CORPORATE ACCOUNTING.

B COM

(2019 Admission)

III SEMESTER

CORE COURSE (BCM3 B04)

UNIVERSITY OF CALICUT

School of Distance Education

Calicut University P.O. Malappuram, Kerala,

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UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

Study Material

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CORPORATE ACCOUNTING

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MODULE 1

REDEMPTION OF DEBENTURES

A company raises its capital by means of issue of shares. But the funds raised by the issue of shares are seldom adequate to meet their long term financial needs of a company. Hence, most companies turn to raising long-term funds also through debentures which are issued either through the route of private placement or by offering the same to the public. The finances raised through debentures are also known as long-term debt. This chapter deals with the accounting treatment of issue and redemption of debentures and other related aspects

Redemption of Debentures

Redemption of debentures refers to extinguishing or discharging the liability on account of debentures in accordance with the terms of issue. In other words redemption of debentures means repayment of the amount of debentures by the company.

Treatment of Discount or loss on issue of debentures

Writing-off Discount/Loss on Issue of Debentures The discount/loss on issue of debentures is a capital loss or a fictitious asset and, therefore, must be written-off during the life time of debentures. The amount of discount/loss on issue of debentures should normally not be written-off in the year of issue itself since the benefit of the debentures would accrue to the company till their redemption. The discount/loss on it is, therefore, treated as capital loss. The discount may be charged to Securities Premium A/c or may be written-off over 3 to 5 years through statement of profit and loss as per guidelines issued by ICAI. Section 78 of the Companies Act, 1956 also permits the utilization of 'Securities Premium Account' and other capital profits for writing-off the discount/loss on issue of debentures. In case, however, there are no capital profits or if the capital profits are not adequate, the amount of such discount/ loss can be written-off against the revenue profits every year by passing the following journal entry.

Statement of Profit and Loss Dr.

To Discount/Loss on Issue of Debentures A/c

(Discount/loss on issue of debentures written-off)

Illustration 1

A Ltd. Company has issued ` 1,00,000, 9% debentures at a discount of 6%. These debentures are to be redeemed equally, spread over 5 annual installments. Show Discount on issue of debentures account for five years.

Solution:

Books of A Ltd. Discount on Issue of Debentures Account

Date	*Particulars*	*Amount* `	*Date*	*Particulars*	*Amount* `
Ist year	Debenture	6,000	Ist year	Statement of Profit & Loss	2,000
				Balance c/d	4,000
		6,000			**6,000**
		4,000			1,600
					2,400
IInd year	Balance b/d	**4,000**	IInd year		**4,000**
		2,400		Statement of Profit & Loss	1,200
				Balance c/d	1,200
		2,400			**2,400**
IIIrd year			IIIrd year		
	Balance b/d	1,200		Statement of Profit & Loss	800
				Balance c/d	400
		1,200			**1,200**

IVth year		400	IVth year		400
		400			**400**
Vth year	Balance b/d		Vth year	Statement of Profit & Loss Balance c/d	
	Balance b/d			Statement of Profit & Loss	

Workings Notes:

Total discount on the issue of debentures = 100000 x $\frac{6}{100}$ = 6000

Amount of discount to be written-off is determined as follows:

Year	Amount (Rs.)	Ratio	Amount (Rs)
1	1,00,000	5	5/15 6,000 = 2,000
2	80,000	4	4/15 6,000 = 1,600
3	60,000	3	3/15 6,000 = 1,200
4	40,000	2	2/15 6,000 = 800
5	20,000	1	1/15 6,000 = 400
		15	

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

The discount or loss on issue of debentures is shown under 'assets' under the heading "other current /non current assets' as amortised expenses till it is written off. The amount which is to be written off in next 12 months should be recorded as unamortized expenses under the heading " other Current Assets". The balancesheet amount which is to be written off after that period should be shown as un amortised expenses under the heading " other non current assets " in the balancesheet.

Sources of redemption of debentures

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

Methods of redeeming debentures

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

Redemption of debenture by lump-sum method

Under this method the entire amount of debentures is redeemed at the end of the specified period (expiry) as per the terms of the issue. In other words, the amount of debentures is paid in one lump-sum to the debenture holders according to the conditions of the issue at the end of the life of the debentures.

Redemption out of capital

When debentures are redeemed out of current assets or sources of the company, it is known as redemption out of capital. In this method, the debenture redemption reserve Account (DRR) is not created. In short, when profits are not used in the redemption of debentures, then it is said to be redemption out of capital.

Journal entries for redemption of debentures out of capital

a. When debentures are redeemed at par

Debenture a/c Dr

Debenture holders account

(Amount due to debenture holders)

Debenture holders a/c Dr

Bank

(Payment to debenture holders)

b. When debenture are redeemed at premium

Debenture a/c Dr

Premium on redemption a/c Dr

Debenture holders a/c

(Amount due to debenture holders)

Securities premium reserve/general reserve /p/l a/c Dr

Premium on redemption a/c

(Premium on redemption provided out of securities premium reserve or general reserve or p/l a/c)

Debenture holders a/c Dr

Bank

(Payment due to debenture holders)

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

Debenture A/c Dr.

Debenture holders a/c

Capital reserve a/c

(Amount due to debenture holders on redemption after deducting the discount)

Debenture holders a/c Dr

Bank a/c

(Payment due to debenture holders)

Redemption of Debentures of out of profit/surplus

When sufficient profits are transferred from Statement of Profit and Loss to the Debenture Redemption Reserve Account at the time of redemption of debentures, such redemption is said to be out of profits. This is called redemption out of profit because it reduces the amount of profit available for dividend. The amount thus saved because of non-payment of dividends is utilized for the redemption of debentures. This method does not affect working capital of the company.

As per Section 71(4) of the Companies Act 2013, the new provisions regarding redemption of debentures out of profits are:-

1. The company shall create Debenture Redemption Reserve equivalent to at least 25% of the face value of debentures before the debenture redemption commences.

2. The above Debenture Redemption Reserve shall be created out of the profits available for payment of dividend by the company. Thus, the dividend gets reduced because profits are utilised in redemption of debentures.

3. Every company required to create Debenture Redemption Reserve shall on or before the 30th day of April in each year, investor deposit a sum which shall

not be less than 15 per cent of the amount of its debentures maturing during the year ending on the 31st March of the next year, in any one or more of the following methods:

a. in deposits with any scheduled bank, free from any charge or lien;

b. in unencumbered securities of the Central Government or of any State Government

c. in unencumbered securities mentioned in sub-clauses (a) to (d) and (e) of Section 20 of the Indian Trusts Act, 1882;

d. in unencumbered bonds issued by any other company which is notified under sub- clause (f) of Section 20 of the Indian Trusts Act, 1882,

e. the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above :

Provided that the amount remaining invested or deposited shall not at any time fall below 15 per cent of the amount of the debentures maturing during the year ending on the 31st March of that year;

4. In case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue.

5. The amount credited to the Debenture Redemption Reserve shall not be utilised by the company for any purpose other than redemption of debentures,

Accounting Treatment

The following journal entries are passed in case of redemption of debentures

1. For investing the amount so appropriated in the debenture redemption investment (ie, at least 15% of the amount of debentures to be redeemed by 31st March of the next year)

Debenture redemption investment A/c Dr.

To Bank A/c

(Amount Invested In Debenture Redemption Investment A/C As Statutorily Required)

2. For receiving interest on debenture redemption investment account

Bank A/c Dr.

To Interest on Debenture Redemption Investment A/c

(*Received interest on debenture redemption investment*)

3. For realising the amount invested in debenture redemption investment Alc

Bank A/C Dr.

To Debenture Redemption Investment A/C

To Debenture Redemption Reserve A/c

(*Amount realised on sale of investment and the profit (if there is profit) transferred to DRR Account*)

4. For creation of Debenture Redemption Reserve (DRR)

Statement of Profit and Loss (Surplus) Dr.

To Debenture Redemption Reserve A/C

(Amount transferred to DRR Account)

5. For making payment to the debenture holders

Entries have already been given After redemption of all debentures the balance of DRR A/c should be transferred to General Reserve Account. The entry is

Debenture Redemption Reserve A/C Dr

To General Reserve A/c

(*Balance of DRR A/c transferred to General Reserve A/c)*

Redemption of debentures by annual drawings or installments

When redemption of debentures is made by annual installments (drawings) then it is called as redemption of debentures by annual installments (drawings). This method is also called "lottery method" of redeeming debentures. There are two methods of redemption of debentures by annual installments. They are:-

1. **Redemption of Debentures out of Capital**: When the debentures are redeemed out of current sources of the company, it is known as redemption of debentures out of capital. It adversely affects the working capital of the company. Important Note: According to the Companies (shares Capital and Debentures) Rules, 2014, it is compulsory to transfer an amount equal to at least 25% of the total amount of redeemable debentures to Debenture Redemption Reserve Account before starting the redemption of debentures. Thus, redemption of debentures, fully out of capital, is not possible now.

2. **Redemption of Debentures out of Profits**: When the amount payable is charged out of surplus from profit and loss statement before the redemption of debentures, then it is called redemption of debentures out of profits. Important Note: If it is not specified whether debentures are redeemed out of capital or out of

profits, then it should always be supposed to be out of profits.

Illustration 2

A ltd, issued 4000, 11% debentures of Rs. 100 each on April 1, 2016 at a discount of 5% redeemable at premium of 10% in equal annual drawings in 4 years out of capital.

Give journal entries both at the time of issue and redemption of debentures. (ignore the treatment of los on issue of debenture sand interest)

1/4/16	Bank a/c Dr	380000	
	Loss on issue of debentures a/c	60000	
	11% debentures a/c		400000
	Premium on redemption of debentures a/c		40000
	(Issue of debentures at 5% discount and redeemable at premium of 10%)		
	Debenture redemption investment a/c Dr	15000	
	Bank A/c		15000
	(investment made in government securities equal to		

	15% the face of value of debentures to be redeemed)		
30/4/16	Statement of profit and loss (surplus) Debenture redemption reserve a/c (creation of DRR @ 25% of face value of debentures)	100000	100000
31/3/17	11%Debentures A/C Dr Premium on Redemption of Debentures A/C Dr. To Debenture holders A/C (Amount due on redemption of 1/4th debentures)	100000 10000	110000
	Debenture holders' A/C Dr. To Bank A/C (Redemption of debentures)	110000	110000
	11% Debentures A/C Dr. Premium on Redemption of Debentures A/C Dr.	110000 10000	

31/3/18	To Debenture holders A/c (Amount due on redemption of 1/4" debentures)		110000
	Debenture holders A/c Dr. To Bank A/C (Redemption of debentures)	110000	110000
31/3/19	11% Debentures A/C Dr. Premium on Redemption of Debentures A/c Dr. To Debenture holders A/C (Amount due on redemption of 1/4th debentures)	100000 10000	110000
	Debenture holders A/c Dr. To Bank A/c (Redemption of debentures)	110000	110000
31/3/20	Bank A/C Dr. To Debentures Redemption Investment A/c (Debenture redemption investment encashed)	15000	15000

	11% Debentures A/C Dr. Premium on Redemption of Debentures A/C Dr. To Debenture holders' A/c (Amount due on redemption of 1/4th debentures)	100000 10000	110000
	Debenture holders A/C Dr. To Bank A/C (Redemption of debentures)	110000	110000
	Debenture Redemption Reserve A/c To General Reserve A/C (DRR A/c closed by transferring it to General Reserve)	100000	100000

Redemption by Sinking Fund

Debentures may be redeemed by creating a sinking fund. Under this method of redemption, every year a part of the profit (fixed instalment) is set aside and sinking fund is created. The sinking fund (also called debenture redemption fund) is invested in outside securities (like shares, debentures, bonds of other companies or corporations). The interest received on such investments along with annual amount set aside from profit will again be invested as usual. This process continues till the date of redemption of debentures. The investment will be sold and the cash thus received will be used to repay the debentures. The working capital of the company will not be affected as the cash is separately made available for redemption. Under this method of redemption sinking fund account, and sinking fund investment account will be opened. After the debentures have been redeemed, the balance of sinking fund account is transferred to general reserve.

Merits of Sinking Fund Method

The chief merits of sinking fund method are:

1. As the funds required for redemption accumulates outside the business, liquid cash is available at the time of redemption. Hence debentures can be repaid without disturbing the financial position of the company

2. in the interim period, the security may be pledged or sold out to get liquid cash in case of any emergency

Demerits of Sinking Fund Method

The demerits of the method are:

1. There may be losses in realising the investments

2. The rate of returns on investments may be less than the earning rate of the business.

3. As a part of the profit is set aside for creating a sinking fund, shareholders get a comparatively low rate of dividend during the currency of debentures.

Insurance policy method

This is an alternative to sinking fund method. Under the sinking fund method, annual contribution is invested in outside securities. Under the insurance policy method, an insurance policy is purchased by paying annual premium. Such policy will mature on the date when the debentures become redeemable. The total premium paid will amount to less than the policy amount, but the policy amount will be equal to the amount required for redemption. Thus the difference between the policy amount and premium paid will be interest on premiums.

Redemption by Purchase of Own Debentures from the Open Market

A company can buy its own debentures if it is authorised by its Articles. When a company purchases own debentures it will constitute redemption of debentures. This is because the old debentures are withdrawn or taken back from the debenture holders by paying them either at par or at premium. The purchase of debentures may be paid from sinking fund or out of profit or out of capital. This method is used in the following circumstances:

(a) When the rate of interest on debentures is higher than the market interest rate.

(b) When the market price of debentures falls below the face value or redemption price.

(c) When sufficient amount is available in surplus fund.

Advantages

Redemption by purchase of debentures has the following advantages:

1. The company gets profit because the purchase is made when the market price of debentures is the lowest.

2. It reduces the burden of loan.

3. It reduces the interest burden.

4. It avoids the payment of premium on redemption

Purposes of Purchase of Own Debentures

The debentures may be purchased either for (a) Immediate cancellation, or for (b) Investment.

Purchase of Own Debentures for Immediate Cancellation

A company may purchase its debentures for the purpose of immediate cancellation. This results in reduction of debenture liability to the extent of par value of debentures cancelled. When the debentures are cancelled immediately, generally there may be profit to the company. This is because the debentures are purchased from the open market at lower price than the face value of the debentures. Besides, if debentures are redeemable at premium, the company need not pay this redemption premium. This is a gain to the company. Both gains should be transferred to profit on purchase of debenture a/c. no interest is required to be paid on the debentures purchased and cancelled after the date of cancellation.

Accounting treatment

1. When debentures (redeemable at par) are purchased at par or at nominal value

   Debenture a/c Dr.

   To Bank A/c

2. When debentures (redeemable at premium) are purchased at par or nominal value

   Debenture A/c Dr.

Premium on redemption of Debentures A/c Dr.

To Bank

To Profit on redemption on debentures

Profit on redemption or purchase of debentures is a capital profit. Hence, it should be transferred to capital reserve. The entry is:

Profit on Redemption of Debentures A/c Dr

To Capital Reserve

Note: when there is sinking fund, the profit on redemption of debentures a/c should be credited to sinking fund a/c (and not to capital reserve a/c)

3. When debentures (redeemable at par) are purchased at a discount (ie at less than nominal value)

a. Debenture a/c Dr

To bank a/c

To profit on purchase /redemption alc

b. Profit on purchase/redemption a/c Dr

To capital reserve

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

a. Debentures a/c

To bank

To profit on redemption or purchase of debentures a/c

b. Profit on redemption (or purchase) of debentures a/c

To capital reserve

5. When debentures (redeemable at par) are purchased at more than nominal (ie, at premium) on the due date of interest.

a. Debenture a/c Dr

Loss on redemption/ purchase of debentures a/c Dr

To bank

6. When debentures (redeemable at premium) are purchased at more than nominal value ie, at premium on the due date of interest.

Expenses on purchase of Debentures

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

Purchase of debentures for investment (own debentures)

A company may purchase its own debentures for investment (not for immediate cancellation). The debentures so purchased are kept alive (debenture liability remains the same) and are treated as investments. In the future they may be cancelled or reissued. After cancellation, the debentures stand redeemed. This means that the debenture liability is reduced. Debentures when purchased for investment are popularly called own debentures.

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

Accounting treatment

a. On purchase of own debentures

Own debentures a/c Dr

To bank a/c

b. On cancellation of own debentures

Debentures a/c Dr

To own debentures

To profit on redemption of debentures

c. On transfer of profit on redemption

Profit on redemption of debentures a/c Dr

To capital reserve

d. On reissue of own debentures

Bank a/c Dr

Loss on reissue of debentures a/c Dr.

To own debentures a/c

To profit on reissue of debentures

Interest on Own Debentures

If own debentures are not cancelled immediately after the purchase of debentures, interest becomes due on such debentures also. The company will pay interest only to outsiders (debenture holders). The interest on own debentures will be retained by the company and this will be credited to Interest on Own Debentures Account (income).

The required journal entry is:

Interest on Debentures A/c Dr. (Total interest)

To Bank A/c(Payable to outsiders)

To Interest on Own Debentures (Due to the company)

When there is no Sinking Fund, the total interest on debentures (expense) is debited to Profit or Loss and the

"Interest on Own Debentures" (income) is credited to Statement of Statement of Profit or Loss. The net debit represents the interest payable to outsiders. However, when there is sinking fund, the "Interest on Own Debentures" is credited to Sinking Fund A/c instead of Statement of Profit or Loss.

Ex-Interest and Cum-Interest Quotations

Generally interest on debentures is paid on fixed dates, i.e., half yearly or yearly. However, the company can buy its own debentures from the open market at any time during the year. If a company purchases its own debentures on the date of payment of interest, there will be no problem with regard to interest. This is because the interest accrued upto the date of purchase fie, on the date of payment of interest) will be payable to debenture holder. If the debentures are purchased before the due date of the interest payment, then the problem arises as to whether the price paid includes interest for the expired period or not. Sometimes, the price paid for debentures includes the interest for the expired period. Sometimes, the price paid does not include the interest for the expired period. Expired period means the period from the date of previous payment of Interest upto the date of purchase. The interest portion included in the purchase price constitutes revenue and the balance is capital (actual cost of debentures). The price paid for the debentures depends on the type of quotation. There are two types of quotations - cum-interest quotation and ex-interest quotation.

Cum-interest Quotation

If the purchase price includes interest for the period from previous date of interest to the date of purchase, it is called cum interest price ('Cum' is a Latin word which means 'with i.e., cumulative or inclusive of interest). It means the price paid by the company for the debentures includes the interest for the expired period also.

Journal Entries

At the time of recording the purchase of own debentures, only the price paid towards the cost of debentures must be debited to the own debentures account. The interest must be debited to interest account.

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

Debentures A/C Dr. (Nominal value of debentures)

Interest on debentures a/c Dr

To bank

To profit on redemption of debentures (profit on redemption)

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

Own Debentures A/C Dr. (Cost of debentures)

Interest on Debentures A/C Dr. (Interest for the expired period)

To Bank A/C (Amount paid)

In this case, Own Debentures A/c should be debited with cost of debentures (and not nominal value of debentures).

Cost of Own Debentures = Price paid - Interest for the expired period.

Note: When own debentures are purchased as investment, there will be no profit or loss on redemption of debentures. Profit or loss on redemption will arise at the time of cancellation of debentures.

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

Debentures A/C Dr (Nominal value)

To Own Debentures A/c (Cost, i.e., price paid minus interest)

To Profit on Redemption of Debentures (Balance)

Ex-interest Quotation

If the purchase price excludes the interest for the expired period, it is called Ex-interest price ('Ex' is also a Latin word which means 'without', i.e., exclusive of interest). This means that the purchase price of debentures does not include the interest for the expired period. This further means that the purchaser (company) has to pay, in addition, the interest for the expired period. Thus,

Cost of Own Debentures = Price paid

Journal Entries

a. When debentures are purchased for immediate cancellation

Debentures A/C Dr. (Nominal value of debentures)
Interest on Debentures A/c Dr. (Interest for the expired period)
To Bank A/C (Total amount paid, i.e.,cost of debentures + interest)
To Profit on Redemption of Debentures (Balancing figure)

b. When debentures are purchased as investment

Own Debentures A/C Dr.
(Cost of debentures, i.e., Price paid)
Interest on Debentures A/C Dr. (Interest for the expired period)

To bank (total)

c. When own debentures purchased for investment are cancelled in future

Debenture a/c Dr (nominal value)

To own debenture (price paid)

To profit on redemption of debentures (balance)

Illustration

A ltd purchases its own 12% debentures of Rs. 30000 at Rs. 98 on 01/04/2020. Interest is payable on 30th june and 31st December every year. Give entries n the books of A ltd. If the quotation is (i) cum-interest, and (ii) ex-interest. The company closes its books on 31st December.

Solution

(i)	Cum-interest Own debentures A/c Dr Interest on debentures A/c Dr To bank A/c (300x98) (purchase of own debentures at Rs. 98 cum interest)	 **28500** **900**	 **29400**
(ii)	Ex-interest Own debentures A/c Interest on Debentures To bank A/c (29400+900)		

Working note

1. Cum-interest

Total Price paid 300*98 = 29400.

Less: interest on 30000 *12/100 x12/100 = 900

Cost 28500

2. Ex-interest price paid for debentures

300*98 = 29400

Add: int. for 3 months from 1.1.20 to

31.3.20 (30000*12/100*3/12) = 900

Total price 30300

Redemption by Conversion

This is another method of redeeming debentures. Redemption by conversion means redeeming the debentures by converting them into new debentures and/or shares within a stipulated period at the option of the debenture holders. Under this method, a company gives
an option to debenture holders at the time of issue of debentures that after a certain period they can convert their debentures into shares or new debentures. The redemption by conversion of debentures can be made

either at par or at premium but not at discount. However, the new debentures may be issued either at par, or at premium or at discount. New shares can be issued at par or at premium, but not at discount.

Advantages of redemption by conversion

A. Advantages to company

a) Any financial source is not needed for redemption.

b) It has no adverse effect on working capital of the company.

c) Creation of debenture redemption reserve is not required by the company.

d) Investment is not needed for redemption.

B. Advantages to debenture holders

a) The debenture holders can participate in profits and management of the company

b) The conversion depends upon the will of debenture holders, not forcibly.

c) Debenture holders accept this type of redemption in hope of higher interest/dividend

Accounting treatment

A. At the time of conversion, the following journal entries are to be passed.

1. Debenture a/c Dr

To Debenture holders

(transfer of debenture to debenture holders)

2. Debenture A/c Dr

To new debentures A/c/ Share capital

(Issue of new debenture or share at par)

B. When debentures are redeemed at premium at maturity and new shares/debentures are issued at par.

1. Debenture A/c Dr

Premium on redemption of debenture A/c Dr.

To debenture holders A/c

(Amount due to debenture holders and premium due)

2. Debenture A/c Dr.

To new debenture a/c / share capital a/c

(Issue of new debentures or shares at par)

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

1. Debentures a/c Dr

To debenture holders a/c

(Amount due to debenture holders on redemption)

2. Debenture holders a/c Dr

To Equity share capital / new debenture a/'c

To securities premium reserve a/c

(Issue of new debentures or shares at premium)

D. When debenture are redeemed (by conversion) at premium at maturity and new shares/ debentures are issued at premium.\

1. Debentures a/c Dr

Premium on redemption of debentures a/c

To debenture holders a/c

(Amount due to debenture holders on redemption)

2. Debenture holders a/c

To Equity share capital/ new debenture a/c

To securities premium reserve a/c

(Issue of new debentures or shares at premium)

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

1. Debenture a/c Dr.

To debenture holders a/c

(Amount due to debenture holders on redemption)

2. Debenture holders A/c Dr.

Discount on issue of debenture A/c Dr

To new debenture a/c

(Issue of new debenture at discount)

F. When debentures originally issued at discount are redeemed by conversion:

Debentures may by redeemed either before maturity or maturity

a. Conversion before maturity

When debentures originally issued at discount are converted before maturity, the number of shares or debentures to be issued are calculated on the basis of net proceeds.

Journal entries

1. For amount due to debenture holders

Debenture a/c Dr.

To discount on issue of debentures a/c

To statement of profit and loss

To Debenture holders a/c

2. For issue of shares or debentures at par

Debenture holders a/c Dr

To Equity share capital/preference share capital/debentures

3. For issue of shares or debentures at premium

Debenture holders a/c

To equity/ preference/ debenture a/c

To securities premium reserve a/c.

b. Conversion of debenture on maturity

If debentures issued at discount are converted into shares or debentures on maturity, then it is converted on the basis of the face value or nominal value and not at its net proceeds. In such cases, the provisions of the companies Act are not violated because the discount on issue of debentures has already been written.

REDEMPTION OF PREFERENCE SHARES

Introduction

A company limited by shares may (if so authorised by its Articles) issue preference shares which are liable to be redeemed within a period not exceeding 20 years from the date of their issue.

Redeemable preference shares are those shares which are repayable after a fixed period or earlier at the discretion of the company. Section 55(i) of the Companies Act, 2013 prohibits the issue of any preference share that is irredeemable.

Redemption of Preference Shares

Redemption means repayment of capital. Thus, redemption of preference share means repayment of preference share capital to the preference shareholders.

Condition of Redemption of Preference Shares (Provisions of the Companies Act – Sec. 55)

According to Section 55 of the Companies Act, 2013, a company limited by shares, If authorized by its Articles, can redeem the preference shares, subject to the following conditions:

a) The shares to be redeemed must be fully paid up.

b) The shares should redeemed either out of profits of the company available for distribution as dividend or out of the proceeds of fresh issue of shares made for the purpose of redemption.

c) Any premium payable on redemption must be provided out of the profits of the company or out of the company's security premium account (from fresh issue r existing balance). Generally, it is provided out of security premium, if there is existing security premium or premium on fresh issue.

d) Where any such shares are redeemed out of profits available for dividend, an amount equal to the nominal value of shares to be redeemed must be transferred out of the divisible profits to Capital Redemption Reserve Account

e) The capital redemption reserve account can be utilised only for the issue of fully paid up bonus shares. This means that partly paid up shares cannot be made fully paid up out of Capital Redemption Reserve A/c.

Methods of Redemption

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

(a) Redemption out of fresh issue of shares.

(b) Redemption out of Profits.

(c) Redemption partly out of fresh issue and partly out of profit.

Redemption out of fresh issue of shares

Under this method the company redeems the preference shares out of the proceeds of fresh issue of shares made for the purpose. In other words, a company issues new shares (equity or preference) and the proceeds from such issue are used for redemption of preference shares. The company may issue fresh shares either at par or at premium.

Accounting Procedure

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

1. First see whether the redeemable preference shares are fully paid up or partly paid up.

If they are partly paid up, pass the following journal entries to make them fully paid.

(a) Preference Share Final Call A/c Dr

To Preference Share Capital A/c

(b) Bank A/c Dr.

To Preference Share Final Call A/c

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

(a) At Par

Bank A/c Dr.

To Share Capital A/c

(b) At Premium

Bank A/c Dr.

To Share Capital A/c

To Security Premium A/c

(c) At Discount

Bank A/c Dr.

Discount on Issue of Share A/c Dr.

To Share Capital A/c

3. Write journal entry for redemption of preference shares

(a) When Redemption is at Par

Redeemable Preference Share Capital A/c Dr.

To Preference Shareholders A/c

(For transferring the capital to preference shareholders)

Preference Shareholders A/c Dr

To Bank A/c

(For paying the amount due to preference shareholders)

(b) When Redemption is at Premium

Security Premium A/c / Profit and Loss A/c Dr.

To Premium on Redemption of Preference Shares A/c

(For providing premium on redemption out of security premium or profit and loss)

Redeemable Preference Share Capital
A/c Dr.

Premium on Redemption of Preference Share A/c Dr.

To Preference Shareholders A/c

(For transferring the capital and premium to preference shareholders)

Preference Shareholders A/c Dr.

To Bank A/c

(For paying the amount due to preference shareholders)

Note: If the preference shares are redeemed at a premium, such premium on redemption is provided out of Security Premium Account(existing or fresh issue) or Profit and Loss or General Reserve.

Illustration 1 (Fresh Issue of Shares at Par and Redemption, at Par)

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

Solution

Face value of share to be redeemed (10,000 x 100) = 10,00,000

Proceeds per new share = Rs. 10

No. of shares to be issued = $\frac{10,00,000}{10}$ = 1,00,000 shares

Illustration (Fresh Issue of Shares at Premium and Redemption at Par)

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

Solution

Value of shares to be redeemed (3,000 x 200) = 6,00,000

Proceeds per new share = Rs. 25

No.of shares to be issued = $\frac{6,00,000}{25}$ = 24,000 shares

Illustration (Fresh Issue of Shares at Discount and Redemption at Par)

C Ltd had 9000,8% Redeemable Preference Shares of `20 each, fully paid up. The company decided to redeem these shares by issue of sufficient No. of equity shares of `.10 each fully paid at 10% discount. Pass necessary journal entries in company's book.

Solution

Value of shares to be redeemed (9,000 x 20) = Rs. 1,80,000

When shares are issued at discount, the proceeds must be sufficient to cover the face value of preference shares to be redeemed, i.e., `1,80,000.

Proceeds per new share = 10 -10% = Rs. 9

No.of Shares = Rs.$\frac{1,80,000}{9}$ = 20,000 shares

or

$\frac{1,80,000}{9} \times \frac{100}{90} = \frac{2,00,000}{10}$ = 20,000 shares

Illustration (Issue of Fresh Equity Shares)

Ahuja Company Ltd. had 5,000, 8% Redeemable Preference Shares of Rs. 100 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of 10 each fully paid up at par. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

Journal Entries in the books of Ahuja Company Ltd.

Date	Particulars		Dr. (`)	Cr. (`)
	Bank A/c To Equity Share Capital A/c (Being the issue of 50,000 Equity Shares of ₹ 10 each at par for the purpose of redemption of preference shares)	Dr.	5,00,000	 5,00,000
	8% Redeemable Preference Share Capital A/c To	Dr.	5,00,000	 5,00,000

	Preference Shareholders A/c (Being the amount payable on redemption of preference shares transferred to Preference Shareholders Account)	Dr.	5,00,000	5,00,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)			

Illustration 5 (Issue of Fresh Equity Shares)

A Ltd. had 10,000, 10% Redeemable Preference Shares of Rs. 100 each, fully paid up. The company decided to redeem these preference shares at par, by issue of sufficient number of equity shares of Rs. 10 each at a premium of Rs. 2 per share as fully paid up. You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

Journal Entries in the books of A Ltd.

Date	Particulars		Dr. (`)	Cr. (`)
	Bank A/c	Dr.	12,00,000	
	To Equity Share Capital A/c			10,00,000
	To Securities Premium A/c			2,00,000
	(Being the issue of 1,00,000 Equity Shares of ₹ 10 each ata premium of 2 per share)			
	10% Redeemable Preference Share Capital A/c	Dr.	10,00,000	
	To Preference Shareholders A/c			10,00,000
	(Being the amount payable on redemption of preference shares transferred to Preference			

	Shareholders			
	Preference Shareholders A/c	Dr.	10,00,000	
	To Bank A/c			10,00,000
	(Being the amount paid on redemption			

Note: Amount required for redemption is `10,00,000. Therefore, face value of equity shares to be issued for this purpose must be equal to `10,00,000. Premium received on new issue cannot be used to finance the redemption.

Illustration (Issue of Fresh Equity Shares)

S India Ltd. had 9,000 10% redeemable Preference Shares of `10 each, fully paid up. The company decided to redeem these preference shares at par by the issue of sufficient number of equity shares of `9 each fully paid up.

You are required to pass necessary Journal Entries including cash transactions in the books of the company.

Solution

In the books of S India Limited Journal

Date	Particulars		Dr. (`)	Cr. (`)
	Bank A/c	Dr.	90,000	
	To Equity Share Capital A/c			90,000
	(Being the issue of 10,000 Equity Shares of ₹ 9 each at par)			
	10% Redeemable Preference Shares Capital A/c	Dr.	90,000	
	To Preference Shareholders A/c			90,000
	(Being the amount payable on redemption of preference sharestransferred to Preference Shareholders A/c)			
	Preference Shareholders A/c	Dr.		
	To Bank A/c		90,000	
	(Being the amount paid on redemption of preference shares)			90,000

Redemption out of Profits

Redeemable preference shares can be redeemed out of the divisible profits. Divisible profits for dividend. The examples of divisible or undistributed profits include general reserve, reserve fund, dividend equalisation reserve, investment fluctuation reserve, insurance fund, workmen's compensation fund, workmen's accident fund, debenture redemption reserve, reserve for contingencies, any other revenue reserve, profit and loss account balance etc.

In the case of shares so redeemed should be transferred from divisible profits to ***Capital Redemption Reserve Account.***

Reasons for Creating CRR

CRR is created for the following reasons:

1) **Capital maintenance:** The important purpose of creating CRR is to maintain the capital intact. By creating CRR, it is possible to protect capital structure and components of capital as it is. If much variation is taking place in components and volume of capital, business activities would be reduced. This causes dissatisfaction among shareholders.

2) **Safeguard of creditors:** The other reason for creating CRR is to protect the interest of creditors. If CRR is not created, the directors may distribute the entire amount of profits by way of dividend. This will adversely affect the interest of creditors.

Note: For calculating CRR, the premium on redemption and security premium are totally ignored.

Accounting Treatment

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

1. When Shares are Redeemed at Par

(a) On transfer to Capital Redemption Reserve A/c

Profit and Loss A/c / General Reserve A/c Dr.

To Capital Redemption Reserve A/c

(b) On the redemption of shares

Preference Share Capital A/c Dr.

To Preference Shareholders A/c

(c) On Payment to Preference Shareholders

Preference Shareholders A/c Dr.

To Bank A/c

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

2. When Shares are Redeemed at Premium

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

(b) On providing Premium Payable on Redemption

Security Premium A/c / Profit & Loss A/c / Capital Reserve A/c Dr.

To Premium on Redemption A/c

(c) On making money due to preference shareholders

Preference Share Capital A/c Dr.

Premium on Redemption A/c Dr.

To Preference Shareholders A/c

(d) On payment to Shareholders

Same entry as under 1(c) above

Illustration (Redemption out of Profits)

The Balance Sheet of Y Ltd. as on 31st March, 2018 is as follows:

Particulars	
EQUITY AND LIABILITIES	
1. Shareholders' funds	
a) Share capital	2,90,000
b) Reserves and Surplus	48,000
2. Current liabilities	
Trade Payables	56,500
Total	3,94,500
ASSETS	
1. Fixed Assets	
Tangible asset	3,45,000
Non-current investments	18,500
2. Current Assets	
Cash and cash equivalents (bank)	31,000
Total	3,94,500

The share capital of the company consists of `50 each equity shares of `2,25,000 and ₹ 100 each Preference shares of `65,000(issued on 1.4.2016). Reserves and Surplus comprises Profit and Loss Account only. In order to facilitate the redemption of preference shares at a premium of 10%, the Company decided:

(a) to sell all the investments for `15,000.

(b) to finance part of redemption from company funds, subject to, leaving a bank balance of `12,000.

(c) to issue minimum equity share of `50 each at a premium of `10 per share to raise the balance of funds required.

You are required to pass: The necessary Journal Entries to record the above transactions and prepare the balance sheet as on completion of the above transactions.

Solution

Journal

Date	Particulars		Dr. (`)	Cr. (`)
	Bank A/c	Dr.	37,500	
	To Share Application A/c			37,500
	(For application money received on 625 shares @ ` 60 per share)			
	Share Application A/c	Dr.	37,500	

	To Equity Share Capital A/c To Securities Premium A/c (For disposition of application money received)			31,250 6,250
	Preference Share Capital A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (For amount payable on redemption of preference shares)	Dr. Dr.	65,000 6,500	71,500
	Profit and Loss A/c To Premium on Redemption of Preference Shares A/c (For writing off premium on redemption out of profits)	Dr.	6,500	6,500
	Bank A/c Profit and Loss A/c (loss on sale) A/c To Investment A/c	Dr. Dr.	15,000 3,500	18,500

	(For sale of investments at a loss of `3,500)			
	Profit and Loss A/c	Dr.	33,750	
	To Capital Redemption Reserve A/c			33,750
	(For transfer to CRR out of divisible profits an amount equivalent to excess of nominal value of preference shares over proceeds (face value of equity shares) i.e., ` 65,000 -`31,250)			
	Preference Shareholders A/c	Dr.	71,500	
	To Bank A/c			71,500
	(For payment of preference shareholders)			

Balance Sheet (after redemption)

Date	Particulars	Notes No.	(₹)
	EQUITY AND LIABILITIES		
1.	Shareholders’ funds		
	a) Share capital	1	2,56,250
	b) Reserves and Surplus	2	44,250

2.	Current liabilities		
	Trade Payables		56,500
	Total		3,57,000
	ASSETS		
1.	Fixed Assets		
	Tangible asset		3,45,000
	Current Assets		
2.	Cash and cash equivalents (bank)	3	12,000
	Total		3,57,000

Notes to accounts

			₹
1.	Share Capital		
	Equity share capital (2,25,000 + 31,250)		2,56,250
2.	Reserves and Surplus		
	Capital Redemption Reserve		33,750
	Profit and Loss Account (48,000 – 6,500 – 3,500 – 33,750)		4,250
	Security Premium		6,250

			44,250
3.	Cash and cash equivalents		
	Balances with banks (31,000 + 37,500 +15,000 – 71,500)		12,000

Working Note:

Calculation of Number of Shares:	`
Amount payable on redemption	71,500
Less: Sale price of investment	(15,000)
	56,500
Less: Available bank balance(31,000-12,000)	(19,000)
Funds from fresh issue	37,500

No. of shares = 37,500/60=625 shares

Illustration 8 (Capitalisation of Undistributed Profits)

The following are the extracts from the Balance Sheet of ABC Ltd. as on 31st December, 2018.

Share capital: 40,000 Equity shares of `10 each fully paid – `4,00,000; 1,000 10% Redeemable preference shares of `100 each fully paid – `1,00,000.

Reserve & Surplus: Capital reserve – `50,000; Securities premium – `50,000; General reserve –`75,000; Profit and Loss Account – ₹ 35,000

On 1st January 2019, the Board of Directors decided to redeem the preference shares at par by utilisation of reserve.*You are required to pass necessary Journal Entries including cash transactions in the books of the company*.

Solution

Journal Entries in the books of ABC Limited

Date	Particulars		Dr. (₹)	Cr. (₹)
2019 Jan1	10% Redeemable Preference Share Capital A/c To Preference Shareholders A/c (Being the amount payable on redemption transferred to Preference Shareholders Account)	Dr.	1,00,000	1,00,000
	Preference Shareholders A/c To Bank A/c (Being the amount paid on redemption of preference shares)	Dr.	1,00,000	1,00,000

	General Reserve A/c	Dr.	75,000	
	Profit & Loss A/c	Dr.	25,000	
	To Capital Redemption Reserve A/c (Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			1,00,000

Note: Securities premium and capital reserve cannot be utilised for transfer to Capital Redemption Reserve.

Illustration (Capitalisation of Undistributed Profits)

B Limited had 3,000, 12% Redeemable Preference Shares of `100 each, fully paid up. The company had to redeem these shares at a premium of 10%. It was decided by the company to issue the following:

i) 25,000 Equity Shares of `10 each at par,

ii) 1,000 14% Debentures of `100 each.

The issue was fully subscribed and all amounts were received in full .The payment was duly made. The company had sufficient profits. Show Journal Entries in the books of the company.

Solution

Journal Entries in the books of B Limited

Date	Particulars		Dr. (`)	Cr. (`)
	Bank A/c	Dr.	2,50,000	
	To Equity Share Capital A/c			2,50,000
	(Being the issue of 25,000 equity shares of ` 10 each at par)			
	Bank A/c	Dr.	1,00,000	
	To 14% Debenture A/c			1,00,000
	(Being the issue of 1,000 Debentures of `100 each)			
	12% Redeemable Preference Share Capital A/c	Dr.	3,00,000	
	Premium on Redemption of Preference Shares A/c	Dr.	30,000	
	To Preference Shareholders A/c			3,30,000
	(Being the amount payable on redemption transferred			

	to Preference Shareholders Account)			
	Preference Shareholders A/c	Dr.	3,30,000	
	To Bank A/c			3,30,000
	(Being the amount paid on redemption of preference shares)			
	Profit & Loss A/c	Dr.	30,000	
	To Premium on Redemption of Preference Shares A/c			30,000
	(Being the adjustment of premium on redemption against Profits & Loss Account)			
	Profit & Loss	Dr.	50,000	
	To Capital Redemption Reserve A/c			50,000
	(Being the amount transferred to Capital Redemption Reserve Account as per the requirement of the Act)			

Working Note:

Amount to be transferred to Capital Redemption Reserve Account

Face value of shares to be redeemed	`3,00,000
Less: Proceeds from new issue	(2,50,000)
Total Balance	₹ 50,000

·Redemption of Partly Paid up Shares

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

(a) Preference shares having calls in arrears should not be redeemed,

(b) It is presumed that calls in arrears are collected and all the preference shares are redeemed.

Illustration10 (Partly Paid up Shares)

The Balance Sheet of ABC Ltd. as at 31st December, 2018 inter alia includes the following:

`50,000, 8% Preference Shares of `100 each, `70 paid up	35,00,000
1,00,000 Equity Shares of ₹ 100 each fully paid up	1,00,00,000
Securities Premium	5,00,000
Capital Redemption Reserve	20,00,000
General Reserve	50,00,000

Under the terms of their issue, the preference shares are redeemable on 31st March, 2019 at 5% premium. In order to finance the redemption, the company makes a rights issue of 50,000 equity shares of `100 each at `110 per share, `20 being payable on application, `35 (including premium) on allotment and the balance on 1st January, 2020. The issue was fully subscribed and allotment made on 1st March, 2019. The money due on allotment were received by 31st March, 2019. The preference shares were redeemed after fulfilling the necessary conditions of Section 55 of the Companies Act, 2013.

You are asked to pass the necessary Journal Entries and show the relevant extracts from the balance sheet as on

31st March, 2019 with the corresponding figures as on 31st December, 2018.

Solution

Journal Entries in the books of ABC Ltd.

Date	Particulars		Dr. (`)	Cr. (`)
	8% Preference Share Final Call A/c	Dr.	15,00,000	
	To 8% Preference Share Capital A/c			15,00,000
	(For final call made on preference shares @ `30 each to make them fully paid up)			
	Bank A/c	Dr.	15,00,000	
	To 8% Preference Share Final Call A/c			15,00,000
	(For receipt of final call money on preference shares)			
	Bank A/c	Dr.	10,00,000	
	To Equity Share Application A/c			10,00,000
	(For receipt of			

	application money on 50,000 equity shares @ ` 20 per share)			
	Equity Share Application A/c	Dr.	10,00,000	
	To Equity Share Capital A/c			10,00,000
	(For capitalisation of application money received)			
	Equity Share Allotment A/c	Dr.	17,50,000	
	To Equity Share Capital A/c			12,50,000
	To Securities Premium A/c			5,00,000
	(For allotment money due on 50,000 equity shares @ ` 35 pershare including a premium of ` 10 per share)			
	Bank A/c	Dr.	17,50,000	
	To Equity Share			17,50,000

	Allotment A/c (For receipt of allotment money on equity shares)			
	8% Preference Share Capital A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (For amount payable to preference shareholders on redemption at 5% premium)	Dr. Dr.	50,00,000 2,50,000	52,50,000
	General Reserve A/c To Premium on Redemption A/c (For writing off premium on redemption of preference shares)	Dr.	2,50,000	2,50,000
	General Reserve A/c To Capital Redemption Reserve	Dr.	27,50,000	27,50,000

	A/c (For transfer of CRR the amount not covered by the proceeds offresh issue of equity shares i.e., `50,00,000 - `10,00,000 - `12,50,000)	Dr.	52,50,000	
	Preference Shareholders A/c To Bank A/c (For amount paid to preference shareholders)			52,50,000

Balance Sheet (extracts)

	Particulars	Notes No.	As at 31.3.2019 (`)	As at 31.12.2018 (`)
	EQUITY AND LIABILITIES			
1.	Shareholders' funds			
	a) Share capital	1	1,22,50,000	1,35,00,000
	b) Reserves and Surplus	2	77,50,000	75,00,000

Notes to accounts

	Particulars	As at 31.3.2019	As at 31.12.2018
1.	**Share Capital**		
	Issued, Subscribed and Paid up:		
	1,00,000 Equity shares of ₹ 100 each fully paid up	1,00,00,000	1,00,00,000
	50,000 Equity shares of ₹ 100 each ₹ 45 paid up	22,50,000	-
	50,000, 8% Preference shares of ₹ 100 each, ₹ 70 called up		35,00,000
		1,22,50,000	**1,35,00,000**
2.	**Reserves and Surplus**		
	Capital Redemption Reserve	47,50,000	20,00,000
	Securities Premium (5,00,000 + 5,00,000)	10,00,000	5,00,000
	General Reserve	20,00,000	50,00,000
		77,50,000	**75,00,000**

Note: Amount received (excluding premium) on fresh issue of shares till the date of redemption should be considered for calculation of proceeds of fresh issue of shares. Thus, proceeds of fresh issue of shares are `22,50,000 (`10,00,000 application money plus `12,50,000 received on allotment towards share capital).

BONUS SHARES

A bonus share is a free share issued without any consideration to an existing shareholder in the ratio of number of shares held by that shareholder.

Issue of Bonus share —

a) Decreases the Reserve & Surplus;

b) Increases the issued capital but does not bring any change in cash flow and net worth.

Way to capitalize profits or reserves:

(a) By paying up amounts unpaid on existing partly paid shares so as to make them fully paid up shares, or

(b) By issuing fully paid bonus shares to the existing members.

Circumstances issuing bonus shares

1. When the company wishes to capitalize its huge undistributed profits or reserve built

2. When the company has not sufficient cash reserves, it issues bonus shares without adversely affecting its working capital.

3. When value of fixed assets of a company exceeds its capital, the difference is capitalized by issuing bonus shares.

4. The company may capitalize its reserve or profits by issuing bonus shares with a view to avoid problems such as demand by the workers for higher wages etc.

5. When market value of shares far exceeds the paid up value of the shares, the company may issue bonus shares.

Sources for fully paid-up bonus shares [Sec 63]

As per Sec 63(1), a company may issue fully paid-up bonus shares to its members out of-

- Its Free Reserves
- Its Securities Premium Account; or
- Its Capital Redemption Reserve Account

Restrictions

No issue of bonus shares shall be made by capitalizing reserves created by the Revaluation of Assets i.e. Revaluation Reserves.

Meaning of Free Reserves: As per Sec 2(43) of the

Companies Act, 2013, “Free Reserves” mean such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend.

Exclusions from Free Reserves:

1) Any amount representing unrealized gains, notional gains or revaluation of assets, where shown as a reserve or otherwise, or

2) Any change in carrying amount of an asset or of a liability recognized in equity, including surplus in Profit and Loss Account on measurement of the Asset or the Liability at Fair Value.

Conditions for issue of fully paid-up bonus shares [SEC 63(2)]

a) A company can issue bonus shares if its Articles expressly authorize to do so.

b) A resolution is required to be passed by the Board of Directors recommending its decision to issue bonus shares.

c) A resolution is required to be passed by the members in the general meeting to approve the Board’s resolution recommending the issue of bonus shares.

Members' resolution —

- Must have an intention to capitalize the profits or reserves, and
- Must mention the amount of profits or reserves to be capitalized.

d) The company has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it.

- ✓ The Company has not defaulted in respect of payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus.
- ✓ The partly-paid shares, if any, outstanding on the date of allotment are made fully paid-up.
- ✓ A Company must comply with Prescribed Conditions.

The bonus shares shall not be issued in lieu of dividend.

SEBI guidelines on issue of bonus issues:

A listed company proposing to issue bonus shares shall comply with the following requirements:

1. The articles of association of the company must contain a provision for capitalization of reserves, etc; If there is no such provision in the articles the company must pass a resolution at

its general meeting making provision in the articles of association for capitalization;

2. The company has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption;
3. The company has not defaulted in payment of statutory dues of the employees such as contribution to provident fund, gratuity etc.
4. The partly-paid shares, if any, outstanding on the date of allotment are required to be made fully paid-up.
5. No company shall, pending conversion of FCDs/PCDs, issue any by way of bonus unless similar benefit is extended to the holders of such FCDs/though reservation of shares in proportion to such convertible part of FCDs or PCDs.
6. The declaration of bonus issue, in lieu of dividend, shall not be made.
7. A company which announces its bonus issue after the approval of the Board of directors must implement the proposal within a period of 15 days from the date of such approval (if Shareholders' approval is not required) or 2 months (if Shareholders' approval is required).

8. Once the decision to make a bonus issue is announced, the same cannot be withdrawn.

Advantages of Issuing Bonus Shares:

A. From the company's view point:

(a) By issuing bonus shares shareholders are to be satisfied when the company cannot pay dividend in cash due to shortage of liquid funds, i.e., profit can be distributed without distributing the liquid resources, viz., cash.

(b) By issuing bonus shares shareholders are to be satisfied particularly when the company does not prefer to pay dividend in cash for the purpose of either its extension or its working capital or any other specific purposes.

(c) Sometimes a company is bound to reduce its reserve for the interest of its own. It may so happen that the amount of earning profit exceeds the amount of total paid up capital of the company which, in other words, encourages the competitors and creates unhealthy relationship between workers and the company.

B. From the shareholder's view point:

(a) Shareholders need not pay tax on the bonus shares but they are to pay them on the dividend so received in cash.

(b) Shareholders, if they so desire, can convert the shares into cash by disposing of the same at a higher price.

(c) If partly paid shares are converted into fully paid by issuing bonus, the shareholders need not pay a further sum for the purpose. On the other hand, their shares become fully paid up.

Disadvantages of issuing Bonus Shares:

(a) If the rate of dividend fluctuates, i.e., cannot be maintained, the market value of shares may go down.

(b) If the rate of profit is not increased, the rate of dividend may be decreased.

(c) It encourages speculation which is not desirable.

Accounting Entries:

The various accounting entries relating to bonus issue are given below:

Particulars	L.F.	Dr.	Cr.
1. On giving Bonus by converting partly paid shares into fully paid shares Capital Reserve A/c (realized in cash only) General reserve A/c Dr. Dr. Profit & Loss A/c Dr. To Bonus to			

Shareholders A/c			
2. On making the final call due Share Final Call A/c Dr. To Share Capital A/c			
3. On adjustment of final call Bonus to Shareholder A/c Dr. To Share Final Call A/c			
On issue of fully paid Bonus Shares			
On Declaration of such bonus			
Capital Redemption Reserve A/c Dr Securities Premium A/c Dr Capital Reserve A/c (realized in cash only) Dr General Reserve A/c Dr Profit andLoss A/c Dr To Bonus to Shareholders A/c			
2. On issue of fully paid Bonus Shares			

Bonus to Shareholders A/c Dr

To Share Capital A/c

Illustration

Following items appear in the Trial Balance of M Ltd. as at 31st March, 2015:

Particulars	Amount
60,000 Equity Shares of ` 10 each	6,00,000
Capital Redemption Reserve	45,000
Plant Revaluation Reserve	15,000
Securities Premium Account	52,500
General Reserve	1,50,000
Profit & Loss Account	75,000
Capital Reserve (including Rs. 37,500 being Profit on Sale of Machinery)	1,12,500

The company decided to issue bonus shares to its share holders at the rate of one share for every four shares held.

Required: Pass the necessary journal entries. It is desired that there should be minimum reduction in free reserves. **Solution:**Journal

Date	Particulars	LF	Dr	Cr
1	Capital Reserve A/c Dr.		**37500**	
2	Capital Redemption Reserve		**45000**	

	A/c Dr. Securities Premium A/c Dr. General Reserve A/c Dr. To Bonus to Shareholders A/c (Being the bonus declared by issuing 1 bonus share for every 4 shares held as per general body's resolution dated...)		**52500** **15000**	**150000**
	Bonus to Shareholders A/c Dr. To Equity Share Capital A/c (Being the issue of 15,000 shares of ` 10 each by way of bonus)		**150000**	**150000**

Notes:

(a) Plant Revaluation Reserve cannot be utilized to issue bonus shares.

(b) Capital Reserve realized in cash can be utilized for bonus issue.

Illustration

Following is the extract of the Balance Sheet of YY Ltd. as at 31st March, 2015:

Authorized Capital	
15,000 12% Preference shares of Rs. 10 each	1,50,000
1,50,000 Equity shares of Rs. 10 each	15,00,000
	16,50,000
Issued and Subscribed Capital:	
12,000 12% Preference Shares of Rs. 10 each fully paid	1,20,000
1,35,000 Equity shares of Rs. 10 each, Rs. 8 paid up	10,80,000
Reserves and Surplus:	
Capital Redemption Reserve	30,000
General Reserve	1,80,000
Capital Reserve	1,12,500
Securities Premium	37,500
Profit and Loss Account	2,70,000
Secured Loans:	

12% Partly Convertible Debentures @ Rs. 100 each	7,50,000

On 1st April, 2015 the Company has made final call @ 2 each on 1,35,000 equity shares. The call money was received by 20th April, 2015. Thereafter the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held. Securities premium of Rs. 37,500 includes a premium of Rs. 7,500 for shares issued to vendors pursuant to a scheme of amalgamation. Capital reserves include ` 60,0000, being profit on sales of plant and machinery 20% of 12% Debentures are convertible into equity shares of `10 each fully paid on 1st June 2015.

Required: Show necessary entries in the books of the company and prepare the extract of the Balance Sheet immediately after bonus issue but before conversion of debentures. Are the convertible debenture holders entitled to bonus shares?

Solution:

Journal of Y Y Ltd.

Date	Particulars	LF.	Dr.	Cr.
April 1	Equity Share Final Call A/c Dr. To Equity Share Capital A/c (Being the Final call of `. 2 per		2,70,000	 2,70,000

	share on 1,35,000 equity shares due as per Board's Resolution dated...)			
April 20	Bank A/c Dr. To Equity Share Final Call A/c (Being the Final Call money on 1,35,000 equity shares received)		2,70,000	2,70,000
	Capital Redemption Reserve A/c Dr. Capital Reserve A/c [Realized in cash] Dr. Securities Premium A/c [37,500 – 7,500] Dr. General Reserve A/c Dr. Profit and Loss A/c Dr. To Bonus to Shareholders A/c (Being the Bonus issue @ one share for every four shares held by utilising various reserves as per Board's Resolution dated...)		30,000 60,000 30,000 1,80,000 37,500	**3,37,500**

April 20	Bonus to Shareholders A/c Dr.		3,37,500	
	To Equity Share Capital A/c			**3,37,500**
	(Being the Capitalisation of profits to issue 33,750 equity shares of Rs. 10 each, fully paid.			

An Extract of BALANCE SHEET as at 30th April, 2015 (after bonus issue)

Particulars	**Note No.**	`
EQUITY AND LIABILITIES		
(1) Shareholders' Funds		
(a) Share Capital	1	18,07,500
(b) Reserves and Surplus	2	2,92,500
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	7,50,000
Total		28,50,000

Notes to Accounts:

Particulars	`
1. Share Capital	
Authorised Share Capital	
1,87,500 Equity Shares of `. 10 each	18,07,500
15,000,12% Preference Shares of `. 10 each	1,50,000
	19,57,500
Issued, Subscribed and fully paid Share Capital	
1,68,750 Equity Shares of `. 10 each, fully paid	16,87,500
(Out of above, 33,750 equity shares @ `. 10 each were issued by way of bonus)	
12,000 12% Preference Shares of `. 10 each	1,20,000
Total	18,07,500
2. Reserves and Surplus	
Capital Reserves [1,12,500 - 60,000]	52,500
Securities Premium Reserves [37,500 - 30,000]	7,500
Surplus (Profit & Loss Account) [2,70,000 – 37,500]	2,32,500
Total	2,92,500
3. Long-term borrowings Secured	

Secured 12% Convertible Debentures @ `100 each (Out of above 1,50,000 Debentures @ `. 100 each to be converted into 15,000 Equity Shares @ Rs. 10 each 1st July,2015	7,50,000
Total	7,50,000

Working Notes:

1. Capital Reserve realized in cash can be utilized for issue of fully paid bonus shares.

2. As per SEBI guidelines, securities premium collected in cash can only be utilized for bonus issue.

3. As per pare (ii) of SEBI guidelines, no-company can issue bonus shares to its shareholders without extending similar benefit to convertible debentures holders. Pending such conversion, necessary number of shares should be earmarked for convertible debentures holders. Therefore, convertible debenture holders are also entitled to the bonus shares in the same ratio as the equity shareholders.

4. It is assumed that the company will pass necessary resolution at its general body meeting for increasing the authorized capital by Rs. 2,50,000.

Issue of Bonus Shares to equity shareholders [22,500 × 10]	2,25000
Issue of Bonus Shares to be issued to Debenture holders after conversion	25,000
[(20% of 5,00,000)/10]× 1/4 ×10	2,50,000

Illustration

The following is the balance sheet of reliance company ltd as on 31.12.2018

Liabilities:	(Rs.)
Issued and paid up capital: 225000 equity shares of `10 each fully called up	22,50,000
Less: Calls in arrear	50,000
(25000 shares of Rs. 2 each)	
100000 equity shares of `each, `4 paid up	4,00,000
P/L A/c	12,50,000
Dividend Equalization Reserve	1,00,000
General Reserve	1,50,000
Development Rebate reserve	2,50,000

Capital reserve	1,50,000
Securities premium	2,50,000
Capital redemption reserve	4,00,000
Current liability	10,00,000
Total	6,15,0000
Assets:	(Rs)
Non current assets	
Fixed assets	30,00,000
Current assets	10,00,000
Cash at bank	21,50,000
	61,50,000

The board of directors of the company took the following decisions.

a. To forfeit the shares on which final call of `. 2 each is due.

b. To issue fully paid bonus shares @ 1 fully paid up share for every 2 fully paid shares held.

c. To pay bonus to the partly paid shares at an equivalent rate as in (b)above without collecting any amount from the related shareholders.

d. to reissue the forfeited shares @ `. 12 each fully fed up.

e. To pay dividend equivalent to 10% on share capital including bonus shares.

f. To issue right shares in the ratio of 1 fully paid up share for every four existing fully paid up shares held after bonus issue at Rs. 15 per share.

g. To use minimum balance of profit and loss account.

Note:

1. All Capital Reserve are realized in cash.
2. One fifth of the development rebate reserve is free.

Pass necessary journal entries in the books of the company including cash transaction after the above decisions are implemented.

Solution:

Date	Particulars			
	Equity Share Capital A/c	Dr	2,50,000	
	To calls in arrear			50,000
	To share forfeiture			2,00,000

	Capital redemption reserve	Dr.	4,00,000	
	Securities premium	Dr.	2,50,000	
	Capital reserve	Dr.	1,50,000	
	Development rebate reserve	Dr.	50,000	
	General reserve	Dr.	1,50,000	
	To bonus to shareholders			10,00,000
	Bonus to shareholders	Dr.	10,00,000	
	To equity share capital			10,00,000
	Equity share call	Dr.	2,00,000	
	To equity share capital			**2,00,000**

	Equity share call To equity share capital	Dr .	2,00,000	 2,00,000
	Dividend equalization reserve Profit and loss To bonus to shareholders	Dr. Dr.	1,00,000 1,00,000	 2,00,000
	Bonus to shareholders To equity share call	Dr	2,00,000	 2,00,000
	Bank (12 × 25000) To equity share capital To securities premium	Dr	3,00,000	 2,50,000 50,000
	Share forfeiture To capital reserve	Dr	2,00,000	 2,00,000
	Profit and loss To equity dividend	Dr .	3,85,000	 3,85,000
	Equity dividend To bank	Dr .	3,85,000	 3,85,000
	Bank To equity share	Dr .	12,18,750	 8,12,500

	capital To securities premium			4,06,250

Illustration

MG Limited was registered on 1st January 2017 with an authorised capital of `3,00,000 divided into 30000 equity shares of `10 each. During the next 12 months to 31st November 2017 following events occurred which related to the share capital of the company.

On 1st January 2017 the company offered for subscription of 10,000 equity shares at a price of rupees 19 each, to be paid as follows:

At the date of issue including premium `10

On allotment `4

On first and final call `5

On 30th June 2017 the company made right issue on 1 for 2 basis at ``22.50 per share, payable in full on 10th July 2017. Only 80% of the issue was subscribed for by the shareholders with a payment being made on the due date. On 30th November 2017 Company decided to make a bonus issue of shares at par by utilising the entire balance of securities premium account.

Prepare the equity share capital account and the securities premium account of the company for the year ended 31st December 2017. A share holder who had subscribed initially for 140 shares had subsequently taken up 80% of the right issue and then received the bonus shares to which he was entitled.

Calculate the ultimate number of shares owned by him and the total price paid by him for those shares.

Solution:

Equity Share Capital Account

Particulars	**Amount (`)**	**Particulars**	**Amount (`)**
		By, Share Application A/c	10,000
		By, Share Allotment A/c	40,000
		By, Share First and Final Call A/c	50,000
		By, Bank (right issue)A/c	40,000
To, Balance c/d	2,80,000	By, Bonus to Shareholders A/	1,40,000
	2,80,000		**2,80,000**

Securities Premium Account

Particulars	Amount (`)	Particulars	Amount (`)
To Bonus to Shareholders	1,40,000	By, Share Application	90,000
		By, Bank	50,000
	1,40,000		**1,40,000**

Working notes:

- ✓ Securities premium per share on original issue = `(19-10) = 9. Securities premium per share on right issue = ` (22.50 -10) = `12.50.
- ✓ Number of right shares issued = 80% (1/2×10000) = 4000 shares.
- ✓ Total securities premium available =(10000×9)+(4000×12.50) = ` (90,000+50,000) = `1,40,000.
- ✓ So number of bonus share to be issued at par = `1,40,000 / `10 = 14000, i.e , rate of bonus issue is 14000 : 14000 = 1:1, i.e. , 1 bonus share issued for every share held after right issue.
- ✓ Number of right shares purchased by the shareholder = 80% x (1/2 × 140) = 56 shares. So number of bonus shares to be received by him @ 1:1 =

(140+56)= 196 shares.

- ✓ It is remembered that no amount is payable by the shareholders against bonus issue of shares.
- ✓ Calculation of ultimate number of equity shares owned by :

Particulars	No of Shares	Amount
Main issue of shares in jan 2017:		
a. As application money 140x10	140	1,400
b. As allotment money 140x4		560
c. As first and final money 140x 5		700
		2,660
For right issue @1:2 (80% of 140 shares x1/2 x 22.50)	56	1,260
For bonus issue of shares @ 1:1 for total 196 shares held	196	nil
	392	3,920

BUY BACK OF SHARES

Buy back is the reverse of issue of shares. Buy back simply means buying of own shares. It is a process of capital restructuring. It allows a company to buy back its own shares, which were issued by its earlier

Objectives/Advantages of Buy-back of shares:

1. To increase the promoters holding as the shares which are bought are cancelled.

2. To increase EPS, if there is no dilution in companies earnings as the buy-back reduces the outstanding number of shares.

3. To support the share price when the share price, in the opinion of the management is less than its fair value.

4. To pay surplus cash to the shareholders when the company does not need it for the business. For e.g. TCS, Infosys, Wipro, HCL and Tech Mahindra are regularly conducting such programmes since 2014 as part of their capital allocation policies.

5. To reward shareholders by Buy-back of shares at much higher price than ruling market price.

6. It safeguard against a hostile takeover by increasing promoters holding.

Restrictions on Purchase by Company or giving of Loans by it for Purchase of its Shares [Section 67]

1. No company limited by shares or by guarantee and having a share capital shall have power to buy its own

shares unless the consequent reduction of share capital is effected under the provisions of this Act.

2. No public company shall give, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.

3. Nothing in sub-section (2) shall apply to—

a. the lending of money by a banking company in the ordinary course of its business;

b. the provision by a company of money in accordance with any scheme approved by company through special resolution and in accordance with such requirements as may be prescribed, for the purchase of, or subscription for, fully paid-up shares in the company or its holding company, if the purchase of, or the subscription for, the shares held by trustees for the benefit of the employees or such shares held by the employee of the company;

c. the giving of loans by a company to persons in the employment of the company other than its directors or key managerial personnel, for an amount not exceeding their salary or wages for a period of six months with a view to enabling them to purchase or subscribe for fully paid- up shares in the company or its holding company to be held by them by way of beneficial ownership.

Provided that disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates shall be made in the Board's report in such manner as may be prescribed.

4. Nothing in this section shall affect the right of a company to redeem any preference shares issued by it under this Act or under any previous company law.

5. If a company contravenes the provisions of this section, it shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

Power of Company to Purchase its Own Securities [Section 68]

1. Notwithstanding anything contained in this Act, but subject to the provisions of sub-section (2), a company may purchase its own shares or other specified securities hereinafter referred to as buy- back) out of—

- its free reserves;
- the securities premium account; or
- the proceeds of the issue of any shares or other specified securities:

Provided that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

2. No company shall purchase its own shares or other specified securities under sub-section (1), unless—

- the buy-back is authorised by its articles;
- a special resolution has been passed at a general meeting of the company authorising the buy-back.

Provided that nothing contained in this clause shall apply to a case where—

    - the buy-back is, ten per cent. or less of the total paid-up equity capital and free reserves of the company; and
    - such buy-back has been authorised by the Board by means of a resolution passed at its meeting;

- the buy-back is twenty-five per cent. or less of the aggregate of paid-up capital and free reserves of the company:

Provided that in respect of the buy-back of equity shares in any financial year, the reference to twenty-five per cent. in this clause shall be construed with respect to its total paid-up equity capital in that financial year;

- the ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves:

Provided that the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

- all the shares or other specified securities for buy-back are fully paid-up;
- the buy-back of the shares or other specified securities listed on any recognized stock exchange is in accordance with the regulations made by the Securities and Exchange Board in this behalf; and
- the buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with such rules as may be prescribed.

Provided that no offer of buy-back under this sub-section shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back, if any.

3. The notice of the meeting at which the special resolution is proposed to be passed under clause (b) of sub-section (2) shall be accompanied by an explanatory statement stating—

- a full and complete disclosure of all material facts;
- the necessity for the buy-back;
- the class of shares or securities intended to be purchased under the buy-back;
- the amount to be invested under the buy-back; and
- the time-limit for completion of buy-back.

4. Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board under clause (b) of sub-section (2).

5. The buy-back under sub-section (1) may be—

- from the existing shareholders or security holders on a proportionate basis;
- from the open market;
- by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

6. Where a company proposes to buy-back its own shares or other specified securities under this section in pursuance of a special resolution under clause (b) of sub-section (2) or a

resolution under item (ii) of the proviso thereto, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board, a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, in such form as may be prescribed and verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board.

Provided that no declaration of solvency shall be filed with the Securities and Exchange Board by a company whose shares are not listed on any recognised stock exchange.

7. Where a company buys back its own shares or other specified securities, it shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back.

8. Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make a further issue of the same kind of shares or other securities including allotment of new shares under clause (a) of sub-section (1) of section 62 or other specified securities within a period of six months except by way of a bonus issue or in the discharge of subsisting obligations such as conversion of

warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

9. Where a company buys back its shares or other specified securities under this section, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.

10. A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board a return containing such particulars relating to the buy- back within thirty days of such completion, as may be prescribed.

Provided that no return shall be filed with the Securities and Exchange Board by a company whose shares are not listed on any recognised stock exchange.

11. If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board, for the purposes of clause (f) of sub-section (2), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall

not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

Disclosure Requirements relating to Buy-Back of Shares or Other Securities in Explanatory Statement to be Annexed to the Notice of the General Meeting

The explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 in relation to buy-back of shares or other securities by the private companies and unlisted public companies shall contain the following disclosures, namely:-

- the date of the board meeting at which the proposal for buy-back was approved by the board of directors of the company;
- the objective of the buy-back;
- the class of shares or other securities intended to be purchased under the buy-back;
- the number of securities that the company proposes to buy-back;
- the method to be adopted for the buy-back;
- the price at which the buy-back of shares or other securities shall be made;
- the basis of arriving at the buy-back price;

- the maximum amount to be paid for the buy-back and the sources of funds from which the buy-back would be financed;
- the time-limit for the completion of buy-back;
- (j)
    - o the aggregate shareholding of the promoters and of the directors of the promoter, where the promoter is a company and of the directors and key managerial personnel as on the date of the notice convening the general meeting;
    - o the aggregate number of equity shares purchased or sold by persons mentioned in sub-clause (i) during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;
    - o the maximum and minimum price at which purchases and sales referred to in sub-clause (ii) were made along with the relevant date;
- (k) if the persons mentioned in sub-clause (i) of clause (j) intend to tender their shares for buy- back –
    - o the quantum of shares proposed to be tendered;

  - o the details of their transactions and their holdings for the last twelve months prior to the date of the board meeting at which the buy-back was approved including information of number of shares acquired, the price and the date of acquisition;

- a confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans or interest payable thereon to any financial institution or banking company;
- a confirmation that the Board of directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-
  - ✓ that immediately following the date on which the general meeting is convened there shall be no grounds on which the company could be found unable to pay its debts;
  - ✓ as regards its prospects for the year immediately following that date, that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in

their view be available to the company during that year, the company shall be able to meet its liabilities as and when they fall due and shall not be rendered insolvent within a period of one year from that date; and

✓ The directors have taken into account the liabilities(including prospective and contingent liabilities), as if the company were being wound up under the provisions of the Companies Act, 2013.

- A report addressed to the Board of directors by the company's auditors stating that-
    - they have inquired into the company's state of affairs;
    - the amount of the permissible capital payment for the securities in question is in their view properly determined;
    - that the audited accounts on the basis of which calculation with reference to buy back is done is not more than six months old from the date of offer document; and
    - the Board of directors have formed the opinion as specified in clause (m) on reasonable grounds and that the company, having regard to its state of affairs, shall not be rendered insolvent within a period of one year from that date.

Prohibition for Buy-Back in Certain Circumstances [Section 70]

1. No company shall directly or indirectly purchase its own shares or other specified securities –
   - Through any subsidiary company including its own subsidiary companies;
   - Through any investment company or group of investment companies; or
   - If a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company.

Provided that the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

2. No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of sections 92, 123, 127 and section 129.

SEBI Guidelines:

The Securities and Exchange Board of India, has issued the following guidelines with regard to buy- back of shares or other specified securities by companies, having been empowered to do so by the Companies (Amendment) Act, 1999. These guidelines came into effect from 14-11-1998.

Modes of Buy-Back:

Buy-back is permissible:

- from the existing security holders on a proportionate basis through the tender offer; or
- from the open market through
  - ✓ Book-building process,
  - ✓ ii. stock exchange;
- from odd lots, that is to say, where the lot of securities of a public company whose shares are listed on a recognized stock exchange is smaller than such marketable lot as may be specified by the stock exchange: or
- by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Where a company proposes to buy-back its own shares. It shall after passing the special resolution or resolution of its

Board of Directors make a public announcement in at least one English National Daily one Hindi National Daily and Regional Language Daily with wide circulation at the place where the registered office of the company is located.

The public announcement shall specify a date which shall be the 'specified date' for the purposes of determining the names of the shareholders to whom the letter of offer shall be sent. The specified date cannot be earlier than 30 days and not later than 42 days from the date of such public announcement. The letter of offer shall be despatched not earlier than 21 days from the submission of its draft with SEBI through the merchant banker. The date of opening of the offer shall not be earlier than 7 days or later than 30 days after the specified date. Companies buying back through the tender offer have to open an escrow account.

A company cannot buy-back its shares from any person:

- through negotiated deals whether on or off the stock exchange; or
- through spot transactions; or
- through any private arrangements.

Price at which shares shall be bought back has to be determined by shareholders through a special resolution. A copy of their resolution has to be filed with the SEBI as well as the stock exchanges where the shares of the company are listed, within 7 days from the date of passing the resolution. Companies buying back through stock exchanges should disclose purchases daily. Buy-back offer shall remain open for not less than 15 days and not more than 30 days. The verification of shares bought back has to be completed within 15 days of the closure of the offer and payments made within 7 days. The onus of complying with the SEBI guidelines is on the merchant banker who has to file a 'due diligence certificate' with the SEBI.

Escrow Account

Regulation 10(1) of the Securities and Exchange Board of India provides that a company shall, as and by way of security for performance of its obligations on or before the opening of the offer of re- purchase, deposit in an escrow account such sum as is specified in 10(2), that is:

- If the consideration payable does not exceed ` 100 crores, 25% of the consideration;
- If the consideration payable exceeds ` 100 crores, 25% up to ` 100 crores, and 10% thereafter.

Escrow account means an account in which money is held until a specified duty is performed, i.e., till the consideration for buy-back of shares is paid to the shareholders. This account consists of cash deposited with a scheduled commercial bank, or bank guarantee in favour of the merchant banker, or deposit of acceptable securities with appropriate margin, with the merchant banker, or combination of these.

Advantages of buy-back

Buy-back have the following advantages:

- A company with capital, which cannot be profitably employed, may get rid of it by resorting to buy-back, and re-structure its capital.
- Free reserves which are utilized for buy-back instead of dividend enhance the value of the company's shares and improve earnings per share.
- Surplus cash may be utilized by the company for buy-back and avoid the payment of dividend tax.
- Buy-back may be used as a weapon to frustrate any hostile take-over of the company by undesirable persons.

Accounting for buy-back

Buy-back of shares is just the opposite of issue of shares. Just as shares may be issued at par, at a premium, even buy-back may be at par, at a premium or at a discount. The basis of accounting for buy-back is Section 68 of the Amended Companies Act. This Section not only permits a company to buy-back or redeem its equity shares, but also specifies the sources from out of which re-purchase is to be effected.

According to this Section, a company may buy-back its shares or other specified securities from out of

1. Its free reserves, or
2. The securities premium account, or
3. The proceeds of any shares or other specified securities like employees' stock option.

However, no buy-back of shares shall be made out of the proceeds of an earlier issue of the same kind of shares. This Section also lays down that all the shares or other specified securities for buy-back are fully paid up.

As per to Section 69, when a company purchases its own shares out of free reserves. Then a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer should be disclosed in the balance sheet.

Determination of quantum for buy-back. Sec. 68 of Company Act, 2013

The maximum number of shares to be bought back is determined as the least number of shares arrived by performing the following tests :

- Share outstanding test
- Resource test
- Debt-Equity Ratio test.

Share Outstanding test:

- Ascertain the number of shares
- 25% of the number of shares is eligible for buy back with the approval of shareholders.

Resource test :

- Ascertain shareholders fund (Capital + Free Reserves)
- (b) No. of shares held for buyback $= \frac{\text{Shareholders fund}}{\text{buy back price}}$

Free Reserve includes Securities Premium, General Reserve, Revenue Reserves, Profit & Loss A/c (Cr. Balance)

excludes Revaluation Reserve, any other specific reserves.

Accounting — Buy-back of Shares

1. Shares held for buy-back

   Equity Share Capital A/c Dr.

   Premium on Buyback A/c Dr.

   To Equity Shareholders A/c

   or Shares bought back A/c

2. Adjustment of premium on buyback

   Securities Premium A/c Dr.

   General Reserve A/c Dr.

   To Premium on Buyback A/c

3. Transferring reserves to the extent of capital redeemed

    Reserves A/c Dr.

    Profit Loss A/c Dr.

        To Capital Redemption Reserve

4. On buy-back of shares

    Equity Shareholders A/c Dr.

    or Shares bought back A/c Dr.

        To Bank A/c

Illustration (Buy-back at par)

X Co. Ltd. buys back its own 2,00,000 equity shares of ` 10 each at par. The company has sufficient profits otherwise available for dividend besides general reserve. No fresh issue of shares is made for this purpose. The shares are fully paid up.

Journalise the transactions.

Solution:

In the Books of X Co. Ltd.

Journal Entries

Date	Particulars	Debit	Credit
	Equity share capital a/c Dr To Bank (Buying back 200000 equity shares of `. 10 each at par)	2000000	 2000000
	General reserve A/c Dr Capital redemption reserve a/c (transfer of nominal value of shares bought back)	2000000	 2000000

Illustration

(Where shares are partly paid up)

The BCG Co. Ltd. resolved by a special resolution to buy-back 2,00,000 of its equity shares of the face value of`10 each on which ` 8 has been paid up. The general reserve balance of the company stood at `50,00,000 and no fresh issue of shares was made. Journalize the transactions.

Solution:

In the Books of BCG Co. Ltd.

Journal Entries

Date	Particulars		Debit (`)	Credit (`)
	Equity Share Final Call A/c	Dr.	4,00,000	
	To Equity Share Capital A/c			4,00,000
	(Final call of `2 per share due on 2,00,000 equity shares as per Board resolution)			
	Bank A/c	Dr.	4,00,000	
	To Equity Share Final Call A/c			4,00,000
	(Final call money on 2,00,000 shares received)			
	Equity Share Capital A/c	Dr.	20,00,000	
	To Equity Shareholders A/c			20,00,000
	(Amount due to equity shareholders transferred to their account for Buy Back)			
	Equity Shareholders A/c	Dr.		
	To Bank A/c		20,00,000	

	(Payment to shareholders towards buy-back)		20,00,000
	General Reserve A/c Dr. To Capital Redemption Reserv A/c (Transfer of nominal value of shares Bought-back.)	20,00,000	20,00,000

Illustration

(Where shares are bought-back at a premium)

The share capital of Beta Co. Ltd consists of 1,00,000 equity shares of ` 10 each, and 25,000 preference shares of `100 each, fully called up. Its securities premium account shows a balance of `40,000 and general reserve of

` 7,00,000. The company decides to buy-back 20,000 equity shares of ` 12 each. Pass the necessary journal entries.

In the Books of Beta Co. Ltd.

Journal Entries

Date	Particulars	Debit	Credit
	Equity Share Capital A/c Securities Premium A/c To Equity Shareholders A/c	200000 40000	240000

	(Amount due to equity shareholders for buying-back of 20,000 equity shares)		
	Equity Shareholders A/c To Bank A/c (Payment to shareholders on account of buy-back)	240000	240000
	General Reserve A/c To Capital Redemption Reserve A/c (Transfer of nominal amount of equity shares Bought back.)	200000	200000

Illustration

(Fresh issue of shares for purposes of buy-back).

Alpha Co. Ltd. has a paid up equity share capital of ``20,00,000 in 2,00,000 shares of `10 each. It resolved to buy-back 50,000 equity shares at `15 per share. For this purpose. it issued 20,000 12% preference shares of `10 each, at par, payable along with application. The company has to its credit `2,50,000 in securities premium account and ` 10,00,000 in the general reserve account. The company utilized the general reserve. Pass the necessary journal entries.

Date	Particulars	Debit	Credit
	Bank A/c Dr.	2,00,000	
	ToPreference Share Application A/c		2,00,000
	(Application money on 20,000 preference shares at ` 10 each)		
	Preference Share Application A/c Dr.	2,00,000	
	To Preference Share Capital A/c		2,00,000
	(Transfer of application money to preference share capital account on shares being allotted)		
	Equity Share Capital A/c	5,00,000	
	Securities Premium A/c	2,50,000	
	To Equity Shareholders A/c		7,50,000
	(Amount due to equity shareholders consequent upon buy-back of 50,000 Shares at `15)	7,50,000	7,50,000

	Equity Shareholders A/c To Bank A/c (Payment to equity shareholders for amount due to them)	3,00,000	3,00,000
	General Reserve A/c ToCapital Redemption Reserve A/c (Transfer of the nominal value of shares bought Back out of profit)		

MODULE 2

ACCOUNTS OF BANKING COMPANIES

A bank is a commercial institution, licensed to accept deposits and acts as a safe custodian of the spendable funds of its customers. Banks are concerned mainly with the functions of banking, i.e., receiving, collecting, transferring, buying, lending, investing, dealing, exchanging and servicing (safe deposit, custodianship, agency, trusteeship) money and claims to money both domestically and internationally. The principal activities of a bank are operating current accounts, receiving deposits, taking in and paying out notes and coins, and making loans.

Banking activities undertaken by banks include personal banking (non-business customers), commercial Banking (small and medium-sized business customers) and corporate banking (large international and multinational corporations).

Sources of income

The principal sources from which a bank derives its income are:

1. interest on loans and overdrafts
2. discount on bills discounted
3. dividend and interest on its own investments
4. profit on overseas exchange transactions

5. commission on transfer of funds, issue of bank drafts and charges for various services rendered.

Revenue expenses

1. interest on deposits

2. general expenses of management

3. maintenance of premises and equipment

4. taxation

According to Charles J. Woelfel:

A complete banking service would comprehend a variety of functions, including any of the following:

1. Receive demand deposits and pay customers' cheques drawn against them, and operate Automated Teller Machines (ATM);
2. Receive time and savings deposits, issue negotiable orders of withdrawal, and pay interest thereon, as well as provide Automatic Transfer Service (ATS) for funds from serving accounts to cover cheques;
3. Discount notes, acceptances and bills of exchange;
4. Supply credit to business firms with or without security, issue letters of credit and accept bills drawn thereunder;
5. Transfer money at home and abroad;
6. Make collections and facilitate exchanges;

7. Issue drafts, cashier's cheques, money orders, and certify cheques;
8. Furnish safe deposit vault service;
9. Provide custodianship for securities and other valuables;
10. Provide personal loans, credit and services to individuals, and lend or discount customer instalment receivables of vendors;
11. Act in a fiduciary capacity for individuals, as well as establish common trust funds;
12. Provide corporate trust services (stock transfer agent, registrar, paying agent, escrow agent, and indenture trustee);
13. Act as factors and engage in equipment leasing;
14. Deal in Government securities and underwrite general obligations of state and municipal securities;
15. Invest in government and other debt securities;
16. Act as fiscal agent or depository for the Central Government, states and subdivisions of states;
17. Provide miscellaneous services such as place orders in securities for customers; act as insurance agent of incidental to banking transactions; serve as finder to bring buyers and sellers together; act as travel agent and issue letters of credit and traveler's cheques; provide club accounts and other special purpose accounts; act as agent for accepting service of

legal process of incidental normal banking or fiduciary transactions of the bank; act as pay role issuer; establish charitable foundations, invest in small business investment corporations and bank service corporations; deal in foreign exchange; buy and sell gold bullion under license from the Treasury Department, and foreign coin; provide domestic and international correspondent banking services, etc.

In India, banking activities are governed by The Banking Regulation Act, 1949. As per the provisional Section 5(b) of the said Act, “banking” means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or other-wise, and withdraw able by cheque, drafts, order or otherwise.

Section 5(c) defines “Banking Companies” as any company which transacts the business of banking in India. However, any company which is engaged in the manufacture of goods or carries on any trade and which accept deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause.

Business of Banking Companies

As per the provision of Section 6 of the Banking Regulation Act, 1949, a banking company may engage in any one or more of the following forms of business, in addition to the business of banking. These are:

1. The borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments, and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, traveler's cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes: the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise, the providing of safe deposit vaults; the collecting and transmitting of money and securities;

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

treasurer of a company;

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

4. The effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, municipal or other loans or of shares, stock, debentures, or debenture stock of any company, corporation or association, and the lending of money for the purpose of any such issue;

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

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

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

8. Undertaking and executing trusts;

Undertaking the administration of estates as executor, trustee or otherwise;

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

b. The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purposes of the company;

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

d. Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub-section;

e. Doing all such other things as are incidental or conducive to the promotion

Restriction on Business of Banking Company

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

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

b. No banking company can engage in any trade, or buy, sell or barter goods for others otherwise than in connection with bills of exchange received for collection or negotiation or with such of its business or is referred to in clause (i) of sub-section (1) of section 6.

Some Important Provisions of the Banking Regulation Act, 1949 Time limit for disposal of non- banking Assets (Section – 9)Non- banking assets must be disposed off within 7 years from the date of acquisition or period extended by RBI. Minimum paid up capital and reserve [Section 11]

Banking Company	**Minimum Aggregate value of paid up capital and reserve**
1. **In case of banking company Incorporated outside India:**	
(a) Having a place (s) of business in the city of Mumbai or Kolkata or both	`20 lacs
(b) Not having a place (s) of business in the city of Mumbai or Kolkata or both	`15 lacs

2. In case of a banking company incorporated in India:	`10 lacs
(a) Having place of business in more than one state including place(s) business in the city of Mumbai or Kolkata or both	
(b) Having all its places of business in one state and none of which is in the city of Mumbai or Kolkata.	`1 lac + `10,000 for each of other places of business in the district in which it has its principal place of business + `25,000 for each place of business elsewhere in the state subject of maximum of ``5 lacs

Restriction as to payment of dividend [Sections 15 (1) and (2)]

Before paying any dividend, a banking company has to write off completely all its capitalised expenses including preliminary expenses, organisation expenses, share-selling commission, brokerage, and amounts of losses incurred by tangible assets. However, a banking company may pay dividend on its shares without writing off:

1. the depreciation in the value of its investment in approved

securities in any case where such depreciation has not actually been capitalised or accounted for as a loss;

2. the depreciation in the value of its investment in shares, debentures or bonds (other than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditor of the banking company;

3. the bad debts in any case where adequate provision for such debts had been made to the satisfaction of the auditor of the banking company.

Minimum transfer of profits to reserve fund [Section 17]

Every banking company incorporated in India is required to transfer at least 25% of its profit to the reserve fund. The profit of the year as per the profit and loss account prepared u/s 29 is to be taken as base for the purpose of such transfer and transfer to reserve fund should be made before declaration of any dividend. If any banking company makes any appropriation from the reserve fund or securities premium account, it has to report to the Reserve Bank of India the reasons for such appropriation within 21 days.

Cash Reserve (Section 18)

Every banking company, not being a scheduled bank, has to maintain a cash reserve (CRR) of at least a percentage of the total of its demand and time liabilities in India, as on last Friday of the second preceding fortnight, as specified by R. B.

I. time to time. Cash reserve can be maintained with itself or by way of a balance in the Current account with the reserve bank or by way of net balance in current accounts or in one or more of the aforesaid ways.

Restrictions on Loans and Advances (Section 20)

No banking company shall

a. grant any loans or advances on the security of its own shares, or

b. enter into any commitment for granting any loan or advance to or on behalf of

- Any of its directors,
- Any firm, in which any of its directors is interested as partner, manager, employee or guarantor, Or
- Any company (not being a subsidiary of the banking company or a company registered under Section 25 of the Companies Act, 1956 or a Government Company) of which any of the directors of the banking company is a director, manager, employee or guarantor or in which he holds substantial interest, or
- Any individual, in respect of whom any of its directors is a partner or guarantor.

Now-a-days, the daily transactions of bank numerous. All these transactions are to be recorded immediately to reflect the exact position of each customer's account. Therefore, a bank has to adopt specialised system of book-keeping, which will ensure immediate entry of numerous transactions and keep an internal check on the books of account. To achieve these objectives, banks generally maintain a large number of subsidiary and memorandum books in addition to Principal Books of Account. These are as below

Liquidity norms (Section 24)

Every banking company has to maintain in cash, gold or unencumbered approved securities, an amount at % prescribed (by RBI) of its demand and time liabilities in India. However, this percentage is changed by the Reserve Bank of India from time to time considering the general economic conditions. This is in addition to the average daily balance which a scheduled bank is required to maintain under Section 42 of the Reserve Bank of India Act, and in case of other banking companies, the cash reserve required to be maintained under Section 18 of the Banking Regulation Act.

Unclaimed deposits

Every banking company is required to submit a return in the prescribed form and manner to the Reserve Bank of India at the end of each calendar year of all accounts in India which could not be operated for 10 years. This report is to be submitted within 30 days after the close of each calendar year. In case of fixed deposit, such 10 years are to be reckoned from the date of expiry of the fixed period.

Bank's Book-Keeping System

Entering transactions in the ledger directly from vouchers

Under bank's Bookkeeping system, every transaction particularly concerning the customers is entered in the personal ledger directly from vouchers as soon as it takes place.

The objective of the system is

(a) to keep up-to-date detailed ledgers,

(b) to balance the trial balance every day, to keep all control accounts in agreement with the detailed ledgers.

Main Characteristics of a Bank's Book-Keeping System

The main characteristics of a bank's system of book-keeping are as follows:

Voucher Posting	Entries in the personal ledger are made directly from vouchers instead of being posted from the books of prime entry.
Voucher Summary Sheets	The vouchers entered into different personal ledgers each day are summarised on summary sheets, totals of which are posted to the control accounts in the general ledger.
Daily Trial Balance	The general ledger trial balance is extracted and agreed every day.
Continuous Checks	All entries in the detailed personal ledgers and summary sheets are checked by persons other than those who have made the entries. A considerable force of such check is employed, with the general result that most clerical mistakes are detected before another day begins.
Control Accounts	A trial balance of the detailed personal ledgers is prepared periodically, usually every two weeks, agreed with general ledger control accounts.
Double	Two vouchers are prepared for every

Voucher System	transaction not involving cash-one debit voucher and another credit voucher.

Book of Accounts

1. General Ledger	The General Ledger contains: (a) Control Accounts of all personal ledgers. (b) Profit and Loss Account. (c) Assets' Accounts. (d) Contra Accounts. **Usefulness** It facilitates the preparation of Balance Sheet.
2. Profit and Loss Ledger	The Profit and Loss Ledger contains: (a) Detailed Accounts of Revenue items. (b) Detailed Accounts of Expense items. Usefulness It facilitates the preparation of Profit and Loss Account.

Principal Books of Accounts Subsidiary Books

1. Personal Ledgers	(a) Current Accounts Ledger. (b) Saving Bank Accounts Ledgers. (c) Fixed Deposit (often further classified by length of period of deposit) Ledgers. (d) Loan Ledger. (e) Overdraft Ledger. (f) Cash Credit Ledger. (g) Customers' Acceptances, Endorsements and Guarantee Ledgers.
2. Bill Registers	(a) Inward Bills for Collection. (b) Outward Bills for Collection. (c) Bills Discounted and Purchased Register.

Subsidiary Registers

1. Demand Drafts, Telegraphic Transfers and Mail Transfers issued on Branches and Agencies.
2. Demand Drafts, Telegraphic Transfers and Mail Transfers received from Branches and Agencies.
3. Letters of Credit.
4. Letters of Guarantee

Memoranda Books

1. Departmental Journals	Maintain a record of all the transfer entries originated by each department
2. Cash Department's	(a) Receiving Cashiers' Cash Book (pay-in-slips are vouchers). (b) Paying Cashiers' Cash Book (Bearer Cheques/drafts etc. are vouchers). (c) Main Cash Book (by person other than cashier). (d) Cash Balance Book.
3. Clearing Department's	(a) Outward Clearing (for cheques received from customers): ➢ Clearing Cheques Received Book. ➢ Bank wise List of above Cheques (one copy of which is sent to the clearing house together with cheques). (b) Inward Clearing (for cheques issued by customers received from other Banks).

4. Loans and Overdraft Departments'	(i) Registers for shares and other securities held on behalf of each customer. (ii) Summary Books of Securities giving details of Government securities, shares of individual companies etc. (iii) Godown registers maintained by the godown-keeper of the bank. (iv) Price register giving the wholesale price of the commodities pledged with the bank. (v) Overdraft Sanction register. (vi) Drawing Power book. (vii) Delivery Order books. (viii) Storage books.
5. Deposits Department	(a) Account Opening and Closing registers. (b) For Fixed Deposits, Rate register giving analysis of deposits according to rates.

	(c) Due Date Diary. (d) Specimen signature book.
6. Establishment department	(a) Salary and allied registers, such as attendance register, leave register, overtime register, etc. (b) Register of fixed assets, e.g. furniture's and fixtures, motor cars, vehicles, etc. (c) Stationery registers. (d) Old records register.
7. General	(a) Signature book of bank's officers. (b) Private Telegraphic Code and Cyphers.

Statistical Books

- To record Average Balance in Loan and Advances etc.
- To record Deposits received and amount paid out each month in the various departments.
- Number of Cheques paid.
- Number of Cheques, Drafts, Bills etc. collected.

THE THIRD SCHEDULE

Form 'A'

FORM OF BALANCE SHEET

Balance Sheet of …..

Balance Sheet as on 31st March……..

	Schedule No.	As on 31.3. (Current Year)	As on 31.3. (Previous Year)
Capital and Liabilities			
Capital	1		
Reserves & Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities and Provisions	5		
Total			
Assets			
Cash and balances with RBI	6		
	7		

Balances with banks and money at call and short notice	8 9 10		
Investments			
Advances	11		
Fixed Assets	12		
Other Assets			
Total			
Contingent liabilities Bills for collection			

Form 'B'

FROM OF PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH

	Schedule No.	**Year ended 31.3 (Current Year)**	**Year ended 31.3 (Previous Year)**
I. Income Interest earned Other Income	13 14		
Total			

II. Expenditure Interest Expended Operating Expenses Provision and contingencies	15 16		
Total			
III. Profit /Loss Net Profit/(Loss) (–) for the year Profit/(Loss) (–) brought forward			
Total			
Transfer to statutory reserve Transfer to other reserve Proposed Dividend Balance carried forward to Balance sheet			
Total			

Note:

1. The total income includes income of foreign branches at `------------

2. The total expenditure includes expenditure of foreign branches at '………..

3. Surplus / Deficit of foreign branches `_________

SCHEDULES

Details of all schedules are in below:

A. Capital and Liabilities

1. **Capital**
2. **Reserve and Surplus**: It includes Statutory Reserve, Capital Reserve, Security Premium, Revenue and other Reserve and Profit and Loss Account balance.
3. **Deposits:** It includes Demand Deposits, Savings Bank Deposits and Term Deposits.

4. Borrowings: (i) It includes Borrowings from Reserve Bank of India, other banks, others institutions and agencies. (ii) Borrowing outside India.

4. Other Liabilities and Provisions: It includes Bills payable, inter-office adjustments (net), interest accrued, others (including provisions) provision for bad debts, provision for taxation.

B. *Assets*

1. **Cash and Balances with Reserve Bank of India**: Cash in hand (including foreign currency notes); and balances with Reserve Bank of India are shown under this item.

2. **Balances with Banks and Money at Call and Short Notice**: In India Balances with banks; money at call and short notice are shown under this item.

Outside India — Current Account other Deposit Accounts, Money at call and short notice.

3. **Investments:** Investment in Government securities, other approved securities, shares, debentures and bonds, subsidiaries and /or joint ventures, others, gold etc., are shown under this item.

4. **Advances**: Bills purchased and discounted, cash credit, overdrafts and loans payable on demand; and term loans etc. are shown under this item.

Fixed Assets: Premises, other fixed assets (including

1. furniture and fixtures) are shown under this item.
2. **Other Assets**: Inter-office adjustments, interest accrued, tax paid in advance, stationery and stamps, non- banking assets acquired in satisfaction of claims are shown under this item.

3. **Contingent Liabilities**: It is shown by way of a footnote. It represents liabilities not provided in the Balance Sheet.

Profit and Loss Account

Profit and Loss Account of a banking company is also prepared in vertical form. 'Form B' of the Third Schedule of the Banking Regulation Act, 1949 is to be used for preparing Profit and Loss Account. It is divided into four sections:

I. Income;
II. Expenditure;
III. Profit/Loss; and
IV. Appropriations.

I. *Income:*

The schedules of Income are:

a. Interest Earned. It includes interest/discount on advances/bills, income on investments, interest on balances with RBI etc. It should be noted that according to the new form, bad debts and provision for bad debts, other provisions are not to be deducted from the interest earned. For greater transparency in accounts, these items are shown as separate items in the Profit and Loss Account.

b. **Other income.** It includes commission, exchange and brokerage, profit on sale of investments, profit on revaluation of investments, profit on sale of land, building and other assets, profit on exchange transaction, and income earned by way of dividends from subsidiaries, etc.

II. *Expenditure*

a. Interest expended. Interest paid on deposits, interest on RBI borrowings; interest on inter- bank borrowings, etc., are shown under this item.

b. Operating expenses. Salaries and wages of staff; rent, rates and taxes; printing and stationery; advertisement; depreciation on banks' properties; director's fees; auditor's fees; law charges; postage; repairs; insurance; etc., are shown under this item.

c. Third item of this section is provisions and contingencies. Provision for bad debts, provision for taxation and other provisions are shown under this item.

III. *Profit/Loss*

In this section, profit/loss for the current year (difference between income and expenditure explained above) and brought forward profit/loss are shown.

IV Appropriations

In this section, amount transferred to statutory reserve as per Section 17; amount transferred to other reserve; proposed dividend, etc., are shown. The balance is transferred to the Balance Sheet.

FORMS OF SCHEDULE 1-CAPITAL

Particulars	**As on 31.3. (Current Year)**	**As on 31.3. (Previous Year)**
I. **For Nationalised Banks** Capital (Fully owned by Central Government) II. **For Banks Incorporated Outside India** Capital (i) (The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head)		

(ii) Amount of deposit kept with the RBI under Section 11(2) of Banking Regulation Act, 1949 **Total** III. For Other Banks Authorised Capital .... shares of` .... each Issued Capital .... shares of `` ...................................... each Subscribed Capital .......... shares of `` .... each Called-up Capital .... shares of each Less: Calls unpaid Add: Forfeited shares	

SCHEDULE 2 - RESERVES AND SURPLUS

Particulars	As on 31.3. (Current Year)	As on 31.3. (Previous Year)
I. tatutory Reserves Opening Balance Additions during the year Deductions during the year		
II. apital Reserves 1. Opening Balance 2. Additions during the year 3. Deductions during the year		
III. ecurities Premium Opening Balance Additions during the year Deductions during the year		
IV. Revenue and other Reserves		

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

Particulars	**As on 31.3. (Current Year)**	**As on 31.3. (Previous Year)**
I. Statutory Reserves Opening Balance Additions during the year Deductions during the year		
II. Capital Reserves 1. Opening Balance		
2. Additions during the year		

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

SCHEDULE 3 - DEPOSITS

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

SCHEDULE 4 - BORROWINGS

Particulars	As on 31.3. (Current Year)	As on 31.3.(Previous Year)
I. Borrowings in India		
(i) Reserve Bank of India		
(ii) Other Banks		
(iii) Other Institution and agencies		
II. Borrowings Outside India		
1. Total (I + II)		
Secured borrowings in I and II above. '…..		

SCHEDULE 5 - OTHER LIABILITIES AND PROVISIONS

Particulars	As on 31.3. (Current Year)	As on 31.3. (Previous Year)

I. Bills Payable II. Inter-Office adjustments (net) III. Interest accrued IV. Others (Including Provisions)		
Total		

SCHEDULE 6 - CASH AND BALANCES WITH RESERVE BANK OF INDIA

Particulars	**As on 31.3.(Current Year)**	**As on 31.3.(Previou**
I. Cash in hand (including foreign currency notes)		
II. Balances with RBI (i) in Current Account (ii) in Other Accounts **Total (I + II)**		

SCHEDULE 7 - BALANCES WITH BANKS AND MONEY AT CALL & SHORT NOTICE

Particulars	As on 31.3. (Current Year)	As on 31.3 (Previous Year)
I. In India		
(i) Balances with Banks		
(a) In Current Accounts		
(b) In Other Deposit Accounts		
(ii) Money at Call and Short Notice		
(a) With Banks		
(b) With other institutions		
Total (i + ii)		
II. Outside India		
(i) in Current Accounts		
(ii) in Other Deposit Accounts		
(iii) Money at Call and Short Notice		
Total (i, ii, iii) Grand Total (I + II)		

SCHEDULE 8 - INVESTMENTS

Particulars	As on 31.3. (Current Year)	As on 31.3. (Previous Year)
I. Investments in India		
(i) Government Securities		
(ii) Other Approved Securities		
(iii) Shares		
(iv) Debentures and Bonds		
(v) Subsidiaries and/or Joint Ventures		
(vi) Others (to be specified)		
Total		
II. Investments Outside India		
(i) Government securities (including local authorities)		
(ii) Subsidiaries and/or Joint Ventures abroad		
(iii) Other investments (to be		

specified)		
Total		
Grand Total (I + II)		

SCHEDULE 9 – ADVANCES

Particulars	**As on 31.3. (Current Year)**	**As on 31.3. (Previous Year)**
A. (i) Bills Purchased and Discounted (ii) Cash Credits, Overdrafts and Loans Payable on Demand		
(iii) Term Loans		
Total		
B. (i) Secured by Tangible Assets (i) Covered by		

Bank/Government Guarantees		
(iii) Unsecured		
Total		
C. **I. Advances in India**		
(i) Priority Sectors		
(ii) Public Sector		
(iii) Banks		
(iv) Others		
Total		
II. **Advances Outside India**		
(i) Due from Banks		
(ii) Due from others		
(a) Bills Purchased and Discounted		
(b) Syndicated Loans		
(c) Others		
Total		
Grand Total (I + II)		

SCHEDULE 10 - FIXED ASSETS

Particulars	As on 31.3. (Current Year)	As on 31.3. (Previous Year)
I. Premises At cost as on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date		
II. Other Fixed Assets (including Furniture and Fixtures) At cost as on 31st March of the preceding year Additions during the year Deductions during the year Depreciation to date **Total (I + II)**		

SCHEDULE 11 - OTHER ASSETS

Particulars	As on 31.3. (Current Year)	As on 31.3. (Previous Year)
I. Inter-Office Adjustments (net)		
II. Interest Accrued		
III. Tax paid in Advance / Tax deducted at source		
IV. Stationery and Stamps		
V. Non-banking assets acquired in satisfaction of claims		
VI. Others		
Total		

SCHEDULE 12 - CONTINGENT LIABILITIES

Particulars	As on 31.3. (Current Year)	As on 31.3. (Previous Year)
I. Claims against the bank not acknowledged as debts		
II. Liability for partially paid investments		
III. Liability on account of outstanding forward exchange contracts		
IV. Guarantees given on behalf of constituents		
(a) In India		
(b) Outside India		
V. Acceptances, endorsements and, other obligations		
VI. Other items for which the bank is contingently liable		
Total		

SCHEDULE 13 -INTEREST EARNED

Particulars	As on 31.3. (Current Year)	As on 31.3. (Previous Year)
I. Interest /discount on advances /bills		
II. Income on investments		
III. Interest on balances with Reserve Bank of India and other inter-bank funds		
IV. Others		
Total		

SCHEDULE 14 - OTHER INCOME

Particulars	As on 31.3. (Current Year)	As on 31.3. (Previous Year)

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

SCHEDULE 15 - INTEREST EXPENDED

Particulars	As on 31.3. (Current Year)	As on 31.3. (Previous Year)
I. Interest on deposits II. Interest on Reserve Bank of India / inter-bank borrowings III. Others **Total**		

SCHEDULE 16 - OPERATING EXPENSES

Particulars	As on 31.3. (Current Year)	As on 31.3. (Previous Year)

I. Payments to and provisions for employees II. Rent, taxes and lighting III. Printing and stationery IV. Advertisement and publicity V. Depreciation on Bank's property VI. Directors' fees, allowances and expenses VII. Auditors' fees and expenses (including branch auditors fees and expenses) VIII. Law Charges IX. Postages, Telegrams, Telephones, etc. X. Repairs and maintenance XI. Insurance XII. Other expenditure		
Total		

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

Disclosure of Accounting Policies

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

1. *General*

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

2. *Transactions involving Foreign Exchange*

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

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

c. Profit or loss on pending forward contracts has been accounted for.

3. *Investments*

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

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

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

4. *Advances*

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

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

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

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

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

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

5. *Fixed Assets*

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

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

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

6. *Staff Benefits*

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

7. *Net Profit*

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

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

ii. Provisions for doubtful advances.

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

iv. Transfers to contingency funds.

v. Other usual or necessary provisions.

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

SOME SPECIAL TRANSACTIONS

Interest on Doubtful Debts

When a debt is found to be doubtful at the end of the accounting year, a question may arise whether the interest on that should be credited to Interest Account or not. There is no doubt that interest has accrued; but it is equally clear that the realisation of this interest is doubtful.

Therefore, as a prudent accounting policy, such interest should be transferred to Interest Suspense Account by means of the following entry:

Loan Account   Dr.

To Interest Suspense Account

In the Balance Sheet, it should be shown on the liability side.

Next year, if a part of interest is realised and the balance becomes bad, the following entry should be passed

Interest Suspense Account Dr.

[Total interest]

To Interest Account [Interest realised]

To Loan Account [Interest unrealized]

It should be noted that if a debtor becomes insolvent, the bank should not take interest into account after the date of insolvency.

Illustration 1:

When closing the books of a bank on 31.12.2012 you find in the loan ledger an unsecured balance of `2,00,000 in the account of a merchant whose financial condition is reported to you as bad and doubtful. Interest on the same account amounted to `20,000 during the year.

How would you deal with this item of interest in 2012 account?

During the year 2013, the bank accepts 75 paise in the rupee on account of the total debt due up to 31.12.2012. Show the entries and the necessary accounts showing the ultimate effect of the transactions in 2013 books of account under Interest Suspense Method.

Solution:

Under Interest Suspense Method

When preparing the 2012 accounts the sum of ` 20,000 due from the merchant on account of interest should not be carried to Profit and Loss Account, because its recovery was doubtful. It should, therefore, be transferred to an Interest Suspense Account which would appear as a liability in Balance Sheet on 31.12.2012.

Date	Particulars	L. F.	Debit (`)	Credit (`)
2012 Dec. 31	Merchant A/c To Interest Suspense A/c (Interest due transferred to Interest Suspense A/c)		20,000	20,000
	Interest Suspense A/c Dr Bad Debts A/c To Merchant A/c (Interest not received and balances transferred to Bad Debts A/c)		5,000 50,000 1,65,000	55,000 1,65,000

	Cash A/c Dr To Merchant A/c (Amount received @ 0.75 p in the rupee from the merchant.)		15,000	15,000
	Interest Suspense A/c Dr To Profit and Loss A/c (Interest received out of Interest Suspense transferred)			

In the Books of Bank Journal

In the Books of the Bank

Dr Merchant's Account Cr.

Date	Particulars	`	Date	Particulars	`
2012	To Balance b/d	2,00,000	2012	By Balance c/d	2,20,000
Dec. 31	Int. Suspense A/c	20,000	Dec. 31		

		2,20,000			2,20,000
2013			2013		
Jan. 1	To Balance b/d	2,20,000	Dec. 31	By Cash (Dividend @ 75p in the rupee)	1,65,000
				" Int. Suspense A/c (amount of Int. not covered)	5,000
				" Bad Debts	50,000
		2,20,000			2,20,000

Interest Suspense Account

Date	Particulars	`	Date	Particulars	`
2012 Dec.	To Balance c/d	20,000	2012 Dec.	By Merchant's	20,000
		20,000			20,000

Notes:

31 2013	To Merchant's A/c	5,000 15,000	31 2013	A/c	20,000
Dec. 31	Profit & Loss A/c	20,000	Jan. 1	By Balance b/d	20,000

1. Interest amounting to `20,000 due from customer has been debited to him by crediting Interest Suspense Account (and not to Interest A/c as its recovery is doubtful) and Interest Suspense A/c will appear in the liability side of the Balance Sheet.

2. Actual amount of interest which has been received in cash, i.e. `15,000, is transferred to P& L A/c.

Principal Accounting Policies :

i. **Foreign Exchange Transactions**

ii. Monetary assets and liabilities have been translated at the exchange rate prevailing at the close of year. Non-monetary assets have been carried in the books at the historical cost.

iii. Income and Expenditure items in respect of Indian branches need to be translated at the exchange rates on the date of transactions and in respect of foreign branches at the exchange rates prevailing at the close of the year.

iv. Profit or Loss on foreign currency position including pending forward exchange contracts have been accounted for at the exchange rates prevailing at the closing of the year.

v. *Investment*

Permanent category investments are valued at cost. Valuation of investment in current category depends on the nature of securities. While valuation of government securities held as current investments have been made on yield to maturity basis, the investments in shares of companies are valued on the basis of book value.

b. *Advances*

Advances due from sick nationalised units under nursing programmes and in respect of various sticky, suit filed and decreed accounts have been considered good on the basis of–

i. Available estimated value of existing and prospective primary and collateral securities including personal worth of the borrowers and guarantors.

ii. The claim lodged/to be lodged under various credit guarantee schemes.

iii. Pending settlement of claims by Govt.

Provisions to the satisfaction of auditors have been made and deducted from advances. Tax relief available when the advance is written off will be accounted for in the year of write off.

c. *Fixed Assets*

The premises and other fixed assets except for foreign branches are accounted for at thei

historical cost. Depreciation has been provided on written down value method at the rates specified in the Income Tax Rules, 1962. Depreciation in respect of assets of foreign branches has been provided as per the local laws.

Acceptance, Endorsement and Other Obligations

These are the liabilities of a bank which are taken by a bank on behalf of its customers and appear in the liabilities side of the Balance Sheet. For this purpose bank takes corresponding indemnities from its customers to avoid anytrouble which may appear in future. In addition to that bank also takes adequate securities. These items are shown under the head Contingent Liabilities in Schedule – 12. These items include: Bills accepted by the bank on behalf of its customers, letter of credit etc.

Illustration 2:

From the following details prepare "Acceptances, Endorsements and other Obligation A/c" as would appear in the general ledger.

On 1.4.12 Acceptances not yet satisfied stood at ` 33,45,000. Out of which ` 30 lacs were subsequently paid off by clients and bank had to honour the rest. A scrutiny of the Acceptance Register revealed the following

Client	**Acceptances/ Guarantees**	**Remarks**
	(`)	
P	15,00,000	Bank honoured on 10.6.12
Q	18,00,000	Party paid off on 30.9.12
R	7,50,000	Party failed to pay and bank had to honour on 30.11.12
S	12,00,000	Not satisfied upto 31.3.13
T	7,50,000	-do-
X	4,05,000	-do-
Total	64,05,000	

Acceptances, Endorsements and other Obligation Account

(in General Ledger)

Date	Particulars	Amount	Date	Particulars	Amount
2012-13	To Constituents' liabilities for acceptances/guarantees etc. (Paid off by clients)	3,000	1.4.12	By, Balance b/d	3,345
	To Constituent's liabilities for acceptances/ guarantees etc. (Honoured by bank 33.45 lakhs less ` 30 lakhs)	345	2012-13	By, Constituents' liabilities for Acceptances / guarantees etc. P 1,500 Q 1,800 R 750	6,405
10.6.12	To Constituents' liabilities for acceptances/guarantees etc. (Honoured by	1,500			

	bank)			S 1,200 T 750 X 405	
30.9.12	To Constituents' liabilities for acceptances/guarantees etc. (Paid off by party)	1,800			
30.11.12	To Constituent's liabilities for acceptances/guarantees etc. (Honoured by bank on party's failure to pay)	750			
31.3.13	To Balance c/d (Acceptances not yet satisfied)	2,355			
		9,750			**9,750**

REBATE ON BILLS DISCOUNTED

One of the major functions of a bank is to discount customers' bill. We know that when the bill is discounted by the bank Bill Discounted and Purchased Account should be debited with full amount and Customers' Current Account is credited for such discounting by the bank with net amount. In this way, total amount of discount so earned during this year is credited to Interest and Discount Account. Discount is calculated from the period of discounting the bill to the date of maturity of the bill. This is the usual transactions which are recorded in the books of bank for discounting of the bill. No problem will arise if the entire amount of discount is received during the period. In real world situation, this is not happened as the bill may not have matured for payment during the period of closing the accounts. Thus, an adjustment is required for discounting of those bills which are related to next accounting periods.

Entries For adjustment

Interest & Discount A/c Dr.

To rebates on bill discount Account Computation of rebates on Bills discounted

$$\text{Rebate on Bills Discounted} = \text{Amount of Bill} \times \text{Rate of Discount} \times \frac{\text{Unexpired Period}}{12}$$

Illustration 3:

In Calculate Rebate on Bills discounted as on 31 December, 2011 from the following data and show journal entries:

	Date of Bill	`	Period	Rate of Discount
(i)	15.10.2011	50,000	5 months	8%
(ii)	10.11.2011	30,000	4 months	7%
(ii)	25.11.2011	40,000	4 months	7%
(iv)	20.12.2011	60,000	3 months	9%

Solution:

Calculation of Rebate on Bills Discounted

`	Due Date	Days after 31 December, 2013	Discount Rate	`
50,000	18/03/2012	31+ 29 +18 = 78	8%	852.46
30,000	13/03/2012	31+29+13 = 73	7%	418.85
40,000	28/03/2012	31+29+28 = 88	7%	673.22
60,000	23/03/2012	31+29+23 = 83	9%	1,224.59
Total				3,169.12

Dec. 31	Particulars	Dr. `	Cr. `

	Interest and Discount Account Dr. To, Rebate on Bills Discounted. (Being the provision for unexpired discount required at the end of the year)	3,169.12	3,169.12

Illustration

On 31 March, 2011 Victory Bank Ltd. had a balance of `18 crores in "rebate on bill discounted" account. During the year ended 31st March, 2012, Victory Bank Ltd. discounted bills of exchange of ` 8,000 crores charging interest at 18% p.a., the average period of discount being for 73 days. Of these, bills of exchange of `1,200 crores were due for realization from the acceptor/customers after 31st March, 2012, the average period outstanding after 31st March, 2012 being 36.5 days. Victory Bank Ltd. asks you to pass journal entries and show the ledger accounts pertaining to:

i. Discounting of Bills of Exchange; and
ii. Rebate on bill D

In the books Victory bank Ltd.

Journal

Date	Particulars	L.F.	Debit (`) Crore	Credit (`) Crore
10.2012	Rebate on Bill Discounted A/c D To, Discount on Bills A/c (Being the transfer of opening balance to Rebate on Bill Discounted Account)		18.00	 18.00
	Bills Purchased and Discounted A/c Dr To, Client A/c To, Discount on bills A/c ` 8,000 crores x $\frac{18}{100}$ x $\frac{73}{365}$ (Being the discounting of bills during the year)		8,000	 7,712.00 288.00
	Discount on bills A/c Dr To, Rebate on Bills Discounted A/c (Being the Provision for		21.60	 21.60

	unexpired discount as on 31.03.2012)			
	Discount on bills A/c Dr. To, Profit and Loss A/c (Being the amount of income for the year from dis- counting of bills of exchange transferred to Profit and Loss Account)		284.40	284.40

Ledger of Victory bank Ltd.

Rebate on Bills Discounted Account (` In Crores)

Date	Particulars	Amount (`)	Date	Particulars	Amount (`)
01.4.11	To, Discount on bills A/c	18.00	01.4.11	By balance b/d	18.00
31.03.11	To balance c/d	21.60	31.3.12	By Discount on bills A/c (Rebate required)	21.60
		39.60			39.60

Discount on Bills Account (` In Crores)

Date	Particulars	Amount ()	Date	Particulars	Amount (`)
31.03.12	To Rebate on Bills Discount A/c	21.60	01.4.11	By rebate on Bills	18.00
,,	To Profit and Loss A/c (Transfer)	284.40	2011-12	By bills Purchased and Discount A/c	288.00
		306.00			306.00

Secured and Unsecured Advance

Secured advance means where a bank grants advance to its customers against any tangible security. Similarly, where as advance is granted by a bank to its customers without taking any tangible security, the same is called unsecured advance. It is needless to mention here that when an advance is granted by a bank to its customers against any tangible security, bank can dispose of the said security for the realization of principle and interest in case of default. The status of securities and the value of such securities must be mentioned by every bank is Schedule 9. Before granting credit every bank must compare with the market value of securities so pledged to the bank and the amount of advance granted by the bank together with the amount of interest.

RBI's Prudential Accounting Norms

Just to control the lending activities, the recommendation of Narasimhan Committee was accepted by RBI. As per the recommendation, RBI's Prudential Accounting Norms are:

(a) Recognition of Income;

(b) Classification of Assets; and

(c) Provision for Loans and Advances

A. Recognition of Income:

As per RBI's norms, every bank must recognize its income

i. Under Cash Basis (for income under non-performing asset); and

ii. Under Accrual Basis (for income on performing assets).

Illustration 6:

Given below are details of interest on advance of a Commercial Bank as on 31.03.2013:(` in Crore)

Particulars	**Interest Earned** (`)	**Interest Received** (`)
Performing Assets		
Term Loan	240	160
Cash Credit and Overdraft	1,500	1,240
Bills Purchased and Discounted	300	300
Non-Performing Assets		
Term Loan	150	10
Cash Credit and Overdraft	300	24
Bills Purchased and Discounted	200	40

Find out the income to be recognized for the year ended 31st March 2013

Solution:

As per RBI Circular, Interest on non-performing assets are considered on Cash Basis whereas interest on performing assets are considered on Accrual Basis.

Statement Showing the Recognition of Income (` in Crore)

Particulars	Amount (`)	Amount (`)
1. Interest on Term Loans		
(i) Performing Assets	240	
(ii) Non-performing Assets	10	250
2. Interest on Cash Credit and Overdraft		
(i) Performing Assets	1,500	
(ii) Non-performing Assets	24	1,524
3. Interest on Bills Purchased and Discounted		
(i) Performing Assets	300	
(ii) Non-performing Assets	40	340
Income to be Recognised		2,114

Classification of Assets

Assets are classified as:

Assets

Performing or Standard Asset Non-performing Assets

Sub-Standard Asset Doubtful Asset Loss Asset

Standard or Performing Asset

Practically, these assets bear a little amount of risk like normal risk. They do not create any trouble regarding their realization.

Provision required = 0.40%

Restructured Advances:

- Restructured accounts classified as standard advances will attract a provision (as prescribed from time to time) in the first two years from the date of restructuring. In cases of moratorium on payment of interest/ principal after restructuring, such advances will attract a provision for the period covering moratorium and two years thereafter;

- Restructured accounts classified as non-performing advances, when upgraded to standard category will attract a provision (as prescribed from time to time) in the first year from the date of upgradation.

Banks will hold provision against the restructured advances as per the extant provisioning norms.

The above-mentioned higher provision on restructured standard advances (2.75 per cent as prescribed vide circular dated November 26, 2012) would increase to 5 per cent in respect of new restructured standard accounts (flow) with effect from June 1, 2013 and increase in a phased manner for the stock of restructured standard accounts as on May 31, 2013 as under:

- per cent - with effect from March 31, 2014 (spread over the four quarters of 2013-14)
- 4.25 per cent - with effect from March 31, 2015 (spread over the four quarters of 2014-15)
- 5.00 per cent - with effect from March 31, 2016 (spread over the four quarters of 2015-16)

1. Sub-Standard Advances:

Advances classified as “sub-standard” will attract a provision of 15 per cent as against the 10 per cent. The “unsecured exposures” classified as sub-standard assets will attract an additional provision of 10 per cent, i.e., a total of 25 per cent as against the 20 per cent. However, “unsecured exposures” in respect of Infrastructure loan accounts classified as sub-standard, in case of which certain safeguards such as escrow accounts are available, will attract an additional provision of 5 per cent only i.e. a total of 20 per cent as against 15 per cent.

2. Doubtful Advances:

Doubtful Advances will continue to attract 100% provision to the extent the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis. However, in respect of the secured portion, following provisioning requirements will be applicable: The secured portion of advances which have remained in “doubtful” category up to one year will attract a provision of 25 per cent (as against 20 per cent); The secured portion of advances which have remained in “doubtful” category for more than one year but up to 3 years will attract a provision of 40 per cent (as against 30 per cent); and The secured portion of advances which have remained in “doubtful” category for more than 3 years will continue to attract a provision of 100%

Rates of Provisioning for Non-Performing Assets and Restructured Advances

Category of Advances	**Rate (%)**
Standard Advances	
(a) Direct advances to agricultural and SME	0.25
(b) Advances to Commercial Real Estate (CRE) Sector	1.00
(c) All other loans	0.40
Sub-standard Advances	
Secured Exposures	15
Unsecured Exposures in respect of Infrastructure loan accounts where certain safeguards such as escrow accounts are available.	20
Unsecured other loans	25
Doubtful Advances – Unsecured Portion	100
Doubtful Advances – Secured Portion	
For Doubtful upto 1 year	25
For Doubtful > 1 year and upto 3 years	40
For Doubtful > 3 years	100

As per RBI DBOD Circular No. BP.BC 94/21.04.048/2011-12 dated 18/05/2011.

Loss Asset

The asset which are not realizable at all are known as loss assets. The entire amount should be written off or full provision should be made for the amount of outstanding provision @ 100% for such assets.

HOW TO MAKE PROVISION IN RESPECT OF ADVANCES COVERED BY THE GUARANTEES OF DICGC/ECGC

In the case of advances guaranteed by Export Credit Guarantee Corporation (ECGC) or by Deposit Insurance and Credit Guarantee Corporation (DICGC), provision is required to be made only for the balance in excess of the amount guaranteed by these corporations. In case the bank also holds a security in respect of an advance guaranteed by ECGC/DICGC, the realizable value of the security should be deducted from the outstanding balance before the ECGC/ DICGC guarantee is off-set.

Where there is an upper limit to which the ECGC/ DICGC guarantee applies; this fact should be duly recognized in computing the amount of provision required. Statement showing the calculation of Provision

	`
A. Amount Outstanding	xxx
B. Less: Realizable value of Security (if any held)	(xxx)
	xxx
C. Less: ECGC/DICGC cover (% limited to ….)	(xxx)
D. Unsecured Portion [A-B-C]	xxx
E. Provision required for unsecured portion of Doubtful Asset @100%	xxx
F. Provision required for secured portion of Doubtful Asset @ 25%,/40%/100%	Xxx
G. Total Provision required [E+F]	Xxx

Illustration

From the following information of details of advances of X Bank Limited calculate the amount of provisions to be made in Profit and Loss Account for the year ended 31.3.2012:

Asset classification	` in lakhs
Standard	6,000
Sub-standard	4,400

Doubtful:	
For one year	1,800
For two years	1,200
For three years	800
For more than three years	600
Loss assets	1,600

Solution:

Statement showing provisions on various performing and non-performing assets

Asset Classification	**Amount**	**Provision**	**Amount of Provision**
	`in Lakhs	%	` In lakhs
Standard	6,000	0.40	24
Sub-standard	4,400	15	660
Doubtful			
One year	1,800	25	450
2 years	1,200	40	480
3 years	800	40	320

More than 3 years	600	100	600
Loss assets	1,600	100	1,600
			4,134

Illustration

From the particulars given below, ascertain the amount of provision to be made against the advances of SBI, Kolkata. (` in '00,000)

Particulars	**Amount (`)**
Total amount of Loans & Advances	120
Advance fully secured	70
Advance overdue for 15 months	20
Advance overdue for more than 2½ year but less than 3 years	10
(Secured by mortgage of land & building valued ` 5 lakhs)	—
Unsecured Advance not recoverable	20

Solution:

Statement Showing the Ascertainment of Provision (` in '00,000)

Type of Advance	**Amount** (` in lakh)	**Percentage of Provisions (%)**	**Amount of Provision** (`)
Standard Asset	70	0.40%	28,000
Sub-Standard Asset	20	15%	3,00,000
Doubtful Asset	10	(Unsecured provision + 40% of secured provision)	7,00,000*
Loss Asset	20	100%	20,00,000
			30,28,000

* Unsecured Provision (` 10,00,000 - ` 5,00,000) ` 5,00,000 + 40% of ` 5,00,000

= ` 5,00,000 + ` 2,00,000

= ` 7,00,000

Provisions covered by Guarantee of DICG/ECGC in case of advance :

Illustration

Rajatapeeta Bank Ltd. had extended the following credit lines to

a Small Scale Industry, which had not paid any Interest

since March, 2006:

Particulars	Term Loan	Export Loan
Balance Outstanding on 31.03.2012	`35 lakhs	`30 lakhs
DICGC/ECGC cover	40%	50%
Securities held	`15 lakhs	`10 lakhs
Realisable value of Securities	` 10 lakhs	` 08 lakhs

Particulars	Term loan (` in lakhs)	Export credit (` in lakhs)
Balance outstanding on 31.3.2012	35.00	30.00

Less: Realisable value of Securities	10.00	8.00
Less: DICGC cover @ 40%	25.00	22.00
	10.00	–
ECGC cover @ 50%	-	11.00
Unsecured balance	15.00	11.00

Compute necessary provisions to be made for the year ended 31st March, 2012.

Solution:

Required Provision:

	Term loan (` in lakhs)	**Export credit (`in lakhs)**
100%* for unsecured portion	15.00	11.00
100% for secured portion	10.00	8.00
Total provision required	25.00	19.00

* The above solution has been provided based on the latest NPA provisions (as per the Master Circular issued by RBI.

Illustration

From the following information find out the amount of provisions required to be made in the Profit & Loss Account of a commercial bank for the year ended 31st March, 2013:

i. Packing credit outstanding from Food Processors `90 lacs against which the bank holds securities worth `22.50 lacs. 50% of the above advance is covered by ECGC. The above advance has remained doubtful for more than 3 years.

ii. Other advances :

Assets classification	` in lacs
Standard	4500
Sub-standard	3300
Doubtful :	
For one year	1350
For two years	900
For three years	600
For more than 3 years	450

Loss assets 900

Solution *(`in lacs)*

	(`)	**(`)**
Amount outstanding (packing credit)	90.00	
Less : Realisable value of securities	22.50	
	67.50	
Less : ECGC cover (50%)	33.75	
Net Unsecured Balance	33.75	
Required provision :		
Provision for unsecured portion (100%)		33.75
Provision for secured portion (100%)*		22.50
		56.25

Other advances: *(` in lacs)*

Assets	**Amount**	**% of provision**	**Provision**
Standard	4500	0.40*	18

Sub-standard	3300	15	495
Doubtful :			
For one year	1350	25	337.5
For two years	900	40	360
For three years	600	40	240
For more than three years	450	100*	450
Loss	900	100	900
Required provision	12,000		2,800.5

Note : Doubtful advances have been taken as fully secured. However, in case, the students assume that no security cover is available for these advances, provision will be made for 100%.

* As per the Master Circular issued by RBI

Preparation of Profit and Loss Account

Illustration

The following are the figures extracted from the books of Y Bank Ltd. [Scheduled Commercial Bank] as on 31.3.2013.

Other information:**(Amount in`)**

Interest and Discount received	20,30,000	Directors' fees and allowance	12,000
Interest paid on Deposits	12,02,000	Rent and taxes paid	54,000
Issued and Subscribed Capital	5,00,000	Stationery and printing	12,000
Reserve under Section 17	3,50,000	Postage and Telegram	25,000
Commission, Exchange and Brokerage	90,000	Other expenses	12,000
Rent received	30,000	Audit fees	4,000
Profit on sale of investment	95,000	Depreciation on Bank's properties	12,500
Salaries and Allowances	1,05,000		

i. Provision for bad and doubtful debts necessary ` 2,00,000.

ii. Rebate on bills discounted as on 31.3.2013 `7,500.

iii. Provide ` 3,50,000 fo income tax.

iv. The directors desire to declare 10% dividend.

Make the necessary assumption and prepare the Profit and Loss Account in accordance with the law

Solution:

In the books of Y Bank Ltd.

Profit and Loss Account for the year ended 31st March, 2013

		Schedule	**Year ended 31.3.2013 (Current**	**Year ended 31.3.2012 (Previous**
I.	**Income**			
	Interest earned	13	20,22,500	
	Other income	14	2,15,000	
	Total		22,37,500	
II.	**Expenditure**			
	Interest expended	15	12,02,000	
	Operating expenses	16	2,36,500	

	Provisions and contingencies (Note 1)		5,50,000	
	Total		19,88,500	
III.	**Profit / Loss**			
	Net Profit / Loss (–) for the year		2,49,000	
	Profit / Loss (–) brought forward		—	
	Total		2,49,000	
IV.	**Appropriations**			
	Transfer to Statutory Reserves		62,250	
	(25% of Net Profit) (Note 3)			
	Transfer to Other Reserves		—	
	Proposed dividend (10% of ` 5,00,000) (Note 4)		50,000	

	Balance carried over to Balance Sheet		1,36,750	
	Total		2,49,000	

Working Notes :

- ✓ Calculation of Provisions and Contingencies

`

- ✓ Provision for doubtful debts : 2,00,000
- ✓ Provision for Income tax 3,50,000

5, 50,000

- ✓ It is assumed that Rebate on Bill Discounted as on 31.3.2012 was nil.
- ✓ As per the provision of section 17 of the Banking Regulation Act, 1949 amount to be transferred to Statutory Reserve should not be less than 25% of Net Profit.
- ✓ It is assumed that the dividend has been proposed as per RBI guidelines
- ✓ Corporate Dividend tax is payable when

dividend is proposed / paid.

Schedule 13: Interest Earned

		`	`
I.	Interest and Discount received	20,30,000	
	Less: Rebate on bill discounted as on 31.3.2013	7,500	20,22,500
II.	Income on Investments		
III.	Interest on balances with RBI and other inter-bank fund		
IV.	Others		
	Total		20,22,500

Schedule 14: Other Income

I.	Commission, exchange and brokerage	90,000
II.	Rent received	30,000
III.	Net Profit on sale of investments	95,000
IV.	Net Profit on revaluation of investments	—
	Less : Net Loss on revaluation of	—

	investments	
V.	Net Profit on sale of land, buildings & other assets	—
VI.	Net Profit on exchange transactions	—
VII.	Income earned by way of dividends etc from subsidiaries/joint ventures setup abroad/in India	—
VIII.	Miscellaneous Income	—
	Total	2,15,000

Schedule 15: Interest Expended

		`
I.	Interest on Deposits	12,02,000
II.	Interest on RBI / Inter-bank borrowings	—
III.	Others	—
	Total	12,02,000

Schedule 16 : Operating Expenses

		`
I.	Payment to and provision for employees	1,05,000
II.	Rent, taxes and lighting	54,000
III.	Printing and stationery	12,000
IV.	Advertisement and publicity	—
V.	Depreciation on Bank's property	12,500
VI.	Directors' fees and allowances	12,000
VII	Auditor's fees and expenses	4,000
VIII	Law charges	—
IX.	Postage and telegram	25,000
X.	Repairs and maintenane	—
XI.	Insurance	—
XII	Other expenditure	12,000
	Total	2,36,500

Preparation of Balance Sheet

Illustration

From the following trial balance and the additional information, prepare a Balance Sheet of Lakshmi Bank Ltd. a Scheduled Commercial Bank as at 31st March, 2013:

Debit balance	**` (in Lakhs)**
Cash Credits	1,218.15
Cash in hand	240.23
Cash with Reserve Bank of India	67.82
Cash with other Banks	132.81
Money at call and short notice	315.18
Gold	82.84
Government securities	365.25
Current Accounts	42.00
Premises	133.55
Furniture	95.18
Term Loan	1,189.32
	3,882.33

Credit balance	` (in Lakhs)
Share Capital (29,70,000 equity shares of ` 10 each, fully paid up)	297.00
Statutory Reserve	346.50
Net Profit for the year (before appropriation)	225.00
Profit & Loss Account (Opening balance)	618.00
Fixed deposit Accounts	775.50
Savings Deposit Accounts	675.00
Current Accounts	780.18
Bills Payable	0.15
Borrowings from other Banks	165.00
	3,882.33

Additional Information :

1) Bills for collection : `18,10,000
2) Acceptance and endorsements : `14,12,000
3) Claims against the bank not acknowledged as debts : `55,000
4) Depreciation charged on premises : ` 1,10,000 and Furniture : `78,000

Solution:

Lakshmi Bank Ltd.

Balance Sheet as on 31.3.2013

Details	**Schedule No.**	**Amount (`` in Lakhs)**
Capital and Liabilities:		
Capital	1	297.00
Reserves and Surplus	2	1,189.50
Deposits	3	2,230.68
Borrowings	4	165.00
Other Liabilities and	5	0.15

Provisions		
Total		3,882.33
Assets :		
Cash and Balance with RBI	6	308.05
Balances with Banks and Money at Call and Short Notice	7	489.99
Investments	8	448.09
Advances	9	2,407.47
Fixed Assets	10	228.73
Total		3,882.33
Contingent Liabilities	12	14.67
Bills for Collection		18.10

Schedules Schedule 1 - Capital

	` (in lakh)
Issued, Subscribed and Called – up Capital	297.00
(29,70,000 @` 10)	

Schedule 2 - Reserves and Surplus

	` (in lakh)	**` (in lakh)**
1. Statutory Reserve		346.50
Add: 20% of ` 2,25,00,000		56.25
(Assumed to be an unscheduled Bank)		402.75
2. Profit & Loss A/c Opening	618.00	
Add: Current Year		
` (2,25,00,000 – 56,25,000)	168.75	786.75
		1,189.50

Schedule 3 – Deposit

	` (in lakh)
1. Demand Deposits	780.18
2. Savings Bank Deposits	675.00
3. Term Deposit	775.50
	2,230.68

Schedule 4 - Borrowings

	` (in lakh)
Borrowings from other Banks	165.00

Schedule 5 - Other Liabilities

	` (in lakh)
Bills Payable	0.15

Schedule 6 - Cash and Balances with RBI

	` (in lakh)
Cash in Hand	240.23
Balances with RBI	67.82
	308.05

Schedule 7 - Balances with Banks and Money at Call and Short Notice

	` (in lakh)
Cash with other Banks	132.81
Money at Call and short Notice	315.18
Current Accounts	42.00
	4,89.99

Schedule 8 – Investment

	` (in lakh)
Government securities	365.25
Gold	82.84
	4,48.09

Schedule 9 – Advances

	` (in lakh)
Cash Credit	1,218.15
Term Loans	1,189.32
	2,407.47

Schedule 10 - Fixed Assets

	` (in lakh)	` (in lakh)
Premises	1,34,65,000	
Less : Depreciation	(1,10,000)	133.55
Furniture	95,96,000	
Less : Depreciation	(78,000)	95.18
		228.73

Schedule 11 - Other Assets — NIL

Schedule 12 - Contingent Liabilities

	` (in lakh)	` (in lakh)
Acceptance and Endorsements	14.12	
Claims against the Bank not acknowledge as Debts	0.55	
		14.67

MODULE 3

ACCOUNTS OF LIFE INSURANCE COMPANIES

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

Types of Insurance

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

1. **Life Insurance**

A life insurance contract is a long term contract in which the assured must pay the premium at stated intervals and the insurer guarantee to pay a certain sum of money to the assured on the happening of the event which is certain (either death or expiry of the fixed period). Section 2 of Indian Insurance Act 1938 defines life insurance as “life insurance business is the business of effecting contracts upon human life".

2. **General Insurance**

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

FINANCIAL STATEMENTS OF INSURANCE COMPANIES

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

Final Accounts of Life Insurance Companies

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

Revenue Account (Form A -RA)

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

FORM A – 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	Previous year
	Premiums earned – net			
	(a) Premium	1		
	(b) Reinsurance ceded			
	(c) Reinsurance accepted			
	Income from investments			
	(a) Interest, dividends & rent – Gross			
	(b) Profit on sale/redemption of investments			
	(c) (Loss on sale/redemption of investments)			
	(d) Transfer/ Gain on revaluation/change in			

	(a) fair value* Other income (to be specified) **Total (A)** Commission Operating Expenses related to insurance business Provision for doubtful debts 3 Bad debts written off Provision for tax Provisions (other than taxation) (a) For diminution in the value of investments (net) (b) Others (to be specified) **Total (B)** Benefits Paid (Net) 4 Interim Bonuses paid	2 3		

	Change in valuation of liability in respect of life policies (a) Gross** (b) Amount ceded in Reinsurance **(c)** Amount accepted in Reinsurance **Total (C)** Surplus (Deficit) (D)=(A) (B) (C) **Appropriations** Transfer to Shareholders' Account Transfer to Other Reserves (to be specified Balance being Funds for Future Appropriations **Total (D)**	4		

Notes:

- Represents the deemed realized gain as per norms specified by the Authority.
- Represents Mathematical Reserves after allocation of bonus

The total surplus shall be disclosed separately with the following details:

(a) Interim bonuses paid

(b) Allocation of bonus to policyholders

(c) Surplus shown in the Revenue Account

(d) Total Surplus: [(a)+(b)+(c)]

Profit And Loss Account (Form A PL)

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

FORM A PL

Name of the insurer

Registration No. and Date of Registration with the IRDA

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

Shareholders' Account (Non technical Account)

No.	Particulars	Schedul	Current year	Previous year

	Amounts transferred from/to the Policyholders Account (Technical Account) Income from investments a) Interest, dividends & rent – Gross b) Profit on sale/redemption of investments c) (Loss on sale/redemption of investments) Other income (to be specified) **Total (A)** Expenses other than those directly related to the insurance business Bad debts written off Provision for tax Provisions (other than taxation) a) For diminution in the value of investments (net) b) Provision for doubtful debts			

	c) Others (to be specified)			
	Total (B)			
	Profit (Loss) before tax (A-B)			
	Provision for taxation			
	Appropriations			
	a) Balance at the beginning of the year			
	b) Interim dividends paid during the year			
	c) Proposed final dividend			
	d) Dividend Distribution Tax			
	e) Transfer to Reserves/other accounts (to be specified)			

Notes to Form A RA and A PL:

- ✓ Premium income received from business concluded in and outside India shall be separately disclosed.
- ✓ Reinsurance premiums whether on business ceded or accepted are to be brought into account

gross (i.e., before deducting commissions) under the head reinsurance premiums

- ✓ Claims incurred shall comprise claims paid, specific claims settlement costs wherever applicable and change in the outstanding provisions for claims at the year end.
- ✓ Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs.500000 whichever is higher, shall be shown as a separate line item.
- ✓ Fees and expenses connected with claims shall be included in claims.
- ✓ Under the sub head "Others" shall be included items like foreign exchange gains or losses and other items.
- ✓ Interest, dividends and rentals receivable in connection with an investment should be stated at

gross amount, the amount of income tax deducted at source being included under “advance taxes paid and taxes deducted at source”.

- ✓ Income from rent shall include only the realized rent. It shall not include any notional rent.

Balance Sheet (Form A BS)

Balance Sheet of Life Insurance Company is prepared in vertical format. The form of Balance Sheet is as follows:

FORM A BS

Name of the insurer

Registration No. and Date of Registration with the IRDA

Balance Sheet as at 31st March, 20….

No	Particulars	Schedule	Current year	Previous year

	Sources of Funds	5		
	Shareholders' Funds:	6		
	Share Capital			
	Reserves and Surplus			
	Credit/[Debit] Fair Value Change Account	7		
	Sub Total			
	Borrowings			
	Policyholders' Funds:			
	Credit/[Debit] Fair Value Change Account			
	Policy Liabilities			
	Insurance Reserves			

	Provision for Linked Liabilities			
	Sub Total			
	Funds for Future Appropriations			
	Total			
	Application of Funds			
	Investments			
	Shareholders’	8		
	Policyholders’			
	Assets held to Cover Linked Liabilities	8A		
		8B		
	Loans			
	Fixed Assets			
		9		
	Current Assets			
	Cash and Bank Balances	10		

	Advances and Other Assets Sub -Total (A) Current Liabilities Provisions Sub -Total (B) Net Current Assets (C)=(A)(B) Miscellaneous Expenditure (to the extent not written off or adjusted) Debit Balance in Profit and Loss Account (Shareholders' Account) Total	11 12 13 14 15		

CONTINGENT LIABILITIES

Particulars	Current year	Previous year
1. Partly paid-up investment 2. claims other than against policies, not acknowledged as debt by the company. 3. underwriting commitment outstanding 4. guarantees given by or on behalf of the company 5. statutory demands/liabilities in dispute, not provided for 6. reinsurance obligations 7. others (to be specified)		

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS

SCHEDULE 1 PREMIUM

No.	Particulars	Current year	Previous year
1	First year premium		

2	Renewal premium		
3	Single premium		
	Total premium		

SCHEDULE 2–COMMISSION EXPENSES

Particulars	Current year	Previous year
Commission paid		
Direct First Year Premiums		
Renewal Premiums		
Single Premiums		
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 reinsurance accepted or re-insurance ceded figures

SCHEDULE 3 – OPERATING EXPENSES RELATED TO INSURANCE BUSINESS

Particulars	Current year	Previous year
1. Employees remuneration & welfare benefits		
2. Travel, conveyance and vehicle running expenses		
3.. Rents, rates & taxes		
4. Repairs		
5. Printing & stationery		
6. Communication expenses		
7. Legal & Professional charges		
8. Medical fees		
9. . Auditors' fees, expenses etc		
• As auditor		
• As adviser or in any other capacity, in respect of:		
➢ Taxation matters		
➢ Insurance matters		

➢ Management services; and • In any other capacity 10. Advertisement and publicity 11. Interest and bank charges 12. Others(to be specified) 13. Depreciation Total		

Note: Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs.500000 whichever is higher, shall be shown as a separate line item.

SCHEDULE 4 – BENEFITS PAID [NET]

Particulars	Current year	Previous year
Insurance Claims: (a) Claims by Death (b) Claims by Maturity (c) Annuities/Pension payment		

(d) Other benefits, specify.		
2. (Amount ceded in reinsurance):		
(a) Claims by Death		
(b) Claims by Maturity		
(c) Annuities/Pension payment		
(d) Other benefits, specify.		
3. Amount accepted in reinsurance:		
(a) Claims by Death		
(b) Claims by Maturity		
(c) Annuities/Pension payment		
(d) Other benefits, specify.		
Total		

Notes:

1. Claims include specific claims settlement costs, wherever applicable.

2. Legal and other fees and expenses shall also form part of the claims cost, wherever applicable.

SCHEDULE 5 – SHARE CAPITAL

1. Authorised capital Equity shares of Rs…..each 2. Issued Capital Equity shares of Rs…..each 3. Subscribed Capital Equity shares of Rs…..each 4. Called up Capital Equity shares of Rs…..each 5. Less: Calls unpaid Add: 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:

- Particulars of the different classes of capital should be separately stated.
- The amount capitalized on account of issue of bonus shares should be disclosed.
- 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]

	Current year		Previous year	
	No. of shares	% of holdings	No. of shares	% of holdings
Promoters Indian				

Foreign Other Total				

SCHEDULE 6 – RESERVES AND SURPLUS

No	Particulars	Current year	Previous year
1	Capital Reserve		
2	Capital Redemption Reserve		
3	Share Premium		
4	Revaluation Reserve		
5	General Reserves		
6	Catastrophe Reserve		
7	Other Reserves (to be specified)		
8	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

Particulars	Current year	Previous year
1. Debentures/Bonds 2. Banks 3. Financial Institutions 4. Others (to be specified)		

SCHEDULE 8 – INVESTMENTS SHAREHOLDERS

No.	Particulars	Current year	Previous year
	Long –term Investments		
1	Government securities and Government Guaranteed Bonds including treasury bill		
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)		
4	(f) Subsidiaries		
	Investment Properties – Real Estate		
5	Investments in Infrastructure and Social sector		
1	Other than Approved Investments		
2	**Short –term Investments**		
3	Government securities and Government Guaranteed		
	Bonds including treasury bills		
	Other approved securities		
	Other investments		
	(a) Shares		

4	(aa)Equity (bb)Preference (b) Mutual Funds (c) Derivative Instruments (d) Debentures/Bonds (e) Other securities (to be specified) (f) Subsidiaries Investment Properties – Real Estate 4. Investments in Infrastructure and Social sector 5 Other than Approved Investments		

SCHEDULE 8 A– INVESTMENTS POLICYHOLDERS

No.	Particulars	Current year	Previous year
. 1	**Long –term Investments**		

2 3 4 1	Government securities and Government Guaranteed Bonds including treasury bills Other approved securities (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 Investments in Infrastructure and Social sector Other than Approved Investments		

2	**Short –term Investments**		
3	Government securities and Government Guaranteed Bonds		
	including treasury bills		
	Other approved securities		
	a. Shares • Equity • Preference		
	b. Mutual Funds		
	c. Derivative Instruments		
4.	d. Debentures/Bonds		
5.	e. Other securities (to be specified)		
	f. Subsidiaries		
	g. Investment Properties – Real Estate		
	Investments in Infrastructure and Social sector Other than Approved Investments		

	Total Investments 1. India 2. Outside india Total		

SCHEDULE 8 B– ASSETS HELD TO COVER LINKED LIABILITIES

No.	Particulars	Current year	Previous year
 1. 2 3	**Long –term Investments** Government securities and Government Guaranteed Bonds including treasury bills Other approved securities (a) Shares • Equity • Preference		

4. 5 1 2 3	(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 **Short –term Investments** Government securities and Government Guaranteed Bonds including treasury bills Other approved securities (a) Shares • Equity		

4 5	• 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	Previous year
1	**Security -wise Classification** Secured		

	1. On mortgage of property		
	• In India		
	• Outside India		
	2. On Shares, Bonds, Govt. Securities, etc.		
	3. Others (to be specified)		
	Unsecured		
2	1. Loans against policies		
	2. Other (to be specified)		
	Total		
	Borrower -wise Classification		
	(a) Central and State Governments		
3	(b) Banks and Financial Institutions		
	(c) Subsidiaries		

4	(d) Companies (e) Loans against policies (e) Others (to be specified) Total **Performance -wise Classification** 1) Loans classified as standard • In India • Outside India 2) Non standard loans less provisions • In India • Outside India Total **Maturity -wise Classification** (a) Short Term (b) Long Term		

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 **Total** **Previous Year**										

SCHEDULE 11– CASH AND BANK BALANCES

Particulars	Current year	Previous year

1. cash (including cheques, drafts and stamps)
2. bank balances
• Deposit account
  • Short-term
  • Others
• Current accounts
a. Others (to be specified)		

• Money at call and short notice a. with banks b. With other institutions • Others (to be specified) Total Balances with non scheduled banks in 2 and 3 above Cash and Bank Balances 1. In India 2. Outside India Total		

SCHEDULE 12– ADVANCES AND OTHER ASSETS

No	Particulars	Current year	Previous year
	Advances		
1	Reserve deposits with ceding companies		
2	Application money for investments		
3			

4	Prepayments		
5	Advances to Directors/Officers		
6	Advance tax paid and taxes deducted at source (Net provision for taxation)		
	Others (to be specified)		
1	Total (A)		
2	**Other Assets**		
3	Income accrued on investments		
4	Outstanding Premiums		
5	Agents' balances		
	Foreign Agencies Balances		
6	Due from other entities		
7	carrying on insurance business (including reinsurers)		
8	Due from subsidiaries/holding company		
	Deposit with Reserve Bank of India [Pursuant to section 7 of Insurance Act, 1938]		

	Others (to be specified) Total (B) Total (A+B)		

SCHEDULE 13– CURRENT LIABILITIES

No	Particulars	Current year	Previous year
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	Annuities due		
10	Due to Officers/Directors		
11			

	Others (to be specified) Total		

SCHEDULE 14– PROVISIONS

No	Particulars	Current year	Previous year
1	For taxation (less payments and taxes deducted at source)		
2	For proposed dividends		
3	For dividend distribution tax		
4	Others (to be specified)		
	Total		

SCHEDULE 15– MISCELLANEOUS EXPENDITURE

No	Particulars	Current year	Previous year
1	Discount allowed on issue of shares/debentures		
2	Others (to be specified)		
	Total		

Explanation of some items in final accounts

1. Claims – Claim is the amount payable by the insurance company. In life insurance business, claims may arise due to two reasons i.e., by death or maturity.
2. Annuity – It is an annual payment which a life insurance company guarantees to pay for lump sum money received in the beginning.
3. Surrender value – If an insured is unable to pay the further premium, he can get his policy paid from the company. It is the present cash value of the policy which a holder gets from the company on surrendering all the rights of the policy.
4. Bonus in reduction of premium – instead of paying bonus in cash, the insurance company may deduct the bonus from the premium due from the insured. This is known as bonus in reduction of policy.
5. Consideration for annuities granted - Any lump sum payment received by the insurance company in lieu of granting annuity is called consideration for annuity granted.
6. Re-insurance – When a company accepts a business of more value and in order to reduce the

risk, may pass on some business to the other company, it is called reinsurance.

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

Life insurance fund

Life insurance fund is maintained by life insurance company. It represents the excess of revenue income over revenue expenditure. The object of maintaining this fund is to meet the aggregate liability on all outstanding policies. This is shown in schedule 6

Adjusting entries

Following entries are recorded at the time of preparing final accounts for recording unrecorded transactions in the books of insurance company:

1. Premium outstanding at the end of the year:

Outstanding premium a/c Dr

Premium a/c

(Premium outstanding for the year)

2. for premium received in advance

Premium a/c Dr

To premium received in advance

(the premium received in advance)

3. for re-insurance premium

Premium A/c Dr

To re-insurer's or other insurance company a/c

(the premium covered under reinsurance)

4. for outstanding claims at the end of the year:

Claims A/c Dr

To claim outstanding a/c

(the claims outstanding at the end of the year)

5. For expenses relating to claims such as survey expenses, legal expenses etc. but included in other expenses

Claims a/c Dr

To management expenses a/c

To survey/legal expenses a/c

(The expenses relating to claims charged to claims account)

6. For claims covered under re-insurance

Insurance claim / reinsurance company a/c Dr

To claims a/c

(The claims recovered under reinsurance)

7. For interest accrued but not due:

Interest accrued A/c Dr

To interest A/c

(The interest accrued but not due)

8. For interest due but not received

Outstanding interest a/c Dr

Interest A/ c

9. For bonus in reduction of premium

Bonus in reduction of premium a/c Dr

To premium a/c

(The bonus in reduction of premium adjusted)

10. For rent of own building

Rent A/c Dr

To rent of own building A/c

(The rent of own building charged)

11. For commission on reinsurance accepted due but not paid

Commission on reinsurance Accepted A/c Dr

To reinsurance company

(Commission payable on reinsurance accepted)

12. For commission on reinsurance ceded due:

Reinsurance company A/c Dr

To commission on reinsurance ceded.

(The commission earned on reinsurance ceded, made due)

Illustration

The following balances appeared in the books of the happy mutual life Assurance Society ltd as on 31/03/2020.

Particulars	` in lakhs	Particulars	` in lakhs
Claims less reinsurance paid during the year: Death By maturity Annuities Furniture and office equipment at cost (including ` 40 lakhs bought during the year) Printing and stationary Cash with bank in current a/c Cash and stamps in hand Surrenders less reassurance	2200 1500 6 250 77 1350 30 40 250	Life assurance fund at the beginning of the year Premiums less reassurance Claims less reassurance Outstanding at the beginning of the year: By death By maturity Credit balances pending adjustment Consideration for annuity granted Interest dividend and rent	50000 15000 900 600 60 2 1800

Commission Expenses of management Sundry deposits with electricity companies etc Advance payment of income tax Sundry debtors Agents balances income tax Income tax on interest Dividend and rents loans on mortgages Loans on policies Investments (`250 lakhs	3100 1 50 50 100 450 500 150 3250 52000	Registration and other fees Sundry deposits Taxation provision Premium deposits Sundry creditors Contingency reserve Furniture and office equipment Depreciation a/c Building depreciation a/c	2 100 300 1150 350 150 40 300

deposited with the RBI) House property at cost (including `80 lakhs added during the year)	5400		
	70754		70754

From the foregoing balances and the following information, prepare balance sheet of the happy mutual life assurance society ltd. As on 31st march, 2020 and its revenue account for the year ended on that date.

1. Claims less reassurances outstanding at the end of the year- by death: `. 600 lakhs, by maturity ` 400 lakhs
2. Expenses outstanding Rs. 6 lakhs and prepaid ` . 15 lakhs.
3. Provide ` 45 lakhs for depreciation on building; ` 15 lakhs for depreciation on furniture and office equipment ; and ` 110 lakhs for taxation.
4. Premiums outstanding ` 2028 lakhs ; commission thereon
   ` 65 lakhs

5. Interest, dividend and rents outstanding (net) ` 30 lakhs and interest and rent accrued (net) ` 350 lakhs.

Happy mutual life assurance society ltd

Revenue account

For the year ended 31st march 2020

	Schedule	`in lakhs
Premiums earned-net	1	17028
Income from investments:		
Interest, dividend and rent –gross		2180
Other income:		
Annuities granted		2
Registration and other fees		2
Total (A)		19212
Commission	2	315
Operating expenses related to insurance	3	3282
		760
Provision for tax		4357
Total (B)	4	3246

Benefits paid (net)		3246
Total (C)		11609
Surplus/deficit (D)= A-B-C\		
Provision for tax = 450+500+110+-300		

Happy mutual life assurance society ltd

Balance sheet as at 31st march 2020

	schedule	`in lakhs	`in lakhs
Sources of fund			
Shareholders fund:	5		
Share capital	6		
Reserves and surplus	7	61759	
Borrowings		1250	63009

Applications of funds			
Investments:			
Shareholders	8	56805	
Loans	9	3400	
Fixed assets	10	195	60400
Current assets	11	1380	
Cash and bank balances	12	2874	
Advances and other assets		4254	
Sub total (A)	13	1535	
Current liabilities	14	110	
Provisions		1645	
Sub total (B)			2609
Net Current Assets (C) (A-B)			63009
Total			

Schedule 1: Premiums

Particulars	`in lakhs

Premium Add: outstanding	15000 2028
	17028

Schedule 2: Commission expenses

Particulars	`in lakhs
Commission paid Add: Commission on reinsurance accepted	250 65
	315

Schedule 3: operating expenses

Particulars		`in lakhs
Expenses of management paid	3100	.
Add: unpaid	60	
		3145
Less prepaid		77

Printing and stationary	3160	
Depreciation: Building	15	
Furniture		
Total	45	60
	15	
		3282

Schedule 4: benefits paid

Particulars		`in lakhs
Insurance claims:		
Claims by death		
Paid	2200	
Add: outstanding	600	
	2800	
Less: outstanding at the beginning	900	1900

Claims by maturity Paid	1500 400	
Add: outstanding at the end	1900 600	1300
Less: outstanding at the beginning Other benefits: Annuities Surrender less re-insurance		6 40

Schedule 6: Reserves and surplus

Particulars	`in lakhs
Contingency reserve Life insurance fund Balance of P/L a/c	150 50000 11609
Total	61759

Schedule 7: borrowings

Particulars	`in lakhs

Premium deposits	1150
Sundry deposits	100
	1250

Schedule 8 investment

Particulars		`in lakhs
Sundry other investments		51750
Investment in house property	5315	
Add: addition	85	
	5400	
Less: depreciation (300+45)	345	5055
Total		56805

Schedule 9 loans

Particulars	`in lakhs
On mortgage	150
On policies	3250
	3400

Schedule 10: Fixed asset

Particulars	`in lakhs
Furniture cost less depreciation (250-55)	195

Schedule 11: Cash and bank balances

Particulars	`in lakhs
Cash in hand including stamp	30
Cash with banks in current account	1350
	1380

Schedule 12: Advances and other assets

Particulars	`in lakhs
Prepaid expenses	15
Interest, dividends and rent outstanding	30
Interest, dividends and rent accruing	350
Advance payment of income tax	50
Agents balances	100
Outstanding premium	2028
Deposit with RBI	250
Deposit with electricity companies	1

Sundry debtors	50
	2874

Schedule 13: Current liabilities

Particulars	`in lakhs
Sundry creditors	350
Claims outstanding	1000
Credit balances pending adjustments	60
Outstanding expenses	60
Commission due but not paid	65
Total	1535

Schedule 14: Provisions

Particulars	`in lakhs
Provision for tax	110

Determination of profit in life insurance business

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

In order to ascertain the profit or loss of life insurance business, the net liability is to be compared with life assurance fund on a particular date. This comparison is done ina separate statement called valuation balance sheet. If the amount of life assurance fund is more than net liability, excess is treated as surplus (profit). If net liability is more than the life assurance fund, the difference represents loss. The following is the form of valuation balance sheet.

Valuation balance sheet as on ……………..

	`		`
To net liability as per Actuary's valuation '' surplus		By life insurance fund as per B/S '' deficiency	

Illustration

A life insurance company gets its valuation made in every two years. Its life assurance fund on 31st December 2020 amounted to ` 8000000 before providing `80000 for the shareholders dividend for the year 2020. Its actuarial valuation done on 31st December 2020, disclosed a net liability of ` 7600000 under assurance annuity contracts. An interim bonus of ` 100000 was paid to the policy holders during the two years ending 31st December 2020.

Prepare a statement showing the amount now available as bonus to policy holders.

Valuation balance sheet as on 31st December 2020

	`		`
To net liability as per actuarial valuation To surplus	7600000 400000	By life assurance fund as per B/S	8000000
	8000000		8000000

Statement showing the amount due to policy holders

	`
Surplus as per valuation B/S	400000
Less: Dividend payable to shareholders	80000
	320000
Add: interim bonus paid	100000
Net surplus (profit)	420000
Policy holders will get 95% of ` 420000	399000
Less: interim bonus already paid	100000

Amount due to the policy – holders 299000

MODULE 4

CONSOLIDATED FINANCIAL STATEMENT (IND AS 110)

Sometimes a company purchases or acquires more than 50% or majority or all the shares of another company for securing control. Many big companies today have a subsidiary or subsidiaries over which the company has control. In other words, today, companies started working in groups. A company which acquires more than 50% of the shares of another company is called parent company (or holding company). A company whose majority of shares are acquired by parent company is known as subsidiary company. Suppose A Ltd. acquires 75% of the equity shares of B Ltd. Here A Ltd. is the parent company and B Ltd is the subsidiary company.

Meaning of Consolidated Financial Statements

The information contained in the individual financial statements of a parent company and each of its subsidiaries does not give a picture of the group's total activities. When the financial statements of a parent and its subsidiaries are combined together, we shall get a picture of the group's total activities. Such financial statements are called consolidated financial statements. Consolidated financial statements can be prepared from the individual ones. Consolidated financial statements are required when one company (parent) acquires a controlling proportion (more than 50%) of equity of another (subsidiary). Both companies continue their separate legal identities. In other words, a group has no separate legal existence, except for accounting purposes. Thus, consolidated financial statements should be prepared when the parent company has control over the subsidiary or subsidiaries.

Ind AS 110 lays down the accounting principles and procedures for the presentation and preparation of consolidated financial statements. In India, the Companies Act, 2013 requires holding company to present consolidated financial statements of the holding company and its subsidiaries. SEBI requires a holding company to publish consolidated financial statements.

Thus, consolidated financial statements refer to the combined or aggregated financial statements of a parent company and its subsidiaries. In short, these are the financial statements of a group presented as those of a single enterprise. Consolidated financial statements are also known as group financial statements. The Standard requires an entity (the parent or the acquirer) that controls one or more other entities (subsidiaries or acquirees) to present consolidated financial statements.

Definitions in the Ind AS 110

1. **Consolidated financial statements**: Consolidated financial statements are financial statements of a group in which the assets, liabilities, equities, income, expense and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

2. **Parent:** Parent is an entity that controls one or more entities. In other words, it is an enterprise that has one or more subsidiaries. It is a company which holds the majority (more than 50%) of equity shares of another company. Parent company is also known as holding company.

3. **Subsidiary:** A subsidiary is a company whose majority of equity shares are held by another company (parent or holding company). If the parent has purchased 100% of the outstanding equity shares, the subsidiary is called wholly owned subsidiary.

4. **controls of an investee**

   An investor controls an investee when it is exposed or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Group companies

If one company owns more than 50% of the equity shares of another company, it gives the first company (parent) control of the second company (subsidiary). The parent company has enough voting power to appoint all the directors of the subsidiary company in strict legal terms, parent and subsidiary remains distinct. But in economics substance, they can be regarded as single unit, ie, a group. Thus, the parent company and its subsidiary companies are collectively called group.

Group structure

There are different group structures. Important group structures are:

1. **Direct holding:**

The simplest structure is one in which a parent company has only a direct interest in the shares of its subsidiary companies. For example

P

100%	80%	90%
S1	S2	S3

Here S1 is a wholly owned subsidiary of P. S2 and S3 are partly owned subsidiaries of P. in these subsidiary companies a proportion (less than 50%)of the share is hold by outside investors

2. Indirect holding

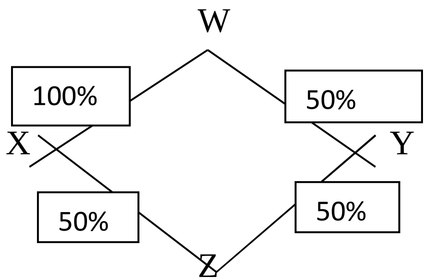
A parent may have indirect holdings in its subsidiaries. This can lead to more complex group structure. Following are the various complex group structures:

a. one type of indirect group structure is one in which a parent company holds more than 50% of the shares of another company. This subsidiary company holds more than 50% of the share of another company. For example

P
51%
S
51%
SS

In the above example, P company owns 51% of the equity shares in S company. Thus S company is the subsidiary of P company. S company in turns owns 51% of the equity shares in SS company. Thus SS company is the subsidiary of S company. Consequently, SS company becomes the subsidiary of P company. SS company would describe S company as its parent company and P company as its ultimate parent company.

b. another type of group structure is that a company (owns) 100% of the equity of another company (second company). Besides, the first company owns 50% of the equity of another company (third company). The second company and third company each own 50% of the equity of another company (fourth company). For example



Thus W company owns 100% of the equity of X company and 50% of the equity of Y Company. X company and Y Company each owns 50% of the equity of Z Company.

Non-Controlling Interest

Non-controlling interest or minority interest situation occurs when an organization does not own 100% of a subsidiary organization. The organization only owns a part of the subsidiary. The joint partnership agreement details the official relationship is between the two or more organizations that own the subsidiary.

The agreement outlines what ownership relationship is and thus how to account for the subsidiary when consolidating subsidiaries. As a result, there are several different consolidation approaches when accounting for a subsidiary that isn't 100% owned.

Controlling Interest

Controlling Interest occurs when an organization owns more than 50% but less than 100% of the subsidiary. This means that control of the subsidiary lies in the hands of that organization. The organization will need to consolidate 100% of the financial results (by line item) with a factor for the portion of income and equity owned by a 3rd party. This controlling interest can also be achieved if the organization has substantial operational influence even if the ownership is below 50%.

Non-controlling Interest (Minority Interest) calculation

Income Statement

To calculate the NCI of the income statement, take the subsidiaries net income and multiply by the NCI percentage. For example, if the organization owns 70% of the subsidiary and a minority partner owns 30% and subsidiaries net income say $1M. The non-controlling interest would be calculated as $1M x 30% = $300k. This $300k would be placed on a non-operating line item on the Income Statement. Minority Interest $300k this would reduce the organizations Net Income by the amount of Net Income that is not owned by the organization.

Balance Sheet

To calculate the non-controlling interest of the balance sheet, take the subsidiaries book value and multiply by the non-controlling interest percentage. For example, if the organization owns 70% of the subsidiary and a minority partner owns 30% and subsidiaries book value is $8M. The non-controlling interest would be calculated as $8M x 30% = $2.4M. This $2.4 would be placed on in either a non-current liability (US GAAP) or within equity in it's own distinct section separate from the rest of the parent's equity (US GAAP, IFRS).

Methods of calculating NCI

Method 1

Value of shares held by minority share holders xxx

Add: share in the pre acquisition profit of subsidiary xxx

Share in the post acquisition profit of sub co xxx xxx

NCI XXX

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

Method 2

Share of minority shareholders in the net assets of subsidiary co. xxx

Net assets acquired = share capital + reserves and surplus, or

Total assets acquired – total liabilities assumed

Calculation of goodwill

For acquiring the shares in a subsidiary the parent company has to pay the price or consideration. This is the cost of investment made by the parent co apny in the subsidiary company. When the parent company acquires the shares in the subsidiary company, the parent company will be entitled to a proportion of the net assets of the subsidiary company.

The method of calculation of goodwill varies according to situations.

Situation 1

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

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

Goodwill = consideration transferred+ reserves and surplus, or

Total assets acquired – total liabilities assumed.

Situation 2

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

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

Goodwill = consideration paid + non controlling interest – net assets acquired

Goodwill can be calculated in an alternative was as below

Goodwill = consideration paid – proportionate share of parent in the net assets of the subsidiary.

Gain from bargain purchase (negative goodwill)

In a business combination, *bargain purchase* occurs when the fair value of net assets of the acquiree exceeds the purchase consideration paid by the acquirer plus fair value of any non controlling interest. The difference is recognized as a gain by the acquirer. It is also called negative goodwill. before recording negative goodwill ,it is necessary to review all assets, liabilities and contingent liabilities to ensure that they have been properly accounted for.also ,the acquirer shall determine whether there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase.if there exists such clear evidence ,the acquirer shall recognize the resulting gain.this gain from bargain purchase should be included in' other comprehensive income ' in the statement of profit and loss .this should be treated as capital reserve and accumulated in equity.

In short ,bargain purchase (or negative goodwill) arises when the fair value of the net assets acquired exceeds the consideration paid for them.

When one company acquires another, it pays the company or its shareholders an amount referred to as purchase consideration. It is either cash or stock or it can be any other asset. In return the acquirer gets net assets of the acquiree or stock of the acquiree representing his control. In most cases, the consideration paid by the acquirer is more than the fair value of the net assets. It is because not all assets appear in the books of accounts, but there are certain other characteristics of the business such as its customer satisfaction, brand value, repute, synergy, culture, etc. which cause the fair value of the business to be higher than the fair value of its net assets. A bargain purchase is exactly opposite. In case of a bargain purchase, the fair value of individual assets is higher than the combined worth of the business as measured by the amount paid to acquire it

Preparation of consolidated financial statements

When a company has one or more subsidiaries, consolidated financial statements should be prepared. Consolidated financial statements presents the performance and financial position of the group, as if it is a single economic entity. All the results and the assets and liabilities that are under the control of the parent are combined together to show single totals for each line items in the consolidated financial statements.

Importance of consolidated financial statements

Consolidated financial statements are an essential part of the accounting process for group companies. This key information provides perspective on the entire business, something that is often lost when looking only at figures for the parent or a single subsidiary.

Given that each company within the group prepares its own set of financial statements, is it really necessary to go to the trouble of compiling a consolidated version for the entire group? The short answer is: yes. There are a number of reasons why it remains important for any group of companies to continue to prepare consolidated financial statements.

- Broad perspective. Insights offered by consolidated financial statements relate to the entire business. This may be crucial, whether for potential investors, the owner of the business or for analysts. The consolidated version of financial statements indicates the health of the business as a whole and will also show how each subsidiary within the group impacts on the parent business.
- Reducing the volume of paperwork involved. Without consolidated financial statements, anyone looking to get an overview of the group as a whole would need to go through an individual set of paperwork for each of the companies. That could be multiple documents – for example if a parent company owns seven subsidiaries the total will be 32 separate financial reports (four for each of the subsidiaries and the parent company). Where consolidated financial statements are prepared

only a single document is required. This makes it quicker to access data and much easier to grasp the state of the business as a whole.

- Simplifying the process. Consolidated financial statements – especially where prepared using software – enable the process of analysis to be considerably simplified. For example, it can exclude those transactions that occur between subsidiaries and a parent company that in effect already cancel each other out. This produces a much more simplified version of financial statements that focus on the key data that is necessary for analysis and decision-making.

Procedure to prepare to Consolidated financial Statement

IFRS 10 (or Ind AS 110) lays down the basic procedures for preparing consolidated financial statements. The financial statements of a parent and its subsidiaries are combined on a line by-line basis by adding together like items of assets, liabilities, equity, income and expenses. Then the following steps are taken:

1. Offset (eliminate) the carrying amount of the parent's investment in each subsidiary (asset)

2. Eliminate or cancel the parent's portion of equity of each subsidiary (liability).

3.Adjust the non-controlling interests in the net income of subsidiaries against the income of the group, to determine the net income attributable to the shareholders (owners) of the parent

4.Determine the non-controlling interests in the net assets of the subsidiaries.

5. Present the non-controlling interests (as per step 4) separately from the parent shareholders' equity in the consolidated balance sheet.

6. Eliminate in full all intra group assets and liabilities and transactions, and the resulting unrealized profits.

7. Other matters to be dealt with include the following:

a) Goodwill on consolidation should be dealt with according to IFRS 3 or Ind AS 103

b) Dividends paid by a subsidiary must be accounted for. Unrealized losses resulting from intra-group transactions should also be eliminated unless cost can be recovered.

The basic principle of a consolidated balance sheet is that it shows all assets and liabilities of the parent and subsidiaries. The cost of investment in subsidiaries (appearing on the asset side of the balance sheet of the parent) is cancelled with the share capital of the subsidiary .This means that the share capital of the subsidiary is never taken in the consolidated balance sheet. Only the parent company's share capital is taken. Similarly, the retained profits shown in the consolidated balance sheet comprises of parent's profits plus parent's share in the post-acquisition profit of the subsidiary. The parent's share of pre-acquisition profit of the subsidiary is adjusted in the amount of goodwill / bargain purchase.

Consolidated financial statement shall be prepared using uniform accounting policies for the transactions and other events in similar circumstances.

Illustration

The consolidate statement of financial position of H ltd, and its subsidiary S ltd, are as follows:

Particulars	H ltd`	S ltd `

Equity and liabilities		
Equity		
Equity share capital (Rs. 100 each)	400000	150000
Non-current liabilities		
Debentures	50000	
Current liabilities		
Trade payables	200000	100000
	650000	250000
Assets		
Non –current assets		
Tangible assets	275000	140000.
Investment in S ltd at cost (1500 equity shares S ltd)	160000	
Current assets		
Trade receivables	180000	95500
Cash and cash equivalents	35000	14500
	650000	250000

Prepare consolidated statement of financial position of H ltd., and its subsidiary S ltd

Solution

Consolidated balance sheet as on 31/03/2020

Equity and liabilities

Equity

Share capital 4000 shares of Rs. 100 each
400000

Non Current liabilities

Debentures	50000

Current liabilities

Trade payables (200000+100000)	300000
Total equity and liabilities	**750000**

Assets

Non current Assets

Tangible assets (275000+140000)	415000
Goodwill	10000

Current Assets

Trade receivables (180000+95500)
2MODULE 575500

Cash and cash equivalents(35000+14500) 49500

Total assets **750000**

Working note:

Calculation of cost of control or goodwill

Consideration paid (Cost of investment) 160000

Less: Nominal value of shares held (1500*100) 150000

Cost of control/goodwill 10000

MODULE 5

IMPORTANT DISCLOSURE BASED ACCOUNTING STANDARDS

The adoption of internationally accepted financial reporting standards is a necessary measure to facilitate transparency and contribute to proper interpretation of financial statements.

1. Earnings per share(basic and diluted (Ind AS 33))
2. Segment Reporting (Ind AS 108)
3. Events after reporting period (Ind AS 10)
4. Related party Transactions (Ind AS 24)
5. Changes in Accounting policies, Accounting Estimates and Errors (Ind AS 8)
6. Interim financial reporting.(Ind AS 34)

Accounting for Basic and Diluted EPS(IAS 33 and Ind AS 33)

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

Objectives

The principal objective of this standard is to prescribe principles for determining and presenting earnings per share amounts in order to improve performance comparisons between different entities in the same period and between different accounting periods for the same entity. However, the prime focus of this standard is on the denominator of the earnings per share calculation.

Scope

This standard is not mandatory on all entities. However entities whose share are listed or are in process of listing for trading in public and any other entity voluntarily presents EPS must comply with this standard. When an entity presents both consolidated financial statements and separate financial statements, the required disclosures should be presented in both the statement.

Measurement of basic Earnings Per Share

Basic EPS should be calculated by dividing profit or loss from continuing operations attributable to ordinary equity shareholders of the parent entity (the numerator) by the weighted average number of ordinary shares outstanding (denominator) during the period.

$$\text{Basic EPS} = \frac{\text{profit or loss atributable to ordinary equity share holders of the parent entity}}{\text{weighted average number of ordinary shares outstanding during the period}}$$

Segment reporting

Large companies produce a wide range of products and services, in several different countries. Thus, large companies engage in different business activities and operate in different economic environments. Information on the overall results of companies from each of these products or geographical areas will help th users of the financial statements. This is the reason for segmenting reporting. Segment reporting is covered by IFRS 8 or Ind AS 108.

Objectives

IFRS 8 establishes principles for reporting information by operating segments, that is, information about the different business activities of an entity and the different economic environments in which it operates. IFRS 8 requires the identification of operating segments on the basis of internal reports that senior management (also referred to as the chief operating decision maker) use when determining the allocation of resources to a segment and assessing its performance. Scope This standard applies to the stand-alone financial statements of individual entities and the consolidated financial statements of a group with a parent, whose equity or debt securities are traded in a public securities market or that are in the process of issuing such instruments. Other entities that voluntarily choose disclosure under this standard should comply fully with the requirements of IFRS 8. A parent entity is required to present segment information only on the basis of its consolidated financial statements. If a subsidiary's own securities are publicly traded, it will present segment information in its own separate financial report.

Events after reporting period (AS 10&Ind AS 10)

There is always a time gap between the balance sheet date and the date on which the financial statements are approved. During this gap of time, some events shall take place. Such events are called events after reporting period. Thus, events after reporting period happen in the period starting immediately after the balance sheet date and ending at the date of approval of financial statements.

Objectives

- ✓ When an entity should adjust its financial statements for events after the reporting period
- ✓ The disclosure that an entity should give about the date when the financial statement is approved and about events after reporting period.

Scope

- ✓ Accounting treatment of events after the reporting period
- ✓ Disclosure of events after the reporting period

Disclosure of related party transactions

Related party relationships are a normal feature of commerce and business. A related party relationship could have an effect on the profit or loss and financial position of an entity. Related parties may enter into transactions that unrelated parties would not.

Objectives

The objectives of this standard is to ensure that an entity's financial statements contain the disclosure necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties.

Scope

- ✓ Identifying related party relationships and transactions
- ✓ Identifying outstanding balances between an entity and its related parties

- ✓ Identifying the circumstances in which disclosure is required in the financial statements and
- ✓ Determining the disclosure to be made

Accounting policies, changes in accounting estimates and errors (IAS 8 and Ind AS 8)

An entity may be required to change accounting policies and accounting estimates. Similarly, some errors might have committed in financial statements. The IAS (Ind AS)8 guides an entity in selecting and changing accounting policies, changing its accounting estimates and in correction of errors.

Objectives

The objective of this standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors.

Scope

- ✓ Selection and application of accounting policies
- ✓ Accounting for changes in accounting polices
- ✓ Changes in accounting estimates
- ✓ Corrections of prior period errors

Interim reporting

In order to make economic decisions, users require the latest financial information of an entity. They cannot wait a full year for the annual report. Therefore, companies generally publish interim financial report usually at the end of 6 months. Interim financial reporting improves the ability of investor, creditors, and other to understand an entity's capacity to generate earnings and cash flows and its financial conditions and liquidity.

Objectives

The objectives of this standard is to prescribe the minimum content of an interim financial report and the recognition and measurement principles for an interim financial report.

Scope

IAS 34 or Ind AS 34 is not mandatory. However, regulators (like SEBI) often require entities whose debt or equity securities are publicly traded to publish interim financial reports. Ind AS 34 is applicable with Indian accounting standards.

Reference Books:

1. Chintal Patel, Bhupendra Mantri, India Accounting Standards, Taxmann Publications.
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4. S.N. Maheshwari and S.K. Maheshwari, Financial Accounting. 5
5. R.L. Gupta and Radhaswamy, Advanced Accounting, Sultan Chand &Sons, New Delhi.
6. Dr Goyal V.K., Financial Accounting, Excel Books, New Delhi.
7. Ashok Sehgal and Deepak Sehgal, Advanced Accounting, Kalyani Publishers.
8. Jain and Narang, Financial Accounting, Kalyani Publishers.
9. B.S. Raman, Advanced Accountancy.
10. P.C. Tulasian, Introduction to Accounting, Pearson Education.