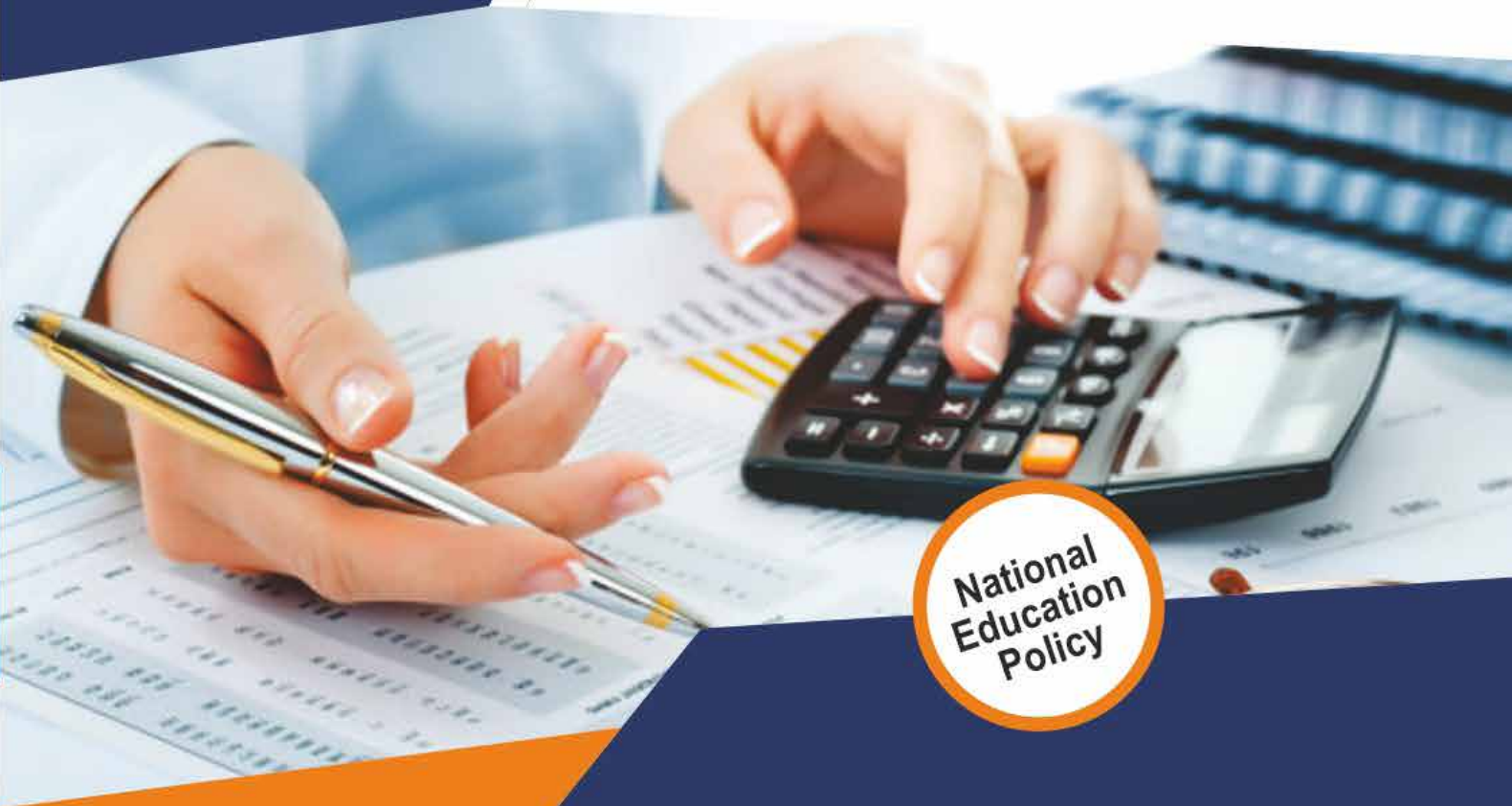
M.Com. ▪ Semester I Paper 411A

(New Syllabus 2023-24 Pattern as per NEP)



National Education Policy

ADVANCED ACCOUNTING - III

▪ CA. Abdul Kadir .N. Arsiwala
▪ Dr. Ameya C. Lohar

Prashant

This text book has been written in accordance with the revised syllabus as prescribed by B.O.S. in Commerce & Management Faculty, KBC North Maharashtra University, Jalgaon for M.Com. (NEP 2020 Pattern) w.e.f. June, 2023

M.Com ▪ Sem I ▪ Paper-411A

ADVANCED ACCOUNTING-III

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Prashant Publications

ADVANCED ACCOUNTING-III

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PREFACE

The Paper on advanced Accountancy at Post Graduate Level concentrates on conceptual understanding and practical applicability of crucial aspects of accounting course. The students are expected to apply the basic knowledge gained at undergraduate level and apply the knowledge in real world situations. The importance of the subject is growing due to various factors like Liberalisation, Globalisation, Free flow of Capital and better Corporate Governance Practices.

This book gives an insight into the important Accounting Standards from the corporate point of view. It also provides an introduction to new Accounting Standards been developed keeping in mind the growing importance of corporate scenario.

This book is divided into six chapters, each chapter addresses a special aspect in accounting. Chapter 1 focuses on Accounting Standards and their importance in corporate accounting. The second chapter deals with Fundamental of E-Commerce Accounting and Key Accounting issues from perspective of Ecommerce Business in elements of financial statements. Third Chapter focuses on novel concept of preparation of Value Added Statements and their Reporting. The Fourth Chapter focuses on preparation of Financial Statements for Holding Companies, the students acquire skills to prepare financial statements of company having single/multiple subsidiaries. The Fifth chapter deals with the liquidation of the companies and Preparation of Statements of affairs including deficiency/surplus account as per the provisions of the company law. The Last chapter introduces the students to the preparation an presentation of accounts of General Insurance Companies.

We hope that students and teachers will find this book highly useful. While all the care has been taken by the authors to ensure that the matter in the book is free from any error and the presentation of the book is simple, there may be some unintentional errors on our part. We are glad to mention that this book would have never been written without the support and encouragement of our family members, many thanks to them. We are thankful to Prashant Publications, Director Shri. Rangrao Patil, Shri. Pradeep Patil and entire team of Prashant Publication for bringing out this book in record time in very fine manner. We welcome the readers to give their valuable views, suggestions and feedback on our email: ameya.c.lohar@gmail.com or abdulkadirarsiwala@gmail.com

With Best Wishes.

- Authors

SYLLABUS

411A : Advanced Accounting-III

M.Com | Sem. I | w.e.f. Academic Year 2023-24 (NEP 2020 Pattern)

Credit – 04 Duration – 60 Hours

Unit 1 - Accounting Standards – (Lectures : 04)

Elementary study of the following Accounting Standards – 1.1 AS–20Earningper Share 1.2 AS- 21 Consolidated Financial Statements

Unit 2 - Accounting For E-Commerce Businesses (Lectures : 08)

2.1 Fundamental of E-Commerce Accounting 2.1.1 Business account types in ecommerce accounting 2.1.2 Ecommerce accounting tasks: Categorize all transactions, Track inventory, Maintain a budget, Track inventory cash flow, Proper recordkeeping, Track returns and chargebacks, Pay sales and income taxes and Analyse financial statements 2.1.3 Ecommerce accounting methods: cash, accrual, and modified cash 2.1.4 E-commerce accounting tasks to regularly complete:Track and categorize sales transactions, Track and categorize expenses, Track and categorize returns, refunds, and chargebacks, Reconcile bank and credit card accounts ,Prepare financial statements , Analyze financial performance, Stay on top of taxes, Keep a business budget ,Keep organized and accurate records. 2.2 Key Accounting issues from perspective of Ecommerce Business in elements of financial statement 2.2.1 Applicability of AS-9 or Ind AS -18 or Ind AS-115(effective from 01.01.2018) 2.2.2 Main source of revenue: Membership and Subscription, Merchandising Activity, Advertising Service , Other Services2.2.3Ex penditure(Revenue): Rebates, discounts and others sales incentives, Paid and Loyalty Programmes, Website Development Cost Etc.)

Unit 3 - Value Added Accounting & Reporting (Lectures : 08)

3.1 Concepts of valueaddition-Meaning, Utility, and Disclosure of Value Added Statement (VAS) - 3.2 Concept and Computation of- 1. Economic Value Added (EVA) 2. Gross Value Added (GVA) 3. Net Value Added (NVA) 4. Market Value Added (MVA) –(Theory and practical problems))

Unit 4 - Financial Statements of Holding Companies (Lectures : 10)

4.1 Consolidated Financial Statements of Holding Companies – 4.2 Consolidation with adjustments of - Inter-company transaction, Issue of Bonus Shares, Revaluation of fixed Assets, Debentures and Preference Shares of subsidiary Company, Dividend. Refer to the Accounting Standard AS21 "Consolidated Financial Statements", and Ind-AS 27–"Consolidated and Separate Financial Statements" (Note-Holding company with two or more subsidiaries tobe studied) (Theory and practical problems))

Unit 5 – Liquidation of Companies (Lectures : 12)

5.1 Preparation of Statements of affairs including deficiency/surplus accountas per the provisions of the company law (Theory and practical problems)

Unit 6 – Financial Statements of Insurance Companies (Lectures : 14)

6.1 Preparation of final accounts of Insurance companies carrying on General Insurance business, as per the forms prescribed by the Insurance Regulatory and Development Authority Regulations 2002 – - Revenue Accounts in Form B- RA - Profit and Loss Account in Form B- PL, and - Balance Sheet in Form B- BS (Theory and practical problems)

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2.2 Key Accounting issues from perspective of Ecommerce Business in elements of financial statement
2.2.1 Applicability of AS-9 or Ind AS -18 or Ind AS-115(effective from 01.01.2018) 2.2.2 Main source of revenue: Membership and Subscription, Merchandising Activity, Advertising Service, Other Services. 2.2.3 Expenditure (Revenue) : Rebates, discounts and others sales incentives, Paid and Loyalty Programmes, Website Development Cost Etc.)

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CHAPTER 1

Accounting Standards

1.1 Introduction
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1.1 Introduction :

Financial statements summarize the end-result business activities of an enterprise during an accounting period in monetary terms. Business activities are varied. It is difficult task to present the facts intelligibly, in a summarized form, keeping the loss of information minimal. In order that the methods and principles adopted by various reporting enterprises are uniform, comparable and well organized, accounting standards are evolved. The term standards denote a discipline, which provides both guidelines and yardsticks for evaluation. As guidelines, they provide uniform practices and common techniques. As yardsticks, standards are used in comparative analysis involving more than one subject matter.

Accounting standard is a code of practice pronounced by a regulatory accountancy body to be observed and applied in the preparation and presentation of financial statements. World over, professional bodies of accountants have the authority and the obligation to prescribe "Accounting Standards". International Accounting Standards (IASs) are pronounced by the International Accounting Standards Committee (IASC). The IASC was set up in 1973, with headquarters in London (UK).

In India, the Institute of Chartered Accountants of India (ICAI) had established the Accounting Standards Board (ASB) in 1977. The composition of ASB includes elected, ex-officio and co-opted members of the Institute, nominees of RBI, FICCI, Assocham, ICSI, ICWAI and special invitees from UGC, ICWAI, and SEBI, IDBI and IIM.

ASB is entrusted with the responsibility of formulating standards on significant accounting matters, keeping in view (a) international developments as also (b) legal requirements in India. According to the preface to the Statement on Accounting Standards issued by the ICAI, Accounting Standards will be issued by the ASB constituted for the purpose of harmonizing the different and diverse accounting policies and practices in use in India and propagating the Accounting Standards and persuading the concerned enterprise to adopt them in the preparation and presentation of financial statement.

Accounting Standards are formulated with a view to harmonize different accounting policies and practices in use in a country. The objective of Accounting Standards is, therefore, to reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different enterprises with a view to provide meaningful information to various users of financial statements to enable them to make informed economic decisions.

1.2 Brief Review of Indian Accounting Standards :

The Institute of Chartered Accountants of India has issued the following accounting standards :

Accounting Standards (AS)	Title of the Accounting Standards
AS – 1	Disclosure of Accounting Policies
AS – 2 (Revised)	Valuation of Inventories
AS – 3 (Revised)	Cash Flow Statements
AS – 4 (Revised)	Contingencies and Events Occurring after the Balance Sheet Date
AS – 5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
AS – 6 (Revised)	Depreciation Accounting
AS – 7 (Revised)	Accounting for Construction Contracts
AS – 9	Revenue Recognition
AS – 10	Accounting for Fixed Assets
AS – 11 (Revised 2003)	The Effects of Changes in Foreign Exchange Rates
AS – 12	Accounting for Government Grants
AS – 13	Accounting for Investments
AS – 14	Accounting for Amalgamations
AS – 15	Accounting for Retirement Benefits in the Financial Statements of Employers

AS – 16	Borrowing Costs
AS – 17	Segment Reporting
AS – 18	Related Patty Disclosures
AS – 19	Leases
AS – 20	Earnings Per Share
AS – 21	Consolidated Financial Statements
AS – 22	Accounting for Taxes on Income
AS – 23	Accounting for Investment in Associates in Consolidated Financial Statements
AS – 24	Discontinuing Operations
AS – 25	Interim Financial Reporting
AS – 26	Intangible Assets
AS- 27	Financial Reporting of Interest in Joint Ventures
AS – 28	Impairment of Assets
AS – 29	Provisions, Contingent Liabilities & Contingent Assets
AS – 30	Financial Instruments: Recognition and Measurement and Limited Revisions to AS 2, AS 11 (revised 2003), AS 21, AS 23, AS 26, AS 27, AS 28 and AS 29
AS – 31	Financial Instruments: Presentation
AS – 32	Financial Instruments: Disclosures, and limited revision to Accounting Standard (AS) 19, Leases

The given below is the brief overview of accounting standards in India :

- **AS-1 – Disclosure of Accounting policies :** Within the overall allowed framework of different accounting standards and provisions of different statutes, a company is free to formulate its own accounting policies. Accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

AS-1 lays down the following requirements :

a) All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed in one place as a part of financial statements.

b) Any change in the accounting policies which has a material impact in the current period or which is expected to have a material effect in later periods should be disclosed and the amount by which any item in the financial statements is affected by such change should also be quantified and disclosed to the extent ascertainable. When such amount is not ascertainable, the fact should be mentioned.

c) If any of the fundamental accounting assumptions (viz., going concern, consistency and accrual) is not followed, the fact should be disclosed.

• **AS-2 – Valuation of Inventories** : Inventories include :

a) Raw materials and components

b) Work-in-process

c) Finished goods

d) Stores and spares

Inventories should be valued at lower of historical cost and net realisable value. For the purpose of comparing historical cost with net realisable value, each item in the inventory should be dealt with separately or similar items may be dealt with as a group.

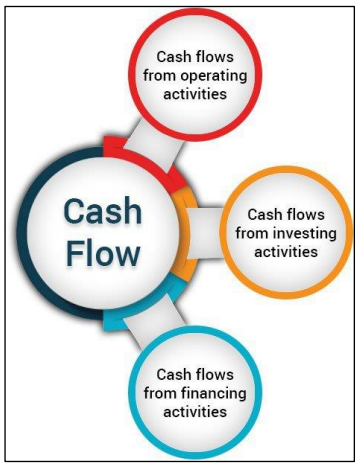
However, the above principle of inventory valuation is not applicable in cases of:

a) Consumable stores and supplies: Should be ordinarily valued at cost.

b) By-products : Where cost of by-product cannot be separately determined, it should be valued at net realisable value.

c) Reusable waste: Should be valued at raw material cost less processing cost.

d) Non-reusable waste: Should be valued at net realisable value.



• **AS-3 – Cash Flow Statement :** The Companies Act does not require corporate entities to prepare and present cash flow statement as part of financial statements. However, listing agreement of different stock exchanges require corporate entities to submit cash flow statement to the respective stock exchanges. Thus, listed companies are bound to prepare cash flow statement.

The cash flow statement should clearly show cash flows from three distinct activities :

a) cash flows from operating activities.

b) cash flows from investing activities.

c) cash flows from financing activities.

• **AS-4 - Contingencies and events occurring after the balance Sheet date :** Contingencies are conditions or situations, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence or non-occurrence, of one or more uncertain future events. Estimates are required for determining the amount to be stated in financial statements for many items, e.g., depreciation, provision for doubtful debts, provision for taxation, etc. However, the fact that the items have been estimated does not make the items contingencies.

Contingencies are of two types – contingent loss and contingent gain. The amount of a contingent loss should be provided for by way of a change in the statement of profit and loss if:

a) It is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability has been incurred as at the balance sheet date, and

b) A reasonable estimate of the amount of the resulting loss can be made.

• **AS-5 – Net profit or loss for the periods, prior period items and changes in accounting policies** : The net profit or loss for a given accounting period comprises essentially of two items –

(a) profit or loss from Ordinary activities and (b) extraordinary items. Ordinary activities are undertaken by a business entity as part of its business and include such related activities in which the entity engages. Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

Both profit or loss from ordinary activities and extraordinary items are to be disclosed on the face of profit and loss statement. It may be noted here that virtually all items of income and expenses included in the determination of net profit or loss arise in the course of ordinary activities of the enterprise. Therefore, occurrence of extraordinary items is a rarity. In most of the cases, only losses arising out of natural calamity can be considered as an extraordinary item.

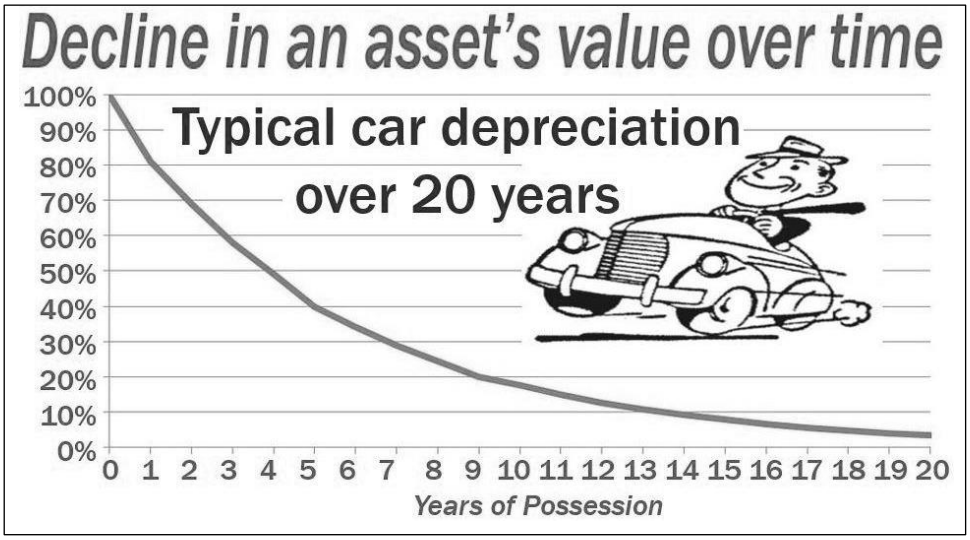
Prior Period Items :

a) The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.

b) The term ‘prior period items’, as defined in this Statement, refers only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.

Changes in Accounting Policies : On the other hand, a change in an accounting policy should be made only if the adoption of the new policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of financial statements of the enterprise.

• **AS-6 – Statements of accounting standards revised depreciation accounting :** The following is the text of the revised Accounting Standard (AS) 6, 'Depreciation Accounting', issued by the Council of the Institute of Chartered Accountants of India. This statement deals with depreciation accounting and applies to all depreciable assets, except the following items to which special considerations apply :



Forests, plantations and similar regenerative natural resources :

- wasting assets including expenditure on the exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources;
- expenditure on research and development;
- goodwill;
- live stock.

This statement also does not apply to land unless it has a limited useful life for the enterprise.

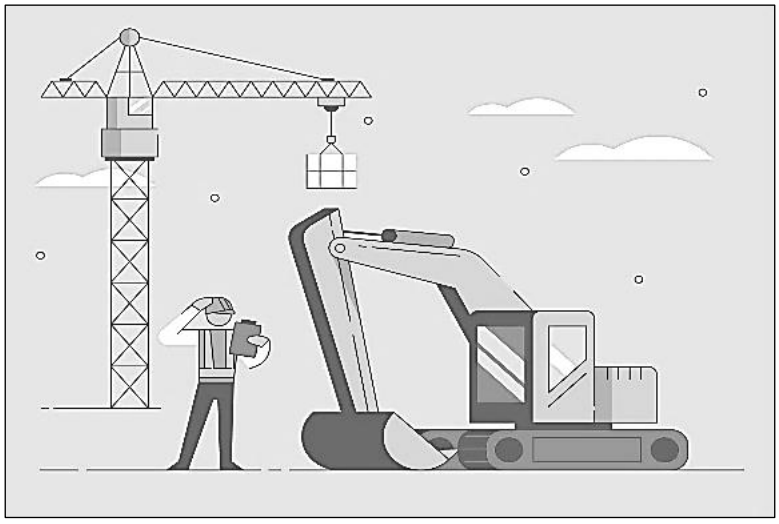
Different accounting policies for depreciation are adopted by different enterprises. Disclosure of accounting policies for depreciation followed by an enterprise is necessary to appreciate the view presented in the financial statements of the enterprise.

• **AS-7 – Accounting for construction contracts :** Construction Contracts (Revised proved reserves contracts) are basically of two types:

a) Fixed price contracts: the contractor gets a fixed price or rate.

b) Cost plus contracts: the contractor is reimbursed for allowable costs plus a fee is paid to the contractor.

Para 2 of AS-7 defines construction contract as a "contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or independent in terms of their design, technology and function or their ultimate purpose or use". Construction contracts also include services rendered by project managers and architects which are directly related to the construction of asset.



• **AS-8 – Accounting for research and development :** Research is an original and planned investigation to gain new scientific or technical knowledge, whereas development is the utilization of research results to produce new or substantially improved materials, devices, products, processes, etc., prior to the commencement of commercial production.

Thus, the sequence can be shown as below :

Step 1 - Research

Step 2 - Development

Step 3 - Commercial Production

If, after step 1, no viable outcome is found, steps 2 and 3 are not undertaken. Similarly, if step 2 does not result in any positive outcome, step 3 is not initiated. Thus, the use of each step depends on the result of the preceding step. However, in India, we do not distinguish between costs incurred for research and development. We use the phrase 'costs of research and development.'

• **AS-9 – revenue recognition :** Para 4.1 of AS-9 states "Revenue is the gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends." Thus, revenue from ordinary activities may arise under three situations:

a) by sale of goods;

b) by rendering of services; and

c) By allowing others to use enterprise resources yielding interest, royalties and dividends.

Revenue recognition is concerned with the timing of recognition of revenue in the profit and loss statement.

• **AS-10 – Accounting for fixed assets :** The following is the text of the Accounting Standard 10 (AS 10) issued by the Institute of Chartered Accountants of India on 'Accounting for Fixed Assets'.

In the initial years, this accounting standard will be recommendatory in character. During this, this standard is recommended for use by companies listed on a recognized stock exchange and other large commercial, industrial and business enterprises in the public and private sectors.

a) Financial statements disclose certain information relating to fixed assets. In many enterprises these assets are grouped into various categories, such as land, buildings, plant and machinery, vehicles, furniture and fittings, goodwill, patents, trademarks and designs. This statement deals with accounting for such fixed assets except as described in paragraphs below.

b) This statement does not deal with the specialised aspects of accounting for fixed assets that arise under a comprehensive system reflecting the effects of changing prices but applies to financial statements prepared on historical cost basis.

c) This statement does not deal with accounting for the following items to which special considerations apply :

- forests, plantations and similar regenerative natural resources;
- wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources;
- expenditure on real estate development; and
- livestock.

Expenditure on individual items of fixed assets used to develop or maintain the activities covered in points above, but separable from those activities, are to be accounted for in accordance with this statement.

d) This statement does not cover the allocation of the depreciable amount of fixed assets to future periods since this subject is dealt with in Accounting Standard 6 on 'Depreciation Accounting'.

e) This statement does not deal with the treatment of government grants and subsidies, and assets under leasing rights. It makes only a brief reference to the capitalization of borrowing costs and to assets acquired in an amalgamation or merger. These subjects require more extensive consideration than can be given within this Statement.

• **AS-11 – The effects of changes in foreign exchange rates :** This standard was revised in 2003 and is made mandatory with effect from 1st April 2004. Originally, this accounting standard was titled "Accounting for the effects of changes in foreign exchange rates". AS-11 discusses how to recognize the financial effect of changes in foreign exchange rates in the financial statements of the reporting entity. Two currencies are involved in determining an exchange rate–foreign currency and reporting currency. The reporting currency for business entities in India is INR (Indian Rupee) and hence the foreign currency is any currency other than INR. AS-11 is applicable in accounting for foreign currency transactions and in translating the financial statements of foreign operations. Thus, accounting for transaction exposure and translation exposure in foreign currency is dealt with in AS-11.

• **AS-12 – Accounting for government grants:** Government grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. Grants as compensation for expense or losses incurred in a previous accounting period.

Government grants can essentially be of four types:

a) Grants related to specific fixed assets.

b) Grants related to revenue items.

c) Grants in the nature of promoters' contribution.

Para 13 of AS-12 states that "Government grants should not be recognised until there is reasonable assurance that (i) the enterprise will comply with the conditions attached to them, and (ii) the grants will be received."

• **AS-13 – Accounting for investments:** There are two types of investment - current and long-term. These two follow different valuation principles. Current investments are valued at lower of cost and fair value, whereas long-term investments are valued mainly at cost. Reclassification of current investments into long-term investments and vice versa is allowed. Where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer. Where current investments are reclassified as long-term investments, transfers are made at the lower of cost and fair value at the date of transfer.

• **AS-14 – Accounting for amalgamations:** Para 43 of AS-14 states "For all amalgamation, the following disclosures should be made in the first financial statements following the amalgamation:

a) Names and general nature of business of the amalgamating companies;
b) Effective date of amalgamation for accounting purposes;
c) The method of accounting used to reflect the amalgamation; and
d) Particulars of the scheme sanctioned under a statute."

• **AS-15 – Accounting for retirement benefits in the financial statements of employers** : Retirement benefits usually consist of:

a) Provident fund
b) Superannuation (pension)
c) Gratuity
d) Leave encashment benefit on retirement
e) Post-retirement health and welfare schemes
f) Other benefits.

Accounting for retirement benefits depends on the nature of the benefit schemes. Retirement benefit schemes are classified into two broad categories: (a) defined contribution schemes; and (b) defined benefit schemes. In case of the former, only the contribution of the employer (as well as that of employee, if any) is certain and the ultimate benefits, which would accrue to the employees, would depend on the prevailing interest rates and other market factors. The benefits under the defined contribution schemes are in no way related to the factors like, employees salary at the time of retirement, number of years of service rendered, etc. The obligation of the employer in these schemes is limited to periodic and timely contribution to the funds/trust managing the schemes. Whereas, in case of defined benefit schemes, the benefits are linked to certain defined criteria and are determinable usually by reference to employee's earnings and/or years of service. The employer, in these schemes, has to ensure that retiring employees get these defined benefits as per entitlements. Provident fund is an example of a benefit under defined contribution scheme. Pension and gratuity benefits are examples of defined benefit schemes.

• **AS-16 – Borrowing Costs :** Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Examples of borrowing costs include: interest and commitment charges on borrowings; amortization of discounts or premiums relating to borrowings; finance charges under finance lease; exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to interest costs.

Borrowing costs incurred in connection with acquisition, construction or production of a fixed asset should be capitalized till the date the asset is ready for commercial use. All other borrowing costs are to be expensed in the year in which they are incurred. Borrowing costs incurred to buy inventories (which are held for a short period of time) are not to be added to the cost of inventories. But borrowing costs incurred to acquire long-term strategic investments can be capitalized with the cost of acquisition.

• **AS-17 – Segment Reporting :** This standard suggests that a business entity should provide important financial information on each reportable segment separately. A reportable segment is a business segment or a geographical segment. Para 5 of AS-17 defines a business segment as "a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments." The same paragraph also defines a geographical segment as "a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments."

A business segment or geographical segment should be identified as a reportable segment if one or more of the following conditions are satisfied (Para 27 of AS-17):

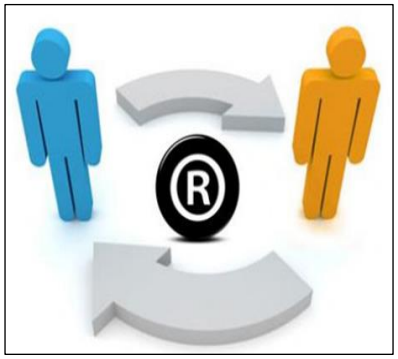
a) its revenue from sales to external customers and from transactions with other segments is equal to or more than 10% of total revenue of the firm; or

b) its segment result (profit or loss) is equal to or more than 10% of combined result of all segments in profit or combined results of all segments in loss, whichever is greater in absolute amount; or

c) its segment assets are 10% or more of the total assets of all segments.

d) Thus, there are three criteria to select a reportable segment – sales basis, profits/loss basis and asset basis.

• **AS-18 – Related party disclosures :** This accounting standard requires that a company reports all transactions entered into with the related parties. Paragraph 10 of AS-18 defines related parties as "parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions." Sometimes it may so happen that related parties enter into certain transactions with such terms and conditions as are not available to unrelated parties. Such favourable terms to related parties might affect the profitability of the firm.



Related parties disclosures include the following (Para 23 of AS-18) :

a) the name of the transacting related party;

b) a description of the relationship between the parties and of the nature of transactions;

c) volume of the transactions either as an amount or as an appropriate proportion;

d) the amount or appropriate proportions of outstanding items relating to related parties at the balance sheet date.

e) amounts written off or written back in the period in respect of debts due from or to related parties; and

f) any other matter.

• **AS-19 – Leases :** There are broadly two types of lease transactions- finance lease and operating lease. In case of finance lease, the lessee should recognise the lease as an asset and a liability in the Balance sheet. Hence, lessee claims depreciation too. The lessor has to recognise assets given under finance lease in its balance sheet as receivables. In case of operating lease, the lessor shows the asset given on lease as its asset in the balance sheet and claims depreciation. However, Income Tax laws in India still allows tax benefit on depreciation to the lessor for assets under finance lease. Hence, there is a contradiction between the accounting treatment of finance lease suggested in AS-19 and the provisions of Income Tax Act

• **AS-20 – Earning per share :** The traditional method of calculating has been done away with. AS-20 prescribes that the profit available for equity shareholders should be divided by weighted average number of shares instead of closing number of shares.

For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period. All items of income and expense which are recognized in a period, including tax expense and extraordinary items are included in the determination of the net profit or loss for the period unless an Accounting Standard requires or permits otherwise. The amount of preference dividends and any attributable tax thereto for the period is deducted from the net profit for the period (or added to the net loss for the period) in order to calculate the net profit or loss for the period attributable to equity shareholders.

For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period. The weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time. It is the number of equity shares outstanding at the beginning of the period, adjusted by the number of equity shares bought back or issued during the period multiplied by the time-weighting factor. The time-weighting factor is the number of days for which the specific shares are outstanding as a proportion of the total number of days in the period; a reasonable approximation of the weighted average is adequate in many circumstances.

• **AS-21 – Consolidated financial statements :** A holding company is now required (although not legally mandatory) to prepare consolidated financial statements, under certain circumstances, portraying the financial performance of the group in addition to its individual and separate financial statements.

Consolidated financial statements normally include consolidated balance sheet, consolidated statement of profit and loss, and notes, other statements and explanatory material that form an

integral part thereof. Consolidated cash flow statement is presented in case a parent presents its own cash flow statement. The consolidated financial statements are presented, to the extent possible, in the same format as that adopted by the parent for its separate financial statements.

Users of the financial statements of a parent are usually concerned with, and need to be informed about, the financial position and results of operations of not only the enterprise itself but also of the group as a whole. This need is served by providing the users:

a) separate financial statements of the parent; and

b) consolidated financial statements, which present financial information about the group as that of a single enterprise without regard to the legal boundaries of the separate legal entities

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

• **AS-22 – Accounting for taxes on income :** The accounting for taxes on income, before the introduction of AS-22, in India was a rudimentary one where the provision for tax was estimated only on the basis of current tax liability, thereby completely ignoring the deferred tax liability. This treatment was quite contrary to the practices followed globally. AS-22 attempted to reduce this gap. AS-22 demands that taxes on income should be accounted for following the matching principle. Matching of such taxes against revenue for a period poses problem because tax is levied on taxable income and taxable income can be significantly different from accounting income. Such differences arise because taxable income is based on tax laws and accounting income is determined using provisions in the Companies Act, 1956 and in certain cases as laid down in the listing requirements of stock exchanges.

• **AS-23 – Accounting for investment in associates in consolidated financial statements :** This standard comes into force only when a holding company prepares consolidated financial statements. An unlisted holding company is not required to prepare consolidated financial statements. In that case, AS-23 is not applicable for such an unlisted company even if it has an associate. Also, it may be noted that even where a listed holding company prepares and presents consolidated financial statements, AS-23 is not applicable for separate financial statements of the same holding company. Where AS-23 is not applicable, the company should follow AS-13 in presenting its investment in associates in the separate Balance sheet.

An associate is an enterprise in which the investor has significant influence (generally evidenced by holding of equity interest between 20%-50%) and which is neither a subsidiary nor a joint venture of the investor. AS-23 provides that the investment in associates should be accounted for in consolidated financial statements using the equity method.

• **AS-24 – Discontinuing operations :** This standard is mandatory with effect from 1st April 2004 for all listed companies and business entities having annual turnover in excess of Rs 50

crores. For all other enterprises, AS-24 will become mandatory with effect from 1st April 2005. This standard requires separate reporting of discontinuing operations from continuing operations so that users of financial statements may make proper forecast of the entity's future cash flows/earnings from continuing operations. Para 3 of AS-24 defines a discontinuing operation as a component of an enterprise:

a) that the enterprise, pursuant to a single plan, is :

- **i.** disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or
- **ii.** disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or
- **iii.** terminating through abandonment; and

b) that represents a separate major line of business or geographical area of operations; and

c) that can be distinguished operationally and for financial reporting purposes.

Thus, a discontinuing operation must be a separate line of business which is under a plan of disposal or abandonment.

• **AS-25 – Interim financial reporting** : This standard is applicable only when a business entity is required to present interim financial reports. For example, SEBI requires listed companies to prepare and publish quarterly financial results. In such cases, AS-25 should be followed in deciding the form and content of interim financial reporting.

Para 9 of AS-25 states that "an interim financial report should include, at a minimum, the following components :

a) condensed balance sheet;

b) condensed statement of profit and loss;

c) condensed cash flow statement; and

d) selected explanatory notes

An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements. Thus, inventory valuation and depreciation policies followed for interim financial statements should be same as those followed for annual financial statements.

• **AS-26 – Intangible assets :** An intangible asset is an "identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes" (Para 6 of AS-26). Common examples of intangible assets include patents, copyright, computer software, customer list, franchises, brands, etc. Goodwill is a special type of intangible asset in the sense that it is not separable. The definition of an intangible asset as mentioned in Para 6 of AS-26 requires that the asset must be separately

identifiable. In that sense, Goodwill is not an intangible asset as it cannot be bought or sold separately.

An intangible asset can be recognised in the balance sheet as an asset only if two conditions are satisfied :

a) it is probable that future economic benefits out of use of the asset will flow to the enterprise; and

b) the cost of the asset can be reliably estimated.

If both the above conditions are not satisfied, the amount incurred should be fully written off. Goodwill can be recognized as an asset only when money or money's worth is paid for its acquisition. Internally generated Goodwill cannot be recognized as an asset. Similarly, internally generated brands, customer list, publishing titles cannot be recognized as intangible assets.

• **AS-27 – Financial reporting of interests in joint ventures :** A joint venture is a business run by two or more parties. It can take the shape of a partnership or it can also be an incorporated venture. The criterion that one applies to determine whether a business is a joint venture is to look for a contractual agreement (known as Joint venture agreement). Joint ventures can be of three types:

a) Jointly controlled operations;

b) Jointly controlled assets; and

c) Jointly controlled entities.

• **AS-28 – Impairment of assets :** Impairment denotes loss in value. An asset is deemed impaired when its carrying amount (i.e., depreciated value) exceeds its recoverable amount. The difference is called impairment loss. The impairment loss should be recognised as an expense in the statement of profit and loss immediately. This standard attempts to present the assets in the balance sheet in their recoverable amount, where it is lower than the carrying amount. Hence, the standard follows a conservative approach in the sense that it does not suggest carrying an asset at its recoverable amount when it is higher than the carrying amount. Thus, AS-28 attempts to take some care of the criticism of historical cost accounting.

• **AS-29 – Provisions, contingent liabilities and contingent assets :** This is a mandatory accounting standard effective from 1st April, 2004. The standard seeks to make a distinction between provisions and contingencies and suggest recognition and disclosure requirements for these items. At the outset, it should be made clear that provisions (e.g., provision for tax) are different from outstanding liabilities (e.g., salary payable). In the case of the former, the amount is based on estimation, whereas in case of the latter, the liability is certain and hence no estimation is involved. Para 10 of AS-29 defines the term 'provision' as "A provision is a liability which can be measured only by using a substantial degree of estimation".

1.3 AS – 20 Earning per Share :

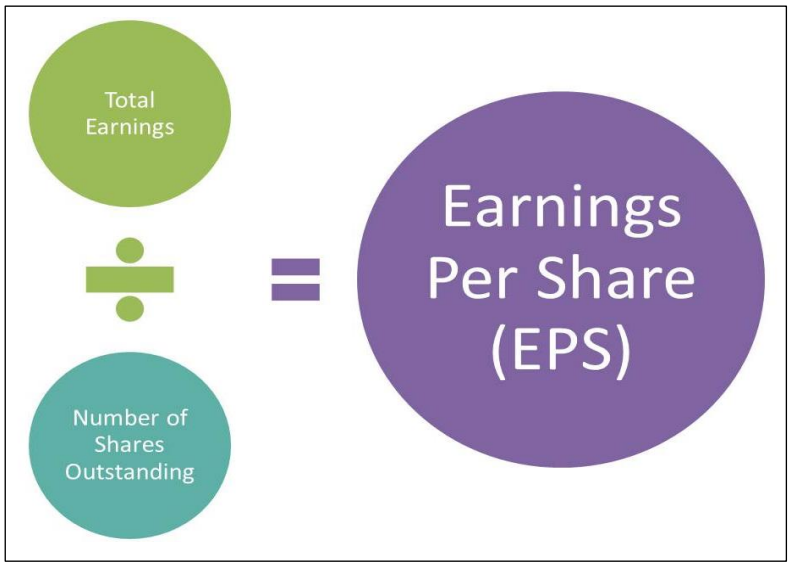
Objective : The Accounting Standard 20 on earnings per share (EPS) Describes the principles for determination and presentation of earnings per share which will improve the comparison of performance among different companies for the same period and for the same company among different accounting periods.

The focus of this standard is on the calculation of earnings per share. even though earnings per share data has limitations because of different accounting policies used for determining 'earnings', a consistently determined denominator enhances the quality of financial reporting.

This accounting standard is mandatory for all companies. however, disclosure of diluted earnings per share (both including and excluding extraordinary items) is not mandatory for small and medium-sized companies, such companies are however encouraged to make these disclosures.

Introduction : Earnings per share (EPS) is a financial ratio. The EPS provides information regarding earnings available on each share held by the company. Ratio assessed in comparing between two or more companies, as well as two or more accounting periods. Thus, this ratio acts as an important financial tool. The AS 20 lists out the process of calculation of earnings per share. there are two types of EPS which are to be reported by enterprise on the face of the statement of profit and loss account.

1. Basic EPS
2. Diluted EPS



Basic EPS = Net Profit or Loss attributable to equity shareholder/Weighted average number of outstanding equity shares.

Net profit or loss for the period is calculated as follows :

Particulars	Amount
Earnings before tax	XXX
(+) extraordinary Incomes	XXX
(-) extraordinary Expenses	(XXX)
(-) tax attributable to the period	(XXX)
(-) preference dividend *	(XXX)
Profit for the purpose of calculating EPS	XXX

The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods. Per share – Basic (Denominator) For calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period. The time-weighting factor = Number of days for which the specified share is outstanding / Total number of days in the period.

1) For the purpose of **calculating basic earnings per share**, the number of equity shares should be the weighted average number of equity shares outstanding during the period. The weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time. It is the number of equity shares outstanding at the beginning of the period, adjusted by the number of equity shares bought back or issued during the period multiplied by the time-weighting factor. The time-weighting factor is the number of days for which the specific shares are outstanding as a proportion of the total number of days in the period; a reasonable approximation of the weighted average is adequate in many.

Illustration 1 : Number of shares outstanding as on 01-04-2023 are 2000. Fresh issue of 600 shares for cash on 31-10-2023. Buyback of 300 shares on 01-01-2024. Find the weighted average outstanding number of shares.
Solution : The weighted average outstanding number of shares = (2000 x 12/12) + (600 x 5/12) – (300 x 3/12) = 2175 shares.

2) Partly paid equity shares are treated as a fraction of an equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period.

Illustration 2 : Opening balance of shares as on 01-04-2023 is 2000 shares. On 31-01-2024, issue of 600 shares of Rs. 10 each, Rs. 5 paid up.
Solution : As per AS 20, partly paid up equity shares should be calculated in the ratio of amount paid up to face value (amount paid / face value). The weighted average outstanding number of shares = (2000 x 12/12) + (600 x 5/10 x 2/12) = 2050 shares.

3) Where an enterprise has equity shares of different nominal values but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

Illustration 3 : On 01-04-2023, 2,00,000 equity shares of Rs. 10 each fully paid up. On 30-09-2023, fresh issue of 2,00,000 equity shares of Rs. 5 each fully paid up.
Solution : The weighted average outstanding number of shares = (2,00,000 x 12/12) + (2,00,000 x 5/10 x 6/12) = 2,50,000 shares.

4) Equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares) are considered outstanding, and included in the computation of basic earnings per share from the date when all necessary conditions under the contract have been satisfied.

5) The weighted average number of equity shares outstanding during the period and for all periods presented should be adjusted for events, other than the conversion of potential equity shares, that have changed the number of equity shares outstanding, without a corresponding change in resources.

6) When bonus shares are issued during the year, it should be calculated in the weighted average from the beginning of reporting period irrespective of issue date. Therefore, the bonus issue is treated as if it had occurred prior to the beginning of the year.

Illustration 4 : Net profit for the year 2022-23 is Rs. 18 lacs. Net profit for the year 2023-24 is Rs. 60 lacs. Number of equity shares outstanding till 31-12-2022 is 20 lacs. Bonus issue on 01-01-2023=2 (new): 1(old). Calculate EPS for the year 2023-24 and adjusted EPS for the year 2023-23.
Solution :

Particulars	Amount (in Rs.)
Net profit for the year 2022-23	18,00,000
Net profit for the year 2023-24	60,00,000

Number of equity shares outstanding till 31-12-2022	20,00,000
Bonus issue on 01-01-2023	20,00,000 x 2 = 40,00,000
Earnings per share for the year 2023-24	60,00,000 / (20,00,000 + 40,00,000) = Re.1
Adjusted Earnings per share for the year 2022-23	18,00,000 / (20,00,000+40,00,000)= Re.0.30

Illustration 5 : Net profit for the year 2022 is Rs. 11,00,000 and for the year 2023 is Rs. 15,00,000. Number of shares outstanding prior to right are 5,00,000 shares. Right issue of one new share for each five outstanding at right issue price of Rs. 15. Last date to exercise rights is 01-11-2023. Fair value of one equity share immediately prior to exercise of rights on 01-11-2023 is Rs. 21. Compute basic EPS for the year 2023 and adjusted EPS for the year 2022.

Solution : The Theoretical ex-rights fair value per share = (Fair value of all shares prior to rights + Right issue proceeds) / Number of shares outstanding post right issue.

= {(Rs. 21 x 5,00,000 shares) + (Rs. 15 x 1,00,000 shares)} / 5,00,000 shares + 1,00,000 shares

= Rs. 20

Bonus element = Fair value per share prior to exercise of rights/Theoretical ex-rights value per share

= 20 / 21 = Rs. 1.05

Computation of Earnings Per Share

Particulars	2022	2023
EPS for the year 2020 as originally reported: Rs. 11,00,000/5,00,000 shares	Rs. 2.20	
EPS for the year 2020 as restated for rights issue: Rs. 11,00,000/(5,00,000 shares x 1.05)	Rs. 2.10	
EPS for the year 2011 including effects of right issue Rs. 15,00,000 / {(5,00,000 x 1.05 x 2/12) + (6,00,000 x 10/12)}		Rs. 2.55

Diluted Earnings Per Share: For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares. In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period, that is:

a) The net profit for the period attributable to equity shares is:

- increased by the amount of dividends recognized in the period in respect of the dilutive potential equity shares as adjusted for any attributable change in tax expense for the period;
- increased by the amount of interest recognized in the period in respect of the dilutive potential equity shares as adjusted for any attributable change in tax expense for the period; and

- adjusted for the after-tax amount of any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.

b) The weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

Illustration 6 : Calculate Diluted EPS from the following information.

Particulars	Amount
Net profit for the current year	Rs. 1,00,00,000
Number of equity shares outstanding	50,00,000
Basic EPS	1,00,00,000/50,00,000 = 2
Number of 12% convertible debentures of Rs. 100 each Each debenture is convertible into 10 equity shares	1,00,000
Interest expense for the current year	Rs. 12,00,000
Tax relating to interest expense (30%)	Rs. 3,60,000

Solution :

Particulars	Amount
Adjusted Net profit for the current year	Rs. (1,00,00,000 + 12,00,000 – 3,60,000) = Rs. 1,08,40,000
Number of equity shares resulting from conversion of debentures	10,00,000
Number of equity shares used to calculate diluted earnings per share	50,00,000 + 10,00,000 = 60,00,000
Diluted earnings per share	1,08,40,000/60,00,000 = Rs. 1.81

Disclosure :

An enterprise should disclose the following :

a) Where the statement of profit and loss includes extraordinary items (within the meaning of AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies), the enterprise should disclose basic and diluted earnings per share computed on the basis of earnings excluding extraordinary items (net of tax expense);

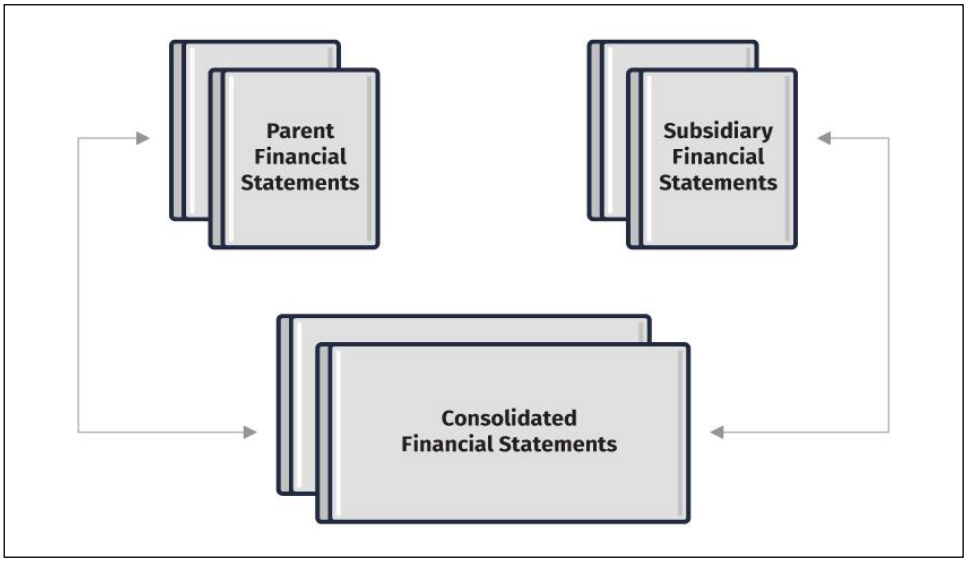
b) The enterprise should also disclose

- The amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;

- The weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and
- The nominal value of shares along with the earnings per share figures.

1.4 AS – 21 Consolidated Financial Statement :

Objective : The objective of this Standard is to lay down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented by the Parent Company (also known as Holding Company) to provide financial information about the economic activities of its Subsidiaries. These statements are intended to present financial information about a parent and its subsidiaries as a single economic entity to show the economic resources controlled by the group, the obligations of the group and results the group achieves with its resources.



Thus AS 21 Consolidated Financial Statements should be applied in preparing and presenting consolidated financial statements for a group of subsidiary companies under the sole control of a parent/ holding company. This statement is applied to ascertain the performance of investment in subsidiaries in the separate financial statement of the parent/ holding company.

However, this standard does not deal with :

- Accounting methods for amalgamations and effects on consolidation, which includes goodwill which arises on an amalgamation
- Accounting for investments in JVs (joint ventures)

- Accounting for investments in associates

Presentation of Consolidate Financial Statements : The users of the financial statement of the company are concerned with the results of operations and financial position of not only the company itself but also the group of companies in which the parent company holds its investments.

This requirement of the users is served by offering them

- Standalone financial statements of a parent; and
- Consolidated financial statements that provide financial information about the business group as that of a lone enterprise without respect to the legal restrictions of the distinct legal entities.

Consolidation Procedure : While preparing a consolidated financial statement, the parent company's financial statements and its subsidiaries must be combined line by line by taking the totals of similar items such as assets, liabilities, income, and expenses.

Below mentioned steps must be followed to consolidate the financial statements so as to present financial information of the group as a stand alone enterprise.

- Eliminate the cost to the parent of its investment made in each of its subsidiaries and such parent's equity portion of each of its subsidiaries, at the date when the investment in such subsidiaries are made.
- Any additional cost to the parent company of the investment in the subsidiary over the parent company's share of the equity of subsidiary, at the date on which the investment in such subsidiary is done, must be shown as goodwill for recognizing as the asset in its consolidated financial statements
- When the cost to the parent of the investment in the subsidiary is lower than the parent company's share of the equity of subsidiary, a date on which the investment in such subsidiary is done, the difference must be treated as the capital reserve in its consolidated financial statements
- A portion of minority interests in net income of the consolidated subsidiary for reporting period must be recognized and adjusted against income of the group for arriving at the net income which is attributable to owners of such parent company; and
- A portion of minority interests in net assets of the consolidated subsidiaries must be recognized and provided for in consolidated balance sheet distinctly from the equity and liabilities of the parent company.
- Minority interests in net assets consists of:
  - amount of equity which is attributable to the minorities at the date on which such investment in the subsidiary is done; and
  - minorities' share of the movements in equity from the date the relationship of parent-subsidiary came in to force

- Where carrying investment amount in a subsidiary is different from the cost, such carrying amount is to be considered for the above calculations.

Disclosure :

- In the consolidated financial statements the list of all the subsidiaries of the parent company which includes the name, country of residence or incorporation, the share of ownership interest and, in case different, the share of voting power held should be disclosed.
- In case the consolidation of a particular subsidiary hasn't been made according to the grounds permissible in the accounting standard, reasons for which such subsidiary isn't included in the consolidation must be disclosed in such consolidated financial statements
- In the consolidated financial statements, following disclosures need to be made:
  - The type of relationship between a parent and its subsidiary, whether there is direct control or indirect control through the subsidiaries.
  - The effect of acquisition and disposal of the subsidiaries on the financial position at the date of reporting results for the reporting period and on corresponding amounts for the preceding period; and
  - Name of the subsidiary(s) of which reporting date(s) is different from that of parent/ holding company.

: EXERCISES :

Answer the following in brief :

1. Explain the concept and need for Accounting Standards.
2. Explain the Accounting Standard 20 on Earning per Share.
3. Explain the concept of Diluted EPS
4. What are the disclosure requirements for AS 20 on earnings per share?
5. Explain the Accounting Standard 21 on Consolidated Financial Statements.
6. Explain the Consolidation Procedure under AS 21
7. Explain the disclosure requirements for AS 21 on Consolidated Financial Statements.
8. Explain the types of differences in taxable income and accounting income. Also give reasons why such differences appear.

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CHAPTER 2

Accounting for E-Commerce Business

2.1 Fundamental of E-Commerce Accounting

2.1.1 Business account types in ecommerce accounting.

2.1.2 Ecommerce accounting tasks : Categorize all transactions, Track inventory, maintain a budget, Track inventory cash flow, Proper recordkeeping, Track returns and chargebacks, Pay sales and income taxes and Analyse financial statements.

2.1.3 Ecommerce accounting methods: cash, accrual, and modified cash.

2.1.4 E-commerce accounting tasks to regularly complete: Track and categorize sales transactions, Track and categorize expenses, Track and categorize returns, refunds, and chargebacks, Reconcile bank and credit card accounts, Prepare financial statements, Analyze financial performance, Stay on top of taxes, keep a business budget, Keep organized and accurate records.

2.2 Key Accounting issues from perspective of Ecommerce Business in elements of financial statement

2.2.1 Applicability of AS-9 or Ind AS -18 or Ind AS-115(effective from 01.01.2018)

2.2.2 Main source of revenue: Membership and Subscription, Merchandising Activity, Advertising Service, Other Services.

2.2.3 Expenditure (Revenue) : Rebates, discounts and others sales incentives, Paid and Loyalty Programmes, Website Development Cost Etc.

2.1 Fundamental of E-Commerce Accounting :

2.1.1 Business account types in ecommerce accounting :

E-commerce has changed how businesses work and given new chances to people who want to start their own businesses. With the growth of online shopping, companies have had to change

how they handle their money. In e-commerce accounting, there are different kinds of business accounts you should know about.

These include -

i. Business-to-Business (B2B),
ii. Business-to-Consumer (B2C),
iii. Consumer-to-Consumer (C2C), and
iv. Consumer-to-Business (C2B).

i. **Business-to-Business (B2B)** : e-commerce involves transactions between two businesses. For example, a manufacturer selling products to a retailer. In this type of e-commerce, the accounting practices are similar to those used in traditional business transactions. The seller will record the sale as revenue, and the buyer will record the purchase as an expense. The seller will also need to keep track of any discounts or allowances given to the buyer.

ii. **Business-to-Consumer (B2C)** : e-commerce involves transactions between a business and individual consumers. For example, an online store selling products directly to customers. In this type of e-commerce, the accounting practices are more complex. The seller will need to keep track of sales tax, shipping costs, and any discounts or promotions offered to customers. The seller will also need to record the sale as revenue and keep track of any returns or refunds.

iii. **Consumer-to-Consumer (C2C)** : e-commerce involves transactions between individual consumers. For example, an online marketplace where individuals can buy and sell goods to each other. In this type of e-commerce, the accounting practices are similar to those used in B2C transactions. The seller will record the sale as revenue, and the buyer will record the purchase as an expense. The seller will also need to keep track of any fees or commissions charged by the marketplace.

iv. **Consumer-to-Business (C2B)** : e-commerce involves transactions where individuals sell products or services to businesses. For example, a freelance writer selling their services to a company. In this type of e-commerce, the accounting practices are similar to those used in B2B transactions. The buyer will record the purchase as an expense, and the seller will record the sale as revenue. The seller will also need to keep track of any taxes or fees associated with the transaction. It's important to understand which type of e-commerce business you are operating, as each type has different accounting implications. For example, B2C transactions require more complex accounting practices than B2B transactions.

It's important to know which type of e-commerce business you're running because each has different rules for accounting. For instance, B2C transactions need more detailed accounting than B2B. Also, if your e-commerce business deals internationally, you have to think about exchange

rates and different tax laws in various countries. Many e-commerce companies use special software to handle their finances. This can help make things easier and reduce mistakes, but you have to make sure the software works well with your e-commerce platform and meets your business's specific accounting needs.

In the end, e-commerce has really changed how businesses manage their money. Understanding the various e-commerce accounts and considering the effects of international deals and technology on accounting are important for e-commerce businesses to handle their finances correctly. This helps companies keep track of their money and profits effectively.

Businesses keep track of their financial transactions and manage their finances effectively. These accounts are crucial for maintaining a clear record of income, expenses, and profits. Here are some of the key business account types used in ecommerce accounting: In this explanation, we'll delve into some of the most common business account types used in ecommerce accounting.

- **Sales Account :**
  - What it is: A sales account is where a business records all the income generated from selling products or services online. This account is essential for tracking the revenue generated from customer purchases.
  - Why it's important: The sales account provides a clear picture of your business's income, which is vital for calculating profits, determining sales trends, and setting revenue goals.
- **Expense Account :**
  - **What it is** : An expense account is where a business records all the costs associated with running an ecommerce operation. This includes expenses such as advertising, shipping, website maintenance, and office supplies.
  - **Why it's important** : Properly categorizing expenses helps businesses understand where their money is going, identify areas for cost-saving, and calculate the net profit. This is critical for making informed financial decisions.
- **Bank Account :**
  - **What it is** : A bank account is where a business keeps its liquid assets, such as cash and money in checking or savings accounts. In ecommerce, businesses often have multiple bank accounts, like a checking account for daily transactions and a savings account for saving surplus funds.
  - **Why it's important** : Bank accounts are the backbone of financial transactions. They allow you to pay suppliers, receive payments from customers, and maintain liquidity. Tracking these accounts is essential to avoid overdrafts and to ensure you can meet your financial obligations.

- **Payment Processor Account :**
  - **What it is** : Payment processors, like PayPal or Stripe, are used by many ecommerce businesses to receive and process online payments. These accounts store funds temporarily before transferring them to a business's bank account.
  - **Why it's important** : Tracking funds in payment processor accounts ensures that all sales are properly accounted for, and it helps in reconciling transactions with the corresponding bank deposits.
- **Inventory Account :**
  - **What it is** : Inventory accounts are used to monitor the value of products or goods held in stock for sale. This account helps businesses keep track of the cost of goods sold and the value of remaining inventory.
  - **Why it's important** : Managing inventory accounts is vital for businesses to avoid overstocking or understocking products. It also plays a crucial role in cost accounting by providing data for calculating the cost of goods sold.
- **Accounts Receivable :**
  - **What it is** : Accounts receivable tracks the money that customers owe your business but haven't paid yet. This often includes credit sales where the customer receives the product or service before making the payment.
  - **Why it's important** : Keeping an eye on accounts receivable helps businesses manage outstanding payments, improve cash flow, and make informed decisions about extending credit to customers.
- **Accounts Payable :**
  - **What it is** : Accounts payable represents the money your business owes to suppliers and vendors. It includes bills and invoices that are yet to be paid.
  - **Why it's important** : Managing accounts payable is crucial to ensure timely payments, maintain good relationships with suppliers, and take advantage of any early payment discounts.
- **Tax Accounts :**
  - **What it is** : Tax accounts are used to set aside money for various taxes that businesses must pay, such as sales tax, income tax, or value-added tax (VAT).
  - **Why it's important** : Properly managing tax accounts ensures that businesses have enough funds to meet their tax obligations when they are due. It also helps in avoiding penalties and interest for late payments.
- **Equity Accounts :**
  - **What it is** : Equity accounts represent the owner's or shareholders' interests in the business. This includes investments made by the owner, retained earnings, and dividends.

- **Why it's important** : Equity accounts show the overall financial health of the business and help in calculating the owner's equity or shareholders' equity.

- **Income Statement and Balance Sheet Accounts :**
  - **What they are** : These accounts are not specific to ecommerce but are fundamental in accounting. The income statement accounts summarize revenues and expenses, showing the profit or loss over a specific period. Balance sheet accounts show a snapshot of the business's financial position, including assets, liabilities, and equity, at a specific point in time.
  - **Why they're important** : Income statements and balance sheets are used to analyze the financial performance and health of the business. They are critical for understanding profitability, assessing financial stability, and preparing financial statements for tax and regulatory purposes.

2.1.2 Ecommerce accounting tasks :

Categorize all transactions, Track inventory, Maintain a budget, Track inventory cash flow, Proper recordkeeping, Track returns and chargebacks, Pay sales and income taxes and Analyse financial statements.

Accounting in the e-commerce industry involves managing financial transactions related to online sales, revenue, and expenses. Proper accounting is crucial for tracking the financial health of your e-commerce business and ensuring compliance with tax regulations. Here are some essential accounting tasks for e-commerce businesses :

- **Record Sales Transactions :**
  - Document all sales transactions, including online orders, subscriptions, and any other income sources.
  - Capture details like order number, date, customer information, and product details.
- **Track Expenses :**
  - Record all business-related expenses, including advertising, shipping, packaging, website maintenance, and more.
  - Categorize expenses for better financial analysis.
- **Inventory Management :**
  - Implement an inventory accounting method (FIFO, LIFO, or weighted average) to track the cost of goods sold (COGS).
  - Regularly update inventory counts to maintain accurate financial records.
- **Payment Processing Reconciliation :**
  - Reconcile payment processor statements with your sales records to ensure all transactions match.
  - Address discrepancies and resolve chargebacks or refunds promptly.

- **Bank Reconciliation :**
  - Reconcile your bank accounts to ensure all transactions are accounted for and there are no discrepancies.
- **Sales Tax Compliance :**
  - Determine your sales tax obligations in various jurisdictions.
  - Collect and remit sales tax correctly, and keep records of all sales tax transactions.
- **Financial Reporting :**
  - Generate regular financial statements, including income statements, balance sheets, and cash flow statements.
  - Use accounting software or tools to automate this process.
- **Tax Compliance :**
  - File income tax returns accurately and on time, considering e-commerce-specific deductions and credits.
  - Comply with state, federal, and international tax laws.
- **Revenue Recognition :**
  - Recognize revenue according to the appropriate accounting standards (e.g., GAAP or IFRS).
  - Determine the point at which revenue is earned and can be recognized.
- **Payroll and Employee Expenses :**
  - Manage payroll, including salaries, benefits, and taxes if you have employees.
  - Track and report employee-related expenses.
- **Accounts Payable :**
  - Monitor and pay bills to suppliers and service providers on time.
  - Maintain records of payables for financial tracking.
- **Budgeting and Forecasting** : Create and update financial forecasts and budgets to plan for future growth and expenses.
- **Cash Flow Management** : Monitor cash flow to ensure that you have enough liquidity to cover expenses and investments.
- **Audit Preparation** : Maintain well-organized financial records in preparation for potential audits.

To streamline these tasks and reduce the risk of errors, many e-commerce businesses use accounting software or hire professional accountants or bookkeepers with experience in e-commerce accounting. Additionally, implementing good accounting practices from the start can save you time and money in the long run while ensuring the financial stability of your e-commerce business.

Categorize all transactions : Categorizing all transactions is a fundamental part of e-commerce accounting. It helps you organize your financial data, track expenses, and generate accurate financial reports. Here are some key categories to consider when categorizing e-commerce transactions :

- **Sales Transactions :**
  - Categorize sales transactions by product or service type, order number, and payment method.
  - Differentiate between product sales, subscription revenue, and any other income sources.
- **Operating Expenses** : Categorize expenses related to the day-to-day operation of your e-commerce business. Common categories may include :
  - Advertising and marketing expenses
  - Shipping and postage costs
  - Packaging and fulfillment expenses
  - Website hosting and maintenance fees
  - Payment processing fees
  - Software and subscription costs
  - Employee salaries and benefits
  - Office rent and utilities
- **Cost of Goods Sold (COGS)** : Categorize expenses related to the production and procurement of your products. Common COGS categories include :
  - Cost of materials and inventory
  - Manufacturing or production costs
  - Shipping and customs duties on products
  - Labor costs related to production
- **Inventory Management** :
  - Categorize transactions related to inventory adjustments, such as purchases, sales, returns, and write-offs.
  - Implement a method to track the cost of goods sold (e.g., FIFO, LIFO, or weighted average).
- **Payment Processing :**
  - Categorize transactions related to payment processors and reconcile them with your sales records.
  - Monitor any chargebacks or refunds.
- **Employee Expenses** : Categorize employee-related transactions, including salaries, benefits, and payroll taxes.

- **Accounts Payable** : Categorize bills and expenses payable to suppliers and service providers. Organize them by due date and payment status.
- **Asset and Liability Transactions** : Categorize transactions related to the acquisition and disposal of assets, as well as liability-related transactions like loans or credit lines.
- **Capital Expenditures** : Categorize transactions for significant investments in equipment, technology, or other assets that have a long-term impact on the business.
- **Revenue Recognition** : Categorize revenue transactions according to the appropriate accounting standards (e.g., GAAP or IFRS).
- **Miscellaneous and Other Expenses** : Create a category for transactions that don't fit neatly into other categories.

Consistently categorizing transactions will make it easier to analyze your e-commerce business's financial performance, prepare for tax filings, and identify areas for cost-saving or revenue-generating opportunities. Accounting software or professional accountants can help ensure that your categorization is accurate and in line with accounting standards.

Track inventory : Tracking inventory is a critical aspect of e-commerce accounting, especially if your business involves selling physical products. Proper inventory management helps you monitor the cost of goods sold (COGS), optimize stock levels, and ensure accurate financial reporting.

Why Track Inventory :

- **Cost of Goods Sold (COGS)** : Inventory tracking is essential for calculating the COGS, which is a key component of your income statement. Accurate COGS calculation is crucial for determining gross profit and, ultimately, net profit.
- **Financial Accuracy** : Proper inventory management ensures that your financial statements, like balance sheets, accurately reflect the value of assets (inventory) and liabilities (if you have unpaid stock).
- **Stock Optimization** : Tracking inventory levels helps you avoid overstocking or understocking, which can impact cash flow and profitability. Maintaining the right inventory balance ensures you can meet customer demand without tying up excess capital.
- **Tax Compliance** : In many jurisdictions, inventory can be subject to property taxes. Accurate inventory records are essential for complying with these tax obligations.
- **Cost Control** : Monitoring inventory levels and turnover can help you identify inefficiencies or areas where you can reduce costs, such as through more efficient ordering or manufacturing processes.

How to Track Inventory :

- **Choose an Inventory System** : Select a tracking method like FIFO, LIFO, or weighted average that aligns with your business needs and accounting requirements.
- **Regular Inventory Counts** : Periodically conduct physical inventory counts to reconcile records with actual stock, identifying discrepancies and potential losses.
- **Inventory Software** : Consider using inventory management software that integrates with your e-commerce platform and accounting system for automation, reporting, and real-time insights.
- **Categorize Inventory** : Organize inventory by product type, SKU, or other criteria to streamline tracking.
- **Adjust for Returns and Damages** : Account for returns, damaged goods, and unsellable inventory separately, impacting inventory value and COGS.
- **Reorder Point Planning** : Set reorder points based on sales history and lead times to prevent running out or delays.
- **Vendor Management** : Maintain supplier relationships for reliable and timely deliveries to keep inventory levels optimized.

Maintain a budget : Maintaining a budget is a crucial aspect of managing the financial health of your e-commerce business. A well-structured budget helps you plan for expenses, allocate resources efficiently, and track financial performance. Here's a step-by-step guide on how to maintain a budget for your e-commerce business:

- **Establish Clear Objectives** : Begin by defining the financial objectives of your e-commerce business. Determine what you want to achieve with your budget, such as increasing profitability, managing cash flow, or scaling operations.
- **Gather Financial Data** : Collect historical financial data, including revenue, expenses, and other relevant financial information. This data will serve as a baseline for your budget.
- **Create a Budget Template** : Develop a budget template or use budgeting software to structure your budget. The budget should be organized by revenue and expense categories.
- **Project Revenue** : Estimate your expected revenue for the budgeting period. Consider past sales data, sales projections, and market trends. Categorize revenue by product or service.
- **List Expenses** : Identify and list all the expenses your e-commerce business incurs. Common categories include advertising, cost of goods sold (COGS), marketing, employee salaries, rent, utilities, software subscriptions, and more.

- **Allocate Resources** : Allocate resources to each expense category based on your historical data and projected revenue. Ensure that you have allocated enough funds to cover all necessary expenses.
- **Monitor Cash Flow** : Pay close attention to your cash flow. Make sure your budget accounts for fluctuations in cash flow, especially if your business experiences seasonal variations.
- **Control Expenses** : Implement cost-control measures when necessary. Identify areas where you can reduce expenses without compromising the quality of your products or services.
- **Tax Planning** : Account for tax obligations in your budget and set aside funds for taxes, including sales tax, income tax, and any other applicable taxes.
- **Use Budgeting Software** : Consider using accounting and budgeting software to automate the budgeting process and track your finances more efficiently.

Track inventory cash flow : Tracking inventory and cash flow are vital components of managing the financial health of your e-commerce business. Accurate inventory and cash flow management can help you optimize working capital, ensure you have the right products in stock, and meet customer demand efficiently. Here's how to track inventory and cash flow in your e-commerce business:

- **Inventory Tracking** :
  - **Inventory Management System** : Implement an inventory management system or use specialized inventory software to help you track inventory levels, sales, and purchases. This system should integrate with your e-commerce platform.
  - **Regular Reconciliation** : Conduct periodic physical inventory counts to reconcile your system's records with actual stock on hand. This helps identify discrepancies, losses, or potential theft.
  - **Inventory Valuation** : Use a consistent inventory valuation method, such as FIFO (First In, First Out), LIFO (Last In, First Out), or weighted average, to value your inventory accurately. This method affects your cost of goods sold (COGS) and financial statements.
  - **Sales Forecasting** : Use historical data and sales trends to predict future demand, enabling you to adjust inventory levels accordingly. Reorder stock in time to prevent stockouts.
  - **Vendor Management** : Maintain good relationships with suppliers to ensure timely deliveries. Timely restocking is crucial for keeping inventory levels optimized.

- **Cash Flow Tracking :**
  - **Cash Flow Statement** : Prepare and regularly update a cash flow statement that tracks the movement of cash into and out of your e-commerce business. This statement should include cash from operations, investing activities, and financing activities.
  - **Revenue Projections** : Estimate your expected revenue based on sales forecasts and historical data. Categorize revenue by product or service.
  - **Expense Projections** : List and categorize your projected expenses, including operating expenses (e.g., marketing, rent, payroll), inventory purchases, and other cash outflows.
  - **Accounts Receivable and Payable** : Monitor accounts receivable (money owed to you) and accounts payable (money you owe) to assess their impact on cash flow. Promptly follow up on overdue receivables and negotiate favorable payment terms with suppliers.
  - **Emergency Fund** : Consider building an emergency fund in your budget to cover unexpected expenses or to bridge gaps in cash flow.
  - **Monitor Trends** : Continuously analyze your cash flow trends and patterns to anticipate any potential issues, such as seasonal fluctuations or periods of high cash demand.
  - **Professional Guidance** : Seek advice from financial advisors or accountants to help you create cash flow projections and strategies to manage cash more effectively.

Proper recordkeeping : Proper recordkeeping is essential for the success and financial stability of your e-commerce business. It involves maintaining organized and accurate records of your financial transactions, business operations, and important documents. Here are some key aspects of proper recordkeeping for your e-commerce business:

- **Financial Transactions** :
  - **Sales Records** : Keep detailed records of all sales transactions, including order numbers, customer information, product descriptions, quantities, and prices.
  - **Expense Records** : Maintain records of all business expenses, such as advertising, marketing, shipping costs, office supplies, employee salaries, and other costs related to running your e-commerce business.
  - **Invoices and Receipts** : Keep copies of all invoices and receipts, both outgoing (for expenses) and incoming (from customers or clients).
  - **Bank Statements** : Regularly review and retain your bank statements to track cash flow, payments, and any transaction fees.

- **Inventory Management :**
  - **Inventory Records** : Maintain accurate records of your inventory, including item descriptions, quantities on hand, cost per unit, and valuation method (e.g., FIFO, LIFO, or weighted average).
  - **Inventory Counts** : Conduct regular physical inventory counts to verify the accuracy of your records and adjust inventory levels as needed.
  - **Inventory Purchases** : Record all inventory purchases, including details like supplier information, purchase dates, and quantities.
- **Tax Documentation** :
  - **Sales Tax Records** : Keep records of all sales tax collected from customers and ensure compliance with tax regulations. File sales tax returns on time.
  - **Income Tax Records** : Maintain records of your business's income and deductions, including relevant tax documents.
- **Invoices and Contracts** : Keep copies of invoices you send to customers or clients. Additionally, store any contracts or agreements you have with suppliers, service providers, and partners.
- **Employee Records** : Maintain personnel records for your employees, including employment agreements, payroll records, time sheets, and tax withholding information.
- **Legal Documents** : Store important legal documents, such as business licenses, permits, and any contracts or agreements related to your e-commerce business.
- **Business Correspondence** : Keep records of important business-related emails, letters, and other communication that may be relevant for legal, financial, or operational purposes.
- **Financial Statements** : Generate and store financial statements, including income statements, balance sheets, and cash flow statements. These documents provide an overview of your financial performance.

Track returns and chargebacks :

Tracking returns and chargebacks is crucial for maintaining accurate financial records and managing the financial health of your e-commerce business. Here's how to effectively track and manage returns and chargebacks :

- **Tracking Returns** :
  - **Establish a Returns Policy** : Create a clear and customer-friendly returns policy that outlines the conditions for returning products, including the timeframe and reasons for returns.
  - **Record Return Requests** : Keep a record of all return requests, whether they come through customer service, your website, or any other channel.

- **Issue Return Authorizations** : If your policy allows for returns, issue return authorizations to customers. This helps you track the returns and ensures that they are legitimate.
- **Receive Returned Items** : When items are returned, verify their condition, and ensure they match the return authorization. Record the returned items, their condition, and date of receipt.
- **Refund or Exchange** : Process refunds or exchanges based on your return policy. Maintain records of the transaction and update inventory levels accordingly.
- **Track Return Costs** : Keep track of the costs associated with returns, such as shipping, restocking, and refurbishing fees. This information is essential for financial analysis.

- **Tracking Chargebacks :**
  - **Understand Chargebacks** : Familiarize yourself with the chargeback process, including the reasons for chargebacks and the associated rules and regulations.
  - **Monitor Chargeback Notices** : Stay vigilant for chargeback notifications from your payment processor. These notices typically detail the disputed transaction and the reason for the chargeback.
  - **Gather Supporting Documents** : Collect all relevant documentation, such as order information, customer communication, tracking numbers, and receipts, to support your case.
  - **Respond to Chargebacks** : Respond promptly to chargebacks with the required documentation and a well-structured dispute. Failure to respond can result in a loss of funds.
  - **Record Chargeback Outcomes** : Maintain a record of the outcomes of chargeback disputes, whether they are resolved in your favor or not. This data can help you identify issues and minimize future chargebacks.
  - **Prevent Chargebacks** : Implement preventive measures to reduce chargebacks, such as improving communication, providing accurate product descriptions, and using secure payment processing methods.

Using Software and Automation : Consider using e-commerce platforms or payment gateways that provide tools and features to help you track and manage returns and chargebacks. These systems can streamline the process and provide valuable data for analysis. Effective tracking of returns and chargebacks can help you minimize losses, improve customer satisfaction, and identify areas of improvement in your e-commerce operations. Additionally, maintaining accurate records of these transactions is important for financial and tax reporting purposes.

Pay sales and income taxes : Paying sales and income taxes is a fundamental financial responsibility for your e-commerce business. Proper tax compliance helps you avoid legal issues,

penalties, and ensures the financial health of your business. Here's how to pay sales and income taxes for your e-commerce business :

- **Paying GST (Goods and Services Tax) :**
  - **Register for GST** : Register your business for GST in each state where you have a GST obligation. This usually involves applying with the state's revenue department.
  - **Calculate GST** : Calculate the applicable GST rate for each transaction, considering the customer's location and your GST nexus. E-commerce platforms and tax software can automate this process.
  - **Collect GST** : Collect GST from customers during the checkout process on your e-commerce platform.
  - **Record GST Collected** : Maintain detailed records of the GST you collect for each sale, including the amount, transaction date, and location.
  - **File GST Returns** : File GST returns in each state where you're registered. These returns typically cover specific reporting periods, such as monthly, quarterly, or annually.
  - **Remit GST Payments** : Pay the GST you've collected to the appropriate state revenue department by the due date specified on the GST return.
- **Paying Income Tax :**
  - **Determine Your Business Structure** : Your business structure (e.g., sole proprietorship, LLP, Company Etc.) affects how you report and pay income tax. Consult with a tax professional to determine the best structure for your e-commerce business.
  - **Maintain Accurate Financial Records** : Keep thorough records of your e-commerce business's income, expenses, and deductions. Use accounting software or hire an accountant to assist with this.
  - **Prepare Financial Statements** : Create accurate financial statements, including an income statement and balance sheet. These documents help calculate your taxable income.
  - **Calculate Taxable Income** : Calculate your taxable income by deducting eligible business expenses and deductions from your gross income.
  - **File Business Tax Returns** : Depending on your business structure, file the appropriate federal and state income tax returns.
  - **Pay Estimated Taxes** : E-commerce businesses often need to make estimated tax payments throughout the year to cover their income tax obligations. These payments are typically made quarterly.

Analyse Financial Statements : Analyzing financial statements is a critical process for understanding the financial health and performance of your e-commerce business. It involves examining key financial ratios and metrics to assess profitability, liquidity, solvency, and operational efficiency. Here are the main aspects to consider when analyzing your financial statements :

- **Income Statement Analysis** :
  - **Gross Profit Margin** : Calculate the gross profit margin by dividing gross profit by total revenue. This metric reveals how efficiently your e-commerce business is generating profits after accounting for the cost of goods sold (COGS).
  - **Net Profit Margin** : Calculate the net profit margin by dividing net income by total revenue. It provides a measure of overall profitability after all expenses, including taxes and interest.
  - **Revenue Growth** : Assess the rate of revenue growth over time. Steady or increasing revenue is usually a positive sign for e-commerce businesses.
- **Balance Sheet Analysis :**
  - **Current Ratio** : Divide current assets by current liabilities to calculate the current ratio. This ratio assesses your business's short-term liquidity and its ability to meet immediate financial obligations.
  - **Quick Ratio** : Calculate the quick ratio by excluding inventory from current assets and dividing the result by current liabilities. This ratio measures your ability to cover short-term liabilities without relying on the sale of inventory.
  - **Debt-to-Equity Ratio** : Divide total debt by total equity to calculate the debt-to-equity ratio. It helps evaluate the level of financial leverage and solvency in your business.
- **Inventory Turnover** : Divide cost of goods sold (COGS) by the average inventory value to determine the inventory turnover rate. A higher turnover indicates efficient inventory management.
  - **Cash Flow Statement Analysis** :
  - **Operating Cash Flow** : Analyze the net cash flow from operating activities. Positive operating cash flow is vital for meeting day-to-day expenses.
  - **Investing and Financing Activities** : Evaluate cash flows from investing and financing activities. Assess whether investments are generating returns and how your business is managing debt and equity financing.
- **Free Cash Flow** : Calculate free cash flow by subtracting capital expenditures from operating cash flow. This measure reflects the funds available for business growth, debt reduction, or shareholder distributions.

- **Trend Analysis** : Compare current financial statement figures to historical data. Identify trends and changes over time, which can provide insights into the performance and trajectory of your e-commerce business.
- **Benchmarking** : Compare your financial metrics to industry benchmarks and competitors to understand how your business measures up and where you might need to improve.
- **Risk Assessment** : Evaluate potential financial risks, such as excessive debt, liquidity issues, or reliance on a small number of customers. Develop strategies to mitigate these risks.

2.1.3 Ecommerce accounting methods: cash, accrual, and modified cash :

Cash : Cash accounting is one of the primary accounting methods that e-commerce businesses can use to track their financial transactions and report their income and expenses. Cash accounting is relatively simple and is based on the concept of recognizing income and expenses when actual cash is received or paid. Here's how cash accounting works for e-commerce businesses:

- **Revenue Recognition** : Under cash accounting, revenue is recognized when you receive actual payment from customers. This means that income is recorded when the funds are deposited into your bank account or when you physically receive cash. In e-commerce, this would be when customers pay for products or services using credit cards, PayPal, or other payment methods.
- **Expense Recognition** : Expenses are recorded when they are paid. For e-commerce businesses, this means that you recognize expenses when you actually make payments, such as paying for inventory, advertising, shipping, or any other business-related expenses.
- **Simplicity** : Cash accounting is straightforward and easy to implement, making it suitable for small e-commerce businesses with simple financial operations.
- **Cash Flow Focus** : Cash accounting provides a clear picture of cash flow, helping you understand the cash position of your business at any given time. This is particularly important for managing liquidity.
- **Tax Advantages** : Some e-commerce businesses may benefit from tax advantages with cash accounting, especially if they have seasonal fluctuations in income and expenses.

However, there are some limitations and considerations associated with cash accounting :

- **Timing Differences** : Cash accounting can lead to timing differences between when revenue is earned and when it's recognized. This may not accurately reflect the financial performance of your business, especially if you have a long sales cycle.

- **Limited Financial Insight** : Cash accounting may not provide a comprehensive view of your business's financial health because it doesn't account for accounts receivable or accounts payable.
- **Inconsistent with GAAP** : Generally Accepted Accounting Principles (GAAP) require businesses to use accrual accounting in many cases. Investment, loans, or plan to go public, using cash accounting may not align with these requirements.
- **Potential Tax Disadvantages** : Cash accounting may not be advantageous for all e-commerce businesses, especially those with consistent sales throughout the year. It can limit your ability to deduct certain expenses in the year they are incurred.

It's essential to carefully consider your e-commerce business's specific needs and consult with a tax advisor or accountant when choosing an accounting method. Some e-commerce businesses may use a combination of cash and accrual accounting, depending on their specific circumstances and goals. Ultimately, the choice of accounting method can impact financial reporting, tax obligations, and your ability to obtain financing or investment.

Accrual : Accrual accounting is another common accounting method that e-commerce businesses use to track financial transactions. Unlike cash accounting, which recognizes income and expenses when cash is exchanged, accrual accounting recognizes transactions when they are incurred or earned, regardless of when the cash is actually exchanged. Here's how accrual accounting works for e-commerce businesses:

- **Revenue Recognition** : Under accrual accounting, revenue is recognized when it is earned, meaning when a sale is made or when the product or service is delivered to the customer. This can be before or after payment is received. In e-commerce, revenue is recognized when the customer places an order or when the product is shipped, regardless of whether payment has been received or not.
- **Expense Recognition** : Expenses are recognized when they are incurred, even if the payment has not been made. For e-commerce businesses, this means recording expenses when you receive goods or services, rather than when you actually pay for them. This includes costs related to inventory, marketing, salaries, and other business expenses.
- **Matching Principle** : Accrual accounting adheres to the matching principle, which aims to match expenses with the revenue they help generate. This provides a more accurate picture of your business's financial performance.
- **Comprehensive Financial Insight** : Accrual accounting provides a more comprehensive view of your business's financial health by accounting for accounts receivable (unpaid customer invoices) and accounts payable (unpaid bills).

- **GAAP Compliance** : Generally Accepted Accounting Principles (GAAP) typically require businesses to use accrual accounting, especially if they are seeking investors, loans, or are publicly traded.

However, there are some considerations and challenges associated with accrual accounting :

- **Complexity** : Accrual accounting can be more complex and require more bookkeeping effort than cash accounting, making it less suitable for very small e-commerce businesses.
- **Potential Cash Flow Issues** : Because income is recognized when earned, e-commerce businesses may face cash flow challenges if customers are slow to pay invoices.
- **Tax Complexity** : Accrual accounting may not align with tax accounting, which often requires cash basis accounting for small businesses.
- **Financial Management** : Effective financial management is essential to ensure you have the necessary funds to cover expenses and manage accounts receivable effectively.

Accrual accounting is well-suited for e-commerce businesses with significant sales and operational complexity. It provides a more accurate representation of financial performance and is often necessary for regulatory compliance and financial reporting purposes. It's important to consult with a professional accountant to implement and manage accrual accounting effectively.

Modified Cash : Modified cash accounting, also known as the modified cash basis or hybrid accounting, is an accounting method that combines elements of both cash and accrual accounting. It offers a middle ground between these two methods and can be useful for certain e-commerce businesses. Here's how modified cash accounting works and when it might be beneficial for e-commerce:

- **Revenue Recognition** : Similar to cash accounting, modified cash accounting recognizes revenue when it is received in cash. This means that income is recorded when actual cash or payments are received from customers.
- **Expense Recognition** : Unlike pure cash accounting, modified cash accounting allows for certain expenses to be recognized on an accrual basis. This means that some expenses can be recorded when they are incurred, even if cash payment has not been made yet. This is more like accrual accounting in this aspect.
- **Selective Accrual** : Under modified cash accounting, you can choose to accrue certain expenses that are essential to your e-commerce business, such as payroll, rent, or utility bills, in line with the accrual method. This offers more accurate financial insights.
- **Simplicity** : Modified cash accounting is less complex than full accrual accounting, making it suitable for smaller e-commerce businesses that want a more accurate financial picture without the administrative burden of full accrual accounting.

- **Cash Flow Focus** : This method still places a significant emphasis on cash flow management, which is crucial for e-commerce businesses.

Modified cash accounting can be beneficial for e-commerce businesses in the following scenarios :

- **Financial Insight** : If you want a more comprehensive view of your financial performance compared to pure cash accounting but without the complexity of full accrual accounting.
- **Seasonal Businesses** : If your e-commerce business experiences significant seasonality, modified cash accounting allows you to recognize revenue when it is collected while providing some flexibility to match expenses with revenue when necessary.
- **Simplicity** : For smaller e-commerce businesses that find full accrual accounting too complex or time-consuming.
- **Regulatory Compliance** : In some cases, modified cash accounting may be more acceptable to regulatory authorities while providing a reasonable degree of financial insight.

It's essential to consult with an accountant or financial advisor to determine if modified cash accounting is suitable for your specific e-commerce business. Your choice of accounting method should align with your business's financial goals, tax requirements, and the level of complexity in your financial operations.

2.1.4 E-commerce accounting tasks to regularly complete :

Track and categorize sales transactions, Track and categorize expenses, Track and categorize returns, refunds, and chargebacks, Reconcile bank and credit card accounts, Prepare financial statements, Analyze financial performance, Stay on top of taxes, Keep a business budget, Keep organized and accurate records.

Track and categorize sales transactions : Tracking and categorizing sales transactions is a fundamental accounting task for e-commerce businesses. It's essential for maintaining accurate financial records and ensuring compliance with tax regulations. Here's how to effectively track and categorize your e-commerce sales transactions on a regular basis:

- **Set Up an Accounting System** : Choose accounting software or a system that aligns with your e-commerce platform. This system should be capable of automatically recording and categorizing sales transactions.
- **Daily or Regular Sales Record Keeping** : Ensure that all sales transactions are recorded promptly. This includes online sales through your e-commerce platform, in-person sales if applicable, and any other revenue-generating activities.

- **Categorize Sales Revenue** : Categorize your sales revenue based on product or service categories. This helps you understand which products or services are the most profitable and informs inventory management and marketing decisions.
- **Record Sales Details** : Include essential information with each transaction, such as customer details, transaction date, order number, and payment method. This information is valuable for customer relationship management and financial analysis.
- **Payment Processing Fees** : Account for payment processing fees that may be deducted from your sales revenue by payment processors like PayPal or credit card companies. These fees should be categorized separately as an expense.
- **Sales Discounts and Promotions** : If you offer discounts, coupons, or promotions, ensure these are accurately reflected in your sales records. Track these separately, so you can analyze their impact on your profitability.
- **Returns and Refunds** : When processing returns and refunds, record these transactions correctly and categorize them as a reduction in revenue.
- **Monthly and Yearly Review** : Regularly review your sales data at the end of each month and year. This review helps you spot trends, assess your financial performance, and make informed business decisions.

Track and categorize expenses : Tracking and categorizing expenses is a critical aspect of e-commerce accounting. Proper expense management helps you understand the financial health of your business, control costs, and maximize profitability. Here's how to effectively track and categorize expenses on a regular basis:

- **Set Up an Expense Tracking System** : Choose accounting software or an expense tracking system that integrates with your e-commerce platform. This system should allow you to easily record and categorize expenses.
- **Daily or Regular Expense Record Keeping** : Record expenses as they occur. This includes payments for inventory, advertising, marketing, shipping, rent, employee salaries, utilities, and any other costs associated with running your e-commerce business.
- **Categorize Expenses** : Create expense categories relevant to your e-commerce business. Common categories include advertising, cost of goods sold (COGS), marketing, rent, utilities, payroll, office supplies, and other specific categories that apply to your operations.
- **Receipts and Documentation** : Keep copies of all receipts, invoices, and bills related to expenses. These documents provide proof of the expense and are essential for tax compliance and financial record-keeping.
- **Payment Method** : Specify the method of payment (e.g., credit card, bank transfer, cash) used for each expense. This helps with reconciliation and cash flow management.

- **Vendor Information** : Include vendor details for each expense, such as the name, address, and contact information. This information is valuable for vendor management and tax reporting.
- **Expense Approval and Tracking** : Implement a system for approving and tracking expenses incurred by employees or contractors. This ensures control over spending and accurate record-keeping.
- **Compliance with Tax Regulations** : Ensure that your expense records are organized and comply with tax regulations. Accurate and organized expense records are crucial for preparing and filing tax returns.
- **Budgeting** : Use your categorized expenses to create and maintain a budget for your e-commerce business. A budget helps you plan and allocate resources effectively.

Track and categorize returns : Tracking and categorizing returns is an important accounting task for e-commerce businesses, as it helps maintain accurate financial records and manage the impact of product returns on your bottom line. Here's how to effectively track and categorize returns on a regular basis:

- **Develop a Return Policy** : Create a clear and customer-friendly return policy that outlines the conditions under which returns are accepted, including the timeframe and reasons for returns.
- **Record Return Requests** : Keep a record of all return requests, whether they come through customer service, your website, or any other communication channel.
- **Issue Return Authorizations** : If your policy allows for returns, issue return authorizations to customers. This helps track the returns and ensures that they are legitimate.
- **Receive Returned Items** : When customers return items, verify their condition and ensure they match the return authorization. Record the returned items, their condition, and the date of receipt.
- **Refund or Exchange** : Process refunds or exchanges based on your return policy. Maintain records of the transaction and update inventory levels accordingly.
- **Record Return Costs** : Keep track of the costs associated with returns, such as return shipping, restocking, and refurbishing fees. This information is essential for financial analysis.
- **Track Patterns and Trends** : Regularly review return data to identify patterns or recurring issues. This analysis can help you improve product quality, customer service, and reduce returns over time.

- **Communicate with Inventory Management** : Ensure that your return records are communicated to your inventory management system or software to update stock levels and track any inventory damage or loss associated with returns.
- **Update Sales and Inventory Records** : Adjust your sales records to reflect the returns. Deduct the corresponding sales revenue and the cost of goods sold (COGS) from your financial statements. Update your inventory records to account for returned items.
- **Customer Feedback** : Leverage the feedback provided by customers during the return process. Use this information to improve product descriptions, customer service, and the overall customer experience.
- **Monitor Return Costs** : Track the direct costs associated with handling returns, such as return shipping fees and restocking costs. Analyze these costs to determine if they are affecting your profitability.

Refunds and Chargebacks : Handling refunds and chargebacks is an integral part of e-commerce accounting and financial management. Properly managing these transactions is essential to maintaining good customer relationships and financial stability. Here are the steps to regularly complete when dealing with refunds and chargebacks :

- **Refunds** :
  - **Record Refund Requests** : Keep a record of all customer refund requests. This includes requests made through customer service, your website, or any other communication channels.
  - **Verify Eligibility** : Ensure that refund requests meet your established refund policy criteria. Check whether the return items are within the specified timeframes and meet the required conditions.
  - **Process Refunds** : Once a refund request is approved, process the refund based on your policy. Update your financial records to reflect the refund amount and the corresponding reduction in revenue.
  - **Categorize Refunds** : Categorize refunds by the reason for the return, product type, or any other relevant criteria. This data can help you identify trends and product issues.
  - **Communicate with Customer Service** : Maintain open communication with your customer service team to handle refund requests efficiently and provide consistent responses to customers.
  - **Track Refund Costs** : Keep track of the costs associated with refunds, such as return shipping, restocking, and credit card processing fees. This information is important for financial analysis.

- **Chargebacks** :
  - **Understand Chargebacks** : Be aware of the chargeback process, including the reasons for chargebacks, the associated rules, and regulations. Chargebacks are typically initiated by customers who dispute a transaction with their credit card company.
  - **Monitor Chargeback Notices** : Stay vigilant for chargeback notifications from your payment processor. These notices usually detail the disputed transaction and the reason for the chargeback.
  - **Gather Supporting Documents** : Collect all relevant documentation, such as order information, customer communication, tracking numbers, and receipts to support your case in the event of a chargeback.
  - **Respond to Chargebacks** : Respond promptly to chargebacks with the required documentation and a well-structured dispute. Failure to respond can result in a loss of funds.

Reconcile bank and credit card accounts : Reconciling bank and credit card accounts is a crucial accounting task for e-commerce businesses to ensure that your financial records match your actual financial transactions. Reconciliation helps identify discrepancies, errors, or fraudulent activities, ensuring the accuracy of your financial records. Here's how to regularly reconcile your bank and credit card accounts :

- **Gather Statements** : Collect your bank and credit card statements for the reconciliation period. This period can be monthly, quarterly, or as needed to maintain accurate financial records.
- **Review Transactions** : Carefully review all transactions on your bank and credit card statements. Ensure that each transaction, including deposits, withdrawals, purchases, and fees, is accurately recorded.
- **Compare to Financial Records** : Compare the transactions on your statements to the corresponding entries in your accounting records or software. This includes your general ledger, accounting software, and any records of e-commerce platform transactions.
- **Identify Discrepancies** : Identify any discrepancies between your financial records and the statements. These discrepancies can include missing transactions, errors in transaction amounts, or discrepancies in dates.
- **Mark Reconciled Transactions** : As you verify each transaction, mark it as reconciled in your accounting software or on your financial records. This helps keep track of your progress and ensures you don't duplicate efforts.

- **Investigate Discrepancies** : If you find any discrepancies, investigate the reasons behind them. It could be an error in data entry, delayed transactions, bank or credit card fees, or potentially fraudulent activity.
- **Adjust Your Records** : Make adjustments to your accounting records to correct any errors or omissions. This may involve adding missed transactions, correcting amounts, or categorizing transactions properly.
- **Record Bank Charges and Fees** : Don't forget to account for bank charges, fees, or interest expenses in your financial records. These can often be missed if not recorded in real-time.
- **Bank Reconciliation Statement** : Consider creating a bank reconciliation statement to document the reconciliation process. This document summarizes the beginning balance, transactions, adjustments, and the ending balance.
- **Maintain Documentation** : Keep records of your bank and credit card statements and the reconciliation statements for future reference. These documents are essential for audits and financial analysis.

Prepare financial statements : Preparing financial statements is a regular and crucial accounting task for e-commerce businesses. These financial documents provide a snapshot of your business's financial performance and position, helping you make informed decisions and meet financial reporting requirements. Here are the key steps to regularly prepare financial statements for your e-commerce business:

- **Collect Financial Data** : Gather all relevant financial data for the period you're preparing the financial statements for. This includes revenue, expenses, assets, liabilities, equity transactions, and cash flow information.
- **Choose an Accounting Method** : Decide whether you will use the accrual accounting method or the cash accounting method for your financial statements. The choice may depend on your business's size, complexity, and reporting requirements.
- **Organize and Input Data** : Input your financial data into your accounting software or spreadsheet. Make sure that every transaction is categorized accurately, and all data is correctly recorded.
- **Calculate Totals** : Calculate the totals for each section of the financial statements based on the data you've input. This includes revenue, expenses, assets, liabilities, and equity components.
- **Review for Accuracy** : Carefully review your financial statements for accuracy. Look for discrepancies, errors, or omissions that might affect the reliability of the statements.
- **Financial Statement Components** : Create the following financial statements :

- **Income Statement (Profit and Loss Statement)** : This statement shows your e-commerce business's revenues, costs, expenses, and profitability over a specific period.
- **Balance Sheet (Statement of Financial Position)** : This statement provides a snapshot of your business's assets, liabilities, and equity at a specific point in time.
- **Cash Flow Statement** : This statement tracks the flow of cash in and out of your business over a specified period.
- **Statement of Changes in Equity** : This statement outlines changes in the equity section of your balance sheet, including contributions from owners, net income, and dividends paid.

- **Review and Analysis** : Thoroughly review and analyze the financial statements. Look for trends, anomalies, and areas where your business can improve its financial performance.
- **Compliance and Reporting** : Ensure that your financial statements comply with regulatory requirements, industry standards, and your internal accounting policies. If necessary, have them reviewed or audited by a professional accountant.
- **Communication** : Share your financial statements with relevant stakeholders, such as investors, lenders, and your management team, as well as use them for internal decision-making.

Analyze financial performance : Analyzing the financial performance of your e-commerce business is a critical and ongoing accounting task. Regular financial analysis helps you make informed decisions, identify areas for improvement, and monitor the health and profitability of your business. Here are the key steps to regularly analyze your e-commerce business's financial performance:

- **Gather Financial Data** : Collect all relevant financial data, including income statements, balance sheets, cash flow statements, and any other financial reports for the period you want to analyze.
- **Key Performance Indicators (KPIs)** : Identify and calculate key performance indicators that are relevant to your e-commerce business, such as gross profit margin, net profit margin, return on investment (ROI), customer acquisition cost, customer lifetime value, inventory turnover, and sales growth rate.
- **Compare Data** : Compare your financial data and KPIs to historical data from previous periods to identify trends and changes in your business's financial performance.
- **Benchmarking** : Compare your financial performance to industry benchmarks or similar e-commerce businesses to understand how your business measures up and where improvements can be made.

- **Revenue and Sales Analysis** : Analyze your sales data, looking for trends in revenue, customer segments, and product categories. Identify which products or services are performing well and which ones might need improvement.
- **Expense Analysis** : Examine your expenses in detail. Identify cost-saving opportunities, assess which expenses can be reduced, and ensure that expenses are in line with your budget.
- **Cash Flow Analysis** : Evaluate your cash flow, including the timing of cash inflows and outflows. Ensure you have sufficient working capital to cover expenses and debts.
- **Inventory Management** : Review your inventory turnover rate and identify any obsolete or slow-moving inventory. Effective inventory management can free up cash and improve profitability.
- **Customer Analysis** : Understand your customer behavior, including customer acquisition costs, customer retention rates, and customer lifetime value. Focus on strategies that increase customer loyalty and reduce customer acquisition costs.
- **Profitability Analysis** : Assess the overall profitability of your business, considering gross profit, net profit, and profit margins. Identify areas where you can improve profitability.
- **Budget vs. Actual Analysis** : Compare your actual financial performance to your budget or financial forecasts. Analyze differences and take corrective actions if you're not meeting your financial goals.
- **Seek Professional Advice** : If you're not experienced in financial analysis, consider consulting with a professional accountant or financial advisor who can provide guidance and insights.

Stay on top of taxes : Staying on top of taxes is a critical accounting task for e-commerce businesses to ensure compliance with tax regulations and avoid potential issues. Here's how to regularly stay on top of taxes:

- **Understand Tax Obligations** : Familiarize yourself with the tax obligations specific to e-commerce businesses in your jurisdiction. This includes Goods and Service tax, income tax, and any other relevant taxes.
- **Goods and Service Tax Collection** : Determine whether you are required to collect goods and services tax on your sales. Many e-commerce platforms offer built-in goods and services tax.features to help you collect the appropriate amount from customers.
- **Goods and Service Tax Registration** : If necessary, register for a Goods and Service Tax permit with your state or relevant tax authorities. This allows you to legally collect and remit goods and services tax.

- **Accurate Record-Keeping** : Maintain accurate records of all sales transactions, including sales tax collected. Ensure your records are well-organized and easily accessible for reporting purposes.
- **Calculate and Remit Goods and Service Tax** : Calculate the goods and services tax collected and remit it to the appropriate tax authorities on time. This often involves filing regular goods and services tax returns, which vary by location.
- **Income Tax** : Understand the income tax requirements for your e-commerce business. Depending on your business structure, you may need to file income tax returns for the business entity or report business income on your personal tax return.
- **Consult with a Tax Professional** : Consider working with a certified public accountant (CPA) or tax professional who specializes in e-commerce businesses. They can help ensure you're following tax laws, optimize your tax strategy, and assist with tax planning.
- **Backup Documentation** : Maintain thorough records and documentation to support your tax returns, including receipts, invoices, financial statements, and any correspondence with tax authorities.
- **E-commerce Platforms and Taxes** : If you use e-commerce platforms like Amazon or Flipkart ensure that they are set up to handle goods and services tax collection and reporting correctly.

Keep a business budget : Keeping a business budget is a fundamental accounting task for e-commerce businesses. A well-managed budget helps you plan and control your finances, make informed decisions, and achieve your financial goals. Here's how to regularly maintain a business budget for your e-commerce operation :

- **Create a Detailed Budget** : Begin by creating a comprehensive budget that outlines all your expected income and expenses. Consider both fixed costs (e.g., rent, utilities) and variable costs (e.g., advertising, inventory).
- **Revenue Projections** : Estimate your expected revenue based on historical data, sales forecasts, and market analysis. Consider seasonal variations, trends, and external factors that may impact sales.
- **Expense Categories** : Categorize your expenses into different categories (e.g., marketing, inventory, rent, salaries, utilities) to make it easier to track and control spending.
- **Budget Period** : Determine the budget period, which could be monthly, quarterly, or annually, depending on your business's needs and financial planning.

- **Monitor Actual vs. Budget** : Regularly compare your actual financial results to the budgeted amounts. This helps you identify variations and take corrective action if needed.
- **Expense Control** : Keep a close eye on your expenses to ensure they align with your budget. If you see costs exceeding budgeted amounts, investigate the reasons and make necessary adjustments.
- **Emergency Fund** : Allocate a portion of your budget for an emergency fund to cover unforeseen expenses or situations.
- **Savings and Investments** : Include a section in your budget for savings and investments, such as building a cash reserve or funding expansion plans.
- **Cash Flow Management** : Focus on managing your cash flow effectively. Ensure that you have sufficient working capital to cover operational costs, such as inventory and payroll.
- **Debt Management** : If your e-commerce business has loans or credit lines, budget for loan payments and interest costs. Monitor your debt levels and ensure you can meet your financial obligations.

Keep organized and accurate records : Keeping organized and accurate records is one of the most critical accounting tasks for e-commerce businesses. It not only ensures financial transparency and compliance but also enables you to make informed business decisions. Here's how to regularly maintain organized and accurate records for your e-commerce business:

- **Document All Transactions** : Record all financial transactions systematically, including sales, purchases, expenses, and revenue. Use accounting software or spreadsheets to keep track of these transactions.
- **Consistent Categorization** : Categorize transactions accurately and consistently. Create well-defined categories and use them uniformly throughout your record-keeping system.
- **Date and Time Stamps** : Include date and time stamps for all transactions to maintain a clear timeline of financial activities.
- **Sales Records** : Maintain detailed records of all sales, including order dates, customer information, product details, quantities, prices, and shipping information.
- **Expense Records** : Record all business-related expenses, including invoices, receipts, and payment records. Categorize expenses by type (e.g., marketing, utilities, inventory).
- **Inventory Management** : Implement effective inventory tracking to monitor stock levels, product costs, and sales. Regularly update inventory records to reflect changes accurately.

- **Bank and Credit Card Statements** : Reconcile your bank and credit card statements with your financial records. Ensure that all transactions are accounted for and accurately recorded.
- **Backup Documents** : Keep copies of all relevant financial documents, such as invoices, receipts, purchase orders, and sales records. Maintain both physical and digital copies for added security.
- **Secure Storage** : Safeguard your financial records by storing them securely, whether in a locked filing cabinet, encrypted digital files, or cloud-based accounting software with robust security features.
- **Backup and Disaster Recovery** : Implement a robust data backup and disaster recovery plan to protect your records from loss, theft, or damage. Regularly back up your data to secure offsite locations.
- **Digital Security** : Ensure that your digital financial records are secure by using strong passwords, enabling multi-factor authentication, and regularly updating your security software.
- **Regular Audits** : Conduct regular internal audits of your financial records to spot discrepancies, errors, or potential fraud. Consider engaging external auditors if necessary.
- **Compliance and Taxes** : Ensure that your records comply with tax regulations. Keep track of sales tax collected, income tax, and any other tax-related information.

2.2 Key Accounting issues from perspective of Ecommerce Business in elements of financial statement :

2.2.1 Applicability of AS-9 or Ind AS -18 or Ind AS-115 (effective from 01.01.2018) :

In the context of an e-commerce business, Accounting Standard 9 (AS-9) is a relevant accounting standard that addresses issues related to the recognition of revenue. AS-9, "Revenue Recognition," provides guidelines for recognizing revenue in financial statements. Here are key accounting issues from the perspective of an e-commerce business and how AS-9 applies :

- **Revenue Recognition** : AS-9 provides guidance on when revenue should be recognized and at what amount. For e-commerce businesses, recognizing revenue accurately and in the appropriate accounting period is essential. Revenue is typically recognized when it is realized or realizable and earned.
- **Sales of Goods** : AS-9 is particularly relevant for e-commerce businesses that sell physical goods. Revenue from the sale of goods is recognized when the significant risks and rewards of ownership are transferred to the buyer.

- **Accounting for Discounts and Promotions** : E-commerce businesses often offer discounts, promotional deals, and loyalty programs. AS-9 provides guidance on accounting for these discounts and promotions, ensuring they are correctly reflected in revenue recognition.
- **Accounting for Returns and Refunds** : AS-9 addresses the accounting treatment of returns and refunds. It's important for e-commerce businesses to account for returns and refunds accurately, reflecting them as deductions from revenue.
- **Consignment Sales** : If your e-commerce business is involved in consignment sales, AS-9 provides guidelines for recognizing revenue when the goods are delivered to the ultimate customer, not when they are received on consignment.
- **Subscription Models** : For e-commerce businesses with subscription-based models (e.g., streaming services, software subscriptions), AS-9 provides guidance on recognizing subscription revenue over the subscription period.
- **Multi-Currency Transactions** : E-commerce businesses often engage in international sales with transactions in different currencies. AS-9 provides guidance on how to account for foreign exchange rate fluctuations when recognizing revenue.

Indian Accounting Standard 18 (Ind AS 18) pertains to Revenue Recognition and provides specific guidance on when and how to recognize revenue in financial statements. From the perspective of an e-commerce business, there are several key accounting issues related to revenue recognition, and Ind AS 18 is applicable in addressing these issues. Here's how Ind AS 18 applies to specific elements of the financial statement for e-commerce businesses :

- **Revenue Recognition** : Ind AS 18 guides e-commerce businesses on the recognition of revenue from the sale of goods, rendering of services, and use of assets. It outlines the principles for revenue recognition, such as recognizing revenue when significant risks and rewards have been transferred to the customer.
- **Sales of Goods** : E-commerce businesses often sell physical goods. Ind AS 18 provides guidance on recognizing revenue from the sale of goods, particularly emphasizing the transfer of risks and rewards as a key criterion for revenue recognition.
- **Accounting for Discounts and Promotions** : Ind AS 18 addresses accounting for discounts and promotional activities. E-commerce businesses must follow the standard's guidance when recognizing revenue with discounts and promotions, ensuring that the correct amount of revenue is recognized.
- **Accounting for Returns and Refunds** : Ind AS 18 provides principles for recognizing revenue and accounting for returns and refunds. Properly accounting for returns and refunds is crucial in e-commerce businesses, and Ind AS 18 offers guidance for this.

- **Consignment Sales** : If an e-commerce business is involved in consignment sales, Ind AS 18 provides guidelines for recognizing revenue when goods are delivered to the ultimate customer, not when they are received on consignment.
- **Multi-Currency Transactions** : E-commerce businesses frequently engage in international sales with transactions in different currencies. Ind AS 18 provides guidance on accounting for foreign exchange rate fluctuations when recognizing revenue in different currencies.
- **Subscription Models** : E-commerce businesses with subscription-based models, such as streaming services or software subscriptions, must adhere to Ind AS 18 to recognize subscription revenue over the subscription period accurately.

Indian Accounting Standard 115 (Ind AS 115) : Revenue from Contracts with Customers, is the applicable accounting standard for revenue recognition in India. It aligns Indian accounting practices with international standards (IFRS 15) and provides guidance on how e-commerce businesses should recognize revenue from contracts with customers. Here are key accounting issues from the perspective of an e-commerce business and how Ind AS 115 applies to specific elements of the financial statement:

- **Revenue Recognition** : Ind AS 115 outlines the principles for recognizing revenue from contracts with customers. E-commerce businesses should follow these principles when recognizing revenue for products or services sold to customers.
- **Sales of Goods** : E-commerce businesses frequently sell physical goods. Ind AS 115 provides guidance on recognizing revenue from the sale of goods, emphasizing the transfer of control as a key criterion for revenue recognition.
- **Accounting for Discounts and Promotions** : Ind AS 115 addresses the accounting treatment of discounts and promotional activities. E-commerce businesses must follow the standard's guidance when recognizing revenue associated with discounts and promotions.
- **Accounting for Returns and Refunds** : AS 115 provides principles for recognizing revenue and accounting for returns and refunds. Accurate accounting for returns and refunds is crucial in e-commerce businesses, and Ind AS 115 offers guidance for this.
- **Consignment Sales** : If an e-commerce business is involved in consignment sales, Ind AS 115 provides guidelines for recognizing revenue when goods are delivered to the ultimate customer, not when they are received on consignment.
- **Multi-Currency Transactions** : E-commerce businesses frequently engage in international sales with transactions in different currencies. Ind AS 115 provides guidance on accounting for foreign exchange rate fluctuations when recognizing revenue in different currencies.

- **Subscription Models** : E-commerce businesses with subscription-based models, such as streaming services or software subscriptions, should adhere to Ind AS 115 to recognize subscription revenue over the subscription period accurately.

2.2.2 Main source of revenue: Membership and Subscription, Merchandising Activity, Advertising Service, Other Services :

Membership and Subscription : From the perspective of an e-commerce business where the main source of revenue is membership and subscription-based services, there are specific accounting issues to consider. These issues are related to recognizing revenue, billing, accounting for subscription fees, and ensuring compliance with relevant accounting standards (such as Ind AS 115 in India or IFRS 15 for international businesses). Here are key accounting issues and considerations :

- **Revenue Recognition** : Both Ind AS 115 and IFRS 15 provide guidance on revenue recognition for subscription-based businesses. Revenue should be recognized when control of promised goods or services is transferred to the customer, typically over the subscription period.
- **Subscription Fee Recognition** : Revenue from subscription fees should be recognized over the subscription period. If the subscription is for a fixed term, the revenue may be recognized on a straight-line basis over the subscription term.
- **Initial Subscription Fees** : If your e-commerce business charges an upfront fee for the initial subscription period, you should allocate a portion of this fee to future services and recognize it over the subscription term.
- **Customer Acquisition Costs** : Costs associated with acquiring new subscribers, such as marketing and sales expenses, should be capitalized and amortized over the expected customer relationship period, aligning with the revenue recognition.
- **Churn and Cancellations** : Be prepared to account for customer churn (cancellations) and potential refunds or prorated subscription adjustments when subscribers terminate their memberships.
- **Accounting for Free Trials and Discounts** : If you offer free trial periods or discounts on subscriptions, accounting for these promotions should consider the impact on revenue recognition.
- **Changes in Subscription Terms** : If there are changes in the terms of subscriptions (e.g., price changes, service modifications), they may affect the timing and pattern of revenue recognition. These changes should be carefully accounted for.
- **Revenue Reporting** : Properly report and disclose subscription revenue and any associated liabilities (deferred revenue) in your financial statements to provide transparency to investors and stakeholders.

- **Internal Controls** : Establish internal controls to manage subscription revenue recognition, billing, and collections effectively.
- **Billing Systems and Software** : Implement robust billing systems or software that can help automate billing and revenue recognition processes.

Merchandising Activity : In an e-commerce business where the main source of revenue is merchandising activity (selling physical products), there are specific accounting issues and considerations related to revenue recognition, inventory management, cost of goods sold, and compliance with accounting standards. Here are key accounting issues from the perspective of an e-commerce business primarily engaged in merchandising:

- **Revenue Recognition** : Proper revenue recognition is vital. Revenue should be recognized when control of goods is transferred to customers, typically upon delivery. Ensure adherence to applicable accounting standards, such as Ind AS 115 or IFRS 15, for accurate revenue recognition.
- **Sales Returns and Allowances** : Accounting for merchandise returns and allowances is crucial. You should have a process in place to account for and properly offset these against revenue.
- **Inventory Valuation** : Effective inventory management is essential. You must correctly value your inventory using methods such as FIFO (First-In, First-Out) or LIFO (Last-In, First-Out) to determine the cost of goods sold and the carrying value of your inventory.
- **Cost of Goods Sold (COGS)** : The COGS represents the direct costs associated with the production or procurement of the goods you sell. Accurate calculation of COGS is necessary for determining gross profit and profitability.
- **Goods in Transit** : Determine the point at which control of goods is transferred to customers. Whether it's at the shipping point or upon delivery can impact when revenue is recognized.
- **Consignment Sales** : If you engage in consignment sales, account for revenue when the goods are delivered to the ultimate customer, not when they are received on consignment.
- **Promotions and Discounts** : Properly account for sales promotions, discounts, and coupons, and ensure that the revenue recognized is net of these incentives.
- **Revenue from Shipping and Handling** : Revenue generated from shipping and handling fees should be recognized separately and accurately, following the applicable revenue recognition standard.
- **Sales Tax and VAT** : Account for sales tax, VAT (Value Added Tax), or GST (Goods and Services Tax) accurately and ensure compliance with local tax regulations.

- **Customer Loyalty Programs** : If you have customer loyalty or rewards programs, account for the expected costs of fulfilling the program and the associated revenue deferrals.
- **Internal Controls** : Implement robust internal controls for inventory management, cost tracking, and accurate financial reporting.

Advertising Service : In an e-commerce business where the main source of revenue is advertising services, there are specific accounting issues and considerations related to revenue recognition, billing, and compliance with accounting standards. Here are key accounting issues from the perspective of an e-commerce business primarily engaged in providing advertising services :

- **Revenue Recognition** : Proper revenue recognition is essential. Revenue from advertising services should be recognized when the services are delivered or when control is transferred to the customer, aligning with the applicable revenue recognition standard (e.g., Ind AS 115 or IFRS 15).
- **Contract Terms** : Carefully assess the terms of advertising contracts to determine when revenue should be recognized. It may be based on clicks, impressions, completed campaigns, or other performance metrics.
- **Multi-Element Arrangements** : If advertising services are bundled with other services or products, properly allocate and recognize revenue for each element of the arrangement.
- **Customer Prepayments** : Account for customer prepayments, if applicable, and ensure that they are recognized as deferred revenue and later recognized as revenue when the services are provided.
- **Sales Commissions and Bonuses** : If sales commissions or bonuses are paid to your sales team, consider these as sales-related expenses to be deducted from revenue when calculating your net revenue.
- **Revenue from Reselling Advertising Space** : If you act as an intermediary, reselling advertising space or services, properly account for revenue as the difference between what you charge clients and what you pay to publishers.
- **Discounts and Credits** : Account for any discounts or credits offered to clients in accordance with the applicable accounting standards, and ensure that revenue recognition is net of these adjustments.
- **Monthly Retainers and Subscription Models** : For recurring advertising services, such as monthly retainers or subscription models, recognize revenue on a monthly basis as services are delivered.

- **Internal Controls** : Implement strong internal controls for accurate revenue recognition, billing, and collections.
- **Tracking Performance Metrics** : Monitor and track key performance metrics related to advertising services to evaluate the effectiveness of your revenue streams.

Other Services : In an e-commerce business where the primary source of revenue comes from offering other services (besides advertising or merchandising), it's essential to consider various accounting issues and financial considerations. The specific accounting issues will depend on the nature of the services provided, but here are some general key accounting considerations from the perspective of an e-commerce business generating revenue from other services:

- **Revenue Recognition** : Proper revenue recognition is fundamental. Revenue from other services should be recognized when control is transferred to the customer, in line with the applicable revenue recognition standard (e.g., Ind AS 115 or IFRS 15).
- **Contract Terms** : Carefully evaluate the terms of service contracts to determine when revenue should be recognized. It may be based on milestones, project completion, or other performance metrics.
- **Multi-Element Arrangements** : If you provide bundled services or a combination of products and services, allocate and recognize revenue for each element of the arrangement.
- **Customer Prepayments** : Account for customer prepayments or upfront fees, if applicable, and ensure they are recognized as deferred revenue and later recognized as revenue when the services are delivered.
- **Variable Consideration** : Consider potential variable considerations in contracts, such as performance-based bonuses, when determining the transaction price and timing of revenue recognition.
- **Monthly Retainers and Subscription Models** : For recurring service models, such as monthly retainers or subscription services, recognize revenue on a monthly basis as services are delivered.
- **Regulatory Compliance** : Ensure that your revenue recognition practices comply with accounting standards and any applicable local regulatory requirements.
- **Discounts and Credits** : Properly account for any discounts or credits offered to clients in accordance with accounting standards, and ensure that revenue recognition is net of these adjustments.
- **Customer Churn and Cancellations** : Account for customer churn (cancellations) and potential refunds or prorated service adjustments when customers terminate their subscriptions or contracts.

- **Internal Controls** : Implement robust internal controls for accurate revenue recognition, billing and collections.

: EXERCISES :

Answer the following in Short :

1. What are the fundamental business account types in e-commerce accounting?
2. Name the three e-commerce accounting methods.
3. What is the importance of categorizing all transactions in e-commerce accounting?
4. What are the key elements of financial statements in e-commerce business?
5. Explain the term "modified cash" in e-commerce accounting methods.
6. How do e-commerce businesses track and categorize expenses?
7. What is the significance of reconciling bank and credit card accounts in e-commerce accounting?
8. Mention some main sources of revenue for e-commerce businesses.
9. What types of expenditures are considered as revenue in e-commerce accounting?
10. How does e-commerce accounting help in staying on top of taxes?

Answer the following in Brief :

1. Describe the fundamental business account types in e-commerce accounting and explain their importance in financial management.
2. Compare and contrast the cash, accrual, and modified cash methods in e-commerce accounting. When should each method be used?
3. What are the key accounting issues that e-commerce businesses face when preparing elements of financial statements? Provide examples.
4. Discuss the applicability of AS-9, Ind AS-18, and Ind AS-115 in e-commerce accounting, and explain their significance.
5. Explore the various sources of revenue for e-commerce businesses, including membership and subscription, merchandising activity, advertising services, and other services. How do these impact financial statements?
6. Explain how e-commerce businesses handle expenditure (revenue) items such as rebates, discounts, and other sales incentives. Provide examples.
7. What role does proper recordkeeping play in e-commerce accounting? How does it facilitate financial management and reporting?

8. Walk through the tasks that e-commerce businesses need to regularly complete, including tracking and categorizing sales transactions, returns, refunds, and chargebacks. How do these tasks contribute to financial accuracy?
9. Discuss the importance of keeping a business budget in e-commerce accounting and the steps involved in creating and maintaining a budget for an e-commerce business.
10. How does e-commerce accounting aid in analyzing financial performance? What tools and techniques are used to evaluate and improve financial results in e-commerce businesses?

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CHAPTER 3

Value Added Accounting and Reporting

3.1 Concepts of value addition – Meaning, Utility, and Disclosure of Value Added Statement (VAS)
3.2 Economic Value Added (EVA)
3.3 Gross Value Added (GVA)
3.4 Net Value Added (NVA)
3.5 Market Value Added (MVA)

3.1 Concepts of value addition :

i. Meaning : Value added is an alternate performance measure to profit. Generally, users of financial statements believe that profit is the only indicator of the prosperity of any organisation. But value added is a superior performance measure as it attracts the attention on inputs controllable by managers.

Value added is defined as "The wealth created by the reporting entity by its own and employee's efforts and comprises salaries and wages, fringe benefits, interest, dividend, tax depreciation and net profit retained". It has also been defined as "The increase in market value resulting from an alteration in the form, location or availability of a product or service excluded the cost of goods and services purchased from outside". From the above definition, we can say that -

- Value added term focuses on the creation and distribution of value added.
- Value added may be termed as gross value added or net value added.
- Gross value added is the term used for the excess of gross sales and income from services over the cost of purchase in material and services.
- Net value added is the term used for the annual charge of depreciation deducted from gross value added.

Value Added Statement : Value added statement is considered as a part of social responsibility reporting. It is a statement particularly prepared as a routine part of management information system. The value added statement is just a re-arrangement of information contained in the trading and profit and loss account. No doubt, this rearrangement of income statement helps us in understanding the contribution of an organisation to the society in a better way. It has been recognized that the activities of an enterprise have both economic and social impacts on the users of financial statements. An enterprise is accountable to the society as it uses common assets of the community at large such as railways, harbour roads and other facilities.

Objectives of Value-Added Statements: The main objectives of preparing Value Added Statements are :

- To indicate the value or wealth created by an enterprise. It can be used to show the wealth creating ability of the organization.
- To show the manner in which the wealth created is distributed amongst the employees, shareholders and the government.
- To indicate the organizations contribution to national income.
- To use it as a basis of making inter-firm and intra-firm analysis, for preparation of financial plans and targets, for developing productivity linked incentive schemes.

ii. Utility / Advantages of Value - Added Statements : The following are some of the advantages of Value Added Statements :

- Reporting on Value Added improves the attitude of employees towards their employing companies. This is because the Value Added statement reflects a broader view of the companies objectives and responsibilities
- Value Added statement makes it easier for the company to introduce a productivity linked bonus scheme for employees based on Value Added. The employees may be given productivity bonus on the basis of Value Added /payroll ratio
- Value Added based (e.g. VA/Payroll, taxation/VA, VA/sales, etc.) are useful diagnostic and predictive tools. Trends in Value Added ratios comparisons with other companies and international comparisons may be useful.
- Value Added provides a very good measure of the size and importance of a company. To use sales figures or capital employed figures as a basis for company ranking can cause distortion. This is because sales may be inflated by large bought-in expenses or a capital intensive company with a few employees may appear to be more important than a highly skilled labour intensive company

- Value Added statement links a company's financial accounts to national income. A company's Value Added indicates the company's contribution to national income.
- Finally Value Added statement is built on the basic conceptual foundation which is currently accepted in balance sheet and income statements. Concepts such as going concern, matching, consistency and substance over form are equally applicable to the Value Added statement.

3.2 Economic Value Added (EVA) :

Economic Value Added (EVA) is a performance measure based on residual income technique. It serves as indicator of profitability. Economic value added (EVA) is an internal management performance measure that compares net operating profit to the total cost of capital.

The underlying premise behind the idea is that real profitability occurs when additional wealth is created for the shareholders and that a business should provide returns over and above their cost of capital.

EVA aims to represent a company's true economic profit. It measures the value a company generates based on the funds that others invested in it, making it extremely reliant on invested capital. It represents the excess profit above the cost of capital, after adjustments for taxes, presented on a cash basis

Calculating EVA can be beneficial when attempting to quantify the cost of investing capital into a certain firm or project when assessing whether an investment generates enough cash or true profit to be considered as a good investment. If the outcome of calculation is a negative EVA, this indicates the company isn't generating value from the funds invested into the business, showing it may be a poor investment. If the outcome of calculation is a positive EVA, this indicates the company is producing value from the invested funds, showing it's likely a good investment.

Steps to Calculate EVA : Following steps are needed to calculate EVA

1. **Identify NOPAT :** Begin by identifying the NOPAT. NOPAT is a company's net operating profit after tax and can help determine the overall profitability of business. It does this by not including recurring expenses such as taxes and the cost of goods in company's year-end profits. It also factors in one-time-only or expiring expenses, such as loan interest, to help give an accurate view of yearly profit if those losses had not occurred.

   Formula : NOPAT= (Net income - non-operating gains + non-operating losses + taxes + interest) x (1 - tax rate)

   Alternatively, if the information of Profit After Taxes, Interest and Tax rates are given then NOPAT can be calculating by first estimating EBIT (earnings before interest

and taxes) and then deducting the tax from EBIT. In such a case the formulas shall be as follows :

EBIT= PAT/ (1-T) + Int

&

NOPAT= EBIT (1-T)

2. **Determine WACC:** Calculate the company's weighted average cost of capital, or WACC. This is the average return a company anticipates paying its investors. Here's the formula for calculating WACC:

   Weighted average cost of capital = (percentage of capital that's equity x cost of equity) + [(percentage of capital that's debt x cost of debt) x (1 - tax rate)]

3. **Calculate capital invested:** Determine the capital invested. This refers to the amount of money used to fund a specific project. Here's the formula for calculating the capital invested:

   Capital investment = equity + long-term debt at the beginning of the period

   Information regarding Capital investment can also be gathered from the balance sheet.

   Capital investment = total assets - current liabilities

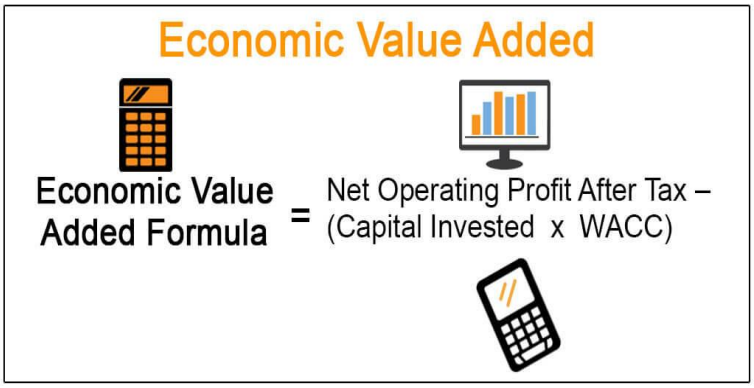


Fig. 3.1 – Economic Value Added

4. **Calculate EVA :** The formula for EVA is as follows :

   EVA = NOPAT – (WACC * capital invested)

   Where, NOPAT = Net Operating Profits After Tax

   WACC = Weighted Average Cost of Capital

   Capital invested = Equity + long-term debt at the beginning of the period

   (WACC* capital invested) is also known as finance charge

   Advantages of EVA : Some advantages of EVA are as follows :

- EVA is a tool which helps to focus managers' attention on the impact of their decisions in increasing shareholders' wealth.
- EVA is a good guide for investors; as on the bias of EVA, they can decide whether a particular company is worth investing money in or not.
- EVA can be used as a basis for valuation of goodwill and shares.
- EVA is a good controlling device in a decentralised enterprise. Management can apply EVA to find out EVA contribution of each decentralised unit or segment of the company.
- EVA linked compensation schemes (for both operatives and managers) can be developed towards protecting (or rather improving) shareholders' wealth.

3.3 Gross Value Added (GVA) :

It is arrived at by deducting the cost of all materials and services brought in from the sales revenue. The **Gross Value Added (GVA) statement** can be shown in form of a statement as given below –

Particulars	Amount
Sales	xxx
Add Direct income (Sale of Scrap, Royalty, etc.)	xxx
Total A	xxx
Cost of brought in materials and services	
All expenses, Direct, Indirect except:	xxx
Employee contribution	
Director contribution	
Taxes (government)	
Interest on long term finance	
Dividend/ shareholders charge	
Any reserve	
Depreciation	
Total B	
Value added by trading / manufacturing activities (A – B)	
Add indirect income	
Add/ less extraordinary items (abnormal)	
Gross Value Added	xxx

Format of Application Statement :

Value Applied Towards	Amount
Employees Directors Government & Taxes Providers of long-term finance Shareholders Entity- for expansion & maintenance	

3.4 Net Value Added (NVA) :

The NVA refers to the difference between GVA and Depreciation. In other words, NVA is the sum of the value added to employees, to providers of loan capital, to Government and to owners.

3.5 Market Value Added (MVA) :

Market value added (MVA) is the amount of wealth that a company is able to create for its stakeholders since its foundation. In simple terms, it's the difference between the current market value of the company's stock and the initial capital that was invested in the company by both bondholders and stockholders.

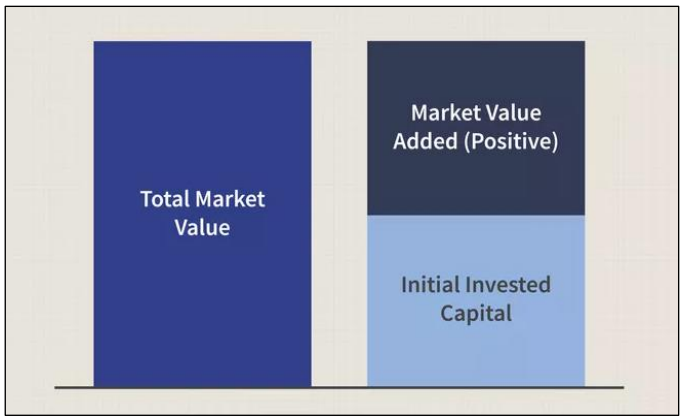


Fig. 3.2 : Market Value Added

The concept of market value added is fairly similar to that of economic value added (EVA). While economic value added (EVA) measures the real profits generated by a company by determining how profitable it has become within a given period of time. Market value added, on

the other hand, is merely the difference between the current value of the company on the market and the initial contributions made by its investors.

If a company has been performing well, it means that it has been retaining earnings. The earnings boost the book value of the company's stocks, encouraging investors to increase the prices of their shares in anticipation of future earnings. The whole process causes the company's market value to soar.

MVA Formula :

MVA = Market Value of Shares – Book Value of Shareholders'

To find the market value of shares, simply multiply the outstanding shares by the current market price per share. If a company offers owns preferred and ordinary shares, then the two are summed together to find the total market value.

As an example, consider Company XYZ whose shareholders' equity amounts to Rs. 75,00,000. The company has 5,000 preferred shares and 1,00,000 equity shares outstanding. The present market value for the common shares is Rs 125 per share and 500 per share for the preferred shares.

Market Value of equity Shares = 1,00,000 x 125 = **1,25,00,000**
Market Value of Preferred Shares = 5,000 x 500 = **25,00,000**
Total Market Value of Shares = 1,25,00,000 + 25,00,000 = **1,50,00,000**
Using the figures obtained above:
Market Value Added = 1,50,00,000 – 75,00,000 = Rs. 75,00,000

Advantages of Market Value Added (MVA) :

1. **Makes companies more attractive to potential investors:** Investors will always prefer companies with higher MVA because it shows the firm's ability to create wealth for its stockholders. In other words, a high MVA shows that the organization is healthy and succeeding – a factor that signals a high probability of generating significant returns later on. So, for investors who are not interested in high-return investments, a firm with a high MVA seems like a safe option.
2. **Boosts the survival chances of a company:** In the corporate world, nothing is 100% sure. A company could be making billions of profits one minute and declaring bankruptcy the next time. However, for a company to register a high MVA, its likelihood to thrive is certainly high.

A high MVA means the company is generating enough wealth so it will continue to attract investors. It then means that it will continue to expand its operations, earn more profit, and stay ahead of its competitors.

Practical Problems :

: Economic Value Added :

Illustration 1 :

Particulars	Amount
Equity Share Capital	10,00,000
Reserves & Surplus	2,00,000
12% Preference Share Capital	2,00,000
10% Debentures	4,00,000
Profit after Tax	2,00,000
Rate of Tax	40%

Weighted Average Cost of Capital is 12%. **Calculate Economic Value Added**

Solution :

EBIT= PAT/ (1-T) + Int
= 2,00,000/ (1-0.40) + 40,000 (Interest on debentures is 10% of 4,00,000)
= 3,73,333

Where:
PAT= Profit after Tax
T= Tax Rate
Int= Interest

NOPAT= EBIT (1-T)
= 3,73,333 x (1 – 0.4)
= 2,24,000

Where:
NOPAT = Net Operating Profit after Taxation but before Interest

Capital Employed= Equity + long-term debt at the beginning of the period
= 10,00,000 + 2,00,000 + 2,00,000 + 4,00,000
= 18,00,000

WACC = 12 % (Given)

EVA = NOPAT – (Capital Employed x WACC)
= 2,24,000 – (18,00,000 x 12%)
= 8,000

<u>Therefore, Economic Value Added is Rs. 8,000</u>

Illustration 2 :

From the following information of **Runaway Ltd.** Calculate Economic Value Added

Particulars	Amount
Equity Share Capital	10,00,000
Reserves & Surplus	4,00,000
12% Preference Share Capital	2,00,000
10% Debentures	4,00,000
Profit after Tax	3,00,000
Rate of Tax	40%

Companies with Beta Facto 1 in similar business have market value return of 15% the Beta Factor of P Ltd. is 1.2. if risk free return is 6%, **Calculate EVA**

Solution:

EBIT= PAT/ (1–T) + Int
= 3,00,000/ (1-0.40) + 40,000 (Interest on debentures is 10% of 4,00,000)
= 5,40,000

Where:
PAT= Profit after Tax
T= Tax Rate
Int= Interest

NOPAT= EBIT (1-T)
= 5,40,000 x (1 – 0.4)
= 3,24,000

Where:
NOPAT = Net Operating Profit after Taxation but before Interest

Capital Employed= Equity + long-term debt at the beginning of the period
= 10,00,000 + 4,00,000 + 2,00,000 + 4,00,000
= 20,00,000

Calculation of WACC :

Source	Amount	Proportion (A)	After Tax Cost of Capital (B)	WACC (A x B)
Equity Shares & Reserves	14,00,000	0.70	16.8% *	11.76
Preference Shares	2,00,000	0.10	12%	1.20
Debentures	4,00,000	0.20	10% x (1-0.40) 6%	1.20
	20,00,000	**1.00**		**14.16%**

* **Ke = Rf + β(Rm – Rf)**	Where
= 6% + 1.2(15% - 6%)	Ke = Cost of Equity
= 6% + 10.8%	Rf = Risk free rate
= 16.8%	Rm= market return rate
	B = Beta value

Therefore, **WACC is 14.16%**

EVA = NOPAT – (Capital Employed x WACC)

= 3,24,000 – (20,00,000 x 14.16%) = 40,800

Therefore, Economic Value Added is Rs. 40,800

Illustration 3 :

From the following information of **Sell fast Ltd.** Calculate Economic Value Added

Particulars	Amt in crores
Debt Capital 12%	2,000
Equity Capital	500
Reserves & Surplus	7,500
Capital Employed	10,000
Risk free rate (Rf)	9%
Beta Factor	1.05
Market Rate of Return (Rm)	19%
Equity (market) risk premium (Rm- Rf)	10%
Net operating profit after tax	2,100
Tax rate	30%

Solution:

EVA = NOPAT – (Capital Employed x WACC)

NOPAT = 2,100 crores

Capital Employed = 10,000

Calculation of WACC :

Source	Amount (Crores)	Proportion (A)	After Tax Cost of Capital (B)	WACC (A x B)
Equity Shares & Reserves	8,000	0.80	19.5%*	15.60%
Debt Capital	2,000	0.20	12% x (1-0.30) 8.4%	1.68%
	10,000	**1.00**		**17.28%**

*** Ke = Rf + β(Rm – Rf)**
= 9% + 1.05(19% - 9%)
= 9% + 10.5%
= 19.5%

Where
Ke = Cost of Equity
Rf = Risk free rate
Rm= market return rate
B = Beta value

EVA = NOPAT – (Capital Employed x WACC)
= 2,100 – (10,000 x 17.28%)
= 2,100 – 1728
= 372

Therefore, Economic Value Added is Rs. 372

Illustration 4 :

Following is the profit and loss account and balance sheet of **Breakaway Ltd.**

Particulars	2022 (Rs in cr.)	2023 (Rs in cr)
Turnover	652	760
Profit before taxes	134	168
Taxes	46	58
Profit after tax	88	110
Dividends	30	36
Retained Earnings (reserves)	58	74

Extracts from Balance Sheet are as follows :

Particulars	2022 (Rs in cr.)	2023 (Rs in cr)
Fixed Assets	240	312
Net Current Assets	260	320
Total	500	632
Equity Share Holders	390	472
Bank Loan	110	160

The company's performance in 2023 has improved over its position in 2022. The turnover has increased so have been the profits. However, the shareholders of the company are not satisfied by the performance of the company. **You are required to calculate EVA and evaluate the reasons for dissatisfaction among the shareholders.**

Following Additional Information is given -

Particulars	2022	2023
Pre-tax cost of debt	9%	10%
Cost of equity	15%	17%
Tax Rate	35%	35%
Interest Expenses	8 crores	12 crores

Solution:

EVA = NOPAT – (Capital Employed x WACC)

Calculation of NOPAT

Particulars	2022 (Rs in cr.)	2023 (Rs in cr)
Profit Before Tax	134	168
Add Interest	8	12
	142	180
Less tax @ 35%	(49.70)	(63)
NOPAT	92.30	117

Calculation of Capital Employed :

Particulars	2022 (Rs in cr.)	2023 (Rs in cr)
Equity share holders	390	472
Bank loan	110	160
Capital Employed	500	632

Calculation of WACC – for the year 2022 :

Source	Amount (Crores)	Proportion (A)	After Tax Cost of Capital (B)	WACC (A x B)
Equity Shares & Reserves	390	0.78	15	11.70%
Debt Capital	110	0.22	9% x (1-0.35) 5.85%	1.29%
	500	**1.00**		**12.99%**

Calculation of WACC – for the year 2023 :

Source	Amount (Crores)	Proportion (A)	After Tax Cost of Capital (B)	WACC (A x B)
Equity Shares & Reserves	472	0.75	17%	12.75%
Debt Capital	160	0.25	10% x (1-0.35) 6.50%	1.62%
	632	**1.00**		**14.37%**

Calculation of EVA :

Particulars	2021	2022
EVA = NOPAT – (Capital Employed x WACC)	92.3 - (500 x 12.99%) 92.3 – 64.95	117 – (632 x14.37%) 117 – 90.82
EVA	**27.35**	**26.18**

It is noticed that even though there has been an increase in turnover and the profit of the company in the last two years. The EVA has decreased. We can infer from above that real profitability of the company has declined and this may be the reason behind the dissatisfaction of shareholders.

Illustration 5 :

From the following information of **Amitabh Ltd.** prepare a statement showing computation of EVA for year ended 31st March 2023.

Profit & Loss Account as on 31st March 2023

Particulars	Amount	Amount
Sales		40,00,000
Cost of Goods Sold		24,00,000
Gross Profit		16,00,000
Less Expenses:		
General Expenses	4,00,000	
Office and Administration	5,00,000	
Selling and Distribution	1,28,000	10,28,000
Profits before interest and taxes (PBIT)		5,72,000
Less Interest		72,000
Profits before tax (PBT)		5,00,000
Tax (40%)		2,00,000
Profit after tax (PAT)		3,00,000

Summarized Balance Sheet as on 31st March 2023 :

Liabilities	Amount	Assets	Amount
Equity Share Capital	4,80,000	Fixed Assets	12,00,000
Reserves	3,20,000	Stock	2,40,000
Term loan	4,80,000	Debtors	1,20,000
Current Liabilities	3,20,000	Bank	40,000
	16,00,000		**16,00,000**

Other Information -

- Expected Return for Equity shareholders is 12%

Solution:

EVA = NOPAT – (Capital Employed x WACC)

NOPAT= EBIT (1-T)
= 5,72,000 x (1 – 0.4)
= 3,43,200

Where:
NOPAT = Net Operating Profit after Taxation but before Interest

Capital Employed= Equity + long-term debt at the beginning of the period
= 4,80,000 + 3,20,000 + 4,80,000
= 12,80,000

Calculation of WACC :

Source	Amount	Proportion (A)	After Tax Cost of Capital (B)	WACC (A x B)
Equity Shares & Reserves	8,00,000	0.62	12%	7.44%
Debt Capital	4,80,000	0.38	15% x (1-0.40) 9%	3.42%
	12,80,000	**1.00**		**10.86%**

EVA = NOPAT – (Capital Employed x WACC)
= 3,43,200 – (12,80,000 x 10.86%)
= 3,43,200 – 1,39,008
= 2,04,192

Therefore, Economic Value Added is Rs. 2,04,192

: Value Added Statements :

Illustration 6 :

Following is the summarized trading, profit & loss a/c of **Dhiru Ltd.** for the year ended 31st March 2023.

Particulars	Rs.	Rs.
Sales		3,03,24,000
Cost of Sales		1,96,20,000
Gross Profit		1,07,04,000
Less Wages & Salaries	34,80,000	
Interest on Loan	8,00,000	
Depreciation	12,40,000	

General Expenses	4,50,000	59,70,000
Profit before tax		47,34,000
Less corporation tax (at 30%)		14,20,200
Profit after tax		33,13,800
Dividends		18,00,000
Retained profit for the year		15,13,800

Prepare a value-added statement for the year ended 31st March 2023

Solution:

Value Added Statement of Dhiru Ltd. as on 31st March 2022

Particulars	Amount
Sales	3,03,24,000
Add other direct income	0
Total A	3,03,24,000
Cost of brought in materials and services	
Cost of Sales	1,96,20,000
General Expenses	4,50,000
Total B	2,00,70,000
Value added by trading/ manufacturing activities (A – B)	**1,02,54,000**
Add indirect income	0
Add/ less extraordinary items (abnormal)	0
Gross Value Added	**1,02,54,000**

Statement of Value Applied

Value Applied	Amount	Amount
Towards Employees		
Wages & Salaries		34,80,000
Towards Government & Taxes		
Corporation Tax		14,20,200
Towards Providers of long-term finance		
Interest on loan		8,00,000
Towards Shareholders		
Dividends		18,00,000
Towards Entity- for expansion & maintenance		
Depreciation	12,40,000	
Retained Earnings	15,13,800	27,53,800
Value Applied		**1,02,54,000**

Illustration 7 :

Following balances were extracted from the books of **Raj Ltd.** for the year ended 31st March 2023. **Prepare Value Added Statement**

Particulars	**Rs. in 000**
Purchase of equipment	7,500
Purchase of raw materials	19,655
Depreciation expenses	675
Interest expenses	350
Investment income	310
Closing stock of raw materials	3,400
Minority interest in profits of subsidiary	200
Dividends	340
GST (included in turnover)	8,000
Wages salaries & pension	5,000
Corporate tax	770
Turnover	32,135

Solution:

Value Added Statement of Raj Ltd. as on 31st March 2023

Particulars	**Amount**
Sales	32,135
Add other direct income	0
Total A	32,135
Cost of brought in materials and services	
Cost of Sales	16,255
Total B	
Value added by trading/ manufacturing activities (A – B)	15,880
Add indirect income	310
Add/ less extraordinary items (abnormal)	0
Gross Value Added	16,190

Statement of Value Applied

Value Applied	Amount	Amount
Towards Employees		
Wages salaries & pension	5,000	
Towards Directors	0	5,000
Towards Government & Taxes		
GST	8,000	
Corporate Tax	770	8,770
Towards Providers of long-term finance		
Interest Expenses		350
Towards Shareholders		
Dividends	340	
Minority Interests	200	540
Towards Entity- for expansion & maintenance		
Depreciation	675	
Retained Earnings	855	1,530
Value Applied		**16,190**

Working note :

Profit & Loss Account

Particulars	Amount	Amount
Turnover	32,135	
Less GST	8,000	24,135
Cost of Sales		
Opening stock of raw materials	0	
Add Purchase of raw materials	19,655	
Less Closing stock of raw materials	-3,400	16,255
Gross Profit		7,880
Add investment income		310
		8,190
Less Expenses		
Depreciation expenses	675	
Interest expenses	350	
Wages salaries & pension	5,000	6,025
Profit Before Tax (PBT)		**2,165**
Less corporate tax		770

Profit After Tax		**1,395**
Less minority interest		200
Less dividends		340
Retained earnings		**855**

Illustration 8 :

Following data is given for **Breakeven Ltd.** for the year ended 31st March 2023.

Particulars	Rs. in ₹ 000	Rs. in ₹ 000
Sale	2,380	
Other income	370	2,750
Operating cost	1,855	
Administrative expenses	150	
Interest cost	215	
Depreciation	240	2,460
Profit before tax		290
Provision for tax		87
Profit after tax		203
Credit balance as per last balance sheet		60
		263

Other information :

Particulars	Rs. in ₹ 000
Operational cost consists of	
Material cost	1,220
Wages & salaries to employees	330
Local taxes	70
Other manufacturing expenses	235
Administrative expenses consist of	
Directors' remuneration	55
Audit fee	25
Provision for doubtful debts	8
Others	62
Interest cost consists of	
Interest on 10% debentures	180
Interest on temporary bank overdraft	35

You are required to prepare Gross Value Added Statement and its application

Solution :

Value Added Statement of Breakeven Ltd. as on 31st March 2023

Particulars	Amount (in ₹ 000)
Sales	2,380
Add other direct income	0
Total A	2,380
Cost of brought in materials and services	
Operating Cost (1,220 + 235)	1,455
Administrative Expenses (25+8+62)	95
Interest Cost	35
Total B	1,585
Value added by trading/ manufacturing activities (A – B)	795
Add indirect income	370
Add/ less extraordinary items (abnormal)	0
Gross Value Added	**1,165**

Statement of Value Applied

Value Applied	Amount (in ₹ 000)	Amount (in ₹ 000)
Towards Employees		
Wages & salaries to employees	330	
Director's remuneration	55	385
Towards Government & Taxes		
Local taxes	70	
Provision for tax	87	157
Towards Providers of long-term finance		
Interest on 10% debentures		180
Towards Shareholders		0
Towards Entity- for expansion & maintenance		
Depreciation	240	
Retained earnings	203	443
Value Applied		**1,165**

Illustration 9 :

Following information is provided in respect of **Dollar Ltd.** as on 31st March 2023 :

Particulars	(Rs. in Lakhs)
Turnover (including returns worth Rs 35 Lakh)	2,500
Plant & Machinery	785
Depreciation on plant & machinery	132
Debtors	205
Dividend to ordinary shareholders	85
Creditors	180
Stock	
Opening stock	180
Closing stock	240
Raw materials purchased	714
Cash at bank	98
Printing and stationary	24
Auditors' remuneration	15
Retained profit (opening balance)	998
Retained profit for the year	445
Transfer to reserve	120
Rent paid	172
Other expenses	88
Share capital (100 each)	1700
Interest on borrowings	40
Income tax for the year	280
Wages and salaries	352
Employees state insurance	32
Provident fund contribution	26

You are required to prepare VAS and its Application for the period 31st March 2023

Solution :

Value Added Statement of Dollar Ltd. as on 31st March 2023

Particulars	(Rs. in Lakh)
Sales (2,500 – 35)	2,465
Add other direct income	0
Total A	2,465

Cost of brought in materials and services	
Raw materials consumed (opening+ purchases - closing) (180 + 714 – 240)	654
Printing & Stationary	24
Auditor's remuneration	15
Rent paid	172
Other expenses	88
Total B	953
Value added by trading/ manufacturing activities (A – B)	1,512
Add indirect income	0
Add/ less extraordinary items (abnormal)	0
Gross Value Added	**1,512**

Statement of Value Applied

Value Applied	Amount	Amount
Towards Employees		
Wages and Salaries	352	
Employee state insurance	32	
Provident fund contribution	26	410
Towards Government & Taxes		
Income tax for the year		280
Towards Providers of long-term finance		
Interest on borrowings		40
Towards Shareholders		
Dividend to ordinary shareholders		85
Towards Entity- for expansion & maintenance		
Depreciation on plant & machinery	132	
Transfer to reserve	120	
Retained profit for the year	445	697
Value Applied		**1,512**

: Market Value Added :

Illustration 10 :

The Capital Structure of **Damani Ltd.** whose shares are listed on BSE is as under :

Particulars	Rs. in Lakhs
Equity Shares of Rs. 100 each fully paid	500
9% Convertible Pref. Shares of Rs. 10 each	150
12% Secured Debentures of Rs. 10 each	10
Reserves	100
Statutory Fund	50

The statutory fund is compulsorily required to be invested in Government Securities.

The ordinary shares are quoted at a premium of 500%; Preference Shares at Rs. 30 per share and debentures at par value. **You are required to ascertain the Market Value added of the company.**

Solution:

MVA Formula = Market Value of Shares – Book Value of Shareholders'

Calculation of Market Value of Damani Ltd.

Particulars	Rs. in Lakhs	Rs. in Lakhs
Equity Share Capital (Market Value) 500 lakhs x 600%	3,000	
Preference Share Capital ($\frac{1,50,00,000}{10}$ x30)	450	
12% Secured Debentures	10	
Current Market Value of the Firm (A)		**3,460**
Equity Share Capital (book value)	500	
9% Convertible Pref. Shares	150	
12% Secured Debentures of Rs. 10 each	10	
Reserves	100	
Statutory Fund	50	
Book Value of the Firm (B)		**810**
Market Value = A – B		**2,650**

Therefore, the market value of S Ltd. is Rs 2,650 lakhs

Illustration 11 :

From the following information of **Crisscross Ltd. You are required to calculate the increase in the market value of the company.**

Particulars	2022	2023
Equity Shares Outstanding	5,00,000	5,00,000
Market value of Equity Shares (per share)	Rs. 75	Rs. 90
Preference Shares Outstanding	1,00,000	1,20,000
Market value of Preference Shares (per share)	Rs. 15	Rs. 16
Book value of invested Capital	1,15,00,000	1,18,00,000

Solution:

Calculation of Market Value of Crisscross Ltd. for 2022

Particulars	Rs.	Rs.
Value of Equity Shares (5,00,000 x 75)	3,75,00,000	
Value of Preference Shares (1,00,000 x 15)	15,00,000	
Current Market Value of the Firm (A)		3,90,00,000
Book Value of the Firm (B)		1,15,00,000
Market Value = A – B		**2,75,00,000**

Calculation of Market Value of Crisscross Ltd. for 2023

Particulars	Rs.	Rs.
Value of Equity Shares (5,00,000 x 90)	4,50,00,000	
Value of Preference Shares (1,20,000 x 16)	19,20,000	
Current Market Value of the Firm (A)		4,69,20,000
Book Value of the Firm (B)		1,18,00,000
Market Value = A – B		**3,51,20,000**

From the above calculations, the **Market value of Crisscross Ltd has increased by Rs. 76,20,000** (3,51,20,000 - 2,75,00,000)

: EXERCISES :

Answer the following in brief :

1. Explain the meaning and objectives of Value Added Statements.
2. What are the advantages of Value Added Statements?
3. Explain the concept of Economic Value Added. Also state the steps to calculate EVA.

4. What are the advantages of EVA?
5. Explain the terms Gross Value Added and Net Value Added in brief.
6. Explain the term Market Value Added and write the advantages of Market Value Added Method.

: SOLVE :

Problem 1 :

From the following information of **Abascus Ltd.** Calculate Economic Value Added

Particulars	Amount
Equity Share Capital	5,00,000
Reserves & Surplus	2,00,000
12% Preference Share Capital	1,00,000
10% Debentures	2,00,000
Profit after Tax	1,50,000
Rate of Tax	30%

Companies with Beta Facto 1 in similar business have market value return of 15% the Beta Factor of P Ltd. is 1.2. if risk free return is 6%.

Problem 2 :

From the following information of **Junglee Ltd.** Calculate Economic Value Added

Particulars	Amount
Debt Capital 12%	2,00,00,000
Equity Capital	50,00,000
Reserves & Surplus	7,50,00,000
Capital Employed	10,00,00,000
Risk free rate (Rf)	7%
Beta Factor	1.10
Market Rate of Return (Rm)	18%
Equity (market) risk premium (Rm- Rf)	11%
Net operating profit after tax	2,10,00,000
Tax rate	30%

Problem 3 :

Following balances were extracted from the books of **Kabira Ltd. for** the year ended 31st March 2023. **Prepare Value Added Statement.**

Particulars	Rs. in 000
Purchase of equipment	15,000
Purchase of raw materials	39,310
Depreciation expenses	1,350
Interest expenses	700
Investment income	620
Closing stock of raw materials	6,800
Minority interest in profits of subsidiary	400
Dividends	680
GST (included in turnover)	16,000
Wages salaries & pension	10,000
Corporate tax	1,540
Turnover	64,270

Problem 4 :

Following data is given for **Breakeven Ltd.** for the year ended 31st March 2023

Particulars	Rs. in ₹ 000	Rs. in ₹ 000
Sale	4,760	
Other income	740	5,500
Operating cost	3,710	
Administrative expenses	300	
Interest cost	430	
Depreciation	480	4,920
Profit before tax		580
Provision for tax		174
Profit after tax		406
Credit balance as per last balance sheet		120
		526

Other information :

Particulars	Rs. in ₹ 000
Operational cost consists of	
Material cost	2,440
Wages & salaries to employees	660
Local taxes	140
Other manufacturing expenses	470
Administrative expenses consist of	
Directors' remuneration	110
Audit fee	50
Provision for doubtful debts	16
Others	124
Interest cost consists of	
Interest on 10% debentures	360
Interest on temporary bank overdraft	70

You are required to prepare Gross Value Added Statement and its application.

Problem 5 :

The Capital Structure of **Sandy Ltd.** whose shares are listed on NSE is as under:

Particulars	Rs. in Lakhs
Equity Shares of Rs. 50 each fully paid	250
10% Convertible Pref. Shares of Rs. 10 each	75
12% Secured Debentures of Rs. 10 each	10
Reserves	50
Statutory Fund	25

The statutory fund is compulsorily required to be invested in Government Securities. The ordinary shares are quoted at a premium of 500%; Preference Shares at Rs. 40 per share and debentures at par value. **You are required to ascertain the Market Value added of the company.**

***

CHAPTER 4

Financial Statements of Holding Companies

4.1 Consolidated Financial Statements of Holding Companies
4.2 Consolidation with adjustments of - Inter-company transaction, Issue of Bonus Shares, Revaluation of fixed Assets, Debentures and Preference Shares of subsidiary Company and dividend
4.3 Reference to AS 21 - Consolidated Financial Statements
4.4 Reference to Ind-AS 27 - Consolidated and Separate Financial Statements
4.5 Holding company with one or two subsidiaries

4.1 Consolidated Financial Statements of Holding Companies :

Group companies or popularly known as the corporate groups is a collection of parent and subsidiary corporations that function as a single economic entity through a common source of control. The concept of a group is frequently used in tax law, accounting and (less frequently) company law to attribute the rights and duties of one member of the group to another or the whole. The companies in corporations can be engaged in entirely different businesses, this kind of group is called a conglomerate. The forming of corporate groups usually involves consolidation via mergers, although the group concept focuses on the instances in which the merged and acquired corporate entities remain in existence rather than the instances in which they are dissolved by the parent. The group may be owned by a holding company which may have no actual operations.

A corporate group or group company is composed of many companies. The general rule is that a company is a separate legal entity from its shareholders that is the shareholder's liability for the subsidiary's debts is limited to the value of the shares, and the shareholders cannot be required to perform the company's obligations.

Salient features of Group Companies :

- It consists of more than one company.
- The forming of corporate groups usually involves consolidation via

- It’s not necessary that the companies work for the same purpose.
- The general rule is that a company is a separate legal entity from its shareholders that is the shareholder’s liability for the subsidiary’s debts is limited to the value of the shares.

Accounting of Group Companies :

All group companies are required to maintain proper books of account of affairs. The important things required to be entered while keeping the accounts records are :

- All sums of money received and expended by the company, and matters in respect of which receiving and expenditure took place.
- All sales and purchases f goods by the company.
- The assets and liabilities of the companies.

The books of accounting of the group companies must contain :

- It must reflect the true and clear statements of the state of affairs of the company or the group of companies, and also explain the transactions.
- The books must be kept on the accurate basis and according to the double entry system of accounting.

The following person is responsible for keeping the records and timely maintenance of it:

- The group of managing directors or the managers, in the general case of group companies there is a board of directors to handle such matters.
- If the companies don’t have managing directors or the managers, then it’s the duty of the directors.
- Every officer and other employee who has been authorized and to whom responsibility to maintain the books have been given by the board of directors.

The legal requirements applicable to group companies for accounting

The preparations of balance sheets and profit/loss accounts:

Part 1 to schedule VI of the companies act, 1956 gives a format in which the balance sheet has to be prepared. The group company has to prepare its balance sheet and profit and loss account from the books of account that has to be maintained by it. Every balance sheet of every group company must give a true and fair view of the state of affairs of the company at the end of a financial year. If the responsible fails to take all reasonable steps with the requirement of law relating to the form and contents of the balance sheets, he is liable to imprisonment up to six months or fine or both.

The main heads in this form are arranged as follows :

- Share capital (fixed assets)
- Reserves and surplus (investments)
- Loans/ miscellaneous expenditures
- Current liabilities

- Profit and loss

Financial statements of business are useful for making decisions by Investors as well as decision makers in business. Inaccurate, no standardized, false or misleading accounting impacts managerial decision making and also prevents investors and other stakeholders from relying on financial statements, which can make raising investment, or exiting from a business (by selling one's stake) more difficult.

To summarized, legal provisions may govern the following :

1. Maintenance of accounts and preparation of financial statements such as profit and loss account, balance sheet, etc., any disclosures in financial statements.
2. Filing of financial statements and reports before various authorities.

Accounting according to Indian Law (The Companies Act) :

India follows two sets of accounting standards which are applicable to different categories of companies as per the applicable law :

1. **Accounting standards under Companies Accounting Standards Rules, 2006** : Companies which are not required to mandatorily follow Indian Accounting standard or those who have not adopted the Ind As standards voluntarily are required to follow the accounting standards laid down under Companies (Accounting Standards) Rules, 2006. The Institute of Chartered Accountants of India (ICAI), which is the body that governs Chartered Accountants, has issued thirty-five Accounting Standards under Companies (Accounting Standards) Rules, 2006, which contain the guidelines for recording or accounting treatment of different types of transactions.
2. **Indian Accounting Standards** : Under the Companies Act, 2013, new accounting standards are known as Indian Accounting Standards will be applicable on different categories of companies in a staggered manner. The new accounting standards are similar to the International Financial Reporting Standards, making the new accounting system at par with the global norms.

As per Section 129 of the Companies Act, 2013 every profit and loss account and balance-sheet of a company must comply with these accounting standards, and any deviations from them must be specifically disclosed, along with reasons for the deviation and the financial effect of such a deviation. A list of accounting standards is attached in the Annexure A to this note.

The Companies Act, 2013 also specifies the format of the balance sheet and profit and loss account. The balance sheet must be prepared as per Schedule III (Part I) and the profit and loss account as per Schedule II (Part II) respectively.

4.2 : Consolidation with Adjustments :

Following adjustment for consolidation are covered in the examples solved below.

- Inter-company transaction,
- Issue of Bonus Shares,
- Revaluation of fixed Assets,
- Debentures and Preference Shares of subsidiary Company and Dividend

4.3 Reference to AS 21 - Consolidated Financial Statements :

Accounting standard 21 is issued by the Institute of Chartered Accountants. It became effective from 1-04-2001. It requires that companies should prepare and present their consolidated financial statements in accordance with the provisions of this standard. Basic theme of this standard is that the financial statements about the holding company and the subsidiary company should be presented as statements of single economic entity, should disclose resources controlled by the group and liabilities owed by the group.

- Consolidated financial statements are required to include information about all the subsidiaries be it domestic or foreign subsidiaries.
- However, consolidation is not required in the following cases:
  - When the control of the holding company on the subsidiary company is of temporary nature; or
  - When subsidiary company operates under severe long-term restrictions resulting in inability to transfer funds to the parent company.
- Such unconsolidated subsidiaries should be accounted for in accordance with AS13

4.4 Reference to Ind-AS 27 - Consolidated and Separate Financial Statements :

The objective of Ind AS 27 is to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The Standard shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity elects, or is required by law, to present separate financial statements.

Separate financial statements are those presented by a parent (i.e., an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with Ind AS 109, Financial Instruments.

When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either :

- at cost, or
- in accordance with Ind AS 109, Financial Instruments.

The entity shall apply the same accounting for each category of investments. Investments accounted for at cost shall be accounted for in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, when they are classified as held for sale (or included in a disposal group that is classified as held for sale). The measurement of investments accounted for in accordance with Ind AS 109 is not changed in such circumstances.

4.5 Holding company with one or two subsidiaries :

Steps to prepare Consolidated Financial Statements : the consolidated financial statements can be prepared by following nine steps

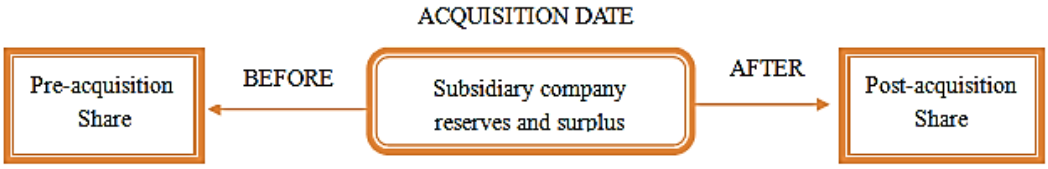
Step 1 Date of acquisition : Ascertain date of acquisition of parent in a subsidiary company

Ex:-X ltd acquired 60% shares on 1st April 2020 in Y ltd, Here date of acquisition is 1st April 2020

Step 2 Shareholding pattern : Determine share holding pattern of the subsidiary company as on the date on which the consolidated balance sheet is to be prepared. This pattern is used for apportionment of subsidiary profits.

Sl. No.	Particulars	No. of Shares	Percentage (%)
1	Parent company	60,000	60
2	Subsidiary Company	40,000	40
3	Total(1+2)	1,00,000	100

Step 3 Analysis of subsidiary reserves and surplus : Analysis of reserves and surplus will include losses also. Subsidiary reserves and surplus are divided into pre acquisition and post-acquisition profits based on acquisition date.



Ex : A ltd acquired 60% shares at Rs.10 lakhs in B ltd as on 31-09-2020,The B ltd reserves as on 01-04-2020 is 1,00,000 and on 31-03-2021 is 2,00,000 profit for the year is 5,00,000

Consolidated balance sheet is prepared on for the period 2020-21

Here the date of acquisition date is 31-09-2020 Pre-acquisition period is before 31-09-2020 and post-acquisition period is after is 31-09-2020

Reserves :

As on 31-03-2021 Rs.2,00,000

As on 01-04-2020 Rs.1,00,000

Profit transferred to reserves For the period 2020-21 is Rs.1,00,000/- (2,00,000-1,00,000)

So, here pre-acquisition reserve is Rs.1,00,000 plus Rs.50,000 (Rs.1,00,000 x 6/12) = Rs.1,50,000/- (Capital profit) balance in reserve will be treated as revenue reserve

Profit :

Profit for the year is Rs.5,00,000/- Pre-acquisition period is 6 months, so the profit will be apportioned between pre-acquisition period and post-acquisition period. Pre-acquisition period profit is Rs.2,50,000/- (5,00,000 x 6/12) Remaining period profit will be Rs.2,50,000/-

Step 4 Apportionment of profits : After analysis of profit and dividing into pre-acquisition and post-acquisition the same will be apportioned between parent company and subsidiary company, the pre-acquisition reserve and surplus will be treated as capital profit and the same will be deducted from cost of investment in purchasing company, post-acquisition reserves and surplus will be merged in parent company reserves and surplus.

Sr. No.	Particular	Pre-acquisition	Post-acquisition profit	
		Capital Profit	Revenue Reserves	Revenue profits
1	General Reserve	1,50,000	50,000	--
2	Other Reserves	xxx	xxx	--
3	Profit and loss	2,50,000	--	2,50,000
4	Less: Miscellaneous expenditure to the extent not written off/unamortized	---	---	---
5	Total	4,00,000	50,000	2,50,000
6	Parent (60%)	2,40,000	30,000	1,50,000
7	Minority Interest (40%)	1,60,000	20,000	1,00,000

Step 5 Minority interest : Compute Minority Interest

Sl. No	Particular	Note	Amount
1	Share capital	Step-2	4,00,000
2	Capital profit	Step-4	1,60,000
3	Revenue reserve	Step-4	20,000
4	Revenue profits	Step-4	1,00,000
5	Equity dividend		--
6	Preference share capital	Held by outsiders	--
7	Preference dividend		--
8	Less:-Stock Reserve	Minority share (upstream)	---
9	**Total**		**6,80,000**

Step 6 Determine cost of control :

Sl. No.	Particular	Amount	Amount
a.	**Cost of investment**		
	Amount invested- carrying amount as per parent's balance sheet	10,00,000	
	Less: Dividend received from pre-acquisition profits of subsidiary	NIL	10,00,000
b.	**Value of investment-**		
	Aggregate of parent's share:		
	Share capital	6,00,000	
	Pre-acquisition profits	2,40,000	
	Total		8,40,000
	Cost of control-(Goodwill/Capital reserve)		**1,60,000**

Note :

If Cost of Investment is more than the value of investment then it will be treated as Goodwill.

If value of investment is more than the cost of investment then it will be treated as Capital Reserve.

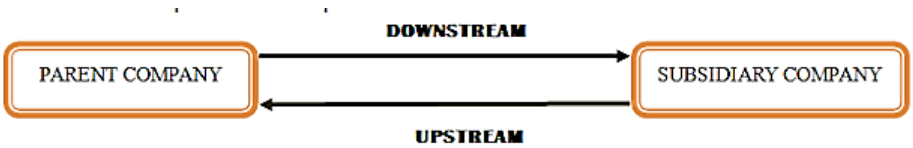
Step 7 Inter company transaction- Elimination/Adjustment :

Intercompany Owing or Debts :

Usual items like debtors/Creditors, bills payable/Bills receivable, Loans given/loans taken, dividend payable/dividend receivable etc. Adjustments for above items will lead to reduction in both companies

Assets comprising goods or machinery purchased from other company :

For the inter company transaction we need to ascertain unrealised profits left over in the balance of stock or Instalment payable for machinery. In transactions between companies involving fixed assets, eliminate unrealized profit by applying downstream and upstream concepts



Particulars	Downstream	Upstream
Transaction flow	From Parent to subsidiary	From Subsidiary to parent
Total of unrealized profit to be eliminated from asset	100 percent	100 percent
Adjustment Parents reserve Minority Interest	 100 percent Nil	 Respective share in subsidiary Step 2

Step 8 Reserves for consolidated balance sheet

Particulars	Capital reserve	Revenue reserve	Profit and loss
Reserves as appearing in parents balance sheet	1,00,000	2,00,000	4,00,000
Less: Dividend received from subsidiary company out of pre-acquisition profits transferred to investment		(xxx)	(xxx)
Add:Parents share of post-acquisition reserves and profits of subsidiary (step 4)		20,000	1,00,000
Less: Reserve for unrealized profits			(xxx)
Add: Capital Reserve (step 6)	xxx		
The net result is the value of reserves to be shown in consolidated balance sheet	1,00,000	2,20,000	5,00,000

Step 9 Preparation of consolidated Balance sheet

Liabilities :

Share capital	Only parent company
Reserves	Step-8
Minority Interest	Step-5
Other liabilities ,loans, current liabilities and provisions	Total of both companies Less: Inter company owing

Assets :

Fixed assets	Total of both companies and goodwill in step 6
Investment	Total outside investment of parent and subsidiary company
Current assets, Loans and advances	Total of both companies Less: Inter company owing
Miscellaneous expenditure to the extent of not written off	Only parent company Subsidiary amount will be net off during process of analysis of profits Step -4

Important Note : For the purpose of this book "T" format of balance sheet is used for solving the problems on consolidated financial statements.

Basic Problem on preparation of Consolidated Balance Sheet

Illustration 1 :

The balance sheet of **Prithvi Ltd.** and **Vaayu Ltd.** As on 31-3-2023 were as follows :

Liabilities	Prithvi Ltd.	Vaayu Ltd.	Assets	Prithvi Ltd.	Vaayu Ltd.
Share Capital (Rs 20)	8,00,000	2,00,000	Land and building	4,00,000	1,00,000
Profit and loss A/c	2,00,000	----	Plant and machinery	4,00,000	1,60,000
General reserve	1,60,000	----	Investment in 10,000 shares of Vaayu Ltd. On 31-3-2021	2,00,000	
Securities premium	80,000	----	Stock	2,00,000	1,40,000
Secured loan	2,00,000	1,60,000	Debtors	2,40,000	1,40,000
Unsecured loan	----	1,40,000	Cash at bank	1,00,000	60,000
Creditors	1,00,000	1,00,000			
	15,40,000	**6,00,000**		**15,40,000**	**6,00,000**

Prepare Consolidated Balance Sheet as on 31-3-2023

Solution :

Consolidated Balance sheet of Prithvi Ltd and its subsidiary Vaayu Ltd. As at 31-3-2023

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	8,00,000
b) Reserves and Surplus	2	4,40,000
Minority Interest		
Non Current Liabilities		
a) Long term borrowings	3	3,60,000
Current Liabilities		
a) Short term borrowings		1,40,000
b) Trade payables	4	2,00,000
TOTAL		19,40,000
II ASSETS		
Non Current Assets		
a) Fixed Assets	5	10,60,000
Current Assets		
a) Inventories	6	3,40,000
b) Trade Recievables	7	3,80,000
c) Cash and Bank balances	8	1,60,000
TOTAL		19,40,000

Notes to accounts

		Amount	Amounts
1	Share Capital		8,00,000
	Equity shares @ 20 each		
2	**Reserve and Surplus**		
	Profit and loss A/c		2,00,000
	General reserve		1,60,000
	Securities premium		80,000
			4,40,000
3	**Secured loan**	-	
	Prithvi Ltd	2,00,000	
	Vaayu Ltd	1,60,000	3,60,000

4	**Trade payables**		
	Creditors		
	Prithvi Ltd	1,00,000	
	Vaayu Ltd	1,00,000	2,00,000
5	**Non Current Assets**		
	Land & Building		
	Prithvi Ltd	4,00,000	
	Vaayu Ltd	1,00,000	5,00,000
	Plant and machinery		
	Prithvi Ltd	4,00,000	
	Vaayu Ltd	1,60,000	5,60,000
			10,60,000
6	**Current Assets**		
	Stock		
	Prithvi Ltd	2,00,000	
	Vaayu Ltd	1,40,000	3,40,000
7	**Debtors**		
	Prithvi Ltd	2,40,000	
	Vaayu Ltd	1,40,000	3,80,000
8	**Cash at Bank**		
	Prithvi Ltd	1,00,000	
	Vaayu Ltd	60,000	1,60,000

In the above Balance sheet, in the place of Investments in Vaayu Ltd., assets and liabilities of Vaayu Ltd. Are taken. This is because Prithvi Ltd. Owns 100% shares of Vaayu Ltd. Here Vaayu. Ltd is known as wholly owned subsidiary of Prithvi Ltd. This implies that all the assets and liabilities of Vaayu Ltd are owned by Prithvi Ltd.

In case of partly owned subsidiary, the holding company does not own 100% shares of the subsidiary company. The balance of the shares of subsidiary are held by shareholders who do not belong to the group of holding company. Since the composition of such shareholders is less than 50%, they are termed as minority shareholders and their interest in the company is termed as minority interest.

As per the AS 21, Minority interest is that part of the net results of operations and of the net assets of the subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary (ies) by the parent. Minority interest consists of

a) The amount of equity attributable to minority shareholders on the date on which investment in subsidiary is made.

b) The share of minority shareholders in the movement of equity since the date from which parent subsidiary relationship came into existence.

: Determination of Minority Interests :

Illustration 2 :

From the following information, prepare consolidated balance sheet of **Alpha Ltd.** and its subsidiary **Beta Ltd.** as on 31-3-2023

Liabilities	Alpha Ltd.	Beta Ltd.	Assets	Alpha Ltd.	Beta Ltd.
Share Capital (Rs 50)	10,00,000	2,00,000	Sundry assets	14,00,000	8,00,000
Profit and loss A/c	2,00,000	1,00,000	Investment in 2,400 shares of Beta Ltd. On 31-3-2022	1,80,000	
Sundry Liabilities	3,80,000	5,00,000			
	15,80,000	**8,00,000**		**15,80,000**	**8,00,000**

Solution:

Consolidated Balance sheet of Alpha Ltd. and its subsidiary Beta Ltd. As at 31-3-2023

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	10,00,000
b) Reserves and Surplus	2	2,00,000
Minority Interest	3	1,20,000
Current Liabilities	4	8,80,000
TOTAL		22,00,000
II ASSETS		
Non Current Assets		
Current Assets	5	22,00,000
TOTAL		22,00,000

Notes to accounts

		Amount	Amount
1	Share Capital		10,00,000
	Equity shares @ 50 each		
2	Reserves and Surplus		
	Profit and Loss A/c		2,00,000
3	Minority Interest (WN 1)		1,20,000
4	Current Liabilities		
	Sundry Liabilities		
	Alpha Ltd	3,80,000	
	Beta Ltd.	5,00,000	8,80,000
5	Current Assets		
	Sundry assets		
	Alpha Ltd	14,00,000	
	Beta Ltd.	8,00,000	22,00,000

Calculation of minority interest and parent interest

Equity shares of subsidiary at the date of acquisition	=	2,00,000
Add profit and loss A/c on the date of acquisition	=	1,00,000
		3,00,000

Minority interest = $\frac{\text{Minority Shares}}{\text{Total Shares}}$ X equity in subsidiary

Parent Interest = 2,400 / 4,000 X 3,00,000 = **1,80,000**

Minority Interest = 1,600 / 4,000 X 3,00,000 = **1,20,000**

In the above illustration, holding company's share in equity of subsidiary on the date of acquisition is Rs 1,80,000 and the cost of investment is also 1,80,000. The cost to the parent of its investment in the subsidiary and the parent's proportion of equity of subsidiary should be eliminated. Thus both of these amounts are adjusted and eliminated in the above illustration. However if the cost of investment in the subsidiary and parents share of equity of subsidiary are different, the difference is treated as follows:

- If the cost of acquisition of shares exceeds the value of equity, the excess is termed as goodwill or cost of control.

- If the amount of value of equity in subsidiary exceeds the cost of investment, the excess is called as capital reserve.

In the consolidated balance sheet goodwill is shown on the assets side and capital reserve on the liabilities side.

: Goodwill and Capital Reserve :

Illustration 3:

From the following information, prepare consolidated balance sheet of **Dhoni Ltd** and its subsidiary **Kohli Ltd** as on 31-3-2023

Liabilities	Dhoni Ltd.	Kohli Ltd.	Assets	Dhoni Ltd.	Kohli Ltd.
Share Capital (Rs 100)	10,00,000	4,00,000	Sundry assets	20,00,000	10,00,000
Profit and loss A/c	6,00,000	4,00,000	Investment in 3,000 shares of Kohli Ltd. On 31-3-2022	7,00,000	
General Reserve	2,00,000	----			
Sundry Liabilities	9,00,000	2,00,000			
	27,00,000	**10,00,000**		**27,00,000**	**10,00,000**

Solution :

Consolidated Balance sheet of Dhoni Ltd and its subsidiary Kohli Ltd. As at 31-3-2023

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	10,00,000
b) Reserves and Surplus	2	8,00,000
Minority Interest	3	2,00,000
Current Liabilities	4	11,00,000
TOTAL		31,00,000
II ASSETS		
Non Current Assets		
a) Fixed Assets		
i) Intangible Assets	5	1,00,000
Current Assets	6	30,00,000
TOTAL		31,00,000

Notes to accounts

		Amount	Amount
1	Share Capital		
	Equity shares @ 100 each		10,00,000
2	Reserves and Surplus		
	Profit and Loss A/c		6,00,000
	General Reserve		2,00,000
			8,00,000
3	Minority Interest (WN 1)		2,00,000
4	Sundry Liabilities		
	Dhoni Ltd	9,00,000	
	Kohli Ltd.	2,00,000	11,00,000
5	Goodwill (WN 2)		1,00,000
6	Sundry assets		
	Dhoni Ltd	20,00,000	
	Kohli Ltd.	10,00,000	30,00,000

WN 1 Calculation of minority interest and parent interest

equity shares of subsidiary at the date of acquisition	=	4,00,000
add profit and loss A/c on the date of acquisition	=	4,00,000
		8,00,000

Minority interest = $\frac{\text{Minority Shares}}{\text{Total Shares}}$ X Equity in subsidiary

Parent Interest = 3,000 / 4,000 X 8,00,000 = **6,00,000**

Minority Interest = 1,000 / 4,000 X 8,00,000 = **2,00,000**

WN 2 Goodwill = Cost of investment – Parents portion of equity in subsidiary

= 7,00,000 – 6,00,000 = **1,00,000**

Calculation of reserves and surplus on date of acquisition:

It is necessary to identify the reserves and surplus of the subsidiary from the date of acquisition to the date of preparing consolidated balance sheet. Such reserves and surplus are known as post acquisition reserve and surplus. It is necessary to calculate such post acquisition reserves and surplus and then bifurcate it among parent company and minority shareholders. Following accounting procedure is followed in distribution of reserves and surplus from the date parent-subsidiary relation comes into existence to the date of preparation of financial statements.

- Minorities share in reserves and surplus becomes a part of minority interest and is presented separately in the liabilities side of consolidated balance sheet.
- Reserves and surplus attributable to parent company is reported as income and added to profit and loss account of parent.

Illustration 4 :

From the following information, prepare consolidated balance sheet of **Tom Ltd.** and its subsidiary **Jerry Ltd.** as on 31-3-2023

Liabilities	Tom Ltd.	Jerry Ltd.	Assets	Tom Ltd.	Jerry Ltd.
Share Capital (Rs 100)	10,00,000	4,00,000	Sundry assets	20,00,000	10,00,000
Profit and loss A/c	6,00,000	4,00,000	Investment in 3,000 shares of Jerry Ltd.	7,00,000	
General Reserve	2,00,000	----			
Sundry Liabilities	9,00,000	2,00,000			
	27,00,000	**10,00,000**		**27,00,000**	**10,00,000**

Investment in shares of Y Ltd. was made on 1-04-2022 on the date of acquisition, the balance sheet of Y Ltd. on 1-04-2022 showed a profit and loss account of Rs.1,00,000 on liabilities side of the balance sheet.

Solution:

Consolidated Balance sheet of Tom Ltd and its subsidiary Jerry Ltd. As at 31-3-203

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	10,00,000
b) Reserves and Surplus	2	10,25,000
Minority Interest	3	2,00,000
Current Liabilities	4	11,00,000
TOTAL		33,25,000
II ASSETS		
Non Current Assets		
a) Fixed Assets		
i) Intangible Assets	5	3,25,000
Current Assets	6	30,00,000
TOTAL		33,25,000

Notes to accounts

		Amount	Amount
1	Share Capital		
	Equity shares @ 100 each		10,00,000
2	Reserves and Surplus		
	Profit and Loss A/c	6,00,000	
	share in post acquisition profit (WN 3)	2,25,000	8,25,000
	General Reserve		2,00,000
			10,25,000
3	Minority interest (WN 4)	2,00,000	
4	Sundry Liabilities		
	Tom Ltd	9,00,000	
	Jerry Ltd.	2,00,000	11,00,000
5	Goodwill (WN 5)		3,25,000
6	Sundry Assets		
	Tom Ltd	20,00,000	
	Jerry Ltd.	10,00,000	30,00,000

Working notes :

1) Total number of shares of Jerry = 4,00,000/100 = 4,000 shares

Shares Acquired by Tom = 3,000 shares

Shares held by minority = 1,000 shares

2) calculation of equity of subsidiary on date of acquisition

share capital = 4,00,000

profit & loss Account = 1,00,000

5,00,000

share of minority = 5,00,000 / 4,000 × 1,000 = **1,25,000**

share of holding co. = 5,00,000 / 4,000 × 3,000 = **3,75,000**

3) Calculation of post-acquisition profits

profit and loss account 31-3-2023 = 4,00,000

profit and loss account 1-4-2022 = 1,00,000

profit earned during 2022-23 = 3,00,000

distribution of post acquisition profit

share of holding co. = 3,00,000 / 4,000 × 3,000 = **2,25,000**

share of minority shareholders = 3,00,000 / 4,000 × 1,000 = **75,000**

4)	**Minority Interest as per AS 21**		
	Share in equity on the date of acquisition	=	1,25,000
	share in post acquisition profits	=	75,000
			2,00,000
5)	**Goodwill**		
	Cost of investment in shares	=	7,00,000
	less parents share of equity	=	3,75,000
	Goodwill	=	**3,25,000**

When shares are acquired during the year, the information about the reserves and surplus on the date of the acquisition is calculated by analysing the opening balances of reserves & surplus on the date of balance sheet and closing balance at the end of the year. Movement of reserves and surplus during the year is calculated and then this amount needs to be distributed among pre acquisition as well as post acquisition period. Generally, profits/ surplus is closely dependent upon pattern of sales and hence the distribution of profit is to be made on the basis of sales made by the subsidiary. However, if information related to sales is not available, then sales are assumed to have been incurred evenly through the year and the distribution of profits are also done evenly through the year on the basis of time. However, if the problem contains information relating to the sales pattern, then the profits are to be apportioned according to the pattern of sales mentioned.

Illustration 5 :

From the following information, calculate profit and loss account balance on date of acquisition and movement of profit since the date of acquisition.

Profit & Loss Account of Arjun Ltd. as on 31-12-2023	2,00,000 (Cr.)
Profit as on 1-1-2023	80,000 (Cr.)
Date of acquisition 1-5-2023	
Loss by fire on 1-10-2023	24,000

Solution:

Calculation of profit and loss account balance on date of acquisition and movement of profit since the date of acquisition.

Profit balance on 1-1-2023	80,000
Profit balance on 31-12-2023	2,00,000
Profit earned during the year	**1,20,000**

Distribution of profit for year 2023

Profit for the year	1,20,000
Add loss by fire	24,000
Profit before loss	**1,44,000**
Profit from 1-1-2023 to 1-5-2023 (4 months) = 4/12 x 1,44,000	48,000
Profit from 1-5-2023 to 31-12-2023 (8 months = 8/12 x 1,44,000	96,000
(since no information on pattern of sales is given in the problem, profit is assumed to be evenly distributed)	

As loss by fire has taken place on 1-10-2023 it will be subtracted from post-acquisition profit from 1-5-2023 to 31-12-2023.

Hence profit for first four months	48,000
Profit for last eight months (96,000-24,000)	72,000
Profit earned during the year	**1,20,000**

Calculation of Pre-acquisition & Post-acquisition profit

Opening Balance of profit (1-1-2023)	80,000
Profit during the first four months (till 1-5-2023)	48,000
Pre-acquisition profit	**1,28,000**
Post-acquisition profit (from 1-5-2023 to 31-12-2023)	**72,000**

Illustration 6 :

From the following information, calculate profit and loss account balance on date of acquisition and movement of profit since the date of acquisition.

Profit & Loss Account of Meta Ltd. as on 31-03-2023	7,00,000 (Cr.)
Profit as on 1-4-2022	4,00,000 (Cr.)
Sales during the year 2022-23	10,00,000
Sales from the date of Acquisition to 31-3-2023	3,00,000

Assume that the gross profit ratio is constant throughout the year

Solution :

Calculation of profit and loss account balance on date of acquisition and movement of profit since the date of acquisition.

Profit balance on 1-04-2022	4,00,000
Profit balance on 31-03-2023	7,00,000
Profit earned during the year	**3,00,000**

Profit balance on 1-04-2022	4,00,000
Add profit from 1-4-2022 upto the date of acquisition (3,00,000 x (10,00,000 – 3,00,000 / 10,00,000)	2,10,000
Profit & Loss A/c balance on date of acquisition (pre-acquisition profit)	**6,10,000**
Profit & loss A/c from the date of acquisition to 31-03-2023 (post-acquisition profit) (3,00,000 x 3,00,000 / 10,00,000)	**90000**

Elimination of Intragroup Balances :

There may be many transactions between the holding company and the subsidiary company. These transactions can be divided into -

- Trading Transactions
  - Debtors and creditors
  - Bills payables and bills receivables
- Non trading/ investment transactions
  - Loans & Advances
  - Debentures and Investment in Debentures
  - Accrued interest and interest outstanding

AS-21 requires that while preparing the consolidated financial statements; intra-group balances and intragroup transactions should be eliminated. Thus common debt is subtracted from liabilities side as well as asset side of the consolidated balance sheet.

Debtors and Creditors/Inter-Company Debts : The transactions relating to purchases and sales of goods which occur between the holding company and the subsidiary company are shown in the assets side of the Balance Sheet of one company and in the liability side of the Balance Sheet of the other company. These transactions, viz., Debtors and Creditors, are eliminated at the time of preparing Consolidated Balance Sheet.

Thus, while preparing Consolidated Balance Sheet the Debtors of both the companies will be added and Creditors of both the companies also will be added and, thereafter, the inter-company

amounts will be subtracted both from the Debtors as well as from the Creditors and will be shown in the asset side and liability side of the Balance Sheet, respectively.

Bills of Exchange/Inter-Company Acceptance : Bills which are drawn by one company and accepted by the other within the group are shown as Bills Receivable in the assets side of the Balance Sheet of the drawer company and as Bills Payable in the liabilities side of the Balance Sheet of the accepting company. These bill transactions are to be eliminated while preparing Consolidated Balance Sheet.

But, if the bill is endorsed or discounted by the bank, the same must be shown in the liability side of the Consolidated Balance Sheet since the accepting company will have to pay such bill at maturity. Therefore, the said bills may not be treated as 'mutual debt'. The company which will discount the bills must include a note as a contingent liability in the Balance Sheet. But such note is not necessary in respect of inter-company bills discounted or endorsed in the Consolidated Balance Sheet.

Thus, while preparing a Consolidated Balance Sheet, like Debtors and Creditors as stated above, the Bills Receivable of both the companies will be added and Bills Payable of both the companies also will be added and, thereafter, the amount of mutual acceptance will be subtracted from the Bills Receivable and Bills Payable Accounts, respectively, in the Consolidated Balance Sheet.

Loans and Advances : The loans which are advanced by one company to the other are shown as 'Asset' in the Assets side of the Balance Sheet of the company which gives loans, and as 'Liability' in the Liabilities side of the Balance Sheet of the company which takes the loan. Now these are to be eliminated at the time of preparing a Consolidated Balance Sheet.

Current Accounts : The current accounts which arc maintained by both the companies (holding and subsidiary) may not show identical balance due to many reasons, viz., one company remits money or goods which are not received by the other, but is lying in-transit. That is, the difference in current account may occur due to these transit items. In order to prepare the Consolidated Balance Sheet, Goods-in-transit Account or Cash-in-transit Account should be debited and the Current Account should be credited. If there is any difference in current account whatever the reasons may be, the same must be adjusted while preparing Consolidated Balance Sheet.

Contingent Liabilities : Contingent liability is a liability which is uncertain. Therefore, it may or may not involve payment in future. The same is shown as a footnote in the Balance Sheet. Some of them are: (i) Liability in respect of Bills Discounted; (ii) Liability on calls on partly paid- up shares; (iii) Arrear dividends on cumulative preference shares, etc.

The treatment of contingent liability will, however, depend on its nature, i.e., whether it is an external one or an internal one. In the case of external contingent liability, the same should be shown as a note in the Consolidated Balance Sheet but, in the case of internal contingent liability, the same should not be shown as a note since they appear as an actual liability in the Consolidated Balance Sheet

Illustration 7 :

Alpha Ltd. invested in 15000 shares of **Gamma Ltd.** for Rs. 3,10,000 on 1st July 2021 the balance sheets of the two companies on 31st march 2022 were as follows :

Liabilities	Alpha Ltd.	Gamma Ltd.	Assets	Alpha Ltd.	Gamma Ltd.
Equity shares of Rs. 20 each fully paid	18,00,000	5,00,000	Machinery	14,00,000	3,00,000
			Furniture	2,00,000	1,40,000
General Reserve	3,20,000	80,000	Investment	3,10,000	----
Profit & Loss A/c	1,60,000	50,000	Stock	2,00,000	1,00,000
Bills Payable	80,000	40,000	Debtors	1,20,000	70,000
Creditors	1,00,000	60,000	Cash at Bank	1,80,000	80,000
			Bills receivable	50,000	40,000
	24,60,000	**7,30,000**		**24,60,000**	**7,30,000**

The following additional information is provided

i. The figure of general reserve appearing in the balance sheet of Gamma Ltd has remained unchanged since 31st March 2021

ii. Profit earned by Gamma Ltd. for the year ended 31st March 2022 amounted to Rs. 40,000

iii. On 1st February 2022 Alpha Ltd. Sold to Gamma Ltd. goods costing Rs. 16,000 for Rs. 20,000. 25% of these goods remained unsold with Gamma Ltd. on 31st March 2022. Creditors of Gamma Ltd. include Rs. 8,000 due to Alpha Ltd on account of these goods.

iv. Out of Gamma Ltd. Acceptances, Rs. 14,000 are those which were accepted in favour of Alpha Ltd.

Solution :

Consolidated Balance sheet of Alpha Ltd and its subsidiary Gamma Ltd. As at 31-3-2022

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	18,00,000
b) Reserves and Surplus	2	5,47,000
Minority Interest	3	2,52,000
Current Liabilities		
a) Trade Payables	4	2,58,000
TOTAL		28,57,000

II ASSETS		
Non Current Assets		
a) Fixed Assets		
i) Property, plant and equipment	5	20,40,000
Current Assets		
a) Inventories	6	2,99,000
b) Trade Receivables	7	2,58,000
c) Cash and Bank balances	8	2,60,000
TOTAL		28,57,000

Notes to accounts

		Amount	Amount
	Share capital		
1	Equity shares of Rs. 20 each		18,00,000
	Reserve and Surplus		
2	General Reserve		3,20,000
	Capital reserve (WN 5)		50,000
	Profit & loss Account	1,60,000	
	add share in profits of		
	Gamma Ltd (WN 2)	18,000	
	less unrealised profit (WN 6)	-1,000	1,77,000
			5,47,000
3	Minority Interest (WN 4)		2,52,000
4	Bills Payable		
	Alpha Ltd.	80,000	
	Gamma Ltd.	40,000	
	less mutual ownings	-14,000	1,06,000
	Creditors		
	Alpha Ltd.	1,00,000	
	Gamma Ltd.	60,000	
	less mutual ownings	-8,000	1,52,000
			2,58,000
5	Machinery		
	Alpha Ltd.	14,00,000	
	Gamma Ltd.	3,00,000	17,00,000
	Furniture		
	Alpha Ltd.	2,00,000	
	Gamma Ltd.	1,40,000	3,40,000
			20,40,000

6	Stock		
	Alpha Ltd.	2,00,000	
	Gamma Ltd.	1,00,000	
	less unrealised profit	-1,000	2,99,000
7	Debtors		
	Alpha Ltd.	1,20,000	
	Gamma Ltd.	70,000	
	less mutual ownings	-8,000	1,82,000
	Bills receivable		
	Alpha Ltd	50,000	
	Gamma Ltd.	40,000	
	less mutual ownings	-14,000	76,000
			258000
8	Cash at Bank		
	Alpha Ltd.	1,80,000	
	Gamma Ltd.	80,000	2,60,000

Working notes :

1) Total number of shares of Gamma Ltd. = 5,00,000 / 20 = 25,000 shares

Shares Acquired by Alpha Ltd. = 60% = 15,000 shares

Shares held by minority = 40% = 10,000 shares

2) Calculation of profit on date of acquisition

Profit earned by Gamma Ltd for year 31-3-2021		40,000
opening Balance of Profit on 1-4-2021		10,000
(50,000- 10,000)		
Distribution of profit		
Balance of profit on 1-4-2021	10,000	
profit balance on 1-7-2021	10,000	20,000
(40,000/12 × 3)		
balance of profit since the date of acquisition		
(40,000/12 × 9)	30,000	
Share of holding Company (60%)		**18,000**
Share of minority (40%)		**12,000**

3) Calculation of equity of subsidiary on the date of acquisition

Share capital of Gamma Ltd.	5,00,000

	profit and loss account on the date of acquisition		20,000
	reserves and surplus on the date of acquisition		80,000
			6,00,000
	Share of holding company (60%)	**=**	**3,60,000**
	Share of minority (40%)	**=**	**2,40,000**
4)	**Minority interest**		
	share in the equity of the subsidiary	=	2,40,000
	share in profits of the subsidiary from the date of acquisition	=	12,000
	Minority Interest		**2,52,000**
5)	**Goodwill/ capital Reserve**		
	Cost of Investment	=	3,10,000
	less share of parent in equity of subsidiary	=	3,60,000
	Capital reserve		**50,000**
6)	**Unrealised Profit**		
	Cost of Goods	=	16,000
	Selling price charged by Alpha Ltd.	=	20,000
	Profit	=	**4,000**
	Stock unsold at end of the year (25%)	=	25%
	Value of Unrealised profit 25% of 4,000	=	**1,000**

Illustration 8 :

Ying Ltd. Acquired 60,000 shares of **Yang Ltd.** at Rs 10 per share on 31-03-2023. The summarised balance sheets of **Ying Ltd** and **Yang Ltd.** as on that date were as follows:

Liabilities	Ying Ltd.	Yang Ltd.	Assets	Ying Ltd.	Yang Ltd.
Equity share capital	30,00,000	8,00,000	Fixed Assets	25,30,000	12,80,000
Capital Redemption Reserve	–	5,40,000	Investments in Yang Ltd.	10,00,000	–
General Reserve	2,00,000	1,00,000	Stock	3,00,000	1,00,000
Profit & Loss A/c	5,00,000	1,00,000	Debtors	2,20,000	3,70,000
Creditors	3,50,000	2,10,000			
	40,50,000	**17,50,000**		**40,50,000**	**17,50,000**

Following additional information is given :

Stock of Ying Ltd includes Rs. 48,000 for goods at invoice price brought from Yang Ltd. while invoicing the goods, Yang Ltd. adds margin of 20% to cost. You are required to prepare consolidated balance sheet as on 31-03-2023.

Solution :

Consolidated Balance Sheet of Ying Ltd and Yang Ltd. as on 31-03-2023

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	30,00,000
b) Reserves and Surplus	2	8,47,000
Minority Interest	3	3,85,000
Current Liabilities		
a) Trade Payables	4	5,60,000
TOTAL		47,92,000
II ASSETS		
Non Current Assets		
a) Fixed Assets		
i) Property, plant and equipment	5	38,10,000
Current Assets		
a) Inventories	6	3,92,000
b) Trade Receivables	7	5,90,000
TOTAL		47,92,000

Notes to accounts

		Amount	Amount
1	Equity Share Capital		30,00,000
2	General Reserve		2,00,000
	Capital Reserve (WN 3)		1,55,000
	Profit and Loss A/c	5,00,000	
	Less unrealised profit (WN 4)	-8,000	4,92,000
			8,47,000
3	Minority interest (WN 2)		3,85,000
4	Creditors		
	Ying Ltd	3,50,000	
	Yang Ltd	2,10,000	5,60,000

5	Fixed Assets		
	Ying Ltd.	25,30,000	
	Yang Ltd.	12,80,000	38,10,000
6	Stock		
	Ying Ltd.	3,00,000	
	Yang Ltd.	1,00,000	
	Less unrealised profit (WN 4)	-8,000	3,92,000
7	Debtors		
	Ying Ltd.	2,20,000	
	Yang Ltd.	3,70,000	5,90,000

Working notes :

1)	Total number of shares of Yang Ltd.	=	8,00,000/10	=	80,000 shares
	Shares Acquired by Ying Ltd.	=	75%	=	60,000 shares
	Shares held by minority	=	25%	=	20,000 shares

2) Calculation of equity of subsidiary on the date of acquisition

Share capital of Yang Ltd.	=	8,00,000
Capital redemption reserve	=	5,40,000
General reserve	=	1,00,000
Profit & Loss A/c	=	1,00,000
Total	=	15,40,000
Share of Parent Company (75%)		**11,55,000**
Share held by minority (25%)		**3,85,000**

3) Goodwill/ capital Reserve

Cost of Investment	=	10,00,000
Less share of parent in equity of subsidiary	=	11,55,000
Capital Reserve		**1,55,000**

4) Unrealised Profit

Goods Sold by Yang Ltd to Ying Ltd	=	48,000
Cost of Goods sold (48,000 x 20/120)	=	40,000
Unrealised Profit		**8,000**

Revaluation of Assets and Liabilities of Subsidiary Company :

Any revaluation in Assets or Liabilities of Subsidiary company will lead to following:

- It will affect net assets of the subsidiary on the date of acquisition of controlling interest by the parent company

- It may also lead to excess/ additional depreciation during the post-acquisition period which in trun will affect the profit of the subsidiary. Accounting Standard 6 on depreciation states that depreciation on revalued assets should be provided with prospective effect for unamortised life of the asset.

Illustration 9 :

Following are the balance sheets of Hero Ltd. and its subsidiary Honda Ltd. as on 31-03-2023:

Liabilities	Hero Ltd.	Honda Ltd.	Assets	Hero Ltd.	Honda Ltd.
Share Capital (Equity shares of Rs 10 each)	8,00,000	2,00,000	Fixed Assets	5,00,000	1,90,000
Surplus	1,00,000	40,000	Investment in 18000 shares of Honda Ltd. on 1st April 2022	2,80,000	---
Other Liabilities	15,00,000	9,60,000	Other Assets	16,20,000	10,10,000
	24,00,000	**12,00,000**		**24,00,000**	**12,00,000**

Following additional information is given :

Honda Ltd. had a balance of Rs 16,000 (Cr) in its surplus on 01-04-2022. Profits have been earned uniformly throughout the year. On 1st April 2022, Hero Ltd. revalued (increased) the fixed asset of Honda Ltd. by 40% of book value of 2,00,000 (revaluation not yet adjusted). Consolidate the balance sheets.

Solution : Consolidated Balance Sheet of Hero Ltd. and Honda Ltd. as on 31-03-2023

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	8,00,000
b) Reserves and Surplus	2	1,18,000
Minority Interest	3	31,600
Current Liabilities	4	24,60,000
TOTAL		34,09,600
II ASSETS		
Non Current Assets		
a) Fixed Assets		
i) Property, plant and equipment	5	7,66,000
ii) Intangible Assets	6	13,600
Current Assets	7	26,30,000
TOTAL		34,09,600

Notes to accounts

		Amount	Amount
1	Equity Share Capital		8,00,000
2	Surplus	1,00,000	
	Add share in post-acquisition	18,000	
	profits of Honda Ltd.(WN 4)		1,18,000
3	Minority Interest (WN 6)		31,600
4	Other Liabilities		
	Hero Ltd.	15,00,000	
	Honda Ltd.	9,60,000	24,60,000
5	Fixed Assets (5,00,000 + 1,90,000)	6,90,000	
	Add revaluation (WN 2)	80,000	
	Less addl. Depreciation of revaluation		
	(WN 3)	-4,000	7,66,000
6	Goodwill (WN5)		13,600
7	Other Assets		
	Hero Ltd.	16,20,000	
	Honda Ltd.	10,10,000	26,30,000

Working Notes :

1) Total number of shares of Honda Ltd. = 2,00,000/10 = 20,000 shares

Shares Acquired by Hero Ltd. = 90% = 18,000 shares

Shares held by minority = 10% = 2,000 shares

2) Revaluation of Fixed Asset

Original value of Asset	=	2,00,000
Asset appreciated by 40% (2,00,000 x 40%)	=	80,000
Revalued value	=	2,80,000
Share of Hero Ltd in profit on revaluation (90% of 80,000)		**72,000**
Share of minority in profit on revaluation (10% of 80,000)		**8,000**

3) Additional Depreciation

Value of Fixed assets on 31-03-2022	=	1,90,000
Value of Fixed assets on 01-04-2021	=	2,00,000
Therefore, depreciation provided during the year	=	10,000
So, Rate of depreciation = 5% (10,000/2,00,000 x 100)		
Addl depreciation = 5% on revalued amount (5% of 80,000)	**=**	**4,000**

4) Calculation of Profit/ loss

Pre-acquisition profit of Honda Ltd.	=	16,000
Share of Hero Ltd. (90%)		14,400
Share of minority (10%)		1,600
Post-acquisition Profits of Honda Ltd. (40,000 – 16,000)	=	24,000
Less Additional depreciation	=	4,000
		20,000
Share of Hero Ltd. (90%)		18,000
Share of minority (10%)		2,000

5) Calculation of Goodwill/ Capital Reserve

Investment in Honda Ltd	2,80,000
Less share of Parent in revaluation of assets	72,000
Less share of Parent in pre acquisition profits	14,400
Less share of Parent in the equity of subsidiary	1,80,000
Goodwill	**13,600**

6) Minority Interest

Share of Minority in Equity	20,000
Share of minority in revaluation of assets	8,000
Share of minority in pre-acquisition profits	1,600
Share of minority in post-acquisition profits	2,000
Minority interest	**31,600**

Illustration 10 :

The following are the balance sheets if **Hit Ltd** and **Sit Ltd.** as on 31-03-2023.

Liabilities	Hit Ltd.	Sit Ltd.	Assets	Hit Ltd.	Sit Ltd.
Equity Share Capital Rs. 10 each	10,00,000	4,00,000	Plant	4,00,000	1,80,000
Profit & Loss A/c	6,00,000	4,00,000	Furniture	2,00,000	90,000
Liabilities	6,00,000	2,00,000	Investments in 32,000 shares of Sit Ltd.	8,00,000	---
			Other Assets	8,00,000	7,30,000
	22,00,000	**10,00,000**		**22,00,000**	**10,00,000**

Following additional information is given :

1. Profit and Loss A/c of Sit Ltd. showed a credit balance of Rs. 2,40,000 on 01-04-2022.
2. Hit Ltd. acquired shares of Sit Ltd. on 01-10-2022.

3. Plant of Hit Ltd. was valued at 6,00,000 and plant of Sit Ltd. whose book value on 01-04-2022 was Rs 2,00,000 was valued at 3,00,000. However no entries were passed for this purpose.

Prepare consolidated Balance Sheet of Hit Ltd. and Sit Ltd.

Solution : Consolidated Balance Sheet of Hit Ltd. and Sit Ltd. as on 31-03-2023

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	10,00,000
b) Reserves and Surplus	2	8,60,000
Minority Interest	3	1,81,000
Current Liabilities	4	8,00,000
TOTAL		28,41,000
II ASSETS		
Non Current Assets		
a) Fixed Assets		
i) Property, plant and equipment	5	11,75,000
ii) Intangible Assets	6	1,36,000
Current Assets	7	15,30,000
TOTAL		28,41,000

Notes to accounts

		Amount	Amount
1	Equity Share Capital		10,00,000
2	Revaluation Reserve (revaluation of Plant of Hit Ltd.)		2,00,000
	Profit & Loss A/c	6,00,000	
	Add share in Sit Ltd.(WN 3)	60,000	6,60,000
			8,60,000
3	Minority Interest (WN 6)		1,81,000
4	Liabilities		
	Hit Ltd.	6,00,000	
	Sit Ltd.	2,00,000	8,00,000
5	Plant	6,00,000	
	Hit Ltd (4,00,000 + 2,00,000)		
	Sit Ltd (1,80,000 + 1,10,000)	2,90,000	
	Less Additional depreciation (WN 2)	5,000	8,85,000

	Furniture		
	Hit Ltd.	2,00,000	
	Sit Ltd.	90,000	2,90,000
			11,75,000
6	Goodwill (WN 5)		1,36,000
7	Other Assets		
	Hit Ltd.	8,00,000	
	Sit Ltd.	7,30,000	15,30,000

Working Notes :

1)	Total number of shares of Sit Ltd.	=	4,00,000/10	=	40,000 shares
	Shares Acquired by Hit Ltd.	=	80%	=	32,000 shares
	Shares held by minority	=	20%	=	8,000 shares

2) Calculation of Additional Depreciation

Plant of Sit Ltd. on 31-03-2023	1,80,000
Plant of Sit Ltd on 01-04-2022	2,00,000
Therefore, depreciation provided during the year	20,000
So, Rate of depreciation = 10%	
Now Plant of Sit as on 01-04-2022	2,00,000
Depreciation @10% for 6 months (till 01-10-2022)	10,000
Book value on the date of acquisition	1,90,000
Add Revaluation of Plant (3,00,000 – 1,90,000)	1,10,000
Revalued Amount	3,00,000
On the above amount depreciation has already been provided on Rs 2,00,000 for full year	
So additional depreciation shall be charged on remaining amount of Rs 1,00,000 @ 10% for six months	5,000

3) Calculation of Profit/ Loss A/c

Profit of Sit Ltd. as on 31-03-2023	=	4,00,000
Profit of Sit Ltd at the beginning of the year on 01-04-2021	=	2,40,000
Profit earned during the year	=	1,60,000
Profit earned till the date of acquisition (1,60,000/12 x 6)	=	80,000
Profit of Sit Ltd as on 01-04-2022	=	2,40,000
Add profit upto 01-10-2022	=	80,000

Pre-acquisition profit		**3,20,000**
Post- Acquisition profit (1,60,000/12 x 6)	=	80,000
Less Additional Depreciation on plant	=	5,000
Post- acquisition profit		**75,000**
Share of Hit Ltd (80%)		**60,000**
Share of Minority (20%)		**15,000**

4) Calculation of Equity of Subsidiary on the date of acquisition

Equity Share Capital	=	4,00,000
Revaluation of plant	=	1,10,000
Profit & Loss account on 01-10-2022	=	3,20,000
Total		8,30,000
Share of Hit Ltd (80%)		**6,64,000**
Share of Minority (20%)		**1,66,000**

5) Calculation of Goodwill/ Capital Reserve

Cost of Investment in Sit Ltd.	=	8,00,000
Less share of Parent in the equity of subsidiary on date of acquisition	=	6,64,000
Goodwill		**1,36,000**

6) Calculation of Minority Interest

Share of Minority in Equity	=	1,66,000
Share of minority in post-acquisition profits (20% of 75,000)	=	15,000
Minority Interest		**1,81,000**

Issue of Bonus Shares : Issue of Bonus shares by the subsidiary will lead to decrease in reserves and surplus of the company and increase in the number of the shares. If the bonus issue has not been recorded by the subsidiary, then the share capital and the reserves will need to be adjusted before preparation of consolidated financial statements. It must be noted that issue of bonus shares does not have any effect on the controlling share of parent in the subsidiary. It merely results in increase of the total shares of subsidiary company for which proper accounting adjustments must be made before proceeding with preparing consolidated financial statements.

Illustration 11 :

Following are the balance sheets of **Okay Ltd.** and its subsidiary **Dokay Ltd.** as on 31st march 2023.

Liabilities	Okay Ltd.	Dokay Ltd.	Assets	Okay Ltd.	Okay Ltd.
Equity share capital (100 Each)	32,00,000	10,00,000	Fixed Assets	28,00,000	10,00,000
General Reserve	12,00,000	2,00,000	Investments in 8,000 shares of Dokay Ltd. (01-04-2021)	12,00,000	
Surplus	4,00,000	4,00,000	Current Assets	16,00,000	8,00,000
Creditors	8,00,000	2,00,000			
	56,00,000	**18,00,000**		**56,00,000**	**18,00,000**

Dokay Ltd. had a balance of Rs. 2,00,000 in general reserve and Rs. 80,000 surplus on 1st April 2022. Profits have been earned uniformly through the year. Bonus shares have been issued by Dokay Ltd. in ratio 1:5 (one for every five shares) out of profits declared in the year 2022-23. Consolidate the balance sheets.

Solution:

Consolidated Balance Sheet of Okay Ltd. and Dokay Ltd. as on 31-03-2023

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	32,00,000
b) Reserves and Surplus	2	16,96,000
Minority Interest	3	3,20,000
Current Liabilities		
a) Trade Payables	4	10,00,000
TOTAL		62,16,000
II ASSETS		
Non Current Assets		
a) Fixed Assets		
i) Property, plant and equipment	5	38,00,000
ii) Intangible Assets	6	16,000
Current Assets	7	24,00,000
TOTAL		62,16,000

Notes to accounts

		Amount	Amount
1	Share Capital		32,00,000
2	General Reserve		12,00,000
	Surplus	4,00,000	
	Share of profits from Dokay Ltd. (WN 3)	96,000	4,96,000
			16,96,000
3	Minority Interest (WN 5)		3,20,000
4	Creditors		
	Okay Ltd.	8,00,000	
	Dokay Ltd.	2,00,000	10,00,000
5	Fixed Assets		
	Okay Ltd.	28,00,000	
	Dokay Ltd.	10,00,000	38,00,000
6	Goodwill (WN 4)		16,000
7	Current Assets		
	Okay Ltd.	16,00,000	
	Dokay Ltd.	8,00,000	24,00,000

Working Notes :

1) Total number of shares of Dokay Ltd. = 10,00,000/100 = 10,000 shares

Shares Acquired by Okay Ltd. = 80% = 8,000 shares

Shares held by minority = 20% = 2,000 shares

2) Amount of Bonus Issue

Amount of share capital issued as bonus shares = 1/5 of Rs. 10,00,000 = Rs. 2,00,000 (This amount is reduced from post-acquisition profits and added to share capital of Dokay Ltd.) 2,00,000

Share of Okay Ltd in bonus issue (80%) 1,60,000

Share of minority in bonus issue (20%) 40,000

3) Calculation of Profit/ loss

Opening balance of general reserves of Dokay Ltd	2,00,000
Opening Balance of Surplus of Dokay Ltd	80,000
Total	2,80,000
Share of Okay Ltd in pre-acquisition profits (80%)	**2,24,000**
Share of Minority in pre-acquisition profits (20%)	**56,000**

Profits earned during the year (Rs. 4,00,000 – Rs. 80,000 profit at beginning of the year)	3,20,000
Less Bonus issue of shares out of the profits	2,00,000
Post-acquisition profits	1,20,000
Share of Okay Ltd in post-acquisition profits (80%)	96,000
Share of Minority in post-acquisition profits (20%)	24,000

4) Calculation of Goodwill/ Capital Reserve

Investment in Dokay Ltd	12,00,000
Less share of parent in Equity of the company	8,00,000
Less share of parent in Bonus issue	1,60,000
Less share of Parent in Pre-acquisition profit	2,24,000
Goodwill	**16,000**

5) Minority Interest

Share of Minority in Equity	2,00,000
Share of minority in Bonus issue	40,000
Share of minority in pre-acquisition profits	56,000
Share of minority in post-acquisition profits	24,000
Minority interest	**3,20,000**

Dividend received by Parent from subsidiary company :

The following points, in respect of dividends, should be kept in mind while preparing consolidated balance sheet.

i) **Proposed Dividend :** When a subsidiary company proposed the dividend, it debits its Profit and Loss Appropriation Account and credits Proposed Dividend Account. Holding Company's share of such dividend will appear with the Profit and Loss Account balance in the consolidated Balance Sheet and the share of such dividend belonging to Minority Shareholders will be added to Minority Interest. Accordingly, proposed dividend need not appear in the consolidated Balance Sheet. This is because a portion is added to Profit and Loss Account balance of holding company and added the rest to the Minority Interest.

ii) **Payment of Dividend :** Where the holding company receives dividend from the subsidiary company, then its treatment in the holding company's books and answer to the question whether such dividend shall be further available as dividend to the shareholders of the holding company will depend upon the following possibilities relating to the source from which such dividends have been paid: is as follows:

a) If the whole of the dividend is from the pre-acquisition profits, it must be treated as capital gain and must be used either for reducing the cost of shares or for increasing capital reserve. The dividend so received is not available to the shareholders of the holding company and thus cannot be taken to the revenue profits of the holding company.

b) If the whole of the dividend is received from the post-acquisition profits, it is again available to the shareholders of the holding company and can be credited to the Profit and Loss Account of the holding company.

c) If dividend declared partly out of capital profits (Pre-acquisition profits) and partly out of revenue profits (post acquisition profits), the dividend received is divided into two parts in proportion to its declaration out of capital profits and revenue profits. The dividend pertaining to the first (capital profits) is credited to Investment Account reducing the cost of control or increasing the Capital Reserve and dividend pertaining to the second part (Revenue Profits) is credited to Profit and Loss Account.

d) If dividend declared by subsidiary company out of preacquisition profits is wrongly credited to profit and loss account by holding company, the error is rectified at the time of consolidation by reducing both profit and loss account and investment in shares of subsidiary to bring the balances of these accounts to correct levels.

Illustration 12 :

Following are the balance sheets of **Hide Ltd.** and its subsidiary **Seek Ltd** as on 31st March 2023 :

Liabilities	Hide Ltd.	Seek Ltd.	Assets	Hide Ltd.	Seek Ltd.
Share capital (Rs. 10 each)	20,00,000	8,00,000	Goodwill	–	1,20,000
			Fixed Assets	10,00,000	7,20,000
General reserve	4,00,000	2,40,000	Investments	12,00,000	
Surplus	5,00,000	3,60,000	Preliminary Exps	–	30,000
Creditors	3,20,000	2,00,000	Stock	5,40,000	4,34,000
Bills Payable	–	1,00,000	Debtors	3,40,000	3,00,000
			Bills receivable	1,20,000	80,000
			Bank	20,000	16,000
	32,20,000	**16,40,000**		**32,20,000**	**17,00,000**

Hide Ltd invested Rs. 10,00,000 for 80% control in Seek Ltd. on 1st April 2021. Seek Ltd had balance of Rs. 2,00,000 in its general reserve and Rs. 3,00,000 surplus on 1st April 2021. Seek Ltd paid final dividend at 25% out of profits of last years. Hide Ltd credited its share of dividend to profit & loss Account. On 1st April 2021, Hide Ltd decreased the value of tangible assets of Seek Ltd from 8,00,000 (as on 01-04-2021) to Rs. 7,00,000 (revaluation not yet adjusted in the books) creditors for Seek Ltd include Rs. 50,000 for goods purchased from Hide Ltd on which Hide Ltd has earned profit of 20%. Of these, goods of Rs. 20,000 are in stock of Seek Ltd as on 31-03-2021. Preliminary expenses are to be written off completely. Consolidate the balance sheets.

Solution:

Consolidated Balance Sheet of Hide Ltd. and Seek Ltd as on 31-03-2022

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	20,00,000
b) Reserves and Surplus	2	9,84,000
Minority Interest	3	2,56,000
Current Liabilities		
a) Trade Payables	4	5,70,000
TOTAL		38,10,000
II ASSETS		
Non Current Assets		
a) Fixed Assets		
i) Property, plant and equipment	5	16,30,000
ii) Intangible Assets	6	1,84,000
Current Assets		
a) Investment		2,00,000
b) Inventories	7	9,70,000
c) Trade Recievables	8	7,90,000
d) Cash and Bank balances	9	36,000
TOTAL		38,10,000

Notes to accounts

		Amount	Amount
1	Equity Share Capital		20,00,000
2	General Reserve	4,00,000	
	Surplus	5,00,000	

	Add share from Seek Ltd.	2,48,000	
	Less dividend wrongly recorded	-1,60,000	
	Less unrealised profit (stock) (WN 7)	-4,000	9,84,000
3	Minority Interest (WN 6)		2,56,000
4	Creditors		
	Hide Ltd	3,20,000	
	Seek Ltd.	2,00,000	
	Less mutual ownings	-50,000	4,70,000
	Bills Payable		1,00,000
			5,70,000
5	Fixed Assets		
	Hide Ltd	10,00,000	
	Seek Ltd.	7,20,000	
	Less revaluation	-1,00,000	
	Add savings		
	in depreciation	10,000	16,30,000
6	Goodwill (1,20,000+64,000) (WN 5)		1,84,000
7	Stock		
	Hide Ltd	5,40,000	
	Seek Ltd.	4,34,000	
	Less unrealised profit	-4,000	9,70,000
8	Debtors		
	Hide Ltd	3,40,000	
	Seek Ltd.	3,00,000	
	Less mutual ownings	-50,000	5,90,000
	Bills receivable		
	Hide Ltd	1,20,000	
	Seek Ltd.	80,000	2,00,000
			7,90,000
9	Bank		
	Hide Ltd	20,000	
	Seek Ltd.	16,000	36,000

Working Notes:

1) Total number of shares of Seek Ltd. = 8,00,000/10 = 80,000 shares

Shares Acquired by Hide Ltd. = 80% = 64,000 shares

Shares held by minority = 20% = 16,000 shares

2)	**Revaluation of assets**		
	Loss on revaluation of assets of Seek Ltd (8,00,000 – 7,00,000)		1,00,000
	Share of Hide Ltd in Revaluation Loss (80%)		**80,000**
	Share of Minority in Revaluation Loss (20%)		**20,000**
3)	**Savings in depreciation**		
	Depreciation for the year 2022-23 (8,00,000 – 7,20,000)		80,000
	Rate of Depreciation		10%
	Saving in depreciation (10% of loss on revaluation)		
	So, 10% of 1,00,000 i.e. Rs10,000 will be added to post-acquisition profits		
4)	**Calculation of Profit/ loss**		
	Opening balance of general reserves of Seek Ltd		2,00,000
	Opening Balance of Surplus of Seek Ltd	3,00,000	
	Less Dividend declared (25% of share capital of 8,00,000)	(2,00,000)	1,00,000
	Less preliminary expenses written off		30,000
	Pre-acquisition profits		2,70,000
	Share of Hide Ltd in pre-acquisition profits		**2,16,000**
	Share of Seek Ltd in pre-acquisition profits		**54,000**
	Post-acquisition profits		
	Balance of general reserve (2,40,000 – 2,00,000)		40,000
	Balance of Surplus (3,60,000 – 1,00,000)	2,60,000	
	Add savings in depreciation	10,000	2,70,000
	Post-acquisition profits		3,10,000
	Share of hide Ltd. in post-acquisition profits		**2,48,000**
	Share on Minority in post-acquisition profits		**62,000**
5)	**Calculation of Goodwill/ Capital Reserve**		
	Investment in Seek Ltd		10,00,000
	Less share of parent in Equity of the company		6,40,000
	Less dividend from Seek Ltd. wrongly credited to Surplus A/c (6,40,000 x 25% dividend)		1,60,000
	Less share of Parent in Pre-acquisition profit		2,16,000
	Share of Loss in revaluation		80,000
	Goodwill		**64,000**

6) Minority Interest

Share of Minority in Equity	1,60,000
Share of minority in loss on revaluation	20,000
Share of minority in pre-acquisition profits	54,000
Share of minority in post-acquisition profits	62,000
Minority interest	**2,56,000**

7) Unrealised profit on stock

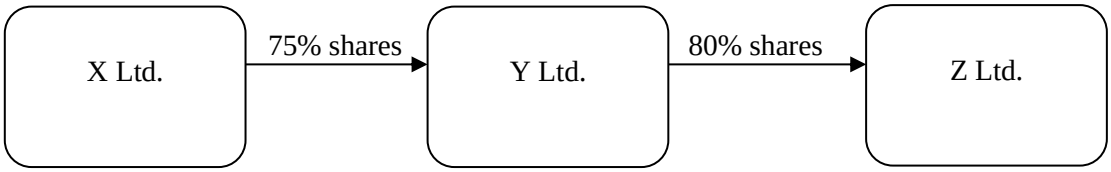
Goods still in stock of Seek Ltd	20,000
Profit earned by Hide Ltd. (20 % on such goods)	4,000

Consolidation of more than one subsidiary : There are two ways in which a company can have more than one subsidiary

- Direct Holding
- Chain Holding (indirect holding)

Direct holding : In this method the company directly acquires the controlling interest in more than one company and various subsidiaries do not hold share in one another. In such case calculation of cost of control, minority interest etc. shall be done separately for each subsidiary.

Chain holding : When a company acquires controlling shares in another company which is already a holding company, it results in chain holding or indirect holding.



To prepare consolidated balance sheet of chain holdings, the consolidation procedure has to be carried out in books of Y Ltd. by analysing the profits of Z Ltd. share of outsiders in profits of Z Ltd. is transferred to minority interest and share of other company (Y Ltd.) in chain is transferred to respective company. Now the profits of Y Ltd are analysed and again the portion of profits belonging to outsiders is transferred to minority interest and usual consolidation procedure is followed in the books of X Ltd.

Illustration 13 (Direct Holding) :

Eena Ltd. owns the entire issued capital of Meena Ltd. and 90% of issued capital of Dika Ltd. their trial balance as at 31-03-2022 is as follows:

Particulars	Eena Ltd.	Meena Ltd.	Dika Ltd.
Equity share capital (shares @ Rs. 10 each)	80,00,000	4,00,000	6,00,000
Profit & Loss Account	16,00,000	1,60,000	4,00,000
Current Liabilities	4,00,000	2,00,000	3,00,000
Due to Eena Ltd.	---	---	3,20,000
Proposed equity dividend	8,00,000	4,00,000	1,00,000
	1,08,00,000	**11,60,000**	**17,20,000**
Fixed Assets	47,80,000	3,20,000	4,80,000
Current Assets	45,20,000	8,40,000	12,40,000
Investment in			
Meena Ltd.	5,00,000		
Dika Ltd.	6,40,000		
Ownings by			
Dika Ltd.	3,60,000		
	1,08,00,000	**11,60,000**	**17,20,000**

On date of acquisition of shares in subsidiaries on 1st April 2021, the balance sheets showed the following:

Particulars	Meena Ltd.	Dika Ltd.
Profit & Loss Account	40,000	1,00,000

Meena Ltd and Dika Ltd have not paid any dividends since becoming subsidiary of Eena Ltd.

The difference in inter company balance is due to a remittance of Rs 40,000 by Dika Ltd. to Eena Ltd. on 31st March 2022 which was received by Eena Ltd in 2023.

Prepare consolidated balance sheet of Eena Ltd and its subsidiaries on 31st March 2022.

Solution:

Consolidated Balance Sheet of Eena Ltd. and its subsidiaries as on 31-03-2022

	Note no	Amount
I EQUITY AND LIABILITIES		
Shareholder's fund		
a) Share Capital	1	80,00,000
b) Reserves and Surplus	2	24,80,000
Minority Interest	3	1,10,000
Current Liabilities	4	17,00,000
TOTAL		1,22,90,000

II ASSETS		
Non Current Assets		
a) Fixed Assets	5	55,80,000
b) Intangible asset	6	70,000
Current Assets	7	66,40,000
TOTAL		1,22,90,000

Notes to accounts

		Amount	Amount
1	Equity share capital A/c		80,00,000
2	**Profit & Loss A/c of Eena Ltd.**		
	Profit & Loss A/c Balance of Eena Ltd.		16,00,000
	Share of profits from Meena Ltd.		5,20,000
	Share of profits from Dika Ltd		3,60,000
	Profit & Loss A/c of Eena Ltd.		**24,80,000**
3	**Minority Interest**		**Dika Ltd.**
	Share Capital		60,000
	Share in pre-acquisition profits		10,000
	Share in post-acquisition profits		40,000
	Minority interest		**1,10,000**
4	**Current Liabilities**		
	Eena Ltd.	4,00,000	
	Meena Ltd.	2,00,000	
	Dika Ltd.	3,00,000	9,00,000
	Proposed Dividend		8,00,000
			17,00,000
5	Fixed Assets		
	Eena Ltd.	47,80,000	
	Meena Ltd.	3,20,000	
	Dika Ltd.	4,80,000	55,80,000
6	Goodwill (WN3)		70,000
7	Current Assets		
	Eena Ltd.	45,20,000	
	Meena Ltd.	8,40,000	
	Dika Ltd.	12,40,000	66,00,000
	Cash in transit		40,000
			66,40,000

Working Notes:

1) Share holding Pattern for Meena Ltd.

Shares held by Eena Ltd (100%)	40,000 shares	Rs. 4,00,000
Shares held by Minority (0%)	0	0

Share holding Pattern for Dika Ltd.

Shares held by Eena Ltd (90%)	54,000 shares	Rs. 5,40,000
Shares held by Minority (10%)	6,000 shares	Rs. 60,000

2)

	CP (Pre)	**RP (post)**
Analysis of Profits of Dika Ltd.		
Balance at date of acquisition	1,00,000	---
Profit since the date of acquisition	---	3,00,000
Proposed dividend of Dika Ltd		1,00,000
	1,00,000	4,00,000
Share of Eena Ltd. (90%)	**90,000**	**3,60,000**
Share of minority	**10,000**	**40,000**
Analysis of Profits of Meena Ltd.		
Balance at date of acquisition	40,000	---
Profit since the date of acquisition	---	1,20,000
Proposed dividend of Meena Ltd	.	4,00,000
Share of Eena Ltd. (100%)	**40,000**	**5,20,000**

3)

Calculation of Goodwill / Cap res.	**Meena Ltd.**	**Dika Ltd**
Cost on investment	5,00,000	6,40,000
Less value of investment	4,00,000	5,40,000
Less capital profit	40,000	90,000
Goodwill	**60,000**	**10,000**

Note:- Dika Ltd has remitted Rs 40,000 at to Eena Ltd. on 31st March 2022 which was received by Eena Ltd in 2023. Hence this amount shall be shown as cash in transit

: EXERCISES :

Answer the following in brief :

1. Define holding company and subsidiary company.
2. Explain cost of control.
3. Describe the treatment of minority interest.
4. How profits are analysed into pre-acquisition and post-acquisition profits?

: SOLVE :

Problem 1 :

The following are the summarized Balance Sheet of Hema Ltd. and its subsidiary Rekha Ltd. as on 31st March 2022:

Liabilities	Hema Ltd.	Rekha Ltd.	Assets	Hema Ltd.	Rekha Ltd.
5,000 Equity shares of Rs.100 each	5,00,000	–	Land	1,00,000	40,000
10,000 Equity shares of Rs.10 each	–	1,00,000	Buildings	1,00,000	50,000
Profit & Loss Account	55,000	40,000	Stock	90,000	30,000
Sundry Creditors	20,000	35,000	Sundry Debtors	40,000	30,000
			Investments: 8,000 Shares of Rekha Ltd.	1,25,000	–
			Cash in hand	1,20,000	25,000
Total	**5,75,000**	**1,75,000**	**Total**	**5,75,000**	**1,75,000**

Hema Ltd. acquired shares in Rekha Ltd. on 1st April 2021 when Rekha Ltd. had Rs.25,000 in Profit & Loss A/c. No dividend has been declared by Rekha Ltd. in 2021-22. You are required to prepare a Consolidated Balance Sheet of Hema Ltd. and its subsidiary Rekha Ltd. as on 31-03-2022.

Problem 2 :

Following are the Balance Sheets of R Ltd. and S Ltd. as at 31-03-2022 :

Liabilities	R Ltd.	S Ltd.	Assets	R Ltd.	S Ltd.
Share Capital:			Fixed Assets	5,00,000	2,40,000
Equity Shares of 10 each, fully paid up	4,00,000	1,50,000	Investments in 15,000 Equity Shares in S Ltd. 01-04-2021	2,00,000	---
General Reserve	50,000	40,000	Current Assets (including Rs.10,000 stock in trade purchased from R ltd.)	3,00,000	2,60,000
Profit & Loss A/c.	30,000	25,000			
12% Debentures	2,00,000	---			
Current Liabilities and Provisions	3,20,000	2,85,000			
Total	**10,00,000**	**5,00,000**	**Total**	**10,00,000**	**5,00,000**

Prepare a Consolidated Balance Sheet as at 31-03-2022, assuming that (a) S Ltd. General Reserve and Profit and Loss Account stood at Rs.25,000 and Rs.10,000 respectively on 01-04-2021 and (b) R Ltd. sells goods at a profit of 25% on cost.

Problem 3 :

When O Ltd. purchased 24,000 equity shares in P Ltd. on 01-04-2021, P Ltd. had Rs.22,500 in General Reserve and Rs.37,500 (Dr.) in Profit and Loss Account. From their Balance Sheets on 31-03-2022 as below, prepare a Consolidated Balance Sheet:

Liabilities	O Ltd.	P Ltd.	Assets	O Ltd.	P Ltd.
Equity Share Capital	7,50,000	3,00,000	Fixed Assets	6,75,000	1,50,000
General Reserve	90,000	7,500	Current Assets	1,20,000	1,21,500
Profit & Loss A/c.	60,000	---	Investments in P Ltd	2,10,000	---
Sundry Creditors	1,05,000	31,500	Profit & loss Account	--	67,500
Total	**10,05,000**	**3,39,000**	**Total**	**10,05,000**	**3,39,000**

Fixed assets standing in the books of P Ltd. Rs.90,000 was considered worth Rs.75,000 on the date of purchase of control. For the purpose of determining the value of shares 20% depreciation has been written off since acquisition. Stock of O Ltd. includes Rs.30,000 on which P Ltd. made Rs.7,500 profit.

Problem 4 :

The following is the Balance Sheet of A Ltd & B Limited as on 31-03-2022

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Equity Shares of Rs.	5,00,000	2,00,000	Fixed Assets	3,50,000	3,20,000
100 each			Stock	35,000	15,000
General Reserves	60,000	40,000	Debtors	60,000	30,000
Profit & Loss Account	30,000	10,000	Bills Receivables	10,000	8,000
12% Debentures	–	1,00,000	1,500, Shares in B	1,80,000	–
Creditors	40,000	25,000	Ltd.		
Bills Payable	12,000	8,000	400, 12%	36,000	–
Proposed Dividend	40,000	20,000	Debentures		
			Cash	11,000	30,000
Total	**6,82,000**	**4,03,000**	**Total**	**6,82,000**	**4,03,000**

Additional information :

1. When A Ltd. acquired shares of B Ltd. the General Reserve and Profit & Loss Account of B Ltd. showed a balance of Rs. 30,000 and Rs. 4,000 (Debit) respectively.
2. Creditors of B Ltd. includes Rs. 10,000 for goods supplied by A Ltd. at a profit of 20% on sales. Half of the goods were still in stock on 31.12.2022
3. The bills accepted by A Limited were all in favour of B Limited.
4. Fixed assets were over-valued by Rs. 20,000

Prepare Consolidated Balance sheet of A Ltd. & Its Subsidiary B Ltd. as on 31-03-2022

Problem 5 :

Bengal Limited acquired 12,000 shares of Barkar Limited of the full value of Rs. 10 each at a price of Rs. 1,70,000 on 01.04.2021. The Balance Sheet of the two companies as on 31.03.2022 was as follows:

Liabilities	Bengal Ltd.	Barkar Ltd.	Assets	Bengal Ltd.	Barkar Ltd.
Equity Shares of Rs. 10 each	10,00,000	2,00,000	Goodwill	3,00,000	70,000
			Land &	4,00,000	1,00,000
General Reserves (on 01.04.2021)	4,20,000	1,00,000	Building	5,00,000	1,00,000
			Machinery	2,00,000	40,500
Profit & Loss Account (on 01.04.2021)	90,000	40,000	Stock	3,00,000	1,34,500
			Debtors	2,00,000	---
Profit for the year	1,70,000	45,000	Investments	20,000	30,000
Creditors	2,40,000	92,000	Bills Receivable	80,000	62,000
Bill Payable	80,000	60,000	Cash & Bank		
Total	**20,00,000**	**5,37,000**	**Total**	**20,00,000**	**5,37,000**

Additional information :

1. Stock in the hands of Barkar Ltd. includes goods purchased from Bengal Ltd. at Rs. 20,000 which includes profit charged by the latter company at 25% on cost.
2. Both the companies have proposed 10% dividend for 2021-2022.
3. Out of the debtors and B/R of Bengal Ltd. Rs. 50,000 and Rs. 16,000 respectively represents due from Barkar Limited.

Prepare Consolidated Balance Sheet of Bengal & its Subsidiary Barkar Limited as on 31-03-2022.

Problem 6 :

The Balance Sheet of Hari Ltd. and its subsidiary Suri Ltd. as at 31st March, 2022 are as follows:

Liabilities	Hari Ltd.	Suri Ltd.	Assets	Hari Ltd.	Suri Ltd.
Equity Shares of Rs.10 each fully paid	4,00,000	1,00,000	Plant & Machinery	4,80,000	90,000
			Furniture	15,000	27,000
General Reserve (1.4.2021)	2,80,000	34,000	Investments	2,00,000	--
			Stocks	95,000	42,000
Profit & Loss Account	1,70,000	42,000	Debtors	60,000	32,000
Creditors	70,000	35,000	Cash at Bank	70,000	20,000
Total	**9,20,000**	**2,11,000**	**Total**	**9,20,000**	**2,11,000**

The following information is also given to you :

i. Hari Ltd. acquired 8000 equity shares in Suri Ltd. as at 1st July, 2021 at a cost of Rs.2,00,000.

ii. Stock of Hari Ltd. includes Rs.6,000 relating to stock purchased from Suri Ltd. which follows the practice of charging 25% extra on the cost for determining the sale price.

iii. Creditors of Hari Ltd. include Rs.10,000 on account of purchases from Suri Ltd.

iv. Profit & Loss Account of Hari Ltd. includes divided @ 10% for the year 2021-22 received from Suri Ltd., which declared and paid it after 1st July, 2022.

v. Balance in Suri Ltd. Profit & Loss Account on 1st April, 2021 was Rs.26,000. Divided @ 10% for the year 2020-21 was declared out of this balance after 1st July, 2021.

vi. Profits during the year 2021-22 have been earned on uniform basis throughout the year.

Prepare a Consolidated Balance Sheet of Hari Ltd. and its subsidiary Suri Ltd. as at 31st March, 2022. Submit all your working notes neatly.

Problem 7 :

The following are the balance of R Ltd. P Ltd. & S Ltd. as 31st March, 2022.

Particulars	R Ltd. (Rs.)	P Ltd. (Rs.)	S Ltd. (Rs.)
Fixed Assets at cost	2,00,000	2,50,000	2,00,000
Investments-			
3600 shares of P Ltd.	3,95,000	--	--
1500 shares of S Ltd.	2,00,000	--	--
Current Assets	50,000	3,25,000	1,35,000
Equity Share Capital (Rs.100)	5,00,000	4,00,000	2,50,000
Profit & Loss Account	2,50,000	1,00,000	30,000
Current Liabilities	95,000	75,000	55,000

Additional Information :

i. Profit & Loss Account of P Ltd. includes Rs.25,000 as pre acquisition profits, the balance representing post acquisition profits.

ii. The balance in the Profit & Loss A/s. of S Ltd. is arrived at after setting off Rs.7,500 being pre-acquisition loss against the post acquisition profits of Rs.37,500.

iii. R Ltd. acquired the shares of P Ltd and S Ltd. on the same date.

iv. Stock included in current assets, stock of S Ltd. includes Rs.20,000 purchased from R Ltd., which has made 25% profit on cost.

Prepare consolidated Balance Sheet of R Ltd. Give working of Minority Interest, Capital & Revenue profit and Capital Reserve or Goodwill.

Problem 8 :

The following are the Balance Sheet of 'H' Ltd., 'A' Ltd, and 'B' Ltd. as on 31-03-2022.

Liabilities	H Ltd.	A Ltd.	B Ltd.
Share Capital	10,00,000	2,00,000	1,00,000
Reserves	1,00,000	60,000	60,000
Profit & Loss Account	4,00,000	1,20,000	60,000
Creditors	2,00,000	1,20,000	60,000
Bills Payable	--	30,000	--
Total	**17,00,000**	**5,30,000**	**2,80,000**

Assets	H Ltd.	A Ltd.	B Ltd.
Sundry Assets	8,00,000	1,20,000	1,00,000
Stock	6,10,000	1,80,000	1,00,000
Debtors	1,30,000	1,70,000	80,000
Bills receivable from A Ltd.	10,000	--	--
Shares in A Ltd.	1,50,000	--	--
Shares in B Ltd.	--	60,000	--
Total	**17,00,000**	**5,30,000**	**2,80,000**

H Ltd. purchased 80% shares in A Ltd. when latter Profit and Loss Account was Rs.80,000 and Reserve was Rs.40,000. A Ltd. purchased 75% shares in B Ltd. when latter Profit and Loss Account was Rs.40,000 and Reserve was Rs.20,000. Prepare consolidated Balance Sheet of H Ltd. and its subsidiaries, A Ltd. and B Ltd. as on 31st March, 2022 together with consolidation schedules.

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CHAPTER 5

Liquidation of Companies

5.1 Introduction, Meaning and Definition
5.2 Types of Liquidation
5.3 Accounting Treatment for Liquidation of Companies
5.4 Preparation of Statements of affairs including deficiency / surplus account as per the provisions of the company law

5.1 Liquidation of Companies :

i. **Introduction :** Liquidation of company refers to a process in which a company's existence is brought to an end. On liquidation the affairs of a company are wound up and its name is struck off from the Register of the Registrar of Companies and this fact is published in the Official Gazette. The word "liquidation" has been replaced by "Winding-up" resulted the term liquidation has not been used anywhere in the Companies Act, 2013. It is the word "winding-up" which has been used in this Act. It is worth mentioning that the process of liquidation is legally termed as "Winding-up" of companies.

ii. **Meaning :** Liquidation or winding up is a legal term and refers to the procedure through which the affairs of a company are wound up by law. A company is the creation of law, it cannot die itself as an natural death. So it comes to its end by law through the process of liquidation. The Liquidation or winding up a company is a process through which life of company and it's all affairs are wound up and its property administered for benefits of its creditors and members. An administrator, who is called liquidator, is appoint to take control of company, collect its assents, pay its debts and finally if any surplus assents are left, they are divided among the members of the company in proportion to their rights under the articles. This being done the company is dissolved on compliance within the requisite formalities prescribed by the companies' ordinance.

iii. **Definition :** As per Section 2 (94A) of the Companies Act 2013, Winding-up means winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable.

Note: Winding-up of a company is different from its dissolution. Winding-up is the process of closing or finishing a company. During this process, the company legally exists. It means that after winding-up and before dissolution the legal entity or existence of the company remains as it is and therefore it can be sued in a court of law. In case of winding-up of a company or bankruptcy of a company, the companies are not allowed to continue its business. But it is important to notice here the main distinction between these two issues is that for bankruptcy of the company or insolvency of the company its total liability should be greater than its total assets (TL> TA) while in case of liquidation it is not compulsory that its total liability should be greater than its total assets. It may happen in both the situation i.e., (TL>/< TA). As per Section 270 of the Companies Act 2013, the procedure for winding up of a company can be initiated either: (a) By the tribunal or, (b) Voluntary.

5.2 Types of Liquidation :

Company Liquidation of an insolvent company has two types Creditors Voluntary Liquidation and Compulsory Liquidation. Business continuity or business restart can only usually take place through Creditors Voluntary Liquidation. Such a restart is sometimes known as a phoenix company. Company liquidation of a solvent company will use a Members Voluntary Liquidation.

- **Creditors Voluntary Liquidation (CVL) :** A Creditors Voluntary Liquidation service is used to close an insolvent company. “Creditors Voluntary” has specific meaning but can be slightly misleading. An Insolvent company is most regularly identified as one that cannot pay its creditors (those who it owes money to) as and when they are due for payment. Most often this position can be seen to be worsening from week to week and month to month. “Creditors Voluntary” distinguishes the fact that the Creditor Voluntary Liquidation Procedure is started by the Directors of the company not the creditors (those who are owed money). This is perhaps in contrast to the fact that it is called “creditors voluntary” not a director’s voluntary. To be clear a Creditors Voluntary Liquidation procedure is started by the Directors of the company.
- **Members Voluntary Liquidation :** A Members Voluntary Liquidation procedure is in contrast to a Creditors Voluntary Liquidation. To undertake a Members Voluntary Liquidation a company must not be insolvent. The “Members Voluntary” description is more accurate than the “Creditors Voluntary” and reflects the fact the Members

Voluntary Liquidation procedure is started by the Members of the company (the shareholders).

- **Compulsory Liquidation :** Be clear that there is no "voluntary" in either the title of style of this procedure. Compulsory Liquidation refers to the fact the in by far the majority of cases the creditors (those who are owed money) of the company force the company in to Compulsory Liquidation. In many cases this is against the wish of the company directors. A Compulsory Liquidation is distinct also in that it is the only style of liquidation that involves the Courts.

Modes of Winding-up : Any company may go foe winding-up in the following pattern –

Circumstances	Provisions Applicable
On Inability to Pay Debts	Insolvency and Bankruptcy code 2016 Reasons
Other than Inability to pay Debts	Companies Act 2013
Voluntary Winding Up – Upto 31/3/2017 – After 1/4/2017	 - Companies Act 2013 - Section 59 of the Insolvency and Bankruptcy code 2016

I. Winding up of a Company by a Tribunal : As per section 271 of the Companies Act 2013, a company can be wound up by a tribunal in the following circumstances :

- If the company has by special resolution resolved that the company be wound up by the tribunal.
- If the company has acted against the interest of the integrity or morality of India, security of the state, or has spoiled any kind of friendly relations with foreign or neighbouring countries.
- If the company has not filed its financial statements or annual returns for preceding five consecutive financial years.
- If the tribunal by any means finds that it is just and equitable that the company should be wound up.
- If the company in any way is indulged in fraudulent activities or any other unlawful business, or any person or management connected with the formation of company is found guilty of fraud, or any kind of misconduct.

II. Filing of Winding Up : Petition Section 272 provides that a winding up petition is to be filed in the prescribed form in 3 sets. The petition for compulsory winding up can be presented by the following persons:

- The company
- The creditors; or
- Any contributory or contributories
- By the central or state govt.
- By the registrar of any person authorized by central govt., for that purpose

The winding up petition has to be accompanied with a Statement of Affairs. The tribunal after hearing the petition has the power to dismiss it or to make an interim order as it think appropriate or it can appoint the provisional liquidator of the company till the passing of winding up order.

III. Voluntary Winding Up of a Company: The company can be wound up voluntarily by the mutual agreement of members of the company, if :

- The company passes a Special Resolution stating about the winding up of the company.
- The company in its general meeting passes a resolution for winding up as a result of expiry of the period of its duration as fixed by its Articles of Association or at the occurrence of any such event where the articles provide for dissolution of company.

Member's Voluntary Winding Up under the Insolvency and Bankruptcy Code, 2016 : The Procedure of Voluntary Winding up of solvent company section 304 is now omitted from the Companies Act, 2013. Therefore section 59 of Insolvency and Bankruptcy Code, 2016 applicable from 1st April, 2017.

Some of Key features of section 59 of Insolvency and Bankruptcy Code, 2016 are as follows :

- Shifting of Powers from Official Liquidator to Insolvency Professional.
- Jurisdictional Authority has been shifted from High Court to National Company Law Tribunal (NCLT).
- Timeline for carrying out the Voluntary Winding up process under the Insolvency and Bankruptcy Code is of 12 months.
- The shifting of Jurisdictional Authority from High Court to NCLT will result into faster execution as Insolvency Professionals have been entrusted with powers of completing the winding up process and reporting to NCLT.
- With the passing of special resolution at the Members meeting and declaration of solvency, the company can commence with the winding up proceedings.

Steps for Voluntary Winding up Process of Company as per Section 59 of the Insolvency and Bankruptcy Code, 2016 :

- Declaration of Solvency duly verified by an Affidavit by Majority of Directors of the Company Affidavit to be accompanied by:
  - Audited Financial Statement of past two years/Since Incorporation whichever is later.
  - Records of Business Operations of past two year/Since Incorporation whichever is later.
  - Report by the Registered Valuer about the valuation of the assets of the Company.
  - Latest Financial Position of the Company, if any.
- Within 4 weeks of Declaration of Solvency, Voluntary Winding up of the Company shall happen and there shall be an appointment of Insolvency Professional to act as Liquidator subject to the approval of the Members in General Meeting and creditors owing 2/3rd of the Value of the Debt of the Company through Special Resolution within 7 days of approval of liquidation of Company. Intimation of the same has to be made to the Registrar of Companies.
- Company has to intimate Insolvency and Bankruptcy Board of India (IBBI) regarding initiation of Voluntary Winding up within 7 days of approval of liquidation of Company/subsequent approval by the creditors.
- Within 5 days of Appointment of Insolvency Professional as Liquidator:
  - A Public Announcement to be made in one English Newspaper and one Regional Language Newspaper having wide circulation where the registered office and the principal office if any, of the Company is situated.
  - Public Announcement to be updated on website of the Company, if any.
- Liquidator has to open a Bank Account in the Name of the Company followed by the words “in voluntary liquidation” in a scheduled bank within one month of passing of Special Resolution.
- Intimate the Income Tax Department within One month of passing resolution regarding Voluntary Winding up of the Company and to obtain NOC for the same.
- Prepare a Preliminary Report to be submitted within 45 days from the commencement of the liquidation process consisting details of:
  - Capital Structure of the Company
  - Estimates of assets and liabilities as on the liquidation commencement
  - Any further inquiry relating to promotion/formation/conduct of the business
  - Proposed plan of action by liquidator including the timeline within in which he proposes to carry it out and the estimated liquidation costs.

- The liquidator shall verify the claims submitted within 30 days from the last date for receipt of claims and may either admit or reject the claim.
- Liquidator has to prepare list of stakeholders within 45 days from the last date for receipt of claims and also has to maintain Particulars/Minutes about any consultation with Stakeholders.
- Liquidator has to value and sell the assets in the manner and mode approved by the Company and have to deposit proceeds of distribution in Bank Account
- Liquidator has to distribute the Proceeds to the stakeholders within 6 months from the receipt of amount.
- Liquidator has to maintain accounts for liquidation period and conduct audit for the same.
- The entire process to be completed within 12 months from the date of commencement of liquidation.
- If the liquidation process extends for more than 12 months, the liquidator shall – Within 15 days from the end of 12 months hold meeting of contributories and Present a Annual Report indicating:
  - Settlement of List of Stakeholders
  - Details of Assets remaining to be sold
  - Distribution made to the stakeholders
- To prepare Final Report with details of Audited Accounts of Liquidation and send it to:
  - The Registrar of Companies
  - The Insolvency and Bankruptcy Board of India
  - The Adjudicating Authority, i.e., NCLT (National Company Law Tribunal)

Commencement of Winding Up by Tribunal after Resolution has been Passed by the Company for Voluntary Winding up (Section 357)

- Where, before the presentation of a petition for the winding up of a company by the Tribunal, a resolution has been passed by the company for voluntary winding up, the winding up of the company shall be deemed to have commenced at the time of the passing of the resolution, and unless the Tribunal, on proof of fraud or mistake, thinks fit to direct otherwise, all proceedings taken in the voluntary winding up shall be deemed to have been validly taken.
- In any other case, the winding up of a company by the Tribunal shall be deemed to commence at the time of the presentation of the petition for the winding up.

Contributory : According to the Companies Act a contributory is "every person liable to contribute to the assets of a company in event of its being wound up, and includes a holder of fully

paid-up shares and also any person alleged to be contributory". In the event of liquidation of a company, the liquidator prepares two lists of contributories :

- **List 'A' :** This list consists of those persons who are members of the company on the date of the winding up. In simple, List 'A' contributories is the list of the present members of the company. They are liable to contribute the amount remaining unpaid on the shares held by them if the amount is needed to make payment to legal claimants. The holders of fully paid-up shares are also treated as contributories even though they are not required to contribute anything to the company. This is necessary because in such a case, the court will know, not only those who will contribute but also who will share the surplus, if any.
- **List 'B':** This list consists of those persons who were the members of the company during the 12 months preceding the date of winding up. In case the assets of the company are not sufficient to pay the liabilities of the company in the event of company's winding up liquidator can ask List 'B' contributories to contribute towards the assets of the company, subject to certain conditions. However their liability is restricted to the amount not called up when the shares were transferred.

Liquidator : The person appointed for conducting the liquidation proceedings of the company is called 'Liquidator'. (In case of Voluntary winding up an Insolvency Professional). The company must submit a statement of affairs to the liquidator. The general duties of the liquidator are to take into his custody all the property of the company and actionable claims and make the payments as per the order laid down in the Companies Act.

Preferential Payments : Preferential creditors are those creditors who are paid in priority to creditors having a floating charge and other (non-preferential) unsecured creditors. As per Sec. 326 of the Companies Act, 2013, preferential creditors include the following:

- All revenues, taxes, cesses and rates due to the Central, State Government or to a local authority which have become due and payable within twelve months before the date of winding up order.
- All wages or salaries of any employee not exceeding ` 20,000 per claimant, in respect of services rendered to the company and due for a period not exceeding four months within the said twelve months before the date of winding up order.
- All amounts due in respect of contribution payable during the twelve months under the Employees' State Insurance Act, 1948 or any other law.
- Compensation due under Workmen's Compensation Act, 1923 in respect of death or disablement of any employee of the company.
- Any amount due to any employee from provident fund, pension fund, gratuity fund for the welfare of the employees maintained by the company.

- Accrued holiday remuneration becoming payable to the employee or in case of his death, to any other person in his right, on termination of his employment before, or by the effect of the winding up.
- The expenses of any investigation held in pursuance of Sec. 213 or 216 in so far as they are payable by the company.

Overriding Preferential Payments (Section 326) : Overriding preferential payments are to be paid in priority to all other debts as per the said Act. They include:

- Dues to workmen.
- Debts due to secured creditors to the extent such debts rank to the security of every creditor shall be deemed to be subject to pari passu charge in favor of the workmen to the extent of workmen's portion therein.

5.3 Accounting Treatment for Liquidation of Companies :

Explanation for Important Terms :

Following are certain matters which require the attention of the students :

1. **Order of payment :** After receiving the amounts realized on assets, surplus from fully secured creditors and by making calls for the unpaid amount on the shares held by shareholders, the liabilities are paid out by the liquidator in the following order:
   a) Legal expenses
   b) Remuneration of the liquidator
   c) Cost of winding up
   d) Payment to preferential creditors
   e) Payment to debenture holders having floating charge on the assets of the company.
   f) Payment to unsecured creditors
   g) Payment to preference shareholders
   h) Payment to equity shareholders.
2. **Liquidator's Remuneration:** The liquidator normally gets the remuneration in the form of commission which is usually based as a percentage on the value of assets realized and amount paid to unsecured creditors. In calculating the liquidator's remuneration, the following points may be noted:
   a) **On assets realized:** The term 'assets realised' does not include cash and bank balances as the liquidator does not realize cash and bank balances. However, in some cases cash and bank balances are given in the list of assets realized by the liquidator, then the remuneration has to be calculated even on cash and bank balances.

Some assets are given as security to secured creditors. If the assets given as security are sold by the liquidator he will get remuneration on the securities sold by him. If the securities are sold by the creditors and the surplus after deducting the amount due to them is given to the liquidator, then remuneration is given to the liquidator on such surplus from securities.

b) **On amount paid to unsecured creditors:** Unless otherwise stated, for the purpose of calculating liquidator's remuneration, the term unsecured creditors includes preferential creditors as basically they are also unsecured creditors. The Commission is calculated as follows:

   i) If the amount available is sufficient to pay unsecured creditors = Preferential Creditors + Unsecured Creditors × Rate/100.

   ii) If the amount available is insufficient to pay Unsecured Creditors in full = Amount available × Rate/100 + Rate.

Note : In some cases, the remuneration is paid on amount paid to shareholders. Commission = Amount available before paying shareholders × Rate/100 + Rate.

3. **Interest on Debentures :** If the company is solvent, interest due on debentures shall be paid upto the date of actual payment. If the company is not solvent, interest should be paid upto the date of liquidation.

4. **Payment of arrears of preference dividend:** The question of preference dividend arises only if the preference shares are cumulative. If the Articles of Association provides for the payment of arrears of dividend on the event of winding up and the said arrears should pertain to the period before liquidation, the arrears shall be paid after paying off the liabilities but before returning the preference share capital. Dividends in any case are not payable for any period after the date of winding up. The question of whether the arrears of dividends to preference shareholders is to be paid first or the repayment of share capital to equity shareholders is to be made first, depends upon the provisions of the Articles of Association.

5. **Calls on Contributories :** The shareholders in the liquidation of the company are known as contributories. They are liable to pay to the extent of unpaid amount on the shares held by them. In case the liquidator is not in a position to pay the creditors in full, and if there are any partly paid shares, the liquidator will make a call on the contributories to the extent required, not exceeding the amount unpaid on the shares. If there are two or more categories of equity shares on which equal amount is not called up by the company. In such a case, the liquidator will have to adjust the rights of the shareholders in an equitable manner.

5.4 Preparation of Statements of affairs including deficiency/surplus account as per the provisions of the company law :

Preparation of Statement of Affairs :

In case of Winding up by Tribunal, section 272(5) of the companies Act states that a petition will be admitted only if it is accompanied by a Statement of Affairs in the form prescribed.

Proforma of Statement of Affairs

Assets not specially pledged (as per list 'A')

Estimated

	Realizable Value ₹
Balance at Bank	
Cash in Hand Marketable	
Securities Bills Receivable	
Trade Debtors	
Loans and Advances	
Unpaid Calls	
Stock-in-Trade	
Work-in-Progress	
_____	
_____	
Freehold Property, Land and Buildings	
Leasehold Property	
Plant and Machinery	
Furniture, Fittings, Utensils, etc.	
Investments other than Marketable Securities	
Livestock	
Other Property, viz.,	
_____	
_____	

*Assets specially pledged (as per List 'B')	(a) Estimated Realizable Values ₹	(b) Due to Secured Creditors ₹	(c) Deficiency Ranking as Unsecured ₹	(d) Surplus Carried to Last Column ₹
Freehold Property				
_____				
_____				
Estimated surplus from assets specially pledged				
Estimated total assets available for preferential creditors, debenture-holders secured by a floating charge, and unsecured creditors (carried forward)				

Summary of Gross Assets

	₹
Gross realisable value of assets specially pledged	–
Other Assets	–

Gross Assets

Gross ₹	Liabilities	₹	₹
	Liabilities (to be deducted from surplus or added to deficiency as the case may be)		
	Secured creditors (as per list 'B') to the extent to which claims are estimated to be covered by assets specially pledged item (a) or (b) whichever is less		
	[(Insert in 'Gross Liabilities' column only)	–	
	Preferential Creditors (as per list 'C')]	–	
	Estimated balance of assets available for debenture holders secured by a floating charge and unsecured creditors)**		
	Debenture holders secured by a floating charge (as per list 'D')	–	

Estimated Surplus/Deficiency as regards Debenture holders Unsecured Creditors (as per list 'E')			
Estimated unsecured balance of claims of creditors partly secured on specific assets, brought from preceding page			
Trade Accounts	–		
Bills payable	–		
Outstanding Expenses	–		
Contingent liabilities (state nature)	–		
Estimated Surplus/Deficiency as regards Creditors (being difference between Gross Assets and Gross Liabilities)		–	
		₹	
		₹	
Issued and Called-up Capital:			
Preference Shares of ..... each			
Called-up (as per list 'F')			
Equity Shares of ..... each			
..... Called-up (as per list 'G')			
Estimated Surplus/Deficiency as regards Members (as per list 'H')			

*** Notes 1 :** All assets specially mortgaged, pledged, or otherwise given as security should be included under this head. In the case of goods given as security, those in possession of the company and those not in possessions, should be separately set out.

**** 2 :** The figures must be read subject to the following :

(a) There is no unpaid capital liable to be called up or the nominal amount of unpaid capital liable to be called up is ₹ ..... estimated to produce ₹ ..... which is not charged in favour of Debenture holders.

(b) The estimates are subject to costs of the winding up and to any surplus or deficiency on trading pending realisation of assets.

Procedure of Preparation of Statement of Affairs :

For the preparation of Statement of Affairs, the following points are to be followed :

First of all, take all assets which are not specifically pledged. These assets are taken at their realisable values. It may be noted that calls in arrears are also treated as an asset not specifically pledged to the extent of estimated realisable amount, but uncalled capital is not shown as an asset.

Secondly add to the realisable value of the assets not specifically pledged, any surplus from assets specifically pledged.

i. From the total as obtained by adding above, first deduct the amount of preferential creditors, then the amount of creditors having a floating charge (e.g., debentures) and the result will be surplus or deficiency as regards debenture holders.

ii. Deduct the amount of unsecured creditors from the figure as obtained in above; the resultant figure will be either surplus or deficiency as regards unsecured creditors.

iii. Deduct the amount of paid-up share capital to the figure as obtained in above; the result will be either surplus or deficiency as regards members or contributories.

iv. Any unrecorded assets or liability should be shown both in the Statement of Affairs and the Deficiency or Surplus Account to make double entry complete.

Lists to be Attached to the Statement of Affairs : Following lists are attached to the Statement of Affairs :

- **List A** gives a complete list of assets not specifically pledged in favour of secured creditors. Creditors having a floating charge on the assets are considered as having assets not specifically pledged with them; so such assets are included in the list.
- **List B** gives the list of assets which are specifically pledged in favour of fully secured and partly secured creditors.
- **List C** gives the list of preferential creditors.
- **List D** gives the list of debenture holders and other creditors having a floating charge on the assets.
- **List E** gives the names, addresses and occupations of unsecured creditors and the amount due.
- **List F** gives the names and number and value of shares held by various preference shareholders.
- **List G** gives the names and holdings of equity shareholders.
- **List H** shows how Deficiency or Surplus in the Statement of Affairs has been arrived at, i.e., it explains the reasons responsible for the surplus or deficiency. According to the law, the period covered by Deficiency or Surplus must commence on a date not less than 3 years before the winding up order, or if the company has not been incorporated for the whole of that period, the date of incorporation of the company, unless the official Liquidator otherwise agrees.

Deficiency / Surplus Account (List H) : Statement of Affairs shows the Deficiency/Surplus as regards creditors and members. This account explains how the deficiency or surplus has arose. This statement must cover at least a 3 year period preceeding the date of winding up order.

This statement starts with capital and liabilities in excess of assets as on a given date. To this are added items contributing to deficiency (or reducing surplus) such as Net trading Losses, Losses other than trading losses written off, etc. From the total, items reducing deficiency (or contributing to surplus) such as excess of assets over capital and liabilities, Net trading profit made during the period, profits and income other than trading profits etc., are deducted. The resultant Net surplus/deficiency must tally with the figure shown in the Statement of Affairs.

The proforma of Deficiency or Surplus Account (List H) is given below :

Form of Deficiency or Surplus Account (List H)

Items contributing to Deficiency or Reducing Surplus : ₹

1.	Excess (if any) of Capital and Liabilities over Assets on the as shown by Balance Sheet	-
2.	Net dividend and bonus declared during the period from to the date of statement	-
3.	Losses on realization of assets	-
4.	Net trading losses (after charging items shown in note below) for the same period.	-
5.	Losses other than trading losses written off or for which provision has been made in the books during the same period	
6.	Estimated losses not written off or for which provision has been made for purposes of preparing the statement	-
7.	Other items contributing to Deficiency or reducing Surplus: Items reducing Deficiency or Contributing to Surplus	-
8.	Excess of assets over capital and liabilities on the as shown in the Balance Sheet	-
9.	Net trading profit (after charging items shown in note below) for the period, and from to date of statement	-
10.	Profit on realization of assets	-
11.	Profits and income other than trading profits during the same period	-
12.	Other items reducing Deficiency or contributing to Surplus: Deficiency/Surplus as shown by the Statement	

Note : In case the company in liquidation has not maintained proper books of accounts after a certain date, a trial balance should be prepared with the available information by taking items at their book values. Any difference found in the trial balance is the profit or loss made by the company during that period.

LIQUIDATORS FINAL STATEMENT OF ACCOUNT

The main duty of the liquidator is to collect the assets of the company and realize them and distribute the amounts realized among the right claimants. He is required to prepare a statement and submit the same to registrar of companies, IBBI, and NCLT after the company is completely wound-up. In case of voluntary winding up such statement is called "Liquidators Statement Account". In case of winding up by Tribunal it is called as "Official Liquidators Final Account". It is a statement of receipts and payments which is prepared in the form of an account.

The form of the Liquidator's Final Statement of Account is given below :

Liquidator's Statement of Account

Receipts	₹	Payments	₹
To Assets: Cash at Bank Cash in hand		By Legal charges	
		By Liquidator's remuneration:	
Marketable Securities		When applicable — % on ₹ …… realized % on ₹ ….. distributed	
Bills Receivable			
Trade Debtors			
Loans and Advances Stock in Trade Work in Progress Freehold Property Leasehold Property		Total (By whom fixed…..)	
Plant and Machinery Furniture, Fittings, Utensils, etc. Patents, Trademarks etc. Investments other than Marketable Securities To Surplus from Securities To Unpaid Calls at commencement of winding up Amounts received from calls on contributories made in the winding up Receipts per Trading Account Other Property, viz.,		By Auctioneers' and valuers' charges Costs of possession and maintenance of estate Costs of notices in Gazette and Newspapers Incidental outlay (establishment charges and other expenses of liquidation) Total costs and charges: 1. By Debenture holders Payment of ₹ ….. per ₹…. debenture Payment of ₹….. per ₹…..	

Total Less: Payments to redeem Securities Costs of execution Payments per Trading Account		Debenture 2. By Creditors ….. * Preferential By Unsecured Dividend (s)….. P. in the rupee on ₹ — (The estimate of the amount expected to rank for dividend was ₹…..) 3. By Returns to Contributories ….. P. per rupee….. ** share….. P. per rupee….. ** share….. P. Per rupee ….. ** share	

* State the number; Preferential creditors need not be separately shown if all creditors have been paid in full.

** State nominal value and class of shares :

1. Following assets estimated to be of the value of ₹ ..... have proved to be unrealizable (Give details of the assets which have proved to be unrealisable).
2. Amount paid into the Companies Liquidation Account in respect of :
   a) Unclaimed dividends payable to creditors in the winding up ₹ .....
   b) Other unclaimed distributions in the winding up ₹ .....
   c) Moneys held by the company in trust in respect of dividends or other sum due before the commencement of the winding up to any person as a member of the company. ₹ .....
3. Add here any remarks the Liquidator thinks desirable (Sd.)
   Dated this..... day of..... 20.....
   Liquidator

I declare that the above statement is true and contains a full and accurate account of the winding up from the commencement to the close of the winding up. (Sd.)

Dated this..... day of..... 20..... Liquidator

Liquidation of Companies: Liquidators Final Statement of Account

Problem 1.

Unfortunate Company Ltd. went in the voluntary liquidation on 31st Dec. 2022 when their Balance Sheet read as under:

Balance Sheet of Unfortunate Co. Ltd. (as on 31.12.2022)

Liabilities	Rs.	Assets	Rs.
Issued and subscribed Capital:		Land and Buildings	5,00,000
5,000 Equity shares of Rs.100 per share, Rs. 75 paid	3,75,000	Machinery and Plants	12,50,000
		Patents	2,00,000
15,000 Equity shares of Rs.100 per share, Rs. 60 paid	9,00,000	Stock	2,75,000
		Sundry Debtors	5,50,000
10,000 10% Cumulative preference share of Rs. 100 per share Fully paid	10,00,000	Cash at Bank	1,50,000
		Profit and Loss A/c	5,62,500
15% Debentures secured by floating charge	5,00,000		
Interest outstanding on debentures	75,000		
Creditors	6,37,500		
	34,87,500		**34,87,500**

i. The liquidator is entitled to a commission of 3% on asset realisation.
ii. The expenses of liquidation amounted to Rs. 54,500.
iii. Preference dividends were arrears for two years.
iv. Creditors included preferential creditors of Rs. 76,000.
v. The Assets Realised as under:

Land and Buildings	Rs. 6,00,000
Patents	Rs. 1,50,000
Sundry debtors	Rs. 4,00,000
Plant and Machinery	Rs.10,00,000
Stock	Rs. 3,00,000

You are required to show the liquidator's final statement of account assuming that the final payments including those on debentures is made on 30th June, 2023.

Solution : **Unfortunate Company Ltd.**

Liquidators Final Statement of Account

Receipts		Rs.	Payments		Rs.
Assets Realised:		24,50,000	Liquidation expenses		54,500
Land and Buildings	6,00,000		Liquidator Remuneration		73,500
Patents	1,50,000		Debenture holders:		
Sundry debtors	4,00,000		Debentures	5,00,000	
Plant and Machinery	10,00,000		Interest accrued	75,000	
Stock	3,00,000		Interest (6 month) from 1.01.23 to 30.06.23	37,500	6,12,500
Cash at Bank		1,50,000	Preferential creditors		76,000
Call on equity shareholders (15,000 x Rs.2.65)		39,750	Unsecured creditors		5,61,500
			Preference Shareholders:		
			Preference Capital	10,00,000	
			Arrears dividends	2,00,000	12,00,000
			Equity share holders on 5,000 shares @ Rs. 12.35 each		61,750
		26,39,750			**26,39,750**

Working Note :

i. Liquidator's Remuneration = 3% on amount realised = 24,50,000 $\times \frac{3}{100}$ = Rs.73,500.

ii. Interest on debentures will have to be paid for the period 01.01.2023 to 30.06.2023.

$= 5,00,000 \times \frac{15}{100} \times \frac{1}{2} = 37,500$

iii. Total equity capital paid up = Rs.12,75,000

Less balance available after payment to unsecured creditors and preference shares

(26,00,000 – 25,78,000)	22,000
Loss to be borne by 20,000 equity shares	12,53,000
Loss per share (12,53,000 ÷ 20,000 shares)	62.65
Hence amount of call on Rs.60 paid share	2.65
Refund on Rs.75 paid shares	12.35

Problem 2 :

The **Looser Company Limited** went in to liquidation on 31 December 2023. The Balance sheet on that date as under:

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Share Capital:		Land and Building	50,000
16,000 Preference share of	1,60,000	Other Fixed Assets	4,00,000
Rs. 10 each		Stock	10,50,000
24,000 Equity Shares of Rs. 10	2,40,000	Debtors	2,00,000
per share		Profit and Loss A/c	1,16,000
Bank Loan	8,00,000		
8% Debentures	2,00,000		
Outstanding interest on debentures	16,000		
Creditors	4,00,000		
	18,16,000		**18,16,000**

You are required to prepare the liquidators statement of account after taking into account the following :

i. Liquidation expenses Rs.20,000.
ii. Liquidators Remuneration is fixed Rs. 6,000.
iii. Fixed assets were realised at book values and current assets at 80% of book values.
iv. Debentures and interest there on are secured by a floating charge on all assets.
v. Bank Loan was secured by pledge of stock.

Solution :

Looser Company Ltd.

Liquidator's Final Statement of Account

Receipts	Rs.	Payments		Rs.
Assets Realised:		Liquidators Remuneration		6,000
Land and Building	50,000	Liquidation expenses		20,000
Other fixed Assets	4,00,000	Debentures having floating		
Debtors	1,60,000	Charge	2,00,000	
Surplus from securities	40,000	Interest	16,000	2,16,000
		Creditors		4,00,000
		Preference share holders @		8,000
		Rs.0.50 per share on 16,000 shares		
	6,50,000			**6,50,000**

Working Notes :

i) Assets Realisation

Fixed Assets at book value = Land and Building = 50,000

Other Fixed Assets = 4,00,000

Current assets at 80% of Book value = Debtors = 2,00,000 × 0.80 = 1,60,000

ii) Surplus from stock

Stock book value = 10,50,000 Realised 80% = 8,40,000

Less – Bank Loan 8,00,000

Surplus —> 40,000

Problem 3.

The **Amar Raj Company Ltd.** went in to liquidation on January 1, 2023. The Balance Sheet of the company as under:

Balance Sheet of Amar Co. Ltd. as on Dec. 31, 2022

Liabilities	Rs.	Assets	Rs.
Paid up capital:		Fixed Assets:	
4,000 Equity shares of Rs.100		Land and Building	4,00,000
each fully paid	4,00,000	Plant and Machinery	4,40,000
6,000 Equity shares of Rs. 100		Current Assets:	
each, Rs. 50 paid	3,00,000	Stock	2,00,000
2,000, 6% Preference shares of		Debtors	2,00,000
Rs. 100 each	2,00,000	Cash at Bank	60,000
Secured Loan:		Profit and Loss A/c	2,00,000
6% Debentures (Floating charge on	2,00,000		
all Assets)			
Others Loan:			
Mortgage on Land and Building	2,00,000		
Creditors	1,80,000		
Income Tax	20,000		
	15,00,000		**15,00,000**

You are required to prepare the liquidator's statement of account after taking in to account the following:

i. All payment were made on June 30, 2023.

ii. Liquidator is entitled to a commission at 2% on all assets realised and 3% on amount distributed to unsecured creditors.

iii. The expenses of liquidation amounted to Rs. 16,000.

iv. The preference dividends were in arrear for 3 years and it is Payable on liquidation.

v. Assets realized as under:

Land and Building	Rs. 4,80,000
Plant and Machinery	Rs. 3,60,000
Stock	Rs. 1,40,000
Debtors	Rs. 1,20,000

Solution :

Liquidator's final statement of Accounts
(From January 1, 2023 to June 30, 2023)

Receipts	Rs.	Payments		Rs.
Assets Realised:		Liquidators Remuneration:		
Cash at Bank	60,000	2% on 11,00,000 realised		22,000
Debtors	1,20,000	3% on Rs.2,00,000		6,000
Stock	1,40,000	distributed to unsecured creditors		
Plant and Machinery	3,60,000	Liquidation expenses		16,000
Surplus from Assets	2,80,000	Preferential creditors (I.T.)		20,000
(Land and Building)		Debentures:		
		Principal	2,00,000	2,06,000
		Interest up to 30th June	6,000	
		Unsecured Creditors:		1,80,000
		Capital	2,00,000	
		Arrears	36,000	2,36,000
		Equity share holders:		
		Rs.57.40 on 4,000 shares		2,29,600
		Rs. 7.40 on 6,000 shares		44,400
	9,60,000			**9,60,000**

Working Notes :

i. Debentures holders are entitled to interest up to the data of payment since the company is solvent.

ii. Amount payable to equity share holders: Amount returnable on fully paid shares 57.40 (50 + 7.40) Amount returnable on partly paid share 7.40.

Problem 4.

The Balance sheet of **Suraksha Ltd.** as on 31.03.2023 being the data of voluntary winding up as follows:

Liabilities	Rs.	Assets	Rs.
12%, 20,000 preference share of Rs. 100 each fully paid	20,00,000	Land and Building	7,72,000
		Plant and Machinery	16,42,000
10,000 equity shares of Rs. 100 each Rs.60 each called and paid	6,00,000	Stock	3,68,000
		Debtors	26,74,000
10,000 equity shares of Rs.100 each Rs. 50 called and paid up	5,00,000	Profit and Loss A/c	7,44,000
Paid up share capital	**31,00,000**		
15% Debentures	8,00,000		
Preferential creditors	2,10,000		
Bank Overdraft	6,06,000		
Trade Creditors	14,84,000		
	62,00,000		**62,00,000**

i. The assets were realized as under:

Land and Building	Rs. 19,68,000
Stock	Rs. 3,26,000
Plant and Machinery	Rs. 14,24,000
Debtors	Rs. 23,82,000

ii. Income Tax payable on liquidation is Rs. 89,000.

iii. Expenses of liquidation is Rs. 1,08,000.

iv. The remuneration of the liquidator is 3% of the realisation.

v. Preference dividend is in arrears for two years.

You are required to prepare the liquidator's final statement of account; assuming that the final payments are made on 31.03.2024.

Solution:

Liquidator's final statement of account of Suraksha Ltd.

Receipts	Rs.	Payments	Rs.
Assets Realised:		Liquidators Remuneration	
Land and Building	19,68,000	(61,00,000 × 3/100)	1,83,000
Stock	3,26,000	Liquidation expenses	1,08,000
Plant and Machinery	14,24,000	Debentures	8,00,000
Debtors	23,82,000	Interest on debentures	1,20,000

		Preferential creditors	2,99,000
Calls on 10,000 Rs. 50 paid		Bank overdraft	6,06,000
shares @ 4 per share	40,000	Creditors	14,84,000
		Preference shares holders:	
		Preference capital 20,00,000	
		+ Arrears of dividend	
		for 2 years 4,80,000	24,80,000
		Equity share holders:	
		Refund on 10,000 shares Rs. 60	
		paid @ Rs.6 per share	60,000
	61,40,000		**61,40,000**

Working Notes :

i. Preferential creditors:

Preferential creditors = Rs.2,10,000

Add Income Tax = Rs. 89,000

Total **2,99,000**

Problem 5.

The **Doobey Company Limited** placed in voluntary liquidation on 31st December, 2023, when its balance sheet was as under:

Balance Sheet

Liabilities	Rs.	Assets	Rs.
10,000 Equity shares of Rs.100		Land and Building	11,60,000
each fully paid less calls in		Plant and Machinery	5,78,000
arrears amounting to Rs.50,000	9,50,000	Motor Vehicles	1,15,000
12,000, 5% preference shares of		Stock	3,72,000
Rs.100 each fully paid	12,00,000	Debtors	1,48,000
Share Premium Account	1,00,000	Profit and Loss A/c	4,28,000
5% Debentures Account	2,00,000		
Interest on debentures	5,000		
Bank overdrafts	1,16,000		
Creditors	2,30,000		
	28,01,000		**28,01,000**

i. Assets realisation as under :

Land and building	Rs. 14,00,000
Plant and Machinery	Rs. 4,80,000
Motor Vehicles	Rs. 1,18,000
Stock	Rs. 3,00,000
Debtors	Rs. 1,20,000
Calls in arrears	Rs. 50,000

ii. The Preference dividend's are in arrears from 2020 onwords.

iii. The company's Articles provide that on liquidation, out of the surplus assets remaining after payment of liquidation costs and outside liabilities, there shall be paid firstly all arrears of preference dividend, secondly the amount paid up on the preference shares together with a premium there on of Rs.10 per share, and thirdly and balance then remaining shall be paid to the equity share holders.

iv. The bank overdraft was guaranteed by the directors who were called upon by the bank to discharge their liabilities under the guarantee. The directors paid the amount to the bank.

v. Creditors were paid less discount of 5%.

vi. The debentures and accrued interest were repaid on 31st March 2024.

vii. Liquidator's remuneration was 2% on the amount realised and liquidation expenses were Rs. 7,640.

Prepare the liquidator's statement of account.

Solution :

Liquidator's final statement of Account of Doobey Ltd.
for the period ending 31st March 2024

Receipts	Rs.	Payments		Rs.
Assets Realised:		Liquidators Remuneration		
Land and Buildings	14,00,000	@ 2% on 24,68,000		49,360
Plant and Machinery	4,80,000	Liquidation expenses		7,640
Motor Vehicles	1,18,000	Debenture holder having a		
Stock	3,00,000	floating charge:		
Debtors	1,20,000	Principal	2,00,000	
Calls in arrears	50,000	Interest up to 31st March	7,500	2,07,500
		Unsecured Creditors:		
		Directors	1,16,000	
		Others creditors	2,18,500	3,34,500

		Preference share holders:		
		Share capital	12,00,000	
		Premium	1,20,000	
		Arrears of dividend	2,40,000	15,60,000
		Equity share holders:		
		@ Rs.30.90 per share		3,09,000
	24,68,000			**24,68,000**

Working Notes :

i. Amount payable to sundry creditors = 2,30,000
Less: Discount @ 5% 11,500
2,18,500

ii. Amount payable to debenture holders:
Principal Amount = 2,00,000
Interest up to 31st March = 7,500
2,07,500

Liquidation of Companies : Statement of Affairs

Problem 6.

Bad Luck Limited went into voluntary liquidation and the proceedings comment on 2nd July 2023. Certain creditors could not receive payment out of the realization of assets and out of the contributions from the contributories of the 'A' list. The following details of share transfers are made available to you.

No. of the transfer or shareholder	No. of shares transferred	Date of the transfer ceasing to be member	Creditors remaining unpaid and outstanding at the time of the transfer or ceasing to be a member (Rs.)
i) A	4,000	1st March 2022	24,000
ii) B	5,000	15th August 2022	32,000
iii) C	2,000	1st October 2022	43,000
iv) D	8,000	1st December 2022	52,000
v) E	1,000	1st April 2024	60,000

All the shares were of Rs.10 each on which Rs.5 per share had been paid up ignoring other details like liquidator's expenses etc. you are required to work out of the liability of the individual contributories listed above.

Solution: **Statement of liability of B List contributories.**

Date	Creditors outstanding Rs.	Incremental Amount Rs.	B (5,000) Rs.	C (2,000) Rs.	D (8,000) Rs.	E (1,000) Rs.
15 Aug. 2022	32,000	32,000	10,000	4,000	16,000	2,000
1st Oct. 2022	43,000	11,000	-	2,000	8,000	1,000
1st Dec. 2022	52,000	9,000	-	-	8,000	1,000
1st April 2024	60,000	8,000	-	-	-	8,000
Maximum amount payable to creditors (A)			10,000	6,000	32,000	12,000
Amount of calls in arrears @ Rs.5 per share (B)			25,000	10,000	40,000	5,000
Actual liability of (A) or (B) Lower Amount			10,000	6,000	32,000	5,000
Total amount paid to creditors (10,000 + 6,000 + 32,000 + 5,000) = 53,000						

Notes:

1. Only a person who had transferred his shares within 12 months preceding the date of winding up is liable for contribution under list B. Hence out of the five persons, one having transferred his holdings more than 12 months prior to the date of winding up is not liable as contributory. The test of the transfers are liable Subject to the restriction that an individual not for more than unpaid value on the shares.
2. Incremental creditors Rs. 8,000 on 1st April 2024 will get only Rs. 1,000 from E Since the maximum amount recoverable from E is Rs. 5,000 of which 4,000 will be absorbed by creditors outstanding on 1st December.
3. The various amounts outstanding on the date of transfer of shares have been apportioned.

Problem 7.

Pessimist Ltd. is to be liquidated their summarized balance sheet as at 31st March 2024 appears as under.

Liabilities	Rs.	Assets	Rs.
5,00,000 equity shares of 10 each	50,00,000	Land and buildings	10,00,000
Secured debentures		Other Fixed Assets	40,00,000
(on land and buildings)	20,00,000	Current Assets	90,00,000
Unsecured loans	40,00,000	Profit and Loss A/c	40,00,000
Trade Creditors	70,00,000		
	1,80,00,000		**1,80,00,000**

Contingent Liabilities are :	Rs.
For bills discounted	2,00,000
For excise duty demands	3,00,000

On investigation it is found that the contingent Liabilities are certain to devolve and that the assets are likely to be realised as follows:

Land and buildings	22,00,000
Other fixed assets	36,00,000
Current assets	70,00,000

Taking the above into account, prepare the statement affairs

Solution:

Statement of affairs of pessimist (in liquidation) as on 31st March 2024

Particulars	Estimated Realisable Value Rs.
Assets not specifically pledged (as per list A):	
Other Fixed Assets	36,00,000
Current Assets	70,00,000
	1,06,00,000
Assets specifically pledge (as per list B)	

Paticulars	(a) Estimated realisable creditors Rs.	(b) Due to secured creditors Rs.	(c) Deficiency ranking unsecured Rs.	(d) Samples carried to last column Rs.	
Land & Building	22,00,000	20,00,000	-	2,00,000	2,00,000
Estimated total assets available to Unsecured creditors					**1,08,00,000**
Summary of gross assets					
Gross realisable value of assets					
Specifically pledged			22,00,000		
Other Assets			1,06,00,000		
Gross Assets			1,28,00,000		

Gross Liabilities Rs.	Liabilities	Rs.
20,00,000	Secured creditors (as per list B) to the extent to which clams are estimated to be covered by assets specifically pledged	–
3,00,000	Preferential creditors (as per list C)	3,00,000
		1,05,00,000
	Unsecured creditors (as per list E)	
40,00,000	Unsecured loans	40,00,000
70,00,000	Trade creditors	70,00,000
2,00,000	Contingent liability on bills discounted	2,00,000
1,35,00,000	Estimated deficiency as legands	
	(1,35,00,000 – 1,28,00,000)	7,00,000
	5,00,000 Equity shares of Rs.10 each (as per list (G)	50,00,000
	Estimated deficiency as regards members	**57,00,000**

Problem 8.

Valueless Ltd. into voluntary liquidation 1st Marh 2024. The following balances are extruded from its book on that data.

Particulars	Rs.	Particulars	Rs.
Capital : 1,00,000 equity shares of 10 each	10,00,000	Buildings	3,00,000
		Plant and Machinery	4,20,000
Debentures	4,00,000	Stock in Trade	1,90,000
(secured by floating charge)		Book Debts 1,50,000	
Bank Overdraft	60,000	Less provision –20,000	1,30,000
Creditors	80,000	Calls in arrears	2,00,000
		Cash on hand	20,000
		Profit and Loss A/c	2,80,000
	15,40,000		**15,40,000**

You are required to prepare a statement of affairs to be submitted to the meeting of creditors after taking in to account the followings.

i. Bank overdraft is secured against buildings.

ii. Plant and machinery valued at Rs.3,00,000; Buildings valued at Rs.2,40,000 ; on realisation, losses of Rs.30,000 are expected on stock.

iii. Calls in arrears are expected to realise 90%.

iv. Preferential creditors for taxes and wages are Rs.12,000.

v. Book Debts will realise Rs.1,40,000.

Solution :

Valuless Ltd.

Statement of affairs As on 1st March 2024

Particulars	**Estimated Realisable Value Rs.**
Assets not specifically pledged (as per list A):	
Cash on hand	20,000
Book Debts	1,40,000
Unpaid calls (Calls in arrears)	1,80,000
Stock in trade	1,60,000
Plant and Machinery	3,00,000
	8,00,000
Assets specifically pledge (as per list B)	

Paticulars	**(a) Estimated realisable creditors Rs.**	**(b) Due to secured creditors Rs.**	**(c) Deficiency ranking unsecured Rs.**	**(d) Samples carried to last column Rs.**
Building	2,40,000	60,000	–	1,80,000

Estimated total surplus for assets Specifically pledged	1,80,000
Estimated total assets a valuable for Preferential creditors, Debentures holders and unsecured creditors	**9,80,000**
Summary of gross assets	
Gross realisable value of assets	
Specifically pledged 2,40,000	
Other Assets 8,00,000	
Gross Assets 10,40,000	

Gross Liabilities Rs.	Liabilities	Rs.
	(To be deducted from surplus or added to deficiency as the case may be)	
60,000	Secured creditors (as per list (B) to the extent to which claims estimated to be covered by assets specifically pledged.	
12,000	Creditors for taxes are wages	12,000
	Estimated balance of as assets available for debenture holders and unsecured creditors	**9,68,000**
4,00,000	Debenture holders secured by first floating charge (List D)	4,00,000
	Estimated balance of assets available for unsecured creditors	**5,68,000**
68,000	Unsecured creditors (List E)	68,000
5,40,000	Estimated surplus as regard contributories	**5,00,000**
	Issued and paid up capital preference shares (List F) Nil	
	10,000 Equity shares of Rs. 10 each fully paid 10,00,000 (List G)	10,00,000
	Estimated deficiency as regards contributors	**5,00,000**

Problem 9.

Weak Co. Ltd. went into voluntary liquidation on 1st April 2024. The following balances are extracted from its books on that date:

Liabilities	Rs.	Assets	Rs.
Capital :		Machinery	1,80,000
48,000 equity shares a Rs. 10 each	4,80,000	Leasehold Properties	2,40,000
Debentures	3,00,000	Stock	6,000
(Secured by Holding charge)		Debtors	3,00,000
Bank overdraft	1,08,000	Investment	36,000
Creditors	1,20,000	Cash in hand	6,000
		Profit and Loss A/c	2,40,000
	10,08,000		**10,08,000**

The following assets are valued as under	**Rs.**
Machinery	3,60,000
Leasehold Properties	4,36,000
Investments	24,000
Stock	12,000
Debtors	2,80,000

The bank overdraft is secured by deposit of title deeds of leasehold properties. There were preferential creditors of Rs. 6,000 which were not included in creditors Rs. 1,20,000.

Prepare a statement of affairs to be submitted to the meeting of members / creditors

Solution : **Weak Co. Ltd.**

Statement of affairs as on the 1st day of April 2024

<table>
<tr><th>Particulars</th><th>Estimated Realisable Values Rs.</th></tr>
<tr><td><u>Assets not specifically pledged (as per list A):</u>
Cash on hand
Investments
Debtors
Stock
Machinery</td><td>
6,000
24,000
2,80,000
12,000
3,60,000</td></tr>
<tr><td></td><td>6,82,000</td></tr>
<tr><td><u>Assets specifically pledge (as per list B)</u>
<table>
<tr><th>Paticulars</th><th>(a) Estimated realisable creditors Rs.</th><th>(b) Due to secured creditors Rs.</th><th>(c) Deficiency ranking unsecured Rs.</th><th>(d) Samples carried to last column Rs.</th></tr>
<tr><td>Leasehold Property</td><td>4,36,000</td><td>1,08,000</td><td>–</td><td>3,28,000</td></tr>
</table>
Estimated total surplus for assets Specifically pledged</td><td>3,28,000</td></tr>
<tr><td>Estimated total assets a valuable for Preferential creditors, Debentures holders secured by floating charges and unsecured creditors.</td><td>10,10,000</td></tr>
<tr><td><u>Summary of gross assets</u>
Gross realisable value of assets
Specifically pledged 4,36,000
Other Assets <u>6,82,000</u>
Gross Assets 11,18,000</td><td></td></tr>
</table>

Gross Liabilities Rs.	Liabilities	Rs.
	(To be deducted from surplus or added to deficiency as the case may be)	
1,08,000	Secured creditors (as per list (B) to the extent to which claims estimated to be covered by assets specifically pledged.	
6,000	Preferential Creditors	6,000
	Estimated balance of as assets available for debenture holders secured by a floating charge and unsecured creditors	**10,04,000**
3,00,000	Debenture holders secured by first floating charge (List D)	3,00,000
	Estimated balance of assets available for unsecured creditors	**7,04,000**
1,20,000	Unsecured creditors (List E)	1,20,000
5,34,000	Estimated surplus as regard creditors [being difference between gross assets (d) and gross liabilities (e)]	**5,84,000**
	Issued and paid up capital	
	48,000 Equity shares of Rs. 10 each (List G)	4,80,000
	Estimated Surplus as regards members	**1,04,000**

Note: Statement of affairs should accompany eight list:

List A : Full particulars of every description of property not specifically pledged and not included in any other list are to be set for in this list.

List B: Assets specifically pledged and creditors fully or partly secured.

List C : Preferential creditors for rates taxes, salaries, wages and other.

List D : List of debenture holders secured by a floating charge.

List E : Unsecured creditors

List F : List of preference share holders

List G : List of equity share holders

List H : Deficiency or surplus account

Problem 10 :

In winding up which commences on 15th September 2023 obtain creditors could not receive payment out of the realization of assets and out of contribution from 'A' list of contributories following are the details of certain share transfers that took place prior to liquidation and the amount of creditors remaining unpaid.

Shareholder	No. of Shares Transfers	Date when ceased to be member	Creditors remaining unpaid and outstanding on the due of ceasing to be a member (Rs.)
L	8,000	31-8-2022	32,000
M	7,200	20-9-2022	48,000
N	4,800	15-11-2022	69,600
O	4,000	22-4-2023	74,400
P	2,000	10-7-2023	88,000

All the shares of Rs.10 each on which Rs. 5 per share had been called and paid up ignoring expense of liquidation, remuneration to liquidator etc. work out the amount to be realised from the above contributories.

Solution :

Statement of Liability of B List Contributors

Creditors outstanding on date of ceasing to be member		M 7,200	N 4,800	O 4,000	P 2,000	Amount to be paid to creditors
Rs.		Rs.	Rs.	Rs.	Rs.	Rs.
i)	48,000 (18 : 12 : 10 : 5)	19,200	12,800	10,668	5,332	48,000
ii)	21,600 (12 : 10 : 5)	–	9,600	8,000	4,000	21,600
iii)	4,800 (10 : 5)	–	–	3,200	1,600	[See Note] 2,000
iv)	13,600	–	–	–	13,600	Nil
	Total (a)	**19,200**	**22,400**	**21,868**	**24,532**	
Maximum Liability on Shares hold (b)		36,000	24,000	29,000	10,000	
Amount Paid Lower of (a) & (b)		19,200	22,400	20,000	10,000	

Only a person who had transferred his shares within 12 months preceding the date of winding up is liable for contribution under list B. Hence out of the five persons, one having transferred his holdings more than 12 months prior to the date of winding up is not liable as contributory. The test of the transfers are liable Subject to the restriction that an individual not for more than unpaid value on the shares.

Note : From O Rs. 1,332

From P Rs. 668 **Rs. 2,000**

Problem 11 :

Failure Ltd. was ordered to be would up on March 31st 2024 on which date its balance sheet was as follows:

Liabilities	Rs.	Assets	Rs.
Subscribed capital		Good will	2,00,000
20,000 shares of Rs. 100 each	2,00,000	Building	7,00,000
5% Debentures	3,20,000	Plant	1,10,000
Interest Accrued (Secured by		Fixtures	46,000
floating charge on all assets)	8,000	Stock	76,000
Bank overdraft		Debtors	50,000
(Secured by hypothecation of stock)	50,000	Cash	1,000
Sundry creditors	72,000	Profit and Loss A/c	2,77,000
	24,50,000		**24,50,000**

The amount estimated to be realized are: Goodwill Rs.2,000; Building Rs.6,00,000; Plant Rs.10,50,000; Fixtures Rs.20,000; Stock Rs.62,000; Debtors Rs. 40,000.

Creditors included Rs.12,000 on account of wages of 15 Men at Rs. 200 Per month for 4 months immediately before the date of winding up Rs.18,000 being the salaries of 5 employees at Rs.600 per month for the previous 6 months, Rents for godown for the last 6 months amounting to Rs.6,000. Income-Tax deducted out of salaries of employees Rs.2,000 and directors fees Rs.1,000.

Three years ago the debit balance in the profit and loss account was Rs.1,55,850 and since that date the accounts of the company here shown the following figures.

Particulars	Years 31-3-2022 Rs.	Years 31-3-2023 Rs.	Years 31-3-2023 Rs.
Gross Profit	1,30,000	90,000	80,000
Wages and Salaries	81,000	72,000	68,800
Electrically and Water Tax	11,500	12,760	10,520
Debentures Interest	16,000	16,000	16,000
Bad Debts	17,080	15,200	13,400
Depreciation	13,400	-	-
Directors fees	2,000	2,000	2,000
Miscellaneous Expenses	21,000	14,530	15,960
Total	**1,61,980**	**1,32,490**	**1,26,680**

In addition it is estimated that the company would have to pay Rs. 10,000 as compensation to an employee for injuries suffered by him which was contingent liability not accepted by the company.

Prepare the statement of Affairs and the Deficiency account in form 57 of companies (Court) rules 1959.

Solution : **Statement of Affairs (In Liquidation) of failure Ltd.**

Particulars	Estimated Realisable Values Rs.
Assets not specifically pledged (as per list A):	
Cash	1,000
Debtors	40,000
Building	6,00,000
Plant	10,50,000
Fixtures	20,000
Goodwill	2,000
	17,13,000
Assets specifically pledge (as per list B)	

Paticulars	(a) Estimated realisable creditors Rs.	(b) Due to secured creditors Rs.	(c) Deficiency ranking unsecured Rs.	(d) Samples carried to last column Rs.
Stock	62,000	50,000	–	12,000

Estimated total surplus for assets Specifically pledged	12,000
Estimated total assets a valuable for Preferential creditors, Debentures holders secured by floating charges and unsecured creditors (carried forward)	**17,25,000**
Summary of gross assets	
Gross realisable value of assets	
Specifically pledged 62,000	
Other Assets 17,13,000	
Gross Assets 17,75,000	

Rs.	Liabilities Gross Liabilities	Rs.
50,000	Secured creditors (as per List B) to the extent which claims are estimated to be covered by assets specifically pledged	42,000
42,000	Preferential creditors (as per list C Estimated balance of assets available for Debenture holders secured by a floating charge and unsecured creditors)	16,91,000
3,28,000	Debentures holders secured by floating charge (as per List D)	3,28,000
	Estimated surplus as regards to Debenture holder*	13,63,000
	Unsecured creditors (as per list E)	
	Estimated Unsecured balance of claims of creditors partly secured on specific assets brought forward (C) Nil	
	Creditors on Trade Account 41,000	
48,000	Outstanding Expenses 7,000	48,000
4,68,000	Estimated Surplus as lagers creditors difference between Gross Assets (D) and Gross Liabilities as per column (E) Issued and called ap capital 2,000 Equity Shares of Rs.100 each fully called up as per list (G)	13,15,000 20,00,000
	Estimated deficiency as regards Contributories	**6,85,000**

Note : This must be lead subject to the following.

i) There is no unpaid capital to be called up.

ii) The estimate are subject to cost of the winding up and to any surplus or deficiency on trading pending realisation of assets.

	List H Deficiency Account Items Contributing to Deficiency	Rs.
1)	Excess of capital and liabilities over assets three years ago as shown by the balance sheet	1,55,850
2)	Net dividends or bonuses declared doting the period	Nil
3)	Net Trading losses (after charging items shown in note below) for the same period.	1,21,150
4)	Losses other than training losses written off or for which provision has been made in the books during the same period	Nil

5)	Estimated losses now written off for which provision has been made for the purpose of preparing the statement		
	Bad Debts	10,000	
	Loss on		
	Goods will	1,98,000	
	Buildings	1,00,000	
	Plant	50,000	
	Fixtures	26,000	
	Stock	14,000	
	Workmen's Compensation	10,000	4,08,000
6)	Other items contribution to deficiency		6,85,000
	Items reducing deficiency		Nil
	Deficiency as shown by the statement of affairs		6,85,000
	Notes as to net training profits and losses:		
	Provision for depreciation on fixed assets		13,400
	Charged of Income Tax		Nil
	Interest on Debentures		48,000
	Payment to directors made by the company and required by low to be disclosed in the accounts		6,000
	Balance (being other trading losses)		53,750
			1,21,150

Particulars of creditors for express	Unsecured	Preferential
Directors fees	1,000	–
Income tax on salaries	–	2,000
Rent (Not distained by land lord)	6,000	–
Wages (15 Men for 4 months at Rs.200 each)	–	12,000
Salaries (5 Men for 6 months at Rs.600 each)	–	18,000
Workmen's Compensation	–	10,000
	7,000	**42,000**

Creditors on trade account are Rs. 57,000 (i.e. Rs. 72,000 less the total of creditors mentioned above, excluding Rs.18,000 for workmen's compensation).

Problem 12 :

Mr. Tommy is appointed liquidator of **Zolzal Company Ltd.** in voluntary liquidation, on 1st July 2023. The following balances are extracted from the books on that date.

Liabilities	Rs.	Assets	Rs.
Capital		Machinery	90,000
48,000 Shares of Rs.5 each	2,40,000	Leasehold properties	1,20,000
Reserve for bad debts	30,000	Stock in trade	3,000
Debentures	1,50,000	Book debts	1,80,000
Bank overdraft	54,000	Investments	18,000
Liabilities for purchase	60,000	Calls in arrear	15,000
		Cash in hand	3,000
		Profit and Loss A/c	1,05,000
	5,34,000		**5,34,000**

Prepare the statement of affairs to be submitted to the meeting of the creditors. The following assets are valued as: Machinery Rs.1,80,000; Leasehold properties Rs.2,18,000; Investment Rs.12,000; Stock in trade Rs.6,000.

Bad debts are Rs.6,000 and the doubtful debts are Rs.12,000; which are estimated to realise Rs.6,000. The bank overdraft is secured by deposit of title deeds of leasehold properties preferential credits are Rs. 3,000. Telephone rent outstanding is Rs.240.

Solution:

Statement of Affairs of Zolzal Company Ltd. as on 1 July 2023

Particulars	Estimated Realisable Values Rs.
Assets not specifically pledged (as per list A):	
Cash in hand	3,000
Marketable securities	12,000
Calls in arrears	15,000
Trade debtors	1,68,000
Stock in trade	6,000
Machinery	1,80,000
	3,84,000

Assets specifically pledge (as per list B)

Paticulars	(a) Estimated realisable creditors Rs.	(b) Due to secured creditors Rs.	(c) Deficiency ranking unsecured Rs.	(d) Samples carried to last column Rs.
Leasehold Properties	2,18,000	54,000	–	1,64,000

Estimated total surplus for assets Specifically pledged	1,64,000
Estimated total assets a valuable for Preferential creditors, Debentures holders secured by floating charges and unsecured creditors (carried forward)	**5,48,000**
Summary of gross assets Gross realisable value of assets Specifically pledged 2,18,000 Other Assets 3,84,000 Gross Assets 6,02,000	
Estimated assets available for preferential creditors, debenture holders having a floating charge and unsecured creditors, brought forward	**5,48,000**

Gross Liabilities	Liabilities	Rs.
54,000	Secured creditors as per List B to the extent to which claims are estimated to be covered by assets specifically pledged	
3,000	Preferential creditors as per List C	3,000
	Estimated balance of assets available for debenture-holders secured by a floating charge and unsecured creditors	**5,45,000**
1,50,000	Debenture holders secured by a floating charge as per list D	1,50,000
		3,95,000
60,240	Unsecured creditors (as per list E)	
	Liability for purchases 60,000	
	Outstanding expenses telephone rent 240	60,240
	Estimated surplus a regards creditors being the difference between Gross assets and Gross liabilities issued and called up capital:	3,34,760
	48000 equity shares of Rs.5 each fully paid (as per list G)	2,40,000
	Surplus as regards contributories	**94,760**

These figures must be read subject to the following notes:

1) There is no unpaid capital liable to called up.

2) The estimates are subject to costs of the winding up and to any surplus or deficiency on trading pending realization of assets.

EXERCISES

Answer the following in brief :

1. What do you mean by liquidation of a company? Discuss the different modes of winding up.
2. In what circumstances compulsory winding up order is issues by the court ?
3. What are the contents of Liquidators Final Statement of Account ?
4. What is voluntary winding up ? Specify the cases in which special resolution is passed.
5. Write short notes on: (a) Liquidator (b) Overriding preferential payments.
6. Specify the duties of liquidator.
7. Who are preferential creditors as per Section 326 of the Companies Act, 2013 ?
8. Give the order of payment followed by a liquidator for settling various claims when a company is liquidated
9. B list of contributories and the liability of contributories in the list.
10. What do you understand by 'A' list and 'B' list of contributories ?
11. Prepare statement of deficiency List H.
12. Give a pro forma of the Statement of Affairs and the Deficiency/Surplus Account with imaginary figures.

: SOLVE :

Problem 1.

Akash Company Ltd. went into voluntary liquidation on 1st April 2024. The following balances are extracted from its books on that date:

Liabilities :	
4,800 equity shares of Rs.100 each	Rs. 4,80,000
Debentures (secured by floating change)	Rs. 3,00,000
Bank overdraft	Rs. 1,08,000
Creditors	Rs. 1,20,000
	10,08,000
Assets:	
Leasehold property	Rs. 2,40,000
Plant and Machinery	Rs. 1,80,000
Stock	Rs. 6,000
Debtors	Rs. 3,00,000
Investments	Rs. 36,000

Cash in hand	Rs. 6,000
Profit & Loss A/c	Rs. 2,40,000
	10,08,000

The assets were realized as under :

Plant and Machinery Rs.3,60,000; Lease hold properties Rs.4,36,000; Investment Rs.24,000; Stock Rs.12,000 and debtors Rs.2,80,000.

The Bank overdraft is secured by deposit of title lead of lease-hold properties. Preferential creditors was Rs.6,000 which were not included in creditors Rs.1,20,000. Prepare a statement of Affairs to be submitted to the meeting of creditors.

Problem 2.

The **Navalsing Company Ltd.** went into liquidation having the following liabilities :

i. Secured creditors Rs. 1,00,000 (securities realized 1,25,000)
ii. Preferential creditors Rs. 30,000.
iii. Preferential creditors Rs. 1,52,500.
iv. Liquidators out of pocket expenses amounted to Rs. 1,260.
v. The liquidators is entitled to a remuneration of 6% on the amount realised and 3% on the amounts distributed to unsecured creditors.
vi. The various assets (excluding securities in the hands of fully-secured creditors) realized Rs. 1,30,000.

Prepare liquidator's account, showing the composition given to the unsecured creditors.

Problem 3.

Suraj Company Limited went into voluntary liquidation on December 31, 2023. When the following balance sheet was prepared.

Liabilities	Rs.	Assets	Rs.
Authorised		Goodwill	60,000
20,000 ordinary shares of Rs. 20 each	**4,00,000**	Lease hold property	50,000
14,520 ordinary shares of Rs. 20 each fully paid	2,90,400	Plant and Machinery	74,800
		Stock	1,17,100
Sundry Creditors:		Sundry debtors	92,440
Preferential Rs. 8,100		Cash	1,000
Partly Secured Rs. 58,360		Profit and Loss A/c	1,18,160
Unsecured Rs. 1,54,320	2,20,780		
Bank overdraft (unsecured)	2,320		
	5,13,500		**5,13,500**

i) The expenses of liquidation amounted to Rs. 1,000.

ii) Liquidator's remuneration was agreed 2.1/2 on the amount realized and 2% on the amount paid to unsecured creditors.

iii) The assets were realized as under :

Lease hold property, which was use in the first instance to pay the

Partly secured creditors prorate	=	36,000
Plant and Machinery	=	50,000
Stock	=	62,000
Sundry debtors	=	87,000
Cash	=	1,000

You are required to prepare the liquidator's final accounts, showing the distribution.

Problem 4 :

Pushpa Company Limited, having carried out its' business objects, went into voluntary Liquidation with the following liabilities.

Particulars			**Rs.**
Trade Creditors			60,000
Bank Overdraft			1,00,000
Capital:			
10,000 Preference shares of Rs.50, Rs.35 called			3,50,000
2,000 Ordinary shares of Rs.50, Rs.45 called = Rs. 90,000			
less calls in arrears		Rs. 2,000	88,000
Cash received in anticipation of calls:			
on Preference shares	Rs. 1,20,000		
on Ordinary shares	Rs. 20,000		1,40,000

i) The assets were realized Rs. 10,00,000 and the expenses of liquidation amounted to Rs.10,000.

ii) The preference shareholders have no prior capital rights.

Prepare the liquidator's final statement of account.

Problem 5 :

The following information was extracted from the books of **Miniature limited company** on 31/12/2021 on which date of winding up order was made.

Particulars	Rs.
Equity share capital 4,000 shares of Rs.100 each	4,00,000
6% preference share capital 6,000 shares of Rs.100 each	6,00,000
Calls in arrear on equity shares (estimated to realize Rs. 4,000)	8,000
5% First Mortgage Debentures secured by a floating charges on the Whole of the assets of the company (Interest paid to date)	4,00,000
Creditors having a mortgage on the freehold Land and Buildings	1,70,000
Creditors having a second charge on freehold Land and Buildings	1,80,000
Trade Creditors	5,40,000
Bills Discounted (of these bills for Rs.15,000 are expected to be dishonoured)	80,000
Unclaimed Dividends	12,000
Bills payable	20,000
Income Tax due	50,000
Salaries and wages (for fire months)	80,000
Bank overdraft secured by a second charge on the whole of the assets of the company	40,000
Cash in hand	2,400
Debtors (of these Rs.1,20,000 are good; Rs.30,000 are doubtful, estimated to realise Rs.10,000 and the rest bad)	1,80,000
Bill of Exchange (considered good)	70,000
Free hold land and buildings (estimated to realise Rs.3,30,000)	3,00,000
Plant and Machinery (estimated to produce Rs.1,80,000)	2,40,000
Fixtures and fittings (estimated to produce Rs.16,000)	24,000
Stock in trade (estimated to produce 25% less)	1,60,000
Patents (estimated to produce Rs.90,000)	1,40,000

On 31st December 2015 the company's share capital stood at the same figures as on 31st Dec. 2021 but, in addition, there was a General Reserve of Rs.1,30,000. In 2016 the company earned a profit of Rs. 1,70,000; but there after it suffered trading losses totaling in all Rs.9,34,000. In 2018 a speculation loss of Rs. 1,82,000 was incurred. Preference dividend was paid for 2016 and 2017 and on equity shares a dividend of 10% was paid in 2016 only.

Excise authorities imposed a penalty of Rs.1,20,000 in 2019 for evasion of excise and income-tax authorities imposed a penalty of Rs.3,20,400 for evasion of tax.

Prepare the statement of affairs and the deficiency account.

Problem 6 :

The following information is extracted from the books of **Unfortunate Ltd.** on 31st December 2021 on which date the winding up order was made:-.

Particulars	Rs.
Unsecured Creditors	18,24,000
Salaries due for 5 months	96,000
Bills payable	5,12,000
Bank overdraft	1,92,000
Weekly wages unpaid	28,000
Liabilities under workmen's compensation A/c	4,000
Income tax due	40,000
Debtors – Goods	18,00,000
Doubtful (estimated to produce Rs.4,00,000)	8,00,000
Bad	5,12,000
Bills receivable (Good 60,000)	80,000
Stock (estimated to produce Rs.28,00,000)	39,60,000
Cash in hand	56,000
Furniture and fixtures (estimated to produce Rs.3,60,000)	4,00,000
Land (estimated to produce Rs.24,00,000)	17,28,000
Estimated liabilities for bills discounted	2,00,000
Secured creditors holding second first mortgage on land	19,20,000
Partly secured creditors holding second mortgage on land	9,60,000
24,000; 9% mortgage debentures of Rs.100 each, interest payable to September 30 and March 31, paid to September 30, 2020 (Interest not provided for 3 months)	24,00,000
Share Capital:	
96,000; 10% preference share of Rs.10 each	9,60,000
2,40,000; equity shares of Rs.10 each	24,00,000
General reserve since December 31, 2017	4,40,000

In 2017 the company earned a profit of Rs. 22,00,000; but thereafter it suffered trading losses totality Rs.28,00,000. The company also suffered as speculation loss of Rs. 2,40,000; during year 2018. Excise authorities imposed a penalty of Rs. 16,00,000 into 2019 for evasion of tax which was paid in 2020.

Prepare the statement of affairs and the deficiency account.

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CHAPTER 6

Financial Statements of Insurance Companies

6.1 Brief Introduction - General Insurance Business
6.2 Preparation of final accounts of Insurance companies carrying on General Insurance business, as per the forms prescribed by the Insurance Regulatory and Development Authority Regulations 2002
6.3 Revenue Accounts in Form B- RA
6.4 Profit and Loss Account in Form B- PL
6.5 Balance Sheet in Form B- BS

6.1 Activity Brief Introduction - General Insurance Business :

Insurance is a form of contract under which one party agrees in return of a consideration to pay an agreed amount of money to another party to compensate for a loss, damage or some uncertain event. Basic concepts of insurance contract Under an insurance contract, one party, called insurer, undertakes to indemnify the losses suffered by the other party, called insured, for some specified causes in consideration for, fixed premium. The document that contains terms of insurance contract is called Insurance Policy which is in the written form. An insurance company makes profit if the claims of loss and expenses of insurance company are less than the premium collected by it; if the claims and expenses are more than the premium, it sustains losses. But insurance companies generally make profit, since the ratio of claims of policy holders to the total premium collected from them tends to be low. Insurance may be broadly classified into two life insurance and general insurance.

There are two types of insurance i.e., Life insurance and General Insurance :

- **Life Insurance :** Under this type of insurance the corporation guarantees to pay a

certain sum of money to the policy holder or to his nominee on reaching a certain age or on his death whichever is earlier. Life insurance has an element both of protection and investment. Life insurance policy covers the life risk of the insured (or assured) up to the policy amounts. In case of death of the policy holder, the nominee of the assured could get the policy value. However, the life insurance policy also provides for payment of the policy value either at maturity or by installments and an agreed bonus.

The life insurance contract is a contingent contract and the claim becomes payable when the contingency occurs, that is, death or the completion of the stipulated period. General insurance, on the other hand, is a contract of indemnity and the claim is payable on the happening of an event insured and there must be a loss consequent to the event. The purpose of general insurance is to compensate the actual loss suffered is by the insured due to the event insured and not to allow him to make any profit out of it. Life insurance agreements are made generally for longer periods whereas general insurance s always for a maximum of one year.

- **Accounts of life insurance business :** The Insurance Act of 1918 governs the procedure in preparing the final accounts. Two types of books are maintained in life insurance businesses : (i) Statutory books and (ii) Subsidiary books.

  i. Statutory books : The following statutory books are maintained.

  - **Register of Policies :** This contains particulars of various policies, such as the name and address of the assured, date on which the policy was effected, etc.
  - **Register of Claims :** This contains the particulars of each claim, such as the name and address of the claimant, the date of claim, the date on which the claim was settled or date and ground for rejection.
  - **Register of Licensed Insurance Agents :** This contains the particulars of various insurance agents, their names, and addresses, particulars of business done and commission due to them.

  ii. Subsidiary Rooks : In order to maintain proper accounts, insurance companies maintain the following subsidiary books :

  - Proposal Register
  - New Premium Cash Register
  - Renewal Premiums Cash Register
  - Agency and Branch Casts Book
  - Petty Cash Book
  - Claims Cash Book
  - General Cash Book
  - Claim Register Lapsed and Cancelled Policies Book

- Agency Ledger
- Policy Loan Ledger
- Investment Ledger

- **General Insurance :** Under a contract of insurance, one party, known as the 'insurer', undertakes to compensate the loss suffered (duo to specified causes) by the other party, known as the 'insured, in consideration for a fixed sum of money, known as 'premium'. Since the amount of premium is generally small, insurance contracts spread the loss suffered by one person a large number of persons. Everyone pays a premium; those who suffer are paid a sum equivalent to the loss (or loss according to terms of the contract) and who do not suffer a loss lose only the premium paid. Thus protection against enforceable events is purchased through a contract of insurance. The document containing the term, of an insurance contract is known as general insurance policy.

  General insurance means insurance other than life insurance. Section 2(6B) of the Insurance Act defines 'General Insurance Business' as fire, marine or miscellaneous insurance business whether carried on singly or in combination with one or more of them. Any type of insurance other than life insurance can be classified under this heading. Some common types of miscellaneous insurance in India are Exchange risk insurance, motor vehicle insurance, credit insurance, burglary insurance. workmen's compensation insurance, professional liability insurance, cash in transit insurance, fidelity insurance, consequential loss etc. (Further explained in detail) An important feature of the general insurance policy is that the insured gets compensation only in case of loss sustained by him due to reasons specified in the policy. Under this type, the insurer undertakes to indemnify the actual loss suffered by the insured on the happening of a certain event, in return for fixed premium, with a stipulation of time. General insurance companies may be doing more than one business.
- **Fire insurance :** In this insurance, the company undertakes to compensate loss caused by fire in consideration of premium received. A fire insurance contract may be defined as an agreement whereby one party for a consideration, undertakes to indemnify the other party up to an agreed amount against financial loss of goods or property which the latter may suffer because of fire. Fire insurance thus covers the risk of loss of property by accidental and non-intentional fire.
- **Marine insurance :** In this insurance, in consideration of premium received, the company undertakes to compensate loss caused by marine risks as per terms of insurance. Marine insurance is perhaps the oldest type of insurance. Under a contract of marine insurance the insurance company or the underwriter agrees to indemnify the owner of a ship or cargo against risks which are incidental to marine adventure such as

sinking or burning of the ship and its contents. Stranding of the ship, collision of ship, Jettison i.e. throwing overboard the cargo into the sea to save the ship from sinking or some other imminent danger, barratry. i.e. wrongful act of the captain of the ship in destroying or stealing the vessel or cargo causing loss to owners.

- **Miscellaneous Insurance Policies :** In addition to the types of general insurance business, there are a number of insurance policies which cover various other types of risks, the important ones of which are discussed hereinafter.

  Motor Vehicle Insurance : Motor Vehicle insurance policies are normally taken out to cover two types of risk :

  (1) the risk of damage by an accident or loss by theft and

  (2) risk of liability arising from an injury or death of any person in an accident caused by a vehicle. Commonly known as Third Party Insurance. The owner of a vehicle is compulsorily required to get third party insurance under the Indian Motor Vehicles Act whereas the other types of insurance are voluntary.

  Fidelity Insurance : This type of insurance protects an employer against the frauds, defalcations etc, on the part of his employees where, as part of their employment obligations, such employees are required to handle cash, goods or other valuables of the employer.

  Credit Insurance : Credit insurance is taken out to protect the insured against the losses caused by bad debts due to insolvency of the debtors or otherwise.

  Burglary Insurance : Burglary insurance policy is issued whereby the insurer undertakes to indemnify the insured against losses from burglary, i.e. the removal of movable goods by theft or burglary.

  Loss of Profit Insurance : Loss of profits insurance is often accompanied by fire insurance it covers the risk of loss of profits caused by lire, including fixed costs which are continued be incurred till the business starts functioning at its normal level. **Workmen Compensation Insurance :** This type of insurance covers the risk of liability arisi4 on account of payment of compensation where a worker suffers injury or dies in an accident in the course of his employment.

  Professional Liability Insurance : A professional liability insurance protects the professional. such as doctors, lawyers and accountants, against the risk of liabilities arising towards diem, of third parties in connection with their work. This may also include legal expenses incurred in defending law suits. The scope of miscellaneous insurance business is very wide and encompasses almost al1 commercial activity.

Insurance is available against most risks that benefit the business as shown below :

Risk	Type of Insurance
Loss through fire	Fire
Marine	Risks of sea transport to goods, ship and freight
Accidents	Accidents or Motor Vehicles
Loss by theft	Burglary
Fidelity	Dishonesty of employees
Damage to third parties	Third Parties
Injury (including sickness) or death of workers caused at work	Workmen's Compensation
Loss of profits due to fire or natural causes	Consequential Loss

Almost anything can be insured if only one is prepared to pay a sufficient premium.

Distinction between life insurance and other forms of insurance :

- **Life Insurance :** It is a contract under which, in consideration of premiums paid by the insured, the insurer agrees to pay a fixed sum of money either on the death of insured or on the lapse of a specified number of years. Life policies may be issued in various forms, the most important of which are the following :
  - Whole Life Policy where the insured amount is payable only on death.
  - Endowment policy where the insured amount is payable either on the lapse of specified number of years or on death, if it occurs earlier. Note: Policies covered by (a) and (b) may be with profits or without profits.
  - Annuity Contract where a specified amount is paid annually to the insured from the date he attains a specified age till his death.
  - Multiple Benefit policy where, on maturity, the insured has several options, e-g.- to obtain the full amount in cash or partly in cash and partly in the form of a "paid-up- policy or wholly in the form of a "paid-up" policy.
- Fire, marine and miscellaneous insurance business These represents the type of contract under which, in return for premiums paid by the insured, the insurer undertakes to reimburse the insured for any loss or liability he may incur on the happening of an uncertain event. There are several types of policies issued for each class of business.
- Since, in life insurance, the amount insured is payable on the happening of an event which is bound to occur, namely, the lapse of the period of time or the death of the

insured, this form of insurance is frequently described as "assurance" business. Other forms of insurance provide only for the reimbursement of loss or liability incurred and, therefore, they are known as 'insurance' business. In practice, this distinction is not always observed, life insurance being termed both as "assurance" and insurance and other forms of insurance being known by the more comprehensive title of "general insurance.

- Human life, being invaluable, may be insured for any amount depending upon the premiums the insured is willing to pay. Other forms of insurance are contracts of indemnity and, therefore, notwithstanding the amount of policy the sum payable under it is limited to the amount of loss actually suffered or the liability incurred.
- Life insurance contracts are long term contracts running over the number of years but general insurance contracts are only for one year though renewable year after year. In the latter case, when the year is over, there is no possibility of a claim but, in case of life insurance, lapse of a year means no such thing and, therefore, the premium received for that year cannot be treated as income.

6.2 Preparation of Final Accounts of Insurance Companies :

Insurance Regulatory and Development Authority (IRDA): In order to regulate the insurance business, the government set up in 1996, the Insurance Regulatory Authority (IRA). Now this authority is known as the Insurance Regulatory and Development Authority. In 2002, the authority came with regulations for the preparation of the financial statement of insurance companies.

IRDA Guidelines : As per the IRDA Guidelines, an insurer carrying on life insurance business shall "with the requirements given in Schedule A. An insurer carrying on general insurance business shall comply with the requirements given in Schedule B and the report of auditor shall be in conformity with the requirement of Schedule C.

Structure of Schedule A & B : The following table depicts structure of A & B given under IRDA regulation are given as under.

Schedule A for Life Insurance Business	Schedule B for General Insurance Business
Part I : Accounting Principles for preparation of financial statement	Part I : Accounting Principles for preparation of financial statement
Part II : Disclosure forming part of Financial Statements	Part II : Disclosure forming part of Financial Statements

Pan III : General Instructions for preparation of financial statements	Pan III : General Instructions for preparation of financial statements
Part IV : Contents of Management Report	Part IV : Contents of Management Report
Pan V : Preparation of Financial statements	Pan V : Preparation of Financial statements
Form A-RA : Revenue Account	Form B-RA : Revenue Account
Form A-PL : Profit and Loss Account	Form B-PL : Profit and Loss Account
Form A-BS : Balance sheet and 15 Schedules forming part of financial statements	Form B-BS : Balance Sheet and 15 Schedules forming part of financial statements

Financial Statements :

- **Life Insurance Business :** The insurance company carrying life insurance business is required to prepare Balance sheet form A-BS Revenue account [Policy holders' account] Form A- RA Profit and loss account form A-PL. These forms have been given in the I RDA Regulations, 2002. No form has been specified for cash flow statement.
- **General Insurance Business :** The insurance company carrying on general insurance business is required to prepare, Balance sheet form B-BS, Revenue account [Policy holders' account] Form B- RA and Profit & loss account form B-PL. These forms have been given in the IRDA Regulations, 2002. No form has been specified for cash flow statement.

6.3 Revenue Accounts in Form B- RA :

As per IRDA Regulations 2012, every General Insurance Company must prepare their Revenue Account according to Schedule B. Naturally, the result of the operation of each individual unit can be known from this account for a particular accounting period which is very important. It is prepared under accrual basis of accounting. 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. The form of Revenue Account is given below:

FORM B – RA

Name of the Insurer :

Registration No. and Date of Registration with the IRDA :

Revenue Account for the year ended 31st March, 20….

Policyholders' Account (Technical Account)

No	Particulars	Schedule	Current Year (Rs. '000)	Previous Year (Rs.'000)
1.	Premiums Earned (Net)	1		
2.	Others (to be specified)			
3.	Change in Provisions for unexpired risk			
4.	Interest, Dividend & Rent - Gross			
	Total (A)			
1.	Claims Incurred	2		
2.	Commission	3		
3.	Operating Expenses related to insurance business	4		
4.	Others (to be specified)			
	Total (B)			
	Operating Profit/ (Loss) from Fire/ Marine/ Miscellaneous business (C) = (A-B)			
	Appropriations			
	Transfer to Shareholders' Account			
	Transfer to Catastrophe Reserve			
	Transfer to Other Reserves (to be specified)			
	Total (C)			

6.4 Profit and Loss Account in Form B- PL :

Profit and Loss Account of General Insurance Company is prepared to know the overall operating result of the company. Operating profits (or losses) of fire, marine and miscellaneous insurance are taken in the P&L A/c. It includes income from investment in the form of dividend, interest, rent etc. Similarly it also includes expenses relating to insurance business, 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. At the same time, all appropriation items, viz payment of dividend (interim and proposed), transfer to reserve etc. will appear in its appropriation part.

FORM B-PL

Name of the Insurer :

Registration No. and Date of Registration with the IRDA :

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

Shareholders' Account (Non-technical Account)

No	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Operating Profit/ (Loss)			
	(a) Fire Insurance			
	(b) Marine Insurance			
	(c) Miscellaneous Insurance			
2.	Income from Investments			
	(d) Interest, dividends & rent – Gross			
	(e) Profit on sale/redemption of investments			
	Less: Loss on sale of investments			
3.	Other income (to be specified)			
	Total (A)			
4.	Provisions (other than taxation)			
	(a) For diminution in the value of investments (net)			
5.	Other Expenses			
	(a) Expenses other than those directly related to the insurance business			
	(b) Bad debts written off			
	(c) Others (to be specified)			
	Total (B)			
	Profit before tax			
	Provision for taxation			
	Profit after tax			
	Appropriations			
	(a) Interim dividends paid during the year			
	(b) Proposed final dividend			
	(c) Dividend Distribution Tax			
	(d) Transfer to Reserves or other accounts (to be specified)			
	Balance of Profit/Loss brought forward from last year			
	Balance carried forward to the Balance Sheet			

6.5 Balance Sheet in Form B- BS :

Balance Sheet of Life Insurance Company is prepared in vertical format. The form of Balance Sheet is as follows: As per IRDA regulation 2002, Balance Sheet of General Insurance Company is prepared under vertical form. It has two sections, viz (a) Sources of funds and (b) Application of funds.

Name of the Insurer :

Reg, No and date of registration with IRDA :

Balance Sheet as at 31st March, 20….

Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
Sources of Funds			
Shareholders' Funds:			
Share Capital	5		
Reserves and Surplus	6		
Fair Value Change Account			
Borrowings	7		
Total			
Application of Funds			
Investments	8		
Loans	9		
Fixed Assets	10		
Current Assets			
Cash and Bank Balances	11		
Advances and Other Assets	12		
Sub-Total (A)			
Current Liabilities	13		
Provisions	14		
Sub-Total (B)			
Net Current Assets (C) = (A) - (B)			
Miscellaneous Expenditure (to the extent not Written off or adjusted)	15		
Debit Balance in Profit and Loss Account			
Total			

Schedules Forming Part of Financial Statements

Schedule 1 – Premium Earned [Net]

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Premium for direct business written Add : Premium on reinsurance accepted Less : premium on reinsurance ceded Net Premium Total Premium Earned (Net)		

Note : Reinsurance premiums whether on business cede or accepted are to be bought into account, before deducting commission under the head of reinsurance premiums.

Schedule 2 – Claims Incurred [Net]

Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
Claims paid Direct Add : Reinsurance accepted Less : Reinsurance ceded Net Claims paid Add : Claims outstanding at the end of the year Less : Claims outstanding at the beginning **Total** Claims Incurred		

Schedule 3 – Commission

Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
Commission Paid Direct Add : Commission on Re-insurance Accepted Less : Commission on Re-insurance Ceded Net Commission		

Note : The profit/commission, if any, are to be combined with the Re-insurance accepted or Re- insurance ceded figures.

Schedule 4 – Operating Expenses Related To Insurance Business

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Employees' remuneration & welfare benefits		
2.	Managerial remuneration		
3.	Travel, conveyance and vehicle running expenses		
4.	Rents, rates & taxes		
5.	Repairs		
6.	Printing & stationery		
7.	Communication expenses Medical fees		
8.	Legal & Professional charges		
9.	Medical Fees		
10.	Auditors' fees, expenses etc		
	(a) As auditor		
	(b) As adviser or in any other capacity, in respect of:		
	(i) Taxation matters		
	(ii) Insurance matters		
	(iii) Management services; and		
	(b) In any other capacity		
11.	Advertisement and publicity		
12.	Interest & bank charges		
13.	Others(to be specified)		
14.	Depreciation		
	Total		

Note : Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs. 5,00,000 whichever is higher, shall be shown as a separate line item.

Schedule 5 – Share Capital

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Authorised capital		
2.	Equity shares of Rs…..each Issued Capital Equity shares of Rs…..each		
3.	Subscribed Capital Equity shares of Rs…..each Called-up Capital		
4.	Equity shares of Rs…..each Less: Calls unpaid Add: Equity Shares forfeited (Amount originally paid up) Less: Par value of equity shares bought back Less: Preliminary Expenses Expenses including commission or brokerage on underwriting or subscription of shares **Total**		

Notes :

a) Particulars of the different classes of capital should be separately stated.

b) The amount capitalized on account of issue of bonus shares should be disclosed.

c) In case any part of the capital is held by a holding company, the same should be separately disclosed.

Schedule 5A – Pattern of Shareholding

[As certified by the Management]

Shareholders	Current Year		Previous Year	
	No. of Shares	% of Holding	No. of Shares	% of Holding
Promoters *Indian *Foreign Others **Total**				

Schedule 6 – Reserves and Surplus

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Capital Reserve		
2.	Capital Redemption Reserve Securities Premium		
3.	General Reserves		
4.	Less: Debit balance in P&L A/c, if any Less: Amount utilized for buy back.		
5.	Catastrophe Reserve		
6.	Other Reserves (to be specified)		
7.	Balance of Profit in P&L A/c		
	Total		

Note : Additions to and deductions from the reserves shall be disclosed under each of the specified heads.

Schedule 7 – Borrowings

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Debentures/Bonds		
2.	Banks		
3.	Financial Institutions		
4.	Others (to be specified)		
	Total		

Schedule 8 – Investments

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Long –term Investments		
1.	Government securities and Government Guaranteed Bonds including treasury bills		
2.	Other approved securities		

3.	**Other investments**		
	(a) Shares		
	Equity		
	Preference		
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other securities (to be specified) (f) Subsidiaries		
	(g) Investment Properties – Real Estate		
4.	**Investments in Infrastructure and Social sector**		
5.	**Other than Approved Investments**		
	Short –term Investments		
1.	Government securities and Government Guaranteed Bonds including treasury bills		
2.	Other approved securities		
3.	Other investments		
	(a) Shares		
	(aa) Equity		
	(bb) Preference		
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other securities (to be specified)		
	(f) Subsidiaries		
	(g) Investment Properties – Real Estate		
	Investments in Infrastructure and Social sector		
	Other than Approved Investments		
	Total		

Schedule 9 – Loans

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	**Security-wise Classification** Secured a) On mortgage of property (aa) In India (bb) Outside India b) On Shares, Bonds, Govt. Securities, etc. c) Others (to be specified) Unsecured **Total** **Borrower-wise Classification**		

Schedule 10 – Fixed Assets

Particulars	Cost/Gross Block				Depreciation				Net Block	
	Opening	Additions	Deductions	Closing	Up to Last Year	For the Year	On Sales/ Adjustments	To Date	As at year end	Previous Year
Goodwill										
Intangibles (specify)										
Land-Freehold										
Leasehold										
Property Buildings										
Furniture & Fittings										
Information Technology										
Equipment										
Vehicles										
Office										
Equipment										
Others (Specify nature)										
Total										
Work in progress										
Grand Total										
Previous Year										

Schedule 11 – Cash and Bank Balances

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Cash (including cheques, drafts and stamps) Bank		
2.	Balances		
	(a) Deposit Accounts		
	(aa) Short-term (due within 12 months)		
	(bb) Others		
	(b) Current Accounts		
	(c) Others (to be specified)		
3.	Money at call and short notice		
	(a) With banks		
	(b) With other institutions		
	Others (to be specified) Total		
4.	Balances with non-scheduled banks in 2 and 3 above		

Schedule 12 – Advances and Other Assets

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Advances		
1.	Reserve deposits with ceding companies		
2.	Application money for investments		
3.	Prepayments		
4.	Advances to Directors/Officers		
5.	Advance tax paid and taxes deducted at source (Net provision		
6.	for taxation)		
	Others (to be specified)		
	Total (A)		
	Other Assets		
	Income accrued on investments		
	Outstanding Premiums		
1.	Agents' balances		
2.	Foreign Agencies Balances		
3.			

4.	Due from other entities carrying on insurance business		
5.	(including reinsurers)		
6.	Due from subsidiaries/holding company		
7.	Deposit with Reserve Bank of India [Pursuant to section 7 of Insurance Act, 1938]		
8.	Others (to be specified) Total (B)		
	Total (A+B)		

Schedule 13 – Current Liabilities

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Agents' balances		
2.	Balances due to other insurance companies		
3.	Deposits held on re-insurance ceded		
4.	Premiums received in advance		
5.	Unallocated premium		
6.	Sundry creditors		
7.	Due to subsidiaries/holding company		
8.	Claims outstanding		
9.	Due to Officers/Directors		
10.	Others (to be specified)		
	Total		

Schedule 14 – Provisions

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Reserve for Unexpired Risk		
2.	For taxation (less payments and taxes deducted at source)		
3.	For proposed dividends		
4.	For dividend distribution tax		
5.	Others (to be specified)		
	Total		

Schedule 15 – Miscellaneous Expenditure
(To the extent not written off or adjusted)

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Discount allowed on issue of shares/debentures		
2.	Others (to be specified)		
	Total		

Reserve for Unexpired Risk :

Policies in general insurance are only for one year. These can be taken by the insured at any time during the year. Premium on such policies is always paid in advance. There may be such policies which are issued during the year but risks covered remain unexpired at the accounting year. Hence a reserve for unexpired risk is made at 50% of the net premium in case of fire insurance and 100 % of the net premium in marine insurance is made. 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'.

At present reserve for unexpired risk will be created as follows :

- 50% of net premium for fire insurance, marine cargo business and miscellaneous insurances.
- 100% of net premium for marine hull business.
- In addition to the above reserve, a company can maintain more reserves. Then it is called Additional Reserve.

Problem 1 :

Goldy Insurance Co. Ltd. Furnishes you with the following information.

i) On 31-12-2022 it had reserve for unexpired risks to the tune of Rs. 80 crores. It comprised of Rs. 30 crores in respect of marine insurance business Rs. 40 crores in respect of life insurance business and Rs. 10 crores in respect of miscellaneous insurance business.

ii) It is the practice of Dhanlaxmi Insurance Co. Ltd. to create reserves at 100% of net premium income in respect of marine insurance policies and at 50% of net premium income in respect of fire and miscellaneous income policies.

iii) During 2023, the following business was conducted. **(Amount in Crores)**

Preima. Collected From	Marine Rs.	Fire Rs.	Misellaneous Rs.
a) Insured in respect of policies issued	36	86	24
b) Other Insurance Companies in respect of risks under taken	14	10	8
Premia paid / Payable to other insurance companies on business ceded	13.4	8.6	14

Goldy Insurance Co. Ltd. Ask's you to :

a) Pass journal entries relating to 'Unexpired risks reserve'.

b) Show in columnar form 'Unexpired risks reserve account for 2023.

Solution :

Journal of Goldy Insurance Account

Date	Particulars	(Rs. in Crores)	
		Dr. (Rs.)	Cr. (Rs.)
2023 Dec.31	Marine Revenue A/c ……Dr To unexpired Risks Reserve A/c (Being the difference between closing provision of Rs.36.60 crores (36 + 14 – 13.4) and opening provision of Rs.30 crores charged to marine revenue account)	6.60	6.60
	Fire Revenue A/c ……Dr. To Unexpired Risks Reserve A/c (Being the difference between closing provision of Rs. 43.7 crores [(86 + 10 - 8.6) / 2] and opening provision of Rs.40 crores charged to fire revenue account)	3.70	3.70
	Unexpired Risks Reserve A/c……..Dr. To miscellaneous Revenue A/c (Being the excess of opening balance of Rs.10 crores over the required closing balance of Rs.9 crores [(24 + 8 – 14) / 2] credited to miscellaneous Revenue A/c	1.00	1.00

Unexpired Risks Reserve A/c

Particulars	Marine Rs.	Fire Rs.	Miscellaneous	Particulars	Marine Rs.	Fire Rs.	Miscellaneous
To Revenue A/c	–	–	1.00	By Bal. b/d	30.00	40.00	10.00
To Balance c/d	36.60	43.70	9.00	By Revenue A/c	6.60	3.70	–
	36.60	**43.70**	**10.00**		**36.60**	**43.70**	**10.00**

Note : Alternatively, the opening balance, of unexpired risk reserve may be reversed in the beginning of the years by transfer to Reverse account and fresh reserve of full required amount may be created at the ends of the year which will be carried forward as closing balances.

Problem 2 :

From the following figures appearing in the Books of Fire Insurance division of a **Prompt Pay General Insurance Company Ltd.** Show the amount of claim as it would appear in the revenue account for the year ended 31st March 2024.

Particulars	Direct Business Rs.	Re. Insurance Rs.
Claims paid during the year	93,40,000	14,00,000
Claims payable – 1st April 2023	15,26,000	1,74,000
31st March 2024	16,24,000	1,06,000
Claims Received	–	4,60,000
Claims Receivable – 1st April 2023	–	1,30,000
31st March 2024	–	2,26,000
Expenses of Management (Includes Rs.70,000 Surveyor's fee and Rs.90,000 Legal expenses for settlement of claims)		4,60,000

Solution :

Form B-RA (Prescribed by IRDA)

Name of Insurer : Prompt Pay General Insurance Co. Ltd. Registration No. and date of Registration with (IRDA) ……

Revenue Account for the year ended

31st March 2024

(Fire Insurance Business)

Schedules forming part of Revenue Account

Schedule – I Claims Incurred (net)		Current Year Rs.	Previous Year Rs.
Claims Paid			
Direct		1,04,40,000	
Add – Claims outstanding at the end of the year		15,04,000	
		1,19,44,000	
Less – Claims outstanding at the beginning of the year		15,70,000	
Total Claims Incurred		**1,03,74,000**	
Working Notes:-			
i) Claims Paid			
Direct		93,40,000	
Reinsurance accepted		14,00,000	
		1,07,40,000	
Add – Fees and Expenses Connected with claims -			
Surveyor's fee	70,000		
Legal Expenses	90,000	1,60,000	
		1,09,00,000	
Less – Claims received from Reinsurance		4,60,000	
		1,04,40,000	
ii) Claims outstanding at the end of the year -			
Direct Business		16,24,000	
Reinsurance		1,06,000	
		17,30,000	
Less – Claims receivable from reinsurances		2,26,000	
		15,04,000	
iii) Claims outstanding at the Beginning of the year			
Direct Business		15,26,000	
Reinsurance		1,74,000	
		17,00,000	
Less – Claims Receivable from reinsurances		1,30,000	
		15,70,000	

Problem 3 :

Starshine India Insurance Co. Ltd. has furnished the following information for preparation of revenue account for fire insurance business for the year ended 31st March 2024.

Particulars	Rs.
Claims admitted but not paid	84,752
Commission Paid	1,00,000
Commission on reinsurance received	24,000
Share transfer fees	10,000
Expenses of Management	1,56,000
Bad Debts	5,000
Claims Paid	30,000
Profit and Loss account appropriation	20,000
Premium received	11,04,000
Reserve for unexpired risks as on 1-4-23	4,60,000
Additional reserve on 1-4-23	80,000
Claims outstanding as on 1-4-23	54,000
Dividend on share capital	37,000

The following further information has also to be considered :

i) Premium outstanding at the end of the year Rs. 80,000.

ii) It is policy of the company to maintain 50% of premium towards reserve for unexpired risks.

iii) Additional reserve at 10% of net premium to be maintained.

Solution :

From B-RA (Prescribed by IRDA)

Name of the Insurer: India Insurance Co. Ltd.

Registration no and date of registration with IRDA ….

Reserve Account for the year ended 31st March 2024

[Fire Insurance Business]

	Schedule Rs.	Current Year Rs.	Previous Year Rs.
A) Premiums earned (Net)	1	11,84,000	
Change in provision for unexpired risks (refer W.N.I.)		1,70,400	
Total (A)		**10,13,600**	

B) Claims Incurred (Net)	2	60,752	
Commission	3	76,000	
Operating Expenses of management related to Insurance Business	4	1,56,000	
Bad Debts		5,000	
Total (B)		**2,97,752**	
C) Operating Profit (C = A – B)		**7,15,848**	

Schedules forming part of Revenue Account

Schedule - 1 Premium earned (net)

Particulars	Current Year Rs.	Previous Year Rs.
Premium from direct business written	11,04,000	
Add – Premium on reinsurance accepted	Nil	
Less – Premium on reinsurance ceded	Nil	
	11,04,000	
Add – Premium outstanding of the end of year	80,000	
	11,84,000	

Working Notes :

i) Change in provisions for unexpired risk reserve :

At the end of the year

50% of the premium income of the year		
(50% x 11,84,000)		5,92,000
Additional Reserve		
(10% x 11,84,000)		1,18,400
		7,10,400
Less: At the beginning of the year	4,60,000	
Additional reserve	80,000	5,40,000
		(1,70,400)

Schedule – 2 Claims Incurred (net)

Particulars	Rs.
Clams Paid	
Direct	30,000
Add – Reinsurance accepted	Nil
Less – Reinsurance ceded	Nil
Net Claims Paid	30,000
Add – Claims outstanding of the end of the year	84,752
	1,14,752
Less – Claims outstanding at the beginning of the year	54,000
Total claims incurred (net)	**60,752**

Schedule – 3 Commission

Particulars	Rs.
Commission Paid	
Direct	1,00,000
Add – Reinsurance accepted	Nil
	1,00,000
Less – Commission of reinsurance ceded	24,000
Net Commission	**76,000**

Problem 4 :

From the following balances as at March 31, 2024 in the books of **Mahalaxmi Insurance Co. Ltd.** Prepare Revenue Account in respect of fire insurance business carried on by them.

Particulars	Rs.
Claims paid	9,60,000
Claims outstanding on April 01, 2023	80,000
Claims intimated and accepted but not paid on March 31, 2024	1,40,000
Premiums Received	24,00,000
Reinsurance Premium paid	2,40,000
Commission	4,00,000
Commission in re-insurance ceded	16,000
Commission in re-insurance accepted	8,000
Expenses of Management	6,04,000

Provision for unexpired risk on April 01, 2023	8,00,000
Additional provision for unexpired risk on April 1, 2023	40,000
Bonus utilized in reduction of premium	24,000
Reinsurance recoveries of claims	16,000
Medical expenses regarding claims	10,000
Loss on sale of Motor Car	7,000
Bad Debts	5,000
Refund of double taxation	9,000
Interest and Dividends	16,000
Income – Tax deducted thereon	3,000
Legal expenses regarding claims	8,000
Profit on sale of Investments	7,000
Rent of staff quarters deduction from staff salaries	4,800
Depreciation of furniture	9,200

You are required to –

Provide for additional reserve for unexpired risk on 1% of the net premium in addition to the opening balance of additional reserve.

Solution :

From B-RA (Prescribed by IRDA)

Name of the Insurer - Mahalaxmi Insurance Co. Ltd.

Reg. No. and date of Registration with IRDA ….

Revenue Account for the year ended

31st March 2024

[Fire Insurance Business]

Particulars	Schedule	Current Year Rs.	Previous Year Rs.
A) Premiums earned (Net)	1	21,84,000	
Change in provision for unexpired risks (9,35,440 – Rs.8,40,000)		(95,440)	
Interest, Dividends and Rent, Gross		20,800	
Double Income Tax Refund		9,000	
Profit on Sale of Investment		7,000	
Loss on Sale of Motor Car		(7,000)	
Total (A)		**21,18,360**	

B) Claims Incurred (Net)	2	10,22,000	
Commission	3	3,92,000	
Operating expenses related to Insurance business	4	6,13,200	
Bad Debts		5,000	
Indian and Foreign taxes		3,000	
Bonus utilized in reduction of premium		24,000	
Total (B)		**20,59,200**	
C Operating profit (C = A – B)		**59,160**	

Scheduled forming part of Revenue Account

Schedule – 1 Premium earned (net)

Particulars	Current Year Rs.	Previous Year Rs.
Premium from direct business written	24,00,000	
Add – Premium on reinsurance accepted	Nil	
	24,00,000	
Less – Premium on reinsurance ceded	2,40,000	
	21,60,000	
Add – Bonus utilized in reduction of premium	24,000	
	21,84,000	

Schedule – 2 Claims Incurred (net)

Particulars	Rs.	Rs.
Claims paid-Direct (Refer WN I)	9,62,000	
Add – Reinsurance Accepted	Nil	
Less – Reinsurance ceded	Nil	
Net Claims paid	9,62,000	
Add – Claims outstanding at the end of the year	1,40,000	
	11,02,000	
Less – Claims outstanding at the beginning of the year	80,000	
Claims Incurred (net)	**10,22,000**	

Working Notes :

i) Claim paid 9,60,000

Add – Medical expenses Regarding claims	10,000
Legal Expenses	8,000
	9,78,000
Less – Reinsurance Recoverance (ceded)	16,000
	9,62,000

Schedule – 3 Commission

Particulars	Rs.	Rs.
Commission Paid		
Direct	4,00,000	
Add – Reinsurance Accepted	8,000	
	4,08,000	
Less – Reinsurance Ceded	16,000	
Net Commission	**3,92,000**	

Schedule – 4

Particulars	Rs.	Rs.
Operating expenses related to insurance business		
Expenses of Management	6,04,000	
Depreciation of Furniture	9,200	
	6,13,200	

Problem 5.

Prepare Fire Insurance Revenue Account as per IRDA regulations for the year ended 31st March 2024 from the following details.

Particulars	Rs.
Claims Paid	9,80,000
Legal Expenses Regarding Claims	20,000
Premiums Received	26,00,000
Re-Insurance Premium Paid	2,00,000
Commission	6,00,000
Expenses of Management	4,00,000
Provision Against unexpired risk 1st April 2023	11,00,000
Claims Unpaid on 1st April 2023	1,00,000
Claims Unpaid on 31st March 2024	1,60,000

Solution :

Form B-RA

Name of the Insurer:

Registration No. and Date of Registration with the IRDA

Fire Insurance Revenue Account

For the Year Ended 31st March 2024

Particulars	Schedule	Amount
1) Premium Earned	1	23,00,000
2) Other Income		–
3) Interest, Dividend and Rent		–
Total (A)		**23,00,000**
4) Claims Incured	2	10,60,000
5) Commission	3	6,00,000
6) Operating Expenses related to Insurance Business	4	4,00,000
Total (B)		**20,60,000**
Operating Profit (A) – (B)		**2,40,000**

Scheduled forming part of Revenue Account

Schedule – 1 Premium Earned (Net)	**Rs.**
Premium Received	26,00,000
(–) Re-Insurance Premium	2,00,000
Net Premium	**24,00,000**
Adjustment for change in reserve for unexpired Risk (Refer W.N.)	1,00,000
	23,00,000

Working Notes :

i) Change in the provision for unexpired risk **Rs.**

Unexpired risk reserve on 31st March 2023 = 50% of net premium 12,00,000

(i.e. 50% of Rs.24,00,000 (See schedule – 1)

Less: Unexpired risk reserve as on 1st April 2023 11,00,000

Change in the Provision for unexpired Risk 1,00,000

Schedule – 2 Claims Incurred

Claims paid including legal expenses (9,80,000 + 20,000) 10,00,000

Add – Claims outstanding at the end of the year 1,60,000

Less – Claims outstanding at the beginning of the year	1,00,000
Total Claims Incurred	**10,60,000**

Schedule – 3 Commission

Commission Paid	6,00,000
	6,00,000

Schedule – 4 Operating expenses

Expenses of Management	4,00,000
	4,00,000

Problem 6 :

From the following information as on 31st March 2023. Prepare the Revenue Accounts of **Ajay & Vijay Co. Ltd.** engaged in Marine Insurance Business :

Particulars		Direct Business Rs.	Reinsurance Rs.
1) Premium :			
Received		48,00,000	7,20,000
Receivable -	1st April 2022	2,40,000	42,000
	31st March 2023	3,60,000	56,000
Premium Paid		4,80,000	–
Payable -	1st April 2022	–	40,000
	31st March 2023	–	84,000
2) Claims:			
Paid		33,00,000	2,50,000
Payable -	1st April 2022	1,90,000	26,000
	31st March 2023	3,50,00	44,000
Received		–	2,00,000
Receivable -	1st April 2022	–	18,000
	31st March 2023	–	24,000
3) Commission			
On Insurance accepted		3,00,000	22,000
On Insurance ceded			28,000

Other Expenses and Income :

Salaries Rs. 5,20,000; Rent Rates and Taxes Rs. 36,000; Printing and Stationary Rs. 46,000; Indian Income Tax paid Rs. 4,80,000; Interest, Dividend and Rent received (net) Rs. 2,31,000;

Income tax deducted at source 49,000; Legal Expenses (inclusive or Rs.40,000 in connection with the settlement of claims) Rs. 1,20,000; Bad Debts Rs. 10,000; Double Income Tax refund Rs. 24,000; Profit on safe of motor car Rs.10,000.

Balance of Fund on 1st April 2022 was Rs. 53,00,000 including Additional Reserve of Rs. 65,00,000 Additional Reserve has to be maintained at 5% of the net premium of the year.

Solution:

Ajay Vijay Co. Ltd.

Revenue Account In respect of Marine Business

For the year ended 31st March 2023

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To claim Less Re-insurance paid during the year	33,90,000		By Balance of fund at the beginning of the year	46,50,000	
Add: outstanding at the end of the year	3,70,000		Additional Reserve	6,50,000	53,00,000
	37,60,000				
Less : outstanding at the beginning of the year	1,98,000	35,62,000	By premium less Re-insurance received	56,54,000	
To Commission:			Less: Premium paid on Reinsurance ceded	5,24,000	51,30,000
1) on direct business		3,00,000	By Interest, Dividend & Rent	2,80,000	
2) On Re-insurance accepted		22,000	Less: Income tax thereon	49,000	2,31,000
To Expenses of Management		6,82,000			
			By Commission on reinsurance ceded		28,000
To Bad Debts		10,000			
To Indian and foreign taxes		4,80,000	By Double Income Tax Refund		24,000
To profit transferred to Profit & Loss A/c	2,80,500		By profit on sale of motor car		10,000
Balance of the fund at end of the year: Reserve for unexpired Risk	51,30,000				
5% Additional Reserve	2,56,500	53,86,500			
		1,07,23,000			**1,07,23,000**

Note : In exercise of the powers conferred by section 114 A of the Insurance Act 1938 (4 of 1938) the Insurance Regulatory and Development Authority in consultation with the Insurance, Advisory committee prescribed the new formats for the financial statements of Insurance companies i.e. Preparation of financial statements and Auditors Report of Insurance companies Regulation 2000. Therefore the above revenue account can be prepared as:-

Form B-RA (prescribed by IRDA)
Revenue Account for the year ended 31st March 2023
Marine Insurance Business

Particulars	Schedule	Current Year Rs.	Previous Year Rs.
Premium earned (net)	1	51,30,000	
Change in Provision for unexpired risk (53,86,500 – 53,00,000)		(–) 86,500	
Interest, Dividends and Rent-Gross		2,31,000	
Double Income Tax refund		24,000	
Profit on sale of motor car		10,000	
Total (A)		**53,08,500**	
Claims incurred (net)	2	35,62,000	
Commission	3	2,94,000	
Operating expenses related to Insurance business	4	6,82,000	
Bad Debts		10,000	
Indian and foreign taxes		4,80,000	
Total (B)		**50,28,000**	
Profit from marine Insurance business (A–B)		**2,80,500**	

Schedules forming part of Revenue Account

Schedules : 1 Premium Earned (Net)

Particulars	Current Year Rs.	Previous Year Rs.
Premiums earned (net)		
Premiums from direct business written	56,54,000	
Less: Premium on reinsurance ceded	5,24,000	
Total premium earned (net)	**51,30,000**	

Schedule – 2 Claims Incurred

Claims incurred (net)	**35,62,000**	

Schedule – 3 Commission

Commission Paid		
Direct	3,00,000	
Add: Re-insurance accepted	22,000	
Less: Reinsurance ceded	28,000	
	2,94,000	

Schedule – 4 Operating expenses

Operating expenses related to insurance business		
Employees remuneration and welfare benefits	5,20,000	
Rent Rates and Taxes	36,000	
Printing and Stationary	46,000	
Legal and Professional Charges	80,000	
	6,82,000	

Working Notes :

Sr.	Particulars	Direct Rs.	Reinsurance Rs.
1)	**Total Premium Income**		
	Received	48,00,000	7,20,000
	Add: Receivable on 31st March 2023	3,60,000	56,000
	Loss: Receivable on 1st April 2022	51,60,000	7,76,000
	Total Premium Income	2,40,000	42,000
	49,20,000 + 7,34,000 = **56,54,000**	**49,20,000**	**7,34,000**
2)	**Premium Paid**		
	Paid	4,80,000	
	Add: Payable on 31st March 2023	84,000	
		5,64,000	
	Less : Payable on 1st April 2022	40,000	
		5,24,000	
3)	**Claims paid**		
	Direct Business	33,00,000	
	Re-insurance	2,50,000	
	Legal expenses	40,000	
		35,90,000	
	Less: Re-insurance claims Received	2,00,000	
		33,90,000	

4)	**Claims outstanding as on 31st March 2023**		
	Direct	3,50,000	
	Re-Insurance	44,000	
		3,94,000	
	Less: Recoverable from		
	Re-Insurance on 31st March 2022	24,000	
		3,70,000	
5)	**Claims outstanding as on 1st April 2022**		
	Direct	1,90,000	
	Re-Insurance	26,000	
	Less: Recoverable from	2,16,000	
	Re-insurance on 1st April	18,000	
		1,98,000	
6)	**Expenses of Management**		
	Salaries	5,20,000	
	Rent, Rates and Taxes	36,000	
	Printing and Stationary	46,000	
	Legal Expenses	80,000	
		6,82,000	

Problem 7 :

The following figures are from the books of **Aag Fire insurance Co.Ltd**. as at the end of their financial year ended 31st March 2024.

Financial Statements of Insurance Companies

Particulars	Rs.	Particulars	Rs.
Fire fund	12,40,000	Share capital	12,00,000
General reserve	6,00,000	Additional reserve	4,40,000
Investments	40,00,000	Profit and Loss A/c	1,00,000
Premiums	36,02,044	Re-insurance Premium	1,50,034
Claims paid	8,03,754	Claims recovered from reinsurance	28,158

Additional Information :	Rs.
Commission on reinsurance ceded	64,022
Commission on direct business	3,99,554
Commission on reinsurance accepted	80,200
Outstanding Premiums	29,730
Claims intimated but not paid (1.4.2023)	80,000
Expenses of management	5,75,930
Audit fees	24,000
Director's fees	24,000
Rates and Taxes	7,738
Rents	90,000
Income from investments	2,00,000
Share transfer fees	4,000
Loans (Dr.)	8,00,000
Sundry creditors	30,000
Agents balance (Dr.)	3,60,000
Cash in hand	40,310
Cash at Bank	2,02,974

From the above you are required to prepare fire revenue account, profit and loss account and balance sheet of the company, after taking into account the following :

i) Income tax to be provided Rs. 5,00,000

ii) Transfer to General reserve Rs. 2,00,000

iii) Proposed dividend 12%

iv) Claims intimated but not paid as on 31st March 2024 Rs. 1,21,600.

Solution :

Name of the insurer : Aag Fire Insurance Co. Ltd.

Registration No. and date of Registration with IRDA

Revenue Account for the year ended 31st March 2024

[Fire insurance business]

Particulars	Schedule	Current Year Rs.
A) Premiums earned (net)	1	34,52,010
Charge in provision for unexpired reserve (refer W.N.1)		(–) 1,40,804
Profit/Loss on Sale / redemption of Investments		Nil
Total (A)		**33,11,206**

B) Claims incurred (net)	2	8,17,196
Commission	3	4,15,732
Operating expenses of management related to Insurance Business	4	7,21,668
Total (B)		**19,54,596**
Operating Profit (C = A – B)		**13,56,610**

: Schedule forming part of Revenue Account :

Schedules – 1 Premiums earned (net)

Particulars	Current Year
Premiums from direct business written	36,02,044
Add : Premium on reinsurance accepted	Nil
	36,02,044
Less: Premium on reinsurance ceded	1,50,034
	34,52,010

Working Notes : 1

Change in provision for unexpired risk:	**Rs.**
Unexpired risk reserve at the end of the accounting period	
40% of the net premiums received	13,80,804
Addition reserve	4,40,000
	18,20,804
Unexpired risk reserve at the beginning of the accounting period	
(12,40,000 + 4,40,000)	16,80,000
	1,40,804

Schedules – 2 Claims incurred (net)

Claims Paid	
Direct	8,03,754
Add: Reinsurance accepted	Nil
Less: Reinsurance ceded	28,158
Net claims paid	**7,75,596**
Add: Claims outstanding at the beginning of the year	1,21,600
	8,97,196
Less: Claims outstanding at the beginning of the year	80,000
Total claims incurred	**8,17,196**

Schedule – 3 Commission

Commission Paid	
Direct	3,99,554
Add : Re-insurance accepted	80,200
	4,79,754
Less: Commission on reinsurance ceded	64,022
Net commission	**4,15,732**

Schedule – 4 : Operating expenses

Operating expenses of management related to insurance business	
Expenses of Management (given)	5,75,930
Audit fees	24,000
Directors fees	24,000
Rent, rates and taxes (7,738 + 90,000)	97,738
	7,21,668

From B–PL (prescribed by IRDA)

Profit and Loss Account for the year ended 31st March 2024

A) Operating profit from fire insurance business	13,56,610
Income from investments	2,00,000
Other income share transfer fees	4,000
Total (A)	**15,60,610**
B) Provisions (Other than taxation)	Nil
Other expenses	Nil
Total (B)	**Nil**
C) Profit before tax (C = A – B)	**15,60,610**
Provision for taxation	5,00,000
Balance	**10,60,610**
<u>Appropriations :</u>	
a) Interim dividends paid during the year	Nil
b) Proposed dividends (12% x 12,00,000)	1,44,000
c) Dividend distribution Tax	Nil
d) Transfer to general reserve	2,00,000
	3,44,000
Balance brought forward from last year	1,00,000
Balance carried to balance sheet	**8,16,610**
[10,60,610 – 3,44,000 + 1,00,000]	

From B – BS (Prescribed by IRDA)
Balance sheet as at 31st March 2024

Particulars	Schedule	Current Years Rs.	Previous Years Rs.
Sources of funds			
Share Capital		12,00,000	
Reserves and Surplus	5	34,37,414	
	Total	**46,37,414**	
Application of Funds			
Investments		40,00,000	
Loans		8,00,000	
Fixed Assets		Nil	
	Total	**48,00,000**	
Current Assets			
Cash and bank balances	6	2,43,284	
Advances and other assets	7	3,89,730	
Sub total (A)		**6,33,014**	
Current Liabilities		1,51,600	
Provisions	8	6,44,000	
Sub Total (B)		**7,95,600**	
Net current assets (C = A – B)		**(–) 1,62,586**	
Miscellaneous expenditure (to the extent not written off a adjusted)		Nil	
	Total	**46,37,414**	
Current liabilities			
Sundry creditors		30,000	
Outstanding claims		1,21,600	
		1,51,600	

Schedule – 5 : Reserves and Surplus

Fire fund		13,80,804	
Additional reserve		4,40,000	
General reserve		8,00,000	
Profit and Loss A/c		8,16,610	
		34,37,414	

Schedule – 6 : Cash and bank balances

Cash in hand		40,310	
Cash at bank		2,02,974	
		2,43,284	

Schedule – 7 : Advances and other assets

Agent balance		3,60,000	
Outstanding Premiums		29,730	
		3,89,730	

Schedule – 8 : Provisions

Proposed dividend		1,44,000	
Provision for Taxation		5,00,000	
		6,44,000	

Problem 8 :

From the following balance as on 31.3.2024. Prepare the necessary Revenue Account for the Marine Insurance business of **Jalpari insurance company.**

Particulars	Direct Business Rs.	Re-Insurance Rs
A) Premium:		
Received	1,84,00,000	28,80,000
Receivable:		
1st April 2023	7,44,000	1,08,000
31st March 2024	10,48,000	1,02,000
Paid		18,40,000
Payable :		
1st April 2023		1,12,500
31st March 2024		1,86,000
B) Claims		
Paid	94,00,000	12,00,000
Payable:		
1st April 2023	5,00,000	1,14,000
31st March 2024	6,24,000	1,32,000
Received		5,10,000
Receivables:		
1st April 2023		48,000
31st March 2024		69,000

C) Commission		
On insurance accepted	8,80,000	76,000
On reinsurance ceded		78,000

D) Other Expenses and Income :

Salaries Rs.9,60,000;
Rent Rates and taxes Rs.1,16,000;
Postage, Telegrams, Stationary and Printing expenses Rs.1,72,000;
Income tax paid Rs.13,20,000;
Interest, Dividend and Rent, received (net) Rs.5,60,000;
Income Tax deducted at source Rs.1,12,000;
Legal expenses (Including Rs.72,000 incurred for settlement of claims) Rs.1,60,000.

E) Balance of fund on 1st April 2023 was Rs.1,53,80,000 including additional reserve of Rs.13,80,000 Additional reserve is to be maintained at 5% of the net premium in the year.

Solution:

Financial statement of insurance companies

Jalpari Insurance Company. Ltd.

Marine revenue account for the year ended 31st March 2024

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
Claims less reinsurance paid during the year	1,01,62,000		Balance of fund at the beginning of year	1,40,00,000	
Add: Outstanding at the end of the year	6,87,000		Additional reserve	13,80,000	1,53,80,000
	1,08,49,000		Premium less reinsurance received	2,15,78,000	
Less: Outstanding at the beginning of the year	5,66,000	**1,02,83,000**	Less: Reinsurance	19,13,500	1,96,64,500
Commission:			Interest dividend & Rent (Gross)	6,72,000	
on direct business	88,00,000		Less: Income Tax		
On reinsurance accepted	76,000	9,56,000	deducted thereon	1,12,000	5,60,000
Expenses on management		13,36,000	Commission on reinsurance		78,000
Income Tax		13,20,000			
Profit and Loss A/c		11,39,774			
Balance of fund at end of year: Reserve for unexpired risk	1,96,64,500				
Additional reserve	9,83,226	2,06,47,726			
		3,56,82,500			**3,56,82,500**

Working Notes:

A) Premium Income		**Rs.**
Received		
Direct		1,84,00,000
Reinsurance		28,80,000
		2,12,80,000
Receivable:		
Direct		10,48,000
Reinsurance		1,02,000
		2,24,30,000
Less: Due on 1st April 2023		
Direct	7,44,000	
Reinsurance	1,08,000	8,52,000
		2,15,78,000
B) Reinsurance Premium		
Paid		18,40,000
Add: Due		1,86,000
		20,26,000
Less: Payable on 1st April 2023		1,12,500
		19,13,500
C) Claims:		
Paid:		
Direct		94,00,000
Reinsurance		12,00,000
Legal Expenditure		72,000
		1,07,12,000
Less: Reinsurance received		5,10,000
		1,01,62,000
D) Claims outstanding on 31.03.2024		
Direct		6,24,000
Reinsurance		1,32,000
		7,56,000
Less: Due from reinsurance		69,000
		6,87,000
E) Claims due on 01.04.2023		
Direct		5,00,000

Reinsurance	1,14,000
	6,14,000
Less: Due from reinsurance	48,000
	5,76,000
F) Expenses of Management:	
Salaries	9,60,000
Rent, rates and taxes etc.	1,16,000
Postage and Printing etc.	1,72,000
Legal charges	88,000
	13,36,000

Form B–RA (Prescribed by IRDA)

Name of the insurer : **Jalpari Insurance Company. Ltd.**

Registration No. and date of Registration with IRDA.

Marine Revenue Account for the year ended on 31st March 2024

Particulars	Schedule	Current Years Rs.	Previous Years Rs.
A) Premiums Earned (Net)	1	1,96,64,500	
Charge in provision for unexpired risk		(–) 52,67,726	
Total (A)		**1,43,96,774**	
B) Claims Incurred (Net)	2	1,02,83,000	
Commission	3	8,78,000	
Operating expenses related to insurance business	4	13,36,000	
Total (B)		**1,24,97,000**	
C) Operating profit from marine – Insurance business (C = A – B)		**18,99,774**	

Note:	**Current Years Rs.**
i) Unexpired risk reserve as on 31.03.2024	
100% of premium income	1,96,64,500
Additional Reserve	9,83,226
	2,06,47,726
Change in Provision for unexpired risk:	
Opening	1,53,80,000
Closing	2,06,47,726
Provision made during the year	(–) 52,67,726

Form B–PL (Prescribed by IRDA)

Name of the insurer: **Jalpari Insurance Company. Ltd.**

Registration No. and date of Registration with IRDA…..

Profit & Loss Account for the year ended 31st March 2024

Particulars	Current Years Rs.
A) Operating Profit (Loss)	
Marine Insurance	18,99,774
Income from Investment :	
Interest Dividend & Rent–Gross	6,72,000
Total (A)	**25,71,774**
B) Expenses	Nil
Total (B)	**Nil**
C) **Operating Profit (C = A–B)**	**25,71,774**
Provision for taxation	14,32,000
Profit after tax	**11,39,774**
Profit available for appropriation	11,39,774
Balance carried forward to Balance Sheet	**11,39,774**

Note : It has been assumed that total income tax liability is **Rs. 14,32,000** (Rs.13,20,000 + 1,12,000)

: Schedules forming Part of Revenue Account :

Schedule – 1 Premium earned (net)

Particulars	Current Year Rs.	Previous Year Rs.
Premium from direct business written	1,87,04,000	
Add – Premium on reinsurance accepted	28,74,000	
	2,15,78,000	
Less – Premium on reinsurance ceded	19,13,500	
	1,96,64,500	

Schedule – 2 Claims Incurred (net)

Particulars	Rs.	Rs.
Claims paid-Direct	95,96,000	
Add – Reinsurance Accepted	12,18,000	
Less – Reinsurance ceded	5,31,000	
Net Claims paid	**1,02,83,000**	

Schedule – 3 Commission

Particulars	Rs.	Rs.
Commission Paid		
Direct	8,80,000	
Add – Reinsurance Accepted	76,000	
	9,56,000	
Less – Reinsurance Ceded	78,000	
Net Commission	**8,78,000**	

Schedule – 4 Operating expenses

Particulars	Rs.	Rs.
Operating expenses related to insurance business		
Employees remuneration and welfare benefits	9,60,000	
Rents, Rates and Taxes	1,16,000	
Legal and Professional Charges	88,000	
Other Postage and Printing	1,72,000	
	13,36,000	

Working Notes :

1) Premium Income

Direct	1,84,00,000
Received	10,48,000
Add: Receivable	**1,94,48,000**
Less: Due on 1st April 2023	7,44,000
Direct	**1,87,04,000**

2) Re-insurance premium (accepted)

Received	28,80,000
Add: Receivable	1,02,000
	29,82,000

Less: Dues on 1st April 2023	1,08,000
	28,74,000
3) Claims:	
Direct	
Paid	94,00,000
Add: Legal expenditure	72,000
Add: Outstanding on 31.03.2024	6,24,000
Less: Outstanding on 01.04.2023	5,00,000
	95,96,000
4) Re-insurance claim (accepted)	
Paid	12,00,000
Add: Outstanding on 31.03.2024	1,32,000
Less: Outstanding on 01.04.2023	1,14,000
	12,18,000
5) Re-insurance claim (ceded)	
Received	5,10,000
Add: Outstanding on 31.03.2024	69,000
Less: Outstanding on 01.04.2023	48,000
	5,31,000
6) Re-insurance Premium (ceded)	
Paid	18,40,000
Add: Payable as on 31.03.2024	1,86,000
	20,26,000
Less : Payable as on 01.04.2023	1,12,500
	19,13,500

: EXERCISES :

Answer the following in brief :

1. Explain different types of General insurance.
2. Explain in short, the following principles and term of insurance business:
   (i) Principle of Indemnity
   (ii) Insurable interest;
3. Write short note on :
   (i) Unexpired Risks Reserve
   (ii) Write short note on Re-insurance.
4. Which accounts are required to be maintained by insurance companies ?
5. Write a note on Insurance Regulatory and Development Authority.
6. How to create reserve for unexpired risk ?

7. Prepare following formats :
   (i) FORM B-RA
   (ii) FORM B-PL
   (iii) FORM B-BS

: SOLVE :

Problem 1 :

Domestic Assurance Co. Ltd. received Rs. 11,80,000 as premium on new policies and Rs. 2,40,000 as renewal premium. The company received Rs. 1,80,000 towards reinsurance accepted and paid Rs. 1,40,000 towards reinsurance ceded. How much will be credited to Revenue Account towards premium?

Problem 2 :

From the following figures appearing in the books of Fire Insurance division of a **General Insurance Company**, show the amount of claims as it would appear in the Revenue Account for the year ended 31st March 2024.

Particulars	Direct Business	Re-insurance
Claims paid during the year	93,40,000	14,00,000
Claims Payable –		
1st April, 2023	15,26,000	1,74,000
31st March, 2024	16,24,000	1,06,000
Claims received	4,60,000	---
Claims Receivable -		
1st April, 2023	1,30,000	---
31st March, 2024	---	2,26,000
Expenses of Management	4,60,000	
(Includes 70,000 Surveyor's fee and 90,000 Legal expenses for settlement of claims)		

Problem 3 :

Prepare Revenue Account in proper form for the year ended 31st March, 2024, from the following particulars related to **Krishna General Insurance Co.**

Particulars	Direct Business	Re-insurance
Premiums :		
Amount received	30,00,000	2,40,000
Receivable at the beginning	1,80,000	24,000
Receivable at the end	----	9,107
Amount paid	2,40,000	3,60,000
Payable at the beginning	----	30,000
Payable at the end	----	42,000
Claims :		
Amount paid	18,00,000	1,80,000
Payable at the beginning	60,000	12,000
Payable at the end	1,20,000	18,000
Amount Recovered	----	1,20,000
Receivable at the beginning	----	18,000
Receivable at the end	----	12,000
Commission :		
Amount Paid	72,000	10,800
Amount Received	----	14,400

Additional Information :

a) Interest, dividend and rent received 30,000, Income - tax in respect of above 6,000

b) Management expenses including 12,000 related to legal expenses regarding claims 1,32,000

c) Provision for income - tax existing at the beginning of the year was 1,95,000, the income - tax actually paid during the year 1,68,000 and the provision necessary at the year end 2,07,000.

d) The net premium income of the company during the year 2020-21 was 24,00,000 on which reserve for unexpired risk @ 50% and additional reserve @ 7.5% was created. This year, the balance to be carried forward is 50% of net premium on reserve for unexpired risk and 5% on additional reserve.

Problem 4 :

Prepare the Fire Insurance Revenue A/c as per IRDA regulations for the year ended 31st March, 2024 from the following details :

Claims paid	4,90,000
Legal expenses regarding claims	10,000
Premiums received	13,00,000
Re-insurance premium paid	1,00,000
Commission	3,00,000
Expenses of Management	2,00,000
Provision against unexpired risk on 1st April, 2023	5,50,000
Claims unpaid on 1st April, 2023	50,000
Claims unpaid on 31st March, 2024	80,000

Problem 5 :

From the following information as on 31st March, 2024, prepare the Revenue Accounts of **Samudra Bima Co. Ltd.** engaged in Marine Insurance Business. Prepare Revenue Account of Marine Insurance Business in the prescribed form as per

Particulars	Direct Business	Re-insurance
I. Premium:		
Received	24,00,000	3,60,000
Receivable - 1st April, 2023	1,20,000	21,000
- 31st March, 2024	1,80,000	28,000
Premium paid	2,40,000	—
Payable - 1st April, 2023	—	20,000
- 31st March, 2024	—	42,000
II. Claims:		
Paid	16,50,000	1,25,000
Payable - 1st April, 2023	95,000	13,000
- 31st March, 2024	1,75,000	22,000
Received	—	1,00,000
Receivable - 1st April, 2023	—	9,000
- 31st March, 2024	—	12,000
III. Commission:		
On Insurance accepted	1,50,000	11,000
On Insurance ceded	—	14,000

Other expenses and income :

Salaries 2,60,000; Rent, Rates and Taxes 18,000; Printing and Stationery 23,000; Indian Income Tax paid 2,40,000; Interest, Dividend and Rent received (net) 1,15,500; Income Tax deducted at source 24,500; Legal Expenses (Inclusive of 20,000 in connection with the settlement

of claims) 60,000; Bad Debts 5,000; Double Income Tax refund 12,000; Profit on Sale of Motor Car 5,000.

Balance of Fund on 1st April, 2023 was 26,50,000 including Additional Reserve of 3,25,000. Additional Reserve has to be maintained at 5% of the net premium of the year.

Problem 6 :

Prepare a Revenue Account for Fire Business from the following details for the year 2024 :

Reserve for unexpired risk on 1.1.2024 @ 50%	1,80,000
Additional Reserve	36,000
Est on 31.12.2024	42,000
Claims paid	3,65,000
Legal expenses	6,000
Reinsurance recoveries	32,000
Medical expenses	4,000
Bad Debts	800
Premiums recovered	4,86,000
Premiums on re-insurance accepted	32,000
Premiums on re-insurance ceded	43,000
Commission on direct business	48,600
Commission on reinsurance accepted	1,600
Commission on reinsurance ceded	2,150
Expenses of management	90,000
Interest, dividend and rent	24,000
Profit on sale of investments	3,000

Create reserve on 31 12.2023 to the same extent as on 1.1.2023.

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Notes...

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