PERIYAR UNIVERSITY

Reaccredited by NAAC with 'A++' Grade - State University,

Salem-636 011, Tamil Nadu, India.

CENTRE FOR DISTANCE AND ONLINE EDUCATION (CDOE)

MASTER OF COMMERCE

SEMESTER II

SELF-LEARNING MATERIAL

Prepared by:

Centre for Distance and Online Education (CDOE),

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<table>
<tr><th rowspan="2">Subject Code</th><th rowspan="2">Subject Name</th><th rowspan="2">Category</th><th rowspan="2">L</th><th rowspan="2">T</th><th rowspan="2">P</th><th rowspan="2">O</th><th rowspan="2">Credits</th><th rowspan="2">Inst. Hours</th><th colspan="3">Marks</th></tr>
<tr><th>CIA</th><th>External</th><th>Total</th></tr>
<tr><td></td><td>Corporate Accounting</td><td>Soft Skills</td><td>-</td><td>-</td><td>2</td><td>-</td><td>2</td><td>30</td><td>25</td><td>75</td><td>100</td></tr>
<tr><th colspan="12">Course Objectives</th></tr>
<tr><td>1</td><td colspan="11">To understand the accounting treatment for issue of shares</td></tr>
<tr><td>2</td><td colspan="11">To determine profits for fire and marine insurance</td></tr>
<tr><td>3</td><td colspan="11">To prepare consolidated financial statement</td></tr>
<tr><td>4</td><td colspan="11">To account for price level changes</td></tr>
<tr><td>5</td><td colspan="11">To adopt financial reporting standards</td></tr>
</table>

SYLLABUS

UNIT	Details	No. of Hours	Course Objectives
I	**Issue of Shares and Final Accounts of Companies** Issue of Shares: ESOPs - ESPS - Sweat Equity Shares – Book Building-Buy-back of Shares- Conversion of debentures into shares - Final accounts of Companies as per Schedule III of the Companies Act, 2013 – Managerial remuneration.	6	C1
II	**Insurance Company Accounts** Insurance Company Accounts: Types of Insurance - Final accounts of life assurance Companies- Ascertainment of profit- Valuation Balance Sheet- Final accounts of Fire, Marine and miscellaneous Insurance Companies.	6	C2
III	**Consolidated financial statements** Consolidated financial statements as per AS 21: Consolidated Profit and Loss Account– Minority interest – Cost of control – Capital reserve – Inter-company holdings – Preparation of consolidated	6	C3

	Balance Sheet		
IV	**Contemporary Accounting Methods** Accounting for price level changes - Social responsibility accounting - Human resource accounting - Forensic Accounting.	6	C4
V	**Financial reporting:** Meaning, Objectives, Characteristics – Indian Accounting Standards (AS 5, AS 10, AS 19, AS 20) – Corporate Social Responsibility: Meaning, Key provisions of Companies Act, 2013, Accounting for CSR expenditure, Reporting of CSR, Presentation	6	C5
	Total	30	

Course Outcomes	On completion of this course, students will	Programme Outcomes
CO1	Determine profit and financial position by preparing financial statements of companies as per schedule III of Companies Act,2013	PO4, PO6
CO2	Apply the provisions of IRDA Regulations in the preparation of final accounts of Life Insurance and General Insurance Companies	PO4, PO6
CO3	Determine the overall profitability and financial position by preparing consolidated financial statements of holding companies in	PO4, PO6
CO4	Analyse contemporary accounting methods	PO4, PO6
CO5	Examine Financial Reporting based on appropriate Accounting Standards and provisions of Companies Act 2013 with respect to Corporate Social Responsibility.	PO4, PO6

Reading List

1. Maheshwari S. N., Sharad K. Maheshwari &Suneel K. Maheshwari, (2022),“Advanced Accountancy - Volume I &II”, 11th Edition, Vikas Publishing House Pvt. Ltd., New Delhi.

2. Reddy T. S. &Murthy A., (2022), “Corporate Accounting – Volume I &II”, 17th Edition, Margham Publications, Chennai.

References Books	
1.	Arulanandam M.A &Raman K.S., (2021), "/
2.	Shukla M C, Grewal T S and Gupta S C, (2022), "Advanced Accounts Volume
3.	Gupta R. L., (2022), "Problems and Solutions in Company Accounts",2nd Edition,Sultan Chand &Sons, New Delhi
4.	Reddy T. S. &Murthy A., (2022), "Corporate Accounting – Volume I &II", 17th Edition, Margham Publications, Chennai.
5.	Maheshwari S. N., Sharad K. Maheshwari &Suneel K. Maheshwari, (2022),"Advanced Accountancy - Volume I &II", 11th Edition, Vikas Publishing House Pvt. Ltd., New Delhi.

TABLE OF CONTENTS

	Meaning, Objectives, Characteristics – Indian Accounting Standards (AS 5, AS 10, AS 19, AS 20) – Corporate Social Responsibility: Meaning, Key provisions of Companies Act, 2013, Accounting for CSR expenditure, Reporting of CSR, Presentation	

Unit I

Issue of Shares and Final Accounts of Companies

Issue of Shares: ESOPs - ESPS - Sweat Equity Shares - Book Building- Buy- back of Shares - Conversion of debentures into shares - Final accounts of Companies as per Schedule III of the Companies Act, 2013 – Managerial remuneration.

UNIT I - ISSUE OF SHARES AND FINAL ACCOUNTS OF COMPANIES

1.1 ISSUE OF SHARES

The term "issue of shares" refers to the process by which a company offers and sells its shares to investors or shareholders. It involves the creation and allocation of new shares or the transfer of existing shares to new owners, resulting in a change in the ownership structure of the company. Here are some key points to understand about the issue of shares:

1. Share Capital: Shares represent ownership in a company and are typically divided into units of equal value called shares. The total value of all shares issued by a company is referred to as its share capital.

2. **Types of Shares:** Companies can issue different types of shares, such as common shares (also known as ordinary shares) and preferred shares. Common shares usually carry voting rights and provide ownership participation in profits and assets. Preferred shares may have certain preferential rights, such as priority in dividend payments or liquidation proceeds.

3. **Reasons for Issuing Shares:** Companies issue shares for various reasons, including raising capital for expansion, funding new projects, reducing debt, acquiring assets or other companies, rewarding employees through stock options or employee share ownership plans, or complying with regulatory requirements.

4. **Share Issuance Methods:** Shares can be issued through different methods, such as initial public offerings (IPOs), rights issues, private placements, or bonus issues. An IPO involves offering shares to the general public for the first time, while rights issues allow existing shareholders to purchase additional shares at a discounted price. Private placements involve offering shares to a select group of investors, often institutional investors, without a public offering

5. **Share Subscription Process:** The process of issuing shares typically involves several steps, including obtaining necessary approvals from shareholders or regulatory authorities, determining the number and price of shares to be issued, preparing offering documents or prospectuses, receiving applications from potential investors, allotting shares based on the subscription process, and collecting payment for the shares.

6. **Dilution of Ownership:** The issue of new shares can lead to dilution of ownership for existing shareholders. When new shares are issued, the ownership percentage of existing shareholders may decrease unless they participate in the share issuance or exercise pre-emotive rights, if available.

7. **Legal and Regulatory Considerations:** The issue of shares is subject to legal and regulatory requirements specific to the jurisdiction in which the company operates. These requirements may include compliance with securities laws, stock exchange regulations, and disclosure obligations to protect the interests of investors and ensure transparency in the capital markets. The issue of shares is an important mechanism for companies to raise capital and finance their operations. It provides opportunities for investors to participate in the growth and success of a company by becoming shareholders. The process is governed by various legal and

regulatory frameworks to ensure fairness, transparency, and investor protection.

1.2 ESOP

Employee Stock option plan or Employee Stock Ownership Plan (ESOP) is an employee benefit scheme that enables employees to own shares in the company. These shares are purchased by employees at price below market price, or in other words, a discounted price. The purpose of providing ESOP is to make the employee more committed towards the company. In other words, ESOP motivates the employee to be committed towardsthe company for a long term and also take ownership of the company.

If the employees are provided with a sense of ownership of the company by making them shareholders of the company, this will result in the employees focusing more on performing better for the company.

However, in order to claim the benefits of the ESOP, the employees have to wait for a certain time period which is known as the vesting period. After the completion of the vesting period the employees can purchase the specified amount of shares.

ESOPs are awarded to employees based on tenure or on performance. Therefore, it serves

- ❖ It acts as a source of motivation for the employees after making them shareholders of the company. Owning a stock makes them more responsible towards the company and they provide betterperformance for increasing the value of shares of the company.
- ❖ It helps the business owners in retaining the employees and ensures better performancefor their works.

Benefits of ESOP

Following are the benefits of ESOP

- ✧ It acts as a source of motivation for employees who will be benefiting when the pricesof the company shares rise in the market.
- ✧ It helps to retain employees in the organization
- ✧ Employees are benefited for the hard work they perform in trying times.
- ✧ It helps in preventing a significant amount of cash outflow from the company.

1.3 Employee Stock Purchase Scheme (ESPS)

An Employee Stock Purchase Scheme (ESPS), also known as an Employee Stock Purchase Plan (ESPP), is a program offered by a company that allows its employees to purchase company shares at a discounted price. The scheme aims to provide employees with an opportunity to become shareholders in the company they work for. Here's a closer look at the meaning and objectives of an Employee Stock Purchase Scheme:

1. **Meaning:** An ESPS is a voluntary benefit program that allows eligible employees to set aside a portion of their salary to purchase company shares. The shares are typically offered at a discounted price, which can be below the market value. The company sets specific rules and parameters for the scheme, such as the discount rate, contribution limits, and holding periods.

2. **Employee Ownership:** The primary objective of an ESPS is to foster a sense of ownership and alignment between employees and the company's success. By allowing employees to invest in company shares, it creates a direct link between their performance, efforts, and the financial performance of the company. It can enhance employee engagement, loyalty, and motivation.

3. **Financial Benefits:** Employees participating in an ESPS can potentially benefit from the appreciation of the company's stock value over time. If the share price increases, employees can sell their shares at a profit. The discounted purchase price provides employees with an immediate financial advantage, as they can acquire shares at a lower cost compared to the open market.

4. **Wealth Accumulation:** An ESPS can serve as a means for employees to accumulate wealth over the long term. By regularly contributing a portion of their salary towards purchasing company shares, employees can build a portfolio of company stock. As the value of the shares grows, employees can potentially build significant wealth through capital appreciation.

5. **Employee Retention and Attraction:** Offering an ESPS can be an effective tool for employee retention and attraction. The scheme provides an additional incentive for talented individuals to join and remain with the company. It demonstrates that the company values its employees and provides them with an opportunity to share in the company's success.

6. **Broad-Based Participation:** An ESPS aims to encourage broad-based participation among eligible employees. It typically includes all or a significant portion of the workforce,

ensuring that employees at various levels and functions can benefit from the scheme. This promotes a sense of inclusiveness and fairness within the organization.

7. **Long-Term Focus:** ESPSs often incorporate holding periods, which require employees to hold the shares for a certain period before selling them. This encourages a long-term perspective and discourages short-term speculative trading. It aligns employees' interests withthe company's long-term growth and value creation.

It's important to note that the specific details and features of an Employee Stock Purchase Scheme can vary from one company to another. Companies need to design their ESPS in compliance with applicable laws, regulations, and accounting standards. Consulting with legal and financial professionals is advisable to ensure the scheme is implemented effectively andmeets the objectives of the company and its employees.

1.4 Sweet Equity Shares

Sweet equity shares, also known as sweat equity shares, refer to shares issued by a companyto its employees or directors as a form of compensation for their efforts, expertise, or value addition to the company. Unlike regular equity shares, which are issued for cash consideration, sweet equity shares are issued at a discount or for nominal consideration.

a. **Purpose:** Sweet equity shares are used to reward and incentivize employees or directors for their contributions to the company's growth, profitability, or intellectual property. It serves as a non-monetary benefit to align the interests of key individuals with the long-term success of the company.

b. **Discounted or Nominal Consideration:** Sweet equity shares are offered at a discounted price or for a nominal value compared to the prevailing market price or facevalue of the company's shares. The discount or nominal consideration represents the value attributed to the efforts or expertise of the recipients.

c. **Regulatory Guidelines:** The issuance of sweet equity shares is subject to regulatory guidelines and restrictions prescribed by the relevant corporate laws and regulations. These guidelines specify the eligibility criteria, maximum limit, lock-in period, and valuation methodology for issuing sweet equity shares.

1.5 Book Building

Book building is a process used by companies to determine the price at which they will offer their shares to the public during an initial public offering (IPO) or follow-on public offering (FPO). It involves collecting and analyzing bids from investors to determine the demand and price range for the company's shares.

a. **Objective:** The objective of book building is to discover the optimal price for the company's shares based on the demand and market conditions. It helps in maximizing the proceeds from the offering and ensures a fair and efficient price discovery process.

b. **Process:** During the book building process, the company, under the guidance of its investment bankers, invites bids from institutional and retail investors. The investors indicate the quantity of shares they are willing to purchase and the price range within which they are comfortable buying the shares.

c. **Price Discovery:** The company collects and analyzes the bids received from investors to determine the demand for its shares at various price levels. Based on the bids, the company sets the final offer price or price range for the shares. This price is usually thehighest price at which the demand is sufficient to meet the supply of shares.

d. **Allotment:** Once the final offer price is determined, the shares are allotted to the investors based on their bids and the allocation criteria set by the company. The allotment is typically done in proportion to the demand and subject to any regulatory requirements.

e. **Transparency and Efficiency:** Book building enhances transparency and efficiency in the pricing of shares, as it allows market forces to determine the price based on investor demand. It enables a more accurate reflection of the market value of the company's shares compared to a fixed pricing method.

Both sweet equity shares and book building play significant roles in corporate finance and capital markets, albeit in different contexts. While sweet equity shares reward employees or directors for their contributions to the company, book building is a mechanism for price discovery during public offerings.

1.6 Buy Back of Shares:

Originally there was no provision for buyback of shares in the Companies Act, 1956. But there had been a persistent demand for buyback of own shares from the corporate sector. The

Central Government approved the buyback of shares by companies and ordinance to this effect was issued by the President on 31st October, 1998. Consequent to this the Companies (Amendment) Act, 1999 was passed which become effective w.e.f. 31st October, 1998, the date of the ordinance, where under the companies were permitted to buy back their own shares and other specified securities subject to certain conditions. Thus, the provisions for buyback of shares were introduced w.e.f. 31-10-1998 in the Companies Act, 1956, SEBI alsoframed certain regulations for buyback of securities in case of listed companies in 1999. Section 68 of the Companies Act, 2013 gives power to company to purchase its own shares and other specified securities.

Meaning of Buyback of Shares

Buy back of shares means purchase of its own shares by a company:

When shares arebought back by a company, they have to be cancelled by the company. Thus, share buybackresults in decrease in share capital of the company. A company cannot buy its own shares forthe purpose of investment. A company having sufficient cash may decide to buy its own shares.

Objectives/Advantages of Buyback

The following may be the objectives/advantages of buyback of shares:

a) To increase promoters holding as the shares which are bought back are cancelled.

b) To increase earnings per share if there is no dilution in company's earnings as the buyback of shares reduces the outstanding number of shares.

c) To support the share price on the stock exchanges when the share price, in the opinion of the company management, is less than its worth, especially in the depressed market.

d) To discourage others to make hostile bid to take over the company as the buyback will increase the promoters holding.

e) To pay surplus cash to the shareholders when the company does not need it for the business.

f) To reward the shareholders by buyback of shares at substantially higher price than market price.

Limitations of Buyback

The following are the limitations of buyback of shares:

a) It may be used as a tool for insider trading.

b) It increases promoters holding and thus decreases the public shareholding in case oflisted companies, especially when the public shareholding is less.

Sources of buyback

Section 68 of the Companies Act, 2013 allows a company to buy its own shares and other specified securities out of its:

(i) free reserves

(ii) the securities premium account

(iii) the proceeds of any shares or other specified securities. However, buyback of any kind of shares or other specified securities cannot be made out of the proceeds of an earlier issueof the same kind of shares or same kind of other securities.

Securities Premium Account includes premium on issue of shares, debentures, bonds or otherfinancial instrument.

According to section 69 of the Companies Act, 2013, where buy-back is done out of free reserves or securities premium account, then an amount equal to the nominal value of shares bought back must be transferred to “Capital Redemption Reserve Account” and its detail must be disclosed in the Balance Sheet. As per section 55, Capital Redemption Reserve Accountcan be used only for issue of fully paid bonus shares.

As per Explanation II to section 68, for the purposes of section 68 “free reserves” includessecurities premium account. Free reserves should be calculated after adjusting losses and unamortized expenses.

Following reserves amongst others, are not available for buyback of shares:

(a) Capital redemption reserve

(b) Debenture redemption reserve

(c) Share forfeited account

(d) Revaluation Reserve

(e) Profit prior to incorporation

(f) Statutory reserves created under the Income-tax Act.

Meaning of “Reserve” and “Free Reserves”

Reserve: The Companies Act, 2013 does not define the term “reserve”. A reference can be made to clause 82 of Table F of Schedule I of the Companies Act, 2013. This clause inter alia, prescribes that the Board of Directors of a company may before recommending any dividend set aside such sums as they deem fit as reserve or reserves and the company may also carry forward profit of the company without setting aside them as reserves. Further, the profit which has been carried forward without setting aside as reserve or reserves would be considered as “surplus”. Although, Table F is not mandatory for all companies but it has relevance as it is part of the Companies Act, 2013. Thus, the profit which has been carried forward by the company would not form part of the reserve.

Further reference can also be made to Schedule III of the Companies Act, 2013. The Schedule III prescribes that “surplus” refers to Balance of the Statement of Profit and Loss after disclosing allocations and appropriations made by the company such as dividend, bonus shares, transfer to reserves and transfer from reserves. It further prescribes that debit balance of Statement of Profit and Loss shall be shown as a negative figure under the head ‘“surplus”. Thus, carried forward profit of the company, i.e. accumulated profit of past years would constitute “surplus”’ and not “reserve”. As there are restrictions on use of reserve for distribution as dividend, the companies generally retain their excess profit under Profit and Loss Account or Surplus Account.

Free Reserves: The expression “free reserves” was not specifically defined under the Companies Act, 1956. There were references to free reserves in some sections where such definition was required. For instance, section 372A of the Companies Act, 1956 defined free reserves for limited purpose of that section.

According to section 2(43) of the Companies Act, 2013, “Free reserves” means such reserves which, as per the latest audited balance sheet of a company, are available for distribution asdividend:

Provided that—

(i) any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserve.

Thus, the expression "free reserves" under the Companies Act, 1956 was defined specifically for the purpose for which the definition was required, whereas under the Companies Act, 2013 it is defined in generic sense, unless any section provides for specific alteration. For example, for the purposes of section 68, "free reserves" includes securities premium account.

Meaning of Specified Securities

Explanation I to section 68 provides as follows:

For the purposes of this section (i.e. section 68) and section 70, "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time.

No security has so far been notified as "specified securities".

Meaning of "Proceeds of any shares or other specified securities"

As per section 68 of the Companies Act, 2013, buyback of shares and other specified securities can be made out of the proceeds of earlier issue of other kind of shares or other kind of specified securities made for the purpose of buyback of shares. For example, preference shares may be issued for buy-back of equity shares; and equity shares may be issued for buy-back of preference shares.

When shares are issued at par, proceeds mean par value of the shares issued. When shares are issued at premium, the proceeds in this case also mean the par value of the shares issued, because securities premium can be used only for five purposes mentioned in section 52 of the Companies Act, 2013.

Conditions for buyback

Section 68 of the Companies Act, 2013 provides that no company shall purchase its own

a) The share buy-back must be authoriesd by its articles.

b) A special resolution has been passed in general meeting of the company authorizing buy-back. However, if the buy-back is up to 10% of the total paid up equity capital and free reserves of the company, the Board of Directors by passing a resolution at its meeting may authorize the company for such buy-back. But only one such buy-back is allowed in a year.

c) The buy-back must be equal to or less than 25% (i.e. not more than 25%) of the total paid-up capital and free reserves of the company. (Resource Test)

d) Further, the buyback of equity shares in any financial year must not exceed 25% of its paid-up equity capital in that financial year. (Share outstanding Test)

e) The ratio of secured and unsecured debt owed by the company must not be more than twice the capital and its free reserves after such buy-back However, the Central Government may prescribe a higher ratio of debt for a class or classes of companies. 'Debt' here should include both long term debt as well as short term debt ('Debt' 'Equity' Test)

f) All the shares or other specified securities for buy-back must be fully paid up.

g) The buyback of the shares or other specified securities listed on any stock exchange must be in accordance with the regulations made by the SEBI in this behalf.

h) The buy-back in respect of shares not listed on any recognized stock exchange must be in accordance with the rules as may be prescribed. Rule 17 of the Companies (Share Capital and Debentures) Rules, 2014 deals with buyback of shares and other specified securities.

Note : The maximum amount of share buy-back amount in a financial year will be lowest of the three figures calculated as per the above point numbers (c), (d) and (e). These three conditions may be called test conditions. They have been explained later in this chapter. Other conditions may be called procedural conditions.

According to the aforesaid Rule private companies and unlisted public companies shall comply, amongst others, with the following norms:

a) The company which has been authorised by a special resolution shall, before buying back of shares, file with the Registrar of Companies a letter of offer in the prescribed form along with the fee.

b) The letter of offer shall be dispatched to the shareholders or security holders immediatelyafter filing the same with the Registrar of Companies but not later than 21 days from its filing with the Registrar of Companies.

c) The offer of buy-back shall remain open for a period of not less than 15 days and not exceeding 30 days from the date of dispatch of the letter of offer.

d) In case the number of shares or other specified securities offered by the shareholders or security holders is more than the total number of shares or securities to the bought back by the company, the acceptance per shareholder shall be on proportionate basis out of the total shares offered for being bought back.

e) The company shall complete the verification of the offers received within 15 days from thedate of the closure of the offer and the shares or other specified securities lodged shall be deemed to be accepted unless a communication of rejection is made within 21 days from thedate of the closure of the offer.

f) The company shall immediately after the closure of the offer, open a separate bank account and deposit therein, such sum, as would make up the entire sum and payable as consideration for the shares tendered for buy-back in terms of these rules.

g) The company shall within the prescribed time

h) make payment of consideration in case to those shareholders whose securities have beenaccepted

i) return the share certificates to the shareholders whose securities have not been acceptedat all or the balance of the securities in case of part acceptance.

Notice of the meeting

The notice of the meeting at which special resolution is supposed to be passed must be accompanied by an explanatory statement stating—(a) a full and complete disclosure of all material facts; (b) the necessity of the buy-back; (c) the class of security intended to be purchased under the buy-back; (d) the amount to be invested under the buy back; and (e) thetime limit for completion of the buy back.

Completion of buyback

Every buy back must be completed within 12 months from the date of passing of the special resolution or resolution passed by the Board.

Methods of buyback

The buy-back may be : (a) from the existing shareholders or security holders on a proportionate basis; or (b) from the open market, or (c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Declaration of insolvency

Before making the buy-back, the company is required to file with the Registrar, and in case oflisted company with the SEBI also, a declaration of solvency in the form as may be prescribedand verified by an affidavit to the effect that the Board of Directors made a full inquiry into theaffairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the dateof declaration adopted by the Board of Directors. It must be signed by at least two directors ofthe company, one of whom shall be the managing director, if any. However, in case of a company whose shares are not listed on a recognised stock exchange, the declaration of insolvency is to be filed only with the Registrar.

Extinguishment of securities

The company must extinguish and physically destroy the securities bought back within sevendays of the last date of completion of buy-back.

Further issue of securities

Where a company completes a buy-back of its shares or other specified securities, it must notmake further issue of same kind of shares or other specified securities within a period of 6 months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme sweat or conversion of preference sharesor debentures into equity shares.

Register of bought back securities

The company who buys-back the shares or other specified securities is required to maintain a register containing the particulars of bought-back securities.

Filing of return of buyback

After the completion of buy-back, the company has to file a return in the prescribe form with the Registrar (and also with SEBI in case of a listed company) within 30 days of such completion.

Prohibition of Buyback in certain cases

Section 70 of the Companies Act, 2013 provides that no company shall directly or indirectly purchase its own-shares or other specified securities:

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default is subsisting in repayment of deposits or interest due thereon, redemption of debentures or preference shares, or payment of dividend, or repayment of any term loan or interest thereon to any financial institution or bank.

It is further provided that no company shall directly or indirectly purchase its own shares or other specified securities if the company has not complied with the provision of Section 92 (filing of annual return), Section 123 (payment of dividend within 30 days of declaration) Section 127 (Failure to distribute dividend), and Section 129 (preparation of Balance Sheet and Statement of Profit and Loss) in accordance with Schedule III.

SEBI Regulations

SEBI (Buy Back of Securities) Regulations, 1999, inter alia, provide that the notice of the meeting at which special resolution regarding buy-back is proposed to be passed shall be accompanied by an explanatory statement stating:

(i) A full and complete disclosure of all material facts

(ii) The necessity for the buy-back;

(iii) The class of security intended to be purchased under the buy-back

(iv) The amount to be invested under the buy-back;

(v) The amount limit for completion of buy-back

(vi) The specific price or maximum price at which buyback of shares shall be made.

(vii) If the promoter intends to offer their shares:

(viii) The quantum of shares proposed to be tendered, and

(ix) The details of their transactions and their holdings for the last 6 months prior to the passingof the special resolution for buy-back including information on number of shares acquired, theprice and the date of acquisition.

Buyback Methods

The following are the main methods of buyback of shares and other specified securities:

Tender Method

Under this method the company fixes a price at which it wishes to buy-back a specified number of shares from its shareholders. If the number of shares offered for buy-back at the stated price is more than the number of shares to be bought-back, then the shares are bought-backfrom each shareholder proportionately.

Open Market Purchases

Under this method, buy-back is done in the following two ways:

❖ **Open Market through Stock Exchange**: Under this method the company buys-back shares through the stock exchange at the prevailing market price till it purchases the pre- determined number of shares it had originally decided to buy-back and the market price does not exceed the pre-determined maximum price for buy-back. SEBI guidelines provide that in from the promoters or persons in control of the company and the buyback of shares shall be made only on stock exchange with electronic trading facility.

❖ **Open Market through Book-building process:** In this method, a company makes an offer to buy-back a specified number of shares to the shareholders at a specified price range, say ` 40 to ` 45 per share. The shareholders are invited to make a bid quoting a price within the price range and the number of shares offered for buy-back. After receiving the bids, the company selects the offered price from the lowest price onwards at which the cumulative number of shares offered equals or exceeds the maximum number of shares the company proposes to buy-back. The company fixes the buy-back price within the range of minimum offer price and the “highest price accepted” which shall be paid to all the shareholders whoseshares are accepted for buy-back.

Accounting Treatment

The following points should be kept in mind while passing journal entries for buyback of shares:

Sources of buy-back

As stated earlier Section 68 provides that a company may buy-back its own shares or other specified securities out of : (i) its free reserves; or (ii) the securities premium account; or (iii) the proceeds 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 specified securities. Thus, for example, if equity shares are to be bought-back, preference shares may be issued for the purpose.

Fully paid-up shares

The shares or other specified securities which are proposed to be bought-back must be fully paid-up.

Transfer to CRR A/c

Section 69 provides that if the shares are bought-back out of free reserves, then an amount equal to the nominal value of the shares so bought-back must be transferred to the “Capital Redemption Reserve Account.” Capital Redemption Reserve Account can be used only for issuing fully paid bonus shares.

Premium on buy-back

Premium (excess of buy-back price over the par value) paid on buy- back should be adjusted against free reserves and/or securities premium account. Revaluation reserve represents unrealized profit and hence it cannot be used for buyback of securities.

Accounting treatment of buyback of shares is similar to that of the redemption of preference shares. The accounting treatment is as follows:

For making the partly paid shares fully paid

Only fully paid shares can be bought-back. Therefore, if the shares are not fully paid up, they have to be made fully paid up by passing the entry for making the final call due and for receiptof the call.

(a) Share Final Call A/c Dr.
To Share Capital A/c
(Final call made due)

(b) Bank A/c
To Share Final Call A/c Dr.
(Receipt of call money)

Note: If free reserves are used to make partly paid up equity share fully paid up by way of bonus, free reserves (individually) will be debited instead of bank account.

(i) For realizing investments to provide cash for buy-back

(a)	Bank A/c	Dr.	(with sale proceeds)
	*Profit and Loss A/c	Dr.	(with loss on sale)
	To Investments A/c		(with book value of investments sold)
	To *Profit and Loss A/c		(with profit on sale)

*Either of the two may appear.

Note : If some other asset (fixed asset or current asset) is sold to provide cash for buyback of shares, then that asset should be credited in addition to or in place of investments, as the case may be. If bank loan is taken to provide cash for buyback of shares, Bank A/c should be debited and Bank Loan A/c should be credited.

(ii) For fresh issue of other kind of shares

If the company decides to buyback equity shares, it can issue preference shares and if the company decides to buy-back preference shares, it can issue equity shares. If the company decides to make a fresh issue of preference shares as a source of buyback of equity shares, the following journal entries will be passed:

(a) When shares are issued at par

(i) Bank A/c Dr.

To Preference Share Application A/c

(Being the application money received)

(ii) Preference Share Application A/c

To Preference Share Capital A/c

(Being transfer of share application on money on allotment ofpreference shares)

(b) When shares are issued at premium

(i) Bank A/c Dr.

To Preference Share Application A/c

(Being share application money received)

(ii) Preference Share Application A/c Dr.

To Preference Share Capital A/c (with nominal value)

To Securities Premium A/c (with securities premium)

(Being transfer of share application money on allotment of shares)

Note: A combined Share Application and Allotment Account may be opened when full amount is called as share application money, instead of Share Application Account.

(iii) For payment to equity shareholders

Equity Share Buy-Back A/c or

Equity Shareholders A/c Dr.

To Bank A/c

(Being payment for buyback of shares)

Note: As per Rule 17(8) of the Companies (Share Capital and Debentures) Rules, 2014 every company is required to open a **separate bank account** and deposit therein, such sum, as would make up the entire sum due and payable as consideration for the shares tendered for buy-back. This account shall be opened immediately after the date of the closure of the offer. Therefore, in such cases the following entries should be passed in place of the aforesaid entry:

(a) For opening separate bank account

Share Buy-Back Bank A/c Dr.

To Bank A/c

(b) For payment

Equity Share Buy-Back A/c or

Equity Shareholders A/c Dr.

To Share Buy-Back Bank A/c

(iv)For transfer of nominal value of shares redeemed out of free reserves and securities

Securities Premium A/c Dr.

Free Reserves (individually) Dr.

To Capital Redemption Reserve A/c

(Being transfer of nominal value of shares bought-back to CRR A/c)

Amount of fresh issue or transfer to CRR A/c can be calculated as follows:

Nominal value of shares bought back	=	Nominal value of fresh issue of other kind of shares for the purpose of buy back	+	Transfer to capital redemption reserve account

(v) For cancellation of shares bought back

(a) When shares are bought back at par

Equity Share Capital A/c Dr.

To Equity Share Buy-Back A/c or Equity Shareholders A/c

(Being cancellation of bought back shares)

(vi) For payment of buy-back expenses

Buy Back Expenses A/c Dr

To Bank A/c

(Being payment of buy-back expenses)

(vii) For transfer of buy-back expenses

Profit and Loss A/c Dr.

To Buy-Back Expenses A/c

(Being buy-back expenses written off)

(viii) For payment of tax on distributed income

Distributed income is the excess of buy-back price of the shares over issue price of those shares. As per section 115QA of the Income-tax Act, 1961, if an unlisted company buys-backthe shares, it is required to pay tax on distributed income @ 20% of the distributed income plus 12% surcharge (as a percentage of distribution tax) and 4% education Cess, etc. (as a percentage of distribution tax and surcharge) i.e. a total of 23.376% of the distributed income. The tax rate may change from time to time. For this purpose, the following two entriesare passed:

(a) For payment

Tax on Distributed Income for Share Buy-Back A/c Dr.

To Bank A/c

(b) For transfer of the tax

Profit and Loss A/c or Surplus A/c Dr.

(Surplus i.e. Balance in the Statement of Profit and Loss)

To Tax on Distributed Income for Share Buy-Back A/c

Illustration 1: (Buyback of shares out of free reserves at premium)

RS (P) Ltd. purchases 50,000 equity shares of ` 10 each @ ` 40 per share. No fresh issue is made for this purpose. There is a balance of ` 50 lakhs in General Reserve Account. Pass journal entries in the books of the company in accordance with the provisions of company law:

Solution:

JOURNAL ENTRIES

Date	Particulars		L.F.	Dr	Cr
	Share Buy-Back Bank A/c	Dr.		20,00,000	
	To Bank A/c (Separate bank account for buy-backopened)				20,00,000
	Equity Share Buy Back A/c	Dr.		20,00,000	
	To Share Buy-Back Bank A/c (Purchase of 50,000 shares for				20,00,000

	cancellation)				
	Equity Share Capital A/c	Dr.		5,00,000	
	Premium on Share Buy-Back A/c	Dr.		15,00,000	
	To Equity Share Buy-Back A/c (Cancellation of 50,000 bought-backshares of ` 10 each @ 40 per share)				20,00,000
	General Reserve A/c	Dr.		15,00,000	
	To Premium on Share Buy Back A/c (Being writing off of premium on share buy-back)				15,00,000
	General Reserve A/c	Dr.		5,00,000	
	To Capital Redemption Reserve A/c (Transfer of nominal value of shares bought-back to Capital Redemption Reserve Account)				5,00,000

Illustration 2: (Buy-back of shares at discount partly out of fresh issue and partly out of free reserves and securities premium)

Sangeeta Ltd., an unlisted company, had issued capital of ` 50 lakh divided into equity shares of ` 10 each. The balance in the Security Premium Account was ` 2 lakh and General Reserve ` 3 lakh. The company decided to buy-back 1,00,000 shares of ` 10 each at ` 8 per share. The company had issued 50,000, 10% Preference Shares of ` 10 each 3 months backfor the purpose of buy-back of equity shares. Record the transaction in the Journal of the company.

Solution:

JOURNAL ENTRIES

Date	Particulars		L.F.	Dr. (`)	Cr. (`)
	Share Buy Back Bank A/c	Dr.		8,00,000	
	To Bank A/c (Separate bank account opened for buyback of shares)				8,00,000
	Equity Share Buy Back A/c	Dr.		8,00,000	
	To Share Buy Back Bank A/c (Buy-back of 1,00,000 equity shares of ` 10				8,00,000

	at ` 8 each)				
	Equity Share Capital A/c	Dr.		10,00,000	
	To Equity Share Buy Back A/c				8,00,000
	To Capital Reserve A/c (Cancellation of bought back 1,00,000 equity shares of ` 10 each at ` 8 per share)				2,00,000
	Securities Premium A/c	Dr.		2,00,0000	
	General Reserve A/c	Dr.		3,00,000	
	To Capital Redemption Reserve A/c				5,00,000
	(Transfer of nominal value of equity shares redeemed out of General Reserve and Securities Premium to Capital Redemption Reserve Account)				

Illustration 3: (Buyback of shares partly by issue of fresh shares and partly out of free reserve and securities premium)

The Balance Sheet of Ishaan Ltd. as at 31st March 2020 is given below:

Particulars	**Not No.**	**In lakhs**
I. Equity and Liabilities		
1. Shareholders' Funds		
(a) Share Capital	1	2,400
(b) Reserves and Surplus	2	1,640
2. Non-Current Liabilities		
Long-term Borrowings (10% debentures)		1,800
3. Current liabilities		
Trade payables (Total outstanding due to creditors other than micro and small enterprises)		1,160

Total		7,000
II. Assets		
1. Non-Current Assets		
(a) Property, Plant and Equipment (Tangible Assets)	3	4,050
(b) Non-Current Investments (Investments)		150
2. Current Assets		
(a) Inventories (Stock-in-Trade)		1,200
(b) Trade Receivables		800
(c) Cash and Cash Equivalents (Cash at Bank)		800
Total		7,000

Notes to Accounts

Particulars	**` in lakhs**
1. Share Capital	
Subscribed and Fully Paid up	
240 lakh Equity Shares of ` 10 each	2,400
2. Reserves and Surplus	
(a) Securities Premium	350
(b) General Reserve	950
(c) Profit and Loss Account (Surplus i.e. Balance in the statement of Profit and Loss)	340
	1,640
3. Tangible Assets	
Building	450
Machinery	3,600
	4,050

Illustration 4: On 1st April, 2020, the company announced the buy-back of 50 lakhs equity shares at ` 18 per share. For this purpose, it sold all its investments at a profit of 20% and issued 3 lakhs

12% preference shares of ` 100 each at a premium of 10 per cent, the entire amount being payable with application.

The issue was fully subscribed and the company bought back the announced number of equity shares through open market purchases. Pass journal entries to record the above transactionsin the books of the company assuming that the company is not a listed company.

Solution:

Date	Particulars		L.F.	Debit (000)	Credit (000)
	Bank A/c	Dr.		180	
	To Investments A/c				150
	To Profit and Loss A/c (Profit on sale of Investment)				30
	(Being sale of investments at a profit of 20%)				
	Bank A/c	Dr.		330	
	To Preference Share Application and Allotment A/c				330
	(Being the application money received on 3 lakhs 12% pre- ference shares @ ` 110 per share)				
	Preference Share Application and Allotment A/c	Dr.		330	
	To 12% Preference Share Capital A/c				300
	To Securities Premium A/c				30
	(Being transfer of share application money to preference share capital @ ` 100 and the securities premium account @ ` 10 each)				

1.7 Redemption of Debentures

Repayment of debentures to the debenture holders or discharge of the liability on account of debentures is known as the redemption of debentures. They are normally redeemed at the expiry of the period for which they were originally issued. The company may also redeem the debentures before the expiry of the fixed period either by installments or by purchasing them in the open market if authorised by its articles of Association and the terms of issue.

Redemption of Debentures by Conversion into Shares or New Debentures:

Companies usually redeem their debentures in cash; however, sometimes they give an option to debenture holders that their debentures will be converted into shares or redeemed. These types of debentures are known as Convertible Debentures.

Merits of Conversion:

- ❖ In the initial stage, the debenture holders of a company are treated as secured creditors and are paid interest at a fixed rate, whether or not the company earns profits during the year.
- ❖ On conversion of debentures, the debenture holders become shareholders, and get dividends on shares, and exercise their right to vote in the company's general meeting.
- ❖ The converted shareholders also get benefits when there is an appreciation in the value of their shares. Besides in future, these shareholders also might get the right shares and bonus shares as well.

Rules of Conversion:

According to the Companies Act, the non-convertible part of a debenture cannot be redeemed by the method of conversion.

As per SEBI guidelines, the conditions of the creation of DRR (Debenture Redemption Reserve) do not apply to the conversion method.

The debenture holders have the option to convert their debentures in the case when theconversion is to be made at or after 18 months but before 36 months of allotment.

1.7 Conversion of Debentures into shares:

Redemption of debentures by conversion is possible when the debentures original issued as convertible debentures. They may be Partly convertible debentures are fully convertible debentures

The exact terms of conversion of mentioned the debentures issue agreement or trust deed. The Prospective buyers of debentures the two piece of debentures known in advance or the conditions and terms of the new conversion.

Conversion on the rate of redemption:

When the debentures were issued, specified redemption date is fixed and on that the conversion takes place. Technically, instead repaying cash, shares are given to the debenture holders. In such a case, the actual amount payable to the debenture holders has to be converted into shares. The originally issued at discount, the amount payable on redemption is taken as the basis for conversion section 79 of the company's Act relating to the issue of shares and does not apply here.

To Debenture Holders A/c		XXXX
[Being debentures repayable and premium payable thereon]		
For conversion into shares		
Debenture holders A/C	XXXX	
To share capital		XXXX
To Securities Premium		XXXX
(Being conversion of debentures into shares and premium chargeable thereon]		

Illustration

Ltd. redeemed 8,000, 12% debentures of Rs.100 each which were issued at a discount of 5%, by converting them into equity shares of Rs.10 each at par.

Solution

In the books of A. Ltd.

Date	Particulars	L.F.	Debit Rs	Credit Rs
	12% Debenture A/c Dr.		8,00,000	
	To Debenture Holders			7,60,000
	To Discount on Issue of Debentures A/c			40,000
	(Amount of 12% Debentures due to Debenture Holders)			
	Debenture Holders		7,60,000	

Dr.

To Equity Share Capital A/c 7,60,000

(Equity Shares issued to Debenture Holders in lieu of debentures)

Note: Here it has been assumed that the debentures are converted into equity shares before the date of redemption. If the debentures are converted into shares before maturity, then the net proceeds from the issue of debentures will be taken at the time of conversion.

Working Notes: -
Number of Shares to be issued

$$= \frac{\text{Amount due to debenture holders}}{\text{Agreed amount of shares}}$$

$$= \frac{7{,}60{,}000}{10} = 76{,}000$$

Working Note 1:

Number of Preference shares issued =

Total Amount of Debentures / Rate of each Preference shares

= 50,000/100

= 500 Shares @ Rs.100 each

Working Note 2:

No. of equity shares issued =

Total amount of Debentures / Discount Rate of each equity share

= 57,000/95

=600 Equity Shares @ ₹100 each

1.8 Financial Accounts

All types of business organization prepare their final accounts, mainly profit and loss account and balance sheet. In case of a sole proprietor concern or a partnership firm maintenance of proper books of account and preparation of the final accounts at the end of an accounting period is desirable but not compulsory. But companies have a statutory obligation to prepare the final accounts as required by section 209 of the companies Act. Section 209of the companies Act makes it compulsory for every company to keep proper books of account of the companies Act makes it compulsory for every company to keep proper books of account with respect to

All sums of money received and spent by the company and the matters in respectof which the receipt and expenditure takes place.

All sales and purchase of goods by the companyThe

assets and liabilities of the company

The books of account and the relevant vouchers to any entry therein relating to aperiod of at least eight years immediately preceding the current year must be preserved

Books of Accounts to be Maintained by a Company

Section 128 of the Companies Act, 2013 the A company is typically required to maintain several books of accounts to ensure accurate and reliable financial record-keeping. The specific books of accounts to be maintained may vary based on the jurisdiction and applicable regulations. However, here are some common books of accounts that companies

1. General Ledger: The general ledger is the primary book of accounts that contains a record of all financial transactions of the company. It includes entries for revenue, expenses, assets, liabilities, equity, and other relevant financial information. The general ledger servesas the foundation for preparing financial statements.

2. Cash Book: The cash book records all cash and bank transactions of the company. It includes details of cash receipts, cash payments, bank deposits, bank withdrawals, and bank reconciliations. The cash book helps track the company's cash flow and ensures accurate recording of cash transactions.

3. Sales Journal: The sales journal, also known as the sales daybook or sales register, records all sales transactions made by the company. It includes details such as the date of the sale, customer information, invoice number, description of goods or services sold, and the amount of the sale. The sales journal helps monitor sales activity and facilitates the preparation of sales invoices and statements.

4. Purchase Journal: The purchase journal, also called the purchases daybook or purchases register, records all purchases made by the company. It includes details such as the date of purchase, supplier information, invoice number, description of goods or services purchased, and the amount of the purchase. The purchase journal helps track procurement activities andfacilitates the recording of purchase invoices and payments.

5. Inventory Register: The inventory register maintains a record of all inventory items held by the company. It includes details such as the description of the items, quantities on hand, unit costs, and total value of inventory. The inventory register helps monitor stock levels, track inventory movements, and calculate the cost of goods sold.

6. Journal Entries: Journal entries are used to record specific transactions or adjustments that do not fit into other specialized books of accounts. They capture entries such as depreciation, accruals, prepayments, provision for doubtful debts, and other adjusting entries. Journal entries ensure accurate recording of financial transactions and adjustments that impact the company's financial statements.

7. Fixed Assets Register: The fixed assets register maintains a record of all fixed assets owned by the company, such as land, buildings, machinery, vehicles, and equipment. It includes details such as the description of the asset, date of acquisition, cost, accumulated depreciation, and net book value. The fixed assets register helps track the company's fixed asset base, calculate depreciation, and monitor asset values.

Part II: Form of Statement of Profit and Loss

Statement of Profit and Loss of …. for the year ended……(as per revised Schedule VI)

	Note No.	**Rs.**
Revenue from operations	1	Xxx
Other income	2	xxx
Total revenue (A)		
Expenses		
Cost of materials consumed	3	xxx
Purchase of stock-in-trade		
Changes in inventories of finished goods/ WIP		
Stock-in-trade		

Employee benefits expenses	4	Xxx
Finance costs	5	Xxx
Depreciation and amortization expenses	6	Xxx
Other expense	7	xxx
Total expenses (B)		**xxx**
Profit before extraordinary items and tax (A-B)		Xxx
Less: Extraordinary items		Xxx
Tax		xxx
Profit or loss for the period		**xxx**

3.4 Part-I : Form of the Balance Sheet

Balance sheet of ______ as on ______ (as per revised Schedule VI)

	Note No.	Rs.
I. Equity and Liabilities		
i. Shareholders' funds		
Share capital	1	Xxx
Reserve & surplus	2	Xxx
Money received against share warrants	3	xxx
Ii Non-current liabilities		
Long term borrowing	4	Xxx
Deferred tax liabilities	5	Xxx
Other long term liabilities	6	Xxx
Long term provisions	7	Xxx
Iii current liabilities		
Short term borrowings	8	Xxx
Trade payables	9	Xxx
other current liabilities	10	Xxx
short term provisions	11	xxx
Total		

II. Assets		
Non-Current Assets		
a) Fixed assets		
Tangible assets Intangible assets Capital work-in-progress Intangible assets under development	12 13 14 15	Xxx Xxx Xxx Xxx
b) Non-current investments	16	Xxx
c) Deferred tax assets (net)	17	Xxx
d) Long term loans and advances	18	Xxx
e) Other noncurrent assets	19	Xxx
Ii . current assets :		
Current investments Inventories Trade receivables Cash and cash equivalents Short term loans and advancesOther current assets	20 21 22 23 24 25	Xxx Xxx Xxx Xxx Xxx Xx x Xx x xxx
Total		**Xxx**

Table showing place of entering various items in final accounts of companies

Item	**Main head**	**Sub-head**
Sale	Revenue operations	-
Gross profit	Revenue operations	-
Discount received	Other income	-
Commission received	Other income	-
Interest on overdraft	Finance costs	-
Interest on debentures	Finance costs	-
Salaries	Employees benefits exp.	-

Wages	Employees benefits exp.	-
Carriage outwards	Other expenses	-
Discount (Dr.)	Other expenses	-
Selling exp;	Other expenses	-
Advertisement exp;	Other expenses	-
Directors' fees	Other expenses	-
Bad debts	Other expenses	-
Rent and rates	Other expenses	-
Delivery exp.	Other expenses	-
Travelling exp.	Other expenses	-
Legal charges	Other expenses	-
Payment to auditors	Other expenses	-
Provisions for bad debts	Other expenses	-
Miscellaneous exp	Other expenses	-
Commission paid	Other expenses	-
Office exp.	Other expenses	-
Repairs and maintenance	Other expenses	-
M.D remuneration	Other expenses	-
Distribution costs	Other expenses	-
Preliminary exp. written off	Dep.and amortization exp.	-
Debentures	Non-current liabilities	Long term borrowing
Public deposits	Non-current liabilities	Long term borrowing
Securities premium	Shareholders' funds	Reserve and surplus
Capital reserve	Shareholders' funds	Reserve and surplus
Forfeited shares account	Shareholders' funds	Subscribed capital (Shown by way of addition
Interest accrued and due on debentures	Current liabilities	Other Current liabilities
Advanced received from customers	Current liabilities	Other Current liabilities

Sundry creditors	Current liabilities	Trade payables
Unclaimed dividend	Current liabilities	Other current liabilities
Calls-in –arrears	Shareholders' funds	Subscribed capital (Shown by way of addition
Calls –in –advance	Current liabilities	Other Current liabilities
Interest accrued but not due on debentures	As a footnote as contingent Liability	-
Interest accrues and due on secured loans	Current liabilities	Other current liabilities
Interest accrued but not due on unsecured loans	Current liabilities	Other current liabilities
Debentures redemption reserve	Shareholders' funds	Reserve and surplus
Capital redemption reserve	Shareholders' funds	Reserve and surplus
Advances from customers (long term)	Non- current liabilities	Other long term liabilities
Trade payable	Current assets	-
Provision for tax	Current liabilities	Short-term provisions
Surplus i. e balance in statement of profit and loss (Dr.)	Reserve and surplus	As negative amount
Computer software	Non-current assets	Intangible assets
Loose tools	Current assets	Inventories
Proposed dividend	Current liabilities	Short term provisions
Goodwill	Non-current assets	Intangible assets
Bank overdraft	Current liabilities	Other current liabilities
Capital advances	Non-current assets	Long term loans and advances
Trade debtors	Current assets	Trade receivable

Interest accrued oninvestments	Current assets	Other current assets
Outstanding expenses	Current liabilities	Other current assets
Corporate dividend tax	Current liabilities	Short term provisions
Furniture	Non-current assets	Tangible assets
Plant & Machinery	Non-current assets	Tangible assets
Bank Loan	Non-current assets	Long term borrowings
Advance tax advances	Current assets	Short term loans and
Motor vehicles	Non- current assets	Tangible assets
Share capital	Shareholders' funds	-

3.6 Form and Contents of Financial Statements as per Schedule of Companies Act2013

The Companies Act, 2013 in India specifies the form and contents of financial statements to be prepared by companies. The financial statements include the Balance Sheet, Profit and Loss Account, Cash Flow Statement, Statement of Changes in Equity, and Notes to Accounts. Here's an overview of the form and contents of these financial statements:

1. Balance Sheet:

a) The Balance Sheet presents the financial position of the company at a specific date.

b) It should be prepared in the prescribed form (Schedule III of the Companies Act, 2013)and include the following components:

c) Equity and Liabilities: This section includes shareholders' funds, long-term borrowings,short-term borrowings, trade payables, other current liabilities, and provisions.

d) Assets: This section includes non-current assets, current assets, and miscellaneous expenditures.

e) The Balance Sheet should provide a true and fair view of the company's financialposition.

2. Profit and Loss Account:

a) The Profit and Loss Account, also known as the Income Statement or Statement of Comprehensive Income, presents the company's revenue, expenses, gains, and lossesfor a specific accounting period.

b) It should be prepared in the prescribed form (Schedule III) and include the following components:

c) Revenue from operations

d) Other income

e) Expenses, including cost of materials, employee benefits, depreciation, finance costs, and other expenses

f) Exceptional items, if any

g) Profit or loss before tax

h) Tax expense

i) Profit or loss for the period

j) The Profit and Loss Account should provide a true and fair view of the company's financial performance.

3. Cash Flow Statement:

a) The Cash Flow Statement presents the cash inflows and outflows of the company during a specific accounting period, classified into operating, investing, and financing activities.

b) It should be prepared in the prescribed form (Schedule III) and include the following sections:

c) Cash flows from operating activities

d) Cash flows from investing activities

e) Cash flows from financing activities

f) Net increase or decrease in cash and cash equivalents

g) The Cash Flow Statement helps assess the company's cash generation and utilization.

4. Statement of Changes in Equity:

a) The Statement of Changes in Equity presents the changes in the shareholders'equity of the company during a specific accounting period.

b) It should include details of share capital, reserves and surplus, and other equity components, along with any changes in these items.

c) The Statement of Changes in Equity helps track the movement in shareholders' equity.

5. Notes to Accounts:

a) The Notes to Accounts provide additional information and explanations regarding the items presented in the financial statements.

b) They include disclosures about accounting policies, significant accounting estimates and judgments, contingent liabilities, related-party transactions, segment reporting, and other relevant information.

c) The Notes to Accounts provide further clarity and context to the financial statements.

It is important to note that the specific format and disclosure requirements for financial statements may undergo updates or amendments. Therefore, it is advisable to refer to the most recent version of Schedule III of the Companies Act, 2013, and consult with professionals or advisors to ensure compliance with the applicable regulations.

1.8 Final Accounts of companies as per schedule III of the companies Act, 2013

Illustration 1

Moon and star Co. Ltd is a company with an authorized capital of Rs.5, 00,000 divided into 5,000 equity shares of Rs.100 each on 31.12.2015 of which 2,500 shares were fully called up. The following are the balances extracted from the ledger as on 31.12.2015.

Trial balance of Moon & Star Co.Ltd.

Debit	Rs.	Credit	Rs.
Opening stock	50,000	Sales	3,25,000
Purchase	2,00,000	Discount received	3,150
Wages	70,000	Profit& Loss A/c	6,220
Discount allowed	4,200	Creditors	35,200
Insurance(upto31.03.20216)	6,720	Reserves	25,000
Salaries	18,500	Loan from managing director	15,700
Rent	6,000	Share capital	2,50,000
General expenses	8,950		
Printing	2,400		
Advertisements	3,800		
Bonus	10,500		

Debtors	38,700		
Plant	1,80,500		
Furniture	17,100		
Bank	34,700		
Bad debts	3,200		
Calls-in –arrears	5,000		
	6,60,270		**6,60,270**

You are required to prepare statement of profit &Loss for the year ended 31.12.2015and a balance sheet as on that date. The following further information is given:

a) Closing stock was valued at Rs.1, 91,500.

b) Depreciation on plant at 15% and on furniture at 10% should be provided.

c) A tax provision of Rs.8, 000 is considered necessary.

d) The directors declared an interim dividend on 15.08.2015 for 6 months ending June30,2015 @ 6%

Solution:

Notes to accounts on statement of profit and loss

		Rs	Rs.
1	**Revenue from operations:**		
	Sales		3,25,000
2	**Other income**		
	Discount received		3,150
2	**Cost of goods sold**		
	Opening stock	50,000	
	Add: purchases	2,00,000	
		2,50,000	
	Less: Closing Stock	1,91,500	
	Cost of goods sold		**58,500**
3	**Employee benefits expenses**		
	Wages		70,000
	Salaries		18,500
	Bonus		10,500

			99,000
5	**Depreciation and amortization expenses**		
	Dep. on plant		27,075
	Dep. on furniture		1,710
			28,785
6	**Other expenses**		
	Discount allowed		4,200
	Insurance	6,720	
	Less: Prepaid (6,720×3/12)	1,680	5,040
	Rent		6,000
	General expenses		8,950
	Printing		2,400
	Advertising		3,800
	Bad debts		3,200
			33,590

A Ltd.

Statement of Profit and Loss for the ended 31.3.2018 (as per Revised Schedule VI)

	Note No.	Rs.
Revenue from operations	1	3,25,000
Other income	2	3,150
Total revenue (A)		**3,28,150**
Expenses		
Cost of goods sold	3	58,500
Employee benefits expenses	4	99,000
Dep. And amortization exp.	5	28,785
Other expenses	6	33,590
Total expenses (B)		**2,19,875**
Profit before tax (A-B)		1,08,275
Less: Tax expense: current tax		8,000
Profit for the period		**1,00,275**

Notes to accounts on statement of profit and loss

1	**Share capital :**		
	Authorized capital: 5,000 equity shares of Rs.100 each		**5,00,000**
	Issued, Subscribed and called up:		
	2,500 shares of Rs.100 each	2,50,000	
	Less: calls in arrears	5,000	**2,45,000**
2	**Reserve & surplus:**		
	Reserve		
	Surplus in statement of profit and loss		
	Balance at beginning of the year:	6,220	
	Profit for the year	1,00,275	
	Less : Appropriations:	1,06,495	
	Interim dividend (2,45,000×6%)	14700	**91,795**
			1,16795
3	**Long term borrowings:**		
	Unsecured loan		**15,700**
4	**Trade payables**		
	Creditors		**35,200**
5	**Short term provisions:**		
	Provision for tax		**8,000**
6	**Other current liabilities**		
	Interim dividend payable		
7	**Tangible assets**		
	Plant less Dep. (1,80,500-27,075)		**1,53,425**
	Furniture less Dep.(17,100-1,710)		**15,390**
8	**Trade receivable**		**1,68,815**
	Debtors		**38,700**
9	**Short term loans and advances**		
	Prepaid insurance		**1,680**

Moon & Star Ltd. Balance sheetas

on 31.12.2015

(as per Revised Schedule VI)

	Particulars	NoteNo.	Rs.
I	**Equity and liabilities**		
i	**Shareholders' funds:**		
	Share capital	1	2,45,000
	Reserve & surplus	2	1,16,795
ii	**Non- Current liabilities**		
	Long term borrowings	3	15,700
iii	**Current liabilities**		
	Trade payable	4	35,200
	Short term provisions	5	8,000
	Other current liabilities	6	14,700
	Total (i +ii+iii)		**4,35,395**
II	**Assets**		
i	**Non-current assets**		
	Tangible assets	7	1,68,815
ii	**Current assets**		
	Trade receivables	8	38,700
	Closing stock		1,91,500
	Bank		34,700
	Short term loans and advances	9	1,680
			4,35,395

Illustration 2 A Ltd. Was registered with an authorized capital of Rs.6, 00,000 in equity shares of Rs.10 each. The following is its Trial Balance on 31st March 2018.

Trial Balance of A Ltd.

	Debit	**Credit**
Good will	25,000	

Cash	750	
Bank	39,900	
Purchases	1,85,000	
Preliminary expenses	5,000	
Share capital		4,00,000
12% debentures		3,00,000
P&L A/c (Cr)		26,250
Calls-in –arrears	7,500	
Premises	3,00,000	
Plant & Machinery	3,30,000	
Interim dividend	39,250	
Sales		4,15,000
Stock(1.4.2017)	75,000	
Furniture & fixtures	7,200	
Sundry debtors	87,000	
Wages	84,865	
General expenses	6,835	
Freight and carriage	13,115	
Salaries	14,500	
Directors' fees	5,725	
Bad debts	2,110	
Debentures interest paid	18,000	
Bills payable		37,000
Sundry creditors		40,000
General reserve		25,000
Provision for bad debts		3,500
	12,46,750	**12,46,750**

Prepare statement of profit & Loss and Balance sheet in proper from after making the following adjustments:

i. Depreciate plant and machinery by 15%
ii. Write off preliminary expenses

iii. Provide for 6 months' interest on debentures

iv. Leave bad and doubtful debts provision at 5% on sundry debtors.

v. Provide for income tax at 50%.

vi. Stock on 31.3.2018 was Rs.95, 000.

Notes to accounts on statement of profit and loss

			Rs.
1	**Revenue from operations:**		
	Sales		4,15,000
2	**Cost of goods sold**		
	Opening stock	75,000	
	Add: purchases	1,85,000	
	Add: Freight & Carriage	13,115	
		2,73,115	
	Less: Closing Stock	95,000	
	Cost of goods sold		**1,78,115**
3	**Employee benefits expenses**		
	Wages	84,865	
	Salaries	14,500	**99,365**
4	**Finance costs:**		
	Interest on debentures	18,000	
	Add: Outstanding ((1,00,000×12%×6/12)	18,000	**36,000**
5	**Depreciation and amortization expenses**		
	Dep. on plant and machinery		49,500
	Preliminary expenses written off		5,000
6	**Other expenses**		
	General expenses		6,835
	Directors' fees		5,725
	Bad debts	2,110	
	Add: New PBDD	4,350	
		6,460	
	Less: Old PBDD	3,500	2,960

			15,520

A Ltd.

Statement of Profit and Loss for the ended 31.3.2018 (as per Revised Schedule VI)

	Note No.	Rs.
Revenue from operations	1	4,15,000
Other income		-
Total revenue (A)		**4,15,000**
Expenses		
Cost of goods sold	2	1,78,115
Employee benefits expenses	3	99,365
Finance costs	4	36,000
Dep. And amortization exp.	5	54,500
Other expenses	6	15,520
Total expenses		**3,83,500**
Profit before tax		31,500
Less: tax expense		
Current tax (31,500×50%)		15,750
Profit for the period		**15,750**

Notes to accounts on Balance Sheet

1	**Share capital:**		
	Authorized capital: 60,000 equity shares of Rs.10 each		6,00,000
	Issued, subscribed and called up: 40,000 shares of Rs.10 each Less: Calls in arrears	 4,00,000 7,500	 **3,92,500**
2	**Reserve & Surplus:**		
	General reserve		25,000
	Surplus in statement of profit and loss		
	Balance at the beginning of the year	26,250	
	Profit for the year	15,750	**42,000**

	Less: Appropriations:		
	Interim dividend	39,250	
	Corporate dividend tax(39,250×17%)	6,673	(3,923)
			21,077
3	**Long term borrowings**		
	12% Debentures		3,00,000
4	**Trade Payables**		
	Creditors		40,000
	Bills payable		37,000
			77,000
5	**Short term provisions:**		
	Dividend tax payable		6,673
	Provisions for tax		15,750
			22,423
6	**Other current liabilities**		
	Outstanding interest on debentures		18,000
7	**Tangible assets**		
	Plant and machinery less Dep: (3,30,000-49,500)		2,80,500
	Premises		3,00,000
	Fixtures		7,200
			5,87,700
8	**Intangible assets**		
	Goodwill		25,000
9	**Trade receivable**		
	Debtors less PBDD (87,000-4,350)		82,650

A Ltd

Balance Sheet as on 31.3.1998 (as per Revised Schedule VI)

		Note No.	Rs.
I	**Equity and liabilities:**		
i	**Shareholders' funds:**		

	Share capital	**1**	3,92,500
	Reserve & Surplus	**2**	21,077
ii	**Non-current liabilities**		
	Long term borrowings	**3**	3,00,000
iii	**Current liabilities**		
	Trade payable	**4**	77,000
	Short term provisions	**5**	22,423
	Other current liabilities	**6**	18,000
	Total (i+ii+iii)		**8,31,000**
II	**Assets:**		
i	**Non-Current assets**		
	Tangible assets	**7**	5,87,700
	Intangible assets	**8**	25,000
ii	**Current assets**		
	Trade receivables	**9**	82,650
	Closing stock		95,000
	Cash in bank		39,900
	Cash in hand		750
	Total (i+ ii)		**8,31,000**

Illustration 3

Big bull Ltd. has a nominal capital of Rs.6,00,000 dividends into shares of Rs.10 each. The following Trial Balance is extracted from the books of the company as on 31.12.1987.

	Rs		Rs
Calls in arrear	7,500	6% Debentures	3,00,000
Premises (Rs.60,000 added on 1.7.1987)	3,60,000	P&L A/c (1.1.87)	14,500
Machinery	3,00,000	Creditors	50,000
Interim dividend paid	7,500	General reserve	25,000
Purchases	1,85,000	Share capital (called up)	4,60,000
Preliminary expenses	5,000	Bills payable	38,000
Freight	13,100	Sales	4,15,000

Directors' fees	5,740	Provision for bad debts	3,500
Bad debts	2,110		
4% Government securities	60,000		
Stock (1.1.87)	75,000		
Furniture	7,200		
Sundry debtors	87,000		
Goodwill	25,000		
Cash	750		
Bank	39,900		
Wages	84,800		
General expenses	16,900		
Salaries	14,500		
Debentures interest	9,000		
	13,06,000		**13,06,000**

Prepare final accounts of the company for the year ending 31.12.87 in the prescribed from after taking into account the following adjustments:

a) Depreciation machinery by 10% and furniture by 5%.

b) Write off preliminary expenses

c) Wages include Rs. 10,000 paid for the construction of a compound wall to thepremises and no adjustment was made.

d) Provide 5% for bad debts on sundry debtors.

e) Transfer Rs. 10,000 to general reserve

f) Provide for income tax Rs. 25,000.

g) Stock on 31.12.87 was Rs.1,01,000.

Notes to accounts on statement of profit and loss

			Rs.
1	**Revenue from operations:**		
	Sales		4,15,000
2	**Cost of goods sold**		
	Opening stock	75,000	
	Add: purchases	1,85,000	

	Add: Freight & Carriage	13,100	
		2,73,100	
	Less: Closing Stock	1,01,000	
	Cost of goods sold		**1,72,100**
3	**Employee benefits expenses**		
	Wages	84,800	
	Less : Wages for premises	10,000	74,800
	Salaries		14,500
			89,300
4	**Finance costs:**		
	Interest on debentures	9,000	
	Add: Outstanding ((1,00,000×12%×6/12)	9,000	**18,000**
5	**Depreciation and amortization expenses**		
	Dep. on plant and machinery		30,000
			360
	Preliminary expenses written off		5,000
			35,360
6	**Other expenses**		
	Directors' fees		5,740
	Bad debts	2,110	
	Add: New PBDD	4,350	
		6,460	
	Less: Old PBDD	3,500	2,960
	General Expense		16,900
			15,520

Big Bull Ltd.

Statement of Profit and Loss for the ended 31.3.2018 (as per Revised Schedule VI)

	Note No.	**Rs.**
Revenue from operations	1	4,15,000
Other income		-

Total revenue (A)		**4,15,000**
Expenses		
Cost of goods sold	2	1,72,100
Employee benefits expenses	3	89,300
Finance costs	4	18,000
Dep. And amortization exp.	5	35,360
Other expenses	6	25,600
Total expenses (B)		**3,40,360**
Profit before tax (A-B)		74,640
Less: tax expense Current tax(31,500×50%)		25,000
Profit for the period		**49,640**

Notes to accounts on Balance Sheet

1	**Share capital:**		
	Authorized capital: 46,000 shares of Rs.10 each	**4,60,000**	
	Less: Calls –in –arrears	**7,500**	**4,52,500**
2	**Reserve & Surplus:**		
	General reserve		25,000
	Add: Addition during the year		10,000
	Surplus in statement of profit and loss		
	Balance at the beginning of the year	14,500	
	Profit for the year	49,640	
	Less: Appropriations:	**64,140**	
	Interim dividend	7,500	
	Corporate dividend tax(39,250×17%)	1,275	
	General reserve	**10,000**	
			45,365
3	**Long term borrowings**		
	12% Debentures		3,00,000
4	**Trade Payables**		
	Creditors		50,000

	Bills payable		38,000
			88,000
5	**Short term provisions:**		
	Dividend tax payable		1,275
	Provisions for tax		25,000
			26,275
6	**Other current liabilities**		
	Outstanding interest on debentures		9,000
7	**Tangible assets**		
	Premises	3,60,000	
	Add: Wrongly debited to wages a/c	10,000	**3,70,000**
	Machinery	3,00,000	
	Less:10% Dep.	30,000	**2,70,000**
	Fixtures	7,200	
	Less:5% dep	360	**6,840**
			6,46,840
8	**Intangible assets**		
	Goodwill		25,000
9	**Non-Current investments**		
	4% Govt. Securities		**60,000**
9	**Trade receivable**		
	Debtors less PBDD (87,000-4,350)		82,650

Big Bull Ltd

Balance Sheet as on 31.3.1998 (as per Revised Schedule VI)

		Note No.	Rs.
I	**Equity and liabilities:**		
i	**Shareholders' funds:**		
	Share capital	1	4,52,500
	Reserve & Surplus	2	80,365
ii	**Non-current liabilities**		
	Long term borrowings	3	3,00,000

iii	**Current liabilities**		
	Trade payable	4	88,000
	Short term provisions	5	26,275
	Other current liabilities	6	9,000
	Total (i+ii+iii)		**9,56,140**
II	**Assets:**		
i	**Non-Current assets**		
	Tangible assets	7	6,46,840
	Intangible assets	8	26,275
	Non-current investments		9,000
ii	**Current assets**		
	Trade receivables	9	82,650
	Closing stock		1,01,000
	Cash in bank		39,900
	Cash in hand		750
	Total (i+ ii)		**9,56,140**

1.9 Managerial Remuneration

The word managerial is associated with the words such as, management, administration, organizational, etc. Therefore, it can be comprehended that,

a) personnel who all manages the affairs of a company, and/or

b) has command over the administration of the day-to-day affairs of an organization, are given or compensated by money and/or kind and/or perquisites, for the services provided or offered by them towards such company. Such personnel generally are the directors and managers of a company.

As we all know, there are various categories of directors prevailing in organizations such as, Managing Director, Whole-time Director, Executive Director, Non-executive Director, Promoter Director, Nominee Director, Independent Director, Women Director.

Now, let's discuss the

Meaning of Remuneration

The Companies Act, 2013 has specifically defined the meaning of remuneration. As per sub section 78 of Section 2 of the Companies Act, 2013, "remuneration" means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961.

In view of the above, it is evident that, managerial remuneration is paid to the above- mentioned categories of directors and manager of a company.

Now, the question arises how to determine the extent of managerial remuneration to be paid?

Section 197 of the Companies Act, 2013 provides for the payment of overall managerial remuneration to be paid on certain circumstances by a company.

Scenario-I: When a company has profit.

Section 197 of the Companies Act, 2013 provides that, when a company has adequate profitthen, the maximum managerial remuneration in respect of a financial year shall be paid by a company is 11% of the net profit of the company for that financial year in which the remuneration is payable.

However, the Act has stated various conditions on this overall 11% of the managerial remuneration on different situations. Situation-A under Scenario-I: when there is only 1 managing director or whole-time director or manager in a company: Then the remuneration payable to such 1 managing director or whole-time director or manager shall not exceed 5%of the net profits of the company. Situation-B under Scenario-I: when there is more than 1 managing director or whole-time director or manager in a company: The remuneration shallnot exceed 10% of the net profits to all such Directors and manager taken together. Situation-C under

Scenario-I: remuneration payable to other categories of directors who are neither managing directors nor whole-time directors:

a) The remuneration payable to such directors shall not exceed 1% of the net profits of the company if there is 1 managing or whole-time director or manager.
b) 3% of the net profits in any other case. That means, if there is no managing or whole-time director or manager in a company then the maximum managerial remuneration payable to other categories of directors shall not exceed 3% of the net profits of a company.

Scenario-II: When a company has inadequate profit or is in loss. When a company is incurring losses or has inadequate or insufficient profit during a financial year, then the company must follow the provisions and conditions prescribed under Schedule V of the Companies Act, 2013 for payment of managerial remuneration.

Before we jump into the provisions of Schedule V of the Companies Act, 2013, and mugup the conditions specified therein, we must understand that what happens when a company suffers loss or has inadequate profit?

When a company suffers a loss or has inadequate profit, it can have various implicationsfor its financial health, operations, and stakeholders. If the company has borrowed money, it may struggle to meet its debt obligations. This could lead to credit downgrades and increased borrowing costs. Continuous losses can erode the company's capital, making it challenging to fund operations, investments, and debt repayments. Suppliers and creditors may become concerned about the company's ability to meet its obligations,impacting relationships.

With the intention of providing an opportunity to a loss-making company, the Government has stipulated that such loss-making company shall pay managerial remuneration based on its effective capital.

Now, what is effective capital? Let's understand first the meaning of the word effective. The term "effective" generally means producing the intended or desired result; it refers to something that is successful in achieving its purpose. Effectiveness is often associated with efficiency and the ability to accomplish goals or objectives. In the context of effective capital, it would mean the capital that is successful and efficient in achieving its purpose, which is typically related to funding productive activities and generating returns. The effectiveness of capital is assessed by considering factors like debt, equity, and financial obligations to determine the actual resources available forinvestment or operational needs..

Hence, in this situation, as provided by the Schedule V of the Companies Act, 2013, the managerial remuneration shall not exceed the higher limit of the following:

S.No	Where the effective the effective capital is (in Rs.	Limit of yearly remuneration payable shall not exceed in case of a managerial person (inRupees	Limit of yearly remuneration payable shall notexceed in case ofother director (inrupees)
1	Negative or less than 5 crores.	60 Lakhs	12 Lakhs

2	5 crores and above but less than 100 crores.	84 Lakhs	17 Lakhs
3	100 crores and above but less than 250 crores.	120 Lakhs	24 Lakhs
4	250 crores andabove	120 Lakhs Plus 0.01 of the effectivecapital in excess of Rs.250 crores.	24 Lakhs Plus 0.01% of the effective capital in excess of Rs.250 crores

Provided that the remuneration in excess of above limits may be paid, if the resolution passed by the shareholders, is a special resolution. Explanation as per Schedule V of the Companies Act, 2013— "effective capital" means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expensesnot written off.

Key points

1. This section is applicable only for public companies and not for private companies.
2. Managerial remuneration shall be computed only on the basis of net profit and not on gross profit.
3. The process of computation of net profit is stated in Section 198 of the Companies Act, 2013.

Section 197 of the Companies Act, 2013 provides only for the maximum managerial remuneration shall be paid by a company during various circumstances. Conclusion: The Companies Act, 2013, provides a structured framework for the payment of managerial remuneration, highlighting the importance of aligning compensation with corporate profitability and governance standards. The act distinguishes between scenarios of profit and loss, prescribing specific caps on remuneration based on the company's net profits and its effective capital, thereby ensuring that remuneration practices are both fair and sustainable. For companies, adhering to these guidelines is not merely a legal mandate but a step towards robust corporate governance and ethical management practices. As companies navigate through varying financial landscapes, the act's provisions serve as a beacon, guiding them in rewarding managerial efforts appropriately while safeguarding the interests of all stakeholders. Ultimately, the act underscores the principle that managerial remuneration should be reflective of the company's financial health and operational realities, promoting a culture of accountability and excellence in corporate India.

Check your Progress

1. Amount realised from sale of goods in show in the statement of profit and loss as
   a) Other income
   b) **Revenue from operations**
   c) Any of the above
   d) None of the above
2. Gain on sale of fixed assets is shown in the statement of profit and loss as
   a) **Other income**
   b) Revenue from operations
   c) Any of the above
   d) None of the above
3. Dividend received by a financial company is shown in the statement of profit and lossas
   a) Other income
   b) **Revenue from operations**
   c) Any of the above
   d) None of the above
4. Raw material purchases are shown in the statement of profit and loss as
   a) **Cost of material consumed**
   b) Purchase of stock in trade
   c) Changes in inventories
   d) None of the above
5. Goods purchased for reselling is shown in the statement of profit and loss as
   a) Cost of material consumed
   b) **Purchase of stock in trade**
   c) Changes in inventories
   d) d)None of these
6. Payment of wages and salaries is shown in the statement of profit and loss under
   a) **Employees benefits expenses**

b) Other expenses
c) Finance costs
d) None of these

7. Payment of interest on debentures and bank overdraft is shown in the statement ofprofit and loss under
   a) Employees benefits expenses
   b) Other expenses
   c) **Finance costs**
   d) None of these

8. Preliminary expenses written off is shown in the statement of profit and loss under. a)
   a) Employees benefits expenses
   b) Other expenses
   c) Finance costs
   d) Depreciation and amortization expenses

9. Carriage outwards is shown in the statement of profit and loss under
   a) Employees benefits expenses
   b) Other expenses
   c) Finance costs
   d) Depreciation and amortization expenses

10. Debentures redeemable after 10years of issue are shown as
   a) **Long term borrowings**
   b) Short-term borrowings
   c) Other current liabilities
   d) None of these

Other exercises

1. Pawan Ltd. issued Rs.10,00,000 8% debentures on 1sr April 2017 at a premium of 5%. On 31st March 2022out of these Rs.1,00,000 8% debentures were redeemable by converting them into equity shares of Rs.100 each issued at par, and Rs.2,50,000 8% debentures were converted into 10 % Preference Shares of Rs.100 each issued at a premium of 25%. Pass necessary Journal Entries in the books of Pawan Ltd. for the redemption of debentures.
2. From the following balance, prepare the Balance sheet of a company in the prescribed

format. Goodwill Rs.1,50,000; investment Rs.2,00,000; share capital Rs.5,00,000; reserves Rs.1,10,000; securities premium Rs. 15,000; preliminary expense Rs. 10,000; profit & Loss A/c (Cr)Rs. 25,000; Debentures Rs.2,50,000. Other fixed assets Rs.4,70,000; stock Rs. 80,000; Debtors Rs. 60,000; Bank balance Rs. 30,000; secured loan Rs. 65,000; sundry creditors Rs. 35,000.

[Ans: shareholders' fund: Rs.10,50,000; Non-current liabilities; Rs.5,00,000; current liabilities Rs.2,50,000; Non –current assets Rs.13,00,000; current assets Rs.5,00,000; B/S Rs.Rs.18,00,000].

3. Timex Ltd., issued 1,000 8% Debentures of Rs.100 each. Give appropriate journal entries in the books of the company, if the debentures were issued as follows;
   a) Issued at par, redeemable at par
   b) Issued at a discount of 5%, repayable at par
   c) Issued at a premium of 10%, repayable at par
   d) Issued at par, redeemable at a premium 10%
   e) Issued at a discount of 5%, repayable at a premium of 10%

You are also required to show how the items concerned appear in the Balance sheet ineach of the above cases.

6. Moon Rays issued 50000 8 % debentures of Rs.10 each to the public at par to be paid Rs. 4 an application and the balance of allotments. Applications for received for 48,000 allotments was made to all the application and the amount you were received promptly give the journal entries to record the transaction and show how they appear in the balance sheet of the company. Earth movers limited issued 15,000 14% debentures of Rs 100 each for public subscription at a premium of 10% payable as to Rs. 30 on application Rs. 50 (including premium) and allotment and the balance in one call. 25,000applications where received 4,000 applications were rejected and the debentures were allotted to the remaining applications allotment amount was received from all the allottees one of whom did the call amount due on his 1,000 debentures along with allotment money The call amount was also collected on the due date. you are requiredto pass necessary journal entries in the company's books.
7. A limited company was registered with an authoriesd capital of Rs.30,00,000 in equity shares of Rs.10 each. The following is the list of balances extracted from its books

on31.12.94.

	Rs.
Purchases	9,25,000
Wages	4,24,325
Manufacturing expenses	65,575
Salaries	70,000
Bad debts	10,550
Directors' fees	31,125
Debentures interest paid	45,000
Preliminary expenses	25,000
Calls –in –arrears	37,500
Plant & Machinery	15,00,000
Premises	16,50,000
Interim dividend paid	1,87,500
Furniture and fittings	35,000
Sundry debtors	4,36,000
General expenses	84,175
Stock on 1.1.94	3,75,000
Cash in hand	1,00,000
Goodwill	28,750
cash at bank	1,99,500
Subscribed and fully called up capital	20,00,000
Profit & Loss a/c (cr)	72,500
6% Debentures	15,00,000
Sundry creditors	2,90,000
Bills payable	1,67,500
Sales	20,75,000
General reserve	1,25,000

You are requiring to prepare statement of profit and loss for the ended 3 1.12.94 and the balance sheet as on that date, after making, the following adjustments.

Depreciate plant & Machinery by 10%. Provide half years' interest on Debentures. Also write off preliminary expenses and making the provision for bad debts of Rs. 4,250 on Sunday debtors. Stock on 31st December 1994 was Rs.4,55,000. Provide for corporate dividend tax @17%.

[**Ans: Revenue from operations Rs.20,75,000; cost of goods sold Rs.8,45,000; employee benefits expense Rs.4,94,325; finance cost Rs. 90,000; Dep.and amortized exp.Rs.1,75,000; other expenses Rs.1,95,675' profit Rs.2,75,000; shareholders' fund Rs.22,15,625; Non-current liabilities Rs.15,00,000; current liabilities Rs.5,34,375; Non-current assets: Rs.30,63,750; current assets Rs.11,86,250; B/S total Rs.42,50,000.]**

UNIT II INSURANCE COMPANY ACCOUNTS

Insurance Company Accounts: Types of Insurance - Final accounts of lifeassurance Companies- Ascertainment of profit- Valuation Balance Sheet-Final accounts of Fire, Marine and miscellaneous Insurance Companies.

2.1 Introduction

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

2.2 Types of Insurance

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

1. **Life Insurance**

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

2. **General Insurance**

   It includes all other types of insurance except life insurance. e.g. – Fire, Marine, Accident, Theft. etc. Under this type of insurance, the insurer undertakes to indemnify the loss suffered by the insured on happening of a certain event in consideration for a fixed premium.

3. **Insurance Regulatory and Development Authority (IRDA).**

   In order to regulate the insurance business, the government set up in 1996, the

Insurance Regulatory Authority (IRA). Now this authority is known as the Insurance Regulatory and Development Authority. In 2002, the authority came with regulations for the preparation of the financial statement of insurance companies.

Preparation of Financial Statements

2.3 Final Accounts of Life Insurance Companies

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

Revenue Account (Form A-RA)

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

FORM A – RA

Name of the insurer

Registration No. and Date of Registration with the IRDA

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

No	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Premiums earned – net			
	(a) Premium	1		
	(b) Reinsurance ceded			
	(c) Reinsurance accepted			
	Income from investments			
	(a) Interest, dividends & rent – Gross			
	(b) Profit on sale/redemption of Investments			
	(c) (Loss on sale/redemption of			

	investments)			
	(d) Transfer/ Gain on revaluation/change in fair value*			
	Other income (to be specified) Total (A)			
	Commission			
	Operating Expenses related to Insurance Business			
	Provision for doubtful debts Bad debts written off Provision For tax			
	Provisions (other than taxation)			
	(a) For diminution in the value of investments (net)			
	(b) Others (to be specified) Total (B)	2		
	Benefits Paid (Net) Interim Bonuses paid			
	Change in valuation of liability in respect of life policies	3		
	(a) Gross**			
	(b) Amount ceded in Reinsurance			
	(c) Amount accepted in Reinsurance			
	Total (C)			
	Surplus (Deficit) (D)=(A)-(B)-(C)			
	Appropriations			
	Transfer to Shareholders' AccountTransfer to Other Reserves (to be specified)	4		

	Balance			
	being Funds for Future Appropriations Total (D)			

2.4 Profit and Loss Account (Form A-PL)

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

FORM A - PL

Name of the insurer Registration No. and Date of Registration with the IRDA

Profit and Loss Account for the year ended 31st March, 20______ Shareholders' Account (Non-technical Account)

No	Particulars	Schedule	Current Year (Rs.'00)	Previous Year (Rs.'00)
	Amounts transferred from/to the Policyholders Account (Technical Account) Income from investments (a) Interest, dividends & rent – Gross (b) Profit on sale/redemption of investments (c) (Loss on sale/redemption of investments) Other income (to be specified) **Total (A)** Expenses other than those directly related tothe insurance business Bad debts written off Provisionfor tax Provisions (other than taxation) (a) For diminution in the value of investments (net) (b) Provision for doubtful debts (c) Others (to be specified)			

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

Notes to Form A-RA and A-PL:

1. Premium income received from business concluded in and outside India shall be separately disclosed.
2. Reinsurance premiums whether on business ceded or accepted are to be brought into account gross (i.e., before deducting commissions) under the head reinsurance premiums
3. Claims incurred shall comprise claims paid, specific claims settlement costs wherever applicable and change in the outstanding provisions for claims at the year-end.
4. Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs.500000 whichever is higher, shall be shown as a separate lineitem.
5. Fees and expenses connected with claims shall be included in claims.
6. Under the sub-head “Others” shall be included items like foreign exchange gains or losses and other items.
7. Interest, dividends and rentals receivable in connection with an investment should be stated at gross amount, the amount of income tax deducted at source being included under “advance taxes paid and taxes deducted at source”.
8. Income from rent shall include only the realized rent. It shall not include any notional rent.

3.5 Balance Sheet (Form A-BS)

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

No.	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
	Sources of Funds			
	Shareholders' Funds:			
	Share Capital Reserves			
	and Surplus	5		
	Credit/[Debit] Fair Value Change Account	6		
	Sub-Total Borrowings			
	Policyholders' Funds:			
	Credit/[Debit] Fair Value Change Account			
	Policy Liabilities	7		
	Insurance Reserves			
	Provision for Linked Liabilities			
	Sub-Total			
	Funds for Future Appropriations			
	Total			
	Application of Funds			
	Investments			
	Shareholders'			
	Policyholders'			
	Assets held to Cover	8		
	Linked Liabilities	8A		
	Loans	8B		
	Fixed Assets	9		
	Current Assets	10		
	Cash and Bank Balances			
	Advances and Other	11		
	Assets Sub- Total (A)	12		
	Current Liabilities			

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

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS

SCHEDULE 1 - PREMIUM

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
.	First Year Premiums Renew Premiums Single Premiums Total Premium		

SCHEDULE 2 COMMISSION EXPENSES

Particulars	Current Year (Rs.'000	Previous Year (Rs.'000
Commission paid Direct - First Year Premiums Renewal Premiums Single		

Premiums Add: Commission on Re-Insurance Accepted Less: Commission on Re-Insurance Ceded Net Commission		

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

SCHEDULE 3

OPERATING EXPENSES RELATED TO INSURANCE BUSINESS

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

SCHEDULE 4 – BENEFITS PAID [NET]

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

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

SCHEDULE 5- SHARE CAPITAL

No	Particulars	Current Year (Rs.00)	Previous Year (Rs.00)
	Authoriesd capital Equity shares of Rs…..each		
	Issued Capital Equity shares of Rs…..each		
	Subscribed Capital Equity shares of Rs…..each		

	Called-up Capital Equity shares of Rs…..each **Less:** Calls unpaid **Add:** Shares forfeited (Amount originally paid up) Less: Par value of equity sharesbought back **Less:** Preliminary Expenses Expenses including commission or brokerage on underwriting or subscription ofshares **Total**		

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

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

SCHEDULE 6- RESEVES AND SURPLUS

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

	. Capital Reserve Capital Redemption Reserve Share Premium Revaluation Reserve General Reserves Less: Debit balance in P&L A/c, if any Less: Amount utilized for buy back. Catastrophe Reserve Other Reserves (to be specified) Balance of Profit in P&L A/c		

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

SCHEDULE 7 – BORROWINGS

No	Particulars	Current Year (Rs.'00)	Previous Year (Rs.'000
1. 2. 3. 4.	Debentures/Bond s Banks Financial Institutions others (to be specified) Total		

SCHEDULE 8- INVESTMENTS

No.	Particulars	Current Year (Rs.'00)	Previous Year (Rs.'00)
1. 2.	**Long –term Investments** Government securities and Government Guaranteed Bonds including treasury bills Other approved securities		

3	**Other investments** a) Shares b) Equity c) Preference d) Mutual funds e) Derivative instruments f) Debentures /Bonds g) Other securities (to be specified) h) Subsidiaries i) Investments properties- Real Estate Investments in infrastructure and social sector Other than approved investments Other than approved investments Short-term investments Governments securities and government guaranteed bonds including treasury bills Other approved securities **Other investments** a) Shares b) Equity c) Preference d) Mutual funds e) Derivative instruments f) Debentures /Bonds g) Other securities (to be specified)		
	h) Subsidiaries i) Investments properties –Real Estate Investments in infrastructure and social sectorOther than approved investments Total		

SECHEDULE 9- LOANS

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	**Security-wise Classification** Secured (a) On mortgage ofproperty (aa) In India (bb) Outside India (b) On Shares, Bonds, Govt. Securities, etc. (c) Others (to be specified) Unsecured Total		
2.	**Borrower-wise Classification** (a) Central and State Governments (b) Banks and Financial Institutions (c) Subsidiaries (d) Companies (e) Loans against policies (f) Others (to be specified) Total		
3.	**Performance-wise Classification** (a) Loans classified as standard (aa) In India(bb) Outside India (b) Non-standard loans less provisions (aa) In India (bb) Outside India Total		
4	Maturity –wise Classification (a) Short Term (b) Long Term Total		

SCHEDULE 10– FIXED ASSETS

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

SCHEDULE 11– CASH AND BANK BALANCES

No	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Cash (including cheques, drafts and stamps) Bank Balances (a) Deposit Accounts (aa) Short-term (due within 12 months of the date of Balance Sheet) (bb) Others (b) Current Accounts		

	(c) Others (to be specified) Money at call and short notice (a) With banks Balances with non-scheduled banks in 2 and 3 **Cash and Bank Balances** 1. In India 2. Outside India Total		

SCHEDULE 13– CURRENT LIABILITIES

No.	Particulars	Current Year Rs.'000)	Previous Year (Rs.'000)
1. 2. 3. 4. 5. 6. 7. 8. 9. 10. 11.	Agents' balances Balances due to other insurance companies Deposits held on re- insurance ceded Premiums received in advance Unallocated Premium Sundry Creditors Due to subsidiaries/holding company Claims Outstanding Annuities due Due to Officers/ Directors Others (to bespecified) Total		

SCHEDULE -14 PROVISIONS

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

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

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

Preparation of Revenue Accounts

Illustration 1

The following balance are abstracted from the books of New Bharat Life Insurance Co.Ltd., as on 31.3.2006.

	Rs('000)		Rs('000)
Life Assurance fund (1-4-2005)	15,00,000	Claims paid during the year	64,900

Premiums	4,96,000	Annuities	2,050
Consideration for annuities Granted	15,000	Bonus in reduction of premium	1,600
Interest & Dividends	1,00,000	Medical fees	2,400
Fines for revival of policies	750	Surrenders	4,000
Reinsurance Premium	20,750	Commission	18,650
Claims outstanding (1.4.2005)	4,500	Management expenses	22,000
		Income tax on dividends	8,500

Prepare Revenue A/c after making the following adjustments:

	Rs.(000)
Outstanding balances:	
Claims	14,000
Premium	4,600
Further bonus for premium	2,400
Claim under reinsurance	8,000

New Bharath Life Assurance Co., Ltd.

Revenue Accounts for the Year ended 31st March 2006

	Schedulee No	Current Year (Rs.00)	Previous Year (Rs.00)
Premium earned – Net			
a) Premium **b)** Reinsurance ceded **c)** Reinsurance accepted	1	5,03,000 (-) 20,750 -	- - -
Income from Investments Interest and dividends (Gross)		1,00,000	

Other income (to be Specified)			
Consideration for annuities granted		15,000	
Fined for revival of Policies		750	
Total		5,98,000	-
Commission	2	18,650	-
Operating expenses related to insurance business	3	24,400	-
Total (B)		43,050	-
Benefits Paid (Net)	4	76,450	-
Total (C)		76,450	-
Surplus (D)=(A)-(B)-(C)		4,78,500	-

Note: Income tax on dividend is a TDS and will appear in schedule 12 under advances andother assets, as per IRDA form.

Schedule 1- Premium

No	Particulars	Current Year (Rs.000)	Previous year (Rs.000)
	Premium received	4,96,000	-
	Add: Outstanding Premiums	4,600	-
	Add: Further Bonus in reduction of premium	2,400	-
		5,03,000	-

Schedule 2- Commission Expenses

No	Particulars	Current Year (Rs.000)	Previous year (Rs.000)
	Commission Paid	18,650	-
		18,650	-

Schedule 3- Operating expenses related to Insurance Business

No	Particulars	Current Year (Rs.000)	Previous year (Rs.000)
	Management expenses	22,000	-
	Medical fees	2,400	-
		24,400	-

Schedule 4- Benefits Paid (Net)

No	Particulars	Current Year (Rs.000)	Previous year (Rs.000)
	Claims paid	64,900	-
	Add: Outstanding Claims on 31.03.2006	14,000	-
		78,900	-
	Less: Outstanding Claims on 01.4.2005	4,500	
		74,400	
	Less: Claims under reinsurance	8000	
		66,400	
	Annuities	2,050	
	Surrenders	4,000	
	Bonus in reduction of premium (1,600+2,400)	4,000	
		76,450	

Illustration 2

From the following balances extracted from the books of the L.I.C as at 31.3.2006 prepare aRevenue A/c for the year ending 31.3.2006 in the prescribed form:

	Rs(‘000)		Rs(‘000)
Claims by death	3,30,000	Life assurance fund (1.4.2005	63,31,000

Claims by maturity	2,15,000	Premiums	20,65,000
Agents & canvasser's allowance	26,500	Bonus in reduction of premium	1,000
Salaries	44,200	Income tax on interest and dividends	5,700
Travelling expenses	1,200	Printing & Stationery	13,900
Director's fees	8,700	Postage & telegrams	14,300
Auditor's fees	1,000	Receipts stamps	2,300
Medical fees	52,000	Reinsurance premiums	40,950
Commission	2,18,000	Interest on dividend (Gross)	2,72,000
Rent	2,800	Policy renewal fees	9,600
Law charges	200	Assignment fees	540
Advertising	4,300	Endowment fees	690
Bank charges	1,500	Transfer fees	1,400
General charges	2,000		
Surrenders	47,500		

Provide Rs. 1,500 thousand for depreciation of furniture and Rs.2,20,000 thousand for depreciation on investments.

Revenue Accounts of Life Insurance corporation

for the Year ended 31st March 2006

	Schedule No	**Current Year (Rs.000)**	**Previous Year (Rs.000)**
a) Premium **b)** Reinsurance ceded **c)** Reinsurance accepted	1	20,65,000 (-) 40,950 -	- - -
Income from Investments b) Interest and dividends		2,72,000	

(Gross)			
Other income (to be Specified)			
Policy renewal fees		9,600	
Assignment fees		540	
Endowment fees		690	
Transfer fees		1,400	
Total (A)		23,08,280	
Commission	2	2,18,000	-
Operating expenses related to insurance business	3	1,76,400	-
Depreciation in the value of Investments		2,20,000	
Total (B)		6,14,400	-
Benefits Paid (Net)	4	5,93,500	-
Total (C)		5,93,500	-
Surplus (D)=(A)-(B)-(C)		11,00,380	-

Note: Income tax on interest dividends is a TDS and will appear in schedule 12 under advances and other assets, as per IRDA form.

Schedule Formatting Part of Revenue Account

Schedule 1- Premium

No	Particulars	Current Year (Rs.000)	Previous year (Rs.000)
	Premium received	20,65,000	-
		20,65,000	-

Schedule 2- Commission Expenses

No	Particulars	Current Year (Rs.000)	Previous year (Rs.000)
	Commission Paid	2,18,000	-

		2,18,000	-

Schedule 3- Operating expenses related to Insurance Business

No	Particulars	Current Year (Rs.000)	Previous year (Rs.000)
	Agents & Canvassers allowance	26,500	-
	Salaries	44,200	-
	Travelling Expenses	1,200	-
	Directors fees	8,700	
	Auditors fees	1,000	
	Medical fees	52,000	
	Rent	2,800	
	Law charges	200	
	Advertising	4,300	
	Bank charges	1,500	
	General charges	2,000	
	Printing and stationery	13,900	
	Postage and stationery	14,300	
	Receipts stamps	2,300	
	Depreciation: On furniture	1,500	
		1,76,400	

Schedule 4- Benefits Paid (Net)

No	Particulars	Current Year (Rs.000)	Previous year (Rs.000)
	Claims paid		
	By death	3,30,000	-
	By Maturity	2,15,000	-
	Surrenders	47,500	
	Bonus in reduction of premium	1,000	
		5,93,500	

Illustration 3

Prepare from the following a Life Insurance Revenue A/c and Balance Sheet as on 31.12.2006.

	Rs.		Rs
Claims by death	16,890	Outstanding interest on advances (31.03.2006)	1,944
Agent's salaries & allowances	6,420	Bonus paid with claims	2,700
Surrender value paid	2,810	Endowment assurance matured	24,415
Actuarial expenses	1,520	Annuities paid	1,350
Premiums	94,836	Interest revenue	19,060
Commission to agents	8,900	Rent, rates & Taxes	5,475
Salaries	13,500	General charges	1,860
Medical fees	1,200	Fees received	172
Travelling expenses	1,800	Bonus paid in cash	2,825
Director's fees	900	Advertising	726
Agents balance	750	Consideration for annuities	12,853
Claim expenses	1,432	Printing and stationery	650
Premium outstanding (1.4.2005)	2,134	Claims O/S (1.4.05)	2,376
Premium outstanding (31.03.2006)	3,143	Claims O/S (31.03.06)	2,735
Investments	1,46,700	Loans on Policies	38,300
Shares capital	2,00,000	Loans on mortgages	2,90,560
Sundry creditors	9,200	Freehold premises	1,22,600
Life Assurance Fund (1.4.2005)	3,53,672	Furniture & fittings	64,100
Reserve fund	1,46,000	Cash on hand & Deposits	76,300

Schedule 4- Benefits Paid (Net)

Particulars	Current Year (Rs.000)	Previous year (Rs.000)
Claims paid		

By death	16,890	-
By Maturity	24,415	-
	41,737	
Add: claim expenses	1,432	
	42,737	
Less: O/S claims on 1-4-2005	2,376	
Net claims	40,361	
Annuities	1,350	
Surrenders	2,810	
Bonus paid in cash	2,825	
Bonus paid with claims	2,700	
	50,046	

Note: claims outstanding on 31-3.2006 will appear in Schedule 13 as liability

Schedule 5- Share capital

Particulars	**Current Year(Rs.000)**	**Previous year (Rs.000)**
Share capital	2,00,000	
	2,00,000	-

Schedule 6- Reserve & Surplus

Particulars		**Current Year(Rs.000)**	**Previous year (Rs.000)**
Reserve fund		1,46,000	
Life Assurance Fund on 1-4-05	3,53,672		-
Add: Surplus Transferred to funds for future Appropriations	31,790	3,85,462	
		5,31,462	

Schedule 7- Borrowings

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
	-	

Schedule 8- Investments

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
Reserve fund investments	1,46,700	
	1,46,700	

Schedule 9- Loans

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
Loans on Mortgages	2,90,560	
Loans on Policies	38,300	
	3,28,860	

Schedule 10- Fixed Assets

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
Freehold Premises	1,22,600	
Furniture and fittings	64,100	
	1,86,700	

Schedule 11- Cash and Bank Balances

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
Cash on hand and deposits	76,300	

Schedule 12- Advances and other Assets

Particulars	Current Year(Rs.000)	Previous year (Rs.000)

Advances	-	
Other assets:		
Outstanding premiums	3,143	
Outstanding interest and Dividend	1,944	
Agents balances	750	
	5,837	

Schedule 13- Current Liabilities

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
Sundry creditors	9,200	
Outstanding claims	3,735	
	12,935	

Schedule 14 Provisions

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
	-	

Schedule 15- Miscellaneous Expenditure

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
	-	

Illustration 4

From the following Trial Balance of National Life Assurance Co.Ltd., Prepare Revenue A/c andBalance Sheet as on 31.3.2006

Debit Balance	Rs.	Credit balance	Rs
Claims by death	76,980	Life Assurance fund (1.4.05)	14,70,562
Claims by Maturity	36,420	Premiums	2,10,572

Expenses of Management	19,890	Consideration for annuities granted	10,620
Commission	26,541	Interest, Dividends & Rents	52,461
Dividend paid	20,000	Fines	92
Income tax on interest etc.	3,060	Annuities due but not paid	22,300
Surrenders	21,860	Share capital :40,00,000 shares of Rs.100 each	4,00,000
Annuities	29,420	Claims admitted but not paid	80,034
Bonus paid in cash	9,450		
Bonus in reduction of premium	2,500		
Preliminary expenses	200		
Stamps on hand	400		
Govt. securities	8,70,890		
Furniture	20,000		
Mortgages	3,09,110		
Loans on company's policies	2,00,000		
Freehold premises	3,00,000		
Leasehold ground rents	2,00,000		
House property	1,00,000		
	22,46,721		**22,46,721**

Additional Information:

	Rs.(000)
Management expenses due	600
Premium outstanding	7,400
Reinsurance premium	6,000
Interest accrued	15,400
Surrenders adjusted against loans	5,000
Further bonus utilized in reduction of premium	1,500
Further claim intimated	8,000
Claim covered under reinsurance	10,000

Revenue Accounts of Life Insurance corporation

for the Year ended 31st March 2006

	Schedule No	**Current Year (Rs.000)**	**Previous Year (Rs.000)**
Premium earned – (Net)	**1**		**-**
a) Premium		2,19,472	
b) Reinsurance ceded		(-)6,000	
c) Reinsurance accepted			
Income from investments:			
Interest, dividends and Rents (Gross)		67,861	
(52,461+15,400)			
Other incomes (to be Specified):			
Consideration for annuities granted		10,620	
Fines		92	
Total (A)		2,92,045	
Commission	**2**	26,541	**-**
Operating expenses related to insurance business	**3**	20,490	**-**
Total (B)		47,031	**-**
Benefits Paid (Net)	**4**	1,81,130	**-**
Total (C)		**1,81,130**	**-**
Surplus (D)=(A)-(B)-(C)		63,884	**-**
Appropriations			
Transfer to shareholders account		20,000	
Balance being funds for future appropriations		**43,884**	
Total (D)		**63,884**	

Note:

1. Dividend is to be shown as an item of payment in profit and loss account.
2. Income tax on interest ect., is a TDS and it will appear under schedule 12 advancesand other assets, as per the IRDA form.

Balance Sheet as on 31-3-2006

	Schedule No	Current Year (Rs.000)	Previous Year (Rs.000)
Sources of Funds:			
Share capital	**5**	3,99,800	-
Reserves and surplus	**6**	15,14,446	-
Borrowings	**7**	-	-
Total		19,14,246	-
Applications of Funds:			-
InvestmentsLoans	**8**	10,70,890	-
Fixed assets	**9**	5,04,110	-
	10	4,20,000	-
Total		19,95,000	-
Current assets			
Cash and Bank balances	**11**	-	-
Advances and other assets	**12**	36,260	-
Sub-total (A)		36,260	
Current Liabilities	**13**	1,17,014	-
Provisions	**14**	-	-
Sub-total (B)		1,17,010	-
Net current assets (A-B)		(-) 80,754	-
Total (Total of Schedules 8,9,10 and Net current Assets)		19,14,246	-

Schedule Formatting Part of Revenue Account

Schedule 1- Premium

Particulars	Current Year (Rs.000)	Previous year (Rs.000)
Premium received	2,10,572	-
Add: Outstanding premium on 31.3.2006	7,400	-
Add: Bonus in reduction of Premium	1,500	
	2,19,472	

Schedule 2- Commission Expenses

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
Commission	26,541	-
	26,541	-

Schedule 3- Operating expenses related to Insurance Business

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
Expenses of Management	19,890	-
Add: Expenses of Management due	600	-
	20,490	

Schedule 4- Benefits Paid (Net)

Particulars		Current Year (Rs.000)	Previous year (Rs.000)
Claims Paid			
By death	76,980		
By maturity	36,420		
	1,13,400		
Add: Further Claims intimated	10,000	1,11,400	
Annuities		29,420	

Surrenders 21,860		
	26,860	

Particulars		**Current Year (Rs.000)**	**Previous year (Rs.000)**
Bonus paid in cash		**9,450**	
Bonus in reduction of premium	2,500		
Add: further bonus in reduction of premium	1,500	**4,000**	
		1,81,130	

Schedule 5- Share capital

Particulars	**Current Year(Rs.000)**	**Previous year (Rs.000)**
4,00,000 shares of Rs.100 each	4,00,000	
Less: Preliminary Expenses	200	
	3,99,800	

Schedule 6- Reserve & Surplus

Particulars		**Current Year(Rs.000)**	**Previous year (Rs.000)**
Reserve fund		-	
Life Assurance Fund on 1-4-05	14,70,562		-
Add: Transfer to funds for future appropriations	43,884	15,14,446	
		15,14,446	

Schedule 7- Borrowings

Particulars	**Current Year(Rs.000)**	**Previous year (Rs.000)**
	-	

Schedule 8- Investments

Particulars	Current Year (Rs.000)	Previous year (Rs.000)
Govt. securities	8,70,890	
Leasehold ground rents	2,00,000 10,70,800	

Schedule 9- Loans

Particulars		Current Year (Rs.000)	Previous year (Rs.000)
Loans on Mortgages		3,09,110	
Loans on Policies	2,00,000		
Less: Surrenders Adjusted	5,000	1,95,000	
		5,04,110	

Schedule 10- Fixed Assets

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
Freehold premises	3,00,000	
House property	1,00,000	
Furniture	20,000	
	4,20,000	

Schedule 12- Advances and other Assets

Particulars	Current Year (Rs.000)	Previous year (Rs.000)
Advances		
Income tax on interest etc	3,060	
Other assets:		

Outstanding premiums	7,400	
Amount due from other insurers	10,000	
Accrued Interest	15,400	
Stamps	400	
	36,260	

Schedule 13- Current Liabilities

Particulars	**Current Year(Rs.000)**	**Previous year (Rs.000)**
Claims admitted but not paid	80,034	
Further claims intimated	8,000	
Annuities due but not paid	22,380	
Management expenses due	600	
Reinsurance premium due	6,000	
	1,17,014	

Schedule 14 Provisions

Particulars	**Current Year(Rs.000)**	**Previous year (Rs.000)**
	-	

Schedule 15- Miscellaneous Expenditure

Particulars	**Current Year(Rs.000)**	**Previous year (Rs.000)**
	-	

General Insurance

Illustration

From the following figures appearing in the books of Fire insurance divisions of a General company, show the amount of claim as it would appear in revenue account, by preparing schedule 2, claims incurred.

	Direct Business (Rs.000)	Re-Insurance (Rs.000)
Claims paid during 2005-2006	4,670	700
Claims payable 1-4-2005	763	87
31.3.2006	812	53
Claims received		230
Claims receivable – 1.4.2005		65
31.03.2006		113
Includes Rs.35 Thousand) Surveyor's fees and Rs.45 Thousand legal expenses for Settlement of claims)		

Solution

Particulars	Current Year(Rs.000)	Previous year (Rs.000)
Claims paid	4,670	
Add: surveyors fees for settlement of claims	35	
Legal expenses for settlement of claims	45	
Claims paid on reinsurance accepted	700	
Claims payable on direct business on 31.3.06	812	
Claims payable on reinsurance accepted on 31.03.06	53	
Claims receivable on reinsurance on 1.4.05	65	
	6,830	
Less: claims received from reinsurance	230	
Claims Receivable from reinsurance on 31.03.06	113	
Claims payable on direct business on 1-4-05	763	
Claims payable on reinsurance accepted on 1-4-05	87	
Claims incurred (Net)	**5, 187**	

Note: claims paid should be added with all expenses relating to claims, closing outstanding claims,both direct and reinsurance and also opening claims receivable from reinsurance.

Claims paid should be reduced by claims received from reinsurance and its closing outstanding,and also opening outstanding claims both direct and on reinsurance.

Illustration 1

The books of Jai Prakash Insurance Co. Ltd contain the following information in respect of fire insurance as on 31.3.2006.

	(Rs.000)		(Rs.000)
Provisions for unexpired risks (1.4.05)	80,000	Refund of double taxation	600
Estimated liability in respect ofo/s claims: on 1.4.05 On 31.3.06	10,000	Management expenses	55,000
Medical expenses regarding Claims	15,000	Interest & Dividends	8,000
Claims paid	70,000	Legal expenses Regarding claims	1,500
Reinsurance premium	14,500	Profit on sale of investments	1,750
Reinsurance recoveries	1,500	Additional reserve on 31.03.05	60,000
Premiums	1,90,000		
Commission on direct business	25,000		
Commission on reinsurance Ceded	3,000		
Commission on reinsurance accepted	1,000		

Additional reserve is to increased by 10%of the premium income. Prepare revenue A/c keepingthe reserve for unexpired risks at 50% of Premium income.

Solution

Particulars		Current Year(Rs.000	Previous year (Rs.000)
Premium earned (Net)	1	1,50,000	
Profits on sale of Investments		1,750	
Other Incomes:			
Refund of double taxation		600	
Interest, dividends and rents (Gross)		8,000	
Total (A)		1,60,550	
Claims incurred (Net)	2	76,000	
Commission	3	23,000	
Operating expenses related to insurance Business	4	55,000	
Total (B)		1,54,000	
Operating profit from fire business (c)= (a)+(B)		6,550	

SCHEDULES FORMING PART OF REVENUE ACCOUNT

Schedule 1 – Premiums earned (Net)

Particulars		Current Year (Rs.000)	Previous year (Rs.000)
Premiums received		1,90,000	
Less: Reinsurance premium		14,500	
Net premium		1,75,500	
Adjustment for change in provision for unexpired risk:			
Provision for unexpired risk (31.3.06) (1,75,500×50%)	87,750		

Additional Reserve (1,75,000×10%+60,000	77,550	**1,65,330**	
Less : Provision for unexpired risk (1-4-05)	80,000		
Additional reserve (1-4-05)	60,000		
	1,40,000	25,300	
Changes in provisions for unexpired risk		**1,50,200**	

Schedule 2- Claims incurred (Net)

Particulars		**Current ar(Rs.000**	**ious year Rs.000)**
Claims paid		70,000	
Add: Medical Expenses regarding claims		1,000	
Add: Legal expenses		1,500	
Add: Outstanding claims **on (31.3.06)**		15,000	
		87,500	
Less: Outstanding Claims on 1.4.05	10,000		
Less: Reinsurance recoveries	1500	11500	
Claims incurred (net)		**76,000**	

Schedule 3 – Commission

Particulars	**Current Year (Rs.000)**	**Previous year (Rs.000)**
Commission on direct business	25,000	
Add: Commission on reinsurance accepted	1,000	
	26,000	
Less: Commission on reinsurance ceded	3,000	
Net commission	23,000	

Schedule 4 –Operating Expenses Related to Insurance Business

Particulars	Current Year (Rs.000)	Previous year (Rs.000)
Management expense	55,000	
	55,000	

Check your Progress

1. **Insurance business in India is now regulated by the provisions of**
   a) The insurance Act 1938
   b) The IRDA Act 1999
   c) The Banking Regulations Act 1949
   d) The Indian Companies Act 1956
2. **Number of schedules to be prepared by the insurance companies for their financial statements are;**
   a) 26 schedules
   b) 10 schedules
   c) 12 schedules
   d) 15 schedules
3. **In life insurance, the policy amount is payable**
   a) After the death of the assured
   b) After the expiry of the policy period
   c) On death of the insured or on expired whichever is earlier
   d) Only when the insured has incurred loss
4. **Claims paid by life insurance companies is shown in**
   a) Schedules 1
   b) Schedules 2
   c) Schedules3
   d) Schedules 4
5. **The commission received from the re-insurer is called**
   a) Commission on reinsurance accepted
   b) Commission on reinsurance ceded
   c) Commission on direct business
   d) None of the above

6. **The bonus which is to be paid on maturity of the policy along with the policy amount is known as;**
   - **a) Reversionary bonus**
   - b) Annual Bonus
   - c) Interim bonus
   - d) Eventual Bonus
7. **The balance found in the Revenue Account of General Insurance companies is considered as**
   - a) Net Profit / net Loss
   - **b) Surplus / Deficit**
   - c) Life assured Fund
   - d) Gross profit/ Gross Loss
8. **The balance found in the Revenue account of General Insurance companies is treated as**
   - a) Provision for unexpired risk
   - b) Net profit /Net Loss
   - **c) Operating profit or loss from insurance business**
   - d) Gross profit/ gross Loss
9. **The commission paid by the re-insurer is known as**
   - a) Commission on direct business
   - b) Commission on reinsurance ceded
   - **c) Commission on reinsurance accepted**
   - d) None of the above

Exercises

Short Answer Problems:

10. Compute the net premium to be credited to Revenue A/c from the following data:

	Rs.
Premium received during the year ended 31.3.06	16,00,000
Reinsurance premium paid	5,40,000
Reinsurance premium received	6,20,000

Bonus in reduction of premium (not yet adjusted)	20,000
[Ans: Net Premium - Rs.17,00,000]	

11. Compute commission expenses to be derived in schedule 2 of a life insurance company:

	Rs.
Commission on direct business	93,000
Commission on reinsurance accepted	40,000
Commission on reinsurance ceded	50,000
[Ans: Commission expenses - Rs.83,000]	

12. Calculate the net claim to be debited to Revenue a/c

	Rs.
Claims paid for the year ended 31.3.06	5,75,000
Claims outstanding on 1.4.05	55,000
Claims outstanding on 31.3.06	98,000
Claims covered under reinsurance	28,000
[Ans: Net Claim - Rs.5,90,000]	

Life Insurance

Ascertaining correct Life Assurance Fund

13. The revenue account of an assurance company shows the Life assurance fund on31.03.2006 at Rs.62,21,310 before taking into account the following.

	Rs.
Claims covered under reinsurance	12,000
Bonus utilized in reduction of life insurance premium	4,500

Interest accrued on securities	8,260
Outstanding premium	3,420
Claims intimated but not admitted	26,500

What is the Life assurance fund after taking into account the above omissions?

[Ans: correct Life Assurance Fund- Rs.62,20,490]

14. A Life Assurance Fund has been ascertained without adjusting the following. You arerequired to calculate the correct Life Assurance Fund.

Life assurance fund, as ascertained	56,70,000
Premiums outstanding	2,30,000
Claims outstanding	1,80,000
Claims covered under reinsurance	20,000
Claims of last year paid during this year	5,000
Bonus paid in cash	14,000
Bonus utilized in reduction of premium	16,000
Interest and dividend accrued	7,500
Income tax thereon	800

[Ans: Adjusted Life Assurance Fund- Rs.57,37,700]

Preparation of Revenue Account

15. The following figures relate to Life Insurance corporation for the year ended 31.3.2006.Prepare the Revenue a/c

Claims	39	Consideration for annuities granted	16.5
Management expenses	14	Surrenders	9

Director's fees	4	Premium received	151
Audit fees	3	Life fund(1.4.95)	1150
Medical expenses	5	Interest received	40
Agents commission	5	Rent received	10
Depreciation	4	Claims cancelled	.5
Bonus in reduction of premium	1.5	Annuities	1.5

Note: a) Premium outstanding Rs.9 Thousand; b) Claims outstanding Rs.3 Thousand

[Note: Claims cancelled owing to some inherent defect in the policy or any other reason, would reduce the total claim. Hence, the claim cancelled should be deducted from claims]

[Ans: surplus - Rs.1,42,500]

Preparation Revenue accounts and Balance sheet

16. From the following figures relating to the cosmopolitan Life Insurance Company prepareits revenue account and Balance sheet for the year ended 31.3.2006

	Rs ('000)
Shareholders' capital in 2,00,000 shares of Rs.25 each, Rs.10 per share paid up	2,00,000
Claims under policies paid and outstanding less received on Reassurance	45,00,000
Life assurance fund (1.4.05)	4,80,00,000
Investment reserve fund (1.4.05)	50,00,000
Expenses of Management	15,00,427
Investment	5,10,00,000
Freehold and Leasehold property	25,00,000
Unpaid dividends	51,790
Outstanding premium (Net)	6,03,200

Claims admitted but not paid	30,00,000
Outstanding interest	5,90,000
Surrenders	3,58,950
Annuities	30,000
Premium less reassurances	75,00,000
Consideration for annuities granted	50,500
Bonus in reduction of premium	4,000
Gain on redemption of debentures (to be carried to investment reserve fund)	20,000
Interest, dividends and rents received	32,00,337
Interest accrued	3,17,000
Income tax	2,80,149
Transfer fee	6,430
Agents balances	1,45,904
Furniture and fittings	90,500
Loans on company's Policies	49,00,000
Cash in hand and at banks	3,64,000
Stamps on hands	7,322
Cheques paid into banks and in course of collection	**49,000**
Cheques paid but not presented for payment	**66,520**
Sundry creditors	**44,875**
Premium received in advance	**1,00,000**

[Ans: surplus - Rs.40,83,741; B/s Rs. 5,73,03,741; Net Current assets Rs.11,86,759; LifeAssurance Fund Rs.5,20,83,741]

Unit III Consolidated Financial Statement

Consolidated financial statements as per AS 21: Consolidated profit and Loss Account- Cost of control- Capital Reserve – Inter –company Holdings- Preparation of consolidated Balance sheet.		
3.1	**Consolidated financial statements as per AS 21**	
3.2	**Consolidated profit and Loss Account**	
3.3	**Capital Reserve**	
3.4	**Inter –company Holdings**	
3.5	**Preparation of consolidated Balance sheet**	

3.1 Consolidated financial statements as per AS 21

3.1 Introduction

AS 21, or Accounting Standard 21, is an Indian accounting standard issued by the Institute of Chartered Accountants of India (ICAI). AS 21 is titled "Consolidated Financial Statements" and provides guidance on the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent company.

Under AS 21, consolidated financial statements are prepared to present the financial position, financial performance, and cash flows of a parent company and its subsidiaries as a single economic entity. The purpose of consolidated financial statements is to provide a comprehensive view of the financial affairs of the entire group, rather than viewing each entity separately. Here are key aspects of consolidated financial statements as per AS 21:

1. Definition of a Subsidiary

AS 21 defines a subsidiary as an enterprise controlled by another enterprise, referred to as the parent. Control is typically achieved when the parent company owns more than 50% of the voting power or has the power to govern the financial and operating policiesof the subsidiary.

2. Preparation of Consolidated Financial Statements:

AS 21 requires the preparation of consolidated financial statements when a company has one or more subsidiaries. The financial statements of the parent and its subsidiaries are combined, eliminating intercompany transactions,balances, and unrealized profits or losses.

3. Uniform Accounting Policies AS 21 states that consolidated financial statements should be prepared using uniform accounting policies across the group. If any subsidiary uses different accounting policies, adjustments are made to ensure consistency.
4**. Consolidation Procedures** Consolidation involves combining the financial statements of the parent and its subsidiaries. This includes consolidating the assets, liabilities, equity, income, expenses, and cash flows of each entity. Intercompany balances and transactions are eliminated to avoid double counting.
5. Non-controlling Interest: Non-controlling interest, also known as minority interest, represents the portion of equity in a subsidiary not held by the parent company. AS 21 requires the presentation of non-controlling interest separately in the consolidated financial statements to reflect the equity attributable to minority shareholders.
6. Goodwill and Consolidated Reserves: AS 21 addresses the treatment of goodwill arising from the acquisition of subsidiaries. Goodwill is recognized as an asset in the consolidated financial statements and is subject to impairment testing. Consolidated reserves, such as consolidated retained earnings, are also presented in the consolidated financial statements.

3.2 Consolidated Profit and Loss Account:

In holding companies, consolidated profit and loss accounts are prepared to present the combined financial performance of the holding company and its subsidiary entities. The purpose of consolidated profit and loss accounts is to provide a comprehensive view of the overall profitability of the group as a whole. Here are some key aspects of consolidated profit and loss accounts in holding companies:

1. **Inclusion of Subsidiaries:** The consolidated profit and loss account includes the revenues, expenses, gains, and losses of both the holding company and its

subsidiaries. The financial results of all entities within the group are combined to present a unified view of the group's performance.

2. **Elimination of Intercompany Transactions:** Intercompany transactions, such as sales, purchases, and loans between the holding company and its subsidiaries, are eliminated in the consolidation process. This ensures that revenues and expenses are recorded only once and avoids double-counting.

3. **Uniform Accounting Policies:** Consolidated profit and loss accounts are prepared using uniform accounting policies across the group. If any subsidiary uses different accounting policies, adjustments are made to ensure consistency.

4. **Non-controlling Interest:** Non-controlling interest, also known as minority interest, represents the portion of equity in subsidiaries not owned by the holding company. The share of profit or loss attributable to non-controlling interest is presented separately in the consolidated profit and loss account.

5. **Treatment of Dividends:** Dividends received from subsidiaries by the holding company are not recognized as revenue in the consolidated profit and loss account. Instead, they are treated as a reduction of the carrying value of the investment in the subsidiary.

6. **Recognition of Goodwill Impairment**: Goodwill arising from the acquisition of subsidiaries is tested for impairment and any impairment loss is recognized in the consolidated profit and loss account. The impairment loss reduces the carrying value of the goodwill.
7. **Disclosure Requirements:** Consolidated profit and loss accounts in holding companies require comprehensive disclosures. These may include information about the subsidiaries, non-controlling interests, significant accounting policies, related party transactions, exceptional items, and other relevant information to provide users with a clear understanding of the group's financial performance.
8. **Minority Interest:** In holding companies, minority interest refers to the portion of equity in subsidiaries that is not owned by the holding company. It represents the ownership interest held by external shareholders or entities other than the holding company. Minority interest is also referred to as non-controlling interest (NCI) or minority shareholders' interest. Here are

some key aspects of minorityinterest in holding companies:

1. **Definition:** Minority interest arises when the holding company does not own 100% of the subsidiary's equity. It occurs when the subsidiary has external shareholders or when the holding company owns less than 100% of the subsidiary's shares.

2. **Financial Reporting:** Under accounting standards such as International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP), minority interest is presented as a separate component of equity in the consolidated financial statements. It represents the portion of the subsidiary's equity that belongs to non-controlling shareholders.

3. **Consolidation Process:** In the consolidation process, the financial statements of the holding company and its subsidiaries are combined to present the financial position, financial performance, and cash flows of the group as a whole. The share of profit or loss attributable to the minority interest is separately disclosed in the consolidated profit and loss account.

4. **Calculation of Minority Interest:** The minority interest is calculated based on the ownership percentage held by non-controlling shareholders in the subsidiary. It is typically determined by multiplying the subsidiary's net assets (equity) by the non-controlling interest percentage.

5. **Treatment of Dividends:** Dividends declared by the subsidiary and distributed to both the holding company and minority shareholders are allocated proportionately. The share of dividends attributable to the minority interest is not recognized as revenue in the consolidated financial statements. Instead, it is treated as a reduction of the carrying value of the minority interest.

6. **Impact on Consolidated Financial Statements:** The inclusion of minority interest in the consolidated financial statements affects various line items. For example, the minority interest reduces the consolidated net income attributable to the controlling interest (holding company). It also affects the calculation of earnings per share (EPS) and other financial ratios.

7. **Disclosure Requirements:** Consolidated financial statements in holding companies typically require detailed disclosures about minority interest. These disclosures may include information about the subsidiaries in which minority interest exists, the nature of

the non-controlling shareholders' rights, changes in minority interest during the reporting period, and any significant transactions or relationships with minority shareholders.It's important for holding companies to accurately account for and disclose minority interest in their consolidated financial statements to provide transparency and clarity to investors and other stakeholders regarding the ownership Cost of Control: The term "cost of control" refers to the amount of money or resources required to acquire and maintain control over a subsidiary or another entity. It represents the financial investment made by a controlling entity, such as a holding company, to obtain a significant ownership stake and the ability to influence the strategic and operational decisions of the subsidiary. Here are some key aspects related to the cost of control:

8. **Acquisition Cost**: The cost of control encompasses the expenses incurred to acquire a controlling interest in a subsidiary. This includes the purchase price paid for the equity shares or assets of the subsidiary, transaction fees, legal costs, and any other direct costs associated with the acquisition.

9. **Premium Paid:** In some cases, the cost of control may involve paying a premium above the fairvalue of the identifiable net assets of the subsidiary. This premium, known as goodwill, represents the value attributed to intangible assets such as brand reputation, customer relationships, or synergies expected to be achieved through the combination of the controlling and subsidiary entities.

10. **Ongoing Costs:** Once control over the subsidiary is obtained, the cost of control also includes the ongoing expenses required to maintain that control. This may include costs related to management oversight, governance, compliance with regulatory requirements, and any financial support provided to the subsidiary.

11. **Financing Costs:** If the acquisition of control is financed through external sources, the cost of control would also include any interest expenses or financing charges associated with the borrowedfunds used for the acquisition.

12. **Impairment Testing:** The cost of control is subject to impairment testing to determine if there has been a decline in the value of the investment. If the carrying value of the controlling entity's investment exceeds its recoverable amount, an impairment loss is recognized in the financial statements, reducing the cost of control.

13. **Depreciation or Amortization:** If the cost of control includes intangible assets, such as goodwill, these assets are subject to periodic depreciation or amortization over their useful lives. The depreciation or amortization expense is recognized in the financial statements,

reducing the carrying value of the cost of control over time. The cost of control is an important consideration for holding companies and other controlling entities, as it represents a significant investment and commitment to the subsidiarycontrol is crucial for providing transparency and information to stakeholders about the financial implications of controlling a subsidiary.

3.2 Capital reserve

This is a term used in accounting and finance to describe a specific category of reserves or funds that are set aside for specific purposes. It represents a portion of a company's equity or net assets that is not distributable as dividends to shareholders. Here are some key points about capitalreserve:

1. **Definition:** Capital reserve is created through specific transactions or events that are not related to the company's normal operations or revenue generation. It is typically generated from non- operating activities, such as the sale of assets, revaluation of assets, issuance of shares at a premium, or gains on investments.

2. **Purpose:** The primary purpose of capital reserve is to preserve and protect the company's capitalbase. It is usually earmarked for specific uses, such as funding future expansion, financing capitalprojects, reducing debt, or absorbing potential losses.

3. **Legal Restrictions:** Capital reserve may be subject to legal restrictions and regulations. In somejurisdictions, there are specific rules governing the utilization and distribution of capital reserve funds. These restrictions ensure that the capital is preserved for its intended purposes and not distributed as dividends or utilized for other general purposes.

4. **Accounting Treatment:** Capital reserve is typically presented as a separate line item within the equity section of the company's balance sheet. It is separate from other components of equity, suchas share capital, retained earnings, or other reserves. The balance of capital reserve is usually disclosed in the notes to the financial statements, along with any specific details regarding its purpose or utilization.

5. **Utilization:** Companies may utilize the capital reserve for the specific purposes for which it wascreated. For example, it can be used for funding new ventures or projects, acquiring assets, retiring debt, or covering losses. The utilization of capital reserve

requires proper authorization and compliance with legal requirements.

6. **Disclosure:** Companies are required to disclose the nature and purpose of capital reserve in their financial statements. Additionally, any significant changes or events affecting the capital reserve should be disclosed to provide transparency to stakeholders and investors.

    a. It's important to note that the specific rules and regulations regarding capital reserve may vary among jurisdictions and accounting frameworks. It is recommended to consult the applicable accounting standards and legal requirements in the respective jurisdiction for detailed guidance on the creation, utilization, and disclosure of capital reserve.

Inter –Company holdings

Inter-company holdings refer to the ownership relationships between different companies within a group or conglomerate. It occurs when one company, often referred to as the parent or holding company, holds equity or ownership interests in other companies, which are its subsidiaries or affiliates. Inter-company holdings can take various forms, such as owning shares, equity investments, or controlling interests in other entities within the group.

Here are some key aspects related to inter-company holdings:

1. **Parent-Subsidiary Relationship:** Inter-company holdings primarily involve a parent-subsidiary relationship. The parent company has control over the subsidiary, either through majority ownership or significant influence over its financial and operating policies.

2. **Equity Investments**: Inter-company holdings are typically represented by equity investments. The parent company holds a certain percentage of equity shares in its subsidiary companies, givingit ownership rights and influence over their operations.

3. **Control and Consolidation:** The parent company exercises control over its subsidiaries through inter-company holdings. Control is established when the parent owns more than 50% of the voting rights or has the power to direct the financial and operating policies of the subsidiary. Consolidated financial statements are prepared to combine the financial results of the parent and com

4. **Elimination of Intercompany Transactions:** Intercompany holdings often involve transactions between the parent and its subsidiaries. These transactions, such as sales, purchases, loans, and transfers, are eliminated in the consolidation process to avoid double counting and to present a true and fair view of the group's financials.

5. **Non-controlling Interest:** Inter-company holdings may also result in the existence of non- controlling interest or minority interest. Non-controlling interest represents the portion of equity in subsidiaries not owned by the parent company. It is the ownership interest held by external shareholders or entities other than the parent.

6. **Transfer Pricing:** Inter-company holdings can involve transfer pricing, where goods, services, or intellectual property are transferred between companies within the group. Transfer pricing ensures that transactions between related entities are conducted at arm's length and at fair market value, avoiding tax and regulatory implications.

7. **Governance and Decision-making:** Inter-company holdings give the parent company the ability to exercise control, influence strategic decisions, and establish governance structures across the group. The parent can align the subsidiaries' operations with the overall group strategy and objectives.

3.3 Preparation of Consolidated Balance Sheet

The following are the various points to be considered the following for the preparation of a consolidated balance sheet of a holding company and its subsidiaries.

1. Basic philosophy of consolidation elimination of investment accounts Usually a holding company shows the share acquired in a subsidiary as an investment on the side of its balance sheet. This shows the amount paid by the holding company for the shares acquired in the subsidiary. But the details of the opposition or absent. Consolidation AIMS at providing full details about the investment as a part of the balance sheet itself. This is done by replacing the investment account with the individual assets and liabilities of the subsidy company. **Wholly- Owned Subsidiary Company:**

When a holding company own all the equity shares of a subsidiary, elimination of investment account by replacing it, with the assets and liabilities of the subsidiary is a very simple matter, as shown below

Example: **Balance sheet as on 31.03.1997**

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**
Share capital: Shares of Rs.10 each	4,00,000	1,00,000	Sundry assets	5,00,000	2,00,000
Sundry creditors	2,00,000	1,00,000	Investment: 10,000 shares of Rs.10 each in S Ltd	1,00,000	-
	6,00,000	2,00,000		6,00,000	2,00,000

Consolidated Balance sheet of H Ltd. and its subsidiary S Ltd as on 31.3.97

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**
Share capital: 40,000 shares of Rs.10 each (H Ltd. only)		4,00,000	Sundry assets H Ltd S Ltd	5,00,000 2,00,000	7,00,000
Sundry Liabilities: H Ltd. S Ltd.	2,00,000 1,00,000	3,00,000			
		7,00,000			**7,00,000**

The investment account on the assets side of the H limited is replaced by the total assets of S limited on the assets side of the consolidated balance sheet and its liabilities are shown on the liability side.

The effect is that the net asset of the subsidiary is shown in the holding company's balance sheet in place of the "investment.

2. Minority Interest:

a. **Meaning**: Usually, a holding company acquires majority equity shares in a subsidiary, representing the controlling interest. The remaining shares may be in the hands of the general public. Such holding of the general public in the subsidiary company is called "Minority interest".

b. **Treatment:** The minority interest is to be computed and the shown on the liability side of the consolidated balance sheet as a separate item. It may be shown as the last item on the liabilities side or along with the share capital of the holding company. The former method is more popular.

c. Competition: Usually the following items constitute the minority interest:

		Rs.
Face value of minority shares		Xxx
Face value of minority preference shares		Xxx
Minority shares of the capital profit		Xxx
Minorities share of the revenue profits		Xxx
Minorities share of bonus share issue		Xxx
		Xxx
Minority share of capital losses	Xxx	
Minority share of revenue loses	xxx	Xxx
Total minority interest		**xxx**

3. Cost of Control or goodwill

a. **Meaning:** When holding company acquires majority of the shares in a subsidiary, it may be forced to pay more than the face value and even the book value of such shares. The demand and the supply equation operates here. The demand for the subsidiary companies share generated in the process of acquiring controlling interest in the subsidiary pushes up the market price of such share. Thus, cost of control is the penalty or excess paid by the holding company to acquire 'controlling interest in the subsidiary company.

b. **Treatment:** The excess amount paid is usually treated as a goodwill and is shown on the assets side of the consolidated balance sheet along with any Goodwill in the holding If the price paid by the holding company for shares acquired in the subsidy is less than what is received in return in the form of the face value of the shares purchased and the holding company share of the capital profit, such differences is capital gain. such capital profit can be reduced from any goodwill in the balance sheet of the holding and the subsidiary companies. If the capital profit is in excess of such goodwill or there is nogood will in the balance sheet, it must be shown as capital reserve in the liabilities side of the consolidated balance sheet.

c. **Competition the following is the usual method of ascertaining cost of control or capital reserve**

	Rs.	Rs.
Amount paid for shares purchased by the holding company in the subsidiary		xxx
Add: Holding companies shares of a capital losses		**xxx**
		xxx
Less: Face value of shares purchased	**Xxx**	
Holding companies share of the capital profit	**Xxx**	
Holding company share of bonus shares issued by subsidy	**Xxx**	
Holding company share of dividend paid out of capital profit	**Xxx**	**xxx**
Goodwill or capital reserve		**Xxx**

Note: If the balance is positive, it is Goodwill If it is negative it is the capital profit to be treated as a capital reserve. The Goodwill or capital reserve ascertained here must be merged with any Goodwill in the balance sheet of the holding company and subsidiary companies.

4. **Revenue Profits or Post Acquisition Profit**

a. **Meaning** Profits earned by a subsidiary company after the date of acquisition of shares by the holding company are called revenue profits or post-acquisition profits. These profits may be part of the profit and loss account of the subsidiary company or they might have been transferred to reserves or proposed as dividend.

share is added to the holding company's profit and Loss account in the consolidated balance sheet.

b. **Computation**: If shares are purchased by the holding company on the date of the givenbalance sheets, revenue profits are Nil. If shares are purchased during the current year profit and during the current year or assumed to be earned uniformly and the profit proportionate to the number of months after the purchase of shares of treated as a revenue profit s. If the shares were acquired at the beginning of the current year, entire profit of the current year has to be treated as a revenue profits. If exact date of purchaseof shares is not given, other details about profits have to be seen to determine the revenue profits

5. **Revenue Loss or Post Acquisition Profits**

Revenue loses are post-acquisition glasses any losses in curd by the subsidiary company after the date of purchase of shares by the holding company is called revenue losses or post- acquisition losses. Revenue loss has to be divided in the holding minority ratio minority shares has to be subtracted while ascertaining minority interest. Holding company shares has to be reduced from its profit and loss account in the consolidated balance sheet. If profit and loss account does not show any credit balance the revenue loss may be shown on the asset side ofthe consolidated balance sheet under Miscellaneous expenditure**.**

6. **Capital Profits and Losses or Pre acquisition Profits & losses**

   a. **Meaning:** All the accumulated profits of the subsidiary company on the date of purchase of shares by the holding company or called capital profits or Priya position profits. They may be in the form of capital reserve general reserve fund share premium profit and loss account if shares are acquired during the current year profit earned by the subsidiary in the month before purchase of shares in the current year is also to be taken as capital profit. Similarly,any profit on revaluation of assets or liabilities on the date of purchase of shares has to be treated as a capital profit. All accumulated losses on the date of purchase of shares by theholding company or termed as capital losses. Similarly, any losses in curd in the current year before purchase of shares is also capital losses. Any losses on revaluation of assets and liabilities at the time of purchase of shares is also to be treated as a capital loss.

   b. **Treatment:** Any bonus shares issued and dividend paid out of the capital profits has to be subtracted and the balance of capital profit and loss has to be divided in the holding minority ratio. Minority share of the capital profits has to be added to the minority interest. Similarly, minority shares of capital losses has to be subtracted in the competition of minority interest. Holding companies share of capital profit is to be reduced while ascertaining cost of control

   this is due to fat that accumulated profits of the subsidiary must have influence to the price paid for this shares acquired. Based on the same logic holding company shares of the capital losses his added in the competition of cost of control.

Computation: Capital Profits are usually computed as follows:

General reserve, capital reserve, P&L A/c and other reserves of subsidiary on the date of purchase of shares.		**Xxx**
Less: Bonus shares issued by subsidiary from pre-acquisition profits	**Xxx**	
Less: Dividend paid by subsidiary out of pre- acquisition profits	**xxx**	**Xxx**
Add: Subsidiary company profits during the current year before purchase of shares		**Xxx**
Add: Profit on revaluation of assets and liabilities of the subsidiary on the date of purchase		**Xxx**
Less: Loss on revaluation of assets and liabilities of subsidiary on the date of purchase		**Xxx**
Net capital profits		**xxxx**

7. **Revaluation of assets and Liabilities:**

When holding company acquires controlling interest in a subsidiary, it may revalue the assets and liabilities to reflect their current values. These revised values may form the basis for determining the value of shares for the purpose of acquisition.

Any profit or losses on revaluation of assets and the outside liabilities has to be adjusted in the respective assets on liabilities in the consolidated balance sheet, if it is not already done. The same profits or losses has to be included in the computation of capital profits as already explained earlier.

8. **Bonus shares issued by subsidiary company:**

After the holding company acquired and controlled interest, Saturday company may issue bonus share out of its profits to all the shareholders. Holding company also received the bonusshares and the phase value of shares acquired increases.

Bonus out of capital profits: It has no real effect on the consolidated balance sheet. The amount of bonus is reduced from capital profit s. Same amount is added to the face value of shares acquired in the subsidy. This while computing cast of control face value of shares held by the holding company increases and the holding companies shares of capital profit decreasesto the same extent.

Bonus issue out of revenue profit or post-acquisition profits: This type of bonus issue has it impact on the consolidated balance sheet. The amount of bonus has to be reduced from revenue profits before distributing the revenue profits in the holding minority ratio minorities share of the bonus is added to the minority interest holding companies shares of the bonus is subtracted in the calculation of cast of control the net effect is that good will decreases to the extent of the holding company's share of the bonus do the bonus is not out of the three opposition profit.

9. **Dividends from subsidiary company:**

Subsidiary company may declare and dividend to Shah holders, after the holding company acquired shads in the subsidiary. It may be dealt with as follows:

a. **Proposal dividend**: Dividend might have been proposed but not it paid by the subsidiary. Such proposed dividend in need not be separately treated. It should be added to the respective revenue profit and capital profit as the case maybe. So, minority share of the proposed dividend become a part of the minority interest. Holding companies share matches into the revenue and capital profits of the holding company.

b. **Capital dividend or dividend paid by subsidiary out of pre-acquisition profits:** Since the motors already received minority share of the capital dividend has to be ignored. Holding companies share of the capital dividend is credited to investment account representing the share in subsidiary company the effect as that the cost of control or Goodwill is reduced to the extent otherwise the capital reserve increases to the extent of the dividend received by the holding company. Usually when the dividend is received holding company might have included it in its profit and loss account so the holding company's share of the capital dividend which was credited to its profit and Loss account should be subtracted from profit and loss account in the consolidated balance sheet.

c. **Revenue dividend or dividend paid by subsidiary out of profit acquisition profits**: Since amount of dividend is already received minorities shares of the revenue dividend has to be ignored. Holding companies shares of the revenue dividend has to be credit to its profit and loss accounts if it was already credited to profit and last account at the time of receiving no for the adjustment is required. The revenue dividend has to be reduce

from the post-acquisition profit before dividing them between the holding company and the minority.

d. **Composite dividend**: Paid by the subsidiary company may be partly out of capital profit and a partly out of revenue profits. In such a case, the dividend has to be divided into two portions. The capital divide and portion and the revenue dividend portion have to bedealt with separately as indicated above.

e. If there is no indication recording the sources of profit for the dividend paid by the subsidiary, it might be assumed the that the dividend amount was earned during the period for which it was declared does interim dividend must be presumed to be out of current year's profits. Dividend paid for previous year must be out of profits earned before the current year.

10. Preference shares in subsidiary company

Holding company may acquire or war the part of the preference shares in subsidy company, apart from purchasing controlling interest in the equity shares. While ascertaining cost of control, amount paid by the holding company is added to the amount paid for equity shares. Face value of differentiates acquired is reduced. The net effect is that any difference between the amount paid and face value of the shares midges into the Goodwill or capital reserve. Any dividend does on the preference shares till the date of appreciation should also be reduce the competition for cost of control, actor subtracting it from capital profits. Dividend do you on the preference shares for the post appreciation period is to be treated like revenue dividend payable. Minorities share of the preference shares included in the minority interest along with the any preposition dividend payable to the minority.

11. Debentures in subsidiary company

Subsidy company may have debentures in its balance sheet liability side. They are just like any other liability to outside us and must be shown on the consolidated balance sheet. However, it the holding company has purchased a part of all the all of them, such debenture should be eliminated from the consolidated balance sheet, just like any other mutual application which is explained below separately.

12. Elimination of common transactions or mutual obligation or mutual indebtedness:

The holding company and the subsidy company may owe money to each other due to common transactions like buying and selling of goods landing and borrowing of money rendering services to each other all such mutual applications have to be eliminated from the consolidated balance sheet.

13. Contingent liabilities:

Transactions which may become liabilities in future or Sona as contingent liability as fitnessto the balance sheet for example bills endorsed to creditors and discounted with Bank investment in partly paid shares etc

Any contingent liability involving a third party must continue to be shown as footnote to the consolidated balance sheet however any condition liability involving the holding company and its subsidiary alone must be eliminated by not showing them as a footnote to the balance sheet.

14. Provision for unrealized profits in stocks

On the date of consolidated balance sheet the holding company are the subsidiary may have in its stock goods purchased from the other company which were sold at profit so the stock includes the unrealized profit charged by seller in the consolidated balance sheet provision must be made for such and realised profits.

There are two approaches to create search provisions.

a. Making a provision for entire profit include in the stock. This practice is preferred by the American institute of certified public accountants and also by the C.A. institute in India as shown in accounting standard 21.
b. The providing only for the holding company's share of such and realised profit on the basis of that the transactions is complete so for as minority shareholders or consent the former method is followed in this book should be reduced from the stock on the asset and from thebell profit and loss account on the liability side of the consolidated balance.

15. **Abnormal losses:** Holding company might have acquired the shares in the subsidy during the current year. Any abnormal loss which occurred is usually debited to profit and loss account and to the and to that extend the current year's profit decreases. It is more appropriate to adjust the abnormal losses from the pre-acquisition or post-acquisition profit in the current year, dependingon the date of occurrence of the abnormal losses.

Illustration 1

The balance sheets of C Ltd. And D Ltd. as at 31st December, 1986 are as follows:

Liabilities	**C Ltd. Rs**	**D Ltd. Rs.**	**Assets**	**C Ltd. Rs**	**D Ltd. Rs.**
Share capital shares of Rs.10 each)	2,00,000	1,00,000	Sundry assets	1,32,500	1,38,200
General Reserve	18,000	20,000	Goodwill		20,000
Profit & Loss a/c	24,500	23,000	Shares in D Ltd at cost	1,40,000	

Creditors	30,000	15,200			
	2,72,500	**1,58,200**		**2,72,500**	**1,58,200**

In the case of D Ltd. Profit for the year ended 31st December 1986 is Rs. 12,000 and transferto reserve is Rs. 5,000. The holding of C Ltd. in D Ltd is 90% acquired on 30th June 1986. Draft a consolidated Balance Sheet of C Ltd. and its subsidiary.

Solution:

Notes to Accounts:

1	**Share capital:**			
	20,000 shares of Rs.10 each			2,00,000
2	**Reserves and Surplus**			
	General reserve		24,500	18,000
	Surplus instalments of P&L		5,400	
	Balance as per C Ltd. Balance Ltd Balance sheet			
	Add: Share of Revenue Profit			29,900
				47,900
3	**Trade Payables:**			
	Sundry Creditors			
	C Ltd		30,000	
	D Ltd		15,200	45,200
4	**Tangible Assets**			
	Sundry assets			
	C Ltd		1,32,500	
	D Ltd		1,38,200	2,70,700
5	**Intangible Assets**			
	Goodwill			36,700

Consolidate Balance sheet of C Ltd. and its Subsidiary D Ltd as on 31.12.1986 (As Per Schedule VI)

		Note No.	Rs.
I	Equity and Liabilities:		
	I shareholders' funds:		
	Share capital	1	2,00,000

	Reserves and Surplus	2	47,900
	ii. Minority interest (W.N.4)		14,300
	iii. Current Liability Trade payable	3	45,200
	Total (i)+ (ii)+ (iii)		3,07,400
II	Assets		
	i. Non- Current assetsTangible assets Intangible assets	4	2,70,700
	ii. Current Assets	5	36,700
	Total (i)+(ii)		3,07,400

Working notes:

1. **Holding –Minority Ratio**

   C Ltd. acquired 90% of shares in D Ltd

   Therefore, Minority holding in D Ltd=10%

2. **Revenue Profits**

		Rs.
Profit for the current year, given		12,000
Profit made after June 30th or Revenue profit	=12,000×6/12	6,000
Holding company's share	=6,000×9/10	5,000
Minority's share	=6,000×1/10	600

3. **Capital Profits**

	Rs.
General reserve of D Ltd.	20,000
P&L A/c of D Ltd	23,000

	43,000
Less: Revenue Profit	6,000
Capital Profit	**37000**

Holding company's Share = 37,000×9/10 =33,300

Minority's share =37,000×1/10 =3,700

Note: Since it is clearly stated that the profit of D Ltd. for the year 1986 is Rs. 12,000. It is assumed that the transfer to reserve of Rs. 5,000 is a part of the Rs. 12,000.

4. Minority Interest:

	Rs.
Face value of Minority share 1,00,000×10/100	10,000
Add: Minority share of capital profit	3,700
Add: Minority share of revenue Profit	600
Minority interest	**14,300**

5. Cost of Control or goodwill

Amount paid by C Ltd. for shares purchased in D Ltd		1,40,000
Less : Face Value of shares Purchased 1,00,000×90/100	90,000	
Less: Holding company's share of capital Profits	33,300	1,23,300
Goodwill		16,700
Add: goodwill in D Ltd s Balance sheet		20,000
Goodwill to be shown in consolidate balance sheet		**36,700**

Unrealized profit in stock

Illustration 2

On 31st March,1996 the balance sheets of H Ltd. and its subsidiary S Ltd stood as follows

Liabilities	**H Ltd**	**S Ltd**	**Assets**	**H Ltd**	**S Ltd**
Equity share capital	8,00,000	2,00,000		5,50,000	1,00,000
General reserve	1,50,000	70,000		2,80,000	-

P&L A/c	90,000	55,000		1,05,000	1,77,000
Creditors	1,20,000	80,000		2,25,000	1,28,000
	11,60,000	**4,05,000**		**11,60,000**	**4,05,000**

Draw a consolidated Balance sheet as at 31st March,1996 after taking into consideration the following information;

a) H Ltd. acquired the shares on 31st July,1995.

b) S Ltd. earned profit of Rs. 45,000 for the year ended 31st March, 1996.

c) In January 1996 S Ltd. sold to H Ltd. goods costing Rs. 15,000 for Rs. 20,000. On 31st March, 1996 half of these goods were lying as unsold in the godown of H Ltd. Give your working notes.

Notes to Accounts:

1	**Share capital:**			8,00,000
2	**Reserves and Surplus**			
	General reserve			1,50,000
	Surplus instalments of P&L:		90,000	
	Balance as per C Ltd. Balance Ltd Balance sheet		22,500	
			1,12,500	
	Less : Provision for unrealized Profit		2,500	1,10,000
				2,60,000
3	**Trade Payables:**			
	Sundry Creditors			
	H Ltd		1,20,000	
	S Ltd		80,000	2,00,000
4	**Tangible Assets**			
	Sundry assets			
	H Ltd		5,50,000	
	S Ltd		1,00,000	6,50,000
5	**Intangible Assets**			
	Goodwill			58,750
6	**Stock**			

	H Ltd S Ltd		1,05,000 1,77,000	
			2,82,000	
	Less: Provision for unrealized profit		2,500	2,79,500
7	**Other current assets** H Ltd S Ltd		 2,25,000 1,28,000	 3,53,000

Consolidate Balance sheet of H Ltd. and its Subsidiary S Ltd as on 31.12.1996 (As Per Schedule VI)

		Note No.	**Rs.**
I	Equity and Liabilities:		
	I shareholders' funds: Share capital Reserves and Surplus	 1 2	 8,00,000 2,60,00
	iv. Minority interest (W.N.4) v. Current Liability	 3	81,250 2,00,000
	Total (i)+ (ii)+ (iii)		**13,41,250**
II	Assets		
	iii. Non- Current assets Tangible assets Intangible assets iv. Current Assets Stock Other current assets	 4 5 6 7	 6,50,000 58,750 2,79,500 3,53,000
	Total (i)+(ii)		**13,41,250**

Working notes:

1. **Holding –Minority Ratio**

H Ltd. acquired 75% of shares in S Ltd

Therefore, Minority holding in S Ltd=25%

Ratio= 75:25 or 3:1

2. Revenue Profits

		Rs.
Current year profit of S Ltd., given Profit earned by S Ltd. after 31st July or		45,000
or Revenue profit	=45,000×8/12	30,000
Holding company's share	=30,000×3/4	22,500
Minority's share	=30,000×1/4	7,500

3. Capital Profits

	Rs.
General reserve of S Ltd.	70,000
P&L A/c of S Ltd	55,000
	1,25,000
Less: Revenue Profit	30,000
Capital Profit	**95,000**

Holding company's Share = 95,000×3/4 =71,250

Minority's share =95,000×1/4 =23,750

4. Minority Interest:

	Rs.
Face value of Minority share 2,00,000×25/100	50,000
Add: Minority share of capital profit	23,750
Add: Minority share of revenue Profit	7,500
Minority interest	**81,250**

5. Cost of Control or goodwill

Amount paid for shares purchased by H Ltd. in S Ltd		2,80,000
Less : Face Value of shares Purchased 2,00,000×3/4	1,50,000	
Less: Holding company's share of capital Profits	71,250	2,21,250
Goodwill		58,750

6. Provision for unrealized profit in stock

Profit in stock of H Ltd. acquired from S Ltd

(20,000-15,000×1/2=5,000×1,2 =2,500

Therefore, Provision to be created =2,500.

Check your Progress

1. A holding company is one which holds more than:

a. $2/3^{rd}$ share capital of subsidiary company

b. 50% of share capital of subsidiary company

c. 75% of share capital of Government company

d. None of the above

2. A company in which more than 50% of shares are held by another company is termed as

a. Holding company

b. Subsidiary company

d. Public company

3. Profits earned by a subsidiary company up to the date of acquisition of shares by theholding company are called

a. Revenue profit

b. Realization profits

c. Capital profits

d. Revenue profits

4. Profits earned by a subsidiary company after the date of purchase of shares by the holding company are known as

a. Revaluation profits

b. Realization profits

c. Capital profits

d. Revenue profits

5. The term Minority Interest represents

a. The shareholders holding 50% of shares in subsidiary Co.

b. The interest of the outsiders in the subsidiary Co.

c. The company which holds more than 51% in subsidiary co.

d. None of the above

6. The excess price paid by a holding company to acquire controlling interest in thesubsidiary company is transferred to

a. Capital reserve

b. Goodwill a/c

c. Revenue reserve

d. None of the above

7. To excess of the share in equity or net assets of the subsidiary over and above the pricepaid for the investment is shown as

a. Capital reserve

b. Cost of control

c. Revenue reserve

d. None of the above

8. Unrealized profit included in stock is

a. Deducted from stock in combined Balance sheet

b. Deducted from P&L a/c balance in combined Balance Sheet Liabilities sides

d. Shown separately in assets side of CBS

9. Any loss or profit on revaluation of assets and outside liabilities is

a. Treated as revenue profit/Loss

b. Ignored in CBS

c. Treated as capital Profit/ Loss and adjusted in the respective assets / Liabilities in combined Balance sheet

d. Shown separately in liabilities side of CBS

10. Bonus shares issued out of post-acquisition profit will

a. Have no effect on CBS

b. Decrease the revenue profits

c. Decrease the total of assets side of CBS

d. Increase the goodwill to the extent of the holding company's share of the bonu

Exercises

11. H Ltd. acquired 3,000 equity shares in S Ltd. on 1st April 1987. On 31st December 1987 theBalance sheet of S Ltd. was as follows:

Liabilities		Rs.	Assets	Rs.
Share capital:		4,00,000	Sundry assets	6,40,000
4,000 equity shares of Rs.100 each		80,000		
General Reserve on 1.1.87				
Profit & Loss A/c:				
Balance on 1.1.87	20,000			
Profit for 1987	80,000	1,00,000		
Sundry creditors		60,000		
		6,40,000		**6,40,000**

[Ans : Capital Profits – Rs.1,20,000; Revenue profits Rs.60,000]

12. Calculated minority Interest from Balance sheet of Mumbai Ltd.

Liabilities	Rs.	Assets	Rs.

Share capital: 7,00,000 shares of Rs.2 each	14,00,000	Sundry assets	10,00,000
		Plant and machinery	7,00,000
General Reserve on 1.1.97	6,00,000	Other assets	1,50,000
Profit & Loss A/c:	2,00,000	Investment (80% of shares)	6,50,000
Sundry creditors	3,00,000		
	25,00,000		**25,00,000**

Madras Ltd., acquired 80% of the shares at Rs.6,50,000.

[Ans: Minority Interest: Rs.4,40,000

13. A subsidiary company has a capital of Rs.5,00,000 in shares of Rs.100 each out of which the holding company acquired 80% of the shares at Rs.6,00,000. The profits of the subsidiary Co. on the date of acquisition of shares by the holding Co. were Rs.3,00,000. Calculate the value of goodwill or capital reserve.
14. On 30th June 2003 to 2/3rd of the shares of S limited (with a total capital of Rs.12,00,000 were acquired by H limited. The balance sheet of S limited should a debit balance of Rs 6,00,000 on 1st January 2003 and credit balance of Rs. 3,60,000 on 3rd December 2003 the investment made by H limited in S limited share is Rs. 9,00,000 calculate the cost of control or capital reserve.

    [Answer: good will Rs 1,80,000 that is 800000 - 80000 = 720000 – 9,00,000]

15. On 1st July 2001 X Ltd. acquired 60% of the shares Y limited with the total capital of Rs. 5,00,000 for Rs. 380000. The balance sheet of Y limited showed profit and loss account balance on 1st January 2001 Rs. 1,20,000 and profit for the year 2001 Rs. 1,00,000. Calculate the value of goodwill or capital reserve.

[Answer capital reserve Rs 22,000 that is 3000 + 400000 – 3,80,000]

UNIT IV Contemporary Accounting Methods

Accounting for price level changes – Social responsibility accounting – Human resource accounting - Forensic Accounting.	
	Page No
Accounting for price level changes	
Social responsibility accounting	
Human resource	
Forensic Accounting	

4.1 Introduction

The basic objective of accounting is the preparation of financial statements in a way that the income statement should disclose the true profit or loss made by the business during a particular period while the balance sheet must show a true and fair view of the financial position of the business on a particular date. Financial statements are prepared in monetary units, i.e., rupees, in our country. They can serve very well the basic objective if the value of such monetary units remains stable. This is possible only when there is stability in the price levels. However, it has been our experience that over a period of time, the prices have not remained stable. There have been inflationary as well as deflationary tendencies. The inflationary tendencies have beenmore frequent and since 1931 they have been dominating economies of all the countries of the world. It is increasingly being accepted that in spite of all fiscal, monetary and fiscal measures, these tendencies are likely to stay and it seems unlikely that we will return to an era of stable prices in the near future.

4.1.1 Meaning and Scope

In view of the above, it has even increasingly felt that the accountant will be failing in his duties if he continues to remain contented with the time honoured and traditional system of accounting by historical cost. He should move with the time and evolve a suitable system of accounting to deal with the changing price levels.

Price level accounting may, therefore, be defined as that technique of accounting by which the financial statements are restated to reflect changes in the general price level. Such changes, as stated earlier, may be either inflationary or deflationary. Of course, inflation has come to stay and, therefore, price level accounting is more concerned with inflationary tendencies.

4.1.2 Inflation Accounting

Inflation accounting is a term describing a range of accounting systems designed to correct problems arising from historical cost accounting in the presence of inflation. Inflation accounting isused in countries experiencing high inflation or hyperinflation. For example, in countries experiencing hyperinflation the International Accounting Standards Board requires corporate financial statements to be adjusted for changes in purchasing power using a price index.

"Inflation accounting is a system for accounting that purports to record as a built in mechanism ofall economic events in terms of current cost". According to author "Inflation accounting is an accounting technique that aims to record business transactions at current values and to neutralise the impact of changes in the price on the businesstransaction".

"Inflation accounting is a system of accounting just like historical accounting. The difference lies in the process of matching cost against revenue. In historical accounting cost represents 'historical cost' whereas in inflation accounting cost represents the cost prevailing at the date of sale or at the reporting time".

The distinctive features of inflation accounting are as follows:

- The recording procedure is automatic

- The unit of measurement is not assumed to be stable
- It considers all elements of the financial statements and is not concerned only with fixedassets or closing stock
- Realization principles are not followed rigidly, particularly, when recording long-term loansand fixed assets at the current value

4.1.3 Major Drawbacks of Historical Cost System

- Under a historical cost-based system of accounting, inflation leads to two basic problems. First, many of the historical numbers appearing on financial statements are not economically relevant because prices have changed since they were incurred.
- Second, since the numbers on financial statements represent dollars expended at different points of time and, in turn, embody different amounts of purchasing power, they are simplynot additive.
- Financial statements that are prepared according to the conventional or historical cost accounting system, therefore, do not reflect current economic realities, in case of historical accounting system; accounts are prepared without regard to changes in the price levels. inventories are recorded at the prices at which they were purchased. It may be possible that goods sold may comprise those items that might have been purchased in earlier yearswhen the prices were lower than the current year. Thus, neither the balance sheet nor the income statement shows the correct operating and financial position of the business.
- "In most countries, primary financial statements are prepared on the historical cost basis ofaccounting without regard either to changes in the general level of prices or to increases inspecific prices of assets held, except to the extent that property, plant and equipment and investments may be revalued."
- Ignoring general price level changes in financial reporting creates distortions in financial statements such as
- Reported profits may exceed the earnings that could be distributed toshareholders without impairing the company's ongoing operations
- The asset values for inventory, equipment and plant do not reflecttheir economic value tothe business
- Future earnings are not easily projected from historical earnings

- The impact of price changes on monetary assets and liabilities is not clear
- Future capital needs are difficult to forecast and may lead to increased leverage, which increases the business's risk
- When real economic performance is distorted, these distortions leadto social and political consequences that damage businesses (examples: poor tax policies and public misconceptions regarding corporate behavior).
- Thus assumption of a stable monetary unit does not hold well in thepresent times as a result the practical utility of financial statements gets diminished. Inflation accounting is the technique of such accounting methods as are designed to mirror the impact of rising prices on economic magnitudes through the adoption of inflation adjusted accounts.

4.1.4 Methods of Accounting for Changing Prices

The following are the key methods of accounting for price level changes:

1. Current Purchasing Power method
2. Current Cost Accounting method
3. Hybrid method

Current Purchasing Power (CPP) Method

Under this method, all items in the financial statements are to be restated for changesin thegeneral price level.

CIMA Terminology defines current purchasing power accounting as follows:

- "Inflation accounting is a method of accounting for inflation in which the values of the non- monetary items in the historical cost accounts are adjusted using a general price index to show the change in the general purchasing power of money. The current purchasing power balance sheet shows the effect of financial capital maintenance".

The following steps are followed in order to convert the historical cost based financial statements into the financial statements based on current costs using the current purchasing powermethod.

- Calculation of Conversion Factor and Mid-Point Conversion Factor
- Calculation of the Gain or Loss on Monetary Items
- Calculation of Cost of Sales and Inventory at Current Prices

- Calculation of Profits
- Construction of Balance Sheet.

Calculation of Conversion Factor and Mid-Point Conversion Factor:

Conversion Factor: As the financial statements prepared on historical cost accounting basis are to be restated considering the current prices, the value of assets in historical cost accounts are multiplied by the conversion factor.

Conversion factor is calculated as under:

Conversion Factor = Price index at the date of conversion / Price index at the date

Example: Layman Brothers purchased machinery on 1.1.2008 for a sum of `6,60,000. The retail price index on that date stood at 150. You are required to restate the value of the machinery according to CPP method on 31st December, 2008 when the price index stood at 200.

Solution:

Conversion Factor = Price index at the date of conversion/Price index at the date ofitem arose.

= 200/150 = 4/3

Value of machinery on 31st December, 2008 after conversion.

= Existing value × Conversion factor

= 6,60,000 × 4/3

= 8,80,000

Mid-point Conversion Factor: For translating the transactions to current prices occurring throughout the period, conversion factor cannot be used. In such cases, the mid-point conversion factor is used. Normally the mid-point conversion factor is given. In case the same is not given, it can be calculated by taking the average of the index that is at the beginning of the year and at the end of the year. Thus, it is the average index of the period. Transactions such as purchases, sales and payment of expenses are converted using the mid-point conversion factor.

4.1.6 Calculation of Gain or Loss of Monetary Items

Once the conversion factor and mid-point conversion factor are known, the next step is to calculate gain or loss on monetary items.

Did you know? What are the monetary and non-monetary items?

Monetary items are those items that are fixed by contract or otherwise remain fixed irrespective of any change in the general price level. Monetary items can either be monetary assets or monetary liabilities. Examples of monetary items are cash, debtors, creditors, outstanding expenses, and loan.

Value of non-monetary assets cannot be stated in fixed monetary amounts as they change with the changes in the price level. The examples of non-monetary items include land, building, plant, machinery, inventory of fixed goods and equity shares.

Example: Compute the net monetary result of Mohan Company Ltd. as at 31st December2008 from the following particulars:

	1.1.2008 Rs.	31.12.2008 Rs.
Cash	500	1,000
Book Debts	2,000	2,500
Creditors	1,500	2,000
Loan	2,000	2,000
Retail Price Index Numbers are as follows:		
January 1, 2008	200	
December 31, 2008	300	
Average for the year	240	

Solution:

Calculation of conversion factors:

Conversion factor for items as on 1.1.2008:300/200 = 1.5 Mid-term conversion factor for items arising during 2008: 300/240 = 1.25

Calculation of the increase or decrease in monetary assets/liabilities during 2008

	as on 1.1.2008	**as on 31.12.2008**	**Increase during 2008**
(a) Monetary assets	2,500	3,500	1,000

(b) Monetary liabilities	3,500	4,000	500

However, the liabilities on 31.12.2008 stood atGain on holding of monetary liabilities	4.000	1,875
(iii) Monetary assets as on 1.1.2008 should have gone up with increase in price indices (`Rs 2,500x1.5)	3,750	
(iv) Increase in monetary		
assets during 2008 should		
have gone up with increase in price indices (` 1,000 x 1.25)	1 ,250 5,000 3.500	
Monetary assets on 31.12.2008 should have stood at However, the monetary assets on 31.12.2008 stood		(-) 1.500 375
at Loss on holding monetary assets		
Net gain on monetary items		

Example: From the following details ascertain (a) Cost of Sales and (b) Closing Inventoryas per CPP Method when the firm is following FIFO Method:

	Historical	**Price**
	Rs.	**Index**
Opening stock on 1-1-2008	4,000	80
Purchases during 2008	20,000	125
Closing stock (out of purchases made in the last quarter)	3,000	120
		140

Solution:

Cost of Sales and Closing Inventory (FIFO)

Particulars	Historical cost basis	Conversion factor	Converted amount under CPP
Opening inventory	4,000	140/80	7,000
Add: Purchases	20,000	140/125	22,400
Total	24,000		29,400
Less: Closing inventory (b)	3,000	140/120	3,500
Cost of goods sold (a)	21,000		25,900

1.7 **Determination of Profits and Preparing Balance Sheet**

For determining the profits under the current purchasing power method, any of thefollowing two methods can be used:

1. **Net Change Method:**

Under this method, profit is the change in equity over the period. Thus, both the opening balance sheet and the closing balance sheet are converted to reflect the changes in price level and any increase in equity is taken as profit and any reduction in equity is taken as loss. It may be worthwhile to mention here that while converting the figures of the opening balance sheet both monetary and non-monetary items except equity are to be converted and while converting the closing balance sheet, only non-monetary items are converted as they already are reported at current values. Monetary items are not to be converted. Thus, this method is based on the normal accounting principal that profit is the change in the equity during the accounting period.

2. **Conversion or Restatement of Income Statement Method:**

Under the second method, all items of profit or loss account are converted.

Sales and operating expenses are converted using the average index. The index to be usedfor conversion of cost of sales and inventory will depend upon the method i.e., LIFO

or FIFO as discussed above. Fixed assets are converted on the basis of the indices prevailing on the dates they were purchased. The same principle applies for charging depreciation on them. Taxes and dividend paid are to be converted using the indices of the date on which they were paid. Gain on account of monetary items should be calculated and stated separately in the restated income statement

	2007 (Rs)	2008 (Rs)
Assets		
Cash and receivables	2,00,000	2,60,000
Inventories (FIFO method)	1,50,000	1,30,000
Land	40,000	40,000
Equipment	2,10,000	2,70,000
Less: Accumulated depreciation	(Nil)	(24,000)
	6,00,000	6,76,000
Liabilities and Capital		
Current liabilities	80,000	90,000
Long-term liabilities	1,00,000	1,16,000
Equity share capital (` 10)	1,40,000	1,40,000
Share premium	2,80,000	2,80,000
Reserves and surplus	(Nil)	50,000
Total	**6,00,000**	**6,76,000**

Profit before tax	1,60,000
Less: Income Tax	70,000
Profit after tax	90,000
Less: Dividend paid	40,000
Retained earnings	50,000

Equipment costing Rs.60,000 was acquired on July 1, 2008 when the general price index was 157.5. The amount of depreciation has been calculated as follows:

10% on Rs. 2,10,000	21,000

5% on Rs. 60,000 (Rate being 10% p.a.)	3,000
	24,000

Sales, purchases, operating expenses (excluding depreciation) took place evenly throughout the year. Inventories are priced according to first in, first out method. Goods in closinginventories were acquired evenly throughout the year. The dividend of Rs. 40,000 was declared and paid at the end of 2008. Income tax accrued throughout the year.

You are required to recast the above statement taking into account the price level adjustments under CPP Method. The general price indices are as follows:

At the end of year 2007 (and beginning of the year 2008)	150
Average for the year 2008	157.5
At the end of the year 2008	163.8

Solution:

It will be necessary to compute conversion factor for restating the figures under CPPMethod.

Conversion factors For items to which Price Index at the	163.8/150 = 1.092
beginning of 2008 is applicable, For items to which Average Index is Applicable	163.8/157.5 =1040

For Items to which Price Index at the end of 2008 is applicable = 163.8/163.8 = 1

3. ABC Limited Income Statement

For the year ending 31st Dec, 2008

	As per historical cost basis (Rs)	**Conversion factor**	**Restated under CPP Method** (Rs)

Sales (1)	8,00,000	1.040	8,32,000
Cost of goods sold:			
Opening inventory	1,50,000	1.092	1,63,800
Add: Purchases	5,00,000	1.040	5,20,000
Cost of goods available for sale	6,50,000		6,83,800
Less: Closing inventory (Out of current purchases)	1,30,000	1.040	1,35,200
Cost of goods sold (2)	5,20,000		5,48,600
Gross profit (l)-(2)= 3	2,80,000		2,83,400
Operating expenses (excluding depreciation)	96,000	1.040	99,840
Depreciation	24,000	21,000 × 1.092 = 22,932	26,052
		3,000 × 1.040 = 3,120	
Total operating expenses (4)	1,20,000		1,25,892
rofit before "general price level gain or			
loss"(3)-(4)	1,60,000		1,57,508
General price-level loss (see statement below)			4,800
Net profit after general price level loss			1,52,708
Less: Income tax	70,000	1.040	72,800
Net Profit	90,000		79,908
Less: Dividend paid	40,000	1.000	40,000
Retained earnings at the	50,000		39,908

end of 2008			
Net monetary items as on 1-1- 2008			
Cash and Receivables		2,00,000	
Long-term Liabilities	1,00,000	1,80,000	

		20,000	1.0.92	21,840
Add: Source of Net monetary items during 2008:				
Sales		8,00,000	1.040	8,32,000
Total Sources (1)		8,20,000		8,53,840
Uses of net monetary items during 2008				
Purchases		5,00,000	1.040	5,20,000
Operating expenses (excluding depreciation)		96,000	1.040	99,840
Income tax		70,000	1.040	72,800
Dividends paid		40,000	1.000	40,000
Purchases of equipments		60,000	1.040	62,400
Total Uses (2)		7,66,000		7,95,040
Net monetary items as should have been if there were no general Price level gain or loss (l)-(2)				58,800
Net monetary items actually existing as on 31st Dec., 2008				
Cash and Receivables		2,60,000		
Less: Current Liabilities	90,000			
Long-term Liabilities	1,16,000	2,06,000		54,000

General price-level loss during 2008 (58,800-54,000)				4,800

Working Notes:

1. Monetary items at the end of 2008 have not been adjusted since they are already standing at current values at the end of that year.
2. The amount of retained earnings has been taken from the Income Statement as adjusted according to CPP Method.
3. In the preceding pages, the net profit of the business has been determined by restating all items in CPP terms. In case it is desired to determine the net profit after tax for the year 2008 according to 'net change method', this can be done with the help of comparative balance sheet restated in CPP terms as shown on page 3.175. Net profit for 2008 will be the excess of Reserves in 2008 over that in 2007 as stated in CPP terms, as shown below

Assets in CPP terms as on 31-12-2008	7,04,548
Add: Dividends paid on 31-12-91	40,000
	7,44,548
Less: Liabilities in CPP terms as on 31-12-2008	6,64,640
Reserves as on 31-12-2008	79,908
Less: Reserves as on 1-12-2008	(Nil)
Net profit for 2008 (after tax but before dividends)	79,908

ABC Limited Comparative BalanceSheet

	As on 31st Dec. 2007			As on 31st Dec. 2008		
	Historical Cost basis	Conversion factor	CPP Method rolled forward to end of	Historical Cost basis	Conversion factor	CPP Method

			2008			
Assets						
Cash and Receivables	2,00,000	1.092	2,18,400	2,60,000	Note 1	2,60,000
Inventories	1,50,000	1.092	1,63,800	1,30,000	1.040	1,35,200
Land	40,000	1.092	43,680	40,000	1.092	43,680
Equipment	2,10,000	1.092	2,29,320	2,70,000	1.092	2,91,720
Less: Accumulated depreciation	Nil		Nil	(24,000)	(21,000x1.092)	(26,052)
					(3,000x1.040)	
	6,00,000		6,55,200	6,76,000		7,04,548
Liabilities & Share Capital						
Current Liabilities	80,000	1.092	87,360	90,000	Note 1	90,000
Long-term Liabilities	1,00,000	1.092	1,09,200	1,16,000	Note 1	1,16,000
Equity Share Capital (` 10 shares)	1,40,000	1.092	1,52,20080	1,40,000	1.092	1,52,2008 0
Share Premium	2,80,000	1.092	3,05,760	2,80,000	1.092	3,05,760
Retained Earnings	Nil		Nil	50,000	Note 2	39,908
	6,00,000		6,55,200	6,76,000		7,04,548

4.2 Social Responsibility Accounting- Introduction

Social reporting is reporting on those activities of an organisations that have an impact on society at large and are not necessarily represented by its traditional financial report.

Aspects included in social reporting include such information disclosed in the annual reports viz., Statement on Human Resource Accounting, Statement of Value Added Report on Foreign Currency Transactions (revealing the balance of payments position) and Accounting for Various Social Objectives. Social and ethical accounting, auditing and reporting is still relatively new in many developing or third world nations, but is gaining acceptance internationally as the primary demonstration of social accountability.

Did u know? **What do you mean by social report?**

A social report is the result of a thorough evaluative process focusedon the social impact of a business on its various stakeholders.

4.2.1 Meaning and Nature of Social Reporting

As discussed above, social reporting measures and reports the social costs and benefits on account of operating activities of a business enterprise. The concept of social reporting is gaining popularity on account of the following factors:

- Increasing awareness of society regarding the contributions the corporate units are making.
- Providing meaningful means of identifying and rewarding business for social contribution.
- Identifying adverse effects on the environment of the business houses.
- Social reporting improves credibility and reputation of business.
- Transferring cost of social activities to other segments of society.

Social reporting is a rational assessment of and reporting on some meaningful, definable domain of a business enterprises activities that have social impact. This reporting aims at measuring (either in monetary or non-monetary units) adverse and beneficial effects of such activities both on the firms and/or those affected by the firm. Being concerned with the social, human and environmental constraints on organizational behavior, it measures social costs and

outside the firm. Thus social reporting implies the measurement and reporting, internal or external, of information concerning the impact of a business enterprise and its activities on society.

The concept of social responsibility extends beyond the provisions embodied in current law. Essentially, it represents an emerging debate having its roots in political and social theory. While designing the contents to be included in social reporting, due care should be taken to see that it does not conflict with the shareholders' interest. Social reporting presently is being either included in the Annual Reports or finds some reference in the Chairman's Address or the Director's Report.Social reporting format tends to vary from one company to another company as till date no formathas been described by any Act in India.

4.2.3 **Social Corporate Reporting in India**

In India, the Companies Act 1956 deals with the preparation of balance sheet and profit and loss account. The Act requires the auditor to make report under Section 227 to members (shareholders) and express an opinion whether the company's balance sheet ad profit and loss account exhibit true and fair view of the company's state of affairs.

Although, this Act has been amended from time to time, no specific provision has been made requiring companies to provide social responsibility disclosures to their annual reports. The Government of India appointed a Committee under the chairmanship of Justice Rajinder Sachar to consider and report on the changes that are necessary in the form and structure of the Act. The Committee (1978) recommended the inclusion of the following, inter alias, in the directors report:

Some Indian companies have made attempts to provide information on their responsibility activities in published annual reports and/or through separate means of disclosure. Some companies prepare social income statements and social balance sheets and report them in their published annual reports.

4.2.4 Scope of Social Reporting

The following are the major aspects that are covered in social reporting:

❖ **Human Resources:** This area includes social performance directed towards the wellbeing of employees. For example, training programmes, promotion policies and provision for jobenrichment, etc.

❖ **Environmental Contribution:** Activities directed towards alleviating or preventing environmental deterioration (pollution), i.e., air, water, noise pollution. In addition, efforts made by the organisations in conservation of scarce resources and disposal of waste, etc.,are included.

❖ **Product or Service Contribution:** This includes product quality, product safety, etc.

4.2.5 Models Approaches of Social Disclosure

Social accounting measures and reports the social costs and benefits on account of operating activities of a business enterprise. The following are the key models and approaches used for reporting the social cost benefits:

1. **Social statement approach:** According to this approach, two statements are prepared

(i) Social Income Statement and (ii) Social Balance Sheet. The Social Income Statement provides information according to social benefits and costs to employees, local community and the general public. Social balance sheet portrays social investment of capital nature (i.e. social assets) viz. township, roads, buildings, hospitals, schools, clubs, etc. on the assets side and the organisations equity and social equity on the liabilities side.

2. **Operating statement approach:** According to this approach, a firm presents only the positive and negative aspects of social activities as a result of business operations. The positive aspects are broadly termed as social benefits. While negative aspects are termed as social costs.

3. **Narrative approach:** This is simplest and easiest method for reporting social costs and social benefits information. In case of this approach, disclosure regarding social costs and social benefits is made in a narrative and not in a quantitative form. The firm generally highlights the positive aspects of its social activities.

4.2.6 Summary

Social reporting is reporting on those activities of an organisations that have animpact on society at large and are not necessarily represented by its traditional financial report.

4.3.1 Human Resource Accounting

Introduction

The past few decades have witnessed a global transition from manufacturing to service- based economies. The fundamental difference between the two lies in the very nature of their assets. In the former, physical assets like plant, machinery, material, etc., are of utmost importance. In contrast, in the latter, knowledge and attitudes of the employees assume greater significance. For instance, in the case of an IT firm, the value of its physical assets is negligible when compared with the value of the knowledge and skills of its personnel. Similarly, in hospitals, academic institutions, consulting firms, etc., the total worth of the organisation depends mainly on the skills of its employees and the services they render. Therefore, the success of these organizations is contingent on the quality of their human resource — their knowledge, skills, competence, motivation and understanding of the organizational culture.

In knowledge-driven economies therefore, it is imperative that the humans be recognised as an integral part of the total worth of an organisation. However, in order to estimate and project the worth of human capital, it is necessary that some method of quantifying the worth of the knowledge, motivation, skills, and contribution of the human element as well as that of the organisational processes, like recruitment, selection, training, etc., which are used to build and support these human aspects, is developed.

4.3.2 Meaning of HRA

In simple words, human resource accounting is the art of, valuing, recording and presenting systematically the worth of human resources in the books of account of an organisation. This definition brings out three important aspects of human resource accounting:

A. Valuation of human resources.
B. Recording the valuation in the books of accounts.
C. Disclosure of the information in the financial statements of the business.

The American Accounting Society Committee on human resource accounting defines it as follows:

"Human resource accounting is the process of identifying and measuring data about human resources and communicating this information to interested parties."

Mr. Woodruff Jr. Vice President of R.G. Barry Corporation defines human resources accounting as: "Human resource accounting is an attempt to identify and report investments made in the human resources of an organisation that are presently not accounted for in conventional accounting practice. Basically, it is an information system that tells the management what changes over time are occurring to the human resources of the business."

The American Accounting Association's Committee on Human Resource Accounting (1973) has defined Human Resource Accounting as "the process of identifying and measuring data about human resources and communicating this information to interested parties". HRA, thus,not only involves measurement of all the costs/investments associated with the recruitment, placement, training and development of employees, but also the quantification of the economic value of the people in an organisation.

Flamholtz (1971), too has offered a similar definition for HRA. He defines HRA as "the measurement and reporting of the cost and value of people in organizational resources". As far as statutory requirements go, the Companies Act, 1956 does not demand furnishing of HRA related information in the financial statements of the companies. The Institute of Chartered Accountants of India too, has not been able to bring any definitive standard or measurement in the reporting of human resources costs. While the chairmen in their AGMs often make qualitative pronouncements regarding the importance of human resources, quantitative information about their contribution is rarely recorded or communicated. There are a few organizations, however, that do recognize the value of their human resources, and furnish the related information in their

Example: In India, some of these companies are: Infosys, Bharat Heavy Electricals Ltd (BHEL); Steel Authority of India Ltd. (SAIL), Minerals and Metals Trading Corporation of India Ltd. (MMTC), Southern Petrochemicals Industries Corporation of India (SPIC), Associated Cement Companies Ltd, Madras Refineries Ltd., Hindustan Zinc Ltd., Engineers India Ltd, Oil and Natural Gas Commission (ONGC), Oil India Ltd., Cement Corporation of India Ltd., etc.

4.3.3 Objectives of HRA

The following are the key objectives of HRA:

- To furnish the information for making the decisions at the investors' and managers' level
- To evaluate the return on human investment through the results
- To report the worth of human resources to the organization and society.

4.3.4 Nature of HRA

Like any accounting exercise, HRA too depends heavily on the availability of relevant and accurate information. HRA is essentially a tool to facilitate better planning and decision- making based on the information regarding actual HR costs and organisational returns. The kind of data that needs to be managed systematically depends upon the purpose for which HRA is being used by an organisation.

Example: If the purpose is to control the personnel costs, a system of standard costs for personnel recruitment, selection and training has to be developed. It helps in analysing projected and actual costs of manpower and thereby, in taking remedial action, wherever necessary.

4.3.5 Need and Scope of HRA

1. It furnishes cost/value information for making management decisions about acquiring, allocating, developing, and maintaining human resources in order to attain cost- effectiveness.
2. It allows management personnel to effectively monitor the use of human resources.
3. It provides a sound and effective basis of human asset control, that is, whether the asset isappreciated, depleted or conserved.
4. It helps in the development of management principles by classifying the financial consequences of various practices.
5. Basically, HRA is a management tool that is designed to assist senior management in understanding the long-term cost and benefit implications of their HR decisions so that better business decisions can be taken. If such accounting is not done, then the management runs the risk of taking decisions that may improve profits in the short run but may also have severe repercussions in future. For example, very often organisations hire young people from outside on very high salaries because of an immediate business requirement. Later on, however, they find that the de-motivating impact of this move on the existing experienced staff has caused immense long-term harm by reducing their productivity and by creating salary distortions across the organisational structure.

4.3.6 HRA in India

In India, the financial statements of companies have to be prepared as per the provisions of the Companies Act, 1956. The Act does not provide for disclosure of any significant information about human resources employed in a company except that the companies have to give by way of a note to the Profit & Loss Account, particulars of employees getting remuneration of Rs. 6,00,000 per annum or more. However, there is nothing in the Act which prevents a company fromgiving details about its human resources byway of supplementary information attached with its financial statements.

In view of the growing importance of human resource accounting, many corporate enterprises in India are voluntarily giving information about their human resources. They number about 15 in all and include many important public sector enterprise viz. Bharat Heavy Electricals Ltd. (BHEL), Steel Authority of India Ltd. (SAIL), Minerals and Metal Trading Corporation of India (MMTC), National Thermal Power Corporation (NTPC), Oil and Natural Gas Commission (ONGC) and Engineers India Ltd. (EIL), Among all these enterprises BHEL is the pioneer in the field of human resource accounting since mid-1 970.

Most of the Indian companies and corporations have followed basically Lev and Schwartz Model for valuation of human resources. This is one of the popular methods in India, which discounts the future earnings of human resource into present value till the retirement age.

$$Vy = (1+R)\ t - y$$

Vy = Human capital value of a person up to y years old It = the personal annual earnings up to retirement

R = discount rate specific to the person

4.4.1 Forensic Accounting- Introduction

The concept of forensic accounting is a rapidly growing area of accounting. The term forensicaccounting is concerned with the detection and prevention of business fraud and related white- collar crimes. Forensic accounting is different from financial auditing. Financial auditing is performed by certified charted accountants to check the regulations of financial statements of an organisation. On the other hand forensic accounting is performed by an expert in the field to verifyinformation or to investigate frauds.

4.4.2 Meaning and Concept of Forensic Accounting

Forensic accounting is the specialized practice area of accounting. The term 'Forensic' means "suitable for use in Court," and it is to that standard and potential outcome that forensic accountants generally have to work. The forensic engagement is distinguished by engagement objective, emphasis on gathering evidence, and the application of a variety of techniques often custom-developed to the requirements of the specific engagement.

The definition of forensic accounting is changing in response to the growing needs of corporations.

"Forensic Accounting is the application of accounting principles, theories and discipline to facts or hypothesis at issues in a legal dispute and encompasses every branch of accounting knowledge"

AICPA.

"Forensic Accounting is a science that deals with the relation and application of finance, accounting, tax and auditing knowledge to analyse, investigate, inquire, test and examine the mater in civil law, criminal law in an attempt to obtain the truth from which to render an expert opinion" Simply we can say that forensic accounting includes the use of accounting, auditing, and investigative skills to deal with the legal matters. It consists of two major components: litigation services that recognise the role of an accountant as an expert consultant, and investigative services that use a forensic accountant's skills and may require possible courtroom testimony.

4.4.3 Characteristics of Forensic Accounting

The following are the key characteristics of forensic accounting:

- Forensic Accounting involves the use of accounting/ auditing, investigative skills and datamining as an audit tool
- It emphasizes a forensic approach in place of a risk management approach to the analysis ofcorporate governance
- The objective of forensic accounting is to check up for cyber frauds, prevention and detection.
- The key industries requiring the forensic accounting are insurance companies, banks, police, and government agencies considering the growing incidence of cyber crimes or frauds and corporate failures
- Chartered Accountants, with their sound grounding in accounting/auditing/business

requirements/legal requirements, are the most appropriate professionals to offer Forensic Accounting and Fraud Detection service.

4.4.4 Forensic Accounting Engagement

A forensic accountant has to analyse, interpret, summarise and present complex financialand business-related issues for investigation.

Coenen (2005) identify the following as areas of specialty in forensic accounting:

- ❖ Investigating corporate fraud
- ❖ Litigation services
- ❖ Business valuation
- ❖ Computer forensic
- ○ Criminal investigation, which are usually on behalf of the police with the aim of presentingevidence in a professional and concise manner.
- ○ Shareholders and partnership dispute that involve analysis of numerous year financialrecord for valuation and qualification of the issue in dispute;
- ○ Personal injury claim, where for example economic losses from motor accident or wrongfuldismissal may need to be quantified.
- ○ Business interruption and other type of insurance claim. These assignments involve a detailed review of the policy to investigate coverage issues and the appropriate methods of calculating the loss.
- ○ Business/employee fraud investigations which can involve fraud tracing, asset identificationand recovery, forensic intelligence gathering and due diligence review.
- ○ Business economic losses, where contract disputed, construction claims, expropriation, product liability claim and trade mark are the issues.
- ○ Professional negligence, to ascertain the breach and quantify the loss involved, and
- ○ Mediation and arbitration, as a form of alternative dispute resolution.

4.4.5 Skill Requirement of Forensic Accountant

A Forensic Accountant should have the following characteristics:

- curiosity
- persistence
- creativity

- Discretion
- Organisation
- confidence
- sound professional judgment

A Forensic Accountant must be open to consider all alternatives, scrutinize the fine details and at the same time see the big picture. In addition, a Forensic Accountant must be able to listen effectively and communicate clearly and concisely Obtaining document necessary to support or refute a claim

- Reviewing of the relevant documentation to form an initial assessment of the case in an identified area of loss
- Examination for discovering, including the formulation of the act regarding the financial residence
- Attendance at the examination for discovery to review the testimony, assist with understanding the financial issues and to formulate additional questions to be asked

Investigative accountant on the other hand;

- reviews factual situation and provides suggestions regarding possible courses of action
- assist with the protection and recovery of assets
- Co-ordinate other experts

4.4.6 Difference between Forensic Accountant and Auditors

The following table explains the key differences between a forensic accountant and auditor:

Forensic Accountant	Auditor
1. Forensic accountants are public accountants that have completed specialized training in the investigation of crimes such as bankruptcies, fraud, contract disputes and other criminal financial actions.	1. Auditors work to ensure their organization is running efficiently and that mismanagement of funds, waste of resources, or fraudulent activities are not occurring.
2. Forensic accountants use their expertise in accounting to determine when illegal transactions and activity have taken place.	2. Auditors also manage financial records and internal information to verify accuracy of employees and technology-based practices.

3. Forensic accountants, however, will look at nearly every transaction in their area of inquiry, checking to whom money was sent and whether there was adequate documentation for a transaction or series of	3. Auditors try to look at a representative sample of transactions, working under the assumption that if a few transactions follow generally accepted accounting principles, then all similar transactions

transactions. They are also much more proactive and skeptical in their confirmation of financial transactions.	likely follow those principles.

4.4.7 Forensic Accounting Process

Zysman (2005) outlined the following steps in executing Forensic Accounting engagement;

1. Meet with the client to obtain an understanding of the important facts, players and issues at hand.
2. Perform a conflict check as soon as the relevant parties are established.
3. Perform an initial investigation to allow subsequent planning to be based upon a more complete understanding of the issues.
4. Develop an action plan that take into account the knowledge gained by meeting withthe client and carrying out the initial investigation and which will set out the objectivesto be achieved and the methodology to be utilized to accomplish them.
5. Obtain the relevant evidence: This may involve locating documents, economic information, asset, a person or company, another expert or proof of the occurrence ofan event.
6. Perform the analysis: This may involve: O calculating economic damages
   - O summarizing a large number of transactionsO performing a tracing of assets
   - O performing present value calculations utilizing appropriate discount rates Operforming a regression or sensitivity analysis
   - O utilizing a computerized application such as spread sheet, data base or computer model
   - O utilizing charts and graphics to explain the analysis
7. Prepare the report. Often a report will be prepared which may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitation ofscope and findings and/or opinions. The report will include schedules and graphics necessary to properly support explain. Joshi, (2003) stated that the job demands reporting, where the accountability of the fraud is established and the report is considered as evidence in the court of law or in the administrative proceeding.

CHECK YOUR PROGRASS

1. What is inflation accounting?
a. Accounting for the rise and fall of consumer prices
b. Accounting for the effects of inflation on financial statements
c. Accounting for the effects of interest rates on financial statements
d. Accounting for the effects of taxes on financial statements

Answer: b. Accounting for the effects of inflation on financial statements

2. Which of the following is a method of inflation accounting?
a. The accrual basis method
b. The cash basis method
c. The historical cost method
d. The matching principle method

Answer: c. The historical cost method

3. Which method of inflation accounting is more commonly used?
a. The historical cost method
b. The current purchasing power method
c. The cash basis method
d. The accrual basis method

Answer: b. The current purchasing power method

4. Which financial statement is most affected by inflationaccounting?
a. The balance sheet
b. The income statement
c. The statement of cash flows
d. The statement of retained earnings

Answer: a. The balance sheet

5. How does inflation affect financial statements?
a. It increases the value of assets and liabilities
b. It decreases the value of assets and liabilities
c. It has no effect on the value of assets and liabilities
d. It increases the value of assets and decreases the value of liabilities

Answer: b. It decreases the value of assets and liabilities

6. What is the purpose of inflation accounting?

a. To provide a more accurate picture of a company's financial position and performance
b. To reduce a company's tax liability
c. To increase a company's profits
d. To decrease a company's debt

Answer: a. To provide a more accurate picture of a company's financial position and performance

7. Which industry is most affected by inflation accounting?
a. The retail industry
b. The healthcare industry
c. The technology industry
d. The oil and gas industry

8. What is the historical cost method of inflation accounting?
a. It adjusts financial statements for inflation by converting all financial values to current purchasing power using an appropriate price index.
b. It does not adjust financial statements for inflation.
c. It adjusts financial statements for inflation by recording all assets and liabilities at their original purchase price.
d. It adjusts financial statements for inflation by matching expenses with the revenue they generate.

Answer: c. It adjusts financial statements for inflation by recording all assets and liabilities at their original purchase price.

9. Which financial statement shows the effects of inflation accounting?
a. The balance sheet
b. The income statement
c. The statement of cash flows
d. The statement of retained earnings

Answer: b. The income statement

10. Which of the following is an example of a long-lived asset that can be affected by inflationaccounting?
a. Inventory
b. Accounts receivable

c. Land

d. Rent expense

Answer: c. Land

UNIT V FINANCIAL REPORTING

Financial reporting: Meaning, Objectives, characteristics- Indian Accounting Standards (As 5, AS 10, AS 19, AS 20)- Corporate social Responsibility: Meaning , Key Provisions of Companies Act 2013, Accounting for CSR expenditure,Repoting of CSR, Presentation and disclosure in the financial statements.

SECTION: 5.1 FINANCIAL REPORTING

5.1 Introduction

Financial reporting refers to the process of presenting financial information and data about an organization's financial performance and position to various stakeholders, including investors, creditors, regulators, and the general public. It involves the preparation, presentation, and communication of financial statements, which provide a comprehensive overview of the financial activities and results of an entity.

The purpose of financial reporting is to provide relevant, reliable, and timely information that enables users to make informed decisions about the organization. It helps stakeholders assess the profitability, liquidity, solvency, and overall financial health of the entity. Financial reporting also facilitates transparency, accountability, and comparability among different organizations, as well as compliance with applicable accounting standards and regulatory requirements. The key components of financial reporting include:

1. Fnancial Statements: These are formal reports that summarize the financial activities of an organization. The primary financial statements typically include the Balance Sheet (Statement of Financial Position), Income Statement (Statement of Profit and Loss), Cash Flow Statement, and Statement of Changes in Equity.

2. Accounting Policies: These are the specific principles, rules, and procedures followed by an organization to record, measure, and report its financial transactions and events. Accounting policiesensure consistency and comparability in financial reporting.

1. **Notes to Financial Statements:** These provide additional information and disclosures about specific items or transactions in the financial statements. The notes help users understand the basis of preparation, significant accounting policies, contingent liabilities, related party transactions, and other relevant details.
2. **Management Discussion and Analysis (MD&A):** This section of the financial report provides a narrative analysis of the organization's financial performance, results, and future prospects. It includes explanations, insights, and management's interpretation of the financial statements.
3. **Auditor's Report:** An independent auditor examines the financial statements and expresses an opinion on their fairness and compliance with relevant accounting standards. The auditor's report adds credibility and assurance to the financial information presented. Financial reporting is guided by various accounting frameworks and standards, such as Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), depending on the jurisdiction and the nature of the organization. These standards provide guidelines for recognition, measurement, presentation, and disclosure of financial information, ensuring consistency and comparability across different entities.

5.1 Objectives of Financial Reporting:

The objectives of financial reporting are to provide relevant, reliable, and understandable financial information about an organization's financial performance, position, and changes in financial position. These objectives are aimed at meeting the needs of various stakeholders who relyon financial reports to make informed decisions. Here are the key objectives of financial reporting:

1. **Decision-Making:** Financial reporting aims to provide information that helps users, such as investors, creditors, and analysts, make informed decisions about allocating their resources. By presenting relevant and reliable financial information, financial reporting assists stakeholders in assessing the profitability, liquidity, solvency, and overall financial health of an organization.
2. **Transparency and Accountability:** Financial reporting promotes transparency by providing a clear and comprehensive view of an organization's financial activities. It helps ensure that stakeholders have access to accurate and complete information about the entity's financial performance, position, and changes in financial position. This transparency enhances accountability and allows stakeholders to hold management responsible for their actions.
3. **Assessing Stewardship:** Financial reporting enables stakeholders to evaluate how effectively and efficiently an organization's management has utilized the resources entrusted to them. It provides insights into the stewardship of management by disclosing information about the entity's financial results, investments, and use of funds.
4. **Comparability:** Financial reporting aims to enhance comparability by providing consistent and standardized information that allows users to compare the financial performance and position of different entities. By following established accounting standards and principles, financial reporting facilitates meaningful comparisons and benchmarking among organizations within the same industryor across industries.
5. **Forecasting and Planning:** Financial reports provide historical financial data that can be used as a basis for forecasting and planning future activities. By analyzing past performance, trends, andfinancial ratios, stakeholders can make projections and develop strategies for the future.
6. **Regulatory and Legal Compliance:** Financial reporting ensures that organizations comply with applicable accounting standards, regulations, and legal requirements. By providing accurate and complete financial information, organizations fulfill their obligations to regulatory bodies, such as the Securities and Exchange Commission (SEC) in the United States or the International Financial Reporting Standards (IFRS) Foundation internationally.
7. **Facilitating Investment Decisions:** Financial reporting plays a crucial role in attracting

investment capital. Reliable and transparent financial information builds trust and confidence among potential investors, encouraging them to invest in the organization. Accurate financial reporting helps investors assess the risks and potential returns associated with their investment decisions.

Overall, the objectives of financial reporting are to provide stakeholders with relevant, reliable, and understandable financial information that supports decision-making, enhances transparency and accountability, facilitates comparability, and ensures compliance with regulations.

5.2 Characteristics of Financial Reporting:

Financial reporting exhibits several key characteristics that contribute to its effectiveness and usefulness for stakeholders. These characteristics are designed to ensure that financial reports provide relevant, reliable, and understandable information. Here are the main characteristics of financial reporting:

1. **Relevance:** Financial reporting should provide information that is pertinent and useful for the decision-making needs of the users. It should have the ability to influence the decisions of investors, creditors, and other stakeholders. Relevant information is timely, has predictive or confirmatory value, and is capable of making a difference in decision-making.
2. **Reliability:** Financial reporting should be reliable, meaning it is free from material errors or biases and faithfully represents the economic substance of the transactions and events it depicts. Reliable information is verifiable, neutral, and faithfully represented without any intentional distortion.
3. **Understandability:** Financial reports should be presented in a manner that is clear, concise, and understandable to users who have a reasonable knowledge of business and economic activities. The information should be organized, categorized, and disclosed in a way that facilitates comprehension and interpretation.
4. **Comparability:** Financial reporting should enable users to compare and evaluate the financial performance and position of an organization over time and across different entities. Comparability is enhanced by applying consistent accounting policies and principles, making disclosures, and providing sufficient contextual information.
5. **Consistency:** Financial reporting should be consistent in the application of accounting

policies and principles from one reporting period to another. Consistency allows users to make meaningful comparisons and identify trends in an organization's financial performance.

6. **Materiality:** Financial reporting should focus on presenting information that is material or significant to the users. Materiality is based on the nature and magnitude of an item's impact on the financial statements. Information is material if its omission or misstatement could influence the decisions of users.
7. **Faithful Representation:** Financial reporting should faithfully represent the underlying economic transactions and events it purports to depict. It should provide a true and fair view of the financial performance, position, and changes in financial position of the organization.
8. **Objectivity:** Financial reporting should strive to be objective, free from bias or undue influence. It should be based on objective evidence and supported by reliable data and information.
9. **Disclosure:** Financial reporting should include all necessary disclosures to provide a complete and comprehensive view of an organization's financial activities. Disclosures should include relevant information about accounting policies, estimates, contingencies, related party transactions, and other significant matters.
10. **Understandable Units of Measure:** Financial reporting should use standardized units of measure, such as currency, to express financial information consistently. This allows for meaningful comparisons and analysis.

These characteristics ensure that financial reporting provides stakeholders with reliable, relevant, and understandable information to support their decision-making processes and assess the financial performance and position of an organization.

5.3 Indian Accounting Standards AS 5

It refers to the Accounting Standard 5 issued by the Institute of Chartered Accountants of India (ICAI). The full title of AS 5 is "Net Profit or Loss for the Period, Prior Period Items, and Changes in Accounting Policies." It provides guidelines and requirements for the treatment and disclosure of net profit or loss, prior period items, and changes in accounting policies in the financial statements of Indian entities. Here are the key provisions and requirements of AS 5:

1. **Net Profit or Loss for the Period:** AS 5 defines net profit or loss for the period as the residual amount derived from the revenue and expenses of an entity after considering tax expenses, extraordinary items, and prior period adjustments. It provides guidance on the classification and presentation of various items in the statement of profit and loss.
2. **Prior Period Items:** AS 5 requires that material items of income or expense that arise in the current period but relate to prior periods should be separately disclosed in the financial statements. Examples of prior period items include adjustments arising from errors or omissions in the financial statements of prior periods, the effects of changes in accounting policies, and the effects of changesin estimates.
3. **Changes in Accounting Policies:** AS 5 provides guidance on the treatment and disclosure of changes in accounting policies. It states that changes in accounting policies should be applied retrospectively unless it is impracticable to determine the period-specific effects or the cumulative effect of the change. The standard specifies the disclosures required when a change in accounting policy is made.
4. **Extraordinary Items**: AS 5 requires that extraordinary items, which are material events or transactions of an entity that are both unusual in nature and infrequent in occurrence, should be separately disclosed in the statement of profit and loss.
5. **Presentation and Disclosure:** AS 5 provides guidance on the presentation and disclosure of netprofit or loss, prior period items, and changes in accounting policies in the financial statements. It specifies the format and content of the statement of profit and loss and the related disclosures required in the notes to the financial statements.

It's important to note that the AS 5 has been superseded by the Indian Accounting Standards (Ind AS) for companies that fall under the purview of the Companies Act, 2013. Ind AS is converged with International Financial Reporting Standards (IFRS) and is applicable to certain categories of companies in India. However, AS 5 may still be applicable to non-corporate entities or entities that are not required to comply with Ind AS.

5.4 Accounting Standard (AS) 10 in India is titled "Accounting for Fixed Assets." It provides guidelines for the recognition, measurement, presentation, and disclosure of fixed assets in the financial statements of Indian entities. AS 10 is applicable for all enterprises, irrespective of their sizeor nature of business, unless a specific exemption is granted. Here are the key provisions and requirements of AS 10:

1. **Recognition of Fixed Assets:** AS 10 states that an item qualifies as a fixed asset if it meets certain criteria, including being held for use in the production or supply of goods and services, for rental to others, or for administrative purposes. It also specifies that fixed assets should be recognized in the financial statements when it is probable that future economic benefits associated with the asset will flow to the entity, and the cost of the asset can be reliably measured.
2. **Measurement of Fixed Assets:** AS 10 provides guidance on the initial measurement of fixed assets. It states that fixed assets should be initially recorded at cost, which includes the purchase price, any directly attributable costs of bringing the asset to its working condition, and any initial estimated costs of dismantling and removing the asset. Subsequent to initial recognition, fixed assets should be measured at cost less accumulated depreciation and impairment losses.
3. **Depreciation:** AS 10 requires the systematic allocation of the depreciable amount of a fixed asset over its useful life. It provides guidance on selecting an appropriate depreciation method, estimating useful lives, and measuring depreciation expense. The standard emphasizes that depreciation should be charged consistently and reflect the pattern in which the asset's economic benefits are expected to be consumed by the entity.
4. **Revaluation of Fixed Assets:** AS 10 permits the revaluation of fixed assets to fair value, which is the amount for which the asset could be exchanged between knowledgeable and willing parties in an arm's length transaction. Revaluation can be done either for the entire class of assets or for individual assets. The standard specifies the requirements for revaluation, including frequency, treatment of revaluation surplus/deficit, and disclosure.
5. **Impairment of Fixed Assets:** AS 10 requires periodic assessment of fixed assets for any indication of impairment. If there is any indication of impairment, an entity needs to determine the recoverable amount of the asset and recognize an impairment loss if the carrying amount exceeds the recoverable amount. The standard provides guidance on impairment testing and measurement of impairment loss.
6. **Presentation and Disclosure:** AS 10 sets out the presentation and disclosure requirements related to fixed assets in the financial statements. This includes the

disclosure of accounting policies,

5.5 **Accounting Standard (AS) 20** in India is titled "Earnings Per Share." It provides guidelines for the calculation, presentation, and disclosure of earnings per share (EPS) in the financial statements of Indian entities. EPS is a financial ratio that indicates the portion of a company's profit or loss attributable to each outstanding share of common stock. Here are the key provisions and requirements of AS 20:

1. **Calculation of Basic EPS:** AS 20 requires the calculation of basic EPS by dividing the profit or loss attributable to equity shareholders by the weighted average number of equity shares outstanding during the period. The profit or loss attributable to equity shareholders is generally the net profit or loss after adjusting for preference dividends, if any.
2. **Diluted EPS:** AS 20 also addresses the calculation of diluted EPS, which takes into account the potential dilutive effects of convertible instruments, such as convertible bonds or stock options. Diluted EPS is calculated by adjusting the weighted average number of equity shares outstanding for the potential dilutive effects of these instruments.
3. **Presentation and Disclosure:** AS 20 prescribes the presentation and disclosure requirements related to EPS in the financial statements. The basic and diluted EPS should be presented on the face of the statement of profit and loss or in the notes to the financial statements. Additionally, disclosures should be provided about the method of calculating EPS, the effect of potential dilutive instruments, and any contingencies or commitments related to potential equity shares.
4. **Changes in Capital Structure:** AS 20 provides guidance on the treatment of changes in the number of equity shares outstanding, such as bonus issues, share splits, or reverse splits, during the period. These changes should be taken into account in the calculation of weighted average number of equity shares outstanding for the purpose of calculating EPS.

5.6 Corporate Social Responsibility (CSR)

It refers to a business approach where companies voluntarily integrate social and environmental concerns into their business operations and interactions with various stakeholders. Itinvolves a company's commitment to making a positive impact on society and the environment beyond its primary economic goals.

CSR encompasses a wide range of activities and initiatives that go beyond legal and regulatory requirements. It includes the company's efforts to manage its social, environmental, and economic impacts in a responsible and sustainable manner. The specific areas of focus may vary depending on the company, industry, and geographical location, but common CSR areas include:

1. **Philanthropy and Community Engagement:** Many companies engage in philanthropic activities by donating money, resources, or employee volunteer time to support social causes and community development initiatives. This can include supporting education, healthcare, poverty alleviation, and disaster relief efforts.
2. **Employee Well-being and Development:** Companies may prioritize the well-being of their employees by providing a safe and healthy work environment, promoting work-life balance, offering training and development opportunities, and fostering a culture of inclusivity and employee engagement.
3. **Stakeholder Engagement:** CSR involves actively engaging with various stakeholders, including customers, employees, suppliers, local communities, and government entities, to understand their concerns, address their needs, and incorporate their feedback into decision-making processes.
4. **Responsible Supply Chain Management:** Companies may strive to ensure that their supply chains adhere to ethical and sustainable practices. This includes promoting fair trade, responsible sourcing of raw materials, and considering the social and environmental impacts of suppliers and business partners.

Key provisions of Companies Act 2013

The Companies Act, 2013 is a comprehensive legislation that governs the incorporation, operation, and regulation of companies in India. It replaced the Companies Act, 1956 and introduced several important provisions to enhance corporate governance, investor protection, and ease of doing business. While it's not possible to list all the provisions in their entirety, here are some key provisions of the Companies Act, 2013:

- ✧ **Incorporation and Registration**: The Act provides for the incorporation and registration of different types of companies, including private companies, public companies, one-person companies, and small companies. It outlines the procedures and requirements for company formation, including the filing of documents with the Registrar of Companies (RoC).

- **Corporate Governance:** The Act includes various provisions to strengthen corporate governance practices. It mandates the appointment of independent directors, audit committees, nomination andremuneration committees, and women directors in certain types of companies. It also introduces stricter rules regarding related-party transactions, insider trading, and prohibition of certain activities.
- **Share Capital and Shareholders:** The Act establishes regulations regarding share capital, share allotment, and shareholders' rights. It includes provisions related to the issue and transfer of shares,debentures, and other securities. It also covers matters such as rights issues, buybacks, reduction of share capital, and class action suits.
- **Directors and Board of Directors:** The Act outlines the qualifications, appointment, and removal of directors. It mandates the composition and functioning of the board of directors, including their roles, responsibilities, and fiduciary duties. The Act also introduces provisions related to the rotation of directors, independent directors, and the prohibition of certain directorships.
- **Investor Protection:** The Act includes provisions to safeguard the interests of investors and minority shareholders. It ensures greater transparency and accountability in financial reporting and disclosures. It strengthens regulations related to auditors, audited financial statements, and audit committees. It also provides mechanisms for class action suits, investor education, and the establishment of the Investor Education and Protection Fund (IEPF).
- **Mergers, Acquisitions, and Restructuring:** The Act provides regulations and procedures for mergers, amalgamations, acquisitions, and restructuring of companies. It outlines the role and powers of the National Company Law Tribunal (NCLT) in approving and overseeing such transactions. It also introduces the concept of the corporate social responsibility (CSR) and mandates certain companies to spend a prescribed amount on CSR activities.
- **Insolvency and Bankruptcy**: The Act introduces provisions for corporate insolvency resolution processes, liquidation, and the revival of financially

distressed companies. It establishes the Insolvency and Bankruptcy Board of India (IBBI) and the National Company Law Tribunal (NCLT) as key regulatory bodies in insolvency matters.

- **Compliance and Enforcement:** The Act imposes stricter compliance requirements on companies, including maintaining proper books of accounts, conducting annual general meetings, and filing various documents with the RoC. It introduces penalties, fines, and imprisonment for non-compliance with the Act's provisions. The Act also establishes the Serious Fraud Investigation Office (SFIO) to investigate cases of corporate fraud.

These are some of the key provisions of the Companies Act, 2013. The Act is extensive and covers various aspects of company law, corporate governance, financial reporting, compliance, and legal procedures related to companies in India. It's advisable to refer to the full text of the Companies Act, 2013 and consult legal professionals or experts for specific requirements and guidance related to your circumstances.

5.9 Accounting for Corporate Social Responsibility Expenditure Reporting [CSR]

Accounting for Corporate Social Responsibility (CSR) expenditure involves recording, measuring, and reporting the financial transactions and activities related to CSR initiatives undertaken by a company. It aims to provide transparency and accountability regarding the company's CSR activities and their impact on financial performance. Here is an overview of how CSR expenditure is typically accounted for and reported:

- **Classification of CSR Expenditure:** CSR expenditure is generally classified as an expense in the financial statements. It is recognized in the statement of profit and loss (income statement) as a separate line item or included within a broader expense category, such as "Other Expenses" or "CSRExpenses."
- **Measurement and Valuation:** The CSR expenditure should be measured based on the actual costs incurred by the company in undertaking CSR activities. This includes direct costs related to CSR projects, such as donations, grants, employee volunteering expenses, or costs incurred specific CSR initiatives. Indirect costs, such as administrative expenses related to CSR management and monitoring, should also be considered and allocated

appropriately.

- ❖ **Allocation of CSR Expenditure:** If the company incurs expenses that benefit both CSR and non-CSR activities, it is necessary to allocate the expenditure appropriately. This allocation should be based on a reasonable and consistent methodology that reflects the proportionate benefit received by each category. For example, if a company sponsors an event that has both CSR and promotional benefits, the costs should be allocated between CSR and marketing expenses.
- ❖ **Disclosure in Financial Statements:** The financial statements should include appropriate disclosures to provide users with information about the company's CSR activities and expenditure. These disclosures may include:
- ❖ **Reporting in the Directors' Report:** The Companies Act, 2013 in India requires certain companies to include a separate section on CSR in their Directors' Report. This section should provide details regarding the CSR policy, initiatives undertaken, amount spent, and the impact of CSR activities.
- ❖ **Compliance with Applicable Regulations:** It's important to ensure compliance with any specific regulations or guidelines related to CSR reporting and disclosure. In India, companies falling under the CSR provisions of the Companies Act, 2013 are required to comply with the specific reporting requirements outlined in the Act and the related rules.

It's worth noting that the specific accounting treatment and reporting requirements for CSR expenditure may vary based on the applicable accounting standards and regulations in a particular

country. It's advisable to consult the relevant accounting standards, local laws, and professional guidance to ensure accurate and compliant accounting for CSR expenditure in a specific jurisdiction.

5.9 **Presentation and disclosure in financial statements**

It refers to the way information is organized, classified, and presented in a company's financialstatements to provide relevant and meaningful information to users. Here are the key aspects of presentation and disclosure in financial statements:

- ✧ **Financial Statement Structure:** Financial statements typically include the balance sheet (statement of financial position), income statement (statement of profit and loss), statement of cash flows, and statement of changes in equity. The order and format of these statements may vary depending on the reporting framework used (e.g., International Financial Reporting Standards - IFRS or Generally Accepted Accounting Principles - GAAP).

- **Classification and Aggregation:** Items in the financial statements should be appropriately classified and aggregated to provide a clear understanding of the company's financial position and performance. Assets, liabilities, equity, revenues, and expenses should be presented in separate categories, such as current and non-current, operating and non-operating, etc. This helps users analyze and interpret the financial information effectively.

- **Notes to the Financial Statements:** The financial statements are accompanied by detailed explanatory notes that provide additional information about the company's accounting policies, significant accounting estimates, contingent liabilities, related-party transactions, and other relevant disclosures. The notes help users understand the basis of preparation of the financial statements and provide context for interpreting the numbers.

- **Accounting Policies:** The financial statements disclose the significant accounting policies adopted by the company, including the methods used for recognition, measurement, and presentation of various items. The disclosure of accounting policies ensures transparency and consistency in financial reporting and helps users understand the basis on which the financial statements are prepared.**Fair Value Disclosures:** If the company measures certain assets or liabilities at fair value, the financial statements should provide disclosures about the fair value measurements. This includes information about the valuation techniques used, significant inputs, and the level of the fair value hierarchy in which the measurements are categorized.

- **Contingencies and Commitments:** Financial statements disclose information about significant contingencies, such as pending litigations, legal claims, or guarantees. Additionally, the financial statements disclose significant contractual commitments, such as long-term lease agreements or purchase commitments, which may impact the company's future financial position.

- **Related-Party Transactions:** Transactions with related parties, such as key management personnel, subsidiaries, and associates, are disclosed in the financial statements. The nature, extent, and financial effects of these transactions are provided to ensure transparency and identify potential conflicts of interest.

- **Events After the Reporting Period:** If there are significant events or transactions that occur after the reporting period but before the financial statements are authorized for issue, these events are disclosed in the financial statements. This helps users understand any subsequent events that may impact the company's financial position or performance.

It's important to note that the specific presentation and disclosure requirements may vary depending on the reporting framework and applicable accounting standards in a particular jurisdiction. Companies need to comply with the relevant accounting standards and regulations to ensure proper presentation and disclosure of financial information in their financial statements.

Check your Progress

1. Which standard provides guidance on the recognition and measurement of revenue from contractswith customers in India?

a) Ind AS 18

b) Ind AS 115

c) Ind AS 116

d) Ind AS 101

2. Ind AS 16 deals with the accounting treatment for:

a) Intangible assets

b) Property, plant, and equipment

c) Financial instruments

d) Leases

3. Which standard provides guidance on the presentation of financial statements in India?

a) Ind AS 1

b) Ind AS 16

c) Ind AS 38

d) Ind AS 103

4. Ind AS 109 deals with the accounting treatment for:

a) Revenue recognition

b) Financial instruments

c) Leases

d) Business combinations

5. Which standard provides guidance on the accounting treatment for leases in India?

a) Ind AS 17

b) Ind AS 109

c) Ind AS 116

d) Ind AS 103

6. Ind AS 38 provides guidance on the accounting treatment for:

a) Revenue recognition

b) Intangible assets

c) Financial instruments

d) Business combinations

7. Which standard provides guidance on the accounting treatment for employee benefits in India?

a) Ind AS 19

b) Ind AS 103

c) Ind AS 109

d) Ind AS 116

8. Ind AS 2 deals with the accounting treatment for:

a) Revenue recognition

b) Inventories

c) Financial instruments

d) Leases

9. Which standard provides guidance on the accounting treatment for financial instruments in India?

a) Ind AS 17

b) Ind AS 109

c) Ind AS 116

d) Ind AS 9

Long answer Question

1. Company XYZ is a publicly traded company in India. It recently issued convertible bonds to raise funds for a new project. How should the company account for these convertible bonds under Ind AS?
2. ABC Ltd. is preparing its financial statements for the year ending March 31, 2024. The company has significant inventories and wants to ensure that it follows the appropriate accounting treatment under Ind AS. Discuss the relevant Ind AS standard that applies to the accounting for inventories and explain its key provisions.
3. Company PQR is a manufacturing company that leases several pieces of machinery for its production operations. Explain how the adoption of Ind AS 116, "Leases," affects the accounting for leases and the financial statements of Company PQR.
4. XYZ Corporation has a defined benefit pension plan for its employees. The company wants to understand the accounting treatment for employee benefits under Ind AS. Discuss the relevant Ind AS standard that applies to the accounting for employee benefits and explain itskey provisions.
5. Company ABC has recently acquired a subsidiary. Discuss the key provisions of Ind AS 103, "Business Combinations," that are relevant to the accounting treatment of the acquisition and the preparation of consolidated financial statements.
6. XYZ Ltd. is a software development company that incurs significant costs in the developmentof software products. Explain the accounting treatment for the costs incurred in the development of software under Ind AS.

7. ABC Ltd. is a manufacturing company that has entered into several long-term construction contracts. Discuss the relevant Ind AS standard that applies to the accounting for construction contracts and explain its key provisions.
8. Company PQR has significant intangible assets and wants to ensure proper recognition and measurement in its financial statements under Ind AS. Discuss the relevant Ind AS standard that applies to the accounting for intangible assets and explain its key provisions.