

As Per Revised Syllabus under CBCGS System of BAF Course
under Mumbai University w.e.f. June, 2018

Vipul's

FINANCIAL ACCOUNTING - VI

**(BAF Third Year : Fifth Semester)
(Core Courses)**

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Accounting for Banking Company

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Preface

We are happy to present the book Financial Accounting - VI to the students of B.Com. (Accounting and Finance) (BAF) of Mumbai University. In this edition, an effort has been made to incorporate the latest examination questions at relevant places in the book.

The syllabus contains a list of topics covered in each chapter which will avoid the controversies regarding the exact scope of the syllabus. The text follows the term-wise chapter-topic pattern prescribed in the syllabus.

The numerous illustrations are arranged in ascending order of difficulty, containing full solutions to questions asked in various examinations of Mumbai University and Professional Examinations. 'Questions for Self-Practice' contain the Objectives, Theory as well as Practical Questions.

This book is an unique presentation of subject matter in an orderly manner. It is a student friendly book and a tutor at home. We hope the teaching faculty and the student community will find this book of great use.

We welcome constructive suggestions for improvement.

We are extremely grateful to Mr. Nitin Maroo of Vipul Prakashan for the devoted and untiring personal attention accorded by them to this publication. We gratefully acknowledge the immense contribution and suggestion from various colleges.

We are gratefully acknowledge and express our sincere thanks to our parents and to the following people without whose inspiration, support, constant suggestions, this book would not have been possible:

Mr. Jitendra Singh

Ms. Chaitali Chakraborty

Ms. Janki Nishikant Jha

Mr. Muntajar Khan

Authors

SYLLABUS

Sr. No.	Modules / Units	No. of Lectures
1	Final Accounts of Banking Company:	15
	<p>Legal provision in Banking Regulation Act, 1949 relating to Accounts. Statutory reserves including Cash Reserve and Statutory Liquidity Ratio.</p> <p>Bill purchase and discounted, rebate of bill discounted.</p> <p>Final Accounts in prescribed form.</p> <p>Non – performing assets and Income from non – performing assets.</p> <p>Classification of Advances, standard, sub – standard, doubtful and provisioning requirement.</p>	
2	Final Accounts of Insurance Company (Excl. Life Insurance):	15
	<p>General Insurance – Various types of insurance, like fire, marine, Miscellaneous.</p> <p>Special terms like premium, claims, commission, Management expenses, Reserve for unexpired risk, reinsurance.</p> <p>Final Accounts in a prescribed form. Revenue Statement – Form B – RA, Profit / Loss Account – Form B – PL and Balance Sheet Form B – BS.</p>	
3	Non – Banking Financial Companies:	8
	<p>Introduction, Definition, Registration and Regulation, Classification, Income Recognition, Accounting of Investment, Applicability of Prudential Norms, Assets classification, Non- performing Assets, Capital Adequacy, Preparation of Financial statement</p>	
4	Valuation of Goodwill and Shares:	12
	<p>Valuation of Goodwill:</p> <p>Maintainable Profit method, Super Profit Method.</p> <p>Capitalization method, Annuity Method.</p> <p>Valuation of Shares:</p> <p>Intrinsic Value Method, Yield method and Fair Value Method.</p>	
5	Accounting for Limited Liability Partnership:	10
	<p>Statutory provisions.</p> <p>Conversion of partnership business into Limited Liability Partnership.</p> <p>Final accounts.</p>	



Accounting for Banking Company

	Total	60
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Question Paper Pattern

Maximum Marks: 75

Duration: 2½ Hrs.

Questions to be Set: 05

All Questions are Compulsory Carrying 15 Marks each.

Q-1	Objective Questions (A) Sub Questions to be asked 10 and to be answered any 08 (B) Sub Questions to be asked 10 and to be answered any 07 (*Multiple choice / True or False / Match the columns, Fill in the blanks)	15 Marks
Q-2	Full Length Practical Question OR	15 Marks
Q-2	Full Length Practical Question	15 Marks
Q-3	Full Length Practical Question OR	15 Marks
Q-3	Full Length Practical Question	15 Marks
Q-4	Full Length Practical Question OR	15 Marks
Q-4	Full Length Practical Question	15 Marks
Q-5	(A) Theory questions (B) Theory questions OR	08 Marks 07 Marks
Q-5	Short Notes: To be asked 05 To be answered 03	15 Marks

Note: Full length question of 15 marks may be divided into two sub questions of 08 and 07 marks.

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5.	Accounting for Limited Liability Partnership	344-385

Chapter 1

Accounting for Banking Company

INTRODUCTION:

The first bank in India, though conservative, was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases. They are as mentioned below:

- (a) Early phase from 1786 to 1969 of Indian Banks
- (b) Nationalisation of Indian Banks and up to 1991 prior to Indian banking sector Reforms.
- (c) New phase of Indian Banking System with the advent of Indian Financial & Banking Sector Reforms after 1991.

To make this write-up more explanatory, I prefix the scenario as Phase I, Phase II and Phase III.

Phase I:

The General Bank of India was set up in the year 1786. Next came Bank of Hindustan and Bengal Bank. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840) and Bank of Madras (1843) as independent units and called it Presidency Banks. These three banks were amalgamated in 1920 and Imperial Bank of India was established which started as private shareholders banks, mostly Europeans shareholders. In 1865 Allahabad Bank was established and first time exclusively by Indians, Punjab National Bank Ltd. was set up in 1894 with headquarters at Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank,

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and Bank of Mysore were set up. Reserve Bank of India came in 1935. During the first phase the growth was very slow and banks also experienced periodic failures between 1913 and 1948. There were approximately 1100 banks, mostly small. To streamline the functioning and activities of commercial banks, the Government of India came up with The Banking Companies Act, 1949 which was later changed to Banking Regulation Act 1949 as per amending Act of 1965 (Act No. 23 of 1965). Reserve Bank of India was vested with extensive powers for the supervision of banking in India as the Central Banking Authority.

During those days public has lesser confidence in the banks. As an aftermath deposit mobilisation was slow. Abreast of it the savings bank facility provided by the Postal department was comparatively safer. Moreover, funds were largely given to traders.

Phase II:

Government took major steps in this Indian Banking Sector Reform after independence. In 1955, it nationalised Imperial Bank of India with extensive banking facilities on a large scale specially in rural and semi-urban areas. It formed State Bank of India to act as the principal agent of RBI and to handle banking transactions of the Union and State Governments all over the country.

Seven banks forming subsidiary of State Bank of India was nationalised in 1960 on 19th July, 1969, major process of nationalisation was carried out. It was the effort of the then Prime Minister of India, Mrs. Indira Gandhi. 14 major commercial banks in the country was nationalised. Second phase of nationalisation Indian Banking Sector Reform was carried out in 1980 with seven more banks. This step brought 80% of the banking segment in India under Government ownership.

The following are the steps taken by the Government of India to Regulate Banking Institutions in the Country:

- (a) 1949: Enactment of Banking Regulation Act.
- (b) 1955: Nationalisation of State Bank of India.
- (c) 1959: Nationalisation of SBI subsidiaries.
- (d) 1961: Insurance cover extended to deposits.
- (e) 1969: Nationalisation of 14 major banks.
- (f) 1971: Creation of credit guarantee corporation.

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- (g) 1975: Creation of regional rural banks.
- (h) 1980: Nationalisation of seven banks with deposits over 200 crore.

After the nationalization of banks, the branches of the public sector bank India rose to approximately 800% in deposits and advances took a huge jump by 11,000%. Banking in the sunshine of Government ownership gave the public implicit faith and immense confidence about the sustainability of these institutions.

Phase III:

This phase has introduced many more products and facilities in the banking sector in its reforms measure. In 1991, under the chairmanship of M Narasimham, a committee was set up by his name which worked for the liberalization of banking practices. The country is flooded with foreign banks and their ATM stations. Efforts are being put to give a satisfactory service to customers. Phone banking and net banking is introduced. The entire system became more convenient and swift. Time is given more importance than money.

The financial system of India has shown a great deal of resilience. It is sheltered from any crisis triggered by any external macroeconomics shock as other East Asian Countries suffered. This is all due to a flexible exchange rate regime, the foreign reserves are high, the capital account is not yet fully convertible, and banks and their customers have limited foreign exchange exposure.

RECENT DEVELOPMENTS IN THE BANKING SECTOR:

The central banks role has become very significant in the post liberalization era to ensure financial stability. It has been fine tuning its policy to suit the requirements of the economy and also to be on par with international standards. It has taken a number of measures in recent times to strengthen the banking sector .The vital ones are as follows:

- (1) All banks have been advised to undertake a self assessment of their performance and prepare a road map for moving towards basel II smoothly
- (2) Banks have been asked to make a higher provisioning for NPAs in 'doubtful more than three years' category.
- (3) Banks are discouraged from investing in unrated non-SLR securities.

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- (4) Under the special agriculture credit plans (SACP), banks have been asked to increase their disbursements to small and marginal farmers to 40% of their advances by MARCH 2007.
- (5) Private Banks have also been included under the special agriculture credit plans. The target for credit disbursement to agriculture from 2005-2006 is fixed at 20-25% of their total credit.

The reform process and the effective regulation and supervision of the central bank ensured a strong growth of the banking sector in 2003 - 2004. The deposits of scheduled commercial banks increased by 17.5%, credit by 15.3% and investments by 25.1%. The non- performing assets of the scheduled commercial banks declined considerably in 2003-2004. Many measures like restructuring of loans, using lokadalats, civil courts and debt recovery tribunals etc. are being deployed to reduce non-performing assets. The enactment of the securitization and reconstruction of financial assets and enforcement of security interest Act 2002 has given a big boost to the recovery management system. The capital to risk weighted assets ratio (CRAR) has improved both in the case of private and public sector banks. In the first half of 2004-05, CRAR of scheduled commercial banks was 13,4% and new private sector banks were 13.5%. All the bank groups had CRAR more than the minimum requirement of 9% fixed by the central bank. This ratio is prescribed by the central bank to protect the interests of the depositors and ensure stability and efficiency in the banking system. Thus the banking sector is emerging stronger and efficient in the recent time due to the reforms introduced by the central bank.

Section 5 of the Banking Regulation Act, 1949 defines banking as “the accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise”. Therefore, any company which engages itself in the manufacture of goods or carries on any trade and accepts deposits of money from the public for financing its business activities will not be treated as doing banking business. 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 forms of business, namely:

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- (a)** the borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes, coupons drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, traveler's cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities;
- (b)** Acting as agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a company;
- (c)** Contracting for public and private loans and negotiating and issuing the same;
- (d)** Effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, municipal or other loans or of shares, stock, debentures or debenture stock of any company, corporation or association and the lending of money for the purpose of any such issue;
- (e)** Carrying on and transacting every kind of guarantee and indemnity business;
- (f)** Managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;
- (g)** Acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form the

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security or part of the security for any loans or advances or which may be connected with any such security:

- (h) Undertaking and executing trusts;
- (i) Undertaking the administration of estates as executor, trustee or otherwise;
- (j) Establishing and supporting or aiding in the establishment and support of associations, institutions funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons: granting pensions and allowances and making payments towards insurance: subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;
- (k) The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purposes of the company;
- (l) Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;
- (m) Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub-section;
- (n) Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;
- (o) Any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a banking company to engage.

GENERAL INFORMATION:

As per Section 8 of the Banking Regulation Act, 1949 a banking company can neither itself nor on behalf of the others deal in buying or selling or bartering of goods except in connection with the realization of security given to or by it.

- (1) According to Section 12(i) of the Act, no banking company can carry on Business in India unless its subscribed capital is net less than one-half of the authorized capital and its paid-up capital is not less than one-half of the subscribed capital.

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- (2) The capital of the banking company shall consist of equity shares and such preference shares as may have been issued prior to the 1st of July, 1944, [Section 12(u)].
- (3) No banking company shall pay out directly or indirectly by way of commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, any amount exceeding in the aggregate two and one-half percent of the paid-up value of the said shares. (Section 13)
- (4) Section 14 reveals that a banking company cannot create any charge upon its uncalled capital and any such charge shall be void.
- (5) **Payment of Dividend:** No banking company shall pay any dividend on its shares until all its capital expenses (including preliminary expenses, organization expenses, share selling commission, brokerage, amounts of losses incurred and any other item of expenditure not represented by tangible assets) have been completely written off (Section 15)
- (6) A banking company must have a whole time chairman appointed for five years at a time. He may become a director of a subsidiary of the banking Company or of a guarantee Company registered under section 25(g) the Companies Act but cannot take up any other appointment.
- (7) **Statutory Reserve:** According to Section 17, every banking company incorporated in India shall transfer a sum equal to 25% of the profit of each year to a Statutory Reserve before any dividend is declared. However, if the aggregate amount of statutory reserve and securities premium is not less than the paid-up capital, a banking company may be exempted from this restriction by the Central Government on the recommendation of the Reserve Bank of India. If a banking company appropriates any sum from the reserve or the securities premium account, it shall, within 21 days from the date of such appropriation report the fact to the Reserve Bank of India explaining the circumstances relating to such appropriation. The Statutory Reserve is shown separately from other reserves in the Balance Sheet on the liabilities under the heading 'Reserves and Surplus'.
- (8) **Cash Reserve and Statutory Liquidity Ratio:** According to Section 18, a scheduled bank shall maintain with the Reserve Bank equal to at least 3% of its time and demand liabilities (i.e., deposits received

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for fixed periods as well as of its demand liabilities) as on the last Friday of the second preceding fortnight as cash reserves. A non-scheduled bank has to maintain similar balances either in cash or as deposit with the Reserve Bank. The Reserve Bank of India is empowered to raise this percentage up to 15%. Presently, the Cash Reserve Ratio (CRR) is 5%. In addition to the above, every bank is required to maintain in India in the form of cash, gold or unencumbered approved securities, an amount which is not less than 25% or such other percentage not exceeding 40% (as the RBI may specify from time to time) of the total of its demand and time liabilities in India, is called statutory liquidity ratio. The norm of SLR is 25% at present.

(9) Loans and Advances: Section 20 reveals that, no banking company shall make any loans or advances on the security of its own shares or grant or agree to grant a loan or advance to or on behalf of: (a) any of its directors; (b) any firm in which any of its directors is interested as partner, manager or guarantor; (c) any company of which any of its directors is a director, manager, employee or guarantor or in which he holds substantial interest; or (d) any individual in respect of whom any of its directors is a partner.

(10) Section 11 of the Banking Regulation Act, 1949 prescribes the minimum limits of paid-up capital and reserves of the banking company as follows:

(a) For banking companies incorporated outside India:

(i) If it has a place of business in Mumbai or Kolkata `20 lakh

(ii) If the places of business are elsewhere `15 lakh

The above sum must be kept deposited with the Reserve Bank of India either in cash or in unencumbered securities;

In addition to the above, a further amount equal to 20% of the annual profits in respect of business transacted through its branches in India must be kept deposited with the Reserve Bank of India at the end of each year.

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(b) For banking companies incorporated in India:

<p>(i) If the places of business are in more than one State and if any place of business is in Mumbai or Kolkata.</p>	<p>₹10 lakh.</p>
<p>(ii) If the places of business are in more than one State and none of the places of business is in Mumbai or Kolkata.</p>	<p>₹5 lakh.</p>
<p>(iii) If the places of business are only one State and none of the places of business is in Mumbai or Kolkata.</p>	<p>₹1 lakh for the principal placed plus ₹10,000 for each additional place of business in the same district and ₹25,000 for a place of business outside the district subject to a maximum of ₹5 lakh. But if the place of business is only at one place, the maximum amount required is ₹50,000. For a banking company which has commenced business after 15th September 1962, its paid-up capital should be at least ₹5 lakh.</p>
<p>(iv) If the places of business are only in one State and if the places of business are also in Mumbai or Kolkata</p>	<p>₹5 lakh plus ₹25,000 to each place of business outside Mumbai and Kolkata subject to a maximum of ₹10 lakh.</p>

A banking company commencing business after coming into force of the Banking Companies (Amendment) Act, 1962, shall have a paid-up capital of not less than ₹5 lakh irrespective of the number of places of its business.

The limits given above are inadequate. Thus, they strengthen the capital base of the banks; the Reserve Bank of India introduced the risk weighted asset ratio system in 1962 on the recommendations of the Narasimham Committee. According to this system, paid-up capital and reserves of a bank after writing off-bad debts should form an adequate

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percentage (8% to 10%) of the assets of the bank, its investments, loans and advances. All these items, have been assigned weights according to the prescribed risks. The ratio so computed is called Capital Adequacy Ratio. This ratio is calculated as follows:

$$\text{Capital Adequacy Ratio} = \frac{\text{Paid-up Capital + Reserves}}{\text{Risk Weighted Assets, Investments}} \times 100$$

All banks in India were to achieve the capital adequacy ratio of 8% by March 31, 1996 and banks were required to raise this ratio to 10% by 2002.

Accounts and Audit:

The provisions of the Act relating to annual accounts and audit of a banking company are given in Sections 20-33 are as follows:

Preparation of Annual Accounts:

On 31st March, each and every banking company incorporated in India, in respect of all businesses transacted by it, and every banking company incorporated outside India, in respect of all businesses transacted through its branches in India shall prepare a balance sheet with reference to that year and profit and loss account as on the working day of the year in the forms set out in third schedule or as near thereto as circumstances admit. Form A in third schedule is the Balance Sheet and Form B is the Profit and Loss Account. Form A and Form B have been revised with effect from 1st April, 1991.

Audit of Accounts:

The Balance Sheet and Profit and Loss Account of a banking company is required to be audited by a Chartered Accountant. The appointment of the auditor, his powers, duties and liabilities are governed by the Companies Act. But the auditor's report on the accountants of a banking company must include certain additional particulars.

Filing of Accounts:

Three copies of the audited Balance Sheet and Profit and Less Account together with the auditors' report shall be furnished as returns to the Reserve Bank of India within three months from the end of the accounting year. The Reserve Bank can extend the period of three months for a further period up to three months. The Reserve Bank is

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authorized to call for any further information as it may think proper from a banking company relating to the business of such company.

A banking company is also required to send to the Registrar of Companies three copies of its audited Balance Sheet and Profit and Loss Account and Auditor's report and when the Reserve Bank required any additional information in connection with the accounts, a copy of any such additional information shall also be sent to the registrar.

Publication of Accounts:

The Balance Sheet, Profit and Loss Account and the Auditor's Report of every banking company shall be published in any newspaper circulating at the place where it has principal office, within six months from the end of the accounting year.

Accounting System:

The accounting system of a banking company is different from that of a trading or manufacturing enterprise. The following are the main features of a bank's accounting system.

- (1) Entries in the personal ledgers are made directly from the vouchers.
- (2) Every day summary sheets in total are prepared taking entries from the personal ledgers and posted to the control accounts in the general ledger.
- (3) The general ledger trial balance is extracted and agreed every day.
- (4) The entries in the personal ledgers and summary sheets are checked by persons other than those who made the entries with the result that most clerical mistakes are detected before another day begins.
- (5) A trial balance of detailed personal ledgers is prepared periodically (generally after two weeks) and get agreed with the general ledger control accounts.
- (6) Two vouchers, one debit voucher and another credit voucher are prepared for every transaction involving cash.

Books Required:

A banking company is required to maintain a large number of subsidiary books. Some of the important books are as follows;

- (a) Receiving Cashier's Counter Cash Book.
- (b) Paying Cashier's Counter Cash Book.

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- (c) Current Accounts Ledger.
- (d) Savings Bank Accounts Ledger.
- (e) Fixed Deposit Accounts Ledger.
- (f) Investment Ledger.
- (g) Bills Discounted and Purchased Ledger.
- (h) Loan Ledger.
- (i) Cash Credit Ledger.
- (j) Customers' Acceptances, Endorsements and Guarantee Ledger.
- (k) Recurring Deposits Accounts Ledger.

In addition to the above books, the following are the chief registers and memorandum books kept by a bank:

- (1) Demand Draft Register.
- (2) Bills for Collection Register.
- (3) Share Security Register.
- (4) Safe Custody Register.
- (5) Jewellery Register.
- (6) Letter of Credit Register.
- (7) Safe Deposit Vault Register.
- (8) Standing Order Register.

PRINCIPAL ACCOUNTING POLICIES:

(1) General:

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

(2) Transactions involving Foreign Exchange:

- (a) Monetary assets and liabilities have been translated at the exchange rates prevailing at the close of the year. Non-monetary assets have been carried in the books at the historical cost.
- (b) Income and expenditure items in respect of Indian branches have been translated at the exchange rates ruling on the date of the transaction and in respect of overseas branches at the exchange rates prevailing at the close of the year.
- (c) Profit or loss on pending forward contracts has been accounted for.

(3) Investments:

- (a) Investments in Government and other approved securities in India are valued at the lower of cost or at market value.

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- (b) Investments in subsidiary companies and associated companies (i.e., companies in which the bank holds at least 25% of the share capital) have been accounted for on the historical cost basis.
 - (c) All other investments are valued at the lower of cost or market value.
- (4) Advances:**
- (a) Provisions for doubtful advances have been made to the satisfaction of the auditors:
 - (i) In respect of identified advances, based on a periodical review of advances and after taking into account the portion of advance guaranteed by the Deposit Insurance and Credit Guarantee Corporation, the Export Credit and Guarantee Corporation and similar statutory bodies.
 - (ii) In respect of general advances, as a percentage of total advances taking into account guidelines issued by the Government of India and the Reserve Bank of India.
 - (b) Provisions in respect of doubtful advances have been deducted from advances to the extent necessary and the excess has been included under “Other liabilities and provisions”.
 - (c) Provisions have been made on a gross basis. Tax relief which will be available when the advance is written off will be accounted for in the year of write off.
- (5) Fixed Assets:**
- (a) Premises and other fixed assets have been accounted for at their historical cost. Premises which have been revalued are accounted for at the values determined on the basis of such revaluation made by professional valuers. Profit arising on revaluation has been credited to Capital Reserve.
 - (b) Depreciation has been provided by the straight line/diminishing balance method.
 - (c) In respect of revalued assets, depreciation is provided for on the revalued figures and an amount equal to the additional depreciation consequent on revaluation is transferred annually from the Capital Reserve to the General Reserve/ Profit and Loss Account.

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(6) Staff Benefits: Provisions for gratuity/pension benefits to staff has been made on an accrual/cash basis. Separate funds for gratuity/pension have been created.

(7) Net Profit:

(a) The net profit disclosed in the profit and loss account is after:

(i) Provision for taxes on income in accordance with the statutory requirements,

(ii) Provision for doubtful advances,

(iii) Adjustments to the value of “current” investments in Government and other approved securities in India valued at lower of cost or market value,

(iv) Transfer to contingency fund,

(v) Other usual or necessary provisions.

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

GENERAL INSTRUCTIONS:

(1) The formats of Profit and Loss Accounts cover all items. Likely to appear in these statements. In case a bank does not have any particular item to repeat, it may be omitted from the formats.

(2) Corresponding comparative figures for the previous year are to be disclosed as indicated in the formats are only to indicate the order of presentation and may not appear in the accounts.

(3) Figures should be rounded-off to the nearest thousand rupees.

Form of Profit & Loss Account for the year Ended 31st March

	Schedule No.	Year ended 31.3. (Current year)	Year ended 31.3. (Previous year)
1. INCOME:			
Interest earned	13		
Other income	14	.....	.....
Total		.....	.....
2. EXPENDITURE:			
Interest expended	15		
Opening expenses	16	.....	.....
Provisions and contingencies	
Total	
3. PROFIT/LOSS:			
Net Profit/Loss (–) for the year	

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Profit/Loss (-) brought forward	
Total	
3. APPROPRIATIONS:			
Transfer to statutory reserves			
Transfer to other reserves			
Transfer to Govt. /Proposed dividends			
Balance carried over to balance sheet		.....	.....
Total		.....	.....

Schedule 13 – Interest Earned

	Year ended 31.3. (Current year)	Year ended 31.3. (Previous year)
1. Interest/discount on advances/bills:		
2. Income on Investments		
3. Interest on balances with Reserve Bank of India and other inter-bank funds		
4. Others		
Total		

Schedule 14 – Other Income

	Year ended 31.3. (Current year)	Year ended 31.3. (Previous year)
1. Commission, exchange and brokerage		
2. Profit on sale of investments Less: Loss on sale of investments		
3. Profit on revaluation of investments Less: Loss on revaluation of investments		
4. Profit on sale of land, building and other assets Less: Loss on exchange transactions		
5. Income earned by way of dividends etc. from subsidiaries / companies and / or joint ventures abroad / in India		
6. Miscellaneous Income		
Total		

Note: Under items II to V loss figures may be shown in brackets.

Schedule 15 – Interest Expended

	Year ended 31.3. (Current year)	Year ended 31.3. (Previous year)
1. Interest on deposits		

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2. Interest on Reserve Bank of India/inter-bank borrowings		
3. Others		
Total		

Schedule 16 – Operating Expenses

	Year ended 31.3. (Current year)	Year ended 31.3. (Previous year)
1. Payments to and provisions for employees		
2. Rent, taxes and lighting		
3. Printing and Stationery		
4. Advertisement and Publicity		
5. Depreciation on Bank's property		
6. Director's fees allowances and expenses (including branch Auditors)		
7. Auditor's fees and expenses (including branch Auditors)		
8. Law Charges		
9. Postage, Telegrams, Telephones, etc.		
10. Repairs and Maintenance		
11. Insurance		
12. Other expenditure		
Total		

Statutory Reserve Funds (Section 17):

Every banking company incorporated in India is required to transfer at least 20% of its profit to the reserve fund. The profit of the year as per the profit and loss account prepared under Section 29 is to be taken as base for the purpose of such transfer and transfer to reserve fund should be made before declaration of any dividend.

If any banking company makes any appropriation from the reserve fund or share premium account, it has to report to the Reserve Bank of India the reasons for such appropriation within 21 days.

Cash Reserve (Section 18):

Every non-scheduled bank has to maintain a cash reserve atleast to the extent of 3% of its demand and time liabilities in India as on the last Friday of the second preceding fortnight Cash reserve can be maintained by way of balance in a current account with the Reserve Bank of India or by way of net balance in current accounts. Every non-scheduled bank has

Accounting for Banking Company

to submit as return showing the amount so held for cash reserve along with the particulars of its demands and time liabilities an India or such Friday before 20th day of every month. If any such Friday is a holiday under the Negotiable Instruments Act, 1881, such return is to be sent at the close of business on the preceding working day.

Liquidity norms (Section 24):

Banking Companies have to maintain sufficient liquid assets in the normal course of business in bank form over extending their resources, Liquidity normal has been settled and given statutory recognition. Every banking companies has to maintain cash, gold or approved securities, an amount not is charged by R.B.I. from time to time considering the general economic conditions.

Guidelines of Reserve Bank of India for Profit and Loss Account:

Income side items:

(1) Interest Earned (Schedule 13)

(a) Interest/discount on advance/bills	Includes interest and discount on all types of loans and advance like cash credits, demand loans, overdrafts, export loans, term loans, domestic and foreign bills purchased and discounted (including those rediscounted), overdue interest and also interest subsidy, if any, relating to such advances/bills.
(b) Income on investments	Includes all incomes derived from the investment portfolio by way of interest and dividend.
(c) Interest on balances with Reserve Bank of India and other inter bank funds	Includes interest on balances with Reserve Bank and other banks, call loans, money market placements, etc.

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(d) Others	Includes any other interest/ discount income not included in the above heads.
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(2) Other Income (Schedule 14)

(a) Commission exchange and brokerage	Includes all remuneration on services such as commission on collections, commission/exchange on remittances and transfers, commission on letters of credit, letting out of lockers and guarantees, commission on Government business, commission on other permitted agency business including consultancy and other services, brokerage, etc. on securities. It does not include foreign exchange income.
(b) Profit on sale of investments Less: Loss on sale of investments	Includes profit/loss on sale of securities, furniture, land and buildings, motor vehicles, gold, silver, etc. Only the net position should be shown. If the net position is a loss, the amount should be shown as a deduction. The net profit/loss on revaluation of assets may also be shown under this item.
(c) Profit on revaluation of investments Less: Loss on revaluation of investments	
(d) Profit on sale of land, buildings and other assets Less: Loss on sale of land, buildings and other assets.	
(e) Profit on exchange transactions Less: Loss on exchange transactions	Includes profit/loss on dealing in foreign exchange, all incomes earned by way of foreign exchange, commission and charges on foreign exchange transaction excluding interest

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	which will be shown under interest. Only the net position should be shown. If the net position is a lost, it is to be shown as a deduction.
(f) Income earned by way of dividends etc., from subsidiaries, companies, joint ventures abroad/in India	
(g) Miscellaneous income	Includes recoveries from constituents for godown rents, income from bank's properties, security charges, insurance, etc. and any other miscellaneous income. In case any item under this head exceeds one percentage of the total income, particulars may be given in the notes.

Expenditure Side:

(1) Interest Expended (Schedule 15)

(a) Interest on deposits	Includes interest paid on all types of deposits including deposits from banks and other institutions.
(b) Interest on Reserve Bank of India/inter-bank borrowings	Includes discount/interest on all borrowings and refinances from Reserve Bank of India and other banks.
(c) Other	Includes discount/interest on all borrowings/refinance from financial institutions. All other payments like interest on participation certificates, penal interest paid, etc., may also be included here.

(2) Operating Expenses (Schedule 16)

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(a) Payments to and provisions for employees	Includes staff salaries/wages, allowances, bonus, other staff benefits like provident fund, pension, gratuity liveries to staff, leave fare concessions, staff welfare, medical allowance to staff, etc.
(b) Rent, taxes and lighting	Includes rent paid by the bank on buildings and other municipal and taxes paid (excluding income-tax and interest tax) electricity and other similar charges and levies. House rent allowance and other similar payments to staff should appear under the head 'Payments to an provisions for employees'.
(c) Printing and stationery	Includes books and forms and stationary used by the bank and other printing charges which are not incurred by way of publicity expenditure.
(d) Advertisement and publicity	Includes expenditure incurred by the bank for advertisement and publicity purposes including printing charges of publicity matter.
(e) Depreciation on bank's property	Includes depreciation on bank's own property, motor cars and other vehicles; furniture, electric fittings, vaults, lifts, leasehold properties, non-banking assets, etc.
(f) Directors' fees, allowances and expenses	Includes sitting fees all other items of expenditure incurred on behalf of directors. The daily allowance, hotel charges, conveyance charges, etc., which though in the nature of

Accounting for Banking Company

	<p>reimbursement of expenses incurred may be included under this head. Similar expenses of local Committee members may also be included under this head.</p>
(g) Auditor's fees and expenses (including branch auditors' fees and expenses)	<p>Includes the fees paid to the statutory auditors and branch auditors for professional services rendered and all expenses for performing their duties, even though they may be in the nature of reimbursement of expenses. If external auditors have been appointed by banks themselves for internal inspections and audits and other services the expenses incurred in the context including fees may not be included under this head but shown under 'other expenditure'</p>
(h) Law charges	<p>All legal expenses and reimbursement of expenses incurred in connection with legal services are to be included here.</p>
(i) Postage, telegrams, telephones, etc.	<p>Includes all postal charges like stamps, telegrams, telephones, teleprinter, etc.</p>
(j) Repairs and maintenance	<p>Includes repairs to bank's property, their maintenance charges, etc.</p>
(k) Insurance	<p>Includes insurance charges on bank's property, insurance premia paid to Deposit Insurance and Credit Guarantee Corporation, etc., to the extent they are not recovered from the concerned parties.</p>
(l) Other expenditure	<p>All expenses other than those not included in any of the other heads like, license fees, donations, subscriptions to papers, periodicals,</p>

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	entertainment expenses, travel expenses, etc., may be included under this head. In case any particular item under this exceeds one percentage of the total income particulars may be given in the notes.
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(3) Provisions and Contingencies:

	Includes all provisions made for bad an doubtful debts, provisions for taxation, provisions for diminution in the value of investments, transfers to contingencies and other similar items.
--	---

Illustration 1:

From the following information, you are required to prepare the Profit and Loss Account of the UCO Bank of the year ended 31st March, 2015, under the provisions of the Act applicable thereto.

Particulars	₹('000)	Particulars	₹('000)
Interest on Loans	1,295	Postage, Telegrams and Telephones	7.00
Interest on Cash Credits	1,115	Sundry Charges	5.00
Discount on Bills Discounted	975	Advertisement and Publicity	3.50
Interest on Overdrafts	270	Directors' fees	15.00
Interest on Saving Bank Deposits	550	Printing and Stationary	1.00
Interest on Fixed Deposits	1,385	Law Charges	3.50
Commission, Exchange & Brokerage	41	Payment of Employees	270.00
Rent, Taxes and Lighting	90	Lockers Rent	1.75
Auditor's Fees	6	Transfer Fees	3.50
		Depreciation on Bank's Property	25.00

Supplementary Information:

Rebate on bills discounted ₹2,45,000 and provide for bad debts ₹1,45,000.

Solution:

The Uco Bank
Profit and Loss Account for the year ended 31st March, 2015

Accounting for Banking Company

Particulars	Schedule No.	Year ended 31/3/2015
(I) Income		
Interest earned	13	3,410.00
Other income	14	46.25
Total		3,456.25
(II) Expenditure		
Interest expended	15	1,935
Operating expenses	16	426
Provisions and contingencies (245 + 145)		145
Total		2,506
(III) Profit / Loss		
Net profit / Loss (-) for the year		950.25
Profit / Loss (-) brought forward		-
Total		950.25
(IV) Appropriations		
Transfer to Statutory Reserve (25% of `950.25)		237.56
Transfer to other reserves		-
Transfer to Government / Proposed dividend		-
Balance carried over to balance sheet		712.69
Total		950.25

Schedule 13 – Interest Earned

	Year ended on 31/3/15
(I) Interest/discount on advances/bills (1,295 + 1,115 + 975 + 270 – 245)	3,410
(II) Income on investments	-
(III) Interest on balances with Reserve Bank of India and other inter-bank funds	
(IV) Others	-
	3,410

Schedule 14 – Other Income

(`000)

	Year ended 31/3/15
(I) Commission, Exchange and Brokerage	41
(II) Lockers Rent	1.75
(III) Transfer Fees	3.5
Total	46.25

Schedule 15 – Interest Expended

(`000)

	Year ended 31/3/15
(I) Interest on deposits (550 + 1,385)	1,935
	1,935

Schedule 16 – Operating Expenses

	₹('000)
(I) Payment to Employees	270
(II) Rent, Taxes and Lighting	90
(III) Printing and Stationary	1
(IV) Advertisement and Publicity	3.5
(V) Depreciation on Bank's Property	25
(VI) Directors' Fees	15
(VII) Audit Fees	6
(VIII) Law Charges	3.5
(IX) Postage, Telegrams and Telephones	7
(X) Sundry Charges	5
	426

Illustration 2:

From the following information prepare Profit and Loss Account of Yes Bank for the year ended on 31st March, 2015.

Particulars	₹('000)	Particulars	₹('000)
Interest on Loans	3,885	Interest on Overdrafts	2,310
Interest on Fixed Deposits	4,755	Directors' Fees, Allowances and Expenses	45
Rebate on Bills Discounted	735	Auditor's Fees and Expenses	18
Commission	123	Interest on Savings Bank Deposits	1,020
Payment to Employees	810	Postage, Telegrams and Telephones	21
Discount on Bills Discounted (Gross)	2,325	Printing and Stationary	43.5
Interest on Cash Credits	3,345	Sundry Charges	25.5
Rent, Taxes and Lighting	270		

Addition Information:

- (a) Provide for Contingencies ₹3,00,000.
- (b) Transfer ₹23,35,500 to Reserve, and
- (c) Transfer ₹3,00,000 to Central Government.

Solution:

The Yes Bank

Profit and Loss Account for the year ended 31st March, 2015

Particulars	Schedule No.	Year ended 31/3/2015
(I) Income		
Interest earned	13	11,130

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Other income		14	123
	Total		11,253
(II) Expenditure			
Interest expended		15	5,775
Operating expenses		16	1,233
Provisions and contingencies			300
	Total		7,308
(III) Profit / Loss			
Net profit / Loss (-) for the year			3,945
Profit / Loss (-) brought forward			-
	Total		3,945
(IV) Appropriations			
Transfer to Statutory Reserve (25% of `950.25)			986.25
Transfer to other reserves			2,335.5
Transfer to Government / Proposed dividend			300
Balance carried over to balance sheet			323.25
	Total		3,945

Working Notes:

Schedule 13 – Interest Earned

Particulars	Year ended on 31/3/15
(I) Interest / discount on advances / bills (3,885 + 2,325 + 3,345 + 2,310 – 735)	11,130
(II) Income on investments	-
(III) Interest on balances with Reserve Bank of India and other inter-bank funds	-
(IV) Others	-
	11,130

Schedule 14 – Other Income

Particulars	`('000)
Commission	123
	123

Schedule 15 – Interest Expended

Particulars	`('000)
Interest on Fixed Deposits	4,755
Interest on Savings Bank Deposits	1,020
	5,775

Schedule 16 – Operating Expenses

Particulars	`('000)
(I) Payment to Employees	810
(II) Directors' Fees, Allowances and Expenses	45.0
(III) Rent, Taxes and Lighting	270.0

Accounting for Banking Company

(IV) Postage, Telegrams and Telephones	21.0
(V) Auditors' Fees and Expenses	18.0
(VI) Printing and Stationary	43.5
(X) Sundry Charges	25.5
	1,233.0

Illustration 3:

From the following information, prepare Profit and Loss Account of New India Bank Ltd. on 31st March, 2015

Particulars	`('000)	Particulars	`('000)
Interest and discount	6,874	Printing and stationary	360
Income from investments	230	Advertisement and publicity	190
Interest on balance with RBI	360	Depreciation	184
Commission, exchange and brokerage	1,640	Director's fees	440
Profit on sale of investments	220	Auditors' fees	240
Interest on deposits	2,450	Law charges	460
Interest to RBI	322	Postage, telegrams and telephones	140
Payment to and provision	2,088	Insurance	112
Rent, taxes and lighting	420	Repairs and maintenance	96

Other Information:

(a)

Particulars	`('000)
Tax provision for the year	440
Provision during the year for doubtful debts	204
Loss on sale of investments	24
Rebate on bills discounted	116

(b) 20% of profit is transferred to statutory reserve. 5% of profit is transferred to revenue reserve. Profit brought forward from last year `32,000.

Solution:

New Bank

Profit and Loss Account for the year ended 31st March, 2015

Particulars	Schedule No.	Year ended 31/3/2015
(I) Income		
Interest earned	13	7,348
Other income	14	1,836
Total		9,184
(II) Expenditure		

Accounting for Banking Company

Interest expended	15	2,772
Operating expenses	16	4,730
Provisions and contingencies (440 + 204)		644
Total		8,146
(III) Profit / Loss		
Net profit / Loss (-) for the year		1,038
Profit / Loss (-) brought forward		32
Total		1,070
(IV) Appropriations		
Transfer to Statutory Reserve (25% of `1,038)		259.5
Transfer to other reserves (5% of `1,038)		52
Balance carried over to balance sheet		758.50
Total		1,070

Working Notes:

Schedule 13 – Interest Earned

Particulars		₹('000)
(I) Interest / discount		6,874
(II) Income from investments		230
(III) Interest on balance with RBI other inter-bank funds		360
	Total	7,464
Less: Rebate on bills discounted		116
		7,348

Schedule 14 – Other Income

Particulars		₹('000)
(I) Commission, Exchange and Brokerage		1,640
(II) Profit on sale of investments	220	
Less: Loss on sale of investments	<u>(24)</u>	
		196
	Total	1,836

Schedule 15 – Interest Expended

Particulars		₹('000)
(I) Interest on Deposits		2,450
(II) Interest on RBI / Inter-Bank Borrowings		322
	Total	2,772

Schedule 16 – Operating Expenses

Particulars		₹('000)
(I) Payment to an provision for employees		2,088
(II) Rent, taxes and lighting		420
(III) Printing and stationary		360
(IV) Advertisement and publicity		190
(V) Depreciation on bank's property		184



Accounting for Banking Company

(VI) Directors' fees, allowances and expenses	440
(VII) Auditors' fees, allowance and expenses	240
(VIII) Postages, telegrams, telephones, etc.	140
(IX) Law charges	460
(X) Repairs and maintenance	96
(XI) Insurance	112
Total	4,730

THE THIRD SCHEDULE

(See Section 29)

Form 'A'

FORM OF BALANCE SHEET

Balance Sheet of _____ (here enter name of the Banking Company)

Balance Sheet as on 31st March (Year) _____

Capital and Liabilities	Schedule No.	As on 31/3/____ (Current Year)	As on 31/3/____ (Current Year)
Capital	1		
Reserve and Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities and Provisions	5		
Total			
Assets			
Cash and balances with			
Reserve Bank of India	6		
Balance with banks & Money at call & short notice	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
Total			
Contingent Liabilities	12		
Bills for collection			

Schedule 1 – Capital

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(I) For Nationalised Banks: Capital (Fully owned by Central Government)		
(II) For Banks Incorporated Outside India		

Accounting for Banking Company

Capital		
(i) (The amount brought in by banks by way of start up capital as prescribed by RBI should be shown under this head)		
(ii) Amount of deposit kept with the RBI under Section 11 (2) of the Banking Regulation Act, 1949		
Total		
(III) For Other Banks		
Authorized Capital (Share of `each)		
Issued Capital (Shares or `each)		
Subscribed capital (Shares of `each)		
Called-up Capital (Shares of `each)		
Less: Calls unpaid		
Add: forfeited shares		

Schedule 2 – Reserves and Surplus

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(I) Statutory Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
(II) Capital Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
(III) Share Premium		
Opening Balance		
Additions during the year		
Deductions during the year		
(IV) Revenue and other Reserves		
Opening Balance		
Additions during the year		
Deductions during the year		
(V) Balance in Profit and Loss Account		
Total (I, II, III, IV, and V)		

Schedule 3 – Deposits

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(A) (I) Demand Deposits		
(i) From Banks		
(ii) From Others		
(II) Saving Bank Deposits		

Accounting for Banking Company

(III) Term Deposits		
(i) From Banks		
(ii) From Others		
Total (I, II, and III)		
(B) (i) Deposits of branches in India		
(ii) Deposits of branches outside India		
Total		

Schedule 4 – Borrowings

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(A) (I) Demand Deposits		
(i) From Banks		
(ii) From Others		
(II) Saving Bank Deposits		
(III) Term Deposits		
(i) From Banks		
(ii) From Others		
Total (I, II, and III)		
(B) (i) Deposits of branches in India		
(ii) Deposits of branches outside India		
Total		

Schedule 5 – Other Liabilities and Provisions

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(I) Bills payable		
(II) Inter-office adjustments (net)		
(III) Interest accrued		
(IV) Others (including provisions)		
Total		

Schedule 6 – Cash and Balances with Reserve Bank of India

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(I) Cash in hand (including foreign currency notes)		
(II) Balances with Reserve Bank of India		
(i) In Current Account		
(ii) In Other Account		
Total (I and II)		

Schedule 7 – Balances with Banks at Call and Short Notice

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(I) In India		
(i) Balance with banks		
(a) In Current Accounts		

Accounting for Banking Company

(b) In Other Deposit Accounts		
(ii) Money at call and short notice		
(a) With banks		
(b) With other institutions		
Total (I and II)		
(II) Outside India		
(i) In Current Accounts		
(ii) In other Deposit A/cs		
(iii) Money at call and short notice		
Total		
Grand Total (I and II)		

Schedule 8 – Investments

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(I) Investments in India in		
(i) Government Securities		
(ii) Other approved securities		
(iii) Shares		
(iv) Debentures and Bonds		
(v) Subsidiaries and / or Joint Venture		
(vi) Others (to be specified)		
Total		
(II) Investments outside India in		
(i) Government Securities (including local authorities)		
(ii) Subsidiaries and / or Joint Venture abroad		
(iii) Other investments (to be specified)		
Total		
Grand Total		
(I & II)		

Schedule 9 – Advances

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(A) (i) Bills purchased and discounted		
(ii) Cash credits, overdrafts & loans payable on demand		
(ii) Term loans		
Total		
(B) (i) Secured by tangible assets		
(ii) Covered by Bank/Government Guarantees		
(iii) Unsecured		

Accounting for Banking Company

Total		
(C) (I) Advances in India		
(i) Priority Sectors		
(ii) Public Sector		
(iii) Banks		
(iv) Others		
Total		
(II) Advances outside India		
(i) Due from banks		
(ii) Due from others		
(a) Bills purchased and discounted		
(b) Syndicated loans		
(c) Others _____		
Total		
Grand Total (C. I and II)		

Schedule 10 – Fixed Assets

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(I) Premises		
At Cost as on 31st March of the preceding year		
Additions during the year		
Deduction during the year		
Depreciation to date		
(II) Other Fixed articles (including Furniture & Fixtures)		
At cost as on 31st March of the preceding year		
Additions during the year		
Deductions during the year		
Depreciation to date		
Total (I and II)		

Schedule 11 – Other Assets

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(I) Inter-office adjustments (net)		
(II) Interest accrued		
(III) Tax paid in advance/tax deducted at source		
(IV) Stationery and Stamps		
(V) Non-banking assets acquired in satisfaction of claims		
(VI) Others @		
Total (I, II, III, IV, V & VI)		

Accounting for Banking Company

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

Schedule 12 – Contingent Liabilities

Particulars	As on 31/3 (Current year)	As on 31/3 (Previous year)
(I) Claims against the bank not acknowledged as debts		
(II) Liabilities for partially paid investments		
(III) Liability on account of outstanding forward exchange contracts		
(IV) Guarantees given on behalf of constituents		
(a) in India		
(b) Outside India		
(V) Acceptances, endorsements & other obligations		
(VI) Other items for which the bank is contingently liable		
Total		

GUIDELINES OF THE RESERVE BANK OF INDIA FOR BALANCE SHEET CAPITAL AND LIABILITIES SIDE:

Capital:

Nationalized Banks (Schedule 1)

Capital (fully owned by Central Government)	The Capital owned by Central Government as on the date of the Balance Sheet including contribution from Government, if any, for participating in World Bank Projects should be shown.
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BANKING COMPANIES INCORPORATED OUTSIDE INDIA:

- (a) The amount brought in by banks by way of start up capital as prescribed by RBI should be shown under this heading.
- (b) The amount of deposit kept by RBI, under subsection 2 of Section II of the Banking Regulation Act, 1949, should also be shown.

Other Banks (India):

Authorized Capital (___ Shares of `each)	Authorized, issued, Subscribed, Called-up Capital should be given separately. Calls-in-arrears will be deducted from Called-up Capital while the paid-up value of forfeited shares should be added thus arriving
Issued Capital (___ Shares of `each)	
Subscribed Capital (___ Shares of `each)	

Accounting for Banking Company

<p>Called up Capital (___ Shares of `each) Less: Calls unpaid Add: Forfeited Shares Paid-up Capital</p>	<p>at the paid-up capital. Where necessary, items which can be combined should be shown under one head for instance 'Issued and Subscribed Capital'.</p>
--	--

Reserves and Surplus (Schedule 2):

<p>(I) Statutory Reserves</p>	<p>Reserves created in terms of Section 17 or any other Section of Banking Regulation Act must be separately disclosed.</p>
<p>(II) Capital Reserves</p>	<p>The expression 'capital reserves' shall not include any amount regarded as free for distribution through the profit and loss account. Surplus on revaluation should be treated as Capital Reserves. Surplus on translation of the financial statements of foreign branches (which includes fixed assets also) is not a revaluation reserve.</p>
<p>(III) Securities Premium</p>	<p>Premium on issue of share capital may be shown separately under this head.</p>
<p>(IV) Revenues and other Reserves</p>	<p>The expression 'Revenue Reserve' shall mean any reserve other than reserve. This item will include all reserves, other than those separately classified. The expression 'reserve' shall not include any amount written off or retained by way of providing for depreciation, renewals of diminution in value of assets or retained by way of providing for any know liability.</p>
<p>(V) Balance of Profit</p>	<p>Includes Balance of Profit after appropriations. In case of loss the balance may be shown as a deduction.</p> <p>Notes: General Movement in various categories of reserves should be shown as indicated in the schedule.</p>

Deposits (Schedule 3):

<p>(A) (I) Demand Deposits (i) from banks (ii) from others</p>	<p>Includes all bank deposits repayable on demand. Includes all demand deposits of the non-bank sectors. Credit balances in overdrafts, cash credit accounts, deposits payable at call, overdue deposits, inoperative current accounts, matured time deposits and cash certificates, certificates of deposits, etc., are to be included under this category.</p>
<p>(II) Saving Banks Deposits</p>	<p>Includes all savings banks deposits (including inoperative saving bank accounts).</p>
<p>(III) Term Deposits (i) from banks (ii) from others</p>	<p>Includes all type of bank deposits repayable after a specified term. Includes all types of deposits of the non-bank sector repayable after specified term. Fixed deposits, cumulative and recurring deposits, cash certificates, certificates of deposits, annuity deposits, deposits mobilized under various schemes, ordinary staff deposits, foreign currency non-resident deposits accounts, etc., are to be included under this category.</p>
<p>(B) (i) Deposits of branches in India (ii) Deposits of branches outside India</p>	<p>Total of these two items will agree with the total deposits. Notes –General: (a) Interest payable on deposits which is accrued but not due should not be included but shown under other liabilities. (b) Matured time deposits and cash certificates, etc., should be treated as demand deposits. (c) Deposits under special schemes should be included under term deposits if they are not payable on demand. When such deposits have</p>

Accounting for Banking Company

	<p>matured for payment they should be shown under demand deposits.</p> <p>(d) Deposits from banks will include deposits from banks will include deposits from the banking system in India, Co-operative banks, Foreign banks which may or may not have a presence in India.</p>
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Borrowings (Schedule 4):

<p>(I) Borrowings in India</p> <p>(i) Reserve Bank of India</p> <p>(ii) Other Banks</p> <p>(iii) Other Institutions and Agencies</p>	<p>Includes borrowings/refinance obtained from Reserve Bank of India.</p> <p>Includes borrowings/refinance obtained from commercial banks (including co-operative banks)</p> <p>Includes borrowings/reference obtained from Industrial Development Bank of India, Export-Import Bank of India, National Bank for Agricultural and Rural Development and other institutions, agencies (including liability against participation certificates, if any).</p>
<p>(II) Borrowings outside India</p> <p>Secured borrowings included above.</p>	<p>Includes borrowings of Indian branches abroad as well as borrowings of foreign branches.</p> <p>This item will be shown separately includes secured borrowings/refinance in India and outside India.</p> <p>Notes – General:</p> <p>(a) The total of I and II will agree with the total borrowings shown in the balance sheet.</p> <p>(b) Inter-office transactions should not be shown as borrowings.</p>

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	<p>(c) Funds raised by foreign branches by way of certificates of deposits, notes, bonds, etc., should be classified depending upon documentation, as 'deposits', borrowings', etc.</p> <p>(d) Refinance obtained by banks from Reserve Bank of India and various institutions are being brought under the head 'Borrowings'. Hence, advances will be shown at the gross amount on them assets side.</p>
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Other Liabilities and Provisions (Schedule 5):

(I) Bills payable	Includes drafts, telegraphic transfers, traveler cheques, mail transfers payable, pay slips, bankers cheques and other miscellaneous items.
(II) Inter-office adjustments (net)	The inter-office adjustments balance, if in credit, should be shown under this head. Only position of inter-office accounts, inland as well as foreign, should be shown here.
(III) Interest accrued	Includes interest accrued but not due on deposits and borrowings.
(IV) Others (including provisions)	Includes net provision for income tax and other taxes like interest tax (less advance payment, tax deducted at source, account, surplus in aggregate in provisions for depreciation in securities, contingency funds which are not disclosed as reserves but are actually in the nature of reserves, proposed dividend/transfer to Government, other liabilities which are not disclosed under any of the major heads such as unclaimed dividend, provisions and funds kept for specific purposes, unexpired

Accounting for Banking Company

discount, outstanding charges like rent, conveyance, etc. Certain types of deposits like staff security deposits, margin deposits, etc., where the repayment is not free should also be included under this head.

Notes – General:

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

Contingent Liabilities (Schedule 12):

(I) Claims against the bank not acknowledged as debts.	
(II) Liability for partly paid investments	Liabilities on partly paid shares, debentures, etc., will be included in this head.
(III) Liability on account of outstanding forward	Outstanding forward exchange contracts may be included here.

Accounting for Banking Company

<p>(IV) Guarantees given on behalf of constituents.</p> <p>(i) In India (ii) Outside India</p>	<p>Guarantees given for constituents in India and outside India may be shown separately.</p>
<p>(V) Acceptances, endorsements and other obligations.</p>	<p>This item will include letters of credit and bills accepted by the bank on behalf of customers.</p>
<p>(VI) Other items for which the Bank is contingently liable.</p>	<p>Arrears of cumulative dividends, bills rediscounted under underwriting contracts, estimated amounts of contracts remaining to be executed on capital account and not provided for, etc., are to be included here.</p>

Asset Side:

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

<p>(I) Cash in hand (including foreign currency notes)</p>	<p>Includes cash in hand including foreign currency notes and also of foreign branches in the case of banks having such branches.</p>
<p>(II) Balance with Reserve Bank of India</p>	
<p>(i) in Current Account (ii) in other Account</p>	

Balance with Banks and Money at Call and Short Notice (Schedule 7):

<p>(I) In India</p> <p>(i) Balances with banks</p> <p>(a) in current accounts (b) in other deposit accounts</p> <p>(ii) Money at call and short notice</p> <p>(a) with banks (b) with other institutions</p>	<p>Includes all balances with banks in India (including co-operative banks). Balances in current accounts and deposits accounts should be shown separately.</p> <p>Includes deposits repayable within 15 days or less than 15 days notice lent in the inter-bank call money market.</p>
<p>(II) Outside India</p> <p>(i) Current accounts (ii) Deposit accounts</p>	<p>Includes balances held by foreign branches and balances held by Indian branches of the banks</p>

<p>(iii) Money at call and short notice</p>	<p>outside India. Balance held with foreign branches by other branches of the bank should not be shown under this head but should be included in inter branch accounts. The amounts held in 'current accounts' and 'deposit accounts' should be shown separately. Includes deposits usually classified in foreign countries as money at call and short notice.</p>
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Investments (Schedule 8):

<p>(i) Investments in India</p> <p>(i) Government securities</p> <p>(ii) Other approved securities</p> <p>(iii) Shares</p> <p>(iv) Debentures and Bonds</p> <p>(v) Investments in subsidiaries/joint ventures</p> <p>(vi) Others</p>	<p>Includes Central and State Government securities and Government treasury bills. These securities should be shown at the book value. However, the difference between the book value and market value should be given in the notes to the balance sheet.</p> <p>Securities other than Government securities, which according to the Banking Regulation Act, 1949 are treated as approved securities, should be included here.</p> <p>Investments in shares of companies and corporations not included in items (ii) should be included here.</p> <p>Investments in debentures and bonds of companies and corporations not included in item (ii) should be included here.</p> <p>Investments in subsidiaries/joint ventures (including RRBs) should be included here.</p> <p>Includes residual investments, if any, like gold, commercial paper and other instruments in the nature of shares/debentures/bonds.</p>
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<p>(II) Investments outside India</p> <p>(i) Government securities (including local authorities)</p> <p>(ii) Subsidiaries and / or joint ventures abroad</p> <p>(iii) Others</p>	<p>All foreign Government securities including securities issued by local authorities may be classified under this head.</p> <p>All investments made in the share capital of subsidiaries floated outside India and / or joint venture abroad should be classified under this head.</p> <p>All other investments outside India may be shown under this head.</p>
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Advances (Schedule 9):

<p>(A) (i) Bills purchased and discounted</p> <p>(ii) Cash credits, overdrafts and loans repayable on demand</p> <p>(iii) Term loans</p>	<p>In classification under Section 'A', all outstanding-in India as well as outside-less provisions made, will be classified under three heads as indicated and both secured and unsecured advances will be included under these heads.</p> <p>Including over due installments.</p>
<p>(B) (i) Secured by tangible assets</p> <p>(ii) Covered by Bank/Government Guarantee</p> <p>(iii) Unsecured</p>	<p>All advances or part of advances which are secured by tangible assets may be shown here. The item will include advances in India and outside India.</p> <p>Advances in India and outside India to the extent they are covered by guarantees of Indian and foreign banks and DICGC and ECGC are to be included.</p> <p>All advances not classified under (i) and (ii) will be included here.</p>
<p>(C) Advances outside India</p>	<p>Government undertakings including Government companies and corporations which are, according to the statutes to be</p>

Accounting for Banking Company

<p>(i) Due from others</p> <p style="padding-left: 20px;">(a) Bills purchased and discounted</p> <p style="padding-left: 20px;">(b) Syndicated loans</p> <p style="padding-left: 20px;">(c) Others</p>	<p>treated as public sector companies are to be included in the category “Public Sector”. All advances to the banking sector including co-operative banks will come under the head ‘Banks’.</p> <p>All the remaining advances will be included under the head ‘Others’ and typically this category will include non-priority advances to private, joint and co-operative sectors.</p> <p>Notes – General:</p> <p>(a) The gross amount of advances including refinance and rediscounts but excluding provisions made to the satisfaction of auditors should be shown as advances.</p> <p>(b) Term loans will be loans not payable on demand.</p> <p>(c) Consortium advances would be shown net of share from other participating banks/institutions.</p> <p>(d) Consortium advances would be shown net of share from other participating banks/institutions.</p>
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Fixed Assets (Schedule 10):

<p>(I) Premises</p> <p style="padding-left: 20px;">(i) At cost at one 31st March of the preceding year</p> <p style="padding-left: 20px;">(ii) Additions during the year</p> <p style="padding-left: 20px;">(iii) Deductions during the year</p> <p style="padding-left: 20px;">(iv) Depreciation to date</p>	<p>Premises wholly or partly owned by the banking company for the purpose of business including residential premises should be shown against ‘Premises’. In the case of premises and other fixed assets, the previous balance, additions thereto and deductions there from during the year as also the total depreciation written off should be shown. Where sums have been written off on reduction of capital or revaluation of assets, every balance sheet after the first</p>
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	balance sheet subsequent to the reduction or revaluation should show the revised figures for a period of five years with the date and amount of revision made.
(II) Other Fixed Assets (including furniture and fixtures) (i) At cost on 31st March of the preceding year (ii) Additions during the year (iii) Deductions during the year (iv) Depreciation to date	Motor vehicles and all other fixed assets other than premises but including furniture and fixtures should be shown under this head.

Other Assets (Schedule 11):

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

(II) Interest accrued	Interest accrued but not due on Investments and advances and interest due but not collected on investments will be the main components of this item. As banks normally debit the borrowers' accounts with interest due on the balance sheet date, usually there may not be any amount of interest due on advance. Only such interest as can be realized in the ordinary course should be shown under this head.
(III) Tax paid in advance/tax deducted at source	The amount of tax deducted at source on securities, advance tax paid etc., to the extent that these items are not set-off against relative tax provisions should be shown against this item.
(IV) Stationery and stamps	Only exceptional items of expenditure on stationary like bulk purchases of security paper, loose leaf or other ledgers, etc., which are shown as quasi-assets to be written off over a period of time should be shown here. The value should be on a realistic basis and cost escalation should be taken into account, as these items are for internal use.
(V) Non-banking assets acquired in satisfaction of claims	Immovable properties/tangible assets acquired in satisfaction of claims are to be shown under this head.
(VI) Others	This will include items like claims which have not been met, for instance, clearing items, debit items, representing addition to assets to assets or reduction in liabilities which have not been adjusted for technical

Accounting for Banking Company

	<p>reasons, want of particulars, etc., advances given to staff by a bank as employer and not as a banker, etc. Items which are in the nature of expenses which are pending adjustments should be provided for and the provision netted against this item so that only realizable value is shown under this head. Accrued income other than interest may also be included here.</p>
Bills for Collection	<p>Bills and other items in the course of collection and not adjusted will be shown against this item in the summary version only. No separate schedule is proposed.</p>

Explanation to Terms Relating to Balance Sheet:

Money at Call and Short Notice: This term represents temporary loans to Bill Brokers Stock Brokers and other banks, if the loan is given for one day; it is called 'money at call'. If the loan cannot be called back on demand and will require it least a notice of three days for calling back, it is called 'money at short notice'. This item appears on the asset side of a Bank Balance Sheet. It includes deposits repayable within 10 days or less than 15 days notice lent in the inter-bank call money market.

Advances:

Advances include loans, credits, bank overdrafts and bills discounted and purchased. This appears on the assets side as fourth head in the Bank Balance Sheet. Provisions in respect of doubtful advances are deducted from advances to the extent necessary and the excess provision for doubtful debts is included under "Other Liabilities and Provisions".

- (a) **Cash Credit:** It is arrangement by which the customer is granted the right to borrow money from time to time up to a certain limit. Cash credit is usually given on hypothecation or pledge of stock.
- (b) **Discounting of Bills:** When the payment is made on a bill before the maturity date of the bill, it is called discounting of bills. While making payment of the bill, the bank deducts discount for the unexpired period for the amount of the bill discounted. The bank keeps the bill

Accounting for Banking Company

with it till the maturity date and gets its payment for the customer on the due date.

- (c) **Clean Bills:** These are the bills to which no documents such as bill of lading, insurance policy etc., are attached.
- (d) **Documentary Bills:** These are the bills supported by documents such as bills of lading, insurance policy, etc. These bills secured as in case of non-payment of the bill, the bank can attach the goods.
- (e) **Acceptances, 'Endorsements and Other Obligations:** A bank can accommodate its customers by accepting and endorsing bills on their behalf. This is usually done in the case of foreign bills to facilitate negotiations and foreign business dealings. In such cases, the bank is liable towards third parties to whom bills are given or endorsed guarantee of payment is given in case of non-payment of the promised amount. On the other hand, customers are liable to the bank for such claims. The bank enters such bills in the Bills Accepted Register. Outstanding amount of acceptances, endorsements and other obligations at the end of the year has to be shown as contingent liabilities in Schedule 12 on liabilities side of the Balance Sheet.
- (f) **Inter-office Adjustments:** A bank having several branches will receive periodical statements from them regarding the inter branch transactions. At the end of the financial year, it is possible that some entries may remain unadjusted in the head office of the bank. Such entries are recorded in the Balance sheet under the sub-heading 'Branch Adjustments' and may appear on the assets side under the heading 'Other Assets', if it has a debit balance and on the liabilities side under the heading 'Other Liabilities', if it has a credit balance.
- (g) **Non-banking Assets:** A banking company is not allowed to deal directly or indirectly in the purchase or sell or barter of goods except in connection with its legitimate banking business. But a bank can always lend against the security of the assets. The bank may have to take possession of the assets given as security if the loanee fails to repay the loans. In that case, the asset acquired in satisfaction of the claim of the bank will be shown as an asset in the Balance Sheet under the heading 'Other Fixed Assets'. Such assets acquired should be disposed of within seven years as a banking company is not allowed to hold such assets for any period exceeding seven years from the date of their acquisition. Profit or loss on sale of such assets

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is required to be shown separately in the Profit and Loss Account of the Bank.

(h) Rebate on Bills Discounted or Unexpired Discounts: This item represents unearned discounts for those bills which will mature after the closing of the financial accounts.

When a bank discounts a bill, the following entry is recorded:

Bills Discounted Account Dr. (with full value of the bill)

To Customers Account (with the amount of present cash value)

To Discount Account (Discount deducted by the bank)

The bank will deduct discount for the period for which it has to wait to get payment of the bill on the maturity date. At the close of the financial year, some of the bills discounted may not have matured; consequently, the total discount credited in respect of such bills cannot be treated as earned during the current year. So, discount for the unexpired period is debited to Discount Account to cancel the credit given previously and credited to Rebate on Bills Discounted Account or unexpired Discount Account or Discount received in Advance Account. This item is added in 'Provisions' and 'Contingencies' in the Profit and Loss Account. In the Balance Sheet, it appears under the heading 'other liabilities' as unexpired discounts. At the commencement of the next years, reverse entry is passed as follows:

Rebate on Bills Discounted Account Dr.

To Discount Account

(Being unexpired discount of the previous year expiring this year and becoming income).

Illustration 4:

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

Particulars	₹('000)
Rebate on bills discounted 1/1/2015	4,20,000
Discount received	36,00,000
Bills discounted and purchased	2,15,47,000
Bills for collection	10,00,000

Throughout 2011, the bank's rate for discounting has been 18% and the rate of commission on bills for collection 4%. On investigation and analysis, the average due date for the bills discounted and purchased is calculated as 15th February, 2015 and that for bills for collection as 15th January, 2015.

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Show the calculation of the amount to be credited to the Bank's profit and Loss Amount under discount earned for the year 2011. Show also the journal entries required to adjust the above mentioned accounts.

Solution:

Journal Entries in the Books of HSBC Bank

Date	Particulars	LF	Debit	Credit
Dec. 1 2015	Rebate on Bills Discounted a/c To Interest and Discount Received a/c (Proportionate discount on unexpired bills brought forward from the previous year transferred)	Dr.	4,20,000	4,20,000
	Interest and Discount Received a/c To Rebate on Bills Discounted a/c (Adjustment of proportionate discount on unexpired bills adjusted at the end to the year)	Dr.	4,78,166	4,78,166
	Interest and Discount Received a/c To Profit and Loss a/c	Dr.	35,41,834	35,41,834

Balance of Interest and Discount Received a/c	36,00,000
Add: Opening Balance of Rebate a/c	4,20,000
	40,20,000
Less: Closing Balance of Rebate a/c	4,78,166
	35,41,834

Illustration 5:

The following is an extract from Trail Balance of Overseas Bank Ltd. as at 31st March, 2015.

Particulars		
Bills discounted	12,64,00	
Rebate on bills discounted not due on March 31st, 2008		22,160
Discount received		1,05,708

An analysis of the discounted is as follows:

(₹)	Due Date 2015	Rate of Discount (%)
1,40,000	June 5	14
4,36,000	June 12	14
2,82,000	June 25	14
4,06,000	July 6	16

Calculate Rebate on Bills Discounted as on 31/3/2016 and show necessary journal entries and relevant ledger accounts.

Accounting for Banking Company

Solution:

Particulars	
Rebate on bills discounted (op)	22,160
Add: Discount Received for current year	1,05,708
Less: Rebate on Bills discounted (cl)	(42,317)
Profit & Loss	85,551

$$(a) \quad 1,40,000 \times \frac{14}{100} \times \frac{66}{365} = 3,544$$

$$(b) \quad 4,36,000 \times \frac{14}{100} \times \frac{73}{365} = 2,208$$

$$(c) \quad 2,82,000 \times \frac{14}{100} \times \frac{86}{365} = 9,302$$

$$(d) \quad 4,06,00 \times \frac{16}{100} \times \frac{97}{365} = \underline{7,263}$$

42,317

Journal Entries

Date	Particulars	LF	Debit	Credit
1/4/15	Rebate on Bills discounted To discount on bills discounted	Dr.	22,160	22,160
31/3/16	Discount on Bills discounted To Rebate on bills discounted	Dr.	42,317	42,317
31/3/16	Transfer to Profit and Loss A/c Discount on Bills discounted To Profit & Loss A/c		85,551	85,551

Discount on Bills Discounted A/c.

Particulars		Particulars	
To Rebate on Bills discounted	42,317	By Rebate on Bills discounted	22,160
To Profit and Loss A/c	85,551	By bills purchased and discounted	1,05,708
	1,27,868		1,27,868

Rebate on Bills Discounted A/c

Particulars		Particulars	
To Discount on Bills discounted	22,160	By balance b/d	22,160
To Balance c/d	42,317	By discount on Bills discounted	42,317
	64,477		64,477

The discount income will be determined as under

Rebate on Bills discounted (OP)	xx
Add: Discount received for current year	xx

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Less: Rebate on Bills discounted (CL)	XX
	XX

Illustration 6:

Following are the statements of interest on advance in respect of performing and non-performing assets of Axis Bank Ltd. find out the income to be recognised for the year ended 31st March 2015.

Performing Assets	(Rupees in Lakhs)	
	Interest Earned	Interest Received
C. C. and Overdrafts	1,800	1,060
Term Loan	480	320
Bills purchased and Discounted	700	550
Non – Performing Assets		
C. C. and Overdrafts	450	70
Term Loan	300	40
Bills purchased and Discounted	350	36

Solution:

Income to be recognised in Profit and Loss A/c. ('in Lakh)

Particular	Performing Asset	Non-Performing Asset	Total
Cash credit and Overdraft	1,800	70	1,870
Term loan	480	40	520
Bills purchased and discounted	700	36	736
Total	2,980	146	3,126

Illustration 7:

In respect of the following transactions of the Dena Bank Ltd., you are required to indicate the necessary journal entries as well as their treatment in the profit and loss account and Balance sheet in respect of the year ended 31/12/2011.

(1) The following bills were discounted at 5%:

Discounted on	Amount	Due date inclusive of 3 days of grace
28/12/2008	60,000	31/1/2009
29/7/2008	1,00,000	30/11/2008
29/10/2008	4,00,000	30/04/2009
31/12/2008	40,000	03/03/2009

(2) The bank has accepted Bills on behalf of its customers amounting to `3,00,000 at normal commission of 3%.

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- (3)** The Bank has advanced an amount of `5,00,000 having a covering for the same through bills worth `2,00,000 and goods on key-loan basis `4,00,000.

Solution:

Unexpired discount 31/12/2010 to be calculated as under		`
On `60,000 @ 5% for 31days	$\left(\text{Rs. } 60,000 \times \frac{5}{100} \times \frac{31}{365} \right)$	254
On `4,00,000 @ 5% for 120 days	$\left(\text{Rs. } 4,00,000 \times \frac{5}{100} \times \frac{120}{365} \right)$	6,575
On `30,000 @ 5% for 62 days	$\left(\text{Rs. } 30,000 \times \frac{5}{100} \times \frac{62}{365} \right)$	255
		7,084

In the Books Bank Ltd. Journal Entries

Date	Particulars	LF	Debit `	Credit `
Dec. 31 2010	(i) Interest and Discount a/c To Rebate on Bills Discount a/c (Proportionate Discount on unexpired bills adjusted at the end of the year)	Dr.	7,084	7,084
"	(ii) Customer's liability for Acceptance a/c Customer's Current a/c To Acceptance on behalf of Customers a/c To Commission a/c (Bills accepted on customers behalf and earned commission @ 2%)	Dr. Dr.	3,00,000 6,000	3,00,000 6,000
"	(iii) Loans and Advances a/c To Cash a/c (Amount advanced on security of bills and goods on key loan)	Dr.	5,00,000	5,00,000

Classification of Loan Assets (Advances) and Provisions for Doubtful Debts

As per the guidelines of Reserve Bank of India, every bank should classify its loan assets as

- (a) Standard Assets
- (b) Sub-standard Assets
- (c) Doubtful Assets and
- (d) Loss Assets

Standard Assets:

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Standard assets are those assets, which does not have any problem regarding collection. These do not carry more than normal risk in the business. These are also called as performing assts.

Sub-Standard Assets:

Sub-standard assets are those assets, which have classified as a non-performing asset for a period not exceeding 18 months. There is possibility of loss in realizing these assets. These assets may be again classified as standard assets if payment is made for principal and interest of the last two years.

Doubtful Debts:

Sub-standard Assets are those assets, which have classified as a non-performing asset for a period exceeding 18 months. However, w.e.f. from March 31st 2005, an asset is considered as doubtful debt, if it is in the sub-standard category for 12 months.

Loss Assets:

Loss assets are those asset which the bank or the auditors of the bank identified as irrecoverable. Generally, these assets do not have any realizable value.

Provision for Doubtful Debts:

The main purpose of classification of assets it to make provisions on the assets based on their realization value and security. Provision in made on the various (loan) assets in the following manner:

- (1) Standard Asset – 0.25% is required.
- (2) Sub-standard Assets – A provision of 10% of total outstanding.
- (3) Doubtful Assets:
 - (a) To extent the debt is not covered by realizable value of the security, 100% provision is to be made.
 - (b) In addition to the above (a), for the secured portion of the doubtful assets, provision is required to be make between 20% and 50% depending upon the period for which the asset has remained doubtful as given below:

Period for which the Advances	% of Provision
Have been considered doubtful	
Up to one year	20%
More than one year but up to three years	30%
Above three years	50%

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(4) Loss Assets: The entire asset should be written off. If the asset is to be retained in the books for any reason 100% provision is required.

It is to be noted that provision on standard assets should not be deducted from advances. It should be shown separately as contingent provisions against standard assets under “other liabilities and provisions” on the liabilities side of the balance sheet.

Illustration 8:

From the following information find out the amount of provisions required to be made in the Profit and Loss Account of a commercial bank for the year ended 31st March, 2015.

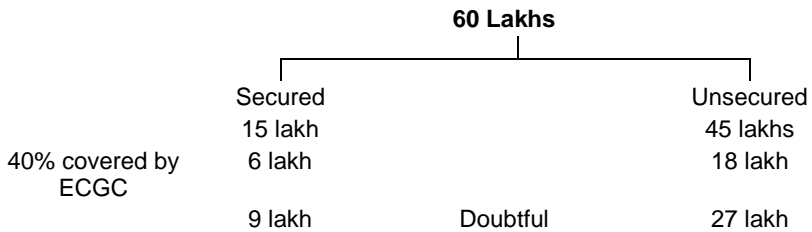
- (1) Packing credit outstanding from Food Processors `60 lakhs which the bank holds securities worth `15 lakhs. 40% of the above advance is covered by ECGC. The above advance has remained doubtful for more than 3 years.

(2) Other advances:

Assets Classification	`in lakhs
Standard	3,000
Sub-standard	2,200
Doubtful:	
For one year	900
For two years	600
For three years	400
For more than 3 years	600
Loss assets	

Solution:

(1) Credit



Provision:

Doubtful Amount			
Secured	9	5%	4.5 Lakh
Unsecured	27	100%	27 lakh
			31.5 lakh

Assets	`	%	Provision
Standard	3,000	0.25	7.5
Sub-standard	2,200	10	220

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Doubtful:			
For one year	900	20	180
For two years	600	30	180
For three years	400	30	120
For more than 3 years	300	50	150
Loss assets	600	100	600
			1,457.5

Illustration 9:

The following is an extract from the Trail Balance of a Grameen Bank as at 31st March, 2015

Particulars		
Bills discounted	77,25,000	
Rebate on bills discounted not yet due, April 1, 2014		45,750
Discount received		2,18,250

Date of Bills		Term Months	Discounted @ % p.a.
January 13	11,25,000	4	12
February 17	9,00,000	3	10
March 6	6,00,000	4	11
March 16	3,00,000	2	10

Find out the amount of discount received to be credited to profit and Loss Account and pass appropriate Journal Entries for the same. How the relevant items will appear in the Bank's Balance Sheet?

Solution:

Calculation of Unexpired Discounts

Date of Bills	Date of Maturity including three days of grace	No. of days after March 31	(₹)	Rate of Discount % p.a.	Total Annual Discount	Proportionate Discount for days after 31st March
2015 Jan. 13	2015 May 16	46	11,25,000	12	1,35,000	17,014 $\left(1,35,000 \times \frac{46}{365}\right)$
Feb. 17	May 20	50	9,00,000	10	90,000	12,328 $\left(90,000 \times \frac{50}{365}\right)$
March 6	July 9	100	6,00,000	11	66,000	18,082 $\left(66,000 \times \frac{100}{365}\right)$

Accounting for Banking Company

March 16	May 19	49	3,00,000	10	30,000	4,027 $\left(30,000 \times \frac{49}{365} \right)$
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Unexpired discounts on 31st March, 2015 `51,451.

The amount to be credited to Profit and Loss Account is ascertained from the Discount Account as follows:

Date	Particulars	`	Date	Particulars	`
2015			2015		
Mar. 31	To Profit and Loss a/c		Mar. 31	Sundries	2,18,250
	(Balance Transferred)	fig. 2,12,549	Mar. 31	By Rebate on Bills Discounted (on 1/4/0/14)	45,750
Mar. 31	To Rebate on Bills Discounted (on 31/3/09)	51,451			
		2,64,000			2,64,000

Journal

Date	Particulars	LF	Debit	Credit
Dec. 31 2015	Rebate on Bills Discounted Account Dr. To Discount Account (Being unexpired discount brought forward from the previous year, credited to Discount Account)		45,750	45,750
"	Discount Account Dr. To Rebate on Bills Discounted Account (Being provision for unexpired discount required at the end of the year)		51,451	51,451
"	Discount Account Dr. To Profit and Loss Account (Being discount earned for the year transferred)		2,12,549	2,12,549

Balance Sheet as on 31/3/2015

Liabilities	`	Assets	`
Other Liabilities		Advances	
Rebate on Bills Discounted	51,451	Bills Discounted	77,25,000

Illustration 10:

From the following information, prepare the Profit and Loss account Bank of India Ltd. for the year ended 31st March, 2014.

Items	`
Interest on Investments	3,00,000
Interest on Balance with RBI	2,00,000
Interest on Loan	25,90,000

Accounting for Banking Company

Interest on fixed deposits	27,50,000
Rebate on Bills discounted (1/4/2009)	4,90,000
Commission	82,000
Establishment Charges	5,40,000
Discount on Bills discounted	14,60,000
Interest on Cash Credit	22,30,000
Interest on Current Accounts	4,20,000
Rent and rates	1,80,000
Interest on Overdraft	15,40,000
Directors' fees	30,000
Auditor's fees	12,000
Interest on Savings Bank Deposits	6,80,000
Postage and Telegram	14,000
Printing and Stationery	29,000
Sundry Charges	17,000
Profit and Loss Account (1/4/2009)	2,00,000
Dividend on shares	2,00,000
Income from Joint ventures	1,00,000
Interest on Borrowings	2,00,000

Notes:

- (1) Baddebts to be written off amounted to ` 4,00,000. Provision for taxation to be made at 55%.
- (2) Rebate on bills Discounted (31/3/2014) ` 5,00,000.
- (3) Provide for doubtful debts ` 1,00,000.

Solution:

In the Books of Bank of India Ltd. Profit and Loss A/c for the year ended 31st March, 2014

Particulars	Schedule No.	Current year ([₹])	Previous year ([₹])
(I) Income:			
Interest earned	13	83,10,000	
Other incomes	14	3,82,000	
Total		86,92,000	
(II) Expenditure			
Interest Expended		40,50,000	
Operating Expenses		8,22,000	
Provision and contingencies		23,26,000	
Total		71,98,000	
(III) Profit / Less Loss			
Profit / loss for the year		14,94,000	
Profit / loss brought forward		2,00,000	
Total		16,94,000	
(IV) Appropriations			

Accounting for Banking Company

Transfer to statutory reserve (20% of 14,94,000)	2,98,800
Balance carried forward to	13,95,200
Balance sheet	16,94,000

Schedule 13 – Interest Earned

Particulars	(₹)
(1) Interest / discount on advance / bills (w.n.1)	78,10,000
(2) Income from Investment	3,00,000
(3) Interest on balance with RBI and other inter bank funds	2,00,000
(4) Others	–
Total	83,10,000

Schedule 14 – Other Income

Particulars	(₹)
Commission	82,000
Dividend on shares	2,00,000
Income from Joint Ventures	1,00,000
Total	3,82,000

Schedule 15 – Interest Expended

Particulars	(₹)
(1) Interest on deposits (W.N.2)	38,50,000
(2) Interest on RBI/inter bank borrowings	2,00,000
(3) others	–
Total	40,50,000

Schedule 16 – Interest Expended

Particulars	(₹)
(1) Payment to and provision for employee	1,80,000
(2) Rent, taxes and lighting	29,000
(3) Printing and stationery	–
(4) Advertisement and publicity	–
(5) Depreciation on banks properties	–
(6) Directors fees allowances and expenses	30,000
(7) Auditor fees and allowance	12,000
(8) Law charges	–
(9) Postage, telegrams, and telephones etc.	14,000
(10) Repairs and Maintenance	–
(11) Insurance	–
(12) Other	–
Establishment charges	5,40,000
Sundry charges	17,000
Total	8,22,000

Working Note:

Particulars	(₹)
(1) Interest / discount on allowances / bills	
Interest on loans	25,90,000

Accounting for Banking Company

Discount on bills discounted	14,60,000
Interest on cash credit	22,30,000
Interest on overdraft	15,40,000
Add: Rebate on bills discounted (1/4/2013)	4,90,000
Less: Rebate on bills discounted (31/3/2014)	(5,00,000)
	78,10,000
(2) Interest on deposits	
Interest on fixed deposits	27,50,000
Interest on current accounts	4,20,000
Interest on saving bank deposits	6,80,000
	38,50,000
(3) Provision and Contingencies	
Bad debts written off	4,00,000
Doubtful debts	1,00,000
Provision for taxation	18,26,000
	23,26,000

Working Note for Taxation:

Income		86,92,000
Expenditure	40,50,000	
	8,22,000	
Provisions	5,00,000	
Other than tax		53,72,000
NPBT		33,20,000
Tax 55%		18,26,000

Illustration 11:

From the following information, prepare Profit and Loss A/c. of HDFC Bank Ltd. as on 31/3/2014.

Items	Current year `000	Previous year `000
Interest and Discount	20,45	14,27
Income from Investments	1,12	1,14
Interest on Balance with RBI	177	1,55
Commission, Exchange and brokerage	7,12	7,22
Profit on Sale of Investments	1,22	12
Interest on Deposit	8,22	6,12
Interest on RBI Borrowings	1,47	1,27
Payment to and provision for Employees	8,55	7,27
Rent, Taxes and Lighting	1,79	1,58
Printing and Stationery	2,12	1,47
Advertisement and Publicity	98	1,12
Depreciation	98	98
Director's Fees	2,12	1,48
Auditor's Fees	1,10	1,10

Accounting for Banking Company

Law Charges	1,52	50
Postage, Telegrams and Telephones	62	48
Insurance	52	42
Repair and Maintenance	66	57

Also give necessary schedules.

Other Information:

- (1) The following items are already adjusted with Interest and Discount (Cr.):

	`('000)
Tax Provision	1,48
Provision for Doubtful Debts	92
Loss on sale of investments	12
Rebate on Bills Discounted	55

- (2) **Appropriations:**

20% of profit is transferred to Statutory Reserves.

5% of profit is transferred to Revenue Reserves.

Solution:

**In the Books of HDFC Bank Ltd.
Profit and Loss A/c for the year Ended 31/03/2014**

Particulars	Schedule No.	Current year (`)	Previous year (`)
(I) Income:			
Interest earned		2,586	1,696
Other incomes		822	734
Total		3,408	2,430
(II) Expenditure			
Interest Expended		969	739
Operating Expenses		2,096	1,697
Provision and Contingencies		240	
Total		3,305	2,436
(III) Profit / Less Loss			
Profit / less for the year		103	(6)
Profit / less brought forward		(6)	
Total		97	
(IV) Appropriations			
Transfer to statutory reserve (20% of 14,94,000)		20.6	
Transfer to renew reserve		5.15	
Balance carried forward to		71.25	
Balance sheet (Balancing Figure)		97	

Schedule 13 – Interest Earned

(`000)

Accounting for Banking Company

Particulars	Current Year	Previous Year
(1) Interest /discount on advance / bill [WN (1)]	2,297	1,427
(2) Income from investments	112	114
(3) Interest on balance with RBI and other inter bank funds	177	155
(4) Others	-	-
Total	2,586	1,696

Schedule 14 – Other Income (‘000)

Particulars	Current Year	Previous Year
Commission, exchange and brokerage	712	722
Profit on sale of investment	122	12
Less: on sale of investment	(12)	-
Total	822	734

Schedule 15 – Interest Expended (‘000)

Particulars	Current Year	Previous Year
(1) Interest on deposits	822	612
(2) Interest on RBI / inter bank borrow	147	127
(3) Others	-	-
Total	969	739

Schedule 16 (‘000)

Particulars	Current Year	Previous Year
(1) Payment to and provision for employees	855	727
(2) Rent, Taxes and Lighting	179	158
(3) Printing and stationery	212	147
(4) Advertisement and publicity	98	112
(5) Depreciation on banks property	98	98
(6) Directors fees, allowances and Expenses	212	148
(7) Auditor fees and allowances	110	110
(8) Law charges	152	50
(9) Postage, telegrams and telephones	62	48
(10) Repairs and Maintenance	66	57
(11) Insurance	52	42
Total	2,096	1,697

Working Notes:

Particulars	(‘)	(‘)
(1) Interest / discount on allowances / bills		
Interest and discount	20,45	14,27
Add: Tax provision	148	
Add: Provision for doubtful debts	92	
Add: Loss on sale of investment	12	

Accounting for Banking Company

(2) Provision and Contingency	2,297	
	Provision for taxation	148
	RDD	92
		240

Illustration 12:

From the following information, prepare Profit and Loss A/c of Hyderabad Bank Ltd. for the year ended 31st March 2014

Items	(`000)
Interest on Cash Credit	18,20
Interest on Overdraft	7,50
Interest on term loans	15,40
Income on investments	8,40
Interest on balance with RBI	1,50
Commission on remittances and transfer	75
Commission on letters of credit	1,18
Commission on government business	82
Profit on sale of land and building	27
Loss on exchange transactions	52
Interest paid on deposit	27,20
Auditor's fees and allowances	1,20
Directors fees and allowances	2,50
Advertisements	1,80
Salaries, allowance and bonus to employees	12,40
Depreciation	1,40
Payment to Provident Fund	2,80
Printing and Stationery	1,40
Repairs and Maintenance	50
Postage, telegrams, telephones	80

Other Information:

(1) Interest on NPA is as follows:

	Earned (`000)	Collected (`000)
Cash Credit	820	4,00
Overdraft	450	1,00
Term Loans	750	2,50

(2) Classification of advances (`000)

	(`000)
(a) Sub-standard	1,120
(b) Doubtful assets not covered by security	200
(c) Doubtful assets covered by security for one year	50
(d) Loss Assets:	200

Accounting for Banking Company

(3) Investments: 2,750

Bank should not keep more than 25% of its investments as held to maturity investment. The market value of its held for trading 75% investment is `2062.50 thousands as on 31/3/2014.

Solution:

**In the Books of Hyderabad Bank Ltd.
Profit and Loss A/c For the year Ended 31/03/2014**

Particulars	Schedule No.	Current year ([₹])	Previous year ([₹])
(I) Income:			
Interest earned		3830	
Other incomes		250	
Total		4080	
(II) Expenditure			
Interest Expended		2720	
Operating Expenses		2480	
Provision and Contingencies		792	
Total		5992	
(III) Profit / Less Loss			
Profit / loss for the year		(1912)	
Profit / loss brought forward		-	
Total		(1912)	

Schedule 13 – Interest Earned

Particulars	([₹])
(1) Interest / discount on advance / bills	2840
(2) Income from investments	840
(3) Interest on Balance with RBI and other international bank funds	150
(4) Others	-
Total	3830

Schedule 14 – Other Incomes

Particulars	([₹])
Commission on remittances and transfer	75
Commission on letters of credit	118
Commission on the government business	82
Profit on sale of land and building	27
Loss on exchange transactions	(52)
Total	250

Schedule 15 – Interest Expended

Particulars	([₹])
(1) Interest on deposit	2720
(2) Interest on RBI / international bank borrowings	
(3) Interest on balance with RBI and other inter bank funds	

Accounting for Banking Company

(4) Others	Total	2720
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Schedule 16 – Operating

Particulars		(₹)
(1) Auditor fees and allowances		120
Directors fees and allowances		250
Advertisements		180
Salaries, allowances and bonus to employees		1240
Depreciation		140
Payment to provident fund		280
Printing and Stationery		140
Repairs and Maintenance		50
Postage, telegraphs, telephones		80
Total		2480

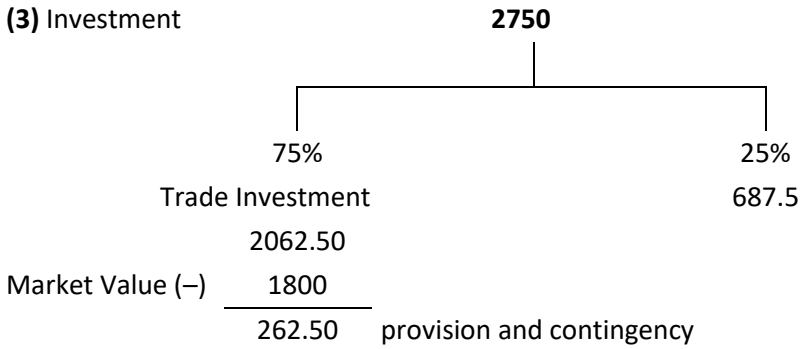
Working Notes:

Particulars		(₹)
(1) Interest / discount on allowances / bills		
Interest on cash credit (1820 – 820 + 400)		1400
Interest on Overdraft (750 – 450 + 100)		400
Interest on term loans (1540 – 750 + 250)		1040
		2840
(2) Provision and contingencies		
Provision for advances		529.5
Loss on investment		262.5
		792

Provision Required on Asset

Particular	Amount	Percentage	Provision
Standard asset	3000	0.25	7.5
Sub-standard	1120	10	112
Doubtful Assets			
Covered by Security (1 year)	50	20	10
Covered by unsecured	200	100	200
Loss assets	200	100	200
			529.5

(3) Investment



Note: If MV of Maturity is given avoided

Adjustment and their effects:

A banking company is prohibited for declaring any dividend until all its miscellaneous expenditure are no/off. Hence if there is adjustment for proposed dividend and it there is miscellaneous expenditure in trail balance then just no/off miscellaneous, expenditure and then do the adjustment for proposed dividend.

(1) Miscellaneous expenditure written off:

- (a) Less from schedule II other assets
- (b) Profit and loss A/c schedule 16 operating expenditure.

(2) Proposed dividend:

- (a) Project and loss A/c appropriation
- (b) Schedules 5 other liabilities.

A Banking Co. has to compulsory transfer 20% of its current year profit to **statutory reserve** also known as **reserve fund**.

(3) Transfer to Reserve:

- (a) Profit and loss A/c appropriation
- (b) Schedule 2 reserve and surplus

(4) Provision for taxation:

- (a) Profit and loss A/c., provisions and contingences.
- (b) Schedule 5, other liabilities.

(5) Bad debts:

- (a) Less from advances, schedule (9)
- (b) Profit and loss A/c, provisions and contingency.

(6) Reserve for doubtful debts:

- (a) Profit and loss A/c, provisions and contingency.

Accounting for Banking Company

(b) Schedule 5, other liabilities.

OR

Less from advances, schedules (9)

Illustration 13:

The following balances stood in the books of ABN-AMRO bank after preparation of its Profit and Loss Account.

Items	(₹'000)
Share Capital:	
Issued and subscribed	60,00,000
Reserve fund	93,00,000
Fixed deposits	6,39,00,000
Savings bank deposits	2,85,00,000
Current accounts	3,48,00,000
Money at call and short notice	27,00,000
Investments	3,75,00,000
Profit and Loss Account (Cr.) 1st April 2013	20,25,000
Dividend for 2012-13	6,00,000
Premises	44,25,000
Cash in hand	5,70,000
Cash with RBI	1,50,00,000
Cash with other banks	90,00,000
Bills discounted and purchased	57,00,000
Loans, cash credits and overdrafts	7,65,00,000
Bills payable	1,05,000
Unclaimed dividend	90,000
Rebate on bills discounted	75,000
Short loans (borrowing from other banks)	71,25,000
Furniture	17,46,000
Other assets	5,04,000
Net Profit for 2014	23,25,000

Prepare Balance Sheet of the bank as on 31st March 2014.

Solution:

Balance Sheet as on 31/03/2014

Particulars	Schedule No.	As on 31/03/2009
Capital and Liabilities:		
Capital	1	60,00,000
Reserves and Surplus	2	1,30,50,000
Deposits	3	12,72,00,000
Borrowings	4	71,25,000
Other Liabilities and Provisions	5	2,70,000
Total:		15,36,45,000

Accounting for Banking Company

Assets:		
Cash and Bank balance with RBI	6	1,55,70,000
Balance with Banks and Money at Call and short Notice	7	1,17,00,000
Investments	8	3,75,00,000
Advances	9	8,22,00,000
Fixed Assets	10	61,71,000
Other Assets	11	5,04,000
Total		15,36,45,000
Contingent Liabilities	12	Nil
Bills for Collection		Nil

Schedule 1 – Capital

Particulars	(₹)
Issued and subscribed share capital	60,00,000

Schedule 2 – Reserves and Surplus

Particulars	(₹)	(₹)
Reserve Fund		93,00,000
Profit and Loss Account	20,25,000	
Less: Dividend for 2012-13	6,00,000	
	14,25,000	
Add: Net profit for 2014 after deducting statutory reserves (23,25,000 – (23,25,000 × 25%))	17,43,750	
		31,68,750
Statutory Reserve (23,25,000 × 25%)		5,81,250
		1,30,50,000

Schedule 3 – Deposits

Particulars	(₹)
Fixed deposits	6,39,00,000
Savings bank deposits	2,85,00,000
Current accounts	3,48,00,000
	12,72,00,000

Schedule 4 – Borrowings

Particulars	(₹)
Short loans	71,25,000

Schedule 5 – Other Liabilities and Provisions

Particulars	(₹)
Bills payable	1,05,000
Unclaimed dividend	90,000
Rebate on bills discounted	75,000
	2,70,000

Schedule 6 – Cash and Bank Balance with RBI

Particulars	(₹)
Cash in hand	5,70,000
Cash with RBI	1,50,00,000

Accounting for Banking Company

1,55,70,000

Schedule 7 – Balance with Banks and Money at Call and Short Notice

Particulars	(₹)
Money at call and short notice	27,00,000
Cash with other banks	90,00,000
	1,17,00,000

Schedule 8 – Investments

Particulars	(₹)
Investments	3,75,00,000

Schedule 9 – Advances

Particulars	(₹)
Bills discounted and purchased	57,00,000
Loans, cash credits and overdrafts	7,65,00,000
	8,22,00,000

Schedule 10 – Fixed Assets

Particulars	(₹)
Premises	44,25,000
Furniture	17,46,000
	61,71,000

Schedule 11 – Other Assets

Particulars	(₹)
Other assets	5,04,000

Schedule 12 – Contingent Liabilities

Particulars	(₹)
	Nil

Illustration 14:

From the following, you are required to prepare the Profit and Loss Account and the Balance Sheet of “State Bank of India” Bank as on 31/03/2014

Particulars	(₹)	(₹)
Issued Capital:		
20,000 shares of ₹150 each		30,00,000
Money at call and short notice	12,00,000	
Reserve fund		10,50,000
Cash in hand	9,75,000	
Deposits		37,50,000
Cash at bank	14,25,000	
Borrowings from SBI		7,50,000
Investments in Government securities	13,50,000	
Secured loans	22,50,000	
Cash credits	7,50,000	
Premises less depreciation	8,70,000	

Accounting for Banking Company

Furniture less depreciation	1,80,000	
Rent	7,500	90,000
Interest and discount		12,00,000
Commission and brokerage		1,05,000
Interest paid on deposits	4,50,000	
Salary and allowances paid to staff	2,25,000	
Interest paid on borrowings	75,000	
Audit fees	15,000	
Directors' fees	12,000	
Non-banking assets	1,20,000	
Depreciation on bank's property	19,500	
Printing	4,500	
Advertisement	1,500	
Stationery	7,500	
Postage and telegrams	3,000	
Other expenses	4,500	
	99,45,000	99,45,000

Adjustments:

- Provide `30,000 for doubtful debts.
- Provide `15,000 on bills discounted but not matured on 31-3-2014.
- Acceptances and endorsements on behalf of customers amounting to `6,00,000.
- Provide `90,000 for taxes.

Solution:

Profit and Loss Account for the year ended 31/03/2014

Particulars	Schedule No.	Year ended 31/03/2014
(I) Income		
Interest earned	13	11,85,000
Other income	14	1,95,000
Total		13,80,000
(II) Expenditure		
Interest expended	15	5,25,000
Operating expenses	16	3,00,000
Provisions and contingencies		1,20,000
Total		9,45,000
(III) Profit / Loss		
Net profit /loss for the year		4,35,000
Profit / Loss brought forward		—
Total		4,35,000
(IV) Appropriations		
Transfer to Statutory Reserve (25% of `4,35,000)		1,08,750
Transfer to other reserves		

Accounting for Banking Company

Transfer to Government / interim proposed dividend		
Balance carried over to balance sheet		3,26,250
Total		4,35,000

Schedule 13 – Interest Earned

Particulars	(₹)
Interest and discounts	12,00,000
Less: Closing rebate on bills discounted	15,000
	11,85,000

Schedule 14 – Other Income

Particulars	(₹)
Rent	90,000
Commission and brokerage	1,05,000
	1,95,000

Schedule 15 – Interest Expended

Particulars	(₹)
Interest paid on deposits	4,50,000
Interest paid on borrowings	75,000
	5,25,000

Schedule 16 – Operating Expenses

Particulars	(₹)
Rent	7,500
Other expenses	4,500
Salary and allowance paid to staff	2,25,000
Postage and telegrams	3,000
Audit fees	15,000
Director's fees	12,000
Depreciation on banks property	19,500
Printing	4,500
Advertisement	1,500
Stationery	7,500
	3,00,000

Provisions and Contingencies

Provision for doubtful debts	30,000
Provision for tax	90,000
	1,20,000

Balance Sheet as on 31/03/2014

Particulars	Schedule No.	As on 31/03/2010
Capital and Liabilities:		
Capital	1	30,00,000
Reserves and Surplus	2	14,85,000
Deposits	3	37,50,000
Borrowings	4	7,50,000
Other Liabilities and Provisions	5	1,05,000

Accounting for Banking Company

Total:		90,90,000
Assets:		
Cash and Bank balance with RBI	6	9,75,000
Balance with Banks and Money at Call and short Notice	7	26,25,000
Investments	8	13,50,000
Advances	9	29,70,000
Fixed Assets	10	10,50,000
Other Assets	11	1,20,000
Total		90,90,000
Contingent Liabilities	12	6,00,000
Bills for Collection		Nil

Schedule 1 – Capital

Particulars	(₹)
Issued and paid-up capital	30,00,000

Schedule 2 – Reserves and Surplus

Particulars	(₹)
Reserve fund	10,50,000
Statutory reserve (current year's transfer) (4,35,000 × 25%)	1,08,750
Profit and Loss Account balance	3,26,250
	14,85,000

Schedule 3 – Deposits

Particulars	(₹)
Deposits	37,50,000

Schedule 4 – Borrowings

Particulars	(₹)
Borrowings from SBI	7,50,000

Schedule 5 – Other Liabilities and Provisions

Particulars	(₹)
Rebate on bills discounted	15,000
Provision for tax	90,000
	1,05,000

Schedule 6 – Cash and Balance with RBI

Particulars	(₹)
Cash in hand	9,75,000

Schedule 7 – Balance with Banks and Money at Call and Short Notice

Particulars	(₹)
Money at call and short notice	12,00,000
Cash at bank	14,25,000
	26,25,000

Schedule 8 – Investments

Particulars	(₹)
Investment in Government securities	13,50,000

Accounting for Banking Company

Schedule 9 – Advances

Particulars	(₹)
Secured loans	22,50,000
Cash credits	7,50,000
	30,00,000
Less: Provision for doubtful debts	30,000
	29,70,000

Schedule 10 – Fixed Assets

Particulars	(₹)
Premises	8,70,000
Furniture	1,80,000
	10,50,000

Schedule 11 – Other Assets

Particulars	(₹)
Non-banking assets	1,20,000

Schedule 12 – Contingent Liabilities

Particulars	(₹)
Acceptances and endorsements	6,00,000

Illustration 15:

The following is the Trial Balance of Corporation Bank as on 31/03/2014

Particulars	(₹)	(₹)
Authorized capita		12,50,000
Unissued capital	5,00,000	
Uncalled capital	3,75,000	
Reserve fund		7,50,000
Investment fluctuation fund		50,000
Bank overdraft, loans and cash credits	10,00,000	
Bank premises	1,50,000	
Government bonds	7,50,000	
Other government securities	5,00,000	
Current accounts		15,00,000
Profit and Loss Account on 01/04/2013		62,500
Money at call and short notice	1,75,000	
Bills discounted	1,82,500	
Shares	42,500	
Cash in hand	2,75,000	
Cash at bank	7,50,000	
Income tax paid	22,500	
Salaries and other expense	1,83,750	
Interest discounts etc.		4,25,000
Interim dividend paid	18,750	
Deposits and savings bank accounts		8,87,500
	49,25,000	49,25,000

Accounting for Banking Company

- (a) The bills discounted mature at an average date of May 19, 2013 for 50 days (including days of grace). All bills are discounted at 10% per annum.
- (b) The market value of investments in government securities was `11,87,500. Increase investment fluctuation fund with the necessary amount.
- (c) Bank added premises during the year for `25,000. Provide 5% depreciation on the opening balance.
- (d) Interest accrued on investment was `1,875.
- (e) Provision for taxation on 01/04/2013 was `25,000. It is to be increased to `75,000.

Prepare the Profit and Loss Account and Balance Sheet.

Solution:

Profit and Loss Account for the year ended 31/03/2010

Particulars	Schedule No.	Year ended 31/03/2014
(I) Income		
Interest earned	13	4,24,375
Other income	14	–
Total		4,24,375
(II) Expenditure		
Interest expended	15	–
Operating expenses	16	1,90,000
Provisions and contingencies		85,000
Total		2,75,000
(III) Profit / Loss		
Net Profit / Loss less fro the year		1,49,375
Profit / Loss less brought forward		37,500
Total		1,86,875
(IV) Appropriations		
Transfer to Statutory Reserve (25% of `1,49,375)		37,344
Transfer to other reserves		–
Transfer to Government / interim proposed dividend		18,750
Balance carried over to balance sheet		1,30,781
Total		1,86,875

Schedule 13 – Interest Earned

Particulars	(₹)
Interest, Discount, etc.	4,25,000
Interest accrued on Investments	1,875
	4,26,875
Less: Closing rebate on bills discounted $\left(1,82,500 \times \frac{50}{365} \times 10\%\right)$	2,500

Accounting for Banking Company

	4,24,375
--	-----------------

Schedule 14 – Other Income

Particulars	(₹)
	Nil

Schedule 15 – Interest Expended

Particulars	(₹)
	Nil

Schedule 16 – Interest Earned

Particulars	(₹)
Salaries and other expenses	1,83,750
Depreciation on premises (1,50,000 – 25,000) × 5%	6,250
	1,90,000

Provision and Contingencies

Particulars	`	`
Provision for taxation:		
Income tax paid	22,500	
Add: New Provision	75,000	
	97,500	
Less: Old Provision	25,000	72,500
Investment fluctuation fund		12,500
		85,000

Balance Sheet as on 31/03/2010

Particulars	Schedule No.	Year ended 31/03/2009
Capital and Liabilities:		
Capital	1	3,75,000
Reserves and Surplus	2	9,80,625
Deposits	3	23,87,500
Borrowings	4	Nil
Other Liabilities and Provisions	5	77,500
Total		38,20,625
Assets:		
Cash and Bank balance with RBI	6	2,75,000
Balance with Bank & Money at call and short notice	7	9,25,000
Investments	8	12,92,500
Advances	9	11,82,500
Fixed Assets	10	1,43,750
Other Assets	11	1,875
Total		38,20,625
Contingent Liabilities	12	Nil
Bills for Collection		Nil

Schedule 1 – Capital

Particulars	(₹)
Authorized Capital	12,50,000

Accounting for Banking Company

Issued capital (12,50,000 – 5,00,000)	7,50,000
Called up and paid-up capital (7,50,000 – 3,75,000)	3,75,000

Schedule 2 – Reserve and Surplus

Particulars	(₹)
Reserve Fund	7,50,000
Investment fluctuation fund (50,000 + 12,500)	62,500
Statutory reserve (current year's transfer)	37,344
Profit and Loss Account balance	1,30,781
	9,80,625

Schedule 3 – Deposits

Particulars	
Current accounts	15,00,000
Deposit and savings bank accounts	8,87,500
	23,87,500

Schedule 4 – Borrowings

Particulars	(₹)
	Nil

Schedule 5 – Other Liabilities and Provisions

Particulars	(₹)
Rebate on bills	2,500
Provision for taxation	75,000
	77,500

Schedule 6 – Cash and Balance with RBI

Particulars	(₹)
Cash in hand	2,75,000

Schedule 8 – Investments

Particulars	(₹)
Government bonds	7,50,000
Other government securities	5,00,000
Shares	42,500
	12,92,500

Schedule 9 – Advances

Particulars	(₹)
Bank over draft, loans and cash credits	10,00,000
Bills discounted	1,82,500
	11,82,500

Schedule 10 – Fixed Assets

Particulars		
Bank premises	1,50,000	1,43,750
Less: Depreciation (5% on 1,25,000)	6,250	

Schedule 11 – Other Assets

Accounting for Banking Company

Particulars	(₹)
Interest accrued on investments	1,875

Schedule 12 – Contingent Liabilities

Particulars	(₹)
	Nil

Illustration 16:

From the following information prepare a Balance Sheet of HSBC International Bank Ltd., as on 31st March, 2014 giving the relevant schedules.

(`in lakh)

Debit Balance	`	Credit Balance	`
Current Accounts	42.00	Share Capital	
Cash Credits	1218.15	19,80,000 shares of `15 each	297.00
Cash in Hand	240.22	Statutory Reserve	346.5
Cash with RBI	56.82	Net Profit before Appropriations	225
Cash with other Banks	233.8	Profit and Loss A/c	618
Money at Call	315.18	Fixed Deposit A/c's	775.5
Gold	82.86	Saving Deposit A/c's	675
Government Securities	165.25	Current A/c	780.18
Premises	233.55	Bills Payable	0.15
Furniture	105.18	Borrowings from other Banks	165.00
Term Loans	1189.32		
	3882.33		3882.33

Additional Information:

Particulars	(₹)
Bills for Collection	27,15,000
Acceptances and endorsements	21,18,000
Claims against the Bank not acknowledged as debt	82,500
Depreciation charges – Premises	1,65,000
Furniture	1,17,000

50% of the Term Loans are secured by Government guarantees. 10% of Cash Credits is unsecured. Also calculate Cash reserves required and statutory liquid reserves required. Cash reserve required 3% of demand and time liabilities, liquid reserves required 30% of demand and time liabilities.

Solution:

Balance Sheet of HSBC International Bank Ltd. as on 31/03/2014

Particulars	Schedule No.	As on 31/03/2010
Capital and Liabilities:		

Accounting for Banking Company

Share Capital	1	297.00
Reserves and Surplus	2	1189.50
Deposits	3	2230.68
Borrowings	4	165.00
Other Liabilities and Provisions	5	0.15
Total		3882.33
Assets		
Cash and Bank balance with RBI	6	307.14
Balances with Banks and Money at Call and Short Notice	7	538.88
Investments	8	248.09
Advances	9	2449.47
Fixed Assets	10	338.73
Other Assets	11	
Total		3882.33
Contingent Liabilities	12	22.00
Bills for Collection		27.15

Schedule 1 – Capital

Particulars	(₹)
Authorized Capital	–
Issued Subscribed and Paid-up Capital 19,80,000 shares of ₹15 each	297
Total	297

Schedule 2 – Reserves and Surplus

Particulars	(₹)
(I) Statutory Reserve	346.5
Additions during the year (25% of 225)	56.25
	402.75
(II) Balance in Profit and Loss A/c (1)	786.75
Total	1189.50

Schedule 3 – Deposits

Particulars	(₹)
(I) Demand Deposits from Others	780.18
(II) Saving Bank Deposits	675.00
(III) Fixed Deposits	775.50
Total	2230.68

Schedule 4 – Borrowings

Particulars	(₹)
Borrowings in India from other banks	165
Total	165

Schedule 5 – Other Liabilities and Provisions

Particulars	(₹)
Other liabilities and provisions	0.15
Total	0.15

Schedule 6 – Cash and Balance with RBI

Accounting for Banking Company

Particulars	(₹)
(I) Cash in Hand	240.22
(II) Balance with RBI (in current A/c) (2)	66.92
Total	307.14

Schedule 7 – Balance with Banks and Money at Call and Short Notice

Particulars	(₹)
In India	
Balances with Banks	
(i) in current A/c (3)	223.70
(ii) Money at call and short notice	315.18
Total	538.88

Schedule 8 – Investments

Particulars	(₹)
Investments in India in	
(i) Government Securities	165.25
(ii) Others – Gold	82.86
Total	248.11

Schedule 9 – Advances

Particulars	(₹)
(A) (i) Cash credits, overdrafts	1260.15
(ii) Term Loans	1189.32
	2449.47
(B) (i) Secured by tangible assets	1728.80
(ii) Secured by bank/Government guarantees	594.66
(iii) Unsecured	126.01
	2449.47

Schedule 10 – Fixed Assets

Particulars	(₹)
(1) Premises	
At cost on 31st March, 2014	235.20
Less: Depreciation to date	1.65
	233.55
(2) Other Fixed Assets	
Furniture at cost on 31st March, 2014	106.35
Less: Depreciation to date	1.17
	105.18
Total (1 + 2)	338.73

Schedule 12 – Contingent Liabilities

Particulars	(₹)
(i) Claims against bank not acknowledged as debts	0.82
(ii) Acceptances, endorsements	21.18
	22.00
Calculation of Cash Reserves and Statutory Liquid Reserves	

Accounting for Banking Company

Total of demand and time liabilities (`775.5 + 675 + 780.18)	2230.68
Cash reserve 3% of `2230.68)	66.92
Statutory liquid reserve (30% of demand and time liabilities)	669.2

Working Notes:

Particulars	(₹)
(1) Balance in P/L A/c:	
Net Profit before appropriations	225.00
Add: Balance of Profit and Loss A/c	618.00
	843.00
Less: Transfer to Statutory Reserve (25% of 225)	56.25
	786.75
(2) Transfer from Cash with Other Banks to Cash with RBI:	
(Cash reserve required @ 3% on `2,230.68 lakh)	66.92
Cash with RBI	56.82
Transfer needed to maintain Cash Reserve	10.10
(3) Liquid Assets:	
Cash in hand	240.22
Cash with other banks	233.80
Money at call and short notice	315.18
Gold	82.86
Government Securities	165.25
	1037.31

Excess Liability (1037.31 – 669.20 (i.e., 30% of `2230.68) = `368.11 lakh
The excess liability enables the transfer as per (2) above, after transfer cash with other banks = `(in lakh) (233.8 – 10.1 = `(in lakh) 223.7).

Illustration 17:

(October 2008)

From the following information relating to Mumbai Bank Limited, prepare Profit/Loss Account for the year ended 31st March 2014 along with necessary schedules as well as previous year figures.

For the year ended 31-3-2013 (in lakhs)	Particulars	For the year ended 31-3-2014 (in lakhs)
505	Interest/Discount on Advances/Bills	610
115	Income from Investments	210
25	Profit on Sale of Investment	40
40	Commission, Exchange, Brokerage	60
120	Interest on deposits	240
40	Interest on Reserve Bank of India borrowings	30
52	Rent, Taxes and Lighting	60

Accounting for Banking Company

102	Payment for employees	112
42	Printing and Stationery	52
22	Advertisement and Publicity	32
64	Depreciation on Bank Property	72
7	Directors fees and Allowances	10
20	Auditors fees and Expenses	25
12	Law Charges	8
42	Postage, Telegram and Telephone	54
20	Repairs and Maintenance	40
12	Insurance	15
106	Balance of Profit/Loss Account Brought Forward	?
30	Provision for Income Tax	40

- (a) Every year the Bank transfers 20% profit to Statutory Reserve and 10% profit to Revenue Reserve.
- (b) The board of Directors propose dividend amounting to `50 lakhs for the year ended 31st March 2014. Last year an identical amount of dividend was proposed.

Solution:

Profit and Loss A/c of Mumbai Bank Ltd. for the Year Ended 31st March 2014

Particulars	Schedule No.	31/03/13 (₹)	31/03/14 (₹)
(I) Income:			
Interest earned	13	620	820
Other incomes	14	65	100
Total (A)		685	920
(II) Expenditure			
Interest Expenses	15	160	270
Operating Expenses	16	395	480
Provision and Contingencies		30	40
Total (B)		585	790
(III) Profit			
Net profit for the year (A – B)		100	130
Profit bought from last year		106	126
Total		206	256
(IV) Appropriations			
Transfer to statutory reserve (20%)		(20)	(26)
Transfer to other Reserve (Revenue Reserve) (10%)		(10)	(13)
Propose dividends and Dividends Tax		(50)	(50)



Accounting for Banking Company

Balance carried over to balance sheet		(126)	(167)
Total		206	256

Schedule 13 – Interest Earned

Particulars	(₹)	(₹)
Interest on Advances	505	610
Income from Investment	115	210
	620	820

Schedule 14 – Other Income

Particulars	(₹)	(₹)
Profit on sale and Investment	25	40
Commission, freehand and Brokerage	40	60
	65	100

Schedule 15 – Interest Expenses

Particulars	(₹)	(₹)
Interest on deposits	120	240
Interest on Reserve Bank India Borrowing	40	30
	160	270

Schedule 16 – Operating Expenses

Particulars	(₹)	(₹)
Rent, Taxes and Lighting	52	60
Payment for employees	102	112
Printing and Stationery	42	52
Advertisement and Publicity	22	32
Depreciation on Bank Process	64	72
Directors Fees and Allowance	7	10
Auditors fees and Expenses	20	25
Law Charges	12	8
Postage, Telegram and Telephone	42	54
Repairs and Maintenance	20	40
Insurance	12	15
Total	395	480

Illustration 18:

(May 2008)

From the following information, Prepare a Balance Sheet of Chak De India Bank Ltd. as on 31-03-2014 along with relevant schedules taking into account additional information.

Particulars	In Crores	
	Debit	Credit
Share Capital (Share of ₹10 each)		100
Statutory Reserve (Opening Balance)		70
Capital Reserve		50
Security Premium		40
Profit / Loss Account (Opening Balance)		60

Accounting for Banking Company

Net Profit before Appropriations		80
Demand Deposit		128
Savings Deposit		212
Term Deposit		160
Borrowings with Other Banks		32
Bills Payable		18
Inter Office Adjustments		8
Interest Accrual		26
Cash on Hand	62	
Cash with RBI	34	
Money at Call and Short Notice	82	
Term Loans	346	
Cash Credit	114	
Premises	112	
Furniture	18	
Gold	88	
Government Security	58	
Cash with Other Banks	70	
	984	984

Additional Information:

- (a) 60% of the term loan are secured by tangible assets. 40% of term loan are secured by Government Guarantee and 10% of cash credit is unsecured.
- (b) Bills for collection `28 Crores.
- (c) Acceptance and Endorsement `32 Crores.
- (d) Depreciation on premises `20 Crores and Furniture `2 Crores provided during the year.
- (e) Transfer 20% of current year profit to Statutory Reserve.
- (f) Also Calculate Cash Reserve required and Statutory Liquidity Reserve required.

Note: Cash Reserve required is 3% of Demand and Time Liability and Statutory Liquidity Reserve required is 30% of Demand and Time Liability.

Solution:

Balance sheet of Chak De India Bank as on 31st March 2014 ('in Crores)

Particulars	Schedule No.	31/03/14 (')
Capital:		
Share Capital	1	100
Reserve and Surplus	2	300
Deposits	3	500

Accounting for Banking Company

Borrowings	4	32
Other Liabilities and Provisions	5	52
Total		984
Assets:		
Cash and Balances with R.B.I	6	96
Balances with other Balances and money call and shares		
Notice	7	152
Investments	8	146
Advances	9	460
Fixed Assets	10	130
Other Assets	11	–
Total		984
Contingent Liabilities	12	32
Bills for Collections		28

Schedule 1: – Share Capital (in Crores)

Particulars	31/03/2014 (₹)
Authorised	?
Issues subscribed called up and paid up	100
Total	100

Schedule 2: – Reserves Surplus (in Crores)

Particulars	31/03/2014 (₹)
Capital Reserve	50
Statutory Reserve-Opening Balance	70
Addition during the year	<u>1.6</u>
Security premium	40
Profit and Loss a/c. Opening Balance	60
Add: Net profit during the year (W.N. 1)	<u>78.4</u>
Total	300

Schedule 3: – Deposits (in Crores)

Particulars	31/03/2014 (₹)
Demand Deposits	128
Saving Deposits	212
Term Deposits	160
Total	500

Schedule 4: – Borrowing (in Crores)

Particulars	31/03/2014 (₹)
Borrowings in India from other banks	32
Total (A)	32
Borrowings outside India (B)	–
Total (A + B)	32

Accounting for Banking Company

Schedule 5: – Other Liabilities and Provision (‘in Crores)

Particulars	31/03/2014 (‘)
Bills payable	18
Inter office Adjustments	8
Interest Accrued	26
Total	52

Schedule 6: – Cash and Balances with Reserve Bank of India (‘in Crores)

Particulars	31/03/2014 (‘)
Cost with RBI (W.N. 2)	34
Cash in Hand	62
Total	96

Schedule 7: – Balance with Banks and money of call and short notice (‘in Crores)

Particulars	31/03/2014 (‘)
In India money at call and short notice	82
Cash with other bank	70
Total	152

Schedule 8: – Investments (‘in Crores)

Particulars	31/03/2014 (‘)
Gold	88
Government Security	58
Total	146

Schedule 9: – Advances (‘in Crores)

Particulars	31/03/2014 (‘)
(A) Term Loans	346
Cash credit	114
Total	460
(B) Secure by tangible assets (207.6 + 10.26)	310.2
Covered by Bank/government guarantees	138.4
Unsecured	11.4
Total	460
(C) Advances in India	?
(D) Advances outside India	?

Schedule 10: – Fixed Assets (‘in Crores)

Particulars	31/03/2014 (‘)
Premises: Opening Balance	132
Loss: Depreciation	<u>20</u>
	112

Accounting for Banking Company

Further: Opening Balance	20	
Loss: Depreciation	<u>2</u>	18
	Total	130

Schedule 12: – Contingent Liabilities (in Crores)

Particulars	31/03/2014 (₹)
Acceptance and Endorsements	32
Bill for collection	28
Total	60

WN 1:

	in Crores
Net Profit before Appropriations	80
Loss: transfer to Statutory Reserve 20% of 80	1.6
	78.4

WN 2:

	in Crores
Cash Liquid Ratio Required	
Demand Deposits	128
Saving Deposits	212
Term Deposits	160
Total Demand and Time Liability	500
∴ Cash Reserve = 3% of 500	15
Liability Reserve = 30% of 500	50
Excess Liquid Ratio	
Cash in hand	62
Cash with other bank	70
Money at call	82
Gold	88
Government Securities	58
Total	360
Less: Liquidity Ratio Reserve	150
Fixed Liquid Reserve	210
Cash Reserve Required	15
Loss: Balance with RBI	34
Fixed Cash Reserve	19

Illustration 19:

(May 2008)

From the following information, prepare Profit / Loss Account of Apana Bank Ltd. for the year ended 31st March, 2014 along with necessary schedules

Items	in thousand
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(xci)

Accounting for Banking Company

Interest on Cash Credit	1,820
Interest on Overdraft	750
Interest on Term Loans	2,540
Income on Investments	840
Interest on Balance with RBI	150
Commission on remittances and transfer	75
Commission on letters of credit	118
Commission on Government Business	82
Profit on Sale of Land and building	27
Loss on Exchange Transactions	52
Interest paid on Deposits	1,726
Auditors Fees and Allowances	120
Directors Fees and Allowances	250
Advertisement	180
Salaries, Allowances and Bonus paid to Employees	1,240
Payment to Provided Fund	280
Printing and Stationery	140
Repairs and Maintenance	50
Postage, Telegrams, Telephones	80

Other Information:

The following adjustments have to be made:

- (1) The above mentioned figure of Interest on Advances includes `2,020 thousands of interest on NPA out of which 750 thousands only has been received.
- (2) Classification of Advances:

	% of Provision	`in Thousand
Standard	0.40%	3,000
Sub-Standard	10%	1,120
Doubtful assets not covered by security	100%	200
Doubtful assets not covered by security for 1 year	20%	50
Loss Assets	100%	200

The necessary provisions against above mentioned advances to be made.

- (3) Make provision for tax @ 30%.

Solution:

Profit/Loss a/c. Apana Bank Ltd. for the year Ended 31st March, 2014

Particulars	Schedule No.	`in '000
(A) Income:		

Accounting for Banking Company

Interest income	13	4,830
Other income	14	250
Total (A)		5080
(B) Expenses		
Interest Expenses	15	1,726
Other operating expenses	16	2,340
Provisions and contingencies	(WN2)	678
Total (B)		4,744
(C) Profit		
Profit of Current you (A – B)	(WN1)	336
Profit brought from last year		–
Total (C)		336
(D) Appropriation		
Transfer to Reserves		–
Balance Carries over to b/s. 20%		67.20
Balance c/fd to B/S		268.80

Schedule 13 – Interest Income

Particulars	in '000
Interest on cash credit	1,820
Interest on overdraft	750
Interest on term loan (2540 + 2020 + 750)	1,270
Income of investments	840
Interest on Balance with RBI	150
Total	4,830

Schedule 14 – Other Income

Particulars	in '000
Commission on remittances and transfer	75
Commission on letters of credit	118
Commission on government business	82
Profit on sale of loans and building	27
Loss on sale of exchange Transactions	(52)
Total	250

Schedule 15 – Interest Expenses

Particulars	in '000
Interest paid on deposits	1,726
Total	1,726

Schedule 16 – Operating expense

Particulars	in '000
Auditors fees and allowances	120
Director fees and allowances	250
Advertisements	180
Salaries allowances and bonus paid to employees	1,240
Payment to provided fund	280

Accounting for Banking Company

Printing and stationery	140
Repair and maintenance	50
Postage, Telegram and Telephone	80
Total	2,340

Working Notes 1: Provision and Advance (in 000)

Particulars	% of provision	Amount of Advance	Provision
Standard	40%	3,000	12
Sub-Standard	10%	1,120	112
Doubtful assets not covered by security	100%	200	200
Doubtful assets not covered by security for 1 year	20%	50	10
Loss Assets	100%	200	200
Total			534

Working Notes 2: Provision for Tax

Particulars	(in 000)
Income (4,830 + 250)	5,080
Less: Expenses and Provision (1,726 + 2,340 + 534)	4,600
Profit before tax	480
Less: Provision for tax @ 30%	144
Profit After tax	336
∴ Total provision = (534 + 144) 678	

Illustration 20: (Nov. 2006)

Following figures have been obtained from the books of Money Bank Ltd. for the year ended 31st March, 2014

Particulars	In '000
Issued and Subscribed Capital	500
Interest and discount earned	1,900
Interest paid	1,000
Salaries and Wages	100
Director fees	15
Rent and Taxes	50
Postages on Sale of Investments	120
Loss on Sale of Investments	20
Rent Received	40
Depreciation	10
Stationery	30
Auditor's Fees	5

Additional Information:

- (i) The Profit & Loss Account had a balance of `5,00,000 on 1st April, 2013

Accounting for Banking Company

- (ii) An advance of `2,40,000 has become doubtful and it is expected that only `1,20,000 of the amount can be recovered from security.
 - (iii) The provision for tax to be made of `3,40,000.
 - (iv) A dividend @ 10% is proposed. Also provide for dividend Tax @ 10% of the amount proposed to be distributed.
 - (v) Every year bank transfers 20% of Profit to Statutory Reserve.
- Prepare Profit and Loss Account of the Money Bank Ltd. along with necessary Schedules for the year ended 31st March, 2014

Solution:

Profit & Loss Account for the Year Ended 31st March 2014

Particulars	Schedule No.	Current Year (₹)
(I) Income:		
Interest earned	13	1,900
Other incomes	14	140
Total		2,040
(II) Expenditure		
Interest expended	15	1,000
Operating expenses	16	210
Provision and contingencies		460
Total		1,670
(II) Profit/Loss		
Profit/Loss for the year		370
Profit/Loss brought forward (opening balance)		500
Total		870
(IV) Appropriations		
Transfer to statutory reserves		(50)
Transfer to other reserves		(74)
Transfer to Government/proposed dividends		(5)
Balance carried over to Balance sheet		741

Schedule 17: Interest earned

Particulars	Current Year (₹)
Interest/Discount on advances/Bills	1,900
Income from investments	–
Interest on balance with RBI and other inter bank funds	–
Total	1,900

Schedule 18: Other Incomes

Accounting for Banking Company

Particulars	Current Year ([₹])
Commission, Exchange and brokerage	
Profit on sale of investment	120
Less: Loss on Sale of Investment	<u>(20)</u>
Profit on revaluation of investment	100
Less: Loss on	
Profit on sale of land, bldg. and other assets	-
Less: Loss	-
Miscellaneous Incomes	-
Rent received	40
Total	140

Schedule 19: Interest Expended

Particulars	Current Year ([₹])
Interest on deposits	1,000
Interest on RBI/Inter bank	
Borrowings	
Other	
Total	1,000

Schedule 16: Operating expenses

Particulars	Current Year ([₹])
Payment to and provision for employees	100
Rent, taxes and lighting	50
Printing and stationery	30
Advertisement and publicity	
Depreciation on banks property	10
Director's fees, allowances and expenses	15
Auditors fees and allowances (including branch auditors)	5
Law charges	
Postage, telegrams and telephone	
Repairs and maintenance	
Insurance	
Other	
Total	210

Schedule 17: Provision and Contingencies

Particulars	Current Year ([₹])
Provision for doubtful debts	120

Accounting for Banking Company

Provision for Tax	340
Total	460

Illustration 21: **(May 2006)**

From the following Trial Balance and the addition of information, prepare the Balance Sheet of Dollar Bank Ltd on 31st March, 2014, giving the relevant schedules:

Particulars	Debit	Particulars	Credit
Cash Credits	1,23,815	Share Capital	
Cash in hand	23,065	[29,70,000 Equity shares	
Cash with RBI	7,740	Of `10 each fully paid Up]	29,700
Cash with other banks	13,281	Statutory Reserves	
Money at call and short notice	31,518	Opening balance	38,650
Gold	6,284	Profit and loss A/c	
Government Securities	36,525	Opening Balance	61,800
Current Accounts	6,200	Net profit for the year	
Premises	12,355	(before appropriations)	18,500
Furniture	8,518	Fixed Deposits	57,050
Term loans	1,18,932	Recurring Deposits	25,500
		Saving Deposits	62,500
		Current Accounts	78,018
		Bills Payable	150
		Borrowing from other banks	16,365
	3,88,233		3,88,233

Additional Information:

- (a) Bills for collection `1,530.
- (b) Acceptance and Endorsements `1,012.
- (c) Claims against the bank not acknowledged as debts `45,
- (d) Depreciation charged during the year premises `445, Furniture `572.

Solution:

Dollar Bank Ltd, from 'A' balance sheet for the year end 31st March 2014.

Particulars	Schedule	Amt.(Rs)
Capital	1	29,700
Reserves	2	1,18,950
Deposit	3	1,45,050
Borrowings	4	94,383
Other Liabilities	5	150
		3,88,233
Cash in hand and balance with RBI	6	30,805
Balance with Bank, Money at call and short notice	7	50,999



Accounting for Banking Company

Investment	8	42,809
Advance	9	2,42,747
Fixed Asset	10	20,873
Other Asset	11	–
		3,88,233
Contingent Liability	12	1,057
Bill for Collection		1,530

Schedules forming part of Balance Sheet

Schedule 1: Capital

Particulars	(₹)
Authorised:	
Equity shorts of ` ___ each	?
	?
Issued, Subscribed, called and partly Paid	
2970000 equity shorts of `10 each	29,700
	29,700

Schedule 2: Reserves

Particulars	(₹)
Statutory Reserve	
Opening	38,650
(+) addition	<u>3,700</u>
P/L A/c	
Opening balance	61,800
(+) Net Profit	18,500
(-) Transfer to statutory Reserve	<u>(3,700)</u>
	76,600
	1,18,950

Schedule 3: Deposits

Particulars	(₹)
Fixed Deposit	57,050
Recurring Deposit	25,500
Saving deposit	62,500
	1,45,050

Schedule 4: Borrowings

Particulars	(₹)
Current Account	78,018
Borrowings with other banks	16,365
	94,383

Schedule 5: Other Liability

Particulars	(₹)
Bills Payable	150
	150

Schedule 6: Cash In Hand and Balance with RBI

Accounting for Banking Company

Particulars	(₹)
Cash In Hand	23,065
Cash with RBI	7,740
	30,805

Schedule 7: Balance with Bank Money at call and short Notice

Particulars	(₹)
Money at call and short notice	31,518
Cash with other bank	13,281
Current Account	6,200
	50,999

Schedule 8: investment

Particulars	(₹)
Gold	6,284
Government Securities	36,525
	42,809

Schedule 9: Advances

Particulars	(₹)
Cash Credit	1,23,815
Tern Loan	1,18,932
	2,42,747

Schedule 10: Fixed Asset

Particulars	(₹)
Premises	
Opening	12,800
(-) Depreciation	<u>(445)</u>
Furniture (Opening)	9,090
(-) Depreciation	<u>(572)</u>
	8,518
	20,873

Schedule 11: Other Asset

Particulars	(₹)

Schedule 12: Contingent Liability

Particulars	(₹)
Acceptance and Endorsement	1,012
Claim against bank not acknowledge as debts	45
	1,057

Illustration 22:

(May 2007)

The following is the Trial balance from the books of Ashwarya and Abhishek Bank Ltd as on 31.03.2014

Accounting for Banking Company

Debit		Credit	
Director Fees	9,960	Paid up capital	20,00,000
Auditor Fees	2,000	Profit and Loss A/c	80,646
Furniture (Cost `100000)	74,560	Current Account	68,25,208
Stamps in hand	378	Fixed Deposit	77,91,108
Land (Cost ``600000)	4,10,000	Saving bank Deposit	51,36,000
Deposit with RBI	8,00,000	Contingency Reserve	100,000
Book Debts, Cash credit and overdraft	1,40,00,000	Investment Reserve	70,000
Postage and telegram	2,306	Branch Adjustment	73,788
Rent taxes and premium	17,000	Statutory Reserve	1,30,000
Salaries	52,300	Reserve fund	4,00,000
Legal Expense	3,300	Interest and Discount	4,20,446
Cash in Hand	8,32,648	Commission and Exchange	2,04,450
Deposits with bank	24,10,250		
Investment	17,56,250		
Printing and Stationery	6,780		
Bills Discounted	28,01,040		
Interest	52,000		
Unexpired Insurance	874		
	2,32,31,646		2,32,31,646

Additional Information:

- The bank has accepted on behalf of consumers bill worth `4,00,000 for collection.
 - Depreciation is to be written off `16,000 From land and `7,000 From furniture.
 - The authorised capital of the Bank is `40,00,000 divided into 40,000 shares of `100 each.
 - All shares have been subscribed but only half the face value has been called up.
 - Create provision for taxation `2,20,000.
 - Transfer 20% of Net profit to Statutory Reserve.
- Prepare Bank final account for the year ended 31.03.2014.

Ashwarya and Abhishek Bank Ltd.

Solution:

Balance Sheet for the year ended 31st March 2014

Particulars	Schedule	
Capital	1	20,00,000
Reserve	2	10,16,022
Deposit	3	1,29,27,108

(c)

Accounting for Banking Company

Borrowings	4	68,25,208
Other Liabilities and provisions	5	2,93,788
Total		2,30,62,126
Cash in hand and balance with RBI	6	8,32,648
Balance with bank, Money at call and short notice	7	24,10,628
Investment	8	17,56,250
Advances	9	1,76,01,040
Other Assets	11	378
Total		2,30,62,126
Contingent Liability	12	4,00,000

Profit and Loss Account for the year end 31/03/14

Income		
Interest earned	13	4,20,446
Other Income	14	2,04,450
		6,24,896
A		
Expenditure		
Interest Expended	15	52,000
Operating Expended	16	1,17,520
Provision / Contingency	17	2,20,000
		3,89,520
B		
Net Profit (A – B)		2,35,376
Add: Profit of previous year		80,646
		3,16,022
Less: Appropriation		
Transfer to statutory Reserve		(47,075)
Balance C/F to Balance Sheet		2,68,947

Forming Part of Final Accounts

Schedules 1: Share Capital

Particulars	(₹)
Authorised	
40000 shares of ₹100 each	40,00,000
Issued, subscribed and called up	
40000 equity shares of ₹50 paid	20,00,000
	20,00,000

Schedules 2: Reserves

Particulars	(₹)
Contingency Reserve	1,00,000
Investment Reserve	70,000
Statutory Reserve	1,30,000

Accounting for Banking Company

Opening	47,075
P/L A/c.	2,68,947
Reserve Fund	4,00,000
	10,16,022

Schedules 3: Deposits

Particulars	(₹)
Fixed Deposits	77,91,108
Saving Bank Deposit	51,36,000
	1,29,27,108

Schedules 4: Borrowings

Particulars	(₹)
Current Account	68,25,208
	68,25,208

Schedules 5: Other asset and provision

Particulars	(₹)
Branch Adjustment	73,788
Provision for Tax	2,20,000
	2,93,788

Schedules 6: Cash in Hand and Balance With RBI

Particulars	(₹)
Cash in Hand	8,32,648
	8,32,648

Schedules 7: Balance with bank, Money at call and short notice

Particulars	(₹)
Deposits with other banks	24,10,250
	24,10,250

Schedules 8: Investment

Particulars	(₹)
Investment	17,56,250
	17,56,250

Schedules 9: Advances

Particulars	(₹)
Deposit with RBI	8,00,000
Book Debt cash credit and overdraft	1,40,00,000
Bills Discounted	28,01,040
	1,76,01,040

Schedules 10: Fixed Asset

Particulars	(₹)
Furniture	
Opening Cost	1,00,000
Less: Provision for depreciation	(25,440)
Less: Depreciation C.Y.	<u>(7,000)</u>
	67,560

Accounting for Banking Company

Land: Cost	6,00,000	
(-) Provision for Depreciation	(1,90,000)	
(-) Depreciation C.Y.	<u>(16,000)</u>	3,94,000
		4,61,560

Schedules 11: Other Asset

Particulars	(₹)
Stamps in hand	378
	378

Schedules 12: Contingent Liability

Particulars	(₹)
Bank accepted of consumer bills	4,00,000
	4,00,000

Schedules 13: Interest Earned

Particulars	(₹)
Interest and Discount	4,20,446
	4,20,446

Schedules 14: Other Income

Particulars	(₹)
Commission and exchange	2,04,450
	2,04,450

Schedules 15: Interest Expended

Particulars	(₹)
Interest	52,000
	52,000

Schedules 16: Operating Expense

Particulars	(₹)
Director Fees	9,960
Auditor Fees	2,000
Postage and telegram	2,306
Rent taxes and premium	17,000
Salaries	52,300
Unexpired Insurance	,874
Legal Expense	3,300
Printing and Stationary	6,780
Depreciation of land	16,000
Depreciation of Furniture	7,000
	1,17,520

Schedules 17: Provisions Contingency

Particulars	(₹)
Provision for tax	2,20,000
	2,20,000

Illustration 23:

Accounting for Banking Company

- (a) While closing its books of Accounts, Mumbai Bank Ltd has its advance classified as follows: (Nov. 2007)

Particulars	Cash Credit (`In '000)	Term Loan (`In '000)
Standard Assets	1,200	2,000
Sub – Slandered Assets	120	160
Doubtful Asset up to 1 year	100	20
One year to three years	160	60
More than three years	60	80
Loss assets	60	80
	170	2,400

No provision has been made against these assets doubtful assets are secured to the extent 50% of amount due.

You are required to prepare a statement of provision to be made for each category. Percent required for the provisions as follows:

- (i) Standard assets @ 0.4%
- (ii) Sub standard assets @ 10%
- (iii) Secured provisions of doubtful assets upto one year @ 20%
- (iv) Secured provisions of doubtful assets one year to three year @ 30%
- (v) Secured provisions of doubtful assets more than three years and unsecured provisions of doubtful assets and loss of assets @ 100%

Solution:

Provision of Advances

Particulars	Cash Credit			Term Loan		
	Amt	%	Amt	Amt	%	Amt
Standard Assets	1,200	0.4	4.8	2,000	0.4	8
Substandard Assets	120	10	12.0	160	10	16
Doubtful Assets						
Secured (@ 50%)						
Upto one year	50	20	10	10	20	2
One year to three years	80	30	24	30	30	9
More than three years	30	100	30	40	100	40
Unsecured (@50%)						
Upto one year	50	100	50	10	100	10
One year to three years	80	100	80	30	100	30
More than three years	30	100	30	40	100	40
Loss asset	60	100	60	40	100	80
			300.8			235

- (b) On 31st March 2013, Rupees Bank Ltd. had balances of `10 crores in 'rebate one bills discounted' account. During the year ended 31st March 2014, Rupees Bank Ltd. discounted Bills of exchange of

(civ)

Accounting for Banking Company

₹10000 charging interest at 10% per annum, the average period of discount being 73 days of these, bills of exchange of ₹1500 crores were due for realization from the acceptors customers after 31st March 2013, the average period outstanding after 31st March 2014 being 36 ½ days. Rupees Bank Ltd asks you to pass journal entries and show the ledger accounts pertaining to:

- (i) Discounting of bills of exchange and;
- (ii) Rebate on bills discounted.

Solution:

Dr.		Discounted Bill of Exchange A/c		Cr.
To Rebate on bills Discounted	5	By Bill of Exchange		200
To P/L A/c	195			
	200			200

Dr.		Rebate on Bill Discounted A/c		Cr.
To balance c/d	15	By balance b/d		10
		By Discounted Bill of Exchange		5
	15			15

Journal Entries

Date	Particulars	LF	Debit	Credit
	Bill of exchange A/c	Dr	200	
	To Discounted bill of exchange (Being 10000 bills discounted during the year)			200
	Discounted Bill of exchange	Dr	5	
	To Rebate on bills discounted			5
	Discounted Bill of exchange	Dr	195	
	To P/L			195

Illustration 24:

From the following information, find out the amount of provisions required to be made in the Profit and Loss Account of HBSB Commercial bank for the year ended 31st March, 2014.

- (a) Packing credit outstanding from Food Processors ₹150 lakh against which the bank holds securities worth ₹37.5 lakh. The above advance has remained doubtful for more than 3 years.
- (b) Other advances:

Particulars	(₹)
Assets Classification	
Standard	7,500
Sub-standard	5,500

Accounting for Banking Company

Doubtful:	
For one year	2,250
For two year	1,500
For three years	1,000
For more than three years	750
Loss assets	1,500

Solution:

In the Books of HSBC Commercial Bank Provision Required Against Packing Credit

Particulars	`in Lakh
Amount outstanding (Packing Credit)	150
Less: Realizable value or securities	37.5
Advance doubtful for more than 3 years	112.5
Required Provision (100% to the extent not secured)	112.5
Add: Provision for secured portion (50% of `37.5 lakh outstanding for more than 3 years)	18.75
	131.25

Provision Required Against Other Advances

Assets	Amount in lakh	% of Provision	Provision in lakh
Standard	7,500		
Sub-standard	5,500	10%	550
Doubtful:			
For one year	2,250	20%	450
For two years	1,500	30%	450
For three years	1,000	30%	300
For more than 3 years	750	50%	375
Loss assets	1,500	100%	1,500
			3,625

Total Provision required `(131.25 + 3,625) = `3,756.25 lakh.

Doubtful advances have been assumed to be fully secured. In case no security cover is available against these advances, provision will be made @ 100%.

Illustration 25:

The following figures were extracted from the books of Citi Bank Ltd., as on 31st March 2014.

Particulars	`
Interest and discounted received	75,90,470
Interest paid on deposits	30,60,904
Issued and subscribed capital	30,00,000
Reserve u/s 17	4,00,000
Rent received	1,10,000

Accounting for Banking Company

Profit on sale of investments	3,00,000
Salaries and Allowances	5,00,000
Directors fees and Allowances	60,000
Rent and Taxes paid	1,00,000
Postage and Telegrams	1,01,172
Depreciation on Bank properties	60,000
Printing and Stationery	1,00,000
Preliminary Expenses	30,000
Audit Fees	10,000
Commission, Exchange and Brokerage	3,00,000

The following further information is given:

- (a) A customer to whom a sum of `25,00,000 has been advanced has become insolvent and it is expected that only 50% can be recovered from his estates. Interest due 18% on his debt has not been provided in the books.
- (b) There was another advance for which a provision of `2,00,000 was considered necessary by the auditors.
- (c) Rebate on Bills discounted as on 31st March 2014 `24,000.
Rebate on Bills discounted as on 31st March 2014 `32,000.
- (d) Tax provision to be made for `12,00,000.
- (e) The directors suggest a **dividend of 20%**.

Prepare the profit and loss account in accordance with law.

Solution:

In the Books of City Bank Ltd., Profit and Loss Account for the ended 31st March 2014

	Schedule No.	Year Ended
(1) Income		
Interest Earned	13	75,82,470
Other income	14	7,10,000
Total		82,92,470
(2) Expenditure		
Interest Expended	15	30,60,904
Operating Expenses	16	9,61,172
Provisions and Contingencies		26,50,000
Total		66,72,076
(3) Profit/Loss		
Net Profit/Loss (-) for year		16,20,394
Profit/loss (-) brought forward		-
Total		16,20,394
(4) Appropriations		
Proposed Dividend @20%		3,24,079

Accounting for Banking Company

Transfer to Statutory reserve @ 25%		4,05,099
Balance carried over to Balance sheet		8,91,216
Total		16,20,394

Schedule 13: Interest Earned

		(₹)
Interest and Discount		75,90,470
Add: Unexpired Discount (Opening)		24,000
		76,14,470
Less: Unexpired Discount (Closing)		32,000
		75,82,470

Schedule 14: Other Incomes

		(₹)
Commission, Exchange and Brokerage		3,00,000
Profit on sale of investments		3,00,000
Rents		1,10,000
		7,10,000

Schedule 15: Interest Expended

		(₹)
Interest paid on deposits		30,60,904
		30,60,904

Schedule 16: Operating Expenses

		(₹)
Payments to and provisions for employees		5,00,000
Rent, Taxes and Lighting		1,00,000
Printing and stationery		1,00,000
Advertisement and publicity		–
Depreciation on bank's property		60,000
Director's fees, Allowances and Expenses		60,000
Auditors fees		10,000
Law charges		–
Postages, Telegrams, Telephones etc.		1,01,172
Repairs and maintenance		–
Insurance		–
Other Expenditure		30,000
		9,61,172

Provisions and Contingencies

		(₹)
Provision for doubtful debts		14,50,000
Provision for taxation (10,00,000 + 2,00,000)		12,00,000
		26,50,000

Illustration 26:

Accounting for Banking Company

From the following information prepare a Balance Sheet of HSBC International Bank Ltd., as on 31st March, 2014 giving the relevant schedules.

(in lakh)

Debit Balance	₹	Credit Balance	₹
Current Accounts	42.00	Share Capital	
Cash Credits	1,218.15	19,80,000 shares of ₹15 each	297.00
Cash in Hand	240.22	Statutory Reserve	346.50
Cash with RBI	56.82	Net Profit before Appropriations	225.00
Cash with other Banks	233.8	Profit and Loss A/c	618.00
Money at Call	315.18	Fixed Deposit A/c's	775.50
Gold	82.86	Saving Deposit A/c's	675.00
Government Securities	165.25	Current A/c	780.18
Premises	233.55	Bills Payable	0.15
Furniture	105.18	Borrowings from other Banks	165.00
Term Loans	1,189.32		
	3,882.33		3,882.33

Additional Information:

Particulars	(₹)
Bills for Collection	27,15,000
Acceptances and endorsements	21,18,000
Claims against the Bank not acknowledged as debt	82,500
Depreciation charges – Premises	1,65,000
Furniture	1,17,000

50% of the Term Loans are secured by Government guarantees. 10% of Cash Credits is unsecured. Also calculate Cash reserves required and statutory liquid reserves required. Cash reserve required 3% of demand and time liabilities, liquid reserves required 30% of demand and time liabilities.

Solution:

HSBC International Bank Ltd.

Particulars	Schedule No.	As on 31/3/2014
Capital and Liabilities:		
Share Capital	1	297.00
Reserves and Surplus	2	1,189.50
Deposits	3	2,230.68
Borrowings	4	165.00
Other Liabilities and Provisions	5	0.15
Total		3,882.33

Accounting for Banking Company

Assets:		
Cash and Bank balance with RBI	6	307.14
Balances with Banks and Money at		
Call and Short Notice	7	548.98
Investments	8	248.11
Advances	9	2,449.47
Fixed Assets	10	338.73
Other Assets	11	–
Total		3,882.33
Contingent Liabilities	12	22.00
Bills for Collection		27.15

Schedule 1 – Capital

Particulars	(₹)
Authorized Capital	–
Issued Subscribed and Paid-up Capital 19,80,000 shares of ₹15 each	297
Total	297

Schedule 2 – Reserves and Surplus

Particulars	(₹)
(I) Statutory Reserve	346.5
Additions during the year (25% of 225)	<u>56.25</u>
	402.75
(II) Balance in Profit and Loss A/c (1)	786.75
Total	1,189.50

Schedule 3 – Deposits

Particulars	(₹)
(i) Demand Deposits from Others	780.18
(ii) Saving Bank Deposits	675.00
(iii) Fixed Deposits	775.50
Total	2,230.68

Schedule 4 – Borrowings

Particulars	(₹)
Borrowings in Indian from other banks	165
Total	165

Schedule 5 – Other Liabilities and Provisions

Particulars	(₹)
Other liabilities and provisions	0.15
Total	0.15

Schedule 6 – Cash and Balance with RBI

Particulars	(₹)
(i) Cash in Hand	240.22
(ii) Balance with RBI (in current A/c) (2)	66.92
Total	307.14

Accounting for Banking Company

Schedule 7 – Balance with Banks and Money at Call and Short Notice

Particulars	(₹)
In India	
Balances with Banks	
(i) In current A/c (3)	233.80
(ii) Money at call and short notice	315.18
Total	548.98

Schedule 8 – Investments

Particulars	(₹)
Investment in India in	
(i) Government Securities	165.25
(ii) Others – Gold	82.86
Total	248.11

Schedule 9 – Advances

Particulars	(₹)
(A) (i) Cash credits, overdrafts	1,260.15
(ii) Term Loans	1,189.32
	2,449.47
(B) (i) Secured by tangible assets	1,728.80
(ii) Secured by bank/Government guarantees	594.66
(iii) Unsecured	126.01
Total	2,449.47

Schedule 10 – Fixed Assets

Particulars	(₹)
(1) Premises	
At costs on 31st March, 2014	235.20
Less: Depreciation to date	1.65
	233.55
(2) Other Fixed Assets:	
Furniture at cost on 31st March, 2014	106.35
Less: Depreciation to date	1.17
	105.18
Total (1 + 2)	338.73

Schedule 12 – Contingent Liabilities

Particulars	(₹)
(i) Claims against bank not acknowledged as debts	0.82
(ii) Acceptances, endorsements	21.18
	22.00
Calculation of Cash Reserves and Statutory Liquid Reserves	
Total of demand and time liabilities	
(`775.5 + 675 + 780.18)	2,230.68
Cash reserve (3% of `2230.68)	66.92
Statutory liquid reserve (30% of demand and time liabilities)	669.2

Accounting for Banking Company

Working Notes:

	(₹)
(1) Balance in P/L A/c:	
Net Profit before appropriations	225.00
Add: Balance of Profit and Loss A/c	618.00
	843.00
Less: Transfer to Statutory Reserve (25% of 225)	56.25
	786.75
(2) Transfer from Cash with Other Banks to Cash with RBI	
Cash reserve required (@ 3% on `2,230.68 lakh)	66.92
Cash with RBI	56.82
Transfer needed to maintain Cash Reserve	10.10
(3) Liquid Assets	
Cash in hand	240.22
Cash with other banks	233.80
Money at call and short notice	315.18
Gold	82.86
Government Securities	165.25
	1,037.31

Excess Liability [1037.31 – 669.20 (i.e., 30% of `2230.68)] = `368.11 lakh. The excess liability enables the transfer as per (2) above, after transfer cash with other banks = `(in lakh) (233.8 – 10.1 = ` (in lakh) 223.7).

Illustration 27:

(March 2011)

From the following details of Arya Bank Ltd. calculate the amount of interest to be credited to Profit and Loss Account for the year ended 31st March, 2014.

	Interest Accrued (01/04/13) Rs in Crores	Interest received (2013 - 14) Rs. in Crores	Interest Accrued (31/03/14) Rs. in Crores
Performing Assets			
Loans	350	960	480
Bills Purchased and Discounted	560	1,400	670
Cash Credit	785	3,600	850
Non-performing Assets			
Loans	2,500	600	1,950
Bills purchased and Discounted	1,850	700	2,050
Cash Credit	2,980	900	1,800

Accounting for Banking Company

Solution:

Arya Bank Ltd.

Particulars	(Rs.)	(Rs.)
Performing Assets:		
Loans (960 – 350 + 480)	1,090	
Bills Purchased and Discounted (1,400 – 560 + 670)	1,510	
Cash Credit (3,600 – 785 + 850)	3,665	6,265
Non-performing Assets:		
Loans	600	
Bills purchased and discounted	700	
Cash Credit	900	2,200
Total		8,465

Illustration 28:

(March 2011)

The following is an extract from the Trial Balance of Money – Penny Bank Ltd. as on 31st March, 2014.

	Dr. Rs.	Cr. Rs.
Bills Discounted	65,50,000	
Rebate on Bills discounted not yet due (01/04/2013)		35,250
Discount received		1,98,500

Date of Bill	Rs.	Period (Months)	Discounted @ % p.a.
Jan. 15, 2014	12,50,000	4	9
Feb. 05, 2014	8,00,000	4	12
Feb. 15, 2014	5,00,000	2	10
March 20, 2014	3,25,000	3	12

Calculate the amount of discount received to be credited to the Profit and Loss Account and pass journal entries for the same.

Solution:

Money-Penny Bank Ltd.

Date of Bill	Date of Maturity	No. of days after 31/3/15	Amount Rs.	Rate of Discount	Total Annual Discount	Unearned Discount
Jan 15	May 18	48	12,50,000	9	1,12,500	14,794.52
Feb 5	June 8	69	8,00,000	12	96,000	18,147.95
Feb 15	April 18	18	5,00,000	10	50,000	2,465.75
March 20	June 23	84	3,25,000	12	39,000	8,975.34
						44,383.56

Journal Entries

Accounting for Banking Company

Date	Particulars	LF	Debit ,	Credit ,
1/4/13	Rebate on Bills Discounted A/c To Discount on Bills A/c		35,250	35,250
31/3/15	Discount on Bills A/c To Rebate on Bills Discounted		44,383.56	44,383.56
31/3/15	Discount on Bills A/c To Profit & Loss A/c		1,89,366.44	1,89,366.44

Illustration 29:

(March 2012)

From the following information of Hiral Bank Ltd. prepare Profit & Loss A/c for the year ended 31/3/2013 and 31/3/2014 along with necessary Schedules.

Particulars	Year Ended 31/3/2013 Rs. '000	Year Ended 31/3/2014 Rs. '000
Interest / Discount on Advances	60,000	50,000
Income on Investments	12,000	10,500
Interest on Balances with RBI	4,500	4,000
Commission, Exchange & Brokerage	3,000	2,500
Profit on Sale of Investment	120	125
Interest on Deposits	31,500	28,000
Interest on RBI borrowings	3,350	3,000
Payments to Provision for Employees	10,000	8,500
Rent, Taxes and Lighting	1,000	800
Printing & Stationery	250	200
Advertisement	100	50
Depreciation on bank property	250	200
Director's fees, allowances & expenses	100	50
Auditor's fees and expenses	50	30
Law charges	20	15
Postages, Telegrams and Telephone	400	250
Repairs and Maintenance	100	75
Insurance	900	800
Other Expenditure	850	900
Balance in P & L a/c b/f	?	1,000

The following adjustments are to be made:

- (1) Make Provisions for Income tax @ 30% for the current year. The rate of Income tax for the year ended 31/3/2014 was also 30%.
- (2) Every year, the bank transfers 25% of Profit to Statutory reserve.

Accounting for Banking Company

- (3) Rebate on Bill discounted on 31/3/2012, 31/3/2013 and 31/3/2014 were Rs. 500 thousand, 650 thousand and 750 thousand respectively.

Solution:

Particulars	Schedule No.	31/3/14 (Rs.)	31/3/13 (Rs.)
(I) INCOME:			
Interest Earned	13	76,400	64,350
Other Income	14	3,120	2,625
Total		79,520	66,975
(II) Expenses:			
Interest Expended	15	34,850	31,000
Operating Expenses	16	14,020	11,870
Provision & Contingencies		9,195	7232
Total		58,065	50,102
(III) Profit:			
Net Profit for the Year		21,455	16,873
Profit brought forward		13,655	1,000
Total		35,110	17,873
(IV) Appropriations:			
Transfer to Statutory Reserves		(5,364)	(4,218)
Balance Carried to Balance Sheet		29,746	13,655

Schedule 13: Interest Earned

Particulars	C.Y. ('000) Rs.	P.Y. ('000) Rs.
Interest/ Discount on Advance	60,000	50,000
Add: Rebate on bill discounted (31/3/12) & (31/3/13)	650	500
Less: Rebate on bill discounted (31/3/14)	(750)	(650)
	59,900	49,850
Income on Investment	12,000	10,500
Interest on balance with RBI	4,500	4,000
	76,400	64,350

Schedule 14: Other Income

Particulars	C.Y. ('000) Rs.	P.Y. ('000) Rs.
Commission, Exchange & Brokerage	3,000	2,500
Profit on Sale of Investments	120	125
	3,120	2,625

Schedule 15: Interest Expended

Particulars	C.Y. ('000) Rs.	P.Y. ('000) Rs.
-------------	--------------------	--------------------

Accounting for Banking Company

Interest on Deposits	31,500	28,000
Interest on borrowing from RBI	3,350	3,000
	34,850	31,000

Schedule 16: Operating Expenses

Particulars	C.Y. ('000)	P.Y. ('000)
	Rs.	Rs.
Payments to Provision for Expenses	10,000	8,500
Rent, Taxes & Lighting	1,000	800
Printing & Stationery	250	200
Advertisement	100	50
Depreciation	250	200
Director fees	100	50
Auditor's fee	50	30
Law charges	20	15
Postage	400	250
Repairs	100	75
Insurance	900	800
Other expenditure	850	900
	14,020	11,870

Working Note:

Particulars	C.Y. ('000)	P.Y. ('000)
	Rs.	Rs.
Interest Earned	76,400	64,350
Other Income	3,120	2,625
	79,520	66,975
Expenditure		
Interest Expended	34,850	31,000
Operating Expenses	11,020	11,870
	48,870	42,870
Profit before tax	30,650	24,105
Less: Income tax @ 30%	(9,195)	(7,232)
Profit After Tax	21,455	16,873

Illustration 30:

(March 2013)

During the two years the following Bills were discounted @ 18% p.a. by New Mumbai Bank Ltd.:

Customers	Date of Bill	Amount `	Term Months
Motu	20/12/13	2,00,000	3
Chotu	09/02/14	3,00,000	4
Lambu	10/06/14	6,00,000	5
Bittu	09/02/15	9,00,000	4

Above bills were realised on due date.

Accounting for Banking Company

Give necessary Journal Entries in the Books of Navi Mumbai Bank Ltd. for the year 2013-14 and 2014-15. Financial year is accounting year.

Solution:

Working Note:

New Mumbai Bank Ltd.

Bill date	Due Date	Amount of bill	No. of days after	Closing rebate	Amount of discount
20/12/13	23/03/14	2,00,000	Nil	–	9,000
09/02/14	12/06/14	3,00,000	73	10,800	18,000
10/06/14	13/11/14	6,00,000	–	–	45,000
09/02/15	12/06/15	9,00,000	73	32,400	54,000

In books of New Mumbai Bank Ltd.

Date	Sr. No.	Particulars	L F	Debit	Credit
31/03/14	1	Discount/Interest A/c Dr. To Rebate on bills discounted (Being provision created for unexpired discount)		10,800	10,800
31/03/14	2	Discount/Interest A/c Dr. To Profit & Loss A/c (Being discount given during the year transferred to P&L A/c)		16,200	16,200
01/04/14	3	Rebate on bills discounted A/c Dr. To Discount/Interest A/c (Being opening rebate recorded)		10,800	10,800
31/03/15	4	Discount/Interest A/c Dr. To Rebate on bills discounted (Being provision for unexpired discount recorded)		32,400	32,400
31/03/15	5	Discount/Interest A/c Dr. To Profit & Loss A/c (Being discount received during the year transferred to P&L A/c)		66,600	66,600

Illustration 31:

(March 2013)

Calculate the Interest Income to be recognised for the year ending 31st March, 2014 of Navi Mumbai Bank Ltd.:

Particulars	Total Earned	On NPA	
		Earned	Collected
Interest on Cash Credit	1,860	640	300
Interest on Term Loan	2,040	860	420
Interest on Overdraft	1,420	480	240

Solution:

New Mumbai Bank Ltd.

Income earned for year ended 31/3/2014

Particulars	Total Earned	on others	On NPA		Total Interest
			Earned	Collected	Recognised
Interest on Cash Credit	1,860	1,220	640	300	1,520
Interest on Term Loan	2,040	1,180	860	420	1,600
Interest on Overdraft	1,420	940	480	240	1,180
Total Interest					4,300

Questions for Self-Practice

OBJECTIVE QUESTIONS

(I) Multiple Choice Questions:

- (1) Banking Regulation Act.
 - (a) 1947
 - (b) 1932
 - (c) 1949
 - (d) 1956
- (2) "Banking" defines in Banking Regulation A/c under section.
 - (a) 3
 - (b) 5
 - (c) 2
 - (d) 4
- (3) Every banking company incorporated in India shall transfer.
 - (a) 20%
 - (b) 25%
 - (c) 30%
 - (d) 15%
- (4) Capital Adequacy Ratio.
 - (a) $\text{Paid-up Capital} / \text{Investment} \times 100$
 - (b) $\text{Reserves} / \text{Investment} \times 100$
 - (c) $\frac{\text{Paid up capital} + \text{Reserves}}{\text{Risk weighted Assets Investment}} \times 100$
 - (d) None of above
- (5) Schedules required to know the Profits and Loss of Banks.
 - (a) 10, 11, 12, 13
 - (b) 13, 14, 15, 16
 - (c) 1, 2, 3, 4
 - (d) 5, 6, 7, 8

Accounting for Banking Company

- (6) Loss on revaluation of Investment.
- Schedule 13
 - Schedule 14
 - Schedule 15
 - Schedule 16
- (7) Interest expended as for schedule 15 include.
- Interest on deposit
 - Others
 - Interest on RBI / intra-bank borrowings
 - All of above
- (8) Reserve and Surbhy does not include.
- Statuary Reserves
 - Capital Reserve
 - Securities Premium
 - Reserve bank of India
- (9) Deposit include.
- Demand deposits
 - Saving Bank deposits
 - Perm deposit
 - All of above
- (10) Schedule 8 includes.
- Shares and securities
 - Debenture and bonds
 - Subsidiaries and joint venture
 - All of above
- (11) Coning and liabilities.
- Schedule 12
 - Schedule 13
 - Schedule 14
 - Schedule 15
- (12) Other Assets includes.
- Inter- Office adjustment
 - Interest accrued
 - Stationary and stamps
 - All of above

[Ans.: (1-c), (2-b), (3-b), (4-c), (5-b), (6-b), (7-d), (8-d), (9-d), (10-d), (11-a), (12-d)]

(II) Mach the Columns:

Column A	Column B
(a) Payment of Dividend	(1) U/S 20
(b) Statutory Reserve	(2) U/S 18
(c) Loans and Advance	(3) U/S 11
(d) CRR and SLR	(4) U/S 12
(e) Limits of paid-up Capital and reserve	(5) U/S 16
	(6) U/S 15
	(7) U/S 17

Ans.: (a-6), (b-7), (C-1), (d-2), (e-3)

Accounting for Banking Company

Column A	Column B
(a) Operating Expenses	(1) Schedule 8
(b) Income on Investment	(2) Contingent Liability
(c) Investment	(3) Premises
(d) Deposits	(4) Schedule 16
(e) Other Assets	(5) Schedule 13
(f) Liability for partly paid investment	(6) Schedule 3
	(7) Interest earned
	(8) Inter-office adjustment (Net)

Ans.: (a-4), (b-8), (c-1), (d-6), (e-q), (f-2)

Column A	Column B
(a) Standard Asset	(1) 10% provision
(b) Sub – Standard Asset	(2) Loss identified
(c) Loss Asset	(3) 6%
(d) CRR	(4) 25% of net demand & time liabilities
(e) SLR	(5) 40% provision
	(6) one
	(7) 8%

Ans.: (1-e), (2-a), (3-b), (4-c), (5-d)

THEORY QUESTIONS

(I) Answer the following questions:

- (1) Explain all three phases of Banking in India.
- (2) Explain Section 6 of Banking Regulated Act, 1949.
- (3) Explain different principle Account of Policies followed by banking companies.
 - (1) Different books required to maintain by banking company.
 - (2) Contingent liabilities.
 - (3) Different types of Assets, losses and its provisions liquidity norms as per section 24.
 - (4) Statutory Reserve fund as per section 17.
 - (5) Recent developments in the Banking Sector.
 - (6) Minimum limits of paid up capital and Reserve Bank Co.
 - (7) Accounting system.
 - (8) Different provisions relating so annual accounts and audit of banking company.

PRACTICE PROBLEMS

- (1) From the following information, find out the amount of provisions required to made in the Profit and Loss Account of a New India Commercial bank for the year ended 31st March, 2009.
 - (a) Packing credit outstanding from Food Processors `150 lakh against which the bank holds securities worth `37.5 lakh. The above advance has remained doubtful for more than 3 years.
 - (b) Other advances:

Particulars	(`)
Assets Classification	
Standard	7,500

Accounting for Banking Company

Sub-standard	5,500
Doubtful:	
For one year	2,250
For two year	1,500
For three years	1,000
For more than three years	750
Loss assets	1,500

- (2) As on 31st March, 2009, the books of Central Bank, include among others, the following balances:

Particulars	(₹)
Rebate on bill discounted	3,20,000
Discounted received	46,00,000
Bills discounted and purchased	3,15,47,000
Bills for collection	12,00,000

Throughout 2008-09, the Bank's rate for discounting has been 18% and the rate of commission on bills for collection, 4%.

On investigation, and analysis, the average due date for the bills discounted and purchased is calculated as 15th May, 2009 and that for collection as 15th April, 2009.

Show the calculation of the amount to be credited to the Bank's Profit and Loss Account under discount earned for the 2008-09. Show also the journal entries required to adjust the above mentioned accounts.

- (3) On 31st March, 2008, UTI Bank Ltd. had a balance of `9 crores in "rebate on bills discounted" account. During the year ended 31st March, 2006. Uncertain Bank Ltd. discounted bills of exchange of `4,000 crores charging interest at 18% per annum, the average period of discount being for 73 days. Of these, bills of exchange of `600 cores were due for realization from the accepts / customers after 31st March, 2009, the average period outstanding after 31st March, 2009 being 365 days. Uncertain Bank Ltd. asks you to show the ledger accounts pertaining to:

- (a) discounting of bills of exchange and
 (b) rebate on bills discounted.

[Ans.: Discount of Bills of Exchange A/c. balance 142.2; Rebate of Bills of Exchange balance 10.8]

- (4) From the following information find out the amount of provisions to be shown in the Profit and Loss Account of a commercial bank.

Accounting for Banking Company

Particulars	(₹) in lakhs
Assets	
Standard	5,000
Sub-standard	4,000
Doubtful:	800
For one year	600
For two year	200
For more than three years	1,000

[Ans.: Provisions 12.5 + 400 + 160 + 180 + 100 + 1,000 = 1852.50]

(5) Union Bank Ltd. gives you the following information for the year 2008-2009.

(i) Export credit given	₹50 lakhs
ECGC Over	40%
Securities held	₹10 lakhs (realisable value of ₹12 lakhs)
Period for which the advance has remained doubtful	More than 3 years
(ii) Term Loan	₹75 lakhs
DICGC cover	50% (maximum limit ₹20 lakhs)
Securities held	₹20 lakhs (realisable value ₹18 lakhs)
Period for which the loan has remained doubtful	More than 3 years

You are asked to compute the provision required on the above advances.

(6) From the following Ledger balances, prepare final balance sheet of South Indian Bank as on 31st March, 2009 giving the relevant schedules:

(₹ in '000)

Particulars	₹Dr.	₹Cr.
Share Capital		
19,80,000 shares of ₹10 each		1,98,00
Statutory Reserve		2,31,00
Net Profit (before appropriations)		1,50,00
Profit and Loss A/c.		4,12,00

Accounting for Banking Company

Fixed Deposit		5,17,00
Saving Deposit		4,50,00
Current Accounts	28,00	5,20,12
Borrowings from other banks		1,10,00
Bills payable		10
Cash credits	8,12,10	
Cash in hand	1,60,15	
Cash with RBI	37,88	
Cash with other banks	1,55,87	
Money at Call	2,10,12	
Gold	55,23	
Government Securities	1,10,17	
Premises	1,55,70	
Furniture	70,12	
Term Loans	7,92,88	
	25,88,22	25,88,22

- (a) Necessary transfer is to be made from cash with other banks to maintain 3% cash reserve on fixed, savings and current accounts with RBI.
- (b) Check if 30% demand and time liabilities (i.e. total of fixed, saving and current accounts balances) is maintained in cash, gold or unencumbered securities. If not, identify the deficit.
- (c) Bills for collection `18,10,000.
- (d) Acceptances and endorsement `14,12,000.
- (e) Claims against bank not acknowledged as debt `5,50,000.
- (f) Depreciation (Accumulated)
Premises `1,10,000 Furniture `78,000.
- (g) 50% of term loans are secured by Government guarantees. 10% of cash credits are unsecured. Other portion is secured by tangible assets.

[Ans.: Profit transferred to R & S `53,200, B/s Total 2,58,822]

- (7) From the following Trial Balance of the HDFC Bank Ltd. prepare the Balance sheet and Profit and Loss Account, making all necessary provisions.

Particulars	
Current Deposits	4,55,00,000
Saving Bank Deposits	1,45,20,000

Accounting for Banking Company

Fixed and Time Deposits	3,71,80,000
Sundry Creditors Accounts	4,55,000
Debts due to banks, secured by investment	1,22,00,000
Rebate on Bills Discounted	15,000
Branch Adjustment (Cr.)	45,55,000
Reserve Fund	1,00,00,000
Dividend Equalisation Fund	25,00,000
Capital: 2,00,000 Shares of `100 each `50 per share paid	1,00,00,000
Interest and Discount Received	58,00,000
Exchange and Commission (Cr.)	17,00,000
General charges recovered	55,000
Profit and Loss A/c., Balance on 01/04/2008	8,52,000
Cash in hand	4,37,500
Cash with bank	68,69,500
Bills for Collection	2,21,00,000
Liability of Customer's acceptances	1,11,68,000
Investments in Government Securities	4,52,00,000
Investment in Shares	47,00,000
Interest accrued on investment	8,75,000
Loans	4,41,00,000
Furniture, Fixture and Equipment	5,00,000
Depreciation	5,00,000
Interest paid	12,00,000
Exchange and commission Paid	1,00,000
Salaries	24,00,000
Director's Fees	1,00,000
Stationery and Advertisement	4,00,000
Miscellaneous Expenses	3,00,000

Accounting for Banking Company

Land and Building	30,00,000
Bills Purchased and Discounted	3,31,00,000
Money at Call	15,00,000
Property acquired in satisfaction of claim	50,000

- (a) Current accounts include `85,00,000 debit balance, being overdrafts.
 (b) One of the accounts, of `95,000 is doubtful.
 (c) During the year property acquired in 2001 in satisfaction of defaulted debt of `25,000 was sold for `18,000. The amount of `18,000 was credited to the account, no further adjustment having been made yet.
 (d) Provision for taxation 10,00,000.
 (e) Transfer to Dividend Equalisation Fund 3,00,000.
 (f) Proposed dividend @ 10%.

[Ans.: Profit transfer R & S 7,14,400 B/s Total 14,88,25,000]

- (8) The following balances stood in the books of a Bank after preparation of its Profit and Loss Account.

Particulars	`
Share Capital:	
Issued and subscribed	60,00,000
Reserve fund	93,00,000
Fixed deposits	6,39,00,000
Savings bank deposits	2,85,00,000
Current accounts	3,48,00,000
Money at call and short notice	27,00,000
Investments	3,75,00,000
Profit and Loss Account (Cr.) 1st April 2005	20,25,000
Dividend for 2004-05	6,00,000
Premises	44,25,000
Cash in hand	5,70,000
Cash with RBI	1,50,00,000
Cash with other banks	90,00,000
Bills discounted and purchased	57,00,000
Loans, cash credits and overdrafts	7,65,00,000
Bills payable	1,05,000

Accounting for Banking Company

Unclaimed dividend	90,000
Rebate on bills discounted	75,000
Short loans (borrowing from other banks)	71,25,000
Furniture	17,46,000
Other assets	5,04,000
Net Profit for 2006	23,25,000

Prepare Balance Sheet of the bank as on 31st March 2006.

[Ans.: B/s Total 15,36,45,000]

- (9) The following figures were extracted from the books of City Bank Ltd., as on 31st March 2009.

Particulars	
Interest and discounted received	75,90,470
Interest paid on deposits	30,60,904
Issued and subscribed capital	30,00,000
Reserve u/s 17	4,00,000
Rent received	1,10,000
Profit on sale of investments	3,00,000
Salaries and Allowances	5,00,000
Directors fees and Allowances	60,000
Rent and Taxes paid	1,00,000
Postage and Telegrams	1,01,172
Depreciation on Bank properties	60,000
Printing and Stationary	1,00,000
Preliminary Expenses	30,000
Audit Fees	10,000
Commission, Exchange and Brokerage	3,00,000

Prepare Balance Sheet of the bank as on 31st March 2006.

[Ans.: P/L to B/s ₹16,20,394]

- (10) From the following information prepare a Balance Sheet of HSBC International Bank Ltd., as on 31st March, 2009 giving the relevant schedules.

(in lakh)

Accounting for Banking Company

Debit Balance		Credit Balance	
Current Accounts	42.00	Share Capital	
Cash Credits	1,218.15	19,80,000 shares of `15 each	297.00
Cash in Hand	240.22	Statutory Reserve	346.5
Cash with RBI	56.82	Net Profit before Appropriations	225
Cash with other Banks	233.8	Profit and Loss A/c	618
Money at Call	315.18	Fixed Deposit A/c's	775.5
Gold	82.86	Saving Deposit A/c's	675
Government Securities	165.25	Current A/c	780.18
Premises	233.55	Bills Payable	0.15
Furniture	105.18	Borrowings from other Banks	165.00
Term Loans	1,189.32		
	3,882.33		3,882.33

Additional Information:

Particulars	(`)
Bills for Collection	27,15,000
Acceptances and endorsements	21,18,000
Claims against the Bank not acknowledged as debt	82,500
Depreciation charges – Premises	1,65,000
Furniture	1,17,000

50% of the Term Loans are secured by Government guarantees. 10% of Cash Credits is unsecured. Also calculate Cash reserves required and statutory liquid reserves required. Cash reserve required 3% of demand and time liabilities, liquid reserves required 30% of demand and time liabilities.

(Oct. 2008)

- (11) From the following information, Prepare a Balance Sheet of Chak De India Bank Ltd. as on 31-03-2008 along with relevant schedules taking into account additional information.

Particulars	In Crores	
	Debit	Credit
Share Capital (Share of `10 each)		100
Statutory Reserve (Opening Balance)		70

Accounting for Banking Company

Capital Reserve		50
Security Premium		40
Profit / Loss Account (Opening Balance)		60
Net Profit before Appropriations		80
Demand Deposit		128
Savings Deposit		212
Term Deposit		160
Borrowings with Other Banks		32
Bills Payable		18
Inter Office Adjustments		8
Interest Accrual		26
Cash on Hand	62	
Cash with RBI	34	
Money at Call and Short Notice	82	
Term Loans	346	
Cash Credit	114	
Premises	112	
Furniture	18	
Gold	88	
Government Security	58	
Cash with Other Banks	70	
	984	984

Additional Information:

- (a) 60% of the term loan are secured by tangible assets. 40% of term loan are secured by Government Guarantee and 10% of cash credit is unsecured.
- (b) Bills for collection `28 Crores.
- (c) Acceptance and Endorsement `32 Crores.
- (d) Depreciation on premises `20 Crores and Furniture `2 Crores provided during the year.
- (e) Transfer 20% of current year profit to Statutory Reserve.
- (f) Also Calculate Cash Reserve required and Statutory Liquidity Reserve required.

Note: Cash Reserve required is 3% of Demand and Time Liability and Statutory Liquidity Reserve required is 30% of Demand and Time Liability.

Accounting for Banking Company

(May 2008)

(12) From the following information, prepare Profit / Loss Account of Apana Bank Ltd. for the year ended 31st March, 2008 alongwith necessary schedules

Items	`in thousand
Interest on Cash Credit	1,820
Interest on Overdraft	750
Interest on Term Loans	2,540
Income on Investments	840
Interest on Balance with RBI	150
Commission on remittances and transfer	75
Commission on letters of credit	118
Commission on Government Business	82
Profit on Sale of Land and building	27
Loss on Exchange Transactions	52
Interest paid on Deposits	1,726
Auditors Fees and Allowances	120
Directors Fees and Allowances	250
Advertisement	180
Salaries, Allowances and Bonus paid to Employees	1,240
Payment to Provided Fund	280
Printing and Stationery	140
Repairs and Maintenance	50
Postage, Telegrams, Telephones	80

Other Information:

The following adjustments have to be made:

(a) The above mentioned figure of Interest on Advances includes `2,020 thousands of interest on NPA out of which 750 thousands only has been received.

(b) Classification of Advances:

	% of Provision	`in Thousand
Standard	0.40%	3,000
Sub-Standard	10%	1,120
Doubtful assets not covered by security	100%	200



Accounting for Banking Company

Doubtful assets not covered by security for 1 year	20%	50
Loss Assets	100%	200

The necessary provisions against above mentioned advances to be made.

(a) Make provision for tax @ 30%.

(May 2008)

(13) From the following information prepares the Profit and Loss A/c of Trinity Bank Ltd. for the year ended 31st March 2006.

	(₹)
Interest on Loan	25,90,000
Interest on fixed Deposits	27,50,000
Rebate on Bills discounted	4, 90,000
Commission	82,000
Establishment Charges	5, 40,000
Discount on Bills Discounted (net)	14, 60,000
Interest on Cash Credits	22, 30,000
Interest in Current Account	4, 20,000
Rent Rates	1, 80,000
Interest on over draft	15, 40,000
Director's fess	30,000
Auditor's Fees	12,000
Interest on Saving Bank Deposits	6, 80,000
Postage and telegram	14,000
Printing and stationery	29,000
Sundry charges	17,000

Bad debts to be written off amounted to `4,00,000.

Provision for taxation may be made at 55% of net profit show your workings.

(14) From the following details, prepare the profit and loss account of Traveni Bank Ltd for the year ended 31st March 2007.

	(₹)
Interest paid on deposits, borrowings etc.	79,26,600
Interest and discount	1,83,74,725
Rentals received	78,000

(cxxx)

Accounting for Banking Company

Net profit on sale of investments	2, 27,000
Salary allowances, bonus and provident fund	97,79,925
Including Remuneration of the Chairman and Managing Director)	
Commission, brokerage and exchange	42, 00,000
Law charges	72,000
Rates and taxes	46,300
Postage and telegrams	3, 26,070
Audit fees	60,000
Directors fees	36,000
Printing and stationery	2, 92,000
Depreciation on Banks property	8, 20,000
Miscellaneous receipts	40,006
Miscellaneous expenditure	1, 65,406
Repairs to property	32,400
Telephones and stamps	4, 83,200
Advertisement	2, 76,000
Insurance and lighting	3, 45,000
Bad debts written off	72,700
Unexpired discount (1 st April.2006)	5, 70,000
Provision for bad debts (1 st April, 2006)	16, 10,000
Provision for taxation (1 st April, 2006)	24, 00,000

During the year Income- Tax proceeding of the previous years were concluded and the liability on this account worked out to `22,40,000.

The Bank has made an evolution at the end of the year of the recoverability of its advances and finds itself in the following position.

- (a) Unsecured advances to the extent of `60,000 would be fully irrecoverable.
- (b) Unsecured Loans to the extent of `40,00,000 would be doubtful of recovery to the extent of 40% and
- (c) Cash credit accounts to the extent of `25,00,000 have been left without the margin due to fall in the value of securities and the accounts to the extent of 10 5 are likely to become bad.

It is the bank's policy to provide fully against the contingency of bad debts.



Accounting for Banking Company

Provision for taxation to remain at 55% of the current profits.

Unexpired discount and interest on bills discounted as on 31st March, 2007 was ₹7,25,000.

(15) Following are some of the balance as on 31st March, 1998 of Vaibhav Bank Ltd.

(in '000)

	(₹)		(₹)
Interest on Advances	800	Statutory Reserves	900
Commission, Exchange and Breakage	200	Profit and loss Account (Cr)	650
Cash Balance	200	Bills Purchased and Discount	250
Balance with other Banks	400	Cash, Credit, Overdrafts and demand	1,425
Cash with RBI	100	Terms Loans	1,275
Profit Sale of Investments	20	Fixed Deposits	275
Other Revenue receipts	80	Savings Deposits	325
Share Capital	2,000	Currents Deposits	125
20% Investments in Govt. Securities		Premises (Net)	1,375
(purchased at 60% of Face Value)	300	Furniture	250
Other Securities @ 25% (purchased at per)	100	Interest (including paid 45)	120
Borrowing from Other Banks	300	Salary	75
Printing and Stationery	35	Bills Payable (Net)	25
Repairs	25	Postage and Telegram	20

The following additional information is furnished.

Have been classified as under with given details:

(in '000) Overdrafts

Cash Credits	Term Loans	Demand Loans
Standard Assets	1,000	975
Sub Standard Assets	?	?
Doubtful; up to one year	100	20
One to three years	120	50

Accounting for Banking Company

More than three years	50	80
Loss Assets	30	?

(a) Standard and sub standard assets in bills portfolio are in the ratio of 9:1.

(b) Term loan comprise loss assets which are half of its substandard.

(c) No provision has been made so far against these assets.

(d) Doubtful assets are secured to the extent of 50% of the dues.

(e) Bills for collection `235 (in thousands).

Prepare final accounts of Vaibhav Bank Limited.

(16) Prepare Profit and Loss Account for the year ended 31-3-99 and a Balance sheet Mini Bank Ltd as on date from following Trial Balance on 31st March 2008.

Debit	(₹)	Credit	(₹)
Unissued Capital	2,00,000	Authorised Capital	5,00,000
Uncalled Capital	1,50,000	(Equity Shares of `100 each)	
Interest paid on Deposits & Borrowings	48,500	Commission Exchanged & Brokerage	49,400
Loss on sale of investment	12,600	Profit on sale of gold	35,900
Provident Fund Contribution	9,200	Short Loans	2,20,000
Directors Fees	5,500	Reserve Fund (Invested Kerala Gov. Bonds)	80,000
Stationery & Printing	5,600	Investment Fluctuation Reserve	20,000
Auditors Fees	1,200	Current Accounts	5,00,000
General Expenses	2,700	Contingency Accounts	1,00,000
Owing by Foreign Correspondents	20,000	Profit and Loss A/c on 1-4-98	25,000
Overdrafts, Loans Cash Credits	3,80,000	Interest and Discount	1,70,000
Bank Premises	60,000	Saving Bank Deposits	3,55,000
Kerala Government Bond	80,000		
Government of India Securities	4,20,000		
Money at Call and Short Notice	70,000		
Bills Discounted	73,000		
Shares of other companies	17,000		

Accounting for Banking Company

Cash in hand and with RBI	1,10,000	
Cash at Banks	3,00,000	
Income Tax Paid	9,000	
Salaries and Allowances	73,500	
Interim Dividend Paid	7,500	
	20,55,300	20,55,300

Additional Information:

- (a) Interest accrued on Investments ₹750.
 - (b) Market Value of Investments in Government Securities was ₹4,75,000 and on crease corresponding fluctuation Reserve with necessary amount.
 - (c) The bills discounted metered at 20th May average date and all bills discounted at 10 % P. a.
 - (d) Premises added during the year ₹10,000 and provide 5% depreciation on Opening Balance.
 - (e) Provision for Taxation on 1-4-1998 stood at ₹15,000 which are to be increased to ₹28,000.
 - (f) Out of the loans and Advances ₹2,50,000 are secured and ₹1,00,000 are guaranteed by Government.
- (17) The following balance have been extracted from the books of Bharat Commercial Bank Ltd. as on 31st March 2008. Prepare the relevant Profit & Loss Account and Balance Sheet;

	(₹)		(₹)
Paid up Capital	10,00,000	Commission and Exchange	1,02,225
Profit and Loss Account (Cr)	40,323	Investment Reserve	35,000
Current A/c	34,12,604	Branch adjustment (Cr)	36,894
Fixed Deposit	38,95,554	Postage & Telegram	1,153
Saving Bank Deposits	25,68,000	Printing & Stationery	3,390
Directors fees	4,980	Rent, Taxes and premium	8,500
Auditors fees	1,000	Provident Fund contribution	10,000
Furniture (cost of ₹50,000)	37,280	Salaries	42,150
Interest and Discount	2,10,223	Unexpired Insurance	437
Stamps in hand	189	Reserve Fund	65,000
Land & Building (cost of ₹3,00,00)	2,05,000	Legal Expenses	1,650
Deposits with Reserve Bank of India	4,00,000	Cash in hand	4,16,324



Accounting for Banking Company

Book Debts, Cash and overdrafts	70,00,000	Deposits with other Banks	12,05,125
Contingency Reserve	50,000	Investments	8,78,125
		Bills Discounted	14,00,520
		Reserve Fund	2,00,000

The authorized Capital of the Bank is `20 Lakhs divided into 20,000 Shares of `100/- each. All shares have been subscribed but only half the face value has been called up. The Bank has accepted on behalf of consumer's bills worth `2 Lakhs against Securities of the value of `3 Lakhs ledged with the Bank. Depreciation is to be written off `8,000 from Land and Building and `3,500 from Furniture's. The Market value of investments on 31st March, 2008 was `8, 40,000 the Investments are to written down to this figure. Create provision for Taxation `1, 10,000.

(18) Following are of the balance as at 31st March, 2005 of Shibani Bank Ltd.

(in `000)

	(`)		(`)
Interest Advances	800	Statuary Reserves	900
Commission Exchange & Brokerage	200	Profit & Loss A/c (Cr)	650
Cash Balance	200	Bills Purchased & Discounted	250
Balance with other Banks	400	Cash Credit, Overdrafts & Demand Loans)	1,425
Cash with RBI	100	Terms Loan	1,275
Profit and Sale of Investments	20	Fixed Deposits	275
Other Revenue Receipts	80	Savings Deposits	325
Share Capital	2005	Currents Deposits	125
Investment in Govt Securities (Purchased at 60% of Face Value)	300	Premises (Net)	1,375
Other Securities @ 25% (Purchased at par)	100	Furniture	250
Borrowing from other Banks	300	Interest (incl. paid 45)	120
Printing & Stationary	35	Salary	35
Repairs	25	Bills Payable (Net)	25
Borrowings from RBI	100	Postage & Telegram	20

The following additional information is furnished.

(cxxxv)

Accounting for Banking Company

(a) Balances had been classified as under given details.

(`In '000)

Cash Credit	Overdrafts / Demand Loans	Terms Loans
Standard Assets	1000	975
Sub-standard Assets	?	100
Doubtful- Upto one Year	100	20
One to Three Years	120	50
More than Three Tears	50	80
Loss Assets	30	?

(b) Standard and sub standard assets in bills portfolio are in ratio of 9:1.

(c) Term Loans comprise loss assets which are half of its substandard.

(d) No provision has been made so far against these assets.

(e) Doubtful assets are secured to the extent of 50 % of the dues.

(f) 40% of the total interest on investments has been accrued.

(g) Bills for collection `235 (in thousands).

Prepare final accounts of Shibani Bank Ltd.

(19) From the following details, prepare Profit and Loss Account of Yes Bank Ltd, for the year ended 31/3/2006.

Particulars	`Lakhs
Interest on Loans	25.90
Interest on Fixed Deposits	27.50
Commission	0.82
Rebate on Bills Discounted	4.90
Salaries and Allowance	5.40
Discount on Bill Discounted (Net)	14.60
Interest on Cash Credit	22.30
Depreciation on Bank's property	4.00
Rent and Rates	1.80
Interest on Overdraft	15.40
Director's Fees	0.30
Audit Fees	0.50
Interest on Savings Deposits	6.80



Accounting for Banking Company

Postage	0.14
Printing and stationary	0.29
Sundry Expenses	0.15

Bad debts to be written off amounted to `3.80 lakhs. Provision for taxation may be made at 35%. Transfer 20% of profits to statutory reserve and provide `3 lakhs for dividends.

- (20) Prepare Profit and Loss account of Global Bank Ltd. for the year ended 31st March, 2006, from the following particulars:

Particulars	`Lakhs
Interest on Loans	34.90
Interest on Fixed Deposits	36.50
Rebate on Bills Discounted	4.80
Commission and Brokerage	9.10
Establishment Charges	15.50
Discount on Bills Discounted	19.40
Interest on Cash Credit	22.40
Interest on Current Accounts	1.20
Rent and Rates	1.80
Interest on Overdraft	12.80
Director's Fees	2.00
Audit Fees	2.20
Interest on Savings Deposits	6.90
Postage	1.50
Printing and stationary	3.90
Miscellaneous Expenses	1.80

Provision for taxation @ 35% of Net Profit.

- (21) From the following balance prepare Balance Sheet of Ravi-Kiran Bank Ltd. For the year ended 31st March, 2006:

Particulars	`Lakhs
Share Capital	20
Statutory Reserve	10

Accounting for Banking Company

Profit and Loss A/c (Balance)	04
Capital Reserve	02
Saving Deposits	29
Fixed Deposit	40
Other Deposits	42
Borrowing from RBI	24
Borrowing from Other Bank (Secured)	80
Bills Payables	03
Inter office Adjustment (Credit)	14
Cash in Hand	12
Cash with RBI	24
Money at call and Short Notice	36
Investment in Government Securities	28
Investment in Gold	20
Cash Credit	36
Overdrafts	30
Term Loans	60
Premises	25
Provision for Taxation	03

The Authorised Capital of the bank was `50 lakhs divided into 5 lakhs shares of `10 each. The bank has bills for collection to the extent of `12 lakhs.

(22) From the following information, prepare Balance Sheet of Century Bank Ltd. as on 31st March, 2006:

Dr.		Cr.	
Particulars	Amount (`in '000)	Particulars	Amount (`in '000)
Current Accounts	28	Share Capital	198
Cash Credits	812	Statutory Reserve	231
Cash in Hand	160	Profit for the year	150
Cash with RBI	37	Profit and Loss A/c	412

Accounting for Banking Company

Cash with Other Banks	155	Fixed Deposit	517
Money at Call & Short Notice	210	Saving Deposit	450
Gold	55	Current Account	520
Government Securities	110	Bills Payable	06
Premises	155	Borrowing from Other Bank	100
Furniture	70		
Term Loans	792		
	2,584		2,584

Additional Information:

- (a) Bill for Collection were `18.10 Lakhs.
 (b) Acceptances and Endorsement were `14.12 Lakhs.
 (c) Claims against the bank not acknowledged as debt were `5.5 Lakhs.

(23) Calculate the provision required to be made in respect of the following advance:

Term Loan	`40 Lakhs
ECGC Cover	30%
Security	`15 Lakhs (Realisable Value is 80%)

Period for which advance has remained doubtful = 2 years.

(24) From the following information, find out the amount of provisions required to be made in the profit and loss account of Laxmi Commercial Bank for the year ended 31/3/06

Advances	`Lakhs
Standard Asset	300
Sub-standard Asset	220
Doubtful Assets for:	
Up to one years	90
One to two years	60
Two to three years	40
More than 3 years	30
Loss Assets	60

(25) From the following info, calculate the provisions to be made against advances for NPA:
 (`Lakhs)

Particulars	Cash Credits & Overdrafts	Term Loans	Bills Purchased & Discounted
Standard Assets	100.00	97.50	22.50

Accounting for Banking Company

Sub-standard Assets	12.50	10.00	2.50
Doubtful Assets:			
Up to 1 Year	10.00	20.00	–
1 to 3 Years	12.00	50.00	–
More than 3 Years	5.00	80.00	–
Loss Assets	3.00	–	–
Total	142.50	257.50	25.00

Doubtful assets are secured to the extent of 50% of the amount due.

(26) The following is the Trial Balance of Mahanagar Bank Ltd. as on 31/3/2006.

(` Lakhs)

Particulars	Dr.	Cr.
Share Capital		3,000
Statutory Reserve		4,000
Fixed Deposits		2,780
Saving Deposits		4,500
Current Accounts		3,740
Cash in hand	290	
Cash with RBI	420	
Interest and Discount		3,000
Commission & Brokerage		500
Interest on Fixed Deposits	300	
Interest on Saving Deposits	200	
Interest on Current Deposits	125	
Salaries and Allowances	1,310	
Rent, Insurance	40	
Postage	90	
Printing and Stationery	700	
Audit Fees	40	
Depreciation	330	

Accounting for Banking Company

Investment in Shares	840	
Loans Cash Credit and Overdraft	10,900	
Bills discounted and Purchased	1,800	
Government Bonds	1,600	
Furniture	400	
Premises	300	
Branch Adjustments	1,835	
	21,520	21,520

Additional Information:

- (a) Rebate on bill discounted `270 Lakhs
- (b) Create reserve for doubtful debts `110 Lakhs
- (c) Acceptances on behalf of customers `800 Lakhs

You are required to prepare Profit and Loss Account for the year ended 31st March, 2006 and Balance Sheet as on that date.

(27) The following is the Trial Balance of Trimurti Bank Ltd. as on 31/3/2006.

(`Lakhs)

Particulars	Dr.	Cr.
Share Capital (`10 each)		500
Statutory Reserve		250
Loans Cash Credit and Overdraft	285	
Premises	60	
Government Securities	400	
Fixed Deposits		100
Saving Deposits		125
Current Deposits		50
Interest on Deposits	14	
Salaries and Allowances	28	
General Expenses	26	
Rent and Rates	04	
Director's Fees	02	
Profit and Loss Account		16

Accounting for Banking Company

Interest and Discount		128
Printing and Stationery	8	
Bills Purchased and Discounted	46	
Interim Dividend	17	
Investment in Shares	19	
Cash in hand	89	
Cash with RBI	103	
Money at call and Short notice	82	
Borrowings from Banks		14
	1,183	1,183

The following information is also available:

- (a) Authorized capital was 85,00,000 Equity Shares of `10 each
- (b) Unexpired discount amounted to `3.8 Lakhs
- (c) Endorsements on behalf of customers were `11.50 Lakhs prepare Profit and Loss Account for the year ended 31st March, 2006 and Balance Sheet as on that date.

(28) On 31st March, 2000, the following balances stood in the books of New Bank Ltd., after preparing Profit and Loss Account

Particulars	Amount	Particulars	Amount
Share Capital	35,00,000	Reserve Fund	24,50,000
Fixed Deposits	66,50,000	Saving Bank A/C	2,10,00,000
Current Accounts	5,60,00,000	Money at call & Short Notice	21,00,000
Investments	2,10,00,000	Profit and Loss A/C (Cr.)	14,70,000
Dividends for 1999	3,50,000	Land and Buildings	74,45,000
Cash in hand	4,20,000	Cash with RBI	1,05,00,000
Cash with Other Banks	91,00,000	Borrowings from Other Banks	44,00,000
Bills Discounted & Purchased	42,00,000	Sundry Creditors	2,10,000
Bills Payable	56,00,000	Unclaimed Dividends	2,10,000
Bills for Collection	9,80,000	Acceptances on behalf of Customers	14,00,000

Accounting for Banking Company

Net Profit for the year	16,80,000	Loans, Overdrafts and Cash Credits	4,90,00,000
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The net profit is after deducting provisions for Bad Debts `2,10,000, tax provision of `7,00,000 and Rebate on Bills Discounted `35,000. Prepare the Balance Sheet as at 31/3/2000.

(29) While closing the books of accounts of a bank were its advances classified as under:

Standard Assets	`16000 Lakhs
Sub-standard Assets	`1300 Lakhs
Doubtful Assets:	
Up to One Year	`700 Lakhs
One to Three Years	`400 Lakhs
More than 3 Years	`200 Lakhs
Loss Assets	`500 Lakhs

You are required to calculate the amount of provisions to be made by the bank.

(30) Calculate rebate on Bills Discounted as on 31/3/2006 from the following data and show the journal entry to be passed for this purpose:

Date of Bill	Amount `	Period	Rate of Discount
15/1/2006	2,50,000	5 Months	9%
10/2/2006	1,50,000	4 Months	9%
25/2/2006	2,00,000	4 Months	8%
20/3/2006	3,00,000	3 Months	8%

(31) Ascertain the provision required to be made in Profit and Loss Account of Dhanlaxmi Bank Ltd. as on 31st March, 2006

Assets	`Lakhs
Standard	74
Sub-standard	30
Doubtful for One Year	10
Doubtful for Four Year	10
Loss Assets	04

(32) The following information pertains to a cash credit account of Damodar Bank Ltd.

Assets	`Lakhs
Sanctioned Limit	50
Drawing Power	40
Minimum Outstanding Balance (1/10/2005 to 31/3/2006)	38
Interest Debited (1/10/2005 to 31/3/2006)	3

Accounting for Banking Company

Amount credited to the account during (1/10/2005 to 31/3/2006)	1
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(33) Calculate the provision required to be made in respect of an advance of a bank

Term Loan	₹30 Lakhs
ECGC Cover	30%
Security	₹10 Lakhs (Realisable Value 80%)
Period for which advance has remained doubtful	2.5 Years

(34) From following information prepare Balance Sheet of Suvarnyug Bank as on 31/3/2006
Dr. Cr.

	₹ (Lakhs)		₹ (Lakhs)
Cash Credit	1624	Share Capital	
Cash in hand	320	(₹10 each)	400
Cash with RBI	125	Statutory Reserve	230
Cash with Other Banks	310	Net profit for the year	450
Money at call & Short Notice	220	Profit and Loss A/C	410
Gold	110	Fixed Deposits	1434
Government Securities	220	Saving Deposits	900
Premises	310	Current Accounts	680
Furniture	140	Bills Payable	120
Term Loans	1692	Borrowings from Banks	603
Overdrafts	156		
Total	5227	Total	5227

Bills for collections ₹16.20 Lakhs Acceptances and Endorsements ₹14.80 Lakhs

(35) From the following information prepare the Profit and Loss Account of Jay Bank Ltd. for the year ended 31st March, 2006

Particulars	₹
Interest on Loans	25,90,000
Interest on Fixed Deposits	27,50,000
Rebate on Bills Discounted	4,90,000
Commission	82,000
Salaries and Allowances	5,40,000

Accounting for Banking Company

Discount on Bills Discounted (Net)	14,60,000
Interest on cash credit	22,30,000
Depreciation on Bank Property	4,20,000
Rent and Rates	1,80,000
Interest on Overdraft	15,40,000
Director's Fees	30,000
Auditor's Fees	12,000
Interest on saving Bank Deposits	6,80,000
Postage and Telegrams	14,000
Printing and Stationery	29,000
Sundry Charges	17,000

(36) Bad Debts to be written off amounted to `4,00,000. Provide for taxation at 35% of profit and transfer 20% of profit to Statutory Reserve and provide `3,00,000 for dividends

The following is the Trial Balance of Avishkar Bank Ltd. as on 31/3/2006

Particulars	Dr.	Cr.
Share Capital 30,000 Shares of `10 each		3,00,000
Statutory Reserve		4,00,000
Deposits:		
Fixed		2,78,000
Saving		4,50,000
Current		3,74,000
Cash in hand	2,90,000	
Cash with Reserve Bank of India	4,20,000	
Interest and Discount		3,00,000
Commission and Brokerage		50,000
Interest on Fixed Deposits	30,000	
Interest on Saving Deposits	20,000	
Interest on Current Deposits	12,000	
Salaries (Including `12,000 to Manager)	1,31,000	

Accounting for Banking Company

Rent, Insurance and Taxes	4,000	
Postage and Telegram	900	
Printing and Stationery	7,000	
Audit Fees	4,000	
Depreciation	3,100	
Investment in Shares	84,000	
Loans, Cash Credit and Overdraft	4,90,000	
Bills Discounted and Purchased	1,80,000	
Government Bonds	1,60,000	
Furniture	40,000	
Premises	3,00,000	
Branch Adjustment Account		24,000
Total	21,76,000	21,76,000

Additional Information:

- (a) Rebate on Bill Discounted `22,000
- (b) Create Reserve for Bad and Doubtful Debts `12,000
- (c) Acceptances on behalf of customers `1,80,000

You are required to prepare Profit and Loss Account for the year ended 31 March, 2006 and Balance Sheet as on that date

- (37) From the following Trial Balance as on 31st March 2006, prepare the Final Accounts of Janata Bank Ltd.

Dr.	Rs. (Lakhs)	Cr.	Rs. (Lakhs)
Cash Balance	200	Interest on Advances	800
Balance with Other bank	400	Interest from Investments	125
Cash with RBI	100	Commission, Exchange & Brokerage	200
Investment in Government Securities	300	Profit on sale of Investment	20
Other Approved Securities	100	Other Revenue Receipts	80
Bills Purchased and Discounted	250	Share Capital	2,000
		Statutory Reserve	900

Accounting for Banking Company

Cash Credits, OD & Demand Loans	1,425	Profit and loss Account	650
Term Loans	1,275	Fixed Deposits	275
Premises (Net)	1,375	Saving Deposits	325
Furniture	250	Current Account	125
Interest paid	120	Borrowing from Other Banks	300
Salary	75	Borrowing from RBI	100
Printing and Stationery	35	Bills Payable	25
Postage and Telegrams	20	Interest Accrued	75
Repairs	25		
Interest Accrued	50		
	6,000		6,000

Additional Information:

(a) Bills for collection as on the above mentioned date were `12,35,000.

(b) Make a provision of `400 Lakhs for NPA.

(38) Prepare Profit & loss A/C for the year ended 31/3/03 & a Balance Sheet of Mini Bank Ltd. as on that date from following Trial Balance on 31st March 2003

Dr.

Cr.

	` (Lakhs)		` (Lakhs)
Unissued Capital	2,00,000	Authorised Capital	5,00,000
Uncalled Capital	1,50,000	(Equity shares of `100 Each)	
Interest paid on deposits	48,500	Commission, Exchanged & Brokerage	49,400
Loss on sale of investment	12,600	Profit on sale of Gold	35,900
Stationery & Printing	5,600	Short Loans	2,20,000
Provident Fund contribution	9,200	Reserve Fund	
Directors Fees	5,500	(invested in Kerala Govt. Bonds)	80,000
Auditors Fees	1,200	Investment Fluctuation Reserve	20,000
General Expenses	2,700	Current Account	5,00,000
Owing by Foreign Correspondents	20,000	Contingency Account	1,00,000
Overdrafts, Loan, Cash credits	3,80,000	Profit & Loss A/C on 1/4/02	25,000

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Bank Premises	60,000	Interest & Discount	1,70,000
Kerala Government Bonds	80,000	Saving Bank Deposits	3,55,000
Government of India Securities	4,20,000		
Money at call & Short Notice	70,000		
Bills Discounted	73,000		
Shares of other Companies	17,000		
Cash in hand & with RBI	1,10,000		
Cash at Bank	3,00,000		
Advance Tax Paid	9,000		
Salaries & Allowances	73,500		
Interim Dividend Paid	7,500		
Total	20,55,300		20,55,300

Additional Information:

- (a) Interest Accrued on investments `750
- (b) Market Value of investments in Government Securities was `4,75,000
- (c) The bill discounted mature at 20th may average date & bills are discounted at 10% p.a.
- (d) Premises added during the year `10,000 & Provide 5% Depreciation on opening balance.
- (e) Provision fro Taxation on 1/4/02 stood at `15,000 which is to be increased to `28,000
- (f) Out of the Loans & advances `2,50,000 are secured & `1,00,000 are guaranteed by government.

(39) From the following information prepare Profit & Loss A/C of Apana Bank Ltd. for the year ended 31st March, 2008 along with necessary schedules:

Items	`in thousand
Interest on Cash Credit	1,820
Interest on Overdraft	750
Interest on term loans	2,540
Income on investments	840
Interest on Balance with RBI	150
Commission on remittances & transfer	75
Commission on Letter of Credit	118
Commission on Government Business	82
Profit on Sale of Land & Building	27

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Loss on Exchange Transactions	52
Interest Paid on deposits	1,726
Auditors Fees & Allowances	120
Directors Fees & Allowances	250
Advertisement	180
Salaries, Allowances & Bonus Paid to Employees	1,240
Payment to Provident fund	280
Printing & Stationery	140
Repairs & Maintenance	50
Postage, Telegrams, Telephones	80

Other Information:

The following adjustments have to be made:

- (a) The above mentioned figure of interest on Advance includes `2,020 thousands of interest on NPA out of which `750 thousands only has been received.
- (b) Classification of Advance:

Particulars	% of Provision	`in thousands
Standard	0.40%	3,000
Sub-Standard	10%	1,120
Doubtful assets not covered by Security	100%	200
Doubtful assets not covered by Security for 1 Year	20%	50
Loss Assets	100%	200

The necessary Provisions against above mentioned advance to be made.

(c) Make Provision for tax @ 30%.

- (40) Following figures have been obtained from the books of Money Bank Ltd. for the year ended 31st March, 2006.

Particulars	`in '000
Issued and Subscribed Capital	500
Interest and discount earned	1,900
Interest paid	1,000
Salaries and Wages	100
Directors Fees	15

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Rent and Taxes	50
Profit on sale of Investments	120
Loss on sale on Investments	20
Rent Received	40
Depreciation	10
Stationery	30
Auditor's Fees	5

Additional Information:

- (a) The P/L A/c had a balance of ₹5,00,000 on 1st April, 2005
- (b) An advance of ₹2,40,000 has become doubtful and it is expected that only ₹1,20,000 of the amount can be recovered from security.
- (c) The Provision for tax to be made of ₹3,40,000.
- (d) A dividend @ 10% is proposed. Also provide for dividend Tax @ 10% of the amount proposed to be distributed.
- (e) Every year bank transfer 20% of profit to Statutory Reserve. Prepare Profit & Loss Account for the year ended 31st March, 2006.

Chapter 2

Accounting for Insurance Company

INTRODUCTION:

The insurance industry has its roots in 17th Century London, England. There was a small coffee shop where ship owners would meet with wealthy merchants and for a small premium the ship and cargo would be insured. If the ship was lost, the merchant would recompenses the ship owner.

The industry has since developed and today is made up of a large number of buyers, intermediaries and sellers. Buyers include the Public, industry and commerce. The intermediaries include brokers, agents, Lloyd's brokers, and collecting representatives. Their role is matching the buyers with the sellers. The sellers include general insurance companies, Lloyds of London, re-insurance companies and the state. There is a complex organisation of relationships between all parties governed by local regulation, industry regulation and national laws. The end result is that risk is shared amongst players in the market. If a loss occurs collected premium cash flow and investment income is used to pay the insured.

Insurance is a financial service. It is pooling of risks. In a contract of insurance, the insurer undertakes in consideration of a sum of money to make good the loss suffered by the insured against a specified risk or any other contingency. There are two parties to an insurance contract, insurance company and the insured party. The document lying down the terms of the contract is called insurance policy. The property, which is insured, is the subject matter of insurance. It may be insured against loss

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arising from uncertain events in the form of destruction or damage to the property or death or disablement of a person. The interest, which the insured has in the subject matter of insurance, is known as insurable interest. Depending on the subject matter, the types of insurance are life insurance and general insurance, in case of life insurance a specified amount becomes payable on the death of the insured or upon the expiry of a specified period. General insurance covers losses caused by fire, accident and marine adventures.

MEANING OF INSURANCE:

Insurance provides financial protection against a loss arising out of happening of an uncertain event. A person can avail this protection by paying premium to an insurance company. A pool is created through contributions made by persons seeking to protect themselves from common risk. Premium is collected by insurance companies which also act as trustee to the pool. Any loss to the insured in case of happening of an uncertain event is paid out of this pool. Insurance works on the basic principle of risk-sharing. A great advantage of insurance is that it spreads the risk of a few people over a large group of people exposed to risk of similar type.

Definition:

Insurance is a contract between two parties whereby one party agrees to undertake the risk of another in exchange for consideration known as premium and promises to pay a fixed sum of money to the other party on happening of an uncertain event (death) or after the expiry of a certain period in case of life insurance or to indemnify the other party on happening of an uncertain event in case of general insurance. The party bearing the risk is known as the 'insurer' or 'assurer' and the party whose risk is covered is known as the 'insured' or 'assured'.

Concept of Insurance / How Insurance works?

The concept behind insurance is that a group of people exposed to similar risk come together and make contributions towards formation of a pool of funds. In case a person actually suffers a loss on account of such risk, he is compensated out of the same pool of funds. Contribution to the pool is made by a group of people sharing common risks and collected by the insurance companies in the form of premiums.

Lets take some examples to understand how insurance actually works:

Example 1	Example 2
<p>Suppose</p> <ul style="list-style-type: none"> • Houses in a village = 1000 • Value of 1 House = `40,000 • Houses burning in a year = 5 • Total annual loss due to fire = `2,00,000 • Contribution of each house owner = `300 	<p>Suppose</p> <ul style="list-style-type: none"> • Number of Persons = 5000 • Age and Physical condition = 50 years & Healthy • Number of persons dying in a year = 50 • Economic value of loss suffered by family of each dying person = `1,00,000 • Total annual loss due to deaths = `50,00,000 • Contribution per person = `1,200
<p>Underlying Assumption: All 1000 house owners are exposed to a common risk, i.e. fire</p>	<p>Underlying Assumption: All 5000 persons are exposed to common risk, i.e. death</p>
<p>Procedure:</p>	<p>Procedure:</p>
<p>All owners contribute `300 each as premium to the pool of funds.</p> <p style="text-align: center;">↓</p> <p>Total value of the fund = `3,00,000 (i.e. 1000 houses × `300)</p> <p style="text-align: center;">↓</p> <p>5 houses get burnt during the year</p> <p style="text-align: center;">↓</p> <p>Insurance company pays `40,000 out of the pool to all 5 house owners whose house got burnt</p>	<p>Everybody contributes `1200 each as premium to the pool of funds.</p> <p style="text-align: center;">↓</p> <p>Total value of the fund = `60,00,000 (i.e. 5000 persons × `1,200)</p> <p style="text-align: center;">↓</p> <p>50 persons die in a year on an average</p> <p style="text-align: center;">↓</p> <p>Insurance company pays `1,00,000 out of the pool to the family members of all 50 persons dying in a year</p>

<p>Effect of Insurance:</p> <p>Risk of 5 house owners is spread over 1000 house owners in the village, thus reducing the burden on any one of the owners.</p>	<p>Effect of Insurance:</p> <p>Risk of 50 persons is spread over 5000 people, thus reducing the burden on any one person.</p>
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THE INSURANCE INDUSTRY – AN OVERVIEW:

It has been consistently observed that the insurance industry is always low in the esteem of its customers, down there battling for last place with the likes of automobile sales and lawyers. The main reason is that insurance is one product no one really wants to buy; there is no instant benefit or return. Every one hope that they won't need it, but realise it would be foolhardy to accept a large loss for the sake of not paying a small premium.

Times in the world marketplace have been tough recently for insurers, the market has been soft and premiums have been low. This is a result of excess capacity and competition. Financial sectors are witnessing a process of convergence in the delivery of financial products, new technologies are appearing and regulations are changing.

TYPES OF INSURANCE COMPANIES:

Insurance companies may be classified as:

- (1) **Life Insurance Companies**, which sell life insurance, annuities and pensions products.
- (2) **Non-Life or General Insurance Companies**, which sell other types of insurance like Fire Insurance, Marine Insurance, Health Insurance, Automobile Insurance, Aviation Insurance, Miscellaneous Insurance etc.

In most countries, life and non-life insurers are subject to different regulatory regimes and different tax and accounting rules. The main reason for the distinction between the two types of company is that life, annuity, and pension business is very long-term in nature — coverage for life assurance or a pension can cover risks over many decades. By contrast, non-life insurance cover usually covers a shorter period, such as one year.



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Mutual Insurance Companies and stock insurance companies are different forms of organized risk sharing: policyholders and owners are two distinct groups in a stock insurer, while they are one and the same in a mutual. Mutual companies are owned by the policyholders, while stockholders (who may or may not own policies) own stock insurance companies. This distinction is relevant to raising capital, selling policies, and sharing risk in the presence of financial distress. Up-front capital is necessary for a stock insurer to offer insurance at a fair premium, but not for a mutual. In the presence of an owner-manager conflict, holding capital is costly. Free-rider and commitment problems limit the degree of capitalization that a stock insurer can obtain. The mutual form, by tying sales of policies to the provision of capital, can overcome these problems at the potential cost of less diversified owners.

Reinsurance Companies are insurance companies that sell policies to other insurance companies, allowing them to reduce their risks and protect themselves from very large losses. A few very large companies, with huge reserves, dominate the reinsurance market. A reinsurer may also be a direct writer of insurance risks as well.

Captive Insurance Companies may be defined as limited-purpose insurance companies established with the specific objective of financing risks emanating from their parent group or groups. This definition can sometimes be extended to include some of the risks of the parent company's customers. In short, it is an in-house self-insurance vehicle. Captives may take the form of a "pure" entity (which is a 100% subsidiary of the self-insured parent company); of a "mutual" captive (which insures the collective risks of members of an industry); and of an "association" captive (which self-insures individual risks of the members of a professional, commercial or industrial association).

GOVERNMENT POLICY:

The Insurance sector in India governed by Insurance Act, 1938, the Life Insurance Corporation Act, 1956, General Insurance Business (Nationalisation) Act, 1972, Insurance Regulatory and Development Authority (IRDA) Act, 1999 and other related acts.

The Insurance Act, 1938:

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The Insurance Act, 1938 was the first legislation governing all forms of insurance to provide strict state control over insurance business.

Life Insurance Corporation Act, 1956:

Even though the first legislation was enacted in 1938, it was only in 19th of January, 1956, that life insurance in India was completely nationalized, through the Life Insurance Corporation Act, 1956. There were 245 insurance companies of both Indian and foreign origin in 1956. Nationalization was accomplished by the govt. acquisition of the management of the companies. The Life Insurance Corporation of India was created on 1st September, 1956, as a result and has grown to be the largest insurance company in India as of 2006.

General Insurance Business (Nationalisation) Act, 1972:

The General Insurance Business (Nationalisation) Act, 1972 was enacted to nationalise the 100 odd general insurance companies and subsequently merging them into four companies. All the companies were amalgamated into National Insurance, New India Assurance, Oriental Insurance, United India Insurance which were headquartered in each of the four metropolitan cities Calcutta, Bombay, New Delhi and Madras, respectively.

Insurance Regulatory and Development Authority (IRDA) Act, 1999:

Till 1999, there were not any private insurance companies in the Indian insurance sector. The Govt. of India, then introduced the Insurance Regulatory and Development Authority Act in 1999, thereby de-regulating the insurance sector and allowing private companies into the insurance. Further, foreign investment was also allowed and capped at 26% holding in the Indian insurance.

Note: In this chapter we will study about general insurances i.e., fire, marine, etc.

SOME IMPORTANT INSURANCE TERMS:

Premium:

The payment made by the insured, as consideration for the grant of the insurance is known as Premium. The premium may be payable annually or at shorter intervals of time & may be payable throughout the

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period of the policy or only for a fixed term, depending upon the conditions in the policy.

Premium Earned & Premium Written:

Premium earned is the amount of premiums earned by the risk covered by an insurer during a period.

Premium written is the amount customers are required to pay for policies written during the year.

The two differ because of the timing of premium payments.

For example if:

- An insurance policy that runs from the 1st July 2008 to the 30th June 2009.
- The premium is `10,000.
- The insurance company has a December year-end.

Then, as the policy runs for six months of this year and six months of next, half the risk is taken in the current year and half next year.

Therefore the premium earned is `5,000 for 2008 and `5,000 for 2009.

However as the cover is agreed during 2008, the gross premium written is `10,000 for 2008.

Claims:

A claim occurs when a policy falls due for payment. In case of life insurance business, it will arise either on death or on maturity of policy i.e. on the expiry of the specified term of years. In case of general insurance business, a claim arises only when the loss occurs or the liability arises.

Premium Deficiency:

Premium deficiency is recognised if the ultimate amount of expected net claim costs, related expenses and maintenance costs exceeds the sum of related premium carried forward to the subsequent accounting period as the reserve for unexpired risk. Premium deficiency is calculated by line of business. The Company considers maintenance costs as relevant costs incurred for ensuring claim handling operations.

Catastrophe Reserve or Unexpired Risks Reserve:

The need for unexpired risks reserve arises from the fact that all policies are renewed annually except in specific cases where short period

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policies are issued. Since the insurers close their accounts on a particular date, i.e. 31st December, not all risks under policies expire on that date. Many policies normally extend beyond this date into the following year during which risks continue. In other words, at the closing date, there is unexpired liability under various policies, which may occur during the remaining term of the policy beyond the year end. The effort involved in calculating unexpired portion of premium under each policy is very time consuming. Therefore, a simple formula to derive a percentage of premium income to be allocated to reserve for unexpired risks is adopted.

According to the requirements of the Insurance Act, it is sufficient if the provision is made for unexpired risks at 50 per cent for Fire, Marine Cargo and Miscellaneous business except for Marine Hull which has to be 100 per cent. It may be mentioned that the insurance companies are governed by the provisions of Section 44 of the Income-tax Act, 1961. In this regard, Rule 5 of the First Schedule to the Income-tax Rules—computation of Profit & Loss of General insurance Business—provides for creation of a reserve for unexpired risks as prescribed under Rule 6E of the said Rules. According to this Rule, the insurance companies are allowed a deduction of 50 per cent of net premium income in respect of Fire and Miscellaneous Business and 100 per cent of the net premium income relating to Marine insurance business. In view of this the reserves are created at the rates allowed under the Income-tax Act.

Fair Value Change:

Fair Value Change account represents unrealised gains or losses in respect of investments outstanding at the close of the year. The balance in the account is considered as component of shareholders' funds though not available for distribution as dividend.

Claims incurred:

Claims incurred shall comprise claims paid, specific claims settlement cost wherever applicable & change in the outstanding provision for claims at the year-end.

Diminution in the value of investments:

Diminution in the value of investments is the reduction in value of investments.

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Annuity:

A recurring payment, which may be constant or may increase, usually made until the death of the person receiving the annuity. An annuity can also be paid to 2 people. In this case, the payment ceases on death of second person.

Annuity Certain:

Annuity, which makes payments for a specified period of time regardless of whether the annuitant is alive or dead during that period.

Policyholder's Surplus:

The amount by which an insurance company's assets exceed its liabilities, as reported in its annual statement. For a stock insurer, the policyholder's surplus is the sum of its capital & surplus; for a mutual insurer, the policyholder's surplus equals the company's surplus.

Shareholders' and Policyholders' Fund:

The Shareholders' Fund comprises of Share Capital, General Reserve and Capital Reserve. The Policyholders' Fund comprises of Technical Reserves and Provision for Outstanding Claims.

Ceded Reinsurance:

The amount of insurance transferred from a ceding insurer to a reinsurer.

Ceding Insurer:

An original or primary insurer that purchases reinsurance; in so doing, the primary insurer cedes part of its business to the reinsurer.

Reinsurance:

Reinsurance plays an- important role in the insurance business of virtually every type. The service provided by re-insurer is similar to that provided by the insurance companies to their policy holders. In general insurance there are risks which, because of their magnitude or nature, one insurance company cannot afford to cover, e.g., aviation insurance. Generally, in such cases, an insurance company insures the whole risk itself and lays off the amount it has accepted to other insurance of reinsurance companies, retaining only that much risk which it can absorb.

A reinsurance transaction may thus be defined as an agreement between a 'ceding company' and a 're-insurer' whereby the former

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agrees to 'cede' and the latter agrees to accept a certain specified share of risk or liability upon terms as set out in the agreement.

A 'ceding company' is the original insurance company which has accepted the risk and has agreed to 'cede' or pass on that risk to another insurance company or a reinsurance company. It may however be emphasized that the original insured does not acquire any right under a reinsurance contract. In the event of loss, therefore, the insured's claim for full amount is against the original insurer.

Since reinsurance is a form of insurance, the principles of insurance business such as 'utmost good faith', 'insurable interest' and 'indemnity' equally apply to reinsurance contracts also.

Broadly-speaking, there are two types of reinsurance contracts, namely, Facultative Reinsurance and Treaty Reinsurance. These are discussed in brief in the subsequent paragraphs.

Facultative Reinsurance - It is that type of reinsurance whereby the contract relates to one particular risk and is expressed in a reinsurance policy. This is the oldest method of reinsurance and it necessitates consideration of each risk separately. Each transaction under Facultative Reinsurance has to be negotiated individually and each party to the transaction has a free choice, i.e. for the ceding company to offer and the reinsurer to accept. The main drawbacks of this type of insurance is the volume of work involved and time taken to cover the risk.

Treaty Insurance:

Under this type of reinsurance a Treaty agreement is entered into between ceding company and the re-insurer(s) whereby the reinsurances are within the limits of the Treaty. These limits can be monetary, geographical, section of business, etc. Under this contract it is obligatory for the re-insurer to accept all risks within the scope of this Treaty and it is obligatory for the ceding company to cede risks in accordance with the terms of the Treaty.

Retrocession:

A reinsurance of reinsurance. Example: Company "B" has accepted reinsurance from Company "A", and then obtains for itself, on such business assumed, reinsurance from Company "C". This secondary reinsurance is called a Retrocession. The transaction whereby a reinsurer

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cedes to another reinsurer all or part of the reinsurance it has previously assumed.

Until 1999, insurance services were provided in India by two monopolistic public sector organizations namely, Life Insurance Corporation of India and General Insurance Corporation of India. In order to provide better insurance cover to citizens and also to annulment the flow of long-term sources of financing infrastructure the government opened up the insurance sector and also set up a statutory Insurance Regulatory and Development Authority in 1999.

The Insurance act provides the broad framework for the insurance sector in the country. Any class of insurance business in India can be carried out only by:

- (i) A public limited company.
- (ii) A cooperative society.
- (iii) An insurance cooperative company society.

Having paid up capital of Rs 100 crores in which no body corporate holds more than 26 per cent of its paid up capital and whose sole purpose is to carry on insurance business in India. Thus, only Indian Insurance companies are permitted to carry out any class of insurance business after the commencement of IRDA Act 1999. An Indian Insurance Company is defined as a company formed/registered under the Companies Act.

Life insurance business in India can now be carried on only by the Life Insurance Corporation of India – a public corporation set up by the Government in 1956. The various provisions of the Insurance Act of 1938 regarding final accounts continue to apply to the Corporation. The chief peculiarity of the life insurance business is that the life insurance contracts are for a long term and that, on a particular date, the future implications of a contract must be considered before profit can be ascertained. Under an annuity contract, the life insurance office does not receive any amount after the initial payment but has to go paying till the annuitant dies. On a particular date, therefore there is a liability because against a policy, the premiums expected to be received in future will generally be much less than the amount payable by the way of the claim. Suppose, A takes out a policy for Rs 10,000 on 5th July, 1978 for twenty

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years, the premium being Rs 500 per annum. On 31st March, 1994, the life insurance company is faced with the position that only four premiums (in 1994-95, 1995-96, 1996-97, 1997-98) can be expected, amounting in all to `2,000. The company will have to pay `10,000 latest, on 5th July, 1999. There is a gap of `8,000. In terms of 31st March, 1994 the gap is slightly less because of interest. The possibility of A's death must be kept in mind because death means stoppage of payment of premium and hastening the payment of claim leading to loss of interest. The chief point to remember is that in respect of policies already issued and still in force, there is a deficiency of claims that are expected to arise over premiums that are expected to be received. This deficiency is known as "net liability". A company cannot be said to made profits unless it has reserves equal to he net liability. The calculation is made only by actuaries, mathematicians well versed in the intricacies of life insurance. Previously, the calculation was made every three years. The Life Insurance Corporation of India gets the calculations made valuation, as it is called every two years. It means that the Life Insurance Corporations cannot find out what profit it has made every alternate year. This must be remembered while preparing the revenue account.

Accounting for Claims:

Claims are one of the main items of expenditure for an insurance company. It is the amount payable by an insurer to the insured when the policy becomes due for payment. In respect of life insurance business, the policy becomes due for payment on the death of the insured or maturity of the policy, whichever is earlier. In case of general insurance business, the amount becomes payable when the contingency for which insurance has been done occurs.

As claims are expenditure items for the insurance company, it is shown on the debit side of the revenue account. When calculating the total claim amount during the accounting period, one has to take into account not the claims paid during the year but the total amount of claims due for payment during the period.

Claims due for payment include claims intimated and accepted but not paid and claims intimated but not accepted and paid. These claims

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are due for payment and therefore are to be treated as outstanding claims. The entry for this is

Claims Account (Amount payable on the claims)	Dr.	xx	
To Claims intimated and accepted but not paid Account			xx
To Claims intimated but not accepted and paid account			xx

Premium:

Premium is the amount charged by the insurer for providing the insurance cover. In case of life insurer, the premium income is to be recognized when it is due from the policyholders. In case of general insurer, the premium shall be recognized as **income** over the contract period or the period of risk, whichever is appropriate. Unearned premium as well as premium received in advance, both of which represent the premium income not relating to the current accounting period, shall be disclosed separately in the financial statements.

Premium received in advance, which represents the premium received prior to the commencement of the risk shall be shown under the head '**Current Liabilities**' in the financial statements.

In case of general insurance business, revenue recognition for the premium income is based on the pattern of risk to which the insurer is exposed. An insurer based on past experience can reliably estimate the pattern of risk for a particular type of insurance business. Most insurers bring the premium revenue to account on the basis of the passage of time. This is generally appropriate where the risk of events occurring and giving rise to claims is more or less uniform throughout the policy period subject to any regulatory prescription in this regard.

For some classes of insurance, it is usual for the premium to be adjusted as a result of events and information that become known during or after the policy period, for example, marine cargo. Further, in some cases, risk pattern may not be evenly spread over the period of insurance because of the very nature of the risk covered for example, some infrastructure projects involving varying degrees of risk factors. A deposit premium is paid in such cases at the beginning of the policy period and subsequently adjusted. The basis of determination of premium earned shall be adequately justified, preferably supported by external evidence such as by certification from an actuary and/or other technical experts.

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Adequate disclosure about the basis of determination of premium has to be made.

Unearned Premium:

Unearned premium is the premium that is received by the insurance company for future coverage. For example, a one year policy is having `12,000 as premium. At the end of the first month, one twelfth of the premium or `1,000 has been earned. The remaining `11,000 is an unearned premium. Unearned premium is a liability for the company till it is earned and is recorded as unearned premium reserve. Unearned premium reserve is that part of the premium written which is attributable and to be allocated to the succeeding accounting periods. Unearned premium shall be shown separately under the head '**Current Liabilities**' and appropriate disclosures regarding the management's basis of assessment shall be made in the financial statements. Premium received in advance shall not be included in the unearned premium and shall be shown separately.

Premium Deficiency:

If the sum of the expected claims costs, related expenses and maintenance costs exceed the related unearned premiums, then it is to be recognized as premium deficiency.

Bonus:

Sometimes in life insurance business, policyholders are given the right to participate in the profits of the business. Life Insurance Corporation of India distributes 95% of its profits from life insurance business by means of bonus. Bonus is paid to the policyholders in different manners.

- (a) **Bonus in Cash:** In this, the bonus is paid in cash upon declaration.
- (b) **Reversionary Bonus:** Reversionary bonus is paid on maturity of the policy along with the policy amount.
- (c) **Bonus in Reduction of Premium:** Bonus can also be distributed by reduction in the future premiums payable by the policyholders. The entry for such adjustment is

Bonus in Reduction of Premium A/c Dr.

xx

(With the bonus amount adjusted)

To Premium A/c

xx

WHAT IS GENERAL INSURANCE?

Insurance other than 'Life Insurance' falls under the category of General Insurance. General Insurance comprises of insurance of property against fire, burglary etc, personal insurance such as Accident and Health Insurance, and liability insurance which covers legal liabilities. There are also other covers such as Errors and Omissions insurance for professionals, credit insurance etc.

Non-life insurance companies have products that cover property against Fire and allied perils, flood storm and inundation, earthquake and so on. There are products that cover property against burglary, theft etc. The non-life companies also offer policies covering machinery against breakdown, there are policies that cover the hull of ships and so on. A Marine Cargo policy covers goods in transit including by sea, air and road. Further, insurance of motor vehicles against damages and theft forms a major chunk of non-life insurance business.

In respect of insurance of property, it is important that the cover is taken for the actual value of the property to avoid being imposed a penalty should there be a claim. Where a property is undervalued for the purposes of insurance, the insured will have to bear a rateable proportion of the loss. For instance if the value of a property is `100 and it is insured for `50, in the event of a loss to the extent of say `50, the maximum claim amount payable would be `25 (50% of the loss being borne by the insured for underinsuring the property by 50%). This concept is quite often not understood by most insureds.

Personal insurance covers include policies for Accident, Health etc. Products offering Personal Accident cover are benefit policies. Health insurance covers offered by non-life insurers are mainly hospitalization covers either on reimbursement or cashless basis. The cashless service is offered through Third Party Administrators who have arrangements with various service providers, i.e., hospitals. The Third Party Administrators also provide service for reimbursement claims. Sometimes the insurers themselves process reimbursement claims.

Accident and health insurance policies are available for individuals as well as groups. A group could be a group of employees of an organization

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or holders of credit cards or deposit holders in a bank etc. Normally when a group is covered, insurers offer group discounts.

Liability insurance covers such as Motor Third Party Liability Insurance, Workmen's Compensation Policy etc offer cover against legal liabilities that may arise under the respective statutes— Motor Vehicles Act, The Workmen's Compensation Act etc. Some of the covers such as the foregoing (Motor Third Party and Workmen's Compensation policy) are compulsory by statute. Liability Insurance not compulsory by statute is also gaining popularity these days. Many industries insure against Public liability. There are liability covers available for Products as well.

There are general insurance products that are in the nature of package policies offering a combination of the covers mentioned above. For instance, there are package policies available for householders, shop keepers and also for professionals such as doctors, chartered accountants etc. Apart from offering standard covers, insurers also offer customized or tailor-made ones.

Suitable general Insurance covers are necessary for every family. It is important to protect one's property, which one might have acquired from one's hard earned income. A loss or damage to one's property can leave one shattered. Losses created by catastrophes such as the tsunami, earthquakes, cyclones etc have left many homeless and penniless. Such losses can be devastating but insurance could help mitigate them. Property can be covered, so also the people against Personal Accident. A Health Insurance policy can provide financial relief to a person undergoing medical treatment whether due to a disease or an injury.

Industries also need to protect themselves by obtaining insurance covers to protect their building, machinery, stocks etc. They need to cover their liabilities as well. Financiers insist on insurance. So, most industries or businesses that are financed by banks and other institutions do obtain covers. But are they obtaining the right covers? And are they insuring adequately are questions that need to be given some thought. Also organizations or industries that are self-financed should ensure that they are protected by insurance.

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Most general insurance covers are annual contracts. However, there are few products that are long-term.

It is important for proposers to read and understand the terms and conditions of a policy before they enter into an insurance contract. The proposal form needs to be filled in completely and correctly by a proposer to ensure that the cover is adequate and the right one.

VARIOUS TYPES OF GENERAL INSURANCE:

The general insurance business in India is governed by the Insurance Act, 1938 which is based on the British Insurance Act. The Act was amended in 1969 for 'social control' to govern the general insurance business on healthy lines. However, it was felt that there still existed some scope for improvement. In view of this, on May 13, 1971 the government nationalised the general insurance industry by an ordinance which became the General Insurance 1 (Nationalisation) Act, 1972. At that time there were 63 domestic insurance companies and 44 foreign insurance companies operating in India. The managements of all the 107 companies were taken over by the Government and accordingly the General Insurance Corporation (QIC) was formed as a government company in November 1972. The QIC as the holding company is entrusted with the task of superintending, controlling and carrying on the general insurance business in the country. Its subsidiaries in all the four zones of the country viz., the Oriental Fire & General Insurance Company (now known as the Oriental Insurance Co. Ltd.), the National Insurance Company Ltd., the New India Assurance Company Ltd. and the United India Insurances Company do all classes of direct business of general insurance except aviation which is done by the QIC.

FIRE INSURANCE:

A fire insurance contract may be defined as an agreement whereby one party, for a consideration, undertakes to indemnify the other party upto an agreed amount against financial loss of goods or property which the latter may suffer because of fire. Fire insurance thus covers the risk of loss of property by accidental and non-intentional fire.

Types of Fire Policies:

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- (1) **Valued policy:** A policy in which the value of the property is ascertained and/or agreed upon which the insurer undertakes to pay in the event of destruction of goods/property by fire is known as valued policy. This type of policy is not very common these days.
- (2) **Specific policy:** It is a policy which insures a risk for a specific amount. In case of any loss under this policy, the insurer pays whole loss provided it is not more than the sum specified in the policy. Thus, the value of the goods/property is not considered for this purpose.
- (3) **Average policy:** An average policy contains the 'average clause' which lays down that if the property is under-insured, i.e. insured for a sum smaller than the value of the property, the insurer will bear only that proportion of the actual loss which the sum assured bears to the actual value of the property at the time of loss.
- (4) **Floating policy:** It is the policy which covers several types of goods lying at different locations under one amount and for one premium. The premium normally charged under this policy is the average of the premia that would have been paid if each lot of the goods had been insured under specific policies for specific sums.
- (5) **Excess policy:** Where the stocks of the insured fluctuate he may take out a policy for the amount below which his stocks normally do not fall and another policy to cover the maximum amount of stocks which may be reached at times. The former type of policy is known as the First Loss Policy and the latter as the Excess Policy.
- (6) **Blanket policy:** A blanket policy is that which covers all assets - fixed as well as current under one policy.
- (7) **Comprehensive policy:** A policy which covers risks such as fire, flood, riots, strikes, burglary etc. upto a certain specified amount is known as the comprehensive policy.
- (8) **Consequential loss policy:** The objective of this policy is to indemnify the insured against the loss or profit caused by any interruption of business due to fire. It is also known as Loss of Profit Policy.
- (9) **Re-instatement policy:** It is a policy under which the insurer pays the amount which is sufficient to re-instate assets or property destroyed.

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(10) Open declaration policy: It is a policy whereby the insured makes a deposit with the insurer and declares the value of the subject matter in respect of which risk is covered.

Such policies are normally taken where the value of stocks etc. fluctuates considerably.

MARINE INSURANCE:

Marine insurance is perhaps the oldest type of insurance. Under a contract of marine insurance, the insurance company or the underwriter agrees to indemnify the owner of a ship or cargo against risks which are incidental to marine adventure such as sinking or burning of the ship and its contents, stranding of the ship, collision of ship, Jettison, i.e., throwing overboard the cargo into the sea to save the ship from sinking or some other imminent danger, barratry, i.e., wrongful act of the captain of the ship in destroying or stealing the vessel or cargo causing loss to owners.

Types of Marine Insurance:

The common types of marine insurance are as follows:

- (1) Cargo insurance:** This type of marine insurance covers risks to the cargo on the ship. The cargo on the ship is exposed to risks arising from an act of God, enemies, fire etc.
- (2) Hull insurance:** The ship is also exposed to the perils described in above. Therefore, the owner of the ship may effect 'hull' insurance to cover such perils.
- (3) Freight insurance:** Where the owner of goods promises or undertakes to pay the freight when the cargo is safely delivered at the port of destination and the cargo is destroyed on the way, the shipping company would lose the freight. The shipping company can cover this risk by taking out a freight insurance policy.

The persons who insure cargo, hull or freight are known as underwriters because they write their name and sign at the foot of the policy. Originally, only individuals used to underwrite the policies in their own names. Later associations were formed for this purpose, the pioneer being the Lloyd's Association which was formed in 1774. In the year 1779, the Association adopted a definite policy known as the "Lloyd's policy" which is in use even now.

Types of Marine Losses:

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Marine losses may be broadly of two types - (/) Total loss, and (//) Partial loss which are discussed below:

- (1) **Total Loss:** When the subject matter of insurance, i.e., cargo, ship, freight etc. is totally lost, it is known as a 'total loss'. Total loss is also of two types:
 - (a) **Actual Total Loss:** When the subject-matter of insurance is absolutely destroyed or totally lost to the insured, it is known as actual total loss.
 - (b) **Constructive Total Loss:** When the subject matter is not actually totally lost but is lost for all practical purposes e.g., where the ship or cargo is reasonably abandoned and taken as lost or expenses to be incurred for saving the cargo or the ship are expected to be more than the value thereof, it is known as constructive total loss.
- (2) **Partial Loss:** When only a part of the subject matter is lost, it is known as partial loss. This loss may also be of two types as discussed below:
 - (a) **General Average Loss:** Such a loss is caused by extraordinary voluntary sacrifice made or expenditure incurred with the objective of protecting the interests of all owners in a voyage. An example of this type of loss is when the ship has run aground and part of the cargo is to be jettisoned to lighten the ship to save it as well as the cargo from total loss.
 - (b) **Particular Average Loss:** It is a partial loss of the subject matter of insurance caused by a peril against which it is insured but which is not a general average loss.

Types of Marine Insurance Policies:

Generally a standard form for all policies is used for all marine insurance policies to cover various types of risks. However, differing needs of the insured have led to the evolution of a variety of marine insurance policies, the main among which are:

- (1) **Time policy:** It is that policy which covers the risk of the subject matter for a specified period of time. It is generally used for hull insurance though it can be taken out also for cargo.
- (2) **Voyage policy:** This is a policy whereby the subject matter in transit is insured from one place to another. It is generally carried out for cargo which is exposed to marine risks in transit.

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- (3) **Mixed policy:** This is also known as time and voyage policy as under this the subject matter on a particular voyage is insured for a specified period of time.
- (4) **Floating policy:** This policy is taken out by cargo owners who make regular shipments of cargo to insure the shipments expected to be shipped for a certain time by one policy. At the time the cargo is shipped, the insured declares the value of the shipment and the total value of the policy is reduced by that amount
- (5) **Blanket policy:** This policy is taken for a specified amount, the premium in respect of which is paid for the entire policy at the beginning itself and is adjusted at the end of the specified period for the value of risks covered during this period.
- (6) **Fleet insurance policy:** This policy insures the whole fleet of ships.
- (7) **Open policy:** This type of policy is taken out without specifying the value where at the time of insurance, the insured is not aware of the value of the subject matter to be insured, which is ascertained and declared to the insurer later. The insurance cover is subject to the limit of the sum assured.
- (8) **Port policy:** This policy covers the ship when it is docked/stationed at a port
- (9) **Composite policy:** It is a policy underwritten by more than one underwriter. The liability of each underwriter is however distinct and separate.
- (10) **Valued policy:** Under this policy, the value of the subject matter is agreed between the underwriters and the insured at the time of taking the policy and is specified therein

Clauses in a Marine Policy:

A marine policy may cover or exclude various types of risks. In view of this some special clauses may be inserted in the policy. Some of the important clauses are discussed below.

- (1) **Lost or Not Lost Clause:** When this clause is inserted in the policy, the goods net insured irrespective of whether they are already lost or not lost before the policy is taken out. In other words, it covers loss of goods occurring between shipment of goods and the issuance of policy
- (2) **Waiver Clause:** When this clause is included in a marine policy no act of the insurer or the insured in saving, maintaining and preserving

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the cargo or the hull will be considered as a "waiver", i.e., in case the insured takes steps under Sue, Labour and Travel clause after the notice of abandonment is given by him to the insurer out is not accepted by the insurer, it will not amount that the notice of abandonment is waived, Thus, if the insurer takes any such steps, it cannot be taken to mean as an acceptance of the notice of abandonment.

- (3) **Permission to Touch and Stay Clause:** As per this clause, the ship is permitted to touch and stay at the ports mentioned in the policy in the order specified therein. In case nothing is specified, the ship must touch and stay at ports which are normally touched in the particular trade. Any deviation from the route specified is permitted in an emergency to save the ship and the lives of the passengers.
- (4) **Running Down Clause (RDC):** This clause enables the insured to claim the loss caused by collision with another ship.
- (5) **Free of Capture and Seizure Clause (PCS):** This clause is included in the policy to clarify that the underwriters will not be liable for any loss caused by ship being captured or seized in a war or warlike situation.
- (6) **Continuation Clause:** This clause may be included in a time policy whereby the ship will be covered until the end of the voyage or for not more than 30 days thereafter where the ship is still at sea at the time of expiry of the policy. A monthly pro rata premium is required to be deposited for this purpose.
- (7) **Excepted Perils Clause:** This clause specifies the risks not covered by the insurance policy.
- (8) **Free of Particular Average (FPA) and Free of All Averages (FAA) Clauses:** As the names suggest, the FPA clause exempts the underwriter from particular average and all averages, i.e., both general and particular average liabilities (discussed hereinafter).
- (9) **Insurance Clause:** This clause covers, among others, the losses caused by the negligence of master, crew etc. or by explosives or by other defects in machinery of the ship.
- (10) **Jettison Clause:** This clause covers the loss caused by jettisoning of goods, i.e., throwing overboard goods to reduce the weight of the ship and prevent capture by the enemy.

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(11) Barratry: This clause covers all losses caused by willful misconduct or defaults of the master and crew of the ship.

MISCELLANEOUS INSURANCE POLICIES:

In addition to the types of general insurance business discussed above, there are a number of insurance policies which cover various other types of risks, the important ones of which are discussed hereinafter.

Motor Vehicle Insurance:

Motor Vehicle insurance policies are normally taken out to cover two types of risk-(1) the risk of damage by an accident or loss by theft, and (2) risk of liability arising from an injury or death of any person in an accident caused by a vehicle, commonly known as Third Party Insurance. The owner of a vehicle is compulsorily required to get third party insurance under the Indian Motor Vehicles Act whereas the other types of insurance are voluntary.

Fidelity Insurance:

This type of insurance protects an employer against the frauds, defalcations etc., on the part of his employees where, as part of their employment obligations, such employees are required to handle cash, goods or other valuables of the employer.

Credit Insurance:

Credit insurance is taken out to protect the insured against the losses caused by bad debts due to insolvency of the debtors or otherwise.

Burglary Insurance:

Burglary insurance policy is issued whereby the insurer undertakes to indemnify the insured against losses from burglary, i.e., the removal of movable goods by theft or burglary.

Loss of Profit Insurance:

Loss of profits insurance is often accompanied by fire insurance and it covers the risk of loss of profits caused by fire, including fixed costs which are continued to be incurred till the business starts functioning at its normal level.

Workmen's Compensation Insurance:

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This type of insurance covers the risk of liability arising on account of payment of compensation where a worker suffers injury or dies in an accident in the course of his employment.

Professional Liability Insurance:

Professional liability insurance protects the professionals, such as doctors, lawyers and accountants, against the risk of liabilities arising towards clients of third parties in connection with their work. This may also include legal expenses incurred in defending law suits. The scope of miscellaneous insurance business is very wide and encompasses almost all commercial activity.

FINAL ACCOUNTS OF GENERAL INSURANCE COMPANIES:

General Insurance covers losses caused by fire, accident and marine adventures. A contract of general insurance is an annual contract or for a particular period/voyage. It also includes miscellaneous insurance such as theft or any other risk.

- (1) Accounting Principles:** Every Balance sheet, receipt and payment accounts and profit and loss account of the general insurance company should be in conformity with the Accounting standards issued by ICAI to the extent to the issuers carrying on business insurance in India.
 - (a)** Premium should be recognized as income over the contact period or the period of risk. Premium received should be in advance should be disclosed separately.
 - (b)** Premium deficiency should be recognized if the sum of expected claims cost, related expenses and maintenance exceeds related reserves for unexpired risk.
 - (c)** Acquisition costs should be expensed in the period in which they are occurred.
 - (d)** Investments should be valued as per subscribed manner.
- (2) Disclosures:** The following should be disclosed as the part of Financial Statements by the way of notes to the Balance Sheet in addition to the disclosures to be shown by Life Insurance companies.
 - (a)** Actuarial assumptions for claims liabilities in the cases of policies exceeding four years.
 - (b)** Claims, less reinsurance, paid to claimants in and outside India.

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- (c) Ageing of claims – distinguishing between claims outstanding for more than six months and others.
- (d) Fair value of investment properties and basis therefore.
- (3) General Instructions:** In addition to the general instructions relating to life insurance business, income from rent should not include any notional rent.
- (4) Management report:** A management report, containing all the information included in the management report relating to life insurance business duly authenticated, by the management, except the certification to the effect that no part of insurance fund has been directly or indirectly applied in contravention of the provisions of the insurance act, should be attached to the financial statements.
- (5) Preparation of financial statements:** A general insurance company should prepare the Revenue Account, Profit and Loss Account and the Balance sheet in the Form B-RA, Form B-PL and Form B-BS as prescribed in the Act. The Revenue Account should be prepared separately for Fire, Marine and Miscellaneous Insurance business and separate schedules should be prepared for Marine Cargo and the following classes of Insurance business namely motor, workmen's compensation, engineering, public/product liability aviation, personal accident, health insurance and others.

RESERVE FOR UNEXPIRED RISK:

A reserve for unexpired risk is created every year in order to ascertain the profit in case of general insurance business. Such reserve represents the income received by the insurance company in advance in the form of insurance premiums. The insurance company charges premium in advance and the risk may happen on a day in future. Therefore, it is necessary to carry forward a part of the premium income received by the insurance company during a particular year to the next year for meeting any loss that may arise in respect of policies issued during the proceeding year.

The provision for unexpired risk should be 100% of the net premium in case of marine insurance business and 50% in case of other business. However, an insurance company may keep additional reserves if it so feels necessary.

Schedule B:

PART I accounting principles for Preparation of financial statements:

- (1) Applicability of Accounting Standards:** Every Balance Sheet, Receipts and Payments Account [Cash Flow statement] and Profit and Loss Account [Shareholders' Account] of the insurer shall be in conformity with the Accounting Standards (AS) issued by the ICAI, to the extent applicable to the insurers carrying on general insurance business, except that:
- (a) Accounting Standard 3 (AS 3):** Cash Flow Statements - Cash Flow Statement shall be prepared only under the Direct Method.
 - (b) Accounting Standard 13 (AS 13):** Accounting for Investments, shall not be applicable.
 - (c) Accounting Standard 17 (AS 17):** Segment Reporting - shall apply to all insurers irrespective of the requirements regarding listing and turnover mentioned therein.
- (2) Premium:** Premium shall be recognised as income over the contract period or the period of risk, whichever is appropriate. Premium received in advance, which represents premium income not relating to the current accounting period, shall be disclosed separately in the financial statements.

A reserve for unexpired risks shall be created as the amount representing that part of the premium written which is attributable to, and to be allocated to the succeeding accounting periods and shall not be less than as required under section 64 V(1) (ii) (b) of the Act.

Premium Received in Advance, which represents premium received prior to the commencement of the risk, shall be shown separately under the head 'Current Liabilities' in the financial statements.

- (3) Premium Deficiency:** Premium deficiency shall be recognised if the sum of expected claim costs, related expenses and maintenance costs exceeds related reserve for unexpired risks.
- (4) Acquisition Costs:** Acquisition costs, if any, shall be expensed in the period in which they are incurred.

Acquisition costs are those costs that vary with, and are primarily related to, the acquisition of new and renewal insurance contracts.

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The most essential test is the obligatory relationship between costs and the execution of insurance contracts (i.e. commencement of risk).

- (5) Claims:** The components of the ultimate cost of claims to an insurer comprise the claims under policies and specific claims settlement costs. Claims under policies comprise the claims made for losses incurred, and those estimated or anticipated under the policies following a loss occurrence.

A liability for outstanding claims shall be brought to account in respect of both direct business and inward reinsurance business. The liability shall include:

- (a)** Future payments in relation to unpaid reported claims;
- (b)** Claims Incurred But Not Reported (IBNR) including inadequate reserves [sometimes referred to as Claims Incurred But Not Enough Reported (IBNER)], which will result in future cash/asset outgo for settling liabilities against those claims. Change in estimated liability represents the difference between the estimated liability for outstanding claims at the beginning and at the end of the financial period.

The accounting estimate shall also include claims cost adjusted for estimated salvage value if there is sufficient degree of certainty of its realisation.

Actuarial Valuation of Claim Liability-in some Cases:

Claims made in respect of contracts where the claims payment period exceeds four years shall be recognised on an actuarial basis, subject to regulations that may be prescribed by the Authority. In such cases, certificate from a recognised actuary as to the fairness of liability assessment must be obtained. Actuarial assumptions shall be suitably disclosed by way of notes to the account.

- (6) Procedure to determine the value of investments:** An insurer shall determine the values of investments in the following manner:-
- (a) Real Estate:** Investment Property- Investment Property shall be measured at historical cost less accumulated depreciation and impairment loss, residual value being considered zero and no revaluation being permissible.

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The Insurer shall assess at each balance sheet date whether any impairment of the investment property has occurred.

An impairment loss shall be recognised as an expense in the Revenue/Profit and Loss Account immediately.

Fair value as at the balance sheet date and the basis of its determination shall be disclosed in the financial statements as additional information.

- (b) Debt Securities:** Debt securities including government securities and redeemable preference shares shall be considered as “held to maturity” securities and shall be measured at historical cost subject to amortisation.
- (c) Equity Securities and Derivative Instruments that are traded in active markets:** Listed equity securities and derivative instruments that are traded in active markets shall be measured at fair value as at the balance sheet date. For the purpose of calculation of fair value, the lowest of the last quoted closing price of the stock exchanges where the securities are listed shall be taken.

The insurer shall assess on each balance sheet date whether any impairment of listed equity security(ies) / derivative(s) instruments has occurred.

An active market shall mean a market, where the securities traded are homogenous, availability of willing buyers and willing sellers is normal and the prices are publicly available.

Unrealised gains/losses arising due to changes in the fair value of listed equity shares and derivative instruments shall be taken to equity under the head 'Fair Value Change Account'. The 'Profit on sale of investments' or 'Loss on sale of investments', as the case may be, shall include accumulated changes in the fair value previously recognised in equity under the heading Fair Value Change Account in respect of a particular security and being recycled to Profit and Loss Account on actual sale of that listed security.

For the removal of doubt, it is clarified that balance or any part thereof shall not be available for distribution as dividends. Also, any debit balance in the said Fair Value Change Account

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shall be reduced from the profits/free reserves while declaring dividends.

The insurer shall assess, at each balance sheet date, whether any impairment has occurred. An impairment loss shall be recognised as an expense in Revenue/Profit and Loss Account to the extent of the difference between the remeasured fair value of the security/investment and its acquisition cost as reduced by any previous impairment loss recognised as expense in Revenue/Profit and Loss Account. Any reversal of impairment loss, earlier recognised in Revenue/Profit and Loss Account shall be recognised in Revenue/Profit and Loss Account.

- (d) Unlisted and other than actively traded equity securities and derivative:** Instruments-Unlisted equity securities and derivative instruments and listed equity securities and derivative instruments that are not regularly traded in active market will be measured at historical costs. Provision shall be made for diminution in value of such investments. The provision so made shall be reversed in subsequent periods if estimates based on external evidence show an increase in the value of the investment over its carrying amount. The increased carrying amount of the investment due to the reversal of the provision shall not exceed the historical cost.

For the purposes of this regulation, a security shall be considered as being not actively traded, if as per guidelines governing mutual funds laid down from time to time by SEBI, such a security is classified as "thinly traded".

- (7) Loans:** Loans shall be measured at historical cost subject to impairment provisions.

The insurer shall assess the quality of its loan assets and shall provide for impairment. The impairment provision shall not be lower than the amounts derived on the basis of guidelines prescribed from time to time by the Reserve Bank of India, that apply to companies and financial institutions.

- (8) Catastrophe Reserve:** Catastrophe reserve shall be created in accordance with norms, if any, prescribed by the Authority.

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Investment of funds out of catastrophe reserve shall be made in accordance with prescription of the Authority.

PART II:

Disclosures forming part of Financial Statements A:

The following shall be disclosed by way of notes to the Balance Sheet:

(1) Contingent Liabilities:

- (a) Partly-paid up investments
- (b) Underwriting commitments outstanding
- (c) Claims, other than those under policies, not acknowledged as debts
- (d) Guarantees given by or on behalf of the company
- (e) Statutory demands/liabilities in dispute, not provided for
- (f) Reinsurance obligations to the extent not provided for in accounts
- (g) Others (to be specified)

(2) Encumbrances to assets of the company in and outside India.

(3) Commitments made and outstanding for Loans, Investments and Fixed Assets.

(4) Claims, less reinsurance, paid to claimants in/outside India.

(5) Actuarial assumptions for determination of claim liabilities in the case of claims where the claims payment period exceed four years.

(6) Ageing of claims- distinguishing between claims outstanding for more than six months and other claims.

(7) Premiums, less reinsurance, written from business in/outside India.

(8) Extent of premium income recognised, based on varying risk pattern, category wise, with basis and justification therefore, including whether reliance has been placed on external evidence.

(9) Value of contracts in relation to investments, for:

- (a) Purchases where deliveries are pending;
- (b) Sales where payments are overdue.

(10) Operating expenses relating to insurance business: Basis of allocation of expenditure to various classes of business.

(11) Historical costs of those investments valued on fair value basis.

(12) Computation of managerial remuneration.

(13) Basis of amortisation of debt securities.

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(14) (a) Unrealised gain/losses arising due to changes in the fair value of listed equity shares and derivative instruments are to be taken to equity under the head 'Fair Value Change Account' and on realisation reported in profit and loss Account.

(b) Pending realisation, the credit balance in the 'Fair Value Change Account' is not available for distribution,

(15) Fair value of investment property and the basis therefore.

(16) Claims settled and remaining unpaid for a period of more than six months as on the balance sheet date.

(B) The following accounting policies shall form an integral part of the financial statements:

(1) All significant accounting policies in terms of the accounting standards issued by the ICAI, and significant principles and policies given in Part I of Accounting Principles. Any other accounting policies followed by the insurer shall be stated in the manner required under Accounting Standard AS 1 issued by the ICAI.

(2) Any departure from the accounting policies as aforesaid shall be separately disclosed with reasons for such departure.

(C) The following information shall also be disclosed:

(1) Investments made in accordance with any statutory requirement should be disclosed separately together with its amount, nature, security and any special rights in and outside India.

(2) Segregation into performing/non performing investments for purpose of income recognition as per the directions, if any, issued by the Authority.

(3) Percentage of business sector-wise.

(4) A summary of financial statements for the last five years, in the manner as may be prescribed by the Authority.

(5) Accounting Ratios as may be prescribed by the Authority.

(6) Basis of allocation of Interest, Dividends and Rent between Revenue Account and Profit and Loss Account.

PART III:

General Instructions for Preparation of Financial Statements:

(1) The corresponding amounts for the immediately preceding financial year for all items shown in the Balance Sheet, Revenue Account and Profit and Loss Account should be given.

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- (2)** The figures in the financial statements may be rounded off to the nearest thousands.
 - (3)** Interest, dividends and rentals receivable in connection with an investment should be stated as gross value, the amount of income tax deducted at source being included under 'advance taxes paid'.
 - (4)** Income from rent shall not include any notional rent. 5. (I) For the purposes of financial statements, unless the context otherwise requires:
 - (a)** the expression 'provision' shall, subject to note II below mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability or loss of which the amount cannot be determined with substantial accuracy;
 - (b)** the expression "reserve" shall not, subject to as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability;
 - (c)** the expression capital reserve shall not include any amount regarded as free for distribution through the profit and loss account; and the expression "revenue reserve" shall mean any reserve other than a capital reserve
 - (d)** The expression "liability" shall include all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities.
- (II) Where:**
- (a)** any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or
 - (b)** any amount retained by way of providing for any known liability is in excess of the amount which in the opinion of the directors is reasonably necessary for the purpose, the excess shall be treated for the purposes of these accounts as a reserve and not as a provision.
- (1)** The company should make provisions for damages under lawsuits where the management is of the opinion that the award may go against the insurer.
 - (2)** Extent of risk retained and reinsured shall be separately disclosed.

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- (3) Any debit balance of Profit and Loss Account shall be shown as deduction from uncommitted reserves and the balance if any, shall be shown separately.

PART IV:

Contents of Management Report:

There shall be attached to the financial statements, a management report containing, inter alia, the following duly authenticated by the management:

- (1) Confirmation regarding the continued validity of the registration granted by the Authority;
- (2) Certification that all the dues payable to the statutory authorities have been duly paid;
- (3) Confirmation to the effect that the shareholding pattern and any transfer of shares during the year are in accordance with the statutory or regulatory requirements;
- (4) Declaration that the management has not directly or indirectly invested outside India the funds of the holders of policies issued in India;
- (5) Confirmation that the required solvency margins have been maintained;
- (6) Certification to the effect that the values of all the assets have been reviewed on the date of the Balance Sheet and that in his (insurer's) belief the assets set forth in the Balance-sheets are shown in the aggregate at amounts not exceeding their realisable or market value under the several headings – "Loans", "Investments", "Agents balances", "Outstanding Premiums", "Interest, Dividends and Rents outstanding", "Interest, Dividends and Rents accruing but not due", "Amounts due from other persons or Bodies carrying on insurance business", "Sundry Debtors", "Bills Receivable", "Cash" and the several items specified under "Other Accounts";
- (7) Disclosure with regard to the overall risk exposure and strategy adopted to mitigate the *« v same;
- (8) Operations in other countries, if any, with a separate statement giving the management's estimate of country risk and exposure risk and the hedging strategy adopted

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- (9)** Ageing of claims indicating the trends in average claim settlement time during the preceding five years;
- (10)** Certification to the effect as to how the values, as shown in the balance sheet, of the investments and stocks and shares have been arrived at, and how the market value thereof has been ascertained for the purpose of comparison with the values so shown;
- (11)** Review of asset quality and performance of investment in terms of portfolios, i.e., separately in terms of real estate, loans, investments, etc.
- (12)** A responsibility statement indicating therein that:
 - (a)** in the preparation of financial statements, the applicable accounting standards, principles and policies have been followed along with proper explanations relating to 4 material departures, if any;
 - (b)** The management has adopted accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the operating profit or loss and of the profit or loss of the company for the year;
 - (c)** The management has taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the applicable provisions of the Insurance Act 1938 (4 of 1938) / Companies Act, 1956 (1 of 1956), for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
 - (d)** The management has prepared the financial statements on a going concern basis;
 - (e)** The management has ensured that an internal audit system commensurate with the size and nature of the business exists and is operating effectively.
- (13)** A schedule of payments, which have been made to individuals, firms, companies and organisations in which Directors of the insurer are interested.

PART V:

Preparation of Financial Statements:

Accounting for Banking Company

- (1)** An insurer shall prepare the Revenue Account, Profit and Loss Account [Shareholders' Account] and the Balance Sheet in Form B-RA, Form B-PL, and Form B-BS, or as near thereto as the circumstances permit.

Provided that an insurer shall prepare Revenue Accounts separately for fire, marine, and miscellaneous insurance business and separate schedules shall be prepared for Marine Cargo, Marine – Other than Marine Cargo and the following classes of miscellaneous insurance business under miscellaneous insurance and accordingly application of AS 17 -Segment Reporting - shall stand modified.

- (a)** Motor
 - (b)** Workmen's Compensation/Employers' Liability
 - (c)** Public/Product Liability
 - (d)** Engineering
 - (e)** Aviation
 - (f)** Personal Accident
 - (g)** Health Insurance
 - (h)** Others
- (2)** An insurer shall prepare separate Receipts and Payments Account in accordance with the Direct Method prescribed in AS 3 - "Cash Flow Statement" issued by the ICAI.

FORM B-RA

Name of the Insurer:

Revenue Account for the Year Ended 31st March, 20_.

Particulars	Schedule	Current Year (`000)	Previous Year (`000)
(1) Premiums earned (Net)	1		
(2) Profit/ Loss on sale/redemption of Investments			
(3) Others (to be specified)			
(4) Interest, Dividend & Rent – Gross			
Total (A)			
(1) Claims Incurred (Net)	2		
(2) Commission	3		

Accounting for Banking Company

(3) Operating Expenses related to Insurance Business	4		
Total (B)			
Operating Profit/(Loss) from Fire/Marine/Miscellaneous Business C = (A – B)			
Appropriations			
Transfer to Shareholders' Account			
Transfer to Catastrophe Reserve			
Transfer to Other Reserves (to be specified)			
Total (C)			

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_____

Particulars	Schedule	Current Year ('000)	Previous Year ('000)
(1) Operating Profit/(Loss):			
(a) Fire Insurance			
(b) Marine Insurance			
(c) Miscellaneous Insurance			
(2) Income From Investments:			
(a) Interest, Dividend & Rent - Gross			
(b) Profit on sale 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			
(b) For doubtful debts			
(c) Others specified)			
(5) Other Expenses:			
(a) Expenses other than those related to Insurance Business			
(b) Bad debts written off			
(c) Others (To be specified)			
Total (b)			
Profit Before Tax			
Provision for Taxation			

Accounting for Banking Company

Appropriations:			
(a) Interim dividends paid during the year			
(b) Proposed final dividend			
(c) Dividend distribution tax			
(d) Transfer to any Reserves or Other Accounts (to be specified)			
Balance of profit/ loss brought forward from last year			
Balance carried forward to Balance Sheet			

FORM B-BS

Name of the Insurer:

Registration No. and Date of Registration with the IRDA

Balance Sheet As At 31st March, 20_____

Particulars	Schedule	Current Year (`000)	Previous Year (`000)
Sources of funds			
Share capital	5		
Reserves and surplus	6		
Fair value change account			
Borrowings	7		
Total			
Application of funds			
Investments	8		
Loans	9		
Fixed assets	10		
Current assets			
Cash and Bank Balances	11		
Advances and Other Assets	12		
Sub-Total (A)			
Current Liabilities	13		
Provisions	14		
Sub-Total (B)			
Net Current Assets (C) = (A - B)			
Miscellaneous Expenditure (to the extent not written off or adjusted)	15		
Debit Balance in Profit and Loss Account			
Total			

Contingent Liabilities:

Particulars	Current Year	Previous Year
(1) Partly paid-up investments		

Accounting for Banking Company

(2) Claims, other than against policies, not acknowledged as debts by the company		
(3) Underwriting commitments outstanding (in respect of shares and securities)		
(4) Guarantees given by or on behalf of the Company		
(5) Statutory demands/ liabilities in dispute, not provided for		
(6) Reinsurance obligations to the extent not provided for in accounts		
(7) Others (to be specified)		
Total		

Schedule 1: Premium

Particulars	C.Y.	P.Y.
(a) Premium from direct business written	(a)	
(b) Add: Premium on reinsurance accepted	(b)	
(c) Less: Premium on reinsurance ceded	(c)	
Total Premium Earned (Net):		
(+/-) Adjustment for change in reserve for unexpired risk (W.N.: 1)	(W.N.: 1)	
Premium Earned		
Total		

Working Note:

Particulars	Direct Business	Reinsurance Accepted	Reinsurance Ceded
Premium received/paid			
Add: Outstanding at end			
Less: Outstanding at beginning			
	(a)	(b)	(c)

Working note: 1 Adjustment for change in reserve for unexpired risk

Opening provision: Normal provision Additional provision	
Less: Closing provision: Normal provision Additional provision	

Schedule 2: Claims Incurred [Net]

Particulars	Current Year ('000)	Previous Year ('000)
Claims from direct business written		
Add: claims on reinsurance accepted		
Less: claims on reinsurance ceded		
Net claims		

Accounting for Banking Company

Add: Claims outstanding at the year end		
Less: Claims outstanding in the beginning		
Total claims incurred		

Schedule 3: Commission

Particulars	Current Year (`000)	Previous Year (`000)
Commission from direct business written Add: commission on reinsurance accepted Less: commission on reinsurance ceded Net commission		

Schedule 4: Operating Expense

Particulars	Current Year (`000)	Previous Year (`000)
(1) Employees remuneration and welfare benefit		
(2) Travel, conveyance and vehicle running expenses		
(3) Training expenses		
(4) Rent rates and taxes		
(5) Repairs		
Total		

Schedule 5: Share Capital

Particulars	Current Year (`000)	Previous Year (`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 Less: Par value of equity shares bought back Less: Preliminary expenses Expenses including commission or brokerage on Underwriting or subscription of shares		
Total		

Schedule 6: Reserves and Surplus

Particulars	Current Year (`000)	Previous Year (`000)

Accounting for Banking Company

(1) Capital reserve		
(2) Capital redemption reserve		
(3) Share premium		
(4) General reserve		
Less: debit balance in profit and loss account		
Less: Amount utilized for buy back		
(5) Catastrophe reserve		
(6) Other reserves		
(7) Balance of profit in profit and loss account		
Total		

Schedule 7: Borrowings

Particulars	Current Year (`000)	Previous Year (`000)
(1) Debentures/ bonds		
(2) Banks		
(3) Financial institutions		
(4) Others (to be specified)		
Total		

Schedule 8: Investments

Particulars	Current Year (`000)	Previous Year (`000)
Long term investments:		
(1) Government securities		
Other investments		
Short term investments		
Total		

Schedule 9: Loans

Particulars	Current Year (`000)	Previous Year (`000)
(1) Security wise classification		
Secured unsecured		
Total		
(2) Borrower wise classification		
(3) Performance wise classification		
(4) Maturity wise classification		
Short term		
Long term		
Total		

Schedule 10: Fixed Assets

Accounting for Banking Company

Particulars	Cost/Gross Block				Depreciation			Net Block		
	Opening	Addition	Deductions	Closing	Upto Last Year	For the Year	On Sales/ Adjustments	To Date	As at Year End	Previous Year
Goodwill										
Intangibles (specify)										
Land- Freehold										
Leasehold Property										
Buildings										
Furniture & Fittings										
Information Technology										
Equipment										
Vehicles										
Office Equipment										
Others (Specify nature)										
Total										
Previous Year										

Note: Assets include in land, property and building above exclude Investment Properties as defined in note (e) to Schedule 8.

Schedule 11: Cash and Bank Balances

Particulars	Current Year ('000)	Previous Year ('000)
(1) Cash (including cheques, drafts and stamps)		
(2) Bank balances		
(a) Deposit accounts		
(b) Current accounts		
(c) Others (to be specified)		
(3) Money at call and short notice		
(4) Others (to be specified)		
Total		

Schedule 12: Advances and Other Assets

Particulars	Current Year ('000)	Previous Year ('000)
Advances:		
(1) Reserve deposits with ceding companies		
(2) Application money on investment		
(3) Prepayments		

Accounting for Banking Company

	Total (A)		
Other Assets:			
(1) Income accrued on investments			
(2) Outstanding premiums			
(3) Agents balances			
	Total (B)		
	Total (A + B)		

Schedule 13: Current Liabilities

Particulars	Current Year (`000)	Previous Year (`000)
(1) Agents balances		
(2) Balances due to other insurance companies		
(3) Deposits held on reinsurance ceded		
(4) Premiums received in advance		
Total (A + B)		

Schedule 14: Provisions

Particulars	Current Year (`000)	Previous Year (`000)
(1) Reserve for unexpired risk		
(2) For taxation(less advance tax paid and TDS)		
(3) For proposed dividend		
(4) Others		
Total		

Schedule 15: Miscellaneous Expenditure

Particulars	Current Year (`000)	Previous Year (`000)
(1) Discount allowed in issue of shares/ debentures		
(2) Others(to be specified)		
Total		

Notes:

No items shall be included under the head "Miscellaneous Expenditure" and carried forward unless:

- (1) Some benefits from the expenditure can reasonably be expected to be received in future, and
- (2) The amount of such benefit is reasonably determinable.

Illustration 32:

From the following balances as at March 31, 2014 in the books of Reliance General Insurance Co. Ltd. prepare a Revenue Account in respect of Fire Insurance business carried on by them.

Accounting for Banking Company

Particulars	`
Claims paid	4,80,000
Claims outstanding on April 1, 2013	40,000
Claims intimated and accepted, but not paid on March 31, 2014	70,000
Premium received	12,00,000
Re-insurance Premium paid	1,20,000
Commission	2,00,000
Commission on re-insurance ceded	8,000
Commission on re-insurance accepted	4,000
Expenses of Management	3,02,000
Provision for unexpired risk on April 1	4,00,000
Additional provision for unexpired risk on April 1	20,600
Re-insurance recoveries of claims	8,000
Survey expenses regarding claims	5,000
Loss on sale of Motor Car	3,500
Bad debts	2,500
Profit on sale of furniture	54,500
Interest and Dividends (Net)	8,000
Income tax deducted thereon	1,500
Legal expenses regarding claims	4,000
Profit on sale of investments	3,500
Rent of staff Quarters deducted from salaries	2,400
Depreciation of Furniture	4,600

You are required to provide for additional reserve for unexpired risk at 1% of the net premium in addition to the opening balance of Additional Reserve.

Solution:

Reliance General Insurance Co. Ltd.
Revenue Account for the year ended 31st March, 2014
In respect of Fire Insurance Business

Particulars	Schedule No.	Current Year (`)	Previous Year (`)
(1) Premium earned (Net)	1	9,29,200	
(2) Profit / Loss on sale of insurance		3,500	
(3) Other income		-	
(4) Interest, dividend etc. (Gross) (8,000 + 1,500)		9,500	
Total (A)		9,42,200	
(1) Claims incurred (net)	2	5,11,000	
(2) Commission	3	1,96,000	
(3) Operating expenses	4	3,11,500	
Total (B)		10,18,500	

Accounting for Banking Company

Operating net profit transferred to Profit / Loss a/c	(76,300)
---	----------

Schedule 1: Premium

Particular	
Premium on direct business	
Add: Premium on Re-insurance Accepted	12,00,000
Less: Premium on Re-insurance Ceded	(1,20,000)
	10,80,000
Less: Adjust for change in Reserve for unexpired Risk (WN (1))	(1,50,800)
	9,29,200

Schedule 2: Claims

Particular	
Claims on direct business	4,80,000
Add: Claims on Re-insurance Accepted	
Less: Claims on Re-insurance Ceded	(8,000)
	(40,000)
Less: Claims o/s at beginning	
Add: Claims o/s at end	70,000
Add: Survey expenses claims	5,000
Add: Legal expenses regarding claims	4,000
	5,11,000

Schedule 3: Commission

Particular	
Commission on direct business	2,00,000
Add: Commission on Re-insurance Accepted	4,000
Less: Commission on Re-insurance Ceded	(8,000)
	1,96,000

Operating Expenses

Particular	
Expenses of Management	3,02,000
Bad debts	2,500
Rent of staff quarters dedicated from salaries	2,400
Depreciation on furniture	4,600
	3,11,500

Working Notes (1):

Operating Balance	4,00,000
Additional provision	<u>20,600</u>
	<u>4,20,600</u>
Reserve (50% or 10,80,000)	5,40,000
Add: Reserve (1% of 10,80,000 + of 20,000)	<u>31,400</u>
	<u><u>5,71,400</u></u>

Accounting for Banking Company

4,20,600
(1,50,800)

Change in Reserve for unexpired risk

Illustration 33:

Prepare a revenue account in respect of Fire Insurance Business from the following details of Imperial General Insurance Company for the year ended 31st march 2014.

Particulars	Amount
Reserve for unexpired risk on 1-4-2013 @ 50%	1,60,000
Additional reserve	32,000
Estimated liability for claims admitted	
on 1-4-2013	30,000
on 31-3-2014	40,000
Claims paid	3,60,000
Legal expenses	10,000
Reinsurance recoveries	30,000
Medical expenses	5,000
Bad debts	4,000
Premiums recovered	4,80,000
Premiums on reinsurance ceded	42,000
Premiums on reinsurance accepted	32,000
Commission on direct business	45,000
Commission on reinsurance accepted	2,000
Commission on reinsurance ceded	3,000
Expenses of management	40,000
Interest dividend and rent	24,000
Profit on sale of investment	4,000

Create reserves on 31-3-2014 to the same extent as on 31-3-2013.

Solution:

Particulars	Schedule no	Current Year	Previous Year
Premiums earned (net)	1	4,7,0000	
Profit/ Loss/ redemption of Investment		4,000	
Others		3,000	
Interest, Dividend and Rent (gross)		24,000	
Total (A)		5,01,000	
Claims incurred	2	3,40,000	
Commission	3	47,000	
Operating expenses related to insurance business	4	59,000	
Total (B)		4,46,000	
Operating Profit/ Loss from business (A-B)		55,000	
Appropriations:			
Transfer to Shareholders Account			

Accounting for Banking Company

Transfer to Catastrophe Account			
Transfer to Other Reserves			

Schedule 1: Premium (Net)

Particular	
Premium recovered	4,80,000
Add: Premium on Reinsurance accepted	32000
Less: Premium on Reinsurance ceded	(42,000)
Net Premium	4,70,000

Schedule 2: Claims Incurred

Particular	
Claims paid	3,60,000
Less: Reinsurance reserves	(30,000)
Add: Claims outstanding on 31-3-2014	40,000
Less: Claims outstanding on 31-3-2013	(30,000)
Total	3,40,000

Schedule 3: Commission

Particular	
Commission on direct business	45000
Add: Commission on reinsurance accepted	2000
Total	47000

Schedule 4: Operating expenses

Particular	
Expenses of Management	40000
Legal expenses	10000
Medical expenses	5000
Bad debts	4000
Total	59000

Note: Calculation of reserve for unexpired risk:

50% of premium income	2,35,000
Additional reserves	
10% of premium less reinsurance	<u>47,000</u>
Total	<u>2,82,000</u>

Illustration 34:

From the following information as on 31st March 2014, prepare the Revenue Account of the Indian Marine Insurance Co. Ltd.

Particular	Direct Business ('000)	Reinsurance ('000)
(I) Premium:		
Received	46,00,000	7,20,000

Accounting for Banking Company

Receivable – 1st April	2,48,000	27,000
Paid – 31st March	3,36,000	34,000
Payable – 1st April	–	4,60,000
(II) Claims:		
Paid	23,50,000	3,00,000
Payable – 1st April	1,66,000	39,000
– 31st March	2,08,000	44,000
Received	–	1,70,000
Receivable – 1st April	–	16,000
– 31st March	–	23,000
(III) Commission:		
On Insurance accepted	2,20,000	19,000
On Re-insurance ceded	–	26,000

(IV) Other Expenses and Income:

Salaries – `3,20,000, Rent Rates and Taxes `29,000; Postage and Telegrams `43,000; Indian Marine Tax paid `4,40,000; Interest, Dividends and Rent Received (net) `1,37,500; Income Tax deducted at Source `40,250; Legal expenses (inclusive of `40,000 in connection with settlement of claims) `72,000.

(V) Balance of Fund on 1st April, `38,45,000 including Additional Reserve of `4,45,000. Additional Reserve has to be maintained at 5% of the net premium of the year.

Solution:

Indian Marine Insurance Co. Ltd. Revenue Account for the year ended 31st March, 2014 In respect of Marine Insurance Business

Particulars	Schedule No.	Current Year (₹)
(1) Premium earned (net)	1	35,98,500
(2) Profit / Loss on sale of Investment		–
(3) Other Income		–
(4) Interest dividend etc. (Gross)		1,77,750
Total (A)		37,76,250
(1) Claims incurred (net)	2	25,60,000
(2) commission	3	2,13,000
(3) Operating expenses	4	8,64,000
Total (B)		36,37,000
Operating Net Profit transferred to Profit / Loss A/c		1,39,250

Schedule 1: Premium Earned

Particular	₹
Premium on direct business	46,88,000
Add: Premium on Re-insurance Accepted	7,27,000
Less: Premium on Re-insurance Ceded	(4,85,000)
Net Premium	49,30,000

Accounting for Banking Company

Less: Adjust for change in Reserve for unexpired Risk	(13,31,500)
	35,98,500

Schedule 2: Claims

Particular	
Claims on direct business	23,93,000
Add: Claims on Re-insurance Accepted	3,05,000
Less: Claims on Re-insurance Ceded	(1,77,000)
Net Claims	25,20,000
Add: Legal expenses in respect of claim	40,000
	25,60,000

Schedule 3: Commissions

Particular	
Commission on direct business	2,20,000
Add: Commission on Re-insurance Accepted	19,000
Less: Commission on Re-insurance Ceded	(26,000)
Net Claims	2,13,000

Schedule 4: Operating Expenses

Particular	
Salaries	3,20,000
Rent, Rates and Taxes	29,000
Postage and Telegrams	43,000
Indian Marine Tax paid	32,000
	8,64,000

(1) Working Notes:

Premium	
Received	46,00,000
Add: O/s at end	3,36,000
Less: O/s at begin	(2,48,000)
	46,88,000

(2) Working Notes:

Premium of Reinsurance accepted	
Received	7,20,000
Add: O/s at end	34,000
Less: O/s at begin	(27,000)
	7,27,000

(3) Working Notes:

Premium on Re-insurance ceded	
Received	4,60,000
Add: O/s at end	62,000
Less: O/s at begin	(37,000)
	4,85,000

(4) Working Notes:

Claim on Direct Business	

Accounting for Banking Company

Paid	23,50,000
Add: O/s at end	2,08,000
Less: O/s at begin	(1,66,000)
	28,92,000

(5) Working Notes:

Claim on Reinsurance accepted	\
Paid	3,00,000
Add: O/s at end	44,000
Less: O/s at begin	(39,000)
	3,05,000

(6) Working Notes:

Claim on Reinsurance ceded	\
Paid	1,70,000
Add: O/s at end	23,000
Less: O/s at begin	(16,000)
	1,77,000

(7) Working Notes:

Marine Insurance (100%) (Provision for unexpired Risk)	\
Reserve (100% of 49,30,000)	49,30,000
Add: Reserve (5% of 49,30,000)	2,46,500
	51,76,500
Less: Operating Balance	
Reserve	34,00,000
Add: Reserve	<u>4,45,000</u>
	38,45,000
	13,31,500

Illustration 35:

From the following balance of The New India Insurance Company Ltd. prepare the necessary Revenue Accounts and the Profit and Loss Account in respect of the year 2013-14.

Particulars	\	Particulars	\
Bad Debts (Fire)	5,000	Interest, Dividends etc. received	19,000
Bad Debts (Marine)	10,000	Difference in Exchange (Cr.)	300
Auditors Fees	2,000	Profit on Sale of Investments	60,000
Directors Fees	4,200	Fire premium	6,00,000
Share Transfer Fee	400	Marine premium	10,80,000
Miscellaneous Income	1,600	Management Expenses:	
Fire fund (1/4/2013)	2,50,000	Fire	1,45,000
Marine Fund (1/4/2013)	8,20,000	Marine	4,02,000

Accounting for Banking Company

Claims paid (fire)	1,40,000	Claims outstanding on 1/4/13 (fire)	50,000
Claims paid (Marine)	3,00,000	Claims outstanding on 1/4/13 (Marine)	60,000
Commission paid (Fire)	90,000	Commission earned on reinsurance ceded:	
Commission paid (Marine)	1,08,000	Fire	30,000
Additional Reserve on 01/04/2013 (Fire)	50,000	Marine	60,000
Depreciation	35,000		

(i) The normal reserve required is 50% of net premium for fire and 100% of net premium of marine. In addition, for fire 15% of the net premium is to be provided as additional reserve.

(ii) The estimated liability in respect of outstanding claims due and intimated on 31/03/2014. was as under:

Fire	1,00,000
Marine	1,40,000

(iii) The Management expenses stated above are the direct expenses for the respective departments. In addition common expenses of `20,000 were incurred which must be charged to each of departments on a suitable basis.

(iv) The following reinsurance premium in respect of business accepted and ceded respectively have not been included in the above figures.

	Reinsurance accepted (`)	Reinsurance ceded (`)
Fire	25,000	20,000
Marine	60,000	45,000

Solution:

The New India Insurance Co. Ltd.
Revenue Account for the year ended 31st March, 2014
In respect of Fire Insurance Business

Particulars	Current Year (`)	Previous Year (`)
(1) Premium earned (Net)	5,11,750	
(2) Profit / Loss on sale of Investments		
(3) Other Incomes		
(4) Interest, Dividend, Rent etc. (Gross)		
Total (A)	5,11,750	
(1) Claim Incurred (Net)	1,90,000	



Accounting for Banking Company

(2) Commission		60,000	
(3) Operating Expenses		1,57,118	
Total (B)		4,07,118	
Operating profit transferred to Profit/Loss A/c.		(1,04,632)	

New India Insurance Co. Ltd.
Revenue Account for the year ended 31st March, 2014
In respect of Marine Insurance Business

Particulars	Schedule No.	Current Year (₹)
(1) Premium Earned (Net)		8,20,000
(2) Project / Loss on sale of Invest		
(3) Other incomes		
(4) interest dividend etc. (Gross)		
Total (A)		8,20,000
(1) Claim incurred (Net)		3,80,000
(2) Commission		48,000
(3) Operating Expenses		4,24,882
Total (B)		8,52,882
Operating project transferred to Profit & Loss Account (A – B)		(32,882)

Profit & Loss Account for the year ended 31st March 2014

Particulars	Schedule No.	(₹)	(₹)
(1) Profit / Loss from Revenue Account:			
Profit from fire		1,04,632	
Loss from Marine		(32,882)	71,750
(2) Income from Investment:			
Interest, Dividend		19,000	
Profit from Invest		60,000	79,000
(3) Other Income:			
Share transfer fees		400	
Miscellaneous Income		1,600	
Difference in exchange		300	2,300
Total (A)			1,53,050
(4) Provisions (Other taxation):			
(5) Others expenses:			
Auditors fees		2,000	
Director fees		4,200	
Depreciation		35,000	41,200
NPBT (A – B)			1,11,850

Schedule 1: Premium

Particular	Fire	Marine
Premium on direct business	6,00,000	10,80,000

Accounting for Banking Company

Add: Premium on Re-insurance accepted	25,000	60,000
Less: Premium on Re-insurance ceded	(20,000)	(45,000)
Net Premium	6,05,000	10,95,000
Adjustment for change in Reserve for unexpired Risk	(93,250)	(2,75,000)
	5,11,750	8,20,000

Schedule 2: Claim

Particular	Fire	Marine
Claims on direct business	1,40,000	3,00,000
Add: Premium on Re-insurance accepted	–	–
Less: Premium on Re-insurance ceded	–	–
Net Claim	1,40,000	3,00,000
Add: O/s at end	1,00,000	1,40,000
Less: O/s at beginning	(50,000)	(60,000)
	1,90,000	3,80,000

Schedule 3: Commission

Particular	Fire	Marine
Commission on direct business	90,000	10,80,000
Add: Commission on Re-insurance accepted	–	–
Less: Premium on Re-insurance ceded	(30,000)	(60,000)
	60,000	48,000

Schedule 4:

Particular	Fire	Marine
Bad debts (Fire)		
(Marine)	5,000	10,000
Management Expenses (Fire and Marine)	1,45,000	4,02,000
Common expenses (605; 1095)	7,118	12,882
	1,57,118	4,24,882

(1) Working Note: Provision

	Fire	Marine
Opening Balances of Provisions	2,50,000	8,20,000
Add provision	50,000	–
	3,00,000	8,20,000

(2) Closing Balance

	Fire	Marine
Reserves (50% of 6,05,000) (100% of 10,95,000)	3,02,500	10,95,000
Add Reserve (15%) (Fire)	90,750	–

Accounting for Banking Company

	3,93,250	10,95,000
	93,250	2,75,000

Illustration 36: **(October 2008)**

Young India Insurance Company Limited furnishes you with the following information.

- (1) On 31-3-2013 it had reserve for unexpired risk to the tune of `100 crores. It comprised of `50 crores in respect of Marine Insurance business, Ts. 30 crores in respect of Fire Insurance business and `20 crores in respect of Miscellaneous Insurance business.
- (2) It is the practice of Young India Insurance Company Limited to create reserve at 100% of net premium income in respect of Marine Insurance policies and at 50% of net premium income in respect of Fire and Miscellaneous Insurance policies.
- (3) During the year 2013-14 following business was conducted.

Particulars	`in Crores		
	Marine	Fire	Miscellaneous
Premium collected from—			
Insurance in respect of Direct Business	180	200	90
Other Insurance Companies	20	40	10
Premium paid/payable to other Insurance Company on business ceded	12	8	16

You are ask to give in the Books of Young India Insurance Company Limited.

- (1) Give Journal entries relating to “Unexpired Risk Reserve”.
- (2) Show in columnar form Unexpired Risk Reserve Account for the year 2013-14. Financial year is the accounting year.

Solution:

In the books of Young India Insurance Company

Journal Entries

Date	Particular	Debit ([₹])	Credit ([₹])
2007	Marine Revenue A/c. Dr.	138	

Accounting for Banking Company

March 31	Fire Revenue A/c.	Dr.	186	
	Miscellaneous Revenue a/c.	Dr.	22	
	To Unexpired Risk Reserve			346
	(Being excess claims provision per unexpired risk of `188 crore, 116 crores and 42 crore over 50 crore, 30 crore and 20 crore reflectively for Marine, Fire and Miscellaneous insurance a/c.)			

Working Note:

Requires closing balance in unexplained Risk Reserve

Marine Insurance = $180 + 20 - 12 = 188 \times 100\% = 188$ crore

Fire Insurance = $200 + 40 - 8 = 232 \times 50\% = 116$ crore

Miscellaneous Insurance = $90 + 10 - 16 = 84 \times 50\% = 42$ crore.

Unexpired Risk Reserve A/c

(` in Crores)

Date	Particular	Marine	Fire	Misce.	Date	Particular	Marine	Fire	Misce.
31/03/08	To balance c/d.	188	116	42	01/04/07	By balance b/d.	50	30	20
					31/03/08	By Revenue A/c.	138	86	22
		188	116	42			188	116	22

Illustration 37:

(May 2008)

The following balance relate to Nano Insurance Company Ltd.

Particulars	Year Ending	Year Ending
	31-12-13	31-12-14
Premium	5,00,000	6,00,000
Commission on Direct Business	22,500	30,000
Commission on Re-insurance Accepted	17,500	25,000
Commission on Re-insurance Ceded	22,000	24,000
Claims under Policies (paid during the year)	86,250	1,62,250
Dividend Received	20,000	5,000
Management Expenses:		
Audit fees	10,000	10,000
Salaries to Staff	1,25,750	1,57,200
Printing, Postage and Stationery	46,500	57,500

Accounting for Banking Company

Legal Expenses (Not related with Claims)	5,000	4,000
Miscellaneous Expenses	29,750	38,250
Recoveries in respect of claim under reinsurance	10,000	20,000
Premium on Reinsurance Ceded	50,000	1,00,000

Total amount of estimated liability in respect of outstanding claims as at 31-12-2012, 31-12-2013 and 31-12-2014 were `34,250, `44,750 and `55,550 respectively. Reserve for unexpired risks as at 31-12-2012 was `3,20,000 and the additional reserve was `32,000. Reserve for unexpired risks was to be provided at 100% and additional reserve at 10% of the net premium income for the year ending 31-12-2013 and 31-12-2014. All expenses are related to Insurance Business.

Solution:

Marine Revenue A/c of Nano Insurance Co. Ltd.

for the year ended 31st March 2013 & 2014

Particulars	Schedule No.	Year Ending	Year Ending
		31/03/13	31/03/14
(1) Premium earns (Net)	1	3,07,000	4,45,000
(2) Profit/Loss sale of investment		—	—
(3) Other		—	—
(4) Interest, Dividend and rent (gross)		20,000	5,000
Total (A)		3,27,000	4,50,000
Less:			
(1) Claims incomes (Net)	2	86,750	1,53,050
(2) Commission	3	18,000	31,000
(3) Operating expenses related to insurance business	4	2,17,000	2,66,950
Total (B)		3,21,750	4,51,000
Operating Profit Loss (A – B)		5,250	(1,000)
Add: Last/year Profit		—	5,250



Accounting for Banking Company

Balance c/fd:		5,250	4,250
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Schedule 1 – Premium Earns

Particulars	2013	2014
	(‘)	(‘)
Premium on direct business	5,00,000	6,00,000
Add: Premium on Re-insurance accepted	–	–
Less: Premium on Re-insurance cedes	(50,000)	(1,00,000)
Total Premium earns	4,50,000	5,00,000
Less: Addition Reserve for unexpired risk [WN (1)]	1,43,000	55,000
Net	3,07,000	4,45,000

Schedule 2 – Claims

Particulars	2013	2014
	(‘)	(‘)
Claims Paid during the year	86,250	1,62,250
Less: Claims Reserve from Re-insurance	10,000	20,000
	76,250	1,42,250
Opening o/s	34,250	44,750
Add: Closing o/s	44,750	55,550
Net Claims	86,750	1,53,050

Schedule 3 – Commission

Particulars	2013	2014
	(‘)	(‘)
Commission Direct business	22,500	30,000
Add: Commission on Re-insurance Accepted	17,500	25,000
Less: Commission on Re-insurance ceded	22,000	24,000
Net Commission	18,000	31,000

Schedule 4 – Operating expense

Particulars	2013	2014
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Accounting for Banking Company

	(₹)	(₹)
Audit fees	10,000	10,000
Salaries to staff	1,25,750	1,57,200
Printing, postage and stationery	46,500	57,500
Legal expenses	5,000	4,000
Miscellaneous expenses	29,750	38,250
Total	2,17,000	2,66,950

(1) Working Note: Reserve for Unexpired Risk

Particulars	2013	2014
	(₹)	(₹)
Net premium earns	4,50,000	5,00,000
Unexpired risk Reserve @ (100 + 10)%	4,95,000	5,50,000
Less: Opening Reserve	3,52,000	4,95,000
Additional Reserve	1,43,000	55,000

Illustration 38:

The following figures are extracted from the books of Oriental Insurance Co. Ltd. as at 31/03/2014.

Particulars	
Claims paid less re-insurance:	
Fire	80,000
Marine	62,000
General Reserve	1,18,000
Commission paid:	
Fire	
Marine	48,000
Share Capital (20,000 shares of ₹100 each)	20,00,000
Expenses of Management:	
Fire	53,000
Marine	36,000
Reserve for unexpired risks:	
Fire	2,04,000
Marine	1,23,000
Investment at cost:	
Central Government Securities deposited with RBI	19,21,000
Other Central Government Securities	1,23,000

Accounting for Banking Company

State Government Securities	2,22,000
Shares in Companies	2,49,000
Depreciation	21,000
Additional Reserves:	
Fire	1,32,000
Marine	16,000
Interest Accrued	25,000
Furniture (Cost `18,000)	12,000
Building (Cost `1,25,000)	87,000
Office Equipment (Cost `48,000)	30,000
Cash in hand	56,000
Cash at Bank	1,04,000
Premium less re-insurance:	
Fire	2,11,000
Marine	1,62,000
Tax deducted at source	9,000
Premium Due:	
Fire Marine	28,000
Marine	20,000
Claims Outstanding 1/04/2013:	
Fire	14,000
Marine	2,000
Due from other insurers	27,000
Director's Fees	4,000
Commission on Reinsurance ceded:	
Fire	23,000
Marine	2,000
Dividends	20,000
Interest on Investments	1,00,000
Dues to other Insurers	43,000
Contingency Reserve	39,000
Sundry Creditors	47,000

The following further information is also given:

- (1) Claim outstanding as on 31/03/2014 are:

Fire	17,000
Marine	6,000
- (2) Market Value of Investments `24, 01,000.
- (3) Increase Additional Reserve by 10% of net premium for the year for Fire.

Accounting for Banking Company

- (4) Maintain reserves for unexpired risks at 50% of premium for the year in case of Fire Insurance and 100% premium for the year in case of Marine insurance.

Prepare Revenue Accounts, Profit and Loss Account and Balance Sheet.

Solution:

**In The Books of Oriental Insurance Co. Ltd.
Revenue Account for the year ended 31st March, 2014
In respect of Fire Insurance Business**

Particulars	Schedule No.	(₹)
(1) Premium Earned (Net)	1	2,88,400
(2) Project / Loss investments		–
(3) Other Incomes		–
(4) Interest, Dividend, Rent etc.		–
Total (A)		2,88,400
(1) Claim incurred (Net)	2	83,000
(2) Commission	3	25,000
(3) Operating Expenses	4	53,000
Total (B)		1,61,000
Operating project transferred to Profit & Loss A/c		1,27,400

**In The Books of Oriental Insurance Co. Ltd.
Revenue Account for the year ended 31st March, 2014
In respect of Marine Insurance Business**

Particulars	Schedule No.	(₹)
(1) Premium Earned (Net)	1	1,23,000
(2) Project / Loss on investments		–
(3) Other Incomes		–
(4) Interest, Dividend, Rent etc.		–
Total (A)		1,23,000
(1) Claim Incurred (Net)	2	66,000
(2) Commission	3	37,000
(3) Operating Expenses	4	36,000
Total (B)		1,39,000
Operating Loss transferred to Profit / Loss A/c.		(16,000)

Profit and Loss Account for the year ended

Particulars	Schedule No.	C.Y. (₹)
(1) Profit/Loss from Revenue A/c.		
Fire		1,27,400

Accounting for Banking Company

Marine		(16,000)
(2) Income from Investments:		1,11,400
(a) Interest, Dividend, Rent, etc.		1,00,000
(b) Profit on sale of Interest		–
Less: Loss on sale of Investments		–
(3) Other Incomes:		20,000
	Total (A)	2,31,400
(4) Provisions (other than tax):		–
(5) Other Expenses W.N. (1)		25,000
	Total (B)	25,000
Profit before taxation (A – B)		2,06,400
Less: Provision for taxation profit after taxation		–
Less: Appropriation		–
Net profit after appropriation		2,06,400

Balance Sheet As on 31/03/2014

Particulars	Schedule No.	C.Y. (₹)
Sources of Funds:		
Share Capital	5	20,00,000
Reserve and Surplus	6	3,63,400
Borrowings	7	–
	Total	23,63,400
Application of Funds:		
Investments	8	25,15,000
Loans	9	–
Fixed Assets	10	1,29,000
Current Assets:		
(a) Cash and Bank balance	11	1,60,000
(b) Advance and other Asset	12	1,09,000
	Sub-Total (A)	29,13,000
Current Liabilities	13	1,30,000
Provisions	14	4,36,600
	Sub-Total (B)	(5,49,600)
Miscellaneous Expenditure		–
Debt Balance in Profit A/c.		–
	Total [A – B]	23,63,400

Schedule 1: Premium

Particular	Fire	Marine
Premium on direct business		
Add: Premium on Re-insurance accepted		
Less: Premium on Re-insurance ceded		

Accounting for Banking Company

Net Premium	2,11,000	1,62,000
Adjustment for change in Reserve for unexpired Risk	77,400	(39,000)
	2,88,400	1,23,000

Working Note (1): Adjustment for change in Revenue for Unexpired Risk

	Fire	Marine
Opening balances	2,04,000	1,23,000
Addition Reserve	1,32,000	16,000
	3,36,000	1,39,000
Add: Closing Balance	1,05,500	1,62,000
Addition Reserve	1,53,100	16,000
	2,58,600	1,78,000
Change in reserve	77,400	(39,000)

Schedule 2: Claims

Particular	Fire	Marine
Claims on direct business		
Add: Claims on Re-insurance accepted		
Less: Claims on Re-insurance ceded		
Net Claims	80,000	62,000
Add: O/s at the end	17,000	6,000
Less: O/s at the beginning	(14,000)	(2,000)
	83,000	66,000

Schedule 3: Commission

Particular	Fire	Marine
Commission on direct business	48,000	39,000
Add: Commission on Re-insurance accept		
Less: Commission on Re-insurance ceded	(23,000)	(2,000)

Schedule 4: Operating Expenses

Particular	Fire	Marine
Expenses of Management	53,000	36,000

Schedule 5: Share Capital

Particular	Marine
Authorised	
Issued, Subscribed and Paid Up	
Share capital 20,000 shares of ₹100 each	20,00,000

Schedule 6: Reserve and Surplus

Particular	Fire

Accounting for Banking Company

General Reserve	1,18,000
Contingency Reserve	39,000
Profit and Loss a/c	2,06,400
	3,63,400

Schedule 8: Investments

Particular	Marine
Central Government Securities deposited with RBI	19,21,000
Other Central Government Securities	1,23,000
State Government Securities	2,22,000
Shares in Companies	2,49,000
	25,15,000

Schedule 10: Fixed Assets

Particular	Gross Block	Depreciate	Net Block
Furniture	18,000	6,000	12,000
Building	1,25,000	38,000	87,000
Office equipments	48,000	18,000	30,000
			1,29,000

Schedule 11: Cash and Bank Balance

Particular	Marine
Cash in Hand	56,000
Cash at Bank	1,04,000
	1,60,000

Schedule 12: Advance and Other Assets

Particular	Marine
Interest Accrued	25,000
Tax deducted at Sources	9,000
Premium due (28,000 + 20,000)	48,000
Due from other insurers	27,000

Schedule 13: Current Liabilities

Particular	Marine
Due to other Insurers	43,000
Sundry creditors	47,000
	90,000
Claims	23,000
	1,09,000

Schedule 14: Provisions

	Fire	Marine	Total

Accounting for Banking Company

	\	\	\
Provision for Unexpired Risk:	1,05,500	1,62,000	
Clear Balance	1,53,100	16,000	4,36,600

Other Expenses

	\
Depreciation	21,000
Directors fees	4,000

Illustration 39:

(May 2006)

Prepare a Revenue Account in respect of Fire business from the following details for the year 2014-15.

Particulars	\
Reserve for Unexpired Risk on 1-4-2014 @ 50%	18,00,000
Additional Reserve	3,60,000
Estimated Liability for claims intimated on 1-4-2014	3,10,000
Estimated Liability for claims intimated on 31-3-2015	4,20,000
Claims paid	36,50,000
Legal Expenses	60,000
Re-insurance Recoveries (ceded)	3,20,000
Miscellaneous Expenses	40,000
Bad Debts	8,000
Premiums recovered	48,60,000
Premiums on re-insurance accepted	3,20,000
Premiums on re-insurance ceded	4,30,000
Commission on Direct Business	4,86,000
Commission on re-insurance accepted	16,000
Commission on re-insurance ceded	21,500
Expenses on Management	9,00,000
Interest, Dividend and Rent	2,40,000
Profit on Sale of Investment	30,000

Create Reserve on 31-3-2015 to the same extent as on 1-4-2014

Solution:

Revenue a/c. in Respect of Fire Insurance

Business for the year ended 2014-15

Particulars	Schedule No.	Current Year (₹)	Previous Year (₹)
Premium earned	1	47,50,000	

Accounting for Banking Company

Other incomes		30,000
Changes in provisions for unexpired risks		(6,90,000)
Interest, dividends etc. (Gross)		2,40,000
	(A)	43,30,000
Claims incurred (net)	2	35,00,000
Commission	3	4,80,500
Operating expenses related to insurance business	4	9,48,000
Other expenses		–
	(B)	49,28,500
Operating profit transferred to profit and loss account (A – B)		(5,98,500)

Provision for Unexpired Risks

Particulars		
Opening Normal	18,00,000	
Additional	3,60,000	21,60,000
Closing Normal	23,75,000	
Additional	4,75,000	28,50,000
Change in provision for unexpired risks		(6,90,000)

Schedule 1: Premium Earned

Particulars	
Premium on direct business	48,60,000
Add: Premium on reinsurance accepted	3,20,000
Less: Premium on reinsurance ceded	(4,30,000)
Net Premium	47,50,000

Schedule 2: Claims

Particulars	
Claims on direct business	36,50,000
Add: Claims on reinsurance accepted	
Less: Claims on reinsurance ceded	(3,20,000)
Add: Outstanding at the end	4,20,000
Less: Outstanding at the beginning	(3,10,000)
Add: Legal expenses	60,000

Schedule 3: Commission

Particulars	`
Commission on direct business	4,86,000
Add: Commission on reinsurance accepted	16,000
Less: Commission on reinsurance ceded	(21,500)
	4,80,500

Schedule 4: Operating Expenses

Particulars	`
Miscellaneous expenses	40,000
Bad debts	8,000
Expenses of management	9,00,000
	9,48,000

Illustration 40:
(May 2006)

From the following information extracted from Trial Balance, prepare Revenue Account of AG Marine Insurance Company Ltd. for the year ended 31st March 2014

Debit Balance	`	Credit Balance	`
	24,80,000		38,45,000
Claims Paid	0	Balance of Funds A/c. (including	0
Surveyor's Charges for Settlement of		additional Reserve `2,46,525)	54,15,000
Claims	40,000	Premium Received and Receivable	0
Commission Re-Insurance Accepted	19,000	Interest, Dividends & Rent Received (Net)	1,37,500
Re-Insurance Premium Paid	4,84,500	Commission on Re-Insurance Ceded	26,000
Expenses of Management	4,24,000	Claims intimated but not paid as on	
Indian and Foreign Taxes	4,40,000	31-3-2005	1,89,000
Outstanding Premium	3,08,000		
Commission on Direct Business	2,20,000		

Additional Information:

- (1) Claims intimated but not paid as on 31-3-2014 is `2,29,000
- (2) Create additional reserve same as last year.

Solution:

Revenue Account in Respect of Marine Insurance Company

for the year ended 31st March 2014

Accounting for Banking Company

Particulars	Schedule No.	Current Year (')	Previous Year (')
Premium earned (net)	1	52,38,500	
Other Incomes		–	
Changes in provisions for unexpired risks		(16,40,025)	
Interest, dividends etc. (Gross)		1,37,500	
(A)		37,35,975	
Claims incurred (net)	2	25,60,000	
Commission	3	2,13,000	
Operating expenses related to insurance business	4	8,64,000	
Other expenses		–	
(B)		36,37,000	
Operating profit transferred to Profit & Loss account			
(A – B)		98,975	

Provision for Unexpired Risks

Particulars	'
Opening Normal	35,98,475
Additional	2,46,525
	38,45,000
Closing Normal	52,38,500
Additional	2,46,525
	54,85,025
change in provision for unexpired risks	16,40,025

Schedule 1: Premium Earned

Particulars	'
Premium on direct business	
Add: Premium on reinsurance acted	54,15,000
Less: Premium on reinsurance ceded	4,84,500
Add: Outstanding premium	3,08,000
	52,38,500

Schedule 2: Claims Incurred

Accounting for Banking Company

Particulars	₹
Claims on direct business	24,80,000
Add: Claims on reinsurance accepted	—
Less: Claims on reinsurance ceded	—
Add: Surveyor's changes for settlements	40,000
Add: Outstanding at the end	2,29,000
Less: Outstanding at the beginning	1,89,000
	25,60,000

Schedule 3: Commission

Particulars	₹
Commission on direct business	
Commission on direct business	2,20,000
Add: Commission on reinsurance accepted	19,000
Less: Commission on reinsurance ceded	(26,000)
	2,13,000

Schedule 4: Operating expenses

Particulars	₹
Expenses of management	4,24,000
Indian and Foreign Taxes	4,40,000
	8,64,000

Illustration 41:

(Oct. 2007)

From the following figures taken from the books of Agni Insurance Co. Ltd. doing Fire Underwriting business, prepare the Final Accounts for the year ended 31st March, 2015:

Particulars	Dr. Rs	Cr. ₹
Fire Fund as on 01-04-2014		9,30,000
General Reserve		4,50,000
Investments	36,00,000	
Share Capital: 9,000 Equity Shares of ₹100 each		9,00,000
Additional Reserve (01-04-2014) (Unexpired Risk)		3,30,000
Re-insurance Premium ceded	1,12,000	
Claims recovered from re-insurers		21,000

Accounting for Banking Company

Commission on re-insurance ceded		48,000
Advance Tax Paid	2,50,000	
Commission on Direct Business	3,00,000	
Commission on Re-insurance accepted	60,000	
Claims intimated but not yet paid (01-04-2014)		60,000
Expenses on Management	4,31,000	
Audit Fees	36,000	
Rent	74,000	
Sundry Creditors		22,000
Agents Balance	42,000	
Cash on Hand and Bank Balance	1,81,000	
Premiums		27,00,000
Claims Paid	6,03,000	
Profit and Loss A/c (01-04-2014)		75,000
Income from Investments		1,53,000
	56,89,000	56,89,000
	0	0

The following further information may also be noted:

- (a) The expenses of management include survey fees and legal expenses of `36,000/-and `20,000/- relating to claims.
- (b) Claims intimated but not paid on 31st March, 2015 `1,04,000/-
- (c) Income Tax to be provided at `6,36,000/-
- (d) Transfer of `200000/- to be made from Current Profits to General Reserve.
- (e) Make provision for unexpired Risk `13,65,000/- including additional reserve.

Solution:

In the Books of AGNI Insurance Co. Ltd.

Accounting for Banking Company

Particulars	Schedule No.	Current Year (₹)
Premium earned (net)	1	24,83,000
Other Incomes		1,53,000
Changes in provisions for unexpired risks		
Interest, dividends etc. (Gross)		
(A)		26,36,000
Claims incurred (net)	2	6,82,000
Commission	3	3,12,000
Operating expenses related to insurance business	4	4,85,000
Other Expenses		–
(B)		14,79,000
Operating profit transferred to Profit and Loss a/c.		
(A – B)		11,57,000

Provision for Unexpired Risks

Particulars	Current Year (₹)
Opening Normal	9,30,000
Additional	3,30,000
Closing Normal	13,65,000
Additional	(1,42,000)
	24,83,000

Schedule 1: Premium earned

Particulars	Current Year (₹)

Accounting for Banking Company

Premium on direct business	27,00,000
Add: Premium on reinsurance accepted	
Less: Premium on reinsurance ceded	(1,12,000)
Net Premium	25,80,000

Schedule 2: Claims Incurred

Particulars	Current Year ([₹])
Claims on direct business	6,03,000
Add: Claim on reinsurance accepted	–
Less: Claim on reinsurance ceded	(21,000)
	5,82,000

Schedule 3: Commission

Particulars	Current Year ([₹])
Commission on direct business	
Add: Commission on reinsurance accepted	
Commission on reinsurance ceded	

Schedule 4: Operating Expenses

Particulars	Current Year ([₹])
Expenses on Manager	3,75,000
Audit fees	36,000
Rent	74,000

Profit and Loss for the Year Ended

Particulars	Current
-------------	---------

Accounting for Banking Company

	Year (₹)
(1) Profit and Loss transferred from revenue account FIRE	11,57,000
(2) Income from Investments	–
(3) Other Incomes	–
(A)	
Less: Provision (other than taxation)	–
Other Expenses	–

Profit Before Taxation (A – B)

Particulars	Current Year (₹)
Less: Provision for taxation	6,36,000
Profit After Taxation	5,21,000
Less: Appropriations	(2,00,000)
Profit After Appropriation	3,96,000
Add: Opening balance	–
Balance c/d. to balance sheet	3,96,000

Illustration 42:

(March 2012)

Following figures are from books of Oriental Fire Insurance Company Ltd. for the year ended 31st March' 2014.

Trial Balance for the year ended 31st March' 2014

Particular	Dr. Rs.	Cr. Rs.
Equity Share Capital Share of Rs. 10 each		1,800,000
General Reserve		9,00,000
Investment	60,00,000	
Reserve for unexpired risk 1st April' 2013		18,60,000
Additional Reserve 1st April' 2013		6,60,000
Premium		54,03,000
Claims Paid	12,06,000	
Profit & Loss 1/04/2013		1,50,000
Re-insurance premium Ceded	2,25,000	

Accounting for Banking Company

Claims recovered from Reinsurance		42,000
Commission on direct business	5,99,000	
Commission on Reinsurance accepted	1,20,000	
Commission on Reinsurance ceded		96,000
Outstanding Premium 31/3/2014	45,000	
Claims intimated but not paid 01/04/2013		1,20,000
Operating expenses of management	8,64,000	
Audit Fees	36,000	
Director Fees	36,000	
Rent, Rates & Taxes	1,47,000	
Income from Investments		3,00,000
Share transfer fees		6,000
Loans	12,00,000	
Sundry Creditors		45,000
Agent Balances	5,40,000	
Cash & Bank	3,64,000	
Total	1,13,82,000	1,13,82,000

From the above you are required to prepare Fire Revenue A/c, Profit & Loss A/c, Profit & Loss Appropriation A/c and Balance Sheet of the company for the year 2013-14 taking into account the following:

- (1) Transfer to General Reserve Rs. 3,00,000.
- (2) Claims Outstanding as on 31st March' 2014 Rs. 1,82,000.
- (3) Proposed Dividend @ 12%.
- (4) Provision for Income Tax to be made Rs. 7,50,000.
- (5) Make provision for unexpired risk @ 50% of Net premium received & additional reserve to be maintained at same level i.e. Rs. 6,60,000.

Solution: **Oriental Fire Insurance Company Ltd.**

Fire Revenue A/c for the year ended 31st March' 2014

Particulars		Rs.
Premium Earned	Sch. 1	51,78,000
Reserve for unexpired risk		(7,29,000)
Total	(A)	44,49,000
Claims Paid	Sch. 2	12,26,000
Commission	Sch. 3	6,23,000
Operating Expenses relating to Insurance Business	Sch. 4	8,64,000
Total	(B)	27,13,000
Operating Profit	(A) – (B)	17,36,000
Profit & Loss a/c for the year ended 31st March 2014		

Accounting for Banking Company

Operating Profit C/d		17,36,000
Income From Investment		3,00,000
Share transfer fees		6,000
	(C)	20,42,000
Expenses:		
Audit Fees		36,000
Director Fees		36,000
Rent, Rates & Taxes		1,47,000
	(D)	2,19,000
Net Profit Before Tax	(C) – (D)	18,23,000
Provision for Tax		7,50,000
Profit after Tax		10,73,000
Add: Profit Opening Balance		1,50,000
		12,23,000
Less: Profit & Loss Appropriation		
Transfer to General Reserve		3,00,000
Proposed Dividend		2,16,000
Balance transfer to Balance sheet		7,07,000

Oriental Fire Insurance Company Ltd. Balance Sheet as on 31st March 2014

Particulars	Schedule No.		Rs.
Sources of Fund:			
Share Capital	5		18,00,000
Reserve and Surplus	6		19,07,000
Borrowings	7		–
Total			37,07,000
Application of Fund			
Investments	8		60,00,000
Loans	9		12,00,000
Fixed Assets	10		
Current Assets			
Cash and Bank	11	3,64,000	
Advance and Other Assets	12	5,85,000	
	(E)	9,49,000	
Current Liabilities	13	2,27,000	
Provisions	14	42,15,000	
	(F)	44,42,000	(34,93,000)
Total			37,07,000

Schedule 1: Premium Received

Particulars	Rs.
Premium Received	54,03,000

Accounting for Banking Company

Less: Reinsurance Premium Credited		2,25,000
		51,78,000
Reserve for unexpired Reserve		–
Opening Balance		18,60,000
Additional Reserve		6,60,000
	(A)	25,20,000
Less: Closing Balance 50% of Rs. 51,78,000		25,89,000
Additional Reserve		6,60,000
	(B)	32,49,000
	(A) – (B)	(7,29,000)

Schedule 2: Claims Paid

Particulars	Rs.
Claim Paid	12,06,000
Less: Claim Received	42,000
	11,64,000
Add: Claims outstanding at the end	1,82,000
Less: Claims outstanding at Opening	1,20,000
	12,26,000

Schedule 3: Commission Paid

Particulars	Rs.
Commission Direct	5,99,000
Commission Paid Reinsurance	1,20,000
	7,19,000
Less: Commission Ceded	96,000
	6,23,000

Schedule 4: Operating Expenses

Particulars	Rs.
Operating Expenses of Manages	8,64,000

Schedule 5: Share Capital

Particulars	Rs.
Authorised	
Issued Subscribed called up and paid up	
Rs. 1,80,000 Equity Shares of Rs. 10 each	18,00,000

Schedule 6: Reserve and Surplus

Particulars	Rs.	Rs.
General Reserve (Opening Balance)	9,00,000	
Addition during the year	3,00,000	12,00,000
Profit & Loss Account		7,07,000
		19,07,000

Schedule 8: Investments

Particulars	Rs.
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Accounting for Banking Company

Investments	60,00,000
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Schedule 9: Loans

Particulars	Rs.
Loans	12,00,000

Schedule 11: Cash and Bank Balance

Particulars	Rs.
Cash & Bank Balance	3,64,000

Schedule 12: Advance and Other Assets

Particulars	Rs.
Outstanding Premium	45,000
Agent Balance	5,40,000
	5,85,000

Schedule 13: Current Liabilities

Particulars	Rs.
Sundry Creditors	45,000
Outstanding Claims	1,82,000
	2,27,000

Schedule 14: Provisions

Particulars	Rs.
Provision for Tax	7,50,000
Reserve for unexpired risk	25,89,000
Additional Reserve	6,60,000
Proposed Dividend	2,16,000
	42,15,000

Questions for Self-Practice

OBJECTIVE QUESTIONS

(III) Multiple Choice Questions:

- (1) General Insurance include.
 - (a) Fire Insurance
 - (b) Marine Insurance
 - (c) Miscellaneous insurance
 - (d) All of above
- (2) Primary function of Insurance Companies is to protect.
 - (a) Individuals
 - (b) Policy holders
 - (c) Corporates
 - (d) None of above
- (3) Insurance industry is classified in to

Accounting for Banking Company

- (a) Life Insurance
 - (b) General Insurance
 - (c) Life and General Insurance
 - (d) None of above
- (4) General Insurance covers Loss of
- (a) Real property
 - (b) Personal property
 - (c) Real and personal property
 - (d) Real or personal property
- (5) Insurance business deals with
- (a) Risk Management
 - (b) Wealth Management
 - (c) Portfolios Management
 - (d) Marketing Management
- (6) Terms used in Insurance business
- (a) Claim
 - (b) Premium
 - (c) Surrender value
 - (d) All of Value
- (7) As per the Insurance Act 1938, following are the mandatory books to be kept by insurance companies
- (a) Register of policies
 - (b) Register of Claim
 - (c) Register of licensed
 - (d) All above
- (8) Schedule B of IRDA (preparation of Financial states and Auditors Report of insurance companies)
- (a) Revenue Account in form BRA
 - (b) P/L A/c in form B-BL
 - (c) Balance Sheet in form B-BL
 - (d) Deposits with RBI
- (9) As per schedule 12 other assets does not include
- (a) Outstanding Premium
 - (b) Agent's Balances
 - (c) Prepay meets
 - (d) Deposits with RBI
- (10) How many Schedules are there in General Insurance final Accounts?
- (a) 12
 - (b) 10
 - (c) 15
 - (d) 9

Ans.: (1-d), (2-b), (3-c), (4-c), (5-a), (6-d), (7-d), (8-d), (9-c), (10-c)

(IV) State whether the following statements are TRUE or FALSE:

- (1) Premium deficiency is the shortfall in the premium in relation to claim received against such policy.

[Hint: (1) False]

(V) Match the Columns:

Column A	Column B
(a) Premium earned	(1) Schedule 14

Accounting for Banking Company

<ul style="list-style-type: none"> (b) Claims (c) Operating expenses (d) Current liabilities (e) Investment 	<ul style="list-style-type: none"> (2) Schedule 3 (3) Schedule 1 (4) Schedule 8 (5) Schedule 2 (6) Schedule 13 (7) Schedule 4
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Ans.: (a-3), (b-5), (c-7), (d-6), (e-1),

Column A	Column B
<ul style="list-style-type: none"> (a) Managerial remuneration (b) Calls unpaid (c) Legal Charges (d) Catastrophe Reserve (e) Fixed Deposits (f) Derivative Instrument 	<ul style="list-style-type: none"> (1) Reserves and supply (2) Barrowings (3) Investments (4) Capital Reserve (5) Operating Expenses (6) Share Capital (7) Fixed Assets (8) Loans (9) Provision

Ans.: (a-9), (b-6), (c-5), (d-1), (e-3), (f-2)

Column A	Column B
<ul style="list-style-type: none"> (8) Revenue A/c (9) Premium on Re-insurance ceded (10) P & LA/c (11) Balance Sheet (12) Fixed Deposits 	<ul style="list-style-type: none"> (a) Form BPL (b) Form BS (c) Disclosed under borrowing (d) Deducted from premium (e) Form BRA (f) investment (g) Claim

Ans.: (1-e), (2-d), (3-a), (4-b), (5-c)

Column A	Column B
<ul style="list-style-type: none"> (1) Money at call & short notice (2) Agents Balances (3) Claim Outstanding (4) Catastrophe Reserve (5) Re-insurance obligations 	<ul style="list-style-type: none"> (a) Current Liabilities (b) Reserves & Surplus (c) Contingent Liabilities (d) 25% of net demand & time liabilities (e) 40% provision (f) Other Assets (g) Cash & Bank

Ans.: (1-g), (2-f), (3-a), (4-b), (5-c)

THEORY QUESTIONS

(I) **Answer the following questions:**

(9) Define concept of insurance with suitable examples?

Accounting for Banking Company

- (10) What are the different government policies taken in to accounts for insurance industry in India?
 - (11) Different statutory requirements by insurance companies?
 - (12) Explain various types of Fire Policies.
 - (13) Explain various types of Marine Insurance and policies.
 - (14) Explain various types of miscellaneous insurance policies.
 - (15) Explain different types of Insurance?
 - (16) Procedure of Final Accounts for General Insurance company.
- (II) **Write short notes on:**
- (4) Premium.
 - (5) Claims.
 - (6) Resource for unexpired Risk.
 - (7) Re-insurance.
 - (8) Surrendered.
 - (9) Bonus.
 - (10) Annuities.
 - (11) Commission.
 - (12) Government policy for insurance industry.

PRACTICE PROBLEMS

- (41) The following figures are from the books of Varuna Fire Insurance Co. Ltd. as at the end of their financial year ended 31st March, 2009.

Particular	`
Fire Fund	6,20,000
Share Capital (`10)	6,00,000
General Reserve	3,00,000
Additional Reserve	2,20,000
Investments in Central Government Securities	20,00,000
Profit and Loss A/c.	50,000
Premiums	18,01,022
Re-insurance Premium	75,017
Claims Paid	4,01,877
Claims recovered from re-insurers	14,079
Commission on re-insurance ceded	32,011
Commission on direct business	1,99,777
Commission on re-insurance accepted	40,100
Outstanding Premiums	14,865
Claims intimated but not paid (01/04/2008)	40,000
Expenses of Management	2,87,965

Accounting for Banking Company

Audit fees	12,000
Directors' Fees	12,000
Rates and Taxes	3,869
Rents (Dr.)	45,000
Provision for Tax	1,00,000
Share Transfer fees	2,000
Advance Tax	4,00,000
Sundry Creditors	15,000
Agents Balance (Dr.)	1,80,000
Cash in Hand	20,155
Cash at Bank	1,01,487

From the above, you are required to prepare Fire Revenue Account, Profit and Loss Account, and Balance Sheet of the Company, after taking into account the following:

- (a) Income tax to be provided ₹2,50,000
- (b) Transfer to General Reserve ₹1,00,000
- (c) Proposed Dividend 12%
- (d) Claims intimated but not paid as on 31st March, 2008, ₹60,800.

[Ans. Revenue Profit 6,05,704; net Profit 2,36,704 Total 12,35,704]

(42) The following trial balance is prepared from the books of HDFC Insurance Company Ltd. on 31st March, 2009.

Debit Balance	₹	Credit Balance	₹
Agents balance	13,500	Share Capital	30,000
Interest Accrued but not due	2,250	Reserve for Doubtful debts	2,000
Due from Insurers	6,450	Balance of funds as on 01/04/2008	
Balance with Bank	7,480	Fire Insurance A/c.	85,410
Cash in hand	350	Marine Insurance A/c.	95,000
Furniture (cost ₹8,400)	5,800	Unclaimed dividends	850
Stationery Stock	140	Due to Insurance Companies	3,450
Expenses of Management:		Sundry Creditors	7,250
Fire Insurance A/c.	28,000	Deposit and suspense A/c.	2,280
Marine Insurance A/c.	16,000	Profit & Loss A/c on 01/04/2008	8,040

Accounting for Banking Company

General P & L A/c.	3,000	Interest on income tax refund	3,000
Outstanding Premium	8,200	Transfer Fees	100
Foreign Taxes-Marine Insurance	800	Premiums less reinsurance:	
Donation paid	1,000	Fire Insurance A/c.	1,76,250
Income tax paid	12,000	Marine Insurance A/c.	1,02,250
Sundry Debtors	2,500	Interest & Dividend (Gross)	
Mortgage Loans	73,260	Fire Insurance	2,980
Government Securities deposited with		Marine Insurance	1,000
Reserve Bank of India	3,700	General P & L	3,050
State Government Securities	1,02,000		
Debentures of public bodies	46,550		
Equity Shares of Companies	22,500		
Claims less reinsurances:			
Fire insurance a/c.	45,000		
Marine Insurance	35,890		
TDS on Interest and Dividend			
Fire Insurance	640		
Marine insurance	250		
General Profit & Loss	650		
Commission:			
Fire insurance a/c.	50,000		
Marine Insurance a/c.	35,000		
	5,22,910		5,22,910

Following further information should be taken into consideration:

(a) Depreciation of furniture	∩ 2,000
Transfer to General Reserve	∩ 10,000
Transfer to Investment Reserve	∩ 10,000
Provision for Tax	50%

Accounting for Banking Company
Outstanding claims on 31/03/2009

Fire Insurance Account	₹ 20,000
Marine Insurance Account	₹ 5,000

- (b) The funds (Reserve for unexpired risks) are to be provided on the basis of 50% of the premium income of the year for Fire Insurance and 100% for Marine Insurance.
- (c) There is uncalled liability of ₹7,500 in respect of partly paid equity share of companies held by Safety Insurance Company Ltd.

Prepare Revenue Accounts, Profit and Loss Account for the year ended 31/03/2009 and Balance Sheet of HDFC Insurance Company Ltd. as at 31st March, 2009.

[Ans. Revenue Profit Fire 33,245 Marine 3,310 P/L A/c. 6393 B/s Total 56,397]

- (43) The following figures are extracted from the books of Oriental Insurance Co. Ltd. as at 31/03/2009.

Particulars	₹
Claims paid less re-insurance:	
Fire	80,000
Marine	62,000
General Reserve	1,18,000
Commission paid:	
Fire	
Marine	48,000
Share Capital (20,000 shares of ₹100 each)	20,00,000
Expenses of Management:	
Fire	53,000
Marine	36,000
Reserve for unexpired risks:	
Fire	2,04,000
Marine	1,23,000
Investment at cost:	
Central Government Securities deposited with RBI	19,21,000
Other Central Government Securities	1,23,000

Accounting for Banking Company

State Government Securities	2,22,000
Shares in Companies	2,49,000
Depreciation	21,000
Additional Reserves:	
Fire	1,32,000
Marine	16,000
Interest Accrued	25,000
Furniture (Cost `18,000)	12,000
Building (Cost `1,25,000)	87,000
Office Equipment (Cost `48,000)	30,000
Cash in hand	56,000
Cash at Bank	1,04,000
Premium less re-insurance:	
Fire	2,11,000
Marine	1,62,000
Tax deducted at source	9,000
Premium Due:	
Fire Marine	28,000
Marine	20,000
Claims Outstanding 1/04/2008:	
Fire	14,000
Marine	2,000
Due from other insurers	27,000
Director's Fees	4,000
Commission on Reinsurance ceded:	
Fire	23,000
Marine	2,000
Dividends	20,000

Accounting for Banking Company

Interest on Investments	1,00,000
Dues to other Insurers	43,000
Contingency Reserve	39,000
Sundry Creditors	47,000

The following further information is also given:

(a) Claim outstanding as on 31/03/2009 are:

Fire	17,000
Marine	6,000

(b) Market Value of Investments `24, 01,000.

(c) Increase Additional Reserve by 10% of net premium for the year for Fire.

(d) Maintain reserves for unexpired risks at 50% of premium for the year in case of Fire Insurance and 100% premium for the year in case of Marine insurance.

Prepare Revenue Accounts, Profit and Loss Account and Balance Sheet.

(44) From the following, you are required to calculate the Loss on Account of Claims to be shown in the Revenue Account for the year ending 31st December 2007 in the books of United Insurance Company Ltd.

Claims:

Intimated in	Admitted in	Paid in	
2006	2006	2007	40,000
2007	2007	2008	20,000
2005	2006	2006	10,000
2005	2006	2007	25,000
2007	2008	2008	12,000
2007	2007	2007	2,00,000

Claims on account of Re-insurance was `42,000.

(Oct. 2008)

(45) From the following information as at 31st March, 2008, prepare Revenue Account of Bima Marine Co. Ltd. engaged in Marine Business only for the year 01-04/2007 to 31/03/2008.

Particulars	Direct	Re-insurance
(1) PREMIUM:		
Received	2,400,000	360,000
Receivable – 1st April, 2007	120,000	21,000

Accounting for Banking Company

Receivable – 31st March, 2008	180,000	28,000
Premium Paid		240,000
Payable – 1st April, 2007		20,000
Payable – 31st March, 2008		42,000
(2) CLAIMS:		
Paid	1,650,000	125,000
Payable – 1st April, 2007	95,000	13,000
Payable – 31st March, 2008	175,000	22,000
Received		100,000
Receivable – 1st April, 2007		9,000
Receivable – 31st March, 2008		12,000
(3) COMMISSION:		
Insurance Accepted	150,000	11,000
Insurance ceded		14,000

Operating Expenses relating to Marine Insurance Business:

Salaries `2,60,000; Rent `18,000; Printing and Stationery `23,000; Legal Expenses `65,000 (including `20,000 in connection with settlement of claims);

Balance of fund on 1st April, 2007 was `26,50,000 including additional reserve of `3,45,000. Create Reserve for unexpired Risk @ 100% of premium received less reinsurance. Additional reserve is to be maintained at 5% of the net premium of the year. **(Nov. 2006)**

- (46)** Prepare a Revenue Account in respect of Fire business from the following details for the year 2005-06.

Particulars	
Reserve for Unexpired Risk on 1-4-2005 @ 50%	18,00,000
Additional Reserve	3,60,000
Estimated Liability for claims intimated on 1-4-2005	3,10,000
Estimated Liability for claims intimated on 31-3-2006	4,20,000
Claims paid	36,50,000
Legal Expenses	60,000

Accounting for Banking Company

Re-insurance Recoveries (ceded)	3,20,000
Miscellaneous Expenses	40,000
Bad Debts	8,000
Premiums recovered	48,60,000
Premiums on re-insurance accepted	3,20,000
Premiums on re-insurance ceded	4,30,000
Commission on Direct Business	4,86,000
Commission on re-insurance accepted	16,000
Commission on re-insurance ceded	21,500
Expenses on Management	9,00,000
Interest, Dividend and Rent	2,40,000
Profit on Sale of Investment	30,000

Create Reserve on 31-3-2006 to the same extent as on 1-4-2005

(May 2006)

(47) From the following information extracted from Trial Balance, prepare Revenue Account of AG Marine Insurance Company Ltd. for the year ended 31st March 2006

Debit Balance		Credit Balance	
	24,80,00		38,45,00
Claims Paid	0	Balance of Funds A/c. (including	0
Surveyor's Charges for Settlement of		additional Reserve `2,46,525)	
Claims	40,000	Premium Received and Receivable	54,15,00
Commission Re-Insurance Accepted	19,000	Interest, Dividends & Rent Received (Net)	0
Re-Insurance Premium Paid	4,84,500	Commission on Re-Insurance Ceded	1,37,500
Expenses of Management	4,24,000	Claims intimated but not paid as on	26,000
Indian and Foreign Taxes	4,40,000	31-3-2005	1,89,000
Outstanding Premium	3,08,000		
Commission on Direct Business	2,20,000		

Additional Information:

Accounting for Banking Company

- (a) Claims intimated but not paid as on 31-3-2006 is `2,29,000
 (b) Create additional reserve same as last year.
- (48) From the following balance as at March 31, 2006 in the books of General Insurance Co. Ltd. Prepare a Revenue Account in respect of Fire Insurance business carried on by them.

	(₹)
Claims paid	4,80,000
Claims outstanding on April 1, 2005	40,000
Claims intimated and accepted, but not paid on March 31, 2006	70,000
Premium received	12,00,000
Re- insurance Premium paid	1,20,000
Commission	2,00,000
Commission on re- insurance ceded	8,000
Commission on re- insurance accepted	4,000
Expenses of Management	3,02,000
Provision for unexpired risk on April 1	4,00,000
Additional provision for unexpired risk on April 1	20,600
Re- insurance recoveries of claims	8,000
Survey expenses regarding claims	5,000
Loss on sale of Motor Car	3,500
Bad debts	2,500
Profit on sale of furniture	54,500
Interest and Dividends (Net)	8,000
Income tax deducted thereon	1,500
Legal expenses regarding claims	4,000
Profit on sale of investments	3,500
Rent of staff Quarters deducted from salaries	2,400
Depreciation of Furniture	4,600

You are required to provide for additional reserve for unexpired risk at 1% of the net premium in addition to the opening balance of Additional Reserve.

- (49) From the following information as on 31st March 2006, Prepare the Revenue Account of the Indian Marine Insurance Co. Ltd.

Accounting for Banking Company

	Direct Business	Reinsurance
	(₹)	(₹)
(I) Premium:		
Received	46,00,000	7,20,000
Receivable		
1st April	2,48,000	27,000
31st March	3,36,000	34,000
Paid	—	4,60,000
Paid Payable		
1st April	—	37,000
31st March	—	62,000
(II) Claims:	23,50,000	3,00,000
Paid		
1st April	1,66,000	39,000
Payable		
31st March	2,08,000	44,000
Received	—	1,70,000
Receivable		
1st April	—	16,000
31st March	—	23,000
(III) Commission:		
On Insurance accepted	2,20,000	19,000
On Re- insurance ceded	—	26,000

(IV) Other Expenses and Income:

Salaries ₹3,20,000, Rent rates and Taxes ₹29,000; Postage & Telegrams ₹43,000; Indian Marine Tax paid- ₹4,40,000; Interest, Dividends and rent Received (net) ₹1,37,500; Income Tax deducted at Source ₹40,250; Legal expenses (inclusive of ₹40,000 in connection with settlement of claims) ₹72,000.

- (V) Balance of Fund on 1st April, ₹38, 45,000 including Additional Reserve of ₹4, 45,000. Additional Reserve has to be maintained at 5% of the net premium of the year.

(50) The following balances relate to the Sea Blessed Insurance Co. Ltd.

	(₹)	(₹)
Premiums	5,00,000	6,00,000
Commission on Direct Business	22,500	30,000
Commission on Re- insurance Accepted	17,500	25,000

Accounting for Banking Company

Commission on Re- insurance ceded	4,000	24,000
Claims under Policies (paid during the year)	86,250	1,62,250
Depreciation on Furniture, car etc.	12,750	15,750
Profit on Sale of Motor Car	6,000	Nil
Loss on Sale of sold furniture	Nil	2,000
Interest on Income Tax Refund	14,000	7,000
Audit Fees	10,000	10,000
Salaries to staff	1,25,000	1,35,000
Printing, Postage and Stationery	46,500	57,500
Legal Expenses	5,000	4,000
Bad Debts	15,500	22,500
Recoveries in respect of claim under re- insurance	750	22,200
Re- insurance Premium	10,000	20,000
Year ending 31 st March,2005	50,000	1,00,000
Year ending 31 st March, 2006	5,00,000	

Total amounts of estimated liability in respect of outstanding claims as at 31-3-2004:

31-3-2005; 31-3-2005 were `34,250, `44,750 and `55,550 respectively. Reserve for unexpired risk as at 31-3-2004 was `3, 20,000 and the additional Reserve was `32,000. Reserve for unexpired was to be provided for at 100% and Additional Reserve at 10% of the net Premium income for the year ending 31-3-2005 and 31-3-2006.

Prepare Marine in Revenue Account of Sea Blessed Insurance Co. Ltd, for the year ending 31-3-2005 and 31-3-2006 in the prescribed form.

- (51)** From the following balances of Integrated India Insurance Company Ltd. prepares the necessary Revenue Accounts and the Profit and Loss Account in respect of the year 2005-06.

	(₹)		(₹)
Bad Debts (Fire)	5,000	Interest, Dividends etc, recd.	19,000
Bad Debts (Marine)	10,000	Difference in Exchange (Cr.)	300
Auditors Fees	2,000	Profit on Sale of Investments	60,000
Directors Fees	4,200	Fire premium	6,00,000
Share Transfer Fees	400	Marine premium	10,80,000

Accounting for Banking Company

Miscellaneous Income	1,600	Management Expenses:	
Fire Fund (1.4.2005)	2,50,000	Fire	1,45,000
Marine Fund (1.4.2005)	8,20,000	Marine	4,02,000
Claims paid (fire)	1,40,000	Claims outstanding on 1.4.2005 (Fire)	50,000
Claims paid (Marine)	3,00,000	Claims outstanding on 1.4.2005 (Marine)	60,000
Commission paid (fire)	90,000	Commission earned	
Commission paid (marine)	1,08,000	on reinsurance ceded:	
Additional Reserve on	50,000	Fire	30,000
1. 4.2005 (Fire)	35,000	Marine	60,000
Depreciation			

- (a) The normal reserve required is 50% of net premium for fire and 100% of net premium for marine. In addition, for fire 15% of the net premium is to be provided as additional reserve.
- (b) The estimated liability in respect of outstanding claims due and intimated on 31.3.2006 was as under:
- | | |
|--------|-----------|
| Fire | 1, 00,000 |
| Marine | 1, 40,000 |
- (c) The Management expenses stated above are the direct expenses for the respective departments. In addition common expenses of `20,000 were incurred which must be charged to each of departments on a suitable basis.
- (d) The following reinsurance premium in respect of business accepted and ceded respectively have not been included in the above figures.

	Reinsurance accepted	Reinsurance ceded
	(`)	(`)
Fire	25,000	20,000
Marine	60,000	45,000

- (52) The following figures are extracted from the books of Z Insurance Co. Ltd as at 31.3.2006:

	(`)
Claims paid less re-insurance:	
Fire	80,000
Marine	62,000

Accounting for Banking Company

General Reserve	1,18,000
Commission paid:	
Fire	48,000
Marine	39,000
Share Capital (20,000 shares of `100 each)	20,00,000
Expenses of Management:	
Fire	53,000
Marine	36,000
Reserve for unexpired risk:	
Fire	2,04,000
Marine	1,23,000
Investment at cost:	19,21,000
Central Govt. Securities deposited with RBI	1,23,000
Other Central Govt. Securities	2,22,000
Shares in Companies	2,49,000
Depreciation	21,000
Additional Reserves:	
Fire	1,32,000
Marine	16,000
Interest Accrued	25,000
Furniture (Cost `18,000)	12,000
Building (Cost `1,25,000)	87,000
Office Equipment (Cost `48,000)	30,000
Cash in hand	56,000
Cash at Bank	1,04,000
Premium less re-insurance:	
Fire	2,11,000

Accounting for Banking Company

Marine	1,62,000
Tax deducted at source	9,000
Premium Due:	
Fire	28,000
Marine	20,000
Claims Outstanding 1.4.2005:	
Fire	14,000
Marine	2,000
Due from other insurers	27,000
Director's Fees	4,000
Commission on Reinsurance ceded:	
Fire	23,000
Marine	2,000
Dividends	20,000
Interest on Investments	1,00,000
Due to other Insurers	43,000
Contingency Reserve	39,000
Sundry Creditors	47,000

The following further information is also given:

(a) Claims outstanding as on 31.3.2006 are:

Fire 17,000

Marine 6,000

(b) Market Value of Investments ₹24, 01,000.

(c) Increase Additional Reserve by 10% of net premium for the year for Fire.

(d) Maintain reserves for unexpired risk at 50% of premium for the year in case of Fire Insurance and 100% premium for the year in case of Marine insurance.

Prepare Revenue Accounts, Profit and Loss Account and Balance Sheet.

(53) The following figures are from the books of Varuna Fire Insurance Co. Ltd as at the end of their financial year ended 31st March, 2006.

	(₹)
Fire Fund	6,20,000
Share Capital (₹10)	6,00,000

Accounting for Banking Company

(d) Claims intimated but not paid as on 31st March, 2005, `60,800.

(54) The following trial balance is prepared from the books of Safety Insurance Company Ltd. on 31st March 2006.

Debit Balances	(`)	Credit Balance	(`)
Agents balances	13,500	Share Capital	30,000
Interest Accrued but not due	2,250	Reserve for Doubtful debts	2,000
Due from Insurers	6,450	Bal. of Funds as on 1.4.2005	
Balance with Bank	7,480	Fire Insurance A/c.	85,410
Cash in hand	350	Marine Insurance A/c.	95,000
Furniture (cost `8,400)	5,800	Unclaimed Dividends	850
Stationery Stock	140	Due to Insurance companies	3,450
Expenses of Management:		Sundry Creditors	7,250
Fire Insurance A/c	28,000	Deposit and suspense A/c	2,280
Marine Insurance A/c	16,000	Profit & Loss A/c on 1.4.2005	8,040
General P & A A/c	3,000	Interest on income tax refund	3,000
Outstanding Premium	8,200	Transfer Fees	100
Foreign Taxes- Marine Ins.	800	Premiums less reinsurance:	
Donation paid	1,000	Fire Insurance A/c	1,76,250
Income tax paid	12,000	Marine Insurance A/c.	1,02,250
Sundry Debtors	2,500	Interest & Dividend (Gross)	
Mortgage Loans	73,260	Fire Insurance	2,980
Govt. securities deposited with		Marine Insurance	1,000
Reserve Bank of India	3,700	General P & L	3,050
State Govt. Securities	1,02,000		
Debentures of public bodies	46,550		
Equity Shares of companies	22,500		
Claims less reinsurances:			
Fire insurance a/c.	45,000		
Marine Insurance a/c	35,890		

Accounting for Banking Company

Claims receivable – 1st April, 2002	–	65,000
Claims receivable – 31st March, 2003	–	1,13,000
Expenses of Management (includes `35,000 Surveyor's fee and `45,000 Legal expenses for settlement of claims)	2,30,000	

(56) From the following balances, prepare the Fire Insurance Revenue Account for the year ended 31 December 2001, of ABC Fire Insurance Co. Ltd.:

	(₹)		(₹)
Commission on re-insurance accepted	1,86,458	Legal Expenses	23,400
Commission on direct business	1,95,172	Electricity charges	16,100
Depreciation on furniture	650	Provident Fund contribution	11,875
Depreciation on library	148	Audit fee	2,500
Depreciation on Motor Cars	6,240	Professional taxes	250
Loss on sale of Motor Cars	12,074	Miscellaneous expenses	2,875
General Manager's Salary	24,000	Bad debts written off	2,206
Telephone	5,100	Claims under policies less re-insurance paid during the year	1,52,930
Postage and Telegrams	5,150	Total estimated liability in respect of outstanding claims as at 31 December	
Rent	62,500	2001 whether due or intimated	6,264
Traveling expenses	45,600	Total estimated liability in respect of outstanding claims as at 31 December	
Motor Car expenses	45,500	2000 whether due or intimated	1,198
Establishment	1,45,500	Reserve for unexpired risks as at 31/12/2000	3,66,594
Bonus	24,000		
Stationery	35,550		
Newspaper and periodicals	14,062		

Accounting for Banking Company

	Additional Reserve for unexpired risks as at 31/12/2000	45,824
	Premiums received less re-insurance	9,89,980
	Commission on re-insurance ceded	3,41,208

You are required to make 40 per cent of the net premiums received as reserve for unexpired risks as at 31/12/2001 and 10% of the net premiums as additional reserve for the same.

- (57) New Insurance Co. Ltd. is doing composite insurance business. The following balances pertaining to its marine business as at 31 December, 2001 are submitted to you for preparing the Revenue Account for the year ended on that date in the prescribed form:

	(₹)		(₹)
Commission on re-insurance accepted	1,86,000	Printing Stationery & periodical	49,000
Commission on direct business	1,95,000	Law charges	25,000
Commission on re-insurance ceded	3,42,000	Electricity charges	11,000
Depreciation	7,000	Contribution to Staff Provident Fund	10,900
Loss on sale of motor car	12,000	Audit Fees	4,000
General Manager's salary	48,000	Bad debts	1,200
Rent	62,500	Miscellaneous expenses	2,500
Postage, Telegram & Telephones	10,000	Claims under policies paid during the year	6,53,000
Staff salary and bonus	1,50,000	Reserve for unexpired risks as on 31December, 2000	13,67,000
Traveling expenses	25,600	Additional Reserve for unexpired risks as on 31/12/00	46,000
Motor Car expenses	85,000		

Accounting for Banking Company

		Premium received less re-insurances	9,90,000
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You have also to consider the following information and directions:

- (i) Gross premium written direct in India was `12,23,000.
- (ii) No premium was written outside India and as such no business was transacted outside India during 2001.
- (iii) Total estimated liability in respect of claims due or intimated as on 31 December, 2000 and 31 December, 2001 were `1,200 and `6,300 respectively
- (iv) The General Manager's salary pertaining to Marine Department was `24,000 only
- (v) Make an additional reserve of 10 per cent of the premium received in addition to the usual reserve required to be maintained as per the code of conduct in respect of unexpired risks as on 31 December, 2001.

Chapter 3

Non-Banking Financial Companies

INTRODUCTION OF NBFCs:

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 and is engaged in the business of loans and advances, acquisition of Shares/stock/bonds/debentures/securities issued by Government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, sale/purchase/construction of immovable property. A non-banking institution which is a company and which has its principal business of receiving deposits under any scheme of arrangement or any other manner, or lending in any manner is also a non-banking financial company (Residuary non-banking company).

Bank Vs. Non-Bank:

- Both are Financial Intermediaries.
- Banks can-
 - Maintain Demand Deposits (Savings/Current Accounts).
 - Form a part of payment and settlement mechanism.
- Non-banks can-
 - Accept only Term Deposits.
 - Does not form part of payment and settlement mechanism.

Accounting for Banking Company

NBFCs are doing functions similar to that of banks; however there are a few differences as given below:

- An NBFC cannot accept demand deposits;
- An NBFC is not a part of the payment and settlement system and as such an NBFC cannot issue cheques drawn on itself; and
- Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available for NBFC depositors like banks.

DEFINITION OF NBFCs:

Section 45-I (f) of RBI act, 1934 “Non-banking financial company” means:

- A “Financial Institution” which is a company;
- A Non-Banking Institution which is a company and which has as its Principal Business the receiving of deposits, under any scheme or arrangements or in any other manner, or lending in any manner;
- Such other Non-Banking Institution or class of such institutions, as RBI specifies.

REGISTRATION OF NBFCs:

- In terms of Section 45-IA of the RBI Act, 1934, it is mandatory that every NBFC should be registered with RBI to commence or carry on any business of non-banking financial institution as defined in clause (a) of Section 45 I of the RBI Act, 1934. It has to be registered with RBI and must has Net Owned Fund (NOF) not less than 200 lacs by the end of March 2017 as per the milestones given below:
 - (1) Rs. 100 lacs by the end of March 2016.
 - (2) Rs. 200 lacs by the end of March 2017.
- However, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI. Housing Finance Companies, Merchant Banking Companies, Stock Exchanges, Companies engaged in the business of stock-broking/sub-broking, Venture Capital Fund Companies, Nidhi Companies, Insurance companies and Chit Fund Companies are NBFCs but they have been exempted from the requirement of registration under Section 45-IA of the RBI Act, 1934 subject to certain conditions.

Accounting for Banking Company

- Housing Finance Companies are regulated by National Housing Bank, Merchant Banker/Venture Capital Fund Company/stock-exchanges/stock brokers/sub-brokers are regulated by Securities and Exchange Board of India, and Insurance companies are regulated by Insurance Regulatory and Development Authority. Similarly, Chit Fund Companies are regulated by the respective State Governments and Nidhi Companies.

REGULATION OF NBFCs:

- (1) A company incorporated under the Companies Act, 1956 and desirous of commencing business of non-banking financial institution as defined under Section 45 I(a) of the RBI Act, 1934 should have a minimum Net Owned Fund of Rs. 200 lakhs (w.e.f April 21, 1999).
- (2) All NBFCs are not entitled to accept public deposits. Only those NBFCs holding a valid Certificate of Registration with authorization to accept Public Deposits can accept/hold public deposits. NBFCs authorized to accept/hold public deposits besides having minimum stipulated Net Owned Fund (NOF) should also comply with the directions such as investing part of the funds in liquid assets, maintain reserves, rating etc. issued by the Bank.
- (3) Traditionally, deposit taking NBFCs (NBFCs-D) were subjected to prudential regulation on various aspects of their functioning while the non-deposit taking NBFCs (NBFCs-ND) were subject to minimal regulation. In the light of the growing integration of the financial sector, it was felt that all systemically relevant entities offering financial services ought to be brought under a suitable regulatory framework to contain systemic risk. Therefore, as a first step, in December 2006 all NBFCs-ND with an asset size of Rs. 100 crore and above as per the last audited balance sheet were designated as systemically important NBFCs-ND (NBFCs-ND-SI) and a specific regulatory framework was put in place from April 1, 2007 for such entities.
- (4) To ensure a measured movement towards strengthening the financials of all deposit taking NBFCs, in June 2008, NBFCs-D with a minimum Net Owned Fund (NOF) of less than Rs. 200 lakhs were asked to freeze their deposits, and bring it down to the revised ceiling of deposits, which in turn was dependent on the extent by which their NOF was less than the prescribed minimum of Rs. 200 lakhs.

Accounting for Banking Company

- (5) To enhance the focus on the NBFCs-ND with asset size of Rs. 50 crore and above but less than Rs. 100 crore (which were earlier not supervised), it was decided to call for basic information from non-deposit taking NBFCs with asset size between Rs. 50 crore and Rs. 100 crore at quarterly intervals. To ensure better supervision, all NBFCs (both deposit taking and non-deposit taking) with asset size of Rs. 100 crore and above were asked to furnish the information about downgrading/upgrading of the assigned rating of any financial product issued by them, within fifteen days of such a change in the rating.

CLASSIFICATION OF NBFCs:

Originally, NBFCs registered with RBI were classified as:

- (i) Equipment Leasing Company;
- (ii) Hire-Purchase Company;
- (iii) Loan company;
- (iv) Investment company.

However, with effect from December 6, 2006 the above NBFCs registered with RBI have been reclassified as mentioned in table.

Non-Banking Financial Entity	Principal Business
(I) Non-Banking Financial Company.	In terms of the Section 45-l(f) read with Section 45-i(c) of the RBI Act, 1934, as amended in 1997, their principal business is that of receiving deposits or that of a financial institution, such as lending, investment in securities, hire purchase finance or equipment leasing.
(a) Equipment leasing company (EL).	Equipment leasing or financing of such activity.
(b) Hire purchase finance company (HP).	Hire purchase transactions or financing of such transactions.
(c) Investment company (IC).	Acquisition of securities. These include Primary Dealers (PDs) who

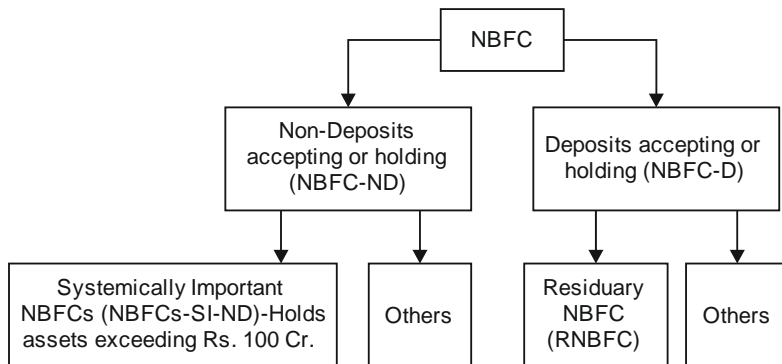
Accounting for Banking Company

	deal in underwriting and market making for government securities.
(d) Loan company (LC).	Providing finance by making loans or advances, or otherwise for any activity other than its own; excludes EL/HP/Housing Finance Companies (HFCs).
(e) Residuary non-banking company (RNBC).	Company which receives deposits under any scheme or arrangement by whatever name called, in one lump-sum or in instalments by way of contributions or subscriptions or by sale of units or certificates or other instruments, or in any manner. These companies do not belong to any of the categories as stated above.
(II) Mutual Benefit Financial Company (MBFC) i.e., Nidhi Company.	Any company which is notified by the Central Government as a Nidhi Company under section 620A of the Companies Act, 1956 (1 of 1956).
(III) Mutual Benefit Company (MBC), i.e., potential <i>Nidhi</i> company.	A company which is working on the lines of a Nidhi company (MBC), but has not yet been so declared by the Central Government, has minimum net owned fund (NOF) of Rs.10 lakh, has applied to the RB1 for Certificate of Registration (CoR) and also to Department of Company Affairs (DCA) for being notified as Nidhi company and has not contravened directions/ regulations of RBI/DCA.
(IV) Miscellaneous non-banking company (MNBC), Managing, conducting or supervising as a	(MNBC), Managing, Conducting or agent of any transaction or

Accounting for Banking Company

<p>promoter, foreman or i.e. Chit Fund Company.</p>	<p>arrangement by which the company enters into an agreement with a specified number of subscribers that every one of them shall subscribe a certain sum in instalments over a definite period and that every one of such subscribers shall in turn, as determined by tender or in such manner as may be provided for in the arrangement, be entitled to the prize amount.</p>
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The above types of companies are further classified into those accepting deposits and those not accepting deposits. Below is the graphical presentation of types of NBFC.



Regulatory Norms and Directions for NBFCs:

Important Statutory Provisions of Chapter III B of the RBI Act as applicable to NBFCs:

Sr. No.	Subject	Particulars
(1)	Certificate of Registration:	No company, other than those exempted by the RBI, can commence or start the business of non-banking financial institution without obtaining a Certificate of Registration (CoR). The pre-requisite for eligibility for such a CoR is that the NBFC have a minimum Net Owned Fund (NOF) of Rs. 25 lakh (since raised to Rs. 2 crore on April 21, 1999 for any new applicant NBFC). The RBI considers grant CoR after satisfying itself about the

Accounting for Banking Company

		company's compliance with the enumerated in Section 45-1A of the RBI Act.
(2)	Maintenance of Liquid Assets:	NBFCs have to invest in unencumbered approved securities, valued at a not exceeding current market price, an amount which, at the close of business on any day, shall not be less than 5.0 per cent but not exceeding 25.0 per cent specified by RBI, of the deposits outstanding at the close of business on the working day of the second preceding quarter.
(3)	Creation of Reserve Fund:	Every non-banking financial company shall create a reserve fund and transfer thereto a sum not less than 20.0 per cent of its net profit every year as in the profit and loss account and before any dividend is declared. Such fund to be created by every NBFC irrespective of the fact whether it accepts deposits or not. Further, no appropriation can be made from the fund without prior written approval of RBI.
(1) Deposit Acceptance Related Regulations:		
(1)	Ceiling on quantum of public Deposits:	<p>Loan and investment companies - 1.5 times of NOF if the company has NOF of Rs. 25 lakh, Minimum Investment Grade (MIG) credit rating, complies with all the prudential norms and has Capital to Risk Assets Ratio (CRAR) of 15 per cent. Equipment leasing and hire purchase finance companies - if company has NOF of Rs. 25 lakh and complies with all the prudential norms:</p> <p>(i) With MIG credit rating and 12 per cent CRAR - 4 times of Net Owned Funds (NOF).</p> <p>(ii) Without MIG credit rating but CRAR 15 per cent or above - 1.5 times of NOF, or Rs. 10 crore, whichever is less.</p>
(2)	Investment in liquid assets:	<p>NBFCs: 15 per cent of outstanding public deposit liabilities as at the close of business on the last working day of the second preceding quarter, of which:</p> <p>(i) not less than 10 per cent in approved securities and</p> <p>(ii) not more than 5 per cent in term deposits with scheduled commercial banks.</p> <p>Directions for investments by RNBCs were rationalized in June 2004 with a view to reducing the overall systemic risk in the financial sector and safeguarding</p>

Accounting for Banking Company

		<p>the interest of the depositors. In this regard the following roadmap was prescribed:</p> <p>(a) From the quarter ended June 2005 and onwards, RNBCs were permitted to invest only to the extent of 10% of the Aggregated Liabilities to Depositors (ALDs) as at the second preceding quarter or one time of their Net Owned Funds, whichever is lower, in the manner which in their opinion of the company is safe as per approval of its Board of Directors.</p> <p>(b) From the quarter ended June 2006 onwards, this limit would stand abolished and RNBCs would not be permitted to invest any amount out of ALDs as per their discretion. However, to avoid strain, in complying with 100% directed investments by companies, the same had been modified to 95% of ALD up to March 31, 2007 and 100% of ALD thereafter. These liquid asset securities are required to be lodged with one of the scheduled commercial banks or Stock Holding Corporation of India Ltd. or a depository or its participant (registered with SEBI). Effective October 1, 2002, government securities are to be necessarily held by NBFCs either in Constituent's Subsidiary General Ledger Account with a scheduled commercial bank or in a Demat account with a depository participant registered with SEBI. These securities cannot be withdrawn or otherwise dealt with for any purpose other than repayment of public deposits.</p>
(3)	Period of Deposits:	<p>No demand deposits</p> <p>NBFCs – 12 to 60 months</p> <p>RNBCs – 12 to 84 months</p> <p>MNBCs (chit Funds) – 6 to 36 months.</p>
(4)	Ceiling of deposit rate:	<p>NBFCs, MNBCs and Nidhis - 11.0 per cent per annum (effective March 4, 2003).</p> <p>RNBCs - Minimum interest of 4.0 per cent on daily deposits and 6.0 per cent on other than daily deposits. Interest may be paid or compounded at periods not shorter than monthly rests.</p>

Accounting for Banking Company

(5)	Advertisement methodology for acceptance of deposits/ public deposits:	Every company which accepts deposits by advertisement has to comply with the advertisement rules prescribed in this regard the deposit acceptance form should contain certain prescribed information, issue receipt for deposits and maintain a deposit register etc.
(6)	Submission of returns:	All NBFCs holding or accepting public deposits have to submit periodical returns to RBI at Quarterly, half yearly and annual intervals.
(2) Prudential Norms applicable to only those NBFCs which are accepting/holding public deposits:		
(1)	Capital to Risk Assets Ratio (CRAR):	<p>The NBFCs holding/accepting public deposits are required to (CRAR) maintain as under:</p> <ul style="list-style-type: none"> (i) Equipment leasing companies/hire purchase finance companies (with MIG credit rating) 12 percent. (ii) Equipment leasing companies/hire purchase finance companies (without MIG credit rating) 15 percent. (iii) Loan/investment companies 15 percent. (iv) RNBCs 12 per cent. <p>CRAR comprises – tier I and tier II capital to be maintained on a daily basis and not merely on the reporting dates. Tier I Capital – core capital or NOF but includes compulsorily convertible preference shares (CCPS) as a special case for CRAR purposes. Tier II Capital – all quasi-capital like preference shares (other than CCPS) subordinated debt, convertible debentures, etc. Tier III Capital not to exceed tier I capital General provisions and loss reserves not to exceed 1.25 per cent of the risk – weighted assets. Subordinated debt issued with original tenor of 60 months or more.</p>

Accounting for Banking Company

(2)	Restrictive norms:	<p>Acceptance of public deposits not allowed if the prudential norms are not complied with fully.</p> <p>Any NBFC defaulting in repayment of the matured deposits prohibited from creating any further assets until the defaults are rectified.</p> <p>Investments in real estate, except for own use, restricted to 10 per cent of the owned fund.</p> <p>Investments in unquoted shares restricted as under - EL/HP Companies 10 percent of owned fund. Loan/investment companies, 20 per cent of owned fund.</p> <p>No further investments in real estate or unquoted shares in case of excess position held till its regularization. Sufficient adjustment period allowed - further extension on merits of each case.</p>
(3)	Credit/investment concentration norms:	<p>Single borrower exposure limits credit - 15 percent of owned norms fund.</p> <p>Investments - 15 percent of owned fund.</p> <p>Single group of borrower exposure limits credit - 25 percent of owned fund.</p> <p>Composite (credit and investments) exposure limits</p> <p>Single borrower - 25 percent of owned fund.</p> <p>Single group of borrowers - 40 percent of owned fund.</p>
		<ul style="list-style-type: none"> • Exposure norms also applicable to own group companies and subsidiaries. • Includes all forms of credit and credit related and certain other receivables as also off balance sheet exposures. • Debentures/bonds to be treated as credit for the purpose of prudential norms but as investments for the purpose of balance sheet and compliance with investment obligations.
(4)	Reporting System: Half yearly return:	<p>Half-yearly returns to be submitted as at the end of March and September every year,</p> <p>-Time allowed for submission - 3 months from the due date,</p> <p>-The return to be certified by the statutory auditors of the company. However, it need not wait for audit and the figures furnished therein could be the unaudited figures but must be certified by auditors.</p>

Accounting for Banking Company

(3) Prudential Norms applicable to all NBFCs irrespective of whether they accept/hold public deposits or not:		
(1)	Income Recognition Norms:	<p>The recognition of income as under:</p> <ul style="list-style-type: none"> • On the Non Performing Asset: allowed on cash basis only. The unrealized income recognized earlier is required to be reversed. • On Performing Asset: allowed on accrual basis only as follows: <ol style="list-style-type: none"> (1) Loans and Advances - Overdue up-to 6 months. (2) Hire Purchase and Leasing - Overdue up-to 12 months. • Dividend Income on shares may be recognized when right to dividend has been established. • Interest on Bonds and Debentures to be recognized on accrual basis.
(2)	NPA norms:	<ul style="list-style-type: none"> • Recognition of income on accrual basis before the asset becomes NPA as under: <ol style="list-style-type: none"> (1) Loans and Advances: Up to 6 months and 30 days past due period (past due period done away with effect from March 31, 2003). (2) Lease and Hire Purchase Finance: 12 months: • Meaning of NPA: <ol style="list-style-type: none"> (1) Interest remaining overdue for 6 months. (2) In case of term loan, installment remaining overdue for 6 months. (3) Bill discounted remaining overdue for 6 months. (4) Lease rental and hire purchase installments remaining overdue for 12 months or more.
(3)	Restrictive Norms:	Loans against own shares not allowed.
(4)	Policy on demand/ call loans:	Companies to frame a policy for demand and call loans relating to cut-off date for recalling the loans, the rate of interest, periodicity of such interest, periodical reviews of such performance, etc.

Accounting for Banking Company

(5)	Accounting Standards:	All the Accounting Standards and Guidance Notes issued by Institute of Chartered Accountants of India (ICAI) are applicable to all NBFCs in so far as They are not inconsistent with the guidelines of RBI.
(6)	Accounting for investments:	<p>All NBFCs to have a well defined investment policy. Investments classified into two categories - (i) long term and (ii) current investments.</p> <p>Long term investments to be valued as per Accounting Standard (AS 13), issued by ICAI.</p> <p>Current investments to be classified into - (a) quoted and (b) unquoted.</p> <p>Current quoted investments to be valued at lower of cost or market value. Block valuation permitted - Notional gains or losses within the block permitted to be netted - but not inter-block, net notional gains to be ignored but notional losses to be provided for. Valuation norms for current unquoted investments are as under:</p> <ul style="list-style-type: none"> (i) Equity shares (at lower of cost or breakup value or fair value). (ii) Re. 1/- for the entire block of holding if the balance sheet of the investee company is not available for the last two years. (iii) Preference shares at lower of cost or face value. (iv) Government securities at carrying cost: <ul style="list-style-type: none"> (i) Mutual Fund units at net asset value (NAV) for each scheme and (ii) Commercial paper (CP) at its carrying cost
(7)	Assets Classification:	<p>All forms of credit (including receivables) to be classified into four categories:</p> <ul style="list-style-type: none"> • Standard asset: Performing Asset that does not show any credit weakness. • Sub-standard asset: An asset that is NPA for a period not exceeding 18 months (For banks 12 months). • Doubtful asset: An asset which is sub-standard for a period over 18 months (For banks 12 months). • Loss asset: NIL security available and non-recoverable in nature.

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(8)	Provisioning for Non-Performing Assets – Loans and Advances:	<p>Standard assets: No provision Sub-standard assets - 10 per cent of outstanding balance.</p> <p>Doubtful assets: on unsecured portion 100 per cent and on secured portion 20, 30 and 50 per cent depending on the age of the doubtful assets.</p> <p>Loss asset: 100 per cent of the outstanding.</p>
(9)	Provisioning for Non-Performing Assets – Equipment Lease and Hire Purchase accounts:	<ul style="list-style-type: none"> • Unsecured portion to be fully provided for. • Further provisions on net book value (NBV) of EL/HP assets. • Accelerated additional provisions against NPAs. • NPA for 12 months or more but less than 24 months 10 per cent of NBVNPA. • For 24 months or more but less than 36 months 40 per cent of NBVNPA. • For 36 months or more but less than 48 months 70 per cent of NBVNPA. • For 48 months or more 100 per cent of NBV value of any other security considered only against additional provisions. Rescheduling in any manner will not upgrade the asset up-to 12 months of satisfactory performance under the new terms. Repossessed assets to be treated in the same category of NPA or own assets – option lies with the company.
(10)	Risk – Weights and Credit Conversion factors:	<ul style="list-style-type: none"> • Risk: Weights to be applied to all assets except intangible assets. • Risk: Weights to be applied after netting off the provisions held against relative assets. • Risk: Weights are 0, 20 and 100. • Assets deducted from owned fund like exposure to subsidiaries or companies in the same group or intangibles to be assigned 0 per cent risk - weight. • Exposures to all-India financial institutions (AIFIs) at 20 percent risk -weight and all other assets to attract 100 per cent risk - weights. • Off-balance sheet items to be factored at 50 or 100 and then converted for risk - weight.

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(11)	Disclosure requirements:	<ol style="list-style-type: none"> (1) Every NBFC is required to separately disclose in its balance sheet the provisions made as outlined above without netting them from the income or against the value of assets. (2) The provisions shall be distinctly indicated under separate heads of accounts as under: <ol style="list-style-type: none"> (i) provisions for bad and doubtful assets; and (ii) provisions for depreciation in investments. (3) Such provisions shall not be appropriated from the general provisions and loss reserves held, if any, by the NBFC. (4) Such provisions for each year shall be debited to the profit and loss account. The excess of provisions, if any, held under the heads general provisions and loss reserves may be written back without making adjustment against them. (5) <i>Nidhis and Chit Fund</i> companies exempted.
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Format of Financial Statement of NBFCs:

At present the NBFCs prepare their financial statements as on 31st March every year in accordance with the provisions of sections 210 and 211 of the Companies Act, 1956; the formats are prescribed in Schedule VI thereof. The said Schedule VI consists of the following parts;

Part I: This part prescribes two alternative forms of presenting the balance sheet, viz., horizontal form and vertical form. It also indicates the information relating to different assets and liabilities, which should be disclosed therein. Besides, certain general instructions have been prescribed in the formats, which must be followed in preparing the balance sheet.

Part II: This part deals with the requirements as to disclosures to be made in profit and loss account. Unlike balance sheet, no format for profit and loss account has been prescribed. As such, a company may adopt any format suitable to its requirements.

Part III: This part contains the interpretation of certain terms.

Part IV: This part contains Balance Sheet abstract and the company's general business profile.

While the above can be considered as basic provisions on reporting, companies are also required to disclose certain additional information

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such as expenditure on research and development and energy conservation measures which are mostly applicable to non-financial companies. Companies which are listed in any stock exchanges are further required, as per the listing agreement, to attach a cash flow statement and a statement containing the comparison of the projections made for the respective years in the prospectus with the actual performance.

Besides this, in terms of extant provisions of the Directions issued by RBI on deposit acceptance and prudential norms, NBFCs are also required to disclose the following information:

- (i) Under the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 it has been prescribed that the report of the Board of Directors to members should contain the following particulars/information:
 - (a) total number of accounts of public deposit which have not been claimed by the depositors or not paid by the company after the date on which the deposit became due for repayment and the total amount due in such accounts;
 - (b) steps taken or proposed to be taken by the Board of Directors for the repayment of the amounts due to the depositors remaining unclaimed or undisbursed (This statement is necessary only in such cases where the amount of deposits unclaimed or undisbursed are in excess of rupees five lakh).
- (ii) Under the Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 every NBFC, to which the Directions are applicable, is required to disclose in its balance sheet the provisions made under the following two heads:
 - (a) Provisions for bad and doubtful debts.
 - (b) Provisions for diminution in value of investments.

Owned Fund and Net Owned Fund:

Particulars	Amount
Equity Share Capital	xxx
Add: Free Reserve	xxx
Less: Losses	xxx
Less: Deferred Exp.	xxx
Less: Intangible Assets	xxx
Owned Funds	xxx

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Less: Excess Advance and Investment (In group companies beyond 10% of Owned Funds)	xxx
Net Owned Funds Net Owned Funds = Tier I – Capital Employed	xxx

Note:

- Above calculation include CRR, DRR, Securities Premium, General Reserves, Convertible Preference Share Capital, and Capital Reserves if realized in cash.
- NBFC should transfer a minimum of 20% of their profit to reserve before declaration of dividend.

Tier-II Capital Employed:

Particulars	Amount
Non-Convertible Preference Share Capital	xxx
Add: Revaluation Reserve	xxx
Add: Capital Reserve (not realized in cash)	xxx
Tier-II Capital Employed	xxx

Note:

Tier-II Capital Employed cannot exceed Tier-I Capital Employed.

Capital to Risk Weighted Asset Ratio (CRAR):

Every NBFC to which the prudential norms are applicable, shall have CRAR of minimum 15%.

$$\% \text{ of CRAR} = \frac{\text{Capital Employed}}{\text{Risk Weighted Assets}} \times 100$$

$$\text{Capital Employed} = \text{Tier-I} + \text{Tier-II}$$

Provisioning requirement on Hire purchase and Lease asset:

Particulars	Percentage
Standard Assets	0.25%
Sub-Standard Assets	10%
Doubtful Assets:	
On unsecured part	100%
On secured part	
-Up-to 1 year	20%
-1 year to 3 years	30%
-More than 3 years	50%
Loss Assets	100%

Basic Provision:

Particulars	Percentage
Installment Due but not received	xxx

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Add: Installment due in future	XXX
Less: Interest Income not yet recognized in future	XXX
Less: Depreciated Value of Asset (Cost – 20% Depreciation on SLM)	XXX
	XXX

Additional Provision:

Particulars	Percentage
Up-to 12 months	Nil
Over 12 months and up-to 24 months	10% of Net Book Value
Over 24 months and up-to 36 months	40% of Net Book Value
Over 36 months and up-to 48 months	70% of Net Book Value
Over 48 months	100%

Note:

After expiry of 12 months from the last date of installment due, full outstanding amount shall be provided for.

Net Book Value = Total Investment due and not due – Future installment – Provision made

Illustration 1:

'XYZ' a finance limited gave a machine on lease to Mr. Anirudh whose cost is Rs. 1,00,000. Agreed payments are:

1st installment Rs. 20,000 and then Rs. 19,000, Rs. 18,000, Rs. 17,000, Rs. 16,000, Rs. 15,000, Rs. 14,000, Rs. 13,000, Rs. 12,000, and Rs. 11,000. Rate of Interest 10%. Mr. Anirudh failed to pay 4th installment. Calculate provision.

Solution:

Cost	Installment	Interest
1,00,000	-	-
(10,000)	20,000	10,000
90,000		
(10,000)	19,000	9,000
80,000		
(10,000)	18,000	8,000
70,000		
(10,000)	17,000	7,000
60,000		
(10,000)	16,000	6,000
50,000		
(10,000)	15,000	5,000
40,000		
(10,000)	14,000	4,000
30,000		

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(10,000)	13,000	3,000
20,000		
(10,000)	12,000	2,000
10,000		
(10,000)	11,000	1,000

Calculation of provision at year 4:

Particulars	Amount
Installment due but not paid	17,000
Add: Installment not yet due	81,000
(16,000 + 15,000 + 14,000 + 13,000 + 12,000 + 11,000)	
Less: Amount not yet credited to P&L A/c	(21,000)
(6,000 + 5,000 + 4,000 + 3,000 + 2,000 + 1,000)	(20,000)
Less: Book value of the asset	
[1,00,000 – (1,00,000 × 20% × 4)]	
	57,000
Additional provision	Nil
(Because up-to 12 months)	

Calculation provision at year 5:

Particulars	Amount
Installment due but not paid	33,000
(17,000+16,000)	
Add: Installment not yet due	65,000
(15,000 + 14,000 + 13,000 + 12,000 + 11,000)	
Less: Amount not yet credited to P&L A/c	
(7,000 + 6,000 + 5,000 + 4,000 + 3,000 + 2,000 + 1,000)	
Less: Book value of the asset	
[1,00,000 – (1,00,000 × 20% × 5)]	
	70,000
Additional provision at 10% of Net Book Value	Nil

Illustration 2:

Calculate the Net Owned Fund from the extracts of the balance sheet given below.

Particulars	Amount
Paid up capital	100
Free Reserves	500
Loans	400
Deposits	400
Leased out asset	800
Investment in shares of group co.	100
Investment in Debentures of group co.	100
Cash and bank balance	200

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Deferred Exp.	200
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Solution:

Calculation of Net Owned Fund:

Particulars	Amount
Equity Share Capital	100
Free Reserve	500
Less: Deferred Exp.	(200)
Owned Fund	400
Less: Investment in group co.	(160)
Exceeding 10% of Owned Fund [200 – (400 × 10%)]	
Net Owned Fund	240

Illustration 3:

Super Finance Ltd. is a non-banking financial company. It provides you with the following information regarding its outstanding amount, Rs. 200 lakhs of which installments are overdue on 200 accounts for last two months (amount overdue Rs. 40 lakhs), on 24 accounts for three months (amount overdue Rs. 24 lakhs). On 10 accounts for more than 30 months (amount overdue Rs. 20 lakhs) and on 4 accounts for more than three years (amount over due Rs. 20 lakhs-already identified as sub-standard assets) and one account of Rs. 10 lakhs which has been identified as non-recoverable by the management. Out of 10 accounts overdue for more than 30 months, 6 accounts are already identified as sub-standard asset for a period of less than fourteen months.

Classify the assets of the company in line with Non-banking Financial Company - systematically important non-deposit taking company and deposit taking company (Reserve Bank) Directions, 2016.

Solution:

Statement showing classification as per Non-banking Financial Company systemically important non-deposit taking company and deposit taking company (Reserve Bank) Directions, 2016.

Particulars	Amount Rs. in Lakhs	Amount Rs. in Lakhs
Standard Assets:		
Accounts (Balancing figure)	86	
200 accounts overdue for a period for 2 months	40	
24 accounts overdue for a period by 3 months	24	150
Sub-standard Assets:		

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4 accounts identified as substandard asset for a period less than 14 months		14
Doubtful Debts:		
6 accounts identified as sub-standard for a period more than 14 months	6	
4 accounts identified as sub-standard for a period more than 3 years	20	26
Loss Assets:		
1 account identified by management as loss asset		10
Total overdue		200

Illustration 4:

While closing its books of account on 31st March, 2017 a Non-banking Finance Company has its advances classified as follows:

Particulars	Amount Rs. in Lakhs
Standard Assets:	16,800
Sub-standard assets	1,340
Secured portions of doubtful debts:	
– upto one year	320
– one year to three years	90
– more than three years	30
Unsecured portions of doubtful debts	97
Loss assets	48

Calculate the amount of provision, which must be made against advances as per:

- (i) The Non-banking Financial Company - Non-systemically Important Non-deposit taking company (Reserve Bank) Directions 2016 and
- (ii) Non-banking Financial Company - Systemically Important Non-deposit taking company (Reserve Bank) Directions, 2016.

Solution:

Calculation of amount of provision required on advances as on 31st March 2017 as follows:

(i)

Particulars	Amount Rs. in Lakhs	Percentages of Provision	Provisions Rs. in Lakhs
Standard assets	16,800	0.25	42
Sub-standard assets	1,340	10.00	134
Secured portions of doubtful debts:			
– upto one year	320	20.00	64

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– one year to three years	90	30.00	27
– more than three years	30	50.00	15
Unsecured portions of doubtful debts	97	100.00	97
Loss assets	48	100.00	48
			427

(ii)

Particulars	Amount Rs. in Lakhs	Percentage of Provision	Provision Rs. in Lakhs
Standard assets	16,800	0.35	58.80
Sub-standard assets	1,340	10.00	134.00
Secured portions of doubtful debts:			
– upto one year	320	20.00	64.00
– one year to three years	90	30.00	27.00
– more than three years	30	50.00	15.00
Unsecured portions of doubtful debts	97	100.00	97.00
Loss assets	48	100.00	48.00
			443.80

Questions for Self-Practice

OBJECTIVE QUESTIONS

(VI) **Multiple Choice Questions:**

- (13) For the purpose of RBI Directions relating to acceptance of public deposits, non-banking financial company means the non-banking institution which is a _____.
- Loan company or investment company
 - Hire-purchase finance company or equipment leasing company
 - Both (a) and (b)
- (14) For sub-standard assets in the case of NBFC, a general provision of _____.
- 5% of total outstanding shall be made
 - 10% of total outstanding shall be made
 - 15% of total outstanding shall be made
- (15) "Owned fund excludes _____.
- Paid up capital
 - Free reserves, balance in share premium account
 - Reserves created by revaluation of asset

[Ans.: (1 - c), (2 - b), (3 - c)]

THEORY QUESTIONS

(17) Write short notes on:

(cclxviii)

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- a. Non-performing Assets" as per NBFC Prudential Norms (RBI) Directions.
- b. Earning Value (Equity Share).

PRACTICE PROBLEMS

(Ex. 1) Shine Financiers Ltd. is an NBFC providing hire purchase solutions for acquiring consumer durables. The following information is extracted from its books for the year ended 31st March, 2017.

Assets Funded	Interest Overdue but Recognized in Profit & Loss		Net Book Value of Outstanding Asset
	Period Overdue	Interest Amount	
		(Rs. in Crore)	(Rs. in Crore)
LCD Televisions	Upto 12 months	480.00	20,123
Washing Machines	For 24 months	102.00	2,410
Refrigerators	For 30 months	50.50	1,280
Air Conditioners	For 45 months	26.75	647

You are required to calculate the amount of provision to be made.

Chapter 4

Valuation of Goodwill and Shares

MEANING OF GOODWILL:

Goodwill is an intangible but not fictitious assets means it has some realisable value. From the accountants point of view goodwill, in the sense of attracting custom, has little significance unless it has a saleable value. To the accountant therefore goodwill may be said to be that element arising from the reputation, connection, or other advantages possessed by a business which enables it to earn greater profits than the return normally to be expected on the capital represented by the net tangible assets employed in the business. In considering the return normally to be expected regard must be had to the nature of the business, the risks involved, fair management remuneration and any other relevant circumstances.

DEFINITION OF GOODWILL:

Mr. Kohler defines goodwill as “the current value of expected future income in excess or normal return on the investment in net tangible assets”.

The goodwill possessed by a firm may be due, inter-alia, to the following:

- (1) The location of the business premises. The nature of the firm’s products or the reputation of its service.

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- (2) The possession of favorable contracts, complete or partial monopoly etc.
- (3) The personal reputation of the promoters
- (4) The possession of efficient and contented employees.
- (5) The possession of trade marks, patents or a well-known business name.
- (6) The continuance of advertising campaigns.
- (7) The maintenance of the quality of the firm's product, and development of the business with changing conditions.

NEED FOR VALUATION:

The need for evaluating goodwill may arise in the following cases:

- (1) When the business or when the company is to be sold to another company or when the company is to be amalgamated with another company:
- (2) When, stock exchange quotations not being available, shares have to be valued for taxation purposes, gift tax, etc.;
- (3) When a large block of shares, so as to enable the holder to exercise control over the company concerned, has to be bought or sold; and
- (4) When the company has previously written off goodwill and wants its write back.

FACTORS AFFECTING GOODWILL:

In valuation of goodwill, consideration of the following factors will have a bearing:

- (a) Nature of the industry, its history and the risks to which it is subject to.
- (b) Prospects of the industry in the future.
- (c) The company's history – its past performance and its record of past profits and dividends.
- (d) The basis of valuation of assets of the company and their value.
- (e) The ratio of liabilities to capital.
- (f) The nature of management and the chance for its continuation.
- (g) Capital structure or gearing.
- (h) Size, location and reputation of the company's products.
- (i) The incidence of taxation.
- (j) The number of shareholders.

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- (k) Yield on shares of companies engaged in the same industry, which are listed in the Stock-Exchanges.
- (l) Composition of purchasers of the products of the company.
- (m) Size of block of shares offered for sale since for large blocks very few buyers would be available and that has a depressing effect on the valuation. Question of control, however, may become important, when large blocks of shares are involved.
- (n) The Major factor of valuation of good-will is the profits of the company. One who pays for goodwill looks to the future profit. The profits that are expected to be earned in future are extremely important for valuation of goodwill. The following are the important factors that have a bearing on future profits.
 - (i) Personal skill in management.
 - (ii) Nature of business.
 - (iii) Favorable location.
 - (iv) Access to supplies.
 - (v) Patents and trade marks protection.
 - (vi) Exceptionally favorable contracts and
 - (vii) Capital requirements and arrangement of capital.
- (o) Estimation of the profits expected to be earned by the firm and the amount of capital employed to earn such profits, are to be computed carefully.
- (p) Market reputation which the company and its management enjoys.
- (q) Returns expected by investors in the industry to which the firm or company belongs.

CHARACTERISTICS OF GOODWILL:

- (1) Goodwill is intangible asset. It is non-visible but it is not a fictitious asset.
- (2) Valuation of goodwill is subjective and is highly dependent on the judgement of the valuer.
- (3) Goodwill can not be valued in isolation. It cannot be separated from the business. It's valuation is attached to the total value of the business.
- (4) It's value is not fixed. It is subject to fluctuation due to internal as well as external factors of business.
- (5) It has value only on going concern basis.

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- (6) It is either created internally or purchase from outside.
- (7) A firm is able to earn excess profits because of goodwill than the other firms in the same class of business.

CONCEPT OF GOODWILL:

When one company buys another company, the purchasing company may pay more for the acquired company than the fair market value of its net identifiable assets (tangible assets plus identifiable intangibles, net of any liabilities assumed by the purchaser). The amount by which the purchase price exceeds the fair value of the net identifiable assets is recorded as an asset of the acquiring company. Although sometimes reported on the balance sheet with a descriptive title such as “excess of acquisition cost over net assets acquired”, the amount is customarily called goodwill.

Goodwill arises only part of a purchase transaction. In most cases, this is a transaction in which one company acquires all the assets of another company for some consideration other than an exchange of common stock. The buying company is willing to pay more than the fair value of the identifiable assets because the acquired company has a strong management team, a favorable reputation in the marketplace, superior production methods, or other unidentifiable intangibles.

The acquisition cost of the identifiable assets acquired is their fair market value at the time of acquisition. Usually, these values are determined by appraisal, but in some cases, the net book value of these assets is accepted as being their fair value. If there is evidence that the fair market value differs from net book value, either higher or lower, the market value governs.

TYPES OF GOODWILL:

Goodwill is generally of two types (a) purchased goodwill and (b) Non-purchased or Inherent goodwill.

- (a) **Purchased Goodwill:** Purchased Goodwill arises when a business concern is purchased and the purchase consideration paid exceeds the fair value of the net assets acquired.

The main features of purchased goodwill are:

- (i) It arises only on purchase of business.
- (ii) It is demonstrated by a purchase consideration.

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(iii) It is shown on assets side of the Balance Sheet.

(iv) It's cost depends upon the future maintainable profits.

(b) Non-purchased Goodwill / Inherent Goodwill: Non-purchased (or inherent) goodwill arises only when a business generates its own goodwill over a period of time due to various factors such as location, good management, good quality etc.

The main features of Non-purchased/Inherent Goodwill as follows:

(i) It is internally generated.

(ii) It is reflected by purchase consideration.

(iii) Value of goodwill is based on the subjective judgement of the valuer.

(iv) It is not shown in the Balance Sheet.

(v) No cost can be placed on it.

Illustration 5:

Company X acquires all the assets of company Y, giving Company Y `15 lakhs cash. Company Y has cash `50,000 accounts receivable that are believed to have a realizable value of `60,000, and other identifiable assets that are estimated to have a current market value of `11 lakhs.

Particular	`	`
Total purchase price		15,00,000
Less:		
Cash acquired	50,000	
Accounts receivable	60,000	
Other identifiable assets (estimated)	11,00,000	12,10,000
Goodwill		2,90,000

This extra amount of `2,90,000 paid over an above, Net worth `12,10,000 is goodwill, which is a capital loss far purchasing company and to be shown on assets side of Balance Sheet. This entire amount will be written off against revenue profit i.e. Profit and Loss Account over period of time.

METHODS OF VALUATION OF GOODWILL:

(a) Future Maintainable Profit Method.

(b) Super Profit Method.

(a) Future Maintainable Profit Method:

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While valuation, the purchaser is interested in finding out how much of the past profits will continue to be earned in future. This is called Future Maintainable Profit. However Future Maintainable Profits can be calculated to the certain extent on the basis of past profits of few years following are the steps.

(i) Adjusted Profits:

Past profits are subjected to the adjustments items of income or expenses which are extraordinary in nature such as profit or loss on sale of assets, loss by fire speculation gain, interest on non-trading investment etc. These items are not likely in be maintained in future and hence need to be adjusted from the past profits. Similar way if any item of capital expenditure was written off as revenue expenditure in the past. Hence must be adjusted from the past profits to find out future maintainable profits. Following is the format to calculate adjusted profits.

Table 1

Particulars	1st Yr.	2nd Yr.	3rd Yr.
Net Profit before adjustment and Tax	xy	xy	xy
Less: Non Trading Income (i.e. Income from investment Asset)			
Less: Non Recurring Income (i.e. profit on sale of investment/Asset)	(xx)	(xx)	(xx)
Add: Non Recurring Loss (i.e. Loss on sale of investment/Asset)	xx	xx	xx
Trading profit After Adjustment and before tax.	xxx	xxx	xxx

(ii) Calculation of Average profit:

$$(a) \text{ Simple Average Profit} = \frac{\text{Total profit of (past years)}}{\text{Total number of past years}}$$

(b) Weighted Average profit:

Table 2

Years	Trading profit (a)	Weight (b)	Product (a × b)
2014	Xx	1	xx
2015	Xx	2	xx
2016	Xx	3	xx
		6	xxx

$$\text{Weighted Average Profit} = \frac{\text{Total product}}{\text{Total of weight}}$$

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Notes:

If past profits are in increasing or decreasing trend with consistency then calculate Average profit by weighted average method or otherwise simple average method.

(iii) Calculation of F.M.P: (Future maintainable profit):

- (i) All actual expenses and losses not likely to occur in the future are added back to profits.
- (ii) All expenses and losses not occurred in the past and likely to occur in the future are deducted from profits.
- (iii) All profits likely to come in the future are added and all profits not likely to come in future are deducted from profits as follows:

Particular	`
Simple/weighted Average profit before tax	XX
Add: Expenses incurred in past not to be incurred in future (i.e. Rent paid in past not payable in future)	XX
Less: Income no longer receivable	XX
Less: Expenses not incurred in past to be incurred in future (i.e. Rent not paid in past payable in future)	(XX)
Add: Income likely to arise in future	(XX)
Less: Notional management Remuneration	(XX)
Future maintainable profit before tax.	XXX
Less: Tax	(XX)
Future maintainable profit after tax.	XXX

After adjusting profit in the light of future possibilities, F.M.P. are estimated and then the value of goodwill is estimated. If goodwill is to be valued at 3 years' purchase of the F.M.P. and F.M.P. after tax is `50,000, the goodwill will be `1,50,000, i.e. $3 \times `50,000$.

This method is a simple one and has nothing to recommend since goodwill is attached to profits over and above what one can earn by starting a new business and not to total profits.

It ignores the amount of capital employed for earning the profit. However, it is usual to adopt this method for valuing the goodwill of the practice of a professional person such as a chartered accountant or a doctor.

Future Maintainable Profit and Method of Valuation:

- (i) No. of years purchase method.

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(ii) Capitalisation Method: In this method, Future Maintainable Profits are capitalized and Goodwill is calculated as below:

$$(a) \text{ Capitalized Value of FMP} = \frac{\text{Future Maintainable Profit} \times 100}{\text{Normal Rate of Return}}$$

$$(b) \text{ Net Tangible Trading Assets} = \text{Tangible Trading Assets} - \text{Outsiders Liabilities.}$$

$$(c) \text{ Goodwill} = \text{Capitalized Value of F.M.P.} - \text{Net Tangible Trading Assets}$$

Note: Future Maintainable Profits Methods are used to value goodwill when there are no super profits.

(b) Super Profit Method:

In this method, the future maintainable profits of the firm are compared with the normal profits for the firm. Super Profit is the excess future maintainable profits over normal profits. Normal earnings of a business can be judged only in the light of normal rate of earning and the capital employed in the business. Hence, this method of valuing goodwill would require the following information:

- (i) A normal rate of return for representative firms in the industry.
- (ii) The fair value of capital employed.

The normal rate of earning is that rate of return which investors in general expect on their investments in the particular type of industry. Normal rate of return depends upon the risk attached to the investment, bank rate, market, need, inflation and the period of investment.

• **Normal Rate of Returns (N.R.R):**

It is the rate at which profit is earned by normal business under normal circumstances or from similar course of business. Normal Rate of Returns means rate of profit on capital Employed which is normally earned by others in a similar type of business. It will always be given in the problem in form of percentages. **Or**

$$\text{NRR} = \text{Rate of Risk} + \text{Rate of Returns or } \frac{\text{Dividend per share}}{\text{Market price per share}} \times 100$$

• **Capital Employed:**

As the capital employed may be expressed as aggregate of share capital and reserves less the amount of non-trading assets such as investments. The capital employed may also be ascertained by adding up

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the present values of trading assets and deducting all liabilities. Super profit is the simple difference between future maintainable operating profit and normal profit.

Calculation of Capital Employed and Average Capital Employed (Liabilities Side Approach):

Particulars	Rs.
Paid up Share Capital (Equity + Preference Share Capital)	xx
Add: Reserves and Surplus (Accumulated Profits)	xx
Add: Revaluation Profits	xx
Less: Revaluation Loss	xx
Fictitious Assets	xx
Non Trading Assets	xx
Goodwill (If given in Balance Sheet)	xx
Capital Employed	xx
Less: α of Current Year Profit	xx
Average Capital Employed	xx

Calculation of Capital Employed and Average Capital Employed: (Asset side Approach)

Particulars	Rs.	Rs.
Tangible Trading Assets (At agreed/Adjustment Value) (Except Intangible, Non Trading, Fictitious Assets)		
Land and Building	xx	
Furniture and Fixtures	xx	
Stock	xx	
Cash /Bank	xx	xxx
Less: External Liability (at agreed / Adjust value) (Except: Capital and Reserve and surplus)		
Loans	xx	
Debentures	xx	
Creditors	xx	xxx
O/s Expenses etc.	xx	
Capital Employed		xxx

\therefore Average Capital Employed =

$$\frac{\text{Opening Capital Employed} + \text{Closing Capital Employed}}{2}$$

OR

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= Closing capital employed – α of current years profit + Current years dividend

Illustration 6:

Rishi Computers Ltd. gives you the following summarized balance sheet as at 31st December, 2014.

Liabilities		Assets		
Preference share		Fixed Assets: cost	50,00,000	
Capital	5,00,000	Depreciation	30,00,000	20,00,000
Equity Share Capital	20,00,000	Capital Work-in Progress		40,00,000
Reserves and surplus	25,00,000	Investment 10%		5,00,000
Long-term Loans	27,00,000	Current Assets		25,00,000
Current Liabilities and Provisions	15,00,000	Underwriting commission		2,00,000
	92,00,000			92,00,000

The company earned a profit of `18,00,000 before tax in 2014. The capital work in progress represents additional plant equal to the capacity of the present plant; if immediately operational there being no difficulty in sales. With effect from 1st January, 2015, two additional Works Managers are being appointed at `1,00,000 p.a. Ascertain the Future maintainable profit and the capital employed, assuming the present replacement cost of fixed assets is `1,00,00,000 and the annual rate of depreciation is 10% on original cost.

Solution:

Normal profit: Suppose investors are satisfied with a 180% return, in the above example the normal profit will be `11,34,000 i.e. 18% of `63 lakhs.

The followings are some items which generally require adjustment in arriving at the average of the past earnings:

- (1) Exclusion of material non recurring Items such as loss of exceptional nature through strikes, fires, floods and theft, etc., profit or loss of any isolated transaction not being part of the business of the company.
- (2) Exclusion of income and profits and losses from non-trading assets.

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- (3) Exclusion of any capital profit or loss or receipt or expense included in the profit & loss account.
- (4) Adjustments for any matters suggested by notes, appended to the accounts or by qualifications in the Auditor's Report, such as provision for taxation and gratuities, bad debts, under or over provision for depreciation, inconsistency in valuation of stock, etc.
- (5) Depreciation is an important item that calls for careful review. The valuer may adopt book depreciation provided he is satisfied that the tale was realistic and the method was suitable for the nature of the company and they were consistently applied from year to year. But imbalances do arise in cases where consistently written down value method was in use and heavy expenditure in the recent past has been made in rehabilitating or expanding fixed assets, since the depreciation charges would be unfairly heavy and would prejudice the seller. Under such circumstances, it would be desirable to readjust depreciation suitably as to bring a more equitable charge in the profits meant for averaging.

Another important factor comes up for consideration in averaging past profits and that is the trend of profits earned. It is imperative that estimation of maintainable profits be based on the only available record i.e., the record of past earnings, but indiscrete use of past results may lead to an entirely fallacious and unrealistic result.

Where the profits of a company are widely fluctuating from year to year, an average fails to aid future projection. In such cases, a study of the whole history of the company and of earnings of a fairly long period may be necessary. If the profits of a company do not show a regular trend upward or downward an average of the cycle can usefully be employed for projection of future earnings.

In some companies, profits may record a distinct rising or falling trend from year; in these circumstances, a simple average fails to consider a significant factor, namely, trend in earnings.

The shares of a company which record a clear upward trend of past profits would certainly be more valuable than those of a company whose trend of past earnings indicates a down-trend. In such cases, a weighted average giving more weight to the recent years than to the past, is appropriate. A simple way of weighing is to multiply the profits by the

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respective number of the years arranged chronologically so that the largest weight is associated with the most recent past year and the least for the remotest.

Future Profitability Projections: Project is more a matter of intelligent guesswork since it is essentially an estimation of what will happen in the risky and uncertain future. The average profit earned by a company in the past could be normally taken as the average profit that would be maintainable by it in the future, if the future is considered basically as a continuation of the past. If future performance is viewed as departing significantly from the past, then appropriate adjustments will be called for before accepting the past average profit as the future maintainable profit of the company.

Super Profits and Methods of Valuation:

There are three methods of calculating goodwill based on super profit. The methods and formulae are as follows:

(i) No of Years Purchase of Super Profit Method:

Goodwill as per this method is: Super profit multiplied by a certain number of years. Under this method an important point to note is that the number of years of purchase as goodwill will differ from industry to industry and from firm to firm. Theoretically, the number of years is to be determined with reference to the probability of a new business catching up with an old business. Suppose it is estimated that in two years' time a business, if started now will be earning about the same profits as an old business is earning now, goodwill will be equivalent to two times the super profits. In the example given above, goodwill will be `12.12 lakhs i.e. `6.06 lakhs \times 2 years.

(ii) Annuity Method of Super Profit:

Goodwill in this case is the discounted value of the total amount calculated as per purchase method. The idea behind super profits methods is that the amount paid for goodwill will be recouped during the coming few years. But in this case, there is a heavy loss of interest. Hence, properly speaking what should be paid now is only the present value of super profits paid annually at the proper rate of interest. Tables show that the present value 18% of Re. 1 received annually two years is 1.566.

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In the above example, the value of goodwill under this method will be $1.3 \times `6.06$ lakhs or `9.49 lakhs.

(iii) Capitalization of Super Profit Method:

This method tries to find out the amount of capital needed for earning the super profit.

The formula is:

$$= \frac{\text{Super Profit}}{\text{NRR}} \times 100$$

In above e.g. Goodwill will be

$$= \frac{6.06 \text{ Lakh} \times 100}{18}$$
$$= `33.67 \text{ Lakh}$$

Given in the Problems:

- (1) Information of old firms assets and Liability.
- (2) Information regarding past or profit
- (3) Adjustment valuation of goodwill.

Required to Prepare:

Valuation of goodwill by different methods.

Steps method and formula for calculation of goodwill:

(I) Goodwill by purchase of average profit method:

Steps:

- (1) Find out average trading profit.
- (2) Find out no of years purchase (it will always be given in problem)
- (3) Goodwill: No of year of purchase \times Average trading profit.

(II) Goodwill by purchase of future maintainable profit method:

Steps:

- (1) Find out future maintainable profit.
- (2) No. of year purchase (given in problem)
- (3) Goodwill: No of years of purchase \times future maintainable profit.

(III) Goodwill by capitalization of future maintainable profit method:

- (1) Find out future maintainable profit.
- (2) Find out capitalized value of future maintainable profit

$$\text{Capitalization Value of future maintainable Profit} = \frac{\text{F.M.P}}{\text{N.R.R}} \times 100$$

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(3) Calculate capital Employed:

(4) Goodwill = capitalized value of F.M.P. – Capital Employed

(IV) Goodwill by purchase of super profit method:

(1) Find out average trading profit.

(2) Find out future maintainable profit.

(3) Find out capital Employed.

(4) Find out Normal Rate Returns (always given in the problem in term of %).

(5) Find out number of year of purchase (given in the problem).

(6) Find out normal profit

$$\text{Normal profit} = \frac{\text{Capital Employed} \times \text{NRR}}{100}$$

(7) Find out super profit:

$$\text{Super profit} = \text{Future maintainable profit} - \text{Normal profit}$$

(8) Goodwill = Number of year purchase × Super profit.

(V) Goodwill by capitalization super profit method:

(1) Calculate super profit as discuss above.

$$(2) \text{ Goodwill} = \frac{\text{Super Profit} \times 100}{\text{N.R.R}}$$

(VII) Goodwill by present value of super profit method:

(1) Calculate super profit as discuss above.

$$\text{Goodwill} = \text{Annuity Rate} \times \text{Super profit}$$

Notes: Annuity Rate will always be given in the problem.

Illustration 7:

X agreed to purchase the business of Y on 30th June, 2016. Profits earned by Y for the three preceding years were as below:

Year ending	
31/12/2013	82,000
31/12/2014	80,000
31/12/2015	84,000

The profit for the year 2014 includes an abnormal income of ₹3,000. The profit for the year 2015 is after writing off a loss due to theft of ₹4,000. At present the assets of the business are not insured. X wants to take a comprehensive policy and has ascertained that an annual premium of ₹400 would have to be paid. X would like to manage the business whole

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time and this would involve giving up the present job in which he is drawing `2,000 per month. If X manages the business, the employment of the manager who is looking after the business for a salary of `1,500 per month can be terminated and X will draw a salary of `2,000 per month from the business. Calculate the goodwill if both the parties have agreed to value it at 2 years purchase of average profits.

Solution:

Profit for the year 2013		82,000
Profit for the year 2014	80,000	
Less: Abnormal Income	3,000	
Profit for the year 2015	84,000	
Add: Loss due to theft	4,000	88,000
		2,47,000
Average Profits (2,47,000/3)		82,333.33
Less: Expenses to be paid-up future Insurance Premium	400	
X's salary (2,000 ×12)	24,000	(24,400)
		47,933.33
Add: Manager's salary (1,500 × 12)		18,000
Expected average annual profits		75,933.33

$$\begin{aligned} \text{Goodwill} &= \frac{\text{Expected average annual profits} \times \text{Number of}}{\text{years of purchase}} \\ &= \frac{75,933.33 \times 2}{1} = \text{`1,51,866.66} \end{aligned}$$

Illustration 8:

P is negotiating with M for the purchase of the latter's business. It was decided to value goodwill according to the super profit method. M has been running the business only for the three years and hence P would like to attach weights for the profits of the three years in such a way that the most recent profits would be assigned a higher weight than the other year's profits. The profits of the past three years are as follows:

Year	Profit
2013	36,000
2014	40,000

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2015	38,000
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Calculate the annual average profits.

Solution:

Since P would like to attach a higher weightage to the profits of 2001, one method of weighting would be:

Year	Weight
2013	1
2014	2
2015	3

The weighted average annual profits of the business may be calculated as follows:

Year	Profits (₹)	Weights	Product (₹)
2013	36,000	1	36,000
2014	40,000	2	80,000
2015	38,000	3	1,14,000
		6	2,30,000

Average annual profit = ₹38,333

Illustration 9:

The following particulars are available in the books of Bharti Telecom.

- (a) Capital employed ₹1,50,000
- (b) Trading profit after tax
 - 2012 ₹1,12,200
 - 2013 ₹1,15,000
 - 2014 ₹1,02,000 (loss)
 - 2015 ₹1,21,000
- (c) Market rate of interest on investment 8%.
- (d) Rate of risk return on capital invested in business 2%
- (e) Remuneration from alternative employment of the proprietor (if not engaged in business ₹13,600 p.a.).

You are required to compute the value of goodwill on the basis of 3 years purchase of super profits of the business calculated on the average profit of the last four years.

Solution:

- (a) Calculation of Average Profits:

	-
2012	1,12,200

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2013	1,15,000
2014	(1,02,000)
2015	1,21,000
	2,46,200

$$\text{Average Profits} = \frac{2,46,200}{4} = 61,550$$

(b) Calculation of Super Profits:

Average Profits	61,550
Less: Remuneration	13,600
F.M.P.	47,950
Less: Normal Profit @ 10%	
Capital employed × NRR (8% + 2%) on `1,50,000 (1,50,000 × 10%)	15,000
Super Profit	32,950
Goodwill = 3 years purchase of super profits = 3 × 32,950 = 98,850	

Illustration 10:

From the following information given by Tata Telecom calculate the value of goodwill:

- (1)** Average capital employed `12,00,000.
- (2)** Company declares 15% dividend on the shares of `20 each fully paid which is quoted in the market at `25.
- (3)** Net trading profit of the firm (after tax) for the past 3 years `2,15,200, `1,81,400, `2,25,000.

You are required to compute the value of goodwill on the basis of 5 years purchase of super profits of the business calculated on the average profit of the last three years.

Solution:

1st Year	2,15,200
2nd Year	1,81,400
3rd Year	2,25,000
	6,21,600
Average Profit $\frac{6,21,600}{3} =$	2,07,200

Calculation of super profit:

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Average Trading Profit	2,07,200
Less: Normal Profit @ 12% on `12,00,000	1,44,000
Super Profit	63,200

Goodwill = 5 years purchase of super profits $5 \times 63,200$
 = `3,16,000

Working Notes:

(1) Dividend per share = 15% of `20 = `3

(2) Rate of return on capital = $\frac{\text{Dividend per share (DPS)}}{\text{Market price per share (MPS)}} \times 100 = \frac{3}{25} \times 100 = 12\%$

Illustration 11:

From the following information ascertain the value of goodwill of Micro Computers Ltd. under Super profit method.

Balance Sheet as on 31st March, 2014

Liabilities	`	Assets	`
Paid up Capital 5,000 share of `100 each fully paid	5,00,000	Goodwill at Cost	50,000
Bank overdraft	1,16,700	Land and Building at cost	2,20,000
Sundry creditors	1,81,000	Plant and Machinery at cost	2,00,000
Provision for Taxation	39,000	Stock in Trade	3,00,000
Profit and Loss Appropriation a/c	1,13,300	Bad Debts	1,80,000
	9,50,000		9,50,000

The company commenced operations in 1995 with a paid up capital of `5,00,000. Profits for recent years (after taxation) have been as follows:

Year ended 31st March

Year	`
2010	40,000 (Loss)
2011	88,000
2012	1,03,300
2013	1,16,000
2014	1,30,000

The loss in 2010 occurred due to a prolonged strike.

The income tax paid so far has been at the average rate of 40%. Dividends were distributed at the rate of 10% on the paid up capital in 2011 and 2012 and at the rate of 15% in 2013 and 2014. The market price of share is ruling at `125 at the end of the year ended 31st March, 2009.

Solution:

Valuation of Goodwill of Micro Computers Ltd

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Capital employed		
Land and Building at Cost		2,20,000
Plant and Machinery at Cost		2,00,000
Stock in Trade		3,00,000
Sundry Debtors		1,80,000
		9,00,000
Less: Sundry Liabilities		
Bank Overdraft	1,16,700	
Sundry Creditors	1,81,000	
Provision for Taxation	39,000	
		3,36,700
Capital employed at the end of the year		5,63,300
Add back		
Dividend paid for the year	75,000	
Less: Half of the profits	65,000	10,000
Average capital employed		5,73,300
Rate of Return		
Average Dividends for the last 4 years 12% $\left(\frac{10 + 15 + 10 + 15}{4}\right)$		
Market price of shares on 31st March `125		
Normal Rate of Returns: $\frac{12.5}{125} \times 100 = 10\%$		

It may be more appropriate to relate the normal rate of return to the dividend paid in the last two years since price is related to dividend expected in future and for that, the most recent experience is relevant.

In that case the normal rate of return will be:

$$\left(\frac{\text{Dividend per share (DPS)}}{\text{Market price per share (MPS)}} \times 100\right)$$

$$\frac{15 \times 100}{125} = 12\%$$

Normal Profit on Average Capital employed

at 10% on `5,73,300 57,330

at 12% on `5,73,300 68,796

Future maintainable profits – weighted average

Year	Profits (₹)	Weights	Product (₹)
2011	88,000	1	88,000

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2012	1,03,000	2	2,06,000
2013	1,16,000	3	3,48,000
2014	1,30,000	4	5,20,000
		10	11,62,000

Average annual profit (after tax) `1,16,200 FMP

Super Profits:

	Normal Rate	Normal Rate
	12%	10%
	(`)	(`)
Average maintainable profits	1,16,200	1,16,200
Normal profit on capital employed	68,796	57,330
Super Profit	47,404	58,870
Goodwill at 5 years' purchase of Super Profits	2,37,020	2,94,350
Goodwill at 3 years' purchase	1,42,212	1,76,610

Three to five years' purchase of super profits can be taken as fair value of goodwill. Thus, depending on the assumptions regarding the normal rate of return and the number of years' purchase, goodwill may range between `1,42,212 and `2,94,350.

Illustration 12:

The following is the balance sheet of HCL Ltd. as on March 31, 2015.

Liabilities	`	Assets	`
40,000 equity shares of `10 each	4,00,000	Goodwill	40,000
10% debenture	1,20,000	Land and banking	2,00,000
Profit & Loss balance as on 01/04/14		Plant and Machinery	2,90,000
40,000		Investment	1,00,000
Add: Profit for the year before		Stock	80,000
providing for taxes <u>1,60,000</u>	2,00,000		
Sundry creditors	80,000	Debtors	90,000
Provision for taxation	40,000	Cash and bank	40,000
	8,40,000		8,40,000

Profit includes `10,000 which is the income from investments. The present market value of the assets are:

Particular	`
Land and building	2,50,000
Plant and Machinery	3,50,000
Investment	1,50,000

Current assets (book value)

Normal return on capital employed in this type of business is 10%.

Adjustment of depreciation is not required for valuation of goodwill.

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

Solution:

Average Trading Capital Employed

Particular	`
Land and building	2,50,000
Plant and machinery	3,50,000
Stock	80,000
Debtors	90,000
Cash and Bank	40,000
Less: Current Liabilities	8,10,000
Sundry creditors	`80,000

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Provision for taxation	`40,000	(1,20,000)
Capital Employed		6,90,000
Less: Half of current year's profit		(37,500)
Average Capital Employed		6,52,500

Working Notes:

The half of Current year's profit is calculate as below

Particular	`
Profit for the year	1,60,000
Less: Non-trading income	10,000
	1,50,000
Less: Income tax (say 50%)	75,000
Current year's profit	75,000
$\frac{75,000}{2} = 37,500$	

$$\therefore \text{Normal Profit} = \text{Average Capital Employed} \times \frac{\text{NRR}}{100}$$

$$= 6,52,000 \times \frac{10}{100} = 65,200$$

$$\text{Super Profit} = \text{Average Profit} - \text{Normal Profit}$$

$$= 75,000 - 65,200 = 9,800$$

$$\therefore \text{Goodwill} = \text{S. P.} \times \text{No. of years purchase}$$

$$= 9,800 \times 3 = \mathbf{29,400}$$

Illustration 13:

From the following information calculate value of the goodwill for Reliance Ltd. by:

(a) Super profit method.

(b) Capitalization method.

(i) Average capital employed in the business `6,00,000.

(ii) Net trading profit of the firm for the past three years were `1,07,600, `90,700 and `1,12,500.

(iii) Rate of interest expected from capital having regard to the risk involved 12 per cent.

(iv) Fair Remuneration to the firm for their services `12,000 per annum.

(v) Sundry assets of the firm `7,54,762

(vi) Sundry liabilities `31,329.

(Note: take 8 years purchase of super profit as value of good will)

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Solution:

(1) Calculation of profit:

$$\begin{aligned} \text{Simple Average} &= \frac{1,07,600 + 90,700 + 1,12,500}{3 \text{ years}} \\ &= ₹1,03,600 \end{aligned}$$

(2) Calculation of future maintainable profit

Simple average profit	1,03,600
Less: Fair Remunerations to partner	<u>(12,000)</u>
Future maintainable profit tax	<u>91,600</u>

(3) Calculation of capital Employed:

Given: ₹6,00,000

(4) N.R.R = 12% (given)

(5) Normal of Years purchase: 8 years (Given)

(6) Calculation of Normal profit:

$$\begin{aligned} \text{Normal profit} &= \text{Capital Employed} \times \frac{\text{N.R.R}}{100} \\ &= 6,00,000 \times \frac{12\%}{100} \\ &= ₹72,000 \end{aligned}$$

$$\begin{aligned} \text{Super profit} &= \text{F.M.P.} - \text{Normal profit} \\ &= 91,600 - 72,000 = 19,600 \end{aligned}$$

Calculation of Goodwill by purchase super profit method

$$\begin{aligned} \text{Goodwill} &= \text{Number of years purchase} \times \text{super profit} \\ &= 8 \times 19,600 \\ &= ₹1,56,800 \end{aligned}$$

(7) Calculation of Goodwill by capitalized value of super profit method:

$$\begin{aligned} \text{Goodwill} &= \frac{\text{Super profit} \times 100}{\text{N.R.R}} \\ &= \frac{1,9600}{12} \times 100 \\ &= ₹1,63,333 \end{aligned}$$

OR

Calculation of capitalised value of super profit method

(ccxcii)

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$$\begin{aligned} \text{Goodwill} &= \text{Capitalized value of F.M.P} - \text{capital Employed} \\ &= 7,63,333 - 6,00,000 \\ &= \text{`}1,63,333 \end{aligned}$$

Illustration 14:

A company desirous of selling its business to another company has earned an average profit in past `1,50,000 per annum. It is considered that such average profit fairly represents the profit likely to be earned in the future except that:

- (a) Directors fees `10,000 charged against such profit will not be payable by the purchasing company whose existing board can cope-up with additional work without additional fees.
- (b) Rent at `20,000 p.a. which has been paid by the existing company will not be charged in the future.

The value of the tangible assets of the existing company at the proposed date of sale was `19,00,000 and was considered that reasonable return on capital invested, for the type of company was 8%.

Solution:

Calculate the value of Goodwill at 3 years purchase of super profits.

Particular	`
(i) Calculation of Average profit: `1,50,000 (Given)	
(ii) Calculation of Future maintainable profit	1,50,000
Add: Direct fees not required in future	10,000
Add: Rent not payable in future	20,000
Future maintainable profit	1,80,000
(iii) Calculation of capital employed: `19,00,000 (Given)	
(iv) Calculation of N.R.R.: 8% (Given)	
(v) Calculation of No. of years purchase: 3 years (Given)	
(vi) Calculation of Normal profit	= Capital Employed $\times \frac{\text{N.R.R.}}{100}$
= $\frac{19,00,000 \times 8}{100}$	1,52,000

- (i) Calculation of super profit = F. M. P – Normal profit

$$\begin{aligned} &= 1,80,000 - 1,52,000 \\ &= \text{`}28,000 \end{aligned}$$

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(ii) Calculation of good will by purchase of super profit method:

$$\begin{aligned} \text{Goodwill} &= \text{Super profit} \times \text{Number of years purchase} \\ &= 28,000 \times 3 \\ &= \text{`84,000} \end{aligned}$$

Illustration 15:

The Average net profit was (before adjustment) 2,07,000 it included investment income `2,000 the cost (also present value) of investment was `50,000. Expenses amounting to `3,000 p.a. are likely to be discontinued in future. 50 paise in rupee may be taken as average annual taxation 6% represented a fair commercial return. The average capital employed was `13,50,000 but upon valuation obtained, the actual was valued `14,50,000.

(a) Assuming seven years purchase of super profit what is the value of Goodwill?

(b) What will be the value of Goodwill under capitalization method?

Solution:

(i) Calculation of Average Profit:		
Average profit (before adjustment)		2,07,000
Less: Invest income		(2,000)
Average profit (After Adjustment)		2,05,000
(ii) Calculation of future maintainable profit:		
Average profit (After Adjustment)		2,05,000
Add: Expenses likely to be discontinued in future		3,000
Future maintainable profit before tax		2,08,000
Less: Tax @ 50%		(1,04,000)
Future maintainable profit after tax		1,04,000
(iii) Calculation of capital employed.		
As given	14,50,000	
Less: Investment	(50,000)	
Actual Capital Employed	14,00,000	
(iv) N.R.R = 6% (Give)		
(v) Normal of years purchase = 7 years (Given)		
(vi) Calculation of Normal Profit = Capital $\times \frac{\text{N. R. R.}}{100}$		
		$= 14,00,000 \times \frac{6}{100}$
		$= \text{`84,000}$

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<p>(vii) Calculation of super profit</p> <p style="margin-left: 40px;">Super profit = 1,04,000 – 84,000 = `20,000</p> <p>(viii) Calculation of Goodwill by purchase of super profit method</p> <p style="margin-left: 40px;">Goodwill = No. 8 years × Super Profit = 7 × 20,000 = `1,40,000</p> <p>(ix) Goodwill by capitalization of super profit:</p> <p style="margin-left: 40px;">Goodwill = $\frac{S.P.}{N.R.R} \times 100 = \frac{20,000}{6} \times 100$ = `3,33,333</p>		
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Illustration 16:

L, M A & N are partners sharing profit and losses in the ratio of 4:3:3 respectively. The firm closes its account on 31st December, every year. On 31st March, 2015 N died and it was decided to calculate the amount of the goodwill to be paid to the heirs of Mr. N. According to the partnership agreement, Goodwill was to be valued at the three year purchase of average super profits of the three years upto the death after deducting 17.5% interest on capital employed and paying a reasonable remuneration of `30,000 per annum to each partner. Average capital employed in the business was `2,00,000.

The profits of the earlier years before charging interest on capital employed were as follows:

Year	Profit
2012	1,47,000
2013	1,59,000
2014	2,23,000

The profits for the year ending 31st December, 2015 were `1,31,000 profits may be considered to have he earned uniformly for all the years including 2015. Calculate the amount the amount of goodwill to be paid to the heirs of Mr. N.

Solution:

(1)

Year	Profit	Weight	Total Produce
2012	1,47,000	1	1,47,000
2013	1,59,000	2	318,000
2014	2,23,000	3	6,69,000
		6	11,34,000

Accounting for Banking Company

(2) Calculation for Average Profit:

$$\therefore \text{Weighted Average Profit} = \frac{11,34,000}{6} = ₹1,89,000$$

(3) Calculation for F.M.P:

$$\therefore \text{Weighted Average present} = ₹1,89,000$$

Less: Managerial Remuneration (30,000 × 3)

(90,000)

$$\text{FMP} = \underline{₹99,000}$$

(4) Calculation for capital Employed = ₹2,00,000

(5) Calculation of N.R.R. = 17.5%

Calculation for normal profit

$$= \text{Capital Employed} \times \frac{\text{N.R.R}}{100}$$

$$= 2,00,000 \times \frac{17.5}{100}$$

$$= ₹35,000$$

(6) Calculation for super profit:

$$\text{Super Profit} = \text{F.M.P} - \text{Normal Profit}$$

$$= 99,000 - 35,000$$

$$= 64,000$$

(7) Calculation of Goodwill purchase of super profit.

$$\text{Goodwill} = \text{Number of years purchase} \times \text{super profit}$$

$$= 3 \times 64,000$$

$$= ₹1,92,000$$

$$\therefore \text{Goodwill to be paid to legal heirs of N} = 1,92,000 \times \frac{3}{10} = 57,600$$

Illustration 17:

Following is the Balance sheet of A LIMITED as on 31st March, 2014:

Liabilities		Assets		
Share Capital		Goodwill		1,25,000
5,000 share of ₹100 each	5,00,000	Land and Building (cost)	1,80,000	
Reserve fund	1,50,000	Less: Depreciation	36,000	1,44,000
Workmen compensation fund	25,000	Plant and machinery		

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Workmen profit sharing fund	45,000	(at cost)	2,40,000	
Profit and loss Account	1,50,000	Less: Depreciation	40,000	2,00,000
Creditors	2,30,000	Investment for		1,00,000
Other Liabilities	1,00,000	Replacement of plant & machinery		
		Books Debts	3,60,000	
		Less: R.D.D	30,000	
				3,30,000
		Stock		2,00,000
		Cash at Bank		75,000
		Preliminary expense		26,000
	12,00,000			12,00,000

Further information:

(1) Ltd. had been carrying on business for, the past several years. The company is to be taken over by another company and for this purpose you are required to value Goodwill by “Capitalistion of maintainable profits method”. For this purpose following additional information is available.

(a) The profit earned by the company for the past three years were as under:

Year ended 31st March, 2012 `3,10,000

Year ended 31st March, 2013 `2,73,000

Year ended 31st March, 2014 `2,90,000

The profits given are profits before tax, which was 50% throughout.

(b) The new company expects to carry on business with its own board of directors, without any addition.

The directors Fees paid by A Ltd., to its directors amounted to `9,000 per year, no more payable in future.

(c) The new company expects a large increase in volume of business and there fore, will have to pay extra rent of `12,000 per year.

(d) As on 31st March, 2015, land and buildings were worth `12,000, whereas plant and Machinery were worth only `1,80,000 there is sufficient provision for doubtful debts. There is no fluctuation in the value of investments and stock.

Accounting for Banking Company

- (e) Liability under workmen compensation fund was only `5,000.
- (f) The expected rate of return on similar business may be taken at 12%.

You are required to value Goodwill according to above instructions. All your workings should form part of your answer. (Take average capital employed, the same as closing employed for your calculations.)

Solution:

Calculation of Average profit

$$\begin{aligned} \text{Simple Average} &= \frac{\text{Total profit (past year)}}{\text{Total Number of years}} \\ &= \frac{3,10,000 + 2,73,000 + 2,90,000}{3} \\ &= `2,91,000 \end{aligned}$$

(1) Calculation of future maintainable profit.

	`
Simple Average, Profit	2,91,000
Add: Directors' fees not required in future	9,000
Less: Extra Rent payable in future	(12,000)
F.M.P. before tax	2,88,000
Less: tax @ 50%	(1,44,000)
F.M.P. Adjust tax	1,44,000

(2) Calculation of capital Employed:

Tangible trading Asset (at Average Value)	`	`
Land and Building	3,00,000	11,85,000
Plant and Machinery	1,80,000	
Investment	1,00,000	
Debtors	3,30,000	
Stock	2,00,000	
Cash at Bank	75,000	
Less: External Liability		
Workmen Compensation fund	5,000	
Workmen profit sharing fund	45,000	
Creditors	2,30,000	
Other Liability	1,00,000	(3,80,000)
Capital Employed		8,05,000

- (3) N.R.R = 12% (Given)
- (4) Number of year purchase = 3 years (Given)
- (5) Calculation for capitalized value of F.M.P.:

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$$\begin{aligned} \text{Capitalised Value of F.M.P} &= \frac{\text{F.M.P}}{\text{N.R.R}} \times 100 \\ &= \frac{1,44,000}{12} \times 100 \\ &= \text{`}12,00,000 \end{aligned}$$

(6) Calculation of Goodwill by capitalized of F.M.P Method.

$$\begin{aligned} \text{Goodwill} &= \text{Capitalized value of F.M.P} - \text{Capital Employed} \\ &= 12,00,000 - 8,05,000 \\ &= \text{`}3,95,000 \end{aligned}$$

Illustration 18:

From the following Balance sheet of Prosperous Ltd. as at 31st Dec. 2015 and further information, value goodwill at five year purchase of super profit based on average profit of last three years.

Liabilities			Assets		
Share capital			Fixed Assets		
Equity capital	1,50,000	2,00,000	Goodwill	20,000	5,00,000
Preference capital	50,000		Machinery	2,10,000	
Reserves and surplus		Land and Building	1,20,000		
General Reserves	2,60,000	Furniture	60,000		
Profit and Loss Account	15,000	2,75,000	Vehicles	90,000	
Secured Loan		1,25,000	Stocks	55,000	
Current Liabilities:			Debtors	1,00,000	
Sundry creditors	60,000		Cash and Bank Balance	25,000	1,80,000
Bills Payable	30,000		Misc. Expenditure		20,000
Outstanding expenses	10,000	1,00,000			
		7,00,000			7,00,000

(i) Profit (before tax)

For 2014 ` 1,11,000

For 2013 ` 1,05,000

For 2012 ` 99,000

(ii) Machinery costing `10,000 purchased on 31st December, 2015 was wrongly charged to revenue.

(iii) Normal return in similar business is 10% of the average net tangible capital employed.

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(iv) Machinery, land and Buildings have appreciated by 10% and 20% respectively. Furniture and vehicles have depreciated by 5% and 10% respectively. Outstanding expenses were up by `3,750.

(v) Provision for tax – 50%.

(vi) Ignore additional depreciation effect on revalued figures of Assets.

Solution:

Calculation of Average profit:

Year	Profit	Weight	Product
2013	99,000	1	99,000
2014	1,05,000	2	2,10,000
2015	1,11,000	3	3,33,000
		6	6,42,000

$$\begin{aligned}
 \text{(i) Weighted Average profit} &= \frac{\text{Total of product}}{\text{Total of weight}} \\
 &= \frac{6,42,000}{6} \\
 &= 1,07,000
 \end{aligned}$$

(ii) Calculation of F.M.P:

Average profit before tax 1,07,000

Less: Tax @ 50% (53,500)

F.M.P. After tax 53,500

(iii) Calculation of capital Employed:

Tangible trading Asset (at value)		
Machinery	2,42,000	
Land and Building	1,44,000	
Furniture	57,000	
Vehicles	81,000	
Stock	55,000	
Debtors	1,00,000	
Cash and Bank	25,000	7,04,000
Less:		
Sundry Creditors	60,000	
Bills payable	30,000	
O/s experience	13,750	
Secured Loan	(1,20,000)	(2,23,750)
Capital employed		4,75,250

(iv) N.R.R. = 10% (Given)

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(v) Normal years purchase = 5 years (Given)

(vi) Calculation of Normal Profits:

$$\begin{aligned}\text{N.P} &= \text{Capital Employed} \times \frac{\text{N.R.R}}{100} \\ &= 4,75,250 \times \frac{10}{100} \\ &= \text{`}47,525\end{aligned}$$

(vii) Calculation of super profits:

$$\begin{aligned}\text{Super profit} &= \text{F.M.P. Normal profit} \\ &= 53,500 - 47,525 \\ &= \text{`}5,975\end{aligned}$$

(viii) Calculation for Goodwill by purchased super profit method:

$$\begin{aligned}\text{Goodwill} &= \text{Number of year purchase} \times \text{super profit} \\ &= 5 \times 5975 \\ &= \text{`}29,875\end{aligned}$$

Illustration 19:

ALTD agreed to purchase business of A for that purpose goodwill is to be valued at three years purchase of the weighted average of previous 4 years adjust profits.

The profits for the year ending 31/12/2012 to 31/12/2015 were as under:

Year ending 2012	`20,200
Year ending 2013	`24,800
Year ending 2014	`25,000
Year ending 2015	`30,000

Following additional information is available:

- (1) On 01/09/2014, major repair expenditure to plant and machinery for 6,000 was charged to revenue. That was agreed to be capitalized for goodwill, subject to 10% p.a. depreciation on diminishing balance method to be calculated.
- (2) The closing stock for the year ending 31/12/2013 was over value by `2,400.
- (3) In order to cover cost of management, an annual charge of `4,800 should be made for valuation of Goodwill. Compute value of goodwill.

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Calculation of Trading profit: (If the word Adjusted profit is used this method).

Solution:

	2012	2013	2014	2015
Profit before adjustment	20,200	24,800	25,000	30,000
Add: P/M capital Expenses charged As Revenue Express	–	–	6,000	–
Less: Depreciation 10% on above P/m				W.D.V. method (580) (6,000 – 200 × 10%)
For (4 & 12 month)			(200)	
Less: Closing st over valued.		–	–	
Add: Op. st. over valued.		(2,400)	2,400	–
Less: Cost of management	(4,800)	(4,800)	(4,800)	(4,800)
Adjusted Profit	15,400	17,600	28,400	24,620

Year	Profit	Weights	Product
2012	15,400	1	15,400
2013	17,600	2	35,200
2014	28,400	3	85,200
2015	24,620	4	98,480
		10	2,34,280

$$\text{Weighted Average Profit} = \frac{2,34,280}{10}$$

$$= ₹23,428$$

Calculation for Goodwill by purchase of weighted Average method

$$\begin{aligned} \text{Goodwill} &= \text{Number of years purchase} \times \text{weighted Average profit} \\ &= 3 \times 23,428 \\ &= ₹70,284 \end{aligned}$$

Illustration 20:

The balance sheet of a partnership was as follows:

Particulars			Particulars	
Capital Accounts			Goodwill	1,000
A	50,000		Plant	70,000
B	30,000		Furniture	3,000

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C	20,000	1,00,000	Stock in trade	45,000
Current Account			Sundry debtors	28,000
A	8,000		Prepayments	10,000
B	7,000		Bank balance	19,000
C	10,000	25,000		
Sundry Creditors		51,000		
		1,76,000		1,76,000

It was proposed to form a company to acquire the business for the purpose of the acquisitions the assets revalued as follows:

Plant of `60,000; Furniture `4,000; stock `25,000; pre-payment Nil. It was ascertain that the profits before charging anything in respect of the partners had, for the past five years been as follow `25,000; `29,000 `33,000 `35,000; `33,000 included in these profits were non-recurring items, averaging `1,500. But from the nature of the business, casual non-recurring items were found to arise every year and promoters agreed that a figure of `1,200 should he allowed as profit from this source.

Similar business paid a dividend of 8 per cent per annual on their ordinary share and partners who would be directors of the company were worth remuneration of: A: `4,000, B: `5,000 & C: `6,000 p.a.

Five years purchase of the adjusted super profits on annuity basis was the agreed price for goodwill; the super profit being taken on the value of the goodwill. Ignore taxation.

Solution:

(i) Calculation of average profit:

$$\begin{aligned} \text{Simple Average} &= \frac{25,000 + 29,000 + 33,000 + 35,000 + 33,000}{5} \\ &= 31,000 \end{aligned}$$

Less: Non recurring (1500)

Add: Appeared by management 1200

Average Profit **30,700**

(ii) Calculation of F.M.P.

Average profit before tax 30,700

Less: Managerial Remuneration (15,000)

(4,000 + 5,000 + 6,000)

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F.M.P

15,700

(iii) Calculation of capital Employed:

Tangible Trading Asset		
Plant	60,000	
Furniture	4,000	
Stock	42,000	
Debtors	25,000	
Pre-Payments	Nil	
Bank	19000	1,50,000
Less: External liability		
Sundry Creditors		(51,000)
Capital Employed		99,000

(iv) Calculation of N.R.R. = 8%

(v) Number of year purchase = 5 years

(vi) Calculation of normal profit

$$\begin{aligned}
 \text{N.P.} &= \text{Capital Employed} \times \frac{\text{N.R.R}}{100} \\
 &= 99,000 \times \frac{8}{100} \\
 &= `7,920
 \end{aligned}$$

(vii) Calculation super profit

$$\begin{aligned}
 \text{Super Profit} &= \text{F.M.P.} - \text{Normal profit} \\
 &= 15,700 - 7,920 \\
 &= `7,780
 \end{aligned}$$

(viii) Calculation of Goodwill by purchase of super profit method

$$\begin{aligned}
 \text{Goodwill} &= \text{Normal of years purchase} \times \text{super profit} \\
 &= 5 \times 7,780 \\
 &= `38,900
 \end{aligned}$$

(ix) Calculation of Goodwill by Annuity method of S.P.

$$\begin{aligned}
 \text{Goodwill} &= \text{Annuity Rate} \times \text{S.P.} \\
 &= 3.75 \times 7,780 \\
 \text{Goodwill} &= `29,175
 \end{aligned}$$

Illustration 21:

From the following information supplied to you, ascertain the value of Goodwill of Anamika Ltd. Which is carrying business as retail trader under the capitalization of profit method?

Balance sheet as on March 31, 2015

Particulars	₹	Particulars	₹
Paid up capital		Goodwill at cost	50,000
5,000 equity shares of ₹100		Land and buildings at cost	2,20,000
Each fully paid	5,00,000	Plant and Machinery cost	2,00,000
Profit and Loss appropriation a/c.	1,13,300	Stock in trade	3,00,000
Bank overdraft	1,16,700	Book debt	
Provide for taxation	39,000	Less provisions for bad debts	1,80,000
Sundry creditors	1,81,000		
	9,50,000		9,50,000

The company commenced operations in 1985 with a paid up capital of ₹5,00,000. Profit for recent years (after taxation) have been as follows:

Year ending March, 31	₹
2011	(Loss) 40,000
2012	88,000
2013	1,03,000
2014	1,16,000
2015	1,30,000

- (1) The loss in 2011 occurred due to prolonged strike.
- (2) The income tax paid so far has been at the average rate of 40%, but it is likely to be 50% now onwards.
- (3) Dividend were distributed at the rate of 10% at the end of the year ending march 31, 2015.
- (4) The market price of shares is ruling at ₹125 at the end of the years ending March, 31, 2015.
- (5) Profit till 2015 had been ascertained after debiting ₹40,000 as remuneration to the managing director. The Government has approved a remuneration of ₹60,000 with effect from April 1, 2015.
- (6) The company has been able to secure a contract for supply of materials at advantageous prices. The advantage has been valued at ₹40,000 p.a. for the next five years.

Solution:

Accounting for Banking Company

(1) Calculation for Average profit.

Note: Loss in the years 2014 is to be ignored because it was due to prolonged strike which is a abnormal event in the normal course of business we are Excluding profit of the years 2012 also because Impact of the strike was there in that year also.

	2013	2014	2015
Profit before tax =	<u>1,03,000</u>	<u>1,16,000</u>	<u>1,30,000</u>
	60%	60%	60%
	=1,71,667	1,93,333	2,16,667

(2) Calculation for weighted Average profit:

Year	Profit	Weights	Product
2013	1,71,667	1	1,71,667
2014	1,93,333	2	3,86,666
2015	2,16,667	3	6,50,001
		6	12,08,334

$$\text{Weighted Average profit} = \frac{12,08,334}{6} = \text{'2,01,389}$$

(3) Calculation for F.M.P:

Weighted Average profit	2,01,389
Less: Extra directors fees in future	(20,000)
Add: Profit likely to be earn in future	<u>40,000</u>
F.M.P before tax	2,21,389
Less: tax 50%	<u>1,10,694</u>
F.M.P after tax	<u>1,10,695</u>

(4) Calculation for Capital employed:

Tangible Trading Asset		
Land & Building	2,20,000	9,00,000
Plant & Machinery	2,00,000	
Stock	3,00,000	
Debtors	1,80,000	
Less: External Liability		
Bank	1,16,700	(3,36,700)
Provision for tax	39,000	
Creditors	1,81,000	
Capital Employed		

(5) Calculation for N.R.R:

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$$\begin{aligned}\text{N.R.R} &= \frac{\text{Dividend Per Share}}{\text{Market Price Per Share}} \times 100 \\ &= \frac{10}{125} \times 100 \\ &= 8\%\end{aligned}$$

(6) Calculation of Normal Profit:

$$\begin{aligned}&= \text{Capital Employed} \times \frac{\text{N.R.R}}{100} \\ &= 5,63,300 \times \frac{8}{100} \\ &= ₹45,064\end{aligned}$$

(7) Calculation of super profit = F.M.P. – Normal profit

$$\begin{aligned}&= 1,10,695 - 45,064 \\ &= ₹65,631\end{aligned}$$

(8) Calculation of Goodwill by capitalization of S.P. method

$$\begin{aligned}\text{Goodwill} &= \frac{\text{Super Profit}}{\text{N.R.R.}} \times 100 \\ &= \frac{65,631}{8\%} \\ &= ₹8,20,387\end{aligned}$$

Valuation of shares:

In the cases of shares quoted in the recognized Stock Exchanges, the Prices quoted in the Stock Exchanges are generally taken as the basis of valuation of those shares. However the Stock Exchange prices are determined generally on the demand supply position of the shares and on business cycle. The London Stock Exchange opines that the Stock Exchange may be linked to a scientific recording instrument which registers not its own actions and options but the actions and options of private institutional investors all over the country/world. These actions and options are the result of fear, guess work, intelligent or otherwise, good or bad investment policy and may other consideration. The quotations what result definitely do not represent valuation of a company by reference to its assets and its earning potential. Therefore the accountants are called upon to value the shares by following the other methods.

Accounting for Banking Company

The value of share of a company depends on so many factors such as:

- (1) Nature of Business.
- (2) Economic policies of the Government.
- (3) Demand and Supply of shares.
- (4) Rate of Dividend paid.
- (5) Yield of other related shares in the Stock Exchange etc.
- (6) Net worth of the company.
- (7) Earning capacity.
- (8) Quoted price of the shares in the stock market.
- (9) Profits made over a number of years.
- (10) Dividend paid on the shares over a number of years.
- (11) Prospects of growth, enhanced earning per share, etc.

Need and purpose of valuation of shares:

The need for valuation of shares may be felt by any company in the following circumstances:

- (1) For Assessment of Wealth Tax, Estate duty, Gift Tax etc.
- (2) Amalgamations, Absorptions etc.
- (3) For converting one class of shares to another class.
- (4) Advancing loans on the security of shares.
- (5) Compensating the shareholders on acquisition of shares by the Government under a scheme of nationalization.
- (6) Acquisition of interest of dissenting shareholder under the reconstruction scheme, etc.

Factors influencing valuation:

The valuation of shares of a company is based, inter alia, on the following factors:

- (1) Current stock market price of the shares.
- (2) Profits earned and dividend paid over the years.
- (3) Availability of reserves and future prospects of the company.
- (4) Realizable value of the net assets of the company.
- (5) Current and deferred liabilities for the company.
- (6) Age and status of plant and machinery of the company.
- (7) Net worth of the company.
- (8) Record of efficiency, integrity and honesty of Board of Directors and other managerial personnel of the company.

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- (9) Quality of top and middle management of the company and their professional competence.
- (10) Record of performance of the company in financial terms.

Methods of valuation of shares:

Certain methods have come to be recognized for valuation of shares of a company, viz.

- (1) Open market price;
- (2) Stock exchange quotation;
- (3) Net assets basis;
- (4) Earning per share method;
- (5) Yield or return method;
- (6) Net worth method;
- (7) Break-up value etc.

IDEAL VALUATION METHOD:

The various methods of valuation of shares of a company as mentioned above have their Individual merits and demerits. Therefore, it has been universally recognize that while valuing the shares of a company, it is advisable not to depend upon any single method but to resort to a combination of three well recognize methods viz, market value method, yield or return on investment method and net assets value method for arriving at a fair and reasonable shares exchange ratio. While doing this, due weightage should he given to each method based on the company's performance and future prospects.

INTRINSIC VALUE METHOD:

This method is also called as Assets backing method, Real value method, Balance Sheet method or Break-up value methods. Under this method the net assets of the company including goodwill and non-trading assets are divided by the number of shares issued to arrive at the value of each share.

If the market value of the assets is available the same is to be considered and in the absence of such information the book values of the assets shall be taken as the market value. While arriving at the net assets the Fictitious assets such as preliminary expenses, the debit balance in the profit and loss a/c should not be considered. The liabilities payable to the Third parties and to the preference shareholders is to be deducted from the total asset to arrive at the net assets. The funds relating to equity shareholders such as General Reserve Profit and Loss Account Balance of Debenture Redemption Fund, Dividend equalization reserve, Contingency reserve, etc. should not be deducted.

Illustration 22:

From the information given below and the balance sheet of Cipla Limited on 31st December, 2015 find the value of share by Intrinsic value method.

Balance sheet

Particulars	₹	Particulars	₹
1000, 8% Preferential Shares of ₹100 each fully paid	1,00,000	Buildings	70,000
4,000 equity shares of ₹100 fully paid	4,00,000	Furniture	3,000
Reserves	1,50,000	Stock (Market value)	4,50,000
Profit and Loss account	5,10,000	Investment at cost (face value 4,00,000)	3,35,000
Creditors	48,000	Debtors	2,80,000
		Bank	60,000
		Preliminary Expenditure	10,000
	12,08,000		12,08,000

Building is now worth of ₹3,50,000 and the Preferential shareholders are having preference as to capital and dividend.

Solution:

Valuation of Equity Share	Intrinsic Value Method
Building	3,50,000
Furniture	3,000
Stock	4,50,000
Investment	3,35,000
Debtors	2,80,000
Bank	60,000
Total Assets	14,78,000
Less: Creditors	(48,000)
Net Assets	14,30,000
less Preference share capital	(1,00,000)
Assets Available for equity shareholders	13,30,000

$$\begin{aligned}
 \text{Value of Equity Share} &= \frac{\text{Net Assets available to Equity Shareholders}}{\text{No. of Equity Shares}} \\
 &= \frac{13,30,000}{4,000} \\
 &= ₹332.5
 \end{aligned}$$

∴ Intrinsic Value of Each equity shares = ₹332.50

YIELD METHOD:

Accounting for Banking Company

The valuation of shares under the Yield methods may be done under two categories:

- (a) **Return on capital employed method:** This method is applied for the purpose of valuation of the shares of majority share holding. A big investor is more interested in what the company earns and not simply in what the company distributes. Even if the Company does not distribute 100% of its earning among its shareholders, it, as a matter of fact strengthens the financial position of the Company. The value of the share under this method is calculated by the formula.

Return on capital Employed

$$\frac{\text{Return of Capital Employed}}{\text{Normal Rate of Return}} \times \text{Paid-up value of shares}$$

- (b) **Valuation on the basis of dividend:** This method is more suitable for valuation of small block of shares. Steps of calculation as follows:

Step 1:

Particulars	
Future Maintainable Profits	XXX
Add: Non-Trading Income	XXX
	XX
Less: Preference Dividend	XX
Transfer to Reserve	XX
Expected Amount of Dividend	XX

Step 2:

$$\text{Expected Rate of Dividend} = \frac{\text{Expected Amount of Dividend}}{\text{Paid up Equity Capital}} \times 100$$

Step 3:

$$\frac{\text{Expected Rate of Dividend}}{\text{Normal Rate of Dividend}} \times \text{Paid-up value of shares}$$

FAIR VALUE METHOD:

This method fixes the value of shares as the average of the values calculated by Intrinsic Value Method and Yield Method.

$$\text{Fair Value} = \frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$$

NORMAL RATE OF DIVIDEND:

Illustration 23:

Accounting for Banking Company

The following Particulars are available in respect of Goodluck Limited.

- (a) Capital 450, 60% preference shares of `100 each fully paid and 4,500 equity shares `10 each fully paid.
- (b) External liabilities: `7,500.
- (c) Reserves and Surplus `35,000.
- (d) The average expected profit (after taxation) earned by the company `8,500.
- (e) The normal profit earned on the market value of equity shares (full paid) of the same type of companies is 9%.
- (f) 10% of the profit after tax is transferred to reserves.

Calculate the intrinsic value per equity share, value per equity share according dividend yield basis and fair value per equity share.

Assume that out of total assets, assets worth of `350 are fictitious:

Solution:

• Intrinsic Value of Shares:

6% Preference share capital (450 × 100)	=	45,000
Equity shares (4,500 × 10)	=	45,000
Reserves and surplus	=	3,500
External liabilities	=	<u>7,500</u>
Total Liabilities	=	<u>1,01,000</u>
As Total Liabilities	=	Total Assets
Total assets	=	1,01,000
Less: Fictitious assets	=	(350)
External liabilities	=	(7,500)
Preference Shares	=	(45,000)
Net assets available for equity shareholders		<u>48,150</u>

$$\therefore \text{Intrinsic Value of Share} = \frac{\text{Net Assets Available for Equity Shareholders}}{\text{Number of Equity Share}}$$

$$= \frac{48,150}{4,500}$$

$$= `10.70$$

• Yield Value:

Average profit after taxation	=	`8,500
Less: Transfer to General Reserves (10%)	=	<u>(850)</u>
	=	7,650
Less: Preference dividend 6% of 45,000	=	<u>2,700</u>
Profit available to equity share holders	=	4,950
Rate of dividend	=	$\frac{4,950}{45,000} \times 100 = 11\%$

$$\therefore \text{Value of Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate}} \times \text{Paid-up Value of Share}$$

$$= \frac{11}{9} \times 10$$

Accounting for Banking Company

$$= ₹12.22$$

- **Fair Value per Equity Shares:**

$$= \frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$$

$$= \frac{10.70 + 12.22}{2}$$

$$= ₹11.46$$

Illustration 24:

The capital structure of company as on 31st March, 2015 was as under:

Equity Share Capital	5,00,000
11% Preference Share Capital	3,00,000
12% Secured Debentures	4,00,000
Reserves	3,00,000

The company on an average earns a profit of ₹4,00,000 annually before deduction of interest on Debentures and Income Tax, which works out to 45%. The normal return on equity shares on companies similarly placed is 15% provided.

- The profit after tax covered the fixed interest and fixed dividends at least four times.
- Equity capital and reserves are 150% of debentures and preference capital.
- Yield on shares is calculated at 60% of profits distributed and 5% on undistributed profits.

The company is regularly paying an equity dividend of 18%. Ascertain the value of equity share of the company.

Solution:

	₹
(i) Average profit of the companies before interest and tax	4,00,000
Less: Debenture interest 12% of 4,00,000	48,000
Profit after interest but before tax	3,52,000
Tax @ 45%	1,58,400
Profit After interest and Tax	1,93,600

Accounting for Banking Company

Evaluation of Conditions given in the question:

- (a)** Profit after tax whether covers fixed interest and fixed dividend at least four times. Profit after tax.

$$= 40,000 - 1,58,400 = 2,41,600 \text{ Fixed interest}$$

and fixed dividend interest.

$$\text{Interest} = 48,000$$

$$\text{Fixed dividend 11\% of 3,00,000}$$

$$= \underline{33,000}$$

$$= \underline{81,000}$$

$$= \frac{2,41,600}{81,000}$$

$$= 2.9827 \text{ times}$$

\therefore Fixed interest and dividend coverage is 2.98 times only and is less than the prescribed 4 times.

- (b)** Whether equity capital and reserves are of 150% of preference share capital and debentures.

Equity share	5,00,000	Preference share	3,00,000
Reserves	3,00,000	Debentures	4,00,000
	8,00,000		7,00,000

$$\therefore \text{Ratio} = \frac{8,00,000}{7,00,000} \times 100 = 114.28\%$$

\therefore Ratio is less than the Prescribed Ratio of 150%.

- (c)** Yield on Profit:

Average Profit after Interest and tax		1,93,000
Less: Preference Dividend 11% of	33,000	
18% Equity Dividend (Regularly Paying)	90,000	
$5,00,000 \times \frac{18}{100}$		1,23,000
\therefore Undistributed profits		70,600
\therefore Yield = 60% of Distributed		
Profit of = 60% of 90,000		54,000

Accounting for Banking Company

5% of on undistributed profit		3,530
		57,530

$$\therefore \text{Yield Rate} = \frac{57,530}{5,00,000} \times 100 = 11.506\%$$

Expected Yield of Equity Shares

Normal Return if (a), (b) conditions cited above full filled = 15%

Add: For low coverage of fixed interest and dividend (assumed) = 0.5%

For low Ratio of Equity share capital and Reserves (assumed) = 0.5%

16%

\therefore Value of Equity Share

$$= \frac{\text{Possible Yield Rate}}{\text{Expected Yield Rate}} \times \text{Paid-up Value of Shares}$$

$$= \frac{11.506\%}{16\%} \times 10$$

$$= ₹71.91$$

Illustration 25:

From the following information of Dell Ltd. calculate the value of share by yield basis.

Balance sheet as on 31/12/2015

Particulars	₹	Particulars	₹
800 Equity shares of 100 each	80,000	Land and Building	50,000
4,000 Preference share of ₹10 each	40,000	Plant and Machinery	60,000
6% Debentures	20,000	Patents	20,000
Sundry Creditors	40,000	Sundry Debtors	30,000
		WIP and Stock	50,000
		Cash and Bank	10,000
	2,20,000		2,20,000

Land and Building to be valued at 90,000. The company's earnings were as follows:

Accounting for Banking Company

Year	Profit before tax	Tax
2011	30,000	8,000
2012	40,000	16,000
2013	10,000	(Strike) 4,000
2014	50,000	23,000
2015	55,000	30,000

The company paid managerial remuneration of `6,000 per annum but it will become `10,000 in future. There has been no change in capital employed. The company paid dividend of `9 per share and it will maintain the same in future. The company proposes to build up a plant rehabilitation reserve at 15% of profit after tax. Dividend rate in this type of company is fluctuating and the asset backing of the equity share is about 1 ½ times. The equity share with an average dividend of 8% sell at par.

Solution:

Average Maintainable Profits:

Year	Weights	Profit	Product
2011	1	30,000	30,000
2012	2	40,000	80,000
2013	(abnormal due to strike)		
2014	3	50,000	1,50,000
2015	4	55,000	2,20,000
	10		4,80,000

$$\text{Weighted Average Profit} = \frac{48,000}{10} = 48,000$$

Weighted Average Profit	48,000
Less: Increase in the Managerial Remuneration (10,000 – 6,000)	4,000
	44,000
Less: Tax (assuming 50%)	22,000
Profits available for distribution	22,000
Less: Plant Rehabilitation Reserve	3,300
	18,700
Less: Preference Dividend 9% of 40,000	3,600
	15,100

Average Backing per Equity Share:

Tangible Trading Asset		
Land and Building		90,000
Plant and Machinery		60,000

Accounting for Banking Company

Patents		20,000
Sundry Debtors		30,000
WIP and Stock		50,000
Cash and Bank		10,000
		2,60,000
Less: Sundry Creditors	40,000	
Preference Share Capital	40,000	
6% Debentures	20,000	1,00,000
∴ Net assets available for equity shareholders		1,60,000

$$\therefore \text{Asset Backing} = \frac{1,60,000}{80,000} = 2 \text{ Times.}$$

Dividend Rate:

Normal Dividend Rate 8.0%

Less: For higher dividend rate of 9% (0.5%)

For higher asset backing (2 times compared to 1.5) (0.5%)

7.0%

$$\therefore \text{Capitalization factor} = \frac{100}{7} = 14.226$$

$$\therefore \text{Value of equity share factor} = \frac{\text{Profit available for equity shareholders}}{\text{Number of Equity Shares}} \times \text{Capitalization factor}$$

$$= \frac{15,100}{800} \times 14.286 = 269.64$$

Fair value of a share:

The Fair value of a share is the average of the value obtained by the net asset method and the yield method.

$$\text{Fair Value} = \frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$$

Illustration 26:

The Balance Sheet of Diamond Limited as on 30-06-2015 is as follows:

Liabilities		Assets	
Share Capital: 2,000 shares of ₹100 each	2,00,000	Land and Building	1,10,000
General Reserve	40,000	Plant and Machinery	1,30,000
Profit and Loss Account	32,000	Patents and Trade Marks	20,000
Sundry Creditors	1,28,000	Stock	48,000
Income Tax Reserve	60,000	Debtors	88,000
		Bank balance	52,000
		Preliminary expenses	12,000
	4,60,000		4,60,000

Accounting for Banking Company

The expert valuer valued the land building at `2,40,000, goodwill at `1,60,000 and plant and Machinery at 1,20,000. Out of the total debtors, it is found that debtors of `8,000 are bad. The profits of the company have been as follows:

	`
2013	80,000
2014	90,000
2015	1,06,000

The company follows the practice of transferring 25% of profits to General Reserve. Similar type of companies earn at 10% of the value of their shares. Ascertain the values of shares of the company under: (Ignore taxation)

- (1) Intrinsic value method.
- (2) Yield value method and,
- (3) Fair value method.

Solution:

(a) Intrinsic Value Method:

Tangible Trading Asset	`	`
Land and Building		2,40,000
Goodwill		1,60,000
Patent and Machinery		1,20,000
Patents and Trademarks		20,000
Stock		48,000
Debtors	88,000	
Less: Bad	8,000	80,000
Banks Balance		52,000
		7,20,000
Less: Sundry Creditors		1,28,000
Net Assets		5,92,000

$$\begin{aligned} \therefore \text{Intrinsic value of shares} &= \frac{\text{Net Assets}}{\text{No. of Equity Shares}} \\ &= \frac{5,92,000}{2,000} = 296 \end{aligned}$$

(b) Yield Value Method:

		`
Total profit of the year	2013 =	80,000
	2014 =	90,000
	2015 =	1,06,000

Accounting for Banking Company

	2,76,000
Less Bad debts	(8,000)
	2,68,000

$$\therefore \text{Average profit} = \frac{2,68,000}{3} = 89,333.33$$

Less: Depreciation on account of Revaluation of plant and Machinery
(1,30,000 – 1,20,000)

$$= 10,000 \times \frac{10}{100} = 1,000$$

Land and Building

$$= (2,40,000 – 1,10,000)$$

$$= 1,30,000 \times \frac{5}{100} = \underline{6,500}$$

$$\underline{5,500} \qquad \underline{(5,500.00)}$$

$$83,8.33.33$$

$$\text{Transfer to Reserves (25\%)} \qquad \underline{20,958.33}$$

$$\underline{62,875.00}$$

$$\therefore \text{Rate of Dividend} = \frac{62,875}{2,00,000} \times 100 = 31.4375\%$$

$$\therefore \text{Yield value of each sale} = \frac{\text{Rate of Dividend}}{\text{Normal Rate}} \times \text{Paid-up value of share}$$

$$= \frac{31.4375\%}{10\%} \times 100 = 314.375$$

$$(c) \quad \text{Fair Value} = \frac{\text{intrinsic value} + \text{yield value}}{2}$$

$$= \frac{296 + 314.375}{2} = 305.1875$$

Note: The Depreciation Rates are assumed.

Value of Right Shares:

According to Section 81 of the Companies Act, if the company increases its share capital issuing new shares, the existing shareholders have a right to subscribe to the new shares in a fix proportion of their existing shares. If the Shareholders want to sell his right of such shares the value of such right can be ascertained by the following formula,

Accounting for Banking Company

$$R = \frac{r}{N + r} \times (M - S)$$

Where,

R = Value of right share

r = Number of right shares

M = Market price per share

S = Subscription price i.e. issue price

N = No. of old shares.

Illustration 27:

Sunitha Limited offers to its existing shareholders two shares for every seven shares held by them. The right issue price is `140 (including premium of `40) and the market value of the share at the time of right issue is `190 per share. Calculate the value of rights.

Solution:

Value of Right

$$= \frac{r}{N + r} \times (M - S)$$

r = No. rights = 2

$$= \frac{2}{(7 + 2)} \times (190 - 140) = \frac{2}{9} \times 50$$

N = No. of old shares = 7

M = Market + Price = 190

S = Subscription/Issue Price = 140

= `11.11

Valuation of Preference Shares:

In case of non participating preference shares, the value of such shares will be their face value plus the arrear dividend if any. However the Participating Preference shareholders have a right to participate in the surplus incase of liquidation. The surplus will be distributed to equity and preference shareholders in the ratio of paid-up share capital. In such case the value of preference share is equal to face value of each preference share plus arrears preference dividend plus Surplus of each preference share.

Illustration 28:

The following information is extracted from the books of M/s TVS Limited:

Accounting for Banking Company

- (a) The paid-up share capital of the company consists of 1,000, 15% preference shares of ₹100 each and 20,000 equity shares of ₹10 each.
- (b) The average annual profits of the company after providing for depreciation and taxation amounted to ₹75,000. It is considered necessary to transfer ₹10,000 to general reserve before declaring any dividend.
- (c) The normal return expected by investors on equity shares from this type of business carried on by the company is 10%.

Calculate the value of an equity share.

Solution:

Average annual profit	75,000
Less: Preference dividend: 15% on ₹(100 × 100)	15,000
	60,000
Less: Transfer to general reserve	10,000
Profit for equity shareholder	50,000
Equity share capital = 20,000 × ₹10 = ₹2,00,000	
ROE = (Profit for equity share holder/outstanding balance of equity share capital	
= (₹50,000 / ₹2,00,000) × 100 = 25%.	
Normal rate of return = 10%	
Value of equity share = ₹10 × (25% / 10%)	
= ₹25	

Illustration 29:

The following is the balance sheet of Asaraf Ltd. as on March 31, 2015.

Liabilities		Assets	
Equity share capital of ₹10 each fully paid	15,00,000	Plant and Machinery	8,75,000
Reserve and Surplus	2,75,000	Building	6,25,000
12% Debentures	3,25,000	Furniture	3,90,000
Sundry Creditors	80,000	Stock	1,20,000
		Sundry Debtors	1,40,000
		Cash	30,000
	21,80,000		21,80,000

Other information related to operation of the company is given below:

Accounting for Banking Company

Particulars	March 31st	March 31st	March 31st	March 31st
	2012 (₹)	2013 (₹)	2014 (₹)	2015 (₹)
Sale	10,00,000	11,00,000	13,00,000	15,00,000
Expenses	4,25,000	6,15,000	7,00,000	8,75,000
Interest on debentures	39,000	39,000	39,000	39,000

It is the usual practice of the company to transfer ₹50,000 every year to general reserve. Assume, a rate of tax of 50% and normal earnings of 15%.

Compute the value of equity share by capitalization of earning method.

Solution:

Particulars	2011-12 (₹)	2012-13 (₹)	2013-14 (₹)	2014-15 (₹)
Sales (₹)	10,00,000	11,00,000	13,00,000	15,00,000
Less: Expenses (₹)	4,25,000	6,15,000	7,00,000	8,75,000
	5,75,000	4,85,000	6,00,000	6,25,000
Less: interest on debentures	39,000	39,000	39,000	39,000
Profit before tax less:	5,36,000	4,46,000	5,61,000	5,86,000
Tax (50%)	2,68,000	2,23,000	2,80,500	2,93,000
Profit after Tax	2,68,000	2,23,000	2,80,500	2,93,000

$$\text{Average profit} = \frac{(2,68,000 + 2,23,000 + 2,80,500 + 2,93,000)}{4}$$

$$= \frac{(10,64,500)}{4}$$

$$= ₹2,66,125$$

$$\text{Expected rate of earnings} = \frac{(\text{Average profit})}{\text{Outstanding balance of equity shares}}$$

$$= \frac{2,66,125}{15,00,000} \times 100 = 17.74\%$$

$$\text{Value per share} = \left(\frac{\text{Expected earnings}}{\text{Normal earnings}} \times \text{Face value} \right) = \left(\frac{17.74\%}{15\%} \right) \times ₹10$$

Accounting for Banking Company

= ₹11.83

Illustration 30:

Liabilities		Assets	
1,00,000 equity shares of ₹10 each		Land and Building at cost	12,00,000
equity share of ₹10 paid-up	10,00,000		
₹7.50 paid-up	7,50,000	Plant and Machinery at cost	14,00,000
1,00,000 equity shares of ₹10 each	5,00,000	Patent and copyrights	2,00,000
Fully paid (₹5 paid up)			
Capital reserves	3,00,000	Investment at cost	1,50,000
General reserves	4,00,000	Closing stock	6,00,000
Profit and Loss a/c	2,00,000	Sundry debtors	8,00,000
Share premium a/c	5,00,000	Bank balance	1,60,000
Sundry creditors	5,10,000	Preliminary expenses	40,000
Worker's Compensation fund	60,000		
Dividend equalization fund	1,00,000		
Prov. for dep. on P & M	2,00,000		
Prov. for bad and doubtful debts	30,000		
	45,50,000		45,50,000

The balance sheet as on March 31st, 2015 does not contain a provision for unassessed taxes, which are estimated to be ₹75,000.

The present market value of the assets are as follows:

	₹
Land and Building	15,00,000
Plant and Machinery	13,00,000
Patent and copyrights	1,00,000
Investment	1,80,000

Current assets are valued at their book value but bad debt provision should be maintained at 2% of sundry debtors.

Calculate the value of each type of equity share per unit by using the asset backing method (excluding goodwill) based on the notional calls.

Solution:

Asset Backing Method:

Value of assets	₹
Assets	
Land and Buildings	15,00,000
Plant and Machinery	13,00,000

Accounting for Banking Company

Patents and copyrights	1,00,000
Investments	1,80,000
Closing stock	6,00,000
Sundry debtors less provision for bad and doubtful debts (98% of `8,00,000)	7,84,000
Bank balance	1,60,000
Total assets	46,24,000
Liabilities	
Sundry creditors	5,10,000
Tax provision	75,000
Total liabilities	5,85,000
Net assets = Total Assets – Total Liabilities	40,39,000
Add notional calls:	
1,00,000 equity share × `2.50	2,50,000
1,00,000 equity shares × `5.00	5,00,000
	47,89,000

Net value of assets:

$$\begin{aligned} \text{Value of each equity share} &= \left(\frac{\text{Net value of asset}}{\text{Number of equity shares}} \right) \\ &= \frac{(47,89,000)}{(3,00,000)} = `15.96 \end{aligned}$$

Value of each `10 paid equity share = `15.96

Value of each `10 each, 7.50 paid up equity share = `15.96 – 2.50
= 13.46

Value of each `10 each, 5.00 paid up capital share = `15.96 – 5.00
= 10.96

Illustration 31:

The following is the Balance sheet of Kemicolour Industries Ltd. as on 31st December, 2015:

Liabilities	`	Assets	`
10,000 Eq. shares of `10 each	1,00,000	Goodwill	50,000
General Reserve	2,50,000	Fixed Assets	1,50,000
Term Loans	50,000	Investments	1,00,000
Current Liabilities	1,50,000	Current Assets	2,50,000
	5,50,000		5,50,000

On 31st December, 2015 the fixed assets were independently valued at `2,10,000 and that Goodwill was to be revalued at 2 years' purchase of super profits. The post tax profits for the three years were:

Accounting for Banking Company

	`
2013	51,600
2014	54,800
2015	40,600

A yield of 12% is considered to be normal in this line of industry. Tax rate is 30%.

You are asked to compute the value of an equity share on Net Assets backing Basis.

Solution

(a) Calculation for Average Profit:

$$\begin{aligned} \text{Simple Average} &= \frac{51,600 + 54,800 + 40,600}{3} \\ &= `49,000 \end{aligned}$$

(b) Calculation for F.M.P:

$$\text{Simple Average Profit} = 49,000$$

$$\text{F.M.P} = 49,000$$

(c) Calculation of capital Employed:

Tangible trading Assets	`	`
Fixed Assets	2,10,000	4,60,000
Current Assets	2,50,000	
Less: External liability		
Term Loan	50,000	
Current Liability	1,50,000	(2,00,000)
Capital Employed		2,60,000

(i) Calculation of N.R.R = 12% (given)

(ii) Number of years purchase = 2 years.

(iii) Calculation of Normal Profit

$$\begin{aligned} \text{Normal Profit} &= \text{Capital employed} \times \frac{\text{N.R.R}}{100} \\ &= 2,60,000 \times \frac{12}{100} \\ &= `31,200 \end{aligned}$$

(iv) Calculation of super profit

$$\begin{aligned} \text{Super Profit} &= \text{F.M.P} - \text{Normal Profit} \\ &= 49,000 - 31,200 \\ &= `17,800 \end{aligned}$$

Accounting for Banking Company

(v) Calculation of Goodwill by purchase of super profit method:

$$\begin{aligned} \text{Goodwill} &= \text{Number of years purchase} \times \text{Super profit} \\ &= 2 \times 17,800 \\ &= 35,600 \end{aligned}$$

(vi) Calculation for amount available for share holders:

All Assets (at agreed/Adjustment value)	
Capital Employed (Excluding Goodwill & Investment)	2,60,000
Goodwill	35,600
Invest Amount available for Equity shareholders	<u>1,00,000</u>
	<u>3,95,600</u>

(vii) Calculation for share by Assets backing method:

$$\begin{aligned} &= \frac{\text{Amount available for Equity share holders}}{\text{No. of Equity Share}} \\ &= \frac{3,95,600}{10,000} \\ &= `39.56 \end{aligned}$$

Illustration 32:

The following is the summarized Balance sheet of M/s. Vijay Engineers as on 30/09/15.

Liabilities		Assets	
Share Capital		Plant	50,000
30,000 Equity shares of `10 each	3,00,000	Property	1,20,000
Reserves and surplus		Stock	3,10,000
General	1,20,000	Debtors	2,03,000
Capital	40,000	Bank	1,17,000
Profit & Loss a/c	<u>1,20,000</u>	Cash	1,700
Current Liabilities Provisions:			
Creditors	93,700		
I.T. Payable	11,500		
Proposed Dividend	33,000		
Provision for tax	<u>82,500</u>		
	2,20,700		
	8,01,700		8,01,700

Net profit before taxation for three years ended 30th September 2013. `1,38,000 30th September, 2014 `1,83,000; and 30th September, 2015,

`1,97,000 freehold property was valued `1,60,000. Average yield in this

Accounting for Banking Company

type of business is 10% on capital employed. You are required to find out the value of each equity share on the basis of above mentioned facts as:

- (i) Net Assets basis, and
- (ii) Yield basis.

The company has a practice of transferring 20% of its yearly profit after tax to General reserve.

Solution

(a) Calculation for amount Available for share holders:

Particulars		
Plant	50,000	
Property	1,60,000	
Stock	3,10,000	
Debtors	2,03,000	
Bank	1,17,000	
Cash	1,700	8,41,700
Less: External Liability		
Creditors	93,700	
I.T. Payable	11,500	
Proposed dividend	34,000	
Provision for Taxes	82,500	(2,21,700)
Amount Available for equity Share holders		6,20,000

(b) Calculation for share by Net Asset Value (I.V.) method:

$$\begin{aligned}
 \text{I.V.} &= \frac{\text{Amount available for Equity share holder}}{\text{Number of Equity share}} \\
 &= \frac{6,20,000}{30,000} \\
 &= `20.67
 \end{aligned}$$

II Yield Value:

(1) Calculation of Average profit:

Year	Profit	Weights	Product
2013	1,38,000	1	1,38,000
2014	1,83,000	2	3,66,000
2015	1,97,000	3	5,91,000
		6	10,95,000

$$\text{Weighted Average Profit} = \frac{10,95,000}{6}$$

$$\therefore \text{F.M.P before tax} = `1,82,500$$

(cccxxvii)

Accounting for Banking Company

(2) Calculation for Profit available to share holders:

	`
F.M.P before tax	1,82,500
Less: Tax @ 50%	(91,250)
F.M.P after tax	91,250
Less: Transfer to General Reserves (20%)	(18,250)
Profit available future Equity share holders	73,000

(a) Calculation for E.R.R.:

$$\begin{aligned}
 \text{E.R.R.} &= \frac{\text{Profit available for Equity share holder}}{\text{Total Equity share capital}} \times 100 \\
 &= \frac{73,000}{3,00,000} \times 100 \\
 &= 24.33\%
 \end{aligned}$$

(b) Calculation of value of share by yield value method:

$$\begin{aligned}
 \text{Yield Value} &= \frac{\text{E.R.R}}{\text{N.R.R}} \times \text{paid up Face Value of each equity share} \\
 &= \frac{24.33 \times 10}{10} \\
 &= `24.33
 \end{aligned}$$

Illustration 33:

Following is the balance sheet of Super Prospects Co. Ltd. as on 31st December, 2015.

Liabilities	`	Assets	`
Share capital		Land and Building (At cost)	30,000
3,000 5% pref. shares of `		Plant and machinery	
10 each fully paid	30,000	(at cost less depreciation)	50,000
9,000 Equity shares of `10		Furniture and fixtures (at cost	
each		less	
Full paid	90,000	depreciation)	10,000
Reserves	30,000	6% Government securities	12,000
Profit and Loss a/c.	12,000	(Normal value `10,000)	
6% Debentures	20,000	(Market value `(14,000)	
Creditors	15,000	Debtors (all good)	39,000
		Stock	46,000
		Cash in hand	5,000
		Preliminary expenditure	5,000
	1,97,000		1,97,000

Accounting for Banking Company

Find out the fair value of equity shares after considering the following information as, (i) intrinsic value method (ii) on basis of yield.

- (a) Average annual profit (before taxation) `51,200.
- (b) Rate of income tax is 50%.
- (c) `5,000 is transferred to General Reserve every year.
- (d) Normal return is 9% on capital employed.
- (e) Goodwill is to be valued at 4 years purchase of super profits.
- (f) Dividend declared by companies doing similar business is 10%.
- (g) All assets are worth book value subject to following changes.
 - (i) The land and building is valued `35,000.
 - (ii) Investment as given in the Balance sheet.

Solution:

Super Prospects Co. Ltd.

(i) Calculation of Average profit: 51,200 (Given)

(ii) Calculation for F.M.P.

Average profit before tax 51,200

Less: tax @ 50% (25,600)

F.M.P. after tax 25,600

(iii) Calculation for capital Employed:

Tangible trading Assets	`	`
Land and Building	3,5000	
Plant and Machinery	50,000	
Furniture and Fixture	10,000	
Debtors	39,000	
Stock	46,000	
Cash	5,000	1,85,000
Less: External Liability		
6% Debtors	20,000	
Creditors	15,000	(35,000)
Capital Employed		1,50,000

(iv) Calculation of N.R.R. = 9%

(v) Calculation of Number of years = 4 years.

(vi) Calculation Normal Profit = Capital Employed $\times \frac{\text{N.R.R}}{100}$

$$= 1,50,000 \times \frac{9}{100}$$

$$= `13,500$$

(cccxxix)

Accounting for Banking Company

(vii) Calculation of super profit = F.M.P. – Normal profit

$$= 25,600 - 13,500$$

$$= 12,100$$

(viii) Calculation of Goodwill by purchase of S.P. method:

$$\text{Goodwill} = \text{Number of years purchase} \times \text{S.P.}$$

$$= 4 \times 12,100$$

$$= 48,400$$

(I) Intrinsic value method:

(i) Calculation for amount available for share holder fund:

All Assets (at agreed value)

Capital Employed (Excluding Goodwill & Investment) 1,50,000

Goodwill 48,400

6% Government securities 14,000

Amount available for share holders 2, 12,400

Less: Preference share holders share

Preference share capital (30,000)

Amount Available for Equity Share holders. **1,82,400**

(ii) Calculation for value of share by Intrinsic method:

$$IV = \frac{\text{Amount available for Equity share holder}}{\text{Number of Equity shares}}$$

$$= \frac{1,82,400}{9,000}$$

$$= `20.27$$

(II) Yield value method:

(i) Calculation for profit available to share holder.

F.M.P before tax + Investment Income (51,200 + 600) 51800

Less: tax @ 50% (25900)

F.M.P After tax 25,900

Less: Transfer to Reserves (5000)

Profit available to share holder 20,900

Less: Preference dividend (30,000 × 5/100) (1500)

Profit available to Equity share holder **19,400**

Accounting for Banking Company

(ii) Calculation to E.R.R.:

$$\begin{aligned} \text{ERR} &= \frac{\text{Profit available to Equity share holder}}{\text{Total Equity Share Capital}} \times 100 \\ &= \frac{19,400}{90,000} \times 100 \end{aligned}$$

(iii) Calculation for yield value for share:

$$\begin{aligned} \text{Yield Value} &= \frac{\text{E.R.R}}{\text{N.R.R}} \times \text{Paid up Value of Each Equity} \\ &= \frac{21.56}{10} \times 10 \\ &= 21.56 \end{aligned}$$

(III) Fair value:

$$\begin{aligned} \text{Fair value} &= \frac{\text{I.V} + \text{Y.V}}{2} \\ &= \frac{20.27 + 21.56}{2} \\ &= 20.92 \end{aligned}$$

Illustration 34:

The following is the balance sheet of T Ltd. on 31st March, 2015.

Liabilities		Assets	
3,00,000 Equity shares of ₹10 each Fully paid	30,00,000	Goodwill	1,00,000
Reserves	30,00,000	Building	9,00,000
Long Term Loans	20,00,000	Machinery	40,00,000
Current Liabilities	54,00,000	Vehicles	1,00,000
		Shares in subsidiary and Ltd	80,00,000
		4,000 Equity shares of ₹100 each (at cost)	
		Current Assets	3,00,000
	1,34,00,000		1,34,00,000

Find out the value on net assets of Equity share of T Ltd. On the basis of the following information

- (i) Goodwill is valued at ₹10,00,000 machinery at ₹49,50,000 Building at ₹20,00,000 and vehicles at ₹50,000.
- (ii) Current Assets and current Liabilities are to be taken at book value.
- (iii) Share of Ltd are to be valued on the basis of Net Assets of F Ltd.

Accounting for Banking Company

Liabilities		Assets	
5000 Equity shares of `100 each	5,00,000	Fixed Assets	9,00,000
Reserves	8,00,000	Current Assets	11,00,000
Current Liabilities	7,00,000		
	20,00,000		20,00,000

Solution:

For "F" Ltd.:

(a) Calculation for amount available for equity shareholder.

All Assets (at agreed value)		
Fixed Assets	9,00,000	
Current Assets	11,00,000	20,00,000
Less: External Liability		
Current Liability		(7,00,000)
Amount available for		13,00,000
Equity share holder		

(b) Calculation for value of share by I V method:

$$\begin{aligned} \text{Intrinsic Value} &= \frac{\text{Amount available for equity share holder}}{\text{Number of Equity share}} \\ &= \frac{13,00,000}{5,00,00} \\ &= `260 \end{aligned}$$

FOR "T" Ltd.:

(a) Calculation for amount available for share holder:

All Assets (at agreed / adjustment value)		
Goodwill	10,00,000	
Building	20,00,000	
Mach	49,50,000	
Vehicles	50,000	
Share of subsidiary "F" Ltd. (4000 × 260)	10,40,000	90,40,000
Less: External Liability		
Long term Loans	20,00,000	
Current Liability	54,00,000	(74,00,000)
Amount available for Equity share holder.		16,40,000

(b) Calculation of share by I. V. method:

$$\text{Intrinsic Value} = \frac{\text{Amount available for Equity share holder}}{\text{Normal of Equity share}}$$

Accounting for Banking Company

$$= \frac{16,40,000}{3,00,000}$$

$$= ₹5.47$$

Illustration 35:

A shareholders of X PRIVATE LTD. requests you to advise him about the fair value of the Equity shares of the Company. The Company's financial position as on 31st December, 2015 is as under:

Liabilities		Assets	
Share capital 20,000		Fixed Assets (at cost)	
6% Cum. pref. shares of Rs.10 each	2,00,000	Goodwill	1,20,000
12,000 equity shares of Rs. 20 each		Plant and Machinery	2,00,000
fully paid	2,40,000	Investments (at Cost)	1,20,000
Debenture Redemption Fund	40,000	Current Assets	
Profit and Loss A/c.		Stock	1,20,000
Balance as on 1/1/2008		Debtors	1,40,000
45,000		Cash at Bank	1,52,000
Profit for the year <u>1,30,000</u>	1,75,000	Land and Building	2,00,000
(before tax)			
5% Debentures	2,00,000		
Creditors	1,67,000		
Depreciation Fund (Plant etc.)	30,000		
	10,52,000		10,52,000

The following information is relevant:

- (1) Goodwill is revalued at ₹1,45,000.
- (2) Normal Rate of return expected is 10%.
- (3) The shares of the company are not freely transferable.
- (4) Investments are part of business assets.
- (5) Profits for the year as stated above are before annual transfer of ₹12, 700 to Debenture Redemption Fund.
- (6) Income tax may be taken at 50% of the profits.
- (7) Dividend record of the company is not stable.

Work out the fair value of equity shares as requested.

Solution:

(i) Calculation of amount available to share holder:

All Assets (at agreed value)	(₹)	(₹)	(₹)
Goodwill		1,45,000	

Accounting for Banking Company

Plant and machinery	2,00,000		
Less: Depreciation	(30,000)	1,70,000	
Investment		1,20,000	
Stock		1,20,000	
Debtors		1,40,000	
Cash at bank		1,52,000	
Land and Building		2,00,000	10,47,000
Less: External Liability			
5% debentures		2,00,000	
Creditors		1,67,000	(3,67,000)
Amount available for share holder			6,80,000
Less: preference share capital			(2, 00,000)
Amount available for Equity share holder			4,80,000

(ii) Calculation for share value by I.V. method:

$$\begin{aligned}
 \text{Intrinsic Value} &= \frac{\text{Amount available for Equity share holder}}{\text{Number of Equity share}} \\
 &= \frac{4,80,000}{12,000} \\
 &= ₹40
 \end{aligned}$$

(II) Yield Value:

(i) Calculation for profit available:

F.M.P before tax	1,30,000
Less: Tax @50%	<u>(65,000)</u>
F.M.P after tax	65,000
Less: Transfer to Reserves	<u>(12,700)</u>
Profit available to share holder	52,300
Less: Preference dividend (6% × 2,00,000)	<u>(12,000)</u>
Profit available for Equity shareholder	<u>40,300</u>

(ii) Calculation for ERR:

$$\begin{aligned}
 \text{E.R.R.} &= \frac{\text{Profit available to Equity share holder}}{\text{Total Equity share Capital}} \times 100 \\
 &= \frac{40,300}{9,40,000} \times 100 \\
 &= ₹16.79
 \end{aligned}$$

(iii) Calculation of share by yield value

Accounting for Banking Company

$$\begin{aligned}
 Y.V &= \frac{E.R.R}{N.R.R} \times \text{Paid up Value of each share} \\
 &= \frac{16.79}{10} \times 20 \\
 &= `33.58 \\
 \text{Fair Value} &= \frac{I.V + Y.V.}{2} \\
 &= \frac{40 + 33.58}{2} \\
 &= 36.79
 \end{aligned}$$

Illustration 36:

BOWLING LTD. and GREEN LTD. propose to sell their business to a new company being formed for that purposes.

The summarised Balance Sheets as on 31st December, 2015 and profits of the companies for the past three years are as follows:

	Bowling Ltd.	Green Ltd.		Bowling Ltd.	Green Ltd.
Ordinary shares of `1 each	60,000	25,000	Freehold property at cost	36,000	12,000
Capital Reserve	-	15,000	Plant and Machinery at cost less depn.	-	18,000
General Reserve	39,000	12,000	Investment at cost	-	10,000
Profit and Loss A/c.	11,000	16,000	Stock-in-trade	11,100	8,950
Creditors	21,580	12,680	Debtors	8,800	6,400
			Balance at Bank	43,680	25,130
	1,31,580	80,680		1,31,580	80,680

Particulars	Bowling Ltd.	Green Ltd.
Net profits for the years ended		
31st December, 2013	17,450	10,760
31st December, 2014	19,340	12,290
31st December, 2015	21,750	14,450

You are also given the following relevant Information

- (a) it is agreed
- (i) That the properties and Plant and Machinery to be re-valued as follow:

Accounting for Banking Company

Particulars	Bowling Ltd.	Green Ltd.
Freehold property	44,800	14,400
Plant and Machinery	30,750	17,095

- (ii) that the value of stocks be reduced by 10% and a provision of 12-1/2% be made on debtors for bad and doubtful debts.
- (iii) that goodwill be valued at two year's purchase of the average annual trading profits of the past three years, after deducting a standard profit of 10% on the net trading assets before re-valuation or Adjustment, on 31st December, 2009.
- (b) Profits of Green Ltd. includes Rs. 600 income from the investments in each of the three years. The market value of the investment as on 31st December, 1984. Was `10,000?

You are required to prepare a statement how you would arrive at the intrinsic value per share to the nearest rupee of the ordinary share in (i) Bowling Ltd. (ii) Green Ltd.

Solution:

- (1) Calculation of Average profit:

Blowing Ltd.:

Years	Profit	Weight	Product
2013	17,450	1	17,450
2014	19,340	2	38,680
2015	21,470	3	64,410
		6	1,20,540

Green Ltd.:

Years	Profit	Weight	Product
2013	10,760	1	10,760
2014	12,290	2	24,580
2015	14,450	3	43,350
		6	78,690

$$\text{"B" weight Average} = \frac{1,20,540}{6} = 20,090$$

$$\text{"G" weight Average} = \frac{78,690}{6} = 13,115$$

- (2) Calculation of Goodwill by purchase of Average profit method
- Goodwill = Normal of years purchase \times Average profit
- "B" Ltd = 2 \times 20,090
- = 40,180



Accounting for Banking Company
"G" Ltd = 2 × 13,115
= 26,230

Accounting for Banking Company

(3) Calculation of amount available for share holders.

Particulars	'B' Ltd.	'G' Ltd.
All Assets at agreed value		26,230
Goodwill	40,180	14,400
Freehold property	44,800	17,095
Plant and mach	30,750	
Investment		10,000
Stock (110%)	9,990	8055
Debtors (12.5)	7700	5600
Bank balance	43,680	25,330
Less: External Liability	11,77,100	10,6,710
Creditors	(21,580)	(12,680)
Amount Available for Equity	1,55,520	94,030
Share holders		

(i) Calculation of value of share by I.V method:

$$\text{Intrinsic Value} = \frac{\text{Amount of Equity share holder}}{\text{Number of Equity share}}$$

$$\begin{aligned} \text{"B" Ltd.} &= \frac{1,55,520}{60,000} \\ &= `2.59 \end{aligned}$$

$$\text{"G" Ltd.} = \frac{94,030}{25,000} = `3.76$$

Illustration 37:

'GOOD – BYE LTD.' was to be taken over by another company for which you are required to value: Equity shares by Net assets method, taking revised values of All assets & Liabilities and Goodwill at 2 years purchase of super profits based on simple Average of the last three year's adjusted Net Profit.

Balance Sheet as on 31st December, 2015

Liabilities		Assets	
-------------	--	--------	--

Accounting for Banking Company

Equity share capital (6,000 shares of `100 each)	6,00,000	Goodwill	1,00,000
Preference share capital	3,00,000	Other Fixed Assets	8,00,000
Reserves & Surplus	2,00,000	Trade Investments	50,000
Secured Loans	1,50,000	Current Assets	4,60,000
Creditors	40,000	Preliminary Expenses	30,000
Workmen compensation Fund	10,000		
Workmen profit sharing Fund	20,000		
Workmen Savings Account	30,000		
Proposed Dividend on shares	90,000		
	14,40,000		14,40,000

Further Information:

- (1) The new company expects to carry on business with its own Board of Directors, without any addition The Directors fees paid by 'A' Ltd. to its directors amounted to `9,000 per year.
- (2) The new company expects a large increase in volume of business and therefore, will have to take an additional office for which it will have to pay extra rent of `12,000 - per rear.
- (3) Net profit of 2013 includes `8,000 being profit on sale of Furniture whereas net profit of 2014 includes loss of `6,000 debited to profit & loss account as a result of fall in value of Investments.
- (4) In 2015, the company received a refund of `73,000 - from excise department for some old pending matter. This amount was credited to profit & loss account.
- (5) The profits upto now were subject to 40% Tax, but is likely to be 50% now onwards.
- (6) Dividends were distributed at the rate of 10% at the end of 31.12.2015 when the market price ruling is `125.
- (7) Fixed Assets were valued 20% more than the Book value and current assets at 10% less than the Book value.
- (8) Net profits (after tax) of last three years were 2013: 1,08,000: 2014 - 1, 23,000 & 2015 – 1,50,000.

Solution:

(i) Calculation of Trading Profit: (Adjustment profit)

Particular	2013	2014	2015
Profit after tax	108000	1,23,000	150000
Tax	60%	60%	60%
Profit before adjustment	1,80,000	2,05,000	2,50,000
Less: Net profit on sale of furniture	(8000)		

Accounting for Banking Company

Add: Loss on sale of furniture	-	6000	
Less: Co' received refund		-	(73,000)
Adjustment Profit before	1,72,000	2,11,000	1,77,000

$$\text{Simple Average Profit} = \frac{1,72,000 + 2,11,000 + 1,77,000}{3} = ₹1,86,667$$

(ii) Calculation of F.M.P.:

Average Profit	1,86,667
Add: Directors Fees not required in future	9,000
Less: Rent not incurred in past to be Incurred in future	<u>(12,000)</u>
F.M.P. before tax	1,83,667
Less: Tax @ 50%	<u>(91,834)</u>
F.M.P after tax	91,833

(iii) No of years purchase = 2years

$$\begin{aligned} \text{(iv) N.R.R} &= \frac{\text{Dividend Rate}}{\text{Market Price per Share}} \times 100 \\ &= \frac{10}{125} \times 100 \\ &= 8\% \end{aligned}$$

(v) Calculation of capital Employed:

Tangible Trading Assets		
Other fixed Assets	$\frac{120}{100} \times 8,00,000$	6,66,667
Trade Investment:		50,000
Current Asset:	$\left(\frac{90}{100} \times 4,60,000\right)$	5,11,111
Less: External Liability		<u>12,27,778</u>
Secured Loans	1,50,000	
Creditors	40,000	
Workmen profit sharing fund.	20,000	
Workmen saving A/C.	30,000	
Proposed dividend on share	90,000	(3,30,000)
Capital Employed		8,97,778

(vi) Calculation of Normal profit:

$$\begin{aligned} \text{Capital employed} \times \frac{\text{N.R.R}}{100} \\ &= 8,97,778 \times \frac{8}{100} \\ &= ₹71,822 \end{aligned}$$

(vii) Calculation super profit:

$$\text{S.P.} = \text{F.M.P} - \text{N.P}$$

Accounting for Banking Company

$$= 91,833 - 71,822$$

$$= 20,011$$

(viii) Calculation for Goodwill by Purchase of S.P method:

$$\text{Goodwill} = \text{No. of. Years. Purchase} \times \text{S.P}$$

$$= 2 \times 20,011$$

$$= 40,022$$

(ix) Calculation for amount available for share holder:

All Assets (at Agreed value)

Capital Employed (Excluding Goodwill) 8,97,778

Good will 40,022

Amount available for share holder 9,37,800

Preference share (3, 00,000)

Amount available for equity share hold 6,37,810

(x) Calculation for share by Net asset method:

$$\text{I.V.} = \frac{\text{Amount available for Equity share holders}}{\text{Number of Equity share}}$$

$$= \frac{6,37,800}{6,000}$$

$$= \text{`106.}$$

Illustration 38:

The following is the Balance Sheet of H. Ltd. on 30th September, 2015.

Liabilities		Assets	
5,000 Equity shares of `100 each fully paid	5,00,000	Land and Building	10,00,000
Profit and Loss Account	7,50,000	Machinery	2,00,000
Bank Loan	2,50,000	Stock	3,00,000
Creditors	1,00,000	Debtors (due for less than one year)	1,80,000
Proposed Dividend	1,20,000	Bank Balance	2,10,000
Income Tax Provision	2,00,000	Preliminary Expenses	30,000
	<u>19,20,000</u>		<u>19,20,000</u>

The net Profits (after tax) for the five years ending 30th September, 2009 were as follows:

(i) 2010-11 `2,20,000.

(ii) 2011-12 `2,50,000.

(iii) 2012-13 `1,75,000.

Accounting for Banking Company

(iv) 2013-14 `3,00,000.

(v) 2014-15 `1,60,000.

The Profit for 2011-12 was `20,000 less due to loss by theft and the profit of 2013-14 included a profit of `30,000 one sale of investments. Land and Building is revalued at `15,00,000 and a return of 10% on tangible capital employed (before adjustments) is considered reasonable.

Goodwill is to be calculated at five years purchase of annual super profit. Also find out the intrinsic value of the equity shares.

Proposed Dividend has been subsequently approved and paid.

Solution:

(i) Calculation of Average Profit:

Particulars	2010-11	2011-12	2012-13	2013-14	2014-15
Profit before adjustment	2,20,000	2,50,000	1,75,000	3,00,000	1,60,000
Add: Loss due to theft	—	20,000	—	—	—
Loss: Sale of Invest	—	—	—	(30,000)	—
	2,20,000	2,70,000	2,75,000	2,70,000	1,60,000

(ii) Calculation of simple Average

$$= \frac{2,20,000 + 2,70,000 + 1,75,000 + 2,70,000 + 1,60,000}{5}$$

$$= \frac{10,95,000}{5}$$

$$= `2,19,000$$

(iii) Calculation of F.M.P:

Average Profit of F.M.P = 2,19,000

(iv) Calculation of capital Employed

Tangible Trading Assets			
Land and Building	1	5,00,000	23,90,000
Machinery		2,00,000	
Stock.		3,00,000	
Debtors.		1,80,000	
Bank balance		2,10,000	
Less: External Liability			

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Bank loan	2,50,000	
Creditors	1,00,000	
Proposed dividend	1,20,000	
Income tax provided	2,00,000	(6,70,000)
Capital Employed		17,20,000

(v) N.R.R. = 10%

(vi) Calculation of Normal profit = Capital employed $\times \frac{\text{N.R.R.}}{100}$

$$= 17,20,000 \times \frac{10}{100}$$

$$= ₹1,72,000$$

(vii) Number of years purchase

$$= 5 \text{ years.}$$

(viii) Calculation of super profit

$$= \text{F.M.P} - \text{N.P}$$

(ix) Calculation of amount available for share holder fund.

$$\text{Goodwill} = \text{S.P.} \times \text{No. of years purchase}$$

$$= 47000 \times 5$$

$$= 2,35,000$$

(x) Calculation of amount available for share holder fund.

All Assets

Capital Employed 17, 20,000

Goodwill 2, 35,000

Amount available for Equity share holder 19, 55,000

(xi) Calculation of share by I.V. method:

$$\text{Intrinsic Value} = \frac{\text{Amount available for Equity Share holder}}{\text{Number of Equity share}}$$

$$= \frac{19,55,000}{5,000}$$

$$= ₹391$$

Illustration 39:

WIMCO LIMITED furnishes the following information and request you to find out.

Accounting for Banking Company

(i) Value of Goodwill- on the basis of Capitalisation of future maintainable profits method.

(ii) Value of Shares.

Balance Sheet as on 31st March, 2015

Liabilities		Assets	
Share Capital:		Goodwill	2,50,000
10,000 shares of RS.1 00 each	10,00,000	Property	2,88,000
General Reserves	3,00,000	Equipments	4,00,000
Profit & Loss Account	3,00,000	Investments	2,00,000
Workmen Fund for		Receivables	6,60,000
Compensation	1,40,000	Inventory	4,00,000
Loans	2,00,000	Cash & Banks	1,50,000
Current Liabilities	4,60,000	Capital Issues Expenses	52,000
Total	24,00,000		24,00,000

Further Information:

- (1) The investments are earmarked to provide funds for replacement of equipment as and when required.
- (2) The provisions already deducted from assets are
 - Depreciation on property `72,000
 - Depreciation on Equipments `80,000
 - Bad & Doubtful Debts `60,000
- (3) The property is worth `6,00,000 and Equipments are worth `3,60,000. Other assets are valued properly.
- (4) The Liability for Workmen Compensation is expected at `1,00,000.
- (5) The expected rate of return is 12%.
- (6) The profits of past three years (before tax @ 50%) have been:
 - Year ended on 31.3.2015 `5,60,000
 - On 31.3.2014 `5,46,000
 - On 31.3.2013 `6,20,000
- (7) The changes expected from ensuing year are:
 - (a) Increase Rent for new office @ `18,000 p.a.

Accounting for Banking Company

(b) Increase in Directors fees @ `24,000 p.a.

(c) Reduction in publicity expenses @ `36,000 p.a.

(8) For the purpose of valuation year end capital employed should be considered.

Solution:

(i) Calculation of Average profit:

$$\begin{aligned} \text{Simple Average profit} &= \frac{5,60,000 + 5,46,000 + 6,20,000}{3} \\ &= `5,75,333. \end{aligned}$$

(ii) Calculation of FMP:

F.M.P before adjust	5, 75,333
Add: Reduction in publicity	36,000
Less: Rent for new office	(18,000)
Less: Directors tees	(24,000)
F.M.P before tax	5,69,333
Less: Tax @ 50 %	<u>2,84,667</u>
FMP after tax	<u>2,84,666</u>

(iii) Calculation of capital Employed:

Particular		
Tangible trading Assets		
Property	6,00,000	
Equipment	3,60,000	
Investment	2,00,000	
Receivable	6,60,000	
inventory	4,00,000	
Cash and bank.	1,50,000	23,70,000
Less: External Liability		
Workmen fund compensation	1,00,000	
Loans	2,00,000	
Current Liability	4,60,000	(76,000)
Capital Employed		16,10,000

(i) N.R.R = 12%

(ii) Number of years Purchase = 3 years

(iii) Calculation of Capitalisation value of F.M.P

Accounting for Banking Company

$$\begin{aligned} \text{Capital value of F.M.P} &= \frac{\text{F.M.P}}{\text{N.R.R}} \times 100 \\ &= \frac{2,84,666}{12} \times 100 \\ &= `23,72,217 \end{aligned}$$

(iv) Calculation of Goodwill by F.M.P

$$\begin{aligned} \text{Goodwill} &= \text{Capitalised value of F.M.P} - \text{Capitalised employed} \\ &= 23,72,217 - 16,10,000 \\ &= `7, 62,217 \end{aligned}$$

(v) Amount available for share holders

All Assets

Capital Employed.	16,10,000
Goodwill	<u>7,62,217</u>
Amount available for Equity Shareholder	23,72,217

(iv) Calculation of share by IV method:

$$\begin{aligned} \text{Intrinsic Value} &= \frac{\text{Amount available for Equity Share holder}}{\text{No of Equity share}} \\ &= \frac{23,72,217}{1,000} \\ &= `237.22 \end{aligned}$$

(vi) Profit available for Equity share holder:

Particulars

F.M.P before tax	5,69,333
Less: Tax @ 50%	<u>(2, 84,667)</u>
F.M.P after tax	<u>2, 84,666</u>

(vii) Calculation of I.R.R:

$$\begin{aligned} \text{E.R.R} &= \frac{\text{Profit Available for Equity share holders}}{\text{Total Equity share Capital}} \times 100 \\ &= \frac{2,84,666}{10,00,000} \times 100 \\ &= `28.47\% \end{aligned}$$

(viii) Calculation of share by yield value:

Accounting for Banking Company

$$\begin{aligned} \text{Yield Value} &= \frac{\text{E.R.R}}{\text{N.R.R}} \times \text{Paid-up Value of Each Equity share} \\ &= \frac{28.47}{12} \times 100 \\ &= `237.25 \end{aligned}$$

(ix) Calculation of share by fair value

$$\begin{aligned} \text{Fair Value} &= \frac{\text{I.V} + \text{Y.V}}{2} \\ &= 237.23 \end{aligned}$$

Illustration 40:

Kiran Enterprises Ltd. has the following items appearing in its Balance Sheet as on 31st March, 2015.

Liabilities	`	Assets	`
Share Capital:		Goodwill	2,50,000
Equity Shares `10	10,00,000	Freehold property	2,88,000
10% Preference Shares `10	5,00,000	Plant and Machinery	4,00,000
Profit and Loss A/c.	5,00,000	Investment	2,00,000
Bank Loan	10,00,000	Stocks	6,60,000
Current Liabilities	1,50,000	Debtors	4,00,000
Bank and Cash	1,50,000		
Total	31,50,00		31,50,00

- (1) The Profit for the past three years are year ended 31st

March 2013	`1,40,000
March 2014	`3,25,000
March 2015	`5,50,000
- (2) The profits shown above are after debiting
 - (a) Goodwill @ `50,000 p.a.
 - (b) Dividend on Preference Shares as applicable
 - (c) Dividend on Equity Capital
@ `10% in 2014, and
@ `12% in 2015.
- (3) The recent valuation of Fixed Assets revealed property is worth `5,00,000 and Machinery worth `25,00,000.
- (4) The investment are trade investment is worth `2,50,000.
- (5) Obsolete and worthiness stock included above is `4,00,000
This can only realise `50,000:
You are required to calculate:

Accounting for Banking Company

(i) Future maintainable profit applying weights:

2013 -	1
2014 -	2
2015 -	3

Value equity shares on basis of capitalized value of Future maintainable Profit @ 8-1/3%.

Intrinsic Value of Equity Shares:

Solution:

(i) Calculation of Trading Profit:

Particulars	2013	2014	2015
Profit adjustment	1,40,000	3,25,000	5,50,000
Add: Goodwill	50,000	50,000	50,000
Add: Dividend on preference share (10% × 5,00,000)	50,000	50,000	50,000
Add: Dividend on Equity share capital 10% of 10,00,000 in 2014	–	1,00,000	
Add: Dividend on equity share capital 10,00,000 in 2015	–	–	1,20,000
Adjustment Profit	2,40,000	5,25,000	7,70,000

Calculation of weighted Average profit:

Years	Profit	Weight	Product
2013	2,40,000	1	2,40,000
2014	5,25,000	2	10,50,000
2015	7,70,000	3	2,30,000
		6	36,00,000

$$\text{Weighted Average Profit} = \frac{36,00,000}{6} = 6,00,000$$

(ii) Calculation of F.M.P

F.M.P before tax	6,00,000
Less: Tax @ 50%	<u>3,00,000</u>

Accounting for Banking Company
F.M.P After tax 3,00,000

(iii) Calculation of capital Employed:

Particular		
Tangible trading Assets		
Freehold property	5,00,000	
Plant and mach	25,00,000	
Investment	2,50,000	
Stock	1,50,000	
Debtors	3,50,000	
(500000 - 400000) + 50,000		
Bank and cash	1,50,000	39,00,000
Less: External Liability		
Bank Loan	10,00,000	
Current Liability	1,50,000	(11,50,000)
Capital Employed		27,50,000

(iv) $N.R.R = 8.1/3\% = \frac{25\%}{3} = 8.333\%$

(v) Calculation of Capitalised value of F. M. P:

$$\begin{aligned} \text{Capitalised Value of} &= \frac{F.M.P}{N.R.R} \times 100 \\ &= \frac{3,00,000}{25/3} \times 100 \\ &= \frac{3,00,000 \times 100 \times 3}{25} \\ &= `36,00,000 \end{aligned}$$

(vi) Goodwill by Capitalised of F.M.P:

$$\begin{aligned} \text{Goodwill} &= \text{Capitalized value of F.M.P} - \text{Capitalised Employed} \\ &= 36,00,000 - 27,50,000 \\ &= `8, 50,000 \end{aligned}$$

(vii) Calculation of amount available to share holders:

All Assets	
Capital Employed	27,50,000
Goodwill	<u>8,50,000</u>
Amount available to share holder.	36,00,000
Less: Prefrencc share capital.	<u>(5,00,000)</u>

Accounting for Banking Company

Amount available to Equity share holders 31,00,000

$$\begin{aligned}
 \text{(viii) Calculation of I.V.} &= \frac{\text{Amount available Equity share holders}}{\text{Number of Equity share}} \\
 &= \frac{31,00,000}{1,00,000} \\
 &= `31
 \end{aligned}$$

Illustration 41:

Final Accounts of Quest Ltd. as on 31st March, 2015 revealed following significant information:

- (i) Share Capital (Fully paid up)
Equity – 1,00,000 shares of `10 - each
12% preference - 20,000 shares of `50 - each.
- (ii) Reserve & Surplus - `1,50,000
- (iii) Preliminary Expenses - `30,000
The valuation of assets revealed that assets as per accounts are undervalued by `2,50,000.
- (iv) The average pre-tax profits of past three years was `5,00,000 - Tax applicable to company is @ 50%.
- (v) It is anticipated that due to favorable market condition, pre-tax profit will increasing by 20%.
- (vi) Equity shareholders expect a return at 15% Find the FAIR VALUE of Shares:
- (b) Gem. Limited submits following information as on 31st March. 2015:

(i) Fixed Assets (Tangible)	15,00,000
(ii) Current Assets	6,00,000
(iii) Patent Right	2,50,000
(iv) Investments	1,00,000
(v) Capital Issues Expenses	50,000
(vi) liabilities	4,00,000
(vii) Capital comprises of 12,500 shares of `100 each fully paid.	

It is ascertained that Patent Rights are valueless.

Solution:

(i) Calculation of Fixed Assets:

Balance sheet

Accounting for Banking Company

Liabilities		Assets	
Share Capital:		Fixed Assets	21,20,000
100,000 Equity share of ₹10 each	10,00,000	Preference Expenses	30,000
20,000 12% preference share of ₹50	10,00,000		
Reserves and surplus	1,50,000		
	21,50,000		21,50,000

(ii) Calculation of amount available for share holders:

All Assets	
Fixed Assets (21,20,000 + 2,50,000)	23,70,000
Less: External liability	<u>Nil</u>
	23,70,000
Less: Preference share capital	<u>10,00,000</u>
Amount available to Equity share holder	<u>13,70,000</u>

(iii) Calculation of value of share by I.V. method:

$$\begin{aligned}
 \text{Intrinsic Value} &= \frac{\text{Amount available to equity share holder}}{\text{Total Normal of Equity share}} \\
 &= \frac{13,70,000}{1,00,000} \\
 &= ₹13.7
 \end{aligned}$$

(iv) Calculation of F.M.P.: (profit available)

	(₹)		
Average tax (preference tax) profit	5,00,000		
Add: Increase in profit (20%)	<u>1,00,000</u>		
FM.P before tax	6,00,000		
Less: Tax @ 50%	<u>(3,00,000)</u>		
F.M.P after tax	3,00,000		
Less: Preference dividend normal	(1,20,000)	(12%	of
10,00,000)			
Profit available			
for Equity share holder	1,80,000		

(v) Calculation of ERR:

Accounting for Banking Company

$$\begin{aligned}
 \text{E.R.R} &= \frac{\text{profit available for Equity share holder}}{\text{Total Equity share capital}} \times 100 \\
 &= \frac{1,80,000}{10,00,000} \times 100 \\
 &= 18\%
 \end{aligned}$$

(vi) Calculation of share by yield value method:

$$\begin{aligned}
 \text{yield value} &= \frac{\text{E.R.R}}{\text{N.R.R}} \times \text{paid up value} \\
 &= \frac{18}{15} \times 10 \\
 &= `12
 \end{aligned}$$

$$\begin{aligned}
 \text{(vii) Fair value} &= \frac{\text{I.V} + \text{Y. V.}}{2} \\
 &= \frac{13.7 + 12}{2} \\
 &= `12.85
 \end{aligned}$$

[B] Calculation for amount available to share holders:

Particular	`	`
All Assets (at agreed value)		
Fixed assets	15,00,000	
Current assets	6,00,000	
Investment	1,00,000	22,00,000
Less: External Liability		
Liability		(4,00,000)
Amount available to Equity share holder		18,00,000

$$\begin{aligned}
 \text{Intrinsic Value} &= \frac{\text{Amount available for Equity share holders}}{\text{Number of share}} \\
 &= \frac{18,00,000}{12,500} \\
 &= `144
 \end{aligned}$$

Illustration 42:

Rana & Co. presents the following Balance Sheet on 31st December. 2015.

Particulars	`	Particulars	`
Sham Capital (`10 each)	3,00,000	Fixed Assets	4,50,000

Accounting for Banking Company

Reserves	1,20,000	Current Assets	30,000
Loans	50,000		
Current Liabilities	10,000		
Total	4,80,000	Total	4,80,000

It is observed that fixed assets are undervalued by `30,000. The current assets are overvalued by `2,000. The Assets are to be valued properly.

It is proposed to issue fully paid shares by capitalization of General Reserves in the ratio of one share for three shares held. Find the value of shares

Before issue of bonus shares; and after issue of bonus shares.

Solution:

(i) Calculation of Amount available for share holder.

All Assets			
	Fixed Assets	4,80,000	
Add:	(under value by 30,000)		
	Current Assets		
Less:	(Cover valued by 2000)	28,000	5,08,000
Less:	External Liability:		
	Loans	50,000	
	Liability	10,000	(60,000)
	Amount available to Equity share holder		4,48,000

(i) Before issue of bonus share

$$\begin{aligned}
 \text{Intrinsic Value} &= \frac{\text{Amount available for share holders}}{\text{Number of share}} \\
 &= \frac{4,48,000}{30,000} \\
 &= `14.93
 \end{aligned}$$

Accounting for Banking Company

(II) After issue of bonus shares

$$\text{Intrinsic Value} = \frac{\text{Amount available for share holders}}{\text{Number of equity share}}$$

No. of equity shares held = 30,000

Bonus shares ratio = For every 3 shares held, 1 bonus share

= 3 : 1

$$\text{No. of bonus shares issue} = \frac{30,000}{3}$$

= 10,000 shares

Total number of equity shares = 30,000 + 10,000

= 40,000 shares

$$\text{Intrinsic value} = \frac{4,48,000}{40,000}$$

= ₹11.2

Illustration 43:

Beeta Ltd. capital is ₹11,00,000 divided in shares of ₹10 each. Of these 40,000 shares are 8% preference and remaining are equity shares.

The average profit (after tax @ 50%) earned during past 3 years is ₹1,50,000. In future, expenses will increase by ₹12,000.

The expected yield for risk capital is 10%, net of tax.

Find the value of equity shares.

Solution:

Yield Method:

Calculation for profit available for shareholders:

Particular	₹
F.M.P (after tax)	1,50,000

Accounting for Banking Company

Less: Expenses will increase not incurred in future	(12,000)
Less: Dividend of preference share (8% of 4,00,000)	(32,000)
FM.P after adjustment	1,06,000

(ii) Calculation of ERR:

$$\text{E.R.R.} = \frac{\text{Profit available to Equity Share holder}}{\text{Paid up Equity Share Capital}} \times 100$$

$$= \frac{10,6,000}{7,00,000} \times 100$$

$$= 15.14$$

$$\text{Yield Value} = \frac{\text{ERR}}{\text{NRR}} \times \text{Paid up value of each share}$$

$$= \frac{15.14}{10} \times 10$$

$$= 15.14$$

Illustration 44:

AMTEE LTD. presents the following Balance Sheet as on 31st March 2015.

Particulars	₹	Particulars	₹
Share capital (in 10 shares)		Goodwill	40,000
Equity 4,00,000		Property	2,40,000
Less: Calls in arrears (5,000) × 2	3,90,000	Equipment	2,20,000
8% preference 2,00,000		Plant	10,000
Less: Calls in arrears (20) (2,000)	1,98,000	Vehicles	1,60,000
General Reserve	1,60,000	Investments	1,60,000
Profit & Loss Account	32,000	Stock	1,10,000
Loan Bank	1,20,000	Debtors	1,80,000

Accounting for Banking Company

Creditors	3,10,000	Bank	20,000
Acceptances	60,000	Preliminary Expenses	20,000
Total	12,70,000		12,70,000

The company desires to value its Equity Shares on the basis of its Business Assets and Liabilities.

To enable the valuation of shares following information is furnished

All Fixed Assets (except Goodwill) are worth 30% above Book Value.

(After following adjustments)

Stock is overvalued by `10,000.

`2,000 due from a customer is doubtful.

All investments earn income @ 10%. However only 10% are Trade Investment and remaining are Non-Trade.

On verification it was noticed that `20,000 paid in 2012-13 for a plant was debited as repairs. The depreciation @ 10% p.a. on cost is provided by company.

Goodwill is valued at 2 years purchase of past four year's average profits. The profits and Loss Account revealed following profits 2011-12 `1,60,000; 2012-13 `1,80,000; 2013-14 `2,10,000 and 2014-15 `2,00,000.

Ascertain value of fully paid and partly paid shares.

Solution:

Calculation of Trading Profit

Particulars	2011-12	2012-13	2013-14	2014-15
Profit before adjustment	1,60,000	1,80,000	2,10,000	2,00,000
Less: income from non trade invest (90% of 1,60,000)				(1,44,000)
Add: Plant debited as repair (10% of 20,000)		20,000		
Less: Depreciation on Above plant		(2,000)	(2,000)	(2,000)
Profit after adjustment	1,60,000	1,98,000	2,08,000	54,000

(i) Calculation of Average profit

= Simple Average Profits

Accounting for Banking Company

$$= \frac{1,60,000 + 1,98,000 + 2,80,000 + 54,000}{4}$$

$$= ₹1,55,000$$

(ii) Calculation of Goodwill by purchase of Average profit method

$$\text{Goodwill} = \text{Number of years purchase} \times \text{Average Profit}$$

$$= 2 \times 1,55,000$$

$$= 3,10,000$$

(iii) Calculation of amount available for share holders:

All Assets			
Goodwill		3,10,000	
Property	(2,40,000 + 30%)	3,12,000	
Plant	(2,20,000 + 30%)	2,86,000	
Equity	(1,20,000 + 30%)	1,56,000	
Vehicles	(1,60,000 + 30%)	2,08,000	
Invest		1,06,000	
Stock	(1,10,000 + 30%)	1,00,000	
Bank		20,000	
Less: Notional call 12000	(1,00,000 + 2,000)	32,000	
Debtors	(1,80,000 – 2,000)	1,78,000	
Less: External Liability			17,42,000
	Less: External Liability		
	Loans Bank	1,20,000	
	Creditors	3,10,000	
	Acceptances	60,000	(4,90,000)
	Amount available		(12,52,000)
	Less: preference share capital		(2,00,000)

Accounting for Banking Company

	Amount available to Equity share capital holder		10,52,000
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(iv) Calculation of for fully paid up Equity Share by I.V. Method

$$\begin{aligned} \text{Intrinsic Value} &= \frac{\text{Amount Available for Equity shareholder}}{\text{No. of equity share}} \\ &= \frac{10,52,000}{40,000} \\ &= `26,30 \end{aligned}$$

(v) Calculation for Value of Share = Value of fully paid up share – C. I. A

$$\begin{aligned} &= 26.3 - 2 \\ &= 24.3 \end{aligned}$$

Illustration 45:

(M.U. TYBAF October 2008)

The following is the Balance Sheet of Amruta and Co. Ltd for the year ended 31st December, 2013.

Liabilities	`	Assets	`
Equity Share Capital (50,000 @ 10 each)	5,00,000	Land	1,00,000
2000, 10% Cumulative Preference shares of `100 each		3,00,000	
Reserves	2,00,000	Bills Receivable	50,000
Creditors	1,00,000	Debtors	3,00,000
Bills Payable	2,10,000	Cash	2,00,000
	80,000	Preliminary Expenses	40,000
	10,90,000		10,90,000

Compute the value of each equity share by:

(a) Yeild Method

(b) Intrinsic Value Method

(c) Fair Value Method. Given that:

All the fixed assets are revalued at `6,00,000

Accounting for Banking Company

Profits for the years 2011, 2012 and 2013 was `1,00,000, `3,00,000 and `2,00,000

Company had a practice to transfer 10% profit to Reserve Fund.

Normal Rate of return is 12%.

Arrears of Preference Dividend for last 3 years.

Solution:

(a)	Profit of 2011	1,00,000
	2012	3,00,000
	2013	2,00,000
	Total	6,00,000

$$\text{Average Profit} \left(\frac{6,00,000}{3} \right) \quad 2,00,000$$

$$\text{Loss: Transfer to Reserve (10\%)} \quad \underline{20,000}$$

$$1,80,000$$

$$\text{Loss: Preference dividends} \quad \underline{20,0000}$$

$$\text{Profit for equity shareholders} \quad 1,60,000$$

Extended Rate of Return

$$= \frac{\text{Amount available for equity shareholders}}{\text{Paid up value of euqity share capital}} \times 100$$

$$= \frac{1,60,000}{5,00,000} \times 100$$

$$= 32$$

Yield value of share

$$= \frac{\text{C.R.R}}{\text{N.R.R}} \times \text{Paid up value of each share}$$

Accounting for Banking Company

$$= \frac{32}{12} \times 10$$

$$= 26.67$$

Note: For calculation simple average has been taken

(b) Intrinsic value method:

Calculation of Intrinsic value

	(₹)	(₹)
Assets:		
Fixed Assets	6,00,000	
Bills Receivable	50,000	
Debtors	3,00,000	
Cash	2,00,000	11,50,000
Less: Outside Liabilities		
Creditors	2,10,000	
Bills Payable	80,000	2,90,000
		8,60,000
Less: Preference Shareholders Claims		
Capital	2,00,000	
Arrears of Dividends	60,000	2,60,000
Amount available for equity shareholders		6,00,000

$$\text{Intrinsic Value} = \frac{\text{Amount available for equity shareholders}}{\text{No. of equity shareholders}}$$

$$= \frac{6,00,000}{5,00,000}$$

$$\text{Intrinsic Value} = ₹12 \text{ per share}$$

$$\text{(c) Fair Value} = \frac{\text{Yield Value} + \text{Interinsic Value}}{2}$$

$$= \frac{26.67 + 12}{2}$$

$$\text{Fair Value} = ₹19.335 \text{ per share}$$

Illustration 46:

(M.U. TYBAF October 2008)

Accounting for Banking Company

Following is the Balance Sheet of RNRL Ltd. As on 31st December 2015. Compute its goodwill as 5 years purchase of Super Profit Method.

Liabilities		Assets		
Equity Share Capital	18,00,000	Plant and Machinery		5,00,000
General Reserves	2,00,000	Building		10,00,000
Secured Loan	3,00,000	Furniture		6,00,000
Unsecured Loan	5,00,000	10% Non-Trade Investment (Purchased on 1st Jan. 203)		1,00,000
Bills Payable	1,00,000	Debtors	800,000	
Creditors	4,25,000	Less: R.D.D.	50,000	7,50,000
		Stock		1,25,000
		Cash		2,00,000
		Discount On Issued of Shares		50,000
	33,25,000			33,25,000

- (1) The company profit before Managing Director's remuneration of `30,000 p.a and Taxation @ 50% are as follows:

Years	Profit before Tax (`)
2011	5,00,000
2012	7,00,000
2013	8,00,000
2014	6,00,000
2015	2,00,000

- (2) Normal rate return is 10% p.a.
 (3) In the year 2013 company earn prize of `10,000 for good performance for the year.
 (4) In future the existing rent of the building will be increased by `2,000 per month.
 (5) All fixed assets to be decreased by 10%
 (6) Closing Stock for the year 2014 is overvalued by `5,000.

Solution:

Calculation of Future Maintenance Profit (FMP)

Particulars	2011	2012	2013	2014	2015
Profit before tax and Remuneration	5,00,000	7,00,000	8,00,000	6,00,000	2,00,000
Less: Prize for good performance			(10,000)		
Less: Income from investment	(10,000)	(10,000)	(10,000)	(10,000)	(10,000)
Less: Closing stock overvalue				(5,000)	

Accounting for Banking Company

Add: Opening stock overvalue					5,000
	4,90,000	6,90,000	7,80,000	5,85,000	1,95,000

Average profit	5,48,000
Less: extra Rent payable in future	(2,00,000)
Less: M.D. Remuneration	(30,000)
	<u>5,16,000</u>
Taxation @ 50%	2,58,000
F.M.P (after tax)	<u>2,58,000</u>

(c) Calculation of Capital employees:

	(₹)	(₹)
Tangible Trading Assets		
Plant and Machinery	5,50,000	
Building	11,00,000	
Furniture	6,60,000	
Debtors	7,50,000	
Stock	1,50,000	
Cash	2,00,000	33,85,000
Less: Outsiders Liability		
Secures Loan	3,00,000	
Unsecures Loan	5,00,000	
Bills payable	1,00,000	
Creditors	4,25,000	13,25,000
Capital employees		20,60,000

Super Profit = F.M.P – Normal Profit

$$= 2,58,000 - \frac{\text{N.R.R}}{100} \times \text{Capital Employees}$$

$$= 2,58,000 - \frac{10}{100} \times 20,60,000$$

$$= 2,58,000 - 2,06,000$$

$$\therefore \text{Super Profit} = 52,000$$

Goodwill = 5 year purchase of Super Profit

$$= 5 \times 52,000$$

$$= 2,60,000$$

Accounting for Banking Company

∴ Goodwill of the RNRL Ltd. = ₹2,60,000

Illustration 47:

(M.U. TYBAF May 2008)

The Balance Sheet of Gorakhnath Alloy Ltd. as on 31st December, 2013 were as follows:

Liabilities	₹	Assets	₹
Equity Share Capital (50,000 @ 10 each)	5,00,000	Land and Building	5,00,000
Profit and Loss Account	2,00,000	Plant and Machinery	2,00,000
Debentures	1,80,000	Furniture and Fixture	1,00,000
Creditors	1,50,000	10% Government Bonds	50,000
Provision for Taxation	50,000	Stock	80,000
Proposed dividend	1,00,000	Debtors	2,00,000
	10,20,000	Cash	50,000
			10,20,000

The net profits of the company after charging depreciation and taxes were as follows:

Year	₹
2009	1,00,000
2010	1,25,000
2011	1,50,000
2012	1,75,000
2013	2,00,000

On 31st December, 2007 Land and Building were revalued at ₹6,00,000 Plant and Machinery at ₹1,50,000 and Furniture and Fixture at ₹80,000.

Normal Rate of return is 10%.

Find value of goodwill by 5 years purchase of super Profits and Capitalisation of Future maintainable Profits Method.

One of the Machinery was purchase on 01/01/2011 for ₹50,000 was wrongly charged to Profit and Loss Account has to be rectified and depreciation charge on that machinery @ 10% by WDV method.

Use Simple Average.

Government bonds are purchased on 01/01/2009.

Solution:

(a) Calculation of Capital employees.

Accounting for Banking Company

Particulars	(₹)	(₹)
(A) Assets		
Loans and Building	6,00,000	
Plant and machinery	1,50,000	
Furniture	80,000	
Stock	80,000	
Debtors	2,00,000	
Cash	50,000	
Machine wrongly charge in profit and loss a/c. (50,000 – 10% = 45,000 10% = 40,500 10%)	36,450	12,96,450
Less: Liabilities		
Debenture	1,80,000	
Creditor	1,50,000	
Provision to Taxation	50,000	
Proposed Dividends	1,00,000	4,80,000
Capital employed		7,16,450

Calculation of Future Maintainable Profit (FMP)

Particulars	2009	2010	2011	2012	2013
Net Profit After Tax	1,00,000	1,25,000	1,56,000	1,75,000	2,00,000
Add: Machine wrongly changed to P/L			5,000		
Less: Depreciation on Machinery			(5,000)	(4,500)	(4,050)
Less: Interest on good bonus	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
Profit	95,000	1,20,000	1,96,000	1,75,500	1,90,950

∴ Average Profit

$$= \frac{95,000 + 1,20,000 + 1,96,000 + 1,75,500 + 1,90,950}{5}$$

Average profit = 1,53,490

Bills payable	50,000	3,50,000
Capital employees		10,80,000

Accounting for Banking Company

Less: Preference shareholder claim		
Capital	1,00,000	
Dividend in asset	10,000	1,10,000
Amount available for shareholder		9,70,000

Value of Equity share

$$= \frac{\text{Amount available for equity share}}{\text{No. of equity share}}$$

$$= \frac{9,70,000}{5,000}$$

Value of equity share

$$= 194 \text{ per share}$$

(b) Yield Method:

Calculation of F.M.P.

Particulars	(₹)
Average Profit $\frac{50,000 + 75,000 + 1,00,000 + 2,50,000 + 2,00,000}{5}$	135,000
Less: Transfer to Reserve	13,500
	1,21,500
Less: Preference Dividend	10,000
Amount available for equity shareholders	1,11,500

Value of Equity share

$$= \frac{\text{Amount available for equity shareholder}}{\text{No. of equity share}}$$

$$= \frac{1,11,500}{500}$$

Value per share = 22.3 per share

Accounting for Banking Company

$$(c) \text{ Fair Value} = \frac{\text{Net Asset Value} + \text{Yield Value}}{2}$$

$$\text{Fair Value} = \frac{194 + 22.3}{2}$$

$$\text{Fair Value} = 108.15 \text{ per share}$$

$$\text{Super Profit} = \text{Average Profit} - \text{Normal Profit}$$

$$= 1,53,490 - \frac{10}{100} \times 7,16,450$$

$$= 1,53,490 - 71,645$$

$$= 81,845$$

Valuation of goodwill:

(1) Valuation of goodwill purchase by of super profit

$$= \text{Super profit} \times \text{No. of years purchase}$$

$$= 81,845 \times 5$$

$$\therefore \text{Goodwill} = `4,09,225$$

(2) Capitalisation of FMP

$$= \frac{\text{FMP}}{\text{NRR}} - \text{Capital Employed}$$

$$= 1,53,490 \times \frac{100}{10} - 7,16,450$$

$$= 1,53,490 \times 10 - 7,16,450$$

$$= 15,34,900 - 7,16,450$$

$$\therefore \text{Goodwill} = `8,18,450$$

Illustration 48:

(M.U. TYBAF May 2008)

Accounting for Banking Company

The balance Sheet of Mahi Ltd. as on 31st December, 2013 is as follows:

Liabilities	\`	Assets	\`
10% Cum Preference Share Capital	100,000	Goodwill	50,000
Equity Share Capital (5,000 @ 100 each)	500,000	Land and Building	300,000
Profit and Loss	250,000	Plant and Machinery	200,000
Bank Loan	100,000	Investment (market Price 2,00,000)	50,000
Creditors	200,000	Stock	100,000
Bills Payable	50,000	Debtors	300,000
		Cash	100,000
		Bank	100,000
	12,00,000		12,00,000

Additional Information:

- (1) Land and Building Revalued at `4,00,000.
- (2) Plant and Machinery revalued at `2,50,000.
- (3) Investment should be taken at market price.
- (4) Closing stock include stock of `20,000 worthless.
- (5) Net profits for the year 2009, 2010, 2011, 2012 and 2013 amounted to `50,000, `75,000, `1,00,000, `2,50,000 and `2,00,000 respective.ly.
- (6) Normal Rate of Return is 10%.
- (7) Transfer 10% profit to General Reserve.
- (8) Preference dividend are in arrears for one year.

Calculate value of equity shares:

- (a) Net Assets Method.

Solution:

Net Asset Method

Liabilities	\`	\`
(A) Assets		
Land and Building	4,00,000	

Accounting for Banking Company

Plant and machinery	2,50,000	
Investment	2,00,000	
Stock	80,000	
Debtors	3,00,000	
Cash	1,00,000	
		14,30,000
Less: Liabilities		
Bank Loan	1,00,000	
Creditors	2,00,000	

Illustration 49:

(M.U. TYBAF Oct. 2006)

Greg Cappell & Co. want to purchase the business of Saurabh & Co. on 31-12-2015 Balance Sheet and Profits of Saurabh & Co. for the last four years were:

Balance sheet as on 31-12-2005

Liabilities		Assets	
Capital	2,00,000	Land and Building	1,20,000
General Reserve	70,000	Machinery	90,000
Profit and Loss	1,03,050	Vehicle	50,000
Creditors	30,000	10% Non-Trade Investments	25,000
Bills Payable	31,475	(Cost `20,000 and Purchase on	
Outstanding Expenses	18,475	1-1-2005)	
		Debtors	55,000
		Cash in hand	48,000
		Cash at Bank	50,000
		Bills Receivable	15,000
	4,53,000		4,53,000

Years	Profit (')
-------	------------

(ccclxviii)

Accounting for Banking Company

2012	37,200
2013	49,600
2014	77,500
2015	96,100

The following additional information about Saurabh & Co. is also available:

An unexpected income of ₹9,300 was included in the profit of 2012 which can never be expected in future.

There was a fire in the premises in the year 2013 which caused loss of ₹3,100.

After acquisition Greg Chappell & Co. has to pay rent of ₹3,100 p.a. which was not paid by Saurabh & Co.

Normal rate of Return is 10%.

Proprietor had a practice to withdrew profits at regular basis.

Greg Chappell, the proprietor of Greg Chappell & Co. will be managing a company at a salary of ₹3,100 p.a. The business of Saurabh & Co. was managed by a salaried manager who was paid a salary of ₹1,240 p.a.

Calculate the Goodwill by:

3 years purchase of super profit.

Capitalization of Future Maintainable Profit Method.

Use simple average.

Solution:

$$\text{Goodwill} = 3 \times \text{purchase of super profit}$$

$$\text{Super profits} = \text{FMP} - \frac{\text{NRR}}{100} \times \text{Capital employed}$$

Future Maintainable Profit

Particulars	2012	2013	2014	2015
Given Profit	37,200	49,600	77,500	96,100
Less: Income (non-recurring)	(9,300)			
Add: Non recurring expenses		3,100		
	27,900	52,700	77,500	96,100

Accounting for Banking Company

	(₹)
Average Past Profits = $\left(\frac{27,900 + 52,700 + 77,500 + 96,100}{4}\right)$	63,550
Less: Rent payable in future	(3,100)
Less: Managing director's salary 3,100	(1,860)
<u>1,240</u>	
Future Maintainable Profits	58,590
Less: Income from investments	2,000
FMP	56,590

Capital Employed

	(₹)
Land and Building	1,20,000
Machinery	90,000
Vehicle	50,000
Debtors	55,000
Cash in hand	48,000
Cash at Bank	50,000
Bills receivable	15,000
	4,28,000
Less: Outside liabilities	
Creditors 30,000	
Bills payable 31,475	
Outstanding expenses <u>18,475</u>	79,950
Capital Employed	3,48,050

$$\text{Super profits} = 56,590 - \frac{10}{100} \times 3,48,050$$

$$= 56,590 - 34,805$$

$$= ₹21,785$$

$$\text{Goodwill} = 3 \times 21,785$$

$$= ₹65,355$$

Accounting for Banking Company
Capitalization of future maintainable profit

$$= \frac{\text{FMP}}{\text{NRR}} \times 100 - \text{Capital Employed}$$

$$= \frac{56,590}{10} \times 100 - 3,48,050$$

$$= 5,65,900 - 3,48,050$$

$$= ₹2,17,850$$

Illustration 50: **(M.U. TYBAF May 2006)**

Mohan Enterprises provides following details in its:

Balance Sheet as on 31-12-2015

Liabilities	`	Assets	`
Equity Share Capital of (`10 each fully paid)	8,00,000	Goodwill	80,000
General Reserve	3,80,000	Fixed Assets	10,00,000
Profit and Loss A/c.	2,40,000	Current Assets	8,00,000
14% Debentures	2,00,000		
Current Liabilities	2,60,000		
	18,80,000		18,80,000

Following additional information is provided:

The Fixed Assets were valued at `7,60,000 and Goodwill `1,00,000.

The Net profits for the three years are 2013 was `1,89,600, 2014 was `2,08,000 and 2015 was `2,02,400.

The company transfers 20% of profit to General Reserve.

The profit earned by similar companies is 16%.

Ignore Taxation.

Calculate the value per share under:

Intrinsic Value Method.

Yield Value Method.

Fair Value Method.

Accounting for Banking Company

Solution:

$$\text{Intrinsic Value} = \frac{\text{Amount available to equity shareholders}}{\text{No. of equity shares}}$$

	(₹)
All assets	1,00,000
Goodwill	7,60,000
Fixed Assets	8,00,000
	16,60,000
Less: 14% Debentures	2,00,000
Current Liabilities	<u>2,60,000</u>
Amount available to Equity shareholders	12,00,000
Intrinsic Value = $\frac{1,20,000}{80,000}$	
= ₹15 per share	
Yield Value Method	
Average post profits = $\left(\frac{1,89,600 + 2,08,000 + 2,024,00}{3} \right)$	2,00,000
Less: Transfer to Reserve @ 2%	40,480
Profit available to equity shareholders	1,59,520
ERR = $\frac{\text{Profit available to equity shareholders}}{\text{paid up equity share capital}} \times 100$	
= $\frac{1,59,520}{8,00,000} \times 100$	
= 19.94%	
Yield Value = $\frac{\text{ERR}}{\text{NRR}} \times \text{Paid up value per equity share}$	
= $\frac{19.94}{16} \times 10$	
= ₹12.46	
(c) Fair value = $\frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$	
= $\frac{15 + 12.46}{2}$	
= ₹13.73	

Illustration 51:

(M.U. TYBAF May 2007)

Balance Sheet of Shubhangi Co. Ltd. as on 31st March, 2013 is as follows:

Accounting for Banking Company

Liabilities		Assets		
Share Capital		Fixed Assets		
Equity Share Capital	3,00,000	Goodwill		30,000
Preference Share Capital	2,00,000	Land		2,00,000
Reserves and Surplus		Building		2,50,000
General Reserve	1,50,000	Furniture		75,000
Capital Reserve	50,000	Current Assets and		
Profit and Loss	1,27,500	Loans and Advances		
Current Liabilities and		Debtors	1,20,000	
Provisions		Less: R.D.D	20,000	
Creditors	1,17,500			1,00,000
Provisions for Taxation	75,000	Stock		1,30,000
Current Year		Cash		75,000
		Bills Receivable		50,000
		Bank		1,10,000
	10,20,000			10,20,000

The following information is available:

The reasonable return on capital invested in the class of business done by the company is 10%.

50% provision has been made in accounts for income tax and adequate provision has been made for depreciation.

In future cost reduction scheme will save `25,000 expenditure.

You are required to value the goodwill by:

Five years purchase of super profit method.

Capitalisation of super profit method.

Solution:

$$\text{Goodwill} = 5 \times \text{Super Profit}$$

$$(a) \text{ Super Profit} = \text{FMP} - \frac{\text{NRR}}{100} \times \text{Capital Employed}$$

Accounting for Banking Company Future Maintainable Profit (FMP)

Particulars	₹
Average Past Profits (B. Tax)	1,50,000
Add: Expenses not payable in future	25,000
Less: Taxation @ 50%	87,500
Future maintainable profits	87,500

Capital Employed

Particulars	₹
Land	20,00,000
Building	2,50,000
Furniture	75,000
Debtors	1,00,000
Stock	1,30,000
Cash	75,000
Bills Receivable	50,000
Bank	1,10,000
	9,70,000

Less: Outside liabilities		₹
Creditors	1,17,500	
Provision for taxation	<u>75,000</u>	1,92,500
Capital Employed		7,77,500

$$\text{Super Profit} = 87,500 - \frac{10}{100} \times 7,77,500$$

$$= 87,500 - 77,750$$

$$= ₹9,750$$

$$\text{Goodwill} = 5 \times 9,750$$

Accounting for Banking Company
= `48,750

$$\text{Capitalisation of super Profit} = \frac{\text{Super Profit}}{\text{NRR}} \times 100$$

$$= \frac{9,750}{10} \times 100$$

$$= `97,500$$

Illustration 52:

(M.U. TYBAF May 2007)

The balance Sheet of Bob Woolmer Ltd. as on 31st December, 2012:

Liabilities		Assets	
Share Capital		Goodwill	68,000
Equity Share of `10 each	5,00,000	Motor Car	1,00,000
10% Preference Shares of `10 each	2,00,000	Land and Building	5,00,000
General Reserve	2,75,000	Machinery	3,00,000
Profit and Loss Account	2,86,000	Furniture and Fixture	2,50,000
Creditors	2,00,000	Investment	1,00,000
Bills Payable	50,000	Debtors	1,50,000
Dena Bank Loan	1,00,000	Stock	90,000
		Cash	43,000
		Discount on issue of Debentures	10,000
	16,11,000		16,11,000

You are required to value each fully paid equity share by:

(a) Asset Backing Method.

(b) Earning capacity Method.

In the year 2010 Motor Car of `10,000 wrongly charged to Profit and Loss Account for which rectification not yet done.

Depreciation is charged @ 10% on motor car by Straight Line method.

Goodwill is valued at `90,000.

All other assets are taken at book value.

Closing Stock of 2012 is undervalued by 10% Remaining assets should be taken on book value.

Debtors to be reduced by `2,000.

Accounting for Banking Company
Normal Rate of Return is 8%.

Profits for 4 years are given as follows (Use simple average).

Years	Profits (₹)
2009	60,000
2010	1,00,000
2011	1,25,000
2012	2,00,000

Solution:

(a) Asset Backing Method = $\frac{\text{Amount available to Equity shareholders}}{\text{No. of equity share}}$

Assets		
Goodwill		90,000
Motor car		1,09,700
Land and Building		5,00,000
Machinery		3,00,000
Furniture and Fixture		2,50,000
Investments		1,00,000
Debtors (1,50,000 – 2,000)		1,48,000
Stock $\left(\frac{90,000}{90} \times 100\right)$		1,00,000
Cash		43,000
		16,40,700
Less: Outside liabilities		
Creditors	2,00,000	
Bills Payable	50,000	
Dena bank loan	1,00,000	3,50,000
		12,90,700
Less: Preference shareholders claims		2,00,000
		10,90,700

Accounting for Banking Company

Asset Backing method = $\frac{10,90,700}{50,000}$ = `21.81 per share		
---	--	--

(b) Earning capacity method

Particulars	2009	2010	2011	2012
Given Profits	60,000	1,00,000	1,25,000	2,00,000
Add: Motor car wrongly charged to profit/loss account	10,000			
Less: Depreciation		(100)	(100)	(100)
Add: Closing stock undervalued				9,000
Business Profit	60,000	1,09,900	1,24,900	2,09,900

$$\therefore \text{Average Past Profit} = \left(\frac{60,000 + 10,9,900 + 1,24,900 + 2,09,900}{4} \right)$$

$$= \text{`1,26,175}$$

$$\text{Less: Preference dividend} = \text{`}(20,000)$$

$$\text{Profit available to equity shareholders} = \text{`1,06,175}$$

$$\text{ERR} = \frac{\text{Profit available to equity shareholders}}{\text{Paid up share capital}} \times 100$$

$$= \frac{1,06,175}{5,00,000} \times 100$$

$$= 21.24\%$$

Earning Capacity method

$$= \frac{21.24}{8} \times 10$$

$$= \text{`26.54 per share}$$

Illustration 53:

(M.U. TYBAF Oct. 2006)

On 31st March, 2012 Ronus Co. Ltd. proposes to purchase the business carried on by M/s Kanus Co. Ltd. Goodwill for the purpose is arghreed to be value three years purchase of the weighted average profit

Accounting for Banking Company
for the last four years. The appropriate weights to be used were decided
as follows:

Years	Profits	Weights
2008-09	18,68,500	1
2009-10	22,94,000	2
2010-11	18,50,000	3
2011-12	25,90,000	4

By verifying the accounts, following information obtained:

- (1) On 1st December, 2009 major repairs of the plant, spending `5,55,000 the amount was charged to revenue. The said surplus is agreed to be capitalised for the purpose of calculation of goodwill subject to the adjustment for depreciation @12% pa on straight line method.
- (2) The closing stock for the year 2009-10 was over valued by `2,22,000.
- (3) To cover administrative cost an annual charge of `4,44,000 is to be made while calculating goodwill. Calculate the goodwill.

Solution:

Ronus Co. Ltd Calculation of FMP.

Particulars	2008-09 (₹)	2009-10 (₹)	2010-11 (₹)	2011-12 (₹)
NPBT	18,68,500	22,94,000	18,50,000	25,90,000
Less: Repairs of plant		5,55,000		
Less: Depreciation		22,200	66,600	66,600
Less: Overvaluation of Closing Stock		2,22,000		
Add: Overvaluation of Opening Stock			2,22,000	
	18,68,500	14,94,800	20,05,400	25,23,400
	1	2	3	4

$$\text{Weighted Average Profit} = \frac{\text{Total Weighted Profit}}{\text{Total Weight}}$$

Accounting for Banking Company

$$= \frac{78,92,100}{10}$$

$$= 7,89,210$$

Particulars	`
Weighted Avg. Profit	7,89,210
Less: Annual Charges	4,44,000
	3,45,210

$$\text{Goodwill} = 3 \text{ Years} \times 3,45,210$$

$$= 3 \times 3,45,210$$

$$= 10,85,630$$

Illustration 54:

(M.U. TYBAF May 2006)

Following the Balance Sheet of Radha Krishna Ltd. as on 31st December, 2011.

Liability	(`)	Asset	(`)
25,000 equity share of `10 each	2,50,000	Land & Building	1,20,000
Securities Premium	50,000	Furniture	50,000
General Reserve	1,19,700	Stock	3,10,000
Profit & Loss	78,800	Debtors	1,03,000
Sundry creditors	2,04,700	Cash at Bank	2,18,700
Provision for tax	98,500		
	8,01,700		8,01,700

The net profits before tax for the last 3 years have been as follows:

Year	(`)
31/12/2009	1,55,500
31/12/2010	1,97,000
31/12/2011	2,10,000

Accounting for Banking Company

Following addition information is provided.

- (1) The rate of income tax is 50%.
- (2) The company transfer 20% for the profits after tax to General Reserve.
- (3) The expected rate of return on similar business is 15%.
- (4) The land and building was valued at `1,82,300 and furniture `1,14,200.

Calculate the value of one equity shares on the basis of:

- (a) Intrinsic value (b) Yield value (c) Fair value.

Solution:

Radha Krishna Ltd.

Particulars	2009	2010	2011
NPBT	1,55,500	1,97,000	2,10,000
Less: Income Tax @ 50%	77,750	98,500	1,05,000
NPAT	7,77,350	98,500	1,05,000
Less: 20% transfer to Gen Res.	15,550	19,700	21,000
	62,200	78,800	84,000

$$\text{Average Profit} = \frac{2,25,000}{3}$$

$$= 75,000$$

$$\text{Goodwill} = 1 \times 7 \times 75,000$$

$$= 75,000$$

(1) Intrinsic Method:

Closing Capital employed.

Assets	`
Land and building	1,82,500
Furniture	1,14,200
Stock	3,10,000

Accounting for Banking Company

Debtors	1,03,000
Cash	2,18,700
Total Assets	9,28,200
Less: Liabilities	
S. Creditors	2,04,700
Prov. For tax	98,500
Total Liabilities	3,03,200
Closing Capital employed	6,25,000

∴ Net Assets available Shareholder

= Closing Cap. employed + Goodwill

= 6,25,000 + 75,000 = 7,00,000

∴ Value Per Share as per Intrinsic = $\frac{\text{Net Assets available to Equity share holder}}{\text{No. of equity shares}}$

$$\text{Method} = \frac{7,00,000}{25,000}$$

= `28

(2) Yield Method:

$$\text{ERR} = \frac{\text{Profit available for Equity share holder}}{\text{Paid up Equity share capital}} \times 100$$

$$= \frac{75,000}{2,50,000} \times 100$$

= 30%

∴ Value Per Share as per Yield = $\frac{\text{ERR}}{\text{NRR}} \times \text{Paid up value per share}$

$$= \frac{30}{15} \times 10$$

(ccclxxxi)

Accounting for Banking Company
= `20

(3) Fair Value Method:

$$= \frac{\text{Intrinsic value} + \text{Yield value}}{2}$$

$$= \frac{28+20}{2}$$

$$= `24$$

Illustration 55:

(M.U. TYBAF May 2009)

The Balance Sheet of Amtek Ltd. as on 31st March 2013 was as under:

Liability	(`)	Asset	(`)
Equity share capital	3,90,000	Goodwill	30,000
General Reserve	38,000	Land	1,50,000
P/L A/c	50,000	Machinery	1,00,000
Creditors	77,000	Furniture	1,50,000
Provision of Depreciation:		Debtors	1,50,000
Furniture	50,000	Stock	20,000
Machinery	20,000	Bank	25,000
	6,25,000		6,25,000

Betek Ltd. want to purchase the business of Amtek Ltd. For this purpose you are required to calculate the value of goodwill by 3 years purchase of super profit method and capitalisation of super profit method after taking the following adjustments:

- (a) The company's average profits of the last five years after making provision for taxation at 50% amounted to `1,00,000.
- (b) Land is revalued at `2,00,000.
- (c) Stock to be revalued and increased by 10%.
- (d) All other assets and liabilities are taken over at book value.
- (e) One of the manager of Ametek Ltd is to be appointed on the Board of directors of Betek Ltd. on `10,000 as a remuneration.
- (f) Normal Rate of Return on Capital is 10%.

Accounting for Banking Company

Solution:

Calculation of Goodwill:

Calculation of Future maintainable profit (FMP)

	`
Profit before Tax	2,00,000
Less: Board of Directors Remuneration	(10,000)
	1,90,000
Less: Tax	(95,000)
FMP	95,000

Calculation of Average Capital Employed

	(₹)	(₹)
Assets (at revised value)		
Land	2,00,000	
Machinery (1,00,000 – 20,000)	80,000	
Furniture (1,50,000 – 50,000)	1,00,000	
Debtors	1,50,000	
Stock	22,000	
Bank	25,000	5,77,000
Less: External liability		
Creditors		(77,000)
Average Capital Employed		5,00,000

$$\text{Normal Profit} = \text{ACE} \times \text{NRR}$$

$$= 5,00,000 \times 10\%$$

$$= 50,000$$

$$\text{Super profit} = \text{FMP} - \text{Normal Profit}$$

$$= 95,000 - 50,000$$

$$= \text{`45,000}$$

$$\text{Goodwill} = \text{Number of years purchased} \times \text{Super profit}$$

$$= 3 \times 45,000$$

(ccclxxxiii)

Accounting for Banking Company
 = `1,35,000

$$\text{Goodwill} = \left(\frac{\text{Super profit}}{\text{Normal Rate Return}} \right) = \left(\frac{45,000}{10\%} \right)$$

= `4,50,000

Illustration 56:

(M.U. TYBAF May 2007)

Following is the Balance sheet of Ramdeo Baba Ltd. as on 31st March 2013:

Liability	(₹)	Asset	(₹)
Share Capital:		Motor Car	5,00,000
1,10,000 equity shares of `10 each	11,00,000	Land and Building	5,00,000
10% preference Share Capital	2,00,000	Machinery	10,00,000
General Reserve	5,02,000	Furniture and Fixture	3,00,000
Profit and loss account	7,85,000	10% Securities Bond	62,000
Creditors	1,00,000	Debtors	2,00,000
12% Debentures	4,00,000	Stock	1,70,000
		Cash	3,30,000
		Discount on issue of Debentures	25,000
	30,87,000		30,87,000

Further Information are as follows:

- (a) Normal rate of return is 8%.
 - (b) Goodwill is to be valued at 3 years purchase of super profit method.
 - (c) Average Annual profit before tax is `5,52,000.
 - (d) Tax Rate is 50%.
 - (e) All assets and liabilities are worth book value.
- You are required to value the equity shares by:

- (a) Fair value method.
- (b) Intrinsic value method.
- (c) Yield method.

Solution:

(b) Calculation of Intrinsic value method of value per share.

	(₹)	(₹)
Arrange capital employed (as per Goodwill)		25,00,000
Add: Goodwill		2,18,700
Add: 10% Securities Bond		62,000
Assets available for shareholders		27,80,700
Less: Preference share holder claim		
Preference share capital	2,00,000	
Preference dividend	20,000	(2,20,000)
Net asset available for equity		25,60,700
÷ Number of equity shares		÷ 1,10,000
Intrinsic value per share		23.28

Calculation of Good will under super Profit-method calculation of Future Maintainable Profit.

	(₹)
Net Profit before Tax	5,52,000
Less: Income from securities Bond	(6,200)
	5,45,800
Less: Tax @ 50%	(2,72,900)
FMP	2,72,900

Calculation of Normal Profit.

Calculation of Average Capital Employed

	(₹)	(₹)
Asset (at revised value)		
Motor car	5,00,000	
Land and building	5,00,000	

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Machinery	10,00,000	
Furniture and Fixture	3,00,000	
Debtors	2,00,000	
Stock	1,70,000	
Cash	3,30,000	30,00,000
Less: External Liability		
Creditors	1,00,000	
12% Debentures	4,00,000	(5,00,000)
Average Capital Employed		25,00,000

$$\text{Normal Profit} = \text{ACE} \times \text{NRR} = 25,00,000 \times 8\% = \text{`2,00,000}$$

$$\begin{aligned} \text{Super Profit} &= \text{FMP} - \text{Normal Profit} \\ &= 2,72,900 - 2,00,000 = \text{`72,900} \end{aligned}$$

$$\begin{aligned} \text{Goodwill} &= \text{Number of years purchase} \times \text{Super Profit} \\ &= 3 \times 72,900 = \text{`2,18,700} \end{aligned}$$

(a) Calculation of Yield Value per share:

	(₹)
Profit before Tax	5,52,000
Less: Tax	(2,76,000)
	2,76,000
Less: Preference Dividend	

$$\begin{aligned} \text{Rate of FMP} &= \frac{\text{FMP}}{\text{Paid up Capital}} \times 100 \\ &= \frac{2,56,000}{11,00,000} \times 100 \\ &= 23.27\% \end{aligned}$$

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$$\text{Yield Value per share} = \frac{\text{Rate of FMP}}{\text{NRR}} \times \text{Paid up value per share}$$

$$= \frac{23.27}{8} \times 10$$

$$= \mathbf{29.09}$$

$$\text{(b) Fair Value Method:} = \frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$$

$$= \frac{23.28 + 29.09}{2}$$

$$= \mathbf{26.19}$$

Illustration 57:

(M.U. TYBAF April 2013)

The following figures are extracted from the books of M/s Prosperous Limited as on 31st March, 2012:

Share Capital:	Rs.
9 percent Preference shares of `100 each	3,00,000
1000 Equity shares of `100 each `50 paid up	50,000
1000 Equity shares of `100 each `25 paid up	25,000
1000 Equity share of `100 each fully paid up	1,00,000
Reserves and Surplus:	
General Reserves	2,00,000
Profit and Loss Account	50,000
Total	7,25,000

On a fair valuation of all the assets of the company it is found that they have an appreciation of `1,05,000. The Articles of Association provided that, in case of liquidation, the preference shareholders will have a further claim to the extent of 10 per cent of the surplus assets. Ascertain the value of each preference and equity shares, assuming.

(a) Company make a call on equity shares, which is paid by all shareholders

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(b) Company does not make a call on equity shares.

Solution:

	(₹)	(₹)
Total Capital and Reserves:		
(i.e. net assets)		7,25,000
Appreciation Asset		1,05,000
Total		8,30,000
Preference Share Capital (–)		3,00,000
Funds for Equity		5,30,000
Equity Share Capital	50,000	
	(+) 25,000	
	(+)	1,75,000
	1,00,000	
Surplus to Equity		3,35,000
(A) If company makes a call total asset will increase by 75,000 + 50,000 = 1,25,000. All Equity shares would be fully called up.		
Total Assets		8,30,000
Call Money Received		(+)
		1,25,000
		9,55,000
Preference Capital		(–)
		3,00,000
For Equity Capital		6,55,000
Less: Equity Share capital (1,75,000 + 1,25,000)		(–)
		3,00,000
Surplus		3,55,000
For Preference		35,500
For Equity		3,19,500
Total Assets for equity		3,00,000

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	(+)
	3,19,500
	6,19,500
No of equity shares 3,000 Value per share (6,19,500/3,000)	206.50
(B) All Equity shares would be fully called up	
Total Assets	8,30,000
Call Money Received	(+) 1,25,000
	9,55,000
Preference Capital	(-) 3,00,000
For Equity Capital	6,55,000
Less: Equity share capital (1,75,000 + 1,25,000)	(-) 3,00,000
	3,55,000
Surplus:	
For Preference	35,500
For Equity	3,19,500
Total assets for equity	3,00,000
	(+) 3,19,500
	6,19,500
No of equity shares 3000 value per share (equity shares) (6,19,500 / 3,000)	206.50
Full Paid 1000 =	206.50
Full Paid 50 = 206.50 – 50.00	156.50
Full Paid 25 = 206.50 – 75.00	131.50
Preference Share Capital	3,00,000
Surplus	35,500
	3,35,500
Value per share (3,35,500/3,000)	111.83

Illustration 58:

The following information made available from the books of R. K. Ltd.

Particulars	Rs.
Issued and paid up Capital:	
10% Preference Shares of ₹ 100 each	5,00,000
Equity Share Capital (₹ 10 each)	15,00,000
Reserves and Surplus	20,00,000
Preliminary Expenses	20,000

All fixed assets were undervalued by ₹ 10,20,000. Current Assets were overvalued by ₹ 1,00,000. You are required to value preference shares if:

- (a) When preference shares are non-participating.
- (b) When preference shares are participating having 10% share in surplus.
- (c) When preference shares are having no preference over equity shares.

Solution:

Calculation of Net Assets (Liability side approach)

Particulars	Rs.
10% Preference Share Capital (100 each)	5,00,000
Equity Share Capital (₹ 10 each)	15,00,000
Reserves and Surplus	20,00,000
Revaluation Profit on Fixed Assets	10,20,000
	50,20,000
Less: Preliminary Expenses	20,000
Loss on Revaluation on Current Assets	1,00,000
Net Assets	49,00,000
Less: Preference Share Capital	5,00,000
Less: Equity Share Capital	1,50,000
Surplus on Liquidation	29,00,000

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(a) When preference shares are non-participating:

$$\begin{aligned} \text{Intrinsic Value of Pref. Share} &= \frac{\text{Paid up Preference Share Capital + Arrears of Dividend}}{\text{No. of Preference Shares}} \\ &= \frac{5,00,000}{5,000} = \text{₹}100 \text{ each} \end{aligned}$$

(b) When preference shares are participating having of 10% shares in surplus:

$$\begin{aligned} \text{Surplus available to preference shareholders} &= 29,00,000 \times 10\% \\ &= 2,90,000 \end{aligned}$$

$$\begin{aligned} \text{Intrinsic Value of Pref. Share} &= \frac{\text{Paid up Pref. Share Capital + Surplus + Arrears of Dividend}}{\text{No. of Preference Shares}} \\ &= \frac{5,00,000 + 2,90,000}{5,000} = \frac{7,90,000}{5,000} = \text{₹}158 \text{ each} \end{aligned}$$

(c) When preference shares are having no preference over equity shares:

In this case, net assets of the company required to divide in the ratio of paid up share capital.

$$\begin{aligned} \text{Preference Share Capital} : \text{Equity Share Capital} \\ 5,00,000 : 15,00,000 \\ 1 : 3 \end{aligned}$$

Therefore net assets available to preference shareholders

$$= 49,00,000 \times \frac{1}{4} = 12,25,000$$

$$\begin{aligned} \text{Intrinsic Value of Pref. Share} &= \frac{\text{Net Assets available to Preference Shareholders}}{\text{No. of Preference Shares}} \\ &= \frac{12,25,000}{5,000} \\ &= \text{₹}245 \text{ each} \end{aligned}$$

Illustration 59:

(CA-Final)

The following is the Balance Sheet of Alpha Limited as on 31st December, 2005.

Liability	(₹)	(₹)	Asset	(₹)
Share Capital:			Fixed Assets:	
Equity Shares of ₹100 each	10,00,000		Land and Building	4,00,000
Less: Call in Arrear	1,00,000	9,00,000	Machinery	4,50,000

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(`20 for final call)		Motor Car	25,000
Reserves and Surplus:		Furniture	25,000
Profit and Loss Account	2,50,000	Investments	50,000
General Reserve	3,50,000	(Face Value)	
Current Liabilities:		Current Assets:	
Sundry Creditors	5,00,000	Stock	7,25,000
		Sundry Debtors	2,00,000
		Cash at Bank	1,05,000
		Miscellaneous Expenditure:	
		Preliminary Expenses	20,000
	20,00,000		20,00,000

Additional information is as under:

- (i) **Fixed assets are Worth:** Building ` 6,00,000 and Machinery ` 5,2,0000.
- (ii) All investments are non-trading investments and are to be valued at 20% above cost. Dividend at uniform rate of 20% is earned on all investments.
- (iii) For the purpose valuation of shares. Goodwill is to be valued on the basis of 3 year's purchase of super profits based on average profit (after tax) of the last three years.
- (iv) Depreciation on appreciated value of Land and Building and Machinery is not considered for valuation of goodwill.
- (v) Profit (after tax) as follows:

Particulars	Rs.
2003	3,80,000
2004	4,20,000
2005	5,00,000

Rate of Income tax 50%.

In similar business, return on capital employed is 20% (after tax).

- (vi) In 2003, Machinery (Book Value ` 20,000) was sold for ` 20,000 but the proceeds were wrongly credited to Profit and Loss Account. The

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mistake has not yet been rectified. Depreciation has been charged on machinery 10% per annum on reducing balance method. Find out the value of each full paid and partly paid equity shares on net assets basis.

Calculation of Future Maintainable Profit:

Particulars	2003	2004	2005
Profits after Tax	3,80,000	4,20,000	5,00,000
Less: Sale of Machinery Credited to Profit and Loss A/c (Net of Tax)	10,000		
Less: Dividend on Non-trading Investment (Net of Tax)	5,000	5,000	5,000
Add: Depreciation of Machinery Sold (Net of Tax-half of `2,000, `1,800 and `1,620)	1,000	900	810
Adjusted Profits	3,66,000	4,15,900	4,95,810

$$\text{Average Profits} = \frac{3,66,000 + 4,15,900 + 4,95,810}{3}$$

$$= \text{`}4,25,903$$

∴ Future Maintainable Profit = 4,25,903

Calculation of Capital Employed:

Particulars	Rs.
Land and Building	6,00,000
Machinery	5,20,000
Motor Car	25,000
Furniture	25,000
Stock	7,25,000
Debtors	2,00,000
Cash	1,05,000
	22,00,000
Less: Creditors	5,00,000

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Closing Capital Employed	17,00,000
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Average Capital Employed = 17,00,000

$$\begin{aligned} \text{Normal Profit} &= \text{Capital Employed} \times \text{N.R.R.} \\ &= 17,00,000 \times 20\% \\ &= 3,40,000 \end{aligned}$$

$$\begin{aligned} \text{Super Profit} &= \text{Future Maintainable Profit} - \text{Normal Profit} \\ &= 4,25,907 - 3,40,000 \\ &= \text{` } 85,903 \end{aligned}$$

$$\begin{aligned} \text{Good Will} &= \text{Super Profit} \times \text{No. of Years Purchase} \\ &= 85,903 \times 3 \\ &= \text{` } 2,57,709 \end{aligned}$$

Valuation of shares on the basis of Net Assets:

Particulars	Rs.
Capital Employed	17,00,000
Add: Non-trading Investment	60,000
Goodwill	2,57,709
	20,17,709
Add; Notional call on shares	1,00,000
Total Net Assets	21,17,709

$$\begin{aligned} \text{Value of Full paid Equity Shares} &= \frac{\text{Total Net Assets}}{\text{No. of Equity Shares}} \\ &= \frac{21,17,709}{10,000} \\ &= \text{` } 211.77 \end{aligned}$$

$$\begin{aligned} \text{Value of Partly paid Equity Share} &= \text{Value of Fully paid Equity Share} - \\ &\quad \text{Notional Call per Share} \\ &= 211.77 - 20 \\ &= \text{` } 191.77 \end{aligned}$$

Questions for Self-Practice

OBJECTIVE QUESTIONS

(VII) Multiple Choice Questions:

- (16) Goodwill is _____.
- (e) A tangible asset
 - (f) An intangible asset
 - (g) A fictitious asset
- (17) Amount of capital used by business concern to run its business activities _____.
- (e) Capital employed
 - (f) Authorised capital
 - (g) Paid-up capital
- (18) A rate of return normally expected by the shareholders on their investment _____.
- (e) Super profit
 - (f) Dividends
 - (g) Normal rate of return
 - (h) Bonus dividend
- (19) Excess of average profit earned by the firm over and above its normal profit _____.
- (e) Excess profit
 - (f) Normal returns
 - (g) Super profit
 - (h) Bumper profit
- (20) The most important element in valuation of goodwill is _____.
- (e) Nature of business
 - (f) Efficiency of management
 - (g) Technical know-how
 - (h) Future maintainable profit
- (21) Any non-trading income included in the profit should be _____ for valuation of goodwill.
- (e) eliminated
 - (f) added
 - (g) ignored
 - (h) none of the above
- (22) Super profit is `18,334 and normal rate of return is 10%. Goodwill as per capitalisation of super profit method is equal to = _____.
- (e) `1,83,340
 - (f) `1,80,000
 - (g) `1,80,340
 - (h) `1,85,000
- (23) Net asset value method is based on the assumption that the company is _____.
- (e) a going concern
 - (f) going to be liquidated

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- (g) (a) & (b) both
(h) None of the above
- (24) Value of a partly paid equity share is equal to _____.
(e) calls in arrears per share
(f) paid-up value per share
(g) value of fully paid share - calls unpaid per share
(h) None of the above
- (25) F.M.P. for yield valuation is _____.
(e) future profits
(f) dividend that would be available to equity shareholders
(g) past profits
(h) all the above
(e) All of above

[Ans.: (1 - b), (2 - a), (3 - c), (4 - c), (5 - d), (6 - a), (7 - a), (8 - a), (9 - c), (10 - b)]

(VIII) Fill in the blanks:

- (1) Goodwill has _____ value.
(2) Goodwill may be _____ or _____.
(3) Investments are _____ assets.
(4) _____ value depends on net assets.
(5) Yield value depends on _____.
(6) _____ preference shares gave right on surplus along with equity share holders.
(7) Value of partly paid equity share = value of fully paid equity share – _____.
(8) _____ is equal to rate of interest plus rate of risk.
(9) For small investors _____ method, is suitable for valuation of shares on 'Yield basis'.
(10) _____ method is applied for the purpose of valuation of shares on 'Yield basis' for majority shares holding.

[Ans.: (1 - Realisable), (2 - purchased or non purchased), (3 - non-trading), (4 - Intrinsic), (5 - Future Dividend), (6 - Participating), (7 - Calls unpaid per share), (8 - Normal Rate of Return), (9 - Expected Dividend Basis), (10 - Expected Earning Basis/Return on Capital Employed)]

(IX) State True or False:

- (1) Goodwill may arise from such attributes of a business as good location.
(2) Purchased goodwill is demonstrated by a purchase transaction.
(3) Non-purchased goodwill is recognised in financial statement.
(4) The majority of shareholders of a company are interested in dividends.
(5) There is no free market for unquoted shares.

[Ans.: (1 - True), (2 - True), (3 - False), (4 - True), (5 - True)]

THEORY QUESTIONS

(II) Answer the following questions:

- (18) Explain the meaning of goodwill.
(19) Explain both the types of goodwill.
(20) Explain different methods for valuation of goodwill.
(21) Explain capital employed and Average Capital Employed.

(III) Write a short notes on:

- (13) Normal Rate of Returns.
(14) Super Profit.
(15) Business Profit.
(16) Abnormal income and Expenses.

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PRACTICE PROBLEMS

(Ex. 1) (a) Rana & Co. presents the following Balance Sheet on 31st December. 2015.

Particulars	`	Particulars	`
Sham Capital (`10 each)	3,00,000	Fixed Assets	4,50,000
Reserves	1,20,000	Current Assets	30,000
Loans	50,000		
Current Liabilities	10,000		
Total	4,80,000	Total	4,80,000

It is observed that fixed assets are undervalued by `30,000. The current assets are overvalued by `2,000. The Assets are to be valued properly.

It is proposed to issue fully paid shares by capitalization of General Reserves in ratio of General Reserves in the ratio of one share for three shares held. Find the value of shares

- (i) Before issue of bonus shares; and
- (ii) After issue of bonus shares.

(b) Beeta Ltd. capital is `11,00,000 divided in shares of `10 each. Of these 40,000 shares are 8% preference and remaining are equity shares.

The average profit (after tax @ 50%) earned during past 3 years is `1,50,000. In future, expenses will increase by `12,000.

The expected yield for risk capital is 10%, net of tax.

Find the value of equity shares.

(Ex. 2) AMTEE LTD. presents the following Balance Sheet as on 31st March 2015.

Particulars	`	Particulars	`
Share capital (in `10 shares)		Goodwill	40,000
Equity	4,00,000	Property	2,40,000
Less: Calls in arrears (@ 2)	3,90,000	Equipment	2,20,000
<u>(10,000)</u>	0	Plant	10,000
8% preference	2,00,000	Vehicles	1,60,000
Less: Cass in arrears (`20)	1,98,000	Investments	1,60,000
<u>(2,000)</u>	0	Stock	1,10,000
General Reserve	1,60,000	Debtors	1,80,000
Profit & Loss Account	32,000	Bank	20,000
Loan Bank	1,20,000	Preliminary Expenses	20,000
Creditors	3,10,000		
Acceptances	60,000		

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Total	12,70,000	12,70,000
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The company desires to value its Equity Shares on the basis of its Business Assets and Liabilities.

To enable the valuation of shares following information is furnished

- (1) All Fixed Assets (except Goodwill) are worth 30% above Book Value. (After following adjustments)
- (2) Stock is overvalued by ₹10,000.
- (3) ₹2,000 due from a customer is doubtful.
- (4) All investments earn income @ 10%. However only 10% are Trade Investment and remaining are Non-Trade.
- (5) On verification it was noticed that ₹20,000 paid in 2012-13 for a plant was debited as repairs. The depreciation @ 10% p.a. on cost is provided by company.
- (6) Goodwill is valued at 2 years purchase of past four year's average profits. The profits and Loss Account revealed following profits 2011-12 ₹1,60,000; 2012-13 ₹1,80,000; 2013-14 ₹2,10,000 and 2014-15 ₹2,00,000.

Ascertain value of fully paid and partly paid shares.

(Ex. 3) The following is the Balance Sheet of Amruta and Co. Ltd for the year ended 31st December, 2015:

Liabilities		Assets	
Equity Share Capital		Land	1,00,000
(50,000 @ 10 each)	5,00,000	Building	3,00,000
2000, 10% Cumulative Preference		Bills Receivable	50,000
shares of ₹100 each	2,00,000	Debtors	3,00,000
Reserves	1,00,000	Cash	2,00,000
Creditors	2,10,000	Preliminary Expenses	40,000
Bills Payable	80,000		
	10,90,000		10,90,000

Compute the value of each equity share by:

- (a) Yield Method
- (b) Intrinsic Value Method
- (c) Fair Value Method. Given that:
 - (1) All the fixed assets are revalued at ₹6,00,000
 - (2) Profits for the years 2013, 2014 and 2015 was ₹1,00,000, ₹3,00,000 and ₹2,00,000
 - (3) Company had a practice to transfer 10% profit to Reserve Fund.
 - (4) Normal Rate of return is 12%
 - (5) Arrears of Preference Dividend for last 3 years.

(Oct. 2008)

(Ex. 4) Following is the Balance Sheet of RNRL Ltd. As on 31st December 2015. Compute its goodwill as 5 years purchase of Super Profit Method.

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Liabilities		Assets		
Equity Share Capital	18,00,000	Plant and Machinery		5,00,000
General Reserves	2,00,000	Building		10,00,000
Secured Loan	3,00,000	Furniture		6,00,000
Unsecured Loan	5,00,000	10% Non-Trade Investment		
Bills Payable	1,00,000	(Purchased on 1st Jan. 203)		1,00,000
Creditors	4,25,000	Debtors	800,000	
		Less: R.D.D.	50,000	7,50,000
		Stock		1,25,000
		Cash		2,00,000
		Discount On Issued of Shares		50,000
	33,25,000			33,25,000

- (1) The company profit before Managing Director's remuneration of `30,000 p.a and Taxation @ 50% are as follows:

Years	Profit before Tax (₹)
2011	5,00,000
2012	7,00,000
2013	8,00,000
2014	6,00,000
2015	2,00,000

- (2) Normal rate return is 10% p.a.
 (3) In the year 2013 company earn prize of `10,000 for good performance for the year.
 (4) In future the existing rent of the building will be increased by `2,000 per month.
 (5) All fixed assets to be decreased by 10%
 (6) Closing Stock for the year 2014 is overvalued by `5,000. **(Oct. 2008)**
(Ex. 5) The Balance Sheet of Gorakhnath Alloy Ltd. as on 31st December, 2015 were as follows:

Liabilities		Assets	
Equity Share Capital	5,00,000	Land and Building	5,00,000

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(50,000 @ 10 each)		Plant and Machinery	2,00,000
Profit and Loss Account	2,00,000	Furniture and Fixture	1,00,000
Debentures	1,80,000	10% Government Bonds	50,000
Creditors	1,50,000	Stock	80,000
Provision for Taxation	50,000	Debtors	2,00,000
Proposed dividend	1,00,000	Cash	50,000
	10,20,000		10,20,000
	0		0

- (a) The net profits of the company after charging depreciation and taxes were as follows:

Year	`
2011	1,00,000
2012	1,25,000
2013	1,50,000
2014	1,75,000
2015	2,00,000

- (b) On 31st December, 2015 Land and Building were revalued at `6,00,000 Plant and Machinery at `1,50,000 and Furniture and Fixture at `80,000.
- (c) Normal Rate of return is 10%.
- (d) Find value of goodwill by 5 years purchase of super Profits and Capitalisation of Future maintainable Profits Method.
- (e) One of the Machinery was purchase on 01/01/2005 for `50,000 was wrongly charged to Profit and Loss Account has to be rectified and depreciation charge on that machinery @ 10% by WDV method.
- (f) Use Simple Average.
- (g) Government bonds are purchased on 01/01/2011. **(May 2008)**

(Ex. 6) The balance Sheet of Mahi Ltd. as on 31st December, 2015 is as follows:

Liabilities	`	Assets	`
10% Cum Preference Share Capital	100,000	Goodwill	50,000
Equity Share Capital (5,000 @ 100 each)	500,000	Land and Building	300,000
Profit and Loss	250,000	Plant and Machinery	200,000
Bank Loan	100,000	Investment (market Price 2,00,000)	50,000
		Stock	100,000

(cd)

Accounting for Banking Company

Creditors	200,000	Debtors	300,000
Bills Payable	50,000	Cash	100,000
		Bank	100,000
	12,00,000		12,00,000

Additional Information:

- (1) Land and Building Revalued at `4,00,000.
 - (2) Plant and Machinery revalued at `2,50,000.
 - (3) Investment should be taken at market price.
 - (4) Closing stock include stock of `20,000 worthless.
 - (5) Net profits for the year 2011, 2012, 2013, 2014 and 2015 amounted to `50,000, `75,000, `1,00,000, `2,50,000 and `2,00,000 respectively.
 - (6) Normal Rate of Return is 10%.
 - (7) Transfer 10% profit to General Reserve.
 - (8) Preference dividend are in arrears for one year.
- Calculate value of equity shares:

- (a) Net Assets Method.
- (b) Yield Method.
- (c) Fair Value Method.

(Ex. 7) Greg Cappell & Co. want to purchase the business of Saurabh & Co. on 31-12-2015 Balance Sheet and Profits of Saurabh & Co. for the last four years were:

Balance sheet as on 31-12-2005

Liabilities	`	Assets	`
Capital	2,00,000	Land and Building	1,20,000
General Reserve	70,000	Machinery	90,000
Profit and Loss	1,03,050	Vehicle	50,000
Creditors	30,000	10% Non-Trade Investments	25,000
Bills Payable	31,475	(Cost `20,000 and Purchase on	
Outstanding Expenses	18,475	1-1-2015)	
		Debtors	55,000
		Cash in hand	48,000
		Cash at Bank	50,000
		Bills Receivable	15,000
	4,53,000		4,53,000

Accounting for Banking Company

Years	Profit (₹)
2012	37,200
2013	49,600
2014	77,500
2015	96,100

The following additional information about Saurabh & Co. is also available:

- (i) An unexpected income of ₹9,300 was included in the profit of 2002 which can never be expected in future.
- (ii) There was a fire in the premises in the year 2003 which caused loss of ₹3,100.
- (iii) After acquisition Greg Chappell & Co. has to pay rent of ₹3,100 p.a. which was not paid by Saurabh & Co.
- (iv) Normal rate of Return is 10%.
- (v) Proprietor had a practice to withdraw profits at regular basis.
- (vi) Greg Chappell, the proprietor of Greg Chappell & Co. will be managing a company at a salary of ₹3,100 p.a. The business of Saurabh & Co. was managed by a salaried manager who was paid a salary of ₹1,240 p.a.

Calculate the Goodwill by:

- (a) 3 years purchase of super profit.
 - (b) Capitalization of Future Maintainable Profit Method.
- Use simple average.

(Oct. 2006)

(Ex. 8) Mohan Enterprises provides following details in its:

Balance Sheet as on 31-12-2015

Liabilities	₹	Assets	₹
Equity Share Capital of (₹10 each fully paid)	8,00,000	Goodwill	80,000
General Reserve	3,80,000	Fixed Assets	10,00,000
Profit and Loss A/c.	2,40,000	Current Assets	8,00,000
14% Debentures	2,00,000		
Current Liabilities	2,60,000		
	18,80,000		18,80,000

Following additional information is provided:

- (1) The Fixed Assets were valued at ₹7,60,000 and Goodwill ₹1,00,000.
 - (2) The Net profits for the three years are 2013 was ₹1,89,600, 2014 was ₹2,08,000 and 2015 was ₹2,02,400.
 - (3) The company transfers 20% of profit to General Reserve.
 - (4) The profit earned by similar companies is 16%.
 - (5) Ignore Taxation.
- Calculate the value per share under:

- (1) Intrinsic Value Method.
- (2) Yield Value Method.
- (3) Fair Value Method.

(May 2008)



Accounting for Banking Company

(Ex. 9) Balance Sheet of Shubhangi Co. Ltd. as on 31st March, 2015 is as follows:

Liabilities		Assets		
Share Capital		Fixed Assets		
Equity Share Capital	3,00,000	Goodwill		30,000
Preference Share Capital	2,00,000	Land		2,00,000
Reserves and Surplus		Building		2,50,000
General Reserve	1,50,000	Furniture		75,000
Capital Reserve	50,000	Current Assets and		
Profit and Loss	1,27,500	Loans and Advances		
Current Liabilities and Provisions:		Debtors	1,20,000	
Creditors	1,17,500	Less: R.D.D	20,000	
Provisions for Taxation Current Year	75,000			1,00,000
		Stock		1,30,000
		Cash		75,000
		Bills Receivable		50,000
		Bank		1,10,000
	10,20,000			10,20,000
	0			0

The following information is available:

- (1) The reasonable return on capital invested in the class of business done by the company is 10%.
 - (2) 50% provision has been made in accounts for income tax and adequate provision has been made for depreciation.
 - (3) In future cost reduction scheme will save `25,000 expenditure.
- You are required to value the goodwill by:

- (a) Five years purchase of super profit method.
- (b) Capitalisation of super profit method.

(May 2007)

(Ex. 10) The balance Sheet of Bob Woolmer Ltd. as on 31st December, 2015:

Liabilities		Assets	
Share Capital		Goodwill	68,000

(cdiii)

Accounting for Banking Company

Equity Share of `10 each	5,00,000	Motor Car	1,00,000
10% Preference Shares of `10 each	2,00,000	Land and Building	5,00,000
General Reserve	2,75,000	Machinery	3,00,000
Profit and Loss Account	2,86,000	Furniture and Fixture	2,50,000
Creditors	2,00,000	Investment	1,00,000
Bills Payable	50,000	Debtors	1,50,000
Dena Bank Loan	1,00,000	Stock	90,000
		Cash	43,000
		Discount on issue of Debentures	10,000
	16,11,000		16,11,000

- (1) You are required to value each fully paid equity share by:
- Asset Backing Method.
 - Earning capacity Method.
- (2) In the year 2013 Motor Car of `10,000 wrongly charged to Profit and Loss Account for which rectification not yet done.
- (3) Depreciation is charged @ 10% on motor car by Straight Line method.
- (4) Goodwill is valued at `90,000.
- (5) All other assets are taken at book value.
- (6) Closing Stock of 2015 is undervalued by 10% Remaining assets should be taken on book value.
- (7) Debtors to be reduced by `2,000.
- (8) Normal Rate of Return is 8%.
- (9) Profits for 4 years are given as follows (Use simple average).

Years	Profits (₹)
2012	60,000
2013	1,00,000
2014	1,25,000
2015	2,00,000

(May 2007)

(Ex. 11) The Asia Ltd. is to be absorbed by the India Ltd. In order to determine the purchase consideration, the two companies considered it necessary to value the goodwill attaching to the business of the Asia Ltd. it is agreed that the basis of the calculation of the goodwill shall be three years purchase of the average annual super profits, the profits being averaged for over 5 years.

(cdiv)



Accounting for Banking Company

The profits of Asia Ltd. for the last five years before charging income-tax at 50% are respectively `4,00,000, `4,96,000, `3,52,000 `5,60,000 and `4,32,000 for each of the above five years.

Two of the Directors of Asia Ltd. will appointed to the Board of India Ltd. on absorption and it is considered that their services have been worth `48,000 each per annum. In the past, no charge was made against the profits of Asia Ltd. for the services of the Directors concerned.

The average capital invested in net tangible assets over the period is `10,96,000, the normal return to be expected from the particular type of business carried on by the Asia Ltd., is 10%.

Calculate the Goodwill of Asia Ltd., based on the above information.

(Ex. 12) A company desirous of selling its business to another company has earned an average profit in the past of `1,50,000 per annum, It is considered that such average profit fairly represents the profit likely to be earned in the future, except that:

- (a) Director's fees `10,000 charged against such profit will not be payable by the purchasing company whose existing board can easily cope with the additional administrative work at present fees payable to the Directors.
- (b) Rent at `20,000 p.a. which had been paid by the vendor company will not be a charge in the future, since the purchasing company owns its own premises and can supply the accommodation necessary of the staff and the equipment of the vendor company.

The value of the net tangible assets of the vendor company at the proposed date of sale was `15,00,000 and it was considered that a reasonable return on capital invested for this type of company, was 10%.

The profit of vendor company would in no way be affected by the sale of its business to the purchasing company and goodwill existed and was to be paid for on the basis that the vendor company was a continuing enterprise.

Calculate the value of goodwill be capitalization of expected future net profits (Ignore taxation).

(Ex. 13) Rama is running a property business whose Assets and Liabilities as on March 31, 2015 are as under:

	(₹)	(₹)
Current Assets:		
Stock-in-hand	30,000	
Sundry Debtors less provision for Doubtful debts	40,000	
Cash and Bank balances	30,000	1,00,000
Fixed Assets:		
Goodwill	20,000	

Accounting for Banking Company

Plant & Machinery less Depreciation	40,000	
Land & Building	40,000	1,00,000
		2,00,000
Represented by:		
Current Liabilities		
Sundry Creditors for Goods		60,000
Loans		40,000
Liabilities for Expenses		15,000
		1,15,000
Capital of Rama		85,000
		2,00,000

Krishna is interested in buying the business. The average return from the particular line of business is estimated at 20%. The pre-tax profits, of the latest five years are found to be:

	(₹)
March 31, 2011	40,000
March 31, 2012	30,000
March 31, 2013	3,20,000
March 31, 2014	30,000
March 31, 2015	33,000

Profits for the year ended March 31, 2011 include a capital profit of ₹10,000 and for the year ended March 31, 2015 are after adjustment of ₹7,500 being loss by fire. An average rate of 40% is payable as income-tax.

Ascertain the Goodwill payable by Krishna for the business, by capitalizing the future maintainable post-tax profits on the basis of the past five year's average annual profits. Also value the Goodwill at 5 years purchases of super profits.

(Ex. 14) Majumdar & Co. decides to purchase the business of Banerjee & Co. on 31/03/2015. Profits of Banerjee & Co. for the last 6 years were:

	(₹)
2009-10	10,000
2010-11	8,000
2011-12	12,000
2012-13	16,000
2013-14	25,000

Accounting for Banking Company

2014-15	31,000
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The following additional information about Banerjee and Co. were also supplied:

- (a) A casual income of ₹3,000 was included in the profit of 2011-12 which can never be expected in future.
- (b) Profit of 2012-13 was reduced by ₹1,000 as a result of an extraordinary loss by fire.
- (c) After acquisition of the business, majumdar & Co., has to pay an insurance premium amounting to ₹1,000 which was not paid by Banerjee & Co.

S. Majumdar, the proprietor of Majumdar & Co., was employed in a firm at a monthly salary of ₹1,000 p.m. The business of Banerjee & Co. was managed by a salaried manager who was paid a monthly salary of ₹400. Now, Mr. Majumdar decides to manage the firm after replacing the manager.

Compute the value of Goodwill on the basis of 3 years purchase of the expected average profit for the last four years (ignore taxation).

(Ex. 15) The following is the Balance Sheet of Poddar Ltd. as on 31/12/2015:

Liabilities	₹	Assets	₹
Share Capital:		Goodwill	20,000
20,000 Equity Shares of ₹10 each	2,00,000	Building at cost	80,000
Profit & Loss A/c	40,000	Plant & Machinery at cost	50,000
Depreciation Fund:		Sundry Debtors	30,000
Building	5,000	Less: Reserve for	
Plant & Machinery	<u>3,000</u>	Bad Debts	<u>3,000</u>
Sundry Creditors	22,000	Stock-in-Trade	43,000
Bills payable	4,000	Cash at Bank	50,000
Provision for taxation	6,000	Discount on issue of shares	10,000
	2,80,000		2,80,000

The profits of the past four years (before providing for taxation) were as follows:

2012 ₹20,000; 2013 ₹30,000; 2014 ₹36,000; 2015 ₹40,000.

Compute the value of Goodwill of the company assuming that the normal rate of return for this type of company is 10%. Income-tax is payable @ 50% on the above profits.

You are requested to follow capitalization of Future Profits Method.

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(Ex. 16) The following is the Balance Sheet of Mr. C as on 31/03/2015:

Liabilities	`	Assets	`
Capital	1,64,000	land and Building	36,000
General Reserve	40,000	Plant	54,500
Creditors	38,040	Investment	30,000
		Stock	26,350
		Bank	75,990
		Debtors	19,200
	2,42,040		2,42,040

The following were the Net Profits for the year ended:

	(`)
2012-13	32,280
2013-14	36,870
2014-15	43,350

The above amounts include income from Investment `10,800 each year.

You are required to ascertain the value of Goodwill from the above business at 2 years purchase of the average Super Profit for 3 years, taking into account the fact that the standard rate of return on Capital employed in such type of business is 10% & assuming that each year's profit is immediately withdrawn in full by Mr. C.

(Ex. 17) Calculate the Goodwill as per:

- (a) Annuity Method
- (b) Five year's purchase of Super Profit method; and
- (c) Capitalisation of Super Profit method for the details given hereunder:

	(`)
(i) Capital employed	1,50,000
(ii) Normal rate of profit	10%
(iii) Present value of Annuity of Re. 1 for five years at 10%	3.78
(iv) Net profit for 5 years:	
1st year	14,400



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2nd year	15,400
3rd year	16,900
4th year	17,400
5th year	17,900

The profit included non-recurring profits on an average basis of `1,000 out of which it was deemed that even non-recurring profits had a tendency of appearing at the rate of `600 p.a.

You are requested to calculate weighted Average, allocating Weight as 1, 2, 3, 4 and 5 respectively.

(Ex. 18) Mr. Wiseman has invested a sum of `2,00,000 in his own business which is a very profitable one. The annual profit earned from his business is `45,000 which includes a sum of `10,000 received as compensation of a part of his business premises.

As an alternative to his engagement in his business, he could have invested the money in long-term deposit with the Bank earning a normal rate of interest of 10% and also could engage himself in employment thereby getting an annual salary income of `7,200. Considering 2% as a fair compensation for the risk involved in the business, calculate the value of Goodwill of his business on capitalization of Super Profits at the normal rate of interest (ignore taxation).

(Ex. 19) Following is the Balance Sheet of Happy and Lucky as at March 31, 2015:

Liabilities			Assets	
Creditors		50,000	Cash and Bank	10,000
Loan from Bold @ 18%		3,00,000	Sundry Debtors	95,000
Capitals:			Stock	55,000
Happy	70,000		Factory Fixed Assets	2,00,000
Lucky	<u>30,000</u>	1,00,000	Land	50,000
			Goodwill	40,000
		4,50,000		4,50,000

Happy and Lucky shared profits and losses in the ratio of 3:2. On the date, they decided to admit Bold as a partner on the following terms and conditions:

- (a) Stock, Factory Fixed Assets and Land are to be revalued at `50,000, `2,50,000 and `1,50,000 respectively.

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- (b) Provision for Doubtful Debts to be made at `3,000. Other Assets and Liabilities except Goodwill are to be taken at the Balance Sheet values.
- (c) Goodwill is to be valued by Capitalisation of Future Maintainable Profits method.
- (d) For the purpose of calculating Future Maintainable Profits, you are informed that:
 - (i) The trend revealed by the Revenue statements for the three years ended March 31, 2003, will be maintained for the next four years.
 - (ii) Depreciation on Factory Fixed Assets is to be provided 20% on Reducing Balance method with reference to the revalued figure.
 - (iii) The normal return expected in the line of business is 16.2/3%.
- (e) The Revenue statements for the three years ended March 31, 2015 are summarized as under:

	2012-13 ([₹])	2013-14 ([₹])	2014-15 ([₹])
Sales	5,50,000	6,00,000	6,50,000
Less: Cost of Sales	3,30,000	3,60,000	3,90,000
Gross Margin	2,20,000	2,40,000	2,60,000
Less: Expenses	50,000	54,000	58,000
Depreciation on Fixed Assets	20,000	20,000	20,000
Interest on Bold's Loan	90,000	72,000	54,000
Total Expenses	1,60,000	1,46,000	1,32,000
Net Profit	60,000	94,000	1,28,000

You are required to value Goodwill of the firm for the purpose of admission of Bold in the firm.

(Ex. 20) The Balance Sheet of a partnership is as follows:

Liabilities			Assets	
Capital Accounts:			Goodwill	10,000
A	50,000		Plant	70,000
B	30,000		Furniture	3,000
C	<u>20,000</u>	1,00,000	Stock-in-Trade	45,000
Current Accounts:			Sundry Debtors	28,000
A	8,000		Prepaid Expenses	1,000

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B	7,000		Bank balance	19,000
C	<u>10,000</u>	25,000		
Sundry Creditors		51,000		
		1,76,000		1,76,000

It was proposed to form a company to acquire the business. For the purpose of the acquisition, the Assets were revalued as follows: Plant ₹60,000, Furniture ₹4,000, Stock ₹42,000, Debtors ₹25,000, Prepaid Expenses Nil.

It was ascertained that the profits before charging anything in respect of the partners, for the past five years, had been as follows: ₹50,000, ₹58,000, ₹66,000, ₹70,000, ₹66,000. Included in these profits were non-recurring items, averaging ₹3,000, but from the nature of the business, casual non-recurring items were bound to arise every year and the promoters agreed that a figure of ₹24,000 should be allowed as profit from this source.

Similar business paid a dividend of 16% per annum on their Equity shares, and the partners who would be the Directors of the company were worth remuneration of:

A ₹8,000 B ₹10,000 and C ₹12,000 per annum

Five year's purchase of the adjusted Super Profits on annuity basis was the agreed price for Goodwill, the Super Profits being taken on the basis of the average past five years.

The present value @ 16% of one rupee paid annually for five years is ₹3,274.

Compute the value of Goodwill (ignore taxation).

(Ex. 21) L, M and N are partners sharing profits and losses in the ratio of 4:3:3 respectively. The firm closes its accounts on 31st December every year. On March 31, 2015, N died and it was decided to calculate the amount of Goodwill to be paid to heirs of Mr. N. According to the partnership agreement, Goodwill was to be valued at three year's purchase of average Super Profits of the three years upto the date of death after deducting 17.5% interest on Capital employed and paying a reasonable remuneration of ₹30,000 p.a to each partner. Average Capital employed in the business was ₹2,00,000.

The profits of the earlier years before charging interest on Capital employed were as follows:

2012	1,47,000
2013	1,59,000
2014	2,23,000

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The profits for the year ending December 31, 2015 was `1,31,000. Profits may be considered to have been earned uniformly for all the years including 2003.

(Ex. 22) Calculate the amount of Goodwill to be paid to the heirs of Mr. N.

Given below is the Balance Sheet of ABC Ltd. as on 31/3/2015.

Liabilities	`	Assets	`
Share Capital	20,00,000	Goodwill (at cost)	2,00,000
General Reserve	4,00,000	Building	5,92,000
12% Debentures	5,00,000	Plant and Machinery	8,28,000
Plant Loan	3,00,000	Debtors	9,50,000
Creditors	5,00,000	Stock	7,00,000
Provision for tax	4,00,000	Trade Investments	2,00,000
Proposed Dividend	1,20,000	15% Non-trade investments	2,40,000
O/s. expenses	80,000	(F. V. `2,00,000)	
		Bills Receivable	4,00,000
		Cash at bank	1,40,000
		Preliminary expenses	50,000
	43,00,000		43,00,000

XYZ Ltd. agreed to absorb the business of ABC Ltd. from details furnished below calculate the value of goodwill:

- (a)** Profit (after tax @ 50%) was as under:
 11-12 `2,20,000 (loss on sale of car `30,000)
 12-13 `2,80,000 (Profit on sale of investments `10,000)
 13-14 `2,90,000 (Loss by theft `10,000)
 14-15 `5,30,000 (Loss by fire `40,000)
- (b)** Above profit includes income from trade investment @ `20,000 p.a.
(c) On 1/10/13 machinery was purchased at `1,00,000 but was charged to Profit and Loss Account A/c Depreciation on Machinery charged @ 20 p.a. under RBM.
(d) On 31/3/14 stock was overvalued by `20,000.
(e) During 14-15 major repairs were carried out on building & `80,000 had been spent but charged to building a/c. Building is depreciated at 10%.

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- (f) The directors of XYZ Ltd. would be able to manage the business with their present directors.
- (g) It has been found that ABC Ltd. never insured goods in the past but XYZ Ltd. would pay ₹10,000 p.a. as insurance premium.
- (h) ABC Ltd. signed an agreement with govt. of Tamil Nadu to supply goods on 29/3/2015 this could increase the income by ₹60,000 p.a.
- (i) Assets are revalued as under:
 Building appreciated by 25% plant and Machinery reduced to market price which is 20% below book value. Provisions for Bad Debts @ 2% stock at market price ₹6,00,000 non-trade investment at market price ₹2,50,000. Market price of trade investment ₹2,20,000.
- (j) Provision for discount on creditors @ 5%.
- (k) Rate of income tax in the future is expected @ 40%.
- (l) Calculate the value of Goodwill as under:
- (i) Super profit method (a) based on 2 years purchase of super profit (b) sliding scale of super profit 40% can be earned for 4 years, 30% for 3 years, 10% for 2 years and balance for 1 year. (c) Based on annuity rate: 2.7254.
- (ii) Capitalisation of maintainable profit method.
- (iii) 2 year's purchase of Future Maintainable Profit.
- (iv) 3 year's purchase of Average profit of the year.

You may assume that expected rate of return in this line of business is 20%. Closing capital employed shall be assumed as 'Average capital employed'.

(Ex. 23) Following is the balance sheet of Rambo Ltd as on 31st March, 2015.

Liabilities		Assets	
Share Capital		Goodwill	1,25,000
40,000 Equity Share of ₹20 each	5,00,000	Land & Building	180000
10 paid up			
10,000, 10% Pref. shares of ₹100 each	1,00,000	Less: Provision for	
General Reserve	1,50,000	Depreciation	<u>36000</u>
Dividend Equalisation Reserve	45,000	Plant and Machinery	24000
			0
Profit and Loss Account	1,50,000	Less: Provision for Dep.	2,00,000
		<u>40000</u>	
Workmen Compensation Fund	25,000	Investments:	
Creditors	2,30,000	In Government securities (for	
Bills Payable	20,000	replacement of Plant & Mach.)	1,00,000
Other Provisional Liabilities	80,000	In Marketable securities	1,00,000
		Stock-in-Trade	1,00,000
		Debtors	360000
		Less: R.D.D	<u>30000</u>
		Cash at Bank	75,000

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		Preliminary Expenses	26,000
	12,00,00		12,00,00
	0		0

Further Information:

- (a) The profits earned by the company for the past three years were as under:
 Year ended 31st March, 2012-13 `3,15,000
 Year ended 31st March, 2013-14 `2,41,000
 Year ended 31st March, 2014-15 `2,08,000
- Profits given are profits before tax, which was 50% throughout but it is expected to be 40%.
- (b) Rambo Ltd. had been carrying on business for the past several years. The company to be taken over by Jumbo Ltd Company and for this purpose you are required to value Goodwill.
- (c) The Jumbo Ltd. expects to carry on business with its own Board of Directors, without any addition. The Director's Fees paid by Rambo Ltd to its Directors amounted to `9,000 per annum.
- (d) As on 31st March, 2015 Land & Building is considered worth `3,00,000 where as Plant and Machinery is considered worth `1,80,000. There is sufficient provision for doubtful debts. There is no fluctuation in the values of investments and stock. Liability for compensation to worker is estimated as `5,000.
- (e) The expected rate of return in similar business may be taken at 12% after taxation.
- (f) On security of books it was found that:
- (i) Profit of 2012-13 includes profit on sale of car `10,000 and loss by theft `5,000.
 - (ii) Profit of 2013-14 was arrived at after charging purchase of furniture `40,000 to P & L A/c.
 - (iii) Furniture is to be depreciated by 10% p.a. under fixed installment method.
 - (iv) Profit of 2002-03 included dividend received on marketable securities `8,000.
 - (v) Stock as on 31/3/2001 was over valued by `10,000.

You are required to value goodwill according to the above information:

- (a) At 2 years purchase of super profit.
 - (b) Under Sliding scale method of valuation by purchasing 25% of the super profit each at 4 years, 2 years, and one year respectively.
 - (c) Under Annuity Valuation of super profit. According to Annuity Tables if `1 is to be paid for 3 years at 8%, the value of goodwill, is `2,577.
 - (d) Under 'Capitalisation of Future Maintainable Profits method.
 - (e) 3 years purchase of future maintainable profit.
- (Ex. 24) Following is the Balance Sheet of A Limited as on 31st March, 2015.

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Liabilities		Assets	
Share Capital	5,00,000	Goodwill	1,25,000
5,000 Shares of `100 each	1,50,000	Land & Bldg. at cost	1,80,000
Reserve Fund	25,000	Less: Depreciation	<u>36,000</u>
Workmen Compensation Fund	45,000	Plant & Mach.	2,48,000
Workmen Profit sharing Fund	1,50,000	Less: Depreciation	<u>48,000</u>
Profit & Loss A/c	2,30,000	Investments (to provide	
Creditors	1,00,000	replacement)	
Other Liabilities		to Plant and machinery	1,00,000
		Book Debts	3,60,000
		Less: Depreciation	<u>30,000</u>
		Stock	2,00,000
		Cash at Bank	75,000
		Preliminary Expenses	26,000
	12,00,000		12,00,000
	0		0

Further Information:

- (i) The profits earned by the company for the past three years were as under:
- | | |
|------------------------------|------------|
| Years ended 31st March, 2013 | ` 3,10,000 |
| Years ended 31st March, 2014 | ` 2,73,000 |
| Years ended 31st March, 2015 | ` 2,90,000 |
- (ii) A Ltd. had been carrying on business for the past several years. The company is to be taken over by another company and for this purpose you are required to value Goodwill by 'Capitalisation of Maintainable Profits Method'. For this purpose following additional information is available:
- The new company expects to carry on business with its own board of directors, without any addition. The director's fees paid by A Ltd. to its directors, amounted to `9,000 per year.
 - The new company expects a large increase in volume of business and therefore, will have to take an additional office for which it will have to pay extra rent of `12,000 per year.
 - As on 31st March, 1998, Land and Building were worth `3,00,000 whereas Plant and Machinery were worth only `1,80,000. There is



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sufficient provision for doubtful debts. There is no fluctuation in the values of investments and stock.

- (d) Liability under workmen compensation fund was only `5,000.
 (iii) The expected rate of return on similar business may be taken at 12%.

You are required to value Goodwill according to above instruction. All your working should form part of your answer. Prepare average capital employed the same as closing employed for your calculation.

(Ex. 25) Given below is the Balance Sheet of Mouse-Hunt Limited as on 31st March, 2015.

Flubber Limited wanted to purchase of Mouse-Hunt Limited. For this purpose the value of assets were revised as follows:

Land to be appreciated by 20%, Furniture to be depreciated by 25%, `50,000 should be written off as bad debts and make provision for doubtful debts at 10%, market value of Sinking Fund Investments was 150% of cost while market value of shares in other companies was 80% of the cost.

Interest in debentures was outstanding for 6 months. There was a claim against company for damages by third party for `50,000 which was not acknowledged as debt and suit is pending the court. Stock should be taken at market price which was 90% of the book value. Plant & Machinery should be appreciated to `5,00,000. Profit for the year was `4,00,000 (before tax).

Liabilities	`	Assets	`
8% Debenture	3,00,000	Land	10,00,000
Creditors	1,50,000	Furniture	5,00,000
O/s Expenses	50,000	Debtors	2,00,000
Provident Fund	20,000	Investment	1,00,000
Employee Profit sharing fund	20,000	Shares in other company	50,000
Sinking fund	50,000	Stock	1,00,000
Reserve fund	50,000	Plant & Machinery	4,00,000

Find the amount of capital to be employed/ Net tangible Assets.

(Ex. 26) Shiva Anand Ltd. submits you the following Balance Sheet as on 31st March, 2015.

Liabilities	`	Assets	`
1,00,000 Eq. Shares of `100 each fully paid	10,00,000	Goodwill	2,33,000
		Building	2,60,000

Accounting for Banking Company

75,000, 12% Pref. Shares of `10		Machinery	19,50,000
each fully paid	7,50,000	Motor Car	26,000
Capital Reserve	1,50,000	Stock in Trade	9,97,500
General Reserve	3,00,000	Book Debts	3,10,000
Profit and Loss A/c		Preliminary Expenses	3,12,500
Last Year's Balance 50,000		Underwriting Commission	4,000
Add: Current Year Profit	9,00,000	Discount Issue of Debenture	4,000
<u>8,50,000</u>			
12.5% Debentures	3,00,000		3,000
Secured Loans (other)	1,50,000		
Sundry Creditors	2,00,000		
Provision for Taxation	3,50,000		
	41,00,000		41,00,000
	0		0

Other Information:

- (a) The market value of the Building is `7,60,000 and that of Machinery is `15,00,000.
- (b) 10% of the Book-Debts are actually bad.
- (c) No Depreciation is charged for the current year on Fixed Assets @ 2.5% on Building and @ 10% on Machinery.
- (d) In similar companies the market value of shares of same denominating is `25 per share and dividend declared is 25%.
- (e) Percentage of Income-Tax is 50% and assumed will remain same in the coming year.

You are asked to calculate the value of Goodwill.

- (i) At five year's purchase of super profit.
- (ii) Under Sliding Scale Method of Valuation by purchasing 20% of the super profit each at 5 years, 4 year, 3 year, 2 year, 1 year respectively.

(Ex. 27) Mr. Efficient has been carrying on business as manufacturer of Luxury Goods. He decided to sell his business to Mr. Excellent of 1st April, 2015. Mr. Excellent agrees to pay Goodwill a sum of equal to four year's purchase of Average super profit of 3 years, in addition to the Book Value of all the Assets and Liabilities of the Business.

Mr. Effacement's Revenue Statement for the past four years are as follows:

	2011-12	2012-13	2013-14	2014-15
Net Sales	5,00,000	6,00,000	7,00,000	8,00,000
	0	0	0	0
Less: Cost of Sales	3,50,000	4,20,000	4,90,000	5,60,000
	0	0	0	0
Gross margin	1,50,000	1,80,000	2,10,000	2,40,000
	0	0	0	0

Accounting for Banking Company

Less: Other Expenses	1,00,00	1,20,00	1,40,00	1,60,00
	0	0	0	0
Net Profit	50,000	60,000	70,000	80,000

It is estimated that after, the charge over, the sales would increase on an average only at ₹50,000 p.a. instead of past growth rate of ₹1,00,000 whereas the cost of sales to sales is estimated to decrease by 10% and the overheads are expected to be at the same rate to sales.

Expected Average Capital employed would be	₹10,00,000 in 15 – 16
	₹12,00,000 in 16 – 17
	₹11,00,000 in 17 – 18

The expected rate of return in this line of business would be 10%.

(Ex. 28) The Balance Sheet of a Partnership was as follows:

Liabilities		Assets	
Capital Accounts:		Goodwill	10,000
A	50,000	Plant	70,000
B	30,000	Furniture	3,000
C	<u>20,000</u>	Stock in Trade	45,000
	1,00,000	Sundry Debtors	28,000
Current Accounts:		Pre-Payments	1,000
A	8,000	Bank Balance	19,000
B	7,000		
C	<u>10,000</u>		
	25,000		
Sundry Creditors	51,000		
	1,76,000		1,76,000

It was proposed to form a company to acquire the business, for purpose of the acquisitions the assets are revalued as follows:

Plant ₹60,000; Furniture ₹4,000; Stock ₹42,000; Debtors ₹25,000; Prepayment Nil it was ascertained that the Profits before charging anything in respect of the partners had, for the past five years, been as follows:

₹25,000; ₹29,000; ₹33,000. Included in these profits were non-recurring items, averaging ₹1,500 but from the nature of the business casual non-recurring items found to be arise every year and the promoters agreed that a figure of ₹1,200 should be allowed as profit from this source.

Accounting for Banking Company

Similar business paid a dividend of 8% p.a. on their ordinary share, and the partner's who could be the directors of the company were worth remuneration: A, adjustment super profits on annuity basis was the agreed price for goodwill, the super profits being taken on the basis of the average of the past five years.

The present value @ 8% of one rupee paid annually for five years may be taken as `3.75

Compute the value of goodwill. Ignore taxation. Assume that partner's withdraws profit from the business.

(Ex. 29) Tom Dick and Harry are partners sharing profits and losses in the ration of 5:3:2. Their Balance Sheet as on 30th September, 2015 was as under.

Liabilities			Assets		
Partner's Capital:			Bank		10,000
Tom	1,00,000		Debtors	1,00,000	
Dick	50,000		Less: R.D.D	<u>5,000</u>	95,000
Harry	<u>35,000</u>	1,85,000	Stock		65,000
Creditors		40,000	Vehicles (w.d.v.)		35,000
			Goodwill		20,000
		2,25,000			2,25,000

They decided to dispose of their business to Jack and Jill sharing profits and losses equally.

All the assets and liabilities are taken over at book values except Goodwill. Tom, Dick and Harry inform you that:

- The average capital invested in the business in the tangible assets other than goodwill has been `1,50,000 over a period of past 5 year.
- The partners had drawn salary amounting to `27,000 p.a. The normal remuneration could be expected to be around `36,000 per annum.
- The net profits as per the revenue statements after debiting the partners salaries actually drawn amounted to:

Years	(`)
2010 – 11	1,00,000
2011 – 12	80,000
2012– 13	90,000
2013 – 14	70,000
2014 – 15	60,000

The maintainable profits should be around 90% of the average profits after necessary adjustment of account of information:

Accounting for Banking Company

(d) The yield in this line of business is 16%. You are asked to evaluate goodwill by:

(a) Purchase of Super-Profits of past 5 years on a selling goodwill by:
1st `20,000 for 5 years; next `20,000 for 4 years.

3rd `20,000 for 3 years; 4th `20,000 for 2 years and balance for 1 year.

(b) Capitalisation of maintainable profits.

(c) Annuity valuations of super profits for a period of 3 years at 8% rate of interest. Rate of Annuity 3.60.

(Ex. 30) Negotiation is going on for transfer of X Ltd. on the basis of the Balance Sheet and additional information as given below:

Liabilities	`	Assets	`
Share Capital (`10 fully paid-up shares)	10,00,000	Goodwill	1,00,000
Reserve and Surplus	4,00,000	Land & Building	3,00,000
Sundry Creditors	3,00,000	Plant & Machinery	8,00,000
		Investments	1,00,000
		Stock	2,00,000
		Debtors	1,50,000
		Cash and Bank	50,000
	17,00,000		17,00,000

Profit before tax for 2014-15 amounted to `6,00,000 including `10,000 as interest on investment. However, an additional amount of `50,000 p.a. shall be required to be spent for smooth running of the business.

Market values of Land and Building & Plant and Machinery are estimated at `9,00,000 and `10,00,000 respectively. In order to match the above figures depreciation to the extent of `40,000 should taken into consideration. Income tax rate may be taken at 50%. Return on capital at the rate of 20% before tax be considered normal for this business at the present stage.

For the purpose of determining the rate of return, profits for this year after the aforesaid adjustments may be taken as expected average profits. Similarly, average trading capital employed is also to be considered on the basis of the position in this year. It has been agreed that four year's purchase of super profits shall be taken as the value of goodwill for the propose of the ideal. You are required to calculate the value of goodwill of the company.

Accounting for Banking Company

(Ex. 31) From the following information supplied to you, ascertain the value of goodwill of Anamika Ltd. Which is carrying business as retail trader under the capitalization of profit method?

Balance Sheet as on March 31, 2015

Liabilities		Assets	
Paid up capital 5,000 equity shares of `100 each fully paid	5,00,000	Goodwill at cost	50,000
Profit and loss appropriation a/c	1,13,300	Land and Building at cost	2,20,000
Bank overdraft	1,16,700	Plant and Machinery cost	2,00,000
provision for taxation	39,000	Stock in trade	3,00,000
Sundry creditors	1,81,000	Book debts	
	9,50,000	Less provision for bad debts	1,80,000
			9,50,000

The company commenced operations in 1985 with a paid up capital of `5,00,000. Profits for recent years (after taxation) have been as follows:

Years	(`)
2011	(loss) 40,000
2012	88,000
2013	1,03,000
2014	11,600
2015	1,30,000

- The loss in 2011 occurred due to prolonged strikes.
- The income tax paid so far has been at the average rate of 40%, but it is likely to be 50% now onwards.
- Dividends were distributed at the rate of 10% at the end of the year ending March 31, 2009.
- The market price of shares is ruling at `125 at the end of the year ending March 31, 2009.
- Profit till 2015 had been ascertained after debiting `40,000 as remuneration to the managing director. The Government has approved a remuneration of `60,000 with effect from April, 1, 2015.
- The company has been able to secure a contract for supply of material at advantageous price. The advantage has been valued at `40,000 p.a. for the next five years.

(Ex. 32) Balance sheet of Shubhangi Co. Ltd. as on 31st March, 2015 is as follows:

Liabilities		Assets		
Share Capital:		Fixed Assets:		

Accounting for Banking Company

Equity share capital	3,00,000	Goodwill		30,000
Preference share capital	2,00,000	Land		2,00,000
Reserve and Surplus:		Building		2,50,000
General Reserve	1,50,000	Furniture		75,000
Capital Reserve	50,000	Current Assets and		
Profit and Loss	1,27,500	Loans and Advances:		
Current Liabilities and Provisions:		Debtors	1,20,000	
Creditors	1,17,500	Less: R.D.D.	20,000	1,00,000
Provisions for	75,000	Stock		1,30,000
Taxation Current Year		Cash		75,000
		Bank		1,10,000
		Bills Receivable		50,000
Total	10,20,000	Total	10,20,000	0
	0			0

The following information is available:

- The reasonable return on invested in the class of business done by the company is 10%.
- 50% provision has been made in accounts for income tax and adequate provision has been made for depreciation.
- In future cost reduction scheme will save ₹25,000 expenditure.

You are required to value the goodwill by:

- Five years purchase of super profit method.
- Capitalization of super profit method.

(Ex. 33) The Balance Sheet of Gorakhnath Alloy Ltd. as on 31st December, 2015 were as follows:

Liabilities	₹	Assets	₹
Equity Share Capital (50,000 @ 10 Each)	5,00,000	land & Building	5,00,000
P & L A/c	2,00,000	Plant & Machinery	2,00,000
Debentures	1,80,000	Furniture & Fixture	1,00,000
Creditors	1,50,000	10% Government	
Provision for Taxation	50,000	Bonds	50,000
Proposed Dividend	1,00,000	Stock	80,000
		Debtors	2,00,000
		Cash	50,000
Total	1,18,000	Total	1,18,000

Accounting for Banking Company

- (a) The net profit of the company after charging depreciation & taxes were as follows:

Years	(₹)
2011	1,00,000
2012	1,25,000
2013	1,50,000
2014	1,75,000
2015	2,00,000

- (b) On 31st December, 2015 Land & Building were revalued at ₹6,00,000, Plant & machinery at ₹1,50,000 & Furniture & Fixture at ₹80,000.
- (c) Normal Rate of return is 10%.
- (d) Find Value of goodwill by 5 years Purchase of Super Profits & Capitalisation of Future Maintainable Profit Method.
- (e) One of the Machinery was Purchased on 1/1/05 for ₹50,000 was Wrongly Machinery @ 10% by WDV Method.
- (f) Use simple Average.
- (g) Government bonds are purchased on 1/1/2003.

(Ex. 34) You are given Balance Sheet of the Expert Ltd. as on 30th September, 2015 and other information to calculate:

- (a) Intrinsic value.
 (b) Capitalised Value of Maintainable Profit.
 (c) Fair value of Equity Share.

Liabilities		Assets	
Share Capital:		Fixed Assets	50,00,000
20,000 Eq. shares of ₹100 each		Investments (10%)	10,00,000
₹90 paid up	18,00,000	Current Assets	9,00,000
10,000, 12% Pref. Share of ₹100 each	10,00,000	Preliminary Expenses	1,00,000
Debenture Redemption Reserve	6,00,000		
Debenture Premium	1,00,000		
General Reserve	6,00,000		
12% Redeemable Debenture	10,00,000		
Depreciation Fund	6,00,000		
Creditors	13,00,000		

Accounting for Banking Company

	70,00,000	70,00,000
	0	0

Other information:

- (a) Fixed Assets included plant, original cost of which was `10,00,000, market value of which was `16,00,000.
- (b) Investments includes, Investments of Debenture Redemption Reserve of `6,00,000.
- (c) Profits of last three years were `5,00,000, 6,00,000 and `7,00,000.
- (d) Last year's dividend on preference share is outstanding.
- (e) Expected rate of return is 10%.
- (f) The annual transfer to Reserve is `1,00,000 after providing for tax @ 50%.
- (g) Goodwill is to be calculated at three years purchase of super profits.

(Ex. 35) X and his wife have all the shares of Green land Industries Pvt. Ltd. which they wish to sell. The summarized Balance Sheet of the company as on 31/12/2015 is as follows:

Particulars	(₹)
Share Capital (`10 per share)	1,00,000
General Reserve	30,000
Workmen's Compensation Fund	10,000
Profit and Loss Account	1,50,000
Bank Overdraft	10,000
Creditors	60,000
Total	3,60,000
Goodwill	20,000
Buildings	1,00,000
Plant and Machinery	80,000
Stock	1,00,000
Debtors	30,000
Cash	20,000
Discount on Debentures	10,000
Total	3,60,000

X further informs you that:

- (a) The building was purchased in 1978 and its current market value is estimated at `2,00,000.

Accounting for Banking Company

- (b) Adequate depreciation has been written off Plant and Machinery which is considered worth.
- (c) Net Profit before the tax but after Directors remuneration for 2013, 2014 and 2015 were `42,000, 45,000 and `50,000.
- (d) Directors remuneration considered reasonable and will be incurred in future also.
- (e) Normal expected return in the industry is 10% of capital employed.
- (f) Goodwill was to be valued at 3 year's purchased of super profit.
- (g) There was a claim against the company for compensation payable to injured worker `10,000.

Assuming that stock has been correctly valued and adequate provision has been made for doubtful debts, you are required to work out valuation of shares.

(Ex. 36) From the Balance Sheet and other information from Hardik Ltd. as on 30th June, 2015 you are required to find out Fair value of an Equity Share.

Balance Sheet as on 30/06/2015

Liabilities	`	Assets	`
1,00,000 Eq. Share of `100 each		Goodwill	10,00,00 0
`75 paid up	75,00,00 0	Building	40,00,00 0
1,00,000 Eq. Share of `100 each		Plant and Machinery	60,00,00 0
`50 paid up	50,00,00 0	Investments	14,00,00 0
50,000, 12% Pref. Share of		Stock	42,00,00 0
`100 each fully paid up		Debtors	58,00,00 0
(re. @ 12% premium)	50,00,00 0	Cash on hand	4,00,000
General Reserve	10,00,00 0	Bank Balance	17,00,00 0
Profit and Loss A/c	5,00,000	Prepaid Insurance	2,00,000
Provident Fund	1,00,000	Preliminary Expenses	3,00,000
Depreciation Fund:			
Building	4,00,000		

Accounting for Banking Company

Plant and Machinery	12,00,000	
Creditors	35,00,000	
Outstanding Expenses	5,00,000	
Bank Overdraft	3,00,000	
Total	2,50,00,000	2,50,00,000

Other Information:

- (a) Building is revalued at `50,00,000.
- (b) Goodwill should be valued at `7,50,000.
- (c) Provision for Bad Debts is calculated at 5% on debtors.
- (d) Employees claim for bonus for `9,00,000 is outstanding.
- (e) Company's profit after tax for last years was `36,00,000.
- (f) Expected rate of return is 10% on investments.
- (g) One year dividend on preference share is outstanding.
- (h) Company transfers `5,00,000 to General reserve every year.

(Ex. 37) Bowling Ltd. and Green Ltd., propose to sell their business to a new company being formed for that purpose. The summarized Balance Sheet as on 31st December, 2015 and profits of the companies for the past three years are as follows:

Liabilities			Assets		
Ordinary Share of `1 each	60,000	25,000	Freehold property at cost	36,000	12,000
Capital Reserve		15,000	Plant and Machinery		
General Reserve	39,000	12,000	at cost less of depreciation	32,000	18,000
Profit and Loss Account	11,000	16,000	Investment at cost		10,000
Creditors	21,580	12,680	Stock-in-trade	11,100	8,950
			Debtors	8,800	6,400
			Balance at Bank	43,680	25,330
	1,31,580	80,680		1,31,580	80,680

	Bowling Ltd.	Green Ltd.
Net Profits for the year ended:		
31st December, 2013	17,450	10,760
31st December, 2014	19,340	12,290
31st December, 2015	21,470	14,450

You are also given the following relevant information:

Accounting for Banking Company

(a) It is agreed:

(i) That the Properties and Plant and Machinery to be revalued as follows:

	Bowling Ltd.	Green Ltd.
Freehold Property	44,800	14,400
Plant and Machinery	30,570	17,095

(ii) That the value of stocks is reduced by 10% and a provision of 12.5% be made on debtors for bad and doubtful debts.

(iii) That goodwill be valued at two year's purchase of the average annual trading profits of the past three year's, after deducting a standard profit of 10% on the net trading assets. Before revaluation of adjustment, on 31st December, 1997.

(iv) Profits of Green Ltd. includes `600 income from the investment in each of the three years. The market value of the investment as on 31st December, 1997 was `10,000.

You are required to prepare a statement how you would arrive at the value per share to the nearest of the ordinary share in:

(i) Bowling Ltd.

(ii) Green Ltd.

(Ex. 38) Mohan Ltd., manufactures machines, all of the same type. The summarized accounts for the year 2015 areas follows:

Trading, Profit and Loss Account

Liabilities		Assets	
To Materials	48,000	By Sales	80,000
To Labour	8,000	(20 Machines)	
To Fixed Overhead	11,600		
To Office Salaries	2,000		
To Director's Remun.	4,000		
To Net Profit	6,400		
Total	80,000	Total	80,000

Balance Sheet as at 31st December, 1997

Liabilities		Assets	
Share Capital		Fixed Assets:	
1,000 Shares of `1 each	1,000	Plant and Machinery	2,500
Profit and Loss A/c. for		Vechiles	1,500
the year	6,400	Current Assets:	
Less: Loss B/r	<u>4,900</u>	Stock	11,000
Creditors	17,000	Debtors	7,000

Accounting for Banking Company

Directors Loan	5,000	Bank Balance	2,500
Total	24,500	Total	24,500

Shankar Ltd. is offered all the issued shares of Mohan Ltd. at their net assets value on 31st December, 2015 subject to the addition of goodwill valued at four times the projected earnings before taxation for 2016 earning to ascertain that:

- (a) Based on firm order, 25 machines should be sold in 2016 at the 2015 prices.
- (b) The percentage costs of production based on sales should remain steady apart from an anticipated increase in the labour rate of 12.5%.
- (c) Fixed overheads will increase by `1,700 and office salaries by 10% and required to calculate value of:
 - (i) Goodwill
 - (ii) The Price at which the shares offered by Mohan Ltd.

(Ex. 39) The following is the Balance Sheet of G Ltd. on 31st March, 2015.

Liabilities		Assets	
10,000, 10% Cum. Pref. Shares of `100 each	10,00,000	Goodwill	7,00,000
2,00,000 Eq. share of 10 each	20,00,000	Land & Building (at cost)	9,00,000
Profit and Loss A/c	10,00,000	Machinery	25,00,000
Bank Overdraft	20,00,000	Investment (at cost)	2,00,000
Creditors	3,00,000	(market value `5,00,000)	
		Stock	10,00,000
		Debtors	7,00,000
		Bank Balances	3,00,000
Total	63,00,000	Total	63,00,000

- (a) Net Profits (after writing off goodwill each year by `1,00,000) were as follows: 2012-13 `2,80,000, 2013-14 `6,50,000, 2014-15 `11,00,000.
- (b) Preference Dividend had been paid every year and on equity shares it was paid at 10% 2013-14 only. Equity capital has not increased since the last five years. Dividend has been deducted in arriving at the profits figures mentioned above.
- (c) Land and Building is valued at `10,00,000 and Machinery at `50,00,000. Annual depreciation on these assets will increase by `4,30,000 in future years.
- (d) Worthless stocks carried forwards since 2009-10 are of the value of `9,00,000. These stocks have a realisable value of only `1,00,000. Find out the value of each equity share in the following cases:

Accounting for Banking Company

- (i) On Net Assets basis also capitalize value of maintainable profits assuming that 10% of maintainable profit is transferred to Reserve.
- (ii) Confine on data given only.
- (iii) Capitalisation rate being 8 1/3%.

(Ex. 40) The following is the Balance Sheet of Alpha Ltd. as at 31st December, 2015.

Liabilities	`	Assets	`
Share Capital:		Fixed Assets:	
Equity Shares of		Land and Building	4,00,000
`100 each 10,00,000		Machinery	4,50,000
Less: calls in arrears	9,00,000	Motor Car	25,000
<u>1,00,000</u>		Furniture	25,000
Reserve & Surplus:		Investment (face value)	50,000
General Reserve	3,50,000	Current Assets:	
Profit and Loss Account	2,50,000	Stock	7,25,000
Sundry Creditors	5,00,000	Sundry Debtors	2,00,000
		Cash and Bank	1,05,000
		Miscellaneous Expenses:	
		Preliminary Expenses	20,000
	20,00,000		20,00,000
	0		0

Additional information is as under:

- (a) Fixed Assets are worth:
 Building `6,00,000

 Machinery `5,20,000
- (b) All investments are non-trading investments and are to be value at 20% cost. Dividend at uniform rate of 20% is earned on all investment.
- (c) For the purpose of valuation of shares, goodwill to be valued on the basis of 3 years purchase of super profit based on average profit (after tax) of last 3 years.
- (d) Depreciation on appreciated value of Land and Building and Machinery is not to be considered for valuation of goodwill.
- (e) Profits (after tax) are as follows:

Years	(₹)
2013	3,80,000
2014	4,20,000
2015	5,00,000
Rate of Income Tax	50%

In similar business, return on capital employed is 20% (after tax).

Accounting for Banking Company

- (f) In 2013, Machinery (Book value of ₹20,000) was sold for ₹20,000 but the proceeds were wrongly credited to Profit and Loss Account. The mistake has not yet been rectified.

Depreciation charged on machinery @ 10% p.a. on reducing balance method.

Find out the value of each fully paid and partly paid equity shares on net assets basis.

Note: Trends in profits value is to be ignored for the purpose of calculation of average profit.

(Ex. 41) Following is the balance sheet of Super Prospects Co. Ltd. as on 31st December, 2015

Liabilities	`	Assets	`
Share capital		Land and Building (at cost)	30,000
3,000 5% preference share of `10 each fully paid	30,000	Plant and machinery (at cost less depreciation)	50,000
9,000 Equity share of `10 each fully paid	90,000	Furniture and fixtures (at cost less depreciation)	10,000
Reserve	30,000	6% Government securities (normal value)	12,000
Profit and Loss A/c	12,000	`10,000) (market value `14,000)	
6% debenture	20,000	Debtors (all good)	39,000
Creditors	15,000	Stock	46,000
		Cash in hand	5,000
		Preliminary expenditure	5,000
Total	1,97,000	Total	1,97,000
	0		0

Find out the fair value of equity shares after considering the following information as,

(i) intrinsic value method (ii) on basis of yield.

- (a) Average annual profit (before taxation) ₹51,200.
 (b) Rate of income tax is 50%.
 (c) ₹5,000 is transferred to general reserve every year.
 (d) Normal return is 9% on capital employed.
 (e) Goodwill is to be valued at 4 year purchase of super profits.
 (f) Dividend declared by companies doing similar business is 10%.
 (g) All assets are worth book value subject to following change.
 (i) The land and building is valued ₹35,000.
 (ii) Investment as given in the balance sheet.

(Ex. 42) WIMCOM LIMITED furnishes the following information and request you to find out.

- (a) Value of Goodwill on the basis of Capitalization on future maintainable profits method.

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(b) Value of shares.

Balance Sheet as on 31st March, 2015

Liabilities		Assets	
Share capital		Goodwill	2,50,000
10,000 shares of `100 each	10,00,000	Property	2,88,000
General Reserve	3,00,000	Equipments	4,00,000
Profit and Loss account	3,00,000	Investments	2,00,000
Workmen fund for compensation	1,40,000	Receivables	6,60,000
Loans	2,00,000	Inventory	4,00,000
Current liabilities	4,60,000	Cash and banks	1,50,000
		Capital issues expenses	52,000
Total	24,00,000	Total	24,00,000

Further information:

- (a) The investments are earmarked to provide funds for replacement equipment as and when required.
- (b) The provision already deducted from assets are:
 Depreciation on property ` 72,000
 Depreciation on Equipments ` 80,000
 Bad & Doubtful debts ` 60,000
- (c) The property is worth `6,00,000 and Equipments are worth `3,60,000 other assets are valued property.
- (d) The liability for workman compensation is expected at `1,00,000.
- (e) The expected rate of return is 12%.
- (f) The profits of past three years (before tax @ 50%) have been:
 Year ended on 31/3/2013 `5,60,000
 On 31/3/2014 `5,46,000
 On 31/3/2015 `6,20,000
- (g) The changes expected from ensuring year are:
 (i) Increase rent for new office @ `18,000 p.a.
 (ii) Increase in directors fees @ 24,000 p.a.
 (iii) Reduction in publicity expenses @ 36,000 p.a.



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(h) For the purpose of valuation year end capital employed should be considered.



Chapter 5

Accounting for Limited Liability Partnership

Limited Liability Partnership (LLP) is a new corporate structure that combines **the flexibility of a partnership** and the **advantages of limited liability of a company at a low compliance cost**. In other words, it is an alternative corporate business vehicle that provides the benefits of limited liability of a company, but allows its members the flexibility of organising their internal management on the basis of a mutually arrived agreement, as is the case in a partnership firm.

Owing to flexibility in its structure and operation, it would be useful for small and medium enterprises, in general, and for the enterprises in services sector, in particular. Internationally, LLPs are the preferred vehicle of business, particularly for service industry or for activities involving professionals.

A Limited Liability Partnership (LLP) is a partnership in which some or all partners (depending on the jurisdiction) have limited liability. It therefore exhibits elements of partnerships and corporations. In an LLP one partner is not responsible or liable for another partner's misconduct or negligence. This is an important difference from that of a limited partnership. In an LLP, some partners have a form of limited liability similar to that of the shareholders of a corporation. In some countries, an LLP must also have at least one "general partner" with unlimited

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liability. Unlike corporate shareholders, the partners have the right to manage the business directly. As opposed to that, corporate shareholders have to elect a board of directors under the laws of various state charters. The board organizes itself (also under the laws of the various state charters) and hires corporate officers who then have as "corporate" individuals the legal responsibility to manage the corporation in the corporation's best interest. An LLP also contains a different level of tax liability from that of a corporation.

Limited liability partnerships are distinct from limited partnerships in some countries, which may allow all LLP partners to have limited liability, while a limited partnership may require at least one unlimited partner and allow others to assume the role of a passive and limited liability investor. As a result, in these countries the LLP is more suited for businesses where all investors wish to take an active role in management.

Limited liability partnership (LLP) is an alternative corporate business entity that provides the advantage of limited liability of a company. At the same time this structure allows its members the flexibility of organizing their internal management on the basis of a mutual agreement like any partnership firm. Liabilities of its partners are restricted to the extent of their individual contributions to the LLP. They would not be held responsible for loss caused on account of fraud of other partners, of which they had no knowledge. This is different from a general partnership in which each partner is liable jointly as well as severally for the debts and obligations of the business. Section 25 of the Partnership Act, 1932 states: "Every partner is liable, jointly with all the other partners and also severally, for all acts of the firm done while he is a partner." The LLP format would be propitious for small and medium enterprises (SME). Professional involved in the knowledge based enterprises would be able take the advantages of both the Company as well as flexibility of the Partnership.

In India several expert groups have examined the need for a concept like LLP. These include the Abid Hussain Committee 1997, the Naresh Chandra Committee on Private Companies and Partnerships 2003 and the Irani Committee for new Company Law, 2005. The Naresh Chandra

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Committee particularly analyzed the concept in detail under following parameters:

- Application of the LLP Regime;
- Incorporation, Registration and Number of Partners;
- Limited Liability;
- Financial Safeguards; and

Tax Treatment of LLPs. Justifying the need to introduce LLP the Committee opines: “The Committee feels that with Indian professionals increasingly transacting with or representing multi-nationals in international transactions, the extent of the liability they could potentially be exposed to is extremely high. Hence, in order to encourage Indian professionals to participate in the international business community without apprehension of being subject to excessive liability, the need for having a legal structure like the LLP is self-evident. Provisions which restrict the number of partners to twenty prevent the growth of professional firms to the large entities operating on an international scale. Such inhibiting conditions have to be removed. Otherwise, Indian professionals may well get excluded from taking their rightful place in the international community, that their skills otherwise entitle them to. The Committee believes that, to encourage greater professionalism and create commercially efficient, vehicles for providing service of the highest quality, it is essential to create a regulatory regime that would govern the formation of such a hybrid entity between the partnership simpliciter, or general partnership, and a private limited company, that is, an LLP. Such an entity would provide the flexibility of a partnership (allowing the owners to adopt whatever form of internal organization they prefer), and limiting at the same time, the owner’s liability with respect to the LLP. Given the wide acceptability of the limited liability company, a partnership of recognised professionals should be given the choice to opt for a more suitable legal entity, and conferred the privilege of limited liability, especially if sufficient safeguards are put in place.”

An earlier version of the LLP Bill was introduced in the Rajya Sabha around 2 years ago on 15th December, 2006 and was referred to the Parliamentary Standing Committee on Finance. The Standing Committee

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submitted its report on 27th November, 2007. Finally the Limited liability partnership Act was passed in 2008 with effect from 1 April, 2009.

In order to appreciate the concept of LLP it is important to understand the broad differences between the Limited liability partnership and Company (under Company Act 1956); and Limited liability partnership and the Partnership under the Partnership Act, 1932. The foremost difference between an LLP and a company lies in that the internal governance structure of a company is regulated by statute (i.e. Companies Act, 1956) whereas for a Limited liability partnership it would be by a contractual agreement between partners. The dichotomy of management-ownership as prevalent in a company is palpably absent in a limited liability partnership. LLP will have lesser compliance requirements and will have more flexibility as compared to a company.

Talking about the differences between the general Partnership and the Limited Liability Partnership, it was abundantly clear the features of the traditional partnership as governed by the Indian Partnership Act, 1932 have increasingly become redundant. The main problems with this anachronistic Act are that

- It does not recognize the distinction between a partnership and its members (i.e. the partners);
- It imposes unlimited liability on each partner for acts committed by any other partner and by the partnership as a whole.
- It restricts the maximum number of partners in a partnership to 20;

In case of general Partnership as per the Indian Partnership Act, 1932, each of the partners is jointly and severally liable for any liability arising out of or in respect of the partnership. The LLP is a separate legal entity with unlimited capacity where no member or partner is liable on account of the independent or unauthorized actions of one's partner, and whose liability is limited to the respective stake of each in the LLP. The members of an LLP would have the option to have a general partner or more with unlimited liability, but it would not shield the partners from legal liability arising out of their own personal acts which are not done for and on behalf of the LLP, that is, any act done beyond the acts and powers of the partners as laid down in the incorporation document. Also the main

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benefit in an LLP is that it is taxed as a partnership, but has the benefits of being a corporate, or more significantly, a juristic entity with limited liability.

There is considerable confusion between LLPs as constituted in the U.S. and that introduced in the UK in 2001 and adopted elsewhere - see below - since the UK LLP is, despite the name, specifically legislated as a Corporate body rather than a Partnership. In India 'The Limited Liability Partnership Act' 2008 was published in the official Gazette of India on January 9, 2009 and has been notified with effect from 31 March 2009. However, the Act, has been notified with limited sections only. The rules have been notified in the official gazette on April 1, 2009. The first LLP was incorporated in the first week of April 2009. In India for all purposes of taxation, an LLP is treated like any other partnership firm.

The salient features of the LLP Act, 2008 are as under:

- The LLP will be an alternative corporate business vehicle that would give the benefits of limited liability but would allow its members the flexibility of organising their internal structure as a partnership based on an agreement.
- The bill is for the benefit of any enterprise which fulfills the requirements of the Act. There can also be a foreign LLP.
- Every person having the capacity to contract according to the law of the land can be a member of LLP. The capacity may be natural or legal. No minor or a simple partnership firm or any entity which is not a body corporate can be a partner in a LLP.
- While the LLP being a separate legal entity is liable to the full extent of its assets, its partners will be liable only to the extent of their agreed contribution in the LLP. Further no partner will be liable for the independent or unauthorized actions of other partners thereby shielding the partners from the joint liability created by the other partners' wrongful business decisions or misconduct.
- LLP shall be a corporate body and a legal entity separate from its partners. It has a perpetual succession. Indian Partnership Act shall not be applicable to LLP and the minimum number of partners of a LLP is two and there is no upper limit to the number of partners.
- An LLP will be under obligation to maintain annual accounts reflecting true and fair view of its state of affairs.

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- LLP can also take actions like mergers amalgamations. Similarly there are provisions for winding up and dissolution.
- Every LLP should have two "Designated partners" at least one of whom should be a resident Indian satisfying the conditions stipulated by the Central Government. They should apply and obtain designated partner identification number (DPIN) and digital signature certificate from the designated authority.
- An intending unlimited liability partnership firm seeking to convert itself into a LLP is required to apply to the Registrar as per form 17 which should be accompanied by written consent from all creditors.
- When once the Registrar accepts and registers the firm it comes into force and all the assets and liabilities would be transferred to the new LLP.
- The Central government by a notification in the Gazette can apply any provisions of the Companies act to LLP either fully or with certain modifications. Perhaps these would cover the time frame within which charges are required to be registered, the forms for this, the inter se priority of charges etc.

How to Incorporate a New Limited Liability Partnership:

A Limited Liability Partnership may be incorporated as per the procedure explained below:

User Registration:

- Register yourself on the website of Ministry of Corporate Affairs, developed for LLP services, i.e. www.llp.gov.in. This website may also be accessed through the website of the ministry www.mca.gov.in On the home page of the URL www.llp.gov.in click "Register" tab on top right hand corner of the page.
- Fill in the registration form. Fields marked * in the form are to be mandatory filled. Select your user name and password.
- Upload digital signature certificate
- On successful registration, system will give a message that you have been registered successfully.

Obtain Designated Partners Identification Number (DPIN):

- All designated partners of the proposed LLP shall obtain "Designated Partner Identification Number (DPIN)" by filing an application individually online in Form -7.

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- For obtaining DPIN kindly log in by clicking on the “Login” tab on top right corner of the home page, enter your user name and password. After login, click on the E-forms link. List of e-forms will open. Click and open Form 7.
- Fill up “Form 7” for allotment of DPIN
- Pay filing fee of `100 online through credit card (master/visa)
- Submit the application form online. The system will generate a provisional DPIN. Kindly note it carefully.
- Take the print out of the application form, affix a latest passport size photograph and get it attested/certified for submission physically along with documentary evidences for proof of identify and proof of residence with the Registrar LLP.
- Deliver the printed and signed application form, along with the prescribed documents by hand/courier/registered post to the Office of Registrar, Ministry of Corporate Affairs, 3rd Floor, “Paryavaran Bhawan”, CGO Complex, Lodhi Road, New Delhi-110003.
- For more details see Instruction Kit provided on the home page under “Users Guide” tab.

Digital Signature Certificate:

- Partner/Designated partner of LLP/proposed LLP, whose signatures are to be affixed on the e-forms has to obtain class 2 or class 3 Digital Signature Certificate (DSC) from any authorized certifying agency, details of which are available on the home page of the LLP portal under the tab “Certifying Authorities”.

Reservation of Name:

- Log on to the LLP portal by clicking the “log in” tab on the top right corner of the homepage and enter your username and password. After login, click “E-Forms” link.
- Open Form-1 for reservation of name and fill in the details. Select name of the proposed LLP (upto 6 choices can be indicated).
- Any partner or designated partner in the proposed LLP may submit Form-1.
- Append digital signatures and submit the e-form.
- Pay the necessary fee by credit card (master/visa).
- Free name search facility (of existing companies / LLPs) is available on MCA portal (hyper link available on LLP portal).The system will

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provide the list of similar/closely resembling names of existing companies/LLPs based on the search criteria filled up.

- Details of minimum two designated partners of the proposed LLP, one of them must be a resident of India, is required to be filled in the application for reservation of name. Only individuals or nominees on behalf of the bodies corporate as partners can act as designated partners.
- Check status of your application by logging on the portal.
- For more details see Instruction Kit provided on the home page under “Users Guide” tab.

Incorporation of LLP:

- Once the name is reserved by the Registrar, log on to the portal and fill up Form-2 “Incorporation Document and Statement”.
- Pay the prescribed registration fee as per the slab given in Annexure A of the LLP Rules, 2009, based on the total monetary value of contribution of partners in the proposed LLP.
- Statement in the e-form is to be digitally signed by a person named in the incorporation document as a designated partner having permanent DPIN and also to be digitally signed by an advocate/company secretary/chartered accountant/cost accountant in practice and engaged in the formation of LLP.
- On submission of complete documents the Registrar after satisfying himself about compliance with relevant provisions of the LLP Act will register the LLP, maximum within 14 days of filing of Form-2 and will issue a certificate of incorporation in Form-16.
- You can check status of your application by logging on to the portal
- For more details see Instruction Kit provided on the home page under “Instruction Kit” tab.

Filing of LLP agreement (Form-3) and Partners’ details (Form-4):

- Form 3 (Information with regard to LLP agreement and changes, if any made therein) and Form-4 (Notice of Appointment of Partner/Designate Partner, his consent etc.) may be filed with the prescribed fee simultaneously at the time of filing Form-2 or within 30 days of the date of incorporation or within 30 days of such subsequent changes.

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- For more details see Instruction Kit provided on the home page under “Instruction Kit” tab.

Need for the New Corporate Form – LLP:

- (1)** With the growth of the Indian economy, the role played by its entrepreneurs as well as its technical and professional manpower has been acknowledged internationally. It is felt opportune that entrepreneurship, knowledge and risk capital combine to provide a further impetus to India’s economic growth. In this background, a need has been felt for a new corporate form that would provide an alternative to the traditional partnership, with unlimited personal liability on the one hand, and, the statute-based governance structure of the limited liability company on the other, in order to enable professional expertise and entrepreneurial initiative to combine, organize and operate in flexible, innovative and efficient manner.
- (2)** The Limited Liability Partnership (LLP) is viewed as an alternative corporate business vehicle that provides the benefits of limited liability but allows its members the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement. The LLP form would enable entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements. Owing to flexibility in its structure and operation, the LLP would also be a suitable vehicle for small enterprises and for investment by venture capital.
- (3)** Keeping in mind the need of the day, the Parliament enacted the Limited Liability Partnership Act, 2008 which received the assent of the President on 7th January, 2009.

The salient features of the LLP Act 2008 inter alia are as follows: - The LLP shall be a body corporate and a legal entity separate from its partners. Any two or more persons, associated for carrying on a lawful business with a view to profit, may by subscribing their names to an incorporation document and filing the same with the Registrar, form a Limited Liability Partnership. The LLP will have perpetual succession; The mutual rights and duties of partners of an LLP *inter se* and those of the LLP and its partners shall be governed by an agreement between partners

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or between the LLP and the partners subject to the provisions of the LLP Act 2008.

The act provides flexibility to devise the agreement as per their choice. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of proposed the LLP Act; The LLP will be a separate legal entity, liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP which may be of tangible or intangible nature or both tangible and intangible in nature. No partner would be liable on account of the independent or un-authorized actions of other partners or their misconduct. The liabilities of the LLP and partners who are found to have acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP; Every LLP shall have at least two partners and shall also have at least two individuals as Designated Partners, of whom at least one shall be resident in India. The duties and obligations of Designated Partners shall be as provided in the law; The LLP shall be under an obligation to maintain annual accounts reflecting true and fair view of its state of affairs. A statement of accounts and solvency shall be filed by every LLP with the Registrar every year. The accounts of LLPs shall also be audited, subject to any class of LLPs being exempted from this requirement by the Central Government; The Central Government have powers to investigate the affairs of an LLP, if required, by appointment of competent Inspector for the purpose; The compromise or arrangement including merger and amalgamation of LLPs shall be in accordance with the provisions of the LLP Act 2008; A firm, private company or an unlisted public company is allowed to be converted into LLP in accordance with the provisions of the Act. Upon such conversion, on and from the date of certificate of registration issued by the Registrar in this regard, the effects of the conversion shall be such as are specified in the LLP Act. On and from the date of registration specified in the certificate of registration, all tangible (moveable or immoveable) and intangible property vested in the firm or the company, all assets, interests, rights, privileges, liabilities, obligations relating to the firm or the company, and the whole of the undertaking of the firm or the

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company, shall be transferred to and shall vest in the LLP without further assurance, act or deed and the firm or the company, shall be deemed to be dissolved and removed from the records of the Registrar of Firms or Registrar of Companies, as the case may be; The winding up of the LLP may be either voluntary or by the Tribunal to be established under the Companies Act, 1956. Till the Tribunal is established, the power in this regard has been given to the High Court; The LLP Act 2008 confers powers on the Central Government to apply provisions of the Companies Act, 1956 as appropriate, by notification with such changes or modifications as deemed necessary. However, such notifications shall be laid in draft before each House of Parliament for a total period of 30 days and shall be subject to any modification as may be approved by both Houses; The Indian Partnership Act, 1932 shall not be applicable to LLPs.

Advantages:

- Check-the-box taxation. An LLP can elect to be taxed as a sole proprietor, partnership, S corporation or C corporation (as long as they would otherwise qualify for such tax treatment), providing for a great deal of flexibility.
- Limited liability, meaning that the owners of the LLP, called "members," are protected from some or all liability for acts and debts of the LLP depending on state shield laws.
- Much less administrative paperwork and record keeping than a corporation.
- Pass-through taxation (i.e., no double taxation), unless the LLP elects to be taxed as a C corporation.
- Using default tax classification, profits are taxed personally at the member level, not at the LLP level.
- LLPs in most states are treated as entities separate from their members, whereas in other jurisdictions case law has developed deciding LLPs are not considered to have separate legal standing from their members.
- LLPs in some states can be set up with just one natural person involved.
- Membership interests of LLPs can be assigned, and the economic benefits of those interests can be separated and assigned, providing the assignee with the economic benefits of distributions of

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profits/losses (like a partnership), without transferring the title to the membership interest (see, for example, the Virginia and Delaware LLP Acts).

- Unless the LLP has chosen to be taxed as a corporation, income of the LLP generally retains its character, for instance as capital gains or as foreign sourced income, in the hands of the members.
- Less risky to be "stolen" by fire-sale acquisitions. (More protection against hungry investors).
- Employees operate as a team (more cooperation, trust, optimism, motivation).
- Owns its own Intellectual Property.

Disadvantages:

- Although there is no statutory requirement for an operating agreement in most states, members of a multiple member LLP who operate without one may run into problems. Unlike state laws regarding stock corporations, which are very well developed and provide for a variety of governance and protective provisions for the corporation and its shareholders, most states do not dictate the governance and protective provisions for the members of a limited liability company. Thus, in the absence of such statutory provisions, the members of an LLP can only establish governance and protective provisions pursuant to contract, in the form of an operating agreement.]
- It may be more difficult to raise financial capital for an LLP as investors may be more comfortable investing funds in the better-understood corporate form with a view toward an eventual IPO. One possible solution may be to form a new corporation and merge into it, dissolving the LLP and converting into a corporation.
- Many states, including Alabama, California, Kentucky, New York, Pennsylvania, Tennessee, and Texas, levy a franchise tax or capital values tax on LLPs. (Beginning in 2007, Texas has replaced its franchise tax with a "margin tax".) In essence, this franchise or business privilege tax is the "fee" the LLP pays the state for the benefit of limited liability. The franchise tax can be an amount based on revenue, an amount based on profits, or an amount based on the number of owners or the amount of capital employed in the state, or some combination of those factors, or simply a flat fee, as in

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Delaware. Effective in Texas for 2007 the franchise tax is replaced with the Texas Business Margin Tax. This is paid as: tax payable = revenues minus some expenses with an apportionment factor. In most states, however, the fee is nominal and only a handful charge a tax comparable to the tax imposed on corporations.

- The District of Columbia considers LLPs to be taxable entities, thus eliminating the benefit of flow-through taxes by subjecting members to double taxation.^[5]
- Renewal fees may also be higher. Maryland, for example, charges a stock or non stock corporation `120 for the initial charter, and `100 for an LLP. The fee for filing the annual report the following year is `300 for stock corporations and LLP, and zero for non-stock corporations. In addition, certain states, such as New York, impose a publication requirement upon formation of the LLP which requires that the members of the LLP publish a notice in newspapers in the geographic region that the LLP will be located that it is being formed. For LLP's located in major metropolitan areas (i.e. New York City), the cost of publication can be significant.
- Some creditors will require members of up-and-starting LLPs to personally guarantee the LLP's loans, thus making the members personally liable for the debt of the LLP.
- The management structure of an LLP may be unfamiliar to many. Unlike corporations, they are not required to have a board of directors or officers.
- Taxing jurisdictions outside the US are likely to treat a US LLP as a corporation, regardless of its treatment for US tax purposes, for example if a US LLP does business outside the US or a resident of a foreign jurisdiction is a member of a US LLP.
- The principals of LLPs use many different titles – e.g., member, manager, managing member, managing director, chief executive officer, president, and partner. As such, it can be difficult to determine who actually has the authority to enter into a contract on the LLP's behalf.

Variations:

- A Professional Limited Liability Company (PLLP, P.L.L.C., or P.L.) is a limited liability company organized for the purpose of providing professional services. Usually, professions where the state requires a

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license to provide services, such as a doctor, chiropractor, lawyer, accountant, architect, or engineer, require the formation of a PLLP. However, some states, such as California, do not permit LLPs to engage in the practice of a licensed profession. Exact requirements of PLLPs vary from state to state. Typically, a PLLP's members must all be professionals practicing the same profession. In addition, the limitation of personal liability of members does not extend to professional malpractice claims.

- A Series LLP is a special form of a Limited liability company that allows a single LLP to segregate its assets into separate series. For example, a series LLP that purchases separate pieces of real estate may put each in a separate series so if the lender forecloses on one piece of property, the others are not affected.

PARTNERSHIP AGREEMENT:

If the agreement is not executed by the partners the relationship between the partners will be governed by the First Schedule to the LLP Ad Even if there is a written agreement, but there is no specific mention about anything, such matters will be governed by first schedule to the LLP Act.

LIMITED LIABILITY:

A partner of LLP is not personally liable, directly or indirectly for any debt or obligations of LLP. However, a partner will be personally liable for, any liability arising from his own wrongful act or omission. The liability of each partner will be limited to the extent of the amount specified in the partnership agreement.

DESIGNATED PARTNERS:

At least two partners (individually) have to be appointed as Designated partners. At least one of the designated partners is a resident of India. Appointment of such partners is governed as per the provisions of the agreement. In case any vacancy arising TIP has to appoint another partner as a designated partner within 30 days. The details of designated partners are to be filed with the ROC in Form No. 4. In case the LLP does not appoint at least two designated partners all their number falls below 2, all the partners shall be considered as designated partners. The

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designated partner has to give his consent in Form. No. 9 This consent is to be filed with the ROC in Form No. 4 within 30 days of his appointment.

OBLIGATIONS OF DESIGNATED PARTNERS:

- (1) They are responsible for compliance of the provisions of LLP Act and Rules including filing of any document, return, statement as required by the Act.
- (2) They are liable for all the penalties imposed on LLP for any violations of the Act.
- (3) Every Designated partner has to sign the Annual financial statements and annual solvency statement.
- (4) Every Designated partner will have to obtain a “Designated partner Identification Number.

ACCOUNTS AND AUDIT:

Following are the provisions about Accounts & Audit:

- (1) Rule 24 of LLP rules prescribe the books of accounts to be maintained by LLP.
- (2) The books are to be retained for eight years.
- (3) The books may be maintained either on cash basis or accrual basis of accounting.
- (4) The accounting year for each LLP shall be financial year ending 31st March.
- (5) The LLP has to prepare a statement of Account and a solvency statement on or before 30th September each year.
- (6) The statements are to be signed by the Designated partners of LLP.
- (7) The Accounts of LLP are to be audited by a Chartered Accountant in accordance with Rule 24 of LLP Rules.
- (8) Audit is compulsory if the turnover exceeds `40,000,000 or contribution of partners exceeds `25,00,000.
- (9) There is no form of Audit Report.
- (10) The Particulars of statement of Accounts & Solvency Statements have to be filed with ROC in Form No. 8 on or before 30th October each year.
- (11) Annual Return has to be filed with ROC on or before 30th May each year in Form No. 2 with prescribed fees.

CONVERSION OF FIRM INTO LLP:

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As per section 55 of the LLP Act an existing partnership may lii' converted into LLP as per the procedure laid down in second schedule. The procedure includes the following steps:

- (1) The firm may apply to convert into a LLP.
- (2) The firm has to comply with the provisions of second schedule to the Act.
- (3) The firm has to follow the procedure for getting the name of LLP approved and procedure of incorporation.
- (4) The firm has to apply for conversion into LLP to ROC in Form No. 17 with prescribed fees. The documents listed in the form are to be submitted.
- (5) The ROC issues a certificate of conversion into LLP in Form No. 19.
- (6) The LLP will have to inform the Registrar of firm about conversion of firm into LLP in Form No. 19.
- (7) The Registrar of firms then removes the name of the firm from the record.

Accounting Procedure for Conversion into LLP:

Calculation of Purchase Consideration:

There are basically four methods of calculating purchase consideration.

(a) Net Asset Method:

Under this method, the consideration is ascertained by adding the agreed values of all the assets taken over by the transferee and deducting there from the agreed values of all the liabilities taken over by the transferee. In the absence of the agreed values, the book values of the assets and liabilities will be taken for the purpose of calculation of purchase consideration. Fictitious assets such as preliminary expenses, debit balance of profit and loss account etc. are not taken over.

Illustration 1:

Given below Balance Sheet of X. as on 31st March, 2010 on which date the assets and liabilities are taken over by Y.

Balance Sheet of X		('000)	
Liabilities	(₹)	Assets	(₹)
Share Capital	25,00	Plant & Machinery	15,00
General Reserve	5,00	Furniture	5,00
12% Debentures	10,00	Stock	15,00

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Sundry Creditors	5,00	Debtors	5,00
		Cash	3,00
		Preliminary Expenses	2,00
	45,00		45,00

Y agreed to take over the assets and liabilities of X at current values:

Plant and Machinery	20% depreciation
Furniture	10% depreciation
Stock	+20% revaluation
Debtors	10% discount

Calculate Purchase Consideration.

Solution:

Value of Assets taken over by Y

	(₹)	(₹)
Plant & Machinery	12,00	42,00
Furniture	4,50	
Stock	18,00	
Debtors	4,50	
Cash	3,00	
Liabilities Taken over		
12% Debentures	10,00	15,00
Sundry Creditors	5,00	
Purchase Consideration		27,00

(b) Net Payment Method:

Under this method the purchase consideration is arrived at by adding up the cash paid and the agreed values of the liabilities paid by the transferee to transferor.

Illustration 2:

A agrees to pay `1,00,000 in cash and allot to B 2,000 12% Debentures of `100 each fully paid at par and 50,000 equity shares of `10 each fully paid at an agreed value of `20 per share, for the business taken over from B. The consideration will be ascertained as follows:

Form	(₹)
Cash	1,00,000
12% Debentures	2,00,000
Equity Shares	10,00,000
Purchase Consideration	13,00,000

Given in the problem:

- Balance Sheet of Vendor.

Accounting for Banking Company

- Adjustment.

Required to prepare:

- Calculation of Purchase consideration & discharge of purchase consideration.
- Pass the Journal entry & prepare a/c to close the books of Vendor.
- Opening entry & opening balance in the books of Purchaser.

Steps for solving the sum:

- Calculation for purchase consideration & discharge of Purchase Consideration.
- Purchase Consideration (PC) means net worth of the business that is asset & liability payable by purchasing company to Vendor there are two methods of calculation Purchase Consideration.

Special Points:

- Record only those assets & liability, which are taken over by purchaser at Agreed Value.
- If nothing is specified in the problem than assume all Assets & Liability are taken over.

- **Close the books of Vendor Co.:**

Following a/c will be prepared to close the books of Vendor Co.

- ◆ Realization a/c
- ◆ LLP Co. a/c
- ◆ Capital a/c
- ◆ Cash & Bank a/c
- ◆ Other a/c if required

- **Transfer of balance sheet item to their respective ledger a/c at book value (Balance Sheet Value).**

Items of Balance Sheet	Where to transfer
Liability Side (Cr. Bal)	
Capital	Capital a/c (Cr Side)
Reserves & Surplus	Capital a/c (Cr Side)
Remaining all other liabilities	Realization a/c (Cr Side)
Asset Side (Dr. Bal)	
Accumulated Expenses /Losses (Deferred Revenue Expenses)	Capital a/c (Dr Side)
Remaining all other assets	Realization a/c (Dr Side)

Accounting for Banking Company

Journal entries to close the books of Vendors Co.

	Particulars	L F	Debit ,	Credit ,
(1)	Transfer of Capital & Reserves & surpluses Capital a/c Dr. Reserves & Surpluses a/c Dr. To Capital a/c		xxx xxx	 xxx
(2)	Transfer of other Liability Sundry Liability a/c Dr. To Realization a/c		xxx	 xxx
(3)	Transfer of Asset Realization a/c Dr. To Sundry Asset a/c [Notes: a) Even Cash or Bank is not taken over then also this will be transferred to Realization a/c, b) Debtors should be transferred at gross value and R.D.D. to be shown separately on the credit side of Realization a/c]. Transfer of Losses (Deferred Revenue Expenses) Capital a/c Dr. To Expense/ Losses a/c		xxx xxx	 xxx
(4)	Entries for Purchase Consideration Entry for P.C. Receivable LLP Co a/c Dr. To Realization a/c		xxx	 xxx
(5)	Entry for P.C. Receipt / Discharge of P.C. Cash /Bank a/c Dr. To LLP Co. a/c		xxx	 xxx
(6)	Entry for Sale of Asset not taken over by Purchaser Cash / Bank a/c Dr. To Realization a/c		xxx	 xxx

Accounting for Banking Company

	(Note: The above entry should be passed for selling price only & not for profit or loss of sale. Whether assets are recorded or unrecorded entry for sale remain the same.)		
(7)	Entry for payment of Realization expenses (Dissolution Expense/ liabilities) Realization a/c Dr. To Cash/Bank a/c	xxx	xxx
(8)	Entry for payment of liability not taken over by Purchaser Realization a/c Dr. To Cash/Bank a/c To Capital a/c (Note: The above entry should be passed on for actual amount paid & not for P&L on payment. Whether liabilities are recorded or unrecorded the entry for payment remains the same. If nothing is specified we will assume that liability is taken over by Purchaser)	xxx	
(9)	Close Realization a/c & transfer the balance into Capital a/c.		
(10)	Close all the other a/c & Transfer the balances Cash/Bank a/c, which must Tally		

Accounting for Banking Company

Opening Entry of in the books of Purchaser [LLP]

	Particulars	L F	Debit ,	Credit ,
(1)	Entry for P.C. Payable Business Purchase a/c Dr. To Vendor a/c		xxx	xxx
(2)	Entry for asset & liability taken over Asset (Taken over at Agreed Value) a/c Dr. Goodwill (Difference) a/c To Liability (Taken over at Agreed Value) To Business Purchase (P.C. Amount) To Capital Reserve (difference)		xxx	xxx
(3)	Entry for discharge of P.C. Vendor a/c Dr. To Cash/Bank		xxx	xxx

Opening balance sheet of Purchaser can be prepared from opening Journal entry which is discussed above where debit items to be reflected on Asset side & Credit items on the liability side of the Balance Sheet. However, some time new balance sheet will be prepared with the help of old balance sheet and for which we should follow the following rules:

Debit	Debit	ADD
Credit	Credit	ADD
Debit	Credit	LESS
Credit	Debit	LESS

Whatever is the final figure will reflect in the Balance Sheet.

Part B: Statement of Account {Statement of Assets and Liabilities of _____ as at _____ (period)}

Particular	Current Yr ([₹])	Previous Yr ([₹])
(I) CONTRIBUTION AND LIABILITIES:		
(1) PARTNER'S FUNDS:		

Accounting for Banking Company

(a) Capital/Contribution		
(b) Reserves and Surplus		
(2) LIABILITIES:		
(a) Secured Loans		
(b) Unsecured Loans		
(c) Short term borrowings		
(d) Creditors/trade payables (Advance from Customers)		
(e) Other Liabilities		
(f) Provisions (for taxation, contingencies, insurance etc)		
Total		
(II) ASSETS:		
(3) FIXED ASSETS:		
(a) Gross Block		
(b) Less: Depreciation		
(c) Net block		
(4) INVESTMENTS:		
(5) CURRENT ASSETS, LOANS AND ADVANCES:		
(a) Inventories		
(b) Sundry Debtors		
(c) Cash and bank Balances		
(d) Other current assets		
(e) Loan and advances		
Total		

Notes: (a) Contingent liabilities not provided for; (b) The disclosures under provision of section 22 of the Micro, Small and Medium Enterprises Development Act, 2006 may be added as attachment to this Form; (c) Any other disclosure the LLP think proper to disclose.

Signature of designated partners of LLP/Authorized representatives (AR) of a foreign LLP DPINS.

Accounting for Banking Company

Statement of Income and Expenditure of _____ for the period from _____ to _____

Particular	Current Year (₹)	Previous Year (₹)
(a) Turnover		
(b) Other Income		
(c) Increase/decrease in Stock		
Total Income		
Less:		
(a) Expenses		
(b) Purchases		
(c) Personal expenses		
(d) Administrative expenses		
(e) Selling expenses		
(f) Depreciation		
(g) Interest		
(h) Other expenses		
(i) Profit Before Tax		
Less:		
(a) Provision for Tax		
(b) Profit After Tax		
(c) Profit transferred to Partners a/c		
(d) Profit transferred to Reserve and Surplus		

Illustration 3:

Sagar carrying on a business. On 31-3-2015, Balance sheet was as under:

Liabilities	\	Assets	\
Capital	7,60,000	Building	1,20,000

Accounting for Banking Company

Suraj's loan	1,20,000	Machinery	1,30,000
(Carrying interest @8% p.a.)		Motor car	5,05,000
Creditors	1,15,000	Stock	1,15,000
Bills payable	1,05,000	Debtors	1,20,000
		Cash	9,000
		Investment	1,01,000
	11,00,000		11,00,000

On the above date, a LLP was incorporated to take over the above business on the following terms and conditions:

- (a) All assets (except cash and investment) and all liabilities (except Suraj's loan) to be taken over by the company for which all assets are valued at par except building which is considered worth `1,27,000 and stock at worth `1,14,000. Further, goodwill is valued at `30,000.
- (b) Suraj's loan to be partly liquidated by his taking over the cash and investment at par.
- (c) Suraj and Sagar will be the partners of LLP sharing profits equally. They contributed `6,00,000 each.
- (d) The purchase consideration is received in cash.

Show ledger accounts to close the books of the firm and pass journal entries in LLP & Balance sheet.

Solution:

**In the books of M/s Sagar & Suraj
Calculation of Purchase Consideration by
Net Asset Method**

	(₹)
Assets taken over (market value)	
Building	1,27,000
Machinery	1,30,000
Motor car	5,05,000
Stock	1,14,000
Debtors	1,20,000
	9,96,000
Add: Goodwill	30,000
	10,26,000
Less: Liabilities taken over (market value)	



Accounting for Banking Company

Creditors	1,15,000
Bills payable	1,05,000
Total P.C.	8,06,000

Dr.		Suraj's loan A/c		Cr.	
	(₹)				(₹)
To Cash/Bank	19,000	By Balance b/d			1,20,000
To investment	1,01,000				
	1,20,000				1,20,000

Dr.		Investment A/c		Cr.	
	(₹)				(₹)
To Balance b/d	1,01,000	By Suraj's loan a/c			1,01,000
	1,01,000				1,01,000

Dr.		Realisation a/c		Cr.	
	(₹)				(₹)
To Sundry Assets		By Sundry Liabilities			
Building	1,20,000	Creditors	1,15,000		
Machinery	1,30,000	Bills payable	<u>1,05,000</u>		2,20,000
Motor Car	5,05,000	By LLP			8,06,000
Stock	1,15,000				
Debtors	<u>1,20,000</u>				
To Profit transferred to capital a/c	36,000				
	10,26,000				10,26,000

Dr.		LLP Co.'s A/c		Cr.	
	(₹)				(₹)
To Realization a/c	8,06,000	By Bank a/c			8,06,000
	8,06,000				8,06,000

Cash/Bank

Dr.		Cr.	
	(₹)		(₹)
To Balance b/d	9000	By Suraj's loan a/c	19,000
To LLP a/c	8,06,000	By Capital a/c	7,96,000
	8,15,000		8,15,000

Capital a/c

Dr.		Cr.	
	(₹)		(₹)
To Bank a/c	7,96,000	By Balance b/d	7,60,000
		By realization a/c	36,000
	7,96,000		7,96,000

Journal of Suraj Sagar LLP

PARTICULARS	Dr.	Cr.
	(₹)	(₹)
Business purchase a/c	Dr. 8,06,000	

Accounting for Banking Company

To Vendor's a/c (Being purchase of business)			8,06,000
Building a/c	Dr.	1,27,000	
Machinery a/c	Dr.	1,30,000	
Motor Car a/c	Dr.	5,05,000	
Stock	a/c	1,14,000	
Dr.			
Debtors a/c	Dr.	1,20,000	
Goodwill a/c	Dr.	30,000	
To Creditors a/c			1,15,000
To Bills Payable a/c			1,05,000
To Business Purchase a/c			8,06,000
(Being purchased the business of Sagar)			
Bank a/c	Dr.	12,00,000	
To Sagar a/c			6,00,000
To Suraj a/c			6,00,000
(Being capital contributed by the partner)			
Vendor's a/c	Dr.	8,06,000	
To Bank a/c			8,06,000
(Being settled purchase consideration)			

PART B: Statement of Account

Statement of Assets & Liabilities of Suraj & Sagar as on 31/3/2015

Particulars	Figures as at the end of the current reporting period
(1)	(2)
(I) CONTRIBUTION & LIABILITIES:	
(1) Partners Fund:	
(a) Contribution	
(b) Reserves and surplus (Surplus being the profit/ loss made during the year)	12,00,000
(2) Liabilities:	
(a) Secured loans	
(b) Unsecured loans	
(c) Short term borrowings	
(d) Creditors / trade payables -Advance from customers	2,20,000
(e) Other liabilities (to specify)	
(f) Provisions	
(i) For taxation	
(ii) For contingencies	
(iii) For insurance	
(iv) Other provisions	

Accounting for Banking Company

	TOTAL	14,20,000
(II) ASSETS:		
(a) Fixed assets		7,92,000
(b) Investments		
(c) Loans & advances		
(d) Inventories		1,14,000
(e) Debtors and trade receivables		1,20,000
(f) Cash and cash equivalents		3,94,000
(g) Other assets		
	TOTAL	14,20,000

Illustration 4:

Arpan decided to convert his business into LLP under the name of ATG LLP. The balance sheet as at 31st March, 2015 was

Balance Sheet as on 31st March 2015

Liabilities	Amount (₹)	Asset	Amount (₹)
Arpan's capital	6,70,000	Camera and Equipment	3,80,000
General reserve	1,60,000	Shooting vans	1,80,000
Loan from Khanna	1,40,000	Copy Rights	1,20,000
Bank overdraft	1,80,000	Stock of films	2,70,000
Sundry Creditors	1,50,000	Bills receivable	2,20,000
		Sundry distributors	1,30,000
Total	13,00,000	Total	13,00,000

Various terms and conditions of conversions agreed upon by and between the partners were as under:

- (1) Camera and equipment to be taken over at `5,00,000.
- (2) LLP, to pay off bank O/D and creditors immediately for which the LLP should sell stock of films at a value of `3,72,000.
- (3) ATG. LLP having R & J partners sharing an equal proportion. The capital contribution is of `600000 each.
- (4) Goodwill of the firm to be valued on the basis of average of profits of the previous 3 years, which were `70,000, `75,000 and `71,000 respectively after setting aside `20,000 to general reserves each year.

You are required to give:

- (a) The statement showing purchase consideration.
 - (b) Realisation A/C and Capital accounts, to close the books of the proprietor.
- (5) The LLP took loan of `100000 for settlement of P.C.

Accounting for Banking Company

Solution:

Working Note 1:

Valuation of Goodwill

Base profit for last three years

	(₹)
I year	70,000
II year	75,000
III year	71,000
	2,16,000
Add: Profit transferred to general reserve during three years (20000 × 3)	60,000
	2,76,000
Goodwill $\frac{(2,76,000)}{3}$	92,000

Statement of Purchase Consideration

NET ASSETS METHOD	(₹)
Goodwill (as per working note 1)	92,000
Camera and Equipments	5,00,000
Shooting Vans	1,80,000
Copy Rights	1,20,000
Stock of Films	2,70,000
Bills Receivable	2,20,000
Sundry Distributors	1,30,000
	15,12,000
Less: Liabilities taken over	
Sundry Creditors 1,50,000	
Bank O/D <u>1,80,000</u>	3,30,000
Total	11,82,000

In the books of M/s Arpan

Dr.	Realization A/C		Cr.
	(₹)		(₹)
To Sundry Assets (At the book values)	3,00,000	By bank O/D	1,80,000
To Profit to Capital A/C	2,12,000	By Creditors	1,50,000
		By ATG LLP	11,82,000
	15,12,000		15,12,000

Capital A/C

	(₹)		(₹)
To Bank A/C	10,42,000	By balance b/d	6,70,000
		By General Reserves A/C	1,60,000

(cdlx)

Accounting for Banking Company

		By Realization A/C	2,12,000
	10,42,000		10,42,000

Cash/ Bank A/C

	(₹)		(₹)
To ATG LLP	11,82,000	By Loan from Khanna	1,40,000
		By Capital A/C	10,42,000
	11,82,000		11,82,000

Journal of ATG LLP

Particulars	L F	Debit Amount	Credit Amount
Business Purchases A/c To vendors A/c (Being purchases of Business)	Dr	11,82,000	11,82,000
Goodwill A/c Camera equipment A/c Shooting Van A/c Copyrights A/c Stock of films A/c Bills receivable A/c Sundry Distributors A/c To Sundry Creditors A/c To Bank O/D To Business Purchase A/c (Being brought into books assets and liabilities taken)	Dr	92,000 5,00,000 1,80,000 1,20,000 2,70,000 2,20,000 1,30,000	1,50,000 1,80,000 11,82,000
Bank A/c To R Capital A/c To J capital A/c (Being Capital Contribution by Partners)	Dr	1200000	6,00,000 6,00,000
Bank A/c To Bank loan A/c (Being loan taken)	Dr	1,00,000	1,00,000
Vendors A/c To Bank A/c (Being Settled Purchase Consideration)	Dr	11,82,000	11,82,000
Bank A/c To Stock of films To P/L A/c (Being sale of stock of films)	Dr	3,72,000	2,70,000 1,02,000
Bank overdraft A/c Creditors A/c To Bank A/c	Dr Dr	1,80,000 1,50,000	3,30,000

Accounting for Banking Company

(Being settled bank OD and creditors)

Adjustment no. 2 & 5 is not relevant for the vendor firm. It affects accounts of ATG. LLP

Part B:

**Statement of accounts Statement of assets
and liabilities of ATG LLP as at 31.03.2015**

Particulars	Figures as at the end of the current reporting period
(1)	(2)
(I) CONTRIBUTION & LIABILITIES:	
(1) Partners Fund:	
(a) Contribution	12,00,000
(b) Reserves and surplus (Surplus being the profit/ loss made during the year)	1,02,000
(2) Liabilities:	
(a) Secured loans	1,00,000
(b) Unsecured loans	—
(c) Short term borrowings	—
(d) Creditors / trade payables – Advance from customers	—
(e) Other liabilities (to specify)	—
(f) Provisions	—
(i) For taxation	—
(ii) For contingencies	—
(iii) For insurance	—
(iv) Other provisions	—
Total	14,02,000
(II) ASSETS:	
(a) Fixed assets	8,92,000
(b) Investments	—
(c) Loans & advances	—
(d) Inventories	—
(e) Debtors and trade receivables	3,50,000
(f) Cash and cash equivalents	1,60,000
(g) Other assets	—
Total	14,02,000

Illustration 5:

Accounting for Banking Company

Mr. Ajay decided to convert his business into LLP on 31/12/15, which B/S as follows:

Liabilities	(₹)	Assets	(₹)
Creditors	1,48,000	Debtors	1,60,000
LOAN	1,40,000	B/R	1,10,000
Bank OD	1,16,000	Stock in trade	1,36,000
Reserves	1,06,000	Patents	1,08,000
Capital a/c Ajay	2,80,000	Plant & Machinery	1,16,000
		Land & Building	1,60,000
Total	7,90,000	Total	7,90,000

- (1) M/s Sanjay, Vijay LLP is formed to take over the business of Ajay
- (2) The loan Creditors were settled
- (3) Land, building, plant & machinery were to be valued @ `3,00,000 and `1,24,000 respectively
- (4) The vendors were to be settled by payment of `12,10,000
- (5) Sanjay & Vijay contributed `750000 each

You are required to show realization a/c of Ajay, general of LLP and balance sheet after conversion.

Solution:

In the books of M/S Ajay Realisation A/c

	(₹)		(₹)
To Sundry Asset (BK)		By Sundry Liabilities	
Land & Building	1,60,000	Creditors	1,48,000
Plant & Machinery	1,16,000	Loan Creditors	1,40,000
Patents	1,08,000	Bank OD	1,16,000
Stock	1,36,000	Sanjay, Vijay LLP a/c	12,10,000
B/R	1,10,000		
Debtors	1,60,000		
Capital a/c profit	8,24,000		
	16,14,000		16,14,000

Journal of Sanjay, Vijay LLP

Particulars	L F	(₹)	(₹)
Business purchase a/c To vendors a/c (Being Purchase of Business)		12,10,000	12,10,000
Goodwill a/c		6,76,000	
Land & Building		3,00,000	
Machinery		1,24,000	
Patents		1,08,000	

Accounting for Banking Company

Stock		1,36,000	
B/R		1,10,000	
DRS		1,60,000	
To Loan Creditors a/c			1,40,000
To Bank OD a/c			1,16,000
To Creditors			1,48,000
To Business Purchase a/c			12,10,000
(Being Brought into Books, Assets and Liabilities)			
Bank a/c		15,00,000	
To S capital a/c			7,50,000
To V capital a/c			7,50,000
(Being Capital Contribution by Partners)			
Vendor a/c		12,10,000	
To Bank a/c			12,10,000
(Being Settled Purchase Consideration)			
Loan creditors a/c		1,40,000	
To Bank a/c			1,40,000
(Being Settled Bank OD and Creditors)			

PART B: Statement of Account

Statement of Assets & Liabilities of Sanjay, Vijay LPP as on 31/3/2015

Particulars	Figures as at the end of the current reporting period
1	2
(I) CONTRIBUTION & LIABILITIES:	
(1) Partners Fund:	
(a) Contribution	15,00,000
(b) Reserves and surplus (Surplus being the profit/ loss made during the year)	
(2) Liabilities:	
(a) Secured loans	
(b) Unsecured loans	
(c) Short term borrowings	1,16,000
(d) Creditors / trade payables -Advance from customers	1,48,000
(e) Other liabilities (to specify)	
(f) Provisions	
(i) For taxation	
(ii) For contingencies	
(iii) For insurance	

Accounting for Banking Company

(iv) Other provisions	Total	17,64,000
(II) ASSETS:		
(a) Fixed assets		12,08,000
(b) Investments		
(c) Loans & advances		
(d) Inventories		1,36,000
(e) Debtors and trade receivables		2,70,000
(f) Cash and cash equivalents		1,50,000
(g) Other assets		
Total		17,64,000

Illustration 6:

Pravin & Pankaj are in partnership and share profits in equal proportion on 30th Sep 2015, they sold their assets to P & A company LLP having Pankaj, Arpan as partners who contributed 1,50,000 each.

Balance Sheet as on 30/9/2015 as under:

Liabilities	(₹)	Assets	(₹)
Creditors	49,000	Sundry assets	1,63,500
Capital		Cash in hand	4,700
Pravin	47,800		
Pankaj	50,400		
Loan from Sagar	21,000		
Total	1,68,200	Total	1,68,200

The LLP Buyers, P & A company agreed as follows:

- (1) Pay 1,59,300 as sundry assets and 30,000 as goodwill.
- (2) To deposit 50,000 immediately to enable payments to CRS and the balance on completion of all formalities on 31/12/2015.
- (3) They agree to pay interest @ 5% on balance of the purchase price.

Pravin & Pankaj are to be allowed interest @ 10% p.a. on their opening capital. Sagar loan a/c is to be credited @ interest @ 12% p.a.

Show necessary ledger a/c's in the books of vendors in Journal P & A Company LLP

Solution:

In the books of the Firm Realisation A/c

Accounting for Banking Company

	(₹)		(₹)
To Sundry Assets	1,63,500	By Creditors	49,000
To Cash	4,700	By P & A a/c	1,89,300
To Creditors	49,000	By P & A (Interest)	1,741
To Interest	3,085		
To Profit trans			
To Capital a/c			
Pravin	9,878		
Pankaj	9,878		
	2,40,041		2,40,041

Interest A/c

	(₹)		(₹)
To Sagar Loan a/c	630	By realization	3,085
To Pravin	1,195		
To Pankaj	1,260		
	3,085		3,085

Partner's Capital A/c

	Pravin (₹)	Pankaj (₹)		Pravin (₹)	Pankaj (₹)
To Cash a/c	58,873	61,539	By Balance b/d	47,800	50,400
			By Interest	1,195	1,260
			By Realization	9,878	9,878
	58,873	61,538		58,873	61,538

Cash A/c

	(₹)		(₹)
To P & A LLP	50,000	By Creditors	49,000
To P & A LLP	1,741	By Sagar's Loan a/c	21,630
To P & A LLP	1,39,300	By Pravin cap. a/c	58,873
		By Pankaj cap. a/c	61,538
	1,91,041		1,91,041

Sagar's Loan A/c

	(₹)		(₹)
To Cash a/c	21,630	By balance b/d	21,000
		By Interest	630
	21,630		21,630

A & P LLP A/c

	(₹)		(₹)
To realization a/c	1,89,300	By cash	50,000
To realization a/c	1,741	By cash	1,741
		By cash	1,39,300
	1,91,041		1,91,041

Journal of A & P LLP

Particulars	(₹)	(₹)
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Accounting for Banking Company

Business Purchase a/c To Vendors a/c (Being Purchase of Business)	1,89,300	1,89,300
Goodwill a/c Sundry Assets To Business Purchase a/c (Being Brought into Books, Assets and Liabilities)	30,000 1,59,300	1,89,300
Bank a/c To Pankaj Capital a/c To Arpan Capital a/c (Being Capital Contribution by Partners)	3,00,000	1,50,000 1,50,000
Vendor a/c To Bank a/c (Being Settled Purchase Consideration)	1,89,300	1,89,300

PART B: Statement of Account

Statement of Assets & Liabilities of Sanjay, Vijay LPP as on 31/3/2015

Particulars	Figures as at the end of the current reporting period
1	2
(I) CONTRIBUTION & LIABILITIES:	
(1) Partners Fund:	
(a) Contribution by Partners	3,00,000
(b) Reserves and surplus (Surplus being the profit/ loss made during the year)	
(2) Liabilities:	
(a) Secured Loans	
(b) Unsecured Loans	
(c) Short term Borrowings	
(d) Creditors / Trade payables - Advance from Customers	
(e) Other liabilities (to specify)	
(f) Provisions	
(i) For Taxation	
(ii) For Contingencies	
(iii) For Insurance	
(iv) Other Provisions	
Total	3,00,000
(II) ASSETS:	
(a) Fixed assets	-
(b) Investments	1,89,300
(c) Loans & advances	-

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(d)	Inventories	—
(e)	Debtors and trade receivables	—
(f)	Cash and cash equivalents	1,10,700
(g)	Other assets	—
Total		3,00,000

Questions for Self-Practice

OBJECTIVE QUESTIONS

(I) Multiple Choice Questions:

- (1) Limited Liability Partnership (LLP) is a new corporate structure.
 - (a) Flexibility of a partnership
 - (b) Advantages of limited liability
 - (c) Low compliance cost
 - (d) All of above
- (2) A limited liability partnership (LLP) is a partnership in which some or all partners have
 - (a) limited liability
 - (b) unlimited liability
 - (c) fixed liability
 - (d) flexible liability
- (3) In an LLP one partner _____ for another partner's misconduct or negligence
 - (a) is responsible and liable
 - (b) is not responsible or liable
 - (c) is responsible
 - (d) is liable
- (4) LLP must also have at least one "general partner" with
 - (a) limited liability
 - (b) unlimited liability
 - (c) fixed liability
 - (d) flexible liability
- (5) An LLP also contains a _____ of tax liability from that of a corporation.
 - (a) limited level
 - (b) unlimited level
 - (c) different level
 - (d) fixed level
- (6) In India several expert groups have examined the need for a concept like LLP. These include
 - (a) Abid Hussain Committee 1997
 - (b) the Naresh Chandra Committee on Private Companies and Partnerships 2003
 - (c) the Irani Committee for new Company Law, 2005
 - (d) All of above
- (7) The Naresh Chandra Committee particularly analyzed the concept in detail under following parameters:

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- (a) Application of the LLP Regime; Incorporation, Registration and Number of Partners;
 - (b) Limited Liability;
 - (c) Financial Safeguards; and Tax Treatment of LLPs.
 - (d) All of above
- (8) The LLP Bill was introduced in the Rajya Sabha in years 2006 on
- (a) 15th Dec., 2006
 - (b) 18th Dec., 2006
 - (c) 12th Dec. 2006
 - (d) 16th Dec., 2006
- (9) Finally the Limited liability partnership Act was passed in 2008 with effect from
- (a) 5 April, 2009
 - (b) 1 April, 2009
 - (c) 5 April, 2009
 - (d) 7 April, 2009.
- (10) LLPs as constituted in the U.S. and that introduced in the UK in 2001
- (a) 2000
 - (b) 2001
 - (c) 2002
 - (d) 2003
- (11) Accounts of LLP are to be audited by
- (a) Chartered Accountant
 - (b) Cost Accountant
 - (c) Company secretary
 - (d) Master of commerce
- (12) Maximum number of partners in LLP is
- (a) 20
 - (b) 50
 - (c) 100
 - (d) No limit
- (13) Agreement for LLP is in Form No.
- (a) 3
 - (b) 8
 - (c) 9
 - (d) 11
- (14) Certificate of incorporation of LLP is issued by
- (a) Registrar of firms
 - (b) Registrar of companies
 - (c) Registrar of co-operative societies
 - (d) Registrar of Universities
- (15) A partner shall cease to be a partner on
- (a) Death
 - (b) Retirement
 - (c) Winding up
 - (d) All of the above
- (16) Liability of partners in LLP
- (a) Limited
 - (b) Unlimited
 - (c) a & b
 - (d) None of the above

Accounting for Banking Company

- (17) The details of designated partners is filed with the ROC in
- Form 1
 - Form 2
 - Form 3
 - Form 4
- (18) Books of accounts of LLP are to be preserved for
- 5 years
 - 7 years
 - 8 years
 - 9 years
- (19) Books of accounts of LLP are maintained on
- Cash basis
 - Accrual basis
 - Cash basis or accrual basis
 - Cash basis and accrual basis

[Ans.: (1-d); (2-a); (3-a); (4-b); (5-a); (6-d); (7-d); (8-a); (9-b); (10-b); (11-a), (12-d), (13-a), (14-b), (15-d), (16-a), (17-d), (18-c), (19-c)]

(II) Match the Column:

Column A	Column B
(1) LLP Act,	(a) Two
(2) A body corporate	(b) DPIN
(3) Minimum number of partners of a LLP	(c) Form-7
(4) Designated partner identification number	(d) 2006
(5) DPIN	(e) Can't be a partner in a LLP
	(f) One
	(g) 2008

[Ans.: (1) d; (2) a; (3) b; (4) b; (5) c;]

Column A	Column B
(1) For reservation of name	(a) Pay filing fee of `100 online
(2) LLP, Rules	(b) DPIN
(3) Purchase Consideration	(c) Form-1
(4) Realisation A/C	(d) 2009
(5) DPIN	(e) Net Payment Method
	(f) Vendor
	(g) 2008

[Ans.: (1) c; (2) d; (3) e; (4) f; (5) a;]

THEORY QUESTIONS

(X) Theory Questions:

- What are the Provisions of LLP Act about conversion of firm in to LLP?
- What are the obligations of Designated Partners?
- How you will account for purchase of business in the books of a LLP?
- What are the problems to be dealt with on conversion of firm in to LLP?
- What are the salient features of the LLP Act, 2008?
- How to Incorporate a New Limited Liability Partnership?
- Write down the advantages of Limited Liability Partnership?

Accounting for Banking Company

(29) Write down the disadvantages of Limited Liability Partnership?

(30) Write down the accounting procedure of Limited Liability Partnership?

PRACTICE PROBLEMS

(1) Following is a Balance sheet of Heart. Their position on 31/12/10 is as under:

Liabilities	(₹)	Assets	(₹)
H's Capital	45,000	Furniture	5,000
General Reserve	9,000	Building	30,000
Creditors	11,000	Stock	28,000
		Cash at Bank	2,000
	65,000		65,000

They decided to dissolve the firm and create LLP with Love and Mind. The assets and liabilities revalued as under: Building ₹60,000; Furniture ₹2,000; Stock ₹26,000. Creditors accepted ₹10,000 in full payment by cash; Realisation expenses amounted to ₹500. For Which they contributed L's Capital ₹1,00,000 and M's Capital ₹1,00,000. Pass the necessary journal entries and prepare the ledger account to close the books of the firm and B/S of LLP.

(2) A, B and C are partners sharing profits and losses in the ratio of 3:2:1. Their position on 31/3/10 was as follows.

Liabilities	(₹)	Assets	(₹)
A's Capital	25,000	Building	31,000
B's Capital	30,000	Furniture	5,000
C's Capital	20,000	Motor Car	9,000
Sundry Creditors	15,000	Sundry Debtors	37,000
Bills Payable	15,000	Bank	5,000
		P & L A/c	18,000
	1,05,000		1,05,000

The partners decided to dissolve the firm create LLP with X, Y and Z as partners who will contribute ₹75,000 each. The assets taken over as under:

Building ₹1,45,000; Sundry Debtors realised ₹1,43,000; Furniture is taken over by 'C' at ₹3,000; Motor car is taken over by 'A' at ₹15,000; Bills payable And Creditor taken over at book value.

Show how to close the books of the firm and also pass the necessary journal entries of LLP and its Balance sheet.

(3) The following was the Balance sheet of M/s Ravi and Uday as on 31st Dec. 10.

Accounting for Banking Company

Liabilities	(₹)	Assets	(₹)
Capital: Ravi	25,000	Building	7,500
Uday	25,000	Machinery	15,000
Reserve Fund	5,000	Furniture	15,000
Ravi's Loan	500	Investments	5,000
Bills Payable	750	Stock	12,500
Outstanding Expenses	250	Debtors	3,500
Creditors	5,000	Cash at Bank	3,000
	61,500		61,500

The firm was dissolved on 31st December 10 and creates LLP with Sanjay, Ramesh and Satish as partners' who will contribute `50,000 each:

Ravi took over investments at `4,600.

The assets revalued were:

Stock	∩	12,250
Debtors	∩	3,750
Machinery	∩	14,000
Building	∩	70,000

Uday agreed to take over Furniture at `14,000 and to meet the Bills Payable

Realisation expenses were `700.

The creditors were paid off at a discount of `150.

Ravi and Uday share profits and losses in the proportion of 3:2.

Prepare Realisation A/c, Partner's Capital A/c and Cash & Bank A/c.

- (4) Mona, Sonu and Jaya are partners of a firm, decided to dissolve their firm on 31st December 2010, when its balance sheet was as under:

Balance Sheet as at 31st December 2010

Liabilities	(₹)	Assets	(₹)
Creditors	18,000	Cash at Bank	9,600
Loan	4,500	Sundry Assets	51,000
Capitals: Mona	82,500	Debtors 72,600	69,000
Sonu	21,000	Less: R.D.D 3,600	

Accounting for Banking Company

Jaya	30,000	Stock	23,400
		Furniture	3,000
	1,56,000		1,56,000

The partners decided to dissolve the firm create LLP with Rama, Ritu and Anjali as partners who will contribute `75,000 each.

- Mona took over the furniture for `2,000 and debtors of `60,000 for `51,000.
- Sona took over the stock at an agreed value of `20,000 and sundry assets of `24,000 for `23,500.
- Jaya took over the remaining sundry assets for `25,000 and agreed to repay the loan along with interest for three months at 12% p.a.
- The expenses of dissolution `1,000 and also the unrecorded outstanding expenses `1,200 were paid by the firm.
- The remaining debtors realised `7,000
- Prepare Realisation A/c, Partner's Capital A/c and Bank A/c.

(5) Mr. Prakash, a sole proprietor having his Balance sheet was as follows:

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	12,000	Cash	6,400
Loan	3,000	Sundry Assets	34,000
Capital		Debtors	48,400
Prakash	89,000	Less: R.D.D.	<u>2,400</u>
		Stock	15,600
		Furniture	2,000
	1,04,000		1,04,000

He sold his business to LLP of Diwakar & Rajan for `3,00,000 which is paid in cash.

You are required to pass Journal entries in the books of the firm.

(6) Kanta and Shanta were partners sharing profits and losses in the ratio of 3:2. Their Balance Sheet on 31st December, 2010 was as follows:

Balance sheet on 31/12/2010

Liabilities	(₹)	Assets	(₹)
Creditors	12,000	Bank	5,500
Bills payable	2,500	Stock	5,500
Capital A/c's.		Buildings	25,000
Kanta	20,000	Plant	10,000
Shanta	15,000	Debtors	3,500

Accounting for Banking Company

	49,500	49,500
--	--------	--------

The firm was dissolved on above date and creates LLP with Janta & Manta who contribute `50,000 each; the assets were revalued as under.

- (a) Stock `5,000, Debtors `2,500, Plant `8,000 and Building `50,000.
 - (b) Kanta agreed to pay off bills payable.
 - (c) Creditors were paid off `8,000.
 - (d) Dissolution expenses were `500.
 - (e) Prepare (1) Realisation Account (2) Capital Accounts of the partners (3) Bank Accounts.
- (7) Antu, Bantu and Chandu were partners sharing profits and losses in proportion of 3:2:1 respectively. On Dec., 31st 2010, their Balance sheet was as follows:

Balances sheet as on 31st December, 2010

Liabilities	(₹)	Assets	(₹)
Bills Payable	13,000	Cash at Bank	14,500
Sundry Creditors	15,000	Stock	19,800
Capitals: Antu	25,000	Sundry Debtors 15,000	
Bantu	20,000	Less: R.D.D. 1,000	14,000
Chandu	15,000	Furniture	4,000
Reserve Fund	12,000	Plant & Machinery	47,700
	1,00,000		1,00,000

The firm was converted in to LLP of Dabbu, Ebbu and Fantu who will contribute `40,000 each for purchase consideration. Debtors revalued `16,500, Plant and Machinery `40,000, stock was taken over by Chandu for `18,000 and he agreed to pay the bills payable at book value. Furniture was taken over by Antu for `5,000 and he agreed to pay the loan of his wife in full. In addition, an outstanding liability for `1,700 not included in account had to be paid. Realisation expenses were `1000.

Prepare:

(a) Realisation A/c. (b) Capital A/c. (c) Bank A/c. (e) Journal entries of LLP and its Balance sheet.

- (8) X, Y & Z are partners sharing profits and losses in the ratio of 2:1:1. Their position on 31/12/2010 was as under:

Liabilities	(₹)	Assets	(₹)
X's Capital	34,000	Plant and Machinery	27,000
Y's Capital	33,000	Furniture	3,000
Z's Capital	28,000	Sundry Debtors	40,000
Creditors	52,000	Less: R.D.D.	4,000

Accounting for Banking Company

Bills payable	5,000		36,000
		Stock	70,000
		Cash at Bank	16,000
	1,52,000		1,52,000

They decided to dissolve the partnership and the firm was converted in to LLP of A, B and C who will contribute `50,000 each for purchase consideration. The assets and liabilities revalued as under: **(a)** Plant and Machinery for `35,000. **(b)** Furniture realised nothing. **(c)** Sundry Debtors at a discount of 5%. **(d)** Stock at a discount of 10%. **(e)** Investment which was written off previously now realised at `600. **(f)** Goodwill Created for `14,000. **(g)** Creditors are taken over at `20,000. **(h)** B's Loan `3,000 is discharged with interest `600. **(i)** Outstanding expenses for repairs of machinery not recorded `2,000 are paid. **(j)** Realisation expenses amounted to `4,000. Prepare the necessary ledger account to close the books of old firm and Journal entries of LLP & its Balance sheet.

(9) The following is the Balance Sheet of M/s. Fat as on 31/12/2010.

Liabilities	(`)	Assets	(`)
Partner's Capital:		Cash at Bank	14,000
Fat	38,000	Stock	30,000
Reserve Fund	7,000	Investment	9,000
Bills Payable	10,000	Sundry Debtors	15,000
Sundry Creditors	15,000	Less: R.D.D.	1,000
Loan from Black	10,000	Fat's Current A/c.	3,000
		Furniture	6,000
		P & L A/c.	4,000
	80,000		80,000

He sold his business to LLP of Thin & Tall for `3,00,000 which is paid in cash.

(a) LLP took over Investment at `8,000 & Stock at `38,000. **(b)** LLP agreed to take over Furniture at `5,000 and also agreed to pay Sundry Creditors at book value. **(c)** Sundry Debtors revalued at book value less 10%. **(d)** Dissolution expenses `1,000. **(e)** Black's loan is paid with interest `200.

Prepare the necessary ledger account to close the books of old firm and Journal entries of LLP & its Balance sheet.

(10)

Balances Sheet as on 31st December 2010

Accounting for Banking Company

Liabilities	(₹)	Assets	(₹)
Capital Account:		Machinery	1,02,000
Law	1,19,000	Furniture	1,01,000
Creditors	1,03,000	Goodwill	2,000
Reserve	4,000	Debtors	62,000
Bills payable	1,05,000	Closing Stock	57,000
		Profit & Loss Account	6,000
		Current Account:	
		Law	1,000
	3,31,000		3,31,000

The collection charges were 10% on total debtors. Debts worth 10% of the total debtors were proved to be bad. Rule & Regulation LLP agreed to take over business of Law for ₹6,00,000. Creditors accepted ₹1,05,000 in satisfaction of their claim. Prepare the necessary ledger account to close the books of old Proprietor and Journal entries of LLP & its Balance sheet

- (11) Following is the trial balance of Sona and Mona. They share profit and losses in the proportion 3:2. From the following balance and adjustments, prepare Trading & Profit and Loss a/c for the year ending 31st March 2010 and Balance Sheet on that date.

Particulars	Dr. (₹)	Cr. (₹)
Stock on 1/4/2009	45,000	
Purchase and Sales	1,12,500	1,87,500
Drawings:		
Sona	16,500	
Mona	15,000	
Returns	3,600	1,500
Wages:		
Productive	5,250	
Unproductive	900	
Salaries	9,300	
Rent, Rates, Insurance	5,100	
Bad Debts	600	

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Discount	1,950	1,500
Machinery	22,500	
Building	54,300	
Sundry Debtors and Creditors	76,500	
Cash	1,500	
Capitals:		
Sona		52,500
Mona		67,500
Bank Overdraft		15,000
Total	3,70,500	3,70,500

Adjustments:

- (1) On 31st March, 2010 the stock was valued at Rs. 28,000.
 - (2) Outstanding productive wages Rs. 300.
 - (3) Rent, Rates and Insurance include Rs. 800 paid for one year ending on 30th June, 2010.
 - (4) Provide for doubtful debts on debtors at 5%.
 - (5) Depreciation Building by 5% and Machinery by 10%.
 - (6) Goods worth Rs. 1,250 were distributed as free samples for which no record has been made in the books.
- (12) From the following Trial Balance of Sagar and Rikish, you are required to prepare a Trading and Profit and Loss a/c. for the year ended 31st March, 2010 and Balance Sheet as on the date, after taking into the consideration the additional information:

Particulars	Dr. (₹)	Cr. (₹)
Opening Stock	17,500	
Salaries and Wages	4,600	
Cash in hand	5,000	
Purchases and Sales	1,12,600	1,65,000
Office expense	4,300	
productive wages	7,000	
Bills receivable	4,000	
Legal expenses	1,500	
Bad debts	500	
Works Manager's Salary	3,000	

Accounting for Banking Company

Commission	1,500	2,400
Investments	10,000	
Debtors and Creditors	20,000	10,000
Bank overdraft		5,000
Patents	4,000	
Losses Tools	3,000	
Furniture	6,000	
Goodwill	6,500	
Interest on investment		3,600
Land and Building	25,000	
Capital Account:		
Sagar		30,000
Rikish		20,000
Total	2,36,000	2,36,000

Adjustments:

- (1) Partners share Profit and Losses in their capital ratio.
 - (2) The Closing Stock - Cost Rs. 20,000 Market Value Rs. 22,500.
 - (3) Sagar has withdrawn goods worth Rs. 600 for his personal use.
 - (4) Uninsured goods worth Rs. 5,000 were destroyed by fire.
 - (5) Rs. 225 written off as bad debts from debtors.
 - (6) Outstanding salaries and wages Rs. 400.
 - (7) Depreciation on Land and Building at 7 1/2%.
- (13) From the following Trial Balance of Mohan and Sohan, you are required to prepare a Trading and Profit and Loss a/c for the year ended 31st March, 2010 and the Balance Sheet as on that date, after taking into consideration the additional information:

Particulars	Dr. (₹)	Cr. (₹)
Mohan's Capital		2,00,000
Sohan's Capital		1,80,000
Mohan's Drawings	14,450	
Sohan's Drawings	10,000	
Stock (1/4/2009)	2,20,000	
Bills receivable	30,000	
Purchases	2,80,000	

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Sales		4,00,000
Bills Payable		40,000
Return Outward		4,500
Return Inward	5,000	
Plant and Machinery	1,00,000	
Goodwill	25,000	
Patents	20,000	
Sundry Debtors and Creditors	1,25,000	1,38,000
Cash in Hand	2,550	
Cash in Bank	75,000	
Salaries	11,000	
Wages	17,000	
Office Expenses	9,500	
Insurance	3,000	
Advertisement	5,000	
General Expenses	6,500	
Factory Rent	3,500	
Total	9,62,500	9,62,500

Adjustments:

- (1) Depreciation plant and machinery by 5% and patent by 15%.
 - (2) Provide for Reserve for bad and doubtful debts @ 5% on Sundry debtors.
 - (3) Prepaid Insurance Rs. 600.
 - (4) Provide for outstanding expenses: Salary Rs. 2,000, Wages Rs. 1,000, and Advertisement Rs. 700.
 - (5) Stock on 31st March 2010 was valued at Rs. 1,20,000.
 - (6) Goods costing Rs. 6,000 were destroyed by fire and the Insurance Company has admitted a claim for Rs. 3,800.
 - (7) Partners share Profit and Losses equally.
- (14) Ramesh and Mahesh are partners sharing Profits and Losses 2:1. Following is the Trial Balance an on 31/3/2010.

Particulars	Dr. (₹)	Cr. (₹)
Land and Building	55,000	
Machinery	40,000	

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Salary and Wages	21,000	
Cash at Bank	40,000	
Cash in Hand	1,100	
Motor Vans	20,000	
Office Expenses	1,000	
Ramesh's Capital		1,16,000
Mahesh's Capital		62,000
Carriage	5,000	
Purchases and Sales	2,20,000	2,80,000
Return Outward		5,500
Return Inward	2,000	
Bad debts	1,000	
Debtors and Creditors	32,800	20,000
Rent	1,100	
Bills payable		35,000
Travelling Expenses	7,000	
Stock (1/4/2009)	30,000	
Insurance	1,500	
Discount	8,000	
Advertisement	12,000	
Furniture	20,000	
Total	5,18,500	5,18,500

Adjustments:

- (1) On 31/3/2010 the cost price of closing stock was Rs. 41,000 and its market price was Rs. 42,000.
- (2) Goods worth Rs. 5,000 were taken over by Ramesh for personal use were not entered in the books of accounts.
- (3) Goods worth Rs. 5,000 were destroyed by fire and Insurance Co. agreed to pay Rs. 4,000 in full settlement of the claim.
- (4) Outstanding expenses: Rent Rs. 100 and Salary Rs. 500.
- (5) Provide depreciation 10% on machinery and 5% on furniture.
- (6) Provide Rs. 800 for Reserve for doubtful debts on debtors.



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You are required to prepare Trading and Profit and Losses a/c. for the year ending 31/3/2010 and the Balance Sheet as on that date after considering the above adjustments.

- (15) Shanta and Banta are partners sharing profits and losses equally. From the following Trial Balance and adjustments you are required to prepare a Trading a/c, Profit and Loss a/c for the year ended on 31st March, 2010 and Balance Sheet as on that date:

Debit Balance	(₹)	Credit Balance	(₹)
Carriage	2,000	Capitals:	
Opening Stock	30,760	Shanta	60,000
Salary	4,000	Banta	40,000
Wages	1,000	Commission	4,000
Discount	500	Interest	4,200
Interest	750	Sales	92,000
Motive Power	4,500	Purchases Return	3,800
Motor Van	28,000	Sundry Creditors	27,400
Bad Debts	1,920	Outstanding Salary	400
Building	34,000		
Debtors	20,000		
Cash in Bank	16,120		
Machinery	10,000		
Investment	12,000		
Purchases	60,250		
Drawings:			
Shanta	2,800		
Banta	3,200		
Total	2,31,800	Total	2,31,800

Adjustments:

- (1) Outstanding wages Rs. 400.
 - (2) Provide depreciation at 10% p.a. Building and Motor Van.
 - (3) Accrued interest on investment Rs. 360.
 - (4) Provide 5% RBDD on Debtors.
 - (5) Stock at 31st March, 2010 was Market Value Rs. 40,000; Cost Price Rs. 50,000.
- (16) Nitin and Nilesch are partners sharing profit and losses equally. Following is their Trial Balance as on 31st March, 2010.

(cdlxxxi)

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Particulars	Dr. (₹)	Cr. (₹)
Buildings	27,500	
Machinery	20,000	
Salary and Wages	10,500	
Cash at Bank	20,000	
Cash in Hand	550	
Motor Cycle	10,000	
Office Expenses	500	
Nitin's Capital		58,000
Nilesh's Capital		31,000
Carriage Outward	2,500	
Purchases and Sales	1,10,000	1,40,000
Return Outwards		2,750
Return Inwards	1,000	
Bad Debts	500	
Debtors and Creditors	16,400	27,500
Rent	550	
Printing and Stationery	750	
Travelling Expenses	2,750	
Stock (1/4/2009)	15,000	
Insurance	750	
Discount	4,000	
Advertisement (for 3 years)	6,000	
Furniture	10,000	
Total	2,59,250	2,59,250

Adjustments:

- (1) The Closing Stock on 31st March, 2010 was valued at cost Rs. 20,500 while its market price is Rs. 22,500.
- (2) Goods worth Rs. 2,500 were destroyed by fire and Insurance Company agreed to pay Rs. 2,000 in full settlement of the claim.
- (3) Unpaid expenses - Rent Rs. 50 and Salary Rs. 250.

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- (4) Provide depreciation at 10% on machinery and 5% on furniture.
- (5) Goods worth Rs. 4,000 were sold on 27th Marhc, 2010 but no entry was made in the books.

You are required to prepare Trading and Profit and Loss a/c for the year ended 31st March, 2010 and the Balance Sheet as on the date after considering the above adjustments.

- (17) A and B who are in partnership sharing profits and losses in the proportion of 3/5 and 2/5 respectively decided to admit C into partnership who was trading alone in the same line and from a new firm ABC {LLP}. Their balance sheets on 31st December, 2010 are as follows:

A and B

Liabilities	(₹)	Assets	(₹)
A's Capital Account	1,05,000	Cash	20,000
B's Capital Account	70,000	Book Debts	65,000
Creditors	15,000	Machinery	35,000
Reserve	10,000	Land and Machinery	10,000
		Stock	70,000
Total	2,00,000	Total	2,00,000

C

Liabilities	(₹)	Assets	(₹)
C's Capital	20,000	Stock	15,000
Creditors	7,500	Book Debts	2,500
		Cash	10,000
Total	27,500	Total	27,500

It is decided that c should be given a quarter shares in the new firm. A and B sharing the balance in the old proportion. It is also agreed that C's assets and liabilities were to be taken over as per his balance sheet, but the following adjustments were to be made in A and B's balance sheet:

- (1) Debtors to be written off by Rs. 15,000.
- (2) Stocks to be written off by Rs. 15,000.
- (3) Machinery to be written off Rs. 5,000.

C also agrees to pay privately to A and B by way of goodwill quarter share of A and B's profits for the last two years which were Rs. 27,000 and Rs. 33,000. It was also decided that the partner's capitals in the new business shall be in the same proportion as they share profits.

Draw up:

- (1) The necessary accounts in the books of A and B.

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- (2) The Journal and the new firm's Balance Sheet at as 1st January 2011 and state
- The total costs to C for his share in the business,
 - How much A and B will each receive for goodwill?
- (18) On 31st December, 2010 Fairplay [LLP] was incorporated with a Total Contribution of Rs. 1,00,000 to take over the business carried on that date by the partnership of P, G and B.
- The balance sheet of the partnership as on 31st December 2010 showed the following position:

Liabilities	P (₹)	G (₹)	B (₹)	Total
Capital A/cs:				
Balance as on 31/12/2009	35,940	26,480	21,000	
Add: Interest on Capital A/cs	720	540	450	
Share of profit for the year	6,126	6,126	4,084	
	42,786	33,146	25,534	
Less: Drawings	8,926	8,726	4,064	
	33,860	24,420	21,470	79,750
Creditors				35,600
Total				1,15,350

Assets	Cost (₹)	Depreciation (₹)	Total (₹)
Fixed Assets:			
Freehold Land and Building	26,000		26,000
Plant and Machinery	42,000	22,000	20,000
Motor Vehicles	19,700	4,700	15,000
	87,700	26,700	61,000
Current Assets:			
Stock			22,400
Debtors			12,200
Balance at Bank			19,750
Total			1,15,350

You are also given the following information:

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- (1) Freehold land and building are to be transferred to the LLP at a valuation of Rs. 30,000 and plant and machinery at Rs. 15,000. Stocks, debtors and creditors are to be transferred to the LLP at book value as on 31st December, 2010.
- (2) The motor vehicles are to be withdrawn from the business by the partners at the following valuations - P Rs. 4,900, G Rs. 3,500, and B Rs. 3,600.
- (3) It is estimated that the LLP will require an opening balance at bank of Rs. 15,000.
- (4) Contributions of Partners in LLP - P: 23,000; G: 21,000; B: 15,000.
- (5) Any surplus / Deficiency on Partners' Accounts is adjusted in cash.

Required:

- (a) Partners' Accounts in columnar form showing all showing all the necessary entries to dissolve the partnership, and,
- (b) A balance sheet of the LLP upon completion.