Practice Manual

INTEGRATED
PROFESSIONAL
COMPETENCE COURSE

ADVANCED ACCOUNTING

Vol. II

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

PAPER 5

ADVANCED ACCOUNTING

VOLUME – II

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge and skills in the subject. Students should also supplement their study by reference to the recommended text books. In case students need any clarifications or have any suggestions to make for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the study material has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

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FOREWORD

The Institute of Chartered Accountants of India, the second largest professional accountancy body in the world, occupies a pivotal position in the Indian economy. As compared to other leading professional accountancy bodies in the world, the Institute enjoys a unique position since it is endowed with the authority not only to conduct examinations and grant license to qualified members but it also imparts theoretical education through diverse methods such as provision of study material, conducting revisionary classes, etc. In fact, the Institute is a pioneer in imparting the education to students through distance education mode since its inception in 1949. Keeping in view the fact that the students of chartered accountancy course are dispersed geographically in the entire world, it is imminent that the Institute must make all efforts to retain its primacy in this particular area.

While all out efforts are being made to leverage the technology for the benefit of students through e-learning, Shiksha Portal, etc. by the Institute, it must continue to serve students through comprehensive study material with the aim to inculcate the self-learning experience. In this direction, I am happy to note that the study material has been thoroughly revised and made user friendly by improving presentation, emphasis on significant issues, illustrations explaining the concept step by step, etc. The inclusion of practical case studies intends to make it more application-oriented and aims to enhance the knowledge of students in the practical environment. A separate Practice Manual shall also enable the students to practice the subject on their own. It is hoped that the revised study material would prove to be very useful for students and their reliance on other external sources shall go down considerably. I am confident that the provision of such education literature shall enable our potential chartered accountants to compete with the best in the world.

January, 2010
Mumbai

CA. Uttam Prakash Agarwal
President

PREFACE

With the fast changing business dynamics, fierce competition, globalization, complicated laws and transactions, there is tremendous pressure on the Chartered Accountancy students to acquire knowledge not only to clear examinations but also to build strong foundation for future endeavours. To strengthen knowledge of students and further build confidence for examination, the Board of Studies has developed the new study material. The new study material is comprehensive enough so that the students dispersed not only within the country but in other parts of the world as well can learn, understand and assimilate the subject through self-learning process. With this avid objective, the study material has been divided in two volumes namely Volume I dealing with the conceptual theoretical framework in detail and Volume II comprising of practice manual.

Volume I of the study material provides the basic concepts, theories and techniques relating to Advanced Accounting and aims to develop the students' ability in understanding the different concepts and their application in the real life situations.

The entire study material has been written in a simple language. A number of self-examination questions are given at the end of each chapter for practice by students. There are also a number of illustrations in each chapter to help students to have a better grasp of the subject. Certain special features have been added in the study material like charts, diagrams, and learning objectives to help the students in understanding the concepts in a simple manner. The significant changes that have taken place in the area of finance have also been incorporated.

Volume II of the study material comprises the Practice Manual. It aims to provide guidance to the students in writing an answer in the examination. Basic concepts in the form of definitions, equations and formulae have been given before each chapter for a quick review. Students are expected to attempt the questions and then compare it with the actual answers. Exercises have also been given at the end of each topic for independent practice. It also contains a matrix showing the analysis of the past examinations. This matrix will help the students in getting an idea about the trend of questions being asked and relative weightage of each topic in the past examinations. The revised study material also contains tips for students to prepare for the examinations.

We acknowledge the contributions made by CA. Parveen Kumar of M/s ASA & Associates, Delhi and his team including CA. Prateet Mittal, CA. Akriti Gomber and CA. Babita Rana towards the improvement of the study material.

The concerned faculty members of Board of Studies Ms. Seema Gupta and Ms. Shilpa Agrawal have put in their best efforts in making this study material lucid and student-friendly.

30th January, 2010 — **CA. Jaydeep Narendra Shah**

New Delhi — Chairman, Board of Studies

A WORD ABOUT STUDY MATERIAL

The study material has been divided into two parts, namely, Volume I dealing with conceptual theoretical framework; and Volume II comprising of practice manual. The Study Material has been designed having regard to the needs of home study and distance learning students in mind. The students are expected to cover the entire syllabus and also do practice on their own while going through the practice manual.

Volume I of the study material deals with the conceptual theoretical framework in detail. The main features of Volume I are as under:

- The entire syllabus has been divided into nine chapters.
- In each chapter, learning objectives have been stated. The learning objectives would enable you to understand the sequence of various aspects dealt within the chapter before going into the details so that you know the direction of your studies.
- In each chapter, the topic has been covered in a step by step approach. The text has been explained, where appropriate, through illustrations and practical problems. You should go through the chapter carefully ensuring that you understand the topic and then can tackle the exercises.
- A question bank has been included after each chapter in Volume I as well as many questions for practice in Volume II.

Volume II of the Study Material comprises the Practice Manual. It aims to provide guidance as to the manner of writing an answer in the examination. Main features of Volume II are as under:

- Important Definition, equation and formulae have been given before each topic for quick recapitulation. Students are expected to attempt the questions and then compare it with the actual answers.
- Compilation of questions appearing during last twenty examinations.
- Exercises have been given at the end of each topic for independent practice.

STUDY TIPS AND EXAMINATION TECHNIQUE

The aim of this section is to provide general guidance as to how to study for your exams. The guidance given herein is supplementary to the manner of study followed by you and is intended to improve your existing technique, but aims to give ideas on how to improve your existing study techniques, as it is essential that you adopt methods and techniques with which you feel comfortable.

Passing exams is partly a matter of intellectual ability, but however accomplished you are in that respect you can improve your chances significantly by the use of appropriate study and revision techniques. In this section we briefly outline some tips for effective study during the earlier stages.

Know your Syllabus

- Go through the syllabus carefully.
- Volume I has been divided in nine chapters/topics based on syllabus.
- Main topics are as under:

Ch. No.		Topics
1		Conceptual framework for presentation and preparation of financial statements
2		Problems based on Accounting Standards
3		Advanced issues in Partnership Accounts
	Unit 1	Dissolution of firms
	Unit 2	Amalgamation, conversion and sale of partnership firm
4		Company Accounts
	Unit 1	ESOPs
	Unit 2	Underwriting of shares and debentures
	Unit 3	Redemption of Debentures
	Unit 4	Amalgamation and Reconstruction
5		Financial Statements of Insurance companies
6		Financial Statements of Banking Companies

7	Financial Statements of Electricity Supply Companies
8	Departmental Accounts
9	Accounting for Branches including Foreign Branch Accounts

- Understand the linkages between chapters at macro-level.

Plan your Study

- Make a study plan covering the entire syllabus and then decide how much time you can allocate to the subject on daily/weekly basis.
- Allocation of time must be done keeping in view your office commitments as well as social needs and personal hobbies.
- Maintain the time balance amongst various subjects such as purely descriptive type and numerical-based papers. Allocate time in such a manner that your interest is well sustained and you are able to score well in the final examination as well.
- Always assess your preparation periodically, say, on monthly basis. If necessary, revise your plan and allocate more time for the subject in which you feel deficient.

Preparing Study Strategy

- Read, understand and assimilate each chapter.
- First of all, have an overview of the chapter to understand the broad contents and sequence of various sub-topics.
- Do the introspection while going through the chapter and ask various questions to yourself.
- Read each chapter slowly to ensure that you understand and assimilate the main concept. If need be, read once again with concentration and then try to attempt exercise at the end of the chapter or given in the Practice Manual.
- Recapitulate the main concept after going through each chapter by way of brief notes.
- Prepare notes in the manner you feel comfortable covering all key points. Use mnemonic form e.g. C V P denoting cost, valuation and price.
- One may use highlighter/underlining the significant points or writing down in the margin.
- The fact that how well you have understood the topic is your ability to attempt the questions given in the exercises as well as in the practice manual. Make a serious attempt at producing your own answers but at this stage do not be much concern

about attempting the questions in examination based conditions. In particular, at initial stages, it is more important to understand and absorb the material thoroughly rather than to observe the time limits that would apply in the actual examination conditions.

- Always try to attempt the past year examination question paper under examination conditions.
- Revision of material should never be selective in any case. Because broad coverage of the syllabus is more important than preparing 2-3 chapters exhaustively.
- Read through the text along with notes carefully. Try to remember the definition and important formulae.

Examination Technique

- Reach examination hall well in time.
- Plan your time so that equal time is awarded for each mark. Keep sometime for revision as well.
- Always attempt to do all questions. Remember that six average answers fetch more marks than five best answers. Therefore, it is important that you must finish each question within allocated time.
- Read the question carefully more than once before starting the answer to understand very clearly as to what is required by the paper-setter.
- Always be concise and write to the point and do not try to fill pages unnecessarily.
- In case a question is not clear, you may state your assumptions and then answer the question.
- While writing answers in respect of essay-type questions, try to make sub-readings so that it catches the examiner's eye. In case of case-study, be very precise and write your conclusion in a clear manner.
- Reference to standards, guidance notes, section of various legislation, etc be done in a clear-cut manner.
- Revise your answers carefully underline important points before leaving the examination hall.

Best of Reading and Luck !

Group II Paper 5 : Advanced Accounting

Matrix :Chapter-wise Categorization of Past 20 Examination Questions

Ch. No.	Topics	Month of Examination																			
		May 1999	Nov. 1999	May 2000	Nov. 2000	May, 2001	Nov. 2001	May 2002	Nov. 2002	May 2003	Nov. 2003	May 2004	Nov. 2004	May 2005	Nov. 2005	May 2006	Nov. 2006	May 2007	Nov. 2007	May 2008	Nov. 2008
1	Conceptual framework for presentation and preparation of financial statements																	1(4)-PCC		2 (2)-PCC	1(4)-PCC
2	Accounting Standards							1 (4)	2 (12)	3 (8)	4 (4)		5 (8)	6 (12)	7 (12)	8 (4)	9(8)			10 (4)	11 (4)
3	Advanced issues in Partnership Accounts																				
Unit 1	Dissolution of partnership firms		1 (10)								2 (16)										3 (8)
Unit 2	Amalgamation, conversion and sale of partnership firm																				1 (8)
4	Company Accounts																				
Unit 1							1 (4) 2 (4)														
Unit 2	Underwriting of shares and debentures		1 (5)			1 (16)						2 (4)			2 (16)						3 (8)
Unit 3	Redemption of Debentures			1(5)																	2 (8)
Unit 4	Amalgamation and Reconstruction				1 (20)			2 (20)			3 (16)	4 (16)		5 (16)	6 (20)						
5	Financial Statements of Insurance companies		3 (5),1(6)	4 (5)	2 (5), 2(12)				3 (16)				1(5)			4 (4)				5 (6)	6 (8)
6	Financial Statements of Banking Companies		1 (4)	3 (5) 2(5)	2 (5) 4(5)	1(5)	5 (4)	3(6)			4 (6)	5 (6)	6 (4)	7 (16)		8 (12)	9 (8)	10 (6)		11 (10)	12 (8)

Ch. No.	Topics	Month of Examination																			
7	Financial Statements of Electricity Supply Companies	1 (5)	1 (8)	2 (5)	3 (5)								2(6)					3 (10)	4 (16)		
8	Departmental Accounts						1 (8)						2 (10)								
9	Accounting for Branches including Foreign Branch Accounts	1 (10)	2 (16)			3 (16)		4 (16)		5 (8)			6 (6)			8 (16)	7 (16)	9 (16)		10 (16)	

CONTENTS

CHAPTER 1

CONCEPTUAL FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

BASIC CONCEPTS

The International Accounting Standards Committee (IASC) issued a Conceptual Framework to serve as a basis for the accounting standards. The Accounting Standards Board of the ICAI has issued a similar framework for the same purpose in July 2000. This framework provides the fundamental basis for development of new standards as also for review of existing standards. The framework sets out the concepts underlying the preparation and presentation of general-purpose financial statements prepared by enterprises for external users.

➢ **Capital Maintenance**

- **Financial capital maintenance at historical cost –** opening and closing assets are stated at respective historical costs to ascertain opening and closing equity.
- **Financial capital maintenance at current purchasing power –** Opening and closing equity at historical costs are restated at closing prices using average price indices
- **Physical capital maintenance at current costs –** The historical costs of opening and closing assets are restated at closing prices using specific price indices

Question 1

What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein?

Answer

The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. The framework suggests that the financial statements should observe and maintain the following four qualitative characteristics as far as possible within limits of reasonable cost/ benefit.

1. *Understandability*: The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities. It is not right to think that more disclosures are always better. A mass of irrelevant information creates confusion and can be even more harmful than non-disclosure. No relevant information can be however withheld on the grounds of complexity.
2. *Relevance*: The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is said to be relevant. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations. The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its omission or misstatement can influence economic decisions of a user.
3. *Reliability*: To be useful, the information must be reliable; that is to say, they must be free from material error and bias. The information provided are not likely to be reliable unless:
   (a) Transactions and events reported are faithfully represented.
   (b) Transactions and events are reported in terms of their substance and economic reality not merely on the basis of their legal form. This principle is called the principle of 'substance over form'.
   (c) The reporting of transactions and events are neutral, i.e. free from bias.
   (d) Prudence is exercised in reporting uncertain outcome of transactions or events.
4. *Comparability*: Comparison of financial statements is one of the most frequently used and most effective tools of financial analysis. The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.
5. *True and Fair View*: Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The conceptual framework does not deal directly with this concept of true and fair view, yet the application of the

principal qualitative characteristics and of appropriate accounting standards normally results in financial statements portraying true and fair view of information about an enterprise.

Question 2

When can a company change its accounting policy?

Answer

A change in accounting policy should be made in the following conditions:

(i) If the change is required by some statute or for compliance with an Accounting Standard.

(ii) Change would result in more appropriate presentation of the financial statement.

Change in accounting policy may have a material effect on the items of financial statements. For example, if depreciation method is changed from straight-line method to written-down value method, or if cost formula used for inventory valuation is changed from weighted average to FIFO, or if interest is capitalized which was earlier not in practice, or if proportionate amount of interest is changed to inventory which was earlier not the practice, all these may increase or decrease the net profit. Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts. Therefore, it is necessary to quantify the effect of change on financial statement items like assets, liabilities, profit / loss.

Question 3

What is meant by accounting estimate? Give two examples for accounting estimate.

Answer

As a result of the uncertainties in business activities, many financial statement items cannot be measured with precision but can only be estimated. These are called accounting estimates. Therefore, the management makes various estimates and assumptions of assets, liabilities, incomes and expenses as on the date of preparation of financial statements. This process of estimation involves judgements based on the latest information available.

Examples of estimation in some fields are:

(i) Estimation of useful life of depreciable assets.

(ii) Estimation of provision to be made for bad and doubtful debts.

Question 4

Mention six areas in which different accounting policies are followed by companies.

Answer

Following are the examples of the areas in which different accounting policies may be adopted by different enterprises:

(i) Methods of depreciation, depletion and amortisation.

(ii) Treatment of expenditure during construction.

(iii) Valuation of inventories.

(iv) Treatment of goodwill.

(v) Valuation of investments.

(vi) Valuation of fixed assets.

Question 5

List the criteria to be applied for rating an enterprise as Level-I enterprise for the purpose of compliance of Accounting Standards in India.

Answer

Following are the criteria for classifying an enterprise as Level -I enterprise:

(i) Enterprises, whose equity or debt securities are listed or is in the process of being listed in India.

(ii) Banks (including co-operative banks), Insurance companies and Financial Institutions.

(iii) All commercial, industrial and other business reporting enterprises whose turnover during the previous year is in excess of Rs.50 crores. Here turnover does not include 'other income'.

(iv) All commercial, industrial and other business reporting enterprises whose total borrowings including public deposits during the accounting year exceeds Rs.10 crores.

(v) Holding and subsidiary companies of any of the above enterprises at any time during the accounting year.

Question 6

"One of the characteristics of financial statements is neutrality"- Do you agree with this statement?

Answer

Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias. Financial Statements are not neutral if by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a pre-determined result or outcome. Financial statements are said to depict the true and fair view of the business of the organization by virtue of neutrality.

CHAPTER 2

ACCOUNTING STANDARDS

BASIC CONCEPTS

Accounting Standards (ASs) are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements. Accounting Standards 4, 5, 11, 12, 16, 19, 20, 26, 29 are covered in this paper.

Question 1

State different types of Leases contemplated in Accounting Standard 19 and discuss briefly.

Answer

Accounting Standard 19 has divided the lease into two types viz. (i) Finance Lease and (ii) Operating Lease.

Finance Lease : A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. title may or may not eventually be transferred. At the inception of a finance lease, the lessee should recognise the lease as an asset and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of the minimum lease payments from the standpoint of the lessee.

Operating Lease : A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership. Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Question 2

(a) When Capitalisation of borrowing cost should cease as per Accounting Standard 16?

(b) Briefly describe, how do you calculate "Diluted Earnings per Share" as per Accounting Standard 20.

(c) Write short note on Sale and Lease Back Transactions as per Accounting Standard 19.

Answer

(a) Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

(b) For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to 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.

The amount of net profit or loss for the period attributable to equity shareholders should be adjusted, after taking into account any attributable change in tax expense for the period.

The number of equity shares should be the aggregate of the weighted average number of equity shares (as per paragraphs 15 and 22 of AS 20) and the weighted average number of equity shares which would be issued on the conversion of all the dilutive potential equity shares into equity shares. Dilutive potential equity shares should be deemed to have been converted into equity shares at the beginning of the period or, if issued later, the date of the issue of the potential equity shares.

An enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.

(c) **Sale and leaseback transactions:** As per AS 19 on 'Leases', a sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the asset back to the vendor. The lease payments and the sale price are usually interdependent, as they are negotiated as a package. The accounting treatment of a sale and lease back transaction depends upon the type of lease involved.

If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sale proceeds over the carrying amount should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

If sale and leaseback transaction results in a operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

Question 3

(a) *Decide when research and development cost of a project can be deferred to future periods as per AS 26.*

(b) *You are an accountant preparing accounts of A Ltd. as on 31.3.2003. After year end the following events have taken place in April, 2003:*

(i) *A fire broke out in the premises damaging, uninsured stock worth Rs. 10 lakhs (Salvage value Rs. 2 lakhs).*

(ii) *A suit against the company's advertisement was filed by a party claiming damage of Rs. 20 lakhs.*

(iii) *Dividend proposed @ 20% on share capital of Rs. 100 lakhs.*

Describe, how above will be dealt with in the account of the company for the year ended on 31.3.2003.

Answer

(a) As per para 41 of AS 26 'Intangible Assets', no intangible asset arising from research should be recognized. The expenditure incurred on development phase can be deferred to the subsequent years if the company can demonstrate all of the following conditions (as specified in para 44 of AS 26 'Intangible Assets'):

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.

(b) Events occurring after the Balance Sheet date that represent material changes and commitments affecting the financial position of the enterprise must be disclosed according to para 15 of AS 4 on Contingencies and Events occurring after the Balance Sheet date. Hence, fire accident and loss thereof must be disclosed.

Suit filed against the company being a contingent liability must be disclosed with the nature of contingency, an estimate of the financial effect and uncertainties which may affect the future outcome must be disclosed as per para 16 of AS 4.

There are events which, although take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. Such items include the amount of dividend proposed or declared by the enterprise after the balance sheet date in respect of the period covered by the financial statements. Thus, dividends which are proposed or declared by the enterprise after the balance sheet date but before approval of the financial statements, should be adjusted as per para 14 of AS 4.

Question 4

How is software acquired for internal use accounted for under AS-26?

Answer

Paragraphs 10 and 11 of Appendix A to the Accounting Standard 26 on Intangible Assets, lays down the following procedure for accounting of software acquired for internal use:-

- The cost of a software acquired for internal use should be recognised as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of this statement.
- The cost of a software purchased for internal use comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the software ready for its use.

Any trade discounts and rebates are deducted in arriving at the cost. In the determination of cost, matters stated in paragraphs 24 to 34 of the Statement which deal with the method of accounting for 'Separate Acquisitions', 'Acquisitions as a part of Amalgamations', Acquisitions by way of Government Grant', and 'Exchanges of Assets', need to be considered, as appropriate.

Recognition criteria as per paragraphs 20 and 21 of the standard are stated below:-

- An intangible asset should be recognised if, and only if:
  - (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
  - (b) the cost of the asset can be measured reliably.
- An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.

Question 5

(a) On 20.4.2003 JLC Ltd. obtained a loan from the Bank for Rs. 50 lakhs to be utilised as under:

	Rs.
Construction of a shed	*20 lakhs*
Purchase of machinery	*15 lakhs*
Working capital	*10 lakhs*
Advance for purchase of truck	*5 lakhs*

In March, 2004 construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31.3.2004 was Rs. 9 lakhs. Show the treatment of interest under AS 16.

(b) A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2003-2004.

Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2004. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard can this revision be considered as an extraordinary item or prior period item?

Answer

(a) As per AS 16, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized. A qualifying asset is an asset that necessarily takes a substantial period of time (usually 12 months or more) to get ready for its intended use or sale. If an asset is ready for its intended use or sale at the time of its acquisition then it is not treated as a qualifying asst for the purposes of AS 16.

Treatment of interest as per AS 16

	Particulars	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
(1)	Construction of a shed	Qualifying asset	$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 20 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 3.60 lakhs	
(2)	Purchase of machinery	Not a qualifying asset*		$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 15 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 2.70 lakhs.

* On the basis that machinery is ready for its intended use at the time of its acquisition/purchase.

(3)	Working capital	Not qualifying asset		$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 10 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 1.80 lakhs
(4)	Advance for purchase of truck	Not a qualifying asset		$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 5 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 0.90 lakhs
	Total		Rs.3.60 lakhs	Rs.5.40 lakhs

(b) The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within the definitions of a prior period item or an extraordinary item [para 21 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies].

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2003-2004. Subsequently in 2004 they revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has material effect in the current period, should be disclosed and quantified. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed.

Question 6

(a) *A major fire has damaged assets in a factory of X Co. Ltd. on 8.4.2004, 8 days after the year end closing of accounts. The loss is estimated to be Rs. 16 crores (after estimating the recoverable amount of Rs. 24 crores from the Insurance Company).*

If the company had no insurance cover, the loss due to fire would be Rs. 40 crores.

Explain, how the loss should be treated in the Final accounts of the year ended 31.3.2004.

(b) *A Company had deferred research and development cost of Rs. 150 lakhs. Sales expected in the subsequent years are as under:*

Years	*Sales (Rs. in lakhs)*
I	*400*
II	*300*
III	*200*
IV	*100*

You are asked to suggest how should Research and Development cost be charged to Profit and Loss account. If at the end of the III year, it is felt that no further benefit will accrue in the IV year, how the unamortised expenditure would be dealt with in the accounts of the Company?

(c) In April, 2004 a Limited Company issued 1,20,000 equity shares of Rs. 100 each. Rs. 50 per share was called up on that date which was paid by all shareholders. The remaining Rs. 50 was called up on 1.9.2004. All shareholders paid the sum in September, 2004, except one shareholder having 24,000 shares. The net profit for the year ended 31.3.2005 is Rs. 2,64,000 after dividend on preference shares and dividend distribution tax of Rs. 64,000.

Compute basic EPS for the year ended 31.3.2005 as per Accounting Standard 20.

Answer

(a) The present event does not relate to conditions existing at the balance sheet date. Hence, no specific adjustment is required in the financial statements for the year ending on 31.3.2004. But if the event occurring after balance sheet date gives an indication that the enterprise may cease to be a going concern, then the assets and liabilities are required to be adjusted for the financial year ended 31st March, 2004. AS 4 (Revised) requires disclosure in respect of events occurring after the balance sheet date representing unusual changes affecting the existence or substratum of the enterprise after the date of the Balance Sheet. In the present event, the loss of assets in a factory can be considered to be an event affecting the substratum of the enterprise. Hence, an appropriate disclosure should be made in the report of the approving authority.

(b) (i) Based on sales, research and development cost to be allocated as follows:

Year	*Research and Development cost allocation*
	(Rs. in lakhs)
I	$\frac{400}{1,000} \times 150 = 60$
II	$\frac{300}{1,000} \times 150 = 45$
III	$\frac{200}{1,000} \times 150 = 30$
IV	$\frac{100}{1,000} \times 150 = 15$

(ii) If at the end of the III year, the circumstances do not justify that further benefit will accrue in IV year, then the company has to charge the unamortised amount i.e. remaining Rs. 45 lakhs [150 – (60 + 45)] as an expense immediately.

Note: As per para 41 of AS 26 on Intangible Assets, expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. It has been assumed in the above solution that the entire cost of Rs. 150 lakhs is development cost. Therefore, the expenditure has been deferred to the subsequent years on the basis of presumption that the company can demonstrate all the conditions specified in para 44 of AS 26. An intangible asset should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Hence the remaining unamortised amount of Rs. 45,00,000 has been written off as an expense at the end of third year.

(c) Basic earnings per share (EPS) = $\dfrac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$

$$= \frac{\text{Rs. } 2{,}64{,}000}{88{,}000 \text{ shares (as calculated in working note)}} = \text{Rs. } 3$$

Working Note:

Calculation of weighted average number of equity shares

	Number of shares	*Nominal value of shares*	*Amount paid*
1st April, 2004	1,20,000	100	50
1st September, 2004	96,000	100	100
	24,000	100	50

As per para 19 of AS 20 on Earnings per share, Partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividends to the extent of amount paid, weighted average number of shares will be calculated as:

Shares

$$1{,}20{,}000 \times \frac{1}{2} \times \frac{5}{12} = 25{,}000$$

$$96{,}000 \times \frac{7}{12} = 56{,}000$$

$$24{,}000 \times \frac{1}{2} \times \frac{7}{12} \quad = \quad 7{,}000$$

88,000 shares

Question 7

(a) *ABC Ltd. could not recover Rs. 10 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalized for the year ended 31.3.2005 by making a provision @ 20% of the amount due from the said debtor.*

The debtor became bankrupt in April, 2005 and nothing is recoverable from him.

Do you advise the company to provide for the entire loss of Rs. 10 lakhs in the books of account for the year ended 31st March, 2005?

(b) *X Co. Ltd. signed an agreement with its employees union for revision of wages in June, 2004. The wage revision is with retrospective effect from 1.4.2000. The arrear wages upto 31.3.2004 amounts to Rs. 80 lakhs. Arrear wages for the period from 1.4.2004 to 30.06.2004 (being the date of agreement) amounts to Rs. 7 lakhs.*

Decide whether a separate disclosure of arrear wages is required.

(c) *An intangible asset appears in Balance Sheet of A Co. Ltd. at Rs. 16 lakhs as on 31.3.2004. The asset was acquired for Rs. 40 lakhs in April, 1991. The Company has been amortising the asset value on straight line basis. The policy is to amortise for 20 years.*

Do you advise the Company to amortise the entire asset value in the books of the company as on 31.3.2004?

Answer

(a) As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

In the given case, bankruptcy of the debtor in April, 2005 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.3.2005. Therefore, the company should be advised to provide for the entire amount of Rs. 10 lakhs according to para 8 of AS 4.

(b) It is given that revision of wages took place in June, 2004 with retrospective effect from 1.4.2000. The arrear wages payable for the period from 1.4.2000 to 30.6.2004 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of Rs. 87 lakhs (from 1.4.2000 to 30.6.2004) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised),' Net Profit or loss for the Period, Prior Period Items and Changes in the Accounting Policies', 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.

However, wages payable for the current year (from 1.4.2004 to 30.6.2004) amounting Rs. 7 lakhs is not a prior period item, hence need not be disclosed separately. This may be shown as current year wages.

(c) AS 26 'Intangible Assets', came into effect for accounting periods commencing on or after 1.4.2003 and is mandatory in nature. Para 67 of the standard provides that if there is persuasive evidence that the life of the intangible asset is 20 years, then no adjustment is required at 1.4.2003. However, para 63 of the standard states that if it cannot be demonstrated that the life of the intangible asset is greater than 10 years, then AS 26 would require the asset to be amortised over not more than 10 years. Since, in the given case, the amortisation period determined by applying para 63 has already expired as on 1.4.2003, the carrying amount of Rs. 16 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1.4.2003.

Question 8

AB Ltd. launched a project for producing product X in October, 2004. The Company incurred Rs.20 lakhs towards Research and Development expenses upto 31st March, 2006. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.

Advise the Company as per the applicable Accounting Standard.

Answer

As per Para 41 of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Therefore, the manager cannot defer the expenditure write off to future years.

Hence, the expenses amounting Rs. 20 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2006.

Question 9

(a) What are the costs that are to be included in Research and Development costs as per AS 26.

(b) X Ltd. entered into an agreement to sell its immovable property included in the Balance Sheet at Rs.10 lacs to another company for Rs.15 lacs. The agreement to sell was concluded on 28th February, 2006 and the sale deed was registered on 1st May, 2006. Comment with reference to AS 4.

Answer

(a) According to paras 41 and 43 of AS 26*, **"**No intangible asset arising from research (or from the research phase of an internal project) should be recognized in the research phase. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred.

Examples of research costs are:

- Costs of activities aimed at obtaining new knowledge;
- Costs of the search for, evaluation and final selection of, applications of research findings or other knowledge;
- Costs of the search for alternatives for materials, devices, products, processes, systems or services; and
- Costs of the activities involved in formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes systems or services."

According to paras 45 and 46 of AS 26, "In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that future economic benefits from the asset are probable. This is because the development phase of a project is further advanced than the research phase.

Examples of development activities/costs are:

- Costs of the design, construction and testing of pre-production or pre-use prototypes and models;

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* AS 8 stands withdrawn w.e.f. 1st April, 2003 i.e. the date from which AS 26 'Intangible Assets' becomes mandatory. Therefore the above answer has been given as per AS 26.

- Costs of the design of tools, jigs, moulds and dies involving new technology;
- Costs of the design, construction ad operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- Costs of the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services."

(b) According to para 92 of AS 15 (Revised 2005) on "Employee Benefits", any actuarial gains and losses should be recognized immediately in the statement of profit and loss account as income or expense.

In the given case, the amount of surplus from pension scheme of Rs. 12 lacs is an actuarial gain, which should be recognized as income in the profit and loss account of the current year and not to be adjusted from the amount of annual contribution.

The surplus arising due to review of actuarial valuation of pension scheme by a company should be treated as a change in accounting policy and disclosed in accordance with AS 5(Revised).

Question 10

A Ltd. had 6,00,000 equity shares on April 1, 2007. The company earned a profit of Rs.15,00,000 during the year 2007-08. The average fair value per share during 2007-08 was Rs.25. The company has given share option to its employees of 1,00,000 equity shares at option price of Rs.15. Calculate basic EPS and diluted EPS.

Answer

Computation of earnings per share

	Earnings	Shares	Earnings per share
Net profit for the year 2007-08	Rs.15,00,000		
Weighted average number of shares outstanding during year 2007-08		6,00,000	
Basic earnings per share			Rs. 2.50
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: (100,000 x 15.00)/25.00	*	(60,000)	
Diluted earnings per share	Rs. 15,00,000	6,40,000	Rs. 2.34 (approx.)

*The earnings have not been increased as the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of the computation to have been issued for no consideration.

Question 11

Discuss the treatment of exchange loss relating to fixed assets as per AS 11 vis – a – vis the Schedule VI disclosure under the Companies Act, 1956.

Answer

Schedule VI to The Companies Act, 1956 provides that any increase or decrease in liability due to change in the rate of exchange relating to any fixed asset should be added to or deducted from the cost of the asset. The amount arrived at should be taken to be the cost of the fixed asset.

AS 11 (revised), however, does not require adjustment of exchange difference in the carrying amount of fixed assets. The exchange difference is required to be recognised in the statement of profit or loss since it is felt that this treatment is conceptually preferable to that required in Schedule VI and is in consonance with the international position in this regard.

The provisions of AS 11 will prevail over Schedule VI of the Companies Act. National Advisory Committee on Accounting Standards (NACAS) has notified AS 11 for preparation of financial statements of companies. ICAI has come up with the announcement in this regard, stating that after the notification of AS 11 by NACAS, AS 11 will overrule Schedule VI of the Companies Act.

EXERCISES

Question 1

The difference between actual expense or income and the estimated expense or income as accounted for in earlier years' accounts, does not necessarily constitute the item to be a prior period item comment.

(Answer: The statement given in the question is correct .)

Question 2

(i) A major fire has damaged the assets in a factory of a limited company on 2nd April-two days after the year end closure of account. The loss is estimated at Rs. 20 crores out of which Rs. 12 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final accounts for the previous year.

(ii) There is a sales tax demand of Rs. 2.50 crores against a company relating to prior years against which the company has gone on appeal to the appellate authority in the department. The grounds of appeal deal with points covering Rs. 2 crores of the demand. State how the matter will have to be dealt with in the final accounts for the year.

(Answer: (i)The loss due to break out of fire is an example of event occurring after the balance sheet date that does not relate to conditions existing at the balance sheet date. (ii) Company should disclose the disputed part of sales tax liability of Rs. 2 crore as contingent liability in their financial statements of the year.)

CHAPTER 3

ADVANCED ISSUES IN PARTNERSHIP ACCOUNTS

UNIT 1 : DISSOLUTION OF PARTNERSHIP FIRMS

BASIC CONCEPTS

- Reasons for which a company could be dissolved are
  - expiry of term for which its was formed
  - death of a partner
  - insolvency of a partner
  - retirement of a partner.
- Reasons when a firm stands dissolved
  - when partners mutually decide to dissolve
  - partners except one becomes insolvent
  - business becomes illegal
  - if partnership is at will any partner gives notice of dissolution
  - Court orders.
- On dissolution
  - assets are realized → all liabilities are paid off

    (*if any liability remains unpaid then it is to be realized from partners in their profit sharing ratio*).
- Piecemeal describes two methods
  - Maximum loss method
  - Highest relative capital method.

(A) Practical Questions:

Question1

A, B and C are partners sharing profits and losses in the ratio of 5:3:2. Their capitals were Rs. 9,600, Rs. 6,000 and Rs. 8,400 respectively.

After paying creditors, the liabilities and assets of the firm were:

	Rs.		Rs.
Liability for interest on		*Investments*	*1,000*
loans from :		*Furniture*	*2,000*
Spouses of partners	*2,000*	*Machinery*	*1,200*
Partners	*1,000*	*Stock*	*4,000*

The assets realised in full in the order in which they are listed above. B is insolvent.

You are required to prepare a statement showing the distribution of cash as and when available, applying maximum possible loss procedure.

Answer

Statement of Distribution of Cash

	Realisation	*Interest on loans from partners' spouses*	*Interest on loans from partners*	*Partners' Capitals A*	*B*	*C*	*Total*
	Rs.	*Rs.*	*Rs.*	*Rs.*	*Rs.*	*Rs.*	*Rs.*
Balances due		2,000	1,000	9,600	6,000	8,400	24,000
(i) Sale of investments	1,000	(1,000)	(1,000)				
		1,000	–				
(ii) Sale of furniture	2,000	(1,000)	(1,000)				
		–	–				
(iii) Sale of machinery	1,200						
Maximum possible loss Rs. 22,800 (total of capitals Rs. 24,000 less cash available Rs. 1,200) allocated to partners in the profit sharing ratio i.e. 5 : 3 : 2				(11,400)	(6,840)	(4,560)	(22,800)
Amounts at credit				(1,800)	(840)	3,840	1,200
Deficiency of A and B written off against C				1,800	840	(2,640)	–
Amount paid				–	–	1,200	1,200

Balances in capital acounts		9,600	6,000	7,200	22,800
(iv) Sale of stock	4,000				
Maximum possible loss	Rs. 18,800				
(Rs. 22,800 – Rs. 4,000) Allocated					
to partners in the ratio 5 : 3 : 2		(9,400)	(5,640)	(3,760)	(18,800)
Amounts at credit and cash paid		200	360	3,440	(4,000)
Balances in capital accounts left unpaid—Loss		9,400	5,640	3,760	18,8000

Question 2

Neptune, Jupiter, Venus and Pluto had been carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1 : 1. They decide to dissolve the partnership on the basis of the following Balance Sheet as on 30th April, 2003:

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Capital Account:			*Premises*		*1,20,000*
Neptune	*1,00,000*		*Furniture*		*40,000*
Jupiter	*60,000*	*1,60,000*	*Stock*		*1,00,000*
General Reserve		*56,000*	*Debtors*		*40,000*
Capital Reserve		*14,000*	*Cash*		*8,000*
Sundry Creditors		*20,000*	*Capital Overdrawn:*		
Mortgage Loan		*80,000*	*Venus*	*10,000*	
			Pluto	*12,000*	*22,000*
		3,30,000			*3,30,000*

(i) The assets were realised as under:

	Rs.
Debtors	*24,000*
Stock	*60,000*
Furniture	*16,000*
Premises	*90,000*

(ii) Expenses of dissolution amounted to Rs. 4,000.

(iii) Further Creditors of Rs. 12,000 had to be met.

(iv) General Reserve unlike Capital Reserve was built up by appropriation of profits.

You are required to draw up the Realisation Account, Partners' Capital Accounts and the Cash Account assuming that Venus became insolvent and nothing was realised from his private estate. Apply the principles laid down in Garner vs Murray.

Answer

Realisation Account

		Rs.			Rs.	Rs.
To	Sundry assets A/c (transfer):		By	Sundry creditors A/c		20,000
	Premises	1,20,000	By	Cash A/c (assets realised):		
	Furniture	40,000		Premises	90,000	
	Stock	1,00,000		Furniture	16,000	
	Sundry Debtors	40,000		Stock	60,000	
To	Cash A/c (creditors paid)	32,000		Debtors	24,000	1,90,000
To	Cash A/c (expenses)	4,000	By	Loss transferred to Capital Accounts:		
				Neptune	54,000	
				Jupiter	36,000	
				Venus	18,000	
				Pluto	18,000	1,26,000
		3,36,000				3,36,000

Cash Account

		Rs.			Rs.
To	Balance b/d	8,000	By	Realisation A/c (creditors)	32,000
To	Realisation A/c (assets realised)	1,90,000	By	Realisation A/c (expenses)	4,000
			By	Mortgage loan	80,000
To	Capital A/c (realisation loss		By	Neptune's Capital A/c	1,18,857
			By	Jupiter's Capital A/c	73,143

	made good):			
	Neptune	54,000		
	Jupiter	36,000		
	Pluto	18,000	1,08,000	
To	Pluto's Capital A/c		2,000	
			3,08,000	3,08,000

Partners' Capital Accounts

	Particulars	Neptune Rs.	Jupiter Rs.	Venus Rs.	Pluto Rs.		Particulars	Neptune Rs.	Jupiter Rs.	Venus Rs.	Pluto Rs.
To	Balance b/d	–	–	10,000	12,000	By	Balance b/d	1,00,000	60,000	–	–
To	Realisastion A/c (loss)	54,000	36,000	18,000	18,000	By	General reserve A/c (3 : 2 : 1 :1)	24,000	16,000	8,000	8,000
To	Venus's Capital A/c (loss)	11,143	6,857	–	–	By	Capital reserve A/c (3 : 2 : 1 :1)	6,000	4,000	2,000	2,000
To	Cash A/c	1,18,857	73,143	–	–	By	Cash A/c (loss on realization)	54,000	36,000	–	18,000
						By	Neptune's Capital A/c	–	–	11,143	–
						By	Jupiter's Capital A/c	–	–	6,857	–
						By	Cash A/c	–	–	–	2,000
		1,84,000	1,16,000	28,000	30,000			1,84,000	1,16,000	28,000	30,000

Question 3

X, Y and Z are partners of the firm XYZ and Co., sharing Profits and Losses in the ratio of 4 : 3 : 2.

Following is the Balance sheet of the firm as at 31st March, 2008:

Balance Sheet as at 31st March, 2008

Liabilities	*Rs.*	*Assets*	*Rs.*
Partners' Capitals:		Fixed Assets	5,00,000
X	4,00,000	Stock in trade	3,00,000
Y	3,00,000	Sundry debtors	5,00,000
Z	2,00,000	Cash in hand	10,000
General Reserve	90,000		
Sundry Creditors	3,20,000		
	13,10,000		13,10,000

Partners of the firm decided to dissolve the firm on the above said date. It was found that a credit purchase of Rs. 20,000 in January, 2008 had not been recorded in the books of the firm.

Fixed assets realized Rs. 5,20,000 and book debts Rs. 4,40,000.

Stocks were valued at Rs. 2,50,000 and it was taken over by partner Y.

Creditors allowed discount of 5% and the expenses of realization amounted to Rs. 6,000.

You are required to prepare:

(i) Realisation account;

(ii) Partners capital account; and

(iii) Cash account.

Answer

(i) Realisation Account

		Rs.			*Rs.*
To	Fixed assets	5,00,000	By	Creditors	3,20,000
To	Stock in trade	3,00,000	By	Cash (5,20,000+4,40,000)	9,60,000
To	Debtors	5,00,000	By	Y (Stock taken over)	2,50,000
To	Cash - Expenses	6,000	By	Loss transferred to	

			partners' capital accounts	
To	Cash -Creditors	3,23,000	X	44,000
	(3,40,000x 95%)		Y	33,000
			Z	22,000
		16,29,000		16,29,000

(ii) Partners' Capital Accounts

		X	Y	Z			X	Y	Z
		Rs.	*Rs.*	*Rs.*			*Rs.*	*Rs.*	*Rs.*
To	Realisation Account	44,000	33,000	22,000	By	Balance b/d	4,00,000	3,00,000	2,00,000
To	Realisation Account	-	2,50,000	-	By	General reserve	40,000	30,000	20,000
To	Cash	3,96,000	47,000	1,98,000					
		4,40,000	3,30,000	2,20,000			4,40,000	3,30,000	2,20,000

(iii) Cash Account

		Rs.			*Rs.*
To	Balance b/d	10,000	By	Realisation A/c (Expenses)	6,000
To	Realisation A/c (Fixed assets and book debts realized)	9,60,000	By	Realisation A/c (Creditors)	3,23,000
			By	X	3,96,000
			By	Y	47,000
			By	Z	1,98,000
		9,70,000			9,70,000

EXERCISES

Question 1

The firm of Kapil and Dev has four partners and as of 31st March, 1995, its Balance Sheet stood as follows:

Balance Sheet as on 31st March, 1995

Liabilities	Rs.	Assets	Rs.
Capital A/cs:		Land	50,000
F. Kapil	2,00,000	Building	2,50,000
S. Kapil	2,00,000	Office equipment	1,25,000
R. Dev	1,00,000	Computers	70,000
Current A/cs		Debtors	4,00,000
F. Kapil	50,000	Stocks	3,00,000
S. Kapil	1,50,000	Cash at Bank	75,000
R. Dev	1,10,000	Other Current Assets	22,600
Loan from NBFC	5,00,000	Current A/c :	
Current Liabilities	70,000	B. Dev	87,400
	13,80,000		13,80,000

The partners have been sharing profits and losses in the ratio of 4:4:1:1. It has been agreed to dissolve the firm on 1.4.1995 on the basis of the following understanding :

(a) The following assets are to be adjusted to the extent indicated with respect to the book values :

Land	200%
Building	120%
Computers	70%
Debtors	95%
Stocks	90%

(b) In the case of the loan, the lender's are to be paid at their insistence a prepayment premium of 1%.

(c) B. Dev is insolvent and no amount is recoverable from him. His father, R.Dev, however, agrees to bear 50% of his deficiency. The balance of the deficiency is agreed to be apportioned according to law.

Assuming that the realisation of the assets and discharge of liabilities is carried out immediately, show the Cash A/c, Realisation Account and the Partners' Accounts.

(Answer: Profit on realisation: F. Kapil 9,600, S. Kapil 9,600, R. Dev2,400.,B. Dev 2,400)

Question 2

The firm of LMS was dissolved on 31.3.95, at which date its Balance Sheet stood as follows:

Liabilities	Rs.	Assets	Rs.
Creditors	2,00,000	Fixed Assets	45,00,000
Bank Loan	5,00,000	Cash and Bank	2,00,000
L's Loan	10,00,000		
Capital			
L	15,00,000		
M	10,00,000		
S	5,00,000		
Total	47,00,000		47,00,000

Partners share profits equally. A firm of Chartered Accountants is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which are to include all expenses is fixed at Rs. 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building.

Realisations are:

S.No.	Amount in Rs.
1	5,00,000
2	15,00,000
3	15,00,000
4	30,00,000
5	30,00,000

The Chartered Accountant firm decided to pay off the partners in 'Higher Relative Capital Method'. You are required to prepare a statement showing distribution of cash with necessary workings.

(Answer: Realization profit credited to partners L 15,66,667, M 15,66,667, S 15,66,666)

Question 3

Ajay, Vijaya, Ram and Shyam are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is their Balance Sheet as at 31st March, 1996 :

Liabilities		Rs.	Assets	Rs.
Sundry Creditors		3,00,000	Sundry Debtors	3,50,000
Capital A/cs :			Less: Doubtful Debts	50,000
Ajay	7,00,000			3,00,000
Shyam	3,00,000		Cash in hand	1,40,000
		10,00,000	Stocks	2,00,000
			Other Assets	3,10,000
			Capital A/cs:	
			Vijay	2,00,000
			Ram	1,50,000
		13,00,000		13,00,000

On 31st March, 1996, the firm is dissolved and the following points are agreed upon:

Ajay is to takeover sundry debtors at 80% of book value

Shyam is to takeover the stocks at 95% of the value and

Ram is to discharge sundry creditors.

Other assets realise Rs. 3,00,000 and the expenses of realisation come to Rs. 30,000.

Vijay is found insolvent and Rs. 21,900 is realised from his estate.

Prepare Realisation Account and Capital Accounts of the partners. Show also the Cash A/c.

The loss arising out of capital deficiency may be distributed following the decision in Garner vs Murray.

(Answer: Vijay's deficiency will be borne by Ajay and Shyam in the ratio of 7 : 3 i.e. on opening capitals of Rs. 7,00,000 and Rs. 3,00,000. Ram will not bear any portion of the loss since at the time of dissolution he had a debit balance in his capital account. Loss on realization- Ajay 28,000, Vijay 7,000, Ram 14,000, Shyam 21,000)

Question 4

Ram, Rahim and Auntony were in partnership sharing profits and losses in the ratio of 1/2, 1/3 and 1/6 respectively. They decided to dissolve the partnership firm on 31.3.1998, when the Balance Sheet of the firm appeared as under :

Balance Sheet of the firm as on 31.3.1998

Liabilities		Rs.	Assets	Rs.
Sundry Creditors		5,67,000	Goodwill A/c	4,56,300
Bank Overdraft		6,06,450	Plant and Machinery	6,07,500
Joint Life Policy Reserve		2,65,500	Furniture	64,650
Loan from Mrs. Ram		1,50,000	Stock	2,36,700
Capital Accounts:			Sundry Debtors	5,34,000
Ram	4,20,000		Joint Life Policy	2,65,500
Rahim	2,25,000		Commission Receivable	1,40,550
Auntony	1,20,000	7,65,000	Cash in Hand	48,750
		23,53,950		23,53,950

The following details are relevant for dissolution :

(i) The joint life policy was surrendered for Rs. 2,32,500.

(ii) Ram took over goodwill and plant and machinery for Rs. 9,00,000.

(iii) Ram also agreed to discharge bank overdraft and loan from Mrs. Ram.

(iv) Furniture and stocks were divided equally between Ram and Rahim at an agreed valuation of Rs. 3,60,000.

(vi) Sundry debtors were assigned to firm's creditors in full satisfaction of their claims.

(vi) Commission receivable was received in toto in time.

(vii) A bill discounted was subsequently returned dishonoured and proved valueless Rs. 30,750 (including Rs. 500 noting charges).

(viii) Ram paid the expenses of dissolution amounting to Rs. 18,000.

(ix) Auntony agreed to receive Rs. 1,50,000 in full satisfaction of his rights, title and interest in the firm.

You are required to show accounts relating to closing of books on dissolution of the firm.

(Answer: Profit on realization- Ram 55,800, Rahim 37,200 , Auntony 18,600 Cash paid to Ram 1,63,410, Rahim 77,640, Auntony 1,50,000 The amount of excess payments to Auntony (Rs. 1,50,000 less Rs. 1,38,600 i.e., Rs. 11,400) has been debited to Ram and Rahim in the ratio of 3:2.)

UNIT 2: AMALGAMATION, CONVERSION AND SALE OF PARTNERSHIP FIRM

BASIC CONCEPTS

- Amalgamation includes
  - closing the old books of Amalgamating Company.
  - opening the new books of Amalgamated Company.
- Creditors play an important role in conversion of partnership firm into company.

Question 1

'S' and 'T' were carrying on business as equal partner. Their Balance Sheet as on 31st March, 2008 stood as follows:

Liabilities		*Rs.*	*Assets*	*Rs.*
Capital accounts:			*Stock*	*2,70,000*
S	*6,40,000*		*Debtors*	*3,65,000*
T	*6,60,000*	*13,00,000*	*Furniture*	*75,000*
Creditors		*3,27,500*	*Joint life policy*	*47,500*
Bank overdraft		*1,50,000*	*Plant*	*1,72,500*
Bills payable		*62,500*	*Building*	*9,10,000*
		18,40,000		*18,40,000*

The operations of the business were carried on till 30th September, 2008. S and T both withdrew in equal amounts half the amount of profits made during the current period of 6 months after 10% per annum had been written off on building and plant and 5% per annum written off on furniture. During the current period of 6 months, creditors were reduced by Rs. 50,000, Bills payable by Rs. 11,500 and Bank overdraft by Rs. 75,000. The Joint Life policy was surrendered for Rs. 47,500 on 30th September, 2008. Stock was valued at Rs. 3,17,000 and debtors at Rs. 3,25,000 on 30th September, 2008. The other items remained the same as on 31st March, 2008.

On 30th September, 2008 the firm sold its business to ST Ltd. The value of goodwill was estimated at Rs.5,40,000 and the remaining assets were valued on the basis of the Balance Sheet as on 30th September, 2008. The ST Ltd. paid the purchase consideration in equity shares of Rs.10 each. You are required to prepare a Realization Account and Capital accounts of the partners.

Answer

Realisation Account

Particulars		*Rs.*	*Particulars*		*Rs.*
To	Sundry assets:		By	Creditors	2,77,500
	Stock	3,17,000	By	Bills payables	51,000
	Debtors	3,25,000	By	Bank overdraft	75,000
	Plant	1,63,875	By	Shares in ST Ltd. (W.N. 3)	18,80,000
	Building	8,64,500			
	Furniture	73,125			

To	Profit:				
	S	2,70,000			
	T	2,70,000	5,40,000		
			22,83,500		22,83,500

Partners' Capital Accounts

Date	*Particulars*		*S*	*T*	*Date*	*Particulars*		*S*	*T*
2008					2008				
April 1	To	Cash – Drawings (W.N. 2)	20,000	20,000	April 1	By	Balance b/d	6,40,000	6,60,000
Sept. 30	To	Shares in ST Ltd.	9,30,000	9,50,000	Sept. 30	By	Profit (W.N.2)	40,000	40,000
						By	Realisation A/c (Profit)	2,70,000	2,70,000
			9,50,000	9,70,000				9,50,000	9,70,000

Working Notes:

(1) Ascertainment of total capital:

Balance Sheet

as at 30th September, 2008

Liabilities	*Rs.*	*Assets*		*Rs.*
Sundry creditors	2,77,500	Building	9,10,000	
Bills payable	51,000	*Less:* Depreciation	45,500	8,64,500
Bank overdraft	75,000	Plant	1,72,500	
Total capital (bal. fig.)	13,40,000	*Less:* Depreciation	8,625	1,63,875
		Furniture	75,000	
		Less: Depreciation	1,875	73,125
		Stock		3,17,000
		Debtors		3,25,000
	17,43,500			17,43,500

(2) **Profit earned during six months to 30 September, 2008**

		Rs.
Total capital (of S and T) on 30th September, 2008 (W.N.1)		13,40,000
Capital on 1st April, 2008		
S	6,40,000	
T	6,60,000	13,00,000
Net increase (after drawings)		40,000

Since drawings are half of profits therefore, actual profit earned is Rs.40,000 x 2 = Rs.80,000 (shared equally by partners S and T).

Half of the profits, has been withdrawn by both the partners equally i.e. drawings Rs. 40,000 (Rs.80,000 x ½) withdrawn by S and T in 1:1 (i.e. Rs.20,000 each).

(3) **Purchase consideration:**

	Rs.
Total assets (W.N.1)	17,43,500
Add: Goodwill	5,40,000
	22,83,500
Less: Liabilities (2,77,500 + 51,000 + 75,000)	4,03,500
Purchase consideration	18,80,000

Note: The above solution is given on the basis that reduction in bank overdraft is after surrender of Joint life policy.

CHAPTER 4

COMPANY ACCOUNTS

UNIT 1:

BASIC CONCEPTS

- As per Section 77B, no company can purchase its own share from
  - Subsidiary company
  - Investment company
  - Default in repayment of deposits or interest payable
  - Not complied with provisions of Sections 159, 207 and 211.
- As per the Companies Amendment Act, 2000, companies can issue equity shares with differential rights.
- ESOP is an option given to whole-time directors, officers or employees of a company to purchase or subscribe the securities offered by the company at a future date, at a predetermined price.

(A) Write short notes on:

Question 1

Conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares.

Answer

As per section 77A of the Companies Act, 1956 a joint stock company has to fulfill the following conditions to buy-back its own equity shares:

(a) The buy-back is authorised by its articles.

(b) A special resolution* has been passed in general meeting of the company authorising the buy-back.

(c) The buy-back does not exceed 25% of the total paid up capital and free reserves of the company. Provided the buy–back must not exceed 25% of its total paid up equity capital in that financial year.

(d) The ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back.

(e) All the shares for buy-back are fully paid up.

(f) The buy-back is made out of the free reserves (which include securities premium) or out of the proceeds of a fresh issue of any shares or other specified securities.

(g) The buy-back is completed within 12 months of the passing of the special resolution or a resolution passed by the Board.

(h) The buy-back of the shares listed on any recognised stock exchange is in accordance with the regulations made by the SEBI in this behalf.

(i) Before making such buy-back, a listed company has to file with the Registrar and the SEBI a declaration of solvency in the prescribed form.

Questions 2

Sweat equity shares and conditions, which must be fulfilled by a Joint Stock Company to issue these shares.

Answer

The Companies (Amendment) Act, 1999 introduced through section 79A a new type of equity shares called 'Sweat Equity Shares. The expression 'sweat equity shares' means equity shares issued by a company to its employees or directors at a discount or for consideration other than

* If the buy-back by the company is or less than 10% of the total paid-up equity capital and free reserves of the company then it can be authorised by the Board by means of resolution passed at its meeting and no special resolution will be required.

cash for providing know-how or making available rights in the nature of intellectual property rights or value additions by whatever name called.

Notwithstanding anything contained in section 79, which deals with the power of a company to issue shares at a discount, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:-

(i) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting.

(ii) the resolution specifies the number of shares, current market price, the consideration if any, and the class or classes of directors or employees to whom such equity shares are to be issued.

(iii) not less than one year has, at the time of the issue, elapsed since the date on which the company was entitled to commence business.

(iv) the sweat equity shares of company, whose equity shares are listed on a recognised stock exchange, are issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf. But in the case of company whose equity shares are not listed on any recognised stock exchange, the sweat equity shares are issued in accordance with the guidelines as may be prescribed.

All the limitations, restrictions and provisions relating to equity shares are applicable to sweat equity shares also.

Question 3

Dividend on partly paid shares.

Answer

In the case of partly paid-up shares, the dividend is payable either on the nominal, called-up or the paid-up amount of shares, depending on the provisions in this regard that there may be in the articles of the company. In the absence of any such provisions, Table A should be applicable. In such a case the amount of dividend payable will be calculated on the amount paid-up on the shares, and while doing so, the dates on which the amounts were paid must be taken into account. Calls paid in advance do not rank for payment of dividend. A company may if so authorised by its articles, pay a dividend in proportion to the amount paid on each share, where a larger amount is paid on some shares than on others (Section 93 of the Companies Act, 1956). But where the articles are silent and Table A has been excluded, the amount of dividend payable will have to be calculated on the nominal amount of shares. It should, however, be noted that according to Clause 88 of Table A dividends are to be declared and paid according to the amounts paid or credited as paid on the shares in respect whereof the dividend is paid, but if and so long as nothing is paid upon any of the shares of the company, dividends may be declared and paid according to the nominal amount of the shares.

UNIT 2 : UNDERWRITING OF SHARES AND DEBENTURES

- Underwriting contracts are basically of two types:
  - Wholly underwritten if one person is responsible to subscribe all the issue.
  - Partially underwritten, when some part of the issue is considered to be underwritten by company.
- Firm underwriting signifies a definite commitment to take up a specified number of shares irrespective of the number of shares subscribed for by the public.
- Underwriting Commission

  (1) No underwriting commission is payable on the shares taken up by the promoters, employees, directors, business associates, etc.

  (2) Commission is payable on the whole issue underwritten.

  (3) In case of shares, the commission paid or agreed to be paid should not exceed **5%** of the price at which the shares are issued.

  (4) In case of debentures, the commission paid or agreed to be paid should not exceed **2.5%** of the price at which the shares are issued.

  (5) Accounting Entries

  1. For Commission due

     Commission Account Dr.

     To Underwriter Account

  2. For payment of Commission

     Underwriter Account Dr.

     To Bank Account [Cheque]

     To Share Capital Account [Shares]

     To Debentures Account [Debentures]

- **When the issue is Fully Underwritten [without Firm Underwriting]**

  Method 1

  Under this method, all unmarked applications are divided between the underwriters in the ratio of **gross liability** of individual underwriter. For determining the liability of individual underwriter, the following steps are followed:

Step 1 Compute gross liability (if it has not been given) of individual underwriter on the basis of agreed ratio.

Step 2 Subtract marked applications from gross liability of respective underwriters.

Step 3 Determine the number of unmarked applications. (Unmarked application = Total applications received less marked applications). Divide unmarked applications between different underwriters in the **ratio of gross liability.** If the resultant figures are all positive or zero, then stop here. Now these figures represents the net liability of each underwriter.

If some of the resultant figures are negative, then continue to Step 4.

Step 4 Add all negative figures and divide the resultant between the underwriters having positive figures in the ratio of gross liability.

Repeat Step 4 unless all figures are positive. Now these figures represent the net liability of each underwriter.

Method 2

Under this method, all unmarked applications are divided between the underwriters in the ratio of **gross liability less marked applications.** For determining the liability of individual underwriter, the following steps are followed:

Step 1 Compute gross liability in the usual manner (if it has not been given).

Step 2 Subtract marked applications from gross liability of respective underwriters, If some of the resultant figures are negative, then add all negative figures and divide their sum in the ratio of gross liability.

Step 3 Determine the number of unmarked applications. Divide unmarked applications between different underwriters in the **ratio of gross liability less marked applications,** i.e., the resultant figures of Step 2. If the resultant figures of Step 3 are **all positive** or zero, then stop here. Now these figures represent the net liability of each underwriter.

If some of the resultant figures are negative, then continue to Step 4.

Step 4 Add all negative figures and divide their sum between the underwriters having positive figures in the same **ratio of Step 3.** Repeat Step 4 unless all figures are non-negative. Now these figures represents the net liability of each underwriter.

- **When the Issue is Fully Underwritten [with Firm Underwriting]**

  There are two alternative ways:

  (i) The benefit of firm underwriting is not given to individual underwriter, or

(ii) The benefit of firm underwriting is given to individual underwriter.

(i) The benefit of firm underwriting is not given to individual Underwriter:

For determining the liability of individual underwriter, the following steps are followed:

Step 1 Compute gross liability in the usual manner (if it has not been given).

Step 2 Subtract marked applications (excluding firm underwriting) from gross liability of respective underwriters. If some of the resultant figures are found negative, then add all negative figures and divide the resultant in the ratio of gross liability.

Step 3 Determine the number of unmarked applications as follows:

Total subscriptions (excluding firm underwriting)	******
Less: Marked applications (excluding firm underwriting)	******
Unmarked applications by public	******
Add: Applications under firm underwriting	******
Total unmarked applications	******

Divide the above calculated unmarked applications in the ratio of **gross liability.**

If the resultant figures of Step 3 are all positive or zero, then it represents **net liability** as per agreement. After this step, go to Step 5 (skip Step 4).

If some of the resultant figures are negative, then continue to Step 4.

Step 4 Add all the negative figures and divide the resultant between the underwriters having positive figures in the ratio of **gross liability.** Repeat Step 4 unless all figures are non-negative. Now these figures represent the **net liability** as per agreement. After this step, to Step 5.

Step 5 Add firm underwriting with the **net liability** as per agreement. The resultant figures represent **total liability.**

Here,

(1) Firm underwriting is treated as unmarked applications and divided in the ratio of gross liability.

(2) The liability of underwriter consists of:

(a) Net liability as per agreement; and

(b) firm underwriting.

(ii) The benefit of firm underwriting is given to individual underwriter

For determining the liability of individual underwriter, the following steps are followed:

Step 1 Compute gross liability in the usual manner (if it has not been given).

Step 2 Subtract marked applications (excluding firm underwriting) from gross liability of respective underwriters. If some of the resultant figures are found negative, then add all negative figures and divide their sum in the ratio of gross liability.

Step 3 Determine the number of unmarked applications as follows:

Total subscriptions (excluding firm underwriting)	******
Less: Marked applications (excluding firm underwriting)	******
Unmarked applications by public	******

Divide the above calculated unmarked application in the **ratio of gross liability.**

Step 4 Subtract "firm underwriting" of individual underwriter from the respective figures of Step 3.

If the resultant figures of Step 4 are all positive or zero, then that represents net liability as per agreement. After this step, go to Step 6 (skip Step 5).

If some of the resultant figures are negative, then continue to Step 5.

Step 5 Add all negative figures and divide it between the underwriters having positive figures in the ratio of gross liability. Repeat Step 5 unless all figures are non-negative. Now these figures represent the net liability as per agreement. After this step, go to Step 6.

Step 6 Add firm underwriting with the net liability as per agreement. The resultant figures represent total liability.

Here,

(1) **Firm underwriting is not treated as unmarked applications.**

(2) **Firm underwriting is credited to individual underwriters separately.**

(3) **The liability of Underwriter consists of:**

  (a) **Net liability as per agreement; and**

  (b) **Firm underwriting.**

(A) Write short notes on:

Question 1

"Firm" underwriting. Also give the accounting entries relating to firm underwriting in the books of: (i) the company, (ii) the underwriter

Answer

'Firm' underwriting signifies a definite commitment to take up a specified number of shares irrespective of the number of shares subscribed for by the public. In such a case, unless it has been otherwise agreed, the underwriter's liability is determined without taking into account the number of shares taken up 'firm' by him, i.e. the underwriter is obliged to take up :

1. the number of shares he has applied for 'firm'; and
2. the number of shares he is obliged to take up on the basis of the underwriting agreement.

For example, A underwrites 60% of an issue of 10,000 shares of Rs. 10 each of XY Co. Ltd. and also applies for 1,000 shares, 'firm'. The underwriting commission is agreed to at the rate of 2.5 percent. In case there are marked applications for 4,800 shares, he will have to take up 2,200 shares, i.e. 1,000 shares for which he applied 'firm' and 1,200 shares to meet his liability of underwriting contract. If, on the other hand, the underwriting contract has provided that an abatement would be allowed in respect of shares taken up 'firm', the liability of A in the above-mentioned case would only be for 1,200 shares in total. The accounting entries in relation to firm underwriting of 1,000 shares in the above example are given below :

Entries in the books of XY Co. Ltd. (Company)

		Dr.	Cr.
		Rs.	*Rs.*
1. A's Account	Dr.	10,000	
To Equity Share Capital Account			10,000
(Being allotment of underwritten equity shares in pursuance of firm underwriting contract, vide Board's resolution)			
2. Underwriting Commission on Issue of Shares Account	Dr.	250	
To A's Account			250
(Being underwriting commission due to the underwriter under the firm underwriting contract...)			

3. Bank Account	Dr.	9,750	
To A's Account			9,750
(Being money received in full settlement of account from underwriter)			

Entries in the books of A (Underwriter)

		Dr. Rs.	Cr. Rs.
1. Underwriting Account	Dr.	10,000	
To XY Co. Ltd. Account			10,000
(Being the liability to take up necessary number of shares of the company in pursuance of firm underwriting contract recorded)			
2. XY Co. Ltd. Account	Dr.	250	
To Underwriting Account			250
(Being underwriting commission income credited to underwriting account)			
3. XY Co. Ltd. Account	Dr.	9,750	
To Bank Account			9,750
(Being balance money paid to the company in full settlement of account)			

Question 2

Write a short note on Firm underwriting and Partial underwriting along with firm underwriting.

Answer

In firm underwriting the underwriter agrees to subscribe upto a certain number of shares/debentures irrespective of the nature of public response to issue of securities. He gets these securities even if the issue is fully subscribed or over-subscribed. These securities are taken by the underwriter in addition to his liability for securities not subscribed by the public. Under partial underwriting along with firm underwriting, unless otherwise agreed, individual underwriter does not get the benefit of firm underwriting in determination of number of shares/debentures to be taken up by him.

(B) Practical Questions:

Question 1

A joint stock company resolved to issue 10 lakh equity shares of Rs. 10 each at a premium of Re. 1 per share. One lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications.

The issue was underwritten by X, Y and Z for a commission @2% of the issue price, 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively. Their firm underwriting was as follows :

X 30,000 shares, Y 20,000 shares and Z 10,000 shares. The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public.

Marked applications were as follows:

X 1,19,500 shares, Y 57,500 shares and Z 10,500 shares.

Unmarked applications totalled 7,00,000 shares.

Accounts with the underwriters were promptly settled.

You are required to :

(i) Prepare a statements calculating underwriters' liability for shares other than shares underwritten firm.

(ii) Pass journal entries for all the transactions including cash transactions.

Answer

(i) Statement showing underwriters' liability for shares other than shares underwritten firm

	X	*Y*	*Z*	*Total*
Gross liability	5,85,000	2,25,000	90,000	9,00,000
(9,00,000 shares in the ratio of 65 : 25 : 10)				
Less : Marked applications	1,19,500	57,500	10,500	1,87,500
	4,65,500	1,67,500	79,500	7,12,000
Less : Allocation of unmarked applications (including firm underwriting i.e. 7,00,000) in the				

ratio 65 : 25 : 10	4,55,000	1,75,000	70,000	7,00,000
	10,500	(7,500)	9,500	12,500
Surplus of Y allocated to X and Z in the ratio 65 : 10	(6,500)	7,500	(1,000)	–
	4,000	–	8,500	12,500
	Rs.	Rs.	Rs.	
Liability amount @ Rs. 11	44,000	–	93,500	
Underwriting commission payable (Gross liability × Rs. 11 × 2%)	1,28,700	49,500	19,800	
Net Amount payable	84,700	49,500		
Net Amount receivable			73,700	

(ii) **Journal Entries**

		Dr.	*Cr.*
Bank A/c	Dr.	11,00,000	
To Equity Shares Application A/c			11,00,000
(Being application money received on 1 lakh equity shares @ Rs. 11 per share)			
Bank A/c	Dr.	97,62,500	
To Equity Share Application A/c			97,62,500
(Application money received on 8,87,500 equity shares @ Rs. 11 per share from general public and underwriters for shares underwritten firm)			
Equity Share Application A/c	Dr.	1,08,62,500	
X' s A/c	Dr.	44,000	
Z' s A/c	Dr.	93,500	
To Equity Share Capital A/c			1,00,00,000
To Securities Premium A/c			10,00,000
(Allotment of 10 lakh equity shares of Rs. 10 each at a premium of Re. 1 per share)			

Underwriting commission A/c	Dr.	1,98,000	
To X's A/c			1,28,700
To Y's A/c			49,500
To Z's A/c			19,800
(Amount of underwriting commission payable to X, Y and Z @2% on the amount of shares underwritten)			
Bank A/c	Dr.	73,700	
To Z's A/c			73,700
(Amount received from Z in final settlement)			
X's A/c	Dr.	84,700	
Y's A/c	Dr.	49,500	
To Bank A/c			1,34,200
(Amount paid to X and Y in final settlement)			

Question 3

Scorpio Ltd. came out with an issue of 45,00,000 equity shares of Rs. 10 each at a premium of Rs. 2 per share. The promoters took 20% of the issue and the balance was offered to the public. The issue was equally underwritten by A & Co; B & Co. and C & Co.

Each underwriter took firm underwriting of 1,00,000 shares each. Subscriptions for 31,00,000 equity shares were received with marked forms for the underwriters as given below:

A & Co.		*7,25,000 shares*
B & Co.		*8,40,000 shares*
C & Co.		*13,10,000 shares*
	Total	*28,75,000 shares*

The underwriters are eligible for a commission of 5% on face value of shares. The entire amount towards shares subscription has to be paid alongwith application. You are required to:

(a) Compute the underwriters liability (number of shares)

(b) Compute the amounts payable or due to underwriters; and

(c) Pass necessary journal entries in the books of Scorpio Ltd. relating to underwriting.

Answer

(a) Computation of liabilities of underwriters (No. of shares):

	A & Co.	B & Co.	C & Co.
Gross liability	12,00,000	12,00,000	12,00,000
Less: Firm underwriting	1,00,000	1,00,000	1,00,000
	11,00,000	11,00,000	11,00,000
Less: Marked applications	7,25,000	8,40,000	13,10,000
	3,75,000	2,60,000	(2,10,000)
Less: Unmarked applications distributed to A & Co. and B & Co. in equal ratio	1,12,500	1,12,500	Nil
	2,62,500	1,47,500	(2,10,000)
Less: Surplus of C & Co. distributed to A & Co. and B & Co. in equal ratio	1,05,000	1,05,000	2,10,000
Net liability (excluding firm underwriting)	1,57,500	42,500	Nil
Add: Firm underwriting	1,00,000	1,00,000	1,00,000
Total liability (No. of shares)	2,57,500	1,42,500	1,00,000

(b) Computation of amounts payable by underwriters:

Liability towards shares to be subscribed @ 12 per share	30,90,000	17,10,000	12,00,000
Less: Commission (5% on 12 lakhs shares @ 10 each)	6,00,000	6,00,000	6,00,000
Net amount to be paid by underwriters	24,90,000	11,10,000	6,00,000

(c) In the Books of Scorpio Ltd.

Journal Entries

Particulars		*Dr.* *Rs.*	*Cr.* *Rs.*
Underwriting commission A/c	Dr.	18,00,000	
To A & Co. A/c			6,00,000

To B & Co. A/c			6,00,000
To C & Co. A/c			6,00,000
(Being underwriting commission on the shares underwritten)			
A & Co. A/c	Dr.	30,90,000	
B & Co. A/c	Dr.	17,10,000	
C & Co. A/c	Dr.	12,00,000	
To Equity share capital A/c			50,00,000
To Share premium A/c			10,00,000
(Being shares including firm underwritten shares allotted to underwriters)			
Bank A/c	Dr.	42,00,000	
To A & Co. A/c			24,90,000
To B & Co. A/c			11,10,000
To C & Co. A/c			6,00,000
(Being the amount received towards shares allotted to underwriters less underwriting commission due to them)			

Question 4

Gemini Ltd. came up with public issue of 30,00,000 Equity shares of Rs. 10 each at Rs. 15 per share. A, B and C took underwriting of the issue in 3 : 2 : 1 ratio.

Applications were received for 27,00,000 shares.

The marked applications were received as under:

A	8,00,000 shares
B	7,00,000 shares
C	6,00,000 shares

Commission payable to underwriters is at 5% on the face value of shares.

(i) *Compute the liability of each underwriter as regards the number of shares to be taken up.*

(ii) *Pass journal entries in the books of Gemini Ltd. to record the transactions relating to underwriters.*

Answer

(i) Computation of liability of underwriters in respect of shares

	(In shares)		
	A	*B*	*C*
Gross liability	15,00,000	10,00,000	5,00,000
Less: Unmarked applications	3,00,000	2,00,000	1,00,000
	12,00,000	8,00,000	4,00,000
Less: Marked applications	8,00,000	7,00,000	6,00,000
	4,00,000	1,00,000	(2,00,000)
Surplus of C distributed to A & B in 3:2 ratio	1,20,000	80,000	2,00,000
Net liability	2,80,000	20,000	Nil

(ii) Journal Entries in the books of Gemini Ltd.

		Rs.	*Rs.*
A's Account	Dr.	42,00,000	
B's Account	Dr.	3,00,000	
To Share Capital Account			30,00,000
To Securities Premium Account			15,00,000
(Being the shares to be taken up by the underwriters)			
Underwriting Commission Account	Dr.	15,00,000	
To A's Account			7,50,000
To B's Account			5,00,000
To C's Account			2,50,000
(Being the underwriting commission due to the underwriters)			
Bank Account	Dr.	34,50,000	
To A's Account			34,50,000
(Being the amount received from underwriter A for the			

shares taken up by him after adjustment of his commission)			
B's Account	Dr.	2,00,000	
To Bank Account			2,00,000
(Being the amount paid to underwriter B after adjustment of the shares taken by him against underwriting commission due to him)			
C's Account	Dr.	2,50,000	
To Bank Account			2,50,000
(Being the underwriting commission paid to C)			

EXERCISES

(A) Practical Questions:

Question 1

Noman Ltd. issued 80,000 Equity Shares which were underwritten as follows:

Mr. A	*48,000 Equity Shares*
Messrs B & Co.	*20,000 Equity Shares*
Messrs C Corp.	*12,000 Equity Shares*

The above mentioned underwriters made applications for 'firm' underwritings as follows:

Mr. A	*6,400 Equity Shares*
Messrs B & Co.	*8,000 Equity Shares*
Messrs C Corp.	*2,400 Equity Shares*

The total applications excluding 'firm' underwriting, but including marked applications were for 40,000 Equity Shares.

The marked Applications were as under:

Mr. A	*8,000 Equity Shares*
Messrs B & Co.	*10,000 Equity Shares*
Messrs C Corp.	*4,000 Equity Shares*

(The underwriting contracts provide that underwriters be given credit for 'firm' applications and that credit for unmarked applications be given in proportion to the shares underwritten)

You are required to show the allocation of liability. Workings will be considered as a part of your answer.

Answer

Noman Ltd.

Statement showing Liability of Underwriters

	Mr. A	*M/s. B & Co.*	*C Corpn.*	*Total*
Gross Liability				
(No. of shares)	48,000	20,000	12,000	80,000
Unmarked Applications*				
(Ratio 48:20:12)	10,800	4,500	2,700	18,000

	37,200	15,500	9,300	62,000
Marked Applications	8,000	10,000	4,000	22,000
	29,200	5,500	5,300	40,000
Firm underwriting	6,400	8,000	2,400	16,800
Balance to be taken under the contract	22,800	-2,500	2,900	23,200
Credit for excess of B & Co. (ratio 48 : 12)	2,000	2,500	500	
Net Liability	20,800		2,400	
Add: Firm Underwriting	6,400	8,000	2,400	16,800
Total Liability	27,200	8,000	4,800	40,000

Working Note :

*	Total Applications	40,000	Shares
	Marked Applications	22,000	Shares
	Unmarked applications	18,000	Shares

UNIT 3 : REDEMPTION OF DEBENTURES

BASIC CONCEPTS

- Debenture creates a charge against some or all the assets of the company.
- Charge may be fixed or floating, depends upon the condition of issue.

Debentures may be redeemed after a fixed number of years or after a certain period has elapsed. Many debentures are issued with the notice that they may be redeemed at the option of the company within a specified period of time and at a price specified. The debentures may be redeemed in one of the four ways:

(a) By payment in lump sum at the end of a specified period of time; or

(b) By payment in annual installments;

(c) By purchasing its own debentures in the open market.

(d) By conversion into shares.

For redemption of Debentures a company shall maintain Debenture Redemption Reserve Fund

(A) Write short notes on:

Question 1

Conditions to be fulfilled by a Joint Stock Company to buy-back its equity shares.

Answer

As per section 77A of the Companies Act, 1956 a joint stock company has to fulfill the following conditions to buy-back its own equity shares:

(a) The buy-back is authorised by its articles.

(b) A special resolution* has been passed in general meeting of the company authorising the buy-back.

(c) The buy-back does not exceed 25% of the total paid up capital and free reserves of the company. Provided the buy–back must not exceed 25% of its total paid up equity capital in that financial year.

(d) The ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back.

(e) All the shares for buy-back are fully paid up.

(f) The buy-back is made out of the free reserves (which include securities premium) or out of the proceeds of a fresh issue of any shares or other specified securities.

(g) The buy-back is completed within 12 months of the passing of the special resolution or a resolution passed by the Board.

(h) The buy-back of the shares listed on any recognised stock exchange is in accordance with the regulations made by the SEBI in this behalf.

(i) Before making such buy-back, a listed company has to file with the Registrar and the SEBI a declaration of solvency in the prescribed form.

Questions 2

Sweat equity shares and conditions, which must be fulfilled by a Joint Stock Company to issue these shares.

Answer

The Companies (Amendment) Act, 1999 introduced through section 79A a new type of equity shares called 'Sweat Equity Shares. The expression 'sweat equity shares' means equity shares

* If the buy-back by the company is or less than 10% of the total paid-up equity capital and free reserves of the company then it can be authorised by the Board by means of resolution passed at its meeting and no special resolution will be required.

issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions by whatever name called.

Notwithstanding anything contained in section 79, which deals with the power of a company to issue shares at a discount, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:-

(i) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting.

(ii) the resolution specifies the number of shares, current market price, the consideration if any, and the class or classes of directors or employees to whom such equity shares are to be issued.

(iii) not less than one year has, at the time of the issue, elapsed since the date on which the company was entitled to commence business.

(iv) the sweat equity shares of company, whose equity shares are listed on a recognised stock exchange, are issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf. But in the case of company whose equity shares are not listed on any recognised stock exchange, the sweat equity shares are issued in accordance with the guidelines as may be prescribed.

All the limitations, restrictions and provisions relating to equity shares are applicable to sweat equity shares also.

Question 3

Dividend on partly paid shares.

Answer

In the case of partly paid-up shares, the dividend is payable either on the nominal, called-up or the paid-up amount of shares, depending on the provisions in this regard that there may be in the articles of the company. In the absence of any such provisions, Table A should be applicable. In such a case the amount of dividend payable will be calculated on the amount paid-up on the shares, and while doing so, the dates on which the amounts were paid must be taken into account. Calls paid in advance do not rank for payment of dividend. A company may if so authorised by its articles, pay a dividend in proportion to the amount paid on each share, where a larger amount is paid on some shares than on others (Section 93 of the Companies Act, 1956). But where the articles are silent and Table A has been excluded, the amount of dividend payable will have to be calculated on the nominal amount of shares. It should, however, be noted that according to Clause 88 of Table A dividends are to be declared and paid according to the amounts paid or credited as paid on the shares in respect whereof the dividend is paid, but if and so long as nothing is paid upon any of the shares of the company, dividends may be declared and paid according to the nominal amount of the shares.

Question 4

State the guidelines of SEBI regarding issue of convertible debentures for disclosure and investor protection.

Answer

SEBI guidelines regarding issue of convertible debentures for disclosure and investor protection are as follows:

(i) Issue of Fully Convertible Debentures (FCDs) having a conversion period of more than 36 months will not be permissible, unless conversion is made optional with "put" and "call" option.

(ii) No company shall make a public issue or rights issue of debts instruments (whether convertible or not), unless credit rating of not less than investment grade is obtained from not less than two registered credit rating agencies and disclosed in the offer document. All the credit ratings including the unaccepted credit ratings shall be disclosed.

(iii) All the credit ratings obtained during the 3 years preceding the public or rights issue of convertible debentures for any listed security of the issuer company shall be disclosed in the offer document.

(iv) No company shall issue a prospectus or a letter of offer to the public for subscription of its debentures without the appointment of a debenture trustees or creation of Debenture Redemption Reserve, in accordance with the provisions of the Companies Act, 1956. The names of the debenture trustees shall be stated in the Offer Document and also in all the subsequent periodical communication. Also a trust deed shall be executed within 3 months of the closure of the issue.

(v) The merchant banker shall ensure that the security created is adequate to ensure 100% asset cover for the debentures and is free from any encumbrances and also the necessary permissions to mortgage the assets or No objection certificate for a second or *pari passu* charged in cases where assets are encumbered have been obtained.

(vi) Premium amount on conversion and time of conversion, shall be predetermined by the issuer company and stated in the prospectus. Interest rates for the above debentures will also be freely determined by the issuer company.

(vii) Any conversion in part or whole of the debentures will be optional in the hands of the debentureholders, if the conversion takes place at or after 18 months from the date of allotment, but before 36 months.

(viii) Premium amount at the time of conversion for the Partly Convertible Debentures (PCD) shall be predetermined and stated in the prospectus. Redemption amount, period of maturity, yield on redemption for the PCDs or NCDs shall also be indicated in the prospectus.

(ix) In case, the non-convertible portions of PCDs or NCDs are to be rolled over with or without change in the interest rate, a compulsory option should be given to those debentureholders who want to withdraw and encash from the debenture programme. Roll over shall be done only in cases where debentureholders have sent their positive consent and not on the basis of the non-receipt of their negative reply.

(x) Before roll over of any NCDs or non-convertible portion of the PCDs, at least two credit ratings of not less than investment grade shall be obtained within a period of six months prior to the due date of redemption and communicated to debentureholders before roll over and fresh trust deed shall be made.

(xi) Letter of information regarding roll over shall be vetted by SEBI with regard to the credit ratings, debentureholder's resolution, option for conversion and such other items which SEBI may prescribe from time to time.

(xii) The disclosures relating to raising of debentures will contain, amongst other things, the existing and future equity and long term debt ratio, servicing behaviour on existing debentures, payment of due interest on due dates on long term loans and debentures, certificate from a financial institution or bankers about their no objection for a second or pari passu charge created in favour of the trustees to the proposed debenture issues.

(xiii) SEBI may prescribe additional disclosure requirement from time to time, after due notice.

(B) Practical Questions:

Question 1

The following is the Balance Sheet of Trinity Ltd. as at 31.3.1995:

Trinity Ltd.

Balance Sheet as at 31st March, 1995

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital		*Fixed Assets*	
Authorised		*Gross Block*	*3,00,000*
10,000 10% Redeemable Preference		*Less : Depreciation*	*1,00,000*
Shares of Rs. 10 each	*1,00,000*		*2,00,000*
90,000 Equity Shares of Rs. 10 each	*9,00,000*	*Investments*	*1,00,000*
	10,00,000	*Current Assets and Loans*	

Issued, Subscribed and Paid-up Capital			*and Advances*	
10,000 10% Redeemable Preference			*Inventory*	*25,000*
Shares of Rs. 10 each		*1,00,000*	*Debtors*	*25,000*
10,000 Equity Shares of Rs. 10 each		*1,00,000*	*Cash and Bank Balances*	*50,000*
	(A)	*2,00,000*	*Misc. Expenditure to the extent*	
Reserves and Surplus			*not written of*	*20,000*
General Reserve		*1,20,000*		
Securities Premium		*70,000*		
Profit and Loss A/c		*18,500*		
	(B)	*2,08,500*		
Current Liabilities and Provisions	*(C)*	*11,500*		
Total	*(A + B + C)*	*4,20,000*	*Total*	*4,20,000*

For the year ended 31.3.1996, the company made a net profit of Rs. 15,000 after providing Rs. 20,000 depreciation and writing off the miscellaneous expenditure of Rs. 20,000.

The following additional information is available with regard to company's operation :

1. *The preference dividend for the year ended 31.3.1996 was paid before 31.3.1996.*
2. *Except cash and bank balances other current assets and current liabilities as on 31.3.1996, was the same as on 31.3.1995.*
3. *The company redeemed the preference shares at a premium of 10%.*
4. *The company issued bonus shares in the ratio of one share for every equity share held as on 31.3.1996.*
5. *To meet the cash requirements of redemption, the company sold a portion of the investments, so as to leave a minimum balance of Rs. 30,000 after such redemption.*
6. *Investments were sold at 90% of cost on 31.3.1996.*

   You are required to

   (a) *Prepare necessary journal entries to record redemption and issue of bonus shares.*

   (b) *Prepare the cash and bank account.*

   (c) *Prepare the Balance Sheet as at 31st March, 1996 incorporating the above transactions.*

Answer

Journal Entries in the Books of Trinity Ltd.

		Dr. Rs.	Cr. Rs.
Securities Premium A/c	Dr.	10,000	
To Premium on Redemption of Preference shares			10,000
(Being amount of premium payable on redemption of preference shares)			
10% Redeemable Preference Capital	Dr.	10,00,000	
Premium on redemption of Preference Shares	Dr.	10,000	
To Preference Shareholders			1,10,000
(Being the amount payable to preference shareholders on redemption)			
General Reserve A/c	Dr.	1,00,000	
To Capital Redemption Reserve			1,00,000
(Being transfer to the latter account on redemption of shares)			
Bank A/c	Dr.	45,000	
Profit and Loss A/c	Dr.	5,000	
To Investments			50,000
(Being amount realised on sale of Investments and loss thereon adjusted)			
Preference shareholders A/c	Dr.	1,10,000	
To Bank			1,10,000
(Being payment made to preference shareholders)			
Capital Redemption Reserve A/c	Dr.	1,00,000	
To Bonus to Shareholders			1,00,000
(Amount adjusted for issuing bonus share in the ratio of 1 : 1.)			
Bonus to Shareholders A/c	Dr.	1,00,000	
To Equity Share Capital			1,00,000
(Balance on former account transferred to latter)			

(b) Cash and Bank A/c

Dr.				Cr.
		Rs.		Rs.
To Balance b/d		50,000	By Preference Dividend	10,000
To Cash from operations:			By Preference shareholders	1,10,000
Profit	15,000		By Balance c/d	30,000
Add : Depreciation	20,000			
Add : Miscellaneous Expenditure written off	20,000	55,000		
To Investments		45,000		
		1,50,000		1,50,000

(c) Balance Sheet of Trinity Limited

as at 31st March, 1996 (after redemption)

Liabilities		*Rs.*	*Assets*			*Rs.*
Share Capital			Fixed Assets			
Authorised Capital		10,00,000	Gross Block		3,00,000	
Issued, Subscribed and Paid-up Capital			*Less* : Depreciation upto 31.3.95	1,00,000		
20,000 Equity Share of Rs. 10 each fully paid		2,00,000	For the year	20,000	1,20,000	1,80,000
(10,000 shares have been allotted as Bonus Shares by capitalising capital Redemption Reserve)			Investments (Market Value Rs. 45,000)			50,000
			Current Assets, Loans and Advances			
Reserves and Surplus						
General Reserve	20,000		Inventory		25,000	

Securities Premium	60,000		Debtors	25,000	
Profit and Loss A/c	18,500	98,500	Cash and Bank Balance	30,000	80,000
Current Liabilities and Provisions					
Sundry Creditors		11,500			
		3,10,000			3,10,000

Working Notes:

(i)	Profit and Loss Account for the year ending 31st March, 1996		*Rs.*
	Balance as on 1.4.1995		18,500
	Add : Profit for the year		15,000
			33,500
	Less : Preference Dividend	10,000	
	Loss on sale of investments	5,000	15,000
	Balance as on 31.3.1996		18,500
(ii)	General Reserve		1,20,000
	Less : Transfer to Capital Redemption Reserve		1,00,000
	Balance as on 31.3.1996		20,000
(iii)	Securities Premium		70,000
	Less : Premium on Redemption of Preference shares		10,000
	Balance as on 31.3.1996		60,000
(iv)	Capital Redemption Reserve		1,00,000
	Less : Transfer for Bonus Shares		1,00,000
	Balance as on 31.3.1996		NIL
(v)	Sale of Investments:		
	Cost of Investments		50,000
	Less : Cash Received		45,000
	Loss on Sale of Investments		5,000
	Total Investments:		1,00,000
	Less : Cost of Investments sold		50,000
	Cost of Investments on hand		50,000
	Market value (90% of Rs. 50,000)		45,000

Question 2

The balance sheet of XYZ Ltd. as at 31st December, 1998 inter alia includes the following :

		Rs.
50,000	*8% Preference shares of Rs. 100 each Rs. 70 paid up*	*35,00,000*
1,00,00	*Equity shares of Rs. 100 each fully paid up*	*1,00,00,000*
	Securities premium	*5,00,000*
	Capital redemption reserve	*20,00,000*
	General reserve	*50,00,000*

Under the terms of their issue, the preference shares are redeemable on March 31, 1999 at a premium of 5%. In order to finance the redemption, the company makes a right issue of 50,000 equity shares of Rs. 100 each at Rs. 20 being payable on application, Rs. 35 (including premium) on allotment and the balance on January 1, 2000. The issue was fully subscribed and allotment made on March 1, 1999. The monies due on allotment were received by March 30, 1999.

The preference shares were redeemed after fulfilling the necessary conditions of Section 80 of the Companies Act, 1956. The company decided to make the minimum utilisation of general reserve.

You are asked to pass the necessary jounal entries and show the relevant extracts from the Balance Sheet as on March 31, 1999 with the corresponding figures as on 31st December, 1998.

Answer

XYZ Ltd.

Journal Entries

		Dr.	Cr.
		Rs. '000	Rs. '000
8% Preference Share Final Call Account	Dr.	15,00	
To 8% Preference Share Capital Account			15,00
(Being the final call made on 50,000 preference shares @ Rs. 30 each to make them fully paid up)			
Bank Account	Dr.	15,00	
To 8% Preference Share Final Call Account			15,00
(Being the final call amount received on 50,000 preference shares @ Rs. 30 each)			

Bank Account	Dr.	10,00	
To Equity Share Application Account			10,00
(Being the application money received on 50,000 equity shares @ Rs. 20 per share)			
Equity Share Application Account	Dr.	10,00	
To Equity Share Capital Account			10,00
(Being the application money on 50,000 equity shares transferred to equity share capital account vide Board's resolution dated...)			
Equity Share Allotment Account	Dr.	17,50	
To Equity Share Capital Account			12,50
To Securities Premium Account			5,00
(Being the amount due on 50,000 equity shares @ Rs. 35 per share [including premium Rs.] 10 vide Board's resolution dated...)			
Bank Account	Dr.	17,50	
To Equity Share Allotment Account			17,50
(Being the allotment money received on 50,000 equity shares @ Rs. 35 per share)			
8% Preference Share Capital Account	Dr.	50,00	
Premium on Redemption of Preference Shares Account	Dr.	2,50	
To Preference Shareholders Account			52,50
(Being the amount payable to preference share holders on redemption)			
Preference Shareholders Account	Dr.	52,50	
To Bank Account			52,50
(Being the payment made to preference shareholders)			
Securities Premium Account	Dr.	2,50	
To Premium on Redemption of Preference Shares Account			2,50
(Being the premium payable on redemption of preference shares charged to share premium account)			

General Reserve	Dr.	27,50	
To Capital Redemption Reserve			27,50
(Being the amount transferred to capital redemption reserve on redemption of preference shares for the balance not covered by proceeds of fresh issue of shares)			

Balance Sheet of XYZ Limited

As at 31st March, 1999 (after redemption of preference shares)

(Relevant extracts)

	Amount Rs. ('000) As on 31.3.99	*Amount Rs. ('000) As on 31.12.98*
1. Sources of funds		
Shareholders' funds :		
(a) Share Capital		
Issued, subscribed and paid-up		
1,00,000 equity shares of Rs. 100 each, fully paid up	1,00,00	1,00,00
50,000 equity shares of Rs. 100 each, Rs. 45 called up and paid up	22,50	—
50,000, 8% Redeemable preference shares *of* Rs. 100 each, Rs. 70 called-up and paid-up (redeemed on 31st March, 1999)	—	35,00
	1,22,50	1,35,00
(b) Reserves and Surplus :		
Capital redemption reserve	47,50	20,00
Securities premium account	7,50	5,00
General reserve	22,50	50,00
	77,50	75,00

The cash and bank balance will be decreased by Rs. 10,00,000 on 31.3.99 as compared to the balance on 31.12.98.

Working Notes :

		Rs. '000
(i)	Transfer to capital redemption reserve	
	Nominal value of preference shares redeemed (Rs. 100 × 50,000)	50,00
	Less : Proceeds of fresh equity issue [(Rs. 20 + 25) × 50,000)]	22,50
	Transfer to capital redemption reserve	27,50
(ii)	Capital redemption reserve as on 31.3.99	
	Balance as on 31.12.98	20,00
	Add : Transfer from general reserve	27,50
	Balance as on 31.3.99	47,50
(iii)	General reserve as on 31.3.99	
	Balance as on 31.12.98	50,00
	Less : Transfer to capital redemption reserve	27,50
	Balance as on 31.3.99	22,50
(iv)	Securities premium as on 31.3.99	
	Balance as on 31.12.98	5,00
	Add : Amount received @ Rs. 10 per share on fresh issue of 50,000 equity shares	5,00
		10,00
	Less : Premium on redemption of preference shares	2,50
	Balance as on 31.3.99	7,50
(v)	Change in cash and bank balance	
	Receipts : (31.12.98 - 31.3.99)	
	Application money on 50,000 equity shares @ Rs. 20 per share	10,00
	Allotment money on 50,000 equity shares @ Rs. 35 per share	17,50
	Final call on 50,000, 8% Preference shares @ Rs. 30 per share	15,00
		42,50
	Payments :	
	Amount paid to preference shareholders on redemption	52,50
	Reduction in cash and bank balance	10,00

Question 3

Provisional Balance Sheet of P Ltd. as at 31st March, 2001 was as under:

Balance Sheet as at 31st March, 2001

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*
Share Capital			*Fixed Assets (at cost less*	
50,000 equity shares of Rs. 10			*depreciation)*	*7,00,000*
each, Rs. 7 per share called up	*3,50,000*		*Cash & Bank balances*	*2,00,000*
Less : Calls in arrear on 10,000			*Other Current assets*	*6,00,000*
shares @ Rs. 2 per share	*20,000*			
	3,30,000			
Add : Calls in advance on				
40,000 shares @				
Rs. 3 per share	*1,20,000*	*4,50,000*		
20,000, 10% Redeemable preference				
shares of Rs. 10 each, fully paid up		*2,00,000*		
Reserves & Surplus :				
General Reserve		*3,00,000*		
Profit & Loss Account		*2,70,000*		
Current Liabilities		*2,80,000*		
		15,00,000		*15,00,000*

Calls in arrear are outstanding for 6 months. Calls in advance were also received 6 months back.

Interest @ 10% p.a. on calls in advance and 12% p.a. on calls in arrear are allowed/charged.

The Board of Directors have recommended that:

(i) Dividend for the year 2000-01 be allowed @ 20% on equity shares.

(ii) Money on calls in advance be refunded and partly paid equity shares be converted as fully paid up by declaring bonus dividend to shareholders.

(iii) The preference shares, which are redeemable at a premium of 10% any time after 31st March, 2001 may be redeemed by issue of 10% Debentures of Rs. 100 in cash.

Show Journal Entries to give effect to the above proposals including payment and receipt of cash and redraft the Profit and Loss Account and Balance Sheet of P Ltd.

Answer

Journal Entries

P Ltd.

		Dr. Rs.	Cr. Rs.
Interest on Calls in Arrear A/c	Dr.	1,200	
To Profit & Loss A/c			1,200
(Being interest @ 12 % p.a. on Rs. 20,000 for 6 months credited to Profit and Loss Account)			
Bank A/c	Dr.	21,200	
To Calls in Arrear A/c			20,000
To Interest on Calls in Arrear A/c			1,200
(Being interest on calls in arrear received)			
Profit & Loss A/c	Dr.	6,000	
To Interest on Calls in Advance A/c			6,000
(Being interest @ 10% on Rs. 1,20,000 for 6 months allowed on calls in advance)			
Profit & Loss A/c	Dr.	90,000	
To Preference Dividend			20,000
To Equity Dividend			70,000
(Being dividend @ 10% on Preference share capital & 20% on Equity share capital proposed)			
Profit & Loss A/c	Dr.	1,50,000	
To Bonus to Equity Shareholders A/c			1,50,000
(Being bonus dividend declared)			
Share Final Call A/c	Dr.	1,50,000	
To Equity Share Capital A/c			1,50,000
(Being final call made @ Rs. 3 on 50,000 shares)			
Bonus to Equity shareholders A/c	Dr.	1,50,000	
To Share Final Call A/c			1,50,000
(Being adjustment of bonus dividend against final call)			

Calls in Advance A/c	Dr.	1,20,000	
Interest on Calls in Advance A/c	Dr.	6,000	
To Bank A/c			1,26,000
(Being amount of calls in advance along with interest refuned)			
Bank A/c	Dr.	2,20,000	
To 10% Debentures A/c			2,20,000
(Being 2,200 Debentures of Rs.100 each issued in cash)			
Profit & Loss A/c	Dr.	20,000	
To Premium on Redemption of Preference shares A/c			20,000
(Being premium payable on redemption)			
Profit & Loss A/c	Dr.	5,200	
General Reserve A/c	Dr.	1,94,800	
To Capital Redemption Reserve A/c			2,00,000
(Transfer to capital redemption reserve)			
Preference Share Capital A/c	Dr.	2,00,000	
Premium on Redemption of Preference Shares A/c	Dr.	20,000	
To Preference Shareholders A/c			2,20,000
(Amount due on redemption of preference shares)			
Preference Shareholders A/c	Dr.	2,20,000	
To Bank A/c			2,20,000
(Amount paid to preference shareholders)			

Profit & Loss Account of P Ltd.

for the year ended 31st March, 2001

	Rs.		*Rs.*
To Interest on calls in advance	6,000	By Balance b/d	2,70,000
To Balance c/d	2,65,200	By Interest on calls in arrear	1,200
	2,71,200		2,71,200
To Premium on redemption	20,000	By Balance b/d	2,65,200
To Preference Dividend	20,000		

To Equity Dividend	70,000	
To Bonus Dividend	1,50,000	
To Capital Redemption Reserve	5,200	
	2,65,200	2,65,200

Balance Sheet of P Ltd.

as on 31st March 2001

Liabilities		*Rs.*	*Assets*	*Rs.*
Share Capital:			Fixed Assets	7,00,000
50,000 equity shares of Rs. 10 each			(Cost less depreciation)	
fully paid up		5,00,000		
(Of the above equity shares			Cash & Bank balance (W.N.)	95,200
Rs. 3 per share has not been				
received in cash but has been capitalised			Other Current Assets	6,00,000
by issuing				
bonus dividend)				
Reserves & Surplus:				
Capital Redemption Reserve		2,00,000		
General Reserve	3,00,000			
Less: utilised for redemption				
of preference share	1,94,800	1,05,200		
Profit & Loss Account		—		
10% Debentures		2,20,000		
Current liabilities		2,80,000		
Proposed dividend		90,000		
		13,95,200		13,95,200

Working Note :

Cash and Bank balance as on 31st March, 2001

	Rs.
Cash and bank balance (given)	2,00,000
Add: Recovery of calls in arrear and interest thereon	21,200
Proceeds from issue of 10% Debentures	2,20,000

		4,41,200
Less:	Payment of calls in advance and interest thereon	1,26,000
	Redemption of preference shares	2,20,000
		95,200

Note : In the absence of information, it has been assumed that the amount of calls in arrear has been received in the given solution. It has been assumed that 20% dividend on equity shares has been proposed before the equity shares are made fully paid by way of bonus dividend.

Question 4

The financial position of P Limited at 31st December, 2001 was as follows:

Liabilities	*Rs.*	*Assets*	*Rs.*
Authorised, Issued and Subscribed Capital		*Assets*	*8,40,000*
		Cash and Bank	*3,00,000*
40,000, 5 % Redeemable Preference shares of			
Rs. 10 each, fully paid	*4,00,000*		
20,000 Equity shares of Rs. 10 each, fully paid	*2,00,000*		
Securities Premium Account	*50,000*		
Profit and Loss Account	*2,80,000*		
Sundry Liabilities	*2,10,000*		
	11,40,000		*11,40,000*

As per the terms of issue of the Preference Shares these were redeemable at a premium of 5 % on 1st February, 2002 and it was decided to arrange this as far as possible out of the company's resources subject to leaving a balance of Rs. 50,000 in the credit of the Profit and Loss Account. It was also decided to raise the balance amount by issue of 17,000 Equity Shares of Rs. 10 each at a premium of Rs. 2.50 per share.

You are required to prepare the necessary Ledger Accounts giving effect to the above arrangments in the company's books. Journal Entries are not required.

Answer

5% Redeemable Preference Share Capital Account

2002		*Rs.*	*2000*		*Rs.*
Feb. 1	To Preference Share holders A/c	4,00,000	Jan. 1	By Balance b/d	4,00,000
		4,00,000			4,00,000

Preference Shareholders Account

2002		*Rs.*	*2002*			*Rs.*
Feb. 1	To Bank A/c	4,20,000	Feb. 1	By	5% Redeemable Preference Share Capital A/c	4,00,000
				By	Premium on Redemption A/c	20,000
		4,20,000				4,20,000

Premium on Redemption Account

2002		*Rs*	*2002*			*Rs.*
Feb. 1	To Preference Share-holders A/c	20,000	Feb. 1	By	Securities Premium A/c	20,000

Equity Shares Application and Allotment Account

2002		*Rs.*	*2002*			*Rs.*
Feb. 1	To Equity Share Capital A/c	1,70,000	Feb. 1	By	Bank A/c	2,12,500
	To Securities Premium A/c	42,500				
		2,12,500				2,12,500

Capital Redemption Reserve Account

2002		*Rs.*	*2002*			*Rs.*
Feb. 1	To Balance c/d	2,30,000	Feb. 1	By	Profit and Loss A/c	2,30,000
		2,30,000				2,30,000

Equity Share Capital Account

2002		*Rs.*	*2002*			*Rs.*
Feb. 1	To Balance	3,70,000	Jan. 1	By	Balance b/d	2,00,000
			Feb. 1	By	Equity shares application and allotment A/c	1,70,000
		3,70,000				3,70,000

Securities Premium Account

2002		Rs.	2002		Rs.
Feb. 1	To Premium on Redemption A/c	20,000	Jan. 1	By Balance b/d	50,000
	To Balance c/d	72,500	Feb. 1	By Equity Shares Application and Allotment A/c	42,500
		92,500			92,500

Profit and Loss Account

2002		Rs.	2002		Rs.
Feb. 1	To Capital Redemption Reserve A/c	2,30,000	Jan. 1	By Balance b/d	2,80,000
	To Balance c/d	50,000			
		2,80,000			2,80,000

Cash and Bank Account

2002		Rs.	2002		Rs.
Jan. 1	To Balance b/d	3,00,000	Feb. 1	By Preference Share Holders A/c	4,20,000
Feb. 1	To Equity Share Application and Allotment A/c	2,12,500		By Balance c/d	92,500
		5,12,500			5,12,500

Note: No dividend has been paid on preference shares in the above solution. Alternatively, dividend may be paid at the rate of 5% for one month because the redemption takes place on 1st February, 2002 assuming that the articles of the company and terms of contract of company with the preference shareholders provide for such dividend.

Question 5

Libra Limited recently made a public issue in respect of which the following information is available:

(a) No. of partly convertible debentures issued 2,00,000; face value and issue price Rs.100 per debenture.

(b) Convertible portion per debenture 60%, date of conversion on expiry of 6 months from the date of closing of issue.

(c) *Date of closure of subscription lists 1.5.1994, date of allotment 1.6.1994, rate of interest on debenture 15% payable from the date of allotment, value of equity share for the purpose of conversion Rs. 60 (Face Value Rs. 10).*

(d) *Underwriting Commission 2%.*

(e) *No. of debentures applied for 1,50,000.*

(f) *Interest payable on debentures half-yearly on 30th September and 31st March.*

Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 1995 (including cash and bank entries).

Answer

In the books of Libra Ltd.

Journal Entries

Date	*Particulars*		*Amount Dr.* *Rs.*	*Amount Cr.* *Rs.*
1.5.94	Bank A/c	Dr.	1,50,00,000	
	To Debenture Application A/c			1,50,00,000
	(Application money received on 1,50,000 debentures @ Rs. 100 each)			
1.6.94	Debenture Application A/c	Dr.	1,50,00,000	
	Underwriters A/c	Dr.	50,00,000	
	To 15% Debentures A/c			2,00,00,000
	(Allotment of 1,50,000 debentures to applicants and 50,000 debentures to underwriters)			
	Underwriting Commission	Dr.	4,00,000	
	To Underwriters A/c			4,00,000
	(Commission payable to underwriters @ 2% on Rs. 2,00,00,000)			
	Bank A/c	Dr.	46,00,000	
	To Underwriters A/c			46,00,000
	(Amount received from underwriters in settlement of account)			

30.9.94	Debenture Interest A/c	Dr.	10,00,000	
	To Bank A/c			10,00,000
	(Interest paid on debentures for 4 months @ 15% on Rs. 2,00,00,000)			
30.10.94	15% Debentures A/c	Dr.	1,20,00,000	
	To Equity Share Capital A/c			20,00,000
	To Securities Premium A/c			1,00,00,0000
	(Conversion of 60% of debentures into shares of Rs. 60 each with a face value of Rs. 10)			
31.3.95	Debenture Interest A/c	Dr.	7,50,000	
	To Bank A/c			7,50,000
	(Interest paid on debentures for the half year)			

Working Note :

Calculation of Debenture Interest for the half year ended 31st March, 1995

On Rs. 80,00,000 for 6 months @ 15%	= Rs. 6,00,000
On Rs. 1,20,00,000 for 1 months @ 15%	= Rs. 1,50,000
	Rs. 7,50,000

Question 6

Progressive Ltd. issued Rs. 10,00,000, 6% Debenture Stock at par on 21.1.1984, Interest was payable on 30th June and 31st December, in each year.

Under the terms of the Debentures Trust the owned stock is redeemable at par. The trust deed obliges the Company to pay to the trustees on 31st December, 1995 and annually thereafter the sum of Rs. 1,00,000 to be utilised for the redemption and cancellation of an equivalent amount of stock, which is to be selected by drawing lots.

Alternatively, the Company is empowered as from 1st January, 1995 to purchase its own debentures on the open market. These Debentures must be surrendered to the Trustees for cancellation and any adjustments for accrued interest recorded in the books of account. If in any year the nominal amount of the stock surrendered under this alternative does not amount to Rs. 1,00,000 then the shortfall is to be paid by the Company to the Trustees in cash on 31st December.

The following purchases of stock were made by the Company:

		Nominal value of stock purchased	Purchase price per Rs. 100 of stock	
		Rs.	*Rs.*	
(1)	*30th September, 1995*	*1,20,000*	*98*	
(2)	*31st May, 1996*	*75,000*	*95*	*(Ex-interest)*
(3)	*31st July, 1997*	*1,15,000*	*92*	

The Company fulfilled all its obligations under the trust deed.

Prepare the following Ledger Accounts :

(a) *Debenture Stock A/c*

(b) *Debenture Redemption A/c*

(c) *Debenture Interest A/c*

Note : *Ignore costs and taxation*

Answer

In the Books of Progressive Ltd.

Debenture Stock Account

1995		*Rs.*	*1995*		*Rs.*
Sept. 30	To Debenture Redemption A/c	1,20,000	Jan. 1	By Balance b/d	10,00,000
Dec. 31	To Balance c/d	8,80,000			
		10,00,000			10,00,000
1996		*Rs.*	*1996*		*Rs.*
May 31	To Debenture Redemption A/c	75,000	Jan. 1	By Balance b/d	8,80,000
Dec.31	To Debenture Redemption A/c	25,000			
	To Balance c/d	7,80,000			
		8,80,000			8,80,000
1997		*Rs.*	*1997*		*Rs.*
July 31	To Debenture		Jan. 1	By Balance b/d	7,80,000

		Redemption A/c	1,15,000				
Dec.31	To	Balance c/d	6,65,000				
			7,80,000				7,80,000

Debenture Redemption Account

1995			*Rs.*	*1995*			*Rs.*
Sept. 30	To	Bank A/c (Rs. 1,20,000×0.98 – Rs. 1,800)	1,15,800	Sept.30	By	Debenture Stock A/c	1,20,000
	To	Capital Reserve A/c	4,200				
			1,20,000				1,20,000
1996			*Rs.*	*1996*			*Rs.*
May 30	To	Bank A/c (Rs. 75,000 × 0.95)	71,250	May 31	By	Debenture Stock A/c	75,000
				Dec. 31	By	Debenture Stock A/c	25,000
	To	Capital Reserve A/c (Profit on cancellation)	3,750				
Dec.31	To	Bank A/c (Shortfall=Rs.1,00,000 – Rs. 75,000)	25,000				
			1,00,000				1,00,000
1997			*Rs.*	*1997*			*Rs.*
July 31	To	Bank A/c (Rs. 1,15,000 ×.92 – Rs. 575)	1,05,225	July 31	By	Debenture Stock A/c	1,15,000
	To	Capital Reserve A/c (Profit on cancellation)	9,775				
			1,15,000				1,15,000

Debenture Interest Account

1997		Rs.	1997		Rs.
June 30	To Bank A/c	30,000	Dec. 31	By Profit and Loss A/c	58,200
Sept. 30	To Bank A/c	1,800			
Dec. 31	To Bank A/c	26,400			
		58,200			58,200

1996		Rs.	1996		Rs.
May 31	To Bank A/c	1,875	Dec. 31	By Profit and Loss A/c	50,175
June 31	To Bank A/c	24,150			
Dec. 31	To Bank A/c	24,150			
		50,175			50,175

1997		Rs.	1997		Rs.
June 30	To Bank A/c	23,400	Dec. 31	By Profit and Loss A/c	43,925
July 31	To Bank A/c	575			
Dec. 31	To Bank A/c	19,950			
		43,925			43,925

Working Notes :

Interest paid on Debentures @6% per annum:

Date	*Amount of Debentures* *Rs.*	*Period*	*Interest* *Rs.*
1995			
June 30	10,00,000	6 months	30,000
Sept. 30	1,20,000	3 months	1,800
Dec. 31	8,80,000	6 months	26,400
1996			
May 31	75,000	5 months	1,875
June 30	8,05,000	6 months	24,150

Dec. 31	8,05,000	6 months	24,150
1997			
June 30	7,80,000	6 months	23,400
July 31	1,15,000	1 month	575
Dec. 31	6,65,000	6 months	19,950

Notes : (1) It has been assumed that debentures are purchased for immediate cancellation.

(2) The purchases of 30th September, 1995 and 31st July, 1997 have been taken on cum-interest basis

Question 7

Pass journal entries in year 1 in the case of the issue of debentures by ABC Co. Ltd.:

Issued Rs. 1,00,000, 11% debentures at 95% redeemable at the end of 10 years.

(i) at 102%, and (ii) at 98%

Answer

ABC Co. Ltd.

Journal Entries

			Dr.	*Cr.*
			Rs.	*Rs.*
(i)	Bank A/c	Dr.	95,000	
	Discount on issue of debentures A/c	Dr.	5,000	
	Loss on issue of debentures A/c	Dr.	2,000	
	To 11% Debentures A/c			1,00,000
	To Premium on Redemption of debentures A/c			2,000
	(Issue of Rs. 1,00,000 11% debentures at a discount of 5% but redeemable at a premium of 2%)			
(ii)	Bank A/c	Dr.	95,000	
	Discount on issue of debentures A/c	Dr.	5,000	
	To 11% Debentures A/c			1,00,000
	(Issue of Rs. 1,00,000, 11% debentures at a discount of 5% and redeemable at discount of 2%)			

Question 8

On 1st April, 2007, in MK Ltd's ledger 9% debentures appeared with a opening balance of Rs. 50,00,000 divided into 50,000 fully paid debentures of Rs. 100 each issued at par.

Interest on debentures was paid half-yearly on 30th of September and 31st March every year.

On 31.5.2007, the company purchased 8,000 debentures of its own @ Rs. 98 (ex-interest) per debenture.

On 31.12.2007 it cancelled 5,000 debentures out of 8,000 debentures acquired on 31.5.2007.

On 31.1.2008 it resold 2,000 of its own debentures in the market @ Rs. 101 (ex-interest) per debenture.

You are required to prepare:

(i) Own debentures account;

(ii) Interest on debentures account; and

(iii) Interest on own debentures account.

Answer

MK Ltd.'s Ledger

(i) Own Debentures Account

			Rs.				Rs.
31.5.07	To	Bank	7,84,000	31.12.07	By	9% Debentures A/c	5,00,000
31.12.07	To	Capital Reserve (Profit on cancellation)	10,000	31.1.08	By	Bank- Resale of 2,000 debentures	2,02,000
31.1.08	To	Profit and Loss A/c (Profit on resale)	6,000	31.3.08	By	Balance c/d	98,000
			8,00,000				8,00,000

(ii) Interest on Debentures Account

			Rs.				Rs.
31.5.07	To	Bank (Interest for 2 months on 8,000 debentures)	12,000	31.3.08	By	Profit and Loss A/c	4,38,750
30.9.07	To	Interest on own debentures (Interest for 4 months on 8,000	24,000				

		debentures)					
30.9.07	To	Bank (Interest for 6 months on 42,000 debentures)	1,89,000				
31.12.07	To	Interest on own debentures (Interest for 3 months on 5,000 debentures)	11,250				
31.3.08	To	Interest on own debentures (Interest for 6 months on 1,000 debentures)	4,500				
31.3.08	To	Bank (Interest for 6 months on 44,000 debentures)	1,98,000				
			4,38,750				4,38,750

(iii) Interest on Own Debentures Account

			Rs.				Rs.
31.3.08	To	Profit and Loss A/c	45,750	30.9.07	By	Interest on Debentures A/c	24,000
				31.12.07	By	Interest on Debentures A/c	11,250
				31.01.08	By	Bank (interest for 4 months on 2,000 debentures)	6,000
				31.03.08	By	Interest on Debentures	4,500
			45,750				45,750

Working Note:

31.5.07	Acquired 8,000 Debentures @ 98 per debenture (ex-interest)		*Rs.*
	Purchase price of debenture 8,000 × Rs. 98	=	7,84,000
	Interest for 2 months Rs. 8,00,000 × 9% × $\frac{2}{12}$	=	12,000
30.9.07	Interest on own debentures		
	[Rs. 8,00,000 × 9% × ½] less Rs.12,000	=	24,000
	Interest on other debentures		
	Rs. 42,00,000 × 9% × ½	=	1,89,000
31.12.07	Cancellation of 5,000 own debentures		
	Face value Rs.100 less acquired at Rs.98 = 2 × 5000	=	10,000
31.1.08	Resale of 2,000 Debentures sold for 101 (ex-interest) acquired for Rs. 98 (ex-interest)		
	2,000 × Rs.3 per Debenture	=	6,000
31.12.07	Interest on cancelled 5,000 debentures		
	5,000 × Rs.100 × 9% × $\frac{1}{4}$	=	11,250
31.3.08	Interest on 1,000 own debentures		
	Rs. 1,00,000 × 9% × ½	=	4,500

UNIT 4 : AMALGAMATION AND RECONSTRUCTION

BASIC CONCEPTS

- Amalgamation means joining of two or more existing companies into one company, the joined companies lose their identity and form themselves into a new company.
- In absorption, an existing company takes over the business of another existing company. Thus there is only one liquidation and that is of the merged company.
- A company which is merged into another company is called a transferor company or a vendor company.
- A company into which the vendor company is merged is called transferee company or vendee company or purchasing company.
- In amalgamation in the nature of merger there is genuine pooling of:
  - Assets and liabilities of the amalgamating companies,
  - Shareholders' interest, Also the business of the transferor company is intended to be carried on by the transferee company.
- In amalgamation in the nature of purchase, one company acquires the business of another company.
- Purchase Consideration can be defined as the aggregate of the shares and securities issued and the payment made in form of cash or other assets by the transferee company to the share holders of the transferor company.
- There are two main methods of accounting for amalgamation:
  - The pooling of interests method, and
  - The purchase method.
- Under pooling of interests method, the assets, liabilities and reserves of the transferor company will be taken over by transferee company at existing carrying amounts.
- Under purchase method, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

Reconstruction

- Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares.
- Reconstruction account is a new account opened to transfer the sacrifice made by the shareholders for that part of capital which is not represented by lost assets.
- Reconstruction account is utilized for writing-off fictitious and intangible assets, writing down over-valued fixed assets, recording new liability etc.
- If some credit balance remains in the reconstruction account, the same should be transferred to the capital reserve account.
- Methods of Internal reconstruction :
  - Alteration of share capital :
    - Sub-divide or consolidate shares into smaller or higher Denomination
    - Conversion of share into stock or vice-versa
  - Variation of shareholders' rights :
    - Only the specific rights are changed. There is no change in the amount of capital.
  - Reduction of share capital
  - Compromise, arrangements etc.
  - Surrender of Shares.

Practical Questions:

Question 1

P Ltd. was incorporated on 1.4.99 with an authorised capital of Rs. 5,00,000 divided into equity shares of Rs. 10 each. It tookover the business of P on the basis of following valuation:

	Rs.
Goodwill	*20,000*
Plant	*80,000*
Stock	*15,000*
Debtors	*30,000*
Cash	*5,000*
Creditors	*8,000*

(a) *Purchase consideration was satisfied by issue of equity shares of Rs. 10 at par.*

(b) *Preliminary expenses paid by the company Rs. 8,000.*

(c) *20,000 shares were issued to Public at Rs. 12 each. The shares were fully subscribed and paid up. In addition to the above, the following further balances arise in the books as on 31.3.2000:*

	Rs.		*Rs.*
Purchases	*3,00,000*	*Branch Suspense (Cr.)*	*14,000*
Sales	*5,20,000*	*Bank*	*1,30,000*
Salaries	*60,000*	*Ramprakash (Suspense) (Dr.)*	*30,000*
Other Expenses	*20,000*	*Gulati (Suspense) (Cr.)*	*25,000*
Debtors	*92,000*	*Closing stock*	*20,000*
Building	*1,75,000*	*Creditors*	*18,000*

The following information is also to be considered:

(1) *Ramprakash Suspense A/c represents Rs. 30,000 paid to him for a joint venture business. In addition to the above, Ramprakash spent personally Rs. 20,000 for purchase of goods and Rs. 2,500 for expenses. Sales made by him were Rs. 70,000 and the balance stock was taken over by him at an agreed valuation of Rs. 2,500. Ramprakash is to get 2/5 of the profit.*

(2) *Gulati's Suspense represents advance made by him against a consignment of 10 TV sets, costing Rs. 10,000 each to be priced 35% over cost. Gulati is to get 15% commission on*

sales. Gulati has incurred Rs. 5,000 as transportation charges and has sold 8 TV sets. No entry was passed on sending the goods.

(3) Sales include the following :

(a) Goods sold on "Sale or Return" basis—Cost Rs. 30,000 on which 25% profit was charged. The goods have not yet been accepted by the customer.

(b) Hire-purchase sales Rs. 50,000; prices being determined by adding $33\frac{1}{3}\%$ on cost price. 30% of instalments have not yet fallen due.

(c) Goods sent to branch Rs. 30,000 (Invoice Price) at 25% profit on Cost price. Remittance received from branch has been credited to Branch Suspense Account. Branch returns disclose that branch had Rs. 10,000 closing stock (invoice price), Rs. 500 in cash and Rs. 7,500 in debtors.

(4) Bank balance given above is not in agreement with the balance as per bank statement. Cheques deposited Rs. 10,000 and cheques issued for Rs. 8,000 have not been recorded in the bank statement; Rs. 15,000 cheque dishonoured by a party and bank charges of Rs. 700 have not yet been entered in cash-book.

(5) Provide 5% depreciation on building, 40% for taxation and 15% dividend. Transfer Rs. 20,000 to General Reserve.

(6) All purchases and sales transactions were on credit.

Prepare Balance Sheet as at 31st March, 2000 and Profit & Loss Account for the year ended 31st March, 2000.

Answer

Profit and Loss Account of P Ltd.

for the year ended as at 31st March, 2000

	Rs.			Rs.
To Stock (taken over)	15,000	By Sales		4,37,500
To Purchases	3,00,000	By Goods sent to branch		24,000
To Gross profit c/d	3,34,000	By Goods sent on hire purchase		37,500
		By Goods sent on consignment		1,00,000
		By Closing stock	20,000	
		Add : Goods sent on		
		sale or return basis	30,000	50,000
	6,49,000			6,49,000

To Salaries	60,000	By Gross profit b/d	3,34,000
To Expenses	20,000	By Profit on:	
To Bank charges	700	Joint venture	12,000
To Depreciation on building		Hire purchase	8,750
(5% on Rs. 1,75,000)	8,750	Consignment	7,800
To Provision for taxation	1,11,640	Branch	6,000
(40% of Rs. 2,79,100)			
To Net profit c/d	1,67,460		
	3,68,550		3,68,550
To Proposed dividend	51,300	By Net profit b/d	1,67,460
To General Reserve	20,000		
To Net profit c/d	96,160		
	1,67,460		1,67,460

Balance Sheet of P Ltd.

as at 31st March, 2000

	Rs.			Rs.
Share capital		*Fixed Assets*		
Authorised		Goodwill		20,000
50,000 Equity shares of		Building	1,75,000	
Rs. 10 each, fully paid up	5,00,000	*Less:* Depreciation	8,750	1,66,250
Issued & subscribed:		Plant		80,000
34,200 Equity shares of		*Current assets loans and advances*		
Rs. 10 each, fully paid up	3,42,000	*Current assets :*		
(Out of these shares, 14,200		Closing stock		
shares have been allotted as		Stock in hand	20,000	
fully paid up for consideration		Goods sent on		
other than cash)		approval basis	30,000	
Reserves and surplus:		Hire purchase stock	11,250	
Securities premium	40,000	Consignment stock	21,000	
General reserve	20,000	Branch stock	8,000	90,250

Profit and loss account	96,160	Sundry debtors	24,500	
Current liabilities and Provisions		*Add :* Branch debtors	7,500	32,000
Current liabilities :		Bank		1,14,300
Sundry creditors	18,000	Cash in hand	64,000	
Provisions :		Cash at branch	500	64,500
Provision for taxation	1,11,640	Gulati's account		61,800
Proposed dividend	51,300	Ramprakash's account		42,000
		Miscellaneous expenditure		
		Preliminary expenses		8,000
	6,79,100			6,79,100

Working Notes :

(1) **Sales Account**

		Rs.		Rs.
To Sundry Debtors A/c-			By Balance b/d (given)	5,20,000
Goods sold on sale or return basis $\left[30{,}000\times\frac{125}{100}\right]$		37,500		
To Sundry Debtors A/c				
Hire purchase sales	15,000			
To Sundry Debtors A/c-				
Goods sent to branch,	30,000			
To Profit & Loss A/c	4,37,500			
	5,20,000			5,20,000

(2) **Memorandum Debtors Account**

	Rs.		Rs.
To P (Debtors taken over)	30,000	By Cash	4,78,000
To Sales	4,37,500	By Balance c/d	24,500
To Hire purchase sales	35,000		
	5,02,500		5,02,500

(3) **Sundry Debtors Account**

	Rs.		Rs.
To Balance b/d	92,000	By Sales A/c	
To Bank A/c (cheque dishonoured)	15,000	(Goods sold on sale or return basis)	37,500
		By Sales A/c-	
		H.P. Sales	15,000
		Goods sent to branch	30,000
		By Balance c/d	24,500
	1,07,000		1,07,000

(4) **Branch Account**

	Rs.		Rs.
To Goods sent to Branch A/c	24,000	By Branch Suspense A/c	14,000
To Profit & Loss A/c	6,000	By Balance c/d-	
		Stock $\left[10,000 \times \frac{100}{125}\right]$	8,000
		Cash	500
		Debtors	7,500
	30,000		30,000

(5) **H.P. Trading Account**

	Rs.		Rs.
To Goods sent on H.P. $\left[50,000 \times \frac{3}{4}\right]$	37, 500	By H.P. Sales	35,000
		By H.P. Stock	11,250
To Profit on H.P. $\left[35,000 \times \frac{1}{4}\right]$	8,750		
	46,250		46,250

(6) **Memorandum Joint Venture Account**

	Rs.		Rs.
To Ram Prakash Suspense A/c	30,000	By Ram Prakash A/c-	
To Ram Prakash A/c (Purchases)	20,000	Sales	70,000
To Ram Prakash A/c (Expenses)	2,500	Stock taken over	2,500
To Share of Profits-			
P & L A/c (3/5)	12,000		
Ram Prakash (2/5)	8,000		
	72,500		72,500

(7) **Ram Prakash's Account**

	Rs.		Rs.
To Mem. Joint Venture A/c-		By Mem. Joint Venture A/c-	
Sales	70,000	Purchases	20,000
Stock taken over	2,500	Expenses	2,500
		Profits share	8,000
		By Balance c/d	42,000
	72,500		72,500

(8) **Consignment Account**

	Rs.		Rs.
To Goods sent on			
consignment A/c	1,00,000	By Gulati A/c (Sales)	1,08,000
(10 × 10,000)		By Consignment Stock	
To Gulati A/c (Expenses)	5,000	(2 × 10,000) = 20,000	
To Gulati A/c (Commission)	16,200	*Add :* Expenses	
(1,08,000 × 15%)		$[5,000 \times \frac{2,000}{10,000}] = \underline{1,000}$	21,000
To Profit & Loss A/c	7,800		
	1,29,000		1,29,000

(9) **Gulati's Account**

	Rs.		Rs.
To Consignment A/c	1,08,000	By Gulati Suspense A/c	25,000
$\left[8 \times 10{,}000 \times \frac{135}{100}\right]$		By Consignment A/c-	
		Expenses	5,000
		Commission	16,200
		By Balance c/d	61,800
	1,08,000		1,08,000

(10) **Sundry Creditors Account**

	Rs.		Rs.
To Cash A/c	2,90,000	By P (Creditors taken over)	8,000
To Balance c/d	18,000	By Purchases A/c	3,00,000
	3,08,000		3,08,000

(11) **Cash and Bank Account**

	Rs.		Rs.
To P A/c (Cash taken over)	5,000	By Creditors A/c	2,90,000
To Memorandum Debtors A/c	4,78,000	By Salaries A/c	60,000
To Sundry Debtors A/c	15,000	By Other Expenses A/c	20,000
To Share Capital A/c	2,00,000	By Ram Prakash Suspense A/c	30,000
To Securities Premium A/c	40,000	By Building A/c	1,75,000
To Gulati Suspense A/c	25,000	By Preliminary Expenses A/c	8,000
To Branch Suspense A/c	14,000	By Balance c/d-	
		Bank (given)	1,30,000
		Cash (balance)	64,000
	7,77,000		7,77,000

(12) **Bank Account**

	Rs.		Rs.
To Balance b/d	1,30,000	By Bank ChargesA/c	700
		By Sundry Debtors A/c	

		(Cheque dishonoured)	15,000
		By Balance c/d	1,14,300
	1,30,000		1,30,000

(13) **Calculation of purchase consideration**

	Rs.	*Rs.*
Assets taken over :		
Goodwill	20,000	
Plant	80,000	
Stock	15,000	
Debtors	30,000	
Cash	5,000	1,50,000
Less : Creditors		8,000
Net assets taken over		1,42,000

Purchase consideration will be discharged by issue of 14,200 equity shares of Rs. 10 each.

Notes :

1. The rate of depreciation for Plant has not been given in the question, therefore, no depreciation has been provided on Plant. Students may assume any suitable rate of depreciation and provide for accordingly.
2. Sundry Debtors Account and Memorandum Debtors Account can be combined also.
3. The provision for corporate dividend tax has been ignored.

Question 2

The following is the Balance Sheet of Rocky Ltd. as at March 31, 2002:

Liabilities	*Rs. in lacs*
Fully paid equity shares of Rs. 10 each	*500*
Capital Reserve	*6*
12% Debentures	*400*
Debenture Interest Outstanding	*48*
Trade Creditors	*165*
Directors' Remuneration Outstanding	*10*

Other Outstanding Expenses	*11*
Provisions	*33*
	1,173
Assets	
Goodwill	*15*
Land and Building	*184*
Plant and Machinery	*286*
Furniture and Fixtures	*41*
Stock	*142*
Debtors	*80*
Cash at Bank	*27*
Discount on Issue of Debentures	*8*
Profits and Loss Account	*390*
	1,173

The following scheme of internal reconstruction was framed, approved by the Court, all the concerned parties and implemented:

(i) All the equity shares be converted into the same number of fully-paid equity shares of Rs. 2.50 each.

(ii) Directors agree to forego their outstanding remuneration.

(iii) The debentureholders also agree to forego outstanding interest in return of their 12% debentures being converted into 13% debentures.

(iv) The existing shareholders agree to subscribe for cash, fully paid equity shares of Rs. 2.50 each for Rs. 125 lacs.

(v) Trade creditors are given the option of either to accept fully-paid equity shares of Rs. 2.50 each for the amount due to them or to accept 80% of the amount due in cash. Creditors for Rs. 65 lacs accept equity shares whereas those for Rs. 100 lacs accept Rs. 80 lacs in cash in full settlement.

(vi) The Assets are revalued as under:

	Rs. in lacs
Land and building	*230*
Plant and Machinery	*220*
Stock	*120*
Debtors	*76*

Pass Journal Entries for all the above mentioned transactions and draft the company's Balance Sheet immediately after the reconstruction.

Answer

Journal Entries

		Rs. in lacs	
		Dr.	*Cr.*
Equity Share Capital (Rs. 10 each) A/c	Dr.	500	
To Equity Share Capital (Rs. 2.50 each) A/c			125
To Reconstruction A/c			375
(Conversion of all the equity shares into the same number of fully paid equity shares of Rs. 2.50 each as per scheme of reconstruction)			
Director's Remuneration Outstanding A/c	Dr.	10	
To Reconstruction A/c			10
(Outstanding remuneration foregone by the directors as per scheme of reconstruction)			
12% Debentures A/c	Dr.	400	
Debenture Interest Outstanding A/c	Dr.	48	
To 13% Debentures A/c			400
To Reconstruction A/c			48
(Conversion of 12% debentures into 13% debentures, Debentureholders forgoing outstanding debenture interest)			
Bank	Dr.	125	
To Equity Share Application A/c			125
(Application money received for equity shares)			

Equity Share Application A/c	Dr.	125	
To Equity Share Capital (Rs. 2.50 each) A/c			125
(Application money transferred to share cpital)			
Trade Creditors	Dr.	165	
To Equity Share Capital (Rs. 2.50 each) A/c			65
To Bank A/c			80
To Reconstruction A/c			20
(Trade creditors for Rs. 64 lakhs accepting shares for full amount and those for Rs. 100 lakhs accepting cash equal to 80% of claim in full settlement)			
Capital Reserve	Dr.	6	
To Reconstruction A/c			6
(Capital Reserve being used for purpose of reconstruction)			
Land and Building	Dr.	46	
To Reconstruction A/c			46
(Appreciation made in the value of land and building as per scheme of reconstruction)			
Reconstruction A/c	Dr.	505	
To Goodwill			15
To Plant and Machinery			66
To Stock			22
To Debtors			4
To Discount on issue of Debentures			8
To Profit and Loss Account			390
(Writing off losses and reduction in the values of assets as per scheme of reconstruction—W.N. 1)			

Balance Sheet of Rocky Ltd. (and Reduced) as on 31st March, 2002

Liabilities		*Rs. in lacs*
1,26,000 Fully paid equity shares of Rs. 2.50 each (W.N. 2)		315
(26,000 shares have been issued for consideration other than cash)		
13% Debentures		400
Outstanding Expenses		11
Provisions		33
		759
Assets	*Rs. in lacs*	*Rs. in lacs*
Goodwill	15	
Less : Amount written off under scheme of reconstruction dated...........	15	Nil
Land and Building	184	
Add : Amount of appreciation made under scheme of reconstruction dated..........	46	230
Plant and Machinery	286	
Less: Amount written off under scheme of reconstruction dated.........	66	220
Furniture and Fixtures		41
Stock		120
Debtors	80	
Less: Provision for Bad Debts	4	76
Cash at bank		72
		759

Note : Goodwill has been written off under reconstruction scheme in the solution given above.

Working Notes :

1. *(Rs. in lacs)*

Reconstruction Account

	Rs.		*Rs.*
To Goodwill	15	By Equity Share Capital A/c	375

To	Plant and Machinery	66	By	Director's Remuneration Outstanding A/c	10
To	Stock	22	By	Debenture Interest Outstanding A/c	48
To	Debtors	4	By	Trade Creditors	20
To	Discount on issue of Debentures	8	By	Capital Reserve	6
			By	Land and Building	46
To	Profit and Loss A/c	390			
		505			505

2. Equity share capital as on 31st March, 2002 (after reconstruction)

	Rs.
Equity Share Capital (Rs. 2.50 each)	125
Add: Fresh issue	125
Add: Equity shares issued to creditors	65
	315

3. Cash at bank as on 31st March, 2002 (after reconstruction)

Cash at bank (before reconstruction)	27
Add: Proceeds from issue of equity shares	125
	152
Less: Payment made to creditors	80
	72

Question 3

The Balance Sheet of Y Limited as on 31st March, 2003 was as follows:

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
5,00,000 Equity Shares of Rs. 10 each fully paid	*50,00,000*	*Goodwill*	*10,00,000*
		Patent	*5,00,000*
9% 20,000 Preference shares of Rs. 100 each fully paid	*20,00,000*	*Land and Building*	*30,00,000*
		Plant and Machinery	*10,00,000*
10% First debentures	*6,00,000*	*Furniture and Fixtures*	*2,00,000*

10% Second debentures	*10,00,000*	*Computers*	*3,00,000*
Debentures interest outstanding	*1,60,000*	*Trade Investment*	*5,00,000*
Trade creditors	*5,00,000*	*Debtors*	*5,00,000*
Directors' loan	*1,00,000*	*Stock*	*10,00,000*
Bank O/D	*1,00,000*	*Discount on issue of debentures*	*1,00,000*
Outstanding liabilities	*40,000*		
Provision for Tax	*1,00,000*	*Profit and Loss Account (Loss)*	*15,00,000*
	96,00,000		*96,00,000*

Note: *Preference dividend is in arrears for last three years.*

A holds 10% first debentures for Rs. 4,00,000 and 10% second debentures for Rs. 6,00,000. He is also creditors for Rs. 1,00,000. B holds 10% first debentures for Rs. 2,00,000 and 10% second debentures for Rs. 4,00,000 and is also creditors for Rs. 50,000.

The following scheme of reconstruction has been agreed upon and duly approved by the court.

(i) *All the equity shares be converted into fully paid equity shares of Rs. 5 each.*

(ii) *The preference shares be reduced to Rs. 50 each and the preference shareholders agree to forego their arrears of preference dividends in consideration of which 9% preference shares are to be converted into 10% preference shares.*

(iii) *Mr. 'A' is to cancel Rs. 6,00,000 of his total debt including interest on debentures and to pay Rs. 1 lakh to the company and to receive new 12% debentures for the Balance amount.*

(iv) *Mr. 'B' is to cancel Rs. 3,00,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance amount.*

(v) *Trade creditors (other than A and B) agreed to forego 50% of their claim.*

(vi) *Directors to accept settlement of their loans as to 60% thereof by allotment of equity shares and balance being waived.*

(vii) *There were capital commitments totalling Rs. 3,00,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.*

(viii) *The Directors refund Rs. 1,10,000 of the fees previously received by them.*

(ix) *Reconstruction expenses paid Rs. 10,000.*

(x) *The taxation liability of the company is settled at Rs. 80,000 and the same is paid immediately.*

(xi) The assets are revalued as under:

	Rs.
Land and Building	*28,00,000*
Plant and Machinery	*4,00,000*
Stock	*7,00,000*
Debtors	*3,00,000*
Computers	*1,80,000*
Furniture and Fixtures	*1,00,000*
Trade Investment	*4,00,000*

Pass Journal entries for all the above mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit & Loss Account and Discount on issue of debentures. Prepare Bank Account and working of allocation of Interest on Debentures between A and B.

Answer

Journal Entries in the Books of Y Ltd.

			Dr.	*Cr.*
			Rs.	*Rs.*
(i)	Equity Share Capital (Rs. 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (Rs. 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of Rs. 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (Rs.100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (Rs.50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of Rs. 50 each and claims of preference dividends settled as per scheme of reconstruction.)			

(iii)	10% First Debentures A/c	Dr. 4,00,000	
	10% Second Debentures A/c	Dr. 6,00,000	
	Trade Creditors A/c	Dr. 1,00,000	
	Interest on Debentures Outstanding A/c	Dr. 1,00,000	
	Bank A/c	Dr. 1,00,000	
	To 12% New Debentures A/c		7,00,000
	To Reconstruction A/c		6,00,000
	(Being Rs. 6,00,000 due to A (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)		
(iv)	10% First Debentures A/c	Dr. 2,00,000	
	10% Second Debentures A/c	Dr. 4,00,000	
	Trade Creditors A/c	Dr. 50,000	
	Interest on Debentures Outstanding A/c	Dr. 60,000	
	To 12% New Debentures A/c		4,10,000
	To Reconstruction A/c		3,00,000
	(Being Rs. 3,00,000 due to B (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)		
(v)	Trade Creditors A/c	Dr. 1,75,000	
	To Reconstruction A/c		1,75,000
	(Being remaining creditors sacrificed 50% of their claim.)		
(vi)	Directors' Loan A/c	Dr. 1,00,000	
	To Equity Share Capital (Rs. 5) A/c		60,000
	To Reconstruction A/c		40,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of Rs. 5 each as per scheme of reconstruction.)		
(vii)	Reconstruction A/c	Dr. 15,000	
	To Bank A/c		15,000
	(Being payment made for cancellation of capital commitments.)		

(viii)	Bank A/c	Dr. 1,10,000	
	To Reconstruction A/c		1,10,000
	(Being refund of fees by directors credited to reconstruction A/c.)		
(ix)	Reconstruction A/c	Dr. 10,000	
	To Bank A/c		10,000
	(Being payment of reconstruction expenses.)		
(x)	Provision for Tax A/c	Dr. 1,00,000	
	To Bank A/c		80,000
	To Reconstruction A/c		20,000
	(Being payment of tax for 80% of liability in full settlement.)		
(xi)	Reconstruction A/c	Dr. 47,20,000	
	To Goodwill A/c		10,00,000
	To Patent A/c		5,00,000
	To Profit and Loss A/c		15,00,000
	To Discount on issue of Debentures A/c		1,00,000
	To Land and Building A/c		2,00,000
	To Plant and Machinery A/c		6,00,000
	To Furniture & Fixture A/c		1,00,000
	To Computers A/c		1,20,000
	To Trade Investment A/c		1,00,000
	To Stock A/c		3,00,000
	To Debtors A/c		2,00,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction.)		

Working Notes:

(1) Outstanding interest on debentures have been allocated between A and B as follows:

			Rs.
A's Share			
10% First Debentures	4,00,000		
10% Second Debentures	6,00,000	10,00,000	
10% on Rs. 10,00,000 i.e.			1,00,000
B's Share			
10% First Debentures	2,00,000		
10% Second Debentures	4,00,000	6,00,000	
10% on Rs. 6,00,000 i.e.			60,000
		Total	1,60,000

(2) **Bank Account**

		Rs.			Rs.
To	A (reconstruction)	1,00,000	By	Balance b/d	1,00,000
To	Reconstruction A/c (paid by directors)	1,10,000	By	Reconstruction A/c (capital commitment penalty paid)	15,000
			By	Reconstruction A/c (reconstruction expenses paid)	10,000
			By	Provision for tax A/c(tax paid)	80,000
			By	Balance c/d	5,000
		2,10,000			2,10,000

Question 4

Following are the Balance Sheet of companies as at 31.12.2003:

Liabilities	*D Ltd.*	*V Ltd.*	*Assets*	*D Ltd.*	*V Ltd.*
	Rs.	*Rs.*		*Rs.*	*Rs.*
Equity share capital			*Goodwill*	*6,00,000*	*–*
(Rs. 100)	*8,00,000*	*6,00,000*	*Fixed Assets*	*5,00,000*	*8,00,000*
General Reserve	*4,00,000*	*3,00,000*	*Investments*	*2,00,000*	*4,00,000*

Investment Allowance			*Current Assets*	*4,00,000*	*3,00,000*
Reserve	*–*	*4,00,000*			
Sundry Creditors	*5,00,000*	*2,00,000*			
	17,00,000	*15,00,000*		*17,00,000*	*15,00,000*

D Ltd. took over V Ltd. on the basis of the respective shares value, adjusting wherever necessary, the book values of assets and liabilities on the basis of the following information:

(i) Investment Allowance Reserve was in respect of addition made to fixed assets by V Ltd. in the year 1997-2002 on which income tax relief has been obtained. In terms of the Income Tax Act, 1961, the company has to carry forward till 2006 reserve of Rs. 2,00,000 for utilization.

(ii) Investments of V Ltd. included 1,000 shares in D Ltd. acquired at cost of Rs. 150 per share. The other investments of V Ltd. have a market value of Rs. 1,92,500.

(iii) The market value of investments of D Ltd. are to be taken at Rs. 1,00,000.

(iv) Goodwill of D Ltd. and V Ltd. are to be taken at Rs. 5,00,000 and Rs. 1,00,000 respectively.

(v) Fixed assets of D Ltd. and V Ltd. are valued at Rs. 6,00,000 and Rs. 8,50,000 respectively.

(vi) Current assets of D Ltd. included Rs. 80,000 of stock in trade received from V Ltd. at cost plus 25%.

The above scheme has been duly adopted. Pass necessary Journal Entries in the books of D Ltd. and prepare Balance Sheet of D Ltd. after taking over the business of V Ltd. Fractional share to be settled in cash, rest in shares of D Ltd. Calculation shall be made to the nearest multiple of a rupee.

Answer

Journal Entries in the Books of D Ltd.

		Dr. Amount Rs.	Cr. Amount Rs.
Business Purchase Account	Dr.	12,42,500	
To Liquidator of V Ltd.			12,42,500
(For purchase consideration due)			
Investments Account	Dr.	1,92,500	
Goodwill Account (Balancing figure)	Dr.	1,00,000	

Fixed Assets Account	Dr.	8,50,000	
Current Assets Account	Dr.	3,00,000	
To Sundry Creditors Account			2,00,000
To Business Purchase Account			12,42,500
(For assets and liabilities taken over at agreed value)			
Liquidator of V Ltd.	Dr.	12,42,500	
To Equity Share Capital Account (Rs. 100)			9,03,600
To Securities Premium Account (Rs. 37.50)			3,38,850
To Cash Account			50
(For purchase consideration discharged)			
Goodwill Account	Dr.	16,000	
To Current Assets (Stock) Account			16,000
(For elimination of unrealized profit on unsold stock)			
Amalgamation Adjustment Account	Dr.	2,00,000	
To Investment Allowance Reserve Account			2,00,000
(For incorporation of statutory reserve)			

Balance Sheet of D Ltd.

as on 31st December, 2003

Liabilities	*Amount Rs.*	*Assets*	*Amount Rs.*
Equity Share Capital: 17,036 shares of Rs. 100 each (out of which 9036 shares are issued in favour of vendor for consideration other than cash)	17,03,600	*Fixed Assets* (5,00,000 + 8,50,000)	13,50,000
		Goodwill (6,00,000 + 1,00,000 + 16,000)	7,16,000
General Reserve	4,00,000	Investments (2,00,000 + 1,92,500)	3,92,500
Securities Premium	3,38,850	Current Assets (7,00,000 – 50 – 16,000)	6,83,950
Investment Allowance Reserve	2,00,000		
Sundry Creditors	7,00,000	Amalgamation Adjustment Account	2,00,000
	33,42,450		33,42,450

Working Notes:

1. Calculation of net asset value of shares

	D Ltd.	V Ltd.
	Rs.	Rs.
Goodwill	5,00,000	1,00,000
Fixed Assets	6,00,000	8,50,000
Investments	1,00,000	3,30,000*
Current Assets	4,00,000	3,00,000
	16,00,000	15,80,000
Less: Sundry Creditors	5,00,000	2,00,000
Net assets	11,00,000	13,80,000
Number of shares	8,000	6,000
Value per equity share	137.50	230

*Investments of V Ltd. are calculated as follows:	Rs.
Shares in D Ltd. (1,000 × 137.50)	1,37,500
Market value of remaining investments (given)	1,92,500
	3,30,000

2. Calculation of Purchase Consideration

	Rs.
Net assets of V Ltd.	13,80,000
Value of Shares of D Ltd.	137.50
Number of shares to be issued in D Ltd. to V Ltd. (13,80,000 ÷ 137.50)	10,036.36
Less: Shares already held by V Ltd.	1,000
Additional shares to be issued	9,036.36
Total value of shares to be issued (9036 × 137.50)	12,42,450
Cash payment for fractional share (.36 × 137.50)	50
	12,42,500

Question 5

Exe Limited was wound up on 31.3.2004 and its Balance Sheet as on that date was given below:

Balance Sheet of Exe Limited as on 31.3.2004

Liabilities	Rs.	Assets			Rs.
Share capital:		Fixed assets			9,64,000
1,20,000 Equity shares of Rs. 10 each	12,00,000	Current assets: Stock		7,75,000	
Reserves and surplus:		Sundry debtors	1,60,000		
Profit prior to incorporation	42,000	Less: Provision for bad and doubtful debts	8,000	1,52,000	
Contingency reserve	2,70,000	Bills receivable		30,000	
Profit and loss A/c	2,52,000	Cash at bank		3,29,000	12,86,000
Current liabilities:					
Bills payable	40,000				
Sundry creditors	2,26,000				
Provisions:					
Provision for income tax	2,20,000				
	22,50,000				22,50,000

Wye *Limited took over the following assets at values shown as under:*

Fixed assets Rs. 12,80,000, Stock Rs. 7,70,000 and Bills Receivable Rs. 30,000.

Purchase consideration was settled by Wye Limited as under:

Rs. 5,10,000 of the consideration was satisfied by the allotment of fully paid 10% Preference shares of Rs. 100 each. The balance was settled by issuing equity shares of Rs. 10 each at Rs. 8 per share paid up.

Sundry debtors realised Rs. 1,50,000. Bills payable was settled for Rs. 38,000. Income tax authorities fixed the taxation liability at Rs. 2,22,000.

Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to Rs. 8,000.

You are required to:

(i) *Calculate the number of equity shares and preference shares to be allotted by Wye Limited in discharge of purchase consideration.*

(ii) *Prepare the Realisation account, Cash/Bank account, Equity shareholders account and Wye Limited account in the books of Exe Limited.*

(iii) *Pass journal entries in the books of Wye Limited.*

Answer

(i) Purchase consideration

	Rs.
Fixed assets	12,80,000
Stock	7,70,000
Bills receivable	30,000
Purchase consideration	20,80,000

Amount discharged by issue of preference shares = Rs. 5,10,000

No. of preference shares to be allotted $= \frac{\text{Rs. } 5,10,000}{100} = 5,100$ shares

Amount discharged by allotment of equity shares = Rs. 20,80,000 – Rs. 5,10,000

= Rs. 15,70,000

Paid up value of equity share = Rs. 8

Hence, number of equity shares to be issued $= \frac{\text{Rs. } 15,70,000}{8}$

= 1,96,250 shares

(ii) Realisation Account

In the books of Exe Ltd.

Dr.		Rs.		Cr.	Rs.
To	Fixed assets	9,64,000	By	Provision for bad and doubtful debts	8,000
To	Stock	7,75,000	By	Bills payable	40,000

To	Sundry debtors	1,60,000	By	Sundry creditors	2,26,000
To	Bills receivable	30,000	By	Provision for taxation	2,20,000
To	Bank account:		By	Wye Ltd. account	
	Liquidation expenses	8,000		(Purchase consideration)	20,80,000
	Bills payable	38,000	By	Bank account: Sundry debtors	1,50,000
	Tax liability	2,22,000			
	Sundry creditors	2,11,000			
To	Equity shareholders (profit transferred)	3,16,000			
		27,24,000			27,24,000

Cash/Bank Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Balance b/d	3,29,000	By	Realisation account:	
To	Realisation account:			Liquidation expenses	8,000
	Sundry debtors	1,50,000		Bills payable	38,000
				Tax liability	2,22,000
				Sundry creditors (Balancing figure)	2,11,000
		4,79,000			4,79,000

Equity Shareholders Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	10% Preference shares in Wye Ltd.		By	Equity share capital account	12,00,000
		5,10,000	By	Profit prior to incorporation	42,000
To	Equity shares in Wye Ltd.	15,70,000	By	Contingency reserve	2,70,000
			By	Profit and loss account	2,52,000
			By	Realisation account (Profit)	3,16,000
		20,80,000			20,80,000

Wye Limited Account

Dr.					Cr.
		Rs.			Rs.
To	Realisation account	20,80,000	By	10% Preference shares in Wye Ltd.	5,10,000
			By	Equity shares in Wye Ltd.	15,70,000
		20,80,000			20,80,000

(iii) **Journal Entries**

in the books of Wye Ltd.

Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
Business purchase account	Dr.	20,80,000	
To Liquidator of Exe Ltd. account			20,80,000
(Being the amount of purchase consideration payable to liquidator of Exe Ltd. for assets taken over)			
Fixed assets account	Dr.	12,80,000	
Stock account	Dr.	7,70,000	
Bills receivable account	Dr.	30,000	
To Business purchase account			20,80,000
(Being assets taken over)			
Liquidator of the Exe Ltd. account	Dr.	20,80,000	
To 10% Preference share capital account			5,10,000
To Equity share capital account			15,70,000
(Being the allotment of 10% fully paid up preference shares and equity shares of Rs 10 each, Rs. 8 each paid up as per agreement for discharge of purchase consideration)			

Question 6

Following is the Balance Sheet as at March 31, 2005:

(Rs. '000)

Liabilities	Max Ltd.	Mini Ltd.	Assets	Max Ltd.	Mini Ltd.
Share capital:			Goodwill	20	–
Equity shares of Rs. 100 each	1,500	1,000	Other fixed assets	1,500	760
9% Preference shares of Rs. 100 each	500	400	Debtors	651	440
			Stock	393	680
General reserve	180	170	Cash at bank	26	130
Profit and loss account	–	15	Own debenture (Nominal value Rs. 2,00,000)	192	
12% Debentures of Rs. 100 each	600	200			
Sundry creditors	415	225	Discount on issue of debentures	2	
			Profit and loss account	411	
	3,195	2,010		3,195	2,010

On 1.4.2005, Max Ltd. adopted the following scheme of reconstruction:

(i) *Each equity share shall be sub-divided into 10 equity shares of Rs. 10 each fully paid up. 50% of the equity share capital would be surrendered to the Company.*

(ii) *Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 90% of the dividend claim and accept payment for the balance.*

(iii) *Own debentures of Rs. 80,000 were sold at Rs. 98 cum-interest and remaining own debentures were cancelled.*

(iv) *Debentureholders of Rs. 2,80,000 agreed to accept one machinery of book value of Rs. 3,00,000 in full settlement.*

(v) *Creditors, debtors and stocks were valued at Rs. 3,50,000, Rs. 5,90,000 and Rs. 3,60,000 respectively. The goodwill, discount on issue of debentures and Profit and Loss (Dr.) are to be written off.*

(vi) *The Company paid Rs. 15,000 as penalty to avoid capital commitments of Rs. 3,00,000.*

On 2.4.2005 a scheme of absorption was adopted. Max Ltd. would take over Mini Ltd. The purchase consideration was fixed as below:

(a) Equity shareholders of Mini Ltd. will be given 50 equity shares of Rs. 10 each fully paid up, in exchange for every 5 shares held in Mini Ltd.

(b) Issue of 9% preference shares of Rs. 100 each in the ratio of 4 preference shares of Max Ltd. for every 5 preference shares held in Mini Ltd.

(c) Issue of one 12% debenture of Rs. 100 each of Max Ltd. for every 12% debentures in Mini Ltd.

You are required to give Journal entries in the books of Max Ltd. and draw the resultant Balance Sheet as at 2nd April, 2005.

Answer

In the Books of Max Ltd.

	Particulars		*Dr.*	*Cr.*
01.04.2005			*Amount*	*Amount*
			Rs.	*Rs.*
	Equity share capital A/c	Dr.	15,00,000	
	To Equity share capital A/c			15,00,000
	(Being sub-division of one share of Rs. 100 each into 10 shares of Rs. 10 each)			
	Equity share capital A/c	Dr.	7,50,000	
	To Capital reduction A/c			7,50,000
	(Being reduction of capital by 50%)			
	Capital reduction A/c	Dr.	13,500	
	To Bank A/c			13,500
	(Being payment in cash of 10% of arrear of preference dividend)			
	Bank A/c	Dr.	78,400	
	To Own debentures A/c			76,800
	To Capital reduction A/c			1,600

(Being profit on sale of own debentures transferred to capital reduction A/c)			
12% Debentures A/c	Dr.	1,20,000	
To Own debentures A/c			1,15,200
To Capital reduction A/c			4,800
(Being profit on cancellation of own debentures transferred to capital reduction A/c)			
12% Debentures A/c	Dr.	2,80,000	
Capital reduction A/c	Dr.	20,000	
To Machinery A/c			3,00,000
(Being machinery taken up by debentureholders for Rs. 2,80,000)			
Creditors A/c	Dr.	65,000	
Capital reduction A/c	Dr.	29,000	
To Debtors A/c			61,000
To Stock A/c			33,000
(Being assets and liabilities revalued)			
Capital reduction A/c	Dr.	4,33,000	
To Goodwill A/c			20,000
To Discount on debentures A/c			2,000
To Profit and Loss A/c			4,11,000
(Being the balance of capital reduction transferred to capital reserve account)			
Capital reduction A/c	Dr.	15,000	
To Bank A/c			15,000
(Being penalty paid for avoidance of capital commitments)			

	Capital reduction A/c	Dr.	2,45,900	
	To Capital reserve A/c			2,45,900
	(Being penalty paid for avoidance of capital commitments)			
02.04.2005	Business Purchase A/c	Dr.	13,20,000	
	To Liquidators of Mini Ltd.			13,20,000
	(Being the purchase consideration payable to Mini Ltd.)			
	Fixed Assets A/c	Dr.	7,60,000	
	Stock A/c	Dr.	6,80,000	
	Debtors A/c	Dr.	4,40,000	
	Cash at Bank A/c	Dr.	1,30,000	
	To Sundry Creditors A/c			2,25,000
	To 12% Debentures A/c of Mini Ltd.			2,00,000
	To Profit and Loss A/c			15,000
	To General reserve A/c Rs. (1,70,000 + 80,000*)			2,50,000
	To Business purchase A/c			13,20,000
	(Being the take over of all assets and liabilities of Mini Ltd. by Max Ltd.)			
	Liquidators of Mini Ltd. A/c	Dr.	13,20,000	
	To Equity Share Capital			10,00,000
	To 9% Preference share capital			3,20,000
	(Being the purchase consideration discharged)			
	12% Debentures of Mini Ltd. A/c	Dr.	2,00,000	
	To 12% Debentures A/c			2,00,000
	(Being Max Ltd. issued their 12% Debentures in against of every Debentures of Mini Ltd.)			

* Rs. 80,000 is the balancing figure adjusted to general reserve A/c as per AS 14 "Accounting for Amalgamation".

Balance Sheet of Max Ltd. as at 2.4.2005

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital:		Fixed Assets	19,60,000
Equity Share Capital	17,50,000	Stock	10,40,000
9% Preference share capital	8,20,000	Debtors	10,30,000
Profit and Loss A/c	15,000	Cash in hand/Bank	2,05,900
General Reserve	4,30,000		
Capital Reserve	2,45,900		
12% Debentures	4,00,000		
Sundry Creditors	5,75,000		
	42,35,900		42,35,900

Working Notes:

1. Purchase Consideration

Equity share capital $10{,}000 \times \frac{50}{5} \times \text{Rs.}10$	= 10,00,000
9% Preference share capital $4{,}000 \times \frac{4}{5} \times \text{Rs.}100$	= 3,20,000
	Rs. 13,20,000

2. General Reserve

	Rs.
Share Capital of Mini Ltd. (Equity + Preference)	14,00,000
Less: Share Capital issued by Max Ltd.	13,20,000
General reserve (resulted due to absorption)	80,000
Add: General reserve of Mini Ltd.	1,70,000
General reserve of Max Ltd.	1,80,000
	4,30,000

EXERCISES

Question 1

Star and Moon had been carrying on business independently. They agreed to amalgamate and form a new company Neptune Ltd. with an authorised share capital of Rs. 2,00,000 divided into 40,000 equity shares of Rs. 5 each.

On 31st December, 1995, the respective Balance Sheets of Star and Moon were as follows :

	Star	Moon
	Rs.	Rs.
Fixed Assets	3,17,500	1,82,500
Current Assets	1,63,500	83,875
	4,81,000	2,66,375
Less: Current Liabilities	2,98,500	90,125
Representing Capital	1,82,500	1,76,250

Additional Information :

(a) *Revalued figures of Fixed and Current Assets were as follows :*

	Star	Moon
	Rs.	Rs.
Fixed Assets	3,55,000	1,95,000
Current Assets	1,49,750	78,875

(b) *The debtors and creditors—include Rs. 21,675 owed by Star to Moon.*

The purchase consideration is satisfied by issue of the following shares and debentures :

(i) *30,000 equity shares of Neptune Ltd., to Star and Moon in the porportion to the profitability of their respective business based on the average net profit during the last three years which were as follows :*

	Star	Moon
1993 Profit	2,24,788	1,36,950
1994 (Loss)/Profit	(1,250)	1,71,050
1995 Profit	1,88,962	1,79,500

(ii) *15% debentures in Neptune Ltd., at par to provide an income equivalent to 8% return on capital employed in their respective business as on 31st December, 1995 after revaluation of assets.*

You are requested to :

(1) *Compute the amount of debentures and shares to be issued to Star and Moon.*

(2) *A Balance Sheet of Neptune Ltd., showing the position immediately after amalgamation.*

(**Answer: Total of Balance Sheet of Neptune Ltd. as at 31st December, 1995 7,56,950)**

UNIT 5 : LIQUIDATION OF COMPANIES

BASIC CONCEPTS

In case of winding up of the company, a statement called Statement of affairs is prepared.

- Deficiency Account is the result of capital plus liabilities exceeding the assets or deficit or debit balance in the profit and loss account.
- Overriding preferential payments are the payments to be made for the workman's dues and debts secured to secured creditors to the extent they rank under section 529(1)(c).
- Creditors that have to be paid in priority to unsecured creditors or creditor having a floating charge.
- In case of voluntary winding up, the statement prepared by the Liquidator showing receipts and payment of cash is called "Liquidator's Statement of Account".
- The shareholders who transferred partly paid shares within one year, prior to the date of winding up may be called upon to pay an amount (not exceeding the amount not called up when the shares were transferred) to pay off such creditors as existed on the date of transfer of shares.

(A) Write short notes on:

Question 1

What are the contents of "Liquidators' statement of account"? How frequently does a liquidator has to submit such statement?

Answer

The statement prepared by the liquidator showing receipts and payments of cash in case of voluntary winding up is called "Liquidators' statement of account" (Form No. 156 Rule 329 of the Companies Act, 1956). There is no double entry involved in the preparation of liquidator's statement of account. It is only a statement though presented in the form of an account.

While preparing the liquidator's statement of account, receipts are shown in the following order :

(a) Amount realised from assets are included in the prescribed order.

(b) In case of assets specifically pledged in favour of creditors, only the surplus from it, if any, is entered as 'surplus from securities'.

(c) In case of partly paid up shares, the equity shareholders should be called up to pay necessary amount (not exceeding the amount of uncalled capital) if creditors' claims/claims of preference shareholders can't be satisfied with the available amount. Preference shareholders would be called upon to contribute (not exceeding the amount as yet uncalled on the shares) for paying of creditors.

(d) Amounts received from calls to contributories made at the time of winding up are shown on the Receipts side.

(e) Receipts per Trading Account are also included on the Receipts side.

Payments made to redeem securities and cost of execution and payments per Trading Account are deducted from total receipts.

Payments are made and shown in the following order :

(a) Legal charges;

(b) Liquidator's expenses;

(d) Debentureholders (including interest up to the date of winding up if the company is insolvent and to the date of payment if it is solvent);

(e) Creditors :

(i) Preferential (in actual practice, preferential creditors are paid before debenture holders having a floating charge);

(ii) Unsecured creditors;

(f) Preferential shareholders (Arrears of dividends on cumulative preference shares should be paid up to the date of commencement of winding up); and

(g) Equity shareholders.

Liquidator's statement of account of the winding up is prepared for the period starting from the commencement of winding up to the close of winding up. If winding up of company is not concluded within one year after its commencement, Liquidator's statement of account pursuant to section 551 of the Companies Act, 1956 (Form No. 153) is to be filed by a Liquidator within a period of two months of the conclusion of one year and thereafter until the winding up is concluded at intervals of not more than one year or at such shorter intervals, if any, as may be prescribed.

Question 2

Overriding preferential payments under section 529A of the Companies Act, 1956.

Answer

The Companies (Amendment) Act, 1985 introduced Section 529A which states that certain dues are to be settle in the case of winding up of a company even before the payments to preferential creditors under Section 530. Section 529A states that in the event of winding up of a company, workmen's dues and debts due to secured creditors, to the extent such debts rank under Section 529(1)(c), shall be paid in priority to all other debts. The debts provable [Section 529(i)(a)] and the valuation of annuities and future and contingent liabilities [Section 529(1)(b)] shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

Workmen's dues, in relation to a company, means the aggregate of the following sums:

1. all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman, in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947;
2. all accrued holiday remuneration becoming payable to any workman, or in the case of his death to any other person in his right, on the termination of his employment before, or by the effect of, the winding up order or resolution;
3. all amounts due in respect of any compensation or liability for compensation under Workmen's Compensation Act, 1923 in respect of death or disablement of any workman of the company;
4. all sum due to any workman from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the workmen, maintained by the company.

Question 3

B List of Contributories and the liability of contributories included in the list.

Answer

The shareholders who transferred partly paid shares (otherwise than by operation of law or by death) within one year, prior to the date of winding up may be called upon to pay an amount (not exceeding the amount not called up when the shares were transferred) to pay off such creditors as existed on the date of transfer of shares.

Their liability will crystallize only (i) when the existing assets available with the liquidator are not sufficient to cover the liabilties; (ii) when the existing shareholders fail to pay the amount due on the shares to the liquidator.

(B) Practical Questions :

Question 1

Pessimist Ltd. has gone into liquidation on 10th May, 2000. The details of members, who have ceased to be members, within the year ended 31st March, 2000 are given below. The debts that could not be paid out of realisation of assets and contribution from present membrs ('A' contributories) are also given with their date-wise break up. Shares are of Rs. 10 each, Rs. 6 per share paid up.

You are to determine the amount realisable from each person.

Shareholders	*No. of shares transferred*	*Date of transfer*	*Proportionate unpaid debts*
P	*1,000*	*20.04.1999*	*3,000*
Q	*1,200*	*15.05.1999*	*5,000*
R	*1,500*	*18.09.1999*	*9,200*
S	*800*	*24.12.1999*	*10,500*
T	*500*	*12.03.2000*	*11,000*

Answer

Statement of liabilities of B List Contributories

	Q	*R*	*S*	*T*	*Amount*
Creditors outstanding on the date of transfer (ceasing to be member)					to be paid to creditors
No. of shares	1,200	1,500	800	500	

Date		Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
15.5.99		5,000	1,500	1,875	1,000	625	5,000
18.9.99	9,200						
	–5,000	4,200	–	2,250	1,200	750	4,200
	10,500						
24.12.99	-9,200	1,300	–	–	800	500	1,300
	11,000						
12.3.2000	10,500	500	–	–	–	500	125*
Total (a)		11,000	1,500	4,125	3,000	2,375	10,625
Maximum liability on shares held (b)			4,800	6,000	3,200	2,000	
Amount paid (a) and (b) whichever is lower			1,500	4,125	3,000	2,000	

Working Note:

P Will not be liable since he transferred his shares prior to one year preceding the date of winding up. The amount of Rs. 5,000 outstanding on 15th May, 1999 will have to contributed by Q, R, S and T in the ratio of number of shares held by them, i.e. in the ratio of 12:15:8:5; thus Q will have to contribute Rs. 1,500; R Rs. 1,875; S Rs. 1,000; T Rs. 625. Similarly, the further debts incurred between 15th May, 1999 to 18th September, 1999, viz. Rs. 4,200 for which Q is not liable will be contributed by R, S and T in the ratio of 15:8:5. R will have to contribute Rs. 2,250. S and T will contribute Rs. 1,200 and Rs. 750 respectively. The further increase from Rs. 9,200 to Rs. 10,500 viz. Rs. 1,300 occurring between 18th September and 24th December will be shared by S and T who will be liable for Rs. 800 and Rs. 500 respectively. The increase between 24th December and 12th March, is solely the responsibility of T.

Question 2

Liquidation of YZ Ltd. commenced on 2nd April, 2004. Certain creditors could not receive payments out of the realisation of assets and out of the contributions from A list contributories. The following are the details of certain transfers which took place in 2003 and 2004:

* Against T's liability of Rs. 2,375, he can be called upon to pay Rs. 2,000, the loss of Rs. 375 will have to be suffered by the creditors.

Shareholders	*No. of Shares transferred*	*Date of Ceasing to be a member*	*Creditors remaining unpaid and outstanding on the date of such transfer*
A	*2,000*	*1st March, 2003*	*Rs. 5,000*
P	*1,500*	*1st May, 2003*	*Rs. 3,300*
Q	*1,000*	*1st October, 2003*	*Rs. 4,300*
R	*500*	*1st November, 2003*	*Rs. 4,600*
S	*300*	*1st February, 2004*	*Rs. 6,000*

All the shares were of Rs. 10 each, Rs. 8 per share paid up. Show the amount to be realised from the various persons listed above ignoring expenses and remuneration to liquidator etc.

Answer

Statement of liabilities of B list contributories

Share-holders	*No. of shares transferred*	*Maximum liability (upto Rs. 2 per share)*	*Division of Liability as on 1.5.2003*	*1.10.2003*	*1.11.2003*	*1.2.2004*	*Total*
		Rs.	*Rs.*	*Rs.*	*Rs.*	*Rs.*	*Rs.*
P	1,500	3,000	1,500	–	–	–	1,500
Q	1,000	2,000	1,000	555	–	–	1,555
R	500	1,000	500	278	188	–	966
S	300	600	300	167	112	21	600
	3,300	6,600	3,300	1,000	300	21	4,621

Working Note:

Date	Cumulative liability	Increase in liability	Ratio of no. of shares held by the members
1.5.2003	3,300	–	30 : 20 : 10 : 6
1.10.2003	4,300	1,000	20 : 10 : 6
1.11.2003	4,600	300	10 : 6
1.2.2004	6,000	1,400	Only S

Liability of S has been restricted to the maximum allowable limit of Rs. 600, therefore amount payable by S is restricted to Rs. 21 only, on 1.2.2004.

Notes:

1. A will not be liable to pay to the outstanding creditors since he transferred his shares prior to one year preceding the date of winding up.
2. P will not be responsible for further debts incurred after 1st May, 2003 (from the date when he ceases to be member). Similarly, Q and R will not be responsible for the debts incurred after the date of their transfer of shares.

Question 3

The position of Valueless Ltd. on its liquidation is as under:

Issued and paid up Capital:

3,000 11% preference shares of Rs. 100 each fully paid.

3,000 Equity shares of Rs. 100 each fully paid.

1,000 Equity shares of Rs. 50 each Rs. 30 per share paid.

Calls in Arrears are Rs. 10,000 and Calls received in Advance Rs. 5,000. Preference Dividends are in arrears for one year. Amount left with the liquidator after discharging all liabilities is Rs. 4,13,000. Articles of Association of the company provide for payment of preference dividend arrears in priority to return of equity capital. You are required to prepare the Liquidators final statement of account.

Answer

Liquidators' Final Statement of Account

Receipts	*Rs.*	*Payments*	*Rs.*
Cash	4,13,000	Return to contributors:	
Realisation from:		Preference dividend	33,000
Calls in arrears	10,000	Preference shareholders	3,00,000
Final call of Rs. 5 per		Calls in advance	5,000
equity share of Rs. 50 each (Rs. 5 × 1,000)	5,000	Equity shareholders of Rs. 100 each (3,000 × Rs. 30)	90,000
	4,28,000		4,28,000

Working Note:

			Rs.
Cash account balance			4,13,000
Less:	Payment for dividend	33,000	
	Preference shareholders	3,00,000	
	Calls in advance	5,000	3,38,000
			75,000
Add: Calls in arrears			10,000
			85,000
Add: Amount to be received from equity shareholders of Rs. 50 each (1,000 × 20)			20,000
Amount disposable			1,05,000

Number of equivalent equity shares:

3,000 shares of Rs. 100 each = 6,000 shares of Rs. 50 each

1,000 shares of Rs. 50 each = 1,000 shares of Rs. 50 each

= 7,000 shares of Rs. 50 each

$$\text{Final payment to equity shareholders} = \frac{\text{Amount left for distribution}}{\text{Total number of equivalent equity shares}}$$

= Rs. 1,05,000 / 7,000 shares = Rs. 15 per share to equity shareholders of Rs. 50 each.

Therefore for equity shareholders of Rs. 100 each $\left(\text{Rs.}\,15 \times \frac{100}{50}\right)$

= Rs. 30 per share to equity shareholders of Rs. 100 each.

Calls in advance must be paid first, so as to pay the shareholders on prorata basis. Equity shareholders of Rs. 50 each have to pay Rs. 20 and receive Rs. 15 each. As a result, they are required to pay net Rs. 5 per share.

Question 4

The following particulars relate to a Limited Company which has gone into voluntary liquidation. You are required to prepare the Liquidator's Statement of Account allowing for his remuneration

@ 2½% on all assets realized excluding call money received and 2% on the amount paid to unsecured creditors including preferential creditors.

Share capital issued:

10,000 Preference shares of Rs.100 each fully paid up.

50,000 Equity shares of Rs.10 each fully paid up.

30,000 Equity shares of Rs.10 each, Rs.8 paid up.

Assets realized Rs.20,00,000 excluding the amount realized by sale of securities held by partly secured creditors.

	Rs.
Preferential creditors	*50,000*
Unsecured creditors	*18,00,000*
Partly secured creditors (Assets realized Rs.3,20,000)	*3,50,000*
Debentureholders having floating charge on all assets of the company	*6,00,000*
Expenses of liquidation	*10,000*

A call of Rs.2 per share on the partly paid equity shares was duly received except in case of one shareholder owning 1,000 shares.

Also calculate the percentage of amount paid to the unsecured creditors to the total unsecured creditors.

Answer

(a) (i) Liquidator's Final Statement of Account

		Rs.					Rs.
To	Assets Realised	20,00,000	By	Liquidator's remuneration			
To	Receipt of call money on 29,000 equity shares @ 2 per share	58,000		2.5% on 23,20,000*		58,000	
				2% on 50,000		1,000	
				2% on (W.N.3)	13,12,745	<u>26,255</u>	85,255

* Total assets realised = Rs.20,00,000 + Rs.3,20,000 = Rs.23,20,000

	By	Liquidation Expenses	10,000
	By	Debenture holders having a floating charge on all assets	6,00,000
	By	Preferential creditors	50,000
_______	By	Unsecured creditors	13,12,745
20,58,000			20,58,000

(ii) Percentage of amount paid to unsecured creditors to total unsecured creditors

$$= \frac{13,12,745}{18,30,000} \times 100 = 71.73\%$$

Working Notes:

1. Unsecured portion in partly secured creditors=Rs.3,50,000-Rs.3,20,000

   = Rs.30,000

2. Total unsecured creditors = 18,00,000 + 30,000 (W.N.1)

   = Rs.18,30,000

3. Liquidator's remuneration on payment to unsecured creditors

   Cash available for unsecured creditors after all payments including payment to preferential creditors & liquidator's remuneration on it = Rs.13,39,000

   Liquidator's remuneration on unsecured creditors = $\frac{2}{102} \times 13,39,000 = \text{Rs.}26,255$

   or on Rs. 13,12,754 x 2/100 = Rs. 26,255

EXERCISES

Question 1

The following is the Balance Sheet of Y Limited as at 31st March, 1994:

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets :	
2,000 Equity Shares of Rs. 100		Land & Buildings	4,00,000
each Rs. 75 per share paid up	1,50,000	Plant and Machineries	3,80,000
6,000 equity shares of Rs. 100		Current Assets :	
each Rs. 60 per share paid up	3,60,000	Stock at cost	1,10,000
		Sundry Debtors	2,20,000
2,000 10% Preference Share of		Cash at Bank	60,000
Rs. 100 each fully paid up	2,00,000	Profit and Loss A/c	2,40,000
10% Debentures (having a floating			
charge on all assets)	2,00,000		
Interest accrued on Debentures			
(also secured as above)	10,000		
Sundry Creditors	4,90,000		
	14,10,000		14,10,000

On that date, the company went into Voluntary Liquidation. The dividends on preference shares were in arrear for the last two years. Sundry Creditors include a loan of Rs. 90,000 on mortgage of Land and Buildings. The assets realised were as under :-

	Rs.
Land and Buildings	3,40,000
Plant & Machineries	3,60,000
Stock	1,20,000
Sundry Debtors	1,60,000

Interest accrued on loan on mortgage of buildings upto the date of payment amounted to Rs. 10,000. The expenses of Liquidation amounted to Rs. 4,600. The Liquidator is entitled to a *remuneration of 3% on all the assets realised (except cash at bank) and 2% on the amounts distributed among equity shareholders. Preferential creditors included in sundry creditors amount to Rs. 30,000. All payments were made on 30th June, 1994. Prepare the liquidator's final statement of account.*

(Answer: Payment to Equity shareholders Rs.35,000 (Rs. 17.50 per share on 2,000 shares) & Rs.15,000 (Rs. 2.50 per share on 6,000 shares)

Question 2

In a winding up of a company, certain creditors remained unpaid. The following persons had transferred their holding sometime before winding up :

Name	*Date of Transfer 1996*	*No. of Shares transferred*	*Amount due to creditors on the date of transfer Rs.*
P	*January 1*	*1,000*	*7,500*
Q	*February 15*	*400*	*12,500*
S	*March 15*	*700*	*18,000*
T	*March 31*	*900*	*21,000*
U	*April 5*	*1,000*	*30,000*

The shares were of Rs. 100 each, Rs. 80 being called up and paid up on the date of transfers.

A member, R, who held 200 shares died on 28th February, 1996 when the amount due to creditors was Rs. 15,000. His shares were transmitted to his son X.

Z was the transferee of shares held by T. Z paid Rs. 20 per share as calls in advance immediately on becoming a member.

The liquidation of the company commenced on 1st February, 1997 when the liquidator made a call on the present and the past contributories to pay the amount.

You are asked to quantify the maximum liability of the transferors of shares mentioned in the above table, when the transferees:

(i) pay the amount due as "present" member contributories;

(ii) do not pay the amount due as "present" member contributories.

Also quantity the liability of X to whom shares were transmitted on the demise of his father R.

(Answer Liability of Q, R/X, S and U will be Rs. 2,174, Rs.3,666, Rs. 5,830 and Rs.18,330 respectively.)

Question 3

The following was the Balance Sheet of X Limited as on 31.3.1998 :

Balance Sheet of X Limited as at 313.1998

Liabilities	Rs.	Assets	Rs.
Share Capital		Fixed Assets	
14%, 40,000 preference shares of		Land	40,000
Rs. 100 each fully paid up	4,00,000	Buildings	1,60,000
8,000 equity shares of Rs. 100 each,		Plant and Machinery	5,40,000
Rs. 60 per share paid up	4,80,000	Patents	40,000
Reserves and Surplus	NIL	Investments	NIL
Secured Loans		Current assets, loans and advances	
1. 14% debentures	2,30,000	A. Current Assets	
(Having a floating charge		Stock at cost	1,00,000
on all assets)		Sundry debtors	2,30,000
Interest accrued on above		Cash at bank	60,000
debentures	32,200	B. Loans and Advances	NIL
(Also having a floating		Miscellaneous expenses	
charge as above)		Profit and Loss A/c	2,40,000
2. Loan on mortgage of land			
and building	1,50,000		
Unsecured Loan	NIL		
Current Liabilities and provisions			
A. Current liabilities			
Sundry creditors	1,17,800		
	14,10,000		14,10,000

On 31.3.1998 the company went into voluntary liquidation. The dividend on 14% preference shares was in arrears for one year. Sundry creditors include preferential creditors amounting to Rs. 30,000.

The assets realised the following sums

Land Rs. 80,000; Buildings Rs. 2,00,000; Plant and machinery Rs. 5,00,000; Patent Rs. 50,000; Stock Rs. 1,60,000; Sundry debtors Rs. 2,00,000.

The expenses of liquidation amounted to Rs. 29,434. The liquidator is entitled to a commission of 2% on all assets realised (except cash at bank) and 2% on amounts among unsecured creditors other than preferential creditors. All paymnts the on 30th June, 1998. Interest on mortgage loan shall be ignored at the time of payment.

Prepare the liquidator's final statement of account.

(Answer: Payment to Equity shareholders Rs. 2,00,960 (Rs. 25.12 per share on 8,000 shares)

CHAPTER 5

FINANCIAL STATEMENTS OF INSURANCE COMPANIES

BASIC CONCEPTS

- ***Claims:*** it refers to the amount payable by insurer to the insured when policy becomes due or the mishappening occurs.

  Claim = Claim intimated + Survey fees + Medical expenses – Claims received on insurance.

- ***Premium*** **:** it refers to the consitderation received by the insurance company to undertake the risk of the loss.it is always net of premium paid on reinsurace.

- ***Annuity (LIC):*** it is fixed annual payment received regularly till insured lives. This is in consideration of lumpsum money paid by him in the beginning of the policy.

- ***Bonus:*** the profit of LIC is distributed among the shareholders and policy holders. The policy holders get 95% of the profit of LIC by way of bonus. The bonus may be of following types:

  - *Cash Bonus:* paid on declaration of bonus in cash.
  - *Revisionery Bonus:* it is paid with the policy maturity instead of cash amount now. This bonus is added in the amount of claims.
  - *Bonus in reduction of Premium:* Bonus is not paid in cash but adjusted against the future premiums.
  - *Interim Bonus:* it refers to bonus paid on the maturity of policy in the year for which the profit has not yet been determined. Such a bonus is included in claims.

- ***Reinsurance :*** if an insurer is not willing to bear the whole of the risk, it reinsure itself. Some risk retains with some other insurer.

- ***Commission on Reinsurance Accepted:*** the reinsurer generally allows commission to reinsured on aprt of business ceded. This is treated as expense of the company.

- ***Commission on Reinsurance ceded:*** Reinsurance generally gets commission for giving the business under reinsurance contract. It appears as an income in revenue account.

- ***Coinsurance:*** when a large risk is offered to an insurance company, then that insurance company retains certain percentage of sum insured and contracts other insurance company to underwriter the balance of risk. In this way, all the companies jointly bear the risk. One is called as the leader who issues the policy and acts on behalf of others.
- ***Reserve for unexpired Risk:***

For Marine Business	=	100% of net premium income
For others	=	40% of net premium income

  (Income tax authorities allow even a provision of 50% of net premium income from other sources)

FINANCIAL STATEMENTS OF INSURANCE COMPANIES

Life Insurance Business

The insurance company carrying life insurance business is required to prepare Balance sheet form A – BS Revenue account [Policy holders' account] Form A- RA Profit and loss account form A-PL. These forms have been given in the IRDA Regulations, 2002.

No form has been specified for cash flow statement.

General Insurance Business

The insurance company carrying on general insurance business is required to prepare Balance sheet form B – BS Revenue account [Policy holders' account] Form B- RA Profit and loss account form B-PL. These forms have been given in the IRDA Regulations, 2002.

No form has been specified for cash flow statement.

(A) Write short notes on:

Question 1

Unexpired Risks Reserve

Answer

In most cases policies are renewed annually except in some cases where policies are issued for a shorter period. Since insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies extend into the following year during which the risk continues. Therefore on the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year and therefore, a provision for unexpired risks is made at normally 50% in case of Fire Insurance and 100% of in case of Marine Insurance. This reserve is based on the net premium income earned by the insurance company during the year

Question 2

Re-insurance.

Answer

If an insurer does not wish to bear the whole risk of policy written by him, he may reinsure a part of the risk with some other insurer. In such a case the insurer is said to have ceded a part of his business to other insurer. The reinsurance transaction may thus be defined as an agreement between a 'ceding company' and 'reinsurer' whereby the former agreed to 'cede' and the latter agrees to accept a certain specified share of risk or liability upon terms as set out in the agreement.

A 'ceding company' is the original insurance company which has accepted the risk and has agreed to 'cede' or pass on that risk to another insurance company or a reinsurance company. It may however be emphasised that the original insured does not acquire any right under a reinsurance contract against the reinsurer. In the event of loss, therefore, the insured's claim for full amount is against the original insurer. The original insurer has to claim the proportionate amount from the reinsurer.

There are two types of reinsurance contracts, namely, facultative reinsurance and treaty reinsurance. Under facultative reinsurance each transaction has to be negotiated individually and each party to the transaction has a free choice, i.e., for the ceding company to offer and the reinsurer to accept. Under treaty reinsurance a treaty agreement is entered into between ceding company and the reinsurer whereby the volume of the reinsurance transactions remain within the limits of the treaty.

Question 3

Give accounting entries pertaining to re-insurance business ceded to and by an insurance company and also corresponding commission entries?

Answer

A re-insurance business transaction may be defined as an agreement between a ceding company and re-insurer, whereby the former agrees to cede and the latter agrees to accept a certain specified share of risk or liability upon terms as set out in the agreement. The accounting entries pertaining to re-insurance business ceded to and by an insurance company may be explained with the help of an example given below:

(X insurance company cedes re-insurance business to Y insurance company and Z insurance company cedes re-insurance business to X insurance company.) Accounting entries pertaining to re-insurance business ceded to and by X insurance company in the above example may be given as follows :

1.	Re-insurance Premium (on re-insurance ceded) Account To Y Insurance Company (Being premium on re-insurance business ceded to Y insurance company recorded)	Dr.
2.	Z Insurance Company To Re-insurance Premium (on re-insurance accepted) Account (Being premium on business ceded by Z insurance company recorded)	Dr.
3.	Y Insurance Company To Claims (on re-insurance ceded) Account (Being claims receivable from Y Co. for part of insurance business ceded)	Dr.
4.	Claims (on re-insurance accepted) Account To Z Insurance Company (Being claims on re-insurance business accepted from Z Company recorded	Dr.
5.	Y Insurance Company To Commission (on re-insurance ceded) Account (Being commission due on re-insurance business ceded to Y insurance company recorded)	Dr.

6. Commission (on re-insurance accepted) Account Dr.
   To Z Insurance Company
   (Being commission due on re-insurance business ceded to Z Company debited)

Question 4

Give computation of "premium income," "claims expense" and "commission expense" in the case of an insurance company.

Answer

Premium income : The payment made by the insured as consideration for the grant of insurance is known as premium. The amount of premium income to be credited to revenue account for a year may be computed as:

		Rs.
Premium received on risks undertaken during the year		
(direct & re-insurance accepted)		–
Add : Receivable at the end of year (direct & re-insurance accepted)		–
Less : Receivable at the beginning of year (direct & re-insurance accepted)		–
Less : Premium on re-insurance ceded:		–
Paid during the year	–	
Add : Payable at the end of year	–	
Less : Payable at the beginning of year	–	
Premium income		–

Claims expenses: A claim occurs when a policy falls due for payment. In the case of alife insurance business, it will arise either on death or maturity of policy that is, on the expiry of the specified term of years. In the case of general insurance business, a claim arises only when the loss occurs or the liability arises.

The amount of claim to be charged to revenue account may be worked out as under :

	Rs.
Claims settled during the year—direct & re-insurance accepted	–
(including legal fees, survey charges etc.)	
Add : Payments to co-insurers	–

Less : Received from co-insurers and re-insurers	–
Net payment	–
Add : Estimated liability at the end of the year	–
(After deducting recoverable from co-insurers and re-insurers)	
Less : Estimated liability at the beginning of the year	–
(after deducting recoverable from co-insurers and re-insurers)	
Claims expense	–

Commission expenses: Insurance Regulatory and Development Authority Act, 1999 regulates the commission payable on policies to agents. Commission expense to be charged to revenue account is computed as follows:

	Rs.
Commission paid (direct & re-insurance accepted)	–
Add : Commission payable at the end of the year	–
(direct & re-insurance accepted)	
Less : Commission payable at the beginning of the year	–
(direct & re-insurance accepted)	
Commission expense	–

(B) Practical Questions:

Question 1

From the following figures appearing in the books of Fire Insurance division of a General Insurance Company, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 1999:

		Direct Business	*Re-Insurance*
		Rs.	*Rs.*
Claim paid during the year		*46,70,000*	*7,00,000*
Claim Payable—	*1st April, 1998*	*7,63,000*	*87,000*
	31st March, 1999	*8,12,000*	*53,000*
Claims received		–	*2,30,000*
Claims Receivable—	*1st April, 1998*	–	*65,000*
	31st March, 1999	–	*1,13,000*
Expenses of Management		*2,30,000*	–

(includes Rs. 35,000 Surveyor's fee and Rs. 45,000 Legal expenses for settlement of claims)

Answer

General Insurance Company

(Abstract showing the amount of claims)

	Rs. '000	Rs. '000
Claims *less* Re-insurance :		
Paid during the year	52,20	
Add : Outstanding claims at the end of the year	7,52	
	59,72	
Less : Outstanding claims at the beginning of the year	7,85	51,87

Working Notes :

	Rs. '000	Rs. '000
1. Claims paid during the year		
Direct business	46,70	
Reinsurance	7,00	53,70
Add : Surveyor's fee	35	
Legal expenses	45	80
		54,50
Less : Claims received from re-insurers		2,30
		52,20
2. Claims outstanding on 31st March, 1999		
Direct business	8,12	
Reinsurance	53	8,65
Less : Claims receivable from re-insurers		1,13
		7,52
3. Claims outstanding on 1st April, 1998		
Direct business	763	
Reinsurance	87	8,50
Less : Claims receivable from re-insurers		65
		7,85

Question 2

From the following balances extracted from the books of Perfect General Insurance Company Limited as on 31.3.2000, you are required to prepare Revenue Accounts in respect of Fire and marine Insurance business for the year ended 31.3.2000 to and a Profit and Loss Account for the same period :

	Rs.		Rs.
Directors' Fees	*80,000*	*Interest received*	*19,000*
Dividend received	*1,00,000*	*Fixed Assets (1.4.1999)*	*90,000*
Provision for Taxation		*Income-tax paid during*	
(as on 1.4. 1999)	*85,000*	*the year*	*60,000*

	Fire	Marine
Outstanding Claims on 1.4.1999	*28,000*	*7,000*
Claims paid	*1,00,000*	*80,000*
Reserve for Unexpired Risk on 1.4.1999	*2,00,000*	*1,40,000*
Premiums Received	*4,50,000*	*3,30,000*
Agent's Commission	*40,000*	*20,000*
Expenses of Management	*60,000*	*45,000*
Re-insurance Premium (Dr.)	*25,000*	*15,000*

The following additional points are also to be taken into account :

(a) *Depreciation on Fixed Assets to be provided at 10% p.a.*

(b) *Interest accrued on investments Rs. 10,000.*

(c) *Closing provision for taxation on 31.3.2000 to be maintained at Rs. 1,24,138*

(d) *Claims outstanding on 31.3.2000 were Fire Insurance Rs. 10,000; Marine Insurance Rs. 15,000.*

(e) *Premium outstanding on 31.3.2000 were Fire Insurance Rs. 30,000; Marine Insurance Rs. 20,000.*

(f) *Reserve for unexpired risk to be maintained at 50% and 100% of net premiums in respect of Fire and Marine Insurance respectively.*

(g) *Expenses of management due on 31.3.2000 were Rs. 10,000 for Fire Insurance and Rs. 5,000 in respect of marine Insurance.*

Answer

Form B – RA (Prescribed by IRDA)
Perfect General Insurance Co. Ltd

Revenue Account for the year ended 31st March, 2000

Fire and Marine Insurance Businesses

	Schedule	*Fire Current Year*	*Marine Current Year*
		Rs.	Rs.
Premiums earned (net)	1	4,55,000	3,35,000
Change in provision for unexpired risk		(-)27,500	(-) 1,95,000
Interest, Dividends and Rent – Gross		—	—
Double Income Tax refund		—	—
Profit on sale of motor car		—	—
Total (A)		4,27,500	1,40,000
Claims incurred (net)	2	82,000	88,000
Commission	3	40,000	20,000
Operating expenses related to Insurance business	4	70,000	50,000
Bad debts		—	—
Indian and Foreign taxes		—	—
Total (B)		1,92,000	1,58,000
Profit from Marine Insurance business (A-B)		2,35,500	(18000)

Schedules forming part of Revenue Account

Schedule –1

Premiums earned (net)	*Fire Current Year*	*Marine Current Year*
	Rs.	*Rs.*
Premiums from direct business written	4,80,000	3,50,000
Less: Premium on reinsurance ceded	25,000	15,000
Total Premium earned (net)	4,55,000	33,5000

Schedule – 2		
Claims incurred (net)	82,000	88,000
Schedule – 4		
Operating expenses related to insurance business		
Expenses of Management	70,000	50,000

Form B-PL

Perfect General Insurance Co. Ltd.

Profit and Loss Account for the year 31st March, 2000

Particulars	*Schedule*	*Current Year Rs.*	*Previous Year Rs.*
Operating Profit/(Loss)			
(a) Fire Insurance		2,35,500	
(b) Marine Insurance		(18,000)	
(c) Miscellaneous Insurance		—	
Income From Investments			
(a) Interest, Dividend & Rent–Gross		1,29,000	
(b) Profit on sale of investments			
Less : Loss on sale of investments			
Other Income (To be specified)			
Total (A)		3,46,500	
Provisions (Other than taxation)		—	
Depreciation		9,000	
Other Expenses –Director's Fee		80,000	
Total (B)		89,000	
Profit Before Tax		2,57,500	
Provision for Taxation		99,138	
Profit After Tax		1,58,362	

Working Notes:

	Fire Rs.	Marine Rs.
1. Claims under policies less reinsurance		
Claims paid during the year	1,00,000	80,000
Add: Outstanding on 31st March, 2000	10,000	15,000
	1,10,000	95,000
Less : Outstanding on 1st April, 1999	28,000	7,000
	82,000	88,000
2. Expenses of management		
Expenses paid during the year	60,000	45,000
Add: Outstanding on 31st March, 2000	10,000	5,000
	70,000	50,000
3. Premiums less reinsurance		
Premiums received during the year	4,50,000	3,30,000
Add: Outstanding on 31st March, 2000	30,000	20,000
	4,80,000	3,50,000
Less : Reinsurance premiums	25,000	15,000
	4,55,000	3,35,000

4. Reserve for unexpired risks is 50% of net premium for fire insurance and 100% of net premium for marine insurance.

5. **Provision for taxation account**

		Rs.			Rs.
31.3.2000	To Bank A/c (taxes paid)	60,000	1.4.1999	By Balance b/d	85,000
			31.3.2000	By P & L A/c	99,138
31.3.2000	To Balance c/d	1,24,138			
		1,84,138			1,84,138

Question 3

From the following information as on 31st March, 2002, prepare the Revenue Accounts of Sagar Bhima Co. Ltd. engaged in Marine Insurance Business:

	Particulars	Direct Business (Rs.)	Re-insurance (Rs.)
I.	Premium :		
	Received	24,00,000	3,60,000
	Receivable – 1st April, 2001	1,20,000	21,000
	– 31st March, 2002	1,80,000	28,000
	Premium paid	2,40,000	–
	Payable – 1st April, 2001	–	20,000
	– 31st March, 2002	–	42,000
II.	Claims :		
	Paid	16,50,000	1,25,000
	Payable – 1st April, 2001	95,000	13,000
	– 31st March, 2002	1,75,000	22,000
	Received	–	1,00,000
	Receivable – 1st April, 2001	–	9,000
	– 31st March, 2002	–	12,000
III.	Commission :		
	On Insurance accepted	1,50,000	11,000
	On Insurance ceded	–	14,000

Other expenses and income:

Salaries – Rs. 2,60,000; Rent, Rates and Taxes – Rs. 18,000; Printing and Stationery – Rs. 23,000; Indian Income Tax paid – Rs. 2,40,000; Interest, Dividend and Rent received (net) – Rs. 1,15,500; Income Tax deducted at source – Rs. 24,500; Legal Expenses (Inclusive of Rs. 20,000 in connection with the settlement of claims) – Rs. 60,000; Bad Debts – Rs. 5,000; Double Income Tax refund – Rs. 12,000; Profit on Sale of Motor car Rs. 5,000.

Balance of Fund on 1st April, 2001 was Rs. 26,50,000 including Additional Reserve of Rs. 3,25,000. Additional Reserve has to be maintained at 5% of the net premium of the year.

Answer

In exercise of the powers conferred by Section 114A of the Insurance Act, 1938 (4 of 1938), the Insurance Regulatory and Development Authority in consultation with the Insurance Advisory Committee prescribed the new formats for the financial statements of Insurance Companies i.e. preparation of Financial Statements and Auditor's Report of Insurance Companies Regulations, 2000. Therefore, the above revenue account can be prepared as:

Form B – RA (Prescribed by IRDA)
Revenue Account for the year ended 31st March, 2002
Marine Insurance Business

	Schedule	*Current Year*	*Previous Year*
		Rs.	Rs.
Premiums earned (net)	1	25,65,000	
Change in provision for unexpired risk (Rs. 26,93,250 – Rs. 26,50,000)		(-)43,250	
Interest, Dividends and Rent – Gross		1,15,500	
Double Income Tax refund		12,000	
Profit on sale of motor car		5,000	
Total (A)		26,54,250	
Claims incurred (net)	2	17,81,000	
Commission	3	1,47,000	
Operating expenses related to Insurance business	4	3,41,000	
Bad debts		5,000	
Indian and Foreign taxes		2,40,000	
Total (B)		25,14,000	
Profit from Marine Insurance business (A-B)		1,40,250	

Schedules forming part of Revenue Account

Schedule –1

Premiums earned (net)	*Current Year*	*Previous Year*
	Rs.	*Rs.*
Premiums from direct business written	28,27,000	
Less: Premium on reinsurance ceded	2,62,000	
Total Premium earned (net)	25,65,000	
Schedule – 2		
Claims incurred (net)	17,81,000	
Schedule – 3		
Commission paid		
Direct	1,50,000	
Add: Re-insurance accepted	11,000	
Less: reinsurance ceded	14,000	
	1,47,000	
Schedule – 4		
Operating expenses related to insurance business		
Employees' remuneration and welfare benefits	2,60,000	
Rent, Rates and Taxes	18,000	
Printing and Stationery	23,000	
Legal and Professional charges	40,000	
	3,41,000	

Working Notes:

1. **Total Premium Income**	Direct	Re-insurance
	Rs.	Rs.
Received	24,00,000	3,60,000
Add: Receivable on 31st March, 2002	1,80,000	28,000
	25,80,000	3,88,000
Less: Receivable on 1st April, .2001	1,20,000	21,000
	24,60,000	3,67,000

Total premium income 24,60,000 + 3,67,000 = 28,27,000

2. Premium Paid

Paid	2,40,000
Add: Payable on 31st March, 2002	42,000
	2,82,000
Less: Payable on 1st April, 2001	20,000
	2,62,000

3. Claims Paid

Direct Business	16,50,000
Re-insurance	1,25,000
Legal Expenses	20,000
	17,95,000
Less: Re-insurance claims received	1,00,000
	16,95,000

4. Claims outstanding as on 31st March, 2002

Direct	1,75,000
Re-insurance	22,000
	1,97,000
Less: Recoverable from Re-insurers on 31st March, 2002	12,000
	1,85,000

5. Claims outstanding as on 1st April, 2001

Direct	95,000
Re-insurance	13,000
	1,08,000
Less: Recoverable from Re-insurers on 1st April, 2001	9,000
	99,000

6. Expenses of Management

Salaries	2,60,000
Rent, Rates and taxes	18,000
Printing and Stationery	23,000
Legal Expenses	40,000
	3,41,000

Question 4

X Fire Insurance Co. Ltd. commenced its business on 1.4.2005. It submits you the following information for the year ended 31.3.2006:

	Rs.
Premiums received	*15,00,000*
Re-insurance premiums paid	*1,00,000*
Claims paid	*7,00,000*
Expenses of Management	*3,00,000*
Commission paid	*50,000*
Claims outstanding on 31.3.2006	*1,00,000*

Create reserve for unexpired risk @40%

Prepare Revenue account for the year ended 31.3.2006.

(c) Form B – RA (Prescribed by IRDA)

Name of the Insurer: X Fire Insurance Co. Ltd.

Registration No. and Date of registration with the IRDA: …………………..

Revenue Account for the year ended 31st March, 2006

	Particulars	*Schedule*	*Current year ended on 31st March, 2006* *Rs.*
1.	Premiums earned (Net)	1	14,00,000
2.	Change in provision for unexpired risk (NIL–5,60,000)	2	(5,60,000)

	Total (A)		8,40,000
1.	Claims incurred (Net)	3	8,00,000
2.	Commission		50,000
3.	Operating Expenses	4	3,00,000
	Total (B)		11,50,000
	Operating Profit/(Loss) from Fire Insurance Business [C =(A - B)]		(3,10,000)

Schedule 1

Premiums earned (Net)	*Rs.*
Premium received	15,00,000
Less: Premium on re-insurance paid	1,00,000
	14,00,000

Schedule 2

Reserve for unexpired risk @ 40% on net premium

$$\text{Rs.}14{,}00{,}000 \times \frac{40}{100} = \text{Rs.}\,5{,}60{,}000$$

Schedule 3

Claims	*Rs.*
Claims paid	7,00,000
Add: Claims outstanding on 31.3.2006	1,00,000
	8,00,000

Schedule 4

Operating expenses	*Rs.*	
Expenses of Management		3,00,000

Question 5

Prepare the Fire Insurance Revenue A/c as per IRDA regulations for the year ended 31st March, 2008 from the following details:

	Rs.
Claims paid	*4,90,000*
Legal expenses regarding claims	*10,000*
Premiums received	*13,00,000*
Re-insurance premium paid	*1,00,000*
Commission	*3,00,000*
Expenses of management	*2,00,000*
Provision against unexpired risk on 1st April, 2007	*5,50,000*
Claims unpaid on 1st April, 2007	*50,000*
Claims unpaid on 31st March, 2008	*80,000*

Answer

FORM B - RA

Name of the Insurer:

Registration No. and Date of Registration with the IRDA:

Fire Insurance Revenue Account

for the year ended 31st March, 2008

	Particulars	*Schedule*	*Amount (Rs.)*
(1)	Premium earned	1	11,50,000
(2)	Other income		-
(3)	Interest, dividend and rent		-
	Total (A)		11,50,000
(4)	Claims incurred	2	5,30,000
(5)	Commission	3	3,00,000
(6)	Operating expenses related to Insurance business	4	2,00,000
	Total (B)		10,30,000
	Operating Profit (A)- (B)		1,20,000

Schedule 1 : Premium earned (net)	*Rs.*
Premium received	13,00,000
Less: Re-insurance premium	1,00,000
Net premium	12,00,000
Adjustment for change in reserve for unexpired risks (Refer W.N.)	50,000
	11,50,000

Schedule 2 : Claims Incurred	*Rs.*
Claims paid including legal expenses (4,90,000 + 10,000)	5,00,000
Add : Claims outstanding at the end of the year	80,000
Less : Claims outstanding at the beginning of the year	(50,000)
Total claims incurred	5,30,000

Schedule 3 : Commission	*Rs.*
Commission paid	3,00,000
	3,00,000

Schedule 4: Operating expenses	*Rs.*
Expenses of management	2,00,000
	2,00,000

Working Note:

Change in the provision for unexpired risk	*Rs.*
Unexpired risk reserve on 31st March, 2008 =50% of net premium	
i.e. 50% of Rs.12,00,000 (See Schedule 1)	6,00,000
Less : Unexpired risk reserve as on 1st April 2007	5,50,000
Change in the provision for unexpired risk	50,000

Question 6

Heaven Life Insurance Co. furnishes you the following information:

	Rs.
Life Insurance fund on 31.3.2008	*52,00,000*
Net liability on 31.3.2008 as per actuarial valuation	*40,00,000*
Interim bonus paid to policyholders during intervaluation period	*3,00,000*

You are required to prepare:

(i) Valuation Balance Sheet;

(ii) Statement of Net Profit for the valuation period; and

(iii) Amount due to the policyholders.

Answer

(i) Heaven Life Insurance Co.

Valuation Balance Sheet as at 31st March, 2008

		Rs.			*Rs.*
To	Net Liability as per actuarial valuation	40,00,000	By	Life Assurance Fund	52,00,000
To	Surplus	12,00,000			
		52,00,000			52,00,000

(ii) Statement showing Net Profit for the valuation period

	Rs.
Surplus as per Balance Sheet (i.e., Valuation Balance Sheet)	12,00,000
Add: Interim bonus paid	3,00,000
	15,00,000

(iii) Amount due to policyholders

	Rs.
95% of net profit due to policyholders (95% of Rs. 15,00,000)	14,25,000
Less: Interim bonus already paid	3,00,000
Amount due to policyholders	11,25,000

EXERCISES

Question 1

The following are the Balances of Hercules Insurance Co. Ltd. as on 31st March, 1996 :

		(Rs. in '000)
Capital		320,00
Balances of Funds as on 1.4.95		
Fire Insurance		800,00
Marine Insurance		950,00
Miscellaneous Insurance		218,65
Unclaimed Dividends		8,50
Amount Due to Other Insurance Companies		34,50
Sundry Creditors		72,50
Deposit and Suspense Account (Cr.)		22,80
Profit and Loss Account (Cr.)		80,40
Agents Balances (Dr.)		135,00
Interest accrued but not due (Dr.)		22,50
Due from other Insurance Companies		64,50
Cash in Hand		3,50
Balance in Current Account with Bank		74,80
Furniture and Fixtures WDV (cost 100,00)		58,00
Stationery Stock		1,40
Expenses of Management		
Fire Insurance	280,00	
Marine Insurance	160,00	
Miscellaneous Insurance	40,00	
Others	30,00	510,00
Foreign Taxes—Marine		8,00

Outstanding premium		82,00
Donation Paid (No 80G Benefit)		10,00
Transfer Fees		1,00
Reserve for Bad Debts		11,70
Income Tax Paid		120,00
Mortgage Loan (Dr.)		975,00
Sundry Debtors		25,00
Government Securities Deposited with RBI		37,00
Government Securities (1020,00)		1020,00
Debentures		465,50
Equity Shares of Joint Stock Companies		225,00
Claims Less Re-insurance		
Fire	450,00	
Marine	358,90	
Miscellaneous	68,00	876,90
Premium Less Re-insurance		
Fire	1762,50	
Marine	1022,50	
Miscellaneous	262,25	3047,25
Interest and Dividends Received on Investments		58,50
Tax Deducted at Source		11,70
Commission		
Fire	500,00	
Marine	350,00	
Miscellaneous	80,00	930,00

You are required to make the following provisions :

Depreciation on Furniture—10% of Original Cost		
Depreciation on investments of Joint Stock Companies Shares		10,00
Transfer to General Reserve		10,00
Outstanding claims as on 31.3.96		
Fire	200,00	
Marine	50,00	
Miscellaneous	32,50	

Provision for tax @50%. Proposed dividends @20%. Provision for the unexpired risks is to be made as follows:

(a) On Marine Policies 100% Premium less reinsurance.

(b) On Other Policies 50% Premium less reinsurance.

You are required to prepare the revenue and profit and loss account for the year ended 31.3.1996 of the company.

(**Answer: Profit from Insurance business -Fire 251,25, Marine 23,10, Misc. 129,27. Balance profit carried forward to Balance Sheet 202,96)**

Question 2

Indian Insurance Co. Ltd. furnishes you with the following information :

(i) On 31.12.1996 it had reserve for unexpired risk to the tune of Rs. 40 crores. It comprised of Rs. 15 crores in respect of marine insurance business : Rs. 20 crores in respect of fire insurance business and Rs. 5 crores in respect of miscellaneous insurance business.

(ii) It is the practice of Indian Insurance Co. Ltd. to create reserves at 100% of net premium income in respect of marine insurance policies and at 50% of net premium income in respect of fire and miscellaneous income policies.

(iii) During 1997, the following business was conducted :

	Marine	Fire	Miscellaneous
	(Rs. in crores)		
	Rs.	Rs.	Rs.
Premia collected from :			
(a) Insureds in respect of policies issued	18	43	12

(b) Other insurance companies in respect of risks undertaken	7	5	4
Premia paid/payable to other insurance companies on business ceded	6.7	4.3	7

Indian Insurance Co. Ltd. asks you to :

(a) Pass journal entries relating to "Unexpired risks reserve".

(b) Show in columnar form "Unexpired risks reserve" a/c for 1997.

(Answer Closing Balances in marine, fire and misc. 18.30 21.85 4.50)

CHAPTER 6

FINANCIAL STATEMENTS OF BANKING COMPANIES

BASIC CONCEPTS

Bank is an important organ of the modern trade and commerce. Banks in India are regulated by the Banking Regulation Act, 1949. The banking activities in India are regulated by the Banking Regulations Act, 1949. Under Section 5(*b*) of the said Act "Banking" means, the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise.

Every bank should maintain a minimum capital adequacy ratio based on capital funds and risk assets. As per the prudential norms, all Indian scheduled commercial banks (excluding regional rural banks) as well as foreign banks operating in India are required to maintain capital adequacy ratio (or capital to Risk Weighted Assets Ratio) which is specified by RBI from time to time.

A Bank's advances are to be classified into performing assets and non-performing assets (NPA). The international practice is not to consider interest income from NPA on accrual basis but to consider such income as and when it is actually received.

An asset becomes non-performing when the bank does not receive income from it for a certain period. In concept, any credit facility (assets) becomes non-performing "when it ceases to generate income for a bank." The Reserve Bank of India has issued detailed guidelines to banks regarding the classification of advances between performing and non-performing assets which have been revised from time to time.

The banks have to classify their advances into four broad groups (*i*) standard assets, (*ii*) sub-standard assets, (*iii*) doubtful assets and (*iv*) loss assets.

Provisions

Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the banks, it has been decided that banks should make provision against sub-standard assets, doubtful assets and loss assets on the following basis:

(a) *Loss assets:* The entire amount should be written off or full provision should be made for the amount outstanding.

(b) *Doubtful assets*: (*i*) Full provision to the extent of the unsecured portion should be made. In doing so, the realisable value of the security available to the bank should be determined on a realistic basis. DICGC/ECGC cover is also taken into account (this aspect is discussed later in this chapter). In case the advance covered by CGTSI guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances.

(ii) Additionally, 20% - 100% of the secured portion should be provided for, depending upon the period for which the advance has been considered as a doubtful asset, as follows:

Period for which the advance has been considered as doubtful	% of provision on secured portion
Upto 1 year	20%
More than 1 year and upto 3 years	30%
More than three years	50%
i. Outstanding stock of NPA's as on 31.03.2004	60% w.e.f. 31.03.2005
	75% w.e.f. 31.03.2006
	100% w.e.f. 31.03.2007
ii. Advances classified as doubtful for more than three years on or after 01.04.2004	100% w.e.f. 31.03.2005

(A) Write short notes on:

Question 1

Non-Performing Assets.

Answer

An asset is classified as non-performing asset (NPA) if dues in the form of principal and interest are not paid by the borrower for a period of 90 days. If any advance or credit facilities granted by a bank to a borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status.

Income from the non-performing assets can only be accounted for as and when it is actually received. In concept, any credit facility (assets) becomes non-performing when it eases to generate income. The RBI has issued guidelines to commercial banks regarding the classification of advances between performing and non-performing assets.

A term loan is treated as a non-performing assets (NPA) if interest and/or instalments of principal remains over due for a period of more than 90 days. A cash credit/overdraft account is treated as NPA if it remains out of order for a period of more than 90 days. An account is treated an 'out of order' if any of the following conditions is satisfied:

(a) the outstanding balance remains continuously in excess of the sanctional limit/drawing power.

(b) though the outstanding balance is less than the sanctioned limit/drawing power—

   (i) there are credits continuously for more than 90 days as on the date of balance sheet or

   (ii) credits during the aforesaid periods are not enough to cover the interest debited during the same period.

Bills purchased and discounted are treated as NPA if they remain overdue and unpaid for a period of more than 90 days. Necessary provision should be made for non-performing assets after classifying them as sub-standard, doubtful or loss asset as the case may be.

Question 2

Classification of advances in the case of a Banking Company.

Answer

Banks have to classify their advances into four broad groups:

(i) **Standard Assets—**Standard assets is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset is not a NPA as discussed earlier.

(ii) **Sub-standard Assets—**Sub-standard asset is one which has been classified as NPA for a period not exceeding 12 months. In the case of term loans, those where instalments of principal are overdue for period exceeding one year should be treated as sub-standard. In other words, such an asset will have well-defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the bank will sustain some loss, if deficiencies are not corrected.

(iii) **Doubtful Assets**—A doubtful asset is one which has remained NPA for a period exceeding 18 months. In the case of term loans, those where instalments of principal have remained overdue for a period exceeding 18 months should be treated as doubtful. A loan classified as doubtful has all the weaknesses inherent in that classified as sub-standard with added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

(iv) **Loss Assets**—A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspectors but the amount has not been written off, wholly or partly.

The classification of advances should be done taking into account (i) Degree of well defined credit worthiness and (ii) Extent of dependence on collateral security.

The above classification is meant for the purpose of computing the amount of provision to be made in respect of advances and not for the purpose of presentation of advances in the balance sheet.

Question 3

Slip system of posting and double voucher system.

Answer

Slip system of posting : Under this system used in the case of banking companies, entries in the personal ledgers are made directly from vouchers instead of being posted from the day book. Pay-in-slips (used by the customers at the time of making deposits) and the cheques are used as slips which form the basis of most of the transactions directly recorded in the accounts of customers. As the slips are mostly filled by the customers themselves, this system saves a lot of time and labour of the bank staff. The vouchers entered into different personal ledgers are summarised on summary sheets every day, totals of which are posted to the different control accounts which are maintained in the general ledger.

Double voucher system : In a bank, two vouchers are prepared for every transaction not involving cash—one debit voucher and another credit voucher. This system is called double voucher system. The vouchers are sent to different clerks who make entries in books under their charge.

Question 4

Acceptances and endorsements

Answer

A bank has a more acceptable credit as compared to that of its customers. On this account, it is often called upon to accept or endorse bills on behalf of its customers. In such a case, the bank undertakes a liability towards the party which agrees to receive such a bill in payment of a debt or agreed to discount the bill after the same has been accepted by the bank. As against this liability, the bank has a corresponding claim against the customer on whose behalf it has undertaken to be a party to the bill, either as an acceptor or as an endorser. Such liabilities which are outstanding at the close of the year and the corresponding assets are disclosed as contingent liability in the financial statements. As a safeguard against the customer not being able to meet the demand of the bank in this respect, usually the bank requires the customer to deposit a security equivalent to the amount of the bill accepted on his behalf. A record of the particulars of the bills accepted as well as of the securities collected from the customers is kept in the Bills Accepted Register. A bank may not treat this book as part of the system of its account. In such a case no further record of the transactions is kept until the bill matures for payment. If the bill, at the end of its term, has to be retired by the bank and the amount cannot be collected from the customer on demand, the bank reimburses itself by disposing of the security deposited by the customer.

Question 5

Classification of investments by a banking company.

Answer

The investment portfolio of a bank would normally consist of both approved securities (predominantly government securities) and other securities (shares, debentures, bonds etc.). Banks are required to classify their entire investment portfolio into three catogories : held-to-maturity, available-for-sale and held-for-maturity. Securities acquired by banks with the intention to hold them upto maturity should be classified as 'held-to-maturity'. Securities acquired by banks with the intention to trade by taking advantage of short–term price interest rate movements should be classifed as held-for trading/maturity. Securities which do not fall within the above two categories should be classified as available-for-sale'.

(B) Practical Questions:

Question 1

From the following details prepare "Acceptances, Endorsements and other Obligation A/c" as would appear in the general ledger.

On 1.4.98 Acceptances not yet satisfied stood at Rs. 22,30,000. Out of which Rs. 20 lacs were subsequently paid off by clients and bank had to honour the rest. A scrutiny of the Acceptance Register revealed the following:

Client	*Acceptances/Guarantees*	*Remarks*
	Rs.	
A	*10,00,000*	*Bank honoured on 10.6.98*
B	*12,00,000*	*Party paid off on 30.9.98*
C	*5,00,000*	*Party failed to pay and bank had to honour on 30.11.98*
D	*8,00,000*	*Not satisfied upto 31.3.99*
E	*5,00,000*	*-do-*
F	*2,70,000*	*-do-*
Total	*42,70,000*	

Answer

Acceptances, Endorsements and other Obligation Account

(in general ledger)

Dr.								*Cr.*
			Rs. '000					*Rs. '000*
1998-99	To	Constituents' liabilities for acceptances/guarantees etc. (Paid off by clients)	20,00	1.4.98	By	Balance b/d		22,30
	To	Constituent's liabilities for acceptances/guarantees etc. (Honoured by bank Rs. 22.30 lakhs less Rs. 20 lakhs)	2,30	1998-99	By	Constituents' liabilities for acceptances/guarantees etc.		
						A	10,00	
						B	12,00	
						C	5,00	
10.6.98	To	Constituents' liabilities for acceptances/guarantees etc. (Honoured by bank)	10,00			D	8,00	
						E	5,00	
						F	2,70	42,70
30.9.98	To	Constituents' liabilities for acceptances/guarantees etc. (Paid off by party)	12,00					

30.11.98	To	Constituent's liabilities for acceptances/guarantees etc. (Honoured by bank on party's failure to pay)	5,00	
31.3.99	To	Balance c/d (Acceptances not yet satisfied)	15,70	
			65,00	65,00

Question 2

From the following information find out the amount of provisions required to be made in the Profit & Loss Account of a commercial bank for the year ended 31st March, 2000 :

(i) *Packing credit outstanding from Food Processors Rs. 60 lakhs against which the bank holds securities worth Rs. 15 lakhs. 40% of the above advance is covered by ECGC. The above advance has remained doubtful for more than 3 years.*

(ii) *Other advances:*

Assets classification	*Rs. in lakhs*
Standard	*3,000*
Sub-standard	*2,200*
Doubtful :	
For one year	*900*
For two years	*600*
For three years	*400*
For more than 3 years	*300*
Loss assets	*600*

Answer

(i) *(Rs. in lakhs)*

		Rs.	*Rs.*
Amount outstanding (packing credit)	60		
Less : Realisable value of securities	15		
	45		
Less : ECGC cover (40%)	18		
Balance	27		

Required provision :	
Provision for unsecured portion (100%)	27.0
Provision for secured portion (100%)*	15.0
	42.0

(ii) Other advances :

(Rs. in lakhs)

Assets	*Amount Rs.*	*% of provision*	*Provision Rs.*
Standard	3,000	0.40*	12
Sub-standard	2,200	10	220
Doubtful :			
For one year	900	20	180
For two years	600	30	180
For three years	400	30	120
For more than three years	300	100*	300
Loss	600	100	600
Required provision			1612

Note : Doubtful advances have been taken as fully secured. However, in case, the students assume that no security cover is available for these advances, provision will be made for 100%.

* The above solution has been provided based on the latest NPA provisions (as per the Master Circular issued by RBI " DBOD No. BP. BC. 11/21.04.048/2005-06" dated November 4, 2005) though in the above question provisions for the year ended 31st march 2000 is required.

Question 3

Bidisha Bank Ltd. had extended the following credit lines to a Small Scale Industry which had not paid any interest since March, 1995.

	Term Loan	*Export Credit*
Balance outstanding on 31.3.2001	*Rs. 70 Lacs*	*Rs. 60. Lacs*
DICGC/ECGC Cover	*50%*	*40%*
Securities held	*Rs. 30 Lacs*	*Rs. 25 Lacs*
Realisable value of securities	*Rs. 20 Lacs*	*Rs. 15 Lacs*

Compute the necessary provisions to be made for the year ended 31st March, 2001

Answer

	Term Loan	*Export Credit*
	Rs. in Lacs	*Rs. in Lacs*
Balance outstanding	70.00	60.00
Less : Realisable value of securities	20.00	15.00
	50.00	45.00
Less : DICGC/ECGC Cover	25.00	18.00
Net unsecured balance	25.00	27.00
Provision in respect of secured portion (100%)*	20.00	15.00
Provision for unsecured portion (100%)	25.00	27.00
Provision required	45.00	42.00

* The above solution has been provided based on the latest NPA provisions (as per the Master Circular issued by RBI " DBOD No. BP. BC. 11/21.04.048/2005-06" dated November 4, 2005) though in the above question provisions for the year ended 31st march 2000 is required.

Question 4

The following particulars are extracted from the (Trial Balance) Books of the M/s Commercial Bank Ltd. for the year ending 31st March, 2003:

		Rs.
(i)	*Interest and Discounts*	*1,96,62,400*
(ii)	*Rebate on Bills Discounted (balance on 1.4.2002)*	*65,040*
(iii)	*Bills Discounted and purchased*	*67,45,400*

It is ascertained that proportionate discount not yet earned on the Bills Discounted which will mature during 2003-2004 amounted to Rs. 92,760.

Pass the necessary Journal entries with narration adjusting the above and show:

(a) Rebate on Bill Discounted Account; and

(b) Interest and Discount Account in the ledger of the Bank.

Answer

The Commercial Bank Ltd.

Journal

Date			Dr.	Cr.
2003			Rs.	Rs.
March 31	Rebate on Bills Discounted A/c	Dr.	65,040	
	To Interest and Discount A/c			65,040
	(Being the amount of provision for unexpired discount brought forward from the previous year credited to Interest and Discount A/c).			
March 31	Interest and Discount A/c	Dr.	92,760	
	To Rebate on Bills Discounted A/c			92,760
	(Being provision for unexpired discount required at the end of the current year.)			
March 31	Interest and Discount A/c	Dr.	1,96,34,680	
	To Profit & Loss A/c			1,96,34,680
	(Being transfer of balance to Profit and Loss A/c).			

(a) Rebate on Bills Discounted Account

2003			Rs.	2002			Rs.
March 31	To	Interest and Discount A/c	65,040	April 1	By	Balance b/d	65,040
				2003			
2003				March 31	By	Interest and Discount	
March 31	To	Balance c/d	92,760			A/c (rebate required)	92,760
			1,57,800				1,57,800

(b) Interest and Discount Account

2003			Rs.	2002			Rs.
March 31	To	Rebate on Bills Discounted A/c	92,760	April 1	By	Rebate on Bills Discounted A/c (opening balance)	65,040
				2003			

March 31	To	Profit & Loss A/c (transfer)	1,96,34,680	March 31	By	Cash and Sundries	1,96,62,400
			1,97,27,440				1,97,27,440

Question 5

Rajatapeeta Bank Ltd. had extended the following credit lines to a Small Scale Industry, which had not paid any Interest since March, 1997:

	Term Loan	*Export Loan*
Balance Outstanding on 31.03.2003	*Rs. 35 lakhs*	*Rs. 30 lakhs*
DICGC/ECGC cover	*40%*	*50%*
Securities held	*Rs. 15 lakhs*	*Rs. 10 lakhs*
Realisable value of Securities	*Rs. 10 lakhs*	*Rs. 08 lakhs*

Compute necessary provisions to be made for the year ended 31st March, 2003.

Answer

	Term loan Rs. in lakhs	*Export credit Rs. in lakhs*
Balance outstanding on 31.3.2003	35.0	30.0
Less: Realisable value of Securities	10.0	8.0
	25.0	22.0
Less: DICGC cover @ 40%	10.0	
ECGC cover @ 50%	___	11.0
Unsecured balance	15.0	11.0
Required Provision:		
100%* for unsecured portion	15.0	11.0
100% for secured portion	10.0	8.00
Total provision required	25.0	19.0

* The above solution has been provided based on the latest NPA provisions (as per the Master Circular issued by RBI " DBOD No. BP. BC. 11/21.04.048/2005-06" dated November 4, 2005) though in the above question provisions for the year ended 31st march 2000 is required.

Question 6

From the following information find out the amount of provisions to be shown in the Profit and Loss Account of a Commercial Bank:

Assets	*Rs. (in lakhs)*
Standard	*4,000*
Sub-standard	*2,000*
Doubtful upto one year	*900*
Doubtful upto three years	*400*
Doubtful more than three years	*300*
Loss Assets	*500*

Answer

Computation of provision:

Assets	*Amount (Rs. in lakhs)*	*% of Provision*	*Provision (Rs. in lakhs)*
Standard	4,000	0.40**	16
Sub-standard	2,000	10	200
Doubtful upto one year*	900	20	180
Doubtful upto three years*	400	30	120
Doubtful more than three years*	300	100**	300
Loss	500	100	500
			1316

* Doubtful assets are taken as fully secured.

** The above solution has been provided based on the latest NPA provisions (as per the Master Circular issued by RBI " DBOD No. BP. BC. 11/21.04.048/2005-06" dated November 4, 2005) though in the above question provisions for the year ended 31st march 2000 is required.

Question 7

From the following information calculate the amount of Provisions and Contingencies and prepare Profit and Loss Account of Zed Bank Ltd. for the year ended 31.3.2004:

		(Rs. in '000)
Interest and Discount		*8,860*
(Includes interest accrued on investments)		
Other Income		*220*
Interest expended		*2,720*
Operating expenses		*2,830*
Interest accrued on Investments		*10*
Additional Information:		
(a)	*Rebate on bills discounted to be provided for*	*30*
(b)	*Classification of Advances:*	
	(i) Standard assets	*4,000*
	(ii) Sub-standard assets	*2,240*
	(iii) Doubtful assets–(fully unsecured)	*390*
	(iv) Doubtful assets – covered fully by security	
	Less than 1 year	*100*
	More than 1 year, but less than 3 years	*600*
	More than 3 years	*600*
	(v) Loss assets	*376*
(c)	*Provide 35% of the profit towards provision for taxation.*	
(d)	*Transfer 20% of the profit to Statutory Reserve.*	

Answer

ZED Bank Ltd.

Profit and Loss Account

for the year ended 31st March, 2004

(Rs. in '000)

	Particulars	*Schedule No.*	*Year ended on 31st March, 2004*
I.	Income		
	Interest earned (W.N. 1)	13	8,830
	Other income	14	220
	Total		9,050
II.	Expenditure		
	Interest expended	15	2,720
	Operating expenses	16	2,830
	Provisions and contingencies (W.N. 4)		2,399
	Total		7,949
III.	Profit/Loss		
	Net profit/(loss) for the year		1,101
	Profit/(loss) brought forward		Nil
	Total		1,101
IV.	Appropriations		
	Transfer to statutory reserve @ 20%		220
	Balance carried to balance sheet		881
	Total		1,101

Working notes:

1. **Schedule 13 – Interest earned** *(Rs.'000s)*

(i)	Interest and discount	8,860	
	Less: Rebate on bills discounted	(30)	
	Interest accrued on investments	(10)	8,820
(ii)	Interest accrued on investments		10
			8,830

2. **Calculation of Provisions and Contingencies**

Assets	*Amount (Rs. in '000)*	*% of Provision*	*Provision (Rs. in '000)*
Standard assets	4,000	0.40*	16
Sub-standard assets	2,240	10	224
Doubtful assets (unsecured)	390	100	390
Doubtful assets – covered by security			
Less than 1 year	100	20	20
More than 1 year but less than 3 years	600	30	180
More than 3 years	600	100*	600
Loss assets	376	100	376
Total provision	8,306		1,806

3. **Calculation of provision on tax** = 35% (Total income – Total expenditure)

= 35% of Rs. [(9,050 – (2,720 + 2,830 + 1,806)]

= 35% of Rs. 1,694

= Rs. 593

4. **Total provisions and contingencies** = Rs. 1,806 + Rs. 593 = Rs. 2,399.

* The above solution has been provided based on the latest NPA provisions (as per the Master Circular issued by RBI " DBOD No. BP. BC. 11/21.04.048/2005-06" dated November 4, 2005) though in the above question provisions for the year ended 31st march 2000 is required.

Question 8

(a) From the following information, compute the amount of provisions to be made in the Profit and Loss Account of a Commercial bank:

	Assets	Rs. in lakhs
(i)	Standard (Value of security Rs.6,000 lakhs)	7,000
(ii)	Sub-standard	3,000
(iii)	Doubtful	
	(a) Doubtful for less than one year (Realisable value of security Rs.500 lakhs)	1,000
	(b) Doubtful for more than one year, but less than 3 years (Realisable value of security Rs.300 lakhs)	500
	(c) Doubtful for more than 3 years (No security)	300

(b) From the following details, prepare bills for collection (Asset) Account and Bills for collection (Liability) Account:

	Rs.
On 1.4.2005, Bills for Collection were	*51,00,000*
During the year 2005-06 Bills received for Collection amounted to	*75,00,000*
Bill collected during the year 2005-06	*98,47,000*
Bill dishonoured and returned during the year	*27,10,000*

Answer

(a)

	Asset Amount	*% of provision*	*Provision*
	Rs. in lakhs		*Rs. in lakhs*
Standard	7,000	0.40*	28
Sub-standard	3,000	10	300
Doubtful (less than one year)			
On secured portion	500	20	100
On unsecured portion	500	100	500
Doubtful (more than one year but less than three years)			
On secured portion	300	30	90
On unsecured portion	200	100	200

Doubtful Unsecured (more than three years)	300	100	300
Total provision			1,518

* The above solution has been provided based on the latest NPA provisions (as per the Master Circular issued by RBI " DBOD No. BP. BC. 11/21.04.048/2005-06" dated November 4, 2005) though in the above question provisions for the year ended 31st march 2000 is required.

(b) Bills for collection (Asset) Account

		Rs.			*Rs.*
1.4.2005	To Balance b/d	51,00,000	2005-06	By Bills for collection (Liability) A/c	98,47,000
2005-06	To Bills for collection	75,00,000		By Bills for collection (Liability) A/c	27,10,000
			31.3.2006	By Balance c/d	43,000
		1,26,00,000			1,26,00,000
1.4.2006	To Balance b/d	43,000			

Bills for collection (Liability) Account

2005- 06	To Bills for collection (Asset) A/c	98,47,000	1.4.2005	By Balance b/d	51,00,000
			2005-06	By Bills for collection (Asset) A/c	75,00,000
	To Bills for collection (Asset) A/c	27,10,000			
31.3.2006	To Balance c/d	43,000			
		1,26,00,000			1,26,00,000
			1.4.2006	By Balance b/d	43,000

Question 9

The following is an extract from the Trial Balance of Dream Bank Ltd. as at 31st March, 2006:

Rebate on bills discounted as on 1-4-2005	*68,259 (Cr.)*
Discount received	*1,70,156 (Cr.)*

Analysis of the bills discounted reveals as follows:

Amount (Rs.)	*Due date*

2,80,000	*June 1, 2006*
8,72,000	*June 8, 2006*
5,64,000	*June 21, 2006*
8,12,000	*July 1, 2006*
6,00,000	*July 5, 2006*

You are required to find out the amount of discount to be credited to Profit and Loss account for the year ending 31st March, 2006 and pass Journal Entries. The rate of discount may be taken at 10% per annum.

Answer

The amount of rebate on bills discounted as on 31st March, 2006 the period which has not been expired upto that day will be calculated as follows:

Discount on Rs.2,80,000 for 62 days @ 10%	4,756
Discount on Rs.8,72,000 for 69 days @ 10%	16,484
Discount on Rs.5,64,000 for 82 days @ 10%	12,671
Discount on Rs.8,12,000 for 92 days @ 10%	20,467
Discount on Rs.6,00,000 for 96 days @ 10%	15,781
Total	70,159

The amount of discount to be credited to the profit and loss account will be:

	Rs.
Transfer from rebate on bills discounted as on 31.03.2005	68,259
Add: Discount received during the year	1,70,156
	2,38,415
Less: Rebate on bills discounted as on 31.03.2006 (as above)	70,159
	1,68,256

Journal Entries

		Rs.	*Rs.*
Rebate on bills discounted A/c	Dr.	68,259	
To Discount on bills A/c			68,259
(Transfer of unexpired discount on 31.03.2005)			

Discount on bills A/c	Dr.	70,159	
To Rebate on bills discounted			70,159
(Unexpired discount on 31.03.2006 taken into account)			
Discount on Bills A/c	Dr.	1,68,256	
To P & L A/c			1,68,526
(Discount earned in the year, transferred to P&L A/c)			

Question 10

From the following information of details of advances of X Bank Limited calculate the amount of provisions to be made in profit and loss account for the year ended 31.3.2007:

Asset classification	*Rs. in lakhs*
Standard	*6,000*
Sub-standard	*4,400*
Doubtful:	
For one year	*1,800*
For two years	*1,200*
For three years	*800*
For more than three years	*600*
Loss assets	*1,600*

Answer

Statement showing provisions on various performing and non-performing assets

Asset Classification	*Amount*	*Provision*	*Amount of Provision*
	Rs. in Lakhs	*%*	*Rs. in lakhs*
Standard	6,000	0.40	24
Sub-standard**	4,400	10	440
Doubtful**			
One year	1,800	20	360

** Sub standard and doubtful assets have been treated as fully secured.

2 years	1,200	30	360
3 years	800	30	240
More than 3 years	600	100*	600
Loss assets	1,600	100	1,600
			3,624

Question 11

The following are the figures extracted from the books of New Generation Bank Limited as on 31.3.2008:

	Rs.
Interest and discount received	*37,05,738*
Interest paid on deposits	*20,37,452*
Issued and subscribed capital	*10,00,000*
Salaries and allowances	*2,00,000*
Directors fee and allowances	*30,000*
Rent and taxes paid	*90,000*
Postage and telegrams	*60,286*
Statutory reserve fund	*8,00,000*
Commission, exchange and brokerage	*1,90,000*
Rent received	*65,000*
Profit on sale of investments	*2,00,000*
Depreciation on bank's properties	*30,000*
Statutory expenses	*40,000*
Preliminary expenses	*25,000*
Auditor's fee	*5,000*

The following further information is given:

(i) A customer to whom a sum of Rs.10 lakhs has been advanced has become insolvent and it is expected only 50% can be recovered from his estate.

(ii) There were also other debts for which a provision of Rs.1,50,000 was found necessary by the auditors.

* w.e.f. 31st March 2007

(iii) Rebate on bills discounted on 31.3.2007 was Rs.12,000 and on 31.3.2008 was Rs.16,000.

(iv) Provide Rs.6,50,000 for Income-tax.

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

Prepare the Profit and Loss account of New Generation Bank Limited for the year ended 31.3.2008 and also show, how the Profit and Loss account will appear in the Balance Sheet, if the Profit and Loss account opening balance was Nil as on 31.3.2007.

Answer

New Generation Bank Limited

Profit and Loss Account for the year ended 31st March, 2008

		Schedule	*Year ended 31.03.2008 (Rs. in '000s)*
I.	**Income:**		
	Interest earned	13	3,701.74
	Other income	14	455.00
	Total		4,156.74
II.	**Expenditure**		
	Interest expended	15	2,037.45
	Operating expenses	16	480.29
	Provisions and contingencies (500 + 150 + 650)		1,300.00
	Total		3,817.74
IIII.	**Profits/Losses**		
	Net profit for the year		339.00
	Profit brought forward		Nil
			339.00
IV.	**Appropriations**		
	Transfer to statutory reserve (25%)		84.75
	Proposed dividend		100.00
	Balance carried over to balance sheet		154.25
			339.00

The Profit & Loss Account balance of Rs.154.25 thousand will appear in the Balance Sheet under the head 'Reserves and Surplus' in Schedule 2.

		Year ended 31.3.2008 (Rs. in '000s)
	Schedule 13 – Interest Earned	
I.	Interest/discount on advances/bills (Refer W.N.)	3,701.74
		3,701.74
	Schedule 14 – Other Income	
I.	Commission, exchange and brokerage	190.00
II.	Profit on sale of investments	200.00
III.	Rent received	65.00
		455.00
	Schedule 15 – Interest Expended	
I.	Interests paid on deposits	2,037.45
		2,037.45
	Schedule 16 – Operating Expenses	
I.	Payment to and provisions for employees	200.00
II.	Rent, taxes and lighting	90.00
III.	Depreciation on bank's properties	30.00
IV.	Director's fee, allowances and expenses	30.00
V.	Auditors' fee	5.00
VI.	Law (statutory) charges	40.00
VII.	Postage and telegrams	60.29
VIII.	Preliminary expenses	25.00*
		480.29

*It is assumed that preliminary expenses have been fully written off during the year.

Working Note:

Interest/discount (net of rebate on bills discounted)	3,705.74
Add: Rebate on bills discounted on 31.3.2007	12.00
Less: Rebate on bills discounted on 31.3.2008	(16.00)
	3701.74

Question 12

Following information is furnished to you by Sound Bank Ltd. for the year ended 31st March, 2008:

	(Rs. in thousands)
Interest and discount - (Income)	*8,860*
Interest on public deposits – (Expenditure)	*2,720*
Operating expenses	*2,662*
Other incomes	*250*
Provisions and contingencies (it includes provision in respect of Non-performing Assets (NPAs) and tax provisions)	*2,004*
Rebate on bills discounted to be provided for as on 31.3.2008	*30*
Classification of Advances:	
Standard Assets	*5,000*
Sub-standard Assets	*1,120*
Doubtful Assets – fully unsecured	*200*
Doubtful assets – fully secured	
Less than 1 year	*50*
More than 1 year but less than 3 years	*300*
More than 3 years	*300*
Loss assets	*200*

You are required to prepare:

(i) Profit and Loss Account of the Bank for the year ended 31st March, 2008.

(ii) Provision in respect of advances.

Answer

Sound Bank Ltd.

Profit and Loss Account

for the year ended 31st March, 2008

		Schedule No.	*(Rs. in thousands)*
Income:	Interest and Discount (8,860 – 30)	13	8,830
	Other income	14	250
			9,080

Expenditure:	Interest expenses	15	2,720
	Operating expenses	16	2,662
	Provision and Contingencies		2,004
			7,386
Net Profit/Loss for the year			1,694

Assets	*Value*	*% of provision*	*Provision*
Standard Assets	5,000	0.40	20.00
Sub-standard Assets*	1,120	10	112.00
Doubtful Assets			
100% unsecured	200	100	200.00
Secured:			
Less than 1 year	50	20	10.00
More than 1 year but less than 3 years	300	30	90.00
More than 3 years	300	100	300.00
Loss Assets	200	100	200.00
Total Provision			932.00

* Sub-standards assets are assumed to be fully secured.

EXERCISES

Question 1

From the following information, prepare a Balance Sheet of International Bank Ltd. as on 31st March, 1994 giving the relevant schedules and also specify at least four important Principal Accounting Polcies :

		Rs. in lakhs
	Dr.	Cr.
Share Capital		198.00
19,80,000 Shares of Rs. 10 each		
Statutory Reserve		231.00
Net Profit Before Appropriation		150.00
Profit and Loss Account		412.00
Fixed Deposit Account		517.00
Savings Deposit Account		450.00
Current Accounts	28.00	520.12
Bills Payable		0.10
Cash credits	812.10	
Borrowings from other Banks		110.00
Cash in Hand	160.15	
Cash with RBI	37.88	
Cash with other Banks	155.87	
Money at Call	210.12	
Gold	55.23	
Government Securities	110.17	
Premises	155.70	
Furniture	70.12	
Term Loan	792.88	
	2,588.22	2,588.22

Additional Information :

Bills for collection	18,10,000
Acceptances and endorsements	14,12,000

Claims against the Bank not acknowledged as debt	55,000
Depreciation charges—Premises	1,10,000
Furniture	78,000

50% of the Term Loans are secured by Government guarantees. 10% of cash credit is unsecured. Also calculate cash reserves required and statutory liquid reserves required.

Note : Cash reserves required 3% of demand and time liabilities; liquid reserves required 30% of demand and time liabilities.

(Answer: balance sheet total 25,88.12 lacs)

Question 2

On 31st March, 1997, Uncertain Bank Ltd. had a balance of Rs. 9 crores in "rebate on bills discounted" account. During the year ended 31st March, 1998, Uncertain Bank Ltd. discounted bills of exchange of Rs. 4,000 crores charging interest at 18% per annum the average period of discount being for 73 days. Of these, bills of exchange of Rs. 600 crores were due for realisation from the acceptors/customers after 31st March, 1998, the average period outstanding after 31st March, 1998 being 36.5 days.

Uncertain Bank Ltd. asks you to pass journal entries and show the ledger accounts pertaining to :

(i) discounting of bills of exchange and

(ii) rebate on bills discounted.

(Answer: Amount debited to P& L Account in Discount on bills A/c Rs. 142.20)

Question 3

Following are the statements of interest on advances in respect of performing and non-performing assets of Madura Bank Ltd. Find out the income to be recognised for the year ended 31st March. 1998.

(Rs. in lakhs)

Performing Assets	Interest earned	Interest received
Cash credit and overdrafts	1,800	1,060
Term loans	480	320
Bills purchased and discounted	700	550
Non-performing Assets		

Cash credit and overdrafts	450	70
Term loan	300	40
Bills purchased and discounted	350	36

(Answer: Total income to be recognised 3,126 lakhs Rs.)

CHAPTER 7

FINANCIAL STATEMENTS OF ELECTRICITY SUPPLY COMPANIES

BASIC CONCEPTS

- Electricity supply undertakings are governed by the Indian Electricity Act, 1910 the Electricity (Supply) Act, 1948 and the Indian Electricity Rules, 1956
- "Double Accounts System" is the system of preparing the final accounts of certain statutory companies, usually public utility undertakings, e.g., electricity companies and railway companies.
- The "Double Accounts System" is not a special method of keeping accounts, rather a special method of presenting accounts
- No depreciation is to be written off when an asset has been written down to 10 per cent of original cost.
- An amount equal to income-tax and super tax (calculated at current rates) which would have been paid but for the development rebate allowed by income-tax authorities, has to be transferred to the Development Reserve Account.

(A) Write short notes on:

Question 1

Main features of "Double Accounts" system of presentation of financial information in the case of public utility concern.

Answer

Double accounts system is the name given to the system of preparing the final accounts of certain statutory companies formed by special Acts of parliament, usually public utility undertakings (for example Electricity Companies). The double accounts system is not a special method of keeping accounts, rather a special method of presenting accounts which are kept under the normal double entry system. Under this system, separate accounts in respect of capital and revenue are prepared in order to show clearly the capital receipts and the manner in which the amounts thereof have been invested. The final accounts prepared under the double accounts system normally consist of :

(i) Revenue Account

(ii) Net Revenue Account

(iii) Capital Account (Receipts and Expenditure on capital account)

(iv) General Balance Sheet.

The Revenue account is analogous to the Profit & Loss Account of a company with some exceptions. The Net Revenue Account resembles with appropriation portion of the Profit & Loss Account of a company. The Balance Sheet is presented in two parts namely Capital Account and General Balance Sheet. The Capital Account shows the total amount of capital raised and its sources and also the manner and extent to which this capital has been applied in the acquisition of fixed assets for the purpose of carrying on the business. The General balance sheet includes the other items.

The Double accounts system in its pure form does no longer exist but the statements submitted to State Governments by electricity companies generally follow the principle of double accounts system. It may be noted that for presenting accounts to the shareholders, electricity companies normally follow Schedule VI of the Companies Act, 1956.

Question 2

"Receipt and payment on capital account" and "General Balance Sheet" of a public utility.

Answer

Under the double accounts system, which is followed by a public utility concern, the balance sheet is split into two parts : (a) Receipt and payment on capital account and (b) General Balance Sheet.

The main purpose of the former is to show (i) the total amount of capial raised its sources and (ii) the manner and the extent to which this capital has been applied in the acquisition of fixed assets for the purpose of carrying on the business of the undertaking. It thus discloses the receipt and expenditure on capital account, that is, the receipts from issue of shares, debentures and loans and the expenditure, out of such receipts, on acquisition of and addition to fixed assets. The receipt and expenditure on capital account is shown in a columnar form. There are three money columns : (a) one showing the amount at the commencement of the period; (b) another disclosing the amount received or spent during the period; and (c) the third showing the balance left at the end of the period.

The other part (called general balance sheet) contains other assets and liabilities and the balance of the receipt and expenditure on capital account. It is drawn up in the usual way, showing on the liabilities side–reserves, depreciation fund, current liabilities and other credit balances and total receipts as per capital account, on the assets side–total of expenditure as per capital account, floating assets and other debit balances.

Question 3

Reasonable returns in electricity supply companies.

Answer

The law seeks to prevent an electricity undertaking from earning too high a profit. For this purpose, “reasonable return” has been defined as consisting of :

(a) An yield at the standard rate which is Reserve Bank rate plus two percent on the capital base as defined below;

(b) Income derived from investment except investment made against Contingencies Reserve;

(c) An amount equal to 1/2% on loans advanced by the Electricity Board;

(d) An amount equal to 1/2% on the amounts borrowed from organisations or institutions approved by the State Government;

(e) An amount equal to 1/2% on the amount raised by the issue of debentures;

(f) An amount equal to 1/2% on balance of Development Reserve; and

(g) Such other amounts as may be allowed by the Central Government having regard to the prevailing tax structure in the country.

The term “Capital Base” used above, can be defined as:

(a) the original cost of fixed assets available for use and necessary for the purpose of the undertaking less contributions, if any made by the consumers for construction of service lines and also amounts written off;

(b) the cost of intangible assets;

(c) the original cost of work in progress;

(d) the amount of investments compulsorily made agaisnt contingencies reserve; and

(e) the monthly average of the stores, materials, supplies and cash and bank balances held at the end of each month of the year of account not exceeding in the aggregate an amount equal to one quarter of the expenditure.

Less:

(i) the amount written off or set aside on account of depreciation of fixed assets and amounts written off in respect of intangible assets in the books of the undertaking;

(ii) the amount of any loans advanced by the Board;

(iii) the amount of any loans borrowed from organisations or institutions approved by the State Government;

(iv) the amount of any debentures issued by the licensee;

(v) the amount of security deposits held in cash;

(vi) the amount standing to the credit of the Tariffs and Dividends Control Reserve;

(vii) the amount set apart for the development reserve; and

(viii) the amount carried forward in the accounts of the licensee for distribution to the consumers.

(B) Practical Questions:

Question 1

Electric Supply Ltd. rebuilt and re-equipped one of their Mains at a Cash Cost of Rs. 40,00,000. The old Mains thus superseded cost Rs. 15,00,000. The capacity of the new Main is double that of the old Main.

Rs. 70,000 was realised from sale of old materials. Four old motors valued at Rs. 2,00,000 salvaged from the old Main were used in the reconstruction. The cost of Labour and Materials is respectively 30% and 25% higher now than when the old Main was built. The proportion of Labour to Materials in the Main then and now is 2 : 3.

Show the Journal entries for recording the above transactions, if accounts are maintained under Double Account System.

Answer

Electric Supply Ltd.

Journal Entries

		Dr. Rs.	*Cr.* Rs.
New Main Account	Dr.	20,95,000	
Replacement Account	Dr.	19,05,000	
To Bank Account			40,00,000
(Being current cost of replacement charged to replacement account and the balance amount capitalised)			
New Main Account	Dr.	2,00,000	
To Replacement Account			2,00,000
(Being the value of motors salvaged from old main used in the reconstruction of main)			
Bank Account	Dr.	70,000	
To Replacement Account			70,000
(Being the amount realised from sale of old materials credited to replacement account)			
Revenue Account	Dr.	16,35,000	
To Replacement Account			16,35,000
(Being the net current cost of replacement transferred to revenue account)			

Working Notes:

1. **Current cost of replacement:**

	Cost of existing main Rs.	*Increase in cost* *Rate*	*Amount* Rs.	*Current cost* Rs.
Materials (3/5 × Rs. 15 lacs)	9,00,000	25%	2,25,000	11,25,000
Labour (2/5 × Rs. 15 lacs)	6,00,000	30%	1,80,000	7,80,000

Estimated current cost for replacement of present main (amount to be charged to replacement account)	19,05,000

2. **Additional cost of reconstruction of main (to be capitalised)**

Cash cost of re-building new main	40,00,000
Less: Estimated current cost for replacement of existing old main	19,05,000
Additional cost in new main to be capitalised (excluding old motors used	20,95,000

3. **Replacement Account**

Dr.			*Cr.*
To Bank A/c	19,05,000	By New Main A/c	2,00,000
		By Bank A/c	70,000
		By Replacement A/c Balancing figure	16,35,000
	19,05,000		19,05,000

Question 2

Power Electric Company decides to replace one of its old plant by an improved plant with larger capacity. The cost of the new plant is Rs. 16,00,000.

Materials and Labour earlier and now are in the ratio of 4 : 6.

Original cost of the old plant is Rs. 3,00,000. Materials cost has gone up by 2½ times and Labour cost by 3 times since then. Old materials worth Rs. 10,000 were used in the construction of the new plant and Rs. 20,000 were realised from the sale of old materials.

Give the necessary Journal Entries for recording the above transactions.

Answer

Journal Entries

Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
Plant account	Dr.	7,70,000	
To Bank account			7,60,000
To Replacement account			10,000
(Being the additional cost incurred and old			

materials utilized in new plant)			
Replacement account	Dr.	8,40,000	
To Bank account			8,40,000
(Being the current cost of replacement)			
Bank account	Dr.	20,000	
To Replacement account			20,000
(Being the old materials sold)			
Revenue account	Dr.	8,10,000	
To Replacement account			8,10,000
(Being the balance of replacement account transferred to revenue account)			

Working Note:

Old cost of the plant Rs. 3,00,000:

Material = $3,00,000 \times \frac{4}{10} = 1,20,000$

Labour = $3,00,000 \times \frac{6}{10} = 1,80,000$

		Rs.
Cost of materials increased by 250% = 1,20,000 × 250%		3,00,000
Cost of labour increased by 300% = 1,80,000 × 300%		5,40,000
Current cost of replacing old plant		8,40,000
Less: Sale of old materials	20,000	
Old materials utilized in new plant	10,000	30,000
Amount to be transferred to Revenue account		8,10,000

Cash cost of the new plant	16,00,000*
Add: Old materials utilized	10,000
	16,10,000
Less: Current cost of replacing old plant	8,40,000
Amount to be capitalized	7,70,000

* The cost of new plant has been given as Rs. 16,00,000 in the question. It has been assumed in the above solution that this cost does not include the cost of old materials used in the construction of new plant worth Rs. 10,000.

Question 3

X Electricity Company Limited decides to replace one of its old plants with a modern one in April, 2006. The plant when installed in the year 2000, costed the company Rs.26 lakhs, the components of materials and labour being in the ratio of 7:3. It is ascertained that the cost of labour and materials have risen by 30% and 25% respectively. The cost of new plant is Rs.66 lakhs and in addition old materials worth Rs.92,000 are reused. Old materials worth Rs.1,68,000 are sold. Under double account system compute the following:

(i) The amount to be written off to Revenue A/c.

(ii) The amount to be capitalized.

(iii) Draw up the necessary Journal entries.

(iv) Draw up the Replacement Account.

Answer

(i) Statement showing amount to be written off to Revenue Account

				Rs.
Cost of old plant				26,00,000
Add:.	Increase in cost of material	$26{,}00{,}000 \text{x} \frac{7}{10} \times \frac{25}{100}$		4,55,000
	Increase in cost of Labour	$26{,}00{,}000 \text{ x } \frac{3}{10} \times \frac{30}{100}$		2,34,000
	Current cost of old plant			32,89,000
Less:	Cost of Material used		92,000	
	Cost of Material sold		1,68,000	(-) 2,60,000
Amount to be written off to Revenue A/c				30,29,000

(ii) Statement showing amount to be capitalised

		Rs.
Cost of new plant excluding the value of old materials used		66,00,000
Less:	Current cost of old plant	32,89,000
Current cost to be capitalized		33,11,000
Add:	Value of old material used	92,000
Total amount to be capitalized		34,03,000

(iii) Journal Entries in the Books of X Electricity Company Ltd.

			Rs.	Rs.
(a)	Replacement Account	Dr.	32,89,000	
	To Bank Account			32,89,000
	(Being the replacement of old plant by a new plant; the current cost of replacement Rs.32,89,000)			
(b)	Plant Account	Dr.	34,03,000	
	To Replacement Account			92,000
	To Bank Account			33,11,000
	(Being additional cost of new plant capitalized and also old materials used in construction of new plant)			
(c)	Bank Account	Dr.	1,68,000	
	To Replacement A/c			1,68,000
	(Being the sale of old materials for Rs.1,68,000)			
(d)	Revenue A/c	Dr.	30,29,000	
	To Replacement Account			30,29,000
	(Being the balance of replacement account transferred to revenue account)			

(iv) Replacement Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Bank A/c	32,89,000	By	New Plant A/c	92,000
			By	Bank A/c	1,68,000
			By	Revenue A/c (Balancing figure)	30,29,000
		32,89,000			32,89,000

Question 4

'H' Electricity Company earned a profit of Rs.60,00,000 (after tax) after paying Rs.48,000 at 12% interest on debentures for the year ended 31.3.2007. The following further information is supplied to you:

	Rs.
Share Capital	*2,50,00,000*
Reserve Fund Investment (invested in 8% Government Securities at par)	*60,00,000*
Contingencies Reserve Fund Investment (7%)	*25,00,000*
Loan from State Electricity Board	*50,00,000*
Development Reserve	*16,00,000*
Fixed Assets	*6,00,00,000*
Depreciation Reserve on Fixed Assets	*60,00,000*
Security Deposits of customers	*80,00,000*
Amount contributed by consumers towards cost of Fixed Assets	*4,50,000*
Intangible Assets	*17,50,000*
Tariffs and Dividends Control Reserve	*22,00,000*
Monthly average of Current Assets including amount due from customers Rs.5,00,000	*36,00,000*

Show, how the profits of the company will be dealt with under the provisions of the Electricity Act, assuming the bank rate of the year was 8%. All working notes should form part of your answer.

Answer

'H' Electricity Company

Statement of Distribution of Profit for the year ended 31.3.2007

Capital Base

	Rs.	*Rs.*
Fixed Assets as reduced by customers contribution		
(6,00,00,000 – 4,50,000)	5,95,50,000	
Intangible Assets	17,50,000	
Monthly average of Current Assets (Excluding amount due		

from customers i.e. 36,00,000 – 5,00,000)	31,00,000	
Contingencies Reserve Fund Investment	25,00,000	6,69,00,000
Deduct:		
Depreciation Reserve	60,00,000	
Loan from Electricity Board	50,00,000	
12% Debentures ($48{,}000 \times \frac{100}{12}$)	4,00,000	
Development Reserve	16,00,000	
Security Deposits of Customers	80,00,000	
Tariffs and Dividends Control Reserve	22,00,000	2,32,00,000
Capital Base		4,37,00,000

Reasonable Return

	Rs.
10% (Bank Rate + 2%) on Capital Base	43,70,000
8% on Reserve Fund Investment	4,80,000
½% on Loan from Electricity Board	25,000
½% on Debentures	2,000
½% on Development Reserve	8,000
Reasonable Return	48,85,000

Surplus and its Disposal

	Rs.
Clear Profit	60,00,000
Surplus (Rs.60,00,000 – Rs.48,85,000)	11,15,000
Less: 20% of Reasonable Return (to be disposed off)	9,77,000
Amount refundable to consumers	1,38,000

Disposal of Surplus of Rs.9,77,000

		Rs.
(i)	$\frac{1}{3}$ of surplus over clear profit limited to 5% of reasonable return will be at the disposal of the company i.e. Rs.3,71,667 >Rs.2,44,250	2,44,250
(ii)	Credit to Tariffs and Dividends Control Reserve (1/2 of remaining balance of 20% of Reasonable Return)	3,66,375
(iii)	Credit to Consumers' Suspense Account	3,66,375
		9,77,000

Total amount at the disposal of the company

		Rs.
(a)	Amount of reasonable return	48,85,000
(b)	Share in surplus	2,44,250
		51,29,250

Total amount refunded to consumers

		Rs.
(a)	Surplus in excess of 20% of reasonable return	1,38,000
(b)	Share in surplus	3,66,375
		5,04,375

CHAPTER 8

DEPARTMENTAL ACCOUNTS

BASIC CONCEPTS

- An organization usually divides the work in various departments, which is done on the principle of division of labour. This can improve efficiency of each and every department of the organization. Each department prepares its separate accounts to judge its individual performance.
- There are two types of departments: (i) Dependent Branches and (ii) Independent Branches

(A) Practical Questions:

Question 1

Department X sells goods to Department Y at a profit of 25% on cost and to Department Z at 10% profit on cost. Department Y sells goods to X and Z at a profit of 15% and 20% on sales, respectively. Department Z charges 20% and 25% profit on cost to Department X and Y, respectively.

Department Managers are entitled to 10% commission on net profit subject to unrealised profit on departmental sales being eliminated. Departmental profits after charging Managers' commission, but before adjustment of unrealised profit are as under :

	Rs.
Department X	*36,000*
Department Y	*27,000*
Department Z	*18,000*

Stock lying at different departments at the end of the year are as under :

	Dept. X *Rs.*	*Dept. Y* *Rs.*	*Dept. Z* *Rs.*
Transfer from Department X	—	*15,000*	*11,000*
Transfer from Department Y	*14,000*	—	*12,000*
Transfer from Department Z	*6,000*	*5,000*	—

Find out the correct departmental Profits after charging Managers' commission

Answer

Calculation of correct Profit

	Depart–ment X *Rs.*	*Depart–ment Y* *Rs.*	*Depart–ment Z* *Rs.*
Profit after charging managers' commission	36,000	27,000	18,000
Add back : Managers' commission (1/9)	4,000	3,000	2,000
	40,000	30,000	20,000
Less : Unrealised profit on stock (Working Note)	4,000	4,500	2,000

Profit before Manager's commission	36,000	25,500	18,000
Less : Commission for Department			
Manager @10%	3,600	2,550	1,800
	32,400	22,950	16,200

Working Note :

Stock lying with

	Dept. X	*Dept. Y*	*Dept. Z*	*Total*
	Rs.	*Rs.*	*Rs.*	*Rs.*
Unrealised Profit of :				
Department X		1/5×15,000 =3,000	1/11×11,000 =1,000	4,000
Department Y	0.15×14,000 =2,100		0.20×12,000 =2,400	4,500
Department Z	1/6×6,000 =1,000	1/5×5,000 =1,000		2,000

Question 2

FGH Ltd. has three departments I.J.K. The following information is provided for the year ended 31.3.2004:

	I	*J*	*K*
	Rs.	*Rs.*	*Rs.*
Opening stock	*5,000*	*8,000*	*19,000*
Opening reserve for unrealised profit	–	*2,000*	*3,000*
Materials consumed	*16,000*	*20,000*	–
Direct labour	*9,000*	*10,000*	–
Closing stock	*5,000*	*20,000*	*5,000*
Sales	–	–	*80,000*
Area occupied (sq. mtr.)	*2,500*	*1,500*	*1,000*
No. of employees	*30*	*20*	*10*

Stocks of each department are valued at costs to the department concerned. Stocks of I are transferred to J at cost plus 20% and stocks of J are transferred to K at a gross profit of 20% on sales. Other common expenses are salaries and staff welfare Rs. 18,000, rent Rs. 6,000.

Prepare Departmental Trading, Profit and Loss Account for the year ending 31.3.2004.

Answer

FGH Ltd.

Departmental Trading and Profit and Loss Account

for the year ended 31st March, 2004

	I	*J*	*K*	*Total*		*I*	*J*	*K*	*Total*
	Rs.	*Rs.*	*Rs.*	*Rs.*		*Rs.*	*Rs.*	*Rs.*	*Rs.*
To Opening stock	5,000	8,000	19,000	32,000	By Sales			80,000	80,000
To Material consumed	16,000	20,000		36,000	By Inter-departmental transfer	30,000	60,000		90,000
To Direct labour	9,000	10,000		19,000	By Closing stock	5,000	20,000	5,000	30,000
To Inter-departmental transfer		30,000	60,000	90,000					
To Gross profit	5,000	12,000	6,000	23,000					
	35,000	80,000	85,000	2,00,000		35,000	80,000	85,000	2,00,000
To Salaries and staff welfare	9,000	6,000	3,000	18,000	By Gross profit b/d	5,000	12,000	6,000	23,000
					By Net loss	7,000			7,000
To Rent	3,000	1,800	1,200	6,000					
To Net profit		4,200	1,800	6,000					
	12,000	12,000	6,000	30,000		12,000	12,000	6,000	30,000
To Net loss (I)				7,000	By Stock reserve b/d (J + K)				5,000
To Stock reserve (J+K) (Refer W.N.)				3,000	By Net profit (J + K)				6,000
To Balance transferred to Profit and loss account				1,000					
				11,000					11,000

Working Note:

Calculation of unrealized profit on closing stock

	Rs.
Stock reserve of J department	
Cost	30,000
Transfer from I department	30,000
	60,000
Stock of J department	20,000

Proportion of stock of I department = $\text{Rs. }20{,}000 \times \frac{\text{Rs.}30{,}000}{\text{Rs.}60{,}000}$ = Rs.10,000

Stock reserve =$\text{Rs.}10{,}000 \times \frac{20}{120}$ = Rs.1667 (approx.)

	Rs.
Stock reserve of K department	
Stock transferred from J department	5,000
Less: Profit (stock reserve) 5,000 × 20%	1,000
Cost to J department	4,000

Proportion of stock of I department =$\text{Rs. }4{,}000 \times \frac{\text{Rs.}30{,}000}{\text{Rs.}60{,}000} =$ Rs.2,000

$\text{Stock reserve} = \text{Rs.}2{,}000 \times \frac{20}{120} =$ Rs.333 (approx.)

Total stock reserve = Rs.1,000 + Rs.333 = Rs.1,333

CHAPTER 9

ACCOUNTING FOR BRANCHES INCLUDING FOREIGN BRANCH ACCOUNTS

BASIC CONCEPTS

- Types of branches
  - Dependent branches
  - Independent branches
- Based on accounting point of view, branches may be classified as follows:
  - Branches in respect of which the whole of the accounting records are kept at the head office
  - Branches which maintain independent accounting records, and
  - Foreign Branches.
- System of accounting
  - Debtors System: under this system head office makes a branch account. Anything given to branch is debited and anything received from branch would be credited.
  - Branch trading and profit and loss account method/branch account method: Under this system head office prepares (a) profit and loss account (b) branch account taking each branch as a separate entity.
  - Stock and debtors system: Under this system head office opens:
    - Branch stock account
    - Branch debtors account
    - Branch asset account
    - Branch expenses account
    - Branch adjustment account

- Types of Foreign branches :
  - Integral Foreign Operation (IFO): It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.
  - Non-Integral Foreign Operation (NFO): It is a foreign operation that is not an Integral Foreign Operation. The business of a NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency.
- Non-Integral Foreign Operation -translation
  - Balance sheet items i.e. Assets and Liabilities both monetary and non-monetary – apply closing exchange rate.
  - Items of income and expenses – At actual exchange rates on the date of transactions
  - Resulting exchange rate difference should be accumulated in a "foreign currency translation reserve" until the disposal of "net investment in non-integral foreign operation".
- Integral Foreign Operation (IFO) - translation
  - at the rate prevailing on the date of transaction

Question 1

Carlin & Co. has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch furnishes you with its trial balance as on 31st March, 1999 and the additional information given thereafter:

	Dr.	Cr.
	Rupees in thousands	
Stock on 1st April, 1998	300	–
Purchases and sales	800	1,200
Sundry Debtors and creditors	400	300
Bills of exchange	120	240
Wages and salaries	560	–
Rent, rates and taxes	360	–
Sundry charges	160	–
Computers	240	–
Bank balance	420	–
New York office a/c	–	1,620
	3,360	3,360

Additional information :

(a) 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.

(b) Unsold stock of Mumbai branch was worth Rs. 4,20,000 on 31st March, 1999.

(c) The rates of exchange may be taken as follows :

  (i) on 1.4.1998 @ Rs. 40 per US $

  (ii) on 31.3.1999 @ Rs. 42 per US $

  (iii) average exchange rate for the year @ Rs. 41 per US $

  (iv) conversion in $ shall be made upto two decimal accuracy.

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 1999 and the balance sheet as on that date of Mumbai branch as would appear in the books of New York head office of Carlin & Co. You are informed that Mumbai branch account showed a debit balance of US $ 39609.18 on 31.3.1999 in New York books and there were no items pending reconciliation.

Answer

Carlin & Co. Ltd.

Mumbai Branch Trial Balance in (US $)

as on 31st March, 1999

	Conversion rate per US $ (Rs.)	Dr. US $	Cr. US $
Stock on 1.4.98	40	7,500.00	–
Purchases and sales	41	19,512.20	29,268.29
Sundry debtors and creditors	42	9,523.81	7,142.86
Bills of exchange	42	2,857.14	5,714.29
Wages and salaries	41	13,658.54	–
Rent, rates and taxes	41	8,780.49	–
Sundry charges	41	3,902.44	–
Computers	–	6,000.00	–
Bank balance	42	10,000.00	–
New York office A/c	–	–	39,609.18
		81,734.62	81,734.62

Trading and Profit & Loss Account

for the year ended 31st March, 1999

	US $		*US $*
To Opening Stock	7,500.00	By Sales	29,268.29
To Purchases	19,512.20	By Closing stock	10,000.00
To Wages and salaries	13,658.54	By Gross Loss c/d	1,402.45
	40,670.74		40,670.74

To Gross Loss b/d	1,402.45	By Net Loss	17,685.38
To Rent, rates and taxes	8,780.49		
To Sundry charges	3,902.44		
To Depreciation on computers	3,600.00		
(US $ 6,000 × 0.6)			
	17,685.38		17,685.38

Balance Sheet of Mumbai Branch

as on 31st March, 1999

Liabilities		*US $*	*Assets*	*US $*	*US $*
New York Office A/c	39,609.18		Computers	6,000.00	
Less : Net Loss	17,685.38	21,923.80	*Less* :Depreciation	3,600.00	2,400.00
Sundry creditors		7,142.86	Closing stock		10,000.00
Bills payable		5,714.29	Sundry debtors		9,523.81
			Bank balance		10,000.00
			Bills receivable		2,857.14
		34,780.95			34,780.95

Note : The above answer has been given on the basis that the Mumbai branch is an integral foreign operation of carlin & Co.

Question 2

An Indian company has a branch at Washington. Its Trial Balance as at 30th September, 1998 is as follows:

	Dr.	*Cr.*
	US $	*US $*
Plant and machinery	*1,20,000*	–
Furniture and fixtures	*8,000*	–
Stock, Oct. 1, 1997	*56,000*	–
Purchases	*2,40,000*	–
Sales	– .	*4,16,000*
Goods from Indian Co. (H.O.)	*80,000*	–
Wages	*2,000*	–
Carriage inward	*1,000*	–

Salaries	*6,000*	–
Rent, rates and taxes	*2,000*	–
Insurance	*1,000*	–
Trade expenses	*1,000*	–
Head Office A/c	– .	*1,14,000*
Trade debtors	*24,000*	–
Trade creditors	– .	*17,000*
Cash at bank	*5,000*	–
Cash in hand	*1,000*	–
	5,47,000	*5,47,000*

The following further information is given :

(1) *Wages outstanding – $ 1,000.*

(2) *Depreciate Plant and Machinery and Furniture and Fixtures @ 10 % p.a.*

(3) *The Head Office sent goods to Branch for Rs. 39,40,000.*

(4) *The Head Office shows an amount of Rs. 43,00,000 due from Branch.*

(5) *Stock on 30th September, 1998 – $ 52,000.*

(6) *There were no in transit items either at the start or at the end of the year.*

(7) *On September 1, 1996, when the fixed assets were purchased, the rate of exchange was Rs. 38 to one $.*

On October 1, 1997, the rate was Rs. 39 to one $.

On September 30, 1998, the rate was Rs. 41 to one $.

Average rate during the year was Rs. 40 to one $.

You are asked to prepare :

(a) *Trial balance incorporating adjustments given under 1 to 4 above, coverting dollars into rupees.*

(b) *Trading and Profit and Loss Account for the year ended 30th September, 1998 and Balance Sheet as on that date depicting the profitability and net position of the Branch as would appear in India for the purpose of incorporating in the main Balance Sheet.*

Answer

(a) **In the books of Indian Company**

Washington Branch Trial Balnce (in Rupees)

as on 30th September, 1998

(Rs. '000)

	Dr.	*Cr. .*	*Conversion*	*Dr.*	*Cr.*
	US $	*US $*	*rate*	*Rs.*	*Rs.*
Plant and Machinery	1,08,000		41	44,28,000	
Depreciation on plant and machinery	12,000		41	4,92,000	
Furniture and fixtures	7,200		41	2,95,200	
Depreciation on furniture and fixtures	800		41	32,800	
Stock, Oct. 1, 1997	56,000		39	21,84,000	
Purchases	2,40,000		40	96,00,000	
Sales		4,16,000	40		1,66,40,000
Goods from Indian Co. (H.O.)	80,000			39,40,000	
Wages	3,000		40	1,20,000	
Outstanding wages	1,000		41		41,000
Carriage inward	1,000		40	40,000	
Salaries	6,000		40	2,40,000	
Rent, rates and taxes	2,000		40	80,000	
Insurance	1,000		40	40,000	
Trade expenses	1,000		40	40,000	
Head Office A/c		1,14,000			43,00,000
Trade debtors	24,000		41	9,84,000	
Trade creditors		17,000	41		6,97,000
Cash at bank	5,000		41	2,05,000	
Cash in hand	1,000		41	41,000	
Exchange gain					10,84,000
(balancing figure)				2,27,62,000	2,27,62,000

(b)

Washington Branch Trading and Profit and Loss Account for the year ended 30th September, 1998

Dr.			*Cr.*
	Rs.		*Rs.*
To Opening stock	21,84,000	By Sales	1,66,40,000
To Purchases	96,00,000	By Closing stock	21,32,000
To Goods from Head Office	39,40,000	(52,000 US $ × 41)	
To Wages	1,20,000		
To Carriage inward	40,000		
To Gross profit c/d	28,88,000		
	1,87,72,000		1,87,72,000
To Salaries	2,40,000	By Gross profit b/d	28,88,000
To Rent, rates and taxes	80,000		
To Insurance	40,000		
To Trade expenses	40,000		
To Depreciation on plant and machinery	4,92,000		
To Depreciation on furniture and fixtures	32,800		
To Net Profit c/d	19,63,200		
	28,88,000		28,88,000

Balance Sheet of Washington Branch as on 30th September, 1998

Liabilities	*Rs.*	*Rs.*	*Assets*	*Rs.*	*Rs.*
Head Office A/c	43,00,000		Plant and machinery	49,20,000	
Add : Net profit	19,63,200	62,63,200	*Less* : Depreciation	4,92,000	44,28,000
Foreign currency			Furniture and fixtures	3,28,000	
Translation reserve		10,84,000	*Less* : Depreciation	32,800	2,95,200
Trade creditors		6,97,000	Closing stock		21,32,000
Outstanding wages		41,000	Trade debtors		9,84,000
			Cash in hand		41,000
			Cash at bank		2,05,000
		80,85,200			80,85,200

Note : (1) Depreciation has been calculated at the given depreciation rate of 10% on WDV basis.

(2) The above solution has been given assuming that the Washington branch is a non-integral foreign operation of the Indian Company.

Question 3

Widespread Ltd. invoices goods to its branch at cost plus 20%. The branch sells goods for cash as well as on credit. The branch meets its expenses out of cash collected from its debtors and cash sales and remits the balance of cash to head office after withholding Rs. 10,000 necessary for meeting immediate requirements of cash. On 31st March, 2000 the assets at the branch were as follows :

	Rs. ('000)
Cash in Hand	*10*
Trade Debtors	*384*
Stock, at Invoice Price	*1,080*
Furniture and Fittings	*500*

During the accounting year ended 31st March, 2001 the invoice price of goods dispatched by the head office to the branch amounted to Rs. 1 crore 32 lakhs. Out of the goods received by it, the branch sent back to head office goods invoiced at Rs. 72,000. Other transactions at the branch during the year were as follows :

	Rs. ('000)
Cash Sales	*9,700*
Credit Sales	*3,140*
Cash collected by Branch from Credit Customers	*2,842*
Cash Discount allowed to Debtors	*58*
Returns by Customers	*102*
Bad Debts written off	*37*
Expenses paid by Branch	*842*

On 1st January, 2001 the branch purchased new furniture for Rs.1 lakh for which payment was made by head office through a cheque.

On 31st March, 2001 branch expenses amounting to Rs. 6,000 were outstanding and cash in hand was again Rs. 10,000. Furniture is subject to depreciation @ 16% per annum on diminishing balance method.

Prepare Branch Account in the books of head office for the year ended 31st March, 2001.

Answer

In the Head Office Books

Branch Account

for the year ended 31st March, 2001

Dr.	*Rs. '000*		*Cr.* *Rs.'000*
To Balance b/d		By Balance b/d	
Cash in hand	10	Stock reserve Rs. 1,080 × $\frac{1}{6}$	180
Trade debtors	384	By Goods sent to branch A/c	72
Stock	1,080	(Returns to H.O.)	
Furniture and fittings	500	By Goods sent to branch A/c	2,188
To Goods sent to branch A/c	13,200	(Loading on net goods sent	
To Bank A/c (Payment for			
furniture)	100	to branch –(Rs. 13,128 × $\frac{1}{6}$)	
To Balance c/d		By Bank A/c	
Stock reserve (Rs.1,470 × $\frac{1}{6}$)	245	(Remittance from	
		branch to H.O.)	11,700
Outstanding expenses	6	By Balance c/d	
To Profit and loss A/c	1,096	Cash in hand	10
(Net Profit)		Trade debtors	485
		Stock	1,470
		Furniture and fittings	516
	16,621		16,621

Working notes :

1. **Invoice price and cost**

Let cost be		100
So, invoice price		120
Loading		20
Loading : Invoice price	= 20 : 120	
	= 1 : 6	

2. Invoice price of closing stock in branch

Branch Stock Account

	Rs. '000		Rs. '000
To Balance b/d	1,080	By Goods sent to branch	72
To Goods sent to branch	13,200	By Branch Cash	9,700
To Branch debtors	102	By Branch debtors	3,140
		By Balance c/d	1,470
	14,382		14,382

3. Closing balance of branch debtors

Branch Debtors Account

	Rs. '000		Rs. '000
To Balance b/d	384	By Branch branch	2,842
To branch stock	3,140	By Branch expenses discount	58
		By Branch stock (Returns)	102
		By Branch expenses	
		(Bad debts)	37
		By Balance b/d	485
	3,524		3,524

4. Closing balance of furniture and fittings

Branch Furniture and Fittings Account

	Rs. '000		Rs. '000
To Balance b/d	500	By Depreciation (80+4)	84
To Bank	100	By Balance c/d	516
	600		600

5. Remittance by branch to head office

Branch Cash Account

	Rs. '000		Rs. '000
To Balance b/d	10	By Branch expenses	842
To Branch stock	9,700	By Remittances to H.O.	11,700
To Branch debtors	2,842	By Balance b/d	10
	12,552		12,552

Question 4

On 31st March, 2000 Kanpur Branch submits the following Trial Balance to its Head Office at Lucknow :

Debit Balances	*Rs. in lacs*
Furniture and Equipment	*18*
Depreciation on furniture	*2*
Salaries	*25*
Rent	*10*
Advertising	*6*
Telephone, Postage and Stationery	*3*
Sundry Office Expenses	*1*
Stock on 1st April, 1999	*60*
Goods Received from Head Office	*288*
Debtors	*20*
Cash at bank and in hand	*8*
Carriage Inwards	*7*
	448
Credit Balances	
Outstanding Expenses	*3*
Goods Returned to Head Office	*5*
Sales	*360*
Head Office	*80*
	448

Additional Information:

Stock on 31st March, 2000 was valued at Rs. 62 lacs. On 29th March, 2000 the Head Office despatched goods costing Rs. 10 lacs to its branch. Branch did not receive these goods before 1st April, 2000. Hence, the figure of goods received from Head Office does not include these goods. Also the head office has charged the branch Rs. 1 lac for centralised services for which the branch has not passed the entry.

You are required to:

(i) Pass Journal Entries in the books of the Branch to make the necessary adjustments

(ii) Prepare Final Accounts of the Branch including Balance Sheet, and

(iii) Pass Journal Entries in the books of the Head Office to incorporate the whole of the Branch Trial Balance.

Answer

(i) **Books of Branch**

Journal Entries

(Rs. in lacs)

		Dr.	*Cr.*
Goods in Transit A/c	Dr.	10	
To Head Office A/c			10
(Goods dispatched by head office but not received by branch before 1st April, 2000)			
Expenses A/c	Dr.	1	
To Head Office A/c			1
(Amount charged by head office for centralised services)			

(ii) **Trading and Profit & Loss Account of the Branch for the year ended 31st March, 2000**

		Rs. in lacs		*Rs. in lacs*
To Opening Stock		60	By Sales	360
To Goods received from			By Closing Stock	62
Head Office	288			
Less : Returns	5	283		
To Carriage Inwards		7		
To Gross Profit c/d		72		
		422		422
To Salaries		25	By Gross Profit b/d	72
To Depreciation on Furniture		2		
To Rent		10		
To Advertising		6		
To Telephone, Postage & Stationery		3		
To Sundry Office Expenses		1		
To Head Office Expenses		1		
To Net Profit Transferred to Head Office A/c		24		
		72		72

Balance Sheet as on 31st March, 2000

Liabilities		*Rs. in lacs*	*Assets*		*Rs. in lacs*
Head Office	80		Furniture & Equipment	20	
Add : Goods in transit	10		*Less :* Depreciation	2	18
Head Office			Stock in hand		62
Expenses	1		Goods in Transit		10
Net Profit	24		Debtors		20
		115	Cash at bank and in hand		8
Outstanding Expenses		3			
		118			118

(iii) **Books of Head Office**

Journal Entries

		Rs. *Dr.*	*Rs.* *Dr.*
Branch Trading Account	Dr.	355	
To Branch Account			355
(The total of the following items in branch trial balance debited to branch trading account			

	Rs. in lacs
Opening Stock	60
Goods received from Head Ofice	288
Carriage Inwards	7)

Branch Account	Dr.	427	
To Branch Trading Account			427
(Total sales, closing stock and goods returned to Head Office credited to branch trading account, individual amounts being as follows:			

	Rs. in lacs
Sales	360
Closing Stock	62
Goods returned to Head Office	5)

Branch Trading Account	Dr.	72	
T0 Branch Profit and Loss Account			72
(Gross profit earned by branch credited to Branch Profit and Loss Account)			
Branch Profit and Loss Account	Dr.	48	
To Branch Account			48
(Total of the following branch expenses debited to Branch Profit & Loss Account			
Rs. in lacs			
Salaries 25			
Rent 10			
Advertising 6			
Telephone, Postage & Stationery 3			
Sundry Office Expenses 1			
Head Office Expenses 1			
Depreciation on furniture & Equipment 2			
Branch Profit & Loss Account	Dr.	24	
To Profit and Loss Account			24
(Net profit at branch credited to (general) Profit & Loss A/c)			
Branch Furniture & Equipment	Dr.	18	
Branch Stock	Dr.	62	
Branch Debtors	Dr.	20	
Branch Cash at Bank and in Hand	Dr.	8	
Goods in Transit	Dr.	10	
To Branch			118
(Incorporation of different assets at the branch in H.O. books)			
Branch	Dr.	3	
To Branch Outstanding Expenses			3
(Incorporation of Branch Outstanding Expenses in H.O. books)			

Question 5

Show adjustment Journal entry in the books of Head Office at the end of April, 2003 for incorporation of inter-branch transactions assuming that only Head Office maintains different branch accounts in its books.

A. Delhi Branch:

(1) Received goods from Mumbai – Rs. 35,000 and Rs. 15,000 from Kolkata.

(2) Sent goods to Chennai – Rs. 25,000, Kolkata – Rs. 20,000.

(3) Bill Receivable received – Rs. 20,000 from Chennai.

(4) Acceptances sent to Mumbai – Rs. 25,000, Kolkata – Rs. 10,000.

B. Mumbai Branch (apart from the above) :

(5) Received goods from Kolkata – Rs. 15,000, Delhi – Rs. 20,000.

(6) Cash sent to Delhi – Rs. 15,000, Kolkata – Rs. 7,000.

C. Chennai Branch (apart from the above) :

(7) Received goods from Kolkata – Rs. 30,000.

(8) Acceptances and Cash sent to Kolkata – Rs. 20,000 and Rs. 10,000 respectively.

D. Kolkata Branch (apart from the above) :

(9) Sent goods to Chennai – Rs. 35,000.

(10) Paid cash to Chennai – Rs. 15,000.

(11) Acceptances sent to Chennai – Rs. 15,000.

Answer

(a) Journal entry in the books of Head Office

Date	*Particulars*		*Dr.*	*Cr.*
			Rs.	*Rs.*
30th April, 2003	Mumbai Branch Account	Dr.	3,000	
	Chennai Branch Account	Dr.	70,000	
	To Delhi Branch Account			15,000
	To Kolkata Branch Account			58,000
	(Being adjustment entry passed by head office in respect of inter-branch transactions for the month of April, 2003.			

Working Note:

Inter – Branch transactions

		Delhi	*Mumbai*	*Chennai*	*Kolkata*
		Rs.	*Rs.*	*Rs.*	*Rs.*
A.	Delhi Branch				
(1)	Received goods	50,000 (Dr.)	35,000 (Cr.)		15,000 (Cr.)
(2)	Sent goods	45,000 (Cr.)		25,000 (Dr.)	20,000 (Dr.)
(3)	Received Bills receivable	20,000 (Dr.)		20,000 (Cr.)	
(4)	Sent acceptance	35,000 (Cr.)	25,000 (Dr.)		10,000 (Dr.)
B.	Mumbai Branch				
(5)	Received goods	20,000 (Cr.)	35,000 (Dr.)		15,000 (Cr.)
(6)	Sent cash	15,000 (Dr.)	22,000 (Cr.)		7,000 (Dr.)
C.	Chennai Branch				
(7)	Received goods			30,000 (Dr.)	30,000 (Cr.)
(8)	Sent cash and acceptances			30,000 (Cr.)	30,000 (Dr.)
D.	Kolkata Branch				
(9)	Sent goods			35,000 (Dr.)	35,000 (Cr.)
(10)	Sent cash			15,000 (Dr.)	15,000 (Cr.)
(11)	Sent acceptances			15,000 (Dr.)	15,000 (Cr.)
		15,000 (Cr.)	3,000 (Dr.)	70,000 (Dr.)	58,000 (Cr.)

Question 6

Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) *Head Office expenses Rs. 3,500 allocated to the Branch, but not recorded in the Branch Books.*

(ii) *Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for Rs. 1,500.*

(iii) Branch paid Rs. 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries account.

(iv) H.O. collected Rs. 10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.

(v) A remittance of Rs. 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of Rs. 3,000 on behalf of Branch B.

Books of Branch A

Journal Entries

	Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
(i)	Expenses account	Dr.	3,500	
	To Head office account			3,500
	(Being the allocated expenditure by the head office recorded in branch books)			
(ii)	Depreciation account	Dr.	1,500	
	To Head office account			1,500
	(Being the depreciation provided)			
(iii)	Head office account	Dr.	2,000	
	To Salaries account			2,000
	(Being the rectification of salary paid on behalf of H.O.)			
(iv)	Head office account	Dr.	10,000	
	To Debtors account			10,000
	(Being the adjustment of collection from branch debtors)			
(v)	No entry in branch books			
(vi)	Head Office account	Dr.	3,000	
	To Cash account			3,000
	(Being the expenditure on account of Branch B, recorded in books)			

Question 7

M/s Shah & Co. commenced business on 1.4.2004 with Head Office at Mumbai and a Branch at Chennai. Purchases were made exclusively by the Head Office, where the goods were processed before sale. There was no loss or wastage in processing.

Only the processed goods received from Head Office were handled by the Branch. The goods were sent to branch at processed cost plus 10%.

All sales, whether by Head Office or by the Branch, were at uniform gross profit of 25% on their respective cost.

Following is the Trial Balance as on 31.3.2005.

	Head Office		Branch	
	Dr.	Cr.	Dr.	Cr.
	Rs.	Rs.	Rs.	Rs.
Capital		3,10,000		
Drawings	55,000			
Purchases	19,69,500			
Cost of processing	50,500			
Sales		12,80,000		8,20,000
Goods sent to Branch		9,24,000		
Administrative expenses	1,39,000		15,000	
Selling expenses	50,000		6,200	
Debtors	3,09,600		1,13,600	
Branch Current account	3,89,800			
Creditors		6,01,400		10,800
Bank Balance	1,52,000		77,500	
Head Office Current account				2,61,500
Goods received from H.O.			8,80,000	
	31,15,400	31,15,400	10,92,300	10,92,300

Following further information is provided:

(i) Goods sent by Head Office to the Branch in March, 2005 of Rs. 44,000 were not received by the Branch till 2.4.2005.

(ii) A remittance of Rs. 84,300 sent by the Branch to Head Office was also similarly not received upto 31.3.2005.

(iii) Stock taking at the Branch disclosed a shortage of Rs. 20,000 (at selling price to the branch).

(iv) Cost of unprocessed goods at Head Office on 31.3.2005 was Rs. 1,00,000.

Prepare Trading and Profit and Loss account in columnar form and Balance Sheet of the business as a whole as at 31.3.2005.

Answer

In the Books of Shah & Co.

Trading and Profit and Loss Account for the year ended 31st March, 2005

	Particulars	*H.O.*	*Branch*	*Total*			*H.O.*	*Branch*	*Total*
		Rs.	*Rs.*	*Rs.*			*Rs.*	*Rs.*	*Rs.*
To	Purchases	19,69,500	–	19,69,500	By	Sales	12,80,000	8,20,000	21,00,000
To	Cost of processing	50,500	–	50,500	By	Goods sent to Branch	9,24,000	–	–
To	Goods received				By	Stock shortage	–	16,000	14,545
	from H.O.	–	8,80,000	–	By	Goods in transit			44,000
To	Gross profit c/d	3,40,000	1,64,000	5,02,545	By	Closing stock:			
						Processed goods	56,000	2,08,000	2,64,000
						Unprocessed goods	1,00,000	–	1,00,000
		23,60,000	10,44,000	25,22,545			23,60,000	10,44,000	25,22,545
To	Admn. Expenses	1,39,000	15,000	1,54,000	By	Gross profit b/d	3,40,000	1,64,000	5,02,545
To	Selling Expenses	50,000	6,200	56,200					
To	Stock shortage	–	16,000	14,545					
To	Stock reserve	22,909	–	22,909					
To	Net profit	1,28,091	1,26,800	2,54,891					
		3,40,000	1,64,000	5,02,545			3,40,000	1,64,000	5,02,545

Balance Sheet as at 31st March, 2005

Liabilities		*Rs.*	*Assets*	*Rs.*
Capital	3,10,000		Debtors	
Add: Net profit	2,54,891		H.O.	3,09,600
	5,64,891		Branch	1,13,600
Less: Drawings	55,000	5,09,891	Closing stock:	

Creditors:			Processed goods			
H.O.	6,01,400		H.O.	56,000		
Branch	10,800	6,12,200	Branch	2,08,000		
				2,64,000		
			Less: Stock reserve	18,909	2,45,091	
			Unprocessed goods		1,00,000	
			Bank Balance			
			H.O.		1,52,000	
			Branch		77,500	
			Goods in transit	44,000		
			Less: Stock reserve	4,000	40,000	
			Cash in transit		84,300	
		11,22,091			11,22,091	

Working Notes:

1. **Calculation of closing stock:**

Stock at Head Office:

Cost of goods processed Rs. (19,69,500 + 50,500 – 1,00,000)		19,20,000
Less: Cost of goods sent to Branch		
$9,24,000 \times \frac{100}{110}$	8,40,000	
Cost of goods sold $12,80,000 \times \frac{100}{125}$	10,24,000	18,64,000
Stock of processed goods with H.O.		56,000

Stock at Branch:

Goods received from H.O. (at invoice price)		8,80,000
Less: Invoice value of goods sold		
$8,20,000 \times \frac{100}{125}$	6,56,000	

Invoice value of stock shortage	$20{,}000 \times \frac{100}{125}$	16,000	6,72,000
Stock at Branch at invoice price			2,08,000
Less: Stock Reserve $2{,}08{,}000 \times \frac{10}{110}$			18,909
Stock of processed goods with Branch (at cost)			1,89,091

2. Stock Reserve:

Unrealised profit on Branch stock $\left(2{,}08{,}000 \times \frac{10}{110}\right)$	18,909
Unrealised profit on goods in transit $\left(44{,}000 \times \frac{10}{110}\right)$	4,000
	22,909

Question 8

Concept & Co., with its Head Office at Mumbai has a branch at Nagpur. Goods are invoiced to the Branch at cost plus 33 1/3%. The following information is given in respect of the branch for the year ended 31st March, 2006:

	Rs.
Goods sent to Branch (Invoice price)	*4,80,000*
Stock at Branch on 1.4.2005 (Invoice price)	*24,000*
Cash sales	*1,80,000*
Return of goods by customers to the Branch	*6,000*
Branch expenses (paid in cash)	*53,500*
Branch debtors balance on 1.4.2005	*30,000*
Discount allowed	*1,000*
Bad debts	*1,500*
Collection from Debtors	*2,70,000*
Branch debtors cheques returned dishonoured	*5,000*
Stock at Branch on 31.3.2006 (Invoice price)	*48,000*
Branch debtors balance on 31.3.2006	*36,500*

Prepare, under the Stock and Debtors system, the following Ledger Accounts in the books of the Head Office:

(i) Nagpur Branch Stock Account

(ii) Nagpur Branch Debtors Account

(iii) Nagpur Branch Adjustment Account.

Also compute shortage of Stock at Branch, if any.

Answer

In the books of head office

Nagpur Branch Stock Account

	Rs.			Rs.
1.4.2005 To Balance b/d	24,000	31.3.06 By Bank A/c (Cash Sales)		1,80,000
31.3.2006 To Goods sent to Branch A/c	4,80,000	By Branch Debtors (Credit Sales)		2,80,000
To Branch Debtors	6,000	By Stock shortage:		
		Branch P&L A/c	1,500*	
		Branch Adjustment A/c (Loading)	500	2,000
		By Balance c/d		48,000
	5,10,000			5,10,000

Nagpur Branch Debtors Account

1.4.2005 To Balance b/d	30,000	31.3.2006 By Bank A/c (Collection)	2,70,000
31.3.2006 To Bank A/c (dishonour of cheques)	5,000	By Branch Stock A/c	6,000
To Branch Stock A/c	2,80,000*	By Bad debts	1,500
		By Discount allowed	1,000
		By Balance c/d	36,500
	3,15,000		3,15,000

Nagpur Branch Adjustment Account

To Branch Stock A/c (loading of loss)	500*	By Stock Reserve A/c	6,000
To Stock Reserve	12,000	By Goods sent to Branch A/c	1,20,000
To Gross Profit c/d	1,13,500		
	1,26,000		1,26,000
To Branch Stock A/c (Cost of loss)	1,500	By Gross Profit b/d	1,13,500
To Branch Expenses	56,000		
To Net Profit (Transferred to General P & L A/c)	56,000		
	1,13,500		1,13,500

*Balancing figure.

Working Notes:

1. Credit Sales have not been given in the problem. So, the balancing figure of Branch Debtors Account is taken as credit sales
2. Loading is 33 $\frac{1}{3}$ % or Cost; i.e. 25% of invoice value

   Loading on opening stock = 24,000 $\times$ 25% = 6,000
3. Loading on goods sent = 4,80,000 $\times$ 25% = Rs.1,20,000
4. Loading on Closing Stock = Rs.48,000 $\times$ 25% = Rs.12,000
5. Total Branch Expenses = Cash expenses + Bad debt + Discount allowed

   = Rs.53,500 + Rs.1,500 + Rs.1,000 = Rs.56,000
6. Gross Profit

   Total sales (at invoice price) - Goods returned by customers (at invoice price) x $\frac{33.33}{100+33.33}$

   {(Rs. 1,80,000+ Rs. 2,80,000)- Rs. 6,000} x $\frac{33.33}{133.33}$ = Rs. 1,13,500

Question 9

Red and Co. of Mumbai started a branch at Bangalore on 1.4.2006 to which goods were sent at 20% above cost. The branch makes both cash sales and credit sales. Branch expenses are met *from branch cash and balance money remitted to H.O. The branch does not maintain double entry books of account and necessary accounts relating to branch are maintained in H.O. Following further details are given for the year ending on 31.3.2007:*

	Rs.
Cost of goods sent to branch	*1,00,000*
Goods received by branch till 31.3.2007 at Invoice price	*1,08,000*
Credit sales for the year	*1,16,000*
Closing debtors on 31.3.2007	*41,600*
Bad debts written off during the year	*400*
Cash remitted to H.O.	*86,000*
Closing cash on hand at branch on 31.3.2007	*4,000*
Cash remitted by H.O. to branch during the year	*6,000*
Closing stock in hand at branch at invoice price	*12,000*
Expenses incurred at branch	*24,000*

Draw up the necessary Ledger Accounts like Branch Debtors Account, Branch Stock Account, Goods sent to Branch Account, Branch Cash Account, Branch Expenses Account and Branch Adjustment A/c for ascertaining gross profit and Branch Profit and Loss A/c for ascertaining Branch profit.

Answer

Branch Debtors A/c

Dr.					*Cr.*
		Rs.			*Rs.*
To	Branch Stock A/c	1,16,000	By	Branch Cash A/c (balancing figure)	74,000
			By	Bad Debts (written off)	400
			By	Balance c/d	41,600
		1,16,000			1,16,000

Goods Sent to Branch A/c

To	Branch Adjustment A/c $1,00,000 \times \frac{20}{100}$	20,000	By	Branch Stock A/c	1,20,000
To	Purchases/ Trading A/c	1,00,000			
		1,20,000			1,20,000

Branch Cash A/c

To	Branch Debtors A/c	74,000	By	Branch Expenses A/c	24,000
To	H.O. A/c (cash remittance)	6,000	By	H.O. (cash remittance)	86,000
To	Branch Stock A/c - Cash Sales (balancing figure)	34,000	By	Balance c/d	4,000
		1,14,000			1,14,000

Branch Stock A/c

To	Goods sent to Branch A/c	1,20,000	By	Branch Debtors A/c	1,16,000
To	Branch Adjustment A/c (Excess profit over normal loading - balancing figure)	54,000	By	Branch Cash A/c (Sales)	34,000
			By	Goods in Transit (1,20,000-1,08,000)	12,000
			By	Balance c/d	12,000
		1,74,000			1,74,000

Branch Expenses A/c

To	Branch Cash A/c	24,000	By	Branch P&L A/c	24,000

Branch Adjustment A/c

To	Stock Reserve A/c	2,000	By	Goods sent to Branch A/c	20,000
To	Goods in transit Reserve A/c	2,000	By	Branch Stock A/c	54,000
To	Branch P&L A/c (Balancing figure)	70,000			
		74,000			74,000

Branch P & L A/c

To	Branch Expenses A/c	24,000	By	Branch Adjustment A/c	70,000
To	Bad Debts	400			
To	Net Profit (transferred to General P&L A/c)	45,600			
		70,000			70,000

Working Notes:

1. Loading is 20% of cost i.e. 16.67% (1/6th) of invoice value.

   Loading on closing stock = Rs. 1/6th of Rs.12,000 =Rs. 2,000.

2. Loading on goods sent to branch = 1/6th of Rs.1,20,000 = Rs. 20,000.

3. Loading on goods in transit = 1/6th of Rs. 12,000 = Rs. 2,000.

Question 10

The Washington branch of XYZ Limited, Mumbai sent the following trial balance as on 31st December, 2007:

	$	$
Head office A/c	_	*22,800*
Sales	_	*84,000*
Debtors and creditors	*4,800*	*3,400*
Machinery	*24,000*	_
Cash at bank	*1,200*	_
Stock, 1 January, 2007	*11,200*	_
Goods from H.O.	*64,000*	_
Expenses	*5,000*	_
	1,10,200	*1,10,200*

In the books of head office, the Branch A/c stood as follows:

Washington Branch A/c

		Rs.			Rs.
To	Balance b/d	8,10,000	By	Cash	28,76,000
To	Goods sent to branch	29,26,000	By	Balance c/d	8,60,000
		37,36,000			37,36,000

Goods are sent to the branch at cost plus 10% and the branch sells goods at invoice price plus 25%. Machinery was acquired on 31st January, 2002, when $ 1.00 = Rs.40.

Rates of exchange were:

1st January, 2007	$ 1.00	=	Rs.46
31st December, 2007	$ 1.00	=	Rs.48
Average	$ 1.00	=	Rs.47

Machinery is depreciated @ 10% and the branch manager is entitled to a commission of 5% on the profits of the branch.

You are required to:

(i) Prepare the Branch Trading & Profit & Loss A/c in dollars.

(ii) Convert the Trial Balance of branch into Indian currency and prepare Branch Trading & Profit and Loss A/c and the Branch A/c in the books of head office.

Answer

(i) In the Books of Head Office

Branch Trading and Profit & Loss A/c (in Dollars)

for the year ended 31st December, 2007

	Particulars	$		Particulars	$
To	Opening stock	11,200	By	Sales	84,000
To	Goods from H.O.	64,000	By	Closing stock (W.N.2)	8,000
To	Gross profit c/d	16,800			
		92,000			92,000
To	Expenses	5,000	By	Gross profit b/d	16,800
To	Depreciation	2,400			

To	Manager's commission (W.N.1)	470		
To	Net profit c/d	8,930		
		16,800		16,800

(ii) (a) Converted Branch Trial Balance (into Indian Currency)

Particulars	*Rate per $*	*Dr. (Rs.)*	*Cr. (Rs.)*
Machinery	40	9,60,000	_
Stock January 1, 2007	46	5,15,200	_
Goods from head office	Actual	29,26,000	_
Sales	47	_	39,48,000
Expenses	47	2,35,000	_
Debtors & creditors	48	2,30,400	1,63,200
Cash at bank	48	57,600	_
Head office A/c	Actual	_	8,60,000
Difference in exchange rate		47,000	_
		49,71,200	49,71,200
Closing stock $ 8,000 (W.N. 2)	48		Rs.3,84,000

(b) Branch Trading and Profit & Loss A/c

for the year ended 31st December, 2007

		Rs.			*Rs.*
To	Opening stock	5,15,200	By	Sales	39,48,000
To	Goods from head office	29,26,000	By	Closing stock (W.N.2)	3,84,000
To	Gross profit c/d	8,90,800			
		43,32,000			43,32,000
To	Expenses	2,35,000	By	Gross profit b/d	8,90,800
To	Depreciation @ 10% on Rs.9,60,000	96,000			
To	Exchange difference	47,000			
To	Manager's				

	commission (W.N.1)	22,560			
To	Net Profit c/d	4,90,240			
		8,90,800			8,90,800

(c) Branch Account

		Rs.				Rs.
To	Balance b/d	8,60,000	By	Machinery	9,60,000	
To	Net profit	4,90,240		*Less:* Depreciation	96,000	8,64,000
To	Creditors	1,63,200	By	Closing stock		3,84,000
To	Outstanding commission	22,560	By	Debtors		2,30,400
			By	Cash at bank		57,600
		15,36,000				15,36,000

Working Notes:

1. **Calculation of manager's commission @ 5% on profit**

   i.e. 5% of $[16,800 – (5,000 + 2,400)]

   Or 5% × $9,400 = $ 470

   Manager's commission in Rupees = $ 470 × Rs.48 = Rs. 22,560

2. **Calculation of closing stock**

	$
Opening stock	11,200
Add: Goods from head office	64,000
	75,200
Less: Cost of goods sold (at invoice price)	
i.e. $\frac{100}{125} \times 84{,}000$	67,200
Closing stock	8,000

Closing stock in Rupees = $8,000 x Rs.48 = Rs.3,84,000.

EXERCISES

Question 1

S & M Ltd., Bombay, have a branch in Sydney, Australia. At the end of 31st March, 1995, the following ledger balances have been extracted from the books of the Bombay Office and the Sydney Office :

	Bombay (Rs. thousands)		Sydney (Austr dollars thousands)	
	Debit	Credit	Debit	Credit
Share Capital	–	2,000	–	–
Reserves & Surplus	–	1,000	–	–
Land	500	–	–	–
Buildings (Cost)	1,000	–	–	–
Buildings Dep. Reserve	–	200	–	–
Plant & Machinery (Cost)	2,500	–	200	–
Plant & Machinery Dep. Reserve	–	600	–	130
Debtors / Creditors	280	200	60	30
Stock (1.4.94)	100	–	20	–
Branch Stock Reserve	–	4	–	–
Cash & Bank Balances	10	–	10	–
Purchases / Sales	240	520	20	123
Goods sent to Branch	–	100	5	–
Managing Director's salary	30	–	–	–
Wages & Salaries	75	–	45	–
Rent	–	–	12	–
Office Expenses	25	–	18	–
Commission Receipts	–	256	–	100
Branch / H.O. Current A/c	120	–	–	7
	4,880	4,880	390	390

The following information is also available :

(1) Stock as at 31.3.95 :

Bombay Rs. 1,50,000

Sydney A $ 3,125

(2) Head Office always sent goods to the Branch at cost plus 25%.

(3) Provision is to be made for doubtful debts at 5%.

(4) Depreciation is to be provided on buildings at 10% and on plant and machinery at 20% on written down values.

(5) The Managing Director is entitled to 2% commission on net profits.

(6) Income–tax is to be provided at 47.5%.

You are required :

(a) To convert the Branch Trial Balance into rupees;

(use the following rates of exchange :

Opening rate	A $ = Rs. 20
Closing rate	A $ = Rs. 24
Average rate	A $ = Rs. 22
For Fixed Assets	A $ = Rs. 18).

(b) To prepare the Trading and Profit & Loss Account for the year ended 31st March, 1995 showing to the extent possible H.O. results and Branch results separately. (Balance Sheet not required.)

(Answer: Exchange loss (balancing figure) in Sydney Branch Trial Balance 2,16,000; Net profit as per profit and loss account 9,88,000)

Question 2

Head Office passes adjustment entry at the end of each month to adjust the position arising out of inter–branch transactions during the month. From the following inter–branch transactions in January, 1996, make the entry in the books of Head Office :

(a) Bombay Branch

(1) Received Goods : Rs. 6,000 from Calcutta Branch, Rs, 4,000 from Patna Branch.

(2) Sent Goods to Rs. 10,000 to Patna, Rs, 8,000 to Calcutta.

(3) Received B/R : Rs. 6,000 from Patna.

(4) Sent Acceptance : Rs. 4,000 to Calcutta, Rs. 2,000 to Patna.

(b) Madras Branch (Apart from the above)

(5) Received Goods : Rs. 10,000 from Calcutta, Rs. 4,000 from Bombay.

(6) Cash Sent : Rs. 2,000 to Calcutta, Rs. 6,000 to Bombay.

(c) Calcutta Branch (Apart from the above)

(7) Sent Goods to Patna : Rs. 6,000.

(8) Paid B/P : Rs. 4,000 to Patna, Rs. 4,000 cash to Patna.

(Answer Madras Branch and Patna Branch debited by 6,000 and 16,000 respectively. Bombay branch and Calcutta Branch credited by 6,000 and 16,000 respectively.)

Question 3

Rahul Limited operates a number of retail outlets to which goods are invoiced at wholesale price which is cost plus 25%. These outlets sell the goods at the retail price which is wholesale price plus 20%.

Following is the information regarding one of the outlets for the year ended 31.3.97 :

	Rs.
Stock at the outlet 1.4.96	30,000
Goods invoiced to the outlet during the year	3,24,000
Gross profit made by the outlet	60,000
Goods lost by fire	?
Expenses of the outlet for the year	20,000
Stock at the outlet 31.3.97	36,000

You are required to prepare the following accounts in the books of Rahul Limited for the year ended 31.3.97 :

(a) Outlet Stock Account.

(b) Outlet Profit & Loss Account.

(c) Stock Reserve Account.

(Answer: Gross Profit as per Outlet Stock Account 60,000; Profit balance Outlet Profit & Loss Account 22,000)

Question 4

T of Calcutta has a branch at Dibrugarh. The branch does not maintain separate books of accounts. The branch has the following assets and liabilities on 31st August, 1997 and 30th September, 1997 :

	31st August, 1997	30th September, 1997
	Rs.	Rs.
Stock of tea	1,80,000	1,50,000
Advance to suppliers	5,00,000	4,50,000
Bank Balance	75,000	1,00,000
Prepaid expenses	10,000	12,000
Outstanding expenses	13,000	11,000
Creditors for purchases	3,00,000	to be ascertained

During the month, Dibrugarh branch :

(a) received by electronic mail transfer Rs. 10,00,000 from Calcutta head office;

(b) purchased tea worth Rs. 12,00,000;

(c) sent tea costing Rs. 12,30,000 to Calcutta, freight of Rs. 80,000 being payable at the destination by the receiver;

(d) spent Rs. 25,000 on office expenses;

(e) paid Rs. 3,00,000 as advance to suppliers;

(f) paid Rs. 6,50,000 to suppliers in settlement of outstanding dues.

In addition, T informs you that the Calcutta office had directly paid Rs. 3,50,000 to Dibrugarh suppliers by cheques drawn on bank accounts in Calcutta during the month. T informs you that for the purpose of accounting, Dibrugarh branch is not treated as an outsider. He wants you to write the detailed accounts relating to the transactions of the Dibrugarh branch as would appear in the books of Calcutta Head Office.

(Answer: Balances in Dibrugarh Tea Stock Account 1,50,000; Advance to Supplier's Account 4,50,000;Supplier's Account 1,50,000; bank account 1,00,000; Expenses Account 21,000;)