STUDY MATERIAL FOR B.COM AND BANKING FINANCE

CORPORATE ACCOUNTING II

SEMESTER – IV

ACADEMIC YEAR 2024-25

PREPARED BY

COMMERCE DEPARTMENT

INDEX

UNIT - I

AMALGAMATION ABSORPTION AND EXTERNAL RECONSTRUCTION

AMALGAMATION

When two or more existing companies combine together to form a new company, it is amalgamation. All the combining companies are liquidated. A new company is floated to take over their business. Real life example: Hero + Honda = Herohonda.

ABSORPTION

When one existing company takes over the business of one or more existing companies, it is absorption. The companies whose business is taken over are liquidated. No new company is formed. Real life example: hutch + Vodafone = Vodafone.

EXTERNAL RECONSTRUCTION

When an existing company is liquidated and a new company is formed with the same shareholders to take over its business, it is external reconstruction. Sick companies with accumulated losses usually undergo such reconstruction. Real life example: Goldstar =LG

ACCOUNTING PROCEDURE FOR EXTERNAL RECONSTRUCTION

The accounting procedure in case of external reconstruction is the same as in case of amalgamation or absorption in the nature of purchase. However, there are no different kinds in this case, unlike in case of amalgamation or absorption, which were of two kinds viz, in nature of merger and in the nature of purchase. The steps in accounting for external reconstruction are outlined below:

1. Calculation of purchase consideration:
2. Ascertainment of discharge of purchase consideration.
3. Closing the books of Vendor Company
4. Passing /opening entries in the books of purchasing company

I. Purchase Consideration:

Purchase Consideration refers to the consideration payable by the purchasing company to the vendor company for taking over the assets and liabilities of Vendor Company. Accounting Standard – 14 defines the term purchase consideration as the "aggregate of the shares and other securities issued and the payment made in the form of ach or other assets by the transferee company to the shareholders of the transferor company". Although, purchase consideration refers to total payment made by purchasing company to the shareholders of Vendor Company, its calculation could be in different methods, as explained below: a. Lump sum method b. Net payments method c. Net Assets Method d. Other basis for purchase consideration

a).Lump sum Method: strictly speaking, this is not a method. Where the purchase consideration amount is mentioned in the agreement directly, it is called Lump Sum consideration. This method, does not involve any calculation regarding purchase consideration.

b).Net Payments Method: under this method, the purchase consideration will be the total of payments made (in any form) by purchasing company to vendor company, on any basis. Generally, purchasing company decides the payment to be made towards liabilities of Vendor Company, not taken over and towards expenses. The total of such payment s will be the purchase consideration.

c) Net Assets Method: under this method, purchase consideration will be the excess of value of assets taken over by the purchasing company, over the value of liabilities taken over. that is, under this method, the purchase consideration will be calculated using the formula Purchase Consideration = Assets taken over (at taken over values) - Liabilities taken over (at taken over value)

d) Intrinsic value method: Under this method, the purchase consideration is ascertained on the basis of ration in which shares of the purchasing company are exchanged with those of the selling company. The exchange ratio is generally, determined on the basis of intrinsic values of the respective companies' shares.

1. The company B Takes over the business of company A. the value agred for various assets is goodwill Rs.22000. land and buildings Rs.25000. plant and machinery Rs. 24000.stock Rs.13,000.Debtors Rs.8000. B company does not take over cash but agrees to assume the liability of sundry creditors at Rs.5000. calculate purchase consideration.

Solution

Net asset method

Particulars	Rs
Goodwill	22000
Land and building	25000
Plant and machinery	24000
Stock	13000
Debtors	8000
Total assets	92000
Less agreed value of liabilities-creditors	5000
Purchase consideration	87000

2. The balance sheet of A and B Ltd as on 31.3.2005

Liabilities	A Ltd	B Ltd	Assets	A Ltd	B Ltd
Sharecapital(50)	50000	40000	Goodwill	5000	2000
General reserve	20000	--	Buildings	17000	10000
p/l a/c	3000	--	Machinery	24000	16000
creditors	4000	8000	Vehicles	5000	7500
bank overdraft	4000	8000	Stock	10000	7500
			Debtors	12000	7000
			Cash	8000	300
			p/l a/c	--	5700
	81000	56000		81000	56000

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

A Ltd- provide 5% on debtors, write off Rs.400 from stock and 33 1/3 from machinery

B Ltd- Eliminate its goodwill and p/l a/c, write off Rs. 1000 on debtors as bad and provide 5% on debtors, write off 10% of machinery and Rs.1400 from stock.

Compute purchase consideration.

Solution

A Ltd

Particulars	Rs
Goodwill	5000
building	17000
machinery24000-8000 -33 1/3 on 24000	16000
vehicles	5000
Stock 10000-400	9600
Debtors 12000-600 - 12000x5%	11400
cash	8000
Total assets	72000
Less agreed value of liabilities-creditors 4000	
Bank overdraft 4000	8000
Purchase consideration	64000

B Ltd

Particulars	Rs
building	10000
machinery 16000-1600	14400
vehicles	7500
Stock 7500-1400	6100
Debtors 7000-1000=6000-300 - 6000x5%	5700
cash	300
Total assets	44000
Less agreed value of liabilities-creditors 8000	
Bank overdraft 8000	16000
Purchase consideration	28000

3. Give journal in the books of a purchasing company. A company purchased assets of Rs.3,50,000 and took the liabilities of Rs. 30,000. It agreed to pay the purchase price Rs. 3,30,000 by issuing debentures of Rs.100 each at a premium of 10%.

Particulars	**Debit**	**Credit**
Business purchase a/c Dr	3,30,000	
To liquidators of vendor company a/c		3,30,000
(being business purchased)		
Assests a/c Dr	3,50,000	
Goodwill a/c Dr (b.f)	10,000	
To liabilities a/c		30,000
To business purchase a/c		3,30,000
(being assets and liabilities taken over)		
Liquidator of vendor company a/c Dr	3,30,000	
To debentures a/c		3,00,000
To debenture premium a/c		30,000

Number of debentures= total amount of Purchase Consideration/ issue price

=330000/100+10=3000 debentures

3000 at 100 debentures = 300000

3000 at 10 debenture premium =30000----------3,30,000.

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

Solution

Number of shares= offered shares of purchase consideration/accepted shares of vendor company x total shares of vendor company

= 3/5x1,00,000=60,000 shares

Total amounts of purchase consideration

60000 shares at 15= 9,00,000

60000 at 10= 600000 share capital

60000 at 5= 3,00,000 securities premium

5. Compute purchase consideration.

1. A cash payment equivalent to Rs.3 for every Rs.10 share in G Ltd(number of shares 1,20,000)

2. The issued of 90,000 shares of Rs.10 fully paid in W ltd. having an agreed value of Rs.12 per share.

3. The issued of 5% debentures of W Ltd for 6% debentures of the G Ltd(Rs.1,00,000)at a premium of 20%.

Solution

By cash Rs.3 for 1,20,000 shares = 3,60,000

By shares 90,000 shares at 12 =10,80,000

Purchase consideration = 14,40,000

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

Solution

Assets- liabilities

Total capital of partners10000+6000+5000=21000

Less increase in value of liabilities 8000

Decrease in value of assets 1000—9000

Purchase consideration 12000

7. The following is the balance sheet of X Ltd, as on 31.3.2008

Liabilities	Rs	Assets	Rs
2,00,000shares of Rs.10 each	20,00,000	Land and building	10,00,000
General reserve	2,50,000	Plant &machinery	15,00,000
Dividend equalisation reserve	2,00,000	Furniture	25,000
p/l a/c	51,000	Stock	6,00,000
12% debentures	10,00,000	Work-in-progress	3,00,000
Sundry creditors	3,00,000	Sundry debtors	2,50,000
		Cash at bank	1,26,000
	38,01,000		38,01,000

The company was absorbed by A ltd on the above date. The consideration for the absorption is the discharge of the debentures at a premium of 5% taking over the liability in respect of sundry creditors and a payment of Rs.7 in cash and one share of Rs.5 in A Ltd at the market value of Rs. 8 per share for every share X ltd. The cost of liquidation of Rs.15,000 is to be met by the purchasing company.

Close the books of X Ltd and pass journal entries in the books of A Ltd.

Solution

In the books of X Ltd (selling company)

Particulars	Debit	Credit
Realisation a/c Dr To sundry assets a/c Being the assets transferred to realisation	38,01,000	 38,01,000
Sundry creditors a/c Dr To realisation a/c Being the liability taken over transfer to realisation a/c	3,00,000	 3,00,000
A Ltd a/c Dr To realisation a/c Being the purchase consideration due	40,50,000	 40,50,000
Bank a/c Dr Shares in A Ltd a/c Dr To A Ltd a/c Being the purchase consideration received	24,50,000 16,00,000	 40,50,000
Debenture a/c Dr Realisation a/c Dr To debenture holders a/c Being the debenture with 5% premium transferred to debenture holder	10,00,000 50,000	 10,50,000
Debenture holder a/c DR TO Bank a/c Being the debenture holder paid	10,50,000	 10,50,000
Share capital a/c Dr General reserve a/c DR Dividend Equalisation reserve a/c Dr p/l a/c Dr TO Equity shareholders a/c Being the share capital and accumulated profit transferred	20,00,000 2,50,000 2,00,000 51,000	 25,01,000
Realisation a/c Dr TO Equity shareholders a/c Being the profit transferred to realisation	4,99,000	 4,99,000
Equity shareholders a/c Dr To bank a/c To shares in A Ltd a/c Being final settlement made	30,00,000	 14,00,000 16,00,000

Realisation a/c

Particulars	Rs	Particulars	Rs
To sundry assets To debenture holder premium To equity shareholders profit	38,01,000 50,000 4,99,000	By sundry creditors By A Ltd	3,00,000 40,50,000
	43,50,000		43,50,000

A Ltd a/c

Particulars	Rs	Particulars	Rs
To Realisation a/c	40,50,000	By Bank By shares A Ltd	24,50,000 16,00,000
	40,50,000		40,50,000

Equity shareholders a/c

Particulars	Rs	Particulars	Rs
To Bank 200000X7 To shares A Ltd	14,00,000 16,00,000	Share capital a/c Dr General reserve a/c DR Dividend Equalisation reserve a/c Dr p/l a/c Dr	20,00,000 2,50,000 2,00,000 51,000
	30,00,000		30,00,000

Bank a/c

Particulars	Rs	Particulars	Rs
To A Ltd a/c	24,50,000	By Debenture holders By equity shareholder	10,50,000 14,00,000
	24,50,000		24,50,000

In the books of A Ltd purchasing company

Particulars	Debit	Credit
Business purchase a/c Dr To liquidators of X Ltd Being the purchase consideration due	40,50,000	 40,50,000
Land and building a/c Dr Plant &machinery a/c Dr Furniture a/c Dr Stock a/c Dr Work-in-progress a/c Dr Sundry debtors a/c Dr Cash at bank a/c Dr Goodwill a/c Dr To sundry creditors a/c To business purchase a/c Being the assets and liabilities taken over	10,00,000 15,00,000 25,000 6,00,000 3,00,000 2,50,000 1,26,000 5,49,000	 3,00,000 40,50,000
Liquidators of X Ltd a/c Dr To bank a/c To share capital 200000x5 To share premium a/c 200000x3 Being the purchase consideration paid	40,50,000	 24,50,000 10,00,000 6,00,000
Goodwill a/c Dr To bank a/ c Being the liquidation expensed paid	15,000	 15,000

Purchase consideration

For shareholders cash 200000x7=1400000

Equity share 200000x1x8=1600000

For debenture holders cash 1000000x105/100=1050000

Purchase consideration 40,50,000

8. Following is the balance sheet of X company as on 30.6.2004

Liabilities	Rs	Assets	Rs
12,000 shares of Rs.500 each	60,00,000	Land and building	27,20,000
reserve fund	6,50,000	Plant &machinery	30,00,000
Insurance fund	1,30,000	Furniture	1,00,000
p/l a/c	20,000	Patent &trademark	4,00,000
2,600 debentures of Rs.500 each	13,00,000	Stock	20,00,000
Workman saving bank	4,00,000	Sundry debtors	6,00,000
Sundry creditors	5,00,000	Cash at bank	1,80,000
	38,01,000		90,00,000

Y company Ltd agreed to take over x Ltd on the following basis

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

2. Payment of cash at Rs.550 for every debenture holder in full discharge of debentures.

3. Exchange of 4 shares of Y company on Rs.75 each (quoted in the market at Rs. 140 each) for every share in x company Ltd.

Show the necessary ledger accounts in X Ltd.

Solution

Realisation a/c

Particulars	Rs	Particulars	Rs
To Land and building	27,20,000	By sundry creditors	5,00,000
To Plant &machinery	30,00,000	By workman saving bank	4,00,000
To Furniture	1,00,000		
To Patent &trademark	4,00,000	By Y Ltd purchase consideration	61,10,000
To Stock	20,00,000		
To Sundry debtors	6,00,000	By equity shareholders - loss	21,20,000
To Cash at bank	1,80,000		
To debenture holders excess payment	1,30,000		
	91,300,000		91,30,000

Bank a/c

Particulars	Rs	Particulars	Rs
To Y Ltd a/c	25,10,000	By debenture holders By equity share holders (b.f)	14,30,000 10,80,000
	25,10,00		25,10,000

Equity shareholders a/c

Particulars	Rs	Particulars	Rs
To realisation loss To shares in Y co. To bank a/c	21,20,000 36,00,000 10,80,000	By equity share capital By reserve fund By insurance fund By profit & loss a/c	60,00,000 6,50,000 1,30,000 20,000
	68,00,000		68,00,000

Debenture holder a/c

Particulars	Rs	Particulars	Rs
To bank a/c	14,30,000	By debenture a/c By realisation excess payment	13,00,000 1,30,000
	14,30,000		14,30,000

Y company

Particulars	Rs	Particulars	Rs
To realisation a/c	61,10,000	By bank a/c By shares in y ltd	25,10,000 1,30,000
	61,10,000		61,10,000

Shares in Y company a/c

Particulars	Rs	Particulars	Rs
To Y company	36,00,000	By equity shareholders	36,00,000
	36,00,000		36,00,000

Purchase consideration

For share holders cash 12000x90= 10,80,000

Shares 12000 x4x75= 36,00,000

For debentures cash 2600x550=14,30,000

Purchase consideration 61,10,000

9. Kala Ltd balance sheet showed the following position on 31.3.2008

Liabilities	Rs	Assets	Rs
10,000 equity shares of Rs 100 each	10,00,000	Fixed asset .	8,00,000
Capital reserve	2,00,000	Current assets	4,00,000
Bank loan	2,00,000	Bank	2,00,000
Trade creditors	3,00,000	Profit & loss a/c	3,00,000
	17,00,000		17,00,000

Mala Ltd was incorporated to take the fixed assets and 60% of the current assets at an agreed value of Rs. 9,00,000 to be paid as Rs. 7,40,000 in equity shares of Rs. 10 each and the balance in 9% debentures. The debentures were accepted by bank in settlement of loan. Remaining current assets realised Rs.90,000 After meeting Rs.20,000 expenses of liquidation all the remaining cash was paid to the creditors in full settlement .

Give journal entries of both company and mala company balance sheet also.

Solution

Books of Kala Ltd - selling company

Particulars	Debit	Credit
Realisation a/c Dr To Fixed assets a/c To current assets a/c Being transfer of assets to realisation except bank	12,00,000	 8,00,000 4,00,000
Mala company a/c Dr To realisation a/c Being purchase price receivable	9,00,000	 9,00,000
Shares in mala company a/c Dr Debentures in Mala company a/c Dr To Mala co. a/c Being purchased price received in shares and debentures	7,40,000 1,60,000	 9,00,000
Bank a/c Dr To Realisation a/c Being amount realised for 40% of the current assets not taken over by Mal co.	90,000	 90,000
Bank loan a/c Dr To debentures in Mala co. To realisation a/c Being payment of liquidation expenses	2,00,000	 1,60,000 40,000
Realisation a/c Dr To bank a/c Being payment of liquidation expenses	20,000	 20,000
Trade creditors a/c Dr To bank a/c To realisation a/c Being settlement of creditors by payment of all the cash available	3,00,000	 2,70,000 30,000
Equity share capital a/c Dr Capital reserve a/c Dr TO Equity share holders a/c Being transfer of capital and reserve	10,00,000 2,00,000	 12,00,000
Equity shareholders a/c Dr To profit and loss a/c Being transfer of accumulated loss	3,00,000	 3,00,000
Shareholders a/c Dr To realisation a/c Being loss on realisation	1,60,000	 1,60,000

Bank a/c

Particulars	Rs	Particulars	Rs
To balance b/d To realisation	200000 90000	By realisation By creditors b.f	20000 270000
	290000		290000

Shareholders

Particulars	Rs	Particulars	Rs
To p/l a/c To realisation To shares in mala	3,00,000 1,60,000 7,40,000	By share capital By capital reserve	10,00,000 2,00,000
	12,00,000		12,00,000

Realisation a/c

Particulars	Rs	Particulars	Rs
To fixed assets To current assets To bank ex	8,00,000 4,00,000 20,000	By mala ltd By bank 40% By bank loan By creditors By shareholders loss	9,00,000 90,000 40000 30000 160000
	12,20,000		12,00,000

In the books of Mala Ltd – purchasing company

Particulars	Debit	Credit
Business purchase a/c Dr To liquidators of kala Ltd	9,00,000	 9,00,000

Being the purchase price payable		
Fixed assets a/c Dr Current assets a/c Dr 400000x60% To business purchase a/c To capital reserve a/c(b.f) Being assets taken over and the capital profit there on	8,00,000 2,40,000	 9,00,000 1,40,000
Liquidators of Kala a/c Dr To debenture a/c To share capital a/c Being the liquidation expensed paid	9,00,000	 1,60,000 7,40,000

Balance sheet of Mala ltd as on 31.3.1995

Shareholders

liabilites	Rs	Assets	Rs
Share capital capital reserve 9% debentures	7,40,000 1,40,000 1,60,000	Fixed assets Current assets	8,00,000 2,40,000
	10,40,000		10,40,000

Meaning of Internal Reconstruction

Internal Reconstruction is an arrangement made by companies whereby the claims of shareholders, debenture holders, creditors and other liabilities are altered/ reduced, so that the accumulated losses are written off, assets are valued at its fair value and the balance sheet shows the true and fair view of the financial position.

Schemes of Internal Reconstruction

A company can reconstruct its internal affairs in the following ways:

i. Reduction of Share Capital and other Liabilities

ii. Re-organization or Alteration of Share Capital

iii. Variation of shareholders rights

iv. Compromise / Arrangement

v. Surrender of shares

Reduction of Share Capital and other Liabilities

Reduction of share capital is an arrangement under which the capital of the shareholders and sometimes even the claims of the creditors and debenture holders are reduced. The amount made available by way of capital reduction is utilized in writing off the fictitious assets, accumulated losses, and the overvalued portion of the other assets. A corporate sector unit can reduce its paid-up capital if

(a) It is authorized by its articles

(b) A special resolution is passed and

(c) A sanction of the court is obtained Methods of Reduction in Capital Page 3 of 269

External Reconstruction

From the plain reading of the internal reconstruction, it can be concluded that the internal reconstruction involves alteration or reduction of share capital; therefore, to draw the differentiation between internal and external reconstruction, it is necessary to understand the meaning and features of external reconstruction.

In External Reconstruction, the company goes into liquidation, and its affairs are transferred to a new company. In other words, it is a process wherein the affairs of the existing company are wound up and transferred to a new company through a scheme of arrangement. The existing company having a large number of accumulated losses and is on the verge of going bankrupt adopts this type of reconstruction by transferring its assets and liabilities to a new company. It is also imperative to mention that external reconstruction is not the same as amalgamation, as, under external reconstruction, the existing company goes into liquidation, and in amalgamation, there is a combination of one or more companies into a single entity.

Under this type of reconstruction, the existing company (transferor) continues to be part of the new company (transferee) and holds a substantial interest in it, as the shareholders transferred to the new company are almost the same.

Features of External Reconstruction

1. Issuance of fresh shares of the new company through transfer.
2. Liquidation of the transferor company.

3. The transferee company undertakes to pay all the financial liabilities of the transferor company.
4. The transferee company agrees to buy the assets of the transferor company at an agreed value.

Difference Between Internal And External Reconstruction

The fundamental difference between internal and external reconstruction is the formation of a company. There is no new company formation of the company under internal reconstruction as compared to external reconstruction, which requires the formation of a new company and winding up of the existing company. Further, the number of differences that can be made between internal and external reconstruction are discussed below:

Basis	Internal Reconstruction	External Reconstruction
Meaning	The internal reconstruction is a type of reconstruction wherein the internal financial structure of the company is reorganised without putting the company into liquidation.	The external reconstruction is a type of reconstruction wherein the company goes into liquidation, and all the assets and liabilities are transferred to the new company.
Reduction of Share Capital	There is a reduction and rearrangement of share capital	There is no reduction or rearrangement of share capital.
Formation of a Company	There is no new formation of a new company	There is formation of a new company
Existence of a transferor company	Since there is no transfer, hence the company continues to exist	The existing or transferor company ceases to exist
Approval of Court	The tribunal's approval is required as a reduction in the share capital may affect the shareholder's rights.	The approval of the tribunal is also required.
Transfer of assets and Liabilities	There is no transfer of assets and liabilities.	There is the transfer of assets and liabilities of the transferor (existing) company to the transferee (new) company.
Ease of Process	It is not a simple process, as reconstruction is possible only through authorisation under the Article of Association and special resolution.	It is a simple process as compared to internal reconstruction
Set off of losses	The existing company can set off their accumulated losses against its future profits.	The existing company cannot set off its accumulated losses with the profits of the new company.

1. Arumugam Ltd has 10,000 equity shares of Rs.100 each Rs 80 per share called up. Now the company decides to pay off Rs. 20 per share of the paid up capital and at the same time reduce 100 to 60 per share fully paid by cancelling the unpaid amount. Pass the journal entries

Particulars	Debit	Credit
Equity share capital a/c Dr To equity share capital a/c To equity shareholders a/c (Being shares of 80 per share paid up)	8,00,000	 6,00,000 2,00,000
Equity shareholders a/c Dr To Bank a/c (Being amount returned to shareholders)	2,00,000	 2,00,000

2. A company's position on 30th June was as follows

20,000 equity shares Rs.100 each 20,00,000

1,000 6% debentures of 1,000 each 10,00,000

Interest on the above 1,20,000

The assets on that date amounted to 9,60,000. The following steps were taken with the approval on all concerned.

The shares were subdivided into shares of 5 each and 90% of the shares were surrendered.

The total claims of the debentures holders were reduced to 490000 and in consideration of this they were allotted shared amounting 250000

Pass journal entries and give the balance sheet of the company after reconstruction.

Particulars	Debit	Credit
Equity share capital a/c Dr To equity share capital a/c (Being subdivision made)	20,00,000	 20,00,000
Equity share capital a/c Dr To surrendered shares a/c	18,00,000	 18,00,000

(Being surender made)		
6% Debentures a/d Dr Interest on debentures a/c Dr To capital reduction a/c (being debentures reduced)	5,10,000 1,20,000	 6,30,000
Surrendered shares a/c Dr To equity share capital a/c (being shares issued)	2,50,0000	 2,50,000
Surrendered shares a/c Dr To capital reduction a/c (being shares cancelled)	1,55,0000	 1,55,0000
Capital reduction a/c Dr To profit and loss a/c To capital reserve (being loss transfer to capital reserve)	21,80,000	 21,60,000 20,000

Differences between amalgamation and absorption

	Amalgamation	Absorption
Process	Merging two or more companies to form a new entity	Acquisition and assimilation of one company by another
Result	Formation of a new legal entity	The absorbed company ceases to exist as a separate entity
Legal framework	Compliance with specific amalgamation regulations	Compliance with specific absorption regulations
Financial consideration	Exchange of shares or payment of consideration to shareholders	Payment of consideration to acquired company's shareholders
Employee and management	Employees and management become	Impact on acquired company's

impact	part of the newly formed entity	employees and management varies
Impact on stakeholders	Impacts stakeholders of both merging companies	Primarily impacts stakeholders of the acquired company
Structural dissimilarities	Creates a new entity that combines the merging companies	Absorbing company remains as the sole entity
Integration complexities	Integration of processes, systems, and resources of merging companies	Integration of acquired company's assets, operations, or liabilities
Competition	Can result in increased market share and enhanced competitiveness	Eliminates competition and gains a larger market share
Access to resources	Combines resources, expertise, and market presence	Acquires assets, technologies, or customer bases of the absorbed company
Risk and cost synergies	Shared risks and improved financial stability	Cost synergies and operational efficiencies through integration
Examples	Merger between Exxon and Mobil, forming ExxonMobil	Google's acquisition of YouTube

Distinguish between amalgamation and external reconstruction

Amalgamation and external reconstruction are two methods of corporate restructuring that companies can undertake.

The main differences between the two are as follows:

1. Meaning: Amalgamation refers to the combination of two or more companies to form a new entity, while external reconstruction refers to the transfer of assets and liabilities of an existing company to a new company.
2. Legal status: In an amalgamation, the old companies cease to exist and a new entity is created. In external reconstruction, the existing company continues to exist but as a new legal entity.
3. Purpose: Amalgamation is typically done to create a more efficient and stronger company, while the external reconstruction is usually done to improve the financial position of an existing company.

4. Accounting treatment: In an amalgamation, the assets and liabilities of the old companies are transferred to the new entity at their respective book values. In external reconstruction, the assets and liabilities of the existing company are transferred to the new entity at their market values.

5. Shareholders' involvement: In an amalgamation, the shareholders of the old companies receive shares in the new entity in proportion to their holdings. In external reconstruction, the shareholders of the existing company may receive shares in the new entity, but this is not always the case. In some cases, shareholders may receive cash or other forms of consideration.

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 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.

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.]

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.

(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.

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

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

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 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 ended-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 ReserveBank of India	6	XXX	XXX
Balance with banks and money atCall and short notice	7	XXX	XXX
Investment	8	XXX	XXX
Advances	9	XXX	XXX
Fixed assets	10	XXX	XXX
Other assets	11	XXX	XXX
Total		XXX	XXX
Contingent liabilities	12	XXX	XXX
Bill for collection.		XXX	XXX

Schedule 1

Capital

I. For Nationalized Banks

Capital (Fully owned by Central Government)

II. For Banks Incorporated Outside India

(i) Capital (The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head)

(ii) Amount of deposit kept with the RBI under section 11(2) of the Banking Regulation Act, 1949

III. For Other Banks

Authorized capital

Issued capital

Subscribed capital

Called-up capital

Less : Calls unpaid

Add : Forfeited shares

Schedule 2 : Reserves and surplus

I. Statutory reserves

Opening balance

Additions during the year

Deductions during the year

II. Capital reserves

Opening balance

Additions during the year

Deductions during the year

III. Share premium

Opening balance

Additions during the year

Deductions during the year

IV. Revenue and other reserves

Opening balance

Additions during the year

Deductions during the year

V. Balance in Profit and Loss Account

Total: (I + II + III+ IV + V)

Schedule 3 : Deposits

Schedule 6 :

Cash and balances with Reserve Bank of India

Cash in hand

(including foreign currency notes)

Balances with Reserve Bank of India

(i) in current account

(ii) in other accounts

Total (I + II)

Schedule 7 : Balances with banks and money at call and short notices

1. In India

(i) Balances with banks

(a) in current accounts

(b) in other deposit accounts

(ii) Money at call and short notice

(a) with banks

(b) with other institutions

Total (I + II)

Outside India

(i) in current accounts

(ii) in other deposit accounts

(iii) Money at call and short notice

Total (I + II + III)

Grand total: (I + II)

Schedule 8 : Investments

1. Investment in Indian in

(i) government securities

(ii) Other approved securities

(iii) shares

(iv) Debentures and Bonds

(v) Subsidiaries and/or joint ventures

(vi) Other (to be specified)

Total :

II. investment outside India in

(i) Government securities (including local authorities)

(ii) Subsidiaries and/or joint venture abroad

(iii) Other investments (to be specified)

A. I. Demand deposits (i) From banks (ii) From others II. Savings bank deposits III. Term deposits (i) From banks (ii) From others Total: (I + II + III) B.(i) Deposits of branches in India (ii) Deposits of branches outside India Total **Schedule 4 :Borrowings** I. Borrowings in India (i) Reserve Bank of India (ii) Other banks (iii) Other institutions and agencies II Borrowings outside India Total (I + II) Secured borrowings included in I and II above – Rs. **Schedule 5 : Other liabilities and provisions** I. Bills payable II. Inter-office adjustments (net) III Interests accrued IV. Others (including provisions) Total :	Total Grand Total (I+II) **Schedule 9 : Advances** A (i) Bills purchased and discounted (ii) Cash credits, overdrafts and loans repayable on demand (iii) Term loans Total B. (i) Secured by tangible assets (ii) Covered by bank / government guarantees (iii) Unsecured Total: C.I. Advances in India (i) Priority sector (ii) Public sector (iii) Banks (iv) Others Total: II. Advances outside India (i) Due from banks (ii) Due from others (a) Bills purchased and discounted (b) Syndicated loans (c) Others Total: Grand Total (CI + CII) **Schedule 10 :Fixed assets** I. Premises At cost on 31st March of the preceding Year Additions during the year Deductions during the year Depreciation to date II Other fixed assets (including furniture and fixtures) At cost as on 31st March of the preceding year Addition during the year Deductions during the year Depreciation to date Total (I+ II)

	Schedule 11 : Other assets I Inter office adjustment (net) II Interest accrued III. Tax paid in advance y tax deducted at source IV Stationery and stamps V.Non-banking assets acquired in satisfaction of claims VI. Others Total: * In case there is any unadjusted balance of loss the same may be shown under this item with appropriate foot-note **Schedule 12 : Contingent liabilities** I. Claims against the bank not acknowledge as debts II. Liability for partly paid investments III. Liability on account of outstanding forward exchange contracts IV. Guarantee given on behalf of constituents (a) in India (b) outside India V. Acceptances, endorsements and other Obligations VI. Other items for which the bank is liable Total

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
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 Profit / loss (-) brought forward		 2,66,000 -
Total		2,66,000
IV. Appropriations Transfer to statutory reserves266000 X 25/100 Balance carried over to Balance sheet		 66,500 1,99,500
Total		2,66,000

Schedule -13 Interest Earned

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

Schedule -14 Other Income

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

Schedule -15 Interest Expended

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

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 p/l a/c on 31.3.04

Interest and discount earned	3,16,28,000
Income on investment	1,18,10,000
Interest received on balance with RBI	42,43,000
Commission ,exchange , brokerage	29,07,000
Profit on sale of investment	1,14,000
Interest on deposit paid	3,14,04,000
Interest on RBI loan paid	33,62,000
Salaries	97,17,000
Depreciation on bank assets	3,79,000
Rent And Lighting	11,68,000
Auditors fees	41,000
Law charges	22,000
Postage	4,03,000

Other expenses	17,99,000
Balance of profit b/d from last year	10,00,000
Directors fees	7,000
Adjustments : provision for income tax	51.75 % on profit .

Transfer to revenue reserve 5 % .

Transfer to proposed dividend 2,00,00.

Solution

Profit and loss account for the year ended 31 march year

particulars	schedule	Year ended current year
I. Income Interest earned Other income	 13 14	 4,76,81,000 30,21,000
Total		5,07,02,000
II. Expenditure Interest expended Operating expenses Provisions and contingencies	 15 16	 3,47,66,000 1,35,36,000 12,42,000
TOTAL		4,95,44,000
III. Profit / Loss Net profit / loss (-) for the year Profit / loss (-) brought forward		 11,58,000 10,00,000
Total		21,58,000
IV. Appropriations Transfer to statutory reserves(N.P) Transfer to other reserves(N.P) Proposed dividend Balance carried over to Balance sheet		 2,89,500 57,900 2,00,000 16,10,600
Total		21,58,000

Schedule -13 Interest Earned

Particulars	Rs
Interest , discount earned	3,16,28,000
Income on investments	1,18,10,000
Interest received on balance with RBI	42,43,000
Total	4,76,81,000

Schedule -14 Other Income

Particulars	Rs
Commission ,exchange and brokerage	29,07,000
Profit on sale of investments	1,14,000
Total	30,21,000

Schedule -15 Interest Expended

Particulars	Rs
Interest on deposits	3,14,04,000
Interest on RBI Loan	33,62,000
Total	3,47,66,000

Schedule -16 Operating Expenses

Particulars	Rs
Salaries	97,17,000
Rent and lighting	11,68,000
Depreciation on bank property	3,79,000
Directors fees	7,000
Auditors fees	41,000
Law charges	22,000
Postage and telegram	4,03,000
Other expenditure	17,99,000
Total	1,35,36,000

Provision for income tax

24,00,000 x 51.75 % = 12,42,000

(5,07,02,000- 3,47,66,000 + 1,35,36,000)

3. Prepare p/l a/c on 31.3.07

Interest on fixed deposit	4,30,000
Interest on loans	6,50,000
Discount on bills discounted	4,15,000
Interest on over draft	2,10,000
Interest on cash credit	4,10,000
Interest on savings bank deposits	1,25,000
Salaries and allowance	1,40,000
Rent tax, insurance	40,000
Locker rent	5,000
Repairs to bank property	2,000
Commission, exchange and brokerage	24,000
Directors fees	25,000
Transfer fees	2,000
Provident fund contribution	12,000
Local committee fees and allowances	10,000
Audit fees	12,000
Printing and stationery	4,000
Loss on government securities	5,000
Loss on sale of furniture	2,000
Postage and telegram	2,500
Depreciation	10,000
Advertisement	4,000
Legal charges	2,500

Adjustment – Rebate on bills discounted 31.3.06- 19,000.
Rebate on bills discounted 31.3.07- 26,000.
Bad debts to be written off 40,000,
Provide for taxation 50,000.

Solution

Profit and loss account for the year ended 31 march year

particulars	schedule	Year ended current year
I. Income		
Interest earned	13	16,78,000
Other income	14	24,000

Total		17,02,000
II. Expenditure Interest expended Operating expenses Provisions and contingencies(40+50)	 15 16	 5,55,000 2,64,000 90,000
TOTAL		9,09,000
III. Profit / Loss Net profit / loss (-) for the year Profit / loss (-) brought forward		 7,93,000
Total		7,93,000
IV. Appropriations Transfer to statutory reserves Balance carried over to Balance sheet		 1,98,250 5,94,750
Total		7,93,000

Schedule -13 interest earned

particulars	Rs
Interest on Loan Interest on overdraft Interest on cash credit Discount on bills + opening rebate – closing rebate(415000+19000-26000)	6,50,000. 2,10,000 4,10,000 4,08,000
	16,78,000

Schedule -14 other income

particulars		Rs
Lockers rent		5,000
Commission exchange and brokerage		24,000
Transfer fees		2,000
		31000
Less loss on sale of Government securities	5000	
Loss on sale of furniture	2000	7000
		24,000

Schedule -15 interest expended

particulars	Rs
Interest on fixed deposits	4,30,000
Interest on saving bank deposit	1,25,000
	5,50,000

Schedule -16 operating expenses

particulars	Rs
Salaries and allowance	1,40,000
Rent and taxes	40,000
Repairs to bank property	2,000
Directors fees	25,000
P.F contribution	12,000
Local committee fees	10,000
Audit fees	12,000
Printing and stationery	4,000
Postage and telegram	2,500
Depreciation on bank properties	10,000
Advertisement	4,000
Legal charges	2,500
	2,64,000

4. Prepare balance sheet for 31.3.08

Share capital	4,00,000
Resesrve 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
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 Reserve and surplus Deposits Borrowings Other liabilities and provisions	1 2 3 4 5	4,00,000 8,70,000 84,80,000 4,75,000 18,000
Total		1,02,43,000
ASSETS Cash and balances with ReserveBank of India Balance with banks and money atCall and short notice Investment Advances Fixed assets Other assets	6 7 8 9 10 11	10,38,000 7,80,000 25,00,000 54,80,000 4,11,400 33,600
Total		1,02,43,000
Contingent liabilities Bill for collection.	12	Nil nil

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
----------	38,750
Add Statutory Reserve	
	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

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 Cash With RBI	38,000 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 Cash With Other Banks	1,80,000 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 Loans Cash Credit And Overdraft	3,80,000 51,00,000
	54,80,000

Schedule -10 Fixed Assets

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

Schedule -11 Other Assets

Particulars	Rs
Other Assets	33,600
	33,600

5. 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	45,00
Cash	22,500
Interest earned	55,000
Balance with RBI	2,03,000
Balance with Foreign Bank	1,20,600
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,
InterimDividend	20,000

P/L A/C

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

Schedule -13 Interest Earned

Particulars	Rs
Interest Earned Discount On Advances –Rebate (24,400-6,400)	55,000 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 Reserve and surplus Deposits Borrowings Other liabilities and provisions(rebate)	1 2 3 4 5	2,00,000 1,53,400 27,16,500 6,48,200 6,400
Total		3724500
Assets Cash and balances with ReserveBank of India Balance with banks and money atCall and short notice Investment Advances Fixed assets Other assets	6 7 8 9 10 11	2,25,500 1,20,600 9,88,200 21,68,500 2,21,700 -
Total		37,24,500
Contingent liabilities. (150000+575000) Bill for collection	12	2,07,500 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 Balance In Profit And Loss A/C	1,27,625 25,775
Total	1,53,400

Schedule – 3 Deposits

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

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 Cash With RBI	22,500 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

Schedule -9 Advances

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

Schedule -10 Fixed Assets

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

Schedule -1I Other Assets

Particulars	Rs
Nil	

Schedule -12 contingent liabilities

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

6. 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

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

Interest and discount a/c

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

7. 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

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 TO Interest and discount a/c (being last year rebate)	30,501	30,501
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

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 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
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 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.

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 Charted 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.

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 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 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 recoverable 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 cancelled 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.

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 fulfil 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 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 labour 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.

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, 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 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:

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.

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 as been paid for in advance that has been "earned" by virtue of the fact that time has passed without claim. Athree-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 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.

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 insured's 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		
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.

14.b.

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
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.

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

UNIT - IV

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.

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 get 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 as 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. It goodwill already exists in the balance sheet of holding company or both the goodwill thus calculated, will be added up to the existing goodwill. Capital Reserve will be deducted from Goodwill. In short, net amount resulting from goodwill and capital Reserve will be shown in the consolidated Balance sheet.

- **MINORITY INTEREST :**

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

1) Share in share capital in subsidiary.

2) Share in reserves (Both pre and post acquisition of subsidiary).

3) Share in accumulated losses should be deducted.

4) Proportionate share of profit or loss on revaluation of assets.

5) Preference share capital of subsidiary company held by outsiders and dividend due on such share capital, if there are profits. Minority interest means outsiders interest. It is treated as liability and shown in consolidated. Balance sheet as current liability. This amount is basically intrinsic value of shares held by minority.

CAPITAL PROFITS AND REVENUE PROFITS :

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

- **ELIMINATION OF INVESTMENTS IN SHARES OF SUBSIDIARY COMPANY :**

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

- **MUTUAL OWING / INTER COMPANY TRANSACTIONS :**

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

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

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 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 sharein 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

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 Sundry liabilities	12,000 8,000	5,000 3,000	Sundry assets Investments 5,000 shares in subsidiary company	15,000 5,000	8,000 -
	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

Particulars	Rs
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
			Investments		
Reserves	50,000	40,000	5,000 shares in subsidiary company	5,20,000	-
Profit and loss a/c	1,00,000	20,000			
				2,00,000	1,00,000
creditors	2,50,000	60,000	Stock	1,00,000	60,000
			Debtors	80,000	40,000
			Cash and bank		
	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

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/L A/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	5,00,000
H Ltd	4,20,000
S Ltd	9,20,000
Total	
5. Inventories	2,00,000
Stock H Ltd	1,00,000
S Ltd	3,00,000
Total	
6.Account Receivable	1,00,000
Debtors H Ltd	60,000
S Ltd	1,60,000
Total	
7. Cash And Cash	80,000
Equivalent	40,000
H Ltd	1,20,000
S Ltd	
Total	

Workings

1. Capital profit

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

2. Calculation of capital reserve or goodwill

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

3. The following are the balance sheet of H Ltd and its Subsidiary company as on 1.3.2015.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 6,000 shares in subsidiary company	90,000	-
Profit and loss a/c	20,000	10,000			
Creditors	20,000	10,000			
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

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**

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	11000x3/5=6,600	15000x3/5=9000	4000x3/5=2,400
2/5th Share For Minority Interest	11,000x2/5=4,400	15,000x2/5=6,000	4000x2/5=1600

3. Minority interest

Particulars	Rs
Paid-up value of shares 4000x10	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**

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

1. H Ltd purchased the shares in S L td 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.

2. All the bills payable of S ltd, were issued in favour of H Ltd

3. 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
Total		**11,85,000**

Ii 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
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

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	1,95,000
	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**

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**
Ii 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	
	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**

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	3,8,4000
capital reserve		59,000

6. The following are the balance sheets of X Ltd and Y Ltd as on 31.3.2016

liabilities	X Ltd	Y Ltd	Assets	X Ltd	Y Ltd
share capital (Rs10 per share)	4,00,000	2,50,000	Freehold property	2,00,000	2,50,000
Reserves	1,60,000	50,000	Plant and machinery	1,50,000	1,20,000
P/l account	1,40,000	60,000	Loan to Y Ltd	50,000	-
Loan from X Ltd	-	50,000	Investments 20,000 shares in Y Ltd	3,00,000	-
Creditors	75,000	60,000	Stock	50,000	40,000
Bills payable	45,000	20,000	Debtors	50,000	50,000
			Cash	20,000	30,000
	8,20,000	4,90,000		8,20,000	4,90,000

Additional information

1. X Ltd acquired the shares of Y Ltd on 1.10.2015

2. On 1.4.2015 reserves and p/l a/c of S Ltd showed a balance of Rs.40,000 and Rs.10,000 respectively

3. Stock of Y Ltd includes goods worth Rs10,000 which was purchased from X Ltd. X Ltd sold goods at a profit of 25 % on cost price.

Prepare consolidated balance sheet

Solution

particulars	Note	Rs
I Equity And Liabilities		
(I) Shareholder's Fund		
Share Capital	1	4,00,000
Reserves And Surplus	2	3,26,000

(Ii)Minority Interest		72,000
(Iii) Current Liabilities		
Account Payable	3	2,00,000
Total		9,98,000
Ii Assets		
(I) Non Current Assets		
Fixed Assets		
Tangible Assets	4	7,20,000
Intangible Assets	5	40,000
(Ii)Current Assets		
Inventories	6	88,000
Account Receivable	7	1,00,000
Cash And Cash Equivalent	8	50,000
Total		9,98,000

Notes To Accounts- Forming Of Balance Sheet

1	Share Capital		4,00,000
2	Reserves And Surplus		
	Reserves – X Ltd	1,60,000	
	Y Ltd-Revenue Reserve	8,000	1,68,000
	P/L A/C X Ltd	1,40,000	
	Revenue Profit - Y Ltd	20,000	
	Capital Reserve	1,60,000	
		2,000	1,58,000
	Total		**3,26,000**
3	Long Term Borrowings		
	Loan From X Ltd	50,000	
	Less Mutual Owings	50,000	Nil

4	Accounts Payable		
	Bills Payable X Ltd	45,000	
	Y Ltd	20,000	65,000
	Creditors -X L Td	75,000	
	Y Ltd	60,000	1,35,000
		Total	**2,00,000**
5	Tangible Assets		
	Freehold Property	2,00,000	
		2,50,000	4,50,000
	Plant And Machinery -H Ltd	1,50,000	
		1,20,000	2,70,000
		Total	**7,20,000**
6	Inventories		
	Stock-X Ltd		50,000
	Y Ltd		40,000
			90,000
	Less Unrealised Profit		2,000
			88,000
7	Accounts Receivable		
	Debtors-X Ltd		50,000
	Y Ltd		50,000
			1,00,000
8	Cash And Cash Equivalent		
	Cash – X Ltd		20,000
	Y Ltd		30,000
			50,000

Workings

1. Share holding company and minority shareholdings

20000:5000

4:1

2. Calculation Of Capital Profit And Revenue Profit

Particulars	Capital Profit	Revenue Profit	
		Reserves	P/L A/C
Reserves	40,000	10,000	-
P/L A/C 1.4.2015	10,000	-	-
Current Year Profit 60,000-10,000=50,000	25,000		25,000
	75,000	10,000	25,000
4/5th Share	60,000	8,000	20,000
1/5th Share	15,000	2,000	5,000

3.Mionrity Interest

Paid Up Valu Of Shares	50,000
Capital Profit	15,000
Revenue Reserve	2,000
Revenue Profit	5,000
Total	72,000

4.Calculation Of Capital Reserve Or Goodwill

Investments		3,00,000
Less Actual Value Of Shares	2,00,000	
Capital Profit	60,000	2,60,000
Goodwill		40,000

5.Unrealised Profit

Unsold Stock=10,000

% On Profit On Cost = 25%

Unrealized Profit- 10,000 X 25/125= 2000

UNIT - V

Meaning of liquidation

Liquidation or winding up is the legal procedure by which a company comes to its end. Liquidation or winding up of a company can be defined as "the process whereby its life is ended and its property is administered for the benefit of its creditors and members".

An administrator, namely a Liquidator, is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights. Unlike an insolvent individual or partnership firm, insolvency proceedings are not applicable to a company. A solvent as well as insolvent company may be liquidated.

Liquidator

A liquidator is the person who is appointed for the purpose of liquidating the company. The main job of a liquidator is to realise all assets of the liquidating company, collects the amount due from the contributories and distribute the sale proceeds of assets of the company among the right claimants. The company must submit a Statement of Affairs to the liquidator within 21 days of the passing of the winding up order. In case of winding up of a company by the Tribunal, the Tribunal at the time of passing of the order of winding up, shall appoint an Official Liquidator or a liquidator from the panel maintained by the Central Government consisting of the names of the Chartered Accountants, advocates, Company Secretaries, Cost Accountants and such other professional as may be notified by the Central Government having at least 10 years' experience in company matters. In case of voluntary winding up, the voluntary liquidator is appointed by resolution in general body meeting of the members and or of the creditors.

Kinds of winding up

Section 425(1) of the companies act provides that a company can be liquidated in any of the following three ways

1. Compulsory winding up

2. Voluntary winding up by the members or creditors

3. Winding up under the supervision of the court

Types of Winding Up

Types of winding up of a company are present in two forms. The company may choose to wind up or may be ordered. Both these winding-up options lead to the same result. The company ceases its operations. Also, all assets are sold off. Find below the types of winding up of a company.

Compulsory Winding Up

A compulsory winding-up type is ordered by the court. This can be the effect of a suit. The company has to appoint a liquidator for this process. The liquidator further manages the company affairs for asset sales and settlements. The compulsory liquidation in the types of winding up of a company can happen because of the following reasons.

Special Resolution

The company may have a special resolution. It can decide to wind up operations with a court order. Company owners decide this resolution. But, the court is not required to pass this order. It can decide the same after due diligence. The court may not pass the resolution order if it's disadvantageous to the company.

Statutory Meeting Default

The company can default in submitting statutory reports or holding the meeting. This default may result in a court order. It can lead to winding up of a company.

Example: For example, company ABC started operations on July 1, 2022. The company is required to hold a shareholders meeting after one month and before months from that date. It is the first meeting after business commencement.

However, ABC was not able to do so because of internal company conflicts. The deadline crossed after three months. Thus, ABC may receive a compulsory winding-up order.

Business Commencement Or Suspension

The company may be wound up if it doesn't start operations within a year of registration. It can also be when the company suspends work for a year. The court may order the compulsory types of winding up of a company. But this power is also optional. The court may do so if there isn't any aim to start operations.

Example: For example, company ABC started operations on July 1, 2022. The company is in the restaurant business. ABC was scheduled to start operations on Jan 1, 2023. The construction work and licenses were taking more time than expected. The company could not start a business even after one year. Thus, the court was notified about this. ABC received a compulsory winding-up order. It was because of not starting operations even after one year.

Membership Reduction

Company types have to maintain members for operations. If they don't have enough members, the court can order the compulsory types of winding up of a company. The public entity requires seven, while the private requires two members. If any member leaves, the company may have to wind up.

Debt Obligations

If the company is unable to fulfill debt obligations, it can lead to the compulsory types of winding up of a company. The company must maintain a suitable cash flow. Debt payments should be on time to avoid this court order.

Example: ABC took a loan of ₹10,00,000 in total from its creditors. The company deals in the food production unit. The company wanted to expand production with this loan. However, the agricultural produce took a hit with a bad monsoon. It led to lower raw materials and high prices. Thus, production was also reduced.

ABC was unable to fulfill creditor terms. The company received a winding-up notice as it couldn't pay dues.

Court Orders

The court may also send an order for the compulsory types of winding up of a company wherever it seems fit. It provides a wider winding-up scope. The court may assess the operations and pass this order. It is often due to fraudulent activities. The company may also be in huge losses for this order. The court must decide the just reason and order the winding-up. Making the case and verifying details before winding up orders is necessary.

Example: ABC dealt in the betting business in sports events. The company was operating in this segment under wraps. It is portrayed as a sports equipment business on the outside. An insider informs the court of the same with proof. Thus, the company is asked to wind up because of its illegal operations.

Voluntary Winding Up

The company can also decide on its own in the voluntary types of winding up of a company. It can be because of low prospects. The company members may also choose the same because of internal reasons. The voluntary types of winding up of a company can happen by the following methods.

- **Ordinary Resolution:** The company can pass an ordinary resolution for the voluntary types of winding up of a company. It can happen when the company's period expires. This is mentioned in company articles. There may be other cases where the company requires a voluntary winding up. An ordinary resolution then leads to the winding up.
- **Special Resolution:** The company owners can also pass a special resolution for voluntary types of winding up of a company. The same must be notified to the stakeholders within fourteen days. The business operations end when this resolution is applicable. The special resolution can be due to any relevant reasons. The company owners decide it.

Types of Voluntary Winding Up

The voluntary winding up can be of two types.

Member's Voluntary Winding Up

The company members may decide to wind up the company. It can be because they've sold the business or the company isn't trading. The key is that the company must be solvent. It means that the company must be able to pay its debts. The member's voluntary types of winding up of a company can only be when it's solvent.

If the company cannot fulfill debt, it will automatically be a creditor's induced winding up.

Example: Suppose ABC company was a subsidiary. It was made for the purpose of one construction project. After the completion of the project, the members agree to wind up the business.

Thus, this winding-up was voluntary. The company was still solvent.

Creditors voluntary winding up

The company's creditors can also trigger a winding up. It happens when the creditors don't receive their dues. The liquidator has to assess the company's assets and debt obligations carefully. Also, the company is insolvent at this time.

The creditors have to prove their claims. The asset sales are distributed proportionally. The creditors don't necessarily receive their full dues.

Contributory

Contributory is a person liable to contribute to the assets of the company in the event of winding up. A contributory's liability is legal, not contractual. A contributory can be either a present member or a past member.

Liquidator's final statement of account (format)

Particulars	Rs	Particulars	Rs
To Balance b/d	xxx	B y Secured Creditors	xxx
To Asset Realized		By Liquidation Expenses	xxx
Debtors	xxx	By Liquidators Remuneration	xxx
Building	xxx	By Debenture Holders	xxx
Plant & Machinery	xxx	By Preferential Creditors	xxx
Stock	xxx	By Unsecured Creditors	xxx
To amount received		By Preferential Shareholders	xxx
from directors	xxx	By Equity Shareholders	xxx
To contributions made			

by the contributories	xxx		
	xxx		xxx

Unsecured creditors

If the amount available is sufficient to make full payment of unsecured creditors , the commission is calculated as follows

Amount available x % of commission /100 (3% commission means 3/100)

If the amount available is not sufficient to make payment to unsecured creditors the commission is calculated as follows

Amount available x % of commission /100 + % of commission (3% commission means 3/103)

1. From the following information prepare liquidator's final statement of account.

Cash at bank	1,00,000
Surplus from securities	10,10,000
Expenses of liquidation	30,000
Liquidators remuneration	7,000
Preferential creditors	2,00,000
Unsecured creditors	7,00,000
Preferential shareholders	1,00,000
Equity shareholders	1,00,000

Solution

Particulars	Rs	Particulars	Rs
To cash	1,00,000	By liquidation expenses	30 ,000
To surplus from securities	10,10,000	By liquidators remuneration	7,000
		By Preferential Creditors	2,00,000
		By Unsecured Creditors	7,00,000
		By Preferential Shareholders	1,00,000
		By Equity Shareholders	73,000
	11,10,000		11,10,000

2. Roohan ltd went into liquidation. Its assets realized Rs.5,50,000 excluding amount realized by the sale of securities held by Secured creditors

Share capital (per share 10)	3,00,000
Secured creditors (securities realised Rs. 84,000)	80000
Preferential Creditors	8,000
Unsecured Creditors	2,50,000
Debentures having floating charge	3,50,000
Liquidation expenses	8,000
Liquidators remuneration	13,000

prepare liquidator's final statement of account.

Solution

Particulars	Rs	Particulars	Rs
To assets realized To surplus (84000-80000)	5,55,000 4,000	By liquidation expenses By liquidators remuneration By debentures By preferential creditors By unsecured creditors	8,000 13,000 3,50,000 8,000 1,75,000
	5,54,000		5,54,000

3. X Ltd. Went into voluntary liquidation on April 1, 2005. The relevant details are given below

liabilities	Rs	Assets	Rs.
Share capital 5000 shares of Rs. 100 Each Rs. 80 per share paid Loans (secured by mortgage of land building, machinery) Unsecured loan and liabilities (including preferential dues 10,000)	4,00,000 1,00,000 2,00,000	Land and building& machinery Other fixed assets Stock Debtors Loans Cash Profit loss a/c	80,000 2,60,000 1,05,000 1,00,000 40,000 5,000 1,10,000
	7,00,000		7,00,000

Land and building& machinery were realized by secured creditors for Rs. 1,20,000. Other fixed assets fetched Rs.40,000, debtors Rs. 20,000, stock Rs. 10,000 loans were wholly bad. The liquidator is entitled to a fixed remuneration of Rs.1,000 plus 2% of the amount paid to unsecured creditors. The liquidators pocket expenses amounted to Rs.1,000. Prepare liquidator's final statement of account.

Solution

Particulars	**Rs**	**Particulars**	**Rs**
To cash	5,000	By secured creditors	1,00,000
To assets realized		By liquidation expenses	1,000
Land building	1,20,000	By liquidators remuneration	
Fixed assets	40,000		1,000
Debtors	20,000	Fixed amount	200
Stock	10,000	On preferential creditors 10000x2%	
To call money (5000x20)	1,00,000	On unsecured creditors	3584
		2/102x182800	10,000
		By preferential creditors	1,79,216
		By unsecured creditors	
	2,95,000		2,95,000

4. From the particulars given below prepare liquidation final accounts allowing for his remuneration at 2 % on the amount realized on assets and 2% on the amount distributed to unsecured creditors other than preferential creditors.

Unsecured creditors	2,24,000
Debentures	75,000
Buildings realized	1,30,000
Other assets realized	7,500
Preferential creditors	70,000
Cash	20,000
Machinery realized	1,10,500
Liquidation expenses	2,000

A call of Rs.2 per share on the partly paid 10,000 equity shares was made and duly paid except in case of one shareholder owning 500 shares.

Solution

Particulars	Rs	Particulars	Rs
To cash	20,000	By liquidation expenses	2,000
To asset realized		By liquidators remuneration	
Building	1,30,000	On assets realized 248000x2/100	4,960
Other assets	7,500	On unsecured creditors 135040x2/102	
Machinery	1,10,500		2,648
To call money 9500x2	19,000	By debentures	75,000
(10000-500)		By preferential creditors	70,000
		By unsecured creditors	1,32,392,
	2,87,000		2,87,000