

Amalgamation, Absorption and External Reconstruction

Introduction

In the modern commercial world dominated by multinational corporations (M.N.Cs), 'Size' is considered as an advantage. Economies of scale and globalisation of Trade and Industry have inevitably given impetus for business combinations in the form of mergers, acquisitions and reorganisations. 'Take overs', both hostile and amicable, have become the order of the day. It is essential to understand the different forms of such takeovers, their legal position and the accounting treatment.

Meaning

(a) Generally understood meaning

The terms '*Amalgamation*', '*Absorption*' and '*External reconstruction*' are commonly understood, in their accounting sense, as follows:

Amalgamation: When two or more existing companies combine together to form a new company, it is *amalgamation*. All the combining companies are liquidated. A new company is floated to take over their businesses.

Absorption: When one existing company takes over the business of one or more existing companies, it is *absorption*. The companies whose business is taken over are liquidated. No new company is formed.

External reconstruction: When an existing company is liquidated and a new company is formed with the same shareholders to take over its business, it is *external reconstruction*. Sick companies with accumulated losses usually undergo such reconstruction.

(b) Legal Meaning and Basis

The Companies Act 1956 has not specifically defined the terms Amalgamation and Absorption. However, interpretations of the Act by Courts of law make it clear that 'Amalgamation' includes absorption also. In S.S. Somayajulu Vs. Hop Prudhomme and Co. Ltd., (1963, Com. L.J. 61), Amalgamation is described as "A state of things under which either two companies are joined so as to form a third entity or one is absorbed into or blended with another".

Sections 390 and 396A of the Companies Act specify the provisions relating to amalgamation. Every scheme of amalgamation involving two or more companies requires the approval of a Court. The court wields wide ranging powers in approving such schemes and may provide for the protection of the different parties involved.

Sec. 494 of the Companies Act 1956 facilitates amalgamation, absorption and external reconstruction. It permits the liquidator of a company to accept shares, policies or other like interests in consideration of the sale of a company's undertaking to another company, with an object to distribute them amongst the members of the transferor company, provided, the following two conditions are satisfied:

- (i) A special resolution is passed by the company to that effect; and
- (ii) the liquidator purchases the interest of any dissenting member at a price to be determined by agreement or by arbitration.

(c) Meaning under 'Accounting Standard' (AS 14)

Accounting for Amalgamations (AS: 14), issued by the Institute of Chartered Accountants of India is mandatory in nature for all companies and is applicable to accounting periods commencing on or after 1.4.1995. The standard specifies the procedure of accounting for amalgamations and the treatment of any resultant goodwill or reserves. The following terms have been used in the standard with the meanings specified:

- (a) Amalgamation means an amalgamation pursuant to the provisions of the Companies Act 1956 or any other statute which may be applicable to companies.
- (b) Transferor company means the company which is amalgamated into another company.
- (c) Transferee company means the company into which a transferor company is amalgamated.

Perusal of the above terms makes it clear that the term 'Amalgamation' as used in AS: 14 includes absorption also.

External Reconstruction

'Reconstruction' of a company involves reorganisation of its 'Financial structure'. If the reorganisation is accomplished without liquidating the company, it is 'Internal Reconstruction' (which is discussed in Chapter 9). When reorganisation of a company's financial structure necessitates winding-up of the company and floatation of a new company with the same assets and shareholders, it is termed as 'External Reconstruction'.

External Reconstruction is like 'amalgamation in the nature of purchase' (see page 10.4). However it involves only one existing company and formation of a new company is mandatory which is not the case with amalgamation when one existing company absorbs another existing company.

Types of Amalgamation

Amalgamations fall into two broad categories. In the first category are those amalgamations where there is a genuine 'pooling', not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of these companies. Such amalgamations are amalgamations which are in the nature of 'merger.' The accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamated companies.

(A) Amalgamation in the nature of merger

An amalgamation should be considered to be an amalgamation in the nature of merger when all the following conditions are satisfied :

- (i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
- (ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than equity shares already held therein, immediately before the amalgamation by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.
- (iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity share in the transferee company, except that cash may be paid in respect of any fractional shares.
- (iv) The business of the transferor company is intended to be carried on, after amalgamation, by the transferee company.
- (v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

The most important points which have significant accounting impact are that:

- (a) all assets and liabilities are to be taken over by the purchasing company;
- (b) purchase consideration should be issued to the shareholders of the selling company in shares only, except for cash to satisfy fractions of shares; and
- (c) assets and liabilities taken over should be shown in purchasing company

at their book values expect in cases requiring changes for ensuring uniform accounting practices.

(B) Amalgamation in the nature of purchase

In the second category are those amalgamations which are in effect a mode by which one company acquires another company and as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company or the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase'.

So, amalgamations which do not satisfy one or more conditions specified for amalgamations in the nature of merger should be treated as 'Amalgamations in the nature of purchase'.

Thus, in amalgamations in the nature of purchase,

- All the assets and liabilities of the selling company may not be taken over.
- Less than 90% of the selling company's shareholders may become shareholders in the purchasing company.
- Consideration payable to shareholders of selling company may be in the form of shares or cash or in any other agreed form.
- Selling company's business may or may not be carried on in future.
- Assets and liabilities taken over by the purchasing company may be shown at values other than book values at the discretion of the purchasing company.

Accounting problems relating to Amalgamation and External Reconstruction :

Introduction : There may be Technical, procedural and practical differences between Amalgamation and external reconstruction. But, from 'accounting' point of view, the problems relating to them are common. The 'Transferor company' (selling company) and the 'Transferee company' (Purchasing company) have to agree upon the terms of takeover, the purchase price mutually acceptable and its form. All the resultant transactions should be recorded in the books of accounts of both Transferor and transferee companies, satisfying all the 'statutory requirements'. Several problems which may crop up as a consequence of the Amalgamation or external reconstruction should be appropriately tackled. These aspects are explained below in detail.

I. Purchase consideration

(A) Meaning of consideration

Accounting Standard - 14 (AS-14) defines the term consideration as follows :
 "Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company."

The above definition has the following implications:

- Purchase consideration is restricted to the total amount payable to the shareholders of the selling company alone.
- Any amount agreed to be paid to the debenture holders or creditors of the selling company cannot be included in the purchase consideration.
 As a result, it is necessary to transfer such liabilities to the purchasing company. In purchasing company's books, payment made for such liabilities can be shown.
- Any amount agreed to be paid for the liquidation expenses of selling company also creates a problem.
 - They can be added to purchase price on the basis that such payment benefits the shareholders of the selling company as they will not be required to bear such expenses.
 - They can be treated as reimbursement. Selling company pays cash for the expenses and gets back the amount from purchasing company.

The second method seems to be more appropriate in the context of the definition of consideration by AS-14, restricting it to the amount payable to the shareholders of the selling company.

(B) Computation of Purchase Consideration

The Purchase Consideration has two aspects – the amount of consideration and its form. They are usually governed by the terms of agreement between the transferor (selling) and Transferee (Purchasing) Companies.

The amount of purchase consideration can be computed under any of the following Four methods, whichever is appropriate, based on the data given.

- | | |
|-----------------------|----------------------------|
| (a) Lumpsum method | (b) Net payment method |
| (c) Net Assets Method | (d) Intrinsic Value Method |

It must be remembered that in all the above four methods, consideration payable to shareholders alone should be shown, as per AS-14.

Amount payable to other claimants, like debenture holders, creditors etc. should not form part of purchase price even if purchasing company agrees to pay for their settlement.

The above methods are explained in detail below.

(a) Lump sum method: The purchase price to be paid to shareholders may be mentioned in the agreement directly. The lump sum is to be taken as purchase consideration, eliminating the need to compute it.

(b) Net payment method: The agreement between the selling and purchasing companies may specify the exact amount payable to the shareholders of the selling company in the form of cash or shares or debentures in the purchasing company. These agreed payments are added to ascertain the purchase consideration. The total of the payments represents the 'net payment' made by the purchasing company for the shareholders of the selling company.

While determining the purchase price under the 'Net payment' method, the following are to be noted:

1. The assets and liabilities taken over by the purchasing company and the values at which they are taken over are not relevant to compute the purchase price.
2. All payments agreed upon should be added, whether it is for equity shareholders or preference shareholders.
3. If any liability is 'taken over' by purchasing company to be discharged later on, such amount should not be deducted or added while computing purchase price.
4. Even if liquidation expenses of the selling company are agreed to be paid by the purchasing company, they should not be added to purchase price.

(c) Net assets method: 'Net assets' taken over by the purchasing company is deemed as the purchase consideration under the net assets method.

Net assets = Agreed value of assets taken over - Agreed value of liabilities taken over.

Net assets method has to be followed when full information is not given about payments to different 'claimants' in selling company. The following relevant points are to be noted while ascertaining the purchase price under the net assets method.

1. When a company takes over another company or the 'business' of another company, it implies that both assets and liabilities are taken over.
2. The term 'Assets' taken over includes cash and bank balances also. However, losses shown on the assets side of balance sheet are not to be taken as assets.
3. Any specific assets not taken over should be ignored while computing the purchase price.

Amalgamation. Absorption and External Reconstruction

1. 'Liabilities' includes all amounts due to third parties (the company being the first party and the shareholders being second party).
2. Trade liabilities' include Creditors and Bills payable. Other liabilities like Bank over draft, Tax payable, outstanding expenses are not a part of trade liabilities.
3. Accumulated profits do not form part of 'liabilities, they belong to the shareholders.
4. If any 'fund' or portion of 'fund' denotes liability to third parties, it has to be included in the 'liabilities'. Examples are Staff Provident fund, workmen's savings bank A/c, Workmen's Profit sharing fund, etc.
5. Liabilities 'not taken over' should be excluded from the computation of net assets.

(d) Intrinsic value method or Shares exchange method: Under this method, the purchase consideration is ascertained on the basis of the ratio in which the shares of the purchasing company are exchanged with those of the selling company. The exchange ratio is generally determined on the basis of 'intrinsic values' of the respective companies' shares.

$$\text{Intrinsic Value} = \frac{\text{Assets available for equity shareholders}}{\text{Number of equity shares}}$$

The assets must be taken at agreed values. All the amounts due to third parties and even preference shareholders must be reduced from total assets to ascertain assets available for equity shareholders.

(C) Form of Consideration

Form of consideration refers to the amount of cash, shares, debentures etc., receivable from the purchasing company as part of purchase price. It depends on the agreement between the purchasing and selling companies.

However, in the Amalgamation in the nature of merger, the consideration should be in the form of purchasing company's shares only. Cash can be paid to adjust 'Fractions of shares' alone.

In amalgamation in the nature of purchase, the consideration can be in form of shares or cash or anything else.

II. Recording

In Amalgamation, two or more companies are liquidated. They are the selling companies. A new company is formed which is the purchasing company.

In Absorption, one company purchases the business of one or more existing companies. The latter are the selling companies which are to be liquidated.

company. A new company is formed to purchase the business of the liquidating company.

In all the above cases, (i) the books of the liquidating or selling company have to be closed by means of journal entries and ledger accounts. (ii) The purchase of business has to be recorded by means of journal entries in the books of the company which acquires the business.

While recording transactions in the books of the purchasing and selling companies, the following must be noted.

- (1) **Assets and Business:** When assets are taken over by a purchasing company, that implies all the tangible and intangible assets including cash and bank balance. However, fictitious assets which are nothing but losses are excluded from the meaning of 'Assets'.
The term 'Business' implies all assets and external liabilities. External liabilities are the amount payable to all outsiders except shareholders.
- (2) **'Liabilities' and 'Trade liabilities':** When liabilities are taken over, it includes all the amounts due to outsiders, excluding the shareholders. 'Trade liabilities' include liabilities for purchase of goods, i.e., Trade Creditors and Bills payable.
- (3) **Provisions and Losses:** In the Balance Sheet of selling company, accumulated losses like the Profit and Loss Account debit balance, preliminary expenses, discount on issue of shares etc. may appear on the assets side. Provisions like provision for doubtful debts, provision for depreciation etc. may appear on the liabilities side of the balance sheet or may be shown as deductions on the assets side from the assets concerned.
The losses are transferred to the shareholders whereas provisions are transferred to realisation account along with the respective assets.
- (4) **Accumulated profits:** Undistributed profits of both revenue and capital nature may appear on the liabilities side of balance sheet. They are transferred to the equity shareholders account. The following table is useful in distinctly identifying provisions, reserves, losses, trade liabilities and liabilities.

Table showing		Trade Liabilities	Provisions	Accumulated Profits	Accumulated Losses
1. Creditors	Creditors (or) Trade creditors	Provision for Doubtful debts	General reserve	P & L A/c (Dr)	
2. Bills Payable	Bills Payable	Provision for depreciation	P & L A/c	Preliminary expenses	
3. Bank Overdraft		Investment fluctuation fund	Capital reserve	Discount on issue of shares and debentures	
4. Outstanding expenses			Dividend equalisation reserve	Underwriting commission	
5. Unclaimed dividends			Sinking fund		
6. Tax payable			Capital redemption reserve		
7. Provident fund			Insurance fund		
8. Pension fund			Development rebate reserve		
9. Workmen's savings Bank A/c			Share premium		
10. Workmen's profit sharing fund			Workmen's compensation fund		
11. Bank Loans			Workmen's Accident fund		
12. Public Deposits			Contingency reserve		
13. Debentures			Forfeited Shares A/c		

III. Methods of Accounting for Amalgamation

There are two main methods of accounting for amalgamations :

- (a) The pooling of interests method; and
- (b) The purchase method.

Pooling of Interests method

The use of this method is confined to the 'merger' type of amalgamation. The following are the salient features of this method:

- (i) In the books of the transferee company, all the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the date of amalgamation. The exception is the adjustments needed to follow uniformity in accounting policies.
- (ii) If any conflicting accounting policies are followed by the transferor and transferee companies on the date of amalgamation, the effects on the financial statements of any changes in the accounting policies should be reported in accordance with AS-5 'prior period and extraordinary items and changes in accounting policies.'
- (iii) The balance of the profit and loss account of the transferor company should be aggregated with the corresponding balance of the transferee company or it may be transferred to the general reserve account.
- (iv) All the reserves of the transferor company are merged with reserves of the same title in the transferee company. If similar reserve does not exist in the transferee company, they have to be separately shown. Thus, general reserve is merged with general reserve, capital reserve is merged with capital reserve. If there is dividend equalisation reserve in the transferor company and no such reserve exists in the transferee company, it should be separately shown in the transferee company's books.
- (v) Any excess amount paid as purchase consideration as shown by the difference between the amount recorded as share capital issued and other amounts paid as purchase price to transferor company's shareholders and he amount of share capital of the transferor company should be adjusted in reserves.

Pooling of interests method has no specific effect on the books of the transferor company.

Purchase Method

When amalgamation is considered to be an amalgamation in the nature of purchase, it should be accounted for under the purchase method whose main features are as given below:

Amalgamation. Absorption and External Reconstruction
 In the books of the transferee company, the assets and liabilities taken over from transferor company should be incorporated either:

- (i) In the books of the transferee company, the assets and liabilities taken over from transferor company should be incorporated either:
 - (a) at their existing carrying amounts or alternatively,
 - (b) the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values on the date of amalgamation.

(ii) Transferor company's reserves, whether capital or revenue or arising on revaluation, other than statutory reserves should not be recorded in the transferee company's books.

(iii) However, statutory reserves in the transferor company's books, if they should be continued for some specific future period, should be recorded in the transferee company's books. The corresponding debit should be to 'Amalgamation Adjustment account'. When the continuance of the reserve is not required, a reverse entry can be passed to close the reserve as well as 'Amalgamation adjustment account'. Till such time the 'Amalgamation adjustment account' is shown on the assets side of Balance sheet under the heading 'Miscellaneous expenditure'.

(iv) Purchase consideration paid by the transferee company has to be shown at agreed values of the shares or debentures issued, showing face value, premium and discount on issue separately.

(v) If the purchase consideration agreed to be paid exceeds the net assets taken over, the excess amount should be debited to 'goodwill account'. If the amount of consideration is less than the value of the net assets acquired the difference should be treated as 'Capital reserve.'

(vi) The goodwill arising on amalgamation should be written off to the profit and loss account in a systematic manner over its useful life. Normally the period to write off the goodwill should not exceed five years, unless a longer period can be justified.

Distinction between pooling of interests method and purchase method

- (a) **Application** : Pooling of interests method is confined to Amalgamations in the nature of merger, whereas purchase method is used for amalgamations in the nature of purchase.
- (b) **Recording of assets and liabilities** : In pooling of interests method, all the assets and liabilities taken over are shown at their original book values whereas in purchase method they can be shown at any changed or market values.

(c) **Reserves of Transferor company** : All the reserves of the selling company are recorded in the same form in purchasing company under pooling of interests method. In purchase method, selling company's reserves are ignored except the statutory reserves.

When amalgamation is considered to be an amalgamation in the nature of purchase, it should be accounted for under the purchase method whose main features are as given below:

- (d) *Excess of consideration over share capital of Transferor company*: Excess of consideration paid over the paid up value of shares of the company must be adjusted in the 'reserves' in pooling of interests method. In purchase method, excess of purchase consideration over net assets taken over is treated as 'goodwill'. If the consideration is less than net assets, the difference is shown as 'capital reserve'.
- (e) *Amalgamation Adjustment Account*: In purchase method, reserves of the selling company which should be continued, standing to 'Amalgamation Adjustment Account' and it is shown on balance sheet assets side. Need for such account does not arise in pooling of interests method.
- (f) *Specific period to write off goodwill*: Under purchase method, goodwill account is debited for excess consideration paid over net assets which should normally be written off within 5 years. The question of such write off does not arise under pooling of interests method.

IV. Specific Problems

(A) Amalgamation after Balance Sheet Date

Amalgamation may be effected after the Balance sheet date but before issuing Financial Statements by the companies involved in Amalgamation. In such case Amalgamation should not be incorporated in the financial statements. Disclosure of the fact and details of amalgamation should be made in accordance with AS-4, "Contingencies and events occurring after the Balance Sheet date." (Para 40 of AS-14)

In certain circumstances, the amalgamation may also provide additional information, affecting the financial statements themselves, for instance, by allowing the 'going concern' assumption to be maintained.

(B) Dissenting Share Holders

'Dissenting shareholders' are shareholders of transferor (selling) company who have not given their acceptance to the proposed scheme of amalgamation. According to section 395(5)(a) of the companies act 1956, 'Dissenting shareholder' includes a shareholder who has not assented to the scheme or contract (of amalgamation) and any shareholder who has failed to transfer his shares to the transferee company in accordance with the scheme of contract (of amalgamation).

According to section 395(2)(a) and (b) of the companies Act 1956, the shares of 'dissenting shareholders' may be acquired by the transferee company as follows:

- (i) On the same terms on which the asserting shareholders transferred their shares; or

Amalgamation, Absorption and External Reconstruction

(i) On other terms agreed upon between the amalgamated company and the dissenting shareholders; or

(ii) On terms ordered by the court on an application made either by the amalgamated company or the dissenting shareholders.

(iii) Accounting treatment of settling dissenting shareholders :

- Accounting shareholders are settled as per (i) above, no separate treatment if dissenting. They are 'on par' with other assenting shareholders.
- (A) If necessary. They are 'on par' with other assenting shareholders. If settlement of dissenting shareholders is as per (ii) or (iii) above, it involves separate settlement of such shareholders, which is different from that of other assenting shareholders. In such case, the following procedure is followed in the books of the transferor company (selling company)
- (a) The agreed consideration for dissenting shareholders is also added to the purchase consideration and received from the transferee company.
- (b) The share capital of the dissenting shareholders is credited to a separate ledger account called 'Dissenting shareholders account'. It is debited with the consideration actually paid to them.
- (c) The balance in dissenting shareholders' account represents profit or loss to the company due to the separate settlement of dissenting shareholders. Such loss or profit is transferred to 'Realisation Account'.
- (d) All the accumulated profits and losses, and also net profit or loss on realisation are transferred to equity shareholders account. (Which represents the assenting shareholders).

(C) Entries at Par value

When purchase consideration is negotiated, it may be on the basis of market value of the shares. It may result in securities premium in the purchasing company's books. Goodwill has to be debited when the purchase price exceeds net assets received. In such situations both transferor and transferee Cos. may agree to make entries only on the basis of 'Par value' of the transferee company's shares. It results in the automatic adjustment of goodwill in the securities premium. (See. Illustration)

(D) Inter company owings

At the time of amalgamation it may be found that the transferee company may owe money to transferor company or vice versa. It may be due to the fact that purchase / sale of goods has taken place between the two companies or loans or bills are given by one company to the other. Thus 'Inter company owings' can be in the form of 'Debtors and Creditors' or 'B/R and B/P' or 'Loan given and Loan taken' in the books of the transferee and transferor companies.

transferor company should also be calculated. These shares will not be actually issued. The value of these shares would be set off against shareholders' account.

- (3) Shares to be issued as per (1) and (2) above should be added up to get the Total number of shares.
- (4) From the Total number as shown in (3) above, shares already held by the Transferor company should be subtracted.
- (5) The 'net number' of shares to be issued as per (4) above should be multiplied with the agreed price per share to get the 'purchase consideration'.

(b) Net Assets Method:

Since there is a cross holding of shares, the net assets of each company depends on the value of shares of the other company. So, it is essential to ascertain the value of each company's share with the help of 'Simultaneous Equation' method.

The following are the necessary steps:

1. Total value of net assets of the transferor and transferee companies should be computed with the help of simultaneous equation method.
 2. From the Net assets of the transferor (selling) company (as per Step 1) Proportionate value of assets because of the claim of the transferee company in the transferor (selling) company should be deducted.
 3. From the balance remaining (after Step 2), the value of shares of the transferee company held by transferor company should be deducted.
- The balance left after Step (3) represents the amount due to outside shareholders of the Transferor company and it can be taken as "purchase consideration".

ACCOUNTING TREATMENT FOR AMALGAMATION

(A) In the books of Transferor company (Or) Selling Company

In all the three cases i.e., Amalgamation or Absorption or External reconstruction, the books of the selling company which is liquidated must be closed. Closing of books involves passing necessary journal entries and preparing the relevant ledger accounts. The following are the model journal entries with relevant notes.

Amalgamation, Absorption and External Reconstruction
Model journal entries in the books of transferor company (or) selling company

Particulars	10.19	
	Dr	Cr
1. For Transferring Assets to Realisation A/c		
Realisation A/c	Dr	xxx
To Sundry assets (individually, at book values)		xxx
To Realisation A/c]		
[Being transfer of assets to realisation A/c]		
Note: (a) All assets, whether taken over or not have to be transferred. Even assets not taken over have to be 'realised'. The only exception is Cash or Bank balance. Cash and Bank balances are transferred to Realisation A/c, if they are taken over. Otherwise, they are shown as opening balances in their respective accounts, since there is no need to 'realise' them.		
(b) Intangible assets like patents, copyrights and goodwill should also be transferred to realisation A/c unless it is clearly given that they are worthless in which case they are transferred to shareholders A/c as 'losses'.		
[See Illustration No. 1]		
2. For Transferring liabilities taken over:		
Liabilities A/c (individually)	Dr	xxx
To Realisation A/c		xxx
[Being transfer of liabilities taken over]		
Note: Liabilities not taken over or liabilities to be settled by immediate payment by selling co., should not be transferred to realisation account. Separate ledger account has to be opened for each liability not taken over and settled separately by selling co.,		
3. For purchase consideration receivable		
Purchasing Co.'s A/c	Dr	xxx
To Realisation A/c		xxx
[Being purchase price receivable]		

4. For receiving the purchase consideration

Bank A/c Dr xxx
 Shares in purchasing Co. A/c (at agreed value) Dr xxx
 Debentures in purchasing Co. A/c (at agreed value) Dr xxx
 To Purchasing Co.'s A/c xxx

[Being purchase price received in the form of cash, shares and debentures from the purchasing Co.]

5. For realising assets not taken over
 Bank A/c Dr xxx
 To Realisation A/c xxx

[Being asset not taken over realised]

6. For payment of liabilities not taken over
 Liability A/c (book value) Dr xxx
 Realisation A/c (any premium on repayment) Dr xxx
 To Bank A/c (actual amount paid) xxx
 To Realisation A/c (any discount on repayment) xxx

[Being repayment of liability at premium/discount]

Note: In the above entry, realisation is debited or credited if there is premium or discount in the settlement of a liability which is not taken over.

7. For payment of realisation expenses

(a) If expenses are to be borne by selling company
 Realisation A/c Dr xxx
 To Bank A/c xxx

[Being payment of expenses of realisation]

(b) If expenses are to be borne by the purchasing company
 Purchasing Co.'s A/c Dr xxx
 To Bank A/c xxx

[Being expenses paid on behalf of purchasing Co.]

(c) When liquidation expenses are reimbursed by the purchasing company:

Amalgamation, Absorption and External Reconstruction

Bank A/c Dr xxx
 To Purchasing Co. xxx
 [Being expenses paid reimbursed by the purchasing company]

8. For discharging the debentures repayable at a premium
 (a) Repayable at a premium
 Debentures A/c (face value) Dr xxx
 Realisation A/c (premium) Dr xxx
 To Debenture holders xxx

[Being the amount of debentures and premium payable credited to debenture holders]

Repayment at discount
 Debentures A/c (face value) Dr xxx
 To Debenture holders A/c (actual amount payable) xxx
 To Realisation A/c (discount) xxx

[Being transfer of debentures after adjusting discount on repayment]

(b) For payment to debenture holders
 Debenture holders A/c Dr xxx
 To Bank A/c (if cash is paid) xxx
 To Debentures in purchasing Co. (if purchasing Co.'s debentures are given) xxx

[Being settlement of the claim of debenture holders]

9. For discharge of preference share capital

(a) For repayment at premium
 Preference share capital A/c (face value) Dr xxx
 Realisation A/c (premium) Dr xxx
 To Preference shareholders xxx

[Being transfer of preference share capital and premium payable to the preference shareholders]

For repayment at discount
 Preference share capital A/c (face value) Dr xxx
 To Preference shareholders (amount payable) xxx
 To Realisation A/c (discount) xxx

[Being transfer of preference share capital, after adjusting discount on repayment]

(b) For payment to preference shareholders

Preference shareholders A/c
 To Bank A/c (cash paid)
 To Shares in purchasing Co.
 (Shares in purchasing Co. given)

[Being settlement of the claim of pref. shareholders]
10. For transfer of equity share capital and accumulated profits

Equity share capital A/c
 General reserve A/c
 Profit & Loss A/c
 Any other reserves A/c
 To Equity shareholders A/c

[Being transfer of capital and accumulated profits to the equity shareholders]

11. For transfer of accumulated losses

Equity shareholders A/c
 To Profit & Loss A/c
 To Preliminary expenses
 To Discount on issue of shares etc.

[Being transfer of accumulated losses to the equity shareholders]

12. For Realisation Profit/Loss

(a) If there is Profit on realisation
 Realisation A/c
 To Equity shareholders A/c

(b) If there is loss on realisation
 Equity shareholders A/c
 To Realisation A/c

13. For final payment to the equity shareholders

Equity shareholders A/c
 To Bank A/c (if cash is paid)
 To Shares in purchasing Co. (if shares in purchasing Co. are given)

[Being final payment made to the equity shareholders]

(B) Model Journal Entries in the Books of Transferee Company or Purchasing Company

Important Points to be noted

(i) In case of Amalgamation in the nature of merger, under pooling of interests method
 (a) A separate working note should be prepared to ascertain the excess of purchase consideration paid over and above the share capital of the selling company/companies.
 (ii) In case of Amalgamation in the nature of purchase, under Purchase Method
 (a) There is no need for ascertaining excess of purchase consideration over share capital of selling company/companies.

(b) There is no need for such a working note because the reserves and Losses in the balance sheet of selling company are to be completely ignored.
 However, any Statutory Reserves in the B/S of selling company, which are required to be maintained should be noted and a separate journal entry has to be passed for them (Entry No. 6 given below)

(See Illustration 3, W.N.1 & Ill. 6, W.N.1)
 (b) All the Reserves and Losses in the Balance Sheet of the selling company should be added to the similar reserves and losses in the Balance Sheet of purchasing company. After adjusting the excess of purchase price paid over share capital of the selling companies ('a' above), the balance of the reserves are to be shown in the Balance Sheet.
 (1) In Amalgamation problems general Reserve of the two or more selling companies, should be added up. From the total, Excess of purchase consideration (as per 'a' above) should be reduced. Balance is shown in the Balance Sheet. If general Reserve is not sufficient, the total of credit balances of P & L A/c of selling companies can be used. (See W.N.1, Ill. 6)
 If any gain arises from settling debentures of selling companies, it can be used to write off the Excess Purchase consideration. (Ill. 3, W.N. 2)
 (2) In Absorption problems, selling company's Reserves can be used to write

off the excess purchase consideration (shown in 'a' above). Balance can be shown in Balance sheet. If the reserves of selling company are not enough, purchasing companies Reserves can be used. (Ill. 4 W.N. 1 and W.N. 1 & 2, Ill. 5)

(3) The amount of Reserves of Purchasing company used to write off the excess purchase consideration should also be debited in the entry for recording assets and liabilities taken over (Entry 2 below) (See Ill. 5)

(4) In External reconstruction problems, the selling company's reserves alone are available and they can be used to write off the excess of purchase price over share capital of the selling company. Any balance of the reserves can be shown in Balance Sheet.

(c) From General Reserve and P & L A/c credit balance, the following also should be reduced.

(1) Expenses of winding up selling company, agreed to be paid by purchasing company (Ill. 5 & 6):

(2) Excess amount agreed to be paid to settle debenture holders and creditors of the selling company.

(d) Any capital Expenditure like preliminary expenses should be separately shown in the assets side of Balance Sheet;

(e) Any goodwill in the Balance Sheets of selling companies should be shown

Amalgamation, Absorption and External Reconstruction as it is in the new Balance Sheet

(1) Good will is debited and Bank credited for the expenses paid. (See Entry 4 below)

(2) Excess amount paid to settle the debenture holders and creditors is recorded in the entry for taking over assets & liabilities (Entry No.2 below). So, the excess is merged with Goodwill or Capital Reserve in the entry.

(d) Capital Expenditure like preliminary expenses are to be separately recorded & shown in the Balance Sheet, on assets side.

(e) Any goodwill in the Balance Sheets of selling companies should be shown recorded.

in purchasing company's books. Good will is ascertained as Balancing figure in the entry for recording assets & liabilities taken over (Entry No. 2 below).

(f) All assets and Liabilities should be shown at their 'agreed values'. If no agreed value is separately given, then book values are recorded.

(i) In case of amalgamation in the nature of merger, under pooling of interests method:

1. For purchase consideration payable:	Dr	xxx	
Business Purchase A/c		xxx	
To Liquidator of Transferor company			
[Being purchase price payable]			
2. For Assets and Liabilities:	Dr	xxx	
Sundry Assets A/c			
Each asset separately at their book values)			
To Sundry Liabilities			
Each liability separately at their book values)			
To Business Purchase A/c			
To Profit and loss A/c			
To Reserves			
(Each reserve separately)			
[Being assets and liabilities taken over			
and reserves of transferor company recorded]			
3. For Payment of purchase price:	Dr	xxx	
Liquidator of transferor Company A/c			
To Bank A/c			xxx
To Share Capital A/c			xxx
To Securities Premium A/c			xxx
[Being shares issued to settle the			
purchase consideration]			

Note: In pooling of interests method cash is paid for fractions of shares alone.

1026

4. For expenses of winding up paid by Transferee company
 General Reserve A/c

To Bank
 [Being expenses of transferee co., paid as per agreement]

5. For Formation Expenses paid:
 Preliminary expenses A/c

To Bank A/c
 [Being formation expenses paid]

6. For payment of any Debentures of transferor company
 Debentures (Transferor Co.) A/c

To Debentures A/c
 To Bank A/c
 [Being payment made to debenture holders of Transferor Co., as per agreement]

7. For payment to creditors of Transferor Co.
 Creditors (Transferor Co.) A/c

To Bank A/c
 [Being payment as per agreement]

(II) In case of Amalgamation in the nature of purchase, under Purchase Method:

1. For Purchase consideration payable
 Business purchase A/c

To Liquidator of Transferor Co.,
 [Being purchase price payable]

2. For Assets and Liabilities taken over
 Sundry Assets A/c

(Each asset separately)
 Goodwill A/c

To Sundry Liabilities A/c
 (Each liability separately)

To Business purchase A/c
 To Capital Reserve A/c

[Being assets and liabilities taken over and goodwill / capital reserve there on]

Amalgamation. Absorption and External Accounts

Note: In the above entry, either goodwill or capital reserve will be taken into consideration.

1. For Payment of Selling Co. A/c
 Liquidator of Selling Co. A/c

To Bank A/c
 To Share Capital A/c
 To Securities Premium A/c
 To Debentures A/c
 [Being purchase price paid in the form of cash, shares and debentures]

2. For expenses of Liquidation agreed to be paid by Transferee Co.
 Goodwill A/c

To Bank A/c
 [Being expenses agreed to be paid]

3. For Formation expenses of Transferee Co.,
 preliminary expenses A/c

To Bank A/c
 [Being formation expenses paid]

4. For statutory reserves of the Transferor Co. to be continued
 Amalgamation adjustment A/c

To Statutory Reserves A/c
 [Being reserves to be continued]

5. For settlement of Debentures holders or creditors of Transferor Co.,
 Debentures (transferor co.) A/c

To Debentures A/c
 To Bank A/c
 [Being settlement of Transferor company's liabilities as per agreement]

Illustration 1

Raman Ltd., agrees to purchase the business of Krishnan Ltd., on the following terms:

- (a) For each of the 10,000 shares of Rs. 10 each in Krishnan Ltd., 2 shares in Raman Ltd. of Rs. 10 each will be issued at an agreed value of Rs. 12 per share. In addition, Rs. 4 per share cash also will be paid.
- (b) 8% Debentures worth Rs. 80,000 will be issued to settle the Rs. 60,000% debentures in Krishnan Ltd.
- (c) Rs. 10,000 will be paid towards expenses of winding up.

Calculate the purchase consideration.

[Madras, B.Com (CS) Nov. 2008; B.Com., B.Com (CS) Ap. 2007]

Solution :

Calculation of purchase consideration

Shares to be issued for shareholders of the selling Co.,

$$10,000 \times 2 \times 12$$

Cash to be paid for shareholders of the selling Co.,

$$10,000 \times 4$$

Purchase consideration

	Rs.
Shares to be issued for shareholders of the selling Co.,	2,40,000
Cash to be paid for shareholders of the selling Co.,	40,000
Purchase consideration	2,80,000

Note : (1) Payment to debenture holders of selling company should not shown as part of purchase consideration. So, the debentures can be shown as taken over by the purchasing company and then settled by issuing debentures in the purchasing company.

(2) Expenses of winding up payable by purchasing company may be treated as reimbursement. Selling company can pay them and get cash from purchasing company without including the amount as part of purchase price. The purchasing company can debit 'General Reserve' for such expenses in 'pooling of interests method' and it can debit 'goodwill A/c' in purchase method of amalgamation.

Some experts, in their interpretation of treatment of expenses under AS-14, add them to purchase consideration, if they are payable by the purchasing company.

Illustration 2

Following is the balance sheet of Sammy Ltd. as on 31-3-2014

Liabilities	Rs.	Assets	Rs.
Share capital :		Fixed Assets	1625,000
8% Preference shares of Rs. 100 each.	3,75,000	Investments	3,00,000
Equity shares of Rs. 10 each	7,50,000	Current Assets	2,50,000
General Reserve	4,50,000		
7% Debentures	3,50,000		
Current Liabilities	2,50,000		
	21,75,000		21,75,000

Romy Ltd. agreed to takeover the business of Sammy Ltd.

(A) Calculate purchase consideration under Net assets method on the basis of the following :

- (i) Romy Ltd. agreed to discharge 7% debentures at a premium of 10% by issuing 9% debentures of Romy Ltd.
- (ii) Fixed assets are to be valued at 10% above book value, the investments at par, current assets at 10% discount and current liabilities at book value.
- (B) Calculate purchase consideration under Net payments method on the basis of the following :
- (i) Romy Ltd. agrees to discharge the 7% debentures at a premium of 10% by issuing 9% debentures of Romy Ltd.
- (ii) Preference shares are discharged at a premium of 10% by issuing 10% Preference shares of Rs. 100 each in Romy Ltd.
- (iii) For every 2 Equity shares in Sammy Ltd. 3 Equity shares of Rs. 10 each in Romy Ltd. will be issued in addition to Cash payment of Rs. 3 per Equity share in Sammy Ltd.

[Thiruvalluvar, B.Com., April 2018]

Solution :
Calculation of Purchase consideration

(A) Net Assets Method :

Value of assets takeover :			
Fixed Assets	16,25,000 + 1,62,500		Rs. 17,87,500
Investments			3,00,000
Current Assets	2,50,000 - 25,000		2,25,000
Total Assets		3,85,000	23,12,500
Less : 5% Debentures (3,50,000 + 35,000)		2,50,000	
Less : Current Liabilities			6,35,000
Purchase Consideration			16,77,500

Note : Though Purchasing company has agreed to discharge the 7% debentures in selling Co., they are reduced from Total Assets so that purchase consideration shows amount payable to shareholders only.

(B) Net Payments method :

Statement showing purchase consideration

Particulars	Cash	Preference shares in Purchasing Co.	Equity Shares in Purchasing Co.	Total
(1) For Preference shareholders : 10% Preference shares in Purchasing Co. $3,75,000 \times \frac{110}{100}$	-	4,12,500	-	4,12,500
(2) For Equity shareholders : Equity shares in Purchasing Co. $75,000 \times \frac{3}{2} \times 10$ Cash 75,000 x 3	-	-	11,25,000	11,25,000
Purchase Consideration	2,25,000	4,12,500	11,25,000	17,62,500

Note : Payment for debentureholders should not be included in the purchase price. They should be assumed to be takeover and discharged by purchasing company.

Amalgamation, Absorption and External Reconstruction

Amalgamation in the Nature of Merger

Illustration 3
Alpha Ltd. and Beta Ltd. were amalgamated on 1st April 2021. A New company Gamma Ltd. was formed to takeover the business of the existing companies. The Balance sheets of Alpha Ltd. and Beta Ltd. as on 31st March 2021 are given below :

(Rs. in Lakhs)

	Alpha Ltd.	Beta Ltd.	Assets	Alpha Ltd.	Beta Ltd.
Liabilities			Fixed Assets	1,200	1,000
Share capital	1,000	800	Current Assets, Loans and Advances	880	565
Equity shares of Rs. 100 each					
Rs. 100 each	400	300			
15% Pref. Shares of Rs. 100 each					
Rs. 100 each	100	80			
Reserves and Surplus :					
Revaluation Reserve	200	150			
General Reserve	80	60			
P&L A/c					
Secured Loan :					
12% Debentures of Rs. 100 each	96	80			
Current Liabilities & Provisions	204	95			
	2,080	1,565		2,080	1,565

Other Informations :

- (i) 12% Debentures of Alpha Ltd. and Beta Ltd. are discharged by Gamma Ltd. by issuing adequate number of 16% Debentures of Rs. 100 each to ensure that they continue to receive the same amount of interest.
- (ii) Preference shareholders of Alpha Ltd. and Beta Ltd. have received same number of 15% Preference shares of Rs. 100 each of Gamma Ltd.
- (iii) Gamma Ltd. has issued 1.5 equity shares for each equity share of Alpha Ltd. and 1 equity share for each equity share of Beta Ltd. The face value of shares issued by Gamma Ltd. is Rs. 100 each.

Required :

Prepare the Balance Sheet of Gamma Ltd. as on 1st April 2021 after the Amalgamation has been carried out using the 'Pooling of Interest method'.

	Rs. in lakh
1. Share capital:	
Issued and paid up capital	
Equity shares of Rs. 100 each	2,300
15% pref. shares of Rs. 100 each	700
	3,000
2. Reserves and Surplus:	
Revaluation reserve (100 + 80)	180
General reserve (W.N 3)	34
Profit & loss a/c (W.N 3)	214
	132
3. Long term borrowings:	
16% Debentures of Rs. 100 each (W.N 2)	2,200
4. Tangible assets:	
Fixed assets (1,200 + 1,000)	2,200

Balance sheet of Gamma Ltd. as on 1.4.2021

	Note No.	Rs. in lakh
I. Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	3,000
Reserves and surplus	2	214
(ii) Non-current liabilities:		
Long term borrowings	3	132
(iii) Current liabilities (204 + 95)		299
Total (i) + (ii) + (iii)		3,645
II. Assets:		
(i) Non-current assets:		
Tangible assets		2,200
Intangible assets		1,445
(ii) Current assets: (880 + 565)		3,645
Total (i) + (ii)		3,645

Working Note 1**Purchase Consideration**

	Alpha Ltd.	Beta Ltd.	Total
Equity shares for shareholders of			
Alpha Ltd. (1,000 × 1.5)	1,500	—	1,500
Equity shares for shareholders of			
Beta Ltd. (800 × 1)	—	800	800
			2,300
Preference shares for shareholders of			
Alpha Ltd. & Beta Ltd.	400	300	700
Purchase consideration			3,000
Share Capital of Transferor Co.s Alpha & Beta	1,400	1,100	2,500
Excess of Purchase consideration over share capital			500

Working Note 2**Settlement of Debentures of Transferor Companies**

	Alpha	Beta	Total
Value of Debentures issued by Gamma Ltd.			
	$96 \times \frac{12}{16} = 72$	$80 \times \frac{12}{16} = 60$	132
Face Value of Debentures of			
Transferor Co.s	96	80	176
Excess of Face Value of Debentures	(24)	(20)	(44)
settled over value of debentures issued.			

Net Excess Payment to be adjusted in the Balance Sheet of Transferor Co., against reserves = 500 - 44 = 456.

Working Note 3**Reserves to be Shown in Balance Sheet**

	General Reserve	P&L A/c
Alpha Ltd.	200	80
Beta Ltd.	150	60
	350	140

10.34

Less : Excess Payment to be adjusted

Balance to be shown in Balance sheet

350	106
-	34

Corporate Accounting

Note : General reserve should be used to adjust Excess payment of purchase consideration. If it is not enough, other reserves and P&L A/c can be used, except Revaluation reserve.

Amalgamation in the Nature of Purchase

Amalgamation – lump-sum method of purchase price

Illustration 8

Raman Ltd. and Sivan Ltd. have agreed to amalgamate. A new company, Sivaram Ltd. has been formed to take over the running concerns as on 31.12.2015. The following Balance Sheets show the position of the companies amalgamating.

Liabilities	Raman Ltd. Rs.	Sivan Ltd. Rs.	Assets	Raman Ltd. Rs.	Sivan Ltd. Rs.
Share capital Rs. 10 each	20,000	50,000	Goodwill	–	6,000
General reserve	16,000	–	Plant	14,000	20,000
Capital reserve	–	4,000	Furniture	8,000	12,000
P & L A/c	4,000	–	Stock	16,000	8,000
Loan from bank	10,000	16,000	Sundry debtors	10,000	17,000
Creditors	10,000	6,000	Cash at Bank	12,000	7,000
	60,000	76,000	P & L A/c	–	6,000
				60,000	76,000

Sivaram Ltd. took over all the assets and liabilities of both the transferor companies at book values except cash at bank, creditors and the goodwill of Sivan Ltd. which was considered worthless.

The purchase consideration was agreed at Rs. 60,000 for Raman Ltd. and Rs. 40,000 for Sivan Ltd. Fully paid equity shares of Rs. 10 each were issued to settle the purchase price for both the companies.

Cash at Bank of both the companies was exactly sufficient to settle their creditors at 10% discount and pay the liquidation expenses.

You are required to give important ledger accounts to close the books of the transferor companies and the Journal and Balance Sheet in the books of the transferee company, assuming that the amalgamation is in the nature of purchase.

[Madras, B.Com (PZAA) Ap. 2008; 10 Times] [Marathwada, B.Com., Adapted]

Solution:

Books of Raman Ltd. (Transferor company)

Ledger

Realisation Account

	Rs.		Rs.
To Plant	14,000	By Loan from bank	10,000
To Furniture	8,000	By Sivaram Ltd.	60,000
To Stock	16,000	By Creditors $\left(10,000 \times \frac{10}{100}\right)$	1,000
To Sundry debtors	10,000		
To Bank (exp.) (12,000 – 9,000)	3,000		
To Shareholders (profit) (bal. fig)	20,000		
	71,000		71,000

Bank A/c			
	Rs.		Rs.
To Balance b/d	12,000	By Creditors (10,000 - 1,000)	9,000
		By Realisation (expenses) (Bal. fig)	3,000
	12,000		12,000

Shareholders A/c			
	Rs.		Rs.
To Shares in Sivaram Ltd.	60,000	By Share capital A/c	20,000
		By General reserve A/c	16,000
		By P & L A/c	4,000
		By Realisation A/c	20,000
	60,000		60,000

Books of Sivan Ltd. (Transferor company)

Ledger

Realisation Account

	Rs.		Rs.
To Plant	20,000	By Loan from Bank	16,000
To Furniture	12,000	By Sivaram Ltd.	40,000
To Stock	8,000	By Creditors $\left(6,000 \times \frac{10}{100}\right)$	600
To Sundry debtors	17,000	By Shareholders (loss) (bal. fig)	2,000
To Bank (exp.) (7,000 - 5,400)	1,600		
	58,600		58,600

Bank Account

	Rs.		Rs.
To Balance b/d	7,000	By Creditors (6,000 - 600)	5,400
		By Realisation (expenses) (bal. fig)	1,600
	7,000		7,000

Shareholders A/c

	Rs.		Rs.
To P & L A/c	6,000	By Share capital	50,000
To Realisation	2,000	By Capital reserve	4,000
To Goodwill	6,000		
To Shares in Sivaram Ltd.	40,000		
	54,000		54,000

Note: Since goodwill of Sivan Ltd. is considered worthless, there is no need to transfer it to realisation account. Like any other loss, it is transferred to shareholders directly.

Books of Sivaram Ltd. (Transferee Company)

Journal entries

Date	Particulars	L.F.	Dr Rs.	Cr Rs.
	Business purchase A/c	Dr	1,00,000	
	To Raman Ltd. A/c			60,000
	To Sivan Ltd. A/c			40,000
	[Being purchase price payable on amalgamation to the vendor companies]			
	Plant A/c	Dr	34,000	
	Furniture A/c	Dr	20,000	
	Stock A/c	Dr	24,000	
	Sundry debtors A/c	Dr	27,000	
	Goodwill A/c (Balancing figure)	Dr	21,000	
	To Business purchase A/c			1,00,000
	To Loan from bank			26,000
	[Being assets and liabilities of Raman Ltd. & Sivan Ltd. taken over and goodwill thereon]			
	Liquidator of Raman Ltd. A/c	Dr	60,000	
	Liquidator Sivan Ltd. A/c	Dr	40,000	
	To Share capital A/c			1,00,000
	[Being shares issued to settle the purchase price payable to vendor companies]			

Notes to Accounts:**1. Share capital:**

Issued and paid up capital

10,000 Equity shares of Rs.10 each

Rs.

1,00,000

2. Long term borrowings:

Loan from bank

26,000

3. Tangible assets:

Plant

34,000

Furniture

20,000

54,000**4. Intangible assets:**

Goodwill

21,000

Balance sheet of Sivaram Ltd. as on 31.12.2015

	Note No.	Rs.
I. Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	1,00,000
Reserves and surplus		
(ii) Non-current liabilities:		
Long term borrowings	2	26,000
(iii) Current liabilities		
Total (i) + (ii) + (iii)		1,26,000
II. Assets:		
(i) Non-current assets:		
Tangible assets	3	54,000
Intangible assets	4	21,000
(ii) Current assets:		
Stock		24,000
Trade receivables (debtors)		27,000
Total (i) + (ii)		1,26,000

Amalgamation – Net assets method**Illustration 9**

M Ltd. and N Ltd. agreed to amalgamate on the basis of the following Balance Sheets as on 31.3.2017.

Liabilities	M	N Rs.	Assets Rs.	M	N Rs.
Rs.					
Share capital			Goodwill	30,000	—
Rs. 25 each	75,000	50,000	Fixed assets	31,500	38,800
P & L A/c	7,500	2,500	Stock	15,000	12,000
Creditors	3,500	3,500	Debtors	8,000	5,200
Depreciation fund	—	2,500	Bank	1,500	2,500
	<u>86,000</u>	<u>58,500</u>		<u>86,000</u>	<u>58,500</u>

The assets and liabilities are to be taken over by a new company formed called P Ltd., at book values. P Ltd.'s capital is Rs. 2,00,000 divided into 10,000 equity shares of Rs. 10 each and 10,000 9% preference shares of Rs. 10 each.

P Ltd. issued the equity shares equally to the vendor companies and preference shares were issued for any balance of purchase price.

Pass journal entries in the books of P Ltd. and prepare its Balance Sheet, if the

amalgamation is in the nature of purchase.

(Periyar, B.Com., Ap. 2005; Bharathiar, B.Com., Ap. 2005; Nov. 2004) (Madras
B.Com(AF) Ap. 2009; 1st M.Com., Ap. 2008; B.Com., Nov. 2007 (10 Times))

Solution:

Statement showing purchase consideration (net assets)

Particulars	M Ltd.		N Ltd.	
	Rs.	Rs.	Rs.	Rs.
Sundry assets taken over		86,000		58,500
Less: Liabilities:				
Creditors	3,500	3,500	3,500	
Depreciation fund	—		2,500	
Purchase consideration		82,500		6,000
Less: Equity shares issued				52,500
equally $\left(\frac{1,00,000}{2}\right)$		50,000		50,000
Value of preference shares issued		32,500		2,500

Books of P Ltd. (Transferee company)

Journal entries

Date	Particulars	L.F.	Dr	Cr
			Rs.	Rs.
31.3.17	Business purchase A/c To Liquidator of M Ltd. To Liquidator of N Ltd. [Being purchase price payable to the vendor companies]	Dr	1,35,000	82,500 52,500
"	Fixed assets A/c Stock A/c Debtors A/c Bank A/c Goodwill A/c To Creditors A/c To Depreciation fund A/c To Business purchase A/c [Being assets and liability taken over from M Ltd. and N Ltd. and goodwill thereon]	Dr Dr Dr Dr Dr	70,300 27,000 13,200 4,000 30,000	7,000 2,500 1,35,000
"	Liquidator of M Ltd. A/c To Equity share capital A/c To 9% preference share capital A/c [Being payment of purchase price]	Dr	82,500	50,000 32,500
"	Liquidator of N Ltd. A/c To Equity share capital A/c To 9% preference share capital A/c [Being payment of purchase price]	Dr	52,500	50,000 2,500

Notes to Accounts:

1. Share capital:

Authorized capital:

10,000 Equity shares of Rs.10 each

10,000 9% Pref., shares of Rs.10 each

Issued and paid up capital:

10,000 Equity shares of Rs.10 each

3,500 9% Pref., shares of Rs.10 each

(all the above shares were issued for consideration other than cash to vendors)

2. Trade payables:

Creditors

3. Tangible assets:

Other fixed assets (70,300 – 2,500)

4. Intangible assets:

Goodwill

Rs.

1,00,000

1,00,000

1,00,000

35,000

1,35,000

7,000

67,800

30,000

Balance sheet of P Ltd. as on 31.3.2017

	Note No.	Rs.
I. Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	1,35,000
Reserves and surplus		
(ii) Non- current liabilities:		
Long term borrowings		
(iii) Current liabilities :		
Trade payables	2	7,000
Total (i) + (ii) + (iii)		1,42,000
II. Assets:		
(i) Non- current assets:		
Tangible assets	3	67,800
Intangible assets	4	30,000
(ii) Current assets:		
Stock		27,000
Trade receivables (debtors)		13,200
Bank		4,000
Total (i) + (ii)		1,42,000

Amalgamation – Net assets and Net payments methods**Illustration 10**

A Ltd. and B Ltd. agreed to amalgamate and form a new company, C Ltd. which takes over all assets and liabilities of the two companies.

In the case of A Ltd. the assets and liabilities are to be taken over at book values for shares in C Ltd. at the rate of 5 shares in C Ltd. at 10% premium (Rs. 11 per share) for every four shares of A Ltd.

In the case of B Ltd.:

- (i) The debentures of B Ltd. would be paid off by the issue of an equal number of 4% debentures in C Ltd. at a discount of 10%.
- (ii) The holders of 6% preference shares of B Ltd. would be allotted four 7% preference shares of Rs. 100 each in C Ltd. for every five preference shares in B Ltd.
- (iii) The equity shareholders would be allotted sufficient shares in C Ltd. to cover the balance on their accounts after adjusting asset values by reducing Plant and Machinery by 10% and providing 5% on sundry debtors.

The summarised Balance Sheets of the two companies just prior to amalgamation were as follows:

<i>Liabilities</i>	<i>A Ltd. Rs.</i>	<i>B Ltd. Rs.</i>	<i>Assets</i>	<i>A Ltd. Rs.</i>	<i>B Ltd. Rs.</i>
Equity capital:					
Shares of					
Rs. 10 each	4,00,000	5,00,000	Plant and		
6% Pref. capital:			Machinery	8,00,000	8,00,000
Shares of			Stock	65,000	60,000
Rs. 100 each	—	3,00,000	Debtors	95,000	50,000
4% Debentures	—	2,00,000	P & L A/c	—	1,40,000
P & L A/c	5,00,000	—	Bank	65,000	40,000
Contingency					
reserve	50,000	—			
Creditors	75,000	90,000			
	<u>10,25,000</u>	<u>10,90,000</u>		<u>10,25,000</u>	<u>10,90,000</u>

You are required to

- (i) Calculate the purchase consideration for A Ltd. and B Ltd.
- (ii) Show journal entries in the books of B Ltd.
- (iii) Prepare Balance Sheet of C Ltd.

Solution: *Note: In the absence of specific information, Amalgamation in the nature of purchase can be assumed.*

1. Calculation of purchase consideration

Purchase consideration for A Ltd. (Net Payment)

A Ltd. gets 5 shares in C Ltd. at Rs. 11 per share for every 4 shares.

$$\therefore \text{Purchase price for A Ltd.} = 40,000 \times \frac{5}{4} = 50,000 \text{ shares.}$$

$$\text{At Rs. 11 per share, the purchase price} = 50,000 \times 11 = \text{Rs. 5,50,000.}$$

Statement showing purchase consideration for B Ltd. (net assets)

		Rs.
<i>Assets taken over:</i>		
	Plant & Machinery (8,00,000 – 80,000)	7,20,000
	Stock	60,000
	Debtors (50,000 – 2,500)	47,500
	Bank	40,000
		<u>8,67,500</u>
<i>Less:</i>	<i>Liabilities taken over:</i>	
	Creditors 90,000	
	Debentures (2,00,000 – 20,000)	1,80,000
		<u>2,70,000</u>
		5,97,500
<i>Less:</i>	<i>Purchase consideration</i>	
	<i>Payment to 6% preference shareholders:</i>	
	7% preference shares of Rs. 100 each, 4 shares	
	for 5 shares held : $3,000 \times \frac{4}{5} \times 100$	2,40,000
		<u>3,57,500</u>

Books of B Ltd (Transferor company)

Journal

Date	Particular	L.F.	Dr	Cr
			Rs.	Rs.
	Realisation A/c	Dr	9,50,000	
	To Plant & Machinery			8,00,000
	To Stock			60,000
	To Debtors			50,000
	To Bank			40,000
	[Being transfer of assets to realisation]			
	Creditors A/c	Dr	90,000	
	4% Debentures A/c	Dr	2,00,000	

To Realisation A/c [Being transfer of liabilities taken over to realisation]			2,90,000
'C' Ltd. A/c	Dr	5,97,500	
To Realisation A/c [Being purchase price receivable]			5,97,500
Equity shares in C Ltd. A/c	Dr	3,57,500	
7% preference shares in C Ltd. A/c	Dr	2,40,000	
To C Ltd. A/c [Being receipt of purchase price]			5,97,500
6% Preference share capital A/c	Dr	3,00,000	
To Preference shareholders A/c [Being transfer of pref. share capital to the shareholders]			3,00,000
Preference shareholders A/c	Dr	3,00,000	
To 7% Preference Shares in C Ltd. To Realisation A/c			2,40,000
[Being settlement of preference shareholders and the transfer of profit thereon to realisation A/c]			60,000
Equity share capital A/c	Dr	5,00,000	
To Equity shareholders A/c [Being transfer of capital to shareholders]			5,00,000
Equity shareholders A/c	Dr	1,40,000	
To Profit & Loss A/c [Being transfer of accumulated loss]			1,40,000
Equity shareholders A/c	Dr	2,500	
To Realisation A/c (W.N.1) [Being loss on realisation debited to shareholders]			2,500
Equity shareholders A/c	Dr	3,57,500	
To Equity shares in C Ltd. [Being final payment to equity shareholders]			3,57,500

Note : Since payment for Debentures should not be included in purchase price as per AS-14 they are transferred to realisation A/c and Purchasing Co., pays them directly after taking over.

Amalgamated
Working Note 1 :

Realisation A/c

	Rs.		Rs.
To Sundry Assets	9,50,000	By Creditors	90,000
		" 4% Debentures	2,00,000
		" 'C' Ltd	5,97,500
		" Preference shareholders	60,000
		" Equity shareholders	2,500
		(Loss)	
	<u>9,50,000</u>		<u>9,50,000</u>

Notes to Accounts:

1. Share capital:

Issued and paid up capital:

85,750 Equity shares of Rs.10 each

2,400 7% Pref. shares of Rs.100 each

(all the above shares were issued for consideration other than cash to vendors)

Rs.
8,57,500

2,40,000

10,97,500

2. Reserves and surplus:

Capital reserve

Securities premium

4,00,000

50,000

4,50,000

3. Long term borrowings:

4% Debentures

2,00,000

4. Trade payables:

Creditors

1,65,000

5. Tangible assets:

Plant & machinery

15,20,000

6. Other current assets:

Discount on issue of debentures

20,000

Balance sheet of C Ltd. (Transferee company)

	Note No.	Rs.
I. Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	10,97,500
Reserves and surplus	2	4,50,000

(ii) Non-current liabilities:		
Long term borrowings	3	2,00,000
(iii) Current liabilities:		
Trade payables	4	1,65,000
Total (i) + (ii) + (iii)		19,12,500
II. Assets:		
(i) Non-current assets:		
Tangible assets	5	15,20,000
(ii) Current assets:		
Stock		1,25,000
Trade receivables (debtors) (1,45,000 – 2,500)		1,42,500
Bank		1,05,000
Other current assets	6	20,000
Total (i) + (ii)		19,12,500

Working notes:**1. Computation of goodwill/capital reserve:**

		Rs.
<i>Total assets taken over:</i>		
Plant & Machinery (8,00,000 + 7,20,000)		15,20,000
Stock (65,000 + 60,000)		1,25,000
Debtors (95,000 + 50,000 – 2,500)		1,42,500
Bank (65,000 + 45,000)		1,05,000
Total assets		18,92,500
Less: Creditors taken over (75,000 + 90,000)		1,65,000
4% Debentures (2,00,000 – 20,000)		1,80,000
Net assets taken over		15,47,500
Less: Purchase price to A Ltd.	5,50,000	
Less: Purchase price B Ltd.	5,97,500	11,47,500
Capital reserve		4,00,000

2. Total equity shares issued

To A Ltd. 50,000 shares of Rs. 10 each	5,00,000
To B Ltd. 35,750 shares of Rs. 10 each	3,57,500
	<u>8,57,500</u>

Securities premium on shares issued to A Ltd.

$$= 50,000 \times (11 - 10) = \text{Rs. } 50,000$$

[Being Liquidation expenses of transferor company reimbursed as per agreement]	20,000
--	--------

Absorption – Net payment method

Illustration 12

The following is the Balance Sheet of X Ltd. as on 31.3.2016

Liabilities		Assets	
	Rs.		Rs.
Share capital:		Land & Buildings	10,00,000
2,00,000 shares of Rs. 10 each	20,00,000	Plant & Machinery	15,00,000
General reserve	2,50,000	Furniture	25,000
Dividend equalisation reserve	2,00,000	Stock	6,00,000
Profit & Loss A/c	51,000	Work-in-progress	3,00,000
12% Debentures	10,00,000	Sundry debtors	2,50,000
Sundry creditors	3,00,000	Cash at Bank	1,26,000
	<u>38,01,000</u>		<u>38,01,000</u>

The company was absorbed by A Ltd. on the above date. The consideration for the absorption is the discharge of the debentures at a premium of 5%, taking over the liability in respect of sundry creditors and a payment of Rs. 7 in cash and one share of Rs. 5 in A Ltd. at the market value of Rs. 8 per share for every share in X Ltd. The cost of liquidation of Rs. 15,000 is to be met by the purchasing company.

Close the books of X Ltd., and pass journal entries in the books of A Ltd.

[Periyar, B.Com (Old) Oct./Nov. 2005]

[Madras, B.Com (AF) Nov. 2009; 1st M.Com., Ap. 2009; Nov. 2008;

B.Com (CS) Nov. 2008; B.Com., Nov. 2007; B.Com (Old (EZK) Oct. 2004]

Solution:

Note: Amalgamation in the Nature of Purchase is assumed, in the absence of instruction.

Working notes:

Statement showing purchase consideration

Particulars	Cash Rs.	Shares Rs.	Total Rs.
For shareholders:			
Cash $2,00,000 \times 7$	14,00,000	—	14,00,000
Shares in A Ltd. $2,00,000 \times 1 \times 8$		16,00,000	16,00,000
Purchase consideration	<u>14,00,000</u>	<u>16,00,000</u>	<u>30,00,000</u>

Note: As per AS-14, Purchase price should include payment to shareholders alone. So, Debentures have to be shown as taken over by 'A' Ltd. and then settled. Cost of Liquidation paid by purchasing Co., should be shown as reimbursement.

Books of X Ltd. (Transferor Company)

Journal entries

Date	Particulars	L.F.	Dr Rs.	Cr Rs.
31.3.16	Realisation A/c To Sundry assets [Being transfer of assets to realisation A/c]	Dr	38,01,000	38,01,000
"	Sundry creditors A/c	Dr	3,00,000	
"	12% Debentures A/c To Realisation A/c [Being transfer of liability taken over to realisation A/c]	Dr	10,00,000	13,00,000
"	A Ltd. A/c To Realisation A/c [Being purchase price receivable as per agreement]	Dr	30,00,000	30,00,000
"	Bank A/c	Dr	14,00,000	
"	Shares in A Ltd. A/c To A Ltd. A/c [Being purchase consideration received in the form of cash and shares]	Dr	16,00,000	30,00,000
"	A Ltd. A/c To Bank A/c [Being payment of the cost of liquidation on behalf of A Ltd.]	Dr	15,000	15,000
"	Bank A/c To A Ltd. A/c [Being expenses paid reimbursed by A Ltd.]	Dr	15,000	15,000
31.3.16	Share capital A/c	Dr	20,00,000	
"	General reserve A/c	Dr	2,50,000	
"	Dividend equalisation reserve A/c	Dr	2,00,000	
"	Profit & Loss A/c To Shareholders A/c [Being transfer of share capital and accumulated profits to shareholders]	Dr	51,000	25,01,000
"	Realisation A/c To Shareholders A/c [Being profit on realisation]	Dr	4,99,000	4,99,000
"	Shareholders A/c To Bank A/c To Shares in A Ltd. A/c [Being final settlement of shareholders by payment of cash and shares]	Dr	30,00,000	14,00,000 16,00,000

Note: Closing the books implies both Journal and Ledger

Ledger

Realisation A/c

	Rs.		Rs.
To Sundry assets	38,01,000	By Sundry creditors	3,00,000
To Shareholders (profit)	4,99,000	By 12% Debentures By A Ltd.	10,00,000
	<u>43,00,000</u>		<u>30,00,000</u>
			<u>43,00,000</u>

A Ltd.'s A/c

	Rs.		Rs.
To Realisation	30,00,000	By Bank	14,00,000
		By Shares in A Ltd.	16,00,000
	<u>30,00,000</u>		<u>30,00,000</u>

Shares in A Ltd. A/c

	Rs.		Rs.
To A Ltd.	16,00,000	By Shareholders	16,00,000
	<u>16,00,000</u>		<u>16,00,000</u>

Bank A/c

	Rs.		Rs.
To Balance b/d	1,26,000	By Realisation A/c (transfer)	1,26,000
	=====		=====
To A Ltd.	14,00,000	By Shareholders	14,00,000
To A Ltd.	15,000	By A Ltd.	15,000
	<u>14,15,000</u>		<u>14,15,000</u>

Shareholders A/c

	Rs.		Rs.
To Bank A/c	14,00,000	By Share capital	20,00,000
To Shares in A Ltd.	16,00,000	By General reserve	2,50,000
		By Dividend equalisation reserve	2,00,000
		By Profit & Loss A/c	51,000
		By Realisation A/c	4,99,000
	<u>30,00,000</u>		<u>30,00,000</u>

Corporate Accounting

Books of A Ltd. (purchasing company)
Journal

Date	Particulars	L.F.	Dr Rs.	Cr Rs.
31.3.16	Business purchase A/c To Liquidator of X Ltd. A/c [Being purchase consideration payable as per agreement]	Dr	30,00,000	30,00,000
"	Land & Buildings A/c	Dr	10,00,000	
	Plant & Machinery A/c	Dr	15,00,000	
	Furniture A/c	Dr	25,000	
	Stock A/c	Dr	6,00,000	
	Work-in-progress A/c	Dr	3,00,000	
	Sundry debtors A/c	Dr	2,50,000	
	Bank A/c	Dr	1,26,000	
	Goodwill A/c (Balancing figure)	Dr	5,49,000	
	To Sundry creditors A/c			3,00,000
	To 12% Debentures of X Ltd.			10,00,000
	To Premium on redemption of Debentures			50,000
	To Business purchase A/c			30,00,000
	[Being assets and liabilities taken over and goodwill thereon]			
"	Goodwill A/c	Dr	15,000	
	To Bank A/c			15,000
	[Being Liquidation Expenses of X Ltd. paid]			
"	12% Debentures of X Ltd. A/c	Dr	10,00,000	
	Premium on redemption of Debentures A/c	Dr	50,000	
	To Debentureholders A/c			10,50,000
	[Being Transfer]			
31.3.16	Debentureholders A/c	Dr	10,50,000	
	To Bank A/c			10,50,000
	[Being discharge of debentureholders' claim]			
"	Liquidator of X Ltd. A/c	Dr	30,00,000	
	To Bank A/c			14,00,000
	To Share capital A/c (2,00,000 × 5)			10,00,000
	To Securities premium A/c (2,00,000 × 3)			6,00,000
	[Being payment of purchase price as per agreement]			

Following is the Balance Sheet of K Ltd. as on 31.12.2020

Liabilities		Assets	
	Rs.		Rs.
2,000 shares of Rs. 10 each fully paid	20,000	Goodwill	4,000
Profit & Loss A/c	7,000	Fixed assets	16,500
Debentures	10,000	Current assets	19,500
Creditors	3,000		
	<u>40,000</u>		<u>40,000</u>

R Limited agreed to take over the assets of K. Ltd. (exclusive of one fixed asset of Rs. 4,000 and cash Rs. 1,000 included in current assets) at 10% more than the book values. It agreed to take over creditors also. The purchase price was to be discharged by the issue of 2,000 shares of Rs. 10 each at the market value of Rs. 15 each and the balance in cash. Liquidation expenses came to Rs. 400.

K Ltd. sold the fixed asset of Rs. 4,000 and realised the book value. It paid off its debentures and liquidation expenses.

You are required to give journal entries in the books of K Ltd. and R Ltd.

[Periyar, B.Com., April 2005]

[Madras, B.Com (AF) Ap. 2009; M.Com., (ICE) (PCMA) April 2007; April 2007, Oct. 2006; Bangalore, B.Com., Nov. 1989]

Solution :

Books of K Ltd. (Transferor company)

Journal entries

Date	Particulars	L.F.	Dr	Cr
			Rs.	Rs.
31.12.20	Realisation A/c Dr		39,000	
	To Goodwill			4,000
	To Fixed assets			16,500
	To Current assets (19,500 - 1,000)			18,500
	[Being transfer of assets to realisation except cash of Rs. 1,000]			
"	Creditors A/c Dr		3,000	
	To Realisation A/c			3,000
	[Being transfer of liability taken over]			
	R Ltd. A/c Dr		35,500	
	To Realisation A/c			35,500
	[Being purchase price receivable]			
"	Bank A/c Dr		5,500	
	To Realisation A/c		30,000	
	[Being purchase price received]			
	Shares in R Ltd. A/c Dr			35,500
	To R Ltd. A/c			
	[Being purchase price received]			

"	Bank A/c				
	To Realisation A/c	Dr	4,000		
	[Being fixed asset not taken over realised]				
"	Realisation A/c			4,000	
	Debentures A/c	Dr	400		
	To Bank A/c	Dr	10,000		
	[Being payment of expenses and discharge of debentures]				10,400
"	Share capital A/c				
	Profit & Loss A/c	Dr	20,000		
	To Shareholders A/c	Dr	7,000		
	[Being transfer of capital and accumulated profit]				27,000
"	Realisation A/c				
	To Shareholders A/c	Dr	3,100		
	[Being profit on realisation]				3,100
"	Shareholders A/c				
	To Bank A/c	Dr	30,100		
	To Shares in R Ltd. A/c				100
	[Being final payment to the shareholders]				30,000

Books of R Ltd. (Transferee company)

Journal Entries

Date	Particulars	L.F.	Dr	Cr
			Rs.	Rs.
31.12.20	Business purchase A/c	Dr	35,500	
	To Liquidator of K Ltd. A/c			35,500
	[Being purchase price payable]			
"	Fixed assets A/c	Dr	13,750	
	Current assets A/c	Dr	20,350	
	Goodwill A/c	Dr	4,400	
	To Creditors A/c			3,000
	To Business purchase A/c			35,500
	[Being assets and liabilities taken over and goodwill thereon]			
"	Liquidator of K Ltd A/c	Dr	35,500	
	To Bank A/c			5,500
	To Share capital A/c (2,000 × 10)			20,000
	To Securities premium A/c (2,000 × 5)			10,000
	[Being payment of purchase price in the form of cash and shares]			

Working notes:

Purchase consideration (net assets method)

Goodwill (4,000 + 400)	Rs.
Fixed assets (16,500 - 4,000 + 1,250)	4,400
Current assets (19,500 - 1,000 + 1,850)	13,750
	<u>20,350</u>
Gross assets taken	38,500
Less: Creditors	3,000
Net assets or Purchase consideration	<u>35,500</u>
Shares to be given (2,000 × 15)	30,000
Cash to be given (bal. fig)	5,500
	<u>35,500</u>

Realisation A/c

	Rs.		Rs.
To Sundry assets	39,000	By Creditors	3,000
To Bank (expenses)	400	By R Ltd. (Purchase price)	35,500
To Shareholders (profit) (bal. fig)	3,100	By Bank (fixed assets)	4,000
	<u>42,500</u>		<u>42,500</u>

Bank A/c

	Rs.		Rs.
To Balance b/d (part of current assets)	1,000	By Realisation (Expenses)	400
To Realisation (Fixed Assets)	4,000	By Debentures	10,000
To R Ltd.	5,500	By Shareholders (Bal. Fig.)	100
	<u>10,500</u>		<u>10,500</u>

Shareholders A/c

	Rs.		Rs.
To Bank	100	By Share capital	20,000
To Shares in R Ltd.	30,000	By P & L A/c	7,000
		By Realisation (Profit)	3,100
	<u>30,100</u>		<u>30,100</u>

Absorption – Intrinsic value method

Illustration 17

The Balance Sheets of 'J' Co. Ltd. and 'H' Co. Ltd. as on 31.3.2014 were as follows:

Liabilities	J Ltd. Rs.	H Ltd. Rs.	Assets	J Ltd. Rs.	H Ltd. Rs.
Share capital: Rs. 100 each	5,00,000	–	Goodwill	40,000	–
Rs. 10 each	–	4,00,000	Fixed assets	4,00,000	8,00,000
Capital reserve	1,00,000	–	Cash at Bank	–	1,00,000
General reserve	35,000	4,00,000	Other current assets	4,50,000	3,30,000
Secured loan	–	2,50,000			
Unsecured loan	1,00,000	–			
Sundry creditors	1,55,000	1,80,000			
	<u>8,90,000</u>	<u>12,30,000</u>		<u>8,90,000</u>	<u>12,30,000</u>

It was proposed that J Co. Ltd. should be taken over by H Ltd. The following arrangements were accepted by both the companies.

- (1) Goodwill of J Ltd. is considered worthless.
- (2) Arrears of depreciation in J Co. Ltd. amounted to Rs. 20,000.
- (3) The holder of every 2 shares in J Ltd. was to receive:
 - (a) As fully paid, at par, 10 shares in H Ltd. and
 - (b) So much cash as is necessary to adjust the rights of shareholders of both the companies in accordance with the intrinsic values of the shares as per their Balance Sheets after the adjustments mentioned above.

You are required to

- (1) Determine the purchase consideration;
- (2) Show the Balance Sheet of H Co. Ltd. after the absorption, if the amalgamation is in the nature of purchase.

[Madras, I M.Com., (CAIA) April 2007; Nov. 2003 (2 Times)]

[Thiruvalluvar, B.Com., April 2018]

Solution:

Statement showing intrinsic value of shares

Particulars	J Co. Ltd.		H Co. Ltd.	
	Rs.	Rs.	Rs.	Rs.
Fixed assets	4,00,000			
Less: Arrears of depreciation	20,000	3,80,000		8,00,000
Cash at Bank				
Other current assets		4,50,000		1,00,000
Gross assets		8,30,000		3,30,000
Less: Secured loan			2,50,000	12,30,000
Unsecured loan	1,00,000			
Sundry creditors	1,55,000	2,55,000	1,80,000	4,30,000
Net assets available to shareholders		5,75,000		8,00,000
No. of equity shares	5,00,000 100	5,000	4,00,000 10	40,000
Intrinsic value per share (net assets ÷ No. of shares)	5,75,000 5,000	115	8,00,000 40,000	20

Cash to be paid as part of purchase price

Intrinsic value of 2 shares in J Ltd. 115×2	=	Rs. 230
Less: Intrinsic value of 10 shares in H Ltd. 20×10	=	200
Cash payable for every 2 shares		30
\therefore Cash payable per share in J Ltd. $\frac{30}{2}$	=	15

Statement showing purchase consideration

Shares to be issued by H Ltd. at Rs. 20 each $5,000 \times \frac{10}{2} \times 20$	=	Rs. 5,00,000
Cash to be paid at Rs. 15 per share = $5,000 \times 15$	=	75,000
Purchase consideration		5,75,000
Face value of shares issued = $5,000 \times \frac{10}{2} \times 10$		2,50,000
Premium on the shares issued = $5,00,000 \times \frac{10}{2} \times 10$		2,50,000
		5,00,000

Notes to Accounts:

	Rs.
1. Share capital:	
Issued and paid up capital:	
65,000 Equity shares of Rs.10 each	6,50,000
(Of these, 25,000 shares were issued for consideration other than cash to vendors)	
2. Reserves and surplus:	
General reserve	4,00,000
Securities premium	2,50,000
	6,50,000
3. Long term borrowings:	
Secured loan	2,50,000
Unsecured loan	1,00,000
	3,50,000
4. Trade payables:	
Sundry creditors	3,35,000
5. Tangible assets:	
Fixed assets	11,80,000

Balance sheet of H Ltd. as on 31.3. 2014

	Note No.	Rs.
I. Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	6,50,000
Reserves and surplus	2	6,50,000
(ii) Non- current liabilities:		
Long term borrowings	3	3,50,000
(iii) Current liabilities :		
Trade payables	4	3,35,000
Total (i) + (ii) + (iii)		19,85,000
II. Assets:		
(i) Non- current assets:		
Tangible assets	5	11,80,000
Intangible assets		
(ii) Current assets:		
Cash at bank (1,00,000 – 75,000)		25,000
Other current assets		7,80,000
Total (i) + (ii)		19,85,000

External reconstruction – Net payment method

Illustration 21

Given below is the Balance Sheet of Hard Luck Ltd. as at 31st March 2016.

Balance Sheet

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
40,000 shares of Rs. 10 each fully paid	4,00,000	Land & Building	3,20,000
Creditors	3,00,000	Plant & Machinery	1,30,000
		Stock	70,000
		Debtors	1,20,000
		Cash	500
		Preliminary expenses	5,000
		Profit & Loss A/c	54,500
	<u>7,00,000</u>		<u>7,00,000</u>

The following scheme of reconstruction was arranged:

- (1) The company to go into liquidation and a new company, Lucky Ltd. with an authorised capital of Rs. 8,00,000 to be formed to take over the assets and liabilities.
- (2) Preferential creditors of Rs. 10,000 included in the above Balance Sheet are to be paid in full.
- (3) Unsecured creditors to receive either (a) 50 per cent of their claim in cash or (b) 6 per cent debentures in the new company, equivalent to their claims at par.
- (4) Shareholders in Hard Luck Ltd. to be allotted one share in the new company of Rs. 10 each, Rs. 5 paid for every existing share held by them.
- (5) Reconstruction costs amounting to Rs. 6,000 to be paid by Hard Luck Ltd. from cash made available by the new company.

Half of the unsecured creditors in value opted out for immediate cash payment for which purpose necessary cash was made available by the new company which made a call of Rs. 5 each on the partly paid shares allotted as aforesaid. The new company valued all assets (except Land & Buildings) taken over from Hard Luck Ltd. at book values.

Prepare the Balance Sheet of the new company after the above transactions are concluded.

[Madras, 1st M.Com., (CAIA) Ap. 2007; M.Com., Oct. 1998]

Solution:

Notes to Accounts:

	Rs.
1. Share capital:	
Authorized capital:	
80,000 shares of Rs.10 each	8,00,000
Issued and paid up capital:	
40,000 shares of Rs.10 each	4,00,000
2. Long term borrowings:	
6% Debentures	1,45,000
3. Tangible assets:	
Land & buildings	1,13,000
Plant & machinery	1,30,000
	2,43,000

Balance sheet of Lucky Ltd. as on 31.3.2016

	Note No.	Rs.
I. Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	4,00,000
Reserves and surplus		-
(ii) Non-current liabilities:		
Long term borrowings	2	1,45,000
(iii) Current liabilities :		
Trade payables		
Total (i) + (ii) + (iii)		5,45,000
II. Assets:		
(i) Non-current assets:		
Tangible assets	3	2,43,000
Intangible assets		
(ii) Current assets:		
Stock		70,000
Trade receivables (debtors)		1,20,000
Cash and Bank		1,12,000
Total (i) + (ii)		5,45,000

Working Note 1 :

Calculation of Purchase consideration

For Shareholders, $40,000 \times 5 = \text{Rs. } 2,00,000$

In partly paid shares

Working Note 2 :

Value of Land & Buildings

		Rs.
Purchase consideration for shareholders		2,00,000
Claims to be settled by Lucky Ltd., after taking over :		
Preferential Creditors (Cash)		10,000
Unsecured Creditors (Cash) $2,90,000 \times \frac{50}{100} \times \frac{50}{100}$		72,500
Unsecured Creditors (Debentures)		1,45,000
Reconstruction expenses to be reimbursed		6,000
Total Payments to be made by Lucky Ltd.		4,33,500
Less : Plant & Machinery	1,30,000	

Stock	70,000	
Debtors	1,20,000	
Cash	500	3,20,500
Land & Building (Bal. Fig.)		1,13,000

- Note :**
1. Except Land and Buildings, all other assets are taken at Book values. So, Land and Buildings must be the Balancing figure in the above calculation.
 2. As per AS-14 purchase consideration should include Cash and securities given by transferee company to the shareholders of Transferor company. So, Preferential Creditors and Unsecured Creditors should be transferred to the purchasing company in whose books payment can be shown.

(3) Balance of Cash and Bank

Cash and Bank A/c

	Rs.		Rs.
To Business purchase A/c	500	By Preferential Creditors	10,000
To Share capital A/c	2,00,000	By Unsecured Creditors	72,500
		By Reconstruction Expenses	6,000
		By Balance c/d	1,12,000
	2,00,500		2,00,500

External reconstruction – Net payment method

Illustration 22

The books of S Ltd. contained the following balances as on May 31.2014

	Debit Rs.	Credit Rs.
Equity share capital (Rs. 10 each)		12,00,000
Creditors		14,00,000
Patents & Trade marks	12,00,000	
Plant & Machinery	4,00,000	
Stock	3,00,000	
Debtors	5,00,000	
Cash	12,500	
Preliminary expenses	72,500	
Profit & Loss A/c	1,15,000	
	26,00,000	26,00,000

The Patents and trade marks are considerably over valued. The company is also not in a position to raise any further capital. The following scheme of reconstruction has, therefore been framed.

- (i) The company will go into voluntary liquidation. A new company S. S. Ltd.

will be formed with an authorised capital of Rs. 20,00,000 to take over the assets.

- (ii) Liability will be discharged by the new company to the creditors by payment of 25 paise in a rupee in cash and 50 paise in a rupee by issue of 9% debentures.
- (iii) 1,20,000 shares of Rs. 10 each (Rs. 5 per share paid) will be issued to the shareholders of S Ltd.; the balance Rs. 5 per share to be paid on allotment.
- (iv) Expenses of liquidation amounting to Rs. 17,500 will be paid by S.S. Ltd.

The scheme was approved by all concerned. You are required to:

- (i) Close the ledger of S. Ltd.
- (ii) Give entries to open the books of S.S. Ltd.
- (iii) Prepare the opening balance sheet of S. S. Ltd.

[Madras, 1st M.Com (ZHC) Nov. 2005; BCS Oct. 2001; M.Com., Sep. 1996]

Solution:

Books of 'S' Ltd. (Transferor company)

Ledger

Realisation A/c

Particulars	Rs.	Particulars	Rs.
To Patents & Trademarks	12,00,000	By S. S. Ltd.	6,00,000
To Plant & Machinery	4,00,000	By Creditors	14,00,000
To Stock	3,00,000	By Shareholders (loss) (bal. fig)	4,12,500
To Debtors	5,00,000		
To Cash	12,500		
	<u>24,12,500</u>		<u>24,12,500</u>

Creditors A/c

Particulars	Rs.	Particulars	Rs.
To Realisation A/c (Transfer)	14,00,000	By Balance b/d	14,00,000
	<u>14,00,000</u>		<u>14,00,000</u>

S. S. Ltd. A/c

Particulars	Rs.	Particulars	Rs.
To Realisation A/c	6,00,000	By Shares in S. S. Ltd.	6,00,000
	<u>6,00,000</u>		<u>6,00,000</u>

Bank A/c

Particulars	Rs.	Particulars	Rs.
To S. S. Ltd. (Expenses)	17,500	By S.S. Ltd. (Expenses)	17,500
	<u>17,500</u>		<u>17,500</u>

Shareholders A/c

Particulars	Rs.	Particulars	Rs.
To Preliminary expenses	72,500	By Share capital A/c	12,00,000
To Profit & Loss A/c	1,15,000		
To Realisation A/c	4,12,500		
To Shares in S.S. Ltd.	6,00,000		
	<u>12,00,000</u>		<u>12,00,000</u>

Shares in S. S. Ltd. A/c

Particulars	Rs.	Particulars	Rs.
To S. S. Ltd. A/c	6,00,000	By Shareholders A/c	6,00,000
	<u>6,00,000</u>		<u>6,00,000</u>

Books of S. S. Ltd. (Transferee company)

Journal entries

Date	Particulars	L.F.	Dr Rs.	Cr Rs.
31.5.94	Business purchase A/c To Liquidator of S Ltd. A/c [Being purchase price payable as per agreement]	Dr	6,00,000	6,00,000
"	Patents & Trademarks A/c	Dr	12,00,000	
	Machinery A/c	Dr	4,00,000	
	Stock A/c	Dr	3,00,000	
	Debtors A/c	Dr	5,00,000	
	Cash A/c	Dr	12,500	
	To Business purchase A/c			6,00,000
	To Creditors $\left(14,00,000 \times \frac{75}{100}\right)$			10,50,000
	To Capital reserve A/c (bal. fig) [Being assets and liabilities taken over and capital profit thereon]			7,62,500
"	Capital reserve A/c To Bank (Expenses)	Dr	7,62,500	17,500

	To Patents & Trademarks A/c (Bal. Fig.) [Being capital profit utilised to write off patents and trademarks after providing for expenses]			7,45,000
31.5.94	Liquidator of S.S. Ltd. A/c To Equity share capital A/c (Rs. 5 paid) [Being payment of purchase price as per scheme of reconstruction]	Dr	6,00,000	6,00,000
"	Bank A/c To Equity share capital A/c [Being receipt of Rs. 5 per share on 60,000 equity shares as per the terms of reconstruction]	Dr	6,00,000	6,00,000
"	Creditors A/c To Bank A/c To 9% Debentures A/c [Being Payment to Creditors]	Dr	10,50,000	3,50,000 7,00,000

Notes to Accounts:**1. Share capital:**

Authorized capital:

2,00,000 shares of Rs.10 each

Issued, subscribed and paid up capital:

1,20,000 shares of Rs.10 each

2. Long term borrowings:

9% Debentures

3. Tangible assets:

Plant & Machinery

4. Intangible assets:

Patents & trade marks (12,00,000 – 7,45,000)

Rs.

20,00,000

12,00,000

7,00,000

4,00,000

4,55,000

Balance sheet of S.S Ltd. as on 31.5. 2014**I. Equity and Liabilities:**

(i) Shareholders' funds:

Share capital

Reserves and surplus

(ii) Non-current liabilities:

Long term borrowings

Note No.

Rs. in lakh

1

12,00,000

2

7,00,000

Amalgamation, Absorption and External Reconstruction

10.103

(ii) Current liabilities :		
Total (i) + (ii) + (iii)		19,00,000
II. Assets:		
(i) Non-current assets:		
Tangible assets	3	4,00,000
Intangible assets	4	4,55,000
(ii) Current assets:		
Stock		3,00,000
Trade receivables (debtors)		5,00,000
Cash		12,500
Bank (6,00,000 – 3,67,500)		2,32,500
Total (i) + (ii)		19,00,000

Notes: (1) Since the patents and trademarks are heavily over valued, the capital profit on the reconstruction is used to write off that asset.

(2) Cash and Bank are separately shown.

Working note :

Alteration of Share Capital and Internal Reconstruction

ALTERATION OF SHARE CAPITAL

There are two types of altering the share capital of a company:

- (i) Alterations which do not require the approval of a court of law.
- (ii) Alterations which require prior approval of a court of law.

The second type of alterations is more complicated, needing fulfilment of several legal formalities. They are separately discussed under the heading, '*Internal Reconstruction*'.

Alteration of share capital, which does not require court approval

This type of alteration can be done under the provisions of Sections 94 to 97 of the Companies Act.

Sec. 94 of the Companies Act permits a limited company to alter the capital clause of its Memorandum of Association in five different ways as follows:

- (a) Increase the share capital by issue of new shares.
- (b) Consolidate all or a part of its existing shares of smaller denomination into shares of larger amounts.
- (c) Sub-divide all or a part of its existing shares of higher denomination into shares of lesser amounts.
- (d) Convert all or any part of its fully paid up shares into stock and vice-versa.
- (e) Cancel the unissued share capital.

A company can make any of the above five alterations: (i) If it is authorised by its Articles of Association to carry out such alteration; (ii) An ordinary resolution is passed in the general body meeting.

As per Sec. 95 of the Companies Act, any such alteration must be notified to the Registrar of Companies and a copy of the resolution should be filed with him within 30 days of the date of passing of such resolution.

Different kinds of alteration of share capital and the necessary accounting entries

(a) **Increase of share capital:** This is the same as new issue of shares. Accounting entries are the same as those for 'issue of shares'.

(b) **Consolidation of shares:** Here existing shares of lower denomination are combined to form shares of higher denomination.

The result is that the paid up capital remains the same but total number of shares reduces.

Example: A company having 5,00,000 8% preference shares of Rs. 10 each decides to consolidate the shares into shares of Rs. 100 each. The required journal entry is as follows:

Journal entry

<i>Particulars</i>	<i>Dr. Rs.</i>	<i>Cr. Rs.</i>
8% Preference Share Capital (Rs. 10) A/c Dr To 8% Preference Share Capital (Rs. 100) A/c [Being consolidation of 5,00,000 preference shares of Rs. 10 each into 50,000 preference shares of Rs. 100 each as per resolution No..... dated.....]	50,00,000	50,00,000

(c) **Sub-division of shares:** In this case, shares of higher face value are divided into several shares of lower face value. The effect is that the paid up capital does not change but the total number of shares increases.

Example: A company which has 2,000 equity shares of Rs. 100 each decides to sub-divide them into shares of Rs. 10 each. The required journal entry is as follows:

Journal entry

<i>Particulars</i>	<i>Dr. Rs.</i>	<i>Cr. Rs.</i>
Equity Share Capital (Rs. 100) A/c Dr To Equity Share Capital (Rs. 10) A/c [Being sub-division of 2,000 equity shares of Rs. 100 each into 20,000 shares of Rs. 10 each as per resolution No..... Dated]	2,00,000	2,00,000

(d) **Conversion of shares into stock and vice versa:** A company can decide to convert its fully paid up shares into stock or convert existing stock into fully paid shares.

Example: A company decides to convert its Rs. 10 equity share capital of Rs. 8,00,000 into stock. The following is the journal entry to be passed.

Journal entry

Particulars	Dr. Rs.	Cr. Rs.
Equity Share Capital A/c Dr To Equity Capital Stock A/c [Being conversion of 80,000 equity shares of Rs. 10 each fully paid into Rs. 8,00,000 equity stock as per resolution No..... Dated.....]	8,00,000	8,00,000

For converting stock into fully paid shares, reverse entry to the above can be passed.

- (e) **Cancellation of unissued shares:** Here, shares which are not yet issued by the company are cancelled. Thus, it is the reduction of unissued capital, without any reduction in the paid up capital.

The authorised capital stands reduced, to the extent of unissued shares cancelled. It does not require any journal entry.

INTERNAL RECONSTRUCTION OR CAPITAL REDUCTION

Reconstruction refers to reorganisation of the capital structure of a company. It may result in the reduction of claims of both the shareholders and creditors against the company. Reconstruction may be necessary for those companies whose financial position is bad. Such reconstruction can be 'External' or 'Internal'.

In external reconstruction, a new company is formed to take over the business of an existing company which will be liquidated.

In internal reconstruction, the capital of a company is reorganised to enable it to make a fresh beginning, after eliminating accumulated losses.

Generally, internal reconstruction is preferred by companies over external reconstruction due to the following reasons:

- (a) Liquidation of the existing company and formation of new company involve a large number of legal formalities and are also expensive.
- (b) Accumulated losses of the liquidating company cannot be set off against the profits of the newly formed company though the shareholders may be the same. Thus, an important tax advantage is lost.
- (c) The time span needed for external reconstruction is generally far more than that of internal reconstruction.

Reduction of share capital

A company can reduce its share capital as per the provisions of Sections 100 to 105 of the Companies Act, 1956. Reduction of capital can take any of the following three forms.

- (1) Reducing or completely extinguishing shareholders liability for uncalled capital.

- (2) Refunding surplus paid up capital which is found to be in excess of the needs of the company.
- (3) Cancelling or writing off paid up capital which is lost and not represented by assets.

Procedure for reducing share capital

- (1) The Articles of Association of the company must permit reduction of share capital. If articles is silent, it may be 'Altered' through a special resolution to enable the company to reduce its share capital.
- (2) In the general body meeting, a special resolution must be passed for reduction of share capital.
- (3) Confirmation of the court for capital reduction must be obtained.

The company has to prepare a specific scheme of capital reduction and apply to the Court for an order of confirmation, submitting the scheme. The Court may make an order confirming the capital reduction on such terms and conditions as it thinks proper. The court usually ensures that the interests of creditors and minority shareholders are protected. If any of them objects to the scheme proposed by the company, the court ensures that their claims against the company are satisfied. The court may also ask the company to publish the reasons for the reduction for the information of the general public. The company may be asked to add the words, 'And Reduced' to its name for a period of time, thought to be appropriate by the Court.

- (4) A copy of the resolution to reduce capital and the court's order of confirmation should be filed with the Registrar of Joint Stock Companies.

Accounting entries for reduction of capital

- (1) **Reducing or completely extinguishing liability of the shareholders for uncalled capital**

Example: A company whose capital consists of 5,000 shares of Rs. 100 each, Rs. 75 called and paid, decides to reduce the shares into 5,000 shares of Rs. 75 each fully paid.

Journal entry

<i>Particulars</i>	<i>Dr. Rs.</i>	<i>Cr. Rs.</i>
Share Capital (Rs. 100) A/c Dr	3,75,000	
To Share Capital (Rs. 75) A/c		3,75,000
[Being conversion of 5,000 shares of Rs. 100 each, Rs. 75 paid up into 5,000 shares of Rs. 75 each, fully paid up]		

- (b) When there is no change in the face value of the share or rate of preference dividend, thus resulting in no change in the category of the share.

Example: A company decides to reduce Rs. 3 per share on its 80,000 equity shares of Rs. 10 each, fully paid.

Journal entry

Particulars	Dr. Rs.	Cr. Rs.
Equity Share Capital A/c Dr	2,40,000	
To Capital Reduction A/c		2,40,000
[Being reduction of Rs. 3 per share on 80,000 shares of Rs. 10 each as per capital reduction scheme]		

- (4) **When debenture holders or creditors make some sacrifice as a part of capital reduction scheme**

Example: As per the capital reduction scheme adopted by a company, 5,000 7% debentures of Rs. 100 each are to be reduced to Rs. 80 each and the trade creditors have agreed to reduce their claims by Rs. 50,000.

Journal entry

Particulars	Dr. Rs.	Cr. Rs.
7% Debentures A/c Dr	1,00,000	
Creditors A/c Dr	50,000	
To Capital Reduction A/c		1,50,000
[Being reduction of Rs. 20 per debenture on 5,000 debentures and reduction of creditors as per capital reduction scheme]		

- (5) **When there is appreciation in the value of any of the assets**

Example: On the date of capital reduction, a company finds that its buildings have appreciated by Rs. 40,000 and the value of stock has gone up by Rs. 30,000.

Journal entry

Particulars	Dr. Rs.	Cr. Rs.
Buildings A/c Dr	40,000	
Stock A/c Dr	30,000	
To Capital Reduction A/c		70,000
[Being appreciation in the value of assets credited to capital reduction]		

- (6) *When any contingent liability or expenses as proposed in the capital reduction scheme have to be paid*

Example: At the time of implementing a capital reduction scheme, it was found that the sales tax under dispute so far for Rs. 20,000 has to be paid immediately and the expenses of implementing the scheme are Rs. 10,000.

Journal entries

Particulars	Dr. Rs.	Cr. Rs.
Sales Tax Payable A/c Dr	20,000	
Scheme Expenses A/c Dr	10,000	
To Bank A/c		30,000
[Being liability for sales tax paid and scheme expenses met]		
Capital Reduction A/c Dr	30,000	
To Sales Tax Payable A/c		20,000
To Scheme Expenses A/c		10,000
[Being sales tax under dispute paid and scheme expenses written off through capital reduction A/c]		

- (7) *When capital reduction account is used to write off losses, reduce assets, etc. as per the approved scheme.*

Journal entry

Particulars	Dr. Rs.	Cr. Rs.
Capital Reduction A/c Dr	xxxx	
To Profit & Loss A/c (Dr balance)		xxxx
To Preliminary expenses A/c		xxxx
To Discount on issue of shares or debentures		xxxx
To Goodwill A/c		xxxx
To Assets A/c (amount to be reduced)		xxxx
To Capital reserve A/c (balance of any)		xxxx
[Being losses written off and assets reduced as per capital reduction scheme]	xxxx	

Some Points to be Noted

- (1) *Deficit or surplus in capital reduction account*

Usually, the balance in the capital reduction is sufficient to write off the losses accumulated and reduce the values of assets. The scheme drafted for presentation to the court of law must take care of this aspect.

Sometimes, a small deficit in capital reduction amount may have to be made up by utilising some provisions like Workmen's Compensation Fund or Provision for Taxation. In such cases, the accounts concerned are debited and capital reduction account is credited.

Any surplus in capital reduction account is automatically transferred to capital reserve account.

(2) **Capital reduction A/c or Reconstruction A/c**

Some accounting experts are of the opinion that sacrifice made by creditors and debenture holders should not be treated as capital reduction and credited to that account. In such cases, the account must be termed as '*Reconstruction Account*' or '*Reorganisation A/c*'.

However, the modern meaning of the term 'Capital' has widened considerably and 'Capital structure' is now agreed to be all the own and borrowed sources of funds. So, usage of the term 'Capital Reduction' is acceptable even when creditors make sacrifices.

(3) **Arrears of preference dividend**

Cumulative preference shareholders are eligible for accumulation of dividends if not paid in any particular year. Unless otherwise mentioned, all preference shares must be assumed as cumulative. Without clearing preference dividend arrears, equity dividend cannot be paid.

If preference dividend is declared it becomes a liability and appears under current liabilities in the balance sheet liabilities side.

If preference shareholders agree to forego the arrears which are already declared, it is transferred to capital reduction account, just like other sacrifices.

If preference dividend is not declared, then it is only a contingent liability shown as a foot note to the balance sheet or shown in the inner column on the liabilities sides of the balance sheet.

If preference shareholders agree to sacrifice the undeclared preference dividend, no separate entry is necessary to record such sacrifice because the dividend was not taken into account. A note may be written to that effect.

If preference dividend not previously declared, is agreed to be paid in cash at the time of implementing a capital reduction scheme, it is to be treated as an additional loss. Dividend is debited and bank is credited for the payment of cash. Then the dividend is written off through capital reduction A/c along with other losses.

(4) **Surrender of shares**

As a part of capital reduction scheme, shareholders may be required to 'surrender' a part of their shares to the company. The surrendered shares may be cancelled immediately by transferring their value to capital

reduction account. It is also possible that some of the surrendered shares may be reissued by the company to the creditors or debentureholders as a part of the capital reduction scheme. In such cases, they usually agree to forego a portion of their claim in return for the issue of surrendered shares. The reduction in their claim is fully transferred to capital reduction account. The following journal entries are usually passed.

Journal entries

Particulars		Dr. Rs.	Cr. Rs.
(1) <i>When shares are surrendered:</i>			
Share Capital A/c	Dr	xxx	
To Surrendered Shares A/c			xxx
(2) <i>When surrendered shares are reissued</i>			
Surrendered Shares A/c	Dr	xxx	
To Share Capital A/c			xxx
(3) <i>When unissued surrendered shares are cancelled</i>			
Surrendered Shares Account	Dr	xxx	
To Capital Reduction A/c			xxx

Model Journal Entries (Summarised)

Transaction	Journal Entry		
1. For consolidation of shares	Share capital (Say Rs. 10) A/c Dr To Share Capital A/c (Say Rs. 100)	xx	xx
2. For Sub-division of shares	Share capital (Say Rs. 100) A/c Dr To Share Capital (Say Rs. 10) A/c	xxx	xxx
3. For Conversion of shares into stock	Equity Share capital A/c Dr To Equity Capital Stock A/c	xxx	xxx
4. When uncalled Capital is reduced or Extinguished	Share capital (Say Rs. 100) A/c Dr To Share Capital (Say Rs. 60) A/c	xxx	xxx
5. For refunding surplus capital	Share capital (Say Rs. 100) A/c Dr To Share capital (Say Rs. 80) A/c To Shareholders A/c / Bank A/c (Say Rs. 20)	xxx	xxx
6. For Reduction of share capital, when rights are changed (either Face value or dividend %)	Share capital (Old) A/c Dr To Share capital (New) A/c To Capital Reduction A/c	xxx	xxx

7. For Reduction of Capital without change in rights (No change in Face value or dividend %)	Share capital A/c	Dr	xxx	
	To Capital Reduction A/c			xxx
8. For Any sacrifice made by Debenture holders or creditors.	Debentures A/c	Dr	xxx	
	Creditors A/c	Dr	xxx	
	To Capital Reduction A/c			xxx
9. For Appreciation in the value of Assets.	Asset A/c	Dr	xxx	
	To Capital Reduction A/c			xxx
10. For Payment of Scheme / Reconstruction expenses.	Scheme / Reconstruction Expenses A/c		xxx	
	To Bank A/c			xxx
11. For Payment of contingent Liability which Materialises.	Contingent Liability A/c	Dr	xxx	
	To Bank A/c			xxx
12. When Shares are Surrendered by Shareholders, as per scheme.	Share Capital A/c	Dr	xxx	
	To Surrendered shares A/c			xxx
13. When Surrendered shares are reissued to Debentureholders, creditors etc.	Surrendered Shares A/c	Dr	xxx	
	To Share capital A/c			xxx
14. For-cancelling unissued surrendered shares.	Surrendered shares A/c	Dr	xxx	
	To Capital Reduction A/c			xxx
15. For writing off Losses and reducing assets as per scheme.	Capital Reduction A/c	Dr	xxx	
	To P&L A/c			xxx
	To Preliminary Expenses			xxx
	To Discount on issue of shares			xxx
	To Goodwill			xxx
	To Patents			xxx
	To Scheme / Reconstruction Expenses			xxx
	To Contingent Liability (Paid)			xxx
	To Assets (Amount to be reduced)			xxx
	To Capital Reserve A/c (Balance, if any)			xxx

ILLUSTRATIONS

ALTERATION OF SHARE CAPITAL

Illustration 1

Ratan Ltd., having a share capital of Rs. 3,00,000 divided into 3,000 shares of Rs. 100 each, resolves to sub-divide the shares into 30,000 shares of Rs. 10 each. Pass the necessary journal entry.

Solution:**In the books of Ratan Ltd.****Journal Entry**

Date	Particulars	L. F.	Dr.	Cr.
			Rs.	Rs.
	Share Capital (Rs. 100) A/c Dr		3,00,000	
	To Share Capital (Rs. 10) A/c			3,00,000
	[Being 3,000 shares of Rs. 100 each sub-divided into 30,000 shares of Rs. 10 each as per Board's resolution dated]			

Illustration 2

Marshall Ltd. has share capital of Rs. 5,00,000 divided into 5,000 shares of Rs. 100 each, fully paid. Show the entries under each of the following conditions:

- (i) When Marshall Ltd. resolves to sub-divide the shares into 50,000 shares of Rs. 10 each fully paid.
- (ii) When Marshall Ltd., resolves to convert its 5,000 shares of Rs. 100 each into Rs. 5,00,000 worth of stock.

[Madras, B.Com., (G&A.F) Ap. 2011; B.Com., Nov. 2008; B.Com., (CS) Ap. 2007]

Marshall Ltd.**Journal entries**

Date	Particulars	L. F.	Dr.	Cr.
			Rs.	Rs.
	(i) Share Capital A/c (Rs. 100) Dr		5,00,000	
	To Share Capital A/c (Rs. 10)			5,00,000
	[Being the sub-division of 5,000 shares of Rs. 100 each into 50,000 shares of Rs. 10 each, fully paid up as per Board's resolution dated.....]			
	(ii) Equity Share Capital A/c Dr		5,00,000	
	To Equity Capital Stock A/c			5,00,000
	[Being the conversion of 5,000 equity shares of Rs. 100 each into Rs. 5,00,000 stock as per Board's resolution dated]			

Illustration 3

'X' Co. Ltd. has the following shares as a part of its share capital
10,000 8% preference shares of Rs. 100 each fully paid.

50,000 equity shares of Rs. 5 each fully paid

20,000 equity shares of Rs. 10 each, Rs. 8 called up and paid up.

The company has decided to alter the share capital as follows:

- (i) To sub-divide the preference shares into shares of Rs. 10 each.
- (ii) To consolidate the equity shares of Rs. 5 each into shares of Rs. 10 each.
- (iii) To convert the partly paid up equity shares into fully paid up shares of Rs. 8 each, with necessary legal sanctions.

Journalise the alterations.

[Madras, B.Com., (CS) (BYA3A) Ap. 2010; B.Com., (A.F) Ap. 2009; B.Com (ICE), Oct. 2005] [Thiruvalluvar, B.Com., April 2018]

Solution:

Books of 'X' Co. Ltd.

Journal entries

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
	(i) 8% Preference Share Capital (Rs. 100) A/c Dr		10,00,000	
	To 8% Preference share capital (Rs. 10) A/c			10,00,000
	[Being sub-division of 10,000 pref. shares of Rs.100 each into 1,00,000 preference shares of Rs. 10 each]			
	(ii) Equity share capital (Rs. 5) A/c Dr		2,50,000	
	To Equity Share Capital (Rs. 10) A/c			2,50,000
	[Being consolidation of 50,000 equity shares of Rs. 5 each into 25,000 equity shares of Rs. 10 each]			
	(iii) Equity Share Capital (partly paid) A/c Dr		1,60,000	
	To Equity Share Capital (fully paid) A/c			1,60,000
	[Being conversion of partly paid shares into fully paid shares]			

Illustration 4

Kay Ltd has an issued capital of Rs. 5,00,000 in 50,000 shares of Rs. 10 each on which Rs. 8 per share has been called up. The company now decides to reduce the share capital to share of Rs. 8 each fully paid by cancelling the unpaid amount of Rs. 2 per share. Pass journal entry.

[Madras, B.Com., (G & A.F), Nov. 2011, B.Com., (A.F) (AF6C) Nov. 2009]

Solution:**Books of Kay Ltd.****Journal entry**

Date	Particulars	L. F.	Dr.	Cr.
			Rs.	Rs.
	Share Capital (Rs. 10) A/c To Share Capital (Rs. 8) A/c [Being reduction of 50,000 shares of Rs. 10 each to Rs. 8 each, by the cancellation of unpaid amount of Rs. 2 per share as per special resolution dated as confirmed by court]	Dr	4,00,000	4,00,000

CAPITAL REDUCTION**Return of Share capital****Illustration 5**

Bee Ltd. has 60,000 equity shares of Rs. 100 each, Rs. 80 per share called up. Now the company decides to pay off Rs. 20 per share of the paid up capital and at the same time to reduce the Rs. 100 share to Rs. 60 share fully paid up by cancelling the unpaid amount. Give journal entries.

[Madras, B.Com., (AF) Ap. 2009]

[Madras, B.Com(CS) (BYA3A) Ap. 2011; B.Com(G&AF),
Nov. 2010; B.Com(AF) (AF6C) Ap. 2009]

Solution:**Books of Bee Ltd.****Journal entries**

Date	Particulars	L.F.	Dr.	Cr.
			Rs.	Rs.
	Share Capital A/c (Rs. 100) To Share Capital A/c (Rs. 60) To Shareholders A/c [Being reduction of 60,000 equity shares of Rs. 100 each, Rs. 80 per share paid to 60,000 shares of Rs. 60 each fully paid and refund of Rs. 20 per share by cancelling the unpaid amount]	Dr	4,80,000	3,60,000 1,20,000
	Shareholders A/c To Bank A/c [Being the amount paid to shareholders]	Dr	1,20,000	1,20,000

Illustration 9

Following a series of losses, XYZ Co. Ltd., resolved to reduce its capital to 50,000 fully paid Rs. 5 shares and to eliminate securities premium account. The company's Balance Sheet prior to implementation of the scheme was:

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
<i>Share Capital :</i>		Goodwill	1,00,000
50,000 fully paid shares		Land & Buildings	1,62,000
of Rs. 10 each	5,00,000	Plant & Machinery	2,07,000
Securities premium A/c	50,000	Stock	92,000
Creditors	62,000	Debtors	74,000
Bank Overdraft	73,000	Profit & Loss A/c	50,000
	<u>6,85,000</u>		<u>6,85,000</u>

It was resolved to apply the sum available under the scheme:

- (i) To write off the goodwill account.
- (ii) To write off the debit balance of the Profit & Loss account
- (iii) To reduce the book values of the assets by the following amounts:

	Rs.
Land & Buildings	42,000
Plant & Machinery	67,000
Stock	33,600

- (iv) To provide a bad debts reserve of 10% of the book value of debtors.

Show the journal entries to give effect to the scheme and prepare the revised balance sheet after its implementation.

[Madras, B.Com(G & A.F) Nov. 2011; B.Com (CS) (BYA3A) Nov. 2010; Ap. 2010; Nov. 2009; B.Com (PZ3A) Nov. 2008; B.Com., B.Com (CS) Ap. 2007; 1st M.Com., (ICE), Oct. 2005; 1st M.Com, (CAIA) Ap. 2008; Ap. 2004]

Solution:**Books of XYZ Co. Ltd.****Journal entries**

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
	Share Capital A/c To Capital Reduction A/c [Being reduction of 50,000 shares by Rs.5 per share]	Dr	2,50,000	2,50,000
	Securities Premium A/c To Capital Reduction A/c [Being share premium A/c transferred to capital reduction A/c]	Dr	50,000	50,000
	Capital reduction A/c To Goodwill A/c To Profit & Loss A/c To Land & Buildings A/c To Plant & Machinery A/c To Stock A/c To Provision for bad debts [Being various losses written off and assets reduced in value as per special resolution..... dated..... as confirmed by Court]	Dr	3,00,000	1,00,000 50,000 42,000 67,000 33,600 7,400

Notes to Accounts:**1. Share capital:**

Issued and paid up capital

50,000 Equity shares of Rs.5 each

2. Trade payables:

Creditors

3. Short term borrowings:

Bank overdraft

4. Tangible assets:

Land and buildings

Plant & Machinery

Rs.

2,50,000

62,000

73,000

1,20,000

1,40,000

2,60,000

Alteration of Share Capital and Internal Reconstruction

Balance sheet of XYZ Co. Ltd. as on .. (and reduced)

	Note No.	Rs.
I. Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	2,50,000
Reserves and surplus		
(ii) Non-current liabilities:		
(iii) Current liabilities		
Trade payables	2	62,000
Short term borrowings	3	73,000
Total (i) + (ii) + (iii)		<u>3,85,000</u>
II. Assets:		
(i) Non-current assets:		
Tangible assets	4	2,60,000
Intangible assets		
(ii) Current assets:		
Stock		58,400
Trade receivables (debtors) (74,000 – 7,400)		66,600
Total (i) + (ii)		<u>3,85,000</u>

Illustration 12 (Pro-rata write off of assets)

The Balance sheet of Nipun Ltd. on 31st March 2016 was as follows:

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
8% preference shares of Rs. 10 each	50,000	Goodwill	90,000
Equity shares of Rs. 10 each	2,50,000	Land & Buildings	1,40,000
General reserve	20,000	Machinery	37,500
6% Debentures (Rs. 100 each)	20,000	Furniture	15,000
Bank overdraft	28,500	Preliminary expenses	1,000
Creditors	40,000	Profit & Loss A/c	1,25,000
	<u>4,08,500</u>		<u>4,08,500</u>

The capital reduction scheme, approved by the Court is as under:

- (i) Holders of 6% debentures of Rs. 100 are to be given 8% debentures of Rs.50 and preference shares of Rs. 10 each of equal amount, for the remaining amount of Rs. 5
- (ii) The value of all preference shares including the preference shares given to debentures as shown above, is to be reduced to Rs. 6 and dividend rate is to be increased upto 9%.
- (iii) The value of equity shares is to be reduced to Rs. 2 each.
- (iv) The existing equity shareholders are to purchase additional equity shares of Rs. 1,00,000 for cash to pay off the bank overdraft.
- (v) All fictitious and intangible assets are to be written off and Machinery and furniture are to be written off in proportion of book values, with the help of general reserve and capital reduction A/c.

Pass necessary journal entries in the books of the company to record the above transactions. Prepare the company's balance sheet after such changes.

[Madras, B.Com., B.Com(CS) Ap. 2009; 2nd M.Com (ICE) Oct. 2000;
B.Com. Oct. 1999; Gujarat B.Com]

Journal:

Books of Nipun Ltd.
Journal entries

Date	Particulars	L.F.	Dr.	Cr.
3.96	6% Debentures A/c To 8% Debentures A/c To 8% Preference Share Capital A/c [For giving 8% debentures and 1,000 8% preference shares of Rs. 10 each to debentureholders for their claims]	Dr	Rs. 20,000	Rs. 10,000 10,000
"	8% Preference Share Capital A/c To 9% Preference Share Capital A/c To Capital Reduction A/c [For converting 8% preference shares of Rs. 10 each into shares of Rs. 6 each and transferring the balance to capital reduction]	Dr	60,000	36,000 24,000
1.3.96	Equity Share Capital A/c To Capital Reduction A/c [For reducing equity shares of Rs.10 into Rs.2 each]	Dr	2,00,000	2,00,000
"	Bank A/c To Equity Share Capital A/c [For issue of 50,000 equity shares of Rs. 2 each to existing equity shareholders]	Dr	1,00,000	1,00,000
"	Bank overdraft A/c To Bank A/c [For repayment of Bank O/D]	Dr	28,500	28,500
"	Capital Reduction A/c General Reserve A/c To Goodwill A/c To Preliminary expenses A/c To P&L A/c To Machinery A/c $\left(28,000 \times \frac{37.5}{52.5}\right)$ To Furniture A/c $\left(28,000 \times \frac{15}{52.5}\right)$ [For writing off the various losses and writing down assets as per capital reduction scheme]	Dr Dr	2,24,000 20,000	90,000 1,000 1,25,000 20,000 8,000

Notes to Accounts:

	Rs.
1. Share capital:	
Issued and paid up capital	
75,000 Equity shares of Rs.2 each	1,50,000
6,000, 9% pref.shares of Rs.6 each	36,000
	1,86,000
2. Long term liabilities:	
8% Debentures (Rs.50)	10,000
3. Trade payables:	
Creditors	40,000
4. Tangible assets:	
Land and buildings	1,40,000
Machinery	17,500
Furniture	7,000
	1,64,500

Balance sheet of Nipun Ltd. as on 31.3.1996 (and reduced)

	Note No.	Rs.
I. Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	1,86,000
Reserves and surplus		
(ii) Non- current liabilities:		
Long term borrowings	2	10,000
(iii) Current liabilities		
Trade payables	3	40,000
Total (i) + (ii) + (iii)		2,36,000
II. Assets:		
(i) Non- current assets:		
Tangible assets	4	1,64,500
Intangible assets		
(ii) Current assets:		
Cash		71,500
Total (i) + (ii)		2,36,000

Reorganisation through Surrender of shares**Illustration 20**

In order to reconstruct the Balance sheet, Robert Ltd. passed the following resolutions:

- (i) The share capital of the company consisting of 1,000 ordinary shares of Rs. 100 each to be converted into 10,000 shares of Rs. 10 each.
- (ii) The shareholders to surrender 60% of their shares after such conversion.
- (iii) The amount available should be utilised to write off machinery of Rs. 10,000, stock Rs. 5,000 and the balance available to write off the debit balance in Profit & Loss account.

You are required to pass the necessary journal entries.

[Madras, B.Com., B.Com (CS) Nov. 2009] [Calicut, B.Com., April 1988]

Solution:**Books of Robert Ltd.****Journal entries**

Date	Particulars	L.F.	Dr Rs.	Cr Rs.
	Equity Share Capital A/c (Rs.100) Dr		1,00,000	
	To Equity Share Capital A/c (Rs. 10)			1,00,000
	[Being 1,000 ordinary shares of Rs. 100 each subdivided into 10,000 shares of Rs. 10 each as per board's resolution dated]			
	Equity Share Capital A/c (Rs. 10) Dr		60,000	
	To Surrendered Shares A/c			60,000
	[Being surrender of 60% of shares by the shareholders]			
	Surrendered Shares A/c Dr		60,000	
	To Capital Reduction A/c			60,000
	[Being cancellation of surrendered shares by transferring to capital reduction A/c]			
	Capital Reduction A/c Dr		60,000	
	To Machinery A/c			10,000
	To Stock A/c			5,000
	To Profit & Loss (Dr) A/c			45,000
	[Being the utilisation of capital reduction A/c to write off machinery, stock and accumulated losses]			

Illustration 21

A Company's position on 31.12.2020 was as follows:

20,000 equity shares of Rs. 100 each	Rs. 20,00,000
10,000 6% debentures of Rs. 100 each	10,00,000
Interest outstanding on debentures	1,20,000
Creditors	5,00,000
Assets on that date were as under:	
Fixed assets	20,00,000
Current assets	6,50,000

Fixed assets were revalued at Rs. 9,60,000 and current assets at Rs. 4,80,000. The capital reduction scheme approved by Court was as follows:

- (i) The shares were subdivided into shares of Rs. 5 each and 90% of the shares were surrendered.
- (ii) Claims of debentureholders were reduced to Rs. 4,90,000 for which Rs. 2,50,000 equity shares were allotted.
- (iii) Creditors agreed to reduce their claims to Rs. 3,00,000, $\frac{1}{3}$ of which was satisfied by the issue of equity shares out of those surrendered.

Draft journal entries.

[Madras, B.Com., Sept. 1991]

Solution:

Journal entries

Date	Particulars	L.F.	Dr	Cr
			Rs.	Rs.
31.12.20	Equity Share Capital (Rs. 100) A/c Dr To Equity Share Capital (Rs. 5) A/c [Being sub-division of 20,000 equity shares of Rs. 100 each into 4,00,000 shares of Rs. 5 each]		20,00,000	20,00,000
"	Equity Share Capital (Rs. 5) A/c Dr To Surrendered Shares A/c [Being surrender of 90% of equity shares by the shareholders as per capital reduction scheme]		18,00,000	18,00,000
"	6% Debentures A/c Dr Interest on Debentures A/c Dr To Capital Reduction A/c [Being reduction of debentureholders' claim to Rs. 4,90,000]		5,10,000 1,20,000	6,30,000
"	Surrendered Shares A/c Dr To Equity Share Capital A/c [Being issue of 50,000 shares of Rs. 5 each to debentureholders out of the surrendered shares as per capital reduction scheme]		2,50,000	2,50,000
"	Creditors A/c Dr		3,00,000	

To Capital Reduction A/c [Being Rs. 2,00,000 reduction in creditors' claim and Rs. 1,00,000 for which surrendered shares are to be issued]			3,00,000
" Surrendered shares A/c To Equity share capital A/c [Being issue of 20,000 shares of Rs. 5 each out of surrendered shares to the creditors to satisfy $\frac{1}{3}$ of their balance of Rs. 3,00,000]	Dr	1,00,000	1,00,000
" Surrendered Shares Account To Capital Reduction A/c [Being unissued surrendered shares cancelled and transferred to capital reduction]	Dr	14,50,000	14,50,000
" Capital Reduction A/c To Profit & Loss A/c To Fixed assets A/c To Current assets A/c To Capital reserve A/c (Balancing figure) [Being loss written off, assets written down and balance transferred to capital reserve]	Dr	23,80,000	9,70,000 10,40,000 1,70,000 2,00,000

Working Note 1: Balance sheet of Company on 31.12.2020

Liabilities	Rs.	Assets	Rs.
20,000 equity shares of Rs. 100 each	20,00,000	Fixed Assets	20,00,000
10,000 6% debentures of Rs. 100 each	10,00,000	Current assets	6,50,000
Outstanding interest on debentures	1,20,000	P & L A/c (Bal. fig)	9,70,000
Creditors	5,00,000		
	<u>36,20,000</u>		<u>36,20,000</u>

Working Note 2:

Sacrifices:

Equity shareholders (20,00,000 × 90%)	Rs.	Rs.
Debentureholders (11,20,000 – (4,90,000 + 2,50,000))		18,00,000
Creditors (5,00,000 – 3,00,000)		3,80,000
		<u>2,00,000</u>
		23,80,000
Less: Losses to be written off:		
Profit & Loss A/c	9,70,000	
Fixed assets (20,00,000 – 9,60,000)	10,40,000	
Current assets (6,50,000 – 4,80,000)	1,70,000	
Capital reserve (bal. fig)		<u>2,00,000</u>

Bank Accounts

Introduction

“Bank” is a comprehensive term for a number of institutions carrying on certain kinds of financial business. In a narrow sense, it may be defined as the place for keeping money and valuables safely, the money being paid out on the customer’s order, *i.e.*, cheques. The Banking Regulation Act 1949 defines banking as “accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise”. Therefore any company which engages itself in the manufacture of goods or carries on any trade and accepts deposits of money from the public for financing its business activities will not be treated as doing business of banking. Till 1949, there was no special legislation to regulate banking companies but since that year the Banking Regulation Act applies to corporate entities carrying on the business of banking in India. Such Companies are also subject to the Companies Act 1956. All the nationalised banks are also governed by the Banking Regulation Act but regulations regarding appointment of directors and disposal of profits etc., do not apply to them.

Business of Banking Companies

A bank deals in money. It buys and sells money in the same way as a trader buys goods for resale at a profit. It buys money from depositors and sells it to borrowers. Section 6 of the Banking Regulation Act contains a detailed list of the forms of business a banking company may carry on, in addition to its banking business. These forms of business are:

- (i) Borrowing, raising or taking up of money;
- (ii) Lending or advancing money;
- (iii) Drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes and other instruments;
- (iv) Granting and issuing of letters of credit, traveller’s cheques and circular notes;
- (v) Buying, selling and dealing in bullion,
- (vi) Buying and selling, on commission, underwriting and dealing in stock, shares, debentures, bonds, etc.

- (vii) Receiving of all kinds of scrips or valuables on deposit or for safe custody;
- (viii) Providing of safe deposit vaults;
- (ix) Collecting and transmitting of money and securities;
- (x) Carrying on and transacting every kind of guarantee and indemnity business;
- (xi) Undertaking and executing trusts;
- (xii) Undertaking the administration of estates as executor, trustee or otherwise;
- (xiii) Contracting for public and private loans and negotiating and issuing the same;
- (xiv) The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purpose of the company;
- (xv) Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into accounts or otherwise dealing with all or any part of the property and rights of the company;
- (xvi) Acquiring and undertaking the whole or any part of the business of any person or company when such business is of a nature enumerated or described in this sub-section.
- (xvii) Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;
- (xviii) Any other form of business which the Central Government may, by notification in the 'Official Gazette', specify as a form of business in which it is for a banking company to engage.

In this chapter, we are mainly concerned with the technique of preparing the final accounts of the banking companies;

Legal Requirements

The important provisions relating to final accounts of a banking company are as follows:

(1) *Prescribed form*: As per Section 29 to 33 of the Banking Regulation Act, every banking company is required to prepare a balance sheet in accordance with Form A set out in the Third Schedule and a Profit and Loss Account in conformity with form 15 of the same schedule. The formats have been revised w.e.f 1st April 1991. In other words, the final accounts for the year ending 31st March 1992 and onwards are to be prepared in the new formats.

(2) *Accounting Year*: On account of the amended provision of the Income Tax Act 1961 requiring every company to close its accounts on 31st March each year, w.e.f financial year ending 31st March 1989, now a banking company also closes its accounts on 31st March each year.

(3) *Prohibition of Trading*: According to Sec. 8, a banking company cannot directly or indirectly deal in the business of buying or selling or bartering of goods, except in connection with the realisation of security given to or held by it or 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 for the administration of estates as executor, trustee or otherwise.

(4) *Non-banking assets*: A banking company may have to take possession of certain assets charged in its favour on account of the failure of a debtor to repay the loan in time. According to Sec. 9, a banking company cannot hold any immovable property however acquired, except for its own use, for any period exceeding seven years from the date of acquisition thereof. Gain or loss on sale of such an asset has to be shown separately in the Profit & Loss Account of the banking company.

(5) *Share capital*: In order to ensure that no banking company commences or carries on business with a weak and vulnerable capital structure, Section 11 lays down the following minimum limits of paid up capital and reserves to be complied with by a banking company which wishes to commence or carry on business in India.

<i>Types of Banking</i>		<i>Aggregate value of paid up capital and reserves</i>
		Rs.
(1) <i>In the case of a banking company incorporated outside India:</i>		
(a) If it has a place or places of business in the city of Bombay or Calcutta or both		20 lakhs
(b) If it has places of business elsewhere		15 lakhs
(2) <i>In the case of a banking company incorporated in India:</i>		
(a) If it has places of business in more than one State and if it has a place or places of business in Bombay or Calcutta or both		10 lakhs
(b) If it has place of business in more than one state but not in Bombay or Calcutta		5 lakhs
(c) If it has all its places of business in one State none of which is situated in the city of Bombay or Calcutta – for the principal place of business		10 lakhs
plus		
(i) in respect of each of its other places of business situated in the same district		10,000
plus		
(ii) in respect of each place of business situated elsewhere in the state otherwise than in the same district		25,000
Subject to an overall limit of 5 lakhs		
(d) If it has one place of business and that also not in Bombay or Calcutta		50,000
(e) If it has all its places of business in one State or more which is or are situated in the city of Bombay or Calcutta		5 lakhs
plus		
in respect of each place of business situated outside the city of Bombay or Calcutta as the case may be		25,000
Subject to an overall limit of		10 lakhs

The above requirements apply to those banks which were established before 1962. The Banking Companies (Amendment) Act 1962 raised the minimum amount of the value of the paid up capital to Rs. 5 lakhs for any Indian bank commencing business after the commencement of that Act.

(6) *Reserve Fund*: Every banking company incorporated in India is required under Section 17(1) of the Act to create a Reserve Fund and to transfer to such fund, before any dividend is declared, a sum equal to not less than 25% of the profit, as disclosed in the Profit and Loss Account. Such reserve is termed as "statutory reserve". This Section does not apply to banking companies incorporated outside India. The Central Government may, on the recommendation of the Reserve Bank, exempt a banking company from this restriction if the aggregate amount of reserves and share premium amount is not less than the paid up capital of the banking company.

(7) *Payment of Dividend*: Section 15 prohibits payment of dividend by any banking company until all of its capitalised expenses have been completely written off. These capitalised expenses include preliminary expenses, organisation expenses, share-selling commission, brokerage, amounts of losses incurred and any other expenditure which is not represented by tangible assets. Payment of dividend out of the profits is considered inappropriate when capitalised expenses are outstanding.

A banking company may, however, pay dividends on its shares without writing off the following:

- (i) Depreciation in the value of its investments in approved securities where such depreciation has not actually been capitalised or otherwise accounted for as loss.
- (ii) Depreciation in the value of its investments in shares, debentures or bonds (other than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditors of the banking company.
- (iii) Bad debts, if any, where adequate provision has been made to the satisfaction of the auditors of the banking company (Section 15)

(8) *Payment of commission, Brokerage, etc.*: According to Sec. 13, a banking company cannot pay out directly or indirectly any commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, exceeding $2\frac{1}{2}$ % of the paid up value of the shares.

(9) *Charge on Uncalled Capital*: Under Sec. 14, a banking company cannot create any charge on unpaid capital and any such charge is invalid.

Under Sec. 14A, banking company cannot create a floating charge on the undertaking or any property of the bank except with the written permission of the Reserve Bank of India certifying that the charge will not be detrimental to the interest of the depositors.

(10) *Subsidiary companies*: In order to prevent the banking company from carrying on trading activities indirectly by acquiring controlling interest, it has been provided that a banking company can form a subsidiary company only for one or more of the following purposes:

- (i) The undertaking and executing of trust;
- (ii) The undertaking of the administration of estates as executor, trustee or otherwise;
- (iii) The carrying on business of banking exclusively outside India, with the prior permission of the Reserve Bank.
- (iv) Such other purposes as are incidental to banking business (Section 19)

(11) *Cash Reserves*: Under Sec. 18 every banking company (not being a Scheduled bank) shall maintain a cash reserve with itself or with the Reserve Bank or the State Bank of India or any other bank notified by the Central Government in this behalf a sum equal to at least 3% of its time and demand liabilities in India.

Under Sec. 42, a Scheduled bank is also required to maintain with the Reserve Bank, an average daily balance of 3% of its total time and demand liabilities in India. The Reserve Bank has the power to increase this percentage upto 20% by a notification in the official gazette (At present CRR is 7.5% w.e.f. 10.11.2007).

(12) *Statutory Liquidity Ratio*: According to Sec. 24 (2A) of the Banking Regulation Act, every banking company in India whether scheduled or non-scheduled, is required to maintain in India in cash, gold, or unencumbered approved securities an amount which is not less than 25% of the total of its demand and time liabilities in India. This is known as "Statutory Liquidity Ratio". The Reserve Bank has the power to increase this ratio upto 40%. At present, the norm for S.L.R, as per RBI is 25%.

(13) *Loans and Advances*: Section 20 of the Banking Regulation Act, imposes certain restrictions on the loans granted by banks to persons connected with their management. This section as amended by the Amending Act of 1968 is as follows:

- (a) No banking company can grant loans and advances on the security of its own shares;
- (b) The banking company should not enter into any commitment for giving any loan or advance to:
 - (i) any of its directors;
 - (ii) to a firm in which any of its directors is interested as partner, manager, employee or guarantor.
 - (iii) To any company of which any of the directors of the banking company is a director, manager, guarantor or
 - (iv) To any individual with whom any of its directors is a partner or a guarantor.

(14) *Limits as to Investments in Shares and Debentures:* Reserve Bank of India has removed limits on investments made by the banks in the equity and debentures issues of 17 financial institutions. These include IDBI, IFCI, ICICI, EXIM Bank of India, IRBI, NABARD, NHB, UTI, LIC, GIC, RCTFC, TDICI, Tourism Finance Corporation of India, etc.

The above restrictions on granting of loans and advances were introduced by an amendment in 1968 in the Banking Regulation Act.

PREPARATION OF PROFIT AND LOSS ACCOUNT

Banks are required to prepare final accounts for each financial year. *i.e.*, their books are closed each year on 31st March. But for internal purpose, banks usually close their books on 30th September called half yearly closing. The Profit & Loss Account of a banking company has to be prepared in Form 'B' of Schedule III, attached to the Banking Regulation Act 1949. Form 'B' is given below:

Form 'B'

Third Schedule

Form of Profit and Loss Account

Profit and Loss Account for the year ended 31st March (000's omitted)

	Schedule No.	Year ended on 31.3..... (current year) Rs.	Year ended on 31.3..... (previous year) Rs.
I. Income:			
Interest earned	13	XXXX	
Other income	14	XXXX	
Total			
II. Expenditure:			
Interest expended	15	XXXX	
Operating expenses	16	XXXX	
Provisions and contingencies		XXXX	
Total			
III Profit/Loss:			
Net Profit/Loss (-) for the year		XXXX	
Profit/Loss (-) brought forward		XXXX	
Total			
IV. Appropriations:			
Transfer to statutory reserves		XXXX	
Transfer to other reserves		XXXX	
Transfer to Govt. /proposed dividend		XXXX	
Balance carried over to balance sheet		XXXX	
Total			

Schedules to be annexed with Profit and Loss Account

Schedule 13: Interest Earned

	Year ended on 31.3.... (current year) Rs. in '000	Year ended 31.3.... (previous year) Rs. in '000
I. Interest/Discount on Advances/Bills	xxxx	
II. Income on investments	xxxx	
III. Interest on balances with RBI and other inter-bank funds	xxxx	
IV. Others	xxxx	
Total		

Schedule 14: Other Income

	Year ended on 31.3.... (current year) Rs. in '000	Year ended 31.3.... (previous year) Rs. in '000
I. Commission, Exchange and Brokerage	xxxx	
II. Profit on sale of investments	xxxx	
Less: Loss on sale of investments	xxxx	xxxx
III. Profit on revaluation of investments	xxxx	
Less: Loss on revaluation of investments	xxxx	xxxx
IV. Profit on sale of Land/Building and other assets	xxxx	
Less: Loss on sale of Land, Building and other assets	xxxx	xxxx
V. Profit on Exchange transactions	xxxx	
Less: Loss on Exchange transactions	xxxx	xxxx
VI. Income earned by way of dividends etc. from Subsidiaries/Companies and or Joint Venture abroad/in India		xxxx
VII. Miscellaneous Income	xxxx	
Total		

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

Schedule 15: Interest Expended

	Year ended on 31.3.... (current year) Rs. in '000	Year ended 31.3.... (previous year) Rs. in '000
I. Interest on Deposits	xxxx	
II. Interest on RBI/Inter-Bank Borrowings	xxxx	
III. Others	xxxx	
Total		

	on 31.3.... (current year) Rs. in '000	31.3.... (previous year) Rs. in '000
I. Payments to and provisions for employees	XXXX	XXXX
II. Rent, taxes and lighting	XXXX	XXXX
III. Printing and Stationery	XXXX	XXXX
IV. Advertisement and Publicity	XXXX	XXXX
V. Depreciation on bank's property	XXXX	XXXX
VI. Directors' fees, allowances and expenses	XXXX	XXXX
VII. Auditor's fees, allowances and expenses	XXXX	XXXX
VIII. Law charges	XXXX	XXXX
IX. Postage, telegrams, telephones, etc.	XXXX	XXXX
X. Repairs & Maintenance	XXXX	XXXX
XI. Insurance	XXXX	XXXX
XII. Other expenditure	XXXX	XXXX
Total	_____	_____

GUIDELINES OF RBI FOR PROFIT AND LOSS ACCOUNT

I. Interest Earned (Schedule 13)

- (a) *Interest/Discount on advances/bills*: It includes interest and discount on all types of loans and advances like cash credits, demand loans, overdrafts, export loans, loans, domestic and foreign bills purchased and discounted (including those rediscounted), over due interest and also interest subsidy, if any, relating to such advances/bills.
- (b) *Income on Investments*: It includes all income derived from the investment portfolio by way of interest and dividend.
- (c) *Interest on Balances with RBI and other inter bank funds*: It includes interest on balances with Reserve Bank and other banks, call loans, money market placements, etc.
- (d) *Others*: It includes any other interest/discount income not included in the above heads.

II. Other Income (Schedule-14)

- (a) *Commission, exchange and brokerage*: It includes all remuneration on services such as commission on collections, commission/exchange on remittances and transfers, commission on letters of credit, letting out of lockers and guarantees, commission, on Government business, commission on other permitted agency business including consultancy and other services, brokerage, etc., on securities. It does not include foreign exchange income.

provisions of the total income particulars may be given in the notes.

V. Provisions and contingencies

It includes all provisions made for bad and doubtful debts, provision for taxation, provision for diminution in the value of investments, transfers to contingencies and other similar items.

BALANCE SHEET

The Balance Sheet of a banking company has to be prepared in Form 'A' of Schedule III attached to the Banking Regulation Act 1949. Form 'A' is reproduced as follows:

Form A

Form at Balance Sheet

Balance Sheet of (here enter name of the banking company) as on 31.3. (year) (000's omitted)

	Schedule No.	As on 31.3.... (current year) Rs.	As on 31.3... (previous year) Rs.
Capital and Liabilities:			
Capital	1		
Reserves and surplus	2		
Deposits	3		
Borrowings	4		
Other liabilities and provisions	5		
Total		_____	_____
Assets			
Cash and balance with RBI	6		
Balance with banks and money at call and short notice	7		
Investments	8		
Advances	9		
Fixed assets	10		
Other assets	11		
Total		_____	_____
Contingent liabilities	12		
Bills for collection			

Schedule 1 : Capital

(000's omitted)

	As on 31.3.... (current year) Rs.	As on 31.3... (previous year) Rs.
1. For Nationalised banks		
Capital (fully owned by Central Govt.)		
Total	_____	_____
II. For banks incorporated outside India		
Capital		
(i) (The amount bought in by banks by way of start-up capital as prescribed by RBI should be shown under this head)		
(ii) Amount of deposit kept with the RBI under section 11(2) of the Banking Regulation Act. 1949		
Total	_____	_____
(iii) For other banks		
Authorised capital (shares of Rs. ... each)		
Issued capital (shares of Rs. ... each)		
Subscribed capital (shares of Rs.... each)		
Called up capital (shares of Rs. ... each)		
Less: Calls unpaid		
Add: Forfeited shares		
	_____	_____

Schedule 2 : Reserves and surplus (000's omitted)

	As on 31.3... (current year) Rs.	As on 31.3... (previous year) Rs.
(i) Statutory Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
(ii) Capital Reserve		
Opening balance		
Additions during the year		
Deductions during the year		
(iii) Share premium		
Opening Balance		
Additions during the year		
Deductions during the year		
(iv) Revenue and other Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
(v) Balance in Profit and Loss Account		
Total (i, ii, iii, iv & v)	_____	_____

Schedule 3 : Deposits

	As on 31.3... (current year) Rs.	As on 31.3... (previous year) Rs.
A. I. Demand Deposits		
(i) From Banks		
(ii) From others		
II. Savings bank deposits		
III. Term deposits		
(i) From banks		
(ii) From others		
Total (I, II and III)	_____	_____
B. (i) Deposits of branches in India	_____	_____
(ii) Deposits of branches outside India	_____	_____
Total	_____	_____

Schedule 4 : Borrowings

	As on 31.3... (current year) Rs.	As on 31.3... (previous year) Rs.
I. Borrowing in India		
(i) Reserve Bank of India		
(ii) Other Banks		
(iii) Other institutions and agencies		
II. Borrowings outside India		
Total (I and II)	_____	_____
Secured borrowings included in I and II above – Rs.	_____	_____

Schedule 5: Liabilities and Provisions

(000's omitted)

	As on 31.3... (current year) Rs.	As on 31.3... (previous year) Rs.
I. Bills payable		
II. Inter-office adjustments (net)		
III. Interest accrued		
IV. Others (including provisions)		
Total		

Schedule 6: Cash and Balances with Reserve Bank of India

	As on 31.3... (current year) Rs.	As on 31.3... (previous year) Rs.
I. Cash in hand (including foreign currency notes)		
II. Balances with Reserve Bank of India		
(i) In Current account		
(ii) In other accounts		
Total (I and II)		

Schedule 7: Balances with banks and money at call and short notice

	As on 31.3... (current year) Rs.	As on 31.3... (previous year) Rs.
I. In India		
(i) Balance with banks		
(a) In current accounts		
(b) In other deposit accounts		
(ii) Money at call and short notice		
(a) With banks		
(b) With other institutions		
Total (I and II)		
II. Outside India		
(i) In Current accounts		
(ii) In other deposit accounts		
(iii) Money at call and short notice		
Total (I, II & III)		
Grand total (I and II)		

Schedule 8 : Investments

(000's omitted)

	As on 31.3... (current year) Rs.	As on 31.3... (previous year) Rs.
I. Investments in India in		
(i) Government securities		
(ii) Other approved securities		
(iii) Shares		
(iv) Debentures and bonds		
(v) Subsidiaries and/or joint ventures		
(vi) Other investments (to be specified)		
Total		
II. Investments outside India in		
(i) Government securities (including local authorities)		
(ii) Subsidiaries and/or joint venture abroad		
(iii) Other investments (to be specified)		
Total		
Grand Total (I and II)		

Schedule 9 : Advances

	As on 31.3... (current year) Rs.	As on 31.3... (previous year) Rs.
A.		
(i) Bills purchased and discounted		
(ii) Cash credits overdrafts and loans repayable on demand		
(iii) Term loans		
Total		
B.		
(i) Secured by tangible assets		
(ii) Covered by Bank/Government guarantees		
(iii) Unsecured		
Total		
C. I. Advances in India		
(i) Priority sectors		
(ii) Public sector		
(iii) Banks		
(iv) Others		
Total		
II. Advance outside India		
(i) Due from banks		
(ii) Due from others		
(a) Bills purchased and discounted		
(b) Syndicated loans		
(c) Others		
Total		
Grand Total (I and II)		

12.15

Schedule 10 : Fixed Assets

(000's omitted)

	As on 31.3... (current year) Rs.	As on 31.3... (previous year) Rs.
I. Premises At cost on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date		
II. Other Fixed assets (including furniture and fixtures) At cost as on 31st March at the preceding year Additions during the year Deductions during the year Depreciation to date		
Total (I and II)		

Schedule 11 : Other Assets

	As on 31.3... (current year) Rs.	As on 31.3... (previous year) Rs.
I. Inter-office adjustments (net)		
II. Interest accrued		
III. Tax paid in advance/ tax deducted at source		
IV. Stationery and stamps		
V. Non-banking assets acquired in satisfaction of claims		
VI. Others		
Total		

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

Schedule 12 : Contingent Liabilities

	Year ending As on 31.3... (current year) Rs.	Year ending As on 31.3... (previous year) Rs.
I. Claims against the bank not acknowledged as debts		
II. Liabilities for partly paid investments		
III. Liabilities on account of outstanding forward exchange contracts		
IV. Guarantees given on behalf of constituents (a) India (b) Outside India		
V. Acceptance endorsements and other obligations		
VI. Other items for which the bank is contingently liable		
Total		

GUIDELINES OF RBI FOR BALANCE SHEET**I. Capital (Schedule 1)****(I) Nationalised banks:**

- (a) Capital (fully owned by Central Government): The capital owned by Central Government as on the date of the balance sheet including contribution from Government, if any, for participating in World Bank projects should be shown.
- (b) Banking Companies incorporated outside India: (i) The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head:
- (c) The amount of deposit kept with RBI, under Sub-Section 2 of Section 11 of the Banking Regulation Act 1949 should also be shown.

II. Other Banks: (Indian)

Authorised, issued, subscribed, called up capital should be given separately. Calls-in-arrears will be deducted from called up capital while the paid up value of forfeited shares should be added thus arriving at the paid up capital. Where necessary items which can be combined should be shown under one head for instance "issued and subscribed capital".

Note: The changes in the above items, if any, during the year, say, fresh contribution made by Government, fresh issue of capital, capitalisation of reserves etc., may be explained in the notes.

2. Reserves and Surplus (Schedule 2)

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

Note: Movement in various categories of reserve should be shown as indicated in the Schedule.

3. Deposits (Schedule 3)**A. I. Demand Deposits**

- (i) *From banks*: It includes all bank deposits repayable on demand.
- (ii) *From others*: It includes all demand deposits of the non-bank sector. Credit balance in overdraft, cash credit account, deposits, payable at call, overdue deposits, inoperative current accounts, matured time deposits and cash certificates, certificates of deposits, etc., are to be included under this category.

A. II Savings Bank Deposits

It includes all savings bank deposits (including inoperative savings bank account).

A. III Term Deposits

- (i) *From Banks*: It includes all types of bank deposits repayable after a specified term.
- (ii) *From others*: It includes all types of deposits of the non-banking sector repayable after a specified term. Fixed deposits, cumulative and recurring deposits, cash certificates, certificates of deposits, annuity deposits, deposits mobilised under various schemes, ordinary staff deposits, foreign currency non-resident deposits accounts, etc., are to be included under this category.

B (I) Deposits of Branches in India and (II) Deposits of Branches outside India:

The total of these two items will agree with the total deposits.

- Notes:**
- (a) Interest payable on deposits which is accrued but not due should not be included but shown under other liabilities.
 - (b) Matured time deposits and Cash Certificates, etc. should be treated as demand deposits.
 - (c) Deposits under special schemes should be included under term deposits if they are not payable on demand. When such deposits have matured for payment they should be shown under demand deposits.
 - (d) Deposits from banks will include deposits from the banking system in India, co-operative banks, foreign banks which may or may not have a presence in India.

4. Borrowings (Schedule 4)**(I) Borrowings in India**

- (i) *Reserve Bank of India*: It includes borrowings/refinance obtained from Reserve bank of India.
- (ii) *Other banks*: It includes borrowings/refinance obtained from commercial banks (including co-operative banks).

(iii) *Other Institutions and Agencies*: It includes borrowings/refinance obtained from IDBI, EXIM Bank of India, NABARD and other institutions, agencies (including liability against participation certificates if any).

II Borrowings outside India

It includes borrowings of Indian branches abroad as well as borrowings of foreign branches.

Secured borrowings included above: This term will be shown separately. It includes secured borrowings/refinance in India and outside India.

Notes:

- (i) The total of I and II will agree with the total borrowings shown in the Balance Sheet.
- (ii) Inter-office transactions should not be shown as borrowings.
- (iii) Funds raised by foreign branches by way of certificates of deposits, notes, bonds, etc., should be classified depending upon documentation, as "deposits" "borrowings" etc.
- (iv) Refinance obtained by banks from RBI and various institutions are being brought under the head "borrowings". Hence advances will be shown at the gross amount on the asset side.

(5) Other Liabilities and Provisions (Schedule 5)

(I) Bills payable

It includes drafts, telegraphic transfers, travellers cheques, mail transfers payable, pay slips, bankers cheque and other miscellaneous items.

(II) Inter-office adjustments (net)

The inter-office adjustments balance, if in credit, should be shown under this head. Only net position of inter-office accounts, inland as well as foreign, should be shown here.

(III) Interest accrued

It includes interest accrued but not due on deposits and borrowings.

IV Others (including provisions)

It includes the net provision for income tax and other taxes like interest tax (less advance payment, tax deducted at source, etc.), surplus in aggregate in provisions for bad debts account, surplus in aggregate in provisions for depreciation in securities. Contingency funds which are not disclosed as a reserve but are actually in the nature of reserves, proposed dividend/transfer to Government, other liabilities which are not disclosed under any of the major heads such as unclaimed dividends, provisions and funds kept for specific purposes, unexpired discount, outstanding charges like rent, conveyance etc., certain types of deposits like staff security deposits, margin deposits etc. where the repayment is not free, should also be included under this head.

Notes:

- (i) For arriving at the net balance of inter-office adjustments all connected inter-office accounts should be aggregated and the net balance only will be shown, representing mostly items in transit and unadjusted items.
- (ii) The interest accruing on all deposits, whether the payment is due or not, should be treated as a liability.
- (iii) It is proposed, to show only pure deposits under this head 'deposits' and hence all surplus provisions for bad and doubtful debts, contingency funds, secret reserves, etc., which are not netted off against the relative assets, should be brought under the head "others (including provisions)".

(6) Cash and Balance with the Reserve Bank of India (Schedule - 6)

I Cash in hand (including foreign currency notes)

II Balance with RBI

(a) in current account;

(b) in other accounts.

It includes cash in hand including foreign currency notes and also of foreign branches in the case of banks having such branches.

(7) Balance with Banks and Money at call and short notice (Schedule - 7)

(I) In India

(i) Balance with banks (a) in current accounts; (b) in other deposit accounts. It includes all balances with banks in India (including co-operative banks). Balances in current accounts and deposit accounts should be shown separately.

(ii) Money at call and short notice: (a) With banks (b) With other institutions. It includes deposits repayable within 15 days or less than 15 days notice lent in the inter-bank call money market.

II Outside India

(i) Current accounts (ii) Deposit accounts

They include balances held by foreign branches and balances held by Indian branches of the banks outside India. Balances held with foreign branches by other branches of the bank should not be shown under this head but should be included in inter-branch accounts. The amount held in "current accounts" and "deposit accounts" should be shown separately.

(iii) Money at call and short-notice: It includes deposits usually classified in foreign countries as money at call and short notice.

(8) Investments (Schedule - 8)

I Investments in India

(i) *Government Securities:* It includes Central and State Government securities and Government treasury bills. These securities should be shown at the book value. However, the difference between the book value and market value should be given in the notes to the balance sheet.

- (ii) *Other Approved Securities*: Securities other than Government securities which according to the Banking Regulation Act 1949, are treated as approved securities, should be included here.
- (iii) *Shares*: Investment in shares of companies and corporations not included in item (ii) above should be included here.
- (iv) *Debenture and Bonds*: Investment in debentures and bonds of companies and corporations not included in items (ii) should be included here.
- (v) *Investment in Subsidiaries/Joint ventures*: Investments in subsidiaries/joint ventures (including RRBs) should be included here.
- (vi) *Others*: It includes residual investment, if any, like gold, commercial paper and other instruments in the nature of shares/debentures/bonds.

II Investment outside India

- (i) *Government securities (including local authorities)*: All foreign government securities including securities issued by local authorities may be classified under this head.
- (ii) *Subsidiaries and/or joint ventures abroad*: All investments made in the share capital of subsidiaries floated outside India and/or joint ventures abroad should be classified under this head.
- (iii) *Others*: All other investments outside India may be shown under this head.

9. Advances (Schedule 9)

- A (i) *Bills purchased and discounted*: In classification under Section 'A' all outstanding in India as well as outside – less provisions.
- (ii) *Cash credits, overdrafts and loans repayable on demand*: These will be classified under three heads as indicated and both secured and unsecured advances will be included under these heads.
- (iii) *Term loans*: Including overdue instalments.
- B (i) *Secured by tangible assets*: All advances or part of advances which are secured by tangible assets may be shown here. The item will include advances in India and outside India.
- (ii) *Covered by Bank/Government guarantee*: Advances in India and outside India to the extent they are covered by guarantee of Indian and foreign governments and Indian and foreign banks and DICGC & ECGC are to be included.
- (iii) *Unsecured*: All advances not classified under (i) and (ii) will be included here.

Total of 'A' should tally with the total of 'B'.

C (I) Advances in India

- (i) Priority sectors
- (ii) Public Sector
- (iii) Banks
- (iv) Others

Advances should be broadly classified into 'Advances in India' and 'Advances outside India'. Advances in India will be further classified on the sectoral basis as indicated. Advances to sectors which for the time being are classified as priority sectors according to the instructions of the Reserve Bank are to be classified under the head 'priority sectors'.

C (II) Advances outside India

- (i) Due from banks
- (ii) Due from others
 - (a) Bills purchased and discounted
 - (b) Syndicate loans
 - (c) Others.

Such advances should be excluded from item (ii) *i.e.*, advances to public sector. Advances to Central and State Governments and other undertakings including Government companies and corporations which are, according to the status, to be treated as public sector companies are to be included in the category "public sector". All advances to the banking sector including co-operative bank will come under the head 'banks'. All the remaining advances will be included under the head 'others' and typically this category will include non-priority advances to the private, joint and co-operative sectors.

Notes:

- (i) The gross amount of advances including refinance and rediscouts but excluding provisions made to the satisfaction of auditors should be shown as advances.
- (ii) Term loans will be loans not repayable on demand.
- (iii) Consortium advances would be shown net of share from other participating banks/institutions.

10. Fixed Assets (Schedule 10)

I Premises

- (i) At cost as on 31st March of the preceding year
- (ii) Additions during the year
- (iii) Deductions during the year
- (iv) Depreciation

Premises wholly or partly owned by the banking company for the purpose of business including residential premises should be shown against 'premises'. In the case of premises and other fixed assets, the previous balance, additions thereon and deductions therefrom during the year as also the total depreciation written off should be shown. Where sums have been written off on reduction of capital or revaluation of assets, every balance sheet after the first balance sheet subsequent to the reduction or revaluation should show the revised figures for a period of five years with the date and amount of the revision made.

II Other Fixed Assets (including furniture and fixtures)

- (i) At cost on 31st March of the preceding year
- (ii) Additions during the year
- (iii) Depreciation to date

Motor vehicles and other fixed assets other than premises but including furniture should be shown under this head.

II. Other Assets (Schedule 11)

I. *Inter-office adjustments (net)*: The inter-office adjustments balance, if in debit, should be shown under this head. Only net position of inter-office accounts, in land as well as foreign should be shown here. For arriving at the net balance of inter-office adjustment accounts, all connected inter-office accounts should be aggregated and the net balance, if in debit, only should be shown representing mostly items in transit and unadjusted items.

II. *Interest accrued*: Interest accrued but not due on investments and advances and interest due but not collected on investments will be the main components of this item. As banks normally debit the borrower's accounts with interest due on the balance sheet date, usually there may not be any amount of interest due on advances. Only such interest as can be realised in the ordinary course should be shown under this head.

III. *Tax paid in advance/tax deducted at source*: The amount of tax deducted at source on securities, advance tax paid etc., to the extent that these items are not set off against relative tax provisions should be shown against this item.

IV. *Stationery and Stamps*: Only exceptional items of expenditure on stationery like bulk purchase of security paper, loose leaf or other ledgers, etc., which are shown as quasi-asset to be written off over a period of time should be shown here. The value should be on a realistic basis and cost escalation should not be taken into account as these items are for internal use.

V. *Non-banking assets acquired in satisfaction of claims*: Immovable properties/tangible assets acquired in satisfaction of claims are to be shown under this head.

VI. *Others*: This will include items like claims which have not been met, for instance, clearing items, debit items representing addition to assets or reduction in liabilities which have not been adjusted for technical reasons, want of particulars etc., advances given to staff by a bank as an employer and not as a banker, etc. Items which are in the nature of expenses which are pending adjustments should be provided for and the provision netted against this item so that only realisable value is shown under this head. Accrued income other than interest may also be included here.

12. Contingent Liabilities (Schedule 12)

- I. Claims against the bank not acknowledged as debts
- II. *Liability for partly paid investments*: Liabilities on partly paid shares, debentures, etc., will be included under this head.
- III. *Liability on account of outstanding forward exchange contract*: Outstanding forward exchange contracts may be included here.
- IV. *Guarantees given on behalf of constituents* : Guarantees given for constituents in India and outside India may be shown separately.
 - (i) In India (ii) Outside India
- V. *Acceptances, endorsements and other obligations*: This item will include letters of credit and bills accepted by the bank on behalf of customers.
- VI. *Other items for which the bank is contingently liable*: Arrears of cumulative dividends, bills rediscounted under underwriting contracts, estimated amounts of contracts remaining to be executed on capital account and not provided for etc., are to be included here.

Bills for collection: Bills and other items in the course of collection and not adjusted will be shown against this item in the summary version only. No separate Schedule is proposed.

Items requiring special attention in preparation of final accounts

The following items require special treatment while preparing final accounts of a bank:

1. *Rebate on bills discounted*: This is also termed as "unexpired discount" or "discount received but not earned".

Bills discounted may have maturity date beyond the current accounting year. The amount of discount relating to the period of a bill falling in the next accounting year is the unexpired discount. In other words, this is the unearned amount of discount received for those bills that will mature after the date of closing the final accounts. For example, if a bill is discounted on 1.12.98 for 3 months at Rs. 6,000 and accounts are closed on 31st December 1998, Rs. 4,000 is the unexpired discount because it relates to two months in 1999.

While closing annual accounts, the rebate on bills discounted is reduced from discount received and it is shown under "other liabilities" in the Balance Sheet. The entry is:

		Rs.	Rs.
	Dr	x	
Discount A/c			x
To Rebate on bills discounted A/c			

[with the amount of unearned discount relating to the next period]

The rebate on bills discounted at the beginning is added to the discount income and the rebate on bills discounted at the end is deducted to find out the net discount income.

If it is given in Trial Balance, it means that it is already adjusted from discount, then it is shown only in the balance sheet. However, if adjustment has to be done after preparation of the Trial Balance in respect of rebate on bills discounted, the amount of unearned discount will be deducted from the total discount in the Profit & Loss Account and will also appear as a liability in the balance sheet.

(2) *Bad debts and provision for doubtful debts:* The business of a banking company depends on public confidence. In order to ensure that this confidence is not impaired, the banks are given a special privilege permitting them not to show in their published accounts bad debts and provisions for doubtful debts. While preparing final accounts, the amount of bad debts and provision for bad debts has to be charged under the heading "provision & contingencies" in the Profit & Loss Account and in the Balance Sheet, the advances are shown after deducting both, bad debts and provision for bad debts.

(3) *Provision for taxation and Income tax:* Provision for taxation is also not disclosed in the final accounts. The amount of provision for taxation has to be charged to the Profit & Loss Account. Under the heading 'Provisions and Contingencies' in the Balance sheet, it will be shown under the heading 'other liabilities and provisions' on the liabilities side. On payment of tax, the amount will be debited to the provision account.

(4) *Interest on Doubtful Debts:* At the time of finalising accounts of a bank, some advances may be doubtful of collection. Interest on such advances cannot be termed as income. Interest earned by a banking company on doubtful debts can be treated in any of the following ways in the accounts of a banking company:

(i) *Interest suspense method:* Under this method, interest on doubtful debts is debited to the loan account and credited to interest suspense account. To the extent interest is received in cash the amount is transferred to interest account and the balance to the loan account. The loan account is closed by transferring the balance to bad debts account.

(ii) *Cash basis:* Under this method, no entry is passed for such interest till it is actually received.

(iii) *Accrual method:* Under this method, interest account may be credited with the full amount of interest due on doubtful debts and simultaneously an adequate provision for bad and doubtful debts may be credited.

It may be noted, as discussed earlier, that the doubtful debts come within the category of non-performing assets and therefore interest income on such doubtful debts should not be recognised and taken to the Profit and Loss Account. The method (ii) is therefore best under the present circumstances.

5. *Money at call and short notice:* This means amount lent should be repayable at call or at short notice. These loans are given to bill brokers, stock brokers and other banks for a short period. When the banks have surplus money with them, they advance their surplus to another banker under this category. At any time, or

by giving a short notice, the money will be repaid by the borrower. The rate of interest will depend on the current money market condition. This item appears on the asset side of a bank balance sheet under Schedule 7, "balance with banks and money at call and short notice".

6. *Investments*: Investments include (a) Central and State Government Securities, trustee securities, treasury bills (b) shares, (c) debentures or bonds and (d) securities of foreign governments, shares of U.T.I., gold. The value of investment is determined in the following manner:

- (i) Investment in Government and other approved securities in India are valued at the lower of cost or market value.
- (ii) Investment in subsidiary companies and Associate Companies (i.e., Companies in which the bank hold atleast 35% of the share capital) have been accounted for on the historical cost basis.
- (iii) All other investments are valued at the lower of cost or market value.

7. *Advances*: Advances appear on the asset side of the bank balance sheet under Schedule 9 and include loans, cash credits, bank overdrafts and bills discounted and purchased. Banks generally advance money to their customers in the form of loans, cash credits, overdrafts and purchasing and discounting of bills.

(a) *Cash credit*: Under this account, the bank gives loans to borrowers against certain security. But the entire loan is not given at one particular time.

What the bank does is that it opens the account in the name of debtor and allows him to withdraw the money from time to time upto a certain limit determined by the value of the stocks kept in the debtors godowns. The godown remains in the possession of the bank. The debtor continues to withdraw small sums of money according to his requirement but he cannot exceed the credit limit allowed to him. The bank, however, charges interest only in the amount withdrawn from the account.

(b) *Overdraft*: When a current account holder is permitted by the banker to draw more than what stands to his credit, such an advance is called an overdraft. The banker may take some collateral security or may grant such advance on the personal security of the borrower. The customer is permitted to withdraw the amount as and when he needs it and to repay it by means of deposit in his account as and when it is feasible for him. Interest is charged on the exact amount overdrawn by the customer and for the period of its actual utilisation.

(c) *Loan*: Under this method, the bank gives a specified sum of money to a person or a firm against some collateral security. The loan money is credited to the account of the borrower and the borrower can withdraw the money from the account according to his requirements. Interest is charged on the total amount of the loan agreed to be paid to a customer whether he uses the full amount of the loan or not. So, customers prefer to avail cash

- credit and pay interest at a little higher rate as they find it convenient to use the whole amount of the loan immediately.
- (d) **Discounting of bills:** Discounting of bills means making payment for the bill before its maturity date. If the holder of a bill needs money immediately, he can get it discounted by the bank. After deducting its commission, the bank pays the present prices of the bill to the holder. When the bill matures, the bank can secure its payment from the property which had accepted the bill.
- (e) **Purchasing and discounting of bills:** The bank may purchase or discount clean or documentary bills at the current rate of interest.
- (i) **Clean bills:** These are the bills to which no documents such as bill of lading, insurance policy, etc. are attached.
- (ii) **Documentary bills:** These bills are supported by documents such as bill of lading, insurance policy, etc. These bills are secured as in case of non-payment of the bill, the bank can attach the goods.

Classification of Bank Advances :

The Usual practice in all Banks was to recognise income from advances on "Accrual Basis" and take credit for interest accrued on all loans, over drafts etc while closing books for an accounting year. This was the case even with advances doubtful of recovery because it was helpful in 'window dressing' of Profits and was considered as a part of 'Bottom Line Management'.

However, in Line with International Accounting Standards, the present practice is to make a distinction between the treatment of income on different advances by classifying them into 'Performing' and 'Non performing' Assets.

Income for 'Performing Assets is recorded on accrual basis'. Income from 'Non performing Assets' is recorded only when income from them is received in cash. In this context the exact meaning of Non performing assets becomes important.

Meaning of NPA: Any asset which generates income is a 'performing asset'. An asset becomes 'non performing' when it ceases to generate income for a bank. This happens when Interest or instalment of Principal or both are not received on due dates and the delay exceeds a 'Stipulated Time'.

Reserve Bank of India (RBI) has given clear guidelines in determining when an asset becomes non performing which are briefly given below.

- (a) *Term Loans*: When Interest and / or instalment of Principal remains over due for more than 180days, it should be considered as NPA.
- (b) *Cash credits and over drafts*: When the account remains 'out of order' for more than 180days, they are to be considered as NPA. An account is out of order' if the outstanding Balance is in excess of the sanctioned limit or drawing power or there are no credits for a continuous period of 180days in the account or credits during the period are not enough to cover the interest debited.
- (c) *Bills purchased and Discounted*: If the Bill remains over due for a period of more than 180days, it should be considered as NPA.
- (d) *Agricultural Advances*: If advances to agricultural sector remain over due for two harvest seasons, not exceeding two half years, they are to be considered as NPA.
- (e) *Other Advances*: When other advances remain over due for more than 180days, they are to be considered as NPA.

NPAs are to be determined on 'Borrower basis' and not on the basis of each kind of advance separately. So, if an advance of one kind to a particular borrower becomes NPA, all other advances to him should be considered as NPAs. It is the usual Practice to determine the status of different advances on the Balance Sheet date.

The latest development regarding NPA is that RBI has instructed all Commercial Banks to classify from 1st April 1994, an Advance as NPA if it is over due or out of order etc. (as mentioned in a,b,c,d,e above) for 90 days instead of 180 days. Infact, the 90 days limit is the international practice.

Provision for NPA

For the Purpose of making provision for Non-Performing assets, different advances of a Bank are classified into four categories with variable provisions, as explained in detail below.

(a) *Standard Assets*: It refers to those assets which do not pose any problems and which do not carry more than normal risk attached to the business. They are not Non-Performing assets (NPS). Earlier no Provisions was required on standard assets. ***However from 1.7.2014, banks are required to create a provision of 0.40% on Standard assets also on global loan folio basis and not on domestic advances alone.***

(b) *Sub-Standard Assets*: With effect from 1.7.2014 a sub-standard asset is one which has been classified as NPA for a period not exceeding 18months. There is no promise of recovering the dues in full, having regard to the values of security or current net worth of the borrower/guarantor, hence the possibility of loss in realising such debts. Term loans in respect of which instalments of principals are over due for more than one year are treated as Sub-Standard Assets.

Also, the assets where terms of loans agreement regarding payment of interest and principal have been renegotiated, re-scheduled after commencement of Production, should be treated as Sub-Standard assets. These assets may again be graded upto standard asset, if atleast two years payments of Principal and interest are made according to reshcheduled terms to the satisfaction of the banks. **In the case of all substandard assets, a general Provision of 15% is to be made on total outstanding amount.**

(c) **Doubtful assets:** With effect from 1.7.2014, an asset is to be classified as doubtful, if it has remained NPA for a period exceeding 18 Months. These assets are so weak that their collection or liquidation in full is considered highly improbable. A loan classified as doubtful has all the weaknesses, make collection or liquidation in full highly questionable and improbable on the basis of currently known facts, Conditions and values.

There are two components for provision in respect of doubtful debts, they are as follows:

- (i) To the extent the debt is not covered by realisable value of the security, 100% provision is to be made.
- (ii) In addition to the above (i), for the secured portion of the doubtful assets, Provision is required to be made between 25% and 100% depending upon the period for which the asset has remained doubtful as given below:

Period for which the advance has been considered doubtful	Percentage of Provision
Upto one year	25
More than one year but upon three years	40
Above three years	100

(d) **Loss Assets:** Loss assets are those which have been identified by the bank or internal auditors or the RBI inspection but the amount has not been written off wholly or partly. These assets are uncollectible and are of such little value that it is not desirable to show them as banks assets though they may have some salvage or recovery value. These assets should be written off completely or if the assets are to be retained in the books for any reason, 100% Provision is required to be made.

8. **Bills for collection:** Customers deposit their bills with the bank to be collected on their behalf. These bills are an asset to the bank because they represent money to be collected. They are also a liability to the bank because they belong to the customers. In the new form, they are shown as a footnote after contingent liabilities in the Balance Sheet.

9. **Acceptance, endorsement and other obligations:** Bankers finance trade and commerce by accepting bills on behalf of their customers and becoming sureties by endorsement and guarantees on bills. In the case of bills accepted they become liable to third parties, while at the same time, they have a claim on

their customers. The bank enters such bills in the bills accepted register. Outstanding amount of acceptances endorsements and other obligations at the end of the year has to be shown as contingent liabilities in Schedule 12 on liabilities side of the Balance Sheet.

10. *Bills payable*: Bank offer cheap remittance facility from one place to another by means of bank drafts, cash order, circular note, letter of credit, telegraphic transfer, etc. Such items create liability for the borrowers and are shown under the head "bills payable" (i.e., under Schedule 5" other liabilities and provisions). Traveller's cheques and gift cheques issued by the bank will also be shown under this head. If the above mentioned items have not been cleared by the closing date, they will be shown under this head.

11. *Short loans*: These are the loans taken by the bank from other banks for a short period. They will be shown under the head "borrowings from other bank", (i.e., Schedule 4) on the liability side of the bank balance sheet.

12. *Contingent liabilities*: These are not liabilities of a bank on the date of a balance sheet, but can become liabilities at a future date. The contingent liabilities are shown under Schedule 12 as a footnote to the balance sheet of a bank. The following are the 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 customers.
- (e) Acceptances, endorsements and other obligations.
- (f) Other items for which the bank is contingently liable.

13. *Inter-office Adjustments*: Branch banking system involves transactions between the Head Office and its branches and also inter-branch transactions. While preparing final accounts, some branch transactions might go unrecorded in the head office books due to non-receipt of advice. Such entries are recorded in the Balance Sheet under the sub-heading "Branch Adjustments" and may appear on the asset side under the heading "other assets" (i.e., Schedule 11) if it has debit balance and on the liabilities side under the heading "other liabilities" (i.e., Schedule 5) if it has a credit balance.

ILLUSTRATIONS

Non-performing assets (N.P.A.) – Provision for doubtful debts

Illustration 1

On 31st March 2018, Bharat Commercial Bank Ltd., finds its advances classified as follows:

	(Rs.)
Standard assets	14,91,300
Sub-standard assets	92,800
Doubtful assets (secured)	
: doubtful for one year	25,660
: doubtful for one year to 3 years	15,640
: doubtful for more than 3 years	6,580
Loss assets	10,350

Calculate the amount of provision to be made by the bank against the above mentioned advances.

[Madras, B.Com (ICE) (UCYD) Oct. 2008; 1st M.Com (ICE) Oct. 2008; B.Com., B.Com (CS) Nov. 2007; B.Com (ICE) Ap 2007; M.Com (ICE) Oct. 2006]

[Thiruvalluvar, B.Com., Ap. 2007]

Solution:

	Amount (Rs.)	% required as provision	Provision (Rs.)
Standard assets	14,91,300	0.40	5965.2
Sub-standard assets	92,800	15	13,920
Doubtful assets: upto one year	25,660	25	6,415
one year to 3 years	15,640	40	6,256
more than 3 years	6,580	100	6,580
Loss assets	10,350	100	10,350
Total provision required			49,486.2

Interest on Doubtful Debts

Illustration 2

While closing the books of a bank on 31st Dec. 2019, you find in the loan ledger as unsecured balance of Rs. 2 lakhs in the account of a merchant whose financial condition is reported to you as bad. Interest on the same account amounted to Rs. 20,000 during the year. During the year 2020, the bank accepted 75 paise in the rupee on account of the debt upto 31st Dec. 2019. Give journal and ledger to record these transactions under alternative accounting policies.

[Madras, B.Com (CS) Ap. 2008; B.Com (PZ4A) Ap. 2007; M.Com (PCMA) Ap. 2007; I M.Com., Oct. 2002]

[Periyar, M.Com (CA) Ap 2005]

Rebate on bills discounted

Illustration 3

On 31st March, 2018 a bank held the following bills, discounted by it earlier:

Date of bill 2018	Term of bill (months)	Discounted @ % p.a.	Amount of bill Rs.
(i) January, 17	4	17	7,30,000
(ii) February, 7	3	18	14,60,000
(iii) March, 9	3	17.5	3,64,000

You are required to calculate the rebate on bills discounted. Also show the necessary journal entry for the rebate.

[Madras 1st M.Com., Ap. 2006 ($\frac{1}{2}$ Figs); 2nd M.Com., Oct. 2002]

[Periyar, B.Com (Old) Oct. Nov. 2005; B.Com., Ap. 2005]

Solution:

Date of bill 2018	Date of maturity 2018	No. of days away from 31.3.18	Discount Rate	Amount of bill Rs.	Discount for days after 31.12.18
January 17	May 20	50	17%	7,30,000	17,000
February 7	May 10	40	18%	14,60,000	28,800
March 9	June 12	73	17.5%	3,64,000	12,740
Closing rebate on bills					58,540

Journal

Date	Particulars	L.F.	Dr Rs.	Cr. Rs.
31.12.18	Discount Received A/c To Rebate on bills discounted A/c [Adjustment made for discount not yet earned on discounted bills]	Dr	58,540	58,540

Working notes:

Rs.

$$(i) \text{ Discount on Rs. 7,30,000 for 50 days @ 17\% p.a.} = 7,30,000 \times \frac{17}{100} \times \frac{50}{365} = 17,000$$

$$(ii) \text{ Discount on Rs. 14,60,000 for 40 days @ 18\% p.a.} = 14,60,000 \times \frac{18}{100} \times \frac{40}{365} = 28,800$$

$$(iii) \text{ Discount on Rs. 3,64,000 for 73 days @ 17.5\% p.a.} = 3,64,000 \times \frac{17.5}{100} \times \frac{73}{365} = 12,740$$

Illustration 4

The Trial Balance of the Nedungadi Bank Ltd., as on 30th June 2014 shows the following balances.

Interest and discount	Rs. 45,40,600
Rebate on bills discounted (1.7.2013)	4,750
Bills discounted and purchased	3,37,400

The unexpired discount as on 30.6.2014 is estimated to be Rs. 5,560. Draft necessary adjusting entries and calculate the amount of interest and discount to be credited to Profit and Loss Account.

[Periyar, B.Com., Ap 2006] [Madras, B.Com., B.Com (CS) Ap 2007; Nov. 2006; B.Com. (PZ4A) Nov. 2006; 1st M.Com., Ap. 2007; M.Com. (Sem - CAIA) Nov. 2005; April 2004; BCS (SY4B) Nov. 2005; B.Com (ICE) Oct. 2005; II M.Com., April 2002; B.Com., Oct. 2000]

Solution:

**Books of Nedungadi Bank Ltd.
Journal (adjustment)**

(a)

Date	Particulars	L.F	Dr	Cr
			Rs.	Rs.
	Rebate on bills discounted A/c Dr		4,750	
	To Discount A/c			4,750
	[Being transfer of opening unexpired discount to discount account]			
	Discount A/c Dr		5,560	
	To Rebate on bills discounted			5,560
	[Being closing unexpired discount out of the current year's discount]			

(b) Calculation of amount of interest and discount to be credited to Profit & Loss Account:

Interest and Discount given	Rs. 45,40,600
<i>Add:</i> Opening balance of rebate on bills discounted	4,750
	45,45,350
<i>Less:</i> Closing balance of rebate on bills discounted	5,560
Interest and discount to be credited to Profit and Loss A/c (schedule 13)	45,39,790

Illustration 5

As on 31st December 2015, the books of the Hercules bank, include among others, the following balances

	Rs.
Rebate on bills discounted (1.1.2015)	3,20,000
Discount received	46,00,000
Bills discounted and purchased	3,15,47,000

Throughout 2015, the bank's rate for discounting has been 18%.

On investigation and analysis, the average due date for the bills discounted and purchased is calculated as 14 th February, 2016.

Show the calculation of the amount to be credited to the banks Profit and Loss A/c under discount earned for the year 2015. Show also the journal entries required to adjust the above mentioned accounts.

[Madras, B.Com., (ICE) (PZG) Oct. 2008]

Solution:

	Rs.
Unexpired discount or rebate on bills on 31.12.15	
$3,15,47,000 \times \frac{18}{100} \times \frac{45}{365}$ (i.e.,) 7,00,084	
Amount to be credited to Profit & Loss A/c has been ascertained as follows:	
Balance in discount received A/c	46,00,000
<i>Add:</i> Balance in rebate account as of 1.1.15 transferred	3,20,000
	49,20,000
<i>Less:</i> Rebate on bills (31.12.15)	7,00,084
Amount to be transferred to Profit and Loss A/c	42,19,916

Journal entries

Date	Particulars	L.F	Dr	Cr
			Rs.	Rs.
2015 Dec. 31	Rebate on bills discounted A/c Dr To Discount received A/c		3,20,000	3,20,000
	[Being transfer of opening balance in the rebate A/c]			
Dec. 31	Discount received A/c Dr To Rebate on bills discounted A/c		7,00,084	7,00,084
	[Being provision for unexpired discount as on 31.12.15]			
Dec. 31	Discount Received A/c Dr To Profit and Loss A/c		42,19,916	42,19,916
	[Being transfer of discount net after adjustments]			

- (i) In schedule 13 (i.e., interest earned) prepared for Profit and Loss Account, opening Rebate on bills discounted is added and closing rebate on bills discounted is subtracted.
- (ii) In Balance sheet liabilities side under schedule 5 (i.e., other liabilities and provisions) closing rebate on bills discounted is shown as a separate item.

Preparation of Profit and Loss Account

Illustration 7

From the following particulars, prepare a Profit and Loss A/c of New bank Ltd., for the year ended 31.12.2016.

	Rs. (in '000)		Rs. (in '000)
Interest on loans	260	Interest on cash credits	225
Interest on fixed deposits	280	Rent and taxes	20
Rebate on bills discounted	50	Interest on overdrafts	56
Commission charged to customers	9	Directors' and Auditor's fees	4
Establishment expenses	56	Interest on savings	
Discount on bills discounted	200	bank accounts	70
Interest on current accounts	45	Postage and telegrams	2
Printing and advertisements	3	Sundry charges	2

[Madras, B.Com (AF) Ap 2009; B.Com (PZ4A) April 2008;
B.Com., (PZG) Nov. 2007; 1st M.Com., Ap. 2007]
[Periyar, B.Com., Ap 2005; Bharathiar, B.Com., Nov. 2004]
[Calicut, B.Com., Oct. 1987]

Solution:

New Bank Ltd.

Profit and Loss Account for the year ended 31.12.2016

	Schedule No.	Year ended 31.12.16 (Current year) Rs. (in'000)	Year ended 31.12.15 (Previous year) Rs. (in'000)
I. Income			
Interest earned	13	741	
Other income	14	9	
Total		<u>750</u>	
II. Expenditure			
Interest expended	15	395	
Operating expenses	16	87	
Provisions and contingencies			
Total		<u>482</u>	

III. Profit/Loss:		
Net Profit for the year (I - II)		268
Profit brought forward		-
	Total	<u>268</u>
IV. Appropriations:		
Transfer to statutory reserve (25% of 268)		67
Transfer to other reserves		-
Transfer to Government/proposed dividend		-
Balance carried over to balance sheet		201
		<u>268</u>

Note: Transfer to statutory reserve is now increased to 25% of Net profit from the earlier 20%.

Working notes:

Schedule 13 : Interest earned

Interest on loans	Rs. (in '000)
Discount on bills discounted	260
Interest on cash credits	200
Interest on over drafts	225
	56
Total	<u>741</u>

Note: Rebate on bills is the closing rebate and it will be shown in schedule 5 in Balance Sheet

Schedule 14 : Other income

Commission charged to customers	9
	<u>9</u>

Schedule 15 : Interest expended

Interest on fixed deposits	280
Interest on current accounts	45
Interest on savings bank accounts	70
	<u>395</u>

Schedule 16 : Operating expenses

Establishment expenses	56
Printing and Advertisements	3
Rent and Rates	20
Director's and Auditor's fees	4
Postage & Telegrams	2
Sundry charges	2
	<u>87</u>

Provisions and Contingencies

Nil

Illustration 8

From the following information relating to Lakshmi Bank Ltd., prepare the Profit & Loss A/c for the year ended 31st December, 2017.

	Rs.		Rs.
Rent received	72,000	Salaries and allowances	2,18,800
Exchange and commission	32,800	Postage	5,600
Interest on fixed deposits	11,00,000	Sundry charges	4,000
Interest on savings bank A/cs	2,72,000	Director's & Auditor's fees	16,800
Interest on overdrafts	2,16,000	Printing	8,000
Discount on bills discounted	7,80,000	Law charges	3,600
Interest on current accounts	1,68,000	Locker rent	1,400
Interest on cash credits	8,92,000	Transfer fees	2,800
Depreciation on bank property	20,000	Interest on loans	10,36,000

[Madras, B.Com., (AF) Nov. 2009; B.Com., (CS) (SY4B) Ap. 2007]

[Osmania, B.Com., Nov. 1988]

Solution:

The Lakshmi Bank Ltd.
Profit and Loss Account
For the year ended 31st December 2017

	Schedule No.	Year ended 31st Dec. 17 Rs.
I. Income		
Interest earned	13	29,24,000
Other income	14	1,09,000
Total		<u>30,33,000</u>
II. Expenditure		
Interest expended	15	15,40,000
Operating expenses	16	2,76,800
Provisions and contingencies		—
		<u>18,16,800</u>
III. Profit/Loss		
Net Profit for the year (I – II)		12,16,200
Profit brought forward		—
		<u>12,16,200</u>
IV. Appropriations		
Transfer to statutory reserve (25% of net profit)		3,04,050
Transfer to other reserves		—
Transfer to Government/proposed dividend		—
Balance carried over to Balance Sheet		9,12,150
		<u>12,16,200</u>

Working notes:

Schedule 13 : Interest earned

	Rs.
Interest on overdrafts	2,16,000
Discount on bills discounted	7,80,000
Interest on cash credits	8,92,000
Interest on loans	10,36,000
	29,24,000

Schedule 14 : Other Income

Locker rent	1,400
Transfer fees	2,800
Exchange and commission	32,800
Rent	72,000
	1,09,000

Schedule 15 : Interest expended

	Rs.
Interest on fixed deposits	11,00,000
Interest on savings bank accounts	2,72,000
Interest on current A/cs	1,68,000
	15,40,000

Schedule 16 : Operating expenses

Depreciation on bank property	20,000
Salaries and allowances	2,18,800
Postage	5,600
Sundry charges	4,000
Director's and Auditor's fees	16,800
Printing	8,000
Law charges	3,600
	2,76,800

Illustration 9

The following figures are extracted from the books of Bheema Bank Ltd. as on 31.12.2017.

	Rs.
Interest and discount received	36,95,738
Commission, exchange and brokerage	2,00,000
Directors' fees and allowances	55,000
Postage and telegrams	62,313
Stationery	17,625
Preliminary expenses	15,000
Interest paid on deposits	20,32,542

Bank Accounts

Rent received	12,42
Salaries and allowances	55,000
Rent and taxes paid	1,75,000
Profit on sale of investments	87,973
Depreciation on building	2,00,000
Audit fees	27,375
	5,000

Additional information:

- (1) A customer to whom a sum of Rs. 10,00,000 has been advanced has become insolvent. It is expected that only 50% can be recovered from his private estate.
 - (2) For the remaining debts, a provision of Rs. 1,50,000 was necessary.
 - (3) Rebate on bills discounted as on 31.12.2016 Rs. 12,000 and on 31.12.2017 Rs.16,000.
 - (4) Provide Rs. 6,50,000 for taxation
 - (5) Write off all preliminary expenses.
- Prepare Profit & Loss A/c in accordance with the law.

[Madras, 1st M.Com., (Sem - CAIA) Ap. 2008; April 2004;
B.Com., (Old - EZK) (ICE) May 2002]

Solution:

**Bheema Bank Ltd.
Profit & Loss A/c for the year ended 31.12.2017**

	Schedule No.	Year ended 31.12.1987 (current year) Rs.
I. Income :		
Interest earned	13	36,91,738
Other income	14	4,55,000
Total		<u>41,46,738</u>
II. Expenditure:		
Interest expended	15	20,32,542
Operating expenses	16	4,45,286
Provisions & Contingencies		13,00,000
Total		<u>37,77,828</u>
III. Profit/Loss:		
Net profit for the year (I – II)		3,68,910
Profit brought forward		—
Total		<u>3,68,910</u>
IV. Appropriations:		
Transfer to statutory reserves (25% of 3,68,910)		92,228
Transfer to other reserves		—
Transfer to Government/proposed dividend		2,76,682
Balance carried over to Balance Sheet		<u>3,68,910</u>

Note: Transfer to Statutory Reserve is now at 25%.

Working notes:

Schedule 13 : Interest earned

	Rs.
Interest and discount received	36,95,738
<i>Add:</i> Rebate on bills discounted on 31.12.16	12,000
	<u>37,07,738</u>
<i>Less:</i> Rebate on bills discounted on 31.12.17	16,000
	<u>36,91,738</u>

Schedule 14 : Other income

Commission, exchange & brokerage	2,00,000
Rent received	55,000
Profit on sale of investments	2,00,000
	<u>4,55,000</u>

Schedule 15 : Interest expended

Interest paid on deposits	20,32,542
	<u>20,32,542</u>

Schedule 16 : Operating expenses

	Rs.
Directors' fees and allowances	55,000
Postage and telegrams	62,313
Stationery	17,625
Preliminary expenses	15,000
Salaries and allowances	1,75,000
Rent & taxes paid	87,973
Depreciation on building	27,375
Audit fees	5,000
	<u>4,45,286</u>

Provisions and Contingencies

Bad debts (10,00,000 × 50%)	5,00,000
Provision for bad debts	1,50,000
Provision for taxation	6,50,000
	<u>13,00,000</u>

Grand total of (i) and (ii)

Total

3,400

Illustration 15

PREPARATION OF BALANCE SHEET

On 31st December 2016. The following balances stood in the books of Asian Bank Ltd., after preparation of its profit and Loss Account.

Share capital:

	Rs. (in '000)
Issued and subscribed	
Reserve fund (under section 17)	4,000
Fixed deposits	6,200
Savings bank deposits	42,600
Current accounts	19,000
Money at call and short notice	23,200
Investments	1,800
Profit and Loss Account (cr) 1st Jan 2016	25,000
Dividend for 2015	1,350
Premises	400
Cash in hand	2,950
Cash with RBI	380
Cash with other banks	10,000
Bills discounted and purchased	6,000
Loans, cash credits and over drafts	3,800
Bills payable	51,000
Unclaimed dividend	70
Rebate on bills discounted	60
Short loans (borrowing from other banks)	50
	4,750

Furniture

1,164

Other assets

336

Net Profit for 2016

1,550

Prepare balance sheet of the bank as on 31st December 2016.

[Madras, 1st M.Com., (ECAIA) Nov. 2008; (CAIA) April 2004]

[Periyar, B.Com., Ap. 2005; Marathawada, B.Com., Nov. 1987]

Solution:

Asian Bank Ltd.

Balance Sheet as on 31.12.2016

(000's omitted)

	Schedule No.	As on 31.12.16 (Rs. in '000)
Capital and Liabilities		
Capital	1	4,000
Reserves & Surplus	2	8,700
Deposits	3	84,800
Borrowings	4	4,750
Other Liabilities & Provisions	5	180
		<u>1,02,430</u>
Assets:		
Cash and balance with RBI	6	10,380
Balance with Banks & Money at call and short notice	7	7,800
Investments	8	25,000
Advances	9	54,800
Fixed assets	10	4,114
Other assets	11	336
		<u>1,02,430</u>
Contingent Liabilities	12	Nil
Bills for collection	-	Nil

Working notes:**Schedule 1 : Capital**

(Rs. in '000)

Issued and subscribed share capital

4,000

Schedule 2 : Reserves and Surplus

Reserve fund		6,200
Profit and Loss A/c (1.1.16)	1,350	
Less: Dividend for 2015	400	
	<u>950.0</u>	
Add: Net profit for 2016 after deducting statutory reserve [15,50,000 - (15,50,000 × 25%)]	1162.5	2,112.5
Statutory reserve		<u>387.5</u>
		<u>8,700.0</u>

Note: Transfer to statutory reserve now is at 25% of Net Profit.

Schedule 3 : Deposits

Fixed deposits	42,600
Savings bank deposits	19,000
Current accounts	23,200
	<u>84,800</u>

Bank Accounts

Schedule 4 : Borrowings	
Short loans	4,750
Schedule 5 : Other liabilities and Provisions	
Bills payable	70
Unclaimed dividend	60
Rebate on bills discounted	50
	180
Schedule 6 : Cash and balances with RBI	
Cash in hand	380
Cash with RBI	10,000
	10,380
Schedule 7 : Balance with banks and money at call and short notice	
Money at call and short notice	1800
Cash with other banks	6000
	7800
Schedule 8 : Investments	
Investments	25,000
Schedule 9 : Advances	
Bills discounted and purchased	3,800
Loans, cash credits and overdrafts	51,000
	54,800
Schedule 10 : Fixed Assets	
Premises	2,950
Furniture	1,164
	4,114
Schedule 11 : Other assets	
Other assets	336
	Nil
Schedule 12 : Contingent liabilities	
Bills for Collection	Nil

Illustration 16

From the following particulars of XY Bank Ltd., having its own premises, prepare the balance sheet in the prescribed form as on 31st December, 2015.

Rupees (in thousands)

Authorised capital	4,000
Subscribed capital 4,00,000 shares of Rs. 10 each Rs. 5 paid	2,000
Investments	7,000
Bills discounted (in India)	15,000
Profit and Loss (Cr)	850

Preparation of Profit and Loss Account and Balance Sheet

Illustration 17

The following is the Trial Balance as on 31.12.2012 extracted from the books of Town Bank Ltd.

Debit balances		Credit Balances	
	Rs.		Rs.
Balances with banks	46,350	Share capital	3,00,000
Investment in Government bonds	1,94,370	Security deposit of employees	15,000
Other investments	1,55,630	SB Accounts	7,420
Gold Bullion	15,130	Current accounts	97,000
Interest accrued on investments	24,620	Fixed deposits	1,13,050
Silver	2,000	Reserve fund	1,40,000
Constituent's liability for acceptances, etc.	56,500	Borrowings from banks	77,230
Building	65,000	Profit and Loss A/c	6,500
Furniture	5,000	Bills for collection	43,500
		Acceptances and endorsements	56,500
Money at call	26,000	Interest	72,000
Loans	2,00,000	Commission	25,300
Bills Discounted	12,500	Discounts	42,000
Interest	7,950	Rent	600
Bills for collection	43,500	Profit on Bullion	1,200
Audit fees	5,000	Miscellaneous income	2,700
Loss on sale of furniture	1,000	Accumulated depreciation on building	20,000
Directors' fees	1,200		
Salaries	21,200		
Postage	50		
Managing director's remuneration	12,000		
Loss on sale of investments	30,000		
Cash in hand	25,000		
Cash with RBI	50,000		
Branch adjustment A/c	20,000		
	<u>10,20,000</u>		<u>10,20,000</u>

You are required to prepare the Profit and Loss Account and Balance Sheet after taking into consideration the following

- (i) Bad debts Rs. 500
- (ii) Rebate on bills 1,000
- (iii) Current year's depreciation on building Rs. 2,000
- (iv) Some current accounts are over drawn to the extent of Rs. 25,000 and total of credit balances is Rs. 1,22,000.

Solution:

Profit and Loss Account for the year ended 31.12.2012 of Town Bank Ltd.

	Schedule No.	Year ended 31.12.2012 Rs.
I. <i>Income</i>		
Interest earned	13	
Other income	14	1,13,000
		<u>- 1,200</u>
		1,11,800
II. <i>Expenditure :</i>		
Interest expended	15	7,950
Operating expenses	16	41,450
<i>Provisions and Contingencies:</i>		500
		<u>49,900</u>
III. <i>Profit/Loss</i>		
Net profit for the year (I – II)		61,900
Profit brought forward		6,500
		<u>68,400</u>
IV. <i>Appropriations:</i>		
Transfer to statutory reserve 25% of 61,900		15,475
Balance carried to Balance Sheet		52,925
		<u>68,400</u>

Note : Transfer to Statutory Reserve should be 25% of Net Profit.

Working notes:

Schedule 13 : Interest earned

Interest	72,000
Discount	42,000
	<u>1,14,000</u>
Less: Closing rebates on bill discounted	1,000
	<u>1,13,000</u>

Schedule 14 : Other income

Commission, etc.		25,300
Rent		600
Profit on Bullion		1,200
Miscellaneous income		2,700
		<u>29,800</u>
Less: Loss on sale of furniture	1,000	
Loss on sale of investments	30,000	31,000
		<u>- 1,200</u>

Schedule 15 : Interest expended

Interest		Rs. 7,950
----------	--	--------------

Schedule 16 : Operating expenses

Salaries (including M.D's salary)	33,200
Directors fees	1,200
Postage	50
Audit fees	5,000
Depreciation on buildings	2,000
	<u>41,450</u>
Provisions and contingencies	
Bad debts	<u>500</u>

Balance sheet of Town Bank Ltd., as on 31.12.2012

	Schedule No.	As on 31.12.12 Rs.
<i>Capital & Liabilities</i>		
Capital	1	3,00,000
Reserves & Surplus	2	2,08,400
Deposit & Other accounts	3	2,42,470
Borrowings	4	77,230
Other liabilities & Provisions	5	16,000
Total		<u>8,44,100</u>
<i>Assets:</i>		
Cash and balance with RBI	6	75,000
Balance with banks and money at call & short notice	7	72,350
Investments	8	3,65,130
Advances	9	2,37,000
Fixed assets	10	48,000
Other assets	11	46,620
Total		<u>8,44,100</u>
Contingent liabilities	12	56,500
Bills for collection	—	43,500

Working notes:

Schedule 1 : Share capital

Share capital	<u>3,00,000</u>
---------------	-----------------

Schedule 2 : Reserves & Surplus

Reserve fund	1,40,000
Add: Additions	15,475
Profit and Loss Account balance	52,925
Total	<u>2,08,400</u>

Schedule 3 : Deposits		Rs.
Savings deposits		7,420
Fixed deposits		1,13,050
Current deposits (97,000 + 25,000)		1,22,000
Total		<u>2,42,470</u>
Schedule 4 : Borrowings		Rs.
Borrowings from bank		<u>77,230</u>
Schedule 5 : Other liabilities:		Rs.
Security deposits of employees		15,000
Rebate on bills discounted		1,000
Total		<u>16,000</u>
Schedule 6 : Cash and balance with RBI		Rs.
Cash in hand		25,000
Cash with RBI		50,000
Total		<u>75,000</u>
Schedule 7 : Balances with banks and money at call and short notice		Rs.
Balances with other banks		46,350
Money at call and short notice		26,000
Total		<u>72,350</u>
Schedule 8 : Investments		Rs.
Government bonds		1,94,370
Other investments		1,55,630
Gold Bullion		15,130
Total		<u>3,65,130</u>
Schedule 9 : Advances		Rs.
Loans, cash credits and overdrafts (2,00,000 + 25,000 - 500)		2,24,500
Bills discounted		12,500
Total		<u>2,37,000</u>
Schedule 10 : Fixed assets		Rs.
Premises (buildings) (65,000 - 20,000 - 2,000)		43,000
Furniture		5,000
Total		<u>48,000</u>
Schedule 11 : Other assets		Rs.
Branch adjustment A/c		20,000
Silver		2,000
Interest accrued on investments		24,620
Total		<u>46,620</u>

Holding Company Accounts

Introduction

Economies of Large scale production have given impetus to business combinations. Mergers and acquisitions have become the order of the day in the corporate world. Acquiring controlling interest in a company provides control over its working without affecting its independent existence and identity. The 'Holding company' method of business combination facilitates creation of closely linked group of companies with interest in mutual well being. Thus, acquiring control over other companies has become a favourite method to build up an industrial empire.

(a) Meaning and Definition of Holding Company and Subsidiary Company

A holding company is one which controls one or more other companies by means of:

- (a) Holding majority shares or
- (b) Controlling the composition of Board of directors or
- (c) Controlling a holding company with subsidiaries.

The Indian Companies Act does not define a holding company directly. Sec. 4 (4) of the Companies Act says "A company shall be deemed to be the holding company of another, if, but only if, that other is its subsidiary".

According to Sec. 4(1) of the Companies Act, a company is a subsidiary of another company if, but only if,

- (a) The other company controls the composition of its board of directors or
- (b) The other company
 - (i) Holds more than half in nominal value of its equity share capital or
 - (ii) If it is a company formed before 1st April 1956 with both equity and preference shareholders having the same voting rights, the other company, exercises or controls more than half of its voting power, or
 - (iii) It is a subsidiary of any company which is that other company's subsidiary.

For example, if company 'A' is subsidiary of company 'B' and company 'C' is a subsidiary of company 'A', then company 'C' becomes subsidiary for company 'B' also indirectly. Such a subsidiary may be called *sub-subsidiary* or *deemed subsidiary*.

Legal requirements relating to presentation of accounts

Sec. 212 of the Companies Act lays down specifically the different aspects of presentation of accounts by a holding company.

1. A holding company has to attach the following documents with its balance sheet in respect of each of its subsidiaries:
 - (a) A copy of the Balance Sheet of the subsidiary;
 - (b) A copy of the Profit & Loss account.
 - (c) A copy of the report of its board of directors
 - (d) A copy of the report of its auditors
 - (e) A statement of the holding company's interest in the subsidiary as specified in sub-section (3).
 - (f) The statement referred to in sub-section (5) if any; and
 - (g) The report referred to in sub-section (6) if any.
2. If the financial years of the holding company and subsidiary coincide with each other, subsidiary company's Balance Sheet and other documents mentioned above relating to the same financial year should be attached to the Balance Sheet of the holding company.

If the financial years of both the companies do not coincide, the preceding year's Balance Sheet and other statements of the subsidiary must be attached. However the time span between the two balance sheets should not be more than six months.

Requirements of Schedule VI

The following items relating to the subsidiary company must be disclosed in the holding company's Balance Sheet as prescribed under Schedule VI.

On the assets side of the Balance Sheet

- (a) Under the heading of 'Investments' Investments in equity shares, preference shares, debentures, etc., of the subsidiary company.
- (b) Under the heading 'Loans and Advances' Advances and loans given to subsidiaries.

On the liabilities side of the Balance Sheet

- (a) Under the heading 'secured loans'
Loans and advances from subsidiaries
- (b) Under the heading 'unsecured loans'
Loans and Advances from subsidiaries
- (c) Under the heading 'Current liabilities and provisions' amount due from subsidiaries.

Consolidated Financial Statements

The 'legal' Balance Sheet of a Holding company should contain the above particulars. However, consolidated financial statements or 'group accounts' are in addition to the legal financial statements which are to be statutorily filed with appropriate authorities.

There is no statutory requirement for a holding company to prepare consolidated Financial Statements. However, the Institute of Chartered accountants of India has issued AS-21 on 'Consolidated Financial Statements' which comes into effect in respect of accounting periods commencing on or after 1st April 2001. But AS-21 is not Mandatory and only those companies which prepare consolidated Financial Statements can prepare and present them in accordance with the standard.

AS-21 Terms a holding company as 'Parent Company' which has one or more subsidiaries and a 'Subsidiary' as an enterprise that is controlled by another enterprise known as 'parent'. A 'group' is a parent and all its subsidiaries. AS-21 should be applied in the preparation and presentation of consolidated Financial Statements for a group of enterprises under the control of a parent.

Consolidation of Profit and Loss account and Balance Sheet implies preparation of a single Profit and Loss account and Balance Sheet of a holding company and its subsidiaries. This is done by aggregating all items of Incomes, Expenses, Assets, Liabilities etc., of the holding company and its subsidiaries. Such consolidation is also known as 'group accounts'. Group accounts are compulsory in England. As per the Companies Act 1956, there is no obligation on the part of a holding company to prepare and present 'group accounts' or consolidated financial statements. However, different users of accounting information like shareholders, employees, lenders, potential investors etc., are in need of information about the financial position and result of operations of the entire group. Consolidated accounts fulfil such a need. Similarly, international accounting standard. IAS-27 makes it obligatory for a holding company, if not exempted, to present consolidated financial statements. Thus, it is apparent that irrespective of legal requirements, consolidated financial statements are of great practical value and are usually prepared and presented by all the progressive companies.

(C) PREPARATION OF CONSOLIDATED BALANCE SHEET

The following are the various points to be considered and followed for the preparation of consolidated Balance Sheet of a holding company and its subsidiaries.

1. Basic philosophy of consolidation – Elimination of investment account

Usually a holding company shows the shares acquired in a subsidiary as an investment on the assets side of its Balance Sheet. This shows the amount paid by the holding company for the shares acquired in the subsidiary. But the details

2. Minority interest

- (a) *Meaning:* Usually, a holding company acquires majority equity shares in a subsidiary, representing the controlling interest. The remaining shares may be in the hands of the general public. Such holding of the general public in the subsidiary company is called 'Minority interest'.
- (b) *Treatment:* The minority interest is to be computed and shown on the liabilities side of the consolidated Balance Sheet as a separate item. It may be shown as the last item on the liabilities side or along with the share capital of the holding company. The former method is more popular.

(c) *Computation*: Usually the following items constitute the minority interest:

		Rx.
Face value of minority equity shares		xxx
Face value of minority preference shares		xxx
Minority share of capital profits		xxx
Minority share of revenue profits		xxx
Minority share of bonus shares issued		xxx
<i>Less:</i> Minority share of capital losses	xxx	xxx
Minority share of revenue losses	xxx	xxx
Total minority interest		xxx

3. Cost of control or goodwill

- (a) *Meaning*: When holding company acquires majority of the shares in a subsidiary, it may be forced to pay more than the face value and even the book value of such shares. The demand and supply equation operates here. The demand for the subsidiary company's shares generated in the process of acquiring controlling interest in the subsidiary 'pushes up' the market price of such shares. Thus, cost of control is the 'penalty' or 'excess' paid by the holding company to acquire 'controlling interest' in the subsidiary company.
- (b) *Treatment*: The excess amount paid is usually treated as 'goodwill' and is shown on the assets side of the consolidated Balance Sheet along with any goodwill in the holding company's Balance Sheet.

If the price paid by the holding company for shares acquired in the subsidiary is less than 'what is received in return' in the form of the face value of shares purchased and the holding company's share of the capital profits, such difference is a capital gain. Such capital profit can be reduced from any goodwill existing in the Balance Sheet of the holding and subsidiary companies. If the capital profit is in excess of such goodwill or there is no goodwill in the Balance sheets, it must be shown as 'capital reserve' in the liabilities side of the consolidated Balance Sheet.

(c) *Computation.* The following is the usual method of ascertaining cost of control or capital reserve.

		Rs.
	Amount paid for shares purchased by the holding company in the subsidiary	
<i>Add:</i>	Holding company's share of capital loss	xxx
		xxx
<i>Less:</i>	Face value of shares purchased	xxx
	Holding company's share of capital profits	xxx
	Holding company's share of Bonus shares issued by subsidiary	xxx
	Holding company's share of dividend paid out of capital profits	xxx
	Goodwill or capital reserve	xxx
		xxxx

Note: If the Balance is positive, it is goodwill. If it is negative, it is capital profit to be treated as capital reserve.

The goodwill or capital reserve ascertained here must be merged with any goodwill in the Balance Sheets of the holding company and the subsidiary companies.

4. Revenue profits or post acquisition profits

Meaning : Profits earned by a subsidiary company after the date of acquisition of shares by the holding company are called *revenue profits* or *post acquisition profits*. These profits may be a part of the Profit & Loss account of the subsidiary company or they might have been transferred to reserves or proposed as dividend.

Treatment : The revenue profits have to be divided in the ratio of shares held by the holding company and the minority in the subsidiary, generally known as 'Holding minority ratio'. The minority share is added in computing minority interest. The holding company's share is added to the holding company's Profit and Loss Account in the consolidated Balance Sheet.

Computation : If shares are purchased by the holding company on the date of the given Balance Sheets, revenue profits are 'Nil'. If shares are purchased during the 'current year', profits earned during the current year are assumed to be earned uniformly and the profits proportionate to the number of months after the purchase of shares are treated as revenue profits. If the shares were acquired at the beginning of the current year, entire profit of the current year has to be treated as revenue profits. If exact date of purchase of shares is not given, other details about profits have to be seen to determine the revenue profits.

5. Revenue losses or post acquisition losses

Any loss incurred by the subsidiary company after the date of purchase of shares by the holding company is called 'revenue loss' or 'post acquisition loss'.

revenue loss may be shown on the assets side of the consolidated Balance Sheet under 'Miscellaneous expenditure'.

6. Capital Profits and Losses or pre acquisition Profits & Losses

Meaning: All the accumulated profits of the subsidiary company on the date of purchase of shares by the holding company are called 'capital profits' or 'pre acquisition profits'. They may be in the form of capital reserve, general reserve, reserve fund, share premium, Profit & Loss account, etc. If shares are acquired during the current year, profit earned by the subsidiary in the months before purchase of shares in the current year is also to be taken as capital profit. Similarly, any profit on revaluation of assets or liabilities on the date of purchase of shares has to be treated as capital profit.

All accumulated losses on the date of purchase of shares by the holding company are termed as 'capital losses'. Similarly, any loss incurred in the current year before purchase of shares is also capital loss. Any loss on revaluation of assets and liabilities at the time of purchase of shares is also to be treated as capital loss.

Treatment: Any Bonus shares issued, and dividend paid out of the capital profits has to be subtracted and the balance of capital profit or loss has to be divided in the 'holding minority ratio. Minority share of the capital profits has to be added to the minority interest. Similarly, minority share of capital loss has to be subtracted in the computation of minority interest.

Holding company's share of capital profit is to be reduced while ascertaining cost of control. This is due to the fact that accumulated profits of the subsidiary must have influenced the price paid for the shares acquired. Based on the same logic, holding company's share of capital loss is added in the computation of cost of control.

Computation. Capital profits are usually computed as follows:

		Rs.
	General reserve, capital reserve, P & L A/c and other reserves of subsidiary on the date of purchase of shares	xxx
Less:	Bonus shares issued by subsidiary from pre acquisition profits	xxx
Less:	Dividend paid by subsidiary out of pre acquisition profits	xxx
Add:	Subsidiary company profits during the current year before purchase of shares	xxx
Add:	Profit on revaluation of assets and liabilities of the subsidiary on the date of purchase	xxx
Less:	Loss on revaluation of assets and liabilities of subsidiary on the date of purchase	xxx
	Net capital profits	xxxx

7. Revaluation of assets and liabilities

When holding company acquires controlling interest in a subsidiary, it may revalue the assets and liabilities to reflect their current values. These revised values may form the basis for determining the value of shares for the purpose of acquisition.

Any profit or loss on revaluation of the assets and the outside liabilities has to be adjusted in the respective assets and liabilities in the consolidated Balance Sheet, if it is not already done. The same profit or loss has to be included in the computation of 'capital profits', as already explained earlier.

Depreciation on Revalued Assets

The changes in the value of any fixed assets as on the date of purchase of shares creates the problem of 'Depreciation'. If there was appreciation on the fixed assets due to revaluation, additional depreciation from the date of revaluation till the Balance Sheet date has to be provided. This additional depreciation has to be reduced from 'Revenue profits' because the depreciation is related to the post acquisition period.

If there was decrease in the value of fixed assets on revaluation, the depreciation attributable to the 'decreased' portion of the asset has to be calculated and added to the revenue profits.

In the combined Balance Sheet, these, additional depreciation or 'saving in depreciation' have to be adjusted in the assets concerned.

The above mentioned assets and liabilities are summarised in the following Specimen Proforma of Consolidated Balance Sheet.

Consolidated Balance Sheet of Holding Co. and its Subsidiary as on

Liabilities		Rs.	Rs.	Assets		Rs.	Rs.
Share Capital :				Fixed Assets :			
Share Capital of Holding Co.			xxx	(i) Cost of Control			
Reserves and Surplus :				Goodwill	xxx		
(i) Capital Reserves of				<i>Add</i> : Goodwill in			
Holding Co.		xxx		B/S of Holding Co.	xxx		
<i>Add</i> : Share in Pre-acquisition				<i>Add</i> : Goodwill in B/s			
Reserves & Profits of				of Subsidiary Co.	xxx		
Subsidiary		xxx					
		—			xxx		
		xxx		<i>Less</i> : Capital Reserve			
<i>Less</i> : Goodwill as per Contra		xxx		as per Contra	xxx		
		—	xxx				xxx
(ii) Revenue Reserves of				(ii) All other fixed			
Holding Co.		xxx		assets of Holding Co.	xxx		
<i>Add</i> : Share in Revenue				<i>Add</i> : All other fixed			
Reserves of Subsidiary		xxx		assets of Subsidiary	xxx		
		—	xxx				xxx
(iii) P&L a/c balance of				Investments :			
Holding Co.		xxx		Investments of			
<i>Add</i> : Share in Revenue				Holding Co.			
Profits of Subsidiary Co.		xxx		except investments			
		—		in subsidiary	xxx		
		xxx		<i>Add</i> : Investments of			
<i>Less</i> : Share in unrealised				Subsidiary	xxx		
Profits		xxx					xxx
		—	xxx	Current Asses, Loans			
Secured Loans :				and Advances :			
Secured loans of Holding Co.		xxx		Current Assets,			
<i>Add</i> : Secured loans of				loans and advances			
Subsidiary Co.		xxx		of Subsidiary Co.	xxx		
		—	xxx				xxx
Unsecured Loans :							
Unsecured loans of				<i>Less</i> : Inter-company			
Holding Co.		xxx		Debts	xxx		
<i>Add</i> : Unsecured loans of							
Subsidiary Co.		xxx					xxx
		—	xxx				

Current Liabilities and Provisions :				Less : Unrealised Profit in stock	
(i) Current liabilities & Provisions of Holding Co.	xxx				xxx
Add : Current liabilities & Provisions of Subsidiary Co.	xxx				xxx
	xxx				xxx
Less : Inter-Company Liabilities	xxx				
(i) Minority Interest		xxx			
		xxx			
		xxx			
					xxx

ILLUSTRATIONS

Goodwill given in Balance Sheet

Illustration 1

The Balance Sheets of C Ltd. and D Ltd. as at 31st December, 2016 are as follows:

<i>Liabilities</i>	<i>C Ltd.</i> <i>Rs.</i>	<i>D Ltd.</i> <i>Rs.</i>	<i>Assets</i>	<i>C Ltd.</i> <i>Rs.</i>	<i>D Ltd.</i> <i>Rs.</i>
Share capital (in shares of Rs. 10 each)	2,00,000	1,00,000	Sundry assets	1,32,500	1,38,200
General reserve	18,000	20,000	Goodwill	—	20,000
Profit & Loss A/c	24,500	23,000	Shares in D Ltd. at cost	1,40,000	—
Creditors	30,000	15,200			
	<u>2,72,500</u>	<u>1,58,200</u>		<u>2,72,500</u>	<u>1,58,200</u>

In the case of 'D' Ltd., profit for the year ended 31st December 2016 is Rs. 12,000 and transfer to reserve is Rs. 5,000. The holding of C Ltd. in D Ltd. is 90% acquired on 30th June 2016.

Draft a consolidated Balance Sheet of 'C' Ltd. and its subsidiary.

[Madras, 1st M.Com (ICE) Oct. 2009; B.Com (AF) Nov. 2008; B.Com., Ap. 2008; 1st M.Com., Ap. 2008; Ap. 2007; M.Com (ICE) Ap. 2007; B.Com. (CS) (PYD) Nov. 2006; B.Com]

Solution:

Notes to Accounts:

1. Share capital:

20,000 shares of Rs.10 each

Rs.

2. Reserves and surplus:

General reserve

2,00,000

Surplus instalment of P & L :

18,000

Balance as per C Ltd. Balance sheet : 24,500

Add: Share of revenue profit :

5,400

29,900

47,900

3. Trade payables:

Sundry creditors

C Ltd.

30,000

D Ltd.

15,200

45,200

4. Tangible assets:

Sundry assets:

C Ltd.

1,32,500

D Ltd.

1,38,200

2,70,700

5. Intangible assets:

Goodwill

36,700

**Consolidated Balance sheet of C Ltd. and its subsidiary D Ltd. as on
31.12.2016 (As per Schedule VI)**

	Note No.	Rs.
Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	2,00,000
Reserves and surplus	2	47,900
(ii) Minority interest (W.N 4)		14,300
(iii) Current liabilities		
Trade payables	3	45,200
Total (i) + (ii) + (iii)		3,07,400

II. Assets:

(i) Non-current assets:		
Tangible assets	4	2,70,700
Intangible assets	5	36,700
(ii) Current assets:		
Total (i) + (ii)		<u>3,07,400</u>

Working notes**1. Holding-minority ratio**

C Ltd. acquired 90% of shares in D Ltd.

∴ Minority holding in D Ltd. = 10%

Ratio = 90 : 10 or 9 : 1

2. Revenue profits

Profit for the current year, given

Profit made after June 30th or revenue profit	=	$12,000 \times \frac{6}{12}$	=	6,000	Rs. 12,000
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Holding company's share	=	$6,000 \times \frac{9}{10}$	=	5,400	
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Minority's share	=	$6,000 \times \frac{1}{10}$	=	600	
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3. Capital profits

General reserve of D Ltd.	Rs. 20,000
Profit & Loss Account of D Ltd.	23,000
	<u>43,000</u>
Less: Revenue profit	6,000
Capital profit	<u>37,000</u>

Holding company's share	=	$37,000 \times \frac{9}{10}$	=	33,300
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Minority's share	=	$37,000 \times \frac{1}{10}$	=	3,700
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Note: Since it is clearly stated that the profit of D Ltd. for the year 2016 is Rs. 12,000, it is assumed that the transfer to reserve of Rs. 5,000 is a part of the Rs. 12,000.

4. Minority interest

Face value of minority shares $1,00,000 \times \frac{10}{100}$	Rs. 10,000
Add: Minority share of capital profit	3,700
Add: Minority share of revenue profit	600
Minority interest	<u>14,300</u>

Holding Company Accounts

14.20

5. Cost of control or goodwill

		Rs.
	Amount paid by C Ltd. for shares purchased in D Ltd.	1,40,000
Less:	Face value of shares purchased $1,00,000 \times \frac{90}{100}$	90,000
Less:	Holding company's share of capital profits	33,300
	Goodwill	16,700
Add:	Goodwill in D Ltd.'s Balance Sheet	20,000
	Goodwill to be shown in consolidated Balance Sheet	36,700

Unrealised profit in stock

Illustration 2

On 31st March, 2018 the balance sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Liabilities	H Ltd.	S Ltd.	Assets	H Ltd.	S Ltd.
	Rs.	Rs.		Rs.	Rs.
Equity share capital	8,00,000	2,00,000	Fixed assets	5,50,000	1,00,000
General reserve	1,50,000	70,000	75% shares in		
Profit & Loss A/c	90,000	55,000	S Ltd. (at cost)	2,80,000	—
Creditors	1,20,000	80,000	Stock	1,05,000	1,77,000
			Other current assets	2,25,000	1,28,000
	<u>11,60,000</u>	<u>4,05,000</u>		<u>11,60,000</u>	<u>4,05,000</u>

Draw a consolidated Balance Sheet as at 31st March, 2018 after taking into consideration the following information:

- H Ltd. acquired the shares on 31st July, 2017.
- S Ltd. earned profit of Rs. 45,000 for the year ended 31st March, 2018.
- In January 2018 S Ltd. sold to H Ltd. goods costing Rs. 15,000 for Rs. 20,000. On 31st March, 2018 half of these goods were lying as unsold in the godown of H Ltd.

Give your working notes.

[Madras, 1st M.Com., Ap. 2009; Nov. 2008; B.Com (PZ4A) Nov. 2007;

B.Com. (PZG) Nov. 2005; BCS (PYD) Nov. 2005;

M.Com., May 1997; A.C.S. Inter, June 1996]

[Thiruvalluvar, B.Com., April 2007]

Solution:

Notes to Accounts:

		Rs.
1. Share capital:		8,00,000
2. Reserves and surplus:		
General reserve		1,50,000
Surplus in statement of P & L:		
Balance as per C Ltd. Balance sheet :	90,000	
Add: H Ltd.'s share of revenue profit :	22,500	
	1,12,500	
Less: Provision for unrealized profit	2,500	
		1,10,000
		2,60,000
3. Trade payables:		
Sundry creditors		
H Ltd.	1,20,000	
S Ltd.	80,000	
	<u>2,00,000</u>	
4. Tangible assets:		
Fixed assets:		
H Ltd.	5,50,000	
S Ltd.	1,00,000	
	<u>6,50,000</u>	
5. Intangible assets:		
Goodwill		58,750
6. Stock:		
H Ltd.	1,05,000	
S Ltd.	1,77,000	
	<u>2,82,000</u>	
Less: Provision for unrealized profit	2,500	
		2,79,500
7. Other current assets:		
H Ltd.	2,25,000	
S Ltd.	1,28,000	
	<u>3,53,000</u>	

	Note No.	Rs.
I. Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	8,00,000
Reserves and surplus	2	2,60,000
(ii) Minority interest (W.N 4)		81,250
(iii) Current liabilities		
Trade payables	3	2,00,000
Total (i) + (ii) + (iii)		<u>13,41,250</u>
II. Assets:		
(i) Non-current assets:		
Tangible assets	4	6,50,000
Intangible assets	5	58,750
(ii) Current assets:		
Stock	6	2,79,500
Other current assets	7	3,53,000
Total (i) + (ii)		<u>13,41,250</u>

Working Notes:

1. **Holding-Minority Ratio :** H Ltd. acquired 75% shares in S Ltd.
 \therefore Minority holding in S Ltd. 25% Ratio = 75 : 25 or 3 : 1

2. Revenue profits

Current year profit of S Ltd., given
Profit earned by S Ltd. after 31st July or

revenue profit	=	$45,000 \times \frac{8}{12}$	=	30,000	Rs.
Holding company's share	=	$30,000 \times \frac{3}{4}$	=	22,500	
Minority share	=	$30,000 \times \frac{1}{4}$	=	7,500	

3. Capital profits

General reserve of S Ltd. on 31.3.18	70,000
Profit & Loss account of S Ltd. on 31.3.18	55,000
	<u>1,25,000</u>
Less: Revenue profit	30,000
Capital profit	<u>95,000</u>

Holding company's share	=	$95,000 \times \frac{3}{4}$	=	71,250
Minority share	=	$95,000 \times \frac{1}{4}$	=	23,750

4. Minority interest

Face value of minority shares	$2,00,000 \times \frac{25}{100}$	50,000
Add: Minority share of capital profits		23,750
Add: Minority share of revenue profits		7,500
Minority interest		<u>81,250</u>

5. Cost of control or goodwill

Amount paid for shares purchased by H Ltd. in S Ltd.		2,80,000
Less: Face value of shares purchased	$2,00,000 \times \frac{3}{4}$	1,50,000
Holding company's share of capital profits		71,250
Goodwill		<u>58,750</u>

6. Provision for unrealised profit in stock

Profit in stock of H Ltd. acquired from S Ltd.

$$(20,000 - 15,000) \times \frac{1}{2} = 5,000 \times \frac{1}{2} = 2,500$$

∴ Provision to be created = 2,500.

Mutual obligation in bills**Illustration 3**

From the following Balance Sheet relating to H Ltd. and S Ltd. prepare a consolidated Balance Sheet.

Balance Sheet as on 31.12.2020

Liabilities	H Ltd.	S Ltd.	Assets	H Ltd.	S Ltd.
	Rs.	Rs.		Rs.	Rs.
Share capital (Shares of Rs.10 each)	10,00,000	2,00,000	Sundry fixed assets	8,00,000	1,20,000
Profit and Loss A/c	4,00,000	1,20,000	Stock	6,10,000	2,40,000
Reserves	1,00,000	60,000	Debtors	1,30,000	1,70,000
Creditors	2,00,000	1,20,000	Bills receivable	10,000	-
Bills payable	-	30,000	Shares in 'S Ltd.' at cost (15,000 shares)	1,50,000	-
	<u>17,00,000</u>	<u>5,30,000</u>		<u>17,00,000</u>	<u>5,30,000</u>

- (a) All profits of S Ltd. have been earned after the shares were acquired by H Ltd. But there was already a reserve of Rs. 60,000 on that date.
- (b) All the bills payable of S Ltd. were accepted in favour of H Ltd.
- (c) The stock of H Ltd. includes Rs. 50,000 purchased from S Ltd. The profit added was 25% on cost.

[Madras, B.Com (CS) (SY4B) Nov. 2007; B.Com (TCE) Oct. 2006; B.Com., Ap. 2002; Ap. 2000; I.M.Com., April 2001; B.Com., March 1995]
 [Periyar, B.Com., Ap. 2005; Bharathiar, B.Com., Nov. 2004]

Solution:

Notes to Accounts:

		Rs.
1. Share capital:		
	1,00,000 shares of Rs.10 each	10,00,000
2. Reserves and surplus:		
	Reserve	1,00,000
	Capital reserve	45,000
	Surplus as per statement of P & L :	
	Balance as per H Ltd. Balance sheet :	4,00,000
	Add: H Ltd.'s share of revenue profit :	90,000
		<u>4,90,000</u>
	Less: Provision for unrealized profit	<u>10,000</u>
		<u>4,80,000</u>
		<u>6,25,000</u>
3. Trade payables:		
	Sundry creditors	2,00,000
	H Ltd.	1,20,000
	S Ltd.	<u>3,20,000</u>
		30,000
	Bills payable:	<u>10,000</u>
	Less: Mutual Obligation	20,000
		<u>3,40,000</u>
4. Tangible assets:		
	Sundry assets:	8,00,000
	H Ltd.	1,20,000
	S Ltd.	<u>9,20,000</u>
5. Stock:		
	H Ltd.	6,10,000
	S Ltd.	<u>2,40,000</u>
		8,50,000
		<u>10,000</u>
	Less: Provision for unrealized profit	<u>8,40,000</u>

8. Trade receivables :

Debit:		
H Ltd.		
S Ltd.	1,30,000	
	<u>1,70,000</u>	
Bills receivable:		
Less: Mutual Obligation	10,000	3,00,000
	10,000	
		<u>3,00,000</u>

**Consolidated Balance sheet of H Ltd. and its subsidiary S Ltd. as on
31.12.2020 (As per Revised Schedule VI)**

	Note No.	Rs.
I. Equity and Liabilities:		
(i) Shareholders' funds:		
Share capital	1	10,00,000
Reserves and surplus	2	6,25,000
(ii) Minority interest (W.N 4)		95,000
(iii) Current liabilities		
Trade payables	3	3,40,000
Total (i) + (ii) + (iii)		<u>20,60,000</u>
II. Assets:		
(i) Non-current assets:		
Tangible assets	4	9,20,000
Intangible assets		
(ii) Current assets:		
Stock	5	8,40,000
Trade receivables	6	3,00,000
Total (i) + (ii)		<u>20,60,000</u>

Working notes**1. Holding-minority ratio**

Total shares in S Ltd.	$\frac{2,00,000}{10}$	20,000
Shares acquired by H Ltd. in S Ltd.		15,000
Minority shares		<u>5,000</u>

∴ Ratio = 15,000 : 5,000 = 3 : 1

2. Capital profits

Reserve of S Ltd. on the date of purchase of shares in S Ltd. by H Ltd.		Rs.
		60,000
∴ Capital profit	= 60,000	
Holding company's share	= $60,000 \times \frac{3}{4}$	= 45,000
Minority share	= $60,000 \times \frac{1}{4}$	= 15,000

3. Revenue profits

Profits earned by S Ltd. after shares were acquired by H Ltd. in S Ltd.	= P & L A/c	= 1,20,000
∴ Revenue profits	= 1,20,000	
Holding company's share	= $1,20,000 \times \frac{3}{4}$	= 90,000
Minority's share	= $1,20,000 \times \frac{1}{4}$	= 30,000

4. Minority interest

Face value of minority shares 5,000 × 10	=	50,000
Add: Minority's share of capital profits	=	15,000
Add: Minority's share of revenue profits	=	30,000
Minority interest		<u>95,000</u>

5. Cost of control or goodwill

Amount paid for shares purchased by H Ltd. in S Ltd.		1,50,000
Less: Face value of shares purchased 15,000 × 10	1,50,000	
Holding company's share of capital profits	45,000	1,95,000
Capital reserve		<u>45,000</u>

6. Provision for unrealised profits in stock

Stock with H Ltd. purchased from S Ltd.		50,000
Profit included in stock 25% on cost		•
(or) 20% on sale price	= $50,000 \times \frac{20}{100}$	= 10,000
Provision to be made		= 10,000