1

HOLDING COMPANIES

Unit Structure

1.1 INTRODUCTION

One of the popular firms of business combination is by means of holding company or Parent Company. A holding company is one which directly or indirectly acquires either all or more than half the number of Equity shares in one or more companies so as to secure a controlling interest in such companies, which are then known as subsidiary companies. Holding companies are able to nominate the majority of the directors of subsidiary company and therefore control such companies. Holding company meet directly from such subsidiary company or it may acquired majority OR shares in existing company. Such company also considered as subsidiary company in which holding company acquired majority shares.

1.2 MEANING UNDER COMPANIES ACT 1956

Section 4 of the companies Act, 1956 defines a subsidiary company. A company is a subsidiary of another if and only if –

a) That other company controls the composition of its Board of Directors; or

b) That other –

i) Where the first mentioned company is an existing company in respect of which the holders of Preference shares issued before the commencement of this Act have the same voting rights in all respect as the holders of Equity shares exercises or controls more than half of the total voting power of such company.

ii) Where the first mentioned company is any other company, holds more than half in nominal value of its Equity share capitals. OR

iii) The company is a subsidiary of any company which is that other company's subsidiary.

1.3 ADVANTAGES OF HOLDING COMPANIES

Following are the advantages of Holding Company:

1) Subsidiary company maintained their separate identity.
2) The public may not be aware the existence of combination among the various company.
3) Holding company need not to be invest entire amount in the share capital in subsidiary company still enjoy controlling power in such company.
4) It would be possible to carry forward losses for income tax purposes.
5) Each subsidiary company prepares its own accounts and therefore financial position and profitability of each undertaking is known.
6) Holding company may additional acquired or disposed of and the shares in subsidiary company in market whenever if desired.

1.4 DISADVANTAGES OF HOLDING COMPANIES

1) There is a possibility of fraudulent manipulation of accounts.
2) Inter company transaction may not be at a fair prices.
3) Minority share holders interest may not be properly protected.
4) The accounts of various companies may be made upon different dates to, manipulate profit or financial position of Group companies.
5) The shareholders in the holding company may not be aware of true financial position of subsidiary company.

6) Creditors and outsiders shareholder in the subsidiary company may not be aware of true financial position of subsidiary company.

7) The Subsidiary Companies may be force to appoint person of the choice of holding company such as Auditors, Directors other officers etc. at in dually high remuneration.

8) The Subsidiary Company may be force for purchases or sale of goods, certain assets etc. as per direction of holding company.

1.5 PRESENTATION OF ACCOUNTS BY HOLDING COMPANIES

As laid down in section (212) of the companies Act, 1956. A holding company requires to attach its balance sheet. The following documents and present the same to its shareholders.

a) A copy of the Balance Sheet of the subsidiary.

b) A copy of the Profit and Loss Account of the subsidiary.

c) A copy of the Report of the Board of Directors of the subsidiary.

d) A copy of the Auditors Report of subsidiary.

e) A statement indicating the extent of holding company's interest in the subsidiary at the end of the accounting year of the subsidiary.

f) Where the financial year of the subsidiary company does not coincident with the financial year of the holding company. a statement showing the following.

i) Whether there are any changes in holding companies interest in subsidiary company since the close of financial year of the subsidiary company.

ii) Details of material changes which have occurred between the end of the financial year or the subsidiary company an end of the financial year of the holding company.

1.6 AS. 21 – Consolidation of Financial statement

AS. 21 come into effect in respect of accounting periods commencing on or after 1st April i.e. for year ending 31st March 2002. The A.S. 21 is applicable to all the enterprises that prepare consolidated financial statement. It is mandatory for Listed companies and Banking companies.

As per AS 21, The Consolidated financial statements would include:

i) Profit & Loss A/c
ii) Balance sheet
iii) Cash flow statement
iv) Notes of Accounts except typical notes.
v) Segment reporting

AS 21 also desire various import terms, as well as treatment and same while preparing consolidated financial statement. Consolidated financial statements should be prepared for both domestic as well as foreign subsidiaries.

1.7 CONSOLIDATION OF BALANCE SHEET

A holding company is required to present to its shareholders consolidated balance sheet of holding company and its subsidiaries. Consolidated balance sheet is nothing but addicting of up or combining the balance sheet of holding and its subsidiary together. However assets and liabilities are straight forward, i.e. added line to line and combination of share capital, reserves, and accumulated losses are not directly added in consolidated balance sheet.

Preparation of consolidated balance sheet. The following points need special attention while preparing consolidated balance sheet.

1) Share of holding company and share of minority (outside shareholders).
2) Date of Balance sheet of holding company and that of various subsidiary companies must be same. If they are not so necessary adjustment must be made before consolidation.
3) Date of Acquisition of control in subsidiary companies.
4) Inter company owing.
5) Revaluation of fixed assets as on date of acquisition, depreciation, adjustment on revaluation amount etc. which are discussed here in after.

- **COST OF CONTROL / GOODWILL / CAPITAL RESERVE :**

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

If there is excess of proportionate share in net assets of subsidiary company intrinsic of shares acquired and cost of shares acquired by holding company there will be capital reserve in favour of holding company.

It goodwill already exists in the balance sheet of holding company or both the goodwill thus calculated, will be added up to the existing goodwill. Capital Reserve will be deducted from Goodwill.

In short, net amount resulting from goodwill and capital Reserve will be shown in the consolidated Balance sheet.

Illustration : 1

Cost of Control / Goodwill

Balance sheet of S Ltd. as on 31st March 2010 (Liabilities only)

	Rs.
Share capital 40,000 Equity shares of Rs. 10/- each	4,00,000
Reserves and surpluses	2,50,000
Secured loan	2,50,000
Other Liabilities	1,00,000
	10,00,000

On the above date H Ltd. acquired 30,000 Equity shares in S Ltd. on the above date for Rs. 7,50,000 fixed assets of S Ltd. were appreciated by Rs. 1,50,000 find out cost of control / Goodwill.

	Rs.	Rs.
Cost of investment in S Ltd.		7,50,000
Less : 1) Share in share capital $\left(4,00,000 \times \frac{3}{4}\right)$	3,00,000	
2) Share in Reserves and surpluses		
Capital profit $2,50,000 \times \frac{3}{4}$	1,87,500	
Share in capital profit		
(Appreciation in fixed assets) $1,50,000 \times \frac{3}{4}$	1,12,500	6,00,000
	Goodwill	1,50,000

Suppose in above case, cost of investment amounted to Rs. 5,00,000 then instead of goodwill, there would be capital Reserve, Rs. 1,00,000.

- **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.

Illustration : 2

The following is the Balance sheet of S Ltd. as on 31^{st} March, 2010.

Liabilities	Rs.	Assets	Rs.
Share capital		Fixed Assets	2,90,000
Equity shares of Rs. 10 each	2,70,000	Investment	2,75,000
General Reserve Profit & Loss A/c	3,60,000	Current Assets	1,30,000
Current liabilities	85,000	Preliminary Expenses	20,000
	7,15,000		**7,15,000**

H Ltd. acquired 25,000 shares in S Ltd. on 31st March, 2010 at a cost of Rs. 2,75,000. fixed assets were revalued at Rs. 3,28,000. find minority interest

Solution :

Minority Interest $= \frac{2,000}{27,000} = \frac{2}{27}$

Minority Interest Rs.

1) Share in share capital

$2,70,000 \times \frac{2}{27}$ 20,000

2) Share in Reserves and Surpluses 20,000

$3,60,000 \times \frac{2}{27}$

3) Share in capital profits 28,000

Profit on appreciation on fixed Assets

(3,60,000 – 20,000 + 38,000)

= $3,78,000 \times \frac{2}{27}$

Minority Interest 68,000

Illustration : 3

Balance sheets as on 31st March, 2010.

Liabilities	H Ltd.	S Ltd.	Assets	H Ltd.	S Ltd.
Share capital			Fixed Assets	3,00,000	1,00,000
Equity Shares of Rs. 10 each fully paid	5,00,000	2,00,000	60% shares in S Ltd. at cost	1,62,400	--
General Reserve	1,00,000	50,000	Current Assets	2,77,600	2,39,000
Profit and loss Account	60,000	35,000	Preliminary Expenses	--	6,000
creditors	80,000	60,000			
	7,40,000	3,45,000		7,40,000	3,45,000

H Ltd. acquired the share on 1st April 2009 on which date General Reserve and profit and loss Account of S Ltd. showed balances of Rs. 40,000 and Rs. 8,000 respectively. No part of preliminary expenses was written off during the year ending 31st March, 2010. prepare the consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as on 31st March 2010.

Solution :

1) Capital profits of the subsidiary (i.e. profits earned prior to acquisition of shares)

	Rs.
General Reserve	40,000
Profit and Loss Account	8,000
	48,000
Less : Preliminary Expenses	6,000
	42,000

2) Revenue profits of the subsidiary (i.e. profits earned after the acquisition of shares)

Profit

	Rs.		Rs.
To General Reserve (Rs.50,000 – Rs. 40,000)	10,000	By balance b/fd	8,000
To Balance c/d	35,000	By Profit for the year	37,000
	45,000		45,000

3) Calculation of cost of control or Goodwill

		Rs.
Amount paid for 60% shares of S Ltd.		1,62,400
Less :		
i) paid up value of 60% shares of S Ltd.	1,20,000	
ii) 60% of capital profits i.e. profits Prior to acquisition Rs. $42,000 \times \frac{60}{100}$	25,200	(1,45,200)
Goodwill		17,200

4) Calculation of minority Interest

	Rs.
Paid up value of 40% shares of S Ltd.	80,000
Add: 40% capital profits $= 42,000 \times \frac{40}{100}$	16,800
Add: 40% Revenue Profits : $37,000 \times \frac{40}{100}$	11,800
	1,11,600

Alternatively, minority interest may be calculated as follows

	Rs.
Paid up value of 40% shares of S Ltd.	80,000
Add : 40% of General Reserve as on 31.3.2010 $\left(Rs. 50,000 \times \frac{40}{100}\right)$	20,000
Add : 40% of profits and Loss Account as on 31.03.2010 Rs. $35,000 \times \frac{40}{100}$	14,000
	1,14,000
Less : 40% of preliminary expenses Rs. $Rs. 6,000 \times \frac{40}{100}$	(2,400)
	1,11,600

Consolidated Balance sheet of H Ltd. and its subsidiary S Ltd. as at 31.3.2010

Liabilities		Rs.	Assets		Rs.
Share capital			Goodwill		17,200
Shares of Rs. 10 each fully paid		5,00,000	Other Fixed Assets		
Minority interest		1,11,600	H Ltd.	3,00,000	
General Reserve		1,00,000	S Ltd.	1,00,000	4,00,000
Profit and loss A/c			Current Assets		
H Ltd.	60,000				
Revenue Profits of			H Ltd.	2,77,600	
S Ltd.	22,200		S Ltd.	2,39,000	5,16,600
$\left(37,000 \times \frac{60}{100}\right)$		82,200			
Creditors					
H Ltd.	80,000				5,16,600
S Ltd.	60,000	1,40,000			
		9,33,800			**9,33,800**

- **CAPITAL PROFITS AND REVENUE PROFITS :**

The holding company may acquire the shares in the subsidiary company either on the balance sheet date or any date earlier than balance sheet date. All the profit earned by the subsidiary company till the date of acquisition of shares by holding company have to be taken as capital profits for the holding company.

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

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

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

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

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

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

As a result of these inter company transactions, certain accounts appear in the balance sheet of the holding company as well as the subsidiary company. In the consolidated balance sheet all these common accounts should be eliminated. For e.g.

1. S Ltd. has taken loan of Rs. 20,000 from H Ltd. then S ltd. balance sheet shows a liability of Rs. 20,000 while H Ltd. balance sheet shows on assets of Rs. 20,000.
2. H Ltd. draws a bill of Rs. 50,000 on S Ltd., then H Ltd. books it will show bills receivable Rs. 50,000 while S Ltd. books will show bills payable Rs. 50,000.

3. S Ltd. issued debentures of Rs. 1,00,000 which are held by H Ltd. then S Ltd. balance sheet will show a liability of Rs. 50,000 while H Ltd. books will show an assets of Rs. 50,000.

All the above inter company transactions have to be eliminated while preparing the consolidated balance sheet. These can be done by deducting inter company transactions from the respective items on both sides of balance sheet.

- **UNREALIZED PROFIT:**

The problem of unrealized profit arises in those cases where the companies of the same group have sold goods to each other at the profits and goods still remain unsold at the end of the year company to whom the goods are sold.

While preparing the consolidated balance sheet, unrealized profit has to be eliminated from the consolidated balance sheet in the following manner.

1. 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.

For e.g.

The sock in trade of S Ltd. includes Rs. 60,000 in respect of goods purchased from H Ltd. These goods have been sold by H Ltd. at a profit of 20% on invoice price.

Therefore, unrealized profit = $60,000 \times \frac{20}{100} = 12,000$

Unrealized profit Rs. 12,000 should be deducted from closing stock in the consolidated balance sheet and from Revenue profits i.e. from profit and loss account.

- **CONTINGENT LIABILITIES:**

As 29 defines a contingent liabilities as:

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

Such contingent liability may be of two types.
a) External contingent liability.
b) Internal contingent liability.

Internal contingent liability relates in respect of transactions between holding and subsidiary company and it will not be shown as foot note in the consolidated balance sheet, as they appear as actual liability in the consolidated balance sheet.

- **REVALUATION OF ASSETS AND LIABILITIES :**

The holding company may decide to revalue the assets and liabilities of the subsidiary company on the date of acquisition of share in the subsidiary company. Any profit or loss on such revaluation is a capital profit or loss.

Profit on revaluation of assets of the subsidiary company whether before or after date of acquisition of shares by the holding company, the same must be shared by the holding company, and the minority share holders in proportion to their respective holding. The minority share holders share should be added to the minority interest. But the holding company share should be treated as capital profits and considered in cost of control.

Further readjustment for depreciation on increase in the value of assets should be made in the profit and loss account in the subsidiary company. And same should be deducted from the Revenue profits of the subsidiary company.

Illustration: 4 (Revaluation of Fixed Assets)

From the following balance sheet of H. Ltd. and its subsidiary S Ltd. drawn up at 31.12.2010. Prepare a consolidated Balance sheet as on that date having regard to the following.

i) Reserve and profit and loss account (cr.) of S. Ltd. stood at Rs. 50,000 and 30,000 respectively, on the date of acquisition of its 80% shares. Held by H Ltd. as on 1/01/2010 and

ii) Machinery (Book value Rs. 2,00,000) and furniture (Book value Rs. 40,000) of S Ltd. were revalued at Rs.3,00,000 and Rs. 30,000 respectively for the purpose of fixing the price of its shares there was no purchase or sale of these assets since the date of acquisition.

Balance sheets of H Ltd. S Ltd. as at 31st December, 2010.

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share capital					
Shares of Rs. 100 each	10,00,000	2,00,000	Machinery	6,00,000	1,80,000
Reserves	4,00,000	1,50,000	Furniture	1,00,000	34,000
Profit & loss A/c	2,00,000	50,000	Other Assets (current)	8,80,000	2,86,000
Creditors	3,00,000	1,00,000	Shares in S Ltd. 1600 at Rs. 200 each	3,20,000	--
	19,00,000	**5,00,000**		**19,00,000**	**5,00,000**

Solution :

Workings

1) Preparation of holding Co. share

H Ltd. shares in S Ltd. $=\frac{1600}{2000}=\frac{4}{5}$

Minority's share $=\frac{400}{2000}=\frac{1}{5}$

2) Capital Profit

	Rs.
Reserve Balance as on date of Acquisition	50,000
Profit and loss	30,000
	80,000
Add : Undervaluation of machinery (3,00,000-2,00,000)	1,00,000
	1,80,000
Less : Overvaluation of Furniture (40,000-30,000)	(10,000)
	1,70,000
H. Ltd. Rs. $1,70,000\times\frac{4}{5}$	1,36,000
S Ltd. $1,70,000\times\frac{1}{5}$	34,000

	Rs.
3) Current profit (Reserve 1,50,000 – 50,000)	1.00.000
Profit and loss A/c (50,000 – 30,000)	20.000
	1.20.000
Less : Depreciation on machinery undercharged @ 10% $\left(\frac{Rs.20,000}{2,00,000}\times 100\right)$ on 10% of Rs. 1,00,000	(10.000)
	1.10.000
Add : Depreciation over charged on furniture @ 15% $\left(\frac{Rs.6,000}{40,000}\times 100\right)$ = 15% on Rs. 10,000	1.500
	1.11.500
H Ltd. Rs. $1,11,500\times\frac{4}{5}$	89.200
Minority share Rs. $1,11,500\times\frac{1}{5}$	22.300
	1.11.500

4) Minority Interest	
Share capital (200 x Rs. 100)	40,000
Add : share in capital profit	34,000
Add : share in Revenue Profit	22,300
	96,300

	Rs.	Rs.
5) Cost of control / Goodwill		
Cost of shares		3,20,000
Less : Nominal value of shares held	1,60,000	
H's Co. share in capital profit	1,36,000	2,96,000
Goodwill		24,000

'H' Ltd and its subsidiary 'S' Ltd

Consolidated balance sheet

as at 31st December 2010.

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital			Fixed assets		
Authorized		?	Goodwill		24,000
Issued and paidup 10,000 Equity shares of Rs. 100 each full paid		10,00,000	Machinery		
Reserve and surplus			H Ltd.	6,00,000	
			S Ltd. 1,80,000		

Reserve H Ltd.	4,00,000		Add : undervaluation 1,00,000 2,80,000		
S Ltd. $\left(10,00,000 \times \frac{4}{5}\right)$	80,000	4,80,000	Less : Depreciation 10,000	2,70,000	8,70,000
Profit & Loss A/c			Furniture H Ltd.	1,00,000	
			S Ltd. 34,000		
H Ltd. S Ltd.	2,00,000 9,200	2,09,200	Less over valuation 10,000 24,000		
(89200-80000) Minority Interest		96,300	Add : Depreciation 1500	25,500	1,25,500
Current Liabilities and provision			Current Assets		
Creditors			Loans and Advances		
H Ltd.	3,00,000		H Ltd.	8,80,000	
S Ltd.	1,00,000	4,00,000	S Ltd.	2,86,000	11,66,000
		21,85,500			**21,85,500**

- **PREFERENCE SHARES IN SUBSIDIARY COMPANY :**

In case the subsidiary company has also Preference share capital, its treatment on consolidation will be as follows:

a) Nominal value of non participating Preference share capital of the subsidiary company is held by the holding company should be adjusted in cost of control against the cost of Preference shares.

b) Preference shares held by outsiders. Paid up value of such Preference shares should be included in Minority interest.

- **BONUS SHARES:**

The issue of bonus shares by the subsidiary company will increase the number of shares held by the holding company as well as by the minority share holders without any additional cost. However ratio of holding will not change. Issue of bonus shares may or may not affect the cost of control depending upon whether such shares are issued out of capital profits or revenue profits.

i) **Issue of bonus shares out of pre acquisition profits (capital profits):** In case the subsidiary company issues bonus shares out of capital profits the cost of control remains unaffected in the consolidated balance sheet on account of issue of bonus shares. As share capital increases by the amount of bonus and capital profits decreases by the same amount. Hence, there is not effect on cost of control when bonus shares are issued from pre acquisition profits.

ii) **Issue of bonus share of post acquisition profits (Revenue profits):** In this case, a part of revenue profits will get capitalised resulting decrease in cost of control or increase in capital reserve.
Issue of bonus shares whether out of capital profits or revenue profits will not affect on minority interest. Minority interest will remain unaffected.

Illustration: 5 (Issue of bonus shares out of capital profit (pre-acquisition profit)

H Ltd. acquired 12,000 Equity shares of Rs. 10 each in S Ltd. on December 31, 2010. The summarised Balance sheets of H Ltd. and S Ltd. as on that date were.

Balance sheet as on 31st December, 2010

Liabilities	H Lrd. Rs.	S Ltd. Rs.		H Ltd. Rs.	S Ltd. Rs.
Capital A/c Authorised			Fixed Assets	5,06,000	1,56,000
Issue and paidup	8,00,000	2,40,000	Investment in S Ltd. at cost 12000 shares of Rs. 10 each	2,00,000	--
12,000 shares of Rs. 5 each	6,00,000		Stock in hand	60,000	20,000
16,000 shares of Rs. 10 each		1,60,000	Bills receivable (including Rs. 2000 from S Ltd.)	4,000	
Capital Reserve		68,000	Debtors and balance at bank	4,000	34,000
General Reserve	40,000	20,000			
Profit and loss A/c	1,00,000	20,000			
Bills payable (including Rs. 2000 to H Ltd.)		7,000			
Creditors	70,000	35,000			
	8,10,000	3,10,000		8,10,000	3,10,000

Note : (Re Balance sheet of H Ltd.) contingent liability for bills discounted Rs. 2400)

On 31.12.10 subsidiary Ltd. utilized part of its capital Reserve to make a bonus issue of every Four shares held, effect of bonus not given in above balance sheet.

You are required to prepare the consolidated balance sheet as on 31.12.10 and show there in how your figures are made up.

Solution :

1) Proportion of holding shares :

H Ltd. share in S Ltd. $= \frac{12000}{16000} = \frac{3}{4}$

Minority S Ltd. $= \frac{4000}{10000} = \frac{1}{4}$

2) Capital profit

		Rs.
Capital Reserve	68000	
Less : Bonus Issue	40000	28,000
Revenue Reserves		20,000
Profit and Loss Account		20,000
		68,000
H Ltd. Rs. $68,000 \times \frac{3}{4}$		51,000
S Ltd. $68000 \times \frac{1}{4}$		17,000
		68,000

3) There will be no revenue profit since the shares are acquired on 31.12.10 at the time of preparing final accounts.

4) Minority interest

	Rs.
Share capital (Rs. 2,00,000 $\times \frac{1}{4}$)	50,000
Circluder Bonus capital profit	17,000
	67000

5) Capital Reserve

		Rs.
Cost of shares in S Ltd.		2,00,000
Less : i) Share in share capital $\left(2,00,000 \times \frac{3}{4}\right)$	1,50,000	
ii) Share in capital profit Including Bonus	51,000	2,01,000
Capital Reserve		1,000

H Ltd. and its subsidiary S Ltd.

Consolidated Balance sheet as at 31.12.2010

Liabilities	Rs.	. Rs.	Assets	Rs.	Rs.
Share capital			Fixed Assets		
Authorized		8,00,000	H Ltd.	5,06,000	
Issue and paid up 1,20,000 shares of Rs. 5 each fully paid		6,00,000	S Ltd.	2,56,000	7,62,000
Reserves and surplus			Investments		
General Reserve		40,000	Current Assets loans and Advances		
Capital Reserve		1,000	Stock		
Profit and Loss Account		1,00,000	H Ltd.	60,000	
Minority Interest		67,000	S Ltd.	20,000	80,000
Creditors			Debtors and Bank Balances		
H Ltd.	70,000		H Ltd.	40,000	
S Ltd.	35,000	1,05,000	S Ltd.	34,000	74,000
Bills payable S Ltd.	7,000		Bills Receivable H Ltd.	4,000	
Less : Bills held by H Ltd. per contra	(2,000)	5,000	Less : accepted by S ltd. per contra	(2,000)	2,000
		9,18,000			**9,18,000**

Issue of bonus share out of current / Revenue profit.

Illustration: 6 Issue of bonus shares Out of current profit (Revenue / post acquisition)

The balance sheets of H Ltd. and S Ltd. as at December, 31st 2010 given below.

Liabilities	H Ltd.	S Ltd.	Assets	H Ltd.	S Ltd.
Share capital (Rs.10 each)	8,00,000	2,00,000	Fixed Assets	7,00,000	2,00,000
General Reserve	2,00,000	80,000	Investment 16,000 shares in S Ltd.	2,00,000	
Profit and Loss A/c	1,00,000	60,000	Current Assets	3,00,000	1,60,000
Creditors	1,00,000	20,000			
	12,00,000	**3,60,000**		**12,00,000**	**3,60,000**

S Ltd. had a credit balance of Rs. 80,000 in the General Reserve when H Ltd. acquired share in S Ltd. S Ltd. decided to capitalize Rs. 40,000 out of post acquisition profits earned by making a bonus issue of one share for every five shares held.

Prepare a consolidated Balance sheet as on December, 31st 2010.

Solution :

	Rs.
1) Proportion of holding shares	$\frac{16,000}{20,000} = \frac{4}{5}$
Minority	$\frac{4,000}{20,000} = \frac{1}{5}$

2) Capital Profit	
General Reserve	80,000
	80,000
H Ltd. $80,000 \times \frac{4}{5}$	64,000
S Ltd. $80,000 \times \frac{1}{5}$	16,000

3) Current Profits		
Profit and Loss A/c	60,000	
Less : Bonus issue	40,000	20,000
		20,000
H Ltd.	$20,000 \times \frac{4}{5}$	16,000
Minority	$20,000 \times \frac{1}{5}$	4,000

4) Minority Interest	Rs.
Share in share capital	40,000
Share in capital profit	16,000
Share in current profit	4,000
F.V. of Bonus shares	8,000
	68,000

5) Capital Reserve		
Cost of shares		2.00.000
Less : i) F. value of shares		
Original held	1,60,000	
ii) Share in capital profit	64,000	
iii) Share in (F.V.)	32,000	
of bonus issue		2,56,000
Capital Reserve		56,000

H Ltd. and its Subsidiary S Ltd.
Consolidated Balance sheet as at December, 31st 2010.

Liabilities	Rs.	. Rs.	Assets	Rs.	Rs.
Share capital			Fixed Assets		
Authorized, Issue and paid up 80,000 Equity shares of Rs. 10 each		8,00,000	H Ltd.	7,00,000	
Reserves and surplus			S Ltd.	2,00,000	9,00,000
General Reserve		2,00,000	Investments		
Capital Reserve		56,000	Current Assets loans and Advances		
Profit and Loss Account			Stock		
Balance	1,00,000		H Ltd.	3,00,000	
Add : Revenue from S Ltd.	16,000	1,16,000	S Ltd.	1,60,000	4,60,000
Minority Interest		68,000			
Secured loan					
Unsecured loan					
Current Liabilities and Provisions					
Creditors					
H Ltd.	1,00,000				
S Ltd.	20,000	1,20,000			
		13,60,000			**13,60,000**

(Includes 8,000 Equity shares issued as fully paid by capitalising Revenue profit)

- **TREATMENT OF DIVIDEND :**

i) Dividend paid

When subsidiary company pays dividend, the holding company will naturally receive its due share. On receipt the holding company will debit bank account. However account to be credited depends upon whether dividend received out of pre-acquisition profit or out of post acquisition profit. Dividend received by the holding company out of Pre-acquisition profit should be credited to investment account. Only the dividend out of post acquisition profit should be treated as Revenue income and credited to profit and loss account.

ii) Proposed dividend :

In case the subsidiary company has proposed dividend on its shares which is not accounted by the holding company for such dividend due on their investment in subsidiary company profits.

Profit may be then analysed between capital Revenue in the usual manner.

iii) Dividend payable :

In case subsidiary company has declared dividend and the holding company taken credits for such dividend in its account, following treatments should be given.

1. No adjustment in respect of such dividend should be done in the subsidiary company book.
2. In the holding company books dividend out of pre-acquisition profit should be credited investment account. Dividend out of post acquisition profit should be credited to profit and loss account.
3. In the consolidated Balance-sheet the amount of dividend payable by the subsidiary company will be cancelled against the amount of dividend receivable by the holding company. dividend payable to minorities may be either included in the minority interest or be shown separately as liability in the consolidated balance sheet.

iv) Intension to propose dividend:

In case subsidiary company as intension to propose dividend, such proposed dividend given in adjustment may be completely ignored while preparing the consolidated balance sheet.

Alternatively proposed dividend on share capital held by minority may be deducted from minorities interest and shown separately liability in the consolidated balance sheet.

- **PRELIMINARY EXPENSES :**

The preliminary expenses of subsidiary company may be taken as capital loss or the amount may be added with the amount of preliminary expenses of the holding company.

- **PROVISION FOR TAXATION :**

Any provision for taxation provided by the subsidiary company should be taken to the consolidated balance sheet and be shown on the liability side.

- **PURCHASE OF SHARES IN INSTALLMENT :**

A holding company may purchase shares of the subsidiary company in installments. In such circumstances division of profit between pre and post acquisition will depend upon the lots in which shares are purchased. However, if small purchases are made over the period of time then date of purchase of shares which results in acquiring in controlling interest may be taken as cut of line for division of profits between capital and Revenue.

- **SALE OF SHARES :**

When a holding company disposed off a part of its holding in the subsidiary company and the relationship of holding and subsidiary company continues as it holds majority of shares of subsidiary. Sale of shares by holding company may be treated as follows.

a) Profit or loss on sale of shares should be ascertained and it should be adjusted while ascertaining goodwill or capital reserve. In brief, such loss or gain on sale of share should be considered in cost of control.

b) The minority interest and cost of control should be ascertained on the basis of number of shares held by the holding company and the minority on the date of consolidated balance sheet.

1.8 CONSOLIDATED PROFIT AND LOSS ACCOUNT

The consolidated profit and loss account of the holding company and its subsidiaries are prepared to show the operating activities of the companies comprising the groups. While preparing the consolidated profit and loss account of the holding company and its subsidiary, the items appearing in the profit and loss account of the holding company and the subsidiary companies have to be aggregated.

But while doing so, the following adjustment have to be made.

1) Prepare profit and loss account in columnar form Amounts relating to inter company transactions are entered in the adjustment column against the respective items and are subtracted while entering amounts in the total columns.

2) All inter company operating transactions are eliminated such as purchase and sale of goods, interest on loans among the group companies.

3) All inter company profits are adjusted.

4) Dividends received from the subsidiary company by the holding company should be eliminated from both the sides of consolidated profit and loss account.

5) Interest accrued and outstanding on Debenture of the subsidiary company held by the holding company should be

accounted by holding and subsidiary company both and then its should be eliminated.

6) Readjustment of Depreciation on Revaluation on fixed Assets at the time of acquisition of shares by the holding company should be adjusted in consolidated balance sheet and respective fixed assets and in the consolidated profit and loss account.

7) The minority interest in the profit of subsidiary company should be transferred minority interest account, in the proportion of total profit after adjustment of revaluation of fixed Assets, but before adjusting unrealized profit on stock.

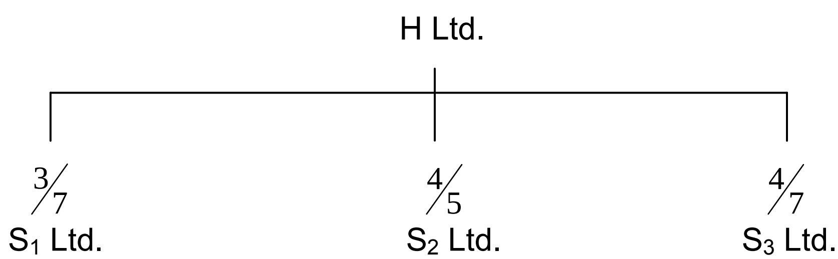
8) The share of holding company in pre-acquisition profit should be transferred to cost of control, in case shares are acquired during the year.

9) Share of holding company in the past acquisition profits shall be considered as revenue profits.

10) The balance in holding company columns will represents the total profit or loss made or suffered by the group as a whole.

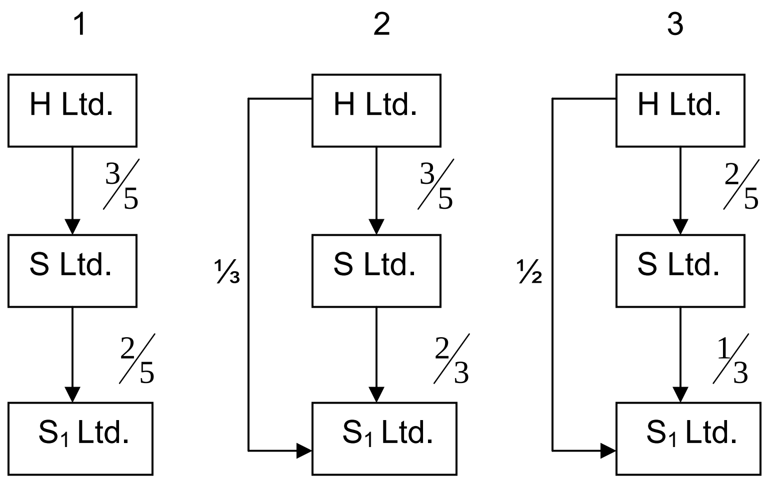
9) **Group Consisting more than one subsidiaries: There are three situations**

a) A holding company may have a number of subsidiaries without any mutual holding between the subsidies. The following chart will clearly show the position.



In this case, the holding company H Ltd. acquired shares of $\frac{3}{7}, \frac{4}{5}, \frac{4}{7}$ of the S_1 ltd. S_2 ltd, S_3 ltd. respectively. And as such the investment account of holding company will show investment in S_1 ltd. S_2 ltd, and S_3 ltd. The calculation of cost of control, minority interest etc. of each company should be done following the usual principles.

b) There may be change holding i.e. the holding company may hold shares in a subsidiary company which is also holding company of its subsidiary company, there may be different combinations which are shown by the following chart.



There may be cross holding i.e. subsidiary company may have shares in the holding company as well. However, according to company's Act, subsidiary company cannot acquires shares in its holding company after becoming subsidiary company, but it can continue to hold those shares in the holding company, which were acquired before it became subsidiary company.

Note: possibilities discuss, 2 and 3 above are at advanced level and therefore not discussed in study material assuming such type of problem should not to be asked in M.com level.

1.9 FOREIGN SUBSIDIARIES:

Foreign subsidiaries companies final A/c should be consolidated along with other subsidiary companies in the usual manner. The trial balance of the subsidiary or balance sheet and profit and loss A/c of the foreign subsidiary is the first converted into home currency.

The rules of conversion are the same as for foreign branches which can be summarized as under.

a) Fixed Assets and fixed liabilities should be converted at the rate of exchange prevailing as on date when such assets were purchased or such liabilities are incurred or the payment was made if they are acquired or raised after acquisitions of shares.

b) Floating assets and liabilities should be converted at the rate of exchange prevailing on the last day of the accounting year.

c) Revenue items or net profit for the year should converted at the average rate of exchange ruling during the period under review.

d) Opening stock should be converted at the rate of exchange at the beginning of the year.

e) Share capital and Reserves of subsidiary company as on date of acquisition, should be converted at the rate of exchange prevailing on date of acquisition.

f) Any remittances for purchases of goods by subsidiary company from holding company or vice-versa should be converted at the actual rates prevailing on the date of purchase or date of receipt of remittances.

g) Fixed assets / Fixed liabilities as on date of acquisition which are carried forward should be converted at the rate of exchange prevailing on date of acquisition of shares; if rate on date of acquisition on fixed assets not given.

After converting the various items of trial balance a new trial balance can be prepared, difference if any in the new trial balance should be transferred to exchange fluctuation account. Such difference may be carried and shown in the Balance sheet either as an asset or as a liability depending on whether balance debit or credit, alternatively difference in exchange can be transferred to profits & loss account.

1.10 SOLVED PROBLEMS

Illustration : 7

The following are summarized Balance Sheets
as on March 31, 2010

	H Ltd. Rs.	S Ltd. $
Share capital (Fully paid shares of Rs. 100/ 100$ each)	40,00,000	1,00,000
Reserves & Surplus	15,00,000	50,000
Bank overdraft	4,00,000	20,000
Sundry Creditors	3,50,000	40,000
	62,50,000	2,10,000
Fixed Assets	33,30,000	1,50,000
Investments		
In S. Ltd.	22,80,000	
Other	1,20,000	15,000
Cash at Bank	40,000	5,000
Other Current Assets	4,80,000	40,000
	62,50,000	2,10,000

Other Information

1. H. Ltd. acquired 600 shares in S Ltd. on October 1, 2009.
2. The Reserves of S Ltd. on April 1, 2009 was $ 20,000.
3. Stock of S Ltd. includes goods costing Rs. 10,000 sold by H Ltd. at the invoice price of Rs. 12,500 which were included in the books of S. Ltd. at $300
4. S Ltd. paid in November 2009 an interim dividend at 10% p.a. for 6 months ended 30th September 2009.
5. S Ltd. Remitted the amount due to H Ltd. when rate of exchange was $ 1 = 43. Amount of dividend received was credited to profit & loss account by H Ltd.
6. The Exchange rate were as under on 1st April 2009 $ 1 = Rs. 41.00.

   On 30th September 2009 $ 1 = Rs. 42.00

   On 31st March 2010 $ 1 = Rs. 44.00

   Average rate $ 1 = Rs. 42.50

   Prepare consolidated Balance sheet.

Solution :

Consolidated Balance Sheet of H Ltd. & its subsidiary S Ltd. as on 31st March 2010

Liabilities			Rs.	Assets		Rs.
Share capital				Fixed Assets		
40000 Equity shares of Rs. 100 each			40,00,000	H Ltd.	33,30,000	
Reserves & Surplus				S Ltd.	63,00,000	96,30,000
H Ltd.	15,00,000			Investments		
Less: Stock Res.	2,500			H Ltd.	12,00,000	
	14,98,500			S Ltd.	6,30,000	7,50,000
Less : Pre-acquisition dividend	(1,29,000)	6,500		Current Assets		
Share of S Ltd. (Revenue)		4,22,580	17,91,080	Stock	12,500	
Capital Reserve (on consolidation)			11,88,000	(-) Stock Reserve	2,500	10,000
Current liabilities				Other current Assets		
Bank overdraft				H Ltd.	4,80,000	
H Ltd.		4,00,000		S Ltd.	17,46,800	22,26,800
S Ltd.		8,80,000	12,80,000	Bank Balance		
Sundry Creditors				H. Ltd.	40,000	
H. Ltd.		3,50,000		S. Ltd.	2,20,00	26,00,000
S Ltd.		17,60,000	21,10,000			
Minority interest			25,07,720			
			1,28,76,800			**1,28,76,800**

Working Note :

Conversion of S Ltd. Balance Sheet as on 31st March 2010

Particulars	Dr. $	Cr. $	Rate	Dr (Rs.)	Cr. (Rs.)
Share capital		1,00,000	42.00		42,00,000
Reserves & surplus as on 1st April 2003 ($ 20000 – S 5000)		15,000	42.00		6,30,000
Profit for half year upto 30th September 09		17,500	42.50		7,35,000
For next half year (after 1.10.09)		17,500	42.50		7,43,750
Bank overdraft		20,000	44.00		8,80,000
Sundry Creditors		40,000	44.00		17,60,000
Fixed Assets	1,50,000		42.00	63,00,000	
Investments	15,000		42.00	6,30,000	
Bank	5,000		42.00	2,20,000	
Stock (purchases from H Ltd.)	300		Actual	12,500	
Other current Assets	39,700		44.00	17,46,800	
Difference in Exchange				39,450	
	2,10,00	2,10,000		89,48,750	89,48,750

Working 2)

Analysis of Reserve & Surplus as on 31st March 2010

Reserve surplus balances.		$ 50,000
Less : Balance as on 1st April 2009.		
Less : Interim Dividend paid	$\begin{pmatrix} 20,000 \\ -5,000 \end{pmatrix}$	$ 15,000
Profit for the year		**$ 35,000**

$\therefore$ Profit upto date of acquisition upto 30th September is equal to 17,500 and Balance profit post-acquisition is equal to $ 17,500.

Working 3) Analysis of profit	Capital (Rs.)	Revenue (Rs.)
Balance as on 1st April 2009	6,30,000	
Profit upto date of Acquisition	7,35,000	
Profit after the Acquisition		7,43,750
Difference in exchange		(39,450)
	1,36,500	74,300
Less – Minority Interest (2/5 th)	(5,46,000)	2,81,720
Balance to H Ltd.	8,19,000	4,22,580

Cost of control / capital Reserve	Rs.
Cost of investment in S Ltd.	22,80,000
Less : Pre-acquisition dividend received $\left[\$\,5000 \times \frac{3}{5} = \$\,3000 \times 43\right]$	(1,29,000)
	21,51,000

Less : 1) Share in face value of share capital		
$\left[42,00,000 \times \frac{3}{5}\right]$	25,20,000	
2) Share in capital Profit	8,19,000	33,39,000
Capital Reserve		11,88,000
Minority Interest $\left[\frac{2}{5}\right]$		
Share in share capital		16,80,000
Share in capital profit		5,46,000
Share in Revenue profit		2,81,720
		28,07,720
Stock Reserve		Rs.
Invoice price		12,500
Less : Cost		10,000
Unrealized profit		2,500

Illustration : 8

The following are summarized Balance Sheets of 'X' Ltd. and 'Y' Ltd. as on 31st December 2010

	X Ltd.	Y Ltd		X Ltd.	Y Ltd.
Paid up capital in			Freehold premises	4,50,000	1,20,000
Shares of Rs. 100 each	10,00,000	3,00,000	Plant & Machinery	3,50,000	1,60,000
General reserve	4,00,000	1,25,000	Furniture	80,000	30,000
Profit and Loss A/c	3,00,000	1,75,000	Debtors	3,00,000	1,70,000
Sundry Creditors	1,00,000	70,000	Stock investment in	3,20,000	1,60,000
			Shares in Y Ltd. at cost	2,60,000	-
			Cash balance	40,000	30,000
	18,00,000	6,70,000		18,00,000	6,70,000

You are required to prepare a consolidated Balance Sheet as on 31st December 2010. Showing in detail necessary adjustments and taking into consideration the following information

a) 'X' Ltd. acquired the shares of Y Ltd. on 1.1.2010 when the balance on their profit and Loss account and general reserve were Rs. 75000 and Rs. 80000 respectively.
b) Stock of Rs. 1,60,000 held by 'Y' Ltd. consists of Rs. 60,000 goods purchased from 'X' Ltd. Who has charges profit at 25% on cost.
c) Included in Debtors of X Ltd. Rs. 30000 due from Y Ltd.

Consolidated Balance Sheet of X Ltd. and Y. Ltd. as on 31.12.2010

Liabilities	Rs.	Assets	Rs.
Share capital in shares of Rs. 10 each	10,00,000	Fixed Assets	
Reserves & Surplus		Freehold premises (4,50,000 + 1,20,000)	5,70,000
Capital Reserve	43,333	Plant & Machinery (3,50,000 + 1,60,000)	5,10,000
General Reserve (4,00,000+30,000)	4,30,000	Furniture (80,000 + 30,000)	1,10,000
Profit & Loss A/c (2,92,000+66,667)	35,867	Investment	NIL
Secured Loans	NIL	Current Assets	
Current Liabilities	NIL	Loans & Advances	
Provisions		Stock (320000 + 160000) 480000	
Creditors (1,00,000 + 70,000)	1,70,000	Less: Unrealised profit 12000	4,68,000
Minority Interest	2,00,000	Debtors (300000 + 170000)	4,70,000
		Cash (40000 + 30000)	70,000
	21,98,000		21,98,000

Notes :

1) Calculation of Capital Reserve

Investment cost		2,60,000
Less : i) Share in share capital	2,00,000	
Less : ii) Propionate Pre-acquisition profit $\left(\frac{2}{3}\times 1,55,000\right)$	1,03,333	3,03,333
Capital Reserve		43,333

2) Minority Interest

Share in Share Capital		1,00,000
⅓ rd of General Reserve		41,667
⅓ rd of Profit & Loss A/c		58,333
		2,00,000

3) General Reserve

Of X Ltd.		4,00,000
Of Y Ltd. (125000- Pre-acquisition 8000)	45,000	
Less : due to minority shareholders (⅓)	15,000	30,000
		4,30,000

4) Unrealised profit

Unrealized profit = 20% of 60,000	12,000

5) Profit & Loss Account

X Ltd. (300000-unrealised profit)		2,88,000
Y Ltd. (175000-Pre-acquisition 75000)	1,00,000	
Less : ⅓ rd of minority	33,333	66,667
		3,54,667

Illustration : 9

H Ltd. acquired 8,000 shares of Rs. 10 each in K Ltd. on 31st March 2011. The summarized Balance Sheets of the two companies as on that date were as follows :

Particulars		H Ltd. Rs.	K Ltd. Rs.
Liabilities :			
Share Capital :			
30,000 Shares of Rs. 10 each	... ...	3,00,000	
10,000 Shares of Rs. 10 each	... ...	-	1,00,000
Capital Reserve	... ...	-	52,000
General Reserve	... ...	25,000	5,000
Profit & Loss Account	... ...	38,200	18,000
Loan from I Ltd.	... ...	2,100	-
Bills payable (including Rs. 1,000 to H Ltd.)	... ...	-	1,700
Creditors	... ...	17,900	5,000
		3,83,200	1,81,700
Assets :			
Fixed Assets		1,50,000	1,44,700
Investments in K Ltd. at cost	... ...	1,70,000	-
Stock-in-hand	... ...	40,000	20,000
Loan to H Ltd.	... ...	-	2,000
Bills Receivable (including Rs. 700 from K Ltd.)	... ...	1,200	-
Debtors	... ...	20,000	10,000
Bank	... ...	2,000	5,000
		3,83,200	1,81,700

You are given the following information :

1) K Ltd. made a bonus issue on 31st March 2011 of one share for every two shares held, reducing the capital reserve equivalently, but the transaction is not shown in the above Balance Sheets.
2) Interest receivable (Rs. 100) in respect of the loan due by H Ltd. to K Ltd. has not been credited in the account of K Ltd.
3) The directors decided that the fixed assets of K Ltd. were overvalued and should be written down by Rs. 5,000.

Prepare the Consolidated Balance Sheet as at 31st March 2011, showing your workings.

Solution : *(M.Com., May 1998, adapted)*

Consolidated Balance Sheet of K Ltd. and its Subsidiary K Ltd. as at 31st March, 2011

LIABILITIES	Rs.	Rs.	ASSETS	Rs.	Rs.
Share Capital			Fixed Assets		
Equity Share Capital			Goodwill (on consolidation)		33,920
30,000 Equity shares of Rs. 10 each, fully paid		3,00,000	Other Fixed Assets	1,50,000	
				1,39,700	2,89,700
Reserves & Surplus			Current Assets, Loans & Advances		
General Reserves	25,000		Stock	40,000	
				20,000	60,000
P & L A/c H Ltd.	38,200	63,200	Debtors	20,000	
Minority Interest		34,020		10,000	30,000
Current Liabilities & Provisions			Bills Receivable	1,200	
Creditors			Less : Mutual Dues	(200)	1,000
H Ltd.	17,900				
K Ltd.	5,000	22,900			
Bills Payable	1,700		Cash & Bank	2,000	
				5,000	7,000
Less : Mutual Dues	(200)	1,500			
Totall		4,21,620	Total		4,21,620

1) Holding Proportion

H Ltd. = $\frac{12,000}{15,000} = 4/5$

Minority Interest $= \frac{3,000}{15,000} = 1/5$

2) Analysis of profits

			Capital Profit	Revenue Profit
P/L as on date of Acq	18,000			
Add: Interest due on ba	100		18,100	-
Reserve on date of Acq				
Capital			52,000	-
General			5,000	-
			75,100	-
Less: Bonus Issue		50,000		
Loss on Revaluation of Fixed Assets		5,000	(55,000)	-
			20,100	-
Holding Co. $4/5$			16,080	-
Minority Interest $1/3$			4,020	-

3) **Cost of control**

Cost of Investment		1,70,000
Less: Equity Share Capital (including Bonus)	1,20,000	
Capital Profit	16,080	(1,36,080)
Goodwill		**33,920**

4) **Minority Interest**

Share Capital	30,000
Share in Capital Profit	4,020
	34,020

Treatment of loan & interest Receivable

On taking credit for interest receivable of Rs. 100 by K Ltd. in respect of loan due by K Ltd., the profit and loss account balance of K Ltd. will increase to Rs. 18,000 and loan to H Ltd. will also increase to Rs. 2,100. On consolidation, inter-corporate loan of Rs. 2,100 is set off and hence has not been shown in the consolidated balance sheet.

Illustration : 10

Following are the balance sheets of H Ltd. and its subsidiary S Ltd., as on 31st December 2010.

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share capital			Goodwill	40,000	30,000
Shares of Rs. 10 each	5,00,000	2,00,000	Land & Buildings	2,00,000	1,30,000
General Reserve on January 1, 2003	1,00,000	60,000	Plant & Machinery	1,60,000	90,000
Profit & Loss Account	1,40,000	90,000	Stock	1,00,000	90,000
Bills payable	-	40,000	Debtors	20,000	75,000
Creditors	80,000	50,000	1,500 Shares in S Ltd. at cost	2,40,000	-
			Cash at Bank	60,000	25,000
	8,20,000	4,40,000		8,20,000	4,40,000

Profit and loss account of S Ltd. showed a balance of Rs. 50,000 on 1 January 2010. A divided of 15% was paid in October, 2010 for the year 2009. This dividend was credited to profit and loss account by H Ltd. H. Ltd. acquired the shares in S Ltd., on 1 July 2010. The bills payable to S. Ltd., were all issued in favour of H Ltd., which company got the bills discounted. Included in the creditors of S Ltd. are Rs. 20,000 for goods supplied by H Ltd. included in the stock of S Ltd. are goods to the value of Rs. 6,000 which were supplied by H Ltd. at a profit of 33 ⅓% on cost. In arriving at the value of the S Ltd. shares, the plant and machinery

which then stood in the books at Rs. 1,00,000 was revalued at Rs. 1,50,000. The new value was not incorporated in the books. No changes in these assets have been made since that date.
Prepare a Consolidated Balance Sheet of H Ltd. and S Ltd. Show working in detail

(M.com., Oct. 97, adapted)

Solution :

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st December 2010.

LIABILITIES	Rs.	Rs.	ASSETS	Rs.	Rs.
Share Capital			Fixed Assets (Net)		
Equity Share Capital 50,000 Equity shares of Rs. each, fully paid		5,00,000	Goodwill H Ltd. S Ltd.	 40,000 30,000 70,000	
Reserves & surplus			Less : Capital Reserve	(60,000)	10,000
General Reserves	1,00,000		(on consolidation)		
Consolidated P & L A/c	1,40,375	2,40,375	Land/Bldg./Property H Ltd	 2,00,000	
Minority Interest		1,00,625	S Ltd	1,30,000	3,30,000
Current liabilities & Provisions			Machinery 'H' 'S' Add: Revaluation	1,60,000 90,000 55,000	
Creditors H Ltd. S Ltd.	 80,000 50,000		 (-) Add Dep	3,05,500 (2,500)	 3,02,500
	1,30,000		Stock 'H' 'S'	1,00,000 90,000	
Less : Mutual Dues	(20,000)	1,10,000	 (-) st Reserve	1,90,000 (1,500)	 1,88,500
Bills Payable S Ltd.		40,000	Debtor 'H' 'S'	20,000 75,000	
			(-) Mutual Dues	(20,000)	75,000
			Cash & Bank		85,000
		9,91,000			**9,91,000**

Working Notes:

1) Proportion of Holding

Holding Co. $\frac{1500}{2000} = \frac{3}{4}$

Minority $\frac{500}{2000} = \frac{1}{4}$

2) Time ratio

Shares acquired on 1.7.2010

∴ Pre Acq. 1.1.2011 to 30.6.2010 = 6 months

Post Acq. 1.7.2010 to 31.12.2010 = 6 months

∴ Time ratio = 1:1

3) **Analysis of profits of S Ltd**

		Capital Profit	Revenue Profit
a) General reserve (op. bal)		60,000	-
b) P/L A/c (op. bal)	50,000		
Less: Pre Acq. Div	(30,000)	20,000	
c) P/L A/c closing. bal	90,000		
- Opening bal	20,000		
	70,000		
Profit earned during the year in T.R.		35,000	35,000
d) Increase in F.A. value due to revaluation		55,000	
e) Less: Depreciation on above			(2,500)
		1,70,000	32,500
H Ltd $\frac{3}{4}$		1,27,500	24,375
Minority $\frac{1}{4}$		42,500	8,125

4) **Cost of Control**

Cost of Investment		2,40,000
Less: a) Pre acquisition Div	22,500	
b) Proportionate Equity share capital	1,50,000	
c) Share in capital profit	1,27,500	(3,00,000)
∴ Capital Reserve		60,000

Adjested against Goodwill already
Appearing in the books of H Ltd

5) **Minority Interest**

a) Equity Share Capital	50,000
b) Share in capital profit	42,500
c) Share in Revenue profit	8,125
	1,10,625

6) **Consolidated P/L A/c**

P/L A/c bal in H Ltd		1,40,000
Add: Share in revenue profits of S Ltd		24,375
		1,64,375
Less: Div out of Pre-Acq profits		
Credited to P/L A/c	22,500	
Stock reserve	1,500	(24,000)
		1,40,375

7) Revaluation plat & machinery

Book value on 1.1.2010	1,00,000
Less: Dep for 6 months	5,000
Book value on 1.7.2010	95,000
Revelued at	1,50,000
∴ Profit on Revalution	**55,000**

8) Additional Depreciation		
On 1,00,000 for 6 month		5,000
On 1,50,000 for 6 month		7,500
	Total	12,500
Less: Already provided		10,000
Addl to be provided		**2,500**

Illustration : 11

The following are the summarized Balance Sheets of X Ltd. and Y Ltd. as at 31st December 2010.

Liabilities	X Ltd. Rs.	Y Ltd. Rs.	Assets	X Ltd. Rs.	Y Ltd. Rs.
Authorized, issued and paid up capital :			Fixed Assets	10,15,000	8,09,000
Equity shares of Rs. 10 each	8,00,000	4,00,000	Investments :		
12% Preference shares of Rs. 10 each		2,00,000			
General Reserve	3,60,000	2,00,000	In Y Ltd. 30,000 Equity shares	4,50,000	-
			15,000 Preference Shares	1,80,000	-
Profit & Loss Account Balance	2,40,000	1,40,000	250-10% Debentures (at face value)	25,000	-
10% Debenture of Rs. 100 each	-	50,000	Current Assets	2,60,000	4,80,000
Proposed Dividends :					
- on Equity shares	1,20,000	60,000			
- on Preference shares	-	24,000			
Debenture interest acrued	-	5,000			
Trade creditors	4,10,000	2,10,000			
	19,30,000	12,89,000		19,30,000	12,89,000

1) X Ltd. acquired its interest in Y Ltd. on 1st January, 2010 when the balance to the General Reserve Account of Y Ltd. was Rs. 1,80,000.

2) The Balance to the Profit & Loss Account of Y Ltd. as on 31st December, 2010 was arrived at as under :

	Rs.	Rs.
Balance on 1-1-2010		40,000
Current Profit (including dividends)		2,04,000
		2,44,000
Deduct : Transfer to General Reserve	20,000	
Proposed Dividends	84,000	(1,04,000)
Balance as on 31-12-2010		**1,40,000**

3) Balance to the Profit and Loss Account of Y Ltd. as on 1-1-2010 was after providing for dividends on Preference shares and 10% dividends on Equity shares for the year ended 31st December, 2009, these dividends were paid in cash by Y Ltd. in May 2010.

4) No entries have been made in the books of X Ltd. for debenture interest due or for proposed dividends of Y Ltd. for the year ended 31-12-2010.

5) Mutual indebtedness of Rs. 24,000 is reflected in the balances shown in the Balance Sheets.

6) Y Ltd. in October 2010 issued fully paid up bonus shares in the ratio of one share for every four shares held – by utilising its general reserve. This was not recorded in the books of both the companies.

7) Dividend paid by Y Ltd. for 2009 was credited to profit & Loss A/c of X Ltd. instead of crediting to investments in Subsidiary Company A/c.

8) X Ltd. acquired both the Equity shares and Preference shares of Y Ltd. on 1^{st} January, 2010.

From the above information, you are required to prepare the Consolidated Balance Sheet of X Ltd. and its subsidiary Y Ltd. as at 31^{st} December, 2010. All workings are to form part of your answer.

Solution : ***(M.Com., Oct., 1998, adapted)***

Consolidated Balance Sheet of X Ltd. and its Subsidiary Y Ltd. as at 31^{st} December 2010.

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital					
Equity share capital 80,000 Equity Shares of Rs. 10 each, fully paid		8,00,000			
Reserves & Surplus			Other Fixed Assets	10,15,000	
General Reserve	3,60,000			8,09,000	18,24,000
Consolidated P & L A/c	3,47,500				
Capital Reserve					
(on consolidation)	33,000	7,40,500			
Minority Interest		2,56,000	Investments		NIL
Secured Loans			Current Assets, Loans & Advances		
Debentures Y Ltd.	50,000				
Less : Mutual Dues	(25,000)	25,000	Other Current Assets / Adv.	2,60,000	
Interest O/S on Debentures Y Ltd.	5,000			4,80,000	
				7,40,000	
Less : Mutual Dues	(2,500)	2,500	Less : Mutual Dues	(24,000)	7,16,000
Current Liabilities & Provisions			Misc. Exp. Not W/O		NIL
Creditors					
X Ltd.	4,10,000				
Y Ltd.	2,10,000				
	6,20,000				
Less : Mutual Dues	(24,000)	5,96,000			
Proposed Dividends X Ltd.		1,20,000			
Total		25,40,000	Total		25,40,000

Working Notes :

1) Holding proportion

	X Ltd	Minority	Total
Before Bonus	30,000	1,00,000	= 40,000
Bonus	7,500	2,500	= 10,000
After Bonus	37,500	12,500	= 50,000
Ratio	$\frac{3}{4}$	$\frac{1}{4}$	

2) The acquisition is one the first day of the year, hence all profits during the year are Revenue / previous years profit post

3) Analysis of Profits		Capital Profits	Revenue Profits
Reserve (opening)	1,80,000		
Profit & Loss A/c (Opening)	40,000		
Undistributed Profits (opening)	2,20,000		
Less : Bonus from capital profit	1,00,000		
Undistributed Profits (On Date of Acquisition)		1,20,000	
Profit for the year [2,04,000 – 84,000]			1,20,000
Basic CP/RP		1,20,000	1,20,000
Minority Interest		30,000	30,000
Holding Co.		90,000	90,000
4) Cost of Control			
Cost of investment of X Ltd.			
Equity		4,50,000	
Preference		1,80,000	6,30,000
Less : Dividend declared out of capital profit			
Equity		18,000	
Preference		30,000	48,000
Carrying Amount of investment			5,82,000
Paid up value of shares			
Equity (Incl. Bonus) share capital	3,75,000		
Preference Share capital	1,50,000	5,25,000	
Share of capital profits		90,000	
Share of carrying Amount of Equity of Y Ltd.			6,15,000
			(33,000)

5) Minority Interest		
Share in Share Capital		1,25,000
Equity (Incl. Bonus)		50,000
Preference		30,000
Share of Capital Profits		30,000
Share of Revenue Profits		
Share of Proposed Dividends	15,000	
Equity (Incl. Bonus)	6,000	21,000
Preference		
Total Minority Interest		2,56,000

6) Consolidated P & L A/c	
Profit & Loss of X Ltd.	2,40,000
Add : Share of Revenue Profit	90,000
Share of proposed dividend	45,000
Equity (Incl. Bonus)	18,000
Preference	2,500
Interest due on debentures in Y Ltd. held by X	3,95,500
Less : Dividend out of capital profit	(48,000)
Credited to Profit and Loss A/c instead of investment	
Balance carried to Balance sheet	**3,47,500**

Illustration : 12

The following are the Balance Sheets of H Limited as S Ltd. as on 31st December, 2010.

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd.	S Ltd.
Share Capital			Fixed Assets	4,80,000	2,50,000
Shares of Rs. 100 each	10,00,000	5,00,000	Investments in S Ltd.	5,00,000	-
Reserve and Surplus :			Current Assets	7,20,000	7,50,000
General Reserve	1,00,000	1,50,000			
Profit and Loss Account	1,60,000	1,50,000			
Current Liabilities	4,40,000	2,00,000			
	17,00,000	10,00,000		17,00,000	10,00,000

The following further information is furnished :

1. H. Ltd. acquired 3,000 shares in S. Ltd. on 1st April 2010. The reserves and surplus position of S Ltd. as on 1st January, 2010 was as under :

   a) General Reserve Rs. 2,50,000

   b) Profit and Loss Account balance Rs. 1,20,000

2. On 1st July, 2010 S Ltd. issued 1 share for every 4 shares held, as bonus share at a face value of Rs. 100 per share. No entry has been made in the books of H Ltd. for the receipt of these bonus shares.

3. On 30th June 2010 S Ltd. declared a dividend out of it pre-acquisition profits, of 25 percent on its then Capital; H Ltd. credited the dividend to its Profit and Loss Account.
4. H Ltd. owed S Ltd. Rs. 50,000 for purchase of stock from S Ltd. The entire stock is held by H Ltd. on 31st December 2010 S Ltd. made a profit of 25 percent on cost.
5. H. Ltd. transferred a machinery to S Ltd. for Rs. 1,00,000. The book value of the Machinery to H. Ltd. was Rs. 80,000.

Prepare a Consolidated Balance Sheet as on 31st December 2010.

(M.Com. Oct. 2000, adapted)

Solution :

Consolidated Balance Sheet of H. Ltd. and its Subsidiary S Ltd. as at 31st December 2010.

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital			Fixed Assets (Net)		
Equity share capital 10,000 Equity Shares of Rs. 10 each, fully paid		10,00,000	Other Fixed Assets H Ltd. S Ltd.	 4,80,000 2,50,000 7,30,000	
Reserves & Surplus General Reserve Consolidated P & L A/c Capital Reserve (on consolidation)	 1,00,000 1,28,125 1,01,875	 3,30,000	Less : Unrealised Profit	(20,000)	7,10,000
Minority Interest Secured Loans Unsecured Loans Current Liabilities & Provisions		2,00,000 NIL NIL	Current Assets, Loans & Advance Other Current Assets / Adv. H Ltd. S Ltd.	 7,20,000 7,50,000 14,70,000	
Other Current Liabilities H Ltd. S Ltd.	 4,40,000 2,00,000 6,40,000		Less : Mutual Dues Less : Unrealised Profit	50,000 10,000	14,10,000
Less : Mutual Dues	(50,000)	5,90,000			
		21,20,000			21,20,000

Working Notes :

1. Proportion of Ownership H Ltd. $= \frac{3,750}{5,000} = \frac{3}{4}$, Minority - ¼

No. of share
Acquired by H Ltd. = 3,000 + Bonus shares 750 (1 share for every 4 share)

2. Analysis of Profits / Movements in Equity

		Capital Profits	*Revenue Profits*
Reserves (opening)	2,50,000		
Less : Bonus from Pre-acquisition profit	1,00,000		
	1,50,000		
Profit & Loss A/c (opening)	1,20,000		
	2,70,000		
Less : Dividend from (pre-acquisition)	1,00,000		
Undistributed profits (on Date of Acquisition)		1,70,000	
Profit for the year divided in Pre & post period pre & post 9 months.	1,30,000	32,500	97,500
		2,02,500	97,500
Minority Interest (¼)		50,625	24,375
Holding Co (¾)		1,51,875	73,125

3. Cost of Control

Cost of investment of H Ltd.	5,00,000	
Less : Dividend out of pre-acquisition carrying amount of investment	75,000	
		4,25,000
Less : i) share in paid up Value of shares	3,75,000	
ii) Share of Capital Profit	1,51,875	
= Capital profit		(5,26,875)
		1,01,875

4. Minority Interest (¼)

Share in Share capital	1,25,000
Share of Capital Profits	50,625
Share of Revenue Profits	24,375,
Minority Interest	**2,00,000**

5. Divided paid out of pre-acquisition opening capital = 4,00,000 × 25% = Rs. 1,00,000
H Ltd. share = 1,00,000 × ¾ = 75,000

6. Depreciation on revation profit or transfer of machinery not considered as date of transferred is not given.

7. Profit of S Ltd. for the year, ascertained by preparing P & L A/c.

Profit & Loss A/c (S Ltd.)

To dividend	1,00,000	By Bal B/fd.	1,20,000
To Bal c/fd	1,50,000	By N.P. (Bal. fig)	1,30,000
	2,50,000		2,50,000

8. Profit & Loss surplus (H Ltd.)	Rs.
Balance as per Balance sheet	1,60,000
Add: Share of Revenue profit S Ltd.	73,125
	2,33,125

Less : i) Stock Reserve	10,000	
ii) Profit on transferred of machinery	20,000	
iii) Pre-acquisition dividend wrongly credited to P/L A/c by H Ltd.	75,000	(1,05,000)
Surplus carried to Balance sheet		1,28,125

Illustration : 13

A Ltd. acquired 6,000 Equity shares of Rs. 10 each in S Ltd. on March 31, 2011. The summarized Balance Sheet of H Ltd. and S Ltd. as on that date were :

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Capital :			Fixed Assets	2,53,000	1,28,000
Authorised	4,00,000	1,20,000	Investment in S Ltd. at cost 6,000 shares of Rs. 10 each	1,00,000	-
Issued and paid up :			Stock in hand	30,000	10,000
30,000 shares of Rs. 10 each	3,00,000	-	Bills Receivable (including Rs. 1,000 from S Ltd.)	2,000	-
8,000 shares of Rs. 10 each	-	80,000	Debtors and Balance at Bank	20,000	17,000
Capital Reserve	-	34,000			
General Reserve	20,000	10,000			
Profit and Loss A/c	50,000	10,000			
Bills payable (including Rs. 1,000 to H Ltd.)	-	3,500			
Creditors	35,000	17,500			
	4,05,000	1,55,000		4,05,000	1,55,000

On 31-03-2011, S. Ltd. proposes to utilize part of its Capital Reserve to make a Bonus issue of share for every four shares held.

You are required to prepare the Consolidated Balance Sheet as on 31-03-2011 and show therein how you figures are made up.

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March 2011

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital :			Fixed Assets (Net)		
Equity Share Capital		3,00,000	Other Fixed Assets		
			H Ltd.	2,53,000	
			S Ltd.	1,28,000	3,81,000
30,000 shares of Rs. 10 each fully paid			Current Assets, Loans & Advances		
Reserves & Surplus			Stock		
			H Ltd.	30,000	
			S Ltd.	10,000	40,000
General Reserve	20,000		Debtors		
			H Ltd.	20,000	
			S Ltd.	17,000	37,000
Consolidated P & L A/c	50,000		Bills Receivable H Ltd.	2,000	
Capital Reserve			Less : Mutual Dues	(1,000)	1,000
(on Consolidation)	500	70,500			
Minority interest		33,500			
Creditors					
H Ltd.	35,000				
S Ltd.	17,500	52,500			
Bills Payable S Ltd.	3,500				
Less : Mutual dues	(1,000)	2,500			
		4,59,000			4,59,000

Working Notes :

1. **Proportion of Holding**

Shares held by H (Original + Bonus) = 7,500 / 10,000 = ¾

Shares held by Minority [Original + Bonus] = 2500/10,000 = ¼

acquisition is on last day of year hence there is no post acquisition, so there is no revenue profit.

2. **Analysis of Profits** *Capital Profits*

Profit & Loss A/c on Date of Acquisition	10,000	
Reserves on Date of Acquisition		
Revenue Reserves	10,000	
Capital Reserves	34,000	54,000
Profit during the year		54,000
Less: Bonus from CP (to be declared)		(20,000)
Total Capital Profit		34,000
Minority Interest [¼]		8,500
Holding Co. [3/4]		25,500

3. **Cost of Control**

Cost of investment of H		1,00,000
Share in share capital	75,000	
Share of capital profits	25,500	
		(1,00,500)
Capital Reserve		500

4. **Minority Interest**

Share in share capital	25,000
Share of Capital Profits	8,500
Total	33,500

Illustration : 14

From the following Balance sheet of H Ltd. and its subsidiary S Ltd. as on 31st March 2011, and the additional information provided there after prepare consolidated Balance sheet on 31.3.11

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share capital (Rs.10)	25,00,000	5,00,000	Land	5,00,000	1,00,000
Reserve	2,00,000	-	Building	10,00,000	3,00,000
Profit & Loss A/c	3,00,000	4,00,000	Machinery	6,00,000	4,50,000
Current Liabilities	1,60,000	90,000	Investment	7,50,000	12,000
			Current Assets	3,10,000	1,28,000
	31,60,000	9,90,000		31,60,000	9,90,000

Additional Information:

1. H. Ltd. acquired 40,000 Equity shares of S Ltd. for Rs. 7,00,000 on 1 July 2010.
2. Land of S Ltd. was revolved as on 30.6.2010 Rs. 5,00,000
3. S Ltd. declared & paid interim dividend @ 20% p.a. for 6 month ended on 30th September 2010. Dividend received by H Ltd., credited to profit a loss A/c
4. Profit & Loss A/c of S Ltd. as on 1st April 2010 showed Dr. Balance amounting Rs. 4,00,000

Solution:

Consolidated Balance Sheet of H Ltd. & its subsidiary S Ltd. as on March 31st 2011.

Liabilities	Rs.	Assets		Rs.	Rs.
I. Share Capital					
2,50,000 Equity shares of Rs. 10 each fully paid up	25,00,000	I. Fixed Assets			
II. Reserved & Surplus		Goodwill			1,25,000
Reserve	2,00,000	Land :	H Ltd.	5,00,000	
			S Ltd.	5,00,000	10,00,000
Profit & Loss A/c	7,65,000	Building	H Ltd.	10,00,000	
			S. Ltd.	3,00,000	13,00,000
III. Secured Loan	-	Machinery	H Ltd.	6,00,000	
			S Ltd.	4,50,000	10,50,000
iv. Unsecured Loan	-	II. Investment			
			H Ltd.	50,000	
			S. Ltd.	12,000	62,000
v. Current Liabilities		III. Current Assets			
H. Ltd.. 1,60,000			H Ltd.	3,10,000	
S. Ltd. 90,000	2,50,000		S Ltd.	1,28,000	4,28,000
Minority Interest	2,60,000				
	39,75,000				39,75,000

1) Degree of control = $\frac{40,000}{50,000} = 4/5 \therefore Minority = 1/5$ shares were purchased on 1 July 2010 during the year; pre-acquisition period = 3 month a pos-acquisition 9 month.

2) Net Profit earned by Company :

Profit & Loss A/c (31.3.11)

To Balance B/d	4,00,000	By Net Profit for the year	8,50,000
To Interim Dividend	50,000		
To Balance C/d	4,00,000		
	8,50,000		8,50,000

3) Analysis Profit of S Ltd.	Capital profit	Revenue profit
Opening Dr. Balance in Profit & Loss A/c	(4,00,000)	--
Revaluation profit on land	4,00,000	--
Retained Net Profit for the year [8,00,000 + 50,000]	2,12,500	6,37,500
8,50,000 in Time Ratio		
Dividend paid for 6 month	(25,000)	(25,000)
$5{,}00{,}000 \times 20\% \times \frac{6}{12} = 50{,}000$		
Total	1,87,500	6,12,500
Minority Int. $\left(\frac{1}{5}\right)$	(37,500)	(1,22,500)
Belonging to H Ltd.	1,50,000	4,90,000

4) **Minority Interest :**

Share in Equity share capital	1,00,000
Share in capital profit	37,500
Share in Revenue profit	1,22,500
Total	**2,60,000**

5) **Cost of Control :**

		Rs.
Cost of investment in S Ltd.		7,00,000
Less : pre-acquisition dividend received		(25,000)
		6,75,000
Less : i) Share in Equity share capital	4,00,000	
ii) Share in Capital profit	1,50,000	(5,50,000)
Goodwill		**1,25,000**

6) **Profit and Loss A/c Balance (H. Ltd.)**

Balance as per Balance sheet	3,00,000
Less : Pre-Acquisition dividend wrongly credited (3 month)	(25,000)
Share in	2,75,000
Add : Revenue profit of S Ltd.	4,90,000
Balance carried to Balance sheet	**7,65,000**

Illustration : 15

Following are the Balance Sheets of H. Ltd. and S. Ltd. as at 31st March 2011

Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share capital share of Rs.10 each	5,00,000	2,00,000	Goodwill	40,000	30,000
General Reserve as on 1.4.03	1,00,000	60,000	Land & Building	2,00,000	1,30,000
Profit & Loss A/c	1,40,000	90,000	Plant & Machinery	1,60,000	90,000
Bills Payable	-	40,000	Stock in Trade	1,00,000	90,000
Creditor s	80,000	50,000	Shares in S. Ltd. 1500 shares (at cost)	2,40,000	
			Cash at Bank	60,000	25,000
	8,20,000	4,40,000		8,20,000	4,40,000

The Profit and Loss Account of S Ltd. showed a credit balance of Rs. 50,000 on 1st April 2010. A dividend of 15% was paid in December 2010 for the year 2009-10. This dividend was credited to profit and loss account by H Ltd.

H Ltd. acquired the shares in S. Ltd. on 1st October, 2010.

The Bills Payable of S Ltd. were all issued in favour of H Ltd. which company got the bills discounted.

Included in the Creditors of S Ltd. is Rs. 20,000 for goods supplied by H Ltd. included in the stock of S Ltd. are goods to the value of Rs. 8,000 which were supplied by H. Ltd. at a profit of 33⅓% on cost.

In arriving at the value of S. Ltd. shares, the plant and machinery which then stood in the books at Rs. 1,00,000 on 1.4.2010 was revalued at Rs. 1,50,000. The new value was not incorporated in the books. No changes in these have been made since then in books of S. Ltd.

Prepare the consolidated balance sheet as on that date.

Solution :

Consolidated Balance Sheet of H. Ltd. and its Subsidiary S Ltd. as at 31.03.2011

Liabilities		**Rs.**	**Assets**		**Rs.**
Share capital :			Goodwill	70,000	
5000 shares of Rs. 100 each		5,00,000	Less : Capital Reserve	60,000	10,000
Minority interest		1,00,562	Land & Building		3,30,000
General Reserve		1,00,000	Plant & Machinery		
Profit & Loss A/c	1,40,000		H. Ltd.	1,60,000	
Add : Post-acquisition	24,188		S. Ltd.	1,42,250	3,02,250
	1,64,188				
Less: Pre-acquisitions dividend	22,500		Stock		1,88,500
	1,41,688		Sundry debtors		75,000
Less: Unrealised profit	1,500	1,40,188	Cash at Bank		85,000
Bills payable		40,000			
Sundry creditors		1,10,000			
		9,90,750			9,90,750

Working Notes :

1 Pre-acquisition Profits and Reserves of S. Ltd.

		Rs.
General Reserve as on 1.4.2010		60,000
Profit & Loss Account as on 1.4.2010	50,000	
Add: Profit for 6 months upto 30.09.2010		
i.e. ½ of Rs. (90,000 + 30,000 – 50,000)	35,000	
	85,000	
Less : Dividend for 2009-10 @ 15% on Rs. 2,00,000	30,000	55,000
		1,15,000
H. Ltd. share ¾th of 1,15,000		86,250
Minority Interest ¼th of 1,15,000		28,750

2. Profit on Revaluation of Plant and Machinery

Book value of plant and machinery as on 1.4.2010	1,00,000
Less : Book value on 31.03.2011	90,000
Depreciation for full year	10,000
Rate of depreciation – 10% $\left(\frac{10,000}{1,00,000}\times 100\right)$	
Depreciation for 6 months (upto 30.09.2003)	5,000
Book value on 1.10.2010 Rs. 1,00,000 – 5,000 (Depreciation for 6 months)	95,000
Profit on revaluation Rs. 1,50,000 – 95,000	55,000
H. Ltd's share (¾th)	41,250
Minority Interest (¼th)	13,750

3.	Revised Book value of Plant & Machinery on 31.03.2011		
	Book value on 31.3.2010		90,000
	Appreciation		55,000
			1,45,000
	Less: Depreciation on Rs. 55000 for 6 months @ 10% p.a.		2,750
	Revised value on 31.03.2011		1,42,250
4.	Post Acquisition Profit		
	Balance as on 31.03.2011		90,000
	Add : Dividend paid		30,000
			1,20,000
	Less : Balance as on 1.4.2010		50,000
	Profit earned during the year		70,000
	Less : Pre-acquisition profits (6 months)		35,000
	Post acquisition profit		35,000
	Less : Pre-acquisition profits (6 months)		
	Post acquisition profit		
	Less : Depreciation in respect of increase		
	In value of plant and machinery		2,750
			32,250
	H. Ltds share (¾th)		24,188
	Minority Interest (¼th)		8,062
5.	Minority Interest		
	Paid-up value of 500 shares		50,000
	Share of pre-acquisition profits		28,750
	Profit on revaluation of plant & machinery		13,750
	Share of post acquisition profits		8,062
			1,00,562
6.	Cost of investment in S Ltd.		2,40,000
	Less : Pre-acquisition dividend received		(22,500)
	Net cost		2,17,000
	Less : i) Share in share capital	1,50,000	
	ii) Share in pre-acquisition profit	86,250	
	iii) Profit on revaluation of	41,250	2,17,500
	Capital Reserve		60,000
7.	Unrealised Profit on stock on S Ltd.		
	= Rs. 8000 $\times\frac{1}{4}\times\frac{3}{4}=$		1500

Illustration : 16

Balance Sheet as on 31st March, 2011

Liabilities	H Ltd. (Rs.)	S. Ltd. (Rs.)
Share capital :		
6% Preference shares of Rs. 10 each	-----	1,60,000
Equity shares of Rs. 10 each	6,00,000	2,00,000
General Reserve	1,00,000	80,000
Profit and loss account	2,00,000	90,000
6% debentures of Rs. 10 each	-----	40,000
Proposed dividend :		
On Equity shares	60,000	20,000
On Preference shares	-----	9,600
Debentures interest accrued	-----	2,400
Sundry creditors	2,94,000	1,25,000
	12,54,000	7,27,000
Assets		
Fixed assets	5,00,000	4,40,000
15000 Equity shares in S Ltd.	3,30,000	-----
12000 Preference shares in S. Ltd.	1,20,000	-----
1000 6% debentures in S Ltd.	10,000	-----
Current assets	2,94,000	2,87,000
	12,54,000	7,27,000

Other information is as under :

i) The general reserve of S Ltd. as on 31.03.2010 was Rs. 80,000

ii) H. Ltd. acquired the shares in S Ltd. on 31.03.2010

iii) The balance of profit and loss account of S Ltd. is made up as follows :

	Rs.
Balance as on 31.03.2010	56,000
Net profit for the year ended 31.03.2010	63,600
	1,19,600
Less : Provision for proposed dividend	29,600
	90,000

iv) The balance of profit and loss account of S Ltd. as on 31.03.2010 is after providing for Preference dividend of Rs. 9,600 and proposed dividend of Rs. 10,000 both of which were subsequently paid and credited to profit and loss account of H. Ltd.

v) No entries have been made in the books of H. Ltd. for debentures interest due from or proposed dividend of S. Ltd. for the year ended on 31.03.2011.

vi) S. Ltd. has issued fully paid bonus shares of Rs. 40,000 on 31.03.2011 among the existing shareholders by drawing upon the general reserves. The transaction has not been given effect to in the books of S. Ltd.

You are required to prepare the consolidated balance sheet of H. Ltd. with its subsidiary S. Ltd. as on 31st March, 2011.

Solution :

H Ltd. consolidated Balance Sheet with its Subsidiary S Ltd. as on 31st March, 2011

Liabilities		Rs.	Assets		Rs
Share capital :			Fixed Assets :		
Equity shares of Rs. 10 each		6,00,000	Goodwill		63,300
Minority Interest		1,39,900	Other Fixed Assets :		
Reserve and Surplus :			H. Ltd.	5,00,000	
General Reserve		1,00,000	S. Ltd.	4,40,000	9,40,000
Profit & Loss A/c	2,00,000		Investments		--
Add: Deb. Interest	600		Current Assets		
Profit from			Loans & Advances :		
S. Ltd.	47,700		H. Ltd.	2,94,000	
	2,48,300		S. Ltd.	2,87,000	5,81,000
Less : Dividend from S. Ltd. for 2010	14,700	2,33,600	A. Current Assets :		
			Deb. Interest due	600	
			Less : Mutual obligation	600	---
Secured Loans :					
6% Debentures	40,000		B. Loans and Advances		---
Less : Mutual obligation	10,000	30,000			

Debenture Interest outstanding		1,800			
Current Liabilities & Provisions					
A. Current Liabilities					
Creditors					
H. Ltd.	2,94,000				
S. Ltd.	1,25,000	4,19,000			
B. Provisions					
Proposed Dividend (H. Ltd.)		6,000			
		1584300			1584300

Working Notes :

		Rs.
1.	**Capital Profit**	
	General Reserve	80,000
	Profit & Loss A/c	56,000
		1,36,000
	Less : Bonus Shares	40,000
		96,000
	Holding Company (¾)	72,000
	Minority Interest (¼)	24,000
2.	**Revenue Profit**	
	Profit and Loss A/c	90,000
	Less : Balance on 1.04.2010	56,000
		34,000
	Add: Proposed dividend for current year	
Ad	Add: i.e. for the period after acquisition of shares	29,600
		63,600
	Holding Company (¾)	47,700
	Minority Interest (¼)	15,900
3.	Bonus Shares	40,000
	Holding Company (¾)	30,000
	Minority Interest (¼)	10,000
4.	Goodwill / Cost of Control	
	Cost of shares acquired :	
	Equity shares	3,30,000
	Preference shares	1,20,000
		4,50,000

Less : Dividend for 2009-10		
Equity (10000 ×¾)	7500	
Preference (9600 ×¾)	7200	14,700
		4,35,300
Less : Paid-up value of shares acquired :		
Equity Shares	1,50,000	
Preference shares	1,20,000	
Capital profit	72,000	
Bonus shares (Equity)	30,000	3,72,000
goodwill		63,300

5. <u>Minority Interest</u>

Share capital (Equity)	50,000
Bonus shares (Equity)	10,000
Preference capital	40,000
Capital profit	24,000
Revenue profit	15,900
	1,39,900

Illustration : 17

More than one subsidiary company H. Ltd. Owns 80% of issued capital of A Ltd. and 90% of issued capital of B Ltd. The following are the balances of all companies as on 31.03.2010.

Assets	**H. Ltd.**	**A. Ltd.**	**B. Ltd.**
Fixed Assets	3,40,000	20,000	54,000
Less : Provision for depreciation	1,40,000	12,000	18,000
	2,00,000	8,000	36,000
Current Assets	5,36,000	1,00,000	1,00,000
Investments			
Shares in A. Ltd.	30,000		
Shares in B Ltd.	50,000		
Current Accounts			
A. Ltd.	40,000		
B. Ltd.	40,000		
Liabilities	8,96,000	1,08,000	1,36,000
Share capital	6,40,000	40,000	50,000
Current Liabilities	80,000	12,000	20,000
Current Accounts	-----	44,000	36,000
Proposed dividend	40,000	-----	5,000
Revenue Reserve	1,36,000	12,000	25,000
	8,96,000	**1,08,000**	**1,36,000**

Additional Information :

1. At the time of acquiring the shares the subsidiaries had the following Revenue Reserves.

   A. Ltd. Rs. 12,000

   B. Ltd. Rs. 6,000

2. Neither of the subsidiaries has paid any dividend since acquisition of shares.
3. Payment of creditors of A. Ltd. H. Ltd. to the extent of Rs. 4,000 has not been considered in the books of A. Ltd.
4. A remittances of Rs. 4,000 by B. Ltd. to H. Ltd. has not yet been adjusted in the books of H. Ltd.
5. The stock of H. Ltd. includes Rs. 6,000 purchased from H. Ltd. which made 25% profit on cost. H. Ltd. stock includes Rs. 5,000 purchased from B. Ltd. which made 20% profit on sales B. Ltd. stock includes Rs. 8,000 (Cost of Rs. 6,000) purchased from A. Ltd.

   Prepare the consolidated Balance Sheet of H. Ltd. and its subsidiaries A. Ltd. and B. Ltd.

Solution :

Consolidated Balance Sheet of H. Ltd. & its subsidiaries A Ltd. & B. Ltd. as at 31st March 2010

Liabilities		Rs.	Assets		Rs.
Share Capital			Fixed Assets		
Authorized Capital		?	H. Ltd.	240000	
Issued, Subscribed & paid-up capital		640000	A. Ltd.	20000	
Minority Interest			B. Ltd.	54000	
A. Ltd.	10000	18400		414000	
B. Ltd.	8000		Less : Pro for Depre.	170000	244000
Reserve & Surplus			Investments		-----
Capital Reserves on consolidation			Current Assets		
A. Ltd.	11600		Loans & Advances		
B. Ltd.	400	12000	A) Current Assets		
Revenue Reserve	----	1,53,400	H. Ltd.	536000	
Secured Loans	-----		A. Ltd.	100000	
Unsecured loans	-----		B. Ltd.	100000	

Current Liabilities & Provision	731800			736000	
A) Current Liabilities			Less : Profit included in stock	4200	
H. Ltd. 12000	40000			731800	
A. Ltd. 4000	8000		Add : Cash in transit	4000	735800
Less : Payment by H. Ltd.			B) Loans & Advances	-----	
B. Ltd.	(20000)	108000			
B) Provision					
Suspense Account		8000			
Proposed dividend		40000			
		979800			979800

Unexpected credit by H. to A

Note : Difference in current A/c has been treated as cash in transit.

Paid up value of shares held by outsiders 25000 × $^1/_{10}$	5000
Add: $^1/_{10}$ th share of pre-acquisition Revenue Reserve	600
Add : $^1/_{10}$ th share of post acquisition Revenue Reserve	2400
	8000
5. Cost of control in B. Ltd. intrinsic value of the shares in B. Ltd.	
Paid up value of the shares held $^9/_{10}$ × Rs. 50000	45000
Add : $^9/_{10}$ th shares of pre-acquisition Revenue	5400
Reserve in B. Ltd.	
Intrinsic value of the shares held	50400
Less : Price paid for the shares held	50000
Capital Reserve	400
6. Unrealised profit included in stock of B. Ltd. Unralised Profit = Rs. (8000-6000)	2000
H Ltd. share of unrealized profit Rs. 1000 × 9/10 × 8/10	1440
C. H. Ltd.	
1. Unrealised profit included in stock of H. Ltd. cost price is the selling price of B Ltd. Unrealised profit = Rs. 10000 × 20/100 × 9/10 = 1800	

2. Revenue Reserves of H. Ltd.	
Revenue Reserves as per Balance sheet	136000
Add : 9/10 share of post-acquisition Revenue Reserve in A Ltd.	21600
	157600
Less : Unrealised profit included in stock (960+1440+1800)	(4200)
Adjusted Balane	153400

Illustration : 18

Balance sheet of H. Ltd. and S Ltd. as on 31.03.2010 were as under.

Liabilities	H. Ltd.	S. Ltd.	Assets	H. Ltd.	S. Ltd.
Equity share capital of Rs. 10 each	10,00,000	5,00,000	Land & Build	3,00,000	1,80,000
Reserves & Surplus : Capital	1,00,000	--	Plant & Machinery	5,75,000	5,05,000
General Reserve	2,00,000	1,00,000	Investments (40000 shares in S. Ltd.)	6,20,000	
Profit and Loss A/c	2,00,000	1,50,000	Stock	1,20,000	50,000
Secured Loan			Sundry Debtors	2,00,000	1,20,000
15% Debentures	3,00,000	1,00,000	Bills Receivable	75,000	50,000
Current Liabilities :			Bank Balance	25,000	15,000
Creditors	75,000	50,000			
Bills payable	40,000	20,000			
	19,25,000	9,20,000		19,25,000	9,20,000

Additional Information :

1. H. Ltd. acquired shares on 1st October 2009 on which date General Reserve of S. Ltd. was Rs. 1,00,000/- Balance in profit and loss A/c on 1.04.2009 was Rs. 80,000/-
2. S. Ltd. paid interim dividend at 5% out of profits on 01.10.2009, which was credited by H. Ltd. to Profit and Loss A/c.
3. Sundry Debtors of H. Ltd. includes Rs. 30,000/- dues from S Ltd. similarly bills receivable includes Rs. 20,000/- accepted by S Ltd.

4. stock of S. Ltd. includes Rs. 25,000/- purchased from H. Ltd. on which profit made by H. Ltd. 25% of cost.
5. H. Ltd. proposed 10% dividend S. Ltd. proposed 5% dividend which was not accounted.
6. On date of take over land and building of S. Ltd. revalued at 3,00,000/- Effect of which was not given by S Ltd. S. Ltd. charged depreciation at 10% on land and building. Prepare consolidated Balance Sheet.

Solution :

Consolidated M/S of H ltd as on 31.3.2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share capital, issued, Subscribed and paid up			Land and Building		
1,00,000 Equity share of			H. Ltd.	3,00,000	
Rs. 10/- fully paid up		10,00,000	S. Ltd.	2,84,500	5,84,500
Reserves and surplus			Plant & Machinery		
Capital Reserves (H. Ltd.)	1,00,000		H. Ltd.	5,75,000	
Capital Reserves	50,000		S. Ltd.	5,05,000	10,80,000
(Cost of control)					
	1,50,000	1,50,000	Investments	NIL	
General Reserve (H. Ltd.)	2,00,000	2,00,000	Current Assets Stock :		
Profit & Loss A/c			H. Ltd.	1,20,000	
H. Ltd.	2,00,000		S. Ltd.	50,000	
				1,70,000	
Less : Pre-acquisition			Less : Unrealised		
dividend	(20,000)		Profit	(4,000)	1,66,000
	1,80,000		Sundry Debtors :		
			H. Ltd.	2,00,000	
Less : Unrealised profit (stock)	4,000		S. Ltd.	1,20,000	
	1,76,000			3,20,000	

Add : Post			Less : Inter		
Acquisition profit	33,600		Company owning	30,000	2,90,000
			Cash and Bank Balance		
	2,09,600		H. Ltd.	25,000	
Less : Proposed			S. Ltd.	15,000	40,000
Dividend (H. Ltd.)	1,00,000	1,09,600			
Minority interest			Bills Receivable :		
(as per working)	1,65,900		H. Ltd.	75,000	
			S. Ltd.	50,000	
Secured Loans:				1,25,000	
15% Debentures			Less : Inter		
H. Ltd.	3,00,000		Company owing	(20,000)	1,05,000
S. Ltd.	1,00,000	4,00,000			
Current Liabilities.					
Sundry Creditors					
H. Ltd.	75,000				
S. Ltd.	50,000				
	1,25,000				
Less : Inter company owing Proposed Dividend	(30,000)	95,000			
H. Ltd.	1,00,000				
S. Ltd.	5,000	1,05,000			
Bills payable					
H. Ltd.	40,000				
S. Ltd.	20,000				
Less : Inter company owing	(20,000)	40,000			
		22,65,500			22,65,500

Working Notes :

1. Holding Proportion

Working for determining the % of holding

H. Ltd.	Minority
40,000	10,000
50,000	50,000
$\frac{4}{5}$th	$\frac{1}{5}$th
80%	20%

2. Analysis of profit of S. Ltd.

Particulars		Pre-acquisition Capital profit	Post – acquisition revenue profit
General Reserve as on 1.10.2009		1,00,000	-
Profit & Loss a/c as on 1/4/09	80,000		
Less : Dividend	(25,000)	55,000	-
Profit for the year (on time basis)	95,000	47,500	47,500
Revaluation profit (Pre-acquisition)		1,10,000	-
Effect of additional depreciation (Post-acquisition)			(5,500)
		3,12,500	42,000
Less : Minority interest (20%)		62,500	8,400
Holding company (80%)		2,50,000	3,360

		Rs.
3)	Cost of control	
	Price of 40000 Equity share	6,20,000
	Less : paid up value	(4,00,000)
		2,20,000
	Less : pre-acquisition profit	(2,50,000)
		30,000
	Less : pre-acquisition dividend	20,000
	Capital Reserve	50,000
4)	Minority Interest	
	10,000 Equity Shares fully paid up	1,00,000
	Proposed dividend	(5,000)
	Pre-acquisition profit	62,500
	Post-acquisition profit	8,400
		1,65,900

5)	Unrealized Profit	
	H. Ltd. stock sell value	25,000
	(25 of cost; 1/5 of selling price)	5,000
	Holding companies share (80)	4,000
6)	Proposed Dividend	
	5 proposed dividend on 500000 × 5/100	25,000
	Holding companies share	20,000
	Minority share	5,000
7)	Profit of S. Ltd. as on 31/3/09	1,50,000
	Less : Revised opening Balance	55,000
	Profit for the year	95,000
8)	Assumed that profit accures evenly throughout the year	
	50 of profit (1/4/09 to 30/09/09 is considered pre-acquisition	47,500
	Balance Profit (1/10/09 to 31/3/10) considered post acquisition	47,500
9)	Land and Building (Effect of Revaluation)	
	Land and Building at W.D.V. on 31/3/10	1,80,000
	Rate of Depreciation	10
	Balance on 1/4/09	
	$18000 \times \frac{100}{90}$	2,00,000
10)	Computation of appreciation	
	W.D.V. cost on 1/4/09	2,00,000
	Less : Depreciation for 6 months	
	200000 × 6/12 × 10/100	10,000
	W.D.V. on 1/10/09	1,90,000
	Revaluation value	3,00,000
	Appreciation (pre-acquisation)	1,10,000
	W.D.V. on 1/10/09	3,00,000
	Less : Depreciation on old value	
	$200000 \times \frac{10}{100} \times \frac{6}{12} = 10000$	
	$110000 \times \frac{10}{100} \times \frac{6}{12} = 5500$	15,500
		2,84,500

Illustration : 19

The following are the profit and Loss accounts of H. Ltd. and S. Ltd. for the year ended 31st March, 2010.

Particulars	H. Ltd.	S. Ltd.	Particulars	H. Ltd.	S. Ltd.
To Opening Stock	100000	-	By Sales	800000	650000
To Purchases	500000	400000	By Closing Stock	150000	100000
To Productive Wages	1,50,000	100000			
To Gross Profit c/d	200000	250000			
	950000	750000		950000	750000
To Sundry Expenses	75000	100000	By Gross Profit b/d	200000	250000
To Debentures Interest	-	6000	By Debenture interest	3000	--
To Provision for Taxation	60000	70000			
To Profit c/d	68000	74000			
	203000	250000		203000	250000
To Preference Dividend	-	3000	By Profit b/s	68000	74000
To Proposed Dividend	20000	20000			
To Corporate Dividend Tax	2000	2300			
To Balance c/d	46000	48700			
	68000	74000		68000	74000

You are also given the following additional information :

1. H. Ltd. holds 1500 Equity shares of Rs. 100 each in S. Ltd. whose capital consists of 2000 Equity shares of Rs. 100 each and 6% 500 cumulative Preference shares of Rs. 100 each. S. Ltd. has also issued 6% Debentures of Rs. 100000 out of which H. Ltd. holds Rs. 50000.
2. The shares in S. Ltd. were acquired by H. Ltd. on 1st July 2009 but the debentures were acquired on 1st April 2009 S. Ltd. was incorporated on 1st 2009.
3. During the year S. Ltd. sold H. Ltd. goods costing Rs. 50000 at the selling price of Rs. 75000. One fourth of the goods manufactured remained unsold on 31st March 2010. The goods were valued at cost to the holding company for closing stock purpose.

   Prepare a consolidated profit and loss account.

Solution :

Consolidated Profit and Loss Account of H. Ltd. and its subsidiary S Ltd. for the year ended 31st March, 2010.

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
To Opening Stock (H. Ltd.)		1,00,000	By Sales H. Ltd. S. Ltd.	 8,00,000 6,50,000	
To Purchase : H. Ltd. S. Ltd.	5,00,000 4,00,000				
	9,00,000			14,50,000	
Less : Inter-co purchases	75,000	8,25,000	Less : Inter co. Sales	75,000	13,75,000
To Productive wages H. Ltd. S. Ltd.	 1,50,000 1,00,000	 2,50,000	By Closing stock H. Ltd. S. Ltd.	 1,50,000 1,00,000	 250000
To Gross Profit C/d		4,50,000			
		16,25,000			16,25,000
To Sundry Expenses : H. Ltd. S. Ltd.	 75,000 1,00,000	 1,75,000	By Gross Profit b/d		4,50,000
To Debenture Interest	6,000		By Debenture interest	3,000	
Less : Inter-co Transaction	3,000	3,000	Less : Inter Co. transaction	3,000	
To Provision for Taxation H. Ltd. S. Ltd.	 60,000 70,000	 1,30,000			
To Stock Reserve		4,688			
To Profit C/d		1,37,312			
		4,50,000			4,50,000
To Proposed Dividend H. Ltd. S. Ltd.	 20,000 20,000		By Profit b/d		1,37,312
	40,000				
Less : Dividend of S due to H. Ltd.	15,000	25,000			

To Preference Dividend		3,000			
To Corporate dividend tax		4,300			
To Capital Reserve		13,256			
To Share of Minority (Interest ¼ of 48700)		12,175			
To Balance c/d		79,581			
		1,37,312			1,37,312

Working Notes :

1. **Capital Reserve has been arrived at as follows :**

   Profit of S. Ltd. after Preference dividend and CDT thereof :

   = Rs. (74000 – 3300)

   = Rs. 70700

   ∴ Pre-acquisition Profit, i.e. profit upto 1st July, 2009

   = ¼ × Rs. 70700 = Rs. 17675

   H Ltd's Share of Pre-acquisition Profits

   = ¾ × Rs. 17675

   = Rs. 13256

2. **Stock Reserve has been arrived at as follows :**

   Total profit made by S. Ltd. on goods sold to H. Ltd.

   = Rs. (75000 – 50000) = Rs. 25000

   ¼th of the goods remained unsold. Hence, profits on ¼th goods.

   ¼ × Rs. 25000 = Rs. 6250

   H Ltd. share of unrealized profits

   ¾ × Rs. 6250 = Rs. 4688

3. Debenture interest paid by S. Ltd. and received by H. Ltd. amounting Rs. 3000 has been eliminated from both sides.

4. Out of the proposed dividend of S. Ltd. ¾th of Rs. 20000, i.e. Rs. 15000 belong to H. Ltd. and as such the same has been eliminated.

Illustration : 20

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

Liabilities	H. Ltd. Rs.	S. Ltd. $	Assets	H. Ltd. Rs.	S. Ltd. $
Equity share capital (Rs. 10 / $ 10)	1,00,00,000	2,00,000	Fixed Assets	11,00,000	3,60,000
Reserves & Surplus			Investment in S. Ltd.	2,10,00,000	
Securities Premium	60,00,000	--	Current Asset	8,50,000	2,40,000
General Reserve	19,00,000	1,20,000			
Profit & Loss A/c	15,00,000	1,00,000			
10% Debentures	17,00,000	--			
Sundry creditors	9,00,000	1,20,000			
Provision for Taxation	9,50,000	60,000			
	2,29,50,000	6,00,000		2,29,50,000	6,00,000

Additional Information :

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

   On April, 2010 1 $ = Rs. 43

   On January, 2011 $ 1 = Rs. 42

   On March 31, 2011 $ 1 = Rs. 45

   Average Rate $ 1 = Rs. 44.

You are required to prepare :

1. Conversion of S Ltd. Balance Sheet
2. Consolidated Balance Sheet as on March 31, 2011.

Illustration :

Consolidated Balance Sheet of H. Ltd. and its subsidiary S. Ltd. as on March 31st, 2011

Liabilities	Rs.	Assets	Rs.
I. Share Capital		I. Fixed Assets	
1,00,000 Equity shares of Rs. 10 each fully paidup	1,00,00,000	Goodwill	76,12,500
II. Reserves & Surpluses		Other Fixed Asset H. Ltd. 11,00,000 S. Ltd. 1,51,20,000	1,62,20,000
Security PremiumH.Ltd	60,00,000	Current Asset	
General Reserve (H. Ltd.)	19,00,000	H. Ltd. 8,50,000 S. Ltd. 1,08,00,000	1,16,50,000
Profit & Loss surplus (working)	14,77,500		
III. Secured Loans			
10% Debentures	17,00,000		
IV. Current Liabilities & Provisions			
S. Creditors H. Ltd. 9,00,000 S. Ltd. 54,00,000	63,00,000		
Provision for Taxation H. Ltd. 9,50,000 S. Ltd. 27,00,000	36,50,000		
Minority Interest	44,55,000		
	3,54,82,500		3,54,82,500

A) Conversion of S. Ltd. Balance sheet as on March 31st 2011.

Particulars	Assets $	Liabilities $	Rate	Assets Rs.	Liabilities Rs.
Share capital		2,00,000	42		84,00,000
General Reserve (1.4.10)		1,20,000	42		50,40,000
Profit & Loss					
Pre-acquisition Balance (60,000 – 20,000) Net Profit for the year (1,00,000 – 40,000) = 60,000		40,000	42		16,80,000
up to date of acquisition $60000 \times \frac{9}{12}$		45,000	42		18,90,000
Net Profit after acquisition (60000 – 45000)		15,000	44		6,60,000
Sundry creditors		1,20,000	45		54,00,000
Provision for Taxation		60,000	45		27,00,000
Fixed Asset	3,60,000		42	1,51,20,000	
Current Assets	2,40,000		45	1,08,00,000	
Difference in Exchange (Balance figure)		-			1,50,000
	6,00,000	6,00,000		2,59,20,000	2,59,20,000

1) Working Notes	H. Ltd.	Minority
No. of Equity shares	15,000	5,000
Total Equity shares	20,000	20,000
$\therefore$ Holding	$\frac{15}{20} = \frac{3}{4}$	$\frac{5}{20} = \frac{1}{4}$

2. Analysis of profit & Loss balance

Balance brought forward (opening Balance)
As on 1.4.10 $ 60,000
- dividend paid out of
Pre-acquisition profit
(200000 × 20% of $\frac{6}{12}$) (20,000) = 40,000

Net profit for the year (31.3.11)
(100000 – 40000) = 60000
Up to date of acquisition = 45000

(60000 × $^{9}\!/_{12}$)
Post –acquisition profit = 15000
(60000 – 45000)
Total profit on shown in the Balance sheet 100000

3) Minority Interest (¼)	Rs.
Share in Equity share capital	21,00,000
Share in Capital Profits	21,52,500
Share in Revenue profits	2,02,500
	44,55,000

4) Cost of controls	Rs.	Rs.
Cost of investments	2,10,00,000	
Less : pre-acquisition dividend received	(6,30,000)	2,03,70,000
Less : I) share in Equity share capital (8400000 × ¾)	63,00,000	
II) Share in Capital profit	64,57,500	(12,57,500)
Goodwill		76,12,500

5) Analysis of Profit	Capital (Rs.)	Revenue Rs.
General Reserve (1.4.10)	50,40,000	
Profit & Loss A/c opening Balance	16,80,000	
Net Profit for current year		
i) upto date of acquisition	18,90,000	
ii) after acquisition	--	6,60,000
Difference in Exchange		1,50,000
Total	86,10,000	8,10,000
Less : Minority Interest (¼)	21,52,500	2,02,500
Balancing to H. Ltd.	64,57,500	6,07,500

6) Profit & Loss A/c Balance carried to Balance sheet	Rs.
Profit & Loss A/c H. Ltd.	15,00,000
Share in Revenue profit In S. Ltd.	21,07,000
Less : Pre-acquisition dividend wrongly credited by H. Ltd.	(6,30,000)
Balance carried to Balance sheet	14,77,500

7) As per A.S. 11, difference in exchange considered as Revenue profit.

Illustration : 21

The following are the Profit & Loss A/c of H. Ltd. & S. Ltd. for the year ended March 31st, 2011

Particulars	H. Ltd. ₹	S. Ltd. ₹		H. Ltd. ₹	S. Ltd. ₹
To Opening Stock	2,00,000	1,00,000	By Sales	19,80,000	14,00,000
To Purchases	12,00,000	7,50,000	By Closing Stock	2,10,000	60,000
To Carriage	20,000	10,000			
To Wages	2,10,000	80,000			
To Gross Profit c/d	5,60,000	5,20,000			
	21,90,000			21,90,000	14,60,000
To Salaries	95,000	45,000	By Gross Profit b/d	5,60,00	5,20,000
To Rent	40,000	25,000	By Commission	1,00,000	
To Commission	-	50,000	By Debenture Interest S Ltd.	10,000	
To Sundry Expenses	65,000	25,000	By Rent	40,000	
To Debentures Interest	-	25,000			
To Provision for Taxation	1,90,000	1,10,000			
To Net Profit c/d	3,20,000	2,40,000			
	7,10,000	5,20,000		7,10,000	5,20,000
To Preference Dividend	-	40,000	By Balance B/d	1,00,000	40,000
To Proposed Dividend	90,000	60,000	By Net Profit B/fd	3,20,000	2,40,000
To Corporate Dividend Tax	15,021	16,690			
To Balance carried to Balance sheet	3,14,979	1,63,310			
	4,20,000	2,80,000		4,20,000	2,80,000

You are given following additional information :

1. H. Ltd. acquired 3000 Equity shares in S. Ltd. on 1st October 2010, of 4000 Equity shares of S. Ltd. However Debentures were acquired on 1st April 2009.
2. During the year H. Ltd. sold goods to S Ltd.costing ₹ 60,000 for ₹ 80,000. One fourth of the goods remained unsold on March 31st 2011. It is included in closing stock at cost to S. Ltd.
3. Commission, Rent credited to profit & Loss A/c of H. Ltd. include ₹ 40,000, ₹ 10,000 received from S. Ltd.

4. Prepare a consolidated profit and Loss A/c for the year ended March 31^{st} 2011.

Solution - Consolidated profit and Loss A/c of H. Ltd. its subsidiary S. Ltd. for year ended March 31^{st} 2011.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock H. Ltd. S. Ltd.	 2,00,000 1,00,000	 3,00,000	By Sales H. Ltd. S. Ltd.	 19,80,000 14,00,000 33,80,000	
To Purchases H. Ltd. S. Ltd.	 12,00,000 7,50,000		Less : Inter Co. Sales	80,000	33,00,000
	19,50,000				
Less : Inter Co. purchases	80,000	18,70,000	By closing Stock H. Ltd. S. Ltd.	 2,10,000 60,000	 2,70,000
To Carriage H. Ltd. S. Ltd.	 20,000 40,000	 30,000			
To Wages H. Ltd. S. Ltd.	 2,10,000 80,000	 2,90,000			
To Gross Profit c/d		10,80,000			
		35,70,000			35,70,000
To Salaries H. Ltd. S. Ltd	 95,000 45,000	 1,40,000	By Gross Profit b/d		10,80,000
To Rent H. Ltd. S. Ltd	 40,000 25,000		By Commission of H. Ltd.	1,00,000	
	65,000				
Less : Inter Co. transactions	(10,000)	55,000	Less : Inter Co. transaction	(40,000)	60,000
To Commission S. Ltd.	50,000		By Debenture Interest S Ltd.	10,000	
Less : Inter Co. transactions	(40,000)	10,000	Less : Inter Co. transaction	(10,000)	
To Sundry Expenses H. Ltd. S. Ltd.	 65,000 25,000	 90,000	By Rent H. Ltd.	40,000	
To Debentures Interest S. Ltd.	25,000		Less : Inter Co. transaction	(10,000)	30,000

Less : Inter Co. transactions	(10,000)	15,000			
To Provision for Taxation H. Ltd. S. Ltd.	 1,90,000 1,10,000	 3,00,000			
To Stock Reserve		5,000			
To Balance c/d		5,55,000			
		11,70,000			11,70,000
To Preference Dividend	-	40,000	By Balance B/d H. Ltd. S. Ltd.	 1,00,000 40,000	 1,40,000
To Proposed Dividend H. Ltd. S. Ltd.	 90,000 60,000		By Net Profit B/fd		5,55,000
	1,50,000				
Less : Dividend of S. Ltd. due to H. Ltd.	45,000	1,05,000			
To Corporate Dividend Tax H. Ltd. S. Ltd.	 15,021 16,690	 31,711			
To Capital Reserve		1,02,497			
To Minority Interest		40,828			
Balance Sheet		3,74,964			
		6,95,000			6,95,000

Working Note :

1. Holding by H. Ltd. $= \frac{3000}{4000} = 3/4 \therefore$ by minority $1/4$.
2. Minority Interest = 163310 $\times \frac{1}{4} = 40,828$.
3. Stock Reserve = 80,000 – 60,000 = 20,000 $\times \frac{1}{4} = 5,000$.
4. Capital Reserve has been calculated as under.

Balance of previous year brought forward 40,000

Net profit for the year : 2,40,000

Less : Preference Dividend and CDT,

There of (40000 + 6676) (46676)

Net profit for the year 193324

Net profit for 6 month (upto 30.9.10) 96,662

Pre-acquisition profit Rs. 1,36,662

Holding Co. share (Capital Reserve) $= 1,36,662 \times \frac{3}{4}$

$= \boxed{1,02,497.}$

1.11 EXERCISES

- **Theory Questions:**

1. How does As 21 Defines
    a) Minority Interest
    b) Subsidiary Company
    c) Holding company
    d) Inter company Owings
2. What do you mean by consolidated profit and loss A/c?
3. How foreign companies final account are converted in home currency?
4. Define Goodwill.
5. Define Capital Reserve.
6. Diesoline Accounting treatment of pre-acquisition dividend received by holding company.
7. How holding co. trates Bonus share received from subsidiary co. out of pre-acquisition profit from subsidiary co.
8. What is accounting treatment in holding companies dividend received, out of post-acquisition profit.
9. Why profit of subsidiary company is divided into pre and post acquisition.
10. How do you treat subsidiaries companies debentures purchased by holding company in open market and debentures interest paid by subsidiary company to holding company?
11. How do you treat pre-acquisition divided received by Holding company, from its subsidiary company?
12. Accounting treatment in respect of dividend distribution tax provided by subsidiary company.
13. How you prepare consolidated profit & Loss A/c?
14. State in brief procedure for consolidation of Foreign subsidiary company; Balance Sheet with Indian Holding Co.

- **Multiple Choice Question :**

1. Preparation of consolidated Balance Sheet of Holding Co. and its subsidiary company as per

   i) As 11 ii) AS – 22

   iii) AS 21 iv) AS – 23

2. The share of outsiders in the Net Assets in subsidiary company is known as under :

   i) outsiders liability ii) Assets

   iii) subsidiary company's liability

   iv) Minority Interest

3. Pre-acquisition profit in subsidiary company is considered as :

   i) Revenue profit ii) Capital profit

   iii) Goodwill iv) Non of the above

4. Excess of cost of investment over net assets of subsidiary company’s considered as

   i) Goodwill ii) Capital Reserve

   iii) Minority Interest iv) Non of above

5. Profit earned before acquisition of share is treated as

   i) Capital profit ii) Revenue profit

   iii) General Reserve iv) Revaluation Loss

6. Preparation of consolidated statement as per AS 21 is

   i) Optional

   ii) Mandatory for listed Companies

   iii) Mandatory for Pvt. Ltd.

   iv) Companies Ltd. partnership firm

7. Consolidated statements are prepared by

   i) Minority ii) Subsidiary company

   iii) Holding Company iv) Listed subsidiary Co.

8. Holding Co. share in capital profits of subsidiary company is adjusted in :

   i) Cost of control

   ii) Shown on Assets side of Balance sheet

   iii) Revenue profit iv) None of above

9. Unrealised profit on goods sold and included in stock is deducted from :

   i) Capital Profit　　ii) Revenue Profit

   iii) Fixed Assets　　iv) Minority interest

10. Face value debentures of subsidiary co. held by Holding Company is deducted from :

   i) Debentures　　ii) Cost of control

   iii) Minority interest

   iv) Debentures in consolidated balance sheet

11. Minority Interest includes :

   i) Share in share capital　　ii) Share in Capital profit

   iii) Share in Revenue profit　　iv) All of the above

12. The Time interval between the date of acquisition of shares in subsidiary company and date of Balance Sheet of Holding Company is known as :

   i) Pre-acquisition period　　ii) Post-acquisition period

   iii) Pre-commencement period

   iv) Pre-incorporation period.

13. Pre-acquisition dividend received by Holding company is credited to

   i) profit & loss A/c　　ii) Capital profit

   iii) Investment A/c　　iv) non of the above

14. Post Acquisition dividend received by Holding Company is debited to :

   i) Bank A/c　　ii) profit & loss A/c

   iii) Dividend A/c　　iv) Investment A/c

15. When cost of acquisition is more than cost of investment in subsidiary company is transferred to

   i) Goodwill　　ii) Capital Reserve

   iii) Revenue Reserve　　iv) Non of the above

16. Which Exchange rate will be considered for conversion of share capital of subsidiary company.

   i) Opening Rate　　ii) closing rate

   iii) Average Rate

   iv) Rate of which date share acquired (actual)

- **Answer in one sentence :**

1. What is Goodwill?
2. What is cost of control?
3. What is Minority Interest?
4. Which is Holding Company as per companies Act 1956?
5. What is capital profit?
6. How you treat Revenue profit?
7. Why date of acquisition of shares by Holding Company is important?
8. Which Accounting standard is issued for preparation of consolidated financial statements?
9. How inter company debts are dealt with?
10. Does issue of Bonus share by Holding Company change value goodwill / capital reverse.
11. Can you debit pre-acquisition dividend received to investment A/c?
12. Bills drawn by Holding company on its subsidiary co. a discounted by it, can this be treated as contingent liability.
13. Why preparation of consolidated financial statements is required?
14. From which date A.S. 21 is effective?
15. Which statements are included in preparation of consolidated financial statement.
16. Why unrealized profit an closing stock is deducted from stock in the consolidated Balance sheet?
17. Why Goodwill / Capital Reverse is not change, when subsidiary company capitalized F pre-acquisition profit (by way of Bonus share)
18. Which exchange rate shall be considered for consolidation of current assets of foreign subsidiary company.
19. Why unclaimed dividend relating to outsiders will appear as liability?
20. Why interim dividend paid by subsidiary company should be ignored, When shares are acquired at the beginning of the year?
21. Why inter company purchases and sales are elimited while preparing consolidated profit & loss, by the Holding Company?

22. Why corporate Dividend Tax provided by subsidiary company, not elimated while preparing consolidated profit & loss A/c
23. How you deal with exchange difference on conversion of foreign subsidiary financial statement?
24. Which accounting standard needs to be followed for conversion of subsidiary companies financial statement.
25. How difference between Nominal value of Debentures issued by subsidiary company and purchased in open market by holding company is dealt with, while preparing consolidated Balance sheet?
26. How you will treate depreciation on revaluation profit, on fixed Assets held by subsidiary company on date of acquisition of shares by the Holding Company?

❖❖❖❖

2

ACCOUNTING AND STATUTORY REQUIREMENTS OF BANKING COMPANIES

Unit structure

2.1. INTRODUCTION

2.1.1 Meaning of Banking Companies:

A bank is a commercial institution, permitted to accept, collect, transfer, lend and exchange money and claims to money both the domestically and internationally and thereby conduct smooth banking activities.

2.1.2. Definition:

Banking companies are governed by the Banking Regulation Act of 1949 and also subject to the companies act. 1956.

According to Banking Regulation act, 1949 Banking means – "The accepting, for the purpose of lending or investment, of deposit of money from the public repayable on demand or otherwise and withdraw able by cheque, draft, order or otherwise.'

2.1.3 Business of Banking Companies:

As per section 6 of the Act, banking companies may engage in the following business in addition to their usual banking business.

1. The borrowing, raising or taking up on money, the lending or advancing of money either upon or without security, the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, ‘hundies’, promissory notes, drafts, bills of lading, railways receipt, warrants, debentures, certificates, scrip’s and other instruments and securities whether transferable or negotiable or not; granting and issuing of letters of credit, traveller’s cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or other, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities.

2. Acting as agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as on attorney on behalf of customers but excluding the business of (managing agent or secretary and treasurer) of a company.

3. Contracting for public and private loans and negotiating and issuing the same.

4. The effecting, insuring, guaranterring, underwriting, participating in managing and carrying out of any issue, public or private of state, municipal or other loans or of shares, stock, debentures or debenture stock of any Company Corporation or association and of the lending of money for the purpose of any such issue.

5. Carrying on and transacting every kind of guarantee and indemnity business.

6. Managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims.

7. Acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form the security or part of the security for any loans or advances which may be connected with any such security.

8. Undertaking and executing trusts.

9. Undertaking the administration of estates as executor, trustee or otherwise.

10. Establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object.

11. The acquisition, construction maintenance and alteration of any building or works necessary or convenient for the purpose of the company.

12. Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company.

13. Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in section 6.

14. Doing all such other things as are incidental or conclusion to the promotion or advancement of the business of the company.

15. Any other form of business which the central Government may by notification in the official Gazette, specify as a form of business in which it is lawful for a banking company to engage.

No Banking Company shall engage in any form of business other than those referred to in section 6.

2.1.4 Restrictions on Business:

The Banking Companies are restricted from conducting certain activities.

A bank can not directly or indirectly deal in the buying or selling or bartering of goods, except in connection with the realization of security given to or held by it, or engage in any trade or buy or sell of barter goods for others otherwise than in connection with bills of exchange, immovable property, except that required for its own use, however acquired, must be disposed of within seven years from the date of acquisition.

2.1.5 Non-Banking Assets:

The case in which the customer to whom a bank sanctioned loan against some security and if he fails to repay the same, the bank decides to acquire such property kept as security to satisfy its claim. Such property or assets termed as 'Non-Banking Assets'. These Assets are exhibited in schedule 11 – "Other Assets".

2.2. IMPORTANT ACCOUNTING PROVISIONS OF BANKING REGULATION ACT 1949.

2.2.1 Minimum Capital and reserves – Section 11.

According to the provision of section 11 (2) of the Banking Regulation Act 1949 the following are the limits imposed on value of paid up Capital and Reserves of a banking Company.

1) In the case of Banking Company incorporated outside India. If it has a place or places of business in the city of Bombay or Calcutta or both Rs. 20 lakhs.

If the places of business are other than Bombay or Calcutta Rs. 15 lakhs. In addition 20% of the profits earned in India must be added to the sums mentioned above.

2) In the case of a banking company incorporated in India.

a) If it has places of business in more than one state and it has a place or places of business in Bombay or Calcutta or both Rs. 10 lakhs.
b) It is has places of business in more than one state but not in Bombay or Calcutta Rs. 5 lakhs.
c) If it has places of business in one state but not in Bombay or Calcutta. Rs. 1 lakhs in respect of its principle place plus Rs. 10,000 for each of its other places of business in the same district and Rs. 25,000 in respect of each place of business outside the district. The total need not exceed Rs. 5 lakhs. In case there is only one place of business Rs. 50,000.

(In case of companies, which have commenced business after the commencement of the Banking Companies (Amendment) Act of 1962, a minimum of Rs. 5 lakhs is required)

d) If it has all its places of business in one state / Rs. 5 lakhs and if the places of business are also in / plus Rs. 25,000 Bombay or Calcutta. / In respect of each place of business situated outside the city of Bombay or Calcutta. The total need not exceed Rs. 10 lakhs.

2.2.2 Restriction on commission Brokerage, Discount, etc. on sale of shares-section B:

A Banking company is not allowed to pay directly or indirectly commission, Brokerage, Discount or remuneration in any form in respect of any shares issued by it, any amount exceeding two and one-half person of the paid up value of the said shares.

2.2.3 Restriction on payment of dividend – section 15:

A Banking company shall not pay dividend unless all of its capitalized expenses (including preliminary expenses, organization expenses, share selling commission, Brokerage, amount of losses incurred and any other item. Of expenditure not represented by tangible assets) have been completely written-off.

However, a banking company may pay dividend on its shares without writing off.

2.2.4 Statutory Reserve – Section 17:

Section 17 of the act lays down that every banking company should create a reserve fund by transferring to it at least 20 percent of its annual profit as disclosed by its profit and loss account before any declaration of dividend, such reserve is known as statutory Reserve. The transfer of profit to reserve fund should be continued even after the accumulated amount of reserve fund and share premium account together exceed its paid up capital. Unless the central government grant on exemption in this regard on the recommendation of Reserve Bank of India.

2.2.5 Cash Reserves – Section 18:

Every Banking Company requires to maintain a balance equal to 3 percent of its time and demand liabilities with RBI (a non scheduled bank has to keep similar balances either in cash or deposit with RBI)

2.2.6 Restrictions on loans and Advances –section 20

A Bank can not

i) grant loans and advances on the security of its own shares and

ii) grant or agree to grant loan or advance to or on behalf of

a) Any of its directors;

b) Any firm in which any of its directors is interested as partner, manager or gurantor;

c) Any company of which any of its directors is a director manager, employee or guarantor or in which he holds substantial interest; or

d) Any individual in respect of whom any of its directors is a partner or guarantor.

2.3. BOOKS OF ACCOUNTS

In order to have immediate entry of voluminous transaction and enables continuous internal check on the record of these transactions, Banks are required to maintain subsidiary books along with its principal books of accounts.

A) Subsidiary books

i. Receiving cashier's counter cash book;
ii. Paying cashier's counter cash book;
iii. Current accounts ledger.
iv. Savings bank accounts ledger
v. Fixed deposit accounts ledger
vi. Investments Ledger
vii. Loans Ledger
viii. Bills discounted and purchased ledger
ix. Customer's acceptances endorsements and guarantee ledger

B) Principal Books

i. Cash book : It records all cash transactions
ii. General Leger : It contains control Accounts of all subsidiary ledgers and different assets and liabilities account

2.4. PROVISIONING OF NON-PERFORMING ASSETS

Meaning:

The 'Non-Performing Assets' refers to those assets which fails to generate expected returns to the bank due to borrowers default in making repayment.

In accordance with the international practice and the directives of RBI, the bank should recognized income on Non-Performing Assets (NPA) when it is actually received and not on accrual basis.

Similarly, the RBI has accepted the definition of a NPA given by Narasimham committee from March 1995 onwards –

‘as an advance where, as on the bank’s balance sheet date, (a) interest on a term loan account is past due or (b) a cash credit / overdraft account remains out of order or (c) a bill purchased / discounted is unpaid or overdue or (d) any amount to be received in respect of any other account remains past due, for a period more than 180 days. (e) in respect of agricultural finance / advance (eg crop loans) interest and / or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years. The period of 180 days has been reduced to 90 days effective from March 31, 2004.

A ‘past due’ account has been defined as an amount which remains outstanding 30 days beyond the due date.

Assets classification and provisioning

In order to make adequate provisions, assets have been classified as follows:

i. Standard assets – These are the assets which does not disclose any problems and does not carry more than normal risk attached to the business therefore no provision is to be made against them.

ii. Substandard assets – These assets exhibit problems and would include assets classified as non-performing for a period not exceeding two years. Hence the provision is to be made at the rate of 10 percent of the total outstanding amount of substandard assets.

iii. Doubtful assets – these are the assets which remain non performing for a period exceeding two years and would also include loans in respect of which installments are overdue for a period exceeding two years.

The provision for doubtful assets as follows:

Period for which the advance Has been considered As doubtful	Provision requirements (%)
Upto one year	20
One to three years	30
More than three years	50

iv. Loss assets – Loss assets are those assets where the loss has been identified but the amounts have not been return off.

Illustration

Exe bank ltd. having the following advances as on 31st March 2009 and provision is to be made against them.

	Bills Purchased and Discounted	Cash credit, overdraft	Term loans
i) Standard Assets	5,150	4,925	2,375
ii) Sub-standard Assets	4,000	1,500	1,000
iii) Doubtful Assets:			
- upto one year	--	500	1,800
- One to 3 years	--	1,800	700
- More than 3 years	--	1,275	550
iv) Loss Assets		350	225
	9,150	10,350	6,650

Solution

	Amount (Rs.)	% of Provision	Amount of Provision (Rs)
i) Standard Assets	12,450	Nil	Nil
ii) Sub-standard Assets	6,500	10%	650
iii) Doubtful Assets:			
- upto one year	2,300	20%	460
- One to 3years	2,500	30%	750
- More than 3 years	1,825	50%	912.5
iv) Loss Assets	575	100%	575
Total Provision on Advances			3,347.5

2.5. FINAL ACCOUNTS

The Banking Regulation act, 1949 prescribes formats of preparing final accounts of the Banking companies. The third schedule of section 29 gives forms 'A' for the balance sheet and Form 'B' for Profit and loss account. The balance sheet consists of total 12 schedules. Schedule 1 to schedule 5 depicts capital and liabilities and schedule 6 to schedule 11 shows Assets of the bank and schedule 12 shows contingent liabilities and there is no specific schedule prescribes for bills for collection.

THE THIRD SCHEDULE
(See Section 29)
Form 'A'
FORM OF BALANCE SHEET

Balance Sheet of……………… (here enter the name of the Banking Company)
Balance Sheet as on 31st March ___________(year) (000's omitted)

	Schedule No.	As on 31.3…… (Current Year)	As on 31.3….. (Previous Year)
Capital & Liabilities			
Capital	1		
Reserves & Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities and Provisions	5		
Total			
Assets			
Cash and balance with Reserve Bank of India	6		
Balances with banks and money at call and short notice	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
Total			
Contingent liabilities	12		
Bills for collection			

Form 'B'
FORM OF PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH

(000's omitted)

	Schedule No.	Year ended 31.3… (Current Year)	Year ended 31.3… (Previous Year)
I. Income			
Interest earned	13		
Other income	14		
Total			
II. Expenditure			
Interest expended	15		
Operating expenses	16		
Provisions and contingencies			
Total			
III. Profit / Loss			
Net profit / Loss (-) for the year			
Profit / Loss (-) brought forward			
Total			
IV. Appropriations			
Transfer to statutory reserves			
Transfer to other reserves			
Transfer to Government / Proposed dividend			
Balance carried over to Balance Sheet			
Total			

NOTE: 1. The total income includes income of foreign branches of Rs.______
2. The total expenditure includes expenditure of foreign branches at Rs. _____
3. Surplus / deficit of foreign branches Rs. ______

SCHEDULE 1 --- CAPITAL

	As on 31.3…. (Current Year)	As on 31.3… (Previous Year)
I. **For Nationalized Banks** Capital (Fully owned by Central Government) II. **For Banks Incorporated Outside India** Capital (The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head) Amount of deposit with the RBI under Section 11(2) of Banking Regulation Act, 1949		
Total		
III. **For Other Banks** Authorized Capital ……. shares of Rs……… each Issued Capital ……. shares of Rs……… each Subscribed Capital ……. shares of Rs……… each Called-up Capital ……. shares of Rs……… each Less: Calls unpaid		
Add: Forfeited shares		

SCHEDULE 2 – RESERVES & SURPLUS

	As on 31.3…. (Current Year)	As on 31.3…. (Previous Year)
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. **Shares 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

	As on 31.3…. (Current Year)	As on 31.3…. (Previous Year)
A. I. **Demand Deposits** i) From Banks ii) From Banks 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

	As on 31.3…. (Current Year)	As on 31.3…. (Previous Year)
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 & II above – Rs.		

SCHEDULE 5 – OTHER LIABILITIES AND PROVISIONS

	As on 31.3…. (Current Year)	As on 31.3…. (Previous Year)
I. Bills payable II. Inter-office adjustments (net) III. Interest accrued IV. Others (including provisions) Total		

SCHEDULE 6 – CASH AND BALANCES WITH RESERVE BANK OF India

	As on 31.3… (Current Year)	As on 31.3… (Previous Year)
I. Cash in hand (including foreign currency notes) II. Balances with RBI (i) in Current Account (ii) in Other Accounts Total (I + II)		

SCHEDULE 7 – BALANCES WITH BANKS & MONEY AT CALL & SHORT NOTICE

	As on 31.3…. (Current Year)	As on 31.3…. (Previous Year)
I. 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		
II. Outside India (i) in Current Accounts (ii) in Other Deposit Accounts (iii) Money at call and short notice		
Total		
Grand Total (I + II)		

SCHEDULE 8 – INVESTMENTS

	As on 31.3…. (Current Year)	As on 31.3…. (Previous Year)
I. Investments in India in i) Government securities ii) Other approved securities iii) shares iv) Debentures and Bonds v) Subsidiaries and / or joint ventures vi) Others (to be specified		
Total		
II. Investments outside India in i) Government securities (including local authorities) ii) Subsidiaries and / or joint ventures abroad iii) Other investments (to be specified)		
Total		
Grand Total (I + II)		

SCHEDULE 9 – ADVANCES

	As on 31.3…. (Current Year)	As on 31.3…. (Previous Year)
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 Sectors 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 (C. I. + C. II.)		

SCHEDULE 10 – FIXED ASSETS

	As on 31.3… (Current Year)	As on 31.3… (Previous Year)
I. Premises At cost as on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date **II. Other Fixed Assets (including furniture and fixtures)** At cost as on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date		
Total (I + II)		

SCHEDULE 11 – OTHER ASSETS

	As on 31.3…. (Current Year)	As on 31.3…. (Previous Year)
I. Inter-office adjustments (net) II. Interest accrued III. Tax paid in advance / 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

	As on 31.3…. (Current Year)	As on 31.3…. (Previous Year)
I. Claims against the bank not acknowledged as debts II. Liability for partly paid investment III. Liability on account of outstanding forward exchange contracts IV. Guarantee given on behalf of constitutents a) In India b) Outside India V. Acceptances, endorsements and, other obligations VI. Other items for which the bank is contingently liable		
Total		

SCHEDULE 13 – INTEREST EARNED

	Year ended 31.3… (Current Year)	Year ended 31.3… (Previous Year)
I. Interest / discount on advances / bills II. Income on investments III. Interest on balances with Reserve Bank of India and other inter-bank funds IV. Others		
Total		

SCHEDULE 14 – OTHER INCOME

	Year ended 31.3… (Current Year)	Year ended 31.3… (Previous Year)
I. Commission, exchange and brokerage II. Profit on sale of investments Less: **Loss on sale of investments** III. Profit on revaluation of investments Less: **Loss on revaluation of investments** IV. Profit on sale of land, buildings and other assets Less: Loss on sale of land, buildings and other assets. V. Profit on exchange transactions Less: **Loss on exchange transactions** VI. Income earned by way of dividends etc. from subsidiaries / companies and / or joint ventures abroad / in India		
VII. Miscellaneous Income Total		

Note : Under items II to V loss figures may be shown in brackets

SCHEDULE 15 – INTEREST EXPENDED

	Year ended 31.3… (Current Year)	Year ended 31.3… (Previous Year)
I. Interest on deposits II. Interest on Reserve Bank of India / inter-bank borrowings III. Others		
Total		

SCHEDULE 16 – OPERATING EXPENSES

	Year ended 31.3… (Current Year)	Year ended 31.3… (Previous Year)
I. Payments to and provisions for employees II. Rent, taxes and lighting III. Printing and stationery IV. Advertisement and publicity V. Depreciation on bank's property VI. Directors' fees, allowances and expenses VII. Auditor' fees and expenses (including branch auditors' fees and expenses) VII. Law charges IX. Postages, telegrams, telephone, etc. X. Repairs and maintenance XI. Insurance XII. Other expenditure		
Total		

GUIDELINES OF RBI FOR COMPILATION OF FINANCIAL STATEMENTS BALANCE SHEET

Item	Schedule	Coverage	Notes and instructions for compilation
(1)	(2)	(3)	(4)
Capital	**1**	**Nationalized Banks** Capital (fully owned by Central Government)	The capital owned by Central Government as on the date of the Balance Sheet, including contribution from Government, if any, for participating in World Bank, Projects, should be shown.

Banking Companies incorporated outside India	(i) The amount brought in by banks by way of start-up capital as prescribed by RBI, should be shown under this head. (ii) The amount or deposits kept with RBI under sub-section 2 of Section 11 of the Banking Regulation Act, 1949 should also be shown.
Other Banks (Indian) Authorized Capital (… shares of Rs… each) Issued Capital (… Shares of Rs... Each) Subscribed Capital (… Shares of Rs…. Each) Called-up Capital (… Shares of Rs… each) Less: **Calls unpaid Add: Forfeited shares: Paid-up Capital**	Authorized, Issued, Subscribed, Called-up Capital should be given separately. Calls-in-arrears will be deducted from Called-up Capital while the paid-up value of forfeited shares should be added, thus arriving at the paid-up capital. The necessary items which can be combined should be shown under one head, for instance, "Issued and Subscribed Capital".
	Notes: General The changes in the above items, if any, during the years, say, fresh contribution made by the Government, fresh issue of capital, capitalization of reserves, etc., may be explained in the notes.

Reserves and Surplus	2	(I) **Statutory Reserves**	Reserves created in terms of Section 17 or another section of Banking Regulation Act, must be separately disclosed.
		(II) **Capital Reserves**	The expression 'capital reserve' shall not include any amount regarded as free for distribution through the Profit and Loss Account. Surplus on revaluation should be treated as Capital Reserves. Surplus on translation of the financial statements of foreign branches (which includes fixed assets also) is not a revaluation reserve.
		(III) **Share Premium**	Premium on issue of share capital may be shown separately under this head.
		(IV) **Revenue and other Reserves**	The expression 'Revenue Reserve' shall mean any reserve other than those separately classified. This expression 'reserve' shall not include any amount, written-off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability.
		(V) **Balance of Profit**	Includes balance of profit after appropriation. In case of loss the balance may be shown as a deduction.

			Notes : General Movement in various categories of reserves should be shown as indicated in the schedule.
Deposits	**3**	**A.** (I) **Demand Deposits** (i) from banks (ii) from others	Includes all bank deposits repayable on demand. Include all demand deposits of the non-banking sectors. Credit balances in overdrafts, cash credit accounts, deposits payable at call, overdue deposits, inoperative current accounts, matured time deposits and cash certificates, certificate of deposits, etc. are to be included under this category.
		(ii) **Saving Bank Deposits**	Includes all savings bank deposits (including inoperative savings bank accounts).
		(III) **Term Deposits** (i) from banks (ii) from others	Includes all types of bank deposits repayable after specified term. Includes all types of deposits of the non-banking sector, repayable after a specified term. Fixed deposits, cumulative and recurring deposits, annuity deposits, deposits mobilized under various schemes, ordinary staff deposits, foreign currency non-resident deposit accounts, etc., are to be included under this category.

		B. (i) **Deposits of branches in India**	The total of these two items will agree with the total deposits.
		(ii) **Deposits of branches outside India**	**Notes :** General (a) Interest payable on deposits which is accrued but not due should not be included but shown under other liabilities. b) Matured time deposits and cash certificates, etc., should be treated as demand deposits. c) Deposits under special schemes should be included under the term deposits, if they are not payable on demand. When such deposits have matured for payment they should be shown under demand deposits. d) Deposits from banks will include deposits from the banking system in India, co-operative banks, foreign banks, which may or may not have presence in India.
Borrowings	**4**	(I) **Borrowings in India** (i) Reserve Bank of India	Includes borrowing / refinance obtained from Reserve Bank of India
		(II) Other Banks	Includes borrowings / refinance obtained from commercial banks (including co-operative banks).
		(iii) Other institutions and agencies.	Includes borrowings / refinance obtained from industrial Development Bank of India, Export-Import of Bank of India,

	National Bank for Agriculture and Rural Development and other institutions, agencies (including liability against participation certificates, if any).
(II) **Borrowings outside India**	Includes borrowings of Indian branches abroad as well as borrowings of foreign branches.
Secured borrowings included above	This item will be shown separately. Includes secured borrowings / refinance in India and outside India.
	Note: General
	(i) The total of I and II will agree with the total borrowings shown in the Balance Sheet.
	(ii) Inter-office transactions should not be shown as borrowings.
	(iii) Funds raised by foreign branches by way of certificate of deposits, notes, bonds, etc., should be classified depending upon documentation, as 'deposits', ' borrowings', etc.
	(iv) Refinance obtained by banks from Reserve Bank of India and various institutions are being brought under the head 'Borrowings'. Hence, advances will be shown at the gross amount on the assets side.

Other Liabilities and Provisions	**5**	I.**Bills Payable**	Includes drafts, telegraphic transfers, traveler cheques, mail transfers payable, pay slips, bankers cheques and other miscellaneous items.
		II. **Inter-office Adjustments**	The inter-office adjustments balance, if the credit should be shown under this head. Only net position of inter-office accounts, inland as well as foreign, should be shown here.
		III.**Interest Accrued**	Includes interest accrued but not due on deposits and borrowings.
		IV.**Others (including provisions)**	Includes net provision for income tax and other taxes like interest tax (less advance payment, tax deducted at source, etc.,) surplus in aggregate in provisions for depreciation in securities, contingency funds which are not disclosed under any of the major heads such as unclaimed dividend, provisions and funds kept for specific purpose, unexpired discount, outstanding charges like rent, conveyance, etc. Certain types of deposits like staff security deposits, margin deposits, etc. where the repayment is not free, should also be included under this head.

			Notes: General i) For arriving at the net balance of inter-office adjustments all connected inter-office accounts should be aggregated and the net balance should only be shown, representing mostly items in transit and unadjusted items. (ii) the interest accruing on all deposits, whether the payment is due or not, should be treated as a liability. iii) it is proposed to show only pure deposits under the head ‘deposits’, and hence, all surplus provisions for bad and doubtful debts, contingency funds, secret reserves, etc., which are not netted off against the relative assets, should be brought under the head ‘others’ (including provisions).
Cash and Balances with the Reserve Bank of India	**6**	I. **Cash in hand (including foreign currency notes)** II. **Balance with RBI** i) In current Account ii) in other Accounts	Includes cash in hand, including foreign currency notes and also of foreign branches in the case of banks having such branches.

Balance with banks and money at call and short notice	**7**	I. **In India** i) Balance with Banks a) in current accounts b) in other deposit accounts	Includes all balance with banks in India (including co-operative banks). Balances in current accounts and deposit accounts should be shown separately.
		ii) Money at call and short notice a) with banks b) with other institutions	Includes deposits repayable within 15 days notice, lent in the inter-bank call money market.
		II. **Outside India** i) Current accounts ii) Deposits	Includes balances held by foreign branches and balances held by Indian branches of the banks outside India. Balance held with foreign branches by other branches of the bank, should not show under this head but should be included in the inter-branch accounts. The amounts held in 'current accounts' and 'deposit accounts should be shown separately.
		iii) Money at call and short notice	Includes deposits usually classified in foreign currencies as money at call and short notice.
Investment	**8**	I. **Investment in India** i) Government securities	Includes Central and State Government securities and Government treasury bills. These securities should be at the book value. However, the difference between the

	book value and market value should be given in the notes to the Balance Sheet.
ii) Other approved securities	Securities other than Government securities, which according to the Banking Regulation Act, 1949, are treated as approved securities, should be included here.
iii) Shares	Investment in shares of companies and corporations not included in item (ii) should be included here.
iv) Debentures and Bonds	Investments in debentures and bonds of Companies, Corporations not included in item (ii) should be included here.
v) Investments in subsidiaries / joint ventures	Investment in subsidiary / joint ventures (including R. R. Bs) should be in included here.
vi) Others	Includes general investments, if any, like gold, commercial paper and other instruments in the nature of shares / debentures / bonds.
II. **Investment outside India**	
i) Government securities (including local authorities)	All foreign Government securities including securities issued by local authorities may be classified under this head.
ii) Subsidiaries and / or joint ventures abroad	All investments made in the share capital of subsidiaries, floated outside India and / or joint

			ventures abroad, should be classified under this head.
		iii) Others	All other investments outside India may be shown under this head.
Advances	**9**	A. i) Bills purchased and discounted ii) Cash credits, overdrafts and loans repayable on demand iii) Terms loans	In classification under Section 'A', all outstanding – in India as well as outside – less provisions made, will be classified under three heads as indicated, and both secured and unsecured advances will be included under these heads including overdue installments.
		B. i) Secured by tangible assets	All advances or part of advances which are secured by tangible assets may be shown here. The item will include advances in India and outside India.
		ii) Covered by Bank / Government Guarantee	Advances in India and outside India to the extent they are covered by guarantees of Indian and foreign governments and Indian and foreign banks and DICGC & ECGC are to be included.
		iii) Unsecured	All advances not classified under (i) and (ii) will be included here. Total of 'A' should tally with the total of 'B'.
		C.I. **Advances in India** i) Priority sectors	Advances should be broadly classified into 'Advances in India' and 'Advances outside India'. Advances in India will be

ii)Public sector iii) Banks iv) Others	further classified on the sartorial basis as indicated.
C.II. **Advances outside India** i) Due from banks ii) Due from others a) Bills purchased and discounted b) Syndicated loans c) Others	Advances to sectors which for the time being are classified as priority sectors according to the instructions of the Reserve Bank are to be classified under the head ‘Priority sectors’. Such advances should be excluded from the item (ii) i.e., advance to public sector. Advances to Central and State Government and other Government undertakings including Government companies and corporations, which are, according to the statutes, to be treated as Public sectors companies, are to be included in the category ‘Public sector’. All advances to the banking sector including co-operative banks, will come under the head ‘Banks’. All the remaining advances will be included under the head ‘Others’ and typically this category will include non-priority advances to the private, joint and co-operative sectors **Note:** General i) The gross amount of advances including refinance and rediscounts but excluding provisions made to the satisfaction of auditors should be shown as advances.

			ii) Term loans will be loans not repayable on demand. iii) Consortium advances would be shown net of share from other participating banks / institutions.
Fixed Assets	**10**	I. **Premises** i) At cost as on 31st March of the preceding year ii) Addition **during the year** iii) **Deductions during the year** iv) **Depreciation to due**	Premises wholly or partly owned by the banking company for the purpose of business, including residential premises should be shown against 'premises'. In the case of premises and other fixed assets, the previous balance, additions there to, deductions there from, during the year, and also the total depreciation written-off should be shown. Where sums have been written off on reduction of capital and revaluation of assets, every Balances Sheet after the first Balance Sheet, subsequent to the reduction or revaluation should show the revised figures for a period of five years, with the date and amount of revision made.
		II.**Other Fixed Assets (including furniture and fixtures)** i) At cost on 31st March of the preceding year	Motor vehicles and all other fixed assets other than premises but including furniture and fixtures should be shown under this head.

		ii)Additions during the year	
		iii) deductions during the year	
		iv) Depreciation to date	
Other Assets	**11**	I. **Inter-office Adjustments (net)**	The inter-office adjustment balance, if in debit, should be shown under this head. Only net position of inter-office accounts, inland as well as foreign, should be shown here. For arriving at the net balance of inter-office adjustment accounts, all connected inter-office accounts should be aggregated and the net balance, if in debit, only should be shown, representing monthly items in transit and unadjusted items.
		II.**Interest Accrued**	Interest accrued but not due or investments and, advance and interest due but not collected on investment, will be the main components of this item. As banks normally debit the borrowers account with the interest due on the Balance Sheet date, usually there may not be any amount of interest due on advances. Only such interest as can be realized in the ordinary course should be shown under this head.

III. **Tax paid in advance / tax deducted at source**	The amount of tax deducted at source on securities, advance tax paid etc. to the extent that these items are not set off against relative tax provisions should be shown against this item.
IV. **Stationery and Stamps**	Only exceptional items of expenditure on stationery like bulk purchase of security paper, loose leaf or other ledgers, etc. which are shown as quasi-asset to be written-off over a period of time, should be shown here. The value should be on a realistic basis and cost escalation should not be taken into account, as these items are for internal use.
V.**Non-banking assets acquired in satisfaction of claims**	Immovable properties / tangible assets acquired in satisfaction of claims are to be shown under this head.
VI. **Others**	This will include items like claims which have not been met, for instance, clearing items, debit items representing addition to assets or reduction in liabilities, which have not been adjusted for technical reasons, want of particulars, etc., advances given to staff by a bank as an employer and not as a banker, etc. Items which are in the nature of expenses, which are pending

			adjustments, should be provided for and the provision netted against this item, so that only realizable value is shown under this head. Accrued income other than interest may also be included here.
Contingent Liabilities	**12**	I. **Claims against the bank not acknowledged as debts**	Liabilities on partly paid shares, debentures, etc., will be included in this head.
		II. **Liabilities for partly paid investments**	
		III. **Liabilities on account of outstanding forward exchange contracts**	Outstanding forward exchange contracts may be included here
		IV. Guarantees given on behalf of constituents	Guarantees given for constituents in India and outside India may be shown separately.
		i) in India	
		ii)outside India	
		V) **Acceptances, endorsement and other obligations**	This item will include letters of credit and bills accepted by the bank on behalf of customers.

		VI. **Other items for which the Bank is contingently liable**	Arrears of cumulative dividends, bills rediscounted under under-writing contracts, estimated amount of contracts remaining to be executed on Capital Account and not provided for, etc., are to be included here.
Bills for Collection			Bills and other items in the course of collection and not adjusted will be shown against this item in summary version only, a separate schedule is proposed.

Profit and Loss Account

Interest earned	13	I. **Interest / discount on advance / bills**	Includes interest and discount on all types of loans and advances, cash credit, demand loans, overdrafts, export loans, term loans, domestic and foreign bills purchased and discounted (including those rediscounted), over interest and also interest subsidy, if any, relating to advances / bills
		II. **Income on investments**	Includes all income derived from the investment portfolio by way of interest and dividend.
		III. **Interest on balances with the Reserve Bank of India and other inter-bank funds**	Includes interest on balances with Reserve Ban and other banks, call loans, money market placements etc.

		IV. **Others**	Includes any other interest / discount income not included in the above heads.
Other Income	**14**	I. **Commission, exchange and brokerage**	Includes all remuneration on services such as commission on collections, commission / exchanges on remittances and transfers, commission on letters of credit, letting out of lockers and guarantees, commission on Government business, commission on other permitted agency business including consultancy and other services, brokerage, etc., on securities. It does not include foreign exchange income.
		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.**	Includes profit / loss on sale of securities, furniture, land and buildings, motor vehicle, gold, silver, etc. Only the net position should be shown. If the net position is a loss, the amount should be shown as a deduction. The net profit / loss on revaluation of assets may also be shown under this item.

		V. **Profit on exchange transactions.** Less: **Loss on exchange transaction**	Includes profit / loss on dealing in foreign exchange, all income earned by way of foreign exchange, commission and charges on foreign exchange transactions excluding interest which will be shown under interest. Only the net position should be shown. If the net position is a loss, it is to be shown as a deduction.
		VI.**Incomeearned by way of dividends etc. from subsidiaries, companies, joint ventures abroad / in India.**	
		VII. **Miscellaneous income.**	Includes recoveries from constituents for godown rents, income from bank's properties, security charges, insurance etc., and any other miscellaneous income. In case, any item under this head exceeds one percentage of the total income, particulars may be given in the notes.
Interest Expended	**15**	I. **Interest on deposits**	Includes interest paid on all types of deposits including deposits from banks and other institutions.
		II. **Interest on Reserve Bank of India / inter-bank borrowings**	Includes discount / interest on all borrowings and refinance from the Reserve Bank of India and other banks.
		III. **Others**	Includes discount / interest on all borrowings / refinance from financial institutions. All other payments like interest on participation certificates, penal interest paid, etc. may also be included here.

Operating Expanses	**16**	I. **Payments to and provisions for employees**	Includes staff salaries / wages, allowances, bonus, and other staff benefits, like provident fund, pension, gratuity, liveries to staff, leave fare concessions, staff welfare, medical allowance to staff, etc.
		II. **Rent, taxes and lighting**	Includes rent paid by the banks on buildings and municipal and other taxes paid (excluding income-tax and interest tax) electricity and other similar charges and levies. House rent allowance and other similar payments to staff should appear under the head 'Payments to and Provisions for Employees'.
		III. **Printing and Stationery**	Includes books and forms, and stationery used by the bank and other printing charges, which are not incurred by way of publicity expenditure.
		IV. **Advertisement and Publicity**	Includes expenditure incurred by the bank of advertisement and publicity purposes including printing charges of publicity matter.
		V. **Depreciation on bank's property**	Includes depreciation on bank's own property, motor cars and other vehicles, furniture, electric fittings, vaults, lifts, leasehold properties, non-banking assets, etc.
		VI. **Director's fees, allowances and expenses**	Includes sitting fees and all other items of expenditure incurred on behalf of the directors. The daily

	allowance, hotel charges, conveyance charges, etc. which though in the nature of reimbursement of expenses incurred, may be included under this head. Similar expenses of Local Committee members may also be included under this head.
VII. **Auditor's fees and expenses (including branch auditor's fees and expenses)**	Includes the fees paid to the statutory auditors and branch auditors for the professional services rendered and also all expenses for performing their duties, even though they may be in the nature of reimbursement of expenses. If external auditors have been appointed by the banks themselves for internal inspections and audits and other services, the expenses incurred in that context including fees may not be included under this head but should be shown under 'other expenditure'.
VIII. **Law charges**	All legal expenses and reimbursement of expenses incurred in connection with legal services are to be included here.
IX. **Postage, telegraphs, telephones, etc.**	Includes all postal charges like stamps, telegrams, telephones, teleprinter etc.
X **Repairs and maintenance**	Includes repairs to bank's property, their maintenance charges, etc.

XI. **Insurance**	Includes insurance charges on bank's property, insurance premia paid to Deposit Insurance and Credit Guarantee Corporation, etc. to the extent they are not recovered from the concerned parties.
XII. **Other expenditure**	All expenses other than those not included in any of the other heads, like, licence fees, donations, subscriptions to papers, periodicals, entertainment expenses, travel expenses, etc., may be included under this head. In case, any particular item under this head exceeds one percentage of the total income, the particulars may be given in the notes.
Provisions and contingencies	Includes all provisions made for bad and doubtful debts, provisions for taxation, provisions for diminution in the value of investments, transfers to contingencies and other similar items.

Disclosure of Accounting Policies

In order that the financial position of banks represent a true and fair view, the Reserve Bank of India has directed the banks to disclose the accounting policies regarding the key areas of operations along with the notes of account in their financial statements for the accounting year ending 31.3.1991 and onwards, on a regular basis. The accounting policies disclosed may contain the following aspects subject to modification by individual banks:

1) General

The accompanying financial statements have been prepared on the historical cost and conform to the statutory provisions and practices prevailing in the country.

2) Transactions involving Foreign Exchange

a) Monetary assets and liabilities have been translated at the exchange rates, prevailing at the close of the year. Non-monetary assets have been carried in the books at the historical cost.

b) Income and expenditure items in respect of Indian branches have been translated at the exchange rates, ruling on the date of the transaction and in respect of overseas branches at the exchange rates prevailing at the close of the year.

c) Profit or losses on pending forward contracts have been accounted for.

3) Investments

a) Investments in Governments and other approved securities in India are valued at the lower of cost or market value.

b) Investments in subsidiary companies and associate companies (i.e., companies in which the bank holds at least 25 percent of the share capital) have been accounted for on the historical cost basis.

c) All other investments are valued at the lower of cost or market value.

4) Advances

a) Provisions for doubtful advances have been made to the satisfaction of the auditors:

i) In respect of identified advances, based on a periodic review of advances and after taking into account the portion of advance guaranteed by the Deposit Insurance and Credit Guarantee Corporation, the Export Credit and Guarantee Corporation and similar statutory bodies;

ii) In respect of general advances, as a percentage of total advances taking into account the guidelines issued by the Government of India and the Reserve Bank of India.

b) Provisions in respect of doubtful advances have been deducted from the advances to the extent necessary and the excess have been included under “Other Liabilities and Provisions”.

c) Provisions have been made on a gross basis. Tax relief, which will be available when the advance is written-off, will be accounted for in the year of write-off.

5) Fixed Assets

a) Premises and other fixed assets have been accounted for at their historical cost. Premises which have been revalued are accounted for the value determined on the basis of such revaluation made by the professional values; profit arising on revaluation has been credited to Capital Reserve.

b) Depreciation has been provided for on the straight line/diminishing balance method.

c) In respect of revalued assets, depreciation is provided for on the revalued figures and an amount equal to the additional depreciation consequent of revaluation is transferred annually from the Capital Reserve to the General Reserve / Profit and Loss Account.

6) Staff Benefits

Provisions for gratuity / pension benefits to staff have been made on an accrual / casual basis. Separate funds for gratuity / pension have been created.

7) Net Profit

a) The net profit disclosed in the Profit and Loss Account is after:

i) provisions for taxes on income, in accordance with the statutory requirements.

ii) provisions for doubtful advances.

iii) adjustments to the value of "current investments" in Government and other approved securities in India, valued at lower of cost or market value.

iv) transfers to contingency funds.

v) other usual or necessary provisions.

b) Contingency funds have been grouped in the Balance Sheet under the head "Other Liabilities and Provisions".

2.6. SOME IMPORTANT TRANSACTIONS

2.6.1 Rebate on Bills Discounted:

Rebate on Bills Discounted is the Discount income not earned by the bank of discounting off the Bill of the Bill as it gets mature after the closing date of its accounting year.

Journal entries :

i) On discounting of Bill

Bills Discounted and purchased A/c Dr (with its full value)
To Customer's Account (with the proceeds value)
To Discount A/c (with the amount of Discount earned during the year)

To Rebate on Bills Discounted (with the amount of unearned Discount)

'Rebate on Bills Discounted' appears on Liabilities side of Balance sheet under – "other liabilities and provisions" (schedule-5) as it is the income received in advance.

ii) At the beginning of Accounting year entry will be Rebate on Bills Discounted A/c Dr.

To Discount A/c (with the amount of unearned Discount)

Illustration 1:

On 1st January 2008 Ajmer Bank Ltd. Discounted a bill of Rs. 3, 00,000 @ 10 percent p.a. The Bills falls due on 31st May 2008 and bank closes its account on 31st March every year. Pass necessary journal entry.

Journal Entry

Solution:

1 Jan, 08	Bills discounted and purchased A/c Dr To Customers' A/c To Discount A/c To Rebate on bills discounted (Being the bills discounted)	3,00,000	 2,87,500 7,500 5,000
1 April, 08	Rebate on bills discounted A/c Dr. To Discount A/c (Being in next accounting year Rebate on bills discounted transferred to discount A/c)	5,000	 5,000

Note : Discount for 3 months = 3,00,000 $\times \frac{10}{100} \times \frac{3}{12} = 7,500$

Rebate on bills for 2 months = 3, 00,000 $\times \frac{10}{100} \times \frac{2}{12} = 5,000$

Illustration 2:

Following are the details of bills discounted by UCO Bank Ltd. During the year ended 31/3/08

Date of Bill 2009	Amount (Rs).	Term (Months)	Rate of Discount p.a. (%)	Discount (Rs.)
Jan 15 March 5 Feb. 6	1,00,000 1,50,000 80,000	4 3 5	12 15 18	4,000 5,625 6,000
Total	3,30,000			15,625

Calculate Rebate on bills discounted and show the necessary Journal entry.

Date of Bill 2009	Date of maturity	No. of days outstanding after 31/3/2008	Amount (Rs.)	Discount (%)	Total amount of discount (Rs.)	Portion of Discount o/s after 31/3/2008 (Rs.)
Jan 15	May 18	(30 + 18) 48	1,00,000	12	12,000	1,578.08
March 05	June 08	(30+31+8) 69	1,50,000	15	22,500	4,253.42
Feb 06	July 09	(30+31+30+9) 100	80,000	18	14,400	3,945.21
Total						9,776.71

Journal Entry:

Bills discounted and purchased A/c Dr. 3, 30,000

To Customer A/c (3, 30,000 – 5,848.29-9776.71)

To Discount A/c (15625-9776.71) 5848.29

To Rebate on bills discounted 9776.71

2.6.2 Acceptance Endorsement and other obligations

The Bank accepts or encloses a bill on behalf of its customers who has raised loan or made purchases on credit basis and a customer deposit equal amount of security into the bank. On maturity bank pays amount to the party on behalf of its customer and at the same time claims same amount from its customer. It is shown under the heading ‘contingent Liabilities’ (Schedule -12)

2.6.3 Bills for collection

Many bank customers usually handover bills receivables to the bank for the purpose of its collection on maturity when the bills get mature, bank credit the amount to the respective client’s account. The ‘Bills for collection’ is shown at the foot of the Balance sheet.

2.6.4 Provisions and contingencies

There is no separate schedule given by the Banking Regulation Act, 1949 regarding provisions and contingencies but it is shown in the profit and loss account under the heading ‘Provisions and contingencies’. It includes provisions for bad and doubtful debts, Provision for income tax provisions for Rebate on bills discounted and such other required provisions and contingencies. It is included in schedule – 5 ‘other liabilities and provisions’ with sub-heading – IV – others”.

2.7 SOLVED PROBLEMS

Illustration 1

A Smruti Bank Ltd. Provides you the following balances as on 31st March 2009.

Particulars	Amount (Rs.)
Share capital (Issued and subscribed)	39,000
Current account	8,58,000
Money at call and short notices	9,885
Rebate on bills discounted	22,500
Commission exchange and brokerage	27,000
Interest on loans	77,700
Interest on fixed deposit	82,500
Commission Received	2,400
Salaries and allowances	31,500
Reserve for building	39,000
Unclaimed discount	936
Unexpired discount	1,950
Investment of cost: Central and State Government	
- Securities	3,90,000
- Debentures	15,600
- Bullion	93,600
Reserve fund	62,400
Fixed deposit	1,56,000
Directors fees and allowances	3,600
Rent and taxes paid	16,200
Postage and telegram	6,000
Rent received	9,000
Interest on balances with RBI	60,825
Profit on sale of Investment	
Loans, advances, overdraft and cash credit	3,90,000
Bills payable	78,000
Borrowings from banks in India	9,750
Branch adjustment	2,25,966
Furniture and fixtures	1,23,900
Non banking assets acquired	2,730
Interest accrued on investment	10,140
Dividend fluctuation fund	23,400

Profit and loss A/c (Credit balance)	7,800
Locker rent	3,000
Transfer fees	1,500
Interest on saving bank deposits	20,400
Interest on cash credit	66,900
Premises at cost	3,90,000
Additions to premises	78,000
Advance payment of tax	4,290
Silver bullion	7,800
Saving Bank deposit	2,34,000
Cash balances with RBI	1,32,600
Cash balances with other banks	46,800
Depreciation Fund on premises	3,12,000

Other Information:

1) There was a claim of rupees 7,800 against bank but not acknowledge as debt.
2) Bank transfer reserve for building to depreciation fund of premises
3) Directors decided to declare 10 percent dividend
4) Provide rupees 1, 05,000 for income tax and rupees 15,000 for doubtful debts.
5) Transfer 20 percent of profit to statutory reserve. Prepare final accounts of the bank.

Solution:

Smruti Bank Ltd.
Balance Sheet as on 31st March 2009

	Schedule No.	As on 31st March 2009
Capital and Liabilities		
Capital	1	39,000
Reserves and surplus	2	1,01,625
Deposits	3	12,48,000
Borrowings	4	9,750
Other Liabilities and provisions	5	5,58,036
Total		19,56,411

Assets	6	1,32,600
Cash and balances with Reserve Bank of India	7	56,685
Balances with banks and money at call and short notice	8	4,99,200
Investments	9	4,25,100
Advances	10	5,91,900
Fixed Assets	11	2,50,926
Other Assets		
Total	12	19,56,411
Contingent liabilities		7,800
Bills for collection		

Profit and Loss account for the year ended 31st March 2009

	Schedule No.	As on 31st March 2009
I. **Income**		
Interest earned	13	2,49,225
Other income	14	42,900
Total		2,92,125
II. **Expenditure**		
Interest expended	15	1,02,900
Operating expenses	16	57,300
Provisions and contingencies		1,20,000
Total		2,80,200
III. **Profit / Loss**		
Net profit / Loss (-) for the year		11,925
Profit / Loss (-) brought forward		7,800
Total		19,725
IV. **Appropriations**		
Transfer to statutory reserves		2,385
Transfer to other reserves		
Transfer to Government / proposed dividend		3,900
Balance carried over to Balance sheet		13,440
Total		19,725

Schedule 1 – Capital

	As on 31st March 2009
Authorized Capital	39,000
Issued and subscribed	39,000
Total	39,000

Schedule 2 - Reserves and surplus

		As on 31st March 2009
I. **Statutory Reserves** Opening Balance Additions during the year	 62,400 2,385	 64,785
II. **Revenue and other Reserves** Dividend fluctuation fund		 23,400
III. Balance in profit and loss Account		13,440
Total (I + II + III)		1,01,625

Schedule 3 – Deposits

	As on 31st March 2009
A. I. Demand Deposits : From banks	8,58,000
II. Saving Bank Deposits	2,34,000
III. Term Deposits : Fixed Deposits	1,56,000
Total (I + II + III)	12,48,000
B. I. Deposits of branches in India	12,48,000
II. Deposits of branches outside India	--
Total	12,48,000

Schedule 4 – Borrowings

	As on 31st March 2009
I. Borrowings in India: other banks	9,750
Total	9,750

Schedule 5–other liabilities and provision

	As on 31st March 2009
I. Bills payable	78,000
II. **Others** : Rebate for bills discount	2,250
Provision for tax and doubtful debts	1,20,000
Unclaimed Discount	936
Unexpired Discount	1,950
Depreciation fund on premises	3,51,000
Proposed dividend	3,900
Total (I + II)	5,58,036

Note : Depreciation fund on premises = 3,12,000 + 39,000
= 3, 51,000

Schedule 6 – Cash and Balances with RBI

	As on 31st March 2009
I. Balances with RBI	1,32,600
Total	1,32,600

Schedule 7 – Balances with Banks and money at calls & short notice

	As on 31st March 2009
I. Balances with other banks in India	46,800
II. Money at call & short notice	9,885
Total (I + II)	56,685

Schedule 8 – Investments

	As on 31st March 2009
I. Investment in Government securities	3,90,000
Debentures	15,600
Bullion	93,600
Total	4,99,200

Schedule 9 – Advances

	As on 31st March 2009
I. Bills purchased and discounted	35,100
II. Cash credits, overdrafts and loans repayable on demand	3,90,000
Total	4,25,100

Schedule 10 – Fixed Assets

	As on 31st March 2009
I. Premises	3,90,000
Opening Balance	78,000
Additions during the year	4,68,000
II. Other Fixed Assets	1,23,900
Total (I + II)	5,91,900

Schedule 11 – Other Assets

	As on 31st March 2009
I. Inter office adjustments	2,25,966
II. Interest accrued on investment	10,140
III. Advance payment of tax	4,290
IV. Non banking Assets acquired in satisfaction of claims	2,730
V. Other : Silver bullion	7,800
Total	2,50,926

Schedule 12 – Contingent Liabilities

	As on 31st March 2009
I. Claims against the bank not acknowledged as debt	7,800
Total	7,800

Schedule 13 – Interest earned

	As on 31st March 2009
I. Interest / discount on Advances / bills:	
Interest on loans	7,77,000
Interest on cash credits	66,900
II. Interest on balances with Reserve Bank of India and other inter-bank funds	60,825
III. Others: Discount on bills discounted	43,800
Total	2,49,225

Schedule 14- Other income

	As on 31st March 2009
I. Commission exchange and brokerage	27,000
II. Profit on sale of investment	28,500
III. Miscellaneous income: Rent Received	9,000
Locker rent	3,000
Transfer fees	1,500
Commission received	2,400
Total	42,900

Schedule 15 – Interest expanded

	As on 31st March 2009
I. Interest on Fixed deposits	82,500
II. Interest on saving bank deposit	20,400
Total	1,.02,900

Schedule 16 – Operating Expenses

	As on 31st March 2009
I. Rent and Taxes paid	16,200
II. Directors fees, allowances and expenses	3,600
III. Postage and telegram	6,000
IV. Other expenditure	31,500
Total	57,300

Illustration 2:

On 31st March 2010 the following trial balance was extracted from Amin Bank Ltd. You are required to prepare profit and loss account for the year ended 31st March 2010 and also the balance sheet as on that date.

Debit Balances	Amount (Rs.)
Insurance charges on bank property	2,899
Depreciation on banks property	3,523
Fees paid to statutory auditor	21,944
Staff salaries and medical allowances	1,45,366
Rent on building and municipal taxes	9,035
Interest due but not collected on investment	33,280
Land and building at cost	4,693
Other fixed Assets	24,570
Loss on sale of other fixed Assets	2,795
Repairs and maintenance	1,508
Legal charges	221
Tax deducted at source	93,873
Cash in hand	27,482
Balances with RBI: Current A/c	9,75,026
Other Accounts	12,805
Printing and stationary	2,418
Printing charges of publicity matters	520
Stationary and stamp	1,846
Term loans	9,11,599
Licence fee	12,155
Directors sitting fees	4,524
Other expenditure	9,295
Balance with other bank: In current A/c	7,139
In other deposit A/c	3,560
Money call and short notices with bank	325
Cash credit and overdraft	12,96,984
Investment:	
Government treasury bills	12,78,576
Other approved securities	4,91,452
Joint ventures	16,380
Debentures and bonds of companies	19,721
Non banking Assets acquired in satisfaction of claims	6,500
Interest on RBI borrowings	5,785
Bills purchased and discounted	2,84,089
Interest paid on deposit: From banks	59,280
Other institution	2,37,159
Inter-office adjustment (net)	16,562

Credit Balances	Amount (Rs.)
Issued, subscribed and paid up share capital: 3250 shares of Rs. 10 each	32,500
Interest on debentures and bonds	1,86,706
Rebate on bills discounted	42,939
Depreciation on building to date	1,417
Statutory Reserve	97,591
Revenue Reserves	71,500
Depreciation on other fixed assets to date	12,610
Demand deposits : From banks	13,39,050
From others	10,9,540
Saving bank deposits	15,41,865
Term deposits	19,04,760
Commission on remittances and transfer	53,582
Letting out lockers	5,920
Interest on balances with RBI and other Inter-bank funds	44,811
Income earned by way of dividend from joint venture	2,274
Interest on advances, cash credit and overdraft	4,04,859
Interest accrued	16,328
Profit on sale of investment	2,275
Bills payable	71,162
Borrowings from RBI	37,700
Profit and loss account	45,500

Adjustments:

1. The authorized capital of bank is rupees 65,000 divided into 6,500 shares of Rupees10 each, 50 percent of it is issued and subscribed.
2. The provision for income tax to be made @ 45 percent
3. All advances are in India and they are classified as follows: priority sectors 12, 46,336; public sector 4, 98,534; banks 3, 94,198; others 3, 53,604. Advances secured by tangible assets Rs. 11, 21,702; covered by bank/ Government guarantees Rs. 8, 72,435 and remaining are unsecured 4, 98,535.
4. Bank Transfer 20 percent of profit to statutory reserve and 15 percent to revenue reserves.
5. contingent liabilities:

   i) Claim against the bank not acknowledged as debt Rs. 2,150.

   ii) Liability on account of outstanding forward exchange contracts Rs. 640.

   iii) Acceptance, endorsement and other obligations 4542.

Solution 2:

Amin Bank Ltd.
Balance Sheet as on 31st March 2010

	Schedule No.	As on 31st March 2010
Capital & Liabilities		
Capital	1	32,500
Reserves & Surplus	2	3,14,691
Deposits	3	48,95,215
Borrowings	4	37,700
Other Liabilities and provisions	5	2,12,329
Total		54,92,435
Assets		
Cash and balances with Reserve Bank of India	6	10,15,313
Balances with banks and money at call and short notice	7	11,024
Investments	8	18,06,129
Advances	9	24,92,672
Fixed Assets	10	15,236
Other assets	11	1,52,061
Total		54,92,435
Contingent Liabilities		7,332

PROFIT & LOSS A/C FOR THE YEAR ENDED ON 31ST MARCH, 2010

	Schedule No.	As on 31-3-10
I. Income: Interest earned	13	6,36,376
Other Income	14	61,256
Total		6,97,632
II. Expenditure: Interest expended	15	3,02,224
Operating expenses	16	2,13,408
Provisions and contingencies		81,900
Total		5,97,532
III. Profit / Loss:		
Net Profit / Loss (-) for the year		1,00,100
Profit / Loss (-) brought forward		45,500
Total		1,45,600
IV. appropriations:		
Transfer to statutory reserves		29,120
Transfer to other reserves		21,840
Transfer to Government/proposed dividend		
Balance carried over to Balance Sheet		94,640
Total		1,45,600

Schedule 1 – Capital

	As on 31st March 2010
For other banks Authorized capital 6500 shares of Rs. 10 each	65,000
Issue capital 3250 shares of Rs. 10 each	32,500
Subscribed capital: 3250 shares of Rs. 10 each	32,500
Called-up capital: 3250 shares of Rs. 10 each	32,500
	32,500

Schedule 2 – Reserves and surplus

	As on 31st March 2010
I. Statutory reserves:	
Opening balance	97,591
Additions during the year	29,120
	1,26,711
II. Revenue and other reserves	
Opening balance	71,500
Additions during the year	21,840
	93,340
III. Balance in profit and loss A/c	94,640
Total (I + II + III)	3,14,691

Schedule 3 – Deposits

	As on 31st March, 2010
I. Demand deposits: From banks	13,39,050
From others	1,09,540
II. Savings bank deposits	15,41,865
III. Term deposits	19,04,760
Total (I + II + III)	48,95,215

Schedule 4 – Borrowings

	As on 31st March, 2010
I. Borrowings in India : Reserve bank of India	37,700
Total	37,700

Schedule 5– Other Liabilities and provisions

	As on 31st March, 2010
Bills payable	71,162
Interest accrued	16,328
Others: Rebate on bills discounted	42,939
Provision for income tax	81,900
Total	2,12,329

Schedule 6 – Cash and balances with RBI

	As on 31st March, 2010
I. Cash in hand	27,482
II. Balances with RBI:	
In current A/c	9,75,026
In other A/c	12,805
Total	10,15,313

Schedule 7 – Balances with banks & money at call & short notice

	As on 31st March, 2010
I. Balances with banks:	
In current A/c	7,139
In other deposit A/c	3,560
II. Money at call & short notice	325
Total (I + II)	11,024

Schedule 8 – Investment

	As on 31st March, 2010
Investments in:	
Government treasury bills	12,78,576
Other approved securities	4,91,452
Debentures and bonds of companies	19,721
Subsidiaries and joint venture	16,380
Total	18,06,129

Schedule 9 – Advances

	As on 31st March, 2010
A)	
i) Bills purchased and discounted	2,84,089
ii) Cash credit, overdraft and loans repayable on demand	12,96,984
iii) Terms loans	9,11,599
Total	24,92,672

B) i) Secured by tangible assets ii) Covered by bank / Government guarantees iii) Unsecured	 11,21,702 8,72,435 4,98,535
Total	24,92,672
C) I) Advances in India : i) Priority sectors ii) Public sector iii) Banks iv) Others	 12,46,336 4,98,534 3,94,198 3,53,604
Total	24,92,672
II) Advances outside India	--

Schedule 10 – Fixed Assets

	As on 31st March, 2010
I) Premises: At cost Depreciation to date	4,693 (1,417)
	3,276
II) Other fixed assets (including Furniture and fixtures): At cost Depreciation to date	 24,570 (12,610)
	11,960
Total (I + II)	15,236

Schedule 11 – Other Assets

	As on 31st March, 2010
Inter office adjustments	16,562
Interest due on investment but not collected	33,280
Tax deducted at source	93,873
Stationary and stamps	1,846
Non banking assets acquired in satisfaction of claims	6,500
Total	1,52,061

Schedule 12 – Contingent Liabilities

	As on 31st March, 2010
Claim against the bank not acknowledge as debts	2,150
Liability on account of outstanding forward exchange contracts	640
Acceptance, endorsement and other obligations	4,542
Total	7,332

Schedule 13 – Interest earned

	As on 31st March, 2010
Interest on advances, cash credit and overdraft	4,04,859
Interest on debentures and bonds	1,86,706
Interest on balances with RBI and other inter bank funds	44,811
Total	6,36,376

Schedule 14 – Other income

	As on 31st March, 2010
Commission on remittances and transfer	53,582
Profit on sale of investment	2,275
Loss on sale of other fixed assets	(2,795)
Income earned by way of dividend, etc Form subsidiaries / companies	2,274
Miscellaneous income:	
Letting out lockers	5,920
Total	61,256

Schedule 15 – Interest expanded

	As on 31st March, 2010
Interest on deposits:	
From banks	59,280
From other Institution	2,37,159
Interest on RBI / inter bank borrowings	5,785
Total	3,02,224

Schedule 16 – Operating Expenses

	As on 31st March, 2010
Staff salaries and medical allowances	1,45,366
Rent on building and municipal taxes	9,035
Printing and stationery	2,418
Printing charges of publicity matters	520
Depreciation on banks property	3,523
Directors fees, allowances and expenses	4,524
Fees paid to statutory auditor	21,944
Law charges	221
Repairs and maintenance	1,508
Insurance charges on bank property	2,899
Other expenditure: license fee	12,155
Other expenses	9,295
Total	2,13,408

Illustration 3

From the following information, prepare final accounts of Jetty Bank Ltd. as on 31st March, 2010

Debit Balances	**Amount (Rs.)**
Inter-office Adjustments (Net)	135
Interest on investment not collected but accrued	365
Stationery and stamp	410
Interest on deposits	2,100
Interest on RBI and Inter-Bank borrowings	820
Investment: In India	
Government securities	2,215
Other approved securities	1,600
Subsidiaries and Joint Ventures	310
Mutual fund	225
Commercial paper	60
Unit Trust of India	365
Outside India	
Foreign Government securities (Issued by local authorities)	665
Subsidiaries and Joint Ventures	234
Rent, Taxes, lighting	500
Printing and stationery	775
Depreciation on land and Building	400

Directors Fees, allowances and expenses	663
Law charges	220
Non-banking assets acquired in satisfaction of claims	900
Tax paid in advance	516
Land and Building at cost	1,295
Other fixed assets	615
Bills purchased and discounted	785
Cash credit, overdrafts and loans	1,315
Terms loans	771
Balance with RBI	1,710
Balance with other Banks	644
Money at call and short notices	224
	20,837

Credit Balances	**Amount (Rs.)**
Authorised, issued and subscribed capital	2,000
Deposits Repayable on demand	225
Certificates of deposits from non-bank sectors	311
Saving Bank deposits	1,775
Term Deposits: From Banks	1,100
Cumulative and Recurring deposits	1,322
Interest on Balances with other banks	775
Interest / discount on advances / bills	1,120
Income on investment	1,335
Commission, exchange and brokerage	330
Profit on sale of land and building	1,000
Income earned by way of dividend from subsidiaries	925
Statutory Reserves	885
Capital Reserves	700
Revenue and other Reserves	435
Borrowings in India : RBI	1,100
Other banks	375
Borrowings outside India	446
Profit on sale of investment (Net)	1,135
Profit on exchange transactions (Net)	531
Bills Payable	411
Inter-office Adjustment (Net)	225
Interest accrued	800
Other provisions	665
Interest on call loans	911
	20,837

Adjustments:

1. Advances amounting Rs. 1,439 are secured by tangible assets; Rs. 1,210 covered by guarantees of Indian and foreign governments and banks; and remaining are unsecured.
2. Advances are made both in India and outside India:

   Advances in India on sectoral basis – priority sector Rs. 860; public sector Rs. 574; Banks Rs. 287 and other Rs. 193

   Advances outside India – Due from Banks Rs. 623 and due from others Rs. 334
3. Provision is to be made for income tax at the rate of 30%.
4. Dividend is proposed at the rate of 15 percent.
5. The contingent liabilities appears as on 31st March 2010 as follows.

   i) Acceptance, endorsement and other obligations Rs. 310.

   ii) Claims against bank not acknowledged as debt Rs. 620.
6. Out of total deposits, Rs. 1,317 are deposits of branches outside India.

Solution:

Balance Sheet of Jetty Bank Ltd. as on 31-03-10

	Schedule No.	As on 31st March 2010
Capital & Liabilities		
Capital	1	2,000
Reserves & Surplus	2	3,528.8
Deposits	3	4,733
Borrowings	4	1,921
Other Liabilities and provisions	5	3,176.2
Total		15,359
Assets		
Cash and balances with RBI	6	1,710
Balances with banks and money at call and short notice	7	868
Investments	8	5,674
Advances	9	2,871
Fixed Assets	10	1,910
Other assets	11	2,326
Total		15,359
Contingent Liabilities	12	930
Bills for collection	--	--

PROFIT & LOSS A/C FOR THE YEAR ENDED ON 31ST MARCH, 2010

	Schedule No.	As on 31-3-10
I. Income:		
Interest earned	13	4,141
Other Income	14	3,921
Total		8,062
II. Expenditure:		
Interest expended	15	2,920
Operating expenses	16	2,558
Provisions and contingencies		775.2
Total		6253.2
III. Profit / Loss:		
Net Profit for the year		1808.8
IV. Appropriations:		
Transfer to statutory reserves		361.76
Transfer to other reserves		--
Transfer to proposed dividend		300
Balance carried over to Balance Sheet		1147.04
Total		1,808.8

Schedule 1 – Capital

	As on 31st March 2010
Authorized, Issue, Subscribed capital:	2,000
	2,000

Schedule 2 – Reserves and surplus

	As on 31st March 2010
I. Statutory reserves:	
Opening balance	885
Additions during the year	361.76
	1246.76
II. Capital reserve	700
III. Revenue and other reserves	435
IV. Balance in profit and loss A/c	1147.04
Total	3,528.8

Schedule 3 – Deposits

	As on 31st March, 2010
A) I. Demand deposits:	
Bank deposits repayable on demand	225
Certificate of deposits from non bank	311
II. Savings bank deposits	1,775
III. Term deposits	1,100
Cumulative and recurring deposits	1,322
Total (I + II + III)	4,733
B)	
I) Deposits of branches in India	3,416
II) Deposits of branches outside India	1,317
Total (I +II)	4,733

Schedule 4 – Borrowings

	As on 31st March, 2010
I. Borrowings in India : RBI	1,100
Other Banks	375
II. Borrowings outside India	446
Total (I + II)	1,921

Schedule 5 – Other Liabilities and provisions

	As on 31st March, 2010
I) Bills payable	411
II) Inter office adjustment	225
III) Interest accrued	800
IV) Others: Provision for tax	775.2
Dividend	300
Total (I + II + III + IV)	3176.2

Schedule 6 – Cash and balances with RBI

	As on 31st March, 2010
I. Cash in hand	--
II. Balances with RBI:	1,710
Total	1,710

Schedule 7 – Balances with banks & money at call & short notice

	As on 31st March, 2010
I. In India: Balances with banks: Money at call & short notice	644 224
Total	868
II. Outside India	--
Total (I + II)	868

Schedule 8 – Investment

	As on 31st March, 2010
I. Investments in India in: Government securities Other approved securities Subsidiaries and joint ventures Others: mutual fund 225 Commercial papers 60 UTI 365	 2,215 1,600 310 650
Total	4,775
II. Investment outside India in: Government securities (including local authorities) Subsidiaries and joint ventures abroad Total	 665 234 899
Grand Total (I + II)	5,674

Schedule 9 – Advances

	As on 31st March, 2010
A) i) Bills purchased and discounted ii) Cash credit, overdraft and loans repayable on demand iii) Terms loans	 785 1,315 771
Total	2,871
B) i) Secured by tangible assets ii) Covered by bank / Government guarantees iii) Unsecured	 1,439 1,210 222
Total	2,871

C) I) Advances in India : i) Priority sectors ii) Public sector iii) Banks iv) Others	 860 574 287 193
Total	1,914
II) Advances outside India i) Due from banks ii) Due from others	 623 334
Total	957
Grand Total (C. I + C. II)	2,871

Schedule 10 – Fixed Assets

	As on 31st March, 2010
I) Premises: At cost II) Other fixed assets (including Furniture and fixtures)	1,295 615
Total (I + II)	1,910

Schedule 11 – Other Assets

	As on 31st March, 2010
i) Inter office adjustments ii) Interest accrued iii) Tax paid in advance iv) Stationary and stamps v) Non banking assets acquired in satisfaction of claims	135 365 516 410 900
Total	2,326

Schedule 12 – Contingent Liabilities

	As on 31st March, 2010
i) Claim against the bank not acknowledge as debts ii) Acceptance, endorsement and other obligations	620 310
Total	930

Schedule 13 – Interest earned

	As on 31st March, 2010
I) Interest / discount on advances / bills (911 + 1120)	2,031
II) Income on investment	1,335
III) Interest on balances with other bank	775
Total	4,141

Schedule 14 – Other income

	As on 31st March, 2010
I) Commission, exchange and brokerage	330
II) Profit on sale of investments	1,135
III) Profit on sale of land, buildings and other assets	1,000
IV) Profit on exchange transactions	531
V) Income earned by way of dividend etc, from subsidiaries / companies	925
Total	3,921

Schedule 15 – Interest expanded

	As on 31st March, 2010
I) Interest on deposits:	2,100
II) Interest on RBI / inter bank borrowings	820
Total	2,920

Schedule 16 – Operating Expenses

	As on 31st March, 2010
I) Rent, taxes and lighting	500
II) Printing and stationery	775
III) Depreciation on banks property	400
IV) Directors fees, allowances and expenses	663
V) Law charges	220
Total	2,558

Illustration 4

The following are the balances of merchant Bank Ltd. for the year ended 31st March, 2008. Prepare profit and loss account for the year ended 31st March, 2008 and also balance sheet as on that date.

Debit Balances	**Amount (Rs.)**
Balance with RBI	1,500
Premises at cost	860
Additions during the year	900
Other fixed assets	1,300
Balances with other banks in current account	3,300
Balances with banks in other deposit A/c	1,000
Money at call and short notices	3,000
Inter-office adjustment	800
Interest accrued	800
Stationary and stamps	1,750
Tax paid in advance	380
Non banking assets acquired in satisfaction of claims	240
Medical allowances	410
Allowances to employees	525
Staff provident fund	230
Other provisions for employees	333
Expenses on books and forms	125
Insurance charges	400
Telephone and stamp	360
Subscription to periodicals	250
Rent and taxes	155
Audit fees and expenses	600
Interest on deposits	930
Interest on inter bank borrowings	630
Bills purchased and discounted	1,830
Cash credit, overdraft and loans	2,070
Term loans	1,330
Investment: In Government securities	3,450
Shares	3,000
Debentures and bonds	782
Subsidiaries	2,200
Total	32,470

Credit Balances	(Rs. In' 000) Amount (Rs.)
Issued, subscribed and called up capital:	
30,000 shares of Rs. 100 each	3,000
Rent received	310
Miscellaneous income	400
Income earned from subsidiaries	830
Commission on remittances and transfer	730
Interest on balance with RBI	840
Dividend on shares	350
Profit on sale of investment	650
Depreciation to date (Premises)	350
Depreciation to date (other assets)	210
Revenue reserves	910
Profit on sale of other assets	1,100
Borrowings: From NABARD	1,200
From RBI	1,100
From Co-operative Banks	980
Capital reserves	1,400
Statutory reserves	1,000
Share premium	590
Bills payable	2,000
Inter office adjustment	900
Interest on loans and advances	1,940
Discount on bills purchased	960
Balances in profit and loss A/c	2,220
Interest accrued	1,500
Interest on debentures and bonds	500
Demand deposits: From banks	2,790
From others	1,210
Fixed deposit	1,050
Saving bank deposit	1,450
Total	**32,470**

Other Information:

1) On 31st March, 2008 advances appears as follows:

(Rs. In '000)

	Bills purchased and discounted	Cash credit, overdraft, loans	Term loan
Standard assets	1,030	985	475
Sub-standard assets	800	300	200
Doubtful assets:			
- upto 1 year	--	100	360
- 1 year to 3 year	--	360	140
- more than 3 years	--	255	110
Loss assets	--	70	45
Total	1,830	2,070	1,330

The provision is yet to be made on above advances.

2) Depreciation to be charged on premises Rs. 1, 53,000 and other assets Rs. 1, 10,000.

3) Directors declare interim dividend @ 10 Percent

4) Claims against the bank not acknowledged as debt Rs. 7, 80,000. Liability for partly paid investment Rs. 5, 95,000.

Solution:

MERCHANT BANK LTD.
Balance Sheet as on 31-3-2008

	Schedule No.	As on 31st March 2010 (Rs. In '000)
Capital & Liabilities		
Capital	1	3,000
Reserves & Surplus	2	8,299.5
Deposits	3	6,500
Borrowings	4	3,280
Other Liabilities and provisions	5	4,950
Total		26029.5
Assets		
Cash and balances with RBI	6	1,500
Balances with banks and money at call and short notice	7	4,330
Investments	8	9,432
Advances	9	4560.5
Fixed Assets	10	2,237
Other assets	11	3,970
Total		26,029.5
Contingent Liabilities	12	1,695
Bills for collection	--	--

PROFIT & LOSS A/C FOR THE YEAR ENDED ON 31ST MARCH, 2008

	Schedule No.	As on 31-3-10 (Rs. In '000)
I. Income: Interest earned	13	4,590
Other Income	14	4,020
Total		8,610
II. Expenditure: Interest expended		1,560
Operating expenses	15	3,651
Provisions and contingencies	16	919.5
Total		6,130.5
III. Profit / Loss:		
Net Profit / Loss (-) for the year		2,479.5
Profit / Loss (-) brought forward		2,220
Total		4,699.5
IV. Appropriations:		
Transfer to statutory reserves		495.9
Transfer to other reserves		
Transfer to Government / proposed dividend		300
Balance carried over to Balance Sheet		3,903.6
Total		4,699.5

Schedule 1 – Capital

	As on 31st March 2008
Authorized capital 30,000 shares of Rs. 100 each	3,000
Issue capital 30,000 shares of Rs. 100 each	3,000
Subscribed capital: 30,000 shares of Rs. 100 each	3,000
Called-up capital: 30,000 shares of Rs. 100 each	3,000

Schedule 2 – Reserves and surplus

	As on 31st March 2008
I. Statutory reserves:	1,000
Additions during the year	495.9
	1,495.9
II. Capital reserve	1,400
III. Shares Premium	590
IV. Revenue and other Reserves	910
V. Balance in profit and loss account	3,903.6
Total (I + II +III +IV + V)	8,299.5

Schedule 3 – Deposits

	As on 31st March, 2008
I. Demand deposits:	
i) From banks	2,790
ii) From others	1,210
II. Savings bank deposits	1,450
III. Term deposits	1,050
Total (I + II + III)	6,500

Schedule 4 – Borrowings

	As on 31st March, 2008
I. Borrowings in India :	
Reserve Bank of India	1,100
Other Banks: From NABARD	1,200
From Co-operative banks	980
Total	3,280

Schedule 5 – Other Liabilities and provisions

	As on 31st March, 2008
I) Bills payable	2,000
II) Inter office adjustment (Net)	900
III) Interest accrued	1,500
IV) Others: Interim Dividend	300
Provision on tax	250
Total	4,950

Schedule 6 – Cash and balances with RBI

	As on 31st March, 2008
I. Balances with RBI	1,500
Total	1,500

Schedule 7 – Balances with banks & money at call & short notice

	As on 31st March, 2008
In India:	
i) Balances with banks:	
a) In current Accounts	330
b) In other deposit accounts	1,000
ii) Money at call & short notice	3,000
Total	4,330

Schedule 8 – Investment

	As on 31st March, 2008
I. Investments in India:	
i) Government securities	3,450
ii) Shares	3,000
iii) Debentures and bonds	782
iv) Subsidiaries and / or joint ventures	2,200
Total	9,432

Schedule 9 – Advances

	As on 31st March, 2008
i) Bills purchased and discounted	1,750
ii) Cash credit, overdraft and loans repayable on demand	1,714.5
iii) Terms loans	1,096
Total	4,560.5

Schedule 10 – Fixed Assets

	As on 31st March, 2008
I) Premises: At cost	860
Additions during the year	900
Depreciation to date (350+153)	(503)
II) Other fixed assets (including Furniture and fixtures) at cost	1,300
Depreciation to date (210 + 110)	(320)
Total (I + II)	**2,237**

Schedule 11 – Other Assets

	As on 31st March, 2008
i) Inter office adjustments (net)	800
ii) Interest accrued	800
iii) Tax paid in advance / tax deducted at source	380
iv) Stationary and stamps	1,750
v) Non banking assets acquired in satisfaction of claims	240
Total	3,970

Schedule 12 – Contingent Liabilities

	As on 31st March, 2008
i) Claim against the bank not acknowledge as debts	780
ii) Liability for partly paid investments	595
ii) Acceptance, endorsement and other obligations	320
Total	**1,695**

Schedule 13 – Interest earned

	As on 31st March, 2008
I) Interest / discount on advances / bills	
Discount on bills purchased	960
Interest on loans and advances	1,940
II) Income on investment	
Interest on debentures and bonds	500
Dividend on shares	350
III) Interest on balances with RBI and other inter bank Funds	840
Total	**4,590**

Schedule 14 – Other income

	As on 31st March, 2008
I) Commission on remittance and transfer.	730
II) Profit on sale of investments	650
III) Profit on sale of land, buildings and other assets	1,100
IV) Income earned by way of dividend etc, from subsidiaries / companies	830
V) Miscellaneous income:	
Rent received	310
Other miscellaneous income	400
Total	**4,020**

Schedule 15 – Interest expanded

	As on 31st March, 2008
I) Interest on deposits:	930
II) Interest on RBI / inter bank borrowings	630
Total	1,560

Schedule 16 – Operating Expenses

	As on 31st March, 2008
I. Allowances to employees	525
II. Medical allowances	410
III. Staff providend fund	230
IV. Other provision for employees	333
V. Rent, taxes and lighting	155
VI. Expenses on books and forms	125
VII. Depreciation on banks property (153 + 110)	263
VIII. Audit fees and expenses	600
IX. Postage and telephones	360
X. Insurance	400
XI. Other expenditure:	
Subscription to periodicals	250
Total	**3,651**

I. Provisions on Advances:

(Rs. In '000)

Assets	Bills Purchased & Discounted	Cash Cr., Overdraft, loans	Term loans	% of provision	Bills Purchased & Discounted	Cash Cr., Overdraft, loans	Term loans
Standard Assets	1,030	985	475	--	--	--	--
Sub-standard Assets	800	300	200	10%	80	30	20
Doubtful assets:							
- upto 1 year	--	100	360	20%	--	20	72
- 1 to 3 years	--	360	140	30%	--	108	42
- More than 3 years	--	255	110	50%	--	127.5	55
Loss Assets	--	70	45	100%	--	70	45
	1,830	2,070	1,330		80	355.5	234

Total Provision on Advances = Rs. 669.5

II Interim dividend $30,00,000 \times \frac{10}{100} = 3,00,000$

III Provision on Tax = 2, 50,000

Illustration – 5

Kranti Bank Ltd. provides you the following balances as on 31st March, 2007. Prepare profit and loss account and balance sheet from the given balances and other information.

Particulars	Amount
Annuity deposit	18,81,630
Matured time deposits	13,85,980
Pay slips and bankers cheques	46,000
Bills purchased and discounted	6,80,110
Borrowings from: PNB bank of India	46,000
Rajgrih co-operative bank	69,000
Statutory reserve fund	32,200
Profit and loss A/c (Credit)	23,000
Deposits repayable within 15 days notice (in India)	23,460
Deposits with Wilson Financial agency (in India)	5,29,000
Capital reserve	92,000
Saving bank deposits	9,30,580
Term loans	32,75,200
Prepaid Insurance	161
Non banking assets acquired in satisfaction of claims	691
Remuneration for consultancy and other services	46,000
Land and building (cost Rs. 1,38,000)	94,300
Furniture and Fixtures (Cost Rs. 23,920)	16,790
Interest paid on deposits	28,750

Cash balance	1,93,200
Balances with RBI	1,84,000
Share premium	5,000
Contingency fund	27,600
Repairs and maintenance of buildings	19,320
Directors fees, allowances and expenses	4,600
Payment to and provision for employees	2,990
Fees paid to statutory auditor	2,990
Traveling allowances	3,910
Postage and telephone	1,380
Advertisement and publicity	1,380
Other expenditure	690
Profit on exchange transaction	4,600
Income on investment	1,20,750
Investment in India: share capital of subsidiaries	2,34,600
Government bonds	2,31,380
Branch adjustment – A/c (Credit)	17,940
Share capital	8,00,000

Other Adjustments:

1. Authorized capital in equity shares of Rs. 100 each, Rs. 16, 00,000. Issued, sub scribed and called up capital Rs. 50 per share.
2. Bills accepted by bank of behalf of customer amounting Rs. 33,000.
3. Depreciation on Land & building Rs. 3,680 and furniture Rs. 1,610 is to be provided.
4. Transfer 20% of net profit to statutory reserve.

Kranti Bank Ltd.
Balance Sheet as on 31st March 2007

	Schedule No.	As on 31-3-07
Capital & Liabilities		
Capital	1	8,00,000
Reserves & Surplus	2	2,52,250
Deposits	3	41,98,190
Borrowings	4	1,15,000
Other Liabilities and provisions	5	91,540
Total		**54,56,980**

Assets		
Cash and balances with RBI	6	3,77,200
Balances with banks and money at call and short notice	7	5,52,460
Investments	8	4,65,980
Advances	9	39,55,310
Fixed Assets	10	1,05,800
Other assets	11	230
Total		54,56,980
Contingent Liabilities	12	33,000
Bills for collection		

PROFIT & LOSS A/C FOR THE YEAR ENDED ON 31ST MARCH, 2007

	Schedule No.	Year ended 31.03.07
I. Income:		
Interest earned	13	1,20,750
Other Income	14	50,600
Total		1,71,350
II. Expenditure:		
Interest expended	15	28,750
Operating expenses	16	42,550
Provisions and contingencies		
Total		71,300
III. Profit / Loss:		
Net Profit / Loss (-) for the year		1,00,050
Profit / Loss (-) brought forward		23,000
Total		1,23,050
IV. Appropriations:		
Transfer to statutory reserves		20,010
Transfer to other reserves		--
Transfer to Government / proposed dividend		--
Balance carried over to Balance Sheet		1,03,040

Schedule 1 – Capital

	As on 31st March 2007
Authorized capital 16,000 shares of Rs. 100 each	16,000,00
Issue capital 16,000 shares of Rs. 50 each	8,00,000
Subscribed capital: 16,000 shares of Rs. 50 each	8,00,000
Called-up capital: 16,000 shares of Rs. 50 each	8,00,000

Schedule 2 – Reserves and surplus

	As on 31st March 2007
I. Statutory reserves:	32,200
Additions during the year	20,010
Total	52,210
II. Capital reserve Opening balance	92,000
III. Shares Premium Opening balance	5,000
IV. Revenue and other Reserves	
V. Balance in profit and loss account	1,03,040
Total	2,52,250

Schedule 3 – Deposits

	As on 31st March, 2007
I. Demand deposits: matured time deposit	13,85,980
II. Savings bank deposits	9,30,580
III. Term deposits: Annuity deposit	18,81,630
Total	41,98,190

Schedule 4 – Borrowings

	As on 31st March, 2007
I. Borrowings in India :	
i) RBI	
ii) Other Banks: PNB Bank of India	46,000
Rajgrih Co-operative Bank	69,000
Total	1,15,000

Schedule 5 – Other Liabilities and provisions

	As on 31st March, 2007
I) Bills payable: Pay slips and bankers' cheques	46,000
II) Inter office adjustment	17,940
III) Others (including provisions)	
- Contingency Fund	27,600
Total	91,540

Schedule 6 – Cash and balances with RBI

	As on 31st March, 2007
I. Cash in hand	1,93,200
II. Balances with RBI	1,84,000
Total	**3,77,200**

Schedule 7 – Balances with banks & money at call & short notice

	As on 31st March, 2007
In India:	
i) Balances with banks:	
ii) Money at call & short notice:	
Deposits repayable within 15 days notice	23,460
Deposits with Wilson financial agency	5,29,000
Total	**5,52,460**

Schedule 8 – Investment

	As on 31st March, 2007
Investments in India:	
Government bonds	2,31,380
Share capital of subsidiaries	2,34,600
Total	**4,65,980**

Schedule 9 – Advances

	As on 31st March, 2007
Bills purchased and discounted	6,80,110
Terms loans	32,75,200
Total	**39,55,310**

Schedule 10 – Fixed Assets

	As on 31st March, 2007
I) Premises: At cost	1,38,000
Depreciation to date (43,700 + 3,680)	(47,380)
	90,620
II) Other fixed assets (including Furniture and fixtures) At cost as on 31st March of the preceding year.	23,920
Depreciation to date (7,130 + 1, 610)	8,740
	15,180
Total (I + II)	**1,05,800**

Schedule 11 – Other Assets

	As on 31st March, 2007
Non banking assets acquired in satisfaction of claims.	69
Prepaid Insurance	161
Total	**230**

Schedule 12 – Contingent Liabilities

	As on 31st March, 2007
Bills accepted on behalf of customer	33,000

Schedule 13 – Interest earned

	As on 31st March, 2007
Income on investment	1,20,750
Total	**1,20,750**

Schedule 14 – Other income

	As on 31st March, 2007
I. Commission brokerage and exchange:	
Remuneration for consultancy and other services	46,000
II. Profit on exchange transactions	4,600
Total	**50,600**

Schedule 15 – Interest expanded

	As on 31st March, 2007
I) Interest paid on deposits:	28,750
Total	**28,750**

Schedule 16 – Operating Expenses

	As on 31st March, 2007
Payment to and provision for employees	2,990
Advertisement and publicity	1,380
Depreciation on bank's property (3,680 + 1,610)	5,290
Director's fees, allowances and expenses	4,600
Fees paid to statutory auditor	2,990
Traveling expenses	3,910
Postage and telephone	1,380
Repairs and maintenance of building	19,320
Other expenditure	690
Total	39,859

Summary:

A bank is a commercial institution, which accepts deposits and repay on demand; lend; transfer and invest the money. Banking companies are governed by Banking Regulation Act, 1949 and also subject to the companies Act, 1956.

Section 6 of the Banking Regulation Act prescribes various business of banking companies which includes borrowing, raising or taking up of money, acting as on agent for any government or local authority or any other person; contracting, guaranteeing and so on. Also the banks are restricted to deal in buying, selling or bartering of goods and also not allowed to engage in any trade related to bills of exchange received for collection or negotiation or such of its business.

The various accounting provisions regarding minimum capital and reserves; restriction on commission, brokerage, discount on sale of shares, restrictions on payment of dividend, statutory reserves, cash reserves and restrictions on loans and advances given under various sections of Banking Regulation Act, 1949.

The banks keep subsidiary and principal books of accounts to minimize the errors in maintaining records of voluminous transactions.

The recommendation of Narsimham Committee report on Non-performing Assets was accepted by RBI and accordingly issued directives to all the banks regarding income recognition, assets classification and loan provisioning. The assets have been classified as standard assets, sub-standard assets, doubtful assets and loss assets and provisioning norms for each category is given.

The final accounts of banking companies are prepared as per the formats given under form ‘A’ for balance sheet and form ‘B’ for profit and loss account. Out of 16 schedules, form A contains 12 schedules and form B contains the remaining 4 schedules.

2.8 EXERCISES:

Q.1 <u>State whether the followings are True or False:</u>

1) All nationalized Banks are governed by the Banking Regulation Act.
2) Section 6 of the Banking Regulation Act, 1949 prescribes requirements of minimum paid-up capital and reserves to be maintained by banking companies.
3) It is voluntary for all Banking companies to publish their Balance Sheet in newspapers.
4) The assets and liabilities of Banking Companies are shown vertically along with the figures of last year.
5) The commission, exchange and brokerage are shown in Schedule 15 of the Bank’s Profit and loss account.
6) Every bank needs to create a reserve fund by transferring 20 percent of its annual profit after the declaration of dividend.
7) Money at call is refundable at 24 hours’ notice and money at short notice is refundable at 7 days notice.
8) The income from non-performing assets should not be taken into profit and loss account unless income had been realized.
9) A credit facility is classified as non-performing if interest and / or installment of principal have remained unpaid for two quarters after it has become past due.
10) The assets which do not yield positive returns become non-performing assets.

Answer: **True - 1; 4; 7; 8; 9; 10;**
False - 2; 3; 5; 6;

Q.2 Multiple choice Question

1) For internal purpose, banks may close their accounts on ________________.
   i) 31^{st} December

ii) 30^{th} June
iii) 31^{st} March
iv) 30^{th} September

2) The principal books of a banking company that gives the summary of the receiving cashier’s counter cash books and the paying cashiers counter cash book.
   i) General Ledger
   ii) Saving Bank accounts ledger
   iii) Cash book
   iv) Investment Ledger

3) The ___________ of section 29 of the Banking Regulation Act, 1949 prescribes formats of Balance sheet and profit and loss account of banking companies.
   i) Third schedule
   ii) Second schedule
   iii) Sixth schedule
   iv) Fourth schedule

4) It is the last item to appear under ‘Capital and liabilities of the Balance Sheet of a bank.
   i) Reserves and surplus
   ii) Deposits
   iii) Borrowings
   iv) Other liabilities and provision.

5) It is shown by way of a footnote and details are given in schedule 12.
   i) Contingent Liabilities
   ii) Other Assets
   iii) Investments
   iv) Other liabilities and provisions.

6) Bills purchased and discounted are shown in __________ on the Balance sheet of a Bank.
   i) Schedule 10
   ii) Schedule 8
   iii) Schedule 9
   iv) Schedule 12

7) Every Bank needs to maintain a cash reserves of at least __________ of the total of its demand and time liabilities.

i) 3 percent
ii) 5 percent
iii) 7 percent
iv) 20 percent

8) In respect of sub-standard assets, a general provision of ____________ of the total outstanding should be created.

i) 20 percent
ii) 10 percent
iii) 30 percent
iv) None of the above

9) The assets which does not disclose any problems and which does not carry more than normal risk attached to the business.

i) Standard assets
ii) Sub-standard assets
iii) Doubtful assets
iv) Loss assets

10) Section 20 of the Banking Regulation Act, 1949 deals with ______________.

i) Cash Reserves
ii) Restrictions on loans and advances
iii) Statutory Reserves
iv) Final account

Answers: 1 – iv; 2 – iii; 3 – I; 4 – iv; 5 – I; 6 – iii; 7 – I; 8 – ii; 9 – I; 10 – ii.

Q.3 Match the following

A)

1)	Principal Books	a) Personal ledger
2)	Contingent liabilities	b) Schedule 11
3)	Share Premium	c) Cash book and General ledger
4)	Subsidiary Books	d) Reserves and surplus
		e) Schedule 12
		f) Bills purchased and discounted

Answer: 1-c; 2-e; 3-d; 4-a

B)

1)	Income on investment	a) Schedule 8
2)	Stationery and stamp	b) Schedule 2
3)	Balance of profit	c) Schedule 5
4)	Bills payable	d) Schedule 11
		e) Schedule 13
		f) Schedule 16

Answer: 1-e; 2-d; 3-b; 4-c.

Q.4 Define Banking Companies and write a note on 'Business of banking companies.

Q.5 Explain the provisions given by Banking Regulation Act, 1949 with regard to following –

i) Statutory Reserve

ii) Minimum capital and Reserves

iii) Restrictions on Payment of Dividend

Q.6 Explain in brief the classification of assets and provisioning of NPA.

Q.7 Explain the following terms:

1) Non-banking assets

2) Doubtful assets and loss assets

3) Rebate on bills discounted

4) Bills for collection

5) Provisions and contingencies

Q.8 The asset of the Bank is bifurcated as performing and non-performing assets and accordingly income to be recognized.

	Interest Earned	**Interest Received**
Performing Assets		
Cash credit and overdraft	10,50,000	8,68,000
Bills purchased and discounted	2,10,000	2,10,000
Term loans	1,68,000	1,12,000
Non-performing Assets		
Cash credit and overdraft	2,10,000	16,800
Bills purchased and discounted	1,40,000	28,000
Term loans	1,05,000	7,000

Answer: Income Recognized – Rs. 14, 79,800.

Q.9 The following are the balances of Armo Bank Ltd. for the year ended 31st March, 2008.

Debit Balances	**Amount (Rs.)**
Money at call and short notices	1,82,000
Constituents, Liability for acceptance & endorsement	3,95,500
Non-banking assets acquired in satisfaction of claims	14,000
Land and Building	35,000
Furniture and fixtures	4,55,000
Advances	14,00,000
Investment in Government bonds	13,60,590
Gold bullion	1,05,910
Other investment	10,89,410
Balances with RBI	2,16,300
Cash in hand	1,08,150
Interest accrued on investment	1,72,340
Interest on deposits	55,650
Bills receivable being bills for collection	3,04,500
Law charges	35,000
Loss on sale of building	7,000
Printing and stationery	350
Rent, taxes and lighting	1,48,400
Repairs and maintenance	8,400
Bills discounted and purchased	87,500
Directors Remuneration	84,000
Branch adjustment	1,40,000
Loss on sale of investment	2,10,000
Deposits with other Banks	5,25,000
Total	**71,40,000**

Credit Balances	**Amount (Rs.)**
Term deposits from banks	51,940
Demand deposits	1,61,350
Share capital	20,00,000
Provision for depreciation on furniture & fixtures	1,40,000
Security deposits of employee	1,05,000
Statutory Reserves	9,80,000
Share Premium account	7,30,000
Borrowings from institutions and agencies	5,40,610
Profit and loss account	45,500
Rent received	4,200
Profit on bullion	8,400
Acceptance and endorsement	3,95,500

Bills for collection	3,04,500
Commission, exchange and brokerage	1,77,100
Discount on advances	2,94,000
Other miscellaneous income	18,900
Current ledger control account	6,79,000
Interest on balances with RBI	5,04,000
Total	**71,40,000**

Adjustment:

1) Depreciation on Furniture and Fixtures for the year amounted to Rs. 35,000 and proposed dividend is 8 percent.
2) Transfer 20 percent to statutory Reserve from the profit earned during the year.
3) Rebate on bills discounted Rs. 35,000.
4) Current account ledger depicts credit balance Rs. 8, 54,000 after the overdrawn to the extent of Rs. 1, 75,000.
5) Liability for partly paid investment Rs. 80,000.

Answer: Current year profit Rs. 1, 50,240

Balance sheet Total Rs. 58, 91,200

Q.10 On 31st March, 2009 the following balances was extracted from Oasis Bank Ltd. You are required to prepared profit and loss account for the year ended 31st March 2009 and also the balance sheet as on that date.

Particulars	**Amount (Rs.)**
Capital Reserve	1,50,000
Interest accrued on Government Bonds	26,125
Bills for collection	9,95,500
Investment in Government Bonds	55,000
Investment in Gold bullion	1,32,000
Current Deposits	25,02,500
Reserve Fund	6,87,500
Interest and discount received	3,19,000
Profit and loss account (Credit Balance)	46,860
Brokerage, exchange and commission received	96,525
Capital	4,00,000
Loans and advances	22,93,500
Saving account	9,08,600
Cumulative and recurring deposits	19,34,900
Sundry creditors	25,025
Debts due to banks (secured)	6,71,000
Branch adjustments (Credit)	2,50,525
Balances : Cash and hand	71,885

Cash with other banks	3,30,000
Liabilities for partly paid investment	8,34,240
Furniture and office equipment	27,500
Depreciation on assets	27,500
Interest paid on Inter-Bank borrowings	66,000
Brokerage, exchange and commission paid	5,500
Rebate on bills discounted	825
Non-banking assets	2,750
Customer's liability for acceptance	8,34,240
Investments in shares	8,74,500
Payment to employees	1,32,000
Auditor's fees	5,500
Repairs and maintenance	22,000
Advertisement and publicity	16,500
Premises	1,87,000
Current a/c balance with other Banks	49,500
Short notices with other institutions and Agencies	33,000

Additional Information:

1) The authorized capital of the bank is Rs. 800,000 divided into 16,000 shares of Rs. 50 each. Out of this 8,000 shares issued, subscribed and paid-up.

2) Current account includes Rs. 4, 67,500 debit balances being overdraft. One of the accounts for Rs. 5,500 including interest Rs. 550 is doubtful.

3) During the year, a property was acquired in satisfaction of a claim amounting to Rs. 2,750 and was sold Rs. 1,980. The loss resulting there from remained unadjusted in the books.

4) Bank guaranteed Rs. 1, 00,000 on behalf of its constituents.

5) Provision for taxation is Rs. 55,000.

Answers: Provisions and contingencies – Rs. 59,950
Profit for the current year – Rs. 63,404
Balance sheet total – Rs. 81,79,490

Q.11 Yashoda Bank Ltd. provides you the following balances you are asked to prepare Profit and Loss account and Balance Sheet.

Particulars	Amount (Rs.)
Share capital	3,40,000
Statutory Reserves	1,04,000
Other Reserves	1,00,000
Term Loans	17,00,000

Cash credit	37,62,100
Bills purchased	27,89,700
Rebate on bills discounted	81,600
Deposits from other Banks	14,87,500
Current deposits	23,23,900
Saving account	29,44,400
Legal charges	62,500
Repairs	2,62,000
Insurance on bank property	95,500
Entertainment expenses	71,100
Directors sitting fees	1,51,000
Printing charges	67,000
Rent and Taxes	35,000
Bonus and other staff benefits	2,30,000
Profit and loss account (credit Balances)	13,94,000
Interest paid on deposits	12,71,600
Discount on domestic Bills purchased	7,59,900
Commission received on letter of credit	4,98,100
Bank property	81,6,000
Cash with RBI	39,100
Interest received on loans and advances	21,86,200
Investments	2,58,100
Stationery and stamps	1,38,000
Cash with Exe Bank Ltd.	4,84,500
Income on investments	13,600

Other Information

1) The Bank provided depreciation on its property at the rate of 12 percent p.a.
2) Tax to be provided at 40 percent.
3) Directors declared dividend at 10 percent.
4) Liabilities on partly paid investment Rs. 81,600

Answer: Profit for current year Rs. 22, 51,344
Balance sheet total Rs. 98, 89,580

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3

ACCOUNTS OF INSURANCE COMPANIES

Unit Structure

3.1 INTRODUCTION

The business of Insurance in India is governed by The Insurance Act, 1938 along with the regulations framed by Insurance Regulations and Development Authorities Act, 1999 (IRDA)

Insurance is an agreement or contract of indemnity between 'insurer' and 'insured'. Insurer is one party agrees to provide protection against loss or damage in the form of promise to pay for such loss to other party known as 'insured' in consideration for a fixed sum of money known as 'premium'.

The terms and conditions of such insurance contract in the written is called 'Insurance Policy'.

Insurance are of the types –

I) Life Insurance
II) General Insurance
 a) Fire insurance
 b) Marine insurance
 c) Miscellaneous insurance

3.2 LIFE INSURANCE BUSINESS

In case of Life Insurance, the insurer guarantees to pay a certain sum of money to the assured on completing a stipulated period or in the event of the death to his legal representative. It covers risks and gives protection for the investment.

Section 2(II) of the Insurance Act, 1938 has defined 'Life Insurance Business" as the business of effecting. Contracts of insurance upon human life, including any contract whereby the payment of money is assured on death or the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include

a) The granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance;
b) The granting of annuities upon human life; and
c) The granting of superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of person engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons.

3.3 STATUTORY BOOKS AND SUBSIDIORY BOOKS

A] Statutory Books –

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

I. **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.

II. **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.

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

B] Subsidiary books –

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

I. **Ledgers** – Life insurance Fund ledger; revenue ledger and miscellaneous ledger

II. **Cash books** – Receipts cash books and expenditure cash books.

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

IV. First year premium book

V. Renewal premium book

VI. Surrender policy book

3.4 SOME IMPORTANT TERMS

I. **Whole life policy –**

Policy under which, amount of policy is received only when the insured expired.

II. **Endowment policy –**

Amount of policy received by the insured either he/she reaches certain age or expired whichever is earlier.

III. **With profit policies -**

Policy holder is entitled to share in profit of insurer along with the guaranteed amount payable on maturity

IV. **Without profit policies –**

On maturity policy holder received only fixed sum of money stated in the policy

V. **Bonus –**

The share of profit enjoyed by insured is called bonus –

- **a)** 'Reversionary bonus' is one which is paid only on maturity of the policy along with guaranteed amount.
- **b)** 'Bonus in cash' is paid immediately
- **c)** 'Bonus in reduction of premium' is normally adjusted by policy holder against the future premium due from him.
- **d)** 'Interim bonus' is paid on maturity of policy before deciding the exact profit amount

VI. **Premium –**

First year's premium is the premium paid for the first year of the life insurance policy and premium paid for the subsequent year is termed as renewal premium. Single premium is the total of all the premiums amount, paid by the policy holder once at the initiation of policy period

VII. Surrender value –

It is the amount which is life insurance company agrees to pay when policy holder discontinue to pay further premium and surrender the policy.

VIII. Claims –

It is the amount payable by an insurer against the policy either on maturity (known as claim by maturity or survivance) or on the death of the policy holder (known as claim by death).

IX. Re-insurance –

Re-insurance is the transfer of part of risk by the insurance company on another insurance company. When the insurance company find it difficult to carry risk involves huge amount, it makes an arrangement for reinsurance by giving away a part of its business to another company (known as accepting company or re-insurance) and receives commission from accepting company

X. Annuities –

The insurance company agrees to pay a fixed sum of money at regular intervals of time to the policy holder during a specified period in return for a lump sum paid in advance known as annuities

3.5. PREPARATION OF FINANCIAL STATEMENTS

The financial statement of the life insurance companies consist of Revenue account, Profit & loss account and Balance sheet. These statements to be prepared in accordance with the provisions of IRDA (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations, 2002 and comply with the requirements of schedule 'A'. The Insurer needs to prepare Revenue A/C in form A-RA; profit & loss A/C inform A-PL and Balance sheet in form A-BS.

The Revenue account contains total 4 schedules- schedule1 – Premium; schedule 2- Commission expenses; Schedule 3- Operating expenses and schedule 4 – Benefits paid. It also shows the items having no specific schedule such as Income from Investments, Interim bonus paid; Provision for doubtful debts; tax and such other provisions. The bottom section of Revenue account exhibits appropriators of surplus such as transfer to shareholders accounts, transfer to other reserves, etc. The remaining balance of revenue account is transferred to life Insurance Fund account.

The profit and loss account shown all expenses and income not directly related to Insurance business

The Balance Sheet of like insurance companies are prepared in 'vertical form' having too sections – sources of fund and application of fund. The schedule 5,6 and 7 deals with sources of fund and schedule 8 to schedule 15 shows the application of Fund.

The contingent liabilities is disclosed as part of financial statement by way of notes to Balance Sheet.

FROM A-RA

Name of the Insurer:

Registration No. and Date of Registration with the India:

Revenue Account for the year ended 31st March, 20…

Policyholder's Account (Technical account)

Particulars	**schedule**	**Current Year (RS'000)**	**Previous Year (Rs'000)**
Premiums earned – net			
(a) Premium	1		
(b) Re-insurance ceded			
(c) Re-insurance accepted			
Income from investments (a) Interest, Dividends and Rent –Gross (b) Profit on sale / redemption of Investments (c) (Loss on sale / redemption of Investments) (d) Transfer / Gain on revaluation /change in fair value*			
Other Income (to be specified)			
Total (A)			
Commission	2		
Operating Expenses related to Insurance Business	3		
Provision for doubtful debts			
Bad debts written off			
Provision for tax			

Provision (other than taxation) (a) For diminution in the value of investment (Net) (b) Other (to be specified)			
Total (B)			
Benefits Paid (Net)	4		
Interim Bonuses Paid			
Change in valuation of liability in respect of life policies (a) Gross** (b) Amount ceded in Reinsurance (c) Amount accepted in Reinsurance			
Total (c)			
Surplus / (Deficit((D) = (A) - (B) - (C)			
Appropriations			
Transfer to Shareholders' Accounts			
Transfer to other Reserves (to be specified)			
Balance being Funds for Future appropriations			
Total (D)			

Notes:

***** Represents the deemed realized gain as per norms specified by the authority.

** Represents Mathematical Reserves after allocation of bonus.

The total surplus shall be disclosed separately with the following details:

a) Interim bonuses Paid;

b) Allocation of Bonus to Policyholders;

c) Surplus shown in the Revenue Account;

d) Total Surplus [(a) + (b) + (c)].

See Notes appended at the end of Form A-PL.

FROM A-PL

Name of the Insurer:

Registration No. and Date of Registration with the IRDA:

Profit and Loss Account for the year ended 31st March, 20..

Shareholders' Account (Non-technical Account)

Particulars	Sche dule	Current Year (RS'000)	Previous Year (Rs'000)
Amounts transferred from /to the Policyholders' Account (Technical account)			
Income from investments (a) Interest, dividends and Rent – Gross (b) Profit on sale /redemption of Investments (c) (Loss on sale/ redemption on Investments)			
Other income (to be specified)			
Total (A)			
Expenses other than those directly related to the insurece business			
Bal debts written off			
Provisions (other than taxation)			
(a) For diminution in the value of investments (Net) (b) Provisions for doubtful debts (c) Others (to be specified)			
Total (B)			
Profit / (Loss) before tax			
Provision for Taxation			
Profit / (Loss) after tax			
Appropriations (a) Balance at the beginning of the year (b) Interim dividends paid during the year (c) Proposed final dividend (d) Dividend distribution on tax			

(e) Transfer to reserves/ other accounts (to be specified)			
Profit carried… to the Balance Sheet			

Notes to Form A-RA and A-PL:

(a) Premium income received from business concluded in and outside India shall be separately disclosed.

(b) Reinsurance premiums whether on business ceded or accepted are to be brought into account gross (i.e. before deducting commissions) under the head reinsurance premiums.

(c) Claims incurred shall comprise claims paid, specific claims settlement costs wherever applicable and change in the outstanding provision for claims at the year end.

(d) Items of expenses and income in excess of one per cent of the total premiums (less re-insurance) or Rs. 5,00,000 whichever is higher, shall be shown as a separate line item.

(e) Fees and expenses connected with claims shall be included in claims.

(f) Under the sub-head “Others” shall be included items like foreign exchange gains or losses and other items.

(g) Interest, dividends and rentals receivable in connection with an investment should be stated as gross amount, the amount of income-tax deducted at source being included under “advance taxes paid and taxes deducted at source”.

(h) Income from rent shall include only the realized rent. It shall not include any notional rent.

FORM A-BS

Name of the Insurer:
Registration No. and Date of Registration with the IRDA:

Balance Sheet as at 31st March, 20 …

Particulars	**sche dule**	**Current Year (RS'000)**	**Previous Year (Rs'000)**
SOURCES OF FUNDS			
Shareholders' Funds:			
Share Capital	5		
Reserves and Surplus	6		
Credit / [Debit] Fair Value Change Account			
Sub total			
Borrowings	7		
Policyholders' Funds:			
Credit/ [Debit] Fair Value Change Account			
Policy Liabilities			
Insurance Reserves			
Provision for Linked Liabilities			
Sub Total			
Funds for Future Appropriations			
Total			
APPLICATION OF FUNDS			
Investments			
Shareholders'	8		
Policyholders'	8a		
Assets Held to Cover Linked Liabilities	8b		
Loans	9		
Fixed Assets	10		
Current Assets			

Cash and Bank Balances	11		
Advances and other Assets	12		
Sub total (A)			
Current Liabilities	13		
Provisions	14		
Sub total (B)			
Net Current Assets (C) = (A)-(B)			
Miscellaneous Expenditure (to the extent not written off or adjusted)	15		
Debit balance in profit and loss account (Shareholders' Account)			
Total			

CONTINGENT LIABILITIES

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Partly paid-up investments		
2. Claims, other than against policies, not acknowledge as debts by the company		
3. Underwriting commitments outstanding (in respect of shares and securities)		
4. Guarantees given by or on behalf of the company		
5. Statutory demands/liabilities in dispute, not provided for		
6. Reinsurance obligations to the extent not provided for in accounts		
7. Others (to be specified)		
Total		

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS

SCHEDULE 1

Premium

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. First year premiums		
2. Renewal premiums		
3. Single premiums		
Net Premium		
Total Premiums		

SCHEDULE 2

Commission Expenses

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
Commission paid		
Direct First year premiums		
Renewal premiums		
Single premiums		
Add: Commission on Re-insurance Accepted		
Less: Commission on Re-insurance Ceded		
Net commission		

Note : The profit/commission, if any, are to be combined with the Re-insurance accepted or Re-insurance ceded figures.

SCHEDULE 3
Operating Expenses Related to Insurance Business

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Employees' remuneration and welfare benefits		
2. Travel, conveyance and vehicle running expenses		
3. Training expenses		
4. Rents, rates and taxes		
5. Repairs		
6. Printing and stationery		
7. Communication expenses		
8. legal and professional changes		
9. Medical fees		
10. Auditors' fees, expenses etc. (a) as auditor (b) as adviser or in any other capacity, in respect of i. taxation matters ii. insurance matters iii. management services, and (c) in any other capacity		
11. Advertisement and publicity		
12. Interest and Bank Changes		
13. Others (to be specified)		
14. Depreciation		
Total		

Note: Items of expenses and income in excess of one per cent of the total premiums (less reinsurance) or Rs. 5,00,000 whichever is higher, shall be shown as a separate line item.

SCHEDULE 4
Benefits Paid (Net)

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Insurance Claims (a) Claims by Death (b) Claims by Maturity (c) Annuities/ Pension Payments (d) Other Benefits, specify		
2. (Amounts ceded n reinsurance): (a) Claims by Death (b) Claims by Maturity (c) Annuities / Pension Payments (d) Other Benefits, specify		
3. Amount accepted in reinsurance: (a) Claims by Death (b) Claims by Maturity (c) Annuities / Pension Payments (d) Other Benefits, specify		
Total		

Note:

(a) Claims include specific claims settlement costs, wherever applicable.

(b) Legal and other fees and expenses shall also form part of the claims cost, wherever applicable.

SCHEDULE 5
Share Capital

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Authorized capital Equity shares of Rs….. each		
2. Issued capital Equity shares of Rs…..each		
3. Subscribed capital Equity shares of Rs…..each		
4. Called-up capital Equity shares of Rs….. each		
Less: Calls unpaid		
Add: Shares forfeited (amount originally paid up)		
Less: Par value of Equity Shares bought back		
Less: Preliminary Expenses Expenses including commission or brokerage on underwriting or subscription of shares		
Total		

Note:

(a) Particulars of the different classes of capital should be separately stated.

(b) The amount capitalized account of issue of bonus shares should be disclosed.

(c) In case any part of the capital is held by a holding company, the same should be separately disclosed.

SCHEDULE 5A
Pattern of Shareholding [As certified by the Management]

Particulars	Current Year		Previous Year	
	Number of Shares	% of Holding	Number of Shares	% of Holding
1. Promoters Indian Foreign				
2. Others				
Total				

SCHEDULE 6
Reserves and Surplus

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Capital Reserve		
2. Capital Redemption Reserve		
3. Share Premium		
4. Revaluation Reserve		
5. General Reserves Less: Debit balance in profit and loss account, if any Less: Account utilized for buyback		
6. Catastrophe Reserve		
7. Other Reserve (to be specified)		
8. Balance of profit in profit and loss account		
Total		

Note: Additions to and deductions from the reserves shall be disclosed under each of the specified heads.

SCHEDULE 7
Borrowings

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Debentures / Bonds		
2. Banks		
3. Financial Institutions		
4. Others (to be specified)		
Total		

Note:

(a) The extent to which the borrowing are secured shall be separately disclosed stating the nature of the security under each sub-head.

(b) Amounts due within 12 months from the date of balance sheet should be shown separately.

SCHEDULE 8
Investments – Shareholders

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
LONG TERM INVESTMENTS		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other Approved Securities		
3. Other Investments (a) Shares (aa) Equity (bb) Preference (b) Mutual funds (c) Derivative instruments (d) Debentures/ Bonds (e) Other securities (to be specified) (f) Subsidiaries investment properties – Real Estate		
4. Investments in infrastructure and Social Sector		
5. Other than approved investments		
SHORT TERM INVESTMENT		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other approved securities		
3. Other investments a) Shares (aa) Equity (bb) Preference b) Mutual funds c) Derivative instruments d) Debentures/ Bounds e) Other securities (to be specified) f) Subsidiaries g) Investment properties – Real Estate		
4. investments in infrastructure and social sector		
5. Other than approved investments		
Total		

NOTE: See Notes appended at the end of schedule 8B.

SCHEDULE 8A
Investments – Policyholders

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
LONG TERM INVESTMENTS		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other Approved Securities		
3. Other Investments a) Shares (aa) Equity (bb) Preference b) Mutual funds c) Derivative instruments d) Debentures/ bonds e) Other securities (to be specified) f) Subsidiaries g) Investment properties – Real Estate		
4. Investments in infrastructure and social sector		
5. Other than approved investments		
SHORT TERM INVESTMENT		
1.Government securities and Government guaranteed bonds including Treasury Bills		
2. Other approved securities		
3. Other investments a) Shares (aa) Equity (bb) Preference b) Mutual funds c) Derivative instruments d) Debentures/ Bonds e) Other Securities (to be specified) f) Subsidiaries g) Investment properties – Real Estate		
4. Investments in infrastructure and social sector		
2. Other than approved investments		
Total		

Note: See Notes appended at the end of Schedule 8B.

SCHEDULE 8B
Assets Held to Cover Linked Liabilities

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
LONG TERM INVESTMENTS		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other Approved Securities		
3. Other Investments (a) Shares aa) Equity bb) Preference (b) Mutual funds (c) Derivative instruments (d) Debentures/ bonds (e) Other securities (to be specified) (f) Subsidiaries (g) Investment properties –Real Estate		
4. Investments in infrastructure and social sector		
5. Other than approved investments		
SHORT TERM INVESTMENT		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other approved securities		
3. Other investments a) Shares (aa) Equity (bb) Preference b) Mutual funds c) Derivative instruments d) Debentures/ Bounds e) Other securities (to be specified) f) Subsidiaries g) Investment properties – Real Estate		
4. Investments in infrastructure and social sector		
5. Other than approved investments		
Total		

Note (applicable to Schedules 8, 8A and 8B):

a) Investments in subsidiary /holding companies, joint ventures and associates shall be separately disclosed, at cost.

I. Holding company and subsidiary shall be construed as defined in the Companies Act, 1956.

II. Joint venture is contractual arrangements whereby two or more parties undertake an economic activity, which is subject to joint control.

III. Joint control is the contractually agreed sharing of power to govern the financial and operating policies of an economic activity to obtain benefits from it.

IV. Associate is an enterprise in which the company has significant influence and which is neither a subsidiary nor a joint venture of the company.

V. Significant influence (for the purpose of this schedule)means participation in the financial and operating policy decisions of a company, but not control of those polices. Significant influence may be exercised in several ways, for example, by representation on the board of directors, participation in the policymaking process, material inter-company transactions, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds, directly or indirectly though subsidiaries, 20 per cent or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor hold, directly or indirectly through subsidiaries, less than 20 per cent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence is clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

b) Aggregate amount of company's investment other than listed equity securities and derivative instruments and also the market value thereof shall be disclosed.

c) Investment made out of Catastrophe reserve should be shown separately.

d) Debt securities will be considered as "held to maturity" securities and will be measured at historical cost subject to amortization.

e) Investment Property means a property (land or building or part of a building or both) held to earn rental income or for capital appreciation or for both use in services or for administrative purposes.

f) Investments maturing within twelve months from balance sheet date and investments made with the specific intention to dispose of within twelve months from balance sheet date shall be classified as short-term investments.

SCHEDULE 9
Loans

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1.SECURITY-WISE CLASSIFICATIONS		
Secured		
a) On mortgage property (aa) in India (bb) outside India b) Shares, Bonds, Government securities etc. c) Loans against policies d) Others (to be specified)		
Unsecured		
Total		
2. BORROWER-WISE CLASSIFICATION		
a) Central and state government b) Banks and financial institutions c) Subsidiaries d) Companies e) Loans against policies f) Other (to be specified)		
Total		
3.PERFORMANCE-WISE CLASSIFICATION		
a) Loans classified as standard (aa) in India (bb) outside India		
a) Non-standard loans less provisions (aa) in India (bb) outside India		
Total		
4. MATURITY-WISE CLASSIFICATION		
a) short-term		
b) long-term		
Total		

Notes:

a) Short-term loans shall include those, which are repayable within 12 months fro the date of balance sheet. Long-term loans shall be the loans other than short-term loans.

b) Provisions against non-performing loans shall be shown separately.

c) The nature of the security incase of all long-term secured loans shall be specified in each case. Secured loans for the purposes of this schedule, means loans secured wholly or partly against an asset of the company.

d) Loans considered doubtful and the amount of provision created against such loans shall be disclosed.

SCHEDULE 10

Fixed Assets

particular	Cost / Gross Block				Depreciation				Net Block	
	Opening	additions	deductions	closing	Up to last Year	For the Year	On Sales / Adjustment	To Date	As at year and	Previous year
Goodwill										
Intangibles (specify)										
Land-freehold										
Leasehold Property										
Buildings										
Furniture and Fittings										
Information Technology Equipment										
Vehicles										
Office Equipment										
Others (specify nature)										
Total										
Work in progress										
Grand total										
Previous Year										

Note: Assets included in land, property and building above exclude Investment Properties as defined in note (e) to Schedule 8.

SCHEDULE 11

Cash and Bank Balances

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Cash (including cheques, drafts and stamps)		
2. Bank Balance a) Deposit accounts (aa) Short term (due within 12 months of the date of balance sheet) (bb) Others b) Current accounts c) Others (to be specified)		
3. Money at call and short notice a) With banks b) With other institutions		
4. Others (to be specified)		
Total		
Balance with non-scheduled banks included in 2 and 3 above		
CASH AND BANK BALANCES		
1. In India 2. Outside India		
Total		

Note : Bank balance may include remittances in transit. If so, the nature and amount shall be separately stated.

SCHEDULE 12
Advances and Assets

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
ADVANCES		
1. Reserve deposits with ceding companies		
2. Application money for investments		
3. Prepayments		
4. Advances to Directors / officers		
5. Advance tax paid taxes deducted at source (net provision for taxation)		
6. Others (to be specified)		
Total (A)		
OTHERS ASSETS		
1. Income accrued on investments		
2. Outstanding Premiums		
3. Agents' Balance		
4. Foreign Agencies Balance		
5. Due from other entities carrying on insurance business (including reinsures)		
6. Due from subsidiaries / holding company		
7. Deposit with Reserve Bank of India (pursuant to Section 7 of Insurance Act, 1938)		
8. Others (to be specified)		
Total (B)		
Total (A+B)		

Notes:

a) The items under the above heads shall not be shown net of provisions for doubtful amounts. The amount of provision against each head should be shown separately.

b) The term 'offer' should conform to the definition of that term as given under the Companies Act, 1956.

c) Sundry debtors will be shown under item 8 (Others).

SCHEDULE 13
Current Liabilities

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Agents' Balance		
2. Balance due to other insurance companies		
3. Deposits held on re-insurance ceded		
4. Premium received in advance		
5. Unallocated premium		
6. Sundry creditors		
7. Due to subsidiaries / holding company		
8. Claims outstanding		
9. Annuities due		
10. Due to officers / directors		
11. Others (to b specified)		
Total		

SCHEDULE 14
Provisions

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. For taxation (less payments and taxes deducted at source)		
2. For proposed dividends		
3. For dividend distribution tax		
4. Others (to be specified)		
Total		

SCHEDULE 15

Miscellaneous Expenditure (To the extent not written off a adjusted)

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Discount allowed in issue of shares / debentures		
2. Others (to be specified)		
Total		

Notes:

a) No item shall be included under the head "Miscellaneous Expenditure" and carried forward unless:

1. some benefit form the expenditure can reasonably be expected to be received in future, and
2. the amount of such benefit is reasonably determinable.

b) The amount to carried forward in respect of any included under the head "Miscellaneous Expenditure" shall not exceed the expected future revenue / other benefits related to the expenditure.

3.6. SOLVED PROBLEMS

Illustration 1

From the following balances of the Axis Life assurance Company Ltd., prepare its revenue account and balance sheet for the year ended 31st March 2006.

Life Assurance Fund at the beginning of the year	2,60,000
Claims admitted but not paid	780
Interest, dividend and rent received	9,100
Loans on life interest	26,000
Loans of mortgages	46,800
Claims by death	7,800
Claims by maturity	13,000
Single premium	10,400
Government securities	1,30,000

Registration and other fees received	260
Surrenders	2,600
Investment fluctuation account	1,300
Considerations for annuities granted	6,500
Deprecation on furniture	390
Provision for depreciation	390
Loans on policies	39,000
Amount due from other insurance company	468
Annuities due	260
Free hold property and furniture	13,390
Salaries	390
Directors fees	39
Promotional expenses	182
Audit fees	195
Law charges	130
Postage and stationary	1404
Office expenses	4680
Bank balance	21892
Commission on Re-insurance accepted	3120
Outstanding premium	3120
Interest accrued on investment but not due	390
Renewal premiums	26,000

Solution

Revenue A/C for the year ended 31st March, 2006

Particulars	Schedule	Amount (Rs)	Amount (Rs)
Premiums earned-net premium	1		36,400
Income from investment:			
Interest, dividend and rent Consideration for annuities granted		9,100 6,500	15,600
Other income:			
Registration and other fees received			260
Total (A)			**52,260**

Commission	2		3.120
Operating expenses related to Insurance Business	3		7,410
Total (B)			**10,530**
Benefit paid (Net)	4		23,400
Total (C)			**23400**
Surplus / (Deficit) (D) = (A)-(B)-(C)			18,330

Balance Sheet as at 31st March 2006

Particulars	Schedule	Amount (Rs)	Amount (Rs)
SOURCES OF FUNDS			
Shareholders fund:			
Share capital	5		-
Reserves and surplus	6		2,79,630
Borrowings	7		-
Total			**2,79,630**
APPLICATION OF FUNDS			
Investments	8	1,30,000	
Loans	9	1,11,800	
Fixed Assets	10	13,000	2,54,800
Cash and bank balance	11	21,892	
Advances and other Assets	12	3,978	
Sub-Total (A)		**25,870**	
Current liabilities	13	1,040	
Sub-Total (B)		**1,040**	
Net Current Assets (C) = (A - B)			24830
Total			**2,79,630**

SCHEDULE 1
Premium

Particulars	Amount (Rs)
Renewal premiums	26,000
Single premium	10,400
Total premium	**36,400**

SCHEDULE 2
Commission Expenses

Particulars	Amount (Rs)
Commission on Re- insurance accepted	3,120
Net commission	**3,120**

Schedule 3
Operating Expenses Related to Insurance Business

Particulars	Amount (Rs)
Salaries	390
Directors fees	39
Postage and stationery	1,404
Law charges	130
Audit fees	195
Promotional expenses	182
Office expenses	4,680
Deprecation on furniture	390
Total	**7,410**

SCHEDULE 4
Benefit Paid (Net)

Particulars	Amount (Rs)
Insurance claims	
a) Claims by death	7800
b) Claims by maturity	13000
c) Surrenders	2600
Total	**23400**

SCHEDULE 6
Reserves and surplus

Particulars	Amount (Rs)
Life assurance fund	2,60,000
Investment fluctuation account	13000
Surplus	18330
Total	**279630**

SCHEDULE 8
Investments – shareholders

Particulars	Amount (Rs)
Government securities	1,30,000
Total	**1,130,00**

SCHEDULE 9
Loans

Particulars	Amount (Rs)
Loans on mortgages	4,6,800
Loans on life interest	26,000
Loans on policies	39,000
Total	**111800**

SCHEDULE 10
Fixed Assets

Particulars	Amount (Rs)
Free hold property and furniture	13390
less depreciation	390
Total	**13,000**

SCHEDULE 11
Cash and bank balance

Particulars	Amount (Rs)
Bank balance	21,892
Total	**21892**

SCHEDULE 12
Advances and Assets

Particulars	Amount (Rs)
Interest accrued on investment but not due	390
Outstanding premium	3,120
Due from other insurance companies	468
Total	**3978**

SCHEDULE 13
Current liabilities

Particulars	Amount (Rs)
Claims admitted but not paid	780
Annuities due	780
Total	**1040**

Illustration 2

Following are the balance available for the year ended 31st March 2007 of Nutan Life Insurance Company Ltd. You are required to prepare revenue account and balance sheet for the year ended 31st March 2007.

Particulars	Amounts (Rs)
Insurance claims	
Claims by death	1,95,000
Claims by maturity	56,250
Other benefits	99,690
General reserve	15,70,560
Life Assurance fund of the begging of the year	31,41,126
First year premium	13,8,126
Traveling and conveyance	31,840
Interest dividend and rent received	15,7,383
Cash and bank balance	20,7,270
Office building	5,00,000
Office equipment	2,00,000

Outstanding premium	1,46,380
Advances to directors	1,57,650
Other sundry assets	1,20,300
Loans against policies	5,02,780
Surrenders	65,304
Employees remuneration and welfare benefit	20,000
Training expenses	17,830
Single premium	67,3590
Interest and bank charges	20,000
Agents balances (Dr)	2,95,500
Deposit with RBI	2,00,000
Commission on re-insurance accepted	1,09,623
Consideration for annuities granted	31,860
Amount due to other insurance companies	87,000
Agents balance outstanding	1,00,191
Subscribed and paid up capital	20,00,000
Brokerage on underwriting of shares	2000
Government bonds	33,81,670
Investment in other approved securities	10,00,000
Investment in mutual fund	16,90,800
Claims outstanding	1,20,051

Adjustments –

Interest dividend and rents outstanding (NET) Rs. 35000 and interest and rent accrued Rs. 65,300.

Depravation on office building Rs. 40,000 and on office equipment Rs. 10,000.

Bonus utilized in reduction of premium Rs. 14,500

Insurance claims arises due to the death of policy holder Rs. 80,000.

Solution

Revenue Account for the year ended 31st March 2007

Particulars	Schedule	Amount (Rs)	Amount (Rs)
Premiums earned – net			
Premium	1		8,26,216
Income from other investments			
Interest, dividend and rent		1,57,383	
Add: outstanding and accrued consideration for annuities granted		1,00,300	2,57,683 31,860
Total (A)			**11,15,759**
Commission	2		1,09,623
Operating expenses related to Insurance Business	3		1,39,670
Total (B)			**2,49,293**
Bonus paid	4		4,96,244
Bonus utilized in reduction of premium			14,500
Total (C)			**5,10,744**
Surplus/ (Deficit) (D) = (A)-(B)-(C)			3,55,752

Balance Sheet as at 31st March 2007

Particulars	Schedule	Amount (Rs)
SOURCES OF FUND		
Shareholders fund		
Share capital	5	19,98,000
Reserves and surplus	6	50,67,408
Sub-Total		70,65,408
Total		**70,65,408**

APPLICATION OF FUND		
Investments : Shareholders	8	50,72,470
Loans	9	5,02,780
Fixed assets	10	6,50,000
		62,25,250
Current assets		
Cash and bank balance	11	2,07,270
Advances and other assets	12	10,20,130
Sub-Total (A)		**12,27,400**
Current liabilities	13	3,87,242
Sub-Total (B)		3,87,242
Net Current Assets (C) = (A – B)		8,40,158
Total		**70,65,408**

SCHEDULE 1
Premium

Particulars	Amount (Rs)
First year premium	1,38,126
Single premium	6,73,590
Add: Bonus utilized in reduction of premium	14,500
Total premiums	**826216**

SCHEDULE 2
Commission expenses

Particulars	Amount (Rs)
Commission on re-insurance accepted	1,09,623
Net commission	**1,09,623**

SCHEDULE 3
Operating Expenses Related to Insurance Business

Particulars	Amount (Rs)
Employee's remuneration and welfare benefit	20,000
Traveling and conveyance	31,840
Training expenses	17,830
Interest and bank charges	20,000
Depreciation on office building	40,000
Depreciation on office equipment	10,000
Total	**1,39,670**

SCHEDULE 4
Benefit Paid (Net)

Particulars	Amount (Rs)
Insurance claims	
Claims by death	1,95,000
Add: further claims arises due to death	80,000
	2,75,000
Claims by maturity	56,250
Surrenders	65,304
Other benefit	99,690
Total	**4,96,244**

SCHEDULE 5
Share Capital

Particulars	Amount (Rs)
Subscribed and paid up capital	20,00,000
Less: brokerage on underwriting of shares	2000
Total	**19,98,000**

SCHEDULE 6
Reserves and Surplus

Particulars	Amount (Rs)
Life Assurance fund at the beginning of the year	31,41,126
General reserves	15,70,560
Surplus	3,55,722
Total	**50,67,408**

SCHEDULE 8
Investments

Particulars	Amount (Rs)
Government bonds	33,81,670
Other approved securities	10,00,000
Investment in mutual fund	6,90,800
Total	**50,72,470**

SCHEDULE 9
Loans

Particulars	Amount (Rs)
Loans against policies	5,02,780
Total	**5,02780**

SCHEDULE 10
Fixed Assets

Particulars		Amount (Rs)
Office building	5,00,000	
Less depreciation	40,000	4,60,000
Office equipment and furniture	2,00,000	
Less depreciation	10,000	1,90,000
Total		**6,50,000**

SCHEDULE 11
Cash and Bank Balance

Particulars	Amount (Rs)
Cash and Bank balance	2,07,270
Total	**2,07,270**

SCHEDULE 12
Advances and Assets

Particulars	Amount (Rs)
Advances of directors	1,57,650
Sundry assets	1,20,300
Interest, dividend and rent accrued	65,300
Interest, dividend and rent outstanding	35,000
Agents balance	2,95,500
Outstanding premium	1,46,380
Deposit with RBI	2,00,000
Total	**10,20,130**

SCHEDULE 13
Current Liabilities

Particulars		Amount (Rs)
Agents balances		1,00,191
Amount due to other insurance companies		87,000
Claims outstanding	1,200,51	
Add: further claims arises due to death	80,000	2,0,051
Total		**3,87,242**

Illustration 3

Prepare Revenue account and Balance sheet from the following balance of Sanjivani Life Insurance Company Ltd. for the year ended 31st March 2005.

Debit:

Particulars	Amounts (Rs)
Agents balances owing	2,10,000
Repairs	10,000
Furniture and fittings	2,00,000
Loans on government securities	11,00,990
Amount due from other Insurance Company	3,30,000
Commission on re0insurnace accepted	62,390
Deposits with ceding companies	11,00,000
Surrenders less assurance	5,25,000
Interim bonus paid	2,10,000
Sundry debtors	4,35,000
Commission paid for single premium	77,600
Buildings	6,50,000
Printing and stationary	12,000
Insurance claim : claim by maturity	23,41,900
Claim by death :	7,66,400
Outstanding premium	3,32,100
Auditors fees	25,000
Investment in government bonds	22,75,100
Re-insurance accepted claims by maturity	8,11,900
Preliminary expenses	11,000
Investment in infrastructure bonds	10,81,000
Bank balance	4,33,300
Advertisement	41,000
Re-insurance irrecoverable	35,000
Total	**1,36,76,680**

Credit:

Particulars	Amounts (Rs)
Premium deposits	6,72,000
First year premium	29,82,500
Commission on re-insurance ceded	59,300
Renewal premium	23,11,900
Deposits held on re-insurance ceded	3,39,100
Balance of account at the beginning of the year	19,52,000
Single premium	11,00,000
Sundry creditors	1,72,780
Borrowings from financial institutions	4,95,000
Re-insurance ceded – claims by maturity	2,12,400
Share capital	20,00,000
General reserves	5,00,000
Profit on realization of assets	35,000
Surplus on revaluations of reversions	2,44,700
Total	**1,30,76,680**

Adjustments

1. The company had a paid up capital of rupees 20,00,000 divided into 20,000 shares of rupees 100 each.

2. Re-insurance obligations to the extent not provided for in accounts Rs. 1,50,000.

3. Transfer 15% of surplus to general reserve

4. Provide Rs. 1,70,000 for taxation

5. Claims by death covered under re-insurance Rs. 86,000 and interest accrued on investment Rs. 59,000.

6. The company hold Rs. 7,64,000 government securities (not included in the agents balance) deposited by chief agent as security.

7. Provide depreciation on furniture Rs. 5000 and on building Rs. 20,000.

Solution

Revenue Account for the Year Ended 31st March 2005

Particulars	Schedule	Amount (Rs)	Amount (Rs)
Premium earned-net			
Premium	1		63,94,400
Income from Investment			
Interest, dividend and rent accrued		59,000	
Surplus on revaluation of reversions		2,44,700	3,03,700
Profit on realization of assets			35,000
Total (A)			**67,33,100**
Commission	2		80690
Operating expenses related to insurance business	3		1,13,000
Re-insurance irrecoverable			35000
Provision for tax			1,70,000
Total (B)			**398690**
Benefits paid (Net)	4		41,46,800
Interim bonuses paid			2,10,000
Total (C)			**43,56,800**
Surplus/ (D)= (A)–(B)-(C)			19,77,610
Appropriations			
Transfer to general reserve (15%)			2,96,642
Balance being funds for future appropriations			16,80,968
Total (D)			19,77,610

Balance Sheet as at 31st March 2005

Particulars	Schedule	Amount (Rs)	Amount (Rs)
SOURCES OF FUNDS			
Shareholders fund			
Share capital	5	19,89,000	
Reserves and surplus	6	44,29,610	
Sub-Total			**64,18,610**
Borrowings	7		11,67,000
Total			**75,85,610**
APPLICATION OF FUNDS			
Investments			
Shareholders	8		41,20,100
Loans	9		11,00,990
Fixed Assets	10		8,25,000
Current Asset			
Cash and bank balance	11	4,33,300	
Advances and other Assets	12	25,52,100	
Sub-Total (A)		**29,85,400**	
Current Liabilities	13	12,75,880	
Provisions	14	1,70,000	
Sub-Total (B)		**14,45,880**	
Net Current Assets (C) = (A – B)			15,39,520
Total			**75,85,610**

Note : Contigent liabilities : Reinsurance obligation to the extent not provided for in amounts to ₹ 1,50,000.

SCHEDULE 1
Premium

Particulars	Amount (Rs)
First year premiums	29,82,500
Renewal premiums	23,11,900
Single premiums	11,00,000
Total premiums	**63,94,400**

SCHEDULE 2
Commission expenses

Particulars	Amount (Rs)
Commission paid for single premium	77,000
Add: commission on re-insurance accepted	62,390
Less: commission of re-insurance ceded	(59,300)
Net commission	**80,690**

SCHEDULE 3
Operating Expenses Related to Insurance Business

Particulars	Amount (Rs)
Repairs	10,000
Printing and stationary	12,000
Auditors fees	25,000
Advertisement and publicity	41,000
Depreciation on furniture	5000
Depreciation of building	20,000
Total	**1,13,000**

SCHEDULE 4
Benefits Paid (Net)

Particulars	Amount (Rs)
Insurance claims	
Claims by death	7,66,400
Claims by maturity	23,41,900
Surrenders less re-insurance	5,25,000
Amounts ceded in Re-insurance	
Claims by death	(86,000)
Claims by maturity	(2,21,400)
Amount Accepted in re-insurance	
Claims by maturity	8,11,900
Total	**41,46,800**

SCHEDULE 5
Share Capital

Particulars	Amount (Rs)
Issued, subscribed, and called up 20,000 shares of Rs. 100 each	20,00,000
Less: preliminary expenses	11,000
Total	**19,89,000**

SCHEDULE 6
Reserves and Surplus

Particulars		Amount (Rs)
Balance of account at the beginning of the year		19,52,000
General reserve	5,00,000	
Add: Transfer from surplus	2,96,642	
		7,96,642
Balance fund		16,80,968
Total		**44,29,610**

SCHEDULE 7
Borrowings

Particulars	Amount (Rs)
Borrowings from financial institutions	4,95,000
Premium deposits	6,72,000
Total	**11,67,000**

SCHEDULE 8
Investments Shareholders

Particulars	Amount (Rs)
Government Securities	7,64,000
Government bonds	22,75,100
Investment in infrastructure bonds	10,81,000
Total	**41,20,100**

SCHEDULE 9
Loans

Particulars	Amount (Rs)
Loans on government securities	11,00,990
Total	**11,00,990**

SCHEDULE 10
Fixed Assets

Particulars		Amount (Rs)
Building	6,50,000	
Less: depreciation	(20,000)	6,30,000
Furniture	2,00,000	
Less: depreciation	(5000)	1,95,000
Total		**8,25,000**

SCHEDULE 11
Cash and Bank Balance

Particulars	Amount (Rs)
Bank balance	4,33,300
Total	**4,33,300**

SCHEDULE 12
Advances and Assets

Particulars	Amount (Rs)
Deposits with ceding companies	11,00,000
Other Assets	
Outstanding premium	3,32,100
Income accrued on investment	59,000
Claims covered under re-insurance	86,000
Due from other insurance company	3,30,000
Sundry debtors	4,35,000
Agents balance	2,10,000
Total	**25,52,100**

SCHEDULE 13
Current Liabilities

Particulars	Amount (Rs)
Security hold against investment	7,64,000
Deposited by chief agent	
Deposits hold on re-insurance ceded	3,39,100
Sundry creditors	1,72,780
Total	**12,75,880**

SCHEDULE 14
Provisions

Particulars	Amount (Rs)
Provision for tax	1,70,000
Total	**1,70,000**

3.7 PROCEDURE TO ASCERTAIN PROFIT OR LOSS OF THE LIFE INSURANCE BUSINESS

The profit or loss of the life insurance business is to be ascertained after every two years by preparing 'Valuation Balance sheet':

In case of life insurance business, the claims arise either on death or expiry of policy period. Hence, a deficiency may arise due to the difference between the present value of the future premium to be received and the present value of future liability on all policies in force. This deficiency is termed as 'net liability'. The estimation of such liability is done of mathematicians well versed in tedious calculations of life insurance – known as 'actuaries'. After the valuation of net liability by appointed actuary, it is compared with Life Assurance fund by preparing Valuation Balance sheet and thereby find out profit or loss of a Life Insurance Company.

Valuation Balance Sheet of ______ as at ______

Particulars	Rs.	Particulars	Rs.
Net Liabilities	xxx	Life Insurance Fund	xxx
Surplus (if any)	xxx	Deficit (if any)	xxx
	xxx		**xxx**

Illustration 4

Gipsy Life insurance company provides following information to prepare Valuation Balance Sheet and profit distribution statement for the year ended on 31st March 2005 and also give journal entries.

	Amount is Rs.
Life insurance fund (as on 1-4-2004)	1,83,865
Interim Bonus Paid	27,500
Revenue account balance (as on 31-3-05)	2,64,000
Net Liability as per Valuation (as on 31-3-05)	1,81,500

The company declared a reverslonary bonus of Rs. 210 per Rs. 1,000 and gave the policy holders an options to take bonus in cash Rs. 120 per Rs. 1,000. Total business of the company was Rs. 7,48,000. The company issued with profit policy only, ¾ of the policy holders in value opted for cash bonus.

Solution

Gipsy Life Insurance Company
Valuation Balance sheet as at 31-3-05

Particulars	Rs.	Particulars	Rs.
Net Liabilities	1,81,500	Life Insurance Fund	2,64,000
Surplus	82,500		
	2,64,000		**2,64,000**

Profit Distribution Statement

Particulars	Amount (Rs)
Surplus as per Valuation Balance sheet	82,500
Add: Interim Bonus Paid	27,500
Profits available for distribution	**1,10,000**
Share of policy holders (95%)	1,04,500
Less: Interim Bonus Paid	27,500
Amount due to policy holders	**77,000**
Shares of shares holders (5%)	5,500

Note: 95% of the surplus must be utilized for the benefit of policy holders and 5% of the surplus to be given to shareholders.

Journal Entries:

Particulars		Dr RS.	Cr Rs.
Life Insurance fund A/C To Profit & loss A/C To [Being profit revealed by Valuation Balance sheet transferred to profit & loss A/C]	Dr	82,500	 82,500
Profit and loss A/C To To Bonus in cash A/C [Being bonus payable @ Rs. 120 per 1,000 on ¾ of Rs. 7,48,000]	Dr	67,320	 67,320
Profit and loss A/C To To life insurance fund A/C [Being the amount @ Rs. 210 per Rs. 1,000 on ¼ of Rs. 7,48,000 transferred to life insurance fund in respect of reversionary bonus.	Dr		

Illustrations 5

Jai Hind Life Insurance Company Ltd. provides information to prepare Valuation Balance sheet and a statement showing amount due to policy holders as on 31st March 2008

Life assurance fund as on 31st March 2008 amounted to Rs. 1,55,104, before providing dividend for the year 2007-08. It's actuarial valuation as on 31st March 2008 discloses net liability of Rs. 1,49,480 under the assurance and annuity contracts. Interim bonus paid Rs. 1,480 for the period ending 31st March 2008.

Solution

Valuation Balance Sheet as on 31-3-08

Particulars	Rs.	Particulars	Rs.
Net Liabilities	1,49,480	Life Insurance Fund	1,55,104
Surplus	5,624		
	1,55,104		**1,55,104**

Profit Distribution Statement

Particulars	Amount (Rs)
Surplus as per Valuation Balance sheet	5,624
Add: Interim Bonus Paid to policy holders	1,480
	7,104
Less: Dividend to shareholders (for 2007-08)	1,184
Profit for 2 years ending on 31-3-08	5,920
Policy holder entitled for 95% of Rs. 5,624	5,624
Less: Already paid interim bonus	1,480
Amount due to policy holders	4,144

3.8 GENERAL INSURANCE BUSINESS

General Insurance Business is the business other than Life Insurance. It is carried by General Insurance Corporation of India through its subsidiary companies and many private companies also involve in General Insurance business.

Section 2(60) of the Insurance Act 1938 has defined ‘General Insurance Business’ as fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them. Fire insurance business means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against the fire insurance policies. Marine Insurance Business means the business of effecting contracts of insurance upon vessels of any descriptions, including cargoes, freights and other interests which may be legally insured in or in relation to such vessels, cargoes and freights, goods wares, merchandise and property of whatever description insured for any transit by land or water, or both and whether or not including warehouse risks or similar risks in addition or incidental to such transit, and includes any other risks customarily included among the risks insured against in marine insurance policies.

3.9 SOME IMPORTANT TERMS

- **RESERVED FOR UNEXPIRED RISK:**

General Insurance Policies are taken for one year period and so risk is covered for 12 months from the date of insurance. The policies are issued throughout the year and remain in force even after the close for the current financial year and the entire premium for his period is colleted in advance. For e.g. this period is colleted in advance. For e.g. a policy is issued on 15 January 2006 and it will be in force up to 14 January 2007 so the premium received on such policy covers partly current year 2005-06 and partly next year 2006-07. the risk may happen on any day during the lifetime of policy. The premium received on individual policy is not separated on time basis. Therefore a provision against unexpired risk is made to meet future claims arises under such policies

Reserves for unexpired risks are laid down as follows.

Fire and miscellaneous business 50% of the premium, net of re-insurance, during the preceding 12 months.

Marine cargo business 50% of the premium, net of re-issue during the preceding 12 months.

Marine hull business 100% of the premium, net of re-issue during the preceding 12 months.

However, an insurance company may keep additional reserve if it feels so.

Accounting Treatment

The opening balance of reserve for unexpired risk is credited to revenue account and closing balance is debited to revenue account.

Illustration 6

Give the journal entries and unexpired risk reserve account from the following information of Biji General Insurance Company Ltd. for the year ended on 31st March 2009.

I. Total reserve for unexpired risk as on 31st March 2008.

Marine Insurance policies	Rs. 285
Fire Insurance policy	Rs. 380
Miscellaneous Insurance policies	Rs. 95
Total	**Rs. 760**

II. Reserves to be created for the year ending 31st March 2009:

Marine Insurance policy – 100% of net premium

Fire and miscellaneous - 50% of net premium insurance policies.

III. During the year the premium received:

Marine Insurance business	Rs. 345
Fire insurance business	Rs. 817
Miscellaneous insurance business	Rs. 228

Premium collected from other insurance companies in respect of risk undertaken

Marine insurance business	Rs. 133
Fire insurance business	Rs. 95
Miscellaneous insurance business	Rs. 76

V. Premium paid to other insurance companies on business ceded

Marine insurance business	Rs. 127.3
Fire insurance business	Rs. 81.7
Miscellaneous insurance business	Rs. 133

Solution

In the Books of Biji General Insurance Company Ltd.
Journal Entries

Date	Particulars	Dr Rs.	Cr Rs.
31st March 2009	Unexpired Risk Reserve (Fire) A/C	380	
	Unexpired Risk Reserve (Marine) A/C	285	
	Unexpired Risk Reserve	95	
	(Miscellaneous) A/C		
	To To fire Revenue A/C	380	
	To To marine Revenue A/C	285	
	To s Revenue A/C To	95	
	[Being opening balance of reserve is credited to revenue A/C]		
	Marine Revenue A/C (note I) To	347.7	
	To Unexpired Risk Reserve A/C		347.7

	[Being the reserve created at 100% of net premium income]		
	Fire Revenue A/C (note l)	415.15	
	To unexpired Risk Reserve A/C		415.15
	[Being the reserve created at 50% of net premium income)		
	miscellaneous Revenue A/C (note I)	85.5	
	To unexpired risk reserve A/C		85.5
	[Being the reserve created at 50% of net premium income)		

Calculation on Net Premium Income

Particulars	Marine	Fire	Miscellaneous
Premium collected from policyholders.	342	817	228
Premium collected from other Insurance company	133		
Less: Premium paid to other Insurance Company	(127.3)	(81.7)	(133)
To other insurance company			
	347.7	**830.3**	**171**
Percentage of reserve	100%	50%	50%
Amount of reserve to be created	347.7	415.15	85.5

Unexpired Risk Reserve Account

Date	Particulars	Marine	Fire	Miscellaneous	Date	Particular	Marine	Fire	Miscellaneous
31, March 2000	To revenue A/C	285	380	95	31st March 09	By balance b/d	285.	380	95
	To balance C/D	347.7	415.15	85.5		By Revenue A/C	347.7	415.15	85.5
		632.7	**795.15**	**180.5**			**632.7**	**795.15**	**180.5**

3.10 PREPARATION OF FINANCIAL STATEMENT.

The General insurance company in India prepares its financial statements in accordance with provision of IRDA regulations, 2002. The financial statements consist of revenue account, profit and loss account and vertical balance sheet in form B-RA, form B-PL and Form B-BS respectively’. Revenue accounts for fire, marine and miscellaneous insurance business to be prepared separately. Revenue account contains schedule-1, schedule-2, schedule-3, and schedule -4 and given operating profit or loss from insurance business which is transferred to profit and loss account.

Items not directly related to the insurance business are exhibited in profit and loss account for e.g. transfer fees, diminution in the value of investment bad debts written-off.

Balance sheet contains source of funds and application of fund. Sources of funds consists of schedule-5, schedule-6 and schedule-7 and application of funds consist of schedule-8 to schedule 15. Contingent liabilities are disclosed at the bottom of Balance Sheet.

Form B-BA

Name of the Insurer:

Registration No. and Date of Registration with the IRDA:

Revenue Account for the year ended 31st March, 20…

Particulars	schedule	Current Year (RS'000)	Previous Year (Rs'000)
1. Premiums eamed – net	1		
2. Profit /Loss on Sale/Redemption of Investments			
3. Other (to be Specified)			
4. Interest, Dividends and Rent - Gross			
Total (A)			
1. Claims Incurred (Net)	2		
2. Commission	3		
3. Operating Expenses related to Insurance Business	4		
Total (B)			
Operating profit/ (Loss) from Fire / Marine /Miscellaneous Business C = (A-B)			

Appropriations			
Transfer to Shareholder Account			
Transfer to Catastrophe Reserve			
Transfer to other Reserves (to be specified)			
Total (c)			

Note: See Notes appended at the end of Form B-PL

FORM B-PL

Name of the Insurer

Registration No. and Date of Registration with the IRDA:

Profit and Loss Account for the year ended 31st March, 20…

Particulars	**schedule**	**Current Year (RS'000)**	**Previous Year (Rs'000)**
1. Operating Profit / (Loss)			
a) Fire insurance b) Marine insurance c) Miscellaneous insurance			
Income form Investment			
Interest, Dividend and Rent – Gross Profit on sale of investments Less: Loss on sale of investments			
3. Other income (to be specified)			
Total (A)			
4. Provisions (other than taxation)			
a) For diminution in the value of investments b) For doubtful debts c) Others (to be specified)			

Other Expenses			
a) Expenses other than those related to insurance business b) Bad debts written off c) Others (to be specified)			
Total (B)			
Profit Before Tax			
Provision for Taxation			
Appropriations a) Interim divided paid during the year b) Proposed final dividend c) Dividend distribution tax d) Transfer to any reserves/ other accounts (to be specified)			
Balance of profit/ loss brought forward from last year			
Balance carried forward to Balance Sheet			

Notes to Form B-RA and B-PL:

a) Premium income received from business concluded in and outside India shall be separately disclosed.

b) Reinsurance premiums whether on business ceded or accepted are to be brought into account gross (i.e. before deducting commissions) under the head reinsurance premiums.

c) Claims incurred shall comprise claims paid, specific claims settlement costs wherever applicable and change in the outstanding provision for claims at the year end.

d) Items of claims at the year end.

e) Fees and expenses connected with claims shall be included in claims.

f) Under the sub-head “others” shall be included items like foreign gains or losses and other items.

g) Interest, dividends and rentals receivable in connection with an investment should be stated as gross amount, the amount of income-tax deducted at source beings included under 'advance taxes paid and taxes deducted at source".

h) Income from rent shall include only the realized rent. It shall not include any national rent.

FROM B-BS

Name of insurer:

Registration No. and Date of Registration with the IRDA:

Balance Sheet as at 31st March, 20…

Particulars	**schedule**	**Current Year (RS'000)**	**Previous Year (Rs'000)**
Sources of Funds			
Share capital	5		
Reserves and surplus	6		
Fair value change account			
Borrowings	7		
Sub Total			
Application of Funds			
Investments	8		
Loans	9		
Fixed assets	10		
Current assets			
Cash and bank balance	11		
Advances and other assets	12		
Sub Total (A)			
Current Liabilities	13		
Provisions	14		
Sub Total (B)			

Net current assets (C)= (A-B)			
Miscellaneous expenditure (to the extent not written off or adjusted)	15		
Debit balance profit and loss account			
Total			

Contingent Liabilities

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
Partly paid-up investments		
Claims, other than against policies, not acknowledged as debts by the company		
Underwriting commitments outstanding (in respect of shares and securities)		
Guarantees given by or on behalf of the company		
Statutory demands / liabilities in dispute, not provided for		
Reinsurance obligations to the extent not provided for in accounts		
Others (to be specified)		
Total		

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS
SCHEDULE 1
Premium Earned (Net)

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
Premium from direct business written		
Add: premium on reinsurance accepted		
Less: premium on reinsurance ceded		
Net premium		
Adjustment for change in reserve for unexpired risks		
Total premium earned (Net)		

Note: Reinsurance premiums whether on business ceded or accepted are to be brought into account, before deducting commission, under the head of reinsurance premiums

SCHEDULE 2

Claims Incurred (Net)

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
Claims paid		
Direct		
Add: Re-insurance accepted		
Less: Re-insurance ceded		
Net claims paid		
Add: claims outstanding at the end of the year		
Less: claims outstanding at the beginning		
Total Claims Incurred		

Notes:

a) Incurred But Not Reported (IBNR), Incurred But Not Enough Reported (IBNER) claims should be included in the amount for outstanding claims.

b) Claims includes specific claims settlement cost but not expenses of management.

c) The surveyor fees, legal and other expenses shall also form part of claims cost.

d) Claims cost should be adjusted for estimated salvage value if there is a sufficient certainty of its realization.

SCHEDULE 3
Commission

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
Commission paid		
Direct		
Add: re-insurance accepted		
Less: commission on re-insurance ceded		
Net Commission		

Note: The profit / commission, if any, are to be combined with the re-insurance accepted or Re-insurance ceded figures.

SCHEDULE 4

Operating Expenses Related to Insurance Business

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Employees remuneration and welfare benefits		
2. Travel, conveyance and vehicle running expenses		
3. Training expenses		
4. Rents, rates and taxes		
5. Repairs		
6. Printing and stationery		
7. Communication		
8. Legal and professional charges		
9. Auditors fees, expenses etc.		
a) As auditor b) As adviser or in any other capacity, in respect of I. Taxation matters II. Insurance matters III. Management services, and c) In any other capacity		
10. Advertisement and publicity		
11. interest and bank charges		
12. others (to be specified)		
13. depreciation		
Total		

Note: Items of expenses and income in excess of one per cent of the total premiums (less reinsurance) or Rs. 5,00,000 whichever higher, shall be shown as a separate line item.

SCHEDULE 5

Share Capital

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Authorized Capital Equity shares of Rs....each		
2. Issue Capital Equity shares of Rs….each		
3. Subscribed Capital Equity shares or Rs….each		
4. Called-up Capital Equity shares of Rs….each		
Less: calls unpaid		
Add: Equity shares forfeited (amount originally paid up)		
Less: Par value of equity shares bought back		
Less: preliminary expenses Expenses including commission or brokerage on underwriting or subscription of shares		
Total		

Notes:

a) Particulars of the different classes of capital should be separately stated.

b) The amount capitalized on account of issue of bonus shares should be disclosed.

c) In case any part of the capital is held by a holding company, the same should be separately disclosed.

SCHEDULE 5A

Pattern of Shareholding [As certified by the Management]

Shareholder	Current Year		Previous Year	
	Number of Shares	% of Holding	Number of Shares	% of Holding
1. Promoters Indian Foreign				
2. Others				
Total				

SCHEDULE 6
Reserves and Surplus

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Capital reserve		
2. Capital Redemption reserve		
3. Share premium		
4. General reserves Less : Debit balance in Profit and Loss Account, if any Less : Amount utilised for Buy back		
5. Catastrophe reserve		
6. Other reserves (to be specified)		
7. Balance of profit in profit and loss account		
Total		

Note: Additions to and deductions from the reserves shall be disclosed under each of the specified heads.

SCHEDULE 7
Borrowings

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Debentures / Bonds		
2. Banks		
3. Financial Institutions		
4. Others (to be specified)		
Total		

Note:

a) The extent to which the borrowing are secured shall be separately disclosed stating the nature of the security under each sub-head.

b) Amounts due within 12 months from the date of Balance Sheet should be shown separately.

SCHEDULE 8
Investments

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
LONG TERM INVESTMENTS		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other Approved Securities		
3. Other Investments a. Shares (aa) equity (bb) preference b. Mutual funds c. Derivative instruments d. Debentures/ bonds e. Other securities (to be specified) f. Subsidiaries g. Investment properties – Real Estate		
4. Investments in infrastructure and social sector		
5. Other than Approved Investments		
SHORT TERM INVESTMENT		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other approved securities		
3. Other investments a) Shares (aa) Equity (bb) Preference b) Mutual funds c) Derivative instruments d) Debentures/ Bounds e) Other securities (to be specified) f) Subsidiaries g) Investment properties – Real Estate		
4. Investments in infrastructure and social sector		
5. Other than Approved Investments		
Total		

Notes:

a) Investments in subsidiary / holding companies, joint ventures and associated shall be separately disclosed, at cost.

I. Holding company and subsidiary shall be construed as defined in the Companies Act, 1956.

II. Joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

III. Joint control is the contractually agreed sharing of power to govern the financial and operating policies of an economic activity to obtain benefits from it.

IV. Associate is an enterprise in which the company has significant influence and which is neither a subsidiary nor a joint venture of the company.

V. Significant influence (for the purpose of this schedule) means participations in the financial and operating policy decisions representation on the board of directors, participation in the policymaking process, material inter-company transactions, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiaries, 20 per cent or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly though subsidiaries, less than 20 per cent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence is clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor form having significant influence.

b) Aggregate amount of company's investments other than listed equity securities and derivative instruments and also the market value thereof shall be disclosed.

c) Investments made out of Catastrophe reserve should be shown separately.

d) Debt securities will be considered as "held to maturity" securities and will be measured at historical cost subject to amortization.

e) Investment Property means a property (land or building or part of a building or both) held to earn rental income or for capital appreciation or for both, rather than for use in services or for administrative purposes.

f) Investments maturing within twelve months from Balance Sheet date investments made with the specific intention to dispose of within twelve months from balance sheet date shall be classified as short-term investments.

SCHEDULE 9
Loans

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1.SECURITY-WISE CLASSIFICATIONS		
Secured		
a) On mortgage property (aa) in India (bb) outside India b) On shares, Bonds, Government securities etc. c) Others (to be specified)		
Unsecured		
Total		
2. BORROWER-WISE CLASSIFICATION		
a) Central and state government b) Banks and financial institutions c) Subsidiaries d) Industrial Undertakings e) Other (to be specified)		
Total		
3.PERFORMANCE-WISE CLASSIFICATION		
a) Loans classified as standard (aa) in India (bb) outside India		
a) Non-performing standard loans less provisions (aa) in India (bb) outside India		
Total		
4. MATURITY-WISE CLASSIFICATION		
a) short-term		
b) long-term		
Total		

Notes:

a) Short-term loans shall include those, which are repayable within 12 months from the date of Balance Sheet. Long-term loans shall be the loans other than short-term loans.

b) Provisions against non-performing loans shall be shown separately.

c) The nature of the security incase of all long-term secured loans shall be specified in each case. Secured loans for the purposes of this schedule, means loans secured wholly or partly against an asset of the company.

d) Loans considered doubtful and the amount of provision created against such loans shall be disclosed.

SCHEDULE 10
Fixed Assets

particular	Cost / Gross Block				Depreciation				Net Block	
	Opening	additions	deductions	closing	Up to last Year	For the Year	On Sales / Adjustment	To Date	As at year and	Previo us year
Goodwill										
Intangibles (specify)										
Land-freehold										
Leasehold Property										
Buildings										
Furniture and Fittings										
Information technology equipment										
Vehicles										
Office Equipment										
Others (specify nature)										
Total										
Work in progress										
Grand total										
Previous year										

Note: Assets included in land, property and building above exclude Investment Properties as defined in note (e) to Schedule 8.

SCHEDULE 11
Cash and Bank Balances

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Cash (including cheques, drafts and stamps)		
2. Bank Balance a) Deposit accounts (aa) Short term (due within 12 months) (bb) Others b) Current accounts c) Others (to be specified)		
3. Money at call and short notice a) With banks b) With other institutions		
4. Others (to be specified)		
Total		
Balance with non-scheduled banks included in 2 and 3 above		

Note : Bank balance may include remittances in transit. If so, the nature and amount shall be separately stated.

SCHEDULE 12
Advances and Other Assets

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
ADVANCES		
1. Reserve deposits with ceding companies		
2. Application money for investments		
3. Prepayments		
4. Advances to Directors / officers		
5. Advance tax paid taxes deducted at source (net provision for taxation)		
6. Others (to be specified)		
Total(A)		

OTHERS ASSETS		
1. Income accrued on investments		
2. Outstanding Premiums		
3. Agents' Balance		
4. Foreign Agencies Balance		
5. Due from other entities carrying on insurance business (including reinsures)		
6. Due from subsidiaries / holding		
7. Deposit with Reserve Bank of India (pursuant to Section 7 of Insurance Act, 1938)		
8. Others (to be specified)		
Total (B)		
Total (A+B)		

Notes:

a) The items under the above heads shall not be shown net of provisions for doubtful amounts. The amount of provision against each head should be shown separately.

b) The term 'officer' should conform to the definition of that term as given under the Companies Act, 1956.

c) Sundry debtors will be shown under item 9 (Others).

SCHEDULE 13
Current Liabilities

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Agents' Balance		
2. Balance due to other insurance companies		
3. Deposits held on re-insurance ceded		
4. Premium received in advance		
5. Unallocated premium		
6. Sundry creditors		
7. Due to subsidiaries / holding company		
8. Claims outstanding		
9. Due to officers / directors		
10. Others (to b specified)		
Total		

SCHEDULE 14
Provisions

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Reserve for Unexpired Risk		
2. For taxation (less advance tax paid and taxes deducted at source)		
3. For proposed dividends		
4. For dividend distribution tax		
5. Others (to be specified)		
Total		

SCHEDULE 15
Miscellaneous Expenditure (To the extent not written off a adjusted)

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Discount allowed in issue of shares / debentures		
2. Others (to be specified)		
Total		

Notes:

a) No item shall be included under the head “Miscellaneous Expenditure” and carried forward unless:

1. some benefit form the expenditure can reasonably be expected to be received in future, and
2. the amount of such benefit is reasonably determinable

b) The amount to carried forward in respect of any included under the head “Miscellaneous Expenditure” shall not exceed the expected future revenue / other benefits related to the expenditure.

Illustration 7

From the following information of the Junk Fire Insurance co. Ltd. you are required to prepare revenue account for the year ended 31st March 2010.

Particulars	Amount Rs. In Lakhs
Reserve for unexpired risk as on 31-3-09	776
Rent, rates and taxes	22
Premium from direct business	830
Premium on re-insurance ceded	47
Auditors fees relating to insurance matters	12
Profit on sale of investment	175
Bad debts	26
Contribution to provident fund	88
Bonus to employees	64
Additional reserve as on 31-3-09	82
Medical expenses	16
Traveling expenses	09
Interest, dividend and rent received	320
Printing and stationary	13
Depreciation on office equipment	12
Survey fees relating to claims	15
Commission paid on direct business	152
Claims outstanding as on 31-3-2010	102
Claims outstanding as on 31-3-2009	74
Claims paid: direct	1,100
Re-insurance accepted	231
Re-insurance ceded	169
Commission on re-insurance ceded	29

The required for unexpired risk as on 31-3-2010 is 50% of the net premium received.

Solution:

Junk Fire Insurance Co. Ltd.
Revenue account for the year ended 31st March 2010

Particulars	Schedule	Amount Rs. in Lakhs
Premiums earned net	1	1,249.5
Profit on sale of investment		17.5
Interest, dividend and rent		320
Total (A)		**1,744.5**
Claims incurred (net)	2	1,205
Commission	3	123
Operating expenses related to insurance business	4	262
Total (B)		**1,590**
Operating profit from fire insurance business C = (A – B)		154.5

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS

SCHEDULE 1
Premium Earned (net)

Particulars		Amount Rs. in Lakhs
Premium from direct business		830
Less premium on reinsurance ceded		(47)
Net premium		**783**
Adjustment for change in reserve for unexpired risk		
Reserve for unexpired risk as on 31-3-2009	776	
Add aditioanl reserve as on 31-3-09	82	858
Less resene for unexpired risk as on 31-3-10		391.5
Total premium earned		**1,249.5,**

SCHEDULE 2
Claims Incurred (net)

Particulars		Amount Rs. in Lakhs
Claims paid : Direct	1,100	
Add: Re-insurance accepted	231	
Less: Re-insurance ceded	(169)	
Net claims paid		1162
Add: claims outstanding as on 31-3-10	102	
Less: claims outstanding as on 31-3-09	74	28
Surveyor fees		15
Total claims incurred		**1205**

SCHEDULE 3
Commission

Particulars	Amt Rs. in Lakhs
Commission paid: Direct	152
Less: commission on re-insurance ceded	29
Net commission	**123**

SCHEDULE 4
Operating Expenses related to Insurance Business

Particulars	Amt Rs. in Lakhs
Contribution to Provident Fund	88
Bonus to employees	64
Traveling expenses	9
Rent, Rates and taxes	22
Printing and stationery	13
Auditors fees related to insurance matters	12
Bad debts	26
Medical expenses	16
Depreciation on office equipment	12
Total	**262**

Illustration 8

Jetty Marine Insurance Co. Ltd provides following information's as on 31st March 2006 and 31st March 2007. You are required to prepare Revenue account for two years.

Particulars	Amt (Rs) 31-3-06	Amt (Rs) 31-3-07
Commission on Direct business	350,000	3,77,500
On re-insurance ceded	3,52,000	2,64,000
On re-insurance accepted	2,47,500	2,75,000
Interest and bank changes	1,10,000	1,14,000
Repairs and maintenance	83,000	92,000
Depreciation on office buildings	40,000	50,000
Audit fees	35,000	50,000
Printing charges	72,000	89,000
Employees salary	13,75,000	14,85,000
Miscellaneous expenses	66,000	63,000
Managers salary	55,000	65,000
Claims paid	8,38,750	15,64,750
Premium from direct business	65,00,000	66,00,000
Re-insurance accepted	10,00,000	10,80,000
Re-insurance ceded	11,61,000	12,10,000

Adjustments

1. Claims outstanding as on:

   31-3-05 Rs. 3,76,750

   31-3-06 Rs. 4,92,250

   31-3-07 Rs. 6,11,050

2. Interest, dividend and rent accrued Rs. 3,30,000 for the year ended on 31-3-07

3. Reserve for unexpired risks as on 31st March 2005 was Rs. 55,20,000 and additional reserve was Rs. 6,62,400.The company's policy is to provide reserve for unexpired risk at @ 100% and addition reserves @ 12% of net premium received.

Solution

Jelly Marine Insurance Co. Ltd
Revenue A/C for the year ended on 31-3-06 & 31-3-07

Particulars	Schedule	Current Year 31-3-07 Amt (Rs)	Previous Year 31-3-06 Amt (Rs)
Premium earned	1	63,23,280	54,21,720
Interest, dividend & rent		3,30,000	
Total (A)		**66,53,280**	**54,21,720**
Claims incurred	2	16,83,550	9,54,250
Commission	3	3,88,500	2,45,500
Operating expenses related to marine business	4	20,08,000	18,36,000
Total (B)		**40,80,050**	**30,35,750**
Operating profit from marine business [C= A–B]		25,73,230	23,85,970

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS
SCHEDULE 1
Premium Earned (net)

Particulars	Current Year 31-3-07 Amt (Rs)	Previous Year 31-3-06 Amt (Rs)
premium from direct business	66,00,000	65,00,000
Add: premium on reinsurance accepted	10,80,000	10,00,000
Less: premium on reinsurance ceded	(12,10,000)	(11,61,000)
Net premium (A)	**64,70,000**	**63,39,000**
Adjustment for change in reserve for		
Unexpired risks		
Add reserve for unexpired risks at the beginning of the year	63,39,000	55,20,000
Additional reserve to the beginning of the year	7,60,680	6,62,400

(B)	**70,99,680**	**61,82,400**
Less reserve for unexpired risks at the end of the year	64,70,000	63,39,000
Additional reserve at the end of the year	7,76,400	7,60,680
(C)	**72,46,400**	**70,99,680**
Total premium (A + B - C)	63,23,280	54,21,720

SCHEDULE 2

Claims Incurred (net)

Particulars	31-3-07 Rs.	31-3-06 Rs.
Claims paid	15,64,750	8,38,750
Add outstanding at the end of the year	6,11,050	4,92,250
Less outstanding at the beginning of the year	(4,92,250)	(3,76,750)
Total claims incurred	16,83,550	9,54,250

SCHEDULE 3

Commission

Particulars	31-3-07 Rs.	31-3-06 Rs.
Commission paid Direct	3,77,500	3,50,000
Add re-insurance accepted	2,75,000	2,47,500
Less re-insurance ceded	(2,64,000)	(3,52,000)
Net commission	3,88,500	2,45,500

SCHEDULE 4

Operating Expenses Related to Insurance Business

Particulars	31-3-07 Rs.	31-3-06 Rs.
Employees salary	14,85,000	13,75,000
Repairs and maintenance	92,000	83,000
Printing charges	89,000	72,000
Audit fees	50,000	35,000
Managers salary	65,000	55,000
Miscellaneous expenses	63,000	66,000
Depreciation office building	50,000	40,000
Total	20,08,000	18,36,000

Illustrations 9

Akbar Ali General Insurance Company Ltd. furnishes you the following balance as on 31st March 2009. you are required to prepare **i)** fire revenue account **ii)** marine revenue account **iii)** profit and loss account and **iv)** Balance Sheet as per the requirements of law.

Particulars	Amount (Rs. in '000)		
	Fire	marine	
Expenses of management	500	600	
Commission paid	823	752	
Commission on reinsurance ceded	316	471	
Claims paid less reinsurance	7,131	9,016	
Claims O/S (as on 31-3-09)	240	273	
Premium less reinsurance	13,356	17,841	
Reserve for unexpired risks (as on 31-3-08)	11,100	13,260	
Additional reserve (as on 31-3-08)	1,110	1,326	
Audit fees	52	65	
Directors sitting fees		44	
Income from Investment			826
Share transfer fees			110
Borrowings from banks			218
Bank balances			1,516

Cash balances			189
Deposits held on reinsurance companies			143
Outstanding premium			2,100
Advances to banks and financial institution			2,901.25
Agents balances			510
Sundry debtors			990
Sundry creditors			281
Advances to directors			122
Investments			
Government securities			17,102.4
Other approved securities			12,771.35
Equity shares			1,000
Mutual fund			1,200
General reserves			920
Other reserves			116
Furniture and fittings			800
Building			1100
Deposits with RBI			373
Share capital			1,000

Adjustments

1. Share capital consists of 30,000 equity shares of Rs. 100 each. Issued, subscribed and called-up 20,000 equity shares of Rs. 50 each.

2. The company directors declared dividend at 10% out of profits earned during the year.

3. Expenses of management include surveyor fees and legal expenses of Rs. 82,000 and Rs. 64,000 respectively relating to fire insurance claims

4. Provision for tax is to be made at 30%

5. The reserves for unexpired risk to be created at 50% of net premium income for fire insurance and at 100% of net premium income for Marine Insurance as on 31st March 2009. Addition reserve for fire and Marine Insurance is to be maintained at 15% and 10% of net premium income.

Solution

Akbar Ali General Insurance Co. Ltd.
Revenue A/C for the year ended as on 31-3-09

Particulars	Schedule	Amount (Rs. in '000)	
		Fire	Marine
premiums earned net	1	16,884.6	12,801.9
Total (A)		**16,884.6**	**12,801.9**
Claims incurred (net)	2	7,517	9,289
Commission	3	507	281
Operating expenses related to	4	409	709
Insurance Business			
Total (B)		**8,433**	**10,279**
Operating profit from fire and marine business (C = A – B)		8,451.6	2,522.9

Profit & Loss A/C for the year ended on 31-3-09

Particulars		31-3-09 amount (Rs. in '000)
Operating profit		
Fire insurance	8,451.6	
Marine insurance	2,522.9	10,974.50
Income from investments		826
Total (A)		**11,800.50**
Other expenses		
Share transfer fees		110
Total (B)		**110**
Profit before tax		11,690.50
Provision for tax (30%)		3,507.15
Profit after tax		8,183.35
Appropriations		
Proposed final dividend		100
Balance, carried forward to balance sheet		8,083.35

Balance Sheet as at 31st March 2009

Particulars	Schedule	Amount (Rs. in '000)
Sources of fund		
Share capital	5	1,000
Reserves and surplus	6	9,119.35
Borrowings	7	218
Total		**10,337.35**
Application of funds		
Investments	8	32,073.75
Loans	9	2,901.25
Fixed assets	10	1,900
		36,875
Current Assets		
Cash and Bank Balance	11	1,705
Advances and other assets	12	4.095
Sub total (A)		**5,800**
Current liabilities	13	424
Provisions	14	31,913.65
Sub total (B)		**32,337.65**
Net current assets (C= A – B)		(26,537.65)
Total		10,337.35

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS

SCHEDULE 1
Premium Earned (net)

Particulars	31-3-09 Amount (Rs. in '000)	
	Fire	Marine
Premium less reinsurance	13,356	17,841
Adjustments for change in reserves for unexpired risks		
Add reserve for unexpired risks (1-4-08)	11,100	31,260
Additional reserve (1-4-08)	1,110	1,326
	25,566	32,427
Less reserve for unexpired risks (31-3-09)	6,678	17,841
Additional reserve (31-3-09)	2,003.4	1784.1
	(8,681.4)	(19,625.1)
Total premium	16,884.6	12,801.9

SCHEDULE 2

Claims Incurred (net)

Particulars		31-3-09 Amount (Rs. in '000) Fire	marine
Claims less reinsurance		7,131	9,016
Add claims O/S at the end		(240)	273
Add surveyor fees	82		
Legal expenses	64	146	
		7,517	**9,289**

SCHEDULE 3

Commission

Particulars	31-3-09 Amount (Rs. in '000) Fire	marine
Commission paid	823	752
Less commission on reinsurance ceded	(316)	(471)
Net commission	**507**	**281**

SCHEDULE 4

Operating Expenses Related to Insurance Business

Particulars		31-3-09 Amount (Rs. in '000) Fire	marine
Expenses of management		500	600
Less surveyors fees	82		
Legal expenses	64	146	
Auditors fees		52	65
Directors sitting fees			44
Total		**406**	**709**

SCHEDULE 5

Share capital

Particulars	Amount (Rs. in '000)
Authorized capital	
30,000 equity shares of Rs. 100 each Issued, subscribed and called-up capital	3,000
20,000 equity shares of Rs, 50 each	1,000
Total	**1,000**

Schedule 6

Reserves and Surplus

Particulars	Amount (Rs. in '000)
General reserves	920
Other reserves	116
Balance of profit in profit & loss A/C	8,083.35
Total	**9,119.35**

SCHEDULE 7

Borrowings

Particulars	Amount (Rs. in '000)
Borrowings from banks	218
Total	**218**

SCHEDULE 8
Investments

Particulars	Amount (Rs. in '000)
Government securities	17,102.40
Other approved securities	12,771.35
Equity shares	1,000
Mutual fund	1,200
Total	**32,073,75**

SCHEDULE 9
Loans

Particulars	Amount (Rs. in '000)
Advances to banks and Financial Institutions	901.25
Total	**901.25**

SCHEDULE 10
Fixed Assets

Particulars	Amount (Rs. in '000)
Buildings	800
Furniture and fittings	1,100
Total	**1,900**

SCHEDULE 11
Cash and Bank Balances

Particulars	Amount (Rs. in '000)
Cash	189
Bank Balance	1,516
Total	**1,705**

SCHEDULE 12
Advances and other Assets

Particulars	Amount (Rs. in '000)
Advances to directors	122
Outstanding premiums	2,100
Agents balances	510
Deposits with RBI	373
Sundry debtors	990
Total	**4,095**

SCHEDULE 13
Current Liabilities

Particulars	Amount (Rs. in '000)
Deposits held on re-insurance ceded	143
Sundry creditors	281
Total	**424**

SCHEDULE 14
Provisions

Particulars	Amount (Rs. in '000)
Reserve for unexpired risk	
Fire Rs. 8,681.4	
Marine Rs. 19,625.1	28,306.5
Tax provision	3,507.15
Proposed dividends	100
Total	**31,913.65**

Illustration 10

From the following figures appearing in the books of Ayush General Insurance Company Ltd. carries on fire insurance business, show the final accounts for the year ended on 31st March 2009.

A. Items directly related to Fire Insurance business

Electricity charges	525
Communication	490
Salaries to staff	2,000
Depreciation	500
Interest and dividend received rent received on accommodation	493
Facilities provided to employees	247

B. Items indirectly related to Fire Insurance business

Refund of double taxation	230
Miscellaneous receipts	115
Professional tax	150
General charges	110
Loss on realization on investment	799
Auditors fees	100
Other common items	
Claims paid on direct business	8950
Amount due to reinsure	4870
Sundry creditors	961
Commission paid on direct business	490
Investment in government bonds	9885
Investment in infrastructure bonds	3365
Commission on reinsurance accepted	250
Claims paid on reinsurance	1306
Reserve for unexpired risk	10,000
Additional reserve	2100
Premium less reinsurance	17500
Share capital	18500
Outstanding claims at the beginning of the year	725
Advance to directors	6500
Application money for investment	8500
Lease hold property	865
Vehicles	207
General reserve	2499
Investment fluctuation reserve	1090
Loans given to other company	700
Agents balance (Dr)	5000
Balance due from reinsure	4050
Bank balance	4100
Cash balance	488

Adjustments

1. Transfer 20% to general reserve from current year profit
2. Rs. 110 income tax deducted at source from interest and dividend received
3. The market value of investment is Rs. 11790
4. Outstanding claims due as on 31st March 2009 Rs. 644
5. It is the policy of the company to maintain 50% of net premium towards reserve for unexpired risk and additional reserve to be increased by 10% of net premium for the year ended on 31st March 2009.

Solution

Ayush General Insurance Company Ltd. Revenue Account for the year ended 31st March 2009

Particulars	Schedule	Amount (Rs)
Premium earned net	1	17000
Interest, dividends and rent gross (493 + 247 + 110)		850
Total (A)		**17850**
Claims incurred (net)	2	10175
Commission	3	740
Operating expenses related to Insurance Business	4	3515
Total (B)		**14430**
Operating profit from fire insurance business C = (A – B)		3420

Profit and Loss Account for the year ended 31st March 2009

Particulars	Amount (Rs)
Operating profit from fire insurance	3420
Income from investments : Loss on realization of investment	(799)
Refund of double tax	230
Other income	
Miscellaneous receipts	115
Total (A)	**2966**

Provisions	
Additional provision for investment	370
Other expenses	
Professional tax	150
General charges	110
Auditors fees	100
Total (B)	**730**
Profit before tax (Total A – Total B)	2236
Appropriations	
Transfer to general reserve (20%)	447.2
Balance carried forward to balance sheet	1788.8

Balance Sheet as at 31st March 2009

Particulars	Schedule	Amount (Rs)
Sources of fund		
Share capital	5	18500
Reserves and Surplus	6	6195
Borrowings	7	
Total		**24695**
Application of funds		
Investments	8	13250
Loan	9	700
Fixed assets	10	1072
Total		**15022**
Current Assets		
Cash and bank balance	11	4588
Advance and other assets	12	24050
Subtotal (A)		28638
Current liabilities	13	6475
Provisions	14	12490
Subtotal (B)		18965
Net current asset (C) = (A – B)		9673
Total		**24695**

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS

SCHEDULE 1
Premium Earned (net)

Particulars		Amount (Rs.)
Premium less: reinsurance		17500
Adjustment for change in reserve for unexpired risks		
Reserve for unexpired risk at the beginning of the year	10,000	
Additional reserve	2100	12,100
Less: reserve for unexpired risk at the end of the year	8750	
Additional reserve (2100 + 1750)	3850	(12,600)
Total premium earned (net)		**17000**

SCHEDULE 2
Claims incurred (net)

Particulars	Amount (Rs.)
Claims paid on direct business	8950
Add: re-insurance accepted	1306
Net claims paid	10256
Add : claims O/S at the end of the year	644
Less : claims O/S at the beginning	(725)
Total claims incurred	**10175**

SCHEDULE 3
Commission

Particulars	Amount (Rs.)
Commission paid on direct business	490
Add: re-insurance accepted	250
Net commission	740

SCHEDULE 4
Operating Expenses Related to Insurance Business

Particulars	Amount (Rs.)
Salaries to staff	2000
Communication	490
Electric charges	525
Depreciation	500
Total	**3515**

SCHEDULE 5
Share Capital

Particulars	Amount (Rs.)
Authorized, issued and paid up equity share capital	18500
Total	**18500**

SCHEDULE 6
Reserves and Surplus

Particulars		Amount (Rs.)
General reserve	2499	
Add: transfer from P & L account	447.2	2946.2
Investment fluctuation reserve	1090	
Add: additional provision	370	1460
Balance of profit in P & L account		1788.8
Total		**6195**

SCHEDULE 8
Investments

Particulars	Amount (Rs.)
Investment in government bonds	9885
Investment in infrastructure bonds	3365
Total	**13250**

SCHEDULE 9
Loans

Particulars	Amount (Rs.)
Loans given to other company	700
Total	**700**

SCHEDULE 10
Fixed Assets

Particulars	Amount (Rs.)
Leasehold property	865
Vehicles	207
Total	**1072**

SCHEDULE 11
Cash and bank balance

Particulars	Amount (Rs.)
Cash balance	488
Bank balance	4100
Total	**4588**

SCHEDULE 12

Advances and other Assets

Particulars	Amount (Rs.)
Application money for investment	8500
Advances to directors	6500
Agents balance	5000
Due from re-insurer	4050
Total	**24050**

SCHEDULE 13
Current Liabilities

Particulars	Amount (Rs.)
Balance due to other reinsure	4870
Sundry creditors	961
Outstanding claims	644
Total	**6475**

SCHEDULE 14
Provision

Particulars	Amount (Rs.)
Reserve for unexpired risk	12600
Less: tax deducted at source	(110)
Total	**12490**

3.11 SUMMARY

Insurance is a contract of indemnity whereby the insurer undertakes inconsideration for a fixed sum of money, to make good the loss suffered by the insured against a specified risk or any other contingency.

The business of insurance in India is governed by The Insurance Act, 1938 and regulated under the framework of Insurance Regulation and Development authorities Act, 1999.

In case of life insurance a specified amount becomes payable on the death of the insured or on maturity of the policy. General insurance covers losses caused by fire, accident and loss incidental to marine business.

The insurance companies in India need to maintain statutory books i.e. register of agents. Besides these books they also maintain subsidiary books i.e. ledgers, journal cash book etc.

There are some important terms related to Insurance Business.

Premium is the amount paid by the policy holder to the insurance company at regular intervals or at one stroke

Claims is the amount payable by an insurer against the policy either on maturity or on the death of the policy holder.

Re-insurance, the insurance company transfer part of its risk on another insurance company in an anticipation for commission against it, is known as reinsurance.

Annuities is a fixed sum of money which the insurance company pays periodically in a series to policy holder in return for a lump sum paid in advance.

Reserve for unexpired risk: In case of general insurance, the reserve for unexpired risk is created every year against the premium received in advance, in order to meet any loss that may raise on any day during the lifetime of policy. The reserve for unexpired risk should be 50% of net premium in case of fire and other miscellaneous insurance and 100% of net premium in case of marine insurance business.

The life insurance companies prepare its revenue account in form A-RA, profit and loss account in form A-PL and balance sheet in form A-BS where as general insurance companies prepare its revenue account in form B-RA, profit and loss account in form B-PL and balance sheet in form B-BS as prescribed in the Act . separate revenue account is prepared for fire insurance, marine insurance and other miscellaneous insurance.

3.12 EXERCISE

Fill in the blanks :

1. The life insurance Fund account appears on the ___________ and the various securities that represent the investment of life insurance fund appear on the ______________ .
2. Premium received for the first time of each insurance policy is separately recorded in the _____________ book.
3. ____________ book is maintained to record second and subsequent premium received after the first one.
4. The ceding company which gives business to a reinsurance company is to receive commission from the later known as ______________ .

5. The revenue account of a insurance company is to be prepared in accordance with provisions of ______________ .
6. The details of commission expenses of a general insurance company is shown under ________________.
7. Balance sheet of insurance company is prepared in _______________ as prescribed by IRDA.
8. The reserve for unexpired risk in case of Fire and miscellaneous business is _________________ of the net premium.
9. In case of general insurance business, a reserve for ______________ is created every year so as to as certain the profit.
10. ______________ means the business of effecting contracts of insurance other than life insurance, fire insurance and marine insurance.

Answers :

1. liabilities side, assets side;
2. new premium book;
3. Revenue premiums
4. reinsurance leded
5. IRDA regulations 2002
6. schedule – 3
7. vertical format
8. 50%
9. unexpired risk
10. miscellaneous insurance business

2. True or False :

1. A life insurance company maintenance life insurance fund ledger, revenue ledger and miscellaneous ledger.
2. In case of a 'without profits' policy, the policy holder gets the amount specified in the policy plus bonuses declared on each valuation.
3. Reinsurance is the insurance of an already insured risk.
4. The annuity paid during the lifetime of the policy holder, it is called perpetuity.
5. The major sources of income of a life insurance company are in the nature of interest / divided on securities and rent from properties let out.
6. The main purpose of preparing profit and loss account of Life Insurance Company is to show in a summarized form the

income and expenditure relating to life insurance business during on accounting period.

7. The major items of expenditure of a general insurance company are the payment of claims.
8. In case of general insurance business a common revenue account is prepared for fire, marine and other miscellaneous insurance business.

Answers : 1-T, 2-F, 3-T, 4-T, 5-F, 6-F, 7-T, 8-F

3) Match the following :

I)

1) Investment of policy holder	A) Schedule -5
2) Share holder's fund	B) Schedule – 8
3) Employees' remuneration & welfare benefits of life insurance business.	C) Schedule – 8A
4) Investments of share holders fund	D) Schedule – 3
5) Claims incurred in general insurance business	E) Schedule – 6
6) Reserve for unexpired risk	F) Schedule - 6
	G) Schedule - 14

Answers : 1-C; 2-A; 3-D; 4-B; 5-E; 6-G

II)

1) Statutory books	A) Form B-Bs
2) Revenue account of life insurance business	B) Income and Expenditure ledger
3) Balance sheet of general insurance business	C) Expenditure Cash book
4) Cash book	D) Register of Agents
	E) Form A-RA
	F) Form A-BS

Answers : 1-D; 2-E; 3-A; 4-C;

4) Explain the following terms :

i) Annuities
ii) Whole –life and endowment policies
iii) With profit and without profit polices

- **iv)** Bonus in reduction of premium
- **v)** Statutory books
- **vi)** Schedule
- **vii)** Commission Expenses

5) Answer the following :

- **i)** Explain the forms and requirements of preparing final accounts of life insurance business.
- **ii)** Write a brief note on 'valuation Balance Sheet'
- **iii)** Distinguish between life insurance and General insurance business.
- **iv)** Explain the preparation of revenue account of general insurance business.
- **v)** What is 'Reserve for unexpired risk'?

6) Jagrut Life Insurance company Ltd. provides the following information and ask to prepare valuation balance sheet and profit distribution statement for the year ended on 31st March 2008. Also given journal entries.

	Amount (Rs.)
life insurance fund as on 1-4-2007	5,51,595
Interim bonus paid	82,500
Balance of revenue account as on 31-3-2008	7,92,000
Net liability as per valuation as on 31-3-08	5,44,500

The company declared reversionary bonus of Rs. 210 per Rs. 1,000 and gave the policy holder an option to take bonus in cash Rs. 120 per Rs. 1,000. Total business of the company was Rs. 22,44,000. The company issued with-profit policy only, ¾ of policy holder in value opted for cash bonus.

Answer : Amount due to policy holders Rs. 2,31,000.

7) Prepare revenue account of Manorama Life Insurance Company for the year ended 31st March 2006. Also prepare valuation Balance Sheet.

Particulars	Amount (Rs.)
Claims by death	5,32,980
Pension payment	2,10,770
First year premium	9,87,966

Renewal premium	39,51,864
Consideration for annuity granted	5,74,889
Claims by death paid against reinsurance accepted	3,74,227
Transfer fees received	903
Balance of life insurance fund at the beginning of the year	1,06,47,000
Expenses of management	2,23,440
Bonus paid in cash	16,912
Commission	67,018
Dividend paid to shareholders	38,500
Interest and dividend received	6,84,880
Income tax	24,99,740
Surrenders	91,980
Bonus in reduction of premium	6,860
Net liability as per valuation as on 31st March 2006	77,35,000

Answer : Balance of life insurance fund as on 31-3-06 Rs. 15,07,3,345**,** Surplus Rs. 73,38,345

8) Niraj Life Insurance company Ltd. provides the following balances as on 31st March 2009. You are required to prepare Revenue account, profit and loss account and vertical Balance sheet as on that date.

Debit balances	Amount (Rs.in '000)
Sundry debtors	6,300
Advances to directors	33,000
Deposits with RBI	13,050
Repairs and maintenance	300
Advertisement and publicity	1,230
Commission paid for renewal premium	2,328
Commission on reinsurance accepted	1,871.7
Interim Bonus paid	6,300
Provision for doubtful debts	1,050
Surrenders	15,750
Communication	360
Auditor fees related to insurance matters	750
Outstanding premium	9,963
Money at call and short notices	12,999

Office equipment	6,000
Leasehold property	19,500
Underwriting commission	330
Insurance claims by maturity	70,257
Insurance claims by deaths	22,992
Investment in approved securities	68,253
Investment in debentures	32,430
Re-insurance accepted claims by maturity	24,357
Loans against mortgage of property	33,029.7
Amount due from other insurance company	9,900
Total	**3,92,300.4**

Credit balances	Amount (Rs.in '000)
Surplus on revaluation of reversions	7,341
Balance due to other insurance company	5,183.4
Commission on reinsurance ceded	1,779
Renewal premium	1,58,832
Single premium	33,000
Deposits held on reinsurance ceded	10,173
Claims by maturity against reinsurance ceded	6,372
Share capital	60,000
Borrowings from Indraprasad bank	14,850
Premium deposits	20,160
Profit on sale of investment	1,050
Balance of account at the beginning of the year	58,560
General reserves	15,000
Total	**3,92,300.4**

Adjustment :

1. Issued, subscribed and paid up capital, 6,00,000 Equity shares of Rs. 100 each.
2. Bonus utilized in reduction of premium Rs. 57,31,000.
3. Guarantees given by or on behalf of the company Rs. 87,50,000.
4. Outstanding advertisement and publicity 8,10,000 and prepaid communication charges Rs. 2,49,000.

5. Interest and rent accrued Rs. 17,70,000.
6. Allocate 20% of surplus to general reserves.

Answer : Balance of fund as per revenue account Rs. 4,96,29,840.Total sources / application of fund as per vertical balance sheet Rs. 23, 02,77,300.

9) As per General Insurance Company Ltd. furnishes you with following balances of its Fire insurance business as on 31st March 2005

Debit balances	Amount (Rs.in '000)
Mutual fund	339
Survey expenses related to claims	33
Training provided to employees in respect of insurance	53
Investments : Equity shares of Aryan Company Ltd.	1,441
Claims less reinsurance	46
Other approved securities	1,990
Commission on direct business	14
Bad debts	13
Director's setting fees related to insurance business	45
Furniture and fittings	180
Claims o/s at the end	13
Land and building	210
Loss on sale of investment	62
Printing and stationery expenses incurred for insurance	29
Cash and bank balance	101
o/s premium	73
Newspapers and periodicals	15
Sundry debtors	29
Miscellaneous expenses	25
Depreciation on furniture	36
Interest and bank charges	61
Total	**4,808**

Credit balances	Amount (Rs.in '000)
Amount due to directors	77
Share capital	750
Premium less reinsurance	1,889
Investment fluctuation reserve	363
Reserve for unexpired risk	990
Dividend received on Equity shares held	48
General reserve	310
Borrowings from ABC Ltd.	69
Additional reserves	85
Other reserve	85
Interest received on approved securities	110
Claims o/s at the beginning	32
Total	**4,808**

Adjustments :

1. Provision for tax to be made at 50%
2. Income Tax deducted at source from interest and dividend received Rs. 52,000.
3. Market value of investment as on 31st March 2005 is as follows :

   Equity shares of Aryan Company Ltd. Rs. 11,30,000; mutual fund Rs. 3,10,000 and other approved securities 18,00,000.
4. Provide for unexpired risk at 50% of net premium and additional reserve at 12% of net premium.

You are required to prepare :

Revenue account, profit and loss account and Balance Sheet as per the prescribed form.

Answer :

Operating profit from Fire insurance business Rs. 15,91,820.
Profit & Loss account balance Rs. 7,11,410.
Total sources / Application of fund Rs. 24,55,410

10) Gold General Insurance Company carries marine insurance business and provides the information of its business as on 31st March 2010.

Debit balances	Amount (Rs.in 100)
Establishment expenses	34,300
Contribution to provident fund	28,400
Rent paid	25,110
Depreciation on motor car	9,500
Claims paid directly	1,20,670
Commission	65,450
Income tax on interest	3,190
Investment : real estate	8,00,000
National saving certificate	3,68,060
Shares in companies	1,50,000
o/s premium	83,000
Fired deposit with Aruna bank	50,000
Agents balances	60,000
Cash balances	29,600
Building	2,50,000
Directors traelling expenses	1,500
Printing and stationery	8,100
Motor car	1,10,000
Total	**21,96,880**

Credit balances	Amount (Rs.in 100)
Interest rent and dividend received	88,270
Bad debts recovered	10,000
Reserve for unexpired risk	1,45,810
Additional reserve	76,790
Premium less reinsurance	3,04,810
Claims o/s at the beginning of the year	2,200
Miscellaneous receipts	3,000
Share capital	10,00,000
Employees security deposits	33,000
Contingency reserve	2,00,000
General reserve	2,50,000
Other reserve	83,000
Total	**21,96,880**

Additional Information :

1. Equity share capital consist of 10,000 shares of Rs. 100 each.
2. Depreciation on building Rs. 25,000 is to be provided.
3. Direct claim includes Rs. 45,000 covered by reinsurer.
4. Provision for unexpired risk to be made at 100% of net premium and additional reserve to be raised by 5% or net premium.

Prepare revenue account, profit & Loss account and vertical Balance Sheet as at 31st March 2010.

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4

ACCOUNTING FOR CO-OPERATIVE SOCIETY

Unit Structure

4.1 INTRODUCTION

Co-operative society came into existence due to the exploitation of the economically and socially weaker section of the society; by manufactures / big businessmen / whole / Retailers.

The Co-operative movement first started in Europe; particularly in England and Germany.

When weaker section of society are finding out difficult with less earning; they were organised them self for mutual help. These organizations lead to firm a Co-operative society.

In Maharashtra Co-op movements, give way to Co-op. Sugar Factories, Left Irrigation, and Co-op Housing Society.

A Co-operating society is a voluntary organisation formed for the purpose of promoting & protecting interest of its members. The main objective of Co-operative society is to protecting interest of its members. it does earn profit which may be partly distributed among its members and partly kept as reserves.

A Co-operative society can be defined as an association of people usually of a limited means, who have voluntarily joined the organisation making equitable contribution to the capital required and excepting a share and risks and benefits of the organisation. Normally a Co-operative society is a service organizations is not interested in making profit.

A Co-operative society is most important form of organisation in Indian economic screen. Co-operative societies are covered by different state Laws which differs from state to state. In Maharashtra, we have State Co-operative Societies Act & Rule 1961.

4.2 MAHARASHTRA STATE CO-OPERATIVE SOCIETIES ACT

The Co-operative Credit Societies Act, 1904 was first Law was comes in forces. At present, Co-operative societies are established in numerous economic activities such as : Banking, farming, credit, housing, marketing, consumer co-op, etc. There has been a central legislation, i.e. The Co-operative societies Act, 1912. However, most of states have enacted their separate Co-operative societies Act. In state of Maharashtra have separate Act, known as The Maharashtra Co-operative Societies Act, 1960. The Maharashtra Co-operative societies Rules 1961 and Maharashtra Ownership Flats Act, 1963.

These Acts has define various important terms, Accounting system and final Accounts format and so on.

4.2.1 Definitions :

Under Maharashtra Co-operative societies Act.

1) Co-operative Society : Under section 2(27) of the Act Society means a co-operative society registered or deemed to be registered under this Act. Co-operative society is distinct from its members.

2) Members : Member means a person joining in an application for the registration of a Co-operative society which is subsequently registered or a person dually admitted to a membership of existing society and includes associate member or nominal member.

a) Associate Member means a member who holds jointly a share of society with others. such members name appears in share certificate subsequent to the name of member. (i.e. 2nd name)

b) Nominal member means a person admitted to membership as such after registration in accordance with its Laws.

c) Sympathizer member means a person who sympathies with aims and objects of the society.

3. Co-operative Year : The Act has Fixed 30th June, as accounting year. However most of societies, with prior approval of Registrar of Co-operative society follows 31st March, (i.e. financial year) as the year ending to confirm with Income Tax Act. On March 31st.

4. Working Capital : Under section 2(31) of the Act, working capital means funds at the disposal of society inclusive of paid-up share capital, funds built up out of profits a money raised by borrowing & other means.

5. Bye Law : Under Section 2(5) Bye Law means bye-law registered under Act for the time being in force and includes registered amendments of such bye law. The provisions of bye laws can not be contrary to the provisions of Co-operative society Act. The bye laws generally includes various provisions relating to internal management & object of society.

The Bye-laws generally includes the following clauses for internal management of Co-operative society.

a) Name and Address
b) Area of operation
c) The manner in which the funds of society raised and limits of its funds.
d) Objects of society
e) Minimum amount of share capital held by each member.
f) Terms and Qualifications for admissible to a member.
g) Nomination to be made by existing member.
h) Right, duties and liabilities of member as well as its managing committee members.
i) Maximum Loan admissible to a member.
j) Disposal of net profit.
k) Responsibility for maintaining and preserving the records.

Audit : As per Rule 69 of Co-operative society audit shall be conducted by the certified auditors. The certified auditors includes the following :

a) Practing Chartered Accounts.
b) A person holding Government diploma in Co-operative dept. of accounts & audits.
c) Retired officers of the state Government Co-operative department of accounts & audit.

4.2.2 Management and Administration

In any Co-operative society, it is not possible that members should look for day to day administration like a company, management of the day to day vests in the hands of managing committee. (sec. 73), however some powers are vested in General Body.

- General Body : General Body of Co-operative society is Final Authority. The following important powers are only with General Body.

1. Amalgamation of one society with other society.
2. Amendment of bye-laws by 2/3 majority.
3. Adoption of accounts, appropriation of profits.
4. Sanction of written off the Bad debts and Loss.

- Managing Committee : Members of society elects some members and form managing committee, to look for the whole of the day to day management of society. For division of labour, different sub-committees are formed such as purchase committee, Repair & maintenance committee, Accounts committee etc. as per need & type of the society.

The administrative functions includes following :

a) Proper custody and maintenance of records as well as properties of society.
b) To summon all meetings, including Annual General Body and records the proceedings.

4.2.3 Accounting System :

The Accounting System of Co-operative societies are on same time than of any commercial system.

Rule No. 65 of Maharashtra Co-operative societies Act gives a specific list of the following books to be maintain by society.

- **Accounting Books / Records**

- Cash Book
- General Ledger & Personal Ledger
- Stock Register
- Property Register.

b) Register of members.
c) Minutes Books.

And any other register which may be require as per needs of society as well as which are specified by the Government.

4.2.4 According to Rule 61 of the Act, & Rules; the society has to prepare, financial statements within 45 days of the close of accounting year. It contains.

i) Receipts & disbursement A/c
ii) Profit & Loss A/c
iii) Balance Sheet

Rule 62 provides prescribed form of financial statement (in form N)

4.3 STATUTORY FORMATS OF FINAL ACCOUNTS

I) Trading A/c : There is no prescribed format for trading A/c. it should prepared in the usual manner disclosing gross profit or gross loss as the case may be.

FORMAT OF PROFIT AND LOSS A/C (N TYPE)

Particulars	Amt.	Amt.	Particulars	Amt.	Amt.
To Gross Loss (if any)	--	--	By Gross Profit (if any)	--	--
To Interest Paid	--	--	By Interest Recd. On Loans/investment	--	--
Add : Outstanding	--	--	By Dividend on Shares		
Less : Prepaid	--	--	By other Incomes -	--	--
To Bank Charges	--	--	a) Share Transfer fee		
To Salaries and Allowances	--	--	b) Rent Received	--	--
To Contribution	--	--	c) Discount and Interest Received		
To Provident Fund	--	--	d) Income from sale of Forms		
To Managing Director’s	--	--	e) Sundry Income		
Allowance and Salaries	--	--	By Net Loss transferred		
To Managing Committee’s Remuneration	--	--		--	--
To Rent, Rates & Taxes	--	--		--	--
To Postage and Telegram	--	--			

To Audit Fees To Printing & Stationery To Supervision Charges To Depreciation on Assets To Reserve for Doubtful Debts To Other Expenses & Fees, if any To Net Profit transferred	-- -- -- -- -- -- --	-- -- -- -- -- -- --			

Balance Sheet (N Type)

Fig. of Previous Year	Liabilities	Amt.	Fig. of Previous Year	Assets	Amt.
--	**Share capital**	--	--	**Cash Balance**	--
	Authorized, Issued & paid-up			On hand	
	Purchased by the Government			At Bank	
	Purchased by Co-operative Societies			(also called Deposits)	
	Purchased by individuals		--	**Investments**	--
	Shares in Advance			Government Securities	
--	Less : Calls in Arrears			Shares in Co-operative institutions	
	Add : Calls in Advance			Fixed Deposits with Banks	
	Subscription / Deposits towards Shares		--	**Provident Fund Investment**	--
--	**Reserve Fund and**			(including advances to provident fund)	
--	**Other Funds, And**	--	--	**Loans & Advances**	--
	Reserve Fund			Loans	
	Building Fund			Cash Credits	
	Development Fund			Dues from the Managing Committee	

	Reserve for Doubtful Debts			Dues from Employees	
	Depreciation Fund		--	**Sundry Debtors**	--
	Dividend Fund			For Credit Sales	
	Bonus Equalisation Fund			For Advances	
	Other Equalisation Fund			**Current Assets**	--
--	**Staff Provident Fund**			Tool and equipments	
	Debentures			Closing Stock	
	Cash Credit			Work in Progress	
	Overdrafts		--	**Fixed Assets**	
	Loans			Land and Building	
	Government Loans			Plant & Machinery	
	Other Secured Loans			Livestocks	
--	**Unsecured Loans**	--		Deadstocks	
	From Banks			Vehicles	
	From Government		--	**Other Expenses &**	--
	Bills Payable			Losses (not written off)	
	Others			Preliminary Expenses	
--	**Deposits**			Advances	
	Fixed Deposits			Payment of Taxes	
	Savings Deposits			Goodwill	
--	Recurring Deposits			Deferred Revenue Expenses	
	Other Deposits			Expenses in connection with issue of Debentures	
--	**Current Liabilities & Provisions**	--	--	**Other Debtors**	--
	Sundry Liabilities			Advances paid	
	Outstanding Salaries etc.			Interest Accrued but not received	
	Advances			Other Dues	
--	**Unclaimed Dividend**	--	--	**Losses**	

--	**Interest due but not paid**	--		**Add :** Current Loss	--
--	**Other Liabilities**	--			
--	**Profit & Loss Appropriation**	--			
	Opening Balance				
	Add : Current years profit				

e) Section 66 requires the societies to maintain Reserves fund, by transferring annually 25% of net profit.

f) Rule 52 empowers the society to create Bonus/Dividend Equalisation fund, amount not exceeding 2% of paid up capital may be transferred each year, however accumulated balance should not exceed 9% of paid up capital.

g) Any society should not pay dividend exceeding 15% of the capital. However, after getting approval from registrar of co-operative societies. Society can pay higher rate of dividend.

h) Section 69 of the Act provider that society may set aside amount not exceeding 20% of the net profit for charitable purpose.

i) Investment of funds.

Section 70 provides that funds of co-operative society shall be invested in a specific form only as given below.

i) Central Bank or State co-operative Bank.

ii) Trust Securities

iii) Any security issued by other societies having limited liabilities.

iv) Co-operative Bank

v) Specified by order of the Government.

4.4 TYPES OF CO-OPERATIVE SOCIETIES :

The Maharashtra Co-operative societies Act classifies societies under various categories as under :

4.4.1 Credit Co-operative Society :

This is oldest type of co-operative in India. It come into existence around 1904 with the passing of co-operative societies Act 1904.

The main purpose of this type of societies is to provide loans to members, at low rate of interest.

4.4.2 Consumers co-operative society :

It is formed by consumers. The consumers co-operative society purchases in bulk and in large quantities and sells it to members / to consumers at reasonable prices and also good quality.

Therefore consumers co-operative society eliminate intermediaries between buyers and sellers / manufacturers.

Categories :

Consumers co-operative society can be classified as under :

1) Primary Consumers society :

Such societies meets needs of direct customers. The controller goods purchased from central stores to which affiliated and others in bulk purchases in open market and sales at reasonal price to members, in some cases to non-members also.

2) Central Whole Stores :

These type of society deal in whole-sale business, and fulfil the needs of primary society.

3) Departmental stores :

In cities super market / Departmental stores are set up which stock are requirement of consumers under one roof. These type of societies need substantial amount for capital.

4.4.3 Industrial Co-operative Society :

It is organised by small producers to carry out certain production activities e.g. sugar mills / milk / cotton cloths co-operative societies.

4.4.4 Agricultural Marketing Society :

i) It means that a society which is marketing agricultural produce

ii) At least ¾ of its member are agriculturist.

4.4.5 Co-operative Bank :

For doing banking business as per section 5 of Bank Companies Act. / For doing Banking business permission of R.B.I. required.

4.4.6 Co-operative Housing Societies :

These type of societies are formed for the purpose providing to its members dwelling houses or flats acquired by its members with common amenities and services. In Maharashtra house construction activities are regulated by Maharashtra Ownership Flat Act, 1963.

4.4.7 Apex society

4.4.8 Central Bank

4.4.9 Farming society

4.4.10 Crop protection society

4.4.11 Federal society: It is a society which has not less than five members are societies and has also regulated 80% of voting rights is held by co-operative societies.

4.4.12 Lift Irrigation society.

4.5 CALCULATION OF NET PROFIT:

4.5.1 Net Profit

In accordance with Rule 49 A, net profit can be arrived at, by deductions the following expanses losses from the gross profit:

1. All interest paid + Accrued
2. All establishment & administrate expenses.
3. Depreciation
4. Provision for Taxation
5. Contribution to the education fund.
6. R.D.D.
7. Contribution to the Co-operative cadre employment fund.
8. Investment fluctuation fund.
9. Provision for capital Redemption fund.
10. Provision for retirement benefits to the employees of the society.
11. Contribution to sinking fund.

Net profit plus balance of profits brought forwards from previous year, shall be available for appropriation.

4.5.2 Appropriation of profits:

As per section 65(2) states that net profit may be appropriation by society, only after its approval in General Body.

Society may appropriate its profit for transfer to Reserve fund, or any other fund, Bonus / Dividend to its members on their shares.

According section 68, every society shall contribute annually towards the education fund and Rule No. 53 prescribed the rate of contribution.

	Class of society	Rate
1	Primary Consumers society	2 ps. Per ₹ 100 of working capital, maximum ₹ 1000/-
2	Urban Credit society	10% of the working capital, subject to maximum ₹ 500/-
3	Co-operative Sugar Factory	25 ps. Per ton of sequence crused subject to maximum ₹ 25,000/-
4	Backword class Housing society class Housing society.	₹ 1, per member ₹ 10 per member
5	Urban Credit Society	$\frac{1}{10}$ % of working capital subject to a maximum of ₹ 1000.

4.6 EXPLANATIONS OF VARIOUS IMPORTANT ITEMS IN FINAL ACCOUNTS.

4.6.1 Liabilities Side :

1 Share Capital :

Contribution by government and other co-operative societies should be shown separately.

Terms of redemption or conversion of any redeemable Preference should be shown.

Calls received in advance should be added to share capital.

2 Reserve Fund & other Funds :

Funds Statutory Reserves funds and other funds should be shown separately.

Bad and doubtful Debts reserve should be shown under this head, not to deducted from sundry Debtors.

Any addition or deduction should be shown separately.

3 Secured Loans :

Nature of security should be shown in each case.

If loan have been guaranteed by government or other Co-operative society etc. should mentioned.

4 Contingent liabilities which have not been provided should be shown by way of note on liability side.

5 Credit Balance in profit & Loss A/c :

Should be shown on liabilities side at last item.

4.6.2 Assets side :

Fixed Deposits and call deposits with central Bank should be shown under heading “Investment” not as Balance with Bank.

1 Investments :

The nature of each investment and mode of valuation should be maintained.

Investment of staff P.F. is to be shown under separate heading.

Quoted and unquoted investment should be separately.

2 Sundry Debtors :

Sundry Debtors are shown under separate head, and not under the head current assets, it includes advances to members of other debtors.

3 Current Assets :

Current Assets includes various type of stock in trade; only.

Mode of valuation should be of each type of stock should be maintained.

4 Fixed Assets:

Fixed Assets are shown in order of permantancy.

Under each head, cost of fixed at the beginning of year, additions or sale if any should be mentioned. Total balance in accumulated depreciation should deduct from cost of fixed Assets.

Goodwill is not be shown as Fixed Assets. However it is to be shown under the head miscellaneous Expenses.

5 Accumulated losses, after adjusting the reserves should be shown on Assets side.

Current year losses should shown separately on Assets side.

6 Maximum cash Balance :

Rule 107 C prescribed the maximum amounts of cash allowable to be kept by different types of society. i.e. Rs. 5,000 by Sugar Factory, Rs. 300 by housing society.

7 Payment by Cheques :

As per Rule 107 D, all payments exceeding ₹ 1000 shall be made by cheques, except loan sanction to members.

8 Federation :

Housing societies have to compulsorily become member of the District Housing Federation.

4.7 APPLICABILITY OF VARIOUS TAXES :

A Co-operative society is liable to file return of income & pay income Tax if it has a taxable income.

- As all Co-operative societies are subject to audit, therefore the due date for filing return of income for them is September 30th.
- Under section 194 C, while making payments to employee, contractors etc., society should deduct Income Tax, if payments exceeds particular amount, & pay TDS to the credit of Central Government on or before 7th of the subsequent month.
- Some societies provides various services to members as well as non-members. these charges are recovered from members other persons, may be subject to service Tax. The above charges collected by society may be chargeable to service tax under the category “Club or Association service.”

- MVAT and Profession Tax – The definition of person under section 2(17) of MVAT, includes society. Thus society is a person under MVAT. If particular society is dealer a its turnover exeeds prescribed limited under MVAT, then it may required to register and pay tax.

- Similarly, a society charged in any profession, trade etc., providing services to non-members may required to obtain certificate of enrolment and pay professional Tax.

- If society have employed persons, with monthly salaries / wages exceeding 5,000 on more, than society is required to deduct profession tax and pay it to Government in such case also, society has to obtain certificate of Registration under profession Tax Act.

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4.8 SOLVED PROBLEMS

Illustration 1 :

Actual Financial statement of Ketan Co-operative Housing Society Ltd. are given herewith, to get idea about the manner in which the are prepare.

The Ketan Co-operative Housing Society Limited
Balance Sheet as on 31st March, 2011

Previous year	Liabilities	Amount Rs. & Ps.	Amount Rs. & Ps.	Previous Year	Assets	Amount Rs. & Ps.	Amount Rs. & Ps.
					Cash & Bank Balances		
20,00,000.00	Authorised Capital		20,00,000.00	3,67,138.77	Union Bank of India	17,076.27	
2,80,500.00	Issued, Subscribed & Paid up		2,80,500.00	8,663.45	Maharashtra State Co-operative Bank Ltd.	8,712.45	
	Reserve & Other Funds			63,929.90	Central Bank of India	45,482.90	
4,26,362.00	Building Repair Fund		4,26,362.00	0.00	Cash on Hand	0.00	
				4,39,732.12			71,271.62
	Reserve Fund				Investments (At Cost)		
0.00	Opening Balance	2,53,433.38			Shares Of		
2,53,433.38	Add: Trf. Fees & Admission Fees	10,500.00		100.00	Bombay Co-op. Housing	100.00	
2,53,433.38			2,63,933.38		Federation Ltd.		
	Sinking Funds			5,000.00	Maharashtra Co-op. Housing	5,000.00	
8,91,574.00	Opening Balance	9,93,472.00			Society Ltd.		
7,436.00	Add: Additions During The Year	7,436.00			Fixed Deposit with		
94,462.00	Accrued Interest On F.D.	86,176.00		2,20,302.00	Union Bank of India	2,46,541.00	

9,93,472.00			10,87,084.00		Maharashtra State Co-op.		
				10,14,800.00	Bank Ltd.	11,17,200.00	
60,004.00	Reserve for Construction Cost		60,004.00	1,56,821.00	Central Bank of India	2,13,906.00	
78,000.00	Premium shares		78,000.00	1,18,275.00	Accrued Interest on F.D.	1,07,564.00	
	Unsecured Loans			15,25,298.00			16,90,311.00
4,67,500.00	Contribution to Capital Cost		4,67,500.00	11,40,000.00	Bonds of Rural Electrification Corp. Ltd.		11,40,000.00
	Secured Loans			36,920	Accrued Interest On Bonds		37,594.00
6,27,000.00	Debentures		6,27,000.00		Loans & Advances		
					Members Dues		
	Members Contribution To:			8,95,068.00	(As Per Schedule)	11,27,760.00	
1,43,100.00	Lease Land		1,43,100.00	38,000.00	Staff Loan	31,000.00	
	Major Repairs			2,563.00	Advances Against Exp.	2,563.00	
50,473.48	Opening Balance	1,10,559.48		10,970.00	B.e.s.t. Deposit	10,970.00	
6,87,786.00	Add : Additions During The Year	1,66,000.00			Deposit With Registrar of		
7,38,259.48		2,76,559.48		1,305.00	Co-op Societies	1,305.00	
6,27,700.00	Less : Trf. To Income & Exp. A/c	2,76,559.48		5,300.00	Water Deposit With B.M.C.	5,300.00	
1,10,559.48			0.00	1,050.00	Electricity Deposit	1,050.00	
					Tax Deducted At Source	1,443.00	
	Deposit cum Advances				Fixed Assets		
2,345.00	Tax Deducted At Source	0.00		9,59,755.00	(As Per Schedule)		9,09,028.00
1,29,918.00	Payable To Contractors	0.00					
2,00,905.00	Outstanding Expenses	1,45,703.00					

3,33,168.00			1,45,703.00				
	Suspense Account (B-28)						
4,86,912	Opening Balance	7,09,240.00					
	Add						
2,22,328.00	Dues From Other Member	2,84,170.00					
7,09,240.00			9,93,410.00				
22,600	Retention Money	0.00					
35,500.00	Garbage & Debris Deposit	40,500.00					
55,000.00	Deposit for Major Repairs	90,000.00					
1,13,100.00			1,30,500.00				
	Income & Expenditure A/c						
7,38,398.39	As per Last Balance sheet	4,66,186.26					
18,778.75	Less : Deficit For the Year	1,39,677.02					
2,53,433.38	Transferred To Reserve Fund	0.00					
0.00	Add : Excess for the year	0.00					
4,66,186.26			3,26,509.24				
50,61,615.12			50,29,595.62	50,61,615.12			50,29,595.62

As Per Our Report of Even Date Attached **For The Ketan Co-operative Housing Society Ltd.**

Chartered Accountants

The Ketan Co-operative Housing Society Ltd.
Income And Expenditure Account for the year ended 31st March, 2011

Previous Year	Expenditure	Amount Rs. P.	Previous Year	Income	Amount Rs. P.
	TO PROPERTY EXPENSES			**BY CONTRIBUTION FROM MEMBERS**	
89,439.00	Municipal Taxes	98,504.00	92,719.00	Municipal Taxes	1,01,802.00
1,68,459	Water Charges	2,03,579.00	7,13,116.00	Maintenance	7,25,116.00
2,00,613.00	Electricity Expenses	2,00,233.00	2,50,396.00	Water Charges	2,10,078.00
2,56,333.00	Repairs & Maintenance	1,07,159.00		**BY OTHER COLLECTION**	
0.00	Major Repairs Expenses	3,79,778.00			
21,700.00	Ground Rent	21,700.00	2,232.00	Service Charges	1,478.00
10,892.00	Pest Control Charges	17,110.00	6,151.00	Interest on Members Dues	5,370.00
	TO ADMINISTRATIVE EXPENSES		48,350.00	Half Rent	72,175.00
3,78,780.00	Salary & Staff Welfare	4,31,912.00	6,500.00	Transfer fees	0.00
25,102.00	Security Charges	30,750.00		**BY OTHER INCOME INTEREST**	
22,336.00	Insurance Premium	29,453.00		On Saving Bank	7,442.00
22,871.00	Office Expenses	13,047.00	8,974.00	On Fixed Deposit	23,523.00
0.00	Meeting Expenses	24,576.00	27,677.25	On Bonds	84,510.00
3,251.00	Audit Fees	3,251.00	91,535.00	Miscellaneous Income	2,371.00
258.00	Education Fund	258.00	1,140.00	Sale of Scrap	0.00

24,815.00	Festival Expenses	36,431.50	26,500.00	Sundry Balances W/back	11,183.00
0.00	Printing, Stationery & Photocopy	7,604.00	0.00	**BY TRF FROM MAJOR REAIRS FUND**	2,76,559.48
4,000.00	Legal & Professional Fees	2,550.00		**BY EXCESS OF EXPENDITURE OVER INCOME**	1,39,677.02
0.00	Name Plate Making Charges	11,790.00			
170.00	Postage Telegram & Bank Charges	697.00	18,778.75		
175.00	Administrative Expenses	175.00			
48,877.00	Depreciation	50,727.00			
16,498.00	Sundry Balance W/off	0.00			
0.00	**TO EXCESS OF INCOME OVER EXPENDITURE**	0.00			
12,94,069.00		**16,71,284.50**	**12,94,069.00**		**16,71,284.50**

As Per Our Report of Even Date Attached **For The Yash Co-op. Housing Society Ltd.**

Chartered Accounts

The Ketan Co-operative Housing Society Ltd.
Income & Expenditure Account For The Year Ended 31/03/2011

Previous Year	Expenditure	Wing A	Amount B	Previous Rs. P.	Income Year	Wing	Amount A	B	Rs. P.
3,78,780.00	To Salary & Staff Welfare	2,63,923.00	1,67,989.00	4,31,912.00		Interest			
89,439.00	Municipal Taxes	33,192.00	65,312.00	98,504.00	8,974.00	On saving Bank	1,447.00	5,995.00	7,442.00
1,68,459.00	Water Charges	64,620.00	1,38,959.00	2,03,579.00	6,151.00	On Members Dues	3,246.00	2,124.00	5,370.00
21,700.00	Ground Rent	8,170.00	13,530.00	21,700.00	27,677.25	On Fixed Deposit	9,038.00	14,485.00	23,523.00
2,56,333.00	Repairs & Maintenance	44,283.00	62,876.00	1,07,159.00	91,535.00	On Bonds	0.00	84,510.00	84,510.00
0.00	Major Repairs Expenses	22,481.00	3,57,297.00	3,79,778.00					
	Postage, Telegram &				2,232.00	Service Charges	774.00	704.00	1,478.00
170.00	Bank Charges	474.00	223.00	697.00	6,500.00	Transfer Fees	6,500.00	3,500.00	10,000.00
24,315.00	Festival Expenses	29,391.00	7,040.00	36,431.50	48,350.00	Hall Rent	0.00	72,175.00	72,175.00
2,00,613.00	Electricity Expenses	1,11,470.00	88,763.00	2,00,233.00	0.00	Membership Fees	200.00	300.00	500.00
25,102.00	Security Charges	0.00	30,750.00	30,750.00					
10,892.00	Pest Control Charges	8,050.00	9,060.00	17,110.00		Members Contribution			
22,336.00	Insurance Premium	14,726.50	14,726.50	29,453.00	92,719.00	Municipal Tax	33,186.00	68,616.00	1,01,802.00
3,251.00	Audit Fees	1,210.00	2,041.00	3,251.00	7,13,116.00	Maintenance	4,64,400.00	2,70,716.00	7,35,116.00
0.00	Meeting Expenses	0.00	24,576.00	24,576.00	2,50,396.00	Water Charges	80,880.00	1,29,198.00	2,10,078.00
48,877.00	Depreciation	20,290.00	30,436.20	50,727.00	7,436.00	Sinking Fund	3,340.00	4,096.00	7,436.00
22,871.00	Office Expenses & Conv.	4,778.00	8,269.00	13,047.00	6,93,186.00	Major Repairs	94,000.00	72,000.00	1,66,000.00
175.00	Administrative Exp.	175.00	0.00	175.00					
0.00	Printing, Stationery & Zerox	2,504.00	5,100.00	7,604.00	1,140.00	Miscellaneous Income	296.00	2,075.00	2,371.00
0.00	Name Patte Making Expenses	0.00	11,790.00	11,790.00	0.00	Sundry Balances W/Back	9,315.00	1,873.00	11,188.00
4,000.00	Legal & Professional Fees	0.00	2,550.00	2,550.00	26,500.00	Sale of Scrap	0.00	0.00	0.00
7,436.00	Trf. To Sinking Fund	3,340.00	4,096.00	7,436.00		Net Consideration From			
258.00	Education Fund	96.00	162.00	258.00	0.00	Sale of Basement - 1483.25SFT	0.00	0.00	0.00
6,93,186.00	Trf. To Major Repairs Fund	94,000.00	72,000.00	1,66,000.00		Trf. From Major Repairs Fund	94,000.00	1,82,559.48	2,76,559.48
16,498.00	Sundry Balances W/off	0.00	0.00	0.00					
	Trf. To Reserve Fund	6,700.00	3,800.00	10,500.00		Excess of Expenditure over			
	Excess of Income Over				18,778.75	Income			
0.00	Expenditure	66,747.20	(2,06,419.22)	(1,39,672.02)					
19,94,691.00	Total	8,00,622.00	9,14,926.48	17,15,548.48	19,94,691.00	Total	8,00,622.00	9,14,926.48	17,15,548.48

Rakesh Co-operative Consumer's Society Ltd.
Balance Sheet as on 31st March, 2011

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
I. Share Capital :			**I. Cash & Bank Balances :**		
Authorized			Cash on Hand	25,000	
20,000 shares of Rs. 10 each		2,00,000	Cash at Bank	1,70,000	1,95,000
Subscribed			**II. Investments**		1,00,000
16,000 shares of Rs. 10 each			**III. Sundry Debtors**		30,000
Fully paid up	1,60,000		Salary Advance		3,000
(-) Calls in Arrears	(10,000)	1,50,000	**IV. Current Assets :**		
II. Reserve Funds & Other Funds :			Closing Stock		1,40,000
Reserve Fund :			**V. Fixed Assets**		
Opening Balance	15,000		Land	9,000	
Add : Transfer	84,875	99,875	Furniture 48,000		
Common Book Fund		5,000	Less : Depreciation (2,400)	45,600	
Education Fund :			Equipment	20,000	74,600
Opening Balance	8,000		**VI. Other Items**		
Add : Transfer	100	8,100	Interest Accrued		
III. Current Liabilities & Provisions :			on Investment		2,000
Creditors	20,000				
Outstanding Salaries	2,000				
Outstanding Rent	1,000				
Commission Payable	4,000	27,000			
IV. Profit & Loss A/c :					
Opening Balance	-				
Add : Net Profit for the year	3,39,500				
Less : Transfer to Reserve Fund	(84,875)				
	2,54,625	-			-
		5,44,600			5,44,600

The Ketan Co-operative Housing Society Ltd.
Fixed Assets

ASSETS	RATE OF DEP.	W.D.V. AS ON 01/04/10	ADDITIONS DURING THE YEAR	TOTAL	DEPRECIATION	W.D.V.AS ON 31/03/11
Buildings	5%	859733.00	0.00	859733.00	42987.00	816746.00
Suction Tank	5%	45252.00	0.00	45252.00	2263.00	42989.00
Furniture & Fixtures	10%	3796.00	0.00	3796.00	380.00	3416.00
Water Pump	10%	6404.00	0.00	6404.00	640.00	5764.00
Intercom	10%	44570.00	0.00	44570.00	4457.00	40113.00
		959755.00	0.00	959755.00	50727.00	909028.00

The Ketan Co-operative Housing Society Ltd.

DUE FROM MEMBERS B WING	**AMOUNT**	
SMT. K. A. GUJAR	1099434.00	
A	**1099434.00**	
A WING		
SMT. N. M. GANDHI	28331.00	
B	**28331.00**	
TOTAL (A + B)	**1127765.00**	
OUTSTANDING EXPENSES	**A WING**	**B WING**
WATER CHARGES	15673.00	8160.00
ELECTRICITY	13665.00	17896.00
AUDIT FEES	1210.00	2041.00
GROUND RENT	32680.00	54120.00
EDUCATION FUND	96.00	162.00
	63324.00	**82379.00**
TOTAL (A WING + B WING)	**145703.00**	

Illustration 2 :

Ashok Co-operative society Ltd. is loans and Rationing facilities to its members. The trial balance of the society as on 31st March, 2011 is as follows.

Trial Balance

Particulars	Dr. Rs.	Cr. Rs.
Share capital		40000
Bank Loan (Simple)		45000
Sahakari Sangh Share purchased	10000	
Stationery and Printing	4000	
Bank share purchased	2000	
Dead Stock	6000	
Interest on Members Loans		25000
Member’s Loan	100000	
Member’s deposit		75000
Purchase of rationing Grains	208900	
Discount		3000
Commission	10000	
Stock of rationing grains	2000	
Sale of rationing grains		206000
Office rent	20000	
Salaries	12000	
Traveling Expenses	4800	
Freight	200	
Coolie charges	2000	
Bank Current A/c	21000	
Bank Interest	46000	
Reserve Funds		60000
Cash Balance	5100	
	454000	454000

Adjustments :

1. Provide for audit fees due Rs. 2600
2. Provide depre on dead stock at 10%
3. Outstanding office salaries is Rs. 4000, rent Rs. 2000
4. Closing stock of rationing grains on 31.03.2011 was Rs. 106500

You are required to prepare trading, Profit & Loss A/c for the year ending on 31.03.2011 and balance sheet as on that date.

Solution :

Ashok Co-operative Society Ltd.
Trading and Profit & Loss A/c for the year ended 31.03.2011

Particulars		Rs.	Particulars	Rs.
To Opening Stock		2000	By Sales of rationing grains	206000
To Purchase of rationing grains		208900	By closing stock	106500
To Freight		200		
To Coolies charges		2000		
To Gross Profit		99400		
		312500		312500
To Printing & Stationery		4000	By Gross Profit	99400
To Rent, Rates & Taxes	20000			
Add : Outstanding	2000	22000	By Interest on Members Loan	25000
To Salaries & allowances	12000			
Add : Outstanding Salary	4000	16000	By Discount	3000
To Bank Interest		46000		
To Outstanding audit fees		2600		
To Depreciation on dead stock		600		
To other expenses & fees, if any				
Traveling expenses				
To Commission		4800		
To Net Profit		21400		
		127400		127400

Balance Sheet as on 30.03.2011

Liabilities	Rs.	Assets	Rs.
Share Capital		Cash Balance	5100
Issued & paid up	40000	Bank Current A/c	21000
Reserve Fund & other Funds		**Investments**	
Depreciation Fund	600	Sahakari Sangh Share purchase	1000
Other	6000	Bank Share Purchased	2000
Staff Provident Fund	NIL	**Provident Fund Investment**	NIL
Secured Loans	NIL	**Loans & Advances**	
Unsecured Loans		Member's Loan	100000
Bank Loans	45000	**Sundry Debtors**	NIL

Deposits		**Current Assets**	
Member's deposit	75000	Stock	106500
Current Liabilities & Provision		Fixed Assets	
Outstanding rent rates	2000	Dead stock	6000
Outstanding audit fees	2600	**Other Expenses & Losses**	
Outstanding office salaries	4000	**Other Debtors**	NIL
Unclaimed dividend	NIL	Losses	NIL
Internet due but not paid	NIL		
Other liabilities	NIL		
Profit & Loss Appropriation A/c	21400		
	250600		250600

Illustration : 3

From the following Trial Balance Damu Co-operative credit society Ltd. as on 30th June 2011 and other international prepare profit and loss A/c for the year ended 30th June, 2011 and Balance Sheet as on that date.

Trial Balance as on June 30th, 2011

Particulars	Rs.	Particulars	Rs.
Cash in hand	10700	Share Capital	800000
Cash with Bank	14000	Reserve Fund	20000
Fixed Deposit with M.S. Co-operative Bank	155000	Member's Deposits	2287200
Office furniture	17000	Dividend Equilisation Reserve	21000
Interest on Deposits	80000	Staff Provident fund	15000
Interest due on loans	8000	Profit & Loss Appropriation A/c Bal.	61000
Salary and allowances	3000	Interest	189000
Establishment for Executive officer	15000	Sundry Income	1000
Printing and stationery	1400	Education fund	1500
Traveling and conveyance	1600		
Insurance premium	4000		
Contribution to Provident Fund	12000		
Loan due from members	3050000		
	3398700		3398700

1. Interest due to members deposits Rs. 12000/-
2. Interest accrued due but not received Rs. 8000/-
3. Addition to Furniture during the year Rs. 7000/- charge Depreciation at 10% on closing Balances.
4. Salary due but not paid Rs. 4000/- whereas are employee is given salary in advances on 30/06/2003 Rs. 1000/-
5. Audit fees unpaid for the year Rs. 5000/-
6. Authorized capital was Rs. 200000/- shares of Rs. 10 each.
7. Directors propose the following appropriations for the current year.
   a) Dividend to share holders at 6%
   b) Necessary amount to reserve Fund.
   c) 5% of Net Profit (after contribution to Reserve Fund) to Co-operative Development Fund.
   d) Contribution to Dividend caualisation Reserve Rs. 500/-
   e) Transfer to Building Fund Rs. 2000/-

Damu Co-operative Credit Society Ltd.
Profit and Loss A/c for the year ended 30/06/2011

Particulars		Rs.	Particulars		Rs.
To Interest on Deposits	80000		By interest	189090	
Add: Interest due	12000	92000	Add: Interest due	8000	197000
To Salary and allowance	3000		By other income		
Add: Outstanding	4000		By Sundry income		1000
	34000				
Less: Advances	1000	33000			
To Printing and stationery		1400			
To Contribution to provident fund		12000			
To Depreciation on Furniture		1700			
To Outstanding Audit Fees		5000			
To Other expenses and fees					
-Establishing for creative officer	15000				
-Traveling & Conveyance	1600				
-Insurance Premium	4000	20600			
To Net Profit		32300			
		198000			198000

Damu Co-operative Society
Balance Sheet as on 30/06/2011

Liabilities	Rs.	Assets		Rs.
Share capital		Cash Balance		
Authorized Capital		Cash in Hand		10700
200000 Shares of Rs. 10 each	2000000	Cast at Bank		14000
Issued Capital		Investments		
80000 Shares of Rs. 10 each	800000	F.D. with M.S. Co-operative Bank		155000
Reserve Fund and other funds		Provident Fund Investment		NIL
Reserve Fund	20000	Loans and Advances		
Dividend Equalisation Reserve	21000	Loan due from Members		3050000
Staff Provident Fund	15000	Sundry Debtors		NIL
Co-operative Development Fund	3000	Current Assets		
Education Fund	1500	Interest due on loans	8000	
Depreciation Fund	700	Add : Interest due	8000	16000
Staff Provident Fund	NIL	Fixed Assets		
Secured Loans	NIL	Office furniture	10000	
Unsecured Loans	NIL	Add : Addition	7000	17000
Deposits		Other Expenses & Losses		
Members Deposits	2287200	Advance Salary		1000
Current Liabilities & Provisions		Other Debtors		
Outstanding Salary	4000	Losses		NIL
Outstanding Audit Fees	5000			
Unclaimed Dividend	NIL			
Interest due but not paid				
Interest due on Member's Deposits	2000			
Other Liabilities	NIL			
P & L appropriation A/c				
Opening	61000			
Current Year	32300			
	3263700			3263700

Memorandum Profit and Loss Appropriation Account

Particulars	Rs.	Particulars	Rs.
To Dividend	48000	By Balance b/d	61000
To Reserve Fund (25%)	8075	By Net Profit	32300
To Co-operative Development Fund	1211		
To Dividend Equalisation Fund	500		
To Building Fund	2000		
To Balance c/d	33514		
	93300		93300

Note : No appropriation out of current year's profit can be made without the approval of the general body.

Illustration 4:

The following are the balance of Katha Co-operative Housing Society Ltd. For the year ended on 30/06/2004.

	Dr.	Cr.
Purchase of Land		600000
Share Capital		75000
Construction of Building	1800000	
Reserve Fund		11600
Architect Fees for Building	40000	
Investment in Shares of Maharashtra Co-operative Society	8000	
Investment in shares of Mumbai Dist Co-op Bank	7000	
Audit Fees	1000	
Contribution from Members for Land		640000
For Building		951000
For Road Construction		51000
For shares M Co-operative Housing		45000
For Administrative Expenses		11500
Land Revenue	400	
Insurance Premium	5,000	
Electric Charges	1,800	
Printing & Stationery	1,200	

Salaries to staff	2,400	
Members personal A/c		14,000
Flat transfer premium		15,100
Dividend on shares		7,200
Interest on saving A/c		360
Furniture & Dead Stock	6,100	
Electrical Motors & Pumps	7,200	
Non Occupancy charges		4,000
Loans to members	6,20,000	
Fixed Deposit with (Mumbai Dist. Co-op)	80,000	
Saving A/c (MDCO-op)	3,100	
Cash on Hand	750	
Electrical Fittings	15,000	
Wages of cleaning water	3,300	
Income & Expenditure A/c (1.7.2011)		10,390
Loan from (M. Co-op Housing)	13,66,100	
	3202250	3202250

Adjustments :

1. Transfer of flat charges of 2 members during the year at Rs. 8000 per Flat is Receivable from member.
2. Provide Depreciation at 10% Furniture, Electrical Motor Pumps.
3. Interest Rs. 6000 on fix deposit with Bank is due but not received.
4. Bill of Rs. 500 for repairs of electrical motors is unpaid.

From the above mentioned information, you are required to prepare income and expenditure account for the year ended 30/06/2011 and Balance sheet as on that date.

Solution :

Katha Co-operative Housing Society Ltd.
Income and Expenditure Account for the year ended 30-06-2011

Dr. Cr.

Expenditure	Rs.	Income	Rs.
To Audit Fees	1000	By Contribution of Members for Administration Expenses	11500
To Land Revenue	400	By Dividend on Shares	7200
To Insurance Premium	5000	By Interest on Saving Account	360
To Electric Charges	1800	By Non-occupancy Charges	4000
To Printing and Stationery	1200	By Outstanding interest on Fixed Deposit	6000
To Salaries to Staff	2400		
To Wages for Cleaning Water-tanks	3300		
To Depreciation :			
Furniture 610			
Electric Motor & Pumps <u>720</u>	1330		
To Repairs of Electric Motor	500		
To Excess of Income over Expenditure	1213		
	29060		29060

Balance Sheet as at 30-06-2011

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital		Cash Balance	
1500 Shares of Rs. 50 each fully paid	75000	Cash on hand	750
Reserve Fund and Other Fund		Saving A/c with Mumbai	3100
Reserve Funds	11600	Dist. Co-op. Bank	
Flat Transfer Premium 15100		Investments	
Add: Receivable for the year 8000	23100	Shares of Maharashtra Co-op. Housing Finance Society	8000
Contribution of Members :		Shares of Mumbai Dist. Co-op. Bank	7000

For Land	640000	Fixed Deposits with Mumbai Dist. Co-op. Bank 80000	
For Construction of Building	951000	Add : Outstanding Interest 6000	86000
For Road Construction	51000	Loans and Advances	
For Shares of Maharashtra Co-op Housing Finance Society	45000	Loan to Members	620000
Secured Loans		Transfer Premium	8000
Loan from Maharashtra Co-op. Housing Finance Society	1366100	Fixed Assets	
Other Liabilities		Purchase of land	600000
Member's Personal A/c	14000	Construction of building 1800000	
Unpaid Expenses of Motor Repairing	500	Add: Architect Fees 40000	1840000
Profit & Loss Appropriation		Furniture & Dead Stock 6100	
Last Year's Balance 10390		Less : Depreciation (610)	5490
Add: Excess of Income of Current year 12130	22520	Electric Motor & Pumps etc. 7200	
		Less Depreciation (720)	6480
		Electric Fittings	15000
	3199820		3199820

Illustration 5 :

A cricket club gives you the following information :

Income and Expenditure Account for the year ended 31-12-2011

Dr. Cr.

Expenditure	Rs.	Income		Rs.
To Remuneration to coach	18000	By Donations & Subscriptions		102000
To Salaries and Wages	24000	By Bar Room :		
To Rent	12000	Receipts	24000	
To Repairs	11000	Less : Expenses	(20000)	4000
To Miscellaneous expenses	7000	By Bank Interest		2000
To Honorarium of Secretary	18000	By Hire – Club Hall		12000
To Depreciation on Equipment	5000			
To Surplus	25000			
	120000			120000

Balance Sheet As at 31/12/2011

Rs. P.	Liabilities	Rs. P.	Rs. P.	Assets	Rs. P.
2010		2011	2010		2011
	Capital Fund as on 31.12.2002	48000	25000	Equipment	2000
	Entrance Fees	10000	6000	Outstanding Subscription	8000
	Surplus	25000	5000	Cash in hand	4000
48000		83000	2500	Cash at bank	10000
4000	Subscriptions in advance	3000	20000	Fixed Deposit	50000
	Outstanding Liabilities :				
1500	Miscellaneous Expenses	1000			
2000	Salary & wages	3000			
3000	Honorarium to secretary	2000			
58500		92000	58500		92000

Prepare the Receipts and Payments Account of the Club for the year ended 31st December, 2011.

Solution :

Receipts & Payments Account
Of the Club for the year ending 31st December, 2011

Dr. Cr.

Receipts	Rs. P.	Payments	Rs. P.
To Balance b/d		By Remuneration to coach	18000
Cash in hand	5000	By Salaries and Wages (Note I)	23000
Cash at bank	2500	By Rent	12000
To Donations & Subscriptions (Note IV)	99000	By Repairs	11000
To Bar receipts	24000	By Miscellaneous expenses (Note II)	7500
To Bank Interest	2000	By Honorarium to Secretary (Note II)	19000
To Hire-Club hall	12000	By Fixed Deposit	30000
To Entrance Fees	10000	By Bar expenses	20000
		By Balance c/d	
		Cash in hand	4000
		Cash at bank	10000
	154500		154500

Working Notes :

	Rs.
I. Salaries and Wages :	
As per income and expenditure account	24000
Add : outstanding at the beginning of the year	2000
	26000
Less : Outstanding at the end of the year	(3000)
	23000

W. Note II	Misc. Exp.	Hon to Sec.	Donations & Subscription
As per Income – Exp A/c	7000	18000	102000
Add: Op. Outstanding	1500	3000	6000
Add: Cl. Received in Advance	-	-	3000
	8500	21000	111000
Less : Cl. Outstanding	(1000)	(2000)	(8000)
Less : Op. Received in Advance	-	-	(4000)
	7500	19000	99000

Illustration 6 :

The following is the receipts and payments of a Books & Periodicals society for the year ended March 31, 2011.

Dr. Cr.

Receipts	Rs. P.	Payments	Rs. P.
To Cash at bank	12500	By Salaries	2500
To Subscriptions	52500	By Printing and Stationery	1250
To Annual day Receipts	26800	By Annual day expenses	1500
To Mushaira receipts	22500	By Mushaira expenses	10000
To Dividend on shares	2500	By Telephone charges	2500
		By Sundry expenses	2000
		By Shares purchased	75000
		By Postage and telegrams	2200
		By Building maintenance	6340
		By Cash at bank	13510
	116800		116800

The following further information is furnished :

1. The value of the building owned by the society stood at Rs. 50000 as at 1st April, 2010 Depreciation at 5 percent has to be provided.
2. there were 200 members paying subscription at the rate of Rs. 250 per annum each.
3. As on 1st April, 2010 subscription had been received in advance but subscriptions were outstanding to the extent of Rs. 1000. As at 31st March, 2011 subscriptions outstanding were Rs. 15000.
4. Postage stamps worth Rs. 250 were with the secretary at the beginning of the year and the stamps at the end of the year were of the value of Rs. 150.
5. The investment in shares at the beginning of the year was to the extent of Rs. 5000.
6. The amount of Rs. 250 in respect of the annual day receipts was yet to be received.
7. the rent of the theatre (amounting to Rs. 25000), where the mushaira (poetic symposium) was held is still to be paid.
8. Hire of telephone to the extend of Rs. 300 is paid in advance.

You are required to prepare the income and expenditure account for the year ended March 31, 2011 and the Balance Sheet.

Solution :

Opening Balance Sheet as on 1st April, 2010

Liabilities	Rs.	Assets	Rs.
Capital Fund (balancing figure)	68750	Building	50000
		Investment	5000
		Subscriptions outstanding	1000
		Postage stamps	250
		Cash at bank	12500
	68750		68750

Income and Expenditure Account for the year ended 31st March, 2011.

Dr. Cr.

Particulars		Rs.	Particulars		Rs.
To salaries		2500	By Subscriptions		50000
To Printing and stationery		1250	By Annual day receipts	26800	
To Telephone charges	2500		Add : Due	250	27050
Less : paid in advance	(300)	2200			
To Sundry expenses		2000	Less : Expenses	1500	25550
To Postage & telegrams	2200		By Mushaira receipts	22500	
Add stamps on 1/4/10	250		Less : expenses including outstanding	(12500)	10000
	2450		By Dividend on shares		2500
Less : Stamps on 31-03-11	(150)	2300			
To Building maintenance		6340			
To Depreciation on building		2500			
To Excess of income over expenditure		68960			
		88050			88050

Note :

Subscriptions due for 200 members @ Rs. 250	=	Rs. 50000
Subscriptions actually received during the year	=	52500
Add: outstanding at the end of the year	=	1500
		54000
Less : outstanding at the beginning of the year	=	1000
		53000
Subscriptions due for the year (200 × 250)	=	50000
Subscriptions received in advance	=	3000

Balance Sheet of the Literary Society as on 31st March 2011.

Liabilities		Rs.	Assets		Rs.
Capital Fund			Buildings	50000	
Opening balance	68750		Less depreciation	(2500)	47500
Add : excess of income			Investments in shares	5000	
Over expenditure	68960	137710	Add purchased during the year	75000	80000
Outstanding rent		2500	Postage stamps		150
Subscriptions received in advances			Subscriptions outstanding		1500
(as per note)		3000	Annual receipts due		250
			Prepaid telephone charges		300
			Cash at Bank		13510
		143210			143210

Illustration : 7

From the following Trial Balance of Hari Co-operative Purchases and Sales Society Ltd. as on 31.3.2011; prepare Trading and Profit & Loss Account for the year ended 31.3.2011 and Balance sheet as on that date after considering the adjustments given thereafter.

Trial Balance as on 31.3.2011

Particulars	Dr. Rs.	Cr. Rs.
Share capital	-	3,36,000
Reserve Fund	-	60,000
Creditors	-	40,000
Profit and Loss A/c 1.4.2010	-	1,76,000
Opening Stock	3,92,000	-
Furniture and Equipment	1,24,000	
Container Deposit	32,000	
Salaries	3,00,000	
Sundry Debtors	60,000	
Commission	88,000	
Rent and Taxes	60,000	
Postage	8,000	
Traveling and Conveyance	18,000	
Printing and Stationery	14,000	
Admission Fees	-	2,000
Purchase	63,40,000	-
Coolie Charges, Freight and Cartage	1,60,000	-
Investments	2,40,000	-
Sales	-	76,20,000
Cash in hand	6,000	-
Bank Balance	4,00,000	-
Development Fund	-	8,000
	82,42,000	82,42,000

Adjustments :

1. Closing Stock is valued at Rs. 4,40,000.
2. Outstanding Rent Rs. 4,000 and Commission Payable Rs. 20,000.
3. Rs. 8,000 Salary was paid as advance as on 31.3.2011.
4. Accrued Income on Investment Rs. 20,000.
5. Provide 10% depreciation on furniture and equipments.

Solution :

Hari Co-operative Society Ltd.
Trading A/c for the year ended 31.3.2011

Dr. **Cr.**

	Rs.		Rs.
To opening Stock	3,92,000	By Sales	76,20,000
To Purchases	63,40,000	By Closing Stock	4,40,000
To Coolie Charges, Freight and Cartage	1,60,000		
To Gross Profit transferred to Profit and Loss A/c	11,68,000		
	80,60,000		80,60,000

Profit and Loss A/c for the year ended 31.3.2011

Dr. **Cr.**

		Rs.		Rs.
To Salaries	3,00,000	2,92,000	By Gross Profit	11,68,000
Less : Advance	8,000		By Accrued Income on Investments	20,000
To Traveling & Conveyance		18,000	By Admission Fees	2,000
To Rent & Taxes	60,000			
Add: Outstanding Rent	4,000	64,000		
To Postage		8,000		
To Printing & Stationery				
To Provision for Audit Fees		600		
To Depreciation on furniture and Equipments		12,400		
To Commission	88,000			
Add: Outstanding	20,000	1,08,000		
To Education Fund		170		
To Net Profit		6,72,830		
		11,90,000		11,90,000

Profit & Loss Appropriation A/c [Memorandum]
For the year ended 31.3.2011

Dr. **Cr.**

	Rs.		Rs.
To Reserve Fund (25% of N.P.)	1,68,208	By Balance b/d	1,76,000
To Balance Carried to Balance Sheet	6,80,622	By Net Profit	6,72,830
	8,48,830		8,48,830

Note : Contribution to Education Fund is as per the rate prescribed.

Hari Co-operative Society Ltd.
Balance Sheet as on 31.3.2011

Liabilities		Rs.	Assets	Rs.
I. Share Capital			I. Cash & Bank Balance	
Authorised … shares of Rs. …. Each		?	Cash on Hand	6,000
Subscribed … shares of Rs. …. Each		3,36,000	Cash at Bank	4,00,000
II. Reserve Funds and other Funds :			II. Investments	
Reserve Fund:			Investments	2,40,000
Opening Balance	60,000		Container Deposits	32,000
Add: Transfer	1,68,208	2,28,208	III. Sundry Debtors	60,000
Development Fund		8,000	Salary Advance	8,000
Current Liabilities and Provisions			IV. Current Assets	
Creditors	40,000		Closing Stock	4,40,000
Outstanding Rent	4,000		V. Fixed Assets	
Education Fund	170		Furniture and Equipments 1,24,000	
Commission Payable	20,000		Less : Depreciation 12,400	1,11,600
Audit Fees payable	600	64,770	VI. Other Items	
P. & L A/c			Interest Accrued	20,000
Opening Balance	1,76,000			
Add : Net profit for the year	6,72,830			
	8,48,830			
Less : Transfer to Reserve fund	1,68,208	6,80,622		
		13,17,600		13,17,600

Illustration 8 :

From the following Trial Balance of Rakesh Co-operative Consumers Society Ltd., Pune as on 31.3.2011, prepare Trading and Profit & Loss Account for the year ended on 31.3.2010 and Balance Sheet as on that date after considering the adjustments given.

Trial Balance as on 31.3.2011

Particulars	Dr. Rs.	Cr. Rs.
Share capital	-	1,60,000
Calls in arrears	10,000	-
Reserve Fund	-	15,000
Common Goods Fund	-	5,000
Opening stock of Consumer's Goods	1,10,000	-
Furniture	48,000	-
Education Fund	-	8,000
Sundry Creditors	-	20,000
Sundry Debtors	30,000	-
Commission Payable	-	4,000
Salaries	71,000	-
Commission	17,400	-
Rent, Rate and Taxes	20,000	-
Postage	12,100	-
Land	9,000	-
Interest on Investment	-	10,000
Equipment	20,000	-
Purchases	16,40,000	-
Investment	1,00,000	-
Sales	-	20,60,500
Cash in hand	25,000	-
Cash at Bank	1,70,000	-
	22,82,500	22,82,500

Adjustments :

1. Outstanding rent payable on 31.3.2011 was Rs. 1,000.
2. Charge 5% depreciation on furniture.
3. Closing Stock of consumer's goods is valued at cost Rs. 1,40,000.
4. Interest accrued on Investment Rs. 2,000.
5. Outstanding salary on 31st March, 2011 was Rs. 2,000 & Rs. 3,000 paid in advance.
6. Authorized capital 20,000 shares of Rs. 10 each.

Solution :

Rakesh Co-operative Consumers Society Ltd.
Trading A/c for the year ended 31.3.2011

Dr. Cr.

	Rs.		Rs.
To opening Stock	1,10,000	By Sales	20,60,500
To Purchases	16,40,000	By Closing Stock	1,40,000
To Gross Profit transferred to Profit and Loss A/c	4,50,500		-
	22,00,500		22,00,500

Profit and Loss A/c for the year ended 31.3.2011

Dr. Cr.

		Rs.			Rs.
To Salaries	71,000		By Gross Profit		4,50,500
Add : Outstanding	2,000		By Interest on investment	10,000	
	73,000		Add : Accrued	2,000	12,000
Less : Advance	3,000	70,000			
To Rent, Rates and Taxes	20,000				
Add : Outstanding Rent	1,000	21,000			
To Education Fund		100			
To Postage		12,100			
To Depreciation on Furniture		2,400			
To Commission		17,400			
To Net Profit		3,39,500			
		4,62,500			4,62,500

Profit & Loss Appropriation A/c [Memorandum]
For the year ended 31.3.2011

Dr. Cr.

	Rs.		Rs.
To Reserve Fund	84,875	By Net Profit	3,39,500
To Balance Carried to Balance Sheet	2,54,625		
	3,39,500		3,39,500

Illustration 9:

From the following Trial Balance of Sadu Consumer's Co-operative Society Ltd. as on 31st March 2011 prepare the Final Accounts in the prescribed format.

Particulars	Dr. ₹	Cr. ₹	Particulars	Dr. ₹	Cr. ₹
Share Capital		1,00,000	Purchases	12,05,000	
Deposit from Members		50,000	Due from Customers	56,000	
Sales		14,50,000	Carriage inwards	4,000	
Purchases Returns		6,000	Sales Returns	3,000	
Due to Suppliers		11,000	Rent (for 10 months)	10,000	
Interest on investment		11,000	Audit Fees	2,000	
Rebate Received		2,000	Sales Tax	3,000	
Common Good Fund		4,000	Staff Salary	50,000	
Price fluctuation Fund		3,000	Printing and Stationery	10,000	
Reserve fund		25,000	Investments	2,00,000	
Cash in Hand	200		Stock in Trade	30,000	
Cash at Bank	76,200		Interest Paid	2,6000	
Furniture	10,000				
				16,62,000	16,62,000

Adjustments :

1. value of closing stock on 31st March, 2011 was ₹ 75000.
2. depreciation on Furniture @ 10% p.a. for full year.
3. Interest accrued on Deposits ₹ 5,000 and interest accrued on investment ₹ 1,200.
4. salary includes advance of ₹ 6,000 paid against salary of April, 2011.
5. outstanding Sales Tax of ₹ 2,000. ***(Mar. 04, adapted)***

Solution :

In the Books of Sadu Consumer Co-operative Society Ltd.
Profit & Loss Account for the year ended 31-3-2011

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To opening Stock	30,000	By Sales	
To Purchases 12,05,000		Less : Returns 14,50,000	14,47,000
Less : Returns 6,000	11,99,000	By Closing Stock (-3,000)	75,000
To Carriage Inwards	4,000		
To Gross Profits	2,89,000		
	15,22,000		15,22,000
To Interest Paid 2,600		By Gross profit b/d	2,89,000
Add : Outstanding 5,000	7,600,	By Interest Received	12,200
To Salaries	44,000	By Rebate Received	2,000
To Rent	12,000		
To Sales Tax	5,000		
To Audit Fees	2,000		
To Printing and Stationery	10,000		
To Depreciation on Furniture	1,000		
To Net Profit Ltd. to B/s	2,21,600		
	3,03,200		3,03,200

Balance Sheet as at 31-3.2011

Liabilities		₹	Assets		₹
Share Capital			Cash Balance		
Authorized, issued & paid up		1,00,000	On hand	200	
Reserve Fund and other Funds			At Bank	76,200	76,400
Reserve Fund	25,000		Investments		
Common Good Fund	4,000		Investments	2,00,000	
Price Fluctuation Fund	3,000	32,000	Add : Interest accrued	1,200	2,01,200
Staff Provident Fund		NIL	Provident Fund vestments		NIL
Secured Loans		NIL	Loans & Advances		NIL
Unsecured Loans		NIL	Sundry Debtors		56,000
Deposits			Current Assets		
Deposits from Members	50,000		Closing stock		75,000
Add : Interest Accrued	5,000	55,000	Fixed Assets		
Current Liabilities & Provision			Furniture		9,000
Suppliers	11,000		Other Expenses & Losses (not w/o)		
Rent Payable	2,000		Salary		6,000
Sales Tax Payable	2,000	15,000	Losses		
Unclaimed Dividend		NIL			
Interest due but not paid		NIL			
Other liabilities		NIL			
Profit & Loss Appropriation					
Opening Balance	?				
Add : Current Year's Profit	2,21,600	2,21,600			
		4,23,600			4,23,600

Illustration 10 :

From the following Trial Balance of M.K.J. Consumer Society as on 31st March, 2011, prepare Final Accounts in the prescribed format.

Particulars	₹	Particulars	₹
Cash in Hand	80,500	Share Capital	5,00,000
Cash at Bank	20,500	Deposit from Members	5,00,000
Furniture	1,00,000	Sales	13,80,000
Purchase	12,15,000	Purchases Return	15,000
Debtors	58,000	Creditors	28,000
Carriage inward	7,000	Interest on investment	80,000
Sales Return	15,000	Rebate Received	3,000
Staff Salary for (11 Months)	55,000	Reserve Fund	12,000
Rent for (13 months)	13,000		
Audit Fees	6,000		
Printing and Stationery	8,000		
Investments @ 10% p.a.	9,00,000		
Stock in Trade	40,000		
	25,18,000		25,18,000

Adjustments :

1. Value of Closing stock as on 31st March, 2011 ₹ 85,000.
2. Depreciation of Furniture @ 10% p.a.
3. Interest Accrued on Deposits 56,000.
4. sales Tax 4,500 to be provided.

Solution :

M. K. J Consumer Society Limited
Balance Sheet as on 31st March 2011

Liabilities ₹	₹	Assets ₹	₹
I. Share Capital		I. Cash Balance	
Authorized Issued and Paid-up	5,00,000	On hand 80,500	
II. Reserve Fund and Other Funds		At Bank (including Deposits) 20,500	1,01,000
Reserve Fund	12,000	II. Investments	
III. Staff Provident Fund	NIL	Other / Miscellaneous 9,00,000	
IV. Secured Loans	NIL	Add : Interest accrued 10,000	9,10,000
V. Unsecured Loans	NIL	III. Provident Fund Investments	NIL
VI. Deposits		IV. Loans and Advances	NIL
Deposit from members 5,00,000		V. Sundry Debtors	
Add : Interest accrued on above 56,000	5,56,000	For Credit Sales	58,000
VII. Current Liabilities and Provisions		VI. Current Assets	
Sundry Liabilities 28,000		Closing Stock	85,000
Outstanding Expenses		VII. Fixed Assets	
- Salaries 5,000		Deadstocks 1,00,000	
- Interest 4,500	37,500	Less : Depreciation 10,000	90,000
VIII. Unclaimed Dividend	NIL	VIII. Other Expenses and Losses (not w/o)	NIL
IX. Interest due but not paid	NIL	IX. Other Debtors	
X. Other Liabilities	NIL	Advances paid	1,000
XI. Profit and Loss Appropriation		X. Losses	NIL
Opening Balance ?			
Add : Current Year's profit 1,39,500	1,39,500		
Total	12,45,000		12,45,000

Profit and Loss Account for the Year ending 31st March 2011

Particulars		₹	Particulars	₹
To Interest Paid		56,000	By Gross Profit b/d	2,03,000
To Salaries and Allowances	55,000		By Interest Received	80,000
Add : Outstanding	5,000	60,000	By Interest Accrued	10,000
To Rent, Rates and Taxes		12,000	By Other Incomes	
To Audit Fees		6,000	Rebate received	3,000
To Printing and Stationery		8,000		
To Depreciation on Assets furniture		10,000		
To Other Expenses and Fees Sales tax		4,500		
To Net Profit transferred		1,39,500		
Total		2,96,000	Total	2,96,000

Illustration 11 :

From the following Trial Balance of Maru Co-operative society, for the year ended 31-12-2011 as follows :

Trial Balance

Particulars	₹	Particulars	₹
Investments in Shares	50,000	Share Capital	1,00,000
Printing and Stationery	10,000	Bank Loan @ 10% Interest P.A.	3,50,000
Investment in Bank Shares	70,000	Interest on Members Loan	3,50,000
Fixed Assets	50,000	Members Deposits	5,00,000
Members Loan	8,00,000	Sales	13,00,000
Purchase	11,90,000	Reserves and Other Funds	4,00,000
Office Rent	1,00,000		
Salaries	1,00,000		
Traveling Expenses	18,000		
Freight	12,000		
Coolie Charges	10,000		
Bank Balance	3,30,000		
Bank Interest Paid	2,60,000		
	30,00,000		30,00,000

i) Provide Audit Fees for ₹ 6,000/-.
ii) Provide Depreciation on fixed Assets @ 5%.
iii) Outstanding Office Salaries ₹ 10,000.
iv) Closing Stock ₹ 3,20,000.

You are required to prepare Trading, Profit and Loss Account for the ended 31st March, 2011 and Balance Sheet as on that date. ***(Oct. 05, adapted)***

Solution :

Maru Co-operative Society Limited
Balance Sheet as on 31st December 2011

Liabilities ₹	₹	Assets ₹	₹
I. Share Capital		I. Cash Balance	
Authorized Issued and Paid-up	1,00,000	At Bank (including deposits)	3,30,000
II. Reserve Fund and Other Funds		II. Investments	
Reserve Fund	4,00,000	Other	1,20,000
III. Staff Provident Fund	NIL	III. Provident Fund	
		Investments	NIL
IV. Secured Loans	NIL	IV. Loans and Advances	
V. Unsecured Loans		Loans	8,00,000
From Banks	3,50,000		
VI. Deposits		V. Sundry Debtors	NIL
Other Deposits	5,00,000	VI. Current Assets	
VII. Current Liabilities and Provisions		Closing Stock	3,20,000
Outstanding Expenses		VII. Fixed Assets	
- Salaries 10,000		Other / Miscellaneous	47,500
- Audit Fees 6,000	16,000	VIII. Other Expenses and Losses (not w/o)	NIL
VIII. Unclaimed Dividend	NIL	IX. Other Debtors	NIL
IX. Interest due but not paid	NIL	X. Losses	NIL
X. Other Liabilities	NIL		
XI. Profit and Loss Appropriation			
Opening Balance --			
Add : Current Year's profit 2,51,000	2,51,500		
Total	16,17,500	Total	16,17,500

Trading Account for the Year ended 31st December 2011

Particulars	₹	Particulars	₹
To Purchases	11,90,000	By Sales	13,00,000
To Freight	12,000	By Closing Stock	3,20,000
To Coolie Charges	10,000		
To Gross Profit c/d	4,08,000		
Total	16,20,000	Total	16,20,000

Profit and Loss Account for the Year ending 31st December 2011

Particulars	₹	₹	Particulars	₹
To Interest Paid		2,60,000	By Gross Profit b/d	4,08,000
To Salaries and Allowances	1,00,000		By Interest Received	3,50,000
Add: Outstanding	10,000	1,10,000		
To Rent, Rates and Taxes		1,00,000		
To Audit Fees		6,000		
To Printing and Stationery		10,000		
To Depreciation on Assets		2,500		
To Other expenses and Fees Travelling		18,000		
To Net Profit transferred		2,51,500		
Total		7,58,000	Total	7,58,000

Illustration 12 :

The Balance Sheet and Receipt and Payments Accounts of Kadia Consumer's Co-operative Stores Ltd. Mumbai are given below :

Kadia Consumer's Co-operative Stores Ltd. Mumbai Balance Sheet as on 31st March, 2010

Liabilities	₹	Assets	₹
Share Capital	60,000	Cash	2,500
Deposits from Members	37,500	Bank	1,000
Reserve Fund	10,000	Investment (Shares of DCCB)	8,000
Interest due	200	Government Securities	5,000
Creditors	3,000	Fixed Deposits	8,500
Sales Tax due	800	Interest due	300
Salaries Payable	500	Furniture	5,000
Dividend Payable	1,500	Debtors	38,500
Profit and Loss A/c	5,800	Stock	50,500
	1,19,300		1,19,300

Receipt and Payment A/c for the year ended 31st March, 2011

Receipts	₹	Payments	₹
To Balance b/d		By Share Capital	1,000
Cash	2,500	By Deposit Repaid	24,000
Bank	1,000	By Purchases	5,55,000
To Share Capital	3,000	By Sales Returns	3,500
To Deposits from member	5,000	By Carriage inward	10,000
To Sales	6,50,000	By Commission	2,500
To Purchases Returns	12,500	By Interest	2,150
To Sundry Income	2,000	By Sales Tax	5,500
To Sundry Debtors	6,30,000	By Dividend paid	3,250
To Sundry Creditors	4,70,000	By Bank charges	225
To Fixed Deposits	1,000	By Salaries	17,000
To Interest	3,000	By Contribution to PF	1,200
To Dividend	800	By Travelling Expenses	5,550
		By Rent	4,800
		By Allowance to MD	500
		By Postage & Telephones	1,490
		By Printing and Stationery	4,600
		By Audit Fees	750
		By Sundry Expenses	385
		By Debtors	6,15,000
		By Creditors	4,60,000
		By Furniture	5,000
		By Fixed Deposits	32,000
		By Balance c/d	
		Cash	4,400
		Bank	21,000
	17,80,800		17,80,800

Adjustments :

a) Authorized Capital was 25,000 shares of ₹ 10 each.
b) Stock on 31st March, 2008 was ₹ 55,000.
c) Depreciate Furniture by ₹ 375.
d) Provide for Doubtful Debts 300.
e) Appropriation out of Profits of the year 2010-11 were as follows :

Reserve Fund	₹ 2,000
Dividend	₹ 600
Education Fund	₹ 1,000

Prepare Find Accounts strictly as per Rule No. 61 of Maharashtra Co-operative Societies Rules, 1961.

(M.Com Part-1, October 2008, adapted)

Solution :

Kadia Consumer's Co-operative Society Ltd.
Trading and Profit and Loss A/c for the year ended 31st March 2011

Dr. **Cr.**

Particulars		₹	Particulars		₹
To Opening stock		50,000	By Sales	6,50,000	
To Purchases	5,55,000		Less : Return	3,500	6,46,500
Less : Return	12,500	5,42,500	By closing Stock		55,000
To Carriage Inward		10,000			
To Gross Profit c/d		98,500			
		7,01,500			7,01,500
To Interest	2,150		By Gross Profit b/d		98,500
Less : Interest due (Op.)	200	1,950	By Interest	3,000	
To Sales Tax	5,500		Less: Receivable (Op.)	300	2,700
Less : Due (Op.)	800	4,700	By sundry Income		2,000
To Salaries	17,000		By Dividend		800
Less : Due (Op.)	500	16,500			
To Dividend	3,250				
Less : Payment	1,500	1,750			
To Depreciation on Furniture		375			
To R & D		300			
To Commission		2,500			
To Bank charges		225			
To Postage		1,490			
To Contribution to PF	225	1,200			
To Travelling Expenses	1,490	5,550			
To Rent		4,800			
To Allowance		500			
To Printing and Stationery		4,600			
To Audit Fees		750			
To Sundry Expenses		385			
To Education Fund		1,000			
To Net Profit c/d		55,425			
		1,04,000			1,04,000

Profit & Loss Appropriation A/c

Particulars	₹	Particulars		₹
To Reserve Fund	2,000	By Opening	5,800	
To Dividend Fund	600	Add : Current Year	55,425	61,225
To P/L transferred to B/S	58,625			
	61,225			61,225

Balance Sheet as on 31st March, 2011

Liabilities	₹	Assets	₹	
Share Capital		Cash / Bank Balances		
Authorized Capital :		Cash		4,400
25,000 shares of ₹ 10 each	2,50,000	Bank		21,000
Issued, Subscribed & paid up Capital	62,000	Investment		52,500
Reserves and other Funds		Investment in PF		
Reserve Fund	12,000	Loans and Advances		
Staff Provident Fund	-	Sundry Debtors		23,200
Secured loans	-	Current Assets		
Unsecured loans	-	Stock		55,000
Deposits	18,500	Fixed Assets		
Current Liabilities		Furniture	10,000	
Creditors	13,000	Less : Depreciation	375	9,625
Proposed Dividend	600	Other Items		-
Unpaid Dividend	-	P & L A/c		-
Interest accrued	-	Current losses		-
Other Liabilities				
Education Fund	1,000			
P & L A/c	58,625			
	1,65,725			1,65,725

Illustration 13 :

From the following Trial Balance of Nitin Co-operative Credit Society Ltd. as on 30th June 2011 and other information, prepare Profit and Loss A/c for the year ended 30th June, 2011 and Balance Sheet as on that date.

Trial Balance

Particulars	₹	Particulars	₹
Cash in Hand	700	Share Capital	7,50,000
Cash with Banks	14,000	Reserve Fund	50,000
Fixed Deposit with M.S. Co-operative Bank	1,55,000	Members Deposits	22,47,750
Office Furniture	7,000	Unpaid Dividend	2,100
Interest on Deposits	80,000	Dividend Equalisation Reserve	18,000
Interest due on Loans	8,000	Staff Provident Fund	20,000
Salary and Allowances	30,000	Profit & Loss Appropriation A/c Balance	31,000
Establishment for Executive Officer	5,000	Interest	1,78,000
Printing and Stationery	400	Renewal Fees	4,000
Traveling and Conveyance	600	Sundry Income	300
Insurance Premium	1,000	Co-operative Development Fund	2,000
Contribution to Provident Fund	2,000	Education Fund	500
Loan due from Members	30,00,000		
	33,03,700		33,07,700

Adjustment :

1. Interest due to members deposits ₹ 5,000.
2. interest accrued due but not received ₹ 2,000.
3. Addition to Furniture during the year ₹ 1,000. Charge depreciation at 10% on closing balance.
4. Salary due but not paid 300, whereas one employee is given salary in advance on 30-6-2011 ₹ 500.
5. Audit fee unpaid for the year ₹ 3,000.
6. Authorised Capital was ₹ 1,00,000 shares of 10 each.
7. Directors propose the following appropriations for the current year.
   a) Dividend to shareholders at 5%.
   b) Necessary amount to Reserve Fund.
   c) 5% of Net Profit (after contribution to Reserve Fund) to Co-operative Development Fund.
   d) Contribution to Dividend Equalisation Reserve ₹ 2,000.
   e) Transfer to Building Fund ₹ 10,000. ***(Oct.07, adapted)***

Nitin Co-operative Credit Society Ltd.
Profit & Loss Account For the year ended 30-6-2011

Dr. **Cr.**

Particulars		₹	Particulars		₹
To Interest on Deposits	80,000		By interest	1,78,000	
Add: Interest due	5,000	85,000	Add: Interest due	2,000	1,80,000
To Salary and allowance	30,000		By other income		
Add: Outstanding	300		-Renewal Fees	4,000	
	30,000		-Sundry Income	300	4,300
Less: Advances	500	29,800			
To Printing and stationery		400			
To Contribution to provident fund		2,000			
To Depreciation on Furniture		700			
To Outstanding Audit Fees		3,000			
To Other expenses and fees					
-Establishing for Executive officer	5,000				
-Traveling & Conveyance	600				
-Insurance Premium	1,000	6,600			
To Net Profit		56,800			
		1,84,300			1,84,300

Balance Sheet as on 30-6-2011

Liabilities	₹	Assets		₹
Share capital		Cash Balance		
Authorized Capital		Cash in Hand		700
1,00,000 Shares of ₹ 10 each	10,00,000	Cast at Bank		14,000
Issued Capital		Investments		
75,000 Shares of ₹ 10 each	7,50,000	F.D. with M.S. Co-operative Bank		1,55,000
Reserve Fund and other funds		Provident Fund Investment		NIL
Reserve Fund	50,000	Loans and Advances		
Dividend Equalisation Reserve	18,000	Loan due from Members		30,00,000
Staff Provident Fund	20,000	Sundry Debtors		NIL
Co-operative Development Fund	2,050	Current Assets		
Education Fund	500	Interest due on loans	8,000	

Depreciation Fund	700	Add : Interest due	2,000	10,000
Staff Provident Fund	NIL	Fixed Assets		
Secured Loans	NIL	Office furniture	6,000	
Unsecured Loans	NIL	Add : Addition	1,000	7,000
Deposits		Other Expenses & Losses		
Members Deposits	22,47,750	Advance Salary		500
Current Liabilities & Provisions		Other Debtors		
Outstanding Salary	300	Losses		NIL
Outstanding Audit Fees	3,000			
Unclaimed Dividend	NIL			
Unpaid Dividend	2,100			
Interest due but not paid				
Interest due on Member's Deposits	5,000			
Other Liabilities	NIL			
P & L appropriation A/c				
Opening 31,000				
Current Year 56,800	87,800			
	31,87,200			31,87,200

4.9 EXERCISES:

Theory Questions :

1. What are the special features in case of Co-operative society in Maharashtra?
2. Write short notes on
   i) Managing Committee
   ii) Bye-Law of Co-operative Society.
   iii) Education Fund
   iv) Consumer Co-operative society
3. What are Books of Accounts maintain by Co-operative Society.
4. How is the net profit is calculated by the Co-operative Society.
5. What are the different types of Co-operative Societies.
6. Write short notes on returns of Co-operative societies?

Particulars Questions :

1. The following particulars relate to a sports club :

Receipts and Payments Accounts for the year ended 31st December 2010.

Particulars	Rs.	Particulars	Rs.
To Balance 1st January	8,400	By Secretary's salary	2,000
To Admission fee 09	2,000	By Printing & Stationery	5,200
To Admission fee 10	20,000	By Publicity	3,200
To Subscriptions 09	1,200	By Fire insurance	2,400
To Subscriptions 10	30,000	By Investments purchased	40,000
To Subscriptions 11	800	By Balance, 31st December	15,600
To Rent received	6000		
	68,400		68,400

Income and Expenditure Account for the year ended 31st December, 2010

Particulars	Rs.	Particulars	Rs.
To Secretary's salary	3,000	By Admission fee	21,000
To Printing & Stationery	4,000	By Subscriptions	31,200
To Publicity	3,200	By Rents received	8,000
To Audit Fees	1,000		
To Fire insurance	2,000		
To Depreciation on equipment	18,000		
To Balance (Excess of income over expenditure)	28,600		
	60,200		60,200

The assets on 1st January, 2010 included :	₹
Advance to staff	10,000
Club Grounds and Pavilion	88,000
Sports Equipment	1,50,000
Furniture and Fixtures	28,000

Prepare the opening and closing Balance Sheets

Exercise 2

From the following Trial Balance Natu Co-operative Consumers Society Ltd. Pune as on 31-3-2011, prepare Trading and Profit and Loss Account for the year ended on 31-3-2011 and Balance Sheet as on that date after considering the adjustments given.

Trial Balance

Particulars	Dr. Rs.	Cr. Rs.
Share capital	-	1,60,000
Calls in arrears	10,000	-
Reserve Fund	-	15,000
Common Goods Fund	-	5,000
Opening stock of Consumer's Goods	1,10,000	-
Furniture	48,000	-
Education Fund	-	8,000
Sundry Creditors	-	20,000
Sundry Debtors	30,000	-
Commission Payable	-	4,000
Salaries	71,000	-
Commission	17,400	-
Rent, Rate and Taxes	20,000	-
Postage	12,100	-
Land	9,000	-
Interest on Investment	-	10,000
Equipment	20,000	-
Purchases	16,40,000	-
Investment	1,00,000	-
Sales	-	20,60,500
Cash in hand	25,000	-
Cash at Bank	1,70,000	-
	22,82,500	22,82,500

Adjustments :

a) Outstanding rent payable on 31-03-2011 was ₹ 1,000.
b) Charge 5% depreciation on furniture.
c) Closing Stock of consumers' goods is valued at cost ₹ 1,40,000.
d) Interest accrued on Investment ₹ 2,000.
e) Investment includes ₹ 75,000 be investment of staff P.F.

Exercise 3 :

Co-operative Society rendering Loans and Rationing facilities to its members has the Trial Balance as on 31.3.2011 as follows :

Trial Balance

Particulars	Dr. Rs.	Cr. Rs.
Member Share Capital	--	14,100
Member's Deposit	--	30,000
Dead Stock	7,000	-
Stationery and Printing	750	-
Bank share Purchased	5,000	-
Sahakari Sangh Share Purchased	2,000	-
Bank Loan (Simple)	-	31,000
Members' Loan	83,250	-
Interest on Members Loans	-	53,150
Purchase of rationing Grains	1,20,000	-
Sale of rationing grains	-	1,27,500
Office rent	9,000	
Salaries	10,550	-
Traveling Expenses	1,250	-
Freight	1,300	-
Coolie charges	900	-
Bank Current A/c	33,500	-
Bank Interest	26,250	-
Reserve and Other Funds	-	45,100
Cash Balance	100	-
	3,00,850	3,00,850

Adjustments :

1. Closing Stock of Rationing Grains on 31.3.2011 was Rs. 35,000/-.
2. outstanding Office Rent is Rs. 1,000/-.
3. provide for Audit Fees due Rs. 600/-.
4. Provide depreciation on Deadstock at 5%.
5. Provide Bad Debts Reserve Rs. 1,500/-.

You are required to prepare Trading, Profit & Loss Account for the year ending on 31.3.2011 and Balance Sheet as on that date.

Trial Balance of Ramkupa Co-operative Society as on 31.3.2011

	Dr. Rs.		Cr. Rs.
Purchases	24,00,000	Interest	89,000
Freight Inward	1,000	Transfer Fees	200
Stock (1-4-2011)	1,20,000	Dividend	23,000
Rent	5,600	Sales	28,00,000
Postage	2,000	Commission	32,000
Bank Interest	62,000	Rent received	6,000
Subscription to Periodicals	1,000	Share Capital	6,00,000
Advertisement	7,000	Reserve Fund	1,00,000
Staff Salaries	17,000	Building Fund	79,000
Electricity Charges	1,600	Bad Debts Funds	32,000
Repairs	1,000	Share Capital	
Meeting Expenses	2,000	Redemption Fund	16,000
Printing & Stationery	5,700	Depreciation Fund	5,000
Traveling Expenses	1,800	Education Fund	1,000
Cash	12,200		
Bank	52,000		
Shares in Co-op. societies	39,000		
Fixed Deposit	2,00,000		
Deposit with M.S.E.B.	500		
Library	300		
Building	3,91,500		
Debtors	4,60,000		
	37,83,200		37,83,200

Adjustments :

a) Closing stock was valued at Rs. 1,50,000.
b) Depreciate Building at 5% p.a.
c) Provide for audit fees Rs. 5,000 and salary Rs. 15,000.
d) Interest due but not received Rs. 700.
e) Advance salary Rs. 1,500.
f) Transfer Rs. 2,000 to Share Capital Redemption Fund.
g) Transfer to education Fund Rs. 500.

Prepare Trading and Profit & Loss Account for the year ended 31.3.2011 and Balance sheet as on that date.

Exercise 5

From the following Trial Balance of Bharat Co-operative Purchase and Sales Society Ltd. as on 31.3.2011, prepare Trading and Profit & Loss Account for the year ended 31.3.2011 and Balance Sheet as on that date.

	Dr. Rs.		Cr. Rs.
Opening Stock	1,90,000	Share Capital	2,50,000
Furniture	60,000	Reserve Fund	50,000
Deposits	20,000	Creditors	30,000
Sundry Debtors	40,000	Profits & Loss A/c (1-4-2010)	90,000
Staff Salaries	1,50,000	Profit & Loss A/c (1-47-2010)	10,000
Commission	40,000	Admission Fees	2,000
Rent	20,000	Sales	39,00,000
Postage & Telegram	5,000	Co-operative Development Fund	5,000
Conveyance	10,000		
Printing & Stationary	6,000		
Dividend paid	6,000		
Purchases	32,00,000		
Freight & Cartage	90,000		
Investments	1,50,000		
Cash	3,000		
Bank Balance	3,47,000		
	43,37,000		43,37,000

Adjustments :

a) Closing stock was valued at Rs. 3,00,000.

b) Rent payable Rs. 3,000.

c) Commission due but not paid Rs. 15,000.

d) Salary of Rs. 500 was paid in advance.

e) Outstanding audit fees amounted to Rs. 6,000.

f) The society declared 5% dividend on its paid up capital as on 31.3.2010 for the year 2009-10. It transferred 25% of its profits for the year ended 31.3.2010 to Reserve Fund and also transferred Rs. 5,000 to Co-operative Development Fund. These appropriations were approved in the general meeting held on 1-09-09.

g) Interest on investment due but not received Rs. 5,000.

h) The Directors propose to recommend dividend of 10% for the current year.

i) Depreciate furniture by 5%.

Exercise 6.

From the following Trial Balance of Manu Consumers Co-operative Society Ltd. prepare Trading and Profit & Loss Account for the year ended 31.3.2011 and a Balance Sheet as on that date.

	Dr. Rs.		Cr. Rs.
Purchases :		Sales :	
Provisions	1,29,000	Provisions	1,35,000
Cloth	25,000	Stationary	90,000
Stationary	60,000	Sugar	1,20,000
Sugar	1,14,000	Cloth	40,000
Freight & Octroi	7,000	Miscellaneous Income	500
Salary to Employees	25,000	Dividend	200
Printing & Stationary	1,500	Discount Received	3,500
Miscellaneous Expenses	500	Interest	1,200
Telephone Charges	500	Bills Payable	16,000
Commission	100	Security Deposit from Employees	5,000
Repairs	400	Share capital	4,00,000
Meeting Expenses and Conveyance	3,000	Reserve Fund	12,000
Contribution to Staff Provident Fund	3,000	Investment	
Professional Tax	1,000	Fluctuation Fund	10,000
Bonus to Staff	4,000	Share Capital	
Discount allowed	3,300	Redemption Fund	9,000
Interest	1,000	Depreciation Fund	6,000
Cash at Bank	90,000	Staff Provident Fund	25,000
Share of M.S.C.F.	3,500		
Advances	600		
Loans against		Rebate on Purchases	7,000
Staff provident Fund	10,000		
Opening Stock	65,000		
Building	2,88,000		
Furniture	20,000		
Staff P.F. investment	25,000		
	6,80,400		6,80,400

Additional Information :

a) Closing stock was valued at Rs. 6,00,000.
b) Outstanding audit fees Rs. 2,000.
c) Depreciate Building and Furniture by 5% and 10% respectively.
d) Interest due but not received Rs. 4,000.
e) Directors propose to recommend dividend at 5%.

7. Ganesh Consumer's Co-operative Stores Ltd. Parel

Balance Sheet as on 31.3.2010

Liabilities	₹	Assets	₹
Share Capital	60,000	Cash	2,500
Deposits from Members	37,500	Bank	1,000
Reserve Fund	10,000	Investment (Shares of DCCB)	8,000
Interest due	200	Government Securities	5,000
Creditors	3,000	Fixed Deposits	8,500
Sales Tax due	800	Interest due	300
Salaries Payable	500	Furniture	5,000
Dividend Payable	1,500	Debtors	38,500
Profit and Loss A/c		Stock	50,500
Last Year 800			
2009-10 5,000	5,800		
	1,19,300		1,19,300

Receipts and Payments A/c for the year ended 31.3.2011

Receipts	₹	Payments	₹
To Balance b/d		By Share Capital	1,000
Cash	2,500	By Deposit Repaid	24,000
Bank	1,000	By Purchases	5,55,000
To Share Capital	3,000	By Sales Returns	3,500
To Deposits from member	5,000	By Carriage inward	10,000
To Sales	6,50,000	By Commission	2,500
To Purchases Returns	12,500	By Interest	2,150
To Sundry Income	2,700	By Education Fund	5,500
To Sundry Debtors	6,30,000	By Honorarium	3,250
To Sundry Creditors	4,70,000	By Sales Tax	5,500
To Fixed Deposits	1,000	By Dividend paid	3,250
To Interest	3,000	By Bank Charges	225
To Dividend	800	By Salaries	17,000
		By Contribution to Provident Fund	1,200
		By Travelling Expenses Directors	800
		Staff	4,750
		By Rent	4,800
		By Allowance to MD	500
		By Postage & Telephones	1,490
		By Printing and Stationery	4,600

		By Audit Fees	750
		By Sundry Expenses	385
		By Debtors	6,15,000
		By Creditors	4,60,000
		By Furniture	5,000
		By Fixed Deposits	32,000
		By Balance c/d	
		Cash	4,400
		Bank	21,000
	17,80,800		17,80,800

Adjustment :

- **a)** Authorised Capital 2,00,000 shares of Rs. 10 each.
- **b)** Stock on 31.3.2011 Rs. 1,05,000.
- **c)** Depreciate Furniture Rs. 500.
- **d)** Provide for Doubtful Debts Rs. 800.
- **e)** Outstanding on 31.3.2011.

	Rs.
Salaries	1,000
Interest Receivable	150
Interest Payable	100
Sales Tax due	1,200

- f) Appropriation out of profits of the year 2009-2010 were as follows :

	Rs.
Reserve Fund	7,000
Dividend	3,000
Honorarium	600
Education Fund	200

Prepare final accounts strictly as per MSC Act :

Exercise 8

Following is the trial balance of a S.I.E.S. College Employees Consumers Co-operative Society as on 31.3.2010. Prepare Trading Account and Profit & Loss Account for the year ended 31.3.2011 and Balance Sheet as on that date.

	Dr. Rs.		Cr. Rs.
Stock (1-4-2011)	16,000	Sales	6,45,900
Purchase	6,25,000	Returns	70
Carriage	3,750	Reserve Fund	9,000
Salaries	8,000	Govt. Loans	1,200
Miscellaneous Expenses	900	Govt. Grants	800
Interest on Govt. Loan	150	Education Fund	2,000
Legal Charges	100	Creditors	6,000
Printing & Stationery	1,000	Building Fund	35,330
Cash and Bank	31,000		
N.S.C. VIIth issue	500		
Deposit with Govt.	200		
Electricity	300		
Advances	4,000		
Dead Stock	500		
Deposit with Consumers Federation	8,900		
	7,00,300		7,00,300

Adjustments :

a) Audit fees due Rs. 4,000.
b) Provide depreciation on Dead Stock at 10%.
c) Provide for Bad Debts Rs. 100.
d) Stock at the end of the year is valued at Rs. 15,000.
e) Interest Accrued on investment Rs. 2,000.

Exercise 9.

Following is the trial balance of Madadev Co-operative Credit society Ltd. on 31.3.2010.

Prepare Final Accounts for the ended 31.3.2011 after taking into consideration additional information.

	Dr. Rs.		Cr. Rs.
Loans due	3,70,000	Share Capital	1,00,000
Contribution to Provident Fund	300	Reserve Fund	10,000
Insurance	200	Deposit from Members	2,70,000
Traveling Expenses	250	Dividend payable	300
Printing & Stationery	100	Dividend	
Salaries	5,000	Equalization Fund	4,000
Interest due on Bonus	1,000	Staff Provident Fund	3,000
Interest on Deposits	9,000	Profit & Loss Appropriation A/c	4,500
Furniture	900	Interest	25,000
Fixed Deposit with Saraswat Co-op.Bank	29,150	Co-operative Development Fund	500
Cash with Bank	2,000	Education Fund	100
Cash	200	Miscellaneous Income	700
	4,18,100		4,18,100

Additional Information :

- **a)** Interest due on members' deposits Rs. 4,000.
- **b)** Interest due but not received Rs. 1,000
- **c)** Outstanding salary Rs. 2,000.
- **d)** Unpaid audit fees Rs. 1,000.
- **e)** Authorized capital 50,000 shares of Rs. 10 each.
- **f)** Directors propose to recommend dividend at 5%.

Objective Question :

Answer in brief :

1. Define Co-operative Society.
2. Define Co-operative year.
3. Define Bye-Laws of a Co-operative society.
4. State different type of member of a society.
5. Mention two powers of managing committee of Co-operative Society.
6. What is Education Fund.
7. State different types of consumers Co-operative society.
8. Mention two items shown under heading Current Assets.
9. Give two examples of contingent Liabilities.
10. Who Can became Nominal member of Co-operative Society.

Multiple Choice Questions :

1. Under The Maharashtra Co-operative Act, a society must prepare final A/c for the year ended.

    i) In form VI   ii) in forms N

    iii) As per schedule VI A   iv) in cash Basis

2. Persons who keeps custody / maintains Accounting Records.

    a) The member   b) The Chairman

    c) Accountant   d) The managing committee

3. Day to day management of society vests in

    a) General Body   b) Staff

    c) Audit Committee   d) The managing Committee

4. Explanation of a member can be done

    a) by Registrar   b) by the Chairman

    c) General Body   d) managing committee

5. As per society Act no part of profit distributed by way of Dividend.
   a) Approval of General Body b) Board of Directors
   c) Majority Member d) Non & Above
6. Receipts & payment A/c can be prepared by a Co-op. Society.
   a) u/s 79 of MSCA b) Rule 61 of M.S.C.S. Rule
   c) not required d) u/s 50 of Income tax Act 1961
7. Under M.S.C.S. Act, a society must prepared the following financial statement for accounting year.
   a) Profit & Loss A/c b) Receipts a payment
   c) Balance sheet d) All the above.
8. Under the Maharashtra Co-operative society Act, Audit of a Co-operative society can be conducted by
   a) A chartered Accounts b) Cost Accountant
   c) Employee & Co-operative d) Non of above
9. A member who holds jointly share of society, a his name appears first in share certificate.
   a) Nominal member b) Associate member
   c) Sympathizes member d) Non of the above
10. Amendment of Bye-Laws of the society can be done.
    a) by General body ½ members
    b) by passing it in managing committee meeting.
    c) by Registrar of societies
    d) by General Body by ⅔ majority subject to approval from Registrar.
11. Every society earning income, must pay Income Tax.
    a) only on its Taxable income
    b) Income of societies are not taxable
    c) On Gross Profit, if it is consumer Co-operative society.
    d) Only if it sales goods to non-member.
12. A consumer society can sale Goods
    a) To member b) non-members
    c) only on cash / credit d) All the above

13. Goodwill is shown in the Balance sheet of a Co-operative society under heading.

    a) Fixed Assets b) Investment

    c) Miscellaneous Expenditure

    d) Non-of the above.

14. Cash & Bank balance shown under hading in the Balance Sheet.

    a) Current Assets b) Loans a Advance

    c) Sundry Assets d) Non of the above

15. Reserve for Bad a doubtful debt is shown under heading in Balance Sheet of Co-operative society.

    a) Deducted from debtors b) Reserve & other reserve

    c) Contingent liabilities d) Non-of the above.

❖❖❖❖

5

FOREIGN CURRENCY CONVERSION

Unit Structure

5.1 INTRODUCTION

A Foreign branch usually maintains a complete set of books under double entry principles. So, the accounting principles of a Foreign Branch will be the same as those applying to an Inland Branch. Before a Trial Balance of the Foreign Branch is incorporated in the H. O. books, it has to be converted home currency.

5.2 RULES FOR CONVERSION:

In case of fluctuating rates of exchange, the following rules for conversion are applied:

No	***Nature of Account***	***Exchange Rate Applicable***
1.	Fixed Assets	Rates ruling at the time they were acquired.
2.	Fixed Liabilities	Rates ruling as on the date of the Trial Balance.
3.	Current Assets & Liabilities	Rates ruling as on the date of the Trial Balance.
4.	Remittance sent by the branch	At the actual rates at which they were made.
5.	Goods received from H. O. as well as goods returned to H. O.	At the rate ruling on the date of dispatch or the date of receipt.
6.	The Nominal A/c's (except next two)	Average rate ruling during the accounting period.

7.	Depreciation on Fixed Assets	Rate of conversion applicable in case of the particular asset concerned [as indicated in (a) above].
8.	Opening and Closing stocks	Rates ruling of on the opening and closing dates respectively.
9.	Balance in H. O. A/c	Value at which the Branch A/c appears in H. O. books on the date.

5.3 BRANCH ACCOUNTING (FOREIGN BRANCH)

FOREIGN BRANCHES

When a branch is established abroad it is called as a Foreign Branch. The accounting arrangements for a foreign branch are exactly the same as for any independent branch up to the Trial Balance. But in this case accounts are maintained in foreign currency to correspond with the local conditions the main problem which the Head Office has to face is the restatement of accounts one currency into another. In order to incorporate the Trial Balance of a foreign branch in the books of the head office it must be translated (using appropriate exchange rates) into the currency of the Head Office.

Rules for conversion of Branch Trial Balance when Exchange Rates are 'Stable'

Exchange rate is said to be stable, when it does not vary to a great extent from time to time. In this situation, a fixed exchange rate can be used to convert the branch Trial Balance into the currency of the Head Office with the exception of (a) Remittances, and (b) Head office Current Account.

a. Remittances: These are converted at the actual rates at which they were made.
b. Head Office Current Account: The actual figures shown for the Branch Current Account in the books of the Head Office (after taking into consideration in-transit items).

When the foreign branch Trial Balance is converted into local currency, a new Trial Balance takes birth known as "Difference on Exchange Account" is opened to make the Trial Balance agree.

Closing of Difference on Exchange Account

i. For debit entry on trial balance

Profit and Loss Account Dr.

OR

Exchange Reserve Account Dr. (if any)

To Difference on Exchange Account

ii. For credit entry on trial balance

Difference on Exchange Account Dr.

To Exchange Reserve Account Big Differences)

(If the difference is very small, it can credited to Profit & Loss account)

The format of the new Trial Balance of the branch is generally drawn up as follows:

Foreign Branch Converted Trial Balance as at 31st December, 2006

Sr. No.	Heads of Accounts	L. F.	Currency		Rate of Exchange	Rupees	
			Dr. $	Cr. $		Dr. Rs.	Cr. Rs.

5.4 SOLVED PROBLEMS

Q.1 ABC Ltd. has a branch in New York as on 31st March 2011 the trial balance of the branch was as follows:

Particulars	Dr. $	Cr. $
Head office account	-	8,500
Goods from head office	44,000	-
Furniture	9,000	-
Bank Balance	1,250	-
Cash	250	-
Rent	1,200	-
Outstanding Expenses	-	800
Sundry debtors	3,150	-
Sales	-	61,000
Stock – 1.4.2010	8,500	-
Salaries	2,800	-
Insurance	150	
	70,300	**70,300**

The branch account in head office shows debit balance Rs. 2,14,500 and goods sent to branch credit balance of Rs. 13,12,500.

Depreciation furniture @ 10% p.a.
Stock at branch 31st March 2011 was $ 7,500
Furniture was purchased in 1997 when 1$ = Rs. 20
Exchange Rates were:
On 1.4.2010 1$= Rs. 28
On 31.3.2011 1$= Rs. 30
Average rate 1$= Rs. 29

You are required to prepare branch trial balance by converting in rupees and prepare branch trading and profit and loss a/c for the year ended 31.3.2011 and balance sheet as on that date.

Solution:

Converted Trial Balance as on 31st March 2011
In the Books of Branch

Sr. no.	Particulars	Dr. ($)	Cr. ($)	Rate	Dr. ($)	Cr. (Rs)
1	Head office account		8,500	Actual	-	214,500
2	Sales		61,000	29	-	1,769,000
3	Goods from Head Office	44,000	-	Actual	1,312,500	
4	Stock on 1-4-10	8,500	-	28	238,000	
5	Furniture	9,000	-	20	180,000	
6	Cash in box	250	-	30	7,500	
7	Bank Balance	1,250	-	30	37,500	
8	Salaries	2,800	-	29	81,200	
9	Rent	1,200	-	29	34,800	
10	Insurance	150	-	29	4,350	
11	Outstanding expenses	-	800	29		24,000
12	Sundry debtors	3,150	-	30	94,500	-
13	Difference in Exchange	-	-	30	17,150	-
		70,300	70,300		2,007,500	2,007,500

In the books of Branch, Trading & Loss a/c for the year ended 31st March 2011

Particulars	Dr. Amt	Particulars	Cr. Amt
To Opening stock a/c	238,000	By Sales	1,769,000
To Goods from H. O.	1,312,500	By Closing stock	225.000
To Rent	34,800		
To Gross profit c/d	408,700		
	1,994,000		1,994,000
To Salaries	81,200	By Gross profit b/d	408.700
To Insurance	4,350		
To Depreciation	18,000		
To Diff. in exchange	17,150		
To Net profit c/d	288,000		
	408.700		408.700

Balance sheet as on 31st March 2011

Liabilities		Amt	Assets		Amt
Head office a/c	2,14,500		Furniture	1,80,000	
Add: Net profit	2,88,000	5,02,500	Less: Depreciation	18,000	1,62,000
			Cash in box		7,500
Outstanding expenses		24,000	Bank balance		37,500
			Sundry debtors		94,500
			Closing Stock		2,25,000
		5,26,500			5,26,500

Q.2 Kedar Ltd. Mumbai had a branch in Washington U. S. A. which is in the nature of an integral operation as defined under AS 11.

The following Trial Balance as on 31st March 2011 is available from respective books.

particular	Mumbai H. O. Rs. In thousand		Washington Branch (Dollars in thousand)	
Shares Capital	-	2,000	-	-
Branch and H. O. Current A/c	120	-	-	7
Reserves & Surplus	-	1,000	-	-
Commission Receipts	-	256	-	100
Land	500	-	-	-
Building	1,000	-	-	-
Building depreciation provision	-	200	-	-
Plant & Machinery	2,500	-	200	-
Depreciation provision	-	600	-	130
Office Expenses	25	-	18	-
Rent	-	-	12	-
Stock	100	-	20	-
Branch stock reserve & provision	-	4	-	-
Wages & salaries	75	-	45	-
M D's Salary	30	-	-	-
Debtors & Creditors	280	200	60	30
Purchase & Sales	240	520	20	123
Goods sent to branch	-	100	5	-
Cash and Bank	10	-	10	-
	4,880	**4,880**	**390**	**390**

The following additional information is also available;

a. Stock on 31.3.2011 at Mumbai Rs. 1,50,000 and at Washington $ 3,125.
b. Head office sends goods to the foreign branch at cost plus 25%
c. Depreciation is to be provided on building and on plant and machinery @ 10% on written down values respectively.
d. Provide 5% for doubtful debts.
e. The managing director is entitled to 2% commission on net profits and income tax is to be provided @47.5%.
f. The rates of exchange for conversion of foreign branch trial balance are

   Opening rate 1$ = 2 Closing rate 1$ = 24

   Average rate 1$ = 22 for fixed assets 1$ = 18

You are required to:

a. Convert the Washington foreign branch trial into rupees.
b. Prepare the trading and P & L a/c for the year ended 31.3.2011 and the balance sheets showing the head office and branch performance and position separately to the extent possible.

Solution:

Converted Branch Trial Balance as on 31st March 11

(in thousand)

Sr. No.	Particulars	Dr ($)	Cr ($)	Rate	Dr (Rs)	Cr (Rs)
1	Plant & Machinery	200	-	18	3,600	-
2	Prov for plant n machinery	-	130	18	-	2,340
3	Debtors n creditors	60	30	24	1,440	720
4	Stock as on 1-4-2004	20	-	20	400	-
5	Cash/bank balance	10	-	24	240	-
6	Purchases/Sales	20	123	22	440	2,706
7	Goods sent to Branch	5	-	Actual	100	-
8	Wages/Salaries	45	-	22	990	-
9	Rent	12	-	22	264	-
10	Office expenses	18	-	22	396	-
11	Commission recd	-	100	22	-	2,200
12	Branch /H.O. Current a/c	-	7	Actual	-	120
13	Diff	-	-		216	-
		390	390		8,086	8,086

Trading & Profit and Loss a/c for the year ending 31st March 2011

Particular		Amt	Particular		Amt
To opening stock	100,000	400,000	By sales	520,000	
To purchases	240,000	440,000	By goods sent to branch	100,000	
To wages & salaries	75,000	990,000	By closing stock	150,000	
To goods from H.O.	-	100,000			
To gross profit c/d	355,000	851,000			
	770,000	2,781,000		770,000	2,781,000
To Office Expenses	25,000	396,000	By gross profit b/d	355,000	851,000
To M. D's salary	30,000	-	By opening stock reserve	4,000	
To depreciation	-	-	By commission recd	256,000	2,200,000
Building	80,000	-			
Plant & machinery	190,000	126,000			
To R. D. D.	14,000	72,000			
To stock reserve A/c	15,000	-			
To M. D. Commission	5,220	-			
To rent	-	264,000			
To diff. in exchange	-	216,000			
To provision for tax	121,496	939,075			
To net profit c/d	134,284	1,037,925			
	615,000	3,051,000		615,000	3,051,000

Balance sheet as on 31st March 2011

Liabilities	Amt	Assets		Amt
Share Capital	2,000,000	Land		500,000
Reserve & Surplus	1,000,000	Building	1,000,000	
Profit & Loss a/c	1,172,209	Less: Prov for Dep	280,000	720,000
Creditors	920,000	Plant & Machinery	6,100,000	
O/s M.D's Commission	5,220	Less: Prov for Dep	3,256,000	2,844,000
Provision for L.T.	1,060,571	Debtors	1,720,000	
		Less: RDD @5%	86,000	1,634,000
		cash & Bank		250,000
		closing stock	225,000	
		Less: Stock reserve	15,000	210,000
	6,158,000			6,158,000

Journal Entry for Stock Reserve:

1. For Closing Stock Reserve-
Profit & Loss A/c Dr 15,000
To Stock Reserve A/c Cr 15,000

2. For Opening Stock Reserve –
Stock Reserve A/c Dr 4,000
To Profit & Loss A/c Cr 4,000

Q.3 The following balance appeared in the books of Surat branch of firm in London as on 31st December 2010.

Particular	Dr. Rs.	Cr. Rs.	Particular	Dr. Rs.	Cr. Rs.
Sales	-	225,000	Stock as on 1st Jan 2008	25,200	-
Debtors	78,000	-	Purchases	150,000	-
Bills Receivable	20,800	-	Wages/salaries	9,600	-
Head Office account	-	66,400	Rent, Rates, Taxes	7,200	-
Cash at Axis Bank	57,980	-	Furniture	9,820	18,200
Miscellaneous Exp	3,000	-	Bills payable		52,000
			Creditors		
				361,600	**361,600**

Stock on 31st December 2010 was Rs. 65,000. Surat branch a/c in the books of London head office showed a debit balance of Rs. 2.680 on 1st December 2010.

Furniture was purchased from a remittance of Rs. 350 received from London H. O. which exactly covered the cost of the item.

The rates of exchange were:

31.12.2009 Rs. 28/1 pound

31.12.2010 Rs. 26/1 pound

The average rate for 2008 may be taken at Rs. 24 per 1 pound.

Prepare the trading and p&I account and balance sheet of Surat branch in the books of London H. O. assuming the branch operations to be integral to the main operation.

Solution:

Converted Trail Balance as on 31st Dec. 2010

Sr. No.	Particulars	Rs.	Rs.	Rate	Pound	Pound
1	Stock as on 1.1.10	25,200	-	28	900	-
2	Purchases	1,50,000	-	24	6,250	-
3	Sales	-	2,25,000	24	-	9,375
4	Debtors	78,000	-	26	3,000	-
5	Creditors	-	52,000	26	-	2,000
6	Bills receivable	20,800	-	26	800	-
7	Bills payable	-	18,200	26	-	700
8	Wages/Salaries	9,600	-	24	400	-
9	Rent, rates, taxes	7,200	-	24	300	-
10	Miscellaneous exp	3,000	-	26	115	-
11	Furniture	9,820	-	-	350	-
12	Cash at Axit Bank	57,980	-	26	2,230	-
13	Head office a/c	-	66,400		-	2,680
14	Diff. in exchange	-	-		410	-
					14,755	14,755

Trading and profit n Loss a/c for the year ending 31.12.2010

Particular	Amt	Particular	Amt
To opening stock a/c	900	By sales	9,375
To purchases	6,250	By closing stock	2,500
To wages/salaries	400		
To gross profit c/d	4,325		
	11,875		11,875
		By gross profit b/d	4,325
To rent, rates and taxes	300		
To difference in exchange	410		
To N. P. c/d	3,615		
	4,325		4,325

Balance sheet as on 31st Dec 2010

Liabilities		Amt	Assets	Amt
Head office a/c	2,680		Debtors	3,000
Add: N. P	3,615	6,295	Bills Receivable	800
			Furniture	350
Creditors		2,000	Cash at Axis bank	2,230
Bills payable		700	Closing Stock	2,500
			Miscellaneous Exp	115
		8,995		8,995

Q.4 Kaun Banga Karedpati Computers Ltd. has head office at Mumbai and Branch at California. The branch submits the foll trial balance as on 31st Mar. 2011.

Particulars	Dr. US $	Cr. US $	Assets	Dr. US $	Cr. Us $
Head office a/c	-	11,606	Salaries	71,130	-
Goods received			Office rent	44,316	-
From H.O.	12,725		Taxes & insurance	13,655	-
Purchases & sales	5,06,323	7,87,777	Debtors and	1,17,117	-
Stock (1.4.10)	13,100		creditors	37,119	1,57,617
Plant & machinery	27,650		Printing & stationary	16,303	-
Furniture & fixtures	18,220		Postage & telegrams	14,784	-
Cash in hand	3,233		Freight	14,784	-
Cost at bank	60,180		conveyance	1,145	-

1. The branch a/c in H. O. showed a blebit balance of Rs. 5,11,100 and goods sent to branch a/c showed a credit blance of Rs. 5,66,600.
2. Plant & machinery was acquired when US$ Rs. 46. furniture was acquired by branch on 1st Jan'11 when Rs. 100 were equivalent to US $ 2.50 H. O. office charges depreciation on plant & machinery @20% p.a. & on furniture & fixture @10% p.a. The closing stock as on 31st Mar'11 at branch was US $

16,550. The exchange rates were as under 1st Apr.'10 US $ 38.50 31st Mar'11 US $ 2.50 Aug US $ 44 convert the branch trial balance into rupees & prepare profit & loss a/c for the year ended 31st Mar'11 prepare balance sheet of California branch of Kaun Banega Karodpati Ltd. as on 31st Mar'11 the foreign operation is in the nature of an integral operation.

Solution:

Converted Trial Balance for the year ending 31st Mar'11

Particulars	Dr. ($)	Cr. ($)	Rate	Dr. ₹	Cr. ₹
Head office a/c	-	11606	Actual		511100
Goods received from H. O.	12725		Actual	566600	
Purchases & sales	506323	787777	44	22278212	34662188
Stock (1.4.10)	13100		38.50	504350	
Plant & Machinery	27650		46	1271900	
Furn & fixtures	18220		40	728800	
Salaries	71130		44	3129720	
Office rent	44316		44	1949904	
Taxes & insurance	13655		44	600820	
Drs/ & creditors	117117	157617	40	4684680	6304680
Priting & creditors	37119		44	1633236	
Printing & stationery	37119		44	717332	
Postage & telegram	16303		44	650496	
Freight	14784		44	50380	
Conveyance	1145		44	129320	
Cash in hand	3233		40		
Diff. in exchanges				2407200	
Cash at bank	60180		40	175018	
Diff in exchange				41477968	41477968

In the books of branch Trading and Profit & Loss a/c for year ended 31st Mar'11

Particulars	Amt	Particulars	Amt
To opening stock	5,04,350	By sales	34662188
To purchases	2,22,78,212		6,62,000
To goods from H. O.	5,66,600	By closing stock (16550 x 40)	
To gross profit c/d	1,19,75,026		
	35324188		35324188
To salaries	31,29,720	By gross profit b/d	1,19,75,026
To office rent	19,49,904		
To taxes & insurance	6,00,820		
To printing & stationary	16,33,236		
To postage & telegram	7,17,332		
To fright	650496		
To conveyance	50380		
To depreciation	327260		
To diff in exchange	1,75,018		
To net profit c/d	27,40,860		
	1,19,75,026		1,19,75,026

Balance sheet as on 31st Mar'11

Liabilities	Amt	Amt	Assets	Amt	Amt
Head office a/c	5,11,100		Plant & mach.	12,71,900	
(+) Net profit	2740860	3251960	(-) & fixtures	2,54,380	10,17,520
			(-) depn	728800	6,55,920
creditors		63,04,680	Debtors	72,880	46,84,680
			Cash in hand		1,29,320
			Cash at bank		24,07,200
			Closing stock		6,62,000
		9556640			9556640

Q.5 XY Ltd has a branch in NewYork. At the end of each year (Dec' 31) a trial balance sent by the branch in dollar currency is converted into rupee currency at the head office. (Bhopal)

The foll trial balance for the year has been complied at the branch as on 31st Dec.'10

Particulars	Dr. $	Cr. $
Bill receivable	2,500	-
Sundry debtors	3,800	-
Sundry creditors	-	1,100
Purchases	1,3,500	-
Sales	-	22,800
Furniture & fixtures	1,340	-
Stock (1st Jan'10)	2,000	-
Establishment expenses	2,000	-
Salaries	1,400	-
Rent, rates & taxes	400	-
Sundry expenses	1,450	-
Depreciation on furniture & fixtures	128	-
Remittances to H. O.	1,502	-
Head office account	-	6,920
Cash on hand & at bank	800	
	30,820	30,820

The stock in hand on Dec 31st '10 was $ 2,500 the rates of exchange were:-

Dec 31'09 to June 30'10 1 $ = 34 July 1st '10 to 31st Dec '10 1$ = 36.

In the Bhopal books the balance of New York branch a/c & of the remittances from New York branch a/c appear as 1,78,847 & Rs. 37,068 respectively. The original furniture & fixture were bought when the rate of exchange was $ 1 = Rs. 30. Convest the above trail balance into rupee currency & prepare the final a/c of the branch.

Solution:

Converted trial bal. as on 31st Dec.'10 in bks of brch

Particulars	Dr. $	Cr.$	Rate	Dr.₹	Cr.₹
Bills receivable	2500		36	90,000	
Sundry debtors	3,800		36	1,36,800	
Sundry creditors		1100	36		39,600
Purchases & sales	13500	22800	35	472500	798000
Furn & fixtures	1340		30	40,200	
Stock 1st Jan 2010	2000		34	68,000	
Establishment expenses	2000		35	70,000	
Salaries	1400		35	49,000	
Rent, rates & taxes	400		35	14,000	
Sundry expenses	1450		35	50,750	
Dep. On furn & fixture	128		30	3840	
Remittance to H. O.	1502		Actual	37068	
H O. account		6920	Actual		178847
Cash on hand & at bank	800		36	28800	
Diff in exchange					44511
				1060958	1060958

In the books of XY Ltd Co. Trading & Profit and Loss a/c for the year ending 31st Dec'10

Particulars	₹	Particulars	₹
To opening stock	68,000	By sales	7,98,000
To purchases	4,72,500	By closing stock ($ 2500x 36)	90,000
To gross profit b/d	3,47,500		
	8,88,000		8,88,000
To establishment exps	70,000	By gross profit b/d	3,47,500
To salaries	49,000	Bu diff. in exchange	44511
To rent rates & taxes	14,000		
To sundry expenses	50,750		
To Dep^n on furniture	3,840		
To net profit c/d	2,04,421		
	3,92,011		3,92,011

Balance sheet as on 31st Dec'10

Liabilities	₹	₹	Assets	₹
H. O. current a/c	1,78,847		Furn & fixture	40,200
(+) net profit	2,04,421			
	383268		Bills receivable	90,000
(-) remittance	37068	346200	Sundry debtors	1,36,800
Sundry creditors		39,600	cash in hand & at bank	28800
			Closing stock	90,00
		3,85,800		3,85,800

5.5 EXERCISE

Q.1 White Coller Ltd have branch in Canada. On 31st December 2010 the trial balance of the branch was as given below.

Particulars	Dr. $	Cr. $
Stock as on 1.1.2010	7,500	-
Head office account	-	9,000
Sales	-	81,000
Goods from head office a/c	45,000	-
Furnitures and fixtures	10,000	-
Owing for expenses	-	-
Rent	1,000	-
Taxes. Insurance etc	250	-
Salaries	13,000	-
Sundry debtors	12,250	-
Cash in hand	1,050	-
Cash in bank	950	1,000
	91,000	**91,000**

The branch account in the head office showed a debit balance of Rs. 1,12,500 and goods sent to branch account a credit balance of Rs. 8,07,500.

Furniture and fixtures are acquired on 1.1.2010. 1 pound = Rs. 15. Provide depreciation @ 10% p.a.

The exchange rates were:>
January 1 pound = Rs. 17.50
December 1 pound = Rs. 18.50
Average 1 pound = Rs. 18.00

The stock at branch on 31st December 2010 were valued at 4500 pounds. Prepare Trading, P & L A/c Balance Sheet of Canada branch account for the year ended 31.12.2010

Q.2 Zenith Computers Ltd. has H. O. at Mumbai and branch at Boston U. S. A. The branch submits the following trail branch as on 31st March 2011.

Particular	Dr. $	Cr. $
H. O. account	-	12,707
Goods received from H. O.	11,600	-
Purchases and sales	387,516	610,416
Stock as on 1.4.2010	14,316	-
Plant & Machinery	34,120	-
Furniture and fixtures	16,316	--
Cash at bank	3,816	-
Cash in hand	1,314	-
Salaries	68,016	-
Office rent	42,340	-
Taxes and insurance	11,672	-
Debtors and creditors	125,430	127,977
Printing and stationary	12,148	-
Postage and telegram	11,010	-
Courier charges	6,316	-
Internet charges	2,718	-
Legal expenses	2,452	-
	751,100	**751,100**

The branch account in head office showed a debit balance or Rs. 5,84,222 and goods sent to branch account showed a credit balance of Rs. 5,56,800. Plant & Machinery was acquired by the branch as on 31st December 2010, when 1US $ = Rs. 45. Furniture & fixtures were acquired by the Boston branch on 30th June 2010 when Rs. 100 was equal to US $ 2.50. H. O. provides depreciation on the P&M @ 25 % p.a. and on furniture and fixture @ 10% p.a.

The Boston branch reported closing stock of US$ 15,350 on 31st March 2002. The exchange rates were at under.

1.4.2010	US $ 1 = 43.50
31.3.2011	Rs. 100 = US $ 2.00
Average	US $ 1 = 45.50

Convert the branch trial balance into rupees and prepare branch profit and loss a/c for the year ended 31st March 2011. also you are required to prepare balance sheet of Boston branch Zenith Computers Ltd. as on 31st March 2011.

Q.3 GHCL & Co. has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch furnishes you with its trail balance as on 31st March 2011 and the additional information given thereafter.

Particulars	Dr. Rs.	Cr. Rs.	Particulars	Dr. Rs.	Cr. Rs.
Stock on 1.4.2004	300	-	Rent, rates & taxes	360	-
Purchases and sales	800	1,200	Sundry charges	160	-
Sundry debtors	400	-	Computers	240	-
Sundry creditors	-	300	Bank balance	420	-
Bills of exchange	120	240	New York office a/c	-	1,620
Wages and salaries	560	-			
				3,360	3,360

Additional Information:

1. Computers were acquired from a remittance of US $ 6,000 received from New York head office and paid to the suppliers. Depreciate computers at 60% for the year.
2. Unsold stock of Mumbai branch was worth Rs. 4,20,000 on 31st march 2011.
3. The rates of exchange may be taken as follows:
   - **a.** On 1.4.2010 @ Rs. 40 per US $
   - **b.** On 31.3.2011 @ 42 per US $
   - **c.** Average exchange rate for the year @ Rs. 41 per US $
   - **d.** Conversion in $ shall be made upto two decimal accuracy.

You are asked to prepare in US $ the revenue statement of the year ended 31st March 2011 and the balance sheet as on that date of Mumbai branch as would appear in the book of New York head office of GHCL & Co.

You are informed that Mumbai branch account showed a debit balance of US $ 39,609.18 on 31.03.2011 in New York books and there were no items pending reconciliation. The foreign operation is in the nature of an integral operation.

Q.4 The foll. Balance appeared in the books of PQR Branch of the firm in Sydney on 31st Dec. 2010.

Particulars	Dr. Rs.	Cr. Rs.	Particulars	Dr. Rs.	Cr. Rs.
Stock as on 1st Jan '10	50,400		Wages & salaries	19,200	
Purchases	3,00,000		Rent rates & taxes	14,400	
Debtors	1,56,000		Miscellaneous exp	6,000	
Bills receivable	41,600		Furniture & fitting	19,640	
Sales		4,50,000	Cash at bank	1,15,960	
Creditors		1,04,000	Head office a/c		1,32,800
Bills payable		36,400			
				7,23,200	**7,23,200**

1. Stock as on 31st Dec'10 was Rs. 1,43,000 PQR Branch a/c in the books of Sydney head office showed Dr. balance on £5,360 on 31st Dec'10.
2. Furniture which exactly were purchased from a remittance of £ 700 received from Sydney head office which exactly covered the cost of item.
3. The rates of exchange were: 31st Dec' 09 Rs. 28 per £, 31st Dec'10 Rs. 26 per £. Average rate for year 2010 may be taken at Rs. 24 per £.
4. Prepare trading profit and loss a/c and balance sheet of PQR branch in the books of Sydney head office assuming branch operation to be integral to the main operations.

Q.5 KBK Ltd has a branch in Sydney, Australia at the end of 31st Mar 2011 the foll. ledger of the Sydney office.

Sydney (Australia Dollars thousand)

Particulars	**Dr. A$**	**Cr. A$**	**Particulars**	**Dr. A$**	**Cr. A$**
Plant & machinery (cost)	200	-	Goods sent to branch	5	
Prov. For plant			Wages & salaries	45	
& machinery	-	130	Rent	12	
Debtors / creditors	60	30	Office expenses	18	
Stock (1.4.10)	20		Commission receipts		100
Cash/bank balance	10		Branch H. O.		
Purchases/sales	20	123	Current a/c		7
				390	390

<u>Theory Question</u>

1. What is Foreign Branch Accounting.
2. Short note on Conversion of Foreign Branch Trial Balance.

❖❖❖❖

6

PUBLISHED CORPORATE ANNUAL REPORTS

Unit Structure

6.1 INTRODUCTION

Today reporting by companies has to assume a high level of importance. Formerly annual reports used to be less revealing and reporting was not timely and we not catering to requirement of various shareholder. More was concealed than what was revealed. But today thanks to investor awareness global standards used the effective functioning of regulatory bodies corporate reporting has become more revealing.

6.2 DEVELOPMENTS OF FINANCIAL REPORTING OBJECTIVES

The subject of financial reporting objectives has been generally recognized as very important in accounting area since a long time. Many accounting and professional institutes all over the word have made attempts to define the objective of financial statements and financial reporting which are vital to the development of financial accounting theory and practice. This section describes developments in this area at the international level, particularly USA and UK. It can be rightly said that most of the attempts in the area of financial reporting objectives has been made in USA and UK and accounting developments in these countries have great impact on accounting developments and practices in other countries of the world.

Accounting Principles Board (APB) Statement No. 4

In USA, the APB Statement No. 4 “Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises”, (1970) was the first publication which published the objectives of financial statements. These objectives may be summarized as follows:

1. The particular objectives of financial statements are to present fairly, and in conformity with generally accepted accounting principles, financial position, results of operations, and other changes in financial position.

2. The general objectives of financial statements are

- **a)** To provide reliable information about economic resources and obligations a business enterprise in order (i) Evaluate its strengths and weakness, (ii) Show its financing and investment, (iii) Evaluate its ability to meet its commitments, and (iv) Show its resources base for growth;
- **b)** To provide reliable information about changes in net resources resulting from a business enterprise’s profit-directed activities in order (i) Show to investors expected dividend return, (ii0 Show the operation’s ability to pay creditors and suppliers, provide jobs for employees pay taxes, and generate funds for expansion, (iii) Provide management with information for planning and control, and (iv) Show its long-term profitability;
- **c)** To provide financial information useful for estimating the earning potential of the firm;
- **d)** To provide other needed information about changes in economic resources and obligations; and
- **e)** To disclose other information relevant to statement user’s needs.

3. The qualitative objectives of financial accounting are the following:

- **a)** Relevance, which means selecting the information most likely to aid users in their economic decisions.
- **b)** Understandability, which implies not only that the selected information must be intelligible but also that the users can understand it.

- **c)** Verifiability, which implies that the accounting results may be corn borated by independent measurers using the same measurement methods.
- **d)** Neutrality, which implies that the accounting information is directed towards the common needs of users rather than the particulars needs of specific users.
- **e)** Timeliness, which implies an early communication of information to avoid delays in economic decision-making.
- **f)** Comparability, which implies that differences should not be the result of different financial accounting treatments.
- **g)** Completeness. Which implies that all the information that 'reasonably' fulfils the requirements of other qualitative objectives should be reported?

True blood Report

To develop objectives of financial statements, a Study Group was appointed in 1971 by American Institute of Certified Public accountants under the Chairmanship of Robert M. Trueblood. The Study Group solicited the views of more than 5000 corporations, professional firms, unions, public interest groups, national and international accounting oragnisations and financial publications. The study group conducted more than 50 interviews with executives from all sectors of the business and from government. To elicit the widest range of views, 35 meeting were held with institutional and professional groups representing major segments of the US economy.

The study group submitted its report to AICPA in October 1973. The objectives developed in the study Group Report are as follows:

1. The basic of financial statements is to provide information useful for making economic decisions.
2. An objective of financial statements is to serve, primarily, those users who have limited authority, ability, or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise's economic activities.
3. An objective of financial statements is to provide information useful to investors and creditors for predicting, comparing and evaluating potential cash flows to them in terms of amount, timing and related uncertainty.
4. An objective of financial statements is to provide users with information for predicting, comparing, and evaluating enterprise earning power.

5. An objective of financial statements is to supply information useful in judging management's ability to utilize enterprise resources effectively in achieving the primary enterprise goal.
6. An objective of financial statements is to provide factual and interpretative information about transactions and other events which is useful for predicting, comparing and evaluating enterprise earning power. Basic underlying assumptions with respect to matters subject to interpretation, evaluation, prediction, or estimation should be disclosed.
7. An objective is to provide a statement of financial position useful for predicting, comparing and evaluating enterprise earning power. This statement should provide information concerning enterprise transactions and other events that are part of incomplete earning cycles. Current values should also be reported when they differ significantly from historical costs. Assets and liabilities should be grouped or segregated by the relative uncertainty of the amount and timing of prospective realization of liquidation.
8. An objective is to provide a statement of periodic earnings useful for predicting, comparing and evaluating enterprise earning power. The net result of completed earning cycles and enterprise activities resulting in recognizable progress towards completion of incomplete cycles should be reported. Changes in values reflected in successive statements of financial position should also be reported, but separately, since they differ in terms of their certainty realization.
9. An objective is to provide a statement of financial activities useful for predicting, comparing, and evaluating enterprise earning power. This statements should report mainly on factual aspects of enterprise transactions having or expected to have significant cash consequences. This statement should report data that require minimal judgment and interpretation by the compiler.
10. An objective of financial statements is to provide information useful for the predictive process. Financial forecasts should be provided when they will enhance the reliability of users' predictions.
11. An objective of financial statements for governmental and non-profit organizations is to provide information useful for evaluating the effectiveness of management of resources in achieving the organization's goals. Performance measures should be qualified in terms of identified goals.
12. An objective of financial statements is to report on those activities of the enterprise affecting society which can be determined and described or measured and which are important to the role of the enterprise in its social environment.

The twelve objectives recommended in the report seem to fall into five tiers as described in Table 1 Tier I is the basic objective which underlies all financial reporting. Tire II objectives identify the financial statement users and their needs. Tier III objectives translate users' needs in terms of enterprise. Tire IV objectives describe information about the enterprise which satisfied or is presumed to satisfy users' needs. Tire V objectives concern skeletal financial statements directed at communicating the information identified by the objectives in Tire IV.

6.3 BASIC OBJECTIVES OF FINANCIAL REPROTING

Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. The prospects for those cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans, the prospects for those cash receipts are affected by an enterprise's ability to generate enough cash to meet its obligations when due and its other cash operating needs, to reinvest in operations, and to pay cash dividends, and may also be affected by perceptions of investors and creditors generally about that ability, which affect market prices of the enterprise's securities. Thus, financial reporting should provide information to help investors, creditors, and others assess the amount, timing and uncertainty of prospective net cash inflows to the related enterprise (Para 37).

Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity) and the effects of transactions, events, and circumstances that change resources and claim to those resources (Para 40)

Financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use Information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' and creditors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (Para. 42)

The primary focus of financial reporting is information about an enterprise performance provided by measures of earning and its components (Para 43)

Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, including cash dividends and other distribution of enterprise resources to owners, and about other factors that may affect an enterprise liquidity of solvency (Para 49).

Financial reporting should provide information about hoe management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it (Para 50).

Financial reporting should provide information that is useful to managers and directors in making decisions in the interests of owners (Para 52).

Besides the above objectives, the FASB Concept No. 1 contains the followings important highlights;

1. Financial reporting is not an end in itself but is intended to provide information that is useful in making business and economic decisions.

2. The objectives of financial reporting are not immutable- they are affected by the economic, legal, political and social environment in which financial reporting takes place.

3. The objectives are also affected by the characteristics and limitations of the kind of information that financial reporting can provide.

   I. The information pertains to business enterprises rather than to industries or the economy as a whole.

   II. The information often results form approximate, rather than exact, measures.

   III. The information largely reflects the financial effects of transactions and events that have already happened.

   IV. The information is but one source of information needed by those who make decisions about business enterprises.

   V. The information is provided and used at a cost.

4. The objectives in this statement (Concept No. 1) are those of general purpose external financial reporting by business enterprises.

a) The objective stem primarily from the needs external users who lack the authority to prescribe the information they want and must rely on information management communicates to them.

b) The objective are directed toward the common interest of many users in the ability of the enterprise favorable cash flows but are phrased using investment and credit decisions as a reference to give them a focus. The objectives are intended to be broad rather than narrow.

c) The objectives pertain to financial reporting and are not restricted to financial statements.

5. Investors' and 'Creditors' are used broadly and include not only those who have or contemplate having a claim to enterprise resources but also those who advise or represent them.

6. although investment and credit decisions reflect investor's and creditors expectations about future enterprise performance, those expectations are commonly based at least partly on valuations of past enterprise performance.

7. The primary focus of financial reporting is information about earnings and its components.

8. Information about enterprises earning based on accrual accounting generally provides a better indication of an enterprise's present and continuing ability to generate favorable cash flows than information limited to the financial effects of cash receipts and payments.

9. financial reporting is expected to provide information about an enterprise's financial performance during a period and about how management of an enterprise has discharged its stewardship responsibility to owners.

10. Financial accounting is not designed to measure directly the value of a business enterprises, but the information it provides may be helpful to those who wish to estimate its value.

11. Investors, creditors, and others may use reported earnings and information about the elements of financial statements in various ways to assess the prospects for cash flows. They may with for example, to evaluated management's performance, estimate 'earning power', predict future earnings, assess risk, or to confirm, change, or reject earlier predictions or assessments. Although financial reporting should provide basic information to aid them, they do their own evaluating, estimating, predicting, assessing, confirming, changing, or rejecting.

12. Management knows more about the enterprise and its affairs than investors, creditors or other outsiders' and accordingly can often increase the usefulness of financial information by identifying certain events and circumstances and explaining their financial effects on the enterprise.

6.4 INDIAN PERSPECTIVE IN FINANCIAL REPRTING

In India, the basic purpose of financial reporting (as per Indian Companies Act. 1956) appears to provide shareholders of the company, financial statement and other related information. In India, shareholders, especially the existing shareholders, are the primary users of financial reporting. However, there are other potential users also who are equally interested in financial reporting information for making economic decisions. Therefore, the purpose of financial reporting in India should be to serve not only existing investors but prospective investors and creditors, and other external users as well.

GENERAL PURPOSE FINANCIAL REPORTING

Generally speaking, the term 'financial reporting' is used to mean general purpose external financial reporting. Often it is said that the purpose of financial reporting is the preparation of general purpose reports for external users.

The users of financial statements include present and potential investors, employees, lenders, suppliers, and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their different needs for information. These needs included the following:

a) **Investor –** The providers of risk capital and their advisors are concerned with the risk inherent, and return, provided by their investment, they need information to help them determine whether they should buy, hold or sell. Shareholders are also interested in information which enables them to assess the ability of the enterprise to pay dividends.

b) **Employees –** Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

c) **Lenders –** Lenders are interested in information them enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

d) **Suppliers and other trade creditors –** Suppliers and other creditors are interested in information that enable them to determine whether amounts owing to them will be pain when due. Trade creditors are likely to be interested in an enterprise over a shorter period than lenders unless they are dependent upon the continuation of the enterprises as a major customer.

e) **Customers –** Customer have an interest in information about the continuance of an enterprise, especially when they have a long-term involvement with, or are dependent on, the enterprise.

f) **Governments and their agencies –** Governments and their agencies are interested in the allocation of resources and, therefore, the activities of enterprises. They also require information in order to regulate the activities of enterprises, determine taxation policies and as the basis for national income and similar statistics.

g) **Public –** Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.

While all of the information needs of these users cannot be met by financial statements. There are needs which are common to all users. As investors are providers or risk capital to the enterprise, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy.

The management of an enterprise has the primary responsibility for the preparation and presentation of the financial statements of the enterprise. Management is also interested in the information contained in the financial information that helps it carry out its planning, decision-making and control responsibilities. Management has the ability to determine the form and content of such additional information order to meet its own needs. The reporting of such information, however, is beyond the scope of this framework. Nevertheless, published financial statements are based on the information used by management about the financial position, performance and changes in financial position of the enterprise.

Management as user of information is as interested in information about assets, liabilities, earnings, and related elements as external users are, and need, generally, the same kind of information about these elements as external users. Thus, management is major user of the same information that is provided by external financial reporting. However, management's primary role in external financial reporting is that of communicating information for use by others. For that reason, it has a direct interest in the cost, adequacy, reliability, and understandability of external financial reporting.

SPECIFIC PURPOSE REPORT

Financial reporting objectives in accounting literature so far has focused on general purpose financial reporting which aims to satisfy the information needs of all potential users. Company law provisions in almost all countries of the world have consistently accepted the utility of general purpose financial reporting. Due to this the separate (specific) needs of specific users have been largely ignored on the assumption that general purpose reports can satisfy the information needs of all external users. However, a reasoning has also been made suggesting that the needs of specific users may be better served by presenting specific purpose reports to help them in their separately identifiable decision functions. For instance, financial reports submitted to obtain credit or loans, or government, or financial reports given to trade and industry may not satisfy other users' needs and expectations.

However, the proposal of specific purpose reports in company financial reporting is criticized on some counts.

Firstly, the cost of the developing specialized reports to satisfy special requirements of specific users may exceed the benefit when the company financial reporting policy is determined in its totally. Secondly, specialized needs of specific users cannot be ascertained with any degree of certainty. Thirdly, issuing multiple reports about the financial results of an enterprise can create confusion among various users. Multiple reports increase the perceived complexity of the environment complexity induce change in decision-makers' cognitive processing capabilities and, in turn, can decrease the effectiveness of decision-making by users. Fourthly, multiple reports may not be desirable and practicable from the standpoint of information economics.

To conclude, company financial reporting, in future, will continue to adhere to general purpose reporting system to aid investors, creditors, and other external users in their economic decisions. Meanwhile, in order to achieve the objectives of financial reporting (though general purpose reports0 there is a continuous need to investigate many vital aspects relating general purpose financial reports such as identifying information need of such users, determining the feasibility of providing general purpose information to meet theses needs, determining the manner of reporting such information, and having a feedback from the users regarding the use and relevance of general purpose information.

6.5 QUALITATIVE CHARACTERISTICS OF FINANCIAL REPORTING INFORMATION

Qualitative characteristics or qualities necessary for information serve a major supporting role in the decision usefulness, decision model approach to accounting theory. Qualitative characteristics are the tributes that make the information provided in financial statements useful of users. Accounting information that is reported to facilitate economic decisions should possess certain characteristics or normative standards. The information must be useful in the formulation of objectives, the making of decisions, or the direction and control of resources to accomplish objectives. The utility of information lies in its ability to reduce uncertainty about the actual state of affairs of a business enterprise to the user. The characteristics make information a desirable commodity and guide the selection of preferred accounting policies and methods form among available alternatives. These characteristics have been viewed as a hierarchy or qualities with usefulness for decision-making or most importance. The hierarchy of informational qualities which has been accepted by FASB (USA) in its Concept No. 2 Qualitative characteristics of Accounting Information is displayed in Table 12.2

International Accounting Standards Committee (IASC) has recognized the four principal qualitative characteristics of accounting information.

1. Understandability
2. Relevance
3. Reliability
4. Comparability

The other qualities suggested by IASC are materiality, faithful representation, substance over form, neutrality, Prudence, completeness, timeliness.

The qualitative characteristics that have been found possessing wider acceptance and recognition accounting literature are as follows;

1. Relevance

Relevance is closely and directly related to the concepts of useful information. Relevance implies that all those items of information should be reported that may aid the users in making decisions and / or predictions. In general information that is given greater weight in decision-making is more relevant. Specially, it is information's capacity to make a difference that identifies it as relevant to a decision. American Accounting Association's Committee to Prepare a Statement of Basic Accounting Theory defines relevance as the primary standard and requires that information must bear upon or be usefully associated with actions it is designed to facilitate or results desired to be produced. Financial Accounting Standards Board in its Concept No. 1 (Para 47, 1978) comments:

"Relevant Accounting information must be capable of making a difference in a decision by helping users to form predictions about the outcomes of past, present and future events or to confirm or correct exceptions".

The question of relevance arises after identification and recognition in of the purpose for which the information will be used. It means that information relevant for one purpose may not be necessarily relevant for other purposes. Information that is not relevant is useless because that will not aid users in making decisions. The relevant information also reduces decision-maker's uncertainty about future acts. A necessary test of the relevance of reportable data is the ability to predict events of interest to statement users. To say that accounting information has predictive value is not to say that it is itself a prediction. Predictive value here mans value as an input into a predictive process, not value directly as a prediction.

In today's complex financial accounting environment, a general purpose report aims to fulfill the common needs of users so that information should be relevant to all users. In judging relevance of general purpose information, attention is focused on the common needs of user and specific needs of particular users will not be considered in this relevance information for all possible users and which may command universal relevance. However, this has been recognized a potentially satisfactory solution.

To conclude, relevance is the dominant criterion in taking decisions regarding information disclosure. It follows that relevant information must be reported. Relevance has been defined in accounting literature, but no satisfactory set of relevant items of information has been suggested. In this regard, an important task is to determine that needs of user (s) and the items of information that are relevant to target user (s).

2. Reliability

Reliability is described as one of the two primary qualities relevance and reliability that make accounting information useful for decision-making. Reliable information is required to form judgment about the earning potential and financial position of a business firm. Reliability differs from item to item. Some items of information presented in an annual report may be more reliable than others. For example, information regarding plant and machinery may be less reliable than certain information about current assets because of differences in uncertainty of realization. Reliability is that quality which permits users of data to depend upon it with confidence as representative of what it purports to represent

3. Understandability

Understandability is the quality of information that enables users to perceive its significance. The benefits of information may be increased by making it more understandable and hence useful to a wider circle of users. Presenting information which can be understood only by sophisticated users and not by others, creates a bias which is inconsistent with the standard of adequate disclosure. Presentation of information should not only facilitate understanding but also avoid wrong interpretation of financial statement. Thus, understandable financial accounting information presents data that can be understood by users of the information and is expressed in a form and with terminology adopted to user's range of understanding. The Corporate Report observes:

"Understandability does not necessarily mean simplicity, or that information must be presented in elementary terms, for that may not be consistent with the proper description of complex economic activities. It does mean that judgment needs to be applied in holding the balance between the need to ensure that all material matters are disclosed and the need to avoid confusing users by the provision of too much detail. Understandability calls for the provision, in the clearest form, of all the information which the reasonably instructed reader can make use of and the parallel presentation of the main features for the use of the less sophisticated."

Understandability of information is governed by a combination of user characteristics, and characteristics inherent in the information. Understandability should be determined in terms of broad classes of users (decision-makers) rather than particular user groups. Since company financial reporting aims at general purpose external financial reporting, all relevant users' needs should be considered in deciding the understandability of the information, and no decision should be based on specific circumstances of individual decision-makers.

4. Comparability

Economic decision required making choice among possible courses of actions. In making decision, the decision-maker will make comparisons among alternatives, which is facilitated by financial information. Comparability implies to have like things reported in a similar fashion and unlike things reported differently. Hendriksen defines comparability as “the quality or state of having enough like characteristics to make comparisons appropriate”. FASB (USA) defines comparability, “as the quality or state of having certain characteristics in common, and comparison is normally a quantitative assessment of the common characteristics. Clearly, valid comparison is possible only if the measurement used-the quantities or ratios- reliably represent the characteristic that is the subject of comparison”.

Financial reports of different firms are not able to achieve comparability because of differences in business operations of companies and also because of the management’s viewpoints in respects of their transactions. Also, because there are different accounting practices to describe basically similar activities. Two corporate management may view the similar risk, uncertainly, benefit or sacrifice in different fashions and, thus, this would lead to different implications of financial statements. With information that facilitates interpretation, users are able to compare and assess the results of similar transactions and other events among enterprises.

Efforts, therefore, should be directed towards developing accounting standards to be applied in appropriate circumstances to facilitate comparisons and interpretation of data: areas of difference in accounting practices, which are not justified by difference in circumstances, should be narrowed; selection of an accounting practice should be based on the economic substance of an event or a transaction being measured and reported; and a desire a produce a particular financial statement result should not influence choice between accounting alternatives.

5. Consistency

Consistency of method over a period of time is a valuable quality that makes accounting numbers more useful. Consistent use of accounting principles from one accounting period to another enhances the utility of financial statements to users by facilitating analysis and understanding of comparative accounting data. It is relatively unimportant to the investor what precise rules or conventions are adopted by a company in reporting its earnings, if he knows what method is being followed and is assured that it is followed consistently from year to year. Lack of consistency produces lack of comparability. The value of inter-company comparisons is substantially reduced when material differences in income are caused by variations in accounting practices.

The quality of consistency can be applied in different situation, e.g. use of same accounting procedures by a single firm or accounting entity from period to period, the use of similar measurement concepts and procedures for related items within the statement of a firm for a single period, and the use of same procedures by different firms. If a change in accounting practices or procedures is made, disclosure of the change and its effects permits some comparability, although users can rarely make adjustments that make the data completely comparable.

Although consistency in the use of accounting principles from one accounting period to another is a desirable quality, but it, if pushed too far, will prove a bottleneck for bringing about improvement in accounting policies, practices, and procedures. No change to a preferred accounting method can be developing without sacrificing consistency; there is no way that accounting can develop without change. Users' needs in changing circumstances. When, it is found that current practices or presentations being followed are not fulfilling users' purposes, a new practice or procedure should be adopted. According to Backer, "different accounting methods are needed to reflect different management objectives and circumstances. The consensus of opinion among analysts interviewed was that standards are desirable as guidelines to financial reporting, but that management should be free to depart from these standards provided methods used and their effects are clearly disclosed".

Thus consistency and uniformity in accounting methods would not necessarily bring comparability. Instead of enforced uniformity, accounting standards should be developed which would be best or preferred methods in most cases. Such accounting standards should be followed unless there is a compelling reason why they will not provide a correct and useful reflection of business operations and results. Also, full disclosure should be made of the alternative method applied and, whenever practical, of the monetary difference resulting from deviations from the standard. To conclude, consistency is desirable, until a need arises to improve practices, policies, and procedures.

6. Neutrality

Neutrality is also known as the quality of freedom from bias' or objectivity. Neutrality means that, formulating or implementing standards, the primary concern should be the relevance and reliability of the information the results, not the effect that the new rule may have on a particular interest or user (s). a natural choice between accounting alternatives is free from bias towards a predetermined result. The objectives of (general purpose) financial reporting serve many different information users who have diverse interest, and no one predetermined result it likely to suit all user's interests and purposes. Therefore, accounting facts and accounting practices should be impartially determined and reported with no objective of purposeful bias toward any user or user group. If there is no bias in selection of accounting information reported, it cannot be said to favour one set of interests over another. It may, in fact, favour certain interests, but only because the information points that way.

To say that information should be free from bias is not to say that standards-setters or providers of information should not have a purpose in mind for financial reporting. In fat, information must be purposeful. Neutrality neither means 'without purpose' not does it mean that accounting should be without influence on human behaviour. Accounting information cannot avoid affecting behaviour, nor should it. If it were otherwise, the information would be valueless-by definition, irrelevant and- the effort to produce it would be futile. It is, above all, the predetermination of a desired result, that is the negation of neutrality in accounting. To be neutral, accounting information must report economic activity as faithfully as possible, without colouring the image it communicates for the purpose of influencing behaviour in some particular direction.

7. Materially

The concept of materiality permeates the entire field of accounting and auditing. The materiality concept implies that not all financial information need or should be communicated in accounting reports-only material information should be reported. Immaterial information may and probably should be omitted. Information should be disclosed in the annual report which is likely to influence economic decision of the users. Information that meets this requirement is material.

Generally, the decision-makers (investor, accountant and manager) see materiality in relation to actual assets or income. Investors see materiality in terms of the rate of changes or change in the rate of change. What seems not to be material in business may turn out to the very important in the investment market. It has been established that the effect on earning was the primary Standard to evaluate materiality in a specific case. Guidelines to test materiality are: amount of the item, trend of net income, average net income for a series of years, assets liability, trends and ratios establish meaningful analytical relationship of information contained in annual reports. Almost always, the relative rather than the absolute size of a judgment item determines whether it should be considered material in a given situation. Losses from bad debts or pilferage that could be shrugged off as routine by a large business may threaten the continued existence of a small one. An error in inventory valuation may be material in a small enterprise for which it cut earnings in half, but immaterial in an enterprise for which it might make barely perceptible ripple in the earnings.

8. Timeliness

Timeliness means having information available to decision-makers before it loses its capacity to influence decisions. Timeliness is ancillary aspect relevance. If information is either not available when it is needed or becomes available long after the reported events that it has no value for future action, it lacks relevance and is of little or no use.

Clearly, there are degrees of timeliness. Some reports need to be prepared quickly, say in case of takeover bid or strike. In some other contexts, such as routine reports by a business firm of its annual results, a longer delay in reporting information may materially affect the relevance and, therefore, the usefulness of information. But in order to have gain in relevance that comes with increased timeliness, it may involve sacrifices of other desirable characteristics of information, and as a result there may be an overall gain or loss in usefulness. For example, it may sometimes be desirable to sacrifice precision for timeliness, for an approximation produced quickly is often more useful than precise information that is reported after a longer delay. It can be argued that if in the interest of timeliness, the reliability of the information is sacrificed to a material degree; the usefulness of the information may be adversely affected.

9. Verifiability

The quality of verifiability contributes to the usefulness of accounting information because the purpose of verification is to provide a significant degree of assurance that accounting measures represent, what they purport to represent. Verification does not guarantee the suitability of method used, much less the correctness of the resulting measure. It does convey some assurance that the measurement rule used, whatever it was, was applied carefully and without personal bias on the part of the measurer. In this process, verification implies and enhances consensus about measurements of some particular phenomenon.

The Accounting Principles Board of USA defines verifiability as: “Verifiable financial accounting information provides results that would be substantially duplicated by independent measurers using the same measurement methods.”[22]

According to FASB, “Verifiability means no more than that several measurers are likely to obtain the same measure. It is primarily a means to attempting to cope with measurement problems stemming from the uncertainty that surrounds accounting measures and is more successful in coping with some measurement problems than others. Verification of accounting information does not guarantee that the information has a high degree of representational faithfulness and a measure with a high degree of verifiability is not necessarily relevant to the decision for which it is intended to be useful.’

10. Conservatism

Conservatism is generally referred to as a convention that many accountants believe to be appropriate in making accounting decisions.

There is a place for a convention, such as conservatism – meaning prudence in financial accounting and reporting, because business and economic activities are surrounded by uncertainty, but it needs to be applied with care. Conservatism in financial reporting should no longer connote deliberate, consistent, understatement of net assets and profits. Conservatism is prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered. Thus, if two estimates of amounts to be received or paid in the future are about equally likely, conservatism dictates using the less optimistic estimates. However, if two amounts are not equally likely, conservatism does not necessarily dictate using the more pessimistic amount rather than the more likely one. Conservatism no longer requires deferring recognition of income beyond the time that adequate evidence of is existence becomes available, or justifies recognizing losses before there is adequate evidence that they have been incurred.

11. Substance over From (Economic Realism)

Economic realism is not usually mentioned as a qualitative criterion in accounting literature, but it is important to investors. It is a concept that seems easy to understand but hard to define because perceptions of reality differ. In essence, economic reality means an accurate measurement, of the business operations, that is, economic costs and benefits generated in business activity. The definitional problem arises from cash v. accrual accounting, or the principle of matching costs with revenues. Accrual accounting is necessary for complex organizations, of course, but, where accruals and estimates have a considerable degree of uncertainty as to amount or timing, cash accounting would seem to come closer to economic realism.

There have been tendencies in accounting for "the media to become the message", i.e. for accounting numbers to become the reality rather than the underlying facts they represent. These may give the illusion of steady earnings and as a result, both investors and management may feel to know the facts about these fluctuations; if they find it useful to average earnings, they can do so themselves. The objective should be "to tell it like is".[25]

The above mentioned characteristics (relevance, Materiality, understandability, comparability, consistency, reliability, neutrality, economic realism) make financial reporting information useful to users. These normative qualities of information are based largely upon the common needs of users.

6.6 ASI, DISCLOSURE OF ACCOUNTING POLICIES

The institute of Chartered Accountants of India (ICAI) issued ASI titled Disclosure of Accounting Policies' in November 1979. This standard is now mandatory and deals with the disclosure of significant accounting policies followed in preparing and presenting Financial Statements.

In general accounting policies are not at present regularly and fully disclosed in all financial statements. Many enterprises include in the Notes on the Accounts, description of some of the significant policies.

Even among the few enterprises that presently include in their annual reports a separate statement of accounting policies, considerable variation exists. The statement of accounting policies forms part of the accounts in some cases while in others it is given as supplementary information.

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

ASI contains explanations on following points:

Fundamental Accounting Assumptions

1. Certain fundamental accounting assumptions underline the preparation and presentation of financial statement. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

The following have been generally accepted as fundamental accounting assumption;

a) Going Concern – The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operation.

b) Accrual – Revenues and costs are accrued, that is, recognized as they are earned or incurred (and not as money is received or paid) and recorded in the financial statement of the periods to which they relate. (The considerations affecting the process or matching costs with revenues under the accrual assumption are not dealt with in this statement.).

2. Nature of Accounting Policies

a) The accounting policies refer to the specific accounting principle and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

b) There is no single list of accounting policies which are applicable to all circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable. The choice of the appropriate accounting principles and the methods of applying those principles in the specific circumstances of each enterprise calls for considerable judgement by the management of the enterprise.

c) The various statements of the institute of Chartered Accountants of India combined with the efforts of government and other regularity agencies and progressive particularly in the case of corporate enterprises. While continuing efforts in this regard in future are likely to reduce the number still further, the availability of alternative accounting principles and methods of applying those principles is not likely to be eliminated altogether in view of the differing circumstances faced by the enterprises.

3. Areas in which deferring accounting policies are encountered

The following are examples of the areas in which different accounting policies may be adopted different enterprises:

- Method of depreciation, depletion and amortization
- Treatment of expenditure during Construction
- Conversion of translation of foreign currency items

- Valuation of inventories
- Treatment of goodwill
- Valuation of investments
- Treatment of retirement benefits
- Recognition of profit on long-term contracts
- Valuation of fixed assets
- Treatment of contingent liabilities

The above list of example is not intended to be exhaustive.

4. Considerations in the Selection of Accounting policies

The primary consideration in the selection of accounting policies by an enterprise is that the financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the enterprise as at the balance sheet data and of the profit or loss for the period ended on that date.

For this purpose, the major considerations governing the selection and application of accounting policies are:

a) **Prudence –** In view of the uncertainty attached to future events, profits are not anticipated but recognized only when realized though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

b) **Substance over Form –** The accounting treatment and presentation in financial statement of transactions and events should be governed by their substance and not merely by the legal form.

c) **Materiality –** Financial statement should disclose all 'material' items, the knowledge of which might influence the decisions of the user of the financial statements.

5. Disclosure of accounting Policies

(i) To ensure proper understanding of financial statement, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

(ii) Such disclosure should form part of the financial statements.

(iii) It would be helpful to the reader of financial statement it they are all disclosed as such is one place instead of being scattered over several statements, schedules and notes.

(iv) Examples of matters in respect of which disclosure of accounting policies adopted will be required are contained in point No. 3. This list of examples is not, however, intended to be exhaustive.

(v) Any change in an accounting policy which has a material effect should be disclosed. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent as certainable. When such amount is not as certainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statement for the current periods, but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

(vi) Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Accounting Standard in ASI

(i) All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

(ii) The disclosure of the significant accounting policies as such should form part of the financial statement and the significant accounting policies should normally be disclosed in one place.

(iii) Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements in affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

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

6.7 NOTES ON ACCOUNTS IN CORPORATE ANNUAL REPORTS

One of the important developments today in corporate reporting under schedules forming part of accounts and roles from part of accounts. Accounts normally consent of Balance Sheet and Profit & Loss Accounts and cash flow statement schedules for main part of accounts includes

(a) Schedule A - Share capital
(b) Schedule B - Reserve & Surplus
(c) Schedule C - Secured Loan
(d) Schedule D - Unsecured Loan
(e) Schedule E - Fixed assets
(f) Schedule F - Investment
(g) Schedule G - Current assets loans and advances
(h) Schedule H - Current Liabilities and provisions
(i) Schedule I - Deferred revenue terms
(j) Schedule J - Contingent liability
(k) Schedule K - Sales and Service
(l) Schedule L - Clts Increase
(m) Schedule M - Manufacturing, construction and Operating expense
(n) Schedule N - Staff Expenses
(o) Schedule O - Sales administrative and other expenses
(p) Schedule P - Investors & borrowers
(q) Schedule Q - Important accounting

Under Schedule Q viz significant accounting polices the are follow:

1. Basic of accounting
2. Sales and service income
3. Research & Development
4. Retirement benefits
5. Fixed Assets
6. Losses
7. Deprecations
8. Investment
9. Investor
10. Security premium account
11. Borrowing costs
12. Interest

13. Employee
14. Deferred revenue expenditure
15. Foreign currency transaction
16. Segment Reporting
17. Taxes on income
18. Accounting for Joint Ventures

Note forming part of accounts:

Under this a company the following are to the points of reporting by a company

1. Allotment of equity shares
2. Shareholder currently shares
3. Secured redeemable non point (NCBS) / Debentures
4. Loans and Mortgage
5. Consumer of finally debtors
6. Progress /money,
7. Balance with the schedule
8. Segment Reporting
9. Of related parts / related partly
10. Loss
11. Deferred tax assets / liabilities
12. Auditor remuneration
13. Vale of
14. Expenditure in foreign currency
15. Lest of SSI to when if company once more for so day
16. Sales corporate
17. Investor
18. Purchase of goods

6.8 DIRECTOR'S REPORT: -

Director's report is a report submitted by the directors of a company to its shareholders, appraising them of the performance of the company under its direction. It is an exercise of self-evaluation. Director's report expresses the opinion of directors on the state of the company, explains performance and the financial results, discusses company's plans for expansion, diversification or modernization, tells about appropriation of profits, and elaborates company's future prospects and plans for investments. It is a synopsis of the company's activities during the year and during the interim period between the date of the balance sheet and date of the annual report. Director's report should take the investors into confidence by providing useful insights into the activities of the business, more than what the financial statements provide.

Director's report is valuable and if read intelligently, gives the investor good sense of company's working, its problems and future prospects.

6.9 AUDITORS REPORT: -

Every company is subject to audit and an auditor makes a report to the members of the company on its state of affairs. It is a comment on accounts and on balance sheet and profit and loss account and other documents attached to the financial statements, which are laid in the AGM. Auditors report to shareholders contains an opinion as to whether the financial statements present a true and fair view of the state of affairs of the company, in case of a balance sheet and of profit or loss in case of profit and loss account. They also report whether the books of accounts are in agreement and whether there is any deviation from generally accepted accounting principles. It indicates the areas to which shareholders and investors must give due attention while assessing the financial strength of the company whose securities are being considered for investment.

6.10 EXERCISE

1. What do you mean by them accounting policy?
2. What is the remuneration of true blood report?
3. What are the primary objects of financial reporting?
4. Discuss the differ user of functional reporting?
5. What are the qualitative characteristics of financial reporting information?
6. What are the financial accounting
7. What are the areas in what different accounting plus are accounted? Discuss
8. Discuss important consideration in relating of accounting p
9. What do you mean by role on accounts in a corporate report?
10. Discuss schedules forming part of company annual report. Make a can study on a report?

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7

ACCOUNTING STANDARDS
PART I
(Borrowing Costs Accounting Standard No 16 and Segment Reporting Accounting Standard No.17)

Unit Structure

7.1 INTRODUCTION TO BORROWING COST

Business enterprises borrow funds for acquiring, constructing, building, fixed & other assets. These assets take time to make them usable or saleable. Interest has to be paid on borrowed funds immediately from the date of borrower. Also there are other costs associated with borrower. This accounting standard aims at prescribing the treatment of borrowing cost.

7.2 MEANING AND DEFINITION OF BORROWING COST

Borrowing costs are defined as interest and other cost incurred associated with borrowing of funds. These include following cost/charges:

1. Interest and commitment charge on borrowing.
2. Amortization of discounts or provision relating to borrowing.
3. Amortization of ancillary costs incurred in connection with arrangement of borrower.
4. Finance charges when the assets are acquired under finance leases.
5. Exchange difference arising from foreign currency borrowings to the extent they are regarded as an adjustment to interest costs.

This standard does not deal with cost of owners' equity or preference share capital.

Qualifying assets:

An asset which takes substantial period of time to get ready for its intended use or sale is called as qualifying asset.

Examples of qualifying assets:

1. Any tangible fixed asset which is in construction process or acquired fixed asset which is not ready for use or sale. e.g. plant and machinery
2. Any tangible asset which are in development stage or acquired but not ready for use e.g. patents
3. Investment property
4. Inventories that require a substantial period to bring them into saleable condition.

As per these accounting standard borrowing costs, which is directly related to the acquisition, construction or production of qualifying assets should be capitalized. Amount of borrowing cost eligible for capitalization is equal to actual borrowing cost incurred during the period less any income on temporary investment on borrowing account.

Conditions for capitalization of borrowing cost:

1. The borrowing cost which is directly attributable to acquisition, construction or production of qualifying asset is eligible for capitalization. Directly attributable cost are those cost which could have been avoided if the expenditure on the qualifying assets had not been made.
2. Qualifying asset will give future economic benefits to the enterprise.

Borrowing cost eligible for capitalization

a) Specific Borrowings

Amount of borrowing cost to be capitalized:

Actual borrowing cost incurred during the period…	xx
Less:	
Income on temporary investment out of borrowed amount…	(xx)
	Xx

b) General borrowings:

When the amount borrowed is generally used for acquisition of qualifying assets.

The borrowing cost to be capitalized should be decided by applying a capitalization rate to the expenditure of that asset. The capitalization rate should be weighted average cost of borrowing. The amount of borrowing cost capitalized during a period shall not exceed the amount of borrowing cost incurred during the period.

Commencement of capitalization of borrowing costs:

Conditions:

Following 3 conditions must be fulfilled before the commencement of capitalization of borrowing cost.

a) Activities which are essential to prepare the assets for its intended use should be in progress.
b) Borrowing cost is incurred.
c) Expenditure for acquisition, construction or production of a qualifying asset is being incurred.

This expenditure includes payment of cash, transfer of other assets or assumption of interest bearing liabilities. Progress payment received and grants received towards the cost incurred should be deducted from the expenditure.

Suspension of capitalization of borrowing costs
Capitalization of borrowing costs should be suspended during extended periods in which active development is interrupted. However capitalization of borrowing cost is not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

Cessation of capitalization:

1. Capitalization of borrowing cost should cease when all the activities necessary to prepare the qualifying asset for its intended use or sale are substantially completed. It means all relevant activities which are essential for intended use or sale of qualifying assets should be completed.

2. Construction of the qualifying asset is carried on in parts/phase and each part/phase can be used independently, required activities are completed for such phase and it is ready for intended use or sale, capitalization of borrowing cost for such part/phase will cease.

Disclosure in financial statements:

The financial statement should disclose:

1. The accounting policy adopted for borrowing cost
2. The amount of borrowing cost capitalized during the period

Substantial period:

The "substantial period" of time essentially depends upon the facts and circumstances of each case. However, ordinarily a period of 12 months is considered as substantial period of time. Sometimes a shorter or longer period can be justified on the basis of facts and circumstances of each case. In deciding the period, time which an asset takes, technologically and commercially to get it ready for its intended use or sale should be considered.

Fees paid for payment of loan

The prepayment fees paid for liquidating high cost debt and availing low cost debt in place of high cost debt cannot be capitalized because it is not a borrowing cost as per AS16.

Exchange difference:

Borrowing cost may include exchange differences arising from foreign currencies borrowings to the extent that they are regarded as an adjustment to interest cost.

AS16 covers exchange difference on the amount of principal of the foreign currency borrowings to the extent of differences between interest on local currency borrowings and interest on foreign currency borrowings.

Illustrations

1. On 20-04-2010, KIC Ltd. obtained loan from the bank for Rs. 25, 00,000 to be utilized as under:-

Construction of shed	Rs.10,00,000
Purchase of Machinery	Rs.7,50,000
Working Capital	Rs.5,00,000
Advance for purchase of Tempo	Rs.2,50,000

On 31st March, 2011, construction of shed was completed and machinery installed. Delivery of Tempo was not received. Total interest charged by the bank for the year ending 31st March, 2011 was Rs.4, 50,000. Show the treatment of interest under AS 16.

SOLUTION:-

AS 16 provide that:

I) A qualifying asset is an asset which takes a substantial period of time to get ready for intended use or sale.

ii) Assets which are ready for their intended use or sale when acquired are not qualifying assets.

iii) Borrowing cost that is directly attributable to acquisition, construction or production of a qualifying asset should be capitalized as part of cost of the asset.

Account Spent on	Qualifying asset or not	Interest to be capitalized	Interest to be charged to Profit & Loss A/c.
Construction of Shed	Yes		
Purchase of Machinery	No		
Working Capital	No		
Advance for purchase of Tempo	No		

2. Yoga Ltd. obtained a term loan of Rs. 2320 lakhs for purchase of machinery on 1-4-2010. The loan was immediately utilized as Rs.1624 lakhs for purchase of machinery which was ready for use on 31-3-2011, Rs. 232 lakhs for advance payment to the supplier for additional machinery and the balance 464 lakhs for financing working capital. Total, Interest on loan for the year ended 31st March ,2011 came to Rs.208.80 Lakhs

Calculate

i) Average borrowing rate
ii) Interest to be capitalized
iii) Interest to be shown as expenses.

Solution:-

(Rs. In lakhs)

i) Average borrowing rate = 208.80/2320 x100 = 9%

ii) Interest to be capitalized :9% of Rs.1624 Lakhs
146.16

iii) Interest to be considered as an expenses
9% of (232+ 464)= 696 lakhs
62.64

208.80

3. Rani Ltd. borrowed Rs. 300 crores on 1-4-2010 for construction of boiler plant @11%p.a. The plant is expected to be completed in 4 years. The weighted Average cost of capital is 13% p.a. The accountant of Rani Ltd. capitalized interest of Rs.39 crores for the accounting period ending on 31-3-2011. Due to surplus fund out of Rs.300 crores in income of Rs. 7.00crores was earned and credited to Profit & Loss A/c.
Comment on above with reference to AS 16.

SOLUTION :

As the company has borrowed Rs.300 crores for construction of a boiler plant it is a specific borrowing as per AS 16. In case a specific borrowing as per AS 16. In case a specific borrowing the total amount of borrowing cost incurred during the period less any income on the temporary investment on borrowed is to be capitalized. Interest to be capitalized is 33.00 less 7.00 =26 crores . The interest earned Rs.7.00 crores cannot be shown as income. It should be deducted from interest cost incurred for the purpose of capitalization.

7.3 INTRODUCTION TO SEGMENT REPORTING

'Segment Reporting', issued by the Council of the Institute of Chartered Accountants of India. This standard comes into effect in respect of accounting periods commencing on or after 1.4.2001 and is mandatory in nature, from that date, in respect of the following:

(i) Enterprises whose equity or debt securities are listed on a recognized stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognized stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crores

OBJECTIVE

The objective of this Statement is to establish principles for reporting financial information, about the different types of product of and services an services an enterprise produces and the different geographical areas which it operates. Such information helps users of financial statements:

a) better understand the performance of the enterprise;
b) better assess the risks and returns of the enterprise; and
c) Make more informed judgments about the enterprise as a whole.

Many enterprises provide groups of products and services or operate in geographical areas that are subject to differing rates of profitability, for growth, future prospects, and risks. Information about different types of products and services of an enterprise and its operations in different geographical areas – often called segment information is relevant to assessing the risks and return of a diversified or multi-locational enterprise but may be determinable from the aggregated data. Therefore, reporting of segment information is widely regarded as necessary for meeting the needs of users of financial statements.

SCOPE

1. The Statement should be applied in presenting general purpose financial statements.

2. The requirements of this Statement are also applicable in case of consolidated financial statements.

3. An enterprise should comply with the requirements of this Statement fully and not selectively.

4. If a single financial report contains both consolidated financial statements and the separate financial statements of the parent, segment information need be presented only on the basis of the consolidated financial statements. In the context of reporting of segment information in consolidated financial statements, the references in this statement to any financial statement items should construed to be the relevant items as appearing in the consolidated financial statements.

DEFINITIONS

The following terms are used in this statement with the meanings specified:

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

a) the nature of the products or services;

b) the nature of the production processes;

c) the type or class or customers for the products or services;

d) the methods used to customers for the products or provide the services; and

e) If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment. Factors that should be considered in identifying geographical segments include:

- **a)** similarity of economic and political conditions;
- **b)** relationships between operations in different geographical areas;
- **c)** proximity of operations;
- **d)** special risks associated with operations in a particular area;
- **e)** exchange control regulations; and
- **f)** the underlying currency risks.

A reportable segment is a business segment or a geographical segment identified on the basis of foregoing definitions for which segment information is required to be disclosed by this Statement.

Enterprise revenue is revenue from sales to external customers as reported in the statement of profit and loss.

Segment revenue is the aggregate of

- **I.** the portion of enterprise revenue that is directly attributable to a segment.
- **II.** the relevant portion of enterprise revenue that can be allocated on a reasonable basis to the segment, and
- **III.** revenue from transaction with other segments of the enterprise.

Segment revenue does not include:

- **a)** extraordinary items as defined in AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies;
- **b)** interest or dividend income, including interest earned on advances or loans to other segments unless the operations of the segments are primarily of a financial nature; and
- **c)** Gains on sales of investments or on extinguishment of debt unless the operations of the segment are primarily of a financial nature.

Segment expense is the aggregate of

- **I.** the expense resulting from the operating activities of a segment that is directly attributable to the segment, and
- **II.** the relevant portion of enterprise expense that can be allocated on a reasonable basis to the segment, including expense relating to transactions with other segments of the enterprise.

Segment expense does not include:

a) extraordinary items as defined in AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies;

b) interest expense, including interest incurred on advances or loans from other segments, unless the operations of the segment are primarily of a financial nature3;

c) losses on sales of investments or losses on extinguishment of debt unless the operations of the segment are primarily of a financial nature;

d) income tax expense; and

e) General administrative expenses, head-office expenses, and other expenses that arise at the enterprise level and relate to the enterprise as a whole. However, costs are sometimes incurred at the enterprise level on behalf of a segment. Such costs are part of segment expense if they relate to the operating activities of the segment and if they can be directly attributed or allocated to the segment on a reasonable basis.

Segment result is segment revenue less segment expense.

Segment assets are those operating assets that are employed by a segment in its operating activities and the either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

If the segment result of a segment includes interest or dividend income, its segment assets include the related receivables, loans, investments, or other interest or dividend generating assets.

Segment assets do not include income tax assets.

Segment assets are determined after deducting related allowances/provisions that are reported as direct offsets in the balance sheet of the enterprise.

Examples of segment assets include current assets that are used in the operating activities of the segment and tangible and intangible fixed assets. If a particular item of depreciation or amortization is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general enterprise or head-office purposes. Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists. Segment assets include goodwill that is directly attributable to a segment or that can be located to a segment on a reasonable basis, and segment expense includes related amortization of goodwill. If segment assets have been revalued subsequent to acquisition, then the measurement of segment assets reflects those revaluations.

Segment liabilities are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

If the segment result of a segment includes interest expense, its segment liabilities include the related interest-bearing liabilities.

Segment liabilities do not include income tax liabilities.

Segment accounting policies are the accounting policies adopted for preparing and presenting the financial statements of the enterprise as well as those accounting policies that relate specifically to segment reporting.

Examples of segment liabilities include trade and other payables, accrued liabilities, customer advance, product warranty, provision, and other claims relating to the provision of goods and service. Segment liabilities do not include borrowings and other liabilities that are incurred for financing rather than operating purposes. The liabilities of segment whose operations are not primarily of a financial nature do not include borrowings and similar liabilities because segment result represents an operating, rather than a net-of-financing, profit or loss. Further, because debt is often issued at the head-office level on an enterprise-wide basis, it is often not possible to directly attribute, or reasonably allocate, the interest-bearing liabilities to segments.

Business and Geographical Segments

Business and geographical segments of an enterprise for external reporting purposes should be those organizational units for which information is reported to the board of directors and to the chief executive office for the purpose of evaluating the unit's performance and for making decision about future allocations of resources, except as provided in paragraph 25.

If internal organizational and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive office are based neither on individual products or services or groups or related products/services nor on geographical areas, paragraph 20(b) requires that the directors and management of the enterprise should choose either business segments or geographical segments as the primary segment reporting format of the enterprise based on their assessment of which reflects the primary source of the risks and returns of the enterprise, with the other as its secondary reporting format. In that case, the directors and management of the enterprise should determine its business segments and geographical segments for external reporting purposes based on the factors in the definitions in paragraph 5 of this Statement, rather than on the basis of its system of internal financial reporting to the board of directors and chief executive officer, consistent with the following:

a) if one or more of the segment reported internally to the directors and management is a business segment or a geographical segment based on the factors in the definitions in paragraph 5 but others are not, sub-paragraph (b) below should be applied only to those internal segments that do not meet the definitions in paragraph 5 (that is, an internally reported segment that meets the definition should not be further segmented);

b) for those segments reported internally to the directors and management that do not satisfy the definitions in paragraph 5, management of the enterprise should look to the next lower level of internal segmentation that reports information along product and service lines or geographical lines, as appropriate under the definitions in paragraph5; and

c) if such an internally reported lower-level segment meets the definition of business segment of geographical segment based on the factors in paragraph 5, the criteria in paragraph 27 for identifying reportable segments should be applied to the segment.

Reportable Segments

A business segment or geographical segment should be identified as a reportable segment if:

- **a)** its revenue from sales to external customers and from transactions with other segments is 10 per cent more of the total revenue, external and internal, of all segments; or
- **b)** its segment result, whether profit or loss, is 10 per cent or more of –
  - **I.** the combined result of all segments in profit, or
  - **II.** the combined result of all segments in loss, whichever is greater in absolute amount;

c) its segment result, whether profit or loss, is 10 per cent or more of –

  I. the combined result of all segments in profit, or

  II. the combined result of all segments in loss, whichever is greater in absolute amount; its segment assets are 10 per cent or more of the total assets of all segments.

d) A business segment or a geographical segment which is not a reportable segment as per paragraph 27, may be designated as reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, is should be included as an unallocated reconciling item.

e) If total external revenue attributable to reportable segments constitutes less than 75 per cent of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 per cent thresholds in paragraph 27, until at least 75 per cent of total enterprise revenue is included in reportable segments.

f) The 10 per cent thresholds in this Statement are not intended to be a guide for determining materiality for any aspect of financial reporting other than identifying reportable business and geographical segments.

g) A segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10 per cent thresholds should continue to be a reportable segment for the current period notwithstanding that its revenue, result and assets all no longer meet the 10 per cent thresholds.

h) If a segment is identified as a reportable segment in the current period because it satisfies the relevant 10 per cent thresholds, preceding-period segment data that is presented for comparative purposes should, unless it is impracticable to do so, be restated to reflect the newly reportable segment as a separate segment, even if that segment, did not satisfy the 10 per cent thresholds in the preceding period.

Segment Accounting Policies

1. Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statement of the enterprise as a whole.

2. There is a presumption that the accounting policies that the directors and management of an enterprise have chosen to use in preparing the financial statements of the enterprise as a

whole are those that the directors and management believe are the most appropriate for external reporting purposes. Since the purpose of segment information is to help user of financial statements better understand and make more informed judgements about the enterprise as a whole, this Statement requires the use, in preparing segment information, of the accounting policies adopted for preparing and presenting the financial statements of the enterprise as a whole. That does not mean, however, that the enterprise accounting policies are to be applied to reportable segments as if the segments were separate stand-alone reporting entities. A detailed calculation done in applying a particular accounting policy at the enterprise wide level may be allocated to segments if there is a reasonable basis for doing so. Pension calculations, for example, often are done for an enterprise as a whole, but the enterprise-wide figures may be allocated to segments based on salary and demographic data for the segments.

3. This Statement does not prohibit the disclosure of additional segment information that is prepared on a basis other than the accounting policies adopted for the enterprise financial statements provided that (a) the information is reported internally to the board of directors and the chief executive officer for purposes of making decisions about allocating resources to the segment and assessing its performance and (b) the basis of measurement for this additional information is clearly described.

4. Assets and liabilities that relate jointly to two or more segments should be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.

5. The way in which asset, liability, revenue, and expense items are allocated to segments depends on such factors as the nature of those items, the activities conducted by the segment, and the relative autonomy of the segment. It is not possible or appropriate to specify a single basis of allocation that should be adopted by all enterprises; nor is it appropriate to force allocation of enterprise asses, liability, revenue, and expense items that relate jointly to two or more segments, if the only basis of making those allocations is arbitrary. At the same time, the definitions of segment revenue, segment expense, segment assets, and segment liabilities are interrelated, and the resulting allocations should be consistent. Therefore, jointly used assets and liabilities are allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments. For example, an asset is included in segment assets it, and only if, the related depreciation or amortization is included in segment expense.

Disclosure

Paragraphs 39-46 specify the disclosures required for reportable segments for primary segment reporting format of an enterprise. Paragraphs 47-51 identify the disclosures required for secondary reporting format of an enterprise. Enterprises are encouraged to make all of the primary-segment disclosures identified in paragraphs 39-46 for each reportable secondary segment although paragraphs 47-51 require considerably less disclosure on the secondary basis. Paragraphs 53-59 address several other segment disclosure matters. Appendix III to this Statement illustrates the application of these disclosure standards.

Primary Reporting Format

1. The disclosure requirements in paragraphs 40-46 should be applied to each reportable segment based on primary reporting format of an enterprise. An enterprise should disclose the following for each reportable segment:

a) segment revenue, classified into segment revenue from sales to external customers and segments revenue from transactions with other segments;

b) segment result;

c) total carrying amount of segment assets;

d) total amount of segment liabilities;

e) total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets);

f) total amount of expense included in the segment result for depreciation and amortization in respect of segment assets for the period; and

g) Total amount of significant non-cash expenses, other than depreciation and amortization in respect of segment assets that were included in segment expense and, therefore, deducted in measuring segment result.

2. Paragraph 40 (b) requires an enterprise to report segment result. If an enterprise can compute segment net profit or loss or some other measure of segment profitability other than segment result, without arbitrary allocations, reporting of such amount (s) in addition to segment result is encouraged. If that measure is prepared on a basis other than the accounting policies adopted for the financial statements of the enterprise, the enterprise will include in its financial statements a clear description of the basis of measurement.

3. An example of a measure of segment performance above segment result in the statement of profit and loss is gross margin on sales. Examples of measures of segment performance below segment result in the statement of profit and loss are profit or loss from ordinary activities (either before or after income taxes) and net profit or loss.

4. Accounting Standard 5, 'Net Profit or Loss for the Period, Prior Items and changes in Accounting Policies' requires that "when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately". Examples of such items include write-downs of inventories, legislative changes having retrospective application, litigation settlements, and reversal of provisions. An enterprise is encouraged, but not required, to disclose the nature and amount of any items of segment revenue and segment expense that are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the segment for the period. Such disclosure is not intended to change the classification of any such items of revenue of expense form ordinary to extraordinary or to change the measurement of such items. The disclosure. However, does change the level at which the significance of such items is evaluated for disclosure purposes from the enterprise level to the segment level.

5. An enterprise that reports the amount of cash flows arising from operating, investing and financing activities of a segment need not disclose depreciation and amortization expense and non-cash expenses of such segment pursuant to sub-paragraphs (f) and (g) of paragraph 40.

6. AS 3, Cash Flow Statements; recommends that an enterprise present a cash flow statement that separately reports cash flows from operating, investing and financing activities. Disclosure of information regarding operating, investing and financing cash flows of each reportable segment is relevant to understanding the enterprise's overall financial position, liquidity, and cash flows. Disclosure of segment cash flow is, therefore, encouraged, though not required. An enterprise that provides segment cash flow disclosures need not disclose depreciation and amortization expense and non-cash expenses pursuant to sub-paragraphs (f) and (g) of paragraph 40.

7. An enterprise should present a reconciliation between the information disclosed for reportable segments and the aggregated information in the enterprise financial statements. In presenting the reconciliation, segment revenue should be reconciled to enterprise revenue; segment result should be

reconciled enterprise net profit or loss; segment assets should be reconciled to enterprise assets; and segment liabilities should be reconciled to enterprise liabilities.

Secondary Segment Information

1. Paragraphs 39-46 identify the disclosure requirements to be applied to each reportable segment based on primary reporting format of an enterprise. Paragraphs 48-51 identify the disclosure requirements to be applied to each reportable segment based on secondary reporting format of an enterprise, as follows:

   a) if primary format of an enterprise is business segments, the required secondary-format disclosures are identified in paragraph 48;

   b) if primary format of an enterprise is geographical segments based on location of assets (where the products of the enterprise are produced or where its service reading operation are based. The required secondary-format disclosures are identified in paragraphs 49 and 50;

   c) if primary format of an enterprise is geographical segments based on the location of its customers (where its products are sold or services are rendered), the required secondary-format disclosures are identified in paragraphs 49 and 51.

2. If primary format of an enterprise for reporting segment information is business segments, it should also report the following information:

   a) Segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue;

   b) The total carrying amount of segment assets by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all geographical segment; and

   c) The total cost incurred during the period to acquire segment assets that the expected to be used during more than one period (tanglible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment assets are 10 per cent more of the total assets are 10 per cent or more of the total assets of all geographical segments.

3. If primary format of an enterprise for reporting segment information is geographical segments (whether based on location of assets or location or customers), it should also report the following segment information for each business segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue or whose segment asserts are 10 per cent or more of enterprise revenue or whose segment assets are 10 per cent or more of the total assets of all business segments:

   a) segment revenue from external customers;

   b) the total carrying amount of segment assets; and

   c) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets).

4. If primary format of an enterprise for reporting segment information is geographical segments that are based on location of assets, and if the location of its customers is different from the location of its assets, them the enterprise should also report revenue from sales to external customers for each customer-based geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue.

5. If primary format of an enterprise for reporting segment information is geographical segments that are based on location of customers, and if the assets of the enterprise are located in different geographical areas from its customers, then the enterprise should also report the following segment information for each asset-based geographical segment whose revenue from sales to external customers or segment assets are 10 per cent or more to total enterprise amounts:

   a) The total carrying amount of segment assets by geographical location of the assets; and

   b) The total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by location of the assets.

Illustrative Segment Disclosures

Appendix III to this Statement presents an illustration of the disclosures for primary and secondary formats that are required by this Statement.

Other disclosures

1. In measuring and reporting segment revenue from transactions with other segments. Inter-segment transfers should be measured on the basis that the enterprise actually used to price those transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.

2. Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable.

3. AS 5 requires that changes in accounting policies adopted by the enterprise should be made only if required by statue, or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of events or transactions in the financial statements of the enterprise.

4. Changes in accounting policies adopted at the enterprise level that affect segment information are dealt with in accordance with AS 5. AS 5 requires that any change in an accounting policy which has a material effect should be disclosed. The impact of , and the adjustments resulting from, such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change. Where the effect of such change is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

5. Some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a significant impact on the segment information reported but will not change aggregate financial information reported for the enterprise. To enable users to understand the impact of such changes, this Statement requires the disclosure of the nature of the change and the financial effect of the change, if reasonably determinable.

6. An enterprise should indicate the types of products and services included in each reported business segment and indicate the

composition of each reported geographical segment, both primary and secondary, if not otherwise disclosed in the financial statements.

7. To assess the impact of such matters as shifts I demand, changes in the prices of inputs or other factors of production, and the development of alternative products and processes on a business segment, it is necessary to know the activities encompassed by the segment. Similarly, to assess the impact of changes in the economic and political environment on the risks and returns of a geographical segment, it is important to know the composition of that geographical segment.

7.4 EXPLANATORY NOTES:

Objective:

The objective of this Statement is to establish principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates which facilitates meaningful reading and analysis of statement of account of an enterprise.

Business Segment:

Business segments are distinguishable components of enterprise as to:

- Product or group of products or services or group of services e.g. Tractors and Jeep as reported by Mahindra and Mahindra
- Production process e.g. Dry linker process and wet clinker process in Cement.
- Type or class of customers' e.g. corporate finance and Retail Finance in case of Banking as reported in ICICI.
- Nature of regulatory policy if applicable. eg. Banking, insurance, or public utilities.

Geographical Segment: Geographical segments are distinguishable components of enterprise as to asset situation and customer situation.

Primary format: as per the provision of AS-17 the Enterprise has to present segment information under primary and secondary format.

The selection of Business or geographical segment as primary is based on the risk and returns attached to it.

E.g. in case of manufacturing enterprise the products manufactured may have more risks and returns attached to it rather than the location of its customers. In such case business segment in presented under primary format.

Similarly in case of service sectors the area of customers or its asset base may have more risks and returns attached to it rather than the type of services provided by it.

1. Attention is specifically drawn to paragraph 4.3 of the Preface, according to which accounting standards are intended to apply only to material items.

2. Reference may be made to the section titled 'Announcements of the Council regarding status of various documents issued by the institute of Chartered Accountants of India' appearing at the beginning of this Compendium for a detailed discussion on the implications of the mandatory status of an accounting standard.

3. See also General Clarification (GC) – 14/2002, issued by the Accounting Standards Board, published elsewhere in this compendium.

4. The Council, at its 224th meeting, held on March 8-10, 2002, considered the matter relating to disclosure of corresponding previous year figures in respect of segment reporting in the first year of application of AS 17. The Council decided that in the first year of application of AS 17, corresponding previous year figures in respect of segment reporting need not be disclosed (See Chartered Accountant', April 2002, pp. 1242).

E.g. software developers have risks and returns more directly related to the countries it exports than the type of software it develops. In such case geographical segment is presented under primary format.

Once primary format is selected the other segment is presented under secondary format.

Steps involved in selection and disclosure of segment information as required by segment reporting.

Step 1. Identify the Primary and Secondary segments as per the provision of para 19.

The segments will either be Business segment (pare 5) or geographical segment, which further could be customer wise or asset wise. (refer to appendix I)

Step 2. Identify the reportable segments as per the provision of para 27, the quantitative thresholds are the 10% limit i.e. either its

- Segment revenue (gross)/Total revenue of all segments (external customers) is at least 10; or
- Segment assets/total assets of all segments is a least 10% (excluding income tax asset); or
- Segment result (profit or loss)/ combined results of all segments of all segments is at least 10%. (refer to para 5 for def of segment result)

Further it should be noted that if a segment has been a reportable segment in last year it shall then be considered as reportable segment even though it may fail to satisfy 10% criteria this year. Also in case a segment which becomes reportable for first time this year then previous year data should be disclosed to the extent possible (or practical)

Step 3. In case where the total revenue from external customer of the reportable segments is less than 75% of total revenue of all segments (external) then additional segments should be identified as reportable segments, even if they do not meet the 10 per cent thresholds in paragraph 27, until at least 75 per cent of total enterprise revenue in included in reportable segments. (Refer to Q1 provided in self-study.)

Step 4. Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the enterprise as a whole.

Step 5. Disclosure Requirements

Primary Segment (Business Segment)

Particulars	A	B	C	Eliminations	Total
Segments revenue					
External					
Domestic					
Export					
Inter segment					
TOTAL REVENUE					
Segment Results					
Unallocated Co. exp.	-	-	-		
Profit before interest and tax					
Interest Cost	-	-	-		
Profit before tax					
Other information					
Segment assets (fixed + current)					
Unallocable assets	-	-	-		
Total assets					
Segments Liabilities					
Unallocable Liabilities					
Total					

SECONDARY SEGMENTS (Geog)	Domestic	Mid east	America	Europe	Pacific
External Revenue by location of customers.					
Carrying Amount of segments assets by location					
Cost incurred for Acquisition of tangible and intangible assets.					

7.5 THEORETICAL QUESTIONS ON THE STANDARD

1. What do you mean by business segment and geographical segment?
2. What are the quantitative thresholds for deciding reportable segments?
3. What are the inclusions and exclusions of segment revenue?

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8

ACCOUNTING STANDARS PART II

(EARNINGS PER SHARE AS. NO 20 AND ACCOUNTING FOR TAXES ON INCOME AS. NO 22)

Unit Structure

8.1 INTRODUCTION TO EARNING PER SHARE

Accounting Standard (AS) 20, "Earnings Per Share', issued by the Council of the Institute of Chartered accounts of India, come into effect in respect of accounting periods commencing on or after 1-4-2001 and is mandatory in nature, from that date, in respect of enterprises whose equity shares or potential equity shares are listed on a recognized stock exchange in India. An enterprise which has neither equity shares nor potential equity shares which are so listed but which discloses earnings per share, should calculate and disclose earnings per share in share in accordance with this Standard from the aforesaid date 3. The following is the text of the Accounting Standard.

OBJECTIVE

The objective of this Statement is to prescribe principles for the determination and presentation of earnings per share, which will improve comparison of performance among different enterprises for the same period and among different accounting periods for the same enterprise. The focus of this Statement is on the denominator of the earnings per share calculation. Even though earnings per share data has limitations because of different accounting policies used for determining 'earnings', a consistently determined denominator enhances the quality of financial reporting.

SCOPE

1. This Statement should be applied by enterprises whose equity shares or potential equity shares are listed on a recognized stock exchange in India. An enterprise which has neither equity shares nor potential equity shares which are so listed but which discloses earnings per share should calculate and disclose earnings per share in accordance with this Statement.[4]

2. In consolidated financial statements, the information required by this Statement should be presented on the basis of consolidated information.5

3. This Statement applies to enterprises whose equity or potential equity shares are listed on a recognized stock exchange in India. An enterprise, which has neither equity shares nor potential equity shares, which are so listed is not required to disclose earnings per share. However, comparability in financial reporting among enterprises is enhanced if such an enterprise tat is required to disclose by any statute or chooses to disclose earnings per share calculates earnings per share in accordance with the principles laid down in this Statement. In the case of a parent (holding enterprise), users of financial statements are usually concerned with, and need to be informed about, the results of operations of both the enterprise itself as well as of the group as a whole. Accordingly, in the case of such enterprise, this Statement requires the presentation of earnings per share information on the basis of consolidated financial statements as well as individual financial statements of the parent. In consolidate financial statements, such information is presented of the basis of consolidate information.

DEFINITIONS

For the purpose of this Statement, the following terms are used with the meanings specified:

An equity share is a share other than a preference share. Equity shares participate in the net profit for the period only after preference shares. An enterprise may have more than one class of equity shares. Equity shares of the same class have the same rights to receive dividends.

A preference share is a share carrying preferential rights to dividends and repayment of capital.

A financial instrument is any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity shares of another enterprise. For this purpose, a financial asset is any asset that is

a) Cash;

b) A contractual right to receive cash or another financial asset from another enterprise.

- **c)** A contractual right to exchange financial instruments with another enterprise under condition that are potentially favorable; or
- **d)** An equity share of another enterprise.

A financial liability is any liability that is a contractual obligation to deliver cash or another financial asset to another enterprise or to exchange financial instruments with another enterprise under conditions that are potentially unfavorable.

A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares.

Examples of potential equity shares are:

- **a)** Debt instruments or preference shares, that are convertible into equity shares;
- **b)** Share warrants;
- **c)** Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans; and
- **d)** Shares which would be issued upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares), such as the acquisition of a business or other assets, or shares issuable under a loan contract upon default of payment of principal or interest, if the contract so provides.

PRESENTATIONS

An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class or equity shares that has a different right to share in the net profit for the period. An enterprise should present basic and diluted earnings per share with equal prominence for all periods presented.

This Statement requires an enterprise present basic and diluted earnings per share, even if the amounts disclosed are negative (a loss per share).

MEASUREMENT

Basic Earnings per Share

1. Basic earnings per share should be calculated by dividing the net profit or loss for the period attributable to equity shareholders by the weighted average number for equity shares outstanding during the period.

2. For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period.

3. All items of income and expense which are recognized in a period, including tax expense and extraordinary items, are included in the determination of the net profit or loss for the period unless an Accounting Standard requires or permits otherwise (see Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies). The amount of preference dividends and any attributable tax thereto for the period is deducted from the net profit for the period (or added to the net loss for the period) in order to calculate the net profit or loss for the period attributable to equity shareholders.

4. The amount of preference dividends for the period that is deducted from the net profit for the period is:

   a) The amount of any preference dividends on non-cumulative preference shares provided for in respect of the period; and

   b) The full amount of the required preference dividends for cumulative preference shares for the period, wither or not the dividends have been provided for. The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods.

5. If an enterprise has more than one class of equity shares, net profit or loss for the period is apportioned over the different classes of shares in accordance with their dividend rights.

Per Share – Basic

1. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

2. The weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at the beginning of the period, adjusted by the number of equity shares bought back or issued during the period multiplied by the time-weighting factor. The time-weighting factor is the

number of days for which the specific shares are outstanding as a proportion of the total number of days in the period; a reasonable approximation of the weighted average is adequate in many circumstances.

Appendix illustrates the computation of weighted average number of shares.

3. In most cases, shares are included in the weighted average number of shares from the date the consideration is receivable, for example:

a) Equity shares issued in exchange for cash are included when cash in receivable;

b) Equity shares issued as a result of the conversion of a debt instrument to equity shares are included as to the date of conversion;

c) Equity shares issued in lieu of interest or principal on other financial instruments are included as of the date interest cease to accrue;

d) Equity shares issued in exchange for the settlement of a liability of the enterprise are included as of the date the settlement becomes effective;

e) Equity shares issued as consideration for the acquisition of an asset other than cash are include as of the date on which the acquisitions in recognized; and

f) Equity shares issued for the rendering of services to the enterprise are included as the services are rendered.

In these and other cases, the timing of the inclusion of equity shares is determined by the specific terms and conditions attaching to their issue. Due consideration should be given to the substance of any contract associated with issue.

4. Equity shares issued as part of the consideration in an amalgamation in the nature of purchase are included in the weighted number of shares as of the date of the acquisition because the transferee incorporates the results of the operations of the transferor into its statement of profit and loss as from the date of acquisition. Equity shares issued during the reporting period as part of the consideration in an amalgamation in the nature of merger are included in the calculation of the weighted average number of shares from the beginning of the reporting period because the financial statements of the combined enterprise for the reporting period are prepared as if the combined entity had exited from the beginning of the reporting period. Therefore, the number of equity shares used for the calculation of basic earnings per share in an amalgamation in the nature of merger is the aggregate of the weighted average number of shares of the combined enterprise, adjusted to equivalent shares of the enterprise whose are outstanding after the amalgamation.

5. Partly paid equity shares are treated as a fraction of an equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period.

Appendix II illustrates the computations in respect of partly paid equity shares.

6. Where an enterprise has equity shares of different nominal values but with the same divided rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

7. Equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares) are considered outstanding, and included in the computation of basic earnings per share from the date when all necessary conditions under the contract have been satisfied.

8. The weighted average number of equity shares outstanding during the period and for all periods presented should be adjusted for events, other than the conversion of potential equity shares that have changes the number of equity shares outstanding, without a corresponding change in resources.

9. Equity shares may be issued, or the number of shares outstanding may be reduced, without a corresponding change in resources. Examples include:

- **a)** A bonus issue;
- **b)** A bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;
- **c)** A share split; and
- **d)** A reverse share split (consolidation of shares).

10. In case of a bonus issue or a share split, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. The number of equity shares outstanding before the event is adjusted for the proportionate change in the number or equity shares outstanding as if the event had occurred at the beginning of the earliest period reported. For example, upon a two-for-one bonus issue, the number of shares outstanding prior to the issue is multiplied by a factor a three to obtain the new total number of shares, or by a factor of two to obtain the number of additional shares.

Appendix III illustrates the computation of weighted average number of equity shares in case of a bonus issue during the period.

11. The issue of equity shares at the time of exercise or conversion of potential equity shares will not usually give rise to a bonus element, since the potential equity shares will usually have been issued for full value, resulting in a proportionate change in the resources available to the enterprise. In a right issue, on the other hand, the exercise price is often les than the fair value of the shares. Therefore, a rights issue usually includes a bonus element. The number of equity shares to be used in calculating basic earnings per share for all periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the following factor:

$$\frac{\text{Fair value per share immediately prior to the exercise of rights}}{\text{Theoretical ex-rights fair value per share}}$$

The theoretical ex-rights fair value per share is calculated by adding the aggregate fair value of the shares immediately prior to the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights. Where the rights themselves are to publicly trader separately from the shares prior to the exercise date, fair value for the purposes of this calculation is established at the close of the last day on which the shares are traded together with the rights.

Appendix IV illustrates the computation of weighted average number of equity shares in case of a rights issue during the period.

Diluted Earnings Per Share

1. For the purpose of calculating diluted earning per share, the net profit or loss for the period attributable or equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.
2. In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period, that is:

a) The net profit for the period attributable to equity shares is:

I. Increased by the amount of dividends recognized in the period in respect of the dilutive potential equity shares as adjusted for any attributable change in tax expense for the period;

II. Increased by the amount of interest recognized in the period in respect of the dilutive potential equity shares as adjusted for any attributable change in tax expense for the period; and

III. Adjusted for the after-tax amount of any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.

b) The weighted average number of equity shares outstanding during the period in increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

3. For the purpose of this Statement. Share application money pending allotment or any advance share application money as at the balance sheet date, which is not statutorily required to be kept separately and is being utilized in the business of the enterprise, is treated in the same manner as dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Dilutive Potential Equity Share

1. Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.

2. An enterprise used net profit form continuing ordinary activities as “the control figure” that is used to establish whether potential equity shares are dilutive or anti-dilutive. The net profit from continuing ordinary activities is the net profit from ordinary activities (as defined in AS 5) after deducting preference dividends and any attributable tax thereto and after excluding items relating to discontinued operations6.

3. Potential equity share are anti-dilutive when their conversion to equity shares would increase earnings per share from continuing ordinary activities or decrease loss per share from continuing ordinary activities. The effects of anti-dilutive potential equity shares are ignored in calculation diluted earnings per share.

4. In considering where potential equity shares are dilutive or anti-dilutive, each issue or series of potential equity shares is considered separately rather than in aggregate. The sequence in which potential equity shares are considered may affect whether or not they are dilutive. Therefore, in order to maximize the dilution of basic earnings per share, each issue or series of potential equity share is calculated. Where the earnings per incremental share is the least, the potential equity share is considered most dilutive and vice-versa.

   Appendix VII illustrates the manner of determining the order in which dilutive securities should be included in the computation of weighted average number of shares.

5. Potential equity shares are weighted for the period they were outstanding. Potential equity shares that were cancelled or allowed to lapse during the reporting period are included in the computation of diluted earnings per share only for the portion of the period during which they were outstanding. Potential equity shares that have been converted into equity shares during the reporting period are included in the calculation of diluted earnings per share from the beginning of the period to the date of conversion; from the date of conversion, the resulting equity shares are included in computing both basic and diluted earnings per share.

Restatement

1. If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or shares split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statement presented should be based on the new number of shares. When per share calculation reflect such changes in the number of shares, that fact should be disclosed.

2. An enterprise does not restate diluted earnings per share of any prior presented for changes in the assumptions used or for the conversion of potential equity shares into equity shares outstanding.

3. An enterprise is encouraged to provide a description of equity share transaction or potential equity share transactions, other

than bonus issues, share splits and reverse share splits (consolidation or shares) which occur after the balance sheet date when they are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions. Examples of such transactions include:

a) The issue of shares for cash;

b) The issue of shares when the proceeds are used to repay debt or preference shares outstanding at the balance sheet date;

c) The cancellation of equity shares outstanding at the balance sheet date;

d) The conversion or exercise of potential equity shares, outstanding at the balance sheet date, into equity shares;

e) The issue of warrants, options or convertible securities; and

f) The satisfaction of conditions that would result in the issue of contingently issuable shares.

4. Earnings per share amount are not adjusted for such transactions occurring after the balance sheet date because such transactions do not affect the amount of capital used to produce the net profit or loss for the period.

Disclosure

1. In addition to disclosures as required by paragraphs 8, 9 and 44 of this Statement, an enterprise should disclose the following:

   a) The amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;

   b) The weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and

2. Contracts generating potential equity shares may incorporate terms and conditions which affect the measurement of basic and diluted earnings per share. These terms and conditions may determine whether or not any potential equity shares are dilutive and, if so, the effect on the weighted average number of shares outstanding and any consequent adjustments to the net profit attributable to equity shareholders. Disclosure of the terms and conditions of such contracts is encouraged by this Statement.

3. If the enterprise discloses, in addition to basic and diluted earnings per share, per share amounts using a reported component of net profit other than net profit or loss for the period attributable to equity shareholders, such amounts should be calculated using the weighted average number of equity shares determined in accordance with this Statement. If a component of net profit is used which is not reported as al line item in the statement of profit and loss, a reconciliation should be provided between the component used and a line item which is reported in the statement of profit and loss. Basic and diluted per share amounts should be disclosed with equal prominence.

4. An enterprise may wish to disclose more information than this Statement requires. Such information may help the users to evaluate the performance of the enterprise and may take the form the per share amounts for various components of net profit, e.g. profit from ordinary activities7. Such disclosures are encouraged. However, when such amounts are disclosed, the denominators need to be calculated in accordance with the Statement in order to ensure the comparability of the per share amounts disclosed.

8.2 THEORY QUESTIONS

1. What do you mean by potential equity share?
2. How do you calculate Basic EPS if bonus shares are issued in that year?
3. How do you calculate theoretical ex right price?
4. What are the disclosure requirements of this standard?

8.3 ACCOUNTING FOR TAXES ON INCOME

Accounting standard (AS) 22, ‘Accounting for Taxes on Income’, issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 1-4-2001. It is mandatory in nature for:

a) All the accounting periods commencing on or after 01.04.2001, in respect of the following:

i) Enterprises whose equity or debt securities are listed on a recognized stock exchange in India and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognized stock exchange in India as evidenced by the board of directors’ resolution in this regard.

- **ii)** All the enterprises of group, if the parent present consolidated financial statements and the Accounting Standard is mandatory in nature in respect of any of the enterprises of that group in terms of (i) above.

b) All the accounting periods commencing on or after 01.04.2002, in respect of companies not covered by (a) above.

c) All the accounting periods commencing on or after 01.04.2003, in respect of all other enterprises.

The Guidance Note on Accounting for Taxes on Income, issued by the Institute of Chartered Accountants of India in 1991, stands withdrawn from 1.4.2001.

OBJECTIVE

The objective of this Statement is to prescribe accounting treatment for taxes on income. Taxes on income are one of the significant items in the statement of profit and loss of an enterprise. In accordance with the matching concept, taxes on income are accrued in the same period as the revenue and expenses to which they relate. Matching of such taxes against revenue to a period special problems arising from fact that I number of cases, taxable income may be significantly different from the accounting income. This divergence between taxable income and accounting income arises due to two main reasons. Firstly, there are difference between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax, purposes. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognized in the statement of profit and loss and the corresponding amount which is recognized for the computation of taxable income.

SCOPE

1. This Statement should be applied in accounting for taxes on income. This includes the determination of the amount of the expense or saving related to taxes on income in respect of accounting period and the disclosure of such an amount in the financial statements.

2. For the purpose of this Statement, taxes on income include all domestic and foreign taxes which are based on taxable income.

3. This Statement does not specify when, or how, an enterprise should account for taxes that are payable on distribution of dividends and other distributions made by the enterprise.

DEFINITIONS

For the purpose of this Statement, the following terms are used with the meaning specified:

Accounting income (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving.

Taxable income (tax loss) is the amount for the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined.

Tax expense (tax saving) is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

Current tax is the amount of income tax determined to be payable recoverable) in respect of the taxable income (tax loss) for a period.

Deferred tax is the tax effect of timing differences.

Timing differences are the differences between taxable income and accounting income for a period that originate in one period and are capable or reversal in one or more subsequent periods.

Permanent differences are the differences between taxable income and accounting income for a period that originate in one period do not reverse subsequently.

Taxable income is calculated in accordance with tax laws. In some circumstances, the requirements of these laws to computer taxable income differ from the accounting policies applied to determine accounting income. The effect of this difference is that the taxable income and accounting income may not be the same.

The differences between taxable and accounting income can be classified into permanent differences and timing differences. **Permanent differences** are those differences between taxable income and accounting income which originate in one period and do not reverse subsequently. For instance, if for the purpose of computing taxable income, the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.

Timing differences are those differences between taxable, income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. Timing differences arise because the periods in which some items of revenue and expenses are included in taxable income do not coincide with the period in which such items of revenue and expenses are included or considered in arriving at accounting income. For example, machinery purchased for scientific resear4ch related to business is fully allowed as deduction in the first year for tax purposes whereas the same would be charged to the statement of profit and loss as depreciation over its useful life. The total depreciation charged on the machinery for accounting purposes and the amount allowed as deduction for tax purposes will ultimately be the same, but periods over which the depreciation is charged and the deduction is allowed will differ. Another example of timing difference is a situation where, for the purpose of computing taxable income, tax laws allow depreciation on the basis of the written down value method, whereas for accounting purposes, straight line method is used. Some other examples of timing differences arising under the Indian tax laws are given in Appendix

Unabsorbed depreciation and carry forward of losses which can be set-off against future taxable income are also considered as timing differences and result in deferred tax assets, subject to consideration of prudence.

RECOGNITION

1. Tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the net profit or loss for the period.

2. Taxes on income are considered to be an expense incurred by the enterprise in earning income and are accrued in the period as the revenue and expenses to which they relate. Such matching may result into timing differences. The tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets (subject to the consideration of prudence as set out in paragraphs 15-18) or as deferred tax liabilities, in the balance sheet.

3. An example of tax effect of a timing difference that results in a deferred tax asset is an expense provided in the statement of profit and loss but not allowed as a deduction under Section 43B of the Income-tax Act, 1961.

   This timing difference will reverse when the education of that expense is allowed under Section 43B in subsequent year(s). an example of tax effect of a timing difference resulting in a deferred tax liability is the higher charge of depreciation allowable under the Income-tax Act, 1961. compared to the depreciation provided in the statement of profit and loss. In subsequent years, the differential will reverse when comparatively lower depreciation will be allowed for tax purposes.

4. Permanent differences do not result in deferred tax assets or deferred tab liabilities.

5. Deferred tax should be recognized for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraphs 15-18.

6. This Statement requires recognition of deferred tax for all the timing differences. This is based on the principle that the financial statements for a period should recognize the tax effect, whether current or deferred, of all the transactions occurring in that period.

7. Except in the situation stated in paragraph 17, deferred tax assets should be recognized and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realized.

8. While recognizing the tax effect of timing differences, consideration of prudence cannot be ignored. Therefore, deferred tax assets are recognized and carried forward only to the extent that there is a reasonable certainty of their realisation. This reasonable level of certainty would normally be achieved by examining the past record of the enterprise and by making realistic estimates of profits of the future.

9. Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognized only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realized.

10. The existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available. Therefore, when an enterprise has a history of recent losses, the enterprise recognizes deferred tax assets only to the extent that it has timing differences the reversal of which will result in sufficient income or there is other convincing evidence that sufficient taxable income will be available against which such deferred tax assets can be realized. In such circumstances, the nature of the evidence supporting its recognition is disclosed.

RE-ASSESSMENT OF UNRECOGNIZED DEFERRED TAX ASSETS

At each balance sheet date, an enterprise re-assesses unrecognized deferred tax assets. The enterprise recognizes previously unrecognized deferred tax assets to the extent that it has become reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available against which such deferred tax assets can be realized. For example, an improvement in trading conditions may make it reasonably certain that the enterprise will be able to generate sufficient taxable income in the future.

MEASUREMENT

Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.

Deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax assets and liabilities are usually measured using the tax rates and tax laws that have been enacted. However, certain announcements of tax rates and tax laws by the government may have the substantive effect of actual enactment. In these circumstances, deferred tax assets and liabilities are measured using such announced tax rate and tax laws.

When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using average rates.

Deferred tax assets and liabilities should not be discounted to their present value.

The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each timing difference. In a number of cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between enterprises. Therefore, this Statement does not require or permit the discounting of deferred tax assets and liabilities.

REVIEW OF DEFERRED TAX ASSETS

The carrying amount of deferred tax assets should be reviewed at each balance sheet date. An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available against which deferred tax asset can be realized. Any such write-down may be reversed to the extent that is becomes reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable, income will e available.

PRESENTATION AND DISCLOSURE

1. An enterprise should offset assets and liabilities representing current tax if the enterprise:
    a. Has a legally enforceable to set recognized amounts; and
    b. Intends to settle the asset and the liability on a net basis.

2. An enterprise will normally have a legally enforceable right to set off an asset and liability representing current tax when they relate to income taxes levied under the same governing taxation laws and the taxation laws permit the enterprise to make or receive a single net payment.

3. An enterprise should offset deferred tax assets and deferred tax liabilities if:

    a) The enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

    b) The deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

4. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.

5. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts.

6. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

TRANSITIONAL PROVISIONS

1. On the first occasion that the taxes on income are accounted for in accordance with this Statement, the enterprise should recognize, in the financial statement, the deferred tax balance that has accumulated prior to the adoption of this Statement, as deferred tax asset/liability with a corresponding credit/change to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets (see paragraphs 15-18). The

amount so credited/charged to the revenue reserves should be the same as that which would have resulted if this Statement has been in effect from the beginning.[3]

2. For the purpose of determining accumulated deferred tax in the period in which this Statement is applied the first time, the opening balanced of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects of these differences, if any, should be recognized as deferred tax assets or liabilities, if these differences are timing differences. For example, in the year in which an enterprise adopts this Statement, the opening balance of a fixed asset is Rs. 100 for accounting purposes and Rs. 60 for tax purposes. The difference is because the enterprise applies written down value method of depreciation for calculating taxable income whereas for a accounting purposes straight line method is used. This difference will reverse in future when depreciation for tax purposes will be lower as compared to the depreciation for a accounting purposes. In the above case, assuming that enacted tax rate for the year is 40% and that there are no other timing differences, deferred tax liability of Rs. 16 [(Rs. 100 – Rs. 60) x 40%] would be recognized. Another example is an expenditure that has already been written off for accounting purposes in the year of its incurrance but is allowable for tax purposes over a period of time. In this case, the asset representing that expenditure would have a balance only for tax purposes but not for accounting purposes. The difference between balance of the asset for tax purposes and the balance (which is nil) for accounting purposes would be a timing difference which will reverse in future when this expenditure would be allowed for tax purposes. Therefore, a deferred tax asset would be recognized in respect of this difference subject to the consideration of prudence (see paragraphs 15 – 18).

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9

VALUATION OF GOODWILL

Unit Structure

9.1 INTRODUCTION

Goodwill means the reputation of a Business concern which enables businessmen to earn extra profit, as compared to other concern. Goodwill means various advantages of reputation and connections of a business.

Mr. Kohler defines goodwill as "the current value of expected future income in excess or normal return on the investment in net tangible assets:"

9.2 NEED FOR VALUATION

The need for valuation of goodwill depends on the form of a business organisation. The circumstances in which the goodwill is valued are given below.

Form of Business Organisation	Need for valuation
Sole proprietor	Sale of business
Partnership firm	Conversion into partnership Admission of partner Retirement / Death of partner Change in profit sharing ratio Amalgamation of firm Dissolution on account of sale of business. Conversion into Private / public Limited company.
Company	Mergers / Acquisitions of business Transfer of controlling block of shares Sale of Business Conversion of one class of shares into another.

9.3 FACTORS AFFECTING GOODWILL :

A firm may earn more profits than other firms in the same type of industry because of numerous factors some of which are stated below:

Sr. No.	Main Factors	Sub factors
I	Managerial and Human Resource Factors	• Superior Management team • Superb Organisation • Exclusive Training programmes for employees. • Co-ordinal labour relationship. • Discovery of talent. • Experienced work force • Long standing experience
II	Product / Service Factors	• Secretor patent manufacturing • Exclusive know-how • Economies of scale of production • Foreign collaboration • Quality and reliability
III	Marketing Factors	• Effective advertisement • Market dominance • Favourable attitude of customers • Adequate selling outlets • Adequate service centres • Established list of customers • Exclusive selling arrangements

IV	Physical factors	• Strategic location • Availability of raw material • Exclusive infrastructural facilities • Adequate input availability like power, man power etc.
V	Fiscal Factors	• Cost saving • Cost of financing • Tax exemptions / deduction benefits • Good credit rating
VI	Other Factors	• Good public image • Favourable Government regulations • Good relationship with suppliers

9.4 CHARACTERISTICS OF GOODWILL :

1. It is an intangible or invisible asset.
2. It's value is not fixed. It is subject to fluctuation due to internal as well as external factors in value.
3. It can not valued in isolation.
4. Its valuation is attached to the total value of the business.
5. It has value only on going concern basis.
6. It is either created internally or purchased from outside.
7. Because off Goodwill a firm is able to earn excess profits than the other firms in the same class of business.
8. value of Goodwill may differ due to different method used. In certain cases it is not transferable.

9.5 NEED FOR VALUATION OF GOODWILL :

In case of partnership firm the necessity of valuating goodwill arises in connection with the following. Whenever there is change in constitution of the business and partnership deed.

1. When there is a change in the profit-sharing ratio among the partners.
2. When a new partner is admitted.
3. When a partner retires or dies and
4. When the firm sells it is business to a company or is amalgamated with another firm.

In case of joint stock company the necessity of valuation of goodwill arises in the following circumstances: -

1) When the business of the company is taken over by another company. e.g. amalgamations, absorptions, mergers.
2) When stock exchange quotations not being available, shares have to be valued for taxation purpose e.g. wealth tax etc.
3) When large stock of shares of the company have to be bought or sold.
4) When the management wants to write back goodwill, which was previously written off.
5) When the company is being taken over by the government.

9.6 VALUATION OF ASSETS :

When Goodwill is be raised / valued, it is necessary to revalue various Assets as guidelines issued by I. C. A. I. some of these are stated below.

1. Fixed Assets

As. 6.	: Depreciation
As. 10.	: Fixed Assets
As. 12.	: Government Grants Received / receivable for revenue expenses or capital expenditure.
As. 16	: Borrowing Cost
As. 19	: Leases (Treatment of various types of lease Assets in the books of lessce / lessor.
As. 22	: Accounting for Taxes on Income
	(e.g. Deferred tax; assets and liabilities)
As. 26	: Intangible Assets
As. 28	: Impairment of Assets
As. 29	:Provisions, Contingent Liabilities and contingent Assets.)

9.7 DETERMINATION OF FUTURE MAINTAINABLE PROFIT [F.M.P]

Determination of Future maintainable profit under normal circumstances is most important and complicated task: F. M. P. is subject to evolution of many factors such as capability of company's management, future govt. policies; general and economical trend etc. For determining F. M. P. non operating expenses and incomes are not to be considered. It is decided on the basis of average post Trading profits subject to certain changes that may have effect on future earning of the business concerns.

1) Calculation of past average earnings :

In order to calculate F. M. P. the profit of the previous year can be considered, if necessary. Such business profit should be making adjusted to make it acceptable for averaging.

Average profit may be simple average or weighted average profit.

a) Simple average profit

$$= \frac{\text{Total Profit}}{\text{No. of years}}$$

b) When profit shows increasing on depreciating tendency weighted average profit should be calculated.

Weighted Average profit

$$= \frac{\text{Total weighted profits / products}}{\text{Total weights}}$$

Calculation of F. M. P.

Particulars	₹	₹
Average Trading profit after tax	X	
Add: Income Tax +	X	
$\left[\frac{\text{W.P.A.T. x Tax Rate}}{\text{1- Tax Rate}}\right]$		
Average Profit before Tax		X
Add: Increase in profit in Future		
i) Saving in expenses	X	
ii) Additional income likely to earn in future	X	X
Less : i) Additional Exp. likely to incurred in future	X	X
ii) Income earned in past but not expected to earn.	X	(x) X
iii) Abnormal gain credited to profit & Loss A/c	X	
F. M. P. before Tax		XY
Less : Income Tax (Revised)		(X)
F. M. P. after Tax		XX

Note : Goodwill can be classified as

i) Purchased Goodwill

ii) Internet Goodwill

iii) Goodwill due to various associate with Govt. / political parties etc.

9.8 NORMAL RATE OF RETURN [N. R. R.]

The term N. R. R. means the rate of return that will satisfy an ordinary investor in the industry concerned. NRR differs from industry to industry. It is also depends upon business risk as well as financial risk in the business.

If N. R. R. not given in the problem, it can be calculated as under.

$$\text{N. R. R.} = \frac{\text{Dividend per equity share in similar Co.}}{\text{Market value per share in similar company}}$$

Note : N. R. R. may adjusted for various changes in the basis satiation related to business concern

9.9 CAPITAL EMPLOYED

The goodwill of a business depends on the amount of capital employed also. It is the present value of tangible trading assets minus all liabilities. Non Trading assets such as investments in shares should be excluded. Similarly intangible assets. Such as goodwill useless patents and Trade marks should be excluded.

It is considered desirable to use average capital employed in place of capital employed since capital employed as calculated from the balance sheet will be on a certain date only

Average capital employed can be calculated as under : -

$$\text{A. C. E.} = \frac{\text{opening capital} + \text{closing capital}}{2}$$

OR

= Opening capital $\times$ ½ of profit earned during the year.

OR

= Closing capital - ½ of the profit earned during the year.

Average Capital employed can be calculated from given Balance Sheet on the particular date. It is calculated as under:

ASSETS SIDE APPROACH

	₹	₹
All tangible trading Assets at revised value Otherwise at book value recorded as will as unrecorded assets (except goodwill, non trade investment, fictitious assets, differed revenue expenditure)	X X X	XX
Less: Third parties liabilities payable recorded as well as unrecorded, e.g. debentures loans, current liabilities provisions etc. Tangible capital employed at the end of the year.	X X	(X) X
Less : Half of the profit earned during the year.		(X)
Average capital employed		XX

Note: Half of profit earned should be deducted only when profit was not withdrawn.

Note : Capital employed represents the fair value of Net Tangible Trading Assets used in the business for earning the profits.

i) Non trade investment should be excluded.

ii) Goodwill and fictitious assets shown in the balance sheet should be excluded.

iii) Unproductive assets should be excluded.

iv) Assets should taken at fair value to the business.

v) External recorded or unrecorded liabilities should considered at amount payable. [i.e. premium payable on redemption of debentures etc]

vi) Debenture redemption fund is not a liability.

vii) Works men profit shearing fund is liability.

viii) Works men compensation fund is liability to the extent actual amount payable.

ix) Liabilities relating to non-trade assets should be excluded.

LIABILITY SIDE APPROACH

Liability side approach may be adopted for deciding average capital employed. It is adjusted owners fund (share holders fund). It can be calculated as under:

	₹
Paid up share capital (equity + Preference share-capital)	xxx
Add: Reserves and surplus (accumulated profits)	xxx
Add : Revaluation OR Profits	xxx
	xxx
Less : i) Revaluation loss X ii) Fictitious assets X iii) Non Trading Assets X	
	xxx
Trading capital employed at the end of the year	xxx
Less : Half of the profit earned should be deducted only if profit was not withdrawn	(xx)
Average capital employed	xxxx

9.10 METHODS OF VALUATION OF GOODWILL

- **NO. OF YEARS PURCHASE OF SALES OR GROSS FEES**

Under this method the purchaser usually professional firms, pays to the vendor the amount of goodwill, calculated on the basis of net sales or fees received during the particular period.

This method is very simple and suitable for valuation of goodwill of professional firms. The period for gross fees received or net sales are settled by agreement between buyer and vendor.

- **NO. OF YEARS PURCHASED METHOD**

Under this method net profit of past few years is worked out. Goodwill is valued either by adding the profit of post three years or by considering average trade net profit.

Goodwill = Average adjusted Trade net profit X no. of years purchase.

- **NO. OF YEARS OF PURCHASE OF FUTURE MAINTAINABLE PROFIT**

Under this method the profits which are likely to be earned in future over the certain period of time are first estimated. To arrive at Future Maintainable Profits (F.M.P.) past profits over the years, after adjusting non-recurring factors as well as expected future events which were not there in the past are also considered.

Goodwill = F. M. P. x No. of years purchase.

- **SUPER PROFIT METHOD**

In this case the future maintainable profits of the firm are compared with the normal profits of the firm super profit is the excess OR the profit earned by firm over the normal profit earned by the concern.

Super profit is excess of F. M. P. over normal profit.

Super Profit = F. M. P. – Normal profit.

Normal Profit

It is average profit earned by the similar concern in the industry. It is decided on the basis of average capital employed and normal rate of return expected by the investors on capital employed.

$$\text{Normal profit} = \text{Average Capital Employed} \times \frac{\text{NRR}}{100}$$

METHODS OF VALUATION OF GOODWILL UNDER SUPER PROFIT

1) Purchase OR Super Profit Method

Goodwill = Super profit x no. of years purchase under this method the no. of years of purchase will differ from industry to industry and from firm to firm.

2) Capitalization of super profit

Under this method the amount of super profit is capitalized at the normal rate of return. This method tries to find out the amount of capital required for earning the super profit.

$$\text{Goodwill} = \frac{\text{super profit}}{\text{N.R.R.}} \times 100$$

3) Sliding scale of valuation of super profit

This method is the variation of the purchased method. It is based on assumption that the greater amount OR super profit, the more difficult it in future to maintain. If the super profit is greater more possibility of competition and therefore is difficult to maintain the same over the many years.

In this method the super profit is divided in two or three divisions / slide each of this is multiplied by different no. of years purchase, descending order from the first division.

E.g. If super profit is estimated Rs. 75,000 goodwill be calculated as under:

	₹
First Rs. 25,000 say three years purchases (25,000 x 3)	75,000
Second Rs. 25,000 for two years purchases (25,000 x 2)	50,000
Third Rs. 25,000 one years purchases (25,000 x 1)	25,000
Goodwill ₹	1,50,000

4) Annuity method of Super Profit

Annuity takes into consideration time value money. Payment of Goodwill is made immediately for Super Profit likely to be earned in future. Goodwill in this case is the discounted value of the Super Profit.

Goodwill = Super Profit x Reference to annuity table

5) Capitalisation of F. M. P. method

Under this method, goodwill is the excess of capitalize & value of F. M. P. over net tangible trading assets. Following are the steps to taken for valuating Goodwill under this method.

Step 1: **Find out F. M. P.**

Step 2: **Capitalised value of F. M. P.** = F. M. P. $\times \dfrac{100}{\text{N.R.R.}}$

Step 3: **Net tangible Trading Assets**

Total Tangible Trading Assets	x
Less : Third parties liabilities payable	(x)

Net Tangible Trading Assets	x

Step 4: Goodwill

= Capitalized value of F.M.P. - Net Tangible Trading Assets.

Note : The value of Goodwill remains the same in case of capitalization of super profit or capitalization of F. M. P.

9.11 SOLVED PROBLEMS

Illustration 1:

Ashok & Co. decided to purchase the business Sonu & Co. on 31-12-2010. Profits of Sonu & Co. for the last 6 year's were :

	Rs.
2005	10,000
2006	8,000
2007	12,000
2008	16,000
2009	25,000
2010	31,000

The following additional information about Sonu & Co. is also supplied :

a) A casual income of Rs. 3,000 was included in the profits of 2007 which can never be expected in future.

b) Profit of 2008 was reduced by Rs. 1,000 as a results of an extraordinary loss by fire.

c) After acquisition of the business. Ashok & Co. has to pay insurance premium amounting to Rs. 1,000 which was not paid by Sonu & Co.

d) Ashok the proprietor of, Ashok & Co. was employed in a firm at a monthly salary of Rs. 1,000 p.m. The business of Sonu & Co. was managed by a salaried manager who was paid a monthly salary of Rs. 400. Now, Mr. Ashok decides to manage the firm after replacing the manager.

Compute the value of goodwill on the basis of 3 years purchase of the average profit for the last 4 years.

Solution : Statement showing adjusted profit

Years	2007 (Rs.)	2008 (Rs.)	2009 (Rs.)	2010 (Rs.)
Profits	12,000	16,000	25,000	31,000
Adjustments				
a) Casual income not likely to be earned	(3,000)	NIL	NIL	NIL
b) Loss by fire	NIL	1,000	NIL	NIL
Adjusted- Trading Profits	9,000	17,000	25,000	31,000

$$\text{Average Profits} = \frac{9000 + 17000 + 25000 + 31000}{4}$$

$$= 20500$$

	Rs.
Average Profits	20,500
Less : Insurance Premium payable	(1,000)
Add : Salary of Managers not payable (400 p.m. x 12 mths.)	+ 4,800
Less : Cost of Services of Ashok (1000 p.m. x 12 mths)	(12,000)
F. M. P.	12,300

Therefore, Adjusted average profit = 12300

Therefore, Goodwill = Average Profit x 3
= 12300 x 3
= 36900.

Illustration : 2

The year wise results of the earnings of Ashok & Co. as disclosed by her profit and Loss Account are like this.

2006	Rs.	50,000	(Profit)
2007	Rs.	60,000	(Profit)
2008	Rs.	90,000	(Profit)
2009	Rs.	5,000	(Loss)
2010	Rs.	60,000	(Profit)

K Brothers are interested in purchasing the above business. Calculate the amount of goodwill payable by K Brothers to Asha & Co. taking following factors into consideration :

i) Goodwill is to be calculated at three years purchase of the average profits of the previous five years.

ii) Asha & Co. earned Rs. 30,000 from adventure of speculative nature in 2008. Out of this gain. Rs. 10,000 were credited to her Profit & Loss Account in that very year. No entry was made in the account for the remaining gain.

iii) The machinery was destroyed by fire in 2005. Loss amounting to Rs 70,000 being terminal depreciation was set off against Profit & Loss Account of 2009.

iv) Asha & Co. engaged the service of an expert who is drawing a salary of Rs. 2000 per month K. Being an expert himself, does not need the service of that man. At present Mr. K is a manager in Q & Sons and is drawing a salary of Rs. 1500 per month. After the purchase of above business Mr. K has to resign from his employment.

Solution :

Calculation of Actual Average Profit

	Profit Given (₹)	Adjustment (₹)	Adjusted Profit (₹)
2006	50,000	NIL	50,000
2007	60,000	NIL	60,000
2008	90,000	-10,000	80,000
2009	-5,000	70,000	65,000
2010	6,000	NIL	60,000
		Total	3,15,000

Average Profit = $\frac{3,15,000}{5} = 63000$

Add Salary of experts no longer required = $\frac{24000}{87000}$

Less : Fair remuneration of K (18000)

Actual average Profit 69000

Calculation of Goodwill = 69,000 x 3
= Rs. 207000

Illustration : 3

The following is the Balance Sheet Sun Ltd. As on 31st December, 2010.

Liabilities	Rs.	Assets	Rs.
Fully paid up capital 12000 shares of Rs. 100 each	1200000	Goodwill	40000
		Land & Bldg.	780000
General Reserve	160000	Plant & Machinery	300000
Profit & Loss A/c	100000	10% Government Securities	
Creditors	80000	(F.V. 50000)	60000
Bills Payable	40000	Debtors	220000
		Bills Receivable	60000
		Stock in trade	120000
	1580000		1580000

The company earned net profits for the past years as follows: (This amounts include interest received from Government Securities).

2007	Rs.	100000
2008	Rs.	200000
2009	Rs.	300000
2010	Rs.	400000

The value of the goodwill should be computed at three years purchase of the average super profit for four years. The normal rate of return on capital employed in a similar business organisation is 12%.

Solutions :

a) Average Capital Employed = Assets at a realisable value – Liabilities payable

Assets at Realisable value :

Land & Bldg.	780000
Plant & Machinery	300000
Debtors	220000
Bills Receivable	60000
Stock in trade	120000
	1480000
Less : Liabilities payable	
Creditors	80000
Bills Payable	40000
Capital Employed	1360000

b) Normal rate of return = 12%

c) Normal Profit = 1360000 x 12%

= 163200

d) Average Past Profit $= \dfrac{100000+200000+300000+400000}{4}$

$= \dfrac{1000000}{4}$

= 250000 – 5000 (Interest on Govt. Securities @ 10% on F. V.

= 245000

e) Future Maintainable Profit = Average past Trading Profit = 245000

f) Super Profit = FMP – Normal Profit
= 245000 – 163200
= 81800

g) Value of Goodwill = Super Profit x No. of years Purchases.
= 81800 x 3
= 245400

Illustration : 4

Ascertain the value of goodwill of Bahts & Co. carrying on business as retail traders from the following information :

Balance Sheet as on 31st December, 2010

Liabilities	Rs.	Assets	Rs.
Paid up capital 2500 shares of Rs. 100 each	250000	Goodwill	25000
		Land & Bldg.	110000
Profit & Loss A/c	56650	Plant & Machinery	100000
Bank Overdraft	58350	Stock	150000
Creditors	90500	Debtors	45000
Provision for taxation	19500	Investment	45000
	475000		475000

The company commenced operations in with a paid up capital of Rs. 250000. The profits earned before providing for taxation (at 50%) have been as follows :

	Rs.
2006	62000
2007	64000
2008	71000
2009	78000
2010	85000

Average dividend paid by the company is at 12½% which is taken as a reasonable return expected on Capital invested in the business.

Goodwill is to be calculated with reference to Capitalisation of future maintainable profits method.

Solution :

a) Average Capital Employed = Assets at a realizable value – Liabilities payable

Assets at Realised value :

Land & Bldg.	110000	
Plant & Machinery	100000	
Stock	150000	
Debtors	45000	
Investment	45000	450000
Bank Overdraft	58350	
Creditors	90500	
Provision for taxation	19500	168350
Capital Employed		281650

b) Normal rate of return = 12.5%

c) Avg. Past Profit = $\frac{62000+64000+71000+78000+85000}{5} = \frac{360000}{5}$

= 72000

d) Future Maintainable Profit :

Avg. Past Profit	72000
Less : Tax 50%	- 36000
FMP after Tax	36000

e) Capitalised value of maintainable profit.

$$= \frac{FMP}{NRR} \times 100$$

$$= \frac{36000}{12.5} \times 100$$

$$= 288000$$

f) Value of Goodwill = Capitalised value of maintainable profits – Actual Cap. Employed

= 288000 – 281650

= 6350

Illustration : 5

The following is the Balance Sheet of Sarah Ltd. As on 31st December, 2010

Liabilities	Rs.	Assets	Rs.
Paid up share capital 1000 shares of Rs. 200 each	200000	Goodwill	30000
		Land & Bldg.	170000
Capital Reserve	40000	Plant & Machinery	160000
General Reserve	60000	Vehicles	70000
Bank Loan	50000	Stock in trade	60000
Profit & Loss A/c	20000	Debtors	50000
Creditors	130000	Investment	30000
Bills Payable	40000		
Provision for taxation	30000		
	570000		570000

On Der. 31, 2010 the asses were revalued as follows :

Land & Bldg.	Rs.	200000
Plant & Machinery	Rs.	150000
Vehicles	Rs.	60000

The company earned profit after depreciation & taxation as follows :

2008	Rs	60000
2009	Rs.	70000
2010	Rs.	80000

The average of these profits are expected to be earned in future.

The valuation of goodwill should be based on two year's purchase of the annual super profit. It is considered that 10% is a reasonable return on tangible capital.

You are required to value the goodwill.

Solution :

a) Average Capital Employed = Assets at a realisable value – Liabilities payable

Assets at Realisable value :	**Rs.**
Land & Bldg.	200000
Plant & Machinery	150000
Vehicles	60000
Stock	60000
Debtors	50000
Investment	30000
	550000

Less : Liabilities		
Creditors	130000	
Bills Payable	40000	
Tax Provision	30000	
Bank Loan	50000	250000
Capital Employed		300000

b) Normal rate of return = 10%

c) Normal Profit = 300000 x 10%

= 30000

d) Average Past Profit = $\frac{60000+70000+80000}{3} = \frac{210000}{3}$

= 70000

e) Future Maintainable Profit = 70,000

f) Super Profit = F. M. P. – Normal Profit

= 70000 – 30000

= 40000

g) Value of Goodwill = Super Profit x No. of years purchase

= 40000 x 2

= 80000

Illustration : 6

The net profits of a company before providing for taxation for the past five years Rs. 40000, Rs, 41,000, Rs. 42500, Rs. 43000 & Rs. 43500. The capital employed in the business is Rs. 400000 on which a reasonable rate of return of 15% is expected. It is expected that the company will be able to maintain it's super profits for the next five years.

a) Calculate the value of goodwill of business on the basis of an annuity of one rupee for five years at 15% interest as Rs. 4%.

b) How would your answer differ if goodwill is calculated by capitalising the excess of the annual average distributable profits over the reasonable return on capital employed on the basis of the same return of 15%?

c) Calculate goodwill on 4 years purchase of super profit.

Solution :

a) Avg. Capital Employed = Rs. 100000

b) NRR = 15%

c) Normal Profit = 1,00,000 x 15% = Rs. 15000

d) Avg. Past Profit= $\frac{40,000+41,000+42,500+43,000+43,500}{5}$

= 42,000

e) F. M. P.

N. P. B. T.	42,000
Tax @ 40%	16,800
FMP after Tax	= 25,200

f) Super profit = 25200 – 15000 = 10200

g) Value of Goodwill = Super Profit x No. of years purchases.

= 10200 x 5 = 51000

Capitalion Method :

Capitalion value $= \frac{\text{FMP}}{\text{NRR}} \times 100$

$= \frac{25200 \times 100}{15} = 168000$

Value of Goodwill = 168000 – 100000 = 68000

Value of Goodwill an annuity of Rs. 1 = 10200 x 4.10 = 41820

Illustration : 7

The following are particulars in respect of Maru Ltd.

i. Capital employed in the business is Rs. 4200000.

ii. A reasonable rate of return expected in a similar type of business is 10%.

iii. Net profit of the company after providing for depreciation & taxation for the past four years were :

Rs. 400000, Rs. 420000, Rs. 460000 & Rs. 480000

iv. It is expected that the company will be able to maintain it's super profit for the next four years.

You are required to calculate the value of goodwill.

a) On the basis of annuity of super profit method taking the present value of an annuity of Re. 1 for four years at 7% interest as Rs. 3.39.

b) By capitalising the excess of the annual average distributable profits over a reasonable return on capital employed on the basis of the return of 7%.

Solution :

a) i) Capital Employed = Rs. 12,00,000

ii) NRR = 7%

iii) Standard Profit = 1200000 x 7% = 84000

iv) Avg. Past Profit $= \dfrac{100000+120000+160000+180000}{4}$

= 140000

v) FMP

Avg. Past Profit 140000

-

140000

vi) Super Profit = FMP – Normal Profit

= 140000 – 84000

= 56000

vii) Value of Goodwill = 3.39 x 56000

= 189840

b) Capitalisation of Super Profit

Goodwill $= \dfrac{\text{Super Profit}}{\text{NRR}} \times 100$

$= \dfrac{56000}{7} \times 100$

= Rs. 8,00,000

Illustration : 8

The following is the Balance Sheet of X Limited as on 31st March 2010.

Liabilities	Rs.	Assets		Rs.
Share Capital		Goodwill		1,25,000
5,000 shares of Rs. 100 each	5,00,000	Land & Building	1,80,000	
Reserve Fund	1,50,000	Less : Depreciation	36,000	1,44,000
Workmen compensation Fund	25,000	Plant & Machinery (at cost)	2,40,000	
Workmen Profit Sharing Fund	45,000	Less : Depreciation	40,000	2,00,000
Profit & Loss Account	1,50,000	Investments (to provide replacement of Plant & Machinery)		1,00,000
Creditors	2,30,000	Book Debts	3,60,000	
Other Liabilities	1,00,000	Less : Provision	30,000	3,30,000
		Stock		2,00,000
		Cash at Bank		75,000
		Preliminary Expenses		26,000
	12,00,000			12,00,000

Further Information

1) The profits after tax @ 50% earned by the company for the three years were as under :

Year ended 31st March 2008 Rs. 5,10,000

Year ended 31st March 2009 Rs. 7,73,000

Year ended 31st March 2010 Rs. 8,90,000

2) X Ltd. had been carrying on business for the past several years. The company is to be taken over by another company. for this purpose you are required to value Goodwill by "capitalization of maintainable profits method". For this purpose following additional information is available :

a) The new company expects to carry on business with its own board of directors, without any addition. The fees paid by X Ltd. to its directors amounted to Rs. 2,000 p.m.

b) The new company expects a large increase in volume of business and therefore, will have to take an additional office for which it will have to pay extra rent of Rs. 36000 p.a.

c) As on 31st March 2010 Land and Buildings were worth Rs. 4,00,000 whereas Plant and Machinery were worth only Rs. 1,80,000. There is sufficient provision for doubtful debts. There is no fluctuation in the values of investments and stocks.

d) Liability under Workmen Compensation Fund was only Rs. 10,000.

3) The expected rate of return on similar business may be taken at 15%.

4) The expected rate of Tax likely to be 40%.

You are required to value Goodwill according to above instructions. All your workings should form part of your answer. Consider average capital employed the same as closing capital employed for your calculations. [Consider weighted average profit]

Solution :

1) Future Maintainable Profits

Year	N.P.A.T.	Add Income Tax	N.P.B.T.	Weight	Product
2007-8	5,10,000	5,10,000	10,20,000	1	10,20,000
2008-9	7,73,000	7,73,000	15,46,000	2	30,92,000
2009-10	8,90,000	8,90,000	17,80,000	3	53,40,000
				6	94,52,000

Average profit before tax $\frac{94,52,000}{6} = 15,75,333$

Add : Expenses Not Payable in future (directors fees)	24,000
Less : Additional Expenses (extra Rent)	(36,000)
Adjusted Profit (before tax)	15,63,333
Less : tax @ 40%	[6,25,333]
Net Profit after tax, or Future Maintainable Profit	9,38,000

2) Capital Employed (Excluding Goodwill)

Particulars		Rs.	Rs.
Assets			
Land & Building (Market Value)		6,00,000	
Plant & Machinery (Market Value)		1,00,000	
Investment (cost) (See note)		1,00,000	
Debtors (Net)		3,30,000	
Stock (cost)		2,00,000	
Cash		75,000	
	(A)		14,05,000
Less: Liabilities :			
Creditors		2,30,000	
Other Liabilities		1,00,000	
Workmen's Compensation Fund (actual)		10,000	
Workmen's Profit sharing Fund		45,000	
	(B)		(3,85,000)
Closing Capital employed as on 31-3-2002	(A-B)		10,20,000

3) Expected Rate of Return = 15% (given)

4) Value of business by capitalization of Future Maintainable Profits at 15%.

$$= \text{F. M. P.} \times \frac{100}{\text{NRR}} = \frac{9,38,000}{15} \times 100 = 62,53,333$$

5) Goodwill = Value of business Less Capital Employed

= 6253333 – 1020000

= 52,33,333

Working Notes :

1) Investments are included in capital employed because they are trading investments meant for replacement of Plant and Machinery.

2) In the absence of information (regarding rate and method of depreciation) no adjustment is made to Future Maintainable Profit for depreciation on revalued Land & Building and Plant & Machinery.

Illustration : 9

Sandwitch, Pizza and Burger are partners in a firm sharing profits and losses in the ratio of 5:2:1. The partnerships deed provides that in the event of retirement or death of a partner goodwill is to be valued at three years' purchase of Weighted Average of Future Maintainable Profits over a Period of four years, (the weights being four for the immediate year after the event, three for the next year, two for the third year and one for the last year) in excess of 12.5% of Capital Employed in the business at the time of retirement/death. On 31st December, 2010 Pizza retired. The Balance Sheet of the firm was as follows:

Liabilities	Rs.	Assets	Rs.
Capitals		Fixed Assets	5,00,000
Sandwitch	7,00,000	Net current assets	8,00,000
Pizza	3,50,000		
Burger	2,50,000		
	13,00,000		13,00,000

Sales during the year ended 31st December 2001 totalled Rs. 1 crore and were at a gross margin of 10%. The expenses amount to 30% of Gross Profit. It is expected that sales will increase at 20% curmulative rate of growth every year. Gross Profit margin percentage being reduced to 9%. The expenses would continue to be at 30% of Gross Profit. Calculate goodwill which is to be credited to Pizza.

(Apr. 2000, adapted)

Solution :

1) Calculation of Future Maintainable Profits (FMO)

Particulars	2011 Rs. '000)	2012 Rs. ('000)	2013 Rs. ('000)	2014 Rs. ('000)
Sales (Increase by 20%	12,000	14,400,00	17,280,00	20,736,00
Gross Margin (9% on Sale)				
Less : Expenses likely to	1,080	1,296,00	1,555,20	1,866,24
arise in future (30% of Gross Profit)	324	388,80	466.56	559.87
FMP				
Weights (as given)	756	907.20	1,088,64	1,306.37
	X 4	X 3	X 2	X 1
Weighted FMP (Products)	3024	2,721,60	2,177,28	1,306.37

Weighted Average of FMP = $\dfrac{\text{Weighted FMP}}{\text{Total of Weights}}$

$$= \frac{3{,}024 + 2{,}721.60 + 2{,}177.28 + 1{,}306{,}37}{10} = \frac{9{,}229.25}{10}$$

= Rs. 922,925

2) Capital Employed = Rs. 13,00,000

3) Normal Profit = Capital Employed x Normal Rate of Return (given)

= Rs. 13,00,000 x 12.5% = Rs. 1,62,500

4) Super Profit = FMP – Normal Profit

= 922,925 – 162500 = 760425

5) Goodwill = Super Profit x No. of years purchased

= 760425 x 3 = 22,81,280

6) Goodwill to be credited to Pizza's A/c

$$= 2281{,}280 \times \frac{2}{8} = \text{Rs. } 570320$$

❖❖❖❖

10

VALUATION OF SHARES AND BUSINESS

Unit Structure

10.1 INTRODUCTION

Share means share in a public or private Ltd. company. The shares of the private Ltd. Company are never quoted on stock Exchange. Also not all the public companies shares are quoted on the stock exchange. It’s value cannot be easily ascertained. A public company may either be widely held or closely held. A closely held public company means a company having very few share holders. Each shareholder owing a substantial part of the share capital. A widely held public company means a company having large number of share holders spread over the entire country thus, it has innumerable share holders. Share of only such companies are quoted on one or more stock exchanges. The prices of such shares depend upon various factors like demand and supply, market sentiments etc.

10.2 NEED FOR VALUATION OF SHARES

Shares of a company are to be valued at different occasions as follows:

a) When shares of one class are to be converted into shares of another class.

b) When shareholders wants to take loan from financial institution against the security of shares hold by him.

c) When shares are to be transferred, bought or sold

d) When the companies are amalgamated absorbed merged or reconstructed.

e) When the Government wants to compensate the shareholders on the nationalization or the company.

f) Whenever there is a death of a shareholder and the distribution of shares held by him is to be made among the legal heir offices.

10.3 FACTORS AFFECTING SHARE VALUATION

Following factors affects on the share value:

1) Nature of business.
2) Market conditions as regards the companies doing the similar business and existing competition.
3) Demand and supply of shares in recognized stock exchange.
4) Earning capacity of the company and growth prospectus.
5) Goodwill of the company.
6) Reputation of the management.
7) Anticipated legislature measures
8) General economic conditions and policies of the Government.

10.4 METHODS OF VALUATION OF SHARES

Generally there are two types of shares:

a) Equity shares

b) Preference shares

Whenever there are preference shares and Equity shares, the Articles of Association must be referred for the purpose of finding out the respective rights of share holders.

Preference shareholders have priority as regards dividends and repayment of Capital. At the same time if Preference shares are participating, there value depends upon the share in supply as per Articles of Association. In such circumstances the valuation of Preference share is also important.

Value of Equity shares depends upon whether they are quoted or unquoted.

In case of quoted shares the value should be as per the quoted in the recognized stock exchange.

Primarily following are the methods of valuation of shares.

a) Intrinsic value

b) Yield value Basic

c) Fair value

d) Earning Capacity method

e) Capitalization of maintainable profits.

- **INTRINSIC VALUE :**

This is also called as “Net Assets Value” or “NAV” of Liquidation value or Breakup value or Asset Backing value.

This method OR valuation is based on the assumption of liquidation of company. Here it is assumed that the company going into liquidation in near future. All the assets are sold and all the liabilities are paid of and then the remaining surplus is distributed among the Equity shareholders.

Steps to find the intrinsic value.

Step No. 1 – Find out amount available to Equity Shareholders

All Assets at current market value including goodwill. non trade investments but excluding fictitious assets.

Goodwill	xxx	
Land and Building	xxx	
Plant and Machinery	xxx	
Furniture and Fixtures	xxx	
Vehicles	xx	
Trade and non trade investments	xxx	
Stock	xxx	
Debtors and Bills Receivable	xxx	
Cash and Bank Balances	xxx	
Loans Advances and prepaid expenses	xxx	
		xxx
Less : All liabilities at current values excluding share capital and Reserves and Surplus	xxx	
Debentures and Accrued Interest	xxx	
Long term loans	xxx	
Creditors and Bills payable	xxx	
Outstanding Expenses	xxx	
Proposed / unpaid Dividend	xxx	
Provision for Taxation	xxx	
Other liabilities payable	xxx	(xxx)
		xxx
Less : Dues to Preference shareholders	xxx	
Paid Preference share Capital	xxx	
Arrears of dividend (if any)	xxx	
Premium payable on redemption (if any)	xxx	(xxx)
Amount available to Equity shareholders		xxxx

Step No. II: Intrinsic Value per Equity share

a) If all the shares are fully paid up

$$= \frac{\text{Amount availabel to equity shareholders}}{\text{No. of equity shares}}$$

Points to be remembered:

While calculating the net asset value the following points should be remembered.

1. only market value of the assets should be considered. If market value is not given then the book value should be considered.
2. All assets recorded and unrecorded should be taken into account.
3. goodwill also should be considered as per instruction of the problems.
4. Non trading assets should be considered.

Merits of intrinsic Value method :

1. it is very sureful when the company is being liquidated.
2. It takes into account both types of Assets.
3. It is simple to use in valuation of different types of equity shares.

Demerits of Intrinsic Value Method :

1. It is difficult to estimate the realizable value of assets.
2. the assumption of liquidation is contradictory with the normal of assumption of going concern principal.
3. The value of goodwill is very much subjective.

- **YIELD VALUE BASIS**

This method of valuation is based on the assumption of going concern principal. Here it is assumed that the company shall carry on business profitability for many years to come. Therefore, value of shares is based on the amount or profit that would be available to Equity shareholders as dividend.

Steps to calculate yield value:

a) Find out Future maintainable Profit (F. M. P.)		
Same as in Goodwill Valuation		xxx
Add : back interest on Non-Trade Investment		xxx
		xxx
Less :		
i. Transfer to Reserve as required under law	xxx	
ii. Preference Dividend	xxx	(xxx)
F. M. P. available to Equity shareholders		xxx

b) Find out rate of F. M. P. = $\frac{\text{F.M.P.}}{\text{Paid up equity capital}} \times 100$

c) Yield Value = $\frac{\text{Rate of F.M.P.}}{\text{N.R.R}} \times \text{Amt. Paid per share}$

ALTERNATIVELY

d) Capitalised value of F. M. P. = $\frac{\text{F.M.P.}}{\text{N.R.R}} \times 100$

e) Yield Value = $\frac{\text{Capitalized Value of F.M.P.}}{\text{No. of Equity shares}}$

- **FAIR VALUE**

This method takes into account both the above methods

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

- **EARNING CAPACITY VALUE**

Under this method, value of share is decided on earning capacity of the company:

Steps to calculate Earning capacity

a) Earning = Net profit after tax + Interest on long term loans.

b) Capital employed = Net Worth + Long Term loans

OR = Assets – Short Term liabilities

OR = Fixed Assets + Investment + Working Capital.

c) Rate of Earning = $\frac{\text{Earning x 100}}{\text{Capital Employed}}$

d) Value per Equity Share

$= \frac{\text{Rate of Earning}}{\text{N.R.R}} \times \text{Paid up value per Equity Share}$

- **CAPITALISATION OF F. M. P. METHOD**

Under this method F. M. P. is capitalized at N. R. R.

Steps to calculate value per share

a) Calculate F. M. P. available to Equity share holders

b) Capitalized value of F. M. P.

$$= \frac{\text{F.M.P.}}{\text{N.R.R}} \times 100$$

c) Value per share

$$= \frac{\text{Capitalized value of F.M.P.}}{\text{Paid up Equity Share Capital}} \times \text{Paid up amount per Share}$$

10.5 VALUATION OF EQUITY SHARES HAVING DIFFERENT PAID UP VALUE

INTRINSIC VALUE:

A company may have Equity shares of same face value, but in some cases shares may partly called up / paid up.

For purpose of valuation a notional call equal to unpaid / uncalled amount on each category of equity shares, should be made to make all Equity shares fully paid up. Notional call amount should be added to net Assets available to equity shareholders. Total amount will be available to Equity Shareholders. when all shares are fully paid up value of Equity shares can be determine as under:

Net Assets available to Equity shares (As calculated earlier)		x
Add : Unpaid share capital	x	
Add national call on partly called up shares, to make shares fully paid up	x	+x
Net Assets available to Equity shareholders, when all shares are fully paid up		xx

$$\text{Value of full paid Equity shares} = \frac{\text{Total Amount}}{\text{Total No. of Equity shares}}$$

Value of partly paid up share

= Value of fully paid share – National call per share

OR

Value can be determined as under

[When no notional call is to be made]

Intrinsic value of an Equity Share

$$= \frac{\text{Amt. avaliable to equity shareholders}}{\text{Total paid up Equity share capital}} \times \text{Paid up amt. of each class of Equity Share}$$

YIELD VALUE

For calculating yield value of Equity Share having different paid up value following procedure should be followed:

Step I $\rightarrow$ Calculate F. M. P. i.e. profit available for Equity dividend.

Step II $\rightarrow$ Calculate Rate of F. M. P.

$$= \frac{\text{F.M.P.}}{\text{Paid up Equity Capital}} \times 100$$

$$\text{Yield Value} = \frac{\text{Rate of F.M.P.}}{\text{N.R.R.}} \times \text{Paid up value per Equity share}$$

SOLVED PROBLEMS Illustration : 1

From following as certain fair value of Equity share.

Particulars	₹
5,000 Equity Shares of ₹ 100 each fully paid up	5,00,000
3,000 Equity shares of ₹ 100 each Rs. 60 paid up	1,80,000
12,000 Equity shares of ₹ 100 each Rs. 40 paid up	4,80,000
	11,60,000

Net Assets were valued at ₹ 44,50,000

Adjusted Average profit after Tax amounted to 49,30,000 and N. R. R. is 20%.

Solution :

Statement showing Total amount available to Equity Shareholders.

Particulars	₹	₹
Net Assets valued (given)		44,50,000
Add : Notional call made		
On 5000 Equity Share @ ₹ 40 each	2,00,000	
On 12000 Equity Share @ ₹ 60 each	7,20,000	9,20,000
Total Amount		53,70,000

Intrinsic Value of Fully Paid up Equity share = $\frac{\text{Total Amount}}{\text{Total No. Equity Shares}}$

$= \frac{53,70,000}{20,000} = ₹\ 268.50$

Value of partly paid Equity Share = value of fully paid share – Notional call per share

Value of Equity Share ₹ 60 paid up = 268.50 – 40

= 228.50

Value of Equity Share ₹ 40 paid up = 268.50 -60

= 208.50

Value Yield

1. F. M. P. = ₹ 30,60,000 given

2. Rate of F. M. P. = $\frac{\text{F.M.P.}}{\text{Paid up Equity Share Capital}} \times 100$

$= \frac{49,30,000}{11,60,000} \times 100 = 425\%$

Yield Value = $\frac{\text{Rate of F.M.P.}}{\text{N.R.R}} \times \text{Paid amt. per equity share}$

Yield Value of fully paid Equity Share = $\frac{425}{20} \times 100 = ₹\ 2125$

Yield Value of Equity Share ₹ 60 paid up = $\frac{425}{20} \times 60 = ₹\ 1275$

Yield value of Equity Share ₹ 40 paid up = $\frac{425}{20} \times 40 = ₹\ 850$

Fair Value of Equity Share = $\frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$

Value of full paid Equity Share = $\frac{268.50 + 2125}{2} = ₹\ 1196.75$

Value of Equity Share, ₹ 60 paid up = $\frac{228.50 + 1275}{2} = ₹\ 751.75$

Value of Equity Share ₹ 40 paid up = $\frac{208.50 + 850}{2} = 529.25$

Particulars	Intrinsic Value ₹	Yield Value ₹	Fair Value ₹
a) ₹ 100 fully paid up Equity Share	268.50	2125	1196.75
b) ₹ 100 Equity Share, 60 paid up	228.50	1275	751.70
c) ₹ 100 Equity Share ₹ 40 paid up	208.50	850	529.25

10.6 VALUATION OF SHARES BEFORE BONUS AND AFTER ISSUE OF BONUS SHARES

A prosperous company may issue bonus shares by capitalizing reserves. Bonus shares allotted to existing Equity shares holders at free of cost. Issue of Bonus Shares increases Equity Shares and Equity capital. However Net Assets of the company remains at same amount, therefore after bonus issue value of Equity share reduces.

Illustration : 2

A Ltd. had an issued capital of 50,000 Equity shares of ₹ 100 each, ₹ 75 paid up. The General Reserve of the company stood at ₹ 90,00,000.

Net Assets valued at ₹ 5,00,00,000.
It was resolved to use a part of General Reserve as under :

a) to make shares fully paid

b) to issue 25,000 bonus share of ₹ 100 each at par. Find out intrinsic value of Equity share before Bonus and After Bonus Issue.

Solution :

Equity Share Capital ₹ No. of Equity Shares

Before Bonus	After Bonus
37,50,000	75,00,000
50,000	75,000

Intrinsic value of Equity Share

$$= \frac{\text{Net Assets available to Equity shareholders}}{\text{No. of Equity Shares}}$$

$$\text{Before Bonus} = \frac{5,00,00,000}{50,000} = ₹1000$$

$$\text{After Bonus} = \frac{5,00,00,000}{75,000} = ₹666.67$$

10.7 VALUATION OF EQUITY SHARES BEFORE RIGHT ISSUE AND AFTER RIGHT ISSUE OF SHARES.

Right shares are issued to employees and / or to existing Equity shareholders at particular amount. Right share price indirectly includes bonus element also. After right shares issued number of Equity shares and Equity share capital increases. Net Assets available to Equity shareholders also increases by proceeds received on right shares issue.

Illustration : 3

ZA Ltd. had an issued capital of 40,000 Equity Shares of Rs. 10 Each fully paid up. Company decided to issue right share at the rate 3 share for every 5 shares @ Rs. 250 each; entire amount payable on application. Net assets before right issue was ₹ 170,00,000.

Assuming right issue was subscribed find intrinsic value of Equity Shares Before right and after right.

Solution :

	Before Rights	After Rights
a) No. of Equity Shares	40,000	64,000
b) Equity Share Capital	4,00,000	6,40,000
c) Net Assets available to Equity share holders	[170,00,000 + 60, 00,000]	
	1,70,00,000	2,30,00,000

10.8 VALUATION OF EQUITY SHARES BEFORE CONVERSION OF DEBENTURES AND AFTER DEBENTURES CONVERSION INTO EQUITY SHARES:

If debentures are converted into Equity shares, it increases it Equity share capital, number of Equity shares and Net worth. Since after conversion debenture interest is not to be payable, it increase F. M. P. also. Therefore it has impact on both net worth and F. M. P.

Illustration : 4

The following particulars are available from Balance Sheet of Ketan Ltd.

a) 60,000 Equity shares of Rs 10 each fully paid up.

b) 5,000 12% Debentures of Rs. 100 each.

c) Net Assets available to Equity shareholders be conversion of Debentures, ₹ 1, 24,00,000.

d) Average net profit before tax ₹ 36, 00,000.

e) Income Tax rate @ 40%.

Debentures are redeemable @ 20% premium. Debentures are converable into Equity share of ₹ 10 each priced at ₹ 50 N. R. R. = 15%

You are require to find out fair value of Equity share after conversion of debenture; assuming all debentures exercise their right in favour of conversion.

Solution

I. Debenture holders claim ₹

12% Debentures	=	5,00,000
Premium payable on redemption @ 20%	=	1,00,000
Total Claim		6,00,000

II. No. of share issued = $\frac{\text{Claim of Debenture holders}}{\text{Issue of one equity share}}$

$$= \frac{6,00,000}{50} = 12000 \text{ Equity Shares}$$

III. F. M. P. After conversion	₹
N. P. Before Tax	36,00,000
Add: saving in Debenture interest [5,00,000 x 12%]	60,000
M. P. B. T (after conversion)	36,60,000
Less Income Tax @ 40%	14,64,000
F. M. P. after conversion [No debenture payable]	21,96,000

IV. Net Assets Before Conversion	=	1,24,00,000
Add: Debentures no more payable	+	5,00,000
Net Assets after Conversion		1,29,00,000

[Amt. available to Equity shareholders]

V. No. of shares after debentures conversion.

= 60, 000 + issued to Debenture holders

= 60,000 + 12,000 = 72,000

Equity Capital = ₹ 7,20,000

A) Intrinsic Value = $\frac{\text{Net Assets availabel to Equity Shareholders}}{\text{No. of Equity Shares}}$

= $= \frac{1,29,00,000}{72,000} = 179.17$

B) Yield Value

i) F. M. P. = 21,96,000

ii) Rate of F. M. P. = $\frac{\text{F.M.P.}}{\text{Paid up Equity Capital}} \times 100$

= $\frac{21,96,000}{7,20,000} \times 100 = 305\%$

Yield Value = $\frac{\text{Rate of F.M.P.}}{\text{N.R.R.}} \times \text{Paid up amt. per Equity share}$

= $\frac{305}{15} \times 10 =$ ₹ 203.33

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

= $\frac{179.17 + 203.33}{2} =$ ₹ 191.25

Note : In case of conversion of preference shares into Equity shares, Income Tax benefit are not available while calculating F. M. P.

I) F.M.P. = Average Profit after Tax – transfer reserve if any.

II) No. of Equity shares and Equity share capital share increased due to Equity share allotted to preference share holders.

10.9 VALUATION OF SHARE BEFORE SUB-DIVISION AND AFTER SUB-DIVISION

In such case number of Equity shares only changes (i.e. increases) Equity share capital remain at same amount. Net Assets also remain same. Value of Equity shares can be calculated as usual.

10.10 VALUATION OF SHARES FROM POINT OF VIEW OF MINORITY / MAJORITY SHAREHOLDERS

Shareholders may be classed into two categories namely:

a) Minority Shareholders:

These shareholders holding smaller portion of share capital of the company. Such shareholders are interested in the rate of dividend declared by the company and appreciation in share-market value. However, valuation of such shares is based on the dividend declared by the company.

Value per share = $\frac{\text{Average Rate of dividend}}{\text{N.R.R.}} \times \text{Amt. paid per Equity Share}$

b) Majority shareholders:

These shareholders are holding larger portion of share capital. Such shareholders are interested in F. M. P. Therefore yield value of shares should be preferred. However in case change in holding / transfer / amalgamation etc. fair value or intrinsic value may be calculated.

10.11 VALUATION OF PREFERENCE SHARE :

Values of Preference share depend upon type of preference shares, which are stated in Articles of Association.

a) When Preference shares are non-participating (having priority)

In such case value of Preference Share will be equal to its paid up value plus premium on redemption if any payable plus arrears of Preference dividend if any.

Intrinsic Value =

$$\frac{\text{paid up pref. capital + Arrears of Dividend + Premium on redeemption if payable}}{\text{No. of Pref. Shares}}$$

b) When Preference shares are participating:

In such a case, Preference share holders get a share in surplus as per provisions of Articles of association.

Intrinsic = $\frac{\text{paid up pref. share capital + surplus + Arrears of Dividend if any}}{\text{No. of Preference Shares}}$

c) When Preference share are having no Preference over Equity Shares:

In such a case, the net assets to all shareholders should be divided between Equity and Preference share holders in the ratio of their paid up capital

$$\text{Intrinsic Value} = \frac{\text{Net Assets availabel to preferene shareholders}}{\text{No. of Preference Shares}}$$

10.12 SOLVED PROBLEMS ON VALUATION OF SHARES

Illustration: 5

The following information made available:

Issued & paid up capital	₹
10% Preference shares of ₹ 100 each	5, 00,000
Equity share capital (₹ 10 each)	15, 00,000
Reserve & Surplus	20, 00,000
Preliminary Expenses	20,000

All fixed Assets (including Goodwill) were under valued by ₹ 10, 20,000 current Assets were over valued by ₹ 1, 00,000.

You are required to value Preference share if,

a) When Preference share are non-participating

b) When Preference share are participating; having 10% share in surplus

c) When Preference shares are having no Preference over Equity shares :

Solution :

Statement showing Net Assets a surplus (Liability side Approach)

Particulars	₹	₹
10% Preference share capital (100 each)		5,00,000
Equity share capital		15,00,000
Reserves & Surplus		20,00,000
Revaluation profit on Fixed Assets		10,20,000
		50,20,000

Less : i) Preliminary Expenses ii) Loss on revaluation on current Assets	20,000 1,00,000	 (1,20,000)
Net Assets Less : i) Preference Share capital ii) Equity Share capital	 5,00,000 15,00,000	49,00,000 (20,00,000)
Surplus on Liquidation		29,00,000

Valuation :

a) When Preference Share not participating intrinsic value

$$= \frac{\text{Paid up Pref. Share Capital} + \text{Arrears of dividend}}{\text{No. of preference shares}}$$

$$= \frac{5,00,000}{5,000} = \text{Rs. 100 each}$$

b) When Preference share participating, having 10% share in surplus :

$\therefore$ surplus available to pref. share holders

= 29,00,000 x 10% = ₹ 29,00,000

Intrinsic Value =

$$\frac{\text{Paid up Pref. Share Capital} + \text{surplus} + \text{Arrears of dividend}}{\text{No. of preference shares}}$$

$$\frac{5,00,000 + 2,90,000}{5,000} = \frac{79,00,000}{5,000}$$

= ₹ 158, per Preference share.

c) When Preference shares having no Preference over Equity Shareholders :

in this case, net assets of the company required to divide in the ratio of paid up share capital

$\therefore$ Preference Share Capital : Equity Share capital

5,00,000 : 1,50,000

$\therefore$ 1 : 3

Therefore net assets available to Preference shareholders

$= 49,00,000 \times \frac{1}{4} = 12,25,000$

$$\text{Intrinsic Value} = \frac{\text{Net Assets Availabel to preference shareholders}}{\text{No of preference shares}}$$

$$= \frac{12{,}25{,}000}{5000}$$

$$= \text{Rs. } 245$$

Illustration : 6

Following is the summarized Balance Sheet of R. K. Ltd. as on 31-3-2010.

Liabilities	Rs.	Assets	Rs.
3,00,000 Equity Shares of Rs. 10 each fully paid	30,00,000	Goodwill	1,00,000
Reserves	30,00,000	Building	9,00,000
Long Term Loan	20,00,000	Machinery	40,00,000
Current Liabilities	54,00,000	Vehicles	1,00,000
		Shares in subsidiary Ltd. 3000 Equity Shares of Rs. 100 each (at cost)	3,00,000
		Current Assets	8,00,000
	1,34,00,000		1,34,00,000

Find out the value of net assets basis of Equity shares of P.K. Ltd. On basis of the following information :

a) Goodwill is valued at Rs. 10,00,000, Machinery at Rs. 49,50,000, Building at Rs. 20,00,000 & Vehicles at Rs. 50,000.

b) Current Assets & Current Liabilities are to be taken at Book Value.

c) Shares of T Ltd. are to be valued on the basis of Net Assets of T Ltd.

Balance Sheet of T Ltd. as on 31.3.2010

Liabilities	Rs.	Assets	Rs.
5000 Equity shares of Rs. 100 each	5,00,000	Fixed Assets	9,00,000
Reserves	8,00,000	Current Assets	11,00,000
Current Liabilities	7,00,000		
	20,00,000		20,00,000

Fixed Assets of T Ltd. revalued at Rs. 12,00,0002-actual current liabilities payable Rs. 6,00,000.

Solution :

Net Assets Basis :

a)	Goodwill	10,00,000	
	Machinery	49,50,000	
	Building	20,00,000	
	Vehicles	50,000	
	Current Assets	80,00,000	
	Equity Shares of T. Ltd.	10,20,000	
		152,20,000	

Less : Liability

Long Term Loan	20,00,000	
Current Liabilities	54,00,000	-(7,40,000)
Net Assets available for Equity shareholder		1,44,80,000

$$\text{Intrinsic Value} = \frac{\text{Net Assets available for ESH}}{\text{No. of equity Shares}}$$

$$= \frac{1,44,80,000}{3,00,000}$$

= 48.27

a) Net Assets value / Equity share of T Ltd.

	₹
Fixed Assets	12,00,000
Current Assets	11,00,000
	23,00,000
Less : Current Liabilities	(6,00,000)
Net Assets	17,00,000

$$\text{Intrinsic Value} = \frac{17,00,000}{5,000}$$

= 340

b) Revaluation of investment

340 x 3000 Equity shares

= 10,20,000

Illustration : 7

Z Ltd. has the following items appearing in it's Balance Sheet as on 31st March, 2010

Liabilities	Rs.	Assets	Rs.
Shares Capital :		Goodwill	3,50,000
Equity shares Rs. 10	10,00,000	Freehold property	4,50,000
10% Preference Shares Rs. 10	5,00,000	Plant & Machinery	12,50,000
Profit & Loss A/c	5,00,000	Investment	1,00,000
Bank Loan	10,00,000	Stock	5,00,000
Current Liabilities	1,50,000	Debtors	3,50,000
		Bank & Cash	1,50,000
	31,50,000		31,50,000

1) The profit for the past three years ended 31st

   March, 2008 Rs. 1,40,000

   March, 2009 Rs. 3,25,000

   March, 2010 Rs. 5,50,000

2) The profit shown above are after debiting

   a) Goodwill @ Rs. 50,000 p.a.

   b) Dividend on Preference shares as applicable.

   c) Dividend an Equity capital

      @ Rs. 10% in 2009 & @ Rs. 12% in 2010

3) The recent value of fixed assets revealed property is worth Rs. 5,00,000 & Machinery worth Rs. 25,00,000.

4) The investment are trade investment worth Rs. 2,50,000.

5) Obsolete & worthless stock included above is Rs. 4,00,000.

   This can also realize Rs. 50,000.

You are required to calculate –

a) F. M. P. applying weights.

   2008 - 1

   2009 - 2

   2010 - 3

b) Value Equity shares on basis of – capitalized value of F. M. P. @ 8⅓%.

c) Intrinsic value of Equity shares.

Solution :

F. M. P.	2008	2009	2010
Add: Goodwill written off	50,000	50,000	50,000
Add : Equity share Dividend	-	1,00,000	1,20,000
Net Profit (after dividend)	1,40,000	3,25,000	5,50,000
	1,90,000	4,75,000	7,20,000
Weights	x 1	x 2	x 3
	1,90,000	9,50,000	21,60,000

a) Weighted Avg. $= \frac{\text{Total Products}}{\text{Total of weights}}$

$= \frac{33,00,000}{6}$

= FMP = 5,50,000

b) Capitalised Value of maintainable profit

$= \frac{\text{FMP after tax}}{\text{NRR}} \times 100$

$= \frac{5,50,000}{8\frac{1}{3}} \times 100 = 66,00,000$

c) Values at Equity share on the basis of capitalized value of FMP = $\frac{\text{Capital Value FMP}}{\text{No. of Equity share}}$

$= \frac{66,00,000}{1,00,000} = \text{Rs. 661 share}$

d) Intrinsic Value :

Goodwill		3,50,000
Freehold property		5,00,000
Plant & Machinery		25,00,000
Investment		2,50,000
Stock (5,00,000 – 4,00,000 + 50,000 realisable)		1,50,000
Debtors		3,50,000
Bank & Cash		1,50,000
		42,50,000
Less Liabilities payable		
Bank Loan	10,00,000	
Current Liabilties	1,50,000	- 11,50,000
		31,00,000
Less : Preference Share capital		-5,00,000
Net Assets available to Equity shareholders		26,00,000

$$\text{Intrinsic Value} = \frac{\text{Net Assets available to Equity Share holders}}{\text{No. of eq. shares}}$$

$$= \frac{26,00,000}{1,00,000}$$

$$= 26$$

Illustration : 8

A) Final Accounts of New Ltd. as on 31st March, 2011 revealed following significant information:

i) Share Capital (Fully paid-up)

Equity – 1,00,000 shares of Rs. 10 each.

12% Preference – 20,000 shares of Rs. 50 each.

ii) Reserve & surplus – Rs. 1,50,000

iii) Preliminary Expenses – Rs. 30,000

iv) The valuation of assets revealed that assets as per accounts are undervalued by Rs. 2,50,000.

v) The average pre-tax profits of past three years was Rs. 5,00,000. Tax applicable to @ 50%.

vi) It is anticipated that due to favourable market conditions, pre-tax profit will increase by 20%.

vii) Equity shareholders expect a return at 15%.

Find the Fair Value of Shares :

B) Sem. Ltd. submits following information as on 31st March, 2011

i)	Fixed assets (Tangible)	Rs. 15,00,000
ii)	Current assets	Rs. 6,00,000
iii)	Patent Rights	Rs. 2,50,000
iv)	Investment	Rs. 1,00,000
v)	Capital issues expenses	Rs. 50,000
vi)	Liabilities	Rs. 4,00,000
vii)	Capital comprise of 12,500 shares of Rs. 100 each fully paid.	

It is ascertained that Patent Rights are valueless. Find Intrinsic Value

Solution :

A) Fair value of Equity shares of New ltd. as Intrinsic value

Step – 1 :

Equity shares	10,00,000
Preference shares	10,00,000
Reserves & surplus	1,50,000
Less : preliminary expenses	- 30,000
Add : Assets undervalued	2,50,000
	23,70,000
Less : Preference shares	- 10,00,000
Net assets available for ESH	13,70,000

Step – 2:

$$\text{Intrinsic Value} = \frac{\text{Net Assets available for ESH}}{\text{No. of equity Shares}}$$

$$= \frac{13,70,000}{1,00,000}$$

$$= 13.7$$

b) Yield Value

Step 3 : Expected rate of dividend

$$= \frac{\text{Net Profit available for ESH}}{\text{Paid-up Equity Capital}} \times 100$$

$$= \frac{1,80,000}{10,00,000} \times 100$$

$$= 18$$

Step. 1 :	F. M. P. before tax	5,00,000
	Increase 20%	1,00,000
		6,00,000
	(-) Tax 50%	-3,00,000
	F. M. P. after tax	3,00,000
	(-) Preference Dividend	-1,20,000
	Net Profit are basic to Equity shareholder	1,80,000

Step – 3 :

$$\text{Yield value} = \frac{\text{Expected rate of Dividend} \times \text{Paid up value / shares}}{\text{NRR}}$$

$$= \frac{18 \times 10}{15} = 12$$

c) Fair Value = $\frac{12 + 13.7}{2} = 12.85$

B) Net Assets value of Sem Ltd.

Fixed Assets	15,00,000
Current Assets	6,00,000
Investments	1,00,000
	22,00,000
Less : O/s Liabilities	- 4,00,000
Net assets available for ESH	18,00,000

$$\text{Intrinsic Value} = \frac{\text{Net Assets available for ESH}}{\text{No. of equity Shares}}$$

$$= \frac{18,00,000}{12,500}$$

= 144

Illustration : 9

A Ltd. & K Ltd. propose to sell their business to a new company being formed for that purposes.

The summarized Balance Sheet as on 31st December, 2011 & profits of the companies for the past three years are as follows :

Liabilities	A Ltd.	K Ltd.	Assets	A Ltd.	K Ltd.
Ordinary shares of Rs. 1 each	60,000	25,000	Freehold property at cost	36.000	12.000
Capital Reserves	NIL	15,000	Plant & Machinery at cost less in dep.	32.000	18.000
General Reserves	39,000	12,000	Investment at cost	NIL	10.000
Profit & Loss A/c	11,000	16,000	Stock in trade	11,100	8.950
Creditors	21,580	12,680	Debtors	8,800	6.400
			Balance at Bank	43,680	25.330
	1,31,580	80,680		1.31580	80.680

	A Ltd.	K Ltd.
Net profit for the years ended	Rs.	Rs.
31st December, 2009	17,450	10,760
31st December, 2010	19,340	12,290
31st December, 2011	21,470	14,450

You are also given the following relevant information :

a) It is agreed :

i) That the properties & Plant and Machinery to be re-valued as follows :

	A Ltd. Rs.	K Ltd. Rs.
Freehold property	44,800	14,400
Plant & Machinery	30,750	17,095

ii) That the value of stock be reduced by 10% & provision of 12½% be made on debtors for bad & doubtful debts.

iii) That goodwill be valued at two years purchase of the average annual trading profits of the past 3 years, after deducting a standard profit of 10% on the net trading assets before revaluation or adjustment, on 31st December, 2010.

b) Profits of K Ltd. include Rs. 600 income from the investment in each of the three years. The market value of the investment as on 31st December, 2011 was Rs. 10,000.

You are required to prepare a statement how you would a arrive at the intrinsic value per shares to the nearest rupee of the ordinary share in (i) A Ltd. ii) K Ltd.

Solutions : Valuation of Goodwill

Step – 1 :

Capital Employed = Assets at realizable value – liabilities .

Assets at real value	A Ltd.	K Ltd
Freehold property	36,000	12,000
Plant & Machinery	32,000	18,000
Stock in trade	11,100	8,950
Debtors	8,800	6,400
Bank Balance	43,680	25,330
	1,31,580	70,680
Less : Liabilities payable		
Creditors	-21,580	- 12,680
Capital Employed	1,10,000	58,000

Step – 2 :

Normal Rate of Return 10%

Step – 3 :

Standard / Normal Profit = Capital Employed x NRR

i) A Ltd. = 1,10,000 x 10% = 11,000

ii) K Ltd. = 58,000 x 10% = 5,800

Step – 4 : Average Past Profit

i) A Ltd. = $\frac{17{,}450 + 19{,}340 + 21{,}470}{3} = 19{,}420$

ii) K Ltd. = $\frac{10{,}760 + 12{,}290 + 14{,}450 - 1{,}800}{3} = 11{,}900$

Less : interest on Investment = $\frac{(600)}{11{,}300}$

Step – 5 :

F. M. P. =

Average Past Profit	A Ltd.	K Ltd.
	19,420	11,300

Step – 6 :

Super / Excess profit = F. M. P. – Standard Profit

A Ltd. = 19,420 – 11,000 = 8,420

K Ltd. = 11,300 – 5,800 = 5,500

Step – 7 :

Value of Goodwill = No. of years purchased x Super Profit

A Ltd. = 2 x 8,420 = 16,840

L Ltd. = 2 x 5,500 = 11,000

B) Valuation of Shares :

Step – 1 :

Intrinsic Value	A Ltd.	K Ltd
Freehold property	44,800	14,400
Plant & Machinery	30,750	17,095
Stock in trade	9,990	8,055
Debtors	7,700	5,600
Bank Balance	43,680	25,330
Investments	NIL	10,000
Add : Goodwill	16,840	11,000
	1,53,760	91,480
Less : Liabilities payable		
Creditors	- 21,580	-12,680
Net Assets available for Equity shareholders	1,32,180	78,800

Step – 2 :

$$\text{Intrinsic Value} = \frac{\text{Net Assets available for ESH}}{\text{No. of Equity Shares}}$$

$$\text{A Ltd.} = \frac{1,32,180}{60,000}$$

$$= 2.203$$

$$\text{K Ltd.} = \frac{78,800}{25,000}$$

$$= 3.152$$

Illustration : 10

Vijay Ltd. furnishes the following information & request you to find out –

i) Value of Goodwill – on the basis of capitalization of F. M. P. methods.

Liabilities	Rs.	Assets	Rs.
Shares capital 10,000 Shares of Rs. 100 each	10,00,000	Goodwill	2,50,000
General Reserves	3,00,000	Property	2,88,000
Profit & Loss A/c	3,00,000	Equipments	4,00,000
Workmen Fund for Compensation	1,40,000	Investment	2,00,000
Loans	2,00,000	Receivables	6,60,000
Current Liabilities	4,60,000	Inventory	4,00,000
		Bank & Cash	1,50,000
		Capital Issues Expenses	52,000
	24,00,000		24,00,000

Further Information :

a) The investments are earn marked to provide funds for replacements as and when required.

b) The provision already deducted from are :

Depreciation on property	Rs.	72,000
Depreciation on equipments	Rs.	80,000
Bad Doubtful Debts	Rs.	60,000

c) The property is worth Rs. 6,00,000 and equipments are worth Rs. 3,60,000, other assets are valued property.

d) The liability for workmen compensation is expected at Rs. 1,00,000.

e) The expected rate of return is @ 12%.

f) The profit of past three years (before tax @ 50%) have been –

Year ended on 31-3-2000	Rs.	5,60,000
31-3-1999	Rs.	5,46,000
31-3-1998	Rs.	6,20,000

g) The changes expected from ensuing year are : -

1) Increase rent for new office @ Rs. 18,000/- p.a.
2) Increase in Directors Fees @ Rs. 24,000/- p.a.
3) Reduction in publicity expenses @ Rs. 36,000/- p.a.

h) For the purpose of valuation year end capital employed should be considered.

Solution :

Step – 1 :

Capital Employed = Assets at realisable value–O/s liabilities.

Assets at real value	
Property	6,00,000
Equipments	3,60,000
Investment	2,00,000
Receivables	6,60,000
Inventory	4,00,000
Cash & Bank	1,50,000
	23,70,000
Less : Liabilities	
Workmen Compensation Fund	- 1,00,000
Loans	- 2,00,000
Current Liabilities	- 4,60,000
Capital Employed	16,10,000

Step – 2 :

Normal Rate of Return = 12%

Step – 3 :

$$\text{Average Past Profit} = \frac{5,60,000 + 5,46,000 + 6,20,000}{3}$$

= 5,75,333

Step – 4 :

F. M. P.

Average Past Profit	5,75,333
Less : Expenses to be incurred in future : Rent	- 18,000
Less : Expenses to be incurred in future : directors Fees	- 24,000
Add : Expenses no to incurred : Publicity / Expenses	36,000
F. M. P. before Tax	5,69,333
Less : Tax 50%	- 2,84,667
F. M. P. after tax	2,84,666

Step – 5 :

Capitalized value of maintainable profit =

$$= \frac{\text{FMP after tax}}{\text{NRR}} \times 100$$

$$= \frac{2,84,666}{12} \times 100$$

= 23,72,217

Step – 6 :

Value of Goodwill = Capitalised value – Average capital employed.

= 23,72,217 – 16,10,000

= 7,62,217

Illustration : 11

A shareholder of M Private Ltd. requests you to advise him about the fair value of the Equity shares of the Company. the Company's financial position as on 31st December, 1997 is as under :

Liabilities	Rs.	Assets	Rs.
Shares Capital :		Fixed Assets (at cost)	
20,000 6% Cum. Preference Shares of Rs. 10 each	2,00,000		
12,000 Equity Shares of Rs. 20 each	2,40,000	Goodwill	1,20,000
Deb. Redemption Fund	40,000	Plant & Machinery	2,00,000
Profit & Loss A/c :		Investment (at cost)	1,20,000
Bal. As on 1-1-1987 45,000		Current Assets	
Profit for the year (before tax)	1,75,000	Stock	1,20,000
13,000			
5% Debentures	2,00,000	Debtors	1,40,000
Creditors	1,67,000	Cash at Bank	1,52,000
Depreciation Fund (Plant etc.)	30,000	Land & Building	2,00,000
	10,52,000		10,52,000

The following information is relevant :

1) Goodwill is revalued at Rs. 1,45,000/-.
2) Normal rate of return expected is 10%.
3) The share of the company are not freely transferable.
4) Investments are part of business assets.
5) Profit for the year as stated above are before annual transfer of Rs. 12,700 to Deb. Redemption Fund.
6) Income tax may be taken at 50% of the profit.
7) Dividend record of the company is not stable.

Work out the fair value of Equity shares as requested.

Solution :

A) Intrinsic Value :

Step – 1 :

Fixed Assets :	
Goodwill	1,45,000
Land & Building	2,00,000
Plant & Machinery	2,00,000
Investment	1,20,000
Current Assets :	
Stock	1,20,000
Debtors	1,40,000
Cash at bank	1,52,000
	10,77,000

Less : liabilities		
Debentures	2,00,000	
Creditors	1,67,000	
Depreciation Fund	30,000	
Provision for taxatior	65,000	- 4,62,000
		6,15,000
Less : Preference Share Capital		- 2,00,000
Net Assets available for ESH		4,15,000

Step – 2 :

$$\text{Intrinsic Value} = \frac{\text{Net Assets available for ESH}}{\text{No. of Equity Shares}}$$

$$= \frac{4,15,000}{1,20,000}$$

= 34.58 Rs. / Share

B) Yield Value

Step – 1 :

F. M. P. before tax	1,30,000
Less : Tax 50%	- 65,000
F. M. P. after tax	65,000
Less : Appropriations	
Dividend on Preference Shares	- 12,000
Deb. Redemption Fund	- 12,700
Net Profit available for ESH	40,300

Step – 2 :

$$\text{Expected rate of Dividend} = \frac{\text{N.P. available for ESH}}{\text{Paid up Equity Capital}} \times 100$$

$$= \frac{40,300}{2,40,000} \times 100$$

= 16.77

Step – 3 :

$$\text{Yield Value} = \frac{\text{Expected rate of Dividend} \times \text{Paid up Equity Capital}}{\text{NRR}}$$

$$= \frac{16.79 \times 20}{12}$$

$$= 27.98$$

$$\text{Fair value of Equity Shares} = \frac{34.58 + 27.98}{2}$$

$$= 31.28$$

Illustration : 11

A Ltd. presents the following Balance Sheet on 31st December, 2011.

Liabilities	Rs.	Assets	Rs.
Shares Capital (Rs. 10/- each)	3,00,000	Assets	4,50,000
Reserves	1,20,000	Current Assets	30,000
Loans	50,000		
Current Liabilities	10,000		
	4,80,000		4,80,000

It is observed that fixed assets are undervalued by Rs. 50,000.

The current assets are overvalued by Rs. 3,000. The assets are to be valued properly.

It is proposed to issue fully paid shares by capitalization of General Reserves in ratio of one share for three shares held. Find the value of shares.

i) Before issue of bonus shares; and

ii) After issue of Bonus shares.

Solution :

A & Co. Ltd.

Valuation of Equity Shares (Net Assets Method)

Gross Assets	Rs.	Rs.
Fixed Assets (4,50,000 + 50,000)		5,00,000
Current Assets (30,000 – 3,000)		27,000
		5,27,000
Less Loans	50,000	
Less Current Liabilities	10,000	(60,000)
Net Assets available to Equity Shareholders		4,67,000

Value Per Fully Paid Equity Share (before Bonus Issue)

$$= \frac{\text{Net Assets for Equity Shareholders}}{\text{No. of Equity Shares}} = \frac{4,67,000}{30,000} = \text{Rs. } 15.57$$

Value Per Fully Paid Equity Share (after Bonus Issue)

$$= \frac{\text{Net Assets for Equity Shareholders}}{\text{No. of Equity Shares}} = \frac{4,67,000}{40,000} = \text{Rs.} 11.67$$

Note : No. of Bonus Shares Issued : ⅓ of 30,000 = 10,000

$\therefore$ Total No. of Shares = 30,000 + 10,000 = 40,000 Shares.

Illustration : 12

O. M. Limited submits the following information as on 31st March, 2010.

		Rs.
i)	Fixed Assets (Tangibles)	15,00,000
ii)	Current Assets	16,00,000
iii)	Patent Rights	2,50,000
iv)	Investments	1,00,000
v)	Capital Issue Expenses	10,000
vi)	Liabilities	4,00,000

Capital Comprises of 25,000 shares of Rs. 100/- each fully paid. It is ascertained that Patent Right are valueless. Ascertain the value of shares on Asset Backing method.

(Oct 97, adapted)

Solution :

O. M. LIMITED (Y. E. 31-3-2010)

Valuation of Equity Shares (Net Assets Method)

Gross Tangible Assets	₹.
Fixed Assets	15,00,000
Current Assets	16,00,000
Investment	1,00,000
	32,00,000
Less : Liabilities	4,00,000
Net Assets available to Equity Shareholders	28,00,000

$$\text{Value Per Fully Paid Equity Share} = \frac{\text{Net Assets for Equity Shareholders}}{\text{No. of Equity Shares}}$$

$$= \frac{\text{Rs. } 28,00,000}{25,000} = \text{Rs. } 112$$

Note : Patents being valueless and Capital Issue Expenses being an intangible asset are ignored while computing net assets value.

Illustration : 13

From the following figures calculate value of a share of Rs. 10 on (i) dividend basis, and the market expectation being 12% (N. R. R.)

Year ended 31st March	Capital Employed Rs.	Profit Rs.	Dividend	Weights
2008	5,00,000	80,000	12	1
2009	8,00,000	1,60,000	15	2
2010	10,00,000	2,20,000	18	3
2011	15,00,000	3,75,000	20	4

50,000 Equity Shares of Rs. 100 each were from 1st January 2006

Solution :

i) Value of share on dividend basis :

the dividend rate on the simple average is 65/4 or 16¼%. But since the dividend has been rising it would be better to take the weighted average which come to 17.6% thus :

Year ended 31st March	Rate	Weight	Product	Profit	Product (A x D)
2008	12	1	12	80,000	80,000
2009	15	2	30	1,60,000	3,20,000
2010	18	3	54	2,20,000	6,60,000
2011	20	4	80	3,75,000	15,00,000
		10	176		25,60,000

Dividing 176 by 10, we get 17.6%

The value of the share on the basis of dividend (weighted average) should be

$$\text{Face Value} \times \frac{\text{Average Rate of Dividend}}{\text{Expected Rate of Dividend}} = \frac{17.6}{12} \times 10 = 14.67$$

ii) Weighted Average Profit (F. M. P)

$$= \frac{\text{Total Product}}{\text{Total Weight}}$$

$$= \frac{25,60,000}{10} = 2,56,000$$

$$\text{Capitalized value of F. M. P.} = \text{F. M. P} \times \frac{100}{\text{N.R.R.}}$$

$$= 2,56,000 \times \frac{100}{12} = 21,33,333$$

$$\text{Value of Equity Share} = \frac{\text{Capitalized value of F.M.P.}}{\text{No. of Equity Share}}$$

$$= \frac{21,33,333}{50,000} = ₹\ 42.67$$

Illustration : 14

Balance Sheet of Anand Ltd. as on 30-6-2010

Liabilities	₹
Share Capital :	
5,000 shares of Rs. 50 each	2,50,000
General reserve	1,40,000
Profit and Loss account	1,32,000
Sundry creditors	1,08,000
Income-tax Provision	80,000
	7,10,000

Assets :	
Land and buildings	1,90,000
Plant and Machinery	2,00,000
Patents and trade marks	25,000
Stock	50,000
Debtors	75,000
Bank balance	50,000
Preliminary expenses	10,000
	7,10,000

The expert valuer valued the land and buildings at Rs. 3,40,000; goodwill at Rs. 2,50,000; and plant and machinery at Rs. 1,80,000. out of the total debtors, it is found that debtors of Rs. 6,000 are bad. The profits of the company have been as follows :

	Rs.
31-3-2008	1,20,000
31-3-2009	1,75,000
31-3-2010	1,55,000

The company follows the practice of transferring 25% of profits to general reserve. Considered depreciation on Land / Building @ 5%, plant-Machinery @ 15%. Similar type of companies earn at 12.5% of the value of their shares. Ascertain the value of shares of the company under :

i) Intrinsic value method;

ii) Yield value method; and

iii) Fair value method.

iv) directors decided to issue right shares 1 share for every 5 shares of Rs 50 each at Rs. 100. find fair value after right issue.

Anand Ltd.

Valuation of shares

i) Intrinsic value method

Assets	Rs.	Rs.
Land and Buildings	3,40,000	
Goodwill	2,50,000	
Plant and machinery	1,80,000	
Patents and trade marks	25,000	
Stock	50,000	
Debtors less bad debts	69,000	
Bank balance	10,000	9,24,000
Less : liabilities		
Sundry creditors	1,08,000	
Provision for tax	88,000	(1,96,000)
Net Assets		7,28,000

Intrinsic value of shares (each share) = $\frac{\text{Net assets}}{\text{No. of shares}} = \frac{7,28,000}{50,000}$

= Rs. 145.60

ii) Yield value method

	Rs.
Total profit of last three years	4,50,000
Less : Bad debts	(6,000)
	4,44,000
Average profit = $\frac{\text{Rs. } 4,44,000}{3} =$	1,48,000
Add. Decrease in depreciation on plant and machinery say @ 15% on Rs. 20,000	3,000
Less : Increase in depreciation on land and building say @ 5% on Rs. 1,50,000	(7,500)
Average profit	
Less : Transfer to reserve	1,43,500
@ 25% of Rs. 1,43,500	(33,875)
Profit available for dividend	1,07,625

Rate of F. M. P. = $\frac{1{,}07{,}625}{2{,}50{,}000} \times 100 = 43.05\%$

Yield value of each share

$$= \frac{\text{Rate of F.M.P.}}{\text{Normal rate of return}} \times \text{Paid up value of each share}$$

$$= \frac{43.05}{12.50} \times 50$$

= 172.20

iii) Fair value method

fair value of each share = $\frac{\text{Intrinsic value} + \text{Yield vlue}}{2}$

iv) $\frac{\text{Rs.}\,145.60 + 172.20}{2} = \frac{317.60}{2} = \text{Rs.}\,158.90$

v) Value of Equity share after Right Issue

	No. of Shares	Equity Share Capital Rs.	Net Asset Rs.
Before Right Issue	5,000	2,50,000	7,28,000
Add : Right share, 1 share for every 5 shares of Rs. 50 each @ Rs. 100	1,000	50,000	1,00,000
After Right Issue	6,000	3,00,000	8,28,000

Intrinsic value = $\frac{\text{Net Asset available to Equity Shareholders}}{\text{No. of Equity Shares}}$

$$= \frac{8{,}28{,}000}{6{,}000}$$

= Rs. 138

Yield Value

F. M. P. = 1,07,625

Rate of F. M. P. = $\frac{\text{F.M.P.}}{\text{Paid up Equity Capital}} \times 100$

$$= \frac{1{,}07{,}625}{3{,}00{,}000} \times 100 = 35.88\%$$

Yield Value

$$= \frac{\text{Rate of F.M.P.}}{\text{N.R.R}} \times \text{Paid up value of a Equity Share}$$

$$= \frac{35.88}{12.50} \times 50$$

= Rs. 143.52

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

$$= \frac{138 + 143.52}{2}$$

= Rs. 140.78

Illustration : 15

Balance Sheet of AB Ltd. as on 31st March 2010

Liabilities	Rs.	Assets	Rs.
8,000 Equity Shares		Land and Building	5,00,000
of Rs. 100 each	8,00,000	Plant & Machinery	6,00,000
4,000, 9%	4,00,000	Patents	2,00,000
Preference shares		Sundry debtors	3,00,000
of Rs. 100 each		W. I. P. and Stock	5,00,000
10% Debentures	2,00,000	Bank Bal.	1,00,000
Reserves	4,00,000		
Sundry Creditors	4,00,000		
	22,00,000		22,00,000

Land and buildings to be valued at Rs. 9,00,000. The company's earnings were as follows:

Year ended 31st March	Profits before tax (Rs.)	Tax paid (Rs.)	
2006	3,00,000	80,000	
2007	4,00,000	1,60,000	
2008	1,00,000	Loss 40,000	(Strike)
2009	5,00,000	2,30,000	
2010	5,50,000	3,00,000	

The company paid managerial remuneration of Rs. 60,000 per annum but it will become Rs. 1,00,000 in future. There has been no change in capital employed. The company paid dividend of Rs. 9 per share and it will maintain the same in future. The company proposes to build up a plant rehabilitation reserve @ 15% of N. P. A. T. dividend rate in this type of company is fluctuating and the asset backing of an Equity share is about 1-½ times. The Equity shares with an average dividend of 10% sell at par. (Tax rate is assumed to be 50%). Find yield value of Equity shares

Solution :

For calculating average maintainable profits in 2008-09 not considered because of low profits due to abnormal reason.

Year ended 31st March	Profits before tax (Rs.)	Weight Rs.	Product
2006	3,00,000	1	3,00,000
2007	4,00,000	2	8,00,000
2008	-	-	-
2009	5,00,000	3	15,00,000
2010	5,50,000	4	22,00,000
		10	48,00,000

	Rs.
Weighted average : (48,00,000/10)	4,80,000
Adjustment :	
Less : Increase in managerial remuneration	40,000
	4,40,000
Less : Tax @ 50%	2,20,000
Profit available for distribution	2,20,000
Less : Rehabilitation Reserve (15% estimated)	33,000
	1,87,000
Less : dividend on Preference Shares	36,000
Profit available for distribution to Equity shareholders	1,51,000

Rs. 1,51,000 capitalised at 10% $= \frac{\text{Rs.}1,51,000 \times 100}{10} = \text{Rs.}15,10,000$

The value of Equity share will be $\frac{15,10,000}{8,000} = 188.75$

Illustration : 16

Balance Sheet of Kaka Ltd. as on 31.12.2010 was as under:

Liabilities	Rs.	Assets	Rs.
Equity share Capital (Rs. 10)		Building	12,00,000
Rs. 10 paid up per share	8,00,000	Plant & Machinery	14,00,000
Rs. 5 paid up per share	7,00,000	Sundry Debtors	10,10,000
9% preference share Capital (Rs. 100)	4,00,000	Stock	2,50,000
Reserve	13,00,000	Cash and Bank	40,000
Sundry Creditors	7,00,000		
	39,00,000		39,00,000

Profit and dividend in last three years were as under:

Year	Profit before tax Rs.	Equity Dividend	Weights
2010	10,20,000	20%	3
2009	9,50,000	16%	2
2008	7,20,000	15%	1

Land and buildings are worth Rs. 24,00,000. Managerial remuneration is likely to go up by Rs. 40,000 p.a. Income tax may be provided at 40%. Equity shares of companies in the same-industry with dividend rate of 10% are quoted at per. Kaka Ltd. is a going concern and it will call the unpaid part of share capital very shortly.

Find the most appropriate value of an Equity share assuming that

a) Controlling interest is to be transferred.

b) Only a few shares are to be transferred.

Ignore goodwill value, depreciation adjustment for revaluation and the need of transfer to General Reserve.

Solution

Future Maintainable Profits

Year	Profit Before Tax	Weight	Product
2010	10,20,000	3	30,60,000
2009	9,50,000	2	19,00,000
2008	7,20,000	1	7,20,000
		6	56,80,000

Weighted Average Profit $\frac{56,80,000}{6}$ $= 9,46,667$

Less : Increase in Managerial Remunerations	(40,000)
Profit Before Tax	9,,06,667
Less : Tax @ 40%	(3,62,667)
Profit After Tax	(5,44,000)
Less : Preference Dividend	(36,000)
Profit for Equity Shareholders	5,08,000

(a) Valuation of Controlling Interest

First Method Capitalisation of Maintainable Profit @ 10%

Capitalised Value = $5,08,000 \times \frac{100}{10}$ $= \text{Rs.}\,50,80,000$

Add : Notional call on partly paid shares [1,40,000 x 5] = 70,000

57,80,000

All Fully paid shares after Notional call = [80,000 + 1,40,000]

= 2,20,000 shares.

Value of Fully paid share = $\frac{57,80,000}{2,70,000} = \text{Rs. } 26.27$

Value of partly paid share = 26.27 – 5 = Rs. 21.27

Net Assets (after revaluation) Second Method - Net Assets Basis

(39,00,000 + Appropriation Building 12,000 = 51,00,000

Add : National call on shares		7,00,000
Less : Creditors	7,00,000	58,00,000
Less : Preference Share Capital	4,00,000	11,00,000
Assets for Equity Shareholders		47,00,000

Value of Fully paid shares = $\frac{47,00,000}{2,20,000} = \text{Rs. } 21.36$

Value of Partly paid share = 21.36 – 5.00 = Rs. 16.36

Fair value of fully paid share = $\frac{26.27 + 21.36}{2} = 23.82$

Fair Value of Partly paid share = $\frac{21.27 + 16.36}{2} = \text{Rs. } 18.82$

b) Valuation of Few Share

Average rate of dividend = $\frac{20 + 16 + 15}{3} = 17\%$

$\therefore$ Value of Fully Paid Share = $\frac{17}{10} \times 10 = \text{Rs. 17 per share}$

Value of Partly Paid Share = $\frac{17}{10} \times 5 \, \text{Rs. } 8.50$

Illustration : 17

The Final Accounts N Ltd. as on 31st March, 2010 revealed following significant information:

i) Share Capital (Fully paid up) –

Equity – 2,00,000 Shares of Rs. 10 each, 10% Preference 30,000 Shares of Rs. 100 each

ii) Reserve and Surplus – Rs. 7,50,000.

iii) Preliminary Expenses – Rs. 30,000.

iv) The valuation of assets revealed that assets as per accounts are undervalued by Rs. 6,50,000.

v) The average pre-tax profits of past three years was Rs. 10,00,000. Tax applicable to company is @ 40%.

vi) It is anticipated that due to favourable market condition, pretax profit will increase by 20%.

vii) Equity shareholders expect a return at 15%.

Find the FAIR VALUE of Shares.

Solution :

1) Valuation of Shares

		Rs.	Rs.
i) Capital Employed :			
Equity Capital		20,00,000	
10% Preference		30,00,000	
Reserves and Surplus	7,50,000		
Less : Preliminary expenses	30,000	7,20,000	57,20,000
Add : Appreciations			6,50,000
	Net Assets		63,70,000
ii) Future Maintainable Profit :			
Pre Tax Profit		10,00,000	
Add : Expected to Increase		2,00,000	
		12,00,000	
Less : Tax @ 40%		4,80,000	7,20,000
Less : Preference Dividend			3,20,000
∴ Future Maintainable Profit			4,20,000

iii) a) <u>Intrinsic Value of Equity Shares</u>

$$= \frac{\text{Net Assets for Equity Sharehold}}{\text{No. of Equity, shares}}$$

$$= \frac{63,70,000 - 30,00,000}{2,00,000}$$

$$= \frac{33,70,000}{2,00,000} = \text{Rs. } 16.85$$

b) i) Rate of FMP = $\frac{\text{FMP}}{\text{Paid up equity capital}} \times 100$

$= \frac{4,20,000}{20,00,000} \times 100$

= 21%

ii) Yield value per share

$= \frac{\text{Rate of FMP}}{\text{NRR}} \times \text{Face Value of one Equity Share}$

$\therefore$ Yield Value Per Share = $\frac{21}{15} \times 10 = \text{Rs.}14$

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

$= \frac{16.85 + 14}{2}$

= Rs. 15.43

b) Gem Ltd. submits following information as on 31st March, 2011.

Fixed Asset (Tangible) Current Assets Patent Right	15,00,000 6,00,000 2,50,000	Investment Capital issues Expenses Liabilities	1,00,000 50,000 4,00,000

Capital comprise of 12,500 shares of Rs. 100 each fully paid.

It is ascertained that Patent Rights are valueless.

Ascertain the value of Shares on asset backing method.

Solution :

Valuation of Shares on Assets Backing Method :

		Rs.	Rs.
a)	Total Value of Assets :		
	Fixed Assets	15,00,000	
	Current Assets	6,00,000	
	Investments	1,00,000	22,00,000
b)	Less : Liabilities :		(-) 4,00,000
	Net Assets available to Equity Shareholders		18,00,000
c)	Value Per Share :		

$$\text{Assets Backing Method} = \frac{\text{Net Assets as above}}{\text{No. of Equity Shares}}$$

$$\text{Value} = \frac{18,00,000}{12,500}$$

= Rs. 144 / Equity Share

Illustration : 18

Mrs. Tata intends to invest Rs. 10,35,000 in Equity shares of B Ltd. and seeks your advice as to the maximum numbers of shares she can purchased on fair value of the shares to be determined by you from following information is available :

1. Issued and paid up Capital

   10% Preference shares of Rs. 100 each 12,00,000

   Equity shares of Rs. 5 each 60,00,000 /

   Reserves and surplus 92,00,000

2. Average Net Profit of the company is Rs. 29,00,000, after tax @ 50%.
3. Expected normal yield is 12% in case of such Equity shares.
4. Net assets on revaluation are worth Rs. 5,20,000 more than the amounts at which they are stated in the books.
5. Goodwill is to be calculated @ 3 years purchase of super profits.
6. Revised tax rate likely to be 40%.
7. Compensation payable to workers not accounted Rs. 50,000.

Solution :

1.	Goodwill	= Super Profit x 3 years purchase	
		= 9,09,600 x 3 = 27,28,800.	
2.	F. M. P.	Average profit after Tax	29,00,000
		Add: Income Tax @ 50%	29,00,000
		N. P. B. T.	48,00,000
		Less : Income Tax @ 40%	19,20,000
		F. M. P.	28,80,000

3. Average Capital employed 72,00,000

Share capital at the end of the year	92,00,000
Reserved and Surplus	5,20,000
Add : revaluation Profit	1,69,20,000
Less : Compensation payable	50,000
	1,68,70,000
Less : ½ of the profit earned (9,00,000 ½)	(4,50,000)
A. C. E. during the year	1,64,20,000

$$\text{Normal Profit} = \text{A.C.E.} \times \frac{\text{N.R.R.}}{100} = 1{,}64{,}20{,}000 \times \frac{12}{100}$$

= 19,70,400

Super Profit = F. M. P. – Normal Profit

= 28,80,000 – 19,70,400 = 9,09,600

ii) Valuation of Shares

a) Intrinsic Value

1. Amount available to Equity Shareholders

	Rs.
Net Assets at Market Value	1,68,70,000
Add : Goodwill	27,28,800
Net Assets available to shareholder	1,95,98,800
Less : Claims of Preference Shareholders (Preference Share Capital)	12,00,000
Amount available to Equity Shareholders	1,83,98,800

2. $$\text{Intrinsic Value} = \frac{\text{Amount available to Equity Shareholders}}{\text{No. of Equity Shares}}$$

$$= \frac{1{,}83{,}98{,}800}{12{,}00{,}000}$$

= Rs. 15.33

b) The Yield Value

	Rs.
1. F. M. P.	
Average Profit	28,80,000
Less : Preference Dividend $\left[\frac{10}{100} \times 12,00,000\right]$	(1,20,000)
F. M. P.	27,60,000

2. Rate of F. M. P. $= \frac{\text{F.M.P.}}{\text{Paid up Equity Capital}} \times 100$

$= \frac{27,60,000}{60,00,000} \times 100 = 46\%$

3. Yield Value $= \frac{\text{Rate of F.M.P}}{\text{N.R.R}} \times \text{Amount paid per Equity Share}$

$= \frac{46}{12} \times 5$

= 19.17

c) Fair Value

$\frac{\text{Intrinsic Value + Yield value}}{2} = \frac{15.33 + 19.17}{2}$

= 17.25

d) No. of shares to be aquired :

$\frac{\text{Investment}}{\text{Fair Value}} = \frac{10,35,000}{17.25}$

= 60,000 shares

Illustration : 19 (When Goodwill and Share Valuation asked)

The Balance Sheet of Ketan Ltd. as on 31-12-2010 was as under :

Liabilities	Rs.	Assets	Rs.
Equity Share Capital :		Goodwill	60,000
Share of Rs. 10 each	2,00,000	Fixed Assets	1,00,000
Shares of Rs. 5 each	1,00,000	Stock	1,20,000
General Reserve	40,000	Debtors	1,45,000
P L A/c	10,000	Cash	10,000
Gratuity Fund	15,000	Prepaid Expenses	2,000
Workmen's P.F.	5,000	Preliminary Expenses	3,000
Depreciation Fund	10,000		
Trade Creditors	25,000		
Liabilities for Expenses	5,000		
Bank Overdraft	30,000		
	4,40,000		4,40,000

A shareholder holding 500 shares of Rs. 10 and 300 shares of Rs. 5 wants to dispose of all the shares.

Dividends paid for last 3 years were 12%, 11%, & 12%. Normal expectation is 10%

Fixed assets are worth Rs. 80,000. goodwill is to be increased to the Average of book value and a calculation made at 4 years' purchase of average super profit for the last 3 years. Debtors are considered good except for Rs. 3,000. Liabilities for expenses are no longer required. On the other hand, there is a claim for bonus amounting to Rs. 10,000 and it is likely to be paid for. Profit for three years after taxation were Rs. 35,000, Rs. 48,000 and Rs. 46,000.

Find out the break up value, market value & fair value of the above 2 types of shares.

Solution :

Goodwill is equal to the average of B. V. of goodwill and goodwill at average super profit.

i) Goodwill $= \dfrac{\text{Book Value of Goodwill} + \text{Revised Goodwill}}{2}$

a) Revised Goodwill = Super Profit $\times$ 4

1. Super Profit = F. M. P. – Normal Profit

i) F. M. P.

Year	Profit Rs.
I	35,000
II	48,000
III	46,000
	1,29,000

Average Profit $= \dfrac{1,29,000}{3} = 43,000$

		Rs.
Average Profit		43,000
Less : i) Bad Debts	3,000	
ii) Claim for Bonus	10,000	13,000
		30,000
Add : Liability for Expenses no longer required		+ 5,000
F. M. P.		35,000

ii) Normal Profit = A. C. E. $\times \frac{\text{M.R.R.}}{100}$

A. C. E. :

		Rs.
Tangible Trading Assets at Market Value		
Fixed Assets		80,000
Stock		1,20,000
Debtors	1,45,000	
Less : Bad Debts	- 3,000	1,42,000
Cash		10,000
Prepaid Expenses		2,000
Total Assets		3,54,000
Less : Liabilities		
Gratuity Fund	15,000	
Workmen's P. F.	5,000	
Creditors	25,000	
Bank Overdraft	30,000	
Bonus Payable	10,000	85,000
Net Tangible Assets		2,69,000

Assumption :

It is assumed that profit is withdrawn from business. Therefore tangible capital at the end of the year considered equal to average capital employed during the year.

Therefore A. C. E. = 2,69,000

Normal Profit = $\frac{\text{N.R.R.}}{100} \times \text{A.C.E}$

$= \frac{10}{100} \times 2{,}69{,}000 = 26{,}900$

Super Profit = F. M. P. – Normal Profit

= 35,000 – 26,900 = 8,100

Goodwill = Super Profit x 4

= 8,100 x 4 = 32,400 (revised Goodwill)

Goodwill for valuation of shares

$$= \frac{\text{Book value of goodwill} + \text{Revised Goodwill}}{2}$$

$$= \frac{60,000 + 32,400}{2}$$

$$= \frac{92,400}{2}$$

$$= 46,200$$

1. Break Up Value (Intrinsic Value)

	Rs.
i) Amount available to Equity Shareholders	
Net Tangible Trading Asset	2,69,000
Add : Goodwill	46,200
Net Amount of Assets available to equity Shareholders	3,15,200

Note : The Net Assets available Rs. 3,15,200 should be distributed between the 2 types of Equity shareholders in the proportion of their paid up value.

Proportion : 2,00,000 : 1,00,000

= 2 : 1

Amount available to Rs 10 Equity shareholders = $\frac{2}{3} \times 3,15,200$

= 2,10,133

Amount available to Rs. 5 shareholders = $\frac{1}{3} \times 3,15,200$

= 1,05,067

ii) Value of share $= \frac{\text{Amount available to Equity Shareholders}}{\text{No. of equity shares}}$

For Rs. 10 $= \frac{2,10,133}{20,000} = 10.51$

For Rs. 5 share $= \frac{1,05,067}{20,000} = 5.25$

2. Market Value (Yield Value)

i) F. M. P. (as per I) 35,000

ii) Rate of F. M. P. $= \dfrac{\text{F.M.P}}{\text{Paid up Equity capital}} \times 100$

$= \dfrac{35,000}{3,00,000} \times 100$

$= 11.67\%$

iii) Market value $= \dfrac{\text{Rate of F.M.P.}}{\text{N.R.R.}} \times \text{Amount paid up per share}$

For Rs. 10 Share $= \dfrac{11.67}{10} \times 10 = 11.67$

For Rs. 5 Share $= \dfrac{11.67}{10} \times 5 = 5.83$

3. Fair Value $= \dfrac{\text{Break up value} + \text{Market value}}{2}$

For Rs. 10 Share $= \dfrac{10.51 + 11.67}{2} = 11.04$

Rs. 5 share $= \dfrac{5.25 + 5.83}{2}$

$= 5.54$

Illustration : 20 (When Equity Shares of different paid up values are given)

From the Balance Sheet of Machine Tools Company Limited as at 31st March, 2011 the following figures have been extracted.

	Rs.
Share capital	
9% Preference Shares of Rs. 100 each	3,00,000
10,000 Equity Shares of Rs. 10 each Rs. 5.00 paid up	50,000
10,000 Equity Shares of Rs. 10 each Rs. 2.50 paid up	25,000
10,000 Equity Shares of Rs. 10 each fully paid up	1,00,000
	4,75,000
Reserves and Surplus	
General Reserve	2,00,000
Profit and A/c	50,000
	7,25,000

On a revaluation of assets on 31st March, 2011 it was found that they had appreciated by Rs. 75,000 over their value in the aggregate.

The articles of association of the company provide that in case of liquidation, Preference shareholders would have a further claim to 10% of the surplus assets if any.

You are required to determine the value each Equity share assuming that liquidation of the company has to take place on 31st March, 2011 and that the expenses of winding up are nil.

Solution :

1. Surplus Assets

Book Value of Net Assets = Paid up capital and Reserves and surplus

= 7,25,000

Revised Value of Net Assets = Book Value + Appreciation

= 7,25,000 + 75,000

= 8,00,000

		Rs.
Revised value of Net Assets		8,00,000
Less : Preference Share Capital		(3,00,000)
		5,00,000
Less : Equity Share Capital (50,000 + 25,000 + 1,00,000)		(1,75,000)
Surplus		3,25,000
Less : Preference Shareholders (10% of Surplus Assets)		32,500
Surplus available to Equity Shareholders		2,92,500
Amount payable to Equity Shareholders		
Towards Capital	Rs.	1,75,000
Towards Surplus	Rs.	2,92,500
Total amount available to Equity Shareholders	Rs.	4,67,500
Total Paid up Capital	Rs.	1,75,000

i.e. Value of share of Different paid up value

$$= \frac{\text{Amount available}}{\text{Total Capital}} \times \text{Amt. paid up per share}$$

i.e. for Rs. 2.50 $= \frac{4,67,500}{1,75,000} \times 2.50$ Rs. 6.68

Rs. 5.00 $= \frac{4,67,500}{1,75,000} \times 5.00$ Rs. 13.36

Rs. 10.00 $= \frac{4,67,500}{1,75,000} \times 10.00$ Rs. 26.71

Alternatively, share can also be valued as follows :

		Rs.
Called up Capital	1,75,000	
Un-Called Capital		
10,000 shares @ Rs. 5.00	50,000	
10,000 shares @ Rs. 7.50	75,000	
i.e. Total- 30,000 shares	3,00,000	
Add : Surplus	2,92,500	
Total Amount available to Equity shareholders	5,92,500	
Value per Share	$\frac{5,92,500}{30,000}$	= 19.75

		Rs.
Value of Fully Called-Up Rs. 10		19.75
Partly Called-Up (Rs. 5)	19.75	
Less :Uncalled (Rs. 5.00)	(5.00)	= 14.75
Value of Fully Called Up (Rs. 2.50)	19.75	
Less : Uncalled (Rs. 7.50)	7.50	12.25

Illustration : 21

Below is given the Balance Sheet of Anand Ltd. as at 31st December 2010

Liabilities	Rs.	Assets	Rs.
Equity shares of Rs. 10 each 2,00,000 Less : Calls in Arrear (Rs. 2 for final call) 5,000	1,95,000	Goodwill	20,000
		Machinery	1,10,000
		Land and Building	1,20,000
		Furniture and Fixtures	60,000
		Vehicles	80,000
6% Preference Shares of Rs. 10 each 1,00,000 Less : Calls in Arrear (Rs. 2 for final call 1,000	99,000	Investments	80,000
		Stock in Trade	55,000
		Sundry Debtors	90,000
		Cash at Bank	10,000
General Reserve	80,000	Preliminary Expenses	10,000
P & L A/c	16,000		
Bank Loan	60,000		
Sundry Creditors	1,55,000		
Bills Payable	30,000		
	6,35,000		6,35,000

For the purpose of valuation of shares, Goodwill is to be considered on the basis of 2 years' purchase of the super profits based on average profit of last 4 years. Profits are as follows :

2007 : Rs. 80,000; 2008 Rs. 90,000; 2009 Rs. 1,05,000; 2010 Rs. 1,10,000

In a similar business normal return on capital employed is 5%.

Fixed assets are worth 30% above their actual book value. Stock is over-valued by Rs. 5,000. Debtors are to be reduced by Rs. 1.000. All trade investments are to be valued at 10% below cost. Of the investments, 10% are trade and the balance non-trade investments were acquired on 1-1-2010 and the rest on 1-1-2008

A uniform rate of dividend of 10% is earned on all investments.

The following further information is relevant :

i) In 2008 a new machinery costing Rs. 10,000 was purchased but wrongly charged to revenue. (No rectification has yet been made for above).

ii) In 2009, some old furniture (Book Value Rs. 5,000) was disposed of for Rs. 3,000. You are require to value each fully paid and partly paid Equity share. (Depreciation is charged on machinery @ 10% on reducing balance system. Ignore Taxation and Dividend)

(M. U. Nov. 1995)

Solution

1.

	Rs.
Investment as per B/S	80,000
Less : Trade Investment	(8,000)
(10% of 80,000)	-
Non Trade Investments	72,000
Loss on Valuation of Trade Investment $\left[\frac{10}{100} \times 8{,}000\right]$	800
Value of Trade Investment (8,000 – 800)	7,200
Non Trade Investment	72,000
Less : 5% of 72,000 acquired on 1-1-2009	3,600
Acquired on 1-1-2008	68,400

2.

Dr. Non – Trade Investment A/c

Date	particulars	Rs.	Date	particulars	Rs.
2008 Jan. 1	To Bank	68,400	2008 Dec. 31	By Balance c/d	68,400
		68,400			68,400
2009			2009		
Jan. 1	To Balance c/d	68,400	Dec. 31	By Balance c/d	72,000
Jan. 1	To Bank	3,600			--
		72,000			72,000
2010			2010		
Jan. 1	To Balance b/d	72,000	Dec. 31	By Balance e/d	72,000
		72,000			72,000

Rate of Interest on non-trading investment is also 10% interest.

3. Interest on non-trade Investment

Date	Interest	Rs.
31-12-08	$\frac{10}{100} \times 68{,}400$	6,840
31-12-09	$\frac{10}{100} \times 72{,}000$	7,200
31-12-10	$\frac{10}{100} \times 7{,}200$	720

4. Machinery

i) Rs. 10,000 should be added to profit of 2008

ii) As machinery was charged to Profit and Loss Account i.e. to revenue, no depreciation on it was provided.

iii) The profits reported in the problem are before providing for depreciation on machinery of Rs. 10,000. while calculating F. M. P. the errors is to be rectified and depreciation is to be provided @ 10% p.a. on Reducing Balance Method.

Depreciation of Machinery

		Rs.
2008	Cost of machinery	10,000
	Less : Depreciation (10% of 10,000)	1,000
		9,000
2009	Less : Depreciation (10% of 9,000)	900
		8,100
2010	Less : Depreciation (10% of 8,100)	810
	Written down Value to be considered	7,290

5. Loss on Sale of Furniture

(5,000 – 3,000 = 2,000)

Rs. 2,000 loss on sale of furniture is an abnormal loss which should be added to the Profit of 2000 for deciding F. M. P. Super Profit = F. M. P. – Normal Profit.

ii) **F. M. P.**

	2007 Rs.	2008 Rs.	2009 Rs.	2010 Rs.
Reported Profits	80,000	90,000	1,05,000	1,10,000
i) Over Valuation of Stock				-5,000
ii) Reduction in Debtors				-1000
iii) Loss on Revaluation of Trade Investment				-800
iv) Interest on Non-trade Investment		-6,840	-7,200	-7,200
v) Machinery charged to Revenue		+ 10,000		
vi) Depreciation on Machinery		- 1,000	-900	-810
vii) Loss on Sale of Furniture		-	+ 2,000	-
Trading Profits	80,000	92,160	98,900	95,190

$$Average\,Trading\;\Pr ofit = \frac{80,000 + 92,160 + 98,900 + 95,190}{4}$$

$$= \frac{3,66,250}{4}$$

$$= 91,563$$

ii) Normal Profit $= \frac{N.R.R.}{100} \times ACE$

Average Capital Employed

		Rs.
Tangible Trading Assets		
Machinery		1,10,000
Add: W.D.V. of Machine charged as Expense		7,290
		1,17,290
Land & Building		1,20,000
Furniture & Fixtures		60,000
Vehicles		80,000
Book Value of All Fixed Assets	3,77,290	
Add : 30% of Book Value	1,13,187	
Revised Value		4,90,477
Trade Investment		7,200
Stock in Trade	55,000	

Less : Over Valuation	-5,000	50,000
Debtors	90,000	
Less : Reduction	-1,000	89,000
Bank Balance		10,000
		6,46,677
Less : Liabilities		
Bank Loan	60,000	
Sundry Creditors	1,55,000	
B/P	30,000	2,45,000
Tangible Trading Capital at the end of the year		4,01,677

$\therefore A.C.E. \quad = 4,01,677$

$$Normal\ Proft = \frac{NRR}{100} \times A.C.E$$

$$= \frac{5}{100} \times 4,01,677 = 20,083.85 = 20,084$$

$$Super\ Profit = F.M.P. - Nomial\ Profit$$

$$= 91,563 - 20,084 = 71,479$$

$$Goodwill = Super\ Profit \times No.of\ \ years\ purchase$$

$$= 71,479 \times 2 \quad = 1,42,958$$

Net Assets Value (Intrinsic Value)

Amount available to Equity Shareholders

		Rs.
Net Tangible Trading Assets		4,01,677
Add: Goodwill		1,42,958
Non Trading Investments		72,000
Calls in Arrears : Equity	5,000	
Preference	1,000	6,000
		6,22,635
Less : Preference Share Capital		1,00,000
Amount available to Equity Shareholders		5,22,635

$$Net\ Assets\ Value\ of\ share = \frac{Amount\ avaliable\ to\ Equity\ shareholders}{No.of\ Equity\ Shares}$$

$$= \frac{5,22,635}{20,000} = 26.13$$

Value of partly paid share = value of fully paid - calls unpaid per share

= 26.13-2.00

= 24.13

Illustration 22 :

Find out fair value of each share of Ekar Ltd. from the following information :

a) Balance sheet as on 31st December, 2007

Liabilities	₹	Assets	₹
5,000 Equity shares of Rs. 100 each fully paid up	5,00,000	Fixed Assets	11,99,000
Reserves	8,00,000	Cash	70,000
Loans	4,00,000	Other current assets	6,00,100
Creditors	1,50,000	Preliminary Expenses	30,900
Workmen's saving Accounts	50,000		
	19,00,000		19,00,000

b) Goodwill to be valued at 3 years purchases of super profits calculated on the basis of weighted average profits of last 5 years.

c) In similar business, normal return on capital employed is 15%.

d) Profits for last 5 years, after tax are as follows;

	Year	2009	2008	2007	2006	2005
(Rs.)	₹ N.P.A.T	2,61,000	2,35,000	3,21,000	2,10,000	2,40,000

e) i) Druning 2005 a heavy repairs was done to machinery for ₹ 50,000, which was wrongly debited to Revenue. It is to be capitalized for the purpose of goodwill and shares, valuation taking depreciation @ 10% on W. D. V.

ii) In 2006, closing stock was overvalued by Rs. 2000.

iii) In 2008, there was fire which resulted in loss of Rs. 8,000, which was debited to profit & Loss A/c.

iv) In 2007, the company have sold some fixed Assets resulting into profit of Rs. 25,000, credited to P/L A/c.

v) Additional Rent of Rs. 6,000 p.a. will be payable.

vi) Directors fees paid upto now was Rs. 10,000 p.a. but hence forth it will be Rs. 13,000 p.a.

f) Income Tax upto now was at the rate of 50%, but hence forth it will be 40%

g) i) Fixed Assets are overvalued by 10%.

ii) Other Current Assets are undervalued by 15%.

h) N. R. R. for valuation of shares 10%.

i) Company has practice of transferring Rs. 15,000 to General Reserves every year.

Solution :

A) Valuation of Goodwill :

Statement Showing adjusted profit

Particulars	2005	2006	2007	2008	2009
N. P. A. Tax	2,40,000	2,10,000	3,21,000	2,35,000	2,61,000
(A) Income Tax	2,40,000	2,10,000	3,21,000	2,35,000	2,61,000
N. P. B. Tax	4,80,000	4,20,000	6,42,000	4,70,000	5,22,000
(+) Repairs calpitazed	50,000	--	--	--	--
(-) Depreciation	(5,000)	(4,500)	(4,050)	(3,645)	(3,281)
Over valuation of stock on 31/12/06	--	(2,000)	2,000	--	--
(+) loss due to fire in 2008	--	--	--	8,000	--
(-) abnormal gains	--	--	(25,000)	--	--
Adjusted profit B.T.	5,25,000	4,13,500	6,14,950	4,74,355	5,18,719
(x) weight	X 1	X 2	X 3	X 4	X 5
Product ₹	5,25,000	8,27,000	18,44,850	18,97,420	25,93,595

Working for depreciation :

	₹
Repairs capitalized in 2005	50,000
(-) Dep^n for 2005	(5,000)
WDV as on 31.12.05	45,000
(-) Dep^n for 2006	(4,500)
WDV as on 31.12.06	40,500
(-) Dep^n for 2007	(4,050)
WDV as on 31.12.07	36,450
(-) Dep^n for the year 2008	(3,645)
WDV as on 31.12.08	32,805
(-) Dep^n for the year 31.12.09	(3,281)
WDV as on 31.12.09	29,524

$$weighted\ avgerage\ profit\ before\ tax = \frac{Total\ of\ \ products}{Total\ weights}$$

$$= \frac{76,87,865}{15} = 5,12,524$$

		₹
Weighted average profit	=	5,12,524
(-) increase in exp. in future		
Additional rent		(6,000)
Add. Directors fee payable		(3,000)
F.M.P. Before Tax		5,03,524
(-) Increase Tax @ 40%		(2,01,410)
F.M.P. after Tax		3,02,114

Net Tangible Trading Assets :

Particulars	₹	₹
Fixed Assets $\left(11,99,000 \times \frac{100}{110}\right)$	10,90,000	
Repairs (WDV value of repairs capatalised)	29,524	
Cash	70,000	
Other C. A. $\left(6,00,100 \times \frac{100}{85}\right)$	7,06,000	
		18,95,524
Less : liabilities payable		
Loan	4,00,000	
Creditors	1,50,000	
Workmen's sauing A/c	50,000	(6,00,000)
Net tangible trading assets as on 31.12.2009		12,95,524

Normal Profit = Avg. Capital equp. $\times \frac{\text{NRR}}{100}$

= 12,95,524 × 15%

= 1,94,329

Super Profit = F.M.P. – Normal profit

= 3,02,114 – 1,94,329

= 1,07,785

Goodwill = super profit × 3 years of purchase

= 1,07,785 × 3

= 3,23,355

B) Valuation of shares :

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

= $\frac{323.78 + 574.2}{2}$

= 448.99

Fair value ₹ = 449

WN:

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

$$= \frac{16,18,879}{5,000}$$

= 323.78

Net asset available to Equity S. H.	₹
Net tangible trading asset as calculated	12,95,524
(+) Goodwill	3,23,355
Net assets available to Equity share holders	16,18,879

Yield value :

FMP = Adjusted avg. profit – pref. dividend – statutory Preference to Reserves

FMP = 3,02,114 – 15,000

= 2,87,114

Rate of FMP = $\frac{FMP}{paid\ up\ equity\ cap} \times 100$

$$= \frac{2,87,114}{5,00,000} \times 100$$

= 57.42%

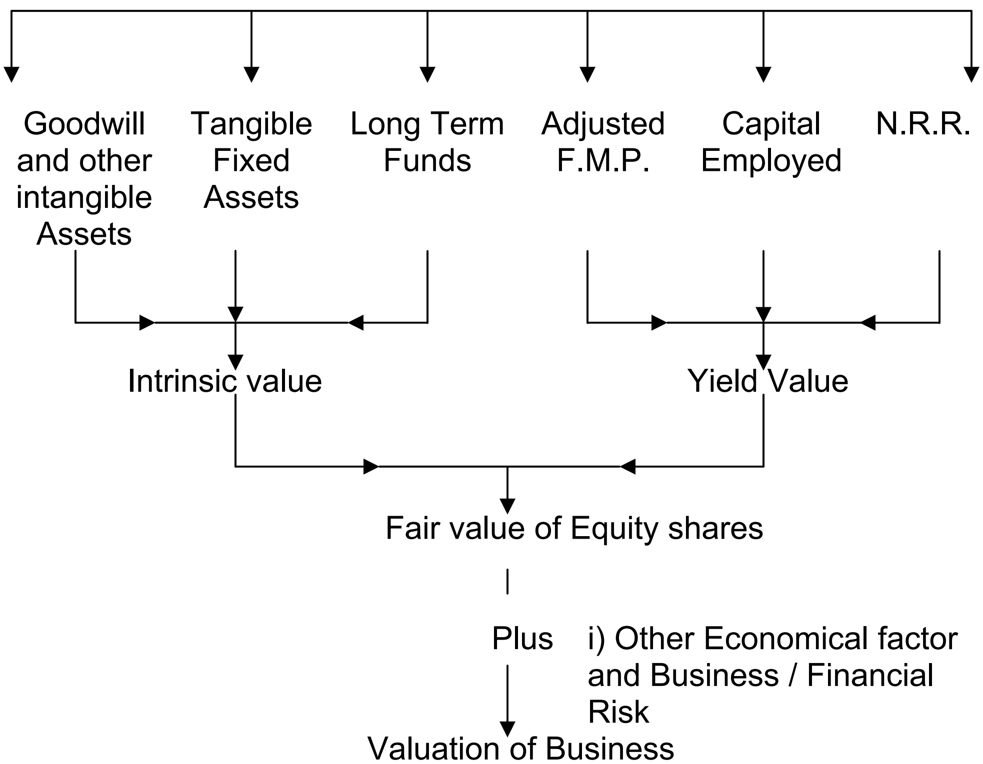
Yield value = $\frac{Rate\ of\ FMP}{NRR} \times paid\ up\ value\ of\ a\ equity\ share$

$= \frac{57.42}{10} \times 100$

₹ = 574.2

10.13 VALUATION OF BUSINESS

Valuation of Business



Business valuation process involves multiple judgments. It uses to estimate the economic value of the owner's interest in the Business. It is the price vender of business willing to receive and purchaser of business willing to pay. It not only shares valuation but also valuation of intangible assets, anticipation of future earnings, analysis of company's cash flows etc. It also guide share holders to hold shares or purchase addition share or sell part / all his shares. Valuation is used by financial market participant to determine the price, to buy or to sell the business.

Some of the methods of business Valuation are as follows:

1. EARNING PER SHARE METHOD (E.P.S)

Step I F.M.P. = Profit available for Equity Dividend
= Adj. Average profit – Pref. Dividend – statutory transfer to reserves

Step II $$\text{E.P.S.} = \frac{\text{FMP}}{\text{No. of equity shares outstanding}}$$

Step III Value of total Equity Share = No. of Equity shares x E.P.S.

Step IV Business Value = Valuation of E.P.S. (Step III) x $\frac{100}{N.R.R}$

2. DIVIDEND CAPITALISATION METHOD

This method is based on dividend. Equity dividend paid / declared is capitalized by using N.R.R.

Following steps should be followed :

Step 1 - Ascertain Equity Dividend per share

Step 2 - Determine N.R.R. N.R.R. for dividend yield approach should be different than N.R.R. for goodwill valuation. It depends upon many factors e.g. promoters total holding, whether shares are listed or unlisted. Higher the promotes holding N.R.R. can be less, similarly higher the unlisted co. shares N.R.R. should be higher, as high risk.

a) Earning yield approach

$$N.R.R. = \frac{E.P.S.}{Market\ price\ per\ share} \times 100$$

b) Dividend yield approach

$$N.R.R. = \frac{Dividend\ per\ share}{Market\ price} \times 100$$

Step 3 - $Value\ per\ share = \dfrac{Dividend\ per\ share}{N.R.R.} \times 100$

Step 4 - Business value

= No. of Equity shares outstanding x value on calculated on above.

3. PRICE EARNING MULTIPLE APPROACH

Price Earnings Ratio = $\dfrac{Market\ price\ per\ share}{E.P.S.}$

Price Earning ratio shows price currently paid for each ₹ of currently reported E.P.S. It is market price based method. It is relationship between per share & E.P.S.

Business valuation can be ascertain as follows:

Step I - Determine P.E. multiple applicable for similar size companies in same type of indenty.
Step II - Compute E.P.S. of the company being under consideration, As per As – 20
Step III - Value per share = P.E. ratios x E.P.S.
Step IV - Business Valuation
= No. of outstanding Equity shares x Value determine in Step III above.

4. BOOK VALUE METHOD

This is market based. Book value can be ascertained on the basis of company's book of accounts. Book value method represents relationship between market price of the share and book value of the same.

Step 1:

$$Book\ value\ per\ share = \frac{Net\ Assets\ available\ to\ Equity\ share\ holders}{No.\ of\ equity\ shares.}$$

In such valuation net assets appearing books of accounts or i.e. equal to shareholders fund.

Step 2: Determine Book value multiple of the similar sized and type company.

$$= \frac{Market\ value\ per\ share}{Book\ Value\ per\ share}$$

Step 3: Value per share
= Book Value per share x Book value multiple.

Step 4: Business Value
= No. of Equity shares x Value per shares (step 3)

5. DISCOUNTED CASH FLOW METHOD

Cash flow is that cash flow through out during the year. Cash flow is defined as "Earnings before Interest on Long Term Loans, Depreciation, but after Taxes".

Cash flows = N.B.I. + Tax + Depreciation + Amortization

Free cash flow represents the cash flow which are available for :

1. Expansion
2. Diversification
3. Withdrawal

Free cash flows represent the cash flow available from earning after adjusting for:

1. Additional cash required for incremental working capital needs.
2. Replacement of assets in normal circumstances.

Normally this method is preferred by investment Bankers to value business as the company's value can be estimated by forecasting future performance and measuring future surplus cash flow generated by the company. The cash flows and cash deficient cash flows are discounted back to present value and added together to get the valuation of business.

As per this method to ascertain value of business following produce should be followed:

Step 1 - Ascertain Future cash flow for which projections can be made with certainly.

Step 2 - Discount above future cash flow at cost of capital.

Step 3 - Take total of above discounted cash flow.

Step 4 - Decide the Terminal value for last year of projections. The Terminal value is ascertained by capitalising the last year earning at N.R.R.

Step 5 - Discount the terminal value @ rate of cost of capital.

Step 6 - Add all these values to estimate the company's present value, assuming co. is debt free.

a)	Discounted cash flows	X
b)	Discounted Terminal value	X
	Value of Business	

Step 7 - Value per share = $\frac{\text{Value of Business}}{\text{No. of shares outstanding}}$

10.14 SOLVED PROBLEMS ON VALUATION OF BUSINESS

Illustration 23:

Following information is available from books of Ketan Ltd.

a) Free Cash Flows:

Year	Rs. in Lakhs
2006	100
2007	150
2008	250
2009	400
2010	500

b) The company uses 60% debt. And 40% Equity for long term financing. Debt. Is obtained at 12%. The tax rate is 40% cost of Equity is 25%

c) Assets amounting 362 lakhs were not used in generation of the cash flow.

d) The company expects a steady cash flow growth at 5%.

Using Discounted Cash flow technique, you are required to calculate the value of Business

Solution :

1. Weighted Average Cost

Sources of Capital	Cost of Capital	Tax Shield	Net Cost of Capital		Proportion of Capital		Weighted Cost
Equity	25	--	25	X	40%	=	10.00
Debt	12	0.40	7.20	X	60%	=	4.32
						W.A.C.C.	14.32

2. Present Value of cash flow :

Year	Cash flow Rs. Lakhs	D.F.@ 14.32%	P.V. of Cash flow Rs. in Lakhs
2006	100	0.8747	87.47
2007	150	0.7651	114.77
2008	250	0.6693	167.33
2009	400	0.5855	234.20
2010	500	0.5121	256.05
P.V. of Total Cash Flows			859.82

Discount factor is calculated by constant factor using calculate as

$$\frac{100}{114.32} \times \times = \textit{for } 2006 \textit{ year}$$

$$= \textit{for } 2007 \textit{ year}$$

$$= \textit{for } 2008 \textit{ year}$$

$$= \textit{for } 2009 \textit{ year}$$

$$= \textit{for } 2010 \textit{ year}$$

3. $$\text{Terminal value} = \frac{500 \times 1.05}{0.11432 - 05} = \frac{525}{0.06432}$$

= 8162.31 Lakhs.

4. P.V. of Terminal Value = 8162.31 x 0.5121
= 4180; in lakhs.

5.

Value of Ketan Ltd.	₹ (in lakhs)
P.V. of cash flow	859.82
+ P.V. of Terminal cash flow	4180.00
+ Value of non-operating asset	362.00
Value of Business	5401.82

Note : As net present value concept not covered in syllabus, we are of opinion that discounted cash flow method should not be asked in M. Com. Part I.

Illustration 24:

Following information from X Ltd. & Y Ltd., were available.

	X Ltd.	Y Ltd.
Earning after Tax	Rs. 2,50,00,000	Rs. 12,00,000
No. of Equity Share	5,00,000	2,00,000
P.E. Ratio C Times	12	7

You are required if Y Ltd. is taken over by X Ltd.

i) Calculate market price of shares of X Ltd. & Y Ltd.
ii) Find out swap ratio based on market price.
iii) What would be E.P.S. of X Ltd. after take over Y Ltd.
iv) What would be the market value of the merged of Company?

Solution :

	X Ltd.	Y Ltd.
E.P.S. $= \dfrac{N.P.A.T. - \text{Preference Dividend}}{No. of \ Equity \ Share}$	$= \dfrac{25,00,000}{5,00,000}$	$\dfrac{12,00,000}{2,00,000}$
E.P.S.	= Rs. 50	Rs. 6
P.E. Ratio $= \dfrac{Market \ Price}{E.P.S.}$		
$\therefore$ Market Price	= 12 x 50	7 x 6
= P. E. Ratio x E. P. S.	= ₹ 600	₹ 42

ii) Swap price based on market price

$$= \frac{Market \ price \ of \ Y \ Ltd.}{Market \ price \ of \ X \ Ltd.} = \frac{42}{600} = 0.07$$

$\therefore$ 7 Shares of X Ltd. for every 100 shares of Y Ltd.

iii) E. P. S. of X Ltd. after takes over Y Ltd.

$\therefore$ No. of shares issued to Y Ltd. = 2,00,000 $\times \dfrac{7}{100}$ = 14,000 shares.

Total No. of shares of X Ltd. after takes over = 5,00,000 + 14, 000= 5,14,000.

Total Earning after take over = 2,50,00,000 + 12,00,000 = 2,62,00,000.

E.P.S. After Take over $= \dfrac{2,62,00,000}{5,14,000} =$ ₹ 50.97

$\therefore$ Expected Market Price

After take over = 12 x 50.97

= 611.64

Market Value of X Ltd. = No. of shares x market price per share

= 5, 14,000 x 611.64

= 31,43,82,960

Illustration : 25

Anand Ltd. is intending to acquire Raj Ltd. by waerger and following information is available.

	Anand Ltd.	Raj Ltd.
No. of Equity shares	5,00,000	1,00,000
No. of 10% Pref. shares of Rs. 100 each	1,00,000	50,000
Earning after Tax	60,00,000	22,00,000
M. V. per Equity Share	45	67.50

You are required :

i) Calculate E. P. S. for Anand Ltd. and Raj Ltd.
ii) Calculate E. P. S. after mager

Solution :

i) E.P.S. $= \frac{N.P.A.T. - preference\ Dividend}{No. of\ \ Equity\ shares}$

Anand Ltd. E.P.S. $= \frac{60,00,000 - 10,00,000}{5,00,000}$

$= \frac{50,00,000}{5,00,000} = ₹\,10\ per\ share$

Raj Ltd. E.P.S. $= \frac{22,00,000 - 5,00,000}{1,00,000} = ₹\,15\ per\ share$

ii) No. of shares issued to Raj Ltd. by Anand Ltd.

$\frac{67.50}{45} \times 1,00,000 = 1,50,000$

$\therefore$ Total share of Anand Ltd. = 5,00,000 + 1,50,000 = 6,50,000

$\therefore$ Earnings after takeover = 50,00,000 + 15,00,000 = 65,00,000

E.P.S. after merger $= \frac{65,00,000}{6,50,000} = ₹\,10\ per\ share$

Illustration 26 :

Z Ltd. Furnished to following information, Assets (including goodwill 17,50,000)

	Rs.
Net Assets [including goodwill]	1,75,000
10% Preference Capital Rs. 10 each	4,00,000
Equity share capital Rs. 5 each	6,00,000
Avg. Net profit after tax	12,50,000
Normal rate of return 12%	

Information :

1) Intrinsic value
2) Fair Value
3) Director decided to allow one fully paid equity share at bonus for every 3 shares held.
4) After boun issued offer was made for right share issue @ 1 share Rs. 25 per share for every 4 shares prices was fully subscribed fair value before right and after right.

Solution :

Particulars	Nos.	Rs.
Net Asset		17,50,000
(Less) Preference Capital		4,00,000
Net Asset available to Equity share holder	1,20,000	13,50,000
Add + : Bonus (1,20,000 ×⅓)	40,000	--
Net Asset	1,60,000	13,50,000
Add +: Right issue (1,60,000 ×¼) (40,000 × 25)	40,000	10,00,000
Net Assets	2,00,000	23,50,000

Yield Value

FMP Given	12,50,000
(Less) Preference dividend (4,00,000 x 10%)	40,000
FMP	12,10,000

1) Fair Value $= \dfrac{Intrinsic\ Value + Yield\ Value}{2}$

$$= \frac{11.25 + 84.03}{2}$$

$$= 47.64/-$$

a) Intrinsic Value : $= \dfrac{Net\ Asset\ available\ to\ equity\ shareholders}{No.\ of\ equity\ shares}$

$$= \frac{13,50,000}{1,20,000}$$

$$= 11.25$$

b) Yield Value

i) FMP = 12,10,000

ii) Rate of FMP $= \dfrac{FMP}{paid-up\ equity\ share\ capital} \times 100$

$$= \frac{12,10,000}{6,00,000} \times 100$$

= 201.67%

iii) Yield Value $= \dfrac{Rate\ of\ FMP}{NRR} \times Paid\ up\ Amount\ per\ share$

$$= \frac{201.67}{12} \times 5$$

$$= 84.03$$

2) Valuation of shares before bonus and after bonus

a) Fair value before bonus = 47.64

b) Fair value after bonus $= \dfrac{Intrinsic\ value + yield\ value}{2}$

$$= \frac{8.44 + 63.02}{2}$$

$$= 35.73$$

i) Intrinsic Value $= \dfrac{Net\ asset\ available\ to\ equity\ shareholder}{No.\ equity\ share\ (After\ bonus)}$

$$= \frac{13,50,000}{1,60,000}$$

$$= 8.44$$

ii) Yield Value

i) FMP = 12,10,000

ii) Rate of FMP $= \dfrac{FMP}{paid\ up\ equity\ capital} \times 100$

$$= \frac{12,10,000}{8,00,000} \times 100$$

$$= 151.25$$

iii) Yield Value $= \frac{Rate\ of\ NNR}{NRR} \times Paidup\ value\ per\ share$

$= \frac{151.25}{12} \times 5$

$= 63.02\%$

3) Fair value before right and after right (but after bonus)

a) Before Rights
Fair value = 35.73

b) After Rights

i) Fair value $= \frac{Intrinsic\ value + yield\ value}{2}$

$= \frac{11.75 + 50.42}{2}$

$= 31.085$

ii) Intrinsic Value $= \frac{Net\ asset\ available\ to\ equity\ share\ holder}{No.\ of\ equity\ shares}$

$= \frac{23,50,000}{2,00,000}$

$= 11.75$

iii) Yield Value

i) FMP = 12,10,000

ii) Rate of FMP $= \frac{FMP}{paid\ up\ equity\ capital} \times 100$

$= \frac{12,10,000}{10,00,000} \times 100$

$= 121\%$

iii) Yield Value $= \frac{Rate\ of\ FMP}{NRR} \times paidup\ value\ per\ share$

$= \frac{121}{12} \times 5$

$= 50.42$

Illustration 27:

Following Information were made available from Y Ltd.

Equity share capital (Rs. 25 each)	50,00,000
10% Preference share capital (Rs. 100 each)	10,00,000
Net Asset	94,00,000
Net Profit after Tax	21,00,000

Information :

1. Preferencial were converted into Equity shares @ rate of 2 shares for every 5 shares.
   NRR 15%
2. You are required to ascertain fair value before conversion and after conversion.

Solution :

1. On Convrsion no. of Equity share issue = 10,000 $\times {}^{2}\!/_{5}$ = 4,000
2. Net asset available to Equity shareholder.

	Particular	No.	Rs.
	Before Conversion		94,00,000
	(Less) Preference capital		10,00,000
	Net Asset Before Conversion	2,00,000	84,00,000
3)	After Conversion (2,00,000 + 4,000)	2,04,000	94,00,000
4)	FMP Before Conversion		21,00,000
	(Less) Preference dividend		1,00,000
	FMP (Before Conversion)	2,00,000	20,00,000
5)	After Conversion	2,04,000	21,00,000

a) Fair value before conversion of Preference shares

$$= \frac{Intrinsic\,Value + yield\ value}{2}$$

$$= \frac{42 + 66.67}{2}$$

$$= 54.335$$

i) Intrinsic Value

$$= \frac{Net\ Asset\ available\ to\ equity\ shareholder}{No.\ of\ equity\ shares}$$

$$= \frac{84,00,000}{2,00,000}$$

$$= 42$$

2) Yield Value

i) FMP = 20,00,000

ii) Rate of FMP

$$= \frac{FMP}{paidup\ equity\ capital} \times Face\ Value\ of\ \ preference\ shares$$

$$= \frac{20,00,000}{50,00,000} \times 100$$

$$= 40\%$$

iii) Yield value $= \frac{Rate\ of\ \ FMP}{NRR} \times Paidup\ Value\ per\ equity\ share$

$$= \frac{40}{15} \times 25$$

$$= 66.67$$

B) After Conversion

Fair value $= \frac{Intrinsic\ value + yield\ value}{2}$

$$= \frac{46.08 + 68.03}{2}$$

$$= 57.35$$

i) Intrinsic Value $= \frac{Net\ asset\ available\ to\ equity\ share\ holder}{2}$

$$= \frac{94,00,000}{2,04,000}$$

$$= 46.08$$

2) Yield Value

i) FMP = 21,00,000

ii) Rate of FMP $= \frac{FMP}{Paidup\ equity\ share} \times 100$

$$= \frac{21,00,000}{51,00,000} \times 100$$

$$= 41.18\%$$

iii) Yield Value $= \frac{Rate\ of FMP}{NRR} \times paidup\ value\ per\ equity\ share$

$$= \frac{41.18}{15} \times 25$$

$$= 68.63$$

Illustration : 28

Equity share capital (Rs. 25 each	50,00,000
10% Debentures (Rs. 100 each)	10,00,000
Net Assets	94,00,000
N.P.A.T. @ 40%	24,00,000
N.R.R. @ 12.50%	

Information :

Debentures are convertible into Equity shares @ rate of 3 for every 5 debentures.

You are required to ascertain after conversion of debentures.

Solution :

1) No. of Equity shares issued to debentures holders =

= 10,000 × $3/5$

= 6,000 Equity shares.

2)

Net asset before conversion	94,00,000
Add + Debenture (as converted to Equity no liability)	10,00,000
Net Asset after conversion	10400000

3) FMP

N.P.A.T.	2400000
Add + Income Tax $\left(2400000 \times \frac{40}{60}\right)$	1600000
FMP Before Tax	4000000
Add + Debenture Interest	100000
N.P.B.T.	4100000
(Less-) Tax @ 40%	(1640000)
FMP	2460000

Intrinsic Value after conversion

1) Intrinsic Value $= \frac{\textit{Net asset available to equity shareholder}}{\textit{No. of equity shares}}$

$$= \frac{10400000}{206000}$$

$$= 50.49$$

2) Yield value

i) FMP = 2460000

ii) Rate of FMP $= \frac{FMP}{paidup\ equity\ share\ capital} \times 100$

$= \frac{2460000}{5150000} \times 100$

$= 47.77\%$

iii) Yield Value $= \frac{Rate\ of FMP}{NRR} \times paidup\ value\ per\ share$

$= \frac{47.77}{12.50} \times 25$

$= 95.54$

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

$= \frac{50.49 + 95.54}{2}$

$= 73.015$

10.15 KEY POINTS ON VALUATION OF GOODWILL, SHARES AND BUSINESS

Goodwill : It is intangible fixed Asset, which can be brought and / or sold along with business.

F.M.P. : It is Future maintainable Trading profit after income tax, duty adjusted for possibilities of increases / decreases in profit due to the certain changes.

Capital Employed : It is net tangible trading assets. It is excess of market value of trading assets over external liabilities payable.

N.R.R. : It is normal rate of return excepted in same type of industry.

Super Profit : It is excess of F. M. P. over normal profit earned.

Weighted Average Profit : When profit earned over no. of years shows increasing or decreasing tendency, weighted average profit should be preferred for ascertaining F.M.P.

Share : Share means share in share capital in a public or private Ltd. Company.

Preference Share : Preference shares are those shares enjoys preferential rights over Equity shareholders in respect of dividend and repayment of capital.

Intrinsic Value of Shares : It is amount available to one share in liquidation of company, after payment of external liabilities and Preference share capital.

Yield Value of Share: It is value of Equity share based on profit available to Equity share holder, by way of dividend.

Fair value : It is average of intrinsic value and yield value.

10.16 EXERCISE ON VALUATION OF GOODWILL, SHARES AND BUSINESS

Objective Questions :

I. Answer in Brief :

1. Define Goodwill
2. Explain F.M.P.
3. Capital Employed
4. N.R.R.
5. Capitalisation of F.M.P.
6. Capitalisation of Super profit
7. Intrinsic value of Equity share
8. Yield value of Equity share
9. Fair value of equity share.
10. Participating Preference share.
11. When to consider weighted average profits.
12. Explain valuation of Business.

II. Multiple choice Question :

1. Money value of the reputation of business concern.

   a) patenad b) working capital

   c) Goodwill d) know-how

2. Goodwill is

   a) Current Assets b) intangible assets

   c) Fictitious Assets d) Net Assets

3. While calculating capital employed following assets are included :

   a) Fixed Assets b) Current Assets

   c) Trade Investment d) All the above

4. While calculating super profit; following income included.

   a) Operating Net Profit b) Income from trade investment

   c) Normal profit d) All the above

5. Normal profit depends on

   a) Average capital employed b) N.R.R.

   c) F. M. P. d) both a & b

6. Super profit is :

   a) Excess of F.M.P. over normal profit

   b) F. M. P.

   c) Excess of normal profit over F.M.P.

   d) none of the above

7. Intrinsic value of share is also known as,

   a) Assets Backing value b) Yield value

   c) Liquidation value d) both a and c

8. While calculating capital employed for valuation of share, following assets are included.

   a) Goodwill b) Fictitious Assets

   c) Unrecorded Assets d) both a and b

9. Shares are to be valued on

   i) wealth tax ii) purchased of major shares

   iii) amalgamation iv) All the above

10. Quoted share means

    i) Reported in new paper ii) Quoted by seller

    iii) held by promoters iv) Listed on the stock exchange

11. Super profit is 13,20,000 N.R.R. 33⅓% Goodwill is valued by capitalization of super profit is

    i) 3,96,000 ii) 39,60,000

    iii) 39,59,553 iv) 60,39,000

12. Fair value of share is equal to

    i) Net Assets ii) Intrinsic value

    ii) Yield value iv) None of the above

13. Calculate intrinsic value of share, if 10,000 Equity shares of Rs. 10 each are fully paid up and Net Asset of the companies valued of Rs. 12,40,000

    i) Rs. 124 ii) 2400

    iii) 214 iv) None of the abobe

14. If profit earned by the company for last 5 years Rs. 50,000, Rs. 60,000, Rs. 90,000, Rs. 80,000; weight assigned, 1, 2, 3 & 4 respectively, weighted average profit is

    i) 70,000 ii) 95,000

    iii) 50,000 iv) Non of the abobe

15. Fixed Assets undervalued by 15% = Rs. 97,75,000. It market value.

    i) 1,11,24,1250 ii) 1,15,00,000

    iii) 1,11,55,000 iv) Non of the above

Theory Question :

1. What is goodwill?
2. Specify the circumstances when goodwill is valued?
3. Describe the factors which influence value of Goodwill?
4. State various method of valuation of Goodwill?
5. Explain valuation of shares in following circumstances.

a) Before Bonus and After Bonus

b) Before right issue of shares and after right issue.

c) Before conversion of Debentures and after conversion of Debentures into shares.

d) Partly called shares and after converting partly paid into fully paid up, by capitalizing reserves.

6. Explain dividend capitalization method for valuation of business.
7. Write short notes on :

- Valuation of Preference shares.
- Fair value of share
- Price earning multiple approach method of business.
- Net assets by liabilities side approach.
- Valuation of goodwill by capitalization of F. M. P.

8. State limitation of intrinsic value of shares
9. How you value Equity shares when company have issued participating Preference shares.
10. Give the formula for valuation of fair value of Equity shares.

❖❖❖❖

11

INTERNATIONAL FINANCIAL REPORTING STANDARDS

Unit Structure

11.1 INTRODUCTION

Accounting is the art and science of recording business transactions in best possible manner with proper selection and adoption of accounting policies and principles. Over the time it was felt necessary to ensure easy comparability the enterprises should follow uniform accounting methods. In India the Institute of Chartered Accountants of India governs the profession of accountancy. The institute ensures professionalism and prudence in preparation and presentation of financial statements by issuing guidelines, accounting standards from time to time.

In today’s world of globalization business enterprises have become more dependent on each other, across the nation and across the world. The globalization has forced more and more countries to open their doors for business expansion across borders and to foreign investments. Traditionally companies raised funds from domestic capital markets and financial institutions. The business was restricted to very few countries. The rapid expansion of international trade and internationalization of firms, the development of new communication technologies, and the emergence of international competitive forces has made it extremely necessary to have uniform and internationally acceptable accounting standards. Now it has been realized that under this global business scenario the business community is badly in need of a common accounting language that should be spoken by all of them across the world.

A financial reporting system supported by a strong governance, high quality standards and firm regulatory framework is the key to economic development. Indeed, sound financial reporting standards underline the trust that investors place in financial reporting information and thus play an important role in contributing to the economic development of a country. Different countries have local accounting standards which spell out the accounting treatment and disclose your requirements for preparing of financial statements, some sort of compatibility or convergence is necessary to enable all the stake holders to take appropriate economic decisions. This is sought to be ensured through the International Financial Reporting Systems (IFRS) adopted by International Accounting Standards Board (IASB). Most of the countries have started adopting IFRS or making their local GAAP convergent with IFRS. Major stock exchanges across the world today accept IFRS.

11.2 MEANING OF IFRS:

- IFRSs are principle-based standards.
- The principle-based standards have distinct advantage that the transactions cannot be manipulated easily to achieve a particular accounting.
- The Financial Accounting Standards Board (FASB), USA, is having a convergence project with the IASB and is broadly adopting the principle-based approach instead of rule-based approach.
- IFRSs lay down treatments based on the economic substance of various events and transactions rather than their legal form.
- The application of this approach may result into events and transactions being presented in a manner different from their legal form.
- To illustrate, as per IAS 32, preference shares that provide for mandatory redemption by the issuer are presented as a liability.

11.3 OBJECTIVES OF IFRS:

WHY IFRS?

A single set of accounting standards would enable internationally to standardize training and assure better quality on a global screen, it would also permit international capital to flow more freely, enabling companies to develop consistent global practices on accounting problems. It would be beneficial to regulators too, as a complexity associated with needing to understand various reporting regimes would be reduced.

OBJECTIVES OF IFRS:

1. The main objective of IFRS is to develop in the public the interest of a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions.
2. To promote the use and rigorous application of those standards; in fulfilling the objectives associated with it.
3. To take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies.
4. To bring about convergence of national accounting standards and International Accounting standards and IFRS to high quality solutions.

11.4 SCOPE OF IFRS:

All International Accounting Standards (IASs) and Interpretations issued by the former IASC (International Accounting Standard Committee) and SIC (Standard Interpretation Committee) continue to be applicable unless and until they are amended or withdrawn. IFRSs apply to the general purpose financial statements and other financial reporting by profit-oriented entities -- those engaged in commercial, industrial, financial, and similar activities, regardless of their legal form. Entities other than profit-oriented business entities may also find IFRSs appropriate.

General purpose financial statements are intended to meet the common needs of shareholders, creditors, employees, and the public at large for information about an entity's financial position, performance, and cash flows. Other financial reporting includes information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions. IFRS apply to individual company and consolidated financial statements. A complete set of financial statements includes a balance sheet, an income statement, a cash flow statement, a statement showing either all changes in equity or changes in equity other than those arising from investments by and distributions to owners, a summary of accounting policies, and explanatory notes.

If an IFRS allows both a 'benchmark' and an 'allowed alternative' treatment, financial statements may be described as conforming to IFRS whichever treatment is followed. In developing Standards, IASB intends not to permit choices in accounting treatment. Further, IASB intends to reconsider the choices in existing IASs with a view to reducing the number of those choices. IFRS will present fundamental principles in bold face type and other guidance in non-bold type (the 'black-letter'/'grey-letter' distinction). Paragraphs of both types have equal authority. The provision of IAS 1 that conformity with IAS requires compliance with every applicable IAS and Interpretation requires compliance with all IFRSs as well.

11.5 LIST OF IFRS:

- IFRS 1: First-time Adoption of International Financial Reporting Standards
- IFRS 2: Share-based Payment
- IFRS 3: Business Combinations
- IFRS 4: Insurance Contracts
- IFRS 5: Non-current Assets Held for Sale and Discontinued Operations
- IFRS 6: Exploration for and Evaluation of Mineral Resources
- IFRS 7: Financial Instruments: Disclosures
- IFRS 8: Operating Segments
- IFRS 9: Financial Instruments

International Accounting Standards (IAS)

IAS relates to standards on various aspects of accounting issues. These are mainly relevant for maintenance of accounts as well as disclosure of Information.

- IAS 1: Presentation of Financial Statements.
- IAS 2: Inventories
- IAS 7: Cash Flow Statements

- IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors
- IAS 10: Events After the Balance Sheet Date
- IAS 11: Construction Contracts
- IAS 12: Income Taxes
- IAS 16: Property, Plant and Equipment (summary)
- IAS 17: Leases
- IAS 18: Revenue
- IAS 19: Employee Benefits
- IAS 20: Accounting for Government Grants and Disclosure of Government Assistance
- IAS 21: The Effects of Changes in Foreign Exchange Rates
- IAS 23: Borrowing Costs
- IAS 24: Related Party Disclosures
- IAS 26: Accounting and Reporting by Retirement Benefit Plans
- IAS 27: Consolidated Financial Statements
- IAS 28: Investments in Associates
- IAS 29: Financial Reporting in Hyperinflationary Economies
- IAS 31: Interests in Joint Ventures
- IAS 32: Financial Instruments: Presentation
- IAS 33: Earnings per Share
- IAS 34: Interim Financial Reporting
- IAS 36: Impairment of Assets
- IAS 37: Provisions, Contingent Liabilities and Contingent Assets
- IAS 38: Intangible Assets
- IAS 39: Financial Instruments: Recognition and Measurement
- IAS 40: Investment Property
- IAS 41: Agriculture

11.6 CHALLENGES OF IFRS

Economic Environment

- Some IFRSs require fair value approach to be followed, examples include:
  - IAS 39, Financial Instruments: Recognition and Measurement
  - IAS 41, Agriculture

- The markets of many economies such as India normally do not have adequate depth and breadth for reliable determination of fair values.
- With a view to provide further guidance on the use of fair value approach, the IASB is developing a document.
- Till date, no viable solution of objective fair value measures is available.

SME concerns
SMEs face problems in implementing IFRSs because of:

- Scarcity of resources and expertise with the SMEs to achieve compliance
- Cost of compliance not commensurate with the expected benefits

Keeping in view the difficulties faced by the SMEs, the IASB is developing an IFRS for SMEs.
Training to Preparers

- Some IFRSs are complex.
- There is lack of adequate skills amongst the preparers and users of Financial Statements to apply IFRSs.
- Proper implementation of such IFRSs requires extensive education of preparers

Interpretation

- A large number of application issues arise while applying IFRSs.
- There is a need to have a forum which may address the application issues in specific cases.

11.7 CONVERGENCE WITH IFRSS: INDIAN PERSPECTIVE

- Indian Accounting Standards (ASs) are formulated on the basis of the IFRSs.
- While formulating ASs, the endeavor of the ICAI remains to converge with the IFRSs.
- The ICAI has till date issued 29 ASs corresponding to IFRSs.
- Some recent ASs, issued by the ICAI, are totally at par with the corresponding IFRSs, e.g., the Standards on ‘Impairment of Assets’ and ‘Construction Contracts’.

- While formulating Indian Accounting Standards, changes from the corresponding IAS/ IFRS are made only in those cases where these are unavoidable considering:
    - o Legal and/ or regulatory framework prevailing in the country.
    - o To reduce or eliminate the alternatives so as to ensure comparability.
    - o State of economic environment in the country
    - o Level of preparedness of various interest groups involved in implementing the accounting standards.

11.8 BENEFITS OF IFRS

The forces of globalization prompt more and more countries to open their doors to foreign investment and as businesses expand across borders the need arises to recognize the benefits of having commonly accepted and understood financial reporting standards. Following are some of the benefits of adopting IFRS -

- Transparency and comparability
- Low cost of capital
- Eliminates need for multiple reporting
- True value of acquisition
- Cross border transaction
- Sets a benchmark
- Improvement in planning and forecasting

11.9 FRAMEWORK FOR THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS:

This Framework sets out the concepts that underlie the preparation and presentation of financial statements for external users. The Framework deals with: The objective of financial statements; the qualitative characteristics that determine the usefulness of information in financial statement; The Definition, recognition and measurement of the elements from which financial statements are constructed; and Concept of capital and capital maintenance. The Objective of Financial statements is to provide useful information to users of financial statements in making economic decision. Financial Statements are prepared to provide information on Financial Position, Operating Performance and changes in financial position of an entity Financial Statements are normally prepared on the assumption that entity is a going concern and will continue in operation for the foreseeable future, and prepared on accrual basis of accounting. The four Qualitative characteristics are Understandability, relevance; reliability and comparability are the attributes that make the financial information useful to users. The elements directly related to the measurement of financial position are assets, liabilities and equity. An item that meets the definition of an element should be recognized if: it is probable that any future economic benefit associated the item will flow to or from the entity. The item has a cost or value that can be measured with reliability. Measurement is the process of determining the monetary amounts at which each element in the financial statements is to be recognized and carried in the Balance Sheet and Income statement. The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured.

11.10 IFRS -1: FIRST TIME ADOPTION OF IFRS

An entity shall prepare and present an opening IFRS statement of financial position at the date of transition to IFRSs. This is the starting point for its accounting under IFRSs. An entity shall prepare an opening IFRS balance sheet at the date of transition to IFRSs. This is the starting point for its accounting under IFRSs. An entity need not present its opening IFRS balance sheet in its first IFRS financial statements. In general, the IFRS requires an entity to comply with each IFRS effective at the end of its first IFRS reporting period. In particular, the IFRS requires an entity to do the following in the opening IFRS statement of financial position that it prepares as a starting point for its accounting under IFRSs: recognize all assets and liabilities whose recognition is required by IFRSs. not to recognize items as assets or liabilities if IFRSs do not permit such recognition; IFRS-1. IFRS-1 reclassify items that it recognized under previous GAAP as one type of asset, liability or component of equity, but are different type of asset, liability or component of equity under IFRSs. Apply IFRSs in measuring all recognized assets and liabilities. The IFRS grants limited exemptions from these requirements in specified areas where the cost of complying with them would be likely to exceed the benefits to users of financial statements. The IFRS also prohibits retrospective application of IFRSs in some areas; particularly where retrospective application would require judgments by management about past conditions after the outcome of a particular transaction is already known. The IFRS requires disclosures that explain how the transition from previous GAAP to IFRSs affected the entities reported financial position, financial performance and cash flows.

OBJECTIVE OF THIS STANDARD: The objective of this IFRS is to specify the financial reporting by an entity when it undertakes a share-based payment transaction. In particular, it requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees.

IFRS -2: SHARE-BASED PAYMENTS

The IFRS requires an entity to recognize share-based payment transactions in its financial statements, including transactions with employees or other parties to be settled in cash, other assets, or equity instruments of the entity. There are no exceptions to the IFRS, other than for transactions to which other Standards apply. This also applies to transfers of equity instruments of the entity's parent, or equity instruments of another entity in the same group as the entity, to parties that have supplied goods or services to the entity. This IFRS sets out measurement principles and specific requirements for three types of share-based payment transactions: equity-settled share-based payment transactions, in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options); (b) cash-settled share-based payment transactions, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity; and (c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash or by issuing equity instruments.

The IFRS also sets out requirements if the terms and conditions of an option or share grant are modified (e.g. an option is reprised) or if a grant is cancelled, repurchased or replaced with another grant of equity instruments. For example, irrespective of any modification, cancellation or settlement of a grant of equity instruments to employees, the IFRS generally requires the entity to recognize, as a minimum, the services received measured at the grant date fair value of the equity instruments granted. For cash-settled share-based payment transactions, the IFRS requires an entity to measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity is required to re measure the fair value of the liability at each reporting date and at the date of settlement, with any changes in value recognized in profit or loss for the period.

IFRS -3: BUSINESS COMBINATIONS:

The objective of the IFRS is to enhance the relevance, reliability and comparability of the information that an entity provides in its financial statements about a business combination and its effects. It does that by establishing principles and requirements for how an acquirer:

(a) Recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire;

(b) Recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase.

(c) Determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

Points: Core principle an acquirer of a business recognizes the assets acquired and liabilities assumed at their acquisition-date fair values and discloses information that enables users to evaluate the nature and financial effects of the acquisition. Applying the acquisition method a business combination must be accounted for by applying the acquisition method, unless it is a combination involving entities or businesses under common control. One of the parties to a business combination can always be identified as the acquirer, being the entity that obtains control of the other business (the acquiree). Formations of a joint venture or the acquisition of an asset or a group of assets that does not constitute a business are not business combinations.

IFRS -4: INSURANCE CONTRACTS:

The objective of this IFRS is to specify the financial reporting for insurance contracts by any entity that issues such contracts (described in this IFRS as an insurer) until the Board completes the second phase of its project on insurance contracts. In particular, this IFRS requires: limited improvements to accounting by insurers for insurance contracts. disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.

IFRS -5: NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS:

The objective of this IFRS is to specify the accounting for assets held for sale, and the presentation and disclosure of discontinued operations. In particular, the IFRS requires: assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease; and assets that meet the criteria to be classified as held for sale to be presented separately in the statement of financial position and the results of discontinued operations to be presented separately in the statement of comprehensive income.

IFRS-6: EXPLORATION FOR AND EVALUATION OF MINERALS:

The objective of this IFRS is to specify the financial reporting for the exploration for and evaluation of mineral resources. POINTS: Exploration and evaluation expenditures are expenditures incurred by an entity in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting a mineral resource are demonstrable. Exploration for and evaluation of mineral resources is the search for mineral resources, including minerals, oil, natural gas and similar non-regenerative resources after the entity has obtained legal rights to explore in a specific area, as well as the determination of the technical feasibility and commercial viability of extracting the mineral resource. Exploration and evaluation assets are exploration and evaluation expenditures recognized as assets in accordance with the entity's accounting policy.

FRS-7: FINANCIAL INSTRUMENTS DISCLOSURE:

The objective of this IFRS is to require entities to provide disclosures in their financial statements that enable users to evaluate: the significance of financial instruments for the entity's financial position and performance; and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks. The qualitative disclosures describe management's objectives, policies and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Together, these disclosures provide an overview of the entity's use of financial instruments and the exposures to risks they create.

IFRS-8: OPERATING SEGMENTS:
This IFRS shall apply to:

(a) The separate or individual financial statements of an entity: whose debt or equity instruments are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market.

(b) The consolidated financial statements of a group with a parent: whose debt or equity instruments are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or that files, or is in the process of filing, the consolidated financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market. IFRS-8

IFRS - Indian Context

Convergence with IFRS has gained momentum in recent years all over the World.

India is committed to adopt IFRS from 2011.

United States of America has announced its intention to adopt IFRS from 2014 and it also permits foreign private filers in the U.S. Stock Exchanges to file IFRS compiled Financial Statement, without requiring the presentation of reconciliation statement.

In this scenario of globalization, India cannot insulate itself from the developments taking place worldwide. In India, so far as the ICAI is concerned, its aim has always been to comply with the IFRS to the extent possible with the objective to formulate sound financial reporting standards. The ICAI, being a member of the International Federation of Accountants (IFAC), considers the IFRS and tries to integrate them, to the extent possible, in the light of the laws, customs, practices and business environment prevailing in India. The Preface to the Statements of Accounting Standards, issued by the ICAI, categorically recognizes the same. Now, as the world globalizes, it has become imperative for India also to make a formal strategy for convergence with IFRS with the objective to harmonize with globally accepted accounting standards.

In the present era of globalization and liberalization, the World has become an economic village. The globalization of the business world and the attendant structures and the regulations, which support it, as well as the development of e-commerce make it imperative to have a single globally accepted financial reporting system. A number of multinational companies are establishing their businesses in various countries with emerging economies and vice versa.

The entities in emerging economies are increasingly accessing the global markets to fulfill their capital needs by getting their securities listed on the stock exchanges outside their country. Capital markets are, thus, becoming integrated consistent with this World-wide trend. The use of different accounting frameworks in different countries, which require inconsistent treatment and presentation of the same underlying economic transactions, creates confusion for users of financial statements. This confusion leads to inefficiency in capital markets across the world. Therefore, increasing complexity of business transactions and globalization of capital markets call for a single set of high quality accounting standards. High standards of financial reporting underpin the trust investors place in financial and non-financial information. Thus, the case for a single set of globally accepted accounting standards has prompted many countries to pursue convergence of national accounting standards with IFRS.

The paradigm shift in the economic environment in India during last few years has led to increasing attention being devoted to accounting standards as a means towards ensuring potent and transparent financial reporting by any corporate.

ICAI, being a premier accounting body in the country, took upon itself the leadership role by establishing ASB, more than twenty five years back, to fall in line with the international and national expectations. Today, accounting standards issued by the Institute have come a long way.

The ICAI as the accounting standard - setting body in the country has always made efforts to formulate high quality Accounting Standards and has been successful in doing so. Indian Accounting Standards have withstood the test of time. As the world continues to globalize, discussion on convergence of national accounting standards with International Financial Reporting Standards (IFRS) has increased significantly.

At present, the ASB of ICAI formulates the AS based on IFRS. However, these standards remain sensitive to local conditions, including the legal and economic environment. Accordingly, AS issued by ICAI depart from corresponding IFRS in order to ensure consistency with legal, regulatory and economic environment of India.

Formation of IFRS Task Force by the Council of ICAI Recommendation of the IFRS Task Force submitted to the Council Full adoption of IFRS from accounting period commencing on or after 1 April 2011 Proposed to be applicable to listed entities and public interest entities such as banks, insurance companies and large sized entities Involvement of various regulators (MCA, RBI, IRDA, Tax authorities and SEBI)

Draft Schedule VI and Accounting Standard 1 (Exposure Draft) consistent with IFRSs Convergence Strategy presented by Technical Directorate of ICAI on 02.02.2009:

– ICAI has begun the process of issuing IFRS equivalent AS with following proposed changes:

1. Removal of alternative treatments
2. Additional disclosures, where required
3. AS number will continue but IFRS number will be given in parenthesis
4. IFRICs will be issued as appendices

– ICAI has constituted a Group in liaison with government & regulatory authorities and this group has constituted separate core groups to identify inconsistencies between IFRS and various relevant acts.

An entity:

i Whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India; or

ii Which is a bank (including a cooperative bank), financial institution, a mutual fund, or an insurance entity; or

iii Whose turnover (excluding other income) exceeds rupees one hundred crores in the immediately preceding accounting year; or

iv Which has public deposits and/or borrowings from banks and financial institutions in excess of rupees twenty five crores at any time during the immediately preceding accounting year; or

v Which is a holding or a subsidiary of an entity which is covered in (i) to (iv) above
Transition to IFRS – Things to remember

First year of reporting:
Accounting period commencing on or after 1 April 2011 (Normally 1 April 2011 – 31 March 2012)

Date of adoption:
The first day of the first reporting financial year (1 April 2011)

Date of reporting:
The last day of the first reporting financial year (31 March 2012)

Comparative year:
Immediately preceding previous year (1 April 2010 – 31 March 2011)

Date of transition:
The beginning of the earliest period for which an entity presents full comparative information (1 April 2010)

First time adoption of IFRS on the date of reporting envisages-

1. Restatement of opening balances as at 1 April 2010
2. Presentation of comparative financial statements for the year 2010-11
3. Preparation and presentation of financial statements for the first year of reporting 2011-12
4. Explicit and unreserved statement of compliance with IFRS

All the above statements (as stated in 1 to 3 above) have to be drawn as per the IFRS in force on the date of reporting.

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Advanced Financial Accountancy
Paper I
April 2011

[Total Marks : 100]

N.B. 1) Question Nos. 1 and 2 are compulsory.

2) Attempt any three questions from the question nos. 3 to 7.

3) Figures to the right indicate full marks.

4) Give working notes and state clearly the assumptions made by you wherever necessary.

5) The students who have taken admission in College and registered in the academic year 2010-11 shall write Revised Course while all other students including IDOL students shall write Old Course.

1. The following Balance Sheets are given of the two companies, as on 31st March 2010. (20)

Liabilities	BIG Limited (Rs.)	SMALL Limited (Rs.)	Assets	BIG Limited (Rs.)	SMALL Limited (Rs.)
Paid up Share Capital –			Fixed Assets – Building		
Equity shares of Rs. 100 each	2,40,000	1,20,000	Machinery	1,30,000	88,000
			Furniture	78,000	
			Investments	12,000	28,000
				1,00,000	7,000
Reserves and Surplus –			Current Assets		
			Stock	24,000	38,000
General Reserve	90,000	20,000	Debtors	76,000	52,000
Profit and Loss account	34,000	48,000	Bills Receivables	14,000	8,000
			Bank Balance	3,000	2,000
Current Liabilities -					
Creditors for goods	30,000	15,000			
Bills payable	33,000	14,000			
Outstanding Expenses	10,000	6,000			
	4,37,000	2,23,000		4,37,000	2,23,000

The additional information is available :

a) Big limited aquired 9,000 shares of Rs. 10 each in Small Limited on 1st April, 2009.

b) Debtors of Big Limited include due from Small Limited Rs. 5,000.

c) Bills receivable of Small Limited include Rs. 3,000 due from Big Limited.

d) Stock of Small Limited includes stock purchased from Big Limited for Rs. 4,000 which includes profit charged by Big Limited @ 25% on cost.

e) The position of Reserves and Surplus of Small Limited on 31st March 2009 was :

General Reserve	Rs. 15,000
Profit and Loss account	Rs. 30,000

You are required to prepare the Consolidated Balance Sheet as on 31st March 2010.

2. a) Choose the most appropriate alternative from those below and rewrite the sentence : (12)

1) The preparation of the consolidated financial statements as per AS 21 is
   - a) Compulsory b) Machinery
   - c) Not mandatory d) None of the above

2) Goodwill is ------------------ asset.
   - a) Not ficticious but intangible
   - b) ficticious and intangible
   - c) ficticious and tangible
   - d) tangible and fixed

3) Inter-office-adjustments (net) will appear in the balance sheet of a bank under
   - a) other liabilities only
   - b) either other liabilities or other assets
   - c) other assets only
   - d) both other assets and other liabilities as contra

4) Credit balance in overdrafts are shown by the bank under
   - a) borrowings b) demend deposits
   - c) other liabilities d) balances with the bank

5) The provisions regarding the audit of a co-operative society under Maharashtra state co-operative societies act are contained in
   - a) Section 79 b) Section 32
   - c) Section 81 d) Section 70

6) Deadstock items are shown in the balance sheet of a co-operative society
   - a) under fixed assets b) under current assets
   - c) separately d) miscellaneous expenditure

7) The narrative disclosures which are contained in the published company accounts cover
   a) only qualitative information
   b) only quantitative information
   c) both qualitative and quantitative information
   d) either qualitative or quantitative information but not both

8) Following is an example of accounting policy
   a) entity b) consistency
   c) going concern d) stock valuation

9) The following factor should be considered while selecting and adopting accounting policies
   a) consistency b) prudence
   c) dual concept d) cost

10) According to AS 1 disclosure of accounting policy should be part of
   a) final accounts b) auditor's report
   c) director's report d) books of accounts

11) Total no. of IFRS are
   a) 41 b) 9 c) 19 d) 33

12) Segment Reporting is covered in
   a) AS 17 b) AS16 c) AS21 d) AS22

2. b) Match the following (8)

No. of accounting standards	Holding company
Consolidated Financial statements	Contingent Liability
Bank Guarantee	31
Partly paid up shares as investments	Audit Report
CARO	Goodwill
Education Fund	Other assets
Future Maintainable Profit	Fixed Assets
Non-Banking Assets	Co-operative Society
	41
	Other liability
	Banking Company

3. The following Trial Balance of Mahanagar Bank Ltd. as on 31st March, 2011.

Particulars	Dr (Rs.) in lacs	Cr. (Rs.) in lacs
Share Capital		3,000
General Reserve		4,000
Fixed Deposits		2,780
Saving Deposits		4,200
Current Accounts		3,740
Cash in Hand	290	
Cash with RBI	420	
Interest and Discount		3,000
Commission and Brokerage		500
Interest on Fixed Deposits	300	
Interest on Saving Deposits	200	
Interest on Other Deposits	100	
Salaries and Allowance	1,010	
Rent and Taxes	40	
Postage and Telephone	90	
Printing and Stationery	700	
Audit Fees	40	
Depreciation	330	
Investment in Shares	840	
Loans and Advance	9,500	
Overdrafts	1,400	
Bill Discounted and Purchased	1,800	
Government Bonds	1,600	
Furniture	400	
Premises	300	
Branch Adjustment	1,835	
Repairs	25	
	21,220	21,220

Additional Information :

a) Rebate on bills discounted is Rs. 270 lacs.
b) Provide for NPA Rs. 110 lacs.
c) Acceptances on behalf of customers Rs. 800 lacs.

You are required to prepare profit and loss account for the year ended 31st March 2011 and Balance Sheet as on that date.

4. Hindustani (India) Limited has a branch in New Jercy, America. Its Trial Balance as on 31st March 2010 is as below :

(20)

	Debit US $	**Credit US $**
Machinery	2,40,000	
Furniture	16,000	
Stock (opening)	1,12,000	
Purchases	4,80,000	
Sales		8,32,000
Goods received from India	1,60,000	
Wages	4,000	
Carriage Inwards	2,000	
Salaries	12,000	
Rent and Taxes	4,000	
Insurance	2,000	
General Expenses	2,000	
Head Office account		2,28,000
Sundry Debtors	48,000	
Sundry creditors		40,000
Bank Balance	10,000	
Cash Balance	2,000	
Printing and Stationery	1,500	
Telephone Expenses	4,500	
	11,00,000	11,00,000

The additional Information available is as below :

a) Wages outstanding are $ 2,000.
b) Provide depreciation @ 10 on Machinery and Furniture
c) The goods sent to branch were Rs. 78,40,000

d) Branch account in the books of Head office shows debit balance of Rs. 86 lac.

e) Closing stock in the branch was $ 1,04,000.

f) The rates of exchange were :

On 1st April 2009 $ 1 = Rs. 39.

On 31st March 2010 $ 1 = Rs. 41

Average rate was $ 1 = Rs. 40.

The Fixed assets were purchased when the rate was $ 1 = Rs. 38.

g) There were no items in transit at the end of the year.

You are required to prepare the Trial Balance as on 31st March 2010 in Indian Rupees. Prepare Trading and Profit and Loss account for the year ending 31st March 2010 and the Balance Sheet as on the same date, taking into account requirements of AS 11.

5. On 31st March 2010 the Balance Sheet of Ganga Ltd. was as follows : (20)

Liabilities	Rs.	Assets	Rs.
Share Capital		Land and Buildings	6,00,000
Authorized 40,000 equity Shares of Rs. 100 each	40,00,000	Plant and Machinery	3,45,000
Issued and paid up 30,000 equity shares of Rs. 100 each 30,00,000		Stock	9,00,000
Less : Calls in arrears At Rs. 20 each 4,000		Sundry Debtors	18,15,000
Profit and Loss Account		Cash	40,000
Bank Overdraft		Bank	2,60,000
Creditors			
Provision for Taxation			
Proposed Dividend			
Total	39,60,000	Total	39,60,000

The Net profits of the company after providing for tax were as follows :

Year Ended	
31st March, 2010	3,45,000
31st March, 2009	3,00,000
31st March, 2008	3,75,000
31st March, 2007	3,60,000
31st March, 2006	2,70,000

On 31st March, 2010 Land and Building were valued at Rs. 7,50,000 and Plant and Machinery were valued at Rs. 4,50,000. Normal rate of Return can be considered at 8%. Goodwill is to be valued at 3 years purchase of super profits based on average profit of last 5 years.

Find the intrinsic value of fully paid and partly paid equity shares.

6. Following is the Trial Balance of Aamchi Patpedhi Co-operative Credit Society Limited as on 31st March 2010 : (20)

Particulars	Debit (Rs.)	Particulars	Credit (Rs.)
Telephone Expenses	4,000	Interest on Bank Deposits	15,000
Postage expenses	1,000	Share Capital	15,00,000
Legal fees	5,000	Reserve Fund	1,00,000
Cash on hand	1,400	Members Deposits	44,95,500
Bank Balance	38,000	Unpaid Dividend	4,200
Fixed Deposit with Dombivli Nagari Sahakari Bank Limited	3,00,000	Dividend Equalisation Reserve	36,000
Office Furniture	19,000	Staff Provident Fund	40,000
Interest on deposits	1,60,000	Profit and Loss Appropriation Account	62,000
Interest due on loans given	16,000	Interest on loans received	3,56,000
Salary and Allowances	60,000	Renewal Fees	8,000
Establishment expenses	10,000	Sundry Income	600
Printing and Stationary	800	Co-Operative Development Fund	4,100
Conveyance and Travelling	1,200	Education Fund	1,000
Insurance Premium	2,000		
Contribution to Provident Fund	4,000		
Loans due from members	60,00,000		
	66,22,400		66,22,400

Additional Information is as below :

a) Interest due to members on deposits is Rs. 10,000.
b) Interest due on members loans is Rs. 4,000.
c) Addition to furniture made during the year is Rs. 2,000. Provide depreciation @ 10% on closing balance of Furniture
d) Salary outstanding is Rs. 600 and paid in advance is Rs. 1,000.
e) Audit fees payable for the year is Rs. 6,000.
f) Authorised share capital is 2 lac shares of Rs. 10 each.
g) The following appropriations are made out of the profits :
   i) Proposed Dividend @ 5%
   ii) Contribution to Dividend Equalisation reserve is 4000.
   iii) Transfer to Building Fund Rs. 20,000.
   iv) Transfer to Co-operative development fund 5% of current year's net profit.
   v) Transfer to reserve Fund 25% of current year's net profit.

You are required to prepare Profit and Loss account for the year ending 31st March 2010 and Balance sheet as on that date in the form 'N'.

7. a) Following Information is available from the books of Sinkavoiders Insurance Company Limited for the year ending 31.3.2010. (12)

Particulars	Direct business (Rs.)	Reinsurance Rs.)
(I) Premium		
Received	24,00,000	3,60,000
Receivable (1.4.2009)	1,20,000	21,000
Receivable (31.3.2010)	1,80,000	28,000
Paid	2,40,000	0
Payable (1.4.2009)	0	20,000
Payable (31.3.2010)	0	42,000
(II) Claims		
Paid	16,50,000	1,25,000
Payable (1.4.2009)	95,000	13,000
Payable (31.3.2010)	1,75,000	22,000
Received	0	1,00,000
Receivable (1.4.2009)	0	9,000
Receivable (31.3.2010)	0	12,000
(III) Commission		
On Re-Insurance accepted	1,50,000	11,000
On Re-Insurance ceded		14,000

Other expenses and Incomes

Particulars	Rs.	Particulars	Rs.
Salaries	2,60,000	Interest Dividend Rent received (net)	1,15,000
Rent and taxes	18,000	Income tax deducted at source	24,500
Printing and Stationary	23,000	Legal expenses (including those in) Connection with settlement of claims Rs. 20,000)	60,000
Income tax	2,40,000	Profit on sale of motor car	5,000
Bad debts	5,000		
Double income tax refund	12,000		

Balance of fund on 1.4.2009 was Rs. 26,50,000 including additional reserve Rs. 3,25,000.
Additional premium should be maintained at 5% of net premium of the year.
Prepare Revenue account for the company for the year ending 31.3.2010.

b) Solve the following :

i) Calculate basic EPS from the following as per AS 20 (4)

Equity share capital as on 1.4.2009 was 5000 shares of Rs. 10 each

Issue of right shares at par for cash on 1.7.2009-1 share for every 5 shares.

Issue of bonus shares, (excluding right issue) on 1.10.2009 in the ratio of 1 share for every 5 shares held.
Net profit (before tax) Rs. 40,000.

ii) Average capital employed is Rs. 4,02,500. Normal rate return is 12% (2)

Net Profit (before tax) for the last 3 years Rs. 1,25,000, Rs. 1,55,000, Rs. 1,52,000

Rate of Income tax is 50%

Compute goodwill by capitalization of FMP method.

iii)

Date of bill	Amount of bill (Rs.)	Period Months	Rate of discount %
24.2.2010	15,000	2	12
28.2.2010	25,000	3	12.5
15.2.2010	12,500	1	12

(2)

Calculate rebate on bills discounted as on 31.3.2010

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REVISED SYLLABUS OF

M.COM. PART – I
(ACCOUNTANCY)
(w.e.f. academic year 2010-11)
Paper 1 – Advanced Financial Accounting

Sr. No.	Topics
1.	I- Consolidated Financial Statements
	a) Accounting Standard 21 b) Consolidated Balance Sheet c) Consolidated Profit & Loss Account d) Simple Subsidiary Company Only e) Excluding Inter Company Holding of Shares f) Foreign Subsidiary Company
2.	II- Accounting & Statutory Requirements of
	a) Banking Companies • Accounting Provision of Banking Regulation Act • Provisioning of Non-Performing Assets • Form & Requirements of Final Account b) Insurance Companies • Accounting Provision for Insurance Act and Insurance Regulations & Development Authorities for 1) Life Insurance business 2) General Insurance business • Forms & Requirements of Final Accounts for 1) Life Insurance Business 2) General Insurance business. c) Co-operative Societies • Accounting Provision of Maharashtra State Co-operative Societies Act and Rules • Forms & Requirements of Final Accounts
3.	III – Foreign Currency Conversion a) Requirements as per AS – 11 b) Foreign Branches

4.	IV – Published Corporate Annual Reports a) Contents of Annual Reports b) Notes of Accounts c) Director's Reports d) Auditor's Reports e) Management Discussion Analysis
5.	V – Accounting Standards a) AS – 16 Borrowing Costs b) AS – 17 Segment Reporting c) AS – 20 Earnings per share d) AS – 22 Accounting for taxes on income
6.	VI – Valuations for Amalgamation, Merger a) Methods of Goodwill b) Methods of Shares c) Methods of Business
7.	VII – International Financial Reporting Standards (IFRS) a) I. F. R. S.

PATTERN OF QUESTION PAPER

Maximum Marks 100		**Duration 3 Hours**
No. of question to be asked		7
No. of questions to be answered		5
Question No. 01 Compulsory	Practical question	20 Marks
Question No. 02 Compulsory	Objective	16 Marks
Question No. 03 to Question No. 07		16 Marks each

Notes :

1) From Question No. 03 to Question No. 07 not more than one question may be theory including short problems / questions.
2) Student to all the Question out of Question No. 03 to Question No. 07
3) Objective questions to be based on all topics and include Inter alia questions like :

   a) Multiple choice b) Answer in one sentence

Reference Books

Accountancy

- ⇨ Introduction to Accountancy by T. S. Grewal
- ⇨ Advance Accounts by Shukla & Grewal
- ⇨ Advance Accountancy by R. I. Gupta and M. Radhaswamy
- ⇨ Modern Accountancy by Mukherjee and Hanif
- ⇨ Financial Accounting by Lesile Chandwichk
- ⇨ Financial Accounting for Management by Dr. Dinesh Harsalekar
- ⇨ Financial Accounting by P. C. Tulsian
- ⇨ Accounting Principles by Anthony, R. N. and Reece J. S.
- ⇨ Financial Accounting by Gupta and Radhaswamy M
- ⇨ Financial Accounting by Monga, J. R. Ahuja, Girish and Shehgai Ashok

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M.Com.
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Accountancy Paper -I
Advanced Financial Accounting

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