

## Module 1

### ACCOUNTING FOR SHARE CAPITAL

A company is an association of persons who contribute money or money's worth to a common stock and uses it for a common purpose. In the words of Justice James, "a company is an association of persons united for a common object". Sec 3(1) (i) of the Companies Act 1956 defines a company as "company formed and registered under this Act or an existing company".

#### Characteristics of Company

1. It is a voluntary association of persons
2. It has a separate legal entity
3. It has a common seal
4. It has a perpetual succession.

#### Kinds of Companies

##### I. On the basis of formation

1. **Chartered companies** – Those companies which are incorporated under a special charter by the king or sovereign such as East India Company.
2. **Statutory companies** – These companies are formed by the special Act of legislature or parliament like RBI.
3. **Registered companies** – Such companies are incorporated under the Companies Act 1956 or were registered under any previous Companies Act.

##### II. On the basis of liability

1. **Limited companies**- In these companies, the liability of each member is limited to the extent of face value of shares held by him.
2. **Guarantee companies** – The liability of member of such companies are limited to the amount he has undertaken to contribute to the assets of the company in the event of its winding up.
3. **Unlimited Companies** – In these companies, the liability of the members is unlimited and members are personally liable to the creditors of the company for making up the deficiency. Such companies are rare these days.

##### On the basis of public investment

1. **Private Companies** – These are companies by its Articles, (i) limits the

number of members to 50,(ii)prohibits the invitation to the public to subscribe their shares or debentures and (iii) restricts the transferability of their shares.

2. **Public companies** – These are companies other than private companies.

#### SHARE CAPITAL

Total capital of the company is divided into units of small denominations; each one is called a share. According to Sec 2(46) of the Companies Act 1956, share has been defined as a share in the share capital of the company; and includes stock except where a distinction between stock and share is expressed or implied.

#### Classes of Shares

##### A. Preference Shares

Shares which enjoy the preferential rights as to dividend and repayment of capital in the event of winding up of the company over the equity shares are called preference shares. The holder of preference shares will get a fixed rate of dividend.

##### Types of preference shares

1. **Cumulative preference shares** – In case of these shares, the arrears of dividend are carried forward and paid out of the profits of the subsequent years.
2. **Non-cumulative preference shares** – If dividend not to accumulate and not to carried forward to next year, these are called non-cumulative preference shares.
3. **Participating preference shares** – In addition to a fixed dividend, balance of profit (after meeting equity dividend) shared by some preference shareholders. Such shares are participating preference shares.
4. **Non-participating preference shares** – These shares get only a fixed rate of dividend. These do not get share in the surplus profit.
5. **Redeemable preference shares** – If preference shares are returned after a specified period to shareholders, these preference shares are called redeemable preference shares.
6. **Convertible preference shares** – These

## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

shares are given the right of conversion into equity shares within a specified period or at a specified date according to the terms of issue.

### **B. Equity Shares**

Equity shares are those which are not preference shares. Equity shares do not carry any preferential gain in respect of dividend or repayment of capital. So these are known as ordinary shares. There will be no fixed rate of dividend to be paid to the equity shareholders and this rate may vary from year to year. In winding up, the equity capital is repaid last. However, equity shareholder gets full voting power.

### **Difference between equity shares and preference shares**

<b>Equity shares</b>	<b>Preference shares</b>
It is an ownership security	It is a hybrid security
Dividend rate is not fixed	Dividend rate is fixed
Capital is repaid only in winding up	Capital is repaid after a stipulated period
These shares have voting rights	Generally do not have voting rights
Face value is lower	Face value is higher

### **Types of share capital**

1. **Authorized (Registered or Nominal) Capital** – It is the maximum amount of capital which the company is authorized to raise by way of public subscription.

2. **Issued Capital** – The part of authorized capital which is offered to the public for subscription is called issued capital.

3. **Subscribed Capital** – That part of the issued capital for which applications are received from the public is called subscribed capital.

4. **Called-up Capital** – That part of subscribed capital which has been called-up or demanded by the company is called called-up capital.

5. **Paid-up Capital** – The part of called-up capital which is offered and actually paid by

the members is known as paid-up capital. Any unpaid amount of balance on the called-up capital is known as unpaid capital or calls in arrears.

6. **Reserve Capital** – It is that portion of the uncalled capital which is called-up only at the event of company's winding up.

### **Issue of Share Capital**

The shares can be issued either at par, premium or at discount. Shares are said to be issued at par when a shareholder is required to pay the face value of the shares to the company. Shares are said to be issued at premium when a shareholder is required to pay more than the face value to the company. Shares are said to be issued at discount when the shareholder is required to pay less amount than the face value to the company.

### **Allotment of shares**

Allotment of shares means the acceptance of offer of the applicant for the purchase of shares. Directors have the discretionary power to reject or accept the applications. But the public company cannot allot its shares unless the minimum subscription has been subscribed by the public and the amount of application has been received. After the allotment of shares to the applicants who will become the shareholders of the company.

### **Journal Entries for Share Issue**

1. **On receipt of application money:**

Bank A/c Dr

To Share Application A/c

2. **On acceptance of application:**

Share application A/c Dr

To Share Capital A/c

3. **On allotment money due:**

Share allotment A/c Dr

To Share capital A/c

4. **On receipt of allotment money:**

Bank A/c Dr

To Share allotment A/c

5. **On making first call due:**

Share first call A/c Dr

To Share capital A/c

## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

### 6. On receipt of first call money:

Bank A/c Dr

To Share first call A/c

(Note: similar entries may be passed for second call, third call, if any.)

### Issue of shares at premium

Shares are said to be issued at premium when a shareholder is required to pay more than the face value to the company. The excess amount received over the face value is called share premium. It is a capital receipt. The share premium shall be transferred to "Securities Premium A/c". It should be shown on the liability side of balance sheet under the head "Reserves and Surplus".

### Journal entries:

(a) **If premium is received with application money:**

(i) Bank A/c Dr

To Share application A/c

(ii) Share application A/c Dr (with total)

To Share capital A/c (application)

To Securities premium A/c (premium)

(b) **If premium is received with allotment money:**

(i) Share allotment A/c Dr (total)

To Share capital A/c (allotment due)

To Securities premium A/c (premium)

(ii) Bank A/c A/c

To Share allotment A/c

### Issue of shares at discount

Shares are said to be issued at discount when the shareholder is required to pay less amount than the face value to the company. Discount on issue of shares is a capital loss and it should be debited to a separate account called "Discount on issue of shares A/c". It is shown on the assets side of balance sheet under "Miscellaneous Expenditure". The rate of discount should not exceed 10% of nominal value of shares. Generally the discount on issue is recorded at the time of allotment. It is also noted that a newly registered company cannot issue shares at

discount. **The journal entry is**

Share allotment A/c Dr (allotment money)

Discount on issue of shares A/c Dr (disc.)

To Share capital A/c (Total)

### When both Preference and Equity Shares are issued

When a company issues both preference and equity shares the journal entries are written separately for each type of share capital.

### Under subscription of shares

Sometimes the applications for shares received will be less than the number of shares issued. This is called under subscription. In such a case, the allotment will be equal to the number of shares subscribed and not to the shares issued.

### Over subscription of shares

Sometimes the applications for shares received will be more than the number of shares issued. This is called over subscription. When there is over subscription, it is not possible to issue shares to all applicants. In such a situation company shall reject some applications altogether, allot in full on some applications and make a **pro-rata allotment** on some applications. Pro-rata allotment means that allotment on every application is made in the ratio which the number of shares allotted bears to number of shares applied. In case of applications fully rejected will be returned to the applicants. In pro-rata allotment the excess application will be adjusted either on allotment and or on calls. Any surplus left even after the adjustment will be refunded to the applicants. **Journal entries are**

1. **When application money is returned:**

Share application A/c Dr

To Bank A/c

2. **When excess application is adjusted towards allotment or call:**

Share application A/c Dr (total)

To share allotment A/c

To Call (if any)

### Calls in Arrears and Calls in Advance

Sometimes shareholders may fail to pay the allotment money and or call money. Such

dues are called calls in arrears. It is shown in the balance sheet as a deduction from the called-up capital. Directors are authorized to charge interest on calls in arrears at a rate as per Articles. In its absence, the interest does not exceed 5% pa.

When a shareholder pays more money than called up, the excess money is called calls in advance. The company must pay interest on calls in advance at a rate prescribed by Articles. In its absence, the company is liable to pay interest @6% pa. But the shareholder is not entitled to any dividend on calls in advance.

**Forfeiture of shares**

The cancellation of shares due to non-payment of allotment money or call money within a specified period is called forfeiture of shares. It is the compulsory termination of membership of the defaulting shareholders. He also loses whatever amount he has paid to the company so far. A company can forfeit the shares only if it is authorized by its Articles. The forfeiting is done only after giving 14 day notice to the defaulting shareholders. The balance of forfeited shares A/c should be shown by way of an addition to called up capital on the liability side of balance sheet till the shares are reissued.

**Journal entries**

**1. Forfeiture of shares - issued at par:**

Share Capital A/c Dr (amount called up)  
     To share allotment A/c (unpaid)  
     To share call A/c (unpaid)  
     To forfeited shares A/c (total paid)

**2. Forfeiture of shares-issued at premium:**

**(a) When allotment money (incl. premium) and call money not paid**

Share Capital A/c Dr (amount called up)  
 Security premium A/c Dr (unpaid)  
     To share allotment A/c (unpaid)  
     To share call A/c (unpaid)  
     To forfeited shares A/c (total paid)

**(b) When call money not paid**

Share Capital A/c Dr (amount called up)  
     To share call A/c (unpaid)  
     To forfeited shares A/c (total paid)

**3. Forfeiture of shares which were issued at discount:**

Share Capital A/c Dr (amount called up)  
     To share allotment A/c (unpaid)  
     To share call A/c (unpaid)  
     To forfeited shares A/c (total paid)  
     To discount on issue of shares A/c

**Reissue of forfeited shares**

Forfeited shares may be reissued by the company either at pr, premium or discount. But the discount on reissue should not exceed the amount forfeited.

**Journal entries**

**1. On reissue at par (issued at par or premium):**

Bank A/c Dr (received on reissue)  
     To share capital A/c (paid up)

**2. On reissue of at a discount (issued at par or premium):**

Bank A/c Dr (received on reissue)  
 Forfeited shares A/c Dr (disc. on reissue)  
     To share capital A/c (paid up)

**3. On reissue at a premium (issued at par or premium):**

Bank A/c Dr (received on reissue)  
     To share capital A/c (paid up)  
     To security premium A/c (on reissue)

**4. On reissue at a discount (issued at a discount):**

Bank A/c Dr (received on reissue)  
 Discount on issue of shares A/c Dr (original)  
 Forfeited shares A/c Dr (over org. issue)  
     To share capital A/c (paid up)

If all forfeited shares have been reissued, the credit balance in forfeited shares A/c (capital profit) shall be transferred to capital Reserve A/c by passing the following entry

**Forfeited shares A/c Dr**

**To capital reserve A/c**

If all forfeited shares are not reissued, only the profit on shares which are issued is transferred to Capital reserve A/c.

**Surrender of shares**

Sometimes a shareholder is not able to pay further calls and returns his shares to the company for cancellation. Such voluntary

return of shares to the company by the shareholder himself is called surrender of shares. The accounting treatment of surrender of shares is the same as that of forfeiture of shares.

**REDEMPTION OF PREFERENCE SHARES**

When the preference shares are issued it is to be paid back by the company to such shareholders after the expiry of a stipulated period whether the company is to be wound up or not. As per Sec 80 of the Companies Act, a company limited by shares can redeem the preference shares, subject to the **following conditions:**

1. The shares to be redeemed must be fully paid up.
2. Such shares can be redeemed either out of profit or out of the proceeds of fresh issue of shares. But these cannot be redeemed out of fresh issue of debentures or out of sale proceeds of any property of the company.
3. Premium payable on redemption must be provided out of profits of company or out of company's security premium account.
4. When shares are redeemed out of profit, a sum equal to the nominal amount of shares so redeemed must be transferred out of profit to a reserve account namely Capital Redemption Reserve A/c.
5. The Capital Redemption reserve A/c can be utilized only for the issue of fully paid up bonus shares.

The preference shares can be redeemed either at par or at premium (but not at discount). Premium on redemption is provided out of existing security premium account or security premium on fresh issue. If they are not sufficient, the redemption premium should be provided out of P&L A/c or General Reserve.

**Methods of Redemption**

There are three methods for redemption of preference shares. They are:

- (a) Redemption out of fresh issue of shares
- (b) Redemption out of profits
- (c) Redemption partly out of fresh issue and partly out of profit

**Accounting Procedure for Redemption**

1. Ensure that the redeemable preference shares are fully paid. If they are partly paid, the **following entries** are passed to make them fully paid.

(a) Preference Share Final Call A/c Dr  
    To Preference Share Capital A/c

(b) Bank A/c Dr  
    To Preference Share Final Call A/c

2. **Entry for total amount due to preference shareholders**

Preference Shares Capital A/c Dr  
Premium on Redemption A/c Dr  
    To Preference Shareholders A/c

3. **Entry for issue of equity shares either with or without premium**

Bank A/c Dr (amount received)  
Discount on issue of shares A/c Dr  
    To Equity share capital A/c  
    To Security Premium A/c

4. **Entry for providing premium on redemption**

Security premium A/c  
or P&L A/c or General Reserve A/c Dr  
    To Premium on Redemption A/c

5. **Entry for appropriation from divisible profits to meet deficiency of amount on redemption (or if redemption is out of profit)**

P & L A/c or General Reserve A/c Dr  
    To Capital Redemption Reserve A/c

6. **Entry for payment to preference shares**

Preference Shareholders A/c Dr  
    To Bank A/c

**Use of equation for determining the face value of shares to be issued**

An equation can be applied when the given amount of premium in security premium A/c in the balance sheet plus amount of premium to be obtained from fresh issue of shares is not sufficient to pay premium on redemption of preference shares. It is due to security premium A/c given in balance sheet cannot be used for redeeming the face value of shares.

(a) **When fresh issue is to be made at a premium:** [Redeemable preference share capital + premium on redemption] = [{Balance in security premium A/c in B/S} + {Revenue profit available for redemption} + {N} + {N x % rate of premium on fresh issue}]

(b) **When fresh issue of shares is to be made at a discount:** [Redeemable preference share capital + premium on redemption] = [{Balance in security premium A/c in B/S} + {Revenue profit available for redemption} + {N} - {N x % rate of discount on fresh issue}]

Note: N=Nominal value of fresh issue of shares to be made for redemption

**BUY BACK OF SHARES**

Buy back is a method of cancellation of share capital. It simply means buying of own shares. It leads to reduction in the share capital of a company.

**Objectives of buy back**

1. To return surplus cash to investors
2. To improve the financial health
3. To increase the EPS
4. To increase the market price of the share

**Advantages of buy back**

1. It helps to return the surplus cash to investors
2. It helps to increase the EPS
3. It increases promoter’s holding in the company
4. It helps to restructure the capital base of the company

**Disadvantages of buy back**

1. It implies under valuation of company’s stock
2. It may be used as a tool of insider trading
3. It may be used for manipulating the prices of shares.

**Methods of buy back**

As per SEBI guidelines, there are two methods of buy back of shares. They are:

1. Buy back through tender offer – Under this, a company can buy back its shares from its existing shareholders on a proportionate basis.

2. Buy back from the open market – A company can also buy back its shares from the open market either through stock exchanges or book building process.

**DEBENTURES**

The term ‘debenture’ has been derived from the Latin word ‘debere’, which means ‘to borrow’. Debenture is an instrument in writing given by a company acknowledging debt received from the public. The Companies Act defines debenture as “debenture includes debenture stock, bonds or any other securities of a company, whether constituting a charge on the assets of the company or not”.

**Features of Debenture**

1. It is an instrument of debt issued by company under its seal.
2. It carries fixed rate of interest.
3. Debenture is a part of borrowed capital.
4. It is repaid after a long period.
5. It is generally secured.

**Difference between shares and debentures**

<b>Share</b>	<b>Debenture</b>
The person holding share is called shareholder	The person having debenture is called debenture holder
It is part of owned capital	It is a part of borrowed capital
Dividend is paid on shares	Interest is paid on debenture
Rate of dividend varies year to year	Rate of interest is fixed
Shareholder has voting right	doesn’t have voting right
It can’t be converted into debenture	It can be converted into share

**Classification of debentures**

1. **Secured or Mortgage debentures** – These debentures are secured either on a particular asset or on the assets of the company in general.
2. **Unsecured or Naked debentures** – These debentures do not create any charge on the assets of the company.

## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

3. **Registered debentures** – These debentures are payable to the persons recorded in the register of debenture holders of the company and these are transferable only with the knowledge of the company.

4. **Bearer debentures** – In these debentures company maintains no register of debenture holders and these are transferable by mere delivery.

5. **Redeemable debentures** – These debentures are repayable after a fixed period either in lump sum or in installments.

6. **Perpetual or Irredeemable debentures** – These debentures are not repayable during the life time of the company.

7. **Convertible debentures** – These debentures can be converted into the shares within or after a Specified period, at the option of the holder.

8. **Non-Convertible debentures** – These debentures can't be converted into shares.

### Issue of Debentures

Issue of debentures can be studied in the following two points of view

#### 1. From consideration point of view

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

Bank A/c Dr

Discount on issue of debentures A/c Dr (if )

To Debentures A/c

To Security premium A/c (if any)

b. **For consideration other than cash:**

i. **For purchase of assets**

Sundry Assets A/c Dr

To Vendor A/c

ii. **For issuing debentures** for payment of purchase consideration

Vendor A/c Dr

To Debentures A/c

c. **As collateral security:** When debentures are issued as subsidiary or secondary security in addition to the principal security against a loan or bank over draft such an issue of debentures is called issue of debentures as collateral security.

2. From price point of view : From this

point of view debentures can be issued either at par, at premium or at discount.

a. **When debentures are issued at par**

Bank A/c Dr (with face value)

To debentures A/c

b. **When debentures are issued at discount**

Bank A/c Dr (net amount received)

To Disc. on issue of Debentures A/c

To Debentures A/c (with face value)

c. **When debentures are issued at premium**

Bank A/c Dr (total amount)

To Debentures A/c (with face value)

To Security premium A/c

### condition of redemption

There are six cases on the basis of terms of issue and conditions of redemption of debentures. They are as follows:

a. Issued at par and redeemable at par.

b. Issued at premium and redeemable at par.

c. Issued at discount and redeemable at par.

d. Issued at par and redeemable at premium.

e. Issued at discount and redeemable at premium.

f. Issued at premium and redeemable at premium.

**A. When issued at par and redeemable at par.**

Bank A/c Dr

To Debentures A/c

**B. When issued at premium and redeemable at par.**

Bank A/c Dr (face value+ premium)

To Debentures A/c (face value)

To security premium A/c

**C. When issued at discount and redeemable at par.**

Bank A/c

Dr

Discount on issue of debentures A/c Dr

To Debentures A/c (face value)

**D. When issued at par and redeemable at premium.**

Bank A/c Dr (amount received)

Loss on issue of debentures A/c Dr

To debentures A/c (face value)

To premium on redemption A/c

## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

### E. When issued at discount and redeemable at premium.

Bank A/c Dr (amount received)  
Loss on issue of debentures A/c Dr  
    To debentures A/c (face value)  
    To premium on redemption A/c

### F. When issued at premium and redeemable at premium.

Bank A/c Dr (amount received)  
Loss on issue of debentures A/c Dr  
    To debentures A/c (face value)  
    To security premium A/c  
To premium on redemption A/c

### Discount or Loss on issue of debentures

Discount or loss on issue of debentures and premium on redemption are capital losses. They are shown in the balance sheet under the head "Miscellaneous Expenditure". Being the losses, they are to be written off against capital reserve or security premium A/c. In its absence it is written off to P & L A/c during the life of debentures. **The entry is**

Capital res./ Security prem P & L A/c Dr  
    To Disc. /Loss on issue of debnt.

### REDEMPTION OF DEBENTURES

Redemption of debentures refers to the discharge of liability on account of debentures. It simply means repayment of debentures. As per Companies Act, the debentures should be redeemed in accordance with the terms and conditions of issue. The following entries are passed for redemption of debentures.

#### a. When debentures are redeemed at par

i. Debentures A/c Dr  
    To debenture holders A/c

ii. Debenture holders A/c Dr  
    To Bank A/c

#### b. When debentures are redeemed at premium

i. Debentures A/c Dr  
Premium on redemption A/c Dr  
    To debenture holders A/c

ii. Security premium/ General reserve/P&L A/c Dr

    To Premium on redemption A/c

iii. Debenture holders A/c Dr  
    To Bank A/c

### Sources of redemption of debentures

**1. Redemption out of fresh issue.:** A company may issue new shares or debentures or both for redeeming the existing debentures.

**2. Redemption out of Capital:** If debentures are redeemed out of capital, no amount of divisible profit is kept aside for Redeeming debentures. Redemption out of Capital reduces the liquid resources available to the company. As per the guidelines issued by SEBI, a company has to create Debenture Redemption Reserve (DRR) equivalent to 50% of the amount of debenture issue before redemption of debentures commences. But the creation of DRR is not required in the following cases

a. Debentures with maturity of 18 months or less

b. Fully convertible debentures.

**3. Redemption out of profit:** When sufficient profits are transferred from P & L Appropriation A/c to the Debenture Redemption Reserve A/c at the time of redemption of debentures, such redemption is said to be out of profits. It reduces the profits available for dividend. The **following entry** is passed for transfer of profit.

P & L Appropriation A/c Dr  
    To Debenture Red. Reserve A/c

On the completion of redemption of all debentures, the DRR A/c is close by transferring it to general reserve. The entry is as follows

Debenture Red. Reserve A/c Dr  
    To General Reserve A/c

P & L Appropriation A/c Dr  
    To Debenture Red. Reserve A/c



## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

(Transfer of amount for debenture redemption)

8% Debentures A/c Dr  
     To Debenture holders A/c  
 (amount due to debenture holders)

Debenture holders A/c Dr  
     To Bank A/c  
 (payment to debenture holders)

Debenture Redemption Reserve A/c Dr  
     To General Reserve A/c  
 (transfer of DRR to GR after redemption)

Note: Amount equal to the value of debentures redeemed is transferred from P&L Appropriation A/c to DRR A/c.

**4. Redemption by Sinking Fund:** Under this method of redemption, every year a part of the profit (fixed amount) is set aside and sinking fund (Debenture Redemption Fund) is created. Sinking fund is invested in outside securities. The interest received of such investments along with the amount set aside from profit will again be invested as usual. It continues till the date of redemption of debenture. The investment will be sold and the cash thus realized will be used to repay the debentures. Under this method, sinking fund A/c (Debenture Redemption Fund A/c) and sinking fund investment A/c (Debenture Redemption Fund Investment A/c) will be opened. After the redemption, balance of sinking fund A/c is transferred to general reserve. The following **entries** are required under this method.

**At the end of first year:**

**i. For the amount set aside every year**

P & L Appropriation A/c Dr  
     To Sinking Fund A/c

**ii. For investment of sinking fund**

Sinking Fund Investment A/c Dr  
     To Bank A/c

**At the end of second and subsequent years:**

**i. For interest received on investment**

Bank A/c Dr

    To Interest on Sinking Fund Invt. A/c  
**ii. For transferring interest to sinking fund**

Interest on Sinking Fund Invt. A/c Dr  
     To Sinking Fund A/c

**iii. For annual amount set aside**

P & L Appropriation A/c Dr  
     To Sinking Fund A/c

**iv. For investment of annual installment and interest**

Sinking Fund Investment A/c Dr  
     To Bank A/c

**At the end of last year:**

All the entries except entry (iv) in second and subsequent year should be passed.

**i. For amount realized on sale of investment**

Bank A/c Dr  
     To Sinking Fund Investment A/c

**ii. For profit on sale of investment**

Sinking Fund Investment A/c Dr  
     To Sinking Fund A/c

(Note: if loss the above entry is reversed)

**iii. For amount due to debenture holders**

Debentures A/c Dr  
     Premium on redemption A/c Dr  
     To Debenture holders A/c

**iv. For amount paid to debenture holders**

Debenture holders A/c Dr  
     To Bank A/c

**v. For transfer of balance in sinking fund A/c**

Sinking Fund A/c Dr  
     To General Reserve A/c

**5. Redemption by Insurance Policy:** This is an alternative to sinking fund method. Under this method, an insurance policy is purchased by paying annual premium. Such policy will mature on the date of redemption. This method provides funds for redemption and covers the risk involved in the transactions.

**6.Redemption by Conversion:** Sometimes the debenture holders of a company are given the option to convert their debentures into the shares or new debentures within a

## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

stipulated period. The new shares or debentures can be issued either at par or at premium or at discount. The following **entry** will be made for the purpose.

Old Debentures A/c Dr

Disc. on issue of shares/debentures A/c Dr

To New Share Capital/ Debenture A/c

To Prem on issue of shares/ deb A/c

### **Own Debentures**

The directors can purchase debentures whenever they find the market price favorable to the company. Such purchased debentures can be either cancelled by the company or may be kept as an investment called own debentures and may be utilized for reissue when needed afterwards. Purchase of own debentures are to be treated in account in the same way as an ordinary investment. The **entry** will be:

Own Debentures A/c Dr (purchase price)

To Bank A/c

### **Module 2**

#### **FINAL ACCOUNTS OF COMPANIES**

It is not obligatory to sole proprietors and partnership firms to prepare the final accounts as per the statute. But, according to Section 210 of Indian Companies Act 1956 it is a statutory obligation to a joint stock company to prepare its final accounts. The final accounts of a company consist of (a) Balance Sheet and (b) Profit and Loss Account.

#### **Balance Sheet**

The Balance sheet of companies must be prepared according to the prescribed form given in Part I of Schedule VI of the Companies Act. As per the Companies Act, the Balance sheet of companies can be prepared in two forms – (i) Horizontal Form and (ii) Vertical Form.

#### **Profit and Loss Account**

In Companies Act, there is no specified format for preparation of Profit and Loss Account of companies. It is not required to

split the Profit and Loss Account into three sections (Trading Account, Profit and Loss Account and Profit and Loss Appropriation Account). Only the Profit and Loss Account is prepared which cover items appearing in Trading Account and Profit and Loss Appropriation Account. But it is desirable to split the Profit and Loss Account into three sections so that Gross profit, Net profit and Surplus carried to balance sheet may be ascertained.

#### **Difference between Reserves and Provisions**

<b>Reserves</b>	<b>Provisions</b>
It is an appropriation of profit. Hence it is debited to Profit and Loss Appropriation Account	It is a charge against profit. Hence it is debited to Profit and Loss Account
It needs not be created when profits are inadequate.	It must be made irrespective of whether profit or loss.
It is shown on the liability side of balance sheet under the head 'Reserves and Surplus'.	It is usually shown by way of deduction from the amount of the item for which it is created.
It can be utilized for distribution of dividend.	It cannot be utilized for distribution of dividend.

#### **Provision for taxation**

A company will estimate the tax payable for the current accounting period and on this basis it will make provision for taxation. Provision for taxation is debited to Profit and loss Account and it will appear on the liability side of balance sheet under the head 'Provisions'. When assessment completed, the provision for tax will be adjusted. If the assessed tax is more than the provision made in the previous year, the excess has to be shown on the debit side of Profit and Loss Appropriation Account. If the assessed tax is

less than the opening provision, such excess provision should be credited to the Profit and Loss Appropriation Account.

### **Dividend**

The divisible profit (profit available to shareholders) of a company is distributed among the shareholders of the company on the basis of number of shares held. This is called dividend. Dividend is usually paid on paid up capital.

**Proposed dividend** :It is the dividend recommended by Board of Directors after the close of the books of account. When it approved by the shareholders in the annual general meeting, it becomes final dividend.

**Interim dividend** :Interim dividend refers to the dividend paid by the company before the preparation of final accounts. It is declared between two annual general meetings.

**Final dividend** :It is the dividend which is proposed and declared at the end of the accounting year after the close of the books of account.

**Unclaimed dividend**: It refers to the dividend not yet claimed by the shareholders within 30 days of declaration of dividend. It is shown as a current liability in the balance sheet.

### **Corporate Dividend Tax (CDT)**

The companies distributing dividend are required to pay tax on such dividends. It is called Corporate Dividend Tax (CDT). CDT is payable on any amount declared, distributed or paid by a company as dividend. At present, the rate of CDT is 16.995 % ( 17%). Corporate Dividend Tax is shown on the debit side of Profit and Loss Appropriation Account and on the liability side of Balance sheet under the head 'Current liabilities and Provisions' (Provisions).

### **Transfer to Reserves**

Generally, Board of Directors has the discretionary power regarding the transfer of profit to the reserve. However, as per Section 205(2A) of the Act, it is compulsory for a company to transfer certain minimum

amount to the reserve at a rate not exceeding 10%. Amount of transfer to reserve depends on the rate at which dividend is to be declared as follows:

i. **If the dividend proposed exceeds 10% but not exceed 12.5%** of the paid up capital, the amount to be transferred to the reserve shall not be less than **2.5%** of the current profits.

ii. **If the dividend proposed exceeds 12.5% but not exceed 15%** of the paid up capital, the amount to be transferred to the reserve shall not be less than **5%** of the current profits.

iii. **If the dividend proposed exceeds 15% but not exceed 20%** of the paid up capital, the amount to be transferred to the reserve shall not be less than **7.5%** of the current profits.

iv. If the dividend proposed **exceeds 20%** of the paid up capital, the amount to be transferred to the reserve shall not be less than **10%** of the current profits.

### **Module 3**

### **AMALGAMATION OF COMPANIES**

There are many forms of business combinations to obtain the economies of large scale production or to avoid the cut throat competition. They are amalgamation, absorption, external reconstruction etc.

The term amalgamation is used when two or more existing companies go into liquidation and a new company is formed to take over the business of liquidated companies. The term absorption is used when an existing company takes over the business of one or more existing companies which go into liquidation.

In external reconstruction, one existing company goes into liquidation and a new company is formed to take over the former company.

### **Definitions**

a. **Amalgamation** – means an amalgamation pursuant to the provisions of the Companies Act 1956 or any other statute which may be applicable to companies.

## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

b. **Transferor Company** – means the company which is amalgamated into another company.

c. **Transferee Company** – means the company to which a transferor company is amalgamated.

d. **Reserve** – means the portion of earnings, receipts or other surpluses of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than provision for depreciation or diminution in the value of assets or for a known liability.

### Types of Amalgamation

As per AS-14 there are two types of amalgamation (1) Amalgamation in the nature of merger and (2) Amalgamation in the nature of purchase.

### Amalgamation in the nature of Merger (Pooling Interest Method)

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 or companies before amalgamation should become 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 (excluding the proportion held by the transferee company) should become the shareholders of the transferee company.

iii. The consideration payable to the above mentioned shareholders should be discharged by the transferee company by the issue of the equity shares and cash can be payable in respect of fractional shares.

iv. The business of the Transferor Company/ companies is intended to be carried on 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/ companies when they are incorporated in the financial statements of the transferee company except

to ensure uniformity of accounting policies.

### Amalgamation in the nature of purchase

An amalgamation should be considered to be an amalgamation in the nature of purchase, when any one or more of the conditions specified for amalgamation in the nature of merger is not satisfied.

### Difference between Amalgamation in the nature of merger and Amalgamation in the nature of purchase

Merger	Purchase
There is a genuine pooling of assets and liabilities of the transferor companies as well as the share holders' interest.	One company acquires another
Assets, liabilities and reserves of the transferor company are recorded by the transferee company at their book values.	Assets, liabilities and reserves are recorded by the transferee company either at book value or at values revised
The balance of P&L A/c of the transferor company aggregated with the balance of the P&L A/c of the transferee company	The balance of P&L A/c of the transferor company is not included in the books of the transferee company
All reserves whether capital or revenue of Transferor Company are merged into the reserves of Transferee Company	Only statutory reserves are taken in the books of Transferee Company in order to preserve their identity.
It is always intended to continue the business of transferor company	It may not be intended to continue the business of Transferor Company

## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

All the assets of Transferor Company become the assets of the transferee company.	All the assets may or may not become the assets of the transferee company.
Purchase consideration is usually valued at the par value of the shares issued.	Purchase consideration is usually valued at the market price of the shares issued.

### Purchase Consideration

Purchase consideration is the amount which is paid by the transferee company for the purchase the business of Transferor Company. As per AS-14, consideration for amalgamation means the aggregate of 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. Purchase consideration does not include any payment to outsiders including debenture holders.

The purchase consideration may be calculated in the **following ways**:

1. **Lump Sum Method**: When the transferee company agrees to pay a fixed sum to the transferor company, it is called lump sum payment of purchase consideration. For example, X Ltd purchases the business of Y Ltd for a consideration of 1000000.

2. **Net Worth (Net Assets) Method**: Under this method, the net worth of the assets taken over by the transferee company is taken as purchase consideration. Here, Purchase consideration = Assets taken over at agreed values – Liabilities taken over at agreed values.

The following points are noted while calculating purchase consideration under his method:

- Cash balance is usually included in assets. But if it is not taken over, it will not be included.
- Fictitious assets should never be added.
- Accumulated profits and reserves should not be considered.
- The term 'liabilities' include all liabilities

to third parties. But 'trade liabilities' include only trade creditors and bills payable.

e. The term 'business' will always means both the assets and liabilities.

3. **Net Payment method**: Under this method, purchase consideration is the aggregate of all payments in the form of cash, shares, securities etc. to the shareholders of the transferor company by the transferee company. The following points are considered while calculating purchase consideration under this method:

- The assets and liabilities taken over by the transferee company are not considered.
- Purchase consideration includes the payments to shareholders only.
- Any payments made by the transferee company to some other party on behalf of the transferor company are to be ignored.

4. **Share exchange or Intrinsic value Method**: Under this method purchase consideration is calculated on the basis of intrinsic value of shares. The intrinsic value of a share is calculated by dividing the net assets available for equity shareholders by the number of equity shares. This value determines the ratio of exchange of the shares between the transferee and transferor companies.

### Steps in accounting procedure of amalgamation, absorption and external reconstruction

- Calculation of purchase consideration.
- Ascertainment of discharge of purchase consideration.
- Closing the books of transferor companies.
- Passing opening entries in the books of purchasing or transferee company.

### Accounting entries in the books of transferor company

1. **For transferring assets to Realization A/c**:

Realization A/c Dr

To Assets A/c (individually )

(Note :( a). Fictitious assets should not be transferred to Realization A/c (b). If cash in hand and bank are not taken over by

## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

transferee company should not be transferred to Realization A/c. But it can be taken as opening balance of cash or bank A/c and (c). Other assets, even if they are not taken over, should be transferred to Realization A/c)

### 2. For transferring liabilities(outside liabilities only) to Realization A/c:

Liabilities A/c Dr (individually)  
To Realization A/c

(Note : ( a). If any liability is not taken over by transferee company should not be transferred to Realization A/c, (b). Items in the nature of provisions are to be transferred to Realization A/c and (c). Any fund which denotes both liability and reserve, the portion of liability should be transferred to Realization A/c).

### 3. For purchase consideration due from transferee company:

Transferee Company A/c Dr  
To Realization A/c

### 4. On receiving or discharging purchase consideration:

Equity shares in Transferee co. A/c Dr  
Pref. shares in Transferee co. A/c Dr  
Debentures in Transferee co. A/c Dr  
Cash/ Bank A/c Dr  
To Transferee company A/c

### 5. For sale of assets not taken over by transferee company:

Cash/ Bank A/c Dr (Sale proceeds)  
To Realization A/c

### 6. For discharging liabilities not taken over by transferee company:

Liability A/c Dr  
Realization A/c Dr (if excess paid)  
To Cash/ Bank A/c  
To Realization A/c (If less)

### 7. For liquidation (realization) expenses:

a. If liquidation expenses are met by transferor company.

Realization A/c Dr  
To Cash/ Bank A/c

b. If liquidation expenses are met by transferee company.

No entry is required.

### 8. For closing preference share capital:

Preference share capital A/c Dr  
Realization A/c Dr (if excess paid)  
To Preference shareholders A/c  
To Realization A/c (if less)

### 9. For paying off Preference shareholders:

Preference shareholders A/c Dr  
To Pref. shares in Transferee co A/c  
To Cash/ Bank A/c (if any)  
To Debentures A/c (if any)

### 10. For trans. equity capital, reserves

Equity share capital A/c Dr  
General reserve A/c Dr  
P&L A/c Dr  
Dividend equalization reserve A/c Dr  
Security premium A/c Dr  
To equity shareholders A/c

### 11. For transferring fictitious assets:

Equity shareholders A/c Dr  
To P&L A/c  
To preliminary expenses  
To Disc./ expense on issue

### 12. For closing Realization A/c:

a. For loss on realization (if debit > credit).

Equity shareholders A/c Dr  
To Realization A/c

b. For profit on realization (if credit > debit).

Realization A/c Dr  
To Equity shareholders A/c

### 13. For payment to equity shareholders:

Equity shareholders A/c Dr  
To Equity shares in Transferee co. A/c  
To Cash/ Bank A/c (if any)

After payment to equity shareholders, all accounts in the book of transferor company will be closed.

### entries in the books of transferee company (nature of purchase)

1. For purchase consideration due and assets and liabilities taken over:

Assets A/c Dr (At revised, or book value)  
Goodwill A/c Dr (if credit > debit)  
To Liabilities A/c (At revised,  
To Liquidator of transferor co.(PC)  
To Capital reserve (if debit > credit)

## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

### 2. For payment of purchase consideration:

Liquidator of transferor company A/c Dr  
 To Share capital A/c  
 To Debenture A/c  
 To Bank A/c

(Note: if shares are issued at premium, security premium A/c is credited with premium. If shares are issued at discount, discount on issue of shares A/c is debited with discount).

### 3. For payment of liquidation expenses by transferee company:

Goodwill/ Capital reserve/ P&L A/c Dr  
 To Cash/ Bank A/c

### 4. For payment of formation expenses:

Preliminary expenses A/c Dr  
 To Cash/ Bank A/c

### 5. If there are both Goodwill and Capital reserve A/c, Goodwill may be set off against Capital reserve:

Capital Reserve A/c Dr  
 To Goodwill A/c

### 6. If any liability (including debenture) is discharged by transferee company:

Liability A/c Dr (Amount payable)  
 To Share capital/ Deb./ Bank A/c

### 7. To record Statutory Reserves of transferor company:

Amalgamation Adjustment A/c Dr  
 To Statutory Reserve A/c

(Note: Amalgamation adjustment A/c is shown on the assets side of the company's Balance Sheet under the head "Miscellaneous Expenditure").

### Accounting entries in the books of transferee company (Amalgamation in the nature of merger)

#### 1. For purchase consideration due and assets and liabilities taken over:

Assets A/c Dr (Individually)  
 To Liabilities A/c (Individually)  
 To Reserves of Transferor co. A/c  
 To P & L A/c  
 To Liquidtr. of transferor co A/c (PC)

(Note: The diff. between Dr and Cr is adjusted in the reserves of Transferee Co.)

### 2. For payment of purchase consideration:

Liquidator of transferor company A/c Dr  
 To Share capital A/c  
 To Debenture A/c  
 To Bank A/c

(Note: if shares are issued at premium, security premium A/c is credited with premium. If shares are issued at discount, discount on issue of shares A/c is debited with discount).

### 3. Payment of liquidation expense by transferee company:

General Reserve/ P & L A/c Dr  
 To Cash/ Bank A/c

### 4. For the payment of formation expenses:

Preliminary expenses A/c Dr  
 To Cash/ Bank A/c

### ACCOUNTING FOR INTERNAL RECONSTRUCTION

There are two types or reconstruction, namely external reconstruction and internal reconstruction. In external reconstruction, a new company is formed to take over the assets and liabilities of an existing company which goes into liquidation. But in internal reconstruction, there will be neither liquidation of an existing company nor formation of a new company. Internal reconstruction means an internal rearrangement that gives a new look to the capital structure, adjusts the rights of shareholders, debenture holders and creditors along with some adjustments in the values of assets and writing off fictitious assets. Internal reconstruction may be done due to the accumulate losses, shortage of working capital, overvaluation of assets etc.

### Forms or Methods of Internal reconstruction

1. Alteration of share capital.
2. Reduction of share capital.
3. Variation of shareholders' rights.
4. Scheme of compromise

## CORPORATE A/CING – (Al Jamia Arts and Science College, Poopalam)

**Difference between Internal reconstruction and External reconstruction**

Internal reconstruction	External reconstruction
The company does not lose its identity	The company loses its identity
The overvalued assets are revalued at their net worth and the losses written off.	The newly formed company takes over the assets and liabilities of the liquidated company at agreed values.
No new company is formed nor is any existing company liquidated.	A new company is formed in place of the old company.
Debenture holders, creditors and bank overdraft may continue	These parties will have to be settled.

### Alteration of Share Capital

According to Sec. 94 of the Companies Act, a limited company can, if authorized by its articles of association, alter the capital clause of its memorandum of association in any of the following ways.

- a. By increasing its share capital by issue of new shares.
- b. By consolidating existing shares of smaller amounts into shares of larger amounts.
- c. By subdividing the existing share into shares of smaller amounts.
- d. By converting fully paid shares into stock or stock into fully paid shares.

### Accounting entries for alteration of capital

#### a. For increasing its share capital

i. Bank A/c Dr  
    To Share Application & Allotment A/c

ii. Share Application & Allotment A/c Dr  
    To Share Capital A/c

#### b. For consolidation of shares:

Share Capital (old) A/c Dr  
    To Share Capital (New) A/c

#### c. For subdivision of shares:

Share Capital (old) A/c Dr  
    To Share Capital (New) A/c

#### d. For conversion of shares into stock:

Share Capital A/c Dr  
    To Stock A/c

#### e. For conversion of stock into shares:

Stock A/c Dr  
    To Share Capital A/c

### Reduction of Share Capital

Reduction of capital is unlawful except when sanctioned by the court because conservation of capital is one of the main principles of the Company Act. In order to reduce the share capital, the company must be authorized by its articles of association, a special resolution must be passed at general meeting, and confirmation of court etc. is required. A company can reduce its share capital by any of the following ways:

- a. By reducing the liability of the shareholders for uncalled capital.
- b. By paying off the surplus capital.
- c. By reducing paid up capital which is not represented by available assets.

### Accounting entries for reduction of share capital

#### a. For reducing the liability in respect of uncalled capital:

Share Capital (old) A/c Dr  
    To Share Capital (New) A/c

#### b. For paying off surplus capital:

i. Share Capital A/c Dr  
    To Shareholders A/c

ii. Shareholders A/c Dr  
    To Bank A/c

#### c. For reducing or cancelling capital which is not represented by available assets:

##### i. For reducing paid up capital by changing its face value:

Share Capital (old) A/c Dr  
    To Share Capital (New) A/c  
    To Capital Reduction A/c

##### ii. For reducing paid up capital without changing its face value:

Share Capital A/c Dr (amt of reduced capital)  
    To Capital Reduction A/c



**Capital Reduction Account**

Capital Reduction Account is a new account opened for transferring that part of capital which is lost or not represented by the assets. It is a temporary account opened for carrying out internal reconstruction. This account will be closed as soon as the scheme is carried out. The balance in Capital Reduction A/c can be used to write off fictitious assets, past losses and excess value of assets. The **entry** is as follows:

Capital Reduction A/c Dr

- To P&L A/c (Debit balance)
- To Goodwill A/c
- To Preliminary Expenses A/c
- To disc. on issue of shares/ deb. A/c
- To Patents/ Trademarks A/c
- To Plant & Machinery A/c
- To other Assets A/c
- To Capital Reserve A/c (Bal. Fig)

**Variation of Shareholders' rights**

Under this, the shareholders rights are altered by changing the rate of dividend or changing the classes of shares. For example, it can be done by changing the cumulative preference shares to non-cumulative preference shares or from 10% preference shares into 7% preference shares etc.

**Module 4**

**FINAL ACCOUNTS OF BANKING COMPANIES**

In India, banking companies are governed by the Banking Regulation Act 1949. Section 5 of the Act defines banking as “the accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, and order or otherwise“. Business of banking companies In addition to the business of banking, a banking company may engage in any one or more of the following business:

- i. The borrowing, raising, or taking up of money
- ii. The lending or advancing of money either

upon or without security

iii. The drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments, and securities whether transferable or negotiable or not.

iv. The granting and issuing of letter of credit, travelers cheques and circular notes

v. On receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise.

vi. The buying, selling and dealing in bullion

vii. The collecting and transmitting of money and securities

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

ix. Carrying on and transacting every kind of guarantees and indemnity business

x. Undertaking and executing trusts, etc...

**Important provisions of the Banking Regulation Act 1949**

**1. Statutory Reserve:** As per Section 17, banking companies incorporated in India shall transfer every year at least 25% of its profit before any dividend is declared to a Statutory reserve (Reserve fund) until the amount of the reserve together with the security premium Account is equal to the paid up capital.

**2. Cash Reserve Ratio (CRR):** Banks are required to maintain with the Reserve Bank of India a cash reserve of at least 3% of the total of its demand and time liabilities in India.

**3. Statutory Liquidity Ratio (SLR):** Banks are also required to maintain atleast 25% of the demand and time liabilities in the form of liquid assets like cash, gold or unencumbered. SLR may vary in a range of 25% to 40%.

**4. Non - Banking Assets:** These are the assets which are not used in the ordinary course of business of banking, but they are such immovable and movable properties

which come under the possession of the banking company for recovering the amount due from customers.

**5. Minimum Capital and Reserves:** In case of a banking company incorporated in India, the sum of its paid up capital and reserves shall not be less than the amount mentioned below:

a. If it has places of business in more than one state Rs.500000, and if any such place of business is situated in Mumbai or Kolkata or in both, Rs.1000000.

b. If it has all its places of business in one state, none of which is Mumbai or Kolkata, Rs.100000 in respect of its principal place of business plus Rs.10000 for each additional place of business in the same district plus Rs.25000 for each place of business elsewhere in the state (the maximum amount required being Rs.500000).

#### Accounting System

The accounting system of a banking company is different from that of a trading or manufacturing company. The main features of a bank's accounting system are as follows:

1. Entries in the personal ledgers are made directly from the vouchers
2. From such entries in the personal ledgers each day summary sheets in total are prepared which are posted to the control accounts in the general ledger.
3. The general ledger's trial balance is extracted and agreed every day.
4. All entries in the personal ledgers and summary sheets are checked by persons other than those who have recorded entries. It helps in detection of mistakes.
5. A trial balance of detailed personal ledgers is prepared periodically and gets agreed with the general ledger control accounts.
6. Two vouchers are prepared for every transaction not involving cash.

#### Books maintained by banks

1. Receiving Cashier's Counter Cash Book.
2. Paying Cashier's Counter Cash Book.
3. Current Accounts Ledger.

4. Saving Bank Accounts Ledger.
5. Fixed Deposit Accounts Ledger.
6. Investment ledger.
7. Bills Discounted and Purchased Ledger.
8. Loan Ledger.
9. Cash Credit Ledger.
10. Customers' Acceptances, endorsements and Guarantee Ledger.
11. Recurring Deposits Accounts Ledger, etc.

#### The Slip System

This is not a system of book keeping, but a method of rapidly posting entries to books kept on double entry system. In this system, posting is made from slips prepared inside the organization itself or from slips filled in by its customers. In a banking company, the main slips are pay-in-slips, withdrawal slips and cheques and all these slips are filled in by clients of the bank.

#### Advantages of Slip system

1. It makes accounts reliable.
2. Slips are the basis of auditing.
3. The bank saves a lot of clerical labour as most of the slips are filled in by its customers.
4. There is no need for keeping subsidiary books.

#### Disadvantages of Slip system

1. Slips may be lost, destroyed or misappropriated as these are loose.
2. In the absence of subsidiary books, books cannot be verified.
3. It is very difficult and expensive to keep date wise record of a large number of slips.
4. Customers feel difficulty on account of slip system.

#### Final Accounts of Banks

As per Section 29, a banking company incorporated in India, is required to prepare, at the end of each accounting year, a Balance sheet and profit and Loss Account as on the last working day of the year.

#### Profit and Loss Account

A banking company is required to prepare its Profit and Loss Account according to Form B in the Third Schedule to the Banking Regulation Act, 1949.

### **Balance Sheet**

The balance sheet of a banking company is prepared according to Form A in Third Schedule

### **Explanation of some items relating to Balance Sheet**

1. **Money at call and short notice:** It represents temporary loans to bill brokers, stock brokers and other banks. If the loan is given for one day, it is called “money at call” and if the loan cannot be called back on demand and will require at least a notice of three days for calling back, it is called “money at short notice”.

2. **Advances:** Advances include Bills discounted and purchased, loans, cash credit and overdraft.

3. **Inter - office adjustments:** Every head office will have a number of transactions with its branches. The head office makes necessary adjustments in its books on the receipt of information from the branches. On the date of balance sheet some transaction may remain unadjusted in the books of the head office. Such entries are recorded in the balance sheet under the sub-heading ‘Branch Adjustments’ and may appear on the assets side under the heading ‘Other Assets’ if it has a debit balance and on the liabilities side under the heading ‘Other Liabilities’ if it has a credit balance.

4. **Bills for Collection:** When the bank receives bills receivables from its customers for collection, it keeps them till maturity. On the date of maturity when bills are collected, customers account is credited with the amount collected. If some bills remain outstanding, such bills are treated by the banks as outstanding bills for collection. It is shown as ‘Contingent Liability (Schedule 12)’.

5. **Acceptance, endorsement and other obligation:** This represents bank’s liability on account of bills endorsed or accepted on behalf of its customers. For greater security, the drawer of bill wants acceptance of the drawee’s bank. The bank incurs a liability by

accepting bills on behalf of customers. On the maturity of bill, the bank pays and collects the amount from its customers. At the end of the accounting period, if there is any outstanding bills it is shown on the ‘Contingent Liability (Schedule 12)’.

### **Non-Performing Assets (NPA)**

Bank advances can be classified as Performing Assets and Non-Performing Assets (NPA). An asset becomes NPA when it ceases to generate income for the bank. NPA means a credit facility in respect of which interest and/or principal repayment installments is in arrears for more than 90 days. Interest income from NPA is considered as income as and when it is received rather than on accrual basis.

### **Asset Classification**

Bank’s loans and advances are to be classified into two broad categories- Standard assets and Non-Performing Assets. NPAs are subdivided into three- Substandard, Doubtful and Loss Assets. These may be explained as follows:

1. **Standard Assets** – Standard assets are those which do not carry more than the normal credit risk attached to the business. These are assets which are not NPAs.

2. **Sub-standard Assets** – These have been classified as NPA for a period not exceeding 12 months.

3. **Doubtful Assets** - Doubtful Assets are those which have remained NPA for a period exceeding 12 months.

4. **Loss Assets** – Loss assets are those assets in which loss has been identified by the bank, auditors or RBI but the amount has not been written off wholly or partly. These assets are irrecoverable.

### **Rebate on bills discounted or unexpired discounts**

The whole amount of discount on bills discounted may not be related to that accounting year. A part of it may be related to next accounting period. This is so because at the close of the accounting year, some of the bills discounted may not have matured.

In short rebate on bills discounted means the unearned amount or discount received for those bills which mature after the date of closing the final accounts. It is also called unexpired discount or discount received in advance. It is carried forward to next year by passing the following entry:

Interest and discount A/c Dr  
    To Rebate on bills discounted.

If rebate on bills discounted is given in trial balance, it should be taken to Balance sheet under "Other Liabilities and Provisions". If it is given under adjustments, it should be deducted from "Interest and Discount" in Profit and loss Account and should be taken to Balance sheet under "Other Liabilities and Provisions". At the commencement of next accounting year it is transferred to Interest and Discount Account by reversing the above entry.

#### **Module 5**

### **FINAL ACCOUNTS OF INSURANCE COMPANIES**

Insurance is a contract whereby one party agrees for a consideration called premium to indemnify the other against a possible loss or to pay a stated sum of money on the happening of a particular event. This agreement or contract when put in writing is known as **policy**. The person whose risk is covered is called **insured or assured** and the company or corporation which insures is known as **insurer, assurer or underwriter**. The consideration in return for which the insurer agrees to make good the loss is known as **premium**.

#### **Types of Insurance**

From accounting point of view, the insurance may be divided into two as follows:

1. **Life Insurance** : A life insurance contract is a long term contract in which the assured must pay the premium at stated intervals and the insurer guarantee to pay a certain sum of money to the assured on the happening of the event which is certain (either death or expiry of the fixed period).

Section 2 of Indian Insurance Act 1938 **defines** life insurance as "life insurance business is the business of effecting contracts upon human life".

2. **General Insurance** :All insurance other than life insurance is general insurance. Under this type of insurance, the insurer undertakes to indemnify the loss suffered by the insured on happening of a certain event in consideration for a fixed premium. Usually all these are short term agreements for a year. Fire insurance, marine insurance, accident insurance, burglary insurance, third party insurance etc. are the examples for general insurance.

### **FINANCIAL STATEMENTS OF INSURANCE COMPANIES**

Insurance Regulatory and Development Authority (IRDA) has issued the regulations regarding the preparation of financial statements.

#### **Final Accounts of Life Insurance Companies**

The final accounts of a life insurance company consist of (a) Revenue Account, (b) P&L A/c and (c) Balance Sheet.

#### **Revenue Account (Form A-RA)**

Revenue Account is prepared as per the provisions of IRDA regulations 2002 and complies with the requirements of Schedule A as follows:

#### **Profit And Loss Account (Form A-PL)**

The P&L A/c is prepared to calculate the overall profit of the life insurance business. The incomes or expenses that are not related to any particular fund are recorded in the P&L A/c.

#### **Balance Sheet (Form A-BS)**

Balance Sheet of Life Insurance Company is prepared in vertical format.

#### **Explanation of items in final accounts**

1. **Claims** – Claim is the amount payable by the insurance company. In life insurance business, claims may arise due to two reasons i.e., by death or maturity.

2. **Annuity** – It is an annual payment which a life insurance company guarantees to pay for

lump sum money received in the beginning.

3. **Surrender value** – If an insured is unable to pay the further premium, he can get his policy paid from the company. It is the present cash value of the policy which a holder gets from the company on surrendering all the rights of the policy.

4. **Bonus in reduction of premium** – instead of paying bonus in cash, the insurance company may deduct the bonus from the premium due from the insured. This is known as bonus in reduction of policy.

5. **Consideration for annuities granted** - Any lump sum payment received by the insurance company in lieu of granting annuity is called consideration for annuity granted.

6. **Re-insurance** – When a company accepts a business of more value and in order to reduce the risk, may pass on some business to the other company, it is called reinsurance.

7. **Commission on Reinsurance Accepted or Ceded** – The Company which passes some business to the other company gets some commission which is known as commission on reinsurance business ceded. Commission paid on reinsurance business accepted is known as Commission on Reinsurance Accepted.

#### **Determination of profit in life insurance business**

A life insurance company earns profit when the life insurance fund exceeds its net liability. The net liability is the excess of present value of future claims of current policies over the present value of premiums to be received in future in respect of current policies. Net liability is to be compared with life assurance fund on a particular date in order to calculate the surplus or deficiency. Usually this comparison is made by preparing a statement called Valuation Balance Sheet.

#### **Final Accounts of General Insurance Companies**

The final accounts of a general insurance company consist of (a) Revenue Account, (b) P&L A/c and (c) Balance Sheet.

#### **Revenue Account**

General insurance company may be doing more than one business like fire, marine, accidental etc. For each type of business a separate Revenue Account is to be prepared in the prescribed form B-RA.

#### **Profit And Loss Account (Form B-PL)**

The P&L A/c is prepared to calculate the overall profit of the general insurance business. Operating profits (or losses) of fire, marine and miscellaneous insurance are taken in the P&L A/c. Income from investments, profit or loss on sale of investments, bad debts, provision for doubtful debts etc. are taken in the P&L A/c.

#### **Reserve for Unexpired Risk**

The reserve maintained to meet any possible liability in respect of those policies which are not expired at the end of an accounting year is called reserve for unexpired risk. Opening balance for reserve for unexpired risk is added to the premium and closing balance of reserve for unexpired risk is deducted from the premium. The net premium should be shown in revenue account. The closing balance of reserve for unexpired risk should be shown in the balance sheet under the head 'provisions'.

**MUHAMMED RIYAS N**

**ASST. PROF.**

**AL JAMIA ARTS AND SCIENCE COLLEGE  
POOPALAM, PERINTHALMANNA**

**PH: 9747799772**

**E-mail : riyasmuhammed89@gmail.com**

**Study  
Well...**