



CS EXECUTIVE NEW SYLLABUS

EDITION - 3

CORPORATE ACCOUNTING



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CHAPTER-1

INTRODUCTION TO ACCOUNTING

INTRODUCTION

Business is the activity of making one's living or making money by producing or buying and selling products (such as goods and services). It is also "any activity or enterprise entered into with the motive of earning profits and maximization of the wealth for owners. No business can run in isolation. Largely, the business activity is carried out by people coming together with a purpose to serve a common cause. This term is often referred to as an organization, which could be in different forms such as sole proprietorship, partnership, corporate body, etc.

- **Sole proprietorship:** A sole proprietorship, also known as a sole trader, is owned by one person and operates for their benefit. All assets of the business belong to a sole proprietor, including, for example, a computer infrastructure, any inventory, manufacturing equipment, or retail fixtures, as well as any real property owned by the sole proprietor.
- **Partnership:** A partnership is a business owned by two or more people. In most forms of partnerships, each partner has unlimited liability for the debts incurred by the business. The three most prevalent types of for-profit partnerships are general partnerships, limited partnerships, and limited liability partnerships.
- **Corporation:** The owners of a corporation have limited liability and the business has a separate legal personality from its owners. Corporations can be either government-owned or privately owned, and they can organize either for profit or as non profit organizations.
- **Co-operative:** Often referred to as a "co-op", a co-operative is a limited-liability business that can organize as for-profit or not-for-profit. A cooperative differs from a corporation in that it has members, not shareholders, and they share decision-making authority.
- **Franchises:** A franchise is a system in which entrepreneurs purchase the rights to open and run a business from a larger corporation. Franchising in the United States is widespread and is a major economic powerhouse.
- **A company limited by guarantee:** Commonly used where companies are formed for non-commercial purposes, such as clubs or charities. The members guarantee the payment of certain (usually nominal) amounts if the company goes into insolvent liquidation, but otherwise, they have no economic rights in relation to the company. A company limited by guarantee may be with or without having share capital.
- **A company limited by shares:** The most common form of the company used for business ventures. Specifically, a limited company is a "company in which the liability of each shareholder is limited to the amount individually invested" with corporations being "the most common example of a limited company."
- **A company limited by guarantee with a share capital:** A hybrid entity, usually used where the company is formed for non-commercial purposes, but the activities of the company are partly funded by investors who expect a return.
- **An unlimited company with or without a share capital:** A hybrid entity, a company where the liability of members or shareholders for the debts (if any) of the company are not limited. In this case, the doctrine of a veil of incorporation does not apply.

The business activities require resources (which are limited and have multiple uses) primarily in terms of material, labor, technology etc. The success of a business depends on how efficiently and effectively these resources are managed. Therefore, there is a need to ensure that the businessman tracks the use of these resources. The resources are not free, and thus one must be careful to keep an eye on the cost of acquiring them as well. As the basic purpose of business is to make profit, one must keep an ongoing track of the activities undertaken in the course of business. Two basic questions would have to be answered:

- (a) What is the result of any business operations? i.e. whether it has made profit or loss?
- (b) What is the position of the resources acquired and used for business purposes? How are these resources financed and where do the funds come from?

The answers to these questions can be found through recording all the business activities / transaction / event. Recording of business activities has to be done in a scientific manner so that they reveal the correct outcome.

Accounting, also known as **accountancy**, is the measurement, processing, and communication of financial and nonfinancial information about economic entities such as businesses and corporations. Accounting, which has been called the “language of business”, measures the results of an organization’s economic activities and conveys this information to a variety of stakeholders, including investors, creditors, management, and regulators. Practitioners of accounting are known as accountants. The terms “accounting” and “financial reporting” are often used as synonyms.

“Accounting is “the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof”. - **American Institute of Certified Public Accountants (‘AICPA’)**

Attributes of Accounting



- (i) **Accounting is an Art** - Accounting is classified as an art, as it helps us in attaining our aim of ascertaining the financial results, that is, operating profit and financial position through analysis and interpretation of financial data which requires special knowledge, experience and judgment.
- (ii) **It involves recording, classifying and summarizing** - Recording means systematically writing down the transactions and events in account books soon after their occurrence. Classifying is the process of grouping transactions or entries of the same type at one place. This is done by opening accounts in a book called ledger. Summarizing involves the preparation of reports and statements from the classified data (ledger), understandable and useful to management and other interested parties. This involves preparation of final accounts namely profit and loss account and balance sheet.
- (iii) **It records transactions in terms of money** - All transactions are recorded in terms of common measure, i.e., money which increases the understanding of the state of affairs of the business.
- (iv) **It records only those transactions and events which are of financial character** - If an event has no financial character then it will not be capable of being measured in terms of money; it will not be, therefore, recorded.
- (v) **It is the art of interpreting the results of operations** - to determine the financial position of the enterprise, the progress it has made and how well it is getting along.

Objectives of Accounting

Providing Information to the Users for Rational Decision making	Accounting provides useful information for decision-making to stakeholders such as owners, management, creditors and investors and other stake holders. Various outcomes of business activities such as costs, prices, sales volume, value under ownership and return on investment are measured in the accounting process. All these accounting measurements are used by stakeholders in decision making process. Hence, accounting is identified as the language of a business.
Systematic Recording of Transactions	To ensure reliability and precision for the accounting measurements, it is necessary to keep a systematic record of all financial transactions of a business enterprise which is ensured by book-keeping. These financial records are classified, summarized and reposted in the form of accounting measurements to the users of accounting information i.e., stakeholders.
Ascertainment the results of above Transactions	Profit/Loss is a core accounting measurement done and measured by preparing a Profit and Loss Account for a particular period. Difference between these revenue incomes and revenue expenses is known as the result of business transactions identified as profit/loss. As this measure is used very frequently by stakeholders for rational decision making, it has become the objective of accounting. For example, Income Tax Act requires that every business should have an accounting system that can measure taxable income of the business and also explain nature and source of every item reported in Income Tax Return.
Ascertain the Financial Position of Business	Financial position is identified by preparing a statement of ownership meaning Assets, and owing meaning Liabilities of the business as on a certain date. This statement is popularly known as Balance Sheet. This statement may be used by various stakeholders for taking financing and investment decisions.
To Know the Solvency Position	Balance Sheet and Profit and Loss Account provide useful information to stockholders regarding potential of the entity to meet their obligations in the short as well as in the long run.

BOOK-KEEPING

As defined by Carter, “Book-Keeping is a science as well as art of correctly recording in books of accounts all those business transactions that result in transfer of money or money’s worth”.

Book-keeping is an activity concerned with recording and classifying financial data related to business operations in order of occurrence.

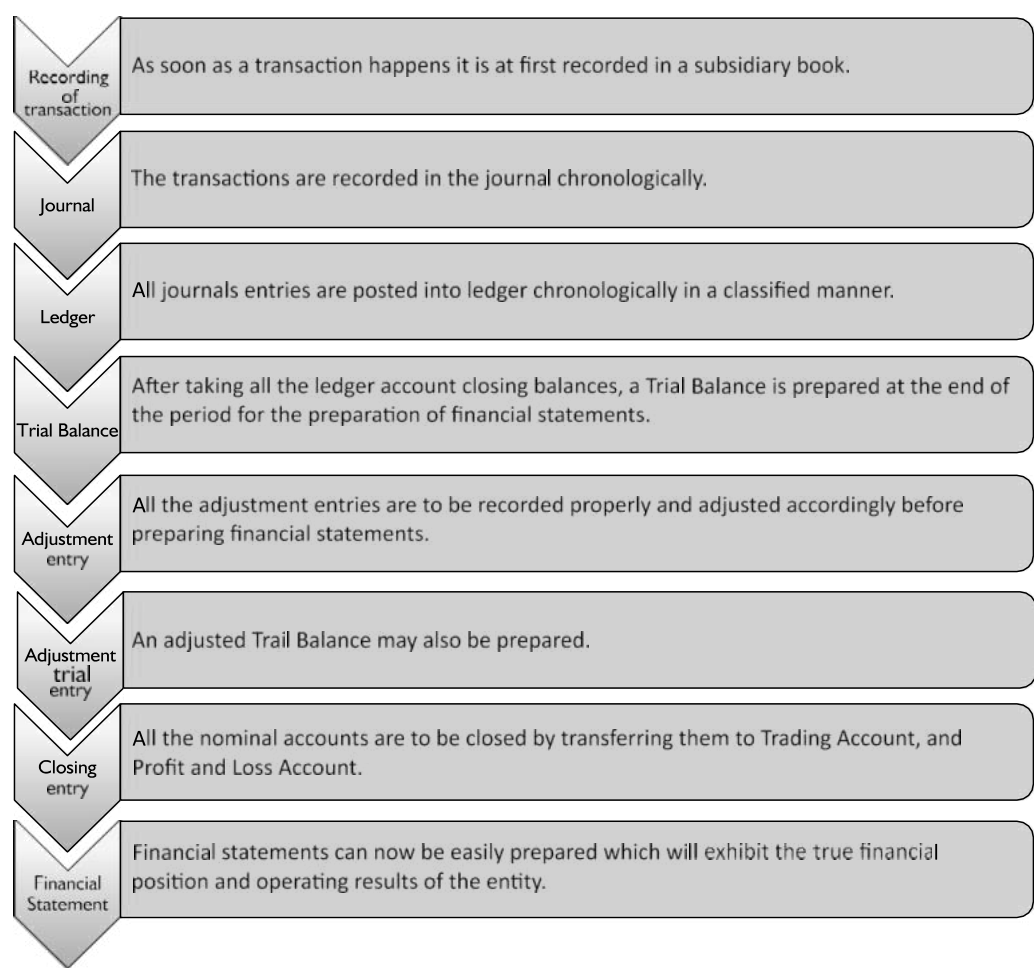
Book-keeping involves:

- Collection of basic financial information
- Identification of events and transactions with financial character, i.e., economic transactions
- Measurement of economic transactions in terms of money
- Recording of financial effects of economic transactions in order of its occurrence
- Classifying effects of economic transactions
- Preparing organized statement known as Trial Balance

Distinction between Book-Keeping and Accounting

Book-Keeping	Accounting
Output of book-keeping is an input for accounting.	Output of accounting permits informed judgments and decisions by the user (stakeholders) of accounting information.
Purpose of book-keeping is to keep systematic record of transactions and events of financial character in order of occurrence.	Purpose of accounting is to find results of operating activity of a business and to report its financial strength.
Book-keeping is the foundation of accounting.	Accounting is considered as a language of business.
Book-keeping is carried out by the junior staff.	Accounting is done by the senior staff who have skills of analysis and interpretation.
Objective of book-keeping is to summarize the cumulative effect of all economic transactions of business for a given period by maintaining permanent record of each business transaction with its evidence and financial effects on accounting variable.	Object of accounting is not only book-keeping but also analyzing and interpreting reported financial information for informed decisions by the stake-holders or user of financial statement.

ACCOUNTING CYCLE



The accounting cycle is a basic, eight-step process for completing a company’s book-keeping tasks. It provides a clear guide for the recording, analysis, and final reporting of a business’s financial activities.

The steps or phases of accounting cycle can be developed as under:

Basic Accounting Terms

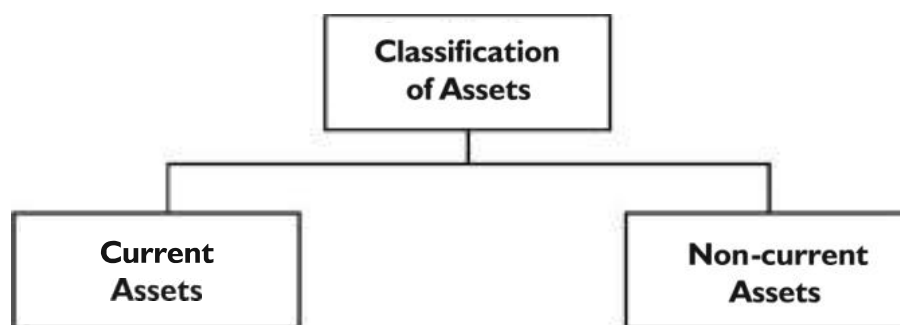
In order to understand the Accounting clearly, one must grasp the following common expressions used in business accounting. The aim here is to enable the student to understand these often used concepts before we embark on accounting procedures and rules.

- Transaction:** It means an event or a business activity which involves exchange of money or money’s worth between parties. The event can be measured in terms of money and changes the financial position of a entity e.g., purchase of goods would involve receiving material and making payment or creating an obligation to pay to the supplier at a future date. Transaction

could be a cash transaction or credit transaction. When the parties settle the transaction immediately by making payment in cash or by cheque, it is called a cash transaction. On the other hand, in credit transactions, the payment is settled at a future date as per agreement between the parties.

- **Event:** An event may be described as any incidence that occurs as a result of something. In an accounting sense, an event can be understood as the final outcome of a business activity that can affect the account balances of the company if it is financial in nature. Whenever there is an increase or decrease in the company's assets or liabilities, an accounting event takes place. Therefore, it can change the fundamental accounting equation and can be expressed monetarily.
- **Goods/Services:** These are tangible article or commodities in which a business deals. These articles or commodities are either bought and sold or produced and sold. At times, what may be classified as goods to one business firm may not be goods to the other firm, e.g., for a machine manufacturing company, the machines are goods as they are frequently made and sold. But for the buying firm, it is not goods as the intention is to use it as a long-term resource and not sell it. The services are intangible in nature and are rendered with or without the object of earning profits.
- **Capital Expenditure:** This represents expenditure incurred for the purpose of acquiring a fixed asset which is intended to be used over long term for earning profits there from, e.g., amount paid to buy a computer for office use is a capital expenditure. At times expenditure may be incurred for enhancing the production capacity of the machine. This will also be a capital expenditure. Capital expenditure forms a part of the Balance Sheet.
- **Revenue Expenditure:** This represents expenditure incurred to earn revenue of the current period. The benefits of revenue expenses get exhausted in the year of the incurrence. For example repairs, insurance, salary and wages to employees, travel, etc. The revenue expenditure results in the reduction in profit or surplus. It becomes part of the Income statement.
- **Profit and Loss Account or Income Statement:** This account shows the revenue earned by the business and the expenses incurred by it to earn that revenue. This is prepared usually for a particular accounting period, which could be a month, quarter, half a year or a year. The net result of the Profit and Loss Account shows profit earned or loss suffered by the business entity.
- **Profit:** The excess of revenue over expenses is called profit.
- **Loss:** The excess of expense over income is called loss.
- **Trade Discount:** It is the discount usually allowed by the wholesaler to the retailer computed on the list price or invoice price. For example, the list price of a TV set could be Rs. 15,000. The wholesaler may allow 20% discount thereof to the retailer. This means the retailer will get it for Rs.12,000 and is expected to sell it finally to a customer at the list price. Thus, the trade discount enables the retailer to make profit by selling at the list price. Trade discount is not recorded in the books of accounts. The transactions are recorded at net values only. In the above example, the transaction will be recorded at Rs. 12,000 only.
- **Cash Discount:** It is allowed to encourage prompt payment by the debtor. It has to be recorded in the books of accounts. It is calculated after deducting the trade discount, like if list price is Rs. 15,000 on which a trade discount of 20% and cash discount of 2% apply, the first trade discount of Rs.3,000 (20% of Rs. 15,000) will be deducted and the cash discount of 2% will be calculated on Rs.12,000 (Rs.15,000 – Rs.3,000). Hence, the cash discount will be Rs.240 (2% of Rs. 12,000) and net payment will be Rs. 11,760 (Rs. 12,000 - Rs. 240)

- **Balance Sheet:** It is the statement of the financial position of the business entity on a particular date. It lists all assets, liabilities and capital. It is important to note that this statement exhibits the state of affairs of the business as on a particular date only. It describes what the business owns and what it owes to outsiders (this denotes liabilities), and to the owners (this denotes capital). It is prepared after incorporating the resulting Profit/Loss or Income Statement.
- **Asset:** Asset is a resource owned by a business with the purpose of using it for generating future profits. Assets can be tangible and intangible.
- **Tangible Assets** are the capital assets which have some physical existence. These can, therefore, be seen, touched and felt, e.g., plant and machinery, furniture and fittings, land and buildings, books, computers and vehicles.
- **Intangible Assets:** The capital assets which have no physical existence and whose value is limited by the rights and anticipated benefits that possession confers upon the owner are known as intangible assets. These cannot be seen or felt although these help to generate revenue in future, e.g., goodwill, patents, trade-marks, copyrights, brand equity, designs and intellectual property, etc.
- **Classification of Assets:** Assets can also be classified as Current Assets and Non-Current Assets.



- **Current Assets** – An asset can be classified as Current if it satisfies any of the following:
 - i. It is expected to be realized in, or is intended for sale or consumption in the company's normal operating cycle;
 - ii. It is held primarily for the purpose of being traded;
 - iii. It is due to be realized within 12 months after the Reporting Date; or
 - iv. It is Cash or Cash Equivalent unless it is restricted from being exchanged or used to settle liability for at least 12 months after the Reporting Date.
- **Non-Current Assets** – Other than Current Assets, all other assets are classified as Non-Current Assets, e.g., Machinery held for Long-term, etc.
- **Current Investments:** Current investments are investments that are by their nature readily realizable and are intended to be held for not more than one year from the date on which such investment is made. 11-months Commercial Paper is an example of current investment.
- **Non-Current Investments:** Non-Current Investments are investments which are held beyond the current period for sale or disposal, like a Fixed Deposit for 5 years.

- **Debtor:** The sum total or aggregate of the amounts which the customer owes to the business for the purchase of goods on credit or services rendered or in respect of other contractual obligations, is known as Sundry Debtors or Trade Debtors, or Trade Payable, or Book-Debts or Debtors. These debtors may again be classified as under:
 - (a) **Good Debts:** The debts which are sure to be realized are called good debts.
 - (b) **Doubtful Debts:** The debts which may or may not be realized are called doubtful debts.
 - (c) **Bad Debts:** The debts which cannot be realized at all are called bad debts.
- **Fictitious Assets:** Fictitious assets are not assets at all since they are not represented by any tangible possession. They appear on the asset side simply because of a debit balance in a particular account not yet written off, e.g., provision for discount to creditors, discount on issue of shares, etc.
- **Wasting Assets:** Such assets as mines, quarries, etc., that become exhausted or reduce in value by their workings are called wasting assets.
- **Liability:** It is an obligation of financial nature to be settled at a future date. It represents amount of money that the business owes to the other parties. For instance, when goods are bought on credit, the firm will create an obligation to pay to the supplier, the price of goods on an agreed future date, or when a loan is taken from bank, an obligation to pay the interest and principal amount is created. Depending upon the period of holding, these obligations could be further classified into long term or Non-current liabilities, and short term or current liabilities.
- **Current Liabilities** – A liability is classified as current when it satisfies any of the following:
 - i. It is expected to be settled in the company's normal Operating Cycle;
 - ii. It is held primarily for the purpose of being traded;
 - iii. It is due to be settled within 12 months after the Reporting Date; or
 - iv. The company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.
- **Non-Current Liabilities** – Other than Current Liabilities, all other liabilities shall be classified as Non-Current Liabilities. For example loan taken for 5 years, Debentures issued etc.
- **Contingent Liability:** It represents a potential obligation that could be created depending on the outcome of an event. For example, if a supplier of a business files a legal suit, it will not be treated as a liability because no obligation is created immediately. If the verdict of the case is given in favour of the supplier then only the obligation is created. Till that time it is treated as a contingent liability. Please note that contingent liability is not recorded in books of account, but disclosed through a note in the financial statements.
- **Capital:** Capital is the amount invested in a business by its owners. It may be in the form of cash, goods, or any other asset which the proprietor or partners of business invest in the business.
- **Drawings:** It represents the amount of cash, goods or any other assets which the owner withdraws from business for his or her personal use, e.g., the life insurance premium of the proprietor or a partner of the firm is paid from the business, it is called drawings. Drawings will result in a reduction in the owners' capital. The concept of drawing is not applicable to the corporate bodies like limited companies.
- **Net worth:** It represents the excess of total assets over total liabilities of a business. Technically, this amount is made available to be distributed to the owners in the event of closure of the business after payment of all liabilities.
- **Creditor:** A creditor is a person to whom the business owes money or money's worth. For example, money payable to the supplier of goods or provider of service. Creditors are generally classified as Current Liabilities.

SINGLE ENTRY SYSTEM

Single-entry bookkeeping, also known as, single-entry accounting, is a method of bookkeeping that relies on a one-sided accounting entry to maintain financial information. In case of double entry

system of book-keeping both the aspects of every transaction are recorded. In this system, the first entry is made to the debit of an account, and the second entry to the credit of second account. However, in case of single entry system, the business houses for their convenience and more practical approach ignore the strict rules of double entry system. The users of this system maintain only the essential records. In other words, it is a system which may not keep some books of subsidiary records, and some ledger accounts too which otherwise are kept in case of double entry system.

According to a Dictionary of Accountancy by Kohler, "A system of book-keeping in which as a rule only records of cash and of personal accounts are maintained, it is always incomplete double entry varying with the circumstances." Thus, under the so-called single entry system both the aspects of business transactions and events are not recorded. Under the single entry system usually a cash book and personal accounts are maintained.

DOUBLE ENTRY SYSTEM

Double-entry bookkeeping, also known as double-entry accounting, is a method of bookkeeping that relies on a two-sided accounting entry to maintain financial information. Every entry to an account requires a corresponding and opposite entry to a different account. The double-entry system has two equal and corresponding sides known as debit and credit.

It was in 1494 that Luca Petiole, the Italian mathematician, first published his comprehensive treatise on the principles of Double Entry System. The use of principles of double entry system made it possible to record not only cash but also all sorts of mercantile transactions. It had created a profound impact on auditing too, because it enhanced the duties of an auditor to a considerable extent.

Features of Double Entry System

- (a) Every transaction has two-fold aspects, i.e., one party giving the benefit and the other receiving the benefit.
- (b) Every transaction is divided into two aspects, debit and credit. One account is to be debited and the other account is to be credited.
- (c) Every debit must have its corresponding and equal credit.

Advantages of Double Entry System

- (a) Since personal and impersonal accounts are maintained under the double entry system, both the effects of the transactions are recorded.
- (b) It ensures arithmetical accuracy of the books of accounts, for every debit, there is a corresponding and equal credit. This is ascertained by preparing a trial balance periodically, or at the end of the financial year.
- (c) It prevents and minimizes error. Moreover frauds can be detected early.
- (d) Errors can be checked and rectified easily.
- (e) The balances of receivables and payables are determined easily, since the personal accounts are maintained.
- (f) The businessman can compare the financial position of the current year with that of the past years.
- (g) The businessman can justify the standing of his business in comparison with the previous year purchase, sales, and stocks, incomes and expenses with that of the current year figures.
- (h) Helps in decision-making.
- (i) The net operating results can be calculated by preparing the Trading and Profit and Loss A/c for the year ended and the financial position can be ascertained by the preparation of the Balance Sheet.
- (j) It helps the Government to decide sickness of business units and extend help accordingly.
- (k) The other stakeholders, like suppliers and banks can take a proper decision regarding grant of credit or loans.

Limitations of Double Entry System

- (a) The system does not disclose all the errors committed in the books of accounts.
- (b) The Trial Balance prepared under this system does not disclose certain types of errors i.e. compensating error.
- (c) It is costly as it involves maintenance of numbers of books of accounts.

ACCOUNTING CONCEPT

Accounting concepts are the generally accepted rules and assumptions that assist accountants in preparing financial statements. In layman's terms, they are the fundamental building blocks of the transactions of the business. The following are the some Accounting Concepts that's need to be kept in mind while recording the transaction in books of accounts.

1. **Accruals Concept:** An accrual is a journal entry that is used to recognize revenues and expenses that have been earned or consumed, respectively, and for which the related cash amounts have not yet been received or paid out. Accruals are needed to ensure that all revenues and expenses are recognized within the correct reporting period, irrespective of the timing of the related cash flows.
2. **Conservatism Concept:** Revenue is only recognized when there is a reasonable certainty that it will be realized, whereas expenses are recognized sooner, when there is a reasonable possibility that they will be incurred. This concept tends to result in more conservative financial statements.
3. **Consistency Concept:** Once a business chooses to use a specific accounting method, it should continue using it on a go-forward basis. By doing so, financial statements prepared in multiple periods can be reliably compared.
4. **Economic Entity Concept:** The transactions of a business are to be kept separate from those of its owners. By doing so, there is no intermingling of personal and business transactions in a company's financial statements.
5. **Going Concern Concept:** Financial statements are prepared on the assumption that the business will remain in operation in future periods. Under this assumption, revenue and expense recognition may be deferred to a future period, when the company is still operating. Otherwise, all expense recognition in particular would be accelerated into the current period.
6. **Matching Concept:** The expenses related to revenue should be recognized in the same period in which the revenue was recognized. By doing this, there is no deferral of expense recognition into later reporting periods, so that someone viewing a company's financial statements can be assured that all aspects of a transaction have been recorded at the same time.
7. **Materiality Concept:** Materiality is an accounting principle which states that all items that are reasonably likely to impact investors' decision-making must be recorded or reported in detail in a business's financial statements using GAAP standards. Materiality is a concept that defines why and how certain issues are important for a company or a business sector. A material issue can have a major impact on the financial, economic, reputational, and legal aspects of a company, as well as on the system of internal and external stakeholders of that company. Items or events which have significant effect in decision based on Financial Statement must be clearly disclosed. Both nature and volume of a transaction is capable to make it material.

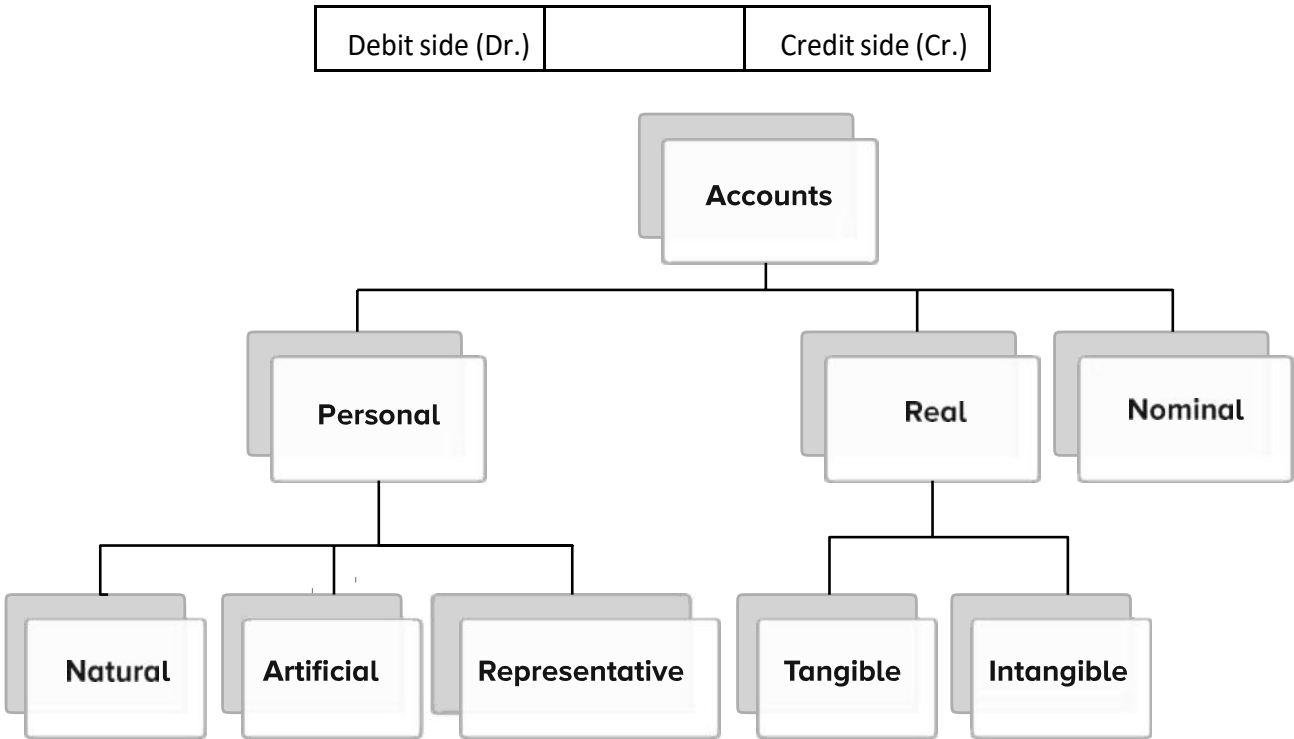
TYPES OF ACCOUNTS

An account is defined as a summarized record of transactions related to a person or a thing, e.g., when the business deals with customers and suppliers, the customer and supplier will each be a separate account.

The account is also related to things – both tangible and intangible, like, land, building, equipment, brand value and trademarks are some of the things. When a business transaction happens, one has to

identify the account that will be affected by it and then apply the rules to decide its accounting treatment.

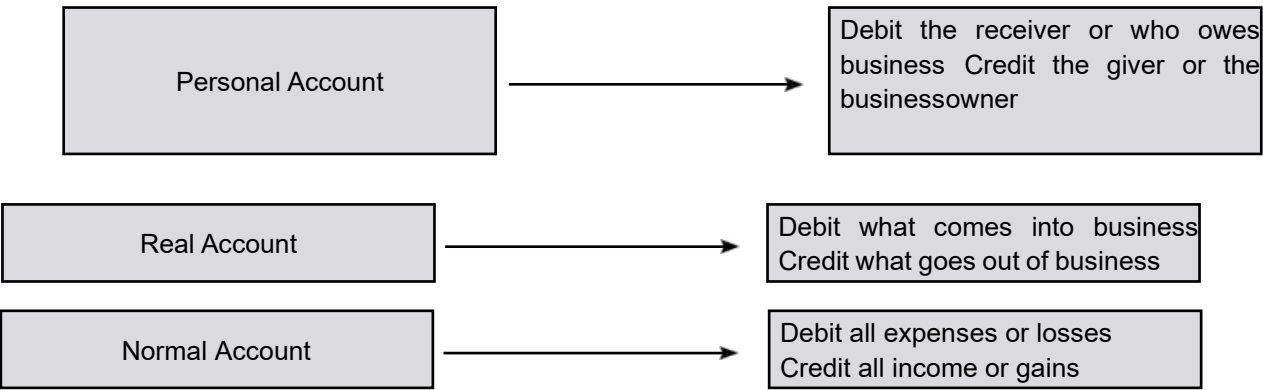
Typically, an account is expressed as a statement in the form of English letter 'T'. It has two sides. The left hand side is called as the Debit side, and the right hand side is called as the Credit side. The debit is denoted as 'Dr' and the credit as 'Cr'. The convention is to write the Dr. and Cr. labels on both sides as shown below.



1. **Personal Account:** As the name suggests these are accounts related to persons.
 - (a) These persons could be natural persons, like Suresh's A/c, Anil's A/c and Rani's A/c.
 - (b) The persons could also be artificial persons like companies, bodies corporate or association of persons or partnerships. Accordingly, we could have Videocon Industries A/c, Infosys Technologies A/c, Charitable Trust A/c, Ali and Sons Trading A/c and ABC Bank A/c.
 - (c) There could be representative personal accounts as well. Although the individual identity of persons related to these is known, the convention is to reflect them as collective accounts, e.g., when salary is payable to employees, we know how much is payable to each of them, but collectively the account is called as Salary Payable A/c.
2. **Real Accounts:** These are accounts related to assets or properties or possessions Depending on their physical existence or otherwise, they are further classified as follows:
 - (a) *Tangible Real Account* – Assets that have physical existence and can be seen and touched, under this as Machinery A/c, Stock A/c, Cash A/c, Vehicle A/c, and the like.
 - (b) *Intangible Real Account* – These represent possession of properties that have no physical existence but can be measured in terms of money and have value attached to them like Goodwill A/c, Trade Mark A/c, Patents & Copy Rights A/c and Intellectual Property Rights A/c.
3. **Nominal Account:** These accounts are related to expenses or losses and incomes or gains e.g. Salary and Wages A/c, Rent and Rates A/c, Travelling Expenses A/c, Commission received A/c and Loss by fire A/c.

Golden Rules of Accounting

When one identifies the account that is getting affected by a transaction and type of that account, the next step is to apply the rules to decide whether the accounting treatment is to be debited or credited from that account. The Golden Rules will guide whether the account is to be debited or credited. These rules are shown below:



JOURNAL

A journal is often referred to the Book of Prime Entry or Book of Original Entry. In this book transactions are recorded in their chronological order. The process of recording transaction in a journal is called ‘Journalization’.The entry made in this book is called ‘journal entry’.

Advantages of Journal

- The following are the advantages of a journal:
- (a) **Chronological Record:** It records transactions as and when it happens. So it is possible to get detailed day-to-day information.
 - (b) **Minimizing the possibility of errors:** The nature of transaction and its effect on the financial position of the business is determined by recording and analyzing into both debit and credit aspects.
 - (c) **Narration:** It means explanation of the recorded transactions.
 - (d) **Helps to finalize the accounts:** Journal is the basis of ledger posting and the ultimate Trial Balance. The Trial Balance helps to prepare the final accounts.

Specimen of a Journal Book

Journal Entries in the Books of xxx

Date	Particulars	Voucher Number	Ledger folio	Debit amount (Rs.)	Credit Amount (Rs.)
dd-mm-yy	Name of A/c from which to be Debited Name of A/c to be credited (narration describing the transaction)	-----	Reference of page number of the A/c in ledger	-----	-----

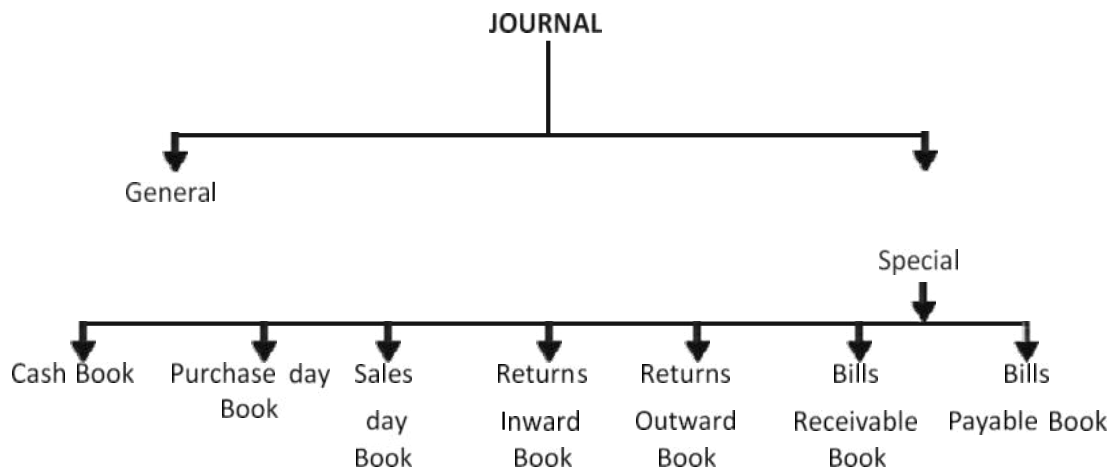
- (a) **Date Column:** This column contains the date of the transaction.
- (b) **Particulars:** This column contains which account is to be debited and which account is to be credited. It is also supported by an explanation called narration.
- (c) **Voucher Number:** This column contains the number written on the voucher of the respective transaction.
- (d) **Ledger Folio (L.F.):** This column contains the folio (i.e., page no.) of the ledger, where the transaction is posted.

- (e) **Dr. Amount and Cr. Amount:** This column shows the financial value of each transaction. The amount is recorded in both the columns, since for every debit there is a corresponding and equal credit.

Sub-division of Journals

Journal is divided into two types –

- (i) General Journal and (ii) Special Journal.



- (i) *General Journal*
- (a) This book contains chronological record of transactions.
 - (b) This book records those transactions which occur so infrequently that they do not warrant the setting up of special journals.

Examples of such entries: (i) opening entries (ii) closing entries (iii) rectification of errors. The form of this general journal, is as under:

JOURNAL

Date	Particulars	L.F.	Dr. Amount	Cr. Amount

Recording of transactions in this book is called journalizing and the record of transactions is known as journal entry.

- (ii) *Special Journal*

It is sub-divided into Cash Book, Purchase Day Book, Sales Day Book, Returns Inward Book, Returns Outward Book, Bills Receivable Book and Bills Payable Book. These books are called subsidiary books.

Subsidiary Books

Subsidiary Books refer to books meant for specific transactions of similar nature. These books are also known as special journals or day books. To overcome shortcoming of the use of the journal only as a book of original entry, the journal is sub-divided into specific journals or subsidiary books.

The sub-division of journal is done as follows:

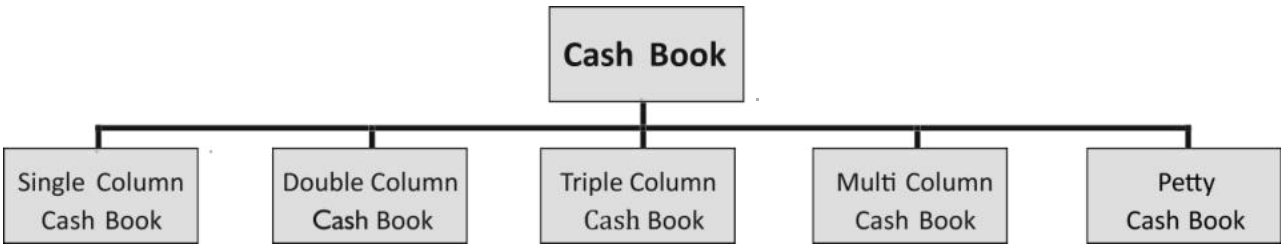
Transaction	Subsidiary Book
All cash and bank transactions	Cash Book has columns for cash, bank and cash discount

All credit purchase of goods – only those goods that are purchased for resale are covered here	Purchase Day Book or Purchase Register
All credit sale of goods	Sales Day Book or Sales Register
All purchase returns – i.e., return of goods back to suppliers due to defects	Purchase Return Book or Return Outward Book
All sales returns – i.e., return of goods back from Customers	Sales Return Book or Return Inward Book
All bill receivables – these are bills accepted by Customers to be honored at an agreed date	Bills Receivable Book
All bills payable - these are bills accepted by the business to be honored by paying to suppliers at an agreed date	Bills Payable Book
For all other transactions not covered in any of the above categories – i.e., purchase or sale of assets, expense accruals, rectification entries, adjusting entries, opening entries and closing entries	Journal Proper

Cash Book

A Cash Book is a special journal which is used for recording all cash receipts and cash payments. Cash Book is a book of original entry since transactions are recorded for the first time from the source documents. The Cash Book is larger in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side. Thus, the Cash Book is both a journal and a ledger.

Types of Cash Book



(a) **Single Column Cash Book**- Single Column Cash book has one amount column on each side. All cash receipts are recorded on the debit side and all cash payments on the payment side; this book is nothing but a Cash Account and there is no need to open separate cash account in the ledger.

Dr. *Specimen of Single Column Cash Book* Cr.

Receipts				Payments			
Date	Particulars	L.F.	Cash	Date	Particulars	L.F.	Cash

(b) **Double Column Cash Book**- The Double Column Cash Book has two amounts columns on each side as under:

- (a) Cash and discount columns
- (b) Cash and bank columns
- (c) Bank and discount columns

Dr. *Specimen of Double Column Cash Book* Cr.

Receipts					Payments				
Date	Particulars	L.F.	Cash	Disc. Allowed	Date	Particulars	L.F.	Cash	Disc. Received

(c) **Triple Column Cash Book**- Triple Column Cash Book has three amount columns, one for cash, one for bank and one for discount on each side. All cash receipts, deposits into bank and discounts allowed are recorded on the debit side and all cash payments, withdrawals from bank and discounts received are recorded on the credit side. In fact, a triple-column cash book serves the purpose of both Cash Account and Bank Account. Thus, there is no need to create these two accounts in the ledger.

Dr. *Specimen of Triple Column Cash Book* Cr.

Receipts						Payments				
Date	Particulars	L.F.	Cash	Bank	Discount Allowed	Date	Particulars	L.F.	Bank	Discount Received

- (d) **The multi-column cash book** has multiple columns on both the sides of the cash book.
(e) The petty cash book.

Is the Cash Book a Journal or a Ledger?

Cash Book is a book of original entry since transactions are recorded for the first time from the source documents. It is a ledger in the sense that it is designed in the form of a Cash Account and records cash receipts on the debit side and cash payments on the credit side. Thus, the cash book is both a journal and a ledger.

Purchase Day Book

The purchase day book records the transactions related to credit purchase of goods only. Any cash purchase or purchase of things other than goods is not recorded in the purchase day book. Periodically, the totals of purchase day book are posted to purchase account in the ledger. A specimen of purchase day book is given below:

In the Books of _____ *Purchase Day Book*

Date	Name of the Suppliers and details of Goods purchased	Invoice reference	L. F.	Amount (Rs.)	Remarks

The format for Purchase Return Book is exactly the same; hence separate illustration is not given.

Sales Day Book

The sales day book records transactions of credit sale of goods to customers. Sale of other things, even on credit, will not be entered in the sales day book, but is entered in Journal. If goods are sold for cash, it is entered in the cash book. Total of sales day book is periodically posted to the sales account in the ledger. A specimen of a sales day book is given below.

In the Books of *Sales Day Book*

Date	Particulars	Invoice reference	L. F.	Amount (Rs.)	Remarks

The format of sales return book is exactly the same; hence a separate illustration is not given.

Other Subsidiary Books – Returns Inward, Return Outward, Bills Receivable, Bills Payable

- i) **Return Inward Book**- The transactions relating to goods which are returned by the customers for various reasons (may be for the reason that the goods are not according to sample, or not up to the mark) are recorded in return inward book. It is also known as Sales Return Book. Generally, when a customer returns goods to suppliers, he issues a Debit Note for the value of the goods returned by him. Similarly, the supplier who receives those goods issues a Credit Note.

Returns Inward Day Book

<i>Date</i>	<i>Particulars</i>	<i>Outward Invoice</i>	<i>L. F.</i>	<i>Details</i>	<i>Totals</i>	<i>Remarks</i>

- ii) **Return Outward Book**- This book records the transactions relating to goods that are returned by us to our creditors, e.g., goods broken in transit, or not matching with the sample, etc. It is also known as Purchase Return Book.

Return Outward Day Book

<i>Date</i>	<i>Particulars</i>	<i>Debit Note</i>	<i>L. F.</i>	<i>Details</i>	<i>Totals</i>	<i>Remarks</i>

- iii) **Bills Receivable Book**- It is a book where all bills received are recorded and therefrom posted directly to the credit of the respective customer's account. The total amounts of the bills so received during the period (either at the end of the week or month) is to be posted in one sum to the debit of Bills Receivable A/c.

Bills Receivable Day Book

No. of Bills	Date of Receipt of Bill	From whom	Name of the Receiver	Name of Drawer	Name of Acceptor	Date of Bill	Due Date	L.F.	Amount of Bill	How disposed off

- iv) **Bills Payable Book**- Here all the particulars relating to bills accepted are recorded and therefrom posted directly to the debit of the respective creditor's account. The total amounts of the bills so accepted during the period (either at the end of the week or month) is posted in one sum to the credit of Bills Payable Account.

Bills Payable Day Book

No. of Bills	Date of Acceptance	To whom given	Name of Drawer	Name of Payee	Name of Payable	Date of Bill	Term	Due Date	L.F.	Amount of Bill	How disposed off

Journal Proper

Credit transactions that cannot be entered in any other subsidiary book are entered in journal proper. It will cover purchase or sale of assets, expense accruals, rectification entries, adjusting entries, opening entries and closing entries. The format of journal proper is same as the Journal.

LEDGER ACCOUNTS

The book which contains accounts is known as the ledger. Since finding information pertaining to the financial position of a business emerges only from the accounts, the ledger is also called the Principal Book. As a result, all the necessary information relating to any account is available from the ledger.

This is the most important book of the business and hence is rightly called the “King of All Books”.

Dr.

Specimen of Ledger Account

Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)

Ledger Posting

As and when the transaction takes place, it is recorded in the journal in the form of journal entry. This entry is posted again in the respective ledger accounts under double entry principle from the journal. This is called ledger posting.

The rules for writing up accounts of various types are as follows:

Assets: Increases on the debit side and decreases on the credit side. **Liabilities:** Increases on the credit side and decreases on the debit side. **Capitals:** Increases on the credit side and decreases on the debit side. **Expenses:** Increases on the debit side and decreases on the credit side.

Incomes or Gain: Increases on the credit side and decreases on the debit side.

To summarize:

Dr.	Assets	Cr.	Dr.	Expenses or Loses	Cr.
Increase		Decrease	Increase		Decrease
Dr.	Liabilities & Capital	Cr.	Dr.	Income or Gains	Cr.
Decrease		Increase	Decrease		Increase

Posting to Ledger Accounts from Subsidiary Books

In the above section, we have explained how posting is done to ledger accounts directly on the basis of journal entries. In practice, however, we know that use of subsidiary books is in vogue. Let us see how the posting to ledger accounts is done based on these records. For each of the subsidiary books, there is a ledger account, e.g., for purchase book, there is Purchase Account, for sales book there is Sales A/c, for cash book there is Cash A/c as well as Bank A/c and so on. In case of balance various ledger accounts, some accounts show debit balance, while the others show credit balance. Is there any relationship between the type of account (whether it is the account of asset, liability, capital, owner’s equity, income or gain, expenses or losses) and the kind of balance (debit or credit).

The answer is generally ‘Yes’. You may test to find the following are typical relationships.

Type of Account	Type of balance
All asset accounts	Debit balance
All liability accounts	Credit balance
Capital & Owner’s equity account	Credit balance
Expenses or loss accounts	Debit balance
Income or gain accounts	Credit balance

Let us test these possibilities for confirmation. How does one go about testing this? Consider ‘Cash A/c’.

Whenever business receives cash we debit it, and whenever it pays we credit it. Is it possible to see a situation where credits to cash are more than debits? In other words could we have negative cash in hand?No. Cash account will therefore always show a debit balance. So is true for all real asset accounts.

After solving problems, if the contrary is observed, there is every chance that an error has been made while passing the accounting entries.

Closing Balance and Opening Balance

The debit or credit balance of an account that we get at the end of the accounting period is known as closing balance of that account.

The “balance of the nominal accounts” is closed by transferring to trading account, and the profit and loss account which shows the net operating results – net profit or net loss.

The “balance of the personal accounts and real accounts” representing assets, liabilities, owner’s equity are reflected in the Balance Sheet, which shows the financial position of a business on a particular date. These balances are transported as opening balance in the succeeding accounting period.

Some terms used:

Casting — totaling

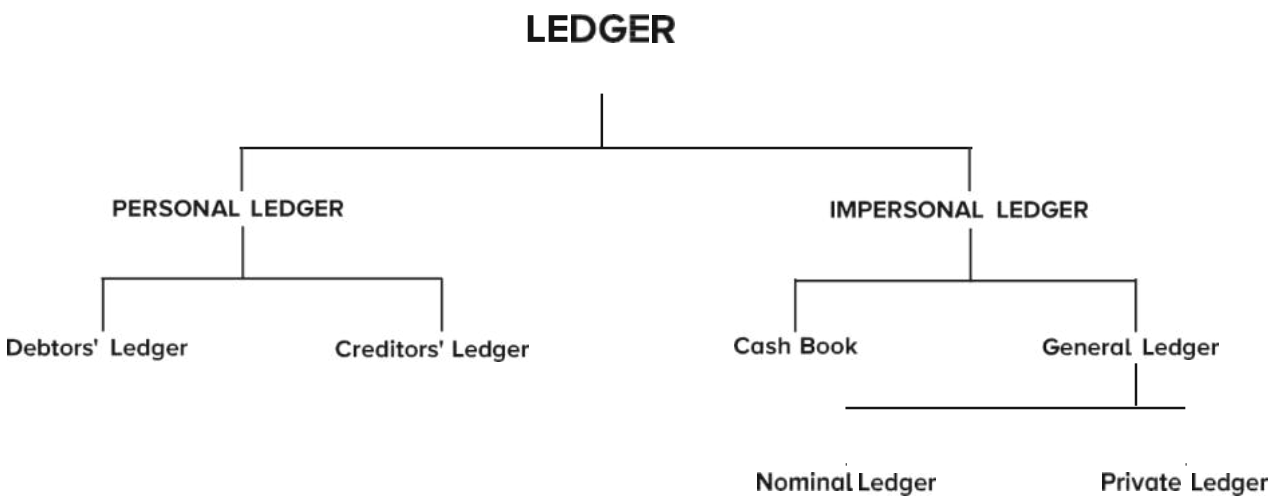
Balancing — to find the difference between debit side total and credit side total of an account.C/d -Carried down B/d -Brought down

C/o - Carried over B/o - Brought over

C/f - Carried forward B/f - Brought forward

Sub-divisions of Ledger

Practically, the Ledger may be divided into two groups - Personal Ledger and Impersonal Ledger.They are again sub-divided as:



Personal Ledger: The ledger where the details of all transactions about persons who are related to the accounting unit are recorded is called Personal Ledger.

Again, Personal Ledger may be divided into two groups: viz. (a) Debtors’ Ledger, and (b) Creditors’ Ledger.

- i) **Debtors' Ledger:** The ledger where the details of transactions about the persons to whom goods are sold, cash is received, etc., are recorded is called Debtors' Ledger.
- ii) **Creditors' Ledger:** The ledger where the details of transactions about the persons from whom goods are purchased on credit, cash paid to them, etc., are recorded, is called Creditors' Ledger.

Impersonal Ledger: The ledger where details of all transactions about assets, income & expenses, etc., are recorded is called Impersonal Ledger.

Impersonal Ledger may, again be divided into two groups, viz., (a) Cash Book; and (b) General Ledger.

- i) **Cash Book:** The book wherein all cash & bank transactions are recorded is called Cash Book.
- ii) **General Ledger:** The ledger where all transactions relating to real accounts, nominal accounts are recorded is called General Ledger.

General Ledger may again be divided into two groups, viz., Nominal Ledger & Private Ledger.

- a) **Nominal Ledger:** The ledger where all transactions relating to income and expenses are recorded is called Nominal Ledger.
- b) **Private Ledger:** The Ledger where all transactions relating to assets and liabilities are recorded is called Private Ledger.

TRIAL BALANCE

Trial Balance may be defined as a statement or a list of all ledger account balances taken from various ledgerbooks on a particular date to check the arithmetical accuracy.

Trial Balance is defined as "a list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements". According to Rolland, "The final list of balances, totaled and combined, is called Trial Balance". – **By Eric. L. Kohler**

As this is merely a listing of balances, it will always be on a particular date. Further, it must be understood that Trial Balance does not form part of Books of Account, but it is a report prepared by extracting balances of accounts maintained in the books of accounts.

When this list with tallied debit and credit balances is drawn up, the arithmetical accuracy of basic entries, ledger posting and balancing is ensured. However, it does not guarantee that the entries are correct in all respects.

It can be seen that the respective total of debit and credit balances is exactly matching. This is the result of double entry book-keeping wherein every debit has equal corresponding credit.

Features of a Trial Balance

- (i) It is a list of debit and credit balances which are extracted from various ledger accounts.
- (ii) It is a statement of debit and credit balances.
- (iii) The purpose is to establish arithmetical accuracy of the transactions recorded in the Books of Accounts.
- (iv) It is not an account. It is only a statement of account.
- (v) It is not a part of the financial statements.
- (vi) It is usually prepared at the end of the accounting year but it can also be prepared anytime as and when required like weekly, monthly, quarterly or half-yearly.
- (vii) It is a link between the Books of Accounts, Profit and Loss Account and Balance sheet.

Preparation of Trial Balance

- (i) The ledger accounts are balanced at first. They will have either "debit-balance" or "credit balance" or "nil-balance".
- (ii) The accounts containing debit-balance are written on the debit column, and those with credit-balance are written on the credit column.

- (iii) The sum total of both the balances must be equal for “Every debit has its corresponding and equal credit”.

Purpose of a Trial Balance

It serves the following purposes:

- (i) To check the arithmetical accuracy of the recorded transactions.
- (ii) To ascertain the balance of any ledger account.
- (iii) To serve as an evidence of the fact that the double entry has been completed in respect of every transaction.
- (iv) To facilitate the preparation of final accounts promptly.

Specimen of Trial Balance as on

Is Trial Balance Indispensable?

It is a mere statement prepared by the accountants for their convenience, and if it agrees, it is assumed that at least arithmetical accuracy has been done, although there may be an error.

Trial Balance is not a process of accounting, but its preparation helps us to finalize the accounts. Since it is prepared on a particular date, as at / as on is stated

Method of Preparation

- (a) Total Method or Gross Trial Balance.
- (b) Balance Method or Net Trial Balance.
- (c) Compound Method.

These are explained as hereunder:

- (a) **Total Method or Gross Trial Balance :** Under this method, two sides of the accounts are to be totalled. The total of the debit side is called the “debit total”, and the total of the credit side is called the “credit total”. Debit totals are entered on the debit side of the trial balance while the credit total is entered on the credit side of the trial balance.
If a particular account has total in one side, it will be entered either in the debit column or the credit column as the case may be.

Advantages:

- (a) It facilitates arithmetical accuracy of the accounts.
- (b) Extraction of ledger balances is not required at the time of preparation of trial balance.

Disadvantages: Preparation of final accounts is not possible.

- (b) **Balance Method or Net Trial Balance:** Under this method, all the ledger accounts are balanced. The balances may be either “debit-balance” or “credit balance”.

Advantages:

- (a) It helps in the easy preparation of final accounts.
- (b) It saves time and labour in preparing a trial balance.

Disadvantages: Errors may remain undisclosed irrespective of the agreement of trial balance.

- (c) **Compound Method:** Under this method, totals of both the sides of the accounts are written in separate columns. Along with this, the balances are also written in the separate columns. Debit balances are written in the debit column and credit balances are written in the credit column of the trial balance.

Advantages: It offers the advantage of both the methods.

Disadvantages: It is a lengthy process and more time is consumed in the preparation of a trial

Summary of Rules
Debit Balance - All Assets, Drawings, Debtors, Expenses and Losses.Credit
Balance - All Liabilities, Capital, Creditors, Gains and Incomes.

balance.

FINAL ACCOUNTS

The primary function of accounting includes computing the net result of operations of the business for the current period. To meet out this purpose, Trading Accounts, Income statement and Balance sheet are prepared.These documents are popularly called as Final Accounts. It is the last phase of Accounting Process.

The components of final accounts depend upon the type of entity. In case of non-manufacturing entities, the business operations include purchase and sale of goods. That is why Trading Account is prepared to calculateGross Profit. But a manufacturing entity is interested in computation of total cost of manufacturing the finished products. For this purpose, separate account is prepared as Manufacturing Account. The following table shows the components of final accounts for manufacturing and non-manufacturing firms:

Manufacturing firm		Non-Manufacturing Firm	
1	Manufacturing A/c	1	Trading A/c
2	Trading A/c	2	Profit and Loss A/c
3	Profit and Loss A/c	3	Balance Sheet
4	Balance Sheet		

The process of final accounts starts after preparation of trial balance. It is mainly divided into following twoparts:

1. Income Statement: It is prepared to find out the net result of the operations. It is sub-divided into twoparts:

a) Trading Account
b) Profit and Loss Account
2. Position Statement: It includes Balance Sheet showing the status of assets and liabilities as at aparticular point of time.

CHAPTER-2

Introduction to Corporate Accounting

INTRODUCTION

There is no legal obligation for sole proprietorship and a partnership firm to prepare final accounts, but otherwise companies have statutory obligations to keep proper books of account and to prepare its final accounts every year in the manner as prescribed in the Companies Act. Chapter IX, Sections 128 to 138 of the Companies Act, 2013 deals with the legal provisions relating to the Accounts of Companies. These sections including Schedule II and III were brought into force from 1st April, 2014. The relevant rules pertaining to these provisions have also been notified. All these relevant provisions/schedules and rules will be applicable for the financial years commencing on or after 1st April, 2014.

What provisions are applicable for financial years that commenced earlier than 1st April 2014?

It is clarified that in respect of financial years that commenced earlier than 1st April 2014, shall be governed by the relevant provisions/schedules and rules of the Companies Act, 1956.

RECORDS OF ACCOUNTS TO BE MAINTAINED BY A COMPANY

Section 128 of the Companies Act, 2013 governs the Books of Account, etc., to be kept by Company as per which every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

However, all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company shall, within seven days thereof, file with the Registrar a notice in writing giving the full address of that other place. Further the company may keep such books of account or other relevant papers in electronic mode in the

Manner of Books of Account to be kept in Electronic Mode

The books of account and other relevant books and papers maintained in electronic mode shall remain accessible in India, at all times, so as to be usable for subsequent reference.

Provided that for the financial year commencing on or after April 01, 2023, every company which uses accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.

The books of account and other relevant books and papers referred above shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.

following manner:

The information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches. The information in the electronic record of the document shall be capable of being displayed in a legible form.

There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law:

Provided that the back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a daily basis.

Notice of Address at Which Books of Account are to be Maintained

As per the Companies (Accounts) Rules, 2014 the notice regarding address at which books of account may be kept shall be in Form AOC-5.

Where a company has a branch office in India or outside India, it shall be deemed to have complied with the above provisions, if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarized returns periodically are sent by the branch office to the company at its registered office or the other place referred above.

The books of account and other books and papers maintained by the company within India shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours, and in the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director subject to such conditions as mentioned below:

Conditions Regarding Maintenance and Inspection of Certain Financial Information by Directors

The summarised returns of the books of account of the company kept and maintained outside India shall be sent to the registered office at quarterly intervals, which shall be kept and maintained at the registered office of the company and kept open to directors for inspection.

Where any other financial information maintained outside the country is required by a director, the director shall furnish a request to the company setting out the full details of the financial information sought, the period for which such information is sought.

The company shall produce such financial information to the director within fifteen days of the date of receipt of the written request.

The financial information shall be sought for by the director himself and not by or through his power of attorney holder or agent or representative.

Further, the inspection in respect of any subsidiary of the company shall be done only by the person authorized in this behalf by a resolution of the Board of Directors.

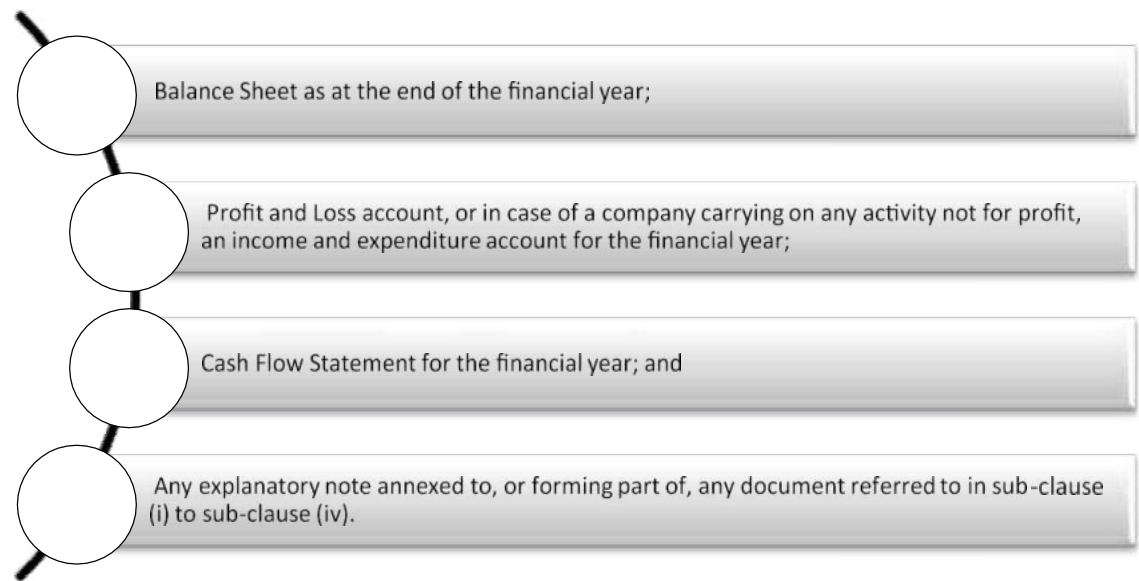
Where an inspection is made, the officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.

Period for Retention of Books of Accounts: The books of account of every company relating to a period of not less than **eight financial years** immediately preceding a financial year, or where the company had been in existence for a period less than eight years, in respect of all the preceding years together with the vouchers relevant to any entry in such books of account shall be kept in good order. However, where an investigation has been ordered in respect of the company under Chapter XIV, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.

Penalty: If the managing director, the whole-time director in charge of finance, the Chief Financial Officer or anyother person of a company charged by the Board with the duty of complying with the provisions of this section,contravenes such provisions, such managing director, whole-time director in charge of finance, Chief Financialofficer or such other person of the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

FINANCIAL STATEMENTS

According to Section 2(40) of Companies Act, 2013 financial statement in relation to a company, includes –



However, the financial statement, with respect to One Person Company, small company and dormant company may not include cash flow statement.

PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

Section 129 of the Companies Act, 2013 governs the preparation and presentation of financial statements of a company. The financial statements shall give a true and fair view of the state of affairs of a company or companies, comply with the accounting standards notified under Section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.

Central Government to Prescribe Accounting Standards

The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

- The items contained in such financial statements shall be in accordance with the accounting standards.
- Nothing contained in this sub-section shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.
- The financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose –
 - (a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
 - (b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
 - (c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
 - (d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

- At every annual general meeting of a company, the Board of Directors of the company shall lay before all members financial statements for the financial year.
- Where a company has one or more subsidiaries, it shall, in addition to financial statements provided under Sub-section (2), prepares a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under Sub-section (2).
- The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries. According to the rules, the statement shall contain the salient features of the financial statement of a company's subsidiary or subsidiaries, associate company and joint venture.
- The consolidation of financial statements of the company shall be made in accordance with the Accounting Standards, subject however, to the requirement that if under such Accounting Standards(AS), consolidation is not required for the reason that the company has its immediate parent outside India, then such companies will also be required to prepare Consolidated Financial Statements in the manner and format as specified under Schedule III to the Act.
- The provisions of this Act are applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, apply to the consolidated financial statements.
- Where the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.
- The Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of this section or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.
- If a company contravenes the provisions of this section, the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person shall be give the charge by the Board with the duty to complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but

Explanation –Any reference to the financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under this Act.

which may extend to rupees five lakh or with both.

SCHEDULE III OF THE COMPANIES ACT, 2013

According to Section 129 of the Companies Act, 2013, all the companies registered under this Act will have to present its financial statements in Schedule III of the Companies Act. The Schedule III of the Companies Act, 2013 has been formulated to keep pace with the changes in the economic philosophy leading to privatization and globalization and consequent desired changes/reforms in the corporate financial reporting practices. It deals with the Form of Balance Sheet, Statement of Profit and Loss, and disclosures to be made therein, and it applies uniformly to all the companies registered under the Companies Act, 2013, for the preparation of financial statements of an accounting year. It has several new features like:

- A vertical format for presentation of Balance Sheet with classification of Balance Sheet items into current and non-current categories.
- A vertical format of Statement of Profit and Loss with classification of expenses based on nature.
- Elimination of the concept of “Schedules” and such information is now to be furnished in terms of

Notes to Accounts”.

- It does not contain any specific disclosure for items included in Schedule VI under the head, “Miscellaneous Expenditure”. As per Accounting Standard -16 borrowing cost and discount or premium relating to borrowing could be amortized over the loan period. Further, share issue expenses, discount on shares, discount/ premium on borrowing, etc. are excluded from AS-26. These items be amortized over the period of benefit, i.e., normally 3-5 years. The draft guidance note issued by ICAI suggests that unamortized portion of such expenses be shown under the head “Other Current/Non-current Assets” depending on whether the amount will be amortized in the next 12 months or thereafter.
- Debit Balance of Statement of Profit & Loss A/c will be disclosed under the head, Reserves & Surplus as the negative figure.
- No change in the format of cash flow statement as per revised schedule and therefore its preparation continues to be as per AS-3 i.e. cash flow statement.
- It gives prominence to Accounting Standards (AS), i.e., in case of any conflict between the AS and the Schedule, AS shall prevail.

GENERAL INSTRUCTIONS FOR THE PREPARATION OF BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

[Financial Statements for a company whose Financial Statements are required to comply with the Companies (Accounting Standards) Rules, 2006 - Division I]

The Schedule III sets out minimum requirements for disclosure on the face of the Balance Sheet, and the Statement of Profit and Loss and Notes. Line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the company’s financial position or performance or to cater to industry/sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act or under the Accounting Standards. This means new line items or sub-items can be added or substituted on the face of the Financial Statements when such presentation is:

- Relevant to an understanding of the company’s financial position or performance or to cater to industry/sector-specific disclosure requirements.
- To cater to industry/sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act.
- Under the Accounting Standards.

Where compliance with the requirements of the Act including Accounting Standards as applicable to the companies require any change in treatment or disclosure including addition, amendment, substitution or deletion in the head or sub-head or any changes, inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements of this Schedule shall stand modified accordingly.

The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards prescribed under the Companies Act, 2013. Additional disclosures specified in the Accounting Standards shall be made in the notes to accounts or by way of additional statement unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act shall be made in the notes to accounts in addition to the requirements set out in this Schedule.

Notes to accounts shall contain information in addition to that presented in the Financial Statements and shall provide where required

- Narrative descriptions or disaggregation of items recognized in those statements; and
- Information about items that do not qualify for recognition in those statements.

Each item on the face of the Balance Sheet and Statement of Profit and Loss shall be cross-referenced to any related information in the notes to accounts. In preparing the Financial Statements including the notes to accounts, a balance shall be maintained between providing excessive detail that may not assist users of

financial statements and not providing important information as a result of too much aggregation.

Depending upon the Total income of the company, the figures appearing in the Financial Statements shall be rounded off as given below:

	<i>Total Income</i>	<i>Rounding off</i>
(a)	less than one hundred crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof.
(b)	one hundred crore rupees or more	To the nearest lakhs, millions or crores, or decimals thereof.

Once a unit of measurement is used, it should be used uniformly in the Financial Statements.

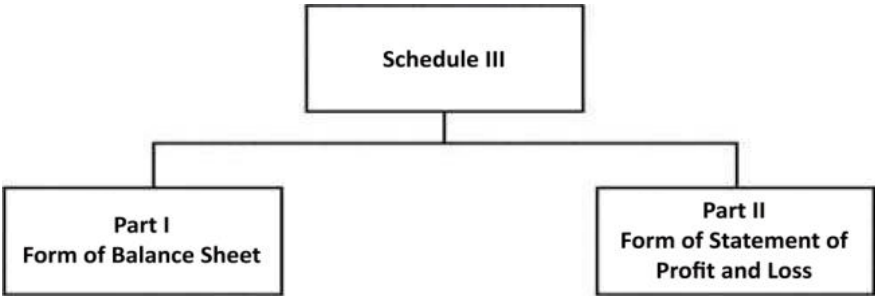
Except in the case of the first Financial Statements laid before the Company (after its incorporation) the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including notes shall also be given.

PRESENTATION OF BALANCE SHEET

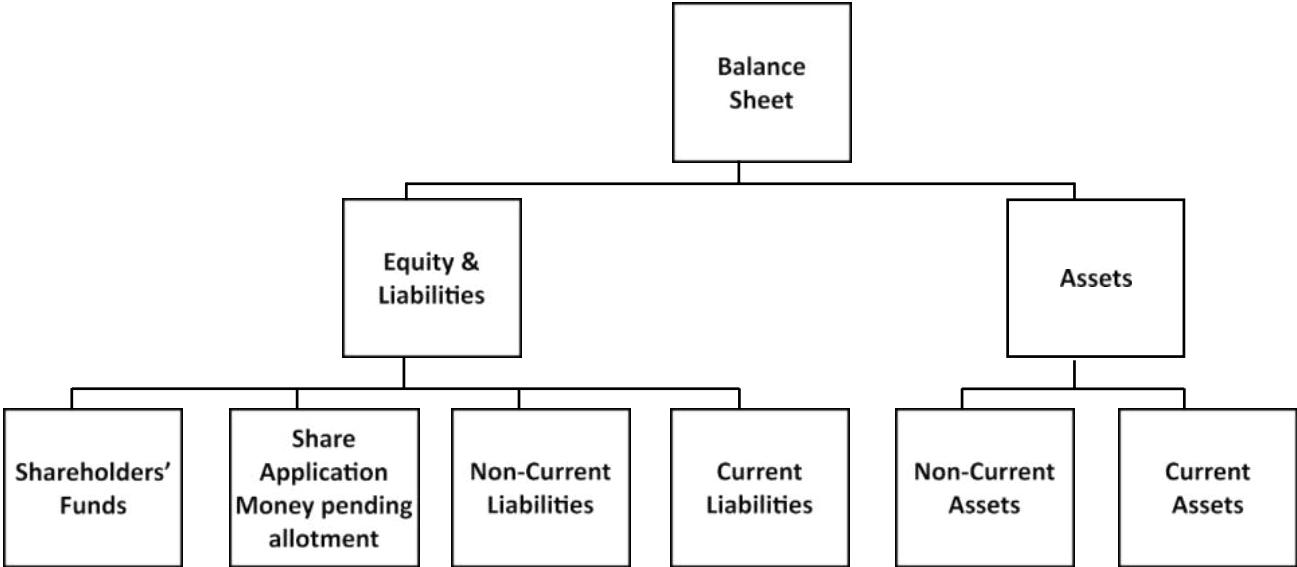
A Balance Sheet is a statement of the financial position of an enterprise as at a given date, which exhibits its assets, liabilities, capital, reserves and other account balances at their respective book values.

How often is a Balance sheet of a company calculated?

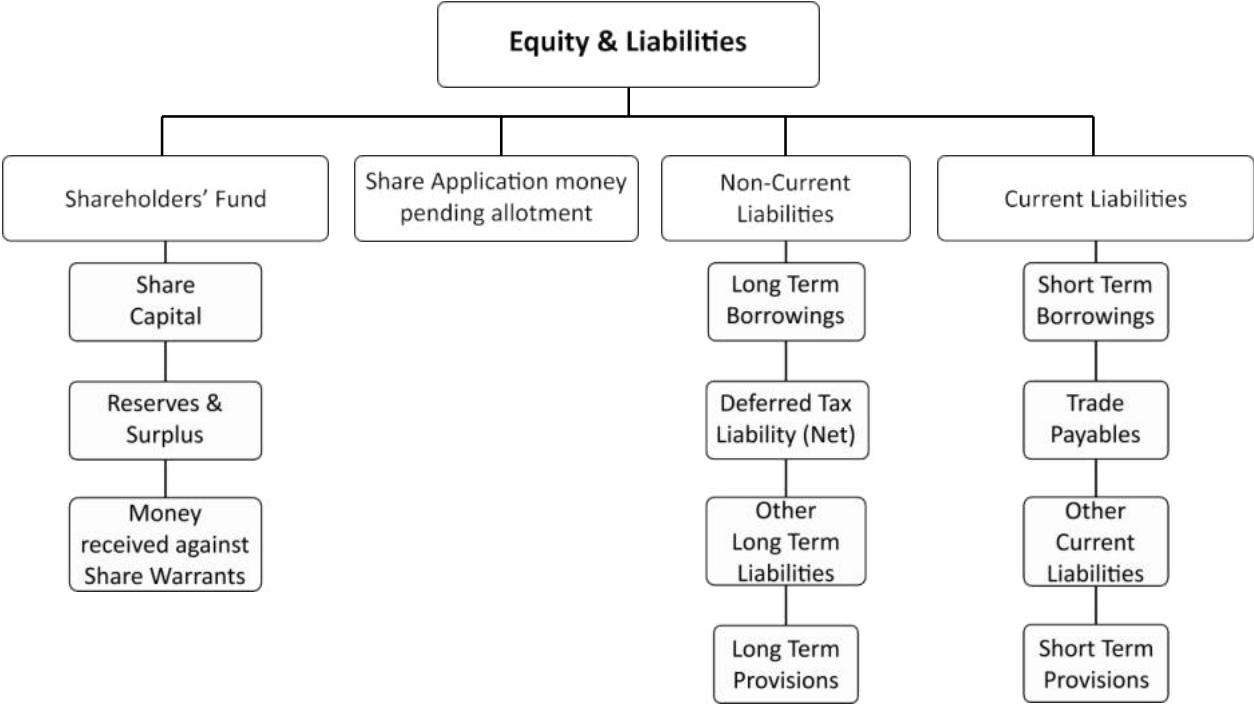
Balance sheet is more like a snapshot of the financial position of a company at a specified time, usually calculated after every quarter, six months or one year.



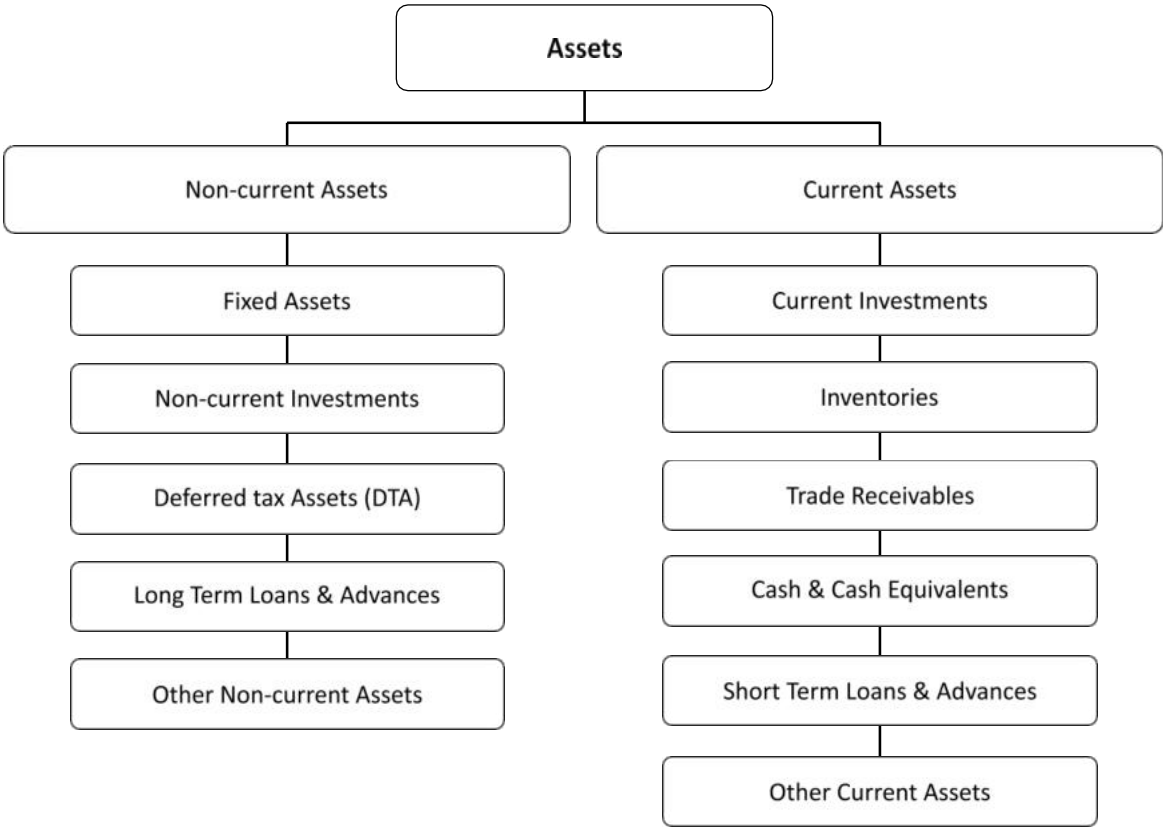
PART I – FORM OF BALANCE SHEET



Break-up of Equity & Liabilities



Break-up of Assets



PART I – FORM OF BALANCE SHEET

[Financial Statements for a company whose Financial Statements are required to comply with the Companies (Accounting Standards) Rules, 2006 - Division I]

Name of the Company:

Balance Sheet as at:

	<i>Particulars</i>	<i>Note No.</i>	<i>Figure as at the end of Current Reporting Period</i>	<i>Figures as at the end of the PreviousReporting Period</i>
			<i>(Rs.)</i>	<i>(Rs.)</i>
I.	EQUITY AND LIABILITIES			
(1)	Shareholders’ Funds			
	(a) Share Capital			
	(b) Reserves & Surplus			
	(c) Money Received against Share Warrants			
(2)	Share Application money pending allotment			
(3)	Non-Current Liabilities			
	(a) Long-Term Borrowings			
	(b) Deferred Tax liabilities (Net)			
	(c) Other Long-Term Liabilities			
	(d) Long-Term Provisions			
(4)	Current Liabilities			
	(a) Short-Term Borrowings			
	(b) Trade Payables (A) Total outstanding dues of micro enterprisesand small enterprises and (B) Total outstanding dues of creditor other thanmicro enterprises and small enterprises.			
	(c) Other Current Liabilities			
	(d) Short-Term Provisions			
	TOTAL			
II.	ASSETS			
(1)	Non-Current Assets			

	(a) Property, Plant and Equipment and Intangibleassets			
	(i) Property, Plant and Equipment			
	(ii) Intangible Assets			
	(iii) Capital work-in-progress			
	(iv) Intangible Assets under Development			
	(b) Non-Current Investments			
	(c) Deferred Tax Assets (DTA) (Net)			
	(d) Long-Term Loans & Advances			
	(e) Other Non-Current Assets			
(2)	Current Assets			
	(a) Current Investments			
	(b) Inventories			
	(c) Trade Receivables			
	(d) Cash & Cash Equivalents			
	(e) Short-Term Loans & Advances			
	(f) Other Current Assets			
	Total			

DISCLOSURE REQUIREMENT: SCHEDULES FORMING PART OF FINANCIAL STATEMENTS

[Financial Statements for a company whose Financial Statements are required to comply wih the Companies (Accounting Standards) Rules, 2006 - Division I]

(A) FOR “EQUITY AND LIABILITIES” ITEMS

(1) SHAREHOLDERS’ FUNDS

(a) SHARE CAPITAL

Schedule III Disclosure Requirement	Points to be considered
General	- Schedule III deals only with presentation and disclosure requirements. - Accounting classification into Debt and Equity components isgoverned by the applicable Accounting Standard. - Preference Shares will have to be classified as “Share Capital”and they also include such Preference Shares of which redemption is overdue.

For each Class of Share Capital (different classes of Preference Shares to be treated separately):	
(a) Authorized Capital	It is the maximum number and face/par value, of each class of shares that a corporate entity may issue in accordance with its instrument of incorporation.
(b) Number of Shares Issued, Subscribed and Fully Paid, and Subscribed but not Fully Paid	• “Subscribed Share Capital” is “that portion of the Issued Share Capital which has actually been subscribed by the public and subsequently allotted to the shareholders by the entity. This also includes any Bonus shares issued to the Shareholders. • “Paid-up Share Capital” is “that part of the Subscribed Share Capital for which consideration in cash or otherwise has been received. This also includes Bonus Shares allotted and Shares issued otherwise than for cash against purchase consideration, by the corporate entity.” • If Shares are not fully called, then disclose the called up value per share.
(c) Face/Par Value per Share	Face Value/Par Value as per Capital Clause in Memorandum of Association should be disclosed.
(d) Reconciliation of No. of Shares	• For the Amount of Share Capital; • For comparative previous period; • Separate statements for both Equity and Preference Shares, which should again be sub-classified and represented for each class of Shares.
(e) Rights, Preferences and Restrictions attaching to shares including restrictions on the distribution of Dividends and the Repayment of Capital	• For Equity Share Capital, such rights / preferences / restrictions may be with voting rights, or with differential voting rights as to dividend, voting or otherwise as per Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001. • For Preference Shares, the rights include dividend and/ or capital related rights. Further, Preference Shares can be cumulative, non-cumulative, redeemable, convertible, non-convertible, etc. • All such Rights, Preferences and Restrictions attached to each class of Shares, terms of redemption, etc., should be disclosed separately.
(f) Shares held in the Company held by its Holding Company or its ultimate Holding Company including Shares held by Subsidiaries or Associates of the Holding Company or the ultimate Holding Company in aggregate	• Disclose number of Shares held by the entire chain of Subsidiaries and Associates starting from the Holding Company and ending right up to the Ultimate Holding Company. • All such disclosures should be made separately representing for each class of Shares, (for both Equity and Preference Shares).

(g) List of Shareholders holding more than 5% shares as on the Balance Sheet Date	• Date for computing the 5% limit should be taken as the Balance Sheet date. So, if during the year, any Shareholder held more than 5% Equity Shares but does not hold as much at the Balance Sheet date, disclosure is not required. • Companies should disclose the Shareholding for each class of Shares, both within Equity and Preference Shares. So, such% should be computed separately for each class of Shares. • This information should also be given for comparative previousperiod.
(h) Shares Reserved for issue under Options and Contracts/ commitmentsfor the sale of Shares/ Disinvestment, including the Terms and Amounts	• Shares under Options generally arise under Promoters or Collaboration Agreements, Loan Agreements or Debenture Deeds (including Convertible Debentures), agreement to convert Preference Shares into Equity Shares, ESOPs or Contracts for supply of Capital Goods, etc. • Disclosure is required for the Number of Shares, Amounts and Other Terms for Shares so reserved. Such options are in respect of Unissued Portion of Share Capital.
(i) For the period of 5 years immediately preceding the date as at which the Balance Sheet is prepared- • Aggregate Number & Class of Shares allotted as Fully Paid up Pursuant to Contract(s) without payment being received in Cash • Aggregate No. and Class of Shares allotted as fully Paid up byway of Bonus Shares • Aggregate Number & Class of Shares bought back	Disclose only if such event has occurred during a period of 5 years immediately preceding the Current Year Balance Sheet date. • The aggregate number of shares allotted or bought back • If the company is in operation for a period of less than 5 years, then disclosure should cover all such earlier financial years. Not to disclose the following allotments: The following allotments are considered as Shares allotted for payment being received in cash, and hence should not be disclosed under this Clause – (a) If the subscription amount is adjusted against a bonfire debt payable in money at once by the Company, (b) Conversion of Loan into Shares in the event of default in repayment.
(j) Terms of any Securities Convertible into Equity / Preference Shares issued along with the earliest date of conversion in descending order starting from the farthest such date	• In case of Compulsorily Convertible Securities, where conversion is done in fixed tranches, all the dates of conversion have to be considered. • In case of Convertible Debentures/Bonds, etc., for the purpose of simplification, reference may also be made to the terms disclosed under the note on Long- Term Borrowings where these are required to be classified in the Balance Sheet, rather than disclosing the same against under this Clause.
(k) Calls Unpaid (showing aggregate value of Calls Unpaid by Directors and Officers)	Unpaid Amount towards Shares subscribed by the Subscribers of Memorandum of Association should be considered as ‘Subscribed and paid-Up Capital’ in the Balance Sheet and the Debts due from the Subscribers should be appropriately disclosed as an Asset in the Balance Sheet.

(l) Forfeited Shares (amount originally paid up)	

(m) Shareholding of Promoter	Share held by promoter at the end of year			% Change during the years
	Sr. No.	Promoters Name	No. of Shares	% of Total Shares
	Total			

(1) (b) RESERVES & SURPLUS

Schedule III Disclosure Requirement	Points
Reserves & Surplus shall be classified as – (a) Capital Reserves	- Capital Reserve is a Reserve of a Corporate Enterprise which is not available for distribution as Dividend. - Profit on Re-issue of Forfeited Shares is basically profit of a Capital Nature and, hence, it should be credited to Capital Reserve.
(b) Capital Redemption Reserve	Capital Redemption Reserve (CRR) is required to be created u/s 55 and 68 (for redemption of Preference Share Capital and buyback of Equity Share Capital), subject to conditions specified in the respective Sections.
(c) Securities Premium	
(d) Debenture Redemption Reserve	Debenture Redemption Reserve (DRR) is required to be createdu/s 71 and maintained until such Debentures are redeemed. On redemption of the Debentures, the amounts no longer necessary to be retained in this Account should be transferredto the General Reserve.
(e) Revaluation Reserve	Revaluation Reserve is a Reserve created on the revaluation of Assets or Net Assets of an Enterprise represented by the surplus of the estimated Replacement Cost or estimated market values over the Book Values thereof.
(f) Share Options Outstanding Account	As per ICAI Guidance Note on ESOP, Share Options Outstanding should be shown as separate line item. Under Schedule III, this line item should be shown separately under Reserves & Surplus.
(g) Other Reserves (specify the nature & purpose of each Reserve and the amount inrespect thereof)	This includes any other Statutory Reserves, e.g. Tonnage Taxreserve to be created under the Income Tax Act, 1961.
(h) Surplus, i.e., balance in Statement of P&L disclosing allocations & appropriations, suchas, Dividend, Bonus Shares and Transfer to/from Reserves, etc.	
(Additions & Deductions since last Balance Sheet to be shown under each of specified heads)	Appropriations to the Profit for the year (including carriedforward balance) is to be presented under the main head ‘Reserves and Surplus’. Under Schedule III, the Statement of P&L will no longer reflect any appropriations, like Dividends transferred to Reserves, Bonus Shares, etc.

Notes:

1. **Fund** : A Reserve specifically represented by Earmarked Investments shall be termed as a 'Fund'.
2. **Profit and Loss Account (Dr.)** : Debit Balance Statement of Profit & Loss shall be shown as a Negative Figure under the head 'Surplus'. Similar, the balance of 'Reserves & Surplus', after adjusting Negative balance of Surplus, if any, shall be shown under the head 'Reserves & Surplus' even if the resulting figure is in the negative.

(1) (c) MONEY RECEIVED AGAINST SHARE WARRANTS

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
To be shown as a separate line item on the face of Balance Sheet	In case of Listed Companies, Share warrants are issued to Promoters & others in terms of the Guidelines for Preferential Issues, viz. SEBI (Issue of Capital and Disclosure Requirements), Guidelines, 2009. Effectively, Share Warrants are amounts which would ultimately form a part of the Shareholder's Funds. Since Shares are yet to be allotted against the same, these are not reflected as a part of Share Capital, but as a separate line-item

(2) SHARE APPLICATION MONEY PENDING ALLOTMENT

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
To be shown as a separate line item on the face of Balance Sheet	Share Application Money not exceeding the Issued Capital and to the extent not refundable is to be disclosed as a separate line item after "Share Holders Funds" and before "Non-Current Liabilities". If the Company's Issued Capital is more than the Authorized Capital, and approval of increase in Authorized Capital is pending, the amount of Share Application Money received over and above the Authorized Capital should be shown under the head "Other Current Liabilities". The amount shown as 'Share Application Money Pending Allotment' will not include Share Application Money to the extent refundable, for example, the amount in excess of Issued Capital, or where Minimum Subscription requirement is not met. Such amount will have to be shown separately under 'Other Current Liabilities'. Calls Paid in Advance are to be shown under "Other Current Liabilities". The amount of interest which may accrue on such advance should also be reflected as a Liability.

(3) NON-CURRENT LIABILITIES**(3) (a) LONG-TERM BORROWINGS**

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
Long-Term Borrowings shall be classified as – (a) Bonds/Debentures	-----
(b) Terms Loans – (i) from Banks, and (ii) from Other Parties,	Loans with repayment period beyond 36 months are usually known as "Term Loans". So, Cash Credit, Overdraft and Call Money Accounts/ Deposits are not covered by the expression "Term Loans".

(c) Deferred Payment Liabilities,	Deferred Payment Liabilities would include any Liability for which payment is to be made on deferred credit terms, e.g., Deferred Sales Tax Liability, Deferred Payment for Acquisition of fixed Assets, etc.
(d) Deposits,	Deposits classified under Borrowings would include Deposits accepted from Public and Inter-Corporate Deposits which are in the nature of Borrowings.
(e) Loans & Advances from Related Parties,	Loans and Advances from related parties are required to be disclosed. Advances under this head should include those Advances which are in the nature of loans.
(f) Long-Term Maturities of Finance Lease Obligations	
(g) Other Loans & Advances (specify nature)	

Notes: 1. Security-wise Classification: Borrowings shall further be sub-classified as Secured and Unsecured. Nature of Security shall be specified separately in each case.	• Nature of Security shall be specified separately in each case. A blanket disclosure of different securities covering all Loans classified under the same head such as “All Term Loans from Banks” will not suffice. • However, where one security is given for multiple Loans, the same may be clubbed together for disclosure purposes with adequate details of cross referencing. • Disclosure about the nature of security should also cover the type of asset given as security, e.g., Inventories, Plant and Machinery, Land and Building, etc. • When Promoters, other Shareholders or any third party have given any personal security for any borrowing, e.g., Shares or Other Assets held by them, disclosure should be made thereof, though such security does not result in the classification of such borrowing as secured.

2. Guarantees: Where Loans have been guaranteed by Directors or Others, the aggregate amount of such Loans under each head shall be disclosed.	The word “Others” used in the phrase “Directors or Others” would mean any Person or Entity other than a Director, e.g., Related Parties, or any person associated with the Company in some manner.
3. Maturity Date wise: Bonds / Debentures (along with Rate of Interest & particulars of Redemption or Conversion, as the case maybe) shall be stated in descending order of maturity or conversion, starting from farthest Redemption or Conversion Date, as the case may be.	• Current Maturities of all Long-Term Borrowings will be disclosed under “Other Current Liabilities” and not under Long-Term Borrowings and Short-Term Borrowings. • So, it is possible that the same Bonds/Debentures/ Term Loans may be bifurcated under both “Long-Term Borrowings” as well as under “Other Current Liabilities”.

4. Installment Redemption: Where Bonds/ Debentures are redeemable by Installments,the Date of Maturity for the purpose mustbe reckoned as the Date on which the First Installment becomes due.	
5. Power to Reissue: Particulars of any redeemed Bonds/Debentures which the Company has power to reissue shall be disclosed.	
6. Terms of Repayment: Repayment of TermLoans and Other Loans shall be stated.	Other Loans should be interpreted to mean all categories listed under the heading ‘Long-Term Borrowings’ as per Schedule VI (R). Disclosure of terms of repayment should bemade preferably for each Loan unless the repayment terms ofindividual loans within a category are similar, in which case, they may be aggregated.
7. Default: Period and amount of continuing default as on the Balance Sheet date in repayment of Loans and Interest, shall be specified separately in each case.	The term “Continuing Default” is used w.r.t. Long-Term Borrowings, whereas the term “Default” is used w.r.t. Short- Term Borrowings. • Under CARO, the Auditor shall report on the default made and the period of default. • As per Schedule VI (R), the period and amount of continuing default as on the Balance Sheet datein repayment or Term Loans and Interest shall be specified separately in each case. • Disclosures relating to default should be made for all items listed under the category of Borrowings such as Bonds/ Debentures, Deposits, Deferred Payment Liabilities, Finance Lease Obligations, etc., and not only to items classified as “Loans” such as Term Loans, Loans and Advances.
	• Defaults other than in respect of repayment of Loan and Interest, e.g., non-compliance with Debt Covenants, etc., need not be disclosed. • Any default that had occurred during the year and was subsequently made good before the end of the year need not be disclosed.

(3) (b) DEFERRED TAX LIABILITIES (Also Refer AS-22)

Schedule III Disclosure Requirement	Points
To be shown as a separate line item on theface of Balance Sheet.	----

(3) (c) OTHER LONG-TERM LIABILITIES

Schedule III Disclosure Requirement	Points

It shall be classified as – (a) Trade Payables	Sundry Creditors for Goods or Services, and Acceptances should be disclosed as part of Trade Payables. Disclosure Requirements under MICRO, SMALL & MEDIUM ENTERPRISES DEVELOPMENT (MSMED) Act will also be required to be made in the annual Financial Statements.
(b) Others	Amounts due under contractual obligations, e.g., payables in respect of statutory obligations, like contribution to Provident Fund, Purchase of Fixed Assets, Contractually Reimbursable Expenses, Interest Accrued on Trade Payables, etc., should be classified as “Others” and each such item should be disclosed nature wise.

(3) (d) LONG-TERM PROVISIONS

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
It shall be classified as – (a) Provision for Employee Benefits	This should be classified into short-term and long-term portions, and the latter amount should be included here.
(b) Others (Specifying nature)	This would include items like Provisions for Warranties.

(4) CURRENT LIABILITIES

(a) SHORT-TERM BORROWINGS

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
1. Short-Term Borrowings shall be classified as –	Short-Term Borrowings will include all Loans within a period of 12 months from the date of the loan, Loans payable on demand, etc., but they will not include Current Maturity of Long-Term Borrowings (which should be treated only as “Other Current Liabilities”).

- Loans Repayable on demand– (i) from Banks, & (ii) Other Parties, - Loans and Advances from Related Parties, - Deposits, - Others Loans and Advances (specify nature) - Current maturities of Long Term Borrowing	- In case of Short-Term Borrowings, all defaults (not continuing defaults as in the case of Long Term Borrowings) existing as at the date of the Balance Sheet should be disclosed (item wise) - A 3-Year Loan taken for a business with a 4-year Operating Cycle will be categorized only as Short-Term Borrowings, and not as Long-Term Borrowings.

(4) (b) TRADE PAYABLES

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>

It shall be classified as – (A) Total outstanding dues of micro enterprises and small enterprises; and (B) Total outstanding dues of creditors other than micro enterprises and small enterprises.”	• Liability for Capital Goods Purchases: Amount due towards purchase disclosed under “Other CurrentLiabilities” with a suitable description. • Liability under Contractual Obligations: Liability towards Employees, Leases or other Contractual Liabilities should not be included under Trade Payables. Only “Commercial Dues” can be included under Trade Payables.

(4) (d) SHORT TERM PROVISIONS

Schedule III Disclosure Requirement	Points
It shall be classified as – (a) Provision for Employee Benefits	This should be classified into short-term and long- term portions,and the former amount should be included here.
(b) Others (Specifying nature)	This includes Provision for Dividend, Provision for Taxation,Provision for Warranties, etc.

B. DISCLOSURE REQUIREMENTS FOR “ASSETS” ITEMS

(1) NON-CURRENT ASSETS

(1) (a) (i) PROPERTY PLANT AND EQUIPMENT (Also Refer AS – 6, 10)

Schedule III Disclosure Requirement	Points
1. Classification shall be given as – (a) Land, (b) Buildings, (c) Plant andEquipment, (d) Furniture & Fixtures, (e) Vehicles, (f) Office Equipment, (g)Others (Specify Nature).	AS-19 excludes Land Leases from its scope. Leasehold Land should be presented as a separate assets class under Tangible Assets. Also, Freehold Land should be presented as a separateasset class.
2. Assets under Lease shall be separatelyspecified under each class of Asset.	• The term “under lease” should mean – (a) Assets given on Operating Lease in the case ofLessor, and (b) Assets held under Finance Lease in the case ofLessee. • Leasehold Improvements should continue to be shownas a separate asset class.
3. Re-evaluation: Where sums have been written off on a Reduction of Capital or Re- evaluation of Assets of where sums have been added on Re-evaluation of Assets,every Balance Sheet subsequent to dateof such write off, in addition shall show the Reduced or Increased figures as applicableand shall be way of a Note also show the amount of the Reduction or Increase asaplicable together with the date thereof for the first 5 years subsequent to the dare of such Reduction or Increase.	• AS-10 requires disclosure of details such as Gross Book Value of Re-evalued Assets, Method adopted to compute re-evalued amounts, Nature of indices used,Year of appraisal, Involvement of External Valuer, etc. as long as the concerned assets are held by the Enterprise. [but only 5 years period is specified inSchedule III] • AS-10 requirements will prevail. [Note: AS 26 does not permit re-evaluation of Intangible Assets.]

4. Reconciliation: A Reconciliation of the Gross and Net Carrying Amounts of each Class of Assets at the Beginning and End of the Reporting period showing Additions, Disposals, Acquisitions through Business Combinations and other Adjustments and the related Depreciation and Impairment Losses / Reversals shall be disclosed separately.	(a) Since reconciliation of Gross and Net Carrying Amounts of Fixed assets is required, the Depreciation/ Amounts of fixed assets is required, the Depreciation/ Amortization for each class of asset should be disclosed in terms of – • Opening Accumulated Depreciation, • Depreciation/Amortization for the year, • Deductions/Other Adjustments, and • Closing Accumulated Depreciation/ Amortization. (b) Similar disclosures should also be made for Impairment, if any, as applicable. (c) Business Combinations: • Business Combination should be taken as an amalgamation or acquisition or any other mode of restructuring of a set of Assets and/or a group of Assets and Liabilities constituting a business. • Acquisitions through ‘Business Combinations’ should be disclosed separately for each class of assets. • Asset Disposals through Demergers, etc., if any also be disclosed separately for each class of assets. (d) Other Adjustments: This includes – • Capitalization of FOREX Differences where such option has been exercised by the Company as per AS-11. • Adjustments on a/c of Exchange Fluctuations for Fixed Assets in case of Non-Integral Operations (AS-11). • Borrowing Costs capitalized as per AS-16.

(1) (a)(ii) INTANGIBLE ASSETS (Also Refer AS-26)

Schedule III Disclosure Requirement	Points
Classification shall be given as – (a) Goodwill, (b) Brands / Trademarks, (c) Computer Software, (d) Mastheads and Publishing Titles, (e) Mining Rights, (f) Copyrights, and Patents and Other Intellectual Property Rights, Services and Operating Rights, (g) Recipes, Formula, Models, Designs and Prototypes, (h) Licenses and Franchise, (i) Others (specify nature).	Classification of Intangible Assets has been introduced under Schedule VI (R). Intangible Assets under development should also be disclosed separately, if AS-26 criteria are met.

A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of intangible assets) and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.

(1) (a)(iii) CAPITAL WORK IN PROGRESS

Schedule III Disclosure Requirement	Points
To be shown as a separate line item on theface of Balance Sheet	Capital Advances should be included under Long- Term Loansand Advances and hence, cannot be included under Capital WIP.

(1) (a)(iv) INTANGIBLE ASSETS UNDER DEVELOPMENT

Schedule III Disclosure Requirement	Points
To be shown as a separate line-item on theface of Balance Sheet	Intangible Assets under development should be disclosed under this head provided they can be recognized based on thecriteria laid down in AS-26.

(1) (b) NON CURRENT INVESTMENTS (Also Refer AS – 13)

Schedule III Disclosure Requirement	Points
Non-Current Investments shall be classifiedas Trade Investments and Other Investments, and further classified as Investments in – (a) Property, (b) Equity Instruments, (c) Preference Shares, (d) Government / Trust Securities, (e) Debentures or Bonds,(f) Mutual Funds, (g) Partnership Firms, and (h) Other Non-Current Investments(specify nature).	- If a Debenture is to be redeemed partly within 12 months and balance again after 12 months, the amount to be redeemed within 12 months should be disclosed as current, and balance as Non-Current. “Trade Investment” is normally understood as an Investment made by a Company in Shares orDebentures of another Company, to promote the tradeor business of the first Company.
Notes: 1. Under each classification, details shall be given about the Names of Bodies Corporate (indicating separately whether such bodies are – (i) Subsidiaries, (ii) Associates, (iii) Joint Ventures, or (iv) Controlled Special	(a) Controlled SPEs: - Schedule III requires separate disclosure of Investments in “Controlled Special Purpose Entities” in addition to Subsidiaries, Joint Venture, Associates, etc. - Since the expression “Controlled SPEs” is not defined in the Act/Sch. III/AS, no disclosures would be additionally

Purpose Entities) in whom Investments have been made and the nature and extent of the Investment so made in each such Body Corporate (showing separately Investments which are partly-paid).	required to be made under this caption. If and when such terminology is explained/ introduced in the applicable AS, the disclosure requirement would become applicable. (b) Other Points: “Nature and Extent” of Investment in each Body Corporate should be interpreted to mean the Number and Face Value of Share. Also, it is advisable to clearly disclose whether Investments are fully paid or partly paid. (item wise)
. With regard to Investments in the capital of Partnership Firms, the Names of the Firms (with the names of all their Partners, Total Capital and the Shares of each Partner) shall be given.	(a) LLP: A LLP is a Body Corporate, and not a Partnership Firm as envisaged under the Partnership Act, 1932. Hence, disclosures pertaining to Investments, in Firms will not include LLPs. Investments in LLPs will be disclosed separately under “Other Investments”. (b) Change in Constitution: In case of change in constitution of the Firm during the year, the names of the Other Partners should be disclosed based on the position existing as on the date of Company’s Balance Sheet. (c) Capital: • The Total Capital of the Firm, to be disclosed, should be with reference to the Amount of Capital on the date of the Company’s Balance Sheet. • If the Partnership Firm has separate accounts for Partners’ Capital, Drawings or Current, Loans to or from Partners, etc. disclosure must be made with regard to the Total of Capital Accounts alone, since this is what constitutes the capital of the Partnership Firm. • Where, however, such Accounts have not been segregated, or where the Partnership Deed Provides that the Capital of each Partner is to be calculated by reference to the Net Amount at his credit after merging all the Accounts, the disclosure relating to the Partnership Capital must be made on the basis of the total effect of such accounts taken together. • Share of each Partner: Share of each Partner means share in the Profits of the Firm, rather than the share in the Capital. • Different Reporting Dates: If it is not practicable to draw up the Financial Statements of the Partnership upto such date and, are drawn upto different reporting dates, drawing analogy from AS-21 and AS-27, adjustments should be made for effects of significant transactions or other

	events that occur between those dates and the date of the Partners' Financial Statements. Also, the difference between reporting dates should not be more than 6 months. In such cases, the difference in reporting dates should be disclosed.
3. Investments carried at other than at Cost should be separately stated specifying the basis for valuation thereof.	Basis of Valuation: Disclosure for the basis of valuation of Non- Current Investments may be either of – (a) Cost, or (b) Costless Provision for other than temporary diminution, or (c) Lower of Cost and Fair Value.
4. The following shall also be disclosed- (a) Aggregate amount of Quoted Investments and Market Value thereof, (b) Aggregate Amount of Unquoted Investments, (c) Aggregate Provision for Diminution in value of Investments.	It is recommended to disclose the amount of provision netted-off for each Long-Term Investment. However, the aggregate amount of provision made in respect of all Non- Current Investments should also be separately disclosed to comply with the specific disclosure requirement in Schedule III.

(1) (c) DEFERRED TAX ASSET (Also Refer AS – 22)

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
To be shown as a separate line-item on the face of Balance Sheet.	—

(d) LONG TERM LOANS AND ADVANCES

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>

1. General Classification: Long-Term Loans and Advances shall be classified as – (a) Capital Advances, (b) Loans and Advances to Related Parties (giving details thereof), (c) Other Loans and Advances (specify nature)	Capital Advances: • It should be specifically included under Long-Term Loans and Advances and hence, cannot be included under Capital Work-In-Progress. • Capital Advances are advances given for procurement of Fixed Assets which are Non-Current Assets. They are not realized back in cash, and over a period, get converted into Fixed Assets. Hence, they are always Long-Term Advances, irrespective of when the Fixed Assets are expected to be received. Other Loans and Advances should include all other items in the nature of advances recoverable in cash or kind, e.g., Prepaid Expenses, Advance Tax, CENVAT Credit Receivable, VAT Credit Receivable and Service Tax Credit Receivable which are not expected to be realized within the next 12 months or operating cycle whichever is longer, from the Balance Sheet date.

2. Security wise Classification: The above shall be separately sub-classified as – (a) Secured, considered Good (b) Unsecured, considered Good (c) Doubtful.	–
3. Bad / Doubtful: Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately.	–
4. Directors etc.: Loans and Advances due by Directors or Other Officers of the Company or any of them either severally or jointly with any other persons or amounts due by Firms or Private Companies respectively in which any Director is a Partner in a Director of a Member should be separately stated.	The term “Details” of Loans and Advances of Related Parties would mean disclosure requirements contained in AS-18.

(1) (e) OTHER NON-CURRENT ASSETS

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
1. Other Non-Current Assets shall be classified as – (a) Long-term Trade Receivables (including Trade Receivables on Deferred Credit Terms) (b) Securities Deposits (c) Others (specify nature)	• A Receivable shall be classified as ‘Trade Receivable’ if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.
2. Security wise Classification: Long-Term Receivables shall be separately sub classified as – (a) Secured, considered good	• Dues in respect of Insurance Claims, Sale of Fixed Assets, Contractually Reimbursable Expenses, Interest Accrued on Trade Receivables, etc., should be classified as “Others” and each such item should

(b) Unsecured, Considered Good (c) Doubtful.	be disclosed according to their nature.
3. For Trade Receivables Outstanding	Trade Receivables ageing schedule

2. CURRENT ASSETS

(2) (a) CURRENT INVESTMENTS (Also Refer AS – 13)

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
Current Investments shall be classified as – (a) Investments in Equity Instruments, (b) Investment in Preference Shares, (c) Investments in Government or Trust Securities, (d) Investments in Debentures or Bonds, (e) Investments in Mutual Funds, (f) Investments in Partnership Firms, (g) Other Investments (specify nature).	Principles given for Non- current Investments will apply here also to the relevant. However, Trade vs Non-Trade Classification, is not required for Current Investments.
Notes: - Under each classification, details shall be given of Names of Bodies Corporate [indicating separately whether such Bodies are – (i) Subsidiaries, (ii) Associates, (iii) Joint Ventures, or (iv) Controlled Special Purpose Entities] in whom Investments have been made and the nature and extent of the Investment so made in each such Body Corporate (showing separately investments which are party-paid). In regard to Investments in the Capital of Partnership Firms, the names of the Firms (with the names of all their Partners, Total Capital and the percentage of Shares of each Partner) shall be given. - The following shall also be disclosed: (a) Basis of Valuation of individual Investments, (b) Aggregate Amount of Quoted Investments and Market Value thereof,	

(c) Aggregate Amount of Unquoted Investments, (d) Aggregate Provision made for Diminution in Value of Investments.	

(2) (b) INVENTORIES (Also Refer AS-2)

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
Inventories shall be classified as – (a) Raw materials, (b) Work In Progress,	Goods in Transit should be included under relevant heads with suitable disclosure.
(c) Finished Goods, (d) Stock-in-Trade (in respect of goods acquired for trading), (e) Stores and Spares, (f) Loose Tools, (g) Others (specify nature). Note: Goods-in-Transit shall be disclosed under the relevant subhead of Inventories. Mode of Valuation shall be stated.	The heading “Finished Goods” should comprise all Finished Goods other than those acquired for trading purposes. Those acquired for trading purposes are to be shown under “Stock in Trade”.

(2) (c) TRADE RECEIVABLES

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>

1. aggregate amount of Trade Receivables outstanding for a period exceeding 6 months from the date they are due for payment should be separately stated. 2. Security wise Details: Trade Receivables shall be separately sub classified as – (a) Secured, considered Good (b) Unsecured, considered Good (c) Doubtful. 3. Bad /Doubtful: Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately. 4. Directors, etc: Debts due by Directors or Other Officers of the Company or any of them either severally or jointly with any other person or debts due by Firms or Private Companies, respectively in which any Director is a Partner, or a Director, or a Member should be separately stated. 5. Trade Receivables ageing schedule	● Schedule III requires separate disclosure of “Trade Receivables O/s for a period exceeding 6 months from the date they become due for payment”, only for the current portion of Trade Receivables. ● Where no due date is specifically agreed upon, normal credit period allowed by the Company should be taken into consideration for computing the due date, which may vary depending upon the Nature of Goods or Services sold and the Type of Customers, etc. ● Amounts due under contractual obligations, e.g., dues in respect of Insurance Claims, Sale of Fixed Assets, Contractually Reimbursable Expenses, Interest Accrued on Trade Receivables, etc., cannot be included within Trade Receivables. Such Receivables should be classified as “Other Current Assets” and each such item should be disclosed naturewise. ● Lean Period Activities: Receivables arising out of sale of materials/ rendering of services during a Company’s lean period, should be included under “Trade Receivables”, if such activity is in the normal course of business. If they are not part of “normal course of business”, they are to be classified under “Other Assets”.

(2) (d) CASH AND CASH EQUIVALENTS (Also Refer AS-3)

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
Cash and Cash Equivalents shall be classified as – (a) Balances with Banks, (b) Cheques, Drafts on Hand, (c) Cash on Hand, (d) Other (Specify nature).Notes: ● Earmarked Balances with Banks (e.g. for Unpaid Dividend) shall be separately stated. ● Balances with Banks to the extent held as margin Money or Security against the Borrowings, Guarantees, Other Commitments shall be disclosed separately. ● Repatriation restrictions, if any, in respect of Cash and Bank Balances shall be separately stated. ● Bank Deposits with more than 12 months Maturity shall be disclosed separately.	● “Other Bank Balances” would comprise items like Balances with Banks to the extent of holding as Margin Money or Security against Borrowings, etc., and Bank Deposits with more than 3 months maturity. ● Bank Deposits with more than 12 months maturity will also need to be separately disclosed under the above subhead. ● The Non-Current Portion of each of the above balances should be classified under the head “Other Non-Current Assets” with separated disclosure thereof.

(2) (e) SHORT TERM LOANS AND ADVANCES

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>

1. General Classification: Short-Term Loans and Advances shall be classified as – (a) Loans and Advances to Related Parties (giving details thereof), (b) Others (specify nature). 2. Security wise Classification: The above shall also be sub classified as- (a) Secured, considered Good, (b) Unsecured, considered Good, (c) Doubtful. 3. Bad / Doubtful: Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately. 4. Directors, etc.: Loans & Advances due by Directors or Other Officers of the Company or any of them either severally or Jointly with any other person or amounts due by Firms or Private Companies, respectively in which any Director is a Partner or a Director or a Member shall be separately stated.	Principles given for Long-Term Loans and Advances will apply here to the relevant extent.

(f) OTHER CURRENT ASSETS

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
• This is an all-inclusive heading, which incorporates Current Assets which do not fit into any other Asset Categories. • Nature of each item should be specified • In case any amount classified under this category is doubtful, it is advisable that such doubtful amount as well as any provision made there against should be separately disclosed.	• This is an all-inclusive heading, which incorporates Current Assets that do not fit into any other asset categories, e.g., Unbilled Revenue, Unamortized Premium on Forward Contracts, etc.

(g) CONTINGENT LIABILITIES AND COMMITMENTS (TO THE EXTENT NOT PROVIDED FOR)

<i>Schedule III Disclosure Requirement</i>	<i>Points</i>
(i) Contingent liabilities shall be classified as: a) Claims against the company not acknowledged as debt; b) Guarantees; c) Other money for which the company is contingently liable. (ii) Commitments shall be classified as: a) Estimated amount of contracts remaining to be executed on capital account and not provided for; b) Uncalled liability on shares and other investments partly paid; c) Other commitments (specify nature).	The amount of dividends proposed to be distributed to equity and preference shareholders for the period and the related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends on preference shares shall also be disclosed separately. Where in respect of an issue of securities made for a specific purpose, the whole or part of the amount has not been used for the specific purpose at the balance sheet date, there shall be indicated by way of note how such unutilised amounts have been used or invested. Where the company has not used the borrowings from banks and financial institutions for the specific purpose for which it was taken at the balance sheet date, the company shall disclose the details of where they have been used.

(h) ADDITIONAL REGULATORY INFORMATION

i. Title deeds of Immovable Property not held in name of the Company ii. Where the Company has revalued its Property, Plant and Equipment, the company shall disclose as to whether the revaluation is based on the valuation by a registered valuer as defined under rule 2 of the Companies (Registered Valuers and Valuation) Rules, 2017. iii. Following disclosures shall be made where Loans or Advances in the nature of loans are granted to promoters, directors, KMPs and the related parties (as defined under Companies Act, 2013,) either severally or jointly with any other person, that are:

a) repayable on demand or

- b)** without specifying any terms or period of repayment
- iv.** Capital-Work-in Progress (CWIP)
- v.** Intangible assets under development
- vi.** Details of Benami Property held
- vii.** Where the Company has borrowings from banks or financial institutions on the basis of security of current assets, it shall disclose the following:-
 - a)** whether quarterly returns or statements of current assets filed by the Company with banks or financial institutions are in agreement with the books of accounts.
 - b)** if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.
- viii.** Wilful Defaulter- Where a company is a declared wilful defaulter by any bank or financial Institution or other lender, following details shall be given:
 - a)** Date of declaration as wilful defaulter,
 - b)** Details of defaults (amount and nature of defaults),
- ix.** Relationship with Struck off Companies
- x.** Registration of charges or satisfaction with Registrar of Companies
- xi.** Compliance with number of layers of companies
- xii.** Following Ratios to be disclosed:-
 - a)** Current Ratio,
 - b)** Debt-Equity Ratio,
 - c)** Debt Service Coverage Ratio,
 - d)** Return on Equity Ratio,
 - e)** Inventory turnover ratio,
 - f)** Trade Receivables turnover ratio,
 - g)** Trade payables turnover ratio,
 - h)** Net capital turnover ratio,
 - i)** Net profit ratio,
 - j)** Return on Capital employed,
 - k)** Return on investment.
- xiii.** Compliance with approved Scheme(s) of Arrangements
- xiv.** Utilization of Borrowed funds and share premium.

Special Point: Unamortized portion of share issue expenses, etc.

- Schedule III does not contain any specifies disclosure requirement for the unamortized portion of expense items such as Share Issue Expenses, Ancillary Borrowing Costs and Discount or Premium relating to Borrowings.
- As per AS-16, Ancillary Borrowing Costs and Discount or Premium relating to Borrowings could be amortized over the loan period. Further, share Issue Expenses, Discount on Shares, Ancillary Costs-Discount, Premium on Borrowing, etc. being special nature items, are excluded from the scope of AS- 26 Intangible Assets.
- Certain companies have taken a view that it is an acceptable practice to amortize these expenses over the period of benefit, i.e., normally 3 to 5 years.
- Conclusion: Schedule III does not deal with any accounting treatment of these items, and the same continues to be governed by the respective AS / best practices. So, a Company can disclose the Unamortized Portion of such expenses as “Unamortized Expenses”, under the head “Other Current/ Non- Current Assets”, depending on whether the amount will be amortized in the next 12 months or thereafter.

PART II-FORM OF STATEMENT OF PROFIT AND LOSS

Name of the Company :.....

Profit and Loss Statement for the year ended:..... (Rs. in.)

Particulars	Note No.	Figures for the Current Reporting Period	Figures forthe Previous Reporting Period
I	Revenue from Operations	XXX	XXX
II	Other Income	XXX	XXX
III	Total Income (I+II)	XXX	XXX
IV	Expenses:		
	Cost of Materials Consumed Purchases of Stock-In-Trade	XXX	XXX
	Changes in Inventories of Finished Goods/ Work-in-progress and Stock-In-Trade	XXX	XXX
	Employee Benefits Expense	XXX	XXX
	Finance Costs	XXX	XXX
	Depreciation and Amortization Expense	XXX	XXX
	Other Expenses	XXX	XXX
Total Expenses		XXX	XXX
V	Profit before Exceptional & Extraordinary Itemsand Tax (III – IV)	XXX	XXX

VI	Exceptional Items	XXX	XXX
VII	Profit before Extraordinary Items (V-VI)	XXX	XXX
VIII	Extraordinary Items	XXX	XXX
IX	Profit before Tax (VII-VIII)	XXX	XXX
X	Tax Expenses:	XXX	XXX
	(1) Current Tax		
	(2) Deferred Tax		

XI	Profit /(Loss) for the period from Continuing Operations (IX – X)	XXX	XXX
XII	Profit /(Loss) from Discontinuing Operations	XXX	XXX
XIII	Tax Expense of Discontinuing Operations	XXX	XXX
XIV	Profit /(Loss) from Discontinuing Operations (After Tax) (XII-XIII)	XXX	XXX
XV	Profit / (Loss) for the period (XI + XIV)	XXX	XXX
XVI	Earnings per Equity Share: (1) Basic (2) Diluted	XXX	XXX

GENERAL INSTRUCTIONS FOR PREPARATION OF STATEMENT OF PROFIT AND LOSS

Item	Description	
1. Revenue from Operations	For Company other than a Finance Company: Revenue from Operations shall disclosed separately in the Notes, Revenue from – (a) Sale of Products (b) Sale of Services (ba) Grants or donation received (relevant in case of Section 8 Companies) (c) Other Operating Revenues (d) Less: Excise Duty	For Finance Company: Revenue from Operations shall include Revenue from: (a) Interest & (b) Other Financial Services Revenue under each of the above heads shall be disclosed separately byway of Notes to Accounts to the extent applicable.
2. Finance Costs	Finance Costs shall be classified as – (a) Interest Expenses, (b) Other Borrowing Costs, (c) Applicable Net Gain / Loss on Foreign Currency Transactions and Translation.	
3. Other Income	Other Income shall be classified as – (a) Interest Income (in case of a Company other than a Finance Company), (b) Dividend Income, (c) Net Gain/Loss on Sale of Investments, (d) Other Non-Operating Income (Net of Expenses directly attributable to such income).	
4. Additional Information	A Company shall disclose by way of Notes, additional information regarding Aggregate Expenditure and Income on the following items referred below.	

(i) Employee Benefits, Expense, Income Items, etc:

- (a) Employee Benefits Expense [showed separately – (i) Salaries & Wages, (ii) Contribution to PF and Other Funds, (iii) Expense on ESOP and Employee Stock Purchase Plan (ESPP), (iv) Staff Welfare Expenses]
 - (b) Depreciation and Amortization Expenses,
 - (c) Any item of Income or Expenditure which exceeds 1% of Revenue from Operations or Rs. 1,00,000 whichever is higher,
 - (d) Interest Income,
 - (e) Interest Expense, (f) Dividend Income,
 - (g) Net Gain / Loss on Sale of Investments,
 - (h) Adjustments to the Carrying Amount of Investments,
 - (i) Net Gain / Loss on Foreign Currency Transaction & Translation (other than the cost considered as Finance Cost),
 - (j)) Payments to the Auditor as – (a) Auditor, (b) For Taxation Matters, (c) For Company Law Matters, (d) For Management Services, (e) For other Services, (f) For Reimbursement of Expenses,
 - (k) In case of companies covered u/s 135, amount of expenditure incurred on Corporate Social Responsibility activities
 - (l) Item of Exceptional and Extraordinary Nature,
 - (m) Prior Period Items.
- (ii) Materials, Goods, Services, etc.**
- (a) In the case of Manufacturing Companies –
Raw Materials under broad heads. Goods Purchased under broad heads.
 - (b) In the case of Trading Companies, Purchases in respect of goods Traded in by the Company under broad heads.
 - (c) In the case of Companies rendering or supplying services, Gross Income derived from Services Rendered or Supplied, are shown under broad heads.
 - (d) In the case of a Company, which falls under more than one of the categories mentioned in (a), (b) and (c) above, it shall be sufficient compliance with the requirements herein if Purchases, Sales and Consumption of Raw Material and the Gross Income from Services rendered is shown under broad head.
 - (e) In the case of Other Companies, Gross Income derived under broad heads are shown.
- (iii) In the case of all concerns regarding Works-in-Progress are shown under broad heads.**
- (iv) Reserves – Creation & Utilization:**
- (a) The aggregate, if material, of any amounts set aside or proposed to be set aside to Reserve, without including Provisions made to meet any Specific Liability, Contingency or Commitment known to exist at the date as to which the Balance Sheet is made up.
 - (b) The aggregate, if material, of any amounts withdrawn from such Reserves.
- (v) Provision – Creation & Utilization:**

- (a) The aggregate, if material, of the amounts set aside to Provisions made for meeting Specific Liabilities, Contingencies or Commitments.
- (b) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.

(vi) Expenses, etc: Expenditure incurred on each of the following items, separately for each item:

- (a) Consumption of Stores and Spare Parts,
- (b) Power and Fuel,
- (c) Rent,
- (d) Repairs of Buildings,
- (e) Repairs of
Machinery
- (f) Insurance,
- (g) Rates and Taxes, excluding Taxes on Income,
- (h) Miscellaneous Expenses.

(vii) Subsidiaries Information:

- (a) Dividends from Subsidiary Companies.
- (b) Provisions for Losses of Subsidiary Companies.

(viii) Forex Information: The P&L A/c shall also contain by way of a Note the following Information, namely –

- (a) Value of Imports calculated on CIF basis by the Company during the Financial Year in respect of –
(I) Raw Materials, (II) Components and Spare Parts, (III) Capital Goods
- (b) Expenditure in Foreign Currency during the Financial Year on account of Royalty, Know-How, Professional and Consultation Fees, Interest, and Other Matters
- (c) Total Value if all Imported Raw Materials, Spare Parts and Components consumed during the Financial Year and the Total Value of all Indigenous Raw Materials, Spare Parts and Components similarly consumed and the Percentage of each to the Total Consumption,
- (d) Amount remitted during the year in Foreign Currencies on account of Dividends with a specific mention of the total number of Non-Resident Shareholders, the Total Number of Shares held by the company which the Dividends were due and the year to which the Dividends related.
- (e) Earnings in Foreign Exchange classified under the following heads, namely-Export of Goods calculated on FOB Basis, Royalty, Know-How, Professional & Consultation Fees, Interest and Dividend, Other Income, indicating the nature thereof.

Note: Broad heads shall be decided taking into account the concept of Materiality and Presentation of True and Fair view of Financial Statements.

(ix) Undisclosed income:

The Company shall give details of any transaction not recorded in the books of accounts that has been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (such as, search or survey or any other relevant provisions of the Income Tax Act, 1961), unless there is immunity for disclosure under any scheme and also shall state whether the previously unrecorded income and related assets have been properly recorded in the books of account during the year.;

(x) Corporate Social Responsibility (CSR):

Where the company covered under section 135 of the companies act, the following shall be disclosed

with regard to CSR activities:-

- a. amount required to be spent by the company during the year,
- b. amount of expenditure incurred,
- c. shortfall at the end of the year,
- d. total of previous years shortfall,
- e. reason for shortfall,
- f. nature of CSR activities,
- g. details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,
- h. where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately.

(xi)Details of Crypto Currency or Virtual Currency:

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:-

- a. profit or loss on transactions involving Crypto currency or Virtual Currency
- b. amount of currency held as at the reporting date,
- c. deposits or advances from any person for the purpose of trading or investing in Crypto Currency/ virtualcurrency.

TRUE AND FAIR VIEW OF FINANCIAL STATEMENTS

According to Section 128 (1) of the Companies Act, 2013, every company shall prepare and keep its registeredoffice books of account and other relevant books and papers and financial statements for every financial year which give a true and fair view of the state of the affairs of the company.

Further Section 129(1) of the Companies Act, 2013, states that the financial statements shall give a true and fairview of the state of affairs of the company or companies, comply with the accounting standards notified under Section 133 and shall be in the form provided for different class or classes of companies in Schedule III.

Thus, the Companies Act requires that the profit and loss account must exhibit a true and fair view of the profitearned or loss suffered by the company during the period for which the account has been prepared.

The term ‘true and fair’ has not been defined nor has it been the subject of any judicial decision. But in order to show a true and fair view financial statement (Statement of Profit and Loss and Balance Sheet) should not mislead the user about the financial health of organization.

From the accounting point of view, the profit and loss account should be drawn upon the principles statedbelow:

- (a) Materiality:** All significant factors which will have an impact on the mind of the reader should bedisclosed.

For example, if a large quantity of raw materials is sold and there is a amount of profit or loss, the sale should not be included in the Sales Account; instead, the cost of the materials should be deducted from materials consumed and the profit or loss on the sale of raw materials should be separately disclosed in the profit and loss account. The reader will then know why the profit or loss occurred and how much it was; the reason will not be clear if the sale of raw materials is added to Sales or deducted from materials consumed. If, however, only a small quantity was sold leading to a rather insignificant profit or loss, separate disclosure is not necessary because such a disclosure will not change the impression of the reader about the profit situation.

What is material does not depend upon the judgment of the management. But the materiality of a figureshould be judged from the point of view of both the total amount of the item and

the amount of the profit or loss. In the above example, materiality has to be seen from the point of view of :

- (i) the amount of materials consumed and
- (ii) the profit or loss during the year.

- (b) **Prior-Period Items:** The rule in India is that once accounts are adopted at the annual general meeting, they cannot be reopened. If any error is discovered, it can be corrected only in the accounts of the subsequent period. Apart from errors, some of the accounts relating to the

For example, rates have been revised with effect from October, 2015, but the decision was made only in March, 2017, The increased wages for 2016-17 can certainly be added to the 2016-2017 wages but the increased wages for six months of 2015-2016 will also have to be taken out into account. Errors and other items relating to the previous year should be shown separately in the profit and loss account, and not clubbed with the item relating to the current year unless the concerned amounts are not material. Preferably, errors and prior year items should be stated below the line, i.e., in the Profit and Loss Appropriation Account.

previous year may come to knowledge or may be ascertained only in the current year.

- (c) **Extraordinary Items:** If expenses or income that do not arise in the ordinary course and are material they should be stated separately in the profit and loss account.

For example, if a fixed asset is sold, its profit or loss has to be shown separately. Another example would be speculation loss or profit; yet another would be subsidy received from government for operational purposes.

- (d) **Change in Accounting Policies:** It is well known that if there is any change in an accounting policy, say method of valuation of inventories or of change in depreciation, there has to be a disclosure about the fact of change and on profit or loss resulting from such a change.

XBRL (EXTENSIBLE BUSINESS REPORTING LANGUAGE)

XBRL is a language for the electronic communication of business and financial data which is revolutionizing business reporting around the world. It provides major benefits in the preparation, analysis and communication of business information. It offers cost savings, greater efficiency and improved accuracy and reliability to all those involved in supplying or using financial data. XBRL stands for extensible Business Reporting Language. It is already being put to practical use in a number of countries and implementations of XBRL are growing rapidly around the world.

How Does XBRL work?

XBRL makes the data readable, with the help of two documents – Taxonomy and instance document. Taxonomy defines the elements and their relationships based on the regulatory requirements. Using the taxonomy prescribed by the regulators, companies need to map their reports, and generate a valid XBRL instance document. The process of mapping means matching the concepts as reported by the company to the corresponding element in the taxonomy. In addition to assigning XBRL tag from taxonomy, information like unit of measurement, period of data, scale of reporting etc., needs to be included in the instance document.

How do companies create statements in XBRL?

There are a number of ways to create financial statements in XBRL:

- XBRL-aware accounting software products are becoming available which will support the export of data in XBRL form. These tools allow users to map charts of accounts and other structures to XBRL tags.
- Statements can be mapped into XBRL using XBRL software tools designed for this purpose.
- Data from accounting databases can be extracted in XBRL format. It is not strictly necessary for an accounting software vendor to use XBRL; third party products can achieve the

transformation of the data to XBRL.

- Applications can transform data in particular formats into XBRL. The route which an individual company may take will depend on its requirements and the accounting software and systems it currently uses, among other factors.

XBRL filing under the Companies Act, 2013

The following class of companies shall file their financial statements and other documents under section 137 of the Companies Act with the Registrar in e-form AOC-4 XBRL as per Annexure-I:-

- (i) Companies listed with stock exchanges in India and their Indian subsidiaries;
- (ii) Companies having paid up capital of five crore rupees or above;
- (iii) Companies having turnover of one hundred crore rupees or above;
- (iv) All companies which are required to prepare their financial statements in accordance with Companies (Indian Accounting Standards) Rules, 2015.

The companies preparing their financial statements under the Companies (Accounting Standards) Rules, 2006 shall file the statements using the Taxonomy provided in Annexure-II and companies preparing their financial statements under Companies (Indian Accounting Standards) Rules, 2015, shall file the statements using the Taxonomy provided in Annexure-II A. However, non-banking financial companies, housing finance companies and companies engaged in the business of banking and insurance sector are exempted from filing of financial statements under these rules.

The companies which have filed their financial statements under above rule shall continue to file their financial statements and other documents though they may not fall under the class of companies specified therein in succeeding years.

The companies which have filed their financial statements under the erstwhile rules, namely the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011, shall continue to file their financial statements and other documents though they do not fall under the class of companies specified therein.

Benefits of XBRL

XBRL increases the usability of financial statement information. The need to re-key financial data for analytical and other purposes can be eliminated. By presenting its statements in XBRL, a company can benefit investors and all other stakeholders and enhance its profile. It meets the requirements of regulators, lenders and other consumers of financial information, who are increasingly demanding reporting in XBRL. This improves business relations and lead to a range of benefits.

All types of organizations can use XBRL to save costs and improve efficiency in handling business and financial information. Because XBRL is extensible and flexible, it can be adapted to a wide variety of different requirements. All participants in the financial information supply chain can benefit, whether they are preparers, transmitters or users of business data.

XBRL offers major benefits at all stages of business reporting and analysis. The benefits are seen in automation, cost saving, faster, more reliable and more accurate handling of data, improved analysis and in better quality of information and decision-making. XBRL enables producers and consumers of financial data to switch resources away from costly manual processes, typically involving time-consuming comparison, assembly and re-entry of data. They are able to concentrate effort on analysis, aided by software which can validate and process XBRL information. XBRL is a flexible language, which is intended to support all current aspects of reporting in different countries and industries. Its extensible nature means that it can be adjusted to meet particular business requirements, even at the individual organization level.

XBRL benefits comparability by helping to identify data which is genuinely alike and distinguishing information which is not comparable. Computers can process this information and populate both pre defined and customized reports.

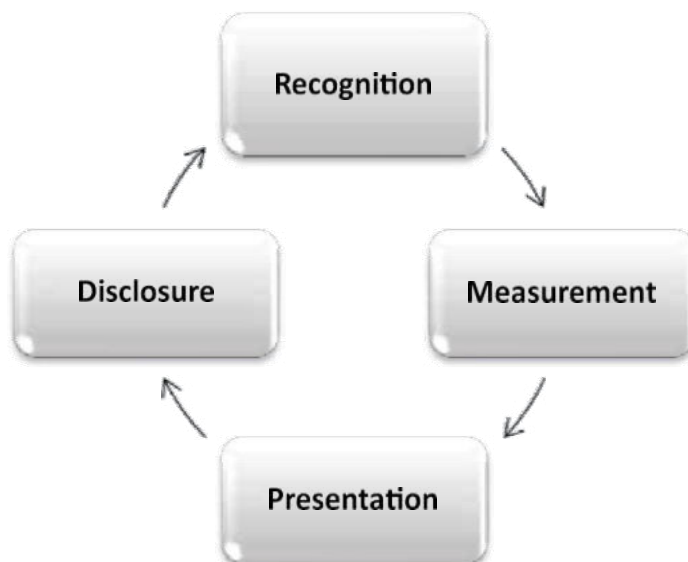
With full adoption of XBRL, companies can automate data collection. For example, data from different company divisions with different accounting systems can be assembled quickly, cheaply and efficiently. Once data is gathered in XBRL, different types of reports using varying subsets of the data can be produced with minimum effort. A company finance division, for example, could quickly and reliably generate internal management reports, financial statements for publication, tax and other regulatory filings, as well as credit reports for lenders. Not only can data handling be automated, removing time-consuming, error-prone processes, but the data can be checked by software for accuracy

CHAPTER-3

Accounting Standards

INTRODUCTION - ACCOUNTING STANDARDS

Accounting Standards are written policy documents issued by expert accounting body or by the government or other regulatory body covering the aspects of recognition, measurement, presentation, and



disclosure of accounting transactions in financial statements.

This point may be explained as under:

- (i) **Recognition of transactions and other events:** Recognition is the process of incorporating an item in the Balance Sheet and statement of Profit and Loss. It involves the depiction of an item in words and by a monetary amount and inclusion of that amount in the totals of the Balance Sheet and Statement of Profit and Loss. The Accounting standards tell us which items to recognize in the Balance sheet and which ones in the Statement of Profit and Loss.
- (ii) **Measurement of the transactions and other events:** Accounting standards also provide guidance as to what monetary amount should be allocated to the transaction and events i.e. these help in the measurement or quantification of the items of transactions and events. For example, Accounting Standard (AS) 10 'Property, Plant and Equipment' provides that for the initial recognition of an item of PPE, the costs of the items to be considered are (a) Purchase price less trade discount and rebates; (b) Non-refundable purchase taxes; (c) Import duties; (d) Directly attributable cost to bring the asset in the location and condition for operation as intended by the management.
- (iii) **Presentation of transactions and other events:** Accounting Standards also deal with the manner of presentation of transactions and other events in the Balance Sheet and Statement of Profit and Loss. For Example, paragraphs 8 to 17 of Accounting Standard 3 'Cash Flow Statements' deal with the manner of presentation of operating activities, investing and financing activities in the cash flow statement.
- (iv) **Disclosure of transactions and other events:** Accounting standards also deal with the manner of disclosure of transactions and other events in the financial statements. For example, paragraph 37 of the AS 10 provides that in the financial statements, gross and net carrying amounts of the items of PPE at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements should be disclosed separately.

It may be noted that almost all the Accounting Standards deal with recognition, measurement, presentation and disclosure of transactions and other events in the Financial Statements.

NEED OF ACCOUNTING STANDARD

The accounting standards seek to describe the accounting principles, valuation techniques and the

methods of applying these accounting principles in the preparation and presentation of the financial statements so that they represent a true and fair view of the financial position and financial performance of the enterprise. The ostensible purpose of the standards setting bodies is to promote the dissemination of the timely and useful financial information to the users. The need of Accounting Standards may be enumerated as under:

- (i) **Improvement of credibility and reliability of financial statements:** The accounting standards create an environment of confidence among the users of accounting information by providing a uniform structure of uniform guidelines which provide credibility and reliability to the accounting information. In this way, the financial statements present a true and fair view of the financial position and financial performance of an entity.
- (ii) **Comparability of financial Statements made easy:** The value of the accounting information is enhanced if the same may be compared in the same line of business activity. But, the comparability is possible only if the same accounting standards are used in the preparation of the financial statements of the different enterprises in the same industry. It is a positive step to protect the interests of the users of the accounting information.
- (iii) **Benefits to the accountants and auditors:** The accounting standards provide a basis for the uniform accounting principles. Due to this reason, there is a less possibility of frauds being committed by the accountant. There is more transparency in the accounting information. Since the accounting profession follows the accounting standards without any exception, they are helpful not only to the accounting entity but also to the accountants and the auditors. Any type of misinformation can lead to a strict action against the accountants and the auditors.
- (iv) **Additional disclosures:** There are certain areas where the important information is not required to be disclosed by the law. The accounting standards require the disclosure of such matters such as the method of depreciation and the change in the method of depreciation which help the users of the financial statements to take important financial decision.
- (v) **Evaluation of the managerial ability:** Accounting standards are useful in measuring the efficiency of the management regarding profitability, liquidity, solvency and other general areas of progress of the enterprise. In the absence of Accounting Standards, it would be difficult to evaluate the managerial efficiency because there is no basis to compare the financial statements of one enterprise with those of another. Each enterprise would evolve its own rules and standards to suit its own purpose and users would, therefore, not be able to get a true and fair view of the functioning of the enterprise.
- (vi) **Helpful to the Government:** The Government officials would find the financial information useful for economic planning, market analysis and tax collection if the financial statements are based on the established accounting standards.

LIST OF ACCOUNTING STANDARDS ISSUED BY ICAI

The Institute of Chartered Accountants of India has, so far, issued 32 Accounting Standards. However, the Accounting Standard 8 “Accounting for Research and Development” was withdrawn subsequent to the issuance of Accounting Standard 26 “Intangible Assets” and the Accounting Standard 6 “Depreciation Accounting” was withdrawn subsequent to the issuance of revised Accounting Standard 10 “Property, Plant and Equipment” including the matters related to depreciation accounting for the old AS 10 “Accounting for Fixed Assets”. The Accounting Standards 30, 31 and 32 related to “Financial Instruments” have been withdrawn by the ICAI in the year 2016. Thus, effectively, there are only 27 Accounting Standards at present.

AS 1	Disclosure of Accounting Policies
AS 2	Valuation of Inventories (Revised)
AS 3	Cash Flow Statements
AS 4	Contingencies and Events Occurring After Balance Sheet Date (Revised)
AS 5	Net profit or Loss for the period, Prior Period Items and Changes in Accounting Policies

AS 7	Construction Contracts
AS 9	Revenue Recognition
AS 10	Property, Plant and Equipment (Revised)
AS 11	The Effects of Changes in Foreign Exchange Rates
AS 12	Government Grants
AS 13	Accounting for Investments (Revised)
AS 14	Accounting for Amalgamations (Revised)
AS 15	Employee Benefits
AS 16	Borrowing Costs
AS 17	Segment Reporting
AS 18	Related Party Disclosures
AS 19	Leases
AS 20	Earnings per Share
AS 21	Consolidated Financial Statements (Revised)
AS 22	Accounting for Taxes on Income
AS 23	Accounting for Investments in Associates
AS 24	Discontinuing Operations
AS 25	Interim Financial Reporting
AS 26	Intangible Assets
AS 27	Financial Reporting of Interests in Joint Ventures
AS 28	Impairment of Assets
AS 29	Provisions, Contingent Liabilities and Contingent Assets (Revised)

APPLICABILITY OF ACCOUNTING STANDARDS

As per paragraph 3.3. of the ‘Preface to the Statements of Accounting Standards’ in the ‘Compendium of Accounting Standards (Accounting Standards as on July 1, 2019)’ issued by the Institute of Chartered Accountants of India (ICAI), accounting standards are intended to apply to enterprises (whether organized in corporate, co-operative or other forms) engaged in commercial, industrial or business activities irrespective of whether it is profit oriented or it is established for charitable or religious purposes. However, the Accounting Standards will not apply to the enterprises which carry on only those activities which are not of commercial, industrial or business nature (e.g. an activity of collecting donations and giving them to flood affected people). Exclusion of an enterprise from the applicability of Accounting Standards would be permissible only if no part of the activity of such enterprise is commercial, industrial or business in nature. Even if a very small proportion of the activities of an enterprise is considered to be commercial, industrial or business in nature, the Accounting Standards would apply to all its activities including those which are not commercial, industrial or business in nature.

Thus, it may be stated that the Accounting Standards apply to:

- (a) Sole proprietorship concerns/individuals
- (b) Partnership firms
- (c) Societies
- (d) Trusts
- (e) Hindu Undivided families
- (f) Association of Persons (AOP)

- (g) Body of individuals (BOI)
- (h) Co-operative societies
- (i) Companies and LLPs

Applicability of Accounting Standard to which types of financial statements or reports?

As per paragraph 3.3 of the ‘Preface to the Statements of Accounting Standards’ in the ‘Compendium of Accounting Standards (Accounting Standards as on July 1, 2019)’ issued by the Institute of Chartered Accountants of India (ICAI), Accounting Standards apply to the general-purpose financial Statements and other financial reporting which are subject to attest functions of the members of the ICAI. As per paragraph 3.4 of the said preface, the term ‘General purpose Financial Statements’ includes ‘Balance Sheet’, ‘Statement of Profit and Loss’, ‘A Cash Flow Statement’ (where applicable), and Statements and explanatory notes which form part thereof issued for the use of various stakeholders, government and their agencies and the public at large.

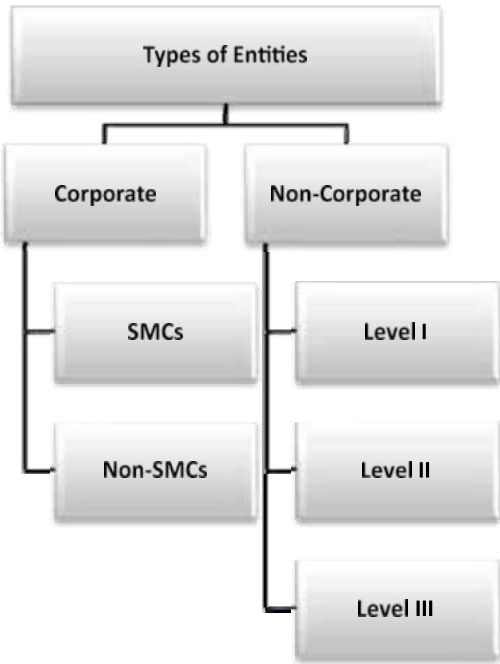
ACCOUNTING STANDARD AND AUDITORS

It is the duty of the auditors that while discharging their function, they ensure that the Accounting Standards issued and made mandatory by the Central Government are complied with. Section 143(3)(e) of the CompaniesAct, 2013 requires the auditor to report whether in his opinion, the financial statements comply with the Accounting Standards referred in section 133 of the Companies Act, 2013.

ACCOUNTING STANDARD AND BOARD’S REPORT

Section 134(5)(a) of the Companies Act, 2013 states that Directors Responsibility Statement should include thatin the preparation of the annual accounts, the applicable Accounting Standards had been followed along with proper explanations relating to material departure.

For the purpose of applicability of Accounting Standard, entities are grouped as follows:



Corporate Entities		
Type	Conditions	Applicability of Accounting Standard
Small and Medium Companies (SMCs)	SMCs are companies that satisfy the following conditions: (a) Equity and debt securities of the company are not listed or are not in the process of listing on any stock exchange, whether in India or outside India (b) Company is not a bank or financial	Partial Exemption: Certain relaxations are provided with respect to following Accounting Standard: AS 17 – Segment Reporting AS 15 – Employee Benefits AS 19 – Leases

	institution or insurance company (c) Company’s turnover (excluding other income) does not exceed Rs. 50 crores in the immediately preceding accounting year (d) Company does not have borrowing (including public deposits) exceeding Rs. 10 crores at any time during the immediately preceding accounting year and (e) Company is not a holding company or subsidiary of a non-SMC.	AS 20 – Earnings Per Share (EPS) AS 29 – Provisions, contingent liabilities and contingent assets Full Exemption AS 3 – Cash Flow Statements, shall not apply to SMCs if it is a One Person Company (OPC), dormant company and Small Company
Non-SMCs	Any Other Corporate Entities not falling under SMCs	All the accounting standards are applicable to Non-SMCs.

Non-Corporate Entities		
Level	Conditions	Accounting Standards applicable
Level I	- Entities whose equity or debt instruments are listed or are in process of listing on any stock exchange (in or outside India) - Banks (including co-operative banks), financial institutions or entities carrying on Insurance business - All commercial, industrial or business reporting entities having: - Borrowings > 10 crores (at any time during immediately preceding accounting year) - Turnover > 50 crores (during preceding accounting year) - Holding or subsidiary entities of any of the above.	All the accounting standards are applicable to Level I entities. However, AS 21, 23 and 27 will apply based on regulatory requirement.
Level II	- Other than Level I entities if they fall under the following limit. - All commercial, industrial or business reporting entities having: - Borrowings > 1 crores (at any time during immediately preceding accounting year) - Turnover > 10 crores (during preceding accounting year) - Holding or subsidiary entities of any of the above.	Fully applicable AS
		All accounting standards are applicable to Level II entities except AS 21, 23, 25, 27 and those discussed below. AS applicable but certain relaxations regarding disclosure requirement AS 19 – Leases AS 20 – Earning Per Share AS 29 – Provisions, contingent liabilities and contingent assets.
		Accounting standards not applicable AS 3 – Cash Flow Statement

		AS 17 – Segment Reporting.
Level III	All non-corporate entities other than Level I and Level II.	In addition to partial and full exemption as given in Level II, full exemption with respect to these two are also available: AS 18 – Related Party Disclosures AS 24 – Discontinuing Operations.

Conflict between Act and Accounting Standards In case there is any conflict between provisions of any applicable Act and Accounting Standard (AS), the provisions of the Act shall prevail to that extent.

OVERVIEW OF ACCOUNTING STANDARD		
AS	Deals with	Details
AS 1	Disclosure of Accounting Policies	Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements. All significant accounting policies should be disclosed. Such disclosure form part of financial statements. All disclosures should be made at one place. Specific disclosure for the adoption of fundamental accounting assumptions is not required. Disclosure of accounting policies cannot remedy a wrong or inappropriate treatment of the item in the accounts.
AS 2	Valuation of Inventories	A primary issue in accounting for inventories is the determination of the value at which inventories are carried in the financial statements until the related revenues are recognized. This Standard deals with the determination of such value, including the ascertainment of cost of inventories and any write-down thereof to net realizable value. Inventories should be valued at the lower of cost and net realizable value. The cost of inventories should comprise- All costs of purchase (a) Costs of conversion (b) Other costs incurred in bringing the inventories to their present location and condition.
AS 3	Cash Flow Statements	The Standard deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities. An enterprise should prepare a cash flow statement and should present it for each period for which financial statements are presented. Cash Flows are inflows and outflows of cash and cash equivalents. Cash Flow Statement represents the cash flows during the specified period by operating, investing and financing activities.

AS 4	Contingencies and Events Occurring After the Balance Sheet Date	This Standard deals with the treatment in financial statements of: (a) contingencies, and (b) Events occurring after the balance sheet date. A contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events. Events occurring after the balance sheet date are those significant events, both favorable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.

AS 5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	The objective of this Standard is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises prepare and present such a statement on a uniform basis. This enhances the comparability of the financial statements of an enterprise over time and with the financial statements of other enterprises. Accordingly, this Standard requires the classification and disclosure of extraordinary and prior period items, and the disclosure of certain items within profit or loss from ordinary activities. It also specifies the accounting treatment for changes in accounting estimates and the disclosures to be made in the financial statements regarding changes in accounting policies. This Standard should be applied by an enterprise in presenting profit or loss from ordinary activities, extraordinary items and prior period items in the statement of profit and loss, in accounting for changes in accounting estimates, and in disclosure of changes in accounting policies.
AS 7	Construction Contracts	The objective of this Standard is to prescribe the accounting treatment of revenue and costs associated with construction contracts. Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed. This Standard uses the recognition criteria established in the Framework for the Preparation and Presentation of Financial Statements to determine when contract revenue and contract costs should be recognized as revenue and expenses in the statement of profit and loss. It also provides practical guidance on the application of these criteria. This Standard should be applied in accounting for construction contracts in the financial statements of contractors. A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are

		closely interrelated or interdependent in terms of their design, technology andfunction or their ultimate purpose or use.
AS 9	Revenue Recognition	This Standard deals with the bases for recognition of revenue in the statement of profit and loss of an enterprise. The Standard is concernedwith the recognition of revenue arising in the course of the ordinary activities of the enterprise from: (a) the sale of goods, (b) the rendering of services, and (c) the use by others of enterprise resources yielding interest,royalties and dividends.
		Revenue is the gross inflow of cash, receivables or other considerationarising in the course of the ordinary activities of an enterprise fromthe sale of goods, from the rendering of services, and from the useby others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers orclients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.
AS 10	Property, Plant and Equipment	Property, plant and equipment are tangible items that are held for usein the production or supply of goods or services, for rental to other or for administrative services. The objective of this AS is to prescribe theaccounting treatment for property, plant and equipment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, determination of their carrying amounts and depreciation charges and recognition of impairment losses in relation to them. Under this AS, property, plant and equipment are initially recognized at cost, subsequently measured by using either cost model or revaluation model and depreciated so that its depreciable amountis allocated on a systematic basis over its useful life.
AS 11	The Effects of Changes in Foreign Exchange Rates	An enterprise may carry on activities involving foreign exchange in twoways. It may have transactions in foreign currencies or it may have foreign operations. In order to include foreign currency transactions and foreign operations in the financial statements of an enterprise, transactions must be expressed in the enterprise’s reporting currencyand the financial statements of foreign operations must be translated into the enterprise’s reporting currency. This Standard should be applied: (a) in accounting for transactions in foreign currencies; and (b) in translating the financial statements of foreign operations

AS 12	Accounting for Government Grants	This Standard deals with accounting for Government Grants. Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, etc. Government grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise. The receipt of government grants by an enterprise is significant for preparation of the financial statements for two reasons. Firstly, if a government grant has been received, an appropriate method of accounting therefor is necessary. Secondly, it is desirable to give an indication of the extent to which the enterprise has benefited from such grant during the reporting period. This facilitates comparison of an enterprise's financial statements with those of prior periods and with those of other enterprises.
AS 13	Accounting for Investments	This Standard deals with accounting for investments in the financial statements of enterprises and related disclosure requirements. Investments are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade are not 'investments'. Enterprises hold investments for diverse reasons. For some enterprises, investment activity is a significant element of operations, and assessment of the performance of the enterprise may largely, or solely, depend on the reported results of this activity. An enterprise should disclose current investments and long term investments distinctly in its financial statements. Further classification of current and long-term investments should be as specified in the statute governing the enterprise. In the absence of a statutory requirement, such further classification should disclose, where applicable, investments in: (a) Government or Trust securities (b) Shares, debentures or bonds (c) Investment properties (d) Others-specifying nature.
AS 14	Accounting for Amalgamations	This standard deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves. This standard is directed principally to companies although some of its requirements also apply to financial statements of other enterprises. According to this Standard, amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies.

		An amalgamation may be either – (a) an amalgamation in the nature of merger, or (b) an amalgamation in the nature of purchase.
AS 15	Employee Benefits	The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The Standard requires an enterprise to recognize: • a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and • an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits. Employee benefits are all forms of consideration given by an enterprise in exchange for service rendered by employees.
AS 16	Borrowing Costs	The objective of this Standard is to prescribe the accounting treatment for borrowing costs. Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard. Other borrowing costs should be recognized as an expense in the period in which they are incurred. The financial statements should disclose: (a) the accounting policy adopted for borrowing costs; and (b) the amount of borrowing costs capitalized during the period.
S 17	Segment Reporting	The objective of this Standard is to establish principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates. Such information helps users of financial statements: • better understand the performance of the enterprise; • better assess the risks and returns of the enterprise; and • make more informed judgments about the enterprise as a whole. If a single financial report contains both consolidated financial statements and the separate financial statements of the parent, segment information need be presented only on the basis of the consolidated financial statements. In the context of reporting of segment information in consolidated financial statements, the references in this Standard to any financial statement items should be construed to be the relevant item as appearing in the consolidated financial statements.

AS 18	Related Party Disclosures	The objective of this Standard is to establish requirements for disclosure of: • related party relationships; and • transactions between a reporting enterprise and its related parties. This Standard should be applied in reporting related party relationships and transactions between a reporting enterprise and its related parties. The requirements of this Standard apply to the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company.

AS 19	Leases	The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures in relation to finance leases and operating leases. This Standard should be applied in accounting for all leases other than: • lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights; • licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and • lease agreements to use lands.
AS 20	Earnings per Share	The objective of this Standard is to prescribe principles for the determination and presentation of earnings per share which will improve comparison of performance among different enterprises for the same period and among different accounting periods for the same enterprise. The focus of this Standard is on the denominator of the earnings per share calculation. Even though earnings per share data has limitations because of different accounting policies used for determining ‘earnings’, a consistently determined denominator enhances the quality of financial reporting. This Standard should be applied by all companies. However, a Small and Medium Sized Company, as defined in the Notification may not disclose diluted earnings per share (both including and excluding extraordinary items). In consolidated financial statements, the information required by this Statement should be presented on the basis of consolidated information.

AS 21	Consolidated Financial Statements	The objective of this Standard is to lay down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented by a parent (also known as holding enterprise) to provide financial information about the economic activities of its group. These statements are intended to present financial information about a parent and its subsidiary (ies) as a single economic entity to show the economic resources controlled by the group, the obligations of the group and results the group achieves with its resources. This Standard should be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent. This Standard should also be applied in accounting for investments in subsidiaries in the separate financial statements of a parent.

AS 22	Accounting for Taxes on Income	The objective of this Standard is to prescribe accounting treatment for taxes on income. Taxes on income is one of the significant items in the statement of profit and loss of an enterprise. In accordance with the matching concept, taxes on income are accrued in the same period as the revenue and expenses to which they relate. Matching of such taxes against revenue for a period poses special problems arising from the fact that in a number of cases, taxable income may be significantly different from the accounting income. This divergence between taxable income and accounting income arises due to two main reasons. Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss. This Standard should be applied in accounting for taxes on income. This includes the determination of the amount of the expense or saving related to taxes on income in respect of an accounting period and the disclosure of such an amount in the financial statements.
AS 23	Accounting for Investments in Associates in Consolidated Financial Statements	The objective of this Standard is to set out principles and procedures for recognizing, in the consolidated financial statements, the effects of the investments in associates on the financial position and operating results of a group. This Standard should be applied in accounting for investments in associates in the preparation and presentation of consolidated financial statements by an investor.

AS 24	Discontinuing Operations	The objective of this Standard is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations. This Standard applies to all discontinuing operations of an enterprise. The requirements related to cash flow statement contained in this Standard are applicable where an enterprise prepares and presents a cash flow statement.
AS 25	Interim Financial Reporting	The objective of this Standard is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an enterprise's capacity to generate earnings and cash flows, its financial condition and liquidity.

		This Standard does not mandate which enterprises should be required to present interim financial reports, how frequently, or how soon after the end of an interim period. If an enterprise is required or elects to prepare and present an interim financial report, it should comply with this Standard.
AS 26	Intangible Assets	The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard. This Standard requires an enterprise to recognise an intangible asset if, and only if, certain criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets. This Standard should be applied by all enterprises in accounting for intangible assets, except: (a) intangible assets that are covered by another Accounting Standard; (b) financial assets; (c) mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources; and (d) intangible assets arising in insurance enterprises from contracts with policyholders. An intangible asset should be recognised if, and only if: (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and

		(b) the cost of the asset can be measured reliably. An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.
AS 27	Financial Reporting of Interests in Joint Ventures	The objective of this Standard is to set out principles and procedures for accounting for interests in joint ventures and reporting of joint venture assets, liabilities, income and expenses in the financial statements of ventures and investors. This Standard should be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of ventures and investors, regardless of the structures or forms under which the joint venture activities take place.

AS 28	Impairment of Assets	The objective of this Standard is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Standard requires the enterprise to recognize an impairment loss. This Standard also specifies when an enterprise should reverse an impairment loss and it prescribes certain disclosures for impaired assets. This Standard should be applied in accounting for the impairment of all assets, other than: (a) inventories (see AS 2, Valuation of Inventories); (b) assets arising from construction contracts (see AS 7, Construction Contracts); (c) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and deferred tax assets (see AS 22, Accounting for Taxes on Income).
AS 29	Provisions, Contingent Liabilities and Contingent Assets	The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount. The objective of this Standard is also to lay down appropriate accounting for contingent assets. This Standard should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, except: (a) those resulting from financial instruments¹ that are carried at fair value; (b) those resulting from executory contracts, except where the contract is onerous;

		(c) those arising in insurance enterprises from contracts with policyholders; and (d) those covered by another Accounting Standard.

At present, there are two sets of Accounting Standards under Companies Act as under:

1. Accounting Standards (ASs) as notified by the Companies (Accounting Standards) Rules, 2006. These are from AS-1 to AS-5, AS-7 and AS-9 to AS-29, as amended by notification dated 30th March, 2016.
2. Indian Accounting Standards (Ind AS) as notified by the Companies (Indian Accounting Standards) Rules, 2015. These are from Ind AS-1 to Ind AS-41 and Ind AS-101 to Ind AS-116 as amended by Companies (Ind AS) Amendment Rules, 2016 dated 30th March, 2016.

Indian Accounting Standards (Ind AS) are another set of accounting standards notified by the Ministry of Corporate Affairs, Government of India which are converged with International Financial Reporting Standards (IFRS). These accounting standards are formulated by Accounting Standards Board of Institute of Chartered Accountants of India (ICAI). The Ind ASs are named and numbered in the same way as the corresponding IFRS. The Ministry of Corporate Affairs (MCA) has notified 41 Ind ASs as Companies (Indian Accounting Standards) Rules, 2015 as amended by Companies (Indian Accounting Standards) Amendments Rules, 2016.

NEED FOR CONVERGENCE WITH GLOBAL STANDARDS

The last decade has witnessed a sea change in the global economic scenario. The emergence of transnational corporations in search of money, not only for fuelling growth, but to sustain ongoing activities has necessitated raising of capital from all parts of the world, cutting across frontiers.

Each country has its own set of rules and regulations for accounting and financial reporting. Therefore, when an enterprise decides to raise capital from the markets other than the country in which it is located, the rules and regulations of that other country apply, and this, in turn, will require that the enterprise is in a position to understand the differences between the rules governing financial reporting in the foreign country as compared to its own country of origin. Therefore, translation and re-instatements are of utmost importance in a world that is rapidly globalizing in all ways. In themselves also, the Accounting Standards and principle need to be robust so that the larger society develops degree of confidence in the financial statements, which are put forward by organizations.

International analysts and investors would like to compare financial statements based on similar Accounting Standards, and this has led to the growing support for an internationally accepted set of Accounting Standards for cross-border filings. The harmonization of financial reporting around the world will help to raise confidence of investors generally in the information they are using to make their decisions and assess their risks.

Also a strong need was felt by legislation to bring about uniformity, rationalization, comparability, transparency and adaptability in financial statements. Having a multiplicity of Accounting Standards around the world is against the public interest. If accounting for the same events and information produces different reported numbers, depending on the system of standards that are being used, it is self-evident that accounting will be increasingly discredited in the eyes of those using the numbers. It creates confusion, encourages error and facilitates fraud. The cure for these ills is to have a single set of global standards, of the highest quality, set in the interest of public. Global Standards facilitate cross-border flow of money, global listing in different bourses and comparability of financial statements.

The convergence of financial reporting and Accounting Standards is a valuable process that contributes to the free flow of global investment and achieves substantial benefits for all capital market stakeholders. It improves the ability of investors to compare investments on a global basis and thus lowers their risk of errors of judgment. It facilitates accounting and reporting for companies with global operations and eliminates some costly requirements reinstatement of financial statements. It has the potential to create a new standard of accountability and greater transparency, which are values of great significance to all market

participants, including regulators. It reduces operational challenges for accounting firms and focuses their value and expertise around an increasingly unified set of standards. It creates an unprecedented opportunity for standardsetters and other stakeholders to improve the reporting model. For the companies with joint listings in both domestic and foreign country, the convergence is very much significant.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) AS GLOBAL STANDARDS

With a view of achieving these objectives, the London-based group namely the International Accounting Standards Committee (IASC), responsible for developing International Accounting Standards, was established in June, 1973. It is presently known as International Accounting Standards Board (IASB). The IASC comprises the professional accountancy bodies of over 75 countries (including the Institute of Chartered Accountants of India). Primarily, the IASC was established, in the public interest, to formulate and publish, International Accounting

Standards to be followed in the presentation of audited financial statements. International Accounting Standards were issued to promote acceptance and observance of International Accounting Standards worldwide. The members of IASC have undertaken a responsibility to support the standards promulgated by IASC and to propagate those standards in their respective countries.

Between 1973 and 2001, the International Accounting Standards Committee (IASC) released International Accounting Standards. Between 1997 and 1999, the IASC restructured their organization, which resulted in the formation of International Accounting Standards Board (IASB). These changes came into effect on 1st April, 2001. Subsequently, IASB issued statements about current and future standards: IASB publishes its Standards in a series of pronouncements called International Financial Reporting Standards (IFRS). However, IASB has not rejected the standards issued by the IASC. Those pronouncements continue to be designated as “International Accounting Standards” (IAS). The IASB approved IASB Resolution on IASC Standards at their meeting in April, 2001, in which it confirmed the status of all IASC Standards and SIC Interpretations in would come into effect on 1st April, 2001.

The term IFRS comprises IFRS issued by IASB, IAS issued by International Accounting Standards Committee (IASC), and Interpretations issued by the Standard Interpretations Committee (SIC) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB. Every major nation is moving towards adopting IFRS to some extent. Large number of authorities requires public companies to use IFRS for stock- exchange listing purposes, and in addition, banks, insurance companies and stock exchanges may use them for their statutorily required reports. The increased use of IFRS is not limited to public-company listing requirements or statutory reporting. Many lenders and regulatory and government bodies are looking to IFRS to fulfil local financial reporting obligations related to financing or licensing.



Following are some of the advantages of IFRS:

- It would facilitate increased comparability of financial information among companies operating in different countries.
- The financial reporting process would become more transparent.
- The standardization of accounting methodology provides creditors and investors with the ability to analyze businesses around the world using the same financial methods.
- It would also permit international capital to flow more freely.
- It would give investors a better understanding of the financial statements and assess the investment opportunities in other countries.
- It would also benefit the accounting professionals as they will be able to sell their services in the different parts of the world.

All these benefits of IFRS have prompted many countries to pursue convergence of national Accounting Standards with IFRS. India has also decided to facilitate the convergence of the Indian Accounting Standards with IFRS and in this direction all existing Accounting Standards are being revised and converged with corresponding IAS/IFRS. Convergence of entire world towards IFRS would benefit the corporate sector, investors, regulators and facilitate economic growth as a whole.

CONVERGENCE OF ACCOUNTING STANDARD WITH IFRS IN INDIA

WHY IFRS?

The IFRSs are important because of their following features:

- a. Single set of Accounting Standards would enable internationally to standardize and assure better quality on a global scale.
- b. It would also permit international capital to flow more freely, enabling companies to develop consistent global practices on accounting problems.
- c. It would be beneficial to the regulators too, as the complexity associated with needing to understand various reporting regimes would be reduced.
- d. For investors, it gives a better understanding of the financial statements and assess the investment opportunities other than their Home Country.
- e. It also benefits the accounting professionals in a way that they will be able to sell their services in the different parts of world.

LIST OF IFRS

- IFRS 1-First time Adoption of International Financial Reporting Standards
- IFRS 2-Share Based Payments
- IFRS 3-Business Combinations
- IFRS 4-Insurance Contracts
- IFRS 5-Non-current Assets Held for Sale and Discontinued operations
- IFRS 6-Exploration for and Evaluation of Mineral Resources
- IFRS 7-Financial Instruments: Disclosures
- IFRS 8-Operating Segments
- IFRS 9-Financial Instruments
- IFRS 10-Consolidated Financial Statements
- IFRS 11-Joint Arrangements

- IFRS 12-Disclosure of Interests in other Entities
- IFRS 13-Fair Value Measurement
- IFRS 14-Regulatory Deferral Accounts
- IFRS 15-Revenue from Contracts with Customers
- IFRS 16-Leases
- IAS-1-Presentation of Financial Statements
- IAS-2- Inventories
- IAS-7- Statement of Cash Flows
- IAS-8- Accounting Policies, Change in Accounting estimates and Errors
- IAS-10- Events after balance sheet date
- IAS-12- Income Taxes
- IAS-16-Property, Plant and Equipment's
- IAS-19- Employee Benefits
- IAs-20-Accounting for Govt. Grant and Disclosure of Govt. Assistance
- IAS-21- The Effect of Changes in Forex Rates
- IAS-23-BorrowingCosts
- IAS-24- Related Party Disclosures
- IAS-26- Accounting and reporting by retirement benefit plans
- IAS-27- Separate Financial Statements
- IAS-28- Investment in Associates and Joint Ventures
- IAS-29- Financial Reporting in Hyper inflationary Conditions
- IAS-32- Financial Instruments- Presentation
- IAS-33- Earnings Per Share
- IAS-34- Interim Financial Reporting
- IAS-36- Impairment of Assets
- IAS-37- Provisions, Contingent Liabilities and Contingent Assets
- IAS-38- Intangible Assets
- IAS-40-Investment Property
- IAS-41-Agriculture

APPLICABILITY OF INDIAN ACCOUNTING STANDARDS [IND AS]

The Ministry of Corporate Affairs (MCA), in 2015, had notified the Companies (Indian Accounting Standards (IND AS) Rules 2015, which stipulated the adoption and applicability of Ind AS in a phased manner beginning from the Accounting period 2016-17. The MCA has issued Amendment Rules in the year 2016, 2017, 2018 and 2019 to amend the 2015 rules.

- (a) For companies other than Banking companies, Non-banking Financial Companies (NBFCs) and Insurance companies:
 - (i) *For the Accounting period beginning on or after 1st April, 2016:* The following companies were Adoption, Convergence and Interpretation of IFRS and Accounting Standards in India required to prepare their financial statements by adopting Indian Accounting Standards (Ind ASs):
 - (a) Companies whose equity or debt securities are listed or are in the process of listing on any stock exchange either in India or out of India and having the net worth of Rs. 500 crore or more;
 - (b) Unlisted companies having the net worth of Rs. 500 crore or more; and

- (c) Holding companies, subsidiary companies, joint venture or associate companies of the companies mentioned at (a) or (b) above.

Comparatives for the above periods shall be for the period ending on 31st March, 2016 or thereafter.

- (ii) *For the Accounting period ending on or after 1st April, 2017* : The following companies wererequired to prepare their financial statements by adopting Indian Accounting Standards (Ind ASs):

- (a) Listed companies having net worth of less than Rs. 500 crores;
- (b) Unlisted companies having net worth of Rs. 250 crore or more but less than Rs. 500 crores;and
- (c) Holding, subsidiary, joint venture and associate companies of the companies mentioned ator (b) above.

Comparatives for the above periods shall be for the period ending on 31st March, 2017 or thereafter.

Once a company starts applying Indian Accounting Standards (Ind ASs) for the preparation of the financial statements based on the mandatory criteria specified above, it will have to prepare the financial statementsin compliance with the Indian Accounting Standards (Ind ASs) for all the subsequent years even if the criterionlater on does not apply to it. A company may voluntarily apply the Indian Accounting Standards (Ind ASs) for the preparation of the financial statements for the accounting period starting on or after 1st April, 2015. However,such a company cannot subsequently revert back to the preparation of financial statements by adopting the Accounting Standards specified under the Companies (Accounting Standards) Rules, 2006.

It may be noted that the net worth of the company will be considered based on the audited financial statementsof the company concerned as at 31st March, 2014 or based on the first audited financial statements of the company concerned as at any date after 31st March, 2014.

Once the Indian Accounting standards (Ind ASs) are required to be applied in the preparation of the financial statements by a company, the same will apply to both the stand-alone financial statements and consolidated financial statements.

Companies whose securities are listed or are in the process of being listed on SME Exchanges will continue toapply the existing Accounting Standards specified under the Companies (Accounting Standards) Rules, 2006.

Companies which are not required to mandatorily follow Indian Accounting Standards (Ind ASs) are required tofollow the existing Accounting Standards specified under the Companies (Accounting Standards) Rules, 2006unless they voluntarily choose to apply Indian Accounting Standards (Ind ASs).

For Non-banking Financial Companies (NBFCs):

- (i) For the Accounting period beginning on or after 1st April, 2018: The following NBFCs will be required toadopt Ind ASs:
 - (a) NBFCs having net worth of Rs. 500 crore or more; and
 - (b) Holding, subsidiary, joint venture and associate companies of the above companies.

The comparatives will be for the period ending on 31st March, 2018 or thereafter.

- (ii) For the Accounting period beginning on or after 1st April, 2019: The following NBFCs will be required tofollow Ind ASs:
 - (a) Listed NBFCs having net worth of less than Rs. 500 crores;
 - (b) Unlisted NBFCs with net worth of Rs.250 crore or more but with net worth of less than Rs. 500crores; and
 - (c) Holding, subsidiary, joint venture and associate companies of the above companies.

The comparatives will be for the period ending on 31st march, 2019 or thereafter.

Note: The net worth for the above purpose will be computed as per the audited financial statements for the yearended 31st March, 2016 or the first audited financial statements thereafter.

For the Scheduled commercial banks (excluding regional rural banks) and insurance companies

The following will be required to apply Indian Accounting Standards (Ind ASs) for preparing their financial statements for the period ending beginning on or after 1st April, 2018:

- (a) Scheduled Commercial banks (excluding regional rural banks);
- (b) All India term lending refinancing institutions (i.e. Exim Bank, NHB, NABARD, SIDBI);
- (c) Insurers/insurance companies; and
- (d) Holding, subsidiary, joint venture and associate companies of the above companies.

The comparatives will be given for the period ending on 31st March, 2018 or thereafter.

OVERVIEW OF IND AS

Ind AS	Deals with	Details
Ind AS 101	First-time Adoption of Indian Accounting Standards	The objective of this Indian Accounting Standard (Ind AS) is to ensure that an entity’s first Ind-AS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that: a) is transparent for users and comparable over all periods presented; b) provides a suitable starting point for accounting in accordance with Ind ASs; and c) can be generated at a cost that does not exceed the benefits. An entity shall apply this Ind-AS in: a) its first Ind-AS financial statements, and b) each interim financial report, if any, that it presents in accordance with Ind AS 34 Interim Financial Reporting for part of the period covered by its first Ind-AS financial statements. An entity’s first Ind AS financial statements are the first annual financial statements in which the entity adopts Ind ASs according to the Ind ASs notified under the Companies Act, 2013 and makes an explicit and unreserved statement in those financial statements of compliance with Ind ASs.

Ind S 102	Share-based Payment	The objective of this Standard is to specify the financial reporting by an entity when it undertakes a share- based payment transaction. In particular,it requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associatedwith transactions in which share options are granted to employees. An entity shall apply this Standard in accounting for all share-based paymenttransactions, whether or not the entity can identify specifically some or all ofthe goods or services received, including: • equity-settled share-based payment transactions, • cash-settled share-based payment transactions, and • Transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuingequity instruments. A share based payment arrangement is an agreement between the entity (or another group entity or any shareholder of any group entity) and anotherparty (including an employee) that entitles the other party to receive: a) cash or other assets of the entity for amounts that are based onthe price(or value) of equity instruments (including share or share options) of the entity or another group entity, or b) equity instruments(including shares or share options) of the entity oranother group entity. Provided that specified vesting conditions, if any, are met. A share-based payment transaction is a transaction in which the entity: a) receives goods or services from the supplier of those goods or services(including an employee) in a share based payment arrangement, or b) Incurs an obligation to settle the transaction with the supplier in a sharebased payment arrangement when another group entity receives those goods or services.
Ind AS 103	Business Combinations	The objective of this Indian Accounting Standard is to improve the relevance, reliability and comparability of the information that a reporting entity providesin its financial statements about a business combination and its effects. To accomplish that, this Indian Accounting Standard establishes principles andrequirements for how the acquirer: (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire; (b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and

		(c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This Indian Accounting Standard applies to a transaction or other event that meets the definition of a business combination. This Indian Accounting Standard does not apply to: (a) the formation of a joint venture. (b) the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognize the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in Ind AS 38 Intangible Assets) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill. (c) Appendix C deals with accounting for combination of entities or businesses under common control. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as ‘true mergers’ or ‘mergers of equals’ are also referred to as business combinations as that term is used in this Ind AS.
Ind AS 104	Insurance Contracts	The objective of this Indian Accounting Standard is to specify the financial reporting for insurance contracts by any entity that issues such contracts (described in this Indian Accounting Standard as an insurer). In particular, this Indian Accounting Standard requires: a) Limited improvements to accounting by insurers for insurance contracts. b) Disclosure that identifies and explains the amounts in an insurer’s financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts. An entity shall apply this Indian Accounting Standard to: a) Insurance contracts (including reinsurance contracts) that it issues, and reinsurance contracts that it holds. b) Financial instruments that it issues with a discretionary participation feature. Ind AS 107 Financial Instruments: Disclosures requires disclosure about financial instruments, including financial instruments that contain such features. An insurance contract is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified future event (the insured event) adversely affects the policyholder.

Ind AS 105	Non-Current Assets Held for Sale and Discontinued Operations	The objective of this Indian Accounting Standard is to specify the accounting for assets held for sale, and the presentation and disclosure of discontinued operations. In particular, the Indian Accounting Standard requires: (a) assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease; and (b) assets that meet the criteria to be classified as held for sale to be presented separately in the balance sheet and the results of discontinued operations to be presented separately in the statement of profit and loss. A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale and: (a) represents a separate major line of business or geographical area of operations, or (b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or (c) is a subsidiary acquired exclusively with a view to sale.
Ind AS 106	Exploration for and Evaluation of Mineral Resources	The objective of this Indian Accounting Standard is to specify the financial reporting for the exploration for and evaluation of mineral resources. In particular, the Indian Accounting Standard requires: (a) limited improvements to existing accounting practices for exploration and evaluation expenditures. (b) entities that recognize exploration and evaluation assets to assess such assets for impairment in accordance with this Indian Accounting Standard and measure any impairment in accordance with Ind AS 36 Impairment of Assets. (c) disclosures that identify and explain the amounts in the entity's financial statements arising from the exploration for and evaluation of mineral resources and help users of those financial statements understand the amount, timing and certainty of future cash flows from any exploration and evaluation assets recognized. Exploration for and evaluation of mineral resources is the search for mineral resources, including minerals, oil, natural gas and similar non-regenerative resources after the entity has obtained legal rights to explore in a specific area as well as the determination of the technical feasibility and commercial viability of extracting the mineral resources.
Ind AS 107	Financial Instruments: Disclosures	The objective of this Indian Accounting Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate: (a) the significance of financial instruments for the entity's financial position and performance; and
		(b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks. The principles in this Indian Accounting Standard complement the

		principlesfor recognizing, measuring and presenting financial assets and financial liabilities in Ind AS 39 Financial Instruments: Recognition and Measurementand Ind AS 32 Financial Instruments: Presentation.
Ind AS 108	Operating Segments	An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. This Accounting Standard shall apply to companies to which Indian Accounting Standards (Ind AS) notified under the Companies Act apply. If an entity that is not required to apply this Indian Accounting Standard chooses to disclose information about segments that does not comply with this Indian Accounting Standard, it shall not describe the information as segment information. If a financial report contains both the consolidated financial statements of a parent that is within the scope of this Indian Accounting Standard as well as the parent’s separate financial statements, segment information is required only in the consolidated financial statements. An operating segment is a component of an entity: (a) that engages in business activities for which it may earn revenues and incur expenses(including revenues and expenses relating to transactions with other components of the same entity), (b) whose operating results are regularly reviewed by the chief operatingdecision-maker to make decisions about resources to be allocated to the segment and assess its performance, and (c) for which discrete financial information is available.
Ind AS 109	Financial Instruments	The objective of this Standard is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity’s future cashflows.
Ind AS 110	Consolidated Financial Statements	The objective of this Indian Accounting Standard (Ind AS) is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. Consolidated financial statements are the financial statements of a groupin which the assets, liabilities, equity, expenses, income and cash flows of the parents and its subsidiaries are presented as those of a single economicentity.
Ind AS 111	Joint Arrangements	The objective of this Indian Accounting Standard (Ind AS) is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (i.e. joint arrangements). To meet the objective, this Ind AS defines joint control and requires anentity that is a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations and to account for those rights and obligations in accordance with that type of joint arrangement.

		This Ind AS shall be applied by all entities that are a party to a joint arrangement. A joint arrangement is an arrangement of which two or more parties have joint control. A joint arrangement has the following characteristics: (a) The parties are bound by a contractual arrangement. (b) The contractual arrangement gives two or more of those parties joint control of the arrangement. A joint arrangement is either a joint operation or a joint venture.
Ind AS 112	Disclosure of Interests in Other Entities	The objective of this Indian Accounting Standard (Ind AS) is to require an entity to disclose information that enables users of its financial statements to evaluate: (a) the nature of, and risks associated with, its interests in other entities; and (b) the effects of those interests on its financial position, financial performance and cash flows. Interest in another entity refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as provision of funding, liquidity support, credit enhancement and guarantees. It includes other means by which the entity has control or joint control of, or significant influence over another entity. An entity does not necessarily have an interest in another entity solely because of a typical customer supplier relationship.
Ind AS 113	Fair Value Measurement	This Ind AS: (a) defines fair value; (b) sets out in a single Ind AS a framework for measuring fair value; and (c) requires disclosures about fair value measurements.
		Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same - to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between the market participants at the measurement date.

Ind AS 114	Regulatory Deferral Accounts	The objective of this Standard is to specify the financial reporting requirements for regulatory deferral account balances that arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation. An entity is permitted to apply the requirements of this Standard in its first Ind AS financial statements if and only if it: (a) conducts rate-regulated activities; and (b) recognized amounts that qualify as regulatory deferral account balances in its financial statements in accordance with its previous GAAP. A regulatory deferral account balance is a regulatory asset or a regulatory liability as defined in the Guidance Note on Accounting for Rate regulated activities. Rate regulated activities are the entity's activities that are subject to rate regulation.
Ind AS 115	Revenue from Contracts with Customers	The objective of this Standard is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. A contract is an agreement between two or more parties that creates enforceable rights and obligations. Revenue is the income arising in the course of an entity's ordinary activities. Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than the contributions from equity participants.
Ind AS 116	Leases	The objective of this Ind AS is to set out the principles for recognition, measurement, presentation or disclosure of leases so that the lessees and lessors provide the relevant information in a manner that faithfully represent those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity.
		To apply this standard, an entity shall consider the terms and conditions of contracts and all relevant facts and circumstances. An entity shall apply this Standard consistently to contracts with similar characteristics and in similar circumstances. A lease is a contract, or part of a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.
Ind AS 1	Presentation of Financial Statements	This Standard prescribes the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their contents. An entity shall apply this Standard in preparing and presenting general purpose financial Statements in accordance with Ind AS. General purpose financial statements are those financial statements that are intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

Ind AS 2	Inventories	The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognized as an asset and carried forward until the related revenues are recognized. This Standard deals with the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also deals with the cost formulas that are used to assign costs to inventories. Inventories are assets: (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.
Ind AS 7	Statement of Cash Flows	Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilize those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation. The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows which classifies cash flows during the period from operating, investing and financing activities.
		An entity shall prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented. A statement showing cash flows is called a Statement of Cash Flows. Cash flows are the inflows and outflows of cash and cash equivalents. Cash comprises cash on hand and demand deposits. Cash equivalents are short term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.
Ind AS 8	Accounting Policies, Changes in Accounting Estimates and Errors	The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. The Standard is intended to enhance the relevance and reliability of an entity's financial statements and the comparability of those financial statements over time and with the financial statements of other entities. Disclosure requirements for accounting policies, except those for changes in accounting policies, are set out in Ind AS 1 Presentation of Financial Statements. This Standard shall be applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors. Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements. A change in an accounting estimate is the adjustment in the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset that results from the

		assessment of the present status of, and expected future benefits and obligations with the asset or liability. Changes in accounting estimates result from new estimates or new developments, and accordingly are not correction of errors.
Ind AS 10	Events after the Reporting Period	The objective of this Standard is to prescribe: (a) When an entity should adjust its financial statements for events after the reporting period; and (b) the disclosures that an entity should give about the date when the financial statements were approved for issue and about events after the reporting period. The Standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting period indicate that the going concern assumption is not appropriate. This Standard shall be applied in the accounting for, and disclosure of, events after the reporting period. Events after the reporting period are those events, favorable and unfavorable, that occurs between the end of the reporting period and that date when the financial statements are approved by the Board of directors in the case of a company and by the corresponding approving authority in the case of any other entity for issue.
Ind AS 12	Income Taxes	The objective of this Standard is to prescribe the accounting treatment for income tax. The principal issue in accounting for income tax is how to account for the current and future tax consequences of: (a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognized in an entity's balance sheet; and (b) transactions and other events of the current period that are recognized in an entity's financial statements. It is inherent in the recognition of an asset or liability that the reporting entity expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences. This Standard requires an entity to recognize a deferred tax liability (deferred tax asset), with certain limited exceptions.
Ind AS 16	Property, Plant and Equipment	The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts, and the depreciation charges and impairment losses to be recognized in relation to them. This Standard shall be applied in accounting for property, plant and equipment except when another Standard requires or permits a different accounting treatment. Property, plant and equipment are tangible items that: (a) are held for use in the production or supply of goods or services, for rental to others or for administrative purposes; and (b) are expected to be used during more than one period.

Ind AS 19	Employee Benefits	The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The Standard requires an entity to recognize: (a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and (b) an expense when the entity consumes the economic benefit arising from the service provided by an employee in exchange for employee benefits. Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment.
Ind AS 20	Accounting for Government Grants and Disclosure of Government Assistance	This Standard shall be applied in accounting for, and in the disclosure of, government grants and in the disclosure of other forms of government assistance. This Standard does not deal with: (a) the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature. (b) Government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or tax loss, or are determined or limited on the basis of income tax liability. Examples of such benefits are income tax holidays, investment tax credits, accelerated depreciation. (c) Government participation in the ownership of the entity. (d) Government grants covered by Ind AS-41, Agriculture. (e) Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance does not include benefits provided only indirectly through actions affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on the competitors. Government grants are assistance by government in the form of transfer of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. Government grants exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with the government which cannot be distinguished from the trading transactions of the entity.
Ind AS 21	The Effects of Changes in Foreign Exchange Rates	An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency. The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

Ind AS 23	Borrowing Costs	Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense. An entity shall apply this Standard in accounting for borrowing costs. The Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.
		An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of: (a) a qualifying asset measured at a fair value, for example, a biological asset; or (b) Inventories that are manufactured or otherwise produced, in large quantities on a repetitive basis.
Ind AS 24	Related Party Disclosures	The objective of this Standard is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties. This Standard shall be applied in: (a) identifying related party relationships and transactions; (b) identifying outstanding balances, including commitments, between an entity and its related parties; (c) identifying the circumstances in which disclosure of the items in (a) and (b) is required; and (d) determining the disclosures to be made about those items. A related party is a person or entity that is related to the entity preparing its financial statements. A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party regardless of whether the price is charged.
Ind AS 27	Separate Financial Statements	The objective of this Standard is to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. This Standard shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity elects, or is required by law, to present separate financial statements. This Standard does not mandate which entities produce separate financial statements. It applies when an entity prepares separate financial statements that comply with Indian Accounting Standards. Separate financial statements are those presented by a parent (i.e. an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or as per Ind AS 9 "Financial Instruments".

Ind AS 28	Investments in Associates and Joint Ventures	The objective of this Standard is to prescribe the accounting for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. This Standard shall be applied by all entities that are investors with joint control of, or significant influence over, an investee. An associate is an entity over which the investor has significant influence. A joint venture is a joint arrangement whereby the parties that have the joint control of the arrangement has rights to the net assets of the arrangement.
Ind AS 29	Financial Reporting in Hyperinflationary Economies	This Standard shall be applied to the financial statements, including the consolidated financial statements, of any entity whose functional currency is the currency of a hyperinflationary economy. In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.
Ind AS 32	Financial Instruments: Presentation	The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset. The principles in this Standard complement the principles for recognizing and measuring financial assets and financial liabilities in Ind AS 39 Financial Instruments: Recognition and Measurement, and for disclosing information about them in Ind AS 107 Financial Instruments: Disclosures. A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or an equity instrument of another entity.
Ind AS 33	Earnings per Share	The objective of this Standard is to prescribe principles for the determination and presentation of earnings per share, so as to improve performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity. Even though earnings per share data have limitations because of the different accounting policies that may be used for determining 'earnings', a consistently determined denominator enhances financial reporting. The focus of this Standard is on the denominator of the earnings per share calculation. An entity shall calculate basic earnings per share amounts for profit or loss attributable to the ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders. Basic earnings per share shall be calculated by dividing profit or loss attributable to the ordinary equity holders of the parent entity by the weighted average number of ordinary shares outstanding during the period.

		An entity shall calculate diluted earnings per share amounts for profit or loss attributable to the ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders. For the purpose of calculating diluted earnings per share, an entity shall adjust profit or loss attributable to the ordinary equity holders of the parent entity and weighted average number of ordinary shares outstanding during the period, from the effects of all dilutive potential ordinary shares.
Ind AS 34	Interim Financial Reporting	The objective of this Standard is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an entity's capacity to generate earnings and cash flow and its financial condition and liquidity. Interim financial report is a financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period. An interim period is a financial reporting period shorter than a full financial year.
Ind AS 36	Impairment of Assets	The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the entity to recognize an impairment loss. The Standard also specifies when an entity should reverse an impairment loss and prescribes disclosures. An impairment loss is the amount by which the carrying amount of an asset or a cash generating unit exceeds its recoverable amount. Carrying amount is the amount at which an asset is recognized after deducting any accumulated depreciation (amortization) and any accumulated impairment losses thereon. A cash generating unit is the smallest identifiable group of assets that generates cash flows that are largely independent of the cash inflows from other assets or group of assets.
Ind AS 37	Provisions, Contingent Liabilities and Contingent Assets	The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to enable users to understand their nature, timing and amount. A provision is a liability of uncertain timing or amount. A contingent liability is: a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the entity; or b) a present obligation that arises from past events but is not recognized because: i. it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

		ii. the amount of obligation cannot be measured with sufficient reliability. A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the entity.
Ind AS 38	Intangible Assets	The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognize an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets. An intangible asset is an identifiable non-monetary asset without physical substance. Monetary assets are money held and assets to be received in fixed or determinable amount of money. An intangible asset to be identifiable should be distinguishable from goodwill. An asset is identifiable if it either: a) is separable, i.e., is capable of being separated or dividend from the entity and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or b) arises from contractual or other legal rights, regardless of whether those rights are transferrable or separable from the entity or from other rights and obligations.
Ind AS 40	Investment Property	The objective of this Standard is to prescribe the accounting treatment for investment property and related disclosure requirements. This Standard shall be applied in the recognition, measurement and disclosure of investment property. Among other things, this Standard applies to the measurement in a lessee's financial statements of investment property interests held under a lease accounted for as a finance lease and to the measurement in a lessor's financial statements of investment property provided to a lessee under an operating lease. This Standard does not deal with matters covered in Ind AS 17 Leases, including: a) classification of leases as finance leases or operating leases; b) recognition of lease income from investment property (see also Ind AS 18 Revenue); c) measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease; d) Measurement in a lessor's financial statements of its net investment; e) accounting for sale and lease back transactions; - and f) disclosure about finance leases and operating leases.

		Investment property is a property (i.e. land or a building or part of a building or both) held (by the owner or a lessee as a right of use asset) to earn rentals, or for capital appreciation, or both rather than for: a) use in the production or supply of goods or services or for administrative purposes; or b) sale in the ordinary course of business.
Ind AS 41	Agriculture	The objective of this Standard is to prescribe the accounting treatment and disclosures related to agricultural activity. This Standard shall be applied to account for the following when they relate to agricultural activity: a) biological assets; b) agricultural produce at the point of harvest; and c) Government grants covered by paragraphs 34 and 35. Agricultural activity is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets. Agricultural produce is the harvested produce of the entity's biological asset. A biological asset is a living animal or plant. Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.

IFRS VS IGAAP

Indian GAAP is a set of accounting standards that are specifically designed for the Indian context. GAAP stands for Generally Accepted Accounting Principles. Most Indian companies follow Indian GAAP while preparing their accounting records. When a company follows IFRS, it needs to provide a disclosure in the form of a note that it is complying with the IFRS. But for Indian GAAP, the disclosure of the statement isn't mandatory. When a company is said to follow the Indian GAAP, it's assumed that they're complying with the Indian GAAP to portray the true and fair view of their financial affairs.

<i>Basis</i>	<i>IFRS</i>	<i>IGAAP</i>
First time adoption	Full retrospective application of IFRS to P&L Account and Balance Sheet. Reconciliation of P&L Account and Balance Sheet with respect of last year's reported numbers under previous GAAP.	No needs to prepare reconciliation on first time adoption.
Components of Financial Statements	Comprises of Balance Sheet, Profit and Loss A/c. Cash Flow Statement, changes in equity and accounting policy and notes to Accounts.	Comprises of Balance Sheet, Profit and Loss A/c. Cash Flow Statement (if applicable), and Notes to Accounts.
Balance Sheet	No particular format, a current/non current presentation of assets and liabilities is used.	As per Format Prescribed in Schedule III for Companies, adherence to Banking Regulation for Banks, etc.
Income Statement	No particular format prescribed (IAS-1).	As per Format Prescribed in Schedule III (AS-1).

Cash Flow Statements	Mandatory for all entities (IAS-7).	Level 3 entities are exempted (AS-3).
Dividends	Liability to be recognized in the period when dividend is declared. (IAS- 10).	Recognized as an appropriation against the profit, and recorded as liability at BS date even if declared subsequent to reporting period but before the approval of Financial statements (AS-4).
Cost of major repairs and overhaul expenditure on fixed assets	Recognized in carrying amount of the assets (IAS-16).	Expensed off. Only expenses which increase the FEB are to be capitalized. (AS-10).
Re-evaluation	Re-evaluation (if done) to be updated periodically so that carrying amount does not differ from fair value at the end period. Re-evaluation to be done for entire class of assets (IAS-16).	No specific requirement for re-evaluation. Re-evaluation can be done on systematic basis like for one location leaving aside the assets of other location. (AS-10).
Change in the method of depreciation	Considered as a change in accounting estimate. To Be applied prospectively. (IAS-16 and IAS 8).	Considered as change in accounting policy, retrospective computation and excess or deficit is adjusted in same period. Required to be disclosed (AS- 6).
Earnings Per Share	Disclosure to be made in only consolidated financials of the parent Co. (IAS-33).	Disclosure of EPS in both consolidated and separate financials (AS-20) .
Component Accounting	Required each major part of No such requirement (AS-10). PPE with a cost that is significant in relation to total cost, should be depreciated separately (IAS-16).	No such requirement (AS-10).
Intangible Assets	Intangible assets can have indefinite useful life and hence such assets are tested for impairment and not amortized.	There is no concept of indefinite useful life. Assets have definite life (usually 10 years).
Reporting Currency	Requires the measurement of profit using the functional currency. Entities may, however, present financial statements in a different currency (IAS- 21).	Schedule III to the Companies Act, 2013 specifies Indian Rupees as the reporting currency (AS-11).

Key Management Personnel (KMP)	Includes Executive as well as non executive directors (IAS-24).	Excludes non-executive directors (AS-18).
Compensation to KMP	Disclosure to be made for total compensation such as short term employee benefits and post employment benefits.	AS-18 does not require the break-up of compensation cost.

Fringe Benefits Tax	Included as part of related expense (fringe benefit) which gives rise to incurrence of the tax.	Disclosed as a separate item after profit before tax on the face of the income statement.
Uniform Accounting Policies	Prepared using uniform accounting policies across all entities in a group. (IAS-27)	Policies may differ due to impracticability. (AS-21)
Disclosure of extraordinary items	Prohibits such disclosure (IAS-1). No such term in IFRS.	Disclosure to be made in notes (AS-5).

COMPARISON OF INDIAN GAAP AND IND AS

The significant difference between the Indian GAAP (current Indian Accounting Standards) converged Indian Accounting Standards (Ind AS) are discussed in detail in the following pages.

Comparison of Ind AS 1 with Existing Indian GAAP 1

Sr. No.	Basis of Comparison	Ind AS 1 <i>Presentation of Financial Statements</i>	AS 1 <i>Disclosure of Accounting Policies</i>
1.	Presentation of Extraordinary Item	Prohibits presentation of any item as extraordinary item in the statement of profit and loss or in the notes	Allows for extraordinary items to be disclosed separately.
2.	Disclosure of Critical Assumption	Requires disclosure of critical assumptions about the future and other sources of measurement uncertainty that can affect carrying amounts of assets and liabilities within next financial year.	Does not require any such disclosure.
3.	Classification of Expenses	Requires classification of expenses be presented on the basis of nature of expenses.	Does not require any such classification.
4.	Reclassification	Reclassification of items, nature, amount and reason for reclassification are disclosed in notes to financial statement.	No such nature, amount and reason for reclassification are required to be disclosed.
5.	Statement of changes in equity	Requires a statement of changes in equity including reconciliation between opening and closing balance for each component of equity.	Statement of changes in equity is not required.

Comparison of Ind AS 2 with Existing Indian GAAP 2

Sr. No.	Basis of Comparison	Ind AS 2 <i>Inventories</i>	AS 2 <i>Inventories</i>
1.	Reversal of Written down value to Net Realizable value	Provides for reversal of the write-down of inventories to net realizable value limited to the amount of original write-down, and requires recognition and disclosure thereof in the financial	Does not provide any specific guidance on the same.

		statements.	
2.	Exclusion	Excludes from its scope inventories held by commodity broker traders (who measure their inventories at a fair value minus costs to sell), producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products.	Excludes from its scope only the measurement of such inventories. Further Ind AS 2 defines fair value and provides an explanation in respect of distinction between net realizable value and fair value.
3.	Explanation	Provides explanation \ regard to inventories of service provide	Does not contain such an explanation
4.	Formula	Requires only the use of consistent cost formulas for all inventories having a similar nature and use to the entity	Specifically requires that the formula used in determining the cost of an item of inventory should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.

Comparison of Ind AS 7 with Existing Indian GAAP 3

S. No.	Bases of Comparison	Ind AS 7 “Statement of Cash Flows”	AS 3 “Cash Flow Statements”
1.	Bank overdraft repayable on demand	Specifically provides that the bank borrowings are generally classified as financing activities. However, bank overdraft repayable on demand is treated as part of cash and cash equivalents.	As 3 is silent on this aspect.
2.	Treatment of cash payments in specific cases	Provides for the treatment of cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale in the ordinary course of business as cash flows from operating activities. Further, treatment of cash receipts from rent and subsequent sale of such assets as cash flow from operating activities is also provided.	AS 3 does not contain such requirements.

3.	New examples of cashflows arising from financing activities	Ind AS 7 includes the following new examples of cash flows arising from financing activities: (a) Cash payments to owners to acquire or redeem the entity's shares; (b) cash proceeds from mortgages; (c) Cash payments by the lessee for the reduction of the outstanding liability relating to a finance lease.	AS 3 does not contain such examples.
4.	Adjustments of the profit or loss for the effects of undistributed profits of the associates and non- controlling interests	Ind AS 7 specifically requires the adjustment of the profit or loss for the effects of 'undistributed profits of associates and non-controlling interests' while determining the net cash flows from operating activities using the indirect method.	AS 3 does not contain such requirements.
5.	Cash flows associated with extraordinary activities	Ind AS 7 does not contain this requirement.	AS 3 requires cash flows associated with extraordinary activities to be separately classified as arising from, operating, investing and financing activities.
6.	Classification as investing activities	Ind AS 3 requires that only the expenditures results in a recognized asset in the balance sheet are eligible for classification as investing activities.	AS 3 does not contain such requirements.
7.	Disclosure of the amount of cash and cash equivalents in specific situations	Ind AS 7 requires an entity (except an investment entity) to disclose the amounts of cash and cash equivalents and other assets and liabilities in the subsidiaries or other businesses over which control is obtained or lost. It also requires to report the aggregate amount of cash paid or received as consideration for obtaining or losing control of such subsidiaries or other businesses in the Statement of Cash Flows, net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.	AS 3 does not contain such requirements.
8.	Cash flows arising from changes in ownership interest in subsidiaries	Ind AS 7 requires classifying cash flows arising from changes in ownership interest in subsidiaries that do not result in a loss of control as	AS 3 does not contain such requirements.

		cash flows from financing activities.	
9.	Investments in subsidiaries associatesand joint ventures (investees)	Ind AS 7 mentions the use of equity or cost method while accounting for an investment in an associate, joint venture or a subsidiary. It also specifically deals withthe reporting of interest in an associate or a joint venture using equity method.	AS 3 does not contain suchrequirements.
10.	Use of different terminology and translation of cash flows of a foreign subsidiary	Ind AS uses the term ‘functional currency’instead of ‘reporting currency’ (as in AS 3). It also deals with the translation of cash flows of a foreign subsidiary.	AS 3 uses the term ‘reporting currency’. AS 3 does not deal with the translation of cash flows of a foreign subsidiary.
11.	Disclosures	Ind AS 7 requires more disclosures ascompared to AS 3.	As 3 requires less disclosuresas compared to Ind AS 7.

Comparison of Ind AS 8 with existing Indian GAAP 5

S. No.	Bases of Comparison	Ind AS 8 “Accounting Policies Changes in Accounting Estimates and Errors”	AS 5 “Net Profit or loss for theperiod, prior period and Changes in Accounting Policies”
1.	Rectification of Prior period errors	Ind AS 8 requires rectification of prior period errors with retrospective effect subject to limited exceptions.	AS 5 requires the rectification of prior period items withprospective effect.
2.	Prior period items	Ind AS 8 defines the term error solarizing from a failure to use or misuse reliable information that was available when the financial statements of the prior periods were approved for issuance and could reasonably be expected to obtained and taken into account in the preparation and presentation of those financial statements..	Existing AS 5 defines prior period items as incomes or expenses which arise in the current periodas a result of errors or omissions in the preparation of financial statements of one or more prior periods.

Comparison of Ind AS 12 with existing Indian GAAP 22

S. No.	Bases of Comparison	Ind AS 12 “Income Taxes”	AS 22 “Accounting for Taxes on Income”
1.	Approach	Ind AS 12, in contracts, is based on balance sheet approach and recognizes tax consequences of differences between the carrying amounts of assets and liabilities and	Existing AS 22, based on income statement approach, recognizes tax consequences of differences between taxable income and accounting income.

		their tax base.	
2.	Recognizes	Ind AS 12 recognizes deferred tax assets for all deductible temporary difference to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized.	Existing AS 22 recognizes and carries forward deferred tax asset only to the extent where there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be utilized.
3.	Recognize of Deferred Tax Assets in case of unused tax losses and unabsorbed depreciation	Under Ind AS 12, deferred tax assets in case of unused tax losses and unabsorbed depreciation are recognized only to the extent that the entity has sufficient taxable temporary differences, or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilized by the entity.	Under existing AS 22, deferred tax assets in case of unused tax losses and unabsorbed depreciation is recognized to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realized.

Comparison of Ind AS 16 with existing Indian GAAP 10

S. No.	Bases of comparison	Ind AS 16 Property, Plant and Equipments	AS 10 Property, Plant and Equipments
1.	Property, plant and equipment retired from active use and held for sale	Ind AS 16 does not deal with the assets held for sale because the treatment of such assets is covered under Ind AS 105“Non-current assets held for sale and Discontinued operations”.	AS 10 deals with the accounting for items of fixed assets retired from active use and held for sale.
2.	Stripping costs in the production phase of a surface mine	Ind AS 16 provides guidance o measuring the stripping cost in n production phase of a surface th mine. e	AS 10 does not contain this guidance.

Comparison of Ind AS 116 with existing Indian GAAP 19

Bases of comparison	Ind AS 116 Leases	AS 19 Leases
Coverage	Ind AS 116 deals with specific provisions related to leases of land and building.	AS 19 does not deal with all types of leases.
Residual value	Ind AS 116 does not define residual value.	AS 19 defines residual value.
Inception of lease and commencement of lease	Ind AS 116 defines and distinguishes between inception of lease and commencement of lease.	AS 19 neither defines nor distinguishes between the two.
Recognition of finance lease	As per Ind AS 116, lessee should recognize finance lease as assets and liabilities at the commencement of lease.	As per AS 19, the lessee should recognize the finance lease at the inception of lease.

Upward revision of unguaranteed residual value	Ind AS 116 permits the upward revision of unguaranteed residual value during the lease term.	AS 19 prohibits such upward revision.
Initial direct costs	Ind AS 116 provides that the initial direct costs incurred by the lessor in case of an operating lease should be included in the carrying amount of the leased asset and amortized as an expense over the lease term.	AS 19 provides that such costs should be charged off by the lessor or amortized over the lease term.
Sale and leaseback transactions in case of finance lease	Ind AS 116 also requires that the excess of sale proceeds over the carrying amount of the asset should be deferred and amortized but it does not specify the method of amortization.	AS 19 provides that the excess of sale proceeds over the carrying amount of the asset should be deferred and amortized over the lease term in proportion to depreciation of the leased asset.
Single lease accounting model for lessee	Ind AS 116 now has a single lease accounting model for the lessee by eliminating the difference between operating lease and finance lease i.e. the lessee has to recognize the lease liability with a corresponding 'right of use' asset.	AS 19 prescribes for the lessee lease accounting depending on the type of lease i.e. operating lease and finance lease.

Comparison between Ind AS 115 with existing Indian GAAP AS 7 and AS 9

<i>Bases of comparison</i>	<i>Ind AS 115 Revenue from Contracts with Customer</i>	<i>AS 7 and AS 9 Construction Contracts and Revenue Recognition</i>
Framework of revenue recognition	Ind AS 115 gives a framework of revenue recognition within the standard. It specifies the core principle for revenue recognition which requires the revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.	AS 7 and AS 9 do not provide any such principle to fall upon in case of doubt.
Comprehensive guidance on recognition and measurement of multiple elements of contracts with a customer	Ind AS 115 provides comprehensive guidance on how to recognize and measure multiple elements of contracts with a customer.	AS 7 and AS 9 do not provide any such guidance on this aspect.

Coverage	Ind AS deals with all types of performance obligation contracts with customers. However, it does not deal with interest and dividend dealt with in the standard on financial instruments.	AS 7 deals only with the revenue from construction contracts which measures the revenue at the consideration received/receivable. AS 9 deals with only the revenue from sale of goods, rendering of services and income form royalty, dividend and interests.
Measurement ofRevenue	Ind AS 115 measures the revenue at the transactionprice i.e. the consideration to which the entityexpects to be entitled in exchange for the transfer of the promised goods or services, excluding the amounts collected on behalf of third parties.	AS 9 provides for the measurement of revenue at the amount of charges made to the customers or clients for the goods transferred or services supplied or the rewards arising from the use of resources by others. AS 7 measures the revenue at the consideration received or receivable.
Recognition ofrevenue	Ind AS 115 provides that the revenue is recognizedwhen the control is transferred to the customer.	AS 9 provides that revenue is recognized upon the transfer of significant risk as and rewards of ownership to the clients. AS 7 provides that the revenue is recognized when the outcomeof a construction contract can be reliably estimated.
Capitalization of costs	Ind AS 115 provides guidance on the recognitionof costs to obtain and fulfill a contract as an asset.	AS 7 and AS 9 do not deal withcapitalization of such costs.
Guidance on service concession arrangements	Ind AS 115 gives guidance on service concessionarrangements and disclosures thereof.	ASs do not provide suchguidance.
Disclosure requirements	Ind AS 115 contains more disclosure requirementsas compared to AS 7 and AS 9.	AS 7 and AS9 contain very less disclosure requirements as compared to Ind AS 115.

<i>Bases of comparison</i>	<i>Ind AS 19 Employee Benefits</i>	<i>AS 15 Employee Benefits</i>
Constructive Obligation	Ind AS 19 covers employee benefits arising fromconstructive obligations.	Existing AS 15 is silent on thesame.
Employee Includes	Ind AS 19 the term employee includes directors.	AS 15, the term employee includes whole time directors.

Scope Cover	Ind AS 19 in its scope covers situations of contractual agreement between a multi-employer plan and its participants that determines how the surplus in the plan will be distributed to the participants (or the deficit funded).	Existing AS 15 is silent on the same.
	Ind AS 19 defines the same as the total of (i) any cumulative unrecognized past service cost and (ii) the present value of economic benefits available in the form of refunds from the plan or reduction in future contributions to the plan.	Existing AS 15 defines the limit for asset ceiling as present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

Comparison of Ind AS 20 with existing Indian GAAP 12

<i>Bases of comparison</i>	<i>Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance</i>	<i>AS 12 Government Grants</i>
Government grants of the nature of promoters contribution	Ind AS 20 does not recognize government grants of such nature and accordingly recognizes as income over the periods.	Existing AS 12 requires government grants of the nature of promoter's contribution to be credited directly to capital reserve and treated as a part of shareholders funds.
Non-Monetary Grants	Ind AS 20 value non-monetary grants at their fair value.	AS 12 which records it at nominal value.
Presentation	Ind AS 20 requires such grants to be presented as deferred income only.	Under existing AS 12, grants related to assets (including non-monetary grants) can be presented as deferred income or by deducting the grant from the gross value of asset concerned in arriving at its book value.

Comparison of Ind AS 21 with existing Indian GAAP 11

<i>Bases of comparison</i>	<i>Ind AS 21 Effects Of Change In Forex Rates</i>	<i>AS 11 Effects Of Change In Foreign Exchange Rates</i>
Forward exchange contracts and other similar financial instruments	Ind AS 21 excludes forward exchange contracts and other similar financial instruments (as it gets treated in accordance with Ind AS 39 Financial Instruments: Recognition and Measurement).	Existing AS 11 covers in its scope, forward exchange contracts and other similar financial instruments.

Approach	Ind AS 21 is based on functional currency approach.	AS 11 is based on reportingcurrency approach.
Presentation currency	Ind AS 21 allows for presentation currency to bedifferent from local currency.	Existing AS 11 does not allow it.
Recognizing of exchange differences arising on translation of certain long-term monetary items fromforeign currency to functional currency	Ind AS 21 allows recognizing of exchange differences arising on translation of certain long-term monetary items from foreign currencyto functional currency directly in equity and transferring the same to profit or loss over the term of such items in an appropriate manner.	Existing AS 11 permits such an option for items not related to acquisition of fixed assets up to 31st March 2011, where such items are related to acquisition of fixed assets, the foreign exchange differences can be recognized as part of the cost of the asset.

Comparison of Ind AS 23 with existing Indian GAAP 16

<i>Bases of comparison</i>	<i>Ind AS 23 Borrowing Costs</i>	<i>AS 16 Borrowing Costs</i>
Borrowing cost exclusion	Ind AS 23 given an option to an entity to exclude from this standards, borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value. Further it also excludes application of this standard to borrowing costs directly attributable to the acquisition, construction or production of inventories that are manufactured, otherwise produced, in large quantities on a repetitive basis.	The same is not exists in AS 16

Comparison of Ind AS 24 with existing Indian GAAP 18

<i>Bases of comparison</i>	<i>Ind AS 24 Related Party Disclosure</i>	<i>AS 18 Related Party Disclosure</i>
Scope of Definition of Relatives and additional disclosure	Under Ind AS 24, the scope and definition of relatives (or close members of the family) government enterprises, key management personnel (KMP) and joint ventures have been expanded. Further, Ind AS 24 requiresadditionaldisclosures in case of government related enterprises and compensation of KMP under different categories.	-

Comparison of Ind AS 27 with existing Indian GAAP 21

<i>Bases of comparison</i>	<i>Ind AS 27 Consolidated and Separate Financial Statements</i>	<i>AS 21 Consolidated Financial Statement</i>
Mandatory	Under Ind AS 27 preparation of consolidated financial statements is mandatory for a parent company.	This does not mandate the same.
Guidance	Ind AS 27 contains guidance regarding accounting for investments in subsidiaries, jointly controlled entities and associates in preparing the separate financial statements.	Under existing AS 21 there is no guidance regarding accounting for investments in subsidiaries, jointly controlled entities and associates in preparing the separate financial statements.
Exemption	Ind AS 27 does not provide any such exemption from consolidation.	AS 21 provides for exclusion of subsidiary from consolidation under circumstances where control is intended to be temporary or when subsidiary operates under long term restrictions.
Effect of potential voting rights	Ind AS 27 takes into account existence and effect of potential voting rights that are currently exercisable or convertible while assessing the control of entity over the subsidiary.	AS 21 does not take into account potential equity shares of the investee held by investor for considering share ownership.

Comparison of Ind AS 28 with existing Indian GAAP 23

<i>Bases of comparison</i>	<i>Ind AS 28 Investment in Associates and Joint Ventures</i>	<i>AS 23 Accounting for investment in Associates</i>
Scope	Ind AS 28 excludes them from its scope as the same is included in Ind AS 39 (Financial Instruments : Recognition and Measurement)	Existing AS 23 includes in its scope, investments in associates held by venture capital organizations, mutual funds, unit trusts and similar entities including investment linked insurance funds.
Potential voting rights	Ind AS 28 considers existence and effect of potential voting rights that are currently exercisable or convertible for assessing significant influence.	Existing AS 23 does not consider potential equity shares of the investee held by investor for determining significant influence.

Equity Method	Ind AS 28 requires application of equity method in financial statement, even if the entity does not have subsidiaries.	Existing AS 23 requires application of the equity method only in case of subsidiary consolidation.
Length of difference in the reporting dates of the investor and the parent	Ind AS 28, length of difference in the reporting dates of the investor and the parent should not be more than three months unless it is impractical.	Existing AS 23 specifies no maximum difference between the reporting date of the associate and that of the parent.
While both existing AS 23 and Ind AS 28 require uniform accounting policies for the preparation of investor's financial statements for a like transactions and events in similar circumstances, existing AS 23 provides exemption to the same, if it is not possible to make adjustments to the accounting policies of the associates. However, the fact needs to be disclosed along with a brief description of the differences between the accounting policies		

Comparison of Ind AS 33 with existing Indian GAAP 20

<i>Bases of comparison</i>	<i>Ind AS 33 Earnings Per Share</i>	<i>AS 20 Earnings Per Share</i>
Options held by the entity	Ind AS 33 specifically deals with options held by the entity on its share.	Existing AS 20 does not deal with the same.
Presentation of basic and diluted EPS from continuing and discontinued operations	Ind AS 33 requires presentation of basic and diluted EPS from continuing and discontinued operations separately.	Existing AS 20 does not require the same.
Presentation of EPS with and without extraordinary items	Ind AS 33 does not require the presentation of EPS with and without extraordinary items as Ind AS 1 (Presentation of Financial Statements) prohibits the disclosure of items as extraordinary.	Existing AS 20 requires the presentation of EPS with and without extraordinary items.

Comparison of Ind AS 34 with existing Indian GAAP 25

<i>Bases of comparison</i>	<i>Ind AS 34 Interim Financial Reporting</i>	<i>AS 25 Interim Financial Reporting</i>
Comply	Ind AS 34 requires such compliance only if the interim financial report is required to be prepared and presented in accordance with accounting standards.	Under existing AS 25, if an entity is required or elects to prepare and present an interim financial report, it should comply with that Standard.
Condensed statement of changes in equity	Ind AS 34, in addition, requires a condensed statement of changes in equity for the period in addition to above requirements.	Existing AS 25 requires at a minimum condensed balance sheet, a condensed statement of profit and loss, a condensed cash flow statement and selected explanatory notes in the contents of an interim financial report.

Preparation of both consolidated and separate financial statements, complete or condensed.	Ind AS 34 neither requires nor prohibits the inclusion of the parents' separate statements in the entity's interim report prepared on a consolidated basis.	AS 25 requires preparation of both consolidated and separate financial statements, complete or condensed.
Furnishing information of contingent liabilities and contingent assets	Ind AS 34 specifies that information, if significant, on both contingent liabilities and contingent assets is required to be furnished.	Existing AS 25 requires furnishing of information on contingent liabilities only.

Comparison of Ind AS 36 with existing Indian GAAP 28

<i>Bases of comparison</i>	<i>Ind AS 36 Impairment of Assets</i>	<i>AS 28 Impairment of Assets</i>
Frequency for Testing of Intangibles	Ind AS 36 requires goodwill and other intangible assets to be tested for impairment at last annually.	Existing AS 28 does not require goodwill to be tested for impairment annually unless there is an indication of impairment.

Reversal of impairment losses	Ind AS 36 prohibits reversal of impairment losses in a subsequent period.	Existing AS 28 allows for reversal of impairment losses on account of goodwill in a subsequent period if the loss was caused by a specific external event of an exceptional nature that is not expected to recur, and subsequent external events that would occur and reverse the effect of that event.
Bottom-up or top-down approach	Under Ind AS 36 there is no bottom-up or top-down approach for allocation of good will. Rather goodwill is allocated to CGUs that are expected to benefit from the synergies of the business combination from which it arose.	Existing AS 28 specifies bottom up or top-down approach for allocation of goodwill under which goodwill is tested for impairment by allocating its carrying amount to each CGU (cash generating unit) or the smallest CGU on a reasonable and consistent basis.

Comparison of Ind AS 37 with existing Indian GAAP 29

<i>Bases of comparison</i>	<i>Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets</i>	<i>AS 29 Provisions, Contingent Liabilities and Contingent Assets</i>

Provisions for constructive obligations	Ind AS 37 requires creation of provisions in respect of constructive obligations.	Under existing AS 29 provisions are not recognized on constructive obligations. However, provisions may be created on account of obligations arising out of normal business practices, custom and a desire to maintain good business relations or to act in an equitable manner.
Discounting of Provision	Ind AS 37 requires discounting of the amount of provisions in cash effect of the time value of money is material.	The same is prohibited under AS 29.
Disclosure of Contingent Assets	Ind AS 37 requires disclosure of contingent assets, when the inflow of economic benefits is probable.	AS 29 does not require disclosure of contingent assets in the financial statements.

Comparison of Ind AS 38 with existing Indian GAAP 26

<i>Bases of comparison</i>	<i>Ind AS 38 Intangible Assets</i>	<i>AS 26 Intangible Assets</i>
Cost or Revaluation Model	Ind AS 38 permits revaluation model in addition to cost model.	Existing standard AS 26 allows for only the cost model as a part of accounting policy.

Useful life may be finite or indefinite	Ind AS 38 recognizes that useful life may be finite or indefinite subject towards fulfillment of certain conditions.	Under existing standard AS 26, useful life of an intangible asset is not always indefinite. It includes a rebuttable presumption that the useful life will not exceed ten years from the date the asset is available for use.
Recognize of Intangible Assets acquired in exchange of a non-monetary asset	Ind AS 38 requires such intangible asset to be recognized at the fair value of the asset given up unless (a) the exchange transaction lacks commercial substance, or (b) the fair value of neither the asset received nor the asset given is reliably measurable.	Under the existing standard AS 26, if an intangible asset is acquired in exchange of a non-monetary asset, its cost should be recognized with reference to the fair market value of the consideration given.
Deferment of payment	Ind AS 38 requires that in case of deferment of payment beyond normal credit terms in case of an intangible asset, the difference between this amount and the total payments is to be recognized as interest expense over the period of credit unless it is capitalized as per Ind AS 23.	Existing AS 26 is silent on this aspect.

Comparison of Ind AS 103 with existing Indian GAAP 14

<i>Bases of comparison</i>	<i>Ind AS 103 Business Combination</i>	<i>AS 14 Accounting for Amalgamation</i>
Scope	Ind AS 103 is much wider in scope as it deals with business combinations.	Existing AS 14 defines only amalgamations.
Method	Ind AS 103 allows for only acquisition method for each business combination.	Existing AS 14 allows pooling of interest method as well as purchase method for amalgamation.
Recognize at Book Value or Fair Value	Ind AS 103 requires the acquired identifiable assets liabilities and non- controlling interest to be recognized at a fair value under acquisition method.	Existing AS 14 requires that acquired assets and liabilities are recognized at their existing book value or at the fair value under the purchase method.
Measure of Non-Controlling interest	Ind AS 103 requires that for each business combination, the acquirer shall measure any non-controlling interest in the acquired at either a) a fair value, or	Existing AS 14 defines that the minority interest is the amount of equity attributable to minorities at the date on which investment in a subsidiary is made, and it is shown outside as shareholders equity.

	b) the present ownership instruments' proportionate share in the recognized amount of the acquiree's identifiable net assets.	
Testing for impairment of Goodwill	Ind AS 103 requires goodwill to be tested for impairment on an annual basis in accordance with Ind AS 36.	Existing AS 14 requires amortization of goodwill arising on amalgamation in the nature of purchase.
Guidance on accounting for reverse acquisitions.	Ind AS 103 specifically provides guidance on accounting for reverse acquisitions.	Existing AS 14 is silent on the same.
Treatment of excess amount	Ind AS 103 requires bargain purchase gain arising on business combination to be recognized as other comprehensive income on the acquisition date and accumulation of the same in equity as capital reserve.	Existing AS 14 treats the excess amount as capital reserve.

Comparison of Ind AS 105 with existing Indian GAAP 24

<i>Bases of comparison</i>	<i>Ind AS 105 Non-Current Assets Held for Sale</i>	<i>AS 24 Discontinued Operations</i>

	<i>andDiscontinued Operations</i>	
Dealt with non-currentassets held for sale	Ind AS 105 specifically deals with accounting for non-current assets held for sale.	Under existing AS 24, same is not dealtwith. Rather it falls under the ambit of existing AS 10 (Accounting for Fixed Assets).
Measure of non-currentassets held for sale	Under Ind AS 105 non-current assets held for sale are measured lower than the carrying amount, and fair value minus costs to sell.	Existing AS 24 follows the principles set out in existing AS 10 which requires fixed assets retired from active uses and held for sale to be stated at the lower of their net book value and net realizable value.
Classification of discontinuing operation	Under Ind AS 105, an operation is classified as discontinued when either it has been disposed of, or is classified asheld for sale.	Under AS 24, classification of discontinuing operation happens at the occurrence of one of the following : (a) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation ; or

		(b) the enterprise’s Board of Directors or similar governing body has both (i) approved a detailed, formal plan for the discontinuance, and (ii) made an announcement of the plan.

Comparison of Ind AS 108 with existing Indian GAAP 17

<i>Bases of comparison</i>	<i>Ind AS 108 Operating Segment</i>	<i>AS 17 Segment Reporting</i>
Identification ofSegment	Ind AS 108, on the contrary identifies segments based on internal reports regularly reviewed by the entity’s chief operating decision maker so as to make decisions about resources to be allocated to the segment and assess itsperformance.	Existing AS 17 requires an enterprise to identify segments based on business products and geographical areas with internal financial reportingsystem serving only as the starting point for identifying those items that can be directly attributed, or reasonably allocated, to segments.

Measure of Segment	Ind AS 108 requires measurement basis for cash segment reported to be that used by the chief operating decision- maker for the purposes of making decisions about allocating resources to the segment and assessing its performance.	Under existing AS 17 segment information is prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements.
Aggregation criteria	Ind AS 108 specifically requires aggregation criteria for aggregation of two or more segments.	AS 17 does not deal with the same.
Disclosure	Ind AS 108 requires disclosures of revenues from external customers for each product and service, or each group of similar products and services. With respect to geographical areas, disclosure is required for revenues from external customers (i) attributed to the entity’s country of domicile and (ii) attributed to all foreign countries in total from which the entity derives revenue.	Existing AS 17 requires disclosures based on the classification of the segments as primary or secondary segments.

LESSON ROUND-UP
- Accounting Standards (ASs) are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements. - The objective of general-purpose financial reporting is to provide financial information that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. - Two important characteristics of financial information relate to relevance and reliability - Convergence of national Accounting Standards with International Financial Reporting Standards (IFRS) has gained worldwide momentum in recent years to ensure uniformity and transparency in reporting standards. - India has started applying its Indian Accounting Standards (Ind AS) converged with IFRS in a phased manner beginning from April 1, 2016. - Ind AS are basically standards that have been harmonized with IFRS to make reporting by Indian companies more globally assessable.

GLOSSARY
Accounting standards : Accounting standards may be defined as the written policy documents issued by an expert Accounting Body or Government or other regulatory bodies covering the aspects of recognition, measurement, presentation and disclosure of the transactions and other events in the financial statements. Indian Accounting Standards (Ind AS) : Indian Accounting Standards (Ind AS) are another set of accounting standards notified by the Ministry of Corporate Affairs, Government of India which are converged with International Financial Reporting Standards (IFRS). International Financial Reporting Standards (IFRSs) : International Financial Reporting Standards (IFRSs) are considered a “principles-based” set of standards. In fact, they establish broad rules rather than dictating specific treatments. IGAAP : Indian GAAP is a set of accounting standards that are specifically designed for the Indian context. GAAP stands for Generally Accepted Accounting Principles.

TEST YOURSELF
1. What is the need for Standards? 2. What is the need for convergence with IFRS? 3. What are the differences between IGAAP & Ind AS? 4. Discuss the roadmap for implementation of Indian Accounting Standards (Ind AS) to achieve convergence with IFRS 5. Discuss the importance of relevance and reliability characteristics of financial information and the need for uniformity and transparency in reporting standards.

CHAPTER 4

ISSHUE OF SHARES AND FOREITURE

MEANING OF SHARES

A share is one unit into which the total share capital is divided. Each share forms a unit of ownership and is offered for sale so as to raise capital for the company. The shares any member in a company are movable property transferable in the manner provided by the articles of the company. Face value of a share is the par value of the share. It is also known as the Nominal value or denomination of a share.

According to Section 2(84) of the Companies Act 2013, “share” means a share in the share capital of a company and includes stock. Thus, in other words, shares are divisions of the share capital of a company. A share represents a fractional part of the share capital of the company. For example, if a company has a share capital of Rs. 5,00,000 divided into 50,000 shares of Rs.10 each and a person who has taken 50 shares of the company is said to have a share of Rs. 500 in the share capital of the company.

Meaning of share capital

When total capital of a company is divided into shares, then it is called share capital. A joint stock company raises its capital by issue of shares to finance its activities. The Memorandum of Association of the company states the amount of capital with which the company is desired to be registered and the number of shares into which it is to be divided. It constitutes the basis of the capital structure of a company.

Kinds of share capital

The share capital of a company limited by shares shall be of two kinds under the Companies Act 2013, namely: –

- a) **Equity share capital:** Equity share capital with reference to any company limited by shares means all share capital which is not preference share capital. Equity share capital can be
 - (i) with voting rights; or
 - (ii) with differential rights, as to dividend or voting or any other right.
- b) **Preference share capital:** Preference share capital with reference to any company limited by shares means that part of the issued share capital of the company which carries or would carry a preferential right with respect to –

- payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
- repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

Deemed preference share capital: The capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely: –

- that in respect of dividends, in addition to the preferential rights to the payment of dividend, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
- that in respect of capital, in addition to the preferential right to the repayment, on a winding up, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

ISSUE OF SHARES

When a public company desires to raise capital by issuing its shares to the public, it has to invite the public to subscribe for its shares. The person who intends to subscribe to those shares should make an application for the desired number of shares to the company. Then, the company will allot shares to the applicant.

Allotment means the appropriation of a certain number of shares to an applicant in response to his application. The company cannot allot more than the number of shares offered to the public for subscription through the prospectus. Moreover, the company cannot make allotment unless the amount stated in the prospectus as the minimum subscription has been subscribed and the sum payable on application for the stated amount has been received by the company.

If the number of shares applied for is less than the number of shares offered, the allotment can be only for the shares applied for provided minimum subscription is raised.

ISSUE OF SHARES AT PAR

Shares are said to be issued at par when the issue price is equal to the face value or nominal value of the shares i.e. issue price is Rs. 10 and face value is also Rs. 10. When the shares are issued, the company may ask the payment of the shares either payable in one lump sum or in installments.

(a) When shares are issued at par and are payable in full in a lump sum:

(1) On receipt of application money

Bank	Dr.
To Share Application and Allotment A/c	
<i>(With the amount received on application)</i>	

(2) On allotment of shares

Share Application and Allotment A/c	Dr.
To Share Capital A/c	
<i>(With the money received on the number of shares allotted)</i>	

Note:

- (i) When the capital of the company consists of shares of different classes, a separate share application account will be opened for each class of shares, i.e. equity shares application account/preference share application account etc.
- (ii) Unless shares are allotted by the company, the receipt of application is simply an offer and cannot be credited to Share Capital Account.
- (iii) If the company fails to raise the minimum subscription, then no shares can be allotted and the application money has to be returned to the applicants. For this, the entry will be as follows:

Share Application and Allotment A/c	Dr.
To Bank	
<i>(With the application money received now refunded)</i>	

- (iv) In actual practice, the cash transactions are not journalised but the same have to be entered in the cash book.

(b) When shares are issued at par and the amount is payable in installments:

When shares are not payable in a lump sum, they can be called in a number of installments. After allotment, whenever the need arises, the directors may demand further money from the

shareholders towards payment of the value of shares taken up by them. Such demands are termed as calls. The different calls are distinguished from each other by their serial numbers, i.e. first call, second call, third call and so on. The last installment is also termed the final call along with the number of the last call.

- First installment is called 'application money'
- Second installment is called 'allotment money'
- Third installment is called 'first call money' and
- The last installment is called 'final call money'.

JOURNAL ENTRIES

(i) On receipt of application money

Bank	Dr.
To Share Application Account	
<i>(with the amount received on application)</i>	

(ii) On allotment of shares

Share Application Account	Dr.
To Share Capital Account	
<i>(with the amount of application money on allotted)</i>	

(iii) On refund of application money on rejected applications

Share Application Account	Dr.
To Bank	
<i>(with the amount actually repaid)</i>	

(iv) On making the allotment money (second installment) due

Share Allotment Account	Dr.
To Share Capital Account	
<i>(with the amount due on allotment)</i>	

(v) On receipt of allotment money is received the following journal entry is made

Bank	Dr.
To Share Allotment Account	

(with the actual amount received as allotment money)

(vi) On making the first call

Share First Call Account Dr.
 To Share Capital Account
(with the amount due on first call)

(vii) On receipt of first call money

Bank Dr.
 To Share First Call Account
(with the amount received on first call)

(viii) When second call is made

Share Second Call Account Dr.
 To Share Capital Account
(with the amount due on second call)

(ix) On receipt of second call money:

Bank Dr.
 To Share Second Call Account
(With the amount actually received on second call)

(x) When the final call is made:

Share Final Call Account Dr.
 To Share Capital Account
(with the amount due on final call)

(xi) On receipt of final call money:

Bank Dr.
 To Share Final Call Account
(with the amount actually received on final call)

ISSUE OF SHARES AT PREMIUM

The shares of many successful companies which offer attractive rates of dividend on their existing capitals fetch a higher price than their face value in the market. When shares are issued at a price higher than the face value, they are said to be issued at a premium. Thus, the excess of issue price over the face value is the amount of premium.

Example: if a share of Rs. 10 is issued at Rs. 12, then Rs. 2 (12 – 10) will be the amount of premium.

The premium on issue of shares must not be treated as revenue profits. On the contrary, it must be regarded as capital receipt. The Companies Act requires that when a company issues shares at a premium whether for cash or otherwise, a sum equal to the aggregate amount of the premium collected on shares must be credited to a separate account called “Securities Premium Account”. There are no restrictions in the Companies Act on the issue of shares at a premium, but there are restrictions on its disposal.

Under Section 52(2) of the Companies Act 2013, the Securities Premium Account may be applied by the company –

- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- (b) in writing off the preliminary expenses of the company;
- (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- (e) for the purchase of its own shares or other securities under section 68.

It is to be noted here that utilization of the amount of Securities Premium Account except in any of the modes specified above, will attract the provisions relating to the reduction of share capital of a company under the section 66 of the Companies Act 2013.

The Securities Premium Account must be shown as “Securities premium reserves” separately in the liabilities side of the balance sheet under the head “Reserves & Surplus”.

The premium is usually payable with the installment due on allotment. However, some companies may charge premium with share application money or partly with share application money and partly at the time of allotment of shares. It may be included in call money also.

Additional Questions:

Ques.: What are Revenue Profits?

Ques.: What are Capital receipts?

JOURNAL ENTRY

— When allotment money becomes due:

Share Allotment A/c	Dr.	<i>(with the money due on allotment including premium)</i>
To Securities Premium A/c		<i>(with the premium amount)</i>
To Share Capital A/c		<i>(with the share allotment amount)</i>

ISSUE OF SHARES AT DISCOUNT

When shares are issued at a price lower than the face value, they are said to be issued at discount. Thus, the excess of the face value over the issue price is the amount of discount.

Example: If a share of Rs. 10 is issued at Rs. 9 then Re. 1 (10 – 9) will be the amount of discount given.

As per companies Act 2013, a company shall not issue shares at a discount except as provided in section 54 for issue of sweat equity shares. Any share issued by a company at a discounted price shall be void.

Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

UNDER-SUBSCRIPTION OF SHARES

In actual practice, it rarely happens that the number of shares applied for is exactly equal to the number of shares offered to public for subscription. If the number of shares applied for is less than the number of shares issued the shares are said to be undersubscribed. When an issue is under-subscribed, entries are made on the basis of number of shares applied for, provided the minimum subscription is raised and the company proceeds to allot the shares.

OVER-SUBSCRIPTION OF SHARES

When the number of shares applied for exceeds the number of shares issued, the shares are said to be oversubscribed. In such situation, the directors allot shares on some reasonable basis because the company can allot only that number of shares actually offered for subscription. Moreover, as per the SEBI, the company cannot reject out-rightly any application for shares unless it has incomplete information or absence of signature(s) or insufficient application money and so on. In short, the following procedure is adopted:

- (i) Total rejection of some applications;
- (ii) Acceptance of some applications in full; and
- (iii) Allotment to the remaining applicants on pro-rata basis.

The shares should be issued in tradable lot. In case of pro-rata allotment, no applicant for shares is refused and no applicant is allotted the shares in full. Each applicant receives the shares in some proportion. In such cases, the excess amount of application money (i.e. overpaid amount) is not refunded but retained and treated as a payment towards allotment money.

Surplus money exceeding that due on allotment should be refunded to the allottees. However, the company may transfer this to Calls-in-Advance Account if:

- (i) Acceptance of calls in advance is permitted by the Company's Articles.
- (ii) The consent of the applicant has been taken either by a separate letter or by inserting a clause in the company's prospectus.

The company can retain the calls in advance at the most so much amount as is sufficient make the allotted shares fully paid up ultimately.

The journal entry will be as follows:

Share Application A/c	Dr.
	To Calls-in-Advance A/c

(with the excess application money left over the amount due on application and allotment)

Calls-in-Advance and Interest on Calls-in-Advance

If authorised by the articles, a company may receive from a shareholder the amount remaining unpaid on shares, even though the amount has not been called up. This is known as calls-in-advance. It is a debt of a company until the calls are made and the amount already paid is adjusted. Calls-in-advance may also arise when the number of shares allotted to a person is much

smaller than the number applied for and the terms of issue permit the company to retain the amount received in excess of application and allotment money. Of course, the company can retain only so much as is required to make the allotted shares fully paid ultimately. When calls are made, the calls-in-advance account is ultimately closed by transfer to the relevant call accounts. It is noted that the money received on calls-in-advance does not become part of share capital. It is shown under a separate heading, namely 'calls-in-advance' on the liabilities side. No dividend is paid on calls-in-advance.

(ENTRY)

(i) On receipt of call money in advance:

Bank	Dr.	
To	Call-in-Advance	A/c
<i>(with the amount of call money received in advance)</i>		

(ii) As and when calls are made:

Calls-in-Advance A/c	Dr.	
To Relevant Call A/c		
<i>(with the amount adjusted on relevant call becoming due)</i>		

The amount received as calls-in-advance is a debt of the company, the company is liable to pay interest on the amount of Calls-in-Advance from the date of receipt of the amount till the date when the call is due for payment. Generally, the Articles of the company specify the rate at which interest is payable. **If the articles do not contain such rate, Table F of the Companies Act, 2013 will be applicable which leaves the matter to the Board of directors' subject to a maximum rate of 12% p.a.**

It is to be noted that the interest payable on Calls-in- Advance is a charge against the profits of the company. As such, Interest on Calls-in-Advance must be paid even when no profit is earned by the company.

(i) If Interest on Calls-in-Advance is paid in cash

Interest on Calls-in-Advance A/c	Dr.	
To Bank		
<i>(with the amount of interest paid)</i>		

(ii) If interest on Calls-in-Advance is not paid in cash

Interest on Calls-in-Advance A/c	Dr.	

To Sundry Shareholders A/c
(with the amount of interest payable)

- (iii) At the end of the year, when interest on Calls-in-Advance is transferred to Profit and Loss A/c

Profit and Loss A/c Dr.
 To Interest on Calls-in-Advance A/c
(with the amount of interest)

Note: The liability to sundry shareholders is to be treated as outstanding liability and should be shown under the head “Current Liabilities” in the balance sheet.

Calls in Arrear and Interest on Calls in Arrear

When calls are made upon shares allotted, the shareholders holding the shares are bound to pay the call money within the date fixed for such payment. If a shareholder makes a default in sending the call money within the appointed date, the amount thus failed is called Calls-in-Arrear.

The interest on Calls-in-Arrear is recoverable according to the provisions in this regard in Articles of the company. But if the Articles are silent, Table 'F' of Schedule I of the Companies Act, 2013, shall be applicable which prescribes that if a sum called in respect of shares is not paid before or on the day appointed for payment, the person who failed to pay shall pay thereof from the day appointed for payment to the time of actual payment at a rate not exceeding 10% per annum. However, the directors have the right to waive the payment of interest on Calls-in-Arrear. The interest on Calls-on-Arrear Account is transferred to the Profit and Loss Account at the end of the year.

(ENTRY)

- (i) When call money is in arrear**

Calls-in-Arrear A/c Dr.
To Relevant Call A/c
(with the amount failed to pay by the shareholders)

- (ii) On receipt of amount of Calls-in-Arrear with interest, on a subsequent date

Bank Dr.

To Calls-in-Arrears A/c

(with the amount received)

Issue of Shares for Consideration other than Cash

A company may also issue shares for consideration other than cash to vendors who sell some assets to the company or to the promoters for their services. When shares are so issued, the Companies Act requires that the same must be clearly stated in the balance sheet and must be distinguished from the issue made for cash.

Issue of Shares to Vendors

A company may purchase assets from the vendors and instead of paying the vendors cash, may settle the purchase price by issuing fully paid shares of the company. This type of issue of shares to the vendors is called issue of shares for consideration other than cash. Such shares may be issued by the vendors either:

(i) at par, or (ii) at a premium.

JOURNAL ENTRIES

(i) when assets are acquired from the vendors:

Sundry Assets A/c Dr.
 To Vendors

(with the purchase price payable for the assets acquired)

(ii) when fully paid shares are issued to vendors at par:

Vendors Dr.
 To Share Capital A/c

(with the nominal value of the shares allotted)

(iii) when fully paid shares are issued to vendors at a premium:

Vendors	Dr.	<i>(with the purchase price)</i>
To Share Capital A/c		<i>(with the nominal value of the shares allotted)</i>
To Securities Premium A/c		<i>(with the amount of premium)</i>

FORFEITURE OF SHARES

If a shareholder fails to pay the allotment money and/or calls made on him, his shares are liable to be forfeited. Forfeiture of shares may be said to be the compulsory termination of membership by way of penalty for nonpayment of allotment and/or any call money.

The Companies Act does not contain any specific provisions regarding forfeiture. The directors must follow certain procedure for forfeiting the shares. They have to give notice to the defaulting shareholder calling upon him to pay the amount due from him together with interest before a specified date (not being earlier than the expiry of fourteen days from the date of service of the notice). This notice must also state that if the shareholder fails to pay the amount along with interest due within the specified date, the shares will be forfeited. If the payment is not received within the specified time, the directors meet to consider the forfeiture and they can proceed to forfeit the shares. The directors must pass a resolution for forfeiting the shares at a duly constituted meeting of the Board of Directors and the defaulting shareholder should be informed about the forfeiture of his shares.

The effect of forfeiture of shares is that the defaulting shareholder loses all his rights in the shares and ceases to be a member. The name of the shareholder is removed from the Register of Members and the amount already paid by him is forfeited. He is not entitled in future to dividends and the rights of membership.

Forfeited shares account is to be shown in the balance sheet by way of addition to the paid-up share capital on the 'liabilities' side, until the concerned shares are reissued.

FORFEITURE OF SHARES ISSUED AT PAR

(JOURNAL ENTRIES)

The forfeiture of shares can be recorded in two ways:

- 1. Where the unpaid calls have already been transferred to Calls-in-Arrear A/c and the respective call accounts have been closed:**

Share Capital A/c	Dr.	<i>(with the amount of called up value of shares forfeited)</i>
To Shares Forfeited A/c		<i>(with the amount already paid-up by the shareholders on the shares forfeited)</i>
To Calls-in-Arrear A/c		<i>(with the amount of unpaid calls)</i>

2. Where the unpaid calls have not been transferred to Calls-in-Arrear A/c and the respective call accounts are showing balances representing unpaid amounts:

Share Capital A/c	Dr.	<i>(With the amount of called up value of shares forfeited)</i>
To Shares Forfeited A/c		<i>(with the amount already paid up by the shareholders on the shares forfeited)</i>
To Share Allotment A/c		<i>(with the amount failed on allotment, if any)</i>
To Share First Call A/c		<i>(with the amount failed on first call, if any)</i>
To Share Final Call A/c		<i>(with the amount failed on final call, if any)</i>

FORFEITURE OF SHARES ISSUED AT A PREMIUM

Case 1: Where shares to be forfeited were issued at a premium and the premium money remained unpaid:

In this case the credit already given to the 'Securities Premium A/c' will be cancelled at the time of forfeiture of the shares by debiting "Securities Premium A/c".

(ENTRY)

Share Capital A/c	Dr.	<i>(with the amount of called up value of shares forfeited)</i>
Securities Premium A/c	Dr.	<i>(with the amount of premium money remaining unpaid on shares forfeited)</i>
To Shares Forfeited A/c		<i>(with the amount already paid by the shareholders on the shares forfeited)</i>
To Calls-in-Arrear A/c		<i>(with the amount unpaid on calls)</i>

Case 2: Where shares to be forfeited were issued at a premium and the premium money was duly received on the shares to be forfeited:

In this case Securities Premium Account is already credited at the time of making call will not be cancelled at the time of forfeiture of the shares. In such a case, the accounting entry on forfeiture will be the same as the one passed in case of shares issued at par.

RE-ISSUE OF FORFEITED SHARES

The Board of Directors can sell/ reissue or dispose of forfeited shares on such terms as it thinks fit. However, the amount receivable on re-issue of such shares together with the amount already received from the defaulting member, shall not, in any case, be less than the face value of the shares. Forfeited shares may be re-issued at par, at a premium or even at a discount.

RE-ISSUE OF FORFEITED SHARES - AT PAR:

The forfeited shares can be re-issued at par. In such a case, the entire amount standing to the credit of Shares Forfeited Account for those shares would be treated as net gain and transferred to Capital Reserve Account.

(ENTRY)

1. On re-issue of shares:

Bank	Dr.
To Share Capital A/c	
<i>(with the amount received on reissue)</i>	

2. On transfer of Shares Forfeited Account to Capital Reserve Account:

Shares Forfeited A/c	Dr.
To Capital Reserve A/c	
<i>(with the forfeited amount on shares re-issued)</i>	

RE-ISSUE OF FORFEITED SHARES – AT A PREMIUM:

If forfeited shares are re-issued at a premium, the amount of such premium should be credited to Securities Premium Account. In such a case also, the entire amount standing to the credit of Shares Forfeited Account would be treated as net gain and transferred to Capital Reserve Account.

(ENTRY)

1. On re-issue of shares:

Bank	Dr.	<i>(with the total amount received on re-issue)</i>
To Share Capital A/c		<i>(with nominal value or paid-up value of shares)</i>

- To Securities Premium A/c *(with the premium amount received)*
- 2. On transfer of Shares Forfeited A/c to Capital Reserve A/c:**
- Shares Forfeited A/c Dr. *(with the forfeited amount on shares re-issued)*
- To Capital Reserve A/c

Important Note: In case only a part of the forfeited shares is re-issued, only the proportionate amount representing the net gain on the shares re-issued should be transferred to Capital Reserve Account and the balance representing the amount received on forfeited shares not yet re-issued should be left in the Shares Forfeited Account itself. This amount should be shown as addition to the paid-up capital on the liabilities side of the balance sheet.

Forfeiture and Re-issue of Shares Allotted on Pro-rata Basis in Case of Over-subscription

In case, the shares of a Company are over-subscribed, it is not possible for the company to satisfy the demand of all the applicants. In such a case allotment may be made on pro-rata basis, i.e., proportionately. For example, 10,000 shares are allotted pro-rata among the applicants for 12,000 shares. In this case, the ratio between allotment of shares and application for shares will be 10,000: 12,000 or 5: 6, i.e., those applying for every 6 shares will be allotted 5 shares.

If shares are allotted on pro-rata basis, the excess application money received on shares allotted will be retained by the company and adjusted subsequently against allotment money and/or call money.

If such shares are subsequently forfeited for non-payment of allotment money and/or call money, the entries will be the same, but it may involve some difficulty in calculation. In such a case, it is to be noted carefully that if there is any excess amount received along with the application and it is adjusted against the allotment money which is failed by the shareholder, such amount should be deducted from the amount due on allotment to arrive at the net amount defaulted by the shareholder.

ISSUE OF SWEAT EQUITY SHARES

SEBI (Issue of Sweat Equity) Regulations, 2002 along with Rule 8 of Companies (Share Capital and Debentures) Rules, 2014

1. Notwithstanding anything contained in section 53, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:
 -

- a) the issue is authorised by a special resolution passed by the company;
 - b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
 - c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
 - d) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.
2. The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *pari passu* with other equity shareholders.

CHAPTER 5

RIGHT ISSUE & BONUS ISSUE

MEANING OF RIGHT ISSUE

A rights issue is a way by which a listed company can raise additional capital. However, instead of going to the public, the company gives its existing shareholders the right to subscribe to newly issued shares in proportion to their existing holdings.

ADVANTAGES OF RIGHT ISSUE OF SHARES

- The shares are offered to the shareholders at the discounted price to encourage them to purchase the rights issue.
- The company saves a significant amount of money, such as underwriting fees, advertisement cost and so on.
- The control of the company remains in the hands of the existing shareholders. This is because the shares are only issued to those shareholders who on the date of rights issue are the holders of the shares.
- There is an equitable distribution of the shares and the same proportion of the voting rights.

WHAT IS RENOUNCEABLE RIGHT

'Renounceable Rights' are Rights that have been allocated to shareholders which are tradeable on the market while valid. Owners of Renounceable Rights have the following options: 1 - Exercise the Rights before the expiry date (purchase the new shares). 2 - Sell them on the market (while Rights are valid).

RIGHT SHARES {Section 62(1)}

1. Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered –
 - a) to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely: –
 - (i) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days

from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

- (ii) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;
 - (iii) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not dis-advantageous to the shareholders and the company;
- b) to employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed; or
 - c) to any persons, if it is authorised by a special resolution, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.
2. The notice referred to in sub-clause (i) of clause (a) of sub-section (1) shall be dispatched through registered post or speed post or through electronic mode to all the existing shareholders at least three days before the opening of the issue.
 3. Nothing in this section shall apply to the increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company:

Provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loan by a special resolution passed by the company in general meeting.

HOW VALUE OF RIGHT IS CALCULATED? -

The value of right is calculated with reference to the market value of the shares and following steps may be taken: -

-  The market value of the shares held by a shareholder has to be ascertained.
-  The price of the new share which is required to be paid to the company has to be added with the market value of the shares held to ascertain the total price of all the shares.
-  The average price of one share has to be ascertained by dividing the total price of all the shares by number of shares.

- ☞ The value of the right will be the difference between the market value and the average price of the share.

Illustration:

A company has decided to increase its existing share capital by making rights issue to the existing shareholders in the proportion of one new share for every two old shares held. You are required to calculate the value of the right if the market value of share at the time of announcement of right issue is Rs. 960. The company has decided to give one share of Rs. 100 each at a premium of Rs. 380 each.

Solution: -

Market value of 2 shares already held by a shareholder (2 x 960)	1,920
Add: - The price required to be paid for acquiring one more share	<u>480</u>
Total price of 3 shares	<u>2,400</u>
Average price of one share = $\frac{2400}{3} = 800$	

Market Value – Average Price = Value of Right

$$960 - 800 = 160$$

An alternative formula is:

$$\frac{\text{Right shares}}{\text{Total shares after right issue}} \times (\text{Cum right price} - \text{New issue price})$$

$$\frac{1}{3} \times (960 - 480) = 160$$

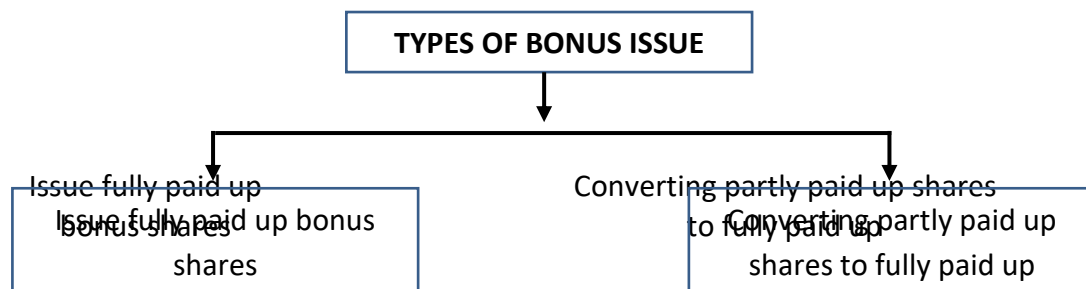
BONUS ISSUE

MEANING OF BONUS ISSUE

Bonus shares are additional shares given to the current shareholders of company free of cost in proportions to their existing shareholding.

FEATURES OF BONUS ISSUE

- Company issue bonus shares out of its accumulated reserves and surplus.
- A bonus issue result in increase in the share capital and decrease of reserves.
- Increasing the number outstanding shares by issuing bonus shares decrease price of the shares making them more affordable for retail investor.
- There is no flow of cash.
- Provision related to bonus issue is given in section 63 of Companies Act, 2013

TYPES OF BONUS ISSUE**Example-**

If company declares 2:1 bonus offer it means company will issue 2 bonus shares for every one share held by shareholder.

So, if investor was holding 100 shares prior to Bonus, he will be given 200 shares without consideration. So after bonus issue his shares will be 300.

1. A company may issue fully paid-up bonus shares to its members, in any manner out of –
 - (i) its free reserves;
 - (ii) the securities premium account; or
 - (iii) the capital redemption reserve account {section 69(2)}

However, no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

2. No company shall capitalise its profits or reserves* for the purpose of issuing fully paid-up bonus shares under (1) above, unless –
 - a) it is authorised by its articles;
 - b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
 - c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
 - d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
 - e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
 - f) The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same. [Rule 14 of Companies (Share Capital and Debentures) Rules, 2014]

** Capitalisation of profit refers to converting a company's retained earnings, which represent the profits held in the business over time to capital. This process involves issuing a stock dividend or bonus shares to existing shareholders*

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

(JOURNAL ENTRIES FOR ISSUE OF BONUS SHARES)

A. On capitalization of reserve for issue of shares

Profit & Loss Account	Dr.	
General Reserve Account	Dr.	
Capital Reserve Account	Dr.	(realised in cash only)
Securities Premium Account	Dr.	
Capital Redemption Reserve Account	Dr.	
		To Bonus to Shareholders Account

B. On issue of Bonus share

Bonus to Shareholders Account	Dr.
	To Share Capital Account

NOTE: *If some shares are partly paid-up, first the shares are to be made fully paid up.*

(JOURNAL ENTRIES)

A. On converting partly paid shares into fully paid shares

Profit & Loss Account	Dr.	
General Reserve Account	Dr.	
Capital Reserve Account	Dr.	(realised in cash only)
		To Bonus to Shareholders Account

B. On making the final call due

Share Final Call Account	Dr.
	To Share Capital Account

C. On adjustment of final call

Bonus to Shareholders Account	Dr.
	To Share Final Call Account

CHAPTER 6

BUY-BACK OF SHARES

When a company has substantial cash resources, it may like to buy its own shares from the market particularly when the prevailing rate of its shares in the market is much lower than the book value or what the company perceives to be its true value. Buy back of shares enables the company to go back to its shareholders and offers to purchase from them the shares they hold. Buy Back of Securities is a very important tool for Companies who want to reduce their Share Capital.

Advantages of Buy Back:

- It is an alternative mode of reduction in capital without requiring approval of the Court/CLB (NCLT),
- to improve the earnings per share;
- to improve return on capital, return on net worth and to enhance the long-term shareholders value;
- to provide an additional exit route to shareholders when shares are undervalued or thinly traded;
- to enhance consolidation of stake in the company;
- to prevent unwelcome takeover bids;
- to return surplus cash to shareholders;
- to achieve optimum capital structure;
- to support share price during periods of sluggish market condition;
- to serve the equity more efficiently.

Sections 68, 69 and 70 of Companies Act, 2013 provides for buy back of shares.

According to section 68(1) of the Companies Act 2013, a company may purchase its own shares or other specified securities (referred to as buy-back) out of—

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

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

Additional Question:**Ques.: What is Free Reserve?****Free Reserve includes following items:**

- Profit and loss accounts
- General Reserve
- Reserve funds
- Contingency reserve
- Dividend equalization reserve
- Workmen compensation fund
- workmen accident fund

It does not include following:

- Security premium
- Capital reserve
- Profit prior to incorporation
- Pre-acquisition profit
- Forfeited share accounts
- Provident fund
- Investment fluctuation accounts
- Development rebate reserve

Explanation:**Section 68 ⇒ free reserves includes security premium account****Conditions for buy back:**

According to section 68(2), following conditions must be satisfied in order to buy-back the shares:

- a) must be authorized by its articles;
- b) a special resolution has been passed at a general meeting of the company authorizing the buy-back, but the same is not required when:
 - (i) the buy-back is 10% or less of the total paid-up equity capital and free reserves of the company; and
 - (ii) such buy-back has been authorized by the Board by means of a resolution passed at its meeting;
- c) the buy-back is twenty-five per cent or less of the aggregate of paid-up capital and free reserves of the company. But in case of Equity Shares, the same shall be taken as 25% of paid up equity capital only.

- d) Debt equity ratio should be 2:1*, where: Debt is aggregate of secured and unsecured debts owed by the company after buy-back and Equity: is aggregate of the paid-up capital and its free reserves:

**** it is 6:1 for government companies which carry on NBFC activities and housing finance activities***

- e) all the shares or other specified securities for buy-back are fully paid-up;
 f) If shares or securities are listed, buy back will be in accordance with the regulations made by the Securities and Exchange Board in this behalf; and
 g) the buy-back in respect of unlisted shares or other specified securities is in accordance with Share Capital and Debentures Rules, 2014.
 h) No offer of buy-back shall be made within a period of one year from the date of the closure of the preceding offer of buy-back, if any.

Explanatory Statement - Section 68(3):

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating –

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

Transfer of certain sums to capital redemption reserves account (section 69)

Where a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet. The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Prohibition on buy back in following circumstances (section 70)

No company shall directly or indirectly purchase its own shares or other specified securities –

- a) through any subsidiary company including its own subsidiary companies;
 b) through any investment company or group of investment companies; or
 c) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or

repayment of any term loan or interest payable thereon to any financial institution or banking company. Provided that the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of:

- a) Sections 92: Annual Return
- b) Section 123: Declaration and Payment of Dividend
- c) Section 127: Failure to pay Dividend
- d) Section 129: Failure to give True and Fair Statement

(ENTRIES)

1. In case investments are sold for buying back own shares

Bank	Dr.
To Investment Account	

2. In case the proceeds of fresh issues are used for buy back purpose

Bank	Dr.
To Debentures/Shares	
To Securities premium account (if any)	

3. For cancellation of shares bought back

Equity Share Capital Account	Dr.	<i>(with the nominal value of shares bought back)</i>
Free reserves/Securities Premium A/c	Dr.	<i>(with the excess amount/premium paid over nominal value)</i>
To Equity Shareholders (with the amount payable)		

4. For Buying back of shares

Equity Shareholders	Dr.	
To Bank		<i>(With the amount paid)</i>

5. In case the shares are bought back at discount

Equity Share Capital Account	Dr.	<i>(with the nominal value)</i>
To Equity shareholders		<i>(with the amount paid)</i>
To Capital Reserve Account		<i>(with the amount of discount on buy-back)</i>

6. For transfer of nominal value of shares purchased out of free reserves/securities premium to Capital Redemption Reserve

Free Reserves	Dr.	(with the amount transferred)
Securities Premium Account	Dr.	(with the amount transferred)
To Capital Redemption Reserve Account		(with the nominal value of shares bought back)

7. For expenses incurred in buy-back of shares

Buy-back Expenses	Dr.	(with the amount)
To Bank		

8. For transfer of buy-back expenses

Profit and Loss Account	Dr.
To Buy-back Expenses	

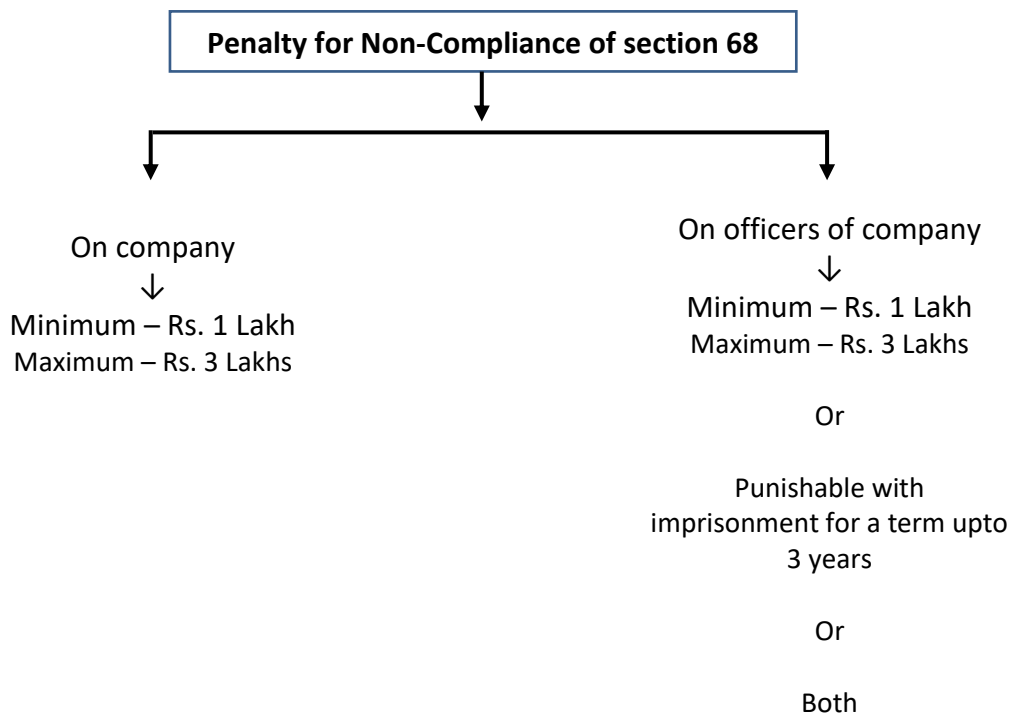
Special Points

- 1) Provision of section 68 relating to buy back of shares are application to all types of companies whether private, public or listed.
- 2) Buyback must be authorized by article of association.
- 3) Maximum permissible Buyback is 25% of the aggregate of paid up capital and free reserve of company with special resolution of shareholders.
- 4) Buyback of the shares or other specified securities listed on any recognized stock exchange is in accordance with SEBI (Buyback of securities) Regulation, 2018.
- 5) No offer for Buy back shall be made within period of 1 year reckoned from date of closure of preceding offer of buy back.
- 6) Method of Buy Back

Tender Method ↓ Pro – rata	Stock Exchange Method	Book Building Method

- 7) Buy back from promoters of company can be done along with other shareholders through tender method or book building method.

- 8) A declaration of solvency shall be filled by at least 2 directors of the company one of whom shall be managing director with ROC and SEBI.
- 9) Declaration of solvency in relation to buy back has to be filed in form SH-9.
- 10) Company shall extinguish and physically destroy shares or securities so brought back within 7 days of the last date of completion of Buy Back.
- 11) Where company completes a buy back of its shares or other specified securities it shall not make a further issue of same kind of shares or specified securities within period of 6 months.
- 12) Buy back of shares should not be through negotiated deals or private spot transaction.
- 13) Where a company buy back its shares or other specified securities it shall maintain register of shares or securities so brought in for SH-10.
- 14) A company shall after the completion of buy back file with ROC & SEBI a return relating to buy back in form SH-11, within 30 days of completion of buy back.
- 15) Penalty for Non-Compliance of section 68



- 16)** Buy back is not prohibited if the various defaults mentioned in that section is remedied and a period of 3 years has lapsed after such default ceased to subsist.

CHAPTER 7

EMPLOYEE STOCK OPTION SCHEME {SECTION 62(1)(B)}

MEANING

As per section 2(37) of the Companies Act, 2013 “employees’ stock option” means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

ESOP or employee stock option plan refers to a basket of instruments and incentive schemes that find favour with the new upward mobile salary class and which are used to motivate, reward, remunerate and hold on to achievers.

SOME IMPORTANT DEFINITIONS UNDER ESOPS:

- What is an ‘option’ in stock options? An option in stock option gives the employee the choice- **a right but not an obligation** – to purchase the shares of the company on the fulfillment of the conditions mentioned in the ESOP plan at the price decided at the time of grant of options.
- What is a grant? The eligibility of a particular employee (depending on the criteria set) for grant of stock options based on his role and performance is known as grant of option.
- What is vesting? Vesting has two components – Vesting percentage and vesting period. Vesting period is the period on the completion of which the said portion can be exercised. Vesting percentage refers to that portion of total options granted, which the employee will be eligible to exercise.
- What is exercise? The activity of converting the options granted to an employee into shares by paying the required exercise price is known as exercise of options.
- What is exercise price and exercise period? Exercise price is the price; the employee has to pay to convert the options into shares. The exercise period is the period within which the employee can decide to exercise the stock options.
- What is the effective date of exercise? The effective date of exercise is the date on which the Company allots the shares.

ISSUE OF EMPLOYEE STOCK OPTIONS {COMPANIES (SHARE CAPITAL AND DEBENTURE) RULES, 2014}

A company, other than a listed company, which is not required to comply with SEBI (Share Based Employee Benefits) Regulations, 2014 shall offer shares to its employees under this scheme after complying of following requirements:

- 1) the issue of Employees Stock Option Scheme has been approved by the shareholders of the company by passing a special resolution. {No S.R. is required for private companies vide Notification of 05/06/2015}

For the purpose of above statement, the word “Employee” means –

- a) a permanent employee of the company who has been working in India or outside India; or
- b) a director of the company, but excluding an independent director; or
- c) an employee as defined in 1(a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company or of an associate company,

Excluding –

- (i) an employee who is a promoter or a person belonging to the promoter group; or
 - (ii) a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.
- 2) The company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution –
 - a) the total number of stock options to be granted;
 - b) identification of classes of employees entitled to participate in the ESOP;
 - c) the appraisal process for determining the eligibility of employees to the ESOP;
 - d) the requirements of vesting and period of vesting;
 - e) the maximum period within which the options shall be vested;
 - f) the exercise price or the formula for arriving at the same;
 - g) the exercise period and process of exercise;
 - h) the Lock-in period, if any;
 - i) the maximum number of options to be granted per employee and in aggregate;
 - j) the method which the company shall use to value its options;
 - k) the conditions under which option vested in employees may lapse e.g. in case of termination of employment for misconduct;
 - l) the specified time period within which the employee shall exercise the vested options in the event of a proposed termination of employment or resignation of employee; and

- m) a statement to the effect that the company shall comply with the applicable accounting standards.
- 3) The companies granting option to its employees pursuant to Employees Stock Option Scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.
- 4) The approval of shareholders by way of separate resolution shall be obtained by the company in case of-
 - a) grant of option to employees of subsidiary or holding company; or
 - b) grant of option to identified employees, during any one year, equal to or exceeding one percent of the issued capital of the company at the time of grant of option.
- 5) (a) The company may by special resolution, vary the terms of ESOP not yet exercised by the employees

(b) The notice for passing special resolution for variation of terms of ESOP shall disclose full details of the variation, the rationale therefor, and the details of the employees who are beneficiaries of such variation.
- 6) (a) There shall be a minimum period of one year between the grant of options and vesting of option. However, in a case where options are granted by a company under its Employees Stock Option Scheme in lieu of options held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required (i.e; 1 year)

(b) The company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.

(c) The Employees shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.
- 7) The amount, payable by the employees, at the time of grant of option –
 - a) may be forfeited by the company if the option is not exercised by the employees within the exercise period; or
 - b) the amount may be refunded to the employees if the options are not vested due to non-fulfillment of conditions relating to vesting of option as per the Employees Stock Option Scheme.
- 8) (a) The option granted to employees shall not be transferable.

- (b) The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.
- (c) Subject to clause (d), no person other than the employees to whom the option is granted shall be entitled to exercise the option.
- (d) In the event of the death of employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.
- (e) In case the employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day.
- (f) In the event of resignation or termination of employment, all options not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.
- 9)** The Board of directors, shall, inter alia, disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme:
- a)** options granted;
 - b)** options vested;
 - c)** options exercised;
 - d)** the total number of shares arising as a result of exercise of option;
 - e)** options lapsed;
 - f)** the exercise price;
 - g)** variation of terms of options;
 - h)** money realized by exercise of options;
 - i)** total number of options in force;
 - j)** employee wise details of options granted to; -
 - (i)** key managerial personnel;
 - (ii)** any other employee who receives a grant of options in any one year of option amounting to five percent or more of options granted during that year.
 - (iii)** identified employees who were granted option, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;

- 10) (a) The company shall maintain a Register of Employee Stock Options in Form No. SH.6 and shall forthwith enter therein the particulars of option granted to employees under a scheme of ESOP subject to above conditions.
- (b) The Register of Employee Stock Options shall be maintained at the registered office of the company or such other place as the Board may decide.
- (c) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorized by the Board for the purpose.
- 11) Where the equity shares of the company are listed on a recognized stock exchange, the Employees Stock Option Scheme shall be issued, in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

EXAMPLE ON ESOP

On September 01, 2015, a company grants its employee 100 options with a vesting period of two years and an exercise period of seven years at an exercise price of Rs 10 per share. Under the Company Rules, there is a one-year cliff period. This implies that the vesting will not commence till September 01, 2016. Since the vesting period is two years, half of the options (i.e. 50) will vest on September 01, 2016 and the remaining half on September 01, 2017. The exercise period of the vested options is seven years. This means that that the employee can convert his 50 options (*that vested upon him on September 01, 2016*) any time before September 01, 2023. For the remaining 50 options that vested in 2017, the employee can exercise his right any time before September 01, 2024.

Let us now assume that on December 01, 2019, the employee decides to exercise his/her right to convert 70 options into common stock. At that stage, an Exercise Application will be addressed to the company. Assuming the exercise price was Rs 10 per share, the employee will pay Rs 700 (*70 options * Rs 10 per share*) to the company and the company will allot the employee 70 equity shares.

EMPLOYEE STOCK OPTION

Question No. 1

ABC Ltd. granted 1000 options on April 1, 2012 at Rs. 20 (nominal value Rs. 10 each) when the market price was Rs. 80, the vesting period was 2 ½ years. The maximum exercise period was one year. On May 1, 2014, 300 unvested options lapsed and 600 options were exercised on

30th June, 2015 remaining 100 options lapsed at the end of exercise period. Pass necessary journal entries.

Question No.2

X Co. Ltd. has its share capital divided into equity shares of Rs. 10 each. On 1.1.2014 it granted 15,000 employees' stock option at Rs. 50 per share, when the market price was Rs. 120 per share. The options were to be exercised between 15th March, 2015 and 31st March, 2015. The employees exercised their options for 10,000 shares only and the remaining options lapsed. The company closes its books on 31st March every year. Show Journal entries (with narration) as would appear in the books of the company up to 31st March, 2015.

Question No. 3

S Ltd. grants 1,000 options to its employees on 1.4.2012 at Rs. 70. The vesting period is two and a half years. The maximum exercise period is one year. Market price on that date is 100. All the options were exercised on 31.7.2015. Journalize, if the face value of equity share is Rs. 10 per share.

Question No. 4

Choice Ltd. grants 1000 employees stock options on 1.4.2011 at Rs. 60, when the market price is Rs. 170. The vesting period is 2½ years and the maximum exercise period is one year. 300 unvested options lapses on 1.5.2013. 600 options are exercised on 30.6.2014. 100 vested options lapses at the end of the exercise period. Pass Journal Entries in the books of Choice Ltd. giving suitable narrations.

Question No. 5

On 1st January, 2016, Tulip Ltd. offered 100 shares of Rs. 10 each to each of its 500 employees at Rs. 30 per share. The employees were given time up to 31st March, 2016 to accept the offer. The shares issued under ESOP shall be subject to lock-in-period of two years from the grant date. Other details provided are as under:

- (i) The market price of shares of the company on the grant date is Rs. 50 per share.
- (ii) Due to post vesting restriction on transfer of shares, the fair market value of shares is estimated at Rs. 40 per share.
- (iii) On 31st March, 2016, 400 employees accepted the offer and paid Rs. 30 per share.

You are required to pass necessary journal entries to record the allotment of shares in the books of the company.

CHAPTER 8

ISSUE OF DEBENTURES

INTRODUCTION OF DEBENTURES

Debentures are company debt. These are medium-long term debt or loans taken by a company to raise capital. These securities are repayable after a fixed-period. Debentures pay the holders a fixed rate of interest (this interest rate is usually lower than OD and bank loans). Debenture interest is paid before paying out dividends.

TYPES OF DEBENTURES

1. Debentures have a lower interest rate than bank overdrafts and bank loans.
2. Debentures are usually repayable at a far off date in the future.
3. Banks require borrowers to use the funds for specific purposes. There is no such restriction on debentures.
4. For debenture holders, debentures are a safe investment. There will be no capital erosion.
5. Debenture holders earn a fixed interest.
6. Debenture holders have no ownership rights. They are treated as creditors.
7. Interest rate on debentures may be fixed or floating.
8. Debentures can be purchased through brokers and stock exchanges.
9. Debentures mature after a specific period of time. Hence, debentures are to be repaid on maturity as stipulated in the issue.
10. Companies may issue debentures with a call feature. This entitles the company to redeem debentures at a certain price before maturity.

The call price of the debentures is usually more than the issue price.

TYPES OF DEBENTURES

Depending on the objectives and needs, a company can issue various types of debentures. The major types of debentures are:

1. Registered Debentures:

Registered debentures are registered with the company. These debentures can be transferred only by a transfer deed. Debenture interest is paid only to those names appearing in the register of the company.

2. Bearer Debentures:

Bearer Debentures are not recorded in the register of a company. As the name suggests, Bearer Debentures are transferable by delivery and don't require a transfer deed. The holder or the bearers of these Debentures are entitled to get the interest.

3. Secured Debentures:

Secured Debentures are secured by a charge on the company assets. They give the holders a right to recover principal amount along with any unpaid debenture interest out of the assets mortgaged by the company.

4. Unsecured Debentures:

Unsecured Debentures are not secured. They do not have any charge on the company assets. Therefore, they have no claim on company assets with respect to the principal amount or unpaid interest.

5. Redeemable Debentures:

Redeemable Debentures are issued for a fixed period. On the expiry of the fixed period, the debenture holders are paid the principal amount.

6. Non-redeemable Debentures:

Non-redeemable Debentures cannot be redeemed in a Company's lifetime. Non-redeemable Debentures are only paid back on company's liquidation.

7. Convertible Debentures:

Convertible Debentures can be converted into shares of the company on completion of a pre decided period. The terms and conditions of the conversion are announced at the time of issue of the debentures.

8. Non-convertible Debentures:

Non-convertible Debentures can't be converted into the shares of the company.

9. First Debentures:

First Debentures are repaid before other debentures.

10. Second Debentures:

Second Debentures are redeemed after first debentures.

ADVANTAGES OF DEBENTURES OVER SHARES:

Companies raise capital through the issue of shares. This means that every time they issue shares, they are diluting the ownership of the company. Contrastingly, debentures are a company's debt. Debentures don't give holders any ownership rights. Depending on the company's objectives, debentures can have advantages over shares in the following ways:

- 1. Avoid ownership dilution:** To run a Company, fund raising is inevitable. But, issuing more shares means diluting the ownership of the company. Say a shareholder owns 10,000 shares out of 1 Lakh equity shares. Their stakes are 10% in the company, thus they own 10% of the company. Say the company issues 1,00,000 more equity shares. Now, the 10% share will shrink to 5%. This will impact the Earnings Per Share (EPS).

Had the company issued debt securities like debentures, there wouldn't have been a dilution. Though EPS will be impacted even now, the impact is fixed and measured as the debentures have a fixed rate of interest.

- 2. Maintain the ownership structure:** As shareholders are the owners of a company, they have a say in the company's ownership structure. If new shares are issued, and these are bought by new shareholders and not the current ones, the new shareholders can change the ownership structure. On the other hand, debentures will not affect the ownership structure.
- 3. Temporary financing:** When it comes to the company, shares are permanent securities. Once shares are issued, the company cannot redeem them. But debentures can be redeemed easily. Debentures can be issued when there is a need for funds and can be paid back when there are surplus funds. The company can also call for the redemption of the debentures before maturity, if it can find cheaper financing elsewhere.

ISSUE OF DEBENTURES

Subject to the restrictions imposed by Section 71 of the Companies Act, 2013, a company can issue debentures. The procedure for issuing debentures by a company is very much similar to that of an issue of shares. Applications for debentures are invited from the public through the prospectus and the applicants are asked to pay the application money along with the

applications. The company may ask for payment of the whole of the amount along with the application or by instalments. Debentures may be issued either, (i) at par, or (ii) at a premium, or (iii) at a discount without any legal restriction.

Again, debentures may be issued by a company in the following ways:

1. for cash,
2. for consideration other than cash, and
3. as collateral security.

DEBENTURES ISSUED FOR CASH

When debentures are issued for cash the amount to be collected on them may be payable in lump sum or in instalments. Where payable in instalments, debenture application account is opened on receipt of applications. Debenture allotment account and debenture calls account are credited as against debenture account.

ISSUE OF DEBENTURES AT PAR

Debentures are said to be issued at par when the debenture holder is required to pay an amount equal to the nominal or face value of the debentures e.g. the issue of Rs. 1,000 debentures for Rs. 1,000.

a) If the full amount is payable along with the application

1. On receipt of application money: -

Bank A/c	Dr.
	To Debenture Application and Allotment A/c

2. On allotment: -

Debenture Application and Allotment A/c	
	To Debentures A/c

b) If the amount is payable in instalments

1. On receipt of application money: -

Bank A/c Dr.	
	To Debenture Application A/c

2. On Allotment due along with application money: -

Debenture Application A/c Dr.	
Debenture Allotment A/c Dr.	
	To Debentures A/c

3. On receipt of allotment money: -

Bank A/c Dr.	

To Debenture Allotment A/c

4. On making calls: -

Debenture Calls A/c Dr.

To Debentures A/c

5. On receipt of call money:

Bank A/c Dr.

To Debenture Calls A/c

Case of Over-subscription: Like shares, the company cannot allot more debentures than issued. The excess application money may be retained by the company against the allotment money due. But the excess application money received on debentures rejected has to be refunded to the applicants. For, this, the accounting entry will be as follows:

Debenture Application A/c	Dr.
To Bank A/c	

Illustration 1.

ABC Ltd. made an issue of 50,000 12% Debentures of Rs 100 each, payable as follows:

Rs 25 on Application

Rs 50 on Allotment

Rs25 on First and Final Call.

Applications were received for 52,000 debentures and the directors allotted 50,000 debentures rejecting applications for 2,000 debentures. The application money received for 2,000 rejected debentures was duly refunded. All the calls were made and the moneys duly received.

Show the Journal Entries to record the above transactions and prepare the Balance Sheet of the company.

Solution:

**ABC Ltd.
Journal Entries**

S.No	Particulars	Debit (Rs)	Credit (Rs)
(i)	Bank A/c Dr. To 12% Debenture Application A/c (Being application money of Rs 25 each on 52,000 debentures received)	13,00,000	13,00,000
(ii)	12% Debenture Application A/c Dr. To 12% Debentures A/c To Bank A/c (Being allotment of 50,000 debentures as per board's resolution dated and 2,000 debentures rejected and refunded)	13,00,000	12,50,000 50,000
(iii)	12% Debenture Allotment A/c Dr. To 12% Debentures A/c (Being allotment money due on 50,000 debentures @ Rs 50 each)	25,00,000	25,00,000
(iv)	Bank A/c Dr. To 12% Debenture Allotment A/c (Being allotment money received)	25,00,000	25,00,000
(v)	12% Debenture First and Final call A/c Dr. To 12% Debentures A/c (Being call money due on 50,000 debentures @ Rs 25 each)	12,50,000	12,50,000
(vi)	Bank A/c – Dr. To 12% Debenture First and Final call A/c (Being the call money received)	12,50,000	12,50,000

**ABC Ltd.
Balance Sheet as on**

Particulars	Note	Rs
EQUITY AND LIABILITIES		
Non-Current Liabilities		
Long Term Borrowings	1	50,00,000
ASSETS		
Cash and cash equivalent		50,00,000

Notes to Account			
	Particulars	Note	Rs
1.	Long Term Borrowings		
	12% Debentures	1	50,00,000
2.	Cash and Cash Equivalent		
	Cash at Bank		50,00,000

ISSUE OF DEBENTURES AT PREMIUM

If the debentures are issued at a price higher than the nominal value of the debentures, the debentures are said to be issued at a premium. The excess of issue price over the nominal value is regarded as the premium amount.

In such a case, the Debentures Account should be credited only with the nominal value of the debentures and the premium should be credited to "Securities Premium Account". The accounting entry will be as follows:

 If premium amount received on application: -

Bank A/c Dr.
To Debenture Application A/c

Debenture Application A/c Dr.
To Debentures A/c
To Securities Premium A/c

 If premium amount received on allotment or any other call: -

Debenture Allotment/call A/c Dr.
To Debentures A/c
To Securities Premium A/c

Bank A/c Dr.
To Debenture Allotment/call A/c

Illustration 2.

Z Ltd. issued 2,500, 10% Debentures of Rs.100 each, a premium of 10% payable as Rs. 20 on application, Rs.50 on allotment (including the premium) and the balance on first & final call. The public applied for 3,500 debentures. Applications for 2,250 debentures were accepted in full, applicants for 500 were allotted 250 debentures, and remaining applications were rejected. All money was duly received.

Journalize these transactions.

Solution:

Z Ltd.

Journal Entries

S.No	Particulars	Debit (Rs)	Credit (Rs)
(i)	Bank A/c Dr. To Debenture Application A/c (Being application money received on 3,500 debentures)	70,000	70,000
(ii)	Debentures Application A/c Dr. To 10% Debentures A/c To Debentures Allotment A/c To Bank A/c (Being the application money adjusted and the surplus refunded)	70,000	50,000 5,000 15,000
(iii)	Debenture Allotment A/c Dr. To 10% Debentures A/c To Securities Premium A/c (Being the Amount due on allotment @ Rs. 50 on 2,500 debentures)	1,25,000	1,00,000 25,000
(iv)	Bank A/c Dr. To Debentures Allotment A/c (Being the Balance of the amount due on allotment received)	1,20,000	1,20,000
(v)	Debentures Call A/c Dr. To 10% Debentures A/c (Being the Amount due on Call @ Rs. 40 on 2,500 debentures)	1,00,000	1,00,000
(vi)	Bank A/c Dr. To Debentures Call A/c (Being the Amount due on call received)	1,00,000	1,00,000

ISSUE OF DEBENTURES AT DISCOUNT

If the debentures are issued at a price lower than the nominal value of the debentures, the debentures are said to be issued at a discount. The difference between the nominal value and the issue price is regarded as the discount. Such discount on issue of debentures may either be written off against revenue profit or capital profits of the company.

When debentures are issued at a discount the Debentures Account should be credited with the nominal value of the debentures and the discount allowed on issue of debentures, being a capital loss, should be debited to "Discount on Issue of Debentures Account". Thus, the accounting entry will be as follows:

@ Rs.25 per debenture)

To 14% Debenture First and 2,50,000

Final Call A/c

(First and final call money on 5,000

debentures @ Rs.50 per debenture)

4,75,000

4,75,000

Z Ltd.

Journal Entries

S.No	Particulars	Debit (Rs)	Credit (Rs)
(i)	14% Debenture Allotment A/c	Dr. 1,00,000	
	14% Debenture Allotment A/c	Dr. 1,25,000	
	Discount on Issue of Debentures A/c	Dr. 25,000	
	To 14% Debentures A/c		2,50,000
	(Allotment of 5,000 14% debentures of Rs. 100 each issued at a discount of 5% and allotment money due on 5,000 debentures @ Rs 25 per debenture as per Board's resolution dated.....)		
(ii)	14% Debenture First and Final Call A/c	Dr. 2,50,000	
	To 14% Debentures A/c		2,50,000
	(First and final call money due on 5,000 debentures @ Rs 50 per debentures as per Board's resolution dated.....)		

Z Ltd.		
Balance Sheet as on		
Particulars	Note	Rs.
EQUITY AND LIABILITIES		
Non-Current Liabilities		
Long-Term Borrowings	1	5,00,000
ASSETS	2	
Non-current assets		
		25,000
Other non-current assets		
Current Assets		
Cash and cash equivalent		4,75,000

Notes to Account		
1	Long-Term Borrowings	1
	14% Debentures	5,00,000
2	Other non-current assets	2
	Discount on the issue of debentures	25,000

DEBENTURES ISSUED FOR CONSIDERATION OTHER THAN CASH

It may so happen that the company acquires some assets from the vendor and instead of paying the vendor in cash, the company may allot debentures in payment of purchase consideration. The issue of debentures to vendors is known as issue of debentures for consideration other than cash. In such a case, the accounting entries will be as follows:

1. For acquisition of assets: -

Respective Asset A/c	Dr.
To Vendors A/c	



Important Points: -

- i. If the value of debentures allotted is more than the agreed purchase price, the difference is debited to Goodwill Account.

- ii. Similarly, if the value of debentures allotted is less than the agreed purchase price, credited to Capital Reserve Account.

2. On allotment of debentures

- at par

Vendors A/c	Dr.
To Debentures A/c	

- at premium

Vendors A/c	Dr.
To Debentures A/c	
To Securities Premium A/c	

- at discount

Vendors A/c	Dr.
Discount on issue of Debentures A/c	Dr.
To Debentures A/c	

Illustration 4.

Radha Ltd. purchased machinery worth Rs.1,20,000 and building worth Rs. 2,00,000 from Deepa Ltd. for an agreed purchase consideration of Rs. 3,00,000 to be satisfied by the issue of 3,000, 12% debentures of Rs. 100 each.

Show the necessary journal entries in the books of Radha Ltd.

Solution:

Radha Ltd.				
Journal Entries				
S.No	Particulars		Debit (Rs)	Credit (Rs)
1	Building A/c	Dr.	2,00,000	
	Plant and Machinery A/c	Dr.	1,20,000	3,00,000
	To Deepa Ltd.			
				20,000
	To Capital Reserve A/c			
	(Purchase of sundry assets and transfer of capital profits as per agreement with the vendor dated.....)			
2	Deepa Ltd.	Dr.	3,00,000	

To 12% Debentures A/c	3,00,000

(Being 3,000, 12% Debentures of Rs 100 each allotted to vendors for consideration other than cash as per Board's resolution dated.....)

DEBENTURES ISSUED AS COLLATERAL SECURITY

The term 'Collateral Security' implies additional security given for a loan. Where a company obtains a loan from a bank or insurance company, it may issue its own debentures to the lender as collateral security against the loan in addition to any other security that may be offered. In such a case, the lender has the absolute right over the debentures until and unless the loan is repaid. On repayment of the loan, however, the lender is legally bound to release the debentures forthwith. But in case the loan is not repaid by the company on the due date or in the event of any other breach of agreement, the lender has the right to retain these debentures and to realise them. The holder of such debentures is entitled to interest only on the amount of loan, but not on the debentures. Such an issue of debentures is known as "Debentures issued as Collateral Security".

Accounting Entries: The following are the two alternative ways by which debentures issued as collateral security can be dealt with:

1. No accounting entry is required to be shown in the books of account at the time of issue of such debentures for the simple reason that the loan against which the debentures are issued as collateral security has already been credited, the debit being given to Bank. But the existence of such debentures issued as collateral security has to be mentioned by way of a note on the Balance Sheet under the specific loan account.

Illustration 5.

B Ltd. secured an overdraft of Rs. 80,000 from the bank by issuing 900, 12% Debentures of Rs. 100 each as collateral security. Prepare the Balance Sheet of the Company.

Balance Sheet of Z Ltd. as at.....		
Particulars	Note	Amount (Rs.)
EQUITY AND LIABILITIES	1	
Current liability		
Short-term borrowings		80,000

2. If it is desired that such an issue of debentures as collateral security is to be recorded in the books of account, the accounting entries will be as follows: -

Debentures Suspense A/c Dr.
To Debentures A/c

In this case, Debentures Suspense Account will appear on the asset side of the balance sheet under the heading other non-current assets. Debentures Account will appear as a liability on the liabilities side of the Balance Sheet.

Debentures A/c Dr.
To Debentures Suspense A/c

Important Note: -

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Illustration 6.

B Ltd. secured an overdraft of Rs.80,000 from the bank by issuing 900,12% Debentures of Rs. 100 each as collateral security. Prepare the Balance Sheet of the Company.

Solution

Journal Entries

Debentures Suspense A/c	D r.	90,000
To Debentures A/c		
90,000		

(Issue of 900, 12% Debentures of Rs.100 each as collateral security for a bank overdraft of Rs. 80,000 as per Board's resolution dated.....)

Balance Sheet of Z Ltd. as at.....

Particulars	Note	Amount (Rs.)
EQUITY AND LIABILITIES	1	
Non-current liabilities		
		90,000
Long-term borrowings		
	2	
Current liability		
Short-term borrowings		90,000
ASSETS		
Non-Current Assets		
	3	
Other non-current assets		90,000

Notes to Account

	Particulars	Amount
1	Long-term borrowings	
	900, 12% Debentures of Rs.100 each	90,000

	(Issued as collateral security as per contra)	
2	Short-term borrowings	
	Bank Overdraft	80,000
	(Secured by the issue of 900, 12% Debentures of Rs.100 each as collateral security)	
3	Other non-current assets	
	Debentures Suspense Account	90,000
	(Issued as collateral security as per contra)	

TERMS OF ISSUE OF DEBENTURES

A company may issue debentures on any specific condition as to its redemption. The following possibilities are underway. The accounting treatments are also given below:

1. Issued at par and redeemable at par:

Bank A/c	Dr.
To Debentures A/c	

2. Issued at discount redeemable at par:

Bank A/c	Dr.
Discount on issue of Debentures A/c	Dr.
To Debentures A/c	

3. Issued at premium redeemable at par:

Bank A/c	Dr.
To Debentures A/c	
To Securities Premium A/c	

4. Issued at par redeemable at premium:

Bank A/c	Dr.
Loss on issue of Debentures A/c	Dr.
To Debentures A/c	
To Premium on redemption of Debentures A/c	

5. Issued at discount, but redeemable at premium

Bank A/c	Dr.
Discount on issue of Debentures A/c	Dr.

Loss on issue of Debentures A/c	Dr.
To Debentures A/c	
To Premium on Redemption of Debentures A/c	

OR

Bank A/c	Dr.
Loss on issue of Debentures A/c	Dr.
To Debentures A/c	
To Premium on redemption of Debentures A/c	

Important Note:

- Premium on Redemption of Debentures Account is shown as liabilities side of the balance sheet.
- Loss on Issue of Debentures Account is written off gradually every year during the life of the debentures. The unwritten off amount is shown in the balance sheet under **‘Other Current or other Non-Current Asset’**.
- Premium on Redemption of Debentures Account is transferred to debenture holders account at the time of redemption.

Illustration 8.

Journalize the following transactions.

Issue of 12%, 1,00,000 debentures of Rs. 100 each

1. at par and redeemable at par.
2. at 10% discount and redeemable at par.
3. at 10% premium and redeemable at par.
4. at 10% premium and redeemable at a premium of 5%.
5. at par and redeemable at a premium of 5%.
6. at 10% discount and redeemable at a premium of 5%.

Solution:

Journal Entries		(in '000)	
S.No	Particulars	Debit(Rs.)	Credit(Rs.)
(i)	Bank Account	Dr. 10,000	
	To 12% Debentures Account		10,000
	(Being 12% Debentures issued at par)		
(ii)	Bank Account	Dr. 9,000	
	Discount on Issue of Debentures Account	Dr. 1,000	
	To 12% Debentures Account		10,000
	(Being 12% debentures issued at 10% discount)		
(iii)	Bank Account	Dr. 11,000	
	To 12% Debentures Account		10,000
	To Securities Premium Account		1,000
	(Being 12% debentures issued at 10% premium)		
(iv)	Bank Account	Dr. 11,000	
	Loss on issue of debenture	Dr. 500	
	To 12% Debentures Account		10,000
	To Securities Premium Account		1,000
	To Premium on redemption of Debentures		500
	(Being 12% debentures issued at 10% premium and redeemed at 5% premium)		
(v)	Bank Account	Dr. 10,000	
	Loss on issue of Debentures Account	Dr. 500	
	To 12% Debentures Account		10,000
	To Premium on redemption of		500

Debentures			
(Being 12% debentures issued at par and redeemed at 5% premium)			
(vi)	Bank Account	Dr.	9,000
	Loss on Issue of Debentures Account	Dr.	1,500
	(1000+500)		10,000
	To 12% Debentures Account		500
	To Premium on redemption of		

Debentures

(Being 12% debentures issued at 10% discount and redeemed at 5% premium)

INTEREST ON DEBENTURES

Wherever a company issues debenture it undertakes to pay interest thereon at a fixed percentage. As the debentures acknowledge a debt, the payment of interest on the debt is obligatory on the part of the company issuing them irrespective of the fact whether the company earns profit or not. Thus, **interest payable on debentures is a charge against the profits of the company. Interest on debentures is normally payable half-yearly and it is calculated at the fixed percentage on the nominal value of debentures issued and not on the issue price.** Thus, the issue of debentures at par or at a premium or at a discount would not make any difference for the purpose of calculating interest on debentures. But, the effective rate of interest on the amount paid by the debenture holders would invariably differ in each of the above cases.

According to Income-tax Act, 1961 a company is liable to deduct income-tax at the prescribed rate from the gross amount of interest payable on debentures before the actual payment is made to the debenture holders and to deposit it with the Government. The balance amount after deduction of income-tax is actually payable to the debenture holders. This is known as deduction of tax at source.

It is important to note in this connection that if the debentures are tax-free, the income-tax on such interest will be paid by the company itself on behalf of the debenture holders.

However, the interest paid by the company has to be grossed up for calculating the interest expense of the company.

Accounting Entries: The following entries are required to be shown in the books of the company to deal with interest on debentures: -

1. On interest becoming due: -

Debenture Interest A/c	Dr.
To TDS or Tax Payable	
To Debenture holder A/c	

2. On payment of interest to the debenture holders: -

Debenture holder A/c	Dr.
To Bank A/c	

3. On payment of income-tax to the Government: -

Tax Payable or TDS A/c	Dr.
To Bank A/c	

4. On transfer of Debenture Interest to Profit and Loss Account at the end of the year: -

Profit/Loss A/c	Dr.
To Debenture Interest	

Notes:

- Until and unless Tax payable/TDS payable is deposited by the company with the Government it will be treated as a liability and shown as a current liability in the of the Balance Sheet.
- While transferring Debenture Interest to Profit and Loss Account at the end of the period, it should be carefully noted whether interest for the full period for which the accounts are being prepared has been provided for or not. If not, the same has to be adjusted first before transferring it to the Profit and Loss Account.
- If the debentures are tax-free, the interest payable on debentures has to be grossed up. Since no company can really issue debentures on which no tax is payable. In this case, tax-free means that the relevant tax will be paid by the company.

Illustration 7.

M Ltd. had issued Rs. 5,00,000, 10% debentures on which interest was payable half-yearly on 30th September and 31st March. Show the necessary journal entries relating to debenture interest for the year ended 31st March, 2018 assuming that all moneys were duly paid by the company. Tax deducted at source is 10%.

Solution:

M Ltd.				
Journal Entries				
Date	Particulars		Debit (Rs)	Credit (Rs)
2017	Debenture Interest A/c	Dr.	25,000	
Sep,30	To Income-tax Payable A/c			2,500
	To Debenture-holders A/c			22,500
	(Interest due on Rs 5,00,000, 10% debentures for 6 months and income-tax deducted at source thereon @ 10%)			
Sep,30	Debenture-holders' A/c	Dr.	22,500	
	To Bank			22,500
	(Payment of interest to debenture-holders)			
Sep,30	Income-tax Payable A/c	Dr.	2,500	
	To Bank			2,500
	(Deposit of income-tax deducted at source from Debenture Interest with the Government)			
March,31	Debenture Interest A/c	Dr.	25,000	
	To Income-tax Payable A/c			2,500
	To Debenture-holders A/c			22,500
	(Interest due on Rs 5,00,000, 10% debentures for 6 months and income-tax deducted at source thereon @ 10%)			
2018	Debenture-holders' A/c	Dr.	22,500	
	To Bank			22,500
	(Payment of interest to debenture-holders)			
March,31	Income-tax Payable A/c	Dr.	2,500	

			2,500
	To Bank		
	(Deposit of income-tax deducted at source from		
	Debenture Interest with the Government)		
March,31	Profit and Loss A/c	Dr. 50,000	
			50,000
	To Debenture Interest A/c		
	(Transfer of Debenture Interest to Profit and Loss A/c)		

WRITING OFF THE DISCOUNT ON ISSUE OF DEBENTURES

Discount on issue of debentures is a *capital loss** of the company and it is required to be shown on the assets side of the Balance Sheet under the heading Other Current or other non-current asset until written off. Although, there is no legal obligation on the part of the company to write off such a loss, sound business policy demands that it should be written off as quickly as possible.

** capital losses are those which occur when selling fixed assets or raising share capital. If a building purchased for Rs. 5,00,000 is sold for Rs. 4,50,000, there will be capital loss of Rs. 50,000. Similarly, when shares of the face value of Rs. 10 are issued at Rs. 9 i.e. at a discount of Rs. 1, the amount of discount will be a capital loss.*

Discount on issue of debentures can be treated in any of the following two ways:

1. Discount on issue of debentures being a capital loss, can be written off against *capital profits***.
2. Discount on issue of debentures can be treated as *deferred revenue expenditure**** and written off against revenue over the period of life of the debentures.

*** Capital profits are those which are earned as a result of selling some fixed assets, or in connection with raising capital for the firm. For instance, a building purchased for Rs. 4,50,000 was subsequently sold for Rs. 4,75,000, this Rs. 25,000 will be profit of capital nature. Similarly, when a company issues its shares of the face value Rs. 10 for Rs. 11 each, it is said that shares have been issued at a premium, the amount of premium being a capital profit. Capital profits are either capitalized i.e. transferred to capital account or transferred to capital reserve account which may be utilized for meeting capital losses.*

*** *deferred revenue expenditure is revenue in character but —*

- (i) *the benefit of which is not exhausted in the year of expenditure, or*
- (ii) *is applicable either wholly or in part to the future years, or*
- (iii) *is accidental with heavy amount and it is not prudent to charge it against the profit of one year.*

In case there is no capital profit and it is decided to treat discount on issue of debentures as deferred revenue expenditure, it is desirable to write it off against revenue over the period of life of the debentures on an equitable basis. The following are the two methods which are generally adopted for this purpose.

1. **Fixed Instalment Method:** Under this method, the total amount of discount allowed on issue of debentures is spread over the life of the debentures equally and every year a fixed amount is written off against revenue. For example, if the total discount allowed on issue of debentures is Rs. 10,000 and the debentures are issued for 10 years, the amount of discount to be written off every year will be 1/10th of the total discount, i.e., every year an amount equal to $(1/10 \times 10,000) = 1,000$ will be written off over a period of 10 years. At the end of the 10th year Discount on Issue of Debentures Account would be completely written off. This method is simple and can be applied only if the debentures are redeemed at the expiry of the period. This method has the advantage of spreading the burden of discount equally over the period of the debentures.
2. **Fluctuating Instalment Method:** Where debentures are redeemed by annual drawings, the first method is not suitable for the simple reason that the burden of discount is equally spread over the period of life of the debentures. Under this method, the amount of discount to be written off every year should bear a proportion to the debentures outstanding at the beginning of each year. Thus, the amount of discount to be written off every year under this method cannot be fixed and will go on diminishing every year, i.e., the burden of discount will be in proportion to the benefits derived out of the debentures. The initial year should bear a greater burden of discount than the subsequent years as each subsequent year has the use of a lesser amount of debentures. Let us take an example as follows:

Illustration 9.

Bee Ltd. issued 2,000, 12% Debentures of Rs.100 each at a discount of 6% on 01.04.2009 repayable by equal annual drawings in four years.

You are required to show the discount on Issue of Debentures Account over the period.

Solution:

Total amount of discount on issue of debentures:

$$= \text{Rs. } 2,00,000 \times 6/100 = \text{Rs. } 12,000$$

This total discount of Rs. 12,000 has to be written off in proportion to the debentures outstanding at the beginning of each year. Thus, outstanding balance ratio will be as follows:

$$1.4.2009 = \text{Rs. } 2,00,000$$

$$1.4.2010 = \text{Rs. } (2,00,000 - 50,000) = \text{Rs. } 1,50,000$$

$$1.4.2011 = \text{Rs. } (1,50,000 - 50,000) = \text{Rs. } 1,00,000$$

$$1.4.2012 = \text{Rs. } (1,00,000 - 50,000) = \text{Rs. } 50,000$$

$$\text{Outstanding balance ratio} = 2,00,000 : 1,50,000 : 1,00,000 : 50,000$$

$$= 4 : 3 : 2 : 1$$

Therefore, amount of discount to be written off every year will be as follows:

	Rs.
31.3.2010 = $12,000 \times 4/10 =$	4,800
31.3.2011 = $12,000 \times 3/10 =$	3,600
1.3.2012 = $12,000 \times 2/10 =$	2,400
31.3.2013 = $12,000 \times 1/10 =$	1,200

Total 12,000

Illustration 10

Nalayak Ltd. issued 1,000, 12% Debentures of Rs. 100 each at a discount of 10%. The terms of issue provided the repayment of the debentures at par by annual drawing of Rs. 20,000 **over a period** of 5 years. How should the amount of discount to be written off be determined?

Solution:

The total discount on issue of debentures is Rs. 10,000. This total discount of Rs. 10,000 has to be written off in proportion to the debentures outstanding at the beginning of each year. Thus, outstanding balance ratio will be as follows:

1st year	...	...	=	Rs. 1,00,000
2nd Year	Rs. (1,00,000 - 20,000)		=	Rs. 80,000
3rd Year	Rs. (80,000 - 20,000)		=	Rs. 60,000
4th Year	Rs. (60,000 - 20,000)		=	Rs. 40,000
5th Year	Rs. (40,000 - 20,000)		=	Rs. 20,000

Outstanding balance ratio = 1,00,000 : 80,000 : 60,000 : 40,000 : 20,000
= 5 : 4 : 3 : 2 : 1

Therefore, amount of discount to be written off every year will be as follows:

1st Year	=	Rs. 10,000 x 5/15	=	Rs. 3,333
2nd Year	=	Rs. 10,000 x 4/15	=	Rs. 2,667
3rd Year	=	Rs. 10,000 x 3/15	=	Rs. 2,000
4th Year	=	Rs. 10,000 x 2/15	=	Rs. 1,333
5th Year	=	Rs. 10,000 x 1/15	=	Rs. 667
Total				Rs. 10,000

Accounting Entries: Every year, when the discount on issue of debentures is written off against revenue, the following entry is required to be shown in the books of the company:

Profit/Loss A/c	Dr.
To Discount on issue of Debentures A/c	

LOSS ON ISSUE OF DEBENTURES

If a company issues debenture at par or at a discount which are redeemable at a premium, the premium payable on redemption of the debentures should also be treated as capital loss and as such it should be dealt with in the same manner as 'Discount on Issue of Debentures'.

Redemption of debentures at a premium is a known loss at the time of issue of debentures as the terms of issue generally contain such provisions for redemption. As such, it would be prudent on the part of the company to write off such loss during the life time of the debentures. The loss to be incurred by a company for a particular issue of debentures is ascertained in the following manner:

- (i) If the debentures are issued at par and redeemable at a premium, the loss will be equal to the amount of premium payable on redemption.
- (ii) if the debentures are issued at a discount and redeemable at a premium, the loss will be equal to the total of the amount of discount on issue and the amount of premium on redemption.

Thus, total loss = Discount on issue of Debentures + Premium Payable on redemption of debentures. In such a case, there is no need to debit Discount on Issue of Debenture Account. Instead, "Loss on Issue of Debentures Account" should be debited with total loss.

When debentures are redeemable at a premium the liability for premium payable on redemption is recorded in the books at the time of issue of the debentures although the actual liability will arise only at the time of redemption. The main advantage derived by the company is that the loss on issue of debentures is completely written off before the debentures are due for redemption.

Accounting Entries: The following accounting entries are required to be shown in the books of the company:

1. On issue of debentures: -

Bank A/c	Dr.
Loss on issue of Debentures A/c	Dr.
To Debentures A/c	
To Premium on redemption of Debentures A/c	

2. On writing off loss on issue of debentures every year against revenue: -

Profit/Loss A/c	Dr.
To Loss on issue of Debentures A/c	

3. On redemption of debentures: -

Debentures A/c	Dr.
Premium on redemption of Debentures A/c	Dr.
To Debenture holders A/c	
Debenture holders A/c	Dr.
To Bank A/c	

Note:

- "Premium on Redemption of Debentures Account" will appear as a liability in the Balance Sheet until it is paid at the expiry on the life-time of the debentures.
- On redemption of the debentures the liability for the premium on redemption of debentures is wiped out.

CHAPTER 9

REDEMPTION OF DEBENTURES

Meaning

Redemption of debentures refers to the discharge of liability in respect of the debentures issued by a company. According to Section 71 (1) of the Companies Act, 2013, a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. According to Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014, the company shall not issue secured debentures, unless it complies with the following conditions, namely: -

- An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue. Provided that a company engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years.

Creation of debenture redemption reserve account

Section 71(4) states that when debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions:

Rule 18 (1)

The company shall not issue secured debentures, unless it complies with the following conditions, namely:-

- (a) An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue.

Provided that the following classes of companies may issue secured debentures for a period exceeding ten years but not exceeding thirty years,

- Companies engaged in setting up of infrastructure projects;
- 'Infrastructure Finance Companies

- (iii) Companies permitted by a Ministry or Department of the Central Government or by Reserve Bank of India or by the National Housing Bank or by any other statutory authority to issue debentures for a period exceeding ten years.]

Rule 18 (7)

The company shall comply with the requirements with regard to Debenture Redemption Reserve (DRR) and investment or deposit of sum in respect of debentures maturing during the year ending on the 31st day of March of next year, in accordance with the conditions given below:-

- (a)** Debenture Redemption Reserve shall be created out of profits of the company available for payment of dividend;
- (b)** the limits with respect to adequacy of Debenture Redemption Reserve and investment or deposits, as the case may be, shall be as under;-
 - (i)** Debenture Redemption Reserve is not required for debentures issued by All India Financial Institutions regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures;
 - (ii)** For other Financial Institutions within the meaning of clause (72) of section 2 of the Companies Act, 2013, Debenture Redemption Reserve shall be as applicable to Non - Banking Finance Companies registered with Reserve Bank of India.
 - (iii)** For listed companies (other than All India Financial Institutions and Banking Companies as specified in sub-clause (i)), Debenture Redemption Reserve is not required in the following cases –
 - (A)** in case of public issue of debentures
 - A. for NBFCs registered with Reserve Bank of India under section 45-IA of the RBI Act, 1934 and for Housing Finance Companies registered with National Housing Bank;
 - B. for other listed companies;
 - (B)** in case of privately placed debentures, for companies specified in sub-items A and B.
 - (iv)** for unlisted companies, (other than All India Financial Institutions and Banking Companies as specified in sub-clause (i) –

- (C) for NBFCs registered with RBI under section 45-IA of the Reserve Bank of India Act, 1934 and for Housing Finance Companies registered with National Housing Bank, Debenture Redemption Reserve is not required in case of privately placed debentures.
- (D) for other unlisted companies, the adequacy of Debenture Redemption Reserve shall be ten percent. of the value of the outstanding debentures;
- (v) In case a company is covered in item (A) of sub-clause (iii) of clause (b) or item (B) of sub-clause (iv) of clause (b), it shall on or before the 30th day of April in each year, in respect of debentures issued by such a company, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent. , of the amount of its debentures maturing during the year, ending on the 31st day of March of the next year in any one or more methods of investments or deposits as provided in sub-clause (vi):

Provided that the amount remaining invested or deposited, as the case may be, shall not any time fall below fifteen percent of the amount of the debentures maturing during the year ending on 31st day of March of that year

- (vi) for the purpose of sub-clause (v), the methods of deposits or investments, as the case may be, are as follows:-

- (E) in deposits with any scheduled bank, free from any charge or lien;
- (F) in unencumbered securities of the Central Government or any State Government;
- (G) in unencumbered securities mentioned in sub-clause (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;
- (H) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882:

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

- (c) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule.
- (d) the amount credited to Debenture Redemption Reserve shall not be utilized by the company except for the purpose of redemption of debentures.

MOBILISATION OF FUNDS FOR REDEMPTION OF DEBENTURES

If no provision is made for mobilising additional funds required for the redemption of the debentures, the company may find great difficulty in discharging the liability when the debentures become due for payment.

In order to overcome the above difficulties, the following courses of actions are open to the company for mobilizing the additional funds required at the time of redemption:

- 1. Utilising a part of the profits of the company:** A part of the profits may be withheld (*deducted*) and utilised by the company for the purpose of redemption of the debentures. Here again, the company is having the following options:
 - a) The amount of profits withheld by the company may be retained in the business itself as owned capital in the form of General Reserve.
 - b) The amount of profits withheld by the company may be withdrawn from the business and the same may be invested either:
 - (i) in readily convertible securities, or
 - (ii) in taking out an insurance policy to provide funds when needed.
- 2. Raising the capital:** In order to provide for additional funds required for the redemption of the debentures, the company may issue new shares or debentures for the purpose. Old debentures will be redeemed out of the proceeds of fresh issue and the new share capital or debentures will take the place of the old debentures.
- 3. Disposing of the assets of the company:** Additional funds required for the redemption of debentures may also be provided by the company by disposing of some of its fixed assets.

METHODS OF REDEMPTION OF DEBENTURES

a) By annual drawings

Under this method, a certain portion of the total debentures is redeemed every year over the life-time of the debentures and thus at the end, the debentures are fully redeemed. Which debenture should be paid in which year usually depends on the drawings. What is actually done is that slips bearing the number of debentures are mixed up and put into a drum and then as many slips as the debentures to be redeemed are taken out of the drum at random. This procedure is known as "Drawing by lot". The amount of debentures to be redeemed every year is generally calculated by dividing the total amount of the debentures by the

number of years for which they have been issued. In such a case, the amount of annual drawings will be equal. But the amount of annual drawings may also be unequal in some cases.

When debentures are redeemed by annual drawings, the amount of annual drawings should be transferred to General Reserve Account out of the profits of the company and the same need not be invested in any other way.

b) By payment in one lump sum at the expiry of a specified period

Under this method the entire amount of the debenture debt is paid to the debentureholders in one lump sum at the expiry of a specified period, i.e., at maturity or at the option of the company at a date within such specified period according to the terms of issue.

As the amount involved is large and the date on which debentures have to be redeemed is known to the company well in advance, it is possible for the company to make necessary arrangement to provide for the additional funds required for the debentures from the very beginning.

In such a case, the best method is to set aside every year throughout the life of the debentures a part of the profits of the company which would otherwise be available for dividend and to invest the same in readily convertible securities together with compound interests at a fixed rate will amount to the sum required to pay off the debentures at the specified date. The investments, thus made, are sold when the debentures become due for payment. This method ensures the availability of sufficient cash for the redemption of debentures when they become due and is known as "Sinking Fund method".

c) By purchase of debentures in the open market

Under this method, a company may purchase its own debentures in the open market if it seems to be convenient and profitable to the company. When the market price of the debentures goes down below par or debentures are quoted at a discount on the stock exchange, the company usually takes the opportunity to buy the debentures in the open market and to cancel them. Own debentures may, also, be purchased by the company for its own investment when it is desired to keep the debentures alive with a view to issuing them in future. The law does not prohibit a company from purchasing its own debentures unless the terms of issue specify otherwise.

In such a case, the purchase of debentures can be made out of the amount realised on sale of investments where *sinking fund** exists. Where there is no sinking fund, the debentures can be purchased out of the company's cash balance.

** a fund formed by periodically setting aside money for the gradual repayment of a debt or replacement of a wasting asset.*

d) By conversion into shares

A company may issue convertible debentures giving option to the debentureholders to exchange their debentures for equity shares or preference shares in the company. The debentureholders are given the right on certain dates or before a specified date to exchange the debentures for the shares. A certain number of shares are offered for each debenture. When the debenture-holders exercise this option and the company issues the shares, it is referred as redemption by conversion.

REDEMPTION OF DEBENTURES OUT OF PROFIT

The company withholds a part of divisible profits for redeeming the debentures. The amount of profit is reduced to the extent of the debentures to be redeemed and hence not available for distribution by way of dividends among the shareholders. The payment to debentureholders in such a case is out of profit earned in the course of the business and therefore it is termed as redemption out of profits. Thus, the existing liquid resources are not affected by redemption in this method.

There are two options available to the company in regard:

- A.** The amount of divisible profits withheld by the company may be retained in the business itself as a source of internal financing i.e. in the form of general reserve and no investment is made outside to provide cash for redemption. **In such a case, the following journal entries are passed:**

1. On debentures becoming due for payment: -

Debentures A/c Dr.
To Debentureholder A/c

2. On redemption: -

Debentureholder A/c Dr.
To Bank A/c

3. On transfer of profit equal to face value of debentures to Debenture Redemption Reserve (D.R.R.): -

Profit/Loss appropriation A/c Dr.
To Debenture Redemption Reserve A/c

Reserve:

To General Reserve A/c

- (i) readily marketable securities, or
- (ii) taking out insurance policy to provide funds when required. In either case, the profit set aside will be accumulated in an account styled as Debenture Redemption Fund or Sinking Fund.

a) Debenture Redemption Fund/Sinking Fund Method

ACCOUNTING ENTRIES

First Year (at the end)

- For creation of sinking fund i.e. on transfer of profit to sinking fund A/c:-
Profit/Loss Appropriation A/c Dr.

To Sinking Fund A/c
- The amount appropriated is invested in readily marketable securities:-
Sinking Fund Investment A/c Dr.

To Bank A/c

{*Debenture Redemption Fund Investment Account will appear on the Assets side of the Balance Sheet while Debenture Redemption Fund Account will appear on the Liabilities side of the Balance Sheet, under the head “Reserves and Surplus”.}

Second and subsequent years over the life of the Debentures excepting the last year (at the end)

- 1. When interest on Debenture Redemption Fund Investment is received: -**
- | | |
|--|-----|
| Bank A/c | Dr. |
| To Interest on Sinking Fund Investment A/c | |

☠️ {Rate of interest on investment will be calculated with reference to the face value of investments}

2. On transfer of interest to Debenture Redemption Fund: -

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

3. When annual instalment is appropriated out of profits: -

Profit/Loss Appropriation A/c Dr.
To Sinking Fund A/c

4. When annual amount appropriated plus the interest received is invested in securities: -

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

In the last year when the debentures become due for redemption (at the end) –

1. On receipt of interest on Debenture Redemption Fund Investment: -

Bank A/c Dr.
To Interest on Sinking Fund Investment A/c

2. On transfer of the interest to sinking fund: -

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

3. When annual instalment is appropriated out of profits: -

Profit/Loss Appropriation /c Dr.
To Sinking Fund A/c

 ***{No investment should be made in the last year for the simple reason that payment have to be made to the Debentureholders in the last year by realising the investments. Therefore, there is no logic behind making investment in the last year and then immediately realising the same.}***

4. When sinking fund investments are sold to provide cash for the redemption (if there is any profit or loss on sale of investments, the same is also to be transferred to Debenture Redemption Fund Account.): -

i. When sold at profit: -

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

ii. When sold at loss: -

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

5. On transfer of Debentures to Debenture holders Account for payment to be made i.e. when debentures are redeemable ----

i. At Par: -

Debentures A/c	Dr.
To debenture holder A/c	

ii. At Premium: -

Debentures A/c	Dr.
Premium on redemption of Debentures A/c	Dr.
To Debenture holder A/c	

6. On Payment to Debenture holders: -

Debenture holder A/c	Dr.
To Bank A/c	

7. On transfer of Premium on Redemption of Debentures to Debenture Redemption Fund Account: -

 *(In case Premium on Redemption of Debentures Account is not opened at the time of issue of debentures)*

Sinking Fund A/c	Dr.
To premium on redemption of Debentures A/c	

8. On transfer of Loss of Issue of Debentures Account to Debenture Redemption Fund Account: -

 *(In case the loss on Issue of Debentures Account is not yet written off)*

Sinking Fund A/c	Dr.
To loss on issue of Debentures A/c	

9. On transfer of Debenture Redemption Fund Account balance to General Reserve (after redemption): -

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

 ***{While transferring the balance of debenture redemption fund to general reserve, the profit on cancellation of debentures and profit on sale of investments transferred to debenture redemption fund account should be eliminated and the same should be transferred to capital reserve.}***

Notes:

1. If the Debentures are redeemable at a premium, the total amount to be accumulated in Debenture Redemption Fund Account must include the amount of premium.
2. This method assumes the availability of profits and sufficient cash investments.
3. Sometimes, it may so happen that Sinking Fund may be non-cumulative. In such a case, the interest received on investments should not be credited to the Sinking Fund nor should it be invested. Instead, interest should be treated as interest earned as on general investment and credited to Profit and Loss Account.
4. The balance in the Debenture Redemption Fund is transferred to General Reserve Account after the redemption of debentures.

Sinking Fund to Replace an Asset and to Repay a Liability - The sinking fund is created to provide the cash on the known date for two specific purposes (a) to replace an asset and (b) to redeem debentures (liability).

Though in practice the sinking funds for redemption of a liability and that for replacement of an asset operate in a similar manner yet there are some differences as stated below:

- (i) The annual instalment set aside for sinking fund for the replacement of an asset is really depreciation and is a charge against profit and therefore it is debited to profit and loss account. On the other hand, in case of sinking fund created for redemption of a liability, the annual instalment is an appropriation of profit and debited to profit and loss appropriation account since the purpose is to accumulate profits and not to distribute dividends until the liability is repaid.
- (ii) At the end of the estimated useful life of the assets, the sinking fund investments are sold to replace the old asset. The ultimate balance in sinking fund account then is utilised to write off the book value of the old asset requiring replacement. The sinking fund is therefore extinguished. In the other case, the sale proceeds of the investments would be utilised to discharge the liability involving the closure of liability account and sinking fund investment account. The balance in the sinking fund account is transferred to general reserve. It is in the nature of free reserves and which can be used to pay dividends at the discretion of the company.

b) Insurance Policy Method

Under this method also, profits are set aside and credited to Debenture Redemption Fund Account in the same manner as it is done in case of Sinking Fund Method. But instead of investing the amount of profit set aside in readily convertible securities an Insurance Policy is taken out for the required sum and an amount equal to the profit set aside is paid as premium. Thus, at the maturity of the policy, the required cash would be available for carrying out redemption of debentures. **This method differs from the Sinking Fund Method in respect of interest on investment. Unlike Sinking Fund Method, interest will not be received every year but will accrue at a fixed rate. The total amount of premium will always be less than the amount of policy. Thus, the difference between the policy amount and the total amount of premium paid on the policy is the total amount of interest that accrues on the premiums paid.**

The main advantage of this method is that the policy is not subscribed to any fluctuation in prices unlike securities in the Sinking Fund Method and as such the exact sum insured will be available at maturity. However, the following disadvantages may be accounted for:

- (i) the annual rate of interest is lower than that obtainable from investments; and
- (ii) if the policy is cancelled on account of non-payment of premium, the surrender value will be very much less than the amount which has been paid by way of annual premiums.

The accounting entries will be as follows:

All the years till the maturity of the policy (including the last year): -

1. For payment of insurance premium at the beginning of the year: -

Debenture Redemption Fund Policy A/c	Dr.
To Bank A/c	

2. For transfer of profit to Debenture Redemption Fund Account at the end of the year:

-

Profit/Loss Appropriation A/c	Dr.
To Debenture Redemption Fund A/c	

In the last year on maturity of the policy: -

In addition to the above two entries, the following entries are also required on maturity of the policy at the end of the last year.

1. On realisation of the policy amount from the Insurance Company: -

Bank A/c	Dr.
To Debenture Redemption Fund Policy A/c	

2. On transfer of accrued interest or say for profit on insurance policy (i.e. the difference between the policy amount and the total premium paid) to Debenture Redemption Fund Account: -

Debenture Redemption Fund Policy A/c	Dr.
To Debenture Redemption Fund A/c	

3. On transfer of Debentures Account to Debentureholders' Account for payment to be made i.e. when debentures are to be redeemed: -

i. At par: -

Debentures A/c	Dr.
To Debenture holder A/c	

ii. At premium: -

Debentures A/c	Dr.
Premium on Redemption of Debentures A/c	Dr.
To Debenture holder A/c	

4. On payment: –

Debenture holder A/c	Dr.
To Bank A/c	

5. On transfer of Premium on Redemption of Debentures to Debenture Redemption Fund A/c

 **(In case Premium on Redemption of Debenture Account is not opened at the time of issue of debentures): -**

Debenture Redemption Fund A/c	Dr.
To Premium on Redemption of Debentures	

6. On transfer of Loss of Issue of Debentures Account to Debenture Redemption Fund Account

 **(In case Loss on Issue of Debentures Account is not yet written off): -**

Debenture Redemption Fund A/c	Dr.
To loss on issue of Debentures A/c	

7. On transfer of Debenture Redemption Fund Account balance to General Reserve -

Debenture Redemption Fund A/c	Dr.
To General Reserve A/c	

REDEMPTION OUT OF THE PROCEEDS OF FRESH ISSUE OF SHARES OR DEBENTURES

Debentures may be redeemed from the funds raised by the issue of fresh shares or debentures. Accounting entries are to be passed for fresh issue of shares/ debentures apart from the entries for redemption. The following entries will be passed:

1. On issue of fresh shares or debentures: -

Bank A/c	Dr.
To Share Capital/Debentures A/c	



Note: - Here shares or Debentures can be issued at par or at premium also.

2. On Redemption of old debentures: -

Debentures A/c	Dr.
To Debentureholders A/c	

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



Important Points:



Working capital remains intact as the new share capital or debenture takes the place of old debentures.



If the fresh issue is made at a premium or at a discount the entry should be passed accordingly.



If the debentures are redeemable at a premium, Premium on Redemption of Debentures A/c should be credited at the time of issue by debiting Loss on Issue of Debentures A/c and before the payment is made, the same should be transferred to Debenture holders A/c.



The creation of Debenture Redemption Reserve may not be necessary in this case since the additional capital or debentures raised for the purpose of redemption of debentures replaces the existing debentures.

REDEMPTION OUT OF SALE PROCEEDS OF ASSETS OF THE COMPANY

When debentures are redeemed out of the sale proceeds of assets of the company, the accounting treatment is as follows:

(i) On sale of assets-

Bank A/c	Dr.
To Respective Assets A/c	



Important Point:

The profit or loss on sale of the asset will be transferred to profit and loss account and the entries for redemption will be the same as discussed before.

PURCHASE OF DEBENTURES IN THE OPEN MARKET

A company if authorized by its articles of association, can buy its own debentures in the open market. The debentures so purchased can be used either for:

- i. immediate cancellation, or
- ii. redemption of debentures or for investment. The debentures so purchased for investment can subsequently either be
 - a) reissued when the company requires additional cash, or
 - b) be cancelled if the company so desires.

Debentures when purchased for investment are popularly known as “Own Debentures”. This can be categorised as follows:

1. Purchase of debentures for immediate cancellation.
2. Purchase of debentures as investment:
 - a. Debentures so purchased may be kept as investment and can again be re-issued if the company so wishes.
 - b. Debentures so purchased may subsequently be cancelled if the company so desires.

PURCHASE OF DEBENTURES FOR IMMEDIATE CANCELLATION

a) When there is no sinking fund: -

1. On purchase and cancellation of debentures at par: -

Debentures A/c	Dr.
To Debentureholders A/c	

Debentureholders A/c	Dr.
To Bank A/c	

2. On purchase and cancellation of debentures at discount: -

Debentures A/c	Dr.
To Debentureholders A/c	
To Profit on cancellation of Debentures A/c	

Debentureholders A/c	Dr.
To Bank A/c	

3. On purchase and cancellation of debentures at premium: -

Debentureholders A/c	Dr.
Loss on cancellation A/c	Dr.
To Debentureholders A/c	

Debentureholders A/c	Dr.
To Bank	

Since, profit on cancellation is a capital profit, the same should be transferred to Capital Reserve A/c, of which entry will be: -

Profit on cancellation of Debentures A/c	Dr.
To Capital Reserve A/c	

While loss on cancellation of debentures is a capital loss and hence should be adjusted against either capital profit or security premium or Profit/loss A/c, of which entry will be: -

Profit/Loss A/c	Dr.
Capital Reserve A/c	Dr.
Security Premium A/c	Dr.
To Loss on cancellation of Debentures A/c	

4. Amount equal to the nominal value of the debentures cancelled should be transferred to either General Reserve/ Debenture Redemption Reserve: -

P/L appropriation A/c	Dr.
To General Reserve A/c	
To Debenture Redemption Reserve A/c	

b) When there is Sinking fund: -

1. When sinking fund investments are sold: -

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

i. For profit on sale of investment: -

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

ii. For loss on sale of investment: -

Sinking Fund A/c	Dr.
Sinking Fund Investment A/c	

2. On purchase and cancellation of debentures: -

i. At par: -

Debentures A/c	Dr.
To Bank A/c	

ii. At discount: -

Debenture A/c	Dr.
To Bank A/c	
To Profit on cancellation of Debentures A/c	

iii. At profit: -

Debentures A/c	Dr.
Loss on cancellation A/c	Dr.
To Bank A/c	

Since, profit on cancellation is a capital profit, the same should be transferred to Sinking Fund A/c, of which entry will be: -

Profit on Cancellation A/c	Dr.
To Sinking Fund A/c	

While loss on cancellation of debentures is a capital loss and hence should be adjusted against either capital profit or security premium or Profit/loss A/c, of which entry will be: -

Sinking Fund A/c	Dr.
To Loss on Cancellation of Debentures A/c	

3. Amount equal to the nominal value of the debentures cancelled should be transferred to either General Reserve/ Debenture Redemption Reserve: -

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

PURCHASE OF DEBENTURES AS INVESTMENT (OWN DEBENTURES)

a) When there is no sinking fund: -

1. When Debentures are purchased at investment: -

Own Debentures A/c	Dr.
To Bank A/c	

2. When debentures are cancelled: -

- i. At par: -

Debentures A/c	Dr.
To Own Debentures A/c	

- ii. At Profit: -

Debenture holders A/c	Dr.
To Own Debentures A/c	
To Profit on cancellation of Debentures A/c	

- iii. At Loss: -

Debentures A/c	Dr.
Loss on cancellation A/c	Dr.
To Bank	

Since, profit on cancellation is a capital profit, the same should be transferred to Capital Reserve A/c, of which entry will be: -

Profit on cancellation of Debentures A/c	Dr.
To Capital Reserve A/c	

While loss on cancellation of debentures is a capital loss and hence should be adjusted against either capital profit or security premium or Profit/loss A/c, of which entry will be: -

Profit/Loss A/c	Dr.
Capital Reserve A/c	Dr.
Security Premium A/c	Dr.
To Loss on cancellation of Debentures A/c	

3. Amount equal to the nominal value of the debentures cancelled should be transferred to either General Reserve/ Debenture Redemption Reserve: -

P/L appropriation A/c Dr.

To General Reserve A/c
To Debenture Redemption Reserve A/c

b) When there is Sinking fund: -

1. When sinking fund investments are sold: -

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

i. For profit on sale of investment: -

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

ii. For loss on sale of investment: -

Sinking Fund A/c Dr.
Sinking Fund Investment A/c

2. On purchase of Debentures as investment: -

Own Debentures A/c Dr.
To Bank A/c

3. When own debentures are subsequently cancelled: -

i. At Par: -

Debentures A/c Dr.
To Own Debentures A/c

ii. At Profit: -

Debentures A/c Dr.
To Own Debentures A/c
To Profit on cancellation A/c

iii. At Loss: -

Debentures A/c Dr.
Loss on cancellation A/c Dr.
To Own Debentures A/c

Since, profit on cancellation is a capital profit, the same should be transferred to Sinking Fund A/c, of which entry will be: -

Profit on Cancellation A/c Dr.
To Sinking Fund A/c

While loss on cancellation of debentures is a capital loss and hence should be adjusted against either capital profit or security premium or Profit/loss A/c, of which entry will be: -

Sinking Fund A/c	Dr.
To Loss on Cancellation of Debentures A/c	

4. Amount equal to the nominal value of the debentures cancelled should be transferred to either General Reserve/ Debenture Redemption Reserve: -

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

Note:

- If there is any profit or loss on sale of investments the same has to be transferred to Debenture Redemption Fund Account.
- Own Debentures Account signifies investment and will be shown as an asset in the Balance Sheet unless such debentures are re-issued or cancelled in future.
- Until and unless, these debentures are re-issued or cancelled in future, the question of profit or loss on redemption of debentures will not arise.
- If there is any difference between the nominal value of the debentures cancelled and the amount standing to the debit of Own Debentures Account, the same has to be treated as profit or loss on redemption of debentures and should be credited or debited to Profit on Redemption of Debentures Account or Loss on Redemption of Debentures Account.
- If Sinking Fund exists, the accounts of profit on redemption of debentures or loss on redemption of debentures should be transferred to debenture redemption fund account.
- If no Sinking Fund exists it is desirable that an amount equal to the nominal value of the debentures cancelled should be transferred to Debenture Redemption Reserve Account out of the profit of the company on cancellation.
- If Sinking Fund exists, on cancellation, an amount equal to the nominal value of the debentures cancelled should be transferred to General Reserve from the Debenture Redemption Fund Account.

INTEREST ON OWN DEBENTURES

The purchase of its own debentures by a company involves the question of adjustment of interest payable on these debentures. As soon as the company purchases its own debentures, it saves the interest which would have been payable on them. When the company purchases its own debentures for immediate cancellation, outstanding debentures are reduced by the amount cancelled and hence Debenture Interest Account is debited in future only with the net amount of interest payable on the outstanding debentures. But where debentures are purchased as investment, the total debentures are deemed to be outstanding. Some debentures are held by the company itself as its own investment, the interest on these own debentures will be retained by the company and the amount of interest on debentures held by the outsiders will be actually paid by the company. The accounting entries in such a case will be as follows:

a) **Where no Sinking Fund exists:**

1. **On interest becoming due on debentures**

Debenture Interest A/c	Dr.
To Debentureholders A/c	
To Interest on Own Debentures	

2. **On payment of interest on debentures**

Debentureholders A/c	Dr.
To Bank A/c	

3. **On transfer of Debenture Interest to Profit and Loss A/c**

Profit/Loss A/c	Dr.
To Debenture Interest A/c	

4. **On transfer of Interest on Own Debentures to Profit and Loss A/c**

Interest on Own Debentures A/c	Dr.
To Profit/Loss A/c	

b) **Where Sinking Fund exists:** Where the debentures are purchased as an investment against the Sinking Fund, the interest on such debentures is credited to the Sinking Fund Account as if the debentures are outside securities. The accounting entries will be as follows:

1. **On interest becoming due on debentures -**

Debenture Interest A/c	Dr.
To Sinking Fund A/c	
To Debentureholders A/c	

2. **On payment of interest to debentureholders -**

Debentureholders A/c	Dr.
To Bank A/c	

3. **On transfer of interest to Profit and Loss A/c -**

Profit/Loss A/c	Dr.
To Debenture Interest A/c	

 Important Point:

While making payment of interest to debentureholders income-tax has to be deducted at source and deposited with the Government.

PURCHASE OF DEBENTURES BEFORE THE SPECIFIED DATE OF PAYMENT OF INTEREST [CUM-INTEREST AND EX-INTEREST QUOTATIONS]

Interest on debentures is generally paid half-yearly to the holders on certain specified dates, e.g., 30th September and 31st March every year. If debentures are purchased exactly on these specified dates, it involves no problem. In such a case, interest is payable to the holders of debentures. But, where debentures are purchased at a date before the specified date of payment of interest the question which naturally arises is whether the price paid for such debentures includes the interest for the expired period (i.e. from the previous date of payment of interest up to the date of purchase) or not.

For this purpose, it is important to note whether the price paid for the debentures is quoted as “Cum-interest” or “Ex-interest”. If the purchase price for the debentures includes interest for the expired period, the quotation is said to be “Cum-interest”. If, on the other hand, the purchase price for the debentures excludes the interest for the expired period, the quotation is said to be “Ex-interest”. In case of Ex-interest quotation, interest has to be paid to the holders for the expired period in addition to the price paid for the debentures. In any case, the company must pay interest for the expired period and while making entry in its books at the time of purchase of the debentures, the amount paid by way of interest should be treated separately from the price actually paid for the debentures. For example, if a company purchases 10 of its 9% Debentures of 100 each at 95 each on 1st August, 2014 the dates of payment of Interest being 30th September and 31st March, the treatment of the same for “Cum-interest” and “Ex-interest” quotations will be as follows:

N.B. If nothing is stated, purchase and sale of debentures and government securities should be taken to be on ex-interest basis. That of shares should be presumed to be on cum-dividend basis.

1. **In case of cum-interest quotation:** If the purchase price of Rs. 95 is taken to be the cum-interest price, it implies that this includes the interest for the expired period of 4 months (i.e. from 1st April, 2014 to 31st July, 2014 which amounts

$$\begin{aligned} & \text{(Rs. 100) x (9\%)} \times \text{(4/12 months)} \\ & \qquad \qquad \qquad = \qquad \text{Rs. 3} \end{aligned}$$

Therefore, the price actually paid for the debenture should be taken at (Rs. 95 – Rs. 3) = Rs. 92. The accounting entry in such a case should be as follows:

(i) If debentures are purchased for immediate cancellation

9% Debentures A/c	Dr.
Debenture Interest A/c	Dr.

To Bank A/c
To Profit on Redemption of Debentures A/c

(ii) If debentures are purchased as investment

Own Debentures A/c Dr.
Debenture Interest A/c Dr.
To Bank A/c

 Important Point:

The question of profit or loss on redemption of debentures does not arise at the time of its purchase as investment. In such a case, Own Debentures A/c should always be debited with the actual price paid for them.

However, when these Debentures are cancelled in future, the entry would be: -

9% Debentures A/c Dr.
To Own Debentures A/c
To Profit on Cancellation of Debentures A/c

 Important Point:

Profit on cancellation of debentures must be transferred to capital reserve account.

- 2. In case of ex-interest quotation:** If the purchase price of Rs. 95 is taken to be the ex-interest price it implies that this does not include the interest for the expired period of 4 months (i.e. from 1st April, 2014 to 31st July, 2014 which amounts to

$$\begin{aligned} & (\text{Rs. } 100) \times (9\%) \times (4/12 \text{ months}) \\ & \qquad \qquad \qquad = \qquad \text{Rs. } 3 \end{aligned}$$

In this case, the price of Rs. 95 represents the price actually paid for the debentures and the company is required to pay Rs. 3 for every debenture as interest in addition to the purchase price of Rs. 95. Therefore, the company is required to pay (Rs. 95 + Rs. 3) = Rs. 98 for every debenture in total. The accounting entry in such a case should be as follows:

(i) If debentures are purchased for immediate cancellation.

9% Debentures A/c Dr.
Debenture Interest A/c Dr.
To Bank A/c
To Profit on Redemption of Debentures A/c

(ii) If debentures are purchased as investment.

Own Debentures A/c Dr.

Debenture Interest A/c Dr.
 To Bank A/c

However, when these Debentures are cancelled in future, the entry would be: -

9% Debentures A/c Dr.
 To Own Debentures A/c
 To Profit on Cancellation of Debentures A/c



Important Point:

Profit on cancellation of debentures must be transferred to capital reserve account.

CONVERSION OF DEBENTURES INTO SHARES

According to the terms of issue of the debentures, the debentureholders may be given the right to exercise the option to convert their debentures into equity shares or preference shares at a stipulated rate within a specified period. If the debentureholders find the offer is beneficial to them, they will exercise their right and opt for shares, otherwise they may not exercise their right. According to section 71 of the Companies Act, 2013, a company may issue debentures with an option to convert debentures into shares either wholly or partly at the time of redemption.

For example, X Ltd. issued 12% Debentures at a discount of 10% and the debentureholders were given the right to exercise the option of converting the debentures into 14% Preference Shares of Rs. 100 each to be issued at a premium of 10%. The holders of Rs. 33,000 debentures expressed their willingness to exercise the option. In such a case, the number of preference shares to be issued in exchange of Rs. 33,000 debentures will be calculated in the following way:

		Rs.
Face value of debentures to be converted	=	33,000
Less: Discount allowed @ 10% on issue	=	<u>3,300</u>
Actual amount received on issue of the debentures	=	29,700

Now, the issue price of preference shares will be as follows:

	Rs.
Face value of preference shares	100
Add: Premium @ 10%	<u>10</u>
	110

Therefore, number of preference shares to be issued in exchange of Rs. 33,000 debentures =
Rs. 29,700/110 = 270

	Rs.
Thus, face value of 270 preference shares	27,000
Add: premium @ 10%	<u>2,700</u>
	29,700

In case, the debentures are due for redemption, conversion of debentures into shares, may be made on the basis of terms and conditions mutually agreed upon at the time of redemption. In such a case, even debentures originally issued at a discount can be converted into shares on the basis of the nominal value of the debentures.

Accounting Entry for Conversion

At the time of conversion, new shares can be issued at par or at a premium only. As per Companies Act, 2013 issue of shares at discount is prohibited. The accounting entry for all these cases will be as follows:

- If shares are issued at par

Debentures A/c	Dr.
To Share Capital A/c	
- If shares are issued at a premium

Debentures A/c	Dr.
To Share Capital A/c	
To Securities Premium A/c	

Note:

If the debentures to be converted were issued at a discount, Share Capital A/c should be credited with the amount of cash originally realised on the debentures and Discount on Issue of Debentures A/c should be credited with the amount of discount allowed on those debentures.

CHAPTER 10

ISSUE AND REDEMPTION OF PREFERENCE SHARE

MEANING OF PREFERENCE SHARES

Preference shares are shares having preferential rights to claim dividends during lifetime of company and to claim repayment of capital on windup.

FEATURES OF PREFERENCE SHARES

- (i) Preference Shares have a wide range features such as
- (ii) Preference shareholders have no right to vote in the annual general meeting of company.
- (iii) These are long term source of finance.
- (iv) Right on assets when company is liquidated.

TYPES OF PREFERENCE SHARES

- (i) Cumulative Preference Shares.
- (ii) Non - Cumulative Preference Shares.
- (iii) Participating Preference Shares.
- (iv) Non-Participating Preference Shares.
- (v) Convertible Preference Shares.
- (vi) Non-Convertible Preference Shares.

➤ CUMULATIVE AND NON-CUMULATIVE PREFERENCE SHARES

Nonpayment of preference dividend does not amount to bankruptcy but this does not mean that the liability of the company is lost. If the shares are cumulative preference shares, the dividends are accumulated and therefore paid before anything paid to equity shareholders. Even in the event of liquidation, accumulated preference dividend and the preference share capital will be redeemed prior to any payment to equity shareholders. Whereas, for non-cumulative preference shares, if a company does not pay the dividend in the current year, the claim of preference shareholder is lost to that extent. Unless it is specified that preference shares are non-cumulative, it is assumed that it is of cumulative in nature.

➤ PARTICIPATING AND NON-PARTICIPATING PREFERENCE SHARES

Participating preference shares are a unique type of preference shares which has an additional benefit of participating in profits of the company apart from the fixed dividend. The distribution may depend on the terms and conditions mentioned in the agreement which may vary to some extent from case to case. Other preference shares who do not

participate are called non-participating preference shares. Unless it has been mentioned, that preference shares are participating, it is assumed that it is non-participating.

➤ **CONVERTIBLE AND NON-CONVERTIBLE PREFERENCE SHARES**

Convertible preference shares have a similar concept of convertible debentures. These shares possess an option or right whereby they can be converted into an ordinary equity share at some agreed terms and conditions. Non-convertible simply does not have this option but has all other normal characteristics of a preference share.

VOTING RIGHTS OF PREFERENCE SHARES HOLDERS

As per 47(2) in following circumstances preference shares holder has right to vote.

- (a) Where resolutions placed before meeting which directly affects the rights of his Preference Shares.
- (b) Any resolution for winding up of company or for repayment or reduction of its equity or preference shares capital.
- (c) Where dividend has not paid such class of preference shares for period of 2 years or more.

RIGHTS OF PREFERENCE SHAREHOLDERS

1. The Preference Shareholders enjoy a preferential right in the payment of dividend during the life time of the company.
2. The claim of Preference shareholders is prior to the claim of Equity shareholders or any other class of shareholders.
3. The dividend rate is fixed for the preference shareholders, whether the company makes profit or not.
4. If the company will skip preference dividends for three years, then it has to grant voting right to preference shareholders, on matters affecting them.
5. When the company is wound up, then the repayment of capital will paid first to the preference shareholders, prior to the equity shareholders or any other class of shareholders.

USE OF SECURITY PREMIUM

As per section 52 of companies Act, 2013

Application of premiums received on issue of shares

1. Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the securities premium account were the paid-up share capital of the company
2. Notwithstanding anything contained in sub-section (1), the securities premium account may be applied by the company
 - (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
 - (b) in writing off the preliminary expenses of the company
 - (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
 - (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company, or
 - (e) for the purchase of its own shares or other securities under section 68
3. The securities premium account may, notwithstanding anything contained in sub-sections (1) and (2), be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133. -
 - (a) in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares; or
 - (b) in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company, or
 - (c) for the purchase of its own shares or other securities under section 68.

ISSUE OF PREFERENCE SHARES

A company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue under section 55 of the Companies Act 2013. No company limited by shares shall, can issue any preference shares which are irredeemable. {Rule 9 of Companies (Share Capital and Debentures) Rules, 2014}

A company may issue preference shares for a period exceeding 20 years but not exceeding 30 years for infrastructure projects (Specified in Schedule VI). However, it is subject to redemption of minimum 10% of such preference shares per year from the twenty-first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

REDEMPTION OF PREFERENCE SHARES

The preference shares can be redeemed only when **they are fully paid up** –

- out of the profits of the company which would otherwise be available for dividend or
- out of the proceeds of a fresh issue of shares made for the purposes of such redemption.

CAPITAL REDEMPTION RESERVE ACCOUNT

If preference shares are proposed to be redeemed out of the profits of the company, a sum equal to the nominal amount of the shares to be redeemed, shall be transferred to a reserve called the Capital Redemption Reserve Account out of the profits of the company and the provisions of this Act relating to reduction of share capital of a company shall apply as if the Capital Redemption Reserve Account were paid-up share capital of the company. The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

PREMIUM ON REDEMPTION OF PREFERENCE SHARES

- a) For the companies whose financial statements comply with the accounting standards as prescribed under section 133, **the premium payable on redemption shall be provided out of the profits of the company**, before the shares are redeemed.
- b) For redemption of any preference shares issued on or before the commencement of 2013 Act, **the premium payable on redemption shall be provided out of the profits of the company**, or out of the company's securities premium account, before such shares are redeemed.
- c) For the companies whose financial statements need not comply with the accounting standards as prescribed under section 133, **the premium payable on redemption shall**

be provided out of the profits of the company, or out of the company's securities premium account, before such shares are redeemed.

Case 1: Redemption of preference shares out of the profits of the company which would otherwise be available for dividend.

If the redeemable preference shares are redeemed out of the profits of the company which would otherwise be available for dividend, the "Capital Redemption Reserve Account" has to be created which will represent the redeemable preference shares in the balance sheet after the redemption. This capital redemption reserve should be equal to the amount of Preference Shares to be redeemed. The profits available for dividend have to be transferred to Capital Redemption Reserve Account.

(JOURNAL ENTRIES)

1. Transfer profits available for dividend to Capital Redemption Reserve Account

General Reserve Account Dr.

Profit and Loss Appropriation A/c Dr.

To Capital Redemption Reserve A/c

(with the nominal value of the shares to be redeemed)

2. If current assets are realized to provide cash for redemption of preference shares

Bank Dr.

To Respective Assets Account

(with the realized value of assets)

3. On transfer of redeemable preference share capital to be redeemed to Preference Shareholders Account

Redeemable Preference Share Capital A/c Dr.

To Preference Shareholders A/c

4. If preference shares are redeemed at premium

Redeemable Preference Share Capital A/c Dr.

Premium on Redemption of Preference Shares A/c Dr.

To Preference Shareholders A/c

5. For providing premium on redemption of preference shares

Securities Premium Account Dr.

Profit and Loss Appropriation A/c Dr.

To Premium on Redemption of Preference Shares Account

6. On redemption of preference shares

Preference Shareholders Account
To Bank

Dr.

Case 2: If the redeemable preference shares are redeemed out of the proceeds of a fresh issue of shares made for the purpose of redemption:

If the redeemable preference shares are redeemed out of the proceeds of fresh issue of shares, the new Share Capital Account raised by fresh issue will take the place of the Redeemable Preference Share Capital Account after the redemption. Thus, in such a case, new Share Capital Account (Equity or Preference) must be equal to the redeemable preference shares redeemed. First of all, entries for fresh issue of shares will be passed. Then entries for redemption passed as given in previous case.

Case 3: If the redeemable preference shares are redeemed partly out of the profits of the company which would otherwise be available for dividend and partly out of the proceeds of a fresh issue of shares made for the purpose of redemption:

If the redeemable preference shares are redeemed partly out of the profits of the company which would otherwise be available for dividend and partly out of the proceeds of a fresh issue of shares equity or preference, the Capital Redemption Reserve Account and the new Share Capital Account taken together will replace the Redeemable Preference Share Capital redeemed. Thus in such a case, Redeemable Preference Share Capital redeemed = Capital Redemption Reserve Account + New Share Capital Account (Equity or Preference).

Here, all the entries shown under (i) and (ii) have to be passed. But there are certain common entries which can be combined together.

Profits available for redemption (Transfer to C.R.R. is allowed from these profits)	Profits not available for redemption (Transfer to C.R.R. is allowed from these profits)
Reserves General reserve Reserve Fund Dividend equalization fund Insurance fund Workmen's Compensation Fund Workmen's Accident fund Voluntary debenture redemption A/c	Security Premium Account Share Forfeited Account Profit prior to incorporation Capital Reserve Development Rebate Reserve

Debenture Sinking Fund A/c Profit and Loss A/c (Cr.)	

CHAPTER 11

UNDERWRITING OF SHARES

MEANING OF UNDERWRITING

Underwriting services are provided by some large financial institutions, such as banks, insurance companies and investment houses, whereby they guarantee payment in case of damage or financial loss and accept the financial risk for liability arising from such guarantee. An underwriting arrangement may be created in a number of situations including insurance, issues of security in a public offering, and bank lending, among others. The person or institution that agrees to sell a minimum number of securities of the company for commission is called the Underwriter.

DIFFERENCE BETWEEN UNDERWRITERS & BROKERS

	BROKERS	UNDERWRITERS
(1)	A Broker is a person who buys and sells goods or assets for others.	An underwriter is a person or company that underwrites an insurance risk.
(2)	A broker is entitled to receive Commission only on those shares or debentures for which he procures subscription.	While an underwriter receives underwriting Commission on the entire issue which he underwritten.
(3)	Even where the shares or debentures are not offered to the public, the brokerage is payable on shares or debentures for which subscription is procured.	In case, of Underwriters, An underwriting commission is payable only on those shares or debentures which are offered to the public.
(4)	Broker's percentage of brokerage is determined as per prevailing rate	Underwriting commission is payable but it should not exceed 5% of the issue price of shares and 2.5 % of the issue price of debentures.
(5)	The brokers are entitled to brokerage even if the Article of Association of a company is silent on this point.	In case of Underwriters, only if the Article of an Association authorized underwriting Commission, the underwriters are entitled to get such Commission.

(6)	In case, of Broker, It is not required the name and address of each broker is to be disclosed in the prospectus.	While in case of underwriters the name of location and address of each one is to be shown in the prospectus.

ESSENTIAL OF UNDERWRITING COMMISSION

A company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions, namely: -

- (a) the payment of such commission shall be authorized in the company's articles of association;
- (b) the commission may be paid out of proceeds of the issue or the profit of the company or both;
- (c) the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent of the price at which the debentures are issued, or as specified in the company's articles, whichever is less;
- (d) the prospectus of the company shall disclose
 - (i) the name of the underwriters;
 - (ii) the rate and amount of the commission payable to the underwriter, and
 - (iii) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.
- (e) there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;
- (f) a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

SEBI MERCHANT BANKER REGULATION

In respect of every issue to be managed, the lead merchant banker holding a certificate under Category I shall accept a minimum underwriting obligation of five per cent of the total underwriting commitment or rupees twenty-five lacs, whichever is less : Provided that, if the lead merchant banker is unable to accept the minimum underwriting obligation, that lead

merchant banker shall make arrangement for having the issue underwritten to that extent by a merchant banker associated with the issue and shall keep the Board informed of such arrangement. 38[Provided further that in any issue made in accordance with Chapter XA of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 the merchant banker shall, itself or jointly with other merchant bankers associated with the issue, underwrite at least fifteen per cent of the issue size.]

SEBI RULE & REGULATION 1993

No person can act as underwriter unless he holds a certificate of registration granted by SEBI. However, every stock broker or merchant banker holding a valid certificate of registration from the SEBI shall be entitled to act as an underwriter without obtaining a separate certificate for underwriting activities.

For considering the grant of certificate of registration, the SEBI takes into account all matters which are relevant to or related to underwriting and in particular:

- (i) The necessary infrastructure, like adequate office space, equipments and manpower to effectively discharge his activities;
- (ii) Past experience in underwriting or employment of minimum two persons who had the experience in underwriting ; and
- (iii) Capital adequacy requirement of not less than the net worth of Rs. 20 lakhs.

TYPES OF UNDERWRITING

An underwriting agreement may be of any one of the following types:

Complete Underwriting

If the whole of the issue of shares or debentures of a company is underwritten, it is said to be complete underwriting. In such a case, the whole of the issue of shares or debentures may be underwritten by –

- a) one firm or institution, agreeing to take the entire risk;
- b) a number of firms or institutions, each agreeing to take risk only to a limited extent.

Partial Underwriting

If only a part of the issue of shares or debentures of a company is underwritten, it is said to be partial underwriting.

The part of the issue of shares or debentures may be underwritten by -

- a) One person or institution;
- b) A number of firms or institutions each agreeing to take risk only to a limited extent.

In case of partial underwriting, the company is treated as “Underwriter” for the remaining part of the issue.

Firm Underwriting

It refers to a definite commitment by the underwriter or underwriters to take up a specified number of shares or debentures of a company irrespective of the number of shares or debentures subscribed for by the public. In such a case, the underwriters are committed to take up the agreed number of shares or debentures in addition to unsubscribed shares or debentures, if any. Even if the issue is over-subscribed, the underwriters are liable to take up the agreed number of shares or debentures.

UNDERWRITING COMMISSION

The consideration payable to the underwriters for underwriting the issue of shares or debentures of a company is called underwriting commission. Such a commission is paid at a specified rate on the issue price of the whole of the shares or debentures underwritten whether or not the underwriters are called upon to take up any shares or debentures. Thus, the underwriters are paid for the risk they bear in the placing of shares before the public. Underwriting commission may be in addition to brokerage.

PAYMENT OF UNDERWRITING COMMISSION

Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions which are prescribed under Companies (Prospectus and Allotment of Securities) Rules, 2014:

- a) the payment of such commission shall be authorized in the company’s articles of association;
- b) the commission may be paid out of proceeds of the issue or the profit of the company or both;
- c) the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent (2.5 %) of the price at which the debentures are issued, or as specified in the company’s articles, whichever is less;
- d) the prospectus of the company shall disclose -

- the name of the underwriters;
 - the rate and amount of the commission payable to the underwriter; and
 - the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.
- e) there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;
- f) a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

Thus, the Underwriting commission is limited to 5% of issue price in case of shares and 2.5% in case of debentures. The rates of commission given above are maximum rates. The company is free to negotiate lower rates with underwriters.

MARKED AND UNMARKED APPLICATIONS

When the issue of shares or debentures of a company is underwritten by two or more persons, it is usual that the applications for shares or debentures sent through the underwriters should bear a stamp of the respective underwriters. Otherwise, it would be very difficult for the company to determine how many applications have been received through a particular underwriter and, unless this is determined properly, the company would face a problem in determining the liability of the individual underwriters. Thus, the applications bearing the stamp of the respective underwriters are called “Marked Applications” while the applications received directly by the company which do not bear any stamp of the underwriters are called “Unmarked Applications”.

If the entire issue of shares or debentures is underwritten by only one underwriter, the marking of applications is immaterial since he is to get credit of all the applications whether sent through him or received directly in determining his liability. But, the issue of shares or debentures is, generally, underwritten by more than one underwriter as the risk is distributed among the underwriters in an agreed ratio. In such a case, it is essential that the applications sent through the underwriters should be marked properly so as to determine their respective liability correctly.

DETERMINING THE LIABILITY OF UNDERWRITERS

The liability of the underwriter or underwriters would be determined in the following ways:

Complete Underwriting

- a) **If the whole of the issue of shares or debentures is underwritten only by one underwriter:** In such a case, the underwriter will be liable to take up all the shares or debentures that have not been subscribed for by the public. For determining his

liability, it is not material to know how many applications are sent through him and how many applications are received directly by the company. Thus, the liability of the underwriter in such a case will be as follows:

Liability = Shares or debentures offered – Total applications received.

It is to be noted here that if the shares or debentures are oversubscribed or fully subscribed by the public, the underwriter is free from his liability and cannot be called upon to take up any shares or debentures of the company. But he will be entitled to get his commission on the total issue price of the shares or debentures. He must of course take up the shares or debentures as per “Firm Underwriting”. Automatically, this will reduce his liability in case there is under subscription.

- b) If the whole of the issue of shares or debentures is underwritten by a number of underwriters in an agreed ratio: In such a case, the liability of the respective underwriters can be determined as follows:**

The gross liability of each underwriter according to the agreed ratio should be reduced first by the marked applications and then credit may be given in respect of unmarked applications sent directly to the company by way of deduction from the balance left in the ratio of their gross liability. Thus, the liability of each underwriter in such a case will be as follows:

Gross liability according to the agreed ratio	.....
Less: Marked applications	.....

Balance left	.....
Less: Unmarked applications in the ratio of gross liability	.....
Net liability	.....

Sometimes credit to unmarked application is given in the ratio of gross liability as reduced by the marked applications. The individual liability calculated in this way will differ from the liability calculated as per the earlier procedure.

N.B.: In case some figure is in minus then transfer that figure to other underwriters’ account in the ratio of gross liability inter se. This gives the liability of underwriters on account of short fall in the public subscription.

PARTIAL UNDERWRITING

- a) **If a part of the issue of shares or debentures is underwritten only by one underwriter:** In such a case, only a part of the whole issue, say 60% or 70% is underwritten only by one underwriter and so far as the balance 40% or 30% of the issue is concerned, the company itself is said to have underwritten the same. As such, the unmarked applications are treated as marked as far as the company is concerned.

In such a case, the gross liability of the underwriter will be that part of the issue of shares or debentures which is underwritten, say 60% or 70% and the net liability will be determined by deducting the marked applications (the applications sent through him) from the gross liability. Thus, the net liability will be determined as follows:

Net liability = Gross liability (say 60% or 70% of the issue) – Marked applications.

It is to be noted here that if the marked applications exceed or equal the number of shares or debentures underwritten the underwriter is free from his liability and cannot be called upon to take up any shares or debentures of the company. Similarly, if all the shares or debentures are subscribed the underwriter is free from his liability in spite of the fact the marked applications are less than the number of shares or debentures underwritten.

- b) **If the part of the issue of shares or debentures is underwritten by a number of underwriters:** In such a case only a part of the whole issue, say 60% or 70% or 80% is underwritten by a number of underwriters and so far as the balance 40% or 30% or 20% is concerned, the company itself is said to have underwritten the same. As such, the unmarked applications are treated as marked so far as the company is concerned.

In such a case, the method of determining the net liability of the respective underwriters is similar to the method discussed (a) above.

FIRM UNDERWRITING

In the case of 'firm underwriting', the underwriters take up the agreed number of shares or debentures 'firm underwritten' in addition to unsubscribed shares or debentures, if any. In such an instance, an underwriter is not allowed to set off his firm underwriting against his liability otherwise determined, that he will have to subscribe both for shares/debentures 'underwritten firm' and for shares which he has to take under the underwriting contract, ignoring firm underwriting.

While computing the individual liability of the underwriters, the 'firm underwriting' can be dealt with in any of the following manner in the absence of any specific instructions:

- a) The 'firm underwriting' may be adjusted against the individual liability of each underwriter separately or may be treated at par with marked applications. When firm underwriting is treated at par with marked applications. In such a case, the statement of liability of underwriters will be as under:

Gross Liability (agreed ratio-total shares underwritten)	.....
Less: Marked applications including firm underwriting	.....
Balance left	
Less: Unmarked application (ratio of gross liability)	.....
Net liability	
Add: Firm underwriting	.....
Total Liability	.....

- b) The benefit of 'firm underwriting' may be shared by all underwriters or firm underwriting may be treated at par with unmarked applications. In such case, the shares/debentures underwritten firm will be included in the unmarked forms. In such case, the state of liability of underwriters will appear as shown above except that shares/debentures underwritten firm by each underwriter will not be specifically adjusted against his individual liability but will be included in the total unmarked forms to be distributed amongst all underwriters in the ratio of their gross liability.

N.B.: If the question is not specific regarding the treatment of 'firm underwriting' students may follow any one of the treatments discussed above and a foot note to this effect may be given.

ACCOUNTING TREATMENT RELATING TO UNDERWRITING OF SHARES OR DEBENTURES

1. When the shares or debentures are allotted to the underwriters in respect of their liability

Underwriters A/c	Dr.
To Share Capital A/c	
To Debentures A/c	

(with the value of the shares or debentures taken up by the underwriters)

2. When commission becomes payable to the underwriters

Underwriters Commission A/c	Dr.
To Underwriters A/c	

(with the amount of commission due on the total issue price of the shares under-written)

3. When the net amount due from the underwriters on the shares or debentures taken up by them is received

Bank	Dr.
To Underwriters A/c	
<i>(with the net amount due)</i>	

Note: Underwriting commission is not generally paid in cash. Instead the same is adjusted against the money due on shares or debentures taken up by the underwriters and only the net amount (i.e., total amount due on shares or debentures taken up by the underwriters minus the underwriting commission) is received from the underwriters.

LESSON 12

RATIO ANALYSIS

RATIO ANALYSIS

The relationship between two accounting figures is known as ratio. Ratio analysis is a process of comparison of one figure against another, which helps to make proper analysis about the strength and weaknesses of the firm's operations.

The calculation of ratios are a relatively easy and simple task but the proper analysis and interpretation of the ratios is the important task. Ratio analysis is a very powerful analytical tool useful for measuring performance of an organization. Ratio analysis is extremely helpful in providing valuable insight into a company's financial picture. Ratios normally show a business strength and weaknesses.

OBJECTIVES OF RATIO ANALYSIS

- ❖ To show the firms relative strengths and weaknesses.
- ❖ To help to analyze the past performance of the firm and to make further projections.
- ❖ To allow interested parties like shareholders, investors, creditors, government and analysts to make an evaluation of certain aspects of a firm's performance.
- ❖ To concentrate on the inter-relationship among the figures appearing in the financial statements.
- ❖ To provide an easy way to compare present performance with past.
- ❖ To depict the areas in which business is competitively advantaged or disadvantaged.
- ❖ To determine the financial condition and performance of the firm.
- ❖ To help to take suitable corrective measures when the financial conditions and performance are unfavourable to the firm.
- ❖ To study short term and long term solvency of firm with the help of financial statement analysis.

Short term solvency is useful for creditors and long term solvency is useful for debenture holders etc.

ADVANTAGE OF RATIO ANALYSIS

The following are the advantages attributed to the technique of ratio analysis;

- 1) **Simplifies financial statements:** Ratio analysis simplifies the comprehension of financial statement. Ratios tell the whole story of changes in the financial condition of the business.
- 2) **Analyze past and forecast future:** It helps to analyse and understand financial health and trend of a business, including past performance and makes it possible to forecast of future periods. They diagnose the financial health by evaluating liability, solvency, profitability etc.
- 3) **Decision making and cost control:** It serves as a useful tool in management control process for decision making and cost control purposes.
- 4) **Role:** It plays a significant role in cost accounting, financial accounting, budgetary control and auditing.
- 5) **Summaries accounting figures:** It summarises the accounting figures in order to make them more understandable in lucid form. They highlight the inter-relationship which exists between various segments of the business expressed by accounting statements.
- 6) It helps in the identification, tracing and fixing of the responsibilities of managerial personnel at different levels.

LIMITATION OF RATIO ANALYSIS

The ratio analysis is not a full-proof method in financial statement analysis. It suffers from a number of limitations. Some of the important one are :

1. Ratios ignore qualitative factors

Ratios are obtained from the figures expressed in monetary terms. In this way, qualitative factors, which may be important are ignored.

2. Trends are not the actual ratios

The different ratios calculated from the financial statements of a business enterprise for one single year are of limited value. It would be more useful to calculate the important figures in the case of income, dividends, working capital, etc., for a number

of years. Such trends are more useful than absolute ratios.

3. Defective accounting information

The ratios are calculated from accounted data in the financial statements. It means if the information is defective then the calculation of ratios would be wrong. Thus, the deliberate omissions would affect the ratios too.

4. Change in accounting procedures

A comparison of result of two firms becomes difficult when we find that the firms are using different procedures related to certain items, such as inventory valuation and treatment of intangible assets.

5. Variations in general operating conditions

While interpreting the results based on ratio analysis, all business enterprises have to work within given general economic conditions, state of the industry in which the firms are operating and the position of the individual companies within the industry. For example, if the firm is forced by the government to sell their products at a fixed price, its comparison with other firms would become impossible.

6. Single ratio not sufficient

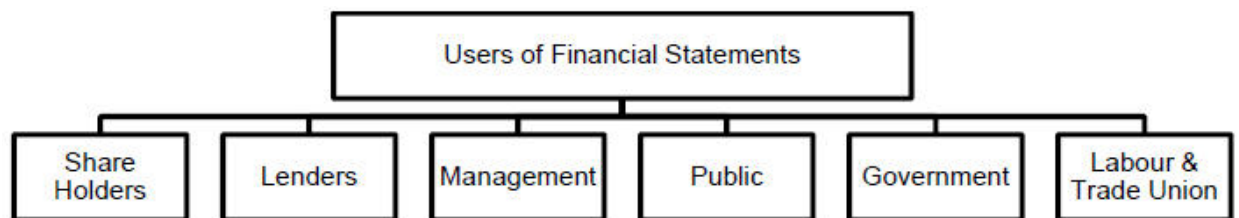
It is very necessary to take into account the combined effect of various ratios so that the results are correctly interpreted regarding the financial condition and the profit-making performance of the business. Each ratio plays a part in interpreting the financial statement.

7. The use of standard ratio

The financial statements represent historical data and, therefore, the ratios based on them would only disclose what happened in the past.

USERS OF FINANCIAL STATEMENTS

The important objective of financial statement is to provide information for the use of following categories of persons



1. Shareholders

Financial Statements act as an important source for the shareholders of the company. They can help in examining efficiency and effectiveness of the management and position, progress and prospects of the company.

2. Lenders

Short-term as well as long-term solvency information is needed by the lenders of the company to accurately assess the position of the business. Trade creditors are interested in short-term solvency, whereas debenture holders, long-term loan provider are interested in long-term solvency.

3. Management

Financial statements helps the management in acquiring accurate information regarding the progress, position and prospects of business. They help the management in finding out the relationship between the working and progress of the business; and therefore help the management in analyzing the trends in the present and future prospectus of the enterprise.

4. Public

Various groups such as financial analysts, lawyers, trade associations, researchers, financial press, labour unions are interested in the trend analysis, working and growth of a business. With the help of published financial information or statement of the enterprise, these interested groups are able to analyse and interpret, and therefore judge the working and growth of an enterprise.

5. Government

The growth of the economy is associated with the growth of the companies registered in the country. Any fraudulent activity or unscrupulous act affects the industry which percolates the growth of the economy. This can retard the economic growth of the country which would have an adverse effect on our national economy.

6. Labour and Trade Union

In India, workers are entitled to bonus under the payment of bonus act. Thus, the statement of Profit & Loss become greatly important to the workers.

CLASSIFICATION OF RATIOS

The ratio analysis is made under following categories:

Financial Ratios	Activity Ratios	Profitability Ratio	Market Test Ratio
Short term solvency ratio	Stock Turnover Ratio	Gross Profit Ratio	Earnings per share
Current Ratio	Debtors Turnover Ratio	Net Profit Ratio	Price Earnings Ratio
Liquidity Ratio	Creditors Turnover Ratio	Cash Profit Ratio	Dividend Payout Ratio
Cash Ratio	Fixed Assets Turnover Ratio	Basic Defence Interval	Dividend Yield Ratio
Long term solvency ratio	Total Assets Turnover Ratio	Return on Investment	
Debt-Equity Ratio	Ratio Working Capital	Return on Net Worth	
Capital Gearing Ratio	Turnover Sales to Capital Employed	Debt Service Coverage	
Fixed Assets Ratio			
Proprietary Ratio			
Interest Cover			
Dividend Cover			

FINANCIAL RATIOS

➤ SHORT-TERM SOLVENCY RATIOS

Liquidity or short-term solvency means ability of the business to pay its short-term liabilities. Inability to pay-off short-term liabilities affects its credibility as well as its credit rating. Short-term lenders and creditors of a business are very much interested to know its state of liquidity because of their financial stake. Two ratios are used to highlight the business 'liquidity'. These are **current ratio** and **quick ratio**.

(1) Current Ratio

This ratio is calculated as follows:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities \& Provisions}}$$

Significance: This ratio shows short-term financial soundness of the business. Higher ratio means better capacity to meet its current obligation. The ideal Current Ratio is **2:1**. In case it is very high it will have adverse impact on profitability of organization. A high current ratio may be due to high level of inventory, inefficiency in collection of debtors, high balance in cash and bank accounts without proper investments.

Current Assets

= *Current Investments*
 + *Inventories (Excluding Stores and Spares and Loose Tools)*
 + *Trade Receivables (Net of Provision for Doubtful Debts)*
 + *Cash and Cash Equivalents + Short – term Loans and Advances*
 + *Other Current Assets*

Current Liabilities

= *Short – term Borrowings + Trade Payables*
 + *Other Current Liabilities + Short – term Provisions.*

(2) Liquid Ratio/Quick Ratio/Acid Test Ratio

This ratio is calculated as follows:

$$\text{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Current Liabilities}}$$

Significance: Liquid Ratio is a fairly stringent measure of liquidity. It is based on those current assets which are highly liquid i.e., can be converted into Cash and Cash Equivalents quickly. Quick Ratio of **1:1** is considered as ideal. Higher the Quick Ratio better the short-term financial position.

$$\text{Quick Assets} = \text{Current Assets} - \text{Inventories} - \text{Prepaid Expenses}$$

Current Liabilities have same meaning as in Current Ratio.

Note:

Bank overdraft and credit facilities are excluded from current liability in case of Liquid Ratio

➤ **LONG-TERM SOLVENCY RATIO**

(1) Debt Equity Ratio

It is calculated as follows:

$$\text{Debt Equity Ratio} = \frac{\text{Long – term Debt}}{\text{Equity (Shareholders' Funds)}}$$

Significance: This ratio assess the long-term financial position and soundness of enterprises. In general, lower the Debt Equity Ratio higher the degree of protection enjoyed by the lenders. The main purpose of this ratio is to determine the relative stakes of outsiders and shareholders.

Debt = Long term Borrowings, (i. e, debentures, mortgage, public deposits)
+ Long term Provisions

Shareholders' Funds = Share Capital + Reserves and Surplus
OR

Non current Assets + Working capital – Non current Liabilities

The ideal debt-equity ratio is taken as **2:1**.

(2) Capital Gearing Ratio

This ratio is calculated as follows:

$$\text{Capital Gearing Ratio} = \frac{\text{Fixed Income/Dividend Bearing Funds}}{\text{Equity Shareholders Funds}}$$

Fixed Income Bearing Funds
= Debentures + Long term Loans + Preference Share Capital

Equity Shareholders Funds
= Equity Share Capital + Reserves & Surplus
– Dr. Balance in P&L A/c – Fictitious Assets

Significance: Capital gearing ratio is very important ratio. Gearing should be kept in such a way that the company is able to maintain a steady rate of dividend. High gearing ratio is not good for a new company or a company of which future earnings are uncertain.

(3) Fixed Assets Ratio

The fixed asset is shown as a proportion to long-term funds as follows:

$$\text{Fixed Assets Ratio} = \frac{\text{Fixed Assets}}{\text{Long term Funds}}$$

This ratio indicates the proportion of long-term funds deployed in fixed assets. The higher the ratio indicates the safer the funds available in case of liquidation. It also indicates the proportion of long-term funds that is invested in working capital.

(4) Proprietary Ratio

It express the relationship between net worth and total assets.

$$\text{Proprietary Ratio} = \frac{\text{Proprietary Funds}}{\text{Total Assets}}$$

Proprietary Funds

$$= \text{Equity Share Capital} + \text{Preference Share Capital} + \text{Reserves} \\ - \text{Fictitious Assets}$$

$$\text{Total Assets} = \text{Fixed Assets} + \text{Current Assets (excluding fictitious assets)}$$

A high proprietary ratio is indicative of strong financial position of the business. The higher the ratio, the better it is.

(5) Interest Cover/Debt Service Ratio

$$\text{Interest Cover or Debt Service Ratio} = \frac{\text{EBIT}}{\text{Interest}}$$

The interest coverage ratio shows how many times interest charges are covered by funds that are available for payment of interest. **An interest cover of 7:1 is considered reasonable by financial institutions.** A very ratio indicates that the firm is conservative in using debt and a very low ratio indicates excessive use of debt.

Alternative view on Debt Service Coverage Ratio:

Lenders are interested in debt service coverage to judge the firm's ability to pay off current interest and instalments.

$$\text{Debt Service Coverage Ratio} = \frac{\text{EBIT}}{\text{Interest} + \text{Instalments}}$$

(6) Dividend Cover

$$\text{Dividend Cover} = \frac{\text{Profit After Tax (PAT)}}{\text{Dividend}}$$

This ratio indicates the number of times the dividends are covered by net profit. This highlights the amount retained by a company for financing of future operations.

PROFITABILITY RATIOS

(1) Gross Profit Ratio

The ratio measures the gross profit margin on the total net sales made by the company. The gross profit margin is calculated as follows:

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

(2) Net Profit Ratio

This ratio measures the efficiency of operation of the company. The net profit is arrived at from gross profit after deducting administration, selling and distribution expenses. The ratio is calculated as follows:

$$\text{Net Profit Ratio} = \frac{\text{Profit After Tax (PAT)}}{\text{Sales}} \times 100$$

(3) Return on Investment (ROI)

This ratio shows how much a company is earning on its investments *i.e.* capital employed. This ratio is considered to be one of the most important ratios because it reflects the overall efficiency with which capital is used. Return on investment is an important measure of profitability and is useful for inter-firm comparison. This ratio is calculated as under:

$$\text{Return on Investment} = \frac{\text{Operating Profit (EBIT)}}{\text{Capital Employed}} \times 100$$

(4) Return on Assets

This ratio is calculated as follows:

$$\text{Return on Assets} = \frac{\text{Profit After Tax (PAT)}}{\text{Net Assets}} \times 100$$

The profitability of the firm is measured by establishing relation of net profit with the total assets of the organization. This ratio indicates the efficiency of utilization of assets in generating revenue.

(6) Return on Net Worth

$$\text{Return on Net Worth} = \frac{\text{Profit After Tax (PAT)}}{\text{Net Worth}} \times 100$$

This ratio expresses the net profit in terms of the equity shareholders funds. This ratio is an important yard stick of performance for equity shareholders since it indicates the return on the funds employed by them. This ratio is useful in measuring the rate of return as a percentage of the book value of shareholders equity.

(7) Operating Ratio

The ratio of operating cost to sales is the operating ratio. It is calculated as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Cost}}{\text{Sales}} \times 100$$

$$\begin{aligned} \text{Operating Cost} \\ &= \text{Material Cost} + \text{Labour Cost} + \text{Factory overheads} \\ &\quad + \text{Office \& selling expenses} \end{aligned}$$

The ratios used to measure the effectiveness of the employment of resources are termed as turnover ratios or activity ratios. How many times the assets turnover during business operations is to be measured by these ratios?

(8) Operating Profit Ratio

$$\text{Operating Profit Ratio} = \frac{\text{Operating profit}}{\text{Sales}} \times 100$$

Where, Operating Profit = Sales – Cost of Sales

Operating profit ratio measures the percentage of each sale in rupees that remains after the payment of all costs and expenses except for interest and taxes. This ratio is followed closely by analysts because it focuses on operating results. Operating profit is often referred to as earnings before interest and taxes or EBIT.

TURNOVER RATIOS

Turnover ratios are used to **measure how effectively the firm employs its resources**. These ratios make comparison between the sales and the investment in various assets/accounts such as inventories, fixed assets, debtors etc. Turnover ratios are also known as **activity ratios**. The greater the ratio more will be the efficiency of assets usage. The following are the important turnover ratios usually calculated:

- 1) Capital Turnover Ratio
- 2) Total Assets Turnover Ratio
- 3) Fixed Assets Turnover Ratio
- 4) Working Capital Turnover Ratio
- 5) Stock Turnover Ratio
- 6) Debtors Turnover Ratio
- 7) Creditors Turnover Ratio

(1) Stock Turnover Ratio/Stock Velocity

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

$$\text{Average Inventory} = \frac{\text{Opening Stock} + \text{Closing Stock}}{2}$$

The inventory turnover ratio measures how many times a company's inventory has been sold during the year. If the inventory turnover ratio is low, it means that either inventory's growing or sales are dropping. Low inventory turnover has impact on the liquidity of the business.

$$\text{Stock Velocity} = \frac{\text{Average stock}}{\text{Cost of goods sold}} \times 365 \text{ days or 12 months}$$

In the case of inventory of raw material the inventory turnover ratio is calculated using the following formula:

$$\text{Stock Turnover Ratio} = \frac{\text{Raw Material Consumed}}{\text{Average Stock of Raw Material}}$$

(2) Debtors Turnover Ratio/Debtors Velocity

Debtor turnover ratio measures whether the amount of resources tied up in debtors is reasonable and whether the company has been efficient in converting debtors into cash. The formula is:

$$\text{Debtors Turnover Ratio} = \frac{\text{Credit Sales}}{\text{Average Accounts Receivable}}$$

The higher the ratio better the position.

$$\text{Debtors velocity} = \frac{\text{Average Accounts Receivable}}{\text{Credit Sales}} \times 12 \text{ months or } 365 \text{ days}$$

Lower the velocity better the position.

(3) Creditors Turnover Ratio/Creditors Velocity

$$\text{Creditors Turnover Ratio} = \frac{\text{Credit Purchases}}{\text{Average Accounts Payable}}$$

The term accounts payable include trade creditors & bills payable.

$$\text{Creditors Velocity} = \frac{\text{Average Accounts Payable}}{\text{Credit Purchase}} \times 365 \text{ days or } 12 \text{ months}$$

In general longer credit period (creditor's velocity) is considered as better, because it means that companies operations are financed interest free by suppliers.

(4) Fixed Assets Turnover Ratio

This ratio is calculated as follows:

$$\text{Fixed Assets Turnover Ratio} = \frac{\text{Sales}}{\text{Fixed Assets}}$$

This ratio indicates the number of times fixed assets are being turned over in a year.

(5) Total Assets Turnover Ratio

This ratio indicates the number of times total assets are being turned over in a year.

$$\text{Total Assets Turnover Ratio} = \frac{\text{Sales}}{\text{Total Assets}}$$

The higher the ratio indicates overtrading of total assets while a low ratio indicates idle capacity.

(6) Working Capital Turnover Ratio

This ratio is calculated as follows:

$$\text{Working Capital Turnover Ratio} = \frac{\text{Sales}}{\text{Working Capital}}$$

This ratio indicates the extent of working capital turnover in achieving sales of the firm.

(7) Sales to Capital Employed Ratio

This ratio is ascertained by dividing sales with capital employed.

$$\text{Sales to Capital Employed Ratio} = \frac{\text{Sales}}{\text{Capital employed}}$$

This ratio indicates efficiency in utilization of capital employed in generating revenue.

MARKET TEST RATIOS

It is calculated as follows:

$$\text{Earnings Per Share (EPS)} = \frac{\text{Profit available for equity shareholders}}{\text{No. of equity shares}}$$

This ratio is calculated to judge the overall profitability of the concern. This ratio measures the profit available for the equity shareholders on a per share basis.

The earnings per share ratio help in determining the market price of the equity shares of the company. It also helps in estimating the company's capacity to pay dividend. The more the earning per share, better are the performance and prospects of the company.

Price Earnings Ratio (P/E Ratio)

$$\text{Price Earnings Ratio} = \frac{\text{Market Price}}{\text{EPS}}$$

This ratio measure the number of times the earning of the latest year at which the share price of a company is quoted. This ratio reflects the market's assessment of the future earnings

potential of the company. A high P/E ratio reflects earnings potential and a low P/E ratio low earning potential. The P/E ratio reflects the market's confidence in the company's equity. P/E ratio is a barometer of the market sentiment.

Dividend Payout Ratio

$$\text{Dividend Payout Ratio} = \frac{\text{Dividend Per Share (DPS)}}{\text{Earnings Per Share (EPS)}}$$

This ratio expresses the relationship between what is available as earnings per share and what is actually paid in the form of dividends out of available earnings. It is a good measure of the dividend policy of the company. A higher payout ratio may mean lower retention and ploughing back of profits, a deteriorating liquidity position and title or on increase in the profit-earning capacity of the company.

Dividend Yield Ratio

$$\text{Dividend Yield Ratio} = \frac{\text{Dividend Per Share}}{\text{Market Price}} \times 100$$

This ratio **reflects the percentage yield that an investor receives on this investment at the current market price** of the shares. This measure is useful for investors who are interested in yield per share rather than capital appreciation.

DU-PONT ANALYSIS

According to DU-PONT Analysis, ROE is affected by 3 things,

1. Operating Efficiency, which is measured by Profit Margin
2. Asset Use Efficiency, which is measured to TOTAL ASSET TURNOVER
3. Financial Leverage, which is measured by Equity Multiplier.

Therefore, DU-PONT Analysis is represented in mathematical form by following calculation:

$$ROE = (\text{Profit Margin} \times \text{Asset Turnover} \times \text{Equity Multiplier})$$

$$ROE = \left(\frac{\text{Net Profit}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Asset}} \times \frac{\text{Asset}}{\text{Equity}} \right)$$

FORMULAS

Ratios	Formula
Short Term Solvency Ratios:	
Liquid Ratio =	$\frac{\text{Liquid Assets}}{\text{Current Liabilities}}$
Current Ratio =	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Long Term Solvency Ratios:	
Debt Equity Ratio =	$\frac{\text{Long Term Debt}}{\text{Equity Shareholders Funds}}$
Capital Gearing Ratio =	$\frac{\text{Fixed Income Bearing Funds}}{\text{Equity Shareholders Funds}}$
Fixed Assets Ratio =	$\frac{\text{Fixed Assets}}{\text{Long Term Debt}}$
Proprietary Ratio =	$\frac{\text{Proprietary Funds}}{\text{Net Assets or Total Assets}}$ Proprietary funds = Shareholders funds
Debt Service Ratio (Interest cover) =	$\frac{\text{EBIT}}{\text{Interest}}$
Dividend Cover (For preference shareholder) =	$\frac{\text{Profit After Tax (PAT)}}{\text{Preference Dividend}}$
Dividend Cover (For equity shareholder) =	$\frac{\text{Profit available for equity shareholder}}{\text{Equity dividend}}$
Turnover Ratios:	
Stock Turnover Ratio =	$\frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$
Stock Velocity =	$\frac{\text{Average Stock}}{\text{Cost of Goods Sold}} \times 12 \text{ months}$
Debtors Turnover Ratio =	$\frac{\text{Credit Sales}}{\text{Average Account Receivable}}$

Debtors Velocity =	$\frac{\text{Average Account Receivable}}{\text{Credit Sales}} \times 12 \text{ months}$
Creditors Turnover Ratio =	$\frac{\text{Credit Purchase}}{\text{Average Account Payable}}$
Creditors Velocity =	$\frac{\text{Average Account Payable}}{\text{Credit Purchase}} \times 12 \text{ months}$
Fixed Assets Turnover Ratio =	$\frac{\text{Total Sales}}{\text{Fixed Assets}}$
Working Capital Turnover Ratio =	$\frac{\text{Total Sales}}{\text{Working Capital}}$
Profitability Ratios:	
Gross Profit Ratio =	$\frac{\text{Gross Profit}}{\text{Sales}} \times 100$
Net Profit Ratio =	$\frac{\text{Net Profit (PAT)}}{\text{Sales}} \times 100$
Return on Investment (ROI) =	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$
Return on Net Worth (for equity shares) =	$\frac{\text{PAT}}{\text{Shareholders funds}} \times 100$
Return on Net Worth (for equity shares) =	$\frac{\text{Profit available for equity shareholder}}{\text{Equity Shareholders Funds}}$
Market test Ratios:	
Earnings Per Share (EPS) =	$\frac{\text{Profit available for equity shareholder}}{\text{No. of equity shares}}$
P/E Ratio =	$\frac{\text{Market Price}}{\text{EPS}}$
Dividend Payout Ratio =	$\frac{\text{Dividend Per Share (DPS)}}{\text{EPS}}$
Dividend Yield Ratio =	$\frac{\text{DPS}}{\text{Market Price}} \times 100$
Operating Ratio =	$\frac{\text{Operating Cost}}{\text{Sales}} \times 100$

SOLVED ILLUSTRATIONS

Illustration 1:

Current Ratio is 2.5; Working Capital is Rs. 60,000. Calculate the amount of Current Assets and Current Liabilities.

Solution:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = 2.5$$

$$\text{Current Assets} = 2.5 \times \text{Current Liabilities}$$

$$\text{Working Capital} = \text{Rs. 60,000 (Given)}$$

$$\text{Let Current Liabilities be } x; \text{ Current Assets} = 2.5x$$

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

$$2.5x - x = \text{Rs. 60,000}$$

$$x = \text{Rs. 60,000} / 1.5 = \text{Rs. 40,000 [Current Liabilities].}$$

$$\text{Current Assets} = \text{Rs. 40,000} \times 2.5 = \text{Rs. 1,00,000.}$$

Illustration 2:

Working Capital is Rs. 7,20,000; Trade Payables Rs. 40,000; Other Current Liabilities Rs. 2,00,000; calculate Current Ratio.

Solution:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{Rs. 9,60,000}}{\text{Rs. 2,40,000}} = 4:1$$

$$\begin{aligned} \text{Current Liabilities} &= \text{Trade Payables} + \text{Other Current Liabilities} \\ &= \text{Rs. 40,000} + \text{Rs. 2,00,000} \\ &= \text{Rs. 2,40,000} \end{aligned}$$

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

$$\begin{aligned} \text{Current Assets} &= \text{Working Capital} + \text{Current Liabilities} \\ &= \text{Rs. 7,20,000} + \text{Rs. 2,40,000} \\ &= \text{Rs. 9,60,000.} \end{aligned}$$

Illustration 3:

Calculate Current Ratio from the following:

Working Capital Rs. 1,50,000; Total Liabilities (other than Shareholders' Funds) Rs. 3,25,000; Long-term Debts Rs. 2,50,000.

Solution:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{Rs. 2,25,000}}{\text{Rs. 75,000}} = \mathbf{3:1}$$

Current Liabilities = Total Liabilities (Other than Shareholders' Funds) – Long-term Debts

$$= \text{Rs. 3,25,000} - \text{Rs. 2,50,000}$$

$$= \text{Rs. 75,000}$$

Working Capital = Current Assets – Current Liabilities

Current Assets = Working Capital + Current Liabilities

$$= \text{Rs. 1,50,000} + \text{Rs. 75,000}$$

$$= \text{Rs. 2,25,000.}$$

Illustration 4:

Current Assets are Rs. 4,00,000; Inventories Rs. 2,00,000; Working Capital Rs. 2,40,000, calculate Current Ratio.

Solution:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{Rs. 4,00,000}}{\text{Rs. 1,60,000}} = \mathbf{2.5:1}$$

Working Capital = Current Assets – Current Liabilities

Current Liabilities = Current Assets – Working Capital

$$= \text{Rs. 4,00,000} - \text{Rs. 2,40,000}$$

$$= \text{Rs. 1,60,000}$$

Note: Inventories are already included in Current Assets. Hence, will not be added to Current Assets.

Illustration 5:

Current Assets are Rs. 5,25,000; Inventories Rs. 2,00,000 (includes Loose Tools Rs. 75,000); Working Capital Rs. 2,25,000, calculate Current Ratio.

Solution:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{Rs. 4,50,000}}{\text{Rs. 3,00,000}} = \mathbf{1.5:1}$$

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

$$\text{Current Liabilities} = \text{Current Assets} - \text{Working Capital}$$

$$= \text{Rs. 5,25,000} - \text{Rs. 2,25,000}$$

$$= \text{Rs. 3,00,000}$$

$$\text{Current Assets} = \text{Current Assets} - \text{Loose Tools}$$

$$= \text{Rs. 5,25,000} - \text{Rs. 75,000}$$

$$= \text{Rs. 4,50,000}$$

Note: Loose Tools are excluded from Current Assets to compute Current Ratio.

Illustration 6:

A Company had Current Assets of Rs. 3,00,000 and Current Liabilities of Rs. 1,40,000. Afterwards it purchased goods for Rs. 20,000 on credit. Calculate Current Ratio after the purchase.

Solution:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$= \frac{\text{Rs. 3,00,000} + \text{Rs. 20,000} *}{\text{Rs. 1,40,000} + \text{Rs. 20,000} *} = \frac{\text{Rs. 3,20,000}}{\text{Rs. 1,60,000}} = \mathbf{2:1}$$

*Purchases of Rs. 20,000 on credit results into increase in stock (*i.e.*, Current Assets) and creditors (*i.e.*, Current Liabilities) by Rs. 20,000.

Illustration 7:

Current Liabilities of a company were Rs. 1,00,000 and its Current Ratio was 2.5:1. It paid Rs. 25,000 to a creditor. Calculate Current Ratio after the payment.

Solution:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\text{Rs. 2,25,000}}{\text{Rs. 75,000}} = \mathbf{3 : 1}$$

Working Note:

As, Current Liabilities are Rs. 1,00,000 and Current Ratio is 2.5 : 1;

∴ Current Assets = Rs. 1,00,000 x 2.5 = Rs. 2,50,000.

After payment of Rs. 25,000 to a creditor, Cash (Current Asset) and Creditors (Current Liability) both will reduce by Rs. 25,000 each. Thus,

Current Assets = Rs. 2,50,000 – Rs. 25,000 = Rs. 2,25,000

Current Liabilities = Rs. 1,00,000 – Rs. 25,000 = Rs. 75,000.

Illustration 8: Ratio of Current Assets (Rs. 6,00,000) to Current Liabilities (Rs. 4,00,000) is 1.5:1. The accountant of the firm is interested in maintaining a Current Ratio of 2:1, by paying a part of the Current Liabilities. Compute amount of Current Liabilities that should be paid, so that Current Ratio at the level of 2:1 may be maintained.

Solution:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\frac{1.5}{1} = \frac{\text{Rs. 6,00,000}}{\text{Rs. 4,00,000}}$$

Let the amount paid towards Current Liabilities be x

After the payment of a part of Current Liabilities,

$$\frac{2}{1} = \frac{\text{Rs. 6,00,000} - x}{\text{Rs. 4,00,000} - x}$$

$$\text{Rs. 8,00,000} - 2x = \text{Rs. 6,00,000} - x$$

$$\text{Rs. 8,00,000} - \text{Rs. 6,00,000} = 2x - x$$

$$\text{Rs. 2,00,000} = x$$

Current Liabilities that should be paid = **Rs. 2,00,000.**

Illustration 9:

Current Ratio of X Ltd. is 2:1. State with reason, which of the following transactions would (i) increase; (ii) decrease; or (iii) not change the ratio:

- (i) Included in the Trade Payables was a bill payable of Rs. 9,000 which was met on maturity.
- (ii) Company issued 1,00,000 Equity Shares of Rs. 10 each to the Vendors of Machinery purchased.

Solution:

<i>Change</i>	<i>Reason</i>
(i) Increase	Including a Bill Payable met on maturity would decrease both Current Assets (Cash) and Current Liabilities (Bills Payable) by the same amount.
(ii) No Change	Payment to Vendors of machinery by way of issuing Equity Shares would neither change Current Assets nor Current Liabilities.

Illustration 10:

The Current Ratio of X Ltd. is 1:1. State with reason, which of the following transactions would (i) increase or (ii) decrease or (iii) not change the ratio?

- (i) Included in the trade payables was a bill payable of Rs. 20,000 which was met on maturity.
- (ii) Company issued 50,000 Equity Shares of Rs. 10 each to the vendors of Machinery purchased.

Solution:

Transaction	Effect on Current Ratio	Reason
(i)	No Change	Current Assets and also Current Liabilities have decreased by equal amount. Therefore, the ratio will not change.
(ii)	No Change	Neither Current Assets nor Current Liabilities are affected.

Illustration 11: Inventories are Rs. 80,000; Working Capital Rs. 2,40,000; Current Assets Rs. 4,00,000; calculate Liquid/Quick Ratio.

Solution:

$$\text{Liquid/Quick Ratio} = \frac{\text{Liquid/Quick Assets}}{\text{Current Liabilities}} = \frac{\text{Rs. 3,20,000}}{\text{Rs. 1,60,000}} = 2:1$$

Working Capital = Current Assets – Current Liabilities

Current Liabilities = Current Assets – Working Capital

= Rs. 4,00,000 – Rs. 80,000

= Rs. 3,20,000

Illustration 12: Calculate Liquid Ratio/Quick Ratio/Acid Test Ratio from the following:

Working Capital Rs. 1,80,000; Total Debts, *i.e.*, Outside Liabilities Rs. 3,90,000; Long-term Debts Rs. 3,00,000; Inventories Rs. 90,000.

Solution:

$$\text{Liquid/Quick Ratio} = \frac{\text{Liquid/Quick Assets}}{\text{Current Liabilities}} = \frac{\text{Rs. 1,80,000}}{\text{Rs. 90,000}} = 2:1$$

Current Liabilities = Total Debts, *i.e.*, Outside Liabilities – Long-term Debts

= Rs. 3,90,000 – Rs. 3,00,000

= Rs. 90,000

Current Assets = Working Capital + Current Liabilities

= Rs. 1,80,000 + 90,000

= Rs. 2,70,000

Liquid/Quick Assets = Current Assets – Inventories

= Rs. 2,70,000 – Rs. 90,000

= Rs. 1,80,000

Illustration 13:

Current Liabilities of a company are Rs. 3,00,000. Its Current Ratio is 3 and Liquid Ratio is 1. Calculate value of Inventories.

Solution:

Current Liabilities = Rs. 3,00,000

$$\text{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Current Liabilities}};$$

$$\therefore 1 = \frac{\text{Liquid Assets}}{\text{Rs. 3,00,000}}$$

$$\begin{aligned}\text{Liquid Assets} &= \text{Rs. 3,00,000} \\ \text{Current Assets} &= \text{Current Ratio} \times \text{Current Liabilities} \\ \text{Current Assets} &= 3 \times \text{Rs. 3,00,000} = \text{Rs. 9,00,000} \\ \text{Inventories} &= \text{Current Assets} - \text{Liquid Assets} \\ &= \text{Rs. 9,00,000} - \text{Rs. 3,00,000} \\ &= \text{Rs. 6,00,000}\end{aligned}$$

Illustration 14:

Current Ratio of A Ltd. is 4.5:1 and Liquid Ratio is 3:1. If its Inventories are Rs. 3,00,000, find out its Current Liabilities; Current Assets and Quick Assets.

Solution:

Let Current Liabilities be x

Current Ratio is 4.5:1; $\therefore$ Current Assets = 4.5x

Liquid Ratio is 3:1; $\therefore$ Liquid Assets or Quick Assets = 3x

Liquid Assets = Current Assets – Inventories

$$\text{Or } 3x = 4.5x - \text{Rs. 3,00,000}$$

$$1.5x = \text{Rs. 3,00,000}$$

$$\therefore x = \frac{\text{Rs. 3,00,000}}{1.5} = \text{Rs. 2,00,000}$$

$$\therefore \text{Current Liabilities} = \text{Rs. 2,00,000}$$

$$\text{Current Assets} = \text{Rs. 2,00,000} \times 4.5 = \text{Rs. 9,00,000}$$

$$\begin{aligned}\text{Quick Assets} &= \text{Current Assets} - \text{Inventories} \\ &= \text{Rs. 9,00,000} - \text{Rs. 3,00,000}\end{aligned}$$

$$= \text{Rs. 6,00,000}$$

Or

$$= \text{Rs. 2,00,000 (Current Liabilities)} \times 3 = \text{Rs. 6,00,000}$$

Illustration 15:

Quick Ratio 1.5; Current Assets Rs. 1,00,000; Current Liabilities Rs. 40,000. Calculate value of Inventories (Stock).

Solution:

Calculation of Quick Assets:

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}} = \frac{\text{Quick Assets}}{\text{Rs. 40,000}} = 1.5$$

$$\text{Quick Assets} = \text{Rs. 40,000} \times 1.5 = \text{Rs. 60,000}$$

Calculation of Inventories (Stock):

$$\begin{aligned} \text{Inventories} &= \text{Current Assets} - \text{Quick Assets} \\ &= \text{Rs. 1,00,000} - \text{Rs. 60,000} \\ &= \text{Rs. 40,000} \end{aligned}$$

Illustration 16:

Working Capital of a company is Rs. 6,00,000. Its Current Ratio is 2.5:1. Calculate value of (i) Current Liabilities, (ii) Current Assets, and (iii) Liquid Ratio/Quick Ratio/Acid Test Ratio, assuming Inventories of Rs. 4,00,000.

Solution:

	Current Ratio	= 2.5 : 1 (Given)
	Let Current Liabilities	= x
Then,	Current Assets	= 2.5x
	Working Capital	= Current Assets – Current Liabilities
	Rs. 6,00,000	= 2.5x – x
	Rs. 6,00,000	= 1.5x

Therefore,

$$(i) \quad \text{Current Liabilities (x)} = \frac{\text{Rs. 6,00,000}}{1.5} = \text{Rs. 4, 00, 000}$$

$$(ii) \quad \text{Current Assets} = \text{Rs. } 4,00,000 \times 2.5 = \text{Rs. } 10,00,000$$

$$(iii) \quad \text{Liquid Ratio/Acid Test Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}} = \frac{\text{Rs. } 6,00,000}{\text{Rs. } 4,00,000} = 1.5 : 1$$

$$\begin{aligned} \text{Quick Assets} &= \text{Current Assets} - \text{Inventories} \\ &= \text{Rs. } 10,00,000 - \text{Rs. } 4,00,000 \\ &= \text{Rs. } 6,00,000. \end{aligned}$$

Illustration 17: Calculate Total Assets to Debt Ratio from the following information:

Long-term Debts Rs. 16,00,000; Total Assets Rs. 24,00,000.

Solution:

$$\text{Total Assets to Debt Ratio} = \frac{\text{Total Assets}}{\text{Long-term Debts}} = \frac{\text{Rs. } 24,00,000}{\text{Rs. } 16,00,000} = 1.5 : 1$$

Illustration 18: Shareholders' Funds Rs. 14,00,000; Total Debts (Liabilities) Rs. 18,00,000; Current Liabilities Rs. 2,00,000. Calculate Total Assets to Debt Ratio.

Solution:

$$\text{Total Assets to Debt Ratio} = \frac{\text{Total Assets}}{\text{Long-term Debts}} = \frac{\text{Rs. } 32,00,000}{\text{Rs. } 16,00,000} = 2 : 1$$

$$\begin{aligned} \text{Long-term Debts} &= \text{Total Debts (Liabilities)} - \text{Current Liabilities} \\ &= \text{Rs. } 18,00,000 - \text{Rs. } 2,00,000 \\ &= \text{Rs. } 16,00,000 \end{aligned}$$

$$\begin{aligned} \text{Total Assets} &= \text{Shareholders' Funds} + \text{Total Debts (Liabilities)} \\ &= \text{Rs. } 14,00,000 + \text{Rs. } 18,00,000 \\ &= \text{Rs. } 32,00,000. \end{aligned}$$

Illustration 19: Compute Total Assets to Debt Ratio from the following information:

Share Capital Rs. 12,00,000; Reserves and Surplus Rs. 8,00,000; Long-term Borrowings Rs. 25,00,000; Long-term Provisions Rs. 5,00,000; Current Liabilities Rs. 10,00,000.

Solution:

$$\text{Total Assets to Debt Ratio} = \frac{\text{Total Assets}}{\text{Debt}} = \frac{\text{Rs. 60,00,000}}{\text{Rs. 30,00,000}} = 2 : 1$$

$$\begin{aligned} \text{Total Assets} = & \text{Share Capital} + \text{Reserves and Surplus} + \text{Long – term Borrowings} \\ & + \text{Long – term Provisions} + \text{Current Liabilities} \end{aligned}$$

$$= \text{Rs. 12,00,000} + \text{Rs. 8,00,000} + \text{Rs. 25,00,000} + \text{Rs. 5,00,000} + \text{Rs. 10,00,000}$$

$$= \text{Rs. 60,00,000}$$

$$\text{Debt} = \text{Long – term Borrowings} + \text{Long – term Provisions}$$

$$= \text{Rs. 25,00,000} + \text{Rs. 5,00,000}$$

$$= \text{Rs. 30,00,000}$$

Illustration 20:

From the following information, calculate Debt to Equity Ratio, Proprietary Ratio and Total Assets to Debt Ratio:

	Rs.		Rs.
Equity Share Capital	2,00,000	12% Debentures	16,00,000
10% Preference Share Capital	3,00,000	Current Liabilities	6,80,000
Reserves:		Fixed Assets (Tangible)	21,00,000
General Reserve	2,50,000	Long-term Trade Investments	2,00,000
Surplus, i.e., Balance in Statement of Profit and Loss	1,50,000	Current Assets	8,80,000

Solution:

$$\text{Debt to Equity Ratio} = \frac{\text{Debt}}{\text{Equity}} = \frac{\text{Rs. 16,00,000}}{\text{Rs. 9,00,000}} = 1.78 : 1$$

$$\text{Proprietary Ratio} = \frac{\text{Shareholders' Funds}}{\text{Total Assets}} = \frac{\text{Rs. 9,00,000 (WN 1)}}{\text{Rs. 31,80,000}} = 0.28$$

$$\text{Total Assets to Debt Ratio} = \frac{\text{Total Assets}}{\text{Debt}} = \frac{\text{Rs. 31,80,000 (WN 3)}}{\text{Rs. 16,00,000 (WN 4)}} = \mathbf{1.99 : 1}$$

Working Notes:

1. Calculation of Shareholders' Funds or Proprietors' Fund or Equity:

Liabilities Approach	Rs.	Assets Approach	Rs.
Equity Share Capital	2,00,000	Fixed Assets (Tangible)	21,00,000
Add: Reserves and Surplus (Rs. 2,50,000 + Rs. 1,50,000)	<u>4,00,000</u>	Long-term Trade Investments	2,00,000
	-		
Equity Shareholders' Funds	6,00,000	Add: Working Capital (WN 2)	<u>2,00,000</u>
Add: Preference Share Capital	<u>3,00,000</u>		25,00,000
		Less: Long-term Borrowings (12 % Debentures)	<u>16,00,000</u>
Shareholders' Funds	<u>9,00,000</u>	Shareholders' Funds	<u>9,00,000</u>

2. *Working Capital = Current Assets – Current Liabilities*

$$= \text{Rs. 8,80,000} - \text{Rs. 6,80,000} = \text{Rs. 2,00,000}$$

3. *Total Assets = Fixed Assets (Tangible) + Long – term Trade Investments + Current Assets*

$$= \text{Rs. 21,00,000} + \text{Rs. 2,00,000} + \text{Rs. 8,80,000} = \text{Rs. 31,80,000}$$

4. Debt = 12% Debentures = Rs. 16,00,000

Illustration 21:

From the following information compute:

- (i) Debt to Equity Ratio;
- (ii) Total Assets to Debt Ratio;
- (iii) Proprietary Ratio

Particulars	Rs.
Long-term Borrowings	5,00,000
Long-term Provisions	2,50,000
Current Liabilities	1,25,000
Non-Current Assets	9,00,000
Current Assets	2,25,000

Solution:

$$(i) \quad \text{Debt to Equity Ratio} = \frac{\text{Debt/Long-term Debt}}{\text{Shareholders' Funds}} = \frac{\text{Rs.7,50,000}}{\text{Rs.2,50,000}} = \mathbf{3:1}$$

$$(ii) \quad \text{Total Assets to Debt Ratio} = \frac{\text{Total Assets}}{\text{Debt}} = \frac{\text{Rs.11,25,000}}{\text{Rs.7,50,000}} = \mathbf{1.5:1}$$

$$(iii) \quad \text{Proprietary Ratio} = \frac{\text{Shareholders' Funds}}{\text{Total Assets}} = \frac{\text{Rs.2,50,000}}{\text{Rs.11,25,000}} = \mathbf{0.22:1}$$

Notes:

$$\begin{aligned} 1. \text{ Debt} &= \text{Long-term Borrowings} + \text{Long-term Provisions} \\ &= \text{Rs. 5,00,000} + \text{Rs. 2,50,000} \\ &= \text{Rs. 7,50,000} \end{aligned}$$

$$\begin{aligned} 2. \text{ Shareholders' Funds} &= \text{Total Assets} - \text{Non-Current Liabilities} - \text{Current Liabilities} \\ &= (\text{Non-Current Assets} + \text{Current Assets}) - (\text{Long-term Borrowings} + \text{Long term Provisions}) - \text{Current Liabilities} \\ &= (9,00,000 + \text{Rs. 2,25,000}) - (\text{Rs. 5,00,000} + \text{Rs. 2,50,000}) - \text{Rs. 1,25,000} \\ &= \text{Rs. 11,25,000} - \text{Rs. 7,50,000} - \text{Rs. 1,25,000} \\ &= \text{Rs. 2,50,000.} \end{aligned}$$

$$\begin{aligned} 3. \text{ Total Assets} &= \text{Non-Current Assets} + \text{Current Assets} \\ &= \text{Rs. 9,00,000} + \text{Rs. 2,25,000} \\ &= \text{Rs. 11,25,000} \end{aligned}$$

Illustration 22:

From the following details obtained from the financial statements of Jeev Ltd., calculate

Interest Coverage Ratio:

Net Profit after Tax	Rs. 1,20,000
12% Long-term Debt	Rs. 20,00,000
Tax Rate	40%

Solution:

$$\begin{aligned}\text{Interest Coverage Ratio} &= \frac{\text{Net Profit before Interest and Tax}}{\text{Interest on Long – term Debt}} \\ &= \frac{\text{Rs. 4,40,000}}{\text{Rs. 2,40,000}} = \mathbf{1.83 \text{ Times.}}\end{aligned}$$

Interest on Long-term Debts = 12% of Rs. 20,00,000 = Rs. 2,40,000

Calculation of Net Profit before Interest and Tax:

Net Profit after Tax = Rs. 1,20,000

Let, Net Profit before Tax = Rs. 100; Tax = Rs. 40; Net Profit after Tax = Rs. 60

$$\text{Net Profit before Tax} = \text{Rs. 1,20,000} \times \frac{100}{60} = \text{Rs. 2,00,000}$$

Net Profit before Interest and Tax = Net Profit before Tax + Interest on Long-term Debts
= Rs. 2,00,000 + Rs. 2,40,000
= Rs. 4,40,000.

Illustration 23:

Opening Inventory Rs. 29,000; Closing Inventory Rs. 31,000; Revenue from Operations (Net Sales) Rs. 3,00,000; Gross Profit 25% on Cost. Calculate Inventory Turnover Ratio.

Solution:

$$\begin{aligned}\text{Inventory Turnover Ratio} &= \frac{\text{Cost of Revenue from Operations}}{\text{Average Inventory}} = \frac{\text{Rs. 2,40,000}}{\text{Rs. 30,000}} \\ &= \mathbf{8 \text{ Times}}\end{aligned}$$

Calculation of Cost of Revenue from Operations (Cost of Goods Sold):

Let Cost of Revenue from Operations (Cost of Goods Sold) be Rs. 100

Gross Profit = Rs. 25

Revenue from Operations = Rs. 100 + Rs. 25 = Rs. 125

If Revenue from Operations (Net Sales) is Rs. 125 then Cost of Revenue from Operations (Cost of Goods Sold) is = Rs. 100.

If Revenue from Operations (Net Sales) is Rs. 3,00,000, then Cost of Revenue from Operations

$$(\text{Cost of Goods Sold}) = \frac{\text{Rs. 100}}{\text{Rs. 125}} \times \text{Rs. 3,00,000} = \text{Rs. 2,40,000}$$

$$\begin{aligned}\text{Average Inventory} &= \frac{\text{Opening Inventory} + \text{Closing Inventory}}{2} \\ &= \frac{\text{Rs. 29,000} + \text{Rs. 31,000}}{2} = \text{Rs. 30,000}\end{aligned}$$

Illustration 24:

From the following information, calculate Inventory Turnover Ratio:

Net Sales Rs. 4,00,000; Average Inventory Rs. 55,000; Gross Loss on Sales is 10%.

Solution:

$$\begin{aligned}\text{Inventory Turnover Ratio} &= \frac{\text{Cost of Revenue from Operations}}{\text{Average Inventory}} = \frac{\text{Rs. 4,40,000}}{\text{Rs. 55,000}} \\ &= \mathbf{8 \text{ Times}}\end{aligned}$$

Working Note:

Net Sales = Rs. 4,00,000

Gross Loss = 10% of Rs. 4,00,000
= 40,000

Cost of Revenue from Operations = Net Sales + Gross Loss
= Rs. 4,00,000 + Rs. 40,000
= Rs. 4,40,000

Illustration 25:

Calculate Trade Receivables Turnover Ratio and Average Collection Period:

Credit Revenue from Operations (Net Credit Sales) for the year is Rs. 6,00,000 and Debtors and Bills Receivable at the year end were Rs. 60,000 and Rs. 40,000 respectively.

Solution:

Trade Receivables Turnover Ratio

$$= \frac{\text{Credit Revenue from Operations (Net Credit Sales)}}{\text{Average Trade Receivables (Debtors + Bills Receivable)}}$$

$$= \frac{\text{Rs. 6,00,000}}{\text{Rs. 60,000 + Rs. 40,000}} = \frac{\text{Rs. 6,00,000}}{\text{Rs. 1,00,000}} = \mathbf{6 \text{ Times}}$$

$$\text{Average Collection Period (Months)} = \frac{\text{No. of Months in a Year}}{\text{Trade Receivables Turnover Ratio}} = \frac{12}{6}$$

$$= \mathbf{2 \text{ Months}}$$

$$\text{Average Collection Period (Days)} = \frac{\text{No. of Days in a Year}}{\text{Trade Receivables Turnover Ratio}}$$

$$= \frac{365}{6} = \mathbf{60.83 \text{ or } 61 \text{ Days.}}$$

Note: Opening balances of debtors and bills receivable are not given. Hence, they are presumed to be nil.

Illustration 26:

From the following details, calculate Trade Receivables Turnover Ratio:

	Rs.
Total Sales for the year (Net)	Rs. 1,75,000
Cash Sales (Net)	20% of Total Net Sales
Sales Return - Out of Credit Sales	10,000
Sundry Debtors:	
Opening balance	8,000
Closing balance	12,000

Solution:

Trade Receivables Turnover Ratio

$$= \frac{\text{Credit Revenue from Operations (Net Credit Sales)}}{\text{Average Debtors}} = \frac{\text{Rs. 1,40,000}}{\text{Rs. 10,000}}$$

$$= \mathbf{14 \text{ Times}}$$

Note: Credit Revenue from Operations, i.e., Net Credit Sales

= Total Net Sales – Net Cash Sales

= Rs. 1,75,000 – Rs. 35,000 (i.e., 20% of Rs. 1,75,000) = Rs. 1,40,000

$$\begin{aligned} \text{Average Debtors} &= (\text{Opening Debtors} + \text{Closing Debtors}) / 2 \\ &= (\text{Rs. 8,000} + \text{Rs. 12,000}) / 2 \\ &= \text{Rs. 10,000.} \end{aligned}$$

Illustration 27:

Calculate amount of Opening Trade Receivables and Closing Trade Receivables from the following figures:

Trade Receivables Turnover Ratio	4 times
Cost of Revenue from Operations (Cost of Goods Sold)	Rs. 6,40,000
Gross Profit Ratio	20%

Closing Trade Receivables were Rs. 20,000 more than in the beginning.

Cash Sales being $33\frac{1}{3}\%$ of Credit Sales.

Solution:

Sales = Cost of Revenue from Operations (Cost of Goods Sold) + Profit

Let Sales = Rs. 100; Gross Profit = Rs. 20

Cost of Revenue from Operations (Cost of Goods Sold) = Rs. 100 – Rs. 20 = Rs. 80.

If the Cost of Revenue from Operations (Cost of Goods Sold) is Rs. 80, then Sales = Rs. 100.

If the Cost of Revenue from Operations (Cost of Goods Sold) is Rs. 6,40,000, then

$$\text{Sales} = \frac{\text{Rs. } 6,40,000 \times 100}{80} = \text{Rs. } 8,00,000$$

$$\text{Total Sales} = \text{Cash Sales} + \text{Credit Sales}$$

Let the Credit Sales be x; Cash Sales = $\frac{x}{3}$

$$\text{Rs. } 8,00,000 = \frac{x}{3} + x \quad \text{or} \quad 3x + x = \text{Rs. } 24,00,000$$

$$X = \text{Rs. } 6,00,000 \text{ (Credit Sales).}$$

Trade Receivables Turnover Ratio

$$= \frac{\text{Credit Revenue from Operations, i.e., Net Credit Sales}}{\text{Average Trade Receivables}}$$

$$\text{Average Trade Receivables} = (\text{Opening Trade Receivables} + \text{Closing Trade Receivables}) / 2$$

$$\text{Let Opening Trade Receivables be } y, \text{ Closing Trade Receivables} = y + \text{Rs. } 20,000$$

$$4 \text{ (Given)} = \frac{\text{Rs. } 6,00,000}{\frac{y + y + \text{Rs. } 20,000}{2}}$$

$$4y + 4y + \text{Rs. } 80,000 = \text{Rs. } 12,00,000$$

$$8y = \text{Rs. } 11,20,000$$

$$Y = \text{Rs. } 1,40,000 \text{ (Opening Trade Receivables).}$$

$$\text{Closing Trade Receivables} = \text{Opening Trade Receivables} + \text{Rs. } 20,000$$

$$= \text{Rs. } 1,40,000 + \text{Rs. } 20,000$$

$$= \text{Rs. } 1,60,000$$

Illustration 28:

From the following information, calculate Trade Receivables Turnover Ratio:

Cost of Revenue from Operations (Cost of Goods Sold) – Rs. 3,00,000

Gross Profit on Cost – 25%

Cash Sales – 20% of Total Sales

Opening Debtors – Rs. 50,000

Closing Debtors – Rs. 1,00,000

Solution:

Trade Receivables Turnover Ratio

$$= \frac{\text{Credit Revenue from Operations, i.e., Net Credit Sales}}{\text{Average Trade Receivables}} = \frac{\text{Rs. 3,00,000}}{\text{Rs. 75,000}} \\ = 4 \text{ Times.}$$

Notes:

1. Revenue from Operations, i.e.,

$$\begin{aligned} \text{Net Sales} &= \text{Cost of Revenue from Operations (Cost of Goods Sold) + Gross Profit} \\ &= \text{Rs. 3,00,000 + 25\% of Rs. 3,00,000} \\ &= \text{Rs. 3,00,000 + Rs. 75,000} = \text{Rs. 3,75,000.} \end{aligned}$$

Credit Revenue from Operations, i.e.,

$$\begin{aligned} \text{Net Credit Sales} &= \text{Net Sales – Cash Sales} \\ &= \text{Rs. 3,75,000 – 20\% of Rs. 3,75,000} = \text{Rs. 3,00,000.} \end{aligned}$$

2. Average Trade Receivables (Average Debtors) = (Opening Debtors + Closing Debtors)/2

$$\begin{aligned} &= (\text{Rs. 50,000 + Rs. 1,00,000}) / 2 \\ &= \text{Rs. 75,000} \end{aligned}$$

Illustration 29:

Current Assets Rs. 12,00,000; Current Liabilities Rs. 2,40,000; Sales: Credit Rs. 24,00,000 and Cash Rs. 5,20,000; Sales Return Rs. 40,000; calculate Working Capital Turnover Ratio from the above information.

Solution:

$$\begin{aligned} \text{Working Capital Turnover Ratio} &= \frac{\text{Revenue from Operations, i.e., Net Sales}}{\text{Working Capital}} \\ &= \frac{\text{Rs. 28,80,000}}{\text{Rs. 9,60,000}} = 3 \text{ Times} \end{aligned}$$

Revenue from Operations, i.e., Net Sales

$$= \text{Cash Sales} + \text{Credit Sales} - \text{Sales Return}$$

$$= \text{Rs. } 5,20,000 + \text{Rs. } 24,00,000 - \text{Rs. } 40,000 = \text{Rs. } 28,80,000$$

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

$$= \text{Rs. } 12,00,000 - \text{Rs. } 2,40,000 = \text{Rs. } 9,60,000$$

Illustration 30:

Working Capital Rs. 2,50,000; Cost of Revenue from Operations (Cost of Goods Sold) Rs. 10,00,000; Gross Profit on Sales 20%. Calculate Working Capital Turnover Ratio from the above information.

Solution:

Calculation of Revenue from Operations, i.e., Net Sales:

Let Sales be = Rs. 100; Profit 20% on Sales = Rs. 20; Therefore, Cost = Rs. 80

When Cost is Rs. 80, then Sales = Rs. 100

When Cost is Rs. 1, then Sales = Rs. 100/Rs. 80

When Cost is Rs. 10,00,000, then Sales = Rs. 100/Rs. 80 × Rs. 10,00,000 = Rs. 12,50,000

$$\text{Working Capital Turnover Ratio} = \frac{\text{Revenue from Operations (Net Sales)}}{\text{Working Capital}}$$

$$= \frac{\text{Rs. } 12,50,000}{\text{Rs. } 2,50,000} = 5 \text{ Times.}$$

Illustration 31:

Calculate Working Capital Turnover Ratio from the following information:

Revenue from Operations Rs. 12,00,000; Current Assets Rs. 5,00,000; Total Assets Rs. 8,00,000; Non-current Liabilities Rs. 4,00,000; and Shareholders' Funds Rs. 2,00,000.

Solution:

$$\begin{aligned}\text{Working Capital Turnover Ratio} &= \frac{\text{Revenue from Operations}}{\text{Working Capital}} \\ &= \frac{\text{Rs. 12,00,000}}{\text{Rs. 3,00,000 (Note)}} = \mathbf{4 \text{ Times.}}\end{aligned}$$

Note: Working Capital = Current Assets – Current Liabilities
= Rs. 5,00,000 – Rs. 2,00,000*
= Rs. 3,00,000

*Current Liabilities = Total Assets – Non-current Liabilities – Shareholders' Funds
= Rs. 8,00,000 – Rs. 4,00,000 – Rs. 2,00,000
= Rs. 2,00,000

Illustration 32:

Compute Gross Profit Ratio from the following information:

Revenue from Operations Rs. 6,00,000; Gross Profit 25% on cost.

Solution:

Let the Cost be Rs. 100; Gross Profit = Rs. 25; Sales = Rs. 125

$$\text{Cost of Revenue from Operations (Cost of Goods Sold)} = \frac{100}{125} \times \text{Rs. 6,00,000} = \text{Rs. 4,80,000.}$$

$$\begin{aligned}\text{Gross Profit} &= \text{Revenue from Operations} - \text{Cost of Revenue from Operations} \\ &= \text{Rs. 6,00,000} - \text{Rs. 4,80,000} \\ &= \text{Rs. 1,20,000}\end{aligned}$$

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Revenue from Operations}} \times 100 = \frac{\text{Rs. 1,20,000}}{\text{Rs. 6,00,000}} \times 100 = \mathbf{20\%}$$

Illustration 33:

Calculate Gross Profit Ratio from the following information:

Cash Sales are 25% of Total Sales; Purchases Rs. 6,90,000; Credit Sales Rs. 6,00,000; Excess of Closing Inventory over Opening Inventory Rs. 50,000.

Solution:

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Revenue from Operations}} \times 100 = \frac{\text{Rs. 1,60,000}}{\text{Rs. 8,00,000}} \times 100 = \mathbf{20\%}$$

Working Notes:

Calculation of Revenue from Operations, i.e., Net Sales = Credit Sales + Cash Sales

Let Revenue from Operations, i.e., Net Sales be x.

Credit Sales (Given) = Rs. 6,00,000

∴ Cash Sales = 25% of x or $\frac{x}{4}$

$X = \frac{x}{4} + \text{Rs. 6,00,000}$ (Credit sales)

$4x = x + \text{Rs. 24,00,000}$ or

$3x = \text{Rs. 24,00,000}$

$X = \text{Rs. 8,00,000}$ (Revenue from Operations, i.e., Net Sales)

Cash Sales = $\text{Rs. 8,00,000} \times \frac{25}{100} = \text{Rs. 2,00,000}$.

Cost of Revenue from Operations (Cost of Goods Sold)

= Purchases + Change in Inventories*

= Purchases – Excess of Closing Inventory over Opening Inventory

= Rs. 6,90,000 – Rs. 50,000

= Rs. 6,40,000

Gross Profit = Revenue from Operations, i.e.,

Net Sales – Cost of Revenue from Operations (Cost of Goods Sold)

= Rs. 8,00,000 – Rs. 6,40,000

= Rs. 1,60,000

*Change in Inventories = Opening Inventories – Closing Inventories. Excess of Closing Inventory over Opening Inventory means negative change. Hence, it is deducted.

Illustration 34:

From the following information, calculate Operating Ratio:

	Rs.
Cost of Revenue from Operations (Cost of Goods Sold)	6,00,000
Revenue from Operations	Rs. 8,00,000
Operating Expenses	Rs. 40,000

Solution:

$$\begin{aligned} \text{Operating Ratio} &= \frac{\text{Cost of Revenue from Operations} + \text{Operating Expenses}}{\text{Revenue from Operations}} \times 100 \\ &= \frac{\text{Rs. 6,00,000} + \text{Rs. 40,000}}{\text{Rs. 8,00,000}} \times 100 = \frac{\text{Rs. 6,40,000}}{\text{Rs. 8,00,000}} \times 100 = \mathbf{80\%} \end{aligned}$$

Illustration 35:

From the following information, calculate Operating Ratio: Revenue from Operations Rs. 6,80,000; Rate of Gross Profit on Cost 25%; Selling Expenses Rs. 1,44,000; Administrative Expenses Rs. 73,000.

Solution:

$$\begin{aligned} \text{Operating Ratio} &= \frac{\text{Cost of Revenue from Operations} + \text{Operating Expenses}}{\text{Revenue from Operations}} \times 100 \\ &= \frac{\text{Rs. 5,44,000} + \text{Rs. 2,17,000}}{\text{Rs. 6,80,000}} \times 100 = \frac{\text{Rs. 7,61,000}}{\text{Rs. 6,80,000}} \times 100 = \mathbf{111.91\%} \end{aligned}$$

Notes:**1. Calculation of Cost of Revenue from Operations:**

Let Cost of Revenue from Operations be Rs. 100; Gross Profit = Rs. 25.

Revenue from Operations = Rs. 100 + Rs. 25 = Rs. 125

$$\text{Cost of Revenue from Operations} = \text{Rs. } 6,80,000 \times \frac{100}{125} = \text{Rs. } 5,44,000$$

$$\begin{aligned} 2. \text{ Operating Expenses} &= \text{Selling Expenses} + \text{Administrative Expenses} \\ &= \text{Rs. } 1,44,000 + \text{Rs. } 73,000 \\ &= \text{Rs. } 2,17,000. \end{aligned}$$

Illustration 36: Revenue from Operations Rs. 4,50,000. Gross Profit 25% on Cost, Operating Expenses Rs. 22,500. Calculate Operating Profit Ratio.

Solution:

$$\begin{aligned} \text{Operating Profit Ratio} &= \frac{\text{Operating Profit}}{\text{Revenue from Operations (Net Sales)}} \times 100 \\ &= \frac{\text{Rs. } 67,500}{\text{Rs. } 4,50,000} \times 100 = \mathbf{15\%} \end{aligned}$$

Notes:

1. Calculation of Cost of Revenue from Operations:

Let Cost of Revenue from Operations = Rs. 100; Gross Profit = Rs. 25

Revenue from Operations = Rs. 100 + Rs. 25 = Rs. 125

When Revenue from Operations is Rs. 4,50,000, Cost of Revenue from Operations =

$$\text{Rs. } 4,50,000 \times \frac{100}{125} = \text{Rs. } 3,60,000.$$

2. Operating Profit = Revenue from Operations – Operating Cost**

$$= \text{Rs. } 4,50,000 - \text{Rs. } 3,60,000 - \text{Rs. } 22,500 = \text{Rs. } 67,500.$$

*Operating Cost = Cost of Revenue from Operations + Operating Expenses.

Illustration 37:

Gross Profit Ratio of a company was 25%. Its cash sales were Rs. 2,00,000 and credit sales were 90% of the total sales. If the indirect expenses of the company were Rs. 20,000, calculate Net Profit Ratio.

Solution:

$$\begin{aligned} \text{Net Profit Ratio} &= \frac{\text{Net Profit}}{\text{Revenue from Operations (Net Sales)}} \times 100 \\ &= \frac{\text{Rs. 4,80,000}}{\text{Rs. 20,00,000}} \times 100 = \mathbf{24\%} \end{aligned}$$

$$\begin{aligned} \text{Total Revenue from Operations} &= \text{Cash Sales} + \text{Credit Sales} \\ &= \text{Rs. 2,00,000} + \text{Rs. 18,00,000} \\ &= \text{Rs. 20,00,000} \end{aligned}$$

$$\text{Cash Sales} = \text{Rs. 2,00,000}$$

$$\text{Credit Sales} = 90\% \text{ of Revenue from Operations, i.e., Net Sales}$$

It means Cash Sales were 10% of the Revenue from Operations, i.e., Net Sales

∴ Revenue from Operations, i.e., Net Sales

$$\begin{aligned} &= \frac{\text{Cash Sales}}{10} \times 100 \\ \text{Sales (Cash + Credit)} &= \frac{\text{Rs. 2,00,000} \times 100}{10} = \text{Rs. 20,00,000} \end{aligned}$$

$$\text{Gross Profit} = \text{Rs. 20,00,000} \times \frac{25}{100} = \text{Rs. 5,00,000}$$

$$\begin{aligned} \text{Net profit} &= \text{Gross Profit} - \text{Indirect Expenses} \\ &= \text{Rs. 5,00,000} - \text{Rs. 20,000} \\ &= \text{Rs. 4,80,000} \end{aligned}$$

Illustration 38:

With the help of the following information, calculate Return on Investment:

Net Profit after Interest and Tax Rs. 6,00,000; 10% Debentures Rs. 10,00,000; Tax @ 40%;

Capital Employed Rs. 80,00,000.

Solution:

$$\text{Return on Investment} = \frac{\text{Net Profit before Interest, Tax and Dividend}}{\text{Capital Employed}} \times 100$$

$$= \frac{\text{Rs. 11,00,000 (WN)}}{\text{Rs. 80,00,000}} \times 100 = \mathbf{13.75\%}$$

Working Note:

Calculation of Net Profit before Interest, Tax and Dividend:

Let Net Profit before Tax = Rs. 100; Tax = Rs. 40.

Net Profit after Interest and Tax = Rs. 100 – Rs. 40 = Rs. 60

Net Profit before Tax = Rs. 6,00,000 $\times \frac{100}{60}$ = Rs. 10,00,000

Net Profit before Interest and Tax = Rs. 10,00,000 + $\left(\text{Rs. 10,00,000} \times \frac{10}{100} \right) =$
Rs. 11,00,000

Illustration 39: From the following information, calculate Return on Capital Employed (or Investment):

	Rs.		Rs.
Net Profit after Interest and Tax	1,20,000	Equity Share Capital	50,000
Tax	1,20,000	10% Preference Share Capital	50,000
Net Fixed Assets	5,00,000	Reserves and Surplus	1,00,000
Long-term Trade Investments (Trade)	50,000	Current Liabilities	1,70,000
Current Assets	2,20,000	12% Debentures	4,00,000

Solution:

Return on Capital Employed (or Investment)

$$= \frac{\text{Net Profit before Interest and Tax}}{\text{Capital Employed}} \times 100$$

$$= \frac{\text{Rs. 2,88,000 (WN 1)}}{\text{Rs. 6,00,000 (WN 2)}} \times 100 = \mathbf{48\%}$$

1.	Calculation of Net Profit before Interest and Tax:	Rs.
	Net Profit after Interest and Tax	1,20,000
	Add: Interest on Debentures (Rs. 4,00,000 x 12/100)	48,000
	Tax	1,20,000
	Net Profit before Interest and Tax	<u>2,88,000</u>
2.	Capital Employed:	
	Net Fixed Assets	5,00,000
	Working Capital (i.e., Current Assets - Current Liabilities)	
	(Rs. 2,20,000 - Rs. 1,70,000)	50,000
	Long-term Trade Investments	50,000
	Capital Employed (Assets Approach)	<u>6,00,000</u>
	Or	
	Equity Share Capital	50,000
	Add: Reserves and Surplus	1,00,000
		<u>1,50,000</u>
	Add: Preference Share Capital	50,000
	Shareholders' Funds	<u>2,00,000</u>
	Long-term Borrowings (12% Debentures)	4,00,000
	Capital Employed (Liabilities Approach)	<u>6,00,000</u>

Trade Investment is an investment made by a company in the shares or debentures of another company for the purpose of promoting its own business.

Illustration 40:

From the following information, calculate:

- (i) Operating Ratio
- (ii) Quick Ratio, and

(iii) Working Capital Turnover Ratio.

Information: Equity Share Capital Rs. 1,00,000; 12% Preference Share Capital Rs. 80,000; 12% Debentures Rs. 60,000; General Reserve Rs. 40,000; Revenue from Operations Rs. 3,00,000; Opening Inventory Rs. 10,000; Purchases Rs. 1,20,000; Wages Rs. 30,000; Closing Inventory Rs. 30,000; Selling and Distribution Expenses Rs. 10,000; Quick Assets Rs. 2,00,000 and Current Liabilities Rs. 1,20,000.

Solution:

(i) Operating Ratio

Operating Ratio

$$= \frac{\text{Cost of Revenue from Operations (Cost of Goods sold)} + \text{Operating Expenses}}{\text{Revenue from Operations (Net Sales)}} \times 100$$

$$= \frac{\text{Rs. 1,30,000} + \text{Rs. 10,000}}{\text{Rs. 3,00,000}} \times 100 = \frac{\text{Rs. 1,40,000}}{\text{Rs. 3,00,000}} \times 100 = \mathbf{46.67\%}$$

Cost of Revenue from Operations (Cost of Goods Sold)

= Opening Inventory + Purchases + Wages – Closing Inventory

= Rs. 10,000 + Rs. 1,20,000 + Rs. 30,000 – Rs. 30,000 = Rs. 1,30,000.

Operating Expenses = Selling and Distribution Expenses = Rs. 10,000

$$\text{(ii) Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}} = \frac{\text{Rs. 2,00,000}}{\text{Rs. 1,20,000}} = \mathbf{20 : 12 \text{ or } 1.67 : 1}$$

$$\text{(iii) Working Capital Turnover Ratio} = \frac{\text{Revenue from Operations}}{\text{Working Capital}}$$

$$= \frac{\text{Rs. 3,00,000}}{\text{Rs. 1,10,000}} = \mathbf{2.73 \text{ Times.}}$$

$$\text{Working Capital} = \text{Inventory} + \text{Quick Assets} - \text{Current Liabilities}$$

$$S = \text{Rs. } 30,000 + \text{Rs. } 2,00,000 - \text{Rs. } 1,20,000 = \text{Rs. } 1,10,000.$$

Illustration 41

From the following information, calculate the value of

- a)** Sales
- b)** Debtors
- c)** Closing stock
- d)** Creditors

Debtors velocity	3 months
Stock velocity	6 months
Creditors velocity	2 months
Gross Profit	20%

Gross profit for the year is Rs 5,00,000. Stock of the year is Rs 20,000 more than what it was in the beginning. Bills receivables & bills payable were Rs 60,000 & Rs 336,667, respectively.

Solution:

Calculation of sales

Gross profit ratio = gross profit / sales x 100

$$20 = \frac{5,00,000}{\text{sales}} \times 100$$

$$\text{Sales} = 25,00,000$$

Calculation of debtors

Debtors velocity = accounts receivables / credit sales x 12

$$3 = x/25,00,000 \times 12$$

$$\text{Accounts receivables} = x = 6,25,000$$

$$\text{Accounts receivables} = \text{bills receivables} + \text{debtors}$$

$$6,25,000 = 60,000 + \text{Debtors}$$

$$\text{Debtors} = 5,65,000$$

Calculation of closing stock

$$\text{Cost of goods sold} = \text{sales} - \text{gross profit}$$

$$= 25,00,000 - 5,00,000$$

$$= 20,00,000$$

$$\text{Stock velocity} = \text{average stock} / \text{cost of goods sold} \times 12$$

$$6 = \text{Avg. Stock} / 20,00,000 \times 12$$

$$\text{Avg. stock} = 10,00,000$$

$$\text{Avg. stock} = \text{opening stock} + \text{closing stock} / 2$$

$$10,00,000 = x + x + 20,000 / 2$$

$$\text{Opening stock} = x = 9,90,000$$

$$\text{Closing stock} = x + 20,000$$

$$9,90,000 + 20,000 = 10,10,000$$

Calculation of creditors

$$\text{Cost of goods sold} = \text{opening stock} + \text{Purchases} - \text{closing stock}$$

$$20,00,000 = 9,90,000 + x - 10,10,000$$

$$\text{Purchases} = x = 20,20,000$$

$$\text{Creditors velocity} = \text{accounts payable} / \text{credit purchases} \times 12$$

$$2 = \text{accounts payable} / 20,20,000 \times 12$$

Accounts payable = 3,36,667

Accounts payable = creditors + bills payable

3,36,667 = creditors + 36,667

Creditors = 3,00,000

Illustration 42.

Closing debtors Rs 2,00,000, cash sales 25% of credit sales , excess of closing debtors over opening debtors Rs 80,000 , Total sales Rs 12,00,000.

Calculate debtors turnover ratio and average collection period.

Solution:

Total sales = 12,00,000

Cash sales = 25% of credit sales

Total sales = cash sales + credit sales

Cash sales = $25 / 125 \times 12,00,000$

= 2,40,000

Credit sales = $100/125 \times 12,00,000$

= 9,60,000

Closing debtors = 2,00,000

Opening debtors = 2,00,000 – 80,000

= 1,20,000

Average debtors = opening debtors + closing debtors / 2

= $1,20,000 + 2,00,000 / 2$

= 1,60,000

Debtors Turnover Ratio

= credit sales / average debtors

= 9,60,000 / 1,60,000

= 6 times

Average Collection Period

= 12 / debtors turnover

= 12/6

= 2 times

Illustration 44.

Calculate Debt – Equity Ratio

Debentures	Rs 4,00,000
Creditors	Rs 1,00,000
Long-term loans	Rs 8,00,000
Share capital	Rs 2,00,000
Reserve fund	Rs 1,20,000
Preliminary expense	Rs 20,000.

Solution:

Debt = debentures + Long term loans

= 4,00,000 + 8,00,000

= 12,00,000

Equity = Share capital + reserve fund – preliminary expenses

= 2,00,000 + 1,20,000 – 20,000

= 3,00,000

Debt – equity ratio = debt / equity

12,00,000 / 3,00,000

= 4

Illustration 44.

From the following information calculate stock at the end:

opening stock	62,000
purchases	4,20,000
sales	6,00,000
gross profit	33.33%
(on cost)	

Solution:

Let the cost of goods = Re 1

Gross profit = 33.33% of Re 1 = $\frac{1}{3}$

Sales = Cost Of Goods Sold (COGS) + Gross Profit

= $1 + \frac{1}{3}$

= $\frac{4}{3}$

If sales are $\frac{4}{3}$, COGS is 1

If sales are 1, COGS = $1 \times \frac{3}{4}$

If sales are Rs 6,00,000 , COGS = $1 \times \frac{3}{4} \times 6,00,000$ = Rs 4,50,000

COGS = opening stock + Purchases – closing stock

Closing stock = opening stock + purchases – COGS

$$= 62,000 + 4,20,000 - 4,50,000$$

$$= 32,000$$

Illustration 45.

Balance sheet and income statement of AG Ltd for the year ended 31.03.2017 are as under:

Income Statement of Ag Ltd.

	(in '000)
Sales	1600
Less: COGS	(1310)
Gross Margin	290
Less: Selling & Distribution expenses	(40)
EBIT	250
Less: Interest	(45)
EBT	250
Less: Tax	(82)
Net profit	123

BALANCE SHEET OF AG LTD

LIABILITIES	(in '000)
Paid up capital	
Equity share capital of Rs 10 each	400
Retained earnings	120
Debentures	700
Creditors	180
Bills payable	20
Other current liabilities	80
	1,500
ASSETS	

Net fixed assets	800
Inventories	400
Debtors	175
Marketable securities	75
Cash	50
	1,500

Price per share Rs 15

INDUSTRY 'S AVERAGE RATIO S

Current ratio	2.4
Quick ratio	1.5
Sales to stock	8 times
Avg collection period	36 days
Debt to assets	40%
Debt equity	2:1
Interest earned	6 times
Net profit	7%
Price to earnings	15
Return to total assets	11%

From the above information

- a) Calculate all the relevant ratios and as a company secretary interpret them to identify the problematic areas, clearly and bring out the reason in respect of identified problem.

Solution:

Particulars	Formula	AG Ltd	Industry	Comment
Current Ratio	Current assets / current liabilities	700/280 = 2.5	2.40	Current ratio is slightly high as compared to the industry average ratio. This is due to high level of stock.
Quick Ratio	Quick assets / current	300/280 = 1.07	1.5	Ratio is less as compared to the industry average. But at the

	liabilities			same time it is noted that both quick ratio and current ratio are high which represents heavy accumulation of stock.
Sales to Stock Ratio	Sales / stock	$1600/400 = 4$ $360 / 4 = 90$ dys	8 45 days	This ratio is weak as stock remains without movement for 108 days, whereas for other firms in the industry it remains for 37 days.
Avg Collection Period	Debtors/credit sales $\times 360$	$175/1600 \times 360 = 40$ days	36 days	Ratio is satisfactory as compared to the Industry ratio.
Debt to Assets	Debt/total assets $\times 100$	$700/1500 \times 100 = 46.67\%$	40%	This ratio is used to ascertain the soundness of longterm financial policies of the business. The ratio is satisfactory as it is near to industry ratio.
Debt Equity	Debt/equity	$700/620 = 1.13$	2	The ratio is low which shows that long-term financial options are not properly availed by the company
Interest Earned	EBIT/Interest	$250/45 = 5.55$	6	The ratio indicates that the firm is conservative in using debt
Price to Earnings	Market price/EPS	$15/3.075 = 4.88$	15	Low ratio indicates low earning potential and less market confidence in the company's equity
Return to Total Assets	Net profit/total assets $\times 100$	$123/1500 \times 100 = 8.2\%$	11%	The ratio is less and hence the position is not satisfactory.

LESSON 13

CASH FLOW STATEMENT

MEANING, BENEFITS & IMPORTANCE

CASH FLOW STATEMENT

A cash flow statement is a statement showing change in cash position from one period to another. It presents a summary of cash flows from operating, investing and financing activities.

Example:

Cash balance as on 31.12.2016 - Rs. 20,000

Cash balance as on 31.12.2017 - Rs. 30,000

Thus, there has been an inflow of cash of Rs. 10,000 in the year 2017.

A projected cash flow statement: It presents a summary of projections of all the future cash flows from operating, investing and financing activities.

BENEFITS OF CASH FLOW STATEMENT

The importance and uses of cash flow analysis can be summarized in the following respects:

- ◆ It explains the reasons for inflows and outflows of cash.
- ◆ It is important tool for planning cash requirements and for controlling the cash position.
- ◆ It facilitates the management to plan and co-ordinate the financial operations properly.
- ◆ It helps for making plans for the future.
- ◆ It helps in ascertaining how much cash will be available to meet obligations to trade creditors, to pay bank loans and to pay dividend to the shareholders.
- ◆ It enables the management to invest it to some profitable investments.

- ◆ It helps to improve liquidity.
- ◆ Long-term lenders of funds can use the statement as a means of estimating the firm's ability to serve its debts.

Distinction between: Cash Flow Statement & Fund Flow Statement

Points	Cash Flow Statement	Funds Flow Statement
Meaning	A cash flow statement is a statement showing change in cash position from one period to another.	Fund flow statement is statement of sources & application of funds and statement of changes in working capital.
Concerned with	Cash flow statement is concerned with cash only, which is only a part of the working capital.	Funds flow statement is based on a wider concept of fund i.e., working capital.
Adjustments for prepaid & outstanding	In the case of cash flow statements adjustments requires for prepaid and outstanding items.	No such adjustments are needed in the case of funds flow statement.
Opening or closing balance	Cash flow statement is generally prepared with opening balance as the starting point and ends with closing balance.	But no such opening or closing balance appear in funds flow statement.
Used as	Cash flow statement is generally used as a tool of short-term financial analysis and cash planning purpose.	Funds flow statement is useful in planning intermediate and long term financing.

Accounting Standard - 3

Introduction: AS-3, 'Cash Flow Statements', issued by the Council of the ICAI, comes into effect in respect of accounting periods commencing on or after 1.4.1997. This Standard is mandatory in nature in respect of accounting periods commencing on or after 1.4.2004 for the enterprises which fall in **Level I category**. (**listed company, banks, financial institution, enterprises carrying insurance business, etc.**)

CASH, CASH EQUIVALENTS AND CASH FLOWS

As per AS-3:

Cash comprises cash in hand and demand deposits with banks.

Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

Cash & Cash Equivalents: Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent, it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value, e.g. treasury bill, commercial paper, money market funds are treated as cash equivalents.

Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, 3 months or less from the date of acquisition.

Investments in shares are excluded from cash equivalents unless they are, in substance, cash equivalents; for example, preference shares of a company acquired shortly before their specified redemption date (provided there is only an insignificant risk of failure of the company to repay the amount at maturity).

Operating, Investing, Financing Activities as Per AS-3

The cash flow statement should report cash flows during the period classified by operating, investing and financing activities.

(1) Operating Activities: These are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

Examples of cash flows from operating activities are:

- (i) Cash receipts from the sale of goods and the rendering of services
- (ii) Cash receipts from royalties, fees, commissions and other revenue
- (iii) Cash payments to suppliers for goods and services
- (iv) Cash payments to and on behalf of employees

- (v) Cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits
- (vi) Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities and
- (vii) Cash receipts and payments relating to futures contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.

(2) Investing Activities: These are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Examples of cash flows arising from investing activities are:

- (i) Cash payments to acquire fixed assets including intangibles. These payments include those relating to capitalized research and development costs and self-constructed fixed assets.
- (ii) Cash receipts from disposal of fixed assets including intangibles.
- (iii) Cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes).
- (iv) Cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures other than receipts from those instruments considered to be cash equivalents and those held for dealing or trading purposes)
- (v) Cash advances and loans made to third parties other than advances and loans made by a financial enterprise.
- (vi) Cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise.
- (vii) Cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities and

(viii) Dividend received on investment in shares.

(ix) Interest received on investment in debentures and bonds.

(3) Financing Activities: These are activities that result in changes in the size and composition of the owners' capital including preference share capital in the case of a company and borrowings of the enterprise.

Examples of cash flows arising from financing activities are:

(a) Cash proceeds from issuing shares or other similar instruments

(b) Cash proceeds from issuing debentures, loans, notes, bonds, and other short or long-term borrowings and

(c) Cash repayments of amounts borrowed.

(d) Dividend paid on company's own share capital.

(e) Interest paid on debentures and bonds issued by reporting entity.

METHODS FOR PREPARATION OF CASH FLOW STATEMENT

Methods for preparation of cash flow statement are

1) Direct Method

2) Indirect Method

As per Companies Act, 2013 Listed companies are required to prepare cash flow statement by using **indirect method** as per revised AS – 3 and Unlisted companies have a choice of either applying direct or indirect method.

FOREIGN CURRENCY CASH FLOWS

Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow. A rate that approximates the actual rate may be used if the result is substantially the same as would arise if the rates at the dates of the cash flows were used. The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period.

Cash flows denominated in foreign currency are reported in a manner consistent with Accounting Standard (AS) 11, The Effects of Changes in Foreign Exchange Rates. This permits the use of an exchange rate that approximates the actual rate. For example, a weighted average exchange rate for a period may be used for recording foreign currency transactions.

Unrealized gains and losses arising from changes in foreign exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at the end-of period exchange rates.

EXTRAORDINARY ITEMS

The cash flows associated with extraordinary items are disclosed separately as arising from operating, investing or financing activities in the cash flow statement, to enable users to understand their nature and effect on the present and future cash flows of the enterprise.

FORMAT OF CASH FLOW STATEMENT AS PER AS - 3.

Cash Flow Statement (Direct method)

For the year ended.....

Particulars	Rs.	Rs.
(A) Cash flows from operating activities		
Cash receipt from customers (See Note 1)	XXXX	
Cash paid to suppliers & employees (See Note 2)	(XXX)	
Cash generated from operation	XXXX	
Other/misc. income	XXXX	
Other/misc. expenses	XXXX	
Income tax/advance tax paid	(XXX)	
Cash before extraordinary item	(XXX)	
Extraordinary receipt	XXXX	
-	XXXX	
-	XXXX	XXXX

(b) Cash flow from investing activities:		
Sale of land & building	XXXX	
Purchase of land & building	(XXX)	
Sale of plant & machinery	XXXX	
Purchase of plant & machinery	(XXX)	
Sale of investment	XXXX	
Purchase of investment	(XXX)	
Sale of equipment	XXXX	
Purchase of equipment	(XXX)	
Sale of other fixed assets	XXXX	
Purchase of other fixed assets	(XXX)	
Investment in subsidiary	(XXX)	
Interest received on investment	XXXX	
Dividend received on investment	XXXX	XXXX
(c) Cash flows from financing activities :		
Issue of share capital	XXXX	
Issue of preference shares	XXXX	
Redemption of preference shares	(XXX)	
Issue of debenture	XXXX	
Redemption of debenture	(XXX)	
Securities premium	XXXX	
Long-term borrowing	XXXX	
Long term borrowing paid	(XXX)	
Repayment other capital liabilities	(XXX)	
Dividend paid	(XXX)	
Interest paid on debenture/long term loans	(XXX)	

Tax on dividends/corporate dividend tax	(XXX)	
Interim dividend paid	(XXX)	XXXX
Total (a) + (b) + (c)	XXXX	
Cash and cash equivalent at the beginning	XXXX	
Cash and cash equivalent at the end	XXXX	

Extraordinary receipt means receipt which is not normal to business generally carried on organization e.g. Lawsuit compensation, compensation received from insurance company, voluntary separation payments etc.

Cash Flow Statement (Indirect method)
For the year ended.....

Particulars	Rs.	Rs.
(A) Cash flows from operating activities		
Net profit before working capital changes (see note)	xxxx	
(+) Decrease in CA		
-	xxxx	
-	xxxx	
(-) Increase in CA		
-	(XXX)	
-	(XXX)	
(+) Increase in CL		
-	XXXX	
-	xxxx	
(-) Decrease in CL		
-	(XXX)	
-	(XXX)	
Cash generated from operation	XXXX	
Other/misc. income	xxxx	
Other/misc. expenses	(XXX)	
Income tax/advance tax paid	(XXX)	
Cash before extraordinary item	xxxx	
Extraordinary receipt		
-	xxxx	xxxx

(b) Cash flow from investing activities		
Sale of land & building	xxxx	
Purchase of land & building	(XXX)	
Sale of plant & machinery	XXXX	
Purchase of plant & machinery	(XXX)	
Sale of investment	xxxx	
Purchase of investment	(XXX)	
Sale of equipment	XXXX	
Purchase of equipment	(XXX)	
Sale of other fixed assets	xxxx	
Purchase of other fixed assets	(XXX)	
Investment in subsidiary	(XXX)	
Interest received on investment	XXXX	
Dividend received on investment	xxxx	xxxx
(c) Cash flows from financing activities:		
Issue of share capital	xxxx	
Issue of preference shares	xxxx	
Redemption of preference shares	(XXX)	
Issue of debenture	XXXX	
Redemption of debenture	(XXX)	
Particulars	Rs.	Rs.
Securities premium	xxxx	
Long-term borrowing	xxxx	
Long term borrowing paid	(XXX)	
Repayment other capital liabilities	(XXX)	
Dividend paid	(XXX)	
Interest paid on debenture/long term loans	(XXX)	
Tax on dividends/corporate dividend tax	(XXX)	
Interim dividend paid	(XXX)	XXXX
Total (a) + (b) + (c)	xxxx	
Cash & cash equivalent at the beginning	XXXX	
Cash & cash equivalent at the end		xxxx

FORMAT OF IMPORTANT WORKING NOTES

Note No.1] Calculation of receipt from customers/debtors (Required only under direct method)

Opening debtors/book debts	XXXX	Closing debtors/book debts	xxxx
Opening bills receivable	xxxx	Closing bills receivable	xxxx

Sales	xxxx	Receipt from customers/debtors	xxxx
		(Bal.Fig.)	
	xxxx		xxxx

Note No. 2] Calculation of payment made to suppliers & employees.

(Required only under direct method)

Closing creditors	XXXX	Opening creditors	xxxx
Closing bills payable	XXXX	Opening bills payable	xxxx
Closing outstanding expenses	XXXX	Opening outstanding expenses	xxxx
Opening sock/inventory	XXXX	Closing sock/inventory	xxxx
Opening advances	xxxx	Closing advances	xxxx
Cash paid to suppliers & employees	xxxx	Operating expenses	xxxx
(Bal Fig.)		Salary & wages	xxxx
		Manufacturing wages	xxxx
		Office/administrative expenses	xxxx
		Selling expenses	xxxx
		Cost of goods sold/cost of sales	xxxx
	xxxx		xxxx

Note No. 3] Calculation of cash & cash equivalents

	Current Year	Previous Year
Cash on hand and at bank	XXXX	XXXX
Short term investment	xxxx	Xxxx
Cash & cash equivalents	xxxx	Xxxx
Effect of foreign exchange rate change	-	Xxxx
Cash & cash equivalents as restated	xxxx	Xxxx

PROBLEMS & SOLUTIONS

Problem No. 1]

Identify the following transactions belonging to (i) Operating Activities, (ii) Investing Activities, (iii) Financing Activities, and (iv) Cash and Cash Equivalents:

1. Cash Sales
2. Cash Purchase
3. Rent paid
4. Cash-in-Hand
5. Income Tax paid
6. Office Expenses
7. Balance at Bank
8. Sale of Machines
9. Issue of Debentures
10. Dividend paid
11. Cash paid against Trade Payables
12. Purchase of Machines
13. Income Tax refund received
14. Issue of Share Capital
15. Sale of Patents
16. Manufacturing Expenses
17. Purchase of Goodwill

18. Short-term Deposits in Banks

19. Purchase of Investments (Non-Current)

20. Cash received from Debtors

Solution:

Operating Activities : 1, 2, 3, 5, 6, 11, 13, 16, 20;

Investing Activities: 8, 12, 15, 17, 19;

Financing Activities: 9, 10, 14;

Cash and Cash Equivalents: 4, 7, 18.

Problem No. 2]

Identify which of the following transactions are (i) Operating Activities, (ii) Investing Activities, (iii) Financing Activities and (iv) Cash and Cash Equivalents:

- 1.** Issue of Share Capital;
- 2.** Sale of Patents;
- 3.** Marketing Expenses;
- 4.** Purchase of Goodwill;
- 5.** Short-term Deposits in Banks;
- 6.** Purchase of Investments;
- 7.** Cash received from Trade Receivables;
- 8.** Buy-back of Equity Shares;
- 9.** Repayment of a Long-term Loan;
- 10.** Commission received;
- 11.** Selling and Distribution Expenses;

12.Redemption of Debentures;

13.Investments in Marketable Securities;

14.Bank Overdraft / Cash Credit

Solution:

Operating Activities: Marketing Expenses, Cash received from Trade Receivables, Commission received, Selling and Distribution Expenses.

Investing Activities: Sale of Patents, Purchase of Goodwill, Purchase of Investments

Financing Activities: Issue of Share Capital, Buy-back of Equity Shares, Repayment of a Long-term Loan, Redemption of Debentures, Bank Overdraft/Cash Credit.

Cash and Cash Equivalents: Short-term Deposits in Banks, Investments in Marketable Securities.

Problem No. 3]

Identify which of the following transactions are (i) Operating Activities, (ii) Investing Activities, (iii) Financing Activities and (iv) Cash and Cash Equivalents.

1. Sale of Investments;
2. Dividend received on Shares;
3. Interest received on Investments;
4. Rent received by a Company whose main Business is a Real Estate Business;
5. Rent received by a Company whose main Business is Manufacturing;
6. Interest paid on Debentures or Long-term Loans;
7. Marketable Securities;
8. Proceeds from Shares issued; and
9. Interest paid on Bank Overdraft.

Solution:

Operating Activities: Rent received by a Company whose main Business is a Real Estate Business.

Investing Activities: Sale of Investments, Dividend received on Shares, Interest received on Investments, Rent received by a Company whose main Business is manufacturing.

Financing Activities: Interest paid on Debentures or Long-term Loans, Proceeds from Shares issued, Interest paid on Bank Overdraft.

Cash and Cash Equivalents: Marketable Securities.

Problem No. 4]

Identify Financing Activities out of the following transactions:

1. Purchase of securities of a company;
2. Brokerage paid for the above purchases;
3. Sale of securities of a company;
4. Dividend and interest received on securities;
5. Dividend paid to the shareholders;
6. Interest paid on borrowings;
7. Loans and advances made; and
8. Receipt of loans and advances made.

Give reasons for the answer.

Solution:

1. Dividend paid to the Shareholders: It is a financing activity as dividend is paid on the Share Capital of the company. Share Capital is to be shown as Financing Activity as per AS-3, Cash Flow Statement.
2. Interest paid on Borrowings: Borrowings are shown as Financing Activity as per AS-3, Cash Flow Statement. Interest is related to borrowings, therefore, it will also be shown as Financing Activity.

Problem No. 5]

Classify the following transactions as Operating Activities for (i) Financial Enterprise, and (ii) Non-financial Enterprise:

- (a) Purchase of securities of a company,
- (b) Brokerage paid for the above purchases,
- (c) Sale of securities of a company,
- (d) Dividend and interest received on securities,
- (e) Dividend paid to shareholders,
- (f) Interest paid on borrowings,
- (g) Loans and advances made, and
- (h) Receipt of loans and advances made.

Give reasons for your answer.

Solution:

1. **Financial Enterprise:** All the transactions except (e), i.e., Dividend paid to shareholders shall be classified or shown as Operating Activities. It is so because Purchase and Sale of Securities and also Borrowings and Advancing Loans are the principal revenue producing activities of a financial enterprise.

- 2. Non-financial Enterprise:** All the transactions except (e) and (f) (i.e., Dividend paid to shareholders and Interest paid on borrowings respectively) shall be classified as Investing Activities because these are not the principal revenue producing activities of the enterprise.

Transactions (e) and (f) shall be classified as Financing Activities because these are related to activities that change the size and composition of the owners' capital and borrowings.

Problem No. 6]

Extract of balance-sheet

	2018-19	2019-20
Building	2,00,000	4,00,000

- (i) Depreciation during current year – 20,000
(ii) Asset costing ₹ 50,000, book value – 20,000 sold for ₹15,000.

Find out cash flow from investing activity.

Problem No. 7]

Extract of balance-sheet

	2018-19	2019-20
Building	2,00,000	3,00,000
(-) Accumulated Depreciation	30,000	40,000
	17,000	260,000

- (i) During year asset costing ₹50,000, accumulated depreciation there on ₹20,000 sold for ₹10,000.

Find out cash flow from investing activity. And amount to be shown in operating activity.

Problem No. 8]

Extract Of Balance-Sheet

	2018-19	2019-20		2018-19	2019-20
Proposed dividend	40,000	50,000			

- (i) Dividend paid during current year – 45,000

Find out amount of dividend proposed during current year.

Problem No. 9]

Extract Of Balance-Sheet

	2018-19	2019-20		2018-19	2019-20
Provision for tax	50,000	60,000			

- (i) Provision for tax during year amounted to ₹65,000. Find out amount of income tax paid during current year

Problem No. 10]

Extract Of Balance -Sheet

	2018-19	2019-20		2018-19	2019-20
Accumulated Depreciation on P/M	2,00,000	2,50,000	Plant & Mach	4,00,000	5,00,000
Proposed dividend	40,000	50,000			

Find out effect of above transaction on operating investing and financing Activities

Problem No. 11]

Extract of Balance-Sheet

	2018-19	2019-20		2018-19	2019-20
Equity share capital	2,00,000	3,00,000	Good will	1,00,000	80,000
P/L	4,00,000	4,50,000	Plant & machinery	2,00,000	2,50,000
Proposed Div.	20,000	40,000			

(i) Balance of accumulated depreciation as on

2018-19	2018-20
40,000	50,000

(ii) During year plant & mach. costing ₹60,000, accumulation dep. There on ₹10,000 sold for ₹30,000.

(iii)

(iv) Dividend paid ₹25,000 during current year. Find out cash flow from operating, financing and investing activity, from above activity.

Problem No. 12]

From the following information, calculate cash flow from investing activities and financing activities.

Particulars	Opening (Rs.)	Closing (Rs.)
Furniture (At cost)	40,000	56,000
Accumulated Depreciation on Furniture	12,000	18,000
Capital	2,00,000	2,80,000
Loan from Bank	50,000	30,000

During the year, furniture costing Rs. 8,000 was sold at a profit of Rs. 6,000. Depreciation on furniture charged during the year amounted to Rs. 10,000.

Problem No. 13]

The balance sheet of SD Ltd was as follows.

Particulars	Note No.	31st March 2017 Amt (Rs.)	31st March 2018 Amt (Rs.)
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
(a) Share Capital		1,00,000	1,40,000
(b) Reserves and Surplus (Balance of statement of profit and loss)		18,000	30,000

2. Non-current Liabilities			
12% Debentures		-	20,000
3. Current Liabilities			
(a) Bills Payable		37,000	42,000
(b) Short-term Provision (Provision for taxation)		10,000	15,000
Total		1,65,000	2,47,000
II. ASSETS			
1. Non-current Assets			
Fixed Assets		93,000	1,66,000
2. Current Assets			
(a) Stock		22,000	26,000
(b) Trade Receivables (Debtors)		26,000	10,000
(c) Bills Receivables		10,000	15,000
(d) Cash at Bank		14,000	30,000
Total		1,65,000	2,47,000

Additional Information:

- (i) Dividend of Rs. 2,500 was paid during the year 2017-18.
 - (ii) Income tax Rs. 10,000 was paid during the year 2017-18.
 - (iii) Fresh debentures were issued on 31st March, 2018.
- Prepare a cash flow statement as per AS-3 (Revised).

Problem No. 14]

What is treatment of interim dividend paid during Financial Year 2018-19

Problem No. 15]

The summarised balance sheet-of Kartik Ltd as at 31st March, 2017 and 2018 are.

Particulars	Note No.	31st March 2017 Amount (Rs.)	31st March 2018 Amount (Rs.)
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
(a) Share Capital		4,50,000	4,50,000
(b) Reserves and Surplus	1	3,56,000	3,78,000

2. Non-current Liabilities			
Mortgage Loan		-	2,70,000
3. Current Liabilities			
(a) Trade Payables		1,68,000	1,34,000
(b) Short-term Provisions (Provision for taxation)		75,000	10,000
Total		10,49,000	12,42,000
II. ASSETS			
1. Non-current Assets			
(a) Fixed Assets (Tangible)		4,00,000	3,20,000
(b) Non-current Investments		50,000	60,000
2. Current Assets			
(a) Inventories		2,40,000	2,10,000
(b) Trade Receivables		2,10,000	4,55,000
(c) Cash and Cash Equivalents		1,49,000	1,97,000
Total		10,49,000	12,42,000

Notes to Accounts:

Particulars	2017 (Rs.)	2018 (Rs.)
1. Reserves and Surplus	3,00,000	3,10,000
General Reserve	56,000	68,000
Balance in Statement of Profit and Loss	3,56,000	3,78,000

Additional Information:

- (i) Investments costing Rs. 8,000 were sold during the year 2017-18 for Rs. 8,500.
- (ii) Provision for taxation made during the year was Rs. 9,000.
- (iii) During the year, part of the fixed assets costing Rs. 10,000 was sold for Rs. 12,000 and the profit was included in the statement of profit and loss.
- (iv) Dividend paid during the year amounted to Rs. 40,000. You are required to prepare the cash flow statement.

Problem No. 16]

From the following summarised balance sheets of Inspiring Lives Ltd as at 31st March, 2018 and 2017, you are required to prepare cash flow statement.

Particulars	Note No.	31st March 2018 Amt (Rs.)	31st March 2017 Amt (Rs.)
I. <u>EQUITY AND LIABILITIES</u>			
1. Shareholders' Funds			
(a) Share Capital		7,00,000	6,00,000
(b) Reserves and Surplus	1	4,60,000	3,00,000
2. Non-current Liabilities			
Long-term Borrowing: 15% Debentures		2,00,000	3,00,000
3. Current Liabilities			
(a) Trade Payables		2,50,000	1,60,000
(b) Short-term Provisions	2	1,10,000	1,00,000
(c) Other Current Liabilities: Outstanding Expenses		12,000	10,000
Total		<u>17.32.000</u>	<u>14.70.000</u>
II. <u>ASSETS</u>			
1. Non-current Assets			
(a) Fixed Asset (Tangible)		9,50,000	8,00,000
(b) Long-term Investments (At cost)	3	1,80,000	1,80,000
2. Current Assets			
(a) Inventories		2,70,000	2,00,000
(b) Trade Receivables		2,45,000	2,25,000
(c) Cash and Cash Equivalents: Cash in Hand		87,000	65,000
Total		<u>17.32.000</u>	<u>14.70.000</u>

NOTES TO ACCOUNTS:

Particulars	2018 Amt (Rs.)	2017 Amt (Rs.)
1. Reserves and Surplus		

Surplus, i.e. Balance in Statement of Profit and Loss	4,50,000	3,00,000
Capital Reserve (Profit on sale of investment)	10,000	-
	<u>4,60,000</u>	<u>3,00,000</u>
2. Short-term Provisions		
Proposed Dividend	34,000	30,000
Provision for Tax	76,000	70,000
	<u>1,10,000</u>	<u>1,00,000</u>
3. Fixed Assets		
Fixed Assets (At cost)	12,00,000	10,00,000
(-) Accumulated Depreciation	(2,50,000)	(2,00,000)
	<u>9,50,000</u>	<u>8,00,000</u>

ADDITIONAL INFORMATION :

- (i) During the year ended 31st March, 2018, fixed assets with a net book value of Rs. 10,000 (accumulated depreciation Rs. 30,000) was sold for Rs. 8,000.
- (ii) During the year ended 31st March, 2018, investment costing Rs. 80,000 was sold.
- (iii) Debentures were redeemed at a premium of 10%.
- (iv) Tax of Rs. 75,000 was paid.
- (v) Debentures interest paid during the year ended 31st March, 2018 was Rs. 30,000

Problem No. 17]

Extract of Balance – Sheet

	31st March, 2018	31st March, 2019
Tangible Assets.		
Machinery	25,40,000	20,00,000
(-) Accumulated Depreciation	(4,00,000)	(3,00,000)
	21,40,000	17,00,000

During the year a piece of Machinery costing Rs. 48,000 on which accumulated depreciation was Rs. 32,000 was sold for Rs. 12,000. What will be effect on operating and investing activity.

Problem No. 18]

From given information find out effect extract of balance-sheet on operating and invest activity.

Extract of Balance – Sheet		
	31st March, 2018	31st March, 2019
Intangible Assets.		
Goodwill	2,00,000	1,50,000
Tangible Assets.		
Building	5,00,000	7,00,000

→ During the year 2018-19 building with book value Rs. 2,00,000 was sold for Rs. 2,70,000.

→ Depreciation for current year Rs. 1,30,000.

Problem No. 19]

Extract of Balance – Sheet		
	31st March, 2018	31st March, 2019
Tangible Assets.		
P/M	4,00,000	5,00,000

→ During year 2018-19 P/M costing Rs. 1,00,000 accumulated depreciation there on Rs. 30,000 sold at profit of Rs. 5,000.

→ Current year depreciation – Rs. 2,00,000

→ Find out effect of above transaction on operating and investing activity.

Problem No. 20]

Extract of Balance – Sheet		
	31st March, 2018	31st March, 2019
Tangible Assets.		
P/M	4,00,000	5,00,000

- During year 2018-19 P/M costing Rs. 1,00,000, Accumulated depreciation there on Rs. 3,00,000 sold at profit of Rs. 5,000.
- Current year depreciation – Rs. 2,00,000
- Find out effect of above transaction on operating and investing activity.

Problem No. 21]

Extract of Balance – Sheet		
	31st March, 2018	31st March, 2019
Liability		
Provision for tax	4,00,000	5,00,000

During year tax paid Rs. 4,50,000. What will be effect on operating activity.

Problem No. 22]

Extract of Balance – Sheet		
	31st March, 2018	31st March, 2019
Liability		
Provision for tax	4,00,000	5,00,000

Provision of tax during current year Rs. 6,00,000. What will be effect on operating activity.

Problem No. 23]

Extract of Balance – Sheet		
	31st March, 2018	31st March, 2019
Liability		
Equity share capital	2,00,000	3,00,000
Security premium	-	2,00,000

When will be effect of above on Financing Activites.

Problem No. 24]

Extract of Balance – Sheet		
	31st March, 2018	31st March, 2019
Plant & Mach	1,20,000	3,00,000

- A machine was sold for Rs. 15,000. The written down value was Rs. 18,000.
- Depreciation of Rs. 15,000 was charged.

What will be effect of above transaction on operating and investment activity.

CHAPTER 14

CONSOLIDATION OF ACCOUNTS

MEANING AND DEFINITION OF HOLDING AND SUBSIDIARY COMPANY

According to section 2(46) of the Companies Act, 2013, “holding company”, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

According to section 2(87) of the Companies Act, 2013, “subsidiary company” or “subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed. For the purposes of this clause, —

- a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
- b) the composition of a company’s Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;
- c) the expression “company” includes any body corporate;
- d) “layer” in relation to a holding company means its subsidiary or subsidiaries.

The definition of a subsidiary as per the 2013 Act includes associates and joint ventures.

Example: Suppose, ‘H’ is holding company of ‘S’ because 51 % shares are of ‘H’ in ‘S’. ‘S’ is also of holding Company of ‘R’ because ‘S’ have power to appoint the board of directors of ‘R’ Company and then ‘H’ is also holding Company of ‘R’.

PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS AS PER THE COMPANIES ACT

The Companies Act 1956 Act does not require preparation of consolidated financial statements (‘CFS’) but listed entities were required to prepare CFS (as per SEBI regulations). The Companies Act, 2013 has made preparation of consolidated accounts mandatory for companies having one or more subsidiaries or associates or joint ventures. According to sub section 3 of the section 129 of the Companies Act, 2013, where a company has one or more subsidiaries or associates or joint ventures, it shall, in addition to its financial statements for the financial year, prepare a consolidated financial statement of the company and of all the subsidiaries or associates or joint ventures in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statement.

The requirement to prepare CFS is largely consistent with internationally accepted practices. However, internationally, such requirements apply only to listed companies; and unlisted intermediate entities are generally exempted. **The existing Indian and international accounting practices do not require preparation of CFS when the Company has investments only in associates and joint ventures (no subsidiaries).**

The Consolidation of financial statements of the company shall be made in accordance with the Accounting Standards, subject however, to the requirement that if under such Accounting Standards, consolidation is not required for the reason that the company has its immediate parent outside India, then such companies will also be required to prepare Consolidated Financial Statements in the manner and format as specified under Schedule III to the Act.

SCHEDULE III OF THE COMPANIES ACT, 2013

The Schedule III of the Companies Act, 2013, provides certain general instructions for the preparation of consolidated financial statements.

1. Accordingly, where a company is required to prepare Consolidated Financial Statements, *i.e.*, consolidated balance sheet and consolidated statement of profit and loss, the company shall *mutatis mutandis* follow the requirements of Schedule III of the Companies Act, 2013, as applicable to a company in the preparation of balance sheet and statement of profit and loss. In addition, the consolidated financial statements shall disclose the information as per the requirements specified in the applicable Accounting Standards including the following:
 - (i) Profit or loss attributable to “minority interest” and to owners of the parent in the statement of profit and loss shall be presented as allocation for the period.
 - (ii) “Minority interests” in the balance sheet within equity shall be presented separately from the equity of the owners of the parent.
2. All subsidiaries, associates and joint ventures (whether Indian or foreign) will be covered under consolidated financial statements.
3. An entity shall also disclose the list of subsidiaries or associates or joint ventures which have not been consolidated in the consolidated financial statements along with the reasons of not consolidating.

PREPARATION OF CONSOLIDATED BALANCE SHEET

The following are the most important points which reserve special consideration in the preparation of the consolidated Balance Sheet of the holding company and its subsidiaries.

CONCEPT 1: INVESTMENT IN SHARES OF SUBSIDIARY COMPANY

- (a) **when all the shares of the subsidiary are held by the holding company - (acquired at par):** In such a case, the investment in shares of subsidiary company represent the ownership of the holding company in the equity or net assets of the subsidiary company.

Net assets are the difference between the total assets and the liabilities of the subsidiary.

OR

Net assets are also equal to the total of all accounts relating to the shareholders, *i.e.*, Share Capital, Reserves, Profit and Loss Account balance, etc.

Treatment: While preparing the Consolidated Balance Sheet, investments of the holding company in shares of subsidiary company have simply to be replaced by the net assets (i.e., total assets and liabilities) of subsidiary company.

- (b) When some of the shares of the subsidiary are held by the outsiders** - In such a case, the outsiders holding shares in the subsidiary company will naturally claim a share in the net assets (i.e., the total assets minus liabilities) of the subsidiary company in proportion to their shareholding.

Treatment: While preparing the consolidated balance sheet, the amount of claim of the outside shareholders must be treated as a liability of the holding company and as such it has to be shown on the liabilities side of the balance sheet under the heading "Minority Interest". All the assets and liabilities of the subsidiary company have to be merged with those of the holding company which will eliminate investments of the holding company in the shares of the subsidiary company.

CONCEPT 2: MINORITY INTEREST

The claim of outside shareholders in the subsidiary company has to be assessed and shown as a liability in the consolidated balance sheet.

But if the subsidiary company have some accumulated profits and reserves or accumulated losses **or** may have some profits or losses on account of revaluation of its assets on the date of acquisition of shares by the holding company then,

Treatment: while calculating the amount of minority interest, all these items have to be taken into account and proportionate share of all such profits and reserves should be added to the amount of minority interest while proportionate share of all such losses should be deducted from the minority interest, thus,

Minority Interest = paid-up value of shares held by minority shareholders + proportionate share of the company's profits and reserves + proportionate shares of profits on revaluation of assets of the company - proportionate share of company's losses – proportionate share of loss on revaluation of assets of the company.

The company's profit and reserves or loss will include both pre-acquisition and post-acquisition profits and reserves or losses.

But, if there are some preference shares of the subsidiary company held by outsiders, the minority interest in respect of the preference share will consist only of the face value of such shares and the dividend due on such shares if there are profits.

CONCEPT 3: PRE-ACQUISITION PROFITS AND RESERVES OF SUBSIDIARY COMPANY

Meaning: Accumulated profits and reserves which appear in the balance sheet of the subsidiary company up to the date of acquisition of its shares by the holding company are called pre-acquisition profits and reserves. Both the holding company and the minority shareholders will have proportionate share in such profits and reserves.

Treatment: The share of the minority shareholders in such profit and reserves will be added to the amount of minority interest. But the holding company's proportionate share in such profits and reserve should be treated as capital profits and credited to Capital Reserve since the holding company cannot earn any revenue profits from its subsidiary before the shares are acquired in it. While preparing the consolidated balance sheet, this Capital Reserve should be shown on the liabilities side or if there is any Goodwill, it can be shown as a deduction from the Goodwill in the assets side.

CONCEPT 4: PRE-ACQUISITION LOSSES OF SUBSIDIARY COMPANY

Meaning: Accumulated losses of the subsidiary company upto the date of acquisition of shares by the holding company are called pre-acquisition losses. Both the holding company and the minority shareholders must share such losses in proportion to their respective holdings.

Treatment: The minority shareholders' share of such losses should be deducted from the amount of Minority Interest. But the holding company's share of such losses should be treated as capital loss and debited to Goodwill account. While preparing the Consolidated Balance Sheet, this Goodwill Account should be shown as an asset.

CONCEPT 5: PROFIT ON REVALUATION OF ASSETS OF SUBSIDIARY COMPANY

If there is any profit resulting from the revaluation of assets of the subsidiary company whether before or after the date of acquisition of shares by the holding company, the same must be shared both by the holding company and the minority shareholders in proportion to their respective holdings.

Treatment: The minority shareholders' share of such profit should be added to the Minority interest. But the holding company's share should be treated as capital profits and dealt with like pre-acquisitions profit and reserve.

Further, **adjustment for depreciation on the increases or decreases in the value of assets** would be made in the profit and loss account of the subsidiary.

- For appreciation in the value of assets, depreciation charge would be increased proportionately and the same would be deducted from the revenue profits of the subsidiary company.
- For revaluation loss due to decrease in the value of assets, excess depreciation provision should be written back.

CONCEPT 6: LOSS ON REVALUATION OF ASSETS OF SUBSIDIARY COMPANY

If there is any loss resulting from the revaluation of the assets of the subsidiary company as on the date of acquisition of shares by the holding company the same must be shared both by the holding company and the minority shareholders in proportion to their respective holdings.

Treatment: The minority shareholders' share of such loss should be deducted from the amount of Minority interest. But, the holding company's share of such loss should be treated as capital loss and dealt with like pre-acquisition losses. But, if such loss occurs after the date of acquisition of shares by the holding company the same should be treated as ordinary loss.

CONCEPT 7: GOODWILL OR COST CONTROL

In actual practice, it rarely happens that the cost of acquisition of shares in the subsidiary company agrees exactly with intrinsic value of the shares (i.e. the net assets of the subsidiary company) on the date of acquisition.

- If the price paid by the holding company for the shares acquired in the subsidiary company is more than the intrinsic value of the shares acquired, the difference should be treated as Cost of Control or Goodwill.
- If the price paid by the holding company for the shares acquired in the subsidiary company is less than the intrinsic value of the shares acquired, the difference should be treated as capital profits and credited to Capital Reserve. It should be noted that while computing the intrinsic value of the shares as on the date of acquisition of control, all profits and losses upto that date, have to be taken into account.

While preparing the consolidated balance sheet, such Goodwill or Capital Reserve, whatever may be the case, must be shown in the Balance Sheet.

CONCEPT 8: POST-ACQUISITION PROFITS OR LOSSES

Meaning: Profits earned or losses incurred by the subsidiary company after the date of acquisition of its shares by the holding company are called post-acquisition profits or losses. Both the holding company and the minority shareholders should share such profits or losses in proportion to their respective holdings.

Treatment:

- The minority shareholders' share in such profits should be added to the amount of minority interest while their share in such losses should be deducted. So far as the minority shareholders are concerned, there is no difference between the pre-acquisition profits or losses and the post-acquisition profits or losses.
- The holding company's share of such profits or losses should be treated as revenue profits or losses and as such credited or debited to its profit and loss account.

CONCEPT 9: INTER-COMPANY UNREALISED PROFITS INCLUDED IN UNSOLD GOODS

If goods are sold by one company to the other (i.e., by the holding company to its subsidiary or *vice-versa*) at a profit and a part of it remains unsold at the end of the year, the unrealised profit and such goods remaining unsold must be provided for. **But it is important to note here that the minority shareholders will not be affected in any way.** Such unrealised profit has to be eliminated from the consolidated balance sheet in the following manner:

- (i) The unrealised profits should be deducted from the current revenue profits of the company which sold the goods.
- (ii) Again, the same should be deducted from the value of stock-in-trade of the company concerned.

CONCEPT 10: INTER-COMPANY TRANSACTIONS

The holding company and the subsidiary company may have a number of inter-company transactions in any one or more of the following matters:

- (i) **Loans advanced** by the holding company to the subsidiary company or vice versa. This appears as an asset in the balance sheet of the company which gives loan and as a liability in the balance sheet of the company which takes the loan.
For example: If S Ltd. has taken a loan of Rs. 20,000 from H Ltd. then S Ltd.'s balance sheet shows a liability of Rs. 20,000, while H Ltd.'s balance sheet shows an asset of Rs. 20,000.
- (ii) **Bills of exchange** given by one company and received by another company appears as bills payable in the balance sheet of the accepting company and as bills receivable in the balance sheet of the drawer company.
For example: If H Ltd. draws a bill of Rs. 10,000 on S Ltd. then H Ltd.'s books will show bills receivable Rs. 10,000 while S Ltd.'s books will show bills payable Rs. 10,000.
- (iii) Transactions relating to **sale and purchase of goods on credit** similarly appears as debtors in the balance sheet of the company selling goods and as creditors in the balance sheet of the company purchasing the goods.
- (iv) **Debentures** issued by one company may be held by the other.
For example: If S Ltd. issues debentures of Rs. 50,000 which are held by H Ltd. then S Ltd.'s books will show a liability of Rs. 50,000 while H Ltd. books will show an asset of Rs. 50,000.

Treatment: All the above inter-company transactions have to be eliminated while preparing the consolidated balance sheet. This can be done by deducting the intercompany transactions from the respective items on both sides of the balance sheet.

CONCEPT 11: CONTINGENT LIABILITIES

If the contingent liabilities relate to the outsiders they must be shown by way of a footnote in the consolidated balance sheet. But a contingent liability in respect of a transaction between holding and subsidiary companies (internal contingent liability) will disappear from the foot note as they appear as actual liability in the consolidated balance sheet.

CONCEPT 12: PREFERENCE SHARES IN SUBSIDIARY COMPANY

Preference share capital in subsidiary company should be shown along with minority interest in the consolidated balance sheet.

However, if a part of the nominal value of non-participating preference share capital of the subsidiary is held by the holding company, it should be adjusted in cost of control against the cost of investment in preference shares. The balance of the preference share capital held by the outsiders should be included in minority interest.

CONCEPT 13: BONUS SHARES

The issue of bonus shares by the subsidiary company will increase the number of shares held by the holding company as well as the minority shareholders. Issue of bonus shares may or may not affect the cost of control depending upon whether such shares are issued out of capital profits or revenue profits.

- a. **Issue of bonus shares out of capital profit (Pre-acquisition profits):** In this case there will be no effect on accounting treatment because while calculating the cost of control the share of the holding company in pre-acquisition profit is reduced because of capitalisation of profit

and the paid-up value of shares held in subsidiary company is increased. Hence there is no effect on cost of control when bonus shares are issued from pre-acquisition profit.

- b. **Issue of bonus shares out of post-acquisition profit:** In this case, a part of the revenue profits will get capitalised resulting in decrease of cost of control or increase in capital reserve.

CONCEPT 14: TREATMENT OF DIVIDEND

Dividends may be received out of capital or revenue profits of the subsidiary company.

- Dividend received by the holding company from the capital profits of the subsidiary company are credited to investment in shares of the subsidiary account thereby reducing the cost of control or increasing capital reserve.
- Dividend received out of the revenue profits (i.e., post-acquisition profits) are treated as income and credited to profit & loss Account by the holding company.
- If dividend declared partly out of capital profits (i.e., pre-acquisition profits) and partly out of revenue profits (i.e., post-acquisition profits), the dividend received is divided into two parts in proportion to its declaration out of capital profits and revenue profits. The dividend pertaining to the first part (i.e., capital profits) is credited to Investment Account reducing the cost of control or increasing the capital reserve and dividend pertaining to the second part (i.e., revenue profits) is credited to profit and loss Account or surplus account.

It may be noted that in the absence of information whether dividend has been declared out of pre-acquisition or post-acquisition profits, it is assumed that dividend is out of profits for the year for which the dividend is declared.



Most Important Concept

Dividend received by the holding company from its subsidiary out of pre-acquisition profits is treated as capital receipt; the journal entry for its record being as follows: —

Bank A/c	Dr.
	To Shares in Subsidiary Company

Its effect on the holding company's balance sheet is as follows: —

Thus, the holding company deducts the amount of dividend received out of pre-acquisition profits from the balance of shares in subsidiary company account.

But it does not alter the amount of cost of control or capital reserve arising out of acquisition of shares; the reason being that although the cost of investment in the subsidiary company is reduced, the holding company's share in the capital profits is also reduced by an identical amount.

Dividend from Subsidiary Company out of post-acquisition Profits:

Dividend received out of post-acquisition profits is treated as a revenue receipt; the journal entries regarding it being as follows: —

Bank A/c	Dr.
To Dividend from Subsidiary Company	
(Dividend received from subsidiary company out of post-acquisition profit)	
Dividend from Subsidiary Company A/c	Dr.
To Profit & Loss A/c	
(Transfer of Dividend from Subsidiary company A/c to Profit & Loss A/c)	

Because such a dividend does not change the cost of shares of the subsidiary company and the holding company's share of capital profits, it will also not alter the cost of control or capital reserve on acquisition of shares.

Rectification of Error Relating to Dividend from Subsidiary Company:

In a question on consolidation of balance sheets, it may be given that the holding company has received dividend from the subsidiary company out of pre-acquisition profits and has credited its Profit & Loss Account with the amount so received. It means an error has been committed in as much as a capital receipt has been treated as an income.

The correct journal entry for receipt of dividend out of pre-acquisition profits is as follows: —

Bank A/c	Dr.
To Shares in Subsidiary Company	
But by mistake, following entry has been passed: -	

Bank A/c	Dr.
To Profit & Loss A/c	

From the above it is clear that there is no error in Bank Account. The error lies in the fact that instead of crediting shares in Subsidiary company, Profit & Loss A/c has been credited. The rectifying journal entry, therefore, will be as follows: -

*Profit & Loss A/c
To Shares in Subsidiary Company*

Dr.

The effect on the balance sheet will be that the credit balance of Profit & Loss A/c will be decreased and the debit balance of shares in Subsidiary company will also be decreased.

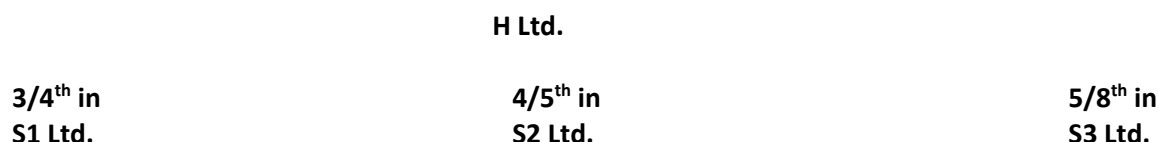
Treatment of Proposed Dividend: If the dividend has simply been proposed by the subsidiary company and appears as 'Proposed Dividend' in its Balance sheet, holding companies share of such dividend will appear with the Surplus or Profit & loss Account balance in the consolidated Balance sheet and share of such dividend belonging to minority shareholders will be added to minority interest. Proposed dividend need not be shown in the consolidated Balance sheet because it has been added to the minority interest and profit & loss Account balance of the holding company.

If **proposed dividend is not given in the Balance sheet** of the subsidiary company or directors of this company have not appropriated the profits for proposed dividend, then the following procedure is followed:

- (i) Calculate the cost of control and minority interest etc. in the usual manner without any adjustment for the proposed dividend.
- (ii) Deduct from minority interest its share of proposed dividend and show the same as a separate item in the consolidated Balance sheet.

CONCEPT 15: HOLDING COMPANY CONSISTING OF MORE THAN ONE SUBSIDIARY

A holding company may have a number of subsidiaries without any mutual holding in between the subsidiaries. The following chart will clearly show the position:



In this case, holding company H Ltd. acquires shares of 3/4th, 4/5th and 5/8th of S1 Ltd., S2 Ltd. and S3 Ltd. respectively and as such the investment account of holding company will show investment in S1 Ltd., S2 Ltd. and S3 Ltd. instead of one in the usual case. The calculation of cost of control, minority interest, elimination mutual indebtedness, unrealised profits on closing stock etc. of each company should be done following the usual principles.

PREPARATION OF CONSOLIDATED PROFIT AND LOSS STATEMENT

While preparing the Consolidated Profit and Loss Statement of the holding company and its subsidiary, the items appearing in the Profit and Loss Statement of the holding and subsidiary companies have to be aggregated. But in doing so, the following adjustments have to be made:

- (i) Transfer of goods between the holding company and the subsidiary company should be eliminated both from the purchases and sales appearing in the Consolidated Profit and Loss Statement.

- (ii) Stock Reserve for unrealised profit in respect of inter-company transactions should be created by debiting Consolidated Profit and Loss Statement and crediting Stock Reserve Account.
- (iii) The share of profits of the subsidiary company arising before the date of acquisition of shares by the holding company that belongs to the holding company will be debited to the Consolidated Profit and Loss Statement and credited to Capital Reserve or Goodwill Account as the case may be. **In case of loss the entry will be just reversed.**
- (iv) The share of profits or losses belonging to the minority shareholders will be respectively credited or debited to Minority Interest Account.
- (v) Dividends received from the subsidiary company by the holding company should be eliminated from both the sides of the Consolidated Profit and Loss Statement.
- (vi) Care should be taken to see that both the companies pass entries for interest accrued and outstanding on debentures of the subsidiary company held by the holding company. The debenture interest should be eliminated from both the sides of the Consolidated Profit and Loss Statement to the extent to which it relates to the debentures held by the holding company.
- (vii) If the subsidiary company has passed entries for proposed dividend and the holding company has taken credit for its shares of the dividends, the holding company's share should be eliminated from both the sides of the Consolidated Profit and Loss Statement. The necessary changes should also be made on both the sides of the Consolidated Balance Sheet. However, if the holding company has not passed entries for proposed dividends of the subsidiary company, the debit in respect of the proposed dividend should be reduced by the holding company's share in such proposed dividend and obviously, the liability in respect of proposed dividend in the Consolidated Balance Sheet should also be reduced.
- (viii) If there are profits and the dividends on cumulative preference shares are in arrears, the arrears of dividends on preference shares held by the Minority shareholders should be debited to the Consolidated Profit and Loss Statement and credited to Minority Interest Account.
- (ix) If fixed assets of the subsidiary company are revalued at the time of acquisition of shares by the holding company without any alteration in book-values, the excess or short depreciation should be adjusted by debiting or crediting the Consolidated Profit and Loss Statement and crediting or debiting the respective Asset Account.
- (x) The minority interest will consist of its proportion of total profits after adjustment of excess or short depreciation due to over or under valuation of fixed assets, but before adjusting the proportionate unrealised profit on stock.

It is important to note here that the consolidated Profit and Loss Statement has got no concern with the Consolidated Balance Sheet. It is prepared in addition to the Consolidated Balance Sheet to serve the purpose of showing the total profits earned by the group of companies for a particular period.

THEORY QUESTIONS

Ques. No. 1: Write a short note on Minority Interest?

Ques. No. 2: What is the treatment of Bonus issue by subsidiary company.

Ques. No. 3: What is the treatment of dividend paid by subsidiary company.

Ques. No. 4: Write a short note on treatment of contingent liabilities.

Ques. No. 5: Write a short note on inter-company transaction between holding and subsidiary.

Ques. No. 6: Write a short not Revaluation of assets and Liabilities of subsidiary company.

Ques. No. 7: Write a short not preference share in subsidiary company.

Ques. No. 8: What is 'cost of control' in the context of preparing consolidated balance sheet?

Ques. No. 9: How are pre-acquisition losses of subsidiary companies shared and accounted for?

Ques. No. 10: When dividend is declared and paid by a subsidiary company out of pre-acquisition and post-acquisition profits, how will the same be dealt with in the books of a holding company?

PRACTICE PROBLEMS

Illustration 1 (Wholly-Owned Subsidiary Company)

From the following extracts of the H Ltd. and S Ltd., prepare a consolidated balance sheet of H Ltd. and its subsidiary S Ltd.:

Balance Sheet as on (an extract)					
Liabilities	H Ltd. Rs.	S Ltd. Rs.	Assets	H Ltd. Rs.	S Ltd. Rs.
Share Capital in shares of Rs 10 each	10,00,000	5,00,000	Sundry Assets	7,00,000	5,40,000
			Investment in 50,000 shares of		
Other Liabilities	2,00,000	40,000	S Ltd. At par	5,00,000	
	<u>12,00,000</u>	<u>5,40,000</u>		<u>12,00,000</u>	<u>5,40,000</u>

Solution

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as on			
	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholder' Funds		
	(a) Share capital	1	10,00,000
	2. Other Liabilities	2	<u>2,40,000</u>
	Total Equity and Liabilities		<u>12,40,000</u>
II	ASSETS		
	Sundry Assets	3	<u>12,40,000</u>
	Total Assets		<u>12,40,000</u>

Notes to Account

	Particulars	Rs
1	Share capital	
	Issued, subscribed and Fully Paid up	
	1,00,000 Equity shares of Rs. 10 each (H Ltd.)	<u>10,00,000</u>
2	Other Liabilities	
	H Ltd.	2,00,000
	S Ltd.	<u>40,000</u>
		<u>2,40,000</u>
3	Other Assets	
	H Ltd.	7,00,000
	S Ltd.	<u>5,40,000</u>
		<u>12,40,000</u>

Illustration 2 (Minority Interest)

From the following information prepare a consolidated balance sheet of H Ltd. and its subsidiary S Ltd.

Credit Balances	H Ltd. Rs.	S Ltd. Rs.	Debit balances	H Ltd. Rs.	S Ltd. Rs.
Share Capital in shares of Rs. 10 each	10,00,000	5,00,000	Sundry Assets	8,00,000	5,40,000
Other Liabilities	2,00,000	40,000	Investments in the shares of S Ltd.: 40,000 shares of Rs. 10 each	4,00,000	
	<u>12,00,000</u>	<u>5,40,000</u>		<u>12,00,000</u>	<u>5,40,000</u>

Solution

Consolidated Balance Sheet of H Ltd. and Its Subsidiary S Ltd. As on

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholder's Funds		
	Share Capital (H Ltd.)	1	10,00,000
	2. Minority Interest	2	1,00,000
	3. Other Liabilities	3	2,40,000
	Total Equity and Liabilities		<u>13,40,000</u>
II	ASSETS		
	Sundry Assets	4	13,40,000
	Total Assets		<u>13,40,000</u>

Notes to Accounts

	Particulars	Rs.
1	Share capital	
	Issued, subscribed and Fully Paid	
	1,00,000 Equity shares of Rs. 10 each (H Ltd.)	10,00,000
2	Minority Interest	
	1/5 share in the share capital of S Ltd.	1,00,000
3	Other Liabilities	
	H Ltd.	2,00,000
	S Ltd.	40,000
		<u>2,40,000</u>
4	Other Assets	
	H Ltd.	8,00,000
	S Ltd.	5,40,000

13,40,000

Illustration 3 (Cost of Control)

From the following Balance Sheets of H Ltd. and its subsidiary of S Ltd., as on 31 March 2017, prepare a consolidated balance sheet:

	Particulars	Note No.	H Ltd.	S Ltd.
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital (in shares of Rs. 100 each)		10,00,000	5,00,000
	(b) Reserve and Surplus Reserves			20,000
	Surplus Account		1,00,000	50,000
	2. Current Liabilities			
	(a) Trade Payables (Creditors)		2,00,000	50,000
	Total		13,00,000	6,20,000
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)		7,00,000	6,20,000
	(b) Non-Current Investments (Investment in the shares of S Ltd.)		6,00,000	
	5,000 shares at cost			
	Total		13,00,000	6,20,000

H Ltd. purchases shares in S Ltd. on the balance sheet date i.e., 31-03-2017.

Solution

Calculation of Cost of Control or Goodwill

		Rs.
Cost (or Acquisition) price of the investment in the shares of S Ltd.		6,00,000
Less: the nominal value of the shares acquired		5,00,000
		1,00,000
Less: Shares in pre-acquisition reserves	20,000	
Shares in pre-acquisition surplus	50,000	70,000
Cost of Control or Goodwill		30,000
Alternatively		
Share Capital		5,00,000
Reserves		20,000
Profits		50,000
		5,70,000
Cost of control or Goodwill (6,00,000 - 5,70,000)		30,000
Price paid for investment in shares of S Ltd.		6,00,000

The consolidated balance sheet is compiled in the same manner as before, but with the addition of **goodwill** to show the cost of acquiring control in S Ltd. as below:

Consolidated Balance Sheet of H Ltd. And
Its Subsidiary S Ltd. As on 31 March 2017

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	10,00,000
	(b) Reserves and Surplus	2	1,00,000
	Sub Total: Shareholders' Funds		11,00,000
	2. Minority Interest		
	3. Current Liabilities		
	Trade Payable	3	2,50,000
	Total Equity and Liabilities		13,50,000
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible (Assumed)	4	13,20,000
	(ii) Intangible	5	30,000
	Total Assets		13,50,000

Notes to Account

	Particulars	Rs.
1	Share capital	
	Issued, subscribed and Fully Paid	
	10,000 Equity shares of Rs. 100 each (H Ltd.)	10,00,000
2	Reserves and Surplus	
	Surplus (H Ltd.)	1,00,000
3	Trade Payable	
	Sundry Creditors	
	H Ltd.	2,00,000
	S Ltd.	50,000
		2,50,000
4	Tangible Fixed Assets (Assumed)	
	H Ltd.	7,00,000
	S Ltd.	6,20,000
		13,20,000
5	Intangible Fixed Assets	
	Goodwill	30,000

Illustration 4 (Capital Reserve)

From the following Balance Sheets of H Ltd. and its subsidiary S Ltd. as on 31-03-2017, prepare a consolidated balance sheet :

	Particulars	Note No.	H Ltd. (Rs.)	S Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital (in shares of Rs. 100 each)		10,00,000	5,00,000
	(b) Reserve and Surplus			
	Reserve		50,000	40,000
	Surplus Account		1,00,000	20,000
	2. Current Liabilities			
	(a) Trade Payables (Creditors)		2,50,000	60,000
	Total		14,00,000	6,20,000
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)		8,80,000	6,20,000
	(b) Non-Current Investments		5,20,000	
	(Investment in 5,000 shares of S Ltd., bought on 31-3-2017)			
	Total		14,00,000	6,20,000

Solution :

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as on 31 March 2017

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	10,00,000
	(b) Reserves and Surplus	2	1,90,000
	Sub Total		11,90,000
	2. Minority Interest		
	3. Current Liabilities		
	Trade Payable	3	3,10,000
	Total Equity and Liabilities		15,00,000
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible (Assumed)	4	15,00,000
	Total Assets		15,00,000

Notes to Accounts		
	Particulars	Rs.
1	Share capital	
	Issued, subscribed and Fully Paid	
	10,000 Equity shares of Rs. 100 each	10,00,000
2	Reserves and Surplus	
	(i) Capital Reserve (on consolidation)	40,000
	(ii) General Reserves (H Ltd.)	50,000
	(iii) Surplus (H Ltd.)	1,00,000
		1,90,000
3	Trade Payables	
	Sundry Creditors :	
	H Ltd.	2,50,000
	S Ltd.	60,000
		3,10,000
4	Tangible Assets	
	Sundry Assets (Assumed to be fixed):	
	H Ltd.	8,80,000
	S Ltd.	6,20,000
		15,00,000

Illustration 5: (Pre-Acquisition Surplus or Profit and Reserves)

From the following information prepare a consolidated balance sheet as on 31 March 2017 :

Credit Balances	H Ltd. Rs.	S Ltd. Rs.	Debit balances	H Ltd. Rs.	S Ltd. Rs.
Share Capital in shares of Rs. 20 each	2,00,000	1,00,000	Sundry Assets	2,20,000	1,50,000
Reserves	60,000	20,000	Investments in 3,000 shares of		
Surplus	20,000	10,000	S Ltd.	90,000	
Creditors	30,000	20,000			
	3,10,000	1,50,000		3,10,000	1,50,000

H Ltd. acquired its shares in S Ltd. on 1 April 2017 when S Ltd.'s reserves stood at Rs. 5,000 and its surplus at Rs. 6,000

Solution

**Consolidated Balance Sheet of H Ltd. And
Its Subsidiary S Ltd. As on 1 April 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	2,00,000
	(b) Reserves and Surplus	2	91,400
	Sub Total		2,91,400
	2. Minority Interest		52,000

3. Current Liabilities			
	Trade Payable	3	50,000
	Total Equity and Liabilities		3,93,400
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible (Assumed)	4	3,70,000
	(ii) Intangible	5	23,400
	Total		3,93,400

Notes to Accounts			
	Particulars	Rs.	Rs.
1	Share Capital (H Ltd.)		
	Issued, subscribed and Fully Paid up		
	10,000 Equity shares of Rs. 20 each		2,00,000
2	Reserves and Surplus		
	(i) Reserves (General)		
	H Ltd.	60,000	
	S Ltd.	9,000	69,000
	(ii) Surplus: H Ltd.	20,000	
	Share in S Ltd.	2,400	22,400
			91,400
3	Trade Payables		
	Sundry Creditors H Ltd.		30,000
	S Ltd.		20,000
			50,000
4	Tangible Assets		
	H Ltd.		2,20,000
	S Ltd.		50,000
			2,70,000
5	Intangible Assets		
	Goodwill		30,000
	Less: Capital Reserve		6,600
			23,400

Illustration 6 (Pre-Acquisition Profit and Reserves)

From the Balance Sheets given below, prepare a consolidated balance sheet of Moti Ltd. and its subsidiary Choti Ltd. :

	Particulars	Note No.	Moti (Rs.)	Choti (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital (shares of Rs. 10 each)		1,20,000	30,000
	(b) Reserve and Surplus			
	General Reserve		25,000	6,000
	Surplus		12,000	9,000
	2. Current Liabilities			
	(a) Trade Payables (Creditors)		15,000	5,000
	Total		1,72,000	50,000
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)			
	Freehold Buildings		72,000	
	Leasehold Property			25,000
	Plant and Machinery		30,000	10,000
	(b) Non-Current Investments		25,000	
	(2,000 shares in Choti Ltd.)			
	2. Current Assets			
	(a) Inventories (Stock-in-trade)		18,000	3,000
	(b) Trade Receivables (Debtors)		22,000	7,000
	(c) Cash and Cash Equivalents (Bank)		5,000	5,000
	Total		1,72,000	50,000

At the time of acquisition by Moti Ltd., of 2,000 Shares in Choti Ltd., the latter company had undistributed surplus and reserves of Rs. 5,000, none of which have been distributed since acquisition.

Solution

**Consolidated Balance Sheet of Moti Ltd.
And Its Subsidiary Choti Ltd. as on**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital (Moti Ltd.)	1	1,20,000
	(b) Reserves and Surplus	2	43,667
	Sub Total		1,63,667
	2. Minority Interest		15,000
	3. Current Liabilities		
	Trade Payables	3	20,000

		Total Equity and Liabilities	1,98,667
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible	4	1,37,000
	(ii) Intangible (Net of Capital Reserves)	5	1,667
	Sub Total		1,38,667
	2. Current Assets		
	(i) Inventories	6	21,000
	(ii) Trade Receivable	7	29,000
	(iii) Cash and Cash Equivalents	8	10,000
	Sub Total		60,000
	Total Assets		1,98,667

Notes to Accounts			
	Particulars	Rs.	Rs.
1	Share capital (M Ltd.)		
	Issued, subscribed and Fully Paid		
	12,000 Equity shares of Rs. 10 each		1,20,000
2	Reserves and Surplus		
	(i) Capital Reserves on consolidation	3,333	
	Less: Goodwill on consolidation	3,333	Nil
	(ii) General Reserves (M Ltd.)	25,000	
	2/3 share in Choti Ltd. (On consolidation)	2,667	27,667
	Surplus: M Ltd.	12,000	
	Share in C Ltd.	4,000	16,000
			43,667
3	Trade Payables		
	Sundry Creditors M Ltd.		15,000
	C Ltd.		5,000
			20,000
4	Tangible Assets		
	Freehold Building M Ltd.		72,000
	Leasehold Property C Ltd.		25,000
	Plant and Machinery M Ltd.	30,000	
	C Ltd.	10,000	40,000
			1,37,000
5	Intangible Assets Goodwill		
	Investments in shares of S Ltd.		25,000
	Less: Face value of shares held in C Ltd.		20,000
	Goodwill on consolidation		5,000
	Less: Capital Reserves		3,333
			1,667

6	Inventories	
	Stock of Goods (M)	18,000
	(C Ltd.)	<u>3,000</u>
		21,000
7	Trade Receivables	
	Debtors for Goods (M)	22,000
	(C Ltd.)	<u>7,000</u>
		29,000
8	Cash and Cash Equivalents	
	Cash at Bank (M)	5,000
	(C Ltd.)	<u>5,000</u>
		10,000

Illustration 7 (Pre-acquisition loss)

The balance sheets of H Ltd. and its subsidiary S Ltd., as on 31 March 2017, were as follows:

	Particulars	Note No.	H Ltd. (Rs.)	S Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital (shares of Rs. 1 each)		10,000	6,000
	(b) Reserve and Surplus			
	General Reserve		4,000	
	Surplus		4,000	1,800
	2. Current Liabilities			
	(a) Trade Payables (Creditors)		2,000	2,200
	Total		<u>20,000</u>	<u>10,000</u>
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)		16,000	10,000
	(b) Non-Current Investments		4,000	
	(4,000 shares in S Ltd.)			
	Total		<u>20,000</u>	<u>10,000</u>

The shares were purchased by H Ltd. in S Ltd. on 30 September 2016.

On 1 April 2016 the profit and loss statement of S Ltd. showed a loss of Rs. 3,000 which was written off from out of the profits earned during the year. Profits are earned uniformly over the year 2016-17. Prepare a consolidated balance sheet of H Ltd. and S Ltd. as on 31 March 2017 giving all workings.

Solution

**Consolidated Balance Sheet of H Ltd.
And Its Subsidiary S Ltd. As On 1 April 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' funds		
	(a) Share Capital (H Ltd.)	1	10,000
	(b) Reserves and Surplus	2	9,600
	Sub Total		<u>19,600</u>
	2. Minority Interest	3	2,600
	3. Current Liabilities		
	Trade Payables	4	4,200
	Total Equity and Liabilities		<u>26,400</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible	5	26,000
	(ii) Intangible	6	400
	Total Assets		<u>26,400</u>

Notes to Account

	Particulars	Rs.	Rs.
1	Share capital (H Ltd.)		
	Issued, subscribed and Fully Paid up		
	10,000 Equity shares of Rs. 1 each		<u>10,000</u>
2	Reserves and Surplus		
	(i) General Reserve (H Ltd.)		4,000
	(ii) Surplus (H Ltd.)	4,000	
	Share in S Ltd.	<u>1,600</u>	<u>5,600</u>
			<u>9,600</u>
3	Minority Interest		
	Equity share capital		2,000
	Add: share in Profit 1/3 of Rs. 1,800		<u>600</u>
			<u>2,600</u>
4	Trade Payables		
	Sundry Creditors for Goods:		
	H Ltd.		2,000
	S Ltd.		<u>2,200</u>
			<u>4,200</u>
5	Tangible Fixed Assets		
	Sundry Fixed Assets : H Ltd.		16,000

	S Ltd.	10,000
		<u>26,000</u>
6	Intangible Fixed Assets	
	Goodwill on consolidation	2,000
	Less: Capital Reserve	<u>1,600</u>
		<u>400</u>

Illustration 8: (Common Transactions)

H Ltd. acquired 8,000 equity shares of S Ltd. on 31 March 2016. The following are the balance sheets of the two companies as at 31 March 2017:

	Particulars	Note No.	H Ltd. (Rs.)	S Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital			
	Equity Shares of Rs. 100 each		20,00,000	10,00,000
	(b) Reserve and Surplus			
	General Reserve (31-3-2016)		4,00,000	2,00,000
	Surplus Account (31-3-2016)		1,00,000	60,000
	Profit for the year 2016-17		2,00,000	80,000
	2. Current Liabilities			
	(a) Trade Payables - Creditors		1,00,000	1,00,000
	Bills Payable		30,000	10,000
	Total		<u>28,30,000</u>	<u>14,50,000</u>
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)			
	Land and Building		5,00,000	3,00,000
	Plant and Machinery		5,00,000	6,00,000
	(b) Non-Current Investments		10,00,000	
	(investment in shares of S Ltd. At cost)			
	(8,000 shares in S Ltd.)			
	2. Current Liabilities			
	(a) Inventories (stock in trade)		1,50,000	1,00,000
	(b) Trade Receivables - Debtors		1,00,000	1,20,000
	Bills Receivable		80,000	10,000
	(c) Cash and Cash Equivalents (Bank)		5,00,000	3,20,000
	Total		<u>28,30,000</u>	<u>14,50,000</u>

(i) Bills receivable of H Ltd. include Rs. 10,000 accepted by S Ltd.

(ii) Sundry debtors of H Ltd. include Rs. 50,000 due from S Ltd.

Prepare a consolidated balance sheet of H Ltd. and its subsidiary S Ltd.

Solution

**Consolidated Balance Sheet of H Ltd.
and Its Subsidiary S Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital (S Ltd.)	1	20,00,000
	(b) Reserves and Surplus	2	7,72,000
	Sub Total		<u>27,72,000</u>
	2. Minority Interest		<u>2,68,000</u>
	3. Current Liabilities		
	(i) Trade Payable	3	1,50,000
	(ii) Other Current Liabilities	4	30,000
	Bills Payable (Presumed to be payable within 12 months)		
	Sub Total		<u>1,80,000</u>
	Total Equity and Liabilities		<u>32,20,000</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	5	19,00,000
	2. Current Assets		
	(i) Inventories	6	2,50,000
	(ii) Trade Receivables	7	1,70,000
	(iii) Cash and Cash Equivalents	8	8,20,000
	(iv) Short Loans and Advances	9	80,000
	Total Assets		<u>32,20,000</u>

Notes to Account

	Particulars	Rs.	Rs.
1	Share capital (S Ltd.)		
	Issued, subscribed and Fully Paid up		
	20,000 Equity shares of Rs. 100 each		<u>20,00,000</u>
2	Reserves and Surplus		
	(a) Capital Reserves on consolidation		8,000
	(b) General Reserves (H Ltd.)		4,00,000
	(c) Surplus (3,00,000 + 64,000)		<u>3,64,000</u>
			<u>7,72,000</u>
3	Trade Payables		
	Sundry Creditors for Goods: H Ltd.		1,00,000
	S Ltd.		1,00,000

					2,00,000
	Less: Inter-company debts				50,000
					1,50,000
4	Bills Payables: H Ltd.				30,000
	S Ltd.				10,000
					40,000
	Less: Inter-Company Bills				10,000
					30,000
5	Tangible Fixed Assets				
	Land and Building: H Ltd.				5,00,000
	S Ltd.				3,00,000
					8,00,000
	Plant and Machinery: H Ltd.	5,00,000			
	S Ltd.	6,00,000			11,00,000
					19,00,000
6	Inventories				
	Stock of Goods: H Ltd.				1,50,000
	S Ltd.				1,00,000
					2,50,000
7	Trade Receivables: H Ltd.				1,00,000
	S Ltd.				1,20,000
					2,20,000
	Less: Inter-Company Debts				50,000
					1,70,000
8	Cash and Cash Equivalents				
	Cash at Bank H Ltd.				5,00,000
	S Ltd.				3,20,000
					8,20,000
9	Short-term Loans and Advances				
	Bill Receivables H Ltd.				80,000
	S Ltd.				10,000
					90,000
	Less: Inter-Company Bills				10,000
					80,000

Illustration 9: (Unrealised Profit on Stock)

A Ltd., acquires all the shares in B Ltd., at cost of Rs. 1,05,000 on 1 April 2016. The extracts of balance sheets of two companies on 31 March 2017 were as follows:

Liabilities	A Ltd. (Rs.)	B Ltd. (Rs.)	Assets	A Ltd. (Rs.)	B Ltd. (Rs.)
Share Capital :			Fixed Assets:		
Shares of Rs. 10 each	3,00,000	45,000	Freehold Premises	1,65,000	28,000
Reserves & Surplus:			Machinery	70,000	26,000

General Reserve			Investments:		
(1-4-2016)	1,00,000	2,000	Shares in Subsidiary		
Surplus	90,000	36,000	Co.	1,05,000	
Current Liabilities:			Current Assets:		
Creditors	10,000	14,000	Stock	62,000	18,000
			Debtors	35,000	14,000
			Cash	63,000	11,000
	5,00,000	97,000		5,00,000	97,000

- (i) The creditors of A Ltd., include Rs. 5,000 due to B Ltd., for purchases on which the latter company made a profit of Rs. 1,000.
- (ii) The stock of A Ltd. includes Rs. 3,000 of the above purchases from B Ltd. Make necessary adjustments and show a consolidated balance sheet as on 31.03.2017.

Solution

**Consolidated Balance Sheet of A Ltd.
And Its Subsidiary B Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	3,00,000
	(b) Reserves and Surplus	2	2,25,400
	Sub Total		<u>5,25,400</u>
	2. Current Liabilities		
	Trade Payables	3	19,000
	Total Equity and Liabilities		<u>5,44,400</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible	4	2,89,000
	(ii) Intangible	5	58,000
	Sub Total		<u>3,47,000</u>
	2. Current Assets		
	(i) Inventories	6	79,400
	(ii) Trade Receivables	7	44,000
	(iii) Cash and Cash Equivalents	8	74,000
	Sub Total		<u>1,97,400</u>
	Total Assets		<u>5,44,400</u>

Notes to Account

	Particulars	Rs.	Rs.
1	Share capital (A Ltd.)		
	Issued, subscribed and Fully Paid up		
	30,000 Equity shares of Rs. 10 each		<u>3,00,000</u>

2	Reserves and Surplus		
	(i) General Reserves (A Ltd.)		1,00,000
	(ii) Surplus	90,000	
	Add: Share in B Ltd.	36,000	
		<u>1,26,000</u>	
	Less: unrealised profit on stock	600	1,25,400
			<u>2,25,400</u>
3	Trade Payables		
	(a) Sundry Creditors A Ltd.		10,000
	B Ltd.		<u>14,000</u>
			24,000
	Less: Mutual Debts		<u>5,000</u>
			<u>19,000</u>
4	Tangible Fixed Assets		
	(a) Freehold Premises A Ltd.		1,65,000
	B Ltd.		<u>28,000</u>
			1,93,000
	(b) Machinery A Ltd.	70,000	
	B Ltd.	<u>26,000</u>	96,000
			<u>2,89,000</u>
6	Inventories		
	Stock of Goods A Ltd.		62,000
	B Ltd.		<u>18,000</u>
			80,000
	Less: Unrealised Profit		<u>-600</u>
			<u>79,400</u>
7	Trade Receivables		
	Sundry Debtors A Ltd.		35,000
	B Ltd.		<u>14,000</u>
			49,000
	Less: Mutual Debts		<u>5,000</u>
			<u>44,000</u>
8	Cash and Cash Equivalents		
	Cash at Bank A Ltd.		63,000
	B Ltd.		<u>11,000</u>
			<u>74,000</u>

There is no minority interest since it is a case of wholly owned subsidiary company.

Illustration 10: (Loss of Stock By Fire and Unrealised Profit On Stock)

The following balance sheets as on 31-3-2017 are presented to you:

Particulars	Note No.	H Ltd. (Rs.)	S Ltd. (Rs.)
I EQUITY AND LIABILITIES			

1. Shareholder's Funds		
(a) Share Capital (shares of Rs. 100 each)	5,00,000	2,00,000
(b) Reserve and Surplus		
General Reserve	1,00,000	-
Surplus Account	80,000	1,00,000
2. Non-Current Liabilities		
(a) Long term borrowings		
6% Debentures		1,00,000
3. Current Liabilities		
(a) Trade Payables (Creditors)	75,000	45,000
Total	<u>7,55,555</u>	<u>2,45,000</u>
II ASSETS		
1. Non-Current Assets		
(a) Fixed Assets (Tangible)	3,50,000	1,50,000
(b) Non-Current Investments		
6% Debentures in S Ltd. Acquired at cost	60,000	
1,500 Shares in S Ltd. At Rs. 80 each	1,20,000	
2. Current Assets		
(a) Inventories (stock in trade)	90,000	40,000
(b) Trade Receivables (Debtors)	60,000	30,000
(c) Cash and Cash Equivalents (Bank)	75,000	25,000
Total	<u>7,55,000</u>	<u>2,45,000</u>

H Ltd. acquired the shares on 1 August 2016. The profit and loss statement of S Ltd. showed a loss of Rs. 1,50,000 on 1 April 2016. During June 2016, goods costing Rs. 6,000 were destroyed by fire against which insurer paid only Rs. 2,000. Trade creditors of S Ltd. include Rs. 20,000 for goods supplied by H Ltd. on which H Ltd. made a profit of Rs. 2,000. Half of the goods were still in stock on 31 March 2017. Prepare a consolidated balance sheet and show the complete working.

Solution

**Consolidated Balance Sheet of H Ltd.
And Its Subsidiary S Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	5,00,000
	(b) Reserves and Surplus	2	2,06,000
	Sub Total		<u>7,06,000</u>
	2. Minority Interest	3	25,000
	3. Non-Current Liabilities		
	Long term loans (secured)	4	40,000
	4. Current Liabilities		
	Trade payables	5	1,00,000
	Total Equity and Liabilities		<u>8,71,000</u>
II	ASSETS		

1. Non-Current Assets

(a) Fixed Assets

(i) Tangible	6	5,00,000
(ii) Intangible	7	72,000
Sub Total		5,72,000

2. Current Assets

(i) Inventories	8	1,29,000
(ii) Trade Receivables	9	70,000
(iii) Cash and Cash Equivalents	10	1,00,000
Sub Total		2,99,000
Total Assets		8,71,000

Notes to Account

	Particulars	Rs.	Rs.
1	Share capital		
	Issued, subscribed and Fully Paid		
	5,000 Equity shares of Rs.100 each		5,00,000
2	Reserves and Surplus		
	(i) General Reserves (H Ltd.)		1,00,000
	(ii) Surplus H Ltd.	80,000	
	S Ltd.	27,000	
		1,07,000	
	Less: Unrealised Profit on stock	1,000	1,06,000
			2,06,000
3	Minority Interest		
	Paid up capital held : 1/4 of Rs. 2,00,000		50,000
	Less: 1/4 of accumulated loss of Rs. 1,00,000		25,000
			25,000
4	Long-term Liabilities		
	6% Debentures (secured)		1,00,000
	Less: Held by H Ltd.		60,000
			40,000
5	Trade Payables		
	Sundry Creditors for goods:		
	H Ltd.		75,000
	S Ltd.		45,000
			1,20,000
	Less: Inter-Company Owings		20,000
			1,00,000
6	Tangible Assets		
	Sundry Fixed H Ltd.		3,50,000
	S Ltd.		1,50,000
			5,00,000
7	Intangible Assets		

	Goodwill on consolidation	72,000
8	Inventories	
	Stock of Goods H Ltd.	90,000
	S Ltd.	40,000
		1,30,000
	Less: Unrealised Profit on Stock	1,000
		1,29,000
9	Trade Receivables	
	Debtors for Goods H Ltd.	60,000
	S Ltd.	30,000
		90,000
	Less: Inter-Company Owings	20,000
		70,000
10	Cash and Cash Equivalents	
	Cash in hand H Ltd.	75,000
	S Ltd.	25,000
		1,00,000

There is no need to split accumulated losses and profits into pre-and-post-acquisition period while calculating share of minority interest in them. The same could be and in fact has been directly calculated as $\frac{1}{4}$ of Rs. 1,00,000 i.e. Rs. 25,000.

Illustration 11: (Preference Share Capital in Subsidiary Company)

The following are balance sheets of R Ltd. and S Ltd. as at 31 March 2017:

	Particulars	Note No.	R Ltd. (Rs.)	S Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital			
	Equity Shares of Rs. 10 each, fully paid		4,00,000	1,50,000
	13% Preference shares of Rs. 100 each, fully paid			1,00,000
	(b) Reserve and Surplus			
	General Reserve		50,000	40,000
	Surplus Account (before appropriation)		30,000	25,000
	2. Non-Current Liabilities			
	(a) Long term borrowings			
	12% Debentures		2,00,000	
	3. Current Liabilities			
	(a) Trade Payables (Creditors)		3,20,000	1,85,000
	Total		10,00,000	5,00,000
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)		5,00,000	2,40,000
	(b) Non-Current Investments			

(15,000 Equity Shares in S Ltd. On 1-4-2016)	2,00,000	
2. Current Assets	3,00,000	2,60,000
(including Rs. 10,000 stock-in-trade purchased from R Ltd.)		
Total	<u>10,00,000</u>	<u>5,00,000</u>

Prepare the consolidate balance sheet as at 31 March 2017 assuming that (a) S Ltd.'s general reserve and profit and loss account (after appropriation for dividends) stood at Rs. 25,000 and Rs. 10,000 respectively on 31 March 2016 and 31 March 2017. (b) R Ltd. Sells goods at a profit of 25% on cost.

Solution

**Consolidated Balance Sheet of R Ltd.
And Its Subsidiary S Ltd. As At 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	4,00,000
	(b) Reserves and Surplus	2	<u>95,000</u>
	Sub Total		<u>4,95,000</u>
	2. Minority Interest	3	1,13,000
	3. Non-Current Liabilities		
	Long term Loans (secured)	4	2,00,000
	4. Current Liabilities		
	Trade Payables	5	<u>5,05,000</u>
	Total Equity and Liabilities		<u>13,13,000</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible	6	7,40,000
	(ii) Intangible	7	<u>15,000</u>
	Sub Total		<u>7,55,000</u>
	2. Current Assets	8	<u>5,58,000</u>
	Total Assets		<u>13,13,000</u>

Notes to Accounts

	Particulars	Rs.	Rs.
1	Share capital (R Ltd.)		
	Issued, subscribed and Fully Paid		
	40,000 Equity shares of Rs. 10 each		<u>4,00,000</u>
2	Reserves and Surplus		
	(i) General Reserves (R Ltd.)		50,000
	Add: Share - in S Ltd.		<u>15,000</u>
			65,000

	(ii) Surplus (R Ltd.)	30,000	
	Add: Share in S Ltd.	<u>2,000</u>	
		32,000	
	Less: Unrealised Profit on Stock	<u>2,000</u>	<u>30,000</u>
			<u>95,000</u>
3	Minority Interest		
	1,000, 13% Preference shares of Rs. 100 each		1,00,000
	Add: Dividends @ 13%		<u>13,000</u>
			<u>1,13,000</u>
4	Long-term Liabilities		
	12% Debentures (secured)		<u>2,00,000</u>
5	Current Liabilities: R Ltd.		3,20,000
	S Ltd.		<u>1,85,000</u>
			<u>5,05,000</u>
6	Tangible Assets		
	Sundry Fixed R Ltd.		5,00,000
	S Ltd.		<u>2,40,000</u>
			<u>7,40,000</u>
7	Intangible Assets		
	Goodwill on consolidation		<u>15,000</u>
8	Current Assets: R Ltd.		3,00,000
	S Ltd.		<u>2,60,000</u>
			5,60,000
	Less: Unrealised Profit on Stock		<u>2,000</u>
			<u>5,58,000</u>

Illustration 12: (Debentures in Subsidiary Company)

The following are the balance sheets of M Ltd. and its subsidiary N Ltd. as at 31 March, 2017 :

	Particulars	Note No.	M Ltd. (Rs.)	N Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital			
	Equity Shares of Rs. 10 each, fully paid		3,00,000	2,00,000
	(b) Reserve and Surplus			
	Capital Redemption Reserve		1,20,000	
	General Reserve		1,00,000	30,000
	Surplus Account (before appropriation)		60,000	40,000

2. Non-Current Liabilities			
(a) Long term borrowings (Debentures)	2,00,000	1,00,000	
3. Current Liabilities			
(a) Trade Payables (Creditors)	1,90,000	1,15,000	
(b) Other Current Liabilities	30,000	15,000	
(Interest due on debenture for one year)			
Total	<u>10,00,000</u>	<u>5,00,000</u>	
II ASSETS			
1. Non-Current Assets			
(a) Fixed Assets (Tangible)	6,00,000	3,40,000	
(b) Non-Current Investments			
15,000 shares in N Ltd. On 30-9-2016	2,00,000		
Debentures of N Ltd. At par	50,000		
Debentures of M Ltd. At par		60,000	
2. Current Assets	<u>1,50,000</u>	<u>1,00,000</u>	
Total	<u>10,00,000</u>	<u>5,00,000</u>	

Prepare the consolidated balance sheet as at 31 March 2017 assuming that N Ltd. has earned uniformly in 2016-2017 and its profit and loss statement showed a loss of Rs. 20,000 on 1.4.2016. Show the working also.

Solution

**Consolidated Balance Sheet of M Ltd.
And Its Subsidiary N Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	3,00,000
	(b) Reserves and Surplus	2	3,02,500
	Sub Total		<u>6,02,500</u>
	2. Minority Interest	3	67,500
	3. Non-Current Liabilities		
	Long Term Borrowings (secured)	4	1,90,000
	4. Current Liabilities		
	(i) Trade payables	5	3,05,000
	(ii) Other Current Liabilities	6	28,500
	Sub Total		<u>3,33,000</u>
	Total Equity and Liabilities		<u>11,93,500</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible	7	9,40,000
	(ii) Intangible	8	20,000
	Sub Total		<u>9,60,000</u>
	2. Current Assets: Other Current Assets	9	<u>2,33,500</u>

Total Assets

11,93,500

Notes to Accounts

	Particulars	Rs.	Rs.
1	Share capital (M Ltd.)		
	Issued, subscribed and Fully Paid		
	30,000 Equity shares of Rs. 10 each		3,00,000
2	Reserves and Surplus		
	(i) Capital Redemption Reserves		1,20,000
	(ii) General Reserves		1,00,000
	(iii) Surplus		
	M Ltd.	60,000	
	Add: Share in N Ltd.	22,500	82,500
			3,02,500
3	Minority Interest		
	Nominal Value of the shares held		
	(1/4 of Rs. 2,00,000)		50,000
	Add: 1/4 of Rs. 30,000 (General Reserves)		7,500
	Add: 1/4 of Rs. 40,000 surplus		10,000
			67,500
4	Long-term Liabilities		
	Debentures (M Ltd.)	2,00,000	
	Less: Holding by N Ltd.	60,000	1,40,000
	Debentures N Ltd.	1,00,000	
	Less: Held by M Ltd.	50,000	50,000
			1,90,000
5	Trade Payables: M Ltd.		1,90,000
	N Ltd.		1,15,000
			3,05,000
6	Other Current Liabilities		
	Interest Accrued And Due on		
	Debentures Issued by M Ltd.	30,000	
	Less: Interest due on Debentures		
	held by N Ltd.	9,000	21,000
	Interest Accrued And Due on		
	Debentures Issued by N Ltd.	15,000	
	Less: Interest due on Debentures		
	held by N Ltd.	7,500	7,500
			28,500
7	Tangible Assets		
	M Ltd.		6,00,000
	N Ltd.		3,40,000

			<u>9,40,000</u>
8	Intangible Assets		
	Goodwill on consolidation :		
	Cost of Investment in N Ltd.	2,00,000	
	Less: Share Capital held	<u>1,50,000</u>	
		50,000	
	Add: Pre-acquisition Loss (3/4)	<u>15,000</u>	
		65,000	
	Less: Share in capital profit and capital reserves	<u>45,000</u>	
		<u>20,000</u>	
9	Current Assets		
	M Ltd.	1,50,000	
	Less: Accrued Interest due on Debentures held in M Ltd.	<u>9,000</u>	
			1,41,000
	N Ltd.		
	Less: Accrued Interest due on debentures held in M Ltd.	1,00,000	
		<u>7,500</u>	92,500
			<u>2,33,500</u>

Illustration 13: (Treatment of Contingent Liabilities)

The balance sheets of H Ltd. and S Ltd. on 31 March 2017 were as under:

	Particulars	Note No.	H Ltd. (Rs.)	S Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital			
	Equity Shares of Rs. 100 each		5,00,000	3,00,000
	(b) Reserve and Surplus			
	General Reserve (1-4-2016)		90,000	51,000
	Surplus on (1-4-2016)		60,000	24,000
	Profit for 2016-17		1,10,000	84,000
	2. Non-Current Liabilities			
	(a) Long term borrowings			
	3. Current Liabilities			
	(a) Trade Payables - Creditors		1,40,000	71,000
	Bills Payable			20,000
	Total		<u>9,00,000</u>	<u>5,50,000</u>
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)			
	Land and Buildings		2,50,000	2,00,000
	Plant and Machinery		1,25,000	1,60,000
	(b) Non-Current Investments		2,95,000	

(2,000 shares in S Ltd.)

2. Current Assets

(a) Inventories (stock-in-trade)	70,000	80,000
(b) Trade Receivables - Debtors	1,20,000	1,05,000
Bills Receivable	30,000	
(c) Cash and Cash Equivalents (cash)	10,000	5,000
Total	9,00,000	5,50,000

H Ltd. acquired shares in S Ltd. on 1.1.2017. S Ltd. issued bills payable to H Ltd. Bills receivable of H Ltd. include bills of S Ltd. for Rs. 12,000. Sundry debtors of S Ltd. include Rs. 10,000 owing by H Ltd. Stock of H Ltd. includes goods worth Rs. 15,000 purchased from S Ltd. for which the latter company has charged profit at 25% on cost. Contingent liability for bills discounted by H Ltd. is Rs. 25,000. Prepare a consolidated balance sheet.

Solution

**Consolidated Balance Sheet of H Ltd.
And Its Subsidiary S Ltd. As At 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	5,00,000
	(b) Reserves and Surplus	2	2,71,000
	Sub Total		7,71,000
	2. Minority Interest	3	1,53,000
	3. Current Liabilities		
	(i) Trade Payables	4	2,01,000
	(ii) Other Current Liabilities	5	8,000
	Sub Total		2,09,000
	Total Equity and Liabilities		11,33,000
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	6	7,35,000
	(ii) Intangible Assets	7	3,000
	Sub Total		7,38,000
	2. Current Assets		
	(a) Inventories	8	1,47,000
	(b) Trade Receivables	9	2,15,000
	(c) Cash and Cash Equivalents	10	15,000
	(d) Short-term Loans and Advances	11	18,000
	Sub Total		3,95,000
	Total Assets		11,33,000

Notes to Accounts

	Particulars	Rs.	Rs.
1	Equity Share capital		
	Issued, subscribed and Fully Paid		
	5,000 Equity shares of Rs. 100 each		5,00,000
2	Reserves and Surplus		
	(i) General Reserve		90,000
	(ii) Surplus		1,81,000
			2,71,000
3	Minority Interest		
	Paid up capital held		1,00,000
	1/3 of 51,000 (General Reserves)		17,000
	1/3 of 24,000 (Surplus : 1-04-2016)		8,000
	1/3 of 84,000 (Surplus for 2016-17)		28,000
			1,53,000
4	Trade Payables		
	Sundry Creditors: H Ltd.		1,40,000
	S Ltd.		71,000
			2,11,000
	Less: Inter-Company Debts		10,000
			2,01,000
5	Other Current Liabilities		
	Bills Payable (S Ltd.)		20,000
	Less: Inter-Company Debts		12,000
			8,000
6	Tangible Assets		
	Land and Building: H Ltd.		2,50,000
	S Ltd.		2,00,000
			4,50,000
	Plant and Machinery: H Ltd.	1,25,000	
	S Ltd.	1,60,000	2,85,000
			7,35,000
7	Intangible Assets		
	Goodwill on consolidation		
	Cost of investments		2,95,000
	Less: Paid up value of shares		2,00,000
			95,000
	Less: Capital Reserve	34,000	
	Capital Profit	58,000	92,000
			3,000
8	Inventories		
	Stock of Goods: H Ltd.		70,000
	S Ltd.		80,000
			1,50,000
	Less: Unrealised Profit		3,000
			1,47,000

9	Trade Receivables	
	Debtors for Goods: H Ltd.	1,20,000
	S Ltd.	<u>1,05,000</u>
		2,25,000
	Less: Inter-Company Debts	<u>10,000</u>
		<u>2,15,000</u>
10	Cash and Cash Equivalents	
	Cash in hand : H Ltd.	10,000
	S Ltd.	<u>5,000</u>
		<u>15,000</u>
11	Short-term Loans and Advances	
	Bill Receivables: H Ltd.	30,000
	Less: Inter-Company Debts	<u>12,000</u>
		<u>18,000</u>

There is a contingent liability of Rs. 17,000

Illustration 14: (Profit on revaluation of assets)

The following are the balance sheets of X Ltd. and its subsidiary Y Ltd. as at 31 March 2017 :

	Particulars	Note No.	X Ltd. (Rs.)	Y Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital			
	(Equity Shares of Rs. 10 each)		4,00,000	1,00,000
	(b) Reserve and Surplus			
	Surplus Account		50,000	20,000
	2. Current Liabilities		<u>7,50,000</u>	<u>4,80,000</u>
	Total		<u>12,00,000</u>	<u>6,00,000</u>
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)			
	Equipments		2,50,000	95,000
	(b) Non-Current Investments		1,40,000	
	(9,000 Equity Shares in Y Ltd. on 1-4-2016)			
	2. Current Assets		<u>8,10,000</u>	<u>5,05,000</u>
	Total		<u>12,00,000</u>	<u>6,00,000</u>

On 1.4.2016, Profit and Loss Statement of Y Ltd. showed a profit of Rs. 8,000 and equipment of Y Ltd. was revalued by X Ltd. at 20% above its book value of Rs. 1,00,000 (but no such adjustment effected in the books of Y Ltd.). Prepare the consolidated Balance Sheet as at 31 March 2017.

Solution

**Consolidated Balance Sheet of X Ltd.
And Its Subsidiary Y Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	4,00,000
	(b) Reserves and Surplus	2	59,900
	Sub Total		<u>4,59,900</u>
	2. Minority Interest	3	13,900
	3. Current Liabilities	4	<u>12,30,000</u>
	Total Equity and Liabilities		<u>17,03,800</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	5	3,64,000
	(ii) Intangible Assets	6	<u>24,800</u>
	Sub Total		<u>3,88,800</u>
	2. Current Assets	7	<u>13,15,000</u>
	Total Assets		<u>17,03,800</u>

Notes to Accounts

	Particulars	Rs.	Rs.
1	Share capital		
	Issued, subscribed and Fully Paid		
	40,000 Equity shares of Rs. 10 each		4,00,000
2	Reserves and Surplus		
	Surplus (H Ltd.)		50,000
	Shares in S Ltd.		<u>9,900</u>
			<u>59,900</u>
3	Minority Interest		
	Paid of Value of Shares held		10,000
	Add: 1/10 of Pre-acquisition Profit		800
	1/10 of Post-acquisition Profit		1,100
	1/10 Profit on Revaluation of Assets		<u>2,000</u>
			<u>13,900</u>
4	Current Liabilities: X Ltd.		7,50,000
	Y Ltd.		<u>4,80,000</u>

			<u>12,30,000</u>
5	Tangible Fixed Assets: X Ltd.		2,50,000
	Equipment Y Ltd.	1,00,000	
	Add: Appreciation	<u>20,000</u>	
		1,20,000	
	Less: Additional Depreciation	<u>6,000</u>	1,14,000
			<u>3,64,000</u>
6	Intangible Assets		
	Goodwill on consideration		<u>24,800</u>
7	Current Assets: X Ltd.		8,10,000
	Y Ltd.		<u>5,05,000</u>
			<u>13,15,000</u>

Illustration 15: (Revaluation of Fixed Assets From the Back Date)

M Ltd. acquired 80% shares of S Ltd. as on 1 October 2016 at a cost of Rs. 2,30,000. The summarised balance sheet as on 31 March 2017 was as under:

	Particulars	Note No.	M Ltd. (Rs.)	S Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital			
	Equity Shares of Rs. 50 each		3,75,000	
	Equity Shares of Rs. 10 each			1,25,000
	(b) Reserve and Surplus			
	General Reserve		2,37,500	5,000
	Surplus		2,00,000	90,000
	2. Current Liabilities			
	Trade Payables (creditors)		<u>37,500</u>	<u>40,000</u>
	Total		<u>8,50,000</u>	<u>2,60,000</u>
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)		3,32,500	1,42,000
	(b) Non-Current Investments		2,30,000	
	2. Current Assets		<u>2,87,500</u>	<u>1,17,500</u>
	Total		<u>8,50,000</u>	<u>2,60,000</u>

(i) About M Ltd.:

M Ltd. purchased goods worth Rs. 30,000 from S Ltd. which were sold at cost + 33 1/3 %. Of these, 50% remains unsold. This purchase has remained unpaid and included in current liabilities. Surplus includes dividend at 16% received from S Ltd. for the year 2015-16.

(ii) About S Ltd.:

The balance in surplus on 1 April 2016 was Rs. 70,000 whereas general reserve has remained unchanged. An item of plant which (included in fixed assets) had book value of Rs. 12,500 was to be valued at Rs. 20,000 on 1 April 2016. Depreciation at 20% is provided on this item. Prepare consolidated balance sheet from the above informations.

Solution

**Consolidated Balance Sheet of M Ltd.
And Its Subsidiary S Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	3,75,000
	(b) Reserves ad Surplus	2	4,33,150
	Sub Total		<u>8,08,150</u>
	2. Minority Interest	3	45,200
	3. Current Liabilities	4	47,500
	Total Equity and Liabilities		<u>9,00,850</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible	5	4,81,000
	(ii) Intangible	6	48,600
	Sub Total		<u>5,29,600</u>
	2. Current Assets	7	3,71,250
	Total Assets		<u>9,00,850</u>

Notes to Accounts

	Particulars	Rs.	Rs.
1	Share capital		
	Issued, subscribed and Fully Paid		
	7,500 Equity shares of Rs. 50 each		<u>3,75,000</u>
2	Reserves and Surplus		
	(i) General Reserve (M Ltd.)		<u>2,37,500</u>
	(ii) Surplus :		
	Balance b/d	2,00,000	
	Add: Share in S Ltd.	<u>15,400</u>	
		2,15,400	
	Less: Dividends wrongly credited	<u>16,000</u>	
		1,99,400	
	Less: Unrealised Profit on stock	<u>3,750</u>	1,95,650
			<u>4,33,150</u>
3	Minority Interest		
	Paid up capital		25,000

	Pre-acquisition Surplus and Reserves	11,000
	Profit on Revaluation of Plant	1,350
	Additional Capital Profit	4,000
	Pre-acquisition Profit	3,850
		45,200
4	Current Liabilities:	
	M Ltd.	37,500
	S Ltd.	40,000
		<u>77,500</u>
	Less: Common Debts	<u>30,000</u>
		<u>47,500</u>
5	Tangible Fixed Assets	
	N Ltd.	3,32,500
	S Ltd.	1,42,500
		<u>4,75,000</u>
	Appreciation	<u>7,500</u>
		<u>4,82,500</u>
	Depreciation	<u>1,500</u>
		<u>4,81,000</u>
6	Intangible Fixed Assets	
	Goodwill on consideration:	<u>48,600</u>
7	Current Assets	
	M Ltd.	2,87,500
	S Ltd.	1,17,500
		<u>4,05,000</u>
	Less: Unrealised Profit on Stock	3,750
	Less: Common Debts	30,000
		<u>-33,750</u>
		<u>3,71,250</u>

Illustration 16 (Entry for Interest Receivable Omitted)

H Ltd. acquired 8,000 shares of Rs. 10 each in S Ltd. on 31 March 2017. The summarised list of assets and liabilities of the two companies as on that are given below:

Liabilities	H Ltd. (Rs.)	S Ltd. (Rs.)
Share Capital		
30,000 Shares of Rs. 10 each	3,00,000	
10,000 Shares of Rs. 10 each		1,00,000
Capital Reserve		52,000
General Reserve	25,000	5,000
Surplus	38,200	18,000
Loan from S Ltd.	2,100	
Bills Payable (including Rs. 500 to H Ltd.)		1,700
Creditors	17,900	5,000
	<u>3,83,200</u>	<u>1,81,700</u>
Assets		

Fixed Assets	1,50,000	1,44,700
Shares in S Ltd. (at cost)	1,70,000	
Stock in hand	40,000	20,000
Loan to H Ltd.		2,000
Bills Receivable (including Rs. 200 from S Ltd.)	1,200	
Debtors	20,000	10,000
Bank	2,000	5,000
	<u>3,83,200</u>	<u>1,81,700</u>

Note on the balance sheet of H Ltd. : There is a contingent liability of Rs. 1,000 for bills discounted.

The following additional information is given to you :

- Interest receivable Rs. 100 in respect of loan due by H Ltd. to S Ltd. has not been credited in the accounts of S Ltd.
- On 31 March 2017, the directors of H Ltd. decide that the fixed assets of S Ltd. are overvalued and should be written down by Rs. 5,000.

Prepare the consolidated Balance Sheet as on 31 March 2017.

Solution

Consolidated Balance Sheet of H Ltd. And Its Subsidiary S Ltd. As On 31 March 2017

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	3,00,000
	(b) Reserves and Surplus	2	63,200
	Sub Total		<u>3,63,200</u>
	2. Minority Interest	3	34,020
	3. Current Liabilities		
	(a) Trade Payables	4	22,900
	(b) Other Current Liabilities	5	1,500
	Sub Total		<u>24,400</u>
	Total Equity and Liabilities		<u>4,21,620</u>
II	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	6	2,89,700
	(ii) Intangible Assets	7	33,920
	Sub Total		<u>3,23,620</u>
	2. Current Assets		
	(a) Inventories	8	60,000
	(b) Trade Receivables	9	30,000
	(c) Cash and Cash Equivalents	10	7,000
	(d) Short-term Loans and Advances	11	1,000
	Sub Total		<u>98,000</u>
	Total Assets		<u>4,21,620</u>

Notes to Accounts			
	Particulars	Rs.	Rs.
1	Share capital (H Ltd.)		
	Issued, subscribed and Fully Paid up		
	30,000 Equity shares of Rs. 10 each		3,00,000
2	Reserves and Surplus		
	General Reserve (H Ltd.)		25,000
	Surplus (S Ltd.)		38,200
			63,200
3	Minority Interest		
	Share Capital		20,000
	Capital Reserve (20% of 52,000)		10,400
	General Reserves (20% of Rs. 5,000)		1,000
	Surplus (20% of 18,000 (18,000 + 100))		3,620
			35,020
	Less: Loss on Revaluation of Fixed Asset		1,000
			34,020
4	Trade Payables		
	Creditors for Goods		
	H Ltd.		17,900
	S Ltd.		5,000
			22,900
5	Other Current Liabilities		
	Bills Payables		1,700
	Less: Mutual Debts		200
			1,500
6	Tangible Assets		
	Equipment		
	H Ltd.		1,50,000
	S Ltd.	1,44,700	
	Loss on Revaluation	-5,000	1,39,700
			2,89,700
7	Intangible Assets		
	Goodwill:		
	Investments in shares of S Ltd.		1,70,000
	Paid up value of Shares held		-80,000
	Pre-acquisition Profit and Reserves		90,000
			-60,800
			29,920
	Loss on Revaluation of Tangible Assets		4,000
			33,920

8	Inventories	
	Stock of Goods	
	H Ltd.	40,000
	S Ltd.	20,000
		<u>60,000</u>
9	Trade Receivables	
	Debtors for Goods	
	H Ltd.	20,000
	S Ltd.	10,000
		<u>30,000</u>
10	Cash and Cash Equivalents	
	Cash at Bank	
	H Ltd.	2,000
	S Ltd.	5,000
		<u>7,000</u>
11	Short term Loans and Advances	
	(a) Loan to H Ltd.	2,000
	Add: Interest accrued	100
	Less: Mutual Debts	2,100
		<u>Nil</u>
	(b) Bills Receivables	1,200
	Less: Mutual Debts	200
		<u>1,000</u>

Illustration 17 (Issue of Bonus Shares From Pre-acquisition Profits)

Strong Ltd., acquired 3,200 equity shares of Weak Ltd., on 31 March, 2017. The summarised figures of the two companies as on that date are given below:

Credit	Strong Ltd. (Rs.)	Weak Ltd. (Rs.)	Debit	Strong Ltd. (Rs.)	Weak Ltd. (Rs.)
Share Capital (Rs. 100 each fully paid-up)	10,00,000	4,00,000	Land & Buildings	3,00,000	3,60,000
General Reserves	4,80,000	3,40,000	Plant & Machinery	4,80,000	3,18,800
Profit & Loss Account	1,14,400	72,000	Investments in Weak Ltd. At cost	6,80,000	
Bank Loan	1,60,000		Stocks	2,40,000	72,000
Bills Payable (including Rs. 8,000 to Strong Ltd.)		16,800	Sundry Debtors	88,000	80,000
Sundry Creditors	94,400	18,000	Bills Receivable (including Rs. 6,000 from Weak Ltd.)	31,600	
			Cash at Bank	29,200	16,000
	<u>18,48,800</u>	<u>8,46,800</u>		<u>18,48,800</u>	<u>8,46,800</u>

You are supplied with the following information:

- (a) Weak Ltd., made a bonus issue on 31 March 2017 of one equity share for every four shares held by its shareholders. Effect has not yet been given in the accounts for this.
- (b) The directors have decided to revalue the land and buildings and Plant & Machinery of Weak Ltd. at Rs. 4,00,000 and Rs. 2,98,800 respectively.
- (c) Sundry creditors of Strong Ltd. included Rs. 24,000 due to Weak Ltd. Prepare the consolidated balance sheet as at 31 March 2017 in the books of Strong Ltd. Show your working clearly.

Also calculate cost of control when bonus shares are not issued.

Solution

**Consolidated Balance Sheet of Strong Ltd.
And Its Subsidiary S Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	10,00,000
	(b) Reserves and Surplus	2	5,94,400
	Sub Total		<u>15,94,400</u>
	2. Minority Interest	3	1,66,400
	3. Non-Current Liabilities		
	Long-term Borrowings	4	1,60,000
	4. Current Liabilities		
	(a) Trade Payables	5	88,400
	(b) Other Current Liabilities	6	10,800
	Sub Total		<u>99,200</u>
	Total Assets and Liabilities		<u>20,20,000</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	7	14,78,800
	(ii) Intangible Assets	8	14,400
	Sub Total		<u>14,93,200</u>
	2. Current Assets		
	(a) Inventories	9	3,12,000
	(b) Trade Receivables	10	1,44,000
	(c) Cash and Cash Equivalents	11	45,200
	(d) Short-term Loans and Advances	12	25,600
	Sub Total		<u>5,26,800</u>
	Total Assets		<u>20,20,000</u>

Notes to Accounts

	Particulars	Rs.	Rs.
1	Share capital (Strong Ltd.)		

	Issued, subscribed and Fully Paid	
	10,000 Equity shares of Rs. 10 each	10,00,000
2	Reserves and Surplus	
	General Reserve	4,80,000
	Surplus	1,14,400
		5,94,400
3	Minority Interest	
	Paid up value of shares held (1/5 of Rs. 5,00,000)	1,00,000
	Add: Profit on Revaluation of Assets	4,000
	Add: Share in General Reserve (Rs. 2,40,000)	48,000
	Add: Share in surplus (Rs. 72,000)	14,400
		1,66,400
4	Long-term Borrowings	
	Bank Loan	1,60,000
5	Trade Payables	
	Strong Ltd.	94,400
	Weak Ltd.	18,000
		1,12,400
	Less: Inter-Company Debts	24,000
		88,400
6	Other Current Liabilities	
	Bills Payables	16,800
	Less: Inter-Company Debts	6,000
		10,800
7	Tangible Assets	
	(i) Land and Building:	
	Strong Ltd.	3,00,000
	Weak Ltd.	4,00,000
		7,00,000
	(ii) Plant and Machinery	
	Strong Ltd.	4,80,000
	Weak Ltd.	2,98,800
		7,78,800
		14,78,800
8	Intangible Assets	
	Goodwill on consolidation	
	Cost of Investment in Weak Ltd.	6,80,000
	Less: Paid up value of share capital acquired (including bonus shares)	4,00,000
		2,80,000
	Less: Profit on Revaluation of Assets	16,000
		2,64,000
	Less: Share in Capital Profits and Capital Reserves	2,49,600
		14,400
9	Inventories	

	Stock of Goods :	
	Strong Ltd.	2,40,000
	Weak Ltd.	72,000
		<u>3,12,000</u>
10	Trade Receivables	
	Debtors for Goods :	
	Strong Ltd.	88,000
	Weak Ltd.	80,000
		<u>1,68,000</u>
	Less: Common Debts	<u>24,000</u>
		<u>1,44,000</u>
11	Cash and Cash Equivalents	
	Cash in hand :	
	Strong Ltd.	29,200
	Weak Ltd.	16,000
		<u>45,200</u>
12	Short term Loans and Advances	
	Bills Receivables	31,600
	Less: Common Debts	<u>6,000</u>
		<u>25,600</u>

Illustration 18 (Bonus Issue)

H Ltd., acquired 1,200 equity shares in S Ltd., on 1.4.2016. The Summarised financial information of H Ltd. and its subsidiary S Ltd. as on 31 March, 2017 are as follows:

Liabilities	H Ltd. (Rs.)	S Ltd. (Rs.)
Preference Share Capital	1,00,000	
Equity Share Capital (Rs. 100 fully paid)	5,00,000	1,50,000
General Reserve	3,40,000	6,000
Surplus	3,60,000	1,08,000
Creditors	1,00,000	44,150
Bills Payable		24,150
	<u>14,00,000</u>	<u>3,32,300</u>
Assets		
Land	3,56,000	70,000
Properties	3,76,000	40,000
Plant and Machinery	1,40,000	91,300
Investments in S Ltd.	1,80,000	
Stock	1,36,000	50,600
Debtors and Cash	2,12,000	80,400
	<u>14,00,000</u>	<u>3,32,300</u>

The other information given are :

- (a) On 1.4.2016, Surplus of S Ltd., stood at Rs. 77,500 and General Reserve at Rs. 3,000. Also H Ltd. revalued Plant and Machinery of S Ltd., at the time of purchase of shares by Rs. 20,000 more than its book value (Ignore Depreciation).
- (b) Stock of H Ltd., includes Rs. 8,000 of stock purchased from S Ltd. Further, debtors of S Ltd., include Rs. 24,000 for sales to H Ltd., on which S Ltd., made a profit of Rs. 6,000.
- (c) S Ltd. made a Bonus issue during the year out of pre-acquisition profits for Rs. 60,000 not recorded in the books.

You are required to prepare the Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31.3.2016.

Solution

**Consolidated Balance Sheet of H Ltd.
And Its Subsidiary S Ltd. As At 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	6,00,000
	(b) Reserves and Surplus	2	7,45,200
	Sub Total		<u>13,45,200</u>
	2. Minority Interest	3	56,800
	3. Current Liabilities		
	(a) Trade Payables	4	1,20,150
	(b) Other Current Liabilities	5	24,150
	Sub Total		<u>1,44,300</u>
	Total Equity and Liabilities		<u>15,46,300</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	6	10,93,300
	(ii) Intangible Assets		Nil
	Sub Total		<u>10,93,300</u>
	2. Current Assets		
	(a) Inventories	7	1,84,600
	(b) Trade Receivables and Cash and Cash Equivalents	8	2,68,400
	Sub Total		<u>4,53,000</u>
	Total Assets		<u>15,46,300</u>

Notes to Account

	Particulars	Rs.	Rs.
1	Share capital (H Ltd.)		
	Issued, subscribed and Fully Paid		
	5,000 Equity shares of Rs. 100 each		5,00,000

	Preference Share Capital		<u>1,00,000</u>
			<u>6,00,000</u>
2	Minority Interest		56,800
3	Reserves and Surplus		
	(i) Capital Reserves		20,400
	(ii) General Reserves		3,40,000
	(iii) Surplus		<u>3,84,800</u>
			<u>7,45,200</u>
4	Trade Payables		
	Creditors for Goods		
	H Ltd.		1,00,000
	S Ltd.		<u>44,150</u>
			1,44,150
	Less : Inter-Company Debts		<u>20,000</u>
			<u>1,20,150</u>
5	Other Current Liabilities		
	Bills Payables		<u>24,150</u>
6	Tangible (Fixed) Assets		
	(i) Land		
	H Ltd.		3,56,000
	S Ltd.		<u>70,000</u>
			<u>4,26,000</u>
	(ii) Properties		
	H Ltd.	3,76,000	
	S Ltd.	<u>40,000</u>	4,16,000
	(iii) Plant and Machinery		
	H Ltd.	1,40,000	
	S Ltd. (91,300 + 20,000)	<u>1,11,300</u>	<u>2,51,300</u>
			<u>10,93,300</u>
7	Inventories		
	Stock of Goods		
	H Ltd.		1,36,000
	S Ltd.		<u>50,000</u>
			1,86,000
	Less: Unrealised Profit		<u>2,000</u>
			<u>1,84,800</u>
8	Trade Receivables and Cash and Cash Equivalents		
	Debtors for Goods and cash in hand		2,92,400

Less: Common Debts	24,000
	<u>2,68,400</u>

Illustration 19 (Bonus Issue From Post-Acquisition Profits)

A Ltd. acquired 2,000 equity shares of Rs. 100 each in B Ltd. on 31 March 2016. The Balance Sheets of the two companies as on 31 March 2017 were as follows:

	Particulars	Note No.	A Ltd. (Rs.)	B Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital			
	Equity Share Capital (Rs. 100 each)		8,00,000	2,50,000
	(b) Reserve and Surplus			
	Reserves		3,00,000	50,000
	Surplus		1,00,000	1,00,000
	2. Current Liabilities			
	Trade Payables (Creditors)		2,00,000	50,000
	Total		<u>14,00,000</u>	<u>4,50,000</u>
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)		7,00,000	2,50,000
	(b) Non-Current Investments		3,00,000	
	(2,000 shares in B Ltd. At cost)			
	2. Current Assets		4,00,000	2,00,000
	Total		<u>14,00,000</u>	<u>4,50,000</u>

B Ltd. had a credit balance of Rs. 50,000 in the reserves and Rs. 20,000 when A Ltd. acquired shares in B Ltd. B Ltd. issued bonus shares in ratio of one for every five shares held out of the profits earned during 2016-17. This is not shown in the above balance sheet of B Ltd. Prepare a consolidated balance sheet of A Ltd. and its subsidiary on 31 March 2017, giving all necessary workings.

Solution

**Consolidated Balance Sheet of A Ltd.
And Its Subsidiary B Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	8,00,000
	(b) Reserves and Surplus	2	<u>4,24,000</u>
	Sub Total		<u>12,24,000</u>
	2. Minority Interest	3	80,000
	3. Current Liabilities	4	2,50,000

		Total Equity and Liabilities	15,54,000
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	5	9,50,000
	(ii) Intangible Assets	6	4,000
	Sub Total		9,54,000
	2. Current Assets	7	6,00,000
	Total Assets		15,54,000

Notes to Accounts			
	Particulars	Rs.	Rs.
1	Share capital (A Ltd.)		
	Issued, subscribed and Fully Paid		
	8,000 Equity shares of Rs. 100 each		8,00,000
2	Reserves and Surplus		
	(i) General Reserves		3,00,000
	(ii) Surplus	1,00,000	
	Add: Share in B Ltd.	24,000	1,24,000
			4,24,000
3	Minority Interest		
	Paid up Capital including Bonus shares		60,000
	Add: 1/5 of Surplus 1,00,000		20,000
			80,000
4	Trade Payables etc (Creditors for Goods)		
	A Ltd.		2,00,000
	B Ltd.		50,000
			2,50,000
5	Tangible (Fixed) Assets		
	A Ltd.		7,00,000
	B Ltd.		2,50,000
			9,50,000
6	Intangible Assets		
	Goodwill on consolidation:		
	Cost of Investments in B Ltd.		3,00,000
	Less: Share Capital including Bonus shares		2,40,000
			60,000
	Less: Capital profit and Reserve		56,000
			4,000
7	Current Assets		
	A Ltd.		60,000
	B Ltd.		20,000
			80,000

Illustration 20 (Dividends Paid From Pre-Acquisition Profits, Cheque-in-Transit and Goodwill of Subsidiary)

From the following balance sheets of a holding company and its subsidiary on 31.3.2017, prepare a consolidated balance sheet:

	Particulars	Note No.	X Ltd. (Rs.)	Y Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital (Rs. 10 each)		5,00,000	2,00,000
	(b) Reserve and Surplus			
	General Reserves		80,000	60,000
	Surplus Account		90,000	70,000
	2. Current Liabilities			
	(a) Trade Payables (Creditors)		50,000	40,000
	(b) Other Current Liabilities (Outstanding Expenses)		20,000	10,000
	Total		<u>7,40,000</u>	<u>3,80,000</u>
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets			
	(i) Tangible (Machinery)		3,00,000	1,50,000
	(ii) Intangible (Goodwill)		30,000	10,000
	(b) Non-Current Investments (16,000 shares in Y Ltd.)		1,90,000	
	2. Current Assets			
	(a) Inventories (stock-in-trade)		80,000	50,000
	(b) Trade Receivables (Debtors)		1,20,000	1,60,000
	(c) Cash and Cash Equivalents (Bank)		20,000	10,000
	Total		<u>7,40,000</u>	<u>3,80,000</u>

When control was acquired, S Ltd. had Rs. 40,000 in general reserve and surplus of Rs. 30,000. Immediately on purchases of shares H Ltd. received Rs. 16,000 as dividend from S Ltd., which was transferred to profit and loss statement. Debtors of H Ltd. include Rs. 20,000 due from S Ltd. whereas creditors of S Ltd. include Rs. 15,000 due to H Ltd. : the difference being accounted for by a cheque-in-transit.

Solution

**Consolidated Balance Sheet of H Ltd.
And Its Subsidiary S Ltd. As At 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	5,00,000
	(b) Reserves and Surplus	2	2,18,000
	Sub Total		<u>7,18,000</u>
	2. Minority Interest	3	66,000
	3. Current Liabilities		
	(i) Trade Payables	4	75,000
	(ii) Other Current Liabilities	5	30,000
	Sub Total		<u>1,05,000</u>
	Total Equity and Liabilities		<u>8,89,000</u>
II	ASSETS		
	1. Non-Current Assets		
	Fixed Assets		
	(i) Tangible Assets	6	4,50,000
	(ii) Intangible Assets	7	14,000
	Sub Total		<u>4,64,000</u>
	2. Current Assets		
	(a) Inventories	8	1,30,000
	(b) Trade Receivables	9	2,60,000
	(c) Cash and Cash Equivalents	10	35,000
	Sub Total		<u>4,25,000</u>
	Total Assets		<u>8,89,000</u>

Notes to Accounts

	Particulars	Rs.	Rs.
1	Share capital		
	Issued, subscribed and Fully Paid up		
	50,000 Equity shares of Rs. 10 each		<u>5,00,000</u>
2	Reserves and Surplus		
	(i) General Reserves (H Ltd.)	80,000	
	Share in S Ltd.	<u>16,000</u>	96,000
	(ii) Surplus (H Ltd.)	90,000	
	Share in S Ltd.	<u>48,000</u>	
		1,38,000	
	Less: Dividend Paid	<u>16,000</u>	<u>1,22,000</u>

			2,18,000
3	Minority Interest		
	Paid up capital		40,000
	1/5 of Rs. 60,000 (General Reserve)		12,000
	1/5 of Rs. 70,000 (Surplus)		14,000
			<u>66,000</u>
4	Trade Payables etc		
	Sundry Creditors for Goods		
	H Ltd.		50,000
	S Ltd.		40,000
			<u>90,000</u>
	Less: Inter-Company debts		15,000
			<u>75,000</u>
5	Other Current Liabilities		
	Creditors for Expenses		
	H Ltd.		20,000
	S Ltd.		10,000
			<u>30,000</u>
6	Tangible Assets		
	Machinery		
	H Ltd.		3,00,000
	S Ltd.		1,50,000
			<u>4,50,000</u>
7	Intangible Assets		
	Goodwill		<u>14,000</u>
8	Inventories		
	Stock of Goods:		
	H Ltd.		80,000
	S Ltd.		50,000
			<u>1,30,000</u>
9	Trade Receivables		
	H Ltd.		1,20,000
	S Ltd.		1,60,000
			<u>2,80,000</u>
	Less: Inter-Company Debts	15,000	
	Cheque-in transit	5,000	-20,000
			<u>2,60,000</u>
10	Cash and Cash Equivalents:		
	Cash in hand and Bank		
	H Ltd.		20,000
	S Ltd.		10,000
			<u>30,000</u>
	Cheque in-transit		5,000
			<u>35,000</u>

Illustration 21 (Dividend from Pre-acquisition Surplus)

The statement of affair of H Ltd. and its subsidiary S Ltd. as on 31 March 2017 are as follows:

Liabilities	H Ltd. (Rs.)	S Ltd. (Rs.)
Equity Shares of Rs. 100 each, fully paid up	10,00,000	5,00,000
General Reserve	1,00,000	1,70,000
Surplus	1,60,000	1,30,000
Current Liabilities	4,40,000	2,00,000
	<u>17,00,000</u>	<u>10,00,000</u>
Assets		
Fixed Assets	4,80,000	2,50,000
Investment in Shares of S Ltd.	5,00,000	
Current Assets	7,20,000	7,50,000
	<u>17,00,000</u>	<u>10,00,000</u>

The following additional information is provided :

- (i) H Ltd. acquired 3,000 shares in S Ltd. on 1 July, 2016. The Reserves and Surplus position of S Ltd. as on 1 April 2016 was as under :
General Reserve : Rs. 2,50,000
Surplus : Rs. 1,20,000
- (ii) On 1 October, 2016 S Ltd. issued one equity share for every four shares held as Bonus shares out of the General Reserve. No entry has been made in the books of H Ltd., for the receipt of these bonus shares. However, entry has been made in the books of S Ltd. for the issue of bonus shares.
- (iii) On 30 September, 2016, S Ltd. declared a dividend out of pre-acquisition profits @ 25% on Rs. 4,00,000, its capital on that date. H Ltd., transferred the dividend to its Profit and Loss Statement.
- (iv) S Ltd. owed H Ltd., Rs. 50,000 for purchase of stock from H Ltd. The entire stock is held by S Ltd. on 31 March 2017. H Ltd. made a profit of 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31 March 2017.

Solution

**Consolidated Balance Sheet of H Ltd.
And Its Subsidiary S Ltd. As On 31 March 2017**

Particulars	Note	Rs.
I EQUITY AND LIABILITIES		
1. Shareholders' Funds		
(a) Share Capital	1	10,00,000

	(b) Reserves and Surplus	2	3,50,000
	Sub Total		<u>13,50,000</u>
	2. Minority Interest	3	2,00,000
	3. Current Liabilities		
	(a) Trade Payables etc.	4	5,90,000
	Total Equity and Liabilities		<u>21,40,000</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	5	7,30,000
	2. Current Assets		
	(a) Inventories, Trade payables	6	14,10,000
	Cash and Cash Equivalents		
	Total Assets		<u>21,40,000</u>

Notes to Accounts			
	Particulars	Rs.	Rs.
1	Share capital (H Ltd.)		
	Issued, subscribed and Fully Paid up		
	10,000 Equity shares of Rs. 100 each		<u>10,00,000</u>
2	Reserves and Surplus		
	(i) Capital Reserves (On consolidation)		
	Cost of Investments in shares of S Ltd.		5,00,000
	Less: Face value of shares held		<u>3,00,000</u>
			2,00,000
	Less: Bonus Issue		<u>75,000</u>
			1,25,000
	Less: Pre-acquisition Surplus		39,375
	Provisional Goodwill		85,625
	Less: Pre-acquisition Reserves		1,12,500
	Dividend wrongly credited		<u>75,000</u>
	Capital Reserve		1,01,875
	(ii) General Reserves		1,00,000
	(iii) Surplus		<u>1,48,125</u>
			<u>3,50,000</u>
3	Minority Interest		
	Face Value of Shares held		1,25,000
	Add: 25% of General Reserve (1,70,000)		42,500
	Add: 25% of Surplus (1,30,000):		<u>32,500</u>
			<u>2,00,000</u>
4	Trade Payables etc		
	H Ltd.		4,40,000
	S Ltd.		<u>2,00,000</u>
			6,40,000
	Less: Mutual owings		<u>50,000</u>

		5,90,000
5	Tangible (Fixed) Assets	
	H Ltd.	4,80,000
	S Ltd.	2,50,000
		7,30,000
6	Inventories, Trade Payables Cash and Cash Equivalents	
	H Ltd.	7,20,000
	S Ltd.	7,50,000
		14,70,000
	Less: Mutual owings	50,000
		14,20,000
	Less: Unrealised profit on stock	10,000
		14,10,000

Illustration 22 (Cheque-in-Transit)

On April 1, 2016 S Ltd. issued 10% Preference Shares of Rs.1,00,000 at par. On this date, S Ltd.'s General Reserve and Statement of Profit and Loss Account showed balances of Rs. 80,000 and Rs. 50,000 respectively. On July 5, 2016 S Ltd. paid a final dividend of 12% on equity shares for the year ended 31 March 2016. On April 1, 2016, H Ltd. acquired 80% equity shares in S Ltd. for Rs. 3,00,000. On this date, machinery of S Ltd. was revalued at Rs. 2,50,000. No entry for this was made in the books of S Ltd.

On March 31, 2017 the summarised balance sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Balance Sheet As At 31 March, 2017				
	Particulars	Note No.	H Ltd. (Rs.)	S Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital			
	Equity Share Capital		8,00,000	3,00,000
	10% Preference Share Capital			1,00,000
	(b) Reserve and Surplus			
	General Reserve		4,00,000	1,50,000
	Surplus		2,00,000	90,000
	2. Non-Current Liabilities			
	(a) Long term borrowings (loans)		1,10,000	
	3. Current Liabilities			
	Trade Payables - Creditors		1,70,000	76,000
	Bills Payable			4,000
	Total		16,80,000	7,20,000

II ASSETS

1. Non-Current Assets

(a) Fixed Assets (Tangible)

Machinery 6,25,000 2,70,000

Furniture 85,000 50,000

(b) Non-Current Investments 3,00,000

(shares in S Ltd.)

(c) Long term loans & Advances

(Loan to H Ltd.) 10,000

2. Current Assets

(a) Inventories (stock-in-trade) 4,00,000 1,90,000

(b) Trade Receivables (Debtors) 1,50,000 80,000

(c) Cash and Cash Equivalents (Bank) 1,20,000 1,10,000

(d) Other Current Assets 10,000

(Preliminary Expenses)

Total 16,80,000 7,20,000

The following further information is furnished:

- (i) S Ltd. provides depreciation on Machinery @ 10% on written down value. No Machine was sold or purchased during the year.
- (ii) H Ltd. remitted a cheque of Rs. 10,000 to S Ltd. on 27 March, 2017 for repayment of loan, which was received by S Ltd. in April 2017.
- (iii) No part of preliminary expenses was written off during the year.

Prepare consolidated Balance Sheet of H Ltd. and S Ltd. as at 31 March, 2017

Solution:

**Consolidated Balance Sheet of H Ltd. And Its
Subsidiary S Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	8,00,000
	(b) Reserves and Surplus	2	6,84,000
	Sub Total		<u>14,84,000</u>
	2. Minority Interest	3	<u>2,05,000</u>
	3. Non-Current Liabilities		
	(a) Long-term Borrowings	4	<u>1,10,000</u>
	4. Current Liabilities		
	(a) Trade Payables	5	2,46,000
	(b) Other Current Liabilities	6	4,000
	Sub Total		<u>2,50,000</u>
	Total Equity and Liabilities		<u>20,49,000</u>
II	ASSETS		
	1. Non-Current Assets		

(a) Fixed Assets

(i) Tangible Assets	7	9,85,000
(ii) Intangible Assets	8	4,000
Sub Total		9,89,000

2. Current Assets

(a) Inventories	9	5,90,000
(b) Trade Receivables	10	2,30,000
(c) Cash and Cash Equivalents	11	2,40,000
Sub Total		10,60,000
Total Assets		20,49,000

Notes to Accounts

	Particulars	Rs.	Rs.
1	Share capital		
	Issued, subscribed and Fully Paid		
	Equity Share Capital		8,00,000
2	Reserves and Surplus		
	(i) General Reserves (H Ltd.)		4,00,000
	Add: Share in S Ltd.		56,000
			4,56,000
	(ii) Surplus (H Ltd.)	2,00,000	
	Add: Share in S Ltd.	56,800	
	Less: Dividend wrongly credited	-28,800	2,28,000
			6,84,000
3	Minority Interest		2,05,000
4	Long-term Borrowings		
	Loans		1,10,000
5	Trade Payables		
	Creditors for Goods		
	H Ltd.		1,70,000
	S Ltd.		76,000
			2,46,000
6	Other Current Liabilities		
	Bills Payables		4,000
7	Tangible (Fixed) Assets		
	(i) Machinery		6,25,000
	H Ltd.	3,00,000	
	S Ltd. (2,70,000 x 100/90)	30,000	2,70,000
	Less: Loss on Revaluation (3,00,000 - 2,50,000)		-50,000
	Add: Reduced Depreciation		5,000
			8,50,000
	(ii) Furnitures		
	H Ltd.	85,000	

	S Ltd.	50,000	1,35,000
			<u>9,85,000</u>
8	Intangible Assets		
	Goodwill (on consolidation)		<u>4,000</u>
	Cost of Investments in shares of S Ltd.		3,00,000
9	Inventories		
	Stock of Goods		
	H Ltd.		4,00,000
	S Ltd.		<u>1,90,000</u>
			<u>5,90,000</u>
10	Trade Receivables		
	Debtors for Goods		
	H Ltd.		1,50,000
	S Ltd.		<u>80,000</u>
			<u>2,30,000</u>
11	Cash and Cash Equivalents		
	Cash at Bank		
	H Ltd.		1,50,000
	S Ltd.		<u>80,000</u>
			<u>2,30,000</u>
	Cheque in transit		<u>10,000</u>
			<u>2,40,000</u>

Illustration 23: (Interim Dividend Paid By Subsidiary Company)

The following are the summarised account balance of Holkar Ltd., and Sunrise Ltd. at 31 March 2017:

Credit	Holkar Ltd. (Rs.)	Sunrise Ltd. (Rs.)	Debit	Holkar Ltd. (Rs.)	Sunrise Ltd. (Rs.)
Share Capital:			Freehold Premises	2,56,000	90,000
Rs. 10 Shares each			Machinery	60,000	81,300
fully paid	3,00,000	1,50,000	Stock	68,000	60,600
General Reserve	1,90,000	6,000	Sundry Debtors	56,000	47,400
Surplus	1,60,000	1,08,000	Cash	60,000	33,000
Sundry Creditors	30,000	48,300	Investment in Shares		
			of Sunrise Ltd. At cost	1,80,000	
	<u>6,80,000</u>	<u>3,12,300</u>		<u>6,80,000</u>	<u>3,12,300</u>

Holkar Ltd., acquired 12,000 shares of Sunrise Ltd., on 1.4.2016 at the total cost of Rs. 1,80,000. On scrutiny of the balance sheet of Holkar Ltd., as at 31.3.2017, the following details are obtained :

- Surplus includes the interim dividend at the rate of 10% p.a. free of tax from Sunrise Ltd.
- Stock includes Rs. 6,000 of stock at cost purchased from Sunrise Ltd.
- Sundry creditors include Rs. 18,000 for purchases from Sunrise Ltd., on which the latter company made a profit of Rs. 4,500.

It is further stated that on 1.4.2016 the surplus of Sunrise Ltd., stood at Rs. 76,000 and the general reserve at Rs. 4,500. No final dividends are yet proposed to be declared by Sunrise Ltd.

Solution

**Consolidated Balance Sheet of Holkar Ltd. And Its
Subsidiary S Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	3,00,000
	(b) Reserves and Surplus	2	3,79,000
	Sub Total		<u>6,79,000</u>
	2. Minority Interest	3	52,800
	3. Current Liabilities		
	Trade Payables	4	60,300
	Total Equity and Liabilities		<u>7,92,800</u>
II	ASSETS		
	1. Non-Current Assets		
	Fixed Assets		
	(i) Tangible Assets	5	4,87,300
	(ii) Intangible Assets		
	2. Current Assets		
	(a) Inventories	6	1,27,100
	(b) Trade Receivables	7	85,400
	(c) Cash and Cash Equivalents	8	93,000
	Total Assets		<u>7,92,800</u>

Notes to Accounts

	Particulars	Rs.	Rs.
1	Share capital		
	Issued, subscribed and Fully Paid		
	30,000 Equity Shares of Rs. 10 each		<u>3,00,000</u>
2	Reserves and Surplus		

(i) Capital Reserves on consolidation:

Cost of Investments		1,80,000
Less: Face Values of Shares	1,20,000	
Capital Profits	<u>64,400</u>	<u>1,84,400</u>
		4,400

(ii) General Reserves	1,90,000	
Add: Additions	<u>1,200</u>	<u>1,91,200</u>

(iii) Surplus		
Balance b/d	1,60,000	
Share in Sunrise Ltd.	<u>37,600</u>	
	1,97,600	
Less: Unrealised Profit	<u>1,500</u>	
	1,96,100	
Less: Interim Dividend Paid :		
Share in Sunrise Ltd.	<u>12,000</u>	<u>1,84,100</u>
		<u>3,79,700</u>

3 Minority Interest

Face value of shares held	30,000	
Share in general reserve (1/5 of 6,000)	1,200	
Share in surplus (1/5 of 1,23,000)	24,600	
(1,08,000 (surplus) + 15,000 (Interim Dividends)		
	55,800	
Less: Interim Dividend Paid	<u>3,000</u>	
	<u>52,800</u>	

4 Trade Payables

Holkars Ltd.	30,000
Sunrise Ltd.	<u>48,300</u>
	78,300
Less: Common Debts	<u>18,000</u>
	<u>60,300</u>

5 Tangible Assets

(i) Freehold Premises	3,46,000
(ii) Machinery	<u>1,41,300</u>
	<u>4,87,300</u>

6 Inventories

Stock of Goods	1,28,600
Less: Unrealised Profit	<u>1,500</u>
	<u>1,27,100</u>

7 Trade Receivables

Sundry Debtors for Goods	1,03,400
Less: Common Debts	<u>18,000</u>
	<u>85,400</u>

8 Cash and Cash Equivalents:

Cash in hand	9,300

Illustration 24: (Preliminary Expenses and Unclaimed Dividend)

The following are the balance sheet of H Ltd. and its subsidiary S Ltd. as at 31 March 2017:

Credit	H Ltd. (Rs.)	S Ltd. (Rs.)	Debit	H Ltd. (Rs.)	S Ltd. (Rs.)

Share Capital			Machinery	3,00,000	1,00,000
(Rs. 10 Share)	6,00,000	7,00,000	Furniture	70,000	45,000
General Reserve	1,50,000	70,000	70% Shares in		
Surplus	70,000	50,000	S Ltd. At cost	2,60,000	
Creditors	90,000	55,000	Stock	1,75,000	1,89,000
Unclaimed Dividends		5,000	Debtors	55,000	30,000
			Bank	40,000	5,000
			Preliminary expenses		6,000
			Bills Receivable	10,000	5,000
	<u>9,10,000</u>	<u>3,80,000</u>		<u>9,10,000</u>	<u>3,80,000</u>

H Ltd. acquired the shares of S Ltd. on 30 June 2016. On 1 April 2016, S Ltd.'s general reserve and profit and loss account stood at Rs. 60,000 and Rs. 20,000 respectively. No part of the preliminary expenses was written off during the year ended 31 March 2017. Prepare a consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as at 31 March 2017. Give all your working notes neatly.

Solution

Consolidated Balance Sheet of H Ltd. And Its Subsidiary S Ltd. As At 31 March 2017

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	6,00,000
	(b) Reserves and Surplus	2	2,41,000
	Sub Total		<u>8,41,000</u>
	2. Minority Interest	3	99,200
	3. Current Liabilities		
	Trade Payables	4	1,45,000
	Total Equity and Liabilities		<u>10,85,200</u>
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	5	5,15,000
	(ii) Intangible Assets	6	61,200
	Sub Total		<u>5,76,200</u>
	2. Current Assets		
	(a) Inventories	7	3,64,000
	(b) Trade Receivables	8	85,000
	(c) Cash and Cash Equivalents	9	45,000
	(d) Short-term Loans and Advances	10	15,000
	Sub Total		<u>5,09,000</u>
	Total Assets		<u>10,85,200</u>

Notes to Accounts

	Particulars	Rs.	Rs.
1	Share capital		
	Issued, subscribed and Fully Paid		
	60,000 Equity Shares of Rs. 10 each		6,00,000
2	Reserves and Surplus		
	(i) General Reserves (H Ltd.)		1,50,000
	Add: Share in S Ltd.		5,250
			1,55,250
	(ii) Surplus (H Ltd.)	70,000	
	Add: Share in S Ltd.	15,750	85,750
			2,41,000
3	Minority Interest		
	Paid up Capital held		60,000
	30% of Rs. 50,000 (Profits)		15,000
	30% of Rs. 70,000		21,000
	Unclaimed Dividends		5,000
			1,01,000
	Share in Preliminary Expenses		1,800
			99,200
4	Trade Payables		
	Creditors for Goods		
	H Ltd.		90,000
	S Ltd.		55,000
			1,45,000
5	Tangible Assets		
	(i) Machinery		
	H Ltd.	3,00,000	
	S Ltd.	1,00,000	4,00,000
	(ii) Furniture		
	H Ltd.	70,000	
	S Ltd.	45,000	1,15,000
			5,15,000
6	Intangible Assets		
	Goodwill on Consolidation		
	Cost of Investments in the shares of S Ltd.		2,60,000
	Paid up value of shares held		-1,40,000
			1,20,000
	H Ltd.: 8 Share in Capital Profits and Capital Reserves		-63,000
			57,000
	Share in preliminary Expenses (7% of 6,000)		4,200
			61,200
7	Inventories		
	Stock of Goods		
	H Ltd.		1,75,000

	S Ltd.	1,89,000
		<u>3,64,000</u>
8	Trade Receivables	
	H Ltd.	55,000
	S Ltd.	<u>30,000</u>
		<u>85,000</u>
9	Cash and Cash Equivalents:	
	Cash at Bank	
	H Ltd.	40,000
	S Ltd.	<u>5,000</u>
		<u>45,000</u>
10	Short-term Loans and Advances	
	Bills Receivables	
	H Ltd.	10,000
	S Ltd.	<u>5,000</u>
		<u>15,000</u>

Illustration 25: (Non-current Investments, Pre-acquisition Dividend Correctly Recorded)

H Ltd. acquired 32,000 equity shares of Rs. 10 each in S Ltd. on October 1, 2016 for Rs. 6,45,600. The final account balances of the two companies as on 31 March 2017 were as follows :

	Particulars	Note No.	H Ltd. (Rs.)	S Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital			
	Equity Capital (Rs. 10 each)		10,00,000	4,00,000
	(b) Reserve and Surplus			
	Reserves (1-4-2016)		4,80,000	2,00,000
	Surplus Account		1,14,400	1,64,000
	2. Current Liabilities			
	(a) Short term borrowings			
	(Bank overdraft)		2,00,000	
	(b) Trade Payables - Creditors		1,39,600	40,000
	Bills Payable			<u>26,000</u>
	Total		<u>19,34,000</u>	<u>8,30,000</u>
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets (Tangible)			
	Land and Building		3,60,000	3,80,000
	Plant and Machinery		4,80,000	2,70,000
	(b) Non-Current Investments		7,20,000	
	2. Current Assets			
	(a) Inventories (stock-in-trade)		2,28,000	84,000
	(b) Trade Receivables - Debtors		88,000	80,000

Bills Receivable	29,600	
(c) Cash and Cash Equivalents (Cash)	28,400	16,000
Total	19,34,000	8,30,000

Additional Information :

- (i) The statement of Profit and Loss of S Ltd. showed a Profit of Rs. 60,000 on 1 April 2016 out of which a dividend of 10% was paid on November 1, 2016. The dividend was correctly recorded by H Ltd.
- (ii) The Plant and Machinery of S Ltd. which stood at Rs. 3,00,000 on 1 April 2016 was considered worth Rs. 3,60,000 on the date of acquisition by H Ltd.

Prepare consolidated Balance Sheet with Work Sheet where necessary.

Solution

**Consolidated Balance Sheet of H Ltd.
And Its Subsidiary S Ltd. As On 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(a) Share Capital	1	10,00,000
	(b) Reserves and Surplus	2	6,49,600
	Sub Total		16,49,600
	2. Minority Interest	3	1,67,200
	3. Current Liabilities		
	(a) Short term Borrowings	4	2,00,000
	(b) Trade Payables	5	1,79,600
	(c) Other Current Liabilities	6	26,000
	Sub Total		4,05,600
	Total Equity and Liabilities		22,22,400
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	7	15,62,000
	(ii) Intangible Assets	8	
	(b) Non-Current Investments	9	1,06,400
	Sub Total		16,68,400
	2. Current Assets		
	(a) Inventories (Stock of Goods)	10	3,12,000
	(b) Trade Receivables	11	1,68,000
	(c) Cash and Cash Equivalent (Cash in hand)	12	44,400
	(d) Short-term Loans and Advances (Bills Receivables)	13	29,600
	Sub Total		5,54,000
	Total Assets		22,22,400

Notes to Accounts			
	Particulars	Rs.	Rs.
1	Share capital		
	Issued, subscribed and Fully Paid		
	1,00,000 Equity Shares of Rs. 10 each		10,00,000
2	Reserves and Surplus		
	(i) General Reserves (H Ltd.)		4,80,000
	(ii) Surplus (H Ltd.)	1,14,400	
	Share in S Ltd.	55,200	1,69,600
			6,49,600
3	Minority Interest		
	Share Capital		80,000
	1/5 of 1,64,000 (Profit)		32,800
	1/5 of 2,00,000 (Reserves)		40,000
	1/5 of 75,000 (Profit on Revaluation of Machinery)		15,000
			1,67,800
	1/5 of Additional Depreciation		-600
			1,67,200
4	Short-term Borrowings		
	Bank Overdraft (H Ltd.)		2,00,000
5	Trade Payables		
	H Ltd.		1,39,600
	S Ltd.		40,000
			1,79,600
6	Other Current Liabilities		
	Bills payables (S Ltd.)		26,000
7	Tangible Assets		
	(i) Land and Building		
	H Ltd.		3,60,000
	S Ltd.		3,80,000
			7,40,000
	(ii) Plant and Machinery		
	H Ltd.	4,80,000	
	S Ltd.	2,70,000	
		7,50,000	
	Appreciation	75,000	
		8,25,000	
	Less: Depreciation	3,000	8,22,000
			15,62,000
8	Intangible Fixed Assets		
	Goodwill		
	Investments in the shares of S Ltd.		6,45,600
	Less: Dividend Correctly recorded		32,000

			6,13,600
	Less: Paid up value held		3,20,000
	Less: Profit on Revaluation of Plant etc.	-60,000	2,93,600
	Capital profit from 1-4-2016 to 30-09-2016	-57,600	
	Pre-acquisition Profit	-16,000	
	Pre-acquisition Reserve	-1,60,000	-2,93,600
			Nil
9	Non-Current Investments:		
	Investments (Total)		7,20,000
	Less: Investments in shares of S Ltd.	6,45,600	
	Less: Dividend from pre-acquisition Profits correctly recorded	32,000	6,13,600
			1,06,400
10	Inventories		
	Stock of Goods		
	H Ltd.		2,28,000
	S Ltd.		84,000
			3,12,000
11	Trade Receivables		
	Debtors for Goods		
	H Ltd.		88,000
	S Ltd.		80,000
			1,68,000
12	Cash and Cash Equivalents:		
	Cash in hand		
	H Ltd.		28,400
	S Ltd.		16,000
			44,400
13	Short-term Loans and Advances		
	Bills Receivables (H Ltd.)		29,600

Illustration 26:

H Ltd. acquired 15,000 shares in S Ltd. for Rs. 1,55,000 on 1st July, 2016. The Balance sheet of the two H Ltd. and S Ltd. companies on 31st March, 2017 were as follows:

	Particulars	Note No.	H Ltd. (Rs.)	S Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital (Rs. 10 each)		9,00,000	2,50,000
	(b) Reserve and Surplus			
	General Reserve		1,60,000	40,000
	Surplus Account		80,000	25,000
	2. Current Liabilities			
	(a) Trade Payables - Creditors		50,000	30,000

	Bills Payable	40,000	20,000
	Total	12,30,000	3,65,000
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets (Tangible)		
	Machinery	7,00,000	1,50,000
	Furniture	1,00,000	70,000
	(b) Non-Current Investments	1,55,000	
	2. Current Assets		
	(a) Inventories (stock-in-trade)	1,00,000	50,000
	(b) Trade Receivables - Debtors	60,000	35,000
	Bills Receivable	25,000	20,000
	(c) Cash and Cash Equivalents (Bank)	90,000	40,000
	Total	12,30,000	3,65,000

The following additional information is provided to you:

- General reserve appearing in the Balance Sheet of S Ltd. has remained unchanged since 31 March, 2016.
- Profit earned by S Ltd. for the year ended 31 March, 2017 amounted to Rs. 20,000.
- H Ltd. sold goods to S Ltd. costing Rs. 8,000 for Rs. 10,000. 25% of these goods remained unsold with S Ltd. on 31 March, 2017. Creditors of S Ltd. include Rs. 4,000 due to H Ltd. on account of these goods.
- Out of Bills payable issued by S Ltd. Rs. 15,000 are those which have been accepted in favour of H Ltd. Out of these, H Ltd. had endorsed by 31 March, 2017, Rs. 8,000 worth of bills receivable in favour of its creditors.

You are required to draw a Consolidated Balance Sheet as at 31 March, 2017.

Solution

Consolidated Balance Sheet of H Ltd. And Its Subsidiary S Ltd. As on 31 March 2017				
	Particulars	Note	Rs.	Rs.
I	EQUITY AND LIABILITIES			
	1. Shareholders' Funds			
	(a) Share Capital	1	9,00,000	
	(b) Reserves and Surplus	2	2,73,500	11,73,500
	2. Minority Interest	3		1,26,000
	3. Current Liabilities			
	Trade Payables	4		1,29,000
	Total Equity and Liabilities			14,28,500
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets			
	Tangible	5		10,20,000
	2. Current Assets			

(a) Inventories	6	1,49,500
(b) Trade Receivables	7	1,29,000
(c) Cash and Cash Equivalent	8	1,30,000
		<u>14,28,500</u>

Notes to Accounts			
	Particulars	Rs.	Rs.
1	Share Capital		
	Authorised :		
	Issued, Subscribed and Fully Paid:		N/A
	90,000 Equity Shares of Rs. 10 each		<u>9,00,000</u>
2	Reserves and Surplus		
	(i) Capital Reserve (on Consolidation)		25,000
	(ii) General Reserves		1,60,000
	(iii) Surplus		
	Add: Share in S Ltd.	80,000	
	Less: Unrealised Profit	<u>9,000</u>	
		89,000	
		<u>500</u>	88,500
			<u>2,73,500</u>
3	Minority Interest		<u>1,26,000</u>
4	Trade Payables		
	(a) Creditors H Ltd.	50,000	
	S Ltd.	<u>30,000</u>	
		80,000	
	Less: Mutual Debts	<u>4,000</u>	76,000
	(b) Bills Payable: H Ltd.	40,000	
	S Ltd.	<u>20,000</u>	
		60,000	
	Less: Mutual Debts	<u>7,000</u>	
			<u>53,000</u>
			<u>1,29,000</u>
5	Tangible Assets		
	(i) Machinery: H Ltd.	7,00,000	
	S Ltd.	<u>1,50,000</u>	8,50,000
	(ii) Furniture: H Ltd.	1,00,000	
	S Ltd.	<u>70,000</u>	1,70,000
			<u>10,20,000</u>
6	Inventories (stock)		
	H Ltd.		1,00,000
	S Ltd.		<u>50,000</u>
			1,50,000
	Unrealised Profit		<u>-500</u>
			<u>1,49,500</u>

7	Trade Receivable		
	(i) Debtors: H Ltd.	60,000	
	S Ltd.	<u>35,000</u>	
		95,000	
	Less: Mutual Debts	<u>4,000</u>	
			91,000
	(ii) Bills Receivable		
	H Ltd.	25,000	
	S Ltd.	<u>20,000</u>	
		45,000	
	Less: Mutual Debts	<u>7,000</u>	38,000
			<u>1,29,000</u>
8	Cash and Cash Equivalents		
	Cash at Bank :		
	H Ltd.		90,000
	S Ltd.		<u>40,000</u>
			<u>1,30,000</u>

Illustration 27: (Negative Surplus and Loss by Fire)

From the following assets and liabilities extracted from the Balance Sheet of H Ltd. and S Ltd. as on 31st March, 2017 and additional information, prepare Consolidated Balance Sheet:

Particulars	H Ltd. (Rs.)	S Ltd. (Rs.)
Equity and Liabilities		
Equity Share Capital (Rs. 100 each)	3,00,000	2,00,000
10% Preference Share Capital (Rs. 100 each)	2,00,000	
General Reserve	80,000	
Surplus (Negative Surplus)	1,70,000	-20,000
6% Debentures		2,00,000
Bills Payable (All accepted in favour of S Ltd.)	30,000	
Sundry Creditors	<u>90,000</u>	<u>40,000</u>
	8,70,000	4,20,000
Assets		
Building	3,50,000	
Machinery	90,000	2,80,000
Long-term Investments		
6% Debentures in S Ltd. Acquired at par value on 1.4.2016	1,00,000	
1,500 Equity Shares in S Ltd. Acquired on 1.10.2016	<u>1,20,000</u>	
Stock	1,60,000	80,000
Debtors	50,000	40,000
Bills Receivable (All Accepted by H Ltd.)		<u>20,000</u>

8,70,000 4,20,000

Note: Contingent liabilities of S Ltd. for bills discounted Rs. 35,000.

Additional Information:

- (i) On 1st April, 2016, S Ltd. had a negative surplus of Rs. 80,000
- (ii) On 15th September, 2016 stock of S Ltd. costing Rs. 20,000 was destroyed by fire and insurance company paid only Rs. 4,000.
- (iii) Stock of S Ltd. included goods of Rs. 15,000 supplied by H Ltd. which sells goods at a profit of 25% on cost.

Solution

**Consolidated Balance Sheet of H Ltd.
and Its Subsidiary S Ltd. As At 31 March 2017**

	Particulars	Note	Rs.	Rs.
I	EQUITY AND LIABILITIES			
	1. Shareholders' Funds:			
	(a) Share Capital	1	5,00,000	
	(b) Reserves and Surplus	2	2,75,500	7,75,500
	2. Minority Interest	3	45,000	45,000
	3. Non-Current Liabilities			
	Long-term Borrowings	4	1,00,000	1,00,000
	4. Current Liabilities			
	Trade Payables	5	1,40,000	1,40,000
	Total Equity and Liabilities			10,60,500
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets			
	(i) Tangible	6	7,20,000	
	(ii) Intangible	7	13,500	7,33,500
	2. Current Assets			
	(a) Inventories	8	2,37,000	
	(b) Trade Receivables	9	90,000	3,27,000
	Total Assets			10,60,500

Notes to Accounts

	Particulars	Rs.	Rs.
1	Share Capital		
	Issued, Subscribed and paid up: (H Ltd.)		
	3,000 Equity Shares of Rs. 100 each fully paid		3,00,000
	2,000, 10% Preference Shares of Rs. 100 each		

	fully paid		2,00,000
			<u>5,00,000</u>
2	Reserves and Surplus		
	(a) General Reserve (H Ltd.)		80,000
	(b) Surplus (H Ltd.)	1,70,000	
	Share in Post-acquisition Surplus of S Ltd.	<u>28,500</u>	
		1,98,500	
	Unrealised Profit on Stock	<u>-3,000</u>	1,95,500
			<u>2,75,500</u>
3	Minority Interest		
	Equity Share Capital		50,000
	Share in Pre-acquisition Negative Surplus		-14,500
	Share in Post-acquisition Surplus		<u>9,500</u>
			<u>45,000</u>
4	Long-term Borrowings		
	6% Debentures in (S Ltd.)		2,00,000
	Less: Debentures held by H Ltd.		<u>1,00,000</u>
			<u>1,00,000</u>
5	Trade Payables		
	(a) Creditors for Goods		
	H Ltd.	90,000	
	S Ltd.	<u>40,000</u>	1,30,000
	(b) Bills Payable		
	H Ltd.	30,000	
	Less: held by S Ltd.	<u>20,000</u>	10,000
			<u>1,40,000</u>
6	Tangible Assets		
	Building (H Ltd.)		3,50,000
	Machinery:		
	H Ltd.	90,000	
	S Ltd.	<u>2,80,000</u>	3,70,000
			<u>7,20,000</u>
7	Intangible Assets		
	Goodwill on Consolidation:		
	Equity Capital held		1,50,000
	Less: Cost of investment in equity capital		<u>1,20,000</u>
			30,000
	Less: Pre-acquisition negative surplus		<u>-43,500</u>
			<u>13,500</u>
8	Inventories		
	Stock of Goods:		
	H Ltd.		1,60,000
	S Ltd.		<u>80,000</u>
			2,40,000
	Less: Unrealised Profit on stock		<u>3,000</u>

			2,37,000
9	Trade Receivables		
	(a) Debtors for Goods		
	H Ltd.	50,000	
	S Ltd.	40,000	
			90,000
	(b) Bills Receivables		
	H Ltd.		
	S Ltd.	20,000	
		20,000	
	Less: Accepted by S Ltd.	20,000	
			90,000

Illustration 28: (Dividend from Pre-acquisition Profit)

The asset and liabilities of H Ltd. and S Ltd. as on 31st March, 2017 were as follows:

Particulars	H Ltd. (Rs. In lac)	S Ltd. (Rs. In lac)
<i>Equity and Liabilities:</i>		
Equity Share Capital (Rs. 10 each)	1,000	400
General Reserve	200	120
Profit and Loss Account	250	180
Trade Creditors	160	100
Bills Payable		50
	1,610	850
<i>Assets:</i>		
Goodwill		60
Plant and Machinery	500	360
Investments	600	
Preliminary Expenses		15
Stock	270	217
Trade Debtors	170	150
Bills Receivable	60	40
Cash at Bank	10	8
	1,610	850

H Ltd. acquired 80% equity shares of S Ltd. on 1st April, 2016 for Rs. 500 lakhs. The profit and Loss Account and General Reserve of S Ltd. on that date amounted to Rs. 150 lakhs and Rs. 100 lakhs respectively. S Ltd. used pre-acquisition profit and loss balance to pay dividend for 2015-16 at the rate of 25% (Ignore corporate dividend tax). H Ltd. credited the amount of dividend received to profit and loss account.

The plant and machinery of S Ltd. has a book value of Rs. 400 lakhs on 1st April, 2016. At the time of acquisition of shares this asset was valued at 350 lakhs. The new value was not incorporated in the books of S Ltd.

The trade creditors of S Ltd. include a sum of Rs. 25 lakhs payable to H Ltd. Two-fifths of these goods were still unsold on the date of preparation of the Balance Sheet. H Ltd. sells goods at a profit of 20% on sale price.

Prepare consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as per Schedule III.

Solution

**Consolidated Balance Sheet of H Ltd.
and Its Subsidiary S Ltd. As At 31 March 2017**

Particulars	Note	Rs. In lacs	Rs. In lacs
I EQUITY AND LIABILITIES			
1. Shareholders' Funds			
(a) Share Capital (100 lacs shares Rs. 10 each)		1,000	
(b) Reserves and Surplus	1	492	
2. Minority Interest		128	
3. Current Liabilities			
Trade Payable	2	285	285
Total Equity and Liabilities			1,905
II ASSETS			
1. Non-Current Assets			
(a) Fixed Assets :			
(i) Tangible Assets	3	815	
(ii) Intangible Assets	4	92	
(b) Non-Current Investments (600 - 500)		100	
			1007
2. Current Assets			
(a) Inventories	5	485	
(b) Trade Receivables	6	395	
(c) Cash and Cash Equivalents	7	18	898
Total Assets			1,905

Notes to Accounts

Particulars	Rs. In lacs	Rs. In lacs
1 Reserves and Surplus		
(i) General Reserve - H Ltd.	200	
Share in Post-acquisition Reserve (80% of 20)	16	216
(ii) Surplus - H Ltd.	250	
Less: Dividend Wrongly Credited	-80	

Add: Share in Post-acquisition

Profit (80% of 135)	108	
Less: Unrealised Profit on Stock	<u>-2</u>	276
25 x 20/100 x 2/5)		<u>492</u>

2 Trade Payables

Creditors: H Ltd.	160	
S Ltd.	<u>100</u>	
	260	
Less: Mutual Debts	<u>25</u>	235
Bills Payable: S Ltd.		<u>50</u>
		<u>285</u>

3 Tangible (Fixed) Assets

Plant and Machinery:		
H Ltd.	500	
S Ltd.	<u>360</u>	
	860	
Less: Loss on Revaluation	<u>50</u>	
	810	
Add: Depreciation Written back	<u>5</u>	815

4 Intangible (Fixed) Assets

Goodwill

H Ltd.		
S Ltd.	60	
Goodwill on consolidation	<u>32</u>	
	<u>92</u>	
5 Inventories		
H Ltd.	270	
S Ltd.	<u>217</u>	
	487	
Less: Unrealised Profit	<u>2</u>	
	<u>485</u>	
6 Trade Receivables		
H Ltd.	170	
S Ltd.	<u>150</u>	
	320	
Less: Mutual Debts	<u>25</u>	295
Bills Receivable		
H Ltd.	60	
S Ltd.	<u>40</u>	<u>100</u>
		<u>395</u>
7 Cash and Cash Equivalents		
Cash at Bank: H Ltd.	10	
S Ltd.	<u>8</u>	

Illustration 29: (Cheque in Transit)

Following are the list of Assets and Liabilities of H Ltd. and S Ltd. as on 31st March, 2016 and 31st March, 2017.

H Ltd.	Rs. 000 31.3.2016	Rs. 000 31.3.2017
<i>Equity and Liabilities</i>		
Equity Share Capital (Rs. 100 each)	14,000	14,000
General Reserve	1,640	2,280
Profit and Loss Account	2,680	3,200
Creditors	1,560	1,400
	<u>19,880</u>	<u>20,880</u>
<i>Assets</i>		
Goodwill	2,000	2,000
Land and Building	4,400	4,400
Plant and Machinery (Net)	3,200	3,000
Stock	1,600	1,880
Investments (36,000 shares of S Ltd.)	6,000	6,000
Debtors	2,200	2,400
Cash and Bank Balance	480	1,200
	<u>19,880</u>	<u>20,880</u>
S Ltd.		
<i>Equity and Liabilities</i>		
Equity Share Capital (Rs. 100 each)	4,000	4,000
General Reserve	700	820
Profit and Loss Account	480	1,140
Creditors	400	320
	<u>5,580</u>	<u>6,280</u>
<i>Assets</i>		
Goodwill	1,600	1,600
Plant and Machinery (Net)	1,800	1,700
Stock	1,000	1,200
Debtors	880	1,280
Cash and Bank Balance	300	500
	<u>5,580</u>	<u>6,280</u>

During the year goods costing Rs. 2,00,000 were sold by H Ltd. to S Ltd. at a profit of 20% on selling price. Half of these goods are still lying unsold. S Ltd. has paid 80% of the amount due so far. Prepare consolidated Balance Sheet as on 31st March, 2017 as per schedule III after taking into account that a cheque of Rs. 20,000 was sent by S Ltd. on 28th March, 2017, not yet received by H Ltd.

Note: Previous year's figures in the Consolidated Balance Sheet not required.

Solution

Ratio 90 : 10

**Consolidated Balance Sheet of H Ltd.
and Its Subsidiary S Ltd. As At March 2017**

Particulars	Note	(Rs. In 000)	(Rs. In 000)
I EQUITY AND LIABILITIES			
1. Shareholders' Funds			
(a) Share Capital (of Rs. 100 each)		14,000	
(b) Reserves and Surplus	1	6,157	20,157
2. Minority Interest			596
3. Current Liabilities			
(a) Trade Payables	2		1,670
Total Equity and Liabilities			22,423
II ASSETS			
1. Non-Current Assets			
(a) Fixed Assets :			
(i) Tangible Assets	3	9,100	
(ii) Intangible Assets	4	4,938	
			14,038
2. Current Assets			
(a) Inventories	5	3,055	
(b) Trade Receivables	6	3,610	
(c) Cash and Cash Equivalents	7	1,720	8,385
Total Assets			22,423

Notes to Accounts

S.No.	Particulars	(Rs. In 000)	(Rs. In 000)
1	Reserves and Surplus		
	(i) General Reserve (H Ltd.)	2,280	
	Add: Share in S Ltd. (Post-acquisition Reserve)		
	(120 x 90/100)	108	2,388
	(ii) Surplus (H Ltd.)	3,200	
	Add: Share in S Ltd. Post-acquisition Profit		
	(90% of 660)	594	
		3,794	
	Less: Unrealised Profit or Stock	-25	3,769
			6,157

2	Current Liabilities	
	Trade Payable H Ltd.	1,400
	S Ltd.	320
		<u>1,720</u>
	Less: Inter Company Adjustment	
	20% of Rs. 2,50,000	<u>-50</u>
		<u>1,670</u>
3	Tangible Assets	
	Land Building H Ltd.	4,400
	Plant and Machinery H Ltd.	3,000
	Plant and Machinery S Ltd.	1,700
		<u>9,100</u>
4	Intangible Assets	
	Goodwill H Ltd.	2,000
	S Ltd.	1,600
	Goodwill on Consolidation	1,338
		<u>4,938</u>
5	Inventories H Ltd.	1,880
	S Ltd.	1,200
		<u>3,080</u>
	Less: Unrealised Profit	<u>-25</u>
		<u>3,055</u>
6	Trade Receivable	
	H Ltd.	2,400
	S Ltd.	1,280
		<u>3,680</u>
	Less: Mutual Debt	<u>-50</u>
		<u>3,630</u>
	Less: Cheque-in-transit	<u>-20</u>
		<u>3,610</u>
7	Cash and Cash Equivalents	
	Cash at Bank:	
	H Ltd.	1,200
	S Ltd.	500
	Cheque-in-transit	20
		<u>1,720</u>

Illustration 30 (Contingent Liability for Bills Discounted)

The Balance Sheet of H Ltd. and S Ltd. on 31st March 2017 is as follows:

	Particulars	Note No.	H Ltd. (Rs.)	S Ltd. (Rs.)
I	EQUITY AND LIABILITIES			
	1. Shareholder's Funds			
	(a) Share Capital			

	(Equity Shares of Rs. 10 each)	20,00,000	12,00,000
	(b) Reserve and Surplus		
	General Reserve (on 1-4-2016)	3,60,000	2,04,000
	Surplus Account (on 1-4-2016)	2,40,000	96,000
	Profit during the year	4,40,000	3,36,000
	2. Current Liabilities		
	(a) Trade Payables - Creditors	5,60,000	2,84,000
	Bills Payable		80,000
	Total	36,00,000	22,00,000
II	ASSETS		
	1. Non-Current Assets		
	(a) Fixed Assets (Tangible)		
	Land and Buildings	10,00,000	8,00,000
	Plant and Machinery	5,00,000	6,40,000
	(b) Non-Current Investments	11,80,000	
	(80,000 shares in S Ltd.)		
	2. Current Assets		
	(a) Inventories (stock-in-trade)	2,80,000	3,20,000
	(b) Trade Receivables - Debtors	4,80,000	4,20,000
	Bills Receivable	1,20,000	
	(c) Cash and Cash Equivalents (Cash)	40,000	20,000
	Total	36,00,000	22,00,000

- (i) H Ltd. acquired shares in S Ltd. on 1-1-2017.
- (ii) S Ltd. issued all bills payable to H Ltd. Bills receivable of H Ltd. include bills of S Ltd. for Rs. 48,000.
- (iii) Sundry Debtors of S Ltd. include Rs. 40,000 owing by H Ltd.
- (iv) Stock of H Ltd. includes goods worth Rs. 60,000 purchased from S Ltd. for which the latter company has charged profit at 25% on cost.
- (v) Contingent liability for bills discounted by H Ltd. is Rs. 1,00,000.

Prepare a Consolidated Balance Sheet.

Solution

**Consolidated Balance Sheet of H Ltd.
and Its Subsidiary S Ltd. As at 31 March 2017**

	Particulars	Note	Rs.
I	EQUITY AND LIABILITIES		
	1. Shareholders' Funds		
	(i) Share Capital	1	20,00,000
	(ii) Reserves & Surplus	2	10,84,000
	2. Minority Interest		6,12,000
	3. Current Liabilities		
	Trade Payables	3	8,36,000

	Total Equity and Liabilities		45,32,000
II	ASSETS		
	1. Non-Current Assets		
	Fixed Assets : Tangible	4	29,40,000
	Intangible	5	12,000
	2. Current Assets		
	Inventories (Stock)	6	5,88,000
	Trade Receivables	7	9,32,000
	Cash and Cash Equivalents	8	60,000
	Total Assets		45,32,000

Notes to Accounts

	Particulars	Rs.	Rs.
1	SHARE CAPITAL		
	Authorised Capital		
	Equity Shares of Rs. 10 each		xxx
	Issued, Subscribed & fully paid		
	2,00,000 Equity Shares of Rs. 10 each		20,00,000
2	RESERVES AND SURPLUS		
	General Reserve		3,60,000
	Surplus A/c (Profit & Loss A/c)		
	[Rs. 2,40,000 + Rs. 4,40,000]	6,80,000	
	Share of S Ltd.	56,000	
		7,36,000	
	Less: Unrealised Profit on Stock	12,000	7,24,000
			10,84,000
3	Trade Payables:		
	(i) Creditors :		
	H Ltd.	5,60,000	
	S Ltd.	2,84,000	
		8,44,000	
	Less: Inter-Company debts	40,000	8,04,000
	(ii) Bills Payable	80,000	
	Less: Inter-Company debts	48,000	
			32,000
			8,36,000
4	Tangible Assets		
	(i) Land & Building		
	H Ltd.		10,00,000
	S Ltd.		8,00,000

			18,00,000
	(ii) Plant & Machinery		
	H Ltd.	5,00,000	
	S Ltd.	6,40,000	11,40,000
			<u>29,40,000</u>
5	Intangible Assets : Goodwill		<u>12,000</u>
6	Inventories (Stock) H Ltd.	2,80,000	
	S Ltd.	3,20,000	
		<u>6,00,000</u>	
	Unrealised Profit	12,000	5,88,000
7	Trade Receivables		
	(i) Debtors		
	H Ltd.	4,80,000	
	S Ltd.	4,20,000	
		<u>9,00,000</u>	
	Less: Inter-company debt	40,000	8,60,000
	(ii) Bills Receivable H Ltd.	1,20,000	
	Less: Inter-company debt	48,000	72,000
			<u>9,32,000</u>
8	Cash & Cash Equivalents: Cash		
	H Ltd.	40,000	
	S Ltd.	20,000	
			<u>60,000</u>
	There is a contingent liability of Rs. 68,000		

Illustration 31 (Loss by Fire)

The following are the Balance Sheets of H Ltd. and S Ltd. as on 31st March, 2016:

EQUITY AND LIABILITIES	H Ltd. (Rs.)	S Ltd. (Rs.)
Equity share capital	8,00,000	2,00,000
(fully paid shares of Rs. 10 each)		
General Reserve (as on 1-4-2015)	2,00,000	2,00,000
Surplus	40,000	4,00,000
Trade Creditors	1,60,000	80,000
Total	12,00,000	8,80,000
ASSETS		
Fixed Assets: Tangible	4,00,000	2,00,000
Investments in Equity shares		
of S Ltd.	4,00,000	
Stock in trade	2,00,000	1,80,000
Trade Receivables	1,20,000	4,00,000
Cash at Bank	80,000	1,00,000
Total	12,00,000	8,80,000

Additional Information :

- (i) H Ltd. had purchased shares in the subsidiary company on January 1, 2016.
- (ii) Balance of surplus of S Ltd. on 1-4-2015 was Rs. 1,60,000.
- (iii) S Ltd. distributed bonus shares out of general reserve in the ratio of one share for every two shares held in February, 2016, but the entry for bonus issue has not been passed by it yet.
- (iv) There was an abnormal loss of goods by fire amounting to Rs. 30,000 on 1st October, 2015.
- (v) H Ltd. held 18,000 equity shares (including bonus shares) in S Ltd. as at 31st March, 2016.

Prepare Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31-03-2016. Show your workings.

Solution

**Consolidated Balance Sheet of H Ltd. and its
Subsidiary S Ltd. As on 31 March, 2016**

S.No.	Particulars	Note	Rs.	Rs.
I	EQUITY AND LIABILITIES			
	1. Shareholders' Funds			
	(a) Share Capital	1	8,00,000	
	(b) Reserves and Surplus	2	3,20,000	11,20,000
	2. Minority Interest	3		3,20,000
	3. Current Liabilities			
	Trade Payables	4		2,40,000
	Total Equity and Liabilities			<u>16,80,000</u>
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets			
	(i) Tangible	5		6,00,000
	2. Current Assets			
	(a) Inventories	6		3,80,000
	(b) Trade Receivables	7		5,20,000
	(c) Cash and Cash Equivalents	8		1,80,000
				<u>16,80,000</u>

Notes to Accounts

S.No.	Particulars	Note	Rs.	Rs.
1	Share Capital			
	Issued, Subscribed and fully paid up:			
	20,000, Equity Shares of Rs. 10 each		2,00,000	2,00,000

2	Reserves and Surplus		
	General Reserve	2,00,000	2,00,000
	Surplus	40,000	
	Add: Share in Surplus of S Ltd.	40,500	80,500
	Capital Reserve on Consolidation		39,500
			3,20,000
3	Minority Interest	3,20,000	3,20,000
4	Trade Payables		
	H Ltd.		1,60,000
	S Ltd.		80,000
			2,40,000
5	Tangible Assets (Fixed Assets)		
	H Ltd.		4,00,000
	S Ltd.		2,00,000
			6,00,000
6	Inventories (Stock-in-Trade)		
	H Ltd.		2,00,000
	S Ltd.		1,80,000
			3,80,000
7	Trade Receivables		
	H Ltd.		1,20,000
	S Ltd.		4,00,000
			5,20,000
8	Cash and Cash Equivalents		
	H Ltd.		80,000
	S Ltd.		1,00,000
			1,80,000

Illustration 32 (Dividend Wrongly Credited)

H Ltd. acquired 32,000 equity shares of Rs. 10 each in S Ltd. on 01-10-2015 for Rs. 6,00,000. The Balance Sheets of the two companies as at 31-03-2016 were as follows:

EQUITY AND LIABILITIES	H Ltd. (Rs.)	S Ltd. (Rs.)
Equity Share Capital:		
Equity shares of Rs. 10 each fully paid up	10,00,000	4,00,000
General Reserve (01-04-2015)	4,80,000	2,00,000
Profit and Loss Account	1,20,000	1,80,000
Unclaimed Dividend		2,000
Bills Payable		30,000
Sundry Creditors	4,00,000	88,000
	20,00,000	9,00,000
ASSETS	H Ltd. (Rs.)	S Ltd. (Rs.)
Land and Building	4,00,000	4,40,000
Plant and Machinery	6,00,000	3,00,000

Investments (including investment in Equity shares of S Ltd.)	8,00,000	
Stock	50,000	30,000
Debtors	40,000	50,000
Bills Receivable	10,000	20,000
Bank Balance	1,00,000	40,000
Preliminary Expenses		20,000
	20,00,000	9,00,000

Note : Contingent liability for Bills discounted Rs. 20,000

Additional Information :

- (i) On 01-04-2015 the Profit and Loss Account of S Ltd. showed a credit balance of Rs. 70,000 out of which a dividend of 10% was paid on 01-11-2015. The dividend was credited by H Ltd. to its Profit and Loss Account. Ignore corporate dividend tax.
- (ii) Creditors of S Ltd. include an amount of Rs. 30,000 for purchase from H Ltd. The goods are still unsold on 31-03-2016. H Ltd. sells the goods at cost plus 20%.
- (iii) Bills Payable of S Ltd. are all issued in favour of H Ltd. of these bills, H Ltd. got discounted bills worth Rs. 20,000.

Solution

**Consolidated Balance Sheet of H Ltd.
and its Subsidiary S Ltd. As on 31 March, 2016**

S.No.	Particulars	Note	Rs.	Rs.
I	EQUITY AND LIABILITIES			
	1. Shareholders' Funds			
	(a) Share Capital	1	10,00,000	
	(b) Reserves and Surplus	2	6,23,000	16,23,000
	2. Minority Interest	3	1,54,000	1,54,000
	3. Current Liabilities			
	Trade Payables	4	4,78,000	4,78,000
	Total Equity and Liabilities			22,55,000
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets:			
	(i) Tangible Assets	5	17,40,000	
	(ii) Intangible Assets	6	20,000	17,60,000
	(b) Non-Current Investments	7	2,00,000	2,00,000
	2. Current Assets			19,60,000
	(a) Inventories	8	75,000	
	(b) Trade Receivables	9	60,000	
	(c) Cash and Cash Equivalents	10	1,40,000	
	(d) Short-term Loans and Advances	11	20,000	2,95,000
	Total Assets			22,55,000

Notes to Accounts

S.No.	Particulars	Note	Rs.	Rs.
1	Share Capital			
	Issued, Subscribed and fully paid			
	1,00,000 Equity Shares of Rs. 10 each			<u>10,00,000</u>
2	Reserves and Surplus			
	(a) General Reserve (H Ltd.)		<u>4,80,000</u>	4,80,000
	(b) Surplus			
	Balance (H Ltd.)		1,20,000	
	Add: Surplus from S Ltd.		60,000	
	Less: Dividend wrongly credited		-32,000	
	Less: Unrealized Profit on stock		<u>-5,000</u>	<u>1,43,000</u>
				<u>6,23,000</u>
3	Minority Interest			<u>1,54,000</u>
4	Trade Payables			
	(a) Sundry Creditors:			
	H Ltd.			4,00,000
	S Ltd.			<u>88,000</u>
				<u>4,88,000</u>
	Less: Inter-Company Debts			<u>30,000</u>
				<u>4,58,000</u>
	(b) Bills Payable			
	S Ltd.		30,000	
	Less: Common Debts		<u>10,000</u>	<u>20,000</u>
				<u>4,78,000</u>
5	Tangible Assets			
	Land and Building:			
	H Ltd.		4,00,000	
	S Ltd.		<u>4,40,000</u>	<u>8,40,000</u>
	Plant and Machinery			
	H Ltd.		6,00,000	
	S Ltd.		<u>3,00,000</u>	<u>9,00,000</u>
				<u>17,40,000</u>
6	Intangible Assets			
	Goodwill			<u>20,000</u>
7	Non-current Investments			
	Total			8,00,000
	Less: Investments in S Ltd.			<u>6,00,000</u>
8	Inventories			<u>2,00,000</u>
	Stock in Trade:			
	H Ltd.			50,000
	S Ltd.			<u>30,000</u>
				<u>80,000</u>

	Less: Unrealised Profit	5,000
		<u>75,000</u>
9	Trade Receivables	
	Debtors:	
	H Ltd.	40,000
	S Ltd.	<u>50,000</u>
		90,000
	Less: Inter-Company Debts	<u>30,000</u>
		<u>60,000</u>
10	Cash and Cash Equivalents	
	Cash at Bank:	
	H Ltd.	1,00,000
	S Ltd.	<u>40,000</u>
		<u>1,40,000</u>
11	Bills Receivables:	
	H Ltd.	10,000
	S Ltd.	<u>20,000</u>
		30,000
	Less: Mutual Debts	<u>10,000</u>
		<u>20,000</u>

Illustration 33 (Common Debts)

The following are the balance sheet of H Ltd. and S Ltd. as on 31st March 2016

Equity and Liabilities	H Ltd.	S Ltd.
Share Capital :		
Equity Shares of Rs. 10 each fully paid up	6,00,000	2,00,000
General Reserve	3,40,000	80,000
Profit and Loss Account	1,00,000	60,000
Creditors	<u>70,000</u>	<u>35,000</u>
Total	11,10,000	3,75,000
Assets		
Plant and Machinery	3,90,000	1,35,000
Furniture	80,000	40,000
Investment (80% Shares of S Ltd.)	3,40,000	
Stock 1,80,000	<u>1,20,000</u>	
Debtors	50,000	30,000
Cash at bank	<u>70,000</u>	<u>50,000</u>
Total	11,10,000	3,75,000

Additional Information :

- (i) P&L Account of S Ltd. stood at Rs. 30,000 on 1st April 2015 whereas General reserve has remained unchanged since that date.

- (ii) H Ltd. acquired 80% shares in S Ltd. on 1st October 2015 for Rs. 3,40,000.
- (iii) Included in the debtors of S Ltd. is a sum of Rs. 10,000 due from H Ltd. for goods sold at a profit of Rs. 2,000, till 31st March 2016 only half of these goods were sold and remaining are still in the godown of H Ltd.

Prepare consolidated balance sheet as at 31st March 2016.

Solution

**Consolidated Balance Sheet of H Ltd.
and its Subsidiary S Ltd. As on 31 March, 2016**

	Particulars	Note	Rs.	Rs.
I	EQUITY AND LIABILITIES			
	1. Shareholders' Funds			
	(a) Share Capital	1	6,00,000	
	(b) Reserves and Surplus	2	4,51,000	10,51,000
	2. Minority Interest	3	68,000	68,000
	3. Current Liabilities			
	Trade Payables	4	95,000	95,000
	Total Equity and Liabilities			12,14,000
II	ASSETS			
	1. Non-Current Assets			
	(a) Fixed Assets			
	(i) Tangible Assets	5	6,45,000	
	(ii) Intangible Assets	6	80,000	7,25,000
	2. Current Assets			
	(a) Inventories	7	2,99,000	
	(b) Trade Receivables	8	70,000	
	(c) Cash and Cash Equivalents	9	1,20,000	4,89,000
	Total Assets			12,14,000

Notes to Accounts

	Particulars	Rs.	Rs.
1	SHARE CAPITAL		
	Issued, Subscribed and Fully Paid:		
	60,000 Equity Shares of Rs. 10 each		6,00,000
2	Reserves and Surplus		
	(a) General Reserve		3,40,000
	(b) Surplus		
	Balance b/d	1,00,000	
	Share in S Ltd.	12,000	
		1,12,000	
	Unrealised profit on stock-in-trade	1,000	1,11,000
			4,51,000
3	Minority Interest		

	Paid up Capital		40,000
	1/5 of Rs. 80,000 (General Reserves)		16,000
	1/5 of Rs. 60,000 (Surplus)		12,000
			<u>68,000</u>
4	Trade Payables		
	Creditors for Goods:		
	H Ltd.		70,000
	S Ltd.		35,000
			<u>1,05,000</u>
	Common Debts		10,000
			<u>95,000</u>
5	Tangible Assets		
	(a) Machinery		
	H Ltd.	3,90,000	
	S Ltd.	<u>1,35,000</u>	5,25,000
	(b) Furniture		
	H Ltd.	80,000	
	S Ltd.	<u>40,000</u>	1,20,000
			<u>6,45,000</u>
6	Intangible Assets		
	Goodwill (Cost of Control)		80,000
7	Inventories		
	Stock-in-hand		
	H Ltd.		1,80,000
	S Ltd.		<u>1,20,000</u>
			3,00,000
	Unrealised Profit		<u>1,000</u>
			<u>2,99,000</u>
8	Trade Receivables		
	Debtors for Goods:		
	H Ltd.		50,000
	S Ltd.		<u>30,000</u>
			80,000
	Less: Common Debts		<u>10,000</u>
			<u>70,000</u>
9	Cash and Cash Equivalents		
	Cash at Bank		
	H Ltd.		70,000
	S Ltd.		<u>50,000</u>
			<u>1,20,000</u>

CHAPTER 15

CORPORATE FINANCIAL REPORTING

INTRODUCTION

A company's annual report contains not only the financial statements, notes thereto and significant accounting policies followed in preparing them, but certain other financial reports as well. The most common and statutorily required reports are as under :

1. Auditor's report
2. Directors' report
3. Corporate governance report and within that or separately, management discussion, and analysis report.
4. Report on corporate social responsibility (CSR) activities.

Financial reporting may be defined as communication of published financial statement and related information from a business enterprise to all users. It is the reporting of accounting information of an entity to a user or group of users. It contains both qualitative and quantitative information.

The Financial report made to the management is generally known as internal reporting, while financial reporting made to the shareholder investors/management is known as external reporting. The internal reporting is a part of management information system, and is used for MIS reporting for the purpose of analysis, and as an aid in decision-making process.

The management of a corporate is ultimately responsible for the generation of accounting

Need for Corporate Reporting

In accounting, Corporate Reporting is a very important issue nowadays. Various statutes have prescribed certain statements to be disclosed periodically by a corporate entity. The purpose of such mandate is to convey a true and fair view of the operating results and the financial position to the users of financial reports. Within a corporate context, financial reporting covers three types of accounting data sets. These include a balance sheet, a statement of profit and loss and a statement of cash flows.

Disclosure of Significant Accounting Policies

As per AS-1 to ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial

statements should be disclosed. Such disclosure should form part of the financial statements. It would be helpful to the reader of financial statements if they are all disclosed as such in one place instead of being scattered over several statements, schedules and notes.

In respect of reporting of accounting policies a company needs to follow following principles.

All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place.

Features of Corporate Financial Reporting

Relevance: Information is relevant when it influences the economic decisions of users by helping them to evaluate past, present, and future events to confirm/correct their past evaluations. The relevance of information is affected by its nature and materiality.

Reliability: Information should be free from material errors and bias. The key aspects of reliability are faithful representation, priority of substance over form, neutrality, prudence, and completeness.

Comparability: Information should be presented in a consistent manner over time, and consistent between entities to enable users to make significant comparisons.

Understandability: Information should be readily understandable by users who are expected to have a reasonable knowledge of business, economies and accounting, and a willingness to study the information with reasonable diligence.

Timeliness: A delay in reporting may improve reliability at the cost of relevance.

Benefit vs. Cost: Benefits derived from information should normally exceed the cost of providing it.

WHAT IS OBJECTIVE OF FINANCIAL REPORTING?

The objectives of financial reporting given by Financial Accounting Standard Board (FASB) are summarized as follows:

Financial reporting should provide information that is useful to investors and creditors and other users in making rational investment, credit and similar decisions.

The information should be useful to both, the present and potential investors.

1. Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners equity) and the effects of transactions event, and circumstances that change resources and claims to those resources.
2. Financial reporting should provide information about the enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise.
3. Financial reporting should provide information about how management of an enterprise obtains and spends cash, its borrowing and repayment of borrowing, capital transactions including cash dividends and other distributions of enterprise resources to owners, and other factors that may affect an enterprise's liquidity or solvency.
4. Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibilities to owners (shareholders) for the use of enterprise resource entrusted to it.
5. Financial reporting should provide information that is useful to management and directors in making decisions in the interest of owners.

AUDITORS REPORT

An audit report is a key deliverable for any organisation which shows the end results of the entire audit process.

The users of financial statements like Investors, Lenders, Customers, and others base their decisions and plans on audit reports of any enterprise.

The auditor should be careful in issuing the audit report as there is a large number of people placing reliance on such report and taking decisions accordingly. The report should be issued by being unbiased and objective in discharging the functions.

Requirements of the Companies Act, 2013

Section 143 of the Companies Act, 2013 deals with the auditors report which should fulfil following requirements :

1. The auditor shall make a report to the members of the company on the accounts examined by him, and on every financial statement and on every other document, which is to be a part of or Annexed to the Balance Sheet or Profit and Loss Account.
2. The report shall state whether, in his opinion and to the best of his information and according to the explanations given to him the said accounts.
 - (a) Give the information required by the Companies Act in the manner so required and ;
 - (b) Give a true and fair view ;
 - In the case of the Balance Sheet, of the state of the company's affairs as at the end of its financial year;
 - In the case of the Profit and Loss Account of the profit or loss in that financial year; and
 - In the case of the cash flow statement, of the cash flows for that financial year.
3. The auditor's report shall also state :
 - (a) Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit and if not, the details thereof and the effect of such information on the financial statements.
 - (b) Whether, in his opinion, proper books of account as required by law have been kept by the company, and proper returns adequate for the purpose for his audit have been received from branches not visited by him.
 - (c) Whether the report on the accounts of any branch office audited by a person other than the company's auditor has been forwarded to him, and how he has dealt with the same in preparing the auditor's report.
 - (d) Whether the company's Balance Sheet and Profit and Loss Account dealt with by the report are in agreement with the books of account and return.
 - (e) Whether, in his opinion, the financial statements comply with the accounting standards.

- (f) The observations or comments of the auditor's on financial transaction or matter which have any adverse effect on the functioning of the company.
 - (g) Whether any director is disqualified from being appointed as director under Sub-Section (2) of Section 164.
 - (h) Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matter connected therewith.
 - (i) Whether the company has adequate financial control with reference to financial statements in place and the operating effectiveness of such controls.
4. Where any of the matters referred to in above is answered in the negative, or with a disqualification, the auditor's report shall state the reasons thereof.
 5. In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Government, or partly by the Central Government and partly by one or more State Government, the Comptroller and Auditor-General of India shall appoint the auditor.
 6. The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report have a right to,—
 - (a) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorise in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and
 - (b) comment upon or supplement such audit report :

Provided that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub section (1) of section 136 and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

7. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139.
8. Every auditor shall comply with the auditing standards.
9. The Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.
10. Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

11. No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith.
12. The provisions of this section shall mutatis mutandis apply to –
 - (a) the cost accountant conducting cost audit under section 148; or
 - (b) the company secretary in practice conducting secretarial audit under section 204.

13. If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.
14. The auditor shall make a statement as to whether the remuneration paid by the company to its directors is in accordance with the provisions of section 197.

Boards' Report

Section 134 of Companies Act, 2013 mandates certain disclosures to be made in the Board's Report, additionally, a listed company is required to comply with disclosures requirement stated under the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015

1. The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director, if any, and the Chief Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.
2. The auditors' report shall be attached to every financial statement.
3. There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include—
 - (a) the web address, if any, where annual return referred to in sub-section (3) of section 92 has been placed
 - (b) number of meetings of the Board;
 - (c) Directors' Responsibility Statement;
 - (ca) details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government;
 - (d) a statement on declaration given by independent directors under sub-section (6) of section 149;
 - (e) in case of a company covered under sub-section (1) of section 178, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178;

- (f) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made –
 - (i) by the auditor in his report; and
 - (ii) by the company secretary in practice in his secretarial audit report;
- (g) particulars of loans, guarantees or investments under section 186;
- (h) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form;
- (i) the state of the company's affairs;
- (j) the amounts, if any, which it proposes to carry to any reserves;
- (k) the amount, if any, which it recommends should be paid by way of dividend;
- (l) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;
- (m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed;
- (n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;
- (o) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year; in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation of the performance of the Board, its Committees and of individual directors has been made;
- (p) such other matters as may be prescribed.

“Provided that where disclosures referred to in this sub-section have been included in the financial statements, such disclosures shall be referred to instead of being repeated in the Board’s report:

Provided further that where the policy referred to in clause (e) or clause (o) is made available on company’s website, if any, it shall be sufficient compliance of the requirements under such clauses if the salient features of the policy and any change therein are specified in brief in the Board’s report and the web-address is indicated therein at which the complete policy is available

- (3A) The Central Government may prescribe an abridged Board’s report, for the purpose of compliance with this section by One Person Company or small company
4. The report of the Board of Directors to be attached to the financial statement under this section shall, in case of a One Person Company, mean a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.
 5. The Directors’ Responsibility Statement shall state that –
 - (a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
 - (b) the directors had selected such 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 profit and loss of the company for that period;
 - (c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
 - (d) the directors had prepared the annual accounts on a going concern basis; and
 - (e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

It may be noted that the term “internal financial controls” means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

- (f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.
6. The Board’s report and any annexures thereto shall be signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.
 7. A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of—
 - (a) any notes annexed to or forming part of such financial statement;
 - (b) the auditor’s report; and
 - (c) the Board’s report.
 8. If a company contravenes the provisions of section 134 of the Companies Act, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

Company Auditor’s Report Order (CARO), 2016 – Reporting Requirements

The Ministry of Corporate Affairs (MCA) issued Company Auditor’s Report Order (CARO), 2016 on 29th March 2016. This order supersedes the earlier order (CARO 2015) and is applicable for reporting on financial statements of companies whose financial year commences on or after 1st April 2015.

1. The Existence of CARO, 2016

MCA was of the objective that there are certain particular issues which are important to be reported with the financial statements for certain entities as a part of their audit reports. The

auditor of such prescribed entities is required to report on the points mentioned under this order after performing procedures for verification of the same.

2. Applicability of CARO 2016

CARO 2016 is applicable to all the companies except the following (which) are specifically excluded from its purview:

- A. Banking Companies
- B. Insurance Companies
- C. Companies registered for Charitable Purposes
- D. One Person Company
- E. Small Companies (Companies with Paid up capital less than or equal to Rs. 50 Lakhs and Last reported turnover less than or equal to Rs. 2 Crores)
- F. The following Private Companies are also exempt from the requirements of CARO, 2016
 - (i) Not a holding or subsidiary of a Public company
 - (ii) Paid up Capital plus Reserves less than or equal to Rs. 1 Crore as at the reporting date
 - (iii) Borrowings less than or equal to Rs. 1 Crore at any time during the year
 - (iv) Revenue less than or equal to Rs. 10 Crores in the financial year

The auditors of all other class or classes of companies are required to report on the matters specified in this order. This order applies to foreign companies also and thus, the auditors for such companies are also required to report on the matters specified in CARO, 2016.

3. Matters specified in CARO 2016

The *Company Auditor's Report Order (CARO), 2016* includes the following matters on which the auditor is required to report mandatorily:

- A. Fixed Assets
- B. Inventory
- C. Loans given by Company
- D. Loan to Directors and Investment by the Company
- E. Deposits
- F. Cost records
- G. Statutory Dues
- H. Repayment of Loans
- I. The utilisation of funds
- J. Reporting of Fraud
- K. Approval of Managerial Remuneration

- L. Nidhi Company
- M. Related Party Transactions
- N. Private placement of Preferential Issues
- O. Non-Cash Transactions
- P. Registration under RBI Act

4. Reporting Requirement Under Each Clause

A brief of reporting requirements under each of the above clauses is hereunder:

A. Fixed Assets

- i. Whether the company maintains proper records showing full particulars including details of quantity and situation of the fixed assets
- ii. Whether physical verification of the fixed assets is conducted by the management at reasonable intervals
- iii. Whether any material discrepancies were noticed on physical verification and if so, whether it has been accounted for in books of accounts
- iv. Whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof

B. Inventory

- i. Whether at reasonable intervals the management has conducted physical verification of inventory
- ii. Whether any material discrepancies were noticed on physical verification and if so, whether it has been accounted for in books of accounts

C. Loans given by Company

Whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,

- i. Whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;
- ii. Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

- iii. If the amount is overdue, state the total amount overdue for more than 90 days, and whether reasonable steps have been taken by the company for recovery of the principal and interest.

D. Loan to Directors and Investment by the Company

Whether the loans and guarantees to directors are in order and in compliance with the limits prescribed.

E. Deposits

In case the company has accepted deposits,

- i. whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed thereunder, where applicable, have been complied with? If not, the nature of such contraventions be stated;
- ii. if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal, whether the same has been complied with or not?

F. Cost Records

Whether maintenance of cost records has been specified by the Central Government under sub-section (1) of Section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.

G. Statutory Dues

The auditor shall report whether the company

- i. is regular in depositing undisputed statutory dues including Provident Fund, employees' State Insurance, Income-tax, Sales-tax, Service Tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and
- ii. if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

Where dues of income Tax or sales Tax or service Tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

H. Repayment of Loans

If the company has defaulted in repayment of loans or borrowings to financial institutions, banks, government, debenture-holders, etc. then the amount and period of default is to be reported.

I. Utilisation of funds

Whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported

J. Reporting of Fraud

Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

K. Approval of Managerial Remuneration

Whether the limits prescribed under the Section 197 read with Schedule V of the Company's Act 2013 for managerial remuneration have been adhered to. If not, the amount of excess amount involved and steps for recovery being taken have to be reported.

L. Nidhi Company

In case of a Nidhi company, whether the following have been complied with:

- i. Maintain net owned funds to deposit in the ratio of 1:20 to meet out the liability
- ii. Maintain 10% unencumbered term deposits to meet out the liability

M. Related Party Transactions

Whether all transactions with the related parties are in compliance with section 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards

N. Private placement of Preferential Issues

Whether the company has made any preferential or private allotments of shares and debentures. Also, whether the amount Raised has been utilized towards the purpose for which it was raised. If not, provide the details in respect of the amount involved and nature of non-compliance

O. Non-Cash Transactions

Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with.

P. Registration under RBI Act

Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

Reasons to be stated for unfavourable or qualified answers.-

- (1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.
- (2) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

Meaning of CORPORATE GOVERNANCE

Corporate Governance is how a corporation is administered or controlled. It is a set of processes, customs, policies, laws and instructions affecting the way a corporation is directed, administered or controlled. The participants in the process include employees, suppliers, partners, customers, government, and professional organization regulators, and the communities in which the organization has presence. The main theme of corporate governance is to integrate sound management policies in the corporate framework in such a manner to bring economic efficiency in the organization in order to achieve twin goals of profit maximization and shareholder welfare.

Definitions of Corporate Governance

"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."

Objectives of Corporate Governance

The objectives of corporate governance include:

- To create social responsibility
- To create a transparent working system
- To create a management accountable for corporate functioning

- To protect and promote the interest of shareholders
- To develop an efficient organization culture
- To aid in achieving social and economic goals
- To improve social cohesion
- To minimize wastages, corruption etc.

Need of Corporate governance

The significance of good corporate governance system has widened because of the increasing conflict between ownership and management disciplines, the non-compliance of financial reporting by auditors which inflicts heavy losses on investors and lack of fair and transparent culture in the company which has lowered the investor trust in the financial viability of the company and its ethical standards. Thus there arises a need to imbibe a good corporate governance system for the betterment of all the stakeholders. It is important for the following reasons:

1. Corporate governance lays down the foundation of a properly structured Board and strives to a healthy balance between management and ownership which is capable of taking independent decisions for creating long-term trust between the company and external stakeholders of the company.
2. It strengthens strategic thinking at the top management by taking independent directors on the board who bring intellectual experience to the company and unbiased approach to deal with matters related to companies welfare.
3. It instills transparent and fair practices in the board management which results in financial transparency and integrity of the audit reports.
4. It sets the benchmark for the company's management to comply with laws in true letter and spirit while adhering to ethical standards of the company for bringing out effective management solutions in order to discharge its responsibility for smooth functioning of the company.
5. It inculcates loyalty among investors as their interest is looked after in the best manner by a company who adopts good management practices.

Corporate Governance under Companies Act, 2013

The Companies Act, 2013 has introduced various key provisions and mandatory disclosure requirements which have changed the corporate regime in such a way so as to run the corporate machinery in alignment with the globalised corporate world. The scope of corporate governance is no longer restricted to only listed public companies but it has also included unlisted public companies.

Some of the important areas of corporate governance introduced in Companies Act, 2013 has been introduction of :

1. Independent Director

Under the Companies Act, 2013 the strength of number of Independent directors for the prescribed companies under Section 149(4) read with Rule 4 of Companies (Appointment and Qualifications of Directors) Rules, 2014 is as follows:

Listed Public Company	At least one third of total number of directors
Unlisted Public Companies having turnover of 100 crores rupees or more	At least 2 directors
Unlisted Public companies having paid up capital of 10 crores rupees or more	At least 2 directors
Unlisted Public Companies with aggregate outstanding loans, debentures, and deposits, exceeding Rs. 50 crore	At least 2 directors

The terms and conditions of appointment of independent directors shall also be posted on the company's website.

2. Woman Director

Section 149(1) of the Companies Act, 2013 read with Rule 3 of Companies (Appointment and Qualifications of Directors) Rules, 2014 prescribes the following classes of companies to have at least one woman director.

- i. All listed companies
- ii. Non-listed public companies having paid up share capital of Rs.100 crores or more or having turnover of Rs.300 crores or more

3. Audit Committees

Section 177 of the Companies Act, 2013 and Rules 6 and 7 of Companies (Meetings of Board and its Powers) Rules 2014 deals with Companies Act, 2013 has increased the ambit of companies to constitute audit committees. The Audit Committee shall consist of a minimum of 3 directors with independent directors forming a majority. The majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement. It shall be applicable to all the listed public companies or nonlisted public companies having paid up share capital of Rs.10 crores or more, Turnover of Rs.100 crores or more, aggregate outstanding loan of Rs. 50 crores or more.

4. Composition of Nomination & Remuneration Committee & Stakeholder relationship Committee

Section 178(1) of the Companies Act and Rule 6 of Companies (Meetings of Board and its Powers) Rules 2014 deals with appointment of Nomination and Remuneration committee. The duty of the Committee shall be to identify the persons who are qualified to become directors and who can be appointed in the senior management and carry out the evaluation of directors. It shall specify the policy and manner for effective evaluation of performance of Board, its committees and individual director. Provided that such policy shall be placed on the website of the company, if any, and the salient features of the policy and changes therein, if any, along with the web address of the policy, if any, shall be disclosed in the Board's report

Section 178(5) prescribed appointment of stakeholder relationship Committee to resolve grievances of security holders of company. It shall be applicable to all the listed public companies or non-listed public companies having paid up share capital of Rs.10 crores or more, Turnover of Rs.100 crores or more, aggregate outstanding loan of Rs. 50 crores or more

5. Internal Audit

Companies Act, 2013 read with Rule 13 Of Companies (Accounts) Rules, 2014, has mandated the internal audit for certain classes of companies under Section 138.

Companies Act, 2013 has mandated the internal audit for certain classes of companies under Section 138.

These companies includes all the listed companies, all the non-listed companies having paid up share capital of Rs.50 crores or more, turnover of Rs.200 crores or more in the preceding financial year, outstanding loans or borrowings from the banks or public financial institutions of Rs.100 crores or more outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year, every private company having turnover of two hundred crore rupees or more during the preceding financial year; or outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

6. Serious Fraud Investigation Office (SFIO)

Section 211 (1) of the Companies Act, 2013 states that the Central Government shall establish an office called the Serious Fraud Investigation office to investigate fraud relating to Company. SFIO can investigate into the affairs of the company on receipt of report of Registrar or inspector or on intimation of a special resolution passed by a company that its affairs are required to be

investigated or in the public interest or on request from any Department of Central Government or State Government.

7. Corporate Social Responsibility

Section 135(1) of Companies Act, 2013 prescribes that every company having networth of Rs.500 crores or more, turnover of Rs.1000 crore or more, or net profit of Rs.5 crores or more during any the immediately preceding financial year shall constitute Corporate Social Responsibility Committee constituting of three or more directors with at least one independent director. Provided that where a company is not required to appoint an independent director under section 149(4) (i.e. Number of Independent Directors), it shall have in its Corporate Social Responsibility Committee two or more directors

Further, as per the CSR Rules, the provisions of CSR are not only applicable to Indian companies but also applicable to branch offices of a foreign company in India.

The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

VALUE ADDED STATEMENT

Introduction

Financial reporting has traditionally been concerned with the income statement, balance sheet and cash flow statement. Over the years, there have been initiatives to expand the financial reporting package. Accounting Standard Steering Committee (ASSC) of Britain suggested the inclusion of a value-added statement (VAS) along with conventional annual corporate reports in 1975.

Value added can be defined as the value created by the activities of a firm and its employees, that is, sales minus the cost of bought in goods and services. The value-added statement (VAS) reports on the calculation of value-added and its allocation among the stakeholders in the company.

The Value Added Statement is divided into two parts : The first part shows how Value Added is arrived at the end and the second part shows the application of such Value Added.

The value-added statement (VAS) is a voluntary disclosure and adds little information to that contained in the income statement. During the last two decades various theories have been used to explain voluntary and social disclosures. The fact that the VAS has attained such widespread publication despite being a relatively marginal disclosure, gives an early indication that the VAS

is not a neutral corporate social disclosure, but that it could be used to benefit those publishing it. VAS is used to alter perceptions about the company and in this way to manage stakeholder expectations.

Definition and Background of Value-Added and the Value-Added Statement (VAS)

The concept of value-added was initially used in 1790 in the first North American Census of Production (Gillchrist 1970). Trenché Cox, a treasury official, whose techniques have since been adopted by most industrial nations in the calculation of Gross National Product (GNP), was responsible for realizing that value-added would avoid double counting.

Value added has also been defined in the economic literature by Ruggles and Ruggles:

The value-added by a firm, i.e., the value created by the activities of the firm and its employees, can be measured by the difference between the market value of the goods that have been turned out by the firm and the cost of those goods and materials purchased from other producers. This measure will exclude the contribution made by other producers to the total value of the firm's production, so that it is essentially equal to the market value created by this firm. (1965, 50)

The VAS is therefore based on an economic definition of value-added and calculates value-added in accordance with the calculation of GNP.

Suojanen (1954) suggests that the value-added concept for income assessment help the management satisfy the various interest groups by providing more information that was not possible from the income statement and balance sheet. This makes him one of the first writers to use the value-added concept in terms of accounting for the results of an enterprise.

In general words, "Value-added can be defined as wealth generated by the entity through the collective efforts of capital providers, management and employees".

Distribution of Gross Value Addition

As per the concept of value added statement, gross value-added is distributed to employees in the form of salaries and wages, to government in the form of taxes and duties, to financier in the form of interest, to shareholders in the form of dividend the and remaining balance in business in the form of retained earning including depreciation.

Value-Added Statement

A simplified financial statement that shows how much wealth has been created by a company. A value-added statement calculates total output by adding sales, changes in stock, and other

incomes, then subtracting depreciation, interest, taxation, dividends, and the amounts paid to suppliers and employees.

Such value-added can be taken to represent in monetary terms the net output of an enterprise. This is the difference between the total value of its output and the value of the inputs of materials and services obtained from other enterprises. The value-added is seen to be due to the combined efforts of capital, management and employees, and the statement shows how the value-added has been distributed among each of these factors.

Advantages of Value-Added Statement –

It is an alternative performance measure to profit and therefore helps in the comparison of the performance of the company. Value added is superior performance measure because it pays attention on inputs which are under the control of the management.

By employing various productivity measures like value-added per rupee of capital employed, value-added per rupee sales, value-added per employee, etc., it helps in judging the productivity of the company.

Resource allocation decisions are normally based on the concept of maximizing profit, but value-added statement provides a better alternative by focusing on other factors rather than just profit.

It also helps in devising the incentives schemes for the employees of the company in a better way.

It reflects a broader view of the company's objectives and responsibilities rather than merely focusing on the small aspects of the company

Limitation of Value-Added Statement

There is a duality associated with the VAS in that it reports on the calculation of value-added and its application among the stakeholders in the company. Many inconsistencies are found in practice in both the calculation and presentation of value-added in the VAS. These inconsistencies make the statement confusing, non-comparable and unverifiable. The main areas of inconsistencies include, though not limited to, the following:

- The treatment of depreciation resulting in gross and net value-added;
- The treatment of taxes like pay-as-you-earn, fringe benefits and other benefits in the employees' share of value-added;
- The timing of recognition of value-added production or sales;

- The treatment of taxes such as VAT /GST and deferred tax; and
- The treatment of non-operating items.
- This has resulted in a company having more than one possible value-added figure and that the allocation of value-added between the various stakeholders can be presented in different ways.

DIFFERENCE BETWEEN VALUE ADDED AND PROFIT

Profit subtracts all the cost incurred in the process of generating revenues. The value added, on the other hand only subtracts the cost of bought-in goods and services. Profits are meant for shareholders whereas value added is meant for stakeholders who include shareholders also. Therefore, value added is a wider term.

FORMAT OF VALUE ADDED STATEMENT

ABC Company Ltd.
Value-Added Statement (Report or Vertical Form)
for the year ended 31st March

Particulars	Amount (Rs.)
A. Generation of Value-Added:	
Sales/Turnover (Including excise duties and sales tax excluding Returns, rebates & discounts, etc.)	xxx
± Stock of semi-finished and finished goods	xxx
Production value	xxx
Add: Income from services	xxx
Less : Bought-in-goods and services purchased from outsiders	xxx
Gross Value-Added (GVA)	xxx
Less : Depreciation and deferred Revenue expenses	xxx
Net Value-Added (NVA)	xxx
B. Application of Value-Added:	
Receipt by Workers/Employees	xxx
Receipt by Providers of Loan Capital	xxx

Receipt by Government	xxx
Receipt by Owners	xxx
Net Value-Added (NVA)	xxx

Extracts of Value-Added Statement Infosys Annual Report 2011-12

VALUE ADDED STATEMENT

	2012	% of VA	2011	% of VA	Growth (%)
Income	33,734		27,501		22.7
Less : Operating expenses excluding personnel costs					
Software development and business process management expenses	2,634		2,083		
Selling and marketing expenses	397		294		
General and administration expenses	1,647		1,304		
Value-Added from operations	29,056		23,820		22.0
Other income (including exceptional items)	1,904		1,211		
Total Value-Added	30,960		25,031		23.7
Distribution of Value-Added					
– Human resources					
Salaries and bonus	18,340	59.2	14,856	59.4	23.5
– Providers of capital					
Dividend(1)	2,699	8.7	3,445	13.8	(21.7)
Minority interest	–	–	–	–	–
Interest on debt	–	–	–	–	–
Taxes					
Corporate income taxes	3,367	10.9	2,490	9.9	35.2
Dividend tax(1)	438	1.4	568	2.3	(22.9)

Income retained in business					
Depreciation and amortization	937	3.0	862	3.4	8.7
Retained in business	5,179	16.8	2,810	11.2	84.3
Total	30,960	100.0	25,031	100.0	23.7

Note : The figures above are based on IFRS financial statements and they were considered on accrual basis

EXTRACTS OF VALUE ADDED STATE MENT OF BHARAT PETROLEUM CORPORATION LIMITED 2010-2011

Rs. in Crores

	2010-11	2009-10
HOW VALUE IS GENERATED		
Value of Production (Refinery)	71,660	55,153
Less : Direct Materials Consumed	(63,304)	(50,825)
Added Value	8,356	4,328
Marketing Operations	3,180	5,453
Value added by Manufacturing & Trading Operations	11,536	9,781
Add : Other Income and prior period items	1,745	2,185
Total Value Generated	13,281	11,966

Rs. in Crores

	2010-11	2009-10
HOW VALUE IS DISTRIBUTED		
Operations & Service Costs	5,162	5,509
Employees' Benefits		
Salaries, Wages & Bonus	1,507	1,606
Other Benefit	1,296	535
Providers of Capital		
Interest on Borrowings	1,101	1,011
Dividend	577	579
Income Tax	866	828
Re-Investment in Business		

Depreciation	1,655	1,242
Deferred Tax	148	(303)
Retained Profit	969	959
Total Value distributed	3,281	11,966

ECONOMIC VALUE ADDED

A critical concept in evaluating the performance of any business is termed as economic value-added. In generic terms, value-added refers to the additional or incremental value created by an activity or a business venture. Economic value-added is a refinement of this concept – it measures the economic rather than accounting profit created by a business after the cost of all resources including both debt and equity capital have been taken into account.

Economic Value-Added (EVA) is a financial measure what economists sometimes refer to as economic profit or economic rent. The difference between economic profit and accounting profit is essentially the cost of equity capital – an accountant does not subtract a cost of equity capital in the computation of profit, so in fact an accountant's measure of income or profit is in essence the residual return to that equity capital since all other costs have been deducted from the revenue stream. In contrast, an economist charges for all resources in his computation of profit – including an opportunity cost for the equity capital invested in the business – so an economist's definition and computation of the profit is net above the cost of all resources.

How to Calculate Economic Value-Added (EVA)

Note that, as in the traditional computation of earnings, interest on debt capital is subtracted from operating earnings (earnings before interest and taxes (EBIT)) to obtain net income. Then, an opportunity cost on equity capital is subtracted to obtain EVA. The opportunity cost on equity capital is computed as the equity or net worth of the business times a rate of return that reflects the rate required by investors in the business. This required rate is in reality an opportunity cost measured by the rate of return that could be obtained on equity funds, if they were invested elsewhere. A positive EVA means the firm is generating a return to invest capital that exceeds the direct, i.e., interest and opportunity cost of that invested capital; a negative EVA means that the firm did not generate a sufficient return to cover the cost of its debt and equity capital.

The followed tables gives a view how to calculate Economic Value-Added (EVA).

Earnings before Interest and Taxes (EBIT)	xxx
Less : Interest	xxx
Net Income	xxx

Less : Cost of Equity Capital	xxx
Economic Value-Added (EVA)	xxx

Expressed as a formula:

$EVA = NOPAT - (WACC \times \text{Capital Employed})$

Where NOPAT = "Net Operating Profit after Taxes"

WACC = Weighted Average Cost of Capital

Capital Employed / Invested Capital = Total Assets – Non interest-Bearing Current Liabilities

**Balance Sheet of ABC Limited
as on 31st March, 2012**

I. EQUITY AND LIABILITIES	Rs.
1. Shareholders' Funds	
Equity	400000
2. Non-Current Liabilities	
Long-Term Debt	600000
3. Current Liabilities	
(a) Account Payables	20800
(b) Bank Overdrafts	48400
TOTAL	1069200
 ii. ASSETS	
1. Non-Current Assets	
(a) Fixed Assets	1,000,000
2. Current Assets	
(a) Inventories	
(i) Raw Material	8640
(ii) Finished Goods	17136
(b) Account Receivable	42930
(c) Cash	494

TOTAL**1069200**

**Statement of Profit of
ABC Limited**

Sales	286200
Less: Operating Expenses	114840
EBIT	171360
Less: Tax Expenses	68544
NOPAT	102816

The average rate of return on similar types of companies is 20%, while risk-free return is 12.5%. Rate of return as charged by bank is 18%, and the tax rate is 40%.

Calculate Economic Value-Added.

Solution

Step 1: Calculation of Capital Employed

	Amount
Equity	4,00,000
Long-Term Debt	6,00,000
Bank Overdrafts	48,400
Total Capital Employed	10,48,400

Step 2: Calculation of Weighted Average Cost of Capital (WACC)

	Amount	Expected Return
Equity	4,00,000	80000 (400000 x 20%)
Long-Term Debt	6,00,000	45000 (600000 x 12.5% x 0.60)
Bank Overdrafts	48,400	5227.2 (48400 x 18% x 0.60)
Total Capital Employed	10,48,400	130227.2

$$\begin{aligned} \text{WACC} &= 130227.2/1048400 \\ &= 12.42\% \end{aligned}$$

Step 3:

$$\begin{aligned} \text{Economic Value-Added} &= \text{NOPAT} - \text{Weighted average cost of capital} * \text{Capital Employed} \\ &= \text{Rs.102816} - \text{Rs.130227.2} \\ &= \text{Rs.27411.2} \end{aligned}$$

What insight does EVA provide about financial performance of a business?

First, like any financial measure, the trend may be more valuable than the absolute value of EVA. Even if EVA is positive, a declining EVA suggests that financial performance is deteriorating over time, and if this trend continues EVA will become negative and financial performance unacceptable. A negative EVA indicates that the firm is not compensating its capital resources adequately, and corrective action should be considered if this negative EVA persists over time.

Corrective Action to Improve EVA

First, operating performance with respect to operating profit margins or asset turnover ratios could be improved to generate more revenue without using more capital.

Second, the capital invested in the business might be reduced by selling under-utilized assets. This strategy will simultaneously improve operating performance through a higher asset turnover ratio, as well as a reduced capital charge against those earnings because of a reduced debt or equity capital investment.

Third, redeploy the capital invested to projects and activities that have higher operating performance than the current projects or investments are exhibiting.

And fourth, if the business is not highly leveraged, change the capital structure by substituting lower cost debt for higher cost equity. Although this last strategy will decrease net income because of the higher interest cost, it will improve the EVA of the business because the total cost of debt and equity is reduced, and EVA measures the value created after all costs of capital (debt and equity) have been taken into account.

Advantages of EVA Analysis

In various cases, company pays bonuses to the employees on the basis of EVA generated. Since a higher EVA implies higher bonuses to the employees, it motivates the employees to work hard and generate higher revenue.

Using EVA, company can evaluate the projects independently, and hence can decide whether to execute the project or not.

It helps the company in monitoring the problem areas and taking corrective actions to resolve those problems.

Unlike accounting profit, such as EBIT, Net Income and EPS, EVA is based on the idea that a business must cover both the operating costs as well as the capital costs and hence it presents a better and true picture of the company to the owners, creditors, employees, shareholders and all other interested parties.

It also helps the owners of the company to identify the best person to run the company effectively and efficiently.

However, there are some disadvantages of EVA like it is difficult to compute, and also it does not take into account inflation into its calculation. Therefore, company should take into account above advantages and disadvantages before deciding whether to implement EVA or not.

MARKE T VALUE ADDED

Value based management and shareholder-value analysis is a well known concept. With the change of time newer related concepts such as MVA have gained importance.

Market value-added is the difference between the company's market and book value of shares. According to Stern Stewart, if the total market value of a company is more than the amount of capital invested in it, the company has managed to create shareholder value. If the market value is less than capital invested, the company has destroyed shareholder value.

Market Value-Added = Company's total Market Value – Capital Invested

With the simplifying assumption that market and book value of debt are equal, this is the same as Market Value- Added = Market Value of equity – Book value of equity.

Book value of equity refers to all equity equivalent items like reserves, retained earnings and provisions. In other words, in this context, all the items that are not debt (interest bearing or non-interest bearing) are classified as equity.

Market value-added (MVATM) is identical in meaning with the market-to-book ratio. The difference is only that MVA is an absolute measure and market-to-book ratio is a relative measure. If MVA is positive, it means that market-to- book ratio is less than one. According to

Stewart's Market value-added tells us how much value the company has added to, or subtracted from, its shareholders investment. Successful companies add their MVA and thus increase the value of capital invested in the company. In unsuccessful companies decrease the value of the capital originally invested decreases.

Whether a company succeeds in creating MVA or not depends on its rate of return. If a company's rate of return exceeds its cost of capital, the company will sell on the stock market with premium compared to the original capital. On the other hand, companies that have rate of return smaller than their cost of capital sell with discount compared to the original capital invested in company. Whether a company has positive or negative MVA depends on the rate of return compared to the cost of capital.

Market value-added can also be defined in relation to Economic Value-Added Measures (EVATM). EVA measures whether the operating profit is enough compared to the total cost of capital employed. Stewart defines EVA as the surplus of Net Operating Profit after Taxes (NOPAT) and after adjusting capital cost, where $\text{NOPAT} = \text{Profit after depreciation and taxes but before interest costs}$ and $\text{Capital Cost} = \text{Weighted average cost of capital} \times \text{capital employed}$ or $\text{EVA} = (\text{ROI} - \text{WACC}) \times \text{Capital employed}$.

He further defines the connection between EVA and MVA as: $\text{Market Value-Added} = \text{Present Value of All future EVA}$ by increasing EVA, i.e., a company increases its market value-added or in other words increases the difference between company's value and the amount of capital invested in it.

The relationship of MVA with EVA has its implication on valuation. By rearranging the formula, market value of equity can be defined as:

$\text{Market value of equity} = \text{Book value of equity} + \text{Present value of all future EVA}$.

Illustration

Company XYZ whose shareholders' equity amounts to 750,000. The company owns 5,000 preferred shares and 100,000 common shares outstanding.

The present market value for the common shares is 12.50 per share and 100 per share for the preferred shares.

Solution:

Market Value of Common Shares = $100,000 * 12.50 = 1,250,000$

Market Value of Preferred Shares = $5,000 * 100 = 500,000$

Total Market Value of Shares = $1,250,000 + 500,000 = 1,750,000$

Using the figures obtained above:

Market Value Added = $1,750,000 - 750,000 = 1,000,000$

SHAREHOLDER VALUE ADDED (SVA)

Shareholder Value-Added (SVA) represents the economic profits generated by a business above and beyond the minimum return required by all providers of capital. “Value” is added when the overall net economic cash flow of the business exceeds the economic cost of all the capital employed to produce the operating profit.

Therefore, SVA integrates financial statements of the business (profit and loss, balance sheet and cash flow) into one meaningful measure.

Shareholder value added = Net operating profit after tax - Cost of capital

The cost of capital is comprised of the company’s weighted average cost of debt and equity, which includes preferred stock.

The SVA approach is a methodology which recognizes that equity holders as well as debt financiers need to be compensated for bearing investment risk. The SVA methodology is a highly flexible approach to assist management in the decision-making process. Its applications include performance monitoring, capital budgeting, output pricing and market valuation of the entity.

ADVANTAGES OF ADOPTING SVA

To create value, management must have an understanding of the variables that drive the value of the business. An organization cannot act directly on value. It has to act on factors it can influence, such as client satisfaction, cost, capital expenditures, the debt / equity mix and so forth. Through an understanding of these drivers of value, management is able to establish a consistent dialogue, both internally and with the shareholders, regarding what needs to be accomplished to create value. The benefits of moving towards SVA include:

Overall, the value-based performance measures will result in greater accountability for the investment of new capital, as well as for the use of existing investments.

Organization will have the opportunity to apply a meaningful private sector benchmark to evaluate performance.

Managers will be provided with an improved focus on maximizing shareholder value.

Limitations of Adopting SVA

A limitation in the use of SVA as a performance measure is that, by nature, it is an aggregate measure. In order to analyze the underlying causes of any changes in calculated value between years, it is necessary to fully comprehend the value drivers and activities specific to a given firm.

There may be certain enterprises which are subject to any degree of price regulation. Hence, then it may not be possible for management to adjust output prices to achieve a commercial return in response to upward movements in input prices. Such a situation may result in SVA getting reduced even though there may have been no decrease in overall efficiency.

Similarly, a reduction in direct Government funding would result in a decrease in SVA.

Combined with the use of traditional accounting measures, a thorough knowledge of the value drivers of the business will assist in determining the underlying causes of fluctuations in the value-added measure.

Again, the use of SVA is not a substitute for detailed analysis of business drivers, rather it is an additional measurement tool with an economic foundation.

The cost of capital may be difficult to ascertain if a company is privately held, so restricting the use of this measurement to publicly held companies is advised.

CHAPTER-16

Forecasting Financial Statements

INTRODUCTION

The financial health and performance of entities shall be a matter of great concern for every stakeholder especially for government, regulators and investors reason being the scale and degree of illegal and unethical corporate practices which traumatize the entire world's business. Corporate scandals and failures in several corporations like Enron, WorldCom, and Arthur Andersen and Satyam scam (often termed as 'India's Enron') that raises debates whether entities should issue or use new-fangled perspectives to measure firm performance to maximize shareholders' wealth. The measurement of the financial health of an entity with the help of financial statements provides a qualitative analysis of the entities' position along with how the entities have effectively employed its capital in production. Similar view has been found in the research of Bhunia et al. (2011) that quantitative financial performance analysis through reported results in financial statements would be an indication of effectiveness and efficiency of resources utilization by management. Financial analysis encompasses the use of quantitative information from financial statements in order to establish relationships of the items that are reported by the company according to the accounting standards. By doing this, the entity is able to evaluate "Heart of Business Entity". It gauges the financial health of a potential investment. It provides detailed information about Strength and weakness of entity, Quality of Profit, Quality of Incomes and Revenue to its stakeholders.

According to section 2(40) of Companies Act, 2013 defines "financial statement" in relation to a company, includes a balance sheet as at the end of the financial year, a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year, cash flow statement for the financial year, a statement of changes in equity, if applicable; and any explanatory note annexed to, or forming part of, any document.

However, every action or inaction of entities / corporate is perceptible from financial statements. Hence, it got practical reliance since Kantilla's time Arthashastra which was written about 2400 years ago. In reality, there has been immense pressure on management to consistently report promising and favorable results of entities which does not reflect economic reality. Similar view has been found in research of Knee, Rockers & Jennings (1996) that entities have to report flattering results due to management pressure and further suggested that rosypicture of financial statements mostly keep shareholders satisfied with smooth income flows and consistent growth. Albrecht, Wrens & Williams (1995) opined strong financial pressure acted as typical incentives for management fraud and perceiving opportunity to commit and conceal a fraud.

FINANCIAL STATEMENTS

According to section 2(40) of Companies Act, 2013 defines “financial statement” in relation to a company, includes

- a Balance Sheet as at the end of the financial year,
- a Profit and Loss account, or (In the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year),
- Cash Flow Statement for the financial year,
- a Statement of Changes in Equity, if applicable, and
- any explanatory note annexed to, or forming part of, any document.

Financial Statements shall be considered as horoscope if one knows how to read and analyze it then probably by addressing the various early warning signal available in statements would have helped to great extent. The financial statement analysis investigates past, present and future financial, capital and income situation of entities based on information from various detailed components provided through financial statements. It also helps to depict and to interpret the financial situations and developments. The accounting financial

statements are considered as an open source of information as per legislation and their composition, disclosure and presentation structure would be unified by basic parameters. In fact, it provides basis for decision making and reflect the cumulative effects of all management's past decisions for different stakeholders. In nutshell, the purpose of financial statement is to facilitate the possibility of Multiple-Criteria Decision Analysis and to evaluate the effectiveness of the performance of entities.

Korableva and Kalimullina (2014) have observed in their research that timely and high-quality financial statements provide a universal picture of a legal entity's performance, effectiveness, financial stability and health. In fact, it diagnoses the causes of deviations from the previously established indicators and expose the idle resources of production. The essence of financial statements' analysis from the position of a user is to assess and evaluate most significant characteristics of entities which testify, in particular, about its success or the risk of bankruptcy. The analysis of financial statements depends on a specific goal for different users subject to the scale of its implementation and hence the analysis and direction of work can be different and useful for different interested stakeholders. Before we understand and learn about financial forecasting, it is very important to understand following terminologies in order to avoid confusions and ambiguities:

Forecast	A probable event where in the business is likely headed (Estimate of what is likely to happen.)

Budget	Future financial target or goals, which may or may not be equal to the forecast.
Projection	A blueprint of forward-looking business options in answer to “What would happen if”.(Scenario: What -if)
Pro Forma	The effects of a future transaction on past financial statements.

FINANCIAL FORECASTING: MEANING AND INTRODUCTION

Financial Forecasting is a process of estimating or predicting a company’s financial future by examining historical performance of data like revenue, cash flow, expenses, or sales. It is at the heart of driving business performance and stakeholder’s confidence. Financial projections performed to facilitate any decision-making relevant for determining future business performance. It is emphasized on concept of “Today’s Commitment for Tomorrow’s actions”. It basically includes the analysis of past business performance, current business trends, and other relevant factors. In fact, Business honchos who adopt and maintain financial forecasting bestpractices are better positioned to grow and to weather unexpected setbacks. Moreover, a financial plan that estimates the projected income and projected expenses of a business, and a solid financial forecast contains both macroeconomic factors and conditions that are specific to the organization. A thorough forecast includes but is not limited to short and long-term outlooks on conditions that could impact revenues and contingencies for expenditures not currently viewed as necessary.

Importance of Financial Forecasting

Financial forecasts are a crucial part of business planning, budgeting, operations, funding that help leaders andoutside stakeholders make better choices. Few important points have been pointed:

- It serves as the basis for budgeting decisions.
- It gives businesses access to cohesive reports, allowing finance departments to establish businessgoals that are both realistic and feasible.
- It provides management valuable insights into the way the business performed in the past and the wayit will compare in the future.
- It provides a barometer for those making material financial decisions.
- It facilities to build investor relations and Show investors and creditors that your corporate has well andstructured plan and is prepared for any unforeseen events impacting revenues and budgets.
- It provides customizable approach based on the core set of foundational components.
- To make accurate budget and facilitates to establish realistic business goals.

- With the help of accurate financial forecasting, problem areas can easily be traced out and company with remedial action plan can reduce the financial risk.
- Many times, accurate and authentic financial forecast reflecting higher Return on Investment and that helps to build and enhance the investor's confidence.

Financial Forecasting vs. Budgeting

Based on research and expert arguments, a concrete financial plan is built on both forecasting and sound spending guidance. It is important to note that the terms “financial forecasting” and “budgeting” are separate process and can't be used interchangeably. Financial forecasting is a critical first step in the budgeting process. Organizations that work hard to create reliable financial forecasts are more likely to build realistic budgets. Financial forecasting should always precede the budgeting process to ensure spending is in line with factors that can impact overall financial performance. Those who create budgets without financial forecasts are at risk of overspending and not having enough available cash for unexpected costs or shortfalls in revenue. Lacking a forecast may also keep the business from green lighting a new capital investment or launching a product that may have ended up being a growth driver.

<i>Basis</i>	<i>Forecast</i>	<i>Budget</i>
Meaning	Mere estimate of what is likely to happen.	Shows that policy and program to be followed in future period under planned conditions
Nature of Event	Probable	Proposed
Tool of control	No	Yes
Base	It's a preliminary step or base for budgeting	Forecasts are converted into budget
Hierarchy	It ends with forecast of likely events	It begins when forecasting ends.
Scope	Wider	Limited

Financial Forecasting Vs. Financial Projection

Financial forecast is a statement of management's expectations which is based on what top management reasonably expects will happen to and in the company and the expected financial impacts. This is the information that is published by publicly traded companies for stakeholders and the general public's review. While on the other hand, a financial projection essentially projects the

likely outcome of one or more hypothetical scenarios or assumptions. It is a tool used to explore business and market scenarios and predict outcomes before adjusting the company's plans. A financial projection is a snapshot of a possible business outcome that is often weighed in terms of probability.

In nut shell, both financial forecasts and financial projections are forward-looking statements and predict future outcomes based on specific assumptions. But it is important to understand demarcation line of difference between them:

Financial forecasts reveal what is likely to happen based on expected events and business conditions (i.e. Financial forecasts are ***what management expects to happen.***)

Financial projections are ***what might happen in any number of hypothetical scenarios.*** For example, keeping in the mind of current market conditions, and seasonal trends, the management of a wholesaler expects sales to increase by 7% over the next quarter. Therefore, a 7% sales increase is his financial forecast for the period. Whereas, company wants to make more profit than that, so he aims for an 10% sales increase. Therefore, his budget calls for an 10% sales increase. The management still expects the company to achieve only 7%, but he hopes for 10%, so he budgets accordingly and aims the sales team at that number. But rather than just crack a whip over the sales team, the Management runs several financial projections to find a way to improve their odds of reaching an 8% or larger sales increase.

FINANCIAL FORECASTING COMPONENTS AND FACTORS

Following components and factors should be considered and incorporated for financial forecasting:

- Define the purpose of financial forecasting
- Collection of historical data and accuracy of data sources
- A forward-looking time horizon (12-18-24 Month span)
- Formulas to determine how much weight to give any piece of data
- Consideration of an Internal and Macro-economic risk
- Best/Worst case (Revenue and Expenses) scenarios
- Selection of financial forecast method
- Documentation/Monitoring/Analysis of data

FINANCIAL STATEMENT FORECASTING

A common type of forecasting in financial accounting is based on pro forma statements. It focuses on a business's future reports which are highly dependent on assumptions made during preparation, such as expected market conditions. Because the term "pro forma" refers to projections or forecasts, pro-forma statements apply to any financial document incorporating Statement of P&L, Balance sheet and Cash flow statements. Various methods are used for forecasting financial statements. Basically there are two methods namely Quantitative methods and Qualitative methods. Quantitative forecasting methods are used to make assumptions about the future based on historical data. Whereas, Qualitative forecasting relies on experts' knowledge and experience to predict performance rather than historical numerical data. These forecasting methods are often called into question, as they're more subjective than quantitative methods and they can provide valuable insight into

forecasts and account for factors that can't be predicted using historical data. Both the methods are discussed below:

(1) Based on Revenue (% of Turnover)

As per this method, items like costs of goods sold (COGS), Stock and cash are calculated as a percentage of sales. Those percentages are then applied to future sales estimates to project each line item's future value. For example, COGS is likely to increase proportionally with turnover; therefore, it's to apply the same % estimate to each. To forecast the percent of sales, examine the percentage of each account's historical profits related to sales. To calculate this, divide each account by its sales, assuming the numbers will remain steady. For example, if COGS has historically been 30% of sales, assume that trend will continue.

(2) Moving Average Method

It is categorized into two parts namely, **The average or Weighted average** of previous periods to forecast the future. It is closely scrutinizing a business's high or low demands. Hence, it is more suitable for short-term forecasting. For example, you can use it to forecast next month's sales by averaging the previous quarter. Using weighted averages to incorporate current periods can increase the accuracy of moving average forecasts. For Moving Average:

$$P1+P2+P3.../N$$

P = Average for a period

N = Total number of periods

(3) Constant Growth Rate

It assumes a company's historical growth rate will remain constant. Forecasting future revenue involves multiplying a company's previous year's revenue by its growth rate. Say, if Growth rate was

12% in 2021-22 (i.e. P.Y), then, Constant rate @12% forecasting for 2022-23 (Next year) shall be considered as it excludes market fluctuations or supply chain issues.

(4) Regression Method

This method is based on a relationship between two variables□: dependent and independent. The dependent variable represents the forecasted amount, while the independent variable is the factorthat influences the dependent variable. E.g. Advertisement expense (Independent Variable) and Sales (Dependent). It means change in advertisement expense would lead to change in sales. It is based on equation:

$$Y = BX + A$$

Y= Dependent variable (Forecasted

number)B = Slope line

X = Independent

variableA = Y-intercept

(5) Delphi Method

The Delphi method i.e. Estimate-Talk-Estimate Technique (ETE) is a systematic and qualitative method offorecasting by collecting opinions from a group of financial experts through several rounds of questions. The Delphi method relies on experts who are knowledgeable about a specific area so they can forecast the outcome of future scenarios, predict the likelihood of an event, or reach consensus about a particular

topic. The financial experts then fill out another questionnaire that gives them the opportunity to provide updated opinions based on what they understand from the summary report. It is one of most important qualitative method.

FORECASTING OF PROFIT & LOSS (PROFITABILITY PROJECTIONS)

Typically, the starting point for Profit & Loss forecasting is to forecast of sales revenue. Moreover, the sales production is closely interrelated. Hence they should be estimated together. Few points should be considered while projection of profitability:

- It is advisable not to assume full Capacity utilization in the beginning year of operation. It meanscapacity utilization should be low in beginning years and rise gradually to reach the maximum level.
- It may be assumed that sales and production would be equal. Hence, adjustments towards finish goodsstock is not required.
- Revenue shall be considered net of excise duty.

- So far as, the cost of production is concerned, the requirements of material per unit of output shall be considered and prices of are defined in Cost, Insurance and Freight (CIF) terms.
- Inflation factor shall be ignored and present cost of material shall be considered.
- Seasonal fluctuations in prices must be considered while

estimation. Following statement may be used for Profitability

Projections :

<i>Particulars</i>	<i>Amount Rs</i>
Revenue (Sales)	***
Less: Variable Cost	***
Contribution	***
Less: Fixed Cost	***
• Depreciation	
• Other	
EBIT	***
Less: Interest	***
EBT	***
Less: Tax	***
EAT (PAT) [Profit for the Year]	***

Case: 1

You are the Company Secretary of DP Ltd and assigned task of profitability projections of difference scenarios based on historical data provided: (Rs in Cr.)

Revenue (Sales)	200
Variable cost (60% of Sales)	120
Fixed Cost (others)	20
Depreciation	25
Taxes	10
Cash flow from operation	50
Net Cash flow	50

Company is forecasting that sales will be increased by 37.5% approximately keeping in the mind of Market forces whereas, the variable cost will be forecasted at 56% of sales. Company is in the anticipation of having fixed cost of Rs.15 cr. On the other side (i.e.) on worst situation, Company is forecasting the that sales will be curb by 25% approximately keeping in the mind of Market forces whereas, the variable cost will be forecasted at 65% of sales. Company is in the anticipation of having fixed cost of Rs. 25 cr. It is forecasted that depreciation remains unchanged in case of any scenario and tax rate shall be applicable at 28.57%.

Solution:

Statement showing Profitability Projection (Rs in Cr.)

Particulars	Historical Data	Optimistic Scenario	Pessimistic Scenario
Sales	200	275 (200+37.5%)	150 (200-25%)
Less: Variable cost	(120) (60% of sales)	(154) (56% of 275)	(97.5) (65% of 150)
Contribution	80	121	52.5
Less: Fixed Cost			
• Other	(20)	(15)	(25)
• Depreciation	(25)	(25)	(25)
EBIT/EBT	35	81	2.5
Less: Tax (28.57%)	(10)	(23.14)	(0.71)
EAT	25	57.86	1.79

So, it can be seen from the above forecasting that, in case of optimistic scenario, company may earn profit Rs. 57.86 crores (i.e. increase in profitability 131% approx.) against the historical data. While, profitability will be lower projected in worst situation i.e. around Rs. 1.79 cr. (i.e., Decrease in profitability 93% approx. as

FORECASTING OF CASH FLOW STATEMENT

It is a statement of change in Cash and cash equivalents. Statement covers three activities namely Net Cash from Operating Activities, Net Cash from Investing Activities, and Net Cash from Financing Activities. Basically, Cash Flows are Inflows and Outflows of cash and cash equivalents. It is normally prepared and presented for each period for which financial statements are presented. Cash Flow arises when the net effect of transaction is either increase or decrease the amount of cash and cash equivalents. Let's understand different activities briefly:

(1) Operating Activities:

So far as operating activities is concerned, they are the principal revenue producing activities of business and generally result from the transactions and other event that enter into the determination of net profit or loss. It reflects Company's ability to generate adequate operating cash flow helps in gaining confidence of the external parties like lenders and investors. Company with high surplus cash flow from operation has high market capitalization and which indicates quality of earnings.

Net Profit Vs Cash from Operating Activities

Points	Net Profit	Cash from Operating Activities
Meaning	It indicates net result of operating and non-operating activities carried out during accounting year.	It indicates cash flow as result of operating activities.
Non-Cash Items	It is computed after taking into consideration the effect of Non-cash items.	It is computed excluding the effect of Non-cash items as it is merely book entries.
Note: ● It's not profit that repays loan; it is the cash that repays loan. ● Non-cash items (shown as foot note) include ● Depreciation ii. Issue of shares/debentures for consideration other than cash iii. Conversion of debentures into equity shares iv. Purchase of business by issue of shares		

(2) Investing Activities:

It basically deals with Proceeds from sale/disposal of Non-Current Assets (whether Tangible/Intangible/ Depreciable/Non-Depreciable) and Non-Operating incomes from investments shall be added such as :

- i. Dividend received on shares held as investment
- ii. Interest received on debentures held as investment
- iii. Rent received from property held as investment

Lenders will be able to know where company has deployed the cash. Whether company has acquired assets related to business, purchased machinery or made investment outside business. If company keeps investing in the CAPEX that indicates the company is focused on capacity building for future growth. If company keeps investing in financial assets like shares, debentures

etc would indicate that management is not very much focused on expansion.

(3) Financing Activities:

It demonstrates the nature of capital structure of entity and reflects the picture of borrower's financing policy. As a lender, it is inevitable to match dividend pay-out with operating cash flow. Amount of dividend should not exceed the operating cash flow.

Following statement may be used for Cash Flow Forecasting :

<i>Particulars</i>	<i>Amount Rs</i>
Net Cash From Operating Activities [A]	***
Net Cash From Investing Activities [B]	***
Net Cash From Financing Activities [C]	***
Total A+B+C	***
Add: Opening balance of Cash and Cash Equivalents	***
Closing balance of Cash and Cash Equivalents	***

Following Points to be considered while preparing cash flow projections

- It's not profit that repays loan; it is the cash that repays loan.
- It is important to disassociate the cash position from the profit of business entity.
- Timing of revenue recognition and expenses don't match with timing of cash inflow and outflow.
- Banks should shift to cash flow-based lending from traditional assets-based lending.
- If company is not doing well, sales and net profit may increase due to window dressing of account but quality of earning (i.e., operating cash flow) may decline.
- If Net operating cash flow shows consistently declining trend over the period of 3-5 years, it's an indication of incipient sickness.
- If company keeps investing in the CAPEX that indicates the company is focused on capacity building for future growth.
- If company keeps investing in financial assets like shares, debentures etc would indicate that management is not very much focused on expansion.
- As a lender, it is inevitable to match dividend pay-out with operating cash flow.
- Amount of dividend should not exceed the operating cash flow.

Case:2

Following is the balance sheet of XL Ltd at the end of 2022 is as follows and you are required to forecast Cash flow for 2023. (Rs. in cr.)

Liabilities	Amount Rs	Assets	Amount Rs
Share Capital	100	Fixed Assets	180
Reserves and Surplus	20	Current Assets:	
Secured Loans	80	Cash	20

Unsecured Loans	50	Trade Receivables	80
Current liabilities	90	Inventories	80
Provisions	20		
Total	360	Total	360

The projected Profit & Loss for the year 2023 is given below:

Revenue from operation	400
Cost of Goods Sold	300
Depreciation	20
Profit Before Interest and taxes	80
Interest	20
PBT	60
Tax	30
PAT	30
Dividend	10
Retained Earnings	20

During the year 2023, company has forecasted to raise secured term loan of Rs. 20 crore and repay of previous term loan to the extent of Rs. 5 crore and increase unsecured loan by Rs. 10 crore. It

is forecasted that current liabilities and provisions remains unchanged. While, company is planning to buy fixed assets worth Rs. 30 crore and increase the inventories and receivables by Rs. 10 crore and Rs. 15 crore respectively. Company is in the projection of paying dividend of Rs. 10 crore. Assuming other asset would remain unchanged except cash.

Solution:

Statement showing forecasted Cash Flow

<i>Particulars</i>	<i>Amount (Rs.)</i>
Profit before Interest and Taxes	80
<i>Add:</i> Depreciation	20
Operating Profit before Working Capital Changes	100
<i>Less:</i>	
• Increase in Inventories	(10)
• Increase in receivables	(15)

Cash Generated from Operation	75
<i>Less:</i> Tax	(30)
Net Cash Flow from Operating Activities [A]	45
Increase in Fixed Assets (CAPEX)	(30)
Net Cash flow from Investing Activities [B]	(30)
Increase in Secured Loan (20-5)	15
Increase in Unsecured Loan	10
Interest	(20)
Dividend	(10)
Net Cash flow from Financing Activities [C]	(5)
A+B+C	10
<i>Add:</i> Opening balance of Cash and Equivalents (Refer Balance sheet)	20
Closing balance of Cash and Equivalents	30

FORECASTING OF BALANCE SHEET

The balance sheet, showing the balances in various assets, equity and liabilities of corporates and which reflects the financial conditions of firms at given point of time. The forecasted balance sheet may be prepared based on following format.

Particulars	Note No.	Figures for Historical data	Figures for forecasted data
I. EQUITY AND LIABILITIES			
1. Shareholders Fund a. Share capital b. Reserves and Surplus (e.g., Debit balance of P&L as negative figure) c. Money received against share warrants 2. Share application Money Pending Allotment 3. Non-Current Liabilities a. Long term borrowings b. Deferred Tax Liabilities c. Other Long-term liabilities d. Long term Provisions			
4. Current Liabilities a. Short term Borrowings b. Trade payables c. Other Current Liabilities d. Short term Provisions			
Total			
II. ASSETS			
(1) Non-Current Assets a. Fixed Assets i. Tangible assets ii. Intangible assets iii. Capital Work in progress iv. Intangible assets under Developments b. Non-current Investments c. Deferred Tax Assets (Net)			

d. Long term loans and Advances e. Other Non-current Assets (2) Current Assets a. Current Investments b. Inventories c. Trade Receivables d. Cash and Cash Equivalents e. Short term loans and advances f. Other Current Assets			
Total			

<i>Liabilities</i>	<i>Amount Rs</i>	<i>Assets</i>	<i>Amount Rs</i>
Share Capital	100	Fixed Assets	180
Reserves and Surplus	20	Current Assets:	
Secured Loans	80	Cash	20
Unsecured Loans	50	Trade Receivables	80

The projected Profit & Loss for the year 2023 is given below:

Unsecured Loans	50	Trade Receivables	80
Current liabilities	90	Inventories	80
Provisions	20		
Total	360	Total	360

Revenue from operation	400
Cost of Goods Sold	300
Depreciation	20
Profit Before Interest and taxes	80
Interest	20
PBT	60
Tax	30
PAT	30
Dividend	10

During the year 2023, company has forecasted to raise secured term loan of Rs. 20 crore and repay of previous term loan to the extent of Rs. 5 crore and increase unsecured loan by Rs. 10 crore. It is forecasted that current liabilities and provisions remains unchanged. While, company is planning to buy fixed assets worth Rs. 30 crore and increase the inventories and receivables by Rs. 10 crore and Rs.15 crore respectively. Company is in the projection of paying dividend of Rs. 10 crore. Assuming other assets would remain unchanged except cash.

Solution:

Statement showing forecasted Balance Sheet

<i>Equity and Liabilities</i>	<i>Note</i>	<i>Historical (Rs. in core)</i>	<i>Forecasted (Rs. in core)</i>	
Shareholders Fund:			Changes	Rs
Share Capital		100	-	100
Reserves and Surplus		20	20 (Retained Earning)	40
Non-Current Liabilities				
Secured Loans		80	+20 (Addition) -5 (Repayment)	95
Unsecured Loans		50	+10 (Addition)	60
Current Liabilities		90	-	90
Provisions		20		20
Total				405
Assets				
Non-Current Assets:				
Fixed Assets		180	+30 (CAPEX) -20 (Depreciation)	190
Current Assets:				
Cash		20		30 (Balancing Amount)
Inventories		80	+10 (Increase)	90
Trade Receivables		80	+15 (Increase)	95
Total				405

Cash Flow Projections

Points to be considered:		
Estimation of CashFlow	• Cash outflow (Cash outlay) • Cash Inflow	
Cash Outflow	• Estimated by Engineering & Product Development	
Revenue Projection	• Estimated by Marketing Group	
Operating Cost	• Estimated by Production people, CMA, Purchase Managers, Personnel executives, tax payers and others	
Overall coordination	• By Finance Managers	
Cash flow stream	Initial Investment	• After tax Cash outlay on CAPEX & NWC (At the time of Set up of Project)
	Operating Cash inflows	• After tax cash inflow from operation of project <i>during economic life.</i>
	Terminal Cash inflows	• After tax cash inflow from Liquidation of project <i>at the end of economic life.</i>
Time horizon of cashflow analysis	1. Physical life of plant 2. Technological life of plant 3. Product Market Life of plant 4. Investment planning horizon of the firm	
Best Measurement Criteria (Cash flow)	• Profit cannot be spent • Profit is subjective and Judgment based	

Factors focusing cash flow	● Depreciation ● Change in Working capital ● Deferred tax ● Capitalization of R&D Expenses ● Opportunity costs
List of Relevant cash flows for decision making	● Cost of New Plant/Machine ● Scrap Value (Salvage/Residual Value) of old/New Plant/Machine ● Working Capital ● Cost reduction/Saving ● Tax liability/Benefits
List of Irrelevant cash flows:	● Sunk Cost ● Allocated overheads ● Committed cost (Fixed Cost) ● Non-cash items (Depreciation)

Note:

Particulars	Free Cash Flow to Firm (FCFF)		Free Cash Flow to Equity (FCFE)	
Meaning	Cash Flow available to both equity and debt holders		Cash Flow available to common equity shares holders	
Leverage	Excludes (i.e. unlevered Cash Flow)		Includes	
Application	To compute Enterprise Value		To compute Equity Value	
Risk Factor	WACOC (i.e. Ko)		Ke	
Formula	Profit after Tax ‘PAT’	**	Profit after Tax ‘PAT’	* *
	Add: Depreciation and NC*	**	Add: Depreciation and NC*	* *
	Cash Flow After Tax	**	Cash Flow After Tax	* *
			Less: Preference Dividend	
	Less: Change in Working Capital	**	Less: Change in Working Capital	* *
	Less: Change in investment ^{\$}	**	Less: CAPEX	* *
	FCFF	**	Less: Repayment of Debt/Pref.	* *
	OR		Add: Proceeds from Debt/Pref.	
	Cash Flow from operation	**	Add: New debt issue	
	Add: Interest*(1-t)	**	FCFE	* *
	Less: CAPEX	**		
	FCFF	**		
	^{\$} investment includes total debt and preference share capital also. *NC – Non-cash charges			

Basic Principles and Biases of Cash flow Estimation			
Separation Principle	● Cash flow associated with Investment side and financing side should be separated. ● Focus on Net Operating Profit After Tax [i.e. PAT + Interest(1-t)]		
Incremental Principle	● Focus on Cash flow for firm with project less without project.		
Post Tax Principles	● Cash flow should be measured on “After Tax Basis”. ● Important issues: 1. What tax rate should be used to assess tax liability? 2. How to treat losses? 3. What is the effect of non-cash charges?		
	[1] What tax rate should be used to assess tax liability? ● Use Marginal Rate of tax instead of Average Rate of Tax		
	[2] How to treat losses?		
	Alt	Project	Firm Action
	1	Loss	LossDefer Tax Saving
	2	Loss	ProfitTake tax saving in yr of loss
	3	Profit	LossDefer taxes until firm makes profit
	4	Profit	ProfitConsider tax in yr of profit
	Stand alone	Loss	-Defer tax saving until project makes profit
	[3] What is the effect of non-cash charges? Examples: i. Depreciation ii. Issue of shares/dentures for consideration other than cash iii. Conversion of debentures into equity shares iv. Purchase of business by issue of shares v. Deferred Tax Charge (or Benefit) and MAT Credit entitlement. <i>Note:</i> Tax benefit of depreciation (Depreciation*Marginal Tax Rate)		
	Deferred Tax Liability or Assets: ● There is a difference between taxable income (As per Income Tax Regulations) andAccounting Profit (As per GAAP) ● Difference may be permanent or temporary ● Permanent Difference (i.e. Some income is exempted but included in accountingprofit) ● Temporary Difference (Timing Difference)		
	➤ Depreciation charged as per WDV for taxable income but as per SLM for accounting profit. ➤ Differences are found on year to year but total depreciation charges over the life of asset would be same under both the methods. ● When Deferred Tax Liability or Assets arises?		

	Because of temporary difference between taxable income and accounting profit. Deferred Tax Liability (Assets) is recognized when charge in the financial statements is less (More) than the amount allowed for the tax purpose.
Consistency Principle	● Cash flow and discount rates applied to these cash flows must be in consistent with respect to investor group and inflation. ● Free Cash Flow to Firm ● Free Cash Flow to Equity ● Incorporate the expected inflation in the estimates of future cash flow and apply nominal discount rate (NDR). ● $NDR = [(1 + RDR) * (1 + EIR)] - 1$ Where, RDR=Real Discount Rate EIR = Expected Inflation Rate
Biases in Cash Flow Estimation	Because of the nature of cash flow estimation, it deals with future and errors in estimation are bound to occur. Hence, critical importance of forecasting of cash flow is given and adequate care should be given to guard against certain biases which may lead to overstatement or understatement of profitability and don't reflect true and fair view of corporate performance. Overstatement of profitability in terms of executives faulty planning, over optimism which mainly deals with cognitive bias and organizational pressure. Whereas Understatement of profitability deals with under estimation of salvage value, ignorance of intangible benefits and sometimes value of future options will be overlooked.