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CS EXECUTIVE

COMPANY ACCOUNTS

By

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Theory Notes of Company Accounts

ACCOUNTING STANDARDS	
Objectives of AS	1. To harmonise different accounting policies and used in a country. 2. To reduce the accounting alternatives in the preparation of financial statements. 3. To ensure comparability of financial statements of different enterprises 4. To call for disclosures beyond that required by the law.
Benefits and Limitation of Accounting Standards?	<u>Benefits:</u> (i) **Standardisation of alternative accounting treatments**: Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements. (ii) **Requirement of additional disclosures**: There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law. (iii) **Comparability of Financial Statements**: The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards adopted in different countries. However, there are some **<u>limitations of setting of accounting standards</u>**: (i) **Difficulty in choosing Accounting policy**: Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult. (ii) **Lack of Flexibility**: There may be a trend towards rigidity and away from flexibility in applying the accounting standards. (ii) **Scope Restricted**: Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.
Composition of Accounting Standard Board	(i) Nominee of the Central Government representing the <u>Department of Company Affairs</u> on the Council of the ICAI (ii) Nominee of the Central Government representing the Office of the <u>Comptroller and Auditor General of India</u> on the Council of the ICAI (iii) Nominee of the Central Government representing the <u>Central Board of Direct Taxes</u> on the Council of the ICAI (iv) Representative of the <u>Institute of Cost and Works Accountants of India</u> (v) Representative of the <u>Institute of Company Secretaries of India</u>

	(vi) Representatives of Industry Associations (1 from Associated Preface to the Statements of Accounting Standards Chambers of Commerce and Industry (ASSOCHAM), from Confederation of Indian Industry (CII) and from Federation of Indian Chambers of Commerce and Industry (FICCI) (vii) Representative of Reserve Bank of India (viii) Representative of Securities and Exchange Board of India (ix) Representative of Controller General of Accounts (x) Representative of Central Board of Excise and Customs (xi) Representatives of Academic Institutions (1 from Universities and 1 from Indian Institutes of Management) (xii) Representative of Financial Institutions
Objectives and Functions of Accounting Standard Board?	The following are the objectives of the Accounting Standards Board: (i) To conceive of and suggest areas in which Accounting Standards need to be developed. (ii) To formulate Accounting Standards with a view to assisting the Council of the ICAI in evolving and establishing Accounting Standards in India. (iii) To examine how far the relevant International Accounting Standard/International Financial Reporting Standard can be adapted while formulating the Accounting Standard and to adapt the same. (iv) To review, at regular intervals, the Accounting Standards from the point of view of acceptance or changed conditions, and, if necessary, revise the same. (v) To provide, from time to time, interpretations and guidance on Accounting Standards. (vi) To carry out such other functions relating to Accounting Standards.
Accounting Standard Setting process?	The standard-setting procedure of ASB can be briefly outlined as follows: ✓ Identification of broad areas by ASB for formulation of AS. ✓ Constitution of study groups by ASB to consider specific projects and to prepare preliminary drafts of the proposed accounting standards. The draft normally includes objective and scope of the standard, definitions of the terms used in the standard, recognition and measurement principles wherever applicable and presentation and disclosure requirements. ✓ Consideration of the preliminary draft prepared by the study group of ASB and revision, if any, of the draft on the basis of deliberations.

	✓ Circulation of draft of accounting standard (after revision by ASB) to the Council members of the ICAI and specified outside bodies such as Department of Company Affairs (DCA), Securities and Exchange Board of India (SEBI), Comptroller and Auditor General of India (C&AG), Central Board of Direct Taxes (CBDT), Standing Conference of Public Enterprises (SCOPE), etc. for comments. ✓ Meeting with the representatives of the specified outside bodies to ascertain their views on the draft of the proposed accounting standard. ✓ Finalisation of the exposure draft of the proposed accounting standard and its issuance inviting public comments. ✓ Consideration of comments received on the exposure draft and finalisation of the draft accounting standard by the ASB for submission to the Council of the ICAI for its consideration and approval for issuance. ✓ Consideration of the final draft of the proposed standard and by the Council of the ICAI, and if found necessary, modification of the draft in consultation with the ASB is done. ✓ The accounting standard on the relevant subject is then issued by the ICAI.
What is accounting policy? List areas where different accounting policies are encountered/ used? When accounting policies can be changed as per as 1?	**Accounting Policy** are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements. Some of the areas in which specific accounting principles can be followed are: • Depreciation and Amortization (AS 6) • Valuation of Inventory (AS 2) • Valuation of Goodwill (AS 10) • Valuation of Fixed Asset and Investments (AS 10 & 13) • Translation of Foreign currency items (AS 11) • Treatment of expenditure during construction and recognition of profit on long term contracts (AS 7) An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless: (a) it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Ind AS 8; or (b) An Ind AS requires a change in presentation.
What are the fundamental	**1. Going Concern**: The enterprise is normally viewed as a Going Concern, i.e continuing in operation for the foreseeable future. It is assumed that enterprise has neither the intention nor the necessity of liquidation or of

accounting assumptions? List all of them?	curtailing materially the scale of operations. **2. Consistency:** The accounting policies are consistent from year to year. **3. Accrual:** Revenue and cost are accrued i.e recognized as they are earned or incurred and recorded in the financial statements of the periods to which they relate and not when money is received or paid.
As 2 does not apply to which type of inventories?	AS 2 should be applied in accounting for inventories other than: a. Work in progress arising under construction contracts, including directly related service contracts; b. Work in progress arising in ordinary course of business of service providers; c. Shares, debentures and other financial instruments held as stock in trade; d. Producer's inventory of livestock, agricultural and forest products, minerals oils, ores and gases to the extent they are measured at net realisable value in accordance with well established practices in those industries.
Cost of inventory comprises of??	The cost of inventories shall comprise of: a. All cost of purchase, b. Cost of conversion and c. Other cost incurred in bringing the inventories to their present location and condition. The cost of purchase consists of purchase price, duties and taxes (other than those subsequently recoverable from taxing authority) Freight inwards and other expenditure directly attributable to the acquisition. Materials held for use in the production of inventories are not written down below cost if finished goods in which they will be incorporated are expected to be sold at or above cost. However, where there is a decline in the value of material and it is estimated that cost of finished goods will exceed the NRV of finished goods, the materials are written down to net realisable value i.e replacement cost of the material. The cost of conversion of inventories includes cost directly related to units of production (Direct material, direct labour and direct expenses). They shall also include a systematic allocation of fixed and variable production overhead that are incurred in converting materials into finished goods. I) Variable production overhead vary with the volume of production and hence can be allocated. II) The fixed production overhead is to be allocated on the basis of normal capacity of the production facilities. Normal capacity is the production expected to be achieved on an average over a number of years taking into account the loss due to planned maintenance. Unallocated overheads are treated as expense in the period in which they are incurred.

Which costs are to be excluded from the cost of inventories?	a. Abnormal cost of wasted material, labour or other production overheads; b. Storage costs of inventory; c. Administration overheads as they do not contribute to bring the inventories to their present location and condition; d. Selling and distribution overheads. e. Interest and borrowing cost relating to inventories.
Cost methods/formula allowed for inventory valuation?	For items **not ordinarily interchangeable**, Specific Identification method should be used. For items that are **ordinarily interchangeable**, FIFO or weighted average method may be used. (LIFO method is not allowed by AS 2) Standard cost method or retail method is also allowed for convenience if the results approximate the actual costs. The retail method is often used in retail trade for measuring inventories of large number of rapidly changing items that have similar margins and for which it is impracticable to use other costing methods.
When change in method of depreciation is allowed?? And how the difference is adjusted?	The method of depreciation is applied consistently to provide comparability of the results of the operations of the enterprise from period to period. A change from one method of providing depreciation to another is made only if : a. the adoption of the new method is required by statute or b. for compliance with an accounting standard or c. if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise. When such a change in the method of depreciation is made, depreciation is recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from **retrospective recomputation** of depreciation in accordance with the new method is adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency is charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus is credited to the statement of profit and loss. *Such a change is treated as a change in accounting policy and its effect is quantified and disclosed.*
Exclusions from applicability of as 6?	(i) Forest, plantation and similar regenerative natural resources. (Industry Standards) (ii) Wasting Assets including expenditure on the exploration for and extraction of minerals, oils, natural gas, and similar non-regenerative resources; (Industry Standards) (iii) Expenditure on Research and Development; (AS 26) (iv) Goodwill and other intangible assets; (AS 26) (v) Live stock; (Industry Standards)

Types of construction contracts as per AS 7?	Construction contracts are of two types: 1. **Fixed Price Contract**: it is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses. 2. **Cost Plus Contract**: it is a construction contract in which contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these cost or a fixed fee.
Measurement of contract revenue and contract costs as per AS 7?	(1) **Percentage of Completion Method**: The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work competed. This method provides information on the extent of contract activity and performance during a period. However, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately. $\textbf{\% Completion} = \dfrac{\textbf{Actual cost to date}}{\textbf{Total estimated cost on the contract}}$ (2) **Stage of Completion Method**: The stage of completion may be determined in a variety of ways. The enterprise uses the method that measures reliably the work performed. Depending upon the nature of the contract, the methods may include: (i) The proportion that contract cost incurred for work performed upto the reporting date bear to the estimated total contract costs; (ii) Surveys of work performed; (iii) Completion of a physical proportion of the contract work. Progress payment and advances received from the customers may not necessarily reflect the work performed. When the outcome of a construction contract cannot be estimated reliably: (i) Revenue should be recognised only to the extent of contract costs incurred by which recovery is probable; and (ii) Contract cost should be recognised as an expense in the period in which they are incurred. An expected loss on the construction contract should be recognised as an expense immediately.
Revenue recognition as per as 9: sale of goods (Dec 2014)	Revenue is recognized when the following conditions are satisfied: a. The seller has transferred to the buyer the **property in goods** for a consideration. OR b. Significant **risk and rewards** of the ownership has been transferred to the buyer where the seller retains no effective control over the goods to a degree usually associated with the ownership;

	AND c. No significant uncertainty exists regarding the amount of consideration that will be delivered from the sale of goods.
Revenue recognition as per as 9: rendering of services	Following conditions must be satisfied: a. The performance may consist of execution of one or more acts. It should be measured using either: i. Completed service contract method; ii. Proportionate completion method; whichever relates the revenue to the work accomplished. b. There is no significant uncertainty regarding the amount of consideration that will be derived from rendering the service. c. It is reasonable to expect the ultimate collection at the time of performance. Otherwise, revenue recognition should be postponed.
Revaluation of fixed assets as per as 10:	When a fixed asset is revalued in financial statements, an entire class of assets should be revalued or the selection of assets for revaluation should be made on a ***systematic basis***. For example, an enterprise may revalue a whole class of assets within a unit. It is not appropriate for the revaluation of a class of assets to result in the net book value of that class being higher than the recoverable amount of the asset of that class. An increase in net book value arising on the revaluation of assets is normally credited directly to owner's interest under the heading of Revaluation Reserves and is regarded as not available for distribution as dividends. It sometimes happen that an increase to be recorded is a reversal of a previous decrease arising on revaluation which has been charged to profit and loss account in which case the increase in to be credited to the extent that it offsets the previously recorded decrease.
Cost of fixed assets:	The cost of an item of fixed asset comprises of its purchase price, including import duties and other non refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. Examples of directly attributable costs are: Site preparation, initial delivery and handling cost, installation cost, professional fees like engineer fees, etc.
Investment & types of investments as per as 13:	Investments are assets held by an enterprise for earning income by way of dividend, interest and rentals, and for capital appreciation, or for other benefits to the investing enterprise. Assets held as "stock in trade" are not investments. Investments are classified as long term and current investments. A current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made.

	A long term investment is an investment other than current investment.
Carrying amount of investments as per AS13?	*<u>Current Investments</u>*: The carrying amount for current investment is the lower of cost and fair value. In respect of investments for which active market exists, market value generally provides the best evidence of fair value. Valuation of current investments on overall basis is not considered appropriate. The most prudent and appropriate method is to carry investments individually at lower of cost and fair value. However, for convenience, enterprise may value investment category wise like equity shares, preference shares, etc. *<u>Long term investments</u>*: Long term investments are usually carried at cost. However, where there is a decline, other than temporary, in the value of long term investment, the carrying value is reduced to recognise the decline. Indicator of value of an investment are obtained by reference to its market value, expected cash flows from investments, etc. The carrying amount of long term investments is determined on an *individual investment basis*.
Amalgamation in nature of merger as per AS 14? (June 2014)	Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions. (i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company. (ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation. (iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares. iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company. v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.
Amalgamation in nature of purchase as per AS 14?	Amalgamation in the nature of purchase is an amalgamation which does not satisfy any one or more of the conditions specified in sub-paragraph (e) above.
Pooling of interest method (Dec 2014) (Dec 2013)	This method is used for accounting in case of merger in the books of transferee. • In preparing the financial statements of Transferee Company after

	amalgamation, Line by Line addition is done for respective assets and liabilities of the Transferor and Transferee Company except for Share Capital. • The difference between the purchase consideration paid by the transferee company to the transferor company and the amount of share capital (Equity + preference Capital) of the transferor company should be adjusted with reserves. • Reserves mean the portion of earnings, for example, Profit & Loss Account, General Reserves, Capital Reserves. • If purchase consideration is more than the share capital of the transferor company then the amount should be debited to reserves, if reverse is the case, the difference is credited to reserves.
Purchase method (Dec 2014) (Dec 2013)	• If any of the conditions of merger is not satisfied, then the amalgamation shall be classified as purchase, therefore, the purchase method of accounting shall be followed in the books of Transferee Company. • As per the purchase method in the books of Transferee Company, assets and liabilities shall be recorded at the value at which these assets and liabilities are taken over by the Transferee Company from the Transferor Company; Certainly assets do not include fictitious assets and liabilities do not include internal liabilities like Reserve and Surplus but includes liabilities outside the books of accounts i.e unrecorded Liabilities. • If the Purchase consideration exceeds the net assets taken over, the difference is debited to goodwill account. If the purchase consideration is less than the net assets taken over, the difference is credited to capital reserve.
Treatment of goodwill arising on amalgamation as per AS 14?	Goodwill represents a (excess) payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life. Due to the nature of goodwill, it is frequently difficult to estimate its useful life with reasonable certainty. Such estimation is however, made on a prudent basis. Accordingly, it is considered appropriate to amortise goodwill over a period not exceeding 5 years unless a somewhat longer period can be justified. The requirement of AS 26 Intangible Asset regarding Amortization shall not apply to such Goodwill.
Types of Leases & their Treatment as per AS 19?	***Leases in the Financial Statement of Lessees*** (a) **Financial Leases**: 1. In this case at the inception of a financial 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 stand point of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the stand point of the lessee. 2. The lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. 3. The finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of

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the liability of each period.

4. Also a finance lease gives rise to a depreciation expense for the asset as well as finance expense for each accounting period. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life whichever is shorter.

(b) <u>Operating Leases</u>:
1. 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.

<u>Leases in the Financial Statement of Lessees</u>

(a) <u>Finance Leases</u>: The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease. The recognition of finance income should be based on a pattern reflecting a constant periodic rate of return on the net investment of the lessor outstanding in respect of the finance lease.

(b) <u>Operating Leases</u>: The lessor should present an asset given under operating lease in its balance sheet under fixed assets. The lease income from operating leases should be recognised 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 in which benefit derived from the use of the leased asset is diminished. The depreciation on leased assets should be on a basis consistent with the normal depreciation policy of the lessor company.
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<tr><td>Treatment of events occurring after balance sheet date as per AS 4?</td><td>
Events occurring after balance sheet date are those significant events, both favorable or unfavorable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in case of a company, and by corresponding approving authority in case of any other entity.

Two types of events can be identified:
(i) Those which provide further evidence of conditions that existed on balance sheet date; (Adjusting Events)

Examples:
(a) Loss on a trade receivable account which is confirmed by insolvency of a customer.
(b) Discovery of frauds and errors that show that the financial statements were incorrect.

(ii) Those which are indicative of conditions that arose subsequent to the balance sheet date. (Non Adjusting Events)
Examples:
(a) Amalgamation effected after balance sheet date.
(b) Decline in market value of investments.
(c) Destruction of major production plant by fire.
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Treatment of Contingent Losses & Contingent Gains as per AS 4?	**<u>Accounting treatment of Contingent Losses:</u>** The accounting treatment of a contingent loss is determined by the outcome of the contingency. If it is likely that a contingency will result in a loss to the enterprise, then it is prudent to provide for that loss in the financial statements. The estimates of the outcome and of the financial effect of contingencies are determined by the judgment of the management of the enterprise. This judgment is based on consideration of information available up to the date on which the financial statements are approved and will include a review of events occurring after the balance sheet date, supplemented by experience of similar transactions and, in some cases, reports from independent experts. If there is conflicting or insufficient evidence for estimating the amount of a contingent loss, then disclosure is made of the existence and nature of the contingency. **<u>Accounting treatment of Contingent Gains:</u>** Contingent gains are not recognized in the financial statements since their recognition may result in the recognition of revenue which may never be realized. However, when a realization of a gain is virtually certain, then such a gain is not a contingency and accounting for the gain is appropriate.
Treatment of Extraordinary Items, Prior Period Items as per AS 5?	**<u>Extraordinary Items:</u>** Extraordinary items are income or expenses that arise from events or transaction that are clearly distinct from the ordinary activities of enterprise and therefore, are not expected to recur frequently or regularly. Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived. Examples of events or transactions that generally give rise to extraordinary items for most enterprises are: – attachment of property of the enterprise; or – an earthquake. **<u>Prior Period Items:</u>** Prior period items are income or expense which arise in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.

	Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight. Examples of prior period items are: (i) Error in calculation in providing expenditure or income; (ii) Omission to account for income or expenditure; (iii) Applying incorrect rate of depreciation; (iv) Treating operating lease as finance lease.
Accounting for Government Grants AS 12?	**<u>Non Monetary Government Grants:</u>** Government grants may take the form of non monetary assets such as land or other resources given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non monetary assets given free of cost are recorded at a nominal value. **<u>Presentation of grants relating to specific fixed assets:</u>** Grants relating to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such asset. Other conditions may be attached restricting the type or location of such assets or period during which such asset should be acquired. **<u>Presentation of grants relating to Revenue:</u>** Grants related to revenue are sometimes presented as a credit in the profit and loss account, either separately or under a general heading such as Other Income. Alternatively, they are deducted in reporting the related expense. **<u>Refund of Government Grants:</u>** Government grants sometimes become refundable if certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5. The amount refundable in respect of a government grant *related to revenue* is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement. The amount refundable in respect of a government grant *related to a specific fixed asset* is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.
Borrowing Cost AS 16?	**<u>What constitutes Borrowing Costs?</u>** a. Interest and *Commitment charges* on bank borrowings and other short term and long term borrowings.

	b. Amortisation of discounts or premiums relating to borrowings. c. Amortisation of ancillary cost relating to arrangement of funds; d. Finance charges in respect of assets acquired under finance lease or under similar arrangements; e. Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. **Recognition:** Borrowing cost that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as a part of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred. **Commencement of Capitalization:** The capitalization of borrowing costs as a part of cost of qualifying asset should commence when all of the following conditions are satisfied: a. Expenditure for the acquisition, construction or production of a qualifying asset is being incurred; b. Borrowing cost are being incurred; and c. Activities that are necessary to prepare the asset for its intended use or sale are in progress;
Earnings Per Share AS 20?	1. A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares. Examples of **potential equity shares** are: (a) debt instruments or preference shares, that are convertible into equity shares; (b) share warrants; (c) options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans; and (d) shares which would be issued upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares), such as the acquisition of a business or other assets, or shares issuable under a loan contract upon default of payment of principal or interest, if the contract so provides. 2. An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares that has a different right to share in the net profit for the period. An enterprise should present basic and diluted earnings per share with equal prominence for all periods presented. 3. For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period. 4. **Dilutive Potential Equity Shares**: Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.

	Potential equity shares are anti-dilutive when their conversion to equity shares would increase earnings per share from continuing ordinary activities or decrease loss per share from continuing ordinary activities. The effects of anti-dilutive potential equity shares are ignored in calculating diluted earnings per share.

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<tr><th colspan="2">CORPORATE FINANCIAL REPORTING</th></tr>
<tr><td>Explain the concept of Corporate Financial Reporting (JUNE 2014)</td><td>
➢ Accounting is a process to identify measure and communicate economic information to permit informed judgments and decisions by the user of the information.
➢ Its function is to provide quantitative information, primarily financial in name, about economic entities, that is intended to be useful in making economic decisions and related choice among alternative course of action.
➢ Financial reporting may be defined as communication of published financial statement and related information from a business enterprise to all users. It is the reporting of accounting information of an entity to a user or group of users. It contains booth qualitative and quantitative information.
➢ The Financial report made to the management is generally known as internal reporting, while financial reporting made to the shareholder investors/management is known as external reporting.
➢ The internal reporting is a part of management information system and the uses MIS reporting for the purpose of analysis and as an aid in decision making process. The management of a corporate is ultimately responsible for the generation of accounting information. The accountability of a company has two distinct aspects – legal and social.
➢ Under legal requirements a company has to supply certain information to the various users through annual reports and under the social obligation, a company has to provide additional information to various user groups.
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<tr><td>Objective of Corporate Financial Reporting</td><td>
The objectives of financial reporting given by Financial Accounting Standard Board (FASB) are summarized as follows:

1. Financial reporting should provide information that is useful to investors and creditors and other users in making rational investment, credit and similar decisions. The information should be useful to both, the present and potential investors.

2. Financial reporting should provide information about the economic resources of an enterprise the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners equity) and the effects of transactions event, and circumstances that change resources and claims to those resources.

3. Financial reporting should provide information about the enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise.

4. Financial reporting should provide information about how management of an enterprise obtains and spends cash, its borrowing and repayment of borrowing, capital transactions including cash dividends and other distributions of enterprise resources to owners, and other factors that may affect an enterprise's liquidity or solvency.

5. Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibilities to owners (shareholders) for the use of enterprise resource entrusted to it.
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	6. Financial reporting should provide information that is useful to management and directors in making decisions in the interest of owners
What is Value Added Statement?	➢ A simplified financial statement that shows how much wealth has been created by a company. ➢ A value added statement calculates total output by adding sales, changes in stock, and other incomes, then subtracting depreciation, interest, taxation, dividends, and the amounts paid to suppliers and employees. ➢ Such value added can be taken to represent in monetary terms the net output of an enterprise. This is the difference between the total value of its output and the value of the inputs of materials and services obtained from other enterprises. ➢ The value added is seen to be due to the combined efforts of capital, management and employees, and the statement shows how the value added has been distributed to each of these factors.
Advantages of Value Added Statement ? (DEC 2014)	1. It is an alternative performance measure to profit and therefore helps in the comparison of the performance of the company. Value added is superior performance measure because it pays attention on inputs which are under the control of the management. 2. By employing various productivity measures like value added per rupee of capital employed, value added per rupee sales, value added per employee etc., it helps in judging the productivity of the company. 3. Resource allocation decisions are normally based on the concept of maximizing profit but value added statement provides a better alternative by focusing on other factors rather than just profit. 4. It also helps in devising the incentives schemes for the employees of the company in a better way. 5. It reflects a broader view of the company's objectives and responsibilities rather than just focusing only on the small aspects about the company.
Limitations of Value Added Statement	There is a duality associated with the VAS in that it reports on the calculation of value added and its application among the stakeholders in the company. Many inconsistencies are found in practice in both the calculation and presentation of value added in the VAS. These inconsistencies make the statement confusing, non-comparable and unverifiable. The main areas of inconsistencies include, but are not limited to, the following: 1. The treatment of depreciation resulting in gross and net value added; 2. The treatment of taxes like pay-as-you-earn, fringe benefits and other benefits in the employees' share of value added; 3. The timing of recognition of value added - production or sales; 4. The treatment of taxes such as VAT /GST and deferred tax; and 5. The treatment of non-operating items.
What is meant by Economic Value Added?	Economic value added (EVA) is a financial measure of what economists sometimes refer to as economic profit or economic rent. The difference between economic profit and accounting profit is essentially the cost of equity

	capital – an accountant does not subtract a cost of equity capital in the computation of profit, so in fact an accountant's measure of income or profit is in essence the residual return to that equity capital since all other costs have been deducted from the revenue stream.
How to Calculate EVA? (DEC 2013)	➢ Note that, as in the traditional computation of earnings, interest on debt capital is subtracted from operating earnings (earnings before interest and taxes (EBIT)) to obtain net income ➢ Then, an opportunity cost on equity capital is subtracted to obtain EVA. The opportunity cost on equity capital is computed as the equity or net worth of the business times a rate of return that reflects the rate required by investors in the business. ➢ This required rate is in reality an opportunity cost measured by the rate of return that could be obtained on equity funds if they were invested elsewhere. ➢ A positive EVA means the firm is generating a return to invested capital that exceeds the direct (i.e. interest) and opportunity cost of that invested capital; a negative EVA means that the firm did not generate a sufficient return to cover the cost of its debt and equity capital. The under given tables gives a view for how to calculate 'Economic Value Added (EVA): Earnings before Interest and Taxes (EBIT) xxx Less : Interest xxx Net Income xxx Less : Cost of Equity Capital xxx Economic Value Added (EVA) xxx <u>Expressed as a formula:</u> EVA = "Net Operating Profit after Taxes" – (Equity Capital X % Cost of Equity Capital).
Advantages of EVA Analysis?	1. In various cases, company pay bonuses to the employees on the basis of EVA generated. Since a higher EVA implies higher bonuses to the employees, it promotes the employees for working hard for generating higher revenue. 2. Using EVA , company can evaluate the projects independently and hence decide on whether to execute the project or not 3. It helps the company in monitoring the problem areas and hence taking corrective action to resolve those problems. 4. Unlike accounting profit, such as EBIT, Net Income and EPS, EVA is based on the idea that a business must cover both the operating costs as well as the capital costs and hence it presents a better and true picture of the company to the owners, creditors, employees, shareholders and all other interested parties. 5. It also helps the owners of the company to identify the best person to run the company effectively and efficiently.
What is Market	1. Market value added is the difference between the Company's market and

Value Added?	book value of shares. According to Stern Stewart, if the total market value of a company is more than the amount of capital invested in it, the company has managed to create shareholder value. If the market value is less than capital invested, the company has destroyed shareholder value. 2. Market Value Added = Company's total Market Value – Capital Invested 3. Book value of equity refers to all equity equivalent items like reserves, retained earnings and provisions. In other words, in this context, all the items that are not debt (interest bearing or noninterest bearing) are classified as equity. 4. Market value added (MVATM) is identical in meaning with the market–to–book ratio 5. According to Stewart, Market value added tells us how much value the company has added to, or subtracted from, its shareholders investment. Successful companies add their MVA and thus increase the value of capital invested in the company. Unsuccessful companies decrease the value of the capital originally invested in the company.
What is Shareholders Value Added?	➢ Shareholder Value Added (SVA) represents the economic profits generated by a business above and beyond the minimum return required by all providers of capital. ➢ "Value" is added when the overall net economic cash flow of the business exceeds the economic cost of all the capital employed to produce the operating profit. ➢ Therefore, SVA integrates financial statements of the business (profit and loss, balance sheet and cash flow) into one meaningful measure. The SVA approach is a methodology which recognises that equity holders as well as debt financiers need to be compensated for the bearing of investment risk. ➢ The SVA methodology is a highly flexible approach to assist management in the decision making process. Its applications include performance monitoring, capital budgeting, output pricing and market valuation of the entity. The **benefits** of moving towards SVA include: 1. Overall, value-based performance measures will result in greater accountability for the investment of new capital, as well as for the use of existing investments. 2. Organisation will have the opportunity to apply a meaningful private sector benchmark to evaluate performance. 3. Managers will be provided with an improved focus on maximizing shareholder value. **Drawbacks:** 1. A limitation in the use of SVA as a performance measure is that, by nature, it is an aggregate measure. In order to analyse the underlying

	causes of any changes in calculated value between years, it is necessary to fully comprehend the value drivers and activities specific to a given firm. 2. There may be certain enterprises which are subject to any degree of price regulation then it may not be possible for management to adjust output prices to achieve a commercial return in response to upward movements in input prices. Such a situation may result in SVA being reduced even though there may have been no decrease in overall efficiency. 3. Similarly, a reduction in direct Government funding would result in a decrease in SVA. 4. Combined with the use of traditional accounting measures, a thorough knowledge of the value drivers of the business will assist in determining the underlying causes of fluctuations in the value added measure. 5. Again, the use of SVA is not a substitute for detailed analysis of business drivers, rather it is an additional measurement tool with an economic foundation

<table>
<tr><th colspan="2">UNDERWRITING OF SECURITIES</th></tr>
<tr><td>Types of underwriting?</td><td>An underwriting agreement may be of any one of the following types:
<u>Complete Underwriting</u>
If the whole of the issue of shares or debentures of a company is underwritten, it is said to be complete underwriting.

In such a case, the whole of the issue of shares or debentures may be underwritten by –
(a) one firm or institution, agreeing to take the entire risk;
(b) a number of firms or institutions, each agreeing to take risk only to a limited extent.

<u>Partial Underwriting</u>
If only a part of the issue of shares or debentures of a company is underwritten, it is said to be partial underwriting.

The part of the issue of shares or debentures may be underwritten by -
(a) One person or institution;
(b) A number of firms or institutions each agreeing to take risk only to a limited extent.

In case of partial underwriting, the company is treated as “Underwriter” for the remaining part of the issue.

<u>Firm Underwriting</u>
It refers to a definite commitment by the underwriter or underwriters to take up a specified number of shares or debentures of a company irrespective of the number of shares or debentures subscribed for by the public. In such a case, the underwriters are committed to take up the agreed number of shares or debentures in addition to unsubscribed shares or debentures, if any. Even if the issue is over-subscribed, the underwriters are liable to take up the agreed number of shares of debentures.</td></tr>
<tr><td>Payment of underwriting commission under companies act 2013</td><td>Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions which are prescribed under Companies (Prospectus and Allotment of Securities) Rules, 2014:
(a) the payment of such commission shall be authorized in the company’s articles of association;

(b) the commission may be paid out of proceeds of the issue or the profit of the company or both;

(c) the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent (2.5 %) of the price at which the debentures are issued, or as specified in the company’s articles, whichever is less;

(d) the prospectus of the company shall disclose -
– the name of the underwriters;</td></tr>
</table>

	– the rate and amount of the commission payable to the underwriter; and – the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally. (e) there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription; (f) a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration. Thus, the Underwriting commission is limited to 5% of issue price in case of shares and 2.5% in case of debentures. The rates of commission given above are maximum rates. The company is free to negotiate lower rates with underwriters.

ISSUES & REDEMPTION OF SECURITIES	
What is Issue of Shares at Premium and where securities premium can be utilized as per companies act (DEC 2013)	The shares of many successful companies which offer attractive rates of dividend on their existing capitals fetch a higher price than their face value in the market. When shares are issued at a price higher than the face value, they are said to be issued at a premium. Thus, the excess of issue price over the face value is the amount of premium. For example, if a share of ` 10 is issued at Rs. 12, Rs. (12 – 10) = Rs. 2 is the premium. The premium on issue of shares must not be treated as revenue profits. On the contrary, it must be regarded as capital receipt. The Companies Act requires that when a company issues shares at a premium whether for cash or otherwise, a sum equal to the aggregate amount of the premium collected on shares must be credited to a separate account called "Securities Premium Account". There are no restrictions in the Companies Act on the issue of shares at a premium, but there are restrictions on its disposal. Under Section 52(2) of the Companies Act 2013, the Securities Premium Account may be applied by the company – (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares; (b) in writing off the preliminary expenses of the company; (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or (e) for the purchase of its own shares or other securities under section 68.
Transfer of profits to reserves for declaration of dividend?	In case of inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with the Companies (Declaration and Payment of Dividend) Rules, 2014. In the event of inadequacy or absence of profits in any year, a company may declare dividend out of free reserves subject to the fulfillment of the following conditions, namely: – – The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year: Provided that this sub-rule shall not apply to a company, which has not declared any dividend in each of the three preceding financial year. – The total amount to be drawn from such accumulated profits shall not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement. – The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared. – The balance of reserves after such withdrawal shall not fall below fifteen per cent of its paid up share capital as appearing in the latest audited financial statement.

	– No company shall declare dividend unless carried over previous losses and depreciation not provided in previous year are set off against profit of the company of the current year the loss or depreciation, whichever is less, in previous years is set off against the profit of the company for the year for which dividend is declared or paid.
Issue of Bonus Shares (Regulations)	(1) A company may issue fully paid-up bonus shares to its members, in any manner out of – (i) its free reserves; (ii) the securities premium account; or (iii) the capital redemption reserve account. However, no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets. (2) No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares under (1) above, unless – a) it is authorised by its articles; b) it has, on the recommendation of the Board, been authorised in the general meeting of the company; c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it; d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus; e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up; f) The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same. [Rule 14 of Companies (Share Capital and Debentures) Rules, 2014] (3) The bonus shares shall not be issued in lieu of dividend.
Buy back of shares (sections 68, 69 & 70)	**<u>Advantages of Buy Back:</u>** ➢ It is an alternative mode of reduction in capital without requiring approval of the Court/CLB(NCLT), ➢ to improve the earnings per share ➢ to improve return on capital, return on net worth and to enhance the long-term shareholders value; ➢ to provide an additional exit route to shareholders when shares are undervalued or thinly traded; ➢ to enhance consolidation of stake in the company; ➢ to prevent unwelcome takeover bids; ➢ to return surplus cash to shareholders; ➢ to achieve optimum capital structure; ➢ to support share price during periods of sluggish market condition; ➢ to serve the equity more efficiently. According to section 68(1) of the Companies Act 2013, a company may

	purchase its own shares or other specified securities (referred to as buy-back) out of— (a) its free reserves; (b) the securities premium account; or (c) the proceeds of the issue of any shares or other specified securities: However, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. **<u>Conditions for buy back:</u>** According to section 68(2), following conditions must be satisfied in order to buy-back the shares. **(a)** must be authorized by its articles; **(b)** a special resolution has been passed at a general meeting of the company authorizing the buy-back, but the same is not required when: i) the buy-back is 10% or less of the total paid-up equity capital and free reserves of the company; and ii) such buy-back has been authorized by the Board by means of a resolution passed at its meeting; **(c)** the buy-back is twenty-five per cent or less of the aggregate of paid-up capital and free reserves of the company. But in case of Equity Shares, the same shall be taken as 25% of paid up equity capital only. **(d)** Debt equity ratio should be 2:1, where: Debt is aggregate of secured and unsecured debts owed by the after buy-back and Equity: is aggregate of the paid-up capital and its free reserves: **(e)** all the shares or other specified securities for buy-back are fully paid-up; **(f)** If shares or securities are listed, buy back will be in accordance with the regulations made by the Securities and Exchange Board in this behalf; and **(g)** the buy-back in respect of unlisted shares or other specified securities is in accordance with Share Capital and Debentures Rules, 2014. **(h)** No offer of buy-back shall be made within a period of one year from the date of the closure of the preceding offer of buy-back, if any. **<u>Other Conditions for Buy back</u>** – Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board. Section 68(4) – The buy-back can be from: a) from the existing shareholders or security holders on a proportionate basis; b) from the open market; c) by purchasing the securities issued to employees of the company pursuant

	to a scheme of stock option or sweat equity. Section 68(5) – Before making such buy-back, file with the Registrar, a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, Form No. SH.9 may be prescribed and verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board Section 68(6). – Company shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back Section 68(7). – Where a company completes a buy-back of its shares or other specified securities, it shall not make a further issue of the same kind of shares or other securities including allotment of new shares or other specified securities within a period of six months except by way of: a) a bonus issue or b) in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.
Prohibition of buy back in certain cases (section 70)	No company shall directly or indirectly purchase its own shares or other specified securities – a) through any subsidiary company including its own subsidiary companies; b) through any investment company or group of investment companies; or c) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company. Provided that the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist
Managerial Remuneration under Companies Act, 2013 (Dec 2014) (Dec 2013)	A. Limit if Adequate Profit u/s 197 of Companies Act, 2013: ➢ Overall managerial remuneration not to exceed 11% of the Net Profit of the F.Y, if company wants to pay Managerial remuneration more than 11% of Net Profits then it must pass a resolution in General Meeting and must take prior approval of Central Government. ➢ MD/WTD: 5% of NP if one. 10% of NP if more than one. ➢ Manger: 5% of NP ➢ Other directors 1% of NP if company has MD/WTD/Manager

3% of NP if company has no MD/WTD/Manager
In all the above cases the approval of central government is required if the company wants to
exceed the above limit.

Net profit for the purpose of calculation of Managerial Remuneration:
Section 198 spells out the method of net profits for the purpose of managerial remuneration, which is as follows:

INCOME	
To be credited u/s 198(2)	**Not to be credited u/s 198(3)**
Gross Profit in usual manner	Securities Premium
Other Income (Rent, Dividend, Interest)	Profit on sale of forfeited shares
Subsidy from Government	Profit on sale of undertaking (Capital profits)
	Profit on sale of fixed assets

EXPENSES	
To be deducted u/s 198(4)	**To be deducted u/s 198(5)**
Usual Working Expenses	Income Tax & Surcharge
Actual Bad debts written off	Loss on sale of undertaking (Capital Losses)
Actual Repairs and Maintenance	Any Compensation or damages payable other than breach of contract
Depreciation u/s 123	
Loss on sale of assets	
Interest on Borrowings	
Insurance Premium	
Brought Forward Losses if any	
Any compensation or damages for breach	

<u>Limit if Inadequate Profit (PART II OF SCHEDULE V=</u>
Higher of A or B;
A)

Effective Capital	Yearly Remuneration
Negative or less than 5 crores	30 Lakhs
5 crores and above but less than 100 crores	42 Lakhs
100 crores and above but less than 250 crores	60 Lakhs
250 crores and above	60 Lakhs + 0.01% of the effective capital in excess of 250 crores

B) In the case of a managerial person who was not a security holder, holding securities of the company of nominal value of rupees five lakh or more or an employee or a director of the company or not related to any director or promoter at any time during the two years prior to his appointment as a managerial person, —2.5% of the current relevant profit:

Provided that the above limits shall be doubled if the resolution passed by the shareholders is a special resolution.

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<tr><td></td><td></td></tr>
<tr><td>What are pre-incorporation Profits and How are they treated in the books of the company? (Dec 2014) (DEC 2011)</td><td>
Profit or Loss of a business for the period prior to the date the company came into existence is referred to as Pre-incorporation Profits or Losses.

When a running business is acquired by the company, the profit or loss earned by the company till the date of incorporation has to be shown separately, since it represents profits of capital in nature. To ascertain the profits as on date of taking over, either a set of financial statements at the date of takeover is prepared or the financials are prepared at the end of accounting period and then the profits are bifurcated into pre (capital) and Post (revenue) Profits. Of the above two options, the latter is preferable and convenient to practice.
<table>
<tr><th>Items</th><th>Basis of Apportionment</th></tr>
<tr><td>Gross Profit/Loss</td><td>Sales Ratio</td></tr>
<tr><td>Fixed Expenses (based on time which will be incurred even if there is no Sale during the year) Example – Salaries, Rent, Taxes, Depreciation, Office expenses, etc</td><td>Time Ratio</td></tr>
<tr><td>Variable Expenses (based on sales which will not be incurred if there is no Sale) Example – Commission, Discount, Advertisement, Sales promotion, Selling expenses, Sales, Audit Fees, etc</td><td>Sales Ratio</td></tr>
<tr><td>Expenses related to Pre-incorporation period alone – Partners remuneration, etc</td><td>Pre Incorporation Period</td></tr>
<tr><td>Expenses related to Post Incorporation period alone – Examples – Director's Fees, Debenture Interest, Discount of issue of debentures, Preliminary Expenses, etc</td><td>Post Incorporation Period</td></tr>
</table>
</td></tr>
<tr><td>What are preliminary Expenses? Give some Examples and how they are presented in Balance Sheet? (DEC 2014)</td><td>
<u>Meaning:</u>
Before incorporation and commencement of business, company and the promoters of the company may incurred so many types of expenses like statuary fees and company logo designing, in some cases rent for the office premises during the time of incorporation not after incorporation etc... These are all comes under preliminary expenses .in simple words preliminary expenses are the expenses that spent by the promoters before the incorporation of company.

<u>Which Expenses are included:</u>
Preliminary expenses refer to those expenses which are incurred in forming a joint stock company. These comprise the expenses incidental to the creation and floatation of a company and the following items are usually included therein:
(i) Stamp duty and fees payable on registration of the company and stamp papers purchased for preliminary contracts of the company.
(ii) The legal charges for preparing the Prospectus, Memorandum and Articles of Association and contracts and of the registration of the company.
(iii) Accountants' and Valuers' fees for reports, certificates, etc.
(iv) Cost of printing the Memorandum and Articles of Association, printing, advertising and issuing the prospectus.
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	(v) Cost of preparing, printing and stamping letters of allotment and share certificates. (vi) Cost of preparing printing and stamping Debenture Trust Deed, if any. (vii) Cost of company's seal and books of account, statutory books and statistical books. **<u>Which expenses are not Included:</u>** But preliminary expenses should not include the following expenses which are incurred before commencement of business: (i) Cost of preparation of the feasibility report. (ii) Cost of preparation of the project report. (iii) Cost of conducting market survey or any other survey necessary for the business of the company. (iv) Consultancy fees payable for engineering services in connection with the business. Generally, a limit is prescribed in the Articles or Prospectus or the Statement in lieu of Prospectus upto which any amount would be spent on preliminary expenses. But sanction of the shareholders is necessary if the amount spent on preliminary expenses exceeds the said limit. **<u>Treatment in Books of Accounts:</u>** Strictly speaking preliminary expenses are of capital nature and as such should be shown on the assets side of the Balance Sheet under the heading "Miscellaneous Expenditure". Although, there is no legal compulsion to write off the amount of preliminary expenses, it is prudent to write it off as soon as possible since it is unrepresented by assets. Preliminary expenses being of capital nature, may be written off against capital profits. Alternatively, such expenses may be treated as deferred revenue expenditure and written off gradually over a number of years by transfer to Profit and Loss Account. For income-tax purposes, such expenses can be written off over a period of 10 years. Until completely written off, Preliminary expenses have to be shown on the assets side of the Balance Sheet under the heading 'Miscellaneous Expenditure'
Adequacy of Debenture Redemption Reserve ??	the company shall create Debenture Redemption Reserve (DRR) in accordance with following conditions:- (i) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures. For other Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013, DRR will be as applicable to NBFCs registered with RBI. (ii) For NBFCs registered with the RBI under Section 45-IA of the RBI (Amendment) Act, 1997, 'the adequacy' of DRR will be 25% of the value of debentures issued through public issue as per present SEBI (Issue and

	Listing of Debt Securities) Regulations, 2008, and no DRR is required in the case of privately placed debentures. (iii) For other companies including manufacturing and infrastructure companies, the adequacy of DRR will be 25% of the value of debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities), Regulations 2008 and also 25% DRR is required in the case of privately placed debentures by listed companies. For unlisted companies issuing debentures on private placement basis, the DRR will be 25% of the value of debentures.
Where the debenture redemption reserve can be invested (Modes of Investment)	(i) in <u>deposits</u> with any scheduled bank, free from any charge or lien; (ii) in <u>unencumbered securities</u> of the Central Government or of any State Government; (iii) in <u>unencumbered securities</u> mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882; (iv) in <u>unencumbered bonds</u> issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882; (v) the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above:
Purchase of Own Debentures in open market (JUNE 2011)	➢ Under this method, a company may purchase its own debentures in the open market if it seems to be convenient and profitable to the company. ➢ When the market price of the debentures goes down below par or debentures are quoted at a discount on the stock exchange, the company usually takes the opportunity to buy the debentures in the open market and to cancel them. ➢ Own debentures may, also, be purchased by the company for its own investment when it is desired to keep the debentures alive with a view to issuing them in future. ➢ The law does not prohibit a company from purchasing its own debentures unless the terms of issue specify otherwise. In such a case, the purchase of debentures can be made out of the amount realised on sale of investments where sinking funds exists. ➢ Where there is no sinking fund, the debentures can be purchased out of the company's cash balance.

CORPORATE RESTRUCTURING	
Why Corporate Restructuring is done?	The various needs for undertaking a Corporate Restructuring exercise are as follows: (i) to focus on core strengths, operational synergy and efficient allocation of managerial capabilities and infrastructure. (ii) consolidation and economies of scale by expansion and diversion to exploit extended domestic and global markets. (iii) revival and rehabilitation of a sick unit by adjusting losses of the sick unit with profits of a healthy company. (iv) acquiring constant supply of raw materials and access to scientific research and technological developments. (v) capital restructuring by appropriate mix of loan and equity funds to reduce the cost of servicing and improve return on capital employed. (vi) Improve corporate performance to bring it at par with competitors by adopting the radical changes brought out by information technology.
What is Corporate Restructuring?	1. Corporate Restructuring is a comprehensive process, by which a company can consolidate its business operations and strengthen its position for achieving its short-term and long-term corporate objectives - synergetic, dynamic and continuing as a competitive and successful entity. 2. The expression 'Corporate Restructuring' implies restructuring or reorganizing a company or its business (or one of its businesses) or its financial structure, in such a way as to make it operate more effectively. This is not a legal term and has no precise meaning nor can it be defined with precision. 3. Corporate Restructuring is concerned with arranging the business activities of the corporate as a whole so as to achieve certain predetermined objectives at corporate level. Such objectives include the following: – orderly redirection of the firm's activities; – deploying surplus cash from one business to finance profitable growth in another; – exploiting inter-dependence among present or prospective businesses within the corporate portfolio; – risk reduction; and – development of core competencies.
Types of Restructuring? (DEC 2013)	Restructuring may be of the following kinds: 1. Financial restructuring which deals with the restructuring of capital base and raising finance for new projects. This involves decisions relating to acquisitions, mergers, joint ventures and strategic alliances. 2. Technological restructuring which involves, inter alia, alliances with other companies to exploit technological expertise. 3. Market restructuring which involves decisions with respect to the product

	market segments, where the company plans to operate based on its core competencies. 4. Organizational restructuring which involves establishing internal structures and procedures for improving the capability of the personnel in the organization to respond to changes. This kind of restructuring is required in order to facilitate and implement the above three kinds of restructuring. These changes need to have the cooperation of all levels of employees to ensure that the restructuring is successful

LIQUIDATION OF COMPANIES	
B List Contributories (June 2014)	➢ On the appointment of Liquidator, director's position will stand automatically vacated and the shareholders will be referred to as contributories. ➢ Shareholders who have transferred that partly paid shares within one year earlier to date of winding up will be placed in "B" List. Such contributories will be referred to as "B" List of contributories. ➢ Liquidator is expected to dispose the assets off to pay off liabilities. In case the disposal of assets was not sufficient to discharge the liabilities, then the liquidator can claim from "A" List of contributories towards their unpaid capital towards the company. ➢ If "A" List of contributories are not meeting the liabilities, then liquidator can fall upon "B" List of contributories to recover money towards unpaid portion of the capital. ➢ The liquidator can fall upon only against transfer of partly paid shares effected during within one year earlier to the date of winding up and transmission of shares will not come under this purview. If there were to be more than one such contributories, then the liability will be fixed against that many contributories in the ratio in which they are expected to contribute towards the capital. In no case, such fixation of liabilities can exceed the statutory liability (towards unpaid capital).
Statement of affairs (Liquidation of company)	The officers and directors of a company under liquidation must, according to section 454 read with section 511A, make out and submit, within 21 days of the Tribunal order (or within such extended time, not exceeding three months, as the liquidator or the Tribunal may allow), a statement showing the following (a) The assets of the company, stating separately the cash balance in hand and at bank, if any, and the negotiable securities, if any, held by the company; (b) Its debts and liabilities; (c) The names, residences and occupations of its creditors, stating separately the amount of secured and unsecured debts and in the case of secured debts, particulars of the securities given, whether by company or its officers, their value and dates on which they were given; (d) The debt due to the company and the names, residences and occupations of the persons from whom the amount likely to be realised on account thereof; (e) Such further or other information as may be prescribed, or as the official liquidator may require. The statement has to be prepared even in case of voluntary winding up.
What are preferential Creditors?	Under Section 530 of the Companies Act , the following creditors are treated as preferential creditors: 1. All revenues, taxes, cesses & rates payable to the government or local authority will be treated as preferential creditors provided that it must become due within 12 months before the date of winding up.

	2. 4 months salary & wages due to the employees of the company will be treated as preferential provided that it must become due within 12 months before the date of winding up. Maximum of ` 20000 will be treated as preferential creditors. All accrued holiday remuneration payable to an employee due to termination of his employment is treated as preferential The person who advances money for making the payment under (ii) & (iii) mentioned above will be treated as preferential. 1. Any sum payable by the company under the Employees State Insurance Act, 1948 will be treated as preferential provided that it must become due within 12 months before the date of winding up. 2. Compensation payable by the company under Workmen Compensation Act, 1923 is treated as preferential. 3. Any sum payable by the company to its employees from a Provided Fund, Pension Fund, Gratuity Fund or any other fund maintained foe the welfare of the employees. 4. The expenses of investigation held Under Section 235 or 237 will be treated as preferential.
Order of payment on Liquidation of Companies	The amount received from the assets not specifically pledged & the amounts contributed by the contributories must be distributed by the liquidator in the following order: 1. Expenses of winding up including the liquidators remuneration 2. Creditors secured by the floating charge on the assets of the company 3. Preferential creditors 4. Unsecured creditors 5. The surplus, if any, amongst the contributories (i.e. preference shareholders & equity shareholders) according to their respective rights & interests.
Consequences of Winding Up	The following are the consequences of winding up: 1. An officer called a liquidator is appointed & he takes over the administration of the company. He may be appointed by High Court, members or by the creditors as the case may be. 2. The powers of the board of directors will cease & will now vest the liquidator. 3. Winding up order or resolution of voluntary winding up shall operate as a notice of discharge to all the members of the company. Members of company are called 'Contributories'. 4. Liquidator of the company will prepare a list of contributories who be made liable to contribute to the assets of the company in case assets are not sufficient to meet the claims of various claimants. In case there is a surplus

	in the assets, the liquidator of the company will prepare a list of those members, who are entitled to share this surplus. 5. Liquidator of the company will collect & realise its assets & distribute the proceeds among right claimants as per the procedure of the law. 6. Winding up ultimately leads to dissolution of the company. The company's life will come to an end & it will be no more an artificial person in the eyes of law.

CONSOLIDATION OF ACCOUNTS	
What is Cost of Control in Consolidation of Accounts? (June 2014)	➢ In actual practice, it rarely happens that the cost of acquisition of shares in the subsidiary company agrees exactly with intrinsic value of the shares (i.e. the net assets of the subsidiary company) on the date of acquisition. ➢ If the price paid by the holding company for the shares acquired in the subsidiary company is more than the intrinsic value of the shares acquired, the difference should be treated as Cost of Control or Goodwill. ➢ If on the other hand, the price paid by the holding company for the shares acquired in the subsidiary company is less than the intrinsic value of the shares acquired, the difference should be treated as capital profits and credited to Capital Reserve. ➢ It should be noted that while computing the intrinsic value of the shares as on the date of acquisition of control, all profits and losses upto that date, have to be taken into account. While preparing the consolidated balance sheet, such Goodwill or Capital Reserve, whatever may be the case, must be shown in the Balance Sheet.
What is Minority Interest	➢ The claim of outside shareholders in the subsidiary company has to be assessed and shown as a liability in the consolidate balance sheet. ➢ Minority interest consists only the face value of the shares held by them. But it may so happen that the subsidiary company may have some accumulated profits and reserves or accumulated losses. Besides, it may have some profits or losses on account of revaluation of its assets on the date of acquisition of shares by the holding company. ➢ While calculating the amount of minority interest, all these items have to be taken into account and proportionate share of all such profits and reserves should be added to the amount of minority interest while proportionate share of all such losses should be deducted from the minority interest, ➢ thus, Minority Interest = paid-up value of shares held by minority shareholders + proportionate share of the company's profits and reserves + proportionate shares of profits on revaluation of assets of the company - proportionate share of company's losses – proportionate share of loss on revaluation of assets of the company. ➢ The company's profit and reserves or loss will include both pre-acquisition and post-acquisition profits and reserves or losses. ➢ But, if there are some preference shares of the subsidiary company held by outsiders, the minority interest in respect of the preference share will consist only of the face value of such shares and the dividend due on such shares if there are profits.
Treatment of Pre Acquisition Losses of Subsidiary Company (Dec 2014)	➢ Accumulated losses of the subsidiary company upto the date of acquisition of shares by the holding company are called pre-acquisition losses. ➢ Both the holding company and the minority shareholders must share such losses in proportion to their respective holdings. The minority shareholders' share of such losses should be deducted from the amount of Minority Interest. ➢ But the holding company's share of such losses should be treated as capital loss and debited to Goodwill account. While preparing the Consolidated Balance Sheet, this Goodwill Account should be shown as an asset.

Treatment of Pre Acquisition PROFITS of Subsidiary Company	➢ Accumulated profits and reserves which appear in the balance sheet of the subsidiary company up to the date of acquisition of its shares by the holding company are called pre-acquisition profits and reserves. ➢ Both the holding company and the minority shareholders will have proportionate share in such profits and reserves. ➢ The share of the minority shareholders in such profit and reserves will be added to the amount of minority interest. But the holding company's proportionate share in such profits and reserve should be treated as capital profits and credited to Capital Reserve since the holding company cannot earn any revenue profits from its subsidiary before the shares are acquired in it. ➢ While preparing the consolidated balance sheet, this Capital Reserve should be shown on the liabilities side or if there is any Goodwill, it can be shown as a deduction from the Goodwill in the assets side.
Profit on Revaluation of Assets of Subsidiary Company	➢ If there is any profit resulting from the revaluation of assets of the subsidiary company whether before or after the date of acquisition of shares by the holding company, the same must be shared both by the holding company and the minority shareholders in proportion to their respective holdings. ➢ The minority shareholders' share of such profit should be added to the Minority interest. But the holding company's share should be treated as capital profits and dealt with like pre-requisitions profit and reserve. ➢ Further, adjustment for depreciation on the increases or decreases in the value of assets would be made in the profit and loss account of the subsidiary. ➢ For appreciation in the value of assets, depreciation charge would be increased proportionately and the same would be deducted from the revenue profits of the subsidiary company. ➢ On the other hand, for revaluation loss due to decrease in the value of assets, excess depreciation provision should be written back.
Loss on Revaluation of Assets of Subsidiary Company	If there is any loss resulting from the revaluation of the assets of the subsidiary company as on the date of acquisition of shares by the holding company the same must be shared both by the holding company and the minority shareholders in proportion to their respective holdings. The minority shareholders' share of such loss should be deducted from the amount of Minority interest. But, the holding company's share of such loss should be treated as capital loss and dealt with like pre-acquisition losses. But, if such loss occurs after the date of acquisition of shares by the holding company the same should be treated as ordinary loss.

VALUATION OF SHARES	
Need for Valuation of Shares (June 2014)	The necessity for valuation of shares arises inter alia in the following circumstances: (i) Assessments under the Wealth Tax Act. (ii) Purchase of a block of shares which may or may not give the holder thereof a controlling interest in the company. (iii) Purchase of shares by employees of the company where the retention of such shares is limited to the period of their employment. (iv) Formulation of schemes of amalgamation, absorption, etc. (v) Acquisition of interest of dissenting shareholders under a scheme of reconstruction. (vi) Compensating shareholders on the acquisition of their shares by the Government under a scheme of rationalization. (vii) Conversion of shares, say, conversion of preference shares into equity. (viii) Advancing a loan on the security of shares. (ix) Resolving a deadlock in the management of a private limited company on the basis of the controlling block of shares being given to either of the parties.
Features of Intangible Assets	Following are the features of intangible assets : (i) It is non-physical in nature. (ii) It gives the specific rights to the holders over several future years. (iii) It is possible for multiple uses at the same time. (iv) It creates future value. (v) It is identifiable as non-monetary asset. (vi) It has limited ability to protect property rights. (vii) Investment in intangible assets is basically risky.
Cost of Inherently Generated Goodwill? & Its Treatment? (AS 26)	**1. Internally generated goodwill should not be recognised as an asset.** **2. No intangible asset arising from research (or from the research phase of an internal project) should be recognised.** **3. An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:** **(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 enterpriseLesson 6 Valuation of Shares and 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 assets during its development reliably.

<u>COST OF INHERENTLY GENERATED GOODWILL:</u>
The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports is prohibited. The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use.

The **cost includes**, if applicable:
(a) expenditure on materials and services used or consumed in generating the intangible asset;

(b) the salaries, wages and other employment related costs of personnel directly engaged in generating the asset;

(c) any expenditure that is directly attributable to generating the asset, such as fees to register a legal right and the amortization of patents and licenses that are used to generate the asset; and

(d) Overheads that are necessary to generate the asset and that can be allocated on a reasonable and consistent basis to the asset (for example, an allocation of the depreciation of fixed assets, insurance premium and rent). Allocations of overheads are made on bases similar to those used in allocating
Overheads to inventories. AS 16, Borrowing Costs, establishes criteria for the recognition of interest as a component of the cost of a qualifying asset. These criteria are also applied for the recognition of interest as a component of the cost of an internally generated intangible asset.

The following are **not components** of the cost of an internally generated intangible asset:
(a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use;

(b) clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance; and

(c) expenditure on training the staff to operate the asset.

Fair Value of Shares	➢ The fair value of a share is the average of the value of shares obtained by the net assets method and the one obtained by yield method. ➢ Under net assets method, the value of an equity share is arrived at by valuing the assets of a company and deducting therefrom all the liabilities and claims of preference shareholders and dividing the resultant figure by the total number of equity shares with the same paid up value. ➢ Under yield method, the value of an equity share is arrived at by comparing the expected rate of return with the normal rate of return. If the expected rate of return is more than normal rate of return, the market value of the share is increased proportionately. The fair value of shares can be calculated by using the following formula: Fair value of share = (Value by net asset method + Value by yield method)/2 ➢ This method is also known as dual method of share valuation. This method attempts to minimise the demerits of both the methods. This is of course, no valuation but a compromised formula for bringing the parties to an agreement. However, it is recognised in Government circles for valuing shares of investment companies for wealth tax purposes.