3RD SEMESTER B.COM

CALICUT UNIVERSITY

CORPORATE ACCOUNTING

2019 ADMISSION

Prepared by

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SYLLABUS

BCM3 BO4 CORPORATE ACCOUNTING

Module I

a. Redemption of Debentures: Meaning- Writing off of Discount on issue and loss on issue of debenture- Methods of redemption- Annual drawings out of profit and capital (New regulation to be taught)- Debenture redemption reserve- Lump sum payment- Sinking funds and Insurance Policy (Theory only)- Purchase of own debentures- For cancellation, Investment and Reissue- Ex-interest and Cum-interest- Redemption by conversion- Journal Entries.
b. Redemption of Preference Shares: Provisions for redemption- Sources used for redemption- Capital redemption reserve- Journal entries
c. Bonus Shares: Cash Bonus- Capital bonus- provisions for the issue of bonus shares- Sources of bonus issue-Advantages of bonus issue- Journal entries.
d. Buy back of shares: Meaning- Provisions for issue- Sources of buyback- Advantages of buyback- Book building - Journal entries.
e) Right Issue: Right of pre-emption – Calculation of value of right
(30 Hours, 25 marks)

Module II

Banking Companies: Meaning of banking- Slip system of ledger posting- Important terms used- Revenue recognition in banks- Rebate on bills discounted with problems- Interest on doubtful debts with problems- Non-Performing Assets- Classification- Provisions for NPA(problems) - Final accounts of banking companies in the new form- Practical Problems. (18 Hours, 15 marks)

Module III

Accounts of Life Insurance: Meaning of life insurance- Features- Types of life insurance- Important terms used- Adjusting entries- Calculation of Life fund with problems- Determination of profit of life business and net bonus payable- Problems- Preparation of final accounts of life business in the new form-Practical Problems. (18 Hours, 15 marks)

Module IV

Consolidated Financial Statements (Ind AS 110): Group Companies and Group Structures– need for consolidation – Calculation of pre-acquisition Calculation of profit- Post-acquisition profit- Calculation of Non-Controlling Interest – Calculation of Cost of Control (Goodwill) or Capital Reserve- Preparation of Consolidated Balance Sheet without adjustments (simple problems)
(20 Hours, 15 marks)

Module V Important Disclosure based accounting standards: Earnings per share(Basic and Diluted) Ind AS 33 – Segment Reporting Ind AS 108- Events after Reporting Period (Adjusting and Non adjusting) Ind AS 10- Related party transactions Ind AS 24 - Changes in accounting policies, accounting estimates and errors Ind AS 8- Interim Financial Reporting Ind AS 34.
(10 Hours, 10 marks)

(Theory and problems may be in the ratio of 30% and 70% respectively)

Reference Books:

1. Chintal Patel, Bhupendra Mantri, India Accounting Standards, Taxmann Publications.

2. T.P. Ghosh, Illustrated Guide to India Accounting Standards, Taxmann Publications.

3. M.C. Shukla, T.S. Grewal and S.C. Gupta, Advanced Accounts, S.Chand& Co., New Delhi.

4. S.N. Maheshwari and S.K. Maheshwari, Financial Accounting.

5. R.L. Gupta and Radhaswamy, Advanced Accounting, Sultan Chand &Sons, New Delhi.

6. Dr Goyal V.K., Financial Accounting, Excel Books, New Delhi.

7. Ashok Sehgal and Deepak Sehgal, Advanced Accounting, Kalyani Publishers.

8. Jain and Narang, Financial Accounting, Kalyani Publishers.

9. B.S. Raman, Advanced Accountancy.

10. P.C. Tulasian, Introduction to Accounting, Pearson Education.

MODULE 1

A) REDEMPTION OF DEBENTURES.

Redemption of debentures means repayment of the debentures. It is the discharge of the liability on account of the debentures. Debentures can be redeemed either at par or at a premium.

Journal entries at the time of issue of debentures: -

[i]Issue at par and redemption at par

Bank a/c Dr
  To debentures a/c

[ii]Issue at discount and redemption at par

Bank a/c Dr
Discount on issue of debentures a/c Dr
  To debentures a/c

[iii]Issue at premium and redemption at par

Bank a/c Dr
  To debentures a/c
  To securities premium a/c

[iv]Issue at par and redemption at premium

Bank a/c Dr
Loss on issue of debentures a/c Dr
  To debentures a/c
  To premium on redemption of debentures a/c

[v]Issue at discount and redemption at premium

Bank a/c Dr
Loss on issue of debentures a/c Dr (discount on issue + premium on redemption)
  To debentures a/c
  To premium on redemption of debentures a/c

[vi]Issue at premium and redemption at premium

Bank a/c Dr
Loss on issue of debentures a/c Dr
  To debentures a/c
  To securities premium a/c
  To premium on redemption of debentures a/c

<u>Journal entries at the time of redemption:-</u>

*In situations **[i]** to **[iii]***

1. Debenture a/c Dr
   To Debenture holders a/c
2. Debenture holders a/c Dr
   To bank a/c

*In situations **[iv]** to **[vi]***

1. Debenture a/c Dr
   Premium on redemption a/c Dr
   To Debenture holders a/c
2. Debenture holders a/c Dr
   To bank a/c

WRITING OFF DISCOUNT/LOSS ON ISSUE OF DEBENTURES

Discount or loss on issue of debentures is a capital loss.it can be written off by debiting it to share premium a/c (section 78 of the companies act).the following two procedures are used.

[i] Fixed instalment method

In case debentures are redeemable after the expiry of a certain specific period in lump sum, the amount of discount can be equally apportioned to different years of debentures tenure.

The entry to write off discount every year is-

Profit and loss a/c Dr

To discount/loss on issue of debentures

[ii] Fluctuating instalment method (proportion method)

When debentures are redeemed by annual drawings or instalments, the total discount or loss on issue of debentures should be written off during the life of debentures in proportion to the debentures outstanding at the beginning of each year.

Disclosure of discount or loss on issue of debentures in balance sheet

It is shown under 'Assets' under the heading "other Current/Non-current Assets' as unamortized expenses till it is written off.

Problem 1(issue of debentures)

Journalize the following transactions relating to the issue of debentures

(a) A debenture issued at ₹95,repayable at ₹100
(b) A debenture issued at ₹95,repayable at ₹105
(c) A debenture issued at ₹100,repayable at ₹105
(d) A debenture issued at ₹105,repayable at ₹100

Note: the face value of each debenture is ₹100

Problem 2(issue and redemption of debentures)

Bhavana Co ltd issued the following debentures. Pass journal entries in the books of the company in connection with the issue and redemption of debentures.

1. 14% debentures of ₹4,00,000 issued at par and redeemable at par.
2. 14% debentures of ₹4,00,000 issued at a discount of 10% but redeemable at par.
3. 14% debentures of ₹4,00,000 issued at a premium 0f 10% but redeemable at par.
4. 14% debentures of ₹4,00,000 issued at a par but redeemable at a premium of 10%
5. 14% debentures of ₹4,00,000 issued at a discount of 10% and redeemable at a premium of 10%
6. 14% debentures of ₹4,00,000 issued at a premium of 10% but redeemable at a premium of 10%

Problem 3(fixed instalment method)

A limited company issued 20000 debentures at a discount of 5%, repayable at the end of 5 years. Show the Discount Account in the ledger for the period.

Problem 4(fluctuating instalment method)

On 1st January 2010, a limited company issued debentures of the value of ₹1,00,000 at a discount of 6%.the debentures were repayable by annual drawings of ₹20,000 made on 31st December each year. The directors decided to charge discount each year with an amount proportionate to debentures outstanding in the year.

Show the Discount Account in the Company's Ledger for the duration of the debentures.

Sources of funds for redemption of debentures

1. Out of fresh issue of shares or debentures
2. By utilization of a part of capital
3. By utilization of profits(accumulated profits)
4. By conversion into shares or debentures
5. Out of proceeds from sales of fixed assets.
6. By purchase of own debentures.

Methods of redemption of debentures

1. Redemption by lump sum payment.
2. Redemption by annual instalment payment.
3. Redemption by sinking fund method.
4. Redemption by insurance policy method.
5. Redemption by purchase of own debentures in open market
6. Redemption by conversion into shares or debentures

METHODS OF REDEMPTION OF DEBENTURES

1. **Payment in lump sum**

   The whole amount is paid to the debenture holders in lump sum at the end of a stipulated period.

(a) Redemption out of capital

When profits are not used in the redemption of debentures, then it is said to be redemption out of capital. This would affect the working capital of the company.

Now it is not possible to redeem debentures purely out of capital. Asper guidelines of SEBI and section 71(4) of Companies Act 2013, it is compulsory to create a Debenture Redemption Reserve (DRR) by an amount equal to 25% (1/4) of the face value of debentures before starting redemption.

According to 18(7) of the Companies (Share Capital and Debenture Rules) issued by the Ministry of Corporate affairs (MCA), the DRR is not required to be created by,

a) All India Financial Institutions regulated by RBI and

b) The banking companies.

c) Non-banking Financial Companies (NBFCs) covered under section 2(72) of the Companies Act

Journal entries for redemption of Debentures out of Capital

(a) When debentures are redeemed at par

(i)Debentures a/c Dr

To Debenture holders a/c

(ii) Debenture holders a/c Dr

To Bank a/c

(b) *When debentures are redeemed at premium*

(i) Debentures a/c Dr

Premium on redemption a/c Dr

To Debenture holders a/c

(ii) Securities Premium Reserve/General reserve/P/L a/c Dr

To Premium on redemption a/c

[on the assumption that premium on redemption has not been provided at the time of issue]

(iii) Debenture holders a/c Dr

To Bank a/c

(c) *When debentures are redeemed at discount (a rare possibility)*

(i)Debentures a/c Dr

To Debenture holders a/c

To Capital Reserve a/c

(ii) Debenture holders a/c Dr

To Bank a/c

Problem

Sun Ltd wants to redeem ₹2,00,000 of the face value of 6% debentures after 5 years from the date of issue. Pass the necessary journal entries at the time of redemption if :(a) the debentures are redeemed at par, (b) the debentures are redeemed at a premium of 10%. (c) the debentures are redeemed at a discount of 5%.

(b) *Redemption of debentures out of Profit / Surplus*

When sufficient profits are transferred from Statement of P/L to the Debenture Redemption Reserve Account at the time of redemption of debentures, such redemption is said to be out of profits.it reduces the profits available for dividend.

As per section 71(4) of the Companies Act 2013, the new provisions regarding this are: -

1. The company should create DRR at least 25%of the face value of debenture.
2. DRR shall be created out of the profits available for payment of dividend
3. Every company required to create DRR shall invest on or before 30th April in each year, a sum which shall not be less than 15% of the amount of its debentures maturing during the year ending on 31st march of the next year in any of the following methods: -
    a) In deposits with any scheduled bank, free from any charge or lien;
    b) In unencumbered securities of Central Government or of any State Govt.
    c) In unencumbered securities mentioned in sub-clauses (a) to (d) and (e) of section 20 of the Indian Trusts Act,1882;
    d) In unencumbered bonds issued by any other company which is notified under sub clause (f) of section 20 of the Indian Trusts Act,1882;

The amount invested above shall not be used for any purpose other than for redemption of debentures and shall not at any time fall below 15% of the amount of debentures.

4. In case of partly convertible debentures, DRR shall be created in respect of non-convertible portion.
5. The amount credited to the DRR shall not be used for any purpose other than for redemption of debentures.

SEBI's Guidelines

1. Every company shall create DRR in case of debenture redeemable after a period of more than 18 months from the date of issue
2. Creation of DRR is obligatory only for non-convertible debentures and non-convertible portion of partly convertible debentures.
3. Company shall create DRR equivalent to at least 25% of the amount of debenture issue before starting the redemption of debenture
4. Withdrawal from DRR is permissible only after 10% of the debenture liability has already been reduced.
5. In case of redemption of debentures fully out of profits/surplus, 100% of the face value of issued debentures should be transferred from P/L to DRR.

Accounting treatment (Journal entries)

1. *For investing the amount so appropriated in the debenture redemption investment (i.e., at least 15%)*
   Debenture Redemption Investment a/c Dr
   To Bank a/c
2. *For receiving interest on DRI a/c*
   Bank a/c Dr
   To Interest on Debenture Redemption Investment a/c

3. *For realizing the amount invested in DRI a/c*
   Bank a/c Dr
   To Debenture Redemption Investment a/c
   To Debenture Redemption Reserve a/c
4. *For creation of DRR*
   Statement of Profit and Loss (surplus) Dr
   To Debenture Redemption Reserve a/c
5. *For making payment to the debenture holders*
   (Entries already discussed)

After redemption of all debentures balance of DRR should be transferred to General reserve a/c.The entry is :

Debenture Redemption Reserve ac Dr
To General reserve a/c

Note: if the company has any balance in its DRR a/c and this balance is not equal to 25% of the nominal value of redeemable debentures, then, only the balance to make it 25% should be transferred to DRR a/c.

2. **Redemption of debentures by annual drawings or installments**

- When redemption is made by annual instalments
  It is also called lottery method of redeeming debentures (i.e. Drawing by lots)

There are two methods

(c) *Redemption out of capital*
- When the debentures are redeemed out of current sources of the company.

This would adversely affect the working capital of the company.

Note: it is compulsory to transfer at least 25% of the total amount of redeemable debentures to DRR before redemption. i.e. redemption fully out of capital is not possible now.

(d) *Redemption of debentures out of Profit / Surplus*
- When the amount payable is charged out of surplus from P/L statement.

Note: if it is not specified whether redemption is out of profit or capital, then it should always be supposed to be out of profits.

Accounting treatment

Accounting entries will be similar as recorded earlier.

Problem

A Ltd issued 4,000, 11% debentures of ₹100 each on April 1, 2016 at a discount of 5% redeemable at premium of 10% in equal annual drawings in 4 years out of capital.

Give journal entries both at the time of issue and redemption of debentures. (Ignore the treatment of loss on issue of debentures and interest).

3. **Redemption by sinking fund**

Every year a part of the profit is set aside and sinking fund is created. The sinking fund is invested in outside securities like shares and debentures of other companies. Interest received on such investment will again be invested. This process continues till the date of redemption. The investment will be sold and cash thus received will be used for redemption, so the working capital will not be affected. Under this method, sinking fund account and sinking fund investment account will be opened. After redemption, balance in sinking fund account is transferred to general reserve.
[in this case company need not create DRR and deposit 15%of the amount to be redeemed]

Merits:-

i) Liquid cash is available for redemption without disturbing financial position.
ii) In case of emergency, the security maybe pledged or sold out to get cash.

Demerits:-

i) Chance of loss in realizing investments.
ii) ROI may be less than the earning rate.
iii) Shareholders get a comparatively low rate of dividend.

4. **Insurance policy method.**

Under this method, an insurance policy is purchased by paying annual premium. Such policy will mature on the date when the Debentures become redeemable. The policy amount will be equal to the amount required for redemption. The difference between the policy amount and premium paid will be interest on premium (or profit on realization of policy).

This method:

i. Provides funds for redemption., and
ii. Covers the risk involved in the transaction.

5.Redemption by purchase of own debentures from the open market.

A company can buy its own debentures if it is authorized by its articles. When a company purchases own debentures it becomes redemption of debentures. This purchase may be paid from sinking fund or out of profit or out of capital.
This method is used when:

a) The rate of interest is higher than the market interest rate.
b) The market price of debentures falls below the face value
c) Sufficient amount is available in surplus fund.

Advantages:-

i) Company gets profit when market price of debentures is the lowest.
ii) It reduces the burden of loan.
iii) It reduces the interest burden.
iv) It avoids the payment of premium on redemption.

Purposes of purchase of Own Debentures

The debentures may be purchased either for

a) Immediate cancellation, or for
b) Investment.

a) Purchase of Own Debentures for Immediate Cancellation.

When debentures are cancelled immediately, there may be profit to the company either because of purchase at lower price or because of saving the redemption premium. Both gains should be transferred to ‘profit on purchase/redemption of debentures a/c’.

Accounting treatment.

i. *When debentures (redeemable at par) are purchased at par or at nominal value.*
Debentures A/c Dr. (with nominal value)
Bank A/c
(**Note:-** Creation of DRR should be done)

ii. *When debentures (redeemable at premium) are purchased at par or nominal value.*
Debentures A/c Dr.(with nominal value)
Premium on redemption of Debentures A/c Dr.
To Bank A/c
To profit on redemption of Debentures (premium on redemption saved)

For transferring profit on redemption to capital reserve.
Profit on Redemption /Purchase of Debentures A/c Dr.
To Capital Reserve

[**Note:-** when there is sinking fund, the profit should be credited to sinking fund A/c and not to Capital Reserve A/c]

Problem

X Ltd had issued 50,000 Debentures of ₹100 each at par redeemable at 20% premium. The company purchased 5,000 debentures from the open market for immediate cancellation at ₹100 each just after the due date of debenture interest. Pass the journal entries for purchase of own debentures for immediate cancellation.

iii. *When Debentures (redeemable at par)are purchased at a discount(i.e., less than nominal value)*

(a) Debentures A/c Dr. (nominal value)
To Bank A/c (with purchase price)
To Profit on Purchase/Redemption of Debentures. A/c (with profit on purchase)

(b) Profit on purchase /redemption of debentures A/c Dr.
To Capital Reserve.

Problem

A Ltd had issued 50,000 debentures of ₹100 each redeemable at par. The company purchased 5,000 debentures from the open market for immediate cancellation at ₹95 each just after the due date of debenture interest. Pass the journal entries for purchase of own debentures for immediate cancellation.

iv. *When debentures(redeemable at premium)are purchased at less than nominal value on the due date of interest.*

(a) Debentures A/c Dr.(nominal value)
Premium on redemption of debentures A/c Dr.
To Bank A/c (with amount paid)
To profit on redemption/purchase of debentures A/c (with both gain,i.e.,premium saved + difference in purchase value and face value)

(b) profit on redemption/purchase of debentures A/c Dr
To Capital Reserve

[‘profit on cancellation of debentures’ can also be used in the place of profit on redemption]

Problem

On 1st April 2018, A Ltd had issued 5,000 debentures of ₹100 each at par. These debentures are redeemable at premium of 10%. Out of these, debentures of the face value of ₹1,00,000 are to be redeemed every year commencing from March 31,2020, either by purchase from open market or by drawing of lots. The company created DRR and invested the required amount as per law.

On March 31st 2020,the company purchased debentures of the face value of ₹1,00,000 at ₹85 each for immediate cancellation. Give journal entries for redemption of debentures during the year 2019-20

v. *When debentures (redeemable at par) are purchased at more than nominal (i.e., at premium)on the due date of interest.*

Debentures A/c Dr. (with nominal value)
Loss on Redemption/purchase of Debentures Dr. (with excess amount paid)
To Bank A/c

To write off loss on redemption of debentures

Capital reserve A/c Dr.(if exists)
Securities Premium Reserve A/c Dr.(if exists)
Statement of Profit and Loss Dr.
To Loss on Redemption/purchase of Debentures

[**Note:-** when there is sinking fund, the loss should be debited to Sinking Fund A/c]

Problem

On 1st April 2018, A Ltd had issued 5,000 debentures of ₹100 each at par. These debentures are redeemable at par. Out of these, debentures of the face value of ₹1,00,000 are to be redeemed every year commencing from March 31,2020, either by purchase from open market or by drawing of lots. The company created DRR and invested the required amount as per law.

On March 31,2020, the company purchased debentures of the face value of ₹1,00,000 at ₹105 each for immediate cancellation. Give journal entries for redemption of debentures during the year 2019-20.

vi. *When debentures (redeemable at premium)are purchased at more than nominal value(i.e.,at premium)on the due date of interest.*

Debentures A/c Dr.(nominal value)
Premium on redemption of Debentures A/c Dr.
Loss on Redemption/purchase of Debentures A/c Dr(excess amount paid)

To Bank A/c
To Profit on redemption/purchase of Deb.a/c

If the gain is greater than the loss, the net profit is transferred to capital reserve. The entry is:

Profit on redemption/purchase of Deb.a/c (gain)
To Loss on Redemption/purchase of Debentures A/c(loss)
To Capital Reserve A/c (balance or difference)

If the loss is greater than the premium, then there is net loss and it should be written off. The entry is:

Profit on redemption/purchase of Deb.a/c (gain) Dr.
Capital reserve/Securities premium reserve/profit or surplus Dr(loss-gain,i.e.,net loss)
To Loss on Redemption/purchase of Debentures A/c

Problem(case of profit)

On 1st April 2018 A Ltd had issued5,000 debentures of ₹100 each at par. These debentures are redeemable at 10% premium. Out of these, debentures of the face value of ₹1,00,000 are to be redeemed every year commencing from March 31, 2020,either by purchase from open market or by drawing of lots. The company created DRR and invested the required amount as per law.

On March 31,2020,the company purchased debentures of the face value of ₹1,00,000 at ₹106 each for immediate cancellation. Give journal entries for redemption of debentures during the year 2019-'20.

Problem (case of loss)

On 1st April 2018,A Ltd had issued 5,000 debentures of ₹100 each at par. These debentures are redeemable at 10% premium. Out of these, debentures of the face value of ₹1,00,000 are to be redeemed at every year commencing from March 31,2020,either by purchase from open market or by drawing of lots. The company created DRR and invested the required amount as per law.

On March 31,2020,the company purchased debentures of the face value of ₹1,00,000 at ₹115 each for immediate cancellation. Give journal entries for redemption of debentures during the year 2019- '20.

Expenses on purchase of Debentures

If any expense is incurred on purchase of debentures, then it will be added with cost of purchase. The same amount is deducted from 'profit on redemption'.

Problem

A Ltd purchased for cancellation 1,000 of its own 10% debentures of ₹100 each at ₹97. The cost of purchase amounted to ₹200 (ignore interest). Give journal entries.

b) Purchase of Debentures for investment (Own Debentures)

A company may purchase its own debentures for investment (not for immediate cancellation). These debentures are treated as investments and in the future they may be cancelled or reissued. After cancellation, the debentures stand redeemed. These Debentures are popularly called *own debentures.*

Debenture interest will continue to be payable on those which are held by outsiders, i.e., debenture holders. But interest on own debentures will be simultaneously income also.

Accounting treatment

(a) *On purchase of own debentures*
Own Debentures A/c Dr. (with purchase price)
To Bank A/c

(b) *On cancellation of own debentures*
Debentures A/c Dr. (nominal or face value)
To own Debentures A/c (with cost or purchase price)
To profit on redemption of Debentures A/c (with profit on redemption)

(c) *On transfer of profit on redemption*
profit on redemption of Debentures A/c Dr.
To Capital Reserve

(d) *On reissue of own debentures*
Bank A/c Dr. (amount received on reissue)
Loss on reissue of Debentures A/c Dr. (if at loss)
To own debentures A/c (cost or purchase price)
To Profit on reissue of Debentures (if at profit)

[**Note:** Profit or loss on redemption of debentures arises only on cancellation or reissue]

Problem

A company purchased ₹30,000, 6% debentures of ₹100 each at ₹95 each for investment. After six months the debentures were cancelled. Show Journal.

Interest on Own Debentures.

If own debentures are not cancelled immediately, the company will pay interest only to outside debenture holders and the interest on own debentures will be retained by the company and this will be credited to interest on own Debentures A/c(income).

The entry is:
Interest on Debentures A/c Dr. (total interest)
To Bank A/c (payable to outsiders)
To interest on Own Debentures (Due to the company)

[when there is sinking fund, the total interest (expense) is debited to Profit/Loss a/c and the "Interest on own Debentures"(income) is credited to Statement of Profit or Loss. The net debit represents the interest payable to outsiders. When there is sinking fund, the "interest on own Debentures" is credited to Sinking Fund A/c.

Problem

On 1st April,2019 X Ltd, had 10,000, 12% Debentures of ₹100 each. 1,000 own debentures @96 each were purchased by the company in the open market on 30th September 2019. Debentures interest is payable half yearly, on 30th September and 31st March. The company cancelled all the purchased debentures on 31st March,2020. There was a balance of ₹2,50,000 in the Debenture Redemption Reserve Account. Accounts are closed on 31st March every year.

Pass necessary journal entries for the year ended 31st March, 2020,ignoring tax.

Ex-interest and Cum-interest quotations

If a company purchases its own debentures on the date of payment of interest, there will be no problem with regard to interest. If the debentures are purchased before the due date of the interest payment, then the problem arises as to whether the price paid includes interest for the expired period or not. There are two types of quotations –

Cum – interest quotation and
Ex – interest quotation.

Cum – interest Quotation

If the purchase price includes interest for the period from previous date of interest to the date of purchase, it is called cum interest price ['Cum'(latin word) means 'with' i.e. Cumulative or inclusive of interest].

Journal entries

(a) *When the debentures are purchased for immediate cancellation:*

Debentures A/c Dr.(nominal value of debentures)
Interest on Debentures A/c Dr.(interest for expired period)
To Bank (amount paid)
To Profit on redemption of debentures (profit on redemption)

(b) *When the debentures are purchased for holding as investment:*

Own Debentures A/c Dr. (cost of debentures)
Interest on Debentures A/c Dr.(interest for the expired period)
To Bank A/c (amount paid)

Here ;
Cost of Own Debentures = Price paid – Interest for the expired period.

(c) *When own debentures purchased for investment are cancelled in future*

Debentures A/c Dr.(nominal value)
To Own Debentures A/c (cost, i.e., price paid minus interest)
To Profit on Redemption of Debentures (balance)

Ex – interest Quotation

If the purchase price excludes the interest for the expired period, it is called Ex-interest price ['Ex' (Latin word) i.e., exclusive of interest]. This means the purchaser(company) has to pay, in addition, the interest for the expired period.

Thus;
Cost of own Debentures = Price paid

Journal Entries

(a) *When debentures are purchased for immediate cancellation*
Debentures A/c Dr. (Nominal value of debentures)
Interest on Debentures A/c Dr. (interest for the expired period)
To Bank A/c (total amount paid,i.e.,cost of debenture + interest)
To Profit on Redemption of Debentures (balancing figure)

(b) *When debentures are purchased as investment*
Own Debentures A/c Dr. (cost of debentures,i.e.,price paid)
Interest on Debentures A/c Dr.(interest for expired period)
To Bank A/c (Total)

(c) *When Own debentures purchased for investment are cancelled in future*
Debentures A/c Dr. (nominal value)
To Own Debentures A/c (cost,i.e.,price paid)
To Profit on Redemption of Debentures (balance)

Problem 1

On 1st July 2018, a company issued 1,000, 6% Debentures of ₹100 each (interest payable on 30th June and 31st December). The company is allowed to purchase own debentures which may be cancelled or kept or reissued at the company's option. The company made following purchases in the open market for immediate cancellation:

On 31st May 2019, 100 debentures at ₹98 ex-interest
On 30th September 2020, 50 debentures at ₹97 cum interest
Give journal Entries

Problem 2

A Ltd purchases its own 12% Debentures of ₹30,000 at ₹98 on 1.4.2020. interest is payable on 30th June and 31st December every year. Give journal entries in the books of A Ltd.
If the quotation is (i) cum-interest, and (ii) ex-interest. The company closes its books on 31st December.

Problem 3

A Ltd cancelled the debentures purchased on 1-4-2020(in the *Problem 2*). Give the entries for cancellation when debentures were purchased on (1) cum- interest basis, and (2) ex-interest basis.

<u>6. Redemption by conversion</u>

It means redeeming the debentures by converting them into new debentures and/or shares with in a stipulated period at the option of the debenture holders. The redemption can be made either at par or at premium but not at discount. However the new debentures may be issued either at par, or at premium or at discount. New shares can be issued at par or at premium, but not at discount.

Legal provisions regarding Redemption by conversion.

i) Non-convertible portion of debentures cannot be redeemed by conversion.
ii) There is no need to create DRR and it is not necessary to invest 15% of the value to be redeemed.
iii) The debenture holders have to apply for this type of redemption.
iv) In case of conversion of debentures originally issued at discount before their redemption date, the Discount on Debentures Account is credited.
v) Those debenture holders who are not willing for conversion are paid in cash.

Advantages

To company

i) Any financial source is not needed for redemption.
ii) It has no adverse effect on working capital of the company.
iii) Creation of DRR is not required by the company.
iv) Investment is not needed for redemption.

To debenture holders

i) They can participate in profits and management of the company.
ii) The conversion depends upon the will of debenture holders, not forcibly.
iii) They accept this type of redemption in hope of higher interest/dividend.

Accounting treatment

a) ***When debentures are redeemed (by conversion) at par on maturity and new shares/debentures are issued at par:***

i) Debentures A/c (old) Dr.(with nominal value)
 To Debenture holders A/c
 (Transfer of debentures to debenture holders)

ii) Debenture holders A/c Dr.
 To New Debentures A/c / Share capital A/c (issue of new debentures or shares at par)

$$\text{No. of new shares/debentures to be issued} = \frac{\text{Amount Payable}}{\text{Issue price per share or debenture}}$$

Problem

A Ltd issued 60,000, 8% debentures of ₹100 each redeemable after 4 years by converting them into equity shares of ₹10 each. Record journal entries for issue and redemption of debentures. Ignore entries for payment of interest.

b) ***When debentures are redeemed (by conversion) at premium at maturity and new shares /debentures are issued at par.***

i) Debentures A/c Dr. (with nominal value)
 Premium on Redemption of Debentures A/c Dr.
 To Debenture holders A/c
 (Amount due to debenture holders and premium due)

ii) Debenture holders A/c Dr.
 To New Debentures A/c / Share capital A/c (issue of new debentures or shares at par)

Problem

X Ltd had issued 2000, 8% debentures of ₹100 each at par and redeemable at 10% premium by converting debentures into equity shares of ₹10 each at par. Write journal entry for conversion.

c) ***When debentures are redeemed (by conversion) at par at maturity and new shares /debentures are issued at premium.***

a. Debentures A/c Dr.(with nominal value)
 To Debenture holders A/c
 (Amount due to debenture holders on redemption)

b. Debenture holders A/c Dr.

To New Debentures A/c / Share capital

To Securities Premium Reserve A/c

(Issue of new debentures or shares at premium)

Problem

X Ltd issued 8,000, 9% debentures of ₹100 each at a premium of 5% on April 1, 2018 redeemable at par by conversion of debentures into shares of ₹20 each at a premium of ₹5 per share on March 31,2020. Record necessary journal entries for issue and redemption of debentures.

d) ***When debentures are redeemed (by conversion) at premium at maturity and new shares /debentures are issued at premium.***

a. Debentures A/c Dr.(with nominal value)

Premium on Redemption of Debentures A/c Dr.

To Debenture holders A/c

(Amount due to debenture holders on redemption)

iii) Debenture holders A/c Dr.

To New Debentures A/c / Share capital A/c To Securities Premium Reserve A/c

(Issue of new debentures or shares at premium)

Problem

Y Ltd., had an outstanding balance of ₹9,00,000, 9% debentures of ₹100 each redeemable at a premium of 5%. According to the terms of redemption, the company redeemed 25% of the above debentures by converting them into shares of ₹10 each at a premium of ₹5. Record the entries for redemption of debentures in the books of Y Ltd

e) ***When debentures are redeemed (by conversion)at par on maturity and new debentures are issued at discount.***

iii) Debentures A/c Dr.(with nominal value)

To Debenture holders A/c

(Amount due to debenture holders on redemption)

iv) Debenture holders A/c Dr.

Discount on issue of debentures A/c.Dr.

To New Debentures (issue of new debentures at discount)

Problem

X Ltd redeemed 9,600, 12% debentures of ₹100 each by converting them into 15% new debentures of ₹100 each at a discount of 4%. Give necessary journal entries regarding redemption in the books of the company.

f) ***When debentures originally issued at discount are redeemed by conversion:***

Debentures may be redeemed either before maturity or at maturity.

A. Conversion before maturity

The number of shares or debentures to be issued is calculated on the basis of net proceeds (i.e., after deducting the discount from the face value). If this is not applied, the provisions of the Companies Act would be violated.

Journal entries

a) Redeemable at par by conversion into shares before maturity

i) For amount due to debenture holders

Debentures A/c (old) Dr.(nominal value)

To Discount on issue of debentures A/c (discount not yet written off)

To Statement of Profit and Loss (discount already written off)

To Debenture holders A/c (net amount due)

ii) For issue of shares or debentures at par

Debenture holders A/c Dr.

To Equity share capital/ Preference share capital/ Debentures A/c

iii) For issue of shares or debentures at premium

Debenture holders A/c Dr.

To Equity share capital/ Preference share capital/ Debentures A/c To Securities Premium Reserve A/c

Note:- if the original period and actual period of redemption are known, the 'Discount on issue of Debentures' should be split into two – the 'discount not written off or yet to be written off' and 'discount already written off'.if the original period and actual period of redemption are not known, the total amount of discount should be credited to "Discount on Issue of Debentures A/c".

Problem

A ltd had issued 2000, 10% debentures of ₹100 each at a discount of 10%. These debentures were given the option to convert their debentures into equity shares of ₹ 100 each at par. The holders of 400 debentures out of the above exercised the option before maturity. Write journal entry for conversion if : a) new equity shares are issued at par, and b) New equity shares are issued at 20% premium.

Redeemable at par by conversion into shares before maturity

i) For amount due to debenture holders

Debentures A/c (old) Dr.(nominalvalue)

Premium on Redemption of Debentures Ac Dr.

To Discount on issue of debentures A/c (discount not yet written off)

To Statement of Profit and Loss (discount already written off)

To Debenture holders A/c (net amount due)

[for issue of shares, the entries havealready been discussed]

Problem

A ltd had issued 2000, 10% debentures of ₹100 each at a discount of 10% on 01-04-2017 redeemable at a premium of 20% after 5 years. These debentures were given the option to convert their debentures into equity shares of ₹ 100 each at any time before maturity. The holders of 400 debentures out of the above exercised the option on 31st March 2020. Write journal entry for conversion. Assume that the equity shares are issued at 10% premium.

B. Conversion of debentures on maturity:

It is converted on the basis of the face value or nominal value and not at its net proceeds. In such cases, the provisions of Companies Act are not violated because the Discount on issue of Debentures has already been written off.

Problem

In 2015 JK Ltd had issued 10% 2,00,000 debentures at discount of 10%. The debentures are redeemable in 2020. In 2020, the Company gave the debenture holders the option of converting the debentures into 6% preference shares of 100 each at a premium of 25%. One debenture holder holding 25000 debentures exercised the option. Give journal entries for redemption by conversion.

B) **REDEMPTION OF PREFERENCE SHARES**

According to section 55(i) of the Companies Act, 2013 a company cannot issue irredeemable preference shares.

Redemption of preference shares means repayment of preference share capital to the preference shareholders.

Provisions (conditions) for redemption of preference shares(section 55)

1. Shares to be redeemed must be fully paid up.
2. Redemption should be either out of profits or out of proceeds of fresh issue.
3. Any premium payable on redemption must be provided out of the profits or reserves of the company.
4. If the shares are redeemed out of profits available for dividend, an amount equal to the nominal value of shares must be transferred to the Capital Redemption Reserve Account.
5. The CRR account can be used only for issue of fully paid up bonus shares.
6. Notice of redemption must be sent to the Registrar of Companies within 30 days from the date of redemption.
7. The redemption of preference shares is not to be considered as reduction of capital. Hence the company may issue shares up to the nominal amount of shares redeemed.

Preference shares can be redeemed either at par or at premium(but not at discount)

Sources of Redemption

There are three sources of redemption of preference shares. They are:

1. Redemption out of fresh issue of shares
2. Redemption out of profits
3. Redemption partly out of fresh issue and partly out of profit.

Redemption out of Fresh Issue of Shares :

Under this method the company redeems the preference shares out of the proceeds of issue of shares made for the purpose. In other words, company issues new shares (equity or preference) and the proceeds from such issue are used for redemption of preference shares. The company may issue fresh shares either at par or at premium. It should be noted that share premium out of a new issue cannot be used for redemption.

Accounting Procedure

For solving problems, the following procedure is to be followed:

1. First see whether the redeemable preference shares are fully paid up or partly paid up. If they are partly paid up, pass the following journal entries to make them fully paid up.

(a) Preference Share Final Call A/c Dr
To Preference Share Capital A/C
(For making the preference share final call)

(b) Bank A/C Dr
To Preference Share Final Call A/c
(For receiving the preference share final call money)

2. Make journal entry for fresh issue of shares when company issues new shares:

(a) *At Par*

Bank A/C Dr
To Share Capital A/c
(Issue of shares at par)

(b) *At Premium*

Bank A/C Dr
To Share Capital A/c
To Securities Premium Reserve A/C
(Issue of shares at premium)

Note: Section 53 of Companies Act, 2013 prohibits the companies to issue shares at discount.

3. Write journal entry for redemption of preference shares

(a) *When Redemption is at Par*

Redeemable Preference Share Capital A/C Dr
To Preference Shareholders A/C
(Transfer of capital to preference shareholders)

Preference Shareholders A/C Dr
To Bank A/C
(Payment to preference shareholders)

(b) *When Redemption is at Premium*

(i) Securities Premium Reserve / Statement of Profit and Loss Dr.
To Premium on Redemption of Preference Shares A/C
(Premium on redemption provided out of securities premium or profit and loss)

(ii) Redeemable Preference Share Capital A/C Dr
Premium on Redemption of Preference Shares A/c Dr
To preference Shareholders A/C
(Transfer of capital and premium to preference shareholders)

(iii) preference Shareholders A/C Dr
To Bank
(Payment to preference shareholders)

Problem 1 (Fresh Issue of Shares at Par and Redemption at Par)

A Ltd had 10,000, 8% redeemable preference shares of ₹100 each, fully paid up. The company decided to redeem these preference shares at par by issue of sufficient number of equity shares of₹ 10 each fully paid at par. Write journal entries in the books of the company.

Problem 2 (Fresh Issue of Shares at Premium and Redemption at Par)

B Ltd had 3,000,9% preference shares of ₹200 each fully paid up. The company decided to redeem these preference shares at par, by issue of sufficient number of ordinary shares of₹ 25 each at a premium of₹ 2 per share as fully paid. Write journal entries in the books of the company.

Problem 3 (Fresh Issue of Shares at Premium and Redemption at Premium)

D Ltd had 2,000, 7% redeemable preference shares of ₹50 each fully paid up. The company decided to redeem these shares at 5% premium by the issue of sufficient number of equity shares of ₹10 each fully paid at 10% premium. The company had ₹75,000 undistributed profit in profit and loss statement on the date of redemption. Write journal entries in the books of the company.

Redemption of Partly Paid up Shares

If the preference shares are partly paid, they will have to be made fully paid before redemption. The journal entries have already been given. In case there are two categories of redeemable preference shares (one fully paid and another partly paid) and there is no instruction regarding redemption, only fully paid preference shares may be redeemed. Sometimes there are calls in arrears in case of redeemable preference shares. In such a case, it is necessary to follow the instructions given in the question. If nothing is mentioned in the question, there are two options.

They are: (a) Preference shares having calls in arrears should not be redeemed.
(b) It is presumed that calls in arrears are collected and all the preference shares are redeemed.

Problem 4 (Partly Paid up Shares)

E Ltd had 8,000, 8% redeemable preference shares of ₹25 each, ₹20 called up. The company decided to redeem the preference shares at 5% premium by the issue of sufficient number of equity shares of ₹10 each fully paid up at a premium of 10%. Pass journal entries relating to redemption.

Redemption out of Profits

Redeemable preference shares can be redeemed out of the divisible profits. Divisible profits mean the profits available for dividend. The examples of divisible or undistributed profits include general reserve, reserve fund, dividend equalization reserve, investment fluctuation reserve, insurance fund, workmen's compensation fund, workmen's accident fund, debenture redemption reserve, reserve for contingencies, any other revenue reserve, profit and loss statement balance etc. These reserves and profits are available for distribution of dividends.

Capital profits are not divisible profits. Examples of capital profits include capital reserves, securities premium reserve, forfeited shares account, profit prior to incorporation, capital redemption reserve account, profit on redemption of debentures, profit on revaluation of assets and liabilities, development rebate reserve, investment allowance reserve etc. These are not available for dividends. Hence, these are not used to redeem preference shares.

In other words, the capital profits or reserves cannot be utilized for redemption of preference shares.

In the case of redemption out of profits, an amount equal to face value or nominal value of Shares so redeemed should be transferred from divisible profits to Capital Redemption Reserve Account.

Reasons for Creating CRR:-

1. Capital maintenance
2. Safeguard of creditors

Accounting Treatment

The following journal entries are required to be passed in the books of the company

1. *When Shares are Redeemed at Par*

(a) On transfer to Capital Redemption Reserve A/c
Statement of Profit and Loss / General Reserve Alc Dr.
To Capital Redemption Reserve A/c

(b) On the redemption of shares
Preference Share Capital A/C Dr
To Preference Shareholders A/C

(c) On Payment to Preference Shareholders
Preference Shareholders A/C Dr.
To Bank A/C

Note: First see whether the preference shares are fully paid up or partly paid up. If the shares are partly paid up they must be made fully paid up. The journal entries have already been given.

2. *When Shares are Redeemed at Premium*

(a) Same entry as under 1 (a) above for transfer to Capital Redemption Reserve A/c from divisible profits.

(b) On providing Premium Payable on Redemption
Securities Premium Reserve A/c/ Statement of Profit & Loss / Capital Reserve A/ Dr.
To Premium on Redemption Alc

(c) On making money due to preference shareholders

Preference Share Capital A/C Dr.
Premium on Redemption A/C Dr.
To Preference Shareholders Alc

(d) On payment to Shareholders
Same entry as under 1(c) above

Problem (Redemption out of Profits)

The following extract from the B/S of Sun Ltd as at 31-12-2020, is given to you:

	₹	
Share Capital		
10,000 Equity Shares of ₹10 each	1,00,000	
10,000 8% Preference Shares of ₹10 each	1,00,000	
Capital Reserve	50,000	
General Reserve	30,000	
Profit & Loss (Suplus)		85,000

The company exercises its option to redeem the preference shares on 1st January 2020. Give journal entries to record the redemption.

Utilisation of CRR

According to Companies Act, the CRR A/c can be utilised for issuing fully paid up bonus shares to existing equity shareholders. CRR cannot be utilised for any other purpose.

Preparation of Balance Sheet after Redemption

Sometimes you are asked to prepare balance sheet after redemption. In such cases, all changes arising on redemption should be taken into consideration while preparing the balance sheet.

Problem (Balance Sheet after Redemption**)**

Moon Ltd has the following Balance Sheet as on 31-3-2020:

Particulars			**Amount**
A. Equity and Liabilities			
1. Equity			
(a) *Share Capital* (30,000 Equity Shares of 20 each fully paid up)			6,00,000
6% Redeemable Preference share capital (2,500 Shares of 40 each)			1,00,000
(b) *Other Equity (Retained Earnings)*			2,00,000
Capital Reserve	10,000		
Securities Premium Reserve	15,000		
Dividend Equalisation Fund	25,000		
General Reserve	50,000		
Profit & Loss (Surplus)		1,00,000	
Current Liabilities			1,00,000
Total Equity and Liabilities			10,00,000

B. Assets

1. Non-current Assets	8,00,000
2. Current Assets	
Cash at Bank	2,00,000
Total Assets	10,00,000

Note: Notes to accounts are not given

On 1st April 2020, the Board of Directors decided to redeem the preference shares at 10% premium by utilisation of revenue profits and balance from P/L. You are requested to pass journal entries in the books of the company and redraft its B/S.

Redemption out of Fresh issue of Shares and Profits

This is the most practical method of redemption. Under this method the company can redeem the preference shares partly from the fresh issue of shares and partly out of revenue profits (undistributed profits).

Steps

1. Determine the amount payable on redemption of preference shares.
2. Decide the amount of fresh issue of shares to be made (i.e., the portion of redemption out of fresh issue).
3. Ascertain the amount to be transferred to Capital Redemption Reserve A/c out of revenue profit i.s., the portion of redemption out of profit). It can be ascertained inthe following manner:

Face value of shares redeemed	XXX
Less : Proceeds from fresh issue of share	XXX
Redemption out of profits (i.e., the amount to be transferred to C.R.R. A/C	XXX

4. If proceeds to be collected from fresh issue is not decided, it is to be ascertained

Problem (Combination of fresh issue and profit)

X Ltd has a part of its share capital in 1000 Redeemable Preference Shares of ₹100 each. The shares have now become due for redemption. It has been discovered that the company's Reserve Fund amounts to ₹75000, 50,000 out of which has been decided to be utilised in connection with the redemption, the balance being met out of a fresh issue of sufficient number of equity shares of 20 each fully paid. You are requested to give the journal entries recording the above transactions.

Use of Equation for determining the Face Value of Shares to be Issued

Sometimes students are not given the number of shares to be issued for the purpose of redemption of preference shares. In such cases students are required to find out the minimum number of shares to be issued for redemption. This problem becomes difficult only when the new issue of shares is to be at premium and the existing redeemable preference shares are redeemable at premium.

In such a case the following equation may be helpful:

Red. Pref. Share Capital + Premium on Redemption = Securities Premium Reserve in the B/S + Divisible Profit in the B/S + (N) + (N x Rate of premium on fresh issue)

Note: N = Face or Nominal value of fresh issue of shares to be made for redemption.
The equation shall be used if the following conditions are satisfied:

a) Amount of fresh issue is not given.
b) Redemption is to be made at premium.
(c) Premium on fresh issue together with the existing premium is not sufficient to meet the redemption premium.
(d) Fresh issue is necessary because divisible profits are not sufficient to redeem preference Shares.

Problem

Find the amount of fresh issue of shares from the following information relating to Star td if fresh issue is to be made at a premium of 5%.

Redeemable Preference Share Capital	₹4,00,000
Premium on Redemption	10%
Divisible Profits (as per B/S)	₹1,20,000
General Reserve (as per B/S)	₹80,000
Securities Premium Reserve A/c (as per B/S)	₹30,000

Arrangement of Cash

Cash is required for redemption of preference shares. If fresh shares are not issued for the purpose of redemption, the problem of availability of cash may arise. If sufficient cash is not available, the company will have to arrange it. For arranging cash, the company may dispose off investments or assets. Sometimes, it arranges from banks in the form of loans The following journal entries are required in this regard:

1. *If investments/assets are sold*

Bank A/C Dr. (sale proceeds)
Statement of Profit & Loss Dr. . (if at a Loss)
To Investment A/c or Asset A/c (book value)
To Statement of Profit & Loss (if at a profit)

Note: If any asset has been sold before redemption, any loss or profit on sale should be transferred to Statement of profit and loss (before transfer of profit to Capital Redemption Reserve A/c).

2. *If loan is taken from bank*

Bank A/c Dr.
To Bank Loan A/c

Untraceable Preference Shareholders

Sometimes it is not possible to trace a preference shareholder(s) due to change of address or some other reason. Therefore, it is not possible to make payment to them at the time of redemption. In such cases, amounts due to untraceable preference shareholders (balance in the preference shareholders account after redemption) should be treated as current liability. This appears in the B/S under the subhead "Other Current Liabilities" under the head "Current Liabilities". A separate entry is not required for this.

Problem

The following is the balance sheet of Shine Ltd. as on 31-03-2020:

Particulars		**Amount**
A. Equity and Liabilities		
1. Equity		
Share Capital		
Preference Share Capital:		
2,500 Shares of 100 each 2,500 Shares of 100 each fully paid:	2,50,000	
Less: Calls in arrears 20)	2,000	2,48,000
Equity Share Capital (30,000 shares of 10, fully paid)		3,00,000
Other Equity		
Statement of Profit & Loss (Surplus)		1,50,000
Securities Premium Reserve		15,000

Current Liabilities	
Creditors	27,000
Total Equity and Liabilities	**7,40,000**
1. Non-current Assets	6,00,000
2.Current Assets	
Investment	50,000
Bank	90,000
Total Assets	**7,40,000**

Note : Notes to accounts are not given.

On 30-06-2020, the Board of Directors decided to redeem the preference shares at a premium of 10% and to sell the investment at its market price of 40,000. They also decided to issue sufficient number of equity shares of ₹10 each at a premium of ₹1 per share, required after utilizing the Profit & Loss leaving a balance of ₹50,000. Premium on redemption is required to be set off against Securities Premium Reserve A/c.

Repayments on redemption were made in full except to one shareholder holding 50 shares only due to his leaving India. Show journal entries and B/S after redemption.

C) BONUS SHARE AND RIGHT ISSUE

BONUS:-

The surplus profit distributed to the shareholders is called “Bonus”.

Methods of Distribution of Bonus:-

1. Cash bonus
2. Bonus shares
3. Making partly paid shares into fully paid up shares

Cash bonus:-

It is not popular because by doing this, the working capital of the company will be reduced.

A company pay cash bonus in the following circumstances:-

a. When company has sufficient an extra amount of cash
b. When company does not want to raise the rate of dividend, and
c. When bonus issue is not possible due to limitation of authorized capital.

Journal entry for cash bonus

1. Statement of Profit &Loss A/c Dr.
   To Bonus payable A/c

2. Bonus payable A/c Dr.
   To Bank A/c

Bonus Shares or Capital Bonus

Bonus shares are those shares which are issued by a company free of cost to the existing shareholders of a company out of its large reserves created out of past profits. Without paying cash, the existing shareholders get additional shares.

When a company issues bonus shares out of profits or reserves, its reserves or profits are converted into capital. So bonus issue is called *Capitalization of profits or Capitalization of Reserves.*

Circumstances for Bonus issue

1. When the company wishes to capitalize its huge undistributed profits or reserves.
2. When the company has not sufficient cash reserves
3. When value of fixed assets of a company exceeds its capital, the difference is capitalized by issuing bonus shares.
4. With a view to avoid problems such as demand by the workers for higher wages
5. When market value of shares far exceeds the paid up value of the shares

Circumstances under which Bonus Shares cannot be issued

1. If subscribed and paid up capital exceeds authorized capital.
2. Bonus shares can be issued only as additional or extra dividends and not as regular dividends.

Effects of Issue of Bonus Shares

1. Increase in the number of ordinary shares
2. Net worth is unaffected
3. Reduced dividend per share
4. No effect on the assets

Advantages of issuing Bonus Shares

A. To the shareholders

1. Get additional shares without paying cash
2. They are not required to pay income tax on bonus shares
3. When the market price of shares increase, the shareholders can earn profits by selling it.
4. They get increased dividend in future, because the number of shares held by them increases.

B. To the company

1. It does not affect the liquidity or working capital of the company
2. The cost of issue is negligible.
3. Increases the creditworthiness and goodwill of the company
4. No tax is payable on issue of bonus shares

Disadvantages of Issuing Bonus Shares

A. To the shareholders

1. Total profits have to be distributed over a large number of shares hence dividend per share is reduced. Thus the shareholders do not gain actually
2. If the rate of dividend cannot be maintained, the market value of shares will fall
3. When the market value of shares falls, the shares held by a shareholder cannot be disposed off so easily.
4. It encourages speculation. This leads to fluctuation in the market value.

B. To the company

1. Market value of shares may fall if the rate of dividend is not maintained. As a result, the company's reputation may suffer.
2. It encourages undesirable speculation.
3. It reduces accumulated profits earned in past years
4. Some expenses like stamp duty, printing and stationery etc. will have to be incurred.

Conditions for Issue of Bonus Shares

According to Section 63(2) of the Companies Act, a company can issue bonus shares when it fulfills the following conditions:-

1. Bonus issue should be authorized by the Articles
2. The proposal of the Board of Directors regarding issue of bonus shares should be approved by the members in the general meeting.
3. The company should have sufficient profits and reserves
4. Bonus issue should satisfy the guidelines issued by SEBI
5. The partly paid shares, if any, should be made fully paid up.

SEBI Guidelines for Bonus issue

Disclosure and Investor's Protection Guidelines issued by SEBI ,w.e.f. 27/01/2002, includes certain guidelines for Bonus Issue.

1. Issue of bonus shares after any public/right issue is subject to the condition that no bonus issue shall be made which will dilute the value of te rights of the holders of the debentures, convertible fully or partly.
2. Reserves created by revaluation of fixed assets are not capitalized
3. The company has not defaulted in respect or principal in respect of fixed deposits or debt securities issued by it.
4. It has not defaulted in respect of the payment of statutory dues of the employees such as contribution to PF, gratuity, bonus, etc.

5. A company which announces its bonus issue after the approval of the Board of Directors must implement the proposals with in a period of six months from the date of such approval.
6. The bonus shares shall not be issued in lieu of dividend.
7. Once the decision to make a bonus issue is announced, the issue cannot be drawn.
8. If the subscribed and paid up capital exceeds the authorized capital as a result of bonus issue, then a resolution should be passed by the company at its general body meeting for increasing the authorized capital.

Sources of Bonus Issue [section 63(1)of the Companies Act 2013]

A. Revenue Reserves/Profits

1. Credit balance in the statement of profit and loss
2. General reserves
3. Credit balance in the sinking fund account for the redemption of a liability(e.g., debentures) after the redemption of the liability
4. Dividend equalization reserve

B. Capital Reserves/Profits

1. Profit prior to incorporation
2. Profit on sale of fixed assets or business
3. Capital Redemption Reserve A/c created for redemption of preference share
4. Securities premium reserve collected in cash only

Note: - CRR a/c and securities premium reserve a/c can be utilized only for issuing fully paid bonus shares (cannot be used for making partly paid shares into fully paid bonus shares).

Generally, a company utilizes the CRR, securities premium reserve and capital reserve first to issue bonus shares. This is because these reserves are not free reserves and are available only for certain restricted purposes like issue of bonus shares.

Types of Bonus Issue

1. **Fully paid bonus shares**: when bonus shares are distributed free of cost in proportion of holding, it is called fully paid bonus shares.
2. **Partly paid bonus shares:** when bonus is applied for converting partly paid shares into fully paid shares, it is called partly paid-up bonus shares.

Accounting Treatment (journal entries)

A. When fully paid bonus shares are issued.

1. When issued at par

(a) Capital Reserve A/c Dr.
Securities Premium Reserve A/c Dr.
Capital Redemption Reserve A/c Dr.
Debenture Redemption Reserve A/c Dr.
General Reserve A/c Dr.
Statement of Profit and Loss (Surplus) A/c Dr.
To Bonus to Shareholders A/c
(On the declaration of bonus out of reserve and/or profit)

(b) Bonus to Shareholders A/c Dr.
To Share Capital A/c
(On issue of bonus shares)

2. *When issued at premium :*
   (a) Securities Premium Reserve A/c Dr.
   Capital Redemption Reserve A/c Dr.
   Sinking Fund A/c Dr.
   General Reserve A/c Dr.
   Statement of Profit and Loss (Surplus) A/c Dr
   To Bonus to Shareholders A/c
   (On the declaration of bonus out of reserve and/or profit)
   (b) Bonus to Shareholders A/c Dr.
   To Share Capital A/c
   To Securities Premium Reserve A/c
   (On issue of bonus shares at premium)

B. When Bonus is given to convert partly paid shares into fully paid shares: (in the case of conversion bonus)
   (a) Capital Reserve A/c Dr.
   Debenture Redemption Reserve A/c Dr.
   General Reserve A/c Dr.
   Statement of Profit and Loss (Surplus) A/c Dr
   To Bonus to Shareholders A/c
   (On the declaration of bonus out of reserve and/or profit)
   (b) Share Final Call A/c Dr.
   To Share Capital A/c
   (On making due the final call)
   (c) Bonus to Shareholders A/c Dr.
   To Share Final Call A/c
   (On utilization of bonus)

The impact of issue of bonus share on balance sheet is that the reserves and profits are reduced and the share capital is increased. Thus reserves are capitalized.

The Bonus shares must be disclosed in the Balance sheet by way of "Notes to Accounts" for a period of 5 years immediately preceding the date as at which the Balance Sheet is prepared.

Problem 1 (*Bonus shares at par*)

X Ltd. With a paid up capital of ₹5,00,000 divided into shares of ₹10 each fully paid had resolved to capitalize ₹80,000 of the accumulated reserves of ₹1,25,000 by issuing bonus shares of ₹10 each fully paid. Pass necessary journal entries.

Problem 2 (*Bonus shares at premium*)

AB Ltd has a share capital of ₹20,00,000 in equity shares of ₹10 as fully paid. The company now declares a bonus out of its free reserves of ₹8,00,000. This bonus is to be paid by issue of the equity share of ₹10 each at a premium of ₹2 per share for every four shares held by the shareholders. The shares are quoted at ₹15 on the date of allotment of bonus shares. Give journal entries to record the above transactions.

Problem 3 (*Conversion of Partly paid Shares*)

XY Ltd. Has a fully paid equity capital of ₹5,00,000 divided into shares of ₹10 each and 1,00,000 partly paid shares of ₹10 each, ₹7 paid up. It has an accumulated profit to the credit of its profit and loss statement of ₹2,00,000, free reserve of ₹1,50,000 and securities premium reserve of ₹50,000. It has decided to convert the partly paid equity shares into fully paid by applying bonus out of accumulated profit and free reserves. The bonus was declared at ₹6 per share on the fully paid up capital. Pass necessary journal entries.

Problem 4 (*Balance Sheet before Bonus Issue*)

Following is the B/S of A Ltd. As on 31.3.2020:

A.	**Equity and Liabilities**	
1.	**Equity**	
	(a) *Share Capital* (5000 shares of ₹100 each, ₹60 paid)	3,00,000
	(b) Retained Earnings	
	Securities Premium Reserve	40,000
	Reserve	2,70,000
	Statement of Profit & Loss(Surplus)	1,25,000
2.	**Current Liabilities**	
	Sundry Creditors	2,65,000
	Total Equity and Liabilities	10,00,000
B.	**Assets**	
1.	**Non-current Assets**	
	Sundry Assets	10,00,000
	Total Assets	10,00,000

Note: Notes to accounts are not given.

The company resolves to distribute ₹1,50,000 as bonus to be utilized in paying up a call of ₹30 per share. Minimum reduction is to be made from free reserves.

Stock Split

`Stock split is the process of reducing the face value of the share (or stock) of a company by dividing one share into two or more parts. For example, if a stock has a face value of ₹10, a two for-one stock split means that there will be twice the number if shares as before with a face value of ₹5 each for the new share. So, if an investor owns 100 shares, he will have 200 shares after the split.

The object of stock split is to make the shares affordable to small investors. This will increase the amount of trading in the shares. This will also improve liquidity.

Difference between Bonus Shares and Stock Split

Both increases the number of shares. But there are a few differences.

Bonus Share	**Stock Split**
1. The face value of the shares does not change. 2. Bonus issue reduces reserves. 3. Bonus issue increases the total number of shares and the paid up capital of the company. 4. Bonus shares are issued when the company has large accumulated reserves.	1. The face value of the share is reduced. 2. Reserves remain as before. 3. The paid up capital does not change with stock split (face value is reduced and the number of shares increased). 4. A share is generally split when it has a high price.

D) RIGHT SHARES or RIGHT ISSUE

'According to Section 62(1) of the Companies Act, 2013 when the company wants to increase the subscribed capital by issue of further shares, such shares must be issued first of all to existing shareholders in proportion of their existing shareholding. These shares are called *Right Shares.*

Meaning of Right Shares or Right Issues
In case a company wants to make a further issue of shares, the issue must first be offered to the existing equity shareholders. Thus, an issue of shares in which existing shareholders have a pre-emptive right to subscribe for the new shares is called 'Right Issue'.

Provisions of Companies Act, 2013 relating to Right issue (clause (a) of sub- section (1) of Section 62**)**

The right shares are offered to the existing shareholders by sending a letter of offer subject to the following conditions:

1. The offer shall be made by notice specifying the number of shares offered, time for accepting offer etc. The time for accepting offer may be minimum 15 days and maximum 30 days.
2. If the offer is not accepted within period specified, then it shall be deemed to have been declined.
3. The above offer shall include a right to renounce the shares offered o him or any of them in favor of any other person and this fact should be specifically mentioned in the above notice.
4. After the expiry of the time specified in the notice or on receipt of earlier intimation from the person that he declines to accept the shares offered, the Board of Directors may dispose off them in such manner which is advantageous to the shareholders and the company.

Advantages of Right Issue

Advantages to companies
a) Issue costs are lower,
b) Issue is made at the direction of the directors,
c) It improves the image of the company,
d) Raising capital is more certain than in the case of public issue.

Advantages to shareholders
a) Existing shareholders get shares at a price which is lower than the market price.
b) It helps in preserving the control of the company in the hands of the existing shareholders.

Value of Right
It is the gain an existing shareholder makes while exercising his right. It is also called *value of pre-emptive right.*

There are two methods of calculating value of right. They are:

Method 1
Value of Right = Market price of the Share – Average Price of a Share
Here;
Average Price of a Share =

$$\frac{\text{Market price of existing shares + Issue price of proportionate right issue}}{\text{No. of Shares + No.of Right Shares}}$$

Average Price is also known *theoretical market price*

Method 2

$$\frac{\text{No. of New or Right Shares}}{\text{Total No. of all Shares (i.e., Fresh + Existing Shares)}} \times (\text{Market price - Issue price})$$

Sometimes **percentage increase in share capital** is required to be found. It is calculated as below:

$$\textbf{\% Increase in Share Capital} = \frac{\text{Increase in Share Capital after right issue}}{\text{Share Capital before right issue}} \times 100$$

Problem

A company offers to its shareholders the right to buy two shares at ₹115 for every 5 shares of ₹100 each held. The market value of the shares is ₹150 each. The existing equity share capital of the company is ₹30 lakhs. Calculate the value of the right and also the percentage increase in share capital.
(Answer: value of right is **₹10**, % increase in share capital **40%**)

Difference between Right Issue and Public Issue

Right Issue	Public Issue
1. A right issue is made to existing share holders 2. The floatation cost is low 3. The price is much less than the existing market price	1. A public Issue is made to the public at large. 2. The floatation cost Is high. 3. The price is generally lower than the expected market price.

Difference between Bonus Shares and Right Shares

Bonus Shares	Right Shares
1. Issued to existing members free of cost 2. Always fully paid. 3. No requirement of minimum subscription. 4. It must be authorized by the Articles 5. Bonus issue increases share capital but reduces accumulated profits without any increase in cash. 6. Regulated by section 63 of Companies Act 2013	1. Issued against payment 2. May be fully paid or partly paid 3. It is subject to minimum subscription 4. Specific provision in the Articles is not required. 5. Right issue increases share capital with simultaneous increase in cash(no effect on accumulated profits) 6. It is regulated by Section 62 of the Companies Act, 2013

E) BUY-BACK OF SHARES

Some years back buy back of shares and securities was not allowed in many developed countries (including India), Over the years, the situation has changed. Companies in India now can buy-back their own shares. Section 88, 69 and 70 of the Companies Act, 2013 deal with buy-back shares.

One of the first companies to offer the buyback of shares in India (in October 2000) was Philips India Pvt. Ltd. Later many MNCs opted for this method to restructure capital or avail other benefits.

Meaning and Definition of Buy-Back of Shares

Buy-back is the reverse of issue of shares, Buy-back simply means buying of own shares. It is a process of capital restructuring. It allows a company to buy-back its own shares, which were issued by it earlier. It is a method of cancellation of a company's share capital. It leads to reduction in the share capital of a company.

Objectives of Buy-Back

1. To improve returns on capital
2. To return surplus cash to the investors.
3. To increase the market price of the share.
4. To change the capital structure (i.e., to restructure capital base).
5. To increase the EPS.
6. To prevent hostile takeover bids.
7. To improve the financial health after buy-back
8. To achieve optimum capital structure
9. To service the equity more efficiently.

Reasons and Benefits (advantages) of Buy-back

1. It helps to increase the EPS.
2. The market price of the share will go up.
3. It help to return surplus the cash to the investors
4. It increases promoters' holding in the company.
5. It helps to restructure the capital base of the company
6. It helps to utilize the liquid assets to enhance the value of the company.
7. It is a reward for investors.
8. It will improve the company's image.

Dangers of Buy-Back

1. It may be used as a tool of insider trading. This gives an opportunity to insiders to make extra money
2. It may be used for manipulating the prices of shares.
3. It weakens the position of minority shareholders.

Sources of Buy-back [sec.68 (1)]

A company can purchase its own shares out of the following:

1. Free reserves (reserves that are free for distribution as dividend).
2. Security premium account
3. Proceeds of any shares or other securities.

However, the proceeds of an earlier issue of same kind of shares / securities should not be used for buy-back. Thus, for example, if equity shares are to be bought back, preference shares or debentures may be issued for the purpose.

Methods (or Modes) of Buy-back

According to SEBI guidelines, there are three methods of buyback of shares. They are:

1. through the tender offer.
2. from open market.
3. from odd lots.

1. Buy-back through tender offer: A company can buy back its shares from its existing equity shareholders on a proportionate basis. Under this method the company fixes a price at which it wishes to buy back a specified number of shares from its shareholders. If the number of shares offered for buy back at the stated price is more than the number of shares to be bought back, then the shares are bought back from each shareholder proportionately.

Escrow Account: A company has to open an Escrow Account if it wants to initiate the process of buy-back of shares. The word 'escrow7 literally means a contract or bond deposited with a third person (normally a bank) to perform its obligations under the scheme of buy-back. The company is required to deposit an amount equal to 25% of the consideration payable for shares to be bought up to Rs. 100 crores and 10% of the consideration in excess of Rs. 100 crores. After completion of all obligations this amount will be refunded to the company.

2. Buy-back from the open market: A company can buy back its shares from the open market also. This may be done in any one of the following methods:
(a) Through stock exchange,
(b) Book building process.
(a) Through stock exchange: Under this method, a company can buy back its shares at the prevailing quoted price in a stock exchange. The buy-back is made only on stock exchange with electronic trading facility. This method does not require Escrow Account.
(b) Through book building process: Under book building process the shareholders offer their shares at a price at which they are willing to sell their shares within a price band (i.e., price range) specified by the company The Company will receive the offers from the shareholders. The merchant banker and the company shall determine the buyback price based on the acceptances received. The final price of buy-back shall be the highest price accepted and this price shall be /paid to all shareholders whose specified securities have been accepted for buy / back, this method, requires the opening of Escrow Account.

3. Buy-back of shares from odd lots: The companies may locate the odd lots of shares (i.e., the block of shares that is not held in multiples of 100) and purchase them back from the odd lot holders.

Conditions of Buy-Back

1. Buy-back should be authorized by Articles.
2. A company should pass a special resolution in a general meeting authorizing the buy-back. However, if the buy-back is up to 10% of the total equity capital and free reserves of the company, the Board of Directors by passing a resolution may authorize the company for such buy-back.
3. The amount involved in buy-back should not exceed 25% of the paid-up capital and free reserves of the company. But, if the equity shares are to be bought back, the amount involved in buy-back should not exceed 25% of the paid up equity share capital in that financial year.
4. The debt-equity (including free reserves) ratio is not more than 2:1 after such buy-back.
5. All shares and other specified securities are fully paid-up. Partly paid-up shares or securities cannot be bought back by the company.
6. Buy-back must be completed within 12 months from the date of passing the special resolution.
7. The securities so bought back should be physically destroyed within 7 days after buy-back.
8. After completion of buy-back, a company cannot issue same kind of share or security for a period of 6 months.
9. Money borrowed from banks/financial institutions cannot be utilized for the purpose of buy-back.

SEBI Guide lines

After the introduction of Companies Act 2013, SEBI made SEBI(Buy-Back of securities)Amendment)Regulations, 201. The important provisions are:

1. No offer of buy-back for 15% or more of the paid up capital and free reserves of the company shall be made from the open market.
2. A company shall not make any offer of buy-back within a period of one year reckoned from the date of disclosure of the preceding offer of buy-back, if any.
3. The company shall ensure that at least 50% of the amount earmarked for buy-back is utilized for buying back shares or other specified securities.

In addition, following are the other guidelines:

a) The company will make true and full disclosure in the letter of offer and the public announcement.
b) Bonus shares will not be announced when the buy-back offer is open
c) All payments will be made only by cash/ cheques
d) Buy-back offer will not be withdrawn after public announcement

Accounting Treatment

Accounting treatment of buy-back of shares is more or less similar to redemption of preference shares. The following points may be noted:

1. Only fully paid up securities can be bought back, If the securities are partly paid, they must be made fully paid up by making final call
2. Sufficient balance must be standing to the credit of free reserves if buy back is to be made from free reserves.
3. If the shares are bought back out of free reserves or security premium, an amount equal to the face value of shares so bought back must be transferred from free reserves or security premium to Capital Redemption Reserve A/c (CRR).
4. The premium, if any paid on buy-back must be written off to security premium or free reserves.
5. Discount on payback, if any, must be transferred to Capital Reserve.
6. CRR can be utilized for the purpose of issuing fully paid bonus shares. It should be noted that for buy-back, security premium can be transferred to CRR.

Note: If the fresh issue of shares (for the purpose of buy back) is less than the amount of shades to be bought back, capital redemption reserve is to be created for the balance.

Accounting Treatment

1. If the company issues fresh securities for the purpose of buy back, appropriate entries are passed.

2. Open a separate Bank a/c for the purpose of buyback [rule 17(8) of the Companies (Share capital and Debentures) Rules, 2014.]. The journal entry is

Buy-Back Bank Account Dr

To Bank Account

3. Buy-Back of Shares: when payment is made to shareholders towards buy back:

Equity Share Buy-Back Account Dr.
To Buy-Back Bank Account

4. Cancellation of shares bought back: As per section 68(1), the shares cannot be purchased by the company for investment purposes.

(a) For buy back at par

Share Capital A/c Dr. (with the face value of shares bought back)

To Equity Share Buy Back A/c (with amount paid)

(b)For buy back at premium

Share Capital A/c Dr. (with the face value) .
Premium payable on Buy-Back A/c Dr.
To Equity Share Buy Back A/c (with the amount paid)

(c) For buy back at discount

Share Capital A/c Dr. (with the face value of shares)
To Equity Share Buy Back A/c (with the amount paid)
To Capital Reserve A/c (with the discount, i.e., the excess of face value over purchase price)

5. Transfer to CRR : (section 69(1) of Companies Act,2013

If the company buys back shares from free reserves or security premium, an amount equal to the nominal value of shares so bought should be transferred to Capital Redemption Reserve A/c.

The entry is:
Security Premium Reserve A/c Dr
Free reserve A/c Dr.
To Capital Redemption Reserve A/c

6. Adjustment of premium paid on Buy-Back:

The journal entry is:-
Security Premium Reserve A/c Dr
General Reserve A/c Dr
Statement of Profit & Loss (surplus) Dr.
To Premium payable on Buy-Back A/c

7. Buy-Back Expenses: The journal entry is

Buy-Back Expenses A/c Dr.
To Bank A/c

Statement of Profit or Loss (or Other Reserves) A/c Dr.
To Buy-Back Expenses A/c

Problem 1(buy back at par out of fresh issue of shares)

A Ltd issued 2,00,000 equity shares of ₹10 each. It wanted to buy back 30,000 equity shares at par. It issued 6% 3,000 preference shares of ₹100 each, the proceeds being utilized for the purpose of buy back. Expenses relating to the buyback amounted to ₹18,000. Give journal entries.

Problem 2 (Buy-back at premium out of free reserves)

A Ltd issued 4,00,000 shares of ₹10 each. The balance in the security premium account and general reserve account were ₹40,00,000 and ₹50,00,000 respectively. The company bought back 1,00,000 shares at a price of ₹ 30 each and issued cheques for this purpose from its bank account. Write journal entries.

Problem 3 (Buy-back of shares at premium out of fresh issue and free reserves)

The following is the B/S of X Ltd as on 31-12-2020:

A.	**Equity and Liabilities ₹**	
	Equity share capital (₹10 each share)	10,00,000
	General Reserve	1,00,000
	Statement of Profit or Loss(surplus)	70,000
	Security Premium	2,20,000
	Non-current liabilities: -	
	Current Liabilities :	
	Creditors	60,000 .
	Total Equity and Liabilities	**14,50,000**
B.	**Assets**	
	Sundry Assets	14,50,000
	Total Assets	**14,50,000**

On 1-1-2021, the company bought back 25,000 equity shares @ ₹20 each. The company issued 2,000 8% preference shares of ₹ 100 each for the purpose. Give journal entries.

Problem 4(Buy back at discount out of fresh issue and free reserves)

A Ltd issued 2,00,000 equity shares of ₹ 10 each, of which 40,000 shares were bought back @ ₹9 per share. The company issued 2,000 6% preference shares of ₹100 each at ₹110 each. The company had ₹ 1,00,000 in securities premium reserve account and ₹1,20,000 in general reserve. Give journal entries.

SALE OF INVESTMENT OR ASSETS

The company may decide to realize its investments or any other assets to finance the buy back in case of shortage of cash balance. The following is the journal entry:

Bank A/c Dr. (Sale proceeds)

Statement of Profit &Loss Dr. (if at a loss)

To Investment/Asset A/c (book value)

To Statement of Profit or Loss(surplus (if at a profit)

BOOK-BUILDING METHOD

Book building was introduced by SEBI with a view to strengthen the capital market and to safeguard the interest of investors. It was introduced on the basis of recommendation of the committee constituted under the chairmanship of Y.H.Malegam in October 1995. Book-building means selling securities to investors at an acceptable price with the help of intermediaries called book runners. It involves sale of securities to the public and institutional bidders on the basis of predetermined price range or price band.

Advantages of Book building

1. It facilitates quick and easy collection of fund.
2. It provides a real and fair price to investors.
3. There is only minimum chance of under and over subscription.
4. The cost of issue is less 5. It is easy to evaluate the intrinsic value of shares and credibility of company.

Limitations of Book building

1. It is suitable for mega issue only
2. It is useful only to big, strong and well-known companies.
3. It may not work very efficiently in immature market conditions.

MODULE 2

ACCOUNTS OF BANKING COMPANIES

A banking system is a backbone of any economy. A bank is a commercial establishment duly authorized and licensed by Government to accept deposits and acts as a safe custodian of the funds of its customers.

Meaning and Definition of a Bank

A bank is a financial institution engaged in banking business. A bank is a financial Intermediary. It deals in money and credit. It deals with other people's money. It collects the savings of some people and gives the money to those who are in need of it. Thus a bank is a reservoir of money. It is a manufacturer of money. It manufactures credit and sells it. That is why a bank is called as a "factory of credit".

According to Horace White, "bank is an institution where money is dealt and the mechanism for transferring funds".

In India, banking companies are governed by the Banking Regulation Act, 1949". Section 5 (b) of the Banking Regulation Act defines banking as "the accepting for the purpose of lending or investment of deposits of money from the public repayable on demand or otherwise withdrawable by cheque, draft, order or otherwise".

Sources of Income

i. Interest on loans and overdrafts.

ii. Discount on bills discounted

iii. Dividend and interest on its own investments

iv. Profit on overseas exchange transactions

v. Commission on transfer of funds, issue of bank drafts and charges for various services rendered.

Revenue Expenses

i. Interest on deposits

ii. General expenses of management

iii. Maintenance of premises and equipment

iv. Taxation

Business of Banking Companies

The main business of a banking company is the business of banking that is, accepting for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and can be withdrawn by cheque, draft, and order or otherwise. Banking companies usually carry on other kinds of business which are auxiliary or incidental to the main business.

Restriction on Business

Section 8 of the Banking Regulation Act 1949, imposes certain restrictions on the business of a banking company. They are:

1. No banking company shall directly or indirectly deal in the buying, selling or bartering of goods except in connection with the realization of security given to or held by it.

2. No banking company can engage in any trade, or buy, sell or barter goods for others, otherwise than in connection with bills of exchange, received for collection or negotiation or with such of its business specified in 6(i).

Minimum Capital and Reserves (Sec. 11):

In case of a banking company incorporated in India, the sum of its paid-up capital and reserves shall not be less than the amount stated below:

i. If it has places of business in more than one state 5 lakh, and if any such place of business are situated in Mumbai or Kolkata or in both, 10 lakh.

ii. If it has all its places of business in one state, none of which is Mumbai or Kolkata, 1 lakh in respect of its principal place of business plus 10,000 for each additional place of business in the same district plus 25,000 for each place of business elsewhere in the state (the maximum amount required being 5 lakh).

Commission & Brokerage etc. on shares: Sec. 13 of the Banking Regulation Act provides that, no banking company shall pay directly or indirectly commission, brokerage, discount or remuneration for issue of shares by it, for any amount exceeding 2'/,% of the paid-up value of such shares.

Dividend: Under Sec. 15, a Banking Company cannot pay dividend until all its capitalized expenses have been completely written off. Capitalized expenses include preliminary expenses, organization expenses, share selling commission, brokerage, amounts of losses incurred by tangible assets and any other item of expenditure not represented by tangible assets. But it may pay dividends without writing off (C) the depreciation, if any, in the value of its investments in approved securities, in any case, where such depreciation has not actually been capitalized or otherwise accounted for as a loss : (i) the depreciation, if any, in the value of its investments in shares, debentures or bonds (other than approved securities), in any case where adequate provision for depreciation has been made to the satisfaction of its actors; (ii) the bad debts, if any, in any case, where adequate Provision for such bad debts has been made to the satisfaction of its auditors.

Statutory Reserve: Under Section 17, Banking Companies incorporated in India shall transfer every year at least 25% of its profit before any dividend is declared, to a Statutory Reserve Fund) until the amount of the reserve together with the Security Premium Account.

Form'B'			
Profit & Loss Account			
for the year ended 31st March …..			
PARTICULARS	Schedule No	CY	PY
(i)Income			
Interest earned	13		
Other income	14		
TOTAL			
(ii) Expenditure			
Interest expended	15		
Operating expenses	16		
Provisions & Contingencies	.		
TOTAL			
(iii) Profit / Loss			
Net profit/Loss (i - ii)			
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			

I. Income

Incomes are shown under the following heads:

I. Incomes are shown under the following heads:

The following items are included under this head:

a) Interest on Loan
b) Interest on Advances
c) Interest on Overdraft
d) Interest on Cash Credit
e) Interest on Balances with Reserve Bank of India interest on other Inter-Bank Funds
f) Rebate on Bills Discounted
g) Income on Investment, etc.

1. Other Income

a) Income from Commission, Exchange and Brokerage
b) Profit from sale of Investment (Loss is deducted, if any)
c) Profit on revaluation (Loss is deducted, if any)
d) Profit on sale of Land, Building and Other Fixed Assets
e) Income by way of dividend from subsidiaries.
f) (Loss is deducted, if any)
g) Other Incomes such as Income received or receivable from Godown Rent, Building Rent
h) Lockers Rent, Cheque Collection etc...

II. Expenditure

Expenditures are shown under the following heads:

1. Interest Expended

a) Interest on Fixed Deposits;
b) Interest on Saving Bank Accounts; Interest on Deposits of Current Accounts;
c) Interest on Recurring Accounts;
d) Interest payable or paid on loan taken from Reserve Bank/Other Banks; or other.
e) Financial institutions or agencies.

2. Operating Expenses

a) Salaries and Wages of Staff

b) Rent, Taxes and Lighting

c) Printing and Stationery Depreciation on Bank's Property

d) Director's fees, Allowances and Expenses Auditors fees, Allowance and Expenses

e) Law Charges

f) Postage, Telegrams, Telephone expenses

g) Repairs and Maintenance

h) Insurance Premium

i) Other operating expenses such as license fees, donations, subscriptions to papers and periodicals, entertainment expenses, travel expenses etc...

III. Profit or Loss

Here Profit/Loss for the current year (difference between income and expenditure explained above) and profit/loss brought forward from previous period are shown.

IV. Appropriation of Profits

a) 25% of the current year's Profit is transferred to Statutory Reserve

b) Transfer of any other reserve;

c) Dividend paid by Bank to Government and Shareholders,

d) Balance of Profit after transferring the above, carried to Balance Sheet.

Balance Sheet

The Balance Sheet of a Bank is to be prepared as per the new forms. In the new form assets and liabilities are shown vertically along with the figures of last year. In the top section capital and liabilities are shown and in the bottom section assets are shown.

Balance Sheet as on			
for the year ended 31st March …..			
PARTICULARS	Schedule No	CY	PY
Capital & Liabilities			
Capital	1		

Reserves & surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities & Provisions	5		
Total			
Operating expenses	16		
Provisions & Contingencies	.		
TOTAL			
Assets			
Cash and balances with RBI	6		
Balances with banks & money			
at call and short and notice	7		
Investments	8		
Advances	9		
Fixed Assets	10		
other Asset	11		
Total			
Contingent Liabilities	12		

Explanation of Various Heads of Balance Sheet

A. Capital and Liabilities

1. Capital: The following particulars of capital are recorded in Schedule 1

a) Capital owned by Central Government in Nationalised Bank;

equipping with excellence
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b) Bank incorporated outside India, capital prescribed by RBI, amount of deposit kept with RBI under section 11(2) of the Banking Regulation Act 1949.

c) The capital of Indian Banks is recorded as;

i. Authorized capital;

ii. Issued capital

iii. Subscribed capital:

iv. Called up capital;

v. Paid up Capital (Deduct calls in arrears and add forfeited shares)

vi. Details are shown in Schedule 1

2. Reserves and Surplus: The following items are recorded under this head in Schedule 2

a) Statutory Reserve

b) Capital Reserve

c) Securities Premium Reserve

d) Revenue and other Reserves

e) Balance of Profit and Loss Account Details are shown in Schedule

3. Deposits

a) Demand Deposits

b) Saving Bank Deposits

c) Terms Deposits

d) Deposits of branches in India and outside India should be shown separately.

e) Details are shown in Schedule 3

4. Borrowings

a) Borrowings from RBI

b) Borrowings from other banks, institutions and agencies

c) The borrowing in India and outside India are recorded under this head Details are shown in Schedule 4

5. Other Liabilities and Provisions

a) Bills Payable

b) Inter office / branch adjustment (net);

c) Accrued Interest

d) Provision for bad debts

e) Provision for taxation

f) Rebate on bills discounted etc.

B. Assets

1) Cash and Balance with RBI:

This is the first item under the head asset. Cash in hand 1 (Including foreign currency notes) and balances with RBI are shown under this item.

The details are shown in Schedule 6.

2) Balance with Banks, Money at Call and Short Notice: Balance with banks, money at call and short notice are shown under this second item.

3) Investments: This head is divided into two parts:

a) Investment in India. It is divided into six sub-heads

i. Central / State Government securities;

ii. Other Approved Securities

iii. Shares

iv. Debentures and Bonds

v. Investment in subsidiaries and joint ventures

vi. Others like Gold, Commercial Papers etc...

b) Investment outside India: It includes:

i. Securities of Foreign Government;

ii. Investment in Foreign Subsidiary Companies and Joint Ventures

iii. Other foreign investments.

4. Advances:

a)

i. Bills discounted and purchased

ii. Cash credit, overdrafts and loans repayable

iii. Term loans

b)...

i) Loans secured by tangible assets

ii. Loans covered by Bank/Govt. Guarantee

iii. Unsecured loan

c)...

i. Advances in India

ii. Advances outside India

5. Fixed Assets:

a) Premises, and

b) Furniture and fixtures, motor vehicle etc.

6. Other

a) Inter office/ branch adjustments (net)

b) Accrued Interest

c) Tax paid in advance / Tax deducted at source

d) Stationery and stamp

e) Non-banking assets.

Contingent Liabilities;

a) Claims against the bank not acknowledged as debts.

b) Liability for partly paid investments.

c) Liability on account of outstanding forward exchange contracts.

d) Guarantees given on behalf of constituents.

e) Acceptance, endorsement and other obligations.

f) Other items for which the bank is contingently liable.

Rebate on Bills Discounted

When a bank discounts a bill of exchange, it gets an income called discount. The whole amount of discount received during an accounting year may not relate to that accounting year. A part of it may relate to the next accounting period. This is so because at the close of the accounting year, some of the bills discounted may not have matured.

Discount (i.e., Interest & Discount) A/C Dr.

To Rebate on Bills Discounted.

Method of Computation of Rebate on Bills Discounted:

$$\text{Amount of bill} \times \frac{\text{Rate of discount for unexpired period}}{365}$$

Accounting Treatment:

1. if it is given not as a balance (i.e., not as a balance of a ledger account forming part of trial balance), but is given just as an information, and if it is instructed to prepare only the P/L Account, then, it should be deducted from the income "interest and discount" (Schedule 13) in the P/L Account.

On the other hand, if it is given as a balance (ie, as an item of trial balance) and if it is instructed to prepare only the P/L Account, then, it should not be taken in the P/L Account. It should be taken only on the liability side of the balance sheet under the head other liabilities and provisions - Schedule 5.

2. If it is given in the trial balance, and if it is instructed to prepare only the balance sheet, then, it is should be shown on the liability side of the balance sheet under the head. "Other liabilities and provisions" (Schedule 5).

3. If it is given in the trial balance, and if it is instructed to prepare both the P/L Account and the Balance Sheet, it should be taken only on the liability side of the balance sheet, under the head "Other liabilities and provisions" (Schedule - 5)

4. If it is given in the adjustment and if it is instructed to prepare both the P/L A/c and the Balance Sheet, then, it should be taken in the P/L A/c as well as in the Balance Sheet. In the P/L A/c, it should be deducted from the income Interest and discount (Schedule - 13). In the B/S, it should be shown on the liability side under the head "Other Liabilities and Provisions".

5. If rebate on bills discounted existing at the beginning of the year. (i.e., opening balance) is given in the Trial Balance (credit balance), then, it should be added to the income "Interest and discount" (Schedule 13) in the P/L Account.

Summary of the Treatment of Rebate on Bills Discounted

If rebate on bills discounted is given in Trial Balance, it should be taken to B/S under the heading "Other Liabilities and Provision". If it is given under adjustment, it should be deducted from "Interest and Discount (Schedule 13), and it should also be taken to B/S under the heading "Other Liabilities and Provisions (Schedule-5). At the commencement of the next accounting year, it is transferred to Interest and Discount A/c by reversing the above entry.

Provision for Income Tax

Provision for taxation is charged to the P/L Account under the heading "Provisions and contingencies". It is also shown on the liability side of the Balance Sheet (Schedule 5). Provision for taxation is made after making provision for doubtful debts.

Income from Non-Performing Assets

While closing books for an accounting year, a bank takes into account interest accrued on term loans, overdrafts, and on bills discounted and purchased. But as per the guidelines of the RBI, income recognition should be objective and based on record of recovery rather than on any subjective consideration. Hence the assets of a bank should be classified into two categories-(a) Performing Assets, and (b) Non-Performing Assets for the purpose of income recognition. An asset is treated as performing asset if interest is serviced promptly and there is no overdue / irregularity in the account. It is a standard asset. According to RBI, an asset becomes non performing when it ceases to generate income for bank. In other words, an asset should be treated as NPA, if income on such assets remain overdue and unpaid for a period fixed under the guidelines issued by the RBI.

RBI's Prudential Accounting Norms

On the basis of recommendations of Narasimham Committee, RBI laid down norms which are called Prudential Accounting Norms. In 1998, the Narasimham Committee had submitted its second Report for further tightening the Prudential Accounting Norms. These consist of the following three norms: (a) Asset classification, (b) Income recognition, and (c) Provisioning.

Assets Classification

(i) Standard Assets: Standard assets are those which do not carry more than the normal credit risk attached to the business. They are assets which are not NPA.

(ii) Substandard Assets: These have been classified as NPA for a period not exceeding 12 months (with effect from 31.03.05).

(iii) Doubtful Assets: Doubtful assets are those which have remained NPA for a period exceeding 12 months.

(iv) Loss Assets: Loss assets are those assets in which loss has been identified by the bank or auditors or the RBI but the amount has not been written off wholly or partly. These assets are irrecoverable. Hence these must be written off even though there may be a remote possibility of recovery of a portion of it. In short, these assets have lost value but not written off.

Capital Adequacy Ratio

Previously adequacy or otherwise of bank's capital and reserves was judged in relation to deposits. Now the trend is to judge the adequacy of capital in relation to risk adjusted assets. The RBI introduced the risk-weighted asset ratio system in April 1992. This is popularly known as capital adequacy ratio. In order to avoid the risk of insolvency, banks should have adequate capital and reserves against advances or other business undertaken by them. It is for this purpose, the RBI had introduced the system of capital adequacy ratio. The main idea of this system was to strengthen the capital base of the banks. It is computed as below:

$$CAR = \frac{\text{Capital Funds}}{\text{Risk} - \text{weighted assets} + \text{Risk} - \text{weighted off B/S items}}$$

MODULE 4

ACCOUNTS OF LIFE INSURANCE COMPANIES

Meaning of insurance

Insurance is contract whereby one party agrees for a consideration called premium to indemnify the other against a possible loss or to pay a stated sum of money on the happening of a particular event.

Types of insurance

a) Life insurance.
b) General insurance.
   i) Fire insurance.
   ii) Marine insurance.
   iii) Miscellaneous insurance.
      - Workmen compensation insurance.
      - Burglary insurance.
      - Motor accident insurance.

Life insurance

Life insurance is a contract by which insurer in consideration of premium agrees to pay certain sum of money either on the death of the insured or on the expiry of specified period whichever happens earlier.

Types of insurance policies.

1) Whole life policy.
2) Endowment policy.
3) Annuity policy.
4) With profit policy.
5) Without profit policy.
6) Joint life policy.
7) Children's deferred insurance.
8) Double accident indemnity policy.
9) Money back policy.

Final accounts of life insurance companies.

Revenue Account

Particulars	Schedule	Current year	Prev. Year
Premiums earned- Net	1		
1) Premium			
2) Re-insurance ceded			
3) Re-insurance accepted			
Income from investments			
a) interest, Dividend & Rent- Gross			
b) Profit on sale/redemption of investment.			
c) Loss on sale/redemption of investment			
d) Transfer/gain on revaluation /change in fair value			
other incomes (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			
Provisions (other than taxation)			
a) For diminution in the value of investments (Net)			

b) others (to be specified)			
TOTAL (B)			
Benefits Paid (Net)	4		
Interim bonus paid			
change in valuation of liability against life policies in force			
a) Gross			
b)Amounted ceded in Re-insurance			
c) Amount accepted in Re-insurance			
TOTAL (C)			
Surplus/(Deficit) (D)= (A)- (B)- (C)			
Appropriations			
Transfer of shareholder's A/C			
Transfer to Reserve (to be specified)			
Balance being fund for future appropriations			
TOTAL (D)			

Items Appearing in Revenue Account

Premium (Schedule 1): Premium is the most important source of income of a life insurance company. Premium is the consideration which the insured has to pay to the insurance company for the protection given to him. Premium paid at the time of insurance agreement is called First year premium'. Premiums paid subsequently are known as 'renewal premium'. In case total premium is paid only once, it is called 'single premium'. Life insurance premiums are collected monthly, quarterly, half yearly or yearly.

The net premium to be shown in the Revenue Account is calculated as below:

Premium received during the year		xxx
Add: Outstanding premium at the end		xxx
Add: Reinsurance premium received during the year		xxx
Add: Reinsurance premium received during the year		xxx
Add : Bonus in reduction of premium		xxx
		xxxx
Less: Outstanding premium at the beginning	xxx	
Less: Reinsurance premium paid during the year (i.e., on reinsurance ceded)	xxx	xxxx

Net premium (to be shown in the revenue account)		xxxx

Consideration for Annuities Granted:

This is the lump sum amount received by the insurance company in the beginning as consideration for payment of annuities. It is out of this amount, the company makes the annual payment (annuity). This is shown in the Revenue A/c under 'Other Incomes'.

Income from Investments:

Another important source of income of life insurance business is income from investments. These include: (i) interest and dividend on securities, rent from properties let out, (ii) profit on sale/redemption of investments, etc.

Commission (Schedule 2):

One of the major expenses of a life insurance company is the commission. It is paid on premium paid by the policy holders on first year, or on renewal or on single premium. It is paid to agents. The Details of commission are shown in Schedule 2.

Commission on Re-insurance Accepted:

The company which has accepted re-insurance, will pay commission to the company which has given reinsurance. The payment of such commission is called 'commission on reinsurance accepted. It is an expense of the company. Hence it is shown (ie., added to commission paid on direct business) in Revenue Account. The details are shown in Schedule 2.

Commission on Re-insurance Ceded: An insurance company will receive commission from other insurance company when it gives a part of business to the other insurance company. Such commission is called 'commission on re-insurance ceded'. It is an income. Hence it is deducted from total commission in Schedule 2 in Revenue Account.

Operating Expenses (Schedule 3) Operating expenses include staff salary (including welfare benefits), travelling expenses, training expenses, rent, rates and taxes, repairs, depreciation, auditors fees etc. Benefits Paid (Net) (Schedule 4): This includes: (i) claims, (II) annuities, and (ii) surrender.

Claims under policies: The most important item of expenditure of a life insurance company is the payment of claims. The claim may arise either on death of the insured or on maturity of the policy, whichever is earlier. When the risk arises, the insured makes a claim on the insurance company.

Claims paid		xxx
Add: Claims outstanding at the end		xxx

Add: Re-insurance claim payable at the end (On re-insurance accepted)		xxx
Add: Expenses relating to settlement of claim (e.g., legal expenses, survey expenses, medical expenses)		xxx
		xxxx
Less: Claims outstanding at the beginning	xxx	
Less: Re-insurance claim recovery (claims covered by re-insurance)	xxx	xxxx
		xxxx

Annuity:

Annuity is the annual payment made by the insurance company to the insured out of the lump sum received in the beginning. Annuity simply refers to annual payment. It is an item of expense. It is shown under "Benefits Paid" (Schedule 4). Annuities relating to reinsurance must be deducted.

Surrenders:

Another item of expense is surrenders. It is the amount paid or payable by the insurance company in respect of the policies surrendered. It is the amount which an insurance company is prepared to return to the policyholder if the policy is surrendered.

Interim bonus paid:

It is the share of profit payable by the life insurance company to policy holders. This includes the following:

(a) Cash bonus: It is the bonus paid to policy-holders in cash when the valuation balance sheet is prepared. It is shown in the Revenue Account as an expense. In short, it is the bonus paid in cash to policy holders immediately on its declaration.

(b) Bonus in reduction of premium: This is the bonus declared, not paid in cash but adjusted in the premium payable by the policy-holders. Thus, premium payable is reduced.

(c) Reversionary bonus: It is added to the policy amount and is paid along with the policy amount on death or maturity. Thus, the bonus paid at the expiry of the policy along with the policy amount is called reversionary bonus. The bonus in respect of reinsurance business must be deducted.

Expenses of Management:

a) Travelling expenses

b) Salaries etc., other than to agents

c) Auditor's fees

d) Director's fees

e) Travelling expenses

f) Medical fees

g) Law charges

h) Advertisement

i) Printing & stationery

j) Rent

k) Other expenses of management

Interest, Dividend and Rent:

If the company received any interest, dividend and rent on its investment, the gross amount (including tax) will be shown as an income in Revenue A/c. If there is outstanding amount of interest, dividend etc., it will be added in this item. Income tax deducted at source should be shown as Advance (asset) the heal "Advances and other assets" (Schedule 12).

Appropriations:

Appropriation of surplus is shown at the lower section of the Revenue A/c Here, amount transferred to shareholders fund and transfer to other funds or reserves are shown. The balance is transferred to 'Fund for Future Appropriation.

Profit and Loss Account (Form A-PL) (Shareholders' Account):

Profit and Loss Account is prepared to calculate the overall profit of the life insurance business. The income or expenses that are not related to any particular fund are recorded in the P/L A/c. Income tax payable to Government, is also shown here. Interim dividends paid during the year, proposed final dividend, dividend distribution tax etc. are shown in the appropriation section of the P/L A/C. The remaining balance of profit is carried to B/S. The form of P/L A/c is given below

FORM A-PL

Name of the Insurer:

Registration No. and Date of Registration with IRDA

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

Shareholders' Account (Non-technical Account)

Particulars	Schedule	Current Year	Previous Year
Balance brought forward from/transferred to the Policyholders Account (Technical A/c) Income from Investments (a) Interest, Dividends & Rent-Gross (b) Profit on sale/redemption of investments (c) Loss on sale/redemption of investments Other Income (to be specified) Total (A) Expenses other than those directly related to the insurance business Bad debts written off Provisions (other than taxation) (a) For diminution in the value of investments (Net) (b) Provision of doubtful debts (c) Others (to be specified) Total (B) Profit/(Loss) before tax (A-B) Provision for Taxation Profit/(Loss) after tax Appropriations a) Brought forward Reserve/Surplus from the B/S b) Interim dividends paid during the year c) Proposed final dividend d) Dividend distribution tax e) Transfer to reserves/other accounts (to be specified)			
Profit carried forward to the Balance Sheet			

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Notes to Form A-RA and A-PL:

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

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

c) Claims incurred shall comprise claims paid, 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 500,000 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'.

Balance Sheet

Balance sheet of a life insurance company is prepared in vertical format. It is divided into wo sections, (a) Sources of funds, and (b) Applications of funds. The form of B/Sis given below:

FORM A-BS

Name of the Insurer:

Registration No. and date of Registration with the IRDA

Balance Sheet as at 31st March, 20

Particulars	Schedule	Current Yr	Prvs Yr
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'			
Policyholders'	8		
Assets held to cover linked liabilities	8A		
Loans	8B		
Fixed Assets	9		
Current Assets:	10		
Cash and Bank Balances			
Advances and Other Assets	11		
Sub-Total (A)	12		
Current Liabilities			
Provisions	13		
Sub-Total (B)	14		
Net Current Assets (C) = (A -B)			
Miscellaneous Expenditure			
(to the extent not written off or adjusted)			
Debit Balance in Profit & Loss A/c.	15		
Total			

Contingent Liabilities

Particulars	Cur.Yr	Prv.Yr
1 Partly paid-up investments 2 Claims, other than against policies, not acknowledged as debts by the company 3. Underwriting commitments outstanding 4. Guarantees given by or on behalf of the company 5. Statutory demands / liabilities in dispute, not provided for 6. Re-insurance obligations 7. Others (to be specified) **Total**		

Items Appearing in the B/S

- **Sources of Funds:** The various sub heads under sources of funds are as follows:

Shareholders' Funds: Shareholders' funds include share capital, and reserves and surpluses

Share Capital: Authorized share capital, issued capital, subscribed capital, and called up capital are shown separately under Schedule 5.

Reserves and surplus: All kinds of reserves are shown separately under Schedule 6. Reserves include capital reserves, capital redemption reserves, securities premium, revaluation reserves, general reserve, catastrophe reserves, and balance of P/L A/c etc. Catastrophe reserve is the reserve created to meet any loss due to natural calamities such as flood, earthquake, tsunami etc.

Borrowings: All kinds of borrowings are shown separately under Schedule 7. Borrowings will include debentures, bonds, fixed deposits, bank loan, loan from financial institutions and other entities carrying on insurance business. Unsecured borrowings and secured borrowings are to be shown separately.

Policy holders' Funds: Any kind of fund related to policy holders should be shown separately under the head policy holders' fund. Life insurance fund, Pension or superannuation fund etc. will be shown under this head.

Funds for future appropriation: If any fund is maintained for future appropriation, it will come under this head.

- **Application of Funds:** The various subheads under application of funds are as follows:

Investments: Investment of shareholders' funds and policy holders' funds are to be shown separately. Investment of shareholders' fund is shown in Schedule 8 and investment of policyholders' fund is shown in Schedule 8A. For both the cases, long term investments and short term investments are to be shown separately.

Loans: Loans are to be classified as per security wise, borrower wise, performance wise, and maturity wise. Loans are shown Schedule 9.

Fixed Assets: Fixed assets are shown in Schedule 10. Fixed assets include goodwill, patent, copyright, freehold land, leasehold property, buildings, furniture and fixtures, information technology equipments (computers, servers, software, networking equipment etc.), vehicles, office equipment etc.

Current Assets: This section has two parts-(a) cash and bank balance and (b) advances and other assets.

Cash and bank balance: This includes cash, bank balance, money at call and short notice etc. These are shown separately in Schedule 11.

Advances and other assets: These are shown in Schedule 12. These include various kinds of advances made by the insurance company. The items come under this head are reserve deposits with ceding company, application money for investments, prepayments, advances to directors officers, advance tax paid etc. Other assets include income accrued on investments, outstanding premiums, agents balance, amounts due from other entities carrying on insurance business, due from subsidiaries etc.

Current Liabilities: Current liabilities are those which are repayable within a short period of time. These include creditors, agents balance, balances due to other insurance companies, Premium received in advance, amount due to subsidiaries / holding companies, claims outstanding, annuities due etc. All these are shown in Schedule 13.

Provisions: All kinds of provisions are shown in Schedule 14. Here, provision for taxation, proposed dividend, dividend distribution tax etc., is shown.

Miscellaneous Expenditure: Discount on issue of shares or debentures, preliminary expenses etc. are shown under this head. These are shown in Schedule 15.

Treatment of Some Important Items

- **Outstanding Claims**: Claims which are intimated and accepted but not paid, or claims which are intimated but not accepted and paid by the end of the accounting year are called outstanding claims. **Treatment in Final Accounts;**
  (a) If the outstanding claims are given in T/B and if they relate to the last year (i.e., outstanding claims at the beginning of the year), it should be taken only in the Revenue Account. In the Revenue Account, it should be deducted from the claims paid during the year.
  (b) If the outstanding claims are given in the T/B, and if they relate to the current year (i.e. outstanding claims at the end of the year), they should be taken only in the B/S. They should be taken as current liabilities under the head "Estimated liability in respect of outstanding claims" (Schedule 13). It may be noted that the outstanding claims given in Trial Balance, with a closing date or without any date should be treated as outstanding claims at the end of the year.
  (c) If the outstanding claims are given in the adjustment, they should be shown in the Revenue Account as well as in the B/S. In the Revenue Account, they should be added to the claims paid during the year. In the B/S, they should be shown as current liability under the head "Estimated liability in respect of outstanding claims"(Schedule 13).

- **Reinsurance Claims (Claims covered under Reinsurance);**
  When an insurance company thinks that a specific risk is so high that it cannot shoulder in its individual capacity, it may reinsure a part of the risk with some other insurance company. This is known as reinsurance. In such a situation proportionate premium has to be given by the first or original insurer to the reinsurer. Hence, reinsurance premium should be deducted from the premium received. On maturity, both the companies will share the claim in the ratio agreed by them.

Treatment in Final Accounts of the Original Insurance Company

a) If the reinsurance claims are given in T/B, they should be taken only in the Revenue Account. They should be deducted from the claims and only the net claim is shown.
b) Of the reinsurance claims are given in the adjustment, they should be shown both in the Revenue Account and in the B/S. In the Revenue Account, they should be deducted from the claims. In the B/S, they should be shown as other assets under the head "Amount due from reinsurers" in Schedule 12.

Summary of Treatment of Important Items

Particulars	Adjustments
1. Outstanding Claims I. At the beginning of the year (opening)	Give in T/B (take at one place only) Deducted from the claims paid in the revenue account.
II. At the end (closing)	Given in adjustment (take at two places) (a) Added to claims paid in the revenue a/c (b) Shown as Current Liability in the B/S under the head "Estimated liability in respect of outstanding claims in Schedule 13.
III. At the end	Given in TB (take at one place only) Shown as Current Liability in the B/S under the head "Estimated liability in respect of outstanding claims in Schedule 13
2. Re-insurance Claim (claims covered under re-insurance) in the books of original insurer	Given in TB(take at one place only) Deducted from the claims paid in the Revenue A/c.
	Given in adjustment (take at two places) (a) Deducted from the claims paid in the Revenue Account. (b) Shown as 'Other Assets' under the head 'Amount due from re-insurers' in Schedule 12.
3. Annuities paid	Given in TB (take at one place only) Shown as Expense in the Revenue A/c in Schedule 4.
4. Outstanding Annuities At the beginning (opening)	Given in TB (take at one place only) Deducted from the annuities paid in the Revenue a/c in Schedule 4.
ii. At the end (Closing)	Given in adjustment (take at two places) (a) Added to 'annuities paid in the revenue a/c.
iii. At the end (closing)	Given in TB(take at one place only) Shown as Current Liability in the B/S under the head 'Annuity due and unpaid in Schedule 13.

5. Bonus Bonus in cash	Given in TB (take at one place only) Shown as an Expense in the Revenue A/c under 'Benefits paid' in Schedule 4
iv. Bonus utilized in reduction of premium	Given in TB (take at one place only) Shown as an Expense in the Revenue A/c under 'Benefits paid' in Schedule 4. Given in adjustment (take at two places) (a) Shown as an Expense in the Revenue A/c under "Benefits paid in Schedule 4. Added to premium in the revenue a/c in Schedule 1.
iii. Interim Bonus	Added to claims under Benefits Paid' in Schedule 4 (If it is not included in claims).
6. Outstanding Premium At the beginning (opening)	Given in TB (take at one place only) Deducted from 'Premium Received in the Revenue A/c (Schedule 1).
ii. At the end (closing)	Given in adjustment (Take at 2 places) (a) Added to Premium received in the Revenue a/c. in Schedule 1. Shown as an Asset in the B/S under the head "Advances and other assets' in Schedule 12.
iii. At the end (closing)	Given in TB (take at one place only) Shown as an Asset in the B/S under the head 'Advances and other assets' in Schedule 12.
7. Accrued Interest and Dividend At the beginning	Given in TB (take at one place only) Deducted from Interest and Dividend received in the Revenue A/c under the head 'Income from investment
ii. At the end (closing)	Given in adjustment (take at two places) (a) Added to Interest & Dividend received

	under the head Income from investment in the Revenue A/c. (b) Shown as an Asset in the B/S under the head 'Advances and other assets' in Schedule 12.
iii. At the end (closing)	Given in TB (take at one place only) Shown as an Asset in the B/S under the head 'Advances and other assets' in Schedule 12.
8. Reversion	Given in TB (Dr.) (take at one place only) Shown as an Asset in the B/S under the head Investments' in Schedule 8
9. Provident Fund, Pension Fund, Superannuation Fund	Given in TB (Cr) (take at one place only) Shown as a Liability in the B/S under the head "Balance of fund and accounts' in Schedule 6.
10. Life assurance fund (opening)	Given in TB (Cr) (take at one place only) Shown as a Liability in the B/s after Schedule 7 - Borrowings,

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Determination of Profit in Life Insurance Business

A life insurance policy is usually taken for a number of years. This means that life insurance is a long term contract. The premium received on such long term contract cannot be treated as income for ascertaining the profit for the year in which the premiums are received. The claim will arise either on death or on the expiry of the period of the policy. This implies that the future premium on the policy may or may not be received depends on the existence of the insured. There is a gap between claims which are expected to arise and premiums which are expected to be received. This gap is known as the net liability of the insurance company, Net liability is the excess of present value of future claims of current policies over the present value of premiums to be received in future in respect of current policies. This net liability on all outstanding policies must be ascertained in order to find out the profit of life insurance business. This calculation is done by experts called actuaries. The process by which the net liability is ascertained by actuaries are called actuarial valuation. The net liability is ascertained by Actuaries once in two years in case of LIC of India.

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MODULE 4

CONSOLIDATED FINANCIAL STATEMENTS (IND AS110)

Consolidated financial statements - are the "Financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent company and its subsidiaries are presented as those of a single economic entity",

Parent company: Parent is an entity that control one or more entities. In other words, it is an enterprise that has one or more subsidiaries. It is a company which holds the majority of equity shares of another company, parent company is also known as holding company

Subsidiary: A subsidiary is a company whose majority of equity shares are hold by another company. If the parent has purchase 100% of the outstanding equity shares, the subsidiary is called wholly owned subsidiary

Group companies

The parent company and its subsidiary companies are collectively called group.

Group structure

Important group structures are

1. **Direct holding**: The simplest structure is one in which a parent company has only a direct interest in the shares of its subsidiary companies.
2. **Indirect holding**: A parent company may have indirect holdings in its subsidiaries. This can lead to more complex structures. They are:-
   a. *First type*: - A parent company holds more than 50% of the shares of another company. This subsidiary company holds more than 50% of the share of another company.
   b. *Second type*: - A company (first company W) owns 100% of the equity of another company (second company X). Besides, the first company owns 50% of the equity of another company (third company Y). The second company and third company each own 50% of the equity of another company (fourth company Z).
   In that case:
      i. X company is a subsidiary of W company
      ii. Y company is not a subsidiary of W company
      iii. Z co is not a subsidiary of either X Co or Y Co. consequently, it is not a subsidiary of W Co

c. *Third type*:- Company P holds, say, 75% of the equity of another company Q. Q holds some shares, say, 36% of shares in another company R. P company, therefore has indirect holdings in R company. Besides, P Company has direct holding in R Company because P holds 20% of the equity of R.

Here, Q is a subsidiary of P. Q holds 36% of the equity of R. Hence, P has indirect control over 36% of the equity of R. If P holds 20% of the equity of R, then P has direct control over 20% of R's equity. Therefore, R Company is a subsidiary of P Company, although P Company's interest in R company's assets is only 47% (i.e., 20%+75% of 36%)

Measurement of non-controlling interest:-

Non-controlling interest (NCI), also known as minority interest, is an ownership position whereby a shareholder owns less than 50% of outstanding shares and has no control over decisions. Non-controlling interests are measured at the net asset value of entities and do not account for potential voting rights. Non-controlling interest should be shown as separate non-current liability in the consolidated financial statement.

NCI arises when a parent company holds less than 100% (but more than 50%) of the equity shares of the subsidiary. If the parent company holds 100% of the shares of the subsidiary, there is no question of NCI.

Disclosure of non-controlling interest in the consolidated balance sheet

A parent company presents non-controlling interest in its consolidated balance sheet separately from the equity of the owners of the parent. Clearly speaking, it is shown under non-current liabilities.

Methods of calculating NCI

Method 1

Value of shares held by minority shareholders		xxx
Add: Share in the pre-acquisition profit of subsidiary company	xxx	
Share in the post-acquisition profit of subsidiary company	xxx	xxx
NCI		xxx

Note: Share in the pre-acquisition loss or post-acquisition loss (if any) should be deducted.

Method 2

Share of minority shareholders in the net assets of subsidiary companies = xxx

Net assets acquired = Share capital +Reserves and Surplus, or
Total assets acquired – Total Liabilities Assumed

Problem 1

X Ltd has owned 75% of the share capital of Y Ltd since the date of Y Ltd's incorporation. The balance sheet of Y Ltd is given below.

Balance sheet of Y Ltd

Equity and Liabilities	
Equity	
Share capital	
40,000 Equity Shares of ₹10 each	6,00,000
Retained earnings	1,20,000
Current Liabilities	1,80,000
Total Equity and Liabilities	9,00,000
Assets	
Non-Current Assets	
Property, Plant and Equipment	5,00,000
Current Assets	4,00,000
Total Assets	9,00,000

Calculate the non-controlling interest.

Recognizing and measuring goodwill (or gain from bargain purchase)

IFRS 3 or Ind AS 103 covers the accounting treatment of goodwill acquired in a business combination. Suppose a company (acquirer) agrees to pay (consideration) for a 100% investment in another company (acquiree) more than the tangible assets of the acquiree. Then this would mean that the acquiree must also have intangible assets. The amount paid over and above the value of the tangible assets is goodwill arising on consideration.

Recognition and measurement of goodwill

Goodwill acquired in a business combination is recognized as an asset and is initially measured at cost. After initial recognition, it is measured at cost less any accumulated impairment losses. The method of calculation of goodwill varies according to situations.

Situation 1

When consideration transferred and net assets acquired are given and 100% share are acquired by the acquirer.

In this situation, 100% shares are acquired. Hence, there is no non-controlling interest. Goodwill is calculated by using the following formula:

Goodwill = consideration transferred – Net assets acquired at acquisition
Net assets acquired = Share capital + Reserves and Surplus, or
Total Assets Acquired – Total Liabilities Assumed

Example

X Ltd acquires 100% shares of Y Ltd which has 40,000 shares of ₹10 each at a market price of ₹12 each. The assets and liabilities of Y Ltd are ₹5,00,000 and ₹1,00,000 respectively. Calculate Goodwill.

Solution:-

Goodwill = consideration transferred – Net assets acquired
Net assets acquired = Total Assets Acquired – Total Liabilities Assumed
= 5,00,000 - 1,00,000
= 4,00,000
Goodwill = 40,000 x 12 – 4,00,000 = ₹80,000

Situation 2

When consideration transferred and net assets acquired are given and the acquirer acquired less than 100% shares of subsidiary

In this situation there is non-controlling interest. This is because a portion of the shares(less than 50%, i.e., non-controlling shares) is held by outsiders. In this case, goodwill is calculated as below:

Goodwill = consideration transferred + Non-controlling interest– Net assets acquired
Or
Goodwill = Consideration paid – proportionate share of parent in the net assets of the subsidiary.

Example

X Ltd. purchased 80% of the shares of Y Ltd. the issued capital of Y Ltd consists of 25,000 shares of ₹10 each. Consideration paid is ₹2,60,000. The identifiable assets and liabilities of Y Ltd are ₹3,00,000 and ₹50,000 respectively. Calculate the amount of goodwill.

(Goodwill is 60,000)

Situation 3

When pre-acquisition profit and post-acquisition profit of subsidiary company are given.
In this situation goodwill is calculated in the following manner:

Amount of consideration transferred		xxx
Less: Paid up value of shares acquired	xxx	
Share in the pre-acquisition profit of subsidiary	xxx	xxx
Goodwill		xxxx

Gain from bargain purchase (Negative goodwill)

In extremely rare circumstances an acquirer will make gain from bargain purchase (negative goodwill) in a business combination. This happens when the net assets acquired is greater than the total consideration. Before recording negative goodwill, it is necessary to review all assets, liabilities and contingent liabilities to ensure that they have been properly accounted for. Also, the acquirer shall determine whether there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase.

In short bargain purchase arises when the fair value of the net assets acquired exceeds the consideration paid for them.

Example

A Ltd purchased 75% shares of B Ltd. The share capital of B Ltd consists of 40,000 shares of ₹10 each. The consideration paid is ₹2,80,000. The identifiable net assets and liabilities of B Ltd are amounted to 5,00,000 and 1,00,000 respectively. Calculate Goodwill / gain from bargain purchase.

(*Answer* gain from bargain purchase 20,000)

Preparation of Consolidated Financial Statements

Consolidated financial statements present the performance and financial position of the group, as if it is a single economic entity.

Need and importance of consolidated financial statements

- It provides useful information to users about the financial position of the group as a whole.
- It enables the readers to understand the overall financial health of an entire group of companies.
- It shows the economic resources controlled by the group, the obligations of the group and the results (profit or loss) the group achieves by using those resources.

Exemption from preparation of consolidated financial statements

A parent need not present consolidated financial statements if it meets all of the following conditions:

1. The parent itself is a wholly or partially owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not preparing consolidated financial statements.
2. The parent's debt or equity instruments are not traded in a public market.
3. The parent did not file its financial statements with a regulatory organization(e.g., SEBI) for the purpose of issuing any class of instruments in a public market, and

4. The ultimate parent company produces financial statements that comply with IFRS or (Ind AS) and are available for public issue.

Summary of consolidation process

In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries should be combined on a line by line basis by adding together like items of assets, liabilities, income and expenses.

In order that the consolidated financial statements present financial information about the group as that of a single enterprise, the following steps should be taken:

(a) The **cost** to the parent **of its investment in each subsidiary** and the parent's portion of equity of each subsidiary, at the date on which investment in each subsidiary is made, **should be eliminated**;

(b) Any **excess of the cost** to the parent **of its investment in a subsidiary over the parent's portion of equity** of the subsidiary, at the date on which investment in the subsidiary is made, should be described as **goodwill** to be recognized as an asset in the consolidated financial statements;

(c) **When the cost** to the parent of its investment in a subsidiary **is less than the parent's portion of equity** of the subsidiary, at the date on which investment in the subsidiary is made, the difference should be treated as a **capital reserve** in the consolidated financial statements;

(d) Minority interests(Non-controlling interest) in the net income of subsidiaries for the reporting period should be identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent; and

(e) Minority interests in the net assets of subsidiaries should be identified and presented in the consolidated balance sheet separately from liabilities and the equity of the parent's shareholders.

(f) Eliminate in full all intra group assets and liabilities and transactions, and the resulting unrealized profits.(Unrealized losses resulting from intra-group transactions should also be eliminated unless cost can be recovered)

- ***The share capital of the subsidiary is never taken in the consolidated balance sheet.***
- ***The retained profits shown in the consolidated balance sheet comprises of parent's profit plus parent's share in the post-acquisition profit of the subsidiary.***
- ***The parent's share of pre-acquisition profit of the subsidiary is adjusted in the amount of goodwill/gain on bargain purchase***.

UNIFORM ACCOUNTING POLICIES

Consolidated financial statements should be prepared using uniform accounting policies for the transactions and other events in similar circumstances. If a member of group uses accounting policies other than those adopted in the consolidated balance sheet for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

Example

X Ltd has owned 60% of the share capital of Y Ltd., since the date of Y Ltd's incorporation. Their latest balance sheets are given below:

Balance Sheet of X Ltd

Equity and Liabilities		
Equity		
80,000 Equity Shares of ₹10 each	8,00,000	
Retained earnings	2,50,000	10,50,000
Current Liabilities		2,00,000
Total Equity and Liabilities		12,50,000
Assets		
Non-current Assets		
Property, Plant and Equipment	5,00,000	
30,000 ₹10 Equity shares in Y Ltd. at cost	3,00,000	8,00,000
Current Assets		4,50,000
Total Assets		12,50,000

Balance sheet of Y Ltd

Equity and Liabilities	
Equity	
50,000 Equity Shares of ₹10 each	5,00,000
Current Liabilities	2,00,000
Total Equity and Liabilities	7,00,000
Assets	
Non-current Assets	
Property, Plant and Equipment	3,50,000
Current Assets	3,50,000
Total Assets	7,00,000

Prepare the consolidated balance sheet.

Goodwill and pre acquisition loss

On the acquisition date, the subsidiary company may have pre acquisition loss. The pre-acquisition loss should be taken into consideration while calculating net assets. Pre-acquisition loss should be deducted from equity share capital and the balance is net assets acquired. This net asset should be compared with the consideration paid. The excess of consideration paid over the net assets acquired represents goodwill.

Goodwill and pre acquisition profit

While acquiring the controlling shares in the subsidiary, the parent company pays not only for the paid up value of shares acquired but also for the profits that the subsidiary has accumulated till the date of acquisition. In such cases the total of share capital of the subsidiary and the parent company's share in the pre-acquisition profit of the subsidiary must be compared with the consideration paid or transferred in order to arrive at goodwill.

Post-acquisition profit of the subsidiary

So far we have discussed the preparation of consolidated balance sheet immediately after acquiring majority shareholding in a subsidiary. Hence the reserves and surplus of the subsidiary were treated as capital profits. Now we turn our attention to the treatment profits earned by the subsidiary after acquisition. This is called post incorporation profit or post acquisition profit (revenue profit).

The share of the parent company in the post-acquisition profit of the subsidiary is added to the reserves and surplus of the parent company. It is shown in the consolidated balance sheet under the head 'retained earnings' or 'reserves and surplus'. The loss, if any, is deducted.

The share of non-controlling shareholders is added to NCI. The share of loss, if any, is deducted.

Revaluation of fixed assets of subsidiary

Fixed assets of subsidiary company may be revalued at the time of acquisition by the parent company. While calculating non-controlling interest, the share of the non-controlling shareholders in the increase in value of fixed assets should be included in the non-controlling interest. This means that the non-controlling shareholders are entitled to their share in the increase in the value of fixed assets on revaluation. Any decrease in the value of fixed assets should be deducted along with their share in the losses or expenses not written off.

Goodwill will decrease and fixed asset will increase as a result of revaluation profit (or gain from bargain purchase and fixed asset will increase). In case of revaluation loss, the effect is reverse.

Preference shares issued by Subsidiary

Preference shareholders usually do not have voting rights. Hence preference shares do not affect the extent of control which the parent company would have over the subsidiary. When the subsidiary company has issued preference shares in addition to equity shares, the accounting treatment is as follows:

1. Any preference shares not held by the parent company would be disclosed as a part of NCI. Even if the non-controlling shareholders hold more than 50% of preference shares, they are not shown separately in the consolidated balance sheet.

2. Out of the profits of the subsidiary company, preference dividend accrued on all preference shares should be deducted. The remaining profits should be apportioned between the parent company and the non-controlling shareholders in the ratio of equity shares held by them.

Preference dividend should be provided out of the profits of the subsidiary company irrespective of whether they have been declared by the subsidiary or not. Parent company's share in preference dividend is included in its profits and is shown in the consolidated balance sheet.

3. The NCI includes the paid up value of preference shares held by the outsiders plus the dividend accrued on them.
4. Goodwill or gain on bargain purchase is not calculated separately for acquisition of preference share capital. It is assumed that any goodwill or gain on bargain purchase would have resulted only from the acquisition of equity shares. The total price paid for the purchase of the equity and preference shares is compared with the net assets acquired (or parent company's share in the net assets acquired) to determine the overall amount of goodwill or gain on bargain purchase.

Mutual Owings.

While preparing the consolidated balance sheet the mutual owings are not required to be shown. They cancel out each other when appearing in the asset side as well as liability. The examples of such mutual owings are:

a. Trade debtors and Trade creditors: Goods are sold by the holding (parent) to the subsidiary or vice-versa on credit and the payment is still outstanding. This will be shown in the sundry debtors on the balance sheet of one company and as sundry creditors on the balance sheet of another. In consolidated balance sheet, both of them should be eliminated.
b. Bills Receivable and Bills Payables: Bills drawn by one company and accepted by another are also eliminated.
c. Loans and Advances: loans and advances given by one company to another are also the examples of mutual owings which shall be eliminated. Similarly, interest receivables and interest payables will also be eliminated.
d. Debentures: Debentures issued by one company and investment made by another in these debentures shall also be eliminated. The difference in the paid up value of debentures by the issuing company and the amount paid by the investing company is adjusted through the capital reserve or goodwill. the debenture interest accrued or payable on debentures is also eliminated as a mutual owing.

Parent company which has two subsidiaries

Sometimes a parent company may have two subsidiaries. Then the parent and its two subsidiaries constitute a group. In such cases, the preparation of consolidated balance sheet is somewhat difficult.

MODULE 5

IMPORTANT DISCLOSURE BASED ACCOUNTING STANDARDS

The adoption of internationally accepted financial reporting standards is a necessary measure to facilitate transparency and contribute to proper interpretation of financial statements. This chapter deals with disclosure related accounting standards such as:

1. Earnings per share (Basic and Diluted (Ind AS 33))

2. Segment Reporting (Ind AS 108)

3. Events after reporting period (Ind AS 10)

4. Related Party Transactions (Ind AS 24)

5. Changes in Accounting Policies, Accounting Estimates and Errors (Ind AS 8)

6. Interim Financial Reporting (Ind AS 34)

1. ACCOUNTING FOR BASIC AND DILUTED EPS (IAS 33 and Ind AS 33)

EPS is an important measure of performance of a company. It is disclosed on the face of the statement of profit or loss. Ind AS 33 specifies the requirements relating to EPS.

Definitions

1. Ordinary share: An ordinary share is an equity instrument that is subordinate to all other classes of equity instruments. It is also known as common share.

2. Potential ordinary share: A potential ordinary share is a financial instrument or other contract that may entitle its holder to ordinary shares. Common examples of potential ordinary shares include convertible debt, convertible preference shares, share warrants, share options, employees stock purchase plans, contractual rights to purchase shares etc.

3. Earnings per share: Earnings per share is the interest of each ordinary share of an entity in the profit or loss of the entity for the reporting period.

4. Dilution: Dilution is a reduction in earnings per share or an increase in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

Measurement

Measurement of Basic Earnings per Share (Basic EPS)

$$\text{Basic EPS} = \frac{\text{Profit or loss attributable to ordinary equity share holders of the parent entity}}{\text{Weighted average number of ordinary shares outstandingduring the period}}$$

Steps in the Calculation of Basic EPS

1. Calculation of earnings (profit or loss).

2. Calculation of number of shares.

Effect on EPS of Changes in Capital Structure

When new shares are issued or existing shares are bought back, there will be effect on EPS. In such situations, the EPS for the previous year will be comparable with that of the current year. This is because the weighted average number of shares have risen or fallen and there is a corresponding increase or decrease in resources. Money shall be received when shares are issued and money shall be paid out when shares are bought back.

Change in number of ordinary shares without a corresponding change in resources

Shares may be issued, or reduced, without a corresponding change in resources. The various examples may be given below:

a) Capitalisation or bonus issue

b) Bonus element in right issue

c) Shares split

d) Reverse shares split (consolidation of shares)

Reverse Shares Split (Consolidation of Shares)

In the case of consolidation of shares the number of outstanding shares is reduced without a corresponding reduction in resources. In such situations the problem is solved by adjusting the number of ordinary shares outstanding before the event for the proportionate change in the number of shares outstanding as if the event had occurred at the beginning of the earliest period reported.

Right Issue

Aright issue of shares is an issue of new shares to existing shareholders at a price below the current market price. Therefore, right issue includes a bonus element.

Calculation of EPS When there is Right Issue

After calculating the theoretical ex-rights price, the next step is to calculate the EPS for the current year and for the previous year. The procedure is as follows:

1. The EPS for the corresponding previous period should be multiplied by the following fraction:

$$\frac{\text{Theoretical ex-rights price}}{\text{Market price on last day of quotation with rights}}$$

2. Then calculate the EPS for the current year. First number of shares is to be calculated. This is calculated in two stages.

a) Multiply the number of shares before the right issue by the fraction of the year before the date of issue and by the following fraction.

$$\frac{\text{Market price on last day of quotation with rights}}{\text{Theoretical ex-rights price}}$$

b) Multiply the number of shares after the right issue by the fraction of the year after the date of issue and add to the figure arrived at in (a). Now we get the total number of shares

3. Then the total earnings should be divided by the total number of shares calculated in (b). We now get the basic EPS.

Diluted EPS

At the end of an accounting year a company may have some securities which do not have at present any claim upon the equity earnings. But in the future a claim upon earnings may arise for such securities. Convertible securities, options or warrants etc. are examples of such Securities. These are dilutive potential ordinary shares.

Calculation of Diluted EPS

Diluted Earnings

The earnings (used for calculating basic EPS) should be adjusted by the after tax effect of the following:

a) Any dividend on dilutive potential ordinary shares (profit is increased by such after tax dividend)

b) Interest recognised in the period for the dilutive potential ordinary shares (profit is increased by such after tax interest)

c) Any other changes income (or expense) that would result from the conversion of the dilutive potential ordinary shares (profit is increased by increase in income or decrease.

Diluted Shares

For the purpose of calculating diluted EPS, the number of ordinary shares should be the weighted average number of ordinary shares (used for calculating basic EPS) plus the weighted average number of ordinary shares that would be issued on the conversion of all dilutive potential ordinary shares into ordinary shares.

After calculating diluted earnings and diluted shares, we can now calculate diluted EPS. It is calculated by dividing the adjusted or diluted earnings by the diluted or adjusted number of shares.

Restatement

If the number of ordinary or potential ordinary shares outstanding increases as a result of capitalization, bonus issue or share split, or decreases as a result of a reverse share split, the calculation of basic and diluted earnings per share for all periods presented shall be adjusted retrospectively. If these changes occur after the reporting date but before the financial statements are authorised for issue, the EPS calculations for the financial statements and any prior period financial statements should be based on the new number of shares (and this should be disclosed)

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