BACHELOR OF COMMERCE (Hons)

BCOM 202- Corporate Accounting

Unit I

Share Capital and Debentures: IPO book building, Issues and forfeiture and buy-back of shares; Redemption of preference shares; issue and redemption of debentures, Right issue and bonus shares; Accounting for employee stock option plan.

Unit II

Final accounts of companies: preparing profit and loss account and balance sheet as per revised schedule VI; Holding companies accounts (excluding cross holding).as per Provisions of Accounting Standard; Preparation of consolidated balance sheet; Valuation of Shares and Goodwill.

Unit III

Amalgamation of Companies: Amalgamation and Internal Reconstruction of Companies as per Accounting Standard; (excluding problems of amalgamation of inter-company holding); Accounting involved in liquidation of companies.

Unit IV

Banking and Insurance Companies: Accounts of banking and insurance companies; Accounting statements of electricity companies. Prudential norms: basis of accounting, income recognition asset classification.

UNIT-1

Book Building

Book Building is essentially a process used by companies raising capital through Public Offerings-both Initial Public Offers (IPOs) or Follow-on Public Offers (FPOs) to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process.

The Process:

- The Issuer who is planning an offer nominates lead merchant banker(s) as 'book runners'.
- The Issuer specifies the number of securities to be issued and the price band for the bids.
- The Issuer also appoints syndicate members with whom orders are to be placed by the investors.
- The syndicate members input the orders into an 'electronic book'. This process is called 'bidding' and is similar to open auction.
- The book normally remains open for a period of 5 days.
- Bids have to be entered within the specified price band.
- Bids can be revised by the bidders before the book closes.
- On the close of the book building period, the book runners evaluate the bids on the basis of the demand at various price levels.
- The book runners and the Issuer decide the final price at which the securities shall be issued.
- Generally, the numbers of shares are fixed; the issue size gets frozen based on the final price per share.
- Allocation of securities is made to the successful bidders. The rest get refund orders.

Guidelines for Book Building

Rules governing Book building are covered in Chapter XI of the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000.

BSE's Book Building System

- BSE offers a book building platform through the Book Building software that runs on the BSE Private network.
- This system is one of the largest electronic book building networks in the world, spanning over 350 Indian cities through over 7000 Trader Work Stations via leased lines, VSATs and Campus LANS.
- The software is operated by book-runners of the issue and by the syndicate members , for electronically placing the bids on line real-time for the entire bidding period.
- In order to provide transparency, the system provides visual graphs displaying price v/s quantity on the BSE website as well as all BSE terminals.

1.2 ISSUES AND FORFEITURE

Procedure of issue of shares:

When company has been registered, the following procedure is adopted by the company to collect money from the public by issuing of shares:

- Issue of prospectus:

  When a Public company intends to raise capital by issuing its shares to the public, it invites the public to make an offer to buy its shares through a document called 'Prospectus'. According to Section 60 (1), a copy of prospectus is required to be delivered to the Registrar for registration on or before the date of publication thereof.

  It contains the brief information about the company, its past record and of the project for which company is issuing share. It also includes the opening date and the closing date of the issue, amount payable with application, at the time of allotment and on calls, name of the bank in which the application money will be deposited, minimum number of shares for which application will be accepted, etc

To receive application:

After reading the prospectus if the public is satisfied then they can apply to the company for purchase of its shares on a printed prescribed form. Each application form along with application money must be deposited by the public in a schedule bank and get a receipt for the same.

The company cannot withdraw this money from the bank till the procedure of allotment has been completed (in case of first allotment, this amount cannot be withdrawn until the certificate to commence business is obtained and the amount of minimum subscription has been received). The amount payable on application for share shall not be less than 5% of the nominal amount of share

- Allotments of shares:

Allotments of shares means acceptance by the company of the offer made by the applicants to take up the shares applied for. The information of allotment is given to the shareholders by a letter known as 'Allotment Letter', informing the amount to be called at the time of allotment and the date fixed for payment of such money. It is on allotment that share come into existence.

Thus, the application money on the share after allotment becomes a part of share capital. Decision to allot the share is taken by the Board of Directors in consultation with the stock exchange. After the closure of the subscription list, the bank sends all applications to the company. On receipt of applications, each application is carefully scrutinised to ascertain that the application form is properly filled up and signed and the money is deposited with the bank.

To make calls on shares:

The remaining amount left after application and allotment money due from shareholders may be demanded in one or more parts which are termed as 'First Call' and 'Second Call' and so on. A word 'Final' word is added to the last call. The amount of call must not exceed 25% of the nominal value of the shares and at least 1 month have elapsed since the date

which was fixed for the payment of the last preceding call, for which at least 14 days notice specifying the time and place must be given.

Modes of issue of shares:

A company can issue shares in two ways:

1. for cash.

2. for consideration other than cash.

- Issue of shares for cash: When the shares are issued by the company in consideration for cash such issue of shares is known as issue of share for cash. In such a case shares can be issued at par or at a premium or at a discount. Such issue price may be payable either in lump sum along with application or in instalments at different stages (e.g. partly on application, partly on allotment, partly on call).

Issue of shares at par:

Shares are said to be issued at par when they are issued at a price equal to the face value. For example, if a share of Rs. 10 is issued at Rs. 10, it is said that the share has been issued at par.

Issue of shares at premium: When shares are issued at an amount more than the face value of share, they are said to be issued at premium. For example, if a share of Rs. 10 is issued at Rs. 15; such a condition of issue is known as issue of shares at premium. The difference between the issue price and the face value [i.e. Rs. 5 (Rs.15 – Rs.10)] of the shares is called premium. It is a capital profit for the company and will show credit balance; hence it will be shown in the liability side of the Balance Sheet under the heading 'Reserves and Surplus' in a separate account called 'Security Premium Account'. Shares of those companies can be issued at premium which offer attractive rate of dividend on their existing shares, having a good profit track for last few years and whose shares are in demand. The amount of premium depends upon the profitability and demand of shares of such company.

The Company may collect the amount of security premium in lump sum or in instalments. Premium on shares may be collected by the company either with application money or with the allotment money or even with one of the calls. In absence of any information, the amount of the premium is to be recorded with allotment.

Issue of shares at discount:

Shares are said to be issued at a discount when they are issued at a price lower than the face value. For example if a share of Rs. 10 is issued at Rs. 9, it is said that the share has been issued at discount. The excess of the face value over the issue price [i.e. Re.1 (Rs. 10 – Rs. 9)] is called as the amount of discount. Share discount account showing a debit balance denotes a loss to the company which is in the nature of capital loss. Therefore, it is desirable, but not compulsory, to write it off against any Capital Profit available or Profit and Loss Account as soon as possible, and the unwritten off part of it is shown in the asset side of the Balance Sheet under the heading of 'Miscellaneous Expenditure' in a separate account called 'Discount on issue of Shares Account'.

Conditions for issue of shares at discount: For issue of shares a discount the company has to satisfy the following conditions given in section 79 of the Companies Act 1956:

- (i) At least one year must have elapsed since the company became entitled to commence business. It means that a new company cannot issue shares at a discount at the very beginning.
- (ii) The company has already issued such types of shares.
- (iii) An ordinary resolution to issue the shares at a discount has been passed by the company in the General Meeting of shareholders and sanction of the Company Law Tribunal has been obtained.
- (iv)The resolution must specify the maximum rate of discount at which the shares are to be issued but the rate of discount must not exceed 10% of the face value of the shares. For more than this limit, sanction of the Company Law Tribunal is necessary.
- (v) The issue must be made within two months from the date of receiving the sanction of the Company Law Tribunal or within such extended time as the Company Law Tribunal may allow.

(1) On receipt of application money

Bank Account Dr

To Share Application A/c

(Being the application money on....shares..@ Rs..per share)

(2) On allotment of shares

(a) First of all application money on allotted shares is transferred to shares capital account by passing the following entry.

Share Application Account Dr

To Share Capital A/C

(Being the application money transferred to Share Capital Account)

(b) Those applicants who could not be allotted any share, their application money will be returned. For the following entry will be passed.

Share Application Account Dr

To Bank Account

(Being the application money of shares returned)

(3) On the allotment of share, the allotment money becomes due to the company. For this, the company will pass the following entry

Share Allotment Account

To Share Capital Account

Being the Share allotment money due on ....share @ Rs...per share as per resolution dated...)

(4) On receipt of allotment money, the entry is

Bank A/c Dr

To Share Allotment A/c

(Being the receipt of allotment money)

(5) On making the first call due from shareholders the entry is

Share First Call Account Dr

To Share Capital Account

(Being the first call money due on... shares @ Rs...per shares as per resolution of the Directors dated.....)

(6) On receipt of the first call money, the entry is

Bank Account Dr

To Share First Call Account

(Being share first call money...shares @ Rs....per share received)

- Note:
- Similar entries will be passed for second call, third and final call, if any.

Call in Arrear

Call in arrear means company has demanded his due amount of allotment or call money but .But if shareholder does not pay his allotment money on due date it deems as call in arrear , this is the asset of company and it must deduct from call up capital for calculation paid up capital. If there is no any rule the company has right to get 5% interest on call in arrears. Journal Entries for call in arrear in the books of company

1st journal entry will write at the time of due but not received the allotment money from share holder

Call in Arrear Account -------------Dr.

To Share Allotment Account

(Being share Allotment money...shares @ Rs....per share not received)

2nd When call in Arrear received from shareholder

Bank Account Debit ---------------Dr.

To call in arrear Account

(Being Arrear money...shares @ Rs....per share received)

3rd journal entry is related to company's interest received on due amount of call in arrear.

This is the income of company:-

Bank Account Debit -----------------Dr.

To Interest on Call in Arrear

(Being Interest money...shares @ ......%received)

Call in Advance

Call in advance means that company did not call the allotment or calls but shareholder gives the call money in advance form .So this is the liability of company . Company is liable to pay 6% interest on call in advance to shareholder.

Journal Entry for call in Advance

1st journal entry will pass for adjustment of advance money of allotment received at the time of application

Share Allotment Account -------------Dr.

To Call in Advance

2nd Journal entry will pass for when the amount of allotment due

Call in Advance Account --------------------Dr.

To Share Allotment Account

3rd Journal Entry for paying the interest on call in advance to shareholder

Interest on call in advance Account-------------- Dr.

To Bank Account

Forfeiture of shares:

When any company allots share to the applicants, it is done on the basis of a legal contract between the company and the applicant, which makes it binding upon the shareholders to pay the amount of allotment and calls whenever they are due. Now if any shareholder fails to pay the allotment and or call money due to him, the shareholder violates the contract and the company is entitled to take its share back, which is known as forfeiture of shares. The company can forfeit such shares if authorised by the Articles of Association. Forfeiture of share can be done according to the rules laid sown in the Articles and if no rules are given in Articles, the provisions of Table A, regarding forfeiture will apply. Forfeiture of shares means cancellation of allotment to defaulting shareholders and to treat the amount already received on such shares is not returnable to him – it is forfeited.

Procedure for forfeited shares:

The usual procedure is that the defaulting shareholder must be given a minimum 14 days notice requiring him to pay the amount due on his shares along with interest on it stating that if he fails to pay the amount and the interest on it, the shares will be forfeited. In spite of this notice, the shareholder does not pay the unpaid amount. The directors after passing a resolution will forfeit the shares and information will be given to the defaulting shareholder about the forfeiture his shares.

Effect of forfeiture of shares:

1. Termination of membership: The membership of the defaulting will be terminated and they lose all the rights and interest on those shares i.e. ceases to be the member / shareholder / owner of the company and his name will be removed from the Register of Member.

2. Seizure of money paid: The amount already paid on the forfeited shares by the defaulting shareholders will be seized by the company and in no case will be refunded back to the shareholder.

3. Non payment of dividend: When shares are forfeited the shareholder remains no longer the member of the company therefore he looses the right to receive future dividend

4. Reduction of share capital: Forfeiture of shares result in the reduction of share capital to the extent of amount called up on such shares.

Accounting Entries for Forfeiture of Shares

(1) Shares originally issued at par

Share Capital A/c .... Dr. (Total amount called up on forfeited shares)
To Forfeited Shares A/c (Total amount already received on forfeited shares)
To Share Allotment A/c (Amount due not paid)

To Share First Call A/c (Amount due not paid)

To Share Final Call A/c (Amount due not paid)

Share Capital A/c.................................... Dr. (Total amount called up on forfeited shares)

To Forfeited Shares A/c (Total amount already received on forfeited shares)

To Calls in Arrear A/c (Amount due not paid)

(2) Shares originally issued at Discount

Share Capital A/c .... Dr. (Total amount called up on forfeited shares)

To Forfeited Shares A/c (Total amount already received on forfeited shares)

To Share Allotment A/c (Amount due not paid)

To Share First Call A/c (Amount due not paid)

To Share Final Call A/c (Amount due not paid)

To Discount on issue of Share A/c (Discount on forfeited shares)

Share Capital A/c...................................... Dr. (Total amount called up on forfeited shares)

To Forfeited Shares A/c (Total amount already received on forfeited shares)

To Calls in Arrear A/c (Amount due not paid)

To Discount on issue of Share A/c (Discount on forfeited shares)

(3) Shares originally issued at premium - If Premium due but not received

Share Capital A/c.. Dr. (Total amount called up on forfeited shares)

Security Premium A/c................................ Dr. (Premium called but not paid)

To Forfeited Shares A/c (Total amount already received on forfeited shares)

To Share Allotment A/c (Amount due not paid)

To Share First Call A/c (Amount due not paid)

To Share Final Call A/c (Amount due not paid)

- Re-issue of Forfeited of shares:

Shares forfeited becomes the property of the company and the directors of a company have an authority to re-issue the shares once forfeited by them in accordance with the provisions

contained in Articles of Association. Table 'A' provides that "A forfeited shares may be sold or otherwise disposed off on such terms and in such manner as the Board thinks fit". They can re-issue the forfeited shares at par, at premium or at discount. However, if the shares are re-issued at discount, the amount of the discount does not exceed the amount paid on such shares by the original shareholder but in case of shares originally issued at a discount, the maximum permissible discount will be amount paid on such shares by the original shareholder plus the amount of original discount.

Accounting Entries for Re-issue

Bank A/c .... Dr. (Amount Received)
Forfeited Shares A/c Dr. (Loss on re-issue)
To Share Capital A/c

Forfeited Shares A/c ....Dr. (Profit on forfeiture
To Capital Reserve A/c and re-issue
transferred to
Capital account)

1.3 BUY-BACK OF SHARES:

The term buy-back of share implies the act of purchasing its own shares by a company either from free reserves, securities premium or proceeds of any shares or securities. According to Section 77A of the Companies Act 1956, a company can buy its own shares either from the:

a) Existing equity shareholders on a proportionate basis.

b) Open market

c) Odd lot shareholders

d) Employees of the company pursuant to a scheme of stock option or sweat equity.

Why buy-back

- To increase promoters holding.
- To Increase earnings per share.
- To Support share value.
- To pay surplus cash not required by business.
- To thwart takeover bid.
- To rationalise the capital structure by writing off.
- Capital not represented by available assets.

Resources of buy-back

Free reserves- A sum equal to the nominal value of the buy-back shares shall be transferred to the CRR A/C.

Securities Premium Account

Proceeds of any shares or securities –

A Company cannot buy-back its shares or

Securities out of the proceeds of an earlier

Issue of the same kind of shares or securities.

Conditions for buy-back

- Should be Authorized by the Articles of Association of the Company.
- The Special Resolution is to be passed in the General Meeting of shareholders.
- Less Than 25% of the Total Paid-UP Capital & Free Reserves of the company.
- DEBT-Equity Ratio should not more than 2:1 after such buy-back.
- All the shares for buy-back should be Fully Paid-Up.
- Should be completed within 12 months from the date of passing the Special Resolution

For issue of Debentures

Bank Account …………………………………… Dr.

To Debentures Account

To Securities Premium Account

(Being ______Debentures of Rs.______ each issued

as per B.O.D. Resolution No.____ dated _______)

For decision of buy back of shares

a) At Par (Face Value)

Equity Share Capital Account (NV) ………………Dr.

To Equity Share holders Account (NV)

b) At Premium

Equity Share Capital Account (NV) ……….……....Dr. X

Premium on buy back of share Account (Premium)..Dr.

To Equity Shareholders Account (Total Amt. Payable)

c) At Discount

Equity Share Capital Account (NV)………….……...Dr.

To Equity Shareholders Account (Amount Payable)

To Capital Reserve Account (Discount on buyback)

(Being entry for buyback of equity shares at par / premium / discount as case may be.)

For creating Capital Redemption Reserve

Securities Premium Account ………………...Dr.

General Reserve / Profit & Loss Account …. Dr.

To Capital Redemption Reserve Account X

(Being C.R.R. is created to the extent buy-back out of devisable profit / security premium)

Nominal Value of The proceeds of

CRR = –

Share Bought Back fresh issue For Adjusting premium on buyback

Security Premium Account (As per Latest Audited B/s)…Dr.

Profit & Loss Account / Revenue Reserves Account

(As per Latest Audited B/s) ……………………………….Dr.

To Premium on buy back of shares Account X

(Being premium on buy back adjusted)

5) For payment to equity share holders

Equity Share holders Account ……………………..… Dr.

To Bank Account

(Being amount due on buy back of share paid)

6) For buy back expenses paid OR payable

Expenses for buy back of shares Account ………… Dr.

To Cash / Bank / Creditors for Expenses Account

(Being buy back expenses paid / payable.)

7) For writing off buy back expenses

Profit & Loss Account ………………………………… Dr.

To Expense for buy back of shares Account

(Being buy back expense written off.)

Note : Some companies treat buy back expenses as deferred

revenue expenditure and written off over 3 to 5 years.

8) For any other transaction given, in the problem, usual

accounting entry should be passed.

1.4 REDEMPTION OF PREFERENCE SHARES

Preference share

1- Preference shares represent partial ownership in a company.
2- Preference Shares will carry preferential (cumulative) right to Dividend, at coupon rate, when declared.
3- The dividend will be calculated pro rata i.e. from the date of Allotment of such Preference Shares.
4- Preference shareholders always receive their dividends first.
5- Preference shareholders do not enjoy any of the voting rights.
6- Preference shareholders have a greater claim on the Company's assets than common stockholders.
7- The Preference Shares will have the maximum redemption period of 20 years.

Redemption of preference share

1. Only fully paid up Preference Shares will be redeemed.
2. The redemption of Preference Shares will not be taken as reducing The Authorised Share Capital of the Company.
3. The Preference Shares will be redeemed at par/ at a premium.
4. If the Preference Shares are redeemed at a premium, premium will be provided either out of Securities Premium Account or Profit and Loss Account.
5. Where any Preference Shares are redeemed out of profits for dividend, which a sum equivalent to the nominal value of the Preference Shares redeemed will be transferred to the "Capital Redemption Reserve A/C".
6. Where any Preference Shares are redeemed by issuing of new shares, it must be redeemed within 1 month from the date of issue of new shares & it will not be considered as increase of Authorised Share Capital.

7. Capital Redemption Reserve (CRR) A/c Creates when a company redeem or buy-back its own shares which reduces share capital.
8. It creates with the same with nominal value of the shares are redeemed out of profits.
9. Due to its creation the share capital is not reduced after redemption, - CRR A/C is converted to Share Capital.
10. Capital before Redemption = Capital after Redemption + CRR A/C.
11. Is not distributed among the shareholders.
12. Used only for Issue of Fully Paid Up Shares.
13. Used in paying up unissued shares to be issued to the members as Fully Paid Bonus Shares.
14. Redemption out of available Profit.
15. Redemption partly out of available Profit & partly by issuing new Shares.

Methods Are:

Alternative-1 Redemption out of available Profit for Dividend Alternative-2 Redemption by issuing new Equity or Preference Shares Alternative-3 Redemption partly out of available Profit & partly by issuing new Shares

Important Note A Company has no right to sales it's Assets or issues debentures to redeem its Preference Shares.

Profits available for Dividend U/S 205

Profit & Loss A/C

General Reserve

Reserve Fund

Contingency Reserve

Insurance Fund

Dividend Equalisation Fund

Debenture Redemption Fund

Voluntary Debenture Sinking Fund

Workmen's Accident Fund

Workmen's Compensation Fund

1. When preference shares are due on the maturity date with its premium amount. At that time, we will pass following journal entry.

7% Redeemable Preference Share capital account........ Dr.

Premium on Redemption Account ....Dr.

7%To Redeemable Preference Shareholders' Account

2. When Fund is managed for Repayment to Preference Shareholders.

(i) If company uses his old profit reserves for repayment to preference shareholders. It means, company has saved money out of his profit for this day. We take this money by passing following journal entry.

Profit and loss account............. Dr. or General Reserve Account......................t Dr.

To Capital Redemption Reserve Account

(ii) If company issues new equity shares for redemption of preference shareholders.

Bank Account........................... Dr.

To Equity Share Capital Account

(iii) If company sells its assets on the loss for getting fund for repayment to preference shareholders.

Bank Account... Dr

Profit and Loss Account ....Dr. (Loss on sales of assets)

To Particular Asset Account

(iv) If company gets new loan for repayment to preference shareholders.

Bank Account...................................... Dr.

To Loan Account

3. When Company Pays to Redeemable Preference Shareholders.

Preference Shareholders Account or Preference Redemption Account ....Dr.

To Bank Account

4. When Company converts preference share capital into equity share capital.

At that time, we will not pass above entries; we will pass only following entry.

Preference Share Capital Account.. Dr.

To New Equity Share Capital Account Cr.

5. Premium on Redemption Account is Closed through Stock Premium Account or General Reserve

We can fulfil payable amount of premium on redemption account through stock premium account or our general reserve account.,,

1.5 ISSUE AND REDEMPTION OF DEBENTURES

Debenture is an '*instrument* ' in writing for a '*fixed period'* given by a company acknowledging the liability for total amount received as a result of issue of debenture and agreeing thereby to pay the money raised after the expiry of stipulated period at a certain rate of interest per annum.

Types of Debentures

1. From Security point of view
   a. Naked/Simple Debentures b. Mortgage Debentures

2. From Permanence point of view
   a. Redeemable Debentures b. Irredeemable debentures

3. From priority point of view
   a. First Debentures b. Second Debentures

4. From recording point of view
   a. Bearer Debentures b. Registered Debentures

5. From conversion point of view
   a. Convertible Debentures b. Non-Convertible Debentures

Difference Between Debenture and Debenture Stock

Basis of difference	Debenture	Debenture Stock
1. Fully paid up	They need not to be fully paid up	They must be fully paid.
2. Transfer	They can be transferred fully.	They can be transferred infractions also.
3. Distinct numbers	They are identified by their distinct numbers.	There are no distinct numbers.

Issue of Debentures

The issue aspect of debentures can be studied from different angles are given below:

1. From consideration point of view: Debentures can be issued either for consideration in cash or for consideration other than cash or collateral security.

   a). For consideration in cash. Debentures can be issued for consideration in cash either at par or at discount or at premium. The journal entry will be :

Particulars	L..F.	Dr. (Rs.)	Cr. (Rs.)
Bank A/c ……………………………….. Dr. Discount on debentures A/C (if issued at discount) Dr. To Debentures A/c To Debentures premium A/c (if issued at premium)			

For consideration other than cash. When debentures are issued to the vendors in lieu of purchase consideration, which is known as issue of debentures for consideration other than cash. The journal entries in this case will be:

(i) For purchase of assets

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Sundry Assets A/c …………….. Dr. To Vendor A/c			

(ii) For issuing debentures for payment of purchase consideration

In this case also debentures can be issued at par or at discount or at premium for which due adjustment is to be made in the second entry above like the previous case.

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Vendor A/c Dr. To Debentures A/c			

As collateral security : When debentures are issued as subsidiary or secondary security in addition to the principal security against a loan or a bank overdraft, such an issue of debentures is known as issue of debentures as collateral security.

The basic objective of such an issue is that

if the company does not repay the loan and the interest and the main security is not sufficient, the bank will be entitled to sell the debentures in the market or the bank may keep the debentures with it.

If the company repays the loan, the bank will return the debentures issued as collateral security to the company Debentures issued as collateral security can be dealt in two ways:

First method: No entry need to be passed in the books of the company when debentures are issued as collateral security. Debentures become alive only when loan is not repaid. The fact of such an issue of debentures must be clearly mentioned in the Balance Sheet by way of a note under the loan and debentures as shown below:

BALANCE SHEET (Extract)

Capital and liabilities

- Debentures

  (In addition ……debentures of Rs….each have been issued as collateral security)

- Loan or Bank Overdraft

  (Secured by the issue of….debentures of Rs…each as collateral security).

Second method. Following journal entry can be passed for issue of debentures as collateral security:

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Debentures Suspense A/c Dr. To Debentures A/c			

As and when the loan is paid, the entry passed above is reversed.

In this method entries in the balance sheet will be shown as under :

BALANCE SHEET (Extract)

Capital & liabilities	Property & assets
Debentures	Debenture Suspense A/c
….debentures of	[Debentures issued as
Rs.…each at par	collateral security for bank
Loan from bank	loan as per contra]

2. From price point of view: Debentures can be issued either at par or at discount or at premium.
   - When the amount collected on debentures issued is equal to the face value as issue of debentures of Rs. 100 for Rs. 100, it is said to be issued at par.
   - When the amount collected is more than the face value of a debenture as issue of debenture of Rs. 100 at Rs.105, it is said to be at premium.
   - Debentures is said to be issued at discount when the amount collected is less than the face value as issue of Rs. 100 debentures for Rs. 95.

The entries will be as under:

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
(i)When debentures are issued at par.			
Bank A/c (with face value) Dr. To Debentures A/c		100	100
(ii) When debentures are issued at premium			
Bank A/c (with total amount) Dr. To Debentures A/c (with face value) To Premium on Issue of Debentures A/c		105	100 5

(iii) When debentures are issued at discount			
Bank A/c (with net amount received) Dr. Debentures discount A/c ………….Dr. (with amount of discount) To debentures A/c (with face value)		95 5	100

3. From condition of redemption point of view. When debentures are issued with certain conditions at which redemption can be made, there are five cases which are given as follows:

Case I	Conditions of issue	Conditions of redemption
(a)	Issued at par	Repayable at par
(b)	Issued at premium	Repayable at par
(c)	Issued at discount	Repayable at par
(d)	Issued at par	Repayable at premium
(e)	Issued at discount	Repayable at premium
(f)	Issued at premium	Repayable at premium

The journal entries to be passed at the time of issue and redemption of debentures in the five cases are given below:

I. When debentures are issued at par and repayable at par:

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
(a) On issue of debentures, the entry will be:			
Bank account Dr.			
To debentures a/c			
(b) On redemption of debentures, the entry will be:			
Debentures Account Dr.			
To bank a/c			

II. When debentures are issued at premium and repayable at par.

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
(a) On issue of debentures, the entry will be:			
Bank a/c Dr.			
To debentures a/c			
To debentures premium a/c			
(b) On redemption of debentures, the entry will be			
Debentures a/c Dr.			
To bank a/c			

iii. When debentures are issued at discount and repayable at par.

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
(a) On the issue of debentures, the entry will be			
Bank a/c Dr.			
Discount on issue of debentures a/c Dr.			
To debentures a/c			
(b) On redemption of debentures, the entry will be			
Debentures A/c Dr. To Bank A/c			

IV. When Debentures are issued at par and repayable at premium

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
(a) On issue of debentures, the entry will be:			
Bank account Dr.			
Loss on issue of debentures A/c Dr.			
To Debentures account			
To Premium on redemption of debentures account			

(b) On redemption of debentures, the entry will be :			
Debentures Account ………… Dr.			
Premium on redemption of debentures account ……………. Dr.			
To Bank Account			

V. When debentures are issued at a discount but repayable at a premium:

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
(a) On issue of debentures, the entry will be:			
Bank Account Dr.			
Loss on issue of debentures account Dr. (For discount and premium on redemption)			
To Debentures Account			
To premium on redemption of debentures account.			
(b) On redemption of debentures, the entry will be:			
Debentures Account Dr.			

Premium on redemption of debentures A/c Dr.			
To Bank Account			

VI. When debentures are issued at premium and also repayable at premium

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
(a) On issue of debentures, the entry will be:			
Bank Account Dr.			
Loss on Issue of debentures Account Dr. (For premium on redemption less premium on issue)			
To debentures account			
To Premium on Redemption of debentures account			
To Capital Reserve (If premium on issue is more than premium on redemption)			
(b) On redemption of debentures, the entry will be:			
Debentures account Dr.			
Premium on redemption of debentures			

account Dr.			
To bank Account			

Redemption of debentures

Redemption of debentures refers to the discharge of liability on account of debentures. Following three problems require attention when company wants to redeem the debentures.

1) Time of redemption of debentures
2) Amount to be paid on debentures
3) Sources of finance

Sources of finance

Redemption out of profits
Redemption out of capital
Out of provisions made for redemption
By converting into new shares and debentures

Redemption out of profits

When debentures are redeem out of profits following journal entries are passed:

a) Entry for amount paid on redemption

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Debenture A/c Dr.			
To Bank a/c			

b) Entry for transfer of profit

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Profit or appropriation a/c Dr.			
To Debenture redemption reserve a/c			

c) When balance for DRR A/c is not required for redemption and is transferred to general reserve account.

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Debenture redemption reserve a/c Dr.			
To general reserve a/c			

The balance of general reserve is a free reserve and will be available for all purposes.
The effect of redemption of debenture out of profits is that a company with holds a part of a divisible profits from distribution as dividend which may be retained in the business itself as a source of internal financing.

Redemption out of capital

If debentures are redeem out of capital;

- No amount of divisible profit is kept aside for redeeming debentures.
- Profits are not utilized for redemption of debentures and may go to the shareholders by way of dividends.
- Redemption out of capital reduces the liquid resources available to the company.

Therefore company may adopt this method only when it has sufficient surplus funds.

Creation of Debenture Redemption Reserve is not required in the following cases:

Debentures with a maturity period of 18 months or less.

Fully convertible debentures.

1) When debentures redeemed out of capital, the following journal entry is passed:

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Debentures account Dr.			
To bank account			

Sometimes instead of passing one entry given above, the following two entries are passed:

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Debentures account Dr.			
To debenture holders account			

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Debenture holder a/c Dr.			
To bank a/c			

Redemption by conversion

Sometimes the debenture holders of the company are given the option to convert their debentures into shares or new debentures within a stipulated period. Such option is exercised by debenture holders only when they are very sure about the progress of the progress of the company. Following entry will be made:

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Old debentures a/c …… Dr.			
Discount on issue of shares/debentures a/c Dr.			
To new share capital/debenture a/c			
To premium on issue of shares/debentures a/c			

Redemption out of provision

It is always a wise policy for the company to make arrangements in advance to repay the known liability for redemption of debentures. This can be done by making provisions otherwise it will be difficult for the company to arrange lump sum to repay debts.

This is possible by adopting either

The sinking fund method or

Insurance fund method.

Sinking fund for redemption of debentures

- Debentures are to be paid on a specified date. It is desirable to make some arrangement for their redemption otherwise it will be difficult for the company to pay the lump sum at the time when redemption is due.
- Sinking fund is created out of profits and invested in readily realizable securities with the purpose of providing a definite amount of money needed for redemption of debentures at a particular date.
- How much amount is to be provided every year so that a given amount is available at the end of given period on the rate of interest earned on securities? This amount can be ascertained from sinking fund tables.

Accounting Entries:

At The End Of 1st Year

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Surplus account Dr.			
To sinking fund investment account			

(ii) For the amount kept aside for redemption invested in securities

Particulars	L.F.	Dr.(Rs.)	Cr. (Rs.)
Sinking fund investment account Dr.			
To bank account			

At the end of 2nd n subsequent year

(i) For interest received on investment

Bank account……………………………………Dr.
To sinking fund investment account

(ii) For interest transferred to sinking fund

Interest on sinking fund investment……Dr.
To sinking fund account

(iii) For annual amount set aside

Surplus account……………………………………….. Dr.
To sinking fund account

(iv) For annual installment plus interest

Sinking fund investment account………… Dr.
To bank account

At the end of last year

(i) For the amount realized on the sale of securities

Bank account Dr.
To sinking fund investment account

(ii) For profit on sale of investment

Sinking fund investment account Dr.
To Sinking fund account

(iii)For mount to be paid to debenture holder to redeem the debentures

Debenture account Dr.
To bank account

(iv)For balance of sinking fund transferred to general reserve account

Sinking fund account Dr.
To general reserve account

Insurance Policy Method

Under this method a fixed amount of premium is paid every year to the insurance company which in turn agrees to pay the necessary amount for redemption of debentures at the end of a specific period.

JOURNAL ENTRIES

- First year

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
(i) For amount of premium appropriated from surplus account			
Profit and Loss Appropriation A/c Dr.			
To Debenture Redemption Fund A/c			
(ii) For amount of premium paid to insurance company			
Debenture Redemption Fund Policy A/c Dr.			
To Bank A/c			
NOTE: These entries passed every year including last year also			

Following entries will be passed *at the end* of the specific period on realisation of the policy:

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
(i) For the amount received from insurance co.			
Bank A/c Dr.			
To Redemption Fund Policy A/c			
(ii) For the balance of Debenture Redemption Fund A/c - transferred to Debenture Redemption Fund a/c			
Debenture Redemption Fund Policy a/c Dr.			
To Debenture Redemption Fund a/c			
(iii) For amount paid to debenture holders			
Debenture A/c Dr.			
To Bank A/c			
(iv) For balance of Debenture Redemption Fund A/c transferred to General Reserve.			
Debenture Redemption fund a/c Dr.			
To General Reserve A/c			

Own Debentures

Directors, if authorised by the terms of the contract, can purchase

Debentures whenever they find the market price favourable to the company.

❖ Purchase of own debentures were to be treated in acts as an ordinary investment. The entry will be:

Investment in own Debentures A/c.. Dr
To Bank A/c

The Company cancel investment in own debentures, the entry will be

Debentures A/c	Dr.
Loss on Redemption of debenture A/c (for loss)	.... Dr.
To Own Debentures A/c	
To profit on Redemption of debenture a/c (for profit)	

Interest On Own Debentures

The total amt of interest due on debentures is deemed to be outstanding. But payment of interest on debentures is made only to outsiders.

Following entry is made :

Debenture Interest a/c	Dr.
To Bank a/c	
To Interest on own debentures a/c	

When there is no sinking fund, the debit balance of debentures interest is shown on the debit side of the Profit And Loss Act and credit balance of interest on own debentures is credited to Profit And Loss Act, and in presence of sinking fund , interest on own debentures is transferred to sinking fund.

Ex–Interest and Cum-interest Quotations

- When securities are purchased or sold on a date other than the date of interest, distinction must be made between the capital and revenue portion of the price paid for the debentures.
- Amount paid towards the price of debentures is capital expenditure whereas amt paid for interest is revenue expenditure.
- Price paid for the debentures depends on the market quotation.
- If the quotation is Cum-interest that means it is with interest and interest deducted from the total price.
- If the quotation is Ex-interest it excludes the interest and for recording purposes interest is calculated and added separately to the quotation.

Right issue

Right shares are those shares which are issued to existing shareholders. According to section 81 of Indian company act 1956, “Company can issue right shares only after the two years of creation of company or one year of first issue of shares which ever is earlier."

Steps for issuing right shares

1st Step: Right shares must be in ratio of equity shares of existing shareholders.
2nd Step: Right Issue by 15 days notice
Right shares will be issued with 15 days notice. This notice will be offer. Existing shareholders can either accept or reject this offer.

3rd Step: Right shares issue must not be opened more than 60 days under SEBI guidelines. Provision of 81 will not apply on private company. This rule will not also apply on conversion of debentures into shares.

Benefits of Issuing Right Shares

1. More control on existing shareholders

Because right shares are issued to existing shareholder, so there is no risk of losing of control of existing shareholders. Existing shareholders' share will increase in company and they can take decision without any compromise with the principles of company. It is very helpful to achieve the missions of company.

2. No loss to existing shareholder
By issuing shares to existing shareholders, value of share will increase due to stability in controlling power of company. So, there will not be any loss to existing shareholders with right shares.

3. No cost for issuing shares to public

Company has not to give any invitation to public, so advertising cost and other new issue cost will decrease with right shares.

4. Helpful to increase the goodwill of companyIt is also way to increase the goodwill and reputation of company in industry.

5. Capital formation

Company can get capital at any time without any delay because company can easily issue of shares to existing shareholders just sending right shares offer notice.

6. More scientific

Distribution technique of right shares issue is more scientific. Not all shares will get by single shareholders but it will be in the proportion of existing shares which is in the hand of old shareholders at this time.

For Example

A company is planning to raise funds by making rights issue of equity shares to finance its expansion. The existing equity share capital of the company is Rs. 50, 00,000. The market value of its share is Rs. 42. The company offers to its share the right to buy 2 shares at Rs. 11 each for every 5 share held. You are required to calculate:

1. Theoretical market price after right issue
2. The value of right
3. % increase in share capital

Solution

Market value of 5 shares already held by a shareholder @ Rs. 42 = 210

Add the price to be paid by him for acquiring 2 more shares@ Rs. 11 per share = 22

Total Rs. 232

1. Theoretical market price of one share = 232/7 = Rs. 33.14

2. Value of Right = Market price – theoretical market price = 42- 33.14 = 33.86

3. % increase in share capital

Present capital = 50, 00,000

Right issue Rs. 50, 00,000 X 2/5 = 20, 00,000

% increase in share capital = 20, 00,000 / 50, 00,000 X 100 = 40%

1.6 BONUS SHARES

Shares without Cost for which nothing is paid by shareholders.

Issued to only Existing Shareholders.

Issued in a ratio of the shares an investor hold.

Usually announced by the company with a record date.

Usually gives bonus shares as a substitute of dividend payouts.

The face value of the share doesn't get change after bonus.

Bonus shares increases the number of shares in the market which goes down EPS.

Why bonus shares

Company has more accumulated more reserve.

Accumulated Reserve > Normally Necessity.

Company shares this Excess Reserve with their Existing Shareholders in the form of Bonus Shares.

Company is not in position to pay Cash Bonus or Dividend due to Insufficient Cash.

Cash Bonus affects the Working Capital & future plans of Capitalisation.

Issued Capital is Increased.

Assets remain Intact.

Liquidity of the company is not affected.

Capitalization of profit

Conversion of Retained Earnings into Paid-Up Capital.

Profits or Reserves become the part of Issued Capital.

By issuing bonus shares to current shareholders in proportion to their shareholdings.

By Making Partly Paid Shares as Fully Paid without getting Cash from the shareholders.

By issuing a stock dividend.

Methods of issuing bonus shares

Aletrnative-1

Capitalisation of Profit by Issuing Bonus Shares

Issuing of FREE Fully Paid Shares as Bonus Shares.

Alternative-2

Capitalisation of Profit by Without Issuing Bonus Shares

Making Partly Paid Shares as Fully Paid without getting Cash from the shareholders.

Accounting treatment of bonus Shares

Declaration of bonus from Profits and Reserves of LAST YEAR

On Declaration of Bonus Shares:-

Capital Redemption Reserve A/C Dr.

Capital Reserve A/C .... Dr.

Securities Premium A/C............ Dr.

General Reserve A/C .... Dr.

P&L Appropriation A/C........... Dr.

To Bonus to Shareholders A/C

Accounting treatments of bonus Shares

Declaration of bonus from Profits and Reserves of LAST YEAR

On Issue of Bonus Shares at PAR :-

Bonus to Shareholders A/C .... Dr.

To Equity Share Capital A/C

On Issue of Bonus Shares at PREMIUM :-

Bonus to Shareholders A/C........ Dr.

To Equity Share Capital A/C

To Securities Premium A/C

1.7 ACCOUNTING FOR EMPLOYEE STOCK OPTION PLAN.

In order to retain high calibre employees or to give them a sense of belonging, companies may offer their equity shares to be purchased at their will. Such scheme is called Employee stock option plan (ESOP). Following are the characteristics of this scheme:

1) ESOP implies the right, but not an obligation.

2) The employee has a right to exercise the option of purchase of shares within the vesting period, i.e., the time period during which the scheme remains in operation.

3) Any share issued under the scheme of ESOP shall be locked-in for a minimum period of one year from the date of allotment.

Accounting Treatment of ESOPs

Employers use share-based payments as a part of remuneration package for their employees. Hence the employers engaged in such arrangements with employees recognize the cost of services received over the requisite service period. The accounting value is determined by finding either fair value of the option or intrinsic value of the option. Intrinsic value means the excess of the fair value of the share at the date of grant of the option over the exercise price of the option. Fair value of an option means the market price of the option, had it been traded in the market.

When we account for employee stock options, following new accounts come into existence:

- Employee compensation expense account – It forms part of the compensation expense account and is taken in the profit and loss account.
- Deferred employee compensation expense – This account is created at the time of grant of options for the total amount of compensation expense to be accounted. This account is a part of the Balance sheet and forms a negative balance in the Shareholders equity or Net worth.
- Employee Stock Options Outstanding account – It is a part of the Shareholders equity and is transferred to Share Capital, Share Premium or General Reserves. Amortized employee stock compensation expenses are taken in the Profit and loss account.

Calculation of Compensation Expense / Cost: The total compensation cost is the fair value of the instruments issued multiplied by the number of instruments that actually vest. This cost is recognized over the requisite service period with a corresponding credit to Employee Stock Options Outstanding account. The number of instruments expected to vest is estimated at the service inception date, and is revised during the requisite service period to reflect subsequent information. Total compensation cost is also revised accordingly. Employees earn the right to exercise the option after the completion of the vesting period, which is generally the service condition. The requirement that an individual remain an employee for that period is a service condition. An explicit service condition is explicitly stated in the terms of share-based arrangements (e.g., three years of continuous employee service from January 3, 2012). The objective of accounting for transactions under share-based arrangements with employees is to recognize compensation costs related to employee services received in exchange for equity instruments issued.

The Accounting treatment discussed above can be illustrated by the following numerical example.

Options granted – 500 on 01/04/2012 at Rs. 40

Vesting Period – 2 years.

Fair Value of options: Rs. 15

Fair Value per share: Rs.10

Hence, Total Employee Compensation Expense – Rs. 7500 (500×15)

The accounting entries would be as follows:

Employee Compensation Expense A/C   7500

Employee Stock Options Outstanding A/C 7500

(This entry to be made every year till the vesting period expires)

And in the year of exercising the option, the entry would be:

Bank A/C (Amount actually received)

Employee Stock Options Outstanding A/C

Equity Share Capital A/C

Security Premium A/C (if any)

Surrender of shares:

When a shareholder feels that he cannot pay further calls; he may himself surrender the shares to the company. These shares are then cancelled. Surrender of shares is a voluntary return of shares for the purposes of cancellation. The directors can accept the surrender of shares only when the Articles of Association authorise them to do so. Surrender is lawful only in two cases viz.

2 (a) where it is done as a short cut to forfeiture to avoid the formalities for a valid forfeiture and

3 (b) Where shares are surrendered in exchange for new shares of the same nominal value. A surrender will be void if it amounts to purchase of the shares by the company or if it is accepted for the purpose of relieving a member from his liabilities. Entries are passed just like forfeiture of shares.

4 Thus, surrender of shares is at the instance of shareholder whereas forfeiture of shares at the instance of company.

5 Over subscription of issue:

When the application received from the public are more than the shares issued by the company, this situation is called as over subscription of issue. The Board of Directors cannot allot shares more than that offered to the public, in such a condition the Directors of the company make the allotment of shares on the basis of reasonable criteria. Any allotment to be made by the company in case of over subscription should be according to the scheme, which is finalized with the consultation of Security and Exchange Board of India (S.E.B.I.) The journal entry for application money will be passed for all the shares applied for, but while transferring the application money to share capital account, only the application money on shares issued will be considered.

6 Under subscription of issue:

Shares are said to be under-subscribed when the number of shares applied for is less than the number of shares offered, but at least minimum subscription (According to the guidelines issued by S.E.B.I. minimum subscription means 'If the company does not receive a minimum subscription of 90% of the issued amount within 60 days from the date of closure of the issue, the company shall forthwith refund the entire subscription amount') is received. For example, in case has offered 5,000 shares to public but the public applied for 4,500 shares only, it is called a case of under-subscription. Journal entries are passed on the basis of shares applied for.

7 Preferential allotment:

A preferential allotment is one that is made at a pre-determined price to the pre identified people who wish to take a strategic stake in the company such as promoters, venture capitalists, financial institutions, buyers of companies products ore its suppliers. In other such a case, the allottees will not sell their securities in the open market for a minimum period of three years from the date of allotment. This period is known as the lock-in-period. The preferential allotment can take place only if three-fourths of the shareholders agree to the issue on preferential basis. S.E.B.I. has prescribed that the minimum price of such an issue has to be an average of highs and lows of the 26 week preceding the date on which the board resolves to make the preferential allotment.

8 Under Section 81 of the Companies Act, the existing shareholders have a right to subscribe, in their existing proportion, to the fresh issue of capital or to reject the offer, or sell their rights. The existing shareholders can authorize the company by passing a special resolution to offer such shares to the public.

UNIT-II

1.1 Final accounts of companies

1.2 Holding companies accounts (excluding cross holding)

1.3 Preparation of consolidated balance sheet;

1.4 Valuation of Shares

1.5 Valuation of Goodwill

1.1 FINAL ACCOUNTS OF COMPANIES

Meaning

Every Organization or entity which maintains the books of accounts day to day transactions needs to prepare the Final Accounts at the end of Interval - normally one year.

The final accounts comprises:

I. Profit and Loss Account showing Income, expenses, gains and losses pertaining to the period.

II. Balance sheet enlisting assets, receivables, payables and capital on the specific date.

These accounts or statement has to be prepared in accordance with the requirements of provisions of the law; applicable to it. In addition to these, these accounts also need to comply with the statements and standard issued by The Institute of Chartered Accountants of India to the extent these are relevant on applicable. The preparation and presentation of final accounts is essential for all entity irrespective of the form of organization andnature and volume of transactions. The Objective of preparation of Final Accounts is to satisfy or ensure that these represent a true and fair view of affairs and profits of the entity.

The method of preparation of final accounts :

Irrespective of the form of organization and nature of activity,some of the steps involved for this purpose are commonly applicable to all.

These Steps are: -

Preparation of trial balance

Enlisting all balances extracted from books of accounts maintained during the specified period. This step is to satisfy that the arithmetic accuracy of accounting process is ensured. Scrutinise the accounts

To ensure that the proper accounting effect is made for the following-

i. Provision is made for all unpaid expenses and outstanding income.

ii. Advance receipts of income, pre - payment of expenses is properly segregated.

iii. Accounting Errors - particularly affecting capital and revenue items are identified and rectified.

iv. Provision for all known losses, such as loss by fire or accident, depreciation, devaluation of investments, profit or loss on sale of investments or assets is shown in the accounts.

v. Statutory Provisions as required under applicable laws e.g. Transfer to Reserve, Dividend, Tax.

Compliance with Accounting Standards (AS) and Statements issued by the Institute of Chartered Accountants of India (ICAI)

The ICAI has issued several Standards and Statements to ensure the uniformity in prepare at and presentation of Final Accounts. In many cases, it is mandatory or compulsory to comply

With these, Statements and Standards. The ICAI while issuing such Statements and Standards, specify the type of entity and accounting period covered by the same and also extent to which it is mandatory.

These Standards can he categorized as: -

a) Basic subject matters for preparation and presentation of Final Accounts which has general application eg.

i. Disclosure of Accounting Policies (AS 1)

ii. Valuation of inventories (AS 2)

iii. Depreciation (AS 6)

iv. Revenue Recognition (AS 9)

v. Fixed Assets (AS 10)

vi. Investments (AS 13)

vii. Prior Period - items (AS 5)

viii. Income Tax (AS 22)

ix. Intangible Assets (AS 26)

x. Contingencies & events after Balance Sheet (AS 4)

b) Special Transaction or Items

i. Construction Contracts (AS 7)

ii. Research & Development (AS 8)

iii. Foreign Exchange Translation (AS 11)

iv. Government Grants (AS 12)

v. Retirement Benefit Scheme (AS 15)

vi. Borrowing Costs (AS 16)

vii. Segment Reporting (AS 17)

viii. Related Party (AS 18)

ix. Leases (AS 19)

x. Earnings per share (AS 20)

xi. Amalgamation (AS 14)

xii. Consolidated Statements (AS 21)

xiii. Investments in Associates etc (AS 23)

xiv. Cash Flow Statements (AS 3)

xv. Discontinuing Operation (AS 24)

xvi. Interim Financial Reporting (AS 25)

xvii. Impairment of Assets (AS 28)

xviii. Financial Reporting of interest in Joint Venture (AS 27)

Till Date 28 AS have been issued. Of these AS enlisted as basic are Mandatory and should complied by every enterprise to whom these AS apply. The remaining AS, should be complied if there are transactions or events effected by the enterprise.

c) Statutory Requirements

Certain categories of enterprises are governed or represented by specific laws. These laws specify the provision relating to certain transactions or contracts as also form and requirements for the preparation and presentation of Final Accounts. Some such institutions are -

Companies Act - for Companies

Partnership Act - for Partnership Firm

Bombay Public Trust Act - for Trusts, Associations & Societies.

Maharashtra State Co-operative Societies Act - for Co-operative Societies

Banking Regulation Act - for Banks

Each of these laws require that the final Accounts prepared under these laws should

i. Be in form prescribed under law.

ii. Disclose the information required.

d) Forms of Presentation of Final Accounts

The final Accounts can be presented in convenient form. These are: -

i. Horizontal Form or T form showing Debits, Credits, Assets & Liabilities as two sides of the statements this is also traditional or account form.

ii. Vertical or Columnar form which shows all items as a single column after netting or setting off certain related items.

The form in which accounts should be presented if the form prescribed under the law. Where the law specify alternative form with options or such form is not specified the Final Accounts can be presented in any convenient form. The present syllabus requires the study of preparation and presentation of Final accounts of Companies governed under Companies Act.

Schedule vi of company's act :

The Companies Act 1956 contains elaborate provision for: -

i. Form of Balance Sheet.

ii. Requirement as to Profit & Loss A/c.

iii. Information to be disclosed in Final Accounts.

These requirements are specified in schedule W to the Companies Act.

Schedule VI is divided into 3 parts:

Part I - Balance Sheet

This part specifies the form of Balance sheet and information to be disclosed for every item therein.

Part II – Requirements as to profit & Loss A/c Specifying the matters or items to be shown separately.

Part III - Interpretation of certain terms.

The schedule VI enables the companies to present its accounts in horizontal or vertical form as K may consider appropriate. The schedule also indicates both the forms and

presentation as also the sequence in which these items should be enlisted. The choice of the form is with the company.

However present trend is to present statements in vertical form, supported by schedule to furnish other informal required to be disclosed.

The present syllabus required the study only on Horizontal form only.

The company Act also contains provision for maintenance of books of accounts and the method of accounting to be adopted. As now present provision.

The companies should maintain account as per actual method of according all items of incomes and expenses, gains or losses are should be included on accrual basis. This implies maturing costs and revenue with five periods.

The provisions of schedule VI - as per Vertical from of presentation are as mentioned: -

i. Corresponding figures for immediately preceding previous year should be stated. However in the case of first year after incorporation of company. This is not applicable.

ii. The figures for major group or heading be shows in statement. This can be supplemented by schedule to give the detail and other information required to be disclosed as per provision of schedule vi.

iii. Significant Accounting policies adopted for preparation and presentation of statement of accounts should be shown separately under a different schedule.

iv. The statement should be signed or authenticated at least by two Director and Secretary.

v. The final statement of accounts must accompanied by report of Director and Auditor.

vi. The final accounts as well as report of directors and auditor should be placed before and approved by meeting of shareholder at the annual general meeting.

BALANCE SHEET AS PER SCHEDULE VI :

The form of final accounts and the information to be disclosed are as under:

HORIZONTAL FORM OF BALANCE SHEET

Schedule VI part I

(see sec. 211)

A - HORIZONTAL FORM OF BALANCE SHEET

Balance sheet of ......(Here enter the name of the company) as at .... (Here enter the date as at which the balance sheet is made out)

Figures for the Previous year Rs.	Liabilities	Figures for the current year Rs.	Figures for the previous year Rs.	Assets	Figures for the current year Rs.
	1. Share Capital 2. Reserves and surplus 3. Secured Loans 4. Unsecured Loans 5. Current Liabilities and Provisions			1. Fixed Assets 2. Investments 3. Current Assets, Loans and Advances (a) Current Assets (b) Loans and Advances 4. Miscellaneous	

	(a) Current Liabilities (b) Provisions			Expenditure 5. Profit and Loss A/c	

Note: A footnote to the Balance Sheet may be added to show the contingent liabilities.

The format of the detailed Balance Sheet of a company in a horizontal form is given below:

FORMAT OF THE DETAILED BALANCE SHEET IN A HORIZONTAL FORM

Horizontal Form of Balance Sheet

Balance Sheet of..... (Name of the company) as on.....

Figures for the Previous year Rs.	Liabilities	Figures for the current year Rs.	Figures for the previous year Rs.	Assets	Figures for the current year Rs.

	Share Capital:			Fixed Assets:	
	Authorised			Goodwill	
	…shares of Rs…each			Land	
	Preference			Building	
	Equity			Leasehold Premises	
	Issued :			Railway Sidings	
	…shares of Rs…each			Plant and Machinery	
	Preference			Furniture	
	Equity			Patents and Trademarks	
	Less: Calls Unpaid:			Live stock	
	Add: Forfeited			Vehicles	
	Shares			Investments:	
	Reserves and			Government or Trust Securities,	
	Surplus:			Shares, Debentures, Bonds	
	Capital Reserve			Current Assets, Loans and Advances:	
	Capital Redemption			(A) Current Assets:	
	Reserve			Interest Accrued on investments	
	Securities Premium			Stores and Spare parts	
	Other Reserves			Loose Tools	
	Profit and Loss Account			Stock in Trade	
	Secured Loans:			Work in Progress	

	Debentures Loans and Advance from Banks Loans and Advances from subsidiary Companies Other Loans and Advances Unsecured Loans: Fixed Deposits Loans and Advances from subsidiary companies Short Term Loans and Advances Other Loans and Advances Current Liabilities and Provisions: A. Current Liabilities Acceptances Sundry Creditors Outstanding Expenses B. Provisions: For Taxation			Sundry Debtors Cash and Bank balances (B) Loans and Advances: Advances and Loans to Subsidiaries Bills Receivable Advance Payments and unexpired discounts Miscellaneous - Expenditure: Preliminary Expenses Discount on Issue of Shares and Other Deferred Expenses Profit and Loss Account (debit Balance: if any)	

	For Dividends For Contingencies For Provident Fund Schemes For Insurance, Pension and Other similar benefits				

General instructions for preparation of balance sheet:

a) The information required to be given under any of the items or sub items in this form, if it cannot be conveniently included in balance sheet itself, shall be furnished in a separate schedule or schedule to be annexed to and to form part of the balance sheet. This is recommended when items are numerous.

b) Naye paise can also be given in addition to Rupees, if desired.

c) In the case of *[subsidiary companies] the number of shares held by the holding company as well as by the ultimate holding company and its subsidiaries must be separately stated.

The auditor is not required to certify the correctness of such shareholdings as certified by the management.

[(CC) The item 'Securities Premium Account' shall include details of its utilization in the manner provided in section 78 in the year of utilization]

d) Short - item loan will include those which are due for not more than one year as at the date of the balance sheet.

e) Depreciation written off or provided shall be allocated under the different asset heads and deducted in arriving at the value of fixed assets.

f) Dividends declared by subsidiary companies after the date of the balance sheet *[should] not be included unless they are in respect of period which closed on or before the date of the balance sheet.

g) Any reference to benefits expected from contracts to the extent not executed shall not be made in the balance sheet but shall be made in the Board's report.

h) The debit balance in the profit and loss Account shall be shown as a deduction from the uncommitted reserves if any.

i) As regards loans and advances, (1) [the amounts due from other companies under the same management within the meaning of sub-section (1B) of the section 370 should also be given with the names of the companies] the maximum amount due from every one of these at any time during the year must be shown.

j) Particulars of any redeemed debentures which the company has power to issue should be given.

k) Where any of the company's debentures are held by a nominee or a trustee for the company, the nominal amount of the debentures and the amount at which they are stated in the books of the company shall be stated.

l) A statement of investment (whether shown under investment or under current assets as stock-in-trade) separately classifying trade investments and other investments should be annexed to the balance sheet, showing the names of the bodies corporate (indicating separately the names of the bodies corporate under the same management) in whose shares or debentures, investments have been made (including all investments, whether existing or not, made subsequent to the date as at which the previous balance sheet was made out) and the nature and extent of the investment so made in each such body corporate; provided that in the case of an investment company, that is to say, a company whose principal business is the acquisition of shares, stock, debentures or other securities, it shall be sufficient if the statement shows only the investments existing on the date as at which the balance sheet has been made out. In regard to the investments in capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner), shall be given in the statement.]

m) If in the opinion of the Board, any of the current assets, loans and advances have not a value on realization in the ordinary course of business at least equal to the amount at which they are stated, the fact that the Board is of that opinion shall be stated.

n) Except in the case of the first balance sheet laid before the company after the commencement of the Act, the corresponding amounts for the immediately preceding financial year for all items shown in the balance sheet shall be also given in the balance sheet. The requirement in this behalf shall, in the case of companies preparing quarterly or half-yearly accounts etc, relate to the balance sheet for the corresponding date in the previous year.

o) The amounts to be shown under Sundry debtors shall include the amounts due in respect of goods sold or services rendered or in respect of other contractual obligations but shall not include the amounts which are in the nature of loans or advances.

1. Substituted by notification no. GSR 414, dated 21-3-1961.
2. Inserted, ibid.
3. Substituted by notification no. GSR 494 (E), dated 30-10-1973.

p) Current accounts with directors, [managing agents, secretaries and treasurers] and manager, whether they are in credit, or debit, shall be shown separately.

q) A small scale industrial undertaking has the same meaning as assigned to it under clause (i) of section 3 of the industries development and regulation Act 1951.

VERTICAL FORM OF BALANCE SHEET

Part 1 - VERTICAL FORM OF BALANCE SHEET

B. VERTICAL FORM

Name of the company...........

Balance Sheet as at............

	Schedule No.	Figures as at the end of current financial year	Figures as at the end of previous financial year
I. Sources of Funds (1) Shareholders' funds: (a) Capital (b) Reserve and surplus (2) Loan funds: (a) Secured loans (b) Unsecured loans			
TOTAL II. Application of funds (1) Fixed assets: (a) Gross block (b) Less: Depreciation (c) Net block (d) Capital work-in-progress (2) Investments (3) Current assets, loans and advance (a) Inventories (b) Sundry debtors (c) Cash and bank balances (d) Other current assets (e) Loans and advances Less: Current liabilities and provisions: (a) Liabilities (b) Provisions (4) (a) Miscellaneous expenditure to the extent not written off or adjusted			

(b) Profit and loss account TOTAL			

Notes: (1) Details under each of the above items shall be given in separate schedules. The schedules shall incorporate all the information required to be given under part 1A of the Schedule VI read with notes containing general instructions for preparation of Balance sheet.

(2) The schedules, referred to above, accounting policies And explanatory notes that may be attached shall form an integral part of the balance sheet.
Substituted by notification no. GSR 414, dated 21-3-1961
Inserted by Notification No. GSR 129 (E), dated 22-2-1999
Inserted by Notification No GSR 220(E), dated 12-3-1979

INCOME STATEMENT OR PROFIT AND LOSS ACCOUNT :

The Companies Act 1956, does not prescribe any format for the profit and Loss A/c, it is left to individual companies to choose the format which is appropriate. However, part II of schedule VI of companies Act lays down certain requirements which every company must comply. Every profit and loss A/c should satisfy the following requirements of disclosure. They are as under:

ITEMS TO BE DISCLOSED SEPERATELY IN PROFIT
AND LOSS ACOUNT AS REQUIRED BY PART - II OF SCHEDULE - VI

............................Ltd.

PROFIT AND LOSS A/C

For the year ended------------

Schedule	current year	Previous year
INCOME Sales		

Other income Increase / Decrease in work in progress/stock of Finished goods		
Total		
Expenditure Cost of raw materials and spares Excise duty Employees remuneration and benefits Other expenses Interest Depreciation		
Total		
PROFIT BEFORE TAXATION AND EXTRA ORDINARY ITEMS: Extraordinary item PROFIT FOR THE CURRENT YEAR Prior period adjustments PROFIT BEFORE TAXATION Provision for taxation PROFIT AFTER TAX Balance BIF from the previous year		
TOTAL AVAILAEILE FOR APPROPRIATIONS		
APPROPRIATIONS Proposed dividend Corporate dividend tax General reserve Any other statutory reserves BALANCE CIF TO NEXT YEAR		
TOTAL		

1. The profit and loss account shall disclose every material future, including credits or receipts and debits or expenses in respect of non recurring or exceptional transactions.

2. Items of income

a) Turnover: Aggregate amount of sales, amount and quantity of sales of each class of goods separately. (In case of service companies' gross income derived from services).

b) i) Income from investments distinguishing between trade investments and other investments.

ii) Other income by way of interest specifying nature of income.

iii) TDs should be deducted in above two cases.

c) i) Profits or losses on investments (showing distinctly the profits or losses from a partnership firm).

ii) Profits or losses in respect of transactions of a kind, not usually undertaken by the company, if material.

iii) Amount of material by which any items shown in profit and loss account are affected by any change in basis of accounting.

iv) Miscellaneous income.

d) Dividend from subsidiary companies.

3. Expense

i) Commission paid to sole selling agents (within the meaning of S.294)

ii) Commission paid to other selling agents.

iii) Brokerage and discount on sales (other than trade discount)

In case of manufacturing companies:

Item wise breakup of value and quantity of all important basic raw materials consumed. (Items valuing 10% or more of the total value of the raw valuing 10% or more of the total value of the raw material consumed shall be shown as a separate item).

Value and quantity of opening and closing stocks of each class of goods produced.

Work-in-progress at the commencement and at the end of the accounting period.

In case of trading companies:

Value and quantity of purchases, opening and closing stocks each class of goods. (Items valuing 10% or more of the total value of the purchases, stocks or turnover, shall be shown as a separate item).

i) Consumption of stores and spare parts

ii) Power and Fuel

iii) Rent

iv) Repairs to building

v) Repairs to machinery

vi) 1) Salaries, wages and bonus

2) Contribution to other bonus

3) Workmen and staff welfare expenses

vii) Insurance

viii) Rates and taxes, excluding taxes on income.

xi) Miscellaneous expenses, [Expenses totaling 1% of the total revenue of the company of Rs. 5,000 whichever is higher shall be shown as a separate item)

4. Depreciation, renewals or diminution in the value of fixed assets. (If no provision is made, the fact and the quantum or arrears of depreciation u/s 205 (2) to be disclosed.

5. Interest on debentures and other fixed loans, showing separately amount paid / payable to the Managing Director, Manager.

6. Donations to political parties, giving name of party / person.

7. Income tax.

8. Dividends paid and proposed stating that it is subject to deduction of tax.

9. Provision for losses of subsidiary companies.

10. Amounts reserved for repayment of share capital / loans.

11. i) Amount set aside to reserves, and any amounts withdrawn from such reserves.

ii) Amount, if material, set aside to provision for meeting specific liabilities, contingencies, commitments and the amounts withdrawn from such provisions.

12. Payment to Directors including Managing Directors, Manager, if any by the company, subsidiary of the company and any other person for following.

a) Managerial remuneration u/s 198.

b) Other allowance and commission including guarantee commission (details to be given)

c) Any other perquisite or benefits in cash or in kind. (Stating approximate money value where practicable).

d) Pension, gratuities, payments from provident funds, in excess of own subscription and interest thereon, compensation for loss of office, retirement consideration etc.

13. Computation of net profit u/s 349, with details of the commission payable as percentage of profits to the directors including Managing Directors, Manager (if any).

14. Payments to the Auditors (Whether as fees, expenses or otherwise for services rendered.

a) As auditor

b) As advisor, or in any other capacity, in respect of

i) Taxation matters.

ii) Company law matters.

iii) Management services and

c) In any other manner.

15. In case of manufacturing cmpanys., in respect of each class of goods manufactured, detailed quantitative information in
regards to -

a) The licensed capacity (where license is in force as on the last date of the year)
b) The installed capacity and
c) The actual production

16. Following information to be included by way of note:
a) Value of imports on C.I.F. basis in respect of (i) raw materials (ii) components and spare parts (iii) capital goods.
b) Expenditure in foreign currency for royalty, know-how, professional and consultation fees, interest and other matters.
c) Value of imported raw materials, spare parts and components consumed; value of indigenous raw materials, spare parts and components consumed; and percentage of
each to total consumption.
d) Dividends remitted in foreign currencies; number of non-resident shareholders; number of shares held by them on which dividends are due and the year to which dividends relate.
e) Earnings in foreign exchange, namely
(i) Exports (F.O.B. basis); (ii) royalty, know-how, professional and consultancy fees; (iii) interest and dividend (iv) other income, indicating the nature thereof.

Adjustment specifically applicable to Companies:

As stated earlier the final accounts of Companies, should be in compliance with the statutory provision of the Companies Act.

Such adjustments are: -

1. Managerial remuneration.
2. Provision for income tax (incl. minimum alternate tax)
3. Accounting for assessment of income tax.

4. Transfer to reserve, out of current year profit
5. Proposal of dividend-
6. Dividend distribution tax.
7. Issue of shares without consideration i.e. Capitalization of Reserve and issue of bonus shares.
8. Issue of shares, for non cash consideration

1. Managerial remuneration.

The remuneration to managerial personnel is payable as per term by the company and approved by the company law/registrar of companies.

This consist of (1) Salary, (2) Perquisites and (3) Commission as a percentage on profit or turnover. The schedules XIII to companies Act specify the mode or remuneration and monetary limit.

Where the remuneration is stated as percentage on profit or turnover the care should be taken too uncertain whether percentage is before or after applying the limit.

The amount so calculated, should be provided for to the extent not included in trial balance. Corresponding the same should be shown as current liability.

2. Advance Tax / Tax deducted at source as income

a) Payer of certain amount is required to deduct amount as income tax from payment to be made. The amount so deducted is to be treated as tax paid. The receiver receives net amount. The entry should be passed Tax Deducted at source (TDS) to income.

b The is required to estimate the tax payable on current income and pay the amount is through instalments before end of financial year. The entry to be passed is.

Advance Tax Dr.

To bank A/c

3. Provision for income tax (incl. minimum alternative Tax).

Income tax payable as percentage on profit currently for year ending 31-3-2003, income tax is payable @ 35 on taxable income.The provision should be made at above percentage or other information may be given. The entry would be: -

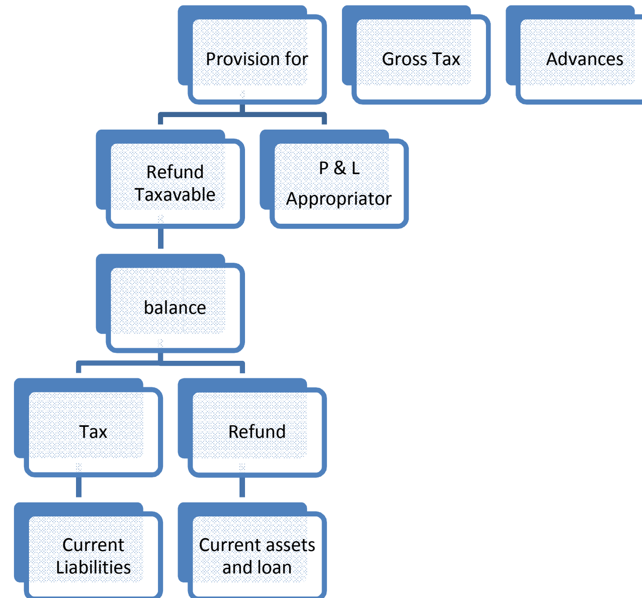
Profit & loss A/c Dr.
To provision for income tax

NOTE: As per accounting standard 22, deducting with income tax, advance tax, TDS and provision for income tax should be shown as net balance. If net amount is debit, then show under heading loan & advance. And if it is credit show it as current liabilities.

4. Completion of assessment.

The liability for income tax is determined by income tax officer after completion of assessment. On receipt of assessment order gross amount liability should be composed with (i) Advance tax & TDS difference would be refund or tax payable. This should be shown as current asset or current liability. And (II) provision for income tax- the difference should be shown as profit & loss

appropriation account as prior period items.



5. Assessment under dispute.

After receipt of assessment order, the company has right to file an appeal and challenge the order. If the assessment is disputed the balance sheet should disclose advance tax and provision for that year till the disposal of the matter. The information of amount of tax subject to appeal should be shown as contingent liability.

6. Corporate dividend tax

As per the finance bill 1997, a provision was introduced regarding payment of tax by the company and therefore, dividend received by the share holder was not taxable. The dividend tax should be treated as appropriation of profit as it is payable on amount do dividend declared which is an appropriation of profit. This tax is an addition to income tax on profits of the company. The rate laid down by the finance Act, 2001 w.e.f. 1-6-2001 is 10% with a surcharge of 2%, making an effective rate of 10.2%. This tax rate is applicable for the year endeding 31.3.2002 it is addition to the proposed rate of dividend.For the year ending 31st March 2003, corporate dividend tax is not is force.

While solving a problem, this adjustment should be shown, if specifically required.

7. Provision for the dividend

Dividends refer to the amount of the profit distributed among the shareholder. Preference shareholders are entitled to get dividend at the fixed rate. Preference dividend is paid before payment of the equity dividend.

If proposed dividend on equity capital is specified, the dividend on preference share capital at a given rate should be added to the amount proposed dividend.

Interim dividend: -

It is declared between two annual general meetings. It does not require approval of the shareholder. The amount of interim dividend is shown as debit profit & loss appropriation A/c Final dividend:

It is the dividend proposed by the directors and declared by the shareholders in the annual general meeting. Companies are required to pay dividend within 42 days from the date of declaration. After expiry of the period, the unpaid dividend is transferred to unpaid dividend bank A/c which is to be transferred to "Investors education & protection fund A/c".

8. Transfer to reserves

As per the rules framed under the companies Act, companies are required to transfer certain percentages of their profit after tax to reserves to declare dividend out of current year's profit which is arrived at after making necessary provision for depreciation as required by the section 205 of the companies Act, 1956. The various rates of transfer based on the rate of dividend are as follows:

Rate of dividend	Transfer to reserves
Exceeds 10% but not 12½% of the paid capital. Exceeds 12.5% but not 15% of the paid up capital.	2½% of the current profit 5% of the current profit 7½% of the current profit 10% of the current profit

Exceeds 15% but not 20% of the paid up capital. Exceeds 20%	

9. Interest on debentures

Interest for the full period for which the accounts are prepared or for which the debentures have been outstanding during such period should be provided for.

10. Issue of bonus share.

Sometimes the company may not be in the position to pay cash dividend inspire of adequate profit due to adverse effect on working capital position. Prudent companies, later on issue bonus shares to the existing equity shareholders. Such shares are issued as per guidelines issued by the SEBI. Issue of bonus shares refers to conversion of reserves into share capital. Following two entries are passed.

1. Profit and loss A/c Dr.
General reserve A/c Dr.
Securities Premium A/c Dr.
Capital redemption reserves A/c Dr.
To bonus to equity shareholder A/c

2. Bonus to equity shareholder A/c Dr.
To equity share capital A/c
To securities premium A/c (if any)

The fact regarding issue of bonus shares should be disclosed in the balance sheet in schedule on share capital. Numbers of bonus share and the sum of bonus should be disclosed.

11. Tax deduction on payments (T.D.S. payable)

Some of the payments to be made by the company are subject to deduction of income tax. The person making such payment have to pay tax at applicable rate and balance to the person entitled thereto.

Some of the items covered are interest, dividend. There are other items also subject to similar condition. The rate of tax to such is 10.2% for the years ended 31-3-2002 item.

When a provision for such payment is required. The amount is current liabilities should be split in two parts as under:

12. Depreciation:

Section 205 (2) lays down that depreciation should be provided to the extent specified by section 350 i.e. at the rates specified in schedule XIV on reducing balance or straight line method. The schedule specify rate of depreciation on various assets. Depreciation is to be provided on Prorata period rate.

The law does not make it compulsory for a company to provide for depreciation on fixed assets. However, it provides that dividend cannot be declared without providing depreciation for previous and current year.

13. Profit on revaluation of fixed assets:

A company may fix assets for various purposes. Any profit on revolution should be accounted as follows:

Assets A/c Dr.
To capital reserve A/c

It should be added to fixed assets in the schedule and added to capital reserve in a schedule of 'Reserves and surplus'.

14. Special points to be considered:

At the time of giving effect to various adjustments, in the process of preparing final account, following points should be given special consideration:

1. Depreciation at a specified percentage as per the specified method should be computed to adjustments regarding purchase of asset, sale of assets or commission relating to fixed assets.

2. Provision for bad and doughtful debts specified rate should be computed on debtors balance after giving effect to the other adjustments regarding debtors. Such as additional bad debts, goods sent to customers on approval etc.

3. Provision for discount on debtors should be computed on the amount of debtors remaining after providing for bad and doughtful debts.

4. Provision for incomes / expenses as per accrual method should be made for full period where information is available directly or indirectly.

5. The interest on loans or debentures should be separated in balance sheet.
Accrual but not be - Current liabilities
Accrued and due - add to loan

6. Provision for the income tax should be made at specified rate on the net profit after charging all the expenses including managerial remuneration managerial remuneration may be as a certain percentage of net profit. If the provision for the both managerial remuneration and income tax is required to be made, firstly managerial remuneration should be provided and then on the remain in profit, provision for income tax should be made.

7. When dividend on equity share capital is declared, effect should be given for.
i) Dividend on preference share capital at state percentage.
ii) Transfer of profit to reserve.
iii) Dividend tax

ACCOUNTING STANDARD-I :

Disclosure of Accounting policies

This AS deals with different accounting policies to be adopted by the concern in the preparation and presentation of financial statements and its disclosure in the such statement. In view of diverse according policies; disclosure of policies adopted is necessary for proper appreciation of statements. The purpose of AS is to promote better understanding of statements by establishing the disclosure of significant accounting policies.

For this AS:

I] Fundamental accounting assumptions undertaking the preparation and presentation of statements. If these are followed, no disclosure is required. These assumptions are.

a) Going concern: An enterprise will continue in operation for foreseeable future. The liquidation or material curtailment of operation is neither necessary nor intended.

b) Consistency in policies from one period to another period particularly where the different alternatives are generally accepted in given situation.

c) Accrual of revenue and costs is the basis of recognition thereof.

II] Considerations in selection of accounting policies. Prime consideration is to enable representation of true and fair view of statement of affairs and profit or loss. Major considerations for them are:

a) Prudence - i.e. conservatism concept
b) Substance over legal term of transaction & events.
c) Materiality - Material item are those items the knowledge of which might influence the decisions of user of statements.

d) Statutory or legal requirements, as applicable to the entity.

III] The AS gives illustrative list of areas where different policies might be adopted by different enterprises. Some areas are:

i) Depreciation & amortization - re: method, period, rate
ii) Expenditure during construction.
iii) Translation of foreign currency item.
iv) Valuation of inventories.
v) Valuation of investments / Goodwill / Fixed assets.
vi) Profits on long-term contracts.
vii) Contingent liabilities.
viii) Retirement benefits.
ix) Method of accounting - accrual / cash

The ASB had issued separate AS for these items.

Disclosure:

AS is to promote better understanding of statements by establishing the disclosure of significant accounting policies.

For this AS:

I] Fundamental accounting assumptions undertaking the preparation and presentation of statements. If these are followed, no disclosure is required. These assumptions are.

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ii) Expenditure during construction.

iii) Translation of foreign currency item.

iv) Valuation of inventories.

v) Valuation of investments / Goodwill / Fixed assets.

vi) Profits on long-term contracts.

vii) Contingent liabilities.

viii) Retirement benefits.

ix) Method of accounting - accrual / cash

The ASB had issued separate AS for these items.

Disclosure:

- All significant accounting policies adopted should be disclosed so as to form part of financial statements.
- Any change in policy, which has a material effect, should be disclosed together with monetary effect of such change (Rs. AS 5)
- If fundamental assumptions are not followed or applicable, the fact should be disclosed.

HOLDING COMPANIES ACCOUNTS (EXCLUDING CROSS HOLDING)

1.1 Introduction

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

1.2 Meaning under companies act 1956

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

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

i) Where the first mentioned company is an existing company in respect of which the holders of Preference shares issued before the commencement of this Act have the same voting

rights in all respect as the holders of Equity shares exercises or controls more than half of the total voting power of such company.

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

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

Advantages of holding companies

Following are the advantages of Holding Company:

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

Disadvantages of holding companies

1) There is a possibility of fraudulent manipulation of accounts.
2) Inter company transaction may not be at a fair prices.
3) Minority share holder's interest may not be properly protected.
4) The accounts of various companies may be made upon different dates to, manipulate profit or financial position of Group companies.

5) The shareholders in the holding company may not be aware of true financial position of subsidiary company.
6) Creditors and outsiders shareholder in the subsidiary company may not be aware of true financial position of subsidiary company.
7) The Subsidiary Companies may be force to appoint person of the choice of holding company such as Auditors, Directors other officers etc. at in dually high remuneration.
8) The Subsidiary Company may be force for purchases or sale of goods, certain assets etc. as per direction of holding company.

1.5 Presentation of accounts by holding companies

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

a) A copy of the Balance Sheet of the subsidiary.
b) A copy of the Profit and Loss Account of the subsidiary.
c) A copy of the Report of the Board of Directors of the subsidiary.
d) A copy of the Auditors Report of subsidiary.
e) A statement indicating the extent of holding company's interest in the subsidiary at the end of the accounting year of the subsidiary.
f) Where the financial year of the subsidiary company does not coincident with the financial year of the holding company. A statement showing the following.

i) Whether there are any changes in holding companies interest in subsidiary company since the close of financial year of the subsidiary company.
ii) Details of material changes which have occurred between the end of the financial year or the subsidiary company an end of the financial year of the holding company.

1.6 AS. 21 – Consolidation of Financial statement

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

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

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

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

1.7 Consolidation of balance sheet

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

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

1) Share of holding company and share of minority (outside shareholders).
2) Date of Balance sheet of holding company and that of various subsidiary companies must be same. If they are not so necessary adjustment must be made before consolidation.
3) Date of Acquisition of control in subsidiary companies.

4) Intercompany owing.

5) Revaluation of fixed assets as on date of acquisition, depreciation, adjustment on revaluation amount etc. which are discussed here in after.

Cost of control / goodwill / capital reserve:

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

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

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

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

Minority interest:

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

Thus, minority interest is the share of outsider in the following.

1) Share in share capital in subsidiary.
2) Share in reserves (Both pre and post acquisition of subsidiary).
3) Share in accumulated losses should be deducted.
4) Proportionate share of profit or loss on revaluation of assets.
5) Preference share capital of subsidiary company held by outsiders and dividend due on such share capital, if there are profits.

Minority interest means outsiders interest. It is treated as liability and shown in consolidated. Balance sheet as current liability. This amount is basically intrinsic value of shares held by minority.

Capital profits and revenue profits:

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

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

Elimination of investments in shares of subsidiary company:

Investment in shares in subsidiary company represents the cost paid by the holding company to acquire the shares of the subsidiary company. The investment in shares of the subsidiary

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

Consolidated profit and loss account

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

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

1) Prepare profit and loss account in columnar form Amounts relating to intercompany transactions are entered in the adjustment column against the respective items and are Subtracted while entering amounts in the total columns.
2) All inter company operating transactions are eliminated such as purchase and sale of goods, interest on loans among the group companies.
3) All inter company profits are adjusted.
4) Dividends received from the subsidiary company by the holding company should be eliminated from both the sides of consolidated profit and loss account.
5) Interest accrued and outstanding on Debenture of the subsidiary company held by the holding company should be accounted by holding and subsidiary company both and then its should be eliminated.
6) Readjustment of Depreciation on Revaluation on fixed Assets at the time of acquisition of shares by the holding company should be adjusted in consolidated balance sheet and respective fixed assets and in the consolidated profit and loss account.

7) The minority interest in the profit of subsidiary company should be transferred minority interest account, in the proportion of total profit after adjustment of revaluation of fixed Assets, but before adjusting unrealized profit on stock.
8) The share of holding company in pre-acquisition profit should be transferred to cost of control, in case shares are acquired during the year.
9) Share of holding company in the past acquisition profits shall be considered as revenue profits.
10) The balance in holding company columns will represents the total profit or loss made or suffered by the group as a whole.

VALUATION OF GOODWILL

Goodwill means the reputation of a Business concern which enables businessmen to earn extra profit, as compared to other concern. Goodwill means various advantages of reputation and connections of a business.

Mr. Kohler defines goodwill as "the current value of expected future income in excess or normal return on the investment in net tangible assets:"

Need for valuation

The need for valuation of goodwill depends on the form of a business organisation. The circumstances in which the goodwill is valued are given below.

Form of Business Organisation	Need for valuation
1. Sole proprietor	Sale of business
2.Partnership firm	Conversion into partners Admission of partner Retirement / Death of partner Change in profit sharing ratio Amalgamation of firm Dissolution on account of sale of business.

3 Company	Conversion into Private /public Limited company. Mergers / Acquisitions of business Transfer of controlling block of shares Sale of Business Conversion of one class of shares into another.

Factors affecting goodwill:

A firm may earn more profits than other firms in the same type of industry because of numerous factors some of which are stated below:

Sr. No.	Main Factors	Sub factors
1.	I Managerial and Human Resource Factors	Superior Management team • Superb Organisation • Exclusive Training programmes for employees. • Co-ordinal labour relationship. • Discovery of talent. • Experienced work force • Long standing experience
2.	II Product / Service Factors	Secretor patent manufacturing • Exclusive know-how

		• Economies of scale of production • Foreign collaboration • Quality and reliability
3.	III Marketing Factors	• Effective advertisement • Market dominance • Favourable attitude of customers • Adequate selling outlets • Adequate service centres • Established list of customers • Exclusive selling arrangements
4.	IV Physical factors	• Strategic location • Availability of raw material • Exclusive infrastructural facilities • Adequate input availability like power, man power etc.
5.	V Fiscal Factors	• Cost saving • Cost of financing • Tax exemptions / deduction benefits • Good credit rating
6.	VI Other Factors	• Good public image • Favourable Government regulations • Good relationship with suppliers

Characteristics of goodwill :

1. It is an intangible or invisible asset.
2. It's value is not fixed. It is subject to fluctuation due to internal as well as external factors in value.
3. It can not valued in isolation.
4. Its valuation is attached to the total value of the business.
5. It has value only on going concern basis.
6. It is either created internally or purchased from outside.
7. Because off Goodwill a firm is able to earn excess profits than the other firms in the same class of business.
8. value of Goodwill may differ due to different method used. In certain cases it is not transferable.

Need for valuation of Goodwill :

In case of partnership firm the necessity of valuating goodwill arises in connection with the following. Whenever there is change in constitution of the business and partnership deed.

1. When there is a change in the profit-sharing ratio among the partners.
2. When a new partner is admitted.
3. When a partner retires or dies and
4. When the firm sells it is business to a company or is amalgamated with another firm.

In case of joint stock company the necessity of valuation of goodwill arises in the following circumstances: -

1) When the business of the company is taken over by another company. e.g. amalgamations, absorptions, mergers.
2) When stock exchange quotations not being available, shares have to be valued for taxation purpose e.g. wealth tax etc.
3) When large stock of shares of the company have to be bought or sold.
4) When the management wants to write back goodwill, which was previously written off.

5) When the company is being taken over by the government.

Methods of valuation of Goodwill

• No. of years purchase of sales or gross fees

Under this method the purchaser usually professional firms, pays to the vendor the amount of goodwill, calculated on the basis of net sales or fees received during the particular period.
This method is very simple and suitable for valuation of goodwill of professional firms. The period for gross fees received or net sales are settled by agreement between buyer and vendor.

No. of years purchased method
Under this method net profit of past few years is worked out. Goodwill is valued either by adding the profit of post three years or by considering average trade net profit.

Goodwill = Average adjusted Trade net profit X no. of years purchase.

No. Of years of purchase of future maintainable profit

Under this method the profits which are likely to be earned in future over the certain period of time are first estimated. To arrive at Future Maintainable Profits (F.M.P.) past profits over the years, after adjusting non-recurring factors as well as expected future events which were not there in the past are also considered.

Goodwill = F. M. P. x No. of years purchase.

Super profit method

In this case the future maintainable profits of the firm are compared with the normal profits of the firm super profit is the excess OR the profit earned by firm over the normal profit earned by the concern. Super profit is excess of F. M. P. over normal profit.

Super Profit = F. M. P. – Normal profit.

Normal Profit

It is average profit earned by the similar concern in the industry. It is decided on the basis of average capital employed and normal rate of return expected by the investors on capital employed.

Normal profit = Average Capital Employed X NRR/ 100

Methods of valuation of goodwill under super profit

1) Purchase OR Super Profit Method

Goodwill = Super profit x no. of years purchase

Under this method the no. of years of purchase will differ from industry to industry and from firm to firm.

2) Capitalization of super profit

Under this method the amount of super profit is capitalized at the normal rate of return. This method tries to find out the amount of capital required for earning the super profit.

$$\text{Goodwill} = \frac{\text{super profit}}{\text{N.R.R.}} \times 100$$

3) Sliding scale of valuation of super profit

This method is the variation of the purchased method. It is based on assumption that the greater amount OR super profit, the more difficult it in future to maintain. If the super profit is greater more possibility of competition and therefore is difficult to maintain the same over the many years. In this method the super profit is divided in two or three divisions / slide each of this is multiplied by different no. of years purchase, descending order from the first division.

E.g. If super profit is estimated Rs. 75,000 goodwill be calculated as under:

	Rs.
First Rs. 25,000 say three years purchases (25,000 x 3)	75,000
Second Rs. 25,000 for two years purchases (25,000 x 2)	50,000
Third Rs. 25,000 one years purchases (25,000 x 1)	25,000
Goodwill	1,50,000

` 4) Annuity method of Super Profit

Annuity takes into consideration time value money. Payment of Goodwill is made immediately for Super Profit likely to be earned in future. Goodwill in this case is the discounted value of the Super Profit.

Goodwill = Super Profit x Reference to annuity table

5) Capitalisation of F. M. P. method

Under this method, goodwill is the excess of capitalize & value of F. M. P. over net tangible trading assets. Following are the steps to taken for valuating Goodwill under this method.

Step 1: Find out F. M. P. 100

Step 2: Capitalised value of F. M. P. = F. M. P.X ----------

Step 3: Net tangible Trading Assets NRR

Total Tangible Trading Assets x

Less : Third parties liabilities payable (x)

Net Tangible Trading Assets x

Step 4: Goodwill

= Capitalized value of F.M.P. - Net Tangible Trading Assets.

Note : The value of Goodwill remains the same in case of capitalization of super profit or capitalization of F. M. P.

VALUATION OF SHARE

Introduction

Share means share in a public or private Ltd. company. The shares of the private Ltd. Company are never quoted on stock Exchange. Also not all the public companies shares are quoted on the stock exchange. It's value cannot be easily ascertained. A public company may either be widely held or closely held. A closely held public company means a company having very few share holders. Each shareholder owing a substantial part of the share capital. A widely held public company means a company having large number of share holders spread over the entire country thus, it has innumerable share holders. Share of only such companies are quoted on one or more stock exchanges. The prices of such shares depend upon various factors like demand and supply, market sentiments etc.

Need for valuation of shares

Shares of a company are to be valued at different occasions as follows:

a) When shares of one class are to be converted into shares of another class.

b) When shareholders wants to take loan from financial institution against the security of shares hold by him.

c) When shares are to be transferred, bought or sold

d) When the companies are amalgamated absorbed merged or reconstructed.

e) When the Government wants to compensate the shareholders on the nationalization or the company.

f) Whenever there is a death of a shareholder and the distribution of shares held by him is to be made among the Legal heir offices.

Factors affecting share valuation

Following factors affects on the share value:

1) Nature of business.

2) Market conditions as regards the companies doing the similar business and existing competition.

3) Demand and supply of shares in recognized stock exchange.

4) Earning capacity of the company and growth prospectus.

5) Goodwill of the company.

6) Reputation of the management.

7) Anticipated legislature measures

8) General economic conditions and policies of the Government.

Methods of valuation of shares

Generally there are two types of shares:

a) Equity shares

b) Preference shares

Whenever there are preference shares and Equity shares,the Articles of Association must be referred for the purpose of finding out the respective rights of share holders.

Preference shareholders have priority as regards dividends and repayment of Capital. At the same time if Preference shares are participating, there value depends upon the share in supply as per Articles of Association. In such circumstances the valuation of Preference share is also important. Value of Equity shares depends upon whether they are quoted or unquoted.

In case of quoted shares the value should be as per the quoted in the recognized stock exchange. Primarily following are the methods of valuation of shares.

a) Intrinsic value
b) Yield value Basic
c) Fair value
d) Earning Capacity method
e) Capitalization of maintainable profits.

• Intrinsic value:

This is also called as "Net Assets Value" or "NAV" of Liquidation value or Breakup value or Asset Backing value. This method OR valuation is based on the assumption of liquidation of company. Here it is assumed that the company going into liquidation in near future. All the assets are sold and all the liabilities are paid of and then the remaining surplus is distribute among the Equity shareholders.

Steps to find the intrinsic value.

Step No. 1 – Find out amount available to Equity Shareholders .All Assets at current market value including goodwill. non trade investments but excluding fictitious assets.

Goodwill	xxx
Land and Building	xxx
Plant and Machinery	xxx
Furniture and Fixtures	xxx
Vehicles	xx

Trade and non trade investments	xxx	
Stock	xxx	
Debtors and Bills Receivable	xxx	
Cash and Bank Balances	xxx	
Loans Advances and prepaid expenses	xxx	
		xxx
Less : All liabilities at current values excluding		
share capital and Reserves and Surplus	xxx	
Debentures and Accrued Interest	xxx	
Long term loan	xxx	
Creditors and Bills payable	xxx	
Outstanding Expenses	xxx	
Proposed / unpaid Dividend	xxx	
Provision for Taxation	xxx	
Other liabilities payable	xxx	(xxx)
		xxx
Less : Dues to Preference shareholders	xxx	
Paid Preference share Capital	xxx	
Arrears of dividend (if any)	xxx	
Premium payable on redemption (if any)	xxx	(xxx)
Amount available to Equity shareholders		xxxx

Step No. II: Intrinsic Value per Equity share

a) If all the shares are fully paid up

=Amount available to equity shareholders/No. of equity share

Points to be remembered:

While calculating the net asset value the following points should be remembered.

1. Only market value of the assets should be considered. If market value is not given then the book value should be considered.
2. All assets recorded and unrecorded should be taken into account.
3. Goodwill also should be considered as per instruction of the problems.
4. Non trading assets should be considered.

Merits of intrinsic Value method:
1. it is very surfeit when the company is being liquidated.
2. It takes into account both types of Assets.
3. It is simple to use in valuation of different types of equity shares.

Demerits of Intrinsic Value Method:
1. It is difficult to estimate the realizable value of assets.
2. the assumption of liquidation is contradictory with the normal of assumption of going concern principal.
3. The value of goodwill is very much subjective.

• Yield value basis

This method of valuation is based on the assumption of going concern principal. Here it is assumed that the company shall carry on business profitability for many years to come. Therefore, value of shares is based on the amount or profit that would be available to Equity shareholders as dividend.

Steps to calculate yield value:

a) Find out Future maintainable Profit (F. M. P.) Same as in Goodwill Valuation

Add : back interest on Non-Trade Investment	XXX
Less :	
i. Transfer to Reserve as required under law	(XXX)
ii. Preference Dividend	(XXX)
F. M. P. available to Equity shareholders	XXX

b) Find out rate of F. M. P. =F.M. P./ Paid-up equity capital X 100

c) Yield Value = Rate of F.M. P./ N.R.R X Amt. Paid per share

ALTERNATIVELY

d) Capitalised value of F. M. P. = F.M.P./ N.R.R X 100

e) Yield Value = Capitalized Value of F.M. P./ No. of Equity shares

FAIR VALUE

This method takes into account both the above methods

$$\text{Fair Value} = \frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$$

Earning capacity value

Under this method, value of share is decided on earning capacity of the company:

Steps to calculate Earning capacity

a) Earning = Net profit after tax + Interest on long term loans.

b) Capital employed = Net Worth + Long Term loans

OR = Assets – Short Term liabilities

OR = Fixed Assets + Investment + Working Capital.

$$\text{c) Rate of Earning} = \frac{\text{Earning} \times 100}{\text{Capital Employed}}$$

d) Value per Equity Share

$$= \frac{\text{Rate of Earning}}{} \times \text{Paid-up value per Equity Share}$$

N.R.R.

CAPITALISATION OF F. M. P. METHOD

Under this method F. M. P. is capitalized at N. R. R. Steps to calculate value per share

a) Calculate F. M. P. available to Equity share holders

b) Capitalized value of F. M. P.

$$= \frac{\text{F.M. P}}{\text{N.R.R}} \times 100$$

c) Value per share

$$= \frac{\text{Capitalized value of F. M. P.}}{\text{Paid-up Equity Share Capital}} \times \text{Paid-up amount per Share}$$

Valuation of equity shares having different paid up value

Intrinsic value:

A company may have Equity shares of same face value, but in some cases shares may partly called up / paid up. For purpose of valuation a notional call equal to unpaid / uncalled amount on each category of equity shares, should be made to make all Equity shares fully paid up. Notional call amount should be added to net Assets available to equity shareholders.Total amount will be available to Equity Shareholders. when all shares are fully paid up value of Equity shares can be determine as under:

Net Assets available to Equity shares (As calculated earlier)

Add : Unpaid share capital

Add national call on partly called up shares, to make shares fully paid up

Net Assets available to Equity shareholders, when all shares are fully paid up xx

Total Amount

Value of full paid Equity shares =--------------------------------

Total No. of Equity shares

Value of partly paid up share

= Value of fully paid share – National call per share

OR

Value can be determined as under

[When no notional call is to be made]

Intrinsic value of an Equity Share

Amt. available to equity shareholders

---X Paid-up amt. of each class of Equity Share

Total paid-up Equity share capital

YIELD VALUE

For calculating yield value of Equity Share having different paid up value following procedure should be followed:

Step I

→

Calculate F. M. P. i.e. profit available for Equity dividend.

Step II

→ Calculate Rate of F. M. P.

$$= \frac{\text{F.M.P.}}{\text{Paid-up Equity Capital}} \times 100$$

$$\text{Yield Value} = \frac{\text{Rate of F.M.P.}}{\text{NRR}} \times \text{Paid-up value per Equity share}$$

UNIT-III

1.1 Amalgamation of Companies (excluding problems of amalgamation of inter-company holding)
1.2 Internal Reconstruction of Companies
1.3 Accounting involved in liquidation of companies

AMALGAMATION OF COMPANIES (EXCLUDING PROBLEMS OF AMALGAMATION OF INTER-COMPANY HOLDING)

Introduction :

Amalgamation means coming together of two or more limited companies for betterment of the business. It includes dissolution of one or more limited companies and formation of one new company. There can be three situations as below :

a) Amalgamation- Here one or more than one existing limited companies come together and form a new limited company to take over their business.
b) Absorption- Here one existing limited company takes over the business of another existing limited company
c) External reconstruction - Here one limited company is newly formed to take over the business of another existing limited company which is a loss making company.

The I.C.A.I has issued Accounting Standard 14 governing the procedure and accounting of Amalgamation of companies.

Accounting standard 14 issued by institute of chartered accounts of India :

i. Scope: Accounting Standard 14 [Accounting for Amalgamation], prescribed by the Institute of Chartered Accounts of India, deals with accounting for amalgamations.
The meaning and types of amalgamation, according to AS 14 are explained below.

ii. Amalgamation: Amalgamation means an amalgamation pursuant to the provision of the Companies Act, 1956 or any other statute which may be applicable to the Companies, Amalgamation involves acquisition of one company by another. After Amalgamation, the acquired company is dissolved and ceases to exist.

iii. Transferor Company: Transferor Company means the Company which a transferor another Company (vendor company).

iv. Transferee Company: Transferee Company means the Company into whicha transferor Company is amalgamated (purchasing company).

v. Types of Amalgamations : (discussed in detail below)

Types of amalgamation:

The Companies Act 1956 has not specifically defined the term "Amalgamation" However from several legal decisions, the definition of Amalgamation may be inferred. The Institute of Chartered Accountants has introduced Accounting Standard no.14 (AS-14) on Accounting for Amalgamations. The standard recognizes two types of Amalgamations.

(a) Amalgamation in the nature of merger.

(b) Amalgamation in the nature of purchase.

(a) Amalgamation in the nature of merger- Means which satisfies all the following conditions:

i. All the assets and liabilities of the transferor company are taken over by the transferee company.

ii. Shareholders holding not less than 90% of the face value of 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 of 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.

(b) Amalgamation in the nature of purchase If Amalgamation
does not satisfy any one of the above five conditions then it will be regarded as Amalgamation in the nature of purchase

Distinction between merger and purchase :

Merger	Purchase
1. Shareholders of the transferor company holding 90% of the face value of equity shares become shareholders of transferee company.	Shareholders of the transferor company may not become shareholders of transferee company.
2. There is a genuine polling of assets and liabilities of the amalgamating companies.	There is no genuine polling of assets and liabilities of the amalgamation companies
3. There is pooling of interest of shareholders also.	There may not be pooling of interest of shareholders
4. Values of assets and liabilities, reserves represent the same values of amalgamating companies.	l iabilities may be different than the amalgamating companies The values of assets and

Purchase consideration:

Meaning

Purchase Consideration is the sale price of the business agreed mutually between the two parties, the transferor company (selling company) and the transferee company (purchasing company). The AS 14 defines the Purchase Consideration as "the aggregate of the shares and other securities issue and payment made in the form of cash or otherwise by the transferee company to the "SHAREHOLDERS OF THE TRANSFEROR COMPANY". In other words any payment made to or in satisfaction of other liabilities should not be included in the amount of purchase consideration. If any payment is made to the creditors, debenture holders or any other liabilities, then it should be assumed that such liability is taken over by the transferee company and then it is settled by the transferee company. It should also be noted that liquidation expenses of the transferor company should not be included in the purchase consideration.

Methods of purchase consideration:

a. Lump-sum method: The problem may give the amount of purchase consideration directly and hence there will not be any need to calculate the purchase consideration.
e.g. Alka techno Ltd. agrees to take over business of WLC Ltd for a sum of Rs.10 lakhs.

b. Net Payment Method: If the purchase consideration is not given Lum-sum then this method should be adopted. Here the purchase consideration is arrived at by adding up cash paid and the agreed values of shares, securities issued by the transferee company to share holders of Transferor Company in discharge of the purchase consideration.
e.g. Reena Engineers Ltd. takes over business of Ramesh Kashyap Ltd. and agrees to pay the purchase consideration as follows:

issue of 10,000 equity shares of Rs.10 each at Rs. 12 each and cash Rs. 50,000.

Hence the purchase consideration would be Rs

10,000 equity shares of Rs.10 each at Rs. 12 each	1,20,000
Cash	50,000
Purchase consideration	1,70,000

c. Net Assets Method : If the purchase consideration can not be calculated by above two methods then this methods should be adopted. It is the aggregate of the assets taken over at agreed values less liabilities taken over at agreed values.

Assets taken over at agreed values,(excluding fictitious assets)	Rs.	Rs.
Goodwill	xx	
Land & Buildings	xx	
Plant & Machinery	xx	
Furniture & Fittings	xx	
Motor vehicles	xx	
Investments	xx	
Stock	xx	
Debtors	xx	
Cash & bank balances	xx	xxx
Less : Liabilities taken over at agreed value		
Creditors	xx	
Bills payables	xx	
Bank over draft	xx	
Debentures	xx	(xxx)
Purchase consideration		xxx

d. Exchange of shares Method / Intrinsic value Method:

Under this method the intrinsic value of the shares of both the companies is calculated and then the transferor company issue the shares to the transferee company on the basis of these values.

Accounting procedure in the books of Transferor Company:

Step 1. Open following Ledger Accounts

1. Realisation A/c
2. Equity Shareholders A/c
3. Preference Shareholders A/c
4. Cash/ Bank A/c
5. Liabilities not taken over A/c
6. Transferee company"s A/c
7. Equity Shares in transferee company A/c
8. Preference Shares in transferee company A/c

Step2. Pass following journal entries

1. Transfer all assets to realization A/c Whether taken over or not , at their book values.

Realisation A/c Dr. xx
To Sundry assets A/c Xx

Note: 1.Fictitious assets should not be transferred to realization A/c
2. Cash & bank balance should be transferred to realization A/c only if it taken over by the transferee company
3. Debtors and R.D.D should be treated as separate A/c. Debtors should be transferred at their gross value on debit side and R.D.D should be transferred on the credit side of realisation A/c
4. This entry closes all Assets A/c

2. Transfer all liabilities which are taken over by the transferee company to realization A/c, credit side

Sundry liabilities A/c Dr. xx

To Realisation A/c xx

3. Open separate A/c for Each liability not taken over and bring down the balance on the credit side.

4. Transfer Equity Share Capital and Reserves to Equity share holders A/c

Equity share Capital A/c Dr. x

Securities Premium A/c Dr. x

Capital Reserve A/c Dr. x

Capital Redemption Reserve A/c Dr. x

General Reserve A/c Dr. x

Profit & Loss A/c Dr. x

To Equity Shareholders A/c x

5. Transfer Preference Share Capital to Preference Shareholders A/c

Preference Share Capital A/c Dr. x

To Preference Shareholders A/c x

6. Record the sale of business Transferee Company A/c Dr. x

To Realisation A/c x

(with the amount of purchase Consideration)

7. Receive the amount of purchase consideration

Equity shares in transferee company A/c Dr x

Preference shares in transferee company A/c Dr. x

Cash/ Bank A/c Dr. x

To Transferee Company A/c x

8. Dispose off assets not taken over by the transferee company

Cash / Bank A/c Dr. Xx

To Realisation A/c Xx

(No separate entry is required for profit/ loss on this transaction it is automatically adjusted in realization A/c)

9. Discharge the liabilities not taken over by the Transferee company.

Liability A/c Dr. Xx

Realisation A/c (if loss) Dr. Xx

To Cash / Bank A/c xx

To Realisation A/c (if Profit) xx

10. Payment of realization Expenses Realisation A/c Dr. Xx

To Cash/ Bank A/c. Xx

11. Settle the claim of preference shareholders

Preference shareholders A/c. Dr. Xx

Realisation A/c. (if paid at premium) Dr. Xx

To preference Shares in transferee Co. A/c Xx

To Cash/ Bank A/c. Xx

To Realisation A/c. (if paid at discount) Xx

12. Balance the Realisation A/c. and transfer the profit / loss on Realisation to Equity Shareholders A/c.

a. If Profit

Realisation A/c Dr. Xx

To Equity shareholders A/c. Xx

OR

b. If loss

Equity shareholders A/c. Dr. Xx

To Realisation A/c. Xx

13. Close the Equity shareholders A/c.

Equity shareholders A/c. Dr. Xx

To Equity shares in transferee Co. A/c Xx

To Cash/ bank A/c Xx

Accounting procedure in the books of Transferee company :

Following Journal Entries are passed in the books of transfer company.

8.7.1 purchase method

1. Recording Purchase of Business Business Purchase A/c Dr. xx

To Liquidator of transferor company X

(The entry should be passed at purchase consideration amount.)

2. Recording of assets and liabilities taken over

Sundry assets A/c(With Agreed values) Dr. xx

Goodwill A/c (if any) Dr. xx

To Sundry Liabilities A/c X

To Business Purchase A/c Xx

To Capital Reserve A/c Xx

3. Recording Discharge of purchase consideration

Liquidator of transferor company A/c Dr. Xx

Discount on issue of shares A/c Dr. Xx

To Equity Share Capital A/c. XX

To Preference Share Capital A/c. XX

To Securities Premium A/c. Xx

4. Discharge of Liabilities of Transferor Company

Debentures of Transferor Company A/c Dr. Xx

Discount on issue of Debentures A/c Dr. Xx

To new Debentures A/c. XX

To Securities Premium A/c. Xx

5. Recording of payment of liquidation expenses

Capital Reserve/ Goodwill A/c. Dr. Xx

To Cash/Bank A/c. Xx

6. Recording of Expenses incurred by the transferee company for its own formation.

Preliminary Expenses A/c. Dr. Xx

To Cash / Bank A/c Xx

7. Recoding of Statutory Reserve of transferor company

Amalgamation adjustment A/c Dr. Xx

To Statutory Reserve A/c. XX

8. Adjusting of mutual indebtedness of transferor & transferee company

Sundry Creditors A/c. Dr. Xx

To Sundry Debtors A/c. Xx

MERGER METHOD

1. Recording Purchase of Business

Business Purchase A/c Dr. xx

To Liquidator of transferor company X

(The entry should be passed at purchase consideration amount.)

2. Recording of assets and liabilities taken over

Sundry assets A/c Dr. xx

General Reserve A/c (if any) Dr. xx

To All Reserves of transferor co.(except General reserve)

To Sundry Liabilities A/c X

To Business Purchase A/c Xx

To General Reserve A/c (Balancing figure) xx

3. Recording Discharge of purchase consideration

Liquidator of transferor company A/c Dr. Xx

Discount on issue of shares A/c Dr. Xx

To Equity Share Capital A/c. XX

To Preference Share Capital A/c. XX

To Securities Premium A/c. Xx

4. Discharge of Liabilities of Transferor Company

Debentures of Transferor Company A/c Dr. Xx

Discount on issue of Debentures A/c Dr. Xx

To new Debentures A/c. XX

To Securities Premium A/c. Xx

5. Recording of payment of liquidation expenses

General Reserve/ A/c. Dr. Xx

To Cash/Bank A/c. Xx

6. Recording of Expenses incurred by the transferee company for its own formation.

Preliminary Expenses A/c. Dr. Xx

To Cash / Bank A/c Xx

7. Adjusting of mutual indebtedness of transferor & transferee company

Sundry Creditors A/c. Dr. Xx

To Sundry Debtors A/c. Xx

INTERNAL RECONSTRUCTION OF COMPANIES

The term reconstruction means reorganizing the capital structure of a company including the reduction of the claim of both the classes of shareholders & the creditors against the company. Sick companies (loss making companies) may be taken over by the profit making companies however in case of c/f of huge losses, assets are overvalued or undervalued, in such cases company may go for reconstruction. It may be external or internal reconstruction.

Types of reconstruction:

The Company can be reconstructed internally or externally. It means two types of reconstruction is possible:

External Reconstruction:

In case of external reconstruction a new company is formed to take over the business of an existing company which has suffered huge losses & which is in bad financial position. The vendor company goes into liquidation & its business is taken over the new company.

Internal Reconstruction:

In case of internal reconstruction, the capital structure of the company is reorganized to infuse new life in the company. It includes alteration, reduction and reorganization of share capital of the company.

Alteration of share capital:

A limited company if authorized by its Articles of Association can alter the capital clause of its Memorandum of Association. As per Sec. 94 to 97 of the Companies Act 1956 a company can alter its share capital. The alteration of share capital may be in following different ways: -

a] Increase in share capital by the issue of new shares.
b] Consolidation of shares:

Consolidation refers to conversion of shares of the smaller denomination into shares of larger denomination e.g.: 5000 equity shares of Rs. 10 each can be consolidated into 500 shares of Rs. 100 each.

c] Subdivision of shares:

Sub division refers to conversion of shares of the larger denomination into shares of small denomination e.g.: 5000 equity shares of Rs. 100 each can be subdivided into 50000 shares of Rs. 10 each.

d] Conversion of shares into stock:

A company may convert its shares into stock. Stocks may be in fractions which is not possible in case of shares. Conversion of shares into stock requires sanction of the Central Government.

e] Surrender of shares:

In a reconstruction scheme the shareholders may be required to surrender a part of their shareholdings. Such a surrender may be either before immediate cancellation or for issue to some of the creditors of the company in satisfaction of their claim.

f] Cancellation of Unissued shares:

In case a company cancels its unissued shares it does not require any accounting entry to be passed. The authorized shares capital of the company will stand reduced by the amount of unissued shares now cancelled.

Legal aspects:

Internal reconstruction scheme should be framed by careful study and proper valuation of assets and liabilities. It involves a compromise or arrangement between the company and its members or/and its creditors. However following aspects should be carefully taken care of while framing the scheme of internal reconstruction –

a] For change in share capital in any form, it should be considered as per provisions of the M/A & A/A, and in case if required the company should alter the provisions in the M/A & A/A.

b] Company is required to give a notice to the Register of Companies within 30 days of its passing resolution.

c] Sanction of SEBI is necessary in certain cases.

d] Board Resolution is necessary to effect the alteration.

Capital reduction:

Internal reconstruction means the reduction of capital to cancel any paid-up share capital which is lost during the course of business i.e. not represented by the real value of the assets. A company can reduce its share capital in the followings ways:

a] Writing off lost capital

b] Refunding surplus paid-up capital.

c] Reducing the liability of the members for uncalled capital.

A company can reduce its share capital only when each of the following condition is satisfied

a] The A/A of the company must permit such reduction.

b] The company passes special resolution for reducing its share Capital.

c] The company obtains the confirmation of the court. Reduction of capital will be effective only when it is sanctioned by the court and registered with Registrar of Companies. Court may at its discretion order the words "And Reduced" to be added to the name of the company for the period prescribed.

Accounting entries :

Capital Reduction Account is opened in the ledger to give effect of sacrifice made by shareholders & others as well as to write off accumulated losses, fictitious assets, & change in values of assets/liabilities.

1] When the face value of share is changed:

Share capital A/c (o/d)..................................... Dr.

(With paid up value of old shares)

To Share Capital A/c (new)

(With paid up value of new shares)

To Capital Reduction A/c

(With difference)

2] When any sacrifice is made by the creditors:

Creditors A/c (with sacrifice)..................................... Dr.

To Capital Reduction A/c

3] When there is reduction in share capital (face value of share is not changed)

Share Capital A/c... Dr.

To Capital Reduction A/c

(With the amount of reduction).

4] When the value of any asset is appreciated:

Asset A/c (increase in value) .... Dr.

To Capital Reduction A/c

5] When any sacrifice is made by the Debenture Holders

Debentures A/c (increase in value).................. Dr.

To Capital Reduction A/c

6] When shares are consolidated:

Share Capital A/c (say Rs. 10) Dr.

To Share Capital A/c (say Rs. 100)

7] When Shares are subdivided:

Share Capital A/c (say Rs. 100) Dr.

To Share Capital A/c (say Rs. 10)

8] When capital reduction is utilised for writing off fictitious assets, losses and excess value of other assets:

Capital Reduction A/c Dr.
To P/L A/c
To Goodwill A/c
To Preliminary Expenses A/c
To Discount on Shares/Debentures A/c
To Other Assets A/c
To Capital Reserve A/c (if any balance is left)

9] When shares are converted into stock:

Share Capital A/c Dr.
To Share Stock A/c

10] When shares are surrendered:

Share Capital A/c Dr.
To Share Surrendered A/c

11] When surrendered shares are converted into preference shares:

Share Surrendered A/c Dr.
To Preference Share Capital A/c

12] When contingent liability/unrecorded liability is paid for:

Capital Reduction A/c Dr.
To Bank A/c

(Note: No entry is required for amount foregone against such liability.)

13] When recorded liability is paid for:

Liability A/c Dr.

To Bank A/c

(Note: Any profit or loss should be transferred to Capital Reduction A/c)

14] When recorded assets are disposed off:

Bank A/c Dr.

To Assets A/c

(Note: Any profit or loss on sale should be transferred to Capital Reduction A/c)

15] When Reconstruction expenses are paid

Capital Reduction A/c Dr.

To Bank A/c

16] When an unrecorded assets is sold off:

Bank A/c Dr.

To Capital Reduction A/c

17] When finance is raised by issue of shares

Bank A/c Dr.

To Share Capital A/c

18] When arrears of preference dividend are cancelled:

No Entry

19] When new debentures are exchanged for old debentures:

Old Debentures A/c Dr.

To New Debentures A/c

20] When arrears of preference dividend are settled by issue

of deposit certificates cash/shares:

Capital Reduction A/c Dr.

To Deposit Certificates/Cash/Share Certificate A/c

21] When the rate of preference dividend is changed:

Preference Share Capital (old) A/c Dr.

To Preference Share Capital A/c (new)

22] When surrendered shares are issued to creditors:

(a) Surrendered A/c Dr.

To Share Capital A/c

(b) Creditors A/c Dr.

To Capital Reduction A/c

Note: Profit or Loss on scheme to be transferred to capital Reduction A/c.

23] When provision for taxation, Capital Reserve,Securities Premium is utilised:

Provision for Taxation A/c Dr.

Capital Reserve A/c .... Dr.

Securities Premium A/c ...... Dr.

To Capital Reduction A/c

Proforma:

Capital Reduction A/c

Particulars	Rs.	Particulars	Rs.
To P & L A/c (Loss written off)	XX	By Share Capital A/c (Amount of reduction)	XX
To Goodwill A/c (Written off)	XX	By Debentures A/c (Amount of Reduction)	XX
To Preliminary expenses A/c (Written off)	XX	By Creditors A/c (Amount of Sacrifice)	XX
To Discount on Shares/Debentures (Written off)	XX	By Assets A/c (Increase in value)	XX
To Assets A/c (Decrease in value)	XX	By Bank A/c (sate of unrecorded assets)	XX
To Bank A/c (payment of unrecorded liability)	XX		
To Bank A/c (payment of Reconstruction Expenses)	XX		
To Bank A/c (Refund of Directors Fees)	XX		
To Capital Reserve (Balancing figure)	XX		
	XXX		XXX

ACCOUNTING INVOLVED IN LIQUIDATION OF COMPANIES

Liquidation or winding up is a Legal term and refers to the procedure through which the affairs of the company are wound up by law. Winding up of a company has been defined in the Companies Act 1956 as “ the process whereby its life is ended and its property is

administered for the benefit of its creditors & members. An Administrator called the Liquidator is appointed and he takes control of the company, collects its assets , pays its debts & finally distributes any surplus among the members in accordance with their rights.

MODES OF LIQUIDATION

- Compulsory winding up
- Voluntary winding up
- Supervision by court

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

- ❑ COMPULSORY WINDING UP BY THE COURT
- ❑ VOLUNTARY WINDING UP BY THE MEMBERS
- ❑ WINDING UP UNDER THE SUPREVISION OF COURT

Generally the provisions of the Act with respect to the winding up apply to winding up of a company whether it be by the court or voluntary or subject to the supervision of the court [Section 425 (2)]

Consequences of winding up

The following are the consequences of winding up:

- ❖ 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.
- ❖ The powers of the board of directors will cease & will now vest the liquidator.
- ❖ 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.
- ❖ 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.

- Liquidator of the company will collect & realise its assets & distribute the proceeds among right claimants as per the procedure of the law.
- Winding up ultimately leads to dissolution of the company. The companies life will come to an end & it will be no more an artificial person in the eyes of law.

Contributory

According to section 428 of the Companies Act, 1956, a contributory is "every person liable to contribute to the assets of a company in the event of it being wound up & includes a holder of fully paid up shares, & also any person alleged to be contributory "

A Contributory can be either a present member or a past member.

Fraudulent preference

Fraudulent preference takes place when one creditor is preferred to another creditor in the matter of payment of his dues. It has been made in the provisions of section 531 that every transfer of property or money made with in 6 months before the commencement of winding up which amounts to fraudulent preference is invalid.

Voluntary transfer

- All voluntary transfers made by the company within a period of one year or before the presentation or petition for winding up or the passing of a resolution for voluntary winding up, are void as against the liquidator.

EMPLOYEES & OFFICERS

- According to section 444, a winding up order operates as a notice of discharge to the employees & officers of the company, except when the business of the company is being continued.

Interest on liabilities

- Interest on liabilities is payable upto the date of actual payment if the company is solvent. But if the company is insolvent, interest on liabilities is payable upto the date of commencement of insolvency proceedings.

Order of payment

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:

- Expenses of winding up including the liquidators remuneration
- Creditors secured by the floating charge on the assets of the company

- Preferential creditors
- Unsecured creditors
- The surplus, if any, amongst the contributories (i.e. preference shareholders & equity shareholders) according to their respective rights & interests.

Preference shareholders

- Preference shareholders get the priority over the equity shareholders as regards the payment of their capital & the dividend payable upto the ate of winding up. The holders of cumulative preference shares are entitled to arrears of dividend if there is a surplus after the return of the amount of the equity shareholders or if the Articles state that arrears of preference dividend are to be paid before anything is paid to equity shareholders.

Equity shareholders

- Any surplus left after making payment to preference shareholders is distributed among the equity shareholders if all the shares are equally paid up. But if the shares are called in unequal proportions, the liquidator should see that the capital contribution by the shareholders should be the same.
- It may be remembered that calls in advance will have priority in repayment over the paid up share capital of that class.

Preferential creditors

Under Section 530 of the Companies Act , the following creditors are treated as preferential creditors:

- 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.
- 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 Rs. 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.
- 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.
- Compensation payable by the company under Workmen Compensation Act, 1923 is treated as preferential.
- Any sum payable by the company to its employees from a Provident Fund, Pension Fund, Gratuity Fund or any other fund maintained foe the welfare of the employees.
- the expenses of investigation held *Under Section 235 or 237* will be treated as preferential.

Format of statement of affairs

ASSETS NOT SPECIFICALLY PLEDGED (list ‘A’)	ESTIMATED REALISABLE VALUE (Rs.)
Balance at Bank	
Cash in hand	
Debtors	
Leasehold Property	
Plant & Machinery	
Investments	
Other Assets	

ASSETS SPECIFICALLY PLDGED (list 'B')	ESTIMATED REALISABLE VALUE Rs.	DUE TO SECURED CREDITORS Rs.	DEFICIENCY RANKING AS UNSECURED Rs.	SURPLUS CARRIED TO LAST COLUMN Rs.
Freehold property				

ESTIMATED SURPLUS FROM ASSETS SPECIFICALLY PLEDGED	
Estimated total assets available for preferential creditors, debenture holders & unsecured creditors.	
SUMMARY OF GROSS ASSETS	AMOUNT
Estimated value of assets specifically pledged	
Other assets	

GROSS LIABILITIES Rs.	LIABILITIES	AMOUNT Rs.
	Secured creditors (list 'B') to the extent it is secured	
	Preferential creditors (list 'C')	
	Estimated balance of assets available for debenture holders	
	Debenture holders secured by floating charge (list 'D')	
	Estimated surplus/deficiency as regards debenture holders	

	Unsecured creditors (list 'E') liability for purchases telephone rent o/s bills payable	
	Estimated surplus/deficiency as regards creditors (being diff. of gross assets & gross liabilities)	

DEFICIENCY ACCOUNT (LIST H)

PARTICULARS	AMOUNT	PARTICULARS	AMOUT
To excess of asset over capital	1,00,000	By net trading losses after depreciation , taxation etc	5,87,750
To net trading asset	4,50,.000	By losses other than trading losses	4,00,000
To profits and income other than trading profits	1,40,000	Speculations loss 50,000	
To deficiency	7,59,750	Penalty imposed by excise autorities 3,50,000	
		By estimated losses now written off	4,62,000
		B/R 6,000	
		Debtors 1,56,000	
		Stock 2,40,000	
		Contingent Liability 60,000	

Liquidators' final statement of accounts

- The main job of the liquidator is to collect the assets of the company & realize them & distribute the money realized among right claimants.
- For this purpose he maintains a cash book for recording the receipts & payments & is required to submit an abstract of the cash book to the court in case of compulsory winding up & to the company in case of voluntary winding up.
- The liquidator is also required to prepare an account known as the Liquidator's Final Statement of accounts after the affairs of the company are fully wound up.

Liquidator's final statement of account

Receipts	Amount (Rs.)	Payments	Amount (Rs.)
To Assets Realized :-		By Legal Charges	
-- Cash at Bank		By Liquidation Expenses	
-- Cash in Hand		By Liquidator Remuneration	
-- Marketable Securities		By Preferential Creditors	
-- Bills Receivable		By Debenture -holders (*having a floating charge on the assets of the co.*)	
-- Trade Debtors		By Unsecured Creditors	
-- Stock in trade		By Preference Shareholders	
-- Freehold property		By Equity Shareholders (*42500 shares @ Rs. 1.50*)	
-- Plant and Machinery			
-- Furniture and Fittings			
To Surplus from Securities held by Secured Creditors			
To Proceeds of calls made on contributories (*on 7500 Equity shares @3.50*)			

UNIT-4

1.1 Banking and Insurance Companies:

1.1.1 Meaning of Banking Companies:

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

1.1.2. Definition:

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

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

1.1.3 Business of Banking Companies:

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

1. The borrowing, raising or taking up on money, the lending or advancing of money either upon or without security, the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, 'hundies', promissory notes, drafts, bills of lading, railways receipt, warrants, debentures, certificates, scrip's and other instruments and securities whether transferable or negotiable or not; granting and issuing of letters of credit, traveller's cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock bonds, obligations, securities and investments of all kinds; the purchasing

and selling of bonds, scrips or other forms of securities on behalf of constituents or other, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities.

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

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

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

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

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

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

8. Undertaking and executing trusts.

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

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

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

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

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

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

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

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

1.1.4 Restrictions on Business:

The Banking Companies are restricted from conducting certain activities.
A bank can not directly or indirectly deal in the buying or selling or bartering of goods, except in connection with the realization of security given to or held by it, or engage in any

trade or buy or sell of barter goods for others otherwise than in connection with bills of exchange, immovable property, except that required for its own use, however acquired, must be disposed of within seven years from the date of acquisition.

1.1.5 Non-Banking Assets:

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

1.1.6. Important accounting provisions of banking regulation act 1949.

1. Minimum Capital and reserves – Section 11.

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

1) In the case of Banking Company incorporated outside India.If it has a place or places of business in the city of Bombay or Calcutta or both Rs. 20 lakhs.If the places of business are other than Bombay or CalcuttaRs. 15 lakhs. In addition 20% of the profits earned in India must beadded to the sums mentioned above.

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

a) If it has places of business in more than one state and it has a place or places of business in Bombay or Calcutta or both Rs. 10 lakhs.
b) It is has places of business in more than one state but not in Bombay or Calcutta Rs. 5 lakhs.
c) If it has places of business in one state but not in Bombay or Calcutta. Rs. 1 lakhs in respect of its principle place plus Rs. 10,000 for each of its other places of business in the

same district and Rs. 25,000 in respect of each place of business outside the district. The total need not exceed Rs. 5 lakhs. In case there is only one place of business Rs. 50,000.

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

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

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

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

3. Restriction on payment of dividend – section 15:

A Banking company shall not pay dividend unless all of its capitalized expenses (including preliminary expenses, organization expenses, share selling commission, Brokerage, amount of losses incurred and any other item. Of expenditure not represented by tangible assets) have been completely written-off. However, a banking company may pay dividend on its shares without writing off.

4 Statutory Reserve – Section 17:

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

5. Cash Reserves – Section 18:

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

6. Restrictions on loans and Advances –section 20

A Bank can not
i) grant loans and advances on the security of its own shares and
ii) grant or agree to grant loan or advance to or on behalf of
a) Any of its directors;
b) Any firm in which any of its directors is interested as partner, manager or gurantor;
c) Any company of which any of its directors is a director manager, employee or guarantor or
in which he holds substantial interest; or
d) Any individual in respect of whom any of its directors is a partner or guarantor.

1.1.7. Books of accounts

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

A) Subsidiary books
i. Receiving cashier's counter cash book;
ii. Paying cashier's counter cash book;
iii. Current accounts ledger.
iv. Savings bank accounts ledger
v. Fixed deposit accounts ledger
vi. Investments Ledger
vii. Loans Ledger

viii. Bills discounted and purchased ledger

ix. Customer's acceptances endorsements and guarantee ledger

B) Principal Books

i. Cash book : It records all cash transactions

ii. General Leger : It contains control Accounts of all subsidiary ledgers and different assets and liabilities account

1.1.8. Provisioning of non-performing assets

Meaning:

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

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

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

'as an advance where, as on the bank's balance sheet date,

(a) interest on a term loan account is past due or

(b) a cash credit /overdraft account remains out of order or

(c) a bill purchased /discounted is unpaid or overdue or (d) any amount to be received in respect of any other account remains past due, for a period more than 180 days.

(e) in respect of agricultural finance / advance (eg crop loans) interest and / or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years. The period of 180 days has been reduced to 90 days effective from March 31, 2004.

A 'past due' account has been defined as an amount which remains outstanding 30 days beyond the due date. Assets classification and provisioning In order to make adequate provisions, assets have been classified as follows:

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

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

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

The provision for doubtful assets as follows:

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

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

2.5. FINAL ACCOUNTS

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

THE THIRD SCHEDULE

(See Section 29)

Form 'A'

FORM OF BALANCE SHEET

Balance Sheet of……………….................. (here enter the name of the Banking Company)

Balance Sheet as on 31St. March __________(year) (000's omitted)

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

Contingent liabilities Bills for collection	11 12		

Form 'B'

Form of profit & loss account for the year ended 31[St] march

(000's omitted)			
	Schedule No.	Year ended 31.3… (Current Year)	Year ended 31.3… (Previous Year)
I. Income Interest earned Other income	 13 14		
Total			
II. Expenditure Interest expended Operating expenses Provisions and contingencies	15 16		
Total			
III. Profit / Loss Net profit / Loss (-) for the year Profit / Loss (-) brought forward			

Total			
IV. Appropriations Transfer to statutory reserves Transfer to other reserves Transfer to Government / Proposed dividend Balance carried over to Balance Sheet			
Total			

NOTE: 1. The total income includes income of foreign branches of Rs.______

2. The total expenditure includes expenditure of foreign branches at Rs. _____

3. Surplus / deficit of foreign branches Rs. ______

SCHEDULE 1 --- CAPITAL

	As on 31.3…. (Current Year)	As on 31.3…. (previous Year)
I. For Nationalized Banks Capital (Fully owned by Central Government) II. For Banks Incorporated Outside India Capital (The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head) Amount of deposit with the RBI under		

Section 11(2) of Banking Regulation Act, 1949		
Total		
III. For Other Banks Authorized Capital ……. shares of Rs……… each Issued Capital ……. shares of Rs……… each Subscribed Capital ……. shares of Rs……… each Called-up Capital ……. shares of Rs……… each Less: Calls unpaid Add: Forfeited shares		

SCHEDULE 2 – RESERVES & SURPLUS

	As on 31.3…. (Current Year)	As on 31.3…. (Previous Year)
I. Statutory Reserves Opening Balance Additions during the year Deductions during the year II. Capital Reserves Opening Balance Additions during the year Deductions during the year III. Shares Premium		

Opening Balance Additions during the year Deductions during the year IV. Revenue and other Reserves Opening Balance Additions during the year Deductions during the year V. Balance in Profit and Loss Account		
Total (I + II + III + IV + V)		

SCHEDULE 3 – DEPOSITS

	As on 31.3…. (Current Year)	As on 31.3…. (previous Year)
A. I. Demand Deposits i) From Banks ii) From Banks II. Savings Bank Deposits III. Term Deposits i) From banks ii) From others		
Total (I + II + III)		
B. i) Deposits of branches in India ii) Deposits of branches outside India		
Total		

SCHEDULE 4 – BORROWINGS		
	As on 31.3…. (current Year)	As on 31.3…. (Previous Year)
I. Borrowings in India i) Reserve Bank of India ii) Other banks iii) Other institutions and agencies II. Borrowings outside India Total (I + II) Secured borrowings included in I & II above – Rs.		

SCHEDULE 5 – OTHER LIABILITIES AND PROVISIONS		
	As on 31.3…. (current Year)	As on 31.3…. (Previous Year)
I. Bills payable II. Inter-office adjustments (net) III. Interest accrued IV. Others (including provisions)		
Total		

SCHEDULE 6 – CASH AND BALANCES WITH RESERVE BANK OF India		
	As on 31.3….	As on 31.3….

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

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

	As on 31.3…. (Current Year)	As on 31.3…. (previous Year)
I. In India		
(i) Balances with banks		
(a) in Current Accounts		
b) in Other Deposit Accounts		
(ii) Money at call and short notice		
a) With banks		
b) With other institutions		
Total		
II. Outside India		
(i) in Current Accounts		
(ii) in Other Deposit Accounts		
(iii) Money at call and short notice		
Total		
Grand Total (I + II)		

SCHEDULE 8 – INVESTMENTS

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

SCHEDULE 9 – ADVANCES

	As on 31.3…. (Current Year)	As on 31.3…. (previous Year)
A. i) Bills purchased and discounted ii) Cash credits, overdrafts and loans repayable on demand		

iii) Term loans		
Total		
B. i) Secured by tangible assets ii) Covered by Bank / Government guarantees iii) Unsecured		
Total		
C. I. Advances in India i) Priority Sectors ii) Public Sector iii) Banks iv) Others		
Total		
II. Advances outside India i) Due from banks ii) Due from others a) Bills purchased and discounted b) Syndicated loans c) Others Total		
Grand Total (C. I. + C. II.)		

SCHEDULE 10 – FIXED ASSETS		
	As on 31.3…. (current Year)	As on 31.3…. (Previous Year)
I. Premises At cost as on 31 st March of the preceding year Additions during the year Deductions during the year Depreciation to date II. Other Fixed Assets (including furniture and fixtures) At cost as on 31 st March of the preceding year Additions during the year Deductions during the year Depreciation to date		
Total (I + II)		

SCHEDULE 11 – OTHER ASSETS		
	As on 31.3…. (current Year)	As on 31.3…. (Previous Year)
I. Inter-office adjustments (net) II. Interest accrued III. Tax paid in advance / tax deducted at source IV. Stationery and stamps V. Non-banking assets acquired in satisfaction of claims VI. Others @ Total		

@ In case there is any unadjusted balance of loss, the same may be shown under this item with appropriate foot-note.

SCHEDULE 12 – CONTINGENT LIABILITIES		
	As on 31.3…. (current Year)	As on 31.3…. (Previous Year)
I. Claims against the bank not acknowledged as debts II. Liability for partly paid investment III. Liability on account of outstanding forward exchange contracts IV. Guarantee given on behalf of		

constituents' a) In India b) Outside India V. Acceptances, endorsements and, other obligations VI. Other items for which the bank is contingently liable		
Total		

SCHEDULE 13 – INTEREST EARNED		
	As on 31.3…. (current Year)	As on 31.3…. (Previous Year)
I. Interest / discount on advances / bills II. Income on investments III. Interest on balances with Reserve Bank of India and other inter-bank funds IV. Others		
Total		

SCHEDULE 14 – OTHER INCOME		
	As on 31.3…. (current Year)	As on 31.3…. (Previous Year)
I. Commission, exchange and brokerage II. Profit on sale of investments Less: Loss on sale of investments III. Profit on revaluation of investments		

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

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

SCHEDULE 15 – INTEREST EXPENDED		
	As on 31.3…. (current Year)	As on 31.3…. (Previous Year)
I. Interest on deposits II. Interest on Reserve Bank of India / inter-bank borrowings III. Others		
Total		

SCHEDULE 16 – OPERATING EXPENSES		
	As on 31.3…. (current Year)	As on 31.3…. (Previous Year)
I. Payments to and provisions for employees II. Rent, taxes and lighting III. Printing and stationery IV. Advertisement and publicity V. Depreciation on bank's property VI. Directors' fees, allowances and expenses VII. Auditor' fees and expenses (including branch auditors' fees and expenses) VII. Law charges IX. Postages, telegrams, telephone, etc. X. Repairs and maintenance XI. Insurance XII. Other expenditure Total		

GUIDELINES OF RBI FOR COMPILATION OF FINANCIAL STATEMENTS BALANCE SHEET

Item	Schedule	Coverage	Notes and instructions for compilation
(1)	(2)	(3)	(4)

Capital	1	Nationalized Banks Capital (fully Owned by Central Government)	The capital owned by Central Government as on the date of the Balance sheet including contribution from Government, if any, for participating in World Bank, Projects, should be shown
		Banking Companies Incorporated outside India	(i) The amount brought in by banks by way of start-up capital as prescribed by RBI, should be shown Under this Head (ii) The amount or deposits kept with RBI under sub-section 2 of Section 11 of the Banking Regulation Act, 1949 should also be shown.
			Authorized, Issued, Subscribed, Called-up Capital should be given separately. Calls-inarrears will be deducted from Called-up Capital

			While the paid-up value of forfeited shares should be added, thus arriving at the paid-up capital. The necessary Items which canbe combined should be shown under one head,for instance,"Issued and Subscribed Capital". Notes: General The changes in the above items, if any, during the years, say, fresh contribution made by the Government, fresh issue of capital, capitalization of reserves, etc., may be explained in the notes.
Reserves and Surplus	2	(I) Statutory Reserves	Reserves created in terms of Section 17 or another section of Banking Regulation Act, must be separately disclosed.
		(II) Capital Reserve	The expression 'capital reserve' shall not include any amount regarded as free for distribution through the Profit and Loss Account. Surplus on

	revaluation should be treated as Capital Reserves. Surplus on translation of the financial statements of foreign branches (which includes fixed assets also) is not a revaluation reserve.
(III) Share Premium	Premium on issue of share capital may be shown separately under this head.
(IV) Revenue and other Reserve	The expression 'Revenue Reserve' shall mean any reserve other than those separately classified. This expression 'reserve' shall not include any amount, written-off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability.
(V)Balance of Profit	Includes balance of profit after appropriation. In case of loss the balance may be shown as a deduction.

Disclosure of Accounting Policies

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

1) General

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

2) Transactions involving Foreign Exchange

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

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

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

3) Investments

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

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

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

4) Advances

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

i) In respect of identified advances, based on a periodic review of advances and after taking into account the portion of advance guaranteed by the Deposit Insurance and Credit

Guarantee Corporation, the Export Credit and Guarantee Corporation and similar statutory bodies;

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

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

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

5) Fixed Assets

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

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

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

6) Staff Benefits

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

7) Net Profit

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

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

ii) provisions for doubtful advances.

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

iv) transfers to contingency funds.

v) other usual or necessary provisions.

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

Some important transactions

Rebate on Bills Discounted:

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

Journal entries :

i) On discounting of Bill

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

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

ii) At the beginning of Accounting year entry will be Rebate on

Bills Discounted A/c Dr.
To Discount A/c (with the amount of unearned Discount)

Acceptance Endorsement and other obligations

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

Bills for collection

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

Provisions and contingencies

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

ACCOUNTS OF INSURANCE COMPANIES

Introduction

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

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

fixed sum of money known as 'premium'. The terms and conditions of such insurance contract in the written is called 'Insurance Policy'.

Insurance are of the types –

I) Life Insurance

II) General Insurance

a) Fire insurance

b) Marine insurance

c) Miscellaneous insurance

Life insurance business

In case of Life Insurance, the insurer guarantees to pay a certain sum of money to the assured on completing a stipulated period or in the event of the death to his legal representative. It covers risks and gives protection for the investment. Section 2(II) of the Insurance Act, 1938 has defined 'Life Insurance Business" as the business of effecting. Contracts of insurance upon human life, including any contract whereby the payment of money is assured on death or the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include

a) The granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance;

b) The granting of annuities upon human life; and

c) The granting of superannuation allowances and annuities

payable out of any fund applicable solely to the relief and maintenance of person engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons.

Statutory books and subsidiory books

A] Statutory Books –

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

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

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

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

B] Subsidiary books –

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

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

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

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

IV. First year premium book

V. Renewal premium book

VI. Surrender policy book

Some important terms

I. Whole life policy –

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

II. Endowment policy –

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

III. With profit policies -

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

Without profit policies –

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

. Bonus –

The share of profit enjoyed by insured is called bonus –

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

Premium –

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

Surrender value –

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

Claims –

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

Re-insurance –

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

Annuities –

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

Preparation of financial statements

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

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

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

The Balance Sheet of like insurance companies are prepared in 'vertical form' having too sections – sources of fund and application of fund. The schedule 5,6 and 7 deals with sources of fund and schedule 8 to schedule 15 shows the application of Fund. The contingent liabilities is disclosed as part of financial statement by way of notes to Balance Sheet.

FROM A-RA

Name of the Insurer:

Registration No. and Date of Registration with the India:

Revenue Account for the year ended 31 st March,201

Policyholder's Account (Technical account)

Particulars	schedule	Current Year (RS'000)	Previous Year (Rs'000)
Premiums earned – net			
(a) Premium	1		
(b) Re-insurance ceded			
(c) Re-insurance accepted			
Income from investments (a) Interest, Dividends and Rent –Gross (b) Profit on sale / redemption of Investments (c) (Loss on sale / redemption of Investments) (d) Transfer / Gain on revaluation /change in fair value*			

Other Income (to be specified)			
Total (A)			
Commission	2		
Operating Expenses related to Insurance Business	3		
Provision for doubtful debts			
Bad debts written off			
Provision for taxation			
Provision (other than taxation) (a) For diminution in the value of investment (Net) (b) Other (to be specified)			
Total (B)			
Benefits Paid (Net)	4		
Interim Bonuses Paid			
Change in valuation of liability in respect of life policies (a) Gross** (b) Amount ceded in Reinsurance (c) Amount accepted in Reinsurance			
Total (c)			
Surplus / (Deficit((D) = (A) - (B) - (C)			
Appropriations			
Transfer to Shareholders' Accounts			

Transfer to other Reserves (to be specified)			
Balance being Funds for Future appropriations			
Total (D)			

Notes:

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

** Represents Mathematical Reserves after allocation of bonus.

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

a) Interim bonuses Paid;

b) Allocation of Bonus to Policyholders;

c) Surplus shown in the Revenue Account;

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

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

FROM A-PL

Name of the Insurer:

Registration No. and Date of Registration with the IRDA:

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

Shareholders' Account (Non-technical Account)

Particulars	Scheduled	Current Year (RS'000)	Previous Year (Rs'000)
Amounts transferred from /to			

the Policyholders' Account (Technical account)			
Income from investments (a) Interest, dividends and Rent – Gross (b) Profit on sale /redemption of Investments (c) (Loss on sale/ redemption on Investments)			
Other income (to be specified)			
Total (A)			
Expenses other than those directly related to the insurece business			
Bad debts written off			
Provisions (other than taxation)			
(a) For diminution in the value of investments (Net) (b) Provisions for doubtful debts (c) Others (to be specified)			
Total (B)			
Profit / (Loss) before tax			

Provision for Taxation			
Profit / (Loss) after tax			
Appropriations			
(a) Balance at the beginning			
of the year			
(b) Interim dividends paid			
during the year			
(c) Proposed final dividend			
(d) Dividend distribution on tax			
(e) Transfer to reserves/ other accounts (to be specified)			
Profit carried… to the Balance Sheet			

Notes to Form A-RA and A-PL:

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

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

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

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

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

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

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

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

FORM A-BS

Name of the Insurer:

Registration No. and Date of Registration with the IRDA:

Balance Sheet as at 31 st March, 20 …

Particulars	schedule	Current Year (RS'000)	Previous Year (Rs'000)
SOURCES OF FUNDS			
Shareholders' Funds:			
Share Capital	5		
Reserves and Surplus	6		
Credit/ [Debit] Fair Value Change Account			
Sub total			
Borrowings	7		
Policyholders' Funds:			
Credit/ [Debit] Fair Value Change Account			
Policy Liabilities			
Insurance Reserves			
Provision for Linked Liabilities			
Sub Total			
Funds for Future Appropriations			
Total			
APPLICATION OF FUNDS			
Investments			
Shareholders'	8		

Policyholders'	8a		
Assets Held to Cover Linked Liabilities	8b		
Loans	9		
Fixed Assets	10		
Current Assets			
Cash and Bank Balances	11		
Advances and other Assets	12		
Sub total (A)			
Current Liabilities	13		
Provisions	14		
Sub total (B)			
Net Current Assets (C) = (A)-(B)			
Miscellaneous Expenditure (to the extent not written off or adjusted)	15		
Debit balance in profit and loss account (Shareholders 'Account)			
Total			

CONTINGENT LIABILITIES

Particulars	Current Year (RS'000)	Previous Year (Rs'000)
1. Partly paid-up investments		
2. Claims, other than against policies, not acknowledge as debts by the company		
3. Underwriting commitments outstanding (in		

respect of shares and securities)		
4. Guarantees given by or on behalf of the company		
5. Statutory demands/liabilities in dispute, not provided for		
6. Reinsurance obligations to the extent not provided for in accounts		
7. Others (to be specified)		
TOTAL		

General insurance business

General Insurance Business is the business other than Life Insurance. It is carried by General Insurance Corporation of India through its subsidiary companies and many private companies also involve in General Insurance business.

Section 2(60) of the Insurance Act 1938 has defined 'General Insurance Business' as fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them. Fire insurance business means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against the fire insurance policies. Marine Insurance Business means the business of effecting contracts of insurance upon vessels of any descriptions, including cargoes, freights and other interests which may be legally insured in or in relation to such vessels, cargoes and freights, goods wares, merchandise and property of whatever description insured for any transit by land or water, or both and whether or not including warehouse risks or similar risks in addition or incidental to such transit, and includes any other risks customarily included among the risks insured against in marine insurance policies.

Some important terms

Reserved for unexpired risk:

General Insurance Policies are taken for one year period and so risk is covered for 12 months from the date of insurance.The policies are issued throughout the year and remain in force even after the close for the current financial year and the entire premium for his period is collected in advance. For e.g. this period is collected in advance. For e.g. a policy is issued on 15 January 200 and it will be in force up to 14 January 2007 so the premium received on such policy covers partly current year 2005-06 and partly next year 2006-07. the risk may happen on any day during the lifetime of policy. The premium received on individual policy is not separated on time basis. Therefore a provision against unexpired risk is made to meet future claims arises under such policies

Reserves for unexpired risks are laid down as follows.

Fire and miscellaneous business 50% of the premium, net of re-insurance, during the preceding 12 months.

Marine cargo business 50% of the premium, net of re-issue during sthe preceding 12 months.

Marine hull business 100% of the premium, net of re-issue during the preceding 12 months.

However, an insurance company may keep additional reserve if it feels so.

Accounting Treatment

The opening balance of reserve for unexpired risk is credited to revenue account and closing balance is debited to revenue account.

PREPARATION OF FINANCIAL STATEMENT.

The General insurance company in India prepares its financial statements in accordance with provision of IRDA regulations, 2002. The financial statements consist of revenue account, profit and loss account and vertical balance sheet in form B-RA, form B-PL and Form B-BS respectively'. Revenue accounts for fire, marine and miscellaneous insurance business to be

prepared separately. Revenue account contains schedule-1,schedule-2, schedule-3, and schedule -4 and given operating profit or loss from insurance business which is transferred to profit and loss account.

Items not directly related to the insurance business are exhibited in profit and loss account for e.g. transfer fees, diminution in the value of investment bad debts written-off.

Balance sheet contains source of funds and application of fund. Sources of funds consists of schedule-5, schedule-6 and schedule-7 and application of funds consist of schedule-8 to schedule 15. Contingent liabilities are disclosed at the bottom of Balance Sheet.

Form B-BA

Name of the lnsurer:

Registration No. and Date of Registration with the IRDA:

Revenue Account for the year ended 31

Particulars	schedule	Current Year (RS'000)	Previous Year (Rs'000)
1. Premiums eamed – net 1			
2. Profit /Loss on Sale/Redemption of Investments			
3. Other (to be Specified)			
4. Interest, Dividends and Rent - Gross			
Total (A)			
1. Claims Incurred (Net) 2			
2. Commission 3			
3. Operating Expenses related to Insurance Business 4			
Total (B)			
Operating profit/ (Loss) from Fire / Marine /Miscellaneous Business C = (A-B)			

Appropriations			
Transfer to Shareholder Account			
Transfer to Catastrophe Reserve			
Transfer to other Reserves (to be specified)			
Total (c)			

Note: See Notes appended at the end of Form B-PL

FORM B-PL

Name of the Insurer

Registration No. and Date of Registration with the IRDA:

Profit and Loss Account for the year ended 31

Particulars	schedule	Current Year (RS'000)	Previous Year (Rs'000)
1. Operating Profit / (Loss)			
a) Fire insurance b) Marine insurance c) Miscellaneous insurance			
2. Income form Investment			
Interest, Dividend and Rent – Gross Profit on sale of investments Less: Loss on sale of investments			
3.Other income (to be specified)			
Total (A)			
4. Provisions (other than taxation)			
a) For diminution in the value of investments			
b) For doubtful debts			

c) Others (to be specified)			
a) Expenses other than those related to insurance business			
b) Bad debts written off			
c) Others (to be specified)			
Total (B)			
Profit Before Tax			
Provision for Taxation			
Appropriations a) Interim dividend paid during the year b) Proposed final dividend c) Dividend distribution tax d) Transfer to any reserves/ other accounts (to be specified)			
Balance of profit/ loss brought forward from last year			
Balance carried forward to Balance Sheet			

Notes to Form B-RA and B-PL:

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

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

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

d) Items of claims at the year end.

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

f) Under the sub-head "others" shall be included items like foreign gains or losses and other items.

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

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

FROM B-BS

Name of insurer:

Registration No. and Date of Registration with the IRDA:

Balance Sheet as at 31st March, 20…

Particulars	schedule	Current Year (RS'000)	Previous Year (Rs'000)
Sources of Funds			
Share capital	5		
Reserves and surplus	6		
Fair value change account			
Borrowings	7		
Sub Total			
Application of Funds			
Investments	8		
Loans	9		
Fixed assets	10		
Current assets			
Cash and bank balance	11		
Advances and other assets	12		
Sub Total (A)			
Current Liabilities	13		
Provisions	14		
Sub Total (B)			

CONTINGENT LIABILITIES

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

ELECTRICITY COMPANY

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1. <u>DOUBLE ACCOUNTING SYSTEM:</u>

   Electricity Company accounts are prepared by following the double accounting system. Accounts are made on Double Accounting System because a Public Utility company cannot invest in fixed Assets until & unless it arranges for some long-term liabilities. In other words such companies cannot use its short-term fund for financing fixed assets. Thus in this system of accounting the: -

   Balance sheet is prepared in two parts i.e.

- Capital account: -
  - ✓ It is a receipt & expenditure on capital account.
  - ✓ Shown in three columns i.e. Opening, During the year, Closing.
  - ✓ Preliminary expenses on formation are treated as capital expenditure.

✓ Premium received on issue of shares or debentures is deducted from the proceeds of the issue and the proceeds are shown net.

- General Balance-sheet

Profit and loss account in two parts i.e.

- Revenue Account: - Similar to P&L a/c. But it should be noted that depreciation is debited to this account and credited to Depreciation Reserve and not to asset account.
- Net Revenue Account: - Similar to P&L Appropriation a/c. But it should be noted that interest on loans & debentures are treated as an appropriation and therefore debited to this account. This is done because debentures and loans are considered as part of the capital of the concern.

2. REPLACEMENT ACCOUNTING:

a)	Replacement of New Asset		
	New Asset Account	DR	(Cash capitalization or Balancing Figure)
	Replacement Account	DR	(Present Value of Old Asset)
	To Bank Account		(Cash Cost of New Asset or Net Payment)
b)	Cost of Auxiliary Assets		
	Auxiliary Assets account	DR	
	To Bank Account		
c)	Use of Old Material in Auxiliary Assets		
	Auxiliary Assets account	DR	
	To Replacement account		
d)	Combined entry for Use of Old material in new asset; Sale of old material; Any balance in Replacement account transferred to Revenue account		
	New Asset Account	DR	(Amount of old Material used in New Asset)

Bank Account	DR (Sale of old material)
Revenue Account	DR (Balancing figure of Replacement account)
To Replacement Account	

Note : - Auxiliary Assets are any abnormal expenditure for repairing any existing Assets. For Example on a total track of 80 KM, 50 KM is totally replaced but 30 KM is repaired. Thus the track of 30 KM is called Auxiliary Asset and the track of 50 KM is called New Asset.

3. DISPOSAL OF SURPLUS

Step 1 Computation of Reasonable Return (R.R.)

(RBI rate + 2%) of Capital Base		xxxx
Income from investment (Excluding income from investment against contingency Reserve)		xxxx
.05% Of: -		
• Debentures		xxxx
• Development reserve balance		xxxx
• Approved institution borrowings		xxxx
• Electricity Board loans		xxxx
Reasonable Return		xxxx
Less: Clear Profit (i.e. Actual profit after interest & tax)		xxxx
Gross Surplus	xxxx	
Less: Return to customer by rebate in rate (Gross surplus – 20% of R.R.)		xxxx
Gross Adjusted Surplus		xxxx

Step 2 Disposal of gross Adjusted Surplus (G.A.S.)

• At company disposal (1/3 of GAS or 5% of RR whichever is less)	xxxx
• Transfer to Tariff & Dividend Control Reserve (1/2 of the Balance)	xxxx
• Transfer to Consumer Benefit Reserve (1/2 of the Balance)	xxxx
	xxxx

Notes: -

1. Calculation of Capital Base

• Original cost of fixed assets available for use	xxxx
• Cost of intangible assets	xxxx
• Original cost of WIP	xxxx
• Compulsory investments (contingency reserve)	xxxx
• Working capital equal to 1/12th of: -	
✓ Book cost of stores, material & supplies at end of each month	xxxx
✓ Cash, bank balance, call & short deposits at end of each month (Not exceeding in aggregate 1/4th of the expenditure)	xxxx

LESS

• Depreciation w/o	xxxx
• Intangible assets w/o	xxxx
• Loans advanced by Board	xxxx
• Loans borrowed institutions approved by SG.	xxxx
• Debentures issued by the licensee	xxxx
• Security deposits held in cash	xxxx
• Tariffs & Dividends Control Reserve	xxxx
• Development reserve	xxxx
• Amount c/f for distribution to consumers	xxxx

General conclusion above calculation of Capital Base is that in calculation of Capital Base we take every item except share capital and Investment (other than contingency Reserve investment)

2. Compulsory transfer to Contingency Reserve
   Minimum .25% and maximum .50% of original cost of fixed assets must be transferred to contingency reserve until it equals 5% of the original cost of fixed assets.
3. 4% of the opening balance of depreciation fund is charged from revenue account and added to depreciation fund in the balance sheet.
4. If nothing is given about Bank Rate than it is taken as 10%

Clear Profit in Profit and Loss Account of Electricity Company

Clear profit means the difference between the total income and total expenditure plus specific appropriations. The above two laws define the income, expenditure and appropriations of electricity company. The provisions are set out below for ready understanding in the form of an account :

Expenditures	Incomes
1. Cost of generation and purchase of energy	1. Gross receipts from sale of energy less discounts applicable to sale
2. Cost of distribution and sale of energy	2. Rental of meters and other apparatus hired to consumers
3. Rent, rates and taxes (Excluding taxes on income or profits)	3. Sale and repair of lamps and apparatus

4. Interest on loans advanced by the board	4. Rents less outgoings not otherwise provided for
5. Interest on security deposits	5. Transfer fees
6. Bad Debts	6. Interest from investments, fixed and call deposits and bank balances
7. Auditor's fees	7. Other receipts liable for Indian income tax and arising from ancillary or incidental to the business of electricity supply.
8. Management expenses including remuneration to managing agents	
9. Depreciation	
10. Other expenses	
11. Contribution to provident fund, staff pension, gratuity, apprentice and other training schemes	
12. Bonus paid to the employees of the undertaking in	

accordance with the decision of labor tribunal of state govt.

13. Balance Profit C/d

Appropriations	1. Balance Profit b/d
1. All taxes on income	
2. Balance being Clear Profit	

PRUDENTIAL NORMS ON INCOME RECOGNITION, ASSET CLASSIFICATION AND PROVISIONING PERTAINING TO ADVANCES-

Basis of Accounting-

- Cash basis
  - Actual cash receipts and payments are recorded.
  - Credit transactions are not recorded.
- Accrual basis
  - The income whether received or not but has been earned or accrued during the period forms part of the total income of the period.
  - The firm has taken benefit of a particular service, but has not paid within that period, the expenses will relates to the period in which the service has been utilized and not to the period in which payment for it is made.

3. Income recognition

3.1 Income Recognition Policy

3.1.1 The policy of income recognition has to be objective and based on the record of recovery. Internationally income from non-performing assets (NPA) is not recognised on

accrual basis but is booked as income only when it is actually received. Therefore, the banks should not charge and take to income account interest on any NPA. This will apply to Government guaranteed accounts also.

3.1.2 However, interest on advances against Term Deposits, National Savings Certificates (NSCs), Indira Vikas Patras (IVPs), Kisan Vikas Patras (KVPs) and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.

3.1.3 Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.

3.2 Reversal of income

3.2.1 If any advance, including bills purchased and discounted, becomes NPA, the entire interest accrued and credited to income account in the past periods, should be reversed if the same is not realised. This will apply to Government guaranteed accounts also.

3.2.2 In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed with respect to past periods, if uncollected.

3.2.3 Leased Assets

The finance charge component of finance income [as defined in 'AS 19 Leases' issued by the Council of the Institute of Chartered Accountants of India (ICAI)] on the leased asset which has accrued and was credited to income account before the asset became non-performing, and remaining unrealised, should be reversed or provided for in the current accounting period.

3.3 Appropriation of recovery in NPAs

3.3.1 Interest realised on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/ additional credit facilities sanctioned to the borrower concerned.

3.3.2 In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

3.4 Interest Application

On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account, and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their books. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

3.5 Computation of NPA levels

Banks are advised to compute their Gross Advances, Net Advances, Gross NPAs and Net NPAs, as per the format in Annex -1.

4. ASSET CLASSIFICATION

4.1 Categories of NPAs

Banks are required to classify nonperforming assets further into the following three categories based on the period for which the asset has remained nonperforming and the realisability of the dues:

Substandard Assets

Doubtful Assets

Loss Assets

4.1.1 Substandard Assets

With effect from March 31, 2005, a substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. 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 banks will sustain some loss, if deficiencies are not corrected.

4.1.2 Doubtful Assets

With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the 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.

4.1.3 Loss Assets

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

4.2 Guidelines for classification of assets

4.2.1 Broadly speaking, classification of assets into above categories should be done taking into account the degree of well-defined credit weaknesses and the extent of dependence on collateral security for realisation of dues.

4.2.2 Banks should establish appropriate internal systems (including technology enabled processes) for proper and timely identification of NPAs, especially in respect of high value accounts. The banks may fix a minimum cut off point to decide what would constitute a high value account depending upon their respective business levels. The cut off point should be valid for the entire accounting year. Responsibility and validation levels for ensuring proper asset classification may be fixed by the banks. The system should ensure that doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per extant guidelines.

4.2.3 Availability of security / net worth of borrower/ guarantor

The availability of security or net worth of borrower/ guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise, except to the extent provided in Para 4.2.9.

4.2.4 Accounts with temporary deficiencies

The classification of an asset as NPA should be based on the record of recovery. Bank should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of the limits on

the due date, etc. In the matter of classification of accounts with such deficiencies banks may follow the following guidelines:

i) Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Drawing power is required to be arrived at based on the stock statement which is current. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular.

A working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory.

ii) Regular and ad hoc credit limits need to be reviewed/ regularised not later than three months from the due date/date of ad hoc sanction. In case of constraints such as non--availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is already on and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/ ad hoc credit limits have not been reviewed/ renewed within 180 days from the due date/ date of ad hoc sanction will be treated as NPA.

4.2.5 Upgradation of loan accounts classified as NPAs

If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as nonperforming and may be classified as 'standard' accounts. With regard to upgradation of a restructured/ rescheduled account which is classified as NPA contents of paragraphs 12.2 and 15.2 in the Part B of this circular will be applicable.

4.2.6 Accounts regularised near about the balance sheet date

The asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for

subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors/Inspecting Officers about the manner of regularisation of the account to eliminate doubts on their performing status.

4.2.7 Asset Classification to be borrower-wise and not facility-wise

i) It is difficult to envisage a situation when only one facility to a borrower/one investment in any of the securities issued by the borrower becomes a problem credit/investment and not others. Therefore, all the facilities granted by a bank to a borrower and investment in all the securities issued by the borrower will have to be treated as NPA/NPI and not the particular facility/investment or part thereof which has become irregular.

ii) If the debits arising out of devolvement of letters of credit or invoked guarantees are parked in a separate account, the balance outstanding in that account also should be treated as a part of the borrower's principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

iii) The bills discounted under LC favouring a borrower may not be classified as a Non-performing advance (NPA), when any other facility granted to the borrower is classified as NPA. However, in case documents under LC are not accepted on presentation or the payment under the LC is not made on the due date by the LC issuing bank for any reason and the borrower does not immediately make good the amount disbursed as a result of discounting of concerned bills, the outstanding bills discounted will immediately be classified as NPA with effect from the date when the other facilities had been classified as NPA.

iv) Derivative Contracts

a) The overdue receivables representing positive mark-to-market value of a derivative contract will be treated as a non-performing asset, if these remain unpaid for 90 days or more. In case the overdues arising from forward contracts and plain vanilla swaps and options become NPAs, all other funded facilities granted to the client shall also be classified as non-performing asset following the principle of borrower-wise classification as per the existing asset classification norms. However, any amount, representing positive mark-to-market value of the foreign exchange derivative contracts (other than forward

contract and plain vanilla swaps and options) that were entered into during the period April 2007 to June 2008, which has already crystallised or might crystallise in future and is / becomes receivable from the client, should be parked in a separate account maintained in the name of the client / counterparty. This amount, even if overdue for a period of 90 days or more, will not make other funded facilities provided to the client, NPA on account of the principle of borrower-wise asset classification, though such receivable overdue for 90 days or more shall itself be classified as NPA, as per the extant Income Recognition and Asset Classification (IRAC) norms. The classification of all other assets of such clients will, however, continue to be governed by the extant IRAC norms.

b) If the client concerned is also a borrower of the bank enjoying a Cash Credit or Overdraft facility from the bank, the receivables mentioned at item (iv) (a) above may be debited to that account on due date and the impact of its non-payment would be reflected in the cash credit / overdraft facility account. The principle of borrower-wise asset classification would be applicable here also, as per extant norms.

c) In cases where the contract provides for settlement of the current mark-to-market value of a derivative contract before its maturity, only the current credit exposure (not the potential future exposure) will be classified as a non-performing asset after an overdue period of 90 days.

d) As the overdue receivables mentioned above would represent unrealised income already booked by the bank on accrual basis, after 90 days of overdue period, the amount already taken to 'Profit and Loss a/c' should be reversed, and held in a 'Suspense Account-Crystalised Receivables' in the same manner as done in the case of overdue advances.

e) Further, in cases where the derivative contracts provides for more settlements in future, the MTM value will comprise of (a) crystallised receivables and (b) positive or negative MTM in respect of future receivables. If the derivative contract is not terminated on the overdue receivable remaining unpaid for 90 days, in addition to reversing the crystallised receivable from Profit and Loss Account as stipulated in para (d) above, the positive MTM pertaining to future receivables may also be reversed from Profit and Loss Account to another account styled as 'Suspense Account – Positive MTM'. The subsequent positive changes in the MTM value may be credited to the 'Suspense Account – Positive MTM', not to P&L Account. The subsequent decline in MTM value may be adjusted

against the balance in 'Suspense Account – Positive MTM'. If the balance in this account is not sufficient, the remaining amount may be debited to the P&L Account. On payment of the overdues in cash, the balance in the 'Suspense Account-Crystalised Receivables' may be transferred to the 'Profit and Loss Account', to the extent payment is received.

f) If the bank has other derivative exposures on the borrower, it follows that the MTMs of other derivative exposures should also be dealt with / accounted for in the manner as described in para (e) above, subsequent to the crystalised/settlement amount in respect of a particular derivative transaction being treated as NPA.

g) Since the legal position regarding bilateral netting is not unambiguously clear, receivables and payables from/to the same counterparty including that relating to a single derivative contract should not be netted.

h) Similarly, in case a fund-based credit facility extended to a borrower is classified as NPA, the MTMs of all the derivative exposures should be treated in the manner discussed above.

4.2.8 Advances under consortium arrangements

Asset classification of accounts under consortium should be based on the record of recovery of the individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account will be treated as not serviced in the books of the other member banks and therefore, be treated as NPA. The banks participating in the consortium should, therefore, arrange to get their share of recovery transferred from the lead bank or get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

4.2.9 Accounts where there is erosion in the value of security/frauds committed by borrowers

In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers it will not be prudent that such accounts should go through various stages of asset classification. In cases of such serious credit impairment the asset should be straightaway classified as doubtful or loss asset as appropriate:

Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category and provisioning should be made as applicable to doubtful assets.

If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off or fully provided for by the bank.

4.2.10 Advances to Primary Agricultural Credit Societies (PACS)/Farmers' Service Societies (FSS) ceded to Commercial Banks

In respect of agricultural advances as well as advances for other purposes granted by banks to PACS/ FSS under the on-lending system, only that particular credit facility granted to PACS/ FSS which is in default for a period of two crop seasons in case of short duration crops and one crop season in case of long duration crops, as the case may be, after it has become due will be classified as NPA and not all the credit facilities sanctioned to a PACS/ FSS. The other direct loans & advances, if any, granted by the bank to the member borrower of a PACS/ FSS outside the on-lending arrangement will become NPA even if one of the credit facilities granted to the same borrower becomes NPA.

4.2.11 Advances against Term Deposits, NSCs, KVPs/IVPs, etc.

Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs, provided adequate margin is available in the accounts. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

4.2.12 Loans with moratorium for payment of interest

In the case of bank finance given for industrial projects or for agricultural plantations etc. where moratorium is available for payment of interest, payment of interest becomes 'due' only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence do not become NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected.

In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates.

4.2.13 Agricultural advances

A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons. A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season. For the purpose of these guidelines, “long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops, would be treated as “short duration” crops. The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee in each State. Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him. The above norms should be made applicable to all direct agricultural advances as listed at paragraph III (1.1) of the Circular on Priority Sector Lending – Targets and Classification RPCD.CO.Plan.BC.9/04.09.01/2013-14 dated July 1, 2013. An extract of the list of these items is furnished in the Annex - 2. In respect of agricultural loans, other than those specified in the Annex - 2 and term loans given to non-agriculturists, identification of NPAs would be done on the same basis as non-agricultural advances, which, at present, is the 90 days delinquency norm.

Where natural calamities impair the repaying capacity of agricultural borrowers, banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or re-schedulement of the repayment period; and the sanctioning of fresh short-term loan, subject to guidelines contained in RBI circular RPCD. No.PLFS.BC.6/05.04.02/2013-14 dated July 1, 2013.

In such cases of conversion or re-schedulement, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms &

conditions and would be treated as NPA if interest and/or instalment of principal remains overdue for two crop seasons for short duration crops and for one crop season for long duration crops. For the purpose of these guidelines, "long duration" crops would be crops with crop season longer than one year and crops, which are not 'long duration" would be treated as "short duration" crops.

While fixing the repayment schedule in case of rural housing advances granted to agriculturists under Indira Awas Yojana and Golden Jubilee Rural Housing Finance Scheme, banks should ensure that the interest/instalment payable on such advances are linked to crop cycles.

4.2.14 Government guaranteed advances

The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition of income. The requirement of invocation of guarantee has been delinked for deciding the asset classification and provisioning requirements in respect of State Government guaranteed exposures. With effect from the year ending March 31, 2006 State Government guaranteed advances and investments in State Government guaranteed securities would attract asset classification and provisioning norms if interest and/or principal or any other amount due to the bank remains overdue for more than 90 days.

4.2.15 Projects under implementation

4.2.15.1 For all projects financed by the FIs/ banks after May 28, 2002, the ‘Date of Completion’ and the ‘Date of Commencement of Commercial Operations’ (DCCO), of the project should be clearly spelt out at the time of financial closure of the project and the same should be formally documented. These should also be documented in the appraisal note by the bank during sanction of the loan.

4.2.15.2 Project Loans

There are occasions when the completion of projects is delayed for legal and other extraneous reasons like delays in Government approvals etc. All these factors, which are beyond the control of the promoters, may lead to delay in project implementation and involve restructuring / reschedulement of loans by banks. Accordingly, the following

asset classification norms would apply to the project loans before commencement of commercial operations.

For this purpose, all project loans have been divided into the following two categories:

(a) Project Loans for infrastructure sector

(b) Project Loans for non-infrastructure sector

For the purpose of these guidelines, 'Project Loan' would mean any term loan which has been extended for the purpose of setting up of an economic venture. Further, Infrastructure Sector is a sector as defined in extant RBI circular on 'Definition of Infrastructure Lending'.

4.2.15.3 Project Loans for Infrastructure Sector

(i) A loan for an infrastructure project will be classified as NPA during any time before commencement of commercial operations as per record of recovery (90 days overdue), unless it is restructured and becomes eligible for classification as 'standard asset' in terms of paras (iii) to (v) below.

(ii) A loan for an infrastructure project will be classified as NPA if it fails to commence commercial operations within two years from the original DCCO, even if it is regular as per record of recovery, unless it is restructured and becomes eligible for classification as 'standard asset' in terms of paras (iii) to (v) below.

(iii) If a project loan classified as 'standard asset' is restructured any time during the period up to two years from the original date of commencement of commercial operations (DCCO), in accordance with the provisions of Part B of this Master Circular, it can be retained as a standard asset if the fresh DCCO is fixed within the following limits, and further provided the account continues to be serviced as per the restructured terms.

(a) Infrastructure Projects involving court cases
Up to another 2 years (beyond the existing extended period of 2 years, as prescribed in para 4.2.15.3 (ii), i.e., total extension of 4 years), in case the reason for extension of date of commencement of production is arbitration proceedings or a court case.

(b) Infrastructure Projects delayed for other reasons beyond the control of promoters
Up to another 1 year (beyond the existing extended period of 2 years, as prescribed in para 4.2.15.3 (ii), i.e., total extension of 3 years), in other than court cases.

(iv) It is re-iterated that the dispensation in para 4.2.15.3 (iii) is subject to adherence to the provisions regarding restructuring of accounts as contained in the Master Circular

which would inter alia require that the application for restructuring should be received before the expiry of period of two years from the original DCCO and when the account is still standard as per record of recovery. The other conditions applicable would be:

a. In cases where there is moratorium for payment of interest, banks should not book income on accrual basis beyond two years from the original DCCO, considering the high risk involved in such restructured accounts.

b. Banks should maintain following provisions on such accounts as long as these are classified as standard assets in addition to provision for diminution in fair value due to extension of DCCO:

Particulars	Provisioning Requirement
If the revised DCCO is within two years from the original DCCO prescribed at the time of financial closure	0.40 per cent
If the DCCO is extended beyond two years and upto four years or three years from the original DCCO, as the case may be, depending upon the reasons for such delay	Project loans restructured with effect from June 1, 2013: 5.00 per cent – From the date of such restructuring till the revised DCCO or 2 years from the date of restructuring, whichever is later Stock of project loans classified as restructured as on June 1, 2013: * 3.50 per cent - with effect from March 31, 2014 (spread over the four quarters of 2013-14) * 4.25 per cent - with effect from March 31, 2015 (spread over the four quarters of 2014-15) * 5.00 per cent - - with effect from March 31, 2016 (spread over the four quarters of 2015-16) The above provisions will be applicable from the date of restructuring till the revised DCCO or 2 years from the date of restructuring, whichever is later.

(v) For the purpose of these guidelines, mere extension of DCCO would not be considered as restructuring, if the revised DCCO falls within the period of two years from

the original DCCO. In such cases the consequential shift in repayment period by equal or shorter duration (including the start date and end date of revised repayment schedule) than the extension of DCCO would also not be considered as restructuring provided all other terms and conditions of the loan remain unchanged. As such project loans will be treated as standard assets in all respects, they will attract standard asset provision of 0.40 per cent.

(vi) In case of infrastructure projects under implementation, where Appointed Date (as defined in the concession agreement) is shifted due to the inability of the Concession Authority to comply with the requisite conditions, change in date of commencement of commercial operations (DCCO) need not be treated as 'restructuring', subject to following conditions:

a) The project is an infrastructure project under public private partnership model awarded by a public authority;

b) The loan disbursement is yet to begin;

c) The revised date of commencement of commercial operations is documented by way of a supplementary agreement between the borrower and lender and;

d) Project viability has been reassessed and sanction from appropriate authority has been obtained at the time of supplementary agreement.

4.2.15.4 Project Loans for Non-Infrastructure Sector (Other than Commercial Real Estate Exposures)

(i) A loan for a non-infrastructure project will be classified as NPA during any time before commencement of commercial operations as per record of recovery (90 days overdue), unless it is restructured and becomes eligible for classification as 'standard asset' in terms of paras (iii) to (iv) below.

(ii) A loan for a non-infrastructure project will be classified as NPA if it fails to commence commercial operations within one year from the original DCCO, even if is regular as per record of recovery, unless it is restructured and becomes eligible for classification as 'standard asset' in terms of paras (iii) to (iv) below.

(iii) In case of non-infrastructure projects, if the delay in commencement of commercial operations extends beyond the period of one year from the date of completion as determined at the time of financial closure, banks can prescribe a fresh DCCO, and retain the "standard" classification by undertaking restructuring of accounts in accordance with

the provisions contained in this Master Circular, provided the fresh DCCO does not extend beyond a period of two years from the original DCCO. This would among others also imply that the restructuring application is received before the expiry of one year from the original DCCO, and when the account is still "standard" as per the record of recovery. The other conditions applicable would be:

a. In cases where there is moratorium for payment of interest, banks should not book income on accrual basis beyond one year from the original DCCO, considering the high risk involved in such restructured accounts.

b. Banks should maintain following provisions on such accounts as long as these are classified as standard assets apart from provision for diminution in fair value due to extension of DCCO:

Particulars	Provisioning Requirement
If the revised DCCO is within one year from the original DCCO prescribed at the time of financial closure	0.40 per cent
If the DCCO is extended beyond one year and upto two years from the original DCCO prescribed at the time of financial closure	Project loans restructured with effect from June 1, 2013: 5.00 per cent – From the date of restructuring for 2 years Stock of Project loans classified as restructured before June 01, 2013: * 3.50 per cent - with effect from March 31, 2014 (spread over the four quarters of 2013-14) * 4.25 per cent - with effect from March 31, 2015 (spread over the four quarters of 2014-15) * 5.00 per cent - with effect from March 31, 2016 (spread over the four quarters of 2015-16) The above provisions will be applicable from the date of restructuring for 2 years.

(iv) For the purpose of these guidelines, mere extension of DCCO would not be considered as restructuring, if the revised DCCO falls within the period of one year from

the original DCCO. In such cases the consequential shift in repayment period by equal or shorter duration (including the start date and end date of revised repayment schedule) than the extension of DCCO would also not be considered as restructuring provided all other terms and conditions of the loan remain unchanged. As such project loans will be treated as standard assets in all respects; they will attract standard asset provision of 0.40 per cent.

4.2.15.5 Other Issues

(i) All other aspects of restructuring of project loans before commencement of commercial operations would be governed by the provisions of Part B of this Master Circular on Prudential norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances. Restructuring of project loans after commencement of commercial operations will also be governed by these instructions.

(ii) Any change in the repayment schedule of a project loan caused due to an increase in the project outlay on account of increase in scope and size of the project, would not be treated as restructuring if:

(a) The increase in scope and size of the project takes place before commencement of commercial operations of the existing project.

(b) The rise in cost excluding any cost-overrun in respect of the original project is 25% or more of the original outlay.

(c) The bank re-assesses the viability of the project before approving the enhancement of scope and fixing a fresh DCCO.

(d) On re-rating, (if already rated) the new rating is not below the previous rating by more than one notch.

(iii) Project Loans for Commercial Real Estate

It has been represented that commercial real estate (CRE) projects also face problems of delays in achieving the DCCO for extraneous reasons. Therefore, it has been decided that for CRE projects mere extension of DCCO would not be considered as restructuring, if the revised DCCO falls within the period of one year from the original DCCO and there is no change in other terms and conditions except possible shift of the repayment schedule and servicing of the loan by equal or shorter duration compared to the period by which DCCO has been extended. Such CRE project loans will be treated as standard assets in all respects for this purpose without attracting the higher provisioning applicable for

restructured standard assets. However, as stated in paragraph 15.1 of this circular, the asset classification benefit would not be available to CRE projects if they are restructured.

(iv) Multiple revisions of the DCCO and consequential shift in repayment schedule for equal or shorter duration (including the start date and end date of revised repayment schedule) will be treated as a single event of restructuring provided that the revised DCCO is fixed within the respective time limits stipulated at paragraphs 4.2.15.3 (iii) and 4.2.15.4 (iii) above, and all other terms and conditions of the loan remained unchanged.

(v) Banks, if deemed fit, may extend DCCO beyond the respective time limits stipulated at paragraphs 4.2.15.3 (iii) and 4.2.15.4 (iii) above; however, in that case, banks will not be able to retain the 'standard' asset classification status of such loan accounts.

(vi) In all the above cases of restructuring where regulatory forbearance has been extended, the Boards of banks should satisfy themselves about the viability of the project and the restructuring plan.

4.2.15.6 Income recognition

(i) Banks may recognise income on accrual basis in respect of the projects under implementation, which are classified as 'standard'.

(ii) Banks should not recognise income on accrual basis in respect of the projects under implementation which are classified as a 'substandard' asset. Banks may recognise income in such accounts only on realisation on cash basis.

Consequently, banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s). As regards the regulatory treatment of 'funded interest' recognised as income and 'conversion into equity, debentures or any other instrument' banks should adopt the following:

a) Funded Interest: Income recognition in respect of the NPAs, regardless of whether these are or are not subjected to restructuring/ rescheduling/ renegotiation of terms of the loan agreement, should be done strictly on cash basis, only on realisation and not if the amount of interest overdue has been funded. If, however, the amount of funded interest is recognised as income, a provision for an equal amount should also be made simultaneously. In other words, any funding of interest in respect of NPAs, if recognised as income, should be fully provided for.

b) Conversion into equity, debentures or any other instrument: The amount outstanding converted into other instruments would normally comprise principal and the interest components. If the amount of interest dues is converted into equity or any other instrument, and income is recognised in consequence, full provision should be made for the amount of income so recognised to offset the effect of such income recognition. Such provision would be in addition to the amount of provision that may be necessary for the depreciation in the value of the equity or other instruments, as per the investment valuation norms. However, if the conversion of interest is into equity which is quoted, interest income can be recognised at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity. Such equity must thereafter be classified in the "available for sale" category and valued at lower of cost or market value. In case of conversion of principal and /or interest in respect of NPAs into debentures, such debentures should be treated as NPA, ab initio, in the same asset classification as was applicable to loan just before conversion and provision made as per norms. This norm would also apply to zero coupon bonds or other instruments which seek to defer the liability of the issuer. On such debentures, income should be recognised only on realisation basis. The income in respect of unrealised interest which is converted into debentures or any other fixed maturity instrument should be recognised only on redemption of such instrument. Subject to the above, the equity shares or other instruments arising from conversion of the principal amount of loan would also be subject to the usual prudential valuation norms as applicable to such instruments.

4.2.16 Takeout Finance

Takeout finance is the product emerging in the context of the funding of long-term infrastructure projects. Under this arrangement, the institution/the bank financing infrastructure projects will have an arrangement with any financial institution for transferring to the latter the outstanding in respect of such financing in their books on a predetermined basis. In view of the time-lag involved in taking-over, the possibility of a default in the meantime cannot be ruled out. The norms of asset classification will have to be followed by the concerned bank/financial institution in whose books the account stands as balance sheet item as on the relevant date. If the lending institution observes that the asset has turned NPA on the basis of the record of recovery, it should be classified accordingly. The lending institution should not recognise income on accrual basis and

account for the same only when it is paid by the borrower/ taking over institution (if the arrangement so provides). However, the taking over institution, on taking over such assets, should make provisions treating the account as NPA from the actual date of it becoming NPA even though the account was not in its books as on that date.

4.2.17 Post-shipment Supplier's Credit

In respect of post-shipment credit extended by the banks covering export of goods to countries for which the Export Credit Guarantee Corporation's (ECGC) cover is available, EXIM Bank has introduced a guarantee-cum-refinance programme whereby, in the event of default, EXIM Bank will pay the guaranteed amount to the bank within a period of 30 days from the day the bank invokes the guarantee after the exporter has filed claim with ECGC.

Accordingly, to the extent payment has been received from the EXIM Bank, the advance may not be treated as a nonperforming asset for asset classification and provisioning purposes.

4.2.18 Export Project Finance

In respect of export project finance, there could be instances where the actual importer has paid the dues to the bank abroad but the bank in turn is unable to remit the amount due to political developments such as war, strife, UN embargo, etc.

In such cases, where the lending bank is able to establish through documentary evidence that the importer has cleared the dues in full by depositing the amount in the bank abroad before it turned into NPA in the books of the bank, but the importer's country is not allowing the funds to be remitted due to political or other reasons, the asset classification may be made after a period of one year from the date the amount was deposited by the importer in the bank abroad.

4.2.19 Advances under rehabilitation approved by Board for Industrial and Financial Reconstruction (BIFR)/Term Lending Institutions (TLIs)

Banks are not permitted to upgrade the classification of any advance in respect of which the terms have been renegotiated unless the package of renegotiated terms has worked satisfactorily for a period of one year. While the existing credit facilities sanctioned to a unit under rehabilitation packages approved by BIFR/TLIs will continue to be classified as substandard or doubtful as the case may be, in respect of additional facilities sanctioned under the rehabilitation packages, the Income Recognition, Asset

Classification norms will become applicable after a period of one year from the date of disbursement.

4.2.20 Transactions Involving Transfer of Assets through Direct Assignment of Cash Flows and the Underlying Securities

i) Originating Bank: The asset classification and provisioning rules in respect of the exposure representing the Minimum Retention Requirement (MRR) of the Originator of the asset would be as under:

a) The originating bank may maintain a consolidated account of the amount representing MRR if the loans transferred are retail loans. In such a case, the consolidated amount receivable in amortisation of the MRR and its periodicity should be clearly established and the overdue status of the MRR should be determined with reference to repayment of such amount. Alternatively, the originating bank may continue to maintain borrower-wise accounts for the proportionate amounts retained in respect of those accounts. In such a case, the overdue status of the individual loan accounts should be determined with reference to repayment received in each account.

b) In the case of transfer of a pool of loans other than retail loans, the originator should maintain borrower-wise accounts for the proportionate amounts retained in respect of each loan. In such a case, the overdue status of the individual loan accounts should be determined with reference to repayment received in each account.

c) If the originating bank acts as a servicing agent of the assignee bank for the loans transferred, it would know the overdue status of loans transferred which should form the basis of classification of the entire MRR/individual loans representing MRR as NPA in the books of the originating bank, depending upon the method of accounting followed as explained in para (a) and (b) above.

ii) Purchasing Bank: In purchase of pools of retail and non-retail loans, income recognition, asset classification and provisioning norms for the purchasing bank will be applicable based on individual obligors and not based on portfolio. Banks should not apply the asset classification, income recognition and provisioning norms at portfolio level, as such treatment is likely to weaken the credit supervision due to its inability to detect and address weaknesses in individual accounts in a timely manner. If the purchasing bank is not maintaining the individual obligor-wise accounts for the portfolio of loans purchased, it should have an alternative mechanism to ensure application of

prudential norms on individual obligor basis, especially the classification of the amounts corresponding to the obligors which need to be treated as NPAs as per existing prudential norms. One such mechanism could be to seek monthly statements containing account-wise details from the servicing agent to facilitate classification of the portfolio into different asset classification categories. Such details should be certified by the authorized officials of the servicing agent. Bank's concurrent auditors, internal auditors and statutory auditors should also conduct checks of these portfolios with reference to the basic records maintained by the servicing agent. The servicing agreement should provide for such verifications by the auditors of the purchasing bank. All relevant information and audit reports should be available for verification by the Inspecting Officials of RBI during the Annual Financial Inspections of the purchasing banks.

iii) The guidelines prescribed above at 4.2.20 (i) & (ii) do not apply to

(a) Transfer of loan accounts of borrowers by a bank to other bank/FIs/NBFCs and vice versa, at the request/instance of borrower;

(b) Inter-bank participations;

(c) Trading in bonds;

(d) Sale of entire portfolio of assets consequent upon a decision to exit the line of business completely. Such a decision should have the approval of Board of Directors of the bank;

(e) Consortium and syndication arrangements and arrangement under Corporate Debt Restructuring mechanism;

(f) Any other arrangement/transactions, specifically exempted by the Reserve Bank of India.

4.2.21 Credit Card Accounts

(i) In credit card accounts, the amount spent is billed to the card users through a monthly statement with a definite due date for repayment. Banks give an option to the card users to pay either the full amount or a fraction of it, i.e., minimum amount due, on the due date and roll-over the balance amount to the subsequent months' billing cycle.

(ii) A credit card account will be treated as non-performing asset if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the next statement date. The gap between two statements should not be more than a month.

(iii) Banks should follow this uniform method of determining over-due status for credit card accounts while reporting to credit information companies and for the purpose of levying of penal charges, viz. late payment charges, etc., if any.

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