second method is adopted in case of minority holding.

2.4.1 Return on Capital Employed (ROCE):

$$.\,\text{ROCE} = \frac{\text{Profit earned}}{\text{Capital employed}} \times 100$$

$$.\,\text{Value of share} = \frac{\text{ROCE}}{\text{Normal rate of return}} \times \text{Paid up value of share}$$

Note: Profit earned means the profit before deducting debenture interest and preference dividend but after charging income tax. Capital employed includes preference share capital, Equity share capital, Reserve and Surplus, Debentures and long-term loans.

2.4.2 . Dividend basis:

a. On the basis of total amount of dividend:

$$\text{i. Capitalised value of profit} = \frac{\text{Total amount of dividend}}{\text{Normal rate of return}} \times 100$$

$$\text{ii. Value of Equity share} = \frac{\text{Capitalised value of profit}}{\text{No.of equity shares}}$$

b. On the basis of rate of dividend:

i. When the rate of dividend is not given it may be ascertained as follows

$$\text{Rate of dividend} = \frac{\text{Expected profit to equity shareholders}}{\text{Equity share capital (paidup)}} \times 100$$

ii. Value of each equity share:

$$= \frac{\text{Expected rate of dividend}}{\text{Normal rete of return}} \times \text{Paidup value of shares}$$

2.5. FAIR VALUE METHOD

There are some accountants who do not prefer to use net assets value or yield value for ascertaining the correct values of shares. They however, prefer the fair value of shares, which is the average of net assets value and yield value which provides a better indication about the value of shares than the earlier two methods. Fair value is the average of intrinsic value and yield value.

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

Illu.6: From the following information, calculate the value of an equity share:

(i) The paid-up share capital of a company consists of 1,000, 15% Preference Shares of Rs.100 each and 20,000 Equity shares of Rs.10 each.

(ii) The average annual profits of the company, after providing for depreciation and taxation amounted to Rs.75,000. It is considered necessary to transfer Rs.10,000 to General Reserve before declaring any dividend.

(iii) The normal return expected by investors on equity shares from the type of business carried on by the company is 10%.

Solution:

Particulars	**Rs.**
Profit after tax	75,000
Less: Transferred to General Reserve	10,000
	65,000
Less: Preference dividend @ 15% on Rs.1,00,000	15,000
Profits available to Equity Shareholders	**50,000**

$$\text{Expected Rate of Dividend} = \frac{\text{Profit available for Dividend}}{\text{Total paid - up Equity Share Capital}} \times 100$$

$$= \frac{\text{Rs.50,000}}{\text{Rs.2,00,000}} \times 100 = 25\%$$

$$\text{Value Per Share} = \frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid - up Value}$$

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

Illu.7: From the following particulars calculate the value of share.

	Rs.
2,000 9% Preference shares of Rs.100 each	**2,00,000**
50,000 Equity shares of Rs.10 each Rs.8 per share paid up	**4,00,000**
Expected profit per year before tax	**2,18,000**
Rate of tax – 50%	

Transfer to General reserve every year – 20% of profit. Normal rate of earnings 15%.

Solution:

1. Calculation of Profit Available for Equity Shareholders:

	Rs.
Expected Profit	2,18,000
Less: Tax at 50% Rs.2,18,000 x 50/100	1,09,000
Profit after tax	1,09,000
Less: Transfer to General Reserve at 20% Rs.1,09,000 x 20/100	21,800

Profit after General Reserve and Tax	87,200
Less: 9% Preference Dividend on Rs.2,00,000	
Preference Share capital (2,00,000 × $^{9}/_{100}$)	18,000
Profit available for Equity shareholders	69,200

2. Calculation of Expected Rate of Earnings:

$$\text{Expected Rate} = \frac{\text{Profits available to Equity shareholders}}{\text{Total paid - up Equity Capital}} \times 100$$

$$= \frac{69{,}200}{4{,}00{,}000} \times 100 = 17.3\%$$

3. Calculation of Value of Equity Share:

$$\text{Value of Preference shares} = \frac{\text{Expected rate}}{\text{Normal rate of return}} \times \text{paid up value of each share}$$

$$= \frac{17.3}{15} \times 8 = Rs.9.23$$

Illu.8: Narmada Ltd., declared dividend at 100% on its shares of Rs.10. Rs.7 paid up. Its share are quoted in market at Rs.32. You are required to calculate the normal rate of earnings.

Solution:

Paid up Value of the Share = Rs.7
Declared Dividend = 100%
Amount of Dividend = Rs.7 × $^{100}/_{100}$ = Rs.7

$$\text{Normal Rate of Earnings} = \frac{\text{Amount of Dividend}}{\text{Market value of share}} \times 100 = \frac{7.00}{32} \times 100 = 21.88\%$$

Normal Rate of Earnings = 21.88%

Note : 100% Dividend was declared on shares. As the Paid up value of share is Rs.7, Dividend at 100% on paid up value of the share will become Rs.7.

Illu.9 : The paid up capital of Kennedy Ltd. consists of 8,000 equity shares of Rs.10 each and 5,000 10% preference shares of Rs.10 each. Raju holds 1,000 equity shares in this company. It is ascertained that the normal annual net profit of such a company is

Rs.30,000 and the normal return by way of dividend on this paid up value of equity share capital is 15%. You are required to value Raju's share.

Solution :

	Rs.
Normal Annual net profit of a company	30,000
Less : Dividend payable to preference shareholders (Rs.50,000 x 10/100)	5,000
Profits available to equity shareholders	25,000

$$\text{Rate of return } = \frac{\text{Expected profits}}{\text{Equity share capital}} \times 100 = \frac{25{,}000}{80{,}000} \times 100 = 31.25\%$$

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

$$= \frac{31.25}{15} \times 10 = \text{Rs.}20.83$$

Value of 1,000 equity shares = 1,000 x Rs.20.83 = Rs.20,830

Illu.10: The following particulars are available in related to Dhrakshrameswara Ltd..

i. **Capital 450, 6% preference shares of Rs.100 each fully paid. 4,500 equity shares of Rs.10 each fully paid.**

ii. **External liabilities Rs.7,500**

iii. **Reserves and surplus Rs.3,500**

iv. **The average normal profit (after taxation) earned every year by the company Rs.8,505.**

v. **The normal profit earned on the market value of equity shares, fully paid, of the same type of companies is 9%. Calculate the value of each type of shares by (1) the asset backing method, assuming that the total assets worth Rs.350 are fictitious; (2) the earning capacity method.**

Solution:

Calculation of Value per share on the basis of:

I. Asset – Backing Method:

Value of Assets as per shareholder's Capital & Liabilities:

		Rs.
(i)	6% Preference Share Capital:	
	450 preferences shares @ Rs.100 each	45,000
(ii)	Equity Share Capital:	
	4,500 equity shares @ Rs.10 each	45,000
(iii)	Reserves & Surplus	3,500
		93,500
	Less: Fictitious assets	350
		Rs,
	Net Assets value	**93,150**
	Less: Amount payable to preference shareholders	45,000
	Net Assets available to equity shareholders	48,150
	Total No. of Equity Shares	4,500

$$\text{Value per equity share} = \frac{\text{Net Assets}}{\text{Total No. of equity shares}}$$

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

$$\text{Intrinsic value of Preference shares} = \frac{\text{Net assets available from preference shareholders}}{\text{No. of preference shares}}$$

$$= \frac{45{,}000}{450} = \text{Rs.}100$$

II. Earning Capacity Method:

		Rs.
I.	Average Normal Profits (after taxation)	8,505
	Less: Dividend on Preference Capital i.e. @ 6% on Rs.45,000 ($45{,}000 \times {}^{6}/_{100}$)	2,700
	Profits available to Equity Shareholders	5,805

$$\text{II. Expected Rate of Dividend} = \frac{\text{Expected profits}}{\text{Equity share capital} \times 100}$$

$$= \frac{5{,}805}{45{,}000} \times 100 = \textbf{12.9\%.}$$

III. Earning capacity value per share =

$$\frac{\text{Expected Rate}}{\text{Normal Rate}} \times \text{Paid up value of each share} = \frac{12.9}{9} \times 10.$$

Value per share = Rs.14.33.

$$\text{Value of Preference shares} = \frac{\text{Expected rate}}{\text{Normal rate of return}} \times \text{paid up value of each share}$$

$$= \frac{6}{6} \times 100 = \text{Rs.100}$$

Value of preference share – Rs.100

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

$$\text{Fair value of equity share} = \frac{\text{Rs.10.70} + 14.33}{2} = \text{Rs.12.52}$$

$$\text{Fair value of preference share} = \frac{\text{Rs.100} + 100}{2} = \text{Rs.100}$$

Illu.11: The following is the Balance Sheet of X Ltd. as at 31-12-2009.

Liabilities	Rs.	Assets	Rs.
Share Capital 10,000		**Land and Buildings**	**55,000**
Shares of Rs.10 each	**1,00,000**		
General Reserve	**20,000**	**Plant and Machinery (at loss depreciation)**	**65,000**
Taxation Reserve	**30,000**	**Trade Marks**	**10,000**
Workmen Savings	**15,000**	**Stock**	**24,000**
Profit and Loss A/c	**16,000**	**Debtors**	**44,000**
Sundry Creditors	**49,000**	**Cash at Bank**	**26,000**
		Preliminary Expenses	**6,000**
	2,30,000		**2,30,000**

The Plant and Machinery is worth Rs.60,000 and Land and Buildings have been valued at Rs.1,20,000 by an independent valuer, Rs.4,000 of the debts are

bad. The profits of the company have been as follows: 2007 Rs.40,000; 2008 Rs.45,000; 2009 Rs.53,000

It is the company's practice to transfer 25% of the profits to reserve ignoring taxation, find out the value of shares. Similar companies give a yield of 10% on the market value of their shares. Goodwill may be taken to be worth Rs.80,000.

Solution:

(a) Net Assets Method or Intrinsic Method

(b)

Particulars	**Rs.**	**Rs.**
Assets:-		
Goodwill		80,000
Land & Buildings		1,20,000
Plant and Machinery		60,000
Trade Marks		10,000
Stock		24,000
Debtors	44,000	
Less: Bad debts	4,000	40,000
Cash at Bank		26,000
Total Assets		3,60,000
Less: Liabilities:-		
Workmen's Savings	15,000	
Sundry Creditors	49,000	
		64,000
Net Assets		**2,96,000**

$$\text{Intrinsic value of the share} = \frac{\text{Net Assets}}{\text{Total No. of Equity shares}} = \frac{2,96,000}{10,000} = \text{Rs.}29.60$$

(b) Yield Method:-

I. Average profits of the Company for

	Rs.
2007	40,000
2008	45,000
2009	53,000
	1,38,000
Less: Bad debts during 2009	4,000
	1,34,000
Average Profit = $^{\text{Rs.1,34,000}}/_{3}$	44,467
Less: Transfer to General Reserve (25%) = 44,667 × $^{25}/_{100}$ = 11,167	11,167
Average Profits available to Equity shareholders	**33,500**

II. $$\text{Expected Rate of Return} = \frac{\text{Average Profits}}{\text{Equity share capital}} \times 100$$

$$= \frac{33{,}500}{1{,}00{,}000} \times 100$$

III. $$\text{Yield value of Shares} = \frac{\text{Expected Rate}}{\text{Normal Rate}} \times \text{Paid up value of each share}$$

$$= \frac{33.5}{10} \times 10 = \text{Rs.}33.50$$

Expected Rate = **33.5%**

Illu.12: The Balance Sheet of Govind Ltd., as on 31-3-2010 was as under:

Liabilities	Rs.	Assets	Rs.
2,000 Equity shares of Rs.100 each	**2,00,000**	**Land and Buildings**	**1,25,000**
General Reserve	**50,000**	**Machinery**	**75,000**
Profit and Loss a/c	**25,000**	**Investments at cost (Market Value Rs.37,500)**	**45,000**
Creditors	**45,000**	**Debtors**	**50,000**
Provision for Taxation	**20,000**	**Stock**	**37,500**
Provident Fund	**17,500**	**Cast at Bank**	**25,000**
	3,57,500		**3,57,500**

Additional Information:

(1) Land and Building and Machinery are valued at Rs.1,37,500 and Rs.55,000 respectively.

(2) Of the total debtors, Rs.2,500 are bad.

(3) Goodwill is to be taken at Rs.25,000.

(4) The normal rate of dividend, declared by such type of companies is 15% on the up capital.

(5) The average rate of dividend, declared and paid by this company is 18% on its paid up capital.

Capital the fair value of the Equity Share of the Company.

Solution:

Value of Equity Shares on the Basis of Intrinsic Value	Rs.	Rs.
Land and Buildings		1,37,500
Machinery		55,000
Investments at market Value		37,500
Debtors less Bad Debts Rs.2,500		47,500
Stock		37,500
Cash at Bank		25,000
Goodwill		25,000
		3,65,000
Less: Creditors	45,000	
Provision for Taxation	20,000	
Provident	17,500	82,500
Net Assets available for Equity Shareholders		**2,82,500**
Number of Equity Shaers		2,000

$$\text{Value of Equity shares} = \frac{\text{Rs.}2{,}82{,}500}{2{,}000} = \text{Rs.}141.25$$

Value of Equity Share according to Yield Method

$$\text{Value of Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Dividend}} \times \text{Paid up value of share}$$

$$= \frac{18\%}{15\%} \times \text{Rs.}100 = \text{Rs.}120$$

Fair Value of Equity Share

$$= \frac{\text{Value on the Basis of Yield} + \text{Value on the Basis of Net Assets}}{2}$$

$$= \frac{\text{Rs.}120 + \text{Rs.}141.25}{2} = \text{Rs.}130.62.$$

Illu.13: The following information are obtained from the books of Sunrise Company Limited, as on 30 April, 2010:

Capital:	**Rs.**
10,000 Equity Shares of Rs.10 each fully paid up	**1,00,000**
10,000 Equity Shares of Rs.10 each, Rs.7.50 per share called and paid up	**75,000**
10,000 Equity Shares Rs.10 each, Rs.5 per share called and paid up	**50,000**

	Rs.
General Reserve	**1,35,000**
Liabilities to Sundry Parties	**55,000**
Fixed Assets *less* Depreciation	**1,67,000**
Commission on Issue of Shares	**6,000**
Preliminary Expenses	**9,000**
Floating Assets	**2,33,000**

It is estimated that the normal average profit *less* tax of the company will be maintained at Rs.34,000, and the expected rate for capitalization purpose is 8%. Calculate the values of each type of share by the assets backing method (excluding goodwill) and also by the earning capacity method. Assume dividends are declared on paid up capital.

Solution:

Valuation of Shares by the Assets Backing:

	Rs.	Rs.
Tangible Assets:		
Fixed Assets		1,67,000
Floating Assets		2,33,000
		4,00,000
Less: Liabilities to Sundries		55,000
		3,45,000
Add: Notional Call:		
(a) On 2nd Equity Shares: 10,000 @ Rs.2.50	25,000	
(b) On 3rd Equity Shares: 10,000 @ Rs.5.00	50,000	75,000
Net Assets		**4,20,000**

$$\text{Value per fully paid share} = \frac{\text{Rs.4,20,000}}{30{,}000} = \text{Rs.14}$$

The value of each 1st Equity Share = Rs.14.
The value of each 2nd Equity Share = Rs.11.50 (i.e., Rs.14 – Rs.2.50)
The value of each 3rd Equity Share = Rs.9 (i.e., Rs.14 – Rs.5)

Valuation of Shares by the Earning Capacity:

Total paid-up Capital = Rs.2,25,000
Normal Average Profit = Rs.34,000

$$\text{Earning Rate} = \frac{34{,}000}{2{,}25{,}000} \times 100 = 15.11\%$$

The value of each 1st Equity Share = $^{15.11}/_{8} \times 10$ = **Rs.18-89**
The value of each 2nd Equity Share = $^{15.11}/_{8} \times 7\text{-}50$ = **Rs.14-17**
The value of each 3rd Equity Share = $^{15.11}/_{8} \times 5$ = **Rs.9-44**

2.6 QUESTIONS

1. What is need for the valuation of shares?
2. Discuss different methods of valuing equity shares.
3. Explain the 'Yield Method' of valuing equity shares.
4. Describe the methods of valuation of shares and discuss which method, in your view, is most appropriate in valuing 'minority' and majority holdings.
5. Distinguish between 'Intrinsic' and 'market' value of shares
6. What are the aims of valuation of shares?
7. What are the factors affecting valuation of shares?
8. Explain the necessity of valuation of shares
9. Explain the circumstances under which valuation of shares is essential and discuss the various methods of valuing the shares.
10. Value of a share under yield method
11. What are the merits and demerits of net assets and yield method?
12. Explain the methods of Valuation of shares
13. Yield method
14. Intrinsic value
15. Briefly explain the various methods of valuation of shares.

2.7 EXERCISES

1. NTT Ltd. declared dividend at 25% on its shares of Rs.10, Rs.6 paid up. Its share are quoted in the market at Rs.10. You are required to calculate the normal rate of earnings.

[Ans.: Normal Rate of Earnings = 15%]

2. X Ltd., declared dividend at 25% on its shares of Rs.10, Rs.8 paid up. Its shares are quoted in the market at Rs.10. You are required to calculate the normal rate of earnings.

[Ans.: Normal Rate of Earnings = 20%]

3. Padmaja Ltd., declared dividend at 100% on its shares of Rs.10. Rs.12 paid up. Its share are quoted in market at Rs.41. You are required to calculate the normal rate of earnings.

[Ans.: Normal rate of return = 29.26%]

4. A company's share has a market value of Rs.15. Dividend paid on the share is Rs.2, what is the normal rate of return?

[Ans.: Normal Rate of Return = 13.33%]

5. A company's share has a face value of Rs.10 and market value of Rs.15. The dividend paid by the company on an average is 30% What is the normal rate of return.

[Ans.: Normal Rate of Return = 20%]

6. A company declared dividend at 20% on its equity shares having a paid up value of Rs.10 and a market price of Rs.25. Calculate the Dividend Yield Ratio.

[Ans.: 8%]

7. X Ltd., declares dividend at 20% on its Rs.50 fully paid up share. If normal expected rate in the market is 10% what shall be the value of a share on yield basis?

[Ans.: Value of Share Rs.100]

8. The following particulars of a company are available.

(a) Equity share capital : 10,000 equity shares of Rs.10 each fully paid.
(b) Preference share capital : 1,000 12% preference shares of Rs.100 each fully paid
(c) Reserves and surplus Rs.15,000
(d) External liabilities : Creditors Rs.12,000, Bills payable Rs.6,000
(e) The average normal profit after tax earned each year by the company Rs.28,500
(f) Transferred to general reserve – 10^%

Assets of the company include one fictitious item of Rs.800. The normal rate of return in respect of the equity share of this type of company is ascertained at 10% (ignore goodwill).

Compute the value of the company's share by (a) the asset backing method; and (b) yield method.

[Ans.: (a) Rs11.42; (b) 13.65]

9. On the basis of the following information, calculate the value of Equity Shares.

	Rs.
10,000 10% Preference shares of Rs.100 each paid	10,00,000
60,000 Equity shares of Rs.10 each fully paid	6,00,000
Total Assets other than Goodwill	20,00,000
Total Outside liabilities	2,00,000
Average net profit after tax	1,00,000

Expected normal yield for Equity Shares 7% of capital. Goodwill is to be taken at 5 years purchase of super profits.

[Ans.: Rs.17.00]

10. From the following information calculate the value per equity shares.

	Rs.
5,000 8% preference shares of Rs.100 each	5,00,000
75,000 Equity shares of Rs.10 each, Rs.8 per share paid up	6,00,000
Expected profits per year before tax	2,80,000
Rate of tax	50%
Transfer to general reserve every year	20% of the profit
Normal rate of earnings	10%

[Ans.: Profits available to equity shareholders Rs.72,000; Normal rate of return 12%; Value of equity share = Rs.9.60]

11. Find the intrinsic value of the share from the following information. Net realisable value of the assets:

	Rs.
Goodwill	4,50,000
Fixed Assets	39,00,000
Other Assets	12,00,000
Capital	
Equity share of Rs.100 each	30,00,000
10% preference share of Rs.100 each	15,00,000
Other Liabilities	Nil

[Ans.: Rs.135]

12. Surabhi Ltd., has 5,000 equity shares of Rs.10 each, Rs.8 paid and 50,000 6% preference shares of Rs.10 each fully paid. The company transfers 20% of the profit to General Reserve every year. If the expected profit (Based on past year's performance) before Tax is Rs.1,00,000 and the rate of tax is 50%, you required to calculate the value of equity shares by yield method. Assume that the normal rate of dividend is 20%.

[Ans.: Profit available for Equity shareholders Rs.10,000; Expected Rate of Earnings 25%; Value of the Equity Share Rs.10]

13. The following figures are extracted from the books of M/s Prosperous Ltd.

Share Capital:	Rs.
9 percent preference shares of Rs.100 each	3,00,000
1000 equity shares of Rs.100 each Rs.50 called up	50,000
1000 equity shares of Rs.100 each Rs.25 called up	25,000
1000 equity shares of Rs.100 each fully called up	1,00,000
	4,75,000

Reserves and Surplus:	Rs.
General Reserve	2,00,000
Profit and Loss Account	50,000
	7,25,000

On a fair valuation of all the assets of the company, it is found that they have an appreciation of Rs.75,000.

The articles association provided that, in case of liquidation, the preference shareholders will have a further claim to the extent of 10 percent of the surplus assets.

Ascertain the value of each preference and equity share.

[Ans.: Value of each Preference Share Rs.110.83; Value of each equity share (a) Rs.197.50; (b) Rs.147.50; (c) Rs.122.50]

14. On December 31, 2009 the Balance Sheet of a Limited company reveals the following position:

Liabilities	Rs.	Assets	Rs.
Issued Share capital each at Rs.10	4,00,000	Fixed Assets	5,00,000
Reserves	90,000	Current Assets	2,00,000
Profit and Loss a/c	20,000	Goodwill	40,000
5% Debentures	1,00,000		
Current Liabilities	1,30,000		
	7,40,000		7,40,000

On December 31, 2009, the fixed assets were independently valued at Rs.3,50,000 and goodwill at Rs.50,000

The net profits for three years were:

	Rs.
2007	51,600
2008	52,000
2009	51,650

Of which 20% was placed under reserve. This proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%. Compute the value of the company's share by

a. net assets method, and

b. yield value method.

[Ans.: (a) Rs.9.25 (b) Rs.10.35]

15. The following is the Balance Sheet of Madhu Ltd. as on 31.03.2010

Liabilities	Rs.	Assets	Rs.
10,000 Equity Shares of Rs.10 each fully paid	1,00,000	Fixed Assets	2,20,000
10,000 Equity Shares of Rs.10 each Rs.8 per share paid up	80,000	Current Assets	1,10,000
10,000 Equity shares of Rs.10 each Rs.5 per share paid up	50,000	Preliminary expenses	5,000
Reserves	50,000	Floating Assets	5,000
Profit & Loss A/c	50,000		
Creditors	10,000		
	3,40,000		3,40,000

The normal average profit of the Company (after tax) will be maintained at Rs.46,000 and normal rate of return is 8%.

Calculate the value of each type of Equity Share by the Assets-Backing Method, and Yield Basis Method.

[Ans.: (i) Rs.13.17, Rs.11.17, Rs. 8.17 (ii) Rs.25.00, Rs.20.00, Rs.12.50]

16. The following is the balance sheet of Visaka Industries Ltd., as at 31st December, 2009

Liabilities	Rs.	Assets	Rs.
Share capital:		Land, Buildings	41,250
7,500 shares, of Rs.10	75,000	Plant & Machinery	48,750
each	15,000	(at cost less depreciation)	
General Reserve			
Taxation Reserve	22,500	Trade marks	7,500
Workmen Savings account	11,250	Stock	18,000
Profit & Loss a/c	12,000	Debtors	33,000
Sundry Creditors	36,750	Cash at Bank	19,500
		Preliminary expenses	4,500
	1,72,500		1,72,500

The Plant and Machinery is worth Rs.45,000 and land and buildings have been valued at Rs.90,000 by an independent valuer. Rs.3,000 of the debtors are bad. The profits of the company have been as follows: 2007 Rs.30,000; 2008 Rs.33,750, 2009 Rs.39,750. It is the company practice to transfer 25% of the profits to reserve. Ignoring taxation, find out the value of the share on the yield basis and also on the next assets basis. Similar companies give an yield of 10% on the market value of their shares.

Goodwill may be taken to be worth Rs.60,000

[Ans.: Intrinsic Value of Share Rs.29.60; Yield value of shares Rs.33.50]

17. Following is the Balance Sheet of Universal Company Ltd. as on 31.3.2010

Liabilities		Rs.	Assets		Rs.
1000, 12% Preference Shares of Rs.200 each fully paid		2,00,000	Building at cost less depreciation		1,70,000
4000 Equity Share of Rs.200 each fully paid		8,00,000	Furniture at cost less depreciation		6,000
Reserve fund		3,00,000	Stock in Trade		9,00,000
P & L A/c. Bal. On 1.4.2009	1,60,000		4% Govt. Securities at cost (Face value Rs.8,00,000)		7,50,000
Profit for 2010	8,60,000	10,20,000			
Provision against			Debtors	6,00,000	
(i) Buildings	20,000		Less: Provision	40,000	5,60,000
(ii) Investments	90,000	1,10,000	Cash and Bank balance		1,20,000
Creditors		96,000	Preliminary Expenses		20,000
		25,26,000			25,26,000

Further information:

1. The Company's Prospects for 2010-11 are equally good.
2. The buildings are now worth Rs.11,30,000.
3. The income-tax liability may be assumed @ 50%.
4. Goodwill is to be valued at three years purchase of Super Profits.
5. Companies doing similar business show a profit earning capacity of 12% on market value of their shares.
6. Profits for the past three years have shown an increase of Rs.1,00,000 annually.

Ascertain the intrinsic value of each equity share.

[Ans.: Goodwill Rs.2,23,320; Intrinsic value of Equity Share Rs.825.83]

18. The following is the balance sheet of Mallikarjuna Ltd. on 31.3.2010:

Liabilities	Rs.	Assets	Rs.
10,000 6% pref. Shares	1,00,000	Sundry Assets	5,10,000
30,000 equity shares	3,00,000	Discount on debentures	10,000
Debentures Redemption Fund	30,000	Preliminary expenses	30,000
7% Debentures	50,000	P & L a/c	60,000
Depreciation fund	30,000		
Sundry creditors	1,00,000		
	6,10,000		6,10,000

Sundry Assets were worth Rs.5.45 Lakhs. Interest on debentures and preference dividend are in arrears for one year. You are required to value the equity shares, if preference shares:

(a) have priority for Repayment of Capital and arrears of dividend.

(b) have no priority for Repayment of capital and arrears of dividend.

[Ans.: (a) Rs.9.52; (b) Rs.9.78]

19. The following is the Balance Sheet of X Ltd. as at March 31, 2010

Liabilities	Rs.	Assets	Rs.
Share Capital: 2,000 Shares of Rs.100 each	2,00,000	Land and Buildings	1,10,000
General Reserve	40,000	Plant & Machinery (at cost less depreciation)	1,30,000
Profit and Loss A/c	32,000	Patents, Trade Marks	20,000
Sundry Creditors	1,28,000	Stock	48,000
Taxation Reserve	60,000	Debtors	88,000
		Cash at Bank	52,000
		Preliminary Expenses	12,000
	4,60,000		4,60,000

The Plant and Machinery is worth Rs.1,20,000 and Land and Buildings have been valued at Rs.2,40,000 by an independent valuer, Rs.8,000 of the debts are bad. The profits of the company have been as follows: 2008 Rs.80,000; 2009 Rs.90,000; 2010 Rs.1,06,000.

It is the company's practice to transfer 25% of the profits to reserve ignoring taxation, find out the value of shares. Similar companies give a yield of 10% on the market value of their shares. Goodwill may be taken to be worth Rs.1,60,000.

[Ans.: Expected rate of Dividend Rs.296; Yield value of Each Share Rs.291.87; Fair Value of each share Rs.293.93]

20. Smt. Dayana intends to invest Rs.32,000 in equity shares of Glory Company Limited and seeks your advice as tot he maximum number of shares she can expect to acquire based on a fair value of the shares to be determined by you. The following information is available.

Issued and Paid up Capital	Rs.
6% Preference shares of Rs.100 each	5,50,000
Equity shares of Rs.10 each	3,50,000
	9,00,000

Average net profit of the business is Rs.75,000. Expected normal yield is 6% in case of such equity shares. It is observed that the net assets on revaluation are worth Rs.70,000 more than the amounts at which they are stated in the books. Goodwill is to be calculated at 5 years' purchase of super profits, if any. Ignore taxation.

[Ans.: Intrinsic Value Rs.12; Value of Equity Share Rs.20]

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Chapter – 3

ISSUE OF BONUS SHARES

Objectives :

After studying this chapter you should be able to :

- understand the meaning of bonus shares
- discuss the SEBI Guidelines on bonus shares
- study the conditions for the issue of bonus shares
- find out the advantages of the issue of bonus shares
- go through the accounting treatment on bonus shares

Structure :

3.1. INTRODUCTION

Bonus shares are the shares allotted to existing equity shareholders without any consideration being received from them, in cash or in kind. They are issued to capitalize profits of the company. Bonus shares can be issued only if Articles of Association of the company permit such an issue. Thus, the shares issued by the company to the existing equity shareholders in settlement of the bonus declared are termed as 'Bonus shares'. The Bonus shares issued become permanently a part of its issued share capital and the process is known as **'Capitalization of Profits or Reserves'.**

Bonus shares cannot be issued in lieu of dividends. Before issuing bonus shares the company has to follow the guidelines issued by the Securities Exchange Board of India (SEBI).

3.1.1 Reasons for the issue of Bonus Shares:

The following circumstances warrant the issue of bonus shares.

(i) When a company possesses large capital or revenue profits (either past profits in the shape of reserves or current profits) and it wants to capitalize these profits by issuing bonus shares;
(ii) When cash resources of the company are not adequate to pay cash bonus;
(iii) When a company wants to show to its shareholders as well as outsiders its correct earning capacity i.e., the true relationship between its capital structure (i.e., capital employed) and earning capacity;
(iv) When the value of fixed assets far exceeds the amount of capital;
(v) When the market value of shares far exceeds the amount of capital; and
(vi) When it is not possible to declare high rate of dividend regularly every year out of accumulated reserves, bonus shares may be issued to facilitate the payment of regular dividend from year to year which is proportionate to the profits earned.

3.2. BONUS SHARES - SEBI GUIDELINES

The Securities Exchange Board of India (SEBI) has issued certain guidelines regarding issue of bonus shares. The following is the effect of these guidelines on a listed company.

(i) The bonus issue can be made only out of free reserves built out of the genuine profits or securities premium collected in cash.
(ii) Reserves created by revaluation of fixed assets are not available for issue of bonus shares.
(iii) The bonus issue cannot be made unless the partly-paid shares, if any, existing, are made fully paid-up.
(iv) The declaration of bonus issue, in lieu of dividend, cannot be made.
(v) Once the company announces bonus issue after the approval of the Board of Directors, it must implement the proposal within a period of six months from the date of such approval and it does not have the option of changing the decision.
(vi) If the Articles of Association of the company does not already contain a provision for capitalization of reserves etc; for issue of bonus shares, the company must pass a resolution at its general body meeting making provisions in the Articles of Association for capitalization.
(vii) If consequent to the issue of bonus shares, the subscribed and paid-up capital exceeds the authorized share capital, the company has to pass a Resolution at its general body meeting for increasing the authorized capital.
(viii) No company can pending conversion of Fully Convertible Debentures/Partly Convertible Debentures (FCDs/PCDs) issue bonus shares unless similar benefit is extended to the holders of such FCDs/PCDs through reservation of shares in proportion to such convertible part of FCDs and PCDs. The shares so reserved may be issued at the time of conversion of such debentures on the same terms on which the bonus issue was made.
(ix) The company issuing bonus shares must not have defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principle

on redemption thereof. It also must have sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.

Note: SEBI guidelines are silent on ratio of bonus issue. Therefore, a company can issue bonus shares in any ratio.

3.3. CONDITIONS FOR THE ISSUE OF BONUS SHARES

According to Companies Act, a company is permitted to issue bonus shares only when the following conditions are fulfilled.

1. Issue of Bonus shares should be authorized by the Articles of Association.
2. The Board of directors' proposal regarding issue of bonus shares should be approved by the members in the general body meeting.
3. The company should have adequate profits and reserves to permit the issue of bonus shares.

3.3.1 Sources for the Issue of Bonus shares:

The Bonus shares may be issued from the following sources

(a) Balance in Profit and Loss account including current year's profit after tax.
(b) General Reserve
(c) Other reserves accumulated out of profits, like dividend equalization fund, accident compensation fund, insurance fund etc.
(d) Capital profits comprising of:
   (i) Profits prior to incorporation
   (ii) Profits on acquisition of business
   (iii) Secret reserves built as a result of under valuation of assets and under valuation of liabilities.
   (iv) Premium on issue of debentures.
   (v) Profits on the redemption of debentures.
(e) Capital Reserve arising from profit on sale of fixed assets received in cash.
(f) Capital Redemption Reserve created at the time of redemption of redeemable preference shares.
(g) Balance standing to the credit of the debenture redemption fund after the redemption of debentures.
(h) Premium received on issue of shares received in cash only.

It should be noted that the securities premium and the capital redemption reserve can be used only for issuing fully paid bonus shares. Other items can be used either for issuing fully paid bonus shares or for making partly paid shares as fully paid shares.

3.3.2 Reserves not to be used for Bonus Shares:

The following reserves are not to be used for the issue of bonus shares.

1. Capital reserves arising due to revaluation of assets.
2. Securities premium arising on issue of shares on amalgamation or take over.
3. Investment allowance reserve before expiry of 8 years of creation.
4. Balance in debenture redemption reserve account before redemption takes place.
5. Surplus arising from a change in the method of charging depreciation.

3.4. ADVANTAGES OF ISSUE OF BONUS SHARES

Issue of Bonus shares is always a preferable method of satisfying the shareholders of the company and increasing the prestige of the company in industry. As such the issue of bonus shares is advantageous both to the company and the shareholders.

3.4.1 Advantages to the company:

The following are the advantages to the company which issues bonus shares.

(i) **No cash outflow:** As there is no outflow of cash, liquidity position is not affected. At the same time, company can satisfy the desire of shareholders to receive dividend by issuing bonus shares.

(ii) **Balanced capital structure:** Issue of bonus shares presents a more realistic relationship between the capital structure of the company and its earning capacity.

(iii) **Increase in the reputation:** Capitalization of reserves increases substantially the credit worthiness of the company.

(iv) **Problems with high dividend:** The company may not be able to declare high rate of dividends due to some problems like tall claims of the employees and regulations by Government. Hence, it is preferable to issue bonus shares in those circumstances.

3.4.2 Advantages to the Shareholders:

The following are the advantages to the shareholders.

(i) As it is very costly to buy shares of successful companies from the market, the issue of bonus shares will enable the shareholders to increase their holding;

(ii) The shareholders can receive dividend on the increased shareholding;

(iii) The shareholders can dispose of the bonus shares for cash whenever they need cash.

3.5. ACCOUNTING TREATMENT

On issue of bonus shares, reserves used for such an issue are debited and bonus to Equity shareholders account will be credited with the amount for which bonus shares are issued. Then, Bonus to Equity Shareholders Account is debited and equity share capital account is credited with the amount of the issue. The journal entries for the issue of bonus shares are to be passed in the following two circumstances.

1. When the payment of bonus is made by the issue of fully paid up bonus shares,
2. When the bonus is given by making partly paid shares into fully paid shares i.e., if the bonus is utilised for making partly paid up shares into fully paid up shares.

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1.	**In case of issue of free fully paid bonus shares:**				
	Profit & Loss a/c	Dr.		x x x	
	General Reserve a/c	Dr.		x x x	
	Capital Redemption Reserve a/c	Dr.		x x x	
	Securities Premium a/c	Dr.		x x x	
	Capital Reserve a/c	Dr.		x x x	
	To Bonus to shareholders a/c				x x x
	(Being the amount transferred for issue of bonus shares – depending upon the available balance in the above said accounts)				
	Bonus to shareholders a/c	Dr.		x x x	
	To Share capital a/c				x x x
	(Being the issue of bonus shares with premium)				
2.	**If the bonus is given by making partly paid shares into fully paid shares**				
	Profit & Loss a/c	Dr.		x x x	
	General Reserve a/c	Dr.		x x x	
	Capital Profit a/c	Dr.		x x x	
	To Bonus to shareholders a/c				x x x
	(Being the bonus declared)				
	Share final call a/c	Dr.		x x x	
	To Share capital a/c				x x x
	(Being the final call on shares)				
	Bonus to shareholders a/c	Dr.		x x x	
	To Share final call a/d				x x x
	(Being the application of bonus to the calls)				

Illu.1: Well done Ltd., has Rs.1,60,000 paid up capital divided into 20,000 equity shares of Rs.10 each, Rs.8 called up. Now the Directors of the company wish to apply the profits earned during the year for making the partly paid up shares fully paid up. Give journal entries for carrying out their wishes.

Solution:

Working Notes :

Called up amount to be adjusted on partly paid shares
Rs.20,000 shares @ Rs.2 = Rs.40,000

Therefore, Rs.40,000 was declared as bonus from the profit earned during the year.

Journal Entries in the books of Well Done Company Ltd.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Equity share final call account Dr.		40,000	
	To Equity share capital a/c			40,000
	(Being the equity share final call money due)			
	Profit and Loss a/c Dr.		40,000	
	To Bonus to shareholders a/c			40,000
	(Being the bonus declared to shareholders)			
	Bonus to shareholders a/c Dr.		40,000	
	To Equity share final call a/c			40,000
	(Being the bonus given to shareholders by converting partly shares into fully paid up shares)			

Illu.2: The following are seen in the balance sheet of Continental health care products ltd. Madras as on 31st December, 2009

a. **1,00,000 equity shares of Rs.100 each, Rs.70 paid.**
b. **General reserve Rs.36,00,000**
c. **Share premium Rs.10,00,000**
d. **Capital reserve Rs.14,00,000**

A resolution was passed for capitalizing the general reserve, changing the partly paid shares into fully paid shares by using share premium and capital reserve. Also passed a resolution for the issue of shares at Rs.20 each with premium of 20% as fully paid up shares. Necessary journal entries in the books of the company.

Solution:

Journal entries in the books of Continental Health Care Products Limited

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	General Reserve a/c	Dr.		30,00,000	
	Profit & Loss a/c	Dr.		10,00,000	
	Capital Reserve a/c	Dr.		14,00,000	
	To Bonus share holders a/c				54,00,000
	(Being the bonus declared out of general reserve, P & L a/c, Capital reserve a/c)				
	Equity share final call a/c	Dr.		30,00,000	
	To Equity share capital a/c				30,00,000
	(Being 1,00,000 equity shares at Rs.30 equity share final call amount due)				
	Bonus to shareholders a/c	Dr.		30,00,000	
	To Share final call a/c				30,00,000
	(Being the adjustment of Rs.30,00,000 bonus for the final call amount to be paid on 1,00,000 shares)				
	Bonus to shareholders a/c	Dr.		24,00,000	
	To Equity share capital a/c				20,00,000
	To Share premium a/c				4,00,000
	(Being the bonus left Rs.24,00,000 used for issuing 1,00,000 shares of Rs.20 each at 20% premium as fully paid)				

Working Notes :

1. Out of Rs.36,00,000 of credit in General reserve a/c, an amount of Rs.30,00,000 was required for share final call. As such, an amount of Rs.30,00,000 was only utilized from the general reserve towards the adjustment of final call amount on shares.

2. Amount remaining for the issue of bonus shares = Rs.24,00,000

Face value of each bonus share	Rs.20
Add : 20% premium	4
Value of bonus share with premium	24

No. of bonus share issued = Remaining amount of bonus/share value with premium

= Rs.24,00,000/24 = 1,00,0000 shares

Face value of 1,00,000 shares = 1,00,000 shares x Rs.20 = Rs.20,00,000

Premium on these shares = 1,00,000 shares x Rs.4 = Rs.4,00,000

Illu.3: The Balance sheet of a company is given below .

Authorised Capital	**Rs.**
20,000 Equity Shares of Rs.10 each	**2,00,000**
Issued and subscribed capital:	
10,000 Equity shares of Rs.10 each	
Rs.8 per share paid up	**80,000**
Share premium	**2,000**
Capital redemption reserve	**4,000**
General reserve	**40,000**

The company passed the following resolution :

(a) That the general reserve be utilized in making the partly paid shares as fully paid up.

(b) That further 1,000 fully paid equity bonus shares of Rs.10 each be issued to the existing shareholders. For the purpose, general reserve should be utilized to the minimum extent.

You are required to the pass the journal entries.

Solution:

For every 10 shares …… 1 bonus share issued
For 10,000 shares …… ?
= $^{10,000}/_{10} \times 1$ = 1,000 shares

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
a.	Equity share final call a/c	Dr.		20,000	
	To Equity share capital a/c				20,000
	(Being the final call due on 10,000 shares @ Rs.2 per share)				
	General reserve a/c	Dr.		20,000	
	To Bonus to share holders a/c				20,000
	(Being the bonus declared along with the general reserve)				
	Bonus to shareholders a/c	Dr.		20,000	
	To Equity share final call a/c				20,000
	(Being the amount due on final call adjusted against bonus declared)				
b.	Share premium a/c	Dr.		2,000	
	Capital redemption reserve a/c	Dr.		4,000	
	General reserve a/c	Dr.		4,000	
	To Bonus to shareholders a/c				10,000
	(Being appropriation made to facilitate issue of bonus shares)				
	Bonus to shareholders a/c	Dr.		10,000	
	To Share capital a/c				10,000
	(Being the issue of fully paid up bonus share by using reserve)				

3.6 SELF ASSESSMENT QUESTIONS

1. What is a Bonus share? When are they issued?
2. From which sources bonus shares can be issued?
3. Cash bonus and capital bonus
4. Under what circumstances does a company issue Bonus shares?
5. Explain the reasons for the issue of bonus shares
6. What are various guidelines for the issue of bonus shares by SEBI.
7. State the advantages of issue of bonus shares to the company.
8. State the advantages of issue of bonus shares to the shareholders.
9. Explain the conditions for the issue of bonus shares.
10. What are various sources for the issue of bonus shares by companies.
11. Enumerate the reserves or sources that can be used for the issue of bonus shares.

3.7 EXERCISES

1. Balarama Bearing Ltd. has resolved to utilise Rs.2,40,000 out of its reserve fund in declaration of bonus to its shareholders. For this purpose 6,000 equity shares of Rs.100 each and Rs.60 paid up shall be treated as fully paid-up. Write necessary journal entries to that extent.

2. Bharat Ltd., had issued 10,000 equity shares of Rs.10 each, Rs.8 per share were called up. The directors of the company now wish to apply the profits earned during the year for making the partly paid up shares fully paid up. Give journal entries for carrying out their wishes.

3. A limited company has resolved to utilise Rs.5,00,000 out of its reserve fund in declaration of a bonus to the shareholders. The bonus, however is to be applied to the extent of Rs.2,00,000 in payment of final call of Rs.40 per share on 5,000 Equity Shares of Rs.100 each and to the extent of Rs.3,00,000 in the issue of 3,000 fully paid Equity Shares of Rs.100 each to the existing shareholders. Give the journal entries necessary to give effect to the above resolution.

4. A company issued 10,000 equity shares of Rs.10 each, Rs.8 paid up. It passed the following resolutions.

a. the profits be used in making the partly paid up shares fully paid up.

b. that further 1,000 shares fully paid up as bonus shares of Rs.10 each be issued to the existing shareholders.

c. that the following balances appearing in the books be used.

Share premium account of Rs.2,000 and capital redemption reserve account Rs.4,000. You are required to give journal entries for recording the above transactions.

5. Ambujodara Air conditioners Ltd., has a large balance in Reserve Account and the directors decide to utilise a part of it for distribution as bonus to its shareholders.

At present the company has a paid-up share capital of Rs.15,00,000 comprising 1,35,000 equity shares of Rs.10 each fully paid up and 30,000 equity shares of Rs.10 each Rs.5 per share paid. The company now proposes to issue one bonus share at a premium of Rs.10 for every fully paid share held and to treat the partly paid shares as fully paid. On the date of allotment of bonus shares the market price of equity share stands at Rs.33 each.

Give necessary journal entries to effect the above changes.

6. The following balances are extracted from Best & Co. Ltd:

Authorised capital: 20,000 equity shares of Rs.10 each

Issued & Subscribed: 8,000 equity shares full paid

Reserve fund: Rs.36,000 P & L A/c (Cr.) Rs.29,000.

Company approved to capitalize Rs.16,000 from reserve and the rest from the P & L a/c to issue 1 bonus share for every 4 shares held. Journalise the same and show the items in balance sheet.

7. The Balance sheet of ABC Company Ltd. is given below on 31-12-2009.
1,00,000 Equity shares of Rs.10 each unit called up and paid up Rs.8 per share. Reserve fund Rs.8,00,000.
Director's of the company decided to utilise reserve fund for the following purposes.
a. Converting partly paid up shares into fully paid up shares
b. Issue of one Bonus share of Rs.10 each at a premium of Rs.2 per share for every two Equity shares in the company.
Pass the entries in the Books of the company.

8. X Ltd. has 10,000 shares of Rs.100 each. The Board of Directors has resolved to issue 2 bonus shares of Rs.100 each for every 5 shares in the company. From the following information write the journal entries for issue.
General Reserve Rs.2,00,000
Profit and Loss account Rs.1,50,000
Share premium account Rs.1,50,000

9. The Balance Sheet of A Co. Ltd. on 31st December 2009 was as follows

	Rs.		Rs.
Share Capital:			
2,000 Shares of Rs.100 each	2,00,000	Sundry Assets	4,75,000
Share Premium	50,000		
Reserve Fund	1,00,000		
P & L account	80,000		
Creditors	45,000		
	4,75,000		4,75,000

The Company decided to issue Bonus Shares at the rate of three shares for every four shares held and decided, for this purpose, to utilise share-premium Rs.60,000 out of reserve and the balance out of P & L a/c. Give Journal entries.

10. The Balance sheet of Vikas Limited, is given below on 31st December, 2009.

	Rs.
Authorised Capital	
20,000 Equity Shares of Rs.10 each	2,00,000
Issued and subscribed capital:	
7,000 Equity shares of Rs.10 each	70,000
Reserve Fund	36,000
Profit and Loss Account	29,000

The Board of Directors pass a resolution to capitalise a part of existing reserves and profits by issuing bonus shares. One bonus share is being issued for every four equity shares held. For this purpose Rs.10,000 is to be provided out of reserve fund and the balance out of profits. Show journal entries and also Balance Sheet.

11. The following is the balance sheet of Jai Hind Limited.

Balance Sheet as on 31st March, 2010

Liabilities	Rs.	Assets	Rs.
Authorised Share Capital		Sundry Assets	17,00,000
1,50,000 Equity shares of Rs.10 each	15,00,000		
Issued, Subscribed and Paid up			
80,000 Equity shares of Rs.7.50 each			
called-up and paid-up	6,00,000		
Reserves:			
Capital Redemption Reserve	1,50,000		
Plant Revaluation Reserve	2,50,000		
Securities Premium Account	1,50,000		
Investment Allowance Reserve	2,50,000		
General Reserve	3,00,000		
	17,00,000		17,00,000

The company wanted to issue bonus share to its shareholders at the rate of one share for every two shares held. Necessary resolutions were passed; requisite legal requirements were compiled with.

You are required to:

a. Give effect to the proposal by passing journal entries in the books of Jai Hind Ltd.

b. Show the amended Balance Sheet.

12. Vijaya Sai Ltd. has Rs.5,60,000 in Equity share capital comprising of 40,000 shares of Rs.10 fully paid and 20,000 shares of Rs.10, Rs.8 paid per share. It has Rs.20,000 in Capital Reserve, Rs.20,000 in Share Premium account, Rs.70,000 in capital Redemption reserve account. Rs.1,50,000 in General Reserve.

By way of Bonus dividend the partly paid up shares are converted into fully paid up shares, and the holders of fully paid-up shares are also allotted fully paid-up bonus shares in the same ratio.

Pass Journal entries showing separately the two types of bonus issue stated above. It is desired that there should be minimum reduction in free reserves.

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Chapter – 4

ISSUE AND REDEMPTION OF PREFERENCE SHARES

Objectives :

After reading this lesson you should able to :

- Know various types of preference shares
- understand the provisions of the companies act on the issue and redemption of preference shares
- study the premium on the redemption of preference shares
- go analyse capital redemption reserve account

Structure :

4.1 PREFERENCE SHARES

A preference share is a combination of the features of an ordinary share and debt. Preference shares represent that part of share capital of a company which carries preferential rights and privileges with respect to income and assets over equity stock.

Preference shares are those shares which enjoy preferential rights both with respect to dividend and with respect to repayment of capital either during the life time or on winding up of the company. They will have the first charge on the distributable amount of net profits.

4.1.1 Kinds of Shares :

The preference shares may be of the following types :

1. **Cumulative Preference Shares :** The dividend payable on these shares goes on accumulating till it is fully paid off. A cumulative preference share holder has a right to claim the fixed dividend of the current year out of future profit. Company is bound to pay dividend only if it has sufficient profits available for distribution. If dividend is not paid in

any year, it goes on accumulating. In the year of profit, the company has to pay the accumulated dividend also.

2. **Non-cumulative Preference Shares :** In the case of non-cumulative preference shares, the dividend shall be payable only out of the profits of the current year. If it is not paid in a particular year, it is lost and the arrears of dividend cannot be carried forward. In other words, the unpaid dividends cannot accumulate.

3. **Participating Preference Shares :** Participating preference shares are not only entitled to a fixed rate of dividend, but also to a share in the surplus profits which remain after the claims of the equity shareholders have been met.

4. **Non-participating Preference Shares :** Non-participating preference shares entitled to only a fixed rate of dividend. They do not share in the surplus which belongs to the equity shareholders.

5. **Convertible Preference Shares :** The holders of these shares have a right to convert them into equity shares within a certain period of time.

6. **Non-Convertible Preference Shares :** The preference shares without a right of conversion into equity shares are known as non-convertible preference shares.

7. **Redeemable Preference Shares :** These are the shares to be repayable after certain specified period by the company.

8. **Non-Redeemable Preference Shares :** Non-Redeemable preference shares constitute permanent capital of the company. These shares cannot be refunded before the winding up of the company.

As a result of amendment in the Companies Act in 1996 no company limited by shares, w.e.f. 1-3-1997, can issue preference shares which are irredeemable or which are redeemable after the expiry of twenty years from the date of issue.

4.2. REDEMPTION OF PREFERENCE SHARES :

A preference share is a combination of the features of an ordinary share and debt. Preference shares represent that part of share capital of a company which carries preferential rights and privileges with respect to income and assets over equity stock.

Preference shares are those shares which enjoy preferential rights both with respect of dividend and with respect of repayment of capital either during the life time or an winding up of the company. They will have the first charge on the distribution of net profits.

4.2.1 Companies Act Provisions :

Sec.80 and 80A of Companies Act provides for the issue and Redemption of Preference shares. The following points are to be taken into account in the redemption of preference shares.

Only fully paid preference shares can be redeemed. So, partly paid preference share cannot be redeemed. To redeem partly paid preference shares a call should be made to make them fully paid. Thereafter, such shares can be redeemed.

The purpose of the provision is to protect the security available to the creditors. In the event of liquidation, redeeming partly paid preference shares deprives the creditors that extra safety margins.

4.2.2 Redemption out of profits available for dividend or out of proceeds of a fresh issue of shares :

The following points deserve attention in the redemption of preference shares.

1. Profits available for dividend are confined to revenue profits of a company. Thus, all the capital profits are excluded for the purpose of redemption.
2. `Proceeds' of a fresh issue of shares clearly indicates that amount received from fresh issue of debentures or loans arranged or assets sold cannot be taken into account technically for the redemption of redeemable preference shares.
3. The word `proceeds' implies the amount received excluding the amount of share premium on the new issue of shares. Similarly, when the new issue is at par or at a discount, the net amount received from the issue should be deemed as proceeds.
4. The main objective of Section 80 of the Companies Act is to protect the interests of the creditors of the company. So proceeds of fresh issue serve the purpose of keeping the capital structure of the company intact. Whatever amount is paid is replaced by `proceeds of the fresh issue.'

4.3 PREMIUM ON REDEMPTION :

Premium on redemption of preference share sis a capital loss which can be provided out of Securities premium account.' If securities premium does not exist or is insufficient, other profits of the company can be used to provide for the premium on redemption.

Profits available for dividend which are used for redemption have to be transferred to `Capital Redemption Reserve'. The purpose of such transfer is `to freeze or immobilize such profits from being used for any other purpose. For example, using such profits for payment of dividend or repayment of debentures is prevented by freezing. Possible cash outflow or security erosion to the creditors to thus prevented.

The capital redemption reserve account will take the place of the Redeemable preference shares capital, after the redemption. If new issue of shares was made, the new share capital takes the place of the redeemable preference shares. Thus, Section 80 of the Companies Act ensures that the preference shares redeemed are completely replaced.

Capital Redemption reserve can be used to issue fully paid bonus shares alone and for no other purpose. Bonus shares do not involve any cash outflow immediately. Such capitalization of reserve ensures that it remains with the company permanently.

Redemption of preference shares does not affect the authorized capital. So, in the balance sheet, the authorized capital remains intact. Issue of shares in the future to the extent of the redemption carried out is permissible.

Minimum fresh issue of shares :

At the time of redemption of preference shares, some companies may decide to utilize all the permissible reserves for the redemption and make new issue to shares for any balance amount required.

4.4 CAPITAL REDEMPTION RESERVE ACCOUNT

As only those profits which are otherwise available for dividends can be used for redemption of preference shares, transfer to Capital Redemption Reserve Account should be made only from such accounts as represent divisible profits. Amounts in Securities Premium Account, Forfeited shares account, Profit prior to incorporation account and Capital Reserve account must not be transferred to Capital Redemption Reserve Account. The credit balances in profit and loss account, general reserve are the examples of the balance available for distribution of dividend and hence for transfer to capital redemption reserve account.

Illu.1 : The following balances are appearing in the ledger of Portor Limited as on 31st March, 2011.

	`
Share capital – Equity shares (fully paid up)	**6,00,000**
Share capital – Preference shares (fully paid up)	**3,00,000**
General Reserve	**2,00,000**
Profit and Loss a/c (credit balance)	**1,25,000**
Securities Premium account	**50,000**

The company decided to redeem the preference shares at a premium of 10 per cent out of its general reserve and undistributed profit. Give journal entries relating to the redemption of the preference shares.

Solution :

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Preference Share capital a/c	Dr.		3.00,000	
	Premium on Redemption of preference shares a/c			30,000	
	To Preference shareholders a/c				3,30,000
	(Being the amount due for redemption of preference shares at a premium of 10%)				
	Securities premium a/c	Dr.		30,000	
	To Premium on redemption of preference shares				30,000
	(Being the premium on redemption provided out of share premium a/c)				
	General Reserve a/c	Dr.		2,00,000	
	Profit and Loss a/c	Dr.		1,00,000	
	To Capital Redemption reserve a/c				3,00,000
	(Being capital redemption reserve provided out of General Reserve and Profit and Loss a/c)				
	Redeemable Preference shareholders a/c	Dr.		3,30,000	
	To Bank a/c				3,30,000
	(Being preference share capital along with the premium needed to preference shareholders)				

Illu.2 : Hanuman Company Ltd., has 1,000 12% redeemable preference shares of Rs.100 each, fully paid. The company passed a resolution on 31st March, 2011 to redeem these shares at a premium of 10%. The company has Rs.4,00,000 credit balance in its profit and loss account. On 1st April, 2011 the company made the following issues.

1. **10,000 equity shares of Rs.10 each at a premium of 10%.**
2. **1,000, 6% Debentures of Rs.100 each.**

The above two issues were subscribed and the cash was realized. The redeemable preference shares were redeemed by using the balance in profit and loss account and the amount received from the above issues. Write the necessary journal entries and showing the cash transactions.

Solution :

Journal Entries in the books of Hanuman Co. Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2011 Ap.1	Bank a/c	Dr.		1,10,000	
	To Equity share capital a/c				1,00,000
	To Securities premium a/c				10,000
	(Being the amount received on issue of 10,000 equity shares of Rs.10 each at a premium of 10%)				
	Bank a/c	Dr.		1,00,000	
	To 6% Debentures a/c				1,00,000
	(Being the issue of 6% Debentures at Rs.100 each)				
	Securities Premium a/c	Dr.		10,000	
	To Premium on redemption of preference shares a/c				10,000
	(Being the premium on redemption provided out of share premium a/c)				
	Profit and Loss a/c	Dr.		1,00,000	
	To Capital Redemption Reserve a/c				1,00,000
	(Being the amount transferred to capital redemption reserve a/c from profit and loss a/c of redeem the preference shares)				
	Redeemable preference share capital a/c	Dr.		1,00,000	
	Premium on redemption of preference share capital a/c	Dr.		10,000	
	To Redeemable Pref.shareholders a/c				1,10,000
	(Being the transfer of amount due on redemption of 1,000 redeemable preference shares of Rs.100 each at a premium of 10%)				
	Redeemable preference shareholders a/c	Dr.		1,10,000	
	To bank a/c				1,10,000
	(Being the redemption of 1,000 preference shares of RS.100 each at a premium of 10%)				

Bank a/c

	Rs.		Rs.
To Equity share capital a/c	1,10,000	By Redeemable preference shareholders a/c	1,10,000
To 6% Debentures a/c	1,00,000	By Balance c/d	1,00,000
	2,10,000		2,10,000

Illu.3 : A Company has 8,000 redeemable preference shares of Rs.100 each fully paid. The company decides to redeem the shares on September 30, 2004 at a premium of 7%. The company has sufficient profits but in order to augment liquid funds the following issues are made:

a) 3,000, 6% debentures of Rs.100 each at Rs.106.

b) 2,000, equity shares of Rs.100 each at Rs.111

The issues were fully subscribed and all the amounts were received. The redemption was duly carried out. Give Journal entries.

Solution :

Journal Entries

Date	Particulars		Debit Rs.	Credit Rs.
	Redeemable preference share capital a/c Premium on redemption of preference shares a/c To Preference shareholders a/c (Being transfer of amount due to redemption)	Dr.	8,00,000 56,000	 8,56,000
	Bank a/c To 6% Debentures a/c To Premium on issue of debentures a/c (Being 6% debentures issued at Premium of Rs.6 per share)	Dr.	3,18,000	 3,00,000 18,000
	Bank a/c To Equity share capital a/c To Premium on equity shares a/c (Being the issue of equity shares at 11% premium)	Dr.	2,22,000	 2,00,000 22,000
	Premium on Equity Shares a/c To Premium on redemption of Preference shares a/c (Being premium on issue of equity shares adjusted to premium on redemption of preference shares)	Dr.	22,000	 22,000
	Profit & Loss a/c To Premium on redemption of preference share a/c (Being balance in premium on redemption of preference shares transferred to Profit & Loss a/c)	Dr.	34,000	 34,000
	Profit & Loss a/c To Capital Redemption Reserve a/c (Being the transfer of profit to capital redemption reserve)	Dr.	6,00,000	 6,00,000

Illu.4 : Exchange Ltd. has on issued share capital of 650 – 7% redeemable preference shares of Rs.100 each and 4,500 equity shares of Rs.50 each. The preference shares are redeemable at premium of 7 1/2 % on April 1, 2011. The company's Balance sheet as on 31st, March 2011 was as follows:

Liabilities	Rs.	Assets	Rs.
Share Capital:		**Fixed Assets**	**3,45,000**
Issued 650-7% Redeemable		**Investments**	**18,500**
preference share of Rs.100 each fully paid	**65,000**		
4500 equity shares of Rs.50 each fully paid	**2,25,000**	**Balance at Bank**	**31,000**
Profit and Loss account	**48,000**		
Sundry creditors	**56,500**		
	3,94,500		**3,94,500**

In order to facilitate the redemption of the Preference Shares, the company decided (a) to sell all the investments for Rs.16, 000. (b) to finance part of the redemption from company's funds subject to leaving a balance of Rs.12, 000 in the Profit and Loss account and (c) to issue sufficient equity shares of Rs.50 each at a premium of Rs.13 per share to raise the balance of funds required.

The preference shares were redeemed on the due date and the issue of equity shares was fully subscribed.

You are required to prepare:

(i) The necessary journal entries to record the above transactions (including cash); and

(ii) The Balance Sheet as on completion.

Solution :

Journal of Exchange Ltd.

Date	Particulars		Debit Rs.	Credit Rs.
	Bank a/c	Dr.	16,000	
	Profit and loss a/c	Dr.	2,500	
	To Investments a/c			18,500
	(Being the investments sold for Rs.16, 000 and loss debited to Profit and Loss Account)			

Date	Particulars		Debit Rs.	Credit Rs.
	7% Redeemable Preference share capital a/c Premium on redemption a/c To Preference shareholders a/c (Being the amount payable on redemption of 650 preference shares transferred to preference shareholders a/c)	Dr. Dr.	65,000 4,875	 69,875
	Bank a/c To Equity share application & allotment a/c (Being the application money received on 630 equity shares of Rs.50 each at a premium of Rs.13 per share)	Dr.	39,690	 39,690
	Equity Shares application and allotment a/c To Equity Share capital a/c To Premium a/c (Being the allotment of 630 equity shares of Rs.50 each at a premium of Rs.13 per share vide Board Resolution dated….)	Dr.	39,690	 31,500 8,190
	Profit and Loss a/c To Capital redemption reserve a/c (Being the amount transferred out of profits equal to nominal value of shares redeemed otherwise than out of proceeds of fresh issue)	Dr.	33,500	 33,500
	Share premium a/c To Premium on redemption a/c (Being the premium payable on redemption of preference shares charged to securities premium account)	Dr.	4,875	 4,875
	Preference shareholders a/c To Bank a/c (Being the payment made on redemption of preference shares at a premium of 7 ½ %)	Dr.	69,875	 69,875

Dr. **Bank Account** **Cr.**

	Rs.		***Rs.***
To Balance b/d	31,000	By Preference shares redemption a/c	69,875
To Investments	16,000	By Balance c/d	16,815
To Share application & allotment a/c	39,690		
	86,690		**86,690**

Profit & Loss Account

	Rs.		***Rs.***
To Investment a/c	2,500	By Balance b/d	48,000
To Capital Redemption reserve	33,500		
To Balance c/d	12,000		
	48,000		**48,000**

ABC Ltd.
Balance Sheet as on 1st April 2011

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets	3,45,000
Authorized…..shares of Rs…. Each		Current Assets:	
issued Subscribed and paid up:			
5,130 Equity shares of Rs.50		Cash at Bank	16,815
each fully paid	2,56,500		
Reserved and Surplus; Capital redemption reserve			
	33,500		
Share premium a/c	3,315		
Profit & Loss a/c	12,000		
Current liabilities and Provisions:			
Sundry Creditors	56,500		
	3,61,815		**3,61,815**

Working Notes:

(1) Calculation of Number of Equity shares to be issued

	Rs.	Rs.
Balance of Profit & Loss Account		48,000
Less: Loss on sale of investment	2,500	
Amount to be retained as balance	12,000	14,500
Amount available for transfer to capital redemption reserve		33,500
Nominal value of Equity shares to be issued (65,000 – 33,500)		31,500

No of equity shares = $\frac{31,500}{50}$ = 630 shares

Illu.5 : The following balances appear in the ledger of a company as on 31-3-2001:

	Rs.
Equity Shares (Fully paid up)	**6,00,000**
Redeemable Preference Shares (Fully Paid up)	**3,00,000**
General Reserve	**2,00,000**
Profit and Loss Account (Credit balance)	**1,25,000**
Share Premium Account	**50,000**

The company decided to redeem the preference shares at a premium of 10% out of its general reserve and undistributed profits.

Solution :

Journal Entries

Date	**Particulars**		**L.F.**	**Debit Rs.**	**Credit Rs.**
1.	Red.Pref.Share capital a/c	Dr.		3,00,000	
	Premium on redemption of Pref.Shares a/c	Dr.		30,000	
	To Pref.shareholders a/c				3,30,000
	(Being the amount payable on redemption with premium transferred to preference shareholders a/c)				
2.	Securities Premium a/c	Dr.		30,000	
	To Premium on redemption of Preference Shares a/c				30,000
	(Being the premium on redemption adjusted against securities premium a/c)				
3.	Pref.Shareholders a/c	Dr.		3,30,000	
	To Bank a/c				3,30,000
	(Being the payment made to pref.shareholders)				
4.	General Reserve a/c	Dr.		2,00,000	
	Profit & Loss a/c	Dr.		1,00,000	
	To Capital Redemption reserve a/c				3,00,000
	(Being the amount transferred to capital redemption reserve account as per the requirement of the act)				

Illu.6 : A company has issued 1,000 fully paid up 15% redeemable preference shares of Rs.100 each. All these shares were redeemable on 1-4-2002 at 5% premium. The summarized Balance Sheet of the company on that date was as following:

Liabilities	Amount Rs.	Assets	Amount Rs.
Share Capital		**Building**	**80,000**
15% Redeemable Preference Shares	**1,00,000**	**Machinery**	**1,00,000**
Equity Shares of Rs.10 each	**1,00,000**	**Furniture**	**5,000**
Share Premium	**2,000**	**Short term investments**	**80,000**
General Reserve	**80,000**	**Stock**	**20,000**
Profit & Loss a/c	**40,000**	**Cash at Bank**	**35,000**
		Cash in Hand	**2,000**
	3,22,000		**3,22,000**

It was decided to redeem the preference shares out of profits. The investments wee sold at book value.

Write the Journal entries and prepare the Balance Sheet of the company after redemption of shares.

Solution :

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1.	15% Redeemable pref. Share capital a/c	Dr.		1,00,000	
	Premium on redemption of Preference shares a/c	Dr.		5,000	
	To Redeemable Preference Shareholders a/c				1,05,000
	(Being the amount payable on 1,000 15% preference shares at a premium of 5% transferred to preference shareholders a/c)				
2,	Bank a/c	Dr.		80,000	
	To Investment a/c				80,000
	(Being the investments sold at book value)				

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
4.	Share premium a/c	Dr.		2,000	
	Profit and Loss a/c	Dr.		3,000	
	To Premium on redemption of Preference shares a/c				5,000
	(Being the premium on redemption charged to share premium a/c and the balance to P & L a/c)				
5.	General reserve a/c	Dr.		80,000	
	Profit & Loss a/c	Dr.		20,000	
	To Capital Red. reserve a/c				1,00,000
	(Being the amount transferred to capital redemption reserve a/c as per the requirement of the Act)				

Balance Sheet as on 1-4-2002

Liabilities	Rs.	Assets	Rs.
Share Capital :			
10,000 equity shares of Rs.10 each	1,00,000	Fixed Assets :	
Reserves and Surplus		Buildings	80,000
Capital redemption reserve account	1,00,000	Machinery	1,00,000
P & L a/c (40,000 – 3,000 – 20,000)	17,000	Furniture	5,000
		Current assets	
		Stock	20,000
		Cash at Bank (35,000 + 80,000 – 1,05,000)	10,000
		Cash in hand	2,000
	2,17,000		**2,17,000**

Illu.7 : ABC Company Ltd. is having 14% 40,000 Redeemable Preference shares of Rs.100 each. The company has decided to redeem the above preference shares at 10% premium in the following way.

a. **to sell the investments, the book value of which is Rs.20,00,000 at 10% less than their book value.**
b. **To issue 3,00,000 equity shares of Rs.10 each at a premium of Rs.2 per share.**
c. **To utilise the balances of the following accounts.**
   General reserve – Rs.7,50,000
   Profit and Loss a/c – Rs.2,50,000

The above decisions are implemented and the preference shares were redeemed. Write the journal entries for the above.

Solution :

Journal Entries in the books of ABC Company Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
(i)	Bank a/c Profit & Loss a/c To Investment a/c (Being the investments sold at 18,00,000 and loss debited to profit and Loss a/c)	Dr. Dr.		18,00,000 2,00,000	 20,00,000
(ii)	14% Red.Pref. Share capital a/c Premium on Redemption of Pref.shares a/c To Pref.shareholders a/c	Dr. Dr.		40,00,000 4,00,000	 44,00,000
(iii)	Bank a/c To Equity share application & Allotment a/c (Being the application money received on 3,00,000 equity shares of Rs.10 each at a premium of Rs.2 per share)	Dr.		36,00,000	 36,00,000
(iv)	Equity shares Application & Allotment A/c To Equity share capital a/c To Securities premium a/c (Being the allotment of 3,00,000 equity shares of Rs.10 each at a premium of Rs.2 per share)	 Dr.		 36,00,000	 30,00,000 6,00,000
(v)	Securities premium a/c To Premium on redemption Preference Shares a/c (Being the premium payable on redemption of preference shares charged to securities premium account)	Dr.		4,00,000	 4,00,000
(vi)	Red. Pre. Shareholders a/c To Bank a/c (Being shareholders paid)	Dr.		44,00,000	 44,00,000

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
(vii)	P & L a/c	Dr.		50,000	
	Securities Premium a/c	Dr.		2,00,000	
	General Reserves a/c	Dr.		7,50,000	
	To Capital Redemption Reserve a/c				
	(Being the amount transferred out of profit, securities premium and general reserve to capital redemption a/c)				10,00,000

4.6 QUESTIONS

1. What are preference shares? What are the conditions of redemption of preference shares?
2. What are the rules regarding redemption of preference shares?
3. What do you mean by Capital Redemption reserve account? How is it created? How can it be utilized?
4. Can partly paid up preference shares be redeemed?
5. State the low relating to redemption of preference shares.
6. Explain the provisions of Section 80 of the Companies Act, 1956 relating to the redemption of Preference Shares?
7. State the provisions relating to redemption of preference shares.

4.7 EXERCISES

1. The following items appear in the balance Sheet of A Ltd. as on 31st March 2003.

(a) Share Capital:
Equity: Authorised – Rs.5,00,000 shares of Rs.10 each.
Issued and subscribed Rs.4,00,000 share of Rs.10 each full paid
Preference: Authorised, issued and subscribed – 60,000, 14% shares of Rs.20 each fully paid.

(b) Investments: Rs.3,50,000

(c) Profit and Loss Account: Rs.7,00,000

It was decided to redeem the 60,000 14% preference shares at a premium of 5% of 31st March 2003. It was further decided to:

(i) Sell all investments for Rs.3,00,000
(ii) Finance part of the redemption from company funds, subject to leaving a balance of Rs.2,00,000 in the profit and loss account and
(iii) Issue sufficient number of equity shares at a premium of Rs.2 to raise the balance of funds required.

The above decisions have been carried out and the preference shares redeemed. Give Journal entries to record the above transactions.

2. What entries can be made for the following redemption made by the company?

(a) In 2001 P Ltd. redeemed Rs.1,00,000 preference shares by converting them into equity shares issued at 25% premium.
(b) In 2002 P Ltd. redeemed Rs.95,000 preference shares by converting them into equity shares issued by 5% discount.
(c) In 2003 P Ltd. redeemed 10,000 preference shares of Rs.10 each at premium of Rs.1.25 per share by converting into equity shares of Rs.10 each issued at 10% discount.

3. The following is the summarised Balance Sheet of a Company on 31-3-2001:

Liabilities	Rs.	Assets	Rs.
10%, 1,000 Redeemable preference shares of Rs.100 each	1,00,000	Sundry assets	8,10,000
50,000 equity shares of Rs.10 each	5,00,000	Cash at Bank	90,000
General Reserve	1,00,000		
Capital Reserve	50,000		
Creditors	1,50,000		
	9,00,000		**9,00,000**

For the purpose of redemption of Preference Shares, the company made a fresh issue of 4,500 equity shares of Rs.10 each at a premium of 10%. The preference shares were redeemed at a premium of 10%.

Show Journal entries and Prepare a Balance Sheet after the redemption of Preference Shares.

4. A company in a series of operations:

(a) Issue at par 20,000 redeemable preference shares of Rs.10 each redeemable at a premium of 50 paise per share.
(b) Redeems 10,000 of the redeemable preference shares out of profits of the company.
(c) Issues at par for cash 20,000 equity of Rs.10 each and out of the proceeds redeems the balance of the redeemable preference shares.

Journalise the transactions.

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Chapter – 5

ISSUE OF DEBENTURES

Objectives :

After reading this lesson you should able to :

- know the meaning of debenture
- find out different kinds of debentures
- discuss the provisions relating to issue of debentures
- explain on the issue of debentures at premium and discount

Structure :

5.1 DEBENTURES - MEANING

The term debenture is derived from the Latin word **"debere"** which means "to owe a debt". A debenture may, be defined as document issued by the company as an evidence of debt. It is the acknowledgement of the company's indebtedness to its holders.

5.1.1 Features:

The following are the features of debentures.

1. Debenture-holders are entitled to periodical payment of interest at an agreed rate.
2. They are also entitled to redemption of their capital as per the agreed terms.
3. They have no voting rights.
4. Usually debentures are secured by charge on or mortgage of the assets of the company.
5. Debenture holders have the right to use the company for any unpaid dues.
6. They can enforce the security by sale in case of default.
7. They can apply for winding up of the company to safeguard their interests.

5.1.2 Kinds of Debentures:

Debentures may be classified as under:

1. **Redeemable debentures:** These debentures are to be repaid within certain specified period as per the terms of their issue.

2. **Irredeemable debentures:** These are perpetual debentures. The company has no right to make the payment of the principal of these debentures during its life time. These debentures are repaid in case of winding up of the company.

3. **Bearer debentures:** These debentures are transferable by mere delivery. The name of the holder is not registered with the company.

4. **Registered debentures:** These debentures are not transferable by mere delivery. The names of the debenture-holders are registered with the company.

5. **Naked debentures:** These debentures are not mortgaged and they are issued without any charge on company's assets. The issue of these debentures is not popular with the company.

6. **Secured or Mortgaged debentures:** These debentures are secured by a charge on company's assets. This charge may be fixed or floating

5.2. DIFFERENCE BETWEEN SHAERS AND DEBENTURES

	Point of difference	**Shares**	**Debentures**
1.	**Share capital**	A share forms part of the share capital of a company	A debenture forms part of the loan capital of a company.
2.	**Ownership**	A shareholder is the owner of a company.	A debenture-holder is the creditor of the company.
3.	**Dividend**	Dividend is payable on shares	A fixed rate of interest is payable on debentures.
4.	**Security**	No security is offered for shares	Security by way of mortgage or charge on assets of the company is offered on debentures.
5.	**Right to vote**	Shareholders have right to vote.	Debenture-holders have no voice in the management.
6.	**Re-payment**	When the company is wound up, share holder has no right of priority in the matter of re-payment of his shares.	Debenture-holder enjoys a right of priority with regards to repayments.

5.3 ISSUE OF DEBENTURES

The procedure for issuing debentures is similar to that of an issue of shares. A prospectus is issued in which the terms and conditions are given. The intending purchasers (lender) apply for the debentures on a prescribed form and the same is deposited into the company's bank together with the application money. The money may be payable in full at a time or by installments.

a. **When Debentures are issued for cash:** When the amount is payable in installment, entries will be similar to the issue of shares. And premium or discount on issues of debenture is normally, adjusted at the time of making allotment.

b. **When Debentures are issued for consideration other than cash:** when a company allots debentures to the vendor of assets in payment of purchase consideration, such issue of debentures is known as 'Issue of Debentures for consideration other than Cash'.

c. **When Debentures are issued as Collateral Security:** When debentures are issued as an additional security for a loan either from a bank or form an Insurance Company, such an issue is termed as 'Issue of Debentures as Collateral Security,' i.e., it is a secondary security given for raising loan, when the loan is repaid the debentures are cancelled. In short, until and unless the loan is repaid, that remains in the possession of the lender.

5.4 ISSUE OF DEBENTURES AT PREMIUM

Debentures can be issued at a price more than the face value of debentures. The excess of issue price over the face value of debentures is the premium The premium is the gain for the company. So it is credited to premium on issue of debentures account when the installment contained premium is made due. The installment is received including premium.

Premium on issue of debentures is a capital gain, so it is shown at the liabilities side of the Balance Sheet under the head "Reserve and Surplus". The premium can be utilised in meeting capital losses. The journal entry regarding share premium is as under.

Date	Particulars		L.F.	Debit	Credit
	Debenture allotment a/c	Dr.		x x x	
	To Debentures a/c				x x x
	To Premium on Issue of Debentures a/c				x x x
	(Being allotment money on … debentures … @ Rs… including premium made etc.)				

When receiving Debenture allotment, premium on issue of debentures will neither be debited nor credited. Ordinarily premium is called up with debenture allotment. If premium is received with application, premium on issue of debentures account is credited while transferring Debenture application money to Debentures Account. In case, the premium is called up with calls, it will be credited when call is made due. The amount of debenture premium can be used for writing off fictitious assets and certain debit balances such as discount or loss or expenses on issue of shares and debentures, preliminary expenses and underwriting commission. It may also be used for forming Debenture Redemption Fund.

5.5. ISSUE OF DEBENTURES AT DISCOUNT

Discount on issue of debentures is the amount which the company receives lesser than the face value of debentures. For example, receiving Rs.90 for a debenture of Rs.100. The amount received lesser is a loss and thus debited in Discount on issue of debentures account. Discount on issue of debenture account is supposed to be on allotment, unless otherwise mentioned. There is no legal restriction on issuing debentures at discount. The following is the journal entry to be passed for the issue of debentures at a discount.

Date	Particulars	L.F.	Debit	Credit
	Debenture allotment a/c Dr.		x x x	
	Discount on Issue of Debentures a/c Dr.		x x x	
	To Debentures a/c			x x x

Discount on issue of debenture account is a fictitious asset, so it should be written off as early as possible during the life time of the debentures. Discount on issue of debentures account will be shown on the assets side of the Balance sheet, under the head “Miscellaneous Expenditure” until it is written off.

Journal Entries

A. Issue of Debentures at Par: (When Debentures are issued for cash):

I. When the entire amount is received in lump sum:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank a/c Dr.		x x x	
	To Debentures a/c			x x x

II. If the Value of debenture is received in certain installments:

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	On receipt of application amount:				
	Bank a/c	Dr.		x x x	
	To Debenture Application a/c				x x x
	For transfer of application amount to Debentures:				
	Debentures Application a/c	Dr.		x x x	
	To Debentures a/c				x x x
	For debenture allotment amount due:				
	Debenture Allotment a/c	Dr.		x x x	
	To Debentures a/c				x x x
	On receipt of Debenture allotment amount:				
	Bank a/c	Dr.		x x x	
	To Debenture allotment a/c				x x x
	For making debenture call due:				
	Debenture call a/c	Dr.		x x x	
	To Debentures a/c				x x x
	On receipt of call amount:				
	Bank a/c	Dr.		x x x	
	To Debenture call a/c				x x x

III. Issue of Debentures at Premium:

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	When premium is payable with allotment money:				
	Debenture allotment a/c	Dr.		x x x	
	To Debenture a/c				x x x
	To Premium on Debentures a/c				x x x

IV. Issue of Debentures at Discount:

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Debenture allotment a/c	Dr.		x x x	
	Discount on Issue of Debentures a/c	Dr.		x x x	
	To Debenture a/c				x x x

B. When Debentures are issued for consideration other than Cash:

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	For Purchase of Assets:				
	Sundry assets a/c	Dr.		x x x	
	To Vendors a/c				x x x
	For Issue of Debentures to Venders:				
	Vendors a/c	Dr.		x x x	
	To Debentures a/c				x x x

Illu.1: Kalyan Ltd., issued 1,000 6% Debentures of Rs.100 each, payable as to Rs.20 on application, and the balance on allotment. Applications were received for 1,500 debentures out of which applications for 900 were allotted fully, applications for 400 were allotted 100 debentures and the remaining rejected. All sums were received Journalise and show Balance Sheet.

Solution:

Journal Entries in the Books of Kalyan Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Bank a/c (1,500×20)	Dr.		30,000	
	To Debenture application a/c				30,000
	(Being application money received on 1,500 debentures @ Rs.20 per debenture)				
	Debenture application a/c (1,500×20)	Dr.		30,000	
	To 6% Debentures a/c (1,000×20)				20,000
	To Debenture allotment a/c (300×20)				6,000
	To Bank a/c (200×20)				4,000
	(Being Debenture application money on 1,000 debentures transferred to 6% Debentures, excess application money to Debenture Allotment a/c and the balance of application money returned)				
	Debenture allotment a/c	Dr.		80,000	
	To 6% Debentures a/c				80,000
	(Being Debenture allotment money due on 1,000 debentures @ Rs.80 per debenture)				
	Bank a/c	Dr.		74,000	
	To Debenture allotment a/c				74,000
	(Being Debenture allotment money received) (Rs.80,000-6,000 = 74,000)				

Balance Sheet of Kalyan Ltd. as on ……

	Liabilities	Rs.		Assets	Rs.
I.	Share Capital:	--	I.	Fixed Assets:	--
II.	Reserve & Surplus:	--	II.	Investments	-
III.	Secured Loans:		III.	Current Assets:	
	1000, 6% Debentures @			Cash at Bank	1,00,000
	Rs.100 each	1,00,000			
		1,00,000			1,00,000

Illu.2: A Public Company issued 20,000 12% Debentures at Rs.100 each at a discount of 5% repayable after 5 years at a premium of 5%. Show the Journal entries for issue and redemption of Debentures.

Solution:

Journal Entries

When debentures are issued at discount and repayable at premium:

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
I.	**At the time of issue:**				
	Bank a/c	Dr.		19,00,000	
	Loss on issue of Debentures a/c	Dr.		2,00,000	
	To 12% Debentures a/c				20,00,000
	To Premium on Redemption of Debentures a/c				1,00,000
	(Being the issue of Rs.2,00,000 debentures at 5% discount and redeemable at 5% premium)				
II.	**At the time of Redemption:**				
	12% Debentures a/c	Dr.		20,00,000	
	Premium on Redemption of Debentures a/c	Dr.		1,00,000	
	To Debentures holders a/c				21,00,000
	(Being 12% Debentures and the premium on redemption of Debentures transferred to Debenture holder's a/c)				
	Debenture holders a/c	Dr.		21,00,000	
	To Bank a/c				21,00,000
	(Being Debenture holders paid off)				

Working Notes:

		Rs.
(1)	Value of 12% Debentures issued (20,000×Rs.100)	20,00,000
	Less: Discount given at 5% (20,00,000 × $^5/_{100}$)	1,00,000
	Cash received on issue of Debentures:	19,00,000
(2)	Loss on issue of Debentures:	
	(a) Discount given	1,00,000
	(b) Premium on redemption (20,00,000×$^5/_{100}$)	1,00,000
		2,00,000

Illu.3: A Company issued 200 12% Debentures of Rs.1,000 each. Write Journal entries for issue of the following:

(a) Debentures are issued at a Premium of 10% redeemable at par.
(b) Debentures are issued at a discount at 5% redeemable at a premium of 10%.

Solution:

Journal Entries in the Books of 'A' Company

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
(a)	Bank a/c Dr.		2,20,000	
	To 12% Debentures a/c			2,00,000
	To Debenture premium a/c			20,000
	(Being 200, 12% Debentures issued at a premium of 10%)			
	(2,00,000+2,00,000×$\frac{10}{100}$=2,20,000)			
	Bank a/c Dr.		1,90,000	
	Loss on issue of Debentures a/c Dr.		30,000	
	To 12% Debentures a/c			2,00,000
	To Premium on Redemption of Debentures a/c			20,000
	(Being 12% Debentures issued at a discount of 5% and redeemable at a premium of 10%)			

Notes:

			Rs.
(1)	Loss on Issue of Debentures:		
	(1) Discount allowed: 5%	$2,00,000 \times \frac{5}{100}$	10,000
	(2) Premium on Redemption: 10%	$2,00,000 \times \frac{10}{100}$	20,000
			30,000
(2)	Value of Debentures issued: 200 12% Debentures × 1,000		2,00,000
	Less: Discount given: 5%	$2,00,000 \times \frac{5}{100}$	10,000
			1,90,000

Illu.4: A company issues 1000 debentures of Rs.1000 each pass the necessary entries for the issue of Debentures in each of the following cases:-

(a) Debentures issued at Rs.950 repayable at Rs.1000
(b) Debentures issued at 950 repayable at Rs.1050
(c) Debentures issued at 1000 repayable at Rs.1050 and
(d) Debentures issued at Rs.1050 repayable at Rs.1,000 you may assume that all the amounts due on the issue of debentures have been received.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
(a)	Bank a/c (1,000×Rs.950)	Dr.		9,50,000	
	Discount on issue of Debentures a/c (1,000×50)	Dr.		50,000	
	To Debentures a/c (1,000×1,000)				10,00,000
	(Being issue of 1,000 debentures of Rs.1,000 each at Rs.950 per debenture)				
(b)	Bank a/c (1,000×950)	Dr.		9,50,000	
	Loss on issue of Debenture a/c (1,000×100)	Dr.		1,00,000	
	To Debentures a/c (1,000×1,000)				10,00,000
	To Premium on redemption of Debentures a/c (1,000×50)				50,000
	(Being issue of 1,000 debentures of Rs.1,000 each at Rs.950 per debenture repayable at Rs.1,050 per debenture)				

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
(c)	Bank a/c (1,000×1,000)	Dr.		10,00,000	
	Loss on issue of Debenture a/c (1,000×50)	Dr.		50,000	
	To Debentures a/c (1,000×1,000)				10,00,000
	To Premium on redemption of Debentures a/c (1,000×50)				50,000
	(Being issue of 1,000 debentures of Rs.1,000 each repayable at Rs.1,050 per debenture)				
(d)	Bank a/c (1,000×1,050)	Dr.		10,50,000	
	To Debentures a/c (1,000×1,000)				10,00,000
	To Premium on issue of Debentures a/c (1,000×50)				50,000
	(Being issue of 1,000 debentures @ Rs.1,050 repayable at Rs.1,000 per debenture)				

Illu.5: Pass journal entries relating to the issue of the following debentures.

(i) 100 8% Rs.1,000 debentures are issued at 5% discount and are repayable at par.

(ii) 100 7% Rs.1,000 debentures are issued at 5% discount and repayable at 10% premium.

(iii) 100 9% Rs.1,000 debentures are issued at 5% premium.

(iv) 500 8½% Rs.100 debentures are issued as collateral security against a loan of Rs.50,000.

Solution:

Journal entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Bank a/c	Dr.		95,000	
	Discount on issue of Debentures a/c	Dr.		5,000	
	To 8% Debentures a/c				1,00,000
	(Being debentures issued at discount with a condition of redemption at par)				
	Bank a/c	Dr.		95,000	
	Discount on issue of debentures a/c	Dr.		5,000	
	Loss on issue of debentures a/c	Dr.		10,000	
	To 7% Debentures a/c				1,00,000
	To Premium on redemption of debentures a/c				10,000
	(Being debentures issued at discount with a condition redemption at premium)				

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Bank a/c	Dr.		1,05,000	
	To 9% Debentures a/c				1,00,000
	To Premium on issue of debentures a/c				5,000
	(Being debentures issued at premium)				
	Debentures suspense a/c	Dr.		50,000	
	To 8½% Debentures a/c				50,000
	(Being debentures issued as collateral security against a loan)				

5.6 QUESTIONS

1. What are debentures?
2. Explain their features.
3. State the provisions relating to the issue of debentures
4. Explain the issue debentures at premium.
5. How do you treat issue of debentures at discount from accounting point of view?
6. Explain the accounting treatment of:
   (a) Debentures issued at discount and repayable at par
   (b) Issued at discount and repayable at premium
   (c) Issue of debentures as collateral security.
7. Define debentures. What are the types of debentures.

5.7 EXERCISES

1. ABC Ltd. issued at par Rs.60 lakhs 15% non-convertible debentures of Rs.1,000 each, payable 20% on application, 20% on allotment, 30% on first call and the balance after three months from the date of first call. Excepting the allotment money on 400 debentures and call money on 600 debentures which were in arrears the debentures money was duly received. Pass journal entries to reflect the above transactions.

2. A company issued Rs.1,00,000, 7½% debentures at par redeemable at 5% premium after 10 years. Pass necessary journal entries to record the transactions.

3. A company issued Rs.1,00,000 7½% debentures at 5% discount redeemable after 10 years at a 5% premium. Pass necessary journal entries.

4. Give entries to record the following issue of debentures.
   a. 6% debentures, Rs.1,00,000 issued at premium of 10%
   b. 5% debentures, Rs.1,00,000 issued at a discount of 5% but redeemable at a premium of 5%.

5. What journal entries will be made for the following types of issues.

a. A company issued 1,000 6% debentures of Rs.100 each at par;

b. A company issued 1,000 6% debentures of Rs.100 each at 10% premium; and

c. A company issued 1,000 6% debentures of Rs.100 each at 10% discount.

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Chapter – 6

REDEMPTION OF DEBENTURES

Objectives :

After reading this lesson you should able to :

- know the features and redemption of debentures
- find out methods of redemption of debentures
- understand the reasons for the creation of debenture redemption reserve.

Structure :

6.1 REDEMPTION OF DEBENTURES

Redemption of debentures is the discharge of liability on account of debentures. The redemption must be according to the terms of issue, as specific in the debenture trust deed.

6.2 METHODS OF REDEMPTION OF DEBENTURES

The various methods of redemption of debentures are as follows:

1. **Lumpsum payment method:** Under this method, the debentures are redeemed by repayment in one lump-sum at the end of the stipulated period of time. Normally a company creates a sinking fund or an insurance policy fund for this purpose.

(i) **Sinking Fund:** A sinking fund may be created for redemption of debentures. This is different from sinking fund for replacement of assets. The former is created out of revenue profits by debiting the profit and loss appropriation account and is not a charge against the profits. The latter is created by debiting profit and loss account and is a charge against the profits. Sinking fund for redeeming debentures is also called 'debenture redemption fund' to distinguish it from any other sinking funds.

(ii) **Insurance Policy Method:** This method is an absolutely certain method of providing exact amount of cash for redemption of debentures. However, this method can be followed when debentures are to be repaid on a definite future date only.

2. **Annual drawings method:** Under this method, a certain amount of debentures is redeemed at regular intervals during the life time of the debentures. In other words, redemption of debentures is done in installments by draw a lots.

3. **Purchase in the open market method:** Under this method, a company may redeem its debentures by purchase in the open market. In this case, the debentures repurchased may be either cancelled immediately or may be retained as investment and cancelled later on along with other debentures. The debentures purchased as investment are called "Own debentures."

4. **Conversion Method:** Under this method, the company gives an option to the debenture-holders to covert their debentures into new debentures/preference shares/equity shares.

6.3 DEBENTURE REDEMPTION RESERVE

As per the present regulations, it is obligatory for all the companies raising resources through debentures to create a Debenture Redemption Reserve equivalent to 50% of the amount of debenture issue before redemption of debentures begins. These guidelines are issued in the interest of debenture-holders. The effect of these guidelines is that it is compulsory for a company to create Debenture Redemption Reserve for non-convertible debentures. A Company cannot redeem its debentures purely out of profits or out of capital. The following points are to be considered in the creation of redemption of reserves.

1. A moratorium upto the date of commercial production can be provided for creation of the debenture redemption reserve in respect of debentures raised for project finance.

2. The debenture redemption reserve may be crated either in equal installments for the remaining period or with higher amounts if profits permit

3. In the case of partly convertible debentures, debenture redemption reserve should be created in respect of non-convertible portion of debentures issue on the same lines as applicable for fully non-convertible debenture issue. In respect of convertible issues by new companies the creation of debenture redemption reserve should commence from the year the company earns profit for the remaining life of debentures.

4. Company should create DRR equivalent to 50% of amount of debentures issue before debenture redemption commences. Withdrawal from DRR is permissible only after 10% of the debenture liability has been actually redeemed by the company.

5. Debenture redemption reserve will be treated as a part of General Reserve for consideration of bonus issue proposal.

Journal Entries

Issue of debentures form condition of redemption point of view:

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Debentures issued at par and redeemable at par:				
	Bank a/c	Dr.		x x x	
	To Debentures a/c				x x x
	Debentures issued at Premium and redeemable at par:				
	Bank a/c	Dr.		x x x	
	To Debentures a/c				x x x
	To Premium on issue of Debentures a/c				x x x
	Debentures issued at discount and redeemable at par:				
	Bank a/c	Dr.		x x x	
	To Discount on issue of Debentures a/c				x x x
	To Debentures a/c				x x x
	Debentures issued at par, redeemable at premium:				
	Bank a/c	Dr.		x x x	
	Loss on issue of Debentures a/c	Dr.		x x x	
	To Debentures a/c				x x x
	To Premium on Redemption of Debentures a/c				x x x
	Debenture issued at discount, redeemable at premium:				
	Bank a/c	Dr.		x x x	
	Loss on issue of Debentures a/c	Dr.		x x x	
	To Debentures a/c				x x x
	To Premium on Redemption of Debentures a/c				x x x

Illu.1: A Public Company issued 20,000 12% Debentures at Rs.100 each at a discount of 5% repayable after 5 years at a premium of 5%. Show the Journal entries for issue and redemption of Debentures.

Solution:

Journal Entries

When debentures are issued at discount and repayable at premium:

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
I.	**At the time of issue:**				
	Bank a/c	Dr.		19,00,000	
	Loss on issue of Debentures a/c	Dr.		2,00,000	
	To 12% Debentures a/c				20,00,000
	To Premium on Redemption of Debentures a/c				1,00,000
	(Being the issue of Rs.2,00,000 debentures at 5% discount and redeemable at 5% premium)				
II.	**At the time of Redemption:**				
	12% Debentures a/c	Dr.		20,00,000	
	Premium on Redemption of Debentures a/c	Dr.		1,00,000	
	To Debentures holders a/c				21,00,000
	(Being 12% Debentures and the premium on redemption of Debentures transferred to Debenture holder's a/c)				
	Debenture holders a/c	Dr.		21,00,000	
	To Bank a/c				21,00,000
	(Being Debenture holders paid off)				

Working Notes:

		Rs.
(1)	Value of 12% Debentures issued (20,000×Rs.100)	20,00,000
	Less: Discount given at 5% (20,00,000 × $^{5}/_{100}$)	1,00,000
	Cash received on issue of Debentures:	19,00,000
(2)	Loss on issue of Debentures:	
	(a) Discount given	1,00,000
	(b) Premium on redemption (20,00,000×$^{5}/_{100}$)	1,00,000
		2,00,000

Illu.2: A Company issued 200 12% Debentures of Rs.1,000 each. Write Journal entries for issue of the following:

(a) Debentures are issued at a Premium of 10% redeemable at par.
(b) Debentures are issued at a discount at 5% redeemable at a premium of 10%.

Solution:

Journal Entries in the Books of 'A' Company

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
(a)	Bank a/c	Dr.		2,20,000	
	To 12% Debentures a/c				2,00,000
	To Debenture premium a/c				20,000
	(Being 200, 12% Debentures issued at a premium of 10%)				
	(2,00,000+2,00,000$\times\frac{10}{100}$=2,20,000)				
	Bank a/c	Dr.		1,90,000	
	Loss on issue of Debentures a/c	Dr.		30,000	
	To 12% Debentures a/c				2,00,000
	To Premium on Redemption of Debentures a/c				20,000
	(Being 12% Debentures issued at a discount of 5% and redeemable at a premium of 10%)				

Notes:

			Rs.
(1)	Loss on Issue of Debentures:		
	(1) Discount allowed: 5%	2,00,000$\times\frac{5}{100}$	10,000
	(2) Premium on Redemption: 10%	2,00,000$\times\frac{10}{100}$	20,000
			30,000
(2)	Value of Debentures issued: 200 12% Debentures $\times$ 1,000		2,00,000
	Less: Discount given: 5%	2,00,000$\times\frac{5}{100}$	10,000
			1,90,000

Illu.4: A company issues 1000 debentures of Rs.1000 each pass the necessary entries for the issue of Debentures in each of the following cases:-

(a) Debentures issued at Rs.950 repayable at Rs.1000

(b) Debentures issued at 950 repayable at Rs.1050

(c) Debentures issued at 1000 repayable at Rs.1050 and

(d) Debentures issued at Rs.1050 repayable at Rs.1,000 you may assume that all the amounts due on the issue of debentures have been received.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
(a)	Bank a/c (1,000×Rs.950)	Dr.		9,50,000	
	Discount on issue of Debentures a/c (1,000×50)	Dr.		50,000	
	To Debentures a/c (1,000×1,000)				10,00,000
	(Being issue of 1,000 debentures of Rs.1,000 each at Rs.950 per debenture)				
(b)	Bank a/c (1,000×950)	Dr.		9,50,000	
	Loss on issue of Debenture a/c (1,000×100)	Dr.		1,00,000	
	To Debentures a/c (1,000×1,000)				10,00,000
	To Premium on redemption of Debentures a/c (1,000×50)				50,000
	(Being issue of 1,000 debentures of Rs.1,000 each at Rs.950 per debenture repayable at Rs.1,050 per debenture)				
(c)	Bank a/c (1,000×1,000)	Dr.		10,00,000	
	Loss on issue of Debenture a/c (1,000×50)	Dr.		50,000	
	To Debentures a/c (1,000×1,000)				10,00,000
	To Premium on redemption of Debentures a/c (1,000×50)				50,000
	(Being issue of 1,000 debentures of Rs.1,000 each repayable at Rs.1,050 per debenture)				
(d)	Bank a/c (1,000×1,050)	Dr.		10,50,000	
	To Debentures a/c (1,000×1,000)				10,00,000
	To Premium on issue of Debentures a/c (1,000×50)				50,000
	(Being issue of 1,000 debentures @ Rs.1,050 repayable at Rs.1,000 per debenture)				

Illu.5: Give journal entries in the books of Purchasing company.

a. **A company purchased assets of Rs.1,75,000 and took over liabilities of Rs.15,000. It agreed to pay the purchase price, Rs.1,65,000 by issuing debentures of Rs.100 each at a premium of 10%.**

b. **A company purchased assets of Rs.1,80,000 and took over liabilities of Rs.17,500. It agreed to pay purchase price of Rs.1,17,475 by issuing debentures of Rs.100 each at a premium of 10% and Rs.65 by cash. The debentures of the same company are quoted in the market at Rs.130.**

c. **A company purchased assets of Rs.1,90,000 and took over the liabilities of Rs.15,000 at an agreed value of Rs.1,66,500. The company issued debentures at 10% discount in full settlement of the purchase price.**

Solution:

Journal Entries in the books of Purchasing Company

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
(a)	Assets a/c	Dr.		1,75,000	
	Goodwill a/c (Balancing figure)	Dr.		5,000	
	To Liabilities a/c				15,000
	To Vendor a/c				1,65,000
	(Being business of vendor company is acquired)				
	Vendor a/c	Dr.		1,65,000	
	To Debentures a/c				1,50,000
	To Premium on issue of debentures a/c				15,000
	(Being liquidator is paid off by issuing debentures of Rs.100 each at Rs.110)				
(b)	Assets a/c	Dr.		1,80,000	
	Goodwill a/c	Dr.		5,007	
	To Liabilities a/c				17,500
	To Vendor a/c				1,67,507
	(Being business of vendor company is Purchased)				
	Vendor a/c	Dr.		1,67,507	
	To Debentures a/c				1,52,250
	To Premium on issue of debentures a/c				15,225
	To Cash a/c				32
	(Being purchase consideration paid)				

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
(c)	Assets a/c	Dr.		1,90,000	
	To Liabilities a/c				15,000
	To Capital reserve a/c (Balancing figure)				8,500
	To Business purchase a/c				1,66,500
	(Being business of vendor company acquired)				
	Liquidator of vendor company a/c	Dr.		1,66,500	
	Discount on issue of debentures a/c	Dr.		18,500	
	To Debentures a/c				1,85,000
	(Being purchase consideration paid)				

Illu.6: Pass journal entries relating to the issue of the following debentures.

(i) 100 8% Rs.1,000 debentures are issued at 5% discount and are repayable at par.
(ii) 100 7% Rs.1,000 debentures are issued at 5% discount and repayable at 10% premium.
(iii) 100 9% Rs.1,000 debentures are issued at 5% premium.
(iv) 500 8½% Rs.100 debentures are issued as collateral security against a loan of Rs.50,000.

Solution:

Journal entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Bank a/c	Dr.		95,000	
	Discount on issue of Debentures a/c	Dr.		5,000	
	To 8% Debentures a/c				1,00,000
	(Being debentures issued at discount with a condition of redemption at par)				
	Bank a/c	Dr.		95,000	
	Discount on issue of debentures a/c	Dr.		5,000	
	Loss on issue of debentures a/c	Dr.		10,000	
	To 7% Debentures a/c				1,00,000
	To Premium on redemption of debentures a/c				10,000
	(Being debentures issued at discount with a condition redemption at premium)				

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Bank a/c	Dr.		1,05,000	
	To 9% Debentures a/c				1,00,000
	To Premium on issue of debentures a/c				5,000
	(Being debentures issued at premium)				
	Debentures suspense a/c	Dr.		50,000	
	To 8½% Debentures a/c				50,000
	(Being debentures issued as collateral security against a loan)				

Illu.7: On 1.1.2003 Keerthi Co. Ltd. issued 7% Debentures of Rs.6,00,000 with a condition that they should be redeemed after 3 years at 10% premium. The amount set aside for the redemption of debentures is invested in 5% Government Securities. The sinking fund table shows that 0.31720856 at 5% compound interest in 3 years will become Re.1. You are required to write the journal entries for recording the above transactions for three years.

Solution:

Journal Entries in the Books of Keerthi Co. Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2003	Bank a/c	Dr.		6,00,000	
Jan.1	Loss on the issue of Deb. a/c	Dr.		60,000	
	To 7% Debentures a/c				6,00,000
	To Premium on Redemption of Deb. a/c				60,000
	(Being issue of 7% Debentures of Rs.6,00,000 issued at par and repayable at 10% premium)				
Dec.31	Profit & Loss Appro. A/c	Dr.		2,09,357.65	
	To Deb. Redemption Fund a/c				2,09,357.65
	(6,60,000 × 0.317207856 = 2,09,357.65)				
	(Being the annual contribution set aside for the redemption of 7% Debentures)				
Dec.31	Debenture Redemption Fund Investment a/c	Dr.		2,09,357.65	
	To Bank a/c				2,0,357.65
	(Being the amount invested in 5% Govt. securities)				

Date	Particulars		L.F	Debit Rs.	Credit Rs.
2004 Dec.31	Bank a/c	Dr.		10,467.88	
	To Debenture Redemption Fund a/c				10,467.88
	(Being Interest received at 5% on Investments)				
Dec.31	Profit & Loss Appr. A/c	Dr.		2,09,357.65	
	To Deb. Redemption Fund a/c				2,09,357.65
	(Being the annual contribution set aside for the redemption of 7% Debentures)				
Dec.31	Deb. Redemption Fund Investment a/c	Dr.		2,19,825.53	
	To Bank a/c				2,19,825.53
	(Being the amount invested in 5% Govt. securities) (2,09,357.65+10,467.88)				
2005 Dec.31	Bank a/c	Dr.		21,459.17	
	To Deb. Redemption Fund a/c				21,459.17
	(Being Interest received at 5% on Investments) (2,09,357.65+2,19,825.53 = 4,29,183.18$\times\frac{5}{100}$)				
Dec.31	Profit & Loss Appro. a/c	Dr.		2,09,357.65	
	To Deb. Redemption Fund a/c				2,09,357.65
	(Being the annual contribution set aside for the redemption of 7% Debentures)				
Dec.31	Bank a/c	Dr.		4,29,183.18	
	To Debenture Redemption Fund Investment a/c				4,29,183.18
	(Being the amount received on the sale of Investment at par value)				
2006 Dec.31	7% Debentures a/c	Dr.		6,00,000	
	Premium on Redemption of Debentures a/c	Dr.		60,000	
	To Debenture Holders a/c				6,60,000
	(Being 7% Debentures along with premium transferred to Debenture holders a/c)				

Date	Particulars	L.F	Debit Rs.	Credit Rs.
Dec.31	Debenture Holders a/c Dr. To Bank a/c (Being the Debenture Holders paid)		6,60,000	 6,60,000
Dec.31	Debentures Redemption Fund a/c Dr. To Loss on issue of Deb. a/c (Being the loss transferred to Debenture Redemption Fund a/c)		60,000	 60,000
Dec.31	Debenture Redemption Fund a/c Dr. To General Reserve a/c (Being the balance in Debenture Reserve Fund a/c transferred to General Reserve)		6,00,000	 6,00,000

Working Notes:

1. for Re.1 the amount required is …… 0.31720856
   For Rs.6,60,000 the amount required is …… ?

i.e. Rs.6,66,000×0.31720856 = Rs.2,09,357.65ps.

(2) Amount payable on Redemption
= Rs.6,00,000 @ a premium of 10%
= Rs.6,00,000 + (6,00,000$\times\frac{10}{100}$)

Ledger Account of Keerthi Co. Ltd.

Dr. **1. Debenture Redemption Fund a/c** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2003 Dec.31	To Balance c/d	2,09,357.65	2003 Dec.31	By Profit & Loss Appropriation a/c	2,09,357.65
		2,09,357.65			2,09,357.65
2004 Dec.31	To Balance c/d	4,29,183.18	2004 Jan.1	By Balance b/d	2,09,357.65
			Dec.31	By Bank a/c (Interest) (2,09,357.65$\times\frac{5}{100}$)	10,467.88
			Dec.31	By Profit & Loss Appropriation a/c	2,09,357.65
		4,29,183.18			4,29,183.18

2005		Rs.	2005		Rs.
Dec.31	To Loss on issue of Debentures a/c	60,000	Jan.1	By Balance b/d	4,29,183.18
	To General Reserve a/c	6,00,000	Dec.31	By Bank a/c (Interest) $(4{,}29{,}183.18\times\frac{5}{100})$	21,459.17
			Dec.31	By Profit & Loss Appropriation a/c	2,09,357.65
		6,60,000.00			6,60,000.00

Dr. **2. Debenture Redemption Fund Investment a/c** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2003			2003		
Dec.31	To Bank a/c	2,09,357.65	Dec.31	By Balance c/d	2,09,357.65
		2,09,357.65			2,09,357.65
2004			2004		
Jan.1	To Balance b/d	2,09,357.65	Dec.31	By Balance b/d	4,29,183.18
	To Bank a/c (10,467.88+2,09,357.65)	2,19,825.59			
		4,29,183.18			4,29,183.18
2005			2005		
Jan.1	To Balance b/d	4,29,183.18	Dec.31	By Bank a/c (Sale of Investments)	4,29,183.18
		4,29,183.18			4,29,183.18

Dr. **3. 7% Debentures a/c** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2002			2002		
Dec.31	To Balance c/d	6,00,000	Jan.1	By Bank a/c	6,00,000
		6,00,000			6,00,000
2003			2003		
Dec.31	To Balance c/d	6,00,000	Jan.1	By Balance b/d	6,00,000
		6,00,000			6,00,000
2004			2004		
Dec.31	To Debenture holders a/c	6,00,000	Jan.1	By Balance b/d	6,00,000
		6,00,000			6,00,000

Dr. **4. Debenture Holders a/c** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2004 Dec.31 3rd year	To Bank a/c	6,60,000	2004 Dec.31 3rd year	By 7% Debentures a/c By Premium on Redemption of Debentures a/c	6,00,000 60,000
		6,60,000			6,60,000

Dr. **5. Premium on Redemption of Debentures a/c** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2003 Dec.31	To Balance c/d	60,000	2003 Jan.1	By Loss on issue of 7% Debenture a/c	60,000
		60,000			60,000
2004 Dec.31	To Balance c/d	60,000	2004 Jan.1	By Balance b/d	60,000
		60,000			60,000
2005 Dec.31	To Debenture holders a/c	60,000	2005 Jan.1	By Balance b/d	60,000
		60,000			60,000

6.4 SELF ASSESSMENT QUESTIONS

1. What are different methods of redemption of debentures?
2. Explain the accounting treatment of:
   (a) Debentures issued at par and redeemable at premium.
   (b) Issue of debentures as collateral security.
3. Sinking Fund for the redemption of debentures
4. Debenture Redemption fund

6.5 EXERCISES

1. What journal entries will be made in the following cases:

a. A company issued Rs.40,000 6% debentures at par redeemable at par;
b. A company issued Rs.40,000 6% debentures at discount of 10% redeemable at par;
c. A company issued Rs.40,000 6% debentures at premium of 5% redeemable at par;

d. A company issued Rs.40,000 6% debentures at par redeemable at 10% premium; and

e. A company issued Rs.40,000 6% debentures at a discount of 5% and redeemable at 5% premium.

Also show how will you deal with the loss on issue of debentures in the books.

7. On 1st January 2001, A Ltd., issues 2,000 6% debentures of Rs.100 each repayable at the end of four years at a premium of 5 per cent. It has been decided to institute a sinking fund for the purpose, the investments being expected to realise four per cent net. Sinking fund tables show that 0.235490 annually amounts to one @ 4%, in four years. Investments were made a multiples of hundred only.

Only 31st December 2005 the balance at Bank was Rs.59,000 and the investments realised Rs.1,56,800. The debentures were paid off. Give journal entries in the books of the company.

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Chapter – 7

ACQUISITION OF BUSINESS & PROFITS PRIOR TO INCORPORATION

Objective :

After going through this lesson you should be able to

- understand the meaning of acquisition of business
- explain methods of determining purchase consideration
- discuss the profits prior to incorporation
- study the basis for allocation and apportionment of expenses.

Synopsis:

7.1 ACQUISITION OF BUSINESS

Now-a-days acquisition of business is becoming very popular. An existing limited company may take over the business of a sole trader or proprietorship business. Sometimes, a new company may be formed to take over the business of a sole trader or a firm. In all these cases, as the company acquires or purchases the business of others, it is called the **Purchasing Company** and the seller concern is called the **vendor.** Purchase price is called **Purchase Consideration.**

7.1.1 Maintenance of Books:

Whenever a new business is acquired, the purchasing company follows any one of the following method.

(i) Opening of New Set of Books of Accounts
(ii) Continuation of the same set of Books of Accounts

Let us now discuss, the accounting methods followed in the acquisition of business in the above two cases.

7.1.2 When the New Set of Books are opened:

When a company acquires a sole trader or partnership business the following three important factors are to be taken into consideration.

1. Assets taken over by the purchasing company
2. Liabilities taken over by the purchasing company
3. Determination of Purchase Consideration.

7.2 METHODS OF DETERMINING PURCHASE CONSIDERATION

Purchase Consideration means the price payable by the purchasing company to the vendor concern as a consideration for business taken over. Such a price is generally stated in the agreement between the two parties. Generally, purchase consideration is given in the question. If it is not given, the following two methods can be adopted for calculating the amount of purchase consideration.

1. Net Assets method:

Under this method, the purchase consideration is arrived at by adding up the various assets at the values taken over less the amount of liabilities taken over by the purchasing company. For example, if the values of the assets taken over are a sum of Rs.10,00,000 while the liabilities are of Rs.6,50,000, the net assets of the business would amount to Rs.3,50,000.

2. Net Payment Method:

Under this method, the purchase consideration is arrived at by adding up the various amounts which the purchasing company agrees to pay to the vendor. Purchase consideration can be paid by purchasing company in any one or more of the following ways,. (a) in cash (b) in shares (c) in Debentures. For example, if the purchasing company agrees to pay Rs.1,00,000 in shares Rs.2,00,000 in debentures and Rs.50,000 in cash, the amount of purchase consideration according to this method, would be to Rs.3,50,000.

7.2.1 Calculation of Goodwill or Capital Reserve:

Whenever a company purchases a business, the purchase price paid for acquisition must be compared with the net assets acquired. The excess of the purchase price paid over the net assets is taken as goodwill and debited to the same. On the other hand, if the net assets are more than the price paid for them, the company makes a capital profit and the same should be credited to capital reserve account. The net assets are calculated by taking the difference between the assets taken over, and liabilities taken over. It may be carefully noted that it is the revised value of the asset or the liability taken over (not the book value of asset and liability) which is important for calculating the value of net assets. If revised values are not given then book values are considered.

Journal Entries in the books of Purchasing Company

The following journal entries will be passed by the purchasing company in its books in case of acquisition of business.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
1.	**For Purchase of Business:**			
	Business Purchase a/c Dr.		x x x	
	To Vendor a/c			x x x
2.	**For assets and liabilities taken over:**			
	Sundry assets a/c (individually) Dr.		x x x	
	To Sundry liabilities a/c (individually)			x x x
	To Business Purchase a/c			x x x
	(Value of purchase consideration)			
	Note: If the credits exceed the debits the difference should be debited to goodwill a/c. If the debits exceed the credits, the difference should be credited to capital reserve account.			
3.	**For payment to vendor:**			
	Vendor's a/c Dr.		x x x	
	To Cash a/c			x x x
	To Share capital a/c			x x x
	To Debentures a/c			x x x

Illu.1: Authorised capital of Rs.2,50,000 consisting of 15,000 equity shares of Rs.10 each and 1,000 preference shares of Rs.100 each, purchased as a going concern, for Rs.1,00,000 the business of A and B who were partners and whose balance sheet was as below.

Liabilities	Rs.	Rs.	Assets	Rs.
Bills payable		**5,000**	**Cash**	**3,000**
Creditors		**15,000**	**Bills receivable**	**1,500**
Capital			**Book debts**	**26,500**
A	**35,000**		**Premises**	**30,000**
B	**35,000**	**70,000**	**Plant, Machinery**	**15,000**
			Stock	**12,000**
			Furniture	**2,000**
		90,000		**90,000**

The purchase consideration was to be paid thus :

5,000 equity shares and 300 preference shares to be allotted as fully paid equally to A and B and the balance to be paid in cash to both. The remainder of the shares were offered to the public and were all subscribed and fully paid up. You are required to pass necessary journal entries in the books of the company and prepare its balance sheet.

Solution:

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c	Dr.		1,00,000	
	To Partnership firm (A, B) a/c				1,00,000
	(Being the purchase agreement made)				
	Cash a./c	Dr.		3,000	
	Bills Receivable a/c	Dr.		1,500	
	Book debts a/c	Dr.		26,500	
	Premises a/c	Dr.		30,000	
	Plant and Machinery a/c	Dr.		15,000	
	Stock a/c	Dr.		12,000	
	Furniture a/c	Dr.		2,000	
	Goodwill a/c	Dr.		30,000	
	To Bills payable a/c				5,000
	To Creditors a/c				15,000
	To Business Purchase a/c				1,00,000
	(Being the assets and liabilities taken over)				
	Partnership Firm (A, B) a/c	Dr.		1,00,000	
	To Equity Share capital a/c				50,000
	To Preference share capital a/c				30,000
	To Bank a/c				20,000
	(Being the share capital paid to partnership firm)				
	Bank a/c	Dr.		1,70,000	
	To Equity share capital a/c				1,00,000
	To Preference share capital a/c				70,000
	(15,000 – 5,0000 = 10 ,000 equity shares, 1,000 – 300 = 700 preference shares issued to public, all shares being subscribed, and realized)				

Balance Sheet as at January, 2010

Liabilities	Rs.	Assets	Rs.
Share Capital		Fixed Assets	
Authorised:		Goodwill	30,000
15,000 Equity shares of Rs.10 each	**1,50,000**	Premises	30,000
		Plant and machinery	15,000
1,000 Preference shares, of Rs.100 each	**1,00,000**	Furniture	2,000
Issued and Paid-up 15,000 Equity		Current Assets	
shares of Rs.10 each fully paid		Stock	12,000
	1,50,000	Book debts	26,500
1,000 preference shares of Rs.100		Bills receivable	1,500
each	1,00,000	Bank (Rs.1,70,000 – 20,000)	1,50,000
Current liabilities		Cash	3,000
Bills payable	5,000		
Creditors	15,000		
	2,70,000		2,70,000

Working Notes :

Calculation of Goodwill	**Rs.**
Total assets taken over	90,000
Less : Liabilities taken over	20,000
Net assets taken over	70,000
Purchase consideration	1,00,000
Value of goodwill shown in the balance sheet	30,000

7.2.2 Debtors and Creditors taken over on behalf of vendors:

Sometimes purchasing company may not take over the book debts and liabilities of the vendor company because it is possible that all the book debts may not be realized and payment to creditors may be more than estimated. The buyers do not want to take this risk. Hence, they do not take over book debts and liabilities. If it is so, it becomes very difficult for the vendor to realize book debts and pay the liabilities after the sale of business. In order to remove this difficulty, vendor appoints the purchasing company as his agent for realizing book debts and discharging liabilities. Purchasing company is paid commission for this purpose. The commission is generally fixed as a certain percentage of amounts collected and paid. In the process of collection of book debts and payment to creditors if any loss and expenses and gains such as bad debts, discounts, etc. arise, such profit or loss will have to be borne by the vendor. In this case, purchasing company opens a Vendor's Suspense Account in its books. The following journal entries are to be passed in the books of purchasing company.

Journal Entries in the books of the Purchasing Company

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1.	**For the acquisition of debtors and creditors, on behalf of vendor:**				
	Vendor's debtors a/c (Gross amount)	Dr.		x x x	
	To Vendor's creditors a/c (gross amount)				x x x
	To Vendor's suspense a/c				x x x
2.	**For realisation of amount of debtors:**				
	Bank a/c	Dr.		x x x	
	To Vendor's debtors a/c				x x x
3.	**For loss on account of bad debts and discount allowed on debtors:**				
	Vendor's suspense a/c	Dr.		x x x	
	To Vendor's Debtors a/c				x x x
4.	**For payment made to creditors:**				
	Vendor's creditors a/c	Dr.		x x x	
	To Bank a/c				x x x
5.	**For gain account of discount received from creditors:**				
	Vendor's creditors a/c	Dr.		x x x	
	To Vendor's suspense a/c				x x x
6.	**When irrecoverable bad debts are recovered:**				
	Bank a/c	Dr.		x x x	
	To Vendor's suspense a/c				x x x
7.	**For Commission due to purchasing Co.:**				
	Vendor's suspense a/c	Dr.		x x x	
	To Commission a/c				x x x
8.	**For final payment to settle the vendor's debtors and creditors:**				
	Vendor's suspense a/c	Dr.		x x x	
	To Bank a/c				x x x
	To Share capital a/c (if share are issued)				x x x
	To Debentures a/c (If debentures are issued)				x x x

Illu.5 : On 1-4-2010 ABC company Ltd., had bought certain assets from Rajesh. The company also undertook to collect his debts amounting to Rs.1,30,000 and to pay his creditors of Rs.30,000 for a commission of 3% on the amount collected and 1% on the amount paid. The debtors realized Rs.1,20,000 only and the creditors were

paid Rs.28,000 in full settlement. Rajesh received Rs.50,000 6% debentures and the balance in cash.

Journalise the transactions in the books of the ABC Company limited.

Solution :

Journal Entries in the books of ABC Company Limited

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Vendor's Debtors a/c Dr. To Vendor's creditors a/c To Vendor's Suspense a/c (Being the acquisition of debtors and creditors on behalf of vendor)		1,30,000	 30,000 1,00,000
	Bank a/c Dr. To Vendor's Debtors a/c (Being the realization of amount of debtors)		1,20,000	 1,20,000
	Vendor's Suspense a/c Dr. To Vendor's debtors a/c (Being the loss on account of bad debts to debtors)		10,000	 10,000
	Vendor's creditors a/c Dr. To Bank a/c (Being the payment made to creditors)		28,000	 28,000
	Vendor's creditors a/c Dr. To Vendor's suspense a/c (Being the irrecoverable bad debts are recovered)		2,000	 2,000
	Vendor's Suspense a/c Dr. To Commission a/c (Being commission due to purchasing company) (1,20,000 x 3/100 = 3,600 + 28,000 + 1/10 = 280)		3,880	 3,880
	Vendor's Suspense a/c Dr. To 6% Debentures a/c To Bank a/c (Being the final payment to settle the vendor's debtors and creditors)		88,120	 50,000 38,120

Vendor's Suspense a/c

	Rs.		Rs.
To Vendor's Debtors a/c	10,000	By Vendor's debtors a/c	1,00,000
To Commission	3,880	By Vendor's creditors a/c	2,000
To balance c/d	88,120		
	1,02,000		1,02,000
To 6% Debentures a/c	50,000	By Balance b/d	88,120
To Bank a/c (Bal.fig)	38,120		
	88,120		88,120

7.2.3 When same set of books are continued:

Sometimes on conversion of a business into a limited company no new set of books are opened but the books of the old business are continued. When the purchasing company decides to continue with the same set of books, then the following steps may be taken.

(i) **Revaluation of Assets and Liabilities:** A revaluation account should be opened where increased and decreased value of assets and liabilities are to be adjusted as is done in case of admission of a partner. The profit or loss on revaluation should be credited to partner's capital accounts in their old profit sharing ratio.

(ii) **Closing of assets and liabilities not taken over by the purchasing company:** Any asset or liability which is not taken over by purchasing company asset is worth its book value, the same can be transferred to capital accounts according to the ratio of final claim.

(iii) **Distribution of Reserves and Losses:** Any balance of accumulated or undistributed profits or reserves should be transferred to capital accounts in profit sharing ratio.

(iv) **Closing the capital accounts:** After making the above adjustments, the capital accounts are closed by debiting the capital accounts and crediting the shares or debentures or cash.

(v) **Preparation of revised balance sheet:** At this stage, a revised balance sheet can be prepared.

Debtors and Creditors are not taken over:

The following accounting treatment should carefully be followed if the debtors and creditors are not taken over by the company when the same set of books are continued.

(i) Debtors and Creditors account should not be closed.

(ii) Two separate accounts for debtors and creditors should be opened under the head "Debtors Suspense account" and "Creditors suspense account".

(iii) It should be remembered that the capital accounts of the vendors have already been credited for debtors who appeared in the balance sheet. As the new company is not taking over the debtors, vendors' capital account must be reduced by the like amount, without, however, canceling the accounts of debtors.

Illu.6 : X and Y are partners sharing profits and losses equally. Their balance sheet as on 31st December, 2009 is as under.

Liabilities	Rs.	Rs.	Assets	Rs.
Creditors		**20,000**	**Land and buildings**	**1,00,000**
Bills payable		**90,000**	**Plant and machinery**	**80,000**
Capital a/cs			**Fixtures**	**40,000**
X	**1,20,000**		**Stock in trade**	**20,000**
Y	**80,000**	**2,00,000**	**Bills receivable**	**10,000**
			Debtors	**50,000**
			Cash at bank	**10,000**
		3,10,000		**3,10,000**

On 1st January, 2010 the above business was purchased by X Ltd. for Rs.3,00,000 to be discharged by using shares of Rs.50 each credited as Rs.40 paid up. The company did not take over fixtures and bills payable. It was decided that the company would take Land and Buildings at Rs.1,35,000, Machinery at Rs.70,000. A provision for doubtful debts was also made at 5% of sundry debtors. There is a claim on account of bills discounted Rs.6,00,000 which the company agreed to take over. But the company refused to take over a workers claim of Rs.2,000 on account of accident. Bills payable was taken over by X at an agreed value of Rs.80,000. Fixtures were disposed off at Rs.34,000.

You are required to make journal entries in the books of the purchasing company assuming that the company continues to the same set of books.

Solution :

Journal Entries in the books of X Company Limited

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Bills payable a/c	Dr.		10,000	
	Land and buildings a/c	Dr.		35,000	
	To Revaluation a/c				45.000
	(Being the transfer of reduction in bills payable and increase in the value of land and buildings to revaluation a/c)				
	Revaluation a/c	Dr.		26,500	
	To Plant and machinery a/c				10,000
	To Provision for doubtful debts a/c				2,500
	To Claim on bills discounted a/c				6,000
	To Claim for accident a/c				2,000
	To Fixtures a/c (Rs.40,000 -34,000)				6,000
	(Being the transfer of reduction in the values of the assets and increasing the value of liabilities to revaluation account)				
	Revaluation a/c	Dr.		18,500	
	To X's capital a/c				9,250
	To Y's capital a/c				9,250
	(Being the transfer of profit on revaluation to partners' capital accounts)				
	Goodwill a/c	Dr.		33,500	
	To X's capital a/c				16,750
	To Y's capital a/c				16,750
	(Being goodwill raised in the books)				
	Claim for accidents a/c	Dr.		2,000	
	To X's capital a/c				1,361
	To Y's capital a/c				639
	(Being the liability for accident to be distributed between X and Y in the ratio of final claim)				
	X's capital a/c	Dr.		23,145	
	Y's capital a/c	Dr.		10,855	
	To Fixtures a/c				34,000
	(Being the amount realised from the proceeds of fixtures taken by X and Y)				
	Bills payable a/c	Dr.		80,000	
	To X's capital a/c				80,000
	(Being the bills payable taken by X)				

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	X's capital a/c	Dr.		2,04,216	
	Y's capital a/c	Dr.		95,784	
	To Share capital a/c				3,00,000
	(Being the final settlement made by the issue of shares)				

Working Notes :

1. Calculation of goodwill :

		Rs	Rs.
	Assets taken over :		
	Land and buildings	1,35,000	
	Plant and machinery	70,000	
	Stock in trade	20,000	
	Bills receivable	10,000	
	Debtors	50,000	
	Cash	10,000	2,95,000
Less :	Liabilities taken over		
	Creditors	20,000	
	Claim on bills discounted	6,000	
	Provision for doubtful debts	2,500	28,500
	Net Assets taken over		2,66,500
	Less : Purchase consideration		3,00,000
	Goodwill		33,500

X's share =- Rs.33,500 x ½ = Rs.16,750; Y's share = Rs.33,500 x ½ = Rs.16,750

2. Calculation of Ratio of final claims :

	X Rs	Y Rs.
Balance b/d	1,20,000	80,000
Profit on revaluation	9,250	9,250
Goodwill	16,750	16,750
Bills payable	80,000	-
	2,26,000	1,06,000
	226	106
Ratio	113	53

Revaluation A/c

	Rs.		Rs.
To Plant and machinery	10,000	By Bills payable a/c	10,000
To Provision for doubtful debts a/c	2,500	By Land and buildings a/c	35,000
To Claim on bills discounted a/c	6,000		
To Claims for accidents a/c	2,000		
To Fixtures a/c	6,000		
To X's capital a/c	9,250		
To Y's capital a/c	9,250		
	45,000		45,000

Partners' Capital Accounts

Particulars	**X Rs.**	**Y Rs.**	**Particulars**	**X Rs.**	**Y Rs.**
To Fixtures	23,145	10,855	By Balance b/d	1,20,000	80,000
To Share capital	2,04,216	95,784	By Goodwill	16,750	16,750
			By Claim for accident	1,361	639
			By Bills payable	80,000	-
			By Revaluation a/c	9,250	9,250
	2,27,361	1,06,639		2,27,361	1,06,639

7.3 PROFITS PRIOR TO INCORPORATION

A company comes into existence after its incorporation. For incorporating a company, the promoter may purchase the existing business of a sole trading organization or partnership. In such cases, the business unit is purchased first and the registration of the acquiring company takes place later. The profit earned (or loss suffered) during the pre-incorporation period is called profit (loss) prior to incorporation. As per the provisions of the Companies Act, 1956 this profit is not available for dividend, since a company cannot earn profit before it comes into existence. However, profit earned after incorporation is available for distribution of dividend. Profit earned before incorporation is a **capital profit** and profit earned after incorporation is a **revenue profit.**

7.3.1 Treatment of Profits or Losses Prior to Incorporation:

The method of treatment of profits or losses prior to incorporation is given below:

Profit prior to Incorporation

(i) Being capital profit in its nature, it cannot be allowed to be a part of profit and loss account.
(ii) It should not be used for payment of dividend to the shareholders.
(iii) It is preferable to credit it to 'Capital Reserve Account' which may be used to write off capital losses and expenses like 'preliminary expenses', 'underwriting commission', 'discount on issue of debentures' etc. Unutilized portion of such capital reserve appears in the liabilities side of the balance sheet under the heading 'reserves and surpluses.'

Loss prior to Incorporation:

(i) Being a 'capital loss', it should not be allowed to be a part of profit and loss account.
(ii) It can be debited to a separate account called 'Loss prior to incorporation account.' This loss can be written off using other capital profits of the company. It appears on the assets side of the balance sheet under the heading 'miscellaneous expenditure'.
(iii) It may be treated as goodwill and debited to goodwill account.
(iv) It may also be treated as 'deferred revenue expenditure' and may be written off out of the profits of the company over several years.

Ascertainment of Profit:

The profit or loss prior to incorporation may be ascertained by preparing the following.
(i) Trading and Profit and Loss account for the period upto the date of incorporation.
(ii) Trading and Profit and loss account for the whole accounting period and apportionment of the resulting profit or loss between pre and post incorporation periods.
(iii) Common Trading Account and the Profit and Loss Account in 'columnar form'.

7.4 ALLOCATION OF EXPENSES - BASES

In the preparation of the above statements, the important problem is the apportionment of expenses. The expenses are to be apportioned to the pre incorporation and post incorporation period on the basis of certain bases explained below.

1. **Time Ratio:** This is the ratio of months or days before and after incorporation during the accounting period. All expenses of a company which can be linked or related to 'time' must be dividend between pre and post incorporation periods in Time Ratio. Examples are salaries, rent, stationery, postage, depreciation, bank charges, interest etc.

2. **Weighted or Adjusted Time Ratio:** If any changes were made in the number of employees, or office accommodation, etc. weightage must be given to the changes in arriving at the time ratio. Such a ratio is called “Weighted Time Ratio.”

3. **Sales ratio:** This is the ratio of sales or turnover of the company before and after incorporation. Sales ratio is the logical basis to divide the gross profit earned by the company. Similarly, all expenses related to sales are also to be apportioned in sales ratio. Examples: Advertising, salesmen’s commission, sales promotion expenses, carriage outwards, bad debts, discount allowed etc.

4. **Weighted Sales Ratio:** If sales were not uniform through the accounting period, weightage must be given to the trends observed in the sales. Sales ratio adjusted for the change in trend is called weighted sales ratio.

7.5 APPORTIONMENT OF EXPENSES

Specific expenses which can be identified with either period have to be fully allocated to that period. All company related expenses like debenture interest, directors’ remuneration or fees, preliminary expenses written off, donations given by the company, etc., have no connection with the pre incorporation period. So they, must be fully charged to the post incorporation period. Similarly, partners’ salaries, interest on purchase price till the date of incorporation may be allocated to the pre-incorporation period.

7.5.1 Actual Expenditure:

If specific details are available about any particular item of expenditure as to how much was spent in the pre and post incorporation periods, the actual amount should be charged to the respective periods.

The following table clearly gives the bases for apportionment of expenses.

7.5.2 Apportionment of Expenses

	Type of expenses	**Basis of Apportionment**
1.	Gross profit/loss	Sales ratio or weighted sales ratio
2.	All fixed expenses like salaries, rent, rates, taxes, insurance, depreciation, postage etc.	Time ratio or weighted time ratio
3.	All variable expenses directly varying with turnover like commission, discount, salesmen’’ remuneration, advertisement, carriage outwards	Sales ratio or weighted sales ratio
4.	All expenses related to pre incorporation period alone such as vendor’s salary till the incorporation date	Allocation to the pre incorporation period.

	Type of expenses	Basis of Apportionment
5.	All expenses wholly applicable to post incorporation period like director's fees, debentures interest, discount on issue of debentures, preliminary expenses donations given by the company etc.	Allocation to the post incorporation period.

Illu.7: Ganesh Ltd. purchased a business on 1.4.2009. The company obtained certificate of incorporation on 31.7.2009. From the following particulars for the year ending 31.3.2010, ascertain profit prior to incorporation and divisible profits.

(a) Total sales upto 31.7.2009 to Rs.10,00,000; Sales from 1.4.2009 to 31.7.2009 Rs.2,50,000

(b) Gross profit for the year Rs.2,12,000

(c) Expenses debited to profit and loss account were as under:

Particulars	Rs.	Particulars	Rs.
Rent	**6,000**	**Printing & Stationery**	**4,200**
Insurance	**1,500**	**Depreciation on machinery**	**30,000**
Salaries	**27,000**	**Commission on sales**	**12,600**
Selling expenses	**9,000**	**Bad debts (Rs.850 related to pre incorporation)**	
Advertisement	**8,000**	**General Expenses**	**4,800**
Interest on debentures	**4,000**	**Preliminary expenses**	**7,200**
Audit fees	**1,200**	**Interest paid to vendors upto 1st September 2009**	**5,000**
Directors' fees	**2,600**		

Solution:

Profit and Loss account for the year ended 31st March, 2010

Particulars	Basis of Allocation	Prior to Incorporation Rs.	After Incorporation Rs.
Gross Profit	Sales	53,000	1,59,000
Apportionment of expenses			
Rent	Time	2,000	4,000
Insurance	Time	500	1,000
Salaries	Time	9,000	18,000
Selling expenses	Sales	2,250	6,750
Advertisements	Sales	2,000	6,000

Particulars	Basis of Allocation	Prior to Incorporation Rs.	After Incorporation Rs.
Interest on Debentures			4,000
Auditor Fees			1,200
Printing and Stationery	Time	1,400	2,800
Depreciation	Time	10,000	20,000
Commission on sales	Sales	3,150	9,450
Bad debts	Actual	850	1,550
General Expenses	Time	1,600	3,200
Directors' fees	-	-	2,600
Preliminary e3xpenses			7,200
Interest paid to Vendors	Time	4,000	1,000
Total expenses		36,750	88,750
Net Profit (Gross Profit – Expenses)		16,250	70,250

Working Notes :

Pre incorporation Sales (1-4-2009 to 31-7-2009) = Rs.2,50,000

Post incorporation sales (1-8-2009 – 31-3-2010) = Rs.7,50,000

Sales Ratio = Rs.2,50,000 : 7,50,000 (or) 1:3

Time ratio = 4 months : 8 months (or) 1:2

Illu.8: X company limited incorporated on 1st April, 2009 took over running business from 1st January, 2009. X company prepares its fist final accounts on 31st December, 2009. From the following information, you are required to calculate the sales ratio of pre incorporation and post incorporation periods.

a. **Sales (January, 2009 to December 2009) – Rs.7,20,000**
b. **The sales for the month of January – Twice of the average sales.**
c. **For the month of February equal to average sales.**
d. **Sales for four months May to August – 1/3 of the average of each month.**
e. **Sales for October and November – Three times the average sales.**

Solution:

$$\text{Average Sales per month} = \frac{\text{Rs.7,20,000}}{12} = \text{Rs.60,000}$$

Sales for the month of :

		Rs.
January	Rs.60,000 x 2	1,20,000
February	Rs.60,000 x 1	60,000
May	Rs.60,000 x ¼	15,000
June	Rs.60,000 x ¼	15,000
July	Rs.60,000 x ¼	15,000
August	Rs.60,000 x ¼	15,000
October	Rs.60,000 x 3	1,80,000
November	Rs.60,000 x 3	1,80,000
Total Sales for 8 months		**6,00,000**

Sales for the remaining 4 months = Rs.7,20,000 – 6,00,000 = Rs.1,20,000

Average sales for the remaining months = $\frac{1,20,000}{4} = Rs.30,000$

Pre incorporation Sales = (January + February + March)

= Rs.1,20,000 + 60,000 + 30,000 = Rs.2,10,000

Post incorporation sales = Rs.7,20,000 – Rs.2,10,000 = Rs.5,10,000

Sales ratio of pre incorporation to post incorporation period
= Rs.2,10,000 : 5,10,000 = 7:17

Illu.9 : You are required to calculate the Time ratio for the pre and post incorporation periods from the following particulars. Also divide the total wages between the pre and post incorporation periods.

(i) Date of incorporation – 1st April, 2009
(ii) Period of financial accounts : January 2009 to December 2009
(iii) Total Wages = Rs.96,000
(iv) No. of workers - Pre incorporation period = 6;
Post incorporation period = 30

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Solution :

Simple Time ratio = 3 months : 9 months = 1:3

Weighted time ratio = Time ratio x No. of workers

= (1 x 6) : (3 x 30) = 6 : 90 = 1:15

Total wages are to be divided on the basis of weighted time ratio.

Wages for pre incorporation = Rs.96,000 x 1/16 = Rs.6,000

Wages for post incorporation = Rs.96,000 x 15/16 = Rs.90,000

Illu.10: Viswa Bharathy Company which was carrying on business from 1st January, 2009 gets itself incorporated as a company on 1st May, 2009. The first accounts are drawn up to 30th September, 2009. The gross profit for the period is Rs.56,000. The general expenses are Rs.14,220; Directors' fees Rs.12,000 p.a., formation expenses Rs.1,500. Rent up to 30th June is Rs.1,200 p.a., after which it is increased to Rs.3,000 per annum. Salary of the manager, who upon incorporation of the company was made a director, is Rs.6,000 p.a. His remuneration thereafter is included in the above figure of fees to directors.

Give Profit and Loss Account showing pre-and post-incorporation profits. The net sales are Rs.8,20,000, the monthly average of which for the first four months of 2009 is one half of that of the remaining period, the company earned a uniform profit. Interest and tax may be ignored.

Solution :

Profit and Loss a/c of Viswa Bharath Company.
for the ended 30th September, 2009

Particulars	Basis of Allocation	Prior to Incorporation	After Incorporation	Particulars	Basis of Allocation	Prior to Incorporation	After Incorporation
To General expenses	(Time 4:5)	6,320	7,900	By Gross Profit	(Sales 2:5)	16,000	40,000
To Rent		400	950				
To Manager's Salary		2,000	---				
To Director's Remuneration		---	5,000				

		Rs.	Rs.			Rs.	Rs.
To Capital Reserve (Pre-incorporation profit transferred)		7,280	---				
To Net Profit c/d		---	26,150				
		16,000	40,000			16,000	40,000
To Formation expenses			1,500	By Net Profit		---	26,150
To Balance of Profit			24,650				
			26,150				26,150

Working Notes:

1. Gross profit is to be distributed on the basis sales value.

   Let us assume
   Sales for first four months = 1
   Sales for next months = 2
   Pre incorporation period (4 months) = 1 x 4 = 4
   Post incorporation period (5 months) = 2 x 5 = 10

   4 : 10 or 2 :5

2. Rent = For 4 months @ Rs.100 = Rs.500 (pre incorporation)
   For 2 months @ Rs.100 = Rs.200 (post incorporation)
   For 3 months @ Rs.250 = Rs.750 (post incorporation)
   Monthly rent upto June = Rs.1,200/12 = Rs.100

   Rent from January 1st to April 30th (4 months) = 4 months x Rs.100 = Rs.400

   Rent from May 1st June 30th (2 months) = 2 months Rs.100 = Rs.200

   Monthly rent from July (Rs.3,000/12) = Rs.250

   Rent from July 1st to September 30th (3 months) = 3 months x Rs.250 = Rs.750

   Pre incorporation rent = Rs.400; Post incorporation rent = Rs.950.

Illu.11 The following trial balance was extracted from the books of Aditya Pvt. Ltd. formed by Mr. Anand of Hyderabad on 1st April, 2009 but was incorporated on 1st July 2009. No entries relating to the transfer of the business were entered in the books which was carried on until 31st March, 2010.

Trial Balance as on 31st March, 2009

	Debit Rs.	Credit Rs.
Stock (1-4-2009)	42,940	
Sales	--	2,79,300
Purchases	1,96,780	--
Carriage outwards	1,650	
Traveller's Commission	6,150	
Office Salaries	16,640	
Rent & Taxes	1,640	
Office expenses	2,400	
Capital of Mr. Anand (1-4-2009)	--	2,00,000
Directors' Salary	15,000	
Fixed Assets	1,25,000	
Current Liabilities		31,660
Current Assets (other than stock)	1,01,200	
Preliminary Expenses	1,560	
	5,10,960	5,10,960

Further Information:

(i) **Stock on 31st March, 2010 amounted to Rs.35,420**

(ii) **Purchase consideration Rs.2,50,000 to be paid by the issue of 25,000 equity shares of Rs.10 each**

(iii) **Gross profit percentage is fixed, turnover is double in April, November, and December.**

(iv) **Preliminary expenses are to be written off.**

(v) **Carriage outward and travellers' commission vary in direct proportion to sales.**

Prepare trading and profit and loss account for the year ended 31st March, 2010 appropriating between the pre and post incorporation periods and a balance sheet as on 31st March, 2010

Solution:

Dr. Trading A/c of Aditya Pvt. Ltd. for the year ended 31.3.2010 Cr.

Particulars	Rs.	Particulars	Rs.
To Opening stock	42,940	By Sales	2,79,300
To Purchases	1,96,780	By Closing stock	35,420
To Gross profit c/d	75,000		
	3,14,720		**3,14,720**

Profit and Loss Account of Aditya Pvt. Ltd. for the year ended 31st March, 2010

Particulars	Basis of Apportionment	Pre Incorporation	Post Incorporation	Total	Particulars	Basis of Apportionment	Pre Incorporation	Post Incorporation	Total
		Rs.	Rs.	Rs.			Rs.	Rs.	Rs.
To Office expenses	1:3	4,160	12,480	16,640	By Gross Profit b/d	4:11	20,000	55,000	75,000
To Directors salary		--	15,000	15,000					
To Rent & Taxes	1:3	410	1,230	1,640					
To Office Expenses	1:3	600	1,800	2,400					
To Travellers commission	Sales ratio	1,640	4,510	6,150					
To Carriage outwards	”	440	1,210	1,650					
To Preliminary expenses		--	1,560	1,560					
To Net profit c/d		12,750	17,210	29,960					
		20,000	**55,000**	**75,000**			**20,000**	**55,000**	**75,000**

Balance Sheet of Aditya Pvt. Ltd., as on 31st March, 2010

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
25,000 shares of Rs.10 each		Goodwill	37,250
fully paid	2,50,000		
(All the shares issued for		Other fixed assets	1,25,000
consideration other than cash)	--		
Reserves & Surpluses:		Current Assets, Loans &	
		Allowances:	
Profit & Loss A/c	17,210	Current Assets other than	1,01,200
		stock	
Current Liabilities	31,660	Closing Stock	35,420
	2,98,870		**2,98,870**

Working Notes:

1. Sales ratio =
   Let us assume sales as x
   Sales for the months of April, November and December = 2x

   Pre incorporation period = April 1st to July 1st = 3 months

   Post incorporation period = July 1st to March 31st = 9 months

   Sales prior to incorporation = April 2x + May x + June x = 4 x

   Sales post incorporation = (July + August + September + October + 4x + November 2x + December 2x + January, February, March = 3x) = 11x

   Sales ratio = 4x : 11x = 4:11
   Time ratio = 3 months : 9 months = 1:3
   Traveller's commission, Carriage outwards are to be distributed proportionately on the basis of sales.

2, Traveller's commission :

a. Pre incorporation = If Rs.75,000 – Rs.6,150

$$\text{Rs.}20{,}000 = \text{-}\ ? = \frac{20{,}000}{75{,}000} \times 6{,}150 = \text{Rs.}1{,}640$$

Post incorporation = If Rs.75,000 – Rs.6,150

$$= \text{Rs.}55{,}000 = ? = \frac{55{,}000}{75{,}000} \times 6{,}150 = \text{Rs.}4{,}510$$

3. Carriage outwards :

a. Pre incorporation = Rs.75,000 - Rs.1,650

= Rs.20,000 - ? = $\frac{20,000}{75,000} \times 1,650 =$ Rs.440

b. Post incorporation = Rs.75,000 – Rs.1,650

Rs.55,000 - ? = $\frac{55,000}{75,000} \times 1,650 =$ Rs.1,210

7.6 SELF ASSESSMENT QUESTIONS

1. What is meant by acquisition of business?
2. What is 'Acquisition of Business'? Explain the methods of computing purchase consideration on acquisition of business.
3. Business acquisition
4. What is the need for calculating 'Profit prior to Incorporation?
5. How do you deal with 'Profit prior to Incorporation' in Account?
6. What is Profit prior to Incorporation? How do you treat it in Accounts?
7. Describe the methods of ascertaining 'Profit prior to Incorporation'
8. How do you apportion various expense and incomes between Pre and Post incorporation periods?
9. What do you mean by profit prior to incorporation?
10. Elucidate the ascertainment of profits prior to incorporation
11. Profit during pre and post incorporation
12. How will you ascertain profits prior to incorporation?

7.7 EXERCISES

1. A company was established with Rs.5,00,000 authorised capital of 25,000 equity shares at Rs.100 each and 2,500 6% Preference shares of Rs.100 each. They want acquire the continuing business of X and his balance sheet given below.

Liabilities	Rs.	Assets	Rs.
Bills payable	3,500	Cash	4,500
Sundry Creditors	6,400	Book debts	7,500
Capital	1,32,100	Stock	35,000
		Machinery	50,000
		Buildings	45,000
	1,42,000		1,42,000

The company agreed for a purchase consideration of Rs.1,75,000. This will be paid in the form of equity shares Rs.50,000, fully paid, Preference Shares of Rs.50,000 fully paid, Rs.30,000 redeemable debentures and the remaining in the form of cash.

The remaining shares were issued to the public and all the amount was paid except 600 equity shares at Rs.3 each. Later these share were forfeited and were issued at a discount of 20%. Write the necessary journal entries for the above transactions and show the Opening Balance Sheet of the company.

[Ans.: Balance Sheet Total Rs.5,39,900; Value of Goodwill Rs.39,900]

2. A company acquired M/s X, Y Business on January 1st, 2010. The company agreed to leave the profit and losses in its implementation to its vendors while allowing them to realise the debts and the payment to the creditors by giving 3% on the cash realised and 2% on cash payment as commission. On the date of purchase the value of debtors were Rs.40,000 and the value of creditors Rs.6,000

After 3 months the company stated the following. Rs.24,000 including the past debt were Rs.1,500 was collected from the debtors. Discount given Rs.600. The creditors were paid fully and discount allowed was Rs.200. However, a claim Rs.500 paid as compensation to a customer for supplying the goods lately. Write journal entries for these transactions in the books of the company.

3. A and B carrying on business in partnership, sharing profits and losses in the ratio of 3:2 wish to dissolve the firm and sell the business to a limited company on 31st December, 2009 when the firm's balance sheet stands as under.

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**
Capital Accounts:			Furniture	8,000
A	70,000		Motor Car	12,000
B	50,000	1,20,000	Stock	81,000
Reserve		20,000	Debtors	60,000
Sundry Creditors		25,000	Cash	4,000
		1,65,000		1,65,000

A limited company with an authorised capital of Rs.3,00,000 in equity shares of Rs.10 each is registered to purchase the above business on the following terms.

i. Goodwill is valued at Rs.30,000
ii. Furniture and stock are revalued at Rs.6,000 and Rs.85,000 respectively.
iii. Debtors are subject to 5% provisions.
iv. Motor car is not required by the company and A takes over the same at an agreed valuation of Rs.8,000.
v. Purchase consideration is satisfied by the issue of equity shares of Rs.10 each at par.

Show Journal entries and Balance Sheet of the company assuming that the same set of books is continued.

[Ans.: Value of purchase Rs.1,57,000; Gross Loss Rs.5,000; Value of Goodwill Rs.30,000; Balance Sheet Total Rs.1,82,000]

4. Radha Madhav Ltd., was incorporated on 1st August 2009. It took over the business of M/s Venu Madhav Ltd. with effect from 1st April 2009. From the following figures relating to the year ending 31st March, 2010 ascertain profit prior to incorporation and profit after incorporation.

a. Sales for the year were Rs.60,00,000 out of which sales upto 1st August, 2009 were Rs.25,00,000

b. Gross profit for the year was Rs.18,00,000

c. The expenses debited to profit and loss account were as follows:

	Rs.
Rent	90,000
Salaries	1,50,000
Directors' fees	38,000
Interest on Debentures	60,000
Company Audit fees	15,000
Discount on sales	36,000
Depreciation	2,40,000
General expenses	48,000
Advertising	1,80,000
Stationery and Printing	36,000
Commission on Sale*s	60,000
Interest to vendors on Purchase consideration upto 1st October, 2009	30,000
Bad debts	15,000

Rs.5,000 of bad debts mentioned above relate to debts created prior to incorporation.

[Ans.: Net Profit (Prior to Incorporation) Rs.4,22,000; Net Profit (After Incorporation) Rs.3,80,000]

5. X Limited was incorporated on 1st May 2010 to acquire a business on 1st January, 2010. The first accounts were closed on 30th September, 2010.

	Rs.
Gross profit for the period was	42,000
Details of other expenses are given below:	
General expenses	7,200
Director's remuneration	12,000
Preliminary expenses	2,000

Rent upto 30th June was Rs.6,000 per annum after which it was increased by 40%.
Salary of the Manager, who on formation of the company had become a whole time director and whose remuneration has been given above, was agreed to be remunerated at Rs.5,100 p.a.
The company earned a uniform gross profit. The sales upto September, 2010 were Rs.98,000. The monthly average of sales for the first four months of the year was one half of the remaining period.
Show the Profit and Loss account and indicated how you would deal with the pre-incorporation results.

[Ans.: Pre-incorporation profit transferred to Capital Reserve Rs.5,100; After-incorporation Net Profit Rs.8,900]

6. A Co. Ltd. was incorporated on May 1, 2009, to take over business of X Company Ltd. as a going concern from January 1st, 2009. The profit and loss account for the year ending December 31st, 2009 is as follows:

Particulars	Rs.	Particulars	Rs.
To Rent, Taxes	12,000	By Gross profit	1,55,000
To Insurance	3,000		
To Electricity charges	2,400		
To Salaries	36,000		
To Directors fees	3,000		
To Auditor's fees	1,600		
To Commission	6,000		
To Advertisements	4,000		
To Discount	3,500		
To Office expenses	7,500		
To Transport	3,000		
To Bank charges	1,500		
To Preliminary expenses	6,500		
To Bad debts	2,000		
To Interest on Loan	3,000		
To Net profit	60,000		

1,55,000	1,55,000

The total turnover for the year ending December 31st, 2009 was Rs.5,00,000 divided into Rs.1,50,000 for the period upto May 1st, 2009 and Rs.35,000 for the remaining period.

Ascertain the profits earned prior to incorporation of the company.

Note: Auditors' fee and bank charges have been divided in time ratio.

[Ans.: Pre-incorporation Net Profit Rs.18,550; Post-incorporation Net Profit Rs.41,450]

7. ABC Ltd. was incorporated on 1st May 2010 and was entitled to commence business on 1st June 2010. It had acquired a running business as from 1st January, 2010. The profit and loss account for 2010 was as under:

Particulars	Rs.	Particulars	Rs.
To Salaries	40,000	By Gross profit	2,00,000
To Carriage	15,000		
To Advertisements	20,000		
To General expenses	10,000		
To Interest on Debentures	6,000		
To Director's fees	4,000		
To Audit fees	5,000		
To Depreciation on fixed assets	20,000		
To Interest to vendor (upto June 30th)	10,000		
To Net profit	70,000		
	2,00,000		2,00,000

Ascertain the profit prior to incorporation. Sales upto 1st May, 2010 were Rs.2,00,000 and after 1st May Rs.8,00,000.

[Ans.: Prior to incorporation profit Rs.1,333; After incorporation profit Rs.68,667]

8. The Partners of Bharathi Agencies decided to covert the partnership into a Bharath Limited Company with effect from January 1, 2009. The consideration was agreed at Rs.1,17,00,000 based on the firm's balance sheet as at 31st December, 2008. Meanwhile, the business was continued on behalf of the company and the consideration was settled on that day with interest at 12% per annum. The same books of accounts were continued by the company which closed its accounts for the first time on 31st March, 2010 and prepared following summarised profit and loss account.

	Rs.
Sales	2,34,00,000
Cost of goods sold	1,63,80,000
Salaries	11,70,000
Depreciation	1,80,000
Advertisements	7,02,000
Discount	11,70,000
Managing Director's remuneration	90,000
Office expenses	1,20,000
Office-cum-show room rent	7,20,000
Interest	9,51,000
	2,14,83,000
Profit	19,17,000

The company's only borrowing was a loan of Rs.50,00,000 at 12% p.a. to pay the purchase consideration due to the firm and for working capital requirements.

The company was able to double the average monthly sales of the firm from 1st April, 2009 but salaries trebled from that date. It had to occupy additional space from 1st July, 2009 for which rent was Rs.30,000 per month.

Prepare a profit and loss account in columnar form apportioning costs and revenue between pre-incorporation and post-incorporation periods. Also suggest how the pre-incorporation profits are to be dealt with.

[Ans.: Pre-incorporation loss Rs.19,000; Post-incorporation Profit Rs.19,36,000]

9. Pragathi Industries Private Limited was incorporated on 1-2-2009. It took over the proprietary business of Pragathi with effect from 1-1-2009. The Balance Sheet of Pragathi as at 31st December, 2009 as follows:

Liabilities	Rs.	Assets	Rs.
Capital	4,31,500	Sundry debtors	25,700
Trade Creditors	17,000	Buildings	1,10,000
Loans	8,500	Machinery	3,00,000
Creditors expenses	2,500	Loss	23,800
	4,59,500		4,59,500

It was agreed to pay Rs.4,50,000 in equity share to Pragathi. The company decided to close its first year's accounts as at 31st December, 2009. The following are the further detailed furnished to you.

Sales Rs.3,00,000; Purchases Rs.1,40,000; Salaries, Wages Rs.40,000; General Expenses Rs.32,000; Freight Rs.4,700; Interest paid Rs.8,000; Stock-in-trade Rs.22,000; Additions to buildings Rs.38,000; Depreciation may be provided at 10% on assets including additions.

The company has requested you to prepare: (1) The Journal entries for the take-over (2) Pragathi's Account and (3) Profit and Loss account showing separately pre-incorporation and post-incorporation profits for the year ending 31st December, 2009.

[Ans.: Goodwill Rs.42,300; Pre-incorporation profit Rs.4,375; Post-incorporation profit Rs.48,125; (1) For lack of information gross profit and all expenses have been apportioned on the basis of time i.e., 1:11 (2) Depreciation on Building Rs.14,800]

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Chapter –8

AMALGAMATION

Objective :

After studying this unit you should be able to

- explain the meaning of amalgamation, absorption and reconstruction
- explain Accounting Standard-14 on the amalgamation of companies
- find out the methods of calculation of purchase consideration
- know the liquidation expenses and accounting procedure in the amalgamation of companies.

Structure :

8.1 INTRODUCTION

8.1.1 Amalgamation:

When two or more companies carrying on similar business go into liquidation and a new company is formed to take over their business, it is called Amalgamation. Amalgamation refers to two or more companies merging to form a new company. Ex. Z Ltd., is formed to take over the business of X Ltd., and Y Ltd.

Absorption: When one existing company takes over the business of one or more existing companies it is called absorption. It refers to the acquisition of business by an existing company. Ex. X Ltd., takes over the business of Y Ltd. In absorption no new company is formed.

8.1.2 Reconstruction:

Reconstruction is of two types.

(a) External Reconstruction: External reconstruction means an existing company is liquidated and a new company is formed with the same shareholders to takeover structure. Here reconstruction means reorganization of a company's financial structure. Ex. X Ltd., is liquidated to X Ltd. (New) to take over the business of X Ltd. (Old). In this type of reconstruction the assets and liabilities of the company will be revalued, the losses suffered by the company will be written off. It is made by a deduction of the paid-up value of shares and/or varying of the rights attached to different classes of shares and compounding with the creditors.

(b) Internal Reconstruction: The capital structure is reorganized without forming a new company. This is also known re-organization which also includes scheme of capital reduction. (See next chapter).

8.1.3.Important Concepts :

1. **Vendor Company:** The Company which sells its business is termed as Vendor Company.
2. **Purchasing Company:** The Company that purchases the business is known as purchasing company.
3. **Purchase consideration:** Purchase price paid by purchasing company to the vendor company for acquiring the business.

Let us now go through the accounting standard relating to amalgamation of companies.

8.2. ACCOUNTING STANDARD – 14

This standard deals with accounting for amalgamations and treatment of any resultant goodwill or reserve. The standard classifies amalgamation into two categories i.e., (i) Amalgamation in the nature of merger; and (ii) Amalgamation in the nature of purchase.

8.2.1 Amalgamation in the nature of merger:

An amalgamation should be considered to be an amalgamation in the nature of merger when all the following conditions are fulfilled.

(a) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(b) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than equity shares already held therein, immediately before the amalgamation by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(c) The consideration of the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

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

(e) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

8.2.2 Amalgamation in the nature of purchase:

Amalgamations which do not satisfy one or more conditions specified for amalgamations in the nature of merger should be treated as 'Amalgamations in the nature of purchase'. Thus, in amalgamation in the nature of purchase:

(a) all the assets and liabilities of the selling company may not be taken over.
(b) Less than 90% of the selling company's shareholders may become shareholders in the purchasing company.
(c) consideration payable to shareholders of selling company may be in the form of shares or cash or in any other form agreed upon.
(d) selling company's business may or may not be carried on in future.
(e) assets and liabilities taken over by the purchasing company may be shown at values other than values at the discretion of the purchasing company.

8.3. SOME IMPORTANT TERMS

While recording transactions in the books of the purchasing and selling companies, the following must be noted.

1. **Trade Liabilities :** Trade liabilities include liabilities for purchase of goods i.e., Trade Creditors and Bills payable.
2. **Liabilities :** When liabilities are taken over, it includes all the amounts due to outsiders, excluding the shareholders.
3. **Assets :** When assets are taken over by a purchasing company, that implies all the tangible and intangible assets including cash and bank balance. However, fictitious assets which are nothing but losses are excluded from the meaning of assets.
4. **Business :** The term business implies all assets and external liabilities. External liabilities are the amount payable to all outsiders except shareholders.

5. **Provisions and losses :** In the balance sheet of selling company accumulated losses like the profit and loss account debit balance, preliminary expenses, discount on issue of shares etc., may appear on the assets side. Provisions like provision for doubtful debts, provision for depreciation etc., may appear on the liabilities side of the balance sheet or may be shown as deductions on the assets side from the assets concerned. The losses are transferred to the shareholders whereas provisions are transferred to realization account along with the respective assets.
6. **Accumulated profits :** Undistributed profits of both revenue and capital nature may appear on the liabilities side of the balance sheet. They are transferred to the equity shareholders account.

The following table is useful in distinctly identifying provisions, reserves, losses, trade liabilities and other liabilities.

Trade Liabilities	**Liabilities**	**Provisions, Accumulated losses**	**Accumulated profits**
1. Creditors (or) Trade Creditors 2. Bills payable	1. Trade creditors 2. Bills payable 3. Bank Overdraft 4. Debentures 5. Bank Loans 6. Workmen's savings bank a/c 7. Workmen's profit sharing fund 8. Provident fund 9. Pension fund 10. Provision for taxation 11. Unclaimed dividend 12. Outstanding expenses	1. Provision for depreciation 2. Provision for doubtful debts 3. Investment fluctuation fund 4. Preliminary expense 5. Discount on issue of shares and debentures 6. Profit and Loss a/c (Dr.)	1. Profit and Loss a/c (Cr) 2. General reserve fund 3. General reserve a/c 4. Debenture redemption fund a/c 5. Capital reserve 6. Capital redemption reserve a/c 7. Forfeited shares a/c 8. Share premium a/c 9. Workers' compensation fund a/c 10. Workmen's accident fund 11. Insurance fund 12. Dividend equalization fund

8.4 CALCULATION OF PURCHASE CONSIDERATION

The purchase consideration is calculated in the following ways.

8.4.1 Consideration – Meaning:

As per AS-14 consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. This meaning has the following implications:

(a) **Shareholders :** Purchase consideration is restricted to the total amount payable to the shareholders of the selling company alone.

(b) **Debenture holders or Creditors :** Any amount agreed to be paid to the debenture holders or creditors of the selling company cannot be included in the purchase consideration. As a result, it is necessary to transfer such liabilities to the purchasing company. In purchasing company's books, payment made for such liabilities can be shown.

(c) **Liquidation expenses :** Any amount agreed to be paid for the liquidation expenses of selling company also creates a problem.

(i) They can be added to purchase price on the basis that such payment benefits the shareholders of the selling company as they will not be required to bear such expenses.

(ii) They can be treated as reimbursement. Selling company pays cash for the expenses and gets back the amount from purchasing company.

8.4.2 Computation of Purchase Consideration:

Purchase consideration can be computed under any of the following methods, whichever is appropriate based on the data given.

(a) Lumpsum method.
(b) Net assets method;
(c) Net payment method; and
(d) Intrinsic value method or shares exchange method.

8.4.3 Lumpsum Method:

In this method, purchase consideration is paid in a lumpsum amount to vendor.

8.4.4 Net Assets Method:

According to this method, purchase consideration is calculated by adding agreed value of assets taken over by the purchasing company minus agreed value of the liabilities to be assumed by the purchasing company. In other words, the purchase consideration is determined a follows:

	Rs.
Agreed value of the all the assets taken over	x x x
Less: Agreed value of Liabilities taken over	x x x
Purchase consideration	x x x
Add: Liquidation expenses agreed to be paid by purchasing company	x x x
Total Purchase consideration	x x x

Note:

1. **All assets taken over:** The term "all assets" includes cash in hand, and cash at bank and excludes fictitious assets such as profit and loss account Debit balance, discount on issue of shares and debentures, preliminary expenses and underwriting commission.
2. **Liabilities:** Liabilities to third parties.
3. **Business taken over:** Both assets and liabilities taken over.

Illu.1: Videocon Company Ltd. agreed to take over Khytan Co. Ltd., on 31st March, 2010. On that date the balance sheet of Khytan Co., Ltd., is given below

Liabilities	Rs.	Assets	Rs.
Share Capital: 6,000 Equity shares of Rs.100 each	**6,00,000**	**Goodwill**	**2,80,000**
15% Debentures	**1,00,000**	**Land and Buildings**	**1,60,000**
Sundry Creditors	**60,000**	**Plant and Machinery**	**2,80,000**
General Reserve	**40,000**	**Stock**	**1,60,000**
Profit and Loss Account	**2,00,000**	**Debtors**	**80,000**
		Cash	**20,000**
		Preliminary Expenses	**20,000**
	10,00,000		**10,00,000**

Company takes over the Business of a Company; Goodwill Rs.2,20,000; Land and Buildings Rs.2,50,000; Plant and Machinery Rs.2,40,000; Stock Rs.1,30,000; Debtors Rs.80,000; Videocon Company does not take over cash but agrees to assume the liability of Sundry Creditors at Rs.50,000. Calculate purchase consideration.

Solution:

Value of assets taken over by Videocon Company :

	Rs.
Goodwill	2,20,000
Land and Buildings	2,50,000
Plant and Machinery-	2,40,000
Stock	1,30,000
Debtors	80,000
Gross Assets Value	9,20,000
Less: Sundry Creditors taken over by Videocon Company	50,000
Purchase Consideration	**8,70,000**

Purchase consideration = Net Assets value = Rs.8,70,000

8.4.5 Net Payment Method:

Under this method purchase consideration is calculated by adding the various payments in the form of cash, shares, and debentures etc., made by the purchase company.

	Rs.
Cash	x x x
Shares	x x x
Debentures	x x x
Liquidation expenses	x x x
Purchase consideration	x x x

Notes:

1. The value of assets and liabilities taken over by the purchasing company need not be taken into consideration.
2. Only the payment made by the purchase company is to be considered.
3. If some part of payment is missing, net assets method should be followed.

Illu.2: A Ltd., has taken over the business of B Ltd. on the following conditions.

1. **For each shares in B Ltd. shareholders will get Rs.25 in cash. For each share of Rs.10 value in B Ltd. 4 shares of Rs.10 value in A Ltd. will be issued to shareholders of A Ltd. Total equity shares = 50,000**
2. **5,000 Debentures in B Ltd at Rs.100 each are to be redeemed with 10% premium**
3. **A Ltd., has bear liquidation expense of Rs.25,000**

Solution:

Calculation of Purchase Consideration:

Particulars	Rs.
1. Cash paid 50,000 shares @ Rs.25 each	 12,50,000
2. Issue of Equity shares (50,000 x Rs.10 x 4)	 20,00,000
3. Cash paid to liquidation expenses	25,000
Purchase Consideration	**32,75,000**

8.4.6 Intrinsic Value Method:

According to this method, the purchase consideration is calculated on the basis of the agreed value of shares of the vendor company.

Therefore, as per AS-14 in all the above four methods, consideration payable to shareholders alone should be shown. Amount payable to other claimants, like debenture holders, creditors etc. should not form a part of purchase price, if they are to be paid by the purchasing company.

llu.3 : Ravi Limited, Raja Limited are two companies carrying on business in the same line of activity. Their capitals are Rs.6,00,000. Rs.3.00,000 respectively (value of each share Rs.10). Raja Ltd. agreed to amalgamate with Ravi Ltd. Shares in Ravi Ltd. and Raja Ltd. are to be valued at Rs.15 and Rs.25 respectively for amalgamation purpose. Calculate the amount of purchase consideration.

Solution :

Shares value of Raja Ltd. (at Market price) = Rs.3,00,000 x 25/10 = Rs.7,50,000

Purchase consideration received by them = Rs.7,50,000

Market price of each share of Ravi Ltd., = Rs.15

No. of shares to be given by Ravi Ltd. to Raja Ltd. as
purchase consideration = Rs.7,50,000/15 = 50,000 shares

In some cases the agreed values of the shares of both the companies are given. In that case the purchase consideration is calculated with reference to the value of shares of two companies involved. For example, Deepa Ltd., Rupa Ltd., are two companies carrying on business in the same line of activity. Their capitals are Rs.6,00,000 and Rs.2,00,000 respectively (value of each Rs.10). The two companies decided to amalgamate in Deepa Rupa Ltd. If each share of Rupa Ltd. and Deepa Ltd. is valued at Rs.15 and Rs.25 respectively for the purpose of amalgamation, then purchase consideration will be as under :

	Deepa Ltd. Rs.	Rupa Ltd. Rs.
60,000 shares @ Rs.15 each	9,00,000	-
20,000 shares @ Rs.25 each	-	5,00,000

1. If shares are held by the Transferor company in the transferee company :

The shares held by transferor (selling) company in the transferee (purchasing) company appear as an asset in its Balance sheet. However these shares cannot be taken over like other assets by the transferee company because it cannot buy its own shares except in the manner permitted by the recent companies Act amendments.

Illu.4 : The following is the balance sheet of Sri Lakshmi Ltd.

	Rs,		**Rs.**
Share capital in fully paid shares of Rs.100 each	**20,00,000**	**1,000 shares in Tulasi Ltd.**	**1,25,000**
Reserves	**6,00,000**	**Sundry assets**	**29,75,000**
Creditors	**5,00,000**		
	31,00,000		**31,00,000**

Tulasi Ltd. absorbed Sri Lakhsmi Ltd. by giving 3 shares @ Rs.150 each for every 4 shares in Sri Lakshmi Ltd. Calculate purchase consideration.

Solution

Shares in Lakshmi Ltd. = Rs.20,00,000/100 = 20,000 shares

As per agreement for 4 shares of Lakshmi Ltd. 3 shares in Tulasi Ltd., will be given.

For 20,000 shares available, shares to be given in Tulasi Ltd. = 20,000 x ¾ = 15,000

No. of Shares in the position of Tulasi Ltd., in Sri lakshmi Ltd. = 1,000 shares

Now purchase consideration in the form of shares = 15,000 – 1,000 = 14,000 shares

Value of purchase consideration = 14,000 shares x Rs.150 = Rs.21,00,000

However Tulasi Ltd., will not be acquiring 1,000 shares of Sri Lakshmi Ltd. As such the shareholders of Sri Lakshmi Ltd., will get 15,000 shares in Tulasi Ltd.

2. If shares are held by the transferee company in the transferor company :

Transferee company is the owner of the proportionate net assets of the transferor company, so purchase consideration has to be adjusted for the shares already held by the transferee company.

3. When shares should be taken at market value :

When calculating purchase consideration, it is a usual practice that the purchasing company issues some shares in its own company as a part of purchase consideration. These shares are always taken at an agreed value which may be the paid up value, market value, or any other value.

4. Treatment of fraction share :

It has already been said that shares in the purchasing company invariably form a part of purchase consideration. But sometimes owing to certain ratio in which shares are to be given it is not possible to find the whole number of shares. Any fraction of shares so arrived at, in the absence of any agreement, is always satisfied in cash. The calculation of equivalent amount of cash is based on the market value of the shares.

Illu.5: A Purchasing company has agreed to issue one share of Rs.10 each Rs.8 called up for every three shares in the vendor company. Find the amount of purchase consideration if there are 50,000 shares in vendor company. The share of the purchasing company are quoted at Rs.16 in the market.

Solution:

Calculation of Purchase Consideration:

For every 3 shares in Vendor Company	-	One share is to be issued Purchasing Co.
For 50,000 shares in Vendor Company	-	?

$^{50,000}/_{3} \times 1$ = 16,666-66 shares or 16,666 $^{2}/_{3}$ shares.

Since it has been agreed to issue the shares at Market value, the shares issued are valued at paid up value of Rs.8 each and the fraction share of $^2/_3$ will be given in cash calculated at Market value.

Purchase Consideration:-

		Rs.
(a) Shares	16,666 shares @ Rs.8	1,33,328.00
(b) Cash	$^2/_3$ shares $\times$ 16	10.67
	Value of Purchase Consideration	**1,33,338.67**

8.5. LIQUIDATION EXPENSES

When a company goes into liquidation, some expenses have to be incurred. These are called liquidation expenses. They can be borne by the purchasing company or by the vendor company. The accounting treatment will be different in different cases. This is as follows.

8.5.1 When Liquidation expenses are borne by the vendor company :

When liquidation expenses are borne by the vendor company they are dealt through realization account. The entry is :

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Realisation a/c Dr. To Bank a/c (Being the payment of liquidation expenses)		x x x	 x x x

Note : If nothing is mentioned about the bearing of liquidation expenses, we have to assume that the selling company is bearing them.

8.5.2 When liquidation expenses are borne by the purchasing company :

When purchasing company agrees to bear liquidation expenses, it can treat it in two ways.

1. As the expenses are met by the purchasing company, this item can be ignored altogether.

2. Treat the item as reimbursable and make the following entries.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Purchasing company a/c	Dr.		x x x	
	To Bank a/c				x x x
	(Being the liquidation expenses paid and due from the purchasing company)				
	Bank a/c	Dr.		Xxx	
	To Purchasing company				Xxx
	(Being the reimbursement of liquidation expenses by the purchasing company)				

In all circumstances the same entry will come in the purchasing company.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Goodwill a/c	Dr.		x x x	
	To Bank a/c				x x x
	(Being the payment of liquidation expenses)				

Note : The following two entries will come if cash is not paid immediately.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Goodwill a/c	Dr.		x x x	
	To Vendor company a/c				x x x
	(Being the amount due on account of liquidation expenses)				
	Vendor company a/c	Dr.		X xxx	
	To Bank a/c				Xxx
	(Being the payment of liquidation expenses)				

8.6. ACCOUNTING PROCEDURE

The following entries are made in the books of Vendor Company relating to amalgamation and external reconstruction.

8.6.1 In the books of Vendor Company:

1. For transferred the assets taken over by the purchasing company at book value:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Realisation a/c Dr. To Vendor assets a/c (Individually)		x x x	 x x x

Note: The following assets should not be transferred to Realisation Account.

a. Cash and Bank balances not taken over by Purchasing Company.

b. Fictitious assets like P & L a/c Debit balance, Preliminary expenses, discount on issue of shares and debentures, underwriting commission.

c. Intangible assets like goodwill, patents, trademarks should be transferred to Realisation a/c.

d. If there is a provision against an asset, such assets should be transferred at gross figures.

e. Other assets, whether taken over by the purchasing company or not, should be transferred.

2. For transferring the liabilities taken over by the Purchasing Company at book figures

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Various Liabilities a/c (Individually) Dr. To Realisation a/c		x x x	 x x x

Note:

a. All liabilities which the purchasing company agrees to pay out are not transferred to Realisation a/c.

b. All liabilities which are not taken over by the Purchasing company are not transferred to Realisation a/c.

c. If any Fund or Reserve denotes liability, it should be transferred to Realisation a/c. If only a portion of the Fund is a liability, that portion should be transferred to realisation a/c.

d. Debentures should not transferred to Realisation a/c except when the debenture holders are satisfied by the purchasing company directly.

e. Accumulated profits and reserves should not transferred.

3. For purchase consideration due from Purchasing Company:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Purchasing company a/c Dr. To Realisation a/c		x x x	 x x x

4. For receiving purchase consideration from the purchasing Company:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank a/c Dr. Shares from Purchasing company a/c Dr. Debentures in Purchasing company a/c Dr. To Purchasing company a/c		x x x x x x x x x	 x x x

5. For Sale of assets not taken over by the Purchasing Company:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Bank a/c Dr. To Realisation a/c		x x x	 x x x

6. For Liquidation expenses:

a. When the liquidation expenses are to be met by the vendor company. If the expenses are included in purchase consideration and not paid separately by the purchasing company:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Realisation a/c Dr. To Bank a/c		x x x	 x x x

b. If the expenses are to be met by the purchasing company, there are two alternatives. First alternative – No entry. Second Alternative. The following two entries are to be passed.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Purchasing company a/c Dr.		x x x	
	To Bank a/c			x x x
	Bank a/c Dr.		x x x	
	To Purchase company a/c			x x x

7. For discharge of Liabilities which are not taken over by the Purchasing company:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Liabilities a/c Dr.		x x x	
	To Bank a/c			x x x

Note: The loss or gain is discharge of liability is to be transferred to Realisation a/c.

8. For transfer of Debentures to Debentureholders:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Debentures a/c Dr.		x x x	
	To Debentureholders a/c			x x x

9. For redemption of debentures:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Debentureholders a/c Dr.		x x x	
	To Bank a/c			x x x
	To Debentures in Purchasing co. a/c			x x x

10. If any premium is paid to debentureholders in discharge of debentures:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Realisation a/c Dr.		x x x	
	To Debenture holders a/c			x x x

Note: If the debentures are redeemed at discount the above entry should be reversed.

11. For transferring Preference share capital to Preference shareholders:

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Preference Share capital a/c To Preference shareholders a/c	Dr.		x x x	 x x x

Note: If arrears of dividend are to be paid to preference shareholders then such excess amount should be debited to Realisation a/c and credited to preference shareholders a/c. If the preference shareholders have agreed to get less than the amount of capital, the reverse entry is to be passed.

12. For closing the realisation account (or) For transferring the profit on realisation to equity shareholders.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Realisation a/c To Equity shareholders a/c	Dr.		x x x	 x x x

Note: If the Realisation shows loss, it should be transferred to Equity shareholders a/c i.e., the above entry should be reversed.

13. For Transfer of Equity Share capital, Accumulated profits and undistributed reserves to equity shareholders a/c

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Equity share capital a/c Accumulated Profits a/c Undistributed Reserves a/c To Equity shareholders a/c	Dr. Dr. Dr.		x x x x x x x x x	 x x x

Note: List of Accumulated profits and undistributed profits:

1. Profit and Loss a/c (Cr.) balance
2. General reserves
3. Reserve fund
4. Debenture Redemption fund
5. Capital reserve
6. Capital Redemption Reserve a/c
7. Shares Forfeited a/c
8. Share premium
9. Workmen compensation Fund
10. Workmen accident fund
11. Insurance fund
12. Dividend Equalisation fund
13. Development Reserve

14. For Transferring accumulated losses and expenses not written off to equity shareholders:

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Equity shareholders a/c	Dr.		x x x	
	To Profit and loss a/c (Dr. balance)				x x x
	To Discount on issue of shares & Debentures a/c				x x x
	To Preliminary expenses a/c				x x x
	To Underwriting commission a/c				X xx

15. For paying off shareholders :

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Preference shareholders a/c	Dr.		x x x	
	Equity shareholders a/c	Dr.		x x x	
	To Bank a/c				x x x
	To Shares in purchasing Co. a/c				x x x
	To Debentures in purchasing a/c				x x x

Illu.6: The Balance sheets of A Ltd. and B Ltd. as on 31st March, 2010

(Rs. in '000)

Liabilities	**A Ltd. Rs.**	**B Ltd. Rs.**	**Assets**	**A Ltd. Rs.**	**B Ltd. Rs.**
Share Capital:			**Goodwill**	**--**	**700**
50,000 Preference shares of Rs.100 each	**5,000**	**--**	**Land and Buildings**	**6,000**	**--**
			Patents	**2,000**	**--**
			Plant & Machinery	**15,500**	**--**
15,00,000 Equity shares of Rs.10 each	**15,000**	**--**	**Motor Vehicles**	**--**	**400**
			Furniture	**--**	**250**
4,00,000 Equity shares of Rs.10 each	**--**	**4,000**	**Investment**	**1,150**	**--**
			Stock	**3,500**	**2,390**
General reserve	**8,000**	**--**	**Debtors**	**800**	**620**
Profit & Loss A/c	**900**	**320**	**Cash at Bank**	**450**	**170**
Creditors	**500**	**210**			
	29,400	**4,530**		**29,400**	**4,530**

A New Company, C Ltd. was formed to acquire the assets and liabilities of A Ltd. and B Ltd. The terms of the amalgamation in the nature of merge were as under:

- **(i) C Ltd. to have an authorized capital of Rs.3,00,00,000 divided into 50,000 13% preference shares of Rs.100 each and 30,00,000 equity shares of Rs.10 each.**
- **(ii) Business of A Ltd. valued at Rs.3,00,00,000; settlement being Rs.60,00,000 in cash and balance by issue of fully-paid equity shares at Rs.12.**
- **(iii) Business of B Ltd. valued at Rs.48,00,000 to be satisfied by issue of fully-paid equity shares of Rs.12**
- **(iv) Preference shares of A Ltd. were redeemed.**

Show necessary entries and ledger for the closure of books A Ltd. and B Ltd.

Solution :

Calculation of Purchase consideration

(Rs.in '000)

	A Limited Rs.	B Limited Rs.
A Ltd., Purchase consideration	30,000	
Cash :		
Shares : Rs.3,00,00,000 – 60,00,000 = $\frac{2,40,00,000}{12}$	6,000	
20,00,000 shares @ Rs.12 fully paid	24,000	
B Ltd. purchase consideration		
Shares : $\frac{48,00,000}{12}$ = 4,00,000 shares each @ Rs.12		4,800
Total Purchase consideration	30,000	4,800

Journal Entries in the books of A Limited

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Realisation a/c Dr.		29,400	
	To Patents a/c			2,000
	To Land and Buildings a/c			6,000
	To Plant and machinery a/c			15,500
	To Investment a/c			1,150
	To Stock a/c			3,500
	To Debtors a/c			800
	To Cash at bank			450
	(Being assets transferred to Realization a/c)			

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Creditors a/c	Dr.		500	
	To Realization a/c				500
	(Being Creditors transferred to realization a/c)				
	C Ltd., a/c	Dr.		30,000	
	To Realization a/c				30,000
	(Being Purchase consideration due from C Limited)				
	Bank a/c	Dr.		6,000	
	Shares in C Ltd., a/c			24,000	
	To C Limited a/c				30,000
	(Being Purchase consideration received)				
	Realization a/c	Dr.		1,100	
	To Equity shareholders a/c				1,100
	(Being profit on realization transferred to shareholders a/c)				
	Preference share capital a/c	Dr.		5,000	
	To Preference shareholders a/c				5,000
	(Being preference share capital transferred to preference shareholders a/c)				
	Preference shareholders a/c	Dr.		5,000	
	To Bank a/c				5,000
	(Being payment made to preference shareholders)				
	Equity share capital a/c	Dr.		15,000	
	General Reserve a/c	Dr.		8,000	
	Profit and Loss a/c	Dr.		900	
	To Equity shareholders a/c				23,900
	(Being share capital, accumulated profits and other credit balances transferred to shareholders a/c)				
	Equity shareholders a/c	Dr.		25,000	
	To Shares in C Limited a/c				24,000
	To Bank a/c				1,000
	(Being Purchase consideration paid to shareholders)				

Ledger accounts

Dr. Realisation a/c Cr.

	Rs.	Rs.		Rs.
To Sundry assets a/c			By Creditors a/c	500
Patents	2,000		By C Ltd., a/c	30,000
Land and buildings	6,000			
Plant and machinery	15,500			
Investments	1,150			
Stock	3,500			
Debtors a/c	800			
Bank a/c	450	29,400		
To Equity shareholders a/c		1,100		
		30,500		30,500

C Limited a/c

	Rs.		Rs.
To Realisation a/c	30,000	By Bank a/c	6,000
		By Equity shares in C Ltd.	24,000
	30,000		30,000

Equity Shares in C Ltd a/c

	Rs.		Rs.
To C Limited a/c	24,000	By Equity shareholders a/c	24,000
	24,000		24,000

Bank a/c

	Rs.		Rs.
To C Limited a/c	6,000	By Preference shareholders a/c	5,000
		By Equity shareholders a/c	1,000
	6,000		6,000

Preference shareholders a/c

	Rs.		Rs.
To Bank a/c	5,000	By Preference share capital a/c	5,000
	5,000		5,000

Equity shareholders a/c

	Rs.		Rs.
To Equity shares in C Ltd., a/c	24,000	By Equity share capital a/c	15,000
To Bank a/c	1,000	By General Reserve a/c	8,000
		By Profit and Loss a/c	900
		By Realization a/c	1,100
	25,000		25,000

Journal Entries in the Books of B Limited

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Realisation a/c Dr.		4,530	
	To Goodwill a/c			700
	To Motor vehicles a/c			400
	To Furniture a/c			250
	To Stock a/c			2,390
	To Debtors a/c			620
	To Bank a/c			170
	(Being assets transferred to Realisation a/c)			
	Creditors a/c Dr.		210	
	To Realisation a/c			210
	(Being Creditors transferred to realization a/c)			
	C Ltd., a/c Dr.		4,800	
	To Realisation a/c			4,800
	(Being Purchase consideration due from C Limited)			
	Realiation a/c Dr.		480	
	To Equity shareholders a/c			480
	(Being profit on realization transferred to shareholders a/c)			

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Equity share capital a/c	Dr.		4,000	
	Profit and Loss a/c	Dr.		320	
	To Equity shareholders a/c				4,320
	(Being share capital, accumulated profits and other credit balances transferred to shareholders a/c)				
	Equity shareholders a/c	Dr.		4,800	
	To Shares in C Limited a/c				4,800
	(Being Purchase consideration paid to shareholders)				

Ledger accounts

Dr. **Realisation a/c** **Cr.**

	Rs.	Rs.		Rs.
To Sundry assets a/c			By Creditors a/c	210
Goodwill	700		By C Ltd., a/c	4,800
Motor vehicles	400			
Furniture	250			
Stock	2,390			
Debtors a/c	620			
Bank a/c	170	4,530		
To Equity shareholders a/c		480		
		5,010		5,010

C Limited a/c

	Rs.		Rs.
To Realisation a/c	4,800	By Equity shares in C Ltd. a/c	4,800
	4,800		4,800

Equity Shares in C Ltd a/c

	Rs.		Rs.
To C Limited a/c	4,800	By Equity shareholders a/c	4,800
	4,800		4,800

Equity shareholders a/c

	Rs.		Rs.
To Equity shares in C Ltd., a/c	4,800	By Equity share capital a/c	4,000
		By Profit and Loss a/c	320
		By Realization a/c	480
	4,800		4,800

8.7 SELF ASSESSMENT QUESTIONS

1. Explain the process of determining purchase consideration.
2. What is purchase consideration? Explain the various methods of calculating purchase consideration?
3. Explain the following.
   a. Amalgamation
   b. Absorption
   c. Reconstruction
4. State the methods of calculating purchase consideration?
5. What is meant by Amalgamation
6. What are the methods of calculating purchase consideration?
7. Explain the similarities between amalgamation and absorption.
   a. Purchase consideration
   b. Amalgamation
8. Differentiate between the terms: Amalgamation by way of Merger and Amalgamation by way of purchase.
9. State the various accounting entries to be passed in the books of the vendor company in the events of its business being taken over by another company.

8.8 EXERCISES

1. A Ltd. acquired B Ltd. Business with the following values.

	Rs.
Fixed Assets	3,00,000
Current assets	1,00,000
Debentures	50,000
Current Liabilities	1,00,000

Calculate purchase consideration.

[Ans.: Purchase Consideration Rs.2,50,000]

2. You have given the balance Sheet of Varsha Ltd. as on 31^{st} March, 2010.

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed assets	4,00,000
10,000 Equity shares,		Investments	1,00,000
Rs.10 each Fully paid	1,00,000	Current assets	2,50,000
General Reserve	3,00,000	Preliminary expenses	60,000
Profit and Loss a/c	1,00,000	Cost of Issue of shares	40,000
Sundry Creditors	1,50,000		
Provision for taxation	1,20,000		
Proposed Dividends	80,000		
	8,50,000		8,50,000

Harsha Ltd. acquired Varsha Ltd. on balance sheet date with the following conditions.

1. Fixed assets were revalued at Rs.5,60,000.
2. Investments were valued at Rs.80,000 in the market.
3. For the purpose of absorption the current assets were valued at Rs.3,00,000.
4. Harsha Ltd., agreed to pay the estimated tax liability of Rs.1,30,000.
5. Varsha Ltd., has to pay dividends before absorption.

Calculate the purchase consideration.

[Ans.: Purchase Consideration Rs.5,80,000]

3. In the following you are given the balance sheet of Anuradha Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital for Rs.10 each	1,00,000	Fixed assets	1,50,000
Debentures	50,000	Current Assets	1,00,000
General Reserve	50,000		
Creditors	50,000		
	2,50,000		2,50,000

Bhadrakali Ltd., decided to acquire the business of Anuradha Ltd. The market share price of Anuradha Ltd. is Rs.15 while the market price Bhadrakali Ltd., is Rs.30. Purchase consideration will be payable through the issue of shares by Bhadrakali Ltd. Calculate purchase consideration.

[Ans.: Purchase Consideration Rs.1,50,000]

4. A purchasing company has agreed to issue one share of Rs.10 each, Rs.8 called up every three shares in the vendor company. Find the amount of purchase consideration if there are 50,000 shares in vendor company. The share of the purchasing company are quoted at Rs.16 in the market.

[Ans.: Purchase Consideration Rs.1,33,338.67]

5. A purchasing company agrees to issue three shares of Rs.10 each; Rs.8 paid up for every 5 shares in the vendor company. Find the number and amount of shares to be issued by purchasing company. The vendor company has Rs.5,00,000 paid up share capital of Rs.10 each Rs.5 paid up.

[Ans.: Purchase Consideration Rs.4,80,000]

6. X Ltd., sells its assets to Y Ltd. for Rs.3,00,000 payable as to Rs.1,20,000 in cash and as to Rs.1,80,000 by the allotment of 12,000 equity shares of Rs.20 each of Y Ltd. at Rs.15 per share paid up to the shareholders of X Ltd. Give necessary journal entries for recording the purchase consideration in the books of X Ltd. and Y Ltd.

7. Company B takes over the business of a company A. The value agreed upon for various assets taken over is Rs.1,84,000. B company also agreed to assume the liability of A company at a value Rs.20,000. What is the purchase consideration?

[Ans.: Purchase consideration = Rs.1,64,000]

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Chapter –9

METHOD OF ACCOUNTING FOR AMALGAMATION

Objectives :

After studying this chapter you should be able to :

- know the methods of accounting for amalgamation
- analyse the accounting procedure under pooling of interest method and purchase method
- know the treatment on dissenting shareholders

Structure :

9.1 METHODS OF ACCOUNTING FOR AMALGAMATION

There are two main methods of accounting for amalgamation of Companies.

(a) The Pooling of Interests Method; and
(b) The Purchase Method.

9.2 POOLING OF INTEREST METHOD

This method is followed in case of an amalgamation in the nature of merger. In this case, the amalgamation is accounted for as if the separate businesses of the amalgamating companies were intended to be carried on by the transferee (i.e., amalgamated) company. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies. The following factors should be taken into consideration while making accounting entries in this method.

a. In the books of the transferee company, the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the date of amalgamation. The balance of the profit and loss account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to general reserve, if any. This reflects the fact that the entries are simply merged together. No goodwill account should be accounted for .

b. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted against the reserves of Transferee Company.

The following journal entries are appropriate for incorporating the financial statements of the transferor company in the books of the transferee company.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1.	**On amalgamation of the business**				
	Business purchase a/c	Dr.		x x x	
	To Liquidator of vendor company a/c				x x x
	(Being the purchase consideration payable)				
2.	**When assets and liabilities taken over and incorporated in the books**				
	Various assets a/.c (individually)	Dr.		Xxx	
	To Various liabilities a/c (individually)				Xxx
	To Reserves a/c				Xxx
	To Business purchase a/c				Xxx
	(Being the assets and liabilities taken over of transferor company recorded)				
3.	**For payment of purchases consideration to the liquidators of vendor company**				
	Liquidator of vendor company a/c	Dr.		Xxx	
	To Bank a/c				Xxx
	To Share premium a/c				Xxx
	To share capital a/c				Xxx
	(Being shares issued to settle the purchase consideration)				

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
4.	**If Liquidation expenses are paid by purchase company** General reserve/Profit and loss a/c Dr. To Bank a/c (Being liquidation expenses paid by purchasing company)		Xxx	X x x
5.	**For formation expenses paid :** Preliminary expenses Dr. To Bank a/c (Being the payment of formation expenses)		Xxx	Xxx

Illu.1 : Clip Ltd., Punch Limited were amalgamated on and from 1st April, 2010. A New company Stapler Ltd., was formed to take over the business of existing companies. The balance sheet of Clip Ltd., and Punch Limited as on 31st March, 2010 are given below.

(Rs.in '0000)

Liabilities	**Clip Ltd.**	**Punch Ltd.,**	**Assets**	**Clip Ltd.,**	**Punch Ltd.**
Share capital			**Fixed Assets**	**1,200**	**800**
Equity shares of Rs.100 each	**600**	**400**	**Less : Depreciation**	**200**	**150**
12% Preference shares of Rs.100 each	**300**	**200**		**1,000**	**650**
Reserves and Surplus			**Investments**	**400**	**150**
Capital reserve	**200**	**150**	**Current Assets :**		
General reserve	**300**	**150**	**Stock**	**300**	**150**
Profit and Loss a/c	**100**	**50**	**Debtors**	**400**	**200**
Secured loans	**400**	**200**	**Cash and bank balances**	**300**	**150**
Trade creditors	**300**	**100**			
Tax provision	**200**	**50**			
	2,400	**1,300**		**2,400**	**1,300**

Other Information :

(a) **Preference shareholders of two companies are issued equivalent number of 15% preference shares of Stapler Ltd. at an issue price of Rs.15 per share.**

(b) **Stapler Ltd., will issue one equity share for every share of Clip Ltd., and Punch Ltd.**

Prepare the balance sheet of Stapler Ltd., on assumption that the amalgamation is in the nature of merger.

Solution ;

(1) Calculation of Purchase Consideration

		Clip Ltd., (Rs.'000)	**Punch Ltd., (Rs.'000)**
(i)	Preference shareholders		
	Clip Limited 3,000 Shares @ Rs.120 each	360	
	Punch Limited 2,000 shares @ Rs.120 each		240
(ii)	Equity shareholders		
	Clip limited 60,000 shares @ Rs.10 each	600	
	Punch Limited 40,000 shares @ Rs.10 each		400
	Total Purchase consideration	**960**	**640**

(2) Amount to be adjusted against the Reserves

	Clip Ltd., (Rs.'000)	**Punch Ltd., (Rs.'000)**
Share capital of transferor companies		
Equity share capital	600	400
Preference share capital	300	200
	900	600
Less : Purchase consideration	900	600
Difference to be adjusted against reserves	Nil	Nil

(3) Total Reserves

	Clip Ltd., (Rs.'000)	Punch Ltd., (Rs.'000)	Total (Rs.'000)
Capital Reserve	200	150	350
General Reserve	300	150	450
Total Reserves	500	300	800

Balance Sheet of Stapler Limited as on 1-4-2010

('000)

Liabilities	Rs.	Assets	Rs.
Share capital		Fixed Assets (Rs.1,200 + 800)	2,000
5,000 Preference shares, of Rs.100 each	500	Less : Depreciation	350
1,00,000 Equity shares of Rs.10 each	1,000		1,650
Reserves and Surplus		Investments (Rs.400 + 150)	550
Capital Reserve	350	Current Assets	
General Reserve	450	Stock (300 + 150)	450
Profit and Loss a/c	150	Debtors (400 + 200)	600
Secured Loans (400 + 200)	600	Cash and bank balances	450
Trade Creditors (300 +100)	400		
Tax provision	250		
	3,700		3,700

9.3 PURCHASE METHOD :

This method is followed in case of an amalgamation in the nature of purchase. Under this method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities of the transferor company at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

This method of accounting is applicable for amalgamation in the nature of purchase. The following factors should be considered while making accounting entries in this method.

1. In the books of the transferee company the assets and liabilities of the transferor company should be incorporated at their existing carrying amount or the consideration should be allocated to individual indefinable assets and liabilities on the basis of their fair values.

2. The reserves (whether capital or revenue arising on revaluation) of the transferor company other than the statutory reserves should not be included in the financial statements of the transferee company.
3. Any excess of the purchase consideration over the value of net assets of the transferor company should be treated as goodwill and debited to goodwill account. On the other hand, if the purchase consideration is lower than the value of net assets acquired, the difference should be credited to capital reserve
4. If it becomes necessary to carry forward any statutory reserve of the transferor company in the books of the transferee for legal compliance, it is accounted by debiting Amalgamation Adjustment Account and crediting statutory reserve account.
5. The amalgamation adjustment account should be disclosed as part of miscellaneous expenditure in the balance sheet. When the identity of the statutory reserve is no longer required to be maintained, both statutory reserve account and amalgamation adjustment account should be reversed.

Thus, the accounting entries in the books of Transferee Company to be passed can be summarized as follows.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1.	**For consideration payable**				
	Business purchase a/c	Dr.		x x x	
	To Liquidator of Transferor company a/c				x x x
	(Being the purchase consideration payable)				
2.	**When assets and liabilities taken over and incorporated in the books**				
	Various assets a/.c (individually)	Dr.		Xxx	
	To Various liabilities a/c (individually)				Xxx
	To Business purchase a/c				Xxx
	To Capital reserve a/c				Xxx
	(Being the assets and liabilities taken over of transferor company recorded)				
3.	**For payment of purchases consideration to the liquidators of vendor company**				
	Liquidator of selling company a/c	Dr.		Xxx	
	To Bank a/c				Xxx
	To Share premium a/c				Xxx
	To share capital a/c				Xxx
	To Debentures a/c				Xxx
	(Being purchase price paid in the form of cash, shares and debentures)				

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
4.	**If Liquidation expenses are paid by transferee company**				
	Goodwill a/c	Dr.		Xxx	
	To Bank a/c				X x x
	(Being liquidation expenses paid)				
5.	**For formation expenses paid :**				
	Preliminary expenses	Dr.		Xxx	
	To Bank a/c				Xxx
	(Being the payment of formation expenses)				
6.	**When statutory reserve of the Transfer co. to be continued**				
	Amalgamation adjustment a/c	Dr.		Xxx	
	To Statutory Reserve a/c				Xxx
	(Being reserves to be continued)				
7.	**When statutory reserve is to be cancelled**				
	Statutory reserve a/c	Dr.		Xxx	
	To Amalgamation adjustment a/c				Xxx
	(Being the cancellation of statutory reserve)				

9.4 DISTINCTION BETWEEN POOLING OF INTEREST METHOD AND PURCHASE METHOD

Let us now discuss the differences between these two methods.

	Basis of Distinction	Pooling of Interest Method	Purchase Method
1.	**Application:**	Pooling of interest method is confined to Amalgamations in the nature of merger	This purchase method is used for amalgamations in the nature of purchase.
2.	**Recording of assets and liabilities:**	In pooling of interest method, all the assets and liabilities taken over are shown at their original book values.	In the Purchase method they are shown at revalued or market values.
3.	**Reserves and Transferor Company:**	All the reserves of the selling company are recorded in the same form in purchasing company under pooling of interests method.	In this method, selling company's reserves are ignored except the statutory reserves which must be continued.

	Basis of Distinction	Pooling of Interest Method	Purchase Method
4.	**Excess of consideration:**	Excess of consideration paid over the paid-up value of shares of the selling company must be adjusted in the reserves in this method.	In this method, excess of purchase consideration over net assets taken over is treated as "goodwill". If the consideration is less than the net assets, the difference is shown as 'capital reserve'.
5.	**Amalgamation Adjustment Account**	Need for such account does not arise in this method.	In this method, statutory reserves of the selling company which should be continued are debited to 'Amalgamation Adjustment Account' and it is shown on balance sheet assets side.
6.	**Specific period to write off goodwill**	The question of such write off does not arise under pooling of interest method.	Under purchase method, goodwill account is debited for excess consideration paid over net assets which should normally be written off within 5 years.

Illu.2 : On April, 2010 Alpha Ltd., and Beeta Ltd., amalgamated by forming a New company Gama Ltd. On March 31, 2010 the Balance sheets of Alpha and Beeta Ltd., are given below

(Rs.in 'lakhs)

Liabilities	Alpha Ltd.	Beeta Ltd.	Assets	Alpha Ltd.	Beeta Ltd.
Share capital			**Fixed Assets :**		
Equity shares of Rs.100 each	**800**	**750**	**Land and Buildings**	**550**	**400**
12% Preference shares of Rs.100 each	**300**	**200**	**Plant and machinery**	**350**	**250**
			Investments	**150**	**50**
Reserves and Surplus			**Current Assets, Loans, Advances**	**150**	**50**
Revaluation reserve	**150**	**100**	**Stock**	**350**	**250**

Liabilities	Alpha Ltd.	Beeta Ltd.	Assets	Alpha Ltd.	Beeta Ltd.
General reserve	**170**	**150**	**Sundry Debtors**	**250**	**300**
Investment allowance reserve	**50**	**50**	**Bills Receivable**	**50**	**50**
			Cash at bank	**300**	**200**
Profit and Loss a/c	**70**	**40**			
Secured loans :					
10% Debentures of Rs.100 each	**40**	**20**			
Sundry Creditors	**270**	**120**			
Bills payable	**150**	**70**			
	2,000	**1,500**		**2,000**	**1,500**

Other Information :

1. **For 10% debentures of Alpha Ltd., and Beeta Ltd., Gama Ltd., issued equal no. of 15% debentures at Rs.100 each.**
2. **For the preference shareholders of both the companies Gama Ltd. issued same no. of 15% of pref. shares at Rs.150 each (Face value of Rs.100).**
3. **For each share of Alpha ltd., shareholders 5 equity shares and for each one share of Beeta Ltd., shareholders 4 equity shares will be issued by Gama Ltd. These shares are issued at Rs.30 each. The face value of each share is Rs.10**
4. **Investment allowance reserve is to be maintained for four more years.**

After the amalgamation prepare the Balance sheet of Gama Ltd. on 1st April, 2010. Assuming the Amalganation is in the nature of purchase.

Solution :

(1) Calculation of Purchase Consideration

		Alpha Ltd., (Rs.in lakhs)	Beeta Ltd., (Rs.in lakhs)
(i)	Preference shareholders		
	Alpha Limited 3,00,000 Shares @ Rs.150 each	450	
	Beeta Limited 2,00,000 shares @ Rs.150 each		300
(ii)	Equity shareholders		
	Alpha limited 40,00,000 shares @ Rs.30 each	1,200	
	Beeta Limited 30.00,000 shares @ Rs.30 each		900
	Total Purchase consideration	**1,650**	**1,200**

Valuation of Net Assets taken over :

(Rs. in lakhs)

			Alpha Ltd.	**Beeta Ltd.**
Assets taken over :				
Land and Buildings			550	400
Plant, Machinery			350	250
Investments			150	50
Stock			350	250
Debtors			250	300
Bills receivable			50	50
Cash at bank			300	200
			2,000	1,500
Less : Liabilities taken Over	Alpha Ltd.	Beeta Ltd.		
Debentures	40	20		
Creditors	270	120		
Bills payable	150	70	460	210
Net Assets taken over			1,540	1,290
Less : Purchase consideration			1,650	1,200
Goodwill/Capital reserve			110	90

Goodwill = Rs.110 – 90 = Rs.20 lakhs.

Balance sheet of Gama Ltd., as on 1st April, 2010

Liabilities	Rs.	Assets	Rs.
Share capital		Fixed Assets	
Equity shares of Rs.10 each (400 + 300)	700	Goodwill	20
Preference shares of Rs.100 each (300 + 200)	500	Land and buildings (550 + 400)	950
Reserves and Surplus :		Plant and machinery (350+250)	600
Share premium	1,650		
Investment allowance reserve (Contra)	100	Investments (150 + 50)	200
Secured loans :		Current assets, Loans, Advances	
15% Debentures	60		
Current Liabilities, Provisions		Current Assets :	
Current Liabilities		Stock (350 + 250)	600
Bills payable (150 + 70)	220	Sundry Debtors (250+300)	550
Creditors (270 + 120)	390	Cash at Bank (300 + 200)1	500
Provisions	-	Loans and advances :	
		Bills receivable (50+50)	100
		Miscellaneous expenses :	
		Amalgamation adjustment a/c (Contra)	100
	3,620		3,620

Notes :

1. The book values of the assets and liabilities of the vendor company are to be considered.

2. Except the reserves and development reserves of the vendor company others are not to be shown in Purchase Company.
3. Since the purchase consideration of the Alpha Co., more than its assets the difference (Rs.1,650 – 1,540) Rs.110 lakhs is treated as goodwill.

4. Since the purchase consideration is less than the net assets of the beta company the difference of (Rs.1,290 – 1,200) Rs.90 lakhs is taken as capital Reserve

5. Goodwill and capital reserve cannot be created at a time. Therefore after the adjustment (Rs.110 – 90) Rs.20 lakhs goodwill will be there.

6. As per AS-14 the investment allowance reserve is to be maintained for four more years by debiting Amalgamation adjustment a/c and crediting investment allowance reserve a/c.

Illu.3: Moon Co. Ltd. and Star Co. Ltd. has agreed to amalgamate. A New Company Planet Co. Ltd., has been formed to take over the combined concern as on 31st March, 2010. After negotiations, the assets of the two companies have been agreed upon on shown below:

Balance Sheet as on 31-3-2010

Liabilities	Moon Co. Ltd. Rs.	Star Co. Ltd. Rs.	Assets	Moon Co. Ltd. Rs.	Star Co. Ltd. Rs.
Share Capital:			Land & Buildings	50,000	30,000
Shares of Rs.10 each	1,00,000	50,000	Plant & Machinery	20,000	25,000
Creditors	8,000	5,000	Patents	11,000	--
Reserve fund	--	5,000	Goodwill	--	5,000
P & L a/c	5,000	5,000	Stock	15,000	2,000
			Debtors	12,000	2,000
			Bank	5,000	1,000
	1,13,000	65,000		1,13,000	65,000

Prepare the balance sheet of Planet Co. Ltd., assuming

(a) The entire purchase price is paid off in the form of equity shares of Rs.100 each in Planet Co. Ltd.

(b) The amalgamation is in the nature of Merger.

Solution ;

(1) Calculation of Purchase consideration :

	Moon Co. Ltd. (Rs.)	**Star Co. Ltd. (Rs.)**
Assets taken over :		
Land and Buildings	50,000	30,000
Plant and machinery	20,000	25,000
Patents	11,000	-
Goodwill	-	5,000
Stock	15,000	2,000
Debtors	12,000	2,000
Cash at bank	5,000	1,000
	1,13,000	65,000
Liabilities taken over :		
Creditors	8,000	5,000
Net Assets Value (Value of Purchase consideration)	1,05,000	60,000
	10	10
No. of shares received	10,500 shares	6,000 shares

Total shares received by moon co. ltd. towards purchase consideration = 10,500'
No. of shares received by star & company Ltd. 6,000
Shares allotted to planet ltd. = 10,500 + 6,000 =
16,500 shares @ Rs.10 each = Rs.1,65,000

(2) Amount adjusted against Reserves (As-14)

	Rs.
Purchase consideration (Rs.1,05,000 + 60,000)	1,65,000
Less : Equity share capital of Moon Co., and Star Co., (Rs.1,00,000 + 50,000)	1,50,000
	15,000
Less : Adjusted in Reserve fund and Profit and loss a/c balances of Moon Co. & Star Co.	15,000
Reserve Fund to be shown in Balance sheet of Planet Co., Ltd.	Nil

Balance Sheet of Planet Co. Ltd., as on 31st March, 2010

Liabilities	Rs.	Assets	Rs.
Share capital		Fixed Assets	
Authorised : 16,500 shares @ Rs.10 each	1,65,000	Goodwill	5,000
Subscribed : 16,500 shares of Rs.10 each fully paid up	1,65,000	Land and Buildings (50,000 + 30,000)	80,000
Reserves and Surplus :		Plant and machinery (Rs.20,000 +25,000)	45,000
Secured Loans	-	Patents	11,000
Current Liabilities, Provisions	-	Current Assets :	
Creditors	13,000	Stock (15,000 + 2,000)	17,000
		Debtors (12,000 + 2,000)	14,000
		Cash at bank (Rs.5,000 + 1,000)	6,000
	1,78,000		1,78,000

Illu.4: X Ltd. and Y Ltd. agreed to amalgamate by transferring their undertakings to a new company XY Ltd., formed for that purpose. On the date of amalgamation, Balance sheet of the companies were as under :

Liabilities	**X Ltd. Rs.**	**Y Ltd. Rs.**	**Assets**	**X Ltd. Rs,.**	**Y Ltd. Rs.**
Share Capital:			**Sundry Assets**	**4,80,000**	**3,22,000**
Equity shares @ Rs.10 each fully paid up	**5,00,000**	**3,00,000**	**Freehold property**	**2,00,000**	**1,00,000**
5% Debentures	**2,00,000**	**1,00,000**	**Investments**	**50,000**	**20,000**
Reserve fund		**50,000**	**Sundry debtors**	**2,50,000**	**1,50,000**
Profit and Loss a/c	**30,000**	**20,000**	**Preliminary expenses**	**20,000**	**8,000**
Mortgage Loan secured on freehold property	**50,000**	**-**			
Sundry creditors	**2,20,000**	**1,30,000**			
	10,00,000	**6,00,000**		**10,00,000**	**6,00,000**

The purchase consideration consists of :

(a) the discharge of the debentures of X Ltd., and Y Ltd., the issue of equivalent amount of 6% debentures in XY Ltd.

(b) assumption of the liabilities in both companies and

(c) the issue of equity shares of Rs.10 each in XY Ltd., at a premium of Rs.2 per share.

For the purpose of amalgamation the assets are to be revalued as under :

	X Ltd. Rs.	Y Ltd. Rs.
Goodwill	**1,00,000**	**75,000**
Sundry Assets	**4,10,000**	**2,80,000**
Freehold property	**2,60,000**	**1,40,000**
Investments	**51,000**	**20,000**
Debtors	**2,25,000**	**1,35,000**

Pass the necessary journal entries in the books of X Ltd. Indicate the basis on which the shares in XY Ltd. will be distributed among the shareholders of X Ltd. and Y Ltd.

Solution :

Calculation of purchase consideration (Assets – Liabilities) :

			X Ltd. Rs.	Y Ltd. Rs.
Assets taken over :				
Goodwill			1,00,000	75,000
Sundry Assets			4,10,000	2,80,000
Freehold property			2,60,000	1,40,000
Investments			51,000	20,000
Debtors			2,25,000	1,35,000
			10,46,000	6,50,000
Less : Liabilities taken Over :	X Ltd.	Y Ltd.		
5% Debentures	2,00,000	1,00,000		
Mortgage loan	50,000	-		
Sundry creditors	2,20,000	1,30,000	4,70,000	2,30,000
Purchase consideration			**5,76,000**	**4,20,000**
Purchase consideration to be discharged by :				
Value of share = (Rs.10 +2 premium)			12	12
No. of shares issued				
X Ltd. (5,76,000/12)			48,000	35,000
Y Ltd. (4,20,000/12)			Shares	shares

Basis of Distribution of shares of XY Ltd

X Ltd., = 50,000 Equity shares of Rs.10 each = Rs.5,00,000
X :Ltd. = Shareholders of X Ltd. will 48,000 shares for 50,000 shares held.
Shareholders of X Ltd., will get 48 shares for every 50 shares held.

Y Ltd = 30,000 equity shares of Rs.10 each = Rs.3,00,000
Y Ltd. = Shareholders of Y Ltd. will get 35,000 shares for 30,000 shares held.

Shareholders of Y Ltd. will get 35 shares for 30 shares held.

	Rs.	Rs.
Equity share capital :		
X Ltd. : 48,000 shares @ Rs.10 each	4,80,000	
Y Ltd. : 35,000 shares @ Rs.10 each	3,50,000	8,30,000
Share premium		
X Ltd. : 48,000 shares @ Rs.2 each	96,000	
Y Ltd. ; 35,000 shares @ Rs.2 each	70,000	1,66,000
		9,96,000

Journal Entries in the books of X Limited

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Realisation a/c	Dr.		9,80,000	
	To Sundry assets a/c				4,80,000
	To Freehold property a/c				2,00,000
	To Investment a/c				50,000
	To Debtors a/c				2,50,000
	(Being assets transferred to Realisation a/c)				
	5% Debentures a/c	Dr.		2,00,000	
	Mortgage loan a/c	Dr.		50,000	
	Sundry Creditors a/c	Dr.		2,20,000	
	To Realisation a/c				4,70,000
	(Being liabilities taken over by XY Ltd. transferred to Realisation a/c)				
	XY Ltd.,	Dr.		5,76,000	
	To Realisation a/c				5,76,000
	(Being Purchase consideration due from XY Limited)				
	Equity shares in XY Ltd.	Dr.		4,80,000	
	Equity share premium a/c	Dr.		96,000	
	To XY Limited a/c				5,76,000
	(Being Purchase consideration received)				

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Realization a/c	Dr.		66,000	
	To Equity shareholders a/c				66,000
	(Being profit on realization transferred to shareholders a/c)				
	Equity share capital a/c	Dr.		5,00,000	
	Profit and Loss a/c	Dr.		30,000	
	To Equity shareholders a/c				5,30,000
	(Being balances transferred to equity shareholders)				
	Equity shareholders a/c	Dr.		20,000	
	To Preliminary expenses a/c				20,000
	(Being the transfer of preliminary expenses)				
	Equity shareholders a/c	Dr.		5,76,000	
	To Equity shares in XY Ltd. a/c				5,76,000
	(Being payment made to equity shareholders)				

Ledger accounts

Dr. Realisation a/c Cr.

Particulars	Rs.	Particulars	Rs.
To Sundry assets a/c	4,80,000	By 5% Debentures a/c	2,00,000
To Freehold property a/c	2,00,000	By Mortgage loan a/c	50,000
To Investments a/c	50,000	By Sundry Creditors a/c	2,20,000
To Debtors a/c	2,50,000	By XY Ltd a/c	5,76,000
To Equity shareholders a/c (profit)	66,000		
	10,46,000		**10,46,000**

Journal Entries in the Books of XY Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c	Dr.		9,96,000	
	To Liquidators of X Ltd.				5,76,000
	To Liquidator of Y Ltd.				4,20,000
	(Being purchase of business of X, Y Ltd.)				
	Goodwill a/c (1,00,000 + 75,000)	Dr.		1,75,000	
	Sundry assets a/c (4,10,000 + 2,80,000)	Dr.		6,90,000	
	Freehold property a/c (2,60,000 + 1,40,000)	Dr.		4,00,000	
	Investment a/c (51,000 + 20,000)	Dr.		71,000	
	Debtors a/c (2,25,000 + 1,35,000)	Dr.		3,60,000	
	To Mortgage loan a/c				50,000
	To Creditors a/c (2,20,000 + 1,30,000)				3,50,000
	To 5% Debentures a/c				3,00,000
	To Business purchase a/c				9,96,000
	(Being the assets and liabilities taken over)				

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Liquidator of X Ltd. a/c	Dr.		5,76,000	
	Liquidator of Y Ltd. a/c	Dr.		4,20,000	
	To Equity share capital a/c				8,30,000
	To Share premium a/c				1,66,000
	(Being the payment of purchase price)				

Illu.5: Jaya Company Ltd., acquired the undertaking of Vijaya Company limited on 31st March, 2010 for a purchase consideration of Rs.6,25,000 to be paid by fully paid equity shares of Rs.10 each. The balance sheets of the two companies on the date of acquisition were as follows.

Liabilities	Jaya Limtied Rs.	Vijaya Limited Rs,	Assets	Jaya Limited Rs.	Vijaya Limtied Rs.
Share Capital:			**Fixed Assets**		
Equity shares @ Rs.10 each fully paid up	**6,25,000**	**3,75,000**	**Plant and machinery**	**5,00,000**	**4,50,000**
General Reserve	**3,00,000**	**45,000**	**Land and Buildings**	**3,00,000**	**2,00,000**
Profit and Loss a/c	**25,000**	**1,32,500**	**Fixtures and Fittings**	**25,000**	**50,000**
Workers compensation fund	**37,500**	**60,000**	**Current Assets**		
Development Rebate reserve	**25,000**	**92,500**	**Stock in trade**	**1,37,500**	**1,00,000**
Current liability	**1,12,500**	**2,37,500**	**Book debts a/c**	**1,12,500**	**1,00,000**
			Cash at bank	**50,000**	**42,500**
	11,25,000	**9,42,500**		**11,25,000**	**9,42,500**

Pass the necessary journal entries in the books of Jaya Ltd., when amalgamation is in the nature of merger and by way of purchase. Also prepare the balance sheet of Jaya Ltd., after amalgamation assuming that Development rebate reserve and Workers compensation fund of Vijaya Ltd., are required to be continued in the books of Jaya Ltd.

Solution :

(i) When Amalgamation is in the nature of Merger :

Journal entries in the books of Jaya Company Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c	Dr.		6,25,000	
	To Liquidators of Vijaya Co. Ltd.				6,25,000
	(Being purchase of business of Vijaya Co. Ltd.)				
	Plant and machinery a/c	Dr.		4,50,000	
	Land and buildings a/c	Dr.		2,00,000	
	Fittings and fixtures a/c	Dr.		50,000	
	Stock in trade a/c	Dr.		1,00,000	
	Book debts a/c	Dr.		1,00,000	
	Bank a/c	Dr.		42,500	
	General Reserve a/c (Bal.fig)	Dr.		72,500	
	To Current Liabilities a/c				2,37,500
	To Workers Compensation fund a/c				60,000
	To Development rebate reserve a/c				92,500
	To Business purchase a/c				6,25,000
	(Being the assets and liabilities taken over)				
	Vijaya Ltd., a/c	Dr.		6,25,000	
	To Equity share capital a/c				6,25,000
	(Being the payment of purchase price)				

Balance sheet of Jaya Company Ltd. as on 31st March, 2010
(after amalgamation)

Liabilities	Rs.	Assets	Rs.
Share capital :		Fixed Assets :	
1,25,000 equity shares of Rs.10 each fully paid up)	12,50,000	Plant and machinery	9,50,000
(Of the above 62,500 shares of Rs.100 each issued for purchase of business of Vijaya Ltd.)		Land and buildings	5,00,000
Reserves and Surplus :		Fixtures and Fittings	75,000
General reserve	2,27,500	Current Assets :	
Profit and Loss a/c	25,000	Stock in trade	2,37,500
Workers compensation fund	97,500	Book debts	2,12,500
Development rebate reserve	1,17,500	Cash at bank	92,500
Current Liabilities	3,50,000		
	20,67,500		20,67,500

(ii) When Amalgamation is by way of Purchase :

Journal Entries in the Books of Vijaya Company Ltd.,

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c	Dr.		6,25,000	
	To Liquidators of Vijaya Co. Ltd.				6,25,000
	(Being purchase of business of Vijaya Co. Ltd.)				
	Plant and machinery a/c	Dr.		4,50,000	
	Land and buildings a/c	Dr.		2,00,000	
	Fittings and fixtures a/c	Dr.		50,000	
	Stock in trade a/c	Dr.		1,00,000	
	Book debts a/c	Dr.		1,00,000	
	Bank a/c	Dr.		42,500	
	To Current Liabilities a/c				2,37,500
	To Business purchase a/c				6,25,000
	To Capital reserve a/c (bal.fig)				80,000
	(Being the assets and liabilities taken over)				
	Vijaya Ltd., a/c	Dr.		6,25,000	
	To Equity share capital a/c				6,25,000
	(Being the payment of purchase price)				
	Amalgamation Adjustment a/c	Dr.		1,52,500	
	To Development rebate reserve a/c				60,000
	To Workers' Compensation fund a/c				92,500
	(Being carrying forward of reserves of Vijaya Co. Ltd.)				

Balance sheet of Jaya Company Ltd. as on 31st March, 2010
(after amalgamation)

Liabilities	Rs.	Assets	Rs.
Share capital :		Fixed Assets :	
1,25,000 equity shares of Rs.10 each fully paid up)	12,50,000	Plant and machinery	9,50,000
(Of the above 62,500 shares of Rs.100 each issued for purchase of business of Vijaya Ltd.)		Land and buildings	5,00,000
		Fixtures and Fittings	75,000
Reserves and Surplus :		Current Assets :	
Capital reserve	80,000	Stock in trade	2,37,500
General reserve	3,00,000	Book debts	2,12,500
Profit and Loss a/c	25,000	Cash at bank	92,500

Liabilities	Rs.	Assets	Rs.
Workers compensation fund	97,500	Miscellaneous expenses	
Development rebate reserve	1,17,500	Amalgamation adjustment a/c	1,52,500
Current Liabilities	3,50,000		
	22,20,000		22,20,000

Illu.6: Bharani ltd., is absorbed by Dharani Ltd. Given below are the balance sheets of the two companies, taken after revaluation of their assets on an uniform basis.

	Bharani Ltd. Rs,	Dharani Ltd. Rs.
Sundry assets	**16,85,000**	**43,57,500**
Cash in hand	**3,500**	**27,500**
	16,88,500	**43,85,000**
Liabilities :		
Authorised capital :		
9,000 Equity shares of Rs.150 each	**13,50,000**	
60,000 Equity shares of Rs.75 each		**45,00,000**
Paid up capital :		
9,000 Equity shares of Rs.135 each	**12,15,000**	
40,000 equity shares of Rs.75 each		**30,00,000**
General Reserve	**4,03,500**	**12,85,000**
Profit and Loss a/c	**15,000**	**35,000**
Sundry Creditors	**55,000**	**65,000**
	16,88,500	**43,85,000**

The holders of every three shares in Bharani Limited were to receive five shares in the Dharani Limited plus as much cash as is necessary to adjust the right of shareholders of both the companies in accordance with the intrinsic values of the shares as per respective balance sheets. Pass the necessary journal entries in the books of Dharani Ltd. assuming it to be an amalgamation in the nature of merger and prepare the balance sheet giving effect to the above scheme of amalgamation.

Solution :

Calculation of Purchase consideration :

For every 3 shares in Bharani Ltd. ….. 5 shares in Dharani Ltd.

For every 9,000 shares in Bharani Ltd……… ?

$$9{,}000 \times \frac{5}{3} = 15{,}000 \text{ shares Rs.75 each} = \text{Rs.}11{,}25{,}000$$

Purchase consideration = 15,000 shares X Rs.75 = Rs.11,25,000

Journal Entries in the books of Bharani Limited

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Realisation a/c	Dr.		16,88,500	
	To Sundry assets a/c				16,85,000
	To Cash in hand a/c				3,500
	(Being assets transferred to Realisation a/c)				
	Sundry Creditors a/c	Dr.		55,000	
	To Realisation a/c				55,000
	(Being liabilities taken over by XY Ltd. transferred to Realisation a/c)				
	Dharani Ltd.	Dr.		11,25,000	
	To Realisation a/c				11,25,000
	(Being Purchase consideration due from Dharani Limited)				
	Equity shares in Dharani Ltd.	Dr.		11,25,000	
	To Dharani Limited a/c				11,25,000
	(Being Purchase consideration received)				
	Equity share capital a/c	Dr.		12,15,000	
	General Reserve a/c	Dr.		4,03,500	
	Profit and Loss a/c	Dr.		15,000	
	To Equity shareholders a/c				16,33,500
	(Being balances transferred to equity shareholders)				
	Equity shareholders a/c	Dr.		5,08,500	
	To Realisation a/c				5,08,500
	(Being loss on realiasation transferred to equity shareholders)				
	Equity shareholders a/c	Dr.		11,25,000	
	To Equity shares in Dharani Ltd. a/c				11,25,000
	(Being payment made to equity shareholders)				

Ledger accounts

Dr. **Realisation a/c** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Sundry assets a/c	16,85,000	By Sundry Creditors a/c	55,000
To Cash in hand a/c	3,500	By Dharani Ltd. a/c	11,25,000
		By Equity shareholders a/c (Loss on realization)	5,08,500
	16,88,500		**16,88,500**

Journal Entries in the Books of Dharani Ltd.,

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c	Dr.		11,25,000	
	To Liquidators of Bharani. Ltd.				11,25,000
	(Being the agreement made for purchase of business)				
	Sundry Assets a/c	Dr.		16,85,000	
	Cash a/c	Dr.		3,500	
	To General reserve a/c				4,93,500
	To Profit and Loss a/c				15,000
	To Sundry Creditors a/c				55,000
	To Business purchase a/c				11,25,000
	(Being the assets and liabilities taken over)				
	Bharani Ltd. Liquidator a./c	Dr.		11,25,000	
	To Share capital a/c				11,25,000
	(Being the payment of purchase price)				

The difference between the share capital of the vendor company and the issued share capital is adjusted with the balance in the reserve account.

	Rs.	Rs.
General reserve in Bharani Ltd.		4,03,500
Bharani ltd. Share capital	12,15,000	
Less : Issue of share capital by Dharani Ltd.	11,25,000	90,000
Adjusted Reserve		4,93,500

Balance sheet of Dharani Ltd. (after amalgamation)

Liabilities		Rs.	Assets		Rs.
Authorised capital			Sundry Assets :		
60,000 Equity shares of Rs.75 each		45,00,000	Bharani	16,85,000	
Paidup capital :			Dharani	43,57,500	60,42,500
55,000 equity shares @ Rs.75 each		41,25,000	Cash in hand		
(includes 15,000 shares issued to the liquidator of Bharani Ltd.)			Bharani	3,500	
General Reserve			Dharani	27,500	31,000
Bharani Ltd.	4,93,500				
Dharani Ltd.	12,85,000	17,78,500			
Profit and Loss a/c					
Bharani Ltd.	15,000				
Dharani Ltd.	35,000	50,000			
Sundry Creditors					
Bharani Ltd.	55,000				
Dharani Ltd.	65,000	1,20,000			
		60,73,500			60,73,500

Illu.7: On April 1, 2010 the Balance Sheet of Amrit Ltd. was as under:

Liabilities	Rs.	Assets	Rs.
Authorised and Issued Capital:		**Goodwill**	**1,00,000**
3,000, 6% Cumulative Pref. Shares of Rs.25 each. fully paid	**75,000**	**Sundry Assets**	**2,50,000**
		Cash	**10,000**
		P & L Account	**1,90,000**
8,000 Equity shares of Rs.50 each fully paid	**4,00,000**		
6% Debentures	**50,000**		
Creditors	**25,000**		
	5,50,000		**5,50,000**

Preference dividends were in arrears for two years. A scheme of reconstruction agreed upon was as under:

1. **A new company to be formed, called Armit (2010) Limited.**
2. **Authorised capital of new company will be Rs.5,00,000 all in equity shares of Rs.100 each.**
3. **On equity share of Rs.100 each fully paid in the new company to be issued in exchange of 3 preference shares in the old company.**
4. **One equity share of Rs.100 each fully paid in the new company to be exchanged for 4 equity shares in the old company.**
5. **Arrears of pref. dividend to be cancelled.**
6. **Debenture holds to receive 500 equity shares in the new company as fully paid.**
7. **Creditors to be taken over by the new company and immediately paid off.**
8. **The new company to issue remaining equity shares to the public.**
9. **The new company to take over old company's assets, subject to revaluation of 'Sundry Assets' at Rs.2,65,000.**

Prepare necessary ledger accounts in the books of Amrit Limited and open the books of the new company by means of Journal entries, assuming that the public subscription was fully responded.

Solution :

Calculation of Purchase consideration :

		Rs.
New Equity shares in the place of old preference shares	3,000 x 1/3 x 100	1,00,000
New equity shares in the place old equity shares	8,000 x ¼ x 100	2,00,000
Purchase Consideration		3,00,000

Ledger accounts in the books of Amrit Ltd.

Dr. **Realisation a/c** **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To Goodwill	1,00,000	By Creditors a/c	25,000
To Sundry Assets	2,50,000	By 6% Debentures a/c	50,000
To Cash	`10,000	By Amrit (2010) Ltd.	3,00,000
To Preference shareholders a/c	25,000	By Equity shareholders a/c (Loss)	10,000
	3,85,000		3,85,000

Dr. Equity shareholders a/c Cr.

Particulars	Rs.	Particulars	Rs.
To Profit and Loss a/c	1,90,000	By Equity share capital a/c	4,00,000
To Realisation a/c	10,000		
To Shares in Amrit (2010) Ltd. a/c	2,00,000		
	4,00,000		4,00,000

Dr. Preference shareholders a/c Cr.

Particulars	Rs.	Particulars	Rs.
To Equity shares in Amrit (2010) :Ltd. a/c	1,00,000	By Preference share capital a/c	75,000
		By Realization a/c	25,000
	1,00,000		1,00,000

Dr. Amrit (2010) Ltd. a/c Cr.

Particulars	Rs.	Particulars	Rs.
To Amrit (2010) Ltd., a/c	3,00,000	By Equity shareholders a/c	2,00,000
		By Preference shareholders a/c	1,00,000
	3,00,000		3,00,000

Notes :

1. Actually the amount payable to the preference shareholders from capital is Rs.75,000 only. However, in the reconstruction process they are to be given new shares worth Rs.1,00,000. The amount of loss due to this is to be borne by equity shareholders and as such the amount is debited to realization account.

2. The amount of preference dividend for two years is written off and hence it is not shown in accounts. As it is given in adjustments and not in the balance sheet. The final result becomes zero and hence not shown in accounts.

Journal Entries in the Books of Amrit (2010) Ltd.,

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c	Dr.		3,00,000	
	To Liquidator of Amrit. Ltd.				3,00,000
	(Being the agreement made for business purchase of business)				
	Goodwill a/c	Dr.		1,00,000	
	Sundry assets a/c	Dr.		2,65,000	
	Cash a/c	Dr.		10,000	
	To Debentures a/c				50,000
	To Creditors a/c				25,000
	To Business purchase a/c				3,00,000
	(Being the assets and liabilities taken over)				
	Liquidator of Amrit Ltd. a./c	Dr.		3,00,000	
	To Equity Share capital a/c				3,00,000
	(Being the payment of purchase price)				
	Bank a/c	Dr.		1,50,000	
	To Equity share capital a/c				1,50,000
	(Being the balance of 1500 shares of Rs.100 face value issued and realize the cash)				
	Creditors a/c	Dr.		25,000	
	To Bank a/c				25,000
	(Being the amount paid to the creditors fully as per the agreement)				
	Debentures a/c	Dr.		50,000	
	To Equity share capital a/c				50,000
	(Being the issue of 5,000 equity shares and the amount used for the payment of debenture holders)				

Illu.8 : Following is the balance sheet of Ashok Company Ltd.

Liabilities	Rs.	Assets	Rs.
Paid up share capital of Rs.10 each	**2,00,000**	**Goodwill**	**40,000**
Accumulated profits	**70,000**	**Fixed assets**	**1,65,000**
Debentures	**1,00,000**	**Current assets**	**1,95,000**
Creditors	**30,000**		
	4,00,000		**4,00,000**

The Chandra Co. Ltd., agreed to take over assets (exclusive of goodwill, one fixed asset of Rs.40,000 and cash Rs.10,000 included in current assets) at 10% less than book value, to discharge trade liabilities and to pay Rs.60,000 for goodwill. The purchase price was to discharged by the issue of 10,000 shares of Rs.10 each, Rs.8 called up a at a market value of Rs.15 per share and the balance in cash. Liquidation expenses amounted to Rs.4,000. Pass necessary journal entries in the books of Ashok Limited.

Solution : Calculation of purchase consideration :

			Rs.
Assets :			
Fixed assets	Rs.1,65,000 – 40,000 = 1,25,000 – 12,500 (10%)		1,12,500
Current assets	Rs.1,95,000 – 10,000 = 1,85,000 – 18,500 = (10%)		1,66,500
Goodwill			60,000
Goodwill			3,39,000
Less : Liabilities			
Creditors		30,000	
Debentures		1,00,000	1,30,000
Purchase consideration			**2,09,000**
Payment of Purchase consideration			
1. Shares	10,000 shares @ Rs.15		1,50,000
2. Cash (Balance)	(Rs.2,09,000 – 1,50,000)		59,000
Purchase Consideration			2,09,000

Journal Entries in the books of Ashok Company Limited

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Realisation a/c	Dr.		3,90,000	
	To Goodwill a/c				40,000
	To Fixed assets a/c				1,65,000
	To Current assets a/c				1,85,000
	(Being assets transferred to Realisation a/c)				
	Debentures a/c	Dr.		1,00,000	
	Creditors a/c	Dr.		30,000	
	To Realisation a/c				1,30,000
	(Being liabilities. transferred to Realisation a/c)				
	Chandra Co. Ltd.	Dr.		2,09,000	
	To Realisation a/c				2,09,000
	(Being Purchase consideration due)				

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Equity shares in Chandra Co. Ltd.	Dr.		1,50,000	
	Cash a./c	Dr.		59,000	
	To Chandra Co. Ltd. a/c				2,09,000
	(Being Purchase consideration received)				
	Cash a/c	Dr.		40,000	
	To Realisation a/c				40,000
	(Being assets not taken over has been disposed)				
	Realisation a/c	Dr.		4,000	
	To Cash a/c				4,000
	(Being liquidation expenses paid)				
	Equity shareholders a/c	Dr.		15,000	
	To Realization a/c				15,000
	(Being loss on realization transferred)				
	Equity share capital a/c	Dr.		2,00,000	
	Accumulated profits a/c	Dr.		70,000	
	To Equity shareholders a/c				2,70,000
	(Being capital and profit transferred)				
	Equity shareholders a/c	Dr.		2,55,000	
	To Equity shares in Chandra Co. Ltd.. a/c				1,50,000
	To Cash a/c				1,05,000
	(Being payment made to equity shareholders)				

Dr. **Realisation a/c** **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To Goodwill a/c	40,000	By Debentures a/c	1,00,000
To Fixed assets a/c	1,65,000	By Creditors a/c	30,000
To Current assets a/c	1,85,000	By Chandra Co. Ltd.	2,09,000
To Cash a/c	4,000	By Cash a/c	40,000
		By Equity shareholders a/c (Loss)	15,000
	3,94,000		3,94,000

Dr. Equity shareholders a/c Cr.

Particulars	Rs.	Particulars	Rs.
To Realisation a/c (Loss)	15,000	By Equity share capital a/c	2,00,000
To Shares in Chandra Co. Ltd.	1,50,000	By Accumulated profits a/c	70,000
To Cash a/c	1,05,000		
	2,70,000		2,70,000

Dr. Cash a/c Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	10,000	By Realisation a/c	4,000
To Realization a/c	40,000	By Equity shareholders a/c	1,05,000
To Chandra Co. Ltd. a/c	59,000		
	1,09,000		1,09,000

Notes :

1. Assume the current assets include an amount of Rs.10,000 as cash.

2. The amount of goodwill is to be taken as nil at the time of its writing off even though Chandra & Co., did not take goodwill. As such it was transferred to realization a/c and written off.

Illu.9 : The Balance sheet of ABC Co. Ltd., as on December, 31st 2009 is given below.

Liabilities	Rs.	Assets	Rs.
Authorised capital		**Goodwill**	**30,000**
1,500 6% Preference shares @ Rs.100 each	**1,50,000**	**Land and Buildings**	**30,000**
1,500 equity shares @ Rs.100 each	**1,50,000**	**Plant, machinery**	**45,000**
	3,00,000	**Stock**	**1,05,000**
Paid up capital		**Loose tools**	**5,000**
1,200 preference share capital fully paid up	**1,20,000**	**Bills receivable**	**13,500**
800 Equity shares fully paid up	**80,000**	**Cash at bank**	**1,500**
5% Debentures	**1,00,000**	**Profit and Loss a/c**	**1,20,000**
Sundry Creditors	**87,500**	**Sundry Debtors**	**55,000**
Bills payable	**17,500**		
	4,05,000		**4,05,000**

It was decided to reconstruct the Company and for this purpose another company called ABC (2009) Company Ltd. registered with a capital of Rs.3,00,000 divided into 2,000, 7% cumulative preference shares of Rs.100 each and 1,000 equity shares of Rs.100 each to take over the assets and liabilities of the ABC Co. Ltd.

The debenture holders in ABC Co. Ltd. agreed to accept 7% cumulative preference shares in ABC (2009) Co. Ltd. in the exchange for their debentures.

The preference shareholders in ABC Co. Ltd., were to receive one preference share in the ABC (2009) Co. ltd., for every three shares held by them in ABC Co. Ltd.

The Equity shareholders were to be allotted one equity share of Rs.75 paid in ABC (2009) Co. Ltd. in the exchange for the every four shares held by them ABC Co. Ltd.

The cost of liquidation of ABC Co. Ltd. Rs.500 was paid by ABC (2009) Co. Ltd.

Give the journal entries necessary to record the above transactions in the books of ABC Co. Ltd., and show the opening balance sheet of ABC (2009) Co. Ltd.

Solution :

Calculation of purchase consideration :

	Rs.
Preference shareholders : One equity share in new company for every three shares held in old company Rs.1,200 x 1/3 = 400 shares @ Rs.100	40,000
Equity shareholders : For every one equity share of Rs.75 value in new company will be given for every four shares held in old company Rs.800 x ¼ = 200 shares @ Rs.75	15,000
Purchase consideration	55,000

Journal Entries in the Books of ABC (2009) Co. Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c	Dr.		55,000	
	To Liquidator of ABC Ltd.				55,000
	(Being the agreement made for business purchase of business)				
	Land and Buildings a/c	Dr.		30,000	
	Plant and machinery a/c	Dr.		45,000	
	Stock a/c	Dr.		1,05,000	
	Loosetools a/c	Dr.		5,000	
	Sundry Debtors a/c	Dr.		55,000	
	Bills receivable a/c	Dr.		13,500	
	Cash at bank a/c	Dr.		1,500	
	Goodwill a/c (Bal.fig()	Dr.		5,000	
	To 5% Debentures a/c				1,00,000
	To Creditors a/c				87,500
	To Bills payable a/c				17,500
	To Business purchase a/c				55,000
	(Being the assets and liabilities taken over)				
	5% Debentures a/c	Dr.		1,00,000	
	To Preference share capital a/c				1,00,000
	(Being				
	Liquidator of ABC Co. Ltd. a./c	Dr.		55,000	
	To Preference Share capital a/c				40,000
	To Equity share capital a/c				15,000
	(Being the payment of purchase price)				
	Goodwill a/c	Dr.		500	
	To Bank a/c				500
	(Being liquidation expenses paid)				

Balance sheet of ABC (2009) Company Ltd.

Liabilities	Rs.	Assets	Rs.
Preference share capital		Fixed Assets :	
2,000, 7% Accumulated preference shares each Rs.100	2,00,000	Goodwill (5,000 + 500)	5,500
1,000 Equity shares @ Rs.100 each	1,00,000	Land, and buildings	30,000
	3,00,000	Plant and machinery	45,000

Liabilities	Rs.	Assets	Rs.
Paid up capital		Loose tools	5,000
1,400 preference capital (1,000 + 400) fully paid up	1,40,000	Current assets :	
200 equity shares @ Rs.75 each	15,000	Debtors	55,000
Sundry Creditors	87,500	Stock	1,05,000
Bills payable	17,500	Bills receivable	13,500
		Cash at bank (Rs.1,500 – 500)	1,000
	2,60,000		**2,60,000**

Illu.10: The Balance Sheets as on 31st December, 2009 of Roji Ltd. and Lilli Ltd. are as under:

Liabilities	Roji Ltd. Rs.	Lilli Ltd. Rs.	Assets	Roji Ltd. Rs.	Lilli Ltd. Rs.
Authorised & Issued Capital:			**Goodwill**	**--**	**2,00,000**
Rs.100 shares	**30,00,000**	**10,00,000**	**Buildings**	**12,00,000**	**--**
Capital Reserve	**--**	**1,00,000**	**Plant & Machinery**	**13,00,000**	**8,40,000**
General Reserve	**4,00,000**	**50,000**	**Furniture**	**20,000**	**10,000**
Profit & Loss a/c	**2,40,000**	**70,000**	**Stock**	**7,60,000**	**3,60,000**
12% Debentures	**--**	**6,00,000**	**Debtors**	**4,60,000**	**3,60,000**
Creditors	**4,80,000**	**1,90,000**	**Cash in hand**	**--**	**10,000**
			Bank	**3,80,000**	**80,000**
			Expenditure on New Project		**1,50,000**
	41,20,000	**20,10,000**		**41,20,000**	**20,10,000**

Lilli Ltd. was absorbed by Roji Ltd. on 1st January, 2010 on the following terms:

a. **Fixed assets other than goodwill to be valued at Rs.10,00,000 including Rs.12,000 for furniture.**

b. **Stock to be reduced by Rs.40,000 and debtors by 5%.**

c. **Roji Ltd. to assume liabilities and to discharge the 12% debentures by issue of 10% debentures of the same value and in addition a premium of 6% was paid in cash.**

d. **The new project to be valued at Rs.1,90,000**

e. **The shareholders of Lilli Ltd. to receive cash payment of Rs.30 per share plus four equity shares in Roji Ltd. for every five shares held in Lilli Ltd.**

f. **Expenses of liquidation of Lilli Ltd. are to be reimbursed by Roji Ltd. to the extent of Rs.10,000.**
The actual expenses amounted to Rs.12,000

Draft journal entries in the books of Roji Ltd. and Lilli Ltd. and prepare the balance sheet of Roji Ltd. after absorption assuming that Roji's authorised capital is Rs.40,00,000.

Solution:

Calculation of Purchase Consideration:

	Rs.
Cash for Shareholders (10,000 × 30)	3,00,000
New Shares for Shareholders (10,000 × 4/5 × 100)	8,00,000
Expenses of liquidation of Lilli Ltd.	10,000
Purchase Consideration	**11,10,000**

In the Books of Lilli Ltd.

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Profit & Loss a/c	Dr.		60,000	
	To Divided Payable Account				60,000
	(Being dividend @ 6% payable on Rs.10,00,000 share capital)				
	Dividend Payable Account	Dr.		60,000	
	To Bank a/c				60,000
	(Being payment of dividend)				
	Realisation a/c	Dr.		19,48,000	
	To Goodwill a/c				2,00,000
	To Plant, Machinery a/c				8,40,000
	To Furniture a/c				10,000
	To Stock a/c				3,60,000
	To Debtors a/c				3,60,000
	To New Project a/c				1,50,000
	To Cash a/c				8,000
	To Bank a/c				20,000
	(Being transfer of assets to Realisation a/c)				

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Creditors a/c	Dr.		1,90,000	
	12% Debentures a/c	Dr.		6,00,000	
	To Realisation a/c				7,90,000
	(Being liabilities agreed to be paid by Roji Ltd. transferred to Realisation Account)				
	Roji Ltd. a/c	Dr.		11,10,000	
	To Realisation a/c				11,10,000
	(Being purchase consideration agreed to be paid by Roji Ltd.)				
	Equity shares in Roji Ltd. a/c	Dr.		8,00,000	
	Bank a/c	Dr.		3,10,000	
	To Realisation a/c				11,10,000
	(Being receipt of purchase consideration)				
	Realisation a/c	Dr.		12,000	
	To Bank a/c				12,000
	(Being payment of realisation expenses not reimbursed by Roji Ltd.)				
	Equity Shareholders a/c	Dr.		60,000	
	To Realisation a/c				60,000
	(Being loss on realisation transferred to Equity Shareholders Account)				
	Equity Share Capital a/c	Dr.		10,00,000	
	Capital Reserve a/c	Dr.		1,00,000	
	General Reserve a/c	Dr.		50,000	
	Profit & Loss a/c (70,000-60,000)	Dr.		10,000	
	To Equity Shareholders a/c				11,60,000
	(Being transfer of equity share capital and reserves to shareholders a/c)				
	Equity Shareholders Account	Dr.		11,00,000	
	To Equity Shares in Roji Ltd.				8,00,000
	To Bank a/c				3,00,000
	(Being payment of amount due to shareholders)				

Dr. **Realisation a/c** Cr.

	Rs.		Rs.
To Goodwill a/c	2,00,000	By Creditors	1,90,000
To Plant, Machinery a/c	8,40,000	By 12% Debentures	6,00,000
To Furniture a/c	10,000	By Roji Ltd. a/c	11,10,000
To Stock a/c	3,60,000	By Realisation a/c (Loss)	60,000

	Rs.		Rs.
To Debtors a/c	3,60,000		
To New Project a/c	1,50,000		
To Cash a/c (10,000-2,000)	8,000		
To Bank a/c	20,000		
To Bank a/c	12,000		
	19,60,000		**19,60,000**

In the books of Roji Ltd.
Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
1-1-2010	Business Purchase a/c	Dr.		11,10,000	
	To Liquidators of Lilli Ltd.				11,10,000
	(Being purchase consideration agreed to be paid for purchase of business of Lilli Ltd.)				
	Goodwill a/c	Dr.		56,000	
	Plant, Machinery a/c	Dr.		9,88,000	
	Furniture a/c	Dr.		12,000	
	New Project a/c	Dr.		1,90,000	
	Stock a/c	Dr.		3,20,000	
	Debtors a/c	Dr.		3,60,000	
	Cash a/c	Dr.		8,000	
	Bank a/c	Dr.		20,000	
	To Creditors a/c				1,90,000
	To Bad debts reserve a/c				18,000
	To 12% Debentures a/c				6,00,000
	To Debentures redemption premium a/c				36,000
	To Business Purchase a/c				11,10,000
	(Being assets and liabilities of Lilli Ltd. taken over)				
	Liquidators of Lilli Ltd. a/c	Dr.		11,10,000	
	To Equity Shares Capital a/c				8,00,000
	To Bank a/c				3,10,000
	(Being payment of the purchase price)				
	12% Debentures a/c	Dr.		6,00,000	
	Debenture redemption premium a/c	Dr.		36,000	
	To Debentures a/c				6,36,000
	(Being the amount due to debenture holders)				

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Profit & Loss a/c	Dr.		1,80,000	
	To Dividend payable a/c				1,80,000
	(Being 6% dividend payable on Rs.30,00,000 share capital)				
	Dividend Payable a/c	Dr.		1,80,000	
	To Bank a/c				1,80,000
	(Being Payment of dividend)				

Balance Sheet of Roji Ltd. as on 1-1-2010

Liabilities	Rs.	Assets		Rs.
Share Capital Authorised:		Assets:		
38,000 Equity shares of		Goodwill		56,000
Rs.100 each (8,000 shares of		Buildings		10,00,000
Rs.100 each for Business		New Project		1,90,000
purchase consideration)	38,00,000			
Reserves & Surplus	4,00,000	Plant & Machinery (13,00,000 + 9,88,000)		22,88,000
Profit & Loss a/c	60,000	Furniture (20,000+12,000)		32,000
Secured Loans:		Stock (7,60,000+3,60,000)		11,20,000
10% Debentures	6,00,000			
Current Liabilities:		Debtors	8,20,000	
Creditors	6,70,000	Less: provision for Doubtful debts	18,000	8,02,000
		Cash and Bank Balance		42,000
	55,30,000			**55,30,000**

Intrinsic value of shares :

In the net asset method purchase consideration is calculated by arriving at the net assets of the selling company. This purchase consideration is discharged by the purchasing company in the form of shares, debentures and cash. As a slight variation, sometimes a student may be asked to calculate the intrinsic value of shares of both the companies and determine the ratio of exchange of the shares between the buying and selling companies. It may be understood that the purchase consideration is still equal to the net assets of the selling company.

The additional feature is the valuation of shares of the purchasing company on the net assets basis for the purpose of allotment to the shareholders of the selling company. In some cases the student is given the agreed value of the shares of both the companies. In such a case there is not need to calculate the intrinsic values of shares and all that is required is to establish the basis of the exchange.

Illu.11 : The following are the balances of Ankineedu Ltd., Bapineedu ltd. as on 31-3-2010

Liabilities	Ankineeedu Rs.	Bapineedu Rs.	Assets	Ankineedu Rs.	Bapineedu Rs.
Share capital			**Fixed Assets**	**35,00,000**	**15,00,000**
Shares of Rs.100	**20,00,000**	**9,00,000**	**Investments**	**25,00,000**	**-**
General reserve	**25,00,000**	**5,00,000**	**Current assets**	**30,00,000**	**10,00,000**
Profit and Loss a/c	**15,00,000**	**4,00,000**			
Secured loans	**17,50,000**	**-**			
Current liabilities :					
Creditors	**12,50,000**	**5,00,000**			
Bills payable	**-**	**2,00,000**			
	90,00,000	**25,00,000**		**90,00,000**	**25,00,000**

Ankineed Ltd., agrees to take over Bapineedu Ltd. Find out the ratio of exchange of shares on the basis of the intrinsic values.

Solution :

(1) Calculation of fair value of share

	Ankineedu Ltd		**Bapineedu Ltd.**	
	Rs.	Rs.	Rs.	Rs.
Assets :				
Fixed Assets		35,00,000		15,00,000
Investments		25,00,000		
Current Assets		30,00,000		10,00,000
Total Gross Assets		90,00,000		25,00,000
Less : Liabilities				
Secured Loans	17,50,000		5,00,000	
Creditors	12,50,000	30,00,000	2,00,000	7,00,000
Net Assets		60,00,000		18,00,000
Fair value of share		$\frac{60,00,000}{20,000}$ =Rs.300		$\frac{18,00,000}{9,000}$ =Rs.200

(2) Calculation of Exchange ratio :

This can be done in two ways. The first method is to calculate the LCM. of the intrinsic values of shares and the amount so obtained is divided by the intrinsic values to arrive at the ratio of exchange.

LCM of Rs.300 and Rs.200 is Rs.600
Therefore 2 shares of Ankineedu Ltd. will be equal to Rs.600
3 shares of Bapineedu Ltd. will be equal to Rs.600.

Consequently, the ratio of exchange is two shares of Ankineedu Ltd. for every three shares of Bapineedu Ltd.

Alternatively, divide the net assets of Bapineedu Ltd., by the intrinsic value of the share of A Ltd., to determine the number of shares to be issued on the basis of which the ratio of exchange can be determined.

Net assets of Bapineedu Ltd = Rs.18,00,000
Intrinsic value of the shares of Ankineedu Ltd., = Rs.300
Number of shares of Ankineedu to be issued = $\frac{18,00,000}{300} = 6,000$ shares

So the ratio of exchange is 6,000 shares of Ankineedu Ltd. for 9,000 shares of Bapineedu Ltd., i.e., two shares of Ankineedu Ltd., for every three shares of Bapineedu Ltd.

Illu.11 : The A Ltd., is absorbed by B Ltd. and the Balance sheet of both companies after revaluation are as given under :

Balance sheet of A Ltd.

Liabilities	Rs.	Assets	Rs.
Equity (Par Rs.100) paid up Rs.90 each	90,000	Fixed Assets	1,10,000
Profit and Loss a/c	62,000	Stores	67,000
Bills payable	30,000	Trade debtors	36,000
Creditors	33,600	Cash	12,000
Provision for taxation	14,400	Preliminary expenses	5,000
	2,30,000		2,30,000

Balance sheet of B Ltd.

Liabilities	Rs.	Assets	Rs.
Equity (Par Rs.100) paid		**Fixed Assets**	**1,66,000**
Up Rs.80 each	**2,40,000**	**Stores and stocks**	**93,000**
General Reserve	**48,000**	**Trade debtors**	**1,05,000**
8% Debentures	**70,000**	**Cash**	**36,000**
Creditors	**36,000**		
Provision for taxation	**6,000**		
	4,00,000		**4,00,000**

The holders of every two shares in A Ltd., is to receive three shares in B Ltd. plus as much cash as is required to adjust the rights of shareholders of both the companies in accordance with the intrinsic value of the shares of both companies.

Journalise the above transactions in the books of B Ltd., and prepare the Balance sheet of B Ltd. giving effect to the above scheme of absorption

Solution :

Calculation of Intrinsic value of shares of A Ltd.,

Intrinsic value of share = Net Assets value ÷ No .of equity shares

	A Ltd. Rs.	B Ltd. Rs.	A Ltd. Rs.	B Ltd. Rs.
Assets :				
Fixed Assets			1,10,000	1,66,000
Stores			67,000	93,000
Debtors			36,000	1,05,000
Cash			12,000	36,000
			2,25,000	4,00,000
Less : Liabilities :				
Creditors	33,600	36,000		
Provision for Taxation	14,400	6,000		
Bills payable	30,000	-	78,000	42,000
Net Assets			1,47,000	3,58,000
No. of Equity shares			1,000 shares	3,000 shares
Intrinsic value of share = $\frac{\text{Net Assets}}{\text{No. of Equity shares}}$			Rs.147	Rs.119.33

Calculation of Purchase consideration :

1. Issue of shares :

   For every two shares in A ltd., three shares are to be given in B Ltd.

   1,000 shares/2 x 3 = 1,500 shares @ Rs.80 = Rs.1,20,000

2. Payment of cash :

   Amount of cash required for equalizing the rights of shareholders of the both the companies against two companies in relation to the companies intrinsic share value.

		Rs.
Intrinsic value of 2 shares in A Ltd.	2 shares @ Rs.147	294
Intrinsic value of 2 shares in B Ltd.	3 shares @ Rs.119.33	358
Payment of cash for the difference for every two shares in A Ltd.		**64**

2 shares = Rs.64

For 1,000 shares = ? 1,000/2 x 64 = Rs.32,000

Total purchase consideration = Rs.1,20,000 + 32,000 = Rs.1,52,000

Journal Entries in the books of B Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c	Dr.		1,52,000	
	To Liquidator of A Ltd.				1,52,000
	(Being the agreement made for business purchase of business)				
	Fixed Assets a/c	Dr.		1,10,000	
	Stores a/c	Dr.		67,000	
	Trade Debtors a/c	Dr.		36,000	
	Cash a/c	Dr.		12,000	
	Goodwill a/c (Bal.fig)	Dr.		5,000	
	To Bills payable a/c				30,000
	To Creditors a/c				33,600
	To Provision for Taxation a/c				14,400
	To Business purchase a/c				1,52,000
	(Being the assets and liabilities taken over)				
	Liquidator of A Ltd. a./c	Dr.		1,52,000	
	To Equity Share capital a/c				1,20,000
	To Cash a/c				32,000
	(Being the payment of purchase price)				

Balance sheet of B Ltd.

Liabilities	Rs.	Assets	Rs.
Share capital (3,500 + 1,000) 4,500 equity shares @ Rs.80 per share fully paid	3,60,000	Goodwill	5,000
General Reserve	48,000	Fixed Assets (Rs.1,66,000 + 1,10,000)	2,76,000
8% Debentures	70,000	Stores (Rs.93,000 + 67,000)	1,60,000
Creditors (Rs.36,000 + 33,600)	69,600	Trade Debtors (Rs.1,05,000 + 36,000)	1,41,000
Bills payable	30,000	Cash (Rs.36,000 + 12,000 + 32,000)	16,000
Provision for taxation (Rs.6,000 + 14,400)	20,400		
	5,98,000		5,98,000

9.5 DISSENTING SHAREHOLDERS

Dissenting shareholders are persons who have not given their assent to the scheme of amalgamation entered into by the prescribed majority of shareholders. Such shareholders refuse to transfer their shares to the purchasing company in accordance with the scheme of amalgamation Under Section 395 of the Companies Act, 1956 the shares of such dissenting shareholders may be acquired by the amalgamated company :

a. on the same terms on which the willing shareholders passed on their shares; or
b. on other terms agreed upon between the amalgamated company and dissenting shareholders; or
c. on terms ordered by the by the court on an application made either by the amalgamated company or the dissenting shareholders.

Sometimes in some problems, one may come across a different type of settlement with dissenting shareholders. In such cases, the paid up capital held by the dissenting shareholders must be transferred to a separate shareholders' account. Any premium they receive or discount they suffer as per the agreement or the order of the court must be adjusted through realization account as in the case of preference shareholders and debenture holders.

The remaining profit or loss on realization will be transferred to willing shareholders' account. All balance sheet items pertaining to shareholders will be transferred to majority (willing) shareholders account only.

Illu.12: Bhavana Ltd. agrees to acquire, as a going concern, the business of Chandana Ltd. on the basis of vendor's balance sheet at 31st December, 2009 which is as follows:

Liabilities	Rs.	Assets		Rs.
Authorised Capital: 25,000 shares of Rs.50 each	12,50,000	Freehold Property		2,50,000
		Plant and Machinery		50,000
Issued Capital – 20,000 shares of Rs.50 each	10,00,000	Stock		3,00,000
		11% Govt. Papers		10,000
Called up Capital 20,000 shares of Rs.50 each Rs.30 called up	6,00,000	Debtors	2,30,000	
		Less: Provision	10,000	2,20,000
Reserve fund	1,25,000	Cash at Bank		30,000
Creditors	75,000			
Profit & Loss a/c	60,000			
	8,60,000			8,60,000

Bhavana Co. Ltd. took over all the assets and liabilities of the vendor company, subject to the retention of Rs.15,000 cash to provide for cost of liquidation, income-tax etc. and to satisfy any dissenting shareholders.

The consideration for the sale is the allotment of the shares to the shareholders in the vendor company of one share Rs.100 (Rs.50 paid up) in the Bhavana Co. Ltd. for every two shares in the Chandana Co. Ltd.

The market value of the Bhavana Co's shares, which are Rs.50 paid up, at the date of sale is Rs.70 each. The liquidator of the vendor company has paid out of Rs.15,000 retained; cost of liquidation amounting to Rs.2,500, income-tax Rs.7,500 and dissenting shareholders of 100 shares at Rs.32.50 per share, i.e., Rs.3,250

The sale and purchase were carried through on terms of the agreement.

Prepare necessary ledger accounts in the books of Chandana Co. Ltd. and journal entries in the books of Bhavana Co. Ltd. taking amalgamation in the nature of purchase.

Solution:

Books of Bhavana Co. Ltd.

Dr. **Realisation Account** Cr.

	Rs.		Rs.
To Freehold property	2,50,000	By Creditors	75,000
To Plant & Machinery	50,000	By Provision for Doubtful Debts	10,000
To Stock	3,00,000	By Chandana Ltd. A/c	4,97,500
To 11% Government	10,000	By Shareholders a/c	2,82,750
To Debtors	2,30,000		
To Bank	15,000		
To Bank a/c (Expenses Rs.2,500 + Income tax Rs.7,500)	10,000		
To Dissenting Shareholders a/c	250		
	8,65,250		**8,65,250**

Purchase consideration :

Total shares in Bhavana Ltd. = 20,000 shares

Shares of Dissenting shareholders = 100 shares

Shares of non-dissenting shareholders = 20,000 – 100 = 19,900 shares

As per the agreement for every two shares in Bhavana Ltd., one share will be given in Chandana. Therefore, the no. of shares received from Chandana towards purchase consideration. = 19,900 x 1./2 = 9,950 shares

Value of share in Chandana ltd. = Rs.50

Purchase consideration = 9,950 x 50 = Rs.4,97,500

Dr. **Chandana Ltd. Account** Cr.

	Rs.		Rs.
To Realisation a/c	4,97,500	By Shares in Chandana Co. Ltd.	4,97,500
	4,97,500		**4,97,500**

Dr. **Dissenting Shareholders Account** Cr.

	Rs.		Rs.
To Bank a/c	3,250	By Share Capital a/c	3,000
		By Realisation a/c	250
	3,250		**3,250**

Dr. **Shareholders Account** Cr.

	Rs.		Rs.
To Realisation a/c	2,82,750	By Share Capital a/c	5,97,000
To Shares in Chandana Co. Ltd. a/c	4,97,500	By Reserve fund a/c	1,25,000
To Bank	1,750	By Profit & Loss a/c	60,000
	7,82,000		**7,82,000**

Bank Account

Dr.	Rs.		Cr. Rs.
To Balance b/d	15,000	By Realisation	10,000
		By Dissenting shareholders	3,250
		By Shareholders a/c	1,750
	15,000		**15,000**

Shares in Chandana Co. Ltd. A/c

Dr.	Rs.		Cr. Rs.
To Chandana Co. Ltd.	4,97,500	By Share holders a/c	4,97,500
	4,97,500		**4,97,500**

Journal Entries of Chandana Co. Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
31-12-2009	Business Purchase a/c	Dr.		4,97,500	
	To Liquidator of Bhavana Co. Ltd.				4,97,500
	(Being the purchase consideration)				
	Freehold Property A/c	Dr.		2,50,000	
	Plant and Machinery a/c	Dr.		50,000	
	Stock a/c	Dr.		3,00,000	
	11% Govt. Papers a/c	Dr.		10,000	
	Debtors a/c	Dr.		2,30,000	
	Cash at Bank a/c	Dr.		15,000	
	To Creditors a/c				75,000
	To Provision for Doubtful debts a/c				10,000
	To Business Purchase a/c				4,97,500
	To Capital Reserve (Bal. Fig.)				2,72,500
	(Being various assets and liabilities taken over and balance treated as capital reserve)				
	Liquidator of Bhavana Co. Ltd. a/c	Dr.		4,97,500	
	To Share Capital a/c				4,97,500
	(Being the payment of purchase consideration)				

9.6 SELF ASSESSMENT QUESTIONS

1. Explain pooling of interest method of amalgamation
2. Explain the various methods for calculation of purchase consideration with regard to amalgamation of companies.
3. Explain how amalgamation is different from external reconstruction.

9.7 EXERCISES

1. Following is the Balance Sheet of Big Co. Ltd., and Small Co. Ltd. as on 31st March, 2010.

Liabilities	Big Co. Rs.	Small Co. Rs.	Assets	Big Co. Rs.	Small Co. Rs.
Equity share capital (Rs.100 each)	26,00,000	10,40,000	Land, Buildings	15,08,000	6,24,000
			Plant, Machinery	23,40,000	9,36,000
Pref. Share capital (Rs.100 each)	10,40,000	5,20,000	Furniture, Fittings	2,60,000	1,00,000
General Reserve	4,16,000	1,00,000	Closing Stock	7,80,000	2,60,000
Investment allowance reserve	3,64,000	1,56,000	Debtors	5,20,000	3,64,000
Profit & Loss a/c	5,20,000	2,60,000	Bank	2,60,000	1,56,000
15% Debentures (Rs.100 each)	2,60,000	1,04,000			
Creditors, Other Liabilities	4,68,000	2,60,000			
	56,68,000	24,40,000		56,68,000	24,40,000

Big Company purchased the Small Co. on 1st April, 2010 with the following conditions.

a. Small Co. Equity shareholders are to be issued equity shares worth Rs.10 at Rs.12.50.
b. In the preference shareholders of Small Ltd. will be issued preference shares of Rs.100 each at 12%.
c. The Debentures of Small Co. Ltd. will be exchanged as debentures of Big Co. Ltd. with the same number and value.
d. The investment allowance reserve of small co. will be maintained for three more years. The Market value of the plant are small Ltd. Rs.7,80,000.

Show the Journal entries in the books of Big Co. Ltd. and Balance sheet after absorption when (i) When Amalgamation is in the nature of merger (ii) When Amalgamation is in the nature of purchase.

[Ans.: Balance Sheet Total (i) Rs.80,08,000 (ii) Rs.81,08,000]

2. The AB company Ltd., BC Company Ltd., decided to amalgamate and a new company viz., ABC Company Ltd., is formed to take over both the companies on 30-6-2010.

The following are the Balance Sheets of the Companies as on that date.

AB Company Ltd.

Liabilities	Rs.	Assets	Rs.
5,00,000 Equity share of Rs.10 each fully paid	50,00,000	Goodwill	10,00,000
		Land and Buildings	25,00,000
Bills payable	5,00,000	Plant and Machinery	20,00,000
Workmen Compensation fund	2,00,000	Stock	20,00,000
Sundry Creditors	10,00,000	Sundry Debtors	10,00,000
Reserve fund	20,00,000	Cash at Bank	5,00,000
P & L a/c	3,00,000		
	90,00,000		90,00,000

BC Company Ltd.,

Liabilities	Rs.	Assets	Rs.
3,00,000 Equity shares of Rs.10 each fully paid	30,00,000	Goodwill	8,00,000
		Land and Buildings	19,00,000
Bank overdraft	5,00,000	Plant and Machinery	25,50,000
Sundry creditors	12,00,000	Patents & Trademarks	5,25,000
Bills payable	3,00,000	Stock	15,00,000
Dividend Equalization fund	10,00,000	Debtors	5,00,000
Reserve fund	15,00,000	Bill receivable	2,00,000
P & L A/c	5,00,000	Cash	25,000
	80,00,000		80,00,000

Show how the amount payable to each company is arrived at and prepare the amalgamated Balance Sheet of ABC Company Ltd.

[Ans.: Purchase Consideration AB Ltd. Rs.75,00,000; BC Ltd. Rs.60,00,000; Balance Sheet Total ABC Co. Ltd. Rs.1,70,00,000]

3. Silicon Co.Ltd. and Rilicon Company decided to amalgamation and a new company called silirilicon Company Limited, is formed to take over both the companies as on 1.1.2010.

The following are the Balance Sheets as on that date:

Silicon Co. Ltd.

Liabilities	Rs.	Assets	Rs.
2,50,000 equity shares of Rs.10 each fully paid	25,00,000	Goodwill	5,00,000
		Land & Building	15,00,000
Bills payable	2,50,000	Plant & Machinery	5,00,000
Workmen's Compensation fund	2,00,000	Stock	10,00,000
Sundry Creditors	5,00,000	Debtors	5,00,000
Reserve Fund	10,00,000	Cash at Bank	6,50,000
Profit & Loss A/c	2,00,000		
	46,50,000		46,50,000

Rilicon Co. Ltd.

Liabilities	Rs.	Assets	Rs.
3,00,000 equity shares of Rs.10 each fully paid	30,00,000	Goodwill	10,00,000
		Land & Building	15,00,000
Bank overdraft	5,00,000	Plant & Machinery	25,50,000
Sundry creditors	10,00,000	Patents & Trade marks	5,25,000
Bills payable	3,00,000	Stock	15,00,000
Dividend equalisation fund	10,00,000	Debtors	5,00,000
Reserve Fund	15,00,000	Bills receivable	2,00,000
Profit & Loss A/c	5,00,000	Cash	25,000
	78,00,000		78,00,000

Show how the amount payable to each company is arrived at and prepare amalgamated Balance Sheet of Silirilicon Company Ltd.

[Ans.: Purchase Consideration: Silicon Ltd. Rs.39,00,000; Rilicon Ltd. Rs.60,00,000; Balance Sheet Total Silirilicion Ltd. Rs.1,24,50,000]

4. Two Companies, Abad Ltd. and Nabad Ltd. amalagamate and form a new company Kamyab Ltd. The position of these companies is as under:

Balance Sheet

Liabilities	Abad Ltd. Rs.	Nabad Ltd. Rs.	Assets	Abad Ltd. Rs.	Nabad Ltd. Rs.
Paid up capital			Goodwill	70,000	--
Equity shares			Stock	1,80,000	80,000
of Rs.10 each	3,00,000	2,00,000	Debtors	2,00,000	2,20,000
P & L A/c	50,000	42,000			
Sundry Creditors	30,000	58,000			
5% Debentures	70,000	--			
	4,50,000	3,00,000		4,50,000	3,00,000

The average profits of Abad Ltd. and Nabad Ltd. have been Rs.30,000 Rs.20,000 respectively. Kamyab Ltd., agrees with the companies to take over botht he concerns for the sum of Rs.6,00,000 and in addition to discharge all liabilities, Rs.1,00,000 to be paid in cash and the balance in shares at face value.

It is agreed that the debtors of Abad Ltd. and Nabad Ltd., before being taken over by Kamyab Ltd., will be written off to the extent of 10% of their respective book figures.

The profit on conversion is to be divided between the shareholders of Abad Ltd. and Nabad Ltd. in the same proportion as to the profits previously earned by them.

Draw up Business Purchase Account on the completion of transfer in the books of Kamyab Ltd. Also show how the share capital account in Abad Ltd. and Nabad Ltd. should be closed.

[Ans.: Profit on conversion Rs.50,000; Abad Ltd. Rs.30,000; Nabad Ltd. Rs.20,000; Purchase Consideration: Abad Ltd. Rs.3,60,000 (Shares Rs.3,00,000 + Cash Rs.60,000); Nabad Ltd. Rs.2,40,000 (Shares Rs.2,00,000 + Cash Rs.40,000); Profit or Loss on Realisation: Abad Ltd. Profit Rs.10,000; Nabad Ltd. Loss Rs.2,000]

5. Das Ltd., and Ash Ltd. agreed to amalgamate and form into Dash Ltd., on which date their assets/liabilities were as follows:

	Das Ltd. Rs.	Ash Ltd. Rs.
Equity shares of Rs.10 each	5,00,000	3,00,000
5% Debentures	2,00,000	1,00,000
Reserve	--	50,000
P & L a/c	30,000	20,000
Sundry Creditors	2,70,000	1,30,000

	Das Ltd.	Ash Ltd.
	Rs.	Rs.
Sundry assets	4,80,000	3,22,000
Property	2,00,000	1,00,000
Investments	50,000	20,000
Sundry debtors	2,50,000	1,50,000
Preliminary expenses	20,000	8,000

Assumed all other liabilities/assets. It issued its shares at a premium of Rs.2. Assets were revalued as follows:

	Das Ltd.	Ash Ltd.
	Rs.	Rs.
Goodwill	1,00,000	75,000
Investments	51,000	20,000
Debtors	2,25,000	1,35,000
Sundry assets	4,10,000	2,80,000
Property	2,60,000	1,40,000

Calculate purchase consideration and pass journal entries necessary in the books of Dash Ltd.

[Ans.: Purchase Consideration Das Ltd. Rs.5,76,000; Ash Ltd. Rs.4,20,000; Realisation Profit Rs.66,000]

6. The X and Y companies having many interests in common, in order to economise decided to amalgamate and form a new company Z. The position of the two companies was as follows:

Liabilities	X Co. Rs.	Y Co. Rs.	Assets	X Co. Rs.	Y Co. Rs.
Capital: Paid-up	30,000	20,000	Debtors	18,000	20,000
Debentures	5,000	--	Stock	20,000	10,000
Creditors	5,000	8,000	Goodwill	5,000	--
Profit & Loss a/c	3,000	2,000			
	43,000	30,000		43,000	30,000

The average profits of X and Y companies have been Rs.3,000 and Rs.2,000 respectively. The new ‘Z’ company agrees with the X and Y companies to take over both the concerns for the sum of Rs.60,000 and, in addition to discharge all liabilities Rs.10,000 to be paid in cash and the balance in shares.

The profit on the conversation is to be divided between the shareholders of X and Y companies in the same proportions as the profits previously earned by the Companies.

Show the Balance Sheet of Z Company and state how much Mr.A holding 5,000 shares in X company and 4,000 shares in Y Co. would get from Z company.

[Ans.: Balance Sheet Total Rs.78,000; Mr.A will receive Rs.9,000 worth of shares in Z Co., Cash Rs.1,800]

7. Following are the balance sheets of Vishnu Ltd., and Priya Ltd., on 31-3-2010.

Liabilities	Vishnu Ltd. Rs.	Priya Ltd. Rs.	Assets	Vishnu Ltd. Rs.	Priya Ltd. Rs.
Equity Capital (Rs.10 each)	1,00,000	60,000	Land and Buildings	30,000	--
6% Debentures	20,000	--	Plant and Machinery	1,10,000	50,000
Reserve fund	34,000	--			
Dividend Equalisation Fund	4,000	--	Stock	16,000	8,000
			Debtors	14,000	9,000
Employment P.F.	3,000	--	Cash	3,000	1,000
Creditors	10,000	8,000			
Profit & Loss a/c	2,000	--			
	1,73,000	68,000		1,73,000	68,000

The two companies agreed to amalgamate into Vishnupriya Ltd. which takes over the Assets and Liabilities of both the companies. The authorised capital of Vishnupriya Ltd., would be 1,00,000 shares of Rs.10 each. Except Land and Buildings, the other assets of Vishnu Ltd. are taken over at 90% book value. Both companies would receive 5% of the Net Valuation as goodwill. In return of debentures of Vishnu Ltd., Debentures of Vishnupriya Ltd., were issued. Calculate purchase consideration and prepare balance sheet of Vishnupriya Ltd.

[Ans.: Purchase Consideration: Vishnu Ltd. Rs.1,53,300; Priya Ltd. Rs.63,000; Vishnu Ltd. Balance Sheet Total Rs.2,37,300]

8. Deva Ltd., and Asura Ltd., carrying on similar business agreed to amalgamate by transferring their undertakings to a new company Devasura Ltd. The Balance Sheets of the two companies as on the date of transfer were as follows:

Liabilities	Deva Ltd. Rs.	Asura Ltd. Rs.	Assets	Deva Ltd. Rs.	Asura Ltd. Rs.
Share Capital:			Land and Buildings	4,65,000	2,55,000
Equity shares of Rs.100 each	5,00,000	3,00,000	Plant and Machinery	5,60,000	3,58,000
6% Preference shares of Rs.100 each	5,00,000	2,50,000	Furniture & fittings	79,000	34,000
5% Debentures	--	40,000	Stock	81,500	52,000
General Reserve	2,00,000	70,000	Debtors	56,000	24,600
Profit and Loss a/c	1,15,000	55,000	Cash at Bank	87,000	22,500
Sundry Creditors	75,000	35,000	Cash in hand	6,400	3,900
			Preliminary expenses	55,100	
	13,90,000	7,50,000		13,90,000	7,50,000

The terms of agreement were as follows:

a. The purchase consideration consists of:
(i) The assumption of liabilities of both the companies (ii) The discharge of debentures in Asura Ltd., at a premium of 5% by the issue of 7% debentures in Devasura Ltd., (iii) The issue of 10 equity shares of Rs.10 each at a premium of Rs.2 per share for each preference held in both the companies (iv) The issue of 10 equity shares of Rs.10 each at a premium of Rs.2 per share and Rs.22 in cash for each equity share in Deva Ltd., and 5 equity shares of Rs.10 each at a premium of Rs.2 per share and Rs.80 in cash for every equity share in Asura Ltd.,

b. All the assets and liabilities of two companies were taken over at their book values except that a provision at 5% to be raised on debtors.

c. In order to raise working capital and to pay the purchase consideration Devasura Ltd., decided to issue 30,000 equity shares of Rs.10 each at a premium of Rs.2.50 per share.

You are required to (a) Pass journal entries in the books of Deva Ltd., to close its accounts and (b) Show the opening Balance Sheet of Devasura Ltd.,

[Ans.: Purchase Consideration: Deva Ltd. Rs.13,10,000; Asura Ltd. Rs.7,62,000; Loss on Realisation Rs.49,900; Goodwill (Rs.52,900 + 48,230) = 1,01,130; Balance Sheet Total Rs.22,07,000]

9. The following is the Balance sheet of XYZ Co. on 31st December, 2009.

Liabilities	Rs.	Assets	Rs.
Capital 20,000 shares of Rs.10 each	2,00,000	Buildings	1,00,000
Debentures	1,00,000	Plant	1,50,000
Creditors	30,000	Work in Progress	30,000
Reserve fund	25,000	Stock	60,000
Dividend Equalisation Fund	20,000	Furniture	2,500
P & L appropriation a/c	5,100	Debtors	25,000
		Bank	12,500
		Cash	100
	3,80,100		3,80,100

The company is absorbed by ABC Company on the above date. The consideration for the absorption is the discharge of debentures at a premium of 5% taking over the liability in respect of creditors, and a payment of Rs.7 in cash and one share of Rs.5 in ABC Company at a market value of Rs.8 per share in exchange for on share in XYZ Co. The cost of Liquidation of Rs.5,000 is to be met by the purchasing company.

Pass journal entries in the books of both the companies. Show how purchase price is arrived at.

[Ans.: Purchase Consideration Rs.4,05,000; Cash to shareholders Rs.1,40,000; Shares Rs.1,60,000; Realisation profit Rs.49,900]

10. Following is the Balance Sheet of X Company Ltd., as on 30th June, 2010.

Liabilities	Rs.	Assets	Rs.
12,000 shares of Rs.500 each		Land and Buildings	27,20,000
2,600 Debentures	60,00,000	Plant, Machinery	30,00,000
of Rs.500 each	13,00,000	Furniture, Fittings	1,00,000
Sundry creditors	5,00,000	Patents, Trademarks	4,00,000
Insurance fund	1,30,000	Stock	20,00,000
Workmen Savings Bank	4,00,000	Sundry Debtors	6,00,000
Reserve fund	6,50,000	Cash	1,80,000
Profit and Loss a/c	20,000		
	90,00,000		90,00,000

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

1. Payment of cash at Rs.90 for every share in X Ltd.
2. Payment of cash at Rs.550 for every debenture holder in full discharge of debentures.
3. 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 the necessary ledger accounts in X Ltd.

[Ans.: Purchase Consideration Rs.92,30,000; Realisation Profit Rs.10,00,000]

11. The Pig Iron Co. Ltd., agrees to absorb the business of the Iron Ore Co. Ltd., as on 30th June, 2010 and to take over the assets and liabilities at their balance sheet values, in exchange for which it is to issue 12 shares of Rs.10 each, for every share of Rs.100 each, in the Iron Ore Co. Ltd. The expense of absorption (Rs.10,000) will be paid by the Pig Co. Ltd. The Balance Sheets of two companies were as follows.

The Iron Ore Co. Ltd.,

Liabilities	Rs.	Assets	Rs.	Rs.
Capital:		Land and Buildings		3,00,000
5,000 Equity shares of		Plant and Machinery		2,00,000
Rs.100 fully paid	5,00,000			
Reserve fund	10,000	Debtors	55,000	
Sundry Creditors	58,000	Less: Bad debts reserve	5,000	50,000
Bills payable	42,000	Stock		25,000
		Cash at Bank		35,000
	6,10,000			6,10,000

The Pig Iron Co. Ltd.,

Liabilities	Rs.	Assets	Rs.
Authorised Capital:		Land, Buildings	5,00,000
2,00,000 Equity shares of		Plant, Machinery	3,00,000
Rs.10 each	20,00,000	Goodwill	1,00,000
Issued Capital:		Stock	60,000
1,00,000 Equity shares of		Sundry Debtors	1,20,000
Rs.10 each fully paid	10,00,000	Cash at Bank	1,00,000
Reserve	60,000		
Sundry Creditors	1,20,000		
	11,80,000		11,80,000

Show the journal entries in the books of the company that is being absorbed and the opening balance sheet of the Pig Iron Co. Ltd.

[Ans.: Purchase Consideration Rs.6,00,000; Realisation Profit Rs.90,000; Balance Sheet Total Rs.18,80,000]

12. The Balance Sheet of Lucky Co. Ltd., on 31st December, 2009 was as follows.

Liabilities	Rs.	Assets		Rs.
8,000 Equity shares of Rs.100 each fully paid	8,00,000	Land and Buildings		4,60,000
General Reserve	1,00,000	Plant and Machinery		3,60,000
Workmen's Compensation Fund (outstanding liability Rs.16,000)	60,000	Furniture		40,000
1,000, 14% Debentures Rs.100 each	1,00,000	Stock		1,80,000
Sundry Creditors	80,000	Sundry Debtors	2,00,000	
Bank Overdraft	20,000	Less: Bad debts provision	10,000	1,90,000
Staff Provident fund	80,000	Cash		10,000
	12,40,000			12,40,000

The business of the company is taken over by Good Luck Co. Ltd., on that date. The purchase consideration is to be discharged as follows.

a. A Payment in cash at Rs.20 for every share in Lucky Co. Ltd.

b. A further payment in cash at Rs.120 for every debentures in Lucky Co. Ltd., in full discharge of the debentures.

c. An exchange of 5 shares in Good Luck Co. Ltd., of Rs.20, each at the market value of Rs.30 per share, for every 2 shares in Lucky Co. Ltd.

Show the Realisation Account, Cash Account and the Sundry shareholders Account in the books of Lucky Co. Ltd. The expenses of liquidation Rs.10,000 were borne by Lucky Co. Ltd.

[Ans.: Purchase Consideration Rs.8,80,000; (a) Cash to Shareholders Rs.1,60,000; Shares to Shareholders Rs.6,00,000; Realisation Loss Rs.1,64,000]

13. Venkat Limited sells its business to Krishna Limited on 31st December, 2009, on which date its balance sheet was as under:

Liabilities	Rs.	Assets	Rs.
Paid-up Capital (2,000 shares of Rs.100 each)	2,00,000	Goodwill	50,000
Debentures	1,00,000	Freehold Property	1,50,000
Trade creditors	30,000	Plant and tools	83,000
Reserve fund	50,000	Stock	35,000
P & L Account	20,000	Bills Receivable	4,500
		Sundry Debtors	27,500
		Cash at bank	50,000
	4,00,000		4,00,000

Krishna Limited agreed to take over the Assets (exclusive of cash and goodwill) at 10% less than Book values, to pay Rs.75,000 for goodwill and to take over the debentures.

The purchase consideration was to be discharged by the allotment to the Venkat Limited 1500 shares of Rs.100 each at a premium of Rs.10 per share and the balance in cash. The cost of liquidation amounted to Rs.3,000.

Show the necessary accounts in the books of Venkat Limited.

[Ans.: Purchase Consideration Rs.2,45,000; Realisation Loss Rs.8,000; Cash available to shareholders Rs.97,000]

14. The Balance Sheet of X Ltd. on 31st December 2009 was as follows.

Liabilities	Rs.	Assets	Rs.
8,000 Equity Share of Rs.50 each	4,00,000	Land & Buildings	2,30,000
		Plant and Machinery	1,80,000
General Reserve	50,000	Furniture	20,000
Workmen's Accident Fund		Stock	90,000
(outstanding liability Rs.8,000)	30,000	Sundry Debtors	95,000
1,000 7% Debentures	50,000	Cash	2,000
Sundry Creditors	40,000	Discount on issue of Debentures	3,000
Bank Overdraft	10,000		
Provident Fund	40,000		
	6,20,000		6,20,000

The business of the Company is taken over by Y Ltd. on that date, the purchase consideration is to be discharged as follows.

(a) A payment in cash at Rs.10 for every share in X Ltd.

(b) A payment of cash at Rs.60 for every debenture in X Ltd.

(c) As exchange of 5 shares in Y Ltd. of Rs.10 each at the market value of Rs.15 per share, for every 2 shares in X Ltd.

(d) The Liquidation expenses Rs.5,000 were borne by x Ltd.

Pass necessary Journal entries in the books of X Ltd. and Y Ltd.

[Ans.: (1) Purchase Consideration Rs.4,40,000; (Cash to Shareholders Rs.80,000; Shares in Y Ltd., per share Rs.3,00,000) (2) Realisation Loss Rs.94,000; Cash paid to shareholders Rs.75,000]

15. Dasaradhi Co. Ltd. agreed to acquire the business of Janaki Co. Ltd. as on 31st March, 2010. The summarised Balance Sheet of Janaki co. Ltd., on that date was as follows:

Liabilities	Rs.	Assets	Rs.
Share capital in fully paid shares of Rs.10 each	12,00,000	Goodwill	2,00,000
		Land, Buildings	8,00,000
General Reserve	3,40,000	Machinery	4,80,000
Profit & Loss a/c	2,20,000	Stock in trade	3,36,000
12% Debentures	2,00,000	Debtors	72,000
Creditors	40,000	Cash	1,12,000
	20,00,000		20,00,000

The consideration payable by Dasaradhi Co. Ltd. was agreed as follows.

a. A cash payment equivalent to Rs.2.50 for every Rs.10 share in Janaki Co. Ltd.

b. The issue of 1,80,000, Rs.10 shares, fully paid in Dasaradhi Co. Ltd., having agreed value of Rs.15 per share.

c. The issue of such an amount of fully paid 10% debentures of Dasaradhi Co. Ltd. at 96% as is sufficient to discharge the 12% debentures of Janaki Co. Ltd., at a premium of 20%.

When computing the agreed consideration, the directors of Dasaradhi Co. Ltd., valued Land and Buildings at Rs.16,00,000, Machinery at Rs.8,00,000, Stock at Rs.2,84,000 and Debtors at this face value subject to allowance of 10% to cover doubtful debts. The cost of liquidation of Janaki Co. Ltd. came to Rs.10,000.

Close the books of Janaki Co. Ltd. and draft journal entries required in the books of Dasaradhi Co. Ltd.

[Ans.: Purchase Consideration Rs.32,40,000; (Cash Rs.3,00,000 + Shares Rs.27,00,000)]

16. Aravida and Co. Ltd., sells its business to Bharath Co. Ltd., as on 31st March, 2010 on which date its balance sheet was as under:

Liabilities	Rs.('000)	Assets	Rs.('000)
Share Capital:		Land and Buildings	2,00,000
40,000 shares of Rs.10 each	4,00,000	Plant	2,63,000
Reserve	80,000	Furniture	70,000
Profit and loss a/c	28,000	Stock	86,000
10% Debentures	2,00,000	Trade Debtors	37,000
Trade Creditors	42,000	Cash at bank	86,000
		Underwriting Commission	8,000
	7,50,000		7,50,000

Bharath Co. Ltd., agreed to take over the Assets except Cash at Bank at book values. However, furniture was valued at Rs.56,000. It also agreed to take over Trade Creditors. The considerations was discharged by

i. The allotment at part of 40,000 fully paid equity shares of Rs.10 each.
ii. Bharath Ltd., converted 10% debentures into 2,000 fully paid 12% debentures of Rs.100 each allotted at par.

Aravind & Co. Ltd., met the expenses of liquidation totalling Rs.6,000. Prepare accounts in Aravind & Co. Ltd.,'s ledger and pass journal entries in the books of Bharath Co. Ltd.

[Ans.: Purchase Consideration Rs.6,00,000; Realisation Loss Rs.20,000]

17. The following is the Balance Sheet of Veerendra Company Limited on 31st March, 2010.

Liabilities	Rs.	Assets	Rs.
Share Capital 10 each	2,00,000	Land and Buildings	1,00,000
Reserve fund	25,000	Plant and Machinery	1,50,000
Dividend Equilisation Fund	20,000	Furniture	30,000
P & L Appropriation a/c	5,000	Stock	60,000
6% Debentures	1,00,000	Sundry Debtors	25,000
Sundry Creditors	50,000	Cash at bank	35,000
	4,00,000		4,00,000

The company is absorbed by Suresh Company Limited on the above date. The consideration for absorption is the discharge of the debentures at 5 per cent premium taking over the liability in respect of the sundry creditors a payment of Rs.8 in cash and one share of Rs.5 in Suresh Company limited at the market rate of Rs.8 per share in exchange for one share in Veerendra Company Limited and payment of cost of liquidation Rs.10,000. Pass journal entries in the books of both the companies.

[Ans.: Purchase Consideration Rs.4,35,000; Cash : Shareholders Rs.1,60,000; Realisation Profit Rs.70,000]

18. The following Balance Sheet of Weak Co. Ltd., as on 30th June, 2009.

Liabilities	Rs.	Assets	Rs.
Share Capital : 2,000 shares		Goodwill	35,000
of Rs.100 each	2,00,000	Land, Buildings	85,000
Reserve fund	20,000	Plant and Machinery	1,60,000
5% Debentures	1,00,000	Stock	55,000
Loan from A (a director)	40,000	Sundry Debtors	65,000
Sundry Creditors	80,000	Cash at bank	34,000
		Discount on Debentures	6,000
	4,40,000		4,40,000

The business of the company is taken over by Strong Co. Ltd., as on that date on the following terms.

a. Strong Co. to take over all assets except each, to value the assets at book values less 10% except goodwill which is to be valued at 4 year's purchase of the excess of average (5 years) profit over 8% of the combined amount of share capital and reserves.

b. Strong Co. to take over trade liabilities which were subject to discount of 5%.

c. The purchase consideration was to be discharged in cash to the extent of Rs.1,50,000 and the balance in fully paid equity shares of Rs.10 each value at Rs.12.50 per share. The average of the 'five years' profit was Rs.30,100. The expenses of absorption Rs.4,000 were paid by Weak Co. Ltd. but afterwards reimbursed by Strong Co. Ltd.

Show the necessary journal entries in the books of Weak Ltd., and Strong Ltd.

[Ans.: Purchase Consideration Rs.3,02,500; Realisation Loss Rs.17,500; Goodwill Rs.50,000]

19. The following is the Balance Sheet of Small & Co. Ltd., as on 31st June, 2010

Liabilities	Rs.	Assets	Rs.
Share Capital		Buildings	1,70,000
4,000 Equity shares of Rs.100		Plant and Machinery	4,00,000
each	4,00,000	Investments	50,600
General Reserve	50,000	Sundry Debtors	1,40,500
Profit and Loss a/c	5,600	Stock	80,700
5% Debentures	2,50,000	Cash at Bank	16,500
Sundry Creditors	80,500		
Proposed Dividend	24,000		
Provision for Taxation	48,200		
	8,58,300		8,58,300

Small Co. Ltd., was absorbed by Big Limited on the above mentioned date on the following terms and conditions. Big Co. Ltd., was to

a. acquire all the assets except investments which was sold-off by Small Co. Ltd., for Rs.45,500
b. assume all liabilities except provision for taxation.
c. Discharge the Debenture debt at a discount of 5% by the issue of 7% debentures in Big Co. Ltd.

d. Issue to the shareholders of Small Co. Ltd., two shares of Rs.60 each in Big Co. Ltd., at the market rate of Rs.65 per share and a payment in cash of Rs.2 in exchange for one share in Small Co. Ltd.
e. Pay the cost of absorption of Rs.1,500

Plant and machinery taken over was depreciated by the absorbing company to the extent of 5% and a provision for doubtful debts equal to 3% was made on Sundry Debtors. Small Co. Ltd., sold-off in the open market one-fourth of the shares received from Big Co. Ltd., at the average price of Rs.63 share.

Show the journal entries to record the above transaction in the books of Small Co. Ltd., and the opening journal entries in the books of Big Co. Ltd.,

[Ans.: Purchase Consideration Rs.7,67,000; Realisation Profit Rs. 65,700; Cash to Shareholders Rs.1,31,300]

20. Bharath Ltd., having a capital of Rs.10,00,000 divided into 10,000 shares of Rs.100 each (Rs.75 paid up) and a Reserve Fund of Rs.2,50,000 was absorbed by Hari Ltd. having a capital of Rs.30,00,000 divided into 40,000 shares of Rs.100 each (Rs.60 paid up) and a Reserve Fund of Rs.6,00,000 on the terms that for every four shares in the absorbed company, the absorbing company was to give five shares partly paid as its original ones.

Prepare ledger accounts in the books of the transferror company. Also prepare Hari Ltd.,'s Balance Sheet soon after absorption.

[Ans.: Purchase Consideration Rs.7,50,000; (12,500 shares of Rs.60 each) Capital Reserve Rs.2,50,000; Hari Ltd. Balance Sheet Total Rs.40,00,000]

21. Ajanta Ltd., agreed to acquire Ellora Ltd. as on 31-3-2010 on which data the financial position of Ellora Ltd., was as follows.

	Rs.		Rs.
10,000, 6% preference shares of Rs.10 each	1,00,000	Land and Buildings	2,00,000
		Machinery	1,00,000
20,000 Equity Shares of Rs.10 each	2,00,000	Stock	2,00,000
		Debtors	50,000
P & L Account	50,000	Cash at Bank	35,000
7% debentures	1,00,000	Preliminary expenses	15,000
Sundry Creditors	1,50,000		

Ajantha Ltd., agreed to

a. Allot 8% preference shares in their company in lieu of the existing preference share holding.

b. Equity shareholders are to be allotted 6 equity shares of Rs.100 each at a premium of 10%, and also a cash payment of Rs.3 for every 5 shares held.

c. 7% debenture holders are to be paid at 8% premium by 9% debentures. Pass journal entries in the books of Ellora Ltd.

[Ans.: Purchase Consideration Rs.4,84,000; (Preference Shares Rs.1,00,000; Equity Shares Rs.2,64,000; Cash Rs.12,000) Realisation Profit Rs.41,000]

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Chapter –10

AMALGAMATION - INTER COMPANY OWINGS

Objectives :

After studying this unit you should be able to :

- know the procedure of accounting on inter company owings in the amalgamation of companies.
- understand the problem of unrealized profit on stock in the amalgamation of companies

Structure :

10.1 INTER COMPANY OWINGS

At the time of amalgamation it may be found that the transferee company may owe money to Transferor Company or vice versa. It may be due to the face that purchase/sale of goods has taken place between the two companies or loans or bills are given by one company to the other. Thus 'Inter company Owings' can be in the form of 'Debtors and Creditors' or 'Bills receivable and Bills payable' or Loan given and Loan taken' in the books of transferee and transferor companies.

10.2 CANCELLATION OF COMMON DEBTS

Books on vendor company : So far as the books of vendor company are concerned there is no effect of these types of transactions on the accounting entries suggested in the earlier part of this chapter. The accounts are closed by transferring them to realization accounts in the usual way. Any owing to or from the purchasing company is transferred to realization account under the presumption that the purchasing company has taken over the accounts.

Books of purchasing company : In the books of purchasing company also, the entries for the purchase of business and that for payment of purchases consideration are made in the usual way. But in addition to these entries extra adjustment entries are needed which are as follows.

i. **Entry for canceling the debtors account in the books of vendor company and corresponding creditors account in the books of purchasing company :**

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Purchasing company creditors a/c Dr.		x x x	
	To Vendor company debtors a/c			x x x

The above entry will have the effect of canceling the debtor in the vendor company.

ii. **Entry for the canceling the debtor of the purchasing company and creditor of the vendor company.**

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Vendor company creditors a/c Dr.		x x x	
	To Purchasing company debtors a/c			x x x

Illu.1: Ajanta Limited agreed to acquire the business of Elora Ltd. as on 31-3-2010. The Balance Sheet of Elora Limited as on that date was as under:

Liabilities	Rs.	Assets	Rs.
Paid up Capital:		**Fixed Assets:**	
10,000 6% Preference		**Land and Building**	**2,00,000**
Shares of Rs.10 each	**1,00,000**	**Machineries**	**1,00,000**
20,000 Equity shares of		**Current Assets:**	
Rs.10 each	**2,00,000**	**Stock**	**2,00,000**
Reserve	**20,000**	**Debtors**	**50,000**
Profit & Loss Account	**30,000**	**Cash and Bank Balances**	**35,000**
7% Debentures	**1,00,000**	**Miscellaneous Expenditure:**	
Sundry Creditors	**1,50,000**	**Preliminary Expenses:**	**10,000**
		Debenture Discount	**5,000**
	6,00,000		**6,00,000**

The consideration payable by Ajanta Limited was agreed as under:

(1) The Preference Shareholders of Elora Limited were to be allotted 8% Preference Shares of Rs.1,10,000

(2) Equity Shareholders to be allotted six Equity Shares of Rs.10 each issued at a premium of 10% and Rs.3 cash against every five shares held.

(3) 7% Debenture holders of Elora Limited to be taken over by the transferee company.

Where arriving at the agreed consideration the directors of Ajanta Limited valued Land and Building at Rs.2,50,000; Stock at Rs.2,20,000 and debtors at their book value subject to an allowance of 4% to cover doubtful debts. The machineries were valued at book value. Debtors of Elora Limited included Rs.10,000 due from Ajanta Limited.

It was agreed that before acquisition Elora Limited will pay dividend at 10% on Equity Shares and will also retain Rs.5,000 for liquidation expenses.

Draft Journal entries necessary to close the books of Elora Limited and to record acquisition in the books of Ajanta Limited.

Solution:

Calculation of Purchase Consideration:

	Rs.	Rs.
a. 8% Preference shares		1,10,000
b. Equity shares, 20,000 × $^{6}/_{5}$ of Rs.10 each	2,40,000	
Securities Premium 10%	24,000	2,64,000
Cash Rs.3 per lot for 4,000 lots of shares		12,000
Purchase consideration		**3,86,000**

Journal of Ajanta Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c	Dr.		3,86,000	
	To Liquidators of Elora Ltd.				3,86,000
	(Being the amount of purchase consideration)				
	Land and Buildings a/c	Dr.		2,50,000	
	Machineries a/c	Dr.		1,00,000	
	Stock a/c	Dr.		2,20,000	
	Sundry Debtors a/c	Dr.		50,000	
	Cash at Bank a/c	Dr.		10,000	
	Goodwill a/c (Bal. Fig.)	Dr.		8,000	
	To 7% Debentures a/c				1,00,000
	To Sundry Creditors a/c				1,50,000
	To Provision for Bad Debts a/c				2,000
	To Business Purchase a/c				3,86,000
	(Being sundry assets and liabilities taken over as per agreement)				

Date	Particulars		L.f.	Debit Rs.	Credit Rs.
	Liquidation of Elora Ltd.	Dr.		3,86,000	
	To 8% Preference Share Capital a/c				1,10,000
	To Equity Share Capital a/c				2,40,000
	To Securities Premium a/c				24,000
	To Bank a/c				12,000
	(Being the settlement of purchase consideration)				
	Sundry Creditors a/c	Dr.		10,000	
	To Sundry Debtors a/c				10,000
	(Being cancellation of inter-company debts on taking over Elora Ltd.)				

10.3. UNREALIZED PROFIT ON STOCK

Inter company owings are usually the result of purchase/sale of goods in the past between the transferor and transferee companies. If the goods acquired are fully disposed off by the company which purchased them, there is no problem. However, if all or parts of the goods are still in stock on the date of purchase, it poses the problem of unrealized profit in stock. If there is unrealized profit on stock it must be eliminated. The following procedure is to be followed in case of unrealized profit in the stock of transferor or Transferee Company.

10.3.1 Transferor Company:

In this case no adjustment is needed in transferor company's books as stock value is already taken into consideration for ascertaining purchase consideration.

10.3.2 Transferee Company:

In this case there may be two situations.

(a) If stock of transferor company includes goods sold by transferee company at a Profit: In this case no separate entry is required to eliminate the unrealised profit as the acquired stock has to be revalued to its original cost. As a result, goodwill or capital reserve gets automatically adjusted.

(b) If stock of transferee company includes goods sold by transferor company at a profit: In this case the following entries are necessary to eliminate the unrealised profit.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
(i)	**If the amalgamation is in the nature of purchase:**			
	Goodwill (Capital reserve) a/c Dr.		x x x	
	To Stock a/c			x x x
	(Being the elimination of unrealized profit)			
(ii)	**If the amalgamation is in the nature of merger:**			
	General Reserve/P & L a/c Dr.		x x x	
	To Stock a/c			x x x
	(Being the elimination of unrealised profit)			

For example, Siva Ltd., had bought goods of the invoice value of Rs.1,00,000 from Krishna Ltd. which company invoices goods at cost plus 20%. Later Siva Ltd. acquired the business of Krishna Ltd., when out of the goods purchased Rs.42,000 were still in stock. The unrealized profit is :

$$\text{Rs.}42{,}000 \text{ x } \frac{20}{120} = \text{Rs.}7{,}000$$

In addition to the other purchase entries Siva Ltd., must pass the following additional entry.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Goodwill a/c Dr.		5,000	
	To Stock a/c			5,000
	(Being the amount of unrealized profit)			

Illu.2 : The balance sheets of Ravali Ltd. and Ragini Ltd. as on 31st March, 2010 are given below.

Liabilities	**Ravali Ltd. (Rs.)**	**Ragini Ltd. (Rs.)**	**Assets**	**Ravali Ltd. (Rs.)**	**Ragini Ltd. (Rs.)**
Share capital			**Fixed Assets**	**3,00,000**	**6,25,000**
Shares @ Rs.10	**2,50,000**	**5,00,000**	**Loan given to Ragini Ltd.**	**25,000**	**-**
Reserve fund	**1,00,000**	**1,50,000**	**Debtors**		**50,000**
Loan from Ravali Ltd.	**-**	**25,000**	**(Including Rs.12,500 due from Ravali Ltd.)**		
Workers compensation fund	**25,000**	**-**	**Debtors**	**75,000**	
			Stock	**50,000**	**75,000**
			Cash at bank	**-**	**25,000**
	4,50,000	**7,75,000**		**4,50,000**	**7,75,000**

Ragini Ltd. agreed to absorb Ravali Ltd. on the following conditions.

(a) For every three shares held in Ravali Ltd. one share at Rs.35 in Ragini ltd. will be allotted.
(b) Market value each share in Ragini ltd. Rs.45
(c) The stock of Rs.37,500 in Ravali Ltd. includes the stock purchased from Ragini Ltd. Ragini Ltd. sold the stock to Ravali Ltd. at 20% profit on cost.

Show the necessary journal entries and ledger accounts in Ravali Ltd. and journal entries and balance sheet after the absorption in Ragini Ltd.

Solution :

Calculation of Purchase consideration :

For every three shares in Vendor Co. (Ravali Ltd.) one share in purchasing company (Ragini Ltd.) at Rs.35 each will be allotted = 25,000/3 = 8,3331/3 shares

Value of shares allotted (exempted fraction in share) 8,333 x Rs.35	2,91,655
Payment of cash (in market value) equal to the fraction of 1/3 value of share 45 x 1/3	15
Purchase consideration	2,91,670

Journal entries in the books of Ravali

Date	**Particulars**	**L.F.**	**Debit Rs.**	**Credit Rs.**
	Realisation a/c Dr.		4,50,000	
	To Fixed assets a/c			3,00,000
	To Ragini Ltd. loan a/c			25,000
	To Debtors a/c			75,000
	To Stock a/c			50,000
	(Being assets transferred to Realisation a/c)			
	Creditors a/c Dr.		75,000	
	To Realisation a/c			75,000
	(Being liabilities. transferred to Realisation a/c)			
	Ragini Ltd. Dr.		2,91,670	
	To Realisation a/c			2,91,670
	(Being Purchase consideration due)			
	Equity shareholders a/c Dr.		83,330	
	To Realisation a/c			83,330
	(Being Loss on realization transferred)			

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Equity shares in Ragini. Ltd.	Dr.		2,91,655	
	Cash a./c	Dr.		15	
	To Ragiini Ltd. a/c				2,91,670
	(Being Purchase consideration received)				
	Equity share capital a/c	Dr.		2,50,000	
	Reserve fund a/c	Dr.		1,00,000	
	Workers compensation fund a/c	Dr.		25,000	
	To Equity shareholders a/c				3,75,000
	(Being capital and profit transferred)				
	Equity shareholders a/c	Dr.		2,91,670	
	To Equity shares in Ragini Ltd.. a/c				2,91,655
	To Cash a/c				15
	(Being payment made to equity shareholders)				

Ledger Accounts

Dr. Realisation Account Cr.

	Rs.		Rs.
To Fixed Assets a/c	3,00,000	By Creditors a/c	75,000
To Ragini Ltd. Loan a/c	25,000	By Ragini ltd. a/c	2,91,670
To Debtors a/c	75,000	By Equity shareholders a/c (Loss)	83,330
To Stock a/c	50,000		
	4,50,000		4,50,000

Dr. Equity shareholders Account Cr.

	Rs.		Rs.
To Realisation a/c	83,330	By Equity share capital a/c	2,50,000
To Shares in Ragini Ltd. a/c	2,91,655	By Reserve fund a/c	1,00,000
To Cash a/c	15	By Workers compensation fund	25,000
	3,75,000		3,75,000

Dr. Realisation Account Cr.

	Rs.		Rs.
To Realisation a/c	2,91,670	By Shares in Ragini Ltd.	2,91,655
		By Cash a/c	15
	2,91,670		2,91,670

Journal Entries in the books of Ragini Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Business Purchase a/c	Dr.		2,91,670	
	To Liquidators of Ravali Ltd.				2,91,670
	(Being the amount of purchase consideration)				
	Fixed assets a/c	Dr.		3,00,000	
	Ravali Ltd. loan a/c	Dr.		25,000	
	Debtors a/c	Dr.		75,000	
	Stock a/c	Dr.		50,000	
	To Sundry Creditors a/c				75,000
	To Business purchase a/c				2,91,670
	To Capital Reserve a/c				83,330
	(Being sundry assets and liabilities taken over as per agreement)				
	Liquidation of Ravali Ltd.	Dr.		2,91,670	
	To Equity Share Capital a/c				2,91,655
	To Cash a/c				15
	(Being the settlement of purchase consideration)				
	Ravali Ltd. Loan a./c	Dr.		25,000	
	To Ragini Ltd. Loan a/c				25,000
	(Being the mutual debt written off)				
	Sundry Creditors a/c	Dr.		12,500	
	To Sundry Debtors a/c				12,500
	(Being cancellation of inter-company debts on taking over Elora Ltd.)				
	Capital Reserve a/c	Dr.		6,250	
	To Stock Reserve a/c				6,250
	(Being the adjustment for unrealized profit)				

Working Notes :

Calculation of unrealized profit :

Stock sold by purchasing company = Rs.37,500
Profit = 20% on cost or 1/5 on cost.
If profit is 1/5 on cost it will be 1/6th on share price
Profit = 1/6 x 37,500 = Rs.6,250

Balance sheet of Ragini Ltd.

Liabilities		Rs.	Assets		Rs.
Share capital			Fixed Assets		
Shares of Rs.35 each		2,91,655	Ravali	3,00,000	
Shares of Rs.10 each		5,00,000	Ragini	6,25,000	9,25,000
Reserve fund		1,50,000	Debtors		
Creditors			Ravali	75,000	
Ravali	62,500		Ragini (Rs.50,000 – 12,500)	37,500	1,12,500
Ragini	1,00,000	1,62,500	Stock		
Capital Reserve	83,330		Ravli	50,000	
Less : Unrealised profit	6,250	77,080	Less : Unrealised profit	6,250	
				43,750	
			Ragini	75,000	1,18,750
			Cash at bank	25,000	
			Less : Payment to Ragini	15	24,985
		11,81,235			11,81,235

Illu.3: Following are the Balance Sheet of A Ltd. and B Ltd. as on 31-3-2010.

A Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital:		**Fixed Assets**	**30,00,000**
40,000 Equity shares of		**Investments**	**5,00,000**
Rs.100 each	**40,00,000**	**Current assets**	**65,00,000**
General reserve	**30,00,000**		
Current liabilities	**30,00,000**		
	1,00,00,000		**1,00,00,000**

B Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital:		**Goodwill**	**50,000**
20,000 Equity shares of Rs.50 each	**10,00,000**	**Fixed assets**	**3,50,000**
General reserve	**5,00,000**	**Current assets**	**14,00,000**
Current liabilities	**1,00,000**		
Provision for tax	**1,00,000**		
Proposed dividend	**1,00,000**		
	18,00,000		**18,00,000**

B Ltd. is to be absorbed by A Ltd. on the following terms:

(i) B Ltd. declares a dividend of 10 per cent before absorption for the payment of which it is to retain sufficient amount of cash.

(ii) The net worth of B Ltd. is valued at Rs.14,50,000.

(iii) The purchase consideration is satisfied by the issue of fully paid-up shares of Rs.100 each in A Ltd.

Following further information is also to be taken into consideration:

(a) A Ltd. holds 5,000 shares of B Ltd. at a cost of Rs.3,00,000.

(b) The stocks of B Ltd. include items valued at Rs.1,00,000 purchased form A Ltd. (cost to A Ltd. Rs.75,000)

(c) The creditors of B Ltd. include Rs.50,000 due to A Ltd.

Show ledger accounts in the books of B Ltd. to give effect to the above and Balance Sheet of A Ltd. after completion of the absorption.

Solution:

Ledger Accounts in the books of B Ltd.

Dr. **1. Realisation a/c** Cr.

Particulars	**Rs.**	**Particulars**	**Rs.**
To Goodwill a/c	50,000	By Current Liabilities	1,00,000
To Fixed Assets a/c	3,50,000	By Provision for tax	1,00,000
To Current assets	13,00,000	By Purchase consideration of A Ltd.	14,50,000
		By Equity Shareholders a/c (Bal.fig Realisation loss)	50,000
	17,00,000		**17,00,000**

Dr. **2. A Ltd. a/c** Cr.

Particulars	Rs.	Particulars	Rs.
To Realisation a/c	14,50,000	By A Ltd. shares a/c	10,87,500
		By Equity shareholders a/c (14,50,000 × 5,000/20,000)	3,62,500
	14,50,000		**14,50,000**

Dr. **3. Equity Shareholders a/c** Cr.

Particulars	**Rs.**	**Particulars**	**Rs.**
To Realisation a/c (loss)	50,000	By Equity share capital a/c	10,00,000
To A Ltd. shares	10,87,500	By General Reserve a/c	5,00,000
To A Ltd. a/c (14,50,000 × 5,000/20,000)	3,62,500		
	15,00,000		**15,00,000**

Dr. **4. A Ltd. Shares a/c** Cr.

Particulars	Rs.	Particulars	Rs.
To A Ltd. a/c	10,87,500	By Equity Shareholders a/c	10,87,500
	10,87,500		**10,87,500**

Dr. **5. Proposed Dividend a/c** Cr.

Particulars	Rs.	Particulars	Rs.
To Current assets a/c	1,00,000	By Balance c/d	1,00,000
	1,00,000		**1,00,000**

Dr. **6. Current Assets a/c** Cr.

Particulars	Rs.	Particulars	Rs.
To Realisation a/c	14,00,000	By Proposed Dividend	1,00,000
		By Realisation a/c	13,00,000
	14,00,000		**14,00,000**

Balance Sheet of A Ltd., as on 31-3-2010

Liabilities	Rs.	Assets	Rs.	Rs.
Shares capital:		Fixed Assets	30,00,000	
		Add: additions	3,50,000	33,50,000
50,875 Equity Shares of				
Rs.100 each fully paid up (1)	50,87,500	Investments	5,00,000	
Reserves & Surplus:		Less: B Ltd.		
Capital Reserve (2)	62,500	Investments	3,00,000	2,00,000
General Reserve	30,00,000	Current Assets (3)		77,50,000
Current Liabilities (30,00,000 + 1,00,000 – 50,000)	30,50,000			
Provision for tax	1,00,000			
	1,13,00,000			1,13,00,000

Working Notes:

		Rs.	Rs.
I.	Share capital		
	40,000 shares @ Rs.100 each		40,00,000
	Add ; Net Purchase consideration		
	Shares issued for payment		
	10,875 shares @ Rs.100 each		10,87,500
	50,875 shares @ Rs.100 each		50,87,500

2.	Capital Reserve	Rs.	Rs.
	Amount received from B Ltd.		3,62,500
	Less : Investments of A Ltd. in B Ltd.		3,00,000
			62,500
3.	Current Assets		
	Current assets of A Ltd.		65,00,000
	Add : current assets taken from B ltd.		13,00,000
	Dividend received from B Ltd.		25,000
	(1/4 x 1,00,000 (proposed)		
			78,25,000
	Less : Stock Reserve		
	(Stock purchased from A Ltd. Rs.1,00,000		
	Cost Rs.75,000 (Rs.1,00,000 – 75,000)	25,000	
	Debtors	50,000	75,000
			77,50,000

10.4 SELF ASSESSMENT QUESTIONS

1. Explain the issues relating to Inter company owings in case of the amalgamation of Companies.
2. How do you treat common debts of Companies in amalgamation?
3. How do you treat the unrealized profit on stock of transferor and transferee companies?

10.5 EXERCISES

1. ‘X’ Company Ltd. was taken over by ‘Y’ Company Ltd. as on 1-1-2009 on the following terms:

a) ‘Y’ Company Ltd. to assume the Liability and take over the assets at book values of X company ltd.

b) Y Company Ltd. to discharge the debentures in X Ltd. at 105% by issue of new debentures at 6% in the Y Company Ltd.

c) Y Company Ltd. has to pay the equity share holders in X Company Ltd., Rs.10 per share and give three shares of Rs.10 each in Y Company Ltd. for every one share in ‘X’ Company Ltd.

The following is the Balance Sheet of ‘X’ Company Ltd. as on 31-12-2009.

Balance Sheet of X Company as on 31-12-2009

	Rs.		Rs.
Issued Capital:		Goodwill	7,00,000
47,500 Shares of Rs.20 each	9,50,000	Buildings	3,13,000
5% Debentures	2,40,000	Machinery	64,200
Reserves Fund	3,00,000	Fixtures	17,000
Creditors	1,53,000	Debtors	2,19,800
P & L A/c	99,200	Stock	93,200
		Investments	2,93,000
		Bank	42,000
	17,42,200		17,42,200

From the above particulars, pass necessary journal entries to close the books of 'X' company Ltd.

[Ans.: Purchase Consideration Rs.21,52,000; Cash Rs.4,75,000; Shares Rs.14,25,000) Realisation Profit Rs.5,50,800]

2. The position of two Companies is as follows:-

Andheri Co. Ltd. Balance Sheet as on 1st January, 2010

	Rs.		Rs.
Nominal Capital:		Fixed Assets	3,00,000
50,000 Shares of Rs.10 each	5,00,000	Debtors	2,50,000
Issued Capital:		Stock	1,00,000
50,000 shares of Rs.10 each		Goodwill	1,00,000
fully paid	5,00,000	Profit and Loss a/c	1,50,000
5% Debentures	1,00,000		
Creditors	3,00,000		
	9,00,000		9,00,000

Bombay Co. Ltd., Balance Sheet as on 1st January, 2010

	Rs.		Rs.
Nominal Capital:		Goodwill	3,50,000
1,00,000 shares of Rs.10 each	10,00,000	Fixed Assets	5,00,000
Issued Capital:		Debtors	1,00,000
70,000 shares of Rs.10 each,		Cash at bank	1,00,000
fully paid	7,00,000		
Creditors	2,00,000		
Profit and Loss Account	1,50,000		
	10,50,000		10,50,000

Bombay Co. Ltd., Agree to absorb Andheri Ltd. upon the following terms:-

(a) The Shares of Andheri Co. Ltd., are to be considered Rs.6 each (of which the shareholders are to be paid one-quarter in cash and the balance in shares in Bombay Co. Ltd.) and the shares in Bombay Co. Ltd. @ Rs.12.50 each.

(b) The debenture holders in Andheri Co. Ltd. agreed to take Rs.95 of 7% Debentures in Bombay Ltd. for every Rs.100 of 5% debentures held in Andheri Co. Ltd.

(c) Andheri Co. Ltd. is to be wound up.

Show the journal entries necessary to record the above in the books of both companies and draw up a balance sheet showing the position of Bombay Co. Ltd. after the absorption. The costs Rs.6,000 which were paid by Bombay Co. Ltd.

[Ans.: (1) Purchase Consideration Rs.3,95,000; (2) Realisation Loss Rs.50,000; (3) Bombay Co. Ltd. Goodwill Rs.4,01,000; Balance Sheet Total Rs.16,75,000]

3. The summarised Balance sheets as on 31-3-2010 of B Ltd. and A Ltd. are as under.

Balance Sheet of B Ltd.

Liabilities	Rs.	Assets	Rs.
Authorised & Issued Capital		Plant, Machinery	6,50,000
15,000 shares of Rs.100	15,00,000	Buildings	6,00,000
Profit and Loss a/c	1,20,000	Furniture	10,000
General Reserve	2,00,000	Debtors	2,30,000
Current Liabilities	2,40,000	Stock	3,80,000
		Cash at Bank	1,90,000
	20,60,000		20,60,000

Balance Sheet as on A Limited

Liabilities	Rs.	Assets	Rs.
Authorised & Issued Capital:		Goodwill	1,00,000
5,000 shares of Rs.100 each	5,00,000	Plant, Machinery	4,20,000
Capital Reserve	50,000	Stock in trade	2,10,000
Revenue Reserve	60,000	Furniture	5,000
10% Debentures	3,00,000	Debtors	1,80,000
Creditors	95,000	Expenses on New project	75,000
		Cash and Bank balances	15,000
	10,05,000		10,05,000

A Ltd. was absorbed by B Ltd. on 1-4-2010 on the following terms.

(a) Fixed assets other than goodwill to be valued at Rs.5,00,000 including Rs.6,000 for Furniture.

(b) Stock to be reduced by Rs.20,000 and Debtors by 5%.

(c) B Ltd. to assume liabilities and to discharge the 6% debentures by the issue of 5% debentures and a cash premium.

(d) The new project to be valued at Rs.95,000.

(e) The shareholders of A Ltd., to receive cash payment of Rs.30 per share plus four ordinary shares in B Ltd. for each five shares held.

(f) B Ltd., to pay the liquidation expenses of A Ltd. amounting to Rs.6,000.

Show the necessary accounts in the books of A Ltd. and show Balance sheet of B Ltd. after absorption.

[Ans.: Purchase Consideration Rs.8,68,000; Cash to Shareholders Rs.1,50,000 + Shares Rs.4,00,000; Realisation Loss Rs.60,000; Balance Sheet Total Rs.28,57,000]

4. X Co. Ltd. is absorbed by Y Co. Ltd. Given below are the balance sheets of the two companies, taken after revaluation of their assets on a uniform laws.

	X Co. Ltd. Rs.	Y Co. Ltd. Rs.		X Co. Ltd. Rs.	Y Co. Ltd. Rs.
Authorised Capital:			Other Assets	33,70,000	87,15,000
9,000 shares of			Cash in hand	7,000	55,000
Rs.300 each	27,00,000				
40,000 shares of					
Rs.180 each		72,00,000			
Paid-up Capital:					
9,000 shares	24,30,000				
40,000 shares		60,00,000			
Creditors	1,10,000	1,30,000			
Reserve fund	8,07,000	25,70,000			
Profit and Loss a/c	30,000	70,000			
	33,77,000	87,70,000		33,77,000	87,70,000

The holders of every three shares in X Co. Ltd. were to receive five shares in the Y Co. Ltd., plus as much cash as is necessary to adjust the right of shareholders of both the companies in accordance with the intrinsic values of the shares as per respective balance sheets. Pass the necessary journal entries, in the books of Y Co. Ltd. and prepare the balance sheet giving effect to the above scheme of absorption.

[Ans.: Purchase Consideration Rs.22,77,000; (Shares Rs.22,50,000 + Cash Rs.27,000) Balance Sheet Total Rs.1,21,20,000; Reserve Total Rs.35,60,000]

5. The Balance Sheet of Bad Luck Ltd. as on 31-3-2010 was as under:

	Rs.		Rs.
Equity Share capital	1,00,000	Land, Buildings	45,000
6% Debentures	20,000	Plant, Machinery	20,000
Creditors	3,000	Stock	30,000
		Debtors	15,000
		Cash	1,000
		Profit and Loss a/c	12,000
	1,23,000		1,23,000

It was decided to reconstruct the company and for this purpose a new company was formed with a nominal capital of Rs.1 lakh divided into 500 5% preference shares of Rs.100 each 5,000 equity shares of Rs.10 each to take over the assets and liabilities of Bad Luck Ltd. on the following basis.

i. The debenture holders are to accept 200 preference shares.
ii. The share holders are to receive one equity share in lieu of Rs.20 shares held by them.
iii. Cost of liquidation Rs.1,500 to be paid by new company.

Close the accounts of the old company and show the Balance Sheet of new company.

[Ans.: Purchase Consideration Rs.70,000; (Equity Shares Rs.50,000) Realisation Loss Rs.38,000; Balance Sheet Total Rs.1,39,500]

6. On 1-4-2010 the balance sheet of Prosperous Ltd. was as follows:

Liabilities	Rs.	Assets	Rs.
5,000 6% Cum. Pref. Shares	50,000	Goodwill	40,000
15,000 Equity shares	1,50,000	Patents	15,000
6% Debentures	30,000	Other Assets	1,64,500
Creditors	20,000	Cash	500
Preference dividend is in arrears for 4 years		Profit & Loss a/c	28,000
		Preliminary expenses	2,000
	2,50,000		2,50,000

A scheme of reconstruction was agreed upon:

1. A new company to be formed called Vijay Ltd. with a capital of Rs.3,25,000 all in equity shares of Rs.10 each
2. One equity shares of Rs.5 paid in Vijay Ltd. to be issued for each equity share in Prosperous Ltd.
3. Two equity shares, Rs.5 paid in Vijay Ltd. to be issued for each pref.share in prosperous Ltd.

4. Arrears to be cancelled.
5. Debenture holders to receive 3,000 equity shares in Vijay Ltd. credited as fully paid.
6. Creditors to be taken up Vijay Ltd.
7. The remaining unissued shares to be taken up and paid for in full by the directors.
8. Vijay Ltd. to take Prosperous Ltd., assets except patents (which realised Rs.1,000) subject to writing down of sundry assets by Rs.35,000

Give journal entries in Vijay Ltd. and its balance sheet.

[Ans.: Purchase Consideration Rs.1,55,000; Equity Shares: Equity shareholders Rs.75,000; Preference Shareholders Rs.50,000; Vijay Ltd. Balance Sheet Total Rs.2,20,000]

10.6 REFERENCE BOOKS

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Chapter – 11

RECONSTRUCTION

Objectives :

After going through this lesson you should be able to

- understand the meaning of internal reconstruction of a company
- find out the types of reconstruction.
- Know the provisions under companies act on reduction of share capital.
- Analyse the procedure for reduction of capital.
- Know the accounting entries on internal reconstruction

Structure :

11.1 INTRODUCTION

Reconstruction refers to reorganization of the capital structure of a company. It may result in the reduction of claims of both the shareholders and creditors against the company. Reconstruction may be necessary for those companies whose financial position is bad. In external reconstruction, a new company is formed to take over the business of an existing company which will be liquidated. This involves many formalities and therefore it is tedious affair. Moreover, the accumulated losses of the liquidated company cannot be set off against the profits of the new company that is formed. That deprives the new company of a very important tax advantage. Therefore, some companies prefer to have internal reconstruction for which there are legal provisions in the Companies Act, 1956.

In internal reconstruction, the capital of a company is reorganized to enable it to make a fresh beginning, after eliminating accumulated losses. Internal reconstruction and reduction of capital are used with the same meaning.

11.2 TYPES OF RECONSTRUCTION

The term reconstruction means reorganizing the capital structure of a company including the reduction of claims of both the shareholders and the creditors against the company. Such reconstruction generally becomes necessary on account of bad financial position of the company. It may be external or internal reconstruction.

1. **External Reconstruction :** In case of such a reconstruction, a new company is formed to take over the business of an existing company which is in a bad financial position. The vendor company goes into liquidation after selling its business to the new company.

2. **Internal Reconstruction :** In case of such reconstruction, the capital of a company is reorganized to infuse new life in the company. It includes both alteration and reduction of share capital.

11.3 REDUCTION OF SHARE CAPITAL

A company can reduce its share capital as per the provisions of Section 100 to 105 of the Companies Act, 1956. Reduction of capital can take any of the following three forms.

1. Reducing or completely extinguishing shareholders liability for uncalled capital.
2. Refunding surplus paid-up capital which is found to be in excess of the needs of the company.
3. Canceling or writing off paid-up capital which is lost and not represented by assets.

11.3.1 Objectives:

The objective of Capital Reduction is the resumption of the payment of normal dividends out of the expected future profits without the necessity of using those profits to write-off the debit balance of the profit and loss account.

11.3.2 Alteration of share capital :

The Companies Act has used the words, `Alteration proper' for alteration of share capital. Such alteration can be done under provisions of Section 94 to 97 of the Companies Act. The term alteration proper includes the following.

1. Increase the share capital by issue of new shares
2. Consolidation or subdivision of the existing shares into shares of largest or smaller denominations.
3. Conversion of fully paid shares into stocks and vice versa.
4. Cancellation of the unissued shares.

A company can make these alterations by passing an ordinary resolution. If it is authorized by its Articles of Association to do so. Such alteration must be notified and a copy of the resolution should be filed with the Registrar within 30 days of the date of the passing of such resolution.

11.4. PROCEDURE FOR REDUCTION OF CAPITAL

According to Sec.100 to 105 of the Companies Act, the following formalities are to be followed in the reduction of share capital of a company.

1. The company must be authorised by its articles of association to reduce the share capital. If there is no provision in the article in this respect, it must pass a Special Resolution to alter its articles of association. It should be noted that an authority to do contained in the Memorandum is of no avail.
2. The company must pass a Special Resolution to reduce the share capital.
3. The company must apply, by petitions, to the Court for an order confirming the reduction. If the Court is satisfied that the creditor's interests have been secured it may confirm the reduction. However, it may impose terms and conditions including a direction that the word **"and reduced"** should be added after the name of the company for a certain period of time and that the company should publish the reasons for such reduction.
4. The company has to deliver to the Registrar of companies a certified copy of the Court's order and a minute approved by the Court showing the details of the shares of registration.
5. The Registrar of Companies will then register the order and the minute.
6. After registration of these, the Resolution to reduce the share capital shall take effect.
7. Notice of the registration shall be published in such a manner as the Court may direct.

11.4.1 Accounting Entries

The accounting entries in respect of alteration of share capital are as follows.

1. **Increase of share capital :** This is similar to making a fresh issue of share capital. Accounting entries in respect of fresh issue of shares have already been explain in an earlier chapter.
2. **Consolidation of shares :** In caser of consolidation of shares, shares of smaller denomination are converted into shares of larger denominations. In such a case the paid up share capital remain the same but the number of shares is reduced.
3. **Sub-division of shares :** In this case, shares of larger denominations are converted into shares of smaller denominations. The journal entry in respect of such conversion would be on the same pattern as explained in case of consolidation of shares, except the number of shares would increase.

4. **Conversion of shares into stock :** A company can covert its fully paid up shares into stock or vice versa.
5. **Cancellation of unissued shares :** In case of company cancels its unissued shares, it does not require any accounting entry to be passed. The authorized share capital of the company will stand reduced by the amount of unissued shares now cancelled.

11.4.2 Reducing or extinguishing the liability of the shareholders for uncalled capital:

Date	Particulars	L.F.	Debit	Credit
	Share capital a/c (Old) Dr. To Share capital a/c (New)		x x x	 x x x

Note: In both cases, the paid up amount is same.

Illu.1: Bharath Ltd., has an issued share capital of 5,00,000 equity shares of Rs.10 each, Rs.7 called up. Having complied with the legal formalities under the companies act the company proceeds to extinguish the uncalled liability on its shares. Show journal entry.

Solution:

Journal Entries in the books of Bharat Ltd.

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Share capital a/c (Rs.10) Dr. To Equity share capital a/c (Rs.7) (Being conversion of 5,00, 000 shares of Rs.10 each, Rs.7 paid up into 5,00,000 shares of Rs.7 each fully paid up)		35,00,000	 35,00,000

11.4.3 Refunding surplus capital which is found to be in excess of the needs of the company:

Date	Particulars	L.F	Debit	Credit
(i)	Share capital a/c (Old) Dr. To Share capital a/c (New) To Shareholders a/c (to be returned)		x x x	 x x x
(ii)	For payment of money: Shareholders a/c Dr. To Bank a/c		 x x x	 x x x

Illu.2 : Telco Ltd., whose paid up capital includes 10,00,000 equity shares of Rs.10 each fully paid decides to return Rs.2 per share to the members, thus reducing each share to Rs.8 each fully paid. Pass necessary journal entries

Solution :

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Share capital a/c (Rs.10)	Dr.		1,00,00,000	
	To Equity share capital a/c (Rs.8)				80,00,000
	To Shareholders a/c				20,00,000
	(Being conversion of 10,00,000 shares of Rs.10 each into shares of Rs.8 each and the balance to be returned transferred to the members)				
	Shareholders a/c	Dr.		2,00,000	
	To Bank a/c				2,00,000
	(Being return of capital to shareholders as per scheme)				

11.4.3. Reducing the paid-up capital:

Date	Particulars		L.F.	Debit	Credit
	Share capital a/c (Old)	Dr.		x x x	
	To Share capital a/c (New)				x x x
	To Capital reduction a/c				

(a) If any sacrifice has been made by creditors and debentureholders:

Date	Particulars		L.F.	Debit	Credit
	Creditors a/c	Dr.		x x x	
	Debentureholders a/c	Dr.		x x x	
	To Share capital a/c (New)				x x x
	To Capital reduction a/c				x x x

(b) When the amount of capital reduction is utilised for writing of fictitious assets:

Date	Particulars	L.F.	Debit	Credit
	Capital reduction a/c Dr.		x x x	
	To Profit and Loss a/c			x x x
	To Goodwill a/c			x x x
	To Preliminary expenses a/c			x x x
	To Discount on Shares and Debentures a/c			x x x
	To Patents and Trademarks a/c			x x x
	To Other assets a/c			x x x
	To Capital reserve a/c (if balance is still left)			x x x

11.4.4 Treatment of arrears of preference dividends :

Preference share are always taken as cumulative unless otherwise stated. In case dividends in respect of preference shares have been declared but have not yet been paid, the unpaid dividends will appear as a liability in the company's balance sheet. The claimants of the unpaid dividends are just like any other creditors of the company. In case they agree to sacrifice under a scheme of reconstruction of the company, their sacrifice will be credited to the capital reduction account.

However, if the preference dividends have not yet been declared by the company, the arrears of preference dividends will appear either in the inner column of the company's balance sheet or by way of footnote outside the company's balance sheet. In case claimants of such arrears of preference dividends agree, under a reconstruction scheme, to sacrifice either in whole or in part, their arrears of dividends, no accounting entry is necessary since the company had not so far admitted any liability in respect of them. However, if the company is required to pay in full or in part of the arrears of preference dividends under the reconstruction scheme, this will be an additional loss to the company. The following journal entries till be passed in such a case.

Date	Particulars	L.F.	Debit	Credit
1.	Capital reduction a/c Dr.		x x x	
	To Preference dividends a/c			x x x
	(Being the amount payable as dividend)			
2.	Preference dividends a/c Dr.		x x x	
	To Bank a/c			x x x
	(Being the amount paid)			

Illu.3: The Balance Sheet of Hyderabad Ltd., as on 31, December, 2009 was as follows:

Liabilities	Rs.	Assets	Rs.
Share Capital:		**Goodwill**	**15,000**
2,000 preference		**Freehold property**	**2,00,000**
shares of Rs.100 each	**2,00,000**	**Plant & Machinery**	**3,00,000**
4,000 equity shares of		**Stock**	**50,000**
Rs.100 each	**4,00,000**	**Debtors**	**40,000**
6% Debentures	**1,00,000**	**P & L a/c**	**2,45,000**
Bank overdrafts	**50,000**		
Creditors	**1,00,000**		
	8,50,000		**8,50,000**

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

(a) The Preference shares to be reduced to Rs.75 per share fully paid up and the equity shares to Rs.62.50.
(b) The Debenture holders took over the stock and book debts in full satisfaction of their claim.
(c) The Goodwill A/c to be eliminated.
(d) The Freehold properties to be depreciated by 50%.
(e) The value of Plant and Machinery to be increased by Rs.50,000.

Give Journal entries for the above and prepare the revised Balance Sheet.

Solution :

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Preference share capital a/c (Rs.2,000 x 100) Dr.		2,00,000	
	To Preference share capital a/c (2,000 x 75)			1,50,000
	To Capital reduction a/c			50,000
	(Being reduction of preference share capital as per scheme)			
	Equity share capital a/c (Rs.4,000 x 100) Dr.		4,00,000	
	To Equity share capital a/c (4,000 x 37.50)			1,50,000
	To Capital reduction a/c			2,50,000
	((Being reduction of equity share capital as per scheme)			

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	5% Debentures a/c	Dr.		1,00,000	
	To Stock a/c				50,000
	To Debtors a/c				40,000
	To Capital Reduction a/c				10,000
	(Being the taken over of debenture holders stock and debtors				
	Plant and Machinery a/c	Dr.		50,000	
	To Capital a/c				50,000
	(Being the revaluation of plant and machinery)				
	Capital reduction a/c	Dr.		3,60,000	
	(Rs.50,000 + 2,50,000 + 10,000 + 50,000)				
	To Goodwill a/c				15,000
	To Profit and Loss a/c				2,45,000
	To Freehold property a/c				1,00,000
	(Being the reduction of asset values from capital reduction account)				

Balance sheet of Hyderabad Limited as on 31st December, 2009 (and reduced)

Liabilities	Rs.	Assets	Rs.
Capital :		Freehold property	
2,000 pref. shares at Rs.75 each	1,50,000	(Rs.2,00,000 – 1,00,000)	1,00,000
4,000 equity shares at Rs.37.50 each	1,50,000	Plant (Rs.3,00,000 + 50,000)	3,50,000
Bank overdraft	50,000		
Creditors	1,00,000		
	4,50,000		4,50,000

Illu.4: On 31-12-2009 the Company's Balance Sheet stood as under:-

Liabilities	Rs.	Assets	Rs.
Nominal Capital:		**Land and Buildings**	**1,00,000**
20,000 shares of Rs.100 each	**20,00,000**	**Machinery**	**2,80,000**
Subscribed Capital:		**Stock**	**3,70,000**
19,000 shares of Rs.100 each		**Debtors**	**1,80,000**
fully paid	**19,00,000**	**Goodwill**	**2,00,000**
Creditors	**1,00,000**	**Profit & Loss a/c**	**9,70,000**
D & Co.	**1,00,000**		
	21,00,000		**21,00,000**

The Company is to be reconstructed on the basis of the following scheme:

a. The 19,000 shares of Rs.100 each are to be reduced to an equal number of fully paid shares of Rs.40 each.

b. The debt of Rs.1,00,000 due to D & Co. was to be also reduced, the remaining 1,000 unissued shares being issued to them as fully paid up shares of Rs.40 each in full settlement of the amount due to them.

c. The amount thus rendered available by the reduction of capital and by the above arrangement with D & Co. is to be utilised in wiping off the goodwill and the Profit & Loss account and in writing down the value of Machinery.

Write the Journal entries and the Balance Sheet after the scheme is implemented.

Solution:

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Preference share capital a/c Dr. To Equity share capital a/c To Capital reduction a/c (Being 19,000 pref. shares of Rs.100 each reduced to pref. Shares of Rs.5 each		19,00,000	 7,60,000 11,40,000
	D & Co. a/c Dr. To Equity share capital a/c To Capital reduction a/c (Being 1,000 equity shares of Rs.100 each reduced to equity shares of Rs.40 each)		1,00,000	 40,000 60,000
	Capital reduction a/c Dr. To Goodwill a/c To Profit and loss a/c To Freehold property a/c (Being various assets written down and losses written off0		12,00,000	 2,00,000 9,70,000 30,000

Balance sheet of Hyderabad Limited as on 31st December, 2009 (and reduced)

Liabilities	Rs.	Assets	Rs.
Nominal capital :		Buildings	1,00,000
20,000 shares of Rs.40 each	8,00,000	Machinery (2,80,000 – 30,000)	2,50,000
Paid up capital : 20,000 shares of Rs.40 each (includes 1,000 shares given to D & Co.)	8,00,000	Stock	3,70,000
		Debtors	1,80,000
Creditors	1,00,000		
	9,00,000		9,00,000

Illu.5: The following is the Balance Sheet of Sick Co. Ltd. as on 31-3-2010:

Liabilities	Rs.	Assets	Rs.
1,000 13% Redeemable Preference Shares of Rs.100 each	**1,00,000**	**Fixed Assets**	**15,00,000**
		Current Assets	**35,00,000**
70,000 Equity shares of Rs.10 each	**7,00,000**	**Profit & Loss a/c**	**3,00,000**
Provision for Taxation	**3,00,000**		
8% Debentures	**3,00,000**		
Current Liabilities	**39,00,000**		
	53,00,000		**53,00,000**

The following scheme of reorganisation is sanctioned:

a. **Fixed Assets are to be written down by 1/3**
b. **Current assets are to be revalued at Rs.27,00,000.**
c. **Preference shareholders decide to forego their right to arrears of dividend which are in arrears for three years.**
d. **The taxation liability of the company is settled at Rs.4,00,000**
e. **One of the creditors of the company, to whom the company owes Rs.25,00,000, decides to forego 50% of his claim. He is allotted 1,00,000 equity shares of Rs.5 each in part satisfaction of the balance of his claim.**
f. **The rate of interest on debentures is increased to 11%. The debenture holders surrender their existing debentures of Rs.100 each and exchange the same for fresh debenture of Rs.75 each.**
g. **All existing equity shares are reduced to Rs.5 each.**
h. **All preference shares are reduced to Rs.7.50**

Pass journal entries and show the balance sheet of the company after giving effect to the above.

Solution:

Working Table – I

Item			
1	2	3	4 (2 – 3)
1. Equity share capital	7,00,000 (Rs.70,000 x 10)	3,50,000 (70,000 x 5)	3,50,000 (Rs.70,000 x 5)
2. Pref share capital	1,00,000 (10,000 x 10)	25,000 (10,000 x 2.50)	75,000 (10,000 x 7.50)
3. Debentures	3,00,000 (3,000 x 100)	75,000 (3,000 x 25)	2,25,000 (3,000 x 75)
4. Sundry Creditors	39,00,000	12,50,000 (25,00,000 x 50%)	21,50,000 (39,00,000 – 12,50,000 – 5,00,000
Total	-	17,00,000	-

Working Table – II

Item			
1	2	3	4 (2 – 3)
1, Fixed assets	15,00,000	5,00,000 (15,00,000 x 1/3)	10,00,000
2. Current assets	35,00,000	8,00,000 (35,00,000 – 27,00,000)	27,00,000
3. Profit and Loss a/c	3,00,000	3,00,000	-
4. Provision for taxation	3,00,000	1,00,000	4,00,000 (3,00,000 + 1,00,000)
Total	-	17,00,000	-

Notes : The amount surrendered in the liabilities side of table – I is equivalent to the written of values of assets and not recorded loan in table – II.

Journal Entries in the books of Sick Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Equity share capital a/c (Rs.10)	Dr.		7,00,000	
	To Equity share capital a/c (Rs.5)				3,50,000
	To Capital reduction a/c				3,50,000
	(Being conversion of equity shares of Rs.10 into Rs.5 per share as per scheme)				
	13% Cumulative pref. share capital a/c	Dr.		1,00,000	
	To 13% Cum. Pref. share capital a/c				75,000
	To Capital reduction a/c				25,000
	(Being conversion of 13% cumulative preference share capital of Rs.100 into 75 per share as per scheme)				
	8% Debentures a/c (Rs.100)	Dr.		3,00,000	
	To 11% Debentures a/c				2,25,000
	To Capital reduction a/c				75,000
	(Being conversion of 8% Debentures into 11% debentures and balance to capital reduction a/c)				
	Sundry Creditors a/c	Dr.		17,50,000	
	To Equity share capital a/c				5,00,000
	To capital Reduction a/c				12,50,000
	(Being a creditor surrendered his claim by 50% and allotted 1,00,000 shares of Rs.5 in part satisfaction of the balance of his claim)				
	Capital reduction a/c	Dr.		17,00,000	
	To Profit and Loss a/c				3,00,000
	To Fixed assets a/c				5,00,000
	To Current assets a/c				8,00,000
	To Provision for taxation a/c				1,00,000
	(Being the utilization of capital reduction account in writing off losses, and bringing down the value of assets as per scheme)				
	Provision for Taxation a/c	Dr.		4,00,000	
	To Liability for taxation a/c				4,00,000
	(Being provision converted into liability)				

Reconstruction a/c

	Rs.		Rs.
To Profit and Loss a/c	3,00,000	By Equity share capital	3,50,000
To Fixed assets	5,00,000	By 13% Pref. share capital a/c (Rs.100)	25,000
To Current assets a/c	8,00,000	By 8% Debentures a/c	75,000
To Provision for taxation a/c	1,00,000	By Sundry Creditors a/c	12,50,000
	17,00,000		17,00,000

Balance sheet of Sick Limited as on 31st March, 2010 (after reconstruction)

Liabilities	Rs.	Assets	Rs.
Share capital : 1,70,000 equity shares of Rs.5 each fully paid	8,50,000	Fixed assets (15,00,000 – 5,00,000)	10,00,000
1,00,000 13% accumulated pref. shares of Rs.75 each fully paid	75,000	Current assets	27,00,000
Secured Loans :			
11% Debentures	2,25,000		
Current Liabilities and Provisions :			
Sundry Creditors	21,50,000		
Liability for taxation	4,00,000		
	37,00,000		37,00,000

Working Notes :

1. Tax liability was determined as Rs.4,00,000. Tax provision of Rs.,300,000 was already there. It means Rs.1,00,000 additional amount is to be written off as liability from capital reduction account. Therefore, the amount of Rs.4,00,000 is to be shown as liability instead of provision.
2. The accumulated dividend for three years surrendered by the preference shareholders need not be adjusted separately. As the dividend is paid to them when the company earns profits. Since, the company is incurring losses continuously the payment of dividend to them doesn't arise.

3. Calculation of Creditors :

	Rs.
Total Creditors	39,00,000
Less : 50% of surrendered amount agreed by creditors	25,00,000
Remaining creditors	14,00,000
Amount of creditor agreed for surrendering	25,00,000
Less : 50% of Surrender amount	12,50,000
	12,50,000
Less :.1,00,000 equity shares allotted @ Rs.5 each	5,00,000
Remaining balance	7,50,000

Total creditors after reconstruction (1 + 2) = Rs.14,00,000 + 7,50,000 = Rs.21,50,000

Illu.6: Given below is the balance sheet of Kismat Ltd. as on December 31, 2009:

Liabilities	Rs.	Assets	Rs.
Share Capital:		**Land and Buildings**	**1,00,000**
4,000 equity shares of Rs.100 each fully paid	**4,00,000**	**Machinery**	**4,00,000**
		Motor vans	**40,000**
1,000 equity A shares of Rs.100 each Rs.50 per share paid	**50,000**	**Furniture**	**10,000**
Development rebate reserve	**1,50,000**	**Investments (market values Rs.40,000)**	**50,000**
Loan (unsecured)	**6,40,000**	**Stock**	**1,00,000**
Creditors (including Rs.10,000 holding lien on some assets)	**2,60,000**	**Debtors**	**1,90,000**
		Bank Balance	**10,000**
		Profit & Loss a/c	**6,00,000**
	15,00,000		**15,00,000**

The company having turned the corner, a scheme of reconstruction was prepared and approved as under:

(a) **To bring in the book the present market value of land and buildings which had appreciated by 150%.**

(b) **Equity shares to be reduced to Rs.10 per share paid by canceling Rs.90 per share, the face value remaining the same at Rs.100 and the equity share holders paying a call of Rs.50 per share to provide funds for the company's working.**

(c) **Unsecured loans to be paid immediately to the extent of Rs.1,00,000.**

(d) **Unsecured creditors to be paid immediately to the extent of 10% of their claims and they accepting a remission of 20% of their claims.**

(e) **Development rebate reserve, being no longer required, to be transferred to profit and loss account.**

(f) **Investments to be brought to their market value and**

(g) **The amount available as a result of the scheme to be used to write off the debit balance in profit and loss account.**

Give journal entries to record the above and give the balance sheet after the reconstruction is effected.

Solution:

Books of Kismat Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Equity Share capital a/c (4,000 × 100)	Dr.		4,00,000	
	To Equity share capital a/c (4,000 × 10)				40,000
	To Capital Reduction a/c (4,000 × 90)				3,60,000
	(Being the reduction of Equity Share Capital as per Scheme)				
	Equity share capital a/c (1,000 × 50)	Dr.		50,000	
	To Equity share capital a/c (1,000 × 10)				10,000
	To Capital Reduction a/c (1,000 × 40)				40,000
	(Being the reduction of Equity 'A' Share capital as per scheme)				
	Bank a/c	Dr.		2,50,000	
	To Equity Share Capital a/c (4,000 × 50)				2,00,000
	To Equity 'A' Share capital a/c (1,000 × 50)				50,000
	(Being the receipt of call money @ Rs.50 per share on both types of equity shares)				
	Land & Buildings a/c	Dr.		1,50,000	
	To Capital Reduction a/c				1,50,000
	(Being the entry to record 150% appreciation in the Land & Buildings i.e. 1,00,000 × $^{150}/_{100}$ = 1,50,000)				

Date	Particulars		L.F	Debit Rs.	Credit Rs.
	Creditors a/c	Dr.		50,000	
	To Capital Reduction a/c				50,000
	(Being the entry for remission of 20% of claims by unsecured creditors)				
	Capital Reduction a/c	Dr.		6,00,000	
	To Investment a/c				10,000
	To Profit & Loss a/c				4,50,000
	To Capital Reserve a/c				1,40,000
	(Being the amount of Capital Reduction a/c used to write off the Loss on Investment; and Profit and Loss a/c and the balance amount transferred to Capital Reserve a/c)				
	Unsecured Loans a/c	Dr.		1,00,000	
	Unsecured Creditors a/c	Dr.		25,000	
	To Bank a/c				1,25,000
	(Being the payment of unsecured loans and creditors to the extent of 10% of their claim)				
	Development Rebate Reserve a/c	Dr.		1,50,000	
	To Profit & Loss a/c				1,50,000
	(Being the balance of Development Rebate Reserve transferred to Profit and Loss a/c)				

Balance Sheet of Kismat Ltd., as on 31st December, 2009

Liabilities	Rs.	Assets		Rs.
Share Capital:		Fixed Assets:		
4,000 Equity shares of Rs.100 each, Rs.60 paid up	2,40,000	Land & Buildings	1,00,000	
		Add: 150% appreciation	1,50,000	2,50,000
1,000 Equity 'A' Share of Rs.100 each Rs.60 paid up.	60,000	Machinery		4,00,000
Reserve & Surplus:		Motor vans		40,000
Capital Reserve	1,40,000	Furniture		10,000
Unsecured Loans: (6,40,000-1,00,000)	5,40,000	Investments		40,000
Current Liabilities:		Current Assets:		
Creditors (including Rs.1,000 holding lien on some assets) (2,60,000-50,000-25,000)	1,85,000	Stock		1,00,000
		Debtors		1,90,000
		Bank Balance (10,000+2,00,000+50,000) – (1,00,000+25,000)		1,35,000
	11,65,000			**11,65,000**

11.4.4 Reorganization through surrender of shares :

Under this method shares are sub divided into shares of smaller denominations and shareholders are made to surrender a part of them to facilitate capital reorganization. Such surrendered shares are usually utilized to reduce or extinguish debentures and trade liabilities. The amount of shares surrendered not reissued, and the claim foregone by debenture holders and creditors are transferred to capital reorganization account, which will be utilized to write off losses.

Illu.7: Babuls Ltd. is in the hands of a Receiver for debenture holders who hold a charge on all assets excepts uncalled capital. The following statement shows the position as regards creditors as on 30th June, 2010:

Liabilities	Rs.	Assets	Rs.
Share Capital:		**Cash in hand of the Receiver**	**27,00,000**
Rs.36,00,000 of Rs.60 each, Rs.30 paid up		**Property, Machinery & Plant etc., cost Rs.39,00,000 estimated at**	**15,00,000**
First Debenture	**30,00,000**	**Change under Debentures**	**42,00,000**
Second Debentures	**60,00,000**	**Uncalled capital**	**18,00,000**
Unsecured Creditors	**45,00,000**	**Deficiency**	**75,00,000**
	1,35,00,000		**1,35,00,000**

A holds the First Debentures for Rs.30,00,000, and Second Debentures for Rs.30,00,000. He is also an unsecured creditor for Rs.9,00,000. B holds Second Debentures for Rs.30,00,000 and is also an unsecured creditor for Rs.6,00,000.

The following scheme of reconstruction is proposed and approved:-

a) A is to cancel Rs.21,00,000 of the total debt owing to him, to advance Rs.3,00,000 in cash and to take First Debentures (in cancellation of those already issued to him) for Rs.51,00,000 in satisfaction of all his claims.

b) B is to accept Rs.9,00,000 in cash in satisfaction of all claims by him.

c) Unsecured creditors (other than A and B) are to accept four shares of Rs.7.50 each, fully paid in satisfaction of 75% of every Rs.60 of their claim. The balance of 25% is to be postponed and to be payable at the end of three years from the date of the Court's approval of the scheme. The nominal share capital is to be increased accordingly.

d) Uncalled capital is to be called up in full and Rs.52.50 per share cancelled, thus making the shares of Rs.7.50 each.

Assuming that the company keeps sectional ledgers, give necessary journal entries and the balance sheet of the company after the scheme has been carried into effect.

Solution:

In this problem, the balance sheet is not given, but it is only a statement which shows the position as regards creditors. The scheme of reconstruction must have been based on the following balance sheet.

Balance Sheet of Babuls Ltd. as on June 30, 2010

Liabilities	Rs.	Assets	Rs.
Share Capital:		Property, Machinery and Plant, etc. at cost	39,00,000
6,000 shares of Rs.60 each, Rs.30 paid up	18,00,000	Cash in hand	27,00,000
First Debentures	30,00,000	Deficiency (or Profit and Loss Account)	87,00,000
Second Debentures	60,00,000		
Unsecured creditors	45,00,000		
	1,53,00,000		**1,53,00,000**

Property, etc. has been shown at cost rather than at realisable value because the company will continue.

Journal Entries of Babuls Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
i)	First Debentures	Dr.		30,00,000	
	Second Debentures	Dr.		30,00,000	
	Total Creditors Account	Dr.		9,00,000	
	To A a/c				69,00,000
	(Being the total amount due to A, transferred to his account)				
ii)	Bank a/c	Dr.		3,00,000	
	To A's a./c				3,00,000
	(Being the amount paid by A under the scheme proposed by Special Resolution No… dated… confirmed by Court Order dated…)				
iii)	A a/c	Dr.		72,00,000	
	To First Debentures (New)				51,00,000
	To Reconstruction Account				21,00,000
	(Being the issue of First Debentures worth Rs.5,10,000 to A in full satisfaction of his claims, the balance of Rs.2,10,000 credited to reconstruction Account in accordance with the sanctioned scheme)				

Date	Particulars		L.F	Debit Rs.	Credit Rs
iv)	Second Debentures	Dr.		30,00,000	
	Total Creditors Account	Dr.		6,00,000	
	To B's a/c				36,00,000
	(Being the total amount due to B, transferred to his account)				
v)	B a/c	Dr.		36,00,000	
	To Bank				9,00,000
	To Reconstruction Account				27,00,000
	(Being the payment to B of Rs.9,00,000 in full satisfaction of his claims in accordance with the sanctioned scheme)				
vi)	Total Creditors Account	Dr.		22,50,000	
	To Share Capital Account				15,00,000
	To Reorganisation Account				7,50,000
	(Being the issue of Rs.7.50 fully paid shares to unsecured creditors 75%, in accordance with the sanctioned scheme, thus: Four shares of Rs.7.50)				
vii)	Bank a/c	Dr.		18,00,000	
	To Share capital Account				18,00,000
	(Being the balance on shares (Rs.30 per share) called up in accordance with the sanctioned scheme)				
viii)	Share Capital Account (Rs.60)	Dr.		36,00,000	
	To Share capital account (Rs.7.50)				4,50,000
	To Reconstruction a/c				31,50,000
	(Being the cancellation of Rs.60 per share on 60,000 shares in accordance with the sanctioned scheme)				
ix)	Reconstruction Account	Dr.		87,00,000	
	To Profit & Loss a/c				87,00,000
	(Being the debit balance in the Profit and Loss Account wiped off with the various reductions made)				

Balance Sheet of Babuls Ltd. as on June 30, 2010

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
2,60,000 shares of Rs.7.50 each		Property, Machinery,	
fully paid	19,50,000	Plant etc. at cost	39,00,000
Secured Loans:		Current Assets:	
First Debentures	51,00,000	Cash & Bank Balances	39,00,000
Current Liabilities and Provisions			
Sundry Creditors	7,50,000		
	78,00,000		**78,00,000**

Ledger Accounts

Reconstruction a/c

	Rs.		Rs.
To Accumulated losses a/c	87,00,000	By A a/c	21,00,000
		By B a/c	27,00,000
		By Unsecured creditors a/c	7,50,000
		By Equity share capital a/c (Rs.60)	31,50,000
	87,00,000		87,00,000

Equity share capital a/c

	Rs.		Rs.
To Balance c/d	19,50,000	By Equity share capital a/c	4,50,000
		By Unsecured creditors a/c	15,00,000
	19,50,000		19,50,000
		By Balance b/d	19,50,000

Bank a/c

	Rs.		Rs.
To Balance b/d	27,00,000	By B a/c	9,00,000
To A a/c	3,00,000	By Balance c/d	39,00,000
To Equity share capital a/c	18,00,000		
	48,00,000		48,00,000
To Balance b/d	39,00,000		

Working Notes :

(1) Calculation of creditors :

	Rs.
Unsecured Creditors	45,00,000
Less : A & B unsecured creditors for (Rs.9,00,000 + 6,00,000)	15,00,000
Unsecured creditors other than A & B	30,00,000
Less : Settlement of Present creditors (75% x 30,00,000)	22,50,000
Creditors not yet settled	7,50,000

(2) Calculation of amount surrendered by the creditors :

	Rs.
Settlement of present creditors	22,50,000
Less :75% of Rs.60 in each claim. It means Rs.30 settle for Rs.45 shares allotted. (Rs.7.50 x 4 shares) (30/45 x 22,50,000)	15,00,000
Amount surrendered by creditors	7,50,000

(3) 25% of Rs.60 claim is to be postponed means for every Rs.60 the immediate down payment will be Rs.45 only. In the same way, for every Rs.45 payment, 4 shares at Rs.7.50 will be issued. Therefore, Rs.30 only will be paid in the same way for every Rs.45, Rs.15 will be available to the reconstruction account (capital reduction account). As such on Rs.22,50,000 the total reconstruction amount = Rs.7,50,000.

(4) Shares allotted to creditors = Share capital/ Share value
= Rs.15,00,000/7.50 = 2.00,000

(5) No. of shares prior to reconstruction = 36,00,000/60 (share value) = 60,000

(6) Share capital paid-up value prior to reconstruction = 60,000 shares x @ Rs.30 on each share = Rs.18,00,000

(7) Amount realized through calls on share capital prior to reconstruction
60,000 x Rs.30 = Rs.18,00,000

(8) No. of shares after reconstruction
= 60,000 (old shares) + 2,00,000 (allotted to creditors) = Rs.2,60,000

Share capital = Rs.2,60,000 x 7.50 = Rs.19,50,000

Illu.8: The Balance sheet of Ragadeepika Ltd. as at December 31, 2009 is as follows.

Liabilities	Rs,	Rs.	Assets	Rs.
Issued, Subscribed capital			Sundry Assets	2,31,000
12,000 shares @ Rs.10 each fully paid up		1,20,000	Investments	4,500
Debentures	2,01,000		Profit and Loss a/c	1,60,500
Add : Interest	6,000	2,07,000		
Creditors :				
Income tax	1,500			
Others	67,500	69,000		
		3,96,000		3,96,000

The following scheme of reconstruction is proposed and approved.

1. **Each share shall be subdivided into 10 fully paid equity shares of Rs.1**

2. **After sub division each shareholder shall surrender to the company 95% of his holding for the purpose of reissue to debenture holders and creditors so far as may be required and otherwise for cancellation.**

3. **Of those surrendered 34,500 shares of Rs.1 each shall be converted into preferences shares of Rs.1 each fully paid.**

4. **The claims of debenture holders shall be reduced by 5/6 and in consideration there for the debentureholders shall receive preference shares to the value of 1/6th of their claim as at 31st December, 2009.**

5. **The income tax liability is to be paid in full, and claims of other creditors to be reduced to 1/5th of their claims to be satisfied by the issue of equity shares of Re.1 each from the shares surrendered.**

6. **Shares surrendered and not reissued shall be cancelled.**

Set out journal entries and the resultant balance sheet assuming that the income tax liability is still outstanding and the amounts of the assets are ulatered.

Solution :

Journal Entries in the books of Ragadeepika Ltd.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Equity Share capital a/c (Rs.10)	Dr.		1,20,000	
	To Equity share capital a/c (Rs.1)				1,20,000
	(Being the sub division of 12,000 shares of Rs.10 each into 1,20,000 shares of Rs.1 each in accordance with the special resolution)				
	Equity share capital a/c	Dr.		1,14,000	
	To Shares surrendered a/c				1,14,000
	(Being the surrender of 95% of the shares accordance with the scheme)				
	Shares surrendered a/c	Dr.		34,500	
	To Preference share capital a/c				34,500
	(Being the shares surrendered at Rs.1 each converted as 34,500 preference shares and debenture holders claim of 1/6th of Rs.,207,000 allotted as consideration)				
	Shares Surrendered a/c	Dr.		13,500	
	To Equity share capital a/c				13,500
	(Being the reissue of shares worth Rs.67,500 ….				
	Shares surrendered a/c	Dr.		66,000	
	To Reconstruction a/c				66,000
	(Being the cancellation of the unissued surrendered shares to reconstruction account)				
	Debentures a/c	Dr.		2,01,000	
	Interest on debentures a/c	Dr.		6,000	
	Creditors a/c	Dr.		67,500	
	To Reconstruction a/c				2,74,500
	(Being the transfer of the liabilities in respect of debentures, and creditors to the reconstruction account since these liabilities have been fully discharged by the issue of shares)				
	Reconstruction a/c	Dr.		1,60,500	
	To Profit and Loss a/c				1,60,500
	(Being the writing off the debit balance of the profit and loss account and the transfer of the balance in the reconstruction account)				

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Reconstruction a/c Dr. To Capital reserve a/c (Being the balance in reconstruction accounting transferred to capital reserve a/c)		1,80,000	 1,80,000

Balance sheet of Ragadeepika Ltd., as on 31st December, 2009
(After reconstruction)

Liabilities	Rs.	Assets	Rs.
Issued, Subscribed capital		Sundry assets	2,31,000
19,500 equity shares @ Rs.1 each	19,500	Investments	4,500
34,500 equity shares @ Rs.1 each	34,500		
(includes 34,500 equity shares and 34,500 preference shares issued for consideration other than for cash)			
Reserves, Surplus :			
Capital reserve	1,80,000		
Creditors :			
Liability for taxation	1,500		
	2,35,500		2,35,500

Working notes :

1. No. of equity shares 12,000, value of each equity share prior to reconstruction Rs.10. Therefore share capital = Rs.1,20,000.

   Each share was divided at Rs.1 each. It means total no. of shares = 1,20,000
   Of these 95% of the shares are surrendered.
   Therefore, total no. of surrendered shares = 1,20,000 x 95/100 = 1,14,000
2. Debenture holders claim Rs.2,07,000. Amount equal to 1/6th of full settlement Rs.34,500 for which preference shares at Rs.1 are issued.

3. Total amount payable to creditors as settlement Rs.67,500. Of which 1/5th of the amount i.e., Rs.13,500 will be issued as equity shares of Rs.1 each.

4. Total No. of equity shares after reconstruction 1,20,000 at Rs.1 each. Of which, non-surrendered shares 5%.

Shares not surrendered = 6,000
Shares issued to creditors = 13,500
Total equity shares = (6,000 + 13,500) = 19,500

11.5 SELF ASSESSMENT QUESTIONS

1. Distinguish between external and internal reconstruction of a company.
2. External reconstruction and Internal reconstruction
3. Explain the need for capital reduction.
4. Explain the meaning of reduction of share capital of a company.
5. Enumerate the steps in reconstruction of a company.
6. When the redemption of shares be made from out of capital?
7. What are the steps to Reconstruct a company?
8. What do you mean by internal reconstruction?
9. External reconstruction and Internal reconstruction
10. Distinguish between Internal and External Reconstruction

11.6 EXERCISES

1. M Ltd., had the following capital.

a. 10,000 Equity shares of Rs.10 each, fully paid.
b. 1,000 8% preference shares of Rs.100 each fully paid.

The company resolved to reconstruct itself and reduce equity shares to Rs.4 each and preference shares to Rs.60 each. The amount thus made available was utilised to write off profit and loss account debit balance of Rs.80,000 and the balance to write off goodwill. Give necessary entries in the books of M Ltd.

[Ans.: Reduction of Share Capital Rs.1,00,000]

2. A public limited company passed the necessary resolution and received sanction of the court for the reduction of its hare capital by Rs.5,00,000 for the purpose enumerated hereunder:

a. To write off the debit balance of P & L a/c Rs.2,10,000
b. To reduce the value of plant and machinery by Rs.90,000
c. To write off goodwill by Rs.40,000
d. To reduce the value of investments to market value by writing off Rs.80,000.

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

Give journal entries in relation to the reduction of share capital and show how you would deal with the balance of the reduction of share capital account.

[Ans.: Reduction of Share Capital Rs.5,00,00]

3. On the reconstruction of a company, the following terms were agreed upon: The shareholders to receive in lieu of their present holding (viz 50,000 shares of Rs.10 each) the following.

a. Fully paid equity shares equal to $^{2}/_{5}$ th of their holding
b. 5 per cent preference shares fully paid, to the extent of $^{1}/_{5}$ th of the above new equity shares.
c. Rs.60,000 6% second debentures.

An issue of Rs.50,000 5% First Debentures was made and allotted, payment for the same having been received in cash. The goodwill which stood at Rs.3,00,000 was written down to Rs.1,50,000The plant and machinery which stood at Rs.1,00,000 were written down to Rs.75,000. The Freehold and leasehold premises, which stood at Rs.1,50,000 were written down to Rs.1,25,000.

Make the journal entries in the books of the company necessitated by the above reconstruction.

[Ans.: Capital Reduction Rs.2,00,000]

4. The following Balances are extracted from the books of Down fall Ltd.

	Rs.
10% Debentures	3,00,000
Outstanding Debenture interest	1,00,000
10% preference share capital	6,00,000
Goodwill	50,000
Preliminary expenses	50,000

The following scheme of reconstruction is executed.

a. Debentureholders agree to forego the interest and to convert 10% Debentures into 15% Debentures.
b. Preference shareholders agree to take 15% preference shares of Rs.5,00,000 in exchange for their shares of Rs.6,00,000
c. Goodwill and preliminary expenses to be written off. Give the necessary journal entries.

[Ans.: Capital Reduction Rs.2,00,000]

5. The following is the balance sheet of Not So Well Ltd., as on 31st March, 2010.

Liabilities	Rs.('000)	Assets	Rs.('000)
10,000 Equity shares of Rs.10 each	1,00,000	Fixed Assets	2,00,000
		Current Assets	20,000
Creditors	2,00,000	Profit and Loss a/c	80,000
	3,00,000		3,00,000

The approval of the court was obtained for the following scheme of reduction of capital:

a. The equity shares to be reduced to Rs.5 per share
b. Fixed assets to be revalued at Rs.2,40,000
c. Current assets to be written down to Rs.10,000

Pass Journal Entries to give effect to the above arrangement.

[Ans.: Reduction of Share Capital Rs.90,000]

6. The Balance Sheet of X company Ltd., as on 31-12-2009 was a follows:

Liabilities	Rs.	Assets	Rs.
40,000 Equity shares Rs.100 each	40,00,000	Goodwill	3,00,000
		Machinery	30,00,000
20,000 preference shares of Rs.100 each	20,00,000	Buildings	16,00,000
		Stock	10,00,000
8% Debentures	12,00,000	Debtors	16,00,000
Sundry Creditors	10,00,000	Profit and Loss a/c	14,00,000
Bills payable	6,00,000	Discount on issue of shares	1,00,000
Share premium a/c	2,00,000		
	90,00,000		90,00,000

The following scheme of Reconstruction was approved by the Court.

a. The Preference shares and Equity shares were reduced to Rs.75 and Rs.50 per share fully paid respectively.
b. Debenture holders agreed to received 10,000 Preference of 100 each fully paid up in full satisfaction of their claims.
c. Fictitious assets including goodwill to be written off.
d. Machinery and buildings were depreciated by 10% and 20% respectively.

Draft necessary journal entries and prepare revised Balance Sheet.

[Ans.: Capital Reserve Rs.2,80,000; Balance sheet Total Rs.65,80,000]

7. The summarised Balance Sheet of Pushpa Company Ltd. on 31-3-2010 was as below:

	Rs.		Rs.
5,000 equity shares of		Goodwill	90,000
Rs.100 each	5,00,000	Land and Buildings	1,00,000
6% Debentures	2,00,000	Plant and Machinery	2,40,000
Profit prior to Incorporation	10,000	Patents	30,000
Creditors	1,40,000	Bank	5,000
Bank Overdraft	50,000	Debtors	90,000
		Motor car	10,000
		Stock in trade	95,000
		Profit and loss a/c	2,00,000
		Preliminary expenses	40,000
	9,00,000		9,00,000

The business has passed through a depression and the worse seems to have been over. The following scheme of reconstruction is adopted with the consent of all.

(a) Each share was to be reduced to one fifth of its value.

(b) Each shareholder was to subscribe for half the number of shares already held by him at its new value and pay immediately in cash for the new shares taken by them to help the company with working capital.

(c) All fictitious items including Goodwill and patents were to be eliminated.

(d) A provision of 5% on debtors in respect of doubtful debts was to be available.

(e) Motor car was to be written down by Rs.5,000 and the balance of the amount available to be used to write off Plant and Machinery.

You are asked to give the journal entries necessary to record the above and show the resulting Balance Sheet.

[Ans.: Balance Sheet Total Rs.5,50,000]

8. Beekay Ltd decided to reduce its capital as at 31st December, 2009 and the following Balance Sheet shows the position as on that date:

	Rs.		Rs.
Share Capital:		Fixed Assets:	
Authorised, Issued and Paid-up		Land and Buildings	4,67,000
15% Preference shares of		Current Assets:	
Rs.10 each	4,00,000	Stock	8,12,500
Equity shares of Rs.10 each	10,00,000	Sundry Debtors	4,67,500
Reserves	4,53,500	Cash	25,000
10% Mortgage debentures of		Profit and Loss a/c	5,56,000
Rs.10 each	2,00,000		
Current Liabilities	2,74,500		
	23,28,000		23,28,000

1. For every 15% Preference share of Rs.10 each will be given one 20% Preference share of Rs.5 each.
2. The equity share is reduced to Rs.2.50 each
3. The balance available on reduction is to be applied to Wiping-off Profit and Loss Account and Writing-down Rs.3,00,000 from Land and Buildings, Rs.5,00,000 from Stock and Rs.20,000 from Sundry debtors. Utilise Reserve if its is necessary.

   Pass necessary entries, prepare the balance sheet after capital reduction.

9. Unluckly Company Ltd. presents you with the following Balance Sheet as at 31.3.2010.

Liabilities	Rs.	Assets	Rs.
Share Capital		Goodwill	60,000
(Rs.100 each full paid):		Land and Buildings	1,50,000
-Equity	4,00,000	Plant and Machinery	3,00,000
-7% preference	3,00,000	Patents	30,000
Profit prior to Incorporation	10,000	Stock	2,20,000
6% Debentures	3,00,000	Sundry Debtors	1,50,000
Sundry Creditors	2,00,000	Cash	5,000
		Preliminary Expenses	25,000
		P & L Account	2,70,000
	12,10,000		12,10,000

The following scheme of reconstruction was duly approved:

a) 7% Preference Shares be converted into 9% preference shares, the amount being reduced by 30%.
b) Equity shares by reduced to fully paid shares of Rs.50 each
c) Land and Buildings be appreciated by 20%.
d) Debentures be reduced by 20%.
e) All intangible and fictitious assets to be written off. Assuming the whole scheme was implemented, prepare the resultant Balance Sheet.

[Ans.: Capital Reduction Rs.3,85,000; Balance Sheet Total Rs.8,55,000]

10. On 31st December, 2009 the Company's Balance Sheet stood as under:-

	Rs.		Rs.
Nominal Capital:		Land & Building	1,00,000
20,000 shares of Rs.100 each	20,00,000	Machinery	2,60,000
Subscribed Capital 19,000 shares of Rs.100 each fully paid	19,00,000	Furniture	20,000
		Stock	3,70,000
		Debtors	1,80,000
Creditors	1,00,000	Goodwill	2,00,000
Jeevanlal & Co.	1,00,000	Profit & Loss A/c.	9,70,000
	21,00,000		21,00,000

The Company is to be reconstructed on the basis of the following scheme

(i) The 19,000 shares of Rs.100 each are to be reduced to an equal number of fully paid shares of Rs.40 each.

(ii) The debt of Rs.1,00,000 due to Jeevanlal & Co. was to be also reduced, the remaining 1,000 unissued shares being issued to them as fully paid-up shares of Rs.40 each in full settlement of the amount due to them.

(iii) The amount thus rendered available by the reduction of capital and by the above arrangement with Jeevanlal & Co. is to be utilised in wiping off the goodwill and the Profit & Loss account and in writing down the value of Machinery.

Write the Journal entries and the Balances Sheet after the schemes is implemented.

[Ans.: (1) Capital Reduction a/c Rs.12,00,000; (Equity Share Capital Rs.11,40,000 + creditor – Jeevanlal Rs.60,000) (2) Balance Sheet Total Rs.9,00,000]

11. Following is the Balance Sheet of Godbole Co. Ltd. as on 31st March, 2010:

Liabilities	Rs.	Assets	Rs.
Share Capital:		Goodwill	22,500
3,000 5% Pref. Shares Rs.100 each	3,00,000	Land and Building	3,00,000
6,000 Equity Share of Rs.100 each	6,00,000	Machinery	4,50,000
6% Debentures	1,50,000	Stock	65,000
Bank Overdraft	1,50,000	Debtors	70,000
Creditors	75,000	Cash	7,500
		P & L A/c	3,50,000
		Preliminary Exp.	10,000
	12,75,000		12,75,000

On the above date, the company adopted following scheme of reconstruction:

(i) The preference Shares are to be reduced to fully paid share of Rs.75 and Equity shares are to be reduced to shares of Rs.40 each fully paid.

(ii) The debenture holders took over stock and debtors in full satisfaction of their claim.

(iii) The fictitious and intangible assets are to be eliminated.

(iv) The Land and Buildings to be appreciated by 30% and Machinery to be depreciated by $33^1/_3$%.

(v) Expenses of Reconstruction amounted to Rs.4,500.

[Ans.: (1) Capital Reduction Rs.5,40,000; (Preference share capital Rs.75,000 + Equity share capital Rs.3,60,000 + Debentureholders Rs.15,000 + Land & Buildings Rs.90,000) (2) Capital Reserve a/c Rs.3,000; (3) Balance Sheet Total Rs.6,93,000]

12. The following is the Balance Sheet of Bihar Industries Ltd. as on June 30, 2010.

Liabilities	Rs.	Assets	Rs.
Authorised capital:		Goodwill	20,000
50,000 Preference shares of Rs.10 each	5,00,000	Leasehold premises	1,07,000
50,000 Equity Shares of Rs.10 each	5,00,000	Plant & Machinery	60,000
	10,00,000	Patents	1,73,900
Issued capital:		Preliminary Exp.	2,000
25,000 Preference shares of Rs.10 each	2,50,000	Stock	34,000
25,000 Equity shares of Rs.10 each	2,50,000	Debtors	56,000
	5,00,000	Cash in hand	100
Sundry Creditors	40,000	Profit & Loss a/c	
Bank Overdraft	36,000	(Debit balance)	1,23,000
	5,76,000		5,76,000

The company proved unsuccessful and resolutions were passed to carry out the following scheme of reduction of capital.

1. That the preference shares be reduced to equal number of fully paid shares of Rs.5 each
2. That the equity shares be reduced to equal number of fully paid shares of Rs.2.50 each;
3. That the amount so available be utilised towards wiping of losses and the reduction of assets as follows:

Preliminary expenses, goodwill and profit and loss account to be written off entirely. Rs.27,000 to be written off leasehold premises, Rs.14,000 to be written off stock, Rs.6,000 to be reserved for doubtful debts, 20 per cent to be written off plant and machinery and patents to be written off with the balance available.

Make journal entries in the books of the company.

[Ans.: (1) Capital Reduction a/c Rs.3,12,500; Preference Share capital Rs.1,25,000 + Equity share capital Rs.1,87,500; Balance Sheet Total Rs.2,63,500]

13. The following balances were extracted from the books of Swarna Ltd. as on 31-3-2010:

	Rs.		Rs.
Preliminary expenses	32,000	2,000 Equity shares of	
Patents	22,000	Rs.100 each	2,00,000
Share premium	50,000	Debentures interest	
Goodwill	17,000	Outstanding	3,000
Profit & Loss A/c (Dr. Balance)	85,800	Property (at cost)	1,10,000
6% Debentures	50,000	Depreciation thereon	20,000
Share Capital:		Stock (31-3-2010)	15,000
1,500, 8% cumulative		Machinery (at cost)	2,20,000
preference shares of Rs.100 each	1,50,000	Depreciation thereon	40,000
		Debtors	31,200
		Creditors	20,000

The following scheme of Capital reduction was duly sanctioned by the court.

(a) Equity shares to be reduced by Rs.90 each.

(b) Preference shares to be reduced by Rs.90 each.

(c) The debentureholders have to forego their right over outstanding interest.

(d) One new equity share paid-up to the extent of 50% only to be issued for each Rs.100 of gross preference dividend, which has not been declared since April 2007.

(e) All credit balances not being the outside liabilities and all debit balances not being the amounts receivable as well as the intangible assets are to be written off.

(f) Any balance available is to be utilised in writing down the fixed assets in proportion to their written down values.

You are required to give Journal entries.

[Ans.: Capital Reduction Rs.2,30,000]

14. The following is the Balance sheet of Sitapati Co. Ltd. as on 31st December, 2009:

Liabilities	Rs.	Assets	Rs.
Authorised Capital:		Goodwill	1,40,000
12,000 shares of Rs.100 each	12,00,000	Buildings	1,60,000
Issued and Subscribed Capital:		Machinery	3,00,000
4,000 shares of Rs.100 each		Stock	1,00,000
fully paid	4,00,000	Debtors	86,000
400, 5% Debentures of		Cash at Bank	5,000
Rs.1,000 each fully paid	4,00,000	Preliminary expenses	9,000
Creditors	1,00,000	Profit and Loss a/c	2,00,000
Bills Payable	10,000		
Bank overdraft	90,000		
	10,00,000		10,00,000

The following is the scheme of reconstruction duly approved and adopted:

(a) Without altering the number of shares in Authorised Capital or Issued and Subscribed Capital, the face value and paid-up value of each share be reduced to Rs.50.

(b) The existing debentures be converted into 200. 7½ % Debentures of Rs.1,000 each fully paid.

(c) Assets be revalued as under:

	Rs.
Buildings	1,44,000
Machinery	2,80,000
Stock	90,000

Debtors subject to a bad debts reserve of Rs.5,000.

(d) Goodwill, preliminary expenses and debit balance of Profit and Loss Account be completely written off.

Show Journal entries in the books of the company and also the Balance Sheet giving effect to the scheme of reconstruction.

[Ans.: Capital Reduction a/c Rs.4,00,000; (Equity share capital Rs.2,00,000 + Debentures Rs.2,00,000); (2) Balance Sheet total Rs.6,00,000]

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Chapter – 12

HOLDING COMPANIES

Objectives :

After studying this lesson you should be able to :

- understand the meaning of a holding company and a subsidiary company
- analyse the advantages and disadvantages of holding companies
- discuss consolidated financial statements under AS-21
- go through the consolidated financial statements of holding companies

Structure :

12.1 INTRODUCTION

In the present business world, Holding company forms of organizations are becoming more popular in India. In fact, the mergers and acquisitions have become the order of the day in the corporate world.

12.1.1 Holding Company:

According to Section 4(4) of Companies Act, 1956, "A holding company is a company which directly or indirectly through the medium of another company either holds more than half of the equity share capital or controls the composition of the Board of directors of some other companies." Examples are Reliance Industries, SAIL, NTPC, Tata Sons, Hindustan Lever Ltd etc.

12.1.2 Subsidiary Company:

A company is said to be the subsidiary of a company when the other company is its holding company. The management and control of a subsidiary company is always in the hands of holding company. Examples of Subsidiary companies are : Rurkela Steel Plant, Ajamjahi Mills, Simhadri Thermal Power Plant etc.

12.1.3 Wholly owned and partly owned subsidiaries :

The wholly owned subsidiary company is one in which all the shares are owned by the holding company (or the group). In such a case, in order to fulfill the legal requirement of minimum number of members the holding company appoints the requisite number of nominee holding one share each on behalf of the holding company.

A partly owned subsidiary is one in which the holding company (or the group) does not hold all the shares. The interest of such shareholders outside the group is termed as Minority interest.

A subsidiary company cannot hold shares in the holding company after it becomes its subsidiary. However, it can continue to own such shares in the holding company which it acquired before it became its subsidiary. But it will have no voting rights in respect of such shares.

12.2. HOLDING COMPANIES – MERITS AND DEMERITS

12.2.1 Advantages:

The following are the advantages of Holding company form of organization.

1. **Decentralization of Management:** Even though the holding company exercises overall control over its subsidiaries, each subsidiary is free to manage its internal affairs. Decentralisation in management helps each subsidiary to grow according to its potential.

2. **Integrated planning and direction:** The holding company facilitates integration in management by centralised purchases, production, sales, research and development.

3. **Professional management:** Management of holding company and its subsidiaries is in the hands of professionally qualified staff.

4. **Centralised planning, promotion and control at industry level:** Formation of a holding company industry can enable managements to formulate policies for planning, promotion and control of the industry as a whole.

5. **Consolidated Financial Position:** The preparation of consolidated financial statements helps the holding company in presenting its strength. The total liquidity

of the holding company and its subsidiary can be measured and hence the companies can communicate their strength as a whole.

12.2.2 Demerits of Holding Company:

The following are the disadvantages of the holding company form of organization.

1. **Conceal important information:** Aggregating the results of holding company and its subsidiary may conceal important information from shareholders when the companies differ in respect of profitability, business risk and growth potential.

2. **Shareholders may be mislead:** Consolidation may mislead the shareholders if the activities of the subsidiary are very dissimilar from those of other companies within the group.

12.3. CONSOLIDATED FINANCIAL STATEMENTS : AS-21

Accounting Standard (AS-21), 'Consolidated Financial Statements' issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 1-4-2001. An enterprise that presents consolidated financial statements should prepare and present these statements in accordance with this standard.

12.3.1 Objectives:

The objective of this statement is to lay down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented by the parent company to provide financial information about the economic activities of its group. These statements are intended to present financial information about a parent and its subsidiary (ies) as a single economic entity to show the economic resources controlled by the group.

12.3.2 Scope:

1. This Statement should be applied in the preparation and presentations of consolidated financial statements for a group of enterprises under the control of a parent.
2. This Statement should also be applied in accounting for investments in subsidiaries in the separate financial statements of a parent.
3. In the preparation of consolidated financial statements, other Accounting Standards also apply in the same manner as they apply to the separate financial statements.
4. This Statement does not deal with:
    a. methods of accounting for amalgamations and their effects on consolidation, including goodwill arising on amalgamation.
    b. accounting for investments in associates
    c. accounting for investments in joint ventures.

AS-21 terms a holding company as ‘Parent Company’ which has one or more subsidiaries and a ‘Subsidiary’ as an enterprise that is controlled by another enterprise known as ‘parent’. A ‘group’ is a parent with all its subsidiaries. AS-21 should be applied in the preparation and presentation of Consolidated Financial Statements for a group of enterprises under the control of a parent.

12.3.3 Consolidated Financial Statements:

Consolidated financial statements normally include consolidated balance sheet, consolidated statement of profit and loss, and notes, other statements and explanatory material that form an integral part thereof. Consolidated cash flow statement is presented in case of a parent presents its own cash flow statements. The consolidated financial statements are presented, to the extent possible, in the same format as that adopted by the parent for its separate financial statements.

12.3.4 Presentation of Consolidated Financial Statements:

A parent who presents consolidated financial statements should present these statements in addition to its separate financial statements. Users of the financial statements of a parent are usually concerned with, and need to the informed about, the financial position and results of operations of not only the enterprise itself but also of the group as a whole. This need is served by providing the users-

(a) separate financial statements of the parent; and
(b) consolidated financial statements, which present financial information about the group as that of a single enterprise without regard to the legal boundaries of the separate legal entities.

12.4. HOLDING COMPANY ACCOUNTS

Section 212 of the Companies Act lays down specifically the different aspects of presentation of accounts by a holding company.

1. A holding company has to attach the following documents with its balance sheet in respect of each of its subsidiaries.

(a) A copy of the Balance Sheet of the Subsidiary
(b) A copy of the profit and loss account
(c) A copy of the report of its Board of directors
(d) A copy of the report of its auditors
(e) A statement of holding company’s interest in the subsidiary as specified in sub-section (3)
(f) The statement referred to in sub-section (5) if any; and
(g) The report referred to in sub-section (6) if any.

2. If the financial years of the holding company and subsidiary coincide with each other, subsidiary company's Balance Sheet and other documents mentioned above relating to the same financial year should be attached to the Balance Sheet of the holding company.

If the financial years of both the companies do not coincide, the preceeding year's balance sheet and other statements of the subsidiary must be attached. However, the time span between the two balance sheets should not be more than six months.

Requirements of Schedule VI:

The following items relating to the subsidiary company must be disclosed in the holding company's Balance Sheet as prescribed under Schedule VI.

On the assets side of the Balance Sheet:

(a) Under the heading of "Investments" Investments in equity shares, preference shares, debentures etc., of the subsidiary company.

(b) Under the heading 'Loans and Advances' Advances and loans given to subsidiaries.

On the liabilities side of the Balance Sheet:

(a) Under the heading 'secured loans' Loans and advances from subsidiaries.

(b) Under the heading 'unsecured loans' Loans and Advances from subsidiaries.

(c) Under the heading "Current Liabilities and Provisions" amount due from subsidiaries.

12.5. CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Profit and Loss Account and Balance Sheet implies preparation of a single profit and loss account and balance sheet of a holding company and its subsidiaries. This is done by aggregating all items of incomes, expenses, assets, liabilities etc. of the holding company and its subsidiaries

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In England, the holding company is required to present, in addition to its normal balance sheet, a consolidated balance sheet covering the holding company and its subsidiaries and a consolidated profit and loss account. In India, the law does not insist on consolidated accounts. However, it is desirable to present one single balance sheet of the holding and subsidiary companies and a single profit and loss account. In fact, AS-21 makes the companies to prepare and present consolidated financial statements.

12.6. PREPARATION OF CONSOLIDATED BALANCE SHEET

In the preparation of Consolidated Balance Sheet, the following points are be taken care of.

12.6.1 Cancellation of Investment and Share Capital:

A consolidated balance sheet can be prepared by simply combining all the assets and liabilities of the holding company and its subsidiary. It will certainly balance, but it is not a consolidated Balance Sheet. This is because the inter-company balances have first to be eliminated. The "Investments in Subsidiary Company" by the holding company should cancel out the Share capital of the subsidiary company.

12.6.2 Calculation of Minority Interest:

The minority interest is to be computed and shown on the liabilities side of the consolidated balance sheet as a separate item. It may be shown as the last item on the liabilities side or along with the share capital of the holding company. The former method is more popular.

Computation of Minority Interest

	Rs.	Rs.
Face value of minority equity shares		x x x
Face value of minority preference shares		x x x
Minority share in capital profits		x x x
Minority share in revenue profits		x x x
Minority share of bonus shares issued		x x x
		x x x
Less: Minority share in capital losses	x x x	
Minority share in revenue losses	x x x	
		x x x
		x x x

12.6.3 Cost of Control/Goodwill or Capital Reserve:

If the holding company purchases the shares of the subsidiary company at a price which is more than the paid-up value of the shares, the excess amount paid represents payment for goodwill or cost of acquiring control of the subsidiary company, if there exist no reserves or profit or loss balance in the subsidiary company on the date of acquisition of shares of the subsidiary company. On the other hand, if the shares are purchased at a price which is less than the paid-up value of the shares, the less amount paid represents **capital reserve.**

Computation of Cost of Acquisition

	Rs.	Rs.
Amount paid for shares purchased by the holding company in the subsidiary		x x x
Add: Holding Company's share in capital loss		x x x
		X x x
Less: Face value of shares purchased	x x x	
Holding company's share in capital profits	x x x	
Holding company's share of bonus shares issued by subsidiary	x x x	
Holding company's share of dividend paid out of capital profits	x x x	
		x x x
Goodwill or capital reserve		x x x

Note: If the Balance is positive, it is goodwill. If it is negative, it is capital profit and therefore it is to be treated as capital reserve.

12.6.4 Pre-acquisition and Post-acquisition of Profits of Subsidiary:

One of the important issues to be taken care of in the presentation of consolidated statement is the division of profit into pre-acquisition and post acquisition profit.

1. **Pre-acquisition Profit:** The profits earned by the subsidiary company before the holding company acquires its control is known as pre-acquisition profit or capital profit. Un-drawn pre-acquisition profit is taken into consideration for calculation of goodwill or capital reserve. It is split between cost of control (goodwill/capital reserve) and minority interest.

2. **Post-acquisition Profit:** The profits earned by the subsidiary company after the holding company acquires its control, is known as post-acquisition profit or revenue profit. It can be distributed as dividend. The post-acquisition profit of a subsidiary company should not take into account in the calculation of goodwill or capital reserve.

3. **Minority Interest:** Minority shareholders are not concerned whether the profits are pre-acquisition or post-acquisition. Post-acquisition profit is apportioned between holding company and minority shareholders. The share of holding company is

added with its profit, while the share of the minority shareholders from a part of the calculation of minority interest.

12.6.5 Revaluation of Assets and Liabilities:

When holding company acquires controlling interest in a subsidiary, it may revalue the assets and liabilities to reflect their current values. Any profit or loss on revaluation of the assets and the outside liabilities has to be adjusted in the respective assets and liabilities in the consolidated balance sheet, if it is not already done. The same profit or loss has to be included in the computation of 'capital profits'.

Depreciation on Revalued assets: The changes in the value of any fixed assets as on the date of purchase of shares creates the problem of 'Depreciation'. If there is appreciation on the fixed assets due to revaluation, additional depreciation from the date of revaluation till the Balance Sheet date has to be provided. This additional depreciation has to be reduced from 'Revenue profits' because the depreciation is related to the post acquisition period.

If there is decrease in the value of fixed assets on revaluation, the depreciation attribute to the 'decreased' portion of the asset has to be calculated and added to the revenue profits. In the consolidated Balance Sheet, these additional depreciation or 'savings in depreciation' have to be adjusted in the assets concerned.

12.6.6 Bonus shares issued by subsidiary company:

In the treatment of bonus shares issued by the subsidiary company we have to verify whether they are issued out of pre-acquisition profit or post-acquisition profit.

Issue of Bonus shares out of Pre-acquisition Profit: If the bonus shares are issued out of pre-acquisition profit, it will not have any effect on the consolidated balance sheet as it will cause decrease in the holding company's share of pre-acquisition profit. On the other hand, paid-up value of the equity shares held by the holding company will be increased by the same amount. Therefore, the amount of goodwill or capital reserve will be same. The portion of the bonus shares of the minority shareholders will be added to the minority interest.

Issue of Bonus shares out of Post-acquisition Profit: If a subsidiary company issues bonus shares out of post-acquisition profit, it will have a direct effect on the Consolidated balance sheet. In such a situation, the holding company's share of revenue profit in the subsidiary company will be reduced and the paid-up value of the shares held by the holding company in its subsidiary will be increased because of the issue of bonus shares. This will reduce the value of goodwill or increase the value of capital reserve. The share of minorities bonus shares will be added to the minority interest.

12.6.7 Dividends from Subsidiary Company:

There may be different type of dividends declared by the subsidiary company. Since the method differs depending upon the dividend we have to verify the type of dividend.

1. **Inter-corporate dividends:** When dividend is paid out of profits of the subsidiary company, the holding company is likely to receive a major portion of it as a shareholder. It should be noted that such dividends may be paid out of pre-acquisition profit or post-acquisition profit.

2. **Dividend paid out of pre-acquisition profit:** Such dividend should be treated as a return of capital to the holding company, since it transfers to the holding company part of the net assets in the subsidiary company that have been paid for. In this situation, we have to deduct such dividend from the cost of investment in the subsidiary for calculating goodwill or capital reserve.

3. **Dividend paid out of Post-acquisition Profit:** Dividend received by the holding company from a subsidiary out of post-acquisition profit is treated as investment income and credited to the profit and loss account of the holding company. It should be noted that any interim dividend paid by the subsidiary company is also treated in the books of the holding company in the same manner as discussed above.

4. **Proposed Dividend:** When a dividend is proposed by the holding company, it will be deducted from the post-acquisition profit of the holding company and will be shown in the Consolidated balance Sheet as a current liability. Further, proposed dividend of the subsidiary will be deducted from the post-acquisition profit of the subsidiary company.

Holding company's share of such proposed dividend is added with the profit and loss account of the holding company. Minority's share of proposed dividend can be added with the minority interest or it can be shown as a current liabilities in the Consolidated Balance Sheet.

12.6.8 Preference Shares held by the Holding Company:

When preference shares are issued by a subsidiary company and are held by the holding company (whether wholly or partly), it should be treated in the same way as equity shares. If the holding company acquires the preference shares at par, the cost of investment of the holding company cancels out the shares shown on the balance sheet of the subsidiary. When the preference shares are acquired at a premium or at discount, the balance is carried to goodwill or capital reserve in the consolidated balance sheet. The portion of the preference shares owned by the minority shareholders are added to minority interest.

Debentures held by the holding company :

The debentures of the holding company will appear in the liabilities side of the Consolidated Balance Sheet, Debenture issued either by the holding company or the subsidiary and held by the other should be cancelled out when they are acquired at par. When parts of the debentures are held by the minority shareholders, it should appear in the liability side of the Consolidated Balance Sheet. The holding company's "Investment in debentures in the subsidiary" will cancel out against the nominal value of debentures shown in the subsidiary company's balance sheet. If the debentures are acquired at a premium or at a discount, the difference between cost and nominal value is adjusted against goodwill or capital reserve in the balance sheet.

12.6.9 Elimination of Inter Transactions:

It is very common that member companies have business dealings not only with outsiders but also with each other. Inter-company transactions may lead to inter-company debts and acceptances. At the time of consolidation, inter-company debts and acceptances which are part of the same group, are to be cancelled out.

i. **Debtors and Creditors:** The debtors and creditors of holding and subsidiary companies may include amount payable and receivable between them for purchase and sale of goods. If the same amount shown by both the companies, it can be reduced on both sides of the consolidated balance sheet. If there is any difference between the amounts, it must be due to cash-in-transit or goods-in-transit. In such a case such 'transit' amount should also be reduced from the side on which higher amount is shown. The cash in transit or goods in transit has to be shown on the assets side of the Balance Sheet as a separate item.

ii. **Bills receivable and bills payable:** Bills receivable and bills payable of the holding and subsidiary companies may include bills accepted and drawn by each other. To the extent such bills are included in the bills receivable, they must be eliminated. Any bills endorsed or discounted represent liability to a third party and must be shown in the consolidated balance sheet.

iii. **Loans payable and receivable:** Loan given or taken between the holding and subsidiary should also be eliminated from the consolidated balance sheet. If any interest is taken into account by one company, but not the other, it should be adjusted by passing entry for it. Thereafter, the loan along with interest payable is also to be eliminated.

iv. **Owing for services rendered:** If entry is already passed by both the companies, it must be a part of outstanding expenses and creditors. It can be subtracted from the respective items in the Balance Sheet. If no entry is passed so far, the amount has to be reduced from revenue profits of the subsidiary company and added to the Profit and Loss Account of the holding company.

12.6.10 Contingent Liability:

Any Contingent liability involving a third party must continue to be shown as a footnote to the consolidated Balance Sheet. However, contingent liabilities involving the holding company and its subsidiaries alone must be eliminated by not showing them as footnotes to the Balance Sheet.

12.7 QUESTIONS

A. Short Answer Questions :

1. Holding Company
2. Subsidiary Company
3. Consolidated Financial Statements
4. Minority Interest
5. Cost of Control
6. Pre-acquisition profit
7. Post-acquisition profit
8. Contingent Liability

B. Essay Questions :

1. What do you mean by holding companies? What are their advantages and disadvantages
2. Explain the preparation of consolidated balance sheet.
3. Discuss the accounting procedure for inter-company investment.
4. Describe how minority interest is shown in a consolidated Balance Sheet.
5. How do you calculate ‘Minority Shareholders interest’?
6. What do you understand by a holding company?
7. Describe how minority interest is shown in a consolidated balance sheet.

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Chapter – 13

ACCOUNTS OF HOLDING COMPANIES (Unrealised profit)

Objective :

After reading this lesson you should be able to

- know the meaning of unrealized profit on stock of holding company
- find out the accounting treatment relating to unrealized profit on fixed assets

Structure :

13.1 UNREALISED PROFIT

13.1.1 Unrealised Profit on Stock:

If the holding company and its subsidiary trade with one another, the goods bought at a profit from one company may appear as unsold stock in the Balance Sheet of another, if the entire quantity is not sold. In the consolidated balance sheet, the aggregate stock of the holding company and its subsidiary is to be stated at a cost. But in this case, the cost to the buying company includes an element of profit earned by the selling company. From the view point of the group, it should be ensured that no unrealised profit enters into group accounts.

Therefore, it would be wrong to account for this profit until the goods have been sold outside the group. The unrealised profit on inter-group stocks, still held, must be computed and should be cancelled out. It should be deducted from the consolidated profit as well as from the aggregate stock valuation in the Consolidated Balance sheet. The above adjustment also holds good when the subsidiary company is a wholly-owned subsidiary.

In case of minority shareholders' share the proportionate amount of unrealised profit should be deducted from consolidated profit as well as from the aggregate stock valuation.

13.1.2 Unrealised Profit on Fixed Assets:

A member company may transfer fixed assets or stock which becomes fixed assets of the transferee company at a profit. At the time of consolidation, unrealised profit should be deducted from the consolidated profit as well as aggregate value of fixed assets. If there is minority interest, the proportionate profit is to be deducted.

Illu.1: Vijay Ltd., acquires all the shares of Ajay Ltd., on 1st April, 2009. On 31st March, 2010 the Balance sheets of Vijay Ltd. and Ajay Ltd., stood as follows. The profit and loss account of Ajay Ltd., had a credit balance of Rs.40,000 on 1-4-2009.

Liabilities	**Vijay Ltd. Rs.**	**Ajay Ltd. Rs.**	**Assets**	**Vijay Ltd. Rs.**	**Ajay Ltd. Rs.**
Share capital :			**Buildings**	**1,00,000**	**1,60,000**
Equity shares @ Rs.10 each	**3,00,000**	**2,00,000**	**Machinery**	**40,000**	**50,000**
General reserve	**90,000**	**1,00,000**	**Stock**	**30,000**	**90,000**
Profit and Loss a/c	**1,00,000**	**80,000**	**Bank**	**-**	**1,00,000**
Creditors	**30,000**	**20,000**	**Shares in Ajay Co.**	**3,50,000**	**-**
	5,20,000	**4,00,000**		**5,20,000**	**4,00,000**

Solution :

Consolidated Balance Sheet of Vijay Ltd. and its subsidiary company of Ajay Ltd. as on 31st March, 2010

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**
Share capital :			Goodwill		10,000
Equity shares @ Rs.10 each	`	3,00,000	Buildings		
General reserve		90,000	Vijay Ltd.	1,00,000	
Profit and Loss a/c			Ajay	1,60,000	2,60,000
Vijay	1,00,000		Machinery		
Ajay	40,000	1,40,000	Ajay	40,000	
Creditors			Vijay	50,000	90,000
Vijay	30,000		Stock		
Ajay	20,000	50,000	Vijay	30,000	
			Ajay	90,000	1,20,000
			Bank		1,00,000
		5,80,000			5,80,000

Working Notes :

1. Credit balance of Profit and loss account on the date of acquisition of shares Rs.40,000
2. Credit balance of profit and loss account on 31-3-2010 Rs.80,000
3. Since there is no profit before acquisition and therefore capital profit will be Rs.40,000
3. Profit after acquisition or Revenue profit Rs.40,000

Calculation of Goodwill :

	Rs.	Rs.
Cost of acquisition of shares		3,50,000
Less : Paid up value of shares	2,00,000	
General Reserve as on 1-4-2009	1,00,000	
Profit prior to acquisition	40,000	3,40,000
Goodwill		**10,000**

Illu.2: On 31st December, 2009 the balance sheet of Avanthi Ltd. Bhargavi Ltd. as follows.

Liabilities	Avanthi ltd. Rs.	Bhargavi Ltd.	Assets	Avanthi Ltd.	Bhargavi Ltd.
Share capital			**Buildings**	**1,25,000**	**1,35,000**
Equity shares			**Machinery**	**1,40,000**	**95,000**
@ Rs.10 each	**4,00,000**	**2,00,000**			
General Reserve	**1,00,000**	**60,000**	**Stock**	**40,000**	**65,000**
Profit and Loss a/c	**1,20,000**	**60,000**	**Bank**	**45,000**	**35,000**
Creditors	**30,000**	**10,000**	**Shares in Bhargavi Ltd.**	**3,00,000**	**-**
	6,50,000	**3,30,000**		**6,50,000**	**3,30,000**

Avanthi Ltd., acquired all the shares in Bhargavi Ltd on October, 2009. On 1st January, 2009 the credit balance of profit and loss account of Bhargavi Ltd., Rs.20,000. Prepare the consolidated balance sheet.

Solution :

Consolidated Balance Sheet of Avanthi Ltd. and its subsidiary Company Bhargavi Ltd., as on 31st December 2009

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital :			Buildings		
Equity shares @ Rs.10 each	`	4,00,000	Avanthi.	1,25,000	
General reserve		1,00,000	Bhargavi	1,35,000	2,60,000
Capital Reserve		10,000	Machinery		
Profit and Loss a/c			Avanthi	1,40,000	
Avanthi	1,20,000		Bhargavi	95,000	2,35,000
Bhargavi	10,000	1,30,000	Stock		
Creditors			Avanthi	40,000	
Avanthi	30,000		Bhargavi	65,000	1,05,000
Bhargavi	10,000	40,000	Bank		
			Avanthi	45,000	
			Bhargavi	35,000	80,000
		6,80,000			6,80,000

Working notes :

1. Credit balance of profit and loss account on 31-12-2009 Rs.60,000
2. Credit balance of profit and loss account on 1-1-2009 Rs.20,000
3. Therefore, profit earned during 2009 Rs.40,000
4. Date of acquisition of shares 1-10-2009
5. Profit earned after acquisition of shares = Rs.40,000 x 3/12 = Rs.10,000
6. Capital profit or profit prior to incorporation = Rs.60,000 – Rs.10,000 = Rs.50,000

Calculation of capital reserve :

	Rs.	Rs.
Cost of acquisition of shares		3,00,000
Less : Paid up value of shares	2,00,000	
General reserve as on 1-1-2009	60,000	
Profit of prior to acquisition	50,000	3,10,000
Capital reserve		10,000

Illu.3: The following are the balance sheets of Reliance Ltd., Silicon Ltd., as at 31st March, 2010.

Liabilities	**Reliance Ltd. Rs.**	**Silicon Ltd. Rs.**	**Assets**	**Reliance Ltd. Rs.**	**Silicon Ltd. Rs.**
Share capital:			**Sundry Assets**	**4,26,000**	**3,04,000**
Shares of Rs.10 each, fully paid	**5,00,000**	**2,00,000**	**100% Shares in Silicon Ltd. acquired on 31st March, 2010 (cost)**	**2,54,000**	
Reserves	**1,00,000**	**50,000**	**Preliminary Expenses**		**6,000**
Creditors	**80,000**	**60,000**			
	6,80,000	**3,10,000**		**6,80,000**	**3,10,000**

Prepare a consolidated sheet as at 31st March, 2010

Solution:

Consolidated Balance Sheet of Reliance Ltd., and Silicon Ltd., as at 31st March, 2010

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**
Share capital:			Cost of Control or Goodwill		10,000
Shares of Rs.10 each, fully paid		5,00,000	Other Assets:		
Reserves		1,00,000	Reliance Ltd.	4,26,000	
Creditors:			Silicon Ltd.	3,04,000	7,30,000
Reliance Ltd.	80,000				
Silicon Ltd.	60,000	1,40,000			
		7,40,000			7,40,000

Working Notes:

	Rs.	Rs.
Calculation of Goodwill or Cost of Control:		
Amount paid for 100% shares in Silicon Ltd.		2,54,000
Less: Paid up value of 100% shares in Silicon Ltd.	2,00,000	
Add: 100% of Reserves of Silicon Ltd. on the date of acquisition	50,000	
	2,50,000	
Less: 100% of unwritten off Preliminary Expenses of Silicon Ltd. as on the date of acquisition	6,000	2,44,000
Goodwill or Cost of Control		10,000

Illu.4 : Balance Sheet as at 31st March 2010:

	H Ltd. Rs.	S Ltd. Rs.		H Ltd. Rs.	S Ltd. Rs.
Share capital Shares of Rs.10 each fully paid	**2,50,000**	**1,00,000**	**Sundry assets**	**2,58,800**	**1,52,000**
			60% shares in S Ltd. acquired on 31st March 2010 (cost)	**81,200**	**-**
Reserves	**50,000**	**25,000**	**Preliminary Expenses**	**-**	**3,000**
Creditors	**40,000**	**30,000**			
	3,40,000	**1,55,000**		**3,40,000**	**1,55,000**

Prepare consolidated Balance Sheet as at 31st March 2010.

Solution :

Consolidated Balance Sheet of H Ltd., and its subsidiary S Ltd., as on 31-3-2010

Liabilities		Rs.	Assets		Rs.
Share capital (shares of Rs.10 each)		2,50,000	Goodwill		8,000
Reserves		50,000	Sundry assets :		
Creditors :			H Ltd.	2,58,800	
H Ltd.	40,000		S Ltd.	1,52,000	4,10,800
S Ltd.	30,000	70,000			
Minority interest		48,800			
		4,18,800			**4,18,800**

1. Holding ratio : 60 : 40 =- 3 :2

The H Ltd. acquire in S Ltd. on 31st March, 2010. Hence the total profits earned by S Ltd., before 31st March, 2010 will be Pre acquisition profits.

2. Pre-acquisition profit :

	Rs.
Reserve in S Ltd.	25,000
Less : Preliminary expenses	3,000
	22,000
H Ltd. share (Rs.22,000 x 3/5)	**13,200**
Share of Minority (2/5)	**8,800**

3. Goodwill / capital reserve :

	Rs.	Rs.
Cost of investments purchased		81,200
Less: Nominal value of shares purchased (Rs.1,00,000 x 60%)	60,000	
Share of H Ltd., in Pre acquisition profit	13,200	73,200
Goodwill		**8,000**

4. Minority Interest :

	Rs.
Nominal value of shares held (Rs.1,00,000 x 40%)	40,000
Add: Share of Pre acquisition profit	8,800
	48,800

Illu.5: N Ltd. purchased 3,000 fully paid up shares at Rs.25 per share in R Ltd. at Rs.40 per share. The transaction took place on 1-1-2010. The balance sheets of both the companies as on 31-12-2010 were given below.

Liabilities	N Co. Rs.	R Co. Rs.	Assets	N Co. Rs.	R Co. Rs.
Share capital	**4,00,000**	**1,00,000**	**Sundry Assets**	**3,75,000**	**1,30,000**
General Reserve (1-1-2010)	**50,000**	**30,000**	**Debtors**	**1,90,000**	**1,20,000**
Profit and Loss a/c (1-1-2010)	**40,000**	**15,000**	**Cash**	**25,000**	**15,000**
Net profit for the year 2010	**1,20,000**	**40,000**	**Shares in R Co,**	**1,20,000**	**-**
Creditors	**1,00,000**	**80,000**			
	7,10,000	**2,65,000**		**7,10,000**	**2,65,000**

Prepare the consolidated balance sheet of N Company on 31-12-2010.

Solution :

Consolidated Balance Sheet of N Co. Ltd. and its subsidiary R Co. Ltd. as at 31st December, 2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital:		4,00,000	Goodwill		11,250
General Reserve		50,000	Sundry assets		
Profit and loss a/c			N Company	3,75,000	
N Company	1,60,000		R Company	1,30,000	5,05,000
R Company	30,000	1,90,000	Debtors		
Minority shareholders interest		46,250	N Company	1,90,000	
			R Company	1,20,000	3,10,000
Creditors			Cash		
N Company	1,00,000		N Company	25,000	
R Company	80,000	1,80,000	R Company	15,000	40,000
		8,66,250			8,66,250

Working Notes :

1. N company acquired shares in R Company on 1-1-2010. The General reserve, capital reserve and profit and loss account balance before the date of acquisition is to be treated as capital profit. Hence, in calculating the goodwill adjustment is to be made in N company's share.

2. Calculation of Goodwill :

	Rs.	Rs.
Cost of acquisition of shares in R Company		1,20,000
Less : paid up value of 3,000 shares	75,000	
¾ Share of capital reserves	22,500	
¾ share in capital profits	11,250	1,08,750
Goodwill		11,250

1. Minority shareholders interest :

	Rs.
1,000 paid up value of shares @ Rs.25 each	25,000
1/4th Share in capital reserve	7,500
1/4th share in capital profits	3,750
1/4th Share in revenue profits	10,000
	46,250

2. The profit earned by R Company after on 1-1-2010 will be taken as revenue profit. The share of N company in revenue profits is to be added to N Company's profit in the consolidated balance sheet liabilities side.

Illu.6: The balance sheets of H Ltd. and S Ltd. as on 31st December, 2009 were as under:-

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share capital:			**Land & Buildings**	**60,000**	**--**
Shares of Rs.10			**Plant & Machinery**	**2,00,000**	**--**
each, fully paid	**2,00,000**	**50,000**			
General Reserve	**30,000**	**10,000**	**3,000 Shares in S Ltd., at cost**	**65,000**	**--**
Profit & Loss Account:			**Stock**	**40,000**	**85,000**
Balance as on 1st January, 2009	**40,000**	**20,000**	**Sundry Debtors**	**10,000**	**30,000**
Profit for 2009	**50,000**	**25,000**	**Bank Balances**	**10,000**	**10,000**
Bills payable	**15,000**	**--**	**Bills Receivable**	**--**	**10,000**
Creditors	**50,000**	**30,000**			
	3,85,000	**1,35,000**		**3,85,000**	**1,35,000**

Shares were acquired by H Ltd., on 1st July, 2009. Bills receivable held by S Ltd., are all accepted by H Ltd. Included in the Sundry Debtors of S Ltd. is a sum of Rs.6,000 owing by H Ltd., in respect of goods supplied. Prepare the consolidated balance sheet.

Solution:

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st December, 2009

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital:			Goodwill		9,500
Shares of Rs.10			Land & Buildings		60,000
each, fully paid		2,00,000			
General Reserve		30,000	Plant & Machinery		2,00,000
P & L Accounts:			Stock:		
H Ltd.	90,000		H Ltd.	40,000	
S Ltd.	7,500	97,500	S Ltd.	85,000	1,25,000
Minority Interest		42,000	Debtors:		
Creditors:			H Ltd.	10,000	
H Ltd.	50,000		S Ltd.	30,000	
S Ltd.	30,000			40,000	

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
	80,000		Less: Mutual owing	6,000	34,000
Less: Mutual owing	6,000	74,000	Bills Receivable	10,000	
Bills payable:	15,000		Less: H Ltd.	10,000	Nil
Less: S Ltd.	10,000	5,000	Bank:		
			H Ltd.	10,000	
			S Ltd.	10,000	20,000
		4,48,500			4,48,500

Working Notes:

1. H Ltd., acquired shares in S Ltd., on 1-7-2009. On the date of acquisition the amount of S Ltd., pertaining to general reserve, is to be treated as capital reserve, and the profit in profit and loss account as capital profits. In the calculation of goodwill the share of H Ltd., is to be adjusted accordingly. In the same way, the profits secured prior to July 1st, 2009 are to be treated as capital profits and the profit earned after the date is to be treated as revenue profit. In the preparation of the consolidated balance sheet the share of H Ltd., in the revenue profit is to be added to its profit.

2. Goodwill:

	Rs.	Rs.
S Ltd. shares amount paid		65,000
Less: Paid up value of 300 shares @ Rs.100	30,000	
H share of Capital Reserve 10,000 $\times \frac{3}{5}$	6,000	
H share of capital profits 20,000 $\times \frac{3}{5}$	12,000	
1-1-2009 stock		
2009 shares profit 25,000 $\times \frac{6}{12} \times \frac{3}{5}$	7,500	55,500
Goodwill		9,500

3. Minority Interest:

	Rs.
Paid up value of 200 shares @ Rs.100	20,000
Share of Capital Reserve 10,000 $\times \frac{2}{5}$	4,000
1-1-2009 profit shares 20,000 $\times \frac{2}{5}$	8,000
2009 profit shares 25,000 $\times \frac{2}{5}$	10,000
	42,000

4. Shareholders share of H Ltd. = 25,000 $\times \frac{6}{12} \times \frac{3}{5}$ = Rs.7,500

Illu.7: Prepare consolidated balance sheet from the balance sheet of the following two companies as on 31st December, 2009.

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share capital:			**Leasehold property**	**9,50,000**	**--**
Shares @ Rs.100 each	**10,00,000**	**1,00,000**	**Machinery**	**1,40,000**	**--**
General reserve	**5,00,000**	**-**	**Stock**	**3,00,000**	**50,000**
Profit and loss a/c	**1,00,000**	**1,50,000**	**Debtors**	**2,00,000**	**70,000**
Creditors	**3,00,000**	**20,000**	**Investments**	**-**	**20,000**
			9,000 shares in S Ltd.	**1,80,000**	**-**
			Bank balance	**1,30,000**	**1,30,000**
	19,00,000	**2,70,000**		**19,00,000**	**2,70,000**

(a) An amount of Rs.1,000 due from S Ltd., was included in the debtors of H Ltd.

(b) Stock of H Ltd., includes goods purchased from S Ltd., for Rs.6,000 which were invoiced by H Ltd., at a profit of 20% on cost.

(c) The shares of S Ltd. were purchased by H Ltd. on 1-1-2009.

Solution :

Consolidated Balance Sheet of H Ltd. and S Ltd.
as on 31-12-2009

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital:			Goodwill		90,000
Shares @ Rs.100 each		10,00,000	Leasehold property		9,50,000
General reserve		5,00,000	Machinery		1,40,000
Profit and Loss a/c			Stock		
H ltd.	1,00,000		H Ltd	3,00,000	
S Ltd.	1,35,000		S Ltd.	50,000	
	2,35,000			3,50,000	
Less : Unrealised profit	900	2,34,100	Less : Unrealised profit	900	3,49,100

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Minority interest		25,000	Debtors		
Creditors			H Ltd.	2,00,000	
H ltd.	3,00,000		S Ltd.	70,000	
S Ltd.	20,000			2,70,000	
	3,20,000		Less : Inter company owings	1,000	2,69,000
Less : Inter Company owings	1,000	3,19,000	Investment		20,000
			Bank balance		
			H Ltd.	1,30,000	
			S Ltd.	1,30,000	2,60,000
		20,78,100			20,78,100

Working Notes :

1. It is assumed that S Ltd., earned all the profit after 1-1-2009.

2. Calculation of Goodwill :

	Rs.
Cost of acquisition of shares in S Ltd.,	1,80,000
Less : 9,000 shares paid up value of each share Rs.10	90,000
Goodwill	90,000

3. Minority Interest :

	Rs.
1,000 paid up value shares @ Rs.10	10,000
$1/10^{th}$ Share in the profit of S Ltd., Rs.1,50,00x 1/10	15,000
	25,000

4. Unrealised profit :
The cost price of goods purchased from S Ltd., = Rs.6,000
Profit earned by S Ltd., on cost of goods sold = Rs.6,000 x 20/120 = Rs.1,000
H Ltd., share in the profit earned by S Ltd., = Rs.1,000 x 9/10 = Rs.900.

Illu.8 : The following are the Balance Sheets of H Ltd. and S Ltd. as on 31-3-2010:

Liabilities	**H Ltd. Rs.**	**S Ltd. Rs.**	**Assets**	**H Ltd. Rs.**	**S Ltd. Rs.**
Share capital:			**Buildings**	**1,45,000**	**50,000**
Shares of Rs.100 each	**2,00,000**	**60,000**	**Plant**	**60,000**	**25,000**
Reserve fund	**50,000**	**15,000**	**Stock**	**40,000**	**10,000**
P & L Account	**25,000**	**21,000**	**Debtors**	**35,000**	**15,000**
6% Debentures	**70,000**	**-**	**Bills receivable**	**15,000**	**10,000**
Creditors	**15,000**	**10,000**	**Bank**	**10,000**	**5,000**
Bills payable	**5,000**	**9,000**	**Investments 400 shares in S Ltd.**	**60,00**	**-**
	3,65,000	**1,15,000**		**3,65,000**	**1,15,000**

On the date of acquisition of shares by H Co. in S co. the later had undistributed profits of Rs.9,000 and Reserve of Rs.6,000. The value of Buildings and Plant of S Co. were considered at Rs.65,000 and Rs.16,000 respectively. Debtors of H Co. include Rs.5,000 due from S co. and Bills payable of H Co. includes a bill of Rs.3,000 accepted in favour of S Co.

Solution :

1. Holding ratio :

No. of shares = 400 : 200 =

Holding ratio = (2 : 1) = (2/3 : 1/3)

	Rs.	**Rs.**
Minority shareholders share capital		
200 shares of Rs.100 each		20,000
General Reserve (15,000 x 1/3)		5,000
Profit and loss a/c (21,000 x 1/3)		7,000
Share of Revaluation profit (15,000 x 1/3)		5,000
Revaluation of buildings	65,000	
Less: Cost of Buildings	50,000	
	15,000	37,000
Less: Share Revaluation loss (9,000 x 1/3)		3,000
Revalue of Machinery	16,000	
Less: Cost of Plant Machinery	25,000	
Loss	**9,000**	
		34,000

2. Goodwill :

	Rs.	Rs.
Cost of 400 shares acquired in S Ltd.		60,000
Less: Face value of 400 shares @ Rs.100 each	40,000	
Pre-acquisition general reserve 6,000		
2/3rd share (6,000 x 2/3)	4,000	
Pre-acquisition profit 2/3 rd share (9,000 x 2/3)	6,000	
Revaluation profit (Buildings) (15,000 x 2/3)	10,000	
	60,000	
Less: Revaluation loss (Plant and Machinery) (9,000 x 2/3)	6,000	54,000
Goodwill		**6,000**

Post acquisition profits :

Post –acquisition General Reserve (15,000 – 6,000) = (9,000 x 2/3)	6,000
Profit and loss account (21,000 – 9,000) = (12,000 x 2/3)	8,000

	14,000

Balance Sheet of S Co. Ltd., as on 31st March, 2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital			Goodwill		6,000
2,000 shares of			Buildings		
Rs.100 each		2,00,000			
Fund Reserve		50,000	H Co.	1,45,000	
Profit and loss a/c			S Co.	65,000	2,10,000
H Co.	25,000		Plant		
S Co.	14,000	39,000	H Co.	60,000	
Interest of Minority			S Co.	16,000	76,000
shareholders		34,000			
6% Debentures		70,000	Stock		
Creditors			H Co.	40,000	
H Co.	15,000		S Co.	10,000	50,000
S Co.	10,000		Debtors		
	25,000		H Co.	35,000	
Less : Inter co. owings	5,000	20,000	S Co.	15,000	
Bills payable				50,000	
H Co.	5,000		Less : Inter co. owings	5,000	45,000
S Co.	9,000		Bills receivable		

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
	14,000		H Co.	15,000	
Less: Inter Co.			S Co.	10,000	
transaction	3,000	11,000			
				25,000	
			Less : Inter Co.	3,000	22,000
			owings		
			Bank		
			H Co.	10,000	
			S Co.	5,000	15,000
		4,24,000			4,24,000

Illu.9: The Balance Sheets of A & B Company as on 31-12-2009 given below.

Liabilities	**A Rs.**	**B Rs.**	**Assets**	**A Rs.**	**B Rs.**
Share capital:			**Buildings**	**1,50,000**	**1,00,000**
At Rs.10 each	**3,00,000**	**2,00,000**	**Machinery**	**95,000**	**47,000**
General Reserve	**65,000**	**--**	**Shares in B Company**	**1,50,000**	**--**
P & L A/c	**90,000**	**--**	**Stock**	**85,000**	**50,000**
Debentures	**1,00,000**	**1,30,000**	**Debtors**	**60,000**	**72,000**
Creditors	**10,000**	**35,000**	**Bills receivable**	**10,000**	**4,000**
Bills payable	**--**	**15,000**	**Cash**	**15,000**	**7,000**
			P & L A/c	**--**	**1,00,000**
	5,65,000	**3,80,000**		**5,65,000**	**3,80,000**

Prepare the consolidated balance sheet from the following.

1. **A company acquired 12,000 shares in B company on 1-7-2009**

2. **The Profit & Loss account of B Company showed a debit balance of Rs.1,50,000 on 1-1-2009**

3. **The Creditors of B company include Rs.10,000 for the stock supplied by A company. On which A company earned Rs.2,000 profit. Half of the goods is still in company stock**

4. **All the bills payable of B company were drawn by A company.**

Solution:

Consolidated Balance Sheet of A Co. and B Co., as on 31-12-2009

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital:			Goodwill		1,05,000
(Rs.10 shares)		3,00,000	Buildings:		
General Reserve		65,000	A Co.	1,50,000	
P & L A/c:			B Co.	1,00,000	2,50,000
A Co.	90,000				
B Co.	15,000		Machinery:		
	1,05,000		A Co.	95,000	
Less: Unrealised profit	600	1,04,400	B Co.	47,000	1,42,000
Debentures:				1,35,000	
A Co.	1,00,000		Less: Unrealised profit	600	1,34,400
B Co.	1,30,000	2,30,000	Debtors:		
	45,000		A Co.	60,000	
Less: Inter Company owings	10,000	35,000	B Co.	72,000	
Bills payable	15,000			1,32,000	
Less: Inter company acceptances.	10,000	5,000	Less: Iner Company owings	10,000	1,22,000
Minority Interest		40,000	Bills receivable:		
			A Co.	10,000	
			B Co.	4,000	
				14,000	
			Less: Inter Co. acceptances.	10,000	4,000
			Cash:		
			A Co.	15,000	
			B Co.	7,000	22,000
		7,79,400			7,79,400

Working Notes:

1. Shares acquired by A Company in B Company on 1-7.2009. Debit balance of profit and loss account of B Company on 1-1-2009 Rs.1,50,000. Hence, it is a capital loss. The debit balance of profit and loss account of B Ltd., in 2009 was reduced to Rs.50,000 . It means the company earned profit during 2009. From this profit, the profit earned upto 1-7-2009 Rs.25,000 was to be taken as capital profit and the amount earned after that date will be taken as revenue profit. In the calculation of goodwill the share of A Company is to be adjusted with the capital profit.

2. Calculation of Goodwill:

	Rs.	Rs.
Cost of acquisition of shares in B Co.		1,50,000
Add: 3/4th share in capital loss Rs.1,50,000 x 3/4		90,000
		2,40,000
Less: paid up of value of shares (Rs.12,000 x 10)	1,20,000	
Less: share in capital profits.	15,000	1,35,000
Goodwill		1,05,000

3. Minority Interest:

	Rs.
Cost of Paid up value of 8,000 shares	80,000
Add: 2/5th share in total profit for 2009	20,000
	1,00,000
Less: 2/5th share in the debit balance of profit and loss a/c on 1-1-2009.	60,000
	40,000

4. Unrealised Profit:

Amount earned by A Company on cost of goods sold Rs.2,000
Profit on unrealized stock at B Company rs.2,000 x ½ = Rs.1,000
Share of A company in the unrealised profit Rs.1,000 x 3/5 = Rs.600

Illu.10: From the following Balance Sheet and information given below prepare consolidated Balance Sheet.

Balance Sheet as on 31st December, 2009

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd Rs.	S Ltd. Rs.
Share capital:			**Assets**	**8,00,000**	**1,20,000**
(Rs.10 shares)	**10,00,000**	**2,00,000**	**Stock**	**6,10,000**	**2,40,000**
Profit & Loss a/c	**4,00,000**	**1,20,000**	**Debtors**	**1,30,000**	**1,70,000**
Reserve	**1,00,000**	**60,000**	**Bills Receivable**	**10,000**	**--**
Bills payable	**--**	**30,000**	**Share in 'S' 15,000 (at cost)**	**1,50,000**	**--**
Creditors	**2,00,000**	**1,20,000**			
	17,00,000	**5,30,000**		**17,00,000**	**5,30,000**

(i) **All the profits of 'S' has been earned since the shares were acquired by H but there was already the Reserve of Rs.60,000 at that date.**

(ii) **The Bills accepted by S Rs.10,000 are favour of H.**

(iii) **Sundry Assets of S are under-valued by Rs.20,000.**

(iv) **The stock of H Includes Rs.50,000 bought from 'S' at a profit to the latter of 25% on cost.**

Solution:

Consolidated Balance Sheet of H. Ltd. and its Subsidiary S. Ltd.
as on 31st December, 2009

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital:			Assets:		
(Rs.10 shares)		10,00,000	H Ltd.	8,00,000	
Profit & Loss A/c:			S Ltd.	1,40,000	9,40,000
H Ltd.	4,00,000		Stock:		
S Ltd.	90,000		H Ltd.	6,10,000	
	4,90,000		S Ltd.	2,40,000	
Less: Unrealised profit	7,500	4,82,500		8,50,000	
Reserve		1,00,000	Less: Unrealised profit	7,500	8,42,500
Capital Reserve		60,000	Debtors:		
Bills Payable	30,000		H Ltd.	1,30,000	
Less: Mutual owing	10,000	20,000	S Ltd.	1,70,000	3,00,000
Creditors:			Bills Receivable	1,00,000	
H Ltd.	2,00,000		Less: Mutual owing	1,00,000	Nil
S Ltd.	1,20,000	3,20,000			
Minority Interest		1,00,000			
		20,82,500			20,82,500

Working Notes:

(a) Analysis of profit	**Capital Rs.**	**Revenue Rs.**
Reserve on 1-1-2009	60,000	-
Profits in 2009	-	1,20,000
Sundry Assets - Undervaluation	20,000	
	80,000	1,20,000

(b) Calculation of Capital Reserve :	**Rs.**	**Rs.**
Cost of acquisition of shares in S Ltd.		1,50,000
Less : Paid up value of 15,000 shares	1,50,000	
¾ th Share in capital profits (Rs.80,000 x ¾)	60,000	2,10,000
		60,000

(c) Minority shareholders Interest :	**Rs.**
Paid up value of 5,000 shares	50,000
Add : ¼th share in capital profits	20,000
1/4th share in Revenue profits	30,000
	1,00,000

(d) Profit and Loss a/c :

¾th share of H Ltd., in S Ltd. = Rs.1,20,000 x ¾ = Rs.90,000

(e) Unrealised profits :

Stock with H Ltd., purchased from S Ltd., = Rs.50,000
Unrealised profit = Rs.50,000 x 25/125 = Rs.10,000
3/4th share of H Ltd., in unrealized profit = Rs.10,000 x ¾ = Rs.7,500

Illu.11: The Balance Sheet of Mota Ltd., Chota Ltd., at 31st December, 2010 and information given below Consolidated Balance Sheet.

Balance Sheet as on 31st December, 2010

Liabilities	**Mota Ltd. Rs.**	**Chota Ltd. Rs.**	**Assets**	**Mota Ltd. Rs.**	**Chota Ltd. Rs.**
Share capital:			**Goodwill**	**40,000**	**30,000**
(Shares of Rs.100 each)	**5,00,000**	**2,00,000**	**Fixed Assets**	**3,60,000**	**2,20,000**
General Reserve (1-1-10)	**1,00,000**	**60,000**	**Stock-in-trade**	**1,00,000**	**90,000**
P & L A/c	**1,40,000**	**90,000**	**Debtors**	**20,000**	**75,000**
Creditors	**80,000**	**50,000**	**1,500 shares in Chota Ltd. at cost**	**2,40,000**	**---**
Bills payable	**---**	**40,000**	**Cash at bank**	**60,000**	**25,000**
	8,20,000	**4,40,000**		**8,20,000**	**4,40,000**

The profit and loss account of Chota Ltd., showed balance of Rs.50,000 on 1-1-2010. A dividend of 15% was paid in October 2010 for the year 2009. This dividend was credited by Mota Ltd., to it's profit and loss a/c. Mota ltd. acquired the shares on 1-7-2010. The bills payable of Chota Ltd., were all issued in favour of Mota Ltd, which company got the bills discounted. Sundry creditors of Chota Ltd. include Rs.20,000 for goods supplied by Mota Ltd. Stock of Chota Ltd. included goods to the value of Rs.8,000 which were supplied by Mota Ltd. at a profit of 33 1/3% on cost.

Solution:

Consolidated Balance Sheet of Mota Ltd. & Its Subsidiary Chota Ltd..
as on 31-12-2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital:			Goodwill		51,250
Rs.100 shares		5,00,000	Fixed Assets:		
General Reserve		1,00,000	Mota	3,60,000	
Profit & Loss A/c:			Chota	2,20,000	5,80,000
Mota	1,40,000		Stock value:		
Chota	26,250		Mota	1,00,000	
	1,66,250		Chota	90,000	
Less: 15% discount	22,500			1,90,000	
Less: Unrealised profit	1,500	1,42,250	Less: Unrealised profit	1,500	1,88,500
Creditors:			Debtors:		
Mota	80,000		Mota	20,000	
Chota	50,000		Chota	75,000	
	1,30,000			95,000	
Less: Mutual owing	20,000	1,10,000	Less: Mutual owing	20,000	75,000
Bills payable		40,000	Cash at Bank		
Minority Interest		87,500	Mota	60,000	
			Chota	25,000	85,000
		9,79,750			9,79,750

Working Notes: (a) Profit & Loss Account

	Rs.	Rs.
General Reserve	60,000	--
Profit & Loss Account (1-1-2010)	50,000	--
Profit for 2010 (90,000-50,000+30,000)	35,000	35,000
	1,45,000	35,000
Less: 15% Discount	30,000	--
	1,15,000	35,000

(b) Goodwill:

	Rs.	Rs.
Cost of acquisition of 1,500 shares		2,40,000
Less: 1,500 paid up value of shares	1,50,000	
Share in capital profits	86,250	
Dividend from capital profits	22,500	2,58,750
Capital Reserve		18,750
Goodwill appeared in balance sheet:		
Mota	40,000	
Chota	30,000	70,000
Goodwill		51,250

(c) Minority Interest:

	Rs.
500 paid up value of shares	50,000
Add: Share in capital profits	28,750
Share in revenue profits	8,750
	87,500

(d) Unrealised Profit :

Unsold stock in Chota Ltd., = Rs.8,000
Unrealised profit = Rs.8,000 x 33 1/3/133 1/3 = Rs.2,000
Share of Chota Ltd., in Unrealised profit = Rs.2,000 x ¾ = Rs.1,500

Illu.12: Hameed Ltd. acquired 3,200 equity shares of Sultan of Rs.100 each on 31st March, 2010. The balance sheets of the two companies as on that date were as under:

Balance Sheet

Liabilities	Hameed Ltd. Rs.	Sultan Ltd. Rs.	Assets	Hameed Ltd. Rs.	Sultan Ltd. Rs.
Equity shares of Rs.100 each fully paid	**10,00,000**	**4,00,000**	**Land & Buildings**	**3,00,000**	**3,60,000**
Captial Reserve	**--**	**2,40,000**	**Plant & Machinery**	**4,80,000**	**2,18,800**
General Reserve	**4,80,000**	**--**	**Investment in Sultan Ltd. (at cost)**	**6,80,000**	**--**
Profit & Loss a/c	**1,14,400**	**72,000**	**Stock**	**2,40,000**	**72,000**

Liabilities	**Hameed Ltd. Rs.**	**Sultan Ltd. Rs.**	**Assets**	**Hameed Ltd. Rs.**	**Sultan Ltd. Rs.**
Bank Overdraft	**1,60,000**	**--**	**Sundry Debtors**	**88,000**	**80,000**
Bills payable (including Rs.8,000 to Hameed Ltd.)	**--**	**16,800**	**Bills Receivable (including Rs.6,000 from Sultan Ltd.)**	**31,600**	
Sundry Creditors	**94,200**	**18,000**	**Cash & Bank**	**29,000**	**16,000**
	18,48,600	**7,46,800**		**18,48,600**	**7,46,800**

The following additional information is available:

1. **Sultan Ltd. has made a bonus issue on 31st March, 2010 of one equity share for every two shares held by its shareholders. This issue has not yet been taken into account.**
2. **Land and Buildings of Sultan Ltd. are undervalued by Rs.40,000 and plant and machinery of Sultan Ltd. overvalued by Rs.20,000. Value of these assets have to be adjusted accordingly.**
3. **Sundry creditors of Hameed Ltd. include Rs.24,000 due to B Ltd.**

Prepare the consolidated balance sheet as at 31st March, 2010.

Solution:

Consolidated Balance Sheet of Hameed Ltd. And its Subsidiary Sultan Ltd. as on 31-3-2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital:			Fixed Assets:		
Rs.100 equity shares		10,00,000	Goodwill		94,400
General Reserve		4,80,000	Land & Buildings:		
Profit & Loss A/c		1,14,400	Hameed Ltd.	3,00,000	
Bank Overdraft		1,60,000	Sultan Ltd.	4,00,000	7,00,000
Bills payable	16,800		Machinery		
Less:	6,000	10,800	Hameed Ltd.	4,80,000	
Creditors:			Sultan Ltd.	1,98,800	6,78,800
Hameed Ltd.	94,200		Stock:		
Sultant Ltd.	18,000		Hameed Ltd.	2,40,000	
	1,12,200		Sultan Ltd.	72,000	3,12,000
Less: Intercompany Creditors	24,000	88,200	Debtors		
Minority Interest		1,46,400	Hameed Ltd.	88,000	
			Sultan Ltd.	80,000	

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
				1,68,000	
			Less: Inter company Debtors	24,000	1,44,000
			Cash, Bank		
			Hameed Ltd.	29,000	
			Sultan Ltd.	16,000	45,000
			Bills Receivable	31,600	
			Less: Inter company bills	6,000	25,600
		19,99,800			19,99,800

Working Notes:

1. Analysis of Capital Profit :	Rs.
Balance of Capital Reserve	2,40,000
Less: amount used for issue of bonus shares	2,00,000
	40,000
Add: Profit upto 31st March, 2010	72,000
Add: Profit on Revaluation of Land and Buildings	40,000
	1,52,000
Less: Loss on Revaluation of Machinery	20,000
	1,32,000
Hameed Ltd. Share = Rs.1,32,000 $\times \frac{80}{100}$	1,05,600
Minority Interest = Rs.1,32,000 $\times \frac{20}{100}$	26,400

2. Calculation of Goodwill	Rs.	Rs.
Cost of investments in Sultan Ltd.		6,80,000
Less: Face value of 3,200 shares	3,20,000	
Capital profit	1,05,600	
Bonus Shares	1,60,000	5,85,600
Goodwill		94,400

3. Calculation of Minority Interest :	Rs.
Face Value of 800 shares	80,000
Add: Capital Profit	26,400
Bonus Shares	40,000
	1,46,400

Illu.13: On 31st March, 2010 Hindustan Ltd. acquired 70,000 equity shares of Andhra Ltd. for Rs.8,00,000 when Andhra Ltd.'s summarised balance sheet stood as follows:-

Liabilities	Rs.	Assets	Rs.
Subscribed Share Capital:		Fixed Assets	7,00,000
Fully paid equity shares of		Current Assets	4,30,000
Rs.10 each	10,00,000		
Profit Prior to Incorporation	20,000		
Profit & Loss Account	40,000		
Creditors	70,000		
	11,30,000		11,30,000

On 31st March, 2010 the balance sheets of the two companies were as follows:-

Liabilities	Hindustan Ltd. Rs.	Andhra Ltd. Rs.	Assets	Hindustan Rs.	Andhra Ltd.
Share capital: Equity Shares of Rs.10 each, fully paid	30,00,000	10,00,000	Fixed Assets	52,80,000	15,40,000
			70,000 shares in Andhra Ltd. (at cost)	8,00,000	--
Securities Premium	6,00,000	--	Current Assets	29,40,000	11,70,000
Profit Prior to Incorporation	--	20,000			
General Reserve	40,00,000	12,70,000			
Profit & Loss A/c	10,50,000	2,80,000			
Creditors	3,70,000	1,40,000			
	90,20,000	27,10,000		90,20,000	27,10,000

The Board of Directors of Andhra Ltd. made a bonus issue in the ratio of one fully paid equity share of Rs.10 for every two shares held.

You are required to calculate as on 31st March, 2010 (i) Cost of Control/Capital Reserve and (ii) Minority Interest and (iii) Consolidated Profit & Loss Account in each of the following situations:-

(a) Just before issue of bonus shares.

(b) Immediately after issue of bonus shares assuming that bonus shares were issued wholly out of post acquisition profits by using General Reserve.

Also prepare a consolidated balance sheet as at 31st March, 2010 after the bonus issue.

Solution:

Consolidated Balance Sheet of Hindustan Ltd. and its subsidiary Andhra Ltd. as at 31st March, 2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital:			Fixed Assets:		
Equity shares of			Hinustan Ltd.	52,80,000	
Rs.10 each fully paid		30,00,000			
Minority Interest		7,71,000	Andhra Ltd.	15,40,000	68,20,000
Capital Reserve		2,92,000	Current Assets:		
Securities Premium		6,00,000	Hindustan Ltd.	29,40,000	
General Reserve		40,00,000	Andhra Ltd.	11,70,000	41,10,000
Profit & Loss Account:					
Hindustan Ltd.	10,50,000				
Add: Share in Andhra Ltd.	7,07,000	17,57,000			
Creditors:					
Hindustan Ltd.	3,70,000				
Andhra Ltd.	1,40,000	5,10,000			
		1,09,30,000			1,09,30,000

(a) Before Issue of Bonus Shares:

(i) Capital Profits	Rs.
Profit Prior to Incorporation	20,000
Profit and Loss Account	40,000
	60,000

Hindustan Ltd.'s share of capital Profits = Rs.60,000 × 70/100 = Rs.42,000

Minority shareholders' share = Rs.60,000 × 30/100 = Rs.18,000

(ii) Revenue Profits	Rs.
General Reserve	12,70,000
Profit & Loss Account (Rs.2,80,000 – Rs.40,000)	2,40,000
	15,10,000
Hindustan Ltd..'s share = Rs.15,10,000 × 70/100 = Rs.10,57,000	
Minority shareholder's share = Rs.15,10,000 × 30/100 = Rs.4,53,000	

(iii) Cost of Control	Rs.	Rs.
Amount paid for 70% shares		8,00,000
Less: Paid up value of 70,000 shares	7,00,000	
H Ltd.'s share of capital profits	42,000	7,42,000
		58,000

(iv) Minority Interest	Rs.
Paid up value of 30,000 shares	3,00,000
Share in Capital Profits	18,000
Share in Revenue Profits	4,53,000
	7,71,000

(v) Consolidated Profit and Loss Account	Rs.
Hindustan Ltd.	10,50,000
Add: Hindustan Ltd.'s share in revenue profits of Andhra Ltd.	10,57,000
	21,07,000

(b) After issue of Bonus Shares:

(i) Capital Profits	Rs.
Profit Prior to Incorporation	20,000
Profit and Loss Account	40,000
	60,000
Hindustan Ltd.'s share = Rs.60,000 × 70/100 = Rs.42,000	
Minority shareholder's share = Rs.60,000 x 30/100 = Rs.18,000	
(ii) Revenue Profits:	
General Reserve	
Less: Amount used for issue of bonus shares	
= Rs.10,00,000 × ½	7,70,000
Profit & Loss Account (Rs.2,80,000 – Rs.40,000)	2,40,000
	10,10,000
Hindustan Ltd.'s share = Rs.10,10,000 × 70/100 = Rs.7,07,000	
(iii) Capital Reserve on acquisition of shares:	Rs.
Paid up value of 70,000 + 35,000 = 1,05,000 shares	10,50,000
Add: Hindustan Ltd.'s share of Capital Profits	42,000
	10,92,000
Less: Amount paid for shares of S Ltd.	8,00,000
Capital Reserve	2,92,000
(iv) Minority Interest:	
Paid up value of 30,000 + 15,000 = 45,000 shares	4,50,000
Share in Capital Profits	18,000
Share in Reserve Profits	3,03,000
	7,71,000

(v) Consolidated Profit & Loss Account:	Rs.
Hindustan Ltd.	10,50,000
Add: Hindustan Ltd.'s share in Revenue Profits	7,07,000
	17,57,000

Illu.14 : H Ltd., acquired 20,000 (i.e., 4/5) equity shares of S Ltd., Rs.100 each on 31st December 2009. The summarized balance sheets of H Ltd., and S Ltd., as at 31st December 2010 were as follow

Liabilities	H Ltd. (Rs.)	S Ltd. (Rs.)	Assets	H Ltd. (Rs.)	S Ltd. (Rs.)
Share capital Shares of Rs.100 each	**80,00,000**	**25,00,000**	**Fixed assets**	**70,00,000**	**25,00,000**
Reserves	**30,00,000**	**5,00,000**	**Current assets**	**40,00,000**	**20,00,000**
			20,000 shares in S Ltd.	**30,00,000**	**-**
Profit & Loss a/c	**10,00,000**	**10,00,000**			
Creditors	**20,00,000**	**5,00,000**			
	1,40,00,000	**45,00,000**		**1,40,00,000**	**45,00,000**

S Ltd., had the credit balance of Rs.5,00,000 in the reserves and Rs.2,00,000 in the Profit and Loss account when H Ltd., acquired the shares in S Ltd., S Ltd., issued shares at one for every 5 shares held out of post-acquisition profits. Calculate cost of control before and after issue of bonus shares and also prepare Consolidated Balance sheet.

Solution :

Consolidated Balance Sheet of H Ltd. and its subsidiary S ltd., as on 31-12-2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital (Shares of Rs.100 each)		80,00,000	Goodwill (cost of control)		40,000
Reserves		30,00,000	Fixed Assets :		
Profit & Loss a/c	10,00,000		H ltd.	70,00,000	
Add: share in S Ltd.	2,40,000	12,40,000	S ltd.	25,00,000	95,00,000
Minority interest		8,00,000	Current Assets		
Creditors :			H ltd.	40,00,000	
H Ltd.	20,00,000		S Ltd.	20,00,000	60,00,000
S ltd.	5,00,000	25,00,000			
		1,55,40,000			**1,55,40,000**

1. **Holding ratio :**

   20,000 shares : 5,000 = 4:1

2. **Pre-acquisition profit :**

	Rs.
Reserves	5,00,000
Profit and loss balance	2,00,000
	7,00,000
Share of minority (7,00,000 x 1/5)	**1,40,000**
Share of H Ltd.	**5,60,000**

3. **Post-acquisition profit :**

	Rs.
Profit earned after purchase of shares by H ltd. (Rs.10,00,000 – 2,00,000)	8,00,000
Less: profit utilised for issue of bonus shares (25,00,000 x 1/5) (i.e.,) 1 share for every 5 shares held	5,00,000
Revenue profits after issue of bonus shares	**3,00,000**
Share of minority (Rs.3,00,000 x 1/5)	**60,000**
Share of H Ltd.	**2,40,000**

4. **Goodwill / Capital Reserve :**

	Rs.	**Rs.**
Cost of investments purchased		30,00,000
Less: Paid-up value of shares purchased (20,000 x 100)	20,00,000	
Paid-up value of bonus shares (5,00,000 x 4/5)	4,00,000	
Share of capital profit	5,60,000	29,60,000
Goodwill		**40,000**

5. **Minority interest :**

		Rs.
Share capital		5,00,000
Paid-up value of bonus shares (5,00,000 x 1/5)		1,00,000
Share in pre-acquisition profit		1,40,000
Share in post-acquisition profit		60,000
Total		**8,00,000**

Illu.15 : M Ltd., acquired all the shares in N Ltd., as on 1st January 2010 at total cost of Rs.5,60,000. The Balance Sheets of two companies as on 31st December 2010 were as follows :

Liabilities	Rs.	Assets	Rs.
Share capital :		Fixed assets	6,65,000
Authorized and Issued :		Investments (Shares in subsidiary Ltd., at cost)	5,60,000
15,000 equity shares of		Stock	1,70,000
Rs.50 each	7,50,000		
General reserve	4,75,000	Debtors	1,40,000
Profit & Loss a/c	4,00,000	Cash at Bank	1,65,000
Creditors	75,000		
	17,00,000		17,00,000

(a) This includes interim dividend at the rate of 16% per annum received from N Ltd.
(b) This includes Rs.30,000 for purchases from N Ltd., on which N Ltd., made a profit of Rs.7,500.
(c) This includes Rs.15,000 stock at cost purchased from N ltd.

Liabilities	Rs.	Assets	Rs.
Share capital :		Fixed assets	2,85,000
Authorized and issued :		Stock	1,01,000
50,000 Equity shares of Rs.5		Debtors	79,000
each	2,50,000		
General reserve (1.01.2010)	10,000	Cash at Bank	55,000
Profit and loss a/c	1,80,000		
Creditors	80,000		
	5,20,000		5,20,000

The profit and loss account had a credit balance of Rs.1,40,000 on 1st January 2010 and an interim dividend of 16% per annum was paid during the year ended 31st December 2010.

Make necessary adjustments and prepare the Consolidated Balance Sheet as on 31st December 2010.

Solution :

Consolidated Balance Sheet of M Ltd., and its subsidiary N Ltd., as on 31-12-2010

Liabilities		Rs.	Assets		Rs.
Share capital			Goodwill		1,60,000
15,000 Equity shares of Rs.50 each		7,50,000	Fixed assets :		
General reserve		4,75,000	M Ltd.	6,65,000	
Profit & Loss a/c	3,60,000		N Ltd.	2,85,500	9,50,500
Add: Profit of N ltd.	76,250	4,36,250	Stock :		
Creditors :			M Ltd.	1,70,000	
M Ltd.	75,000		N Ltd.	1,01,000	
N Ltd.	80,500			**2,71,000**	
	1,55,500		**Less:** Stock reserve	3,750	2,67,250
Less : Mutual owing	30,000	1,25,500	Debtors :		
			M Ltd.	1,40,000	
			N Ltd.	79,000	
			Mutual	**2,19,000**	
			Less: Owing	30,000	1,89,000
			Cash at Bank :		
			M ltd.	1,65,000	
			N ltd.	55,000	2,20,000
		17,86,750			**17,86,750**

1. **Holding ratio :** 100% of shares

2. **Goodwill / Capital reserve :**

Particulars	Rs.	Rs.
Amount paid for purchase of shares by M Ltd.		5,60,000
Less : Nominal value of shares purchased	2,50,000	
Pre-acquisition Profits	1,50,000	4,00,000
Goodwill		**1,60,000**

3. Pre-acquisition Profits :

Particulars	Rs.
Balance in General Reserve	10,000
Balance in Profit and Loss a/c	1,40,000
	1,50,000

4. Profit & Loss of N Ltd. :

Particulars	Rs.
Profit for 2010 after paying interim dividend (Rs.1,80,000 – 1,40,000)	40,000
Add : Interim dividend paid (2,50,000 x 16%)	40,000
	80,000
Less : Stock reserve (7,500 x ½)	3,750
	76,250

Note : Of the goods purchased Rs.30,000 there is a stock of Rs.15,000 still unsold and hence stock reserve is made for ½ of the goods only.

5. Profit & Loss a/c of M Ltd. :

	Rs.
Profit and loss a/c of M Ltd.	4,00,000
Less: Interim dividend received from N Ltd.	40,000
	3,60,000

Illu.16 : The following are the Balance Sheets of Satya Ltd., and Siva ltd., as on December 31, 2009 :

Balance Sheets

	Satya ltd.	Siva Ltd.
Liabilities :		
Share capital : Shares of Rs.10 each	**2,00,000**	**50,000**
General reserve	**50,000**	**20,000**
Profit and loss a/c balance (1-1-09)	**30,000**	**7,500**
Profit for the year 2009	**50,000**	**20,000**
Creditors	**20,000**	**10,000**
	3,50,000	**1,07,500**
Assets :		
Fixed assets	**1,95,000**	**70,000**
Investments : Shares in Siva Ltd.	**60,000**	**-**
Debtors	**35,000**	**25,000**
Other current assets	**60,000**	**12,500**
	3,50,000	**1,07,500**

Notes :

(a) Satya Ltd., purchased on July 1, 2009, 4,000 shares in Siva Ltd., at Rs.15 each.

(b) Stock in Siva Ltd., includes Rs.7,500 worth of goods purchased from Satya Ltd., which company sells goods at 25% above cost.

(c) Creditors of Siva Ltd., include Rs.5,000 due to Satya ltd.
Prepare a consolidated balance sheet as on December 31, 2009.

Solution :

Consolidated Balance Sheet of Satya ltd. and its subsidiary Siva Ltd.
as on 31-12-2009

Liabilities	Rs.	Rs.	Assets		Rs.
Share capital		2,00,000	Fixed assets :		
General reserve		50,000	Satya Ltd.	1,95,000	
Profit & Loss a/c		86,500	Siva Ltd.	70,000	2,65,000
Capital reserve		10,000	Debtors :		
Creditors :			Satya Ltd.	35,000	
Satya Ltd.	20,000		Siva Ltd.	25,000	
Siva ltd.	10,000			**60,000**	
	30,000		**Less:** Inter co. owings	5,000	55,000
Less: Inter co. owings	5,000	25,000	Other current assets :		
Minority Interest		19,500	Satya Ltd.	60,000	
			Siva Ltd.	12,500	
				72,500	
			Less: Stock reserve	1,500	71,000
		3,91,000			**3,91,000**

1. **Holding Ratio :**
   4,000 shares **:** 1000 shares **= 4:1**

2. **Pre-acquisition profit :**

	Rs.
General reserve	20,000
Profit & Loss a/c on 1.1.2009	7,500
Profit for the period from 1.1.2009 to 1.7.2009 [20,000 x 6/12]	10,000
	37,500
Minority interest share [37,500 x 1/5]	**7,500**
Holding Co. share	**30,000**

3. Post-acquisition profit :

	Rs.
Profit for the period from 1.7.2009 to 31.12.2009 {20,000 x 6/12}	10,000
Minority share [10,000 x 1/5]	**2,000**
Holding company share	**8,000**

4. Goodwill / Capital reserve :

	Rs.	Rs.
Cost of investment purchased (4,000 x 15)		60,000
Less: Paid up value (4,000 x10)	40,000	
Pre-acquisition profit	30,000	70,000
Capital reserve		**10,000**

5. Minority interest :

		Rs.
Paid up value of shares (100 shares x 10)		10,000
Add: share of Pre acquisition profit	7,500	
Share of post acquisition profit	2,000	9,500
		19,500

6. Profit & Loss a/c of Holding Co :

	Rs.
Balance of Profit & Loss a/c (1.1.2009)	30,000
Add: Profit during the year	50,000
Share of Post acquisition profit	8,000
	88,000
Less: Stock reserve (Rs.7,500 x 25/125)	1,500
Balance	**86,500**

Illu.17 : From the following Balance sheets and information given below prepare a consolidated Balance Sheet.

Liabilities	H Ltd.	S Ltd.	Assets	H Ltd.	S Ltd.
Share capital :			**Sundry assets**	**80,000**	**12,000**
Rs.10 fully paid	**1,00,000**	**20,000**	**Stock**	**61,000**	**24,000**
Profit and loss a/c	**40,000**	**12,000**	**Debtors**	**13,000**	**17,000**
Reserve fund	**10,000**	**6,000**	**Bills receivable**	**1,000**	**-**
Bills payable	**-**	**3,000**	**Shares in S Ltd. at cost**	**15,000**	**-**
Creditors	**20,000**	**12,000**			
	1,70,000	**53,000**		**1,70,000**	**53,000**

(a) Al the profits of S Ltd. have been earned since the shares were acquired by H Ltd., but there was already reserve of Rs.6,000 on that date.
(b) The bills accepted by S Ltd., are all in favour of H Ltd., which had discounted Rs.2,000 of them.
(c) Sundry assets of S Ltd., are undervalued by Rs.2,000.
(d) The stock of H Ltd., includes Rs.5,000 bought from S Ltd., at a profit to the latter of 25% on cost.

Solution :

Consolidated Balance Sheet of H Ltd., and its subsidiary S Ltd.

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital			**Sundry Assets**		
Authorized capital			H Ltd.	80,000	
Issued and Subscribed			S Ltd.	12,000	
1,000 shares of Rs.10 each		1,00,000		**92,000**	
Capital Reserve		6,000	**Add:** Appreciation	2,000	94,000
General Reserve		10,000	Stock		
Profit and loss a/c			H Ltd.	61,000	
H Ltd.	40,000		S Ltd.	24,000	
Share of profit in S (12,000 x ¾)	9,000			**85,000**	
	49,000		**Less:** Unrealized profit	750	84,250
Less: Share of Unrealized profit	750	48,250	Debtors		
Interest of Minority shareholders		10,000	H Ltd.	13,000	
Creditors			S Ltd.	17,000	30,000
H Ltd.	20,000		Bills Receivable	1,000	
S Ltd.	12,000	32,000	**Less:** Inter company transaction	1,000	-
Bills payable					
S Ltd.	3,000				
Less: Inter company transaction	1,000	2,000			
		2,08,250			**2,08,250**

1. Holding ratio :

No. of shares1,500 : 500
Holding ratio = (3 : 1) (3/4 : ¼)

2. Goodwill or cost of Control :

	Rs.
Cost of acquiring 1,500 shares @ Rs.10 per share	15,000
Less: Face value of shares (1500 shares @ Rs.10 each)	15,000
	-

3. Capital Reserve :

	Rs.
Pre-acquisition Reserve (6,000 x ¾) 4,500	
Revaluation profit (2,000 x ¾) 1,500	6,000

4. Unrealized Profit :

On Rs.5,000 goods bought from S Ltd., there is a profit of 15% on cost. Accordingly if the sale price is Rs.125.

Profit is Rs.25. if the sale price is 5,000 the profit is?

= 25 / 125 x 5,000 = Rs.1,000.

H Ltd., share in profit = 1,000 x ¾ = Rs.750

S Ltd., share in Profit = 1,000 x ¼ = Rs.250

5. Minority Interest :

	Rs.
Share Capital of outside shareholders	5,000
(500 shares of Rs.10 each)	
Post Acquisition profit (12,000 x ¼)	3,000
Pre Acquisition Reserve (6,000 x ¼)	1,500
	9,500
∴Revaluation profit (2,000 x ¼)	500
	10,000

Illu.18 From the Balance Sheets and information given below, prepare Consolidated Balance Sheet:

Liabilities	H ltd. Rs.	S Ltd. Rs.	Assets	H ltd. Rs.	S Ltd. Rs.
Share capital:			**Fixed assets**	**4,00,000**	**60,000**
Shares of Rs.10 each fully paid	**5,00,000**	**1,00,000**	**Stock**	**3,00,000**	**1,20,000**
P & L a/c	**2,00,000**	**60,000**	**Debtors**	**75,000**	**85,000**
Reserves	**60,000**	**30,000**	**Bills receivable**	**20,000**	**-**
Bills payable	**-**	**15,000**	**Shares in 's' Ltd. (7,500 shares @ Rs.10)**	**75,000**	**-**
Creditors	**1,10,000**	**60,000**			
	8,70,000	**2,65,000**		**8,70,000**	**2,65,000**

Additional information:

(i) The bills accepted by S Ltd., are all in favour of H Ltd.

(ii) The stock of H Ltd., includes Rs.25,000 bought from S Ltd., at a profit to latter of 20% on sales

(iii) All the profit of S Ltd., has been earned since the shares wee acquired by H Ltd., But there was already reserve of Rs.30,000 on that date.

Solution :

Consolidated Balance Sheet of H Ltd. and S Ltd. as on …..

Liabilities	Rs.	Assets	Rs.
Share capital	5,00,000	Fixed assets	4,60,000
Profit & Loss a/c	2,41,250	Stock	4,20,000
Reserves	60,000	Debtors	1,60,000
Capital Reserve	22,500	Bills receivable	5,000
Stock Reserve	3,750		
Creditors	1,70,000		
Minority interest	47,500		
	10,45,000		**10,45,000**

1. Holding ratio : 100% of shares

2. Pre acquisition Profit :

Reserve – 30,000

Share of Pre acquisition profit to H Ltd. = 30,000 x 7,500 / 10,000 = 22,500

Share of pre acquisition profit to Minority shareholders = 30,000 – 22,500 = 7,500

3. Post acquisition Profit :

Profit & Loss a/c balance = 60,000

Share of post acquisition profit to H Ltd. = 60,000 x 7,500 / 10,000 = 45,000

Share of post acquisition profit to minority share holders = 60,000 – 45,000 = 15,000

4. Minority Interest :

Share Capital (Rs.2500 x10)	25,000
Pre acquisition Profits	7,500
Post acquisition Profits	15,000

	47,500
	--------

5. Capital Reserve

	Rs.	Rs.
Value of shares in S Ltd. held by H Ltd.		75,000
Less : Par value of shares (7,500 x 10)	75,000	
Less : Share in Pre acquisition Profits	22,500	97,500
Capital reserve		**22,500**

Stock Reserve for unrealised profit in stock :

$$= 25{,}000 \text{ x } \frac{20}{100} = 5{,}000 \qquad = 5{,}000 \text{ x } \frac{7{,}500}{10{,}000} = 3{,}750$$

Profit & Loss a/c to be shown in consolidated Balance sheet

	Rs.	Rs.
Profit & Loss a/c of H Ltd.	2,00,000	
Less : Stock Reserve	3,750	1,96,250
P & L a/c S Ltd. (Post acquisition Profit)		45,000
		2,41,250

Illu.19 : .Balance Sheets

Liabilities	**H ltd. Rs.**	**S Ltd. Rs.**	**Assets**	**H Ltd. Rs.**	**S Ltd. Rs.**
Share capital (Shares of Rs.100 each)	**2,50,000**	**1,00,000**	**Sundry assets**	**3,00,000**	**1,50,000**
Reserves	**70,000**	**25,000**	**750 shares in S Ltd.**	**1,20,000**	**-**
Profits	**50,000**	**15,000**			
Creditors	**50,000**	**10,000**			
	4,20,000	**1,50,000**		**4,20,000**	**1,50,000**

S Ltd. had a credit balance of Rs.5,000 in reserves when H Ltd. acquired shares in it. S Ltd. made bonus issue of one share for every five shares held, and out of post acquisition profits. Calculate cost of control before and after bonus issue and prepare consolidated balance sheet.

Solution :

Consolidated Balance Sheet of H Ltd. & its Subsidiary S Ltd.

Liabilities	Rs.	Assets		Rs.
Share capital	2,50,000	Goodwill		26,250
Minority interest	35,000	Assets :		
Reserves	70,000	H Ltd.	3,00,000	
Profits & Loss Account	61,250	S Ltd.	1,50,000	4,50,000
Creditors	60,000			
	4,76,250			**4,76,250**

Holding ratio :

750 shares : 250 shares

Holding ratio : 3 : 1

		Rs.	Rs.
(1)	**Pre acquisition profit**		
	Reserves		5,000
	Minority interest (1/4)		1,250
	Holding Company share		3,750
(2)	**Post acquisition Profit**		
	Balance		15,000
	Transfer to Reserves		20,000
			35,000
	Less: Bonus Issue		20,000
			15,000
(3)	**Cost of Control before the issue of Bonus shares**		
	Cost of shares in S Ltd.		1,20,000
	Less: Face value of 750 shares of Rs.100 each	75,000	
	Share in Pre acquisition profits	3,750	78,750
	Cost of Control or Goodwill		**41,250**

		Rs.	Rs.
(4)	**Cost of Control after the issue of Bonus Shares**		
	Cost of 750 shares in S Ltd.		1,20,000
	Less: Face value of 750 shares of Rs.100 each held before the issue of bonus shares	75,000	
	Face value of 150 bonus shares of Rs.100 each	15,000	
	Share of Pre acquisition Profit	3,750	93,750
	Cost of Control of Goodwill		**26,250**
(5)	**Minority interest**		
	Share capital held by outsiders before issue of bonus shares		
	250 shares of Rs.100 each		25,000
	Add: 50 {250 x 1/5} bonus shares of Rs.100 each		5,000
	Share in Reserves		1,250
	Share in Post acquisition Profit		3,750
			35,000

Illu.20 : H Ltd. acquired 80% of shares in S Ltd., on 1.10.2009. The summarised balance sheets of H Ltd., and S Ltd. on 31.3.2010 were :

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share capital :			**Goodwill**	**1,00,000**	**-**
Shares of Rs.10 each	**20,00,000**	**10,00,000**	**Machinery**	**5,00,000**	**4,50,000**
Reserves	**1,00,000**	**1,50,000**	**Furniture**	**20,000**	**40,000**
Profit and Loss a/c	**50,000**	**45,000**	**Shares in S ltd.**	**8,80,000**	**-**
9% Debentures	**-**	**2,00,000**	**9% debentures in S ltd.**	**80,000**	**-**
Creditors	**4,00,000**	**2,00,000**	**Stock**	**5,20,000**	**6,50,000**
Bills payable	**20,000**	**10,000**	**Debtors**	**1,80,000**	**2,70,000**
			Bills receivable	**10,000**	**15,000**
			Cash	**2,80,000**	**1,80,000**
	25,70,000	**16,05,000**		**25,70,000**	**16,05,000**

Bills receivable of S ltd. include bills for Rs.8,000 accepted by H Ltd. and creditors of S ltd include Rs.20,000 due to H Ltd. An amount of Rs.30,000 was transferred by S ltd. from the current years profits to reserves.

You are required to prepare the consolidated balance sheet on 31.3.10 showing therein how your figures are made up.

Solution :

Consolidated Balance Sheet of H Ltd. and S Ltd. as on 31.3.2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital :			Goodwill		54,000
Shares of Rs.10 each		20,00,000	Machinery :		
Reserves & Surplus			H Ltd.	5,00,000	
Reserves :		1,00,000	S Ltd.	4,50,000	9,50,000
Profit & Loss a/c :			Furniture :		
H Ltd.	50,000		H ltd.	20,000	
S Ltd.	30,000	80,000	S Ltd.	40,000	60,000
Secured Loans :			Stock :		
9% debentures			H Ltd.	5,20,000	
S Ltd.	2,00,000		S Ltd.	6,50,000	11,70,000
Less : Held by H Ltd.	80,000	1,20,000	Debtors :		
Minority share holders			H Ltd.	1,80,000	
interest		2,39,000			
Creditors :			S Ltd.	2,70,000	
H Ltd.	4,00,000			4,50,000	
S ltd.	2,00,000		Less : Inter Co.		
			transactions	20,000	4,30,000
	6,00,000		Bills Receivable :		
Less : Inter Co.	20,000		H ltd.	10,000	
transactions					
Bills payable :		5,80,000	S Ltd.	15,000	
H Ltd.	20,000			25,000	
S Ltd.	10,000		Less : Inter Co.		
			transactions	8,000	17,000
	30,000		Cash :		
Less : Inter Co.	8,000	22,000	H Ltd.	2,80,000	
transactions					
			S Ltd.	1,80,000	4,60,000
		31,41,000			**31,41,000**

(1) Holding Ratio :

Share Capital of S Ltd. = 10,00,000 of Rs.10 each
No. of shares of S Ltd. = 10,00,000 / 10 = 1,00,000
No. of shares purchased by H Ltd. = 80,000
No. of shares held by minority shareholders = 1,00,000 – 80,000 = 20,000
$\therefore$ Ratio between holding company and minority shareholders = 80,000 : 20,000 = 4 : 1

(2) Interest of minority Shareholders :

	Rs.
Share capital of Rs.20,000 shares of Rs.10/- each	2,00,000
Proportionate share in General Reserve Rs.1,50,000 x 1/5	30,000
Proportionate shares in Profit & Loss a/c Rs.45,000 x 1/5	9,000
	2,39,000

(3) Calculation of a goodwill or capital Reserve :

	Rs.	Rs.
Reserves upto 1.4.2009 (1,50,000 – 30,000)		1,20,000
Share of Profit for 2009-10 :		
Profit & Loss a/c balance	45,000	
Add : Transfer to Reserve	30,000	
	75,000	
Share of Pre acquisition period		37,500
		1,57,500
Share of holding company 1,57,500 x 4/5		1,26,000
Face value of 80,000 shares		8,00,000
		9,26,000
Less : Cost of purchase of shares		8,80,000
Capital profit		**46,000**

	Rs.
Goodwill in H Ltd. B/S	1,00,000
Less : Capital profit on acquisition of shares in S Ltd.	46,000
Shown in Balance sheet	**54,000**

(4) Revenue profits of S Ltd. :

	Rs.
Post Acquisition Profit = 45,000 + 30,000 = 75,000 x ½	37,500
Less : Minority holders interest (37,500 x 1/5)	7,500
	30,000
Less : Transfer to Reserve by S Ltd. 30,000 x ½ = 15,000 x 4/5	12,000
Revenue profit in Profit & Loss a/c	**18,000**

Note : The balance is Profit & Loss a/c of S Ltd. as shown in balance sheet relation is taken as current year profit.

Illu.21 : The Balance sheet of Sridhar Ltd. and its subsidiary Mahesh Ltd. as on 31st March, 2007 were as following :

Balance sheet of Sridhar Ltd. and Subsidiaries as on 31st March, 2007

Liabilities	Sridhar Ltd. Rs.	Mahesh Ltd. Rs.	Assets	Sridhar Ltd. Rs.	Mahesh Ltd. Rs.
Share capital : (Shares of Re.1 each)	5,00,000	3,00,000	Sundry assets	8,00,000	5,00,000
			Investments in Mahesh Ltd.	2,00,000	-
General Reserve	2,00,000	-			
Profit and Loss a/c	2,00,000	90,000			
Creditors	1,00,000	1,10,000			
	10,00,000	5,00,000		10,00,000	5,00,000

The shares were purchased by Sridhar Ltd. in Mahesh Ltd. on 30th September, 2006. On 1st April, 2006, the profit and loss account of Mahesh Ltd. showed a loss of Rs.1,50,000 which was written off from out of the profits earned during the year profits were earned uniformly for the year 2006-2007.
Prepare a consolidated Balance sheet of Sridhar Ltd. and Mahesh Ltd. as on 31st March, 2007.

Solution :

Consolidated Balance Sheet of Sridhar Ltd. and Mahesh Ltd. as on 31st March 2007

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital :			Goodwill		20,000
Shares of Rs.1 each		5,00,000	Sundry assets		
General reserve		2,00,000	Sridhar Ltd.	8,00,000	
Profit & Loss a/c	2,00,000		Mahesh Ltd.	5,00,000	13,00,000
Add : From Mahesh	80,000	2,80,000			
Creditors :					
Sridhar Ltd.	1,00,000				
Mahesh Ltd.	1,10,000	2,10,000			
Minority interest		1,30,000			
		13,20,000			**13,20,000**

	Rs.
Ratio between Sridhar Ltd. and Mahesh Ltd.	
2,00,000 : 1,00,000 = 2 : 1	1,50,000
Less : On 1.4.2006 in Mahesh Ltd. :	
Profit as per Balance Sheet in Mahesh Ltd.	90,000
Profit earned during the year	**2,40,000**

Calculation of Goodwill :

	Rs.
Loss on 1.4.06 – Rs.1,50,000	
Share of Sridhar Ltd. : Rs.1,50,000 x 2/3	1,00,000
Capital profit (1.4.06 to 30.9.06)	
Profit = 2,40,000 x 6/12 = Rs.1,20,000	
Share of Sridhar Ltd. : Rs.1,20,000 x 2/3	80,000
Goodwill	**20,000**

Revenue profit = Rs.2,40,000 x 6/12 = Rs.1,20,000
Sridhar Ltd. share = Rs.1,20,000 x 2/3 = Rs.80,000
Mahesh Ltd. share = Rs.1,20,000 x 1/3 = Rs.40,000

Calculation of capital loss of Mahesh Ltd. share

	Rs.
Loss in Profit & Loss a/c on 1.4.06 = 1,50,000 x 1/3	50,000
Less : Mahesh share in capital profit 1,20,000 x 1/3	40,000
Capital loss of Mahesh Ltd. share	**10,000**

Calculation of minority shareholders interest :

	Rs.
Face value of 1,00,000 shares of Rs.1 each	1,00,000
Share of revenue profit	40,000
	1,40,000
Less : Share of capital loss	10,000
Minority Interest	**1,30,000**

Illu.22 : The Summarized Balance Sheets of Honey Ltd. and Moon Ltd. as on 31.12.2010 were as follows :

Liabilities	**Honey Ltd. Rs.**	**Moon Ltd. Rs.**	**Assets**	**Honey ltd. Rs.**	**Moon Ltd. Rs.**
Capital			**Plant**	**1,20,000**	**54,700**
2,500 shares of			**Building**	**75,000**	**90,000**
Rs.100 each	**2,50,000**	**-**			
1,000 shares of			**Investments in**		
Rs.100 each	**-**	**1,00,000**	**Moon Ltd. at cost**	**1,70,000**	**-**
Capital reserve	**-**	**60,000**	**Stock**	**70,000**	**18,000**
General reserve	**1,20,000**	**-**	**Debtors**	**21,000**	**20,000**
Profit & Loss a/c	**28,600**	**18,000**	**Amount owing by**		
			Moon Ltd.	**1,000**	**-**
Bank overdraft	**50,000**	**-**	**Bank**	**7,250**	**4,000**
Bills payable			**Bills receivable**		
includes Rs.1,500	**-**	**4,200**	**includes Rs.1,500**	**7,900**	
to Honey Ltd.			**from moon ltd.**		
Creditors	**23,550**	**-**			
Creditors :					
Honey Ltd.	**-**	**500**			
Others	**-**	**4,000**			
	4,72,150	**1,86,700**		**4,72,150**	**1,86,700**

Honey Ltd. acquired 800 shares of Rs.100 each in Moon Ltd. on 1.4.2010. Prepare a consolidated Balance Sheet as on 31.12.2010, taking the following information.

(i) Sundry creditors of Honey Ltd. include Rs.6,000 due to Moon Ltd.

(ii) The debtors are advised that the building of Moon Ltd. are undervalued by Rs.10,000 and its plant overvalued by Rs.5,000.

(iii) A cheque for Rs.500 sent to Honey Ltd. by Moon Ltd. on 30.12.2010 was no received by the former until 3.1.2011.

Solution :

Consolidated balance sheet of Honey Ltd.
and its subsidiary Moon Ltd. as at 31.12.2010

Liabilities		**Rs.**	**Assets**		**Rs.**
Share capital :			Goodwill		23,600
2,500 equity shares			Plant : Honey Ltd.	1,20,000	
fully paid @ Rs.100		2,50,000			
each					
General reserve		1,20,000	Moon Ltd.	49,700	1,69,700
			(54,700 – 5,000)		
Profit and loss a/c		28,600	Premises : Honey Ltd.	75,000	
Bank overdraft		50,000	Moon Ltd.	1,00,000	1,75,000
			(90,000 + 10,000)		

Liabilities		Rs.	Assets		Rs.
Bills payable : Moon Ltd.	4,200		Stock : Honey Ltd.	70,000	
Less : Mutual owings	1,500	2,700	Moon Ltd.	18,000	88,000
Creditors : Honey Ltd.	23,550		Debtors : Honey Ltd.	21,000	
Less : Mutual owings	6,000	17,550	Moon Ltd.	20,000	
Creditors of Moon Ltd. :				**41,000**	
Honey Ltd.	500		**Less:** Mutual owings	6,000	35,000
Less : Cheques issued	500	-	Amount due from Moon Ltd. :		
Others		4,000	Honey Ltd.	1,000	
Minority Interest		36,600	**Less :** Cheque send	500	500
			Bank : Honey Ltd.	7,250	
			Moon Ltd.	4,000	11,250
			Bills receivable : Honey Ltd.	7,900	
			Less : Mutual owings	1,500	6,400
		5,09,450			**5,09,450**

Illu.23 : From the following balance Sheets of two companies, prepare consolidated balance sheet as on 31st March, 2010

	H Ltd. Rs.	S Ltd. Rs.		H Ltd. Rs.	S Ltd. Rs.
Share capital (Rs.100 each)	**10,00,000**	**5,00,000**	**Investments 4,000 shares in S Ltd.**	**5,00,000**	**-**
Reserves	**3,00,000**	**2,00,000**	**1000 shares in H ltd.**		**1,10,000**
Creditors	**1,00,000**	**1,00,000**	**Sundry assets**	**9,00,000**	**6,90,000**
	14,00,000	**8,00,000**		**14,00,000**	**8,00,000**

H Ltd., acquired the shares in S Ltd., on 1st April, 2009 when reserves in S Ltd., stood at Rs.1,20,000 and H Ltd., at Rs.1,80,000. S Ltd., had acquired the shares in H Ltd., on 1st April, 2008. Prepare the consolidated balance sheet of the two companies.

Solution :

Consolidated Balance Sheet H Ltd. and its subsidiary company S Ltd. as on 31st March, 2010

Liabilities	Rs.	Rs.	Assets	Rs.
Share capital	10,00,000		Sundry Assets	15,90,000
Less : Shares held by S Ltd.	1,00,000	9,00,000		
Capital Reserve:				
Reserves	3,00,000			
Less : treated as capital profit	30,000			
	2,70,000			
Add : Share of H Ltd.	60,000	3,30,000		
Creditors				
H Ltd.	1,00,000			
S Ltd.	1,00,000	2,00,000		
Minority Interest.		1,50,000		
		15,90,000		**15,90,000**

1. Capital Profit of S Ltd.

Let capital profits of S Ltd., be X and that of H Ltd. Y. Then

X = Rs.1,20,000 + 1/10Y; and

Y = Rs.1,80,000 + 4/5x

Y = Rs.1,80,000 + 4/5 (Rs.1,20,000 + 1/10y) substituting the value of x

Y = Rs.1,80,000 + 96,000 + 2/25y

= Rs2,76,000 + 2/25y

25Y = Rs.69,00,000 + 2y

23Y = Rs.69,00,000

Y = Rs.3,00,000

X = Rs.1,20,000 + 1/10 x 3,00,000 + Rs.1,50,000

Share of minority shareholders : Rs.1,50,000 x 1/5 = Rs.30,000

Share of H Ltd. Rs.1,20,000

Since the capital profit in the balance sheet of S Ltd., is only Rs.1,20,000 in all Rs.30,000 (to make it Rs.1,50,000) it will have to be transferred from the Reserves of H Ltd.

2. Revenue profit of S Ltd.,

Let the Revenue profits of S Ltd,, be x and that H ltd. y. Then,

x = Rs.80,000 + 1/10y; and

y = Rs.1,20,000 + 4/5x

x = Rs.80,000 + 1/10 (Rs.1,20,0000 + 4/5x), substituting the value of y

= Rs.80,000 + 12,0000 + 2/25 x

= Rs.92,000 + 2/25x

25x = Rs.23,00,000 + 2x

23x = Rs.23,00,000

x = Rs.1,00,000

Share of Minority shareholders : Rs.1,00,000 x 1/5 = Rs.20,000

Total profit of S Ltd., being Rs.80,000, the share of H Ltd., is Rs.60,000

3. Cost of control :

	Rs.	**Rs.**
Amount paid for 4,000 shares		5,00,000
Less : Face value	4,00,000	
Capital profit	1,20,000	5,20,000
Capital reserve		20,000
Less : Excess amount paid by S Ltd., (over face value of 1,000 shares)		10,000
Capital Reserve		**10,000**

4. Minority Intereest :

	Rs.
Face value of shares	1,00,000
Add : Share of capital profit	30,000
Share of revenue profits	20,000
	1,50,000

13.2 SELF ASSESSMENT QUESTIONS

A. Short Answer Questions :

1. Unrealised profit
2. Interest on Minority shareholders

B. Essay Questions :

1. What do you mean by holding companies? What are their advantages and disadvantages
2. Explain the preparation of consolidated balance sheet.

3. Discuss the accounting procedure for inter-company investment.
4. Describe how minority interest is shown in a consolidated Balance Sheet.
5. How do you calculate 'Minority Shareholders interest'?
6. What do you understand by a holding company?
7. Describe how minority interest is shown in a consolidated balance sheet.

13.3 EXERCISES

1. Given below are the Balance Sheets of two companies H Ltd. and S Ltd. Prepare Consolidated Balance Sheet.

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital (Rs. 100 each)	5,00,000	2,00,000	Investments 1,600 shares in S Ltd.	2,20,000	-
Profits:			1,000 shares in H Ltd.	-	1,50,000
Capital	1,00,000	80,000	Sundry assets	8,30,000	2,40,000
Revenue	3,00,000	50,000			
Creditors	1,50,000	60,000			
	10,50,000	**3,90,000**		**10,50,000**	**3,90,000**

[Ans.: Balance Sheet total Rs.10,70,000]

2. Prepare Consolidated Balance Sheet as on 31-12-2009 with the help of the Balance Sheets of Indian Products and its subsidiary Bombay Products Ltd.

Indian Products Ltd.

Liabilities	Rs.	Assets	Rs.
Capital – 30,000 shares of Rs.10 each fully paid	3,00,000	Land and Buildings	2,00,000
		Plant and Machinery	1,25,000
General Reserve	1,00,000	6,000 shares @ Rs.15 each in Bombay Products	90,000
Creditors	75,000		
Profit and Loss a/c	40,000	Stock	45,000
		Debtors	40,000
		Cash at Bank	15,000
	5,15,000		5,15,000

Bombay Products Ltd.,

Liabilities	Rs.	Assets	Rs.
Capital – 8,000 shares		Stock	60,000
Rs.10 each fully paid	80,000	Debtors	35,000
General Reserve	10,000	Investments	25,000
Creditor	15,000	Cast at Bank	10,000
Profit and Loss a/c	25,000		
	1,30,000		1,30,000

Bombay Products Limited was having a balance of Rs.16,000 in its profit and loss appropriation account when its shares were purchased by Indian Products Ltd. There was no General Reserve on that day.

[Ans.: Goodwill Rs.18,000; Minority Interest Rs.28,750; Balance Sheet Total Rs.5,73,000]

3. H Ltd. acquired 3,000 shares in S Ltd. The Balance Sheets of these companies as on 31-12-2009 is given below.

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital:			Buildings	4,400	--
Shares at Rs.10	1,50,000	40,000	Machinery	12,000	5,000
Reserve	45,000	13,000	Stock	42,000	10,000
Profit and Loss a/c	26,400	14,000	Debtors	1,19,500	50,000
Creditors	18,000	6,000	Cash	24,000	8,000
			Shares in S Ltd.	37,500	--
	2,39,400	73,000		2,39,400	73,000

On that date of acquisition of shares in S Ltd., the reserve of S Ltd. stood at Rs.6,000, the balance in profit and loss account was Rs.4,000. The Debtors of S Ltd. include Rs.5,000 due from H Ltd.

Prepare Consolidated Balance Sheet.

[Ans.: Minority Interest Rs.16,750; Balance Sheet Total Rs.2,69,900]

4. The Balance sheets of M Limited and N Limited as on 31-12-2009 are as follows:

Liabilities	M Ltd. Rs.	N Ltd. Rs.	Assets	M Ltd. Rs.	N Ltd. Rs.
Share Capital:			Buildings	90,000	--
Shares at Rs.100	3,00,000	75,000	Machinery	3,00,000	--
Reserve	45,000	15,000	Stock	50,000	1,00,000
Creditors	75,000	45,000	Debtors	40,000	72,500
Bills payable	22,500	--	Cash	--	15,000
Profit and Loss a/c (1-1-09)	60,000	30,000	Shares in N Company	97,500	--
Profits during the year	75,000	37,500	Bills receivable	--	15,000
	5,77,500	2,02,500		5,77,500	2,02,500

M Limited acquired shares in N Limited on 1-1-2009. All the bills receivable of N Limited is accepted by N Limited. The debtors of N Limited include Rs.10,000 due from M Limited. Prepare Consolidated Balance Sheet.

[Ans.: Goodwill Rs.1,500; Minority Interest Rs.31,500; Balance Sheet Total Rs.6,59,000]

5. Major Company Limited acquired 11,000 shares in Minor company Limited at Rs.10 each by paying Rs.20 each on 1-7-2009. The Balance Sheets of these companies on 31-12-2009 is as follows.

Liabilities	Major Co. Rs.	Minor Co. Rs.	Assets	Major Co. Rs.	Minor Co. Rs.
Share Capital:	4,00,000	1,20,000	Buildings	3,00,000	1,30,000
General Reserve	1,00,000	12,000	Sundry assets	1,00,000	22,000
Creditors	30,000	20,000	Debtors	40,000	30,000
Profit and Loss a/c on 1-1-2009	50,000	6,000	Shares in Minor Company	2,20,000	--
Profit during the year	80,000	24,000			
	6,60,000	1,82,000		6,60,000	1,82,000

The debtors of the major company limited include Rs.10,000 due from Minor company. Prepare Consolidated Balance Sheet.

[Ans.: Goodwill Rs.82,500; Minority Interest Rs.13,500; Balance Sheet Total Rs.6,94,500]

6. Hugly Company Limited acquired 75% shares of Ganga Company Limited at Rs.10 fully paid up at a cost of Rs.20 each on July 1st 2009. The Balance sheets of both the companies as on 31st December, 2009 are given below:

Liabilities	Hugly Co. Rs.	Ganga Co. Rs.	Assets	Hugly Co. Rs.	Ganga Co. Rs.
Capital	8,00,000	50,000	Fixed Assets	7,50,000	37,500
General Reserve (1-1-09)	1,60,000	16,000	Stock	4,30,000	57,500
Creditors	2,40,000	31,750	Debtors	2,75,000	30,000
Profit and Loss a/c on 1-1-2009	1,30,000	6,250	3,750 shares in Ganga Co.	75,000	--
Profit during the year	2,00,000	21,000			
	15,30,000	1,25,000		15,30,000	1,25,000

The debtors are Hugly Limited include Rs.10,000 due from Ganga Limited. Prepare the consolidated balance sheet as on 31-12-2009.

[Ans.: Goodwill Rs.12,937; Minority Interest Rs.23,312; Balance Sheet Total Rs.15,82,937]

7. H Limited acquired 5,000 shares at Rs.12 each in S Ltd. on June 30th, 2009. Prepare the consolidated balance sheet as on 31st December, 2009 from the following information.

Balance Sheet as on 31-12-2009

Liabilities	H Co. Rs.	S Co. Rs.	Assets	H Co. Rs.	S Co. Rs.
Share Capital:			Buildings	40,000	--
Rs.10 each	1,00,000	80,000	Plant	10,000	60,000
Reserves	40,000	30,000	Stock	40,000	60,000
Bills payable	20,000	10,000	Debtors	50,000	30,000
Creditors	50,000	40,000	Bills receivable	30,000	20,000
Profit & Loss a/c	40,000	20,000	Shares in S Co.	60,000	--
			Cash	20,000	10,000
	2,50,000	1,80,000		2,50,000	1,80,000

The Debtors of H Company include Rs.20,000 due from S Company. The Bills payable of H Company include Rs.5,000 accepted by S Company. S company transferred Rs.5,000 from the current year profits to reserve account.

[Ans.: Capital Reserve Rs.5,625; Minority Interest Rs.48,750; Balance Sheet Total Rs.3,45,000]

8. The Balance Sheets of H Ltd., and S Ltd., as on 31st December, 2009 were as follows:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital:			Land	3,10,000	1,60,000
Rs.100 each	10,00,000	5,00,000	Machinery	2,70,000	1,35,000
General Reserve	1,00,000	50,000	3,000 Shares in S Ltd.	4,50,000	--
Profit and loss a/c (1-1-2009)	40,000	30,000	Stock at cost	2,20,000	1,50,000
Profit for 2009	2,00,000	80,000	Debtors	1,55,000	90,000
Creditors	1,50,000	70,000	Bank	85,000	1,95,000
	14,90,000	7,30,000		14,90,000	7,30,000

H Ltd. acquired 3,000 shares in S Ltd., on 1-7-2009. The Debtors of H Limited include Rs.20,000 due from S Limited. The stock of H Limited include Rs.5,000 purchased from S Limited. H Limited earned profit at 25% on cost. Prepare the consolidated balance sheet as on 31-12-2009.

[Ans.: Goodwill Rs.93,000; Minority Interest Rs.2,64,000; Balance Sheet Total Rs.18,42,250]

9. The Balance Sheet of H Ltd., and S Ltd. as on 31st December, 2009 are given below.

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital:	2,00,000	50,000	Sundry Assets	1,80,000	1,20,000
Reserves	30,000	10,000	Shares in S Ltd.	2,30,000	--
Profit and Loss a/c (1-1-2009)	60,000	30,000	Cash at Bank	20,000	10,000
Profit for the year 2009	40,000	10,000			
Creditors	1,00,000	30,000			
	4,30,000	1,30,000		4,30,000	1,30,000

H Ltd. acquired 80% shares in S Ltd. on July 1st, 2009. The assets of H Ltd. include Rs.30,000 given as loan to S Ltd. Rs.40,000 Furniture included in the Assets of S Ltd. was revalued as Rs.50,000 on July 1st, 2009. Prepare the Consolidated Balance Sheet as on 31st December, 2009.

[Ans.: Goodwill Rs.1,58,000; Minority Interest Rs.22,000; Balance Sheet Total Rs.4,68,000]

10. From the following Balance Sheet of a holding company and its subsidiary prepare consolidated Balance Sheet.

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital (Rs.10)	5,00,000	2,00,000	Goodwill	30,000	10,000
General Reserve	80,000	60,000	Machinery	3,00,000	1,50,000
Profit and Loss a/c	90,000	70,000	Stock	80,000	50,000
Creditors	50,000	40,000	Debtors	1,20,000	1,60,000
Bills payable	20,000	10,000	Bank	20,000	10,000
			16,000 shares in S Ltd.	1,90,000	--
	7,40,000	3,80,000		7,40,000	3,80,000

When control was acquired S Ltd. had Rs.40,000 in General reserve and Rs.30,000 in profit and loss account. Immediately on purchase of share H Ltd. received Rs.16,000 dividend from S Ltd. Debtors of H Ltd. include Rs.20,000 due from S Ltd. whereas creditors of S Ltd. include Rs.15,000 due to H Ltd. difference being accounted for by a cheque in transit. The Machinery of S Ltd. were undervalued by Rs.10,000.

[Ans.: Goodwill Rs.6,000 (Rs.40,000 – 34,000); Minority Interest Rs.68,000; Balance Sheet total Rs.8,96,000]

11. The following are the Balance Sheet of H Ltd. and S Ltd. as on 31-3-2010.

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share capital (Re.1 per share)	10,000	8,000	Fixed assets	5,000	6,000
Reserve	4,000	3,000	Stock	4,000	6,000
Bills payable	7,000	5,000	Share in S Ltd.	6,000	-
P & L a/c	4,000	2,000	Bills Receivable	8,000	5,000
			Cash	2,000	1,000
	25,000	**18,000**		**25,000**	**18,000**

Bills receivables of H Ltd. include Rs.2, 500 given by S Ltd. Rs.500 was transferred by S Ltd. to reserve out of current years profit. Shares of S Ltd. were purchased by H Ltd. on 30-9-2009. Prepare a consolidated Balance Sheet.

[Ans.: Minority interest Rs.4,875; Capital Reserve Rs.563; Balance Sheet Total Rs.34,500]

12. Jai Bharat Co. Ltd., is a Holding Company and Andhra Co. Ltd., is its subsidiary. On 31-3-2008, the stock of Jai Bharat Co. Ltd., includes Rs.6, 000 relating to stock purchased from Andhra Co. Ltd., which follows the practice of charging 25% extra on the cost for determining the selling price.

Find out the stock reserve and explain how will it be treated in the consolidated Balance Sheet.

[Ans.: Unrealised profit Rs.1,200]

13. Chakravarthy Company Ltd., purchased shares in Praveen Company Ltd., on 1-7-2010. On 31-12-2010 the Balance Sheets of the above two companies were as follows:

Liabilities	Chakravarthy Rs.	Praveen Rs.	Assets	Chakravarthy Rs.	Praveen Rs.
Share Capital (Shares of Rs.100 each)	4,00,000	1,00,000	Buildings	1,20,000	-
General Reserve	60,000	20,000	Machinery	4,00,000	-
Profit & Loss a/c as on 1-1-2010	80,000	40,000	Stock	80,000	1,70,000
Profit of 2010	1,00,000	50,000	Sundry Debtors	20,000	60,000
Sundry Creditors	1,00,000	60,000	600 shares in Praveen	1,30,000	-
Bills payable	30,000	-	Bills receivable	-	20,000
			Cash	20,000	20,000
	7,70,000	**2,70,000**		**7,70,000**	**2,70,000**

(a) All the Bills receivable with Praveen Company are accepted by Chakravarthy Company only.
(b) In the Sundry debtors of Praveen Company, Rs.12,000 due from chakravarthy Company is also included.

Prepare the consolidated Balance Sheet.

[Ans.: Balance sheet Total Rs.8,97,000; Minority Interest Rs.84,000; Goodwill Rs.19,000, Profit and Loss account Rs.1,95,000]

14. The following are the Balance Sheets of Suma Ltd. and Mani Ltd. as on December 31, 2010:

Liabilities	Suma Ltd. Rs.	Mani Ltd. Rs.	Assets	Suma Ltd. Rs.	Mani Ltd. Rs.
Share Capital			Fixed Assets	1,95,000	70,000
Shares of Rs.10	2,00,000	50,000	Investments:		
General Reserve	50,000	20,000	Shares in Mani Ltd.	60,000	
P & L a/c Balance (1-1-2010)	30,000	7,500	Debtors	35,000	25,000
Profit for the year 2010	50,000	20,000	Other current	60,000	12,500
Creditors	20,000	10,000			
	3,50,000	**1,07,500**		**3,50,000**	**1,07,500**

Notes:

a) Suma Ltd. Purchased on July 1, 2010, 4,000 share in Mani Ltd. at Rs.15 each.
b) Stock in Mani Ltd. includes Rs.7, 500 worth of goods purchased from Suma Ltd. which company sells goods at 25% above cost.
c) Creditors of Mani Ltd. include Rs.5, 000 due to Suma Ltd.

Prepare a consolidated balance sheet as on December 31, 2010.

[Ans.: Balance Sheet Total Rs.3,91,300; Preacquisition profit Rs.37,500; capital reserve Rs.10,000; Minority interest Rs.19,500]

15. The Sun Company Ltd., acquired the whole of the shares in the Moon Company Ltd. on 1-4-2010. The Balance Sheets of the above companies were as following on 31-3-2010:

Liabilities	Sun Rs.	Moon Rs.	Assets	Sun Rs.	Moon Rs.
Share Capital Equity shares of Rs.10 each	3,00,000	2,00,000	Sundry Assets	1,60,000	2,30,000
Creditors	50,000	30,000	Shares in Moon Co., Ltd.,	1,90,000	
	3,50,000	2,30,000		3,50,000	2,30,000

From the above information, prepare consolidated Balance Sheet as on 31-3-2010.

[Ans.: Balance Sheet Total Rs.3,90,000; Capital reserve Rs.10,000]

16. A Ltd., acquired 1,600 equity shares of Rs.100 each in B Ltd., on 31-3-2010. The summarized Balance Sheets of A Ltd. and B Ltd., as on that date were as under:

Liabilities	A Ltd. Rs.	B Ltd. Rs.	Assets	A Ltd, Rs,	B Ltd. Rs.
Share Capital			Buildings	1,50,000	1,80,000
			Machinery	2,40,000	1,09,400
5000 Equity Shares of Rs.100 each	5,00,000	-			
2000 Equity Shares of Rs.100 each	-	2,00,000	Shares in B Ltd. (at cost)	3,40,000	-
Capital Reserve	-	1,20,000	Stock	1,20,000	36,000
General Reserve	2,40,000	-	Debtors	44,000	40,000
Profit & Loss a/c	57,200	36,000	Bills Receivable (including 3,000 due from B Ltd.)	15,800	-
Bank Overdraft	80,000	-	Cash at Bank	14,500	8,000
Bills payable (Including Rs.3, 000 payable to A Ltd.)	-	8,400			
Creditors	47,100	9,000			
	9,24,300	3,73,400		9,24,300	3,73,400

Additional Information:

a) The Buildings of B Ltd. are undervalued by Rs.20, 000, and the Machinery was overvalued by Rs.10, 000. Values of these assets have to be adjusted accordingly.

b) Sundry Creditors of A Ltd. include Rs.12, 000 due from B Ltd.

You are required to prepare the consolidated Balance Sheet as on 31-3-2010.

[Ans.: Balance Sheet total Rs.9,99,900; Minority interest Rs.73,200; Goowill Rs.47,200, Capital profit Rs.1,66,000]

17. The Balance Sheets of H Company Ltd. and S Company Limited as on 31-12-2009 are given below:

Liabilities	H Co. Rs.	S Co. Rs.	Assets	H Co. Rs.	S Co. Rs.
Share Capital:			Goodwill	40,000	--
Rs.100 each fully paid			Fixed assets	5,60,000	3,00,000
Equity shares	7,00,000	2,50,000	Stock	1,00,000	90,000
General Reserve	1,00,000	60,000	Debtors	20,000	75,000
Bills payable	--	40,000	1,500 shares in S company	2,46,000	--
Creditors	90,000	50,000			
Profit & Loss a/c	1,30,000	90,000	Cash	54,000	25,000
	10,20,000	4,90,000		10,20,000	4,90,000

H Company acquired shares in S Company on 1-5-2009. On that date S company Reserve was Rs.51,000. On 1-1-2009 S Company Profit and Loss Account balance was Rs.18,000. The Creditors of S Company include Rs.8,000 value of stock supplied by H company at $33^1/_3$% profit on cost. All the bills of S Company are issued in favour of H Company. H Company took these on discount basis.

Prepare the consolidated balance sheet of H Company and its subsidiary S company as on 31-12-2009.

[Ans.: Goodwill Rs.38,400; Minority Interest Rs.1,60,000; Balance Sheet Total Rs.13,01,200]

18. The Balance Sheets of H Limited and S Limited as on 31st December, 2009 are given below:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital: at Rs.100 each	6,00,000	3,00,000	Goodwill	60,000	35,000
			Buildings	2,50,000	95,000
General Reserve	2,00,000	--	Machinery	1,90,000	85,000
Profit and Loss a/c	1,00,000	--	Stock	95,000	55,000
9% Debentures	--	1,20,000	Debtors	70,000	30,000
Creditors	65,000	40,000	9% debentures at cost	90,000	--
Bills payable	--	15,000	2000 shares in S Limited	1,60,000	--
			Bank	50,000	35,000
			Profit & Loss a/c	--	1,40,000
	9,65,000	4,75,000		9,65,000	4,75,000

H Limited acquired shares on 1st April, 2009. The Profit and loss account of S Ltd., was showing debit balance of Rs.2,00,000 on 1st January, 2009. All the bills payable of S Ltd. are issued to H Ltd and H Ltd. discounted all these bills. The Creditors of S Ltd. include Rs.17,000 towards the stock supplied by H Ltd. The value of stock of S Ltd. include Rs.9,000 supplied by H Ltd. at $33^1/_3$% profit on cost. The Buildings of S Ltd. undervalued by Rs.11,000. Prepare the consolidated balance sheet as on 31st December, 2009.

[Ans.: Goodwill Rs.76,000; Unrealised Profit Rs.1,500; Balance sheet Total Rs.11,18,500]

19. The following balance sheets as at 31-12-2009 are presented to you.

Liabilities	Ravi Rs.	Chandra Rs.	Assets	Ravi Rs.	Chandra Rs.
Share Capital:			Fixed assets	3,50,000	1,50,000
(Shares of			Stock	90,000	40,000
Rs.100 each)	5,00,000	2,00,000	Debtors	60,000	30,000
General Reserve	1,00,000	--	6% Debentures in		
Profit and Loss a/c	80,000	--	Chandra Co.	60,000	--
6% Debentures	--	1,00,000	Shares in Chandra		
Creditors	75,000	45,000	Co. 1,500 shares at Rs.80	1,20,000	--
			Bank	75,000	25,000
			Profit & Loss a/c	--	1,00,000
	7,55,000	3,45,000		7,55,000	3,45,000

Ravi Ltd., acquired the shares on 1st May, 2009. The profit and loss account of Chandra Ltd. showed a debit balance of Rs.1,50,000 on 1st January, 2009. During March, 2009 goods costing Rs.6,000 were destroyed by fire against which the insurer paid only Rs.2,000. Trade creditors of Chandra Ltd., include Rs.20,000 for goods supplied by Ravi Ltd. on which Ravi Ltd., made a profit of Rs.2,000. Half of good were still in stock on 31st December, 2009.

Prepare a consolidated balance sheet.

[Ans.: Goodwill Rs.72,000; Minority Interest Rs.25,000; Balance Sheet Total Rs.8,71,250; Unrealised Profit Rs.1,000]

20. 'X' Ltd., acquired all the shares in 'Y' Ltd., as on 1st January, 2010 at a cost of Rs.5, 60,000: The Balance Sheets of the two companies as on 31st December 2010 were as follows:

Balance Sheet of 'X' Ltd.,

Liabilities	Rs.	Assets	Rs.
Share Capital		Fixed Assets	6,65,000
15,000 shares of Rs.50 each	7,50,000	Shares in subsidiary company	5,60,000
General Reserve	4,75,000	Current Assets:	
Profits and Loss account (A)	4,00,000	Stock (C)	1,70,000
Creditors (B)	75,000	Debtors	1,40,000
		Cash at Bank	1,65,000
	17,00,000		**17,00,000**

(A) This includes an interim dividend of Rs.40, 000 received from 'Y' Ltd.

(B) This includes Rs.30, 000 for purchases from 'Y' ltd., on which 'y' Ltd., made a profit of 25%.

(C) This includes Rs.15, 000 stock purchased from 'y' Ltd.,

Balance Sheet of 'Y' Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets	2,85,500
50,000 shares of Rs.5 each	2,50,000	Current Assets	
General Reserve as on 1-1-2010	10,000	Stock	1,01,000
Profit and Loss account	1,80,000	Debtors	79,000
Creditors	80,500	Cash at Bank	55,000
	5,20,500		**5,20,500**

The profit and loss account has a credit balance of Rs.1,40,000 on 1st January 2010 and on Interim dividend of Rs.40,000 was paid during the year ended 31st December 2010. Make necessary adjustments and prepare a consolidated Balance Sheet as on 31st December 2010.

[Ans.: Balance Sheet Total Rs.17,86,750; Goodwill Rs.1,60,000, Profit and Loss account Rs.4,36,250]

21. The following are the balance sheets of H Ltd. and S Ltd. as at 31-3-2010:

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Fully paid up equity share of Rs.10 each	6,00,000	2,00,000	Machinery	3,90,000	1,35,000
General Reserve	3,40,000	80,000	Furniture	80,000	40,000
Profit and Loss a/c	1,00,000	60,000	80% shares in S Ltd.	3,40,000	-
Creditors	70,000	35,000	Stock	1,80,000	1,20,000
			Debtors	50,000	30,000
			Cash at Bank	70,000	50,000
	11,10,000	**3,75,000**		**11,10,000**	**3,75,000**

The following information is provided to you.

(a) Profit and loss a/c of S ltd. stood at Rs.30, 000 on 1st April 2009 whereas general reserve has remained unchanged since that date.

(b) H Ltd. acquired 80% shares is S Ltd. On 1st October 2009 for Rs.3,40,000 on mentioned above.

(c) Included in debtors of S Ltd. a sum of Rs.10, 000 due from H Ltd. for goods sold at a profit of 25% on cost price. Till 31st March 2010 only one half of the goods had been sold while the remaining goods were lying in the godown of H Ltd. as on that date.

You are required to prepare consolidated balance sheet as at 31st March 2010. Show all calculations clearly.

[Ans.: Balance Sheet Total Rs.12,14,200; Minority interest Rs.68,000; unrealized profit Rs.1,000, Goodwill Rs.80,000]

13.4 REFERENCE BOOKS :

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13. T.S. Reddy, A. Murthy, Corporate Accounting, Margham Publications. Chennai

Chapter – 14

LIQUIDATION OF COMPANIES

Objectives :

After studying this unit you should be able to

- understand the meaning of liquidation of companies
- find out the modes of winding up of companies
- know the duties and powers of liquidator in the winding up of companies
- understand the order of payment on liquidation
- go through a method of presentation of statement of affairs
- know the procedure on the voluntary winding up of companies

Structure :

14.1 INTRODUCTION

Winding-up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator, called a `Liquidator', will be appointed. He will take control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights. In simple words, winding up means applying the assets of a company in the discharge of its liabilities and returning any surplus to those entitled to it, subject to the cost of doing so. The statutory process by which this is achieved is called 'Liquidation'. Winding up of a company differs from insolvency of an individual in as much as a company cannot be made insolvent under the insolvency law. In fact, a solvent company may also be wound up.

14.2 MODES OF WINDING UP

There are two modes of winding up of a company, viz.,

1. Winding up by the Tribunal (Sections 433 to 483)
2. Voluntary winding up (Sections 484 to 521)
   (a) Members' voluntary winding up,
   (b) Creditors' voluntary winding up.

14.3 WINDING UP BY THE TRIBUNAL

Winding up by the Tribunal (earlier Court) , **also called compulsory winding up**, may be ordered in cases mentioned in Section 433. The tribunal will make an order for winding up on an application by and of the persons enlisted in Section 439. First, let us go through the grand on which the Tribunal may order compulsory winding up of a company.

14.3.1 Grounds for compulsory winding up :

A company may be wound up by the Tribunal on the following grounds:

1. **Special resolution :** The company may, by special resolution, resolve that it be wound up by the Tribunal. The resolution may be passed for any cause whatsoever. However, the Tribunal may not order winding up if it finds it to be opposed to public interest or the interest of the company as a whole.

2. **Default in holding Statutory Meeting :** If a public limited company makes a default in delivering the statutory report to the Registrar or in holding the statutory meeting, the company may be ordered to be wound up. Petition on this ground can be presented either by the Registrar or by a contributory. In case of any other person it should be filed within 14 days from the last day on which the statutory meeting ought to have been held.

3. **Failure to commence business :** If a public limited company does not commence business within a year from incorporation or suspends business for a whole year, it may be ordered to be wound up. Failure to commence or to carry on business is not treated as a ground for compulsory winding up unless the company has no intention of carrying on business or it has become impossible to do so.

4. **Reduction in membership :** If the number of members is reduced below the statutory minimum of 7 in case of a public company or 2 in case of a private company, the company may be ordered to be wound up.

5. **Inability to pay debts :** The Tribunal may order a company to be wound up if it is unable to pay its debts. According to Section 434, a company shall be deemed to be unable to pay its debts :

   (a) Demand for payment neglected : If a creditor for **more than one lakh rupees has served** on the company at its registered office a demand under his hand requiring payment and the company has for three weeks thereafter neglected to pay or secure or compound the sum to the reasonable satisfaction of the creditor; or

   (b) Decreed debt unsatisfied : If execution or other process issued on a judgement or order of any Court or Tribunal in favour of a creditor of the company is returned unsatisfied in whole or in part; or

   (c) Commercial insolvency : If it is proved to the satisfaction of the Tribunal that the company is unable to pay its debts, taken into account its contingent and prospective liabilities.

   A company which has to date paid all its debts as they fell due may still be ordered to be wound up if a consideration of its assets and liabilities shows that it will or may shortly be unable to do so. Inability is to be seen in the commercial sense of a running enterprise and not in the sense of liquidation, i.e., if the company cannot meet its current demand, even though its assets, when realized, would exceed its liabilities, it will be deemed to be unable to pay its debt and may be wound up.

   A company is deemed to be unable to pay its debts, if it is proved to the satisfaction of the Tribunal that the company is unable to pay its debts. In determining whether a company is unable to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the company also.

6. **Just and equitable :** The Tribunal may also order for the winding up of a company if its is of the opinion that it is just and equitable that the company should be wound up. In exercising its power on this ground, the Tribunal shall give due weight to the interest of the company, its employees, creditors and shareholders and the interest of the general public.

Circumstances of winding up under `Just and Equitable Grounds'

The winding up of a company based on the just and equitable clause is the last resort. In the above five cases, definite conditions should be fulfilled but in the 'just and equitable' clause the entire matter is left to the 'wide and wise' direction of the Tribunal. The following are the cases where the Tribunal may order for winding up of a company on just and equitable grounds.

14.3.2 Companies (Amendment) Act, 2002 :

The amendment Act 2002 has added following three circumstances in which a company may be wound up by Tribunal :

1. **Non-filing of Financial Statements :** If the company has made a default in filing with the Registrar its balance Sheet and profit and loss account or annual return for any five consecutive financial years.

2. **Acting against Sovreignty and Integrity of the Country :** If the company has acted against the interests of the sovereignty and integrity of India, the security of the state, friendly relations with foreign States, public order, decency or morality. However, the Tribunal shall make an order in this circumstance on application made by the Central Government or a State Government.

3. **Winding up of a sick company :** If the tribunal is of the opinion that the company should be wound up under the circumstances specified in Sec.424G. The last two clauses in Section 333(I) have been added by the Companies (Amendment) Act, 2002.

14.4 PETITION FOR WINDING UP

A petition for the compulsory winding up of a company may be presented by :

(1) the company itself by the passing of a special resolution; or
(2) any creditor or creditors, including any contingent or prospective creditor or creditors; or
(3) a contributory or contributors; or
(4) any combination of creditors, company or contributories acting jointly or separately; or
(5) the Registrar; or
(6) any person authorized by the Central Government
(7) the official liquidator.

14.4.1 The Company :

A company may make a petition for its winding up, when the members of the company have so resolved by passing a special resolution. However, it is not very common for companies to apply for winding up orders since, if desired, they have only to pass a special resolution for voluntary winding up under Section 484 of the Act. But, where the directors find the company to be insolvent due to circumstances which ought to be investigated by the Tribunal, they may file a petition for winding up order on behalf of the company.

14.4.2 Creditor's Petition :

A creditor has a right to file a petition for winding up of a company. If he can prove that he claims an undisputed debt and that the company has failed to discharge it. The word 'Creditor' includes secured creditor, debenture holder and a trustee for debenture holders. It is not even necessary that the secured creditor should give up his security Sometimes a creditor's petition is opposed by other creditors. In such cases the Tribunal may ascertain the wishes of the majority of the creditors. However, the opinion of the majority of creditors does not bind the Tribunal.

14.4.3 Contributor's petition :

A 'contributory' means any person liable to contribute to the assets of a company in the event of its being wound up. But for this purpose the term 'contributory' includes a holder of fully paid shares. A 'contributory', however, may petition only: (i) on the ground that the number of members is reduced below the statutory minimum of seven members in case of public company and two in case of a private company; (ii) on any other ground if the shares in respect of which he is a contributory or some of them were originally allotted to him, or / have been held by him and registered in his name for at least six out of the eighteen months preceding the commencement of the winding up, or/have developed upon him through the death of the former holder.

A holder of fully paid shares is a contributory for the purpose of a petition not because he is liable to contribute but because he may have an interest in the assets in winding up. The section provides "A contributory shall be entitled to present a petition for winding up a company not withstanding that he may be the holder of fully paid-up shares, or that the company may have no assets at all or may have no surplus assets left for distribution among the shareholders after the satisfaction of its liabilities."

14.4.4 Joint petition :

By all or any of the parties specified above can jointly file a petition for winding up of a company. This means that any combination of the company, the creditors and the contributories can present a petition for winding up.

14.4.5 Registrar of Companies :

The Registrar may file a petition where :

i. a default is made in delivering the statutory report to him or in holding the statutory meeting; or
ii. the company has not commenced its business within a year from its incorporation; or
iii. the number of its members has fallen below the statutory minimum; or

iv. the financial condition of the company, as disclosed in its balance sheet or from the report of a special auditor appointed under Section 233A or any inspector appointed under Sections 235 to 237 it appears that it is unable to pay its debts, or

v. it is just and equitable that the company be wound up.

The petition on the ground of default in delivering the statutory report or holding the statutory meeting cannot be presented before the expiration of 14 days after the last day on which the statutory meeting ought to have been held. In any case, the Registrar cannot present the petition unless sanctioned by the Central Government.

14.4.6 Central Government :

The Central Government may petition for winding up where it appears from the report of inspectors appointed to investigate the affairs of a company under Section 235 that the business of the company has been conducted for fraudulent or unlawful purposes. The Government may authorise any person to act on its behalf for the purpose.

14.4.7 Official liquidator's petition :

According to Sec.440 an official liquidator may present a petition for winding up by the Tribunal where a company is being wound up voluntarily. The Tribunal, however, shall not make a winding up order unless it is satisfied that the voluntary winding up cannot be continued with due regard to the interest of the creditors or contributories or both.

14.4.8 Statement of Affairs to be filed on winding up :

According to the Companies Amendment Act 2002 every company shall file with the Tribunal a statement of its affairs along with the petition for winding up. Where a company opposes a petition for its winding up, it shall file with the Tribunal a statement of its affairs. The statement shall be accompanies by :

(i) the last known addresses of all directors and company secretary of such company;

(ii) the details of location of assets of the company and their value;

(iii) the details of all debtors and creditors with their complete addresses;

(iv) the details of workmen and other employees and any amount outstanding to them;

(v) such other details as the Tribunal may direct.

14.5. COMMENCEMENT OF WINDING UP

Where, before the presentation of a petition for the winding up of a company by the Tribunal, a resolution has been passed by the company for voluntary winding up, the winding up shall be deemed to have commenced from the date of the resolution. In all other cases the winding up of the company by the Court shall be deemed to commence at the time of the presentation of the petition for the winding up. When an order is made for winding up, it relates back to the date of the presentation of the petition. If no order for winding up is made and the winding up petition is dismissed, the date of the presentation of the winding up petition has no relevance. As such until winding up order is made, the company has to comply with the requirements of the Companies Act, 1956 as are required of a company not wound up.

14.5.1 Advertisement of petition :

Every petition for winding up a company shall be advertised 14 days before the hearing, stating the date on which the petition was presented and the names and addresses of petitioners.

14.6. POWERS OF TRIBUNAL IN WINDING UP

The powers of the Tribunal in the winding up of a company are given in Sec.442 and 443.

14.6.1 Power of Tribunal to stay or retrain proceedings against company :

At any time after the presentation of a winding of petition and before a winding up order has been made, the company, or any creditor or contributory may apply to the Tribunal for a stay of, or restraint of, further proceedings in the Tribunal.

14.6.2 Powers of Tribunal on hearing petition :

On hearing a winding up petition, the Tribunal may –

(a) dismiss it, with or without costs; or
(b) adjourn the hearing conditionally or unconditionally; or
(c) make any interim order that it thinks fit; or
(d) make an order for winding up the company with or without costs or any other order as it thinks fit.

The Tribunal shall not refuse to make a winding up order merely because the assets have been fully mortgaged or because there are no assets at all. Where the petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal may refuse to make a winding up order if the petitioners are acting unreasonably in seeking to have the company wound up instead of pursuing some other remedy available to them.

14.6.3 General Powers of the Tribunal

To facilitate the winding up of a company by the Tribunal, the Companies Act, 1956 gives the following powers to the Tribunal. These powers are in addition to the powers conferred on the Tribunal by Section 433 on hearing the petition.

1. **Power to stay winding up** (Section 446) : The Tribunal may at any time after making a winding up order (on the application either of the Official Liquidator of any creditor or contributor and on proof to the satisfaction of the Tribunal that all proceedings in relation to the winding up order be stayed) make an order staying the proceedings either altogether or for a limited time, on such terms and conditions as the Tribunal thinks fit.

2. **Settlement of the list of contributors** (Section 467): The Tribunal has the power to cause the assets of the company to be collected any applied in discharge of its liabilities. For this purpose the Tribunal has the power to make a list of contributors. In settling the list of contributors the Tribunal shall distinguish between those who are contributor in their own right and those who are contributories as being representatives of, or liable for the debts of others.

3. **Power to make calls** (Section 470). : The Tribunal is empowered to make call on all or any of the contributories to the extent of their liability. It should be noted that no statutory liability for an unpaid call can be set off against a credit except in the following cases:

   (a) in the case of an unlimited company, a contributory may set off his debt against any money due to him from the company on any independent dealing or contract with the company. But no set off is allowed for any money due to him as a member of the company in respect of any dividend or profit;
   (b) if, in the case of a limited company, there is any director or manager whose liability is unlimited, he shall have the same right of set off as described in (a) above;
   (c) in the case of any company, whether limited or unlimited when all the creditors have been paid in full, any money due on any account whether to a contributory from the company may be allowed to him by way of set off against any subsequent call.

4. **Power to transfer of moneys due to company** (Section 471) : The Tribunal may order any contributory, purchaser or other person from who any money is due to the company to pay the money into the public account of India in the Reserve Bank of India instead of to the liquidator.

5. **Power to exclude creditors** (Section 474) : The Tribunal may fix a time or times within which creditors are to prove their debts or claims. In such a case, if the creditors fail to

establish their claims in time, they may be excluded from the benefit of any distribution made.

6. **Adjustment of rights of contributors** (Section 475) : The Tribunal, may in the event of assets being insufficient to satisfy the liabilities, make an order for the payment out of the asset, of the costs, charges and expenses incurred in the winding up, in such order of priority inter se as the Tribunal thinks just.

7. **Power to order costs** (Section 476) : The Tribunal may, in the event of assets being insufficient to satisfy the liabilities, make an order for the payment out of the asset, of the costs, charges and expenses incurred in the winding up, in such order of priority inter se as the Tribunal thinks just.

8. **Power to summon persons** (Section 477) : The Tribunal may summon before it any officer of the company or person known or suspected to have in his possession any property or books or papers of the company or known or suspected to be indebted to the company. Any such person may be examined on oath. The Tribunal may also require him to produce any books and papers in his custody or power relating to the company; but where he claims any lien on books or papers produced by him, the production must be without prejudice to that lien.

9. **Power to order public examination of promoter, directors etc** (section 478) : Where the Official Liquidator has made a report to the Tribunal, stating that in his opinion a fraud has been committed by any person in the promotion or formation of the company, or by any officer of the company since its formation, the Tribunal may direct that person or officer may appear before the Tribunal and be publicly examined. Statement so recorded shall be open to the inspection of any creditor or contributory at all reasonable times.

10. **Power to order the appointment of a committee of inspection :** The Tribunal may order for the appointment of a committee of inspection under Sec.464 to act with the liquidator.

11. **Power to arrest a contributory** (Section 479): At any time (either before or after making a winding up order), the Tribunal may, on proof of probable cause for believing that a contributory is about to quit India or otherwise to abscond or is about to remove or cancel any of his property, for the purpose of evading payment of calls or of avoiding examination in respect of the affairs of the company, cause : (a) the contributory to the arrested and safely kept until such time as the Tribunal may order; and (b) his books and papers and movable property be seized and safely kept until such time as the Tribunal may order.

12. **Power to order for dissolution of the company** (Section 481) : When the affairs of a company have been completely wound up or when the Tribunal is of the opinion that the liquidator cannot proceed with the winding up of a company for want of funds and assets or for any other reason what so ever and it is just and reasonable in the circumstances of the case that an order of dissolution of the company. If he makes a default in forwarding a copy as aforesaid, he shall be punishable with fine which may extent to **Rs.500 for every day** during which the default continues.

On the expiry of 5 years from the date of dissolution, the name of the company should be struck off the Registrar. But within 2 years of the date of the dissolution on application by the liquidator of the company or by any other person who appears to the Tribunal to be interested, the Tribunal may make an order, upon such terms as the Tribunal thinks fit, declaring the dissolution to have been void. After such an order is passed, such proceedings may be taken as might have been taken if the company had not been dissolved.

14.6.4. Consequences of Winding up Order :

Once the Tribunal makes an order for the winding up of a company, the consequences date back to the commencement of winding up. The other consequences of winding up by the Tribunal are as follows :

1. **Intimation to Official Liquidator and Registrar** : Where the Tribunal makes an order for the winding up of a company, it shall forthwith cause intimation to be sent to the Official Liquidator and the Registrar of the order of winding up.

2. **Copy of winding up order to be filed with the Registrar** : On the making of the winding up order it shall be the duty of the petitioner and of the company to file with the Registrar within 30 days a certified copy of the order.

3. **Order for winding up deemed to be notice of discharge** : The order for winding up shall be deemed to be notice of discharge to the company is continued. Where a servant of the company is on a contract of service for a fixed term and that term has not expired on the date of the order of the winding up of the company, the order operates as a wrongful discharge and damages are allowed for breach of contract of service and the servant is free from his agreement not to compete with the company.

4. **Suits Stayed** : When the Tribunal has been made, no suit or other legal proceeding shall be commenced against the company except by leave of the Tribunal. Similarly pending suits shall not be proceeded with except by leave of the Tribunal.

5. **Powers of the Tribunal** : Where the Tribunal is winding up the company, shall have jurisdiction to entertain, or dispose of :
   (a) any suit or proceeding by or against the company;

(b) any claim made by or against the company;
(c) any application made under Section 391 for compromise with creditors and / or members :
(d) any question of priorities or any other question whatsoever, whether of law or fact, which may relate to or arise in course of the winding up of the company.

6. **Effect of winding up order** : An order for winding up a company shall operate in favour of all the creditors and of all the contributories of the company as if it had been made on their joint petition.

7. **Official liquidator to be liquidator** : On a winding up order being made in respect of a company, the Official liquidator shall, by virtue of his office, become the liquidator of the company.

14.7. LIQUIDATOR – DUTIES AND POWERS

14.7.1 Official Liquidator :

For the purpose of winding up of companies by Tribunal an official liquidator may be appointed. An official liquidator includes the following

(a) a panel of professional firms of chartered accountants, advocates, company secretaries, cost and works accounts or firms having a combination of these professions which the Central Government constitute for the Tribunal;
(b) may be a body corporate consisting of such professionals as may be approved by the Central Government from time to time.
(c) May be a whole-time or part-time office approved by the Central Government.

On a winding up order being made in respect of a company, the Official Liquidator shall, by virtue of his office, become the liquidator of the company.

14.7.2 Provisional Liquidator :

At any time after the presentation of a winding up petition and before the making of a winding up order, the Tribunal may appoint the Official Liquidator to be the liquidator provisionally.

A provisional liquidator is as much a liquidator in winding up. In fact, the name provisional liquidator is only a convenient label. He has the same powers and to the extent these powers and to the extent these powers imply duties, the same duties as a liquidator in a winding up. The Tribunal may limit and restrict his powers by the order appointing him or by a subsequent order. Otherwise, he has the same powers as a liquidator has.

14.7.3 Notice to company :

Before appointing a provisional liquidator, the Tribunal shall give notice to the company and give a reasonable opportunity to it to make its representations. If the Tribunal thinks fit, it may dispense with such notice; but in that case, it shall in writing record the special reasons for not giving the notice.

On a winding up order being made by the Tribunal, the Official liquidator shall cease to hold office as provisional liquidator and shall become the liquidator of the company.

14.7.4 Duties of Liquidator :

1. **Proceedings in winding up** : The liquidator shall conduct the proceedings in winding up the company and perform duties imposed by the Tribunal. The acts of the liquidator shall be valid not withstanding any defect that may afterwards be discovered in his appointment or qualification.

2. **Liquidator's Report :** The Official Liquidator shall as soon as practicable after receipt of the statement of affairs of the company and not later than 6 months from the date of the order of winding up, submit a preliminary report to the Tribunal. The report shall contain particulars–
   (a) as to the amount of the capital issued, subscribed, and paid-up, and the estimated amount of assets and liabilities.
   (b) If the company has failed, as to the cause of the failure; and
   (c) Whether, in his opinion, further inquiry is desirable as to any matter relating to the promotion, formation, or failure of the company, or the conduct of business thereof.

   The Official liquidator may, if he thinks fit, make further reports stating the manner in which the company was promoted or formed. He may further state if any fraud has been committed by any person in company's promotion or formation, or since the formation thereof. He may also state any other matters which it is desirable to bring to the notice of the Tribunal. If in any further report the Official liquidator states that a fraud has been committed, the Tribunal shall have the further powers provided in Section 478 as to the public examination of promoters and officers.

3. **Custody of company's property** : Where a winding up order has been made or where a provisional liqudiator has been appointed, the liquidator / provisional liquidator shall take into his custody all the property, effects and actionable claims to which the company is entitled. So long as there is no liquidator, all the property and effects of the company shall be deemed to be in the custody of the Tribunal.

4. Control of liquidator's powers : (1) The liquidator shall, in the administration of the assets of the company and the distribution thereof among creditors, have regard to any directions which may be given by resolution of the creditors or contributors at any general meeting or by the committee of inspection. Any directions by the creditors or contributors at any general meeting shall override any directions given by the committee of inspection.

5. Meeting of creditors and contributors : The liquidator may summon general meetings of the creditors or contributors whenever he thinks fit for the purpose of ascertaining their wishes. He shall summon such meetings at such times as the creditors or contributories may by resolution direct, or whenever requested in writing to do so by not less than $1/10^{th}$ in value of the creditors or contributories, as the case may be.

6. Directions from the Tribunal : The liquidator may apply to the Tribunal for directions in relation to any particular matter arising in winding up. He shall also use his own discretion in the administration of the assets of the company and in the distribution thereof among the creditors.

7. Maintenance of books : The liquidator shall keep proper books for making entries or recording minutes of the proceedings at meetings and such other matters as may be prescribed. Any creditor or contributory may, subject to the control of the Tribunal inspect any such books personally or by his agent.

8. Audit of accounts : The liquidator shall, at such times as may be prescribed but at least twice each year during his tenure of office, present to the Tribunal an account of his receipts and payments as liquidator. The account shall be in the prescribed form, shall be made in duplicate, and shall be duly verified. The Tribunal shall cause the account to be audited. For the purpose of the audit, the liquidator shall furnish the Tribunal with such vouchers, information and the books as the Tribunal may require. One copy of the audited accounts shall be filed delivered to the Registrar for filing. Each copy shall be open to the inspection of any creditor, contributory or person interested.

The liquidator shall cause the audited account or its summary to be printed. He shall send a printed copy of the account or its summary by post to every creditor and to every contributory. The Tribunal, however, may dispense with compliance with this provision.

9. Committee of Inspection : The Tribunal may at the time of making an order for the winding up of a company, or at any time thereafter, direct that there shall be appointed a Committee of Inspection to act with the liquidator.

10. Pending Liqudiation : The liquidator shall, within 2 months of the expiry of each year from the commencement of winding up, file a statement duly audited by a qualified auditor of the company, with respect to the proceedings in, and position of the liquidation. The statement shall be filed

(a) in the case of a winding up by the Tribunal, in Tribunal; and
(b) in the case of a voluntary winding up, with the Registrar.

When the statement is filed in Tribunal, a copy shall simultaneously be filed with the Registrar and shall be kept by him along with the other records of the company.

14.7.5 Powers of liquidator :

The following are the powers of the liquidator in the process of winding up of a company.

I. Powers exercisable with the sanction of the Tribunal : The liquidator in a winding up by the Tribunal shall have power, with the sanction of the Tribunal, -

1. To institute or defend suits and other legal proceedings. civil or criminal, in the name and on behalf of the company.
2. To carry on the business of the company so far as may be necessary for the beneficial winding up of the company.
3. To sell the immovable and movable property and its actionable claims with power to transfer the whole or sell the same in parcels.
4. To raise money on the security of the company's assets. The assets include all contributions which the liquidator is entitled to get from the members, past or present, as well as all assets which have been misappropriated as against creditors
5. To do all such other things as may be necessary for winding up the affairs of the company and distributing its assets.

II. Powers exercisable without the sanction of the Tribunal : The liquidator in a winding up by the Tribunal shall have power, without the sanction of the Tribunal, -

(a) to do all acts and to execute documents and debts on behalf of the company under its seal;
(b) to inspect the records and returns of the company or the files of the Registrar without payment of any fee :
(c) to prove, rank and claim in the insolvency of any contributory for any balance against his estate and to receive dividends;
(d) to draw, accept, make and endorse any bill of exchange, hundi or promissory note on behalf of the company in the course of its business;
(e) to take out, in his official name, letters of administration to any deceased contributory, and to do any other act necessary for obtaining payment of any money due from a contributory or his estate;
(f) to appoint an agent to do any business which he is unable to do himself.

III. **Powers exercisable in case of onerous contracts** : The term 'onerous' means a right to property, (e.g., a lease), in which the obligations attaching to it exceed the advantage to be derived from it. The liqudiator may, with the leave of the Tribunal, disclaim onerous contracts, and properties. However, this shall be done within 12 months after the commencement of the winding up, unless the Tribunal extends time.

14.8. ORDER OF PAYMENT

The liquidator is required to follow the following order only in the payment the amount available for distribution among various claimants.

1. Secured creditors
2. Legal charges
3. Remuneration to Liquidator
4. Liquidation expenses
5. Preferential creditors
6. Debentureholders or other creditors having floating charge on the asset of the company.
7. Unsecured creditors
8. Preference shareholders
9. Equity shareholders

If there is any surplus after making the above payments, it will go to equity shareholders unless it has been specifically mentioned that preference shares are participating preference shares. If the preference shares are participating, then they are entitled to get their share in the surplus left after paying the equity capital.

14.8.1 Secured Creditors:

Secured creditors may be fully secured or partly secured. If they are fully secured, the value of security offered to them would be more than the amount due. But in case of partly secured creditors, the value of security would be less than the amount due to them. In such a case, the partly secured creditors are secured to the extent of the value of security offered to them. For the remaining balance due to them, they will be treated as unsecured creditors.

14.8.2 Costs of Liquidation:

The cost of liquidation includes the following.

a. **Legal expenses:** During the period of winding up, the company will have to spend a lot a amount for legal expenses. These expenses are to be met first before making payment to other liabilities.

b. Liquidation expenses

c. Liquidator's remuneration

14.8.3 Liquidator's remuneration:

Liquidator will be paid remuneration on the assets realised by him and payment to unsecured creditors. Sometimes, he may paid for distributing to the contributories also.

For calculating the remuneration on asset realised the following points are to be remembered.

(i) Remuneration on Assets Realised:

While calculating the remuneration on assets realised the following points are to be considered.

- **(a) Securities under the position of Secured Creditors:** If the liquidator realises the assets add it to the asset realised. If the secured creditors realise these assets, it need not be added to assets realised.
- **(b) Cash:** Cash need not be included in assets realised, unless mentioned specifically or given directly.
- **(c) Surplus from Securities:** It need not be included in the assets, unless specifically mentioned.

(ii) Liquidator's remuneration on Payment to Unsecured Creditors:

Sometimes liquidator is given remuneration on the amount distributed to unsecured creditors also. Unless otherwise stated the unsecured creditors includes preferential creditors also. The remuneration is to be calculated taking into account the solvency and insolvency of the company.

(a) In case the company is solvent =

$$\text{Amount due to Unsecured creditors} \times \frac{\text{percentage of remuneration}}{100}$$

(b) If the company is insolvent and the funds are not sufficient to pay to

$$\text{Amount available to Unsecured Creditors} \times \frac{\text{Percentage of remuneration}}{100 + \text{percentage of remuneration}}$$

unsecured creditors fully:

14.8.4 Preferential Creditors:

According to Section 530 of the Companies Act, Preferential creditors are those creditors who have to be paid before any payment is made to any creditors except the cost of liquidations and the remuneration payable to the liquidator. Such preferential creditors or payments are:

(i) All revenues, taxes, cesses and rates due from the company to the Central or a State Government or to a local authority and having become due and payable including the advance Income tax payable within the twelve months next before the commencement of winding up.

(ii) All wages, salaries whether payable for part or full time work, commission to any employee due for period not exceeding four months – within the 12 months next before the commencement of the winding up of the company and any compensation payable to a worker under the Industrial Disputes Act, 1947. The amount payable to any individual worker **should not exceed Rs.20,000.**

(iii) All accrued holiday remuneration payable to any employee or in the case of his death to any other person in this right.

(iv) All amounts payable by the company to an employee under the Employees' State Insurance Act, 1948, unless the company is being would up voluntarily for the purpose of reconstruction and amalgamation.

(v) All amounts payable by the company to an employee under the Workers' Compensation Act, 1923.

(vi) All sums due to an employee from the provident fund pension fund, gratuity etc. maintained by the company for the welfare of the employees.

(vii) The expenses of any investigation held in pursuance of sec.235 or sec.247 in so far as they are payable by the company.

The above debts shall rank equally among themselves and be paid in full unless the assets are insufficient in which case proportionate amount will be payable to them.

Overriding Preferential payment (Sec.529A) :

The Companies (Amendment) Act, 1985 introduced a new Section 529A. The section gives priority in payment to workmen's dues and debts due to secured creditors to the extend they could not be paid because of the former ranking pari passu with the latter. The section provides as follows.

1. Notwithstanding anything contained in any other provisions of this Act or any other law for the time being in force in the winding up of a company : (a) workmen's dues; and (b) debts due to secured creditors to the extent such debts rank under clause (c) of the provision to sub-section (1) of Section 529 pari passu with such dues, shall be paid in priority to all other debts.

   The act has specifically excluded the following persons from the definition of workman :

   (a) A person who is subject to the Army Act, 1950 or the Air Force Act, 1950 or the Navy (Discipline) Act, 1934.
   (b) A person who is employed in the police service or as an officer or other employee of a prison.
   (c) © A person who is employed mainly in a managerial or administrative capacity.
   (d) A person who is employed in a supervisory capacity and draws wages exceeding Rs.1,600 per month or exercise functions mainly of a managerial nature.

2. The debts payable under clause (a) and clause (b) of sub-section (1) shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

14.8.5 Unsecured Creditors:

After paying the preferential creditors, next come unsecured creditors. They are to be paid fully if sufficient amount is there. While coming to the interest on Debentures or other creditors, the interest is to be paid up the date of winding up if the company is solvent.

14.8.6 Payment of Preference shareholders – Arrears of Preferential Dividend:

If the Articles of Association is silent regarding the payment of arrears of dividend, arrears need not be paid. But if ordinary shareholders are receiving the surplus after receiving capital repayment, it is not reasonable to pay surplus to ordinary shareholders, without paying arrears of dividend to preference shareholders. In such a case, arrears of dividend must be paid, even if the Articles is silent.

14.8.7 Repayment to Preference Shareholders:

If the cash available is not sufficient to pay off the preference shareholders and if there is uncalled amount on the ordinary shares, the calls must be made, to pay of the preference share capital.

14.8.8 Capital repayment to ordinary shareholders:

If there are more than two classes of ordinary shareholders first we have to bring all the shareholders as equal sufferers. Therefore, the excess amount paid by one class of shareholders must be repaid and calls must be made on which calls in arrears are there.

If the preference shareholders have no prior right for repayment of capital, the amount available after payment of liability must be paid pro-rata. That is to be done according to capital paid-up ratio.

14.9. STATEMENT OF AFFAIRS

According to Sec.454 the company shall submit a statement to the Official Liquidator as to the affairs of the company within 21 days of the relevant date (i.e., the date of the appointment of a provisional liquidator, or where no such appointment is made, the date of winding up order), The Tribunal may in its discretion direct that the company need not submit this statement.

14.9.1 Contents of the Statement of Affairs :

The statement shall be in the prescribed form, verified by affidavit. It should be contain the following particulars :

1. The assets of the company, showing separately cash in hand and at bank and negotiable securities;
2. Its debts and liabilities;
3. Names, residences and occupations, of its creditors, stating separately the amount of secured and unsecured debts;
4. In the case of secured debts, particulars of the securities held by the creditors, their value and dates on which they were given;
5. The debts due to the company and names and the addresses of persons from whom they are due and the amount likely to be realized;
6. Such further information as may be required by the Official Liquidator.

The Official Liquidator or the Tribunal may extend the period of 21 days for the submission of the statement to a maximum period of 3 months.

14.9.2 Who is to submit the statement?

The statement shall be submitted and verified by one or more of the persons who are at the relevant date directors and by the person who is at that date the manager, secretary or other chief officer of the company. The Official Liquidator may also require any of the following persons to submit and verify the statement. The persons required to submit and verify the statement may be :

(a) present or past officers of the company;
(b) persons who have taken part in the formation of the company at any time within one year before the relevant date;
(c) present employees or employees within 1 year before the relevant date, and who are capable of giving the information required;
(d) employees and officers of another company which is or was within one year before the relevant date, an officer of the company to which the statement relates.

14.9.3 Committee of Inspection :

According to Sec.464 the Tribunal may, at the time of making an order for the winding up of a company or at any time thereafter, direct that there shall be appointed a committee of inspection to act with the liquidator. The liquidator shall then within 2 months from the date of such direction convene a meeting of the creditors of the company for the purpose of determining the membership of the committee.

Within 14 days of the creditors' meeting, the liquidator shall call a meeting of the contributories to consider the decision of the creditors with respect to the membership of the committee. The contributories may accept the decision of the creditors with or without modification or reject it. If the contributories do not accept with or without modification or reject it. If the contributories do not accept the decision of the creditors, the liquidator shall apply to the Tribunal for directions as to what shall be the composition of the committee and who shall be its members.

14.9.4 Constitution and proceedings of the Committee of Inspection :

The committee of inspection shall not have more than 12 members. The members shall be creditors and contributories of the company, in such proportions as may be agreed on by the meetings of creditors and contributories. In case of difference of opinion between creditors and contributories, the proportion shall be determined by the Tribunal (Sec.465).

14.9.5 Powers of the Committee :

The committee of inspection shall have the right to inspect the accounts of the liquidator at all reasonable times. It shall meet at appointed times. The liquidator or any member of the committee may also call its meeting as and when he thinks necessary. The quorum of its meeting shall be $1/3^{rd}$ of the total number of the members or two whichever is higher. It may act by a majority of its members present at a meeting, but it shall not act unless a quorum is present.

14.9.6 Dissolution of Companies (Sec.481)

Dissolution puts an end to the existence of a company. A company which has been dissolved no longer exists as a separate entity capable of holding property of being sued in the Tribunal. **(Employers' Liability Assurance Corpon Vs. Sidgwick Collins & Co. (1927).**

Grounds for dissolution : The Tribunal shall make an order for the dissolution of a company.

1. when the affairs of the company have been completely wound up, or
2. when the Tribunal is of opinion that the liquidator cannot proceed with the winding up for want of funds and assets, or
3. for any other reason

The Tribunal shall make an order for the dissolution of the company only when it is just and reasonable in the circumstances of the case that such an order should be made. The company shall be dissolved from the date of the order of the Tribunal. Within 30 days of the order of the Tribunal, the liquidator shall send a copy of the order to the Registrar who shall make in his books a minute of the dissolution of the company.

14.10. CONTRIBUTORY

14.10.1 Definition of contributory (Sec.428) :

The term `contributory' means every person liable to contribute to the assets of a company in the event of its being would up and includes the holder of any shares which are fully paid.

14.10.2 List of contributories :

The list of contributories shall be prepared in two parts, viz., List A and List B.

a. **List A :** List A shall include the present members of the company, i.e., embers whose names appear in the company, i.e., members whose names appear in the company's register of members at the time of the winding up of the company.

b. **List B :** List B shall include the past members of the company, i.e., members who ceased to be members within one year preceding the commencement of the winding up of the company.

14.10.3 Liability of contributories (Sec.426)

In the event of a company being wound up every present and past member shall be liable to contribute to the assets of the company to an amount sufficient –

(a) for payment of (I) its debts and liabilities and (ii) costs, charges and expenses of the winding up, and
(b) for the adjustment of the rights of the contributories among themselves.

14.10.4 Liability of present members :

The liability of a present member (i.e., List A contributory) shall be limited

1. in the case of a company limited by shares, to the amount remaining unpaid on the shares; and
2. in the case of a company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up

14.10.5 Liability of past members :

A past member (i.e., List B contributory) shall not be liable to contribute –

1. if he has ceased to be a member for 1 year or more before the commencement of the winding up ;
2. in respect of any debt or liability of the company contracted after he ceased to be a member;
3. if it appears to the Tribunal that the present members will be able to satisfy the contributions required to be made by them.
   Where there have been several transfers of the same shares within a year before the winding up, the primary liability is that of the latest transferor in case of default by the A list contributories.

14.10.6 Ex-contractu and ex-lege liability :

According to Sec.429, the liability of a member to be included in the list of contributories is not **ex-contractu**, i.e., it does not arise as a result of the contract of membership. His liability is **ex-lege** which means that it arises by reason of the fact that his name appears in the register of members even though the allotment to him was void or that he had sold his shares to a purchaser who has not got his name registered in the register. In the absence of rectification of the register, his liability is absolute under Sec.429.

14.11. VOLUNTARY WINDING UP

Section 484 to Section 520 deals with voluntary winding up of companies. Voluntary winding up means winding up by the members or creditors of a company without interference by the Tribunal. The object of a voluntary winding up is that the company, i.e., the members as well as the creditors, are left free to settle their affairs without going to the Tribunal.

14.11.1 Circumstances in which a company may be wound up voluntarily

A company may be wound up voluntarily in two ways.

1. **By passing an ordinary resolution :** When the period, if any, fixed for the duration of a company by the Articles has expired, the company in general meeting may pass an ordinary resolution for its voluntary winding up. The company may also do so when the event, if any, on the occurrence of which the Articles provide that the company is to be dissolved, has occurred.

2. **By passing a special resolution :** A company may at any time pass a special resolution that it be wound up voluntarily. No reasons need be given where the members pass a special resolution for the voluntary winding up of the company. Even the Articles cannot prevent the exercise of this statutory right.

14.11.2 Commencement of voluntary winding up (Section 486).

A voluntary winding up shall be deemed to commence at the time when the resolution (ordinary or special, as the case may be) for its voluntary winding up is passed.

14.11.3 Modes of Voluntary Winding up :

A voluntary winding up may be a :

1. Members' voluntary winding up, or
2. Creditors' voluntary winding up

14.12. MEMBERS VOLUNTARY WINDING UP

14.12.1 Declaration of solvency

In a voluntary winding up of a company, if a declaration of its solvency is made in accordance with the provisions of section 488, it is a members' voluntary winding up. The declaration shall be made by a majority of the directors at a meeting of the Board that the company has no debts or that it will be able to pay its debts in full within 3 years from the commencement of the winding up. The declaration shall be verified by an affidavit.

Effect of Declaration : The declaration shall have effect only when it is –

(a) made within five weeks immediately before the date of the resolution, and delivered to the Registrar for registration before that date; and

(b) accompanied by a copy of the report of the auditors of the company on (i) the profit and loss account of the company from the date of the last profit and loss account to the latest practicable date immediately before the declaration of solvency, (ii) the balance Sheet of the company, and (iii) a statement of the company's assets and liabilities as on the last mentioned date.

14.12.2 Annual and final meeting in case of insolvency (Section 498) :

If in the case of a members' voluntary winding up, the liquidator finds that the company is insolvent, shall apply as if the winding up were a creditors' voluntary winding up and not a members' voluntary winding up. It should be noted that in such a case Sections 508 and 509 shall apply to the exclusion of Sections 496 and 497.

14.13. CREDITORS' VOLUNTARY WINDING UP

Section 500 to Sec.509 deals with Creditors voluntary winding up of a company. The procedure in a creditors' voluntary winding up is based upon the assumption that the company is insolvent. From the beginning, meetings of creditors are held in addition to those of the members. The chief power to appoint the liquidator is in the hands of the creditors and there is provision for the appointment of a committee of inspection, if desired.

14.13.1 Meeting of Creditors (Section 500) :

When no statutory declaration of solvency has been made and filed as required by the Act, the Board of Directors, acting on behalf of the company must summon a meeting of the creditors, for the same day or the next day after the meeting at which the resolution for voluntary winding up is to be proposed.

14.13.2 Notice to Registrar :

A copy of any resolution passed at the Creditors' meeting must be filed with the Registrar within 10 days of the passing thereof. If default is made then the company and every guilty officer shall be punishable with fine which may extend to Rs.500 for every day of the default (Section 501).

14.13.3 Appointment of Liquidator (Section 502) :

The creditors and the members at their respective first meetings may nominate a person to be liquidator for the purpose of winding up the affairs and distributing the assets of the company. If the creditor and the members nominate different persons, the creditor's nominee will be the liquidator. But any director, member or creditor may apply to the Tribunal for an order that the company's nominee or the Official Liquidator or some other person should be appointed. If no person is nominated by the creditors, the members' nominee shall be the liquidator.

14.13.4 Committee of inspection (Section 503).

The creditors at their first or any subsequent meeting may, if they think fit, appoint a committee of inspection of not more than five members. The powers of such committee are the same, as those of a Committee of Inspection appointed in compulsory winding up of companies.

14.13.5 Fixing of Liquidator's remuneration (Section 504) :

The Remuneration to be paid to the liquidator or liquidators has to be fixed by the committee of inspection or if there is no much committee, by the creditors. Where the remuneration is not so fixed, it must be determined by the Tribunal.

14.13.6 Board's power to cease on appointment of Liquidator (Section 505) :

On the appointment of liquidator, all the powers of the Board of Directors shall cease, except in so far as the committee of inspection, or if there is not such committee, the creditors in general meeting, may sanction the continuance thereof.

14.13.7 Duty of Liquidator to call meeting of company

In the event of the winding up continuing for more than one year, the liquidator must call a general meeting of the company and a meeting of the creditors at the end of the first year, from the commencement of the winding up and at the end of each succeeding year, or as soon thereafter as may be convenient within 3 months from the end of the year or such longer period as the Central Government may allow. Further, he may lay before the meeting an account of his acts and dealings and of the conduct of winding up during the preceding year, together with a statement in the prescribed form and containing the prescribed particulars with respect to the proceedings and position of the winding up.

14.13.8 Final meeting and dissolution (Section 509) :

As soon as the affairs of the company are fully wound up, the liquidator must:

(a) make up an account of the winding up, showing how the winding up has been conducted and the property of the company has been disposed of; and

(b) call a general meeting of the company and a meeting of the creditors for the purpose of laying the account before the meeting and giving any explanation thereof.

Within one week after the date of the meetings, the liquidator shall send to the Registrar and the Official Liquidator a copy of the account and a return of the meeting held.

The Official Liquidator, after scrutiny of the books and papers of the company, shall make a report to the Tribunal. If this report states that the affairs of the company have not been conducted in a manner prejudicial to the interest of the company or public then from the date of the submission of the report the company shall be deemed to be dissolved; otherwise the Tribunal will ask Official Liquidator to make further investigation and may, after that report, order that the company shall stand dissolved from the specified date

14,13.9 Distinction between Members' voluntary Winding up and Creditor's Voluntary Winding up

Basis of Difference	Members' Voluntary winding up	Creditors' voluntary winding up
1. Declaration of solvency	Members' voluntary winding up can be resorted to by solvent companies and thus requires the filing of a 'declaration of solvency' by the directors of the company with the Registrar;	Creditor's winding up, on the other hand, is resorted to by insolvent companies.
2. Creditors Meeting	In members' voluntary winding up there is no need to have creditors meeting.	But in the case of creditors' voluntary winding up, a meeting of the creditors must be called immediately after the meeting of the members.
3. Appointment of Liquidator	Liquidator, in the case of members' winding up is appointed by the members.	But in the case of creditors' voluntary winding up, if the members and creditors nominate two different persons as liquidators, creditor's nominee shall become the liquidator.
4. Appointment of Committee Inspection	In the case of members' voluntary winding up, there is no provision for any such committee.	In the case of creditors' voluntary winding up, if the creditors so wish a 'Committee of Inspection' may be appointed.

14.14. CONSEQUENCES OF WINDING UP

14.14.1 Consequences as to shareholders :

In a company limited by shares, a shareholder is liable to pay the full amount up to the face value of the shares held by him. His liability continues even after the company goes into liquidation, but he is then described as a contributory. A contributory may be present or past. In a company limited by guarantee, the members are liable to contribute up to the amount guaranteed by them.

14.14.2 Consequences as to creditors :

1. **where the company is solvent :** Where a company is being wound up, all debts payable on a contingency and all claims against the company, present or future, certain or contingent ascertained or sounding only in damages shall be admissible to proof against the company. A just estimate of the value of such debts or claims shall be made. Where a solvent company is wound up, all claims of creditors, when proved, are fully met.

2. **Where the company is insolvent :** Where a company is insolvent and is wound up the same rules shall prevail as in the case of insolvency with regard to :
   (a) debts provable;
   (b) the valuation of annuities and future and contingent liabilities;
   (c) the respective rights of secured and unsecured creditors;

   The security of every secured creditor shall, however, be deemed to be subject to a pari passu charge in favour of the workmen to the extent of the workmen's portion therein. Where a secured creditor instead of relinquishing his security and providing his debt, opts to realise his security.

   (a) the liquidator shall be entitled to represent the workmen and enforce the workmen's charge.
   (b) Any amount realised by the liquidator by way of enforcement of the workmen's charge shall be applied rateable for the discharge of workmen's dues; and
   (c) The debt due to the secured creditor or the amount of the workmen's portion in his security shall rank pari passu with the workmen's dues for the purposes of Sec.529 A (which deals with overriding preferential payments).

All persons who in any such case would be entitled to prove for and receive dividends out of the assets of the company may come in under the winding up, and make such claims against the company as they are entitled to make.

Secured and Unsecured creditors :

The creditors may be secured or unsecured. A secured creditor has 3 alternative before him.

(i) He may relay on his security and ignore the liquidation

(ii) He may value his security and prove for the deficit

(iii) He may surrender his security and prove for the whole debt.

If a secured creditor instead of relinquishing his security and proving his debt proceeds to realise his security, he shall be liable to pay his portion of the expenses incurred by the liquidator (including a provisional liquidator if any) for preservation of the security before its realisation by the secured creditor.

14.14.3 Consequences as to costs :

If assets are the insufficient to satisfy liabilities, the Tribunal may order for payment of the costs, charges and expenses of the winding up out of the assets of the company. The payment shall be made in such order of priority inter se as the Tribunal thinks just. Similarly, all costs, charges expenses properly incurred in a voluntary winding up, including the remuneration of the liquidator, shall be paid out of the assets of the company in priority to all other claims. The payment shall, however, be subject to the rights of secured creditors.

14.15 QUESTIONS

A. Short Answer Questions.

1. What is winding up of a company?
2. What is just and equitable?
3. Who is a contributory?
4. Who is a liquidator?
5. What is statement of affairs?
6. What is liquidators' statement of account?
7. What is voluntary winding up?
8. What is members' voluntary winding up?
9. What is creditors' winding up?
10. What is declaration of solvency?
11. What is the liability of List A contributories?
12. State the liability of List B contributories?

B. Essay Questions :

1. What do you understand by the Liquidator's final statement of Account? Give a proforma of such an account with imaginary figures.

2. Difference between liquidation?
3. Enumerate the duties of a liquidator.
4. In which situation company may go into liquidation?
5. What are liquidation expenses?
6. Explain the meaning of Preferential Creditors.
7. How are statement of affairs and deficiency account prepared?
8. What do you mean by the term “contributory”? Describe the various types of contributors.
9. Distinguish between liquidation and insolvency
10. How and why the statement of affairs is prepared? Give the Proforma of statement of Affairs with imaginary figures.

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Chapter – 15

LIQUIDATOR'S FINAL STATEMENT OF ACCOUNT

Objectives :

After going through this unit you should be able to

- observe the proforma relating to liquidator's final statement of account.
- Understand various lists in the presentation of statement of affairs.

Structure :

15.1 Liquidator's Final Statement of Account
15.2 Presentation of Lists and Statement of Affairs
15.3 Self Assessment Questions
15.4 Exercises
15.5 Reference books

15.1 LIQUIDATOR'S FINAL STATEMENT OF ACCOUNT

The form of liquidator's Final Statement of Account has been prescribed by the Supreme Court. It takes a form of cash account showing receipts of realizations on the left hand side and various payments on the right hand side. The amount is not built up on the basis of double entry. Hence there is no debit side or credit for the Account.

Statement of affairs
Statement of affairs of …… Ltd as on …..

					Estimated realisable Value Rs.
Assets not specifically pledged (as per List A):					
Balance at bank	….	….	….	….	
Cash in hand	….	….	….	….	
Marketable Securities	….	….	….	….	
Bills receivable	….	….	….	….	
Trade debtors	….	….	….	….	
Loans & Advances	….	….	….	….	
Unpaid calls	….	….	….	….	
Stock in Trade	….	….	….	….	

					Estimated realisable Value Rs.
Work in Progress:	....	....	....	....	
…………………	....	....	....	....	
	....	....	....	....	
…………………	....	....	....	....	
Freehold Property	....	....	....	....	
Land and Buildings	....	....	....	....	
Leasehold property	....	....	....	....	
Plant & Machinery	....	....	....	....	
Furniture, Fittings, Utensils etc.	....	....	....	....	
Investments other than securities	....	....	....	....	
Live stock	....	....	....	....	
Other property etc.	....	....	....	....	
………	....	....	....	....	
	....	....	....	....	
………	....	....	....	....	
Assets specifically pledged (as per List B)	(a) Estimated realisable values	(b) Due to secured creditors	(c) Deficiency making as unsecured	(d) Surplus carried to last column	
	Rs.	Rs.	Rs.	Rs.	
Freehold property:					
……………….					
………………					
Estimated surplus from assets specifically pledged					
Estimated total assets available for preferential creditors, debentureholders secured by a floating charge, and unsecured creditors (carried forward)					
Summary of Gross Assets:					
Gross realisable value of assets specifically pledged					x x x
Other assets					x x x
Gross assets					**x x x**

Gross Liabilities.	Liabilities		Rs.
	Liabilities (to be deduced from surplus **or added to deficiency as the case may be)**		
x x x	Secured Creditors (as per List B) to the extent to which claims are estimated to be covered by assets specifically pledged (Insert in Gross Liabilities column only)		
x x x	Preferential Creditors (as per List C):		x x x
	Estimated balance of assets available for Debentureholders secured by a floating charge and unsecured creditors		
x x x	Debentureholders secured by a floating charge (as per List D)		x x x
x x x	Estimated Surplus/Deficiency as regard Debentureholders		
x x x	Unsecured Creditors (as per List E):		
	Trade Creditors	x x x	
	Bills payable	x x x	
	Outstanding expenses	x x x	x x x
	Estimated Surplus/Deficiency as regards Creditors (being difference between Gross assets and Gross Liabilities)		x x x
	Issued and Called-up Capital:		
	…….. Preference shares of ….. each Rs….. called up (as per List F)	x x x	
	….. Equity shares of….. Rs…. called up (as pre list G)	x x x	
		x x x	x x x
	Estimated Surplus/Deficiency as regards members (as per List H)		x x x

15.2 PRESENTATION OF LISTS AND STATEMENT OF AFFAIRS :

The details of the particulars to be given in the statement of affairs can be summarized as follows :

1. **List A :** This consists of all free assets, i.e., assets not specifically pledged in favour of any creditor. Assets against which there is a floating charge will also be included in this list. Calls in arrears will also come in this category to the extent they are realizable. However, uncalled capital should not be included in this list.

2. **List B :** This consists of assets pledged specially in favour of certain creditors. Any excess of the realizable value of the assets over the amount due should be shown

separately as given in the prescribed form of the statement of affairs. In case of deficiency, the amount of such deficiency has to be included in list E i.e., unsecured creditors. For example building worth Rs.20,000 has been mortgaged in favour of bank for a loan of Rs.30,000 the bank is unsecured to the extent of Rs.10,000, and therefore, this amount will be included in List E of unsecured creditors.

3. **List C :** This consists of preferential creditors, i.e., creditors, who are unsecured but are entitled to priority in payment over creditors having floating charge and other unsecured creditors. A list of preferential creditors has already been given earlier in the chapter.

4. **List D :** This consists of those creditors who have floating charge over the asserts of the company. Usually in this list, debenture-holders are included since they are generally presumed to have a floating charge over the assets of the economy. Trade creditors, bills payable, liability for bills discounted (to the extent of possible loss on account of dishonour of the bills), creditors on open account etc., come in this category.

5. **List F :** This consists of holders of the preference share capital of the company. They are to be taken at a value which is left after unrealizable calls in arrears.

6. **List G :** This consists of holders of the equity share capital of the company. The amount due to them is to be arrived after deducting from the called up share capital, any unrealizable amount of calls in arrears.

7. **List H :** This explain the reasons for the surplus or the deficiency as shown by the statement of affairs. Earlier this list used to be in the form of ledger account. Of course, it is still termed as a Deficiency or Surplus Account but it is shown in the form of a statement. The period covered by this account must commence on a date not less than three years before the date of winding up order (or the order appointing Provisional Liquidator, or the date directed by the official liquidator), or if the company has not been incorporated, for the whole of that period, the date of formation of the company, unless the official liquidator otherwise agrees.

Illu.1: The following information was extracted from the books of Dogma company limited on 31st December, 2009 on which date a winding up order was made:

	Rs.
Cash in hand	**5,000**
Stock-in-trade (estimated to produce Rs.15,000)	**20,000**
Fixture & Fittings (estimated to produce Rs.2,100)	**3,000**
Plant and Machinery	**15,000**
Freehold Land and Buildings (estimated to produce Rs.45,000)	**30,000**

	Rs.
Book debts (Estimated to produce Rs.5,200)	**6,200**
Unsecured Creditors	**70,000**
Preferential Creditors	**2,000**
Creditors fully secured (value of securities Rs.11,000)	**9,000**
Creditors fully secured (value of securities Rs.6,000)	**10,000**
Bank Overdraft , secured by a second charge on all the asses of the company	**8,000**
10% Debentures secured by floating charge on all the assets of the company (interest paid to date)	**50,000**
Equity share capital – 6,000 shares of Rs.10 each	**60,000**
11% Preference share capital – 6,500 shares of Rs.10 each	**65,000**
Cash in Arrear on equity shares (Estimated to produce Rs.1,000)	**2,500**
Make out statement of Affairs as regards Creditors and Contributors	

Solution:

Statement of Affairs of Dogma Company Ltd.

as on 31 December, 2009

					Estimated Realisable Value Rs.
Assets not specifically pledged (as per List A):					
Cash in hand					5,000
Sundry Debtors					5,200
Calls in Arrear					1,000
Stock-in-trade					15,000
Freehold Land and Buildings					45,000
Plant and Machinery					15,600
Fixtures & Fittings					2,100
					88,900
Assets specifically pledged (as per List B):					
	Estimated realisale value Rs.	Due to secured creditors Rs.	Deficiency ranking as unsecured Rs.	Surplus carried to last column Rs.	
	11,000	9,000	--	2,000	
	6,000	10,000	4,000	--	
	17,000	19,000	4,000	2,000	
Estimated surplus from assets specifically pledged					2,000

		Estimated Realisable Value Rs.
Estimated total assets available for preferential creditors, debenture-holders and bank overdraft secured by a floating charge and unsecured creditors		90,900
Summary of Gross Assets	Rs.	
Gross realisable value of asses specifically pledged	17,000	
Other Assets	88,900	
	1,05,900	

Gross Liabilities Rs.	Liabilities		Rs.
15,000	Secured Creditors (as per list B) to the extent to which claims are estimated to be covered by assets specifically pledged		--
2,000	Preference Creditors (as per list C)		2,000
	Estimated balance of assets available for debenture holders and bank overdraft secured by a floating charge, and unsecured creditors		88,900
50,000	Debenture holders (as per list D)		50,000
			38,900
8,000	Bank overdraft (as per list D)		8,000
	Estimated surplus as regards debenture holders and bank overdraft		30,900
	Unsecured creditors (as per list E)		
		Rs.	
	Unsecured Creditors	70,000	
74,000	Estimated unsecured balance of claims of creditors partly secured on specific assets	4,000	74,000
1,49,000	Estimated deficiency as regards creditors (being the difference between gross liabilities and gross assets)		43,100
	Issued and called up capital:		
	6,500 preference shares of Rs.10 each fully paid (as per list F)		65,000
	6,000 Equity shares of Rs.10 each, fully called up (as per list G)	60,000	
	Less: Irrecoverable unpaid calls	1,500	58,500
	Estimated deficiency as regards members or contributories (as per list H)		1,66,600

List H – Deficiency or Surplus Account

	Rs.
Items contributing to Deficiency:	
1. Excess (if any) of Capital and Liabilities over Assets on the …….. as shown by Balance sheet	x x x
2. Net dividends and bonuses declared during the period from …… to the date of statement	x x x
3. Net trading Losses (after charging items shown in note to follow) for the same period	x x x
4. Losses other than trading losses written off or for which provision has been made in the books during the same period	x x x
5. Estimated losses now written off or for which provision has been made for the purpose of preparing the statement	x x x
6. Other items contributing to Deficiency or reducing surplus	x x x
	x x x
Items reducing Deficiency or contributing to Surplus:	
7. Excess (if any) of Assets over Capital and Liabilities on the … to the date of statement	x x x
8. Net trading profits (after charging depreciation, taxation, interest on debentures etc.)	x x x
9. Profits and income other than trading profits	x x x
10. Other items reducing deficiency – profit expected to realisation of land	x x x
Deficiency as shown by the Statement of Affairs	x x x

Deficiency account (List H)

		Rs.
I.	**Items contributing to deficiency**	
	Excess of capital and liabilities over assets	
	Net dividend and bonus declared during the period	
	Net trading losses after charging depreciation, taxation, interest on debentures etc. interest on debentures for 1 month)	
	Losses other than trading losses written off or for which provision has been made in the books during the same period:	
	Speculation loss	
	Penalty imposed by excise authorities	

		Rs.
	Estimated losses now written off for which provision has been made for the purpose of preparing the statement:	
	Bills receivable	
	Debtors	
	Stock	
	Contingent Liabilities of bills discounted	
	Total	
II.	**Items reducing Deficiency**	
	Excess of assets over capital and liabilities on…… as shown in the Balance Sheet (General Reserve)	
	Net trading profits (after charging depreciation taxation, interest on debentures etc.)	
	Profits and income other than trading profits	
	Other items reducing deficiency – profit expected on realisation of land	
	Total	
	Deficiency as shown by the statement of affairs (I-II)	

Liquidator's Final Statement of Account

	Rs.		Rs.
Assets realized		Secured creditors	
Unpaid calls at commencement of winding up		Liquidation expenses	
Amount received from calls on contributories made in winding up		Liquidators remuneration	
		on assets realised	
		on Preferential Creditors	
		on Unsecured Creditors	
Reciepts from trading a/c		Debentures	
Other receipts		Creditors	
		a. Preferential Creditors	
		b. Unsecured Creditors	
		Returns to Contributories	
Less: Payment to redeem securities			
Cost of execution			
Payment as per Trading a/c			
Net realizations			

Illu.2 : ABC Co. Ltd., went into voluntary liquidation. Its assets realized Rs.7,00,000. The following was the position.

	Rs.
Share capital : 1,000 shares of Rs.100 each	**1,00,000**
Secured creditors (Securities realized Rs.80,000)	**70,000**
Preferential creditors	**12,000**
Unsecured creditors	**2,80,000**
Debentures having a floating charge	**5,00,000**
Liquidation expenses	**10,000**
Liquidators remuneration	**15,000**

Prepare the Liquidators' final statement of Account

Solution :

Liquidator's Final Statement of Account of ABC Company Ltd.

	Rs.		**Rs.**
To Assets realized	7,00,000	By Liquidator's remuneration	15,000
To Surplus from secured creditors	10,000	By Liquidation expenses	10,000
		By Debentures	5,00,000
		By Preference shareholders	12,000
		By Unsecured creditors (61.79% of Rs.2,80,000)	1,73,000
	7,10,000		**7,10,000**

Illu.3 : XYZ Co. Ltd., went into liquidation with the following liabilities.

(a) Secured creditors Rs.20,000 (Securities realized Rs.25,000)
(b) Preferential creditors Rs.600.
(c) Unsecured creditors Rs.30,500.

Liquidation out of the pocket expenses amounted to Rs.252. The liquidator is entitled to a remuneration of 3% on the amount realized (including securities in the hands of creditors) and 1½% on the amount distributed to unsecured creditors. The various asserts (excluding securities in the hands of secured creditors) realized Rs.26,000.

Prepare Liquidator's account showing the compensation given to unsecured creditors.

Solution :

Liquidator's Final Statement of Account of XYZ Company Ltd.

	Rs.		**Rs.**
To Assets realized	26,000	By Liquidator's remuneration	1,962
To Surplus from secured creditors	5,000	By Liquidation expenses	252
		By Preference shareholders	600
		By Unsecured creditors (92.41% of Rs.30,500)	28,186
	31,000		**31,000**

Notes : Calculation of Liquidator's Remuneration :

		Rs.
1.	3% on the amount of Assets realized (Rs.26,000 + 25,000) x 3/100	1,530
2.	On Unsecured Creditors 1.5% = Rs.600 x 1.5/100	9
3.	On unsecured creditors 1.5% (Rs.28,609 x 1.5/100 + 1.5)	423
		1,962

Illu.4 : Hema Company Ltd., went into voluntary liquidation on 31-12-2009. When the statement affairs was as below.

Unsecured creditors Rs.40,000 (including Rs.5,000 preferential claims). Secured creditors (secured on plant and machinery) Rs.20,000; Cash in hand Rs.1,000.

The liquidator realized plant and machinery for Rs.15,000 and the other assets realized Rs.10,000. The liqudation expenses amounted to Rs.1,000 and the liquidator's remuneration was fixed at 4%of the amount realized including cash balance and 2% of the amount distributed to unsecured creditors including preferential creditors.

Prepare liquidators final statement of account.

Solution :

Liquidator's Final Statement of Account of Hema Company

	Rs.		**Rs.**	**Rs.**
To Assets realized		By Secured Creditors		15,000
Plant and machinery	15,000	By Liquidation expenses		1,000
Other assets	10,000	By Liquidator's remuneration		

	Rs.		**Rs.**	Rs.
Cash in hand	1,000	4% on Rs.26,000	1,040	
		2% on Rs.5,000	100	
		2% on Rs.3,860	76	1,216
		By Preferential creditors		5,000
		By Unsecured creditors		3,784
	26,000			**26,000**

Illu.5: The following particulars relate to X Ltd., which has gone into voluntary liquidation. You are required to prepare the Liquidator's final account allowing for his remuneration at 2% on the amount realised, and 2% on the amount distributed among unsecured creditors other than preferential creditors.

	Rs.
Preferential Creditors	**10,000**
Unsecured Creditors	**32,000**
Debentures	**10,000**
The assets realised:	
Land and Buildings	**20,000**
Plant & Machinery	**18,650**
Fixtures	**1,000**

The liquidator's expenses amounted to Rs.1,000.

Solution:

X Company Ltd.
Liquidator's Final Statement of Account

	Rs.		Rs.	Rs.
Assets realized :		Liquidator's Remuneration:		
Land and Buildings	20,000	on assets realised	793	
Plant and machinery	18,650	on unsecured creditors	350	1,143
Fixtures	1,000	Liquidation expenses		1,000
		Preferential creditors		10,000
		Debentureholders		10,000
		Unsecured creditors		17,507
	39,650			39,650

Working Notes:

Calculating of Liquidator's Remuneration:

a. 2% on the amount of assets realised i.e., Rs.39,650 × $^{2}/_{100}$ = Rs.793

b. On unsecured creditors = Rs.17,857 × $^{2}/_{102}$ = Rs.350

Amount available with the Liquidator:

	Rs.	Rs.
Amount on the assets realised		39,650
Less: (1) Liquidation Expenses	1,000	
(2) Liquidator's Remuneration		
(a) On Assets realised	793	
(b) On preferential creditors		
(3) Amount paid to pref.creditors	10,000	
(4) Amount paid to Debentureholders	10,000	21,793
Amount available with the Liquidator		17,857

Actual amount payable to unsecured creditors Rs.32,000

Amount available with the Liquidator Rs.17,857

Since the amount available with the liquidator is not sufficient to pay the unsecured creditors, the liquidator's remuneration should be calculated as follows.

i.e., Rs.17,857 × $^{2}/_{102}$ = Rs.350

The amount available to unsecured creditors = Rs.17,857 – 350 = Rs.17,507

Illu.6 : A company went into liquidation on 31st December, 2009 when the following balance sheet was prepared.

Liabilities	Rs.	Rs.	Assets	Rs.
Authorised capital			**Goodwill**	**50,000**
30,000 shares of Rs.10 each		**3,00,000**	**Leasehold property**	**48,000**
Paidup capital			**Machinery**	**65,500**
19,500 shares @ Rs.10 each		**1,95,000**	**Stock**	**56,800**
Creditors			**Debtors**	**64,820**
Preferential	**24,200**		**Cash**	**2,500**
Partly secured	**55,310**		**Profit and Loss a/c**	**98,680**
Unsecured	**99,790**	**1,79,300**		
Bank overdraft (unsecured)		**12,000**		
		3,86,300		**3,86,300**

The liquidator realized the following assets : Leasehold property which was used in the first instance to pay partly secured.

	Rs.
Creditors to prorate	**35,000**
Machinery	**51,000**
Stock	**39,000**
Debtors	**58,500**
Cash	**2,500**

The expenses of liquidation came to Rs.1,000 and the liquidator's remuneration was agreed at 2 ½% on the amount realized, including cash and 2% on the amount paid to the unsecured creditors.

You are required to prepare the liquidator's final account showing the distribution.

Solution

Liquidator's Final Statement of account

Receipts	**Rs.**	**Payments**	**Rs.**	**Rs.**
To Assets realized		By Secured Creditors		35,000
Leasehold property	35,000	By Liquidators' remuneration		
Plant and machinery	51,000	2 ½% of Rs.1,86,000	4,650	
Stock	39,000	Amount paid to preference creditors	484	
Debtors	58,500	Payment of unsecured creditors	2,366	7,500
		By Liquidation expenses		1,000
		By Preferential creditors		24,200
		By Secured creditors		1,18,300
	1,86,000			**1,86,000**

Working Notes :

1. Amount payable partly secured creditors Rs.55,310. amount realized on securities Rs.35,000. Hence, the remaining amount Rs.20,310 (Rs.55,310 – Rs.35,000) becomes unsecured creditors.

2. Total Amount payable to Unsecured creditors :

	Rs.
Unsecured Creditors	99,790
Overdraft	12,000
Partly secured creditors	20,310
	1,32,100

3. Amount available for unsecured creditors :

	Rs.	Rs.
Assets realized		1,86,000
Less : Miscellaneous expenses other than		
Liquidator's remuneration		60,200
(Rs.35,000 + 1,000 + 24,200)		
		1,25,800
:Less : Liquidator's remuneration :		
On Assets realized	4,650	
On payment of Preferential creditors	484	5,134
Amount available for unsecured creditors		1,20,666

Amount payable to unsecured creditors Rs.1,32,100. The amount available as surplus amounts to Rs.1,20,666 only. This amount is to be distributed the liquidator and the unsecured creditors. Since the amount is not sufficient the liquidator remuneration is to be calculated in the following way.

Rs.1,20,666 x 2 / 100+2 = Rs.2,366

4. Amount payable to unsecured creditors = Rs.1,20,66 – Rs.2,366 = Rs.1,18,300.

Illu.7: The capital of Delta Company which went into liquidation was as follows:

a. **4,000 equity shares of Rs.100 each, fully paid,**

b. **3,000 equity shares of Rs.100 each, Rs.80 per share pai dup.**

c. **1,000 preference shares of Rs.100 each fully paid (these have preference in the repayment of capital)**

d. **1,000 deferred shares of Rs.100, Rs.80 per share paid up (these to be repaid only after satisfying the claims of equity shareholders). The various remuneration of Rs.2,500. The liquidator made a call of the remaining Rs.20 per share on the deferred shares which was paid in full. He also realised all the assets amounting to Rs.1,91,000.**

A call of Rs.15 per share was made on the equity shares which were partly paid up. This was paid in full, with the exception of that on 100 shares which shares forfeit the right of refund of capital.

Prepare the liqudiator's account showing the return to the shareholders.

Solution:

Delta Company Ltd.
Liquidator's Final Statement of Account

Receipts	Rs.	Payments	Rs.
To Assets realised	1,91,000	By Liquidator's remuneration	2,500
To call on 1,000 deferred shares @ Rs.20 per share	20,000	By Creditors	97,500
To Call money received on 2,900 equity shares @ Rs.15 per share	43,500	By Preference shareholders	1,00,000
		By Equity shareholders:	
		On 4,000 shares @ Rs.10 per share	40,000
		On 2,900 shares @ Rs.5 per share: (Rs.95 paid up)	14,500
	2,54,500		2,54,500

Illu.8: The following is the Balance Sheet of Unfortunate Ltd. as at 31st March, 2010

Liabilities	Rs.	Assets	Rs.
Share Capital:		**Land & Buildings**	**2,00,000**
4,000, 6% preference share of Rs.100 each, fully paid up	**4,00,000**	**Plant & Machinery**	**5,00,000**
2,000 Equity shares of Rs.100 each, Rs.75 per share paid up	**1,50,000**	**Patents**	**80,000**
6,000 Equity shares of Rs.100 each, Rs.60 per share paid up	**3,60,000**	**Stock at cost**	**1,10,000**
5% debentures (having a floating charge on all assets)	**2,00,000**	**Sundry Debtors**	**2,20,000**
Interest accrued on Debentures (also secured as above)	**10,000**	**Cash at bank**	**60,000**
Sundry Creditors	**2,90,000**	**Profit and Loss Account**	**2,40,000**
	14,10,000		**14,10,000**

On that date, the company went into Voluntary Liquidation. The dividends on preference shares were in arrears for the last two years. Sundry Creditors include a loan of Rs.1,00,000 on mortgage of Land and Buildings. The assets realised were as under:

	Rs.
Land & Buildings	**2,40,000**
Plant & Machinery	**4,00,000**
Patents	**60,000**
Stock	**1,20,000**
Debtors	**1,60,000**

The expense of Liquidation amounted to Rs.21,800. The Liquidator is entitled to a remuneration of 3% on all the assets realised (except cash at bank) and 2% on the amounts distributed among equity shareholders. Preferential creditors included in sundry creditors amount to Rs.30,000. All payments were made on 30-9-2010. Prepare the liquidators' final statement of account.

Solution:

Liquidator's Final Statement of Accounts of Unfortunate Ltd.

Receipts	Rs.	Payments	Rs.	Rs.
Cash at Bank	60,000	Liquidation Expenses		33,200
Debtors	1,60,000	Liquidator's Remuneration:		21,800
Stock	1,20,000	5% Debentures	2,00,000	
Patents	60,000	Add: Interest	15,000	2,15,000
Plant & Machinery	4,00,000	Preferential Creditors		30,000
Surplus from Secured	1,40,000	Unsecured Creditors		1,60,000
		Preference Share holders	4,00,000	
		Add: Dividend	48,000	4,48,000
		Equity shareholders:		
		Rs.15.25 per share on 2,000 shares, Rs.75 paid up		30,500
		Re.0.25 per share on 6,000 shares Rs.60 paid up		1,500
	9,40,000			9,40,000

Working Notes:

a.	Liquidator's remuneration	Rs.
	3% on Rs.9,80,000	29,400
	2% on Rs.1,90,000	3,800
		33,200
b.	Total equity capital paid up	5,10,000
	Less : Balance available for refund to equity shareholders	32,000
	Loss to be borne by equity shareholders	4,78,000

Loss per share = $\frac{4,78,000}{(2,000+6,000)} = Rs.59.75$

On 2,000 shares @ Rs.75 paid up share

Refund work out to Rs.75 – Rs.59.75 = Rs.15.25

On 6,000 shares Rs.60 paid up per share :

Refund work out to Rs.60 – Rs.59.75 = Rs.0.25

Illu.9: Kiran Processors Ltd., went into voluntary liquidation on 31st March, 2010 when their balance sheet read as follows.

Liabilities	Rs.	Assets	Rs.
Issued and subscribed capital		**Land and buildings**	**5,00,000**
		Plant and machinery	**12,50,000**
10,000, 10% cumulative preference shares of Rs.100 each fully paid	**10,00,000**	**Patents**	**2,00,000**
		Stock	**2,75,000**
		Sundry Debtors	**5,50,000**
5,000 equity shares of Rs.100 each, Rs.75 paid	**3,75,000**	**Cash at bank**	**1,50,000**
		Profit and Loss a/c	**5,62,500**
15,000 equity shares of RS.100 each, Rs.60 paid	**9,00,000**		
15% Debentures secured by a floating charge	**5,00,000**		
Interest outstanding on debentures	**75,000**		
Creditors	**6,37,500**		
	34,87,500		**34,87,500**

Preference dividends were in arrears for 2 years and the creditors included preferential creditors of Rs.76,000. The assets realized as follows.

Land and buildings Rs.6,00,000, plant and machinery Rs.10,00,000, patents Rs.1,50,000, Stock Rs.3,00,000. Sundry debtors Rs.4,00,000

The expenses of liquidation amounted to Rs.54,500. The liquidator is entitled to a commission of 3% on assets realized except cash. Assuming the final payments including those on debentures is made on 30th June, 2010. Show the liquidators final statement of account.

Solution :

Liquidators' Final Statement of Account

Receipts	Rs.	Payments	Rs.
To Assets realized		By liquidation expenses	54,500
Land and buildings	6,00,000	By Liquidators remuneration	73,500
Plant and machinery	10,00,000	By Debenture holders	6,12,500
Patents	1,50,000	By Preferential creditors	76,000
Stock	3,00,000	By Unsecured creditors	5,61,500
Debtors	4,00,000	By Preference shareholders	
Cash	1,50,000	(10,00,000 + 2,00,000)	12,00,000
To Calls in arrears		By Equity shareholders	
5,000 equity shares of Rs.2.65 each	39,750	5,000 equity shares of Rs.12.35 each	61,750
	26,39,750		26,39,750

Working Notes :

1. Liquidator's remuneration :

(Rs,6,00,000 + 10,000,000 + 1,50,000 + 3,00,000 + 4,00,000)
= Rs.24,50,000 x 3/100 = Rs.73,500

2. Amount payable to debentureholders :

	Rs.
Debentures	5,00,000
Add : Interest outstanding	75,000
Interest due upto 30-6-2010	37,500
	6,12,500

3. Value of unsecured creditors = Rs.6,37,500 – Rs.76,000 = Rs.5,61,500

4. Amount available to equity shareholders :

5.

	Rs.
Assets realized (including cash)	26,00,000
Less : Payments	25,78,000
	22,000
Add : Equity shares 15,000 @ Rs.15	2,25,000
Balance available to equity shareholders	2,47,000

Illu.10: A limited company went into voluntary liquidation with the following liabilities:

	Rs.	Rs.
Trade Creditors		**12,000**
Bank Overdraft		**20,000**
Capital:		
10,000 preference shares of Rs.10 each, Rs.7 called up		**70,000**
10,000 equity shares of Rs.10 each, Rs.9 called up	**90,000**	
Less: Calls in arrears	**2,000**	**88,000**
Cash received in anticipation of calls:		
On preference shares	**24,000**	
On ordinary shares	**4,000**	**28,000**

The assets realised Rs.2,00,000. Expenses of liquidation amounted to Rs.2,000 and liquidator's remuneration Rs.3,000. Prepare liquidator's final account.

Solution:

Liquidator's Final Statement of Account

	Rs.		Rs.
To Assets Realised	2,00,000	By Liquidator's Remuneration	3,000
To Calls in Arrears	2,000	By Expenses of liquidation	2,000
		By preference Creditors	---
		By Debentures	---
		By Trade Creditors (20,000+12,000)	32,000
		By preference share holders (24,000 + 59,938)	83,938
		By Equity shareholders (4,000 + 77,062)	81,062
	2,02,000		2,02,000

Working Notes:

	Rs.	Rs.
Assets realized		2,00,000
Add; Calls in arrears		2,000
		2,02,000
Less : Liquidator's remuneration	3,000	
Liquidation expenses	2,000	
Unsecured creditors	32,000	
Payment of calls in advance		
Preference shareholders	24,000	
Equity shareholders	4,000	65,000
		1,37,000

Note : In the problem it was stated that the preference shareholders do not have preferential rights. As such the remaining amount is to be distributed among equity and preference shareholders in their capital ratio. (70,000 : 90,000).

Illu.11: The Food Ltd., went into voluntary liquidation on 31st December, 2009. The balance sheet in its book on that date were :

Liabilities	Rs.	Assets	Rs.
Share Capital		**Land and buildings**	**2,50,000**
5,000 6% Cumulative	**5,00,000**	**Plant and machinery**	**6,25,000**
preference shares of		**Patents**	**1,00,000**
Rs.100 each		**Stock**	**1,37,500**
2,500 equity shares of	**1,87,500**	**Sundry Debtors**	**2,75,000**
Rs.100 each		**Cash at bank**	**75,000**
7,500 equity shares of		**Profit and loss**	**3,00,000**
Rs.100 each Rs.60 paid	**4,50,000**		
5% Mortgage debentures	**2,50,000**		
Interest outstanding	**12,500**		
Creditors	**3,62,500**		
	17,62,500		**17,62,500**

The liquidator is entitled to a commission of 3% on all assets except cash and 2% on amounts distributed among unsecured creditors other than preferential creditors. Creditors include preferential creditors Rs.37,500 and a loan for Rs.1,25,000 secured by a mortgage on land and buildings. The preference dividends were in arrears for two years. The assets realized as follows :

	Rs.
Land and buildings	**3,00,000**
Plant and machinery	**5,00,000**
Patents	**75,000**
Stock	**1,50,000**
Sundry debtors	**2,00,000**
The expenses of liquidation	**27,250**

Prepare liquidator's statement of account.

Solution :

Liquidator's Final Statement of Accounts of The Food Ltd.

Receipts	Rs.	Payments	Rs.	Rs.
To Assets realized		By Secured creditors		1,25,000
Land and buildings	3,00,000	By Liquidator's remuneration		
Plant, machinery	5,00,000	3% on Assets realization	36,750	
Patents	75,000	2% on Unsecured creditors	4,000	40,750
Stock	1,50,000	By Liquidation expenses		27,250
Sundry debtors	2,00,000	By Preferential creditors		37,500
Cash	75,000	By Debentures	2,50,000	
		Add : Interest	12,500	2,62,500
		By Unsecured creditors		2,00,000
		By Preference shareholders		5,00,000
		By equity shareholders :		
		2,500 shares @ Rs.21.95 each	54,875	
		7,500 shares @ Rs.6.95 each	52,125	1,07,000
	13,00,000			13,00,000

Illu.12 : The Books of Trillian Paints Company showed the following balances on 31-3-2010.

Liabilities	Rs.	Assets	Rs.
Authroised, Issued capital		**Preliminary expenses**	**5,000**
15,000 shares @ Rs.10		**Patent rights**	**1,50,000**
each fully paid up	**1,50,000**	**Plant and Machinery**	**40,000**
Sundry Creditors	**1,40,000**	**Stock**	**20,000**
		Debtors	**60,000**
		Cash	**250**
		Profit and Loss a/c (Dr.)	**14,750**
	2,90,000		**2,90,000**

Due to fall in the value of patent rights and the scarcity of working capital the company was forced to go for reconstruction. The following scheme was suggested to the shareholders and creditors.

1. **The company has to go into voluntary liquidation . For this purpose Rainbow paints (2010) Ltd., will be formed with Rs.3,00,000 nominal capital and all the assets and liabilities are to be sold to this company.**

2. **The preferential creditors are to be paid fully for Rs.1,500. The creditors are to be issued debentures worth Rs.78,500 par value at 6%. The remaining creditors of Rs.60,000 agreed to settle their account by accepting cash to take Re.0.50 for each rupee**
3. **The shareholders of old company will receive 15,000 shares of Rs.10 each as Rs.5 paid per each share in a new company. The remaining Rs.5 is to be paid on allotment.**
4. **Liquidator remuneration of Rs.1,000 and his expenses Rs.960 are to be paid as part of purchase consideration of new company.**

All the unsecured creditors agreed for the above proposals. However, 1,000 equity shareholders did not agree and handed over their shares to the liquidator for selling at Rs.3.75 per each share. Prepare Liquidator's receipts and payments account for its presentation in the meeting of shareholders.

Solution :

Liquidator Final Statement of Account of Trillian Paints Company Ltd.

Receipts	Rs.	Payments	Rs.
To Assets realized		By Liquidator Remuneration	1,000
To 15,000 shares @ Rs.5 each	75,000	By Liquidation expenses	960
To 6% Debentures	78,500	By Preferential creditors	1,500
To Cash	33,460	By 6% Debentures	78,500
To Cash (Dissenting shareholders)	3,750	By Unsecured creditors	30,000
		By Equity share holders	75,000
		15,000 shares @ Rs.5 each	
		By Dissenting shareholders	3,750
	1,90,710		1,90,710

Working Notes :

		Rs.	Rs.
1.	6% Debentures		78,500
2.	15,000 shares @ Rs.10 each Rs.5 paid up		75,000
3.	Cash :		
	Preferential creditors	1,500	
	Unsecured creditors		
	Rs.60,000 each @ Rs.0.50	30,000	
	Liquidators remuneration	1,000	
	Liquidation expenses	960	33,460
	Dissenting shareholders (1,000 x 3.75)		3,750
			1,90,710

Illu.13:A company went into voluntary liquidation on 31st March, 2010, when the following balance sheet was prepared.

Liabilities	Rs.	Assets	Rs.
Issued capital :		**Goodwill**	**3,000**
1,452 shares of Rs.10 each	**14,520**	**Leasehold property**	**2,500**
Sundry creditors :		**Plant and machinery**	**3,740**
Sundry unsecured creditors	**7,716**	**Stock**	**5,855**
Sundry partly secured creditors	**2,918**	**Sundry debtors**	**4,622**
Sundry preferential creditors	**405**	**Cash**	**50**
Bank overdraft (unsecured)	**116**	**Profit and Loss a/c**	**5,908**
	25,675		**25,675**

The Liquidator realized the assets as follows : Leasehold property which was used in the first instance to pay partly secured.

	Rs.
Creditors prorate	**1,800**
Plant and machinery	**2,500**
Stock	**3,100**
Sundry debtors	**4,350**
Cash	**50**

The expenses of liquidation amount to Rs.50 and the liquidation remuneration was agreed to 2 ½% on the amount realized and 2% on the amount paid to unsecured creditors. Prepare the liquidator's final statement of account.

Solution :

Liquidator's Final Statement of Account

Receipts	**Rs.**	**Rs.**	**Payments**	**Rs.**	**Rs.**
To Assets realized			By Liquidation expenses		50
To Leasehold property	1,800		By Liquidation remuneration		
Less : Sundry partly secured creditors	1,800	-	(a) On Assets realization	294	
Plant and machinery		2,500	(b) Preferential creditors	8	
Stock		3,100	(c) On Unsecured creditors	179	481
Debtors		4,530	By Preferential creditors		405
Cash		50	By Unsecured creditors		8,950
			By Equity shareholders (share of Rs.0.0785 each)		114
		10,000			10,000

Working Notes :

1. Liquidator's Remuneration :

a,. On Assets realization = 2 ½ %Commission

Assets realization = Rs.1,800 + 2,500 + 3,100 + 4,350 = Rs.11,750 x 2.5/100 = Rs.294.75

b. On Preferential creditors = Rs.405 x 2/100 = Rs.8.10; Rs.8

c. On unsecured creditors = Rs.8,950 x 2/100 = Rs.179

2. Amount available to equity shareholders :

	Rs.
Total Receipts	11,800
Less : Total payments	11,686
Amount available with the liquidator	114

Illu.14: You are required by a liquidator of a company to prepare a statement of account to be laid before a meeting of the shareholders from the following:

Balance sheet of XYZ as on 1-1-2010

Liabilities	**Rs.**	**Assets**	**Rs.**
Share capital:		**Fixed Assets**	**4,00,000**
4,000 equity shares of Rs.100 each		**Book debts**	**3,00,000**
called up Rs.80	**3,20,000**		
1,000 preference shares of Rs.100		**Loss to date**	**1,00,000**
each called up Rs.70	**70,000**		
Secured loan from banks on			
building and machinery	**1,50,000**		
Trade creditors	**2,60,000**		
	8,00,000		**8,00,000**

The assets realized as follows : 1-4-2010, Book debts Rs.1,00,000. Expenses paid Rs.4,000, 1-6-2010 Fixed assets (final) Rs.3,00,000, Book debts Rs.1,00,000. 1-8-2010 book debts paid, payment Rs.50,000.

The liquidator is entitled to 5% on collections and 2% on the amount paid to equity shareholders. Prepare the statement on the assumption that disbursements are made in accordance with law as and when cash in available.

Solution:

Liquidator's Final Statement of Account

Date	**Receipts**	**Rs.**	**Date**	**Payments**	**Rs.**	**Rs.**
1-4-10	To Realisation of book debts	1,00,000	1-4-10	By liquidation expenses		4,000
				By liquidator commission 5%		5,000
				By Balance c/d		91,000
		1,00,000				**1,00,000**
1-6-10	To Balance b/d	91,000	1-6-10	By Liquidator's remuneration @ 5%		
	To Realisation of book debts	1,00,000		(a) 1,00,000 × 5/100	5,000	
	To Surplus from securities	1,50,000		5,882 × 2/100	118	5,118
				By Trade creditors		2,60,000
				By Preference shareholders		70,000
				By Equity shareholders		5,882
		3,41,000				**3,41,000**
1-8-10	To Realiation of book debts (final)	50,000	1-8-10	By Liquidator		
				(a) Rs.50,000 × 5/100	2,500	
				(b) Rs.46,569 × 2/100	931	3,431
				By share holders (equity share holders Rs.11.64 on 4,000 shares)		46,569
		50,000				**50,000**

Illu.15 : The Sunny Valley Mining Company Limited went into voluntary liquidation on 1st January 2010. The liquidator whose remuneration is 3% on assets realized and 2% on the amount distributed to shareholders, realized all the assets. The following is the position of the company on December 2009 :

	Rs.
Assets realized	**5,00,000**
Expenses of liquidation	**9,000**
Unsecured creditors	**68,000**
10,000 equity shares of Rs.10 each Rs.9 per share called up and paid up	**90,000**
5,000, 6% preference shares of Rs.30 each fully (dividend paid-up to 31st December 2008)	**1,50,000**
General reserve	**1,20,000**
Profit and loss account	**20,000**

Under the Articles of Association the preference shareholders have the right to receive 1/3rd of the surplus remaining after paying the equity share capital.

Solution:

Dr. Liquidator's Final Statement of Account Cr.

Particulars	Rs.	Particulars	Rs.	Rs.
Realization of assets	5,00,000	Liquidation expenses		9,000
		Liquidator's remuneration :		
		- On assets realized (Rs.5,00,000 × 3%)	15,000	
		- On amount available to shareholders (4,08,000 × 2/102)	8,000	23,000
		Unsecured creditors		68,000
		Preference shareholders		2,09,333
		Equity shareholders		1,90,667
	5,00,000			**5,00,000**

Calculation of remuneration on amount distributed to shareholders :

	Rs.	Rs.
Realization of assets		5,00,000
Less: Liquidation expenses	9,000	
Remuneration to liquidator on realization of assets	15,000	
Unsecured creditors	68,000	92,000
Amount available with liquidator for distribution among the shareholders		**4,08,000**

Liquidator's commission on payment to shareholders = 4,08,000 × 2/102 = Rs.8,000
Amount available with the liquidator after payment of commission = 4,08,000 – 8,000 = Rs.4,00,000.

	Rs.	Rs.
Amount available with liquidator		4,00,000
Less: Amount due on preference share capital		
(1,50,000 × 6%) + 1,50,000	1,59,000	
Amount due on equity share capital	90,000	2,49,000
Surplus		**1,51,000**

Share of preference shareholders in surplus Rs.1,51,000 × 1/3 = Rs.50,333
Share of equity shareholders in surplus Rs.1,51,000 × 2/3 = Rs.1,00,667
Total amount payable to preference shareholders = Rs.1,59,000 + 50,333 = Rs.2,09,333
Total amount payable to equity shareholders = Rs.90,000 + 1,00,667 = Rs.1,90,667.

Illu.16 : Balance Sheet of Siva Ltd. as on December 31, 2010:

	Rs.		Rs.
Share Capital:		**Sundry Assets**	**7,00,000**
10,000 9% preference		**Building**	**1,80,000**
shares of Rs.10 each	**1,00,000**		
20,000 equity shares of		**Profit and loss a/c**	**1,00,000**
Rs.10 each , fully paid	**2,00,000**		
10,000 equity shares of		**Preliminary expenses**	**20,000**
Rs.10 each, Rs.8 paid	**80,000**		
9% Debentures	**3,00,000**		
Bank overdraft	**1,20,000**		
Trade creditors	**1,50,000**		
Income tax due	**50,000**		
	10,00,000		**10,00,000**

The debentures were secured by a floating charge on all the assets of the company. The debenture holders appointed a receiver. A liquidator was also appointed, the company being voluntarily wound up. The receiver took charge of sundry assets amounting to Rs.5, 00,000 and sold them for Rs.4, 00,000. The building and the remaining sundry assets realised Rs.1, 20,000 and 2,80,000 respectively. The cost of the received amounted to Rs.2,000 and his remuneration to Rs.2, 500. The expenses of liquidation were Rs.3, 000 and the remuneration of the liquidator was Rs.2, 500.

Prepare the accounts to be submitted by the receiver and the liquidator.

Solution:

Dr. Receiver's Receipts and Payments a/c Cr.

Particulars	Rs.	Particulars	Rs.
Sundry assets realized	4,00,000	Cost of receiver	2,000
		Remuneration of receiver	2,500
		Income tax due (Preferential creditors)	50,000
		Debenture holders	3,00,000
		Balance to liquidator	45,500
	4,00,000		**4,00,000**

Liquidator's final statement of account

Particulars	Rs.	Particulars	Rs.
Surplus from receiver	45,500	Cost of liquidation	3,000
Assets realised :		Remuneration of liquidator	2,500
Buildings	1,20,000	Unsecured creditors ;	
Sundry assets	2,80,000	Trade creditors	1,50,000
		Bank overdraft	1,20,000
		Preference shareholders	1,00,000
		Equity shareholders (B/f)	70,000
	4,45,500		**4,45,500**

Working Notes :
Calculation of deficiency:

	Rs.
Paid-up capital on equity shares (2,00,000 + 80,000)	2,80,000
Less: Amount available with liquidator after payment to preference shareholders	70,000
Total deficiency to be borne by equity shareholders	**2,10,000**

$$\text{Deficiency per share} = \frac{2,10,000}{30,000\ \text{shares}} = \text{Rs.}7$$

Amount payable on share of Rs.10 paid-up (10 – 7) = Rs.3
Amount payable on share of Rs.8 paid-up (8 – 7) = Rs.1
$\therefore$ Total amount payable = (20,000 shares $\times$ 3) + (10,000 shares $\times$ 1) = Rs.70,000

Illu.17 : Rao Limited Balance Sheet as on 31st March 2010

Balance Sheet of P Ltd.

Liabilities	Rs.	Assets	Rs.
Share capital:		Fixed assets :	
1,000, 6% Preference shares		Machinery	1,90,000
of Rs.100 each fully paid	1,00,000		
2,000 equity shares of Rs.100 each fully paid	2,00,000	Furniture	10,000
2,000 equity shares of Rs.100 each, Rs.75 paid	1,50,000	Current assets :	
Loan – bank (secured on stock)	1,00,000	Stock	1,20,000
Current liabilities and provisions:		Debtors	2,40,000
Creditors	3,50,000	Cash at bank	50,000
Income-tax payable	10,000	Miscellaneous expenditure:	
		Profit and Loss a/c	3,00,000
	9,10,000		9,10,000

The company went into liquidation on 1st April 2010. The assets were realised as follows :

	Rs.
Machinery	1,66,000
Furniture	8,000
Stock	1,10,000
Debtors	2,30,000
Liquidation expenses amounted to	4,000

The liquidators are entitled to a commission at 2% on amount paid to unsecured creditors excluding preferential creditors. Calls on partly paid shares were made but the amount due on 200 shares were found to be irrecoverable. Prepare liquidator's final statement of account.

Solution:

Dr. Liquidator's final statement of account Cr.

Particulars	Rs.	Particulars	Rs.
To Cash in hand / bank	50,000	By Liquidation expenses	4,000
To Assets realised :		By Liquidator remuneration on payment to unsecured creditors (Rs.3,50,000 × 2%)	7,000
Machinery	1,66,000	By Preferential creditors (Income tax payable)	10,000
Furniture	8,000	By Trade creditors	3,50,000
Stock (Rs.1,10,000 – 1,00,000)	10,000	By Preference share holders	1,00,000
Debtors	2,30,000	By Equity shareholders Rs.10 on 2,000 shares	20,000
To Proceeds of call on1800 equity shares Rs.15	27,000		
	4,91,000		**4,91,000**

Working Notes :

	Rs.
Return per equity share :	
Cash available before paying preference shareholders (Rs.5,64,000 – 4,71,000)	93,000
Add: Notional calls on 1,800 shares Rs.25 (Rs.2,000 – 200 = 1,800)	45,000
	1,38,000
Less: Preference share capital	1,00,000
	38,000

$$\therefore \text{Return per share} = \frac{\text{Rs.38,000}}{\text{3,800 shares (4,000 - 200)}} = \text{Rs.10}$$

And loss per equity share = 100 – 10 = Rs.90

∴ On fully paid up equity share company has to pay Rs.10 (100 – 90) on per share and on partly paid up share the company has to received Rs.15 per share (90 – 75).

Illu.18 : The following particulars related to a company which has gone into voluntary liquidation. You are required to prepare the liquidators final statement of account allowing for his remuneration at 2 ¼% on the amount realised and 3% on the amount distributed to unsecured creditors.

	Rs.
Preferential Creditors	**15,000**
Unsecured Creditors	**48,000**
Debentures	**15,000**
Liquidation expenses	**2,000**
Assets Realised	**79,300**

Solution:

Dr. Liquidator's final statement of account Cr.

	Rs.		Rs.
To Assets realised	79,300	By Liquidation expenses	2,000
		By Liquidator remuneration (1784 + 1326)	3,110
		By Preferential creditors	15,000
		By Debentures	15,000
		By Unsecured creditors	44,190
	79,300		**79,300**

	Rs.	Rs.
Amount realized from Assets		79,300
Less: Payments		
Liquidation expenses	2,000	
Liquidator remuneration (79,300 × 9/4 × 1/100)	1,784	
Preferential creditors	15,000	
Debentures	15,000	33,784
Amount available to unsecured creditors		45,516
Remuneration @ 3% = 45,516 × 3/103		1,326
		44,190

Illu.19 : A Ltd., Company went voluntary liquidation having the following details :

	Rs.
Securities	**30,000 (realised Rs.37,500)**
Preferential Creditors	**9,000**
Unsecured creditors	**45,750**
Expenses of liquidation	**378**

The liquidator is entitled to a remuneration of 3% on the amount realized (including the securities in the hands of fully secured creditors) and 1 ½% on the amount

distributed to unsecured creditors. The assets (excluding securities in the hands of fully secured creditors) realized Rs.39,000. Prepare liquidators final statement of account.

Solution:

Dr. **Liquidator's Final Statement of Account** **Cr.**

	Rs.	Rs.		Rs.	Rs.
To Realization of assets		39,000	By Cost of liquidation		378
To Surplus received from secured creditors			By Liquidator's remuneration on realization of Assets (76,500 × 3/100)	2,295	
Securities realized	37,500		On preferential creditors (9,000 × 3/ 2 × 100)	135	
Less: Secured Creditors	30,000	7,500	On the amount paid to unsecured creditors	513	2,943
			By preferential creditors		9,000
			By Unsecured creditors		34,179
		46,500			**46,500**

Working Notes :

Calculation of liquidator's remuneration payable on unsecured creditors :

		Rs.	Rs.
Amount realized on assets (Rs.39,000 + 7,500)			46,500
Less:	Cost of liquidation	378	
	Remuneration on the assets realized	2,295	
	Remuneration on the amount paid to preference creditors	135	
	Paid to preferential creditors	9,000	11,808
	Amount available with liquidator		**34,692**

Since the amount available with the liquidator is not sufficient, liquidator's remuneration should be calculated using the following formula:

Liquidator's Remuneration :

$$\frac{\text{Amount available for unsecured creditors} \times \% \text{ of Commission}}{100 + \% \text{ of Commission}}$$

$$= \frac{34{,}692 \times 3 \times 2}{2 \times 203} = \text{Rs.}513$$

Illu.20 : Not so well Ltd., went into voluntary liquidation. The liquidator is entitled to a commission of 2% on the amount realised on assets and 2% on the amount distributed to unsecured creditors other than preferential creditors:

	Rs.
Unsecured creditors	**2,24,000**
Preferential creditors	**70,000**
Debentures	**75,000**
The assets realised as follows:	
Cash in hand	**20,000**
Land and Buildings	**1,30,000**
Plant and Machinery	**1,10,500**
Fixtures	**7,500**

The liquidation expenses amount to Rs.2,000. A call of Rs.2 per share on the partly paid 10,000 equity shares was made and duly paid except in case of one shareholder owing 500 shares.

Prepare liquidator 's final statement.

Solution:

Liquidator's Final Statement of Account

	Rs.		Rs.	Rs.
Assets realised	2,68,000	Liquidation expenses		2,000
Call money from partly paid up shares	19,000	Liquidator's commission		
		On assets realised	5,360	
		On amount paid to unsecured creditors	2,640	8,000
		Debentures having		75,000
		Preferential creditors		70,000
		Unsecured creditors		1,32,000
	2,87,000			**2,87,000**

Assets Realised :

	Rs.
Cash in hand	20,000
Land & Buildings	1,30,000
Plant & Machinery	1,10,500
Fixtures	7,500
	2,68,000

Liquidators commission on assets realised = Rs.2,68,000 × 2/100 = 5,360

Call on partly paid up shares = Rs.10,000 – 500 = 9,500 × 2 = 19,000

Liquidators Commission on unsecured creditors

	Rs.	**Rs.**
Amount available :		
Assets realised	2,68,000	
Call money	19,000	2,87,000
Amount Payable :		
Liquidation expenses	2,000	
Commission on assets	5,360	
Debentures	75,000	
Preferential Creditors	70,000	1,52,360
Amount available to unsecured creditors		1,34,640
Commission Rs.1,34,640 x 2/102		2,640
Paid to unsecured creditors		**1,32,000**

Illu.21 : Delta Co. Ltd. went into voluntary liquidation on 31.10.2010. Given below is its Balance Sheet as on that date :

Liabilities	**Rs.**	**Assets**	**Rs.**
2,000 equity shares of Rs.100 each	**2,00,000**	**Land and Buildings**	**1,40,000**
6% Debentures	**1,00,000**	**Machinery**	**60,000**
Secured loan (secured by machinery)	**50,000**	**Stock**	**1,22,500**
Sundry Creditors	**1,50,000**	**Debtors**	**1,10,000**
		Cash in hand	**2,500**
		Profit and loss a/c	**65,000**
	5,00,000		**5,00,000**

Other Information :

(i) **Sundry Creditors include Rs.6,000 outstanding salaries for six months at the rate of Rs.1,000 per month and also Rs.1,000 taxes payable to Government.**

(ii) **Assets realised as follows :**

	Rs.
Land and Buildings	**60,000**
Machinery	**63,500**
Stock	**90,000**

Debtors 40% of books value.

(iii) **Liquidation expenses amounted Rs.1,850.**

(iv) **Liquidator is eligible for a commission of 3% on the realised value of assets including cash in hand and 2% commission on the amount paid to unsecured creditors other than preferential creditors.**

(v) **Debenture holders were repaid on 31.12.2010 along with two months interest.**

Prepare liquidators final statement of account.

Solution:

Dr. Liquidator's Final Statement of Account Cr.

		Rs.		Rs.	Rs.
Assets realised :			Liquidation expenses		1,850
Land and Buildings		60,000	Preferential creditors		
Stock		90,000	Taxes		1,000
Debtors		44,000	Salaries		4,000
Cash in hand		2,500	Liquidation's remuneration		
Machinery	63,500		3% on Rs.26,000	7,800	
Less: Secured loan	50,000	13,500	2% on Rs.92,500	1,850	9,650
			6% Debentures	1,00,000	
			Add: 2 months interest	1,000	1,01,000
			Sundry creditors		92,500
		2,10,000			**2,10,000**

Working Notes :

		Rs.
Assets Realised :		
Land and Buildings		60,000
Machinery		63,500
Stock		90,000
Debtors		44,000
Cash in Hand		2,500
		2,60,000
Less: Secured loan	50,000	
Salaries (4 months – Preferential)	4,000	
Taxes	1,000	
Liquidation's Remuneration (3% on Rs.2,60,000)	7,800	
Liquidation expenses	1,850	64,650
		1,95,350
6% Debentures	1,00,000	
Add: Interest for 2 months	1,000	1,01,000
		94,350
$94,350 \times 2/102$		1,850
Amount paid to unsecured creditors		**92,500**

Illu.22 : Balance Sheet of Weak Ltd. as on 31st March, 2006 :

Liabilities	Rs.	Assets	Rs.
Share capital : (4,000 preferential shares at Rs.10 each)	**40,000**	**Land and Buildings**	**12,500**
6,000 Equity shares of Rs.10 each	**60,000**	**Other fixed assets**	**1,00,000**
Bank loan	**2,00,000**	**Stock**	**2,62,500**
8% Debentures	**50,000**	**Debtors**	**50,000**
Interest outstanding on debentures	**4,000**	**Profit and Loss a/c**	**29,000**
Creditors	**1,00,000**		
	4,54,000		**4,54,000**

The company went into liquidation on that date. Prepare liquidators statement of final accounts after taking into consideration the following .

(i) **Liquidation expenses Rs.3,000.**
(ii) **Liquidator's remuneration Rs.10,000.**
(iii) **Bank loan was secured by pledge of stock**
(iv) **Debentures and interest thereon are secured by floating charge on all assets.**
(v) **Fixed assets are realised at book values and current assets at 80% of book values.**

Solution:

In the books of Week Ltd. (in Liquidation)
Liquidatior's statement of account

	Rs.		Rs.	Rs.
Assets Realised :		Bank Loan		2,00,000
Land & Building	12,500	Liquidation Expenses		3,000
Other Fixed Assets	1,00,000	Liauidator's Remuneration		10,000
Stock (80% of Rs.2,62,500)	2,10,000	Debentures holders		
Debtors (80% of Rs.50,000)	40,000	8% Debentures	50,00 0	
		Interest outstanding	4,000	54,000
		Creditors		95,500
	3,62,500			**3,62,500**

Illu.23 : Mr. X is appointed is liquidator of Sun Company Ltd. which is in voluntary liquidation on 1-7-2010. The following balances are extracted from the books on that date.

Liabilities	**Rs.**	**Assets**	**Rs.**
Share capital		**Machinery**	**45,000**
24,000 Equity shares of Rs.5 each	**1,20,000**	**Leasehold properties**	**60,000**
General reserve	**15,000**	**Stock in trade**	**1,500**
Debentures	**75,000**	**Debtors**	**90,000**
Bank overdraft	**27,000**	**Investments**	**9,000**
Creditors	**30,000**	**Call in arrear**	**7,500**
		Cash in hand	**1,500**
		Profit and loss a/c	**52,500**
	2,67,000		**2,67,000**

You are required prepare a Statement of Affairs to the meeting of creditors. The assets are valued as under.

	Rs.
Machinery	**90,000**
Leasehold properties	**1,09,000**
Investments	**6,000**
Stock in trade	**3,000**

Bad debts are Rs.3,000 and doubtful debts are Rs.6,000, which are estimated to realise Rs.3,000. The bank overdraft is secured on leasehold properties. Preferential Creditors are Rs.1,500. Telephone rent outstanding Rs.120.

Solution:

Statement of Affairs of Sun Company Ltd. as 1-7-2010

Assets					**Estimated realisable value**
Assets not specifically pledged as per List A :					**Rs.**
Machinery					90,000
Stock in trade					84,000
Debtors					3,000
Investments					6,000
Calls in arrears					7,500
Cash in hand					1,500
Assets specifically pledged as per List B :					
	Estimated realisable value	**Due to secured creditors**	**Deficiency ranking unsecured creditors**	**Surplus carried to last column**	
Lease hold property	1,09,000	27,000	-	82,000	
Estimated surplus from assets specifically pledge					82,000
					2,74,000
Estimated total assets available for preferential creditors, debenture holder having a floating charge and unsecured creditors					
Summary of gross assets :					
Gross realisable value of assets specifically pledged				1,09,000	
Gross realisable value assets not pledged				1,92,000	
				3,01,000	

Gross liabilities	Liabilities	
27,000	Secured creditors as per list B to the extent to which claims are estimated to be covered by assets specifically pledged (Bank over draft)	**-**
1,620	Preferential creditors as per List C : (preferential creditors + Telephone rent)	1,620
	Estimated balance available for Debenture holders secured by floating charge and unsecured creditors	**2,72,380**
75,000	Debenture holders secured by floating charges as per List D	75,000
	Estimated surplus as regards debenture holders	**1,97,380**
30,000	Unsecured creditors as per List E	30,000
	Estimated surplus as regards unsecured creditors	**1,67,380**
	Issued & Called up capital :	
	24,000 equity shares of Rs.5 each	1,20,000
	Estimated surplus as regards members	**47,380**

Notes :

(1) It is assumed to be calls in arrears are totally collected from members.

(2) It is assumed to be preferential creditors and telephone rent outstanding are other than creditors in the balance sheet.

Illu.24 : Over confident company was liquidated on 31-12-2010. All the assets including the securities with the fully secured creditors realised Rs.7, 00,000. Other details of the company are given below:

	Rs.
10,000 shares @ Rs.10 each	**1,00,000**
Debentures having floating charge on assets	**5,00,000**
Liquidation expenses	**10,000**
Preferential creditors	**12,000**
Unsecured creditors	**3,00,000**
Liquidation's wages	**15,000**
Secured creditors	**80,000**
(Sale value of the securities Rs.90, 000)	

Prepare Liquidator' s Fund Statement.

Solution:

Dr. Liquidator's Final Statement Cr.

Particulars	Rs.	Particulars	Rs.
To Assets realised (7,00,000 – 90,000)	6,10,000	By Liquidation expenses	10,000
To Surplus from securities (90,000 – 80,000)	10,000	By Liquidators wages	15,000
		By Debentures	5,00,000
		By Preferential creditors	12,000
		By Unsecured Creditors (b/f)	83,000
	6,20,000		**6,20,000**

Illu.25 : The following particulars related to a Ltd. company which went into voluntary liquidation.

Preferential creditors Rs.25,000; Unsecured creditors Rs.58,000; 6% debentures Rs.30,000; The assets realized Rs.80,000; The expenses of liquidation Rs.1,500 and the liquidators remuneration is 2 ½% on the amount realized and 2% on the amount paid to unsecured creditors including preferential creditors. Prepare liquidators final statement of account.

Solution:

Dr. Liquidator's Final Statement of Account Cr.

	Rs.			Rs.
To Amount realized on assets	80,000	By Liquidators expenses		1,500
		By Liquidator's remuneration		
		On the amount realized (Rs.80,000 × 2.5 / 100)	2,000	
		On the amount paid to preferential creditors (Rs.25,000 × 2/100)	500	
		On the amount paid to unsecured creditors (Rs.21,000 × 2 / 102)	412	2,912
		By Debentures		30,000
		By Preferential creditors		25,000
		By Unsecured creditors		20,588
	80,000			**80,000**

Calculation of remuneration of Liquidator on unsecured creditors :

	Rs.
Amount available with the liquidator	80,000
Less : Rs.1,500 + 2,000 + 500 + 30,000 + 25,000	59,000
	21,000

$$\text{Amount available to unsecured Creditors} \times \frac{\text{Percentage of remuneration}}{100 + \text{Percentage of remuneration}}$$

= Rs.21,000 × 2/102 = 412

Illu.26 : The following is given:

Balance Sheet of A Ltd., on March 31, 2010

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital;		**Land and Buildings**	**1,00,000**
2000, 14% preference shares of Rs.100	**2,00,000**	**Plant & Machinery**	**2,50,000**
100 Equity share of Rs.1000 each Rs.75 paid	**75,000**	**Patents**	**40,000**
3000 Equity shares of Rs.100 each Rs.60 paid	**1,80,000**	**Stock at cost**	**55,000**
14% debentures having a floating charge on all assets	**1,00,000**	**Sundry debtors**	**1,10,000**
Interest outstanding	**14,000**	**Cash at bank**	**75,500**
Creditors	**1,45,000**	**Profit and Loss account**	**83,500**
	7,14,000		**7,14,000**

The company went into liquidation on the above date

The preference dividends were in arrears for two years. The arrears are payable automatically on liquidation. Creditors include a loan for Rs.50, 000 on the mortgage of land and buildings. The assets were realised as follows.

	Rs.
Land and Buildings	**1,20,000**
Plant and Machinery	**2,00,000**
Patents	**30,000**
Stock	**60,000**
Sundry debtors	**80,000**

The expenses of liquidation amounted to Rs.10, 900. The liquidator is entitled to a commission of 3 percent on all assets realised except cash and commission of 3 percent on all assets realised except cash and a commission of 2 percent on amounts distributed among unsecured creditors. Preferential creditors amount to Rs.15, 000. Assume the payment was made on September 30, 2010.

Solution :

Liquidator 's Statement of Account

	Rs.	**Rs.**		**Rs.**	**Rs.**
Assets realised			Secured Creditors		50,000
Cash at Banks	75,500		Liquidators expenses		10,900
Sundry Debtors	80,000		Liquidator Remuneration (14,700 + 1,900)		16,600
Stock	60,000				
Patents	30,000		14% Debentures	1,00,000	
Plant & Machinery	2,00,000		O/s interest	21,000	1,21,000
Land & Buildings	1,20,000	5,65,000	Preferential creditors		15,000
			Unsecured creditors		80,000
			Preference shareholders		
			Capital	2,00,000	
			Dividend arrears	28,000	2,28,000
			Equity shareholders		
			1000 shares @ Rs.22.25		22,250
			3000shares @ Rs.7.25		21,750
		5,65,500			**5,65,500**

	Rs.
Total paid up share capital	2,55,000
Less : Amount available to equity shareholders	44,000
Total Loss to be borne by equity shareholders	2,110,000
Loss per equity share = Rs.2,11,000/4,000 = Rs.52.75	
Hence refund to Rs.75 paid up shareholders	
Rs.75 – Rs.52.75 = Rs.22.25 x 1,000	22,250
Refund to Rs.60 paid up shareholders	
Rs.60 – Rs.52.75 = Rs.7.25 x 3,000	21,750
Amount available to equity shareholders	44,000

Note : Payments are made on 30, September 2010. Hence interest on debentures up to 30 September was also paid off.

Working Notes:

	Rs.	Rs.
Cash at bank		75,500
Add : Assets realized		
Land and buildings	1,20,000	
Plant and machinery	2,00,000	
Patents	30,000	
Stock	60,000	
Sundry Debtors	80,000	4,90,000
		5,65,500
Less : Liquidation expenses	10,900	
Liquidator's remuneration Rs.4,90,000 x 3/100	14,700	25,600
		5,39,900
Less : Payment to creditors		1,45,000
		3,94,900
Less : Liquidator's commission (Rs.1,45,000 – 50,000) x 2/100		1,900
		3,93,000
Less : Debentures	1,00,000	
Interest outstanding	21,000	1,21,000
		2,72,000
Less : Preferential creditors	2,00,000	
Outstanding dividend	28,000	2,28,000
Amount available to equity shareholders		44,000

15.3 QUESTIONS

A. Short Answer Questions.

1. What is statement of affairs?
2. What is liquidators' statement of account?
3. What is the liability of List A contributories?
4. State the liability of List B contributories?

B. Essay Questions :

1. What do you understand by the Liquidator's final statement of Account? Give a proforma of such an account with imaginary figures.
2. How and why the statement of affairs is prepared? Give the Proforma of statement of Affairs with imaginary figures.

15.4 EXERCISES

1. Synthetic Fibre Co. Ltd., went into voluntary liquidation on 1st March, 2010. The following balances are extracted from its books on that date.

Liabilities	Rs.	Assets		Rs.
Capital		Buildings		1,50,000
50,000 equity shares of		Plant and Machinery		2,10,000
Rs.10 each	5,00,000	Stock-in-trade		95,000
Debentures (secured		Book Debts	75,000	
by a floating charge)	2,00,000	Less: Provision	10,000	65,000
Bank overdraft	30,000	Calls in arrears		1,00,000
Creditors	40,000	Cash on hand		10,000
		Profit and Loss account		1,40,000
	7,70,000			7,70,000

Plant and Machinery and buildings are valued at Rs.1,50,000 and Rs.1,20,000 respectively. On realisation losses of Rs.15,000 are expected on stock. Book debts will realise Rs.70,000. Calls in arrears are expected to realise 90% Bank Overdraft is secured against buildings. Preferential creditors for taxes and wages are Rs.6,000 and miscellaneous expenses outstanding Rs.2,000.

Prepare a statement of affairs to be submitted to the meeting of creditors.

[Ans.: Deficiency as regards contributors Rs.2,50,000]

2. Bad luck Co., is to be liquidated. Their summarised Balance Sheet as at 30th September, 2010 appears as under:

Liabilities	Rs.	Assets	Rs.
2,50,000 Equity shares of Rs.10 each	25,00,000	Land and Buildings	5,00,000
		Other Fixed assets	20,00,000
Secured Debentures (On land and Buildings)	10,00,000	Current Assets	45,00,000
		Profit and Loss a/c	20,00,000
Unsecured Loans	20,00,000		
Trade Creditors	35,00,000		
	90,00,000		90,00,000

Contingent Liabilities are:

For bills discounted Rs.1,00,000; For excise duty demands Rs.1,50,000. On investigation, it is found that the contingent liabilities are certain to devolve and that the assets are likely to be realised as follows:

Land and Buildings Rs.11,00,000; Other fixed assets Rs.18,00,000; Current assets Rs.35,00,000.

Taking the above into account, prepare the statement of affairs.

[Ans.: Deficiency as regards creditors Rs.3,50,000; Deficiency as regards contributors : Rs.28,50,000]

3. The following information is extracted from the books of Lucky Ltd. on 31st December, 2009 on which date a winding up order was made.

	Rs.
Unsecured Creditors	3,80,000
Salaries due for five months	20,000
Bills payable	1,06,000
Debtors – Good	4,30,000
Doubtful (estimated to produce Rs.62,000)	1,30,000
Bad debts	88,000
Bills receivable (Good Rs.10,000)	16,000
Bank Overdraft	40,000
Land (estimated to produce Rs.5,00,000)	3,60,000
Stock (estimated to produce Rs.5,80,000)	8,20,000
Furniture and Fixtures	80,000
Cash in hand	4,000
Estimated liabilities for bills discounted	60,000
Secured creditors holding first mortgage on land	4,00,000
Partly secured creditors holding second mortgage on land	2,00,000
Partly secured weekly wages unpaid	6,000
Liabilities under Workmen's Compensation Act, 1923	2,000
Income tax due	8,000
5,000 9% Mortgage Debentures of Rs.100 each interest payable to 30th June 2009	5,00,000
Share capital:	
2,00,000 10% Preference shares of Rs.10 each	2,00,000
50,000 Equity shares of Rs.10 each	5,00,000
General Reserve since 31st December, 2009	1,00,000

In 2005, the company earned profit of Rs.4,50,000 but thereafter it suffered trading losses totaling Rs.5,84,000. The company also suffered a speculation loss of Rs.50,000 during the year 2006. Excise authorities imposed a penalty of Rs.35,000 in 2007 for evasion of tax which was paid in 2008.

From the foregoing information, prepare the Statement of Affairs and the Deficiency Account.

[Ans.: Deficiency as regards : (1) creditors Rs.59,750; (2) Contribotires Rs. 7,59,750]

4. On January 31st, 2010 a compulsory order for winding up was made a against X company Limited, the following particulars being disclosed.

	Book Value	Estimated to produce
	Rs.	Rs.
Cash in hand	100	100
Debtors	4,000	3,600
Land and Buildings	60,000	48,000
Furniture and Fixtures	20,000	20,000
Unsecured Creditors	20,000	
Debentures:		
Secured on Land and Buildings	42,000	
Secured on floating charge	10,000	
Preferential Creditors	6,000	
Share Capital (3,200 shares of Rs.100 each)	3,20,000	

Estimated liability for bills discounted was Rs.6,000 estimated to rank at Rs.6,000. Other contingent liabilities were Rs.12,000 – estimated to rank at Rs.12,000.

The company was formed on the 1st Day of January, 2005 and has made losses of Rs.3,13,900.

Prepare Statement of affairs and deficiency account.

[Ans.: Deficiency as regards : (1) creditors Rs.24,300; (2) Contributors Rs. 3,44,300]

5. A liquidator is entitled for a commission of 2% on assets realised and 3% on the amounts distributed to unsecured creditors. Calculate the amount of commission from the following details.

	Rs.
Assets realised	10,00,000
Liabilities	
Debentures	3,00,000
Preferential creditors	50,000
Unsecured creditors	8,50,000

[Ans.: Liquidator's Commission Rs.39,806; (On Assets Rs.20,000 + On preferential creditors Rs.1,500 + On Unsecured creditors Rs.18,306]

6. R Ltd., went into liquidation. Prepare liquidators' final statement of account from the following particulars. Share capital 1,000 equity shares of Rs.100.

	Rs.
Assets realised	1,65,000
Preferential creditors	5,000
Unsecured creditors	2,00,000
Liquidation expenses	3,000
Liquidator's remuneration	7,000

[Ans.: Amount available to unsecured creditors Rs.1,50,000]

7. Govinda Company went into liquidation. Its assets realised Rs.3,50,000 excluding amount realised by sale of Securities held by the secured creditors. The following was the position.

Share capital:	Rs.
1,000 shares of Rs.100 each	
Secured Creditors:	
(Securities realised Rs.40,000)	35,000
Preferential creditors	6,000
Unsecured creditors	1,40,000
Debentures having a floating charge	2,50,000
Liquidation Expenses	5,000
Liquidator's Remuneration	7,500

Prepare Liquidator's final statement of account.
[Ans.: Amount available to Unsecured Creditors Rs.86,500]

8. The following particulars relate to X Ltd., which has gone into voluntary Liquidation. You are required to prepare the Liquidator's final account allowing for his remuneration at 2% on the amount realised, and 2% on the amount distributed among unsecured creditors other than preferential creditors.

	Rs.
Preferential Creditors	10,000
Unsecured Creditors	32,000
Debentures	10,000
The assets realised:	
Land and Buildings	20,000
Plant & Machinery	18,650
Fixtures	1,000

The liquidator's expenses amounted to Rs.1,000.

[Ans.: Amount available to unsecured creditors Rs.17,507]

9. The following particulars related to a limited company which has gone into voluntary liquidation. You are required to prepare the Liquidator's Final Account, allowing for his remuneration @ 2% on the amount realised and 2% on the amount distributed to unsecured creditors other than preferential creditors:

	Rs.
Preferential Creditors	30,000
Unsecured creditors	96,000
Debentures	30,000

The Assets realised the following sums:

Land & Buildings	60,000
Plant and Machinery	55,950
Fixtures and Fittings	3,000

The Liquidation expenses amounted to Rs.3,000.

[Ans.: Amount available to unsecured creditors Rs.52,521]

10. The Capital of Lakshmi Narayana Company Limited was as follows:

(a) 8,000 equity shares of Rs.100 each fully paid.

(b) 6,000 equity shares of Rs.100 each Rs.80 per share paid up.

(c) 2,000 Preference shares of Rs.100 each fully paid.

The creditors amounted to Rs.2,00,000 including the liquidator's remuneration Rs.5,000. The liquidator realised all the assets amounting to Rs.4,22,000. A call of Rs.15 per share were made on equity shares which were partly paid up.
This was paid in full with the exception of that on 100 shares.
Prepare the liquidator's statement of account showing the return to shareholders.

[Ans.: Amount available to equity shareholders : On fully paid up shares (8,000 x Rs.10.071) Rs.80,568; On partly paid up shares (5,900 x Rs.5.071) Rs.29,932]

11. The American Transport Company Ltd. (in voluntary liquidation) has paid off its creditors in full, and the liquidator is in a position to make a return to the shareholders.
The position is as follows:-
Share Capital issued:
100 Preference shares of Rs.10 each (fully paid)
400 Equity shares of Rs.10 each (fully paid)
400 Equity shares of Rs.10 each (Rs.8 paid)

The articles of the company provide that the preference shares shall have priority over the equity shares as to repayment of capital.

The costs of liquidation are Rs.140, creditors amount to Rs.2,225, the assets, realised Rs.3,740. A call of Rs.2 per share on the partly paid equity shares (to adjust the rights of shareholders inter se) was duly paid except in the case of one shareholder owning 100 shares.

Prepare liquidators Final Statement of Account.

[Ans.: Amount available to equity shareholders Rs.975]

12. The following particulars to a limited company which has gone into liquidation. You are required to prepare the liquidator's final statement of account allowing for his remuneration @ 3% on the amount realised and 2% on the amount paid to the unsecured creditors:

Issued share capital:

1,000 preference shares of Rs.100 each (fully paid)

2,000 Equity shares of Rs.10 each (fully paid)

4,000 Equity shares of Rs.10 each (Rs.8 paid)

Assets realised Rs.3,08,000 excluding amount realised by sale of securities held by secured creditors (security realised Rs.54,000) Rs.46,000.

Unsecured creditors Rs.2,83,698

Preferential creditors Rs.8,000

Debentures having a floating charge on the assets Rs.1,00,000.

Expenses of liquidation Rs.3,000.

A call for Rs.2 per share on the partly paid equity shares was duly paid except in case of one shareholder owning 400 shares.

[Ans.: Amount available to unsecured creditors Rs.1,98,508]

13. Aswini Ltd. went into voluntary liquidation. Its share capital consisted of:

20,000 8% Preference shares of Rs.10 each, fully paid up.

20,000 A-Equity shares of Rs.10 each, Rs.7.50 paid up.

16,000 B-Equity shares of Rs.10 each, Rs.6.00 paid up.

14,000 C-Equity shares of Rs.10 each, Rs.5.00 paid up.

Assets realised Rs. 4.2 lakhs. Liquidation expenses amounted to Rs.15,000. The company borrowed a loan of Rs.50,000 from Diwakar on the security of stock (which realised 60,500 and inlcuded in Rs.4.2 lakhs). The company owed salaries at Rs.300 per month for four clerks for 4 months; at Rs.150 per month for four peons for 3 months. There are creditors for Rs.87,400. Prepare Liquidator's Final statement.

[Ans.: Return on equity capitals : A's share Rs.48,000; B's share Rs.14,400]

14. Bahuguna Company Ltd. went into voluntary liquidation on 31st December 2009 with the under mentioned assets and liabilities. Capital 1,000 shares of Rs.500 each fully paid.

Liabilities of the company:	Rs.
Unsecured Creditors	53,775
Preferential Creditors	5,295
Bank overdraft	4,000
6% Debentures secured by floating charge on the undertaking the interest on which was paid on 30-6-2009	44,000
Assets of the company:	
Cash on hand	750
Stock in trade realized	29,600
Book debts realized	49,200
Furniture realized	1,050
Investments lodged with Bankers against overdraft account, which were sold by the banker for	4,900

The excess amount realised by the sale proceeds of the investments were remitted by the banker to the liquidator. The debentures were paid off on 31-3-2010 together with interest to the date the binding up, and a first dividend distributed to the creditors. The Liquidator's remuneration is to be calculated at the rate of 3% on the net amount realised i.e., excluding the amount paid to the secured creditors out of the proceeds of his security, and 2% on the amount distributed to the unsecured creditors. The expenses of binding up amounted to Rs.1,115.

Prepare liquidator's Final Statement of Account, showing the rate and the amount of final dividend.

[Ans.: Amount available to unsecured creditors Rs.26,685]

15. Progressive Mining Co. Ltd. went into voluntary liquidation on 1st January, 2010. The remuneration of the liquidation is fixed at 3% on assets realised and 2% on amount distributed among shareholders. The following was the position of the company on 31st December, 2009.

	Rs.
Assets realised	15,00,000
Expenses of liquidation	25,000
Unsecured creditors (including Salaries and Wages for one month prior to liquidation Rs.10,000)	2,06,000
5,000 7% Preference shares of Rs.100 each fully paid up (Dividends paid up to 31st December, 2008)	5,00,000
4,000 Equity shares of Rs.100 each fully paid up	4,00,000
General Reserve as on 31st December, 2009	2,00,000
Profit and Loss account as on 31st December, 2009	1,40,000

Under the Articles of Association of the company Preference shareholders have the right to receive ¼ of the surplus remaining after repaying the Equity Share Capital.
Prepare Liquidators Final Statement of Account.
[Ans.: Amount paid to equity shareholders Rs.5,98,750]

16. A limited company went into voluntary liquidation with the following liabilities.

		Rs.
Trade creditors (including Rs.1,500 for taxes outstanding)		18,000
Bank Overdraft		30,000
Share Capital		
15,000 preference shares of Rs.10 each Rs.7 called		1,05,000
15,000 equity shares of Rs.10 each Rs.9 called	1,35,000	
Less: Calls in arrears	3,000	1,32,000
Calls in advance received:		
On preference shares	36,000	
On equity shares	6,000	42,000

The assets realised Rs.3,00,000. Expenses of liquidation amounted to Rs.3,000 and liquidator's remuneration Rs.4,500. Prepare liquidator's final statement of account.
[Ans.: Amount available to equity shareholders Rs.1,06,500]

17. Ganesh Ltd., went into voluntary Liquidation with the following liabilities.

	Rs.
Trade Creditors	20,000
Bank overdraft	30,000
Creditors with a charge on Premises	30,000
6% Debentures	20,000
Capital:	
10,000 Pref. shares of Rs.10 each Rs.7 called up	70,000
10,000 equity shares of Rs.10 each Rs.9 called up	90,000
Calls in advance:	
On Pref. Shares	12,000
On Equity shares	2,000

The assets of the company realised as below:

	Rs.
Premises	36,000
Other fixed assets	1,20,000
Current assets	60,000
Cash in hand	10,000

The liquidation expenses came to Rs.2,000, and the liquidator is entitled for a commission @ 2% on all assets realised except cash, and 2% on the amounts paid to equity shareholders.

Prepare Liquidator's final statement of account.

[Ans.: Amount available to equity shareholders Rs.36,941]

18. Tough Times Ltd., went into voluntary liquidation on 31-12-2009. Their Balance Sheet as on that date was as follows:

Liabilities	Rs.	Assets	Rs.
Share Capital:		Buildings (Rs.30,000)	18,000
(in equity shares of Rs.10		Plant (Rs.28,000)	32,000
each)	50,000	Stock (Rs.22,000)	26,000
8% preference shares (of		Debtors (Rs.19,000)	24,000
Rs.10 each)	20,000	Bank Balance	1,000
10% Debentures	20,000	Profit & Loss a/c	4,000
Sundry creditors	15,000		
	1,05,000		1,05,000

Prepare Liquidator's final statement of account from the following additional information.

a. The figures given in brackets for the assets are their realisable values.

b. The liquidator is eligible for 1.5% commission on all the assets realised including cash balance and 3% on the amount payable to unsecured creditors.

c. Liquidation expenses came to Rs.500

d. Preference share dividend is in arrear for one year and interest on debentures is outstanding for six months. Debentureholders agreed to waive the interest and accept 90% of the face value of debentures in full settlement.

e. Creditors were included in preferential creditors amounting to Rs.800.

[Ans.: Amount available to equity shareholders Rs.42,950]

19. Balance Sheet of Chintamani Co. Ltd., as on 31st March, 2010

Liabilities	Rs.	Assets	Rs.
Share capital-Authorised and		Buildings	1,00,000
subscribed: 2,000 6% preference		Plant	2,50,000
shares of Rs.100 each	2,00,000	Patents	40,000
		Stock	55,000
1,000 Equity shares of Rs.100 each		Debtors	1,10,000
Rs.75 paid	75,000	Bank	30,000
3,000 Equity shares of Rs.100 each		Profit & Loss a/c.	1,20,000
Rs.60 paid	1,80,000		
5% Debentures having a floating charge			
on all assets	1,00,000		
Outstanding interest	5,000		
Creditors	1,45,000		
	7,05,000		7,05,000

The company went into liquidation on the above date. The preference dividends were in arrears for two years. The arrears are payable on liquidation. Creditors include a loan for Rs.50,000 on the mortgage of Buildings. The assets were realised as follows:

	Rs.
Buildings	1,20,000
Plant	2,00,000
Patents	30,000
Stock	60,000
Debtors	80,000

The expenses of liquidation amounted to Rs.10,900.

The liquidator is entitled to a commission of 3% on all assets realised except cash and a commission of 2% on amounts distributed among unsecured creditors. Preferential creditors amounted to Rs.15,000. Assume the payment was made on 30th September 2010.

Prepare the Liquidator's Statement of Account.

[An.s.: Amount available to equity shareholders (Rs.15,000 + 1,000) = 16.000; 1,000 shares @ Rs.15 = Rs.15,000; 4,000 shares @ Rs.0.25 = Rs.1,000]

20. You are asked by a Liquidator of a Company to prepare a statement of account to be laid before a meeting of the shareholders from the following:
Balance Sheet of the company as on date of Liquidation 1.1.2010.

	Rs.		Rs.
Share Capital:		Fixed Assets	8,00,000
8,000 Equity Shares of Rs.100		Book debts	3,00,000
each called Rs.80	6,40,000	Loss on date	2,00,000
2,000 Preference Shares of		Stock	3,00,000
Rs.100 each called Rs.70	1,40,000		
Loan from bank secured on			
Buildings & Machinery	3,00,000		
Trade creditors	5,20,000		
	16,00,000		16,00,000

The assets realised as follows:
1-4-2010 Fixed Assets Rs.2,00,000; book debts : Rs.2,00,000; Expenses paid: Rs.8,000;
1-6-2010 Fixed Assets (final) Rs.4,00,000; Book debts (final) Rs.50,000.
1-8-2010 Stock realised (final) Rs.2,50,000.

The Liquidator is entitled to 5% on Collections and 2% on the amount paid to the equity shareholders. Prepare the statement on the assumption that disbursements are made in accordance with law as and when cash is available.

[Ans.: Amount available to equity shareholders Rs.93,138]

21. The Balance Sheet of a company as on 31.12.2009 was as follows:

Liabilities	Rs.	Assets	Rs.
Share Capital			
(Preference)	10,00,000	Land and Buildings	10,00,000
Share capital (Equity)	10,00,000	Plants	10,00,000
Debentures (secured against		Stocks	5,00,000
land and buildings)	5,00,000	Debtors	3,00,000
Bank Loans against		Cash	1,00,000
Stocks	2,00,000	Preliminary	1,00,000
		Expenses	
Creditors	3,00,000		
	30,00,000		30,00,000

It was decided to take the company into voluntary liquidation.

(a) Remuneration of liquidator is 1% on net amount realised

(b) Realisation of assets was

(i) 10% above book value on Land and Buildings

(ii) 5% below books value on plant

(iii) 5% over book value on stocks

(c) Preferential creditors amounted to Rs.50,000

(d) Preference dividend not paid for 2009 amounted to Rs.1,00,000.

Prepare liquidators final Statement of account.

[Ans.: Amount available to equity shareholders Rs.8,48,250

22. A company went into liquidation on 31-3-2010 the following is the Balance Sheet.

	Rs.		Rs.
Paid up Capital		Goodwill	60,000
20,000 Shares of Rs.10	2,00,000	Buildings	50,000
Sundry Creditors	400	Machinery	60,000
Preferential	25,000	Stock	55,000
Partly Secured	55,000	Debtors	62,000
Unsecured	1,00,000	Cash	1,500
Bank Overdraft (Unsecured)	10,000	Cash at Bank	400
		P & L a/c	1,01,500
	3,90,400		3,90,400

The liquidator realised the assets as follows.

Building which was used in the first instance to pay partly secured creditors Rs.41,250. Machinery Rs.30,000; Sundry Debtors Rs.35,750; Stock Rs.40,000

The expenses of Liquidation amounted to Rs.1,000 and the liquidator's remuneration was agreed at 2% on the amount realised and 2% on account paid to unsecured creditors.

Prepare the liquidator's final statement of accounts.

[Ans.: Amount available to unsecured creditors Rs.74,814]

23. The position of R Ltd. in liquidation is as follows:

Issued share capital:

1,000, 6% preference shares of 100 each, fully paid (arrear of dividend of one year)

1,000 Equity shares of Rs.50 each, fully paid

1,000 equity shares of Rs.40 each, Rs.30 paid

Calls – in arrear Rs.4,000

Calls – in advance Rs.6,000

Cash left after making payments to creditors but before making any call Rs.1,16,000.

You are required to prepare liquidator 's final statement of account. What will be the position if cash in hand is Rs.1,34,000? Assume articles include the provision relating to payment of preference dividend in priority to the equity capital.

[Ans.: Amount available to equity shareholders Rs.10,000; Deficiency Rs.54,000; loss suffered (a) Rs.50 equity share = Rs.30; (b) Rs.40 equity share = Rs.24]

24. The Usha Optimist Ltd. went into liquidation. Its assets realised Rs.3,50,000 excluding amount realised by sale securities held by the secured creditors. The following was the position.

	Rs.
Share capital 1,000 shares of Rs.100 each secured creditors (securities realised Rs.40, 000)	35,000
Preferential creditors	6,000
Unsecured creditors	1,40,000
Debentures having a floating charge on the assets of the company	2,50,000
Liquidation expenses	5,000
Liquidator 's remuneration	7,500

Prepare the liquidator 's final statement of Account in the manner prescribed by law.

[Ans.: Amount available to unsecured creditors Rs.86,500]

25. A company went into liquidation on 31-3-2010 when the following Balance Sheet was prepared.

Prepare liquidators final account by taking his remuneration at 2.5% on the amount realised and 2% on the amount paid to unsecured creditors.

The assets realised by liquidator are as follows: Fixed assets Rs.1, 72,000 (including Rs.70, 000 on free hold property); Current assets Rs.1, 95,000; and Cash Rs.5, 000. Liquidation expenses amounted to Rs.2, 000.

Liabilities	Rs.	Assets	Rs.
Share capital (Rs.10 each)	3,90,000	Goodwill and patents	1,00,000
Creditors – preferential	48,400	Fixed Assets (including freehold property)	2,27,000
Partly secured creditors (on free hold property)	1,10,620	Current assets	2,43,240
Unsecured creditors	2,23,580	Cash	5,000
		Profit & Loss a/c	1,97,360
	7,72,600		7,72,600

[Ans.: Liquidators remuneration (Rs.9,300 + 968 + 4,732) Rs.15,000; Amount available to unsecured creditors Rs.2,36,600]

26. Cash available before payment to unsecured creditors – Rs.30, 000
Unsecured creditors – Rs.10, 000
Share Capital – Rs.15, 000
Liquidator 's remuneration – 5% of the amount distributed among shareholders.
Calculate Liquidator 's remuneration.

[Ans.: Liquidator's remuneration : Rs.952]

27. On 1-1-2010, Tungabhadra Company Ltd., passed a resolution for voluntary Liquidation. On the above date the financial position of the company was as follows:

	Rs.
Paid up share capital	2,00,000
Machinery, Debtors and stock (Book vales)	1,58,000
Cash	2,000
Preferential Creditors	10,000
Trade Creditors	70,000
6% debentures (Having Floating charge on the assets of the company)	1,00,000
Outstanding interest on debentures	3,000

Liquidator get 3% commission on the amounts realised from assets (other than cash) and 2% on the amounts paid to preferential creditors and Trade creditors. Liquidation expenses amounted to Rs.1,000. The assets were realised at their book values.

Prepare the liquidator 's Final Settlement of accounts.

[Ans.: Liquidators remuneration Rs.5,745; Amount available to unsecured creditors Rs.40,255]

28. LT Ltd. went into liquidation with the following liabilities:

Secured creditors Rs.40, 000 (Securities realised Rs.50, 000)
Preferential creditors Rs.1, 200
Creditors Rs.61, 000
Liquidation expenses Rs.500
The liquidator is entitled to remuneration of 3% on the amount realised (including securities in the hands of secured creditors) and 1 ½% on the amount distributed to unsecured creditors. The various assets (excluding the securities in the hands of the secured creditors) realised are Rs.52, 000.
Prepare the liquidators final statement of account.

[Ans.: Liquidator's remuneration RS.3,924; Amount available to unsecured creditors Rs.56,376]

29. The Breakfast Foods Ltd. went in to voluntary liquidation on 31st December 2010. The balances in its Books on that date were:

	Rs.		Rs.
Share Capital:		Land and Building	2,50,000
Authorized and subscribed		Plant and Machinery	6,25,000
5,000-6% Cumulative		Patents	1,00,000
Preference shares of Rs.100 each full paid	5,00,000		
2500 equity shares of Rs.100 each Rs.75 paid	1,87,500	Stock	1,37,500
7,500 equity shares of Rs.100 each Rs.60 paid	4,50,000	Sundry debtors	2,75,000
5% Mortgage debentures	2,50,000	Cash at Bank	75,000
Interest outstanding	12,500	Profit and Loss account	3,00,000
Creditors	3,62,500		
	17,62,500		17,62,500

The liquidator is entitled to commission of 3% on all assets realized except cash and 2% on amounts distributed among unsecured creditors other than preferential creditors.

Creditors include preferential creditors 37,500 and a loan for Rs.1,25,000 secured by mortgage on land and buildings. The dividend on preference shares were in arrears for two years.

The assets realized as follows:

	Rs.
Land and Buildings	3,00,000
Plant and Machinery	5,00,000
Patents	75,000
Stock	1,50,000
Sundry debtors	2,00,000

The expenses of liquidation amounted to Rs.27, 250.
Prepare the liquidators Final statement of account.

[Ans.: Liquidator's remuneration Rs.41,500; Amount available to equity shareholders (a) 2,500 shares @ Rs.15.875 = Rs.39,687.50 (b) Rs.7,500 shares @ Rs.0.875 = Rs.6,562.50]

30. A Limited company went in to voluntary liquidation with the following liabilities:

	Rs.	Rs.
Trade creditors		12,000
Bank overdraft		20,000
Preference share capital		70,000
Equity share capital:		
10,000 Equity shares of Rs.10 each Rs.9 called up	90,000	
Less: Calls in arrears	2,000	88,000
Cash received in advance on shares		28,000

The assets realized Rs.2, 00,000. Expenses of liquidation amounted Rs.2, 000 and liquidators remuneration Rs.3, 000. Calls in arrears are realized. Prepare liquidator's final statement.

[Ans.: Amount available to equity shareholders Rs.67,000]

31. The amount due to unsecured creditors is Rs.10,00,000. The amount available for unsecured creditors before charging commission of the liquidator is Rs.4,12,000. Liquidator's commission is 3% on amount paid to unsecured creditors.

Find out liquidator's commission and the amount paid to unsecured creditors.

[Ans.: Liquidator's commission Rs.12,000; Amount paid to unsecured creditors Rs.4,00,000]

32. The liquidator of a company in Voluntary Liquidation is entitled to a remuneration of 3% on the amount realised (excluding cash on hand) and at 2% on the amount distributed to the unsecured creditors. Unsecured creditors amounted to Rs.40,000. Debenture holders were paid Rs.51,875. Cost of liquidation Rs.510. Cash on hand was Rs.1,000 and the assets realised Rs.79,000. Find out the liquidator's remuneration.

[Ans.: Liquidator's remuneration : Rs.2,865; Amount payable to unsecured creditors Rs.24,750

33. X Company Ltd. went into voluntary liquidation on 1-4-2010. The following balances were extracted from the books on that date :

Liabilities	Rs.	Assets	Rs.
Share capital			
24,000 equity shares of Rs.10 each	2,40,000	Machinery	90,000
Debentures	1,50,000	Leasehold premises	1,20,000
Bank overdraft	54,000	Stock	3,000
Creditors	60,000	Debtors	1,50,000
		Investments	18,000
		Cash in hand	3,000
		Profit & Loss a/c	1,20,000
	5,04,000		5,04,000

The assets were valued as under:

	Rs.
Machinery	1,80,000
Leasehold Premises	2,18,000
Investments	12,000
Stock	6,000
Debtors	1,40,000

The bank overdraft is secured by deposit of deeds of leasehold premises. There were preferential creditors Rs.3,000, which were not included in creditors. The debenture holders are having floating charge. Prepare a statement of affairs to be submitted to the members/creditors.

[Ans.: Estimated surplus as regards as creditors Rs.2,92,000]

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Chapter – 16

ACCOUNTS OF INSURANCE COMPANIES

Objectives :

After studying this unit you should be able to

- understand various types of insurance business
- explain the IRDA regulations relating to the accounting of Life Insurance Business
- know the procedure and formats in the preparation of life insurance accounts

Structure :

16.1. INTRODUCTION

Insurance may be defined as "a contract between two parties under which one of them promise to make good the loss suffered by other partly owing to the happening of a certain specified event."

The person who promises indemnity or make good the loss suffered by the other is called **Insurer or assurer.** The person to whom protection is given under the contract of insurance in known as **Insured or assured. The document containing the contract of insurance is called the Insurance Policy.** The amount payable by the insured to the insurer as per insurance contract is known as **Premium.**

16.2 TYPES OF INSURANCE

Insurance business can be divided into two well marked classes viz., (i) Life insurance (ii) General insurance

16.2.1 Life Insurance :

Thus, a contract of life insurance is a contract under which, in consideration of sums of money called premium, the insurer agrees to pay a certain amount on the death of the assured or upon the expiry of a certain fixed period, whichever is earlier. Life policies are of various types but their main varieties are the following.

1. **Whole life policy :** Under this policy the premium continues to be paid throughout the life time of the assured, but the policy money becomes payable only after his/her death.`

2. **Endowment policy :** It is a policy which runs for a fixed period (i.e., number of years). Under this policy, the money is payable either at the end of a specified number of years or upon death of the insured person whichever is earlier. It may also be taken for the marriage of children when they attain a certain age, or for the education of children after the death of the assured.

16.2.2 General Insurance :

It is a contract under which the insurer, in consideration of a certain premium, undertake to reimburse the insured for any loss or liability he/she may incur on the happening of an uncertain event. In other words, all the insurance other than life are regarded as general insurance.

16.3 IRDA REGULATIONS

The Insurance Regulatory and Development Authority (IRDA) was set up by the Central Government in 1996 for regulating the Insurance Business in India. It has issued regulations regarding the preparation of “Financial Statements” and “Auditors Report” of insurance companies. These are known as “The Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditors Report of Insurance Companies) Regulations, 2000.

The important changes are as under:

a. They make preparation of cash flow statement under the direct method prescribed in AS-3 mandatory for all Insurance Companies.

b. New forms are devised to update and systematize the final Accounts of both life Insurance and General Insurance Companies.
c. New Formats for Revenue Account, Profit and Loss Account (which includes the appropriation part also) are given which should be accompanied by four schedules.
d. New Format is prescribed for Balance Sheet also which should be accompanied by eleven schedules.

16.3.1 Insurance Business in India :

In India, the Insurance Act, of 1938 controls the working and the activities of companies carrying on insurance business. On 19 January 1956, life insurance business was nationalised by the government and later on the Life Insurance Corporation Act of 1956 was passed. The general insurance (fire, marine and miscellaneous) business was also taken over by the Central Government *w.e.f.* 13 May, 1971. The General Insurance Corporation was set up to guide and supervise the general insurers. Thus, all insurance business came under the complete ownership and control of the Central Government.

However, as a result of continued liberalisation policy of the Government, the insurance business has now also been opened to the private sector. The Insurance Regulatory and Development Authority (IRDA) has been constituted under IRDA Act, 1999 passed by Parliament to regulate the total insurance business in the country. As a corollary, the Insurance Act, 1938 has also been amended by the enactment of Insurance (Amendment) Act, 2000.

The insurance business in India at present can be divided into *two* broad categories:

(i) Life Insurance:

(ii) General Insurance: It includes

  (a) Fire Insurance

  (b) Marine Insurance

  (c) Miscellaneous Insurance.

Life insurers can do life insurance business while general insurers can transact the rest of the business. It may be noted that no composites are permitted under the law. In other words, a firm cannot combine life insurance business with general insurance business.

The main players in the insurance business are as under:

Life Insurers

1. **Life Insurance Corporation of India (LIC):** Established under the Life Insurance Corporation of India Act, 1956 and wholly owned by the Government of India. It controls more than 90 per cent of life insurance business in India.

(ii) A number of private players have come into being in life business since April 2000. These private players are as under:

(a) HDFC Standard Life Insurance Co. Ltd.
(b) Max New York Life Insurance Co. Ltd.
(c) ICICI Prudential Life Insurance Co. Ltd.
(d) Om Kotak Mahindra Life Insurance Co. Ltd.
(e) Birla Sun Life Insurance Co. Ltd.
(f) Tata AIG Life Insurance Co. Ltd.
(g) SBI Life Insurance Co. Ltd.
(h) ING Vysya Life Insurance Co. Pvt. Ltd.
(i) Allianz Bajaj Life Insurance Co. Ltd.
(j) Metlife India Insurance Co. Pvt. Ltd.
(k) AMP SANMAR Assurance Co. Pvt.
(l) Aviva Life Insurance Co. India Pvt. Ltd.

16.3.2 Duties, powers and functions of IRDA :

The following are the duties, powers and functions of IRDA as laid down in Section 14 of the IRDA Act, 1999.

1. Subject to the provision of this act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.

2. Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include :

(a) issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration.
(b) Protection of the interests of the policy holders in matters concerning assigning of policy nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
(c) Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;
(d) Specifying the code of conduct of surveyors and loss assessors;
(e) Promoting efficiency in the conduct of insurance business;
(f) Promoting and regulating professional organizations connected with the insurance and re-insurance business;
(g) Levying fees and other charges for carrying out of the purposes of this Act;
(h) Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business
(i) Control and regulations of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and

regulated by the Tariff Advisory Committee under Section 64U of the Insurance Act, 1938;

(j) Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;

(k) Regulating investment of funds by insurance companies

(l) Regulating maintenance of margin of solvency

(m) Adjudication of disputes between insurers and intermediaries or insurance intermediaries.

16.4. ACCOUNTS OF LIFE INSURANCE BUSINESS

Basically insurance is of two types (a) Life Insurance and (b) General Insurance. In this chapter we have discussed about life insurance business only.

Life insurance companies as per Insurance Act, 1938 are required to maintain the following Statutory Books.

16.4.1 Statutory Books:

The following books are to be maintained by all insurance companies in their offices.

a. **Register of Policies:** This register will contain the particulars in respect of each policy issued by the insurer such as the name and address of the policy holder, the date when the policy was effected and record of the assignment of the policy (if any).

b. **Register of Claims:** It contains the particulars of each claim such as the date of claim, the name and address of claimants, the date on which the claim was discharged, date and ground for rejection, in case the claim is rejected.

c. **The Register of Licensed Insurance Agents:** It contains the particulars of various insurance agents, their names, addresses, particulars of business done and commission due to them.

16.4.2 Subsidiary Books:

Beside the above mentioned statutory books, the following subsidiary books are also to be maintained.

1. Register of Proposals and Proposal Advance Cash Book.
2. First Year's Premiums Cash Book
3. Renewal Premiums Cash Book
4. Agency and Branch Cash Book

5. Petty Cash Book
6. Claims Cash Book
7. General Cash Book containing summarised entries for the six above mentioned books.
8. Bank Cash Book
9. Commission Register
10. Lapsed and Cancelled Policies Book.
11. Journal
12. Agency Ledger
13. Policy Loan Ledger
14. General Loan Ledger
15. Investment Ledger

16.5. IMPORTANT TERMS IN LIFE INSURANCE BUSINESS

The following points are to be considered while preparing the final accounts of life insurance companies.

16.5.1 Revenue Account:

The revenue account has to be prepared in all types of insurance business (viz., life, fire, marine and miscellaneous) in the form specified by the Insurance Regulatory & Development Authority. The account discloses the profit or loss made by an insurance business during a particular period. Of course, in the case of life insurance business, the situation is different since the profit or loss is ascertained only every alternate year. The excess of the revenue income over revenue expenditure is not profit, but only a reserve termed as the **"life assurance fund"**, to be carried forward for comparing with the net liability as per acturial valuation for ascertaining the profit or loss made by the life insurance business.

16.5.2 Life assurance fund:

The life assurance (or insurance) fund is available to meet the aggregate liability on all outstanding policies. While preparing the revenue account, the opening balance in the life insurance fund account is shown on the credit side. After putting all items of income and expenditure in the revenue account, the balance of the account represents the closing balance of the life assurance fund.

16.5.3 Premium:

The primary income of every insurance company is premium. It is the amount payable by the policyholder to the Insurance Company for the protection given to him and in consideration of the company guaranteeing to pay the sum assured. The premium received during the accounting period plus outstanding at the end of the period, plus bonus in reduction of premium minus outstanding premium at the beginning of the period minus reinsurance premium is to be shown under the heading “Premium Earned (Net)” (See Schedule –1)

16.5.4 Annuities:

Annuity is the payment made by the Insurance Company every year for the lumpsum money received in the beginning of the Policy. It is an expense and is to be shown in Schedule – 4 relating to Revenue a/c.

16.5.5 Consideration for Annuities granted:

This is lumpsum amount received by the Insurance Company as consideration for payment of “Annuity” every year to the Insured person. Annuity is a fixed amount payable to the insured person every year. It is to be shown as in Income under the heading ‘Other Incomes”.

16.5.6 Re-insurance:

It is an arrangement made between two insurance companies whereby one agrees to take over a portion of risk incurred by the other. The company passing on the risk will have to pay premium to the other company. This is called Re-insurance. An important thing be unified here is whether re-insurance is income or expense to the company and the adjustment is to be made accordingly.

16.5.7 Claims:

The claim may arise either by death or by maturity. In calculating claims, all claims intimated and accepted or not accepted at the end of the year, expenses relating to claims are to be added and out of the total, claims outstanding at the beginning of the year and reinsurance recoveries are to be deducted. The amount of reinsurance recoveries is received under reinsurance contract and it reduces the total claims to be paid by the business.

16.5.8 Bonus:

It is the amount payable by the Life Insurance Company out of profits ascertained on the basis of valuation. It is of three kinds:

1. **Bonus in cash:** It is paid in cash to the policy holders (in case of “with Profit Policies”) as soon as it is declared after valuation.
2. **Bonus in reduction of premium:** The bonus amount declared is not paid in cash but is adjusted out of the premium payable by the policyholders. Thus premium payable is reduced.
3. **Reversionary bonus:** It is added to the policy amount and paid along with the claim. L.I.C. of India is following this system.

16.5.9 Surrender Value:

A policy holder has the right to surrender or to cancel his policy. In such case, the amount receivable for the unexpired policy is known as “Surrender Value”. It is the present cash value of the policy as per actuarial valuation and is payable immediately.

16.5.10 Paid-up Value:

It is that proportion of the policy value which the number of premiums already paid bears to the total number of premium payable. The paid-up value is not immediately payable. But it is payable when the original policy becomes due.

16.5.11 Life Assurance Fund:

The Balance of fund at the beginning of the year is shown on the credit side of the Revenue Account as a first item. The excess of income over expenditure every year is credited to this Fund. The difference between the two sides of the Revenue Account is taken as the balance of fund at the end of the accounting year and it is also shown in the Balance Sheet.

16.5.12 Interest, Dividend and Rent:

The interest, dividend and rents received by the insurance companies is to be shown in Schedule – 12. Only gross amounts are to be taken and if net amount is given after deduction of tax at source, it should be added to get gross amount other adjustments relating accrued and outstanding amounts are to be made.

16.6. LIFE INSURANCE ACCOUNTS – NEW FORMATS

As stated above every insurance company operating in India is required to prepare their financial statements i.e., Revenue Account, Profit and Loss Account and Balance Sheet according to the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditors’ Report of Insurance Companies) Regulations, 2002.

Insurers carrying on Life Insurance Business should comply with the requirements of Schedule A of the Regulations. The final accounts of insurance companies include the following.

Revenue Account	**Form A – RA**
Profit and Loss Account	**Form A – PL**
Balance Sheet	**Form A – BS**

There are 15 schedules in each case, the first four schedules related to Revenue Account and the remaining eleven schedules relate to balance sheet which give details of the summary heads. In both Schedules A and B, profit and Loss Appropriation Account is dispensed with and appropriations are accommodated in the Profit and Loss Account. Let us now go through these formats.

16.7. REVENUE ACCOUNT – FORM A – RA

This account is to be prepared according to Form 'A - RA' of the first schedule to the Insurance Act 1938.

Following is the specimen of the revenue account of a life insurance company.

Name of the Insurer:
Registration No. and Date of Registration with the IRDA:

Revenue Account for the year the ended 31st March ……

Policy holders' Account (Technical Account):

Particulars	Schedule No.	Current Year	Previous Year
		(Rs.'000)	(Rs.'000)
Premium earned – net			
a. Premium			
b. Reinsurance ceded	1		
c. Reinsurance accepted			
Income form Investments			
a. Interest, Dividends & Rent – Gross			
b. Profit on sale/redemption of investments			
c. (Loss on sale/redemption of investments)			
d. Transfer/Gain on revaluation/change in fair value*			
Other Income (to be specified)			
Total (A)			
Commission	2		
Operating Expenses related to Insurance Business	3		
Provision for doubtful debts			
Bad debts written off			
Provision for Tax			
Provision (other than taxation)			
(a) For diminution in the value of investments (Net)			
(b) Others (to be specified)			
Total (B)			
Benefits Paid (Net)	4		
Interim Bonuses Paid			

Particulars	Schedule No.	Current Year (Rs.'000)	Previous Year (Rs.'000)
Change in Valuation of liability in respect of life policies: a. Gross*⁎ b. Amount ceded in Reinsurance c. Amount accepted in Reinsurance			
Total (C)			
Surplus/Deficit (A-B-C)			
Appropriations: Transfer to Shareholders' Account Transfer to other Reserves (to be specified) Balance being Funds for future applications			
Total (D)			

Notes:

* Represents the deemed realised gain as per norms specified by the Authority.

*⁎ Represents Mathematical Reserves after allocation of bonus.

The total surplus shall be disclosed separately with the following details.

a. Interim Bonuses Paid
b. Allocation of Bonus to policyholders
c. Surplus shown in the Revenue Account
d. Total Surplus: [(a) + (b) + (c)]

16.8. PROFIT AND LOSS ACCOUNT – FORM A – PL

Name of the Insurer:
Registration No. and Date of Registration with the IRDA:
Profit and Loss Account for the year the ended 31st March ……
Shareholders' Account (Non-technical Account):

Particulars	Schedule No.	Current Year	Previous Year
		(Rs.'000)	(Rs.'000)
Amounts transferred from/to the Policyholders account (Technical account) Income from Investments (a) Interest, Dividends & Rent – Gross (b) Profit on sale/redemption of investments (c) (Loss on sale/redemption of investments) Other Income (to be specified)			
Total (A)			

Particulars	Schedule No.	Current Year (Rs.'000)	Previous Year (Rs.'000)
Bad debts written off Provisions (Other than taxation) (a) For diminution in the value of Investments (Net) (b) Provisions for doubtful debts (c) Others (to be specified)			
Total (B)			
Profit/(Loss) before tax Provision for Taxation Profit/Loss after tax			
Appropriations (a) Balance at the beginning of the year (b) Interim dividends paid during the year (c) Proposed final dividend (d) Dividend distribution tax (e) Transfer to reserves/other accounts (to be specified)			
Profit carried to the Balance Sheet			

Notes to Form A – RA and A – PL

a. Premium income received from business concluded in and outside India shall be separately disclosed.
b. Reinsurance premiums whether on business ceded or accepted are to be brought into account gross (i.e., before deducting commission) under the head reinsurance premium.
c. Claims incurred shall comprise claims paid, specific claims, settlement costs wherever applicable and change in the outstanding provision for claims at the year-end.
d. Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs.5,00,000 whichever is higher, shall be shown as a separate line item.
e. Fees and expenses connected with claims shall be included in claim.
f. Under the sub-head "others" shall be included items like foreign exchange gains or losses and other items.
g. Interest, dividends and rental receivable in connection with the investment should be stated as gross amount, the amount of income tax deducted at source being included under "advance taxes paid and taxes deducted at source."

h. Income from rent shall include only the realised rent. It shall not include any notional rent.

16.9. BALANCE SHEET – FORM A - BS

The Balance Sheets of all types of insurance business are to be prepared in accordance with form 'A - BS' a specimen of which is given below:

Name of the Insurer:
Registration No. and Date of Registration with the IRDA:

Balance Sheet as at ……

Particulars	Schedule No.	Current Year	Previous Year
		(Rs.'000)	(Rs.'000)
Sources of Funds:			
Shareholders' Funds			
Share Capital	5		
Reserves and Surplus	6		
Credit/Debit Fair value change account			
Sub-Total			
Borrowings	7		
Policyholders' Funds			
Credit/Debit Fair value change account			
Policy Liabilities			
Insurance Reserves			
Provision for linked Liabilities			
Sub-Total			
Funds for Future Appropriations			
Total			
Application of Funds			
Investments			
Shareholders'	8		
Policyholders'	8A		
Assets held to cover linked liabilities	8B		
Loans	9		
Fixed Assets	10		
Current Assets			
Cash and Bank balances	11		
Advances and other Assets	12		
Sub-Total (A)			

Particulars	Schedule No.	Current Year (Rs.'000)	Previous Year (Rs.'000)
Provisions	14		
Sub-Total (B)			
Net Current Assets (C) = (A – B) Miscellaneous Expenditure (to the extent not written off or adjusted) Debit balance in Profit and Loss Account (Shareholders' Account)	 15		
Total			

Contingent Liabilities:

	Particulars	Current Year	Previous Year
		(Rs.'000)	(Rs.'000)
1.	Parly paid-up investments		
2.	Claims, other than against policies, not acknowledged as debts by the company		
3.	Underwriting commitments outstanding (in respect of shares and securities)		
4.	Guarantees given by or on behalf of the company		
5.	Statutory demands/liabilities in dispute, not provided for		
6.	Reinsurance Obligations to the extent not provided for in accounts		
7.	Others (to be specified)		
	Total		

Schedules Forming part of Financial Statements

Schedule – 1 : Premium

(Rs.'000)

Particulars	Current Year	Previous Year
1. First Year Premium 2. Renewal Premium 3. Single Premiums		
Total Premium		

Schedule – 2 : Commission Expenses

(Rs.'000)

	Particulars	Current Year	Previous Year
	Commission Paid Direct: First Premiums Renewal Premiums Single Premiums Add: Commission on Re-insurance Accepted Less: Commission on Re-insurance Ceded		
	Net Commission		

Schedule – 3 : Operating Expenses related to Insurance Business

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	Employees' remuneration & Welfare benefits		
2.	Travel, conveyance and vehicle running expenses		
3.	Training expenses		
4.	Rents, rates and taxes		
5.	Repairs		
6.	Printing & Stationery		
7.	Communication expenses		
8.	Legal and Professional charges		
9.	Medical fees		
10.	Auditors' fees, expenses etc.		
	(a) as auditor		
	(b) as adviser or in any other capacity, in respect of		
	(i) Taxation matters		
	(ii) Insurance matters		
	(iii) Management services; and		
	(c) in any other capacity		
11.	Advertisement and publicity		
12.	Interest & Bank charges		
13.	Others (to be specified)		
14.	Depreciation		
	Total		

Schedule – 4 : Benefits paid (Net)

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	Insurance Claims		
	(a) Claims by Death		
	(b) Claims by Maturity		
	(c) Annuities/Pension payment		
	(d) Other benefits, specify		
2.	Amount ceded in reinsurance:		
	a. Claims by death		
	b. Claims by Maturity		
	c. Annuities/Pension payment		
	d. Other benefits, specify		
3.	Amount accepted in reinsurance		
	(a) Claims by Death		
	(b) Claims by Maturity		
	(c) Annuities/Pension payment		
	(d) Other benefits, specify		
	Total		

Notes:

(a) Claims include specific claims settlement costs, wherever applicable.

(b) Legal and other fees and expenses shall also form part of the claims cost, wherever applicable.

Schedule – 5 : Share Capital

	Particulars	Current Year	Previous Year
1.	Authorised Capital	(Rs.000)	(Rs.000)
	…. Equity shares of Rs. … each		
2.	Issued Capital		
	… Equity shares of Rs. … each		
3.	Subscribed capital		
	… Equity shares of Rs. … each		
4.	Called-up Capital		
	… Equity shares of Rs. … each		
	Less: Calls unpaid		
	Add: Shares forfeited (Amount originally paid up)		
	Less: Par Value of Equity shares bought pack		
	Less: Preliminary expenses		
	Expenses including commission or brokerage on underwriting or subscription of shares		
	Total		

Notes:

(a) Particulars of the different classes of capital should be separately stated.

(b) The amount capitalised on account of issue of bonus shares should be disclosed.

(c) In case any part of the capital is held by a holding company, the same should be separately disclosed.

Schedule – 5A : Pattern of Shareholding

(As certified by the Management)

(Rs.'000)

Shareholders	**Current Year**		**Previous Year**	
	No.of Shares	% of Holding	No.of Shares	% of Holding
Promoters Indian Foreign Others				
Total				

Schedule – 6 : Reserves and Surplus

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	Capital		
2.	Capital Redemption Reserve		
3.	Securities Premium		
4.	Revaluation Reserve		
5.	General Reserve		
	Less: Debit balance in P & L a/c if any		
	Less: Amount utilised for Buy-back		
6.	Catastrophe Reserve		
7.	Other Reserves (to be specified)		
8.	Balance of profit in Profit and Loss account		
	Total		

Schedule – 7 : Borrowings

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	Debentures/Bonds		
2.	Banks		
3.	Financial Institutions		
4.	Others (to be specified)		
	Total		

Notes:

a. The extent to which the borrowings are secured shall be separately disclosed stating the nature of the security under each sub-head.
b. Amounts due within 12 months from the date of Balance Sheet should be shown separately.

Schedule – 8 : Investments – Shareholders

(Rs.'000)

	Particulars	Current Year	Previous Year
	Long-term Investments:		
1.	Government securities and Government guaranteed bonds including Treasury Bills		
2.	Other approved securities		
3.	Other Investments		
	(a) Shares		
	(aa) Equity		
	(bb) Preference		
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other Securities (to be specified)		
	(f) Subsidiaries		
	Investment Properties – Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than Approved Investments		
	Short-term Investments:		
1.	Government securities and Govt. guaranteed bonds including Treasury bills		
2.	Other approved securities		
3.	Other investments		
	(a) Shares		
	(aa) Equity		
	(bb) Preference		
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other Securities (to be specified)		
	(f) Subsidiaries		
	(g) Investment Properties – Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than approved Investments		
	Total		

Notes: See Notes appended at the end of Schedule – 8B

Schedule – 8A : Investments – Policyholders

(Rs.'000)

	Particulars	Current Year	Previous Year
	Long-term Investments:		
1.	Government securities and Government guaranteed bonds including Treasury Bills		
2.	Other approved securities		
3.	Other Investments		
	(a) Shares		
	(aa) Equity		
	(bb) Preference		
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other Securities (to be specified)		
	(f) Subsidiaries		
	Investment Properties – Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than Approved Investments		
	Short-term Investments:		
1.	Government securities and Govt. guaranteed bonds including Treasury bills		
2.	Other approved securities		
3.	Other investments		
	(a) Shares		
	(aa) Equity		
	(bb) Preference		
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other Securities (to be specified)		
	(f) Subsidiaries		
	(g) Investment Properties – Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than approved Investments		
	Total		

Notes: See Notes appended at the end of the Schedule – 8B

Schedule – 8B : Assets held to Cover Linked Liabilities

(Rs.'000)

	Particulars	Current Year	Previous Year
	Long-term Investments:		
1.	Government securities and Government guaranteed bonds including Treasury Bills		
2.	Other approved securities		
3.	Other Investments		
	(a) Shares		
	(aa) Equity		
	(bb) Preference		
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other Securities (to be specified)		
	(f) Subsidiaries		
	Investment Properties – Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than Approved Investments		
	Short-term Investments:		
1.	Government securities and Govt. guaranteed bonds including Treasury bills		
2.	Other approved securities		
3.	Other investments		
	(a) Shares		
	(aa) Equity		
	(bb) Preference		
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other Securities (to be specified)		
	(f) Subsidiaries		
	(g) Investment Properties – Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than approved Investments		
	Total		

Notes:

(a) Investment in subsidiary/holding companies, joint ventures and associates shall be separately disclosed at cost.

- (i) Holding company and subsidiary shall be constructed as defined in the Companies Act, 1956.
- (ii) Joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.
- (iii) Joint Control is contractually agreed sharing of power to govern the financial and operating policies of an economic activity to obtain benefits from it.
- (iv) Associate is an enterprise in which the company has significant influence and which is neither a subsidiary nor a joint venture of the company.
- (v) Significant influence (for the purpose of this schedule) – means participation in the financial and operating policy decisions of a company, but not control of those policies. Significant influence may be exercised in several ways, for example, by representation on the board of directors, participation in the policy making process, material intercompany transactions, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by share ownership statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiaries 20 per cent or more the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiaries, less than 20 per cent of the voting power of the investee, it is presumed that the investor does not have significant influence unless such influence is clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

b. Aggregate amount of company's investments other than listed equity securities and derivative instruments and also the market value thereof shall be disclosed.

c. Investment made out of Catastrophe Reserve should be shown separately.

d. Debt securities will be considered as "held to maturity" securities and will be measured at historical costs subject to amortization.

e. Investment Property means a property (land or building or part of a building or both) held to earn rental income or for capital appreciation or for both, rather than for use in services or for administrative purposes.

f. Investments maturing within twelve months from balance sheet date and investments made with the specific intention to dispose them of within twelve months from balance sheet date shall be classified as short-term investments.

Schedule – 9 : Loans

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	**Security-Wise Classification:** Secured (a) On Mortgage of property (aa) In India (bb) Outside India (b) On Shares, Bonds, Govt. Securities etc. (c) Loans against policies (d) Others (to be specified) Unsecured		
	Total		
2.	**Borrower-wise classification** (a) Central and State Governments (b) Banks and Financial Statements (c) Subsidiaries (d) Companies (e) Loans against policies (f) Others (to be specified		
	Total		
3.	**Performance-wise Classification** (a) Loans classified as standard (aa) In India (bb) Outside India (b) Non-standard loans less provision (aa) In India (bb) Outside India		
	Total		
4.	**Maturity-wise Classifications** (a) Short Term (b) Long Term		
	Total		

Notes:

a. Short-term loans shall include those, which are repayable within 12 months from the date of balance sheet. Long term loans shall be the loans other than short-term loans.

b. Provisions against non-performing loans shall be shown separately.

c. The nature of the security in case of all long term secured loans shall be specified in each case. Secured loans for the purpose of this schedule, mean loan secured wholly or partly against an asset of the company.

d. Loans considered doubtful and the amount of provision created against such loans shall be disclosed.

Schedule – 10 : Fixed Assets

(Rs.'000)

Particulars	Cost/Gross Block			Depreciation			Net Block			
	Opening	Additions	Deductions	Closing	Upto Last year	For the year	On Sales/ Adjust-ments	To Date	As at year end	Previous Year
Goodwill										
Intangible (specify)										
Land-Freehold										
Leasehold property										
Buildings										
Furniture & Fittings										
Information Technology Equipment										
Vehicles										
Office Equipment										
Others (specify nature)										
Total										
Work-in-progress										
Grand Total										
Previous Year										

Note: Assets included in land property and building above exclude investment properties as defined in Note (e) to Schedule 8.

Schedule – 11 : Cash and Bank Balances

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	Cash (including cheques, drafts and stamps)		
2.	Bank balances		
	(a) Deposit Accounts		
	(aa) Short-term (due within 12 months of the date of Balance Sheet)		
	(bb) Others		
	(b) Current Accounts		
	(c) Others (to be specified)		
3.	Money at call and short notice		
	(a) With Banks		
	(b) Wit other Institutions		
4.	Others (to be specified)		
	Total		
	Balances with non-scheduled banks included in 2 and 3 above		
	Cash and Bank Balances:		
	1. In India		
	2. Outside India		
	Total		

Note: Bank balance may include remittances in transit. If so, the nature and amount shall be separately stated.

Schedule – 12 : Advances and other assets

(Rs.'000)

	Particulars	Current Year	Previous Year
	Advances		
1.	Reserve deposits with ceding companies		
2.	Application money for investments		
3.	Prepayments		
4.	Advance to Directors/Officers		
5.	Advance tax paid and taxes deducted at source (Net of provision for taxation)		
6.	Others (to be specified)		
	Total (A)		
	Others Assets:		
1.	Income accrued on investments		
2.	Outstanding Premium		
3.	Agents' Balances		

	Particulars	Current Year	Previous Year
4.	Foreign Agencies Balance		
5.	Due from other entitled carrying on insurance business (including reinsures)		
6.	Due form subsidiaries/holding company		
7.	Deposit with Reserve Bank of India (Pursuant to Section 7 of Insurance Act, 1938)		
8.	Others (to be specified)		
	Total (B)		
	Total (A + B)		

Notes:

a. The item under the above heads shall not be shown net of provisions for doubtful amounts. The amount of provision against each head should be shown separately.
b. The term "officer" should conform to the definition of that term as given under the Companies Act, 1956.
c. Sundry debtors will be shown under item 8 (others)

Schedule – 13 : Current Liabilities

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	Agents' Balances		
2.	Balances due to other insurance companies		
3.	Deposits held on reinsurance ceded		
4.	Premiums received in advance		
5.	Unallocated premium		
6.	Sundry creditors		
7.	Due to subsidiaries/holding company		
8.	Claims outstanding		
9.	Annuities due		
10.	Due to Officers/Directors		
11.	Others (to be specified)		
	Total		

Schedule – 14 : provisions

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	For taxation (Less payment and taxes deducted at source)		
2.	For proposed dividends		
3.	For dividend distribution tax		
4.	Others (to be specified)		
	Total		

Schedule – 15 : Miscellaneous Expenditure
(To the extent not written off or adjsuted)

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	Discount allowed in issue of shares/debentures		
2.	Others (to be specified)		
	Total		

Notes:

a. No item shall be included under the head "Miscellaneous Expenditure" and carried forward unless (1) some benefit from the expenditure can reasonably be expected to be received in future, and (2) the amount of such benefit reasonably determinable.

b. The amount to be carried forward in respect of any item included under the head "Miscellaneous expenditure" shall not exceed the expected future revenue/other benefits related to the expenditure.

Illu.1: The following Trial Balance was extracted from the books of the New Bharat Life Assurance Co. Ltd. as on 31st March, 2009

.

	Dr.(Rs.'000)	Cr.(Rs.'000)
Paid up Share Capital 10,000 Shares of Rs.10 each		**1,00,000**
Life Assurance Fund as on 1-4-2008		**29,72,300**
Dividends paid	**15,000**	
Bonus to Policy holders	**31,500**	
Premium received		**1,61,500**
Claims paid	**1,97,000**	
Commission paid	**9,300**	
Management expenses	**32,300**	
Mortgages in India	**4,92,200**	
Interest and dividends received		**1,12,700**
Agents Balances	**9,300**	
Freehold Properties	**40,000**	
Investments	**23,05,000**	
Loan on Company's Policies	**1,73,600**	
Cash on deposit	**27,000**	
Cash in hand and on current account	**7,300**	
Surrenders	**7,000**	
	33,46,500	**33,46,500**

You are required to prepare Company's Revenue Account for the year ended 31st March, 2009 after taking the following matters into consideration.

	Rs.
i. Claims admitted but not paid	**90,00,000**
ii. Management expenses due	**2,00,000**
iii. Interest accrued	**1,93,00,000**
iv. Premium Outstanding	**1,00,00,000**
v. Bonus utilised in reduction of premium	**20,00,000**
vi. Claims covered under reinsurance	**23,00,000**

Solution:

Name of the Insurer : NEW BHARATH LIFE ASSURANCE CO.

Registration No. and Date of Registration with the IRDA:

Revenue a/c for the year ended 31st March, 2009

Policy holders' Account (Technical Account):

(Rs.'000)

	Schedule No.	Current year ended
Premium earned (Net)	1	1,73,500
Income from Investments		
Interest & Dividends (1,12,700 + 19,300)		1,32,000
Total (A)		**3,05,500**
Commission	2	9,300
Operating expenses related to Business	3	47,500
Total (B)		**56,800**
Benefits paid	4	2,10,700
Bonus paid (Rs.31,500 + 2,000)		33,500
Total (C)		**2,44,200**
Surplus (A - B - C)		4,500
Appropriation (Surplus shown in Revenue account)		4,500

Schedule No.1 : Premium		**Schedule No.2 : Commission**	
	Rs.'000		Rs.'000
Premium	1,61,500	Commission	9,300
Add: Outstanding	10,000		
Add: Bonus utilised in reduction premium	2,000		
	1,73,500		9,300

Schedule No.3 : Operating expenses		Schedule No.4 : Benefits Paid	
	Rs.'000		Rs.'000
Management expenses	47,300	Claims Paid	1,97,000
Add: Outstanding due	200	Add: Outstanding Claims	9,000
			2,06,000
		Less: Re-insurance recoveries	2,300
			2,03,700
		Add: Surrender	7,000
	47,500		2,10,700

Illu.2: From the following particulars prepare Revenue a/c of Prudential Life Insurance Co. Ltd. for the year ended 31st March, 2010.

	Rs.'000		Rs.'000
Claims by death	**88,000**	**Claims by maturity**	**80,000**
Premiums		**Interim bonus paid to**	
First year	**80,000**	**policyholders**	**9,000**
Renewal	**2,04,000**	**Interest and rent received**	**86,400**
Re-Insurance accepted	**20,000**	**Salaries**	**12,000**
Re-insurance premium paid		**Audit fees**	**1,600**
(ceded)	**28,000**	**Rent paid**	**2,000**
Commission:		**Legal Charges**	**1,520**
First Year	**16,000**	**Travelling expenses**	**200**
Renewal Commission	**1,000**	**Office Management expenses**	
On re-insurance accepted	**4,800**		**880**
Commission on re-			
insurance ceded	**1,600**		

Solution:

Name of the Insurer : PRUDENTIAL LIFE ASSURANCE CO.

Registration No. and Date of Registration with the IRDA:

Revenue a/c for the year ended 31st March, 2010

Policy holders' Account (Technical Account)

(Rs.'000)

Particulars	Schedule No.	Current year ended Rs.'000
Premiums earned	1	
a. Premium		2,84,000
b. Re-insurance (ceded)		(-) 28,000
c. Re-insurance (accepted)		20,000
		2,76,000

Particulars	Schedule No.	Current year ended Rs.'000
Income from Investments:		
Interest & Rent Received		86,400
Total A		**3,62,400**
Commission	2	20,200
Operating expenses related to Insurance business	3	18,200
Total B		**38,400**
Benefits paid	4	1,68,000
Interim bonus paid		9,000
Total C		**1,77,000**
Surplus (A - B - C)		1,47,000
Appropriations (Surplus shown in revenue a/c)		1,47,000

Note:

1. Reinsurance accepted : (Re-insurance accepted by another company)
   a. Premium on Re-insurance accepted – Income
   b. Commission on Re-insurance accepted – Expenditure
2. Re-insurance ceded : (Re-insurance to another company):
   a. Premium on Re-insurance ceded – Expenses
   b. Commission on Re-insurance ceded – Income

Schedule No.1 : Premium		**Schedule No.2 : Commission**	
	Rs.'000		Rs.'000
First year	80,000	First year	16,000
Renewal	2,04,000	Renewal	1,000
		Commission on reinsurance ceded	4,800
			21,800
		Less: Commission on re-insurance ceded	1,600
	2,84,000		20,200

Schedule No.3 : Operating expenses		**Schedule No.4 : Benefits Paid**	
	Rs.'00*0		Rs.'000
Salaries	12,000	Claims by death	88,000
Audit fees	1,600	Claims by maturity	80,000
Rent paid	2,000		
Legal expenses	1,520		
Travelling expenses	200		
Office & Management expenses	880		
	18,200		1,68,000

Illu.3: From the following particulars prepare Balance Sheet of Standard Life Assurance Company Ltd. as on 31-3-2010.

	Rs.'000		Rs.'000
Share capital	**1,00,000**	**Life fund on 1-4-2009**	**29,72,300**
Mortgage on policy	**4,92,200**	**Agents balances**	**9,300**
Freehold premises	**40,000**	**Investments**	**23,05,000**
Loans on securities	**1,73,600**	**Cash in hand**	**27,000**
Cash at Bank	**7,300**	**Outstanding claims**	**9,200**
Accrued interest	**19,300**	**Premiums outstanding**	**10,000**
Surplus in Revenue a/c	**4,500**	**Claims covered under reinsurance**	**2,300**

Solution:

Name of the Insurer : Standard Life Assurance Co. Ltd.
Registration No. and Date of Registration with the IRDA

Balance Sheet as on 31-3-2010

Particulars	Schedule No.	Current year ended (Rs.'000)	
Sources of Funds			
Share capital	5		1,00,000
Reserves & Surplus	6		29,76,800
Borrowings	7		--
			30,76,800
Applications of Funds (Assets)			
Investments	8		23,05,000
Loans	9		6,65,800
Fixed Assets	10		40,000
Current Assets:			
Cash & Bank balances	11	34,300	
Advances & Other Assets	12	40,900	
		75,200	
Current Liabilities	13	9,200	
Provisions	14	--	
			66,000
			30,76,800

Schedule 5 : Share Capital		Schedule 6 : Reserves & Surplus	
	Rs.'000		Rs.'000
Share capital	1,00,000	Life fund on 1-4-2009	29,72,300
		Add: Surplus in Revenue a/c	4,500
	1,00,000		29,76,800

Schedule 8 : Investments		Schedule 9 : Loans	
	Rs.'000		Rs.'000
Investments	23,05,000	Mortgage on Policy	4,92,200
		Loans on securities	1,73,600
	23,05,000		6,65,800

Schedule 10 : Fixed Assets		Schedule 11: Cash & Bank balances	
	Rs.'000		Rs.'000
Freehold premises	40,000	Cash in hand	27,000
		Cash at bank	7,300
	40,000		34,300

Schedule 12 : Advances & Other Assets		Schedule 13 : Current Liabilities	
	Rs.'000		Rs.'000
Agents Balances	9,300	Outstanding claims	9,200
Accrued interest	19,300		
Outstanding Premium	2,300		
Claims covered under reinsurance	10,000		
	40,900		9,200

Illu.4: Trial Balance of New Delhi Life Insurance Corporation Ltd. as on 31-3-2009.

	Dr.(Rs.'000)	Cr.(Rs.'000)
Share Capital		**4,00,000**
Life Assurance Fund as on 1-4-2008		**59,44,600**
Bonus to Policy holders	**63,000**	
Premium received		**3,23,000**
Claims paid	**3,94,000**	
Commission paid	**28,600**	
Management expenses	**84,600**	
Mortgages Loans	**9,84,400**	
Interest and dividends received		**2,25,400**
Agents Balances	**18,600**	

	Dr.(Rs.'000)	Cr.(Rs.'000)
Premises	**80,000**	
Investments	**48,10,000**	
Loan on Policies	**3,47,200**	
Cash in hand	**54,000**	
Cash at bank	**14,600**	
Surrenders	**14,000**	
	68,93,000	**68,93,000**

You are required to prepare Company's Revenue Account for the year ended 31st March, 2009 and its Balance Sheet as on that date after taking the following matters into consideration.

	Rs.
i. Claims admitted but not paid	**18,000**
ii. Management expenses due	**400**
iii. Interest accrued	**38,600**
iv. Premium Outstanding	**20,000**
v. Claims covered under reinsurance	**4,600**

Solution:

Name of the Insurer : New Delhi Life Insurance Co. Ltd.
Registration No. and Date of Registration with the IRDA

Revenue Account of for the year ended 31st March, 2009

(Rs.'000)

Particulars	Schedule No.	Current year ended Rs.
Premium earned (Net)	1	3,43,000
Income from Investments:		
Interest & Dividends (2,25,400+38,600)		2,64,000
Total A		**6,07,000**
Commission	2	28,600
Operating expenses related to Business	3	85,000
Total B		**1,13,600**
Benefits paid	4	4,21,400
Bonus paid to policyholders (Rs.31,500-2,000)		63,000
Total C		**4,84,400**
Surplus (A - B - C)		9,000
Appropriation (Surplus shown in revenue a/c)		9,000

Schedule No.1 : Premium		**Schedule No.2 : Commission**	
	Rs.'000		Rs.'000
Premium	3,23,000	Commission	28,600
Add: Outstanding	20,000		
	3,43,000		28,600

Schedule No.3 : Operating expenses		**Schedule No.4 : Benefits Paid**	
	Rs.'000		Rs.'000
Management expenses	84,600	Claims Paid	3,94,000
Add: Outstanding due	400	Surrenders	14,000
			4,08,000
		Add: Outstanding	18,000
			4,26,000
		Less: Claims covered under reinsurance	4,600
	85,000		4,21,400

Name of the Insurer : New Delhi Life Insurance Company Ltd.

Registration No. and Date of Registration with the IRDA :

Balance Sheet as on 31-3-2009

(Rs.'000)

Particulars	Schedule No.	Current year ended	
Sources of Funds			
Share capital	5		4,00,000
Reserves & Surplus	6		59,53,600
Borrowings	7		--
Total			63,53,600
Applications of Funds (Assets)			
Investments	8		48,10,000
Loans	9		13,31,600
Fixed Assets	10		80,000
Current Assets:			
Cash & Bank balances	11	68,600	
Advances & Other Assets	12	81,800	
		1,50,400	
Current Liabilities	13	18,400	
Provisions	14	--	
			1,32,000
Total			63,53,600

Schedule 5 : Share Capital		Schedule 6 : Reserves & Surplus	
	Rs.'000		Rs.'000
Share capital	4,00,000	Life fund	59,44,600
		Add: Surplus in Revenue a/c	9,000
	4,00,000		59,53,600

Schedule 8 : Investments		Schedule 9 : Loans	
	Rs.'000		Rs.'000
Investments	48,10,000	Mortgage Loans	9,84,400
		Loans on Policies	3,47,200
	48,10,000		13,31,600

Schedule 10 : Fixed Assets		Schedule 11 : Cash & Bank balances	
	Rs.'000		Rs.'000
Premises	80,000	Cash in hand	54,000
		Cash at bank	14,600
	80,000		68,600

Schedule 12: Advances & Other Assets		Schedule 13 : Current Liabilities	
	Rs.'000		Rs.'000
Agents Balances	18,600	Outstanding claims	18,000
Accrued interest	38,600	Management expenses	400
Premium Outstanding	20,000		
Claims covered under reinsurance	4,600		
	81,800		18,400

Illu.5: From the following particulars of Fedility Life Insurance Co. Ltd. Revenue a/c and Balance Sheet for the year ended 31-3-2010.

	Rs.		Rs.
Share capital	**4,00,000**	**Life Insurance Fund (1-4-09)**	**6,80,000**
General Reserve	**45,000**	**Advances to Employees**	**9,400**
Due from Re-insurers	**7,700**	**Due to Re-insurers**	**9,500**
Agents Balances	**3,600**	**Annuities paid**	**16,350**
Mortgage Loans	**2,86,500**	**Claims**	**87,000**
Indian Govt. Securities	**2,18,000**	**Deposits with RBI**	**42,000**
Creditors	**360**	**Foreign Govt. Securities**	**15,000**
Re-insurance accepted	**10,000**	**Premiums**	**1,42,000**
Bonus to policyholders	**4,500**	**Re-insurance ceded**	**14,000**
Interest & Rent received	**43,200**	**Loans on policies**	**42,000**
Shares	**3,80,000**	**Buildings**	**12,660**
Outstanding premium	**13,200**	**Cash with Bank**	**13,500**

	Rs.		Rs.
Commission paid	**8,500**	**State Govt. Securities**	**1,45,000**
Commission on Re-insurance ceded	**800**	**Commission on Re-insurance accepted**	**2,400**
Salaries	**7,800**	**Bank loan**	**4,350**
Furniture	**7,900**	**Legal expenses**	**1,300**

Solution:

Name of the Insurer: FIDILITY LIFE INSURANCE CO. LTD
Registration No. and Date of Registration with the IRDA:
Revenue a/c for the year ended 31st March, 2010
Policy holders' Account (Technical Account):

(Rs.'000)

Particulars	Schedule No.	Current year ended
Premium earned (Net)	1	1,38,000
Income from Investments:		
Interest & Rent received		43,200
Total A		**1,81,200**
Commission	2	10,100
Operating expenses related to Business	3	9,100
Total B		**19,200**
Benefits paid	4	1,00,350
Bonus paid to policyholders		4,500
Total C		**1,04,850**
Surplus (A - B - C)		57,150
Appropriation (Surplus shown in revenue a/c)		57,150

Schedule No.1 : Premium		**Schedule No.2 : Commission**	
	Rs.'000		Rs.'000
Premium	1,42,000	Commission	8,500
Re-insurance accepted	10,000	Add: Commission on Re-insurance accepted	2,400
	1,52,000		10,900
Less: Premium on Re-insurance ceded	14,000	Less: Commission on re-insurance ceded	800
	1,38,000		10,100

Schedule No.3 : Operating expenses		Schedule No.4: Benefits Paid	
	Rs.'000		Rs.'000
Salaries	7,800	Annuities Paid	16,350
Legal Expenses	1,300	Claims	84,000
	9,100		1,00,350

Name of the Insurer : FIDILITY LIFE INSURANCE CO. LTD.

Registration No. and Date of Registration with the IRDA:

Balance Sheet as on 31-3-2010

(Rs.'000)

Particulars	Schedule No.	Current year ended	
Sources of Funds			
Share capital	5		4,00,000
Reserves & Surplus	6		7,82,150
Borrowings	7		--
			11,82,150
Applications of Funds (Assets)			
Investments	8		8,00,000
Loans	9		3,28,500
Fixed Assets	10		20,460
Current Assets:			
Cash & Bank balances	11	13,500	
Advances & Other Assets	12	33,900	
		47,400	
Current Liabilities	13	14,210	
Provisions	14	--	
			33,190
			11,82,150

Schedule 5 : Share Capital		Schedule 6 : Reserves & Surplus	
	Rs.'000		Rs.'000
Share capital	4,00,000	General Reserve	45,000
		Life Fund	6,80,000
		Surplus in Revenue a/c	57,150
	4,00,000		7,82,150

Schedule 8 : Investments		Schedule 9 : Loans	
	Rs.'000		Rs.'000
Indian Govt. Securities	2,18,000	Mortgage Loans	2,86,500
Foreign Govt. Securities	15,000	Loans on Policies	42,000
State Govt. Securities	1,45,000		
Shares	3,80,000		
Deposit with RBI	42,000		
	8,00,000		3,28,500

Schedule 10 : Fixed Assets		Schedule 11 : Cash & Bank balances	
	Rs.'000		Rs.'000
Furniture	7,800	Cash at Bank	13,500
Buildings	12,660		
	20,460		13,500

Schedule 12: Advances & Other Assets		Schedule 13 : Current Liabilities	
	Rs.'000		Rs.'000
Agents Balances	3,600	Bank Loans	4,350
Advances to employees	9,400	Creditors	360
	13,000	Due to reinsurance	9,500
Outstanding Premium	13,200		
Due form re-insurance	7,700		
	33,900		14,210

Illu.6: The undermentioned balances form part of the Trial Balance of the Bharath Assurance Co Ltd., as on 31st March, 2009. (Figures in Rs.'000)

Amount of Life Assurance Fund at the beginning of the year, Rs.14,70,562; claims by death Rs.76,980; claims by maturity Rs.56,420; premiums Rs.2,10,572; expenses of management Rs.19,890; commission Rs.26,541; consideration for annuities granted Rs.10,712; interest, dividends and rents Rs.52,461; income tax paid on profits Rs.3,060; surrenders Rs.21,860; annuities Rs.29,420; bonus paid in cash Rs.9,450; bonus paid in reduction of premiums Rs.2,500; preliminary expenses balance Rs.600; claims admitted but not paid at the end of year Rs.10,034; annuities due but not paid Rs.2,380; Capital paid-up Rs.14,00,000; Government securities Rs.24,90,890; sundry fixed assets Rs.4,19,110.

Prepare Revenue Account and the Balance Sheet after taking into account for the following.

a. **Claims covered under reinsurance Rs.10,000 by death**
b. **Further claims intimated Rs.8,000, by death**
c. **Further bonus utilised in reduction of premium Rs.1,500;**
d. **Interest accrued Rs.15,400**
e. **Premiums Outstanding Rs.7,400.**

Solution:

Name of the Insurer : Indian Assurance Co. Ltd.

Registration No. and Date of Registration with the IRDA

Revenue Account for the year ended 31st March, 2009

(Rs.'000)

Particulars	Schedule No.	Current year ended
Premium earned (Net)	1	2,19,472
Income from Investments		67,861
Other Income:		
Consideration for Annuities granted		10,712
Total A		**2,98,045**
Commission	2	26,541
Operating expenses related to Business	3	19,890
Provision for Tax		3,060
Total B		**49,491**
Benefits paid	4	1,96,130
Total C		**1,96,130**
Surplus (A - B - C)		52,424
Balance being funds for Future Appropriations		52,424

Schedule No.1 : Premium		**Schedule No.2 : Commission**	
	Rs.'000		Rs.'000
Premium earned net	2,19,472	Commission	26,541
	2,19,472		26,541

Schedule No.3 : Operating expenses		**Schedule No.4: Benefits Paid**	
	Rs.'000		Rs.'000
Operating expenses	19,800	Insurance Claims	
		a. Claims by death	84,980
		b. Claims by Maturity	56,420
	19,800	c. Annuities	29,420
		d. Surrenders	21,860
		Bonus in cash	9,450
		Bonus in reduction of Premium	4,000
		Amount ceded in reinsurance	
		a. Claims by death	(-)10,000
			1,96,130

Name of the Insurer : Insurance Assurance Co. Ltd.
Registration No. and Date of Registration with the IRDA :
Balance Sheet as at 31-3-2009

(Rs.'000)

Particulars	Schedule No.	Current year ended	
Sources of Funds			
Share capital	5		13,99,400
Policyholders' Funds			
Life Assurance Fund			14,70,562
			28,69,962
Funds for Future Appropriations			52,424
			29,22,386
Applications of Funds (Assets)			
Investments	8		24,90,890
Fixed Assets	10		4,19,110
Current Assets:			
Advances & Other Assets	12	32,800	
Less: Current Liabilities	13	20,414	12,386
			29,22,386

Schedule 5 : Share Capital	Rs.'000
Called up and Paid-up capital	14,00,000
Less: Preliminary expenses	600
	13,99,400

Schedule 8 : Investments	Rs.'000
Government Securities	24,90,890
	24,90,890

Schedule 10 : Fixed Assets	Rs.'000
Fixed Assets	4,19,110
	4,19,110

Schedule 12 : Advances & Other Assets	Rs.'000
Interest accrued on Investments	15,400
Outstanding premiums	7,400
Due from Re-insurers	10,000
	32,800

Schedule 13 : Current Liabilities	Rs.'000
Claims Outstanding	20,414
	20,414

Working Notes:

	Rs.
1. Premiums received	2,10,572
Add: Outstanding	7,400
Covered by bonus utilised for reduction premium	1,500
	2,19,472
2. Interest dividends and rents	52,461
Add: Interest accrued	15,400
Income from Investments	67,861

16.10. VALUATION BALANCE SHEET

As explained earlier, ascertainment of profit in the case of life insurance is done after the expiration of a two-year period. For this purpose a valuation balance sheet is prepared. The balance of life insurance fund is compared with the amount of net liability as per actuarial valuation. In case the balance of life insurance fund on the valuation date is more than the net liability, there is said to be a surplus. In a reserve case there will be a deficiency. The form of the valuation balance sheet is given below.

Valuation Balance sheet … as at..

Liabilities	Rs.	Assets	Rs.
Net Liability under business as shown in the summary of valuation of policies (Form H)	Xxx	Balance of Life Insurance Fund as shown in the balance sheet	xxx
Surplus, if any*	Xxx	Deficiency, if any*	xxx

*Only one figure will be there.

16.10.1 Treatment of profit:

According to Section 28 of Life Insurance Corporation of India Act, 95% of the surplus as disclosed by the valuation Balance Sheet has to be allocated to or reserved for the policy-holders of the Corporation. The balance of the amount is to be paid either to the Central Government or utilised for such other purposes and in such manner the government may determine.

The following points should be kept in mind while determining the share of the policy holders:

(i) Any interim bonus paid to the policy holders should be added back to the surplus as disclosed by the valuation balance sheet since the interim bonus is really an advance payment of the bonus.

(ii) Any expenditure still to be incurred, e.g., divided to shareholders should be deducted from the surplus as disclosed by the valuation balance sheet.

(iii) The share of the policy-holders will be 95% of the surplus left after any deduction made as above. Any interim bonus already paid should be deducted from the amounts as calculated. The balance is the amount now due to the policy-holders.

16.10.2 Accounting Entries:

The accounting entries for disposal of the profit or surplus as disclosed by the valuation balanced sheet are recorded through the following two methods.

1. **First method:** According to his method, the surplus disclosed by the valuation balance sheet is transferred from the life insurance fund to a separate profit and loss account. All appropriation (e.g., transfers to general or contingency reserve, investment fluctuation fund, bonus payable in cash, dividends to shareholders etc.) are made out of profit and loss account. A sum equal to the present value of reversionary bonus declared should be transferred back to the life insurance fund. Any balance of profit and loss account is shown in the balance sheet.

2. **Second method:** According to this method, all entries relating to appropriations are passed directly through the life insurance fund. No profit and loss account is opened. All appropriations are directly charged to the life insurance fund account. No entry for reversionary bonus is required since the life insurance fund was not debited with the full profit in the first instance.

Illu.7: A Life Insurance Company got its valuation made once in every two years. The life fund on 31-3-2010 amounted to Rs.41,92,000 before providing for Rs.32,000 for the shareholders dividend for the year 2010. Its acturial valuation on 31st March, 2010 disclosed that a net liability of Rs.40,40,000 under the assurance and annuity contracts. An interim bonus of Rs.40,000 was paid to the policy holders during the triennium ending 31st March, 2010.

Prepare statement showing the amount now available as bonus to policy holders.

Solution:

Valuation balance sheet of Insurance Company as on 31-3-2010

	Rs.		**Rs.**
To Net liability as per actuarial valuation	40,40,000	By Life fund as per balance sheet	41,92,000
To Surplus	1,52,000		
	41,92,000		41,92,000

Statement showing the amount available as Bonus to policyholders

	Rs.
Surplus as per Valuation balance sheet	1,52,000
Add : Interim bonus paid to policyholders	40,000
	1,92,000
Less : Dividend payable for the year 2009-10	32,000
Net surplus for the year ending 31-3-2010	1,60,000
Policy holders will get 95% of net surplus	1,52,000
Less : Interim bonus already paid	40,000
Amount now available as bonus to policyholders	1,12,000

Illu.8: The life fund of 31st March, 2010 was Rs.86 lakhs. The interim bonus paid during the intervaluation period was Rs.1.5 lakhs. The periodical acturial valuation determined the net liability at Rs.74 lakhs. Surplus brought forward from the previous year was Rs.8.5 lakhs. It is proposed to carry forward Rs.9 lakhs and divide the balance between policyholders and shareholders in 10:1 ratio. Show the valuation balance sheet.

Solution:

Valuation balance sheet of Insurance Company as on 31-3-2010

	Rs.		**Rs.**
To Net liability as per actuarial valuation	74,00,000	By Life fund as per balance sheet	86,00,000
To Surplus	12,00,000		
	86,00,000		86,00,000

Statement showing the amount due to policy holders

	Rs.
Surplus as per Valuation balance sheet	12,00,000
Add : Interim bonus paid to policyholders	1,50,000
	13,50,000
Less : Life fund at the beginning	8,50,000
Net profit for the valuation period	5,00,000

Distribution of Surplus

	Rs.	Rs.
Total Surplus		13,50,000
Less : Surplus to be carried forward		9,00,000
		4,50,000
Distribution to Shareholders $\left(\frac{1}{11}\right): 4{,}50{,}000 \times \frac{1}{11}$		40,909
Distrbution to policyholders $\left(\frac{10}{11}\right): 4{,}50{,}000 \times \frac{10}{11}$	4,09,091	
Less : Interim dividend already paid	1,50,000	2,59,091
Amount payable to policyholders (Rs.4,50,000 – 1,50,000 = Rs.3,00,000)		3,00,000

16.11.QUESTIONS

1. Discuss the IRDA regulations relating to the presentation of final accounts by Life Insurance Companies.
2. Explain the schedules of Revenue Account of Life Insurance Companies to be given in Form A - RA.
3. Explain the schedules of Balance Sheet of Life Insurance Companies to be given in Form A - BS.
4. Distinguish between reinsurance and double insurance.
5. What is an annuity granted by a life insurance company?
6. Re-insurance
7. Important provisions of the Insurance Act, 1938
8. When does life fund appear in final accounts?
9. Profit in Life Insurance Business
10. Life fund
11. Life assurance fund
12. What is the Valuation Balance sheet?

16.12 EXERCISES

1. The revenue account of a life insurance company shows the life assurance fund on 31st March, 2010 at Rs.62,21,310 before taking into account the following items.
   a. Claims covered under reinsurance Rs.12,000
   b. Bonus utilized in reduction of life insurance premium Rs.4,500
   c. Interest accrued on securities Rs.8,260
   d. Outstanding premium Rs.5,410
   e. Claims intimated but not admitted Rs.26,500

What is the life assurance fund after taking into account the above omission?
[Ans.: Life insurance fund Rs.62,20,480]

2. From the following figures relating to the Surabhi Life insurance Company Ltd. Prepare its revenue account for the year ended 31st march, 2010 and a Balance sheet as on that date.

	Rs.
Shareholders capital	
2,00,00,000 shares of Rs.25 each Rs.10 per share s paid up	2,00,000
Claims under policies and outstanding less received on reassurance	45,00,000
Life assurance fund on 1st April, 2009	4,80,00,000
Investment fund on 1st April, 2009	50,00,000
Expenses of management	15,00,426
Investments	5,10,00,000
Freehold and leasehold property	25,00,000
Unpaid dividends	51,790
Outstanding premiums (Net)	6,03,200
Claims admitted or intimated but not paid	30,00,000
Outstanding interest	5,90,000
Surrenders	2,58,950
Annuities	30,000
Premiums less Re-assurance	75,00,000
Consideration for annuities granted	50,500
Bonus in reduction of premiums	4,000
Gain on redemption of debentures (to be carried to investment reserve fund)	20,000
Interest, Dividends and rent received	32,00,336
Interest accrued	3,17,000
Income tax	2,80,148
Transfer of other fees	6,430
Agents' balances outstanding	1,45,904
Furniture and fittings	90,500
Loans on the company's policies within their surrender value	49,00,000
Cash in hand and at bank	3,64,000
Stamps in hand	7,322
Cheques paid into bank and in course of realization	49,000
Cheques issued but not presented for payment	66,520
Sundry creditors	44,874
Premium received in advance	1,00,000
Commission paid	1,00,000
Income tax on interest and dividends	1,20,000

[Ans.: Surplus in Revenue a/c Rs.44,83,890; Balance Sheet total Rs.5,77,03,890]

3. The following balances appeared in the books of the Morgan Life Insurance Co. Ltd., as on 31st March, 2010.

	Rs. in lakhs		Rs.in lakhs
Claims less reassurances paid during the year		Life assurance fund at the beginning of the year	50,000
By death	2,200	Premiums less reassurance	15,000
By Maturity	1,500		
Annuities	6	Claims less reassurance outstanding at the beginning of the year :	
Furniture and office equipment at cost (including Rs.40 lakh bought during the year)	250	By death	900
		By maturity	600
		Credit balances pending adjustment	60
Printing, stationery	77	Consideration for annuities granted	2
Cash with bank on current account	1.350	Interest, dividend, rents	1,800
Cash and stamps in hand	30	Registration and other fees	2
Surrenders	40		
Commission	250	Sundry deposits	100
Expenses on Management	3,100	Taxation provision	300
		Premium deposits	1,150
Sundry deposits with electricity companies	1	Sundry creditors	350
		Contingency reserve	150
Advance payment of income tax	50	Furniture and office equipment, depreciation account	40
Sundry debtors	50		
Agents' balances	100	Building depreciation account	300
Income tax	450		
Income tax on interest, dividends and rents	500		
Loans and Mortgages	150		
Loans on policies	3,250		
Sundry Investments (Rs.250 lakh deposited with the Reserve Bank of India)	52,000		
Buildings at cost (including Rs.85 lakh added during the year	5,400		
	70,754		70,754

From the foregoing balances and the following information, prepare the company's balance sheet as on 31st march, 2010 and its revenue account for the year ended on that date :

1. Claims less reassurances outstanding at the end of the year : By Death Rs.600 lakhs, By maturity Rs.400 lakhs.
2. Expenses outstanding Rs.60 lakh and prepaid Rs.15 lakh
3. Provide Rs.45 lakh for depreciation of buildings, Rs.15 lakh for depreciation of furniture and office equipment and Rs.110 lakh for taxation.
4. Premium outstanding Rs.2,028 lakh; commission thereon Rs.65 lakh
5. Interest, dividends and rents outstanding (net) Rs.30 lakhs and interest and rents accrued (net) Rs.350 lakh.

[Ans.: Surplus Rs.11,609 lakhs, Balance Sheet Total Rs.63,009 lakhs]

4. From the following trial balance, prepare the Revenue account and the balance sheet of the Birla Assurance Co. Ltd.

Trial balance as on 31st March, 2010

	Rs. in lakhs		Rs.in lakhs
Expenses of Management	18,241	Premiums	3,65,982
Deposit with Reserve bank of India	3,42,520	Profit on sale of investments	10,824
Commission	9,872	Claims admitted but not paid	15,421
Investment properties	1,68,421	Sundry trade creditors	724
Bonus in cash	4,222	Life Assurance fund at the beginning of the year 2009-2010	28,00,510
Surenders	21,104		
Claims by maturity	1,04,728	Consideration for annuities granted	12,272
Claims by death	1,72,681		
Annuities paid	7,681	Interest, dividends and rents – gross	1,20,682
Outstanding premiums	21,641	Share capital	1,00,000
Income tax paid	7,139	General reserve	50,000
Agents' balances	6,824		
Port Trust Debentures, interest and principle guaranteed by Government	5,28,241		
Cash at bank, current account	13,178		
Office furniture	1,500		
Fully paid up shares in limited liability companies registered in India	1,81,509		

	Rs. in lakhs		Rs.in lakhs
Stock of policy stamps in hand	68		
Mortgages in India	8,67,911		
Loans on Govt. securities	7,19,961		
Loans on company's policies	1,78,973		
	33,76,415		33,76,415

[Ans.: Surplus Rs.1,64,002 lakhs, Balance sheet total Rs.30,14,602 lakhs]

5. The following trail balance was extracted from the books of the Suraksha Life Assurance company ltd. as on 31st March, 2010.

	Dr (Rs. in corres).	Cr. (Rs in crores)
Paid up capital – 200 crore shares of Rs.10 each		2,000
Life Assurance fund as on 1st April, 2009		59,446
Bonus to policyholders	630	
Premium received		3,230
Claims paid	3,940	
Commission paid	186	
Management expenses	646	
Mortgages in India	9,844	
Interest, dividends and rents		2,254
Agents' balances	186	
Investment properties – real estate	800	
Investment	46,100	
Loan on company's policies	3,472	
Cash on deposit	540	
Cash in hand and on current account	446	
Surrenders	140	
	66,930	66,930

You are required to prepare the company's revenue account for the year ended 31st March, 2010 and its balance sheet as on that date after taking the following matters also into consideration.

1. Claims admitted but not paid Rs.186 crores
2. Management expenses due Rs.4 crores
3. Interest accrued Rs.386 crores
4. Premiums outstanding Rs.240 crores

[Ans.: Surplus Rs.378 crores; Balance sheet total Rs.61,824 crores]

6. From the following particulars of Metlife Life insurance company for the year ended 31-3-2009, you are required to prepare valuation balance sheet as on 31-3-2009 and distribution statement as on that date.

	Rs. in lakhs
Life insurance fund as on 1-4-2008	3,800
Net liability as per valuation	3,000
Interim bonus paid	500

[Ans.: Valuation Balance sheet Total Rs.3,800; Profit Rs.800; Amount payable to policyholders Rs.735]

7. The Life Assurance Fund of Kireeti Life Insurance Company stood at Rs.1,38,36,800 on 31-3-2010. It has paid an interim bonus of Rs.2,36,800. Net liability as per acturial valuation was Rs.1,18,80,000. Surplus brought from previous valuation was Rs.13,60,000. It propses to carry forward a sum of Rs.14,89,600 and to distribute the remaining balance among shareholders and policy holders in the ratio of 1:10. Show valuation balance sheet, ascertainment and distribution of surplus.

[Ans.: Surplus Rs.19,56,800; Net profit Rs.8,33,600; Surplus Distribution Rs.33,46,400]

8. A Life insurance company gets its valuation made once in every two years. Its Life Assurance Fund amounted to Rs.40,00,000 before providing Rs.40,000 for the shareholders dividend for the year 2009-2010. The net liability of the company was Rs.38,00,000. An interim bonus of Rs.50, 000 was paid to the policyholders during the two years ending 31-3-2010.

Prepare a statement showing the amount now available as bonus to policyholders.

[Ans.: Amount available to policy holders Rs.1,49,500]

9. The Net liability in respect of life policies, Annuity contracts of Five Star Insurance Company Ltd. on 31st March, 2009 was Rs.1,20,00,000. Its life fund on that date was Rs.1,85,00,000. During the valuation period it has paid interim bonus of Rs.40,000. The dividend for 2008-09 amounting to Rs.60,000 was not paid. Ascertain the profit earned.

[Ans.: Surplus Rs.65,00,000; Amount due to policyholders Rs.61,16,000]

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Chapter – 17

ACCOUNTS OF GENERAL INSURANCE COMPANIES

Objectives :

After studying this unit you should be able to

- the nature of General Insurance Business
- understand IRDA regulations on the preparation of final accounts.
- Know the procedure on the preparation of final accounts of general insurance companies

Structure :

17.1. INTRODUCTION

Insurance other than life insurance is called general insurance. Fire insurance against loss of property due to fire and marine insurance against loss of cargo, freight and ship are examples of general insurance.

Under this type of insurance the insurer undertakes to indemnify the loss suffered by the insured on happening of a certain event in consideration for a fixed premium.

17.1.1 General Insurance Corporation of India (GIC)

It was set up in 1971 on nationalisation of general insurance business. It was originally a holding company for the following general insurance companies:

(a) The Oriental Insurance Company Limited
(b) The New India Assurance Company Limited
(c) National Insurance Company Limited
(d) United India Insurance Company Limited

However, w.e.f. December, 2000, General Insurance Corporation of India has become a national reinsurer for general insurance business while each of its above four subsidiary companies have been de-linked from it and made as independent insurance companies.

Since April, 2000, a number of private general insurers have also entered insurance business. They include the following:

(a) Royal Sundaram Alliance Insurance Co. Ltd.
(b) Reliance General Insurance Co. Ltd.
(c) IFFCO Tokio General Insurance Co. Ltd.
(d) Tata AIG General Insurance Co. Ltd.
(e) Bajaj Allianz General Insurance Co. Ltd.
(f) ICICI Lombard General Insurance Co. Ltd.
(g) Cholamandalam General Insurance Co. Ltd.
(h) Export Credit Guarantee Corporation Ltd.
(i) HDFC-Chubb General Insurance Co. Ltd.

17.1.2 Distinction between Life Insurance and General Insurance

	Basis of difference	Life Insurance	General Insurance
1.	**Nature of Risk**	The risk is certain in life insurance	This risk is not certain.
2.	**Object**	The object is to secure future and also to make investment	The object is to provide security in the event of a loss.
3.	**Time coverage**	The policy is generally of a longer period	Fire/Marine and general insurance policy generally for a short period
4.	**Premium amount**	It is decided according to the age of insured and time of the policy	Premium is decided according to the risk involved.
5.	**Presence of insurance interest**	In life insurance, insurable interest must exist at the time of acquiring the policy	The insurable interest must exist at the time of contract and also at the time of loss.
6.	**Compensation**	In this case loss is not compensated a fixed amount of money (sum assured) is only paid	In fire/marine insurance actual loss is compensated

	Basis of difference	Life Insurance	General Insurance
7.	**Surrender of policy**	The policy, can be surrendered before its maturity	The policy cannot be surrendered
8.	**Moral obligation**	The moral obligation of the insured is less because nobody may die to get insurance money.	The insured is under moral obligation to protect the goods or property insured
9.	**Payment of premium**	The premium may be paid in installments.	The payments of premium is in lump sum amount payable at one time.

17.2. IRDA GUIDELINES

The general insurance companies should follow all the general instructions given by the Insurance Regulatory Authority (IRDA) in the preparation of their financial statements. The guidelines of the IRDA are given below.

1. The corresponding amounts for the immediately preceding financial year for all items shown in the Balance Sheet, Revenue Account, Profit and Loss account shall be given.
2. The figures in the financial statements may be rounded off to the nearest thousands.
3. Interest, dividends and rentals receivable in connection with an investment should be stated at gross value, the amount of income tax deducted at source being included under ‘advance taxes paid’.
4. Income from rent shall not include any notional rent.
5. (I) For the purpose of financial statements, unless the context otherwise requires;
   a. the expression ‘provision’ shall, subject note (II) below mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability or loss of which the amount cannot be determined with substantial accuracy.
   b. the expression “reserve” shall not, subject to as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability.
   c. The expression ‘capital reserve’ shall not include any amount regarded as free for distribution through the profit and loss account; and the expression ‘revenue reserve’ shall mean any reserve other than a capital reserve.
   d. The expression ‘liability’ shall include all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities.

   (II) Where:

(a) any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or

(b) any amount retained by way of providing for any known liability is in excess of the amount which in the opinion of the directors is reasonably necessary for the purpose, the excess shall be treated for the purpose of these accounts as a reserve and not provision.

6. The company should make provisions for damages under law suits where the management is of the opinion that the award may go against the insurer.
7. Extent of risk retained and reinsured shall be separately disclosed.
8. Any debit balance of the Profit and Loss account shall be shown as deduction from uncommitted reserve and the balance, if any shall be shown separately.

17.2.1 Important points to be considered :

The following points should be kept in mind while preparing annual accounts of general insurance companies:

(i) **Separate Revenue Account ;** A general insurance company may engage itself in more than one insurance business, e.g., fire, marine, miscellaneous, etc. For each type of business, a separate revenue account, at the end of each calendar year will have to be prepared in the form "*B-P&L",* as prescribed the Insurance Regulatory Authority.

(ii) **Reserves :** Reserve for unexpired risks, as explained in the preceding pages, is to be created. Such reserve is to be made at 50% of the net premium income in case of fire and other insurance businesses and at 100% of the net premium income in case of marine insurance business. A prudent insurance company may make additional reserve in case of the fire and miscellaneous insurance business, if it considers it necessary.

(iii) **Forms :** A profit and loss account, incorporating appropriations also, is prepared at the end of each period in the prescribed forms "*B-P&L"* as discussed earlier. A combined balance sheet is also prepared in the form 'B-BS' as prescribed by the Insurance Regulatory and Development Authority.

(iv) **Commission on policies :** Commission on policies affected through insurance agents cannot exceed 5% of the premium in respect of fire and marine business and 10% in case of miscellaneous business. In case of policies effected through principal agents the maximum limits are 20% for fire and marine policies and 15% in the case of miscellaneous insurance *less* any commission payable to an insurance agent with respect to the policy concerned. Certain concessions are available in this respect to principal agents having a foreign domicile.

17.3. BOOKS OF ACCOUNTS – IRDA REGULATIONS

According to Insurance Regulatory Development Authority (IRDA) insurers doing General Insurance Business should comply with requirements of Schedule B of the Regulations which among other things, given the following Forms:

Revenue Account	Form B – RA
Profit and Loss Account	Form B – PL
Balance Sheet	Form B – BS

Thus, every company dealing with General Insurance Business is required to prepare and present a revenue account, profit and loss account and a Balance sheet. There are fifteen schedules, four relates to revenue account and remaining 11 schedules relates to the Balance Sheet.

17.4. PREPARATION OF FINAL ACCOUNTS IMPORTANT POINTS

In the preparation of the accounts of General Insurance Companies the following points are to be taken into consideration.

17.4.1 Consolidated Balance Sheet:

When the General Insurance Company is having different types of insurance i.e., fire, marine, health, accidental insurance, etc., a combined balance sheet is to be prepared in the prescribed form for all types of businesses.

17.4.2 Reserve for Unexpired Risks

An insurance company issues general insurance policies throughout the accounting year. Premium is received at the time of issue of the policy. But the period for which the policy is issued may cover part of the current accounting year and a part of the next accounting year. It means the company may be required to pay for losses which may take place next year in respect of at least some of the policies issued in the current accounting year. It is, therefore, wrong to consider the premium received in an accounting year to be income of the insurance company without taking into account a reserve for unexpired risks. Schedule II B of the Insurance Regulatory and Development Authority (Assets, Liabilities and Solvency Margin of Insurance) Regulation 2000 lays down that the reserve for unexpired risks, shall be in respect of:

i. Fire business, **50 per cent**
ii. Miscellaneous business, **50 per cent**
iii. Marine business other than marine hull business, **50 per cent** and
iv. Marine hull business, **100 per cent** of the premium, net of reinsurance, received or receivable during the proceeding twelve months.

Finally, to ascertain the amount of surplus for which a general insurance company can take credit in respect of a particular type of general insurance business, in the relevant Revenue Account, net premium earned is adjusted for Reserve for unexpired Risks as in the beginning and as at the end of the accounting year concerned.

17.4.3 Maximum Commission Payable

Maximum amount of commission is **5% of the premium** in case of marine and fire business and **10% in case of** miscellaneous business on policies which are effected through insurance agents. If the policies are effected through principal agent then the above percentages are **10% in place of 5%** in case or marine and fire and **15% in place of 10%** in case of miscellaneous business.

17.4.4 Claims Paid:

The Claims paid by the Company must include all expenses directly incurred in setting claims such as legal expenses, medical expenses, surveyor's expenses etc. No Claim of Rs.20,000 or more can be paid, except as the Controller of Insurance may otherwise direct, unless there is a report in respect thereof from an approved surveyor or loss assessor (licensed under the Insurance Act).

17.5. REVENUE ACCOUNT – FORM B – RA

Name of the Insurer:
Registration No. and Date of Registration with the IRDA:

Revenue Account for the year the ended 31st March ……

	Particulars	**Schedule No.**	**Current Year**	**Previous Year**
			(Rs.'000)	**(Rs.'000)**
1.	Premiums earned (Net)	1		
2.	Profit/Loss on sale/redemption of investments			
3.	Others (to be specified)			
4.	Interest, Dividend & Rent-Gross			
	Total (A)			

	Particulars	**Schedule No.**	**Current Year**	**Previous Year**
			(Rs.'000)	**(Rs.'000)**
2.	Commission	3		
3.	Operating Expenses related to Insurance Business	4		
	Total (B)			
	Operating Profit/Loss from Fire/Marine/ Miscellaneous Business (C) = (A - B)			
	Appropriations			
	Transfer to Shareholders' Account Transfer to Catastrophe Reserve Transfer to Other Reserves (to be specified)			
	Total (C)			

Note: See Notes appended at the end of Form-PL

17.6. PROFIT AND LOSS ACCOUNT – FORM B – PL

Name of the Insurer:
Registration No. and Date of Registration with the IRDA:

Profit and Loss Account for the year the ended 31st March ……..

	Particulars	Schedule No.	Current Year	Previous Year
			(Rs.'000)	(Rs.'000)
1.	**Operating Profit/Loss** (a) Fire Insurance (b) Marine Insurance (c) Miscellaneous Insurance			
2.	**Income from Investments** (a) Interest, Dividend & Rent – Gross (b) Profit on Sale of Investments Less: Loss on sale of Investments			
3.	**Other Income (to be specified)**			
	Total (A)			

	Particulars	Schedule No.	Current Year	Previous Year
4.	**Provisions (other than taxation)** (a) For diminution in the value of Investments (b) For doubtful debts (c) Others (to be specified)			
	Total (B)			
	Profit before tax Provision for taxation **Appropriations:** (a) Interim dividend paid during the year (b) Proposed final dividend (c) Dividend distribution tax (d) Transfer to any Reserve or other Accounts (to be specified)			
	Balance of profit/loss brought forward from last year			
	Balance carried forward to Balance Sheet			

Notes to Form B – RA and B – PL

a. Premium income received from business concluded in and outside India shall be separately disclosed.
b. Reinsurance premiums whether on business ceded or accepted are to be brought into account gross (i.e., before deducting commission) under the head reinsurance premium.
c. Claims incurred shall comprise claims paid, specific claims settlement costs wherever applicable and change in the outstanding provision for claims at the year-end.
d. Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs.5,00,000 whichever is higher, shall be shown as a separate line item.
e. Fees and expenses connected with claims shall be included in claim.
f. Under the sub-head "others" shall be included items like foreign exchange gains or losses and other items.
g. Interest, dividends and rental receivable in connection with the investment should be stated as gross amount, the amount of income tax deducted at source being included under "advance taxes paid and taxes deducted at source."

h. Income from rent shall include only the realised rent. It shall not include any notional rent.

17.7. BALANCE SHEET – FORM B – BS

A General Insurance Company prepares a combined Balance Sheet of all the businesses carried on by it but it has to show the amount of 'fund' for each business separately. The Balance Sheet is prepared in Form A prescribed for the purpose. It may be noted that the form of Balance Sheet is same for life Insurance and General insurance businesses.

Name of the Insurer:
Registration No. and Date of Registration with the IRDA:

Balance Sheet as at ……..

	Schedule No.	Current Year	Previous Year
		(Rs.'000)	(Rs.'000)
Sources of Funds:			
Share Capital	5		
Reserves and Surplus	6		
Fair Value change account			
Borrowings	7		
Total			
Application of Funds			
Investments	8		
Loans	9		
Fixed Assets	10		
Current Assets			
Cash and Bank balances	11		
Advances and other Assets	12		
Sub-Total (A)			
Current Liabilities	13		
Provisions	14		
Sub-Total (B)			
Net Current Assets (C) = (A-B)			
Miscellaneous Expenditure (to the extent not written off or adjusted)	15		
Debit balance in Profit and Loss Account (Shareholders' Account)			
Total			

Contingent Liabilities:

	Particulars	Current Year	Previous Year
		(Rs.'000)	(Rs.'000)
1.	Partly paid-up investments		
2.	Claims, other than against policies, not acknowledged as debts by the company		
3.	Underwriting commitments outstanding (in respect of shares and securities)		
4.	Guarantees given by or on behalf of the company		
5.	Statutory demands/liabilities in dispute, not provided for		
6.	Reinsurance obligations to the extent not provided for in accounts		
7.	Others (to be specified)		
	Total		

Schedules Forming part of Financial Statements

Schedule – 1 : Premium Earned (Net)

(Rs.'000)

Particulars	Current Year	Previous Year
Premium from direct business Add: Premium on reinsurance accepted Less: premium on reinsurance ceded		
Net Premium		
Adjustment for change in reserve for unexpired risks		
Total Premium Earned (Net)		

Schedule – 2 : Claims Incurred (Net)

(Rs.'000)

Particulars	**Current Year**	**Previous Year**
Claims Paid Direct: Add: Re-insurance Accepted Less: Re-insurance Ceded		
Net Claims Paid Add: Claims Outstanding at the end of the year Less: Claims Outstanding at the beginning		
Total Claims incurred		

Notes:

a. Incurred but Not Reported (IBNR), Incurred But Not Enough Reported (IBNER) claims should be included in the amount for outstanding claims.
b. Claims include specific claims settlement cost but not expenses of management.
c. The surveyor fees, legal and other expenses shall also form part of claims cost.
d. Claims cost should be adjusted for estimated salvage value if there is a sufficient certainty of its realization.

Schedule – 3 : Commission

(Rs.'000)

Particulars	Current Year	Previous Year
Commission Paid		
Direct:		
Add: Commission on Re-insurance Accepted		
Less: Commission on Re-insurance Ceded		
Net Commission		

Note: The profit/commission, if any, are to be combined with the re-insurance accepted or re-insurance ceded figures.

Schedule – 4 : Operating Expenses related to Insurance Business

(Rs.'000)

Particulars	Current Year	Previous Year
1. Employees' remuneration & Welfare benefits		
2. Travel, conveyance and vehicle running expenses		
3. Training expenses		
4. Rents, rates and taxes		
5. Repairs		
6. Printing & Stationery		
7. Communication expenses		
8. Legal and Professional charges		
9. Auditor's fees, expenses etc.		
(a) as auditor		
(b) as adviser or in any other capacity, in respect of		
(i) Taxation matters		
(ii) Insurance matters		
(iii) Management services; and		
(c) in any other capacity		
10. Advertisement and publicity		
11. Interest & Bank charges		
12. Others (to be specified)		
13. Depreciation		
Total		

Schedule – 5 : Share Capital

(Rs.'000)

Particulars	Current Year	Previous Year
1. Authorised Capital …… Equity shares of Rs. ….. each 2. Issued Capital …… Equity shares of Rs. ….. each 3. Subscribed capital …… Equity shares of Rs. ….. each 4. Called-up Capital …… Equity shares of Rs. ….. each Less: Calls unpaid Add: Shares forfeited (Amount originally paid up) Less: Par Value of Equity shares bought back Less: Preliminary expenses Expenses including commission or brokerage on underwriting or subscription of shares		
Total		

Notes:

(a) Particulars of the different classes of capital should be separately stated.
(b) The amount capitalized on account of issue of bonus shares should be disclosed.
(c) In case any part of the capital is held by a holding company, the same should be separately disclosed.

Schedule – 5A : Pattern of Shareholding

(As certified by the Management)

(Rs.'000)

Shareholders	Current Year		Previous Year	
	No. of shares	% of Holding	No. of Shares	% of Holding
Promoters Indian Foreign				
Others				
Total				

Schedule – 6 : Reserves and Surplus

(Rs.'000)

Particulars	Current Year	Previous Year
1. Capital Reserve		
2. Capital Redemption Reserve		
Securities Premium		
4. General Reserve		
Less: Debit balance in P & L a/c if any		
Less: Amount utilised for Buy-back		
5. Catastrophe Reserve		
6. Other Reserves (to be specified)		
7. Balance of profit in Profit and Loss account		
Total		

Note: Additions to and deductions from the reserve should be disclosed under each of the specified heads.

Schedule – 7 : Borrowings

(Rs.'000)

Particulars	Current Year	Previous Year
1. Debentures/Bonds		
2. Banks		
3. Financial Institutions		
4. Others (to be specified)		
Total		

Notes:

a. The extent to which the borrowings are secured shall be separately disclosed stating the nature of the security under each sub-head.

b. Amounts due within 12 months from the date of Balance Sheet should be shown separately.

Schedule – 8 : Investments

(Rs.'000)

Particulars	Current Year	Previous Year
Long-term Investments:		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other approved securities		
3. Other Investments		
(a) Shares		
(aa) Equity		
(bb) Preference		

	Particulars	Current Year	Previous Year
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other Securities (to be specified)		
	(f) Subsidiaries		
	(g) Investment Properties – Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than Approved Investments		
	Short-term Investments:		
1.	Government securities and Govt. guaranteed bonds including Treasury bills		
2.	Other approved securities		
3.	Other investments		
	(a) Shares		
	(aa) Equity		
	(bb) Preference		
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other Securities (to be specified)		
	(f) Subsidiaries		
	(g) Investment Properties – Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than approved Investments		
	Total		

Notes:

(a) Investments in subsidiary/holding companies, joint ventures and associates shall be separately disclosed at cost.

(i) Holding company and subsidiary shall be constructed as defined in the Companies Act, 1956.

(ii) Joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

(iii) Joint Control is contractually agreed sharing of power to govern the financial and operating policies of an economic activity to obtain benefits from it.

(iv) Associate is an enterprise in which the company has significant influence and which is neither a subsidiary nor a joint venture of the company.

(v) Significant influence (for the purpose of this schedule) – means participation in the financial and operating policy decisions of a company, but not control of those policies. Significant influence may be exercised in several ways, for example, by representation on the board of directors, participation in the policy making process, material intercompany transactions, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by share ownership statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiaries 20 per cent or more the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiaries, less than 20 per cent of the voting power of the investee, it is presumed that the investor does not have significant influence unless such influence is clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

(b) Aggregate amount of company's investments other than listed equity securities and derivative instruments and also the market value thereof shall be disclosed.

(c) Investment trade out of Catastrophe Reserve should be shown separately.

(d) Debt securities will be considered as "held to maturity" securities and will be measured at historical costs subject to amortization.

(e) Investment Property means a property (land and building or part of a building or both) held to earn rental income or for capital appreciation or for both, rather than for use in services or for administrative purposes.

(f) Investments maturing within twelve months from balance sheet date and investments made with specific intention to dispose them of within twelve months from balance sheet date shall be classified as short-term investments.

Schedule – 9 : Loans

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	**Security-Wise Classification:**		
	Secured		
	(a) On Mortgage of property		
	(aa) In India		
	(bb) Outside India		
	(b) On Shares, Bonds, Govt. Securities etc.		
	(c) Others (to be specified)		
	Unsecured		
	Total		
2.	**Borrower-wise classification**		
	(a) Central and State Governments		
	(b) Banks and Financial Statements		
	(c) Subsidiaries		
	(d) Industrial Undertakings		
	(e) Others (to be specified)		
	Total		

	Particulars	Current Year	Previous Year
3.	**Performance-wise Classification**		
	(a) Loans classified as standard		
	(aa) In India		
	(bb) Outside India		
	(b) Non-standard loans less provision		
	(aa) In India		
	(bb) Outside India		
	Total		
4.	**Maturity-wise Classification**		
	(a) Short-Term		
	(b) Long-Term		
	Total		

Notes:

a. Short-term loan shall include those, which are repayable within 12 months from the date of balance sheet. Long-term loans shall be the loans other than short-term loans.

b. Provisions against non-performing loans shall be shown separately.

c. The nature of the security in case of all long term secured loans shall be specified in each case. Secured loans for the purpose of this schedule, mean loans secured wholly or partly against an asset of the company.

d. Loans considered doubtful and the amount of provision created against such loans shall be disclosed.

Schedule – 10 : Fixed Assets

(Rs.'000)

Particulars	Cost/Gross Block				Depreciation				Net Block	
	Opening	Additions	Deductions	Closing	Upto Last Year	For the Year	On Sales/ Adjust ments	To Date	As at year end	Previous Year
Goodwill Intangible (specify) Land-Freehold Leasehold property Buildings Furniture & Fittings Information Technology Equipment										

	Opening	Additions	Deductions	Closing	Upto Last Year	For the Year	On Sales/ Adjust ments	To Date	As at year end	Previous Year
Vehicles Office Equipment Others (specify nature)										
Total										
Work-in-progress										
Grand Total										
Previous Year										

Note: Assets included in land property and building above exclude investment properties as defined in Note (e) to Schedule 8.

Schedule – 11 : Cash and Bank Balances

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	Cash (including cheques, drafts and stamps)		
2.	Bank balances		
	(a) Deposit Accounts		
	(aa) Short-term (due within 12 months of the date of Balance Sheet)		
	(bb) Others		
	(b) Current Accounts		
	(c) Others (to be specified)		
3.	Money at call and short notice		
	(a) With Banks		
	(b) With other Institutions		
4.	Others (to be specified)		
	Total		
	Balances with non-scheduled banks included in 2 and 3 above		

Note: Bank balance may include remittances in transit. If so, the nature and amount shall be separately stated.

Schedule – 12 : Advances and other assets

(Rs.'000)

	Particulars	Current Year	Previous Year
	Advances		
1.	Reserve deposits with ceding companies		
2.	Application money for investments		
3.	Prepayments		
4.	Advance to Directors/Officers		
5.	Advance tax paid and taxes deducted at source (Net of provision for taxation)		
6.	Others (to be specified)		
	Total (A)		
	Others Assets:		
1.	Income accrued on investments		
2.	Outstanding Premium		
3.	Agents' Balances		
4.	Foreign Agencies Balance		
5.	Due from other entitled carrying on insurance business (including reinsures)		
6.	Due from subsidiaries/holding company		
7.	Deposit with Reserve Bank of India (Pursuant to Section 7 of Insurance Act, 1938)		
8.	Others (to be specified)		
	Total (B)		
	Total (A + B)		

Notes:

a. The item under the above heads shall not be shown net of provisions for doubtful amounts. The amount of provision against each head should be shown separately.

b. The term "officer' should conform to the definition of that term as given under the Companies Act, 1956.

c. Sundry debtors will be shown under item 9 (others)

Schedule – 13 : Current Liabilities

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	Agents' Balances		
2.	Balances due to other insurance companies		
3.	Deposits held on reinsurance ceded		
4.	Premiums received in advance		
5.	Unallocated premium		
6.	Sundry creditors		

	Particulars	Current Year	Previous Year
7.	Due to subsidiaries/holding company		
8.	Claims outstanding		
9.	Due to Officers/Directors		
10.	Others (to be specified)		
	Total		

Schedule – 14 : Provisions

(Rs.'000)

	Particulars	Current Year	Previous Year
1.	Reserve for unexpired Risk		
2.	For taxation (Less payment and taxes deducted at source)		
3.	For proposed dividends		
4.	For dividend distribution tax		
5.	Others (to be specified)		
	Total		

Schedule – 15 : Miscellaneous Expenditure
(To the extent not written off or adjusted)

(Rs.'000)

Particulars	Current Year	Previous Year
1. Discount allowed in issue of shares/debentures		
2. Others (to be specified)		
Total		

Notes:

a. No item shall be included under the head "Miscellaneous Expenditure" and carried forward unless (1) some benefit from the expenditure can reasonably be expected to be received in future, and (2) the amount of such benefit reasonably determinable.

b. The amount to be carried forward in respect of any item included under the head "Miscellaneous expenditure" shall not exceed the expected future revenue/other benefits related to the expenditure.

Illu.1: From the following particulars of South India General Insurance Co. Ltd. prepare Fire Revenue a/c.

	Rs.		Rs.
Claims paid	**4,80,000**	**Claims outstanding at the beginning of the year**	**40,000**
Claims outstanding at the end of the year	**60,000**	**Claims intimated but not accepted**	**10,000**
Premium received	**12,12,000**	**Reinsurance premium paid**	**1,20,000**
Commission	**2,00,000**	**Commission on reinsurance accepted**	**5,000**
Commission on reinsurance ceded	**10,000**	**Management expenses**	**3,17,000**
Reserve for unexpired risk at the beginning of the year	**4,00,000**	**Additional reserve for unexpired risk**	**20,000**
Re-insurance recovery of claims	**8,000**	**Sundry expenses regarding claims**	**5,000**
Loss on sale of motor car	**5,000**	**Refund of double taxation**	**5,000**
Bad debts	**3,000**	**Income tax deducted thereon**	
Interest & dividends	**6,000**		**1,000**
Profit on sale of investments	**2,000**	**Legal expenses regarding claims**	**3,000**
Rent of staff quarters deducted from salaries	**2,000**	**Depreciation on furniture**	**6,000**

You are required to provide additional reserve for unexpired risk at 1% at the net premium to addition to the opening balance.

Note: In Fire Insurance Companies are provided for reserve for unexpired risks @ 50% of the net premium. For marine insurance companies provided 100%.

Closing outstanding claims were added, opening outstanding claims were deducted.

Solution:

Name of the Insurer : South India General Insurance Co. Ltd.

Registration No. and Date of Registration with IRDA :

Revenue a/c for the year ended …….

(Rs.'000)

Particulars	Schedule No.	Current year ended
Premium earned (Net)	1	9,35,080
Profit on Sale of Investments		2,000
Refund of Double Taxation		5,000
Rent of Staff Quarters		2,000
Interest, Dividends & Rent (Gross)		6,000
Total (A)		**9,50,080**

	Particulars	Schedule No.	Current year ended
	Claims incurred (Net)	2	5,10,000
	Commission	3	1,95,000
	Operating Expenses related to Insurance Business	4	3,31,000
	Total (B)		**10,36,000**
	Operating Loss from Fire Business (C) = (A – B)		(-) 85,920

Schedule – 1 : Premiums earned (Net)

	Rs.'000	Current year Rs.'000
Premiums from direct business written		12,12,000
Less: Premium on reinsurance ceded		1,20,000
		10,92,000
Less: Adjustment for change in reserve for unexpired risk		
Reserve for unexpired risk at the end of the year 50% of Net premium Rs.10,92,000	5,46,000	
Add: Additional Reserve (Rs.20,000 old to be continued + 1% of Rs.10,92,000 Net premium)	30,920	
	5,76,920	
Less: Reserve for unexpired risks at the beginning of the year	4,20,000	
		1,56,920
		9,35,080

Schedule – 2 : Claims incurred (Net)

	Rs.'000	Current year Rs.'000
Claims Paid	4,80,000	
Less: Reinsurance recoveries of claims	8,000	
	4,72,000	
Add: Claims intimated but not accepted at the end of the year	10,000	
Claim intimated and accepted at the end of the year	60,000	
Sundry expenses regarding claims	5,000	
Legal expenses regarding claims	3,000	
	5,50,000	
Less: Claims outstanding at the beginning of the year	40,000	
		5,10,000

Schedule No.3 : Commission	`	Schedule No.4 : Operating expenses	Rs.'000
Commission Paid	2,00,000	Management Expenses	3,17,000
Add: Commission on reinsurance		Bad debts	3,000
accepted	5,000	Loss on sale of Motor car	5,000
	2,05,000	Depreciation on Furniture	6,000
Less: Commission no			
reinsurance ceded	10,000		
	1,95,000		3,31,000

Illu.2: From the following balances of United General Insurance Company, prepare Marine Revenue a/c for the year ended 31-3-2009

	Rs.		**Rs.**
Claims paid	**7,60,000**	**Additional reserve on 1-4-08**	**40,000**
Sundry expenses		**Bad debts**	**20,000**
regarding claims	**4,000**	**Commission received on**	
Life fund on 1-4-2008	**16,00,000**	**reinsurance ceded**	**40,000**
Insurance premium	**21,60,000**	**Management expenses**	**8,00,000**
Commission paid	**1,10,000**		

Solution:

Name of the Insurer : United General Insurance Co.

Registration No. and Date of Registration with the IRDA :

Revenue a/c for the year ended March, 31, 2009

(Rs.'000)

Particulars	Schedule No.	Current year ended
Premium earned (Net)	1	16,40,000
Profit on Sale of Investments		--
Total (A)		**16,40,000**
Claims	2	7,64,000
Commission	3	70,000
Operating Expenses related to Insurance Business	4	8,20,000
Total (B)		**16,54,000**
Operating Loss (C) = (A – B)		**14,000**

Schedule 1 : Premium		Schedule 2 : Claims	
	Rs.'000		Rs.'000
Premium received	21,60,000	Claims Paid	7,60,000
Add: Opening Life fund	16,00,000	Add: Sundry expenses	4,000
Add: Opening Additional reserve	40,000		
	38,00,000		
Less: unexpired risk	21,60,000		
	16,40,000		7,64,000

Schedule 3 : Commission		Schedule 4 : Operating expenses	
	Rs.'000		Rs.'000
Commission	1,10,000	Management Expenses	8,00,000
Less: Commission earned on reinsurance premium ceded	40,000	Bad debts	20,000
	70,000		8,20,000

Illu.3: From the following figures taken from the books of Western India General Insurance Co. Ltd. doing fire underwriting business, prepare the set of final accounts for the year 2009-10.

	Rs.'000		Rs.'000
Fire Fund (as on 1-4-2009)	**11,80,000**	**Commission on Direct business**	**2,99,777**
General Reserve	**4,50,000**	**Commission on reinsurance accepted**	**60,038**
Investment	**36,00,000**		
Premiums	**26,01,533**	**Outstanding premium**	**22,300**
Claims Paid	**6,02,815**	**Claims intimated but not paid (1-4-2009)**	**60,000**
Share capital – Dividend equity shares of Rs.100 each	**10,00,000**	**Expenses on Management**	**4,31,947**
		Audit fees	**36,000**
Profit and Loss account (Cr.)	**25,000**	**Rates and Taxes**	**5,804**
Re-insurance premium	**1,12,525**	**Rents**	**67,500**
Claims recovered from reinsurers	**21,119**	**Income from Investments**	**1,53,000**
		Sundry Creditors	**22,500**
Commission on reinsurance ceded	**48,016**	**Agents Balance (Dr.)**	**20,000**
Advance income tax paid	**2,50,000**	**Cash in Hand and Bank balance**	**1,32,462**

The following further information may also be noted:

a. **Expenses of management include survey fees and legal expenses of Rs.36,000 thousand and Rs.20,000 thousand relating to claims.**
b. **Claims intimated but not paid on 31st March, 2010 Rs.1,04,000 thousand.**
c. **Income tax to be provided at 40%.**
d. **Transfer of Rs.2,25,000 thousand to be made from current profit to General reserve.**
e. **The company maintains a reserve for unexpired risk @ 50% of net premium income.**
f. **The directors propose a dividend @ 30%. Dividend distribution tax is payable @ 11% which include surcharge.**

Solution:

Name of the Insurer : Western India Insurance Co. Ltd.
Registration No. and Date of Registration with the IRDA :

Revenue a/c for the year ended 31st March, 2010

(Rs.'000)

Particulars	Schedule No.	Current year ended Rs.
Premium earned (Net)	1	24,24,504
Total (A)		**24,24,504**
Claims	2	6,81,696
Commission	3	3,11,799
Operating Expenses related to Insurance Business	4	3,75,947
Total (B)		**13,69,442**
Operating Profit from fire Business (C) = (A – B)		10,55,062
Appropriations		
Transfer to Shareholders' account		10,55,062
Total (c)		**10,55,062**

Name of the Insurer : Western India General Insurance Co. Ltd.
Registration No. and Date of Registration with the IRDA :

Profit and Loss account for the year ended 31st March, 2010

(Rs.'000)

Particulars	Current year ended
Operating Profit from Fire Business	10,55,062
Income from Investments	1,53,000
Total (A)	**12,08,062**

Particulars	Current year ended
Expenses other than those related to Insurance Business	
Rent	67,500
Rates and taxes	5,804
Audit fees	36,000
Total (B)	**1,09,304**
Profit before Tax (A-B)	10,98,758
Provision for Taxation @ 40%	4,39,503
	6,59,255
Appropriations	
Proposed Final Dividend @ 30%	3,00,000
Dividend Distribution Tax at 11%	33,000
Transfer to General Reserve	2,25,000
Balance of profit brought forward from last year	1,01,255
Balance carried forward to Balance Sheet	25,000
	1,26,255

Schedule 1 : Premium		**Schedule 2 : Claims**	
	Rs.'000		Rs.'000
Premium received	26,01,533	Claims Paid	6,58,815
Less: Premium on reinsurance	1,12,525	Less: Reinsurance ceded	21,119
	24,89,008		6,37,696
Less: Adjustment for increase in reserve for unexpired risks	64,504	Add: Claims outstanding at the end of the year	1,04,000
			7,41,696
		Less: Claims outstanding at the beginning	60,000
	24,24,504		6,81,696

Schedule 3 : Commission		**Schedule 4 : Operating expenses**	
	Rs.'000		Rs.'000
Commission paid		Expenses of Management	3,75,947
Direct Business	2,99,777		
Add: Reinsurance accepted	60,038		
	3,59,815		
Less: Reinsurance ceded	48,016		
	3,11,799		3,75,947

Name of the Insurer : Western India General Insurance Co. Ltd.
Registration No. and Date of Registration with the IRDA :

Balance Sheet as on 31-3-2010

(Rs.'000)

Particulars	Schedule No.	Current year ended
Sources of Funds		
Share capital	5	10,00,000
Reserves & Surplus	6	9,31,255
		19,31,255
Applications of Funds (Assets)		
Investments	8	31,30,000
Current Assets:		
Cash & Bank balances	11	4,82,462
Advances & Other Assets	12	42,300
Sub-Total (A)		5,24,762
Current Liabilities	13	1,26,500
Provisions	14	15,97,007
Sub-Total (B)		17,23,507
Net Current Assets (c) = (A – B)		11,98,745
Total		19,31,255

Schedule 5 : Share Capital		**Schedule 6 : Reserves & Surplus**		
	Rs.'000		Rs.'000	Rs.'000
Share capital	10,00,000	General Reserve	5,80,000	
		Addition during the year	2,25,000	
				8,05,000
		Credit balance of P & L a/c		1,26,255
	10,00,000			9,31,255

Schedule 8 : Investments		**Schedule 11 : Cash & Bank balances**	
	Rs.'000		Rs.'000
Investments	31,30,000	Cash and Bank balances	4,82,462
	31,30,000		4,82,462

Schedule 12 : Advances & Other Assets		**Schedule 13 : Current Liabilities**	
	Rs.'000		Rs.'000
Outstanding premium	22,300	Sundry Creditors	22,500
Agents balances	20,000	Claims outstanding	1,04,000
	42,300		1,26,500

Schedule – 14 : Provisions

	Rs.'000	Rs.'000
Reserve for unexpired Risk		12,44,504
For Taxation	4,39,503	
Less: Advance tax paid	4,20,000	
		19,503
For proposed dividend		3,00,000
For Dividend Distribution Tax		33,000
		15,97,007

Illu.4 : The following in the balance accounts of National General Insurance Company Limited as on 31st March, 2010. You required to prepare the balance sheet, revenue account and profit and loss account.

	Rs.	Rs.
Capital		**30,000**
Bad debts reserve		**2,000**
Funds as on April 1st, 2009		
Fire insurance account		**65,410**
Marine insurance account		**85,000**
Accidents Insurance account		**6,455**
Unclaimed dividends		**850**
Due to reinsurance companies		**3,450**
Sundry creditors		**7,250**
Deposits and Suspense account (credit)		**2,280**
Profit and Loss a/c (credit)		**8,040**
Agents' balances (debit)		**13,500**
Interest accrued but not due		**2,250**
Due from insurance companies		**6,450**
Cash in hand		**350**
Cash at bank		**7,480**
Furniture, Fixtures (cost Rs.8,400)		**3,800**
Stationery (stock)		**140**
Advance payment of tax		**3,000**
Expenses of management		
Fire Insurance	**48,000**	
Marine Insurance	**36,000**	
Accidents Insurance	**8,000**	
General Insurance	**3,000**	
		95,000
Foreign taxes (Marine Insurance)		**800**
Outstanding premiums		**8,200**

Claims unpaid on 31st March, 2010	**Rs,**	**Rs.**
Fire Insurance		**20,000**
Marine Insurance		**5,000**
Accidental Insurance		**3,250**
Transfer fees		**100**
Tax on profit paid		**12,000**
Sundry debtors		**4,500**
Mortgage debtors		**7,500**
Govt. Securities deposited with RBI		**3,700**
Indian Govt. Securities		**1,02,000**
Debentures of Public bodies		**40,500**
Equity shares of joint stock companies		**22,500**
Claims less re-insurance (paid during the year)		
Fire Insurance		**60,000**
Marine Insurance		**39,390**
Accidental insurance		**9,300**
Premium less re-insurance		
Fire Insurance		**1,76,250**
Marine Insurance		**1,02,250**
Accidental Insurance		**26,225**
Land, Buildings		**50,500**
Interest, dividends received (tax deducted at source @ 25%)		
Fire Insurance	**2,340**	
Marine Insurance	**750**	
Accidental Insurance	**360**	
General Insurance	**2,400**	**5,850**
Commission		
Fire insurance		**30,000**
Marine insurance		**15,000**
Accidents		**4,500**
Provision for depreciation of furniture 2009-10		**2,000**
Outstanding claims on 31st March, 2009		
Fire Insurance		**15,000**
Marine insurance		**4,500**
Accidents insurance		**3,000**

Fire insurance premiums Rs.1,76,250 (thousands) are after receipt of Rs.20,000 (thousands) and payment of Rs.30,000 (thousands) as re-insurance premiums. An adjustment in respect of commission @ 15% on such premium is still to be made.

There is an uncalled liability of Rs.7,500 (thousands) in respect of partly paid shares of joint stock companies held by the company.

Solution :

Name of the Insurer : National General Insurance Co. Ltd.
Registration No. and Date of Registration with the IRDA :

Revenue a/c for the year ended 31st March, 2010

(Rs.'000)

Particulars	**Schedule No.**	**Fire**	**Marine**	**Accident**
Premium earned (Net)	1	1,53,535	85,000	19,567
Interest and Dividend		3,120	1,000	480
Total (A)		1,56,655	86,000	20,047
Claims incurred (net0	2	65,000	39,890	9,550
Commission	3	28,500	15,000	4,500
Operating Expenses related to Insurance Business	4	48,000	36,800	8,000
Total (B)		1,41,500	91,690	22,050
Operating profit/Loss (C) = (A – B)		15,155	(-) 5,690	(-) 2,003

Name of the Insurer : National General Insurance Co. Ltd.
Registration No. and Date of Registration with the IRDA :

Profit and Loss account for the year ended 31st March, 2010

(Rs.'000)

Particulars		Current year ended
Operating Profit from Fire Business		15,155
Less : Operating Loss : Marine Insurance	5,690	
Accidental Insurance	2,003	7,693
		7,462
Interest and Dividends		3,200
Other income : Transfer fee		100
Total (A)		**10,762**
Management expenses (General Insurance)		3,000
Depreciation on Furniture		2,000
Total (B)		**5,000**
Profit before Tax (A-B)		5,762
Less : Tax on profit		12,000
Net Loss		6,238
Balance of profit b/d		8,040
Balance of profit carried forward to Balance sheet		1,802

Schedules forming part of Financial Statements

Schedule – 1 : Premiums earned (Net)

Particulars	Fire Insurance	Marine Insurance	Accident Insurance
Premiums less Reinsurance Premium			
Adjustments for increase in reserve for unexpired risks	1,76,250	1,02,250	26,225
Add : Reserve for unexpired risks (beginning)	65,410	85,000	6,455
	2,41,660	1,87,250	32,680
Less : Reserve for unexpired risks at the end of the year (50% of net premium in case of fire and accident and 110% of net premium in case of Marine)	88,125	1,02,250	13,113
Total premium earned	1,53,535	85,000	19,567

Schedule – 2 : Claims incurred (Net)

Particulars	Fire Insurance	Marine Insurance	Accident Insurance
Claims less Reinsurance	60,000	39,390	9,300
Add : Outstanding claims on 31-3-2010	20,000	5,000	3,250
	80,000	44,390	12,550
Less : Claims outstanding on 1-4-2009	15,000	4,500	3,000
Total claims incurred	65,000	39,890	9,550

Schedule – 3 : Commission

Particulars	Fire Insurance	Marine Insurance	Accident Insurance
Commission paid	30,000	15,000	4,500
Add : Commission on reinsurance accepted (15% of Rs.20,000 Reinsurance premium received)	3,000	-	-
	33,000	15,000	4,500
Less : Commission on Reinsurance ceded (15% of Rs.30,000 Reinsurance premium paid)	4,500	-	-
Net Commission	28,500	15,000	4,500

Schedule – 4 : Operating expenses related to Insurance Business

Particulars	Fire Insurance	Marine Insurance	Accident Insurance
Expenses on Management	48,000	36,000	8,000
Foreign Taxes	-	800	-
Total	48,000	36,800	8,000

Name of the Insurer : National General Insurance Co. Ltd.
Registration No. and Date of Registration with the IRDA :

Balance Sheet as on 31-3-2010

(Rs.'000)

Particulars	Schedule No.	Rs,	Current year ended
Sources of Funds			
Share capital	5	30,000	
Reserves & Surplus	6	1,802	
		31,802	
Applications of Funds (Assets)			
Investments	8		1,68,700
Loans	9		7,500
Fixed Assets:	10		53,850
Current Assets			
Cash & Bank balances	11	7,830	
Advances & Other Assets	12	42,490	42,300
Sub-Total (A)		50,320	
Current Liabilities	13	45,080	
Provisions	14	2,03,488	
Sub-Total (B)		**2,48,568**	
Net Current Assets (c) = (A – B)			(-) 1,98,248
Total			31,802
Contingent liabilities :			
Uncalled amount on party paid shares			7,500

Schedule 5 : Share Capital

	Rs.'000
Paid up capital	30,000
	30,000

Schedule 6 : Reserves & Surplus

	Rs.'000
Balance of profit and loss account	1,802
	1,802

Schedule 8 : Investments		Schedule 9 : Loans	
	Rs.'000		Rs.'000
Govt. securities with RBI	3,700	Mortgage loans	7,500
Indian Govt. Securities	1,02,000	Total	7,500
Equity shares of joint stock companies	22,500		
Debentures of public bodies	40,500		
	1,68,700		

Schedule – 10 : Fixed Assets

	Rs.'000	Rs.'000	Rs.'000
Land and buildings at cost			50,050
Furniture and Fixture at cost		8,400	
Less : Depreciation upto last year	2,600		
Depreciation for the current year	2,000	4,600	3,800
			53,850

Schedule – 11 : Cash and Bank Balances

	Rs.'000
Cash in hand	350
Cash at bank	7,480
Total	7,830

Schedule – 12 : Advances and other assets

	Rs.'000	Rs.'000
Advances :		
Advance payment of tax		3,000
Tax deducted at source from interest dividends received		
Fire (2,340 x 25/75)	780	
Marine (750 x 25/75)	250	
Accidents (360 x 25/75)	120	
General (2,400 x 25/75)	800	1,950
Total (A)		4,950
Other Assets :		
Interest accrued but not due		2,250
Outstanding premiums		8,200
Agents balances		13,500
Amount due from other insurers		6,450
Commission receivables		4,500

	Rs.'000	Rs.'000
Sundry Debtors	4,500	
Less : Provision for bad debts	2,000	2,500
Stock of Stationery		140
Total (B)		37,540
Total (A + B)		42,490

Schedule 13 : Current Liabilities

	Rs.'000
Amount due to other insurers	3,450
Sundry Creditors	7,250
Claims outstanding	28,250
Unclaimed dividends	850
Commission payable	3,000
Deposit and suspense a/c	2,280
Total	45,080

Schedule 14 : Provisions

	Rs.'000	Rs.'000
Reserve for unexpired risks :		
Fire (50% of 1,76,250 net premium)	88,125	
Marine (100% of 1,02,250 net premium)	1,02,250	
Accidents (50% of 26,225 net premium)	13,113	2,03,488
Total		2,03,488

17.8 QUESTIONS

1. Explain various types of general insurance.
2. Explain the general guidelines of IRDA in the preparation of final accounts of general insurance business.
3. Explain the format of Revenue account of General Insurance Business.
4. Explain the Format of Balance Sheet of General Insurance Companies.
5. What is Reserve for unexpired risks?
6. What are the main features to be maintained by a General Insurance Companies? What statutory books are required to be maintained by a General Insurance Company under the Insurance Act?
7. Explain the features of General Insurance.
8. Average Clause
9. Distinguish between general insurance and life insurance.

17.9 EXERCISES

1. From the following figures appearing in the books of Fire Insurance division of a General Insurance Company, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 2009:

	Direct Business Rs.	**Re-insurance Rs.**
Claims Paid during the year	46,70,000	7,00,000
Claims Payable – 1st April, 2008	7,63,000	87,000
31st March, 2009	8,12,000	53,000
Claims Received	---	2,30,000
Claims Receivable – 1st April, 2008	---	65,000
31st March, 2009	---	1,13,000
Expenses of Management (includes Rs.35,000 Surveyor's fee and Rs.45,000 Legal expenses for settlement of claims)	2,30,000	

[Ans.: Claims incurred Rs.51.87]

2. The books of Jai Hind Insurance Co. Ltd. contained the following information in respect of personal accidents insurance as on 31st March, 2010:-

	Rs. in crores
Provision for unexpired risks on 1st April, 2009	800
Estimated liability in respect of outstanding claims:	
On 1st April, 2009	100
On 31st March, 2010	150
Medical expenses regarding claims	10
Claims paid	700
Reinsurance premiums	140
Reinsurance recoveries	15
Premiums	1,900
Commission on direct business	250
Commission on reinsurance ceded	30
Management expenses	550
Interests and dividends	80
Legal expenses regarding claims	15
Profit on sale of investments for the year ended 31st March, 2010	7

Prepare the Revenue Account for the year ended 31st March, 2010.
[Ans.: Operating profit Rs.237 crores]

3. Zaldi Pay Insurance Co. Ltd. has furnished the following information for preparation of revenue account for the insurance business for the year ended 31st March, 2010:-

	Rs. in crores
Claims admitted but not paid	150
Commission paid	500
Commission on reinsurance ceded	120
Expenses of management	780
Claims paid	1,423
Premiums received	5,520
Reserve for unexpired risks as on 1.4.2009	2,300
Claims outstanding as on 1.4.2009	270

The following further information has also to be considered:-

(i) Premiums outstanding at the end of the year: Rs.400 crore.

(ii) It is the policy of the company to maintain 50% of premium towards reserve for unexpired risks.

[Ans.: Operating profit Rs.2,797 crores]

4. The following balances as at 31st March, 2010 have been extracted from the books of New Insurance Co. Ltd. which carries on only Fire Insurance Business:-

	Rs. in crores
Claims *less* reinsurances	2,500
Provision for unexpired risks on 31.3.2009	2,000
Premiums *less* reinsurances	4,500
Commission on:	
Direct business	350
Reinsurance accepted	150
Reinsurance ceded	200
Claims outstanding on 1.4.2009	50
Bad Debts	10
Expenses of management	895
Share Capital (shares of Rs.10 each)	5,000
General Reserve	2,000
Cash in hand and at Bank	3,060
Investments	5,500
Furniture & Equipments	200
Sundry Creditors	500

	Rs. in crores
Investment Reserve	100
Agents' Balances (Debit)	510
Buildings	1,080
Deposit with Reserve Bank of India	1,270
Profit and Loss Appropriation Account on 1.4.2009	800
Amounts due from other insurers	250
Interests, dividends and rents (Fire)	625

Prepare Revenue Account, Profit and Loss Account and Balance Sheet after taking into consideration the following: Claims outstanding on 31.3.2010 were Rs.100 crore

(i) Provision for taxation is to be made at 35%

(ii) The company's directors propose a dividend @ 10% on share capital after transfer of Rs.150 crore to General Reserve. Dividend tax is payable @ 11%.

[Ans.: Operating profit Rs.1,130 crores; Profit after tax Rs.728 crores; Balance Sheet total Rs.8,073 crores]

5. From the following information as on 31st March, 2009, prepare the Revenue Accounts of Sagar Bhima Co. Ltd. engaged in Marine Insurance Business. Prepare Revenue Account of Marine Insurance Business before and after Insurance (Amendment) At 2002 became effective.

	Particulars		**Direct Business (Rs.)**	**Re-insurance (Rs.)**
I.	Premium:			
	Received		24,00,000	3,60,000
	Receivable	- 1st April, 2008	1,20,000	21,000
		- 31st March, 2009	1,80,000	28,000
	Premium paid		2,40,000	--
	Payable	- 1st April, 2008	--	20,000
		- 31st March, 2009	--	42,000
II.	Claims:			
	Paid		16,50,000	1,25,000
	Payable	- 1st April, 2008	95,000	13,000
		- 31st March, 2009	1,75,000	22,000
	Received		--	1,00,000
	Receivable	- 1st April, 2008	--	9,000
		- 31st March, 2009	--	12,000
III.	Commission:			
	On Insurance accepted		1,50,000	11,000
	On Insurance ceded		--	14,000

Other expenses and income:

Salaries Rs.2,60,000; Rent, Rates and Taxes Rs.18,000; Printing and Stationery Rs.23,000; Indian Income Tax paid Rs.2,40,000; Interest, Dividend and Rent received (net) Rs.1,15,500; Income Tax deducted at source Rs.24,500; Legal Expenses (Inclusive of Rs.20,000 in connection with the settlement of claims) Rs.60,000; Bad Debts Rs.5,000; Double Income tax refund Rs.12,000; Profit on Sale of Motor Car Rs.5,000.

Balance of Fund on 1st April, 2008 was Rs.26,50,000 including Additional Reserve of Rs.3,25,000. Additional Reserve has to be maintained at 5% of the net premium of the year.

[Ans.: Revenue a/c surplus Rs.1,40,250]

6. From the following balances of Prudential General Insurance Co-prepare *(i)* Fire revenue A/c; *(ii)* marine revenue A/c; and *(iii)* Profit and Loss A/c for the year ending on 31 March, 2010:

	Rs.
Claims paid and outstanding (fire)	3,60,000
Claims paid and outstanding (marine)	7,60,000
Additional reserve on 1.4.2009 (fire)	1,00,000
Survey expenses (fire)	20,000
Bad debts (fire)	10,000
Bad debts (marine)	24,000
Auditor’s fees	2,400
Director’s fees	10,000
Share transfer fees	1,600
Bad debts recovered	2,400
Fire fund on 1.4.2009	5,00,000
Maine fund on 1.4.2009	16,40,000
Commission earned on reinsurance ceded (fire)	20,000
Commission earned on reinsurance ceded (marine)	40,000
Depreciation	70,000
Interest, dividends, etc., received	28,000
Difference in exchange (Cr.)	600
Miscellaneous receipts	10,000
Profit on sale of land	1,20,000
Fire Insurance premium less reinsurance	12,00,000
Marine premium less reinsurance	21,60,000
Management expenses (fire)	2,90,000
Management expenses (marine)	8,00,000

Additional reserve in case of fire insurance is to be raised by 5% of net premiums in addition to usual reserves. Reinsurance premiums received amounted to Rs.3,00,000 for fire business and Rs.6,40,000 for marine business. Management expenses are exclusive of commission. The net income of fire business in 2008-09 was Rs.10,00,000.

[Ans.: Operating profit from Fire insurance business Rs.3,00,000; Operating loss from marine insurance Rs.52,000; Profit and loss a/c profit Rs.3,28,200]

17.10 REFERENCE BOOKS

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Chapter – 18

INSURANCE CLAIMS

Objectives :

After going to this unit you should be able to

- understand the problems on the loss of stock due to fire.
- determine the estimation of loss of stock
- explain the objectives of average clause in fire claims

Structure :

18.1. INTRODUCTION

Generally, every businessman takes a fire insurance policy to reduce the risk of damage to the property due to fire. The fire insurance policy may cover the loss on assets including stock and probable loss of profit due to non-business or consequential loss due to fire.

If a fixed asset is destroyed due to fire, one can very easily estimate the loss. But when a stock is destroyed the computation of loss is not so simple because the prices of different items of stock may vary and might have been acquired at varying rates. For most of the businesses, particularly for trading concerns, stock taking is not maintained upto date.

Therefore, at the time of accident no readymade value of stock may be available. If the Stock Register is maintained properly, the value of stock lost by fire can be ascertained from it. However, the business may face a problem, even when the Stock Register is maintained up to date, if the books of account are also destroyed along with the stock.

18.2. LOSS OF STOCK DUE TO FIRE

When there is a loss of stock due to fire, the following points are to be taken into account for estimating the value of stock lost:

1. Opening stock
2. Purchases upto the date of fire accident
3. Sales upto the date of accident
4. Percentage of gross profit on sales
5. Fluctuations in prices
6. Abnormal adjustments for stock
7. Stock saved
8. Average clause

18.3. ESTIMATION OF LOSS OF STOCK

In the estimation of stock lost due to fire, the following procedure is to be followed.

18.3.1 Calculation of Percentage of gross profit to sales:

The first step is the calculation of the percentage of gross profit on sales. It help in ascertaining the cost of goods sold during the year of fire. In the absence of any special circumstances, the percentage of gross profit on sales earned last year is applied to the current year (i.e., the year of fire). Trading Account of last year is to be prepared to determine the gross

$$\text{Percentage of Gross profit on Sales} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

profit ratio of last year.

18.3.2 Preparation of Memorandum Trading Account:

Memorandum Trading Account of the current year upto the date of fire is to be prepared on the basis of opening stock, purchases and sales from the beginning of the year upto the date of fire and estimated gross profit on the basis of the last year's gross profit ratio. The balancing figure in the Memorandum Trading Account will be the estimated value of stock on hand on the date of fire.

Memorandum Trading Account (Proforma)

	Rs.		Rs.
To Opening Stock	x x x	By Sales	x x x
To Purchases	x x x	By Closing stock (Balancing figure)	x x x
To Wages	x x x		
To Power	x x x		
To Gross Profit (… percent on sales)			
	x x x		x x x

18.3.3 Value of Goods Saved:

The next step is to deduct the value of stock saves, if any, from the value of stock as ascertained above. The resultant figure is the amount of claim for the loss of stock to be lodged with the insurance company.

18.4. AVERAGE CLAUSE

Generally every fire insurance policy contain "average clause". The main object of average clause is to discourage under insurance. The amount of insurance premium to be paid at regular intervals depends on the value of stock insured. More the value of stock insured, more is the amount of premium to be paid. Hence, to reduce the burden of insurance premium, the average stock of a business may not be adequately insured with the assumption that fire may not destroy the whole stock.

When a business takes an insurance policy, the value of which is less than the value of the average stock lying in the godown, it is known as **"Under-Insurance".**

As per the clause, the loss will be suffered by both insurer and insured proportionately. Claim under the average clause is calculated with the help of the following formula.

$$\text{Insurance Claim} = \frac{\text{Amount of Policy}}{\text{Value of stock on the date of fire}} \times \text{Loss of stock.}$$

Illu.1: The GP Ratio of a firm is 20%. The Purchases, Sales and Closing Stock amounted to Rs.6.0 lakh, Rs.10.8 lakh and Rs.1.2 lakh respectively. Prepare Memorandum Trading a/c and estimate the opening stock.

Solution:

Memorandum Trading a/c

Particulars	Rs.	Particulars	Rs.
To Opening Stock	3,84,000	By Sales	10,80,000
To Purchases	6,00,000	By Closing Stock	1,20,000
To Gross Profit	2,16,000		
	12,00,000		12,00,000

Gross Profit = Rs.10,80,000 × $^{20}/_{100}$ = **Rs.2,16,000.**

Illu.2: In XYZ the fire accident occurred on September 30, 2005. From the company books, the following information is available.

	Rs.
Opening Stock	**10,000**
Wages	**60,000**
Purchases upto September 30, 2005	**1,00,000**
Import expenses	**5,000**
Sales upto September 30, 2005	**2,00,000**
Gross profit Rate on Sales	**15%**

Prepare Memorandum Trading Account and find the closing stock value on the day of accident occurred.

Solution:

Memorandum Trading a/c

Particulars	Rs.	Particulars	Rs.
To Opening Stock	10,000	By Sales	2,00,000
To Purchases	1,00,000	By Closing Stock	5,000
To Wages	60,000		
To Import expenses	5,000		
To Gross Profit	30,000		
	2,05,000		2,05,000

Gross Profit = Rs.2,00,000 × $^{15}/_{100}$ = **Rs.30,000.**

Illu.3: A building worth Rs.10,00,000 is insured for Rs.6,00,000. It is completely destroyed by fire. How much loss to be admitted by the insurance company? Why?

Solution:

In this case, average clause policy is applicable. Claim under average clause is calculated with the help of the following formula.

Insurance Claim =

$$\frac{\text{Amount of Policy}}{\text{Value of Building at the date of fire}} \times \text{Value of Asset destroyed.}$$

$$= \frac{\text{Rs.6,00,000}}{\text{Rs.10,00,000}} \times \text{Rs.10,00,000} = \text{Rs.6,00,000.}$$

Illu.4: A Building worth Rs.5,00,000 insured for Rs.3,00,000. It is completely destroyed by fire. How much loss is to be admitted by the insurance company? Why?

Solution:

In this case, average clause policy is applicable. Claim under average clause is calculated with the help of the following formula.

$$\frac{\text{Amount of Policy}}{\text{Value of Building at the date of fire}} \times \text{Value of Asset destroyed.}$$

$$= \frac{\text{Rs.3,00,000}}{\text{Rs.5,00,000}} \times \text{Rs.5,00,000} = \text{Rs.3,00,000.}$$

Insurance Claim =

Illu.5: Find out the value of Fire Insurance claim to the lodged where the policy was covered by average clause.

	Rs.
Value of goods destroyed by fire	**4,00,000**
Value of policy	**3,00,000**
Value of goods solvaged	**1,00,000**

Solution:

$$\frac{\text{Value of stock destroyed}}{\text{Value of stock on the date of fire}} \times \text{Policy Value.}$$

$$= \frac{4,00,000}{5,00,000} \times 3,00,000 = \text{Rs.2,40,000.}$$

Value of Fire Insurance claim to be lodged with the Insurance Company =
Value of stock on the date of fire = Rs.4,00,000 + Rs.1,00,000 = Rs.5,00,000

Illu.6: The value of insurance policy for the loss of stock is Rs.1,00,000 and stock in hand on the date of fire is Rs.1,40,000. Out of which stock destroyed is estimated to be Rs.70,000. Calculate the claim to be admitted by the insurance company.

Solution: Claim to be admitted by the Insurance Company:

$$\frac{\text{Amount of Policy}}{\text{Value of Stock on the date of fire}} \times \text{Value of Asset destroyed.}$$

$$= \frac{\text{Rs.1,00,000}}{\text{Rs.1,40,000}} \times \text{Rs.70,000} = \text{Rs.50,000.}$$

Insurance Claim =

Illu.7: The value of insurance policy for the loss of stock is Rs.25,000 and stock in hand on the date of fire is Rs.35,000, out of which stock destroyed is estimated to be Rs.17,500. Calculate the claim to be admitted by the insurance company.

Solution:

Claim to be admitted by the Insurance Company:

Insurance Claim =

$$\frac{\text{Amount of Policy}}{\text{Value of Stock on the date of fire}} \times \text{Value of Asset destroyed.}$$

$$= \frac{\text{Rs.}25{,}000}{\text{Rs.}35{,}000} \times \text{Rs.}17{,}500 = \text{Rs.}12{,}500.$$

Illu.8: Find out the value of Fire Insurance Claim to be lodged where the policy is covered by the average clause.

	Rs.
Loss suffered	**2,50,000**
Sum assured	**2,00,000**
Stock on the date of fire	**2,89,600**

Solution:

$$\text{Average Clause} = \frac{\text{Value of Stock destroyed} \times \text{Value of insurance policy}}{\text{Value of stock on the date of fire}}$$

$$= \frac{2{,}50{,}000 \times 2{,}00{,}000}{2{,}89{,}600} = \text{Rs.}1{,}72{,}652$$

Illu.9: Major part of the stock belonging to Arunachalam Traders was destroyed in a fire accident on 31.08.2004. At the beginning of the year (01-04-2004) the value of the stock was Rs.75,000 while the value of stock salvaged after the fire accident was Rs.16,875. The gross profit on sales was 30 per cent and the sales from 01-04-2004 to 31-8-2004 amounted to Rs.1,91,250 while the purchases during the same period were worth Rs.1,35,625. Prepare a statement of claim for submission to the Insurance Company.

Solution:

Memorandum Trading a/c as on 31-8-2004

	Rs.		Rs.
To Opening Stock	75,000	By Sales	1,91,250
To Purchases	1,35,625	By Closing Stock	76,750
To Gross Profit	57,375	(Bal.fig)	
1,91,250 × $^{30}/_{100}$			
	2,68,000		2,68,000

Claim to be lodged:

	Rs.
Stock on the date of fire	76,750
Less: Stock salvaged	16,875
	59,875

Illu.10: A fire occurred at the premises of a trader on May 31, 2004 destroying a great part of his stock which at January 1, appeared in the books at Rs.60,000. The value of the stock salvaged was Rs.13,500. The gross profit on sales was 30% and sales amounted to Rs.1,53,000 from January 1 to the date of fire, while for the same period the purchases amounted to Rs.1,08,000. Prepare a statement of claim for submission to the Insurance Company.

Solution:

Memorandum Trading a/c of a Trader upto 31st May, 2004

	Rs.		Rs.
To Opening Stock	60,000	By Sales	1,53,000
To Purchases	1,08,000	By Closing Stock	60,900
To Gross Profit	45,900	(Bal.fig)	
(1,53,000 × $^{30}/_{100}$)			
	2,13,900		2,13,900

Statement Showing the amount of claim
to be lodged from Insurance Co.

	Rs.
Value of Closing stock on 31st May	60,900
Less: Value of salvaged stock	13,500
Amount of claim	47,400

Illu.11: On 30th October, 1998 a fire occurred in the godowns of Shivakashi Fire Works. The value of the stock saved was Rs.8,000. The accounting books disclosed that on 1st April, 2003 the stock was valued Rs.70,000. The purchases to the date of fire amounted to Rs.2,00,000 and the sales to Rs.2,95,000. Goods costing Rs.1,000 were taken for personal use and goods sold for Rs.3,000 returned.

During the past five years the average Gross Profit on the cost was 25%. Prepare the memorandum Trading Account and ascertain the amount of claim to be lodged with the insurance company in respect of stock destroyed by fire.

Solution:

Memorandum Trading a/c

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		70,000	By Sales	2,95,000	
To Purchases	2,00,000		Less: Returns	3,000	2,92,000
Less: Drawings	1,000	1,99,000	By Closing Stock		50,000
To Gross Profit		73,000	(Bal. fig)		
		3,42,000			3,42,000

Gross Profit = Rs.2,92,000 $\times$ $^{25}/_{100}$ = Rs.73,000.

Claim:	Rs.
Closing Stock	50,000
Less: Stock Salvaged	8,000
	42,000

Illu.12: On 31st December, 2003 a fire occurred on the premises of a firm which carried on the business of general merchandise. From the various books, which were saved from the five it was ascertained that

Sales from 1st January to 31st December, 2003 Rs.12,80,000
Purchases from 1st January to 31st December 2003 Rs.8,40,000
Stock on hand on 31st December, 2003 Rs.2,36,000

Gross Profit the past five years had averaged at 35% on sales. The value of the salvaged stock was valued at Rs.30,000. Draft statement showing account of the claim on the insurance company. There was no average clause.

Solution:

Memorandum Trading a/c

Particulars	Rs.	Particulars	Rs.
To Opening Stock	2,36,000	By Sales	12,80,000
To Purchases	8,40,000	By Closing Stock	2,44,000
To Gross Profit	4,48,000	(Bal.fig)	
	15,24,000		15,24,000

Gross Profit = Rs.12,80,000 × $^{35}/_{100}$ = Rs.44,800.

Claim:	Rs.
Closing Stock	2,44,000
Less: Stock Salvaged	30,000
	2,14,000

Illu.13: On 15th September, 2003, a fire occurred in the premises of a company and a considerable part of the stock was destroyed. The value of stock saved was Rs.3,200.

The books saved disclosed that on 1st January, 2003 the stock was valued at Rs.66,850 and the purchases to the date of fire amounted to Rs.1,85,000. The sales during the same period amounted to Rs.2,82,500. Goods costing Rs.500 were taken for personal purposes. Goods costing Rs.2,500 were returned by the customers. It is also ascertained that during the past five years the average gross profit ratio was 25%.

You are required to prepare a statement showing the amount to be claimed from insurance company in respect of stock destroyed by fire.

Solution:

Memorandum Trading a/c upto 15th September, 2003

	Rs.	Rs.		Rs.	Rs.
To Stock		66,850	By Sales	2,82,500	
To Purchases	1,85,000		Less: Returns	2,500	2,80,000
Less: Drawings	500		By Stock on 15th		
		1,84,500	Sept. (Bal.fig)		41,350
To Gross Profit			(Bal. fig)		
(2,80,000 × $^{25}/_{100}$)		70,000			
		3,21,350			3,21,350

Amount of Claim:	Rs.
Stock on 15th September	41,350
Less: Salvaged stock	3,200
Amount of claim	38,150

Illu.14: The premises of M/s Brahmayya & Co. caught fire on 15th October, 1999. From the following information prepare the statements of claim to be submitted to the insurance company.

- **a. Value of stocks as on 1-1-1998 and 1-1-1999 are Rs.20,000 and 30,000 respectively.**
- **b. Purchases and sales during the year 1998 are Rs.40,000 and Rs.60,000 respectively.**
- **c. Purchases and sales from 1-1-1999 to 15-10-1999 are Rs.90,000 and Rs.1,00,000.**
- **d. During 1999 the rate of gross profit has come down by 10% over the previous year's (1998) rate.**
- **e. Stocks saved from the fire are valued at Rs.12,000.**
- **f. The insurance policy was taken for an amount of Rs.50,000 the policy contains the 'Average clause.'**

Solution:

Trading a/c of M/s Brahmayya & Co. as on 31-12-1998

Particulars	Rs.	Particulars	Rs.
To Opening Stock	20,000	By Sales	60,000
To Purchases	40,000	By Closing Stock	30,000
To Gross Profit	30,000		
	90,000		90,000

Percentage of Gross Profit on Sales:

If sales are Rs.60,000 ….. Rs.30,000

If sales are Rs.100 ….. ?

$= {}^{Rs.30,000}/_{60,000} \times 100 = 50\%$

Memorandum Trading a/c upto 15-10-1999

Particulars	Rs.	Particulars	Rs.
To Opening Stock	30,000	By Sales	1,00,000
To Purchases	90,000	By Closing Stock	60,000
To Gross Profit	40,000		
	1,60,000		1,60,000

Calculation of Gross Profit = Rs.1,00,000 $\times {}^{40}/_{100}$ = Rs.40,000

Stock lost in fire:

	Rs.
Closing Stock	60,000
Less: Stock saves	12,000
Stock Lost	48,000

$$\text{Amount of Insurance Claim} = \frac{\text{Stock Lost}}{\text{Closing Stock}} \times \text{Policy Amount.}$$

$$= \frac{48{,}000}{60{,}000} \times 50{,}000 = \text{Rs.}40{,}000$$

Note: During 1999 the gross profit has come down by 10% over 1998 rate. Here in 1999 the rate of gross profit is 50 - 10 = 40%.

Illu.15: A fire occurred in the premises of Mr. Ratanlal a merchant on 1-4-2003 and a considerable part of stock was destroyed. The stock salvaged was Rs.1,12,000. Mr.Ratanlal took a fire insurance policy for Rs.6,84,000 to cover the loss of stock by fire. Ascertain the amount of insurance claim which Mr.Ratanlal should claim from the Insurance company for the loss of stock by fire, from the following particulars.

	Rs.
Purchases for the year 2002	**37,52,000**
Sales for the year 2002	**48,40,000**
Purchases from 1-1-2003 to 1-4-2003	**7,28,000**
Sales from 1-1-2003 to 1-4-2003	**9,60,000**
Stock on 1-1-2002	**6,40,000**
Stock 31-12-2002	**8,80,000**
Wages paid during the year 2002	**4,00,000**
Wages paid during 1st January, 2003 to April 1, 2003	**72,000**

Solution:

Trading account for the year ended 31-12-2002

	Rs.		Rs.
To Opening Stock	6,40,000	By Sales	48,40,000
To Purchases	37,52,000	By Closing Stock	8,80,000
To Wages	4,00,000		
To Gross Profit	9,28,000		
	57,20,000		57,20,000

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{9{,}28{,}000}{48{,}40{,}000} \times 100 = 19.17\% \text{ (approximately 19\%).}$$

Memorandum Trading a/c upto 1-4-2003

	Rs.		Rs.
To Opening Stock	8,80,000	By Sales	9,60,000
To Purchases	7,28,000	By Closing Stock	9,02,400
To Wages	72,000	(Bal.fig)	
To Gross Profit			
(9,60,000 × $^{19}/_{100}$)	1,82,400		
	18,62,400		18,62,400

Stock lost in fire:

	Rs.
Closing Stock on 1-4-2003	9,02,400
Less: Stock Salvaged	1,12,000
Stock Lost	7,90,400

$$\text{Amount of Insurance Claim} = \frac{\text{Stock Lost}}{\text{Closing Stock}} \times \text{Policy Amount.}$$

$$= \frac{7{,}90{,}400}{9{,}02{,}400} \times 6{,}84{,}000 = \text{Rs.}5{,}99{,}106.$$

Illu.16: A fire occurred in the premises of John & Co., on 11th May, 2003. Ascertain the Insurance claim with regard to the loss of stock by taking the following information.

1. **The company had the practice of valuing stock at cost less 5%**
2. **The value of Fire Insurance taken was for Rs.2,15,000**
3. **The Policy was to subject to Average clause.**
4. **The stock as on 1-1-2002 Rs.2,85,000**
5. **Stock as on 31-12-2002 Rs.3,80,000**
6. **Purchases made during the year Rs.5,20,000.**
7. **Sales for the year 2002 Rs.6,00,000**
8. **Purchases from 1-1-2003 to 11-5-2003 Rs.2,19,000**
9. **Sales from 1-1-2003 to 11-5-2003 Rs.2,70,000**
10. **Value of stock salvaged Rs.30,000.**

Solution:

Trading a/c for the year ended 31-12-2002

	Rs.		Rs.
To Opening Stock	3,00,000	By Sales	6,00,000
(2,85,000 × $^{100}/_{95}$)		By Closing Stock	4,00,000
To Purchases	5,20,000	(3,80,000 × $^{100}/_{95}$)	
To Gross Profit	1,80,000		
	10,00,000		10,00,000

Rate of Gross Profit = $^{1,80,000}/_{6,00,000} \times 100$ = 30%.

Memorandum Trading a/c upto 11th May, 2003

	Rs.		Rs.
To Opening Stock	4,00,000	By Sales	2,70,000
To Purchases	2,19,000	By Closing Stock	4,30,000
To Gross Profit		(Bal.fig)	
(2,70,000 × $^{30}/_{100}$)	81,000		
	7,00,000		7,00,000

Stock Lost:

	Rs.
Closing Stock on 11-5-2003	4,30,000
Less: Salvaged stock	30,000
Stock Lost	4,00,000

$$\text{Claim Amount} = \frac{\text{Stock Lost}}{\text{Closing Stock}} \times \text{Policy Amount.}$$

$$= \frac{4,00,000}{4,30,000} \times 2,15,000 = \text{Rs.}2,00,000.$$

Illu.17: Vishnu Mills values closing stock at 20% below cost. Prices were high by 10% in the beginning of 2004. Fire broke out on 1st April, 2004. All stocks, except to the value of Rs.5,000 were destroyed by fire. Find out the amount of loss suffered by the company after taking the following into considerations.

	Rs.
Purchases in 2003	**1,80,000**
Stock on 1-1-2003	**40,000**
Stock on 31-12-2003	**20,000**
Sales in 2003	**2,50,000**
Purchases upto 1-4-2004	**1,60,000**
Sales upto 1-4-2004	**2,10,000**

The stock is not insured.

Solution:

Trading Account for the year ended 31-12-2003

	Rs.		Rs.
To Opening Stock (1-1-2003)		By Sales	2,50,000
(40,000 × $^{100}/_{80}$)	50,000	By Stock (31-12-2003)	
To Purchases	1,80,000	(20,000 × $^{100}/_{80}$)	25,000
To Gross Profit (Bal.fig)	45,000		
	2,75,000		2,75,000

Rate of Gross Profit = $^{45,000}/_{2,50,000}$ × 100 = 18%.

Memorandum Trading a/c upto 1st April, 2004

	Rs.		Rs.
To Opening Stock	25,000	By Sales	
To Purchases	1,60,000	(2,10,000 × $^{100}/_{110}$)	1,90,909
To Gross Profit		By Closing Stock	28,455
(1,90,909 × $^{18}/_{100}$)	34,364	(Bal.fig)	
	2,19,364		2,19,364

Stock Lost:

	Rs.
Closing Stock on 1-4-2004	28,455
Less: Salvaged stock	5,000
Claim Amount	23,455

Illu.18: The premises of Bombay Sports House caught fire on 1st April, 2004 and its stock was damaged. The firm makes up its accounts to 31st May each year. The following information is available.

	1st June, 2002 To 31st May, 2003	1st June, 2003 To 1st April, 2004
Stock at commencement valued at 10% above cost	**2,70,000**	**4,84,000**
Purchases	**5,00,000**	**8,00,000**
Sales	**10,00,000**	**12,00,000**

In December, 2003 goods which cost Rs.50,000 were given away to colleges for advertising purpose no entry was made in the books during the same month sales man had misappropriated unrecorded cash sales of Rs.1,00,000. The rate of gross profit is constant from the above make an estimate of the stock on hand on the date of fire.

Solution:

Trading Account of Bombay Sports House
for the year ended 1-4-2004

	Rs.		Rs.
To Opening Stock	2,45,455	By Sales	10,00,000
(Rs.2,70,000 × $^{100}/_{110}$)		By Closing Stock	
To Purchases	5,00,000	(4,84,000 × $^{100}/_{110}$)	4,40,000
To Gross Profit	6,94,545		
	14,40,000		14,40,000

Gross Profit as % of Sales = $^{6,94,545}/_{10,00,000} \times 100 = 69.5\%$

Memorandum Trading a/c

	Rs.	Rs.		Rs.	Rs.
To Opening stock		4,40,000	By Sales	12,00,000	
To Purchases	8,00,000		Add: Unrecorded		
Less: Given for			sales	1,00,000	
Advertising	50,000	7,50,000			13,00,000
To Gross Profit		9,03,500	By Closing stock		7,93,500
		20,93,500			20,93,500

Illu.19 & 20: Fire occurred in the premises of a business man on 20th March, 2004. He took a fire insurance policy of Rs.1,00,000 covering his stock in trade and the policy was subject to an average clause. From the following information ascertain the claim to be lodged.

	Rs.
Stock on 1-1-2003	**90,000**
Purchase during 2003	**3,65,000**
Purchase returns in 2003	**5,000**
Stock on 31-12-2003	**1,26,000**
Sales during 2003	**4,10,000**
Sales returns in 2003	**10,000**
Purchases from 1-1-2004 to date of fire	**84,000**
Sales from 1-1-2004 to date of fire	**1,03,000**
Sales returns from 1-1-2004 to date of fire	**4,000**
Value of stock saved	**19,800**

It was the practice of the business man to value stock at cost less 10%.

Solution:

Memorandum Trading a/c upto 15th September, 2003

	Rs.	Rs.		Rs.	Rs.
To Opening stock			By Sales	4,10,000	
($90,000 \times {}^{100}/_{90}$)		1,00,000	Less: Returns	10,000	
To Purchases	3,65,000				4,00,000
Less: Returns	5,000	3,60,000	By Closing Stock		
To Gross Profit		80,000	($1,26,000 \times {}^{100}/_{90}$)		1,40,000
		5,40,000			5,40,000

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{80,000}{4,00,000} \times 100 = 20\%$$

Memorandum Trading a/c upto 20th March, 2004

	Rs.		Rs.	Rs.
To Opening Stock	1,40,000	By Sales	1,03,000	
To Purchases	84,000	Less: Returns	4,000	
To Gross Profit				99,000
($99,000 \times {}^{20}/_{100}$)	19,800	By Closing Stock		1,44,800
	2,43,800			2,43,800

Stock Lost:	Rs.
Closing Stock on 20-3-2004	1,44,800
Less: Stock Salvaged	19,800
Stock Lost	1,25,000

$$\text{Amount of claim} = \frac{\text{Stock Lost}}{\text{Closing Stock}} \times \text{Policy Amount.}$$

$$= \frac{1,25,000}{1,44,800} \times 1,00,000 = \text{Rs.}86,326.$$

Illu.21: A fire occurred in the premises of a company on 25th March, 2004. The company has taken a fire insurance policy of Rs.2,00,000 covering its stock in trade. The policy was subject to average clause. From the particulars given below, ascertain the amount of claim to be lodged lodged with the insurance company.

	Rs.
Stock on 1-1-2003	**1,80,000**
Purchases during the year 2003	**7,20,000**
Stock on 31.12.2003	**2,52,000**
Sales during the year 2003	**8,00,000**
Purchases from 1.1.1999 to date of fire	**1,68,000**
Sales from 1.1.2004 to date of fire	**2,06,000**
Sales returns from 1.1.2004 to date of fire	**8,000**
Value of stock saved	**39,600**

It was the practice of the company to value stock at cost less 10%.

Solution:

Trading a/c for the year ended 31st December, 2003

	Rs.		Rs.
To Opening Stock		By Sales	8,00,000
(1,80,000 × $^{100}/_{90}$)	2,00,000	By Closing Stock	
To Purchases	7,20,000	(2,52,000 × $^{100}/_{90}$)	2,80,000
To Gross Profit (Bal.fig)	1,60,000		
	10,80,000		10,80,000

$$\text{Percentage of Gross Profit on Sales} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{1,60,000}{8,00,000} \times 100 = 20\%$$

Memorandum Trading a/c of a company upto 25th March, 2004

	Rs.		Rs.	Rs.
To Opening Stock	2,80,000	By Sales	2,06,000	
To Purchases	1,68,000	Less: Returns	8,000	
To Gross Profit				1,98,000
(1,98,000×$^{20}/_{100}$)	39,600	By Closing Stock		2,89,600
	4,87,600			4,87,600

Value of Stock destroyed:

	Rs.
Closing Stock on 25th March, 2004	2,89,600
Less: Stock Salvaged	39,600
Value of stock destroyed	2,50,000

Amount of claim =

$$\frac{\text{Policy Amount}}{\text{Value of stock on the date of fire}} \times \text{Value of stock destroyed}$$

$$= \frac{2,00,000}{2,89,600} \times 2,50,000 = \text{Rs.}1,72,652$$

Illu.22: On 30-9-2003 fire destroyed the goods of a Super Market, which took a fire insurance policy for Rs.50,000. Following information is given.

	Rs.		Rs.
Stock 1-4-2003	**66,000**	**Purchases upto 30-9-2003**	**80,000**
Sales upto 30-9-2003	**88,000**	**Stock 1-4-2002**	**90,000**
Gross Profit (2002-03)	**24%**	**Sales 1995-2003**	**2,00,000**

Stock was valued at 10% below cost on 1-4-2002 and 10% above cost on 31-3-2003. On 31-3-2003 goods worth Rs.5,000, against an order were received but entry is made in the purchases book on 4-4-2003. On 30-9-2003 purchase of goods Rs.4,000 were entered in purchase book but they were lost in transit and not received at all. Find out the fire insurance claim.

Solution:

	Rs.	Rs.
Gross Profit for 2002-03 ($2,00,000 \times {}^{24}/_{100}$)		48,000
Less: Undervaluation of Opening Stock ($90,000 \times {}^{10}/_{90}$)	10,000	
Overvaluation of Closing Stock ($66,000 \times {}^{10}/_{110}$)	6,000	
Unrecorded Purchase	5,000	
		21,000
Correct Gross Profit for 2002-03		27,000

Correct Gross Profit Rate = ${}^{27,000}/_{2,00,000} \times 100 = 13.5\%$

Memorandum Trading a/c upto 30-9-2003

	Rs.	Rs.		Rs.
To Opening Stock			By Sales	88,000
($66,000 \times {}^{100}/_{110}$)		60,000	By Closing Stock	54,880
To Purchases	80,000			
Less: Previous Year	5,000			
	75,000			
Less: Lost in transit	4,000	71,000		
To Gross Profit				
($88,000 \times {}^{13.5}/_{100}$)		11,880		
		1,42,880		1,42,880

$$\text{Claim Amount} = \frac{\text{Stock Lost}}{\text{Closing Stock}} \times \text{Policy Value}$$

$$= \frac{54,880}{54,880} \times 50,000 = \text{Rs.}50,000$$

Illu.23: Fire broke in godown of a merchant on 30-4-2004 and major part of stock was destroyed. The stock salvaged was Rs.5,000. A fire insurance policy containing average clause was taken for Rs.36,000 to cover the loss of stock by fire. Ascertain the amount to be claimed from the insurance company with the help of following information.

	Rs.
Purchases for the year 2003	**1,50,000**
Sales for the year 2003	**2,50,000**
Stock on 1-1-2003	**27,000**
Stock on 31-12-2003	**48,400**
Direct expenses paid during the year 2003	**73,000**
Purchases from 1-1-2004 to date of fire	**66,000**
Sales from 1-1-2004 to date of fire	**1,00,000**
Direct expenses paid during 2004 to the date of fire	**15,000**

Fire had broken on 20th December, 2003 and had destroyed stock worth of Rs.9,000. There was practice in the concern to value stock at cost less 10%, but the practice was changed and stock on 31-12-2003 was valued at cost plus 10%.

Solution:

Trading a/c trader as on 31-12-2003

	Rs.		Rs.
To Opening Stock		By Sales	2,50,000
$(27,000 \times {}^{100}/_{90})$	30,000	By Closing Stock	
To Purchases	1,50,000	$(48,400 \times {}^{100}/_{110})$	44,000
To Direct expenses	73,000		
To Gross Profit (Bal.fig)	41,000		
	2,94,000		2,94,000

Percentage of Gross Profit on Sales = $^{\text{Gross Profit}}/_{\text{Sales}} \times 100$

$= {}^{41,000}/_{2,50,000} \times 100 = 16.4\%$

Memorandum Trading a/c

	Rs.		Rs.
To Opening Stock	44,000	By Sales	1,00,000
To Purchases	66,000	By Closing Stock	41,400
To Direct expenses	15,000		
To Gross Profit			
$(1,00,000 \times {}^{16.4}/_{100})$	16,400		
	1,41,400		1,41,400

Claim:

	Rs.
Stock on the date of fire	41,400
Less: Stock Salvaged	5,000
Stock destroyed in the fire	36,400

$$\text{Average Clause} = \frac{\text{Value of Insurance Policy}}{\text{Value of stock on the date of fire}} \times \text{Value of stock destroyed}$$

$$= \frac{36,000}{41,400} \times 36,400 = \text{Rs.}31,652.$$

Illu.24: Fire accident took place in Mr.Unfortunate shop on 1st July, 2004 and a part of the stock was destroyed. Stock salvaged amounted to Rs.50,000. Fire insurance policy, with average clause, for Rs.3,00,000 was taken to cover the loss of stock. Ascertain the insurance claim amount from the particulars given below as on 1-7-2004.

2003-04	Rs.	2003-04	Rs.
Purchases	**18,00,000**	**Purchases from 1-4-2004**	**3,60,000**
Sales	**24,00,000**	**Sales from 1-4-2004**	**4,80,000**
Opening stock	**2,00,000**	**Wages paid from 1-4-2004**	**40,000**
Closing Stock	**4,00,000**		
Wages paid	**2,00,000**		

Solution:

Memorandum Trading a/c for the year ended 30-3-2004

	Rs.		Rs.
To Opening Stock	2,00,000	By Sales	24,00,000
To Purchases	18,00,000	By Closing Stock	4,00,000
To Wages	2,00,000		
To Gross Profit	6,00,000		
	28,00,000		28,00,000

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{6,00,000}{24,00,000} \times 100 = 25\%$$

Memorandum Trading a/c as on 1-7-2004

	Rs.		Rs.
To Opening Stock	4,00,000	By Sales	4,80,000
To Purchases	3,60,000	By Closing Stock	4,40,000
To Wages	40,000	(Balancing figure)	
To Gross Profit	1,20,000		
	9,20,000		9,20,000

	Rs.
Value of Stock on that date i.e., 1-7-2004	4,40,000
Less: Stock saved from the fire	50,000
Value of stock destroyed by fire	3,90,000

Claim (on Average basis) =

$$\frac{\text{Insurance Policy value}}{\text{Value of stock on the date of fire}} \times \text{Value destroyed in fire}$$

$$= \frac{3,00,000}{4,40,000} \times 3,90,000 = \text{Rs.}2,65,909.$$

Amount to be claimed with insurance company = Rs.2,65,909

Illu.25: Fire occurred in the premises of a company on 15th October, 2005. All stock was destroyed except to the extent of Rs.8,000. From the following figures ascertain the claim to be lodged with the Insurance Company:

	Rs.
Stock on 1.1.2004	**45,000**
Purchases during 2004	**1,90,000**
Sales during 2004	**2,50,000**
Stock on 31.12.2004	**36,000**
Purchases during 2005 upto date of fire	**1,60,000**
Sales during 2005	**2,10,000**

It was the practice of the firm to value stock at cost less 10%. Early in 2005 prices were raised by 5%.

Solution:

Trading a/c for the year ended 31-12-2004

	Rs.		Rs.
To Opening Stock	50,000	By Sales	2,50,000
To Purchases	1,90,000	By Closing Stock	40,000
To Gross Profit	50,000		
	2,90,000		2,90,000

Calculation of Opening Stock = Rs.45,000 × $^{100}/_{90}$ = Rs.50,000
Calculation of Closing Stock = Rs.36,000 × $^{100}/_{90}$ = Rs.40,000
Calculation of Percentage of Gross Profit on Sales = $^{50,000}/_{2,50,000}$ × 100 = 20%

Memorandum Trading a/c as on 15th October, 2005

	Rs.		Rs.
To Opening Stock	40,000	By Sales	2,00,000
To Purchases	1,60,000	(2,10,000 × $^{100}/_{105}$)	
To Gross Profit		By Closing Stock	40,000
(2,00,000 × $^{20}/_{100}$)	40,000	(Balancing figure)	
	2,40,000		2,40,000

Claim:

	Rs.
Stock on the date of fire	40,000
Less: Salvaged stock	8,000
Claim to be lodged	32,000

Illu.26: Fire occurred in the premises of X on 5th April, 2004 and a considerable part of the stock was destroyed. The stock salvaged was Rs.1,00,000. A Fire Insurance policy containing average clause was taken for Rs.7,00,000 to cover the loss of stock by fire. You are required to ascertain the amount to be claimed from the insurance company.

	Rs.
Purchases for the year 2003	**30,00,000**
Sales for the year 2003	**50,00,000**
Stock on 1st January, 2003	**3,42,000**
Stock on 31st December, 2003	**8,80,000**
Wages paid during the year 2003	**14,00,000**
Purchases from 1st January, 2004 to the date of fire	**12,00,000**
Sales from 1st January, 2004 to the date of fire	**20,00,000**
Wages paid during 2004 to the date of fire	**3,00,000**

Fire had broken on 25th December, 2003 and had destroyed Stock of the estimated cost of Rs.2,00,000. There was a practice in the concern to value stock at cost less 10 per cent but this practice was changed and stock on 31st December, 2003 was valued at cost plus 10 per cent.

Solution:

Trading A/c of X Ltd., as on 31-12-2003

	Rs.		Rs.
To Opening Stock	3,80,000	By Sales	50,00,000
(3,42,000 × $^{100}/_{90}$)		By Stock destroyed	2,00,000
To Purchases	30,00,000	By Closing Stock	
To Wages	14,00,000	(8,80,000 × $^{100}/_{110}$)	8,00,000
To Gross Profit	12,20,000		
	60,00,000		60,00,000

Percentage of G.P. To Sales = $^{12,20,000 \times 100}/_{50,00,000}$ = 24.4%

Memorandum Trading a/c as on 5th April, 2004

	Rs.		Rs.
To Opening Stock	8,00,000	By Sales	20,00,000
To Purchases	12,00,000	By Closing Stock	7,88,000
To Wages	3,00,000		
To Gross Profit	4,88,000		
	27,88,000		27,88,000

Claim to be lodged	Rs.
Stock	7,88,000
Less: Salvaged stock	1,00,000
Claim	6,88,000

Average clause = $^{6,88,000}/_{7,88,000} \times 7,00,000$ = Rs.6,11,168.

Illu.27: Fire occurred in the premises of Popat Lal on 30th March, 2004 in order to make a claim on their policies in respect of the stock, they ask your advice and you are able to obtain the following information.

	2001 Rs.	**2002 Rs.**	**2003 Rs.**	**2004 Rs.**
Opening stock as valued	**76,000**	**1,14,000**	**1,52,000**	**76,000**
Purchases less returns	**3,60,000**	**4,30,000**	**4,60,000**	**1,50,000**
Sales less returns	**5,60,00**	**7,00,000**	**8,00,000**	**2,60,000**
Wages	**1,50,400**	**1,91,000**	**1,40,000**	**45,000**
Closing Stock	**1,14,000**	**1,52,000**	**76,000**	**--**

The stock salvaged was Rs.15,400. It was the practice of the firm to value the stock at 5% less cost. Determine the amount of claim to be recovered from the insurance company.

Solution:

Cost of Opening Stocks:

On 1-1-2001 = Rs.76,000 × $^{100}/_{95}$ = Rs.80,000

On 1-1-2002 = Rs.1,14,000 × $^{100}/_{95}$ = Rs.1,20,000

On 1-1-2003 = Rs.1,52,000 × $^{100}/_{95}$ = Rs.1,60,000

On 1-1-2004 = Rs.76,000 × $^{100}/_{95}$ = Rs.80,000

Trading account for the years 2001, 2002 and 2003

	2001 Rs.	2002 Rs.	2003 Rs.		2001 Rs.	2002 Rs.	2003 Rs.
To Opening Stock	80,000	1,20,000	1,60,000	By Sales	5,60,000	7,00,000	8,00,000
To Purchases	3,60,000	4,30,000	4,60,000	By Closing Stock	1,20,000	1,60,000	80,000
To Wages	1,50,400	1,91,000	1,40,000				
To Gross Profit	89,600	1,19,000	1,20,000				
	6,80,000	8,60,000	8,80,000		6,80,000	8,60,000	8,80,000

Opening stock of one year is the closing stock of the previous year.

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$\text{For } 2001 = \frac{89{,}600}{5{,}60{,}000} \times 100 = 16\%$$

$$\text{For } 2002 = \frac{1{,}19{,}000}{7{,}00{,}000} \times 100 = 17\%$$

$$\text{For } 2003 = \frac{1{,}20{,}000}{8{,}00{,}000} \times 100 = 15\%$$

Average rate of Gross Profit = $^{16\%+17\%+15\%}/_{3}$ = 16%

Memorandum Trading a/c upto 30th March, 2004

	Rs.		Rs.
To Opening Stock	80,000	By Sales	2,60,000
To Purchases	1,50,000	By Closing stock	56,600
To Wages	45,000		
To Gross Profit (2,60,000 × $^{16}/_{100}$)	41,600		
	3,16,600		3,16,600

Claim to be recovered from Insurance Company:

	Rs.
Closing Stock on 30th March, 2004	56,600
Less: Stock salvaged	15,400
Amount of Claim	41,200

Illu.28: In the premises of a joint stock company a fire accident took place on 4th May, 2002. All the stocks with the exception of Rs.13,000 destroyed by fire. From the following figures ascertain loss suffered by the company.

	Rs.
Stock on 1st January, 2001	**36,000**
Stock on 31st December, 2001	**66,000**
Purchases during 2001	**4,80,000**
Sales during 2001	**6,00,000**
Purchases during 2002 upto the date of fire	**2,30,000**
Sales during 2002 upto the date of fire	**3,00,000**

On 20th December, 2001 also fire broke out and destroyed stock at genuine cost of Rs.10,000. There was a practice in the firm to value stock at cost less 10%. But all of a sudden they changed this practice and valued stock on 31st December, 2001 at cost plus 10%. The amount of the policy was Rs.40,000 and claim was subject to an average clause.

Solution:

Trading account for the year ended 31-12-2001

	Rs.		Rs.
To Opening Stock	40,000	By Sales	6,00,000
(36,000 × $^{100}/_{90}$)		By Closing Stock	60,000
To Purchases	4,80,000	(66,000 × $^{100}/_{110}$)	
To Gross Profit	1,50,000	By Stock lost in fire	10,000
	6,70,000		6,70,000

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{1,50,000}{6,00,000} \times 100 = 25\%$$

Memorandum Trading a/c upto 4th May, 2002

	Rs.		Rs.
To Opening Stock	60,000	By Sales	3,00,000
To Purchases	2,30,000	By Closing stock	65,000
To Gross Profit	75,000		
(3,00,000 × $^{25}/_{100}$)			
	3,65,000		3,65,000

Stock Lost:	Rs.
Closing Stock	65,000
Less: Stock salvaged	13,000
Stock Lost	52,000

$$\text{Claim amount} = \frac{\text{Stock Lost}}{\text{Closing Stock}} \times \text{Policy Value.}$$

$$= \frac{52,000}{65,000} \times 40,000 = \text{Rs.}32,000.$$

Illu.29: Fire occurred in the premises of Mr. Badluck on 1st July, 2003 and a considerable part of the stock was destroyed. Stock salvaged amounted to Rs.56,000. A

fire insurance policy for Rs.3,42,000 was taken to cover loss of stock by fire. You are required to ascertain the insurance claim which the company should prefer from the following.

	Rs.
Purchased for the year 2002-03	**18,76,000**
Purchases from 1-4-93 to 1-7-03	**3,64,000**
Sales for the year 2002-03	**23,20,000**
Sales from 1-4-94 to 1-7-03	**4,80,000**
Stock on 1-4-02	**2,88,000**
Stock on 31-3-03	**4,84,000**
Wages for 1992-03	**2,00,000**
Wages from 1-4-03 to 31-3-03	**36,000**

Fire also broke out on 21st March, 2003 and destroyed stock of Rs.1 lakh. There was a practice in the concern to value of stock at cost less 10%, but all of a sudden this practice was changed and stock on 31-3-2003 was valued at cost plus 10%.

Solution:

Trading account for the year ended 31-3-2003

	Rs.		Rs.
To Opening Stock	3,20,000	By Sales	23,30,000
(2,88,000 × $^{100}/_{90}$)		By Closing Stock	4,40,000
To Purchases	18,76,000	(4,84,000 × $^{100}/_{110}$)	
To Wages	2,00,000	By Stock lost in fire	1,00,000
To Gross Profit	4,64,000		
	28,60,000		28,60,000

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{4,64,000}{23,20,000} \times 100 = 20\%.$$

Memorandum Trading a/c upto 1st July, 2003

	Rs.		Rs.
To Opening Stock	4,40,000	By Sales	4,80,000
To Purchases	3,64,000	By Closing stock	4,56,000
To Wages	36,000		
To Gross Profit	96,000		
(4,80,000 × $^{20}/_{100}$)			
	9,36,000		9,36,000

Stock Lost:	Rs.
Closing Stock on 1-7-03	4,56,000
Less: Salvaged stock	56,000
Stock Lost	4,00,000

$$\text{Claim amount} = \frac{\text{Stock Lost}}{\text{Closing Stock}} \times \text{Policy Value.}$$

$$= \frac{4,00,000}{4,56,000} \times 3,42,000 = \text{Rs.}3,00,000.$$

Illu.30: From the following figures calculate the amount of claim to be lodged with the insurance company for loss of stock.

	Rs.
Stock at cost on 1st January, 2003	**90,000**
Stock at cost on 1st January, 2004	**70,000**
Purchases during 2003	**4,00,000**
Purchases from 1st January to 30th June, 2004 the date of fire accident	**6,00,000**
Sales during 2003	**6,00,000**
Sales from 1st January, 2004 to 30th June, 2004	**8,80,000**

You are informed that:

a. In 2004 the cost of purchases have risen by 20% above the level prevailing in 2003.

b. In 2004 the selling prices have gone up by 10% over the levels prevailing in 2003.

c. Salvage in Rs.2,000.

Solution:

Trading account for the year ended 31-12-2003

	Rs.		Rs.
To Opening Stock	90,000	By Sales	6,00,000
To Purchases	4,00,000	By Closing stock	70,000
To Gross Profit	1,80,000		
	6,70,000		6,70,000

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{1,80,000}{6,00,000} \times 100 = 30\%.$$

Memorandum Trading a/c upto 30th June, 2004

	Rs.		Rs.
To Opening Stock	70,000	By Sales	8,00,000
To Purchases	5,00,000	(8,80,000 × $^{100}/_{110}$)	
(6,00,000 × $^{100}/_{120}$)		By Closing Stock	10,000
To Gross Profit	2,40,000		
(8,00,000 × $^{30}/_{100}$)			
	8,10,000		8,10,000

Insurance claim = Rs.10,000-2,000 = Rs.8,000.

Illu.31: Fire broke out in the godown of Beharilal on 30th June, 2004 and a large part of the stock was destroyed. The stock was fully insured against fire. From the following information find out the claim to be made for loss of stock.

	Rs.
Stock on 1-4-2003	**26,580**
Stock on 31-3-2004	**22,530**
Purchases from 1-4-2003 to 31-3-04	**62,310**
Purchases from 1-4-04 to 30-6-04	**22,410**
Sales from 1-4-03 to 31-3-04	**91,500**
Sales from 1-4-04 to 30-6-04	**35,400**

While valuing the stock on 31-3-2004, Rs.480 was written off out of the cost price of Rs.1,080 and this stock was sold in May, 2004 for Rs.1,050. Except for this item, the ratio of gross profit was uniform throughout. The value of stock saved was Rs.3,000.

Solution:

Trading account for the year ended 30-3-2004

	Rs.	Rs.		Rs.	Rs.
To Opening stock		26,580	By Sales		91,500
To Purchases	62,310		By Closing Stock	22,530	
Less: Abnormal item	1,080	61,230	Less: Abnormal item	600	21,930
To Gross Profit		25,620			
		1,13,430			1,13,430

Rate of Gross Profit = $^{25,620}/_{91,500} \times 100 = 28\%$

Memorandum Trading a/c upto 30th June, 2004

	Rs.		Rs.	Rs.
To Opening Stock	21,930	By Sales	35,400	
To Purchases	22,410	Less: Abnormal item	1,050	
To Gross Profit				34,350
($34{,}350\times{}^{28}/_{100}$)	9,618	By Closing Stock		19,608
	53,958			53,958

	Rs.
Closing Stock	19,608
Less: Stock saved	3,000
Claim Amount	16,608

Illu.32: A fire occurred on 10th July, 2004 in the premises of Moon & Co. calculate the amount of claim to be lodged with the insurance company for loss of stock.

	Rs.
Stock at cost as on 1-4-2003	**40,000**
Stock at cost as on 1-4-2004	**60,000**
Purchase during the year 2003-04	**80,000**
Purchase from 1-4-2004 to the date of fire	**1,76,000**
Sales during 2003-04	**1,20,000**
Sales from 1-4-2004 to the date of fire	**2,10,000**

During the current year, cost of purchases has risen by 10% above last year's level and the selling prices have gone up by 5%. Stock salvaged was Rs.4,000.

Solution:

Trading account for the year ended 31-3-2003

	Rs.		Rs.
To Opening Stock	40,000	By Sales	1,20,000
To Purchases	80,000	By Closing stock	60,000
To Gross Profit	60,000		
	1,80,000		1,80,000

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{60{,}000}{1{,}20{,}000} \times 100 = 50\%.$$

Memorandum Trading a/c upto 10th July, 2004

	Rs.		Rs.
To Opening Stock	60,000	By Sales	2,00,000
To Purchases	1,60,000	(2,10,000 × $^{100}/_{105}$)	
(1,76,000 × $^{100}/_{110}$)		By Closing Stock	1,20,000
To Gross Profit	1,00,000		
(2,00,000 × $^{50}/_{100}$)			
	3,20,000		3,20,000

Stock Lost:	Rs.
Closing Stock	1,20,000
Less: Stock saved	4,000
Claim Amount	1,16,000

Illu.33: A fire occurred in the godown of Alpha Co. Ltd., on 9th March, 2004 destroying the entire stock. The books and records were salvaged from which the following particulars were ascertained.

	Rs.
Sales for the year 2003	**10,010**
Sales for the period from 1-1-04 to 8-3-04	**3,000**
Purchases for the year 2003	**8,000**
Purchases for the period from 1-1-2003 to 8-3-04	**1,250**
Stock on 1-1-03	**3,311**
Stock on 31-12-2003	**3,850**

The company has been following the practices of valuing the stock of goods at actual cost plus 10 per cent. Included in the stock on 1-1-2003 were some shop spoiled goods which originally cost Rs.20, but were valued at Rs.11. These goods were sold during the year 2003 for Rs.10. Subject to this, the rate of gross profit and the basis of valuation of stock were uniform.

You are required to ascertain the value of the stock destroyed.

Solution:

Dr. **Trading Account for the year ended 31-12-2003** Cr.

	Rs.	Rs.		Rs.	Rs.
To Opening stock			By Sales	10,010	
($3{,}311 \times {}^{100}/_{110}$)	3,010		Less: Abnormal	10	10,000
Less: Abnormal item			By Closing Stock		
($11 \times {}^{100}/_{110}$)	10	3,000	($3{,}850 \times {}^{100}/_{110}$)		3,500
To Purchases		8,000			
To Gross Profit		2,500			
		13,500			13,500

Dr. **Memorandum Trading Account upto 9th March, 2004** Cr.

	Rs.		Rs.
To Opening Stock	3,500	By Sales	3,000
To Purchases	1,250	By Closing stock	2,500
To Gross Profit			
($3{,}000 \times {}^{25}/_{100}$)	750		
	5,500		5,500

Value of Stock Destroyed = Rs.2,500.

Illu.34: On 1st July, 2001 a fire took place in the Godown of Ramesh Kumar which destroyed all stocks. Calculate the amount of insurance claim for stock from the following details.

	Rs.
Sales in 1999	**2,00,000**
Gross Profit in 1999	**60,000**
Sales in 2000	**3,00,000**
Gross Profit in 2000	**60,000**
Stock as on 1-1-2001	**2,70,000**
Purchases from 1-1-2001 to 30-6-2001	**4,00,000**
Sales from 1-1-2001 to 30-6-2001	**7,20,000**

The following are also to be taken into consideration.

a. **Stock as on 31st December, 2000 had been undervalued by 10 per cent.**

b. **A stock taking conducted in March, 2001 had revealed that stock costing Rs.80,000 were lying in a damaged condition. 50 per cent of these stocks had been sold in May, 2001 at 50% per cent of cost and balance were expected to be sold at 40 percent of Cost.**

Solution:

Calculation of Rate of Gross Profit in 2000:

	Rs.
Gross Profit as given	60,000
Sales in 1999	2,00,000

Rate of Gross profit on Sales = $^{Rs.60,000}/_{2,00,000} \times 100 = 30\%$.

Calculation of Rate of Gross profit in 2001

	Rs.
Gross Profit as given	60,000
Add: Profit to be increased due to increase in value of closing stock ($2,70,000 \times {}^{10}/_{9}$)	30,000
	90,000
Sales in 2000	3,00,000

Percentage of Gross profit to sale = $^{90,000}/_{3,00,000} \times 100 = 30\%$.

Average percentage of Gross Profit = $^{30\%(2000)\ +\ 30\%(2001)}/_{2}$

$= {}^{60\%}/_{2} = 30\%$.

Memorandum Trading Account
upto 1st July 2001

	Normal Items Rs.	Abnormal Items Rs.	Total Rs.		Normal Items Rs.	Abnormal Items Rs.	Total Rs.
To Opening Stock	2,20,000	80,000	3,00,000	By Sales	7,00,000	20,000	7,20,000
To Purchases	4,00,000	--	4,00,000	By Gross loss		44,000	44,000
To Gross Profit 30% on normal loss	2,10,000		2,10,000	By Closing Stock (Bal.fig)	1,30,000	16,000	1,46,000
	8,30,000	80,000	9,10,000		8,30,000	80,000	9,10,000

Working Notes:

Calculation of Gross Loss on Abnormal Items:

	Rs.
Cost of abnormal items sold	80,000
Cost of ½ of the abnormal items	40,000
Less: Value of Sales @ 50%	20,000
Gross loss on 50% abnormal items	20,000
Add: 60% loss on balance of 50% goods	
(40,000 × $^{60}/_{100}$)	24,000
Total gross loss on abnormal items	44,000

Amount of claim for loss of stock is total of normal stock and abnormal stock i.e., Rs.1,46,000.

18.5 SELF ASSESSMENT QUESTIONS

1. How is the gross profit computed for the purpose of insurance on loss of profit?
2. Explain the different steps for ascertaining the amount of claim for loss of profit.
3. Explain the steps in the calculation of claim for loss of stock.
4. What is under-insurance.
5. What is Average clause

18.6 EXERCISES

1. A fire occurred on 25th April 2006 in the premises of a company from the following particulars calculate the amount of claim to be lodged in case of the loss of stock which is insured.

   Stock on 1.1.2006 Rs.25,000; Purchases from 1.1.2006 to the date of fire Rs.1,00,000; Wages Rs.20,000; Manufacturing expenses Rs.10,000 Sales from 1.1.2006 to the date of fire Rs.1,50,000. The gross profit ratio is 10%. The stock salvaged was estimated at Rs.5,750.

2. On 18th February, 2005 a fire occurred in the godown of merchant. From the following particulars ascertain the amount of claim to be lodged. Stock on 1st January, 2005 Rs.1,20,000.

   Purchases from 1st January to date of fire Rs.1,80,000; Wages Rs.60,000; Direct expenses Rs.40,000; Sales from 1st January to date of fire Rs.3,20,000. The rate of gross profit is 25% on sales. The stock salvaged Rs.20,000.

3. Fire occurred in the premises of Bad Luck Ltd. on 20th February 2004. The company has taken out a fire insurance policy of Rs.1,00,000 covering its stock in trade and the policy was subject to average clause. From the following particulars ascertain the claim to be lodged :

   Stock on 1st January 2004 Rs.90,000
   Purchases during the year 2004 Rs.3,65,000
   Purchases returns during the year 2004 Rs.5,000
   Stock on 31st December 2004 Rs.1,26,000
   Sales for the year 2004 Rs.4,10,000
   Sales returns during the year 2004 Rs.10,000
   Purchases from 1-1-2005 to the date of fire Rs.84,000
   Sales from 1-1-2005 to date of fire Rs.1,03,000
   Sales returns from 1-1-2005 to date of fire Rs.4,000
   Value of stock saved Rs.19,800
   It was the practice of the concern to value stocks at cost less 10%.

4. From the Following particulars, ascertain the value of stock as on 31st March, 2006.

Stock as on 1.4.2005	Rs.28,500
Purchases	Rs.1,52,500
Sales	Rs.2,48,000
Manufacturing expenses	Rs.30,000

At the time of valuing stock on 31st March, 2005 a sum of Rs.3,500 was written off on a particular item, which was originally purchased for Rs.10,000 and was sold during the year for Rs.9,000. Bearing the transaction relating to this item, the gross profit earned during the year was 20 percent on sales.

5. A fire occurred on September 15, 2006 in the premises of Zenith Ltd. from the following figures. Calculate the amount of claims to be lodged with the insurance company for loss of stock :

	Rs.
Stock at cost as on January 1, 2005	20,000
Stock at cost as on January 1, 2006	30,000
Purchases – 2005	40,000
Purchases from January 1, 2006 to September 15, 2006	88,000
Sales – 2005	60,000
Sales from January 1, 2006 to September15, 2006	1,05,000

During the current year (2006) cost of purchases have risen by 10% above last year level selling prices have gone up by 5% during 2006. Salvage value of stock after fire was Rs.2,000. The policy was taken for Rs.55,000 and was subject to average clause.

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Chapter – 19

BANK ACCOUNTS- I

Objectives :

After studying this unit you should be able to :

- explain the importance of bank accounts
- know the points relating to maintenance of books by banks
- understand the preparation of profit and loss account of a banking company

Structure :

19.1. INTRODUCTION

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

Till 1949, there was no special legislation to regulate banking companies but since that year the Banking Regulations Act, 1949 applies to corporate entities carrying on the business of banking in India. Such Companies are also subject to the Companies Act, 1956. All the nationalized banks are also governed by the Banking Regulation Act, 1949 but regulations regarding appointment of directors and disposal of profits etc., do not apply to them.

19.2 MAINTENANCE OF BOOKS BY BANKS

Due to the peculiar nature of its business, a bank has to keep its ledger accounts up-to-date. Every bank is required to keep specified Subsidiary books, Principal books, Chief Registers and Memorandum Books.

19.2. 1 Subsidiary Books:

A banking company is required to maintain the following subsidiary books.

a. Receiving Cashier's Counter Cash Book
b. Paying Cashier's Counter Cash Book
c. Current Accounts Ledger

d. Savings Bank Accounts Ledger
e. Fixed Deposit Accounts Ledger
f. Recurring Deposit Account Ledger
g. Investment Ledger
h. Loan Ledger
i. Bills discounted and purchased ledger
j. Customer's Acceptance, Endorsements and Guarantee Ledger.

19.2.2 Principal Books of Banks

The principal books of accounts are:

1. **Cash Book:** This book gives the summary of the Receiving Cashier's Counter Cash Book and the paying Cashier's Counter Cash Book.

2. **General Ledger:** This ledger contains control accounts for the subsidiary ledger listed above and accounts of expenses and assets not covered by the subsidiary ledgers.

19.2.3 Chief Registers:

In addition to the above books, the following are the Chief Registers and Memorandum Books kept by a bank.

1. Demand Draft Register	5. Jewellery Register
2. Bills for Collection Register	6. Letter of Credit Register
3. Share Security Register	7. Safe Deposit Vault Register
4. Safe Custody Register	8. Standing Order Register

19.2.4 Legal requirements :

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

1. **Prescribed form :** The final accounts of a banking company include the profit and loss account and the balance sheet. It may be noted that no profit and loss appropriation account is prepared in case of a banking company. All appropriations are done in the profit and loss account itself. The third schedule to the Banking Regulation Act, gives the formats of the Profit and Loss Account and the Balance sheet. The formats have been revised w.e.f. 1st April, 1991. in other words the final accounts for the year ending 31st March, 1992 and onwards are to be prepared in the new format.

2. **Accounting Year :** On account of the amended provisions of the Income Tax Act, 1961 requiring every company to close the accounts on 31st March each year, w.e.f. financial

year ending 31st March, 1989, now a banking company also closes its accounts on 31st March every year. Bank usually close books, for internal purposes, on 30th September also.

3. **Prohibition of trading :** A banking company can neither itself nor on behalf of the other deal in buying or selling or bartering of goods except in connection with the realization of security given to or held by it.

4. **Non-banking assets :** A banking company may have to take possession of certain assets charged in its favour on account of the failure of a debtor to repay the loan in time. According to Sec.9, a banking company cannot hold any immovable property however acquired, except for its own use, for any period exceeding seven years from the date of acquisition thereof. Gain or loss on sale of such an asset has to be shown separately in the profit and loss account of the banking company.

5. **Share capital :** In order to ensure that no banking company commences or carries on business with a weak and vulnerable capital structure, section 11 lays down the minimum limits of paid up capital and reserves to be complied with by a banking company which wishes to commence or carry on business in India.

6. **Reserve Fund :** Every banking company incorporated in India is required under Section 17(1) of the Act to create a Reserve fund and to transfer to fund before any dividend is declared, **a sum equal to not less than 20% of the profit,** as disclosed in the Profit and Loss Account. Such reserve is termed as Statutory Reserve. This section does not apply to banking companies incorporated outside India. The Central Government may, on the recommendation of the Reserve Bank, exempt a banking company from the restriction if the aggregate amount of reserves and share premium amount is not less than the paid up capital of the banking company.

7. **Payment of Dividend :** Section 15 prohibits payment of dividend by any banking company until all of its capitalized expenses have been completely written off. These capitalized expenses include preliminary expenses, organization expenses, share selling commission, brokerage, amounts of losses incurred and any other expenditure which is not represented by tangible assets. Payment of dividend out of the profits is considered inappropriate when capitalized expenses are outstanding.

   A banking company may, however, pay dividends on its shares without writing off the following.

   a. Depreciation in the value of its investments in approved securities where such depreciation has not actually been capitalized or otherwise accounted for as loss.
   b. Depreciation in the value of its investments in shares, debentures or bonds (other than approved securities) in any case where adequate provision for such

depreciation has been made to the satisfaction of the auditors of the banking company.

c. Bad debts, if any, where adequate provision has been made to the satisfaction of the auditors of the banking company. (Section 15).

8. **Payment of Commission, brokerage etc. :** According to Sec.13, a banking company cannot pay out directly or indirectly any commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, exceeding 2 ½% of the paid up value of the shares.

9. **Charge on uncalled capital :** Under Sec.14 a banking company cannot create any charge on unpaid capital and any such charges is invalid.

   Under Sec.14A banking company cannot create floating charge on the undertaking or any property of the bank except with the written permission of the Reserve Bank of India certifying that the charge will not be detrimental to the interest of the depositors.

10. **Subsidiary companies :** In order to prevent the banking company from carrying on trading activities indirectly by acquiring controlling interest, it has been provided that a banking company can form a subsidiary company only for one or more of the following purposes.
    (i) The undertaking and executing of trust;
    (ii) The undertaking of the administration of estates as executor, trustee or otherwise
    (iii) The carrying on business of banking exclusively outside India, with the prior permission of the Reserve bank
    (iv) Such other purposes as are incidental to banking business (section 19)

11. **Cash Reserves :** Under Sec.18 every banking company (not being a Scheduled bank) shall maintain a cash reserve with itself or with the Reserve Bank or the State Bank of India or any other bank notified by the Central Government in this behalf a sum equal to at least 3% of its time and demand liabilities in India.

    Under Sec.42 a Scheduled bank is also required to maintain with the Reserve Bank, an average daily balance of 3% of its total time ad demand liabilities in India. The Reserve Bank has the power to increase this percentage upto to 20% by a notification in the official gazette. (At present CRR is 5.5% w.e.f. February, 2010).

12. **Statutory Liquidity ratio :** According to Sec.24 (2A) of the Baking Regulation Act, every banking company in India whether scheduled or non scheduled, is required to maintain in India in cash, gold or unencumbered approved securities an amount which is not less than 25% of the total of its demand and time liabilities in India. This is known as `Statutory

Liquidity Ratio'. The Reserve Bank has the power to increase this ratio upto 40%. At present, the SLR is 25% w.e.f. October, 2009.

13. **Loans and Advances :** Section 20 of the Banking Regulation Act, imposes certain restrictions on the loan granted by banks to persons connected with their management.

(a) No banking company can grant loans and advances on the security of its own shares

(b) The banking company should not enter into any commitment for giving any loan or advance to :

- (i) any of its directors;
- (ii) to a firm in which any of its directors is interested as partner, manager, employee or guarantor.
- (iii) To any company of which any of the directors of the banking company is a director, manager, guarantor or
- (iv) To any individual with whom any of its directors is a partner or a guarantor.

14. **Limits as to investments in shares and debentures :** Reserve bank of India has removed limits on investments made by the banks in the equity and debentures issues of 17 financial institutions. These include IDBI, IFCI, ICICI, EXIM Bank of India, IRBI, NABARD, NHB, UTI, LIC, GIC, RCTFC, TDICL, Tourism Finance corporation of India etc.

The above restrictions on grating of loans and advances were introduced by an amendment in 1968 in the banking Regulation Act.

19.2.5 Slip System of Ledger Posting :

This system is also known as "Voucher Posting". Due to nature of business, every bank keeps its ledger accounts always upto date. Unless the accounts of the customers' are kept up-to-date, it would not be possible to decide correctly whether to honour or dishonour a cheque. A bank may be liable to pay exemplary damages if it wrongfully dishonours a cheque. The bank will not like to pay a cheque on an account whose balance is inadequate. Hence, a bank has to enter into the ledger every transaction as soon as it takes place.

Under this system, entries in the personal ledgers are made directly from vouchers instead of being posted from the Day Book. Pay-in-slips used by the customers at the time of making deposits and the cheques are the slips which form the basis of most of the transactions directly recorded in the accounts of the customers. As the slips are mostly filled up by the customers themselves, this system saves a lot of time and labour of the bank staff. The vouchers entered into different personal ledgers are summarised on summary sheets every day, totals of which are posted to the different control accounts which are maintained in the general ledger.

Advantages:

The following are the advantages of voucher posting.

1. The slip system helps in keeping all the accounts of the customers' upto date. The bank balances every day transactions by evening.
2. The bank staff can save a lot of clerical labour as most of the slips are filled in by its customers.
3. In this system of posting subsidiary books are avoided as posting is done from slips.
4. The bank staff can be record with minimum delay as slips can easily pass from hand to hand among the bank staff concerned.

Disadvantages:

The disadvantages of the system are:

1. The slips may be lost, destroyed or misappropriated as there are kept in loose form.
2. In the double entry system, the maintenance of subsidiary books is very important and hence books cannot be verified if subsidiary books are not kept.

19.2.6 Final Accounts of Banking Companies :

According to Section 29 of the Banking Regulation Act, 1949 a banking company is required to prepare its Balance Sheet and Profit and Loss Account in the form set out in the Third Schedule of the Act. The new formats of these are applicable from the Accounting year ended 31st March, 1992.

The following are the revised formats which include Form A for Balance sheet, Form B for Profit and Loss Account and sixteen schedules out of which the first twelve schedules pertain to Balance sheet while the remaining four schedules concern profit and loss account.

19.3. PREPARATION OF PROFIT AND LOSS ACCOUNT

Banks are required to prepare final accounts for each financial year i.e., their books are closed each year on 31st March. But for internal purpose, banks usually close their books on 30th September, called half yearly closing. The Profit and Loss Account of a banking company has to be prepared in Form B of Schedule III, attached to the Banking Regulation Act, 1949. Form 'B' is given below:

From – B

Profit and Loss account for the year ended ……..

(Rs.'000)

		Schedule No.	Current Year	Previous Year
I.	**Incomes:**			
	Interest earned	13		
	Other incomes	14		
	Total			
II.	**Expenditure:**			
	Interest Expended	15		
	Operating expenses	16		
	Provisions and Contingencies			
	Total			
III.	**Profit/Loss:**			
	Net Profit/Loss (-) for the year			
	Net Profit/Loss (-) brought forward			
	Total			
IV.	**Appropriations:**			
	Transfer to statutory reserves			
	Transfer to other reserves			
	Transfer to Government/proposed dividend			
	Balance carried over to Balance Sheet			
	Total			

19.3.1. Income :

First item of this section is interest earned. Interest/discount on advances/bills, income on investments, interest on balances with RBI etc., are shown under this item. The details are shown in Schedule 13. It should be noted that according to the new form, bad debts and provision for bad debts, other provisions are not deducted from the interest earned. For greater transparency in accounts, these items are shown as separate items in the profit and loss account.

Second item of this section is `other income.' Commission, exchange and brokerage, profit on sale of investments, profit on revaluation of investments, profit on sale of land, building and other assets, profit on exchange transactions, and income earned by way of dividends from subsidiaries etc., are shown under the item. The details shown in Schedule 14.

19.3.2. Expenditure :

First item of this section is interest expended. Interest paid on deposits, interest on RBI borrowings, interest on inter bank borrowings etc., are shown under this item. The details are shown in Schedule 15.

Second item of this section is operating expenses. Salaries and wages of staff, rent, rates and taxes, printing and stationery, advertisement; depreciation on banks' properties; directors fees, auditor's fees, law charges, postage, repairs, insurance etc., are shown under this item. The details are shown in Schedule 16.

Third item of this section is provisions and contingencies. Provisions for bad debts, provision for taxation and other provisions are shown under this item.

19.3.3. Profit/Loss :

In this section, profit/loss for the current year (difference between income and expenditure explained above) and brought forward profit/loss are shown.

19.3.4 Appropriations

In this section, amount transferred to statutory reserve as per Section17; amount transferred to the other reserves, proposed dividend etc., are shown. The balance is transferred to the Balance sheet.

Schedule 13 – Interest Earned

		Current year	**Previous year**
I.	Interest/Discount on advances		
II.	Income on Investments		
III.	Interest on balances with Reserve Bank of India and other inter-bank funds		
IV.	Others		
	Total		

Schedule 14 – Other Incomes

		Current year	**Previous year**
I.	Commission, Exchange and brokerage		
II.	Profit on sale of investments		
	Less: Loss on sale of investments		
III.	Profit on revaluation of investments		
	Less: Loss on revaluation of investments		

		Current year	Previous year
IV.	Profit on sale of land, buildings and other assets Less: Loss on sale of land, buildings and other assets		
V.	Profit on exchange transactions Less: Loss on exchange transactions		
VI.	Income earned by way of dividends etc., from subsidiaries/companies and/or joint ventures abroad/in India		
VII.	Miscellaneous Income		
	Total		

Note: Under items II to V loss figure may be shown in brackets.

Schedule 15 – Interest Expended

		Current year	Previous year
I.	Interest on deposits		
II.	Interest on Reserve Bank of India/Inter-bank borrowings		
III.	Others		
	Total		

Schedule 16 – Operating Expenses

		Current year	Previous year
I.	Payment to provisions for employees		
II.	Rent, taxes, and lighting		
III.	Printing, Stationery		
IV.	Advertisement and publicity		
V.	Depreciation on bank's property		
VI.	Director's fees, allowances and expenses		
VII.	Auditor's fees, allowances and expenses (including branch auditors).		
VIII.	Legal expenses		
IX.	Postage, Telegram, Telephone		
X.	Repairs and maintenance		
XI.	Insurance		
XII.	Other expenditure		
	Total		

Illu.1: From the following information, prepare profit and loss account of the Subka Bank Ltd. for the period ended on 31st March, 2010. Working should form part of your answer:

	Rs.
Interest on Loans	**3,00,000**
Interest on fixed deposits	**2,75,000**
Commission	**10,000**
Exchange and brokerage	**20,000**
Salaries and allowances	**1,50,000**
Discount on bills (gross)	**1,52,000**
Interest on temporary overdrafts in current accounts	**30,000**
Interest on cash credits	**2,40,000**
Interest on saving bank deposits	**87,000**
Postage, telegrams and stamps	**10,000**
Printing and stationery	**20,000**
Sundry expenses	**10,000**
Rent and Taxes	**15,000**
Audit fees	**10,000**

Additional Information:

a. **Rebate on bills discounted Rs.30,000**
b. **Salary of managing director Rs.30,000**
c. **Provision for Bad debts Rs.40,000**
d. **Provision for income tax is to be made @ 55%**
e. **Interest of Rs.4,000 on doubtful debts was wrongly credited to interest on loan account**
f. **Provide Rs.15,000 as dividend.**

Solution :

Form – B : Subka Bank Limited
Profit and Loss Account as on 31st March, 2010

(Rs.'000)

		Schedule No.	Year ended on 31-3-2010 Current year
I.	**Income**		
	Interest earned	13	688.00
	Other Incomes	14	30.00
	Total		**718.00**
II.	**Expenditure**		
	Interest Expended	15	362.00
	Operating expenses	16	245.00
	Contingencies and provisions		80.85
	Total		**687.85**

		Schedule No.	Year ended on 31-3-2010 Current year
III.	**Profit**		
	P & L a/c for the current year		30.15
	Balance for the last year		---
	Total		**30.15**
IV.	**Appropriations**		
	Statutory Reserve 20%		**6.03**
	Transferred to other reserves		**-**
	Transferred to proposed dividend		15.00
	Balance transferred to Balance sheet		9.12
	Total		**30.15**

Notes : Transferred to Statutory Reserve (20%) = Rs.30,150 x 20/100 = Rs.6,030

Schedule – 13 : Interest Earned			**Schedule – 14 : Other Income**	
	(Rs.'000)	Year ended on 31-3-2010 Current year' (Rs.'000)		Year ended on 31-3-2010 Current year (Rs.'000)
Discount on Bills discounted	152		Commission	10
Less : Rebate on bills discounted	30	122	Exchange and Brokerage	20
Interest on loans (300 – 40)		296	Interest on investments	Nil
Interest on cash credits		240	Total	30
Interest on overdraft		30		
Total		688		

(Rs.'000)

Schedule – 15 : Interest Expended		**Schedule – 16 : Operating Expenses**	
	Year ended on 31-3-2010		Year ended on 31-3-2010
Interest on Deposits		Payment to Employees	150
Fixed deposits	275	Rent, Taxes, Lighting	15
Savings deposits	87	Printing and stationery	20
Interest on RBI Loans	Nil	Advertisement, Publicity	-
Total	362	Depreciation on bank assets	-
		Director's fees	30
		Auditors fees, allowances	10
		Legal expenses	-
		Postage, Telegram, Telephone	10

	Year ended on 31-3-2010
Repairs and maintenance	-
Insurance	-
Other expenses	10
Total	245

Contingencies and Provisions :

		Year ended on 31-3-2010 (Rs.'000)
I.	Provision for bad debts	40.00
II.	Interest on doubtful debts	4.00
III.	Income tax provision (55%)	36.85
	Total	80.85

Illu.2: The following balances are that of New Bank Ltd. as on 31.3.2010

	Rs.
Interest and Discount received	**40,60,000**
Interest paid	**24,04,000**
Issued & Subscribed Capital	**10,00,000**
Reserve under Sec.17	**7,00,000**
Commission Exchange & Brokerage	**1,80,000**
Rent received	**60,000**
Profit on sale of investments	**1,90,000**
Salaries	**2,10,000**
Directors fees & allowances	**24,000**
Rent, tax paid	**1,08,000**
Stationery & Printing	**48,000**
Postage & Telegram	**40,000**
Preliminary expenses	**10,000**
Audit fees	**8,000**
Depreciation on premises	**25,000**

The following further information is given:

- **a.** **A customer to whom Rs.5 lakhs was advanced has become insolvent and only 40% can be recovered. Interest @ 15% is not provided.**
- **b.** **Provision for doubtful debts on other debts required Rs.1,00,000**
- **c.** **Rebate on bills discounted on 1.4.2009 Rs.10,000; and on 31.3.2010 Rs.15,000**
- **d.** **Provide Rs.7,00,000 for income tax.**
- **e.** **Directors desire to declare 10% dividend.**

Prepare Profit & Loss a/c in the prescribed form.

Solution:

Profit and Loss of a/c New Bank Ltd. for the year ended 31st March, 2010

(Rs. in '000)

		Schedule No.	Year ended 31-3-2010
I.	**Income:**		
	Income Earned	13	4,055
	Other Income	14	430
	Total		4,485
II.	**Expenditure:**		
	Interest Expended	15	2,404
	Operating Expenses	16	473
	Provisions and contingencies		1,100
	Total		3,977
III.	**Profit/Loss:**		
	Net Profit for the year		508
	Profit brought forward		--
	Total		508
IV.	**Appropriations**		
	Transfer to statutory Reserve		102
	Transfer to other reserves		--
	Transfer to government/Proposed dividend		100
	Balance carried over to Balance Sheet		306
	Total		508

Schedule 13 – Interest Earned

		(Rs .in 000)	(Rs. in 000)
I	Interest / Discount on Advances / Bills	4.060	
	Add : Rebate on bills discounted 1-4-2009	10	
		4,070	
	Less : Rebate on bills discounted 31-3-2010	15	4,055
	Total		4,055

Schedule – 14 : Other Incomes		Schedule – 15 : Interest Expended	
	(Rs. in 000)		(Rs.in 000)
Commission, Exchange and Brokerage	180	Interest on Deposits	2,404
Rent received	60	Total	2,404
Net profit on sale of investments	190		
Total	430		-

Schedule 16 – Operating Expenses

		(Rs. in 000)
I	Payment to and provision for employees	210
II	Rent, Taxes and Lighting	108
III	Printing and Stationery	48
IV	Depreciation on bank's property	25
V	Directors fees; Allowances and Expenses	24
VI	Auditors fees	8
VII	Postage, telegrams	40
VIII	Other Expenditure	10
	Total	473

Computation of Provisions and Contingencies

		(Rs. in 000)
I	Bad debts and Provisions for Doubtful debts	400
II	Provision for Income Tax	700
	Total	1,100

Working Notes:

Transfer to statutory reserve (20% on profit) = Rs.5,08,000 x 20/100 = Rs.1,01,600

Proposed dividend = Rs.10,00,000 x 10/100 = Rs.1,00,000

Illu.3 : From the following information prepare Profit and Loss Account of Mahesh Bank Limited for the year ended 31st March 2010:

	Rs.
Interest on Loan	**6,00,000**
Interest on Fixed Deposits	**5,50,000**
Commission	**20,000**
Salaries and Allowances	**3,00,000**
Exchange and Brokerage	**40,000**
Taxes and Insurance	**20,000**
Interest on overdrafts	**60,000**
Rent	**30,000**
Directors fees	**60,000**
Interest on Cash credits	**4,80,000**
Interest on S. B. Deposits	**1,74,000**
Postage and Telegram	**20,000**
Sundry expenses	**20,000**
Discounts on Bills	**3,04,000**
Stationery, Printing	**40,000**
Audit fees	**20,000**

Additional Information:

(i) Rebate on bills discounted Rs.15, 000

(ii) Bad debts Rs.20, 000

(iii) Income Tax provision 55%

(iv) 10% Dividends (on capital Rs.10, 00,000)

Solution :

Mahesh Bank Limited

Profit & Loss account for the year ended 31st March 2010

	Particulars	**Schedule Nos.**	**Year ended on 31-3-2010**
I.	**Income:**		
	Interest earned	13	14,29,000
	Other income	14	60,000
	Total		14,89,000
II.	**Expenditure:**		
	Interest paid	15	7,24,000
	Management expenses	16	5,10,000
	Provisions & contingencies		1,49,250
	Total		13,83,250
III.	**Profit / Loss:**		
	Profit for the current year		1,05,750
	Last Year's balance		-
	Total		1,05,750
IV	**Appropriations:**		
	Transfer to Statutory Reserve		21,150
	Dividends		1,00,000
	Balance taken to Balance Sheet (Debit)		(-) 15,400
	Total		1,05,750

Schedule – 13: Interest Earned

	Rs.
Interest on loans	6,00,000
Interest on overdrafts	60,000
Interest on cash credits	4,80,000
Discount on Bills (3,04,000 – 15,000 (Rebate)	2,89,000
Total	14,29,000

Schedule – 14 : Other Incomes

	Rs.
Commission	20,000
Exchange and Brokerage	40,000
Total	60,000

Schedule – 15: Interest Paid

	Rs.
Interest on Fixed deposits	5,50,000
Interest on SB deposits	1,74,000
Total	7,24,000

Schedule – 16 : Management Expenses

	Rs.
Salaries & Allowances	3,00,000
Taxes & Insurance	20,000
Rent	30,000
Director 's fees	60,000
Postage & Telegrams	20,000
Sundry expenses	20,000
Stationery & Printing	40,000
Audit fees	20,000
Total	5,10,000

Provisions & Contingencies:

	Rs.	**Rs.**
Provision for Bad debts		20,000
Income tax provision (55%)		
Income	14,89,000	
Expenditure	12,54,000	
	2,35,000	
= 2,35,000 x 55/100		1,29,250
		1,49,250

Working Notes : Transfer to Statutory reserve = Rs.1,05,750 x 20/100 = Rs.21,150

19.4 SELF ASSESSMENT QUESTIONS

1. What are Principal Books of a Bank?
2. What are various Registers to be maintained by a commercial bank?
3. What is slip system of ledger posting in banks? Explain its advantages and disadvantages.
4. How do you classify advances of a bank?
5. Give the latest Proforma of a Bank Balance Sheet in brief.
6. What is meant by slip system?

19.5 EXERCISES

1. On the basis of the following information prepare:
   (i) Schedule 13 and (ii) Schedule 14.
   Interest and Discount Rs.83,50,000; Interest on balances with RBI Rs.45,000; Profit on exchange transactions Rs.7,80,000; Income on investments Rs.26,30,000; Loss on sale of investments Rs.60,000; Profit on sale of investments Rs.3,27,000; Commission

exchange and Brokerage Rs.12,50,000; Profit on sale of land and buildings Rs.9,50,000; Interest on RBI borrowings Rs.20,000.

[Ans.: (i) Rs.1,10,25,000; (ii) Rs.32,47,000]

2. On the basis of the following information, prepare Schedule – 14 other income:

Profit on Exchange transactions	7,30,000
Loss on Sale of Investments	50,000
Profit on Sale of Investments	2,70,000
Commission, Exchange & Brokerage	15,20,000
Profit on Sale of Buildings & other assets	8,40,000

[Ans.: Rs.33,10,000]

3. The books of Natraj Bank Ltd. reveal the following information with the help of which you are required to prepare schedule 15 and schedule 16.

	Rs.		Rs.
Interest on Fixed Deposits	2,00,000	Rent, Taxes, Lighting	50,000
Interest on savings deposits	1,00,000	Printing & Stationery	60,000
Interest on Borrowings	50,000	Depreciation	50,000
Interest on Loans & Cash credits	2,00,000	Postage	10,000
		Bad debts	20,000
Salaries & Allowances	1,00,000	Advertisements	20,000

[Ans.: Schedule 15 : Rs.3,50,000; Schedule 16 : 2,90,000]

4. Prepare Profit and Loss account of Sahara Bank for the year ending 31-3-2010 from the following information.

	Rs.
Interest on Deposits	32,00,000
Commission (Credit)	1,00,000
Interest on loans granted	24,90,000
Discount on Bills discounted	14,90,000
Interest on Overdraft	16,00,000
Interest on cash credit	23,20,000
Sundry charges (Dr.)	1,00,000
Rent and taxes	2,00,000
Salary and allowances	5,00,000
Auditor fees	35,000
Directors' fees	16,000
Bad debts written off	3,00,000

[Ans.: Total Profit Rs.36,49,000]

5. Prepare Profit and Loss Account for the year ended 31st March, 2010 of the Varanasi Bank Ltd., from the following particulars : Also prepare the schedule.

	Rs.('000)		Rs.('000)
Interest on Loans	250	Discount on bills discounted	40
Interest on Savings a/c	150	Rent, Taxes, Insurance	5
Interest on Cash Credit	160	Commission, Exchange	
Interest on Fixed deposit	190	and Brokerage	15
Interest on Overdrafts	70		
Payment to Employees	150		
Auditors' Fee and Expenses	10		
Director's fees and Expenses	20		

[Ans.: Total Profit Rs.10,000]

6. From the following information prepare Profit and loss account of the Thrifty Bank Ltd. for the year ended 31st March, 2010:

	Rs.		Rs.
Interest on loan	26,00,000	Interest on cash credits	22,00,000
Interest on term deposits	27,00,000	Interest on overdraft	15,00,000
Discount on Bills discounted		Interest on S.B. Deposits	7,00,000
Commission and Profit on		Investment	6,00,000
sale of Exchange	80,000	Rent and taxes	1,60,000
Payment to employees	5,40,000	Auditors fees	20,000
Directors fees	40,000	Printing and Stationary	30,000
Postage and Telegrams	10,000	Income on investments	2,00,000
Depreciation on banks property	80,000	Balance on Profit on 31.3.2009	50,00,000

Bad debts to be written off amounted to Rs.4,00,000 balance of profit provision for taxation is to be made at 50%.

(

[Ans.: Profit Rs.20,00,000]

7. From the following information prepare P & L a/c of Mahesh Bank Ltd., for the year ended 31st March, 2010.

	Rs.in '000		Rs.in '000
Interest on Loan	25.90	Rent and Taxes	1.80
Interest on F.D.s	27.50	Interest on O.D.	15.40
Rebate on Bills Discounted	4.90	Director's fees	0.30
Commission	0.82	Auditor's fees	0.12
Establishment	5.40	Interest on Savings a/c	6.80
Discount on Bills discounted net	14.60	Postage and telegrams a/c	0.14
Interest on cash credit	22.30	Printing and Stationery	0.29
Interest on Current accounts	4.20	Sundry Charges	0.17

Additional Information:
1. Bad debts written off Rs.4.0
2. Provision for Taxation 55%

[Ans.: Total Profit Rs.12,73,500]

8. From the following information prepare profit and loss account of Vasavi Bank Ltd. for the year ended 31st March, 2010.

	Rs.'000		Rs.000
Interest on Loan	300	Interest on overdraft	30
Interest on Fixed Deposits	275	Interest on Savings a/c	87
Commission	10	Postage and telegrams	10
Exchange and Brokerage	20	Printing and Stationery	20
Salaries & allowances	150	Sundry expenses	10
Discount (Gross)	152	Rent	25
Interest on cash credits	240	Taxes and licenses	10

Additional Information:
i. Rebate on bills discounted Rs.30,000
ii. Salary of Managing Director Rs.30,000
iii. Bad debts Rs.40,000
iv. Provision for Income Tax is to be made @ 55%
v. Interest of Rs.4,000 on doubtful debts was wrongly credited to Interest on Loans account.

[Ans.: Total Profit Rs.25.65 lakhs]

9. There is unsecured balance of Rs.1,00,000 in the account of Mr.Babu Rao in the loan ledger of Safety Bank on 31st March, 2009. His financial condition is reported doubtful. Interest on this account amounted to Rs.10,000 during the year. On 8th May, 2010 the Bank accepted to write off 80% of the total debt upto 31st March, 2009. Give the necessary journal entries.

10. Interest at 10% on loan of Rs.1,00,000 granted to Z by Laxmi Bank against personal security is outstanding and his financial position is reported to be very bad. Give entry.

11. The directors of Anantha Bank required the investments standing in the books at a cost of Rs.2,75,000 to be shown in the Balance sheet at their market value Rs.3,25,000. Give journal entry.

12. Lena Dena Bank Limited has a paid up Share capital of Rs.1 crore. You are required to prepare Profit and Loss Account for the year ending 31st March 2010 along with necessary Schedules on the basis of the following additional information.
Particulars: For the year ended 31-3-2010

	Rs.
Interest on Advances	6,13,56,000
Discount on Bills	23,11,000
Income on Investment	2,35,97,000
Interest on balances with R.B.I.	46,20,000
Interest on other inter-bank funds	8,71,000
Commission, exchange and brokerage	51,69,000
Profit on exchange transaction (net)	8,10,000
Profit on Sale of Investments	10,21,000
Profit on sale of land, building and other assets	32,000
Interest on Deposits	6,82,24,000
Interest on R.B.I. inter Bank borrowings	19,02,000
Payments to and provision for employees	1,40,28,000
Rent, Taxes and Lighting	18,85,000
Insurance	17,05,000
Printing and Stationery	4,02,000
Advertisement and Publicity	1,86,000
Depreciation on Bank property	4,56,000
Postage, Telegrams & Telephones	5,32,000
Repairs	1,88,000
Director’s fees, allowances and expenses	22,000
Auditor’s fees and expenses	73,000
Law Charges	41,000
Other expenditure	18,34,000
Balance of Profit and Loss A/c b/d	15,24,000

The following adjustments have to be made:

(a) Rebate on bills discounted on 31.3.2009 and 31.3.2010 were Rs.6,48 thousands and 7,36 thousand respectively.

(b) Make a provision for Income-Tax @ 50%.

(c) Transfer 20% Profit to Statutory Reserve and 10% Profit to

(d) The Board of Directors proposed a dividend @ 10% on paid-up share capital.

[Ans.: Profit Rs.4,115.5]

13. The following balances are that the HDFC Bank Ltd., as on 31.3.2010:

	Rs.'000		Rs.'000
Interest and Discount received	4,060	Interest paid	2,404
Issued & Subscribed Capital	1,000	Reserve under Sec.17	700
Commission Exchange & Brokerage	180	Rent received	60
		Salaries	210
Profit on sale of Investments	190	Rent, tax paid	108
Director's fees & allowances	24	Postage & Telegram	40
Stationery & Printing	48	Audit fees	8
Preliminary expenses	10		
Depreciation on Premises	25		

The following further information is given:

(a) A customer to whom Rs.5 lakhs was advanced has become insolvent and only 40% can be recovered. Interest @ 15% is not provided.

(b) Provision for doubtful debts on other debts required Rs.1 lakh.

(c) Rebate on bills discounted 1.4.2009 Rs.10,000; 31.3.2010 Rs.15,000.

(d) Provide Rs.7 lakh for income tax.

(e) Directors desire to declare 10% divident.

Prepare Profit & Loss a/c in the prescribed form.

[Ans.: Profit Rs.5,08,000]

14. The following particulars are extracted from the books of Tirupathi Bank Ltd., for the year ending 31-12-2009.

a. Interest and discounted – Rs.1,76,62,400

b. Rebate on bills discounted – 65,040 (balance on 1-1-09)

c. Bills discounted Rs.67,45,400

The above interest and discount includes Rs.93,460 relating to bills discounted, the due date of which falls in the year 2010.

Pass the necessary journal entries adjusting the above and show in the ledger of the Bank.

i. Rebate on bills discounted a/c

ii. Interest and discount a/c

[Ans.: Profit and Loss Account is transferred of Discount Rs.1,76,33,980]

15. The following is an extract from the Trial Balance of a Bank as at 31st March, 2010.

	Rs.
Rebate on bills discounted as on 31-3-2010	Rs.30,000
Discount received	Rs.3,00,000

An analysis of the bills discounted shows the following

Amount of the Bill (Rs.)	Due Date (excluding grace days)
3,00,000	May 17, 2010
7,00,000	May 27, 2010
14,00,000	July 6, 2010
20,00,000	July 26, 2010

All the bills were discounted at 6% find out the amount of the discount received, credited to profit and loss account (S.No.13) and pass the journal entries.

[Ans.: Total Rebate on bills discounted Rs.71,836; Discount Credited to Profit and Loss Account Rs.2,58,164]

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Chapter – 20

BANK ACCOUNTS- II

Objectives :

After studying this unit you should be able to

- go through the proforma balance sheet of a banking company
- know the important points in the preparation of final accounts of a banking company
- understand problems relating to income from non performing assets.

Structure :

20.1 Preparation of Balance Sheet
20.2 Important points in the preparation of Bank Final Accounts
20.3 Income from Non-Performing Assets (NPA)
20.4 Self Assessment Questions
20.5 Exercises
20.6 Reference Books

20.1. PREPARATION OF BALANCE SHEET

The Balance Sheet of a banking company has to be prepared in Form 'A' of Schedule III attached to the Banking Regulation Act, 1949. Form 'A' is reproduced as follows:

Form A : Format of Balance Sheet

Balance Sheet of …. Bank as on ……

	Schedule No.	Current year	Previous year
Capital, Liabilities:			
Capital	1		
serves & Surplus	2		
Deposits	3		
Liabilities	4		
Other liabilities and Provisions	5		
Total			

	Schedule No.	Current year	Previous year
Assets:			
Cash and balances with Reserve Bank of India	6		
Balances with banks and money at call and short notice	7		
Investments	8		
Advances	9		
Fixed assets	10		
Other assets	11		
Total			
Contingent Liabilities:			
Bills for collection	12		

20.1.1 Capital and Liabilities :

1. **Capital :** This is the first item to appear under the heading Capital and Liabilities. Its details are shown in Schedule – 1.

2. **Reserves and Surplus :** It is the second item to appear under : Capital and Liabilities. Statutory Reserves, Capital Reserve, Share premium, Revenue and other reserve and profit and loss account balances are shown under this item. The details are shown Schedule – 2.

3. **Deposits :** It is the third item to appear under `Capital and Liabilities'. Demand deposits, savings bank deposits and term deposits are shown under this item. The details are shown in Schedule – 3

4. **Borrowings :** It is the fourth item to appear under `Capital and Liabilities. Borrowings from Reserve Bank of India, other banks, institutions and agencies are shown under this item. The details are shown in schedule 4.

5. **Other liabilities and provisions :** It is the last item to appear under `capital and liabilities. Bills payable, inter-office adjustments (net), interest accrued, provision for bad debts, provision for taxation are shown under this item. The details are shown in Schedule 5.

20.1.2 Assets :

1. **Cash and Balance with Reserve bank of India :** It is the first item that appears under the heading Assets. Cash in hand (including foreign currency notes) and balances with Reserve Bank of India are shown under this item. The details are shown in Schedule 6.
2. **Balances with Banks and Money at call and short notice :** It is the second item to appear under the heading Assets Balances with banks, money at call and short notice are

shown under this item. The details are shown in Schedule 7. Money at call is refundable at 24 hour's notice and money at short notice is refundable at 7 day's notice.

3. **Investments :** It is the third item to appear under the heading `Assets' Investment in government securities, other approved securities, shares, debentures and bonds, subsidiaries, gold etc., are shown under this item. The details are given in Schedule 8.

4. **Advances :** It is the fourth item to appear under the heading `Assets'. Bills purchased and discounted cash credit, overdrafts and loans payable on demand; and term loans are shown under this item. The details are given in Schedule 9.

5. **Fixed Assets :** It is the fifth item to appear under the heading `Assets' premises, other fixed assets (including furniture and fixtures) are shown under this item. The details are shown in schedule 10.

6. **Other Assets :** It is the last item to appear under the heading `Assets' Inter office adjustments, interest shown under this item. The details are shown in Schedule 11.

7. **Contingent Liabilities :** It is shown by way of footnote. It represents liabilities not provided in the Balance sheet. The details are shown in Schedule 12.

Schedule 1: Capital

		Current year	**Previous year**
I.	**For Nationalised Banks:**		
	Capital (Fully owned by Central Govt.)		
	Total		
II.	**For Banks incorporated Outside India Capital**		
	1) The amount brought in by banks by way of start up capital as prescribed by RBI		
	2) Amount of deposit kept with the RBI under Section 11(2) of the Banking Regulation Act, 1949		
	Total		
III	For other banks		
	Authorised Capital		
	(….. Shares of Rs…… each)		
	Issued Capital		
	(….. Shares of Rs….. each)		
	Subscribed Capital		
	(…. Shares of Rs…. each)		
	Called up capital		
	(….. Shares of Rs…. each)		
	Less: Calls in arrears		
	Add: Forfeited shares		
	Total		

Schedule 2 – Reserves & Surplus

		Current year	Previous year
I.	Statutory Reserve:		
	Opening balance		
	Additions during the year		
	Deductions during the year		
II.	Capital Reserve:		
	Opening Balance		
	Additions during the year		
	Deductions during the year		
III.	Share Premium		
	Opening Balance		
	Additions during the year		
	Deductions during the year		
IV.	Reserve and other reserves		
	Opening balance		
	Additions during the year		
	Deductions during the year		
IV.	Reserve and other reserves		
	Opening balance		
	Additions during the year		
	Deductions during the year		
V.	Profit and Loss a/c balance		
	Total (I, II, III, IV & V)		

Schedule 3 – Deposits

		Current year	Previous year
A) I.	Demand Deposits		
	1. From banks		
	2. From others		
II.	Savings Bank Deposits		
III.	Long-term deposits:		
	1. From banks		
	2. From others		
	Total (I, II & III)		
B	1. Deposits of branches in India		
	2. Deposits of branches outside India		
	Total		

Schedule 4 – Borrowings

		Current year	Previous year
I.	Borrowings in India		
	1. Reserve Bank of India		
	2. Other Banks		
	3. Other institutions and agencies		
II.	Borrowings outside India		
	Total (I & II)		

Secured borrowings included I & II above.

Schedule 5 – Other Liabilities and Provisions

		Current year	Previous year
I.	Bills payable		
II.	Inter-Office Adjustments (Net)		
III.	Interest accrued		
IV.	Others (including provisions)		
	Total		

Schedule 6 – Cash and Balance with Reserve Bank of India

		Current year	Previous year
I.	Cash in hand (including foreign currency notes)		
II.	Balances with Reserve Bank of India		
	1. In Current Account		
	2. In other accounts		
	Total (I & II)		

Schedule 7 – Balances with Banks & Money call and short notice

		Current year	Previous year
I.	In India		
	1. Balances with banks		
	a. In Current Accounts		
	b. In other deposit accounts		
	2. Money at call and short notice		
	a. With Banks		
	b. With Other Institutions		
	Total (1+2)		

		Current year	**Previous year**
II.	Outside India 1. In current accounts 2. In Other deposits accounts 3. Money at call and short notice		
	Total (1+2+3)		
	Grand Total (I & II)		

Schedule 8 – Investments

		Current year	**Previous year**
I.	Investments in India 1. Govt. Securities 2. Other approved securities 3. Shares 4. Debentures and Bonds 5. Subsidiaries and/or joint ventures 6. Others (to be specified)		
	Total		
II.	Investments outside India in 1. Govt. Securities (including local authorities) 2. Subsidiaries and/or joint ventures abroad 3. Other Investments (to be specified)		
	Total		
	Grand Total (I & II)		

Schedule 9 – Advances

		Current year	**Previous year**
A)	1. Bills purchased and discounted 2. Cash Credits, overdrafts and loans repayable on demand 3. Term Loans		
	Total		
B)	1. Secured by tangible assets 2. Covered by Bank/Government guarantees 3. Unsecured		
	Total		

		Current year	Previous year
C) I.	Advances in India 1. Priority Sectors 2. Public Sector 3. Banks 4. Others		
	Total		
II.	Advances outside India: 1. Due from Banks 2. Due from others a) Bills purchased and discounted b) Syndicate Loans c) others		
	Total		
	Grand Total (C I & II)		

Schedule 10 – Fixed assets

		Current year	Previous year
I.	Premises At cost as on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date		
II.	Other fixed assets (including furniture and fixtures) At cost as on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date		
	Total (I & II)		

Schedule 11 – Other Assets

		Current year	Previous year
I.	Inter-Office adjustments (Net)		
II.	Interest accrued		
III.	Tax paid advances / tax deducted at source		

		Current year	Previous year
IV.	Stationery and stamps		
V.	Non-banking assets acquired in satisfaction of claims		
VI.	Others*		
	Total (I & II)		

Schedule 12 – Contingent Liabilities

		Current year	Previous year
I.	Claims against the bank not acknowledged as debts		
II.	Liabilities for partly paid investments		
III.	Liability on account of outstanding forward exchange contracts		
IV.	Guarantees given on behalf of constituents		
	a) In India		
	b) Outside India		
V.	Acceptances, endorsements and other obligations		
VI.	Other items for which the bank is Contingently liable		
	Total		

*In case there is any unadjusted balance of loss the same may be shown under this item with appropriate footnote

20.2 IMPORTANT POINTS IN THE PREPARATION OF BANK FINAL ACCOUNTS

20.2.1 Classification of bank Advances :

The banks are required to classify their advances into following four broad groups.

(i) Standard assets
(ii) Sub-standard assets
(iii) Doubtful assets, and
(iv) Loss assets

1. **Standard Assets:** Standard Assets are those are governed which do not create any problems. They do not carry more than normal risk attached to the business. Since they

are performing assets, no provision is required to be made against them. However, banks have been asked to make provision @ 0.40% on their standard advances.

2. **Sub-Standard Assets :** Sub-standard Assets are those which have been classified as Non-Performing Assets (NPA) for a period not exceeding 18 months. In such cases, the security available to the bank is inadequate and there is a distinct possibility that the bank will suffer some loss, if deficiencies are not corrected. As such provisions have to be made at the rate of 10% of the total outstanding amount of sub-standard assets.

However, in respect of accounts where there are potential threats of recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as, frauds committed by borrowers, it will not be prudent for banks to classify them first as sub-standard and then as doubtful after expiry of two years from the date the account has become NPA. Such accounts should be straightaway classified as doubtful asset or loss asset, as appropriate, irrespective of the period for which it has remained as NPA

3. **Doubtful Assets :** Doubtful Assets are those which have remained as Non-Performing Assets (NPA) for a period exceeding 18 months. This period of two years is being reduced to 18 months by March 13, 2001. These Assets are so weak and their collection or liquidation in full is considered highly improbable.

In deciding the amount of provision to be made against Doubtful assets, the unsecured portions and the secured portions of these assets have to be considered separately. The unsecured portion has to be fully provided for i.e., provision has to be made equal to 100% of the amount by which the advance is not covered by the realisable value of the security. Further, provision has to be made even against the secured portion on the following basis.

Period for which the advance has been considered doubtful	Secured portion to be provided for
Upto One year	20%
One year to three years	30%
More than three years	100%

4. **Loss Assets :**Loss assets are those where loss has been identified by the bank or internal or external auditors or the Reserve Bank of India inspectors but the amount has not been written off wholly or partly. These assets are uncollectible, and therefore, they must be written off even though there may be a remote possibility of recovery of some amount. In case of Loss Assets Provision of 100% of the outstanding balance should be made.

Banks are also required to classify **small advance of Rs.25,000** and below in these four categories by March 31, 1998. If the Banks are unable to do it they are required to make provision at **15%** of aggregate outstanding including performing loans.

Illu.1: While closing its books of account, a Global Bank has its Advances classified as follows:

	Rs. in lakhs
Standard Assets	**16,000**
Sub-standard Assets	**1,300**
Doubtful Assets: upto one year	**700**
: one to three years	**400**
: more than three years	**200**
Loss Assets	**500**

You are required to calculate the amount of provision to be made by the bank.

Solution:

Classification of Assets	Amount Rs.in lakhs	Percentage reqd. as provision	Amount of provision Rs. in lakhs
Standard Assets	16,000	0.40	64
Sub-standard Assets	1,300	10	130
Doubtful Assets:			
- upto one year	700	20	140
- one to three year	400	30	120
- more than three years	200	100	200
Loss Assets	500	100	500
			1,154

Illu.2 : From the following information, find out the amount of provisions to be shown in the profit and loss account.

Assets :	**Rs. in '000**
Standard Assets	**6,00,000**
Sub-standard Assets	**3,00,000**
Doubtful Assets: upto one year	**60,000**
: two to three years	**80,000**
: more than three years	**2,00,000**
Loss Assets	**1,50,000**

Solution :

Classification of Assets	**Amount Rs.in lakhs**	**Percentage reqd. as provision**	**Amount of provision Rs. in 000**
Standard Assets	6,00,000	0.40	2,400
Sub-standard Assets	3,00,000	10	30,000
Doubtful Assets:			
- upto one year	60,000	20	12,000
- two to three year	80,000	30	24,000
- more than three years	2,00,000	100	2,00,000
Loss Assets	1,50,000	100	1,50,000
Total	13,90,000		4,18,400

Illu.3: Given below are details of interest on advances of a Geetha Vanijya Bank as on 31-3-2010

	Interest Earned Rs. in 000	**Interest Received Rs. in 000**
Performing Assets:		
Term loan	**240**	**160**
Cash credit and overdraft1	**1,500**	**1,240**
Bills purchased and discounted	**300**	**300**
Non-performing Assets:		
Term loan	**150**	**10**
Cash credit and overdraft	**300**	**24**
Bills purchased and discounted	**200**	**40**

Find out the income to be recognised for the year end 31-3-2010

Solution:

Interest on performing assets should be recognised on accrual basis but interest on non-performing assets should be recognised on Cash basis as per directions given in various circulars issued by R.B.I.

	Rs. in 000
Interest on Term Loan (240 + 10)	250
Interest on cash credit and overdraft (1,500 + 24)	1,524
Income form bills purchased and discounted (300 + 40)	340
Income to be recognised:	2,114

Illu.4: Compute the amount of provision for doubtful debts from the following details of advances of Canara Bank Ltd.

	Rs. in lakhs
1. Total loans and advances	**50**
2. Fully secured advances without any default by the borrowers	**30**
3. Advances overdue for 15 months	**10**
4. Advances overdue for more than 30 months but less than 36 months (secured by mortgage of plant worth Rs.3 lakhs)	**5**
5. Non-recoverable unsecured advances	**3**
6. Small advances not exceeding Rs.25,000 to each borrower	**2**

Solution:

Computation of Provision for Doubtful Debts

Classification of Assets	Total (Rs.'000)	Provision for doubtful debts %	Provision for doubtful debts Rs. ('000)
Standard Assets	30	0.40%	1,20,000
Sub-standard Assets	10	10%	1,00,000
Doubtful Assets	5	Unsecured portion + 30% of secured portion	2,90,000
Loss Assets	3	100%	3,00,000
Small advances	2	15%	30,000
	50		8,40,000

Illu.5 : Given below is an extract from the Trial balance of Jeenath Bank Ltd. as on March 31st, 2010.

		Rs.
I.	**Loans, Cash credits, Overdrafts (in India)**	**4,50,00,000**
II.	**Bills purchased and discounted (in India)**	**50,50,000**
III.	**Bills purchased and discounted (outside India)**	**50,000**

From the above particulars show the balance sheet of the bank as on 31-3-2010 also prepare the advances schedule with hypothetical figures as per the Banking Regulation Act,, 1949.

Solution :

Jeenath Bank Ltd.
Schedule – 9 : Advances as on 31-3-2010

		Year ended on 31-3-2010 (Rs.in '000)
A.	(1) Bills purchased and discounted	5,100
	(2) Cash Credits, Overdrafts, ……	45,000
	(3) Long term loans	-
	Total	50,100
B.	(1) Secured by tangible	45,500
	(2) Secured by Bank/Government guarantee	500
	(3) Unsecured	4,100
	Total	50,100
C. I.	Advances in India :	
	(1) Priority sector	21,000
	(2) Public sector	9,000
	(3) Bank	1,000
	(4) Others	19,050
	Total	50,050
II.	Advances outside India :	
	(1) From banks	-
	(2) From others	
	a. Bills purchased and discounted	50.0
	b. Syndicate loans	-
	c. Others	-
	Total	50.0
	Total (I – II)	50.100

20.2.2 Discounting of Bills :

Discounting of bills means making payments for the bill before its maturity date. If the holder of a bill needs money immediately he can get it discounted by the bank. After deducting its commission, the bank pays the present prices of the bill to the holder. When the bill matures, the bank can secure its payment from the property which had accepted the bill.

Purchasing and discounting of bills ; The bank may purchase discount clear or documentary bills at the current rate of interest.

Clean bills : These are the bills to which no documents such as bill of lading, insurance policy, etc. are attached.

Documentary bill : These bills are supported by documents such as bill of lading, insurance policy etc. These bills are secured as in case of non-payment of the bill, the bank can attach the goods.

20.2.3 Rebate on Bills discounted :

This is also termed as ``unexpired discount; or `discount received but not earned. Bills discounted may have maturity date beyond the current accounting year. The amount of discount relating to the period of a bill falling in the next accounting year is the unexpired discount. In other words, this is the unearned amount of discount received for those bills that will mature after the date of closing the final accounts. While closing annual accounts, the rebate on bills discounted is reduced from discount received and it is shown under the other liabilities in the balance sheet. The entry is :

Date	Particulars	L.F.	Debit	Credit
	Discount a/c Dr. To Rebate on bills discounted a/c (Being the amount of unearned discount relating to the next period)		Xxx	 Xxx

The rebate on bills discounted at the beginning is added to the discount income and the rebate on bills discounted at the end is deducted to find out the net discount income.

If it is given in Trial balance, it means that it is already adjusted from discount, then it is shown only in the balance sheet. However, if adjustment has to be done after preparation of the Trial balance in respect of rebate on bills discounted, the amount of unearned discount will be deducted from the total discount in the profit and loss account and will also appear as a liability in the balance sheet.

Illu.6: On 31st March, 2010 the New Andhra Bank had the following bills in its portfolio:

Date	**Amount (Rs.)**	**Term (Months)**	**Discounted @ (% p.a.)**
2010			
February 9	**50,000**	**4**	**18**
February 17	**60,000**	**3**	**15**
March 6	**40,000**	**4**	**16.5**

Calculate the rebate on bills discounted and give the necessary journal entry.

Solution:

Calculation of unexpired discounts of Rebate on Bills discounted

Date of Bill	Date of Maturity including three days	No. of days after March 31	Amount Rs.	Rate of discount % p.a.	Total Annual Discount Rs.	Proportionate Discount for days after 31st March Rs.
2010	2010					
Feb.9	June 12	73	50,000	18	9,000	1,800.00
Feb.17	May 20	50	60,000	15	9,000	1,232.88
March 6	July 9	100	40,000	16.5	6,600	1,808.22
						4,841.10

Date	**Particulars**	**L.F.**	**Debit Rs.**	**Credit Rs.**
	Discount a/c Dr. To Rebate on bills discounted a/c (Being provision for unexpired discounted)		4,841.10	4,841.10

Illu.7: The following is an extract from the Trial Balance of a Bank as at 31st March, 2010:

	Rs.	**Rs.**
Bills Discounted	**51,50,000**	
Rebate on bills discounted not yet due, (31-3-2010)		**30,501**
Discount received		**1,45,500**

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

Date of Bills	**Amount (Rs.)**	**Term (Months)**	**Discounted @ (% p.a.)**
13-1-2010	**7,50,000**	**4**	**12%**
17-2-2010	**6,00,000**	**3**	**10%**
6-3-2010	**4,00,000**	**4**	**11%**
16-3-2010	**2,00,000**	**2**	**10%**

Find out the amount of discount received to be credited to Profit and Loss Account and pass appropriate Journal Entries for the same. How the relevant items will appear in the Bank's Balance Sheet

Solution:

Calculation of unexpired discounts of Rebate on Bills discounted

Date of Bill	Date of Maturity including three days	No. of days after March 31	Amount Rs.	Rate of discount % p.a.	Total Annual Discount Rs.	Proportionate Discount for days after 31st March Rs.	
2010	2010						
Jan.13	May 16	46	7,50,000	12	90,000	11,342	(90,000 x 46/365)
Feb.17	May 20	50	6,00,000	10	60,000	8,219	(60,000 x 50/365)
Mar.6	July 9	100	4,00,000	11	44,000	12,055	(44,000 x 100/365)
Mar.16	May 19	49	2,00,000	10	20,000	2,685	(20,000 x 49/365)
						34,301	

So, unexpired discounts on 31st Mach, 2010 Rs.34,301.

The amount to be credited to Profit and Loss Account is ascertained from the Discount Account as follows:

Dr. **Discount Account** Cr.

Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
2010			2010		
Mar.31	To Rebate on Bills Discounted (on 31-3-2010)	34,301	Mar.31	By Sundries	1,45,500
Mar.31	To Profit and Loss A/c Bal. fig. (transferred)	1,41,700	Mar.31	By Rebate on Bills Discounted (on 1-4-2009)	30,501
		1,76,001			**1,76,001**

Journal Entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2010 Mar.31	Rebate on Bills Discounted Account Dr.		30,501	
	To Discount Account			30,501
	(Being unexpired discount brought forward from the previous year, credited to Discount Account)			
Mar.31	Discount Account Dr.		34,301	
	To Rebate on Bills Discounted Account			34,301
	(Being provision for unexpired discount required at the end of the year)			
Mar.31	Discount Account Dr.		1,41,700	
	To Profit and Loss Account			1,41,700
	(Being discount earned for the year 2009-2010 transferred)			

Balance Sheet as on 31-3-2010

Liabilities	Rs.	Assets	Rs.
Other Liabilities:		Advances:	
Rebate on Bills discounted	34,301	Bills Discounted	51,50,000

20.2.4 Interest on Doubtful Debts :

At the time of finalizing accounts of a bank, some advances may be doubtful of collection. Interest on such advances cannot be termed as income. Interest earned by a banking company on doubtful debts can be treated in any of the following ways in the accounts of a banking company.

(a) **Interest suspense method :** Under this method, interest on doubtful debts is debited to the loan account and credited to interest suspense account. To the extent interest is received in cash the amount is transferred to interest account and the balance to the loan account. The loan account is closed by transferring the balance to bad debts account.

(b) **Cash basis :** Under this method, no entry is passed for such interest till it is actually received.

(c) Accrual method ; Under this method, interest account may be credited with the full amount of interest due on doubtful debts and simultaneously an adequate provision for bad and doubtful debts may be credited.

It may be noted, that the doubtful debts come within the category of non-performing assets and therefore interest income on such doubtful debts should not be recognized and taken to the profit and loss account. The method (b) is therefore best under the present circumstances.

Illu.8: When Closing the books of a banks on 31st March, 2009 (for the year 2008-09), you find in the 'Loan Ledger' an unsecured balance of Rs.2,00,000 in the account of a merchant whose financial condition is reported to you as bad and doubtful. Interest on the same account amounting to Rs.20,000 (for 2008-09) remains to be recorded.

During the year 2009-10 the bank accept 75 paise in the rupee on account of the total payment of debt from the merchant as on 31st March, 2009.

Pass the necessary journal entries and prepare the necessary ledger accounts in respect of the above under Interest suspense method.

Solution: Interest Suspense Method

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2009 Mar.31	Merchant's loan A/c	Dr.		20,000	
	To Interest suspense a/c				20,000
	(Being interest due on doubtful debt of Rs.2,00,000 credited to interest suspense a/c)				
	P & L a/c	Dr.		2,00,000	
	To Provision for bad debts				2,00,000
	(Being creation of provision for bad debts)				
2010 Mar.31	Cash a/c	Dr.		1,65,000	
	To Merchant's loan A/c				1,65,000
	(Being dividend of 75 paise in a rupee received from the merchant)				
	Interest suspense a/c	Dr.		5,000	
	Bad debts a/c	Dr.		50,000	
	To Merchant's a/c				55,000
	(Being interest not received and balance of the account transferred to bad debts account)				

Date	Particulars	L.F	Debit Rs.	Credit Rs.
	Interest suspense a/c Dr.		15,000	
	To Profit and Loss a/c			15,000
	(Being interest received against interest suspense A/c credited to the Profit and loss a/c)			
	Provision for bad debts a/c Dr.		50,000	
	To Bad debts a/c			50,000
	(Being the bad debts written off against provision)			

Ledger Accounts

Date	Particulars	Rs.	Date	Particulars	Rs.
2008 Apr.1	To Balance b/d	2,00,000	2009 Mar.31	By Balance c/d	2,20,000
2009 Mar.31	To Interest suspense a/c	20,000			
		2,20,000			2,20,000
2009 Apr.1	To Balance b/d	2,20,000	2010 Mar.31	By Cash	1,65,000
				By Interest suspense a/c	5,000
				By Bad debts	50,000
		2,20,000			2,20,000

Interest Suspense Account

Date	Particulars	Rs.	Date	Particulars	Rs.
31-3-09	To Balance c/d	20,000	31-3-08	By Merchants' A/c	20,000
		20,000			20,000
31-3-2010	To Merchants' A/c	5,000	1-4-09	By Balance b/d	20,000
	To P & L a/c	15,000			
		20,000			20,000

20.3. INCOME FROM NON-PERFORMING ASSETS (NPA)

Any asset which generates income is a ‘performing asset’. An asset becomes ‘non-performing’ when it ceases to generate income for a bank. This happens when interest or installment of Principal or both are not received on due dates.

The Reserve Bank of India (RBI) has given clear guidelines in determining when an asset becomes non-performing which are briefly given below.

a. Term Loans: When Interest and/or installment of Principal remains over due for more than two quarters, out of four quarters, it should be considered as NPA.

b. Cash credits and overdrafts: When the account remains ‘out of order’ for more than two quarters out of four quarters, they are to be considered as NPA. In case where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for six months on the date of Balance sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as out of order.

c. Bills Purchased and Discounted: If the Bill remains over due and unpaid for a period of any two quarters. Overdue interest should not be charged and taken to income account in respect of overdue bills unless it is realized.

d. Agricultural Advances: Agricultural advances will be treated as NPA if interest/installment was in arrears for more than two quarters from the date of interest/installment became due for payments.

e. Other Advances: When other advances remain past due for a period of any two quarters, they are to be considered as NPA.

The terms of `Out of Order’ and `Overdue’ have been defined as under.

1. **Out of order :** An account should be treated as `out of order’ if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.
2. **Overdue :** Any amount due to the bank under any credit facility is `overdue’ if it is not paid on the due date fixed by the bank.

Banks have been advised by the Reserve Bank of India that they should identify the non-performing assets and ensure that interest on such non--performing assets is not recognized as income and taken to the profit and loss account. Banks are to recognize their income on accrual basis in respect of income on performing assets and on cash basis in respect of income on non-performance assets. Any interest accrued and credit to income account must be cancelled by a reverse entry once the credit facility comes under the category of non-performing assets.

20.3.1 A non-performing asset may become performing asset :

An asset becomes non-performing when the interest and/or installment of principal is delayed and non received before a stipulated time. In other words, an asset becomes non-performing when it ceased to generate income for banks. A term loan is treated as non-performing asset when interest and/or installment of principal remains overdue for a period of more than two quarters.

The identification of non-performing assets is to be done on the basis of the position as on the balance sheet data. If an account has been regularized before the balance sheet date by payment of overdue amount through genuine sources (not by sanction of additional facilities or transfer of funds between accounts) the account need not be treated as non-performing assets. The bank should however ensure that the account remains in order subsequently.

Hence, non-performing assets, need not be permanently non-performing assets, it shall resume into performing assets, subject to the satisfaction of their norms at the discretion of banks.

Illu.9: On 31st March, 2010, the following balance stood in the books of the Vijaya Bank Ltd. after preparation of profit and loss Account (before making appropriations)

	Rs.		Rs.
Share capital (Authorised and Issued) 70,000 shares of Rs.100 each, Rs.50 paid	**35,00,000**	**Borrowed from Banks**	**49,00,000**
Reserve fund	**24,50,000**	**Bills discounted and purchased**	**42,00,000**
Term Deposits	**66,50,000**	**Bills payable**	**56,00,000**
S.B.Deposits	**2,10,00,000**	**Loans, overdrafts and Cash credits**	**4,90,00,000**
Demand Deposits	**5,60,00,000**	**Unclaimed Dividends**	**2,10,000**
Money at call and short notice	**10,000**	**Bills for collection**	**9,80,000**
Investments at cost	**2,10,00,000**	**Acceptances and endorsements on behalf of customers**	**14,00,000**
Profit and Loss a/c (Cr.) on 1-4-2009	**14,70,000**		
Dividends Paid	**3,50,000**	**Net profit for the year (after deducting provision for doubtful debts Rs.2,10,000 Provision for taxation Rs.7,00,000 and rebate on bills discounted Rs.35,000)**	**16,80,000**
Premises (after depreciation upto 31st March 2010 Rs.11,55,000)	**79,45,000**		
Sundry Creditors	**2,10,000**		
Cash in hand	**4,20,000**		
Cash with R.B.I	**1,05,00,000**		
Cash with other banks	**91,00,000**		

Prepare the balance sheet of the bank in the prescribed form.

Solution :

Vijaya Bank Ltd.,

Profit and Loss account for the year ended March 31, 2010

	Particulars	Schedule Nos.	Year ended on 31-3-2010
III.	**Profit / Loss:**		
	Profit for the current year		1,680
	Last Year's balance		1,470
	Total		3,150
IV	**Appropriations:**		
	Transfer to Statutory Reserve		336
	Dividends		350
	Balance taken to Balance Sheet (Debit)		2,464
	Total		3,150

Vijaya Bank

Balance sheet as on 31st March, 2010

	Schedule No.	As on 31-3-2010 Rs.'000
Capital and Liabilities:		
Capital	1	3,500
Reserve and Surplus	2	5,250
Deposits	3	83,650
Borrowings	4	4,900
Other Liabilities & Provisions	5	6,755
Total		**1,04,055**
Assets		
Cash in hand and cash at reserve bank	6	10,920
Balances with banks and Money at call and short notice	7	11,200
Investments	8	21,000
Advances	9	52,990
Fixed Assets	10	7,945
Other Assets	11	-
Total		**1,04,055**
Contingent Liabilities	12	1,400
		980
Bills for collection		

(Rs.'000)

Schedule 1 : Capital		**Schedule 2 : Reserves and Surplus**	
Authorised Capital		Statutory Reserve	420
70,000 shares @ Rs.100 each	7,000	Capital Reserve	-
Issued capital		Share premium	-
70,000 shares @ Rs.100 each	7,000	Reserve fund	2,450
Subscribed capital :		Profit and Loss a/c balance	2,380
70,000 shares @ Rs.100 each	7,000	Total	5,250
Called, paid up capital			
70,000 shares @ Rs.50 each	3,500		
Total	3,500		

(Rs.'000)

Schedule 3 : Deposits		**Schedule 4 : Borrowings**	
Demand deposits	56,000	Borrowings in India	
Savings Deposits	21,000	Borrowings from other banks	4,900
Term deposits	6,650	Borrowings outside India	-
Deposits of Branches in India	-	Total	4,900
Deposits of branches outside India	-		
Total	83,650		

Schedule – 5 : Other Liabilities and Provisions :

		Rs.'000
I.	Bills payable	5,600
II.	Inter Office adjustments	-
III.	Interest accrued	-
IV.	Others :	
	a. Creditors	210
	b. Unclaimed dividends	210
	c. Provision for taxation	700
	d. Rebate on bills discounted	35
	Total	6,755

(Rs.'000)

Schedule 6 : Cash and Balances with RBI		**Schedule 7 : Balances with Banks & Money at call and short notice**	
Cash in hand	420	In India :	
Cash at Reserve Bank	10,500	(i) Balances with other hanks	9,100
Total	10,920	(ii) Money at call and short notice	2,100
		Total	11,200

(Rs.'000)

Schedule 8 : Investments		**Schedule 9 : Advances**		
Investments in India	21,000	Bills purchased and discounted		4,200
Investments outside India	-	Cash credits and overdrafts	49,000	
		Less : Provision for doubtful debts	210	48,790
Total	21,000	Total		52,990

(Rs.'000)

Schedule 10 : Fixed Assets			**Schedule 12: Contingencies**	
Premises	9,100		Claims against the bank not acknowledged as debts	-
Less : Depreciation	1,155	7,945	Liabilities for partly paid investments	-
Other fixed assets		-	Liability on account of outstanding forward exchange contracts	-
Total		7,945	Guarantee given on behalf of constituents	-
			Acceptance endorsements and other obligations	1,400
			Other items for which the bank is contingently liable	-
			Total	1,400

Illu.13 : The following is the Trial Balance of Murali Bank Ltd. as on 31st March 2009:

Particulars	**Debit (Rs.)**	**Credit (Rs.)**
Loans, Cash credits and overdrafts	**4,27,500**	
Premises	**75,000**	
Subscribed capital:		
75,000 equity shares of Rs.10 each, fully paid		**7,50,000**
Reserve fund		**3,75,000**
Current deposits		**1,50,000**
Fixed deposits (including cash certificates)		**1,87,500**
Savings bank deposits		**75,000**
Indian Government securities	**6,00,000**	
Salaries	**42,000**	
General expenses	**41,100**	
Rent, rates and taxes	**3,450**	

Particulars	**Debit (Rs.)**	**Credit (Rs.)**
Directors fees	**2,700**	
Stock of stationery	**12,750**	
Bills discounted	**69,000**	
Interim dividend paid	**25,500**	
Shares	**75,000**	
Profit and Loss account (1-4-2008)		**24,000**
Interest and discount		**1,92,000**
Recurring deposits		**30,000**
Cash in hand and with RBI	**2,89,500**	
Money at call and short notice	**1,20,000**	
	17,83,500	**17,83,500**

The following information should be considered:

- **(a) Provision for bad and doubtful debts Rs.7, 500**
- **(b) Interest accrued on investments to Rs.12, 000**
- **(c) Unexpired discount amount to Rs.570**
- **(d) Endorsements made behalf of customer Rs.1, 72, 500**
- **(e) Authorized capital was 1,20,000 with equity shares of Rs.10 each.**
- **(f) Market vale of Indian Government securities Rs.5, 85,000**
- **(g) Depreciate premises at 5%.**

Prepare Profit and Loss account ad Balance Sheet for the year ended 31st March, 2009 as per new format only.

Solution ;

Murali Bank Limited

Profit & Loss account for the year ending 31st, March 2009

	Particulars	Schedule No	Year ended on 31st March,2009
I.	Income:		
	Interest earned	13	2,03,430
	Other Income	14	-
	Total		2,03,430
II.	Expenditure:		
	Interest paid	15	-
	Management Expenses	16	93,000
	Provisions & Contingencies		7,500
	Total		1,00,500
III.	Profit / Loss		
	Profit for the current year (I – II)		1,02,930
	Last Year's balance		24,000
	Total		1,26,930

	Particulars	Schedule No	Year ended on 31st March,2009
IV.	Appropriations:		
	Transfer to Statutory Reserve		20,586
	Interim divided		25,500
	Balance take to Balance Sheet		80,844
	Total		1,26,930

Notes : Transferred to Statutory reserve (20%) = Rs.1,02,930 x 20/100 = Rs.20,586

Murali Bank Limited
Balance Sheet as on 31st March, 2009

	Schedule No	As on 31-3-2009
Capital & Liabilities		
Capital	1	7,50,000
Reserves & Surplus	2	4,76,430
Deposits	3	4,42,500
Borrowings	4	-
Other Liabilities & provisions	5	570
Total		16,69,500
Assets		
Cash in hand & with RBI	6	2,89,500
Balance with other banks and money at call and short notice	7	1,20,000
Investments	8	6,75,000
Advances	9	4,89,000
Fixed Assets	10	71,250
Other Assets	11	24,750
Total		16,69,500
Contingent Liabilities	12	1,72,500
Bills for collection		-

Schedule – 1 : Capital

	Rs.	As on 31-3-2009 Rs.
Authorized Capital		12,00,000
Issued, Subscribed, called p ad paid up Capital:		7,50,000
Total		**7,50,000**

Schedule – 2 : Reserves and Surplus

	Rs.	**As on 31-3-2009 Rs.**
Statutory Reserve (Reserve fund)	3,75,000	
Current years contribution	20,586	3,95,586
Profit & Loss a/c		80,844
Total		**4,76,430**

Schedule – 3 : Deposits

	Rs.	**As on 31-3-2009 Rs.**
Current Deposits		1,50,000
Fixed Deposits		1,87,500
Saving Bank deposits		75,000
Recurring Deposits		30,000
Total		4,42,500

Schedule – 5 : Other Liabilities and Provisions

	Rs.	**As on 31-3-2009 Rs.**
Unexpired discount		570
Total		570

Schedule – 6 : Cash in hand and with RBI

	Rs.	**As on 31-3-2009 Rs.**
Cash in hand & with RBI		2,89,500
Total		2,89,500

Schedule – 7 : Balance with other banks and Money at call and short notice

	Rs.	As on 31-3-2009 Rs.
Balance with other Banks Money at call and short notice		1,20,000
Total		1,20,000

Schedule – 8 : Investments

	Rs.	As on 31-3-2009 Rs.
Indian Government Securities		6,00,000
Shares		75,000
Total		6,75,000

Schedule – 9 : Advances

	Rs.	As on 31-3-2009 Rs.
(A) Loans, Cash Credits over drafts		4,20,000
Bills discounted		69,000
Total		4,89,000
(B) (i) Secured by Tangible assets		4,36,000
(ii) Covered by bank / Govt. guarantees		40,000
(iii) Unsecured		13,000
Total		4,89,000
I 1. Advances in India		
Priority Sector		3,86,000
Public Sector		40,000
Banks		10,000
Others		13,000
Total		4,49,000
2. Advances outside India		
Banks		20,000
Others		20,000
Total		40,000
Total (I + II)		4,89,000

Schedule – 10 : Fixed Assets

	Rs.	As on 31-3-2009 Rs.
Premises		71,250
Total		71,250

Schedule – 11: Other Assets

	Rs.	As on 31-3-2009 Rs.
Stock of Stationary		12,750
Interest accrued on investments		12,000
Total		24,750

Schedule – 12 : Contingent Liabilities

	Rs.	As on 31-3-2009 Rs.
Endorsements on behalf of customers		1,72,500
Total		1,72,500

Schedule – 13 : Interest Earned

	Rs.	As on 31-3-2009 Rs.
Interest & discount	1,92,000	
(+) Interest accrued on Investments	12,000	
	2,04,000	
(-) Unexpired discount	570	2,03,430
Total		2,03,430

Schedule – 16 : Operating Expenses

	As on 31-3-2009 Rs.
Payment to provisions for employees	42.00
Rent, taxes, and lighting	3.45
Depreciation on premises (Rs.75,000 x 5/100)	3.75
Directors fees	2.70
Other expenses (General expenses)	41.10
Total	93.00

Provisions and Contingencies

	As on 31-3-2009 Rs.
Provision for bad debts reserve	7.5
Total	7.5

Illu.14: The trial balance of the Indian Bank Ltd., as on 31-3-2010 is as follows:

	Rs.
Paid up share capital	**10,00,000**
Bills discounted	**9,00,000**
General Reserve	**3,85,000**
Cash credits and overdrafts	**14,00,000**
Furniture	**20,000**
Fixed deposits	**20,00,000**
Profit and loss account (Cr.)	**1,10,000**
Stamps	**5,000**
Unclaimed dividends	**5,000**
Loans	**23,00,000**
Current savings deposits	**25,00,000**
Cash in hand	**2,50,000**
Cash at bank	**6,50,000**
Investments (at cost)	**4,75,000**

Of the total loans, Rs.2,85,000 is doubtful. Rs.24,00,000 loans are fully secured by the Bank. For Rs.4,00,000 debts (including Rs.1,15,000 from directors), the bank holds personal securities for one or more persons over and above the personal securities of the debtors. For the balance debts, there are no

securities except the personal surety of the debtors themselves. Liability for bills accepted on behalf of customers is Rs.5,00,000.

The directors of the bank want the investments must be shown at market value in the Balance Sheet at Rs.5,00,000. Prepare the Banks Balance Sheet in the prescribed proforma.

Solution:

Indian Bank Ltd.
Balance Sheet as on 31st March, 2010

(Rs. in '000)

	Schedule No.	Year ended 31-3-2010
Capital and Liabilities:		
Capital	1	1,000
Reserves and Surplus	2	520
Deposits	3	4,500
Borrowings	4	--
Other Liabilities and Provisions	5	5
Total		6,025
Assets:		
Cash and balances with RBI	6	900
Balances with banks and Money at call and short notice	7	--
Investments	8	500
Advances	9	4,600
Fixed Assets	10	20
Other Assets	11	5
Total		6,025
Contingent Liabilities	12	500
Bills for collection		--

Schedule 1 – Capital

(Rs. in '000)

A	Authorised Capital	--
B	Issued Capital	--
C	Subscribed Capital	--
D	Called-up Capital	1,000
	Less: Calls unpaid	--
	Add: Forfeited Shares	--
	Total	1,000

Schedule 2 – Reserves and Surplus

(Rs. in '000)

I.	Revenue and Other Reserves:	
	(i) Opening Balance	410
	(ii) Additions during the year	110
	Balance of Profit & Loss	--
	Total	520

Schedule 3 – Deposits

(Rs. in '000)

A.I.	Demand Deposits	
	(i) From banks	--
	(ii) From others	2,500
II.	Savings Bank Deposits	--
III.	Term Deposits	
	(i) From Banks	--
	(ii) From others	2,000
	Total (I , II & III)	4,500
B.(i)	Deposits of Branches in India	4,500
(ii)	Deposits of Branches outside India	--
	Total	4,500

Schedule – 5 : Other Liabilities and Provisions

		(Rs.;000)
Others (including provisions)		5
Total		5

Schedule 6 – Cash and Balances with Reserve Bank of India

(Rs. in '000)

I.	Cash in hand (including foreign currency notes)	250
II.	Balance with Reserve Bank of India:	
	(i) in current Account	650
	(ii) in other Accounts	--
	Total (I and II)	900

Schedule 8 – Investments

(Rs. in '000)

VI.	Investments in India:	
	(vi) Others	500
	Total	500

Schedule 9 – Advances

(Rs. in '000)

A	(i) Bills purchased and Discounted	900
	(ii) Cash credits, overdrafts, and loans repayable on loans	1,400
	(iii) Term Loans	2,300
	Total	4,600
B.	(i) Secured by Tangible Assets	2,400
	(ii) Covered by Bank/Government guarantees	--
	(iii) Unsecured	2,200
	Total	4,600
C.I.	Advances in India:	
	(i) Priority Sectors	--
	(ii) Public Sectors	--
	(iii) Bank	--
	(iv) Others	4,600
	Total	4,600
II.	Advances outside India:	
	(i) Due from Banks	--
	(ii) Due from others	--
	(a) Bills purchased and discounted	--
	(b) Syndicated Loans	--
	(c) Others	--
	Total	--
	Grand Total (C.I & C.II)	**4,600**

Schedule 10 – Fixed Assets

(Rs. in '000)

II.	Other Fixed Assets (including furniture & Fixtures):	
	(i) At cost as at 31st March of Last year	20
	Total	20

Schedule 11 – Other Assets

(Rs. in '000)

IV.	Stationery and Stamps	5
	Total	5

Schedule 12 – Contingent Liabilities

(Rs. in '000)

V.	Acceptances, Endorsements and other obligations	500
VI.	Other items for which the bank is contingently	--
	Total	500

llu.15: The following Trial Balance of National Bank Ltd. as on 31-3-2010.

	Rs.		Rs.
Loans, Cash Credits and overdrafts	2,85,000	Subscribed capital 50,000 equity shares of 10 each fully paid	5,00,000
Premises	50,000		
Indian Govt. Securities	4,00,000	Reserve fund	2,50,000
Salaries	28,000	Current deposits (including called deposits in demand)	1,00,000
General Expenses	27,400		
Rent, Rates and Taxes	2,300		
Stock and stationery	8,500	Fixe Deposits (including cash certificates	1,25,000
Directors' fee	1,800		
Bills purchased and discounted	46,000	Savings Bank deposits	50,000
Interim dividend paid	17,000	Profit & Loss account (1-4-2009)	16,000
Shares	50,000	Interest and discount	1,28,000
Cash in hand & with reserve bank of India	1,93,000	Recurring deposits	20,000
Money at call and short notice	80,000		
	11,89,000		11,89,000

The following information should be considered.

a) Provision for bad and doubtful debts is required amounting to Rs.5,000

b) Interest accrued on Investments was Rs.8,000

c) Unexpired discounts amounts to Rs.380

d) Interim dividend declared was 4% actual

e) Endorsement made on behalf of customers totalled Rs.1,15,000

f) Authorised capital was Rs.80,000 equity shares of Rs.10 each.

g) Rs.10,000 were added to the premises during the year. Depreciation at 5% on the opening balance is required.

h) Market value of Indian Govt. securities Rs.3,90,000

Prepare profit & loss account for the year ended 31-3-2010 and Balance Sheet as at that date in the prescribed form.

Solution:

National Bank Ltd.,
Profit and Loss account for the year ended 31st March, 2010

(Rs.'000)

		Schedule No.	Year ended 31-3-2010
I.	**Income**		
	Interest/Discount	13	135.62
	Other income	14	-
	Total		**135.62**
II.	**Expenditure**		
	Interest Expended	15	-
	Operating Expenses	16	61.5
	Provisions and Contingencies		5.0
	Total		**66.5**
III.	**Profit/Loss:**		
	Net profit for the year		69.12
	Profit brought forward		16.00
	Total		**85.12**
IV.	**Appropriations:**		
	Transfer of Statutory Reserve 20%		13.82
	Dividend Proposed		20.00
	Balance carried over to Balance Sheet		51.30
	Total		**85.12**

Notes : Transfer to Statutory reserve (20%) = Rs.69,120 x 20/100 = Rs.13,824
Interim Dividend = Rs.5,00,000 x 4/100 = Rs.20,000

(Rs.'000)

Schedule – 13 : Interest Earned

		Year ended on 31-3-10 Current year
Interest/Discount on Advances/Bills	128.0	
Add : Outstanding interest on investments	8.0	
	136.0	
Less : expired discount	0.38	135.62
Total		135.62

(Rs.in'000)

Schedule – 16 : Operating Expenses	Year ended on 31-3-10 Current year
Payment to provisions for employees	28.0
Rent, taxes, and lighting	2.3
Depreciation on Premises	2,.0
Directors fees	1.8
Other expenditure (General expenses)	27.4
Total	**61.5**

Provisions and Contingencies	Year ended on 31-3-10 Current year
Provision for bad and doubtful debts	5.0
	5.0

National Bank Ltd.,

Balance Sheet as on 31st March, 2010

(Rs.'000)

	Schedule No.	As on 31-3-2010
Capital and Liabilities:		
Capital	1	500.00
Reserve and Surplus	2	315.12
Deposits	3	295.00
Borrowings	4	-
Other Liabilities	5	3.38
Total		**1,113.50**
Assets		
Cash and balances with RBI	6	193.00
Balances with banks and Money at call and short notice	7	80.00
Investments	8	450.00
Advances	9	326.00
Fixed Assets	10	48.00
Other Assets	11	16.50
Total		**1,113.50**
Contingent Liabilities	12	
Bills for collection		115.0

Schedule 1 : Capital		**Schedule 2 : Reserves and Surplus**	
	Rs.'000		Rs.'000
Authorised Capital	800.0	Statutory Reserves	13.824
80,000 equity shares of Rs.10 each		Reserve fund, other reserves	250.000
		Profit and loss a/c balance	51.296
Issued, Subscribed and called up Capital			
50,000 Equity shares of Rs.10 each	500.00		
Total	500.0	Total	315.120

Schedule 3 : Deposits		**Schedule 4 : Borrowings**	
	Rs.'000		Rs.'000
Demand Deposits	100.	I. Borrowings in India	
Savings bank deposits	50		
Term deposits	125		
Recurring deposits	20		
Total	295	Total	Nil

Schedule 5 : Other Liabilities & Provisions		**Schedule 6 : Cash Balances with RBI**	
	Rs.'000		Rs.'000
Others : Unexpired discount,	0.38	Cash in hand and with RBI	193
unclaimed dividends (Rs.20,000 – 17,000)	3.00		
Total	3.38	Total	193

Schedule 7: Balances with Banks & Money at call and short notice		**Schedule 8 : Investments**	
	Rs.'000		Rs.'000
Money at call and short notice	80	Govt. Securities (Market value Rs.390)	400
		Shares	50
Total	80	Total	450

Schedule 9 : Advances			Schedule 10 : Fixed Assets	
		Rs.'000		Rs.'000
A. (i) Bills purchased and discounted		46	I. Premises	48
(ii) Cash credits, overdrafts and loans repayable on loans	285		(Rs.40 + 10 – 2)	
Less : Provision for bad and doubtful debts	5	280	Total	48
Total		326		

Schedule 11: Other Assets		Schedule 12 : Contingent Liabilities	
	Rs.'000		Rs.'000
Interest accrued	8.0	Acceptances, endorsement and other obligations	115.0
Stationery balance	8.5		
Total	16.5	Total	115.0

Illu.16: From the following information, prepare a Balance Sheet of International Bank Ltd. as on 31st March, 2010, giving the relevant schedules and also specify at least four important Principal Accounting Policies:

	Rs. in lakhs	
	Dr.	**Cr.**
Share Capital		**198.00**
19,80,000 Shares of Rs.10 each		
Statutory Reserve		**231.00**
Net Profit before appropriations		**150.00**
Profit and Loss Account		**412.00**
Fixed Deposit Account		**517.00**
Savings Deposit Account		**450.00**
Current Accounts	**28.10**	**520.12**
Bills payable		**0.10**
Cash Credits	**812.00**	
Borrowings from other Banks		**110.00**
Cash on Hand	**160.15**	
Cash with RBI	**37.88**	
Cash with Other Banks	**155.87**	
Money at Call	**210.12**	
Gold	**55.23**	
Government Securities	**110.17**	
Premises	**155.70**	
Furniture	**70.12**	
Term Loan	**792.88**	
	2,588.22	**2,588.22**

Additional Information:

Bills for collection	**18,10,000**
Acceptances and endorsements	**14,12,000**
Claims against the Bank not acknowledged as debt	**55,000**
Depreciation charges – Premises	**1,10,000**
- Furnitures	**78,000**

50% of the Term Loans are secured by Government guarantees. 10% of cash credit is unsecured. Also calculate cash reserves required and statutory liquid reserves required.

***Note:* Cash reserve required is 3% of demand and time liabilities; liquid reserves required is 30% of demand and time liabilities.**

Solution:

Balance Sheet of International Bank Ltd.
As on 31st March, 2010

(Rs. in lacs)

	Schedule No.	Year ended 31-3-2010
Capital and Liabilities:		
Share Capital	1	198.00
Reserves and Surplus	2	793.00
Deposits	3	1,487.12
Borrowings	4	110.00
Other Liabilities and Provisions	5	0.10
		2,588.22
Assets:		
Cash and balances with RBI	6	204.76
Balances with banks and Money at call and short notice	7	359.26
Investments	8	165.40
Advances	9	1,632.98
Fixed Assets	10	225.82
Other Assets	11	
		2,588.22
Contingent Liabilities	12	14.67
Bills for collection		18.10

Schedule 1 : Capital		Schedule 2 : Reserves and Surplus		
	Rs.'000			Rs.'000
Authorised Capital		I. Statutory Reserve- Opening Balance	231.00	
Issued, Subscribed and Paid up capital 19,80,000 Shares of Rs.10 each	198.00	Additions during the year	37.50	268.50
		II. Balance in Profit & Loss A/c		524.50
Total	198.00	Total		793.00

Schedule 3 : Deposits		Schedule 4 : Borrowings	
	Rs.'000		Rs.'000
I. Demand Deposits from others	520.12	Other Banks	110.00
II. Saving Bank Deposits	450.00		
III. Fixed Deposits	517.00		
Total	1,487.12	Total	110.00

Schedule 5 : Other Liabilities & Provisions		Schedule 6 : Cash Balances with RBI	
	Rs.'000		Rs.'000
Others liabilities & provisions	0.10	Cash in hand	160.15
		Balances with RBI-	44.61
		In current account [Working Note (i)]	
Total	0.10	Total	204.76

Schedule 7 : Balances with Banks & Money at call and short notice		Schedule 8 : Investments	
	Rs.'000		Rs.'000
I. In India Balance with Banks		I. Investments in India in	
(i) Current Accounts [Working Note (iii)]	149.14	(i) Government Securities	110.17
(ii) Money at call and short notice	210.12	(ii) Others – Gold	55.23
Total	359.26	Total	165.40

Schedule 9 : Advances		Schedule 10 : Fixed Assets		
	Rs.'000			Rs.'000
A. (i) Cash Credits and		1. Premises	156.80	
Overdrafts	840.10	Less: Depreciation	1.10	155.70
(ii) Term loans	792.88	2. Other Fixed Assets:		
Total	1,632.98	Furniture	70.90	
B. (i) Secured by tangible	1,152.53	Less: Depreciation	0.78	70.12
(ii) Secured by Bank/Government guarantees	396.44			
(iii) Unsecured	84.01			
Total	1,632.98	Total		225.82

Schedule 12 – Contingent Liabilities

(Rs. in '000)

(i)	Claims against the bank not acknowledged as debts	0.55
(ii)	Acceptances and endorsements	14.12
	Total	14.67

Working Notes:

1.	**Required cash reserve and liquid reserve**	**Rs. in lakhs**
	Fixed deposits	517.00
	Saving deposits	450.00
	Current accounts (Credit balances)	520.12
	Total demand and time liabilities	1,487.12
	Cash reserve required =	
	3% of Rs.1,487.12 lakh = Rs.44.61 lakh	
	Liquid reserve required =	
	30% of Rs.1,487.12 lakh = Rs.446.14 lakh	
2.	**Profit and Loss Account:**	
	Balance of profit and loss account b/fd	412.00
	Add: Net profit for the year before appropriations	150.00
		562.00
	Less: Transfer to Statutory Reserve, 25% of Rs.150 lakh	37.50
	Balance appearing in balance sheet	524.50
3.	**Cash with other banks:**	
	Cash reserve required	44.61
	Less: Cash with R.B.I	37.88
	Transfer needed to maintain cash reserve	6.73

4.	**Liquid Assets:**	**Rs. in lakhs**
	Cash on hand	160.15
	Cash with other banks	155.87
	Money at call	210.12
	Gold	55.23
	Government Securities	110.54
		691.91
	Cash with other banks	155.87
	Less: Transfer to cash with R.B.I.	6.73
	Balance appearing in balance sheet	149.14

20.4 SELF ASSESSMENT QUESTIONS

1. Give the latest Proforma of a Bank Balance Sheet in brief.
2. What are the books that are to be maintained by a bank?
3. What do you mean by non-banking assets?
4. How is interest on doubtful debts treated in bank accounts.

20.5 EXERCISES

1. From the following details, compute the amount of provision required to be made in the profit and loss account of Kashmir Bank Ltd., for the year 2009-10.

Assets	Rs. in lakhs
Standard	16,000
Sub-standard	12,000
Doubtful	
One year (secured)	4,800
For two to three years (secured)	3,600
For more than 3 years (secured by mortgage of machinery worth Rs.1,000 lakh)	1,800
Non coverable assets	3,000

[Ans.: Provision Rs.7,604]

2. The Advances of Tamilnadu Mercantile Bank Ltd. for the year 2009-10 are classified as given below.

(Rs.in '000)

	Cash credits, overdrafts etc.	**Term Loans**	**Bills purchased**
Standard Assets	1,003	985	433
Sub-standard assets	120	100	-
Doubtful debts			
Upto 1 year	100	20	-
One to three years	120	60	-
More than three years	50	80	-
Loss Assets	12	22	-
	1,405	1,267	433

No provision has been made so far against these assets. Doubtful assets are secured to the extent of 50% of the amount due.

[Ans.: Provision Rs.385 (thousands)

3. From the following information prepare the Balance Sheet of United Bank Limited as on 31st March, 2010.

Debit	Rs.	Credit	Rs.
Bills discounted	900	Paid-up Capital	1,000
Cash credits and overdrafts	1,400	Reserve fund	385
Loans	2,300	Unclaimed dividends	5
Furniture	20	Current and Savings deposits	2,500
Stamps balance	5	Fixed deposits	2,000
Cash in hand	250	P & L Account 31-3-2005	110
Cash at bank	650		
Investments (in cost securities)	400		
Premises	75		
	6,000		6,000

The directors require the bank investments to be shown in the Balance Sheet at market value on31st March, 2005 which is Rs.5,250.

[Ans.: Balance Sheet Total Rs.6,125; Contingent Liabilities Rs.550]

4. Prepare Balance Sheet of Kubera Bank Ltd., in the prescribed form, as on 31-3-2010 from the following balances and adjustments.

	Rs.		Rs.
Paidup Share capital (Fully paid Rs.100 per share)	32,00,000	Profit & Loss Account (Cr.) Stamps and Stationery	3,52,000 16,000
Bills discounted	28,80,000	Cash in hand	8,00,000
Reserve Fund	12,32,000	Cash with Reserve Bank	20,80,000
Cash Credits	32,00,000	Branch Adjustments (Dr.)	2,72,000
Overdrafts	12,80,000	Investments	15,20,000
Unclaimed Dividends	16,000	Loans (Cr.)	19,20,000
Loans	73,60,000	Recurring Deposits	16,00,000
Current Deposits	60,80,000	Fixed Deposits	32,00,000
Furniture	64,000	Cash certificates	16,00,000
		Contingency Reserves	2,72,000

Adjustments:

a. Rebate on Bills Discounted Rs.16,000

b. Provide Rs.1,28,000 for Doubtful debts

c. Bank's acceptance on behalf of customers Rs.10,40,000

[Ans.: Balance Sheet Total Rs.1,94,72,000]

5. The following balances were extracted from the books of Asian Bank Limited after preparation of its Profit and Loss A/c.

	Rs.('000)
Share Capital (Authorised issued)	
80,000 shares of Rs.100 each, Rs.50.	
Paid up	4,000
Statutory Reserve (Section 17)	6,200
Fixed Deposits	42,600
Savings Bank deposits	19,000
Current Accounts	23,200
Money at call and short notice	1,800
Government Securities	9,000
Other Securities	16,000
Profit and Loss a/c (Credit 31-3-09)	2,190
Premises (Depreciation written off Rs.4,50,000 upto 31-3-09)	2,950
Cash in hand	380
Balance with Reserve Bank of India	10,000
Cash with other banks	6,000
Balance discounted and purchased	3,800
Loans, cash credits and overdrafts	51,000
Drafts payable	70
Unclaimed dividends	60
Rebate on bills discounted	50

	Rs.('000)
Short Loans (Cr.)	4,750
Furniture and Fixtures (after writing off depreciation Rs.1,36,000 up to 31-3-09)	1,164
Inter office Adjustments (debit)	336

Assume Rs.3,10,000 was transferred to statutory reserve from the current profit. Prepare Profit and Loss Account and Balance Sheet as on 31-2-2005 from the above particulars.

[Ans.: Balance Sheet Total Rs.10,24,30,000]

6. From the following particulars of Sandhya Bank Ltd., as at 31st March, 2010. Prepare Balance Sheet as per Proforma.

	Rs.		Rs.
Paid-up Capital	5,00,000	Furniture, Fixtures	1,00,000
Authorised capital	25,00,000	Land and Buildings	8,50,000
Money at call or short notice	2,50,000	Loans	3,50,000
Acceptances and endorsements for customers	1,00,000	Cash Credits	1,50,000
		Current accounts	12,50,000
Investments	15,00,000	Fixed deposits	7,00,000
Bills discounted, purchased	2,00,000	Profit for the year	2,00,000
Bills payable	2,50,000	Cash in hand at bank	5,00,000
Statutory Reserve	5,00,000	Savings Bank Accounts	5,00,000
		Customer's Liability acceptance for and endorsements	1,00,000

Other Relevant Information:

a. The profit for the year is arrived at before making adjustment or unexpired discount Rs.2,500 on Bills discounted during the year not matured on 31st March, 2001.

b. Investments include 5,000 shares (of X Co. Ltd.,) of the face value of Rs.100 on which Rs.50 is paid up.

[Ans.: Balance Sheet Total Rs.39,00,000]

7. From the following balance of Nagarjuna Bank Ltd. as on 31st March, 2010. Prepare its Trial Balance and Balance Sheet, taking the balancing figure as premises.

	Rs.		Rs.
Authorised Capital (Rs.10 per share, Rs.5 paid)	4,000	Subscribed Capital	2,000
		Bills discounted India	15,000
Investments	7,000	Bills for collection being bills receivable	100
P & L a/c (Cr. Balances)	850		
Reserve	3,000	Liability for acceptance	5,000
Cash with SBI	4,000	Money at call & short notice	9,000
Bank drafts payable	2,000	Letters of credit issued	500
Short Loans (Cr.)	40	Rebate on bills discounted	10
Cash in hand	2,000	Cash with RBI	4,000
Acceptances	5,000	Bills purchased payable – U.K.	1,000
Loans and Advances	10,000	Current & Deposits a/c	56,000
Cash credits	10,000		
Overdrafts	1,000		
Investment fluctuation fund	100		
Bills receivable being bills for collection	100		

[Ans.: Balance Sheet Total Rs.6,40,00,000; Difference in Trial balance : Premises Value Rs.10,00,000]

8. On the basis of the following particulars prepare Schedule 9. Advances as per the requirements of the Act:

	Rs.
Bills purchased and discounted	35,00,000
Cash credits, overdrafts and loans	40,00,000
Term loans	15,00,000

Out of the total advances, advances to the extent of Rs.70,00,000 are secured by tangible assets, advances to the extent of Rs.18,00,000 are covered by Bank/Government guarantees and the rest are unsecured. All advances have been made in India. Advances to priority sector amount to Rs.60,00,000, public sector Rs.20,00,000, to bank Rs.7,00,000 and the rest to others.

[Ans.: Total Rs.90,00,000]

9. From the books of accounts of New Bank Ltd., as on March 31, 2010 the following particulars regarding loans and advances given by the bank in India are available.

(a)	Loans to corporate sector fully secured (excluding banks but including companies in which directors are interest)	10,00,000
(b)	Loans to Karin Bank Ltd. fully secured	3,00,000
(c)	Debts due by Officers (excluding directors) fully secured	2,00,000
(d)	Loans to non-corporate sector, fully secured	9,00,000
(e)	Loan to X Bank Ltd., fully secured	4,00,000
(f)	Debt due by Mr.K. Prakash a director of the bank, fully secured	1,00,000
(g)	Debts considered good which are unsecured	5,00,000
(h)	Debts considered good guaranteed by third parties	6,00,000
(i)	Debts due by companies in which the directors are interested fully secured (maximum amount of debts at any time during the year Rs.15,00,000)	6,00,000
(j)	Doubtful Debts	50,000
(k)	Provision for bad and doubtful debts	75,000
(l)	Maximum amount of debts due by officers and directors at any time during the year	5,00,000

Show how the above items are statutory required to be disclosed in the Balance Sheet of the Bank.

[Ans.: Schedule 9 : Advances (A) Rs.34,00,000]

10. The following ledger balances of ABC Bank Ltd. as on 31-3-2010 are furnished to you. Prepare profit and loss account and balance sheet as per Act.

	Rs.		Rs.
Statutory Reserve	12,00,000	Interest earned	5,50,000
Bad debts written off	1,28,000	Balance with RBI	20,30,000
Operating expenses	1,82,000	Balance foreign bank	12,06,000
Current accounts	2,02,45,000	Bills for collection	15,00,000
Interest paid	1,60,000	Borrowings from banks	64,82,000
Deposit accounts	69,20,000	Cash credits and OD	1,54,57,000
P & L a/c B/f	2,29,000	Investments	98,82,000
Discount	2,44,000	Share Capital	20,00,000
Endorsement and Guarantee	5,75,000		
Commission	45,000		
Cash	2,25,000		
Bills discounted	62,28,000		
Premises	22,17,000		

The following further information is to be considered.

a. Rebate on bills discounted to be provided of Rs.64,000

b. The bank had paid an interim dividend of Rs.2,00,000 during the year.

[Ans.: Total Profit Rs.3,05,000; Balance Sheet Total Rs.3,72,45,000]

11. The following figures have been extracted from the books of Bharat Bank Ltd. as on 31 March, 2010. Prepare profit and Loss Account and Balance Sheet:

	Rs.		Rs.
Paid-up Capital	10,00,000	Commission and Exchange	1,02,225
P & L A/c (Cr)	40,323	Investment Reserve	35,000
Current Accounts	34,12,604	Branch Adjustments (Cr)	36,894
Fixed deposits	38,95,554	Printing and Stationery	4,543
Saving Bank	25,68,000	Provident fund contribution	10,000
Directors' fee	5,980	Salaries	50,650
Furniture (Cost 50,000)	37,280	Unexpired insurance	437
Interest and discounts	2,10,223	Statutory reserve fund	2,65,000
Stamps in hand	189	Legal Expenses	1,650
Land and Buildings		Cash on hand	4,16,324
(Cost Rs.3,00,000)	2,05,000	Deposits with Banks	12,05,125
Deposit with Reserve Bank	40,00,000	Investments	8,78,125
Cash Credits	70,00,000	Bills discounted	14,00,520
Contingency Reserve	50,000		

The Authorized Capital of the Bank is Rs.20 lakhs divided into 20,000 shares of Rs.100 each. All shares have been subscribed only half of the face value is Called up Depreciation on Land and Buildings Rs.8,000 on Furniture Rs.3,500. Create provision for taxation Rs.1,10,000.

[Ans.: Net Profit Rs.1,18,125; Balance Sheet Total Rs.1,51,31,500]

12. The following Trial Balance was extracted from the Books of the Citizens Bank Ltd. as on 31st March, 2010.

	Rs.		Rs.
Cash in hand and with Banks	46,350	Share Capital	3,00,000
Investments in Govt. of India Bonds	1,94,370	Security Deposits of employees	15,000
Other Investments	1,55,630	Savings Bank Balance	7,420
Gold	15,130	Current Account Balance	97,000
Interest Accrued on	24,620	Fixed Deposits	23,050
Investments		Share premium A/c	90,000
Silver	2,000	Statutory reserve A/c	1,40,000

	Rs.		Rs.
Buildings	65,000	Borrowing from Banks	77,230
Furniture	5,000	Profit and Loss A/c Balance	6,500
Money at call and short notice	26,000	Interest received	72,000
Advances	2,00,000	Commission & Brokerage	25,300
Bills discounted and purchased	12,500	Discounts	42,000
		Rent	600
Interest	7,950	Profit on Bullion	1,200
Audit fees	5,000	Miscellaneous Income	2,700
Loss on sale of Furniture	1,000	Depreciation reserve on building	
Directors fees	1,200		20,000
Salaries	21,200		
Postage	50		
Managing Director's Remuneration	12,000		
Loss on Sale of Investments	30,000		
Deposit with RBI	75,000		
Branch Adjustments	20,000		
	9,20,000		9,20,000

Your are required to prepare Profit and Loss A/c for the year ended 31st March 2010 and Balance Sheet as at the date after considering the following:

a) Provide Rebate on bills discounted Rs.5,000
b) A scrutiny of the Current Account Ledger reveals that there are accounts overdrawn to the extent of Rs.25,000 and the total of the credit balances in Rs.1,22,000.
c) Depreciation on the building for the year amounts to Rs.5,000.
d) Out of profits for the year 20 percent there of transferred to statutory reserve and the directors proposed a dividend of 8 percent.
e) Bills for collection worth Rs.43,500
f) Acceptance and endorsements Rs.56,500.

[Ans.: Profit Rs.55,400; Balance Sheet Total Rs.8,41,600]

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