

UNIT – I

VALUATION OF SHARES AND GOODWILL

What is Share Valuation?

Valuation of shares is the process of knowing the value of company's shares. Share valuation is done based on quantitative techniques and share value will vary depending on the market demand and supply. The share price of the listed companies which are traded publicly can be known easily. But w.r.t private companies whose shares are not publicly traded, valuation of shares is really important and challenging.

When is Valuation of shares required?

Listed below are some of the instances where valuation of shares is important:

- One of the important reason is when you are about to sell your business and you wanted to know your business value
- When you approach your bank for a loan based on shares as a security
- Merger, acquisition, reconstruction, amalgamation etc – valuation of shares is very important
- When your company shares are to be converted i.e. from preference to equity
- Valuation is required when implementing an employee stock ownership plan (ESOP)
- For tax assessments under the wealth tax or gift tax acts
- In case of litigation, where share valuation is legally required
- Shares held by an Investment company
- Compensating the shareholders, the company is nationalized

Sometimes, even publicly traded shares have to be valued because the market quotation may not show the true picture or large blocks of shares are under transfer etc.

How to choose the share valuation method?

There are various reasons for adopting a particular method for share valuation; it generally depends upon the purpose of valuation. Using a combination of methods generally provides a more reliable valuation. Let's see under each approach what the main reason is:

1. Assets Approach

If a company is a capital-intensive company and invested a large amount in capital assets or if the company has a large volume of capital work in progress then asset-based approach can be used. This method is also applicable for valuing the shares during amalgamation, absorption or liquidation of companies.

2. Income Approach

This approach has two different methods namely Discounted Cash Flow (DCF) or Price Earning Capacity (PEC) method. DCF method uses the projection of future cash flows to determine the fair value and if this data is reasonably available, DCF method can be used. PEC method uses historical earnings and if an entity is not in the business for a long time and just started its operations, then this method cannot be applied.

3. Market Approach

Under this approach, the market value of the shares is considered for valuation. However, this approach is feasible only for listed companies whose share prices can be obtained in the open market. If there are set of peer companies which are listed and engaged in the similar business, then such company's share public prices can also be used.

What are Methods of Share Valuation?

There is no one valuation method that will fit any purpose, hence there are various methods of share valuation depending upon the purpose, data availability, nature and volume of the company etc.

1. Asset-based

This approach is based on the value of company's assets and liabilities which includes intangible assets and contingent liabilities. This approach may be very useful to manufacturers, distributors etc where a huge volume of capital assets are used. This approach is also used as a reasonableness check to confirm the conclusions derived under the income or market approaches.

Here, the company's net assets value is divided by the number of shares to arrive at the value of each share. Following are some of the important points to be considered while valuing of shares under to this method:

- All the asset base of the company including current assets and liabilities such as receivables, payables, provisions should be considered.
- Fixed assets have to be considered at their realizable value.
- Valuation of goodwill as a part of intangible assets is important
- Even unrecorded assets and liabilities to be considered
- The fictitious assets such as preliminary expenses, discount on issue of shares and debentures, accumulated losses etc. should be eliminated.

For determination of the net value of assets, deduct all the external liabilities from the total asset value of the company. The net value of assets so determined has to be divided by the number of equity shares for finding out the value of the share. The formula used is as follows:

$$\text{Value per share} = \frac{\text{Net Assets} - \text{Preference share Capital}}{\text{Number of Equity Shares}}$$

2. Income-based

This approach is used when the valuation is done for a small number of shares. Here, the focus is on the expected benefits from the business investment i.e what the business generates in the future. A common method used is the estimate of a business's value by dividing its expected earnings by a capitalization rate. There are two other methods used such as DCF and PEC. PEC can be used by an established entity and newly started business or companies with volatile short-term earnings expectations can use the more complex analysis such as discounted cash flow analysis.

Value per share is calculated on the basis of profit of the company available for distribution. This profit can be determined by deducting reserves and taxes from net profit.

Listed below are the steps to determine the value per share under the income-based approach:

- Obtain the company's profit (available for dividend)
- Obtain the capitalized value data
- Calculate the share value (Capitalized value/ Number of shares)

Capitalized Value is calculated as follows:

$$\text{Capitalized value} = \frac{\text{Profit available for equity dividend}}{\text{Normal Rate of Return}} \times 100$$

3. Market-based

The market-based approach generally uses the share prices of comparable public traded companies and the asset or stock sales of comparable private companies. Data related to private

companies can be obtained from various proprietary databases available in the market. What is more important is how to choose the comparable companies – a lot of pre- conditions to be kept in mind while selecting such as nature and volume of the business, industry, size, financial condition of the comparable companies, the transaction date etc.

There are two different methods when using the yield method (Yield is expected rate of return on an investment) they are explained below:

1. Earning Yield

Shares are valued on the basis of expected earning and the normal rate of return.

Under this method, value per share is calculated using the below formula:

$$\text{Expected rate of Earning} = \frac{\text{Profit after tax}}{\text{Equity Share paid up value}} \times 100$$

$$\text{Value per share} = \frac{\text{Expected rate of earning}}{\text{Normal rate of return}} \times \text{Paid up Equity Value}$$

2. Dividend Yield

Under this method, shares are valued on the basis of expected dividend and the normal rate of return. The value per share is calculated by applying following formula:

Expected rate of dividend = (profit available for dividend/paid up equity share capital) X 100

$$\text{Expected rate of Dividend} = \frac{\text{Profit available for Dividend}}{\text{Equity Shares paid up value}} \times 100$$

Factors affecting valuation of shares:

Demand and supply

Demand and supply of securities influence price of securities. If the demand of securities is more than the supply (buyers are more than the sellers), prices of securities increase. On the other hand if the demand of securities is less than the supply (buyers are less than the sellers), prices of securities decrease.

2. Bank rate

In case of lower bank rate (lower interest rate), the demand for funds would be higher and the demand for securities would be high. Whereas in case of higher bank rate (high interest rate), the demand for funds would be lower and therefore the demand for securities would be lower.

3. Market players

Security prices are influenced by the market players. If the number of bulls are more than the bears, then the prices of securities would increase. On the other hand, if the bears are more than the bulls, the prices of securities would decline.

4. Dividend announcements

Dividends act as a signalling device for share price movement. Dividend announcements influence share prices. If companies announce dividends, generally share prices of those companies tend to increase. An important point to note is, if the rate of dividend announced is less than what was expected by investors, share prices would decline, whereas if they are up to or more than expectations, share prices would increase.

5. Management profile

Management profile significantly influences success of companies and therefore they have an important influence on share prices. If the management comprises of educated, experienced professionals with a successful track record then share prices would be higher. In case the company is taken over by a management having a poor reputation then the share prices would fall.

6. Trade cycle

Trade cycles refer to cyclical fluctuations in economic activity. During boom conditions the share prices would be at their peak and during depression they would be at their lowest point. Share prices would gradually increase during recovery conditions and would fall during conditions of recession.

7. Speculation

In case speculation in the market is high or in case speculation in a stock is high, then the price of that share would be showing high fluctuations. In case speculation is at a low level then the fluctuations in share price would be lower.

8. Political factors

Political factors such as ideology of the party in power, policies of the government, relations with other countries influence share prices. For e.g. when the UPA government won

elections, share prices fell to a great extent because it was felt that the government policies would be influenced by the communist parties.

9. Industrial relations

In case there is good relationship between the workers and the management of a company, the productivity would be high leading to better profits. Therefore share prices would be higher. In case of companies where industrial relations are poor and strikes and lockouts occur regularly, performance of the company would be poor. Therefore share prices would fall.

10. Stability of government

When there is a stable government, businessmen feel confident to invest in new businesses and expand existing businesses. Production, sales and profits are higher and consequently share prices would increase. In case of instability in the government, new investments do not take place. Demand, production and profits are lower and share prices fall.

11. General market sentiments

It is generally said that sentiments move the markets. If there is optimism among market players, more buying would take place leading to increase in share prices. In case market players are pessimistic, then more selling would take place pushing down share prices.

12. Actions of institutional investors

Share prices are influenced by Institutional investors such as mutual funds, investment trusts, pension funds etc. They have large amount of funds at their disposal. When they start buying, share prices would increase and when they sell, share prices decline

13. Level of foreign investment

In recent times, the level of foreign institutional investors (FII's) have played a significant role in influencing share prices. If the level of foreign investment in the market increases (more buying of shares), then the share prices increase. If the level of foreign investment decreases or if FII's sell their investments, then the markets fall.

14. Returns offered by other markets

If the Indian markets offer high returns, institutional investors (especially FII's) would invest in Indian markets. Demand for shares would increase and prices rise. In case returns offered by markets in other countries are attractive, then institutional investors would sell their securities in

order to invest in those markets. In such cases, shares would be sold in large quantities lowering prices.

15. Availability of credit

In case credit is available without much restriction, then investors would borrow to invest in the markets. Demand for shares would be more and therefore prices rise. In case credit is restricted, then the level of borrowing would be less and demand for shares would also be lower.

16. Effective regulation

If the stock market is run in a transparent manner with effective regulation then the investors would feel confident to invest. Therefore more buying would take place and share prices increase. But when regulation is ineffective and if scams occur (Harshad Mehta scam, MS Shoes scam, CRB scam, Ketan Parekh scam and the recent IPO scam) investors would lose confidence. They would panic and sell their shares. So prices would fall.

SUM : 1

The following is the Balance Sheet of NSC Ltd. as on 31st Dec 1998.

Liabilities	Rs.	Assets	Rs.
4,000 10% pref. shares of Rs. 100 each	4,00,000	Sundry assets at book value	12,00,000
60,000 equity shares of Rs. 10 each	6,00,000		
Bills Payable	50,000		
Creditors	1,50,000		
	12,00,000		12,00,000

The market value of 60% of the assets is estimated to be 15% more than the book value and that of the remaining 40% at 10% less than the book value. There is an unrecorded liability of Rs. 10,000.

Find the value of each equity share (it is to be assumed that preference shares have no prior claim as to payment of dividend or to repayment of capital).

Solution

Calculation of net assets:

Sundry assets:	Rs.	Rs.
$12,00,000 \times 60\% \times 115\%$		8,28,000
$12,00,000 \times 40\% \times 90\%$		4,32,000
Total		12,60,000
Less: Current Liabilities:		

Bills Payable	50,000	
Creditors	1,50,000	
Unrecorded Liability	<u>10,000</u>	2,10,000
		10,50,000
Less: Preference Share capital		4,00,000
Net assets available for equity shareholders		6,50,000

$$\text{Intrinsic value per share} = \frac{\text{Net assets for Equity Shareholders}}{\text{No of Equity shares}}$$

$$= \frac{6,50,000}{60,000} = \text{Rs.10.83}$$

SUM : 2

The balance sheet of Saraswati Co. Ltd. disclosed the following position as on 31st December 1998.

Liabilities	Rs.	Assets	Rs.
<i>Share Capital</i>		Goodwill	1,65,000
6,000 equity shares of Rs.100 each	6,00,000	Investments	5,25,000
	75,000	Stock	6,60,000
Profit & Loss A/c	2,25,000	Sundry Debtors	3,90,000
General Reserve	4,50,000	Cash at Bank	60,000
6% Debentures	1,50,000		
Sundry Creditors	3,00,000		
Workmen's Savings bank A/c			
	18,00,000		18,00,000

- i) The profits for the past five years were:
1994 –Rs. 30,000; 1995 – Rs. 70,000; 1996 – Rs. 50,000; 1997 – Rs. 55,000 and 1998- Rs.95,000.
- ii) The market value of investments was Rs. 3,30,000.
- iii) Goodwill is to be valued at three years purchase of the average annual profits for the last five years. Find the intrinsic value of each share.

Solution:

i) Calculation of value of goodwill

$$\begin{aligned} \text{Total profits for 5 years} &= \text{Rs. } 30,000 + \text{Rs. } 70,000 + \text{Rs. } 50,000 + \text{Rs. } 55,000 + \text{Rs. } 95,000 \\ &= \text{Rs. } 3,00,000. \end{aligned}$$

$$\text{Average Profits per year} = \frac{3,00,000}{5} = \text{Rs. } 60,000$$

Goodwill	=	Average profits x No. of years purchase
	=	Rs. 60,000 x 3 years
	=	Rs. 1,80,000.

ii) Calculation of Intrinsic value of share

Calculation of Net Assets:

Rs.

Assets at Market value

Goodwill	1,80,000		
Investments	3,30,000		
Stock	6,60,000		
Sundry Debtors	3,90,000		
		<u>60,000</u>	
Cash at Bank		16,20,000	
Less: Liabilities			
6% debentures		4,50,000	
Sundry Creditors		1,50,000	
Workmen's Savings bank A/c		<u>3,00,000</u>	9,00,000
Net assets			<u>7,20,000</u>

iii) Intrinsic Value of each share

$$\begin{aligned} &= \frac{\text{Net assets}}{\text{No. of Equity shares}} \\ &= \text{Rs. } 7,20,000 \\ &\quad \frac{6000 \text{ shares}}{6000} \\ &= \text{Rs. } 120. \end{aligned}$$

SUM : 3

On 31st Dec 1998, the Balance Sheet of Ganesh Ltd. was as follows:

Liabilities	Rs.	Assets	Rs.
<i>Share Capital</i>		Land and Buildings	6,60,000
15,000 equity shares of Rs.100		Plant & Machinery	2,85,000
each fully paid	15,00,000	Stock	10,50,000
Profit & Loss A/c	3,09,000	Sundry Debtors	4,65,000
Sundry Creditors	2,31,000		
Bank Overdraft	60,000		
Provision for taxation	1,35,000		
Dividend equalisation fund	2,25,000		
	24,60,000		24,60,000

The net profit of the company, after deducting all working charges and providing for depreciation and taxation were as under:

1994 – Rs. 2,25,000; 1995 – Rs. 2,88,000; 1996 – Rs. 2,70,000; 1997 – Rs. 3,00,000; and
1998 – Rs. 2,85,000

On 31st Dec. 1998, Land & buildings were valued at Rs. 7,50,000 and Plant & Machinery at Rs.4,50,000.

In view of the nature of the business, it is considered that 10% is a reasonable return on capital.

Calculate the value of the company's share after taking into account the revised values on fixed assets and your own valuation of goodwill based on four years purchase of the annual super profits.

Solution

i)

Computation of Goodwill:

Calculation of average capital employed:

Rs.

Total net assets:

Land and Buildings	7,50,000
Plant & Machinery	4,50,000
Stock	10,50,000

Sundry Debtors		4,65,000	
			27,15,000
Less: External Liabilities			
Sundry Creditors	2,31,000		
Bank Overdraft	60,000		
Provision for taxation	1,35,000	4,26,000	
Net assets or capital employed		<u>22,59,000</u>	
Less: ½ of net profit of 1998 (2,85,000 x ½)			
			<u>1,42,500</u>
Average capital employed			<u>21,46,500</u>

ii) Normal Profit = Average capital employed x Normal rate of return
= $21,46,500 \times \frac{10}{100}$
= Rs. 2,14,650

iii) Average Profit
Total Profits = Rs. 2,25,000 + R. 2,88,000 + Rs. 2,70,000 + Rs. 3,00,000
+ Rs. 2,85,000 = Rs. 13,98,000.
Average Profit = $\frac{13,98,000}{5}$
= Rs. 2,79,600

iv) Super Profit = Average profit – Normal Profit
= Rs. 2,79,600 – Rs. 2,14,650
= Rs. 64,950

v) Goodwill = Super profit x No. of years purchase
= Rs. 64,950 x 4 years

$$= \text{Rs. } 2,59,800.$$

Valuation of Shares

Net assets (as above)	=	22,89,000
Goodwill		2,59,800
Net assets available for equity sharehodlers		<u>25,48,800</u>

$$\text{Intrinsic value of shares} = 25,48,800 = \text{Rs. } 169.92$$

1500 shares

SUM : 4

On 31st March 1998, the balance sheet of Glorious Ltd. was as follows:

Liabilities	Rs.	Assets	Rs.
<i>Share Capital</i>		Goodwill	1,00,000
8% Preference shares of Rs. 100	2,00,000	Land and Buildings	2,20,000
Each fully paid		Machinery	3,00,000
4,000 equity shares of Rs. 100 each	4,00,000	Furniture	40,000
fully paid	1,60,000	Investment in 4% govt. Securities at cost (face value Rs. 80,000)	1,00,000
General Reserve	1,20,000	Stock	3,00,000
Capital Reserve	1,20,000	Bad debts	1,20,000
Profit & Loss A/c	1,80,000	Cash at bank	60,000
5% debentures	40,000		
Sundry Creditors			
Provision for taxation			
	12,40,000		12,40,000

The assets were revalue as under	Rs.
Land & Building	3,00,000
Machinery	2,50,000
Furniture	50,000

The normal return on capital employed for valuation of goodwill is 12%, the basis of valuation being four years purchase of super profits. 50% of investments in building is treated as non-trading asset because a sum of Rs. 15,000 is collected annually as rent from the building. Calculate the value of each equity share assuming that the average annual profit after tax at 50% is Rs. 1, 40,000.

Solution**i) Computation of Goodwill:****Calculation of capital employed:**

	Rs.	Rs.
Fixed assets (as revalue)	Rs.	
Land and Buildings	3,00,000	
Machinery	2,50,000	
Furniture	<u>50,000</u>	6,00,000
Less: (i.e. Rs. 3,00,000 x 5%) Non-trading buildings		1,50,000
		<hr/>
		4,50,000
Add: Current Assets:		
Stock	3,00,000	
Book Debts	1,20,000	
Cash in Bank	60,000	4,80,000
		<hr/>
		9,30,000
Less: External Liabilities		
5% debentures	1,20,000	
Sundry Creditors	1,80,000	
Provision for taxation	40,000	3,40,000
capital employed	<u> </u>	<u>5,90,000</u>

b) Calculation of average trading profit

Average annual profit after tax	1,40,000
Less: Non-trading income (less 50% tax)	
Rent – 50% of Rs. 15,000	7,500
Interest on Investment – 50% of Rs. 3,200	

(80,000 x 4%)	<u>1,600</u>	9,100
		<u>1,30,900</u>
		<u> </u>

c) Calculation of Super Profit

	Average trading profit	1,30,900
Less:	Normal Profit (5,90,000 x 12%)	<u>70,800</u>
	Super Profit	<u>60,100</u>

d) Calculation of value of goodwill

$$\begin{aligned}
 \text{Goodwill} &= \text{Super profit} \times \text{No. of year purchase} \\
 &= \text{Rs. } 60,100 \times 4 \text{ years} \\
 &= \text{Rs. } 2,40,000
 \end{aligned}$$

II. Computation of value of each equity share

a)

Calculation of net assets

	Goodwill		Rs.
	Land and Building	Rs.	
	Machinery		2,40,400
	Furniture		3,00,000
	Investments		2,50,000
	Stock		50,000
	Book Debts		1,00,000
	Cash at Bank		3,00,000
			1,20,000
			60,000
Less:			<u>14,20,400</u>
	5% debentures		
	Sundry Creditors	1,20,000	
	Provision for taxation	1,80,000	
	8% preference share capital	40,000	
	Net Assets	<u>2,00,000</u>	<u>5,40,000</u>
			<u>8,80,400</u>

b) Intrinsic Value of share = $\frac{\text{Net asset}}{\text{No. of equity shares}} = \text{Rs. } 8,80,400$

$\frac{8,80,400}{4000 \text{ shares}} = \text{Rs. } 220.10$

SUM : 5

From the following information, compute the “Intrinsic value” of an equity share of Sunny Ltd.

Liabilities	Rs.	Assets	Rs.
2,000 equity shares of Rs.100 each, fully paid	2,00,000	Land & Building	80,000
2,000 6% preference shares of Rs. 10 each	20,000	Plant & Machinery	80,000
General reserve	50,000	Book debts	10,000
5% debentures of Rs.100 each	20,000	Stock-in-trade	40,000
Sundry creditors		Cash & Bank balance	70,000
		Investment in 5% Govt. securities	20,000
		Preliminary expenses	10,000
	3,10,000		3,10,000

- (i) Fair return on capital employed in this type of business is 10% p.a.
- (ii) Goodwill is to be taken at 4 years purchase value of super profits.
- (iii) Average of the profits (after deduction of preliminary expenses) for the last seven years is Rs. 38,000. Preliminary expenses to the extent of Rs. 2,000 have been written off every year for the last seven years. Profit is more or less stable over years and the same trend is expected to be maintained in the near future. Ignore taxation.

Solution:

(a) Computation of goodwill

(i) Calculation of capital employed

	Rs.	Rs.
Land & Building		80,000
Plant & Machinery		80,000
Book debts		10,000
Stock-in-trade		40,000
Cash & Bank balance		70,000
		2,80,000
Less : External liabilities		
Sundry creditors	20,000	
5% debentures	<u>20,000</u>	40,000
Capital employed		2,40,000

(ii) **Normal profit** = Rs. 2,40,000 x 10% = Rs. 24,000

(iii) **Average profit** 38,000

Less : Interest on investments (20,000 x 5%) 1,000

—————
37,000

iv) Super Profit = Average profit – Normal Profit

= Rs. 37,000 – Rs. 24,000

= Rs. 13,000

- v) Goodwill = Super Profit x No. of years purchase
= Rs. 13,000 x 4 years
= Rs. 52,000

b) Computation of value of each equity share

Calculation of net assets

	Rs.	Rs.
Investment		20,000
Goodwill		52,000
Land and Building		80,000
Plant & Machinery		80,000
Bad Debts		10,000
Stock in trade		40,000
		70,000
Cash and Bank balances		3,52,000
Less:		
5% debentures	20,000	
Sundry Creditors	20,000	
Preference share capital	20,000	60,000
Net assets available for equity shareholders	2,92,000	2,92,000

$$\begin{aligned}
 \text{c) Intrinsic Value of share} &= \frac{\text{Net asset}}{\text{No. of equity shares}} \\
 &= \text{Rs. } 2,92,000 \\
 &= \frac{\text{Rs. } 2,92,000}{2000 \text{ shares}} \\
 &= \text{Rs. } 146 \text{ SUM : 6}
 \end{aligned}$$

From the following Balance Sheet of Sweetex Ltd. you are asked to-ascertain the value of each Equity Share of the company:

Liabilities	Rs	Assets	Rs
20,000 Equity Shares of Rs.10 each ,fully paid	2,00,000	Good will	30,000
1,000 ,6% Preference shares of Rs 100 each ,fully paid	1,00,000	Land and building	1,00,000
Reserves	60,000	Plant and machinery	1,20,000
Sundry creditors	40,000	Investments (at cost)	60,000
Provision for Taxation	20,000	Stock	50,000
Other liabilities	10,000	Debtors	40,000
		Cash at bank	24,000
		Preliminary Expenses	6,000
	4,30,000		4,30,000

For the purpose of valuing the shares of the company, the assets were revalued as: Goodwill Rs. 50,000; Land and Building at cost plus 50%, Plant and Machinery Rs. 1, 00,000; Investments at book values; Stock Rs. 80,000 and Debtors at book value, less 10%.

Solution

	Rs
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Net Assets	
Goodwill	50,000
Land and building (1,00,000 + 50,000)	1,50,000
Plant and machinery	1,00,000
Investments	60,000
Stocks	80,000
Debtors (40,000-4000)	36,000
Cash at bank	24,000

	5,00,000
Less current liabilities	
Sundry creditors 40,000	
Prov.for taxation 20,000	
Other liabilities 10,000	
	70,000
	4,30,000
Less :	
Preference share capital	1,00,000
Funds available for Equity shareholders	3,30,000

Intrinsic Value of each share = Funds available for Equity Shares/Total Number of Shares

Intrinsic Value of shares = Rs. 3, 30,000/20,000

= Rs. 16.50.

Intrinsic Value of Shares on the Basis of Valuation of Goodwill

B. Yield-Basis Method:

Yield is the effective rate of return on investments which is invested by the investors. It is always expressed in terms of percentage. Since the valuation of shares is made on the basis of Yield, it is called Yield-Basis Method. For example, an investor purchases one share of Rs. 100 (face value and paid-up value) at Rs. 150 from a Stock Exchange on which he receives a return (dividend) @ 20%.

Yield may be calculated as :

$$yield = \frac{\text{Normal Profit}}{\text{capital Employed}} \times 100$$

Note :

Practically ,yield may also be termed as expected Yield, normal rate of return /earning rate of fair return, rate of general Expectations, estimated rate for capitalization etc

Under Yield-Basis method, valuation of shares is made on;

(i) Profit Basis;

(ii) Dividend Basis.

(i) Profit Basis:

Under this method, at first, profit should be ascertained on the basis of past average profit; thereafter, capitalized value of profit is to be determined on the basis of normal rate of return, and, the same (capitalized value of profit) is divided by the number of shares in order to find out the value of each share.

The following procedure may be adopted:

$$\text{capitalised value of profit} = \frac{\text{profit}}{\text{normal rate of return}} \times 100$$

$$\text{value of each equity share} = \frac{\text{capitalised value of profit}}{\text{Number of shares}}$$

OR

$$\text{value of equity share} = \frac{\text{profit}}{\text{normal rate of return} \times \text{number of equity share}} \times 100$$

SUM : 9

Two companies, A Ltd. and B. Ltd., are found to be exactly similar as to their assets, reserves and liabilities except that their share capital structures are different:

The share capital of A. Ltd. is Rs. 11,00,000, divided into 1,000, 6% Preference Shares of Rs. 100 each and 1,00,000 Equity Shares of Rs. 10 each.

The share capital of B. Ltd. is also Rs. 11,00,000, divided into 1,000, 6% Preference Shares of Rs. 100 each and 1,00,000 Equity Shares of Rs. 10 each. .

The fair yield in respect of the Equity Shares of this type of companies is ascertained at 8%. The profits of the two companies for 2009 are found to be Rs. 1, 10,000 and Rs. 1, 50,000, respectively.

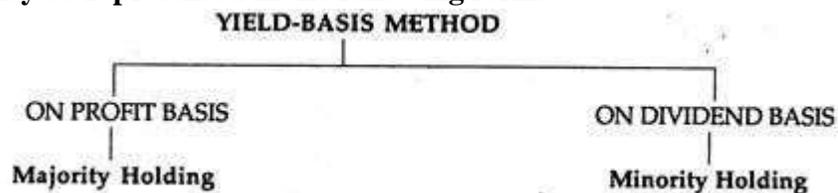
Calculate the value of the Equity Shares of each of these two companies on 31.12.2009 on the basis of this information only. Ignore taxation.

Solution

Valuation of shares of A .Ltd	Rs	Valuation of shares of B .Ltd	Rs
Average profit of 2 years $= \frac{1, 10, 000 + 1, 50,000}{2}$	1,30,000	Average profit	1,30,000
Less : Preference Dividend 6% on 10,00,000	60,000	Less : Pref. Dividend 6% on 1,00,000	6,000
Maintainable Profit	70,000	Maintainable Profit	1,24,000

Capitalized value of profit $\frac{70,000}{8} \times 100$ = 8,75,000 Value of each Equity share $\frac{8,75,000}{10,000} = 87.50$		Capitalized value of profit $\frac{1,24,000}{8} \times 100 =$ 15,50,000 Value of each Equity share $\frac{15,50,000}{1,00,000} = 15.50$	
--	--	---	--

The same principle may be represented in the following form:



Note:

Yield-Basis Method may also be termed as:

Market Value Method; Profit Basis/Income Basis Method; Earning Capacity Method etc.

Value of share under yield basis:

SUM : 11

On December 31, 2009 the Balance Sheet of MA KALI Ltd. disclosed the following position:

Liabilities	Rs	Assets	Rs
Issued capital in Rs.10 shares	4,00,000	Fixed assets	5,00,000
Reserves	90,000	Current Assets	2,00,000
Profit and loss account	20,000	Goodwill	40,000
5% Debenture	1,00,000		
Current liabilities	1,30,000		
	7,40,000		7,40,000

Net profit for three Years were:	
2007	51,600
2008	52,000
2009	51,650

Of which 20% was placed to Reserve, this proportion being considered reasonable in the industry in which the company is engaged and where a fair investment return may be taken at 10%.

Compute the value of the company's share under yield-basis method.

Solution

$$\text{Average profit} = \frac{51,600 + 52,000 + 51,650}{3} = 51,750$$

$$\text{less : transfer to reserve @20\%} = 10,350$$

Maintainable Profit	41,400

Here the rate of dividend is not given the same can be found out with the help of the following

$$\text{Rate of dividend} = \frac{\text{profit}}{\text{Equity capital (Paidup)}} \times 100$$

$$\frac{41,000}{4,00,000} \times 100 = 10.35\%$$

$$\text{value of each equity share} = \frac{\text{rate of dividend}}{\text{normal rate of return}} \times (\text{paid up value of each equity share})$$

$$= \frac{10.35}{10} \times 10$$

$$= \text{Rs. } 10.35$$

SUM : 12

Calculate the value of each Equity Share from the following information:

	Rs
Share capital	

20,000 equity shares of 10 each ,Rs 8 per share paid up	1,60,000
1000 ,10% preference shares of Rs100 each ,fully paid up	1,00,000
Expected profit (before tax and pref .dividend)	1,00,000
Normal rate of return	10%
Rate of tax	50%
Transfer to Reserve	20%

Solution :

Calculation of Rate of Dividend	Rs
Profit (before Tax and Pref.Dividend)	1,00,000
Less : income – Tax@ 50%	50,000
	50,000
Less : Transfer to Reserve @20%	10,000
	40,000
Less Pref.Divided @10%	10,000
Available for equity shareholders	30,000

Rate of Dividend = 30,000 / 1,00,000 * 100

= 30%

Value of each equity share = Rate of dividend/ normal rate of return* paidup value of each equity share

= 30% / 10% * 8

= 24

C. Fair Value Method:

There are some accountants who do not prefer to use Intrinsic Value or Yield Value for ascertaining the correct value of shares. They, however, prescribe the Fair Value Method which is the mean of Intrinsic Value Method and Yield Value Method. The same provides a better indication about the value of shares than the earlier two methods.

$$\text{Fair value} = \frac{\text{intrinsic value} + \text{yield value}}{2}$$

SUM : 13

The following is the Balance Sheet of X Co. Ltd. as on 31.12.2009:

Liabilities	Rs	Assets	Rs
-------------	----	--------	----

Share capital :		Good will	50,000
Equity share of Rs.10 each	1,00,000	Building	1,50,000
12% pref.share of Rs.100 each	1,00,000	Plant	1,00,000
General reserve	60,000	Investment in	
Profit and loss a/c	40,000	10% stock (market value of	48,000
15% debentures	1,00,000	Rs 52,000, Nominal value	
creditors	80,000	Rs.50,000)	
		Stock	60,000
		Debtors	40,000
		Cash	10,000
		Preliminary Expenses	22,000
	4,80,000		4,80,000

Ascertain the value of each equity share under Fair Value Method on the basis of the information given:

Assets are revalued as:

Building Rs. 3, 20,000, Plant Rs. 1, 80,000, Stock Rs. 45,000 and Debtors Rs. 36,000.

Average Profit of the company is Rs. 1, 20,000 and 12½% of profit is transferred to General Reserve, Rate of taxation being 50%. Normal dividend expected on equity shares is 8% whereas fair return on capital employed is 10%. Goodwill may be valued at 3 years' purchase of super-profit.

Calculation of good will	
Total net assets	3,20,000
Building	1,80,000
Plant	45,000
Stock	36,000
Cash	10,000
Less: current liabilities:	
Creditors	80,000
Capital employed
Capital Employed	5,11,000

Normal profit Rs. 51,000 ($5,11,000 = \frac{10}{100}$)

Actual Profit

Average Profit Non trading income ie .income from investment @10% on Rs.50,000	1,20,000 5000
Add: Debenture interest Less: Pref.Dividend Less: Taxation @50% Less : transfer to reserve @12.5%	1,15,000 15,000 1,30,000 12,000 1,18,000 59,000 59,000 7,375 <u>51,625</u>
Super Profit Valuation of goodwill	= Actual profit – Normal Profit = 51,625 – 51,100 = 525 = 525 x 3 = 1575 or 1,600
Valuation of shares Asset – backing Method	
Sundry assets (as above) Add :investments Add:Goodwill	5,11,000 48,000 <u>1,600</u> <u>5,60,600</u>
Intrinsic value of share	5,60,600/10,000 = 56.06

Yield basis Value of share	$\frac{\text{Rate of Dividend}}{\text{normal rate of return}} \times \text{paidup value of each share}$ $\frac{8}{10} \times 10 = 8$
Fair value Fair value	$\frac{\text{intrinsic value} + \text{yield basis}}{2}$ $\frac{56.06 + 8}{2}$ $= 32.03$

VALUATION OF GOODWILL

Methods of Goodwill Valuation

Goodwill is the value of the reputation of a firm built over time with respect to the expected future profits over and above the normal profits. Goodwill is an intangible real asset which cannot be seen or felt but exists in reality and can be bought and sold. In partnership, goodwill valuation is very important. Thus, we will here discuss the various methods of Goodwill Valuation.

Goodwill Valuation

A well-established firm earns a good name in the market, builds trust with the customers and also has more business connections as compared to a newly set up business. Thus, the monetary value of this advantage that a buyer is ready to pay is termed as Goodwill. The buyer who pays for

Goodwill expects that he will be able to earn super profits as compared to the profits earned by the other firms. Thus, goodwill exists only in the case of firms making super profits and not in the case of firms earning normal profits or losses.

Goodwill is recorded in the books only when some consideration in money or money's worth is paid for it. Thus, in the context of a partnership firm, the need for valuation of goodwill arises at the time of:

1. Change in the profit sharing ratio amongst the existing partners
2. Admission of a new partner
3. The retirement of a partner
4. Death of a partner
5. Dissolution of a firm where business is sold as going concern.
6. Amalgamation of partnership firms

Factors Affecting the Value of Goodwill

- **Nature of business:** A firm that deals with good quality products or has stable demand for its product is able to earn more profits and therefore has more value.
- **Location of business:** A business which is located in the main market or at a place where there is more customer traffic tends to earn more profit and also more goodwill.
- **Owner's reputation:** An owner, who has a good personal reputation in the market, is honest and trustworthy attracts more customers to the business and makes more profits and also goodwill.
- **Efficient management:** An organization with efficient management has high productivity and cost efficiency. This gives it increased profits and also high goodwill.

- **Market situation:** The organization having a monopoly right or condition in the market or having limited competition, enables it to earn high profits which in turn leads to higher value of goodwill.
- **Special advantages:** A firm that has special advantages like import licenses, patents, trademarks, copyrights, assured a supply of electricity at low rates, subsidies for being situated in a special economic zones (SEZs), etc. possess a higher value of goodwill.

Methods of Valuation of Goodwill

The choice of the method of goodwill valuation depends entirely on the partners or the partnership deed when they have made it.

1. Average Profits Method

i] Simple Average: Under this method, the goodwill is valued at the agreed number of years“ of purchase of the average profits of the past years. $\text{Goodwill} = \text{Average Profit} \times \text{No. of years}“$ of purchase
 ii] Weighted Average: Under this method, the goodwill is valued at an agreed number of years“ of purchase of the weighted average profits of the past years. We use the weighted average when there exists an increasing or decreasing trend in the profits giving the highest weight to the current year“s profit.

- $\text{Goodwill} = \text{Weighted Average Profit} \times \text{No. of years}“$ of purchase
- $\text{Weighted Average Profit} = \frac{\text{Sum of Profits multiplied by weights}}{\text{Sum of weights}}$

Explore more about Treatment of Goodwill

Treatment of Goodwill

- Accounting Treatment of Goodwill- Death/Retirement of Partner □ Accounting treatment of Goodwill- Change in PSR.
- Accounting Treatment of Goodwill in case of Admission of Partner
- Concept of Goodwill

2. Super Profits Method

(i) The Number of Years Purchase Method: Under this method, the goodwill is valued at the agreed number of years“ of purchase of the super profits of the firm.

- Goodwill = Super Profit x No. of years of purchase
- # Super Profit = Actual or Average profit – Normal Profit
- # Normal Profit = Capital Employed x (Normal Rate of Return/100)

(ii) Annuity Method: This method considers the time value of money. Here, we consider the discounted value of the super profit.

$$\square \text{ Goodwill} = \text{Super Profit} \times \text{Discounting Factor}$$

3. Capitalization Method

(i) Capitalization of Average Profits: Under this method, the value of goodwill is calculated by deducting the actual capital employed from the capitalized value of the average profits on the basis of the normal rate of return.

- Goodwill = Normal Capital – Actual Capital Employed
- # Normal Capital or Capitalized Average profits = Average Profits x (100/Normal Rate of Return)
- # Actual Capital Employed = Total Assets (excluding goodwill) – Outside Liabilities

(ii) Capitalization of Super Profits: Under this method, Goodwill is calculated by capitalizing the super profits directly.

$$\square \text{ Goodwill} = \text{Super Profits} \times (100 / \text{Normal Rate of Return})$$

SUM : 1

M/s Mehta and sons earn an average profit of rupees 60,000 with a capital of rupees 4,00,000. The normal rate of return is 10%. Using capitalization of super profits method calculate the value the goodwill of the firm.

Ans: Goodwill = Super profits x (100/ Normal Rate of Return) = 20,000 x 100/10 = 2,00,000.

Working notes:

(i). Normal Profit = Capital employed x Normal Rate of Return/100 = 4,00,000 x 10/100
= 40,000

(ii) Super Profit = Average Profit – Normal Profit = 60,000 – 40,000 = 20,000

SUM : 2

M/s Joe and John is a partnership firm with Joe and John as its partners. They now decide to admit James in the firm and hence need to value goodwill. Capital employed is 5,00,000 at the end of the 4th year. The normal rate of return is 15%. Assume the interest rate is equal to the Normal Rate of Return. Calculate Goodwill using Annuity Method. Their profits for the last 4 years are:

Year	Profits
1	100000
2	120000
3	150000
4	200000

Ans: Goodwill = Super Profit x Discounting factor = 67500 x 2.855 = 192713

Working notes:

(i) Average Profit = Sum of profits / No. of years = 570000/4 = 142500

(ii) Normal Profit = Capital employed x (Normal Rate of Return/100) = 500000 x (15/100) = 75000

(iii) Super Profit = Average Profit – Normal Profit = 142500 – 75000 = 67500

SUM : 3

Calculate the amount of Goodwill on the basis of three years purchase of the last five years' average profits. The profits for the last five years are:

	Rs.
I year	4,800
II Year	7,200
III Year	10,000
IV Year	3,000
V Year	5,000

Solution:

(i) Average Profit

	Rs.
--	-----

I year	4,800
II Year	7,200
III Year	10,000
IV Year	3,000
V Year	5,000
Total	30,000

Average Profit = $\text{Rs. } 30,000 \div 5 = \text{Rs. } 6,000$

5 years

(ii) Goodwill = Average Profit x No. of years of purchase

= Rs. 6,000 x 3

= Rs. 18,000

SUM : 4

The following information is presented for five years ending 31st Dec 1998.

Year	Profits (after Tax) Rs.	Taxation Rs.	Transfer to Reserve Rs.	Director's Remuneration Rs.
1994	25,000	9,000	5,000	2,000
1995	27,500	10,000	6,000	2,250
1996	24,000	7,500	4,000	2,250
1997	32,500	12,500	7,500	2,500
1998	36,000	17,500	7,500	3,000

Fixed assets have been revalued and the same showed an appreciation of Rs.2,50,000 (depreciation to be provided for @ 10%). The company has a 8% preference share capital of Rs. 50,000. The current rate of taxation may be taken @ 50%.

Calculate the value of goodwill on the basis of four years' purchase of the last five years' average profits.

Solution:

i) Calculation of average maintainable profit:

Adjusted = Profit	(given)	+	Tax	+	Director's	=	Rs.
Profit	Rs.		Rs.		Remuneration		
1994	= 25,000	+	9,000	+	2,000	=	36,000
1995	= 27,500	+	10,000	+	2,250	=	39,750
1996	= 24,000	+	7,500	+	2,250	=	33,750
1997	= 32,500	+	12,500	+	2,500	=	47,500
1998	= 36,000	+	17,500	+	3,000	=	56,500
					Total		<u>2,13,500</u>

$$\text{Average Profit} = \frac{2,13,500}{5(\text{Years})} = 42,700$$

Depreciation @ 10% on Rs.2,50,000 = 25,000

$$\text{Director's Remuneration} \quad 3,000 = 28,000$$

Less:

14,700

$$\text{Less: Income Tax @ 50\%} \quad 7,350$$

7,350

$$\text{Less: Preference Dividend} \quad 4,000$$

$$\text{Average Maintainable profit} \quad \underline{\underline{3,350}}$$

$$\begin{aligned} \text{ii) Goodwil} &= \text{Average maintainable profit} \times \text{No. of years' purchase} \\ &= \text{Rs. } 3,350 \times 4 \\ &= \text{Rs. } 13,400 \end{aligned}$$

Note: Director's Remuneration has been considered as Rs. 3000 i.e., the amount prevailing on 31st Dec 1998 and not the average on since the same cannot be paid less than Rs. 3,000 in future.

SUM : 5

Following details are available about the business of Sagar Ltd.

(i) Profits: 1994-Rs. 80,000; In 1995 – Rs. 1,00,000; In 1996 – Rs. 1,20,000; (ii) Non-recurring income of Rs. 8,000 is included in the profit of 1995.

(iii) Profits of 1994 have been reduced by Rs. 12,000 because goods were destroyed by

fire;

- (iv) Goods have not been insured but it is thought prudent to insure them in future. The insurance premium is estimated at Rs.800 per year;
- (v) Reasonable remuneration of the proprietor of the business is Rs. 12,000 per year but it has not been taken into account for calculation of above mentioned profits;
- (vi) Profits of 1996 include Rs. 10,000 income on investment. Calculate goodwill on the basis of three years purchase of the average profit of last three years.

Solution:

Calculation of Average Profits

Year		Rs.	Rs.
1994	Profits	80,000	
	Add: Unusual Loss: Stock destroyed by fire Profits	12,000	92,000
1995		1,00,000	
	Less: Non- recurring income	8,000	92,000
1996	Profits	1,20,000	
	Less: Income on investment Total Profit	10,000	1,10,000
		Rs. 2,94,000	2,94,000
	Average Profits	3 (years)	98,000
	Less: Insurance Premium	800	
	Proprietor's Remuneration	12,000	12,800
	Average Maintainable Profit		85,200

Goodwill = Average maintainable profits x No. of years purchase
 = Rs. 85,200 x 3 years
 = Rs. 2,55,000

SUM : 6

Vatsal who has been carrying on a retail business for the past 20 years, intends selling his business on 31st December 1998. It is agreed between Vatsal and the buyer that the latter pay Rs. 1,50,000 for goodwill. From the following particulars supplied by vatsal. Calculate the value of goodwill if it were based on four years purchase of the average profits of the last five years including the profit of 1998.

Profit earned:

1994 – Rs. 30,000; 1995 – Rs. 40,000; 1996 – Rs. 46,000; 1997 – Rs. 55,000; 1998 – Rs. 44,000

At the time of acquiring Vatsal's business, the buyer was employed as the manager of a similar business on a salary of Rs. 1,000 per month. The profit of 1998 included income from investment Rs.3,500 and profit of 1995 had been reduced by Rs. 4,000 being loss on speculation. Similarly, the profits of 1997 had been reduced by Rs. 6,000 owing to loss from betting.

Solution:

Calculation of Adjusted Profits

Year	Rs.	Rs.
1994	-	30,000
1995	40,000	44,000
Add: Speculation Loss	4,000	
1996	-	46,000
1997	55,000	61,000
Add: Loss from betting	6,000	
1998	44,000	40,500
Less: Income on investment	3,500	
Total Profit		2,21,500
Average profit	Rs. 2,21,500	
=	5	44,300

Less: Proprietor's Remuneration (Rs. 1,000 x 12)		12,000
Average Maintainable Profit		32,300

Goodwill = Average maintainable profits x No. of years purchase
 = Rs. 32,300 x 4 years
 = Rs. 1,29,200

SUM : 7

The profits of Thilaga Ltd. For the last 5 years were as follows:

	Rs.
1994	15,000
1995	18,000
1996	22,000
1997	25,000
1998	27,000

Compute the value of goodwill of Thilaga Ltd. on the basis of 4 years purchase of weighted average profit after assigning weights 1, 2, 3, 4 and 5 serially to the profits **Solution:**

i) Calculation of weighted average profit

Year (1)	Annual Profits (2) Rs.	Weights (3)	Product (2) x (3) Rs.
1994	15,000	1	15,000
1995	18,000	2	36,000
1996	22,000	3	66,000
1997	25,000	4	1,00,000
1998	27,000	5	1,35,000
		15	_____
			3,52,000

Weighted average profits = $\frac{\text{Rs. } 3,52,000}{15} = \text{Rs. } 23,467$

ii) Calculation of value of goodwill:

$$\begin{aligned}
 \text{Goodwill} &= \text{weighted average profit} \times \text{No. of years purchase} \\
 &= \text{Rs. } 23,467 \times 4 \\
 &= \text{Rs. } 93,868
 \end{aligned}$$

Note: Weighted average profits may be taken if there is specific instruction in the problem or there is a clear increasing trend in profits from year to year.

SUM : 8

XYCo. Ltd. has agreed to purchase the business carried on by Thilak. For this purpose, goodwill is to be valued at 4 years' purchase of the weighted average profits of the past five years. The profits of the previous years were:

1994 – Rs. 20,000; 1995 – Rs. 22,000; 1996 – Rs. 24,000; 1997 – Rs. 28,000; 1998 – Rs. 30,000.

The appropriate weights to be used are

1994 – 1; 1995 – 2; 1996 – 3; 1997 – 4; 1998 – 5

The accounts of the business revealed that:

- i) In the year 1994, a major repair was made in respect of Plant & Machinery and the amount involved was Rs. 5,000. It was agreed that the amount, which was charged to revenue, was to be capitalised for the purpose of valuing goodwill subject to 10% depreciation on the diminishing balance method.
- ii) The closing stock for the same year was over valued by Rs.2,000.
- iii) Rs. 2,800 managerial remuneration should be provided for. Calculate the value of goodwill of the business.

Solution:**i) Calculation of adjusted profit**

Year	Profit Rs.	+	Capital Expenditure Rs.	-	Depreciation Rs.	+	Over valuation opening stock Rs.	-	Managerial remuneration Rs.	=	Adjusted Profit
1994	20,000	+	5,000	-	500	+	0	-	2,800	=	19,700
1995	22,000	+	0	-	450	+	2,000	-	2,800	=	20,750
1996	24,000	+	0	-	405	+	0	-	2,800	=	20,795
1997	28,000	+	0	-	365	+	0	-	2,800	=	24,835
1998	30,000	+	0	-	328	+	0	-	2,800	=	26,872

ii) Calculation of weighted average profits:

Year (1)	Adjusted Profits (2) Rs.	Weights (3)	Product (2) x (3) Rs.
1994	19,700	1	15,000
1995	20,750	2	36,000
1996	20,795	3	66,000
1997	24,835	4	1,00,000
1998	26,872	5	1,35,000
		————— 15	————— 3,52,000

iii) Average profit = $\frac{= 3,57,285}{15}$ Rs. 23,819

iv) Value of goodwill = Rs. 23,819 x 4 = Rs. 95,276

Working Note: Calculation of amount of depreciation

		Rs.
	Capital Expenditure	5,000
Less:	Depreciation for 1994 (5,000 x 10%)	500
		4,500
Less:	Depreciation for 1995 (4,500 x 10%)	450
		4,050
Less:	Depreciation for 1996 (4,050 x 10%)	405
		3,645
Less:	Depreciation for 1997 (3,645 x 10%)	365
		3,280
Less:	Depreciation for 1998 (3,280 x 10%)	328
		2,952

SUM : 9

Purchase of Super Profits method

A firm earned net profits during the last three years as follows:

	Rs.
I year	36,000
II Year	40,000
III Year	44,000

The capital investment of the firm is Rs. 1,00,000

A fair return on the capital, having regard to the risk involved, is 10%.

Calculate the value of goodwill on the basis of 3 years' purchase of super profit.

Solution:

i) Calculation of average expected profit

	Rs.
I year	36,000
II Year	40,000
III Year	44,000
Total Profit	1,20,000

$$\text{Average expected profit} = \frac{\text{Rs. } 1,20,000}{3} = \text{Rs. } 40,000$$

ii) Calculation of normal profit

$$\begin{aligned}\text{Normal Profit} &= \text{Capital employed} \times \text{Normal rate of return} \\ &= 1,00,000 \times 10\% \\ &= \text{Rs. } 10,000\end{aligned}$$

iii) Calculation of Super profits

$$\begin{aligned}\text{Super profits} &= \text{Average expected profit} - \text{Normal profit} \\ &= \text{Rs. } 40,000 - \text{Rs. } 10,000 \\ &= \text{Rs. } 30,000\end{aligned}$$

iv) Calculation of Value of goodwill

$$\begin{aligned}\text{Goodwill} &= \text{Super profits} \times \text{No. of years}^{\text{**}} \text{ purchased} \\ &= \text{Rs. } 30,000 \times 3 \\ &= \text{Rs. } 90,000\end{aligned}$$

Note: „Capital Investment of the firm“ is taken as Average Capital employed.

UNIT 2

AMALGAMATION, EXTERNAL AND INTERNAL RECONSTRUCTION

1.1. MEANING OF AMALGAMATION

The term 'Amalgamation' is used when two or more existing business go in for liquidation and a new company is formed to take over the assets and liabilities. An amalgamation happens when two or more companies combine to form a completely new entity. This process is a distinct form of a merger in which neither company that is involved survives as a legal entity and a completely new brand or legal entity is formed. This new entity houses the combined assets and liabilities of both the involved companies.

Ex: A Ltd and B Ltd agrees to amalgamate and form a new company called 'AB' Ltd.

At the end of the year, instead of preparing two separate balance sheets, a combined single amalgamated balance sheet is prepared to find out the true and fair nature of the business

1.2. TYPES OF AMALGAMATION

1. AMALGAMATION IN THE NATURE OF MERGER:

Amalgamation in the nature of a merger As the name suggests, this is the type of amalgamation which works as a merger. In this, the transferee or the stronger company absorbs the transferor or the weaker company and the two entities pool their shareholders' interest, as well as the assets and liabilities. Businesses of both the companies continue to run under the newly formed entity and if the shareholders of the transferor meet the minimum requirements, then they can become shareholders in the new company as well.

2. AMALGAMATION IN THE NATURE OF PURCHASE:

Amalgamation in the nature of a purchase If the shareholders of the transferor company fail to meet the minimum requirements and conditions, then they cannot retain their position in the new entity and the amalgamation process takes place like a purchase which is made by the stronger transferee company wherein only the shareholders of the transferee company become shareholders in the new entity.

Accounting Problems Relating To Amalgamation And External Reconstruction:

1.3 PURCHASE CONSIDERATION

Purchase consideration is the amount which is given to the vendor company for the acquisition of business. They are usually governed by the terms of agreement between the transferor (selling) and transferee (purchasing) companies.

1.4 DIFFERENT TYPES PURCHASE CONSIDERATION :

- **Net Assets Methods**
- **Net Payment Method**
- **Lump Sum Method**
- **Intrinsic Value Method (Or) Share Exchange Method A. NET ASSETS**

METHODS:

Purchase consideration is calculated by taking over the net assets of the business

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

When a company takes over another company, it implies that both assets and liabilities are taken over.

The term 'Assets' taken over includes cash and bank balances also.

Losses shown on the asset side of the balance sheet are not to be taken as assets.

Any specific assets not taken over should be ignored while computing the purchases price.

'Liabilities' includes all amounts due to third parties.

Accumulated profits do not form part of 'liabilities' they belong to shareholders.

Staff provident funds, workmen's saving bank account, workmen's profit sharing fund etc denotes liabilities to third parties.

B. NET PAYMENT METHOD:

The purchase consideration is calculated by adding all payments made by the company in the form of shares, debentures, cash etc. The total purchase consideration consists of shares, debentures, cash and premium also.

C. LUMP SUM METHOD:

The purchase price to be paid may be mentioned in the agreement directly. The lump sum is to be taken as purchase consideration, eliminating the need to compute it.Me

D. INTRINSIC VALUE METHOD (OR) SHARE EXCHANGE METHOD:

Purchase consideration is ascertained on the basis of the ratio in which the shares of the purchasing company are exchanged with those of the selling company. The exchange ratio is generally determined on the basis of 'Intrinsic values' of the respective companies' shares.

Intrinsic values = Assets available for equity shareholders / Number of equity shares.

All amounts due to third parties and even preference shareholders must be reduced from total assets to ascertain the assets available to equity shareholders.

1.5 METHODS OF ACCOUNTING FOR AMALAGAMATION

There are two main methods of accounting for amalgamations:

a. The Pooling of interest methods

b. The Purchase method

A. THE POOLING OF INTEREST METHODS:

The term pooling of interests refers to an accounting method that was used to combine the balance sheets of two companies that went through a merger or acquisition. The pooling of interests method allowed the merged or acquired company's assets and liabilities to be transferred to the acquirer at their book values. The pooling-of-interests method was phased out in 2001 and replaced by purchase accounting to account for business combinations.

- The pooling of interests method governed how the balance sheets of two companies that were merged would be combined.
- It combined the assets and liabilities of both companies into one at book value.
- Intangible assets were not included, making the pooling of interests a preferred accounting method as it did not result in amortized costs or negatively impacted earnings.
- This method was replaced by the purchase accounting method, which itself was replaced by the current method, the purchase acquisition method.
- The adjustment by FASB to incorporate impairment tests before including amortized expenses reduced the impact of the purchase accounting method.
- Companies must account for assets and liabilities acquired from another business after a merger or acquisition takes place. There are accounting rules set in place that dictate the process. Pooling of interests was a popular method used in the past to account for the balance sheets of companies that were merged or acquired.
- This method allowed assets and liabilities to be transferred from the acquired company to the acquirer at book values. The assets and liabilities were simply summed together for a net number in each category when combining both balance sheets. Past financial statements were then reevaluated. Intangible assets, such as goodwill, were not included in the calculation of the pooling of interests.

- The pooling of interests method was fairly popular among companies as it did not include goodwill reductions. This eliminated the need for the new company to pay any amortized costs and also had a positive impact on corporate earnings. As such, this gave the acquired company's financial ratios a boost.

ADVANTAGES OF THE POOLING OF INTERESTS METHOD

The pooling of interests was an accounting method that companies used when they merged with or acquired another company. It allowed companies to combine their balance sheet with the target company's and assume its assets and liabilities. It allowed the acquirer to use the book values of the assets and liabilities without having to account for goodwill. Without the need for goodwill reductions, the company didn't need to pay any amortized costs. This had a positive impact on earnings and boosted the acquirer's financial ratios.

B. THE PURCHASE METHOD:

Under the purchase method, the transferee company accounts for the amalgamation either

- a. By incorporating the assets and liabilities at their existing carrying amounts or
- b. By allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Many amalgamations recognise that adjustments may have to be made to the consideration in the light of one or more future events. When the additional payment is probable and can reasonably be estimated at the date of amalgamation, it is included in the calculation of the consideration. In all other cases, the adjustment is recognised as soon as the amount is determinable [AS 4].

Accounting Treatment for Amalgamation

In the books of selling company

To Realisation A/c

6. For payment of liabilities not taken over:

Liability A/c Dr

Realisation A/c (any premium) Dr

To Bank A/c

To Realisation A/c (any discount)

7. For payment of Realisation expenses:

a. If expenses are to be borne by selling company

Realisation A/c Dr

To Bank A/c

8. For discharging the debentures:

a. Repayable at a premium:

Debentures A/c Dr

Realisation A/c (premium) Dr

To Debenture holders A/c

b. Repayable at discount:

Debentures A/c (face value) Dr

To Bank A/c

To Debentures in purchasing Co.

9. For discharge of preference share capital:

a. For repayment at premium:

Preference share capital A/c (face value) Dr

Realisation A/c (premium) Dr

To preference shareholders.

For repayment at discount:

Preference share capital A/c(face value) Dr

To Preference shareholders

To Realisation A/c

b. For payment to preference shareholders:

Preference shareholders A/c Dr

To Bank A/c

To Shares in purchasing co.

10. For transfer of equity share capital and Accumulated profits:

Equity share capital A/c Dr

General Reserve A/c Dr

Profit and Loss A/c Dr

Any other reserves A/c Dr

To Equity shareholders A/c

11. For transfer of accumulated losses:

Equity shareholders A/c Dr

To profit & Loss A/c

To preliminary expenses A/c

To Discount on issue of shares etc.

12. For Realisation profit or loss:

For profit:

Realisation A/c Dr

To Equity shareholders A/c

For Loss:

Equity shareholders A/c Dr

To Realisation A/c **13. For final payment**

to the equity shareholders:

Equity shareholders A/c Dr

To Bank A/c

To Shares in purchasing co.

Journal entries in the books of Purchasing Company

1. For purchase consideration payable:

Business purchase A/c Dr

To Liquidator of Transferor company

2. For Assets and Liabilities:

Sundry Assets A/c Dr

To Sundry liabilities

3. For payment of purchase price:

Liquidator of selling co. A/c Dr

To Bank A/c

To Share capital A/c

To Share premium A/c

To Debentures A/c

(Being purchase price paid in the form of cash, shares and debentures)

PROBLEMS:

1. Raman Ltd agrees to purchase the business of Krishna Ltd on the following terms:

- a. For each of the 10,000 shares of Rs.10 each in Krishna Ltd .2 shares in Raman Ltd of Rs.10 each will be issued at an agreed value of Rs. 12 Per share. In addition, Rs.4 per share cash also will be paid.
- b. 8% Debentures worth Rs.80,000 will be issued to settle the Rs.60,000 9% debentures in Krishna Ltd.
- c. Rs.10,000 will be paid towards expenses of winding up.

Calculate the purchase consideration.

SOLUTION :

Calculation of purchase consideration

Shares to be issued for shareholders of the selling Co,	Rs
10,000 x 2x 12	2,40,000
Add: Cash to be paid for shareholders of the selling Co	
10,000x 4	40,000
Purchase consideration	2,80,000

2. Amalgamation in the Nature of Merger

Alpha Ltd and Beta Ltd were amalgamated on 1st April 2021. A new company Gemma Ltd. Was formed to take over the business of the existing companies. The balance sheets of Alpha Ltd and Beta Ltd as on 31st March 2021 are given below:

Liabilities	Alpha Ltd Rs	Beta Ltd Rs	Assets	Alpha Ltd Rs	Beta Ltd Rs

Share Capital	1000	800	Fixed assets	1200	1000
Equity Shares of Rs.100 each 15			Loans and	880	565
% Pref.Shares of Rs.100 each			Advances		
Reserve and surplus	400	300			
Revaluation reserve					
General Reserve	100	80			
P& L A/c	200	150			
Secured loan	80	60			
12 % Debentures of Rs.100					
	96	80			
each					
Current Liabilities					
Provisions	204	95			
	2080	1565		2080	1565

OTHER INFORMATION:

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

SOLUTION:

Notes of Accounts:

	Rs in lakh
1.Share capital	
Issued and paid up capital	
Equity shares of Rs.100 each	2300
15 % Preference shares of Rs. 100 each	700
	3000
2.Reserves and surplus	
Revaluation reserve (100+80)	

	180
General Reserve (W.N.3)	-
Profit & Loss a/c (W.N.3)	34
	214
3.Long term borrowings:	
16 % debentures o Rs.100 each (W.N.2)	132
4.Tangible Assets:	
Fixed Assets(1200+1000)	2200

Balance Sheet of Gamma Ltd as on 1.4.2021

	Note No	Rs.in lakh
1.Equity and liabilities		
(i)Share holders fund		
Share capital	1	3000
Reserves and surplus	2	214
(ii) Non-current liabilities Long term borrowings	3	132
(iii)Current liabilities(204+95)		299
		3645
Total (i)+(ii)+(iii)		
2.Assets:		
(i) Non-current assets:		
Tangible assets		2200
Intangible assets		
(ii) Current assets: (880+ 565)		1445
Total (i)+ (ii)		3645

Working Note: 1

Purchase Consideration

	Alpha Ltd	Beta Ltd	Total
Equity Shares for shareholders Alpha Ltd	1500	-	1500

(1000x1.5)	-		
Equity Shares for shareholders of Beta Ltd (800x 1)		800	800 2300
Preference shares for shareholders of Alpha Ltd & Beta Ltd.	400	300	700 3000
Purchase Consideration Share capital of Transfer Co Alpha & Beta	1400	1100	2500
Excess of purchase Consideration over share capital.			500

Working Note: 2

Statement of Debentures of Transferor Companies

	Alpha Ltd	Beta Ltd	Total
Value of Debentures issued by Gamma Ltd	96x 12/16 = 72	80x 12/16=60	132
Face value of Debentures of Transferor Co	96	80	176
Excess of face value of debentures settled over value of debentures issued.	(24)	(20)	(44)

Net excess payment to be adjusted in the Balance sheet of Transferee Co against reserves= 500-44=456.

Working Note: 3

Reserves to be shown in Balance sheet

	General Reserve	Profit & Loss a/c
Alpha Ltd	200	80

Beta Ltd	150	60
	350	140
Less: Excess payment to be adjusted	350	106
		34
Balance to be shown in Balance sheet	-	

3. The following are the abridged balance sheets of P Ltd and S Ltd as on 31 st March 2019.

Liabilities	P Ltd (in Rs' 000')	S Ltd (in Rs' '000')		P Ltd (in Rs '000')	S Ltd (in Rs' 000')
Equity share capital of Rs.100 each	8000	3000	Fixed Asset	11,000	4730
10% Preference shares	-	1000	Current Assets	4000	1970
General reserve	4610	980			
Statutory reserve	390	125			
Profit & loss a/c	563	355			
12% Debentures	-	250			
Current Liabilities	1437	990			
	15,000	6700		15,000	6700

On 1 st April 2019 , P Ltd takes over S Ltd on the following terms:

- P Ltd will issue 3,50,000 equity Shares of Rs.10 each at par to the equity shareholders of S Ltd.
- P Ltd P Ltd will issue 11,000 Preference shares of Rs.100 each at par to the Preference shareholders of S Ltd.
- The debentures of S Ltd will be converted in to equal number of 12.5 % debentures of the same demonization.

You are informed that the statutory reserves of S Ltd are to be maintained for two more years. You are required to show the balance sheet of P Ltd immediately after the above mentioned scheme of amalgamation has been implemented assuming that:

- The Amalgamation is in the nature of Merger
- The Amalgamation In the nature of Purchase

SOLUTION:

- a) When the Amalgamation is in the nature of Merger

Balance Sheet of P Ltd as on 1.4.2019

	Note No	Rs.in lakh
--	----------------	-------------------

1.Equity and liabilities		
(i)Share holders fund		
Share capital	1	2,26,00,000
Reserves and surplus	2	64,23,000
(ii) Non-current liabilities Long		
term borrowings	3	2,50,000
(iii)Current liabilities		24,27,000
Total (i)+(ii)+(iii)		21,7,00,000
2.Assets:		
(i) Non-current assets:	4	1,57,30,000
Tangible assets		
Intangible assets		
(ii) Current assets:		5970,000
Total (i)+ (ii)		21,7,00,000

Working Note: 1

	Rs
P Ltd's General reserve	46,10,000
Add: S Ltd's General reserve	9,80,000
	55,90,000
Less: Excess Purchase consideration over share capital of S Ltd (46,00,000-40,00,000)	6,00,000
	49,90,000
General reserve to be shown in Balance sheet	

b) When Amalgamation is in the nature of Purchase

Balance Sheet of P Ltd as on 1.4.2019

	Note No	Rs.in lakh
1.Equity and liabilities		
(i)Share holders fund		
Share capital	1	2,26,00,000
Reserves and surplus	2	65,48,000
(ii) Non-current liabilities Long		
term borrowings	3	2,50,000
(iii)Current liabilities		24,27,000
Total (i)+(ii)+(iii)		2,18,25,000

2.Assets:		
(i) Non-current assets:	4	1,57,30,000
Tangible assets		
Intangible assets		
(ii) Current assets:		5970,000
Total (i)+ (ii)		2,18,25,000

Working Note: 2

Calaculatin of Capital reserve or Goodwill

		Rs
Total assets of S Ltd taken over		67,00,000
Less: Debentures of S Ltd	2,50,000	
Less: Current Liabilities of S Ltd	9,90,000	12,40,000
		54,60,000
Less: Consideration payable to :		
Equity shareholders		
Pref. share holders	35,00,000	
	11,00,000	46,,00,000
Capital reserve to be shown in B/S		8,60,000

1.6 EXTERNAL RECONSTRUCTION

MEANING:

‘Reconstruction’ of a company involves reorganization of its ‘Financial structure’. If the reorganization is accomplished without liquidating the company. It is internal reconstruction. When the reorganization of a company financial structure necessitates the winding up of the company and floatation of a new company with the same assets and shareholders, it is termed as ‘External reconstruction.

1.7 INTERNAL RECONSTRUCTION (OR) CAPITAL REDUCTION

MEANING OF INTERNAL RECONSTRUCTION:

Reconstruction refers to Reorganizations of the capital structure of a company. Reconstruction may be necessary for those companies whose financial position is bad. Such reconstruction can be ‘External’ or ‘Internal’.

External Reconstruction means a new company is formed to take over the business of an existing company which will be liquidated.

Internal Reconstruction means the capital of a company is reorganized to enable it to make a fresh beginning after eliminating accumulated losses.

Model of Journal Entries

- 1. For consolidation of shares** Share capital (10) A/c Dr
To Share capital (100)
- 2. For sub-division of Shares:** Share capital (100) A/c Dr
To Share capital (10)
- 3. For conversion of Shares in to stock**
Equity share capital A/c Dr
To Equity share capital stock A/c
- 4. When uncalled capital is reduced or extinguished:**
Share capital (100) A/c Dr
To share capital A/c (60)
- 5. For refunding surplus capital**
Share capital (100) A/c Dr
To share capital A/c (80)
To Shareholders A/c (20)
- 6. For Reduction of share capital,(changes in face value or dividend %)**
Share capital (old) A/c Dr
To Share capital (New) A/c
To Capital Reduction A/c
- 7. For Reduction of Capital (No change of rights)**
Share capital A/c Dr
To Capital Reduction A/c
- 8. For any sacrifice made by debenture or creditors:**

Debentures A/c Dr

Creditors A/c Dr

 To Capital Reduction A/c

9. For Appreciation in the value of assets:

Asset A/c Dr

 To Capital Reduction A/c

10. for payment of Reconstruction expenses:

 Reconstruction Expenses A/c Dr

 To bank A/c

11. for payment of contingent liability:

Contingent liability A/c Dr

 To Bank A/c

12. When shares are surrendered by shareholders

Share capital A/c Dr

 To surrendered shares A/c

13. When surrendered shares are reissued:

Surrendered Shares A/c Dr

 To share capital A/c

14. For canceling unissued Surrendered shares:

Surrendered shares A/c Dr

 To capital Reduction A/c

15. For writing off losses and reducing assets

Capital Reduction A/c Dr

To P&L A/c

To Preliminary expense

To Goodwill

To Patents

To Reconstruction expenses

To Contingent liability

To Discount on issue of shares

To Assets (reduced amount)

To Capital Reserve A/c (balance if any)

PROBLEMS:

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

SOLUTION:

Books of Bee Ltd.

Journal entries

Date	Particulars	L.F	Debit Rs	Credit Rs
	Share capital (Rs 10) A/c Dr To Share capital (Rs 60) A/c To Share holders A/c (Being reduction of 60,000 equity shares of Rs.100 each, Rs.80 per shares paid to 60,000 shares of Rs.60 each fully paid and refund of Rs.20 per share by cancelling the unpaid amount).		4,80,000	3,60,000 1,20,000
	Share holders A/c Dr To Bank A/c (Being the amount paid to share holders)		1,20,000	1,20,000

2. ABC Company Ltd passed resolution and got court permission for the reduction of its share capital by Rs.5,00,000 for the purpose mentioned as under:

- ▶ To write off the debit balance of profit and loss account Rs.2,10,000 .
- ▶ To reduce the value of plant and machinery by 9,00,000 and goodwill by Rs.40,000 ▶ To reduce the value of investment by Rs.80,000.

The reduction was made by converting 50,000 preference share of Rs.20 each fully paid to the same number of preference share of Rs.15 each fully paid and by converting 50,000 equity share of Rs.20 each on which Rs.15 is paid up in to 50,000 equity share of Rs.10 each fully paid up. Give journal entries for the following transaction in connection with internal reconstruction.

SOLUTION:

Books of ABC Ltd.

Journal entries

Date	Particulars	L. F	Debit Rs	Credit Rs
	Preference Share capital A/c (Rs.20) Dr		10,00,000	
	To Preference Share capital A/c (Rs.15)			7,50,000
	To Capital Reduction A/c			2,50,000
	(Being conversion of 50,000 equity shares of Rs 20 each to shares fully paid in to shares of Rs.15 each fully paid and the balance transferred to capital reduction A/c).			
			7,50,000	
	Equity Share capital A/c (Partly paid) Dr			5,00,000
	To Equity Share capital A/c (Fully paid)			2,50,000
	To Capital Reduction A/c			
	(Being conversion of Partly paid shares in to Fully paid and the balance transferred to capital reduction A/c).			
	Capital Reduction A/c Dr		5,00,000	
	To P&L A/c			2,10,000
	To Plant & Machinery			90,000
	To Goodwill A/c			40,000
	To Investment A/c			80,000

Date	Particulars	L. F	Debit Rs	Credit Rs
	Share capital A/c Dr To Capital Reduction A/c (Being reduction of 50,000 equity shares by Rs.5 each).		2,50,000	2,50,000
	Securities Premium A/c Dr To Capital Reduction A/c (Being Securities Premium A/c transferred to Capital Reduction A/c).		50 ,000	50,000
	Capital Reduction A/c Dr To P&L A/c To Plant & Machinery A/c To Land & Building A/c To Goodwill A/c To Stock A/c To provision of bad debts (Being loss written off , assets written down)		3,00,000	50,000 67,000 42,000 1,00,000 33,600 7400

Balance Sheet of XYZ CO Ltd as on

	Note No	Rs
1.Equity and liabilities		
(i)Share holders fund		
Share capital	1	2,50,000
Reserves and surplus	2	-
(ii) Non-current liabilities Long term borrowings	3	-
(iii)Current liabilities		62,000
Trade payables		73,000
Short term borrowings		
Total (i)+(ii)+(iii)		3,85,000
2.Assets:		2,60,000
(i) Non-current assets:	4	
Tangible assets		-
Intangible assets		
(ii) Current assets:		

Stock	58,400
Trade receivables (74,000-7400)	66,600
Total (i)+ (ii)	3,85,000

UNIT 3

LIQUIDATION OF COMPANIES

5.1.1 INTRODUCTION OF LIQUIDATION OF COMPANIES

Liquidation or Winding up is a process by which a company is dissolved. Winding up is the process by which a company's assets are collected and sold to pay off its debts. Any monies remaining after all debts, expenses and costs have been paid off are distributed amongst the company's shareholders. The company will be dissolved and will no longer exist after winding up.

5.1.2. MEANING OF LIQUIDATION OF A COMPANY

The setting up or closure of a company is done through a legal process under the purview of law (or) A company comes into being through a legal process and also comes to an end by law.

“Liquidation is the legal procedure by which the company comes to an end”.

5.1.3 MEANING OF LIQUIDATOR

The job of realising various assets and paying various liabilities in a systematic manner is generally performed by a person is called liquidator.

5.2 .MODES OF WINDING UP

A Company may be wound up in any of the following ways:

1. By the court- Compulsory Winding Up
2. Voluntary Winding Up
 - a) Member's Voluntary Winding Up
 - b) Creditor's Voluntary Winding Up
3. Winding up subject to Supervision of court.

5.2.1. *Compulsory Winding Up - By the Court*

A court order initiates this mode. It usually occurs when the company cannot pay its debts, breaches legal requirements, or when it is just and equitable to wind up. The court appoints an official liquidator to manage the process, which includes selling assets, paying creditors, and distributing any surplus among the shareholders.

5.2.2. Procedure for Compulsory Winding Up

The following steps outline the legal process for such a winding up:

□

- **Filing a Petition:** The process begins with filing a petition to the tribunal, accompanied by a detailed statement of the company's affairs, requesting the winding up.
- **Tribunal's Review:** The tribunal reviews the petition. If the petition is filed by someone other than the company, the tribunal may require the company to submit its objections and statement of affairs within 30 days.
- **Appointment of a Liquidator:** The tribunal appoints a liquidator to oversee and manage the winding-up process, ensuring the company's assets are fairly distributed to its creditors and shareholders.
- **Preparation and Approval of Reports:** The liquidator prepares a preliminary report, which, upon approval, is finalized and submitted to the tribunal to sanction the winding-up order.
- **Submission to the Registrar of Companies (ROC):** The liquidator must submit a copy of the winding-up order to the ROC within 30 days. Failure to do so results in penalties.
- **Final Approval by ROC:** Upon satisfactory review, the ROC officially dissolves the company by removing its name from the register.

5.2.3. Publication in the Official Gazette: The ROC publishes a notice in India to announce the company's dissolution formally. Compulsory Winding Up of Company

The compulsory winding up of a private limited company is a legal process overseen by the tribunal. This action is typically initiated for several reasons, including:

- **Unpaid Debts:** The company fails to settle its debts, prompting creditors to seek legal redress through winding up.
- **Special Resolution:** The company's members pass a special resolution acknowledging the need to dissolve the company due to insurmountable challenges or other reasons.
- **Unlawful Acts:** The company or its management engages in illegal activities, compromising its integrity and legal standing.
- **Fraud and Misconduct:** Involvement in fraudulent practices or serious misconduct tarnishes the company's reputation and operational legality.
- **Non-compliance with ROC Filings:** Failure to file annual returns or financial statements with the Registrar of Companies (ROC) for five consecutive years signals operational dysfunction and possible abandonment.

Tribunal's Discretion: The tribunal, upon reviewing the company's situation, may determine that winding up is in the best interest of the public, creditors, and other stakeholders.

□

5.3.1 Voluntary Winding Up of a Company

This occurs when the members or creditors of the company decide to wind up the company's affairs. It can be initiated by a resolution of the members (shareholders) if the company is solvent and can pay its debts or by the creditors if it is insolvent. The company appoints a liquidator to conduct the winding-up process without court intervention.

As mentioned above, Voluntary winding up is initiated by the members of a company under circumstances that don't involve court intervention. This process can commence under two primary conditions:

- **By Special Resolution:** The company members pass a special resolution for winding up, indicating their collective decision to dissolve the company.
- **By Expiry or Event as Per Articles of Association:** The company is wound up voluntarily due to the expiry of its duration as stipulated in its Articles of Association or upon the occurrence of an event mentioned in the Articles that mandates dissolution.

Documents Required for Voluntary Winding up of a Company

For the voluntary winding up of a company, the following documents are required:

- **Special Resolution (Form-26):** A document proving the company's decision to wind up.
- **Declaration of Solvency (Form 107):** A statement showing the company can pay its debts.
- **Directors' Affidavit:** A sworn statement verifying financial documents like the auditor's report and accounts up to the most recent date before declaring solvency.
- **Liquidator's Consent:** Agreement from the appointed liquidator to undertake the winding-up process.
- **Notice of Winding Up Resolution:** A published notice in the Official Gazette about the company's decision to wind up.
- **Notice of Liquidator Appointment:** A published notice in the Official Gazette about the liquidator's appointment.

Preliminary Liquidator's Report: An initial report from the liquidator outlining the winding-up plan.

- **Final Liquidator's Report and Accounts:** The liquidator's comprehensive final report and financial statements were presented at the last shareholders' meeting.
- **Notice of Final Meeting:** Announcement of the company's conclusive gathering.

□

- Meeting Return: Documentation of the final report, accounts, and meeting minutes to be submitted to the company registration office.

5.3.2. Procedure for Voluntary Winding-up

To conduct a voluntary winding up of a company under the provisions of the relevant ordinance and company law, the following detailed procedure is to be followed:

Step 1: Declaration of Solvency

Directors assess the company's financial position and declare its ability to pay all debts. This declaration, made on Form 107 as per Rule 269, is supported by an auditor's report.

The board convenes to decide on proposing voluntary winding up to the shareholders and schedules a General Meeting (Annual or Extraordinary) as per Section 362.

Step 2: Shareholders' Approval

At the General Meeting, shareholders review the directors' proposal and, upon agreement, pass a Special Resolution to wind up the company voluntarily.

A liquidator is appointed during this meeting, and his remuneration is fixed. The appointment of the liquidator effectively dissolves the Board of Directors, as stated in Sections 358 and 364.

Step 3: Notification of Resolution

The resolution to wind up is published in the Official Gazette and newspapers within 10 days, ensuring public notification. A copy is also filed with the Registrar in compliance with Section 361.

Step 4: Liquidator's Appointment Notification

The company must inform the Registrar about the liquidator's appointment or any changes, along with the liquidator's consent, within 10 days of such occurrence, as mandated by Section 366.

Step 5: Liquidator's Public Announcement

□

The appointed liquidator must announce his role in the Official Gazette and to the Registrar within 14 days of appointment, using Form 110 as prescribed under Rule 271, according to Section 389.

Step 6: Creditors' Meeting

Should the liquidator determine that the company cannot fully settle its debts, he must convene a creditors' meeting, presenting a financial statement that outlines the company's assets and liabilities, as per Section 368.

Step 7: Documentation of Creditors' Meeting

The liquidator must file a return, including the creditors' meeting notice and other relevant documents, with the Registrar within 10 days of the meeting, adhering to Section 368. **Step 8: Annual General Meeting**

Suppose the winding-up process extends over a year. In that case, the liquidator must call an annual general meeting of the shareholders and seek court approval for extending the winding-up duration, as outlined in Section 387(5). **Step 9: Filing of General Meeting Documentation**

A return, including the notice of each general meeting, financial statements, and minutes, must be filed with the Registrar within 10 days post-meeting, as required by Section 369. **Step 10: Final Report and Meeting**

Upon completing the winding-up process, the liquidator compiles a final report and financial account, summoning a meeting of members to present these documents. This step is conducted on Form 111 as per Rule 279, following Section 370.

Step 11: Notice of Final Meeting

The final meeting notice is published in the Gazette and newspapers at least 10 days before the scheduled date, ensuring compliance with Section 370.

Step 12: Submission of Final Documents

Within a week following the final meeting, the liquidator submits a copy of the final report and accounts to the Registrar using Form 112, as dictated by Rule 279 and Section 370, marking the completion of the winding-up process.

□

5.4. Subject to the Supervision of the Court

In this mode, the winding-up process starts voluntarily, but the court oversees the process. The court may decide to intervene and supervise the winding-up process to protect the interests of various stakeholders, ensuring that the process is conducted fairly and transparently.

Winding-up of Company Subject to the Supervision of the Court

When a company resolves through a unique or extraordinary resolution to undergo liquidation or winding up, a court may issue an order to supervise the process upon request from creditors, members, or other stakeholders.

Understanding Court-Supervised Company Liquidation: In instances where a company is being wound up voluntarily, it's essential for the process to be carried out under the oversight of a court. This ensures that the liquidation proceedings are regulated and transparent, providing an added layer of scrutiny and protection for all parties involved.

5.4.1. Implications of Company Winding Up

Winding up a company brings about significant changes affecting various stakeholders. Here's a breakdown of the key consequences:

For the Company

The company continues to exist as a legal entity until officially dissolved, retaining all rights associated with such an entity. However, its management shifts to the appointed liquidator(s) who oversee operations until dissolution.

For Shareholders

Shareholders face a new form of statutory liability as contributors. Any share transfers or changes in shareholders' status post the initiation of winding up, if not sanctioned by the liquidator, are considered null and void.

For Creditors

- **Legal Actions:** Creditors are barred from initiating or continuing any legal proceedings against the company without court permission.
- **Execution of Decrees:** If creditors have previously obtained decrees against the company, they are prevented from enforcing them.

-
- **Debt Claims:** Creditors must formally submit and validate their claims with the liquidator to be considered for repayment.

For Management

Upon a liquidator's appointment, the powers held by the company's directors, chief executive, and other officers are suspended, except for specific actions like notifying stakeholders of the winding-up resolution, appointing a liquidator, and similar procedural tasks.

Regarding Company Assets

Any disposition of the company's assets post the commencement of winding up is invalid without either the liquidator's consent or court approval.

These consequences collectively ensure that the winding-up process is orderly, with the liquidator playing a central role in managing the company's affairs, settling debts, and, ultimately, distributing any remaining assets to the rightful claimants.

5.5. MEANING OF CONTRIBUTORY

Every person liable to contribute to the assets of a company in the event of its being wound up and includes any holder of shares which are fully paid up. This contribution is for an amount sufficient for payment of the company debts and liabilities and costs and expenses of winding up

5.6 ORDER OF PAYMENT IN THE LIQUIDATION OF A COMPANY

The company liability should be discharged in the following order:

- ▶ Secured creditors
- ▶ Cost of liquidation
- ▶ Legal charges
- ▶ Liquidator remuneration
- ▶ Cost of winding up
- ▶ Preferential creditors
- ▶ Debenture holders having floating charge on assets
- ▶ Unsecured creditors
- ▶ Preference shareholders ▶ Equity

shareholders.

□

5.7 SECURED CREDITORS

A secured creditor is one who holds some security for a debt due to him from the company such as pledge, mortgage, charge or lien. Secured creditors may be fully secured or partly secured. If they are fully secured, the value of security offered to them would be more than the amount due but in case of partly secured creditors, the value of security would be less than the amount due to them.

In such a case, the partly secured creditors are secured to the extent of the value of security offered to them for the remaining they will be treated as unsecured creditors.

5.7.1 PREFERENTIAL CREDITORS

Preferential creditors are those creditors which have to be paid or met before any payment is made to any creditors except the cost of liquidations and the remuneration payable to the liquidator.

5.7.2. UNSECURED CREDITORS:

An unsecured creditor is an individual or institution that lends money without obtaining specified assets as collateral. This poses a higher risk to the creditor because it will have nothing to fall back on should the borrower default on the loan. If a borrower fails to make a payment on a debt that is unsecured, the creditor cannot take any of the borrower's assets without winning a lawsuit first.

A debenture holder is an unsecured creditor.

5.8 LIQUIDATOR'S FINAL STATEMENT OF ACCOUNT:

It is the duty of liquidator to realize the assets of the company under liquidation and settle the account of every creditor proving his claim against the company. It is necessary for him to prepare a statement showing how much he realized and how the same was disbursed among the claimants. In other words, he has to maintain a proper cash book for recording his receipts and payments and has to submit a summary of the same to the court in case of compulsory winding up and to the company in case of voluntary winding up. Such document is called Liquidator's final statement of account.

FORMAT FOR LIQUIDATOR'S FINAL STATEMENT OF ACCOUNT:

Receipts	Rs	Payments	Rs
To Assets realized		By Legal expenses	Xxx
Land & Building	Xxx		
Free hold property	Xxx		
Cash in hand	Xxx Xxx		
Debtors	Xxx xxx		
Stock			
Furniture Machinery			

□

To Surplus from secured creditors	Xxx	By Liquidation remuneration % Amount/Assets realized xxx % Preferential Creditors xxx % Unsecured Creditors xxx	Xxx
To Receipt of unpaid calls	Xxx	By Liquidation Expenses	xxx
		By Debenture holders	xxx
		By Preferential Creditors	xxx
		By Unsecured Creditors	xxx
	xxx		xxx

PROBLEMS:

1. A liquidator is entitled to receive remuneration @ 2 % of the assets realized and 3 % on the amount distributed among the unsecured creditors. The assets realized Rs.70,00,000 against which payment was made as follows:

Liquidation expenses Rs.50, 000

Preferential Creditors Rs.1, 50,000 and

Secured Creditors Rs.4, 00,000; unsecured creditors: Rs. 30, 00,000. Calculate the total remuneration payable to the liquidator.

SOLUTION:**Calculation of Liquidators Remuneration****Rs**

(i) Liquidator's commission on assets realized(70,00,000x 2/100)	1,40,000	(ii) Liquidator's commission on amount paid to preferential creditors	4500 (1,50,000x 3/100)
(iii) Liquidator's commission on amount distributed among unsecured creditors(26,55,500 x3/103)			77,345
Total liquidator's remuneration			2,21,845

Working Notes:**Calculation of amount available to unsecured creditors**

$$= 70,00,000 - (50,000 + 1,50,000 + 40,00,000 + 1,40,000 + 4500) = 26,55,500.$$

2. The following particulars relate to a limited company which went in to voluntary liquidation:

Preferential Creditors Rs.25,000

Unsecured creditors: Rs. 58,000

6 % Debentures -30,000

□

The assets realized Rs.80,000. The expenses of liquidation amounted to Rs.1500 and the liquidator's remuneration was agreed at 2 ½ % on the amount realized and 2 % on the amount paid to unsecured creditors including preferential creditors. Show the liquidator's final statement of account.

SOLUTION:

Liquidator's final statement of account.

Receipts	Rs	Payments	Rs
To Assets realized	80,000	By Legal expenses	-
		By Liquidation remuneration % Amount/Assets realized	
		80,000x 2 ½ %	2000
		Preferential Creditors	
		25,000x2%on	500
		Unsecured Creditors	
		20,558x2%	412
			2912
		By Liquidation Expenses	1500
		By Debenture holders	30,000
		By Preferential Creditors	25,000
		By Unsecured Creditors	20,588
	80,000		80,000

Working Notes:

Calculation of amount available to unsecured creditors

$$= 80,000 - (2000 + 500 + 1500 + 30,000 + 25,000) = 21,000 \times \frac{2}{102} = 20,588$$

3. The following particulars relate to a limited company which went in to voluntary liquidation. You are required to prepare the liquidator's final statement of account allowing for his remuneration at 3 % on the assets realized and 2 ½ % on the amount paid to unsecured creditors.

Share capital issued:

5000 preference shares of Rs.100 each (fully paid)

30,000 Equity shares of Rs.100 each (fully paid)

12,000 Equity shares of Rs.100 each (Rs.8 paid up)

Assets realized Rs.9,24,000 excluding amount realized by sale of securities held by the secured creditors.

Preferential Creditors Rs.24,000

Unsecured creditors: Rs. 8,51,094

Debentures having a floating charge on the assets -3,00,000
Liquidation expenses-
Rs.9000

A call of Rs.2 per share on the partly paid equity shares was duly paid except in case of one shareholder owning 1200 shares.

□

SOLUTION:

Liquidator's final statement of account.

Receipts	Rs	Payments	Rs
To Assets realized	9,24,000	By Legal expenses	-
To Surplus from secured creditors (Rs.1,62,000- Rs.1,38,000)	24,000	By Liquidation remuneration On Amount/Assets realized 9,48,000 x 3 %	28,440 600
To receipt of call money on 10,800 equity shares @ Rs.2 per share	21,600	On Preferential Creditors 24,000 x 2 ½ % Unsecured Creditors 5,92,741 x 2 ½ %	14,819 43,859
		By Liquidation Expenses	9000
		By Debenture holders	3,00,000
		By Preferential Creditors	24,000
		By Unsecured Creditors	5,92,741
	9,69,600		9,69,600

UNIT – IV HOLDING COMPANIES

What is a holding company and subsidiary company?

A holding company is a parent company that has control over a subsidiary company. A subsidiary company may be for-profit or non-profit. The parent-subsidiary relationship has various legal and financial implications for both companies.

Advantages of Holding Company

- **Ease of formation**

It is quite easy to form a holding company. The promoters can buy the shares in the open market. The consent of the shareholders of the subsidiary company is not required.

- **Large capital**

The financial resources of the holding and subsidiary companies can be pooled together. The company can undertake large scale projects to increase its profitability.

- **Avoidance of competition**

□

Competition between holding and subsidiary companies can be avoided

if they are in the same line of business.

- **Economies of large scale operations**

The buying and selling of the holding company and the subsidiaries can be centralized. It can enjoy the advantage of quantity discount and better credit terms because of bulk purchases. It can also get better terms from buyers in case of sales.

- **Secrecy maintained**

Secrecy can be maintained as the authority and decision making are centralized. It can protect itself from adverse publicity.

- **Risks avoided**

In case the subsidiaries undertake risky business and fail, the loss does not affect the holding company. It can sell its stakes in the subsidiary company.

Disadvantages of Holding Companies

- **Over capitalization**

Since capital of holding company and its subsidiaries may be pooled together it may result in over capitalization. Shareholders would not get a fair return on their invested capital.

- **Misuse of power**

The financial liability of the members of a holding company is insignificant in comparison to their financial power. It may lead to irresponsibility and misuse of power.

- **Exploitation of subsidiaries**

The holding company may exploit the subsidiary companies. The subsidiaries may be compelled to buy goods from the holding at high prices. They might be forced to sell their produce to the holding company at very low prices.

- **Manipulation**

Information about subsidiaries may be used for personal gains. For example information of the financial performance of subsidiary companies may be misused to indulge in speculative activities.

- **Concentration of economic power**

□

There is concentration of economic power in the hands of those who manage the holding company. Such concentration of economic power is harmful to the general economic welfare.

- **Secret monopoly**

It may lead to the creation of secret monopolies. These secret monopolies may try to eliminate competitors and prevent entry of new firms. They may exploit consumers by charging unreasonable prices.

UNIT V

FINAL ACCOUNTS OF BANKING COMPANIES

A bank is a financial institution which deals with money and credit. It accepts deposits and lends money to those who are in need of it. It helps to transfer money from one place to another. Banker is a person or company carrying on the business of receiving money and collecting drafts for customers subject to the obligation of honouring the cheques drawn upon him from time to time by customers up to the amount available on their customers.

Banking. According to Banking Regulation Act, 1949.

Section 5 Banking is defined as “the accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and withdraw able by cheque, draft, order or otherwise

Section 6 of the Act states that in addition to the business of banking, a banking company may engage in any one or more of the following business:

- i. The borrowing, raising, or taking up of money
- ii. The lending or advancing of money either upon or without security
- iii. The drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrip and other instruments, and securities whether transferable or negotiable or not.
- iv. The granting and issuing of letter of credit, travellers cheques and circular notes
- v. On receiving of all kinds of bonds, scrip's or valuables on deposit or for safe custody or otherwise.
- vi. The buying, selling and dealing in bullion
- vii. The collecting and transmitting of money and securities
- viii. Contracting for public and private loans and negotiating and issuing the same
- ix. Carrying on and transacting every kind of guarantees and indemnity business
- x. Undertaking and executing trusts, etc...

Classification of Bank Advances.

- a. Bills purchased and discounted – It is the advances given to customers on the security of bills, pronote etc. The amount after deducting the discount from the amount of the bill is credited in the customer's account.
- b. Loans – A loan is an advance of a fixed amount give to a customer for a specified period. Interest is charged on the whole amount loaned.

□

- c. Cash credit – It is a form secured advance by a bank. Under this arrangement the bank allows a fixed limit within which the customers can withdraw on the bank. Interest is charged on the amount actually withdrawn.
- d. Overdraft – Under this arrangement, the bank agrees to allow its customers to overdraw from his current account up to a certain limit either with or without security.

Accounting System

The accounting system of a banking company is different from that of a trading or manufacturing enterprise. A bank has large number of customers whose accounts are to be maintained in such a way so that these should be kept up to date and checked regularly. The following are the main features of a bank's accounting system are as follows:

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

Books required by Bank

- 1. Receiving Cashier's Counter Cash Book.
- 2. Paying Cashier's Counter Cash Book.
- 3. Current Accounts Ledger.
- 4. Saving Bank Accounts Ledger.
- 5. Fixed Deposit Accounts Ledger.
- 6. Investment ledger.
- 7. Bills Discounted and Purchased Ledger.
- 8. Loan Ledger.
- 9. Cash Credit Ledger.
- 10. Customers' Acceptances, endorsements and Guarantee Ledger.
- 11. Recurring Deposits Accounts Ledger, etc. The principal books of accounts are
 - 1. Cash Book
 - 2. General Ledger

Slip system of posting - Slip system of posting is made from slips prepared inside the organisation itself or from slips filled in by its customers. So entries are not made in the books of original entry or subsidiary books, but posting of entries is done from slips. In a banking company, the main slips are pay-in -slips, withdrawal slips and cheques and all these slips are filled in by clients of the bank. These slips serve the basis of entry in the ledgers.

Final Accounts of Banks

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

□

Profit and Loss Account

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

Form B**FORM OF PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH****(000s omitted)**

	Schedule No	Year ended 31.3..(Current Year)	Year ended 31.3.(Previous Year)
I. Income			
Interest earned	13		
Other income	14		
Total			
II. Expenditure			
Interest expended			
Operating expenses	15		
Provisions and contingencies	16		
Total			
III. Profit/ Loss			
Net profit / loss for the			
year(I-II) Profit/loss brought forward			
Total			
IV. Appropriations			
Transfer to statutory reserves			
Transfer to other reserves			
Transfer to government/ Proposed Dividend			
Balance carried over to B/S			
Total			

SCHEDULE 13 – INTEREST EARNED**(000s omitted)**

	Year ended 31.3..(Current Year)	Year ended 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 15 – INTEREST EXPENDED

(000s omitted)

	Year ended 31.3..(Current Year)	Year ended 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

(000s omitted)

	Year ended (Current year)	Year ended (Previous Year)
i. Payments to and provisions for employees		
ii. Rent, taxes and lighting		
iii. Printing and stationary		
iv. Advertisement and publicity		
v. Depreciation on bank's property		
vi. Directors' fees, allowances and expenses		
vii. Auditor's fees, allowances and expenses (including branch auditors)		
viii. Law charges		
ix. Postages, telegrams, telephones, etc		
x. Repairs and maintenance		
xi. Insurance		
xii. Other expenditure		

Balance Sheet

The Balance Sheet of Banking Company is prepared according to Form A in Third Schedule. Form A is reproduced as follows:

FORM OF BALANCE SHEET

BALANCE SHEET OF (here enter name of the banking company)

as on 31st March (Year) (000s omitted)

□	Schedule No	As on (Current Year)	As on (Previous Year)
<i>Capital & Liabilities</i>			
Capital	1		
Reserves & Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities and Provisions	5		
Total			
<i>Assets</i>			
Cash and balances with RBI	6		
Balances with banks & money at call and short notice	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
Total			
Contingent liabilities	12		
Bills for collection			

Guidelines of the Reserve Bank of India for the Preparation of Final accounts of Banking Companies.

Statutory Reserve Ratio

Section 17 of Banking Regulation Act of 1949 deals with the term statutory reserve. Therefore, every banking company to create a reserve fund before any dividend is declared, a sum equal to 25% of the net profit of each year.

Cash Reserve Ratio (CRR)

As per Section 42(i) of RBI Act 1934, every scheduled bank shall maintain with the RBI equal to at least 3% of its time and demand liabilities (i.e., deposits received for fixed periods as well as of its demand liabilities) as cash reserve. It is called Cash Reserve Ratio. The Act empowers RBI to prescribe cash reserve of scheduled banks ranging from 3% to 15%. Presently Cash Reserve Ratio is 4%.

Statutory Liquidity Ratio (SLR)

As per Section 24 of the Banking Regulation Act 1949 every commercial bank is required to maintain not less than 25% of its total time and demand liabilities in liquid assets in the form of cash, gold, and unencumbered Government securities and other securities within India. It is called SLR. At present the norm of SLR is 21.5 %.

□

Instead, interest suspense account is credited. Unlike interest account, interest suspense account is not credited to P/L Account. If any portion of interest suspense is realised in subsequent year, then that portion will be credited to interest account and subsequently credited to P/L Account.

Items of Contingent liabilities in the case of Banking Company

Contingent liabilities are liabilities of the bank, which may or may not arise in future. The liabilities are

- a. Liability for partly paid investments.
- b. Liability on account of forward exchange contract.
- c. Guarantees given to customers.
- d. Acceptances, endorsements and other obligations.
- e. Claims against the bank not acknowledged as debt. Non Performing Assets (NPA)

An asset becomes non performing asset when it ceases to generate income for the bank as per the terms of contract. A non performing asset is defined as a credit facility in respect of which interest/instalment remains “past due” for a period of 90 days.

Classification of Bank Advances and its Provisioning. (Asset Classification)

Banks are required to classify advances into four categories which are given below –

a. Standard assets – It consists of all performing assets and advances backed by Government guarantees irrespective of liability. It is also called performing assets.

Standard assets are those assets which do not disclose any problem and which do not carry more than the normal risk attached to the business. A general provision of a minimum of .40 % of total standard assets should be made.

b. Substandard assets – These are the assets which are classified as Non Performing Assets for a period not exceeding two years. These assets indicate the possibility of loss in realising them. There is no certainty to recover them in full. A general provision of 15% of the total outstanding is made for these type assets.

c. Doubtful assets – An asset which has remained NPA for a period exceeding two years should be treated as doubtful. 100 percent of the extent to which 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. In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful: The provision is made on the following basis -

- Doubtful 1 - Up to one year – 25%
- Doubtful 2 – One to three years – 40 %
- Doubtful 3 – More than three years - 100%

d. Loss assets - These are assets which are considered to be uncollectable. Where the loss on assets has been identified by bank or internal auditor or the RBI inspector but the amount has not been written off wholly or partially is known as loss assets. It is also called Bad assets. A provision of 100% of the outstanding should be provided

□

FINAL ACCOUNTS OF INSURANCE COMPANIES

Insurance is a form of contract under which one party agrees in return of a consideration to pay an agreed amount of money to another party to compensate for a loss, damage or some uncertain event.

There are two types of insurance i.e., Life insurance and General Insurance.

Life Insurance – under this type of insurance the corporation guarantees to pay a certain sum of money to the policy holder on reaching a certain age or on his death whichever is earlier. Life insurance has an element both of protection and investment.

General Insurance – it includes all other types of insurance except life insurance. e.g. – Fire, Marine, Accident, Theft.etc. 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. **Insurance Regulatory and Development Authority (IRDA)**

In order to regulate the insurance business, the government set up in 1996, the Insurance Regulatory Authority (IRA). Now this authority is known as the Insurance Regulatory and Development Authority. In 2002, the authority came with regulations for the preparation of the financial statement of insurance companies.

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 (Rs.'000)	Previous Year (Rs.'000)
	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 fair value*			
	Other income (to be specified) Total (A)			
	Commission			
	Operating Expenses related to insurance business			
	Provision for doubtful debts 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)	2		

□

Benefits Paid (Net) Interim Bonuses paid			
Change in valuation of liability in respect of life policies	3		
(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	4		
being Funds for Future Appropriations Total (D)			

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

st

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

Shareholders' Account (Non-technical Account)

No.	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
	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			
	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)			
	Profit carried to the Balance Sheet			

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.

□

- (f) Under the sub-head "Others" shall be included items like foreign exchange gains or losses and other items.
- (g) Interest, dividends and rentals receivable in connection with an investment should be stated at gross amount, the amount of income tax deducted at source being included under "advance taxes paid and taxes deducted at source".
- (h) 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:

No.	Particulars	Sched ul	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Sources of Funds			
	<i>Shareholders' Funds:</i>			
	Share Capital Reserves and Surplus	5		
	Credit/[Debit] Fair Value Change Account	6		
	Sub-Total Borrowings			
	<i>Policyholders' Funds:</i>			
	Credit/[Debit] Fair Value Change Account			
	Policy Liabilities	7		
	Insurance Reserves			
	Provision for Linked Liabilities			
	Sub-Total			
	Funds for Future Appropriations			
	Total			
	Application of Funds			
	Investments			
	Shareholders'			
	Policyholders'			
	Assets held to Cover	8		
	Linked Liabilities	8A		
	Loans	8B		
	Fixed Assets	9		
	Current Assets	10		
	Cash and Bank Balances			
	Advances and Other	11		
	Assets Sub- Total (A)	12		
	Current Liabilities			
	Provisions	13		
	Sub- Total (B)	14		
	Net Current Assets (C)=(A)- (B)			
	Miscellaneous			
	Expenditure (to the extent not written off or adjusted)	15		
	Debit Balance in Profit and Loss Account (Shareholders' Account)			
	Total			

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS

SCHEDULE 1 - PREMIUM

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
.			

□

.	First Year Premiums		
	Renewal Premiums		
	Single Premiums		
	Total Premium		

SCHEDULE 2
COMMISSION EXPENSES

Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
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 Re-insurance accepted or Re-insurance ceded figures.

SCHEDULE 3
OPERATING EXPENSES RELATED TO INSURANCE BUSINESS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
.	Employees' remuneration & welfare benefits		
.	Travel, conveyance and vehicle running expenses		
.	Training expenses		
.	Rents, rates & taxes		
.	Repairs		
.	Printing & stationery		
.	Communication expenses		
.	Legal & Professional charges		
.	Medical fees		
.	Auditors' fees, expenses etc		
.	(a) As auditor		
.	(b) As adviser or in any other capacity, in respect of:		
.	(i) Taxation matters		
.	(ii) Insurance matters		
.	(iii) Management services; and		
.	(c) In any other capacity		
.	Advertisement and publicity		
.	Interest and bank charges		
.	Others(to be specified)		
.	Depreciation		
.	Total		

SCHEDULE 4 –
BENEFITS PAID [NET]

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
.	Insurance Claims: (a) Claims by Death (b) Claims by Maturity (c) Annuities/Pension payment (d) Other benefits, specify. (Amount ceded in reinsurance): (a) Claims by Death (b) Claims by Maturity (c) Annuities/Pension payment (d) Other benefits, specify. Amount accepted in reinsurance: (a) Claims by Death (b) Claims by Maturity (c) Annuities/Pension payment (d) Other benefits, specify. Total		

Notes: (a) claims include specific claims settlement costs, wherever applicable.
 (b) Legal and other fees and expenses shall also form part of the claims cost,
 wherever applicable.

SCHEDULE 5
SHARE CAPITAL

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
.	Authorised capital Equity shares of Rs.....each Issued Capital Equity shares of Rs.....each Subscribed Capital Equity shares of Rs.....each Called-up Capital Equity shares of Rs.....each 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		

□

SCHEDULE 5A – PATTERN OF SHAREHOLDING [As certified by the Management]

Shareholders	Current Year		Previous Year	
	No. of Shares	% of Holdin	No. of Shares	% of Holdin
Promoters				
*Indian				
*Foreign				
Others				
Total				

SCHEDULE 6 – RESERVES AND SURPLUS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
.	Capital Reserve		
.	Capital Redemption Reserve		
.	Share Premium		
.	Revaluation		
.	Reserve General		
.	Reserves		
.	Less: Debit balance in P&L A/c, if any		
.	Less: Amount utilized for buy		
.	back. Catastrophe Reserve		
.	Other Reserves (to be specified)		
.	Balance of Profit in P&L A/c		

Note: Additions to and deductions from the reserves shall be disclosed under each of the specified heads.

SCHEDULE 7 – BORROWINGS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Debentures/Bonds		
2.	Banks		
3.	Financial Institutions		
4.	Others (to be specified)		
	Total		

SCHEDULE 8 – INVESTMENTS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Long –term Investments		
1.	Government securities and Government Guaranteed Bonds including treasury bills		
2.	Other approved securities		

□

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

SCHEDULE 9– LOANS

No.	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Security-wise Classification Secured (a) On mortgage of property (aa) In India (bb) Outside India (b) On Shares, Bonds, Govt. Securities, etc. (c) Others (to be specified) Unsecured Total		
2.	Borrower-wise Classification (a) Central and State Governments (b) Banks and Financial Institutions (c) Subsidiaries (d) Companies (e) Loans against policies (e) Others (to be specified) Total		

□

3.	Performance-wise Classification (a) Loans classified as standard (aa) In India (bb) Outside India (b) Non-standard loans less provisions (aa) In India (bb) Outside India <p style="text-align: right;">Total</p>		
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□

4.	Maturity-wise Classification (a) Short Term (b) Long Term Total		
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SCHEDULE 10– FIXED ASSETS

Particulars	Cost/Gross Block				Depreciation				Net Block	
	Opening	Additions	Deductions	Closing	Up to Last Year	For the Year	On Sales/ Adjustment	To Date	As at year end	Previous Year
Goodwill										
Intangibles (specify)										
Land-Freehold										
Leasehold Property										
Buildings										
Furniture & Fittings										
Information Technology										
Equipment										
Vehicles										
Office Equipment										
Others (Specify nature)										
Total										
Work in progress										
Grand Total										
Previous Year										

SCHEDULE 11– CASH AND BANK BALANCES

No.	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Cash (including cheques, drafts and stamps)		
2.	Bank Balances		
	(a) Deposit Accounts		
	(aa) Short-term (due within 12 months of the date of Balance Sheet)		
	(bb) Others		
	(b) Current Accounts		
	(c) Others (to be specified)		
	Money at call and short notice		
3.	(a) With banks		
	(b) With other institutions		
	Others (to be specified)		
	Total		
4.	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 (Rs.'000)	Previous Year (Rs.'000)
	Advances		
1.	Reserve deposits with ceding companies		
2.	Application money for investments		
3.	Prepayments		
4.	Advances to Directors/Officers		
5.	Advance tax paid and taxes deducted at source (Net provision for taxation)		
6.	Others (to be specified)		
	Total (A)		
	Other Assets		
	Income accrued on investments		
1.	Outstanding Premiums		
2.	Agents' balances		
3.	Foreign Agencies Balances		
4.	Due from other entities carrying on insurance business		
5.	(including reinsurers)		
6.	Due from subsidiaries/holding company		
7.	Deposit with Reserve Bank of India [Pursuant to section 7 of Insurance Act, 1938]		
8.	Others (to be specified)		
	Total (B)		
	Total (A+B)		

SCHEDULE 13– CURRENT LIABILITIES

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Agents' balances		
2.	Balances due to other insurance companies		
3.	Deposits held on re-insurance ceded		
4.	Premiums received in advance		
5.	Unallocated premium		
6.	Sundry creditors		
7.	Due to subsidiaries/holding company		
8.	Claims outstanding		
9.	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 (To the extent not written off or adjusted)

No	Particulars	Current Year (Rs.'000)	Previous Year
1.	Discount allowed on issue of shares/debentures		
2.	Others (to be specified)		
	Total		

Types of Life Insurance Policies

1. Whole life policy - In this type of policy, the sum assured becomes payable to the beneficiary only on the death of the insured. The insured has to pay the premium throughout his life.
2. Endowment policy - It is a policy which runs for a fixed period or up to a particular age to the insured.
3. With profit policy - In this policy, the policy holder to receive , in addition to the sum assured , a share in the profit made by the Life insurance Corporation.
4. Without profit policy - In this policy, the holder gets only the stated sum on the maturity of the policy.

Explanation of items in the final accounts of Life Insurance Company

Claims - The amount paid or payable by the insurance company to the insured for the losses occurs or the particular event happens is called claims. A claim is usually the expenditure of an insurance company.

Annuity - Annuity is an annual payment which a life insurance company guarantees to pay for a lumpsum money received in the beginning.

Surrender value of a policy - Surrender value is the amount paid by the insurance company to the insured for surrendering all claims of the policy to the company.. Usually this amount will get after the payment of two annual premiums.

Bonus in Reduction of Premium - Here, instead of paying bonus in cash to the policy holders, the insurance company deducts the amount from the premium payable to it. The amount of bonus so adjusted in the premium amount is called bonus in reduction of premium.

Consideration for Annuities Granted – Any lumpsum payment received by the insurance company in lieu of granting annuity is called consideration for annuities granted.

Reinsurance - When an insurance company undertakes a big policies in large amount, they reduce their risks by re-insuring it with other insurance companies. Such a process is called reinsurance.

Double insurance - If the same subject matter is insured with more than one insurance company, it is known as Double insurance.

□

Life assurance fund - It is an accumulated reserve fund which is created from excess of income over expenditure in every year.

Reversionary bonus - Reversionary bonus is a bonus which is paid by the insurance company along with the maturity value of the policy.

Commission on reinsurance ceded and Commission on reinsurance Accepted

Insurance companies earn commission from other insurance companies for giving them business under reinsurance contract. This commission is called **commission on reinsurance ceded**. If some other insurance companies give insurance to us, commission paid on such reinsurance is called **commission on reinsurance accepted**.

Determination of Profit in Life Insurance Business

A life policy is generally taken for a number of years. The premium received for such long term contract cannot be treated as income for ascertaining the profits for that year. The future premium may or may not be received depends on the existence of the insured. Thus on a particular date a liability of the corporation is to be calculated as the premium to be received in future will generally be less than the amount payable as claims. There is a gap between claims which are expected to arise and premium which are expected to be received. The gap is known as Net liability. It becomes desirable to create a reserve equal to its net liability in order to ascertain the profit. The Life insurance business made the valuation of net liability every year in order to ascertain the profit. This is done by a person called Actuary. The process by which net liability is ascertained by this person is known as actuarial valuation. The net liability is compared with life assurance fund on a particular date in order to ascertain the surplus or deficiency. This comparison is made by preparing a Valuation Balance sheet, which is given as follows: -

Valuation Balance Sheet

Liabilities	Amount	Assets	Amount
Net Liability as per Actuary's valuation		Life Assurance Fund	
Surplus (Bal. Fig)		Deficit (Bal. Fig)	

□

Only surplus and not deficiency will be shown in the Balance sheet. With profit policy holders have a right to participate in the profits of life insurance business to the extent of 95% of true profit. The balance 5% may be utilized for such purpose as determined by the central government. For calculation of true profit, surplus as disclosed by the valuation Balance sheet must be adjusted.

Surplus as per Valuation Balance Sheet
Less: Actuarial expenses
Dividends payable to shareholders

Add: Interim bonus paid

Surplus

95% of net profit is payable as bonus to policyholders. While paying the above bonus, interim bonus paid already has to be deducted

Final Accounts of General Insurance Companies

General insurance companies may be doing more than one business e.g., fire, marine etc.

Fire insurance - In this insurance, the company undertakes to compensate loss caused by fire in consideration of premium received.

Marine insurance - In this insurance, in consideration of premium received, the company undertakes to compensate loss caused by marine risks as per terms of insurance.

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

□

Revenue Account (Form B-RA)

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

FORM B – RA

Name of the insurer

Registration No. and Date of Registration with the IRDA

Revenue Account for the year ended 31st March, 20.... Policyholders' Account
(Technical Account)

No	Particulars	Sched ule	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Premiums Earned (Net)	1		
2.	Others (to be specified)			
3.	Change in Provisions for unexpired risk			
4.	Interest, Dividend & Rent - Gross			
	Total (A)			
1.	Claims Incurred			
2.	Commission			
3.	Operating Expenses related to insurance business	2		
4.	Others (to be specified)	3		
	Total (B)	4		
	Operating Profit/ (Loss) from Fire/ Marine/ Miscellaneous business (C)=(A-B)			
	Appropriations			
	Transfer to Shareholders' Account			
	Transfer to Catastrophe Reserve			
	Transfer to Other Reserves (to be specified)			
	Total (C)			

Profit And Loss Account (Form B-PL)

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

FORM B-PL

Name of the insurer

□

Registration No. and Date of Registration with the IRDA

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

Shareholders' Account (Non-technical Account)

□

No	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Operating Profit/ (Loss) (a) Fire Insurance			
	(b) Marine Insurance (c) Miscellaneous Insurance			
2.	Income from investments (d) Interest, dividends & rent – Gross (e) Profit on sale/redemption of investments Less: Loss on sale of investments			
3.	Other income (to be specified) Total (A)			
4.	Provisions (other than taxation) (a) For diminution in the value of investments (net)			
5.	(b) For Doubtful Debts (c) Others (to be specified) Other Expenses (a) Expenses other than those directly related to the insurance business (b) Bad debts written off (c) Others (to be specified)			
	Total (B) Profit before tax Provision for taxation Profit after tax			
	Appropriations (f) Interim dividends paid during the year (g) Proposed final dividend (h) Dividend Distribution Tax (i) Transfer to Reserves or other accounts (to be specified)			
	Balance of Profit/Loss brought forward fro last year			
	Balance carried forward to the Balance Sheet			

Balance sheet
FORM B – BS

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

Name of the Insurer

Reg, No and date of registration with IRDA

Balance Sheet as at 31st March, 20...

No	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Sources of Funds			
	<i>Shareholders' Funds:</i>			
	Share Capital			
	Reserves and Surplus	5		
	Fair Value Change Account	6		
	Borrowings			
	Total			
	Application of Funds	7		
	Investments			
	Loans			
	Fixed Assets			
	Current Assets	8		
	Cash and Bank Balances	9		
	Advances and Other Assets	10		
	Sub-Total (A)			
	Current Liabilities	11		
	Provisions	12		
	Sub-Total (B)			
	Net Current Assets (C)=(A)-(B)	13		
	Miscellaneous Expenditure (to the extent not written off or adjusted)	14		
	Debit Balance in Profit and Loss Account			
	Total	15		

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS SCHEDULE 1 – PREMIUM EARNED [NET]

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Premium for direct business written		
	Add: Premium on reinsurance accepted		
	Less: premium on reinsurance ceded Net Premium		
	Total Premium Earned (Net)		

Note: Reinsurance premiums whether on business cede or accepted are to be brought into account, before deducting commission under the head of reinsurance premiums.

SCHEDULE 2 – CLAIMS INCURRED [NET]

Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
Claims paid		
Direct		
Add: Reinsurance accepted		
Less: Reinsurance ceded		
Net Claims paid		
Add: Claims outstanding at the end of the year		
Less: Claims outstanding at the beginning		
Total Claims Incurred		

SCHEDULE 3 – COMMISSION

Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
Commission paid		
Direct		
Add: Commission on Re-insurance Accepted		
Less: Commission on Re-insurance Ceded		
Net Commission		

Note: The profit/commission, if any, are to be combined with the Re-insurance accepted or Re-insurance ceded figures.

SCHEDULE 4 – OPERATING EXPENSES RELATED TO INSURANCE BUSINESS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Employees' remuneration & welfare benefits		
2.	Managerial remuneration		
3.	Travel, conveyance and vehicle running expenses		
4.	Rents, rates & taxes		
5.	Repairs		
6.	Printing & stationery		
7.	Communication expenses		
8.	Legal & Professional charges		
9.	Medical fees		
10.	Auditors' fees, expenses etc		
	(a) As auditor		
	(b) As adviser or in any other capacity, in respect of: (j)		
	Taxation matters		
	(ii) Insurance matters		
	(iii) Management services; and		
	(c) In any other capacity		
	Advertisement and publicity		
	Interest & bank charges		
	Others(to be specified)		
	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 5 – SHARE CAPITAL

SCHEDULE 5 – SHARE CAPITAL

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
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 Less: Calls unpaid Add: Equity Shares forfeited (Amount originally paid up) Less: Par value of equity shares bought back Less: Preliminary Expenses Expenses including commission or brokerage on underwriting or subscription of shares Total		

Notes:

- 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]**

Shareholders	Current Year		Previous Year	
	No. of Shares	% of Holding	No. of Shares	% of Holding
Promoters				
*Indian				
*Foreign				
Others				
Total				

SCHEDULE 6 – RESERVES AND SURPLUS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Capital Reserve		
2.	Capital Redemption Reserve		
3.	Securities Premium		
4.	General Reserves Less: Debit balance in P&L A/c, if any Less: Amount utilized for buy back. Catastrophe Reserve		
5.	Other Reserves (to be specified)		
6.			

□

7.	Balance of Profit in P&L A/c Total		
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Note: Additions to and deductions from the reserves shall be disclosed under each of the specified heads.

SCHEDULE 7 – BORROWINGS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Debentures/Bonds		
2.	Banks		
3.	Financial Institutions		
4.	Others (to be specified)		
	Total		

SCHEDULE 8 – INVESTMENTS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Long –term Investments		
	Government securities and Government Guaranteed Bonds including treasury bills		
2.	Other approved securities		
3.	Other investments		
	(a) Shares		
	(aa) Equity		
	(bb) Preference		
	(b) Mutual Funds		
	(c) Derivative Instruments		
	(d) Debentures/Bonds		
	(e) Other securities (to be specified) (f) Subsidiaries		
	(g) Investment Properties – Real Estate		
	Investments in Infrastructure and Social sector		
	Other than Approved Investments		
	Short –term Investments		
	Government securities and Government Guaranteed Bonds including treasury bills		
4.	Other approved securities		
5.	Other investments		
1.	(a) Shares		
	(aa) Equity		
2.	(bb) Preference		
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		
	Total		

SCHEDULE 9– LOANS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Security-wise Classification Secured (a) On mortgage of property (aa) In India (bb) Outside India (b) On Shares, Bonds, Govt. Securities, etc. (c) Others (to be specified) Unsecured <p style="text-align: right;">Total</p> Borrower-wise Classification		

SCHEDULE 10– FIXED ASSETS

Particulars	Cost/Gross Block				Depreciation				Net Block	
	Opening	Additions	Deductions	Closing	Up to Last Year	For the Year	On Sales/ Adjustmen To Date	As at year end	Previous Year	
Goodwill										
Intangibles (specify)										
Land-Freehold										
Leasehold Property										
Buildings										
Furniture & Fittings										
Information Technology										
Equipment										
Vehicles										
Office Equipment										
Others (Specify nature)										
Total										
Work in progress										
Grand Total										
Previous Year										

SCHEDULE 11– CASH AND BANK BALANCES

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Cash (including cheques, drafts and stamps) Bank		
2.	Balances (a) Deposit Accounts (aa) Short-term (due within 12 months) (bb) Others (b) Current Accounts (c) Others (to be specified)		
3.	Money at call and short notice (a) With banks (b) With other institutions Others (to be specified) Total		

4.	Balances with non-scheduled banks in 2 and 3 above		
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SCHEDULE 12– ADVANCES AND OTHER ASSETS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Advances		
1.	Reserve deposits with ceding companies		
2.	Application money for investments		
3.	Prepayments		
4.	Advances to Directors/Officers		
5.	Advance tax paid and taxes deducted at source (Net provision for taxation)		
6.	Others (to be specified)		
	Total (A)		
	Other Assets		
	Income accrued on investments		
1.	Outstanding Premiums		
2.	Agents' balances		
3.	Foreign Agencies Balances		
4.	Due from other entities carrying on insurance business (including reinsurers)		
5.	Due from subsidiaries/holding company		
6.	Deposit with Reserve Bank of India [Pursuant to section 7 of Insurance Act, 1938]		
7.	Others (to be specified)		
8.	Total (B)		
	Total (A+B)		

SCHEDULE 13– CURRENT LIABILITIES

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Agents' balances		
2.	Balances due to other insurance companies		
3.	Deposits held on re-insurance ceded		
4.	Premiums received in advance		
5.	Unallocated premium		
6.	Sundry creditors		
7.	Due to subsidiaries/holding company		
8.	Claims outstanding		
9.	Due to Officers/Directors		
10.	Others (to be specified)		

SCHEDULE 14–

PROVISIONS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Reserve for Unexpired Risk		
2.	For taxation (less payments and taxes deducted at source)		
3.	For proposed dividends		
4.	For dividend distribution tax		
5.	Others (to be specified)		
	Total		

SCHEDULE 15– MISCELLANEOUS EXPENDITURE (To the extent not written off or adjusted)

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Discount allowed on issue of shares/debentures		
2.	Others (to be specified)		
	Total		

Reserve for Unexpired Risk

Policies in general insurance are only for one year. These can be taken by the insured at any time during the year.. premium on such policies is always paid in advance. There may be such policies which are issued during the year but risks covered remain unexpired at the accounting year. Hence a reserve for unexpired risk is made at 50% of the net premium in case of fire insurance and 100% of the net premium in marine insurance is made. Opening balance for reserve for unexpired risk is added to the premium and closing balance of reserve for unexpired risk is deducted from the premium. The net premium should be shown in revenue account. The closing balance of reserve for unexpired risk should be shown in the balance sheet under the head 'provisions'. At present reserve for unexpired risk will be created as follows:

- a. 50% of net premium for fire insurance, marine cargo business and miscellaneous insurances.
- b. 100% of net premium for marine hull business.

In addition to the above reserve, a company can maintain more reserves. Then it is called Additional Reserve.