



ACADEMIC YEAR 2025-2026, SEMESTER – VI
STUDY MATERIAL FOR B.Com.
SPECIAL ACCOUNTS



STUDY MATERIAL FOR B.COM BANKING & FINANCE

SPECIAL ACCOUNTS

SEMESTER – VI



ACADEMIC YEAR 2025-26

PREPARED BY

COMMERCE DEPARTMENT



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UNIT - I

Definition:

Section 4 of the companies Act 1956 defines a company shall be deemed to be the holding company of another, if that other is its subsidiary”.

1. By holding more than 50% of the face value of the equity shares of the other company.
2. By controlling the composition of Board of directors of the other company.
3. By controlling a holding company which controls another subsidiary company.

For example: If X Ltd is a subsidiary of Y Ltd and Y Ltd is a subsidiary of Z Ltd, then X Ltd is also considered to be subsidiary of Z Ltd.

Advantages of Holding Company

1. Ease of formation

It is quite easy to form a holding company. The promoters can buy the shares in the open market. The consent of the shareholders of the subsidiary company is not required.

2. Large capital

The financial resources of the holding and subsidiary companies can be pooled together. The company can undertake large scale projects to increase its profitability.

3. Avoidance of competition

Competition between holding and subsidiary companies can be avoided if they are in the same line of business.

4. Economies of large scale operations

The buying and selling of the holding company and the subsidiaries can be centralized. It can enjoy the advantage of quantity discount and better credit terms because of bulk purchases. It can also get better terms from buyers in case of sales.

5. Secrecy maintained

Secrecy can be maintained as the authority and decision making are centralized. It can protect itself from adverse publicity.

6. Risks avoided

In case the subsidiaries undertake risky business and fail, the loss does not affect the holding company. It can sell its stakes in the subsidiary company.



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Disadvantages of Holding Companies

1. Over capitalization

Since capital of holding company and its subsidiaries may be pooled together it may result in over capitalization. Shareholders would not get a fair return on their invested capital.

2. Misuse of power

The financial liability of the members of a holding company is insignificant in comparison to their financial power. It may lead to irresponsibility and misuse of power.

3. Exploitation of subsidiaries

The holding company may exploit the subsidiary companies. The subsidiaries may be compelled to buy goods from the holding at high prices. They might be forced to sell their produce to the holding company at very low prices.

4. Manipulation

Information about subsidiaries may be used for personal gains. For example, information of the financial performance of subsidiary companies may be misused to indulge in speculative activities.

5. Concentration of economic power

There is concentration of economic power in the hands of those who manage the holding company. Such concentration of economic power is harmful to the general economic welfare.

6. Secret monopoly

It may lead to the creation of secret monopolies. These secret monopolies may try to eliminate competitors and prevent entry of new firms. They may exploit consumers by charging unreasonable prices.

COST OF CONTROL / GOODWILL / CAPITAL RESERVE:

The holding company acquires more than 50% of the shares of the subsidiary company. Such shares may be acquired at a market price. Which may be at a premium or at discount. This amount is reflected in the balance sheet of holding company of the assets side as investment in the shares of subsidiary company. This is the price paid for shares in net assets of subsidiary company as on date of its acquisition. Net assets of the subsidiary company consist of share capital, accumulated profits and reserve after adjustment, accumulated losses as on the date of acquisition. If the amount paid by the holding company for the shares of subsidiary company is more than its proportionate share in the net asset of the subsidiary company as on the date of acquisition, the difference is considered as goodwill. If there is excess of proportionate share in net assets of subsidiary company intrinsic of shares acquired and cost of shares acquired by holding company there will be capital reserve in favour of holding company. If goodwill already exists in the balance sheet of holding company or both the goodwill thus calculated, will be added



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up to the existing goodwill. Capital Reserve will be deducted from Goodwill. In short, net amount resulting from goodwill and capital Reserve will be shown in the consolidated Balance sheet.

MINORITY INTEREST:

The claim of outside shareholders in the subsidiary company has to be assessed and shown as liability in the consolidated balance sheet. Minority interest in the net assets of the company is nothing but the proportionate share of aggregation of share capital, reserve surpluses funds etc. proportionate share of all assets should be deducted from the minority interest. Thus, minority interest is the share of outsider in the following.

- 1) Share in share capital in subsidiary.
- 2) Share in reserves (Both pre and post acquisition of subsidiary).
- 3) Share in accumulated losses should be deducted.
- 4) Proportionate share of profit or loss on revaluation of assets.
- 5) Preference share capital of subsidiary company held by outsiders and dividend due on such share capital, if there are profits. Minority interest means outsiders interest. It is treated as liability and shown in consolidated. Balance sheet as current liability. This amount is basically intrinsic value of shares held by minority.

CAPITAL PROFITS AND REVENUE PROFITS:

The holding company may acquire the shares in the subsidiary company either on the balance sheet date or any date earlier than balance sheet date. All the profit earned by the subsidiary company till the date of acquisition of shares by holding company have to be taken as capital profits for the holding company. Such reserves lose their individual identity and considered as capital profits. In case, the holding company acquired shares on a date other than balance sheet date of subsidiary, the profits of subsidiary company will have to be apportioned between capital profits and Revenue profits from the point of view of the holding company. Thus any profit earned by subsidiary company before the date of acquisition is the capital profit, while any profit earned by subsidiary company after the date of acquisition is Revenue profits. While preparing the consolidated balance sheet share in capital profits should be adjusted with the cost of control and Revenue profits / Reserves should be merged with the balances in the Reserve and surpluses of the holding company.

ELIMINATION OF INVESTMENTS IN SHARES OF SUBSIDIARY COMPANY :

Investment in shares in subsidiary company represents the cost paid by the holding company to acquire the shares of the subsidiary company. The investment in shares of the subsidiary company entitles the holding company to share the net assets of the subsidiary company. While preparing consolidated balance sheet all the assets and liabilities of subsidiary company have to be merged with those of the holding company and therefore it is logical to eliminate investments of the holding company in the shares of the subsidiary company. Share in net assets of the outside



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shareholders should treat as the minority interest it is shown in the balance sheet on the liability side of holding company.

MUTUAL OWING / INTER COMPANY TRANSACTIONS :

The holding company and the subsidiary company may have number of intercompany transactions in any one or more of the following matters.

1. Loan advanced by the holding company to the subsidiary company or vice versa.
2. Bill of Exchange drawn by holding company on subsidiary company or vice versa.
3. Sale or purchase of goods on credit by holding company from subsidiary company or vice versa.
4. Debentures issued by one company may be held by the other.

UNREALIZED PROFIT:

The problem of unrealized profit arises in those cases where the companies of the same group have sold goods to each other at the profits and goods still remain unsold at the end of the year company to whom the goods are sold. While preparing the consolidated balance sheet, unrealized profit has to be eliminated from the consolidated balance sheet in the following manner.

1. Unrealised profits should be deducted from the current revenue profits of the holding company.
2. The same should be deducted from the stock of the company consolidated balance sheet. Minority shareholders will not be affected in any way due to unrealized profits.

CONTINGENT LIABILITIES:

As 29 defines a contingent liabilities as: A possible obligation that arises from past events and whose existence will be confirmed only by occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity or a present obligation that arises from the past events but not recognized / provided.

Such contingent liability may be of two types. a) External contingent liability. b) Internal contingent liability. Internal contingent liability relates in respect of transactions between holding and subsidiary company and it will not be shown as foot note in the consolidated balance sheet, as they appear as actual liability in the consolidated balance sheet.

REVALUATION OF ASSETS AND LIABILITIES :

The holding company may decide to revalue the assets and liabilities of the subsidiary company on the date of acquisition of share in the subsidiary company. Any profit or loss on such revaluation is a capital profit or loss. Profit on revaluation of assets of the subsidiary company whether before or after date of acquisition of shares by the holding company, the same must be shared by the holding company, and the minority shareholders in proportion to their respective holding. The minority shareholders share should be added to the minority interest. But the



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holding company share should be treated as capital profits and considered in cost of control. Further readjustment for depreciation on increase in the value of assets should be made in the profit and loss account in the subsidiary company. And same should be deducted from the Revenue profits of the subsidiary company

Calculation of cost control/goodwill/ capital reserve

Particulars	Rs	Rs
paid up value of the equity held by the holding company		xxx
ADD		
Proportionate share in the capital profit	xxx	
proportionate share in the capital reserve	xxx	xxx
		xxx
less proportionate share in the capital loss		xxx
Total value		xxx
less Investments		xxx
Goodwill - / capital reserve+		xxx

Calculation of minority interest

Particulars	Rs	Rs
paid up value of the shares held by outsiders		xxx
add Proportionate share in the capital profit and reserve	xxx	
propionate share in the revenue profit	xxx	
Proportionate share in the increase in the value of the assets of the subsidiary	xxx	xxx
		xxx
Less proportionate share in the capital loss	xxx	
proportionate share in the revenue loss	xxx	
proportionate share in the decrease in the value of assets	xxx	xxx
		xxx



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1. Give a consolidated balance sheet for the following balance sheet as on 31.3.2010

Liabilities	Holding company	Subsidiary company	Assets	Holding company	Subsidiary company
Share capital Re.1 per share	12,000	5,000	Sundry assets	15,000	8,000
Sundry liabilities	8,000	3,000	Investments 5,000 shares in subsidiary company	5,000	-
	20,000	8,000		20,000	8,000

Solution

Consolidated balance sheet of H Ltd and S Ltd as on 31.3.2010

Particulars	Schedule no.	Rs
I Equity and liabilities		
Share capital	1	12,000
Other current liabilities	2	11,000
Total		23,000
II Assets		
Fixed assets		23,000
Tangible fixed assets	3	
Total		23,000

Notes to accounts – Forming part of balance sheet



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Particulars	Rs
1.Share Capital	12000
	12000
2. Other Current Liabilities	
H Ltd	8,000
S Ltd	3,000
	11,000
3.Tangible Fixed Assets	
H Ltd	15,000
S Ltd	8,000
	23,000

2. From the following balance sheet of H Ltd and its subsidiary company as on 31.3.2018, prepare consolidated balance sheet

Liabilities	Holding company	Subsidiary company	Assets	Holding company	Subsidiary company
Share capital Re.100 per share	10,00,000	5,00,000	Land and building	5,00,000	4,20,000
Reserves	50,000	40,000	Investments		
Profit and loss a/c	1,00,000	20,000	5,000 shares in subsidiary company	5,20,000	-
creditors	2,50,000	60,000	Stock	2,00,000	1,00,000
			Debtors	1,00,000	60,000
			Cash and bank	80,000	40,000
	14,00,000	6,20,000		14,00,000	6,20,000

H Ltd acquire shares in S Ltd 31.3.2017

Solution

Consolidated balance sheet of H Ltd and S Ltd as on 31.3.2017



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Particulars	Schedule no.	Rs
I Equity and liabilities		
1.shareholders fund		
Share capital	1	10,00,000
Reserve and surplus	2	1,90,000
2.current liabilities		
Accounts payable	3	3,10,000
Total		15,00,000
II Assets		
1.Fixed assets		
Tangible assets	4	9,20,000
2. current assets		
Inventories	5	3,00,000
Account receivable	6	1,60,000
Cash and cash equivalent	7	1,20,000
Total		15,00,000

Notes to accounts – Forming part of balance sheet

Particulars	Rs
1.Share Capital	10,00,000
2.Reserve And Surplus	
Reserves- H Ltd	50,000
P/LA/C H Ltd	1,00,000
Capital Reserve	40,000
Total	1,90,000
3.Accounts Payable	
Creditors H Ltd	2,50,000
S Ltd	60,000
Total	3,10,000
4.Tangible Assets	
Land And Building	
H Ltd	5,00,000
S Ltd	4,20,000
Total	9,20,000
5. Inventories	
Stock H Ltd	2,00,000
S Ltd	1,00,000



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Total	3,00,000
6.Account Receivable	
Debtors H Ltd	1,00,000
S Ltd	60,000
Total	1,60,000
7. Cash And Cash	
Equivalent	
H Ltd	80,000
S Ltd	40,000
Total	1,20,000

Workings

1. Capital profit

Reserves	40,000
P/L account	20,000
	60,000

2. Calculation of capital reserve or goodwill

Cost of investments	5,20,000
Less paid up value 5,00,000	
Capital profit 60,000	5,60,000
Capital reserve	40,000

3. The following are the balance sheet of H Ltd and its Subsidiary company as on 31.3.2015. prepare consolidated balance sheet

Liabilities	Holding company	Subsidiary company	Assets	Holding company	Subsidiary company
Share capital Re.10 per share	2,00,000	1,00,000	Free hold property	1,00,000	50,000
Reserves	60,000	20,000	Investments	90,000	-
Profit and loss a/c	20,000	10,000	6,000 shares in subsidiary		



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Creditors	20,000	10,000	company		
Bills payable	10,000	10,000	Stock	60,000	40,000
			Debtors	50,000	50,000
			Bank	10,000	10,000
	3,10,000	1,50,000		3,10,000	1,50,000

H Ltd acquired shares in S Ltd on 1.4.2014 when S Ltd's reserves stood at Rs.5000 and its profit and loss account at Rs.6,000(credit balance).

Solution

Consolidated balance sheet of H Ltd and S Ltd as on 31.3.2015

Particulars	Schedule no.	Rs
I Equity And Liabilities		
1.Share Holders Fund		
Share Capital	1	2,00,000
Reserve And Surplus	2	91,400
Minority Interest		52,000
2.Current Liabilities		
Accounts Payable	3	50,000
Total		3,93,400
II Assets		
1.Fixed Assets		
Tangible Assets	4	1,50,000
Intangible Assets	5	23,400
2. Current Assets		
Inventories	6	1,00,000
Account Receivable	7	1,00,000
Cash And Cash Equivalent	8	20,000
Total		3,93,400

Notes to accounts – Forming part of balance sheet



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Share Capital		2,00,000
Reserve And Surplus		
Reserves - H Ltd	60,000	
Add : 3/5 th Share In Revenue Reserves Of S Ltd	9,000	69,000
P/L a/c - H Ltd	20,000	
Add : 3/5 th Share In Revenue Profit Of S Ltd	2,400	22,400
Total		91,400
Accounts Payable		
Creditors -H Ltd	20,000	
S Ltd	10,000	30,000
Bills Payable -H Ltd	10,000	
S Ltd	10,000	20,000
Total		50,000
Tangible Assets		
Freehold Property -H Ltd	1,00,000	
S Ltd	50,000	
Total		1,50,000
Intangible Assets		
Goodwill	23,400	
Inventories		
Stock - H L Td	60,000	
S Ltd	40,000	
Total		1,00,000
Accounts Receivable		
Debtors - H Ltd	50,000	
S Ltd	50,000	
Total		1,00,000
Cash And Cash Equivalent		
Bank - H Ltd	10,000	
S Ltd	10,000	
Total		20,000



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Workings

1. Share holding company and minority shareholdings

6000 : 4000

3:2

2. Calculation of revenue profit and revenue profit

Particulars	Capital Profit	Revenue Profit	
		Reserves	Profit And Loss
Reserves	5,000	15,000	-
Profit And Loss Account	6,000		4,000
Total	11,000	15,000	4000
3/5 th Share Of H Ltd	$11000 \times 3/5 = 6,600$	$15000 \times 3/5 = 9000$	$4000 \times 3/5 = 2,400$
2/5th Share For Minority Interest	$11,000 \times 2/5 = 4,400$	$15,000 \times 2/5 = 6,000$	$4000 \times 2/5 = 1600$

3. Minority interest

Particulars	Rs
Paid-up value of shares 4000×10	40,000
2/5th share in capital profit	4,400
2/5 th share in reserves	6,000
2/5 th share in p/l account	1,600
Total	52,000

4. Calculation of capital reserve or goodwill

Particulars	Rs	Rs
Cost of investments in S Ltd's shares		90,000
Less paid up value of shares	60,000	
3/5th share in capital profit	6,600	66,600
Goodwill		23,400



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4. From the balance sheets of H Ltd and S Ltd as on 31.3.2016. Prepare a consolidated balance sheet

Liabilities	Holding company	Subsidiary company	Assets	Holding company	Subsidiary company
Share capital (Rs.10 per share)	6,00,000	2,00,000	Land and building	4,50,000	2,00,000
Reserves	2,50,000	75,000	Stock	1,00,000	40,000
P/L account	80,000	50,000	Debtors	1,80,000	60,000
Bills payable	-	20,000	Bills receivable	40,000	35,000
Creditors	1,00,000	50,000	Cash and bank	20,000	60,000
			Investment 15000 shares in S LID	2,40,000	-
	10,30,000	3,95,000		10,30,000	3,95,000

Additional information

- H Ltd purchased the shares in S Ltd on 1.4.2015 on which date reserves of S Ltd stood at Rs.50,000 and profit and loss account of S Ltd had a balance of Rs.10,000.
- All the bills payable of S Ltd, were issued in favour of H Ltd
- S Ltd also owes Rs.25,000 to H Ltd which is included in its creditors.

Solution

Consolidated balance sheet of H Ltd and S Ltd as on 31.3.2016

Particulars	Note	Rs
I Equity And Liabilities		
(I) Shareholder's Fund		
Share Capital	1	6,00,000
Reserves And Surplus	2	3,78,750
(ii) Minority Interest		81,250
(iii) Current Liabilities		
Account Payable	3	1,25,000



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Total		11,85,000
li Assets		
(I) Non Current Assets		
Fixed Assets		
Tangible Assets	4	6,50,000
Intangible Assets	5	45,000
(ii)Current Assets		
Inventories	6	1,40,000
Account Receivable	7	2,70,000
Cash And Cash Equivalent	8	80,000
Total		11,85,000

Notes To Accounts- Forming Of Balance sheet

1	Share Capital		6,00,000
2	Reserves	2,50,000	
	Add Revenue Reserve-S Ltd	18,750	2,68,750
	Profit And Loss A/C-H Ltd	80,000	
	Add Revenue Profit- S Ltd	30,000	1,10,000
3	Account Payable		
	Bills Payable S Ltd	20,000	
	Less Mutual Owings	20,000	Nil
	Creditors -H L Td	1,00,000	
	S Ltd	50,000	
		1,50,000	
	Less Mutual Owings	25,000	1,25,000
	Total		1,25,000
4	Tangible Assets		
	Land And Buildings -H Ltd		4,50,000
	S Ltd		2,00,000
	Total		6,50,000



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5	Intangible Assets			
	Goodwill			45,000
6	Inventories			
	Stock - H Ltd			1,00,000
	S Ltd			40,000
		Total		1,40,000
7	Account Receivable			
	Bills Receivable- H Ltd	40,000		
	S Ltd	35,000		
		75,000		
	Less Mutual Owings	20,000	55,000	
	Debtors-H Ltd	1,80,000		
	S Ltd	60,000		
		2,40,000		
	Less Mutual Owings	25,000	2,15,000	
		Total		2,70,000
8	Cash And Cash Equivalent			
	Bank - H Ltd			20,000
	S Ltd			60,000
		Total		80,000

Workings

1. Share holding company and minority shareholdings

15,000 : 5,000

3:1

2. Calculation of revenue profit and revenue profit

Particulars	Capital Profit	Revenue Profit	
		Reserves	P/l a/c
Reserves	50,000	25,000	-
P/l a/c	10,000	-	40,000
Total	60,000	25000	40,000
3/4 th - H Ltd	45,000	18,750	30,000
3/4 th minority shareholding	15,000	6,250	10,000



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3	Minority interest	
	Paid up value of shares	50,000
	Capital profit	15,000
	Revenue reserve	6,250
	Revenue profit	10,000
	Total	81,250

4	Calculation of Goodwill / capital reserve	
	Investments	2,40,000
	Less paid up value of shares	1,50,000
	Capital profit	45,000
	Goodwill	45,000

5. The balance sheets of H Ltd and its subsidiary S Ltd on 31.3.2016 are as follows

Liabilities	Holding company	Subsidiary company	Assets	Holding company	Subsidiary company
Share capital (Rs. 10 per share)	8,00,000	500000	Plant and machinery	5,00,000	4,00,000
General reserve 1.4.2015	1,60,000	80,000	Land and buildings	3,00,000	2,50,000
P/L a/c	1,50,000	100000	Investments 3,000 shares in S Ltd	3,25,000	-
Bills payable	65,000	65,000	Bills receivable	60,000	60,000
Creditors	1,50,000	150000	Debtors	70,000	90,000
			Stock	30,000	80,000
			Cash and bank	40,000	15,000
	13,25,000	8,95,000		13,25,000	8,95,000



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H Ltd acquired S Ltd's shares on 1st October 2015. Bills receivable held by S Ltd are all accepted by the H Ltd. Included in the debtors of S Ltd, is a sum of Rs.40,000 owing by H

Ltd for goods supplied by S Ltd.

On 1.4.2015 profit and loss account of S Ltd showed a credit balance of Rs. 20,000

You are required to prepare a consolidated balance sheet as on 31.3.2016

Solution

Consolidated balance sheet as on 31.3.2016

particulars	Note	Rs
I Equity And Liabilities		
(I) Shareholder's Fund		
Share Capital	1	8,00,000
Reserves And Surplus	2	3,93,000
(ii)Minority Interest		2,72,000
(iii) Current Liabilities		
Account Payable	3	3,30,000
Total		17,95,000
li Assets		
(I) Non Current Assets		
Fixed Assets		
Tangible Assets	4	14,50,000
(ii)Current Assets		
Inventories	5	1,10,000
Account Receivable	6	1,80,000
Cash And Cash Equivalent	7	55,000
Total		17,95,000

Notes to accounts- Forming of balance sheet

1 Share capital		8,00,000
2 Reserves and surplus		
General reserve- H Ltd	1,60,000	
S Ltd	-	1,60,000
P/l a/c H Ltd	1,50,000	



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S Ltd	24,000	1,74,000
Capital reserve		59,000
		3,93,000
3 Accounts payable		
Bills payable H Ltd	65,000	
S Ltd	65,000	
	1,30,000	
Less Mutual Owings	60,000	70,000
Creditors -H L td	1,50,000	
S Ltd	1,50,000	
	3,00,000	
Less Mutual Owings	40,000	2,60,000
Total		3,30,000
4 Tangible Assets		
Land And Buildings -H Ltd	3,00,000	
S Ltd	2,50,000	5,50,000
Plant And Machinery -H Ltd	5,00,000	
S Ltd	4,00,000	9,00,000
Total		14,50,000
5 Inventories		
Stock - H Ltd		30,000
S Ltd		80,000
		1,10,000
6 Accounts Receivable		
Bills Receivable- H Ltd	60,000	
S Ltd	60,000	
	1,20,000	
Less Mutual Owings	60,000	60,000
Debtors-H Ltd	70,000	
S Ltd	90,000	
8	1,60,000	
Less Mutual Owings	40,000	1,20,000
Total		1,80,000



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9	Cash And Cash Equivalent	
	Cash And Bank H Ltd	40,000
	S Ltd	15,000
	Total	55,000

Workings

1. Share holding company and minority shareholdings

3000 : 2000

3:2

2.

calculation of capital profit and revenue profit

Particulars	Capital profit	Revenue profit
General reserve on 1.4.2015	80,000	-
p/l a/c 1.4.2015	20,000	-
current year profit 80000(1,00,000-20,000)	40,000	40,000
Total	1,40,000	40,000
3/5 th share H Ltd	84,000	24,000
2/5 th share S Ltd	56,000	16,000

3	Minority interest paid up value of shares	2,00,000
	Add 2/5 th capital profit	56,000
	2/5 th revenue profit	16,000
	Total	2,72,000

4	Calculation of capital reserve or Goodwill investments	3,25,000
	less actual value of shares	3,00,000
	capital profit	84,000
	capital reserve	59,000



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UNIT - II

Banking companies

Section 5(b) of the Banking regulation act of 1949 defines “banking” means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise;

Legal requirements

Prohibition of trading (Section 8):

According to Section 8 of the Banking Regulation Act, a bank cannot directly or indirectly deal with buying or selling or bartering of goods. However it may barter the transactions relating to bills of exchange received for collection or negotiation

Disposal of non-banking assets (Section 9)

Notwithstanding anything contained in section 6, no banking company shall hold any immovable property howsoever acquired, except such as is required for its own use, for any period exceeding seven years from the acquisition thereof or from the commencement of this Act, whichever is later or any extension of such period as in this section provided, and such property shall be disposed of within such period or extended period, as the case may be:

Provided that the banking company may, within the period of seven years as aforesaid, deal or trade in any such property for the purpose of facilitating the disposal thereof:

Provided further that the Reserve Bank may in any particular case extend the aforesaid period of seven years by such period not exceeding five years where it is satisfied that such extension would be in the interests of the depositors of the banking company.

Management

A banking company must have a whole-time chairman appointed for five years at a time. He may become a director of a subsidiary of the banking company or of a guarantee company registered under Section 25 of the Companies Act but cannot take up any other appointment. The Chairman is appointed by the Board of Directors but, in the case of nationalised banks, he is appointed by the Central Government.

At least 51% of the directors of a banking company must be such persons as have specialised knowledge, or practical experience, in respect of accountancy, agriculture, rural company, banking cooperation, economics, finance, law or any other matter which is approved by the Reserve Bank as useful to the banking company. Directors must not be proprietors of any trading, commercial or industrial concerns (other than small industrial concerns) and also must not have substantial interest in, or be connected with (as employee or manager etc.), any commercial company except a guarantee company incorporated under Section 25 of the Companies Act and except a small



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scale industrial concern. The Reserve Bank of India has the power to order the removal of a director or the chairman.

Capital and reserve

Paid up Capital and Reserves for Foreign Banks

As per section 11(2) of Banking Regulation Act, 1949, the banking company incorporated outside India (Foreign Bank) must maintain paid-up capital and reserves of 15 lakhs rupees and if it has a place or places of business in the city of Mumbai or Calcutta or both, 20 lakhs rupees. The bank has to deposit such capital in form of cash or in the form of unencumbered approved securities, or partly in cash and partly in the form of such securities with Reserve Bank of India. Such foreign bank shall deposit an amount of 20 percent of its profit for each year in respect of all business transacted through its branches in India, as disclosed in the profit and loss account. In case of cessation of banking company incorporated outside India, the amount deposited with RBI form the assets of the company and all the creditors of the company shall have first charge.

Indian Banks

As per section 11(2) of Banking Regulation Act, 1949, the banking company incorporated in India must maintain paid-up capital and reserves of:

- Rs 5 lakh if it has places of business in more than one State and if any such place or places of business is or are situated in the city of Mumbai or Calcutta or both, than Rs 10 lakhs
- Rs 1 lakh if it has all its places of business in one State none of which is situated in the city of Mumbai or Calcutta in respect of its principal place of business, plus Rs 10,000 in respect of each of its other places of business situated in the same district in which it has its principal place of business, plus Rs 25,000 in respect of each place of business situated elsewhere in the State otherwise than in the same district. However aggregate value should not exceed Rs 5 lakh. Further if a banking company has only one place of business then the amount is Rs 50,000.

For banking company which commences banking business after the commencement of this act, the amount is limited to Rs 5 lakh.

- Rs 5 lakh if it has all its places of business in one State, one or more of which is or are situated in the city of Bombay or Calcutta. An additional Rs 25,000 for each place of business situated outside the city of Bombay or Calcutta. The aggregate amount should not exceed Rs 10 lakh.
- The initial minimum paid-up capital for a new private sector bank is Rs.200 crore. The initial capital should be raised to Rs.300 crore within three years of commencement of business. The overall capital structure of the proposed bank including the authorised capital is approved by the RBI.



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Paid-up capital, Subscribed capital and Authorised capital

The subscribed capital of the banking company should not be less than one-half of the authorised capital. The paid-up capital should not be less than one-half of the subscribed capital. If the capital is increased, the company must comply with the prescribed conditions within two years or as directed by RBI.

As per Section 12 (1)(ii) of Banking Regulation Act, the capital of bank must consists of equity shares and preference shares. The issue of preference share shall be in accordance with the guidelines framed by the Reserve Bank.

Voting rights of shareholders

The section 12 of the banking regulation act 1949 regulates the Shareholding in Banking Companies in India. No shareholder of banking company can exercise voting rights more than 10 per cent of the total voting rights of all the shareholders of the banking company.

Transfer of statutory reserve

Under Section 17, every banking company incorporated in India is required to transfer at least 25% of its current profit to its reserve fund. It is known as statutory reserve. The profit is the profit arrived as per its profit and loss account before paying dividend.

Restriction as to payment of dividend

(1) No banking company shall pay any dividend on its shares until all its capitalized expenses (including preliminary expenses, organization expenses, share selling commission, brokerage, amounts of losses incurred and any other item of expenditure not represented by tangible assets) have been completely written off.

(2) Notwithstanding anything to the contrary contained in sub-section (1) or in the Companies Act, 1956 (1 of 1956), a banking company may pay dividends on its shares without writing off-

(i) The depreciation, if any, in the value of its investments in approved securities in any case where such depreciation has not actually been capitalized or otherwise accounted for as a loss;

(ii) The depreciation, if any, 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 auditor of the banking company;

(iii) The bad debts, if any, in any case where adequate provision for such debts has been made to the satisfaction of the auditor of the banking company.



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Cash reserve

Cash Reserve Ratio (CRR) is a specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with the central bank. CRR is set according to the guidelines of the central bank of a country.

Statutory liquidity ratio

Statutory Liquidity Ratio or SLR is a minimum percentage of deposits that a commercial bank has to maintain in the form of liquid cash, gold or other securities. It is basically the reserve requirement that banks are expected to keep before offering credit to customers.

Restrictions on loans and advances

In terms of Section 20(1) of the Banking Regulation Act, 1949, a bank cannot grant any loans and advances on the security of its own shares.

Section 20(1) of the Banking Regulation Act, 1949 also lays down the restrictions on loans and advances to the directors and the firms in which they hold substantial interest.

Banks are prohibited from entering into any commitment for granting any loans or advances to or on behalf of any of its directors, or any firm in which any of its directors is interested as partner, manager, employee or guarantor, or any company (not being a subsidiary of the banking company or a company registered under Section 25 of the Companies Act, 1956, or a Government company) of which, or the subsidiary or the holding company of which any of the directors of the bank is a director, managing agent, manager, employee or guarantor or in which he holds substantial interest, or any individual in respect of whom any of its directors is a partner or guarantor.

There are certain exemptions in this regard. In terms of the explanation to the Section, 'loans or advances' shall not include any transaction which the Reserve Bank may specify by general or special order as not being a loan or advance for the purpose of this Section. While doing so the RBI shall, keep in view the nature of the transaction, the period within which, and the manner and circumstances in which, any amount due on account of the transaction is likely to be realised, the interest of the depositors and other relevant considerations.

Prohibition of charge on unpaid capital and floating charge on assets

(1) Notwithstanding anything contained in section 6, no banking company shall create a floating charge on the undertaking or any property of the company or any part thereof, unless the creation of such floating charge is certified in writing by the Reserve Bank as not being detrimental to the interests of the depositors of such company.

(2) Any such charge created without obtaining the certificate of the Reserve Bank shall be invalid.



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(3) Any banking company aggrieved by the refusal of certificate under sub-section (1) may, within ninety days from the date on which such refusal is communicated to it, appeal to the Central Government.

(4) The decision of the Central Government where an appeal has been preferred to it under sub-section (3) or of the Reserve Bank where no such appeal has been preferred shall be final.

Licensing of banking companies

For commencing banking business in India, every banking company is required to obtain a licence from the Reserve Bank of India, under the provisions of Section 22 of the Banking Regulation Act, 1949. No company can carry on banking business in India unless it holds a license issued by the Reserve Bank of India.

Unclaimed deposits

Unclaimed deposits are deposits where the proceeds/maturity amount has not been claimed for a period of 10 years or more.

Bank audit

A bank audit is a routine procedure designed to review the services of financial institutions to ensure they are in compliance with laws and industry standards. An accounting specialist known as a bank auditor carries out the review. Bank or credit union audits can be internal audits or external audits.

The focus of a bank or credit union audit is on compliance. Its purpose is to discover if the institution's financial activities are accurate, legitimate, and complete. Its primary goal is to provide an independent evaluation of the bank's activities, controls, and information systems. Tests are carried out on the systems, findings are generated, and auditors recommend corrective actions the bank needs to take.

Definition of 'Non Performing Assets'

Definition: A non performing asset (NPA) is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days.

Description: Banks are required to classify NPAs further into standard, Substandard, Doubtful and Loss assets.

1. Standard assets

A standard asset is one which is not a non – performing assets which does not disclose any problem

1. Substandard assets: Assets which has remained NPA for a period less than or equal to 12 months.



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2. Doubtful assets: An asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months.

3. Loss assets: As per RBI, “Loss asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted, although there may be some salvage or recovery value.”

Format

Profit and loss account for the year ended 31 march year

particulars	schedule	Year ended current year	Year ended-previous year
I. Income			
Interest earned	13	XXX	XXX
Other income	14	XXX	XXX
Total		XXX	XXX
II. Expenditure			
Interest expended	15	XXX	XXX
Operating expenses	16	XXX	XXX
Provisions and contingencies			
Total		XXX	XXX
III. Profit / Loss			
Net profit / loss (-) for the year		XXX	XXX
Profit / loss (-) brought forward		XXX	XXX
Total		XXX	XXX
IV. Appropriations			
Transfer to statutory reserves		XXX	XXX
Transfer to other reserves		XXXXXX	XXX
Transfer to government/ Proposed dividend			XXX
Balance carried over to Balance sheet		XXX	XXX
Total		XXX	XXX

Schedule-13 Interest earned
I. Interest/discount on advance/bills
II. Income on investments
III. Interest on balances with Reserve Bank of India and other inter-bank funds
IV. Others



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Schedule 14 : Other income

- I. Commission, exchange and brokerage
- II. Profit on sale of investments
Less: Loss on sale of investments
- III. Profit on revaluation of investments
Less: Loss on revaluation of investments
- IV. Profit on sale of land, buildings and other assets
Less: Loss on sale of land, buildings and other assets
- V. Profit on exchange transactions
Less : Loss on exchange transactions
- VI. Income earned by way of dividends, etc. from subsidiaries/companies and/or joint ventures abroad/ in India
- VII. Miscellaneous income

Schedule 15 : Interest expended

- I. Interest on deposits
- II. Interest on Reserve Bank of India/Inter bank borrowings
- III. Others

Schedule 16 : Operating expenses

- I. Payment to and provisions of employees
- II. Rent, taxes and lighting
- III. Printing and stationery
- IV. Advertisement and publicity
- V. Depreciation on bank's property
- VI. Director's fees, allowances and expenses



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- VII. Auditors' fees and expenses (including branch auditors)
- VIII. Law charges
- IX. Postages, Telegrams, Telephones, etc.
- X. Repairs and maintenance
- XI. Insurance
- XII. Other expenditure

FORM A :- Form of Balance Sheet

Capital & liabilities	Schedule	Year ended current year	Year previous year
Capital	1	XXX	XXX
Reserve and surplus	2	XXX	XXX
Deposits	3	XXX	XXX
Borrowings	4	XXX	XXX
Other liabilities and provisions	5	XXX	XXX
Total		XXX	XXX
ASSETS			
Cash and balances with Reserve Bank of India	6	XXX	XXX
Balance with banks and money at Call and short notice	7	XXX	XXX
Investment			
Advances	8	XXX	XXX
Fixed assets	9	XXX	XXX
Other assets	10	XXX	XXX
	11	XXX	XXX
Total		XXX	XXX
Contingent liabilities	12	XXX	XXX
Bill for collection.		XXX	XXX



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<p>Schedule 1</p> <p>Capital</p> <p>I. For Nationalized Banks</p> <p>Capital (Fully owned by Central Government)</p> <p>II. For Banks Incorporated Outside India</p> <p>(i) Capital (The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head)</p> <p>(ii) Amount of deposit kept with the RBI under section 11(2) of the Banking Regulation Act, 1949</p> <p>III. For Other Banks</p> <p>Authorized capital</p> <p>Issued capital</p> <p>Subscribed capital</p> <p>Called-up capital</p> <p>Less : Calls unpaid</p> <p>Add : Forfeited shares</p> <p>Schedule 2 : Reserves and surplus</p> <p>I. Statutory reserves</p> <p>Opening balance</p> <p>Additions during the year</p> <p>Deductions during the year</p> <p>II. Capital reserves</p> <p>Opening balance</p> <p>Additions during the year</p> <p>Deductions during the year</p> <p>III. Share premium</p>	<p>Schedule 6 :</p> <p>Cash and balances with Reserve Bank of India</p> <p>Cash in hand</p> <p>(including foreign currency notes)</p> <p>Balances with Reserve Bank of India</p> <p>(i) in current account</p> <p>(ii) in other accounts</p> <p>Total (I + II)</p> <p>Schedule 7 : Balances with banks and money at call and short notices</p> <p>1. In India</p> <p>(i) Balances with banks</p> <p>(a) in current accounts</p> <p>(b) in other deposit accounts</p> <p>(ii) Money at call and short notice</p> <p>(a) with banks</p> <p>(b) with other institutions</p> <p>Total (I + II)</p> <p>Outside India</p> <p>(i) in current accounts</p> <p>(ii) in other deposit accounts</p> <p>(iii) Money at call and short notice</p> <p>Total (I + II + III)</p> <p>Grand total: (I + II)</p> <p>Schedule 8 : Investments</p>
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<p>Opening balance</p> <p>Additions during the year</p> <p>Deductions during the year</p> <p>IV. Revenue and other reserves</p> <p>Opening balance</p> <p>Additions during the year</p> <p>Deductions during the year</p> <p>V. Balance in Profit and Loss Account</p> <p>Total: (I + II + III+ IV + V)</p> <p>Schedule 3 : Deposits</p> <p>A. I. Demand deposits</p> <p>(i) From banks</p> <p>(ii) From others</p> <p>II. Savings bank deposits</p> <p>III. Term deposits</p> <p>(i) From banks</p> <p>(ii) From others</p> <p>Total: (I + II + III)</p> <p>B.(i) Deposits of branches in India</p> <p>(ii) Deposits of branches outside India</p> <p>Total</p> <p>Schedule 4 :Borrowings</p> <p>I. Borrowings in India</p> <p>(i) Reserve Bank of India</p> <p>(ii) Other banks</p>	<p>1. Investment in Indian in</p> <p>(i) government securities</p> <p>(ii) Other approved securities</p> <p>(iii) shares</p> <p>(iv) Debentures and Bonds</p> <p>(v) Subsidiaries and/or joint ventures</p> <p>(vi) Other (to be specified)</p> <p>Total :</p> <p>II. investment outside India in</p> <p>(i) Government securities (including local authorities)</p> <p>(ii) Subsidiaries and/or joint venture abroad</p> <p>(iii) Other investments (to be specified)</p> <p>Total</p> <p>Grand Total (I+II)</p> <p>Schedule 9 : Advances</p> <p>A (i) Bills purchased and discounted</p> <p>(ii) Cash credits, overdrafts and loans repayable on demand</p> <p>(iii) Term loans</p> <p>Total</p> <p>B. (i) Secured by tangible assets</p> <p>(ii) Covered by bank / government guarantees</p> <p>(iii) Unsecured</p> <p>Total:</p> <p>C.I. Advances in India</p> <p>(i) Priority sector</p> <p>(ii) Public sector</p>
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<p>(iii) Other institutions and agencies</p> <p>II Borrowings outside India</p> <p>Total (I + II)</p> <p>Secured borrowings included in I and II above – Rs.</p> <p>Schedule 5 : Other liabilities and provisions</p> <p>I. Bills payable</p> <p>II. Inter-office adjustments (net)</p> <p>III Interests accrued</p> <p>IV. Others (including provisions)</p> <p>Total :</p>	<p>(iii) Banks</p> <p>(iv) Others</p> <p>Total:</p> <p>II. Advances outside India</p> <p>(i) Due from banks</p> <p>(ii) Due from others</p> <p>(a) Bills purchased and discounted</p> <p>(b) Syndicated loans</p> <p>(c) Others</p> <p>Total:</p> <p>Grand Total (CI + CII)</p> <p>Schedule 10 :Fixed assets</p> <p>I. Premises</p> <p>At cost on 31st March of the preceding Year</p> <p>Additions during the year</p> <p>Deductions during the year</p> <p>Depreciation to date</p> <p>II Other fixed assets (including furniture and fixtures)</p> <p>At cost as on 31st March of the preceding year</p> <p>Addition during the year</p> <p>Deductions during the year</p> <p>Depreciation to date</p> <p>Total (I+ II)</p> <p>Schedule 11 : Other assets</p> <p>I Inter office adjustment (net)</p> <p>II Interest accrued</p>
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	<p>III. Tax paid in advance y tax deducted at source</p> <p>IV Stationery and stamps</p> <p>V.Non-banking assets acquired in satisfaction of claims</p> <p>VI. Others</p> <p>Total:</p> <p>* In case there is any unadjusted balance of loss the same may be shown under this item with appropriate foot-note</p> <p>Schedule 12 : Contingent liabilities</p> <p>I. Claims against the bank not acknowledge as debts</p> <p>II. Liability for partly paid investments</p> <p>III. Liability on account of outstanding forward exchange contracts</p> <p>IV. Guarantee given on behalf of constituents</p> <p>(a) in India</p> <p>(b) outside India</p> <p>V. Acceptances, endorsements and other Obligations</p> <p>VI. Other items for which the bank is liable</p> <p>Total</p>
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1. From the following information prepare p/l a/c for the year ended 31.3.04.

Interest on loans	5,18,000
Interest on fixed deposits	5,50,000
Commission received	16,000
Salaries	1,08,000
Discount on bills discounted	2,92,000
Rebate on bills discounted	98,000



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Interest on investments	4,46,000
Interest on current account	84,000
Rent and taxes	36,000
Interest on overdraft	3,08,000
Directors fees	6,000
Auditors fees	2,000
Interest on savings bank deposit	1,36,000
Postage	3,000
Printing and stationery	6,000
Locker rent	2,000
Depreciation on bank assets	10,000
Sundry charges	4,000
Transfer fees	1,000

Other information- provision for bad debts Rs 80,000, provision for income tax Rs.3,00,000.

Solution

Profit and loss account for the year ended 31 march year

Particulars	schedule	Year ended current year
I. Income		
Interest earned	13	15,64,000
Other income	14	23,000
Total		15,87,000
II. Expenditure		
Interest expended	15	7,70,000
Operating expenses	16	1,71,000
Provisions and contingencies(80000+300000)		3,80,000
Total		13,21,000
III. Profit / Loss		
Net profit / loss (-) for the year		2,66,000
Profit / loss (-) brought forward		-
Total		2,66,000



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IV. Appropriations		
Transfer to statutory reserves $266000 \times 25/100$		66,500
Balance carried over to Balance sheet		1,99,500
Total		2,66,000

Schedule -13 Interest Earned

Particulars	Rs
Interest on loans	5,18,000
Interest on investments	4,46,000
Discount on bills discounted	2,92,000
Interest on overdraft	3,08,000
Total	15,64,000

Schedule -14 Other Income

Particulars	Rs
Commission received	16,000
Locker rent	2,000
Transfer fees	1,000
Sundry charges	4,000
Total	23,000

Schedule -15 Interest Expended

Particulars	Rs
Interest on fixed deposits	5,50,000
Interest on current accounts	84,000
Interest on saving bank deposit	1,36,000
Total	7,70,000



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Schedule -16 Operating Expenses

Particulars	Rs
Salaries and allowance	1,08,000
Rent and taxes	36,000
Directors fees	6,000
Auditors fees	2,000
Postage and telegram	3,000
Printing and stationery	6,000
Depreciation on bank properties	10,000
Total	1,71,000

Provisions and contingencies

Provision for bad debts	80000
Provision for tax	3,00,000
Total	3,80,000

2. Prepare balance sheet for 31.3.08

Share capital	4,00,000
Reserve Fund	6,20,000
Fixes Deposit	42,60,000
Saving Bank Deposits	19,00,000
Current A/C	23,20,000
Money At Call And Short Notice	1,80,000
Investments	25,00,000
P/L A/C (Cr) 1.4.07	1,35,000
Dividend for 2007	40,000
Premises	2,95,000



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Cash in hand	38,000
Cash with RBI	10,00,000
Cash with other banks	6,00,000
Bills discounted and purchased	3,80,000
Loans, cash credit and overdraft	51,00,000
Bills payable	7,000
Unclaimed dividend	6,000
Rebate on bills discounted	5,000
Short loans (borrowings from other banks)	4,75,000
Furniture	1,16,400
Other assets	33,600
Net profit 2008	1,55,000

Solution

Balance sheet as on 31.3.2008

Capital & liabilities	schedule	Year ended current year
Capital	1	4,00,000
Reserve and surplus	2	8,70,000
Deposits	3	84,80,000
Borrowings	4	4,75,000
Other liabilities and provisions	5	18,000
Total		1,02,43,000
ASSETS		
Cash and balances with Reserve Bank of India	6	10,38,000
Balance with banks and money at Call and short notice	7	7,80,000
Investment	8	25,00,000
Advances	9	54,80,000
Fixed assets	10	4,11,400
Other assets	11	33,600
Total		1,02,43,000
Contingent liabilities	12	Nil
Bill for collection.		nil



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Schedule -1 Capital

Particulars	Rs
Capital	4,00,000
	4,00,000

Schedule 2 Reserve and surplus

Particulars	Rs
Reserve Fund	6,20,000
P.L A/C 135000	
Less Dividend 40000	

95000	
Add Net Profit 116250	2,11,250

Add Statutory Reserve	38,750
	8,70,000

Schedule – 3 Deposits

Particulars	Rs
Fixed Deposits	42,60,000
Saving Bank Deposits	19,00,000
Currents Account	23,20,000
	84,80,000

Schedule -4 Borrowings

Particulars	Rs
Short Loans	4,75,000
	4,75,000



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Schedule -5 Other Liabilities And Provision

Particulars	Rs
Bills Payable	7,000
Unclaimed Dividend	6,000
Rebate On Bills Discounted	5,000
	18,000

Schedule -6 Cash And Balance With RBI

Particulars	Rs
Cash In Hand	38,000
Cash With RBI	10,00,000
	10,38,000

Schedule -7 Balance With Banks And Money At Call And Short Notice

Particulars	Rs
Money At Call And Short Notice	1,80,000
Cash With Other Banks	6,00,000
	7,80,000

Schedule -8 Investments

Particulars	Rs
Investments	25,00,000
	25,00,000

Schedule -9 Advances

Particulars	Rs
Bills Discounted And Purchased	3,80,000
Loans Cash Credit And Overdraft	51,00,000
	54,80,000



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Schedule -10 Fixed Assets

Particulars	Rs
Premises	2,95,000
Furniture	1,16,400
	4,11,400

Schedule -11 Other Assets

Particulars	Rs
Other Assets	33,600
	33,600

3. Prepare final account of AX Bank Ltd.

Statutory Reserve	1,20,000
Bad Debts	12,800
Operating Expenses	18,200
Current a/c	20,24,500
Interest Paid	16,000
Deposit a/c	6,92,000
P/L Brought Forward	22,900
Bills receivable for Customers	1,50,000
Discount	24,400
Endorsement And Guarantee	57,500
Commission	45,000
Cash	22,500
Interest earned	55,000
Balance with RBI	2,03,000
Balance with Foreign Bank	1,20,600



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Bills for Collection	1,50,000
Borrowings from Banks	6,48,200
Cash and Overdraft	15,45,700
Investments	9,88,200
Bills Discounted	6,22,800
Premises	2,21,700
Share Capital	2,00,000
Adjustments -	
Rebate On Bills Discounted	6,400
Interim Dividend	20,000

P/L A/C

particulars	schedule	Year ended current year
I. Income		
Interest earned	13	73,000
Other income	14	4,500
Total		77,500
II. Expenditure		
Interest expended	15	16,000
Operating expenses	16	18,200
Provisions and contingencies(bad debts)		12,800
TOTAL		47,000
III. Profit / Loss		30,500
Net profit / loss (-) for the year		22,900
Profit / loss (-) brought forward		
Total		53,400
IV. Appropriations		
Transfer to statutory reserves		7,625
Proposed dividend		20,000
Balance carried over to Balance sheet		25,775
Total		53,400



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Schedule -13 Interest Earned

Particulars	Rs
Interest Earned	55,000
Discount On Advances –Rebate (24,400-6,400)	18,000
Total	73,000

Schedule -14 Other Income

Particulars	Rs
Commission	4,500
Total	4,500

Schedule -15 Interest Expended

Particulars	Rs
Interest On Deposits	16,000
	16,000

Schedule -16 Operating Expenses

Particulars	Rs
Operating Expenses	18,200
	18,200

Balance sheet as on 31.3.2008

Capital & liabilities	schedule	Year ended current year
Capital	1	2,00,000
Reserve and surplus	2	1,53,400
Deposits	3	27,16,500
Borrowings	4	6,48,200
Other liabilities and provisions(rebate)	5	6,400



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Total		3724500
Assets		
Cash and balances with Reserve Bank of India	6	2,25,500
Balance with banks and money at Call and short notice	7	1,20,600
Investment	8	9,88,200
Advances	9	21,68,500
Fixed assets	10	2,21,700
Other assets	11	-
Total		37,24,500
Contingent liabilities. (150000+575000)	12	2,07,500
Bill for collection		Nil

Schedule -1 Capital

Particulars	Rs
Capital	2,00,000
Total	2,00,000

Schedule 2 Reserve And Surplus

Particulars	Rs
Statutory Reserve 120000+7625	1,27,625
Balance In Profit And Loss A/C	25,775
Total	1,53,400

Schedule – 3 Deposits

Particulars	Rs
Currents Account	20,24,500
Deposit Accounts	6,92,000
Total	27,16,500



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Schedule -4 Borrowings

Particulars	Rs
Borrowings From Other Banks	6,48,200
Total	6,48,200

Schedule -5 Other Liabilities And Provision

Particulars	Rs
Rebate On Bills Discounted	6,400
Total	6,400

Schedule -6 Cash And Balance With Rbi

Particulars	Rs
Cash In Hand	22,500
Cash With RBI	2,03,000
Total	2,25,500

Schedule -7 Balance With Banks And Money At Call And Short Notice

Particulars	Rs
Balance With Foreign Banks	1,20,600
Total	1,20,600

Schedule -8 Investments

Particulars	Rs
Investments	9,88,200
Total	9,88,200



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Schedule -9 Advances

Particulars	Rs
Bills Discounted	6,22,800
Cash Credit And Overdraft	15,45,700
Total	21,68,500

Schedule -10 Fixed Assets

Particulars	Rs
Premises	2,21,700
Total	2,21,700

Schedule -11 Other Assets

Particulars	Rs
Nil	

Schedule -12 contingent liabilities

Particulars	Rs
Endorsement And Guarantee	57,500
Bills for collection	1,50,000
Total	2,07,500

4. The following particulars are extracted from the trial balance of c banking company for the year ended 31.3.2008

- | | |
|--------------------------------------|-------------|
| 1. Interest and discount | 1,96,62,400 |
| 2. Rebate on bills discounted 1.4.07 | 65,040 |
| 3. Bills discounted and purchased | 67,45,400 |

It is ascertained that proportionate discount not yet earned on the bills discounted which will mature during 2008-09 amounted to Rs.92,760



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Give journal entries and ledger a/c

Solution

Particulars	DEBIT	CREDIT
1. Rebate On Bills Discounted a/c Dr TO Interest and discount a/c (being last year rebate)	65,040	65,040
2. Interest and discount a/c Dr To Rebate On Bills Discounted a/c (being current rebate)	92,760	92,760
3. Interest and discount a/c Dr To profit and loss a/c (being current profit)	1,96,34,680	1,96,34,680

Rebate On Bills Discounted a/c

Date	particulars	RS	Date	particulars	RS
31.3.08	To Interest and discount a/c	65,040	1.4.08	By balance b/d	92,760
31.3.08	To balance c/d	92,760	31.3.08	By Interest and discount a/c	65,040
		1,57,800			1,57,800

Interest and discount a/c

Date	particulars	RS	Date	particulars	RS
31.3.08	To rebate	92,760	31.3.08	By sundries	1,96,62,400
	To p/l account	1,96,34,680		By rebate	65,040
		1,97,27,440			1,97,27,440

5. The following is an extract from the trial balance of a bank 31.3.08

Bills discounted	51,50,000
Rebate on bills discounted not yet due 1.4.07	30,501
Discount received	1,45,500

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



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Date of bill	amount	Term months	Discounted %
January 13	7,50,000	4	12
February 17	6,00,000	3	10
March 6	4,00,000	4	11
March 16	2,00,000	2	10

Find out the amount of discount received

Solution

Calculation of rebate on bills discounted

Date Of Bill	Maturity	No Of Days After March 31	Amount	Discount	Total Annual Discount	Proportionate Discount
Jan 13	May 16	46	7,50,000	12	90000	11,342(750000x12%x46/365)
Feb 17	May 20	50	6,00,000	10	60000	8,219
Mar 6	July 9	100	4,00,000	11	44000	12,055
Mar 16	May 19	49	2,00,000	10	20000	2,685
						34,301

Discount a/c

31.3.08	To p/l a/c	1,41,700	31.3.08	By sundries	1,45,500
31.3.08	To rebate	34,301	31.3.08	By rebate (1.4.07)	30,501
		1,76,001			1,76,001

Particulars	Debit	Credit
1. Rebate On Bills Discounted a/c Dr	30,501	
TO Interest and discount a/c (being last year rebate)		30,501



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2. Interest and discount a/c Dr To Rebate On Bills Discounted a/c (being current rebate)	34,301	34,301
3. Interest and discount a/c Dr To profit and loss a/c (being current profit)	1,41,700	1,41,700

KAMARAJ WOMENS COLLEGE



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UNIT - III

MEANING AND CONCEPT OF INSURANCE

Insurance is a contract, a risk transfer mechanism whereby a company (Underwriter) promised to compensate or indemnify another party (Policyholder) upon the payment of reasonable premium to the insurance company to cover the subject-matter of insurance. If you are well conversant with these principles, you will be in a better position in negotiating you insurance needs.

Insurance is a means of protection from financial loss. It is a form of risk management primarily used to hedge against the risk of a contingent, uncertain loss.

An entity which provides insurance is known as an insurer, insurance company, or insurance carrier. A person or entity who buys insurance is known as an insured or policyholder. The insurance transaction involves the insured assuming a guaranteed and known relatively small loss in the form of payment to the insurer in exchange for the insurer's promise to compensate the insured in the event of a covered loss. The loss may or may not be financial, but it must be reducible to financial terms, and must involve something in which the insured has an insurable interest established by ownership, possession, or pre existing relationship.

The insured receives a contract, called the insurance policy, which details the conditions and circumstances under which the insured will be financially compensated. The amount of money charged by the insurer to the insured for the coverage set forth in the insurance policy is called the premium. If the insured experiences a loss which is potentially covered by the insurance policy, the insured submits a claim to the insurer for processing by a

Insurability

Risk which can be insured by private companies typically shares seven common characteristics.

1. **Large number of similar exposure units:** Since insurance operates through pooling resources, the majority of insurance policies are provided for individual members of large classes, allowing insurers to benefit from the law of large numbers in which predicted losses are similar to the actual losses. However, all exposures will have particular differences, which may lead to different premium rates.
2. **Definite loss:** The loss takes place at a known time, in a known place, and from a known cause. The classic example is death of an insured person on a life insurance policy. Fire, automobile accidents, and worker injuries may all easily meet this criterion. Other types of losses may only be definite in theory. Occupational disease, for instance, may involve prolonged exposure to injurious conditions where no specific time, place, or cause is identifiable. Ideally, the time, place, and cause of a loss should be clear enough that a reasonable person, with sufficient information, could objectively verify all three elements.
3. **Accidental loss:** The event that constitutes the trigger of a claim should be fortuitous, or at least outside the control of the beneficiary of the insurance. The loss should be pure, in the



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sense that it results from an event for which there is only the opportunity for cost. Events that contain speculative elements such as ordinary business risks or even purchasing a lottery ticket are generally not considered insurable.

4. **Large loss:** The size of the loss must be meaningful from the perspective of the insured. Insurance premiums need to cover both the expected cost of losses, plus the cost of issuing and administering the policy, adjusting losses, and supplying the capital needed to reasonably assure that the insurer will be able to pay claims. For small losses, these latter costs may be several times the size of the expected cost of losses. There is hardly any point in paying such costs unless the protection offered has real value to a buyer.
5. **Affordable premium:** If the likelihood of an insured event is so high, or the cost of the event so large, that the resulting premium is large relative to the amount of protection offered, then it is not likely that the insurance will be purchased, even if on offer. Furthermore, as the accounting profession formally recognizes in financial accounting standards, the premium cannot be so large that there is not a reasonable chance of a significant loss to the insurer. If there is no such chance of loss, then the transaction may have the form of insurance, but not the substance (see the U.S. Financial Accounting Standards Board pronouncement number 113: “Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts”).
6. **Calculable loss:** There are two elements that must be at least estimable, if not formally calculable: the probability of loss, and the attendant cost. Probability of loss is generally an empirical exercise, while cost has more to do with the ability of a reasonable person in possession of a copy of the insurance policy and a proof of loss associated with a claim presented under that policy to make a reasonably definite and objective evaluation of the amount of the loss recoverable as a result of the claim.
7. **Limited risk of catastrophically large losses:** Insurable losses are ideally independent and non-catastrophic, meaning that the losses do not happen all at once and individual losses are not severe enough to bankrupt the insurer; insurers may prefer to limit their exposure to a loss from a single event to some small portion of their capital base. Capital constrains insurers’ ability to sell earthquake insurance as well as wind insurance in hurricane zones. In the United States, flood risk is insured by the federal government. In commercial fire insurance, it is possible to find single properties whose total exposed value is well in excess of any individual insurer’s capital constraint. Such properties are generally shared among several insurers, or are insured by a single insurer who syndicates the risk into the reinsurance market.

In accordance with study books of The Chartered Insurance Institute, there are the following types of insurance:

1. **Co-insurance** – risks shared between insurers



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2. **Dual insurance** – risks having two or more policies with same coverage (Both the individual policies would not pay separately- a concept named contribution, and would contribute together to make up the policyholder's losses. However, in case of contingency insurances like Life insurance, dual payment is allowed)
3. **Self-insurance** – situations where risk is not transferred to insurance companies and solely retained by the entities or individuals themselves
4. **Reinsurance** – situations when Insurer passes some part of or all risks to another Insurer called Reinsurer

Contribution

In a situation where two or more insurers is covering a particular risk, if a loss occurred, the insurers must contribute towards the settlement of the claim in accordance with their rateable proportion.

Subrogation

It has often been said that contribution and subrogation are corollary of indemnity, which means that these two principles operates so that indemnity does not fail. Subrogation operates mainly on motor insurance. When an accident occurred involving two or more vehicles, there must be someone who is responsible for accident. On this basis, the insurer covering the policyholder who was not at fault can recover their outlay from the underwriter of the policyholder who is responsible for the incidence.

Insurable Interest

Insurable interest means that the person opting for insurance must have pecuniary interest in the property he is going to get insured and will suffer financial loss on the occurrence of the insured event. This is one of the essential requirements of any insurance contract. Therefore, a person can go for insurance of only those properties where he stands to benefit by the safety of the property, and will suffer loss, damage, injury if any harm takes place to such property. Thus, if you want to insure Taj Mahal or Red Fort, you will not be allowed to do so as you do not have any pecuniary interest in these properties. This is the financial or monetary interest that the owner or possessor of property has in the subject-matter of insurance. The mere fact that it might be detrimental to him should a loss occurred because of his financial stake in that assets gives him the ability to insure the property.

Material Facts Disclosure

In the Insurance contract, the proposer is required to disclose to the insurer all the material facts in respect of the proposed insurance. This duty of disclosing the material facts not only applies to the material facts which are known to him but also extends to material facts which he is supposed to know. Thus, in case of Life Insurance the proposer must disclose the true age and details of the



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existing illnesses / diseases. Similarly, in case of the insurance of a building against fire, the proposer must disclose the details of the goods stored if such goods are of hazardous nature.

Social effect

Insurance can have various effects on society through the way that it changes who bears the cost of losses and damage. On one hand it can increase fraud; on the other it can help societies and individuals prepare for catastrophes and mitigate the effects of catastrophes on both households and societies.

Insurance can influence the probability of losses through moral hazard, insurance fraud, and preventive steps by the insurance company. Insurance scholars have typically used moral hazard to refer to the increased loss due to unintentional carelessness and insurance fraud to refer to increased risk due to intentional carelessness or indifference. Insurers attempt to address carelessness through inspections, policy provisions requiring certain types of maintenance, and possible discounts for loss mitigation efforts. While in theory insurers could encourage investment in loss reduction, some commentators have argued that in practice insurers had historically not aggressively pursued loss control measures— particularly to prevent disaster losses such as hurricanes—because of concerns over rate reductions and legal battles. However, since about 1996 insurers have begun to take a more active role in loss mitigation, such as through building codes.

PREPARATION OF REVENUE ACCOUNTS AND BALANCE SHEET OF LIFE INSURANCE COMPANIES AS PER PRESCRIBED FORM

FINAL ACCOUNTS OF INSURANCE COMPANIES

Insurance is a form of contract under which one party agrees in return of a consideration to pay an agreed amount of money to another party to compensate for a loss, damage or some uncertain event. There are two types of insurance i.e., Life insurance and General Insurance.

Life Insurance – under this type of insurance the corporation guarantees to pay a certain sum of money to the policy holder on reaching a certain age or on his death whichever is earlier. Life insurance has an element both of protection and investment.

General Insurance

It includes all other types of insurance except life insurance. e.g. – Fire, Marine, Accident, Theft, etc. 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. Insurance Regulatory and Development Authority (IRDA) In order to regulate the insurance business, the government set up in 1996, the Insurance Regulatory Authority (IRA). Now this authority is known as the Insurance Regulatory and Development Authority. In 2002, the authority came with regulations for the preparation of the financial statement of insurance companies.



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Accounts of insurance companies

IRDA has prescribed in specified formats for preparation of financial statements of insurance business in part V of 'schedule A' of IRDA regulations 2002.

Financial statements have to be in conformity with the accounting standards issued by the Institute of Chartered Accountants of India (ICAI). IRDA Act, 1999 provide legal framework of insurance accounting in India.

BOOKS FOR MAINTENANCE OF ACCOUNTS

Statutory Book:

The Insurance Act, 1938, requires the following books to be maintained by all insurance company

Register of Policies – It contains all the details in respect of each policy such as name and address of the policy holder, the date when the policy was effected and a record of any assignment of the policy.

Register of claims – All the particulars of claims are recorded – date of claim, name and address of claimant, the date on which the claim was discharged, the case of a claim which is rejected and reasons for rejection.

Register of agents – It contains all the information of licensed insurance agents such as name and address of the agent, date of appointment, etc.

Subsidiary Book:

Apart from statutory books, the insurance companies also maintain the following books

Ledgers – Life insurance Fund ledger; revenue ledger and miscellaneous ledger

Cash books – Receipts cash books and expenditure cash books.

Journal – Journal for recording transactional relating to outstanding premium and claims and inter-departmental transfer.

- First year premium book
- Renewal premium book
- Surrender policy book

This book consists of 3 registers & Register of claims:- contains date of claim, names address of policy holder, date of policy etc. & Register of licensed insurance:- name of Insurance agent, address, no. of license, commission due etc.

Register of proposal, premium register, general cash book, commission register, cash receipt register address of claimant etc.



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4. FINALACCOUNTS OF LIFE INSURANCE COMPANIES

REVENUE ACCOUNT

Sets out all income & expenses relating to the insurance business. Income includes a) Premium after adjusting reinsurance ceded & reinsurance accepted b) Income from investments Expenses includes a) Commission b) Operating expenses c) Benefits paid d) Bonus paid e) Change in valuation of liability against life policies in force.

PROFIT AND LOSS ACCOUNT

All income and expenses relating to shareholders account. Income comprises of:- a) Depreciation relating to assets held by shareholder's fund, investment expenses, directors fund. b) Transfer of funds to policy holder's fund. c) Preliminary expenses written off.

BALANCE SHEET

Balance sheet includes: a) Shareholders fund b) Policy holders fund c) Investments related to policy holder's fund.

RECEIPTS AND PAYMENTS ACCOUNT CASH FLOW STATEMENTS

This statement of insurance company needs to be worked out as directed method as per IRDA requirements. Major items are:-

- **Operating activities:** Receipts and payments from policy holders, payment to reinsurers agent, employee expenses & investment income.
- **Investing activities:** Purchase and sales of investment, purchase of fixed asset
- **Financing activities:** Issue of share capital or raising of funds from other sources.

FINALACCOUNTS OF GENERAL INSURANCE COMPANIES

Revenue account A separate revenue account is prepared for each type of business. eg. fire, marine etc. It records: incomes & expenses of particular business, profit/ loss is transferred to profit & loss account.

Profit & loss account It records incomes & expenses of general nature and it show how profit has been appropriated in addition to profit/loss of different business. Its balance is shown in balance sheet.

Balance sheet It records various assets and liabilities of General insurance companies.

PREPARATION OF FINANCIAL STATEMENTS

Insurers assume and manage risk in return for a premium. The premium for each policy, or contract, is calculated based in part on historical data aggregated from many similar policies and is paid in advance of the delivery of the service. The actual cost of each policy to the insurer is not known until the end of the policy period (or for some insurance products long after the end of the



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policy period), when the cost of claims can be calculated with finality. The insurance industry is divided into two major segments: property/casualty, also known as general insurance or nonlife, particularly outside the United States, and life/ health. Broadly speaking, property/casualty policies cover homes, autos and businesses; life/health insurers sell life, long-term care and disability insurance, annuities and health insurance. U.S. insurers submit financial statements to state regulators using statutory accounting principles, but there are significant differences between the accounting practices of property/casualty and life insurers due to the nature of their products. These include:

Financial Statements

An insurance company's annual financial statement is a lengthy and detailed document that shows all aspects of its business. In statutory accounting, the initial section includes a balance sheet, an income statement and a section known as the Capital and Surplus Account, which sets out the major components of policyholders' surplus and changes in the account during the year. As with GAAP accounting, the balance sheet presents a picture of a company's financial position at one moment in time—its assets and its liabilities—and the income statement provides a record of the company's operating results from the previous period. An insurance company's policyholders' surplus—its assets minus its liabilities—serves as the company's financial cushion against catastrophic losses and as a way to fund expansion. Regulators require insurers to have sufficient surplus to support the policies they issue. The greater the risks assumed, and hence the greater the potential for claims against the policy, the higher the amount of policyholders' surplus required.

Asset Valuation

Property/casualty companies need to be able to pay predictable claims promptly and also to raise cash quickly to pay for a large number of claims in case of a hurricane or other disaster. Therefore, most of their assets are high quality, income-paying government and corporate bonds that are generally held to maturity. Under SAP, they are valued at amortized cost rather than their current market cost. This produces a relatively stable bond asset value from year to year (and reflects the expected use of the asset.)

However, when prevailing interest rates are higher than bonds' coupon rates, amortized cost overstates asset value, producing a higher value than one based on the market. (Under the amortized cost method, the difference between the cost of a bond at the date of purchase and its face value at maturity is accounted for on the balance sheet by gradually changing the bond's value. This entails increasing its value from the purchase price when the bond was bought at a discount and decreasing it when the bond was bought at a premium.) Under GAAP, bonds may be valued at market price or recorded at amortized cost, depending on whether the insurer plans to hold them to maturity (amortized cost) or make them available for sale or active trading (market value). The second largest asset category for property/ casualty companies, preferred and common stocks, is valued at market price. Life insurance companies generally hold a small percentage of their assets in preferred or common stock. Some assets are "nonadmitted" under



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SAP and therefore assigned a zero value but are included under GAAP. Examples are premiums overdue by 90 days and office furniture. Real estate and mortgages make up a small fraction of a property/casualty company's assets because they are relatively illiquid. Life insurance companies, whose liabilities are longer term commitments, have a greater portion of their investments in commercial mortgages. The last major asset category is reinsurance recoverables. These are amounts due from the company's reinsurers. (Reinsurers are insurance companies that insure other insurance companies, thus sharing the risk of loss.) Amounts due from reinsurance companies are categorized according to whether they are overdue and, if so, by how many days. Those recoverables deemed uncollectible are reported as a surplus penalty on the liability side of the balance sheet, thus reducing surplus.

Liabilities and Reserves

Liabilities, or claims against assets, are divided into two components: reserves for obligations to policyholders and claims by other creditors. Reserves for an insurer's obligations to its policyholders are by far the largest liability. Property/casualty insurers have three types of reserve funds: unearned premium reserves, or pre-claims liability; loss and loss adjustment reserves, or post claims liability; and other.

Unearned premiums are the portion of the premium that corresponds to the unexpired part of the policy period. Premiums have not been fully "earned" by the insurance company until the policy expires. In theory, the unearned premium reserve represents the amount that the company would owe all its policyholders for coverage not yet provided if one day the company suddenly went out of business. If a policy is canceled before it expires, part of the original premium payment must be returned to the policyholder.

Loss reserves are obligations that an insurance company has incurred – from claims that have been or will be filed on the exposures the insurer protected. Loss adjustment reserves are funds set aside to pay for claims adjusters, legal assistance, investigators and other expenses associated with settling claims. Property/casualty insurers set up claim reserves only for accidents and other events that have happened.

Some claims, like fire losses, are easily estimated and quickly settled. But others, such as products liability and some workers compensation claims, may be settled long after the policy has expired. The most difficult to assess are loss reserves for events that have already happened but have not been reported to the insurance company, known as "incurred but not reported" (IBNR). Examples of IBNR losses are cases where workers inhaled asbestos fibers but did not file a claim until their illness was diagnosed 20 or 30 years later. Actuarial estimates of the amounts that will be paid on outstanding claims must be made so that profit on the business can be calculated. Insurers estimate claims costs, including IBNR claims, based on their experience. Reserves are adjusted, with a corresponding impact on earnings, in subsequent years as each case develops and more details become known.



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Revenues, Expenses and Profits

Profits arise from insurance company operations (underwriting results) and investment results. Policyholder premiums are an insurer's main revenue source. Under SAP, when a property/casualty policy is issued, the pre-claim liability or unearned premium is equal to the written premium. (Written premiums are the premiums charged for coverage under policies written regardless of whether they have been collected or "earned." Each day the policy remains in force, one day of unearned premium is earned, and the unearned premium falls by the amount earned. For example, if a customer pays \$365 for a one-year policy starting January 1, the initial unearned premium reserve would be \$365, and the earned premium would be \$0. After one day, the unearned premium reserve would be \$364, and the earned premium would be \$1.

Under GAAP, policy acquisition expenses, such as agent commissions, are deferred on a pro-rata basis in line with GAAP's matching principle. This principle states that in determining income for a given period, expenses must be matched to revenues. As a result, under GAAP (and assuming losses and other expenses are experienced as contemplated in the rate applied to calculate the premium) profit is generated steadily throughout the duration of the contract. In contrast, under SAP, expenses and revenues are deliberately mismatched. Expenses associated with the acquisition of the policy are charged in full as soon as the policy is issued but premiums are earned throughout the policy period. SAP mismatches the timing of revenues and acquisition expenses so the balance sheet is viewed more conservatively. By recognizing acquisition expenses before the income generated by them is earned, SAP forces an insurance company to finance those expenses from its policyholders' surplus. This appears to reduce the surplus available to pay unexpected claims. In effect, this accounting treatment requires an insurer to have a larger safety margin to be able to fulfill its obligation to policyholders.

Preparing a Balance Sheet

When someone, whether a creditor or investor, asks you how your company is doing, you'll want to have the answer ready and documented. The way to show off the success of your company is a balance sheet. A balance sheet is a documented report of your company's assets and obligations, as well as the residual ownership claims against your equity at any given point in time. It is a cumulative record that reflects the result of all recorded accounting transactions since your enterprise was formed. You need a balance sheet to specifically know what your company's net worth is on any given date. With a properly prepared balance sheet, you can look at a balance sheet at the end of each accounting period and know if your business has more or less value, if your debts are higher or lower, and if your working capital is higher or lower. By analyzing your balance sheet, investors, creditors and others can assess your ability to meet short-term obligations and solvency, as well as your ability to pay all current and long-term debts as they come due. The balance sheet also shows the composition of assets and liabilities, the relative proportions of debt and equity financing and the amount of earnings that you have had to retain. Collectively, this information will be used by external parties to help assess your company's



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financial status, which is required by both lending institutions and investors before they will allot any money toward your business.

Balance Sheet Many people and organizations are interested in the financial affairs of your company, whether you want them to be or not. You of course want to know about the progress of your enterprise and what's happening to your livelihood. However, your creditors also want assurance that you will be able to pay them when they ask. Prospective investors are looking for a solid company to bet their money on, and they want financial information to help them make a sound decision. Your management group also requires detailed financial data and the labor unions (if applicable) will want to know your employees are getting a fair share of your business earnings.

Common Classifications On the balance sheet you list your assets and equities under classifications according to their general characteristics. It is a relatively simple matter to make a comparison of one classification with another or to make comparisons within a classification because similar assets or similar equities are listed together. Some of the most commonly used classifications are:

Current Assets

Current assets include cash and other assets that in the normal course of events are converted into cash within the operating cycle. For example, a manufacturing enterprise will use cash to acquire inventories of materials. These inventories of materials are converted into finished products and then sold to customers. Cash is collected from the customers. This circle from cash back to cash is called an operating cycle. In a merchandising business one part of the cycle is eliminated. Materials are not purchased for conversion into finished products. Instead, the finished products are purchased and are sold directly to the customers. Several operating cycles may be completed in a year, or it may take more than a year to complete one operating cycle. The time required to complete an operating cycle depends upon the nature of the business. It is conceivable that almost all of the assets that are used to conduct your business, such as buildings, machinery, and equipment, can be converted into cash within the time required to complete an operating cycle. However, your current assets are only those that will be converted into cash within the normal course of your business. The other assets are only held because they provide useful services and are excluded from the current asset classification. If you happen to hold these assets in the regular course of business, you can include them in the inventory under the classification of current assets. Current assets are usually listed in the order of their liquidity and frequently consist of cash, temporary investments, accounts receivable, inventories and prepaid expenses.

Cash

Cash is simply the money on hand and/or on deposit that is available for general business purposes. It is always listed first on a balance sheet. Cash held for some designated purpose, such as the cash held in a fund for eventual retirement of a bond issue, is excluded from current assets.



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Marketable Securities

These investments are temporary and are made from excess funds that you do not immediately need to conduct operations. Until you need these funds, they are invested to earn a return. You should make these investments in securities that can be converted into cash easily; usually short-term government obligations.

Accounts Receivable

Simply stated, accounts receivables are the amounts owed to you and are evidenced on your balance sheet by promissory notes. Accounts receivable are the amounts billed to your customers and owed to you on the balance sheet's date. You should label all other accounts receivable appropriately and show them apart from the accounts receivable arising in the course of trade. If these other amounts are currently collectible, they may be classified as current assets.

Inventories

Your inventories are your goods that are available for sale, products that you have in a partial stage of completion, and the materials that you will use to create your products. The costs of purchasing merchandise and materials and the costs of manufacturing your various product lines are accumulated in the accounting records and are identified with either the cost of the goods sold during the fiscal period or as the cost of the inventories remaining at the end of the period.

Prepaid expenses

These expenses are payments made for services that will be received in the near future. Strictly speaking, your prepaid expenses will not be converted to current assets in order to avoid penalizing companies that choose to pay current operating costs in advance rather than to hold cash. Often your insurance premiums or rentals are paid in advance.

Investments

Investments are cash funds or securities that you hold for a designated purpose for an indefinite period of time. Investments include stocks or the bonds you may hold for another company, real estate or mortgages that you are holding for income-producing purposes. Your investments also include money that you may be holding for a pension fund.

Plant Assets

Often classified as fixed assets, or as plant and equipment, your plant assets include land, buildings, machinery, and equipment that are to be used in business operations over a relatively long period of time. It is not expected that you will sell these assets and convert them into cash. Plant assets simply produce income indirectly through their use in operations.

Intangible Assets

Your other fixed assets that lack physical substance are referred to as intangible assets and consist of valuable rights, privileges or advantages. Although your intangibles lack physical substance,



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they still hold value for your company. Sometimes the rights, privileges and advantages of your business are worth more than all other assets combined. These valuable assets include items such as patents, franchises, organization expenses and goodwill expenses. For example, in order to become incorporated you must incur legal costs. You can designate these legal costs as organizing expenses.

Other Assets

During the course of preparing your balance sheet you will notice other assets that cannot be classified as current assets, investments, plant assets, or intangible assets. These assets are listed on your balance sheet as other assets. Frequently, your other assets consist of advances made to company officers, the cash surrender value of life insurance on officers, the cost of buildings in the process of construction, and the miscellaneous funds held for special purposes.

Current Liabilities

On the equity side of the balance sheet, as on the asset side, you need to make a distinction between current and long-term items. Your current liabilities are obligations that you will discharge within the normal operating cycle of your business. In most circumstances your current liabilities will be paid within the next year by using the assets you classified as current. The amount you owe under current liabilities often arises as a result of acquiring current assets such as inventory or services that will be used in current operations. You show the amounts owed to trade creditors that arise from the purchase of materials or merchandise as accounts payable. If you are obligated under promissory notes that support bank loans or other amounts owed, your liability is shown as notes payable. Other current liabilities may include the estimated amount payable for income taxes and the various amounts owed for wages and salaries of employees, utility bills, payroll taxes, local property taxes and other services.

Long-Term Liabilities

Your debts that are not due until more than a year from the balance sheet date are generally classified as long-term liabilities. Notes, bonds and mortgages are often listed under this heading. If a portion of your long-term debt is due within the next year, it should be removed from the long-term debt classification and shown under current liabilities.

Deferred Revenues

Your customers may make advance payments for merchandise or services. The obligation to the customer will, as a general rule, be settled by delivery of the products or services and not by cash payment. Advance collections received from customers are classified as deferred revenues, pending delivery of the products or services.

Owner's Equity

Your owner's equity must be subdivided on your balance sheet: One portion represents the amount invested directly by you, plus any portion of retained earnings converted into paid-in



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capital. The other portion represents your net earnings that are retained. This rigid distinction is necessary because of the nature of any corporation. Ordinarily, stockholders, or owners, are not personally liable for the debts contracted by a company. A stockholder may lose his investment, but creditors usually cannot look to his personal assets for satisfaction of their claims. Under normal circumstances, the stockholders may withdraw as cash dividends an amount measured by the corporate earnings. The distinction in this rule gives the creditors some assurance that a certain portion of the assets equivalent to the owner's investment cannot be arbitrarily withdrawn. Of course, this portion could be depleted from your balance sheet because of operating losses. The owner's equity in an unincorporated business is shown more simply. The interest of each owner is given in total, usually with no distinction being made between the portion invested and the accumulated net earnings. The creditors are not concerned about the amount invested. If necessary, creditors can attach the personal assets of the owners.

Cost

Cost is conventionally used as the basis for accountability. Assets, when acquired under normal circumstances, are recorded at the price negotiated between two independent parties dealing at arm's length. Simply stated, the cost of an asset to the purchaser is the price that he or she must pay now or later in order to obtain it. The fair value of the asset is not relevant in recording the transaction on your balance sheet. A purchaser may acquire an asset at a cost that is greater or less than the fair value determined in the marketplace. If the asset is acquired, the purchaser accounts for the assets at his cost, value notwithstanding.

IMPORTANT TERMS IN INSURANCE

Premium- This is the actual cost of your insurance plan. Keep in mind that the higher the premium, the higher your coverage and thus, the less you will have to pay in medical bills throughout the year.

Deductible- The Deductible is the amount that you must pay out of your own pocket before the insurance company will begin paying towards any covered expenses. The deductible affects how much money you will pay to the doctor or hospital, and is typically paid at the time of treatment.

Accidental Death Benefit - In a life insurance policy, benefit in addition to the death benefit paid to the beneficiary, should death occur due to an accident. There can be certain exclusions as well as time and age limits.

Actual Cash Value- Cost of replacing damaged or destroyed property with comparable new property, minus depreciation and obsolescence. For example, a 10-year-old sofa will not be replaced at current full value because of a decade of depreciation.

Adjustable Rate- An interest rate that changes based on changes in a published market- rate index.

Agent -Individual who sells and services insurance policies in either of two classifications:



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Aggregate Limit - Usually refers to liability insurance and indicates the amount of coverage that the insured has under the contract for a specific period of time, usually the contract period, no matter how many separate accidents might occur.

Annuity - An agreement by an insurer to make periodic payments that continue during the survival of the annuitant(s) or for a specified period.

Automobile Liability Insurance - Coverage if an insured is legally liable for bodily injury or property damage caused by an automobile.

Benefit Period - In health insurance, the number of days for which benefits are paid to the named insured and his or her dependents. For example, the number of days that benefits are calculated for a calendar year consists of the days beginning on Jan. 1 and ending on Dec. 31 of each year.

Broker - Insurance salesperson that searches the marketplace in the interest of clients, not insurance companies.

Broker-Agent - Independent insurance salesperson who represents particular insurers but also might function as a broker by searching the entire insurance market to place an applicant's coverage to maximize protection and minimize cost. This person is licensed as an agent and a broker.

Captive Agent - Representative of a single insurer or fleet of insurers who is obliged to submit business only to that company, or at the very minimum, give that company first refusal rights on a sale. In exchange, that insurer usually provides its captive agents with an allowance for office expenses as well as an extensive list of employee benefits such as pensions, life insurance, health insurance, and credit unions.

Casualty Insurance - That type of insurance that is primarily concerned with losses caused by injuries to persons and legal liability imposed upon the insured for such injury or for damage to property of others. It also includes such diverse forms as plate glass, insurance against crime, such as robbery, burglary and forgery, boiler and machinery insurance and Aviation insurance. Many casualty companies also write surety business.

Claim - A demand made by the insured, or the insured's beneficiary, for payment of the benefits as provided by the policy.

Coinsurance - In property insurance, requires the policyholder to carry insurance equal to a specified percentage of the value of property to receive full payment on a loss. For health insurance, it is a percentage of each claim above the deductible paid by the policyholder. For a 20% health insurance coinsurance clause, the policyholder pays for the deductible plus 20% of his covered losses. After paying 80% of losses up to a specified ceiling, the insurer starts paying 100% of losses.

Collision Insurance - Covers physical damage to the insured's automobile (other than that covered under comprehensive insurance) resulting from contact with another inanimate object.



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Comprehensive Insurance - Auto insurance coverage providing protection in the event of physical damage (other than collision) or theft of the insured car. For example, fire damage or a cracked windshield would be covered under the comprehensive section.

Coverage - The scope of protection provided under an insurance policy. In property insurance, coverage lists perils insured against, properties covered, locations covered, individuals insured, and the limits of indemnification. In life insurance, living and death benefits are listed.

Copayment - A predetermined, flat fee an individual pays for health-care services, in addition to what insurance covers. For example, some HMOs require a \$10 copayment for each office visit, regardless of the type or level of services provided during the visit.

Creditable Coverage - Term means that benefits provided by other drug plans are at least as good as those provided by the new Medicare Part D program. This may be important to people eligible for Medicare Part D but who do not sign up at their first opportunity because if the other plans provide creditable coverage, plan members can later convert to Medicare Part D without paying higher premiums than those in effect during their open enrollment period.

Death Benefit - The limit of insurance or the amount of benefit that will be paid in the event of the death of a covered person.

Deductible - Amount of loss that the insured pays before the insurance kicks in.

Defense Base Act Insurance:- Required insurance per FAR 52.228-3 for all federally funded public works contracts overseas (OCONUS). Provides contractually required protection for the contractor's civilian employees for medical expenses, lost wages, disability, and or death, including War Hazard, arising from work related injury or occupational illness.

Direct Writer -An insurer whose distribution mechanism is either the direct selling system or the exclusive agency system.

Earned Premium - The amount of the premium that has been paid for in advance that has been "earned" by virtue of the fact that time has passed without claim. A three-year policy that has been paid in advance and is one year old would have only partly earned the premium.

Employers Liability Insurance - Coverage against common law liability of an employer for accidents to employees, as distinguished from liability imposed by a workers' compensation law.

Errors & Omissions Insurance - Also known as Professional Liability Insurance protects your organization from claims if your client holds you liable for errors, or failure to deliver work as promised in the contract.

Exclusions - Items or conditions that are not covered by the general insurance contract.

General Liability Insurance - Insurance designed to protect business owners and operators from a wide variety of liability exposures. Exposures could include liability arising from accidents resulting



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from the insured's premises or operations, products sold by the insured, operations completed by the insured, and contractual liability.

Grace Period - The length of time (usually 31 days) after a premium is due and unpaid during which the policy, including all riders, remains in force. If a premium is paid during the grace period, the premium is considered to have been paid on time. In Universal Life policies, it typically provides for coverage to remain in force for 60 days following the date cash value becomes insufficient to support the payment of monthly insurance costs.

Hazard - A circumstance that increases the likelihood or probable severity of a loss. For example, the storing of explosives in a home basement is a hazard that increases the probability of an explosion.

Health Maintenance Organization (HMO) - Prepaid group health insurance plan that entitles members to services of participating physicians, hospitals and clinics. Emphasis is on preventative medicine, and members must use contracted health-care providers.

Indemnity - Restoration to the victim of a loss by payment, repair or replacement.

Insurable Interest - Interest in property such that loss or destruction of the property could cause a financial loss.

Liability Insurance - Insurance that pays and renders service on behalf of an insured for loss arising out of his responsibility, due to negligence, to others imposed by law or assumed by contract.

Medical Loss Ratio - Total health benefits divided by total premium.

Mortgage Insurance Policy - In life and health insurance, a policy covering a mortgagor with benefits intended to pay off the balance due on a mortgage upon the insured's death, or to meet the payments due on a mortgage in case of the insured's death or disability.

National Association of Insurance Commissioners (NAIC) - Association of state insurance commissioners whose purpose is to promote uniformity of insurance regulation, monitor insurance solvency and develop model laws for passage by state legislatures.

Personal Accident Insurance: Provides your employees and beneficiaries with financial compensation in the unfortunate event of an accident during an international trip or living and working overseas. It offers 24 hour cover for Accidental Death and Dismemberment (AD&D), Disablement and pays for Medical Expense, Medical Evacuation and Repatriation. Personal Accident benefits are payable in addition to DBA or Workers Compensation benefits.

Personal Injury Protection - Pays basic expenses for an insured and his or her family in states with no-fault auto insurance. No-fault laws generally require drivers to carry both liability insurance and personal injury protection coverage to pay for basic needs of the insured, such as medical expenses, in the event of an accident.



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Policy - The written contract effecting insurance, or the certificate thereof, by whatever name called, and including all clause, riders, endorsements, and papers attached thereto and made a part thereof.

Premium - The price of insurance protection for a specified risk for a specified period of time.

Reinsurance - In effect, insurance that an insurance company buys for its own protection. The risk of loss is spread so a disproportionately large loss under a single policy doesn't fall on one company. Reinsurance enables an insurance company to expand its capacity; stabilize its underwriting results; finance its expanding volume; secure catastrophe protection against shock losses; withdraw from a line of business or a geographical area within a specified time period.

Renewal - The automatic re-establishment of in-force status effected by the payment of another premium.

Replacement Cost - The dollar amount needed to replace damaged personal property or dwelling property without deducting for depreciation but limited by the maximum dollar amount shown on the declarations page of the policy.

Risk Class - Risk class, in insurance underwriting, is a grouping of insureds with a similar level of risk. Typical underwriting classifications are preferred, standard and substandard, smoking and non-smoking, male and female.

1. From the following balances of United General Insurance Company Ltd as on 31.3.2016. Prepare (i) Fire Revenue Account (ii) Marine Revenue Account and profit and loss account

Particulars	Rs(000)	Particulars	Rs(000)
Provision for Unexpired Risk on 1.4.2015		Interest, Dividends etc	28
Fire	500	Difference in Receipts (Cr)	0.6
Marine	1640	Miscellaneous Receipts	10
Additional Reserve on 1.4.2015		Profit on Sale of Land	120
Fire	100	Premium Received	
Bad debts		Fire	290
Fire	10	Marine	800
Marine	24	Commission on Reinsurance Ended	
Auditors Fees	2.4	Fire	60
Directors Fees	10	Marine	120
Share Transfer Fees	1.6		
Bad debts Recovered	2.4		



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Claims Paid Outstanding	
Fire	380
Marine	760
Commission Paid	
Fire	180
Marine	216
Depreciation	70

Provision for unexpired risk is to be kept at 50% of the premiums for fire and at 100% for marine departments. The additional reserve in case of fire insurance is to be increased by 5% of the net premium.

Revenue account

Particulars	Schedule	Fire	Marine
Premium Earned	1	1040	1640
Total A		1040	1640
Claims Incurred	2	380	760
Commission	3	120	96
Operating Ex	4	300	824
Total B		800	1680
Operating Profit		240	-40

Profit and loss account

Particulars	Rs
Operating Profit	
Fire	240
Marine	-40
Net Operating Profit	200
Income From Investments	
Interest	28



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Profit On Sale Of Land	120
Other Income	
Share Transfer Fee	1.6
Bad Debts	2.4
Miscellaneous Receipts	10
Difference	0.6
Total A	362.6
Provision	
Other Expenses	
Directors Fees	10
Auditors Fees	2.4
Depreciation	70
Total B	82.4
Profit Before Tax	280.2
Provisions For Taxation	
Profit After Tax	280.2

2. The life insurance fund of an insurance company showed a balance of Rs. 25,63,000 as on 31.3.2016. Later it was found that the following items have not been taken into account:

Outstanding premium	Rs.41,500
Bonus utilized in reduction of premium	Rs.13,500
Claims intimated but not paid	Rs.16,300
Claims covered under reinsurance	Rs.4,800
Interest accrued on investments	Rs.26,700
Income tax on interest accrued on investments	Rs.3,900

Ascertain the correct balance of life assurance fund.



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Solution

Statement showing correct Life Assurance Fund

particulars	Rs.
Life Assurance Fund	25,63,000
+ outstanding premium	41,500
Interest accrued on investments	26,700
Bonus	13,500
Claims on reinsurance	4,800
	26,49,000
Less claims intimated but not paid	16300
Bonus	13500
Income tax	3900
	33,700
Correct life assurance fund	26,15,800

KAMARAJ WOMENS COLLEGE



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UNIT - IV

Meaning of Double Account System:

These undertakings are usually incorporated under Special Acts and, as a result, the form of accounts is prescribed by, special statute. These public utility undertakings are generally run by Government or by local authorities (except Electric Supply Companies and Tramways)

Main Features of Double Account System:

- (a) Generally, a public utility undertaking needs a large amount of capital which is invested in the acquisition of fixed assets. Therefore, fixed assets, fixed liabilities and current assets, current liabilities are to be separately dealt with. Fixed Assets and fixed or long-term liabilities are recorded in Receipts and Expenditure on Capital Account. Similarly, current assets and current liabilities are recorded in the General Balance Sheet.
- (b) Revenue Account and Net Revenue Account are prepared instead of Profit and Loss Account and Profit and Loss Appropriation Account.
- (c) Normally, no adjustment of asset is made in the Capital Account.
- (d) Depreciation is not deducted from the asset concerned but the same is shown as a liability by way of a fund. And, as such, fixed assets are recorded at book value.
- (e) Any kind of funds and reserve — e.g., Sinking Fund, Depreciation Fund, General Reserve, Capital Reserve, the Balance of Revenue/Net Revenue Account — are shown in the liabilities side of the General Balance Sheet.
- (f) Discount and Premiums are permanently treated as capital items.
- (g) Loan capital (debentures) Shares and Stocks are treated as capital items.
- (h) Interest on Loan and Debentures (i.e., all fixed interests) are to be charged against Net Revenue Account.

Advantages of Double Account System:

The advantages of Double Account System are:

- (a) As Depreciation fund is compulsorily created and invested in outside securities, it helps to replace an asset without affecting the liquid resources, viz., Cash, of the concern.
- (b) Revenue account represents the operating activities which expresses the operating result of the undertaking while extraneous items are recorded on Net Revenue Account which expresses the real operational result.
- (c) The capital account helps us to understand the source of capital in various forms and the application of same in the form of various fixed assets. Thus, it can easily be followed by an ordinary person.



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(d) Since these concerns enjoy almost monopoly rights given by the Government, the Government, may understand whether the concern supplies the efficient service at reasonable cost or not after analysing its prescribed format of accounting.

(e) The undertakings may compile at ease various statistical returns which reflect the service given to the public since the accounts are published in a standardised form.

Disadvantages of Double Account System:

(a) Capital Account incorporates the value of an asset whose life is very short. Those assets appear in the account at their scrap value—although these are shown at a higher value.

(b) Since all Assets are recorded at cost and not the written-down value, the Balance Sheet does not exhibit a real position.

(c) Capital account includes the items like preliminary expenses which are also considered in Single Account System.

(d) It is not always possible to understand the accounting statements and forms by the ordinary people.

(e) In order to replace an asset for improved means it may not always be possible to determine exactly the amount of revenue expenditure items which should be charged.

(f) Since repairs and renewal expenditures are charged to revenue account of the same year, profit of the undertaking, particularly on that year when no expenditures on repairs and renewals are incurred, is affected. That is why, in order to overcome this difficulty, some undertakings may even open a separate account viz., Repair and Renewal Reserve.

(g) Proper distinctions between revenue expenditure and capital expenditure is not possible under this system.

Double accounting system

particulars	debit	credit
1. For the amount spent on new works New work a/c (amount to be capitalized) Replacement a/c (amount to be written off to revenue) To bank (actual amount spent)	Xxx xxx	xxx
2. For the sale of old materials Bank a/c DR To replacement a/c	xxx	xxx
3. For the value of old materials used in the construction New works a/c DR To replacement a/c	xxx	Xxx



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4. For the balance in the replacement a/c Revenue a/c To replacement a/c	Xxx	xxx
5. For the amount entirely spent on new extension New works a/c DR To bank a/c	Xxx	xxx

Double Entry system

1. The Indian Gas Company rebuilt and re-equipped part of their works at a cost of Rs.50,00,000. The parts of the old works, thus superseded cost Rs.30,00,000. The capacity of the new works is double the capacity of the old. Rs. 2,50,000 is realized by the sale of old materials and old materials worth Rs.1,50,000 are used in the construction of the new works and included in the total cost of Rs.50,00,000. The costs of labour and materials are 25% higher now than when the old works were built. Journalise the above.

Solution:

Calculation of Estimated replacement cost

Particulars	Rs
Original cost of the old works	30,00,000
Add Increase in the cost of material 3 30,00,000x25/100	7,50,000
Estimated replacement cost	37,50,000

Calculation of Amount to be capitalised

Particulars	Rs
Actual cost of new works	50,00,000
Less –estimated cost of replacement	37,50,000
Amount to be capitalized	12,50,000



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Calculation of Amount to be transferred to revenue A/c

Estimated cost of replacement	37,50,000
Less material sold 2,50,000	
Material used 1,50,000	4,00,000
Amount to be charge to revenue a/c	33,50,000

Journal entries

Particulars		Debit	Credit
New works a/c	Dr	12,50,000	
Replacement a/c	Dr	37,50,000	
	To Bank a/c		50,00,000
(being the current cost of replacement charged to replacement a/c and the balance is captilised)			
New works a/c	Dr	1,50,000	
	To replacement a/c		1,50,000
(being the cost of old materials used in new works)			
Bank a/c	Dr	2,50,000	
	To replacement a/c		2,50,000
(being old materials realized credited to replacement a/c)			
Revenue a/c	Dr	33,50,000	
	To replacement a/c		33,50,000
(being the new current cost of replacement transferred to revenue a/c)			



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2. Electric supply ltd re built and re equipped one of their mains at a cash cost of Rs. 40,00,000. The cost of old main was Rs 15,00,000.

Rs. 90,000 was realized from sale of old materials. Four old motors valued at Rs. 1,60,000 salvaged from the old main were used in the reconstruction. The cost of labour and materials is respectively 20% and 15% higher now than when the old main then was built. The proportion of labour to materials in the main and now is 1:2. Show the journal entries for recording the above transaction, if the accounts are maintained under double account system.

Solution:

Calculation of break-up cost of old lines

Ratio between cost is 1:2

$$\text{Material cost} = 1500000 \times \frac{2}{3} = \text{Rs } 10,00,000$$

$$\text{Labour cost} = 1500000 \times \frac{1}{3} = \text{Rs } 5,00,000$$

Calculation of Estimated cost of replacement

Item	Original cost	Increase due to price change	Estimated cost
Materials	1000000	$1000000 \times \frac{15}{100} = 150000$	1150000
Labour	500000	$500000 \times \frac{20}{100} = 100000$	600000
		Estimated cost of replacement	1750000

Calculation of amount to be capitalized

Cost of re building new main	40,00,000
Less: Estimated cost of replacement	17,50,000
Amounted to be capitalized	22,50,000

Calculation of amount to be transferred to revenue account

Estimated cost of replacement	17,50,000
Less material sold 90,000	
Material used 1,60,000	2,50,000
Amount to be charge to revenue a/c	15,00,000



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Journal entries

Particulars	Debit	Credit
New main a/c Dr	22,50,000	
Replacement a/c Dr	17,50,000	
To Bank a/c		40,00,000
(being the current cost of replacement charged to replacement a/c and the balance is captilised)		
New main a/c Dr	1,60,000	
To replacement a/c		1,60,000
(being the cost of old materials used in new works)		
Bank a/c Dr	90,000	
To replacement a/c		90,000
(being old materials realized credited to replacement a/c)		
Revenue a/c Dr	15,00,000	
To replacement a/c		15,00,000
(being the new current cost of replacement transferred to revenue a/c)		

3. An Electric Supply company rebuilds it's mains at the cost of Rs.12,00,000. This includes value of Rs. 13,800 material of old main used for new one. The original mains were constructed at a cost of RS. 1,00,000. The ratio of material and labour therein was 7:3. The increase in material prices is 25% and wages rates 30%. Materials worth RS.25,700 from old works was sold. Show the journal entries under double accounts system and prepare necessary ledger accounts.

Solution:

Calculation of Break-up cost of old mains

Ratio 7:3 1,00,000-----materials 70,000 labour 30,000



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Calculation of estimated cost of replacement

item	Original cost	Increase due to price changes	Estimated cost
Materials	70,000	$70,000 \times 25/100 = 17,500$	87,500
Labour	30,000	$30,000 \times 30/100 = 9,000$	39,000
		Estimated cost of replacement	1,26,500

Calculation of amount to be capitalized

Cost of re building new main	12,00,000
LESS: estimated cost of replacement	1,26,500
Amounted to be capitalized	10,73,500

Calculation of amount to be transferred to revenue account

Estimated cost of replacement	1,26,500
Less material sold 23700	
Material used 13800	39,500
Amount to be charge to revenue a/c	87,000

Journal entries

Particulars	Debit	Credit
New main a/c Dr	10,73,500	
Replacement a/c Dr	1,26,500	
To Bank a/c		12,00,000
(being the current cost of replacement charged to replacement a/c and the balance is captilised)		
New main a/c Dr	13,800	
To Replacement a/c		13,800
(being the cost of old materials used in new works)		



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Specimen format of double accounting system

Revenue a/c for the year ending....

Particular	Amount	Particular	Amount
A Generation		By Sale Of Energy For Light	Xxx
To Fuel	Xxx	By Sale Of Energy For Power	Xxx
To Oil, Wastage, Water	Xxx	By Sale Of Energy Under Special	
To Salary Of Engineers	Xxx	Contracts	Xxx
B Distribution		By Public Lights	Xxx
To Salary Of Engineers	Xxx	By Rent Receivable	Xxx
To Wages & Gratuities	Xxx	By Transfer Fees	Xxx
To Repairs	Xxx	By Other Items	Xxx
C Public Lamps		By Miscellaneous Receipts	Xxx
To Attendance & Repairs	Xxx	By Sale Of Ashes	Xxx
To Payments	Xxx	By Receiving And Disconnection	Xxx
		Fees	
D Rent, Rates & Taxes			
To Rent Payable	Xxx		
To Rent & Taxes	Xxx		
E Management Expenses			
To Director's Remuneration	Xxx		
To Management	Xxx		
To General Establishment	Xxx		
To Auditors Of The Company	Xxx		
F Law Charges			
To Law Charges	Xxx		
G Deprecation			
To Lease	Xxx		
To Building	Xxx		
H Special Charges			
To Bad Debts	Xxx		
To Balance Carried To Net Revenue A/C	Xxxxx		Xxxxx



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Net revenue account for the year ending...

Particular	Amount	Particular	Amount
To Interest on security deposits	Xxx	By Balance b/d	Xxx
To Interest on fixed loan	Xxx	By Balance brought from revenue a/c	Xxx
To Contingency reserve	Xxx	By Interest on bank a/c	Xxx
To Dividend control reserve	Xxx		
To Reserve for rebate to consumers	Xxx		
To Balance carried to balance sheet	Xxx		
	XXX		XXX

Receipts and expenditure on capital a/c for the year ending(or) Capital a/c

Expenditure	Exp in pre.yr	Exp in during .yr	Total Exp	Receipts	Rec.in pre.yr	Rec .in during .yr	Total Rec
To preliminary expenses	XXX	XXX	XXX	By loans	XXX	XXX	XXX
To land	XXX	XXX	XXX	By equity shares	XXX	XXX	XXX
To machinery	XXX	XXX	XXX	By debentures	XXX	XXX	XXX
To main plant	XXX	XXX	XXX	By preference Shares			
TOTAL	XXX	XXX	XXX		XXX	XXX	XXX
Expenses							
To balance of capital a/c transferred to GBS				Total receipts			



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General Balance Sheet

Particular	Amount	Particular	Amount
Capital a/c (balance c/d from capital a/c)	XXX	Stores	XXX
Sundry creditors for capital a/c	XXX	Sundry debtors	XXX
Sundry creditors on open a/c	XXX	Cash at bank	XXX
Net revenue a/c	XXX	Cash in hand	xxxx
Reserve fund a/c	XXX		
Depreciation fund			

1. The figures given below relate to the city electric supply company ltd .prepare revenue a/c for the year ended 31.3.2018

Sale of current	1,04,000
Sale of meters	4,000
Cost of generation	28,000
Cost of distribution	4,000
Rent rate and taxes	4,000
Management expenses	25,600

Solution

Revenue a/c of city electric supply co. Ltd for the year ended 31.3.2018

payments	Rs	Receipts	Rs
To Cost of generation	28000	By Sale of current	104000
To Cost of distribution	4000	By Sale of meters	4000
To Rent rate and taxes	4000		
To Management expenses	25600		
To balance carried to net revenue a/c	46400		
	108000		108000



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2. The following are the balances on 31.3.2015 in the books of Madras electric company limited

particulars	debit	credit
Land 1.1.2014	60,000	-
Land expanded during the year	2,000	-
Machinery 1.4.2014	2,40,000	-
Machinery expended during the year	2,000	-
Mains including the cost of laying	80,000	-
Mains expended during the year	20,400	-
Ordinary shares	-	2,19,600
Debentures	-	80,000
Sundry creditors	-	400
Depreciation fund	-	1,00,000
Sundry debtors for current supplied	16,000	-
Other debtors	200	-
Cash	2,000	-
Cost of generation of electricity	14,000	-
Cost of distribution of electricity	2,000	-
Rent and taxes	2,000	-
Management expenses	4,800	-
Depreciation	8,000	-
Sale of current	-	52,000
Rent of meters	-	2,000
Interest on debentures	4000	-
Interim dividend	8,000	-
Balance of net revenue a/c 1.4.2014	-	11,400
	465400	4,65,400



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Prepare revenue a/c, net revenue a/c, capital a/c and general balance sheet.

Solution

Revenue a/c for the year ended 31.3.2015

payments	Rs	Receipts	Rs
To Cost of generation of electricity	14,000	By Sale of current	52,000
To Cost of distribution of electricity	2,000	By Rent of meters	2,000
To Rent and taxes	2,000		
To Management expenses	4,800		
To Depreciation	8,000		
To balance carried to net revenue a/c	23,200		
	54,000		54,000

Net Revenue a/c for the year ended 31.3.2015

Particulars	RS	Particulars	RS
To Interest on debentures	4,000	By balance b/d	11,400
To Interim dividend	8,000	By balance from revenue a/c	23,200
To balance carried to general B/s	22,600		
	34,600		34,600

Receipts and expenditure on capital a/c for the year ending 31.3.2015

Expenditure	Upto 31.3.14	During 14-15	Total	Receipts	Upto 31.3.14	During 14-15	Total
To land	60,000	2,000	62,000	By equity shares	2,19,600	-	2,19,600
To machinery	2,40,000	2,000	2,42,000	By debenture	80,000	-	80,000
To main	80,000	20,400	1,00,400	Total receipts	299600		2,99,600
Total expenses	3,80,000	24,400	4,04,400	By balance c/d			1,04,800
			4,04,400				4,04,400



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General balance sheet as on 31.3.2005

Liabilities	Rs	Assets	Rs
Total capital receipts	2,99,600	Total capital	4,04,400
Creditors	400	expenses	16,000
Depreciation fund	1,00,000	Sundry debtors	200
Net revenue a/c	22,600	Other debtors	2,000
		cash	
	4,22,600		4,22,600

3. The following are the balances of Kunnakudi electric company Ltd as on 31.12.2015

Particulars	Dr	Cr
Land acquired during 2015	5,000	-
Machinery as on 31.12.2014	2,50,000	-
Mains as on 31.12.2014	1,00,000	-
Ordinary shares (100 each)	-	2,70,000
6% debentures	-	90,000
Share premium	-	10,000
Sundry creditors	-	5,000
Depreciation fund	-	1,10,000
Debtors for power supplies	20,000	-
Other debtors	1,000	-
Cash	2,000	-
Cost of generation of power	19,000	-
Cost of distribution of power	2,000	-
Rent and taxes	2,000	-
Management expenses	9,000	-
Depreciation	10,000	-



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Sale of current	-	92,000
Meter rent	-	3,000
Interest on debentures	4,000	-
Interim dividend	11,000	
Net revenue 31.12.2014	-	17,000
Land 31.12.04	70,000	-
Machinery expended during 2015	2,000	-
Mains expended during 2015	90,000	-
Total	5,97,000	5,97,000

During the year there was an issue of 700 shares at premium Of Rs.2 per share which was fully subscribed and paid up. Prepare revenue a/c, net revenue a/c, capital a/c and general balance sheet.

Revenue a/c for the year ended 31.3.2005

payments	Rs	Receipts	Rs
To Cost of generation of electricity	19,000	By Sale of current	92,000
To Cost of distribution of power	2,000	By Rent of meters	3,000
To Rent and taxes	2,000		
To Management expenses	9,000		
To Depreciation	10,000		
To balance carried to net revenue a/c	53,000		
	95,000		95,000

Net Revenue a/c for the year ended 31.3.2005

Particulars	RS	Particulars	RS
To Interest on debentures	4,000	By balance b/d	17,000
To Interim dividend	11,000	By balance from revenue a/c	53,000
To balance carried to general B/s	55,000		
	70,000		70,000



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Receipts and expenditure on capital a/c for the year ending 31.3.2005

Expenditure	Upto 31.3.04	During 04-05	Total	Receipts	Upto 31.3.04	During 04-05	Total
To land	70000	5000	75000	By equity shares	200000	70000	270000
To machinery	250000	2000	252000	By debenture	90000	-	90000
To main	100000	90000	19,00,000	By premium	8600	1400	10000
Total expenses	420000	97000	5170000	Total receipts	298600	714000	370000
				By balance c/d			147000
			517000				517000

General balance sheet as on 31.3.2005

Liabilities	Rs	Assets	Rs
Total capital receipts	370000	Total capital	517000
Creditors	5000	expenses	20000
Depreciation fund	110000	Sundry debtors	1000
Net revenue a/c	55000	Other debtors	
		cash	2000
	540000		540000

Opening capital = closing capital – current issue 200000=270000-70000

Premium 8600=1000-1400

Reasonable Return:

The Electricity (Supply) Act, 1948, imposes restrictions on electricity undertakings on earning too high a profit, by means of the concept of reasonable return, which stipulates the following:

1. A yield at the standard rate which is the Bank Rate stipulated by the Reserve Bank of India from time to time, plus 2% on the Capital Base.
2. Income derived from investments excluding investments made against the Contingencies Reserve.
3. An amount equal to ½% on any loans advanced by the Board.
4. An amount equal to ½% on the amounts borrowed from organisations or institutions approved by the State Government.



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5. An amount equal to ½% on the amounts realised by the issue of debentures.
6. An amount equal to ½% on the accumulations in the Development Reserve.
7. Any other amount as may be allowed by the Central Government, having regard to the prevailing tax structure in the country.

The procedure for computing the capital base is given below:

	Rs
<ol style="list-style-type: none"> 1. Original cost of fixed assets available for the purpose of the undertaking <i>Less</i> contributions, if any, made by the consumers for construction of service lines and also amounts written off 2. The cost of intangible assets including expenses on account of new capital issue 3. The original cost of work-in-progress. 4. The amounts of investments made compulsory against Contingencies Reserve 5. The monthly average of the stores, materials, supplies and cash and bank balances held at the end of each month 	_____ Total (A) _____
Less :	
<ol style="list-style-type: none"> 1. The amounts written off or set aside on account of depreciation of fixed assets and the amounts written off in respect of intangible assets in the books of the undertaking 2. Loans advanced by the Board 3. Loans borrowed from organisations or institutions approved by the State Government 4. Debentures issued 5. Amounts deposited in cash by consumers by way of security 6. The amount standing to the credit of Tariffs and Dividend Control Reserve 7. The amount standing to the credit of the Development Reserve 8. The amount carried forward at the beginning of the year of account to the credit of the Consumers Benefit Reserve 	_____ Total (B) _____
Total A – Total B : Capital Base	_____ _____

Para XVII of the Sixth Schedule of the Act provides guidelines for the computation of clear profits which means the difference between the amount of income and the sum of expenditure plus specific appropriation.



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This is done in the following statement:

<i>Expenditure incurred on</i>	<i>Rs.</i>	<i>Income derived from</i>	<i>Rs.</i>
1. Generation and purchase of energy		1. Receipt from sale of energy less discounts	
2. Distribution and sale of energy		2. Rentals of meters and other apparatus hired to consumers	
3. Rent, rates and taxes		3. Sale and repair of lamps etc.	
4. Interest on Loans		4. Rents	
5. Interest on security deposits		5. Transfer fees	
6. Legal charges		6. Investments, fixed and call deposits and bank balances	
7. Bad debts		7. Other general receipts accountable in the assessment of income tax	
8. Auditor's fees			
9. Management			
10. Depreciation			
11. Other expenses admissible for assessment of income tax			
12. Contributions to provident fund, staff pension etc.			
Total			
Special Appropriations sufficient to cover			
1. Loss of previous year			
2. All taxes on income and profits			
3. Amounts written off intangible assets and new capital expenses			
4. Contribution to the Contingencies Reserve			
5. Contributions towards arrears of depreciations			
6. Other Special appropriations permitted by the State Government			
Grand Total			
Balance – Clear Profit			

An electricity company must adjust the rates so that the clear profit in any year does not exceed the reasonable return by more than 20 per cent of the reasonable return. In case it exceeds, it should be credited to Customers Rebate (or Benefit) Reserve.

Moreover, even the surplus within 20 per cent of the reasonable return has to be disposed of as follows:

- (i) 1/3 of the surplus not exceeding 5 per cent of the reasonable return will be at the disposal of the undertaking.
- (ii) Of the balance, 1/2 will be transferred to the Tariffs and Dividend Control Reserve.



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(iii) The balance left will be distributed among consumers by way of reduction of rates or by way of special rebate.

1. city electricity ltd. Earned a profit of 16,90,000 during the year ended 31.3.04 after debenture interest at 7 ½ % on Rs.5,00,000. With the help of following figures given below, show the disposal of profits

Original cost of fixed assets	2,00,00,000
Formation and other expenses	10,00,000
Monthly average of current assets – net	50,00,000
Reserve fund (represented by 4 % government securities)	20,00,000
Contingency reserve fund investments	5,00,000
Loan from electricity board	30,00,000
Total depreciation written to date	40,00,000
Tariff and dividend control reserve	1,00,000
Security deposits received from customers	4,00,000
Assume bank rate to be 5%	

Solution

Calculation of capital base

Particulars	Rs
Original cost of fixed assets	2,00,00,000
Formation and other expenses	10,00,000
Monthly average of current assets – net	50,00,000
Contingency reserve fund investments	5,00,000
	2,65,00,000
Less	40,00,000
Total depreciation written to date	30,00,000
Loan from electricity board	5,00,000
Debentures	4,00,000
Security deposits received from customers	1,00,000
Tariff and dividend control reserve	80,00,000
Capital base	1,85,000



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2. calculation of reasonable rate of return

Particulars	Rs
Yield at 7% (bank rate 5%+2%) on capital base	12,95,000
Income from reserve fund investments	80,000
½ % on loan from electricity board	15,000
½ % on debentures	2,500
Reasonable return	13,92,500

3. calculation of surplus

Particulars	Rs
Clear profit	16,90,000
Reasonable profit	13,92,500
Surplus	2,97,500

4. calculation of disposal of surplus

Particulars	Rs
Surplus	297500
Less 1/3 of surplus limited to 5% of reasonable return (99167 or 69925 which ever is less)	69925
Balance surplus	2,27,875
½ of balance surplus transferred to tariffs and dividend control reserve	1,13,938
Balance transferred to consumers benefit reserve	1,13,937



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2. Compute reasonable return from the following information given below

Capital base	Rs 34,00,000
Loan from electricity board	30,00,000
Development reserve	10,00,0000
10% Debentures	8,00,000
Reserve fund investment – 6%	60,00,000

Assume bank rate 8%

calculation of reasonable rate of return

Particulars	Rs
Bank rate 8%+2 % on capital base $3400000 \times 10\%$	3,40,000
$\frac{1}{2}$ % on loan from electricity board	15,000
$\frac{1}{2}$ % on development reserve	5,000
$\frac{1}{2}$ % on debentures	4,000
Income from reserve fund investments	3,60,000
Reasonable return	7,24,000

KAMARAJ WOMEN'S COLLEGE



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UNIT - V

Inflation Accounting

Inflation accounting is a special technique used to factor in the impact that soaring or plummeting costs of goods in some regions of the world have on the reported figures of international companies. Financial statements are adjusted according to price indexes, rather than relying solely on a cost accounting basis, to paint a clearer picture of a firm's financial position in inflationary environments. This method is also sometimes referred to as price level accounting.

When a company operates in a country where there is a significant amount of price inflation or deflation, historical information on financial statements is no longer relevant. To counter this issue, in certain cases, companies are permitted to use inflation-adjusted figures, restating numbers to reflect current economic values.

International Accounting Standard (IAS) 29 adopted by the International Financial Reporting Standards (IFRS) is the guide for entities whose functional currency is the currency of a hyperinflationary economy. IFRS defines hyperinflation as prices, interest, and wages linked to a price index rising 100% or more cumulatively over three years.¹

Companies that fall under this category may be required to update their statements periodically in order to make them relevant to current economic and financial conditions, supplementing cost-based financial statements with regular price-level adjusted statements.

Inflation Accounting Methods

There are two main methods used in inflation accounting—current purchasing power (CPP) and current cost accounting (CCA).

Current Purchasing Power (CPP)

Under the CPP method, monetary items and nonmonetary items are separated. The accounting adjustment for monetary items is subject to the recording of a net gain or loss. Nonmonetary items (those that do not carry a fixed value) are updated into figures with an inflation conversion factor equivalent to the consumer price index (CPI) at the end of the period divided by CPI at the date of transaction.

Current Cost Accounting (CCA)

The CCA approach values assets at their fair market value (FMV) rather than historical cost, the price incurred during the purchase of the fixed asset. Under the CCA method, both monetary and nonmonetary items are restated to current values.

ACCOUNTING STANDARDS

Accounting standards refer to the set of guidelines, rules, and procedures that companies use to prepare and present their financial statements. These standards provide a framework for the



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consistent and accurate recording, measurement, and reporting of financial transactions, which enables stakeholders to make informed decisions based on reliable and comparable financial information.

Indian Accounting Standards

Also known as Ind AS, Indian Accounting Standards are formulated by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI). The Ind AS is recommended by ICAI to the National Financial Reporting Authority (NFRA) of the Government of India. Its objective is to bring uniformity in financial transactions recording, accounting, and profit and loss account and balance sheet presentation of a company in the country.

International Accounting Standards

International Accounting Standards (IAS) are a set of rules for financial statements that were replaced in 2001 by International Financial Reporting Standards (IFRS) and have subsequently been adopted by most major financial markets around the world.¹ Both sets of standards were issued by the International Accounting Standards Board (IASB), an independent body based in London.

The United States does not follow IFRS. Instead, the U.S. Securities & Exchange Commission requires public companies in the U.S. to follow Generally Accepted Accounting Standards (GAAP). China and Japan also declined to adopt IFRS.

International Accounting Standards (IAS) were the first international accounting standards that were issued by the International Accounting Standards Committee (IASC), formed in 1973. The goal then, as it remains today, was to make it easier to compare businesses around the world, increase transparency and trust in financial reporting, and foster global trade and investment.⁶

Globally comparable accounting standards promote transparency, accountability, and efficiency in financial markets around the world. This enables investors and other market participants to make informed economic decisions about investment opportunities and risks and improves capital allocation. Universal standards also significantly reduce reporting and regulatory costs, especially for companies with international operations and subsidiaries in multiple countries.

AS 1 – Disclosure of Accounting Policies

The information presented in the financial statements of an organisation is of its financial position. The profit or loss can be affected to a large degree by the accounting policies followed. The accounting policies followed vary from organisation to organisation. It is important to disclose significant accounting policies followed to make the financial statements understandable. The disclosure is required by law in certain cases. In recent years, organisations in India have adopted the practice of including a separate statement of accounting policies followed in their annual reports to shareholders.



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Many organisations list the accounting policies followed by them in the notes to their financial statements, but there is no consistency in the disclosures among organisations. In other words, the disclosure forms part of accounts in some cases, while in others it is given as supplementary information. The purpose of this standard is to promote a better understanding of financial statements by establishing the practice of disclosure of significant accounting policies followed and the manner in which they are disclosed in the financial statements. Such disclosure would also facilitate a more meaningful comparison between financial statements of different organisations.

Fundamental Accounting Assumptions

Certain assumptions are used in the preparation of financial statements. They are usually not specifically stated because they are assumed to be followed. Disclosure is necessary only if they are not followed. The following have been generally accepted as fundamental accounting assumptions:

Going Concern: The organisation is normally viewed as a going concern, that is to say, it will be in continuing operations for the foreseeable future. It is assumed that the organisation has neither the intention nor the necessity of shutting down or reducing the scale of operations.

Consistency: It is assumed that accounting policies are consistently followed from one period to another. No frequent changes are expected.

Accrual: Revenues and costs are recorded when they are earned or incurred (and not as money is received or paid) in the periods to which they relate.

Nature of Accounting Policies

Accounting policies refer to accounting principles and the methods of applying these principles adopted by the organisation in the preparation of their financial statements. There is no single list of accounting policies that are applicable in all circumstances. The different circumstances in which organisations operate make alternative accounting principles acceptable. The choice of the appropriate accounting principles calls for a large degree of judgement by the management of the organisation.

The various standards of the Institute of Chartered Accountants of India, combined with the efforts of the Government and other regulatory agencies have reduced the number of acceptable alternatives in recent years, particularly in case of corporates. While continuing efforts in this regard in the future are likely to reduce the number still further, the availability of alternative accounting principles is not likely to be eliminated altogether keeping in mind the different circumstances faced by the organisations.

Areas in which differing Accounting Policies are possible

The following are examples of areas in which different accounting policies may be adopted by organisations.



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Methods of depreciation, depletion and amortisation

Treatment of expenditure during construction

Conversion or translation of foreign currency items

Valuation of inventories

Treatment of goodwill

Valuation of investments

Treatment of retirement benefits

Recognition of profit on long-term contracts

Valuation of fixed assets

Treatment of contingent liabilities

The above list of examples is not exhaustive.

Considerations in the Selection of Accounting Policies

The primary consideration in the selection of accounting policies by an organisation is that the financial statements should represent a true and fair picture of the financial position for the period. For this purpose, the major considerations governing the selection and application of accounting policies are:

Prudence: In view of the uncertainty of future events, profits are not anticipated but recognised only when earned, though not necessarily in cash. However, provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only an estimate.

Substance over Form: The accounting treatment and presentation of transactions and events in financial statements should be governed by their substance and not merely by the legal form.

Materiality: Financial statements should disclose all “material” items, i.e. items, the knowledge of which might influence the decisions of the user of the financial statements.

Disclosure of Accounting Policies

To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements must be disclosed. Such disclosure should form part of the financial statements. It would be helpful to the reader of financial statements if they are all disclosed in one place instead of being scattered over several statements, schedules and notes. Any change in an accounting policy which has a significant effect should be disclosed.



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The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent it can be calculated. Where such amount is not ascertainable, wholly or in part, the fact should be disclosed.

If a change is made in the accounting policies which has no material effect on the financial statements for the current period but is expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted. Disclosure of accounting policies or of the changes is not a remedy for any wrong or inappropriate treatment of items in the accounts.

AS 3 – Cash Flow Statements

Applicability of AS 3 Cash Flow Statements

The applicability of Cash flow statement has been defined under the Companies Act, 2013. As per the definition in the act, a financial statement includes the following:

Balance sheet

Profit and loss account / Income and expenditure account

Cash flow statement

Statement of changes in equity

Explanatory notes Thus, cash flow statements are to be prepared by all companies but the act also specifies a certain category of companies which are exempted from preparing the same. Such companies are One Person Company (OPC), Small Company and Dormant Company.

◆ OPC means a company which has only one single person as its member.

◆ A Small Company is a private company with a maximum paid up capital of Rs. 50 lakhs and a maximum turnover of Rs. 2 crores.

◆ A Dormant Company is an inactive company which is formed for some future projects or only to hold an asset and has no significant transactions.

Cash and Cash Equivalents

Cash equivalents are held by an enterprise for meeting its short-term cash commitments instead of the purpose of investment or such other purposes. For investments to qualify as cash equivalents:

An investment must be easily convertible into cash and

Must be subject to a very low level of risk with respect to changes in its value Hence, an investment would qualify to be a cash equivalent only when such an investment has a short maturity of three months or less from its acquisition date. AS 3 Cash Flow Statements states that cash flows should exclude the movements between items which forms part of cash or cash



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equivalents as these are part of an enterprise's cash management rather than its operating, financing and investing activities. Cash management consists of the investment of excess cash in the cash equivalents.

Presentation of Cash Flow

A cash flow statement must depict the cash flows within the period classifying them as

Operating activities

Investing

Financing activities Companies must prepare and present cash flows from operating, financing as well as investing activities in such manner that is apt to their business. Grouping the activities provide information which enables the users in assessing the impact of such activities on the overall financial position of an enterprise and also assess the value of the cash and cash equivalents.

Operating Activities

Cash flows from operating activities predominantly result from the main revenue-generating activities of an enterprise. For example:

Cash received from the sale of goods and services

Cash received in form of fees, royalties, commissions and various other revenue forms

Cash paid to a supplier of goods and services

Investing Activities

Cash flows from investing activities represent outflows are made for resources intended for generating cash flows and future income. For instance:

Cash paid for acquiring fixed assets

Cash received from disposal of fixed assets (including intangibles)

Financing Activities

Financing activities are those which brings changes in composition and size of owner's capital and borrowings of an enterprise. For instance:

Cash received from issuing shares or other similar securities

Cash received from issuing loans, debentures, bonds, notes, and other short-term or long-term borrowings

Cash repaid on borrowings

Cash flow from operating activities



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A company must report its cash flows from operating activities using:

1. Direct method – Where all the major classes of cash receipts and cash payments are presented; or

2. Indirect method – Where the net profit or net loss is adjusted for:

Effects of transactions that are non-cash in nature such as depreciation, deferred taxes, provisions, etc.

Accruals or deferrals of future or past operating cash proceeds or payments

Any expense or income related to financing or investing cash flows

Cash Flow from Investing and Financing Activities

A company must separately record all the major classes of cash receipts and cash payments that arise from financing and investing activities, barring the ones which need to be reported on a net basis.

Cash flow on Net Basis

Cash flows which arise from below-mentioned operating, financing or investing activities might be reported on a net basis:

Proceeds and payments in cash on behalf of a client where cash flows reflect the activities of such client rather than that of the company itself

Proceeds and payments in cash for items where the amounts are huge, turnover is quick, and maturities are short.

Cash flows which arise from each of the below-mentioned activities of any financial enterprise might be reported on the net basis:

Proceeds and payments in cash for acceptances and repayments of deposits having fixed maturities

Placement and withdrawal of deposits from other financial enterprises

Loans and cash advances are given to clients/customers and repayment of such loans and advances

Foreign Currency Cash Flows

Cash flows that arise from the transactions in the foreign currencies must be recorded in the company's reporting currency by using the below method: Foreign currency amount * FX rates between the reporting and foreign currency at the date of cash flow. A rate which approximates actual rate might be used in case the outcome is largely the same as it would have been if the rate at the date of cash flows was used. The impact of changes in the exchange rate on cash and cash



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equivalents which is held in the foreign currencies must be reported as a distinct and separate part of the reconciliation of changes in the cash and cash equivalent during the relevant period.

Extraordinary Items, Dividends & Interests

The cash flows related to the extraordinary items must be categorized as arising from operating, financing or investing activities as apt and disclosed distinctly. Cash flows from dividends and interest received and paid must be separately disclosed. Cash flows which arise from dividends and interest received and paid in the case of financial enterprises must be categorized as cash flows from operating activities. For other enterprises, cash flows which arise from interest paid must be categorized as cash flows from the financing activities whereas dividends and interest received must be categorized as cash flows from the investing activities. Any dividends paid must be categorized as cash flows from the financing activities.

Taxes on Income

Cash flows which arise from taxes on income must be disclosed separately and must be reported as cash flows from the operating activities except if they could be explicitly related to investing and financing activities.

Acquisitions and Disposal of Business Units including Subsidiaries

The aggregate cash flows which arise from acquisition and from the disposal of business units including subsidiaries must be shown as investing activities and reported separately. Enterprises must present, in total, with respect to both the acquisitions and disposals of other business units including subsidiaries within the period the followings:

Aggregate purchase or disposal value

The amount of purchase or disposal value which is discharged by way of cash and cash equivalents

Non-Cash Transactions

Financing and investing transactions which don't require cash or cash equivalents mustn't be included in the cash flow statement. Those transactions must be presented elsewhere in financial statements in a way which gives relevant information about such financing and investing activities.

Disclosure

Enterprises must disclose, along with management commentary, the amount of substantial cash and cash equivalents held by an enterprise which isn't available for use. Commitments that may arise from discounted bills of exchange and other similar obligations that are undertaken by an enterprise are typically disclosed in financial statements by means of notes, even in case the probability of loss is remote.



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AS – 6 DEPRECIATION ACCOUNTING

Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, passage of time or obsolescence through technology and market changes.

Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined.

- The depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset.

Depreciable assets are assets which

[1] are expected to be used during more than one accounting period; and

[2] have a limited useful life; and

[3] are held by an enterprise for use in the production or supply or for administrative purposes.

Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost less the estimated residual value.

Useful life is the period over which a depreciable asset is expected to be used by the enterprise.

The useful life of a depreciable asset is shorter than its physical life.

There are two method of depreciation:

1] Straight Line Method (SLM)

2] Written Down Value Method (WDVM)

Note: A combination of more than one method may be used.

AS -10 Property, Plant and Equipment

The depreciation method selected should be applied consistently from period to period. The change in method of depreciation should be made only if;

- The adoption of the new method is required by statute; or
- For compliance with an accounting standard; or
- If it is considered that change would result in a more appropriate preparation of financial statement; or
- When there is change in method of depreciation, depreciation should be recalculated in accordance with the new method from the date of the assets coming into use. (i.e RETROSPECTIVELY)



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The deficiency or surplus arising from such recomputation should be adjusted in the year of change through profit and loss account.

Such change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

The useful lives of major depreciable assets may be reviewed periodically. Where there is a revision of the estimated useful life, the unamortised depreciable amount should be charged over the revised remaining useful life. (i.e. PROSPECTIVELY)⌘

Any addition or extension which becomes an integral part of the existing asset should be depreciated over the remaining useful life of that asset.⌘

The depreciation on such addition may also be applied at the rate applied to the existing asset. Where an addition or extension retains a separate identity and is capable of being used after the existing asset is disposed of, depreciation should be provided independently on the basis of estimate of its own useful life.

Where the historical cost of a depreciable asset has undergone a change due to increase or decrease in the long term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors, the depreciation on the revised unamortised depreciable amount should be provided prospectively over the residual useful life of the asset.⌘

This accounting standard is not applied on the following items.

- Forests and plantations
- Wasting assets
- Research and development expenditure
- Goodwill
- Live stock

Disclosure requirements

- 1] The historical cost
- 2] Total depreciation for each class charged during the period
- 3] The related accumulated depreciation
- 4] Depreciation method used (Accounting policy)
- 5] Depreciation rates if they are different from those prescribed by the statute governing the enterprise.



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AS-14 : Accounting for Amalgamations

AS-14 specifically deals with the accounting for amalgamations and the treatment of any resultant difference arising on amalgamation in the books of Transferee Company. Based on the proprietary of the transaction, the standard classifies an amalgamation as either–

- an amalgamation in the nature of merger, or
- an amalgamation in the nature of the purchase.

As per standard, an amalgamation should be considered to be an “amalgamation in the nature of merger” when all the following conditions are satisfied:

- All assets and liabilities of the transferor company become, after amalgamation, the assets, and liabilities of the transferee company.
- Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before amalgamation by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of amalgamation.
- The consideration is discharged by the transferee company wholly by the issue of equity shares only, except that cash may be paid in respect of any fractional shares.
- The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
- No adjustment is intended to be made to the book value 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.

Based on above classification, the standard prescribes two methods of “Accounting for Amalgamation” as below:

- **The Pooling Of Interests Method** – to be followed in case of “Amalgamation in the nature of merger” The object of Pooling of Interest Method is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies. Accordingly, the assets, liabilities, and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (except for adjustments required to have uniform accounting policies). The identity of the reserves of transferor company is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. 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



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transferor company is adjusted in Reserves in the financial statements of the transferee company.

- **The Purchase Method** – to be followed in case of “Amalgamation in the nature of purchase”. The object of the Purchase Method is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets. Consequently, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities 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 identity of the reserves, other than the statutory reserves, is not preserved. The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company. If the result of the computation is negative (i.e. consideration is higher than the net assets), the difference is debited to Goodwill arising on amalgamation and if the result of the computation is positive, the difference is credited to Capital Reserve. Since the Goodwill arising on amalgamation represents a payment made in anticipation of future income it should be amortized to income on a systematic basis over its useful life. However, the amortization period should not exceed five years unless a somewhat longer period can be justified.

However interesting part is that, the para-42 of the standard itself provide that “where the scheme of amalgamation sanctioned under a statute prescribes the treatment to be given to the reserves of the transferor company after amalgamation, the same should be followed” subject only to few additional disclosures in first financial statement of transferee company post amalgamation.

So, the standard itself allow the accounting treatment as prescribed in the scheme to override the treatment prescribed by the standard. Consequently, no uniformity is being maintained by various corporates in accounting for amalgamation that could have far-reaching implications on assets valuation and profitability of the merged entity for almost all time to come. As a result, net earnings, valuation, the amount of amortization, various profitability and assets cover ratios are permanently distorted.

Mentioned below are some of the real cases indicating how the provision of para-42 of a standard is being used by several corporates to account for amalgamation as it suits them whether the same is in compliance with basic principles of accounting or not.

A Ltd. (- a listed company)

Facts of the case – in brief:

Pursuant to the sanction of the Scheme, the Investment Division of the company has been transferred to D Ltd. at book values and the book value of net assets of the Investment Division of around Rs.20 crore has been debited to “Amalgamation Reserve Account”.



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After demerger of Investment Division referred to above, B LTD. and C LTD. (Transferor Companies) have been merged with the company, as a going concern.

[Why demerger of Investment Division first? – Investment Division comprised of only Equity shares of C LTD. i.e. around 10% of total no. of Equity shares of C LTD. If it would not have been transferred by way of demerger, it would have been canceled in course of merger of C LTD. with the company]

In terms of the Scheme, the company recorded all the assets including investments and liabilities appearing in the books of account of C LTD. and B LTD. and transferred to and vested in the company at their fair values as on appointed date.

The difference of around Rs.100 crore between the fair value of net assets of C LTD. and B LTD. transferred to the company, and the value of equity shares allotted by the company for discharging purchase consideration has been credited to Amalgamation Reserve Account.

In terms of the Scheme, the balance of Rs.80 crore remaining in the Amalgamation Reserve Account (after adjusting debit made on demerger of Investment Division) has been transferred to Reserve for Amortisation of Brand Account. Further, out of the balance in Reserve for Amortisation of Brand Account, an amount equal to the annual amortization of brand (that was already existing in the books of transferee company) will be credited to the Profit and Loss Account each year so that overall depreciation/amortization gets reduced to that extent.

If the company would have followed the Purchase Method as per the AS-14, the resultant difference of around Rs.100 crores would have been debited to "Capital Reserve A/C" instead of treatment given by the company to the Revenue Reserve Account & Profit & Loss Account.

Another impact of the above treatment given is as follow:-

- General Reserve is overstated on demerger of Investment division by Rs.20 crores forever
- Net worth is overstated by around Rs.100 crores
- Profit (before tax) for the year is overstated by Rs.6 crores (around 2.4%)

(For future years it would be Rs.12 crores, since in current year impact for ½ year only)

As a result:

- Book value per share is higher by Rs.20/share i.e. by almost 10% of BV
- EPS for the current year is higher by around Rs.1.20
- P/E Multiple lower by around 0.3 times as against present 9.1 times
- ROCE higher by 0.7%
- Borrowing capacity higher by Rs.200 crores considering a debt-equity ratio of 1:2, etc...



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So, effectively capital profit generated through book entry on amalgamation (not a cash profit) is turned into Revenue Profit, till evaluation of the reserve is fully reversed in future.

It is observed in several other cases that

- Revaluation is used to write off actual cash losses in the form of bad debts, slow moving inventory etc. without routing the same through profit and loss account.
- The resultant difference on the amalgamation between the fair value of assets & face value of shares issued is credited to “Securities Premium A/C” instead of “Capital Reserve A/C” giving an impression that the difference was actually realized in cash.
- Also, where the consideration paid is higher than the Fair Value of the Net Assets acquired, instead of debiting the difference to the Goodwill A/C & amortising the same to income over the years in accordance with AS-14, companies are debiting difference to the brought forward balance in Capital Reserve Account, Securities Premium Account or Revenue Reserve Account thereby avoiding the hit of amortisation of “Goodwill” on current year as well as on future year profitability.

AS 21 Consolidated Financial Statements

Applicability of AS 21 Consolidated Financial Statements

This standard must be applied when accounting for investment in subsidiaries in a separate financial statement of the parent.

It is to be noted that while preparing a consolidated financial statement, other standards also stay relevant in a similar manner as for standalone statements.

This accounting standard doesn't deal with:

Accounting methods for amalgamations and effects on consolidation, which includes goodwill which arises on an amalgamation

Accounting for investments in JVs (joint ventures)

Accounting for investments in associates

Presentation of Consolidated Financial Statements

A parent company presenting its consolidated financial statements must present these statements along with its standalone financial statements.

The users of financial statements of a parent company are typically concerned with and are required to be educated about, the results of operations and financial position of not only the company itself but also of that group together.

This requirement is served by offering the users of financial statements –

Standalone financial statements of a parent; and



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Consolidated financial statements that provide financial information about the business group as that of a lone enterprise without respect to the legal restrictions of the distinct legal entities

Scope of Consolidated Financial Statements

A parent company that presents its consolidated financial statements must consolidate all of its subsidiaries, foreign as well as domestic.

Where a company doesn't have any subsidiary, however, has associates and/or joint ventures such company also needs to prepare consolidated financial statements as per Accounting Standard 23 – Accounting for Associates in Consolidated Financial Statements and Accounting Standard 27 – Financial Reporting of Interests in JVs respectively.

Exclusion of Subsidiaries

A Subsidiary must be excluded from the consolidation when:

control is planned to be temporary since the subsidiary was taken over and was held exclusively for disposal in the near future, or

the subsidiary is operating under severe long-standing restrictions that considerably impair the subsidiary's ability to transfer funds to its parent

In a consolidated financial statement, investments in such subsidiaries must be accounted for as per AS 13 – Accounting for Investments.

Reasons for which a subsidiary isn't included in the consolidation must be disclosed in such consolidated financial statements.

Consolidation Procedures

While preparing a consolidated financial statement, the parent company's financial statements and its subsidiaries must be combined line by line by totaling together similar items such as assets, liabilities, income, and expenses.

For consolidating financial statements in a way to present financial information about a group as that of a lone enterprise, the below-motined steps must be taken:

Eliminate the cost to the parent of its investment made in each of its subsidiaries and such parent's equity portion of each of its subsidiaries, at the date when the investment in such subsidiaries are made any additional cost to the parent company of the investment in the subsidiary over the parent company's share of the equity of subsidiary, at the date on which the investment in such subsidiary is done, must be shown as goodwill for recognizing as the asset in its consolidated financial statements when the cost to the parent of the investment in the subsidiary is lower than the parent company's share of the equity of subsidiary, a date on which the investment in such subsidiary is done, the difference must be treated as the capital reserve in its consolidated financial statements a portion of minority interests in net income of the consolidated subsidiary for reporting period must be recognized and adjusted against income of



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the group for arriving at the net income which is attributable to owners of such parent company; and a portion of minority interests in net assets of the consolidated subsidiaries must be recognized and provided for in consolidated balance sheet distinctly from the equity and liabilities of the parent company.

Minority interests in net assets comprise of: amount of equity which is attributable to the minorities at the date on which such investment in the subsidiary is done; and minorities' share of the movements in equity from the date the relationship of parent-subsidiary came in to force

Where carrying investment amount in a subsidiary is different from the cost, such carrying amount is to be considered for the above calculations.

Accounting for Investments in the Subsidiaries in Separate Financial Statement of the Parent

In a parent company's separate financial statements, the investments made in subsidiaries must be accounted for as per AS 13 – Accounting for Investments.

Disclosures in the Financial Statements

Following disclosures must be made w.r.t. AS 21 Consolidated Financial Statements:

in the consolidated financial statements the list of all the subsidiaries of the parent company which includes the name, country of residence or incorporation, the share of ownership interest and, in case different, the share of voting power held

In case the consolidation of a particular subsidiary hasn't been made according to the grounds permissible in the accounting standard, reasons for which such subsidiary isn't included in the consolidation must be disclosed in such consolidated financial statements in the consolidated financial statements, where valid: type of relationship between a parent and its subsidiary, whether direct control or indirect control through the subsidiaries effect of acquisition and disposal of the subsidiaries on the financial position at the date of reporting results for the reporting period and on corresponding amounts for the preceding period; and Name of the subsidiary(s) of which reporting date(s) is different

Accounting Standard 29 (AS 29) – Provisions, Contingent Liabilities and Contingent Assets

Introduction

Accounting Standard 29 (AS 29), issued by the Institute of Chartered Accountants of India (ICAI), deals with the recognition, measurement, and disclosure of provisions, contingent liabilities, and contingent assets. The standard ensures that financial statements present a fair and consistent view of the obligations and possible gains or losses that may arise from uncertain future events.

Objective

The objective of AS 29 is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent items. It aims to make sure that sufficient information is disclosed in the financial statements to help users understand their nature, timing, and amount.



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Scope

AS 29 applies to all enterprises in accounting for provisions, contingent liabilities, and contingent assets, except those arising from:

Financial instruments covered under other accounting standards,

Executory contracts (unless they are onerous),

Insurance enterprises from policyholder contracts, and

Items covered by other specific accounting standards (like AS 15 for employee benefits).

Definitions

Provision: A liability of uncertain timing or amount.

Liability: A present obligation arising from past events, the settlement of which is expected to result in an outflow of resources.

Contingent Liability: A possible obligation that arises from past events but whose existence will be confirmed only by the occurrence or non-occurrence of uncertain future events.

Contingent Asset: A possible asset that arises from past events, the existence of which will be confirmed only by the occurrence or non-occurrence of uncertain future events not wholly within the control of the enterprise.

Recognition of a Provision

A provision should be recognized when all the following conditions are met:

1. The enterprise has a present obligation (legal or constructive) as a result of a past event.
2. It is probable (more likely than not) that an outflow of resources will be required to settle the obligation.
3. A reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

Measurement of Provisions

The amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The estimate should consider risks and uncertainties and should not be overstated. Future events that may affect the amount of the obligation should be reflected in the provision where there is sufficient evidence.

Reimbursement

If some or all of the expenditure required to settle a provision is expected to be reimbursed by another party (for example, through an insurance claim), the reimbursement should be



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recognized as a separate asset only when it is virtually certain that reimbursement will be received if the obligation is settled. The amount recognized for reimbursement should not exceed the amount of the provision.

Review and Reversal of Provisions

Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources will be required, the provision should be reversed.

Use of Provisions

A provision should be used only for expenditures for which it was originally recognized. It should not be used to adjust profits or losses for other unrelated transactions.

Contingent Liabilities

A contingent liability should not be recognized in the financial statements. Instead, it should be disclosed unless the possibility of an outflow of resources is remote. Disclosure should include:

- A brief description of the nature of the contingent liability,
- An estimate of its financial effect,
- An indication of the uncertainties relating to the amount or timing of any outflow, and
- The possibility of any reimbursement.

Contingent Assets

A contingent asset should not be recognized in the financial statements since this may result in recognizing income that may never be realized. However, when the realization of income is virtually certain, the related asset is no longer contingent and should be recognized. Contingent assets should be disclosed when an inflow of economic benefits is probable.

Onerous Contracts

An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received. A provision should be recognized for the present obligation under an onerous contract.

Restructuring

A provision for restructuring costs should be recognized only when:

1. There is a detailed formal plan for the restructuring, and
2. The enterprise has raised a valid expectation among those affected that it will carry out the restructuring.



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Restructuring provisions should include only direct expenditures arising from the restructuring, not those related to the ongoing activities of the enterprise.

Disclosure Requirements

An enterprise should disclose:

The carrying amount of each class of provision at the beginning and end of the period,

Additional provisions made during the period,

Amounts used or reversed during the period,

A brief description of the nature of the obligation,

Expected timing of outflows, and

Major uncertainties involved.

Importance of AS 29

AS 29 ensures that enterprises recognize obligations and possible assets in a transparent, consistent, and prudent manner. It prevents the creation of hidden reserves or overstatement of assets and helps users assess the financial position more accurately.

Scope and Compliance with Accounting Standards

Accounting Standards issued by the Accounting Standard Board (ASB) of ICAI are of such nature that they do not override the local regulations which govern the preparation and presentation of financial statements and these standards shall apply to items which are material.

While preparing financial statements it is management's responsibility to prepare and present the financial statements in compliance with the relevant applicable accounting standards. In the event of any deviation, it is the responsibility of the auditor to provide adequate disclosures in their audit report to make the users of financial statements aware about the matter.

Formulation of Accounting Standards in India

Since 1977 after the government passed a statute, the Accounting Standard Board (ASB) a committee of the ICAI has been responsible for the formulation of accounting standards in India. Let us take a brief look at the functioning of the ASB and the procedure behind the formulation of accounting standards in India.

Accounting Standard Board

ICAI is the highest accounting body in the country. And the ASB is a committee of the ICAI. But to ensure maximum transparency and independence, the ASB is a completely independent body.

The ASB formulates all the accounting standards for the Indian companies. This process is fully transparent, very thorough and completely independent of any government involvement. While



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framing the standards the ASB will try and incorporate the IFRS and its principles in the Indian standards. While India does not plan to adopt the IFRS, this process will help the convergence of the two standards. So the ASB will modify the IFRS to suit the laws, customs and common usage in the country.

The ASB is composed of various members. There are representatives of industries like the FICCI and ASSOCHAM. There are also certain government officials, a few academics, and regulators from various departments. The idea is to make the ASB as inclusive and representative as possible.

Procedure for Formulation of Accounting Standards

First, the ASB will identify areas where the formulation of accounting standards may be needed

Then the ASB will constitute study groups and panels to discuss and study the topic at hand. Such panels will prepare a draft of the standards. The draft normally includes the definition of important terms, the objective of the standard, its scope, measurement principles and the representation of said data in the financial statements.

The ASB then carries out deliberations of the said draft of the standard. If necessary changes and revisions are made.

Then this preliminary draft is circulated to all concerned authorities. This will generally include the members of the ICAI, and any other concerned authority like the Department of Company Affairs (DCA), the SEBI, the CBDT, Standing Conference of Public Enterprises (SCPE), Comptroller and Auditor General of India etc. These members and departments are invited to give their comments.

Then the ASB arranges meetings with these representatives to discuss their views and concerns about the draft and its provisions

The exposure draft is then finalized and presented to the public for their review and comments

The comments by the public on the exposure draft will be reviewed. Then a final draft will be prepared for the review and consideration of the ICAI

The Council of the ICAI will then review and consider the final draft of the standard. If necessary they may suggest a few modifications.

Finally, the Accounting Standard is issued. In the case of standard for non-corporate entities, the ICAI will issue the standard. And if the relevant subject relates to a corporate entity the Central Government will issue the standard.

Advantages of Accounting Standards

1. Comparison between Two Organizations

The reports of the businesses follow the same format, so after reviewing the financial statements of each business, the users of the financial statements can make judgments based on the



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comparison. It won't be easy to compare the two firms if they employ distinct accounting procedures. As a result, the accounting standard allows for comparison whenever necessary. The standards are helpful in both intra-firm and inter-firm comparisons of operations and positions based on the accounting reports presented.

2. Uniformity in Accounting

Accounting standards provide rules and regulations that must be followed at all costs by the company while documenting a transaction. They use a common format for financial statements and separate values for each organization to ensure consistency throughout the accounting process. It becomes easier for stakeholders to analyze the reports as they are based on accounting standards that follow the presentation format without confusion. Also, these reduce the number of alternative practices adopted in for accounting process.

3. Increased Financial Statement Dependability

There is a standard structure for valuing financial statements, the user, external or internal, completely depends on this financial statement to make any choice. The notes to account also detail a firm's many contingencies and the working notes of the headings, making the system more visible and, as a result, adopting the trait of reliability.

4. Protect Fraud and Manipulation

As previously said, there is a fixed structure for the financial statement that no one can change or conduct fraud throughout the entire accounting process. As a result, the accounting standard has already decreased the possibility of manipulation and fraud while making the accounting system more effective and dependable.

5. Assist Auditors

The auditor's job is to determine whether or not the financial statements prepared by corporations adhere to the principles and norms established by accounting standards, because the accounting standard has already laid down the rules, procedures, and structure, it makes it easier for auditors to assess the financial statements. The quality of financial records improves as they become easily understandable.

6. Assessing Management Accountability

Accounting standards help determine managerial accountability by measuring the managerial component of the organization. It also assesses management performance and the capacity to increase profitability, preserve an entity's solvency, and fulfill other management obligations. Good management will be consistent in their procedures and rules to avoid confusing the user's thoughts.



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7. Helps Resolve Conflicts

These standards cater to the facility to reduce conflict among various users of financial statements or information based on their interests. With this, these standards help in the assessment of management. In the absence of these, a proper analysis of the performance of the business cannot be done, and so of the management.

Disadvantages of Accounting Standards

1. Rigid and Inflexible

Policies have already been established and must be followed by the entity at all costs; hence, making the financial statement rigid means that no one may modify it to their liking. The format has already been established, and it must be followed. As a result, it lacks adaptability.

2. Compromise the Standard

Sometimes, the accounting standard is compromised even in the presence of many regulations due to lobbying or government pressure on accountable institutions. This is because the government or a high authority only wants to grant benefits to large, powerful corporations or if they have some personal interest. As a result, standards are undermined and cannot be depended on fully, which is a very important disadvantage.

3. Selecting an Alternative is Difficult

There are several techniques for recording transactions in the books of account, it might be difficult to decide which method to use and which not to, which further makes it difficult to access when it comes to qualitative analysis. Furthermore, due to limitations in the method of choice, the entity may be forced to abandon its most convenient way, losing quality and efficiency, in favor of a secondary method of documenting transactions.

4. Time Consumption is High

The entire process of adhering to accounting standards takes time since each note and schedule must be prepared by the user and go through a lengthy, time-consuming process. Many a time, it increases the chances of mistakes. The examination becomes a necessity which also becomes an obligation and time-consuming, with repetition of the same task. The work has to be done twice, once the execution and the second that is its examination for correctness.

5. Scope is Limited

Accounting standards must be established following the rules in place in the country at the time keeping in the interest of local functionaries. They are unable to override the law. As a result, the scope for creating policies is limited, which becomes a hurdle to improvement.



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1. Raj Motors Ltd was incorporated contributed capital of Rs. 5,00,000. The objective of investment is subject of buying and selling two wheelers. The dealer price of the two wheeler was Rs.1,00,000 on 1.1.2020 and 1,25,000 on 1.1.2021. The general price level increased by 15% during 2021. The company purchased 5 two wheelers on 1.1.2020 and sold three two wheelers during the year at an average price of Rs. 1,70,000 Show how the financial statements will be prepared under i) HCA ii. CPPA and iii.CCA

Solution:

Income statement of Raj Motors as on 31.12.2021

Particulars	HCA	CPPA	CCA
Sales Revenue	5,10,000	5,10,000	5,10,000
Less cost of goods sold	3,00,000	3,45,000	3,75,000
Operating profit	2,10,000	1,65,000	1,35,000
Add gain	-	45,000	75,000
Realised income	2,10,000	2,10,000	2,10,000
Add unrealised holding gain	-	30,000	50,000
Net income	2,10,000	2,40,000	2,60,000

Balance sheet of Raj Motors Ltd as on 31.12.2021

Assets	HCA	CPPA	CCA
Cash	5,10,000	5,10,000	5,10,000
Stock	2,00,000	2,30,000	2,50,000
	7,10,000	7,40,000	7,60,000
Liabilities	-		
Capital	5,00,000	5,00,000	5,00,000
Operating profits	2,10,000	1,65,000	1,35,000
Realised holdings		45,000	75,000
Unrealised holdings		30,000	50,000
	7,10,000	7,40,000	7,60,000



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2. From the following details calculate the net monetary gain or loss for the accounting year ending 31st March 2023.

Net monetary assets as on 1.4.2022 Rs.5,000

Net monetary assets as on 31.3.2023 Rs.20,500

Transactions for the year are as follows; Rs.

1. Cash sales	20,000
2. Credit sales	25,000
3. Credit purchases	10,000
4. Cash purchases	8,000
5. Wages paid	6,000
6. Administrative expenses	1,500
7. Interest paid on 31.3.2023	4,000

Solution:

Particulars	HCA	CF	CPP
Monetary assets on 1.4.22	5,000	200/100	10,000
Add: Credit & cash sales	45,000	200/150	60,000
Total A	50,000		70,000
Less: Credit & Cash purchase	18,000	200/150	24,000
Wages	6,000	200/150	8,000
Administrative expenses	1,500	200/150	2,000
Interest paid	4,000	200/200	4,000
(Total B)	29,500		38,000
Net monetary assets on 31.12.23	20,500		32,000
Less: Monetary on HCA			20,500
Net monetary loss			12,500